Bard

Bard College
Bard Digital Commons

Hyman P. Minsky Archive
Levy Economics Institute of Bard College

11-9-1993

Blueprint for Financial Reform

Hyman P. Minsky Ph.D.

Follow this and additional works at: http://digitalcommons.bard.edu/hm_archive

Recommended Citation
Minsky, Hyman P. Ph.D., "Blueprint for Financial Reform" (1993). *Hyman P. Minsky Archive.* Paper 165.
http://digitalcommons.bard.edu/hm_archive/165

This Open Access is brought to you for free and open access by the Levy Economics Institute of Bard College at Bard Digital Commons. It has been accepted for inclusion in Hyman P. Minsky Archive by an authorized administrator of Bard Digital Commons. For more information, please contact digitalcommons@bard.edu.

Bard

Blueprint for financial reform.

as of oct 26 with nov 9 additions.

3 aspects of community service and development banks

currency exchanges

narrow bank monopoly of govrnment guaranteed deposits

financing small businesses even micro businesses as viewed by even the smaller banks by a series of manged funds which have conditional valuation of liabilities - the risk of losses after a tranch

Hypotheses:

Hyp. 1. The events of the past decade resulted in a wounded financial system. The debt explosion of the 1980's as documented by Ben Friedman, Wolfson etc created a fragile financial structure which led to the traumatic failures of the past four years.

Hyp. 2. The losses by the FSLIC and FDIC on negative net worth S&L's and Banks forced the Treasury to refinance these government bodies: this led to a large charge to the taxpayers, a bailout to use the common phrase.

Hyp 3. The reform legislation that followed aims to assure that such charges to the Treasury will not occur in

the future: the technique is to assess risk related premiums and force early closure and pay offs of low equity institutions. (Also limit payoff to the statutory $100,000. per depositor per bank?)

Hyp. 4. The reform is in good part misguided. Too great an emphasis is placed upon minimizing costs to Treasury and not enough on the financial system as a determinant of whether the Capital development of the economy is "adequate". The capital development of the economy is adequate when there is both a sufficient amount of investment so that a close approximation to full employment is attained and the investments are efficient in that they lead to improvements in either productive capacity or the quality of life. (Note that if one holds, as we do at the Levy institute, that the total of available capital income over any period of time, is not determined by the technical productivity of capital but by the distribution of demands among consumption, investment, government and foreign demands as well as the saving propensities of wage earners and consumption propensities of the reipients of capital incomes, then we have difficulty with the concept of the efficiency of the selection process for investment.)

Proposition: Reform of the financial system that takes into account the institutional changes of the past 60 years and which focuses upon the financial system as part of the

apparatus which determines the how much and what kind of investment that takes place is needed.

Theoretical presuppositions:

1. A world with Capitalist Finance is not an automatic seeker of an equilibrium in which the technical conditions of production determine the cash flows that either do or do not validate the core financial liabilities which arise when business financies control over the capital assets and the markets of the economy.

2. We remain "wedded" to the Kalecki-Levy view of the determination of profits so that investment drives the core determination of profits. In this Kalecki-Levy view, total profits are determined by the composition of demand; this implies that the profits of the various debtors are not independent.

This has implications for portfolio theory. In particular a diversified portfolio of junk bands is not equal to or superior to a diversified portfolio of high quality bonds. An implication of this is that the fiduciary portfolios could not be a market for junk bonds.

A menu:

1. **The payments system** has evolved into a three part structure

a) currency and coin

b)checks and deposits and

c) credit and debit cards.

The points of contact among the three are cash checking services, ATMS, business deposits of currency, check payments on credit cards and payments by credit card processors to venders.

Business to business as well as wages, interest and dividends payments are done by checks.

Households of a certain income and stability increasingly use credit cards for major purchases and transfer from check account to each credit card processor once a month. Eventually the electronic plus plastic payments system will encompass ever more types of payments. These favored households use ATMs to exchange deposits for currency.

Poor people use currency. Currency exchanges are the banks that the poor use to go between the deposit and currency systems.

Businesses are aware that they have to pay for the transaction services they receive from banks. The costs of the credit card system is paid by a vender's discount (non-par clearance). Households still expect to receive costly transaction services without paying a corresponding fee for services.

A trend in banking is to stop subsidizing the costs of servicing transactions from general bank revenue. The costs of electronic transfers and ATM(?) transactions much less

than cost of either check transfers and transfers that require teller services.

Legislative refinement may be needed to facilitate the spread of the electronic based payments mechanism to households without banking services.

There is a profitable subteranean part of the American Banking System which specializes in cashing checks and making check like payments (money orders) for those who do not have checking accunts: these are the currency exchanges. In some jurisdictions these exchanges are regulated and are allowed to receive welfare and social security checks

2. A revision of the banking structure adding a new type of Bank, a Community Development Bank, to the current mix. Such banks may be needed to facilitate the access to the checking system by households, to finance business by acting as the investment bank for smaller businesses, as well as the proximate service organization for household accounts. A community development bank combines the narrow bank idea and the mutual fund concept for portfolio diversification and the financing of smaller businesses.

The gross profit margins of the Community banks need to be large enough to fund a cadre of loan officers. I don't know if it costs out. The asset base for deposits will not involve any significant acquiring costs. The assets in the mutual fund - investment financing via equities and debts

may be costly to acquire. The development will involve pro formas.

3. Pension funds together with the complex of mutual funds have changed the structure of financing. (The consumption tax I suggested in the WSJ is really a device to open IRA accounts to an unlimited pay ins of pre tax dollars. The argument is that if this is allowed then the income tax is transformed into a consumption tax and the need for pension funds as we now know them is eliminated. The pension funds are pernicious because they can be corrupted and they look to the placements of large bodies of monies.

4. There is need for an RFC that will participate along with private financing devises to finance high risk as well as bet the company projects.

5. There is a need for an organization that can take negative net worth banks and refinance them. We need to get Janeway"s input about the refinancing of the Mellon bank. How does it look one year later?

6. Is it at all feasible to have banks which have conditional value liabilities. Banking and mutual funds. Will banks park their high risk liabilities in such mutual funds. Cannot trust bankers.

What else Brainstorm Monday. Get Gennaro to write up the Ideal, not the practice, of IRRI etc