Synopsis of

Financial Crises: Systemic or Idiosyncratic?

Hyman P. Minsky
Distinguished Fellow
The Jerome Levy Economics Institute
Bard College
Annandale on Hudson, New York.

Paper prepared for a conference on The Crisis in Finance,
April 4-6 of The Jerome Levy Economics Institute.

The significance of the current crisis in finance follows from our knowledge that the deep and long depressions of American History have been associated with financial crises: Every deep and long depression in our history has been associated with a significant financial crisis.

One implication that can be drawn from this history is that there are systemic processes in an American type market economy which lead to periodic financial crises and deep depressions. On the other hand every financial crisis - deep depression combination of experience has taken place in a particular historical and institutional context. After the fact it has been possible to point the finger and impute each financial crisis - deep depression combination to particular institutional flaws or errors of policy.
The theme of this presentation is that the systemic processes and the particular or idiosyncratic elements to the highly decentralized American economy that enter into the intermittent occurrence of the financial crisis - depression combination are related to characteristics that a capitalist financial system needs to possess if it is to be conducive to innovation driven growth. This theme forces us question whether the orthodox generally accepted economic theory - the mathematical general equilibrium theory - which cannot in the words of one of its most distinguished practitioners find any place for money and therefor for financial markets furnishes a suitable framework for the understanding of our type of economy.

The theory that underlies the argument views that the American version of capitalism can best be visualized as a multidimensional non-linear time dependent process of the type that, as is well known, will intermittently become critical, so that unstable behavior results from normal processes. The theory also holds that intervention and apt institutions can contain the instabilities and affect the course of events both when the system is non critical (robust) and critical (fragile). A smooth growing economy in this view exists when the forces making for depression and inflation are thwarted by apt initial conditions and institutions and by the administration of the discretionary interventions by authorities whose model of the economy
recognizes that a successful functioning of the economy is likely to be transitory.

The proposals for reform that were put on the table by the administration are suspect for they do not reflect a consistent view of the economy as a system that is endogenously unstable.