THE JOURNAL OF PHILOSOPHICAL ECONOMICS: REFLECTIONS ON ECONOMIC AND SOCIAL ISSUES

Volume XIII Issue 1 Autumn 2019

ISSN 1843-2298

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A Review of Piero Ferri, Minsky's Moment. An Insider's View on the Economics of Hyman Minsky, *Edward Elgar Publishing, 2019, 252 pp., ISBN 978-1-78897-372-4*

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According to Minsky, business cycles can be explained by the *financial instability hypothesis* (FIH), which – in short - describes the capitalist system as having 'endogenous' self-destructive forces able to convert stability into instability if not properly regulated by government intervention. The term *Minsky's moment*, coined by Paul McCulley of PIMCO, a fund management group, was intended to describe the Russian financial crisis of 1998 (p. 2). However, people (especially finance and investment professionals) turned their attention to Minsky's work only when the recession started. Therefore, this moment (the Great Recession) was named by its followers a *Minsky moment* (p. 2).

The book under review has been written by Professor Piero Ferri who was very close to Minsky's thoughts and works. As Ferri notes, the aim is not to clarify Minsky's FIH, but 'to present it as a particular case of his general vision about the evolution of complex dynamic systems' (p. 4). The book introduction refers to potential interpretations of a dynamic system, which is best described as 'not simply a mechanical sequence of events but represents a struggle between endogenous destabilizing forces thwarted by the adoption of suitable policies and the presence of adapting institutions' (p. 10). 'Endogenous instability forces' constrained by 'thwarting systems' would give – in short - the *dynamics* of a Minsky's economic system as explained in their 1992 paper:

> ...We argue that the current state of economic theory as well as the performance of capitalist recent years support the view that the path through time of a capitalist economy is best described as the result of the interaction between the system's endogenous dynamics, which if unconstrained would lead to complex paths that

Received: 11 October 2019

> include periods of apparent growth, business cycles and economic instability, and the impact of institutions and interventions which, if apt, constrain the outcomes of capitalist market processes to viable of acceptable outcomes. We call these institutions and interventions thwarting systems.

Part I – Can It Happen Again? – discusses the FIH within complex dynamics which is to be studied by deepening the mathematical analysis. It is stated that 'Minsky moments are grounded upon the so-called financial instability hypothesis' which 'simply asserts that long stretches of prosperity sow the seeds of the next crisis' (p. 15). The Great Depression is given as an example of crisis, while the 1920s were its 'incubator'. In describing the four fundamental features of the FIH, Ferri arrives also at banks, which 'can be the source of instability' by 'aggravating the quantity amplifying mechanisms that are operating in the system' (p. 18).

In-depth knowledge of business cycles is based, according to Ferri, on finding the right model to include as many variables as necessary. According to this technocratic ideal, 'one need to consider a meta-model where endogenous forces and thwarting devices interact to create a complex dynamic system. In this system, financial instability is a possibility, but not an inevitability if the right policies and institutions are set in place' (pp. 35-36). Therefore, those in possession of a suitable meta-model can prevent instability by finding a suitable political spectrum for model adoption.

The core of the book (Part II – Co-Authoring) consists of three key journal articles on macroeconomics which Minsky co-authored with Ferri. The first – 'Prices, employment, and profits' – is on methodology, the second is a critique of the neoclassical synthesis – 'The breakdown of the IS-LM synthesis: implications for post-Keynesian economic theory', and the last one offers a 'vision of the economy and a possible research agenda' – 'Market processes and thwarting systems'. The other parts of the book are built around ideas contained in these articles.

From the three co-authored publications, the most important is the last one (published in 1992). As Ferri himself states:

> The vision underlying Minsky's analysis is clearly stated in our joint work „Market processes and thwarting systems". This was the last paper that we wrote together, and it represents the pinnacle of our collaboration, at least from my point of view. (p. 10)

Ferri explains the fall of the IS-LM analysis by the questionable quality of the economic models, which suggests that 'pragmatic choices of the structural

forecasting models began to represent no consistent economic logic. Equations were there and took the form they did because they satisfied the needs of the forecasters, not of economic logic...When the economy ceased to behave in the tranquil manner of the first two decades after the Second World War (which pragmatic equations were designed to track), the predictive and policy-suggestive powers of IS-LM based models broke down' (p. 66).

Ferri offers a positive account of the post-Keynesian economic vision. Thus, 'post-Keynesian theory rejects the notion of economic theory as a study that derives theorems about the behavior of an economy that are not conditioned by a particular historical, social and institutional context' (pp. 75-76). In other words, economic theory cannot derive a priori judgments because everything is historically conditioned. If this is true, then there are no universal economic laws. However, a possible logical inconsistency here would be the dynamics of 'endogenization' within the capitalist system (Minsky's thesis), an analytical tool that is intended to be universal, so it does not depend on any historical context.

Ferri describes two major dynamics of the economic system. One is *exogenous dynamics* (in the works of Slutsky, Frisch, Friedman, Lucas) which holds that 'the economy is a mechanism that transforms exogenous shocks which are either random or unanticipated policy interventions, into business cycles'; the other is *endogenous dynamics* (in the works of Marx, Mitchell, Schumpeter, Kalecki, Keynes) which views business cycles as 'the natural and inherent consequence of self-interest motivated behavior in complex economies with sophisticated financial institutions' (p. 83). Following this stream of thought, the author goes back to classical economics principles such as Adam Smith's *invisible hand*. He understands the famous principle of 'each searching his own gain' as a culprit for 'market relations that make breakdowns of the economy, such as that which occurred over the period 1929-33, endogenous phenomena' (p. 85). An obvious anti laissez-faire position is kept throughout the narrative but remains insufficiently explained:

> In the laissez-faire world each agent's maximizing behavior is consistent with the system's achieving and sustaining its „best". In the complex world in which we live, each agent seeking only its own gain under unconstrained conditions, i.e. maximizing under market constraints as the only conditions, contributes to instability. Intermittent instability, not order, results from each agent behaving in the Smithian manner in an unconstrained environment. Individualistic decision making leads to instability in an unconstrained world, whereas individualistic decision making leads to a tolerable outcome if appropriate institutions and interventions are included (p. 90).

The way Ferri introduces Minsky's FIH leaves the impression that the endogenous failures of the capitalist system (the FIH core) could be avoided by implementing a type of technocratic management of markets, using quantitative methods (mathematical and econometric). However, no argument is given to prove the superiority of such a form of 'instability' management. From a philosophical point of view, this brings Minsky and Ferri closer to the positivist (or Saint-Simonian) ideal in which societies are run by a group of professionals (technicians) who know much better than people do.

In Part III - Deepening the Methodology - Ferri discusses the micro-macro relations from a dynamic perspective. The author suggests a prudent perspective regarding the capacity of the intervention system in an economy, because it 'cannot be put in place once and for all' (p. 90). Therefore, the decision makers are obliged to act and modify the interventions 'accordingly', thus reinforcing their technocratic character and the idea that 'there is no automatic pilot for the economy' (p. 91). Although it is not certain that the decision makers can know the right interventions, Ferri responds that the trial and error process, as in entrepreneurship, would solve the problems. However, we argue that if the trial and error to discover the most adaptive institutions and interventions is possible, then it means that the endogenous dynamics of capitalism can be neutralized. Also, if government interventions are (and are) susceptible to error, how would they be superior to the market-specific trial and error process?

Part IV purports to deepen the analytical tools of Minsky by understanding his 'black box' of tools. For example, Minsky's analysis did not take into account labor markets. Introducing the 'unemployment tool' in the system 'has important consequences'; as the author states, 'unemployment is the most important source of inequality in the economic system' (p. 138) and can be 'used as a proxy for poverty (p. 138). As Ferri points out, summarizing Minsky's message from *Ending Poverty: Jobs, Not Welfare*, government interventions (in a period of recession) in order to increase employment and maintain incomes might be appropriate measures, but they 'cannot cope with a long-run problem' (p. 173), which is poverty. ‚In fact, this is only the second step of a strategy that must have as a first step the creation of jobs. Last, the state must act as an employer of the last resort' (p. 173).

Part V underlines the impact of inequality on the FIH. A meta-model of the FIH is presented 'endogenizing' the role of income distribution (p. 198), reconsidering expectations in an uncertain world, and enriching 'the specifications of various equations starting from the investment equation' (p. 195). An interesting point

is presented here regarding the power of some indicators to detect the crisis, for example the long-term value of the ratio between total debt and gross national product (GNP). When the value of the indicator exceeds the 'long-run level' then 'the likelihood of an unsustainable credit boom increases' (p. 205). Conversely, when the ratio is below the long-run level, the probability of a crisis is low. Referring to the questionable quality of such an indicator, Ferri shows that besides its limited capacity to predict crises, it also warns when there is no probability of a crisis. 'The credit gap has predicted at least three out of zero crises, reinforcing Samuelson's joke about the stock market's capabilities of forecasting crises, having predicted nine out of America's last five recessions' (p. 206). The 'heterogeneity' between countries is presented as an external variable that can cause errors in forecasting.

Taking for granted some of Minsky's theoretical assumptions should however warns the reader about the need of further appraisals. An example would be the hypothesis regarding the banking sector as a source of instability. Although it may hold true in some contexts, the banking sector (like any other sector) can also be a source of stability, by channeling profitable capital to where yields are higher and thus coordinating the structure of production. Banks can prevent the crisis by reducing the amount of capital available for non-performing investments. The institutional framework, as Minsky argued, matters, but - we add - not when taking for granted its implicit ability to stabilize the system. Similarly, one might start with the assumption that there is an endogenous dynamic that creates instability, primarily at the institutional level, for example, the presence of a central bank as a creditor of the last resort. When the crisis has monetary causes, the FIH becomes only a reflection of these causes, an effect.

Another critical hypothesis would refer to *unconstrained behavior* under a laissez-faire system. Yet, laissez faire does not mean unconstrained behavior. Market forces constrain agents. The fact that prices can be lowered through a market mechanism (competition) suggests a very well structured and constrained environment. Moreover, the pretense of a dialectic between 'the laissez faire world' and 'the complex world in which we live' as suggested by the author (p. 90) presumes a better understanding of the world on the part of those who oppose laissez faire, who are supposedly much better 'equipped' than the laissez faire 'dreamers'. It should be recalled that classical economists (especially the French school) are also known as the *harmonists* for their belief in the equality between individual benefits and common good.

> Those charging the economists with bias refer to their alleged eagerness to serve "the interests." In the context of their accusation this refers to selfish pursuit of the well-being of special groups to the prejudice of the common weal. Now it must be remembered that the idea of the common weal in the sense of a harmony of the interests of all members of society is a modern idea and that it owes its origin precisely to the teachings of the Classical economists. Older generations believed that there is an irreconcilable conflict of interests among men and among groups of men. The gain of one is invariably the damage of others; no man profits but by the loss of others. We may call this tenet the Montaigne dogma because in modern times it was first expounded by Montaigne (Mises, 2007, p. 30).

Ferri argues that Minsky's assumption of financial instability ends in public policy recommendations aimed at reducing market power. However, this ignores the fact that one can talk about a hypothesis of political instability starting from the finding that the political environment is often marked by political crises, corruption, pluralism (in ideology) that negatively affect the results of policies, economic progress, quality of life etc. Political instability also creates economic instability, so there can be no a priori case for government intervention to calm markets, as political spectrum can also generate instability. We appreciate that this should have informed Minsky to suspect (at least) that financial instabilities (which generally end in business cycles) may have close links with political instabilities and raise doubts about the fundamental properties of institutions that regulate markets in modern democracies (e.g. central banks, financial security authorities, etc.).

Minsky's moment is not a book for casual reading. It has many mathematical complexities which broaden the analytical universe of Hyman Minsky and stands as a reference reading with regard to his theoretical insights, in particular on the problem of business cycles from a post-Keynesian perspective.

Reference

Mises, Ludwig von (2007), *Theory and History. An Interpretation of Social and Economic Evolution*, Auburn, Alabama: Ludwig von Mises Institute.

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