Professor Minsky's paper titled "Reconstituting the Financial Structure: The United States" is composed of two parts. In part one he makes observations on what actually happened over the years such that the financial sector reform has become the number one policy issue on the American scene. He uses these observations to point at some first principles that must be taken into consideration when approaching the reform issue. In the second part he takes the Treasury report as the basis for criticizing the current level of discourse in the USA, but he does not provide his version of the institutional structure for a good financial society. Professor Minsky's paper is one of the few among many on this topic that wants to discuss the issue on basis of first principles rather than empirical observations and patchwork policy recommendations.

Before I read the Treasury report and the Minsky paper, my exposure to the literature could be summarized as the following areas of agreement and disagreement. It seems that most of the people in USA agreed that bank powers should be expanded, that functional regulation is desirable and that a limited safety net for banks should be retained. Areas of disagreement were related to what activities could be carried out within bank holding companies, where nonbank activities could be carried out inside the bank holding company, and what part of bank holding company should be regulated by bank regulators. The answers to these questions were extreme, those desiring to strictly separate banking and nonbanking affiliates wanted consolidated supervision and those who desired freedom in nonbanking activities favored nonconsolidated supervision. So beliefs on the insulation possibility of banks was the key to the solutions suggested and to positions taken by FED, Treasury, FDIC and the Comptroller of Currency.

Given this exposure to the problem, I adopted a strategy of summarizing the arguments of Prof. Minsky and indicating which ones are leading to new avenues of debate and which ones are generally accepted positions.

Prof. Minsky observes that the role of banks in providing services is reduced as a result of fundamental market determined changes and not by such factors as deregulation. This is in line with the consensus.

He emphasizes three market determined changes:
a) recent form of capitalism which he calls "money manager" capitalism. This trend together with modern finance theory applications of diversification and risk behaviour lead to emphasis on short term performance and new instruments on diversified portfolios such as junk bonds and financing of LBO's. And when banks attempted to compete with the funds during deregulation with high interest rates, the result was the zero
equity-insured deposit-slack supervision combination leading to the current bank and thrift difficulties.

In my judgement most of the people would agree with Prof. Minsky on the market driven role assigned to the contribution of "money manager capitalism" to the current problem.

b) Professor Minsky's second point states that technology driven changes and innovations in credit cards, EFT type of applications led to payment mechanisms which reduced the hold of commercial banks in payments and the importance of checking facilities. Checking never was profitable and had to be subsidized from profitable customer relation banking. But money market funds and credit card innovations with electronic processing systems led to profitable payment mechanisms outside the banking system with which the banks could not compete.

I think that most of the people would agree with this observation, also.

c) The area where Prof. Minsky is not in harmony with the rest of the literature relates to the role of markets and speculation. He states that theoretical demonstrations of Smithian position of Pareto Optimality of competitive equilibrium has been demonstrated only in an abstract world with no money and capital assets. And Smithian equilibrium existence does not guarantee uniqueness and stability. So market mechanisms and results are accepted on basis of faith rather than demonstration. So unconstrained markets leading to disaster and speculation leading to wrong results in capital development is a real possibility. Prof. Minsky points out that when wrong assets such as real estate is financed or liability structures are created, that can not be validated by future cash flows, Smithians explain it by deviations from free markets, while others might explain it by inherent instability of the market mechanisms. So in his judgement the principles that should guide the financial sector reform should be debated first.

d) Prof. Minsky also points at the fact that the USA which once was the world's largest creditor is now the world's largest debtor in home and international markets. And if USA government does play a Ponzi game and does not validate its debts by taxes, interest rates on all debts will be rising, mix of instruments will be changing and market valuations will be affected and debt deflation will become the issue of the day. So Smithian approaches putting emphasis on minimizing cost to taxpayer of sustaining a payment mechanism may not be appropriate as a public policy.

I myself thought that there are very few important real world issues that can be seriously addressed by the Pareto Optimality yardstick.
Hence Prof. Minsky's arguments on relying on markets blindly are justified in my judgement. But on the other hand the instability of markets when money and capital is present has not been generally proven either. I would like to see more discussion, too. For example the post Bretton Woods experience in fx markets gives a very clear indication of destabilizing speculation and market forces. Hence I think that a general stability proof does not exist. But on the other hand what are the types of instabilities we are talking about? Strange attractors of chaotic processes or sudden falls from catastrophic cliffs? I would like to hear more detailed explanations from Prof. Minsky about the cause and nature of unstable markets and speculation. I am afraid of a Bettolucci type finish where there is no happy end and both sides die!

In the second part of his most interesting paper Prof. Minsky takes the Treasury report as the basis of discussion.

The main argument is that that the Treasury Report as well as discussions in USA and in this conference are vague in determining the functional role the financial system plays in capitalist economies. He warns that the failure to approach the issue in a deep and non-superficial fashion with a broad agenda is to get caught unprepared by the next financial crises which he thinks will be as critical and as strong as the previous depressions. He thinks what is at stake is the future development of capital for the global economy.

Hence he thinks that the Treasury report that rephrases the banking and deposit insurance reform in terms of creating a structure of deposit insurance that minimizes the future Treasury liability and focuses mainly on banks, debates only a peripheral issue and not essentials. He claims that the Treasury report that does not address the issue of the proper role of the financial system in the economy has less than met the eye.

Prof. Minsky summarizes the report under five main headings. First, refinancing of the funds with both Treasury money and borrowed funds is seen by him as an attempt to hide budget deficits. Second, he thinks that increasing the regulatory power of the Treasury and the Deposit Insurance Corporations and reducing the power of FED is only an attempt to grab power. Third, allowing nationwide banking allows the weakest part of the system the giant banks to expand while the relation and development oriented and profitable banks of the 1-5 billion class are threatened. Fourth, he sees the bringing of the Glass -Steagall walls which separate
banking and security business as unnecessary, since it is already passe in the secondary market and he wants the relaxation only for the smaller banks.

Fifth, allowing corporations to own banks similar to the business and finance company association may be wrong. He claims that in a country where capital markets are weak, a move to universal banking might be appropriate. But in USA capital markets are strong and the move to universal banking would not be consistent with the growth and development of pension and mutual funds. Hence he thinks market and function orientation is proper for USA.

Given this position by Professor Minsky I must ask the two following basic questions.

A) what is the proper role of the financial system in a capitalist economy?

B) Given your position on the Treasury report, what alternative are you suggesting in sketch?

To aid discussion I will add brief summaries of blueprints suggested in the USA literature to the Treasury proposal.

The proposal by Lowell Bryan would abolish McFadden Act, Glass-Steagall Act and the Bank Holding Company Act. The new Social Contract would create a new "Financial Holding Company" with three subsidiaries, the "Core Bank" subsidiaries would be fully insured and would work like the regional relation oriented banks of today. They would be regulated along principles of today by Treas., FDIC, FDIC. Two uninsured subsidiaries would resemble money market investment banks and finance companies. The "money market investment bank type" would be uninsured and regulated by SEC only and would represent USA in global markets. The finance company equivalent subsidiaries would function like the risky money center banks of today and they would also be regulated by the SEC.

For the core banks, Bryan would limit the size of loans they can give, permit strictly regulated small real estate loans, force real estate people to put equity in the project and Bryan would peg the interest rates for the core banks to Treasury rates in a flexible fashion.

The proposal by James Pierce is based on abolishing forced financial specialization and on design of regulatory system around financial functions rather than institutions. He thinks that the functions which are most important are the monetary functions best undertaken by money market funds and the loan function which is undertaken by a multitude of institutions. So he would create a monetary service company to specialize in monetary function that operates like the money market funds today, but has an equity position financed by stockholders, subject
to the Federal Safety Net, and with free entry. On the other side would be institutions which mostly undertake loan functions, but not prevented from monetary functions. This company could undertake any transaction, could be partners with anybody. Market discipline would replace governmental risk regulation and the FED would be available only in crises time, but no insurance. So people desiring safety would deal with the monetary service institutions, while risk-takers could be anywhere on their own risk.

Two other proposals are by Robert Litan of the Brookings Institution and by Bert Ely and Peter Wallison. These proposals are extreme. Litan would prevent bank failures and thus loss to the FDIC by limiting bank assets to short term government securities. On the other extreme, Ely and Wallison among others suggested a plan where banks would be allowed to take whatever investment risks the market will bear, but would eliminate taxpayer risk by replacing the deposit insurance with a private system.

I would be greatly interested to hear Prof. Minsky discuss the merits of these proposals, along the function of the financial system that he thinks is appropriate for capitalist economies.

I am hoping that he will expand on the link between the financial sector and the real economy, which I feel is the main consideration in the back of his mind.

Deniz Gökçe
I want to thank the Central Bank of Turkey for inviting me to this Conference. It is a wonderful place we are at, the papers are enlightening and thought provoking and I think need to be in Turkey often. A Conference in New Zealand meant that I was more than two hours completed 3/4 or so of a trip around the world.

Instead of beginning with the paper I sent forward by fax - since which was bottled up in transmission - I will start with Mr. Yamashita's paper from yesterday afternoon.

Evolutionary

Mechanically, an economy such as Japan is best thought of as an dynamic process which generates the economic variables through real calendar time, such a process consists of initial conditions plus dynamic interaction. The initial conditions are:

- There are two sets of initial conditions: the institutional structure and initial observations of the variable he system determines. The economic process is evolutionary because
The institutional structures change in response to economic incentives and administrative and legislative intervention in response to system behavior.

The period 1946-48 were 1950 (when did the American Military Government of Japan give up power) set in place the institutional complementarization structure of financial institutions and the economic history of the Japanese Economy has taken place within the context of structure of corporate financial institutions that was complementarized.

The past 40 years has been a period of remarkable growth of Japan. We will not call it a golden age, but we can call it "a practical best."

The financial structure put in place in Japan in the time of the occupation was similar to the U.S. financial structure, which shouldn't surprise us for it was largely imposed. In fact, I might suggest that the financial structure...
was what he termed "new deals" would have looked to put in place in the United States, but the concept itself for Japan did not have the power in the United States that they had in Japan.

More than twenty years, say for 1948-1968 was if not a golden age of prosperity best for the United States. The United States also had a compartmentalized banking system, but was heavily regulated.

Both the United States and Japan had compartmentalized and regulated financial systems during their 1920s and 70s, which led to performance.

This interpretation of his theory does not come anywhere near sufficiently diverse, validity or in fact. Depleted, lonely supervised and uncoordinated financial structures in turn institutional frameworks for a successful enterprise economy.
Now we can turn to the paper I found at one time or another to Mr. Ungerer. Since the first part did not come through clearly, I have a check copy with me and I expect Mr. Ungerer can understand to set your clear clean copy the paper transmitted.

The paper I prepared is part of a larger work. The body pages from him will have 80 and there are 160 pages, at which time publishers no doubt will be clamoring hard and after publication economic analysis in policy will enter a new era.

The paper falls into 6 parts

I. Introduction
II. The Pressing Document
III. Market-Driven Changes in U.S. financial Structure of the United States
IV. Aspects of U.S. Treasury
V. Validity of Financial Instrument
VI. Conclusions
Introduction: Changing, reforming, modernizing a redundant financial system is a problem. The main economic problem in the former Soviet state is the existing financial system in place.

II The Treasury Document

The Treasury document declares: By raising the question of serious implications it suggests that whatever now in the agenda may well be superficial. The central task is to broaden the agenda.

"It ain't broke, but it's fixable."

Deposit insurance is needed and clearly requires reforming if not reforming. It's a matter of reform process.

The document was beyond reform.

The deposit insurance scheme is not what it could be.