

1-1-1986

Where's the Cash Flow?

Hyman P. Minsky Ph.D.

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

Recommended Citation

Minsky, Hyman P. Ph.D., "Where's the Cash Flow?" (1986). *Hyman P. Minsky Archive*. Paper 98.
http://digitalcommons.bard.edu/hm_archive/98

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.

Where's the Cash Flow?

In a memorable T.V. commercial a lady looking at a much publicized hamburger sandwich asks "Where's the beef?". In a like manner, as we take a hard look at the Third World's debt problem we should ask "Where's the cash flow?". It is the realized and prospective cash flows that determine the value of assets and the viability of financial deals. The cash flow, realized or prospective, to validate the Third World's debt structure is not there.

Conceptually cash flows are very simple. In practice, when the prospective cash flows stretch out through the future, they are complex and conjectural. If business and banking are mixed games of chance and skill, then the skill comes largely in the ability of the players size up the cash flow potential in the future of what must be decided upon today.

The first question a banker asks when a loan is being negotiated is "How are you going to get the money to service and repay the loan?". The answer is a scenario which projects the cash flow to the debtor from "future" operations. If the prospective excesses of receipts over operating expenses for a project are more than enough to fulfill the payments on a loan, then financing will be available. A realized positive cash flow from operations yields the cash that pays interest and principal on debts and become profits; today's debts structures are "viable" if realized positive cash flows stretch out over number of years.

The Argentinian and the other International debts that now confront the Great Banks are mainly, though not exclusively, denominated in dollars. If interest is to be paid - let alone the principal repaid - the debt burdened countries need to earn a surplus of dollars through their international trade

accounts. There are ways to obtain dollars, such as, borrowing or selling assets. But in these cases the lender or buyer must expect to earn dollars in return. The lender or buyer is exchanging dollars now for dollars later. This only moves the basic problem a bit into the future.

For the debts of Argentina and each of the other debtor countries ~~are~~ to be good, these countries must show a surplus on trade and services account that is at least as big as their interest bill, and they must be able to transform these surpluses into dollars.

But if the debtor countries must have a surplus in dollars on current trade and surplus account if they are to meet their commitments, then the United States must run a deficit on its trade and services account that is big enough so that the debtors can meet interest payments on their debts. If the global dollar denominated debt is \$1000 billion, and if the prime rate is 12%, then the interest on the global debt is on the order of \$120 billions of dollars. The United States must run a deficit on trade and services account of at least \$120 billion dollars if Argentina, etc. are to make the payments on their debts.

If we allow for a strong United States export performance in agricultural products, airplanes, military technology and various sophisticated high technology goods and if we allow for the fees that United States bankers earn because New York is the financial center of the capitalist world, then the need for the United States to pile up a \$120 billion dollar deficit means that imports must be allowed to make serious inroads into the markets for some commodities and services. We know that has happened to automobile, steel, shoe, textile, etc. imports and domestic production. We know the "horrible" charts about the relative wages of American and Japanese automobile workers. We also know that the high relative wages of American workers on

these charts reflects the high exchange rate of the American dollar.

But the high exchange rate of the American dollar did not appear out of thin air. It is high because the rest of the world must earn dollars by favorable trade balances so that they can service the outstanding dollar denominated debt. We have troubled industry and chronic unemployment, we have our depressed rustbelt because the rest of the world is burdened by enormous dollar denominated debts at interest rates which are now significantly higher than they were in the mid-seventies where much of the explosive growth in debt has its roots. The current level of international debt in good measure resulted from the capitalizing of interest. (Capitalizing interest means that instead of debtors paying interest as it falls due, the interest is in truth "unpaid" but is added to the principle of the amount owed.) A good deal of such capitalizing of interest took place in 1980-82 when interest rates were at record levels. The March Argentine deal involved capitalizing interest, and the prospective I.M.F. agreement with Argentina will add the interest due, but as yet unpaid, to the overall debt of Argentina.

International dollar denominated debts are viable only if the United States runs a huge deficit on traded goods and services. A huge deficit on current trade means unemployment for some workers and distress for some firms. This quite naturally leads to defensive reactions and demands for protection. The call for quotas and voluntary export constraint are natural outgrowths of the indirect impact of international debts on domestic employment and profits.

If quotas and volunteer export restrictions are imposed on some goods and are effective, then U.S. imports of the protected goods will decrease; this will tend to create a global dollar shortage. This global dollar shortage will trigger market processes that raise the exchange value of the dollar

against almost all currencies. This lowers the dollar price of non-restricted imports. The exchange rate effect of a successful program of quotas and export restrictions leads to new United States markets being penetrated by imports.

For example, the quota on Japanese car imports led to the appreciation of the dollar. As a result the Japanese car industry was able to invade the market for higher price cars. Export restrictions have led Japanese manufacturers to abandon the low profit bottom of the automobile market to United States manufacturers even as the total import bill for Japanese cars has risen.

The Argentine settlement of March is a stop-gap agreement until an agreement with the I.M.F. on Argentinian economic policy is reached. The I.M.F. will try to get Argentina to agree to what is by now a traditional program of fiscal and monetary constraint. This will lead to a deep recession in Argentina like those imposed upon Mexico and Brazil in 1982/83. This I.M.F. program succeeded in creating a recession in Mexico and Brazil even as it led to their trade balance improving.

The I.M.F. program may enable Argentina to increase its share of the global pool of dollars made available by the United States trade and service deficit. But it will not increase the global pool of dollars available unless it leads to imports conquering some additional United States market. I.M.F. programs to "save" a particular debtor's currency leads to a shift of dollar earnings among countries. The I.M.F. does not solve the debt problems, it imposes beggar my neighbor policies upon the country in crisis which leads to other countries go into crisis: Mexico getting healthy leads to Argentina getting sick, Argentina getting healthy will lead to Nigeria or the

Phillipines getting sick, etc.

The alternative to beggar my neighbor policies is to lower the global burden of the debt. One way is to lower interest rates; in a 6% world debt servicing will require \$50 to \$60 billion dollars rather than the \$100 to \$120 billion of a 12% world; the second way is for the United States to devise policies that enable it to run the required \$120 billions of deficit and still maintain a reasonably close approximation to full employment.

The center remains the United States. If the United States is able to maintain a close approximation to full employment in the face of the need to run large deficits on current trade and service account and simultaneously achieve interest rates that are substantially below current rates, then the international debt problem is more than manageable, it will disappear. If however the need for a large deficit implies United States unemployment and recessions, and if interest rates remain where they are or rise, then the international debt crises will migrate at an accelerating pace from one country to another until either simultaneous defaults or "concessionary" loans, which require subsidies from the United States Treasury, lead to temporary reductions in the global dollar cash flow that is needed.

The "international" financial problem that so concerns the financial and political capitals comes down to the question of how can a close approximation to full employment and low interest rates be achieved in the United States, even as the United States runs an import deficit large enough to provide the funds that are needed for servicing international debts. The I.M.F. points an accusatory finger at the debtor countries and requires that they mend their ways. However the global problem is beyond the control of the accused. For the I.M.F. to be even handed it would need to impose conditions on the

creditor countries and in particular on the center in whose currency the debts at issue are denominated. These I.M.F. conditions need be that the United States must maintain full employment without inflation even as it maintains free access to United States markets.

We know that this hypothetical I.M.F. condition describes the situation that ruled from 1949 through the mid 1960's. We also know that we do not know how to achieve the desired good performance of the United States economy with the current institutional structure and political climate. We know that 1949 to the mid 1960's was characterized by a robust financial structure in the United States that was largely the legacy of the Great Depression. The recurring international financial crises points to the need for the capitalist would be to go through the economic equivalent of a great depression without actually experiencing a great depression. Unfortunately no one knows how to do that; it is, as Portia remarked, harder to do than "to know what to do".

Hyman P. Minsky
Economics Department
Washington University
St. Louis, Missouri 63130