

Title: Revisiting Minsky's 'Wall Street Perspective'

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ABSTRACT

The Keynes-Minsky financial theories of investment are a starting point for understanding why inherently uncertain complex economies like the U.S. are likely to become plagued with financial fragility instead of being able to pursue the relative tranquility of equilibrium growth. Yet if they are to offer more than 20/20 hindsight, their models must be reinterpreted in light of the institutional changes that have altered the economic environment since the last financial debacle. While much has been written about the changes that the application of information technology has had in transforming the production economy, substantially less has been written about the institutional changes that have impacted on the organizational and financial aspects of the economy's businesses.

Important among these is the emergence since the 1980s of the venture capital industry that has accompanied the reemergence of small and mid-sized business firms. This industry, which is narrowly focused on semiconductors and medical technology, is a predominately American institution whose chief objective is to provide technical and management expertise to take these companies public as initial public offerings (IPOs). The spectacular first-day gains of many IPOs appear to have fostered the psychology of disinvestment as the new source of wealth acquisition. This attitude is exacerbated by the international mobility of financial capital attributable to the NASDAQ as the world's first electronic stock market.

The point of departure for understanding the nature and source of an economy's financial instability, is to recognize that in a capitalistic economy every economic unit can be depicted by its portfolio. In a period of investor exuberance the ratio of debt financing to investment tends to increase as long as endogenous demands for credit are met, and the expectation for rising asset prices continues. Greater leveraging of the capital structure of business firms and households is evidence of systematic increases in financial fragility. The question then is why does the financial fragility of the late 1990s portend an instability borne out of irrational exuberance, even though a relatively stable price level does not portend a Fisher-Minsky debt deflation? The answer appears to reside in recent institutional changes.