International Portfolio
Diversificaion > ? than

Federal Reserve
Constrained from
right money by property
and money by
right hand.

right hand $ \rightarrow \$b \rightarrow
capital of overseas assets
that hold dollar denominated
assets in empire.
Point II. We can have
1. Much bigger gas storage
2. More flexible Federal Reserve

1 + 2 make the environment
more viscous →

a break down of fundamental
g. 32'-33' will take longer to

recognize many more
process before there is a

full restart of growth

also → demand if it can be
driven down as far as
Can "It" Happen Again
Do "It" Happening
Again!

Point 1. Not all recessions
periods are 9 months.
If we view
the economy of the
Winter of 1932-3 as a
the "charlie breakdaw" end
the stock market Crash of
Oct 25 as the triggering
event then we recognize
that it took 42 months to
"Get" to really bottom.
FRAGILITY AND RESILIENCE OF THE INTERNATIONAL FINANCIAL STRUCTURE: SOME GENERAL CONDITIONS AND THEIR APPLICATIONS TO CURRENT CONDITIONS

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Remarks prepared for a round table on "How Robust is the International Trade and Financial System?"

AEA and The International Trade and Finance Association
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Outline:

I. Introduction

The economy is a miniature, multilevel, multi-decision system

II. The Structure of Financial Relations: Hedge, Speculative and Ponzi Finance as "cash flow" relations

The 'Herky' special, hypothesis: Time of fund functioning

III. Refinancing Positions: the Normal Functioning of Financial Markets and Institutions

P.S. For making: Herkes 1950 no much depend on market functioning: market

IV. Fragility as an Evolutionary Consequence of Normal
Functioning, Resilience as a Consequence of Institutional Structure.

V. Central Banking and Other Thwarting Devices: Late Post War Resilience as the Result of the Institutional Structure.

VI. The Coherence of the Post War Economy as a Beneficial Side Effect of American Economic Dominance and the Fiscal Policy Model of the Economy

VII. Althus's Proposition: The Agents in the Model Have a Model of the Model. Alternative possible models of the model as a debt reflection 'part' of the model. Are models that agents have.

VIII. 1971 Power Relations: "What is the Model of the Model that the Main Actors Have?" The U.S. model of the model. The German model of the model.

Annexe: the question: How about the International Business Structures?

I. Introduction

The fragility and resilience of financial structures, whether of an agent, such as a household, firm or financial institution, a national economy, or the international order, reflect the same guiding principles. These guiding principles are the structure of payment commitments, the
The complex time considerations mean is that the mathematical representation of capitalist economies will take the form of equation systems which are multidimensional, time dependent and non-linear. As we now know such equation systems generate paths through time which are not well behaved; periods of apparently coherent macroeconomic behavior will be interrupted by periods of apparently incoherent macroeconomic behavior. This implies that there are endogenous relations within economies which tend to create organized behavior even as there are relations that can emerge which tend to lead to disorganized, incoherent or chaotic behavior. Furthermore the path through time that such systems generate, the jump from coherence to incoherence and back as well as the time spent in each type of behavior, are not predictable. The traditional view of economies as equilibrium seeking and sustaining systems needs to be abandoned. Economies need to be considered as systems which move through time where the path depends upon some combination endogenous dynamics and the impact of institutions and random events.

Capitalist economies are systems in which there are production, life cycle and financial links among yesterdays, todays and tomorrows. This implies that they are likely to spin out of control from time to time. Furthermore the purely production and life cycle characteristics of
economies are likely to be slow moving relative to the pace of change as the economy spins out of control (i.e. production characteristics of the US economy were not substantially different in 1933 from what they had been in 1929). I take this to mean that the observed incoherence of capitalist economies are most likely to be related to the incremental complexity due to the financial characteristics which are inherent to an economy being capitalist.

II. The Structure of Financial Relations: Hedge, Speculative and "Ponzi" Finance.

Every unit in a capitalist economy can be characterized by an income statement and a balance sheet. The balance sheet states the units assets and liabilities in some common denominator, some money. Given our concern with international financial and economic relations it is necessary to note that the balance sheet is denominated in some national currency. However we are not interested in the total balance sheet in the first interest, we are interested in the liability side. The valuation of assets is another matter. The liabilities on a balance sheet are best interpreted as commitments to make payments at stated dates in the currency of denomination; these payments are on both interest and repayment of principle account and there are meaningful penalties for not fulfilling payment
commitments. A balance sheet can be read as a particular dates prior commitments of future cash flows of future payments that will be made out of wages, gross profits, taxes or trade receipts.

The normal source of the funds to fulfill the payment commitments are income cash flows. Most importantly these income cash flows are the gross profits before taxes for business firms, wages for households, tax revenues for national and local governments and net trade receipts for the international accounts. These income cash flows may or may not be sufficient to fulfill the payment commitments on the debts. If they are insufficient then the commitments can be fulfilled by various balance sheet operations. I have long classified balance sheet commitments / income flow relations as reflecting hedge, speculative and Ponzi financial postures. These somewhat flamboyant terms (The characterizations of some not necessarily fraudulent financial postures as Ponzi affronted some colleagues because Ponzi was quite obviously a swindler before his episode was finished and to their minds many who were capitalizing interest were not necessarily swindlers) may have distracted from my message.

A unit is a hedge finance unit when the income cash flows are sufficient in the current and foreseeable future to fulfill all of the legally committed payments. This means that firms which are mainly equity financed so that there
are no commitments to repay any principle sum and the
dividend payments are conditional upon income being earned
are almost always hedge financed firms. For hedge financed
firms the threat of disruption of operations because of
financial pressures is not large.

A second type of financing posture is what I called
speculative finance in that the unit's income flows can
fulfill the interest payments due on its debts but is not
large enough to fulfill the commitments to repay principle.
Furthermore the prospects are that the unit is able to pay
interest at the same level over the foreseeable future. This
means that the unit can roll over its outstanding debts, can
issue new debt to raise the funds on debts that are coming
due. Speculative financing units finance long positions
with short debt: the Government's Treasury Bills is one
example of speculative financing, Savings and Loan
Associations and Banks are other examples of units that
speculative finance their positions.

The third financing posture is Ponzi finance where
the unit's cash flows are not large enough to meet the
interest payments due on its debts. These interest payments
are met by increasing indebtedness. Inasmuch as
indebtedness is increased even as there is no increase in
assets Ponzi finance involves a decrease in the equity
account and an increase in the future interest and principle
payments. Furthermore debt increases even as there is no
increase in the unit's income earning capacity. The ability of a unit to Ponzi finance is limited for as the ratio of payment commitments to expected cash flows increases the willingness of lenders to hazard financing the unit decreases. In the transformation that is taking place right now in the American economy examples of Ponzi financial postures are turning up in he business press almost every day. If one doesn't like the term Ponzi finance they can substitute capitalizing interest for Ponzi.

The robustness or fragility of a financial structure is measured by the ratios of hedge, speculative and Ponzi financial structures in the economy relative to the size, expected increase and assuredness of cash flows for the liability unit. The fundamental proposition in the financial instability hypothesis interpretation of Keynes I put forth more than 15 years ago is that over extended periods of good times the ratio of hedge, speculative and Ponzi finance changes with the weight of speculative and hedge finance increasing. The spectacle of the merger and take over movement of the late 1980's clearly led to an increase in speculative and Ponzi finance; this movement also followed a demonstration that effective government action can contain a recession.