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Hyman Minsky's financial instability hypothesis and the Greek debt crisis ☆

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Abstract

This article attempts to analyze the current debt crisis in Greece based on the financial instability hypothesis developed by Hyman Minsky. This article shows that the hypothesis provides an understanding of how an economy endogenously becomes "financially fragile" and thus prone to crises. The authors analyze how public and private sector behavior in the Greek economy led to the country's debt crisis. In particular, based on a sample of 36 Greek companies, the authors show that between 2001 and 2014, the majority of those companies had switched to fragile financial structures. Special attention is devoted to the negative consequences of applying the neoclassical doctrine of "austerity measures" in Greece as the principal "anti-crisis" concept of mainstream economic science.

JEL classification: B59, E12, E32, E44, E52.
Keywords: financial instability hypothesis, Minsky, Post-Keynesianism, financial fragility, Greek crisis, austerity measures.

1. Introduction

The majority of this article was written last summer, when Greece's national debt to European banks and the IMF was 185% of its GDP, or more than EUR 300 billion. Greece was scheduled to pay back EUR 1.55 billion to the IMF on June 30, but was unable to do so due to its catastrophic liquidity gap. On June 29, the country instituted capital flow controls. For three weeks (until July 20), every bank was closed throughout Greece, while the holidays on the Athens Stock Exchange were

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extended for two weeks, until August 3. On July 5, a poll was taken on whether to compromise with international creditors, and the majority of the country's population is known to have said no. This rejection of the proposed measures meant that the "technical default" would very likely become a recognized fact. For over two weeks, the country's potential exit from the Eurozone was a priority agenda item for the Old World politicians and economists, as well as many others. The issue was removed from the agenda on July 17, when the Eurozone countries signed a tentative agreement to lend EUR 86 billion to Greece for a three-year term, after which discussions of the "Hellenic economy" lost some of their fervor. There is no guarantee, however, that Greece will not leave the Eurozone at some point.

For many years, Greek economic issues have occupied the front pages of various economic and financial publications which have suggested a number of theoretical and practical explanations for the problem. In our opinion, the discussions of this crisis would be far more fruitful if the scientific perspective of their participants went beyond mainstream economic theory. One alternative is the *financial instability hypothesis* developed by Hyman Minsky, an outstanding American economist (1919–1996). According to this hypothesis, a capitalist economy endogenously promotes such financial relationships between economic entities that make it prone to debt crises.

This article reviews the main aspects of Minsky's concept, its comparison with competing approaches and, most importantly, its application to the current Greek debt crisis. We will attempt to prove that the financial instability hypothesis provides the best explanation for why Greece is now in a state of default.

2. Minsky's view on Keynes's theoretical legacy and on money, financial relationships, and investments

Minsky was a leading advocate of Post-Keynesianism, one of the main heterodox[1] schools of modern economic thought. Developing the underlying principles of the Post-Keynesian school, Minsky showed that Keynes's main ideas had been distorted, while many of them were simply omitted by J. R. Hicks, P. Samuelson, and other proponents of traditional Keynesianism.[2]

"Decision-making under uncertainty, the cyclical nature of the capitalist process, and financial relations of an advanced capitalist economy" (Minsky, 1975, p. ix) are what Minsky referred to as the elements of Keynes's theory lost in traditional Keynesianism. The connection between these elements can be described as follows. A capitalist economy, as a system based on using long-term assets in production and circulation exists in a historical time where "its past is given and cannot be changed, and… its future is uncertain and cannot be known."[3] Therefore, one cannot move from the future to the past in this time, unlike in logical time.

[1] Another term is unorthodox. For the differences between mainstream and heterodoxy, see Rozmainsky (2008).

[2] It is the models of traditional Keynesians that form the basis for introductory macroeconomics courses, and it is according to these models that Keynesianism is judged. At the same time, it should be remembered that those models do not fit well into the modern mainstream—although they are slightly better than the theory of Keynes himself or Post-Keynesian elaborations (Rozmainsky, 2008)—primarily because many of them are not based on microeconomic foundations.

[3] The quote belongs to B. Moore and is taken from Arestis (1988, p. 42).