Too late to learn?
*The Cost of Capitalism: Understanding Market Mayhem and Stabilizing our Economic Future*, by Robert Barbera

Reviewed by Julian Delasantellis

Just for a moment, pretend this is the 1967 movie *The Graduate*. You, readers, are poor, confused liberal arts graduate Benjamin Braddock. I’m the older gentleman who, at the graduation party thrown by Ben’s parents at the family home, takes the younger man aside to give some advice derived from the labors and pains of the years.

"I just want to say one word to you. Just one word."
"Yes, sir?"
"Are you listening?"
"Yes sir."
"Minsky. Hyman Minsky. Lot of future in Hyman Minsky"

Actually, the line was that the future was in plastics. But in so many ways, the actual history of the past 40 years has been the story of Hyman Minsky.

A few weeks ago, I wrote about the competition between the followers of John Maynard Keynes and Milton Friedman for the title of the most influential economist of the twentieth century, (see Off with their blinkered heads, Asia Times Online, October 1, 2009). I noted how, even with the followers of the two 20th century greats locked in a death struggle among dead ideologies, there is no question of who the 21st century’s most influential economist is, even with the century barely 10% done.

"His name is Hyman Minsky."

Even among the economic literati the name of Hyman Minsky is not well known, and that is unfortunate. Born in 1919 and raised in the time of Keynes, he was never a doctrinaire Keynesian; by late in his life, economic fashion had flipped to be the time of Friedman; yet, once again more in tune to history’s different drummer, nor was Minsky a Friedmanite monetarist. Out of place in the 20th century, he would have found himself at the central fulcrum of economic ideology in the 21st, had he not died in 1996.

Keynes' burden to bear was the unemployment spurred by the Great Depression in the middle of the last century, and the great inflation that followed the over application of Keynes at the end of the century. The situation that faced Minsky was none, or perhaps all, of both wrapped together - the problem of the financial market bubble.

The rescue of the Great Depression economy by Keynes was, by the 1960s, so comprehensive and thorough that one of the depression's acknowledged causes, destructive financial market bubbles whose dolorous impact spreads out of finance to negatively impact the general economy, was something only remembered by old timers.

The world economy essentially went more than 50 years, from the Wall Street crash of 1929 to at least the gold/silver bubble of 1980, before experiencing another such bubble. With the 1970s' threat of inflation then controlled by monetarism and its strict control of the money supply, interest in studying or even considering financial market bubbles began to be seen as the quick way for young economists to kill their careers.

Economists found tools to smooth out the shooting ascents and crashing descents of the previous decades; the fact that they could, with inflation falling towards zero and recessions becoming few and mild, only confirmed the name of the period given to the era right up until the recent crashes as "the Great Moderation".

The reign of former US Federal Reserve Board chairman, Alan Greenspan, of more than 20 years of
mostly prosperity was monetarism seizing the king’s throne; during his tenure he was famed and feted for his obsession with drawing meaning from the most obscure economic statistics; from truck tire retreadings to rat turds left on freight rail cars, Greenspan was known for his interpretive artistry with the arcana of everyday economic life.

As for his studying gyrations in the financial markets, and their effect on the everyday, outside, real economy, Greenspan cared little. Sometimes financial markets would be going up, sometimes down, but, as long as government did not intervene, it all would work itself out in the end.

Exactly the opposite to what Hyman Minsky believed.

Like a plant dormant for 20 years instead of for just one season, an explosion of interest in Hyman Minsky emerged last spring. He was favorably mentioned by all the right economic commentators in the New York Times and Financial Times; Paul Krugman titled a blog post “The night they re-read Minsky”, after the bawdy 1968 musical comedy, The Night They Raided Minsky’s. Much of Minsky's core canon is being republished, including his 1975 biography of Keynes, and his Stabilizing an Unstable Economy, from 1986. Demonstrating the cojones that have allowed them to rise to the summit of the greasy pole of world retail, Amazon.com is even charging US$5 for a download of a boilerplate academic article written about Minsky in 2005, something available for free to anybody with access to academic databases.

But all these are chock-full of the obtuse jargon of academic economics, and were written before one could see how the current economic crisis was in many ways foretold by Minsky. For this we must look at Wall Street economist Robert Barbera's The Cost of Capitalism: Understanding Market Mayhem and Stabilizing our Economic Future. If you're still looking for a holiday gift for that always difficult to please neo-Schumpeterian, I'd look no further than here.

The springtime fascination with Minsky was short-lived and superficial, and it's now mostly passed. Neither of the two, recent forest-leveling bruisers meant to be the sources of record for the entire crisis, Andrew Ross Sorkin's Too Big To Fail, and Charles Gasparino's The Sellout, carried any mention of Minsky. That leaves it to Barbera as one of the few commentators actually saying something interesting and innovative about the crisis.

In the church of Friedman, inflation was the ol’ devil tempting the good folk; the 1980s seemed to prove that, let loose, it would cause untold havoc on the populace. But, as Barbera notes: The last five major global cyclical events were the early 1990s recession - largely occasioned by the US Savings & Loan crisis, the collapse of Japan Inc after the stock market crash of 1990, the Asian crisis of the mid-1990s, the fabulous technology boom/bust cycle at the turn of the millennium, and the unprecedented rise and then collapse for US residential real estate in 2007-2008. All five episodes delivered recessions, either global or regional. In no case was there a significant prior acceleration of wages and general prices. In each case, an investment boom and an associated asset market ran to improbable heights and then collapsed. From 1945 to 1985, there was no recession caused by the instability of investment prompted by financial speculation - and since 1985 there has been no recession that has not been caused by these factors. Thus, meet the devil in Minsky's paradise - "an investment boom and an associated asset market [that] ran to improbable heights and then collapsed".

According the Barbera, "Minsky's financial instability hypothesis depends critically on what amounts to a sociological insight. People change their minds about taking risks. They don't make a one-time rational judgment about debt use and stock market exposure and stick to it. Instead, they change their minds over time. And history is quite clear about how they change their minds. The longer the good times endure, the more people begin to see wisdom in risky strategies."

In 1985, the rock band Starship, a rump group of leftovers from the 1960s' Jefferson Aiplane and the 1980s Jefferson Starship, released the video for their single We Built This City; in it, a sleepy rural...
settlement is transformed into modern San Francisco just by the power of rock and roll music. In Hyman Minsky's world, modern metropolises are built not with rock, but with investment capital.

In the early, first stages of an investment boom, things can be pretty well signified by Starship's sleepy rural outpost.

Something bad happened within the memory of the participants in the capital markets of this place, namely, the blow-off, destructive phase of the previous boom cycle. Therefore, economic and investment decisions now tend towards the conservative side. The investments are usually made with old-fashioned, fixed-rate financings, and, most importantly, the savings cushion of the borrowers is always enough to be able to cover the payback of both principal and interest of any loans should they come due and have not produced a sufficient revenue stream yet.

This is a very safe investment environment, also, a very boring one. Therefore, like in any evolutionary process, somebody decides to push the envelope in what is then generally accepted as "progress".

Investors start to borrow more, to ramp up both leverage and risk. Borrowing expands, and is no longer solely financed by predictable fixed long-term rates but by much more volatile short-term flexible rates. Most important, it is no longer considered all that necessary to carry as savings sufficient principal and interest needed to pay back the loans. The income-producing investments are up and running; they're producing a cash flow; and, as long as that continues to be reliable, there should be enough to fund the loans.

It is in the final stage of a Minsky expansion where all the greed and glory, the delight and the destruction of unregulated finance capitalism, can be found. All rational and practical limits against the assumption of risk and leverage are abandoned; nobody has two quarters they can rub together in their bank accounts or any other readily accessible sources of emergency cash. With debt obligations far in excess of investment cash flows, more and more borrowing is being used to fund almost all the daily needs of life. This creates a boom in asset prices, which spurs more lending; indeed, the only way people can pay back their old loans is with new, even bigger, very short-term loans.

But what if the collateral to finance the new loans falls in value? At that point, just like in the condominium markets in South Florida and San Diego in mid-2006, the borrowing stops; so does the price appreciation that was addicted to the ever-continually rising borrowing. The entire wealth-creation machine goes into reverse, and assets and wealth are destroyed at a maddening pace. In the current lingo, this asset price turnaround that opens the gates of economic hell is now being called a "Minsky moment".

At Harvard, Minsky had studied under the king of the Austrian School of economics, Joseph Schumpeter, and many see echoes of Schumpeter's famed "creative destruction" in Minsky's theory of financial cycles. Minsky would not have been one of these. Whereas Schumpeter believed that each successive boom and bust cycle led to a more advanced and productive economy, Minsky believed just the opposite, seeing in the successive financial crises that ended with the Great Depression ever greater and greater danger, through the growing amounts involved, to the financial markets and the economy in general.

As I noted here many times, Barbera observes that one common factor driving the blowoff stages of bubbles is "TTID" - this time it's different - the belief that what is on display amongst the irrational exuberance of rapidly rising prices is not the fundamental human characteristic of greed in unholy union with the dynamics of mob psychology, but an existential change in the human dynamic forcing a basic reallocation of capital from the old paradigm to the new. As Barbera noted about his experiences at a 2000 White House Conference on the New Economy, just a few weeks after the actual dot-com top:
I had the misfortune to experience this sentiment firsthand, at the White House Conference on the New Economy, in April 2000. As I noted earlier, Alan Greenspan was the rock star at the conference, peopled almost entirely by true believers. Somewhat inexplicably, I was also in attendance. After the main session was held, all participants were assigned to breakout groups. I joined about a dozen others. Our collective task was to answer the question: "What could go wrong?" Not being the shy type, I volunteered within the first five minutes of our round table that the obvious issue we had to grapple with was the potential for a bursting of the large technology share price bubble.

Our moderator, a White House insider whose name, thankfully, I do not remember, pounced. "This is not a bubble!" ... In the end, the group decided that the big risk going forward, in this brave new world, was the technology gap that was sure to worsen between the United States and poor African and Latin America nations. Bubble? The word was never uttered again.

The year 2000 saw US president Bill Clinton's head, swollen huge from the victories over the baying hounds of impeachment and the vengeful furies of Hillary, grow so massive as to threaten the asphyxiation of the planet. So it's not all that surprising that out of the fertile ground of national hubris and delusion the dot-com tech bubble grew - 2004-06 proved that it was just as easy or easier to grow an even bigger bubble with a dolt as president.

As this is a book targeted not for academics but for finance professionals, I did not expect to see many encouraging words for Minsky's core policy prescription for smoothing out the boom/bust cycles of finance capitalism - a much bigger government role in the economy, up to and including some measure of government control over the private market's investment decisions.

For Minsky, putting investment control in the hands of enlightened bureaucrats whose pay packets were mostly unrelated to the gyrations of the boom/bust cycle prevented lots of unnecessary investment during the boom, and supported it from withering into non-existence during the bust. Barbera, echoing much of current American political discourse, can't see much further than government's inevitable waste: Government projects, once they begin to spend, face no such [spending] discipline. Benefits, as it turns out, are in the eyes of the bureaucrat, they can be refined again and again so as to perpetually justify investment projects. Indeed, at the worse, we may find ourselves authorizing bridges to nowhere! Bridges that, when reversed, lead directly from Sarah Palin's house to the White House.

During the long, beneficent salad days of Greenspan's reign, the populace regarded him almost as a sort of Olympian god of money, greeting him on his trips to be among the mortals in the provinces with extended hand, Roman-type salutes of adoration. These days, the salutes are the same, but they are missing four of the previously present five fingers.

In his defense, the old fox has two refuges. One, that there was no evidence of a real-estate bubble in the period up to 2006; two, that even if there was, the pain of pricking it would have been worse than letting it burst from natural over-inflation.

Minsky proves both these points wrong. First, it was his contention that bubbles were not rare, unpredictable events, but natural, to-be-expected features of modern finance capitalism. The rampant new borrowing required to make the payments on the old borrowing, Minsky's key cenotaph of an economy in bubble, blowoff phase, was self-evidently rampant in that long-passed period of just three years ago.

As to Greenspan's defense that the bursting of the bubble would have been worse than letting it explode naturally, well, currently, the US Department of Labor's broadest measure of unemployment, its so called "U-6" index, is now showing more than one in six American workers now either unemployed, underemployed/working part time, or having given up looking for work altogether. Doing things naturally is good, I suppose, unless its like natural childbirth or speculative bubble bursting, where you can die from it.
To me, the most important insight gained from Barbera's valuable introduction to Minsky is just how much it validates what all Americans witnessed with their own eyes just a few years ago.

Then, the bubble madness was all around, symbolized by such cultural phenomena as the mad rush to have the forests plowed under for another new cookie-cutter housing development, the monomaniacal obsession with rising real-estate prices at all social occasions, the children dropping out of college, or even high school, to try to make their first million before their first shave, and my favorite, a strange new agricultural sprout that seemingly burst overnight from the ground like a tempting but ultimately poisonous kudzu on a small piece of wood nailed to a stake, a hand scribbled magic marker written entreaty to "quit your job to make $100,000 in real estate by next month".

In *The Graduate*, Ben eschews the advice regarding plastics, to first bed his father's partner's wife, then to romance her daughter. *The mother*, the inimitable Mrs Robinson, is none too pleased with this situation; she beats her daughter in protest, crying "It's too late!"

"Not for me!" the daughter responds.

But, if as the cultural zeitgeist seems to demand, and in contrast to all we've learned from Minsky, another bubble is so soon spun in another ill-considered attempt to bring back the prosperity of the previous burst bubbles, it will be too late to maintain the world capitalist economy in any now recognizable form.


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