

Wray, L. Randall – Why Minsky Matters

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After the financial crisis a lot fewer need to be convinced that Minsky does matter. This is a short overview of the academic working life of the late Neo-Keynesian economist Hyman Minsky written by his apprentice, the University of Missouri professor in economics, Randall Wray. After the carnage of the GFC there was a search for improved explanatory models and many found one in Minsky's *Financial Instability Hypothesis*. It even became fashionable to make use of the expression "Minsky moment" among financial market actors. In this book we get a broader understanding of the theories of an unconventional economist.

Minsky's writings centered on financial instability, on employment, inequality and poverty and finally on how to reform capitalism since it is instable in its present form. I will focus more on the financial parts. Underlying his work was the view that economists - Keynesian and neoclassical alike - has it wrong; market processes are not stabilizing around an equilibrium to which they according to conventional thought are supposed to return after being exposed to external shocks.

Minsky's claim that all his academic colleagues were wrong combined with an impermeable writing style full of self-invented Wall Street-like expressions made him an outsider during a career that spanned from the 1950s to the 1990s. Minsky's background was indeed eclectic as he was a devoted Keynesian who also had had the great Joseph Schumpeter as his dissertation advisor. Minsky, as his starting point for economic models, focused on the investment of the entrepreneur and the financing of that investment – similarly to the Austrian business cycle or J. M. Keynes himself, but not the Keynesians or neoclassicists. In addition to his radical political views he sat on the board of a bank and befriended people like Salomon Brothers' investment strategist Henry Kaufman and famed investor Leon Levy.

An important contribution of Minsky is that he adds the functionality of financial markets to the core of macroeconomic models – something that

mainstream economics still fail to do. With regards to the financial system Minsky's key idea is that "stability is destabilizing", i.e. periods of calm change the psychology of the market, making participants take on more risk, which in the end leads to a crisis that ends the calm. There can be no stable equilibrium as the stability of such a state changes behaviors, policies, and business practices in a way that in the end prevents it.

A key part of this pendulum motion between stability and disturbance is the use of leverage and the pro-cyclical behavior of both lenders and borrowers. Minsky developed a classification for financial fragility where "hedge finance" described a situation where the income of a borrower is sufficient to pay both interest and principal, in a "speculative position" only the interest payments are covered and in a "Ponzi position" the obligor will even have to borrow additional funds to finance his interest payments and he can only continue his operations as long as the lender allows the loan balance to grow. Loan growth chases asset values in an upwards spiral until it doesn't. Profit maximizing banks provide liquidity and leverage through financial innovation until they don't. The Minsky moment, a concept that was minted by Paul McCulley at PIMCO after Minsky's death, is the tipping point in time where the spiral goes from positive to negative.

The above cycles and the rejection of equilibrium resonate with most people active on financial markets. However, even though the diagnosis is well executed, I'm not sure all in the financial markets would appreciate the recipe that Minsky prescribed. He was a Keynesian with a belief that the enlightened governing of the big state and the wise handling of central banks could right the inherent wrongs of capitalism as diagnosed.

Wray guides us through the opaque writings of his master. At times it is slightly hard to distinguish the views of the author from those of Minsky but overall this is an important job well done.

Mats Larsson, Feb 3, 2017