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ORIGINAL ARTICLE

Why has Minsky's economic theory been ignored?

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Abstract

Hyman Minsky stands as one of the most influential economists of the twentieth century. His contributions to macroeconomic theory are primarily situated within the post-Keynesian tradition. This paper provides a concise overview of the fundamental elements of Minsky's theoretical framework, focusing on his principal insights, the financial instability hypothesis, and its broader implications. Although Minsky developed his theory predominantly during the 1980s, it remained largely overlooked until the emergence of the global financial crisis in 2008. The present study seeks to evaluate the socioeconomic conditions and prevailing perceptions during the intervening period that contributed to the marginalisation and underappreciation of Minsky's approach and policy recommendations. In so doing, the paper critically analyses several potential explanations for the relative neglect of his theoretical contributions.

Keywords: financial instability; international financial system; macroeconomic theory; Minsky; post-Keynesian economics

JEL classifications: B22; B59; F65; E44; B26; F39

Introduction

Minsky is recognised as an economist who diverged from conventional theoretical frameworks and is commonly regarded as a post-Keynesian thinker. His work offers insightful explanations into the inherent instability of the financial system and the recurrent nature of financial crises. This paper begins by outlining the economists who most significantly influenced Minsky's intellectual development. It proceeds to present the core components of his theoretical framework. and subsequently provides an overview of academic literature seeking to formalise his theory. Although Minsky gained widespread recognition following the global financial crisis (GFC) of 2008, his work did not receive commensurate attention or credibility at the time of its initial publication in the 1970s and 1980s. Consequently, this study aims to identify the factors underlying this initial neglect and concludes by reflecting on Minsky's enduring legacy within economic thought.

Influential economists

Minsky's intellectual development was primarily influenced by the works of Marx, Keynes, Simons, Schumpeter, Lange, and Fisher. He himself acknowledged, stating, 'as a student, I was most influenced by Henry C. Simons, Oscar Lange, and Joseph Schumpeter' (1982, 5).

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Minsky synthesised Keynes's financial theory of investment with Schumpeter's credit-based perspective on money and finance. Furthermore, Irving Fisher's analysis of how financial speculation can precipitate economic collapse served as a significant inspiration for Minsky's financial instability hypothesis (FIH).

Fisher's Debt-Deflation Theory (1933), although less widely recognised compared to his earlier pre-Great Depression work,[1] represented a distinct departure from his previous views on finance. Fisher acknowledged that debts are not always fully repayable and that markets are not perpetually in equilibrium. He conceptualised equilibrium as a stable economic period, with instability emerging once the economy deviates from this state. The accumulation of additional debt during such periods exacerbates the risk of financial crises. When a substantial number of debtors default, a crisis ensues, followed by a deflationary spiral. During this accelerating debt-deflation phase, an unusual phenomenon occurs wherein nominal debt levels decline due to the unavailability of credit, while the debt-to-GDP ratio continues to rise. Regrettably, in the aftermath of the Great Depression, economists predominantly cited Fisher's earlier, pre-crisis finance theory, largely overlooking his debt-deflation hypothesis until it was revitalised by Minsky. The concept of the *Minsky moment* (discussed below) bears a notable resemblance to Fisher's debt-deflation process.

Main standpoints

Like many post-Keynesian economists, Minsky critically challenges several foundational assumptions of conventional economic theory. Among these is the *Efficient Market Hypothesis*, which posits that asset prices fully incorporate all available information. Additionally, he questions the validity of Say's Law and the neutrality of money, both of which effectively diminish the role of effective demand in economic analysis. These assumptions collectively imply that regulatory intervention is unnecessary. Mainstream economic theory typically regards the financial system as inherently stable and efficient, attributing any instability to exogenous shocks. Such disturbances – whether asymmetric shocks or temporary market imperfections – are considered transient phenomena confined to the short run, thereby precluding the possibility of endogenous long-term instability.

This prevailing view has faced substantial criticism. Buiter (2009) argues that the excessive focus on the Efficient Market Hypothesis has misguided financial economics, as traditional theories 'not only did not allow questions about insolvency and illiquidity to be answered, but they did also not allow such questions to be asked'. The recurrence of recent financial crises, coupled with the inability of conventional frameworks to adequately explain them, has prompted serious doubts regarding the relevance of orthodox economics. Krugman (2009) asserts that contemporary economics has lost its essence due to 'the desire for an all-encompassing, intellectually elegant approach that also gave economists a chance to show off their mathematical prowess'. Similarly, Stiglitz (2010) observes that economists have become 'blinded by their faith in free markets'. Allen (2009) contends that traditional economists not only failed to anticipate financial crises but also actively denied their possibility.

Minsky repudiates the traditional emphasis on consumer choice as the central driver of economic activity, instead highlighting the perceptions and behaviours of entrepreneurs and bankers. He stresses the dynamic interactions among industrial capitalism, financial institutions, governments, labour, and consumers, all operating under conditions of fundamental uncertainty.

Minsky also observed a transformation in the drivers of economic growth. He argued that the growth trajectory of modern economies had shifted away from reliance on the

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manufacturing and industrial sectors toward an increasing dependence on the financial sector, which had gained unprecedented influence. Minsky (1986) argues that the financial system shapes investment by determining a demand price for investment goods. Unlike traditional barter-based models, his framework views the economy as driven by the pursuit of financial profits, with finance preceding production and production preceding market exchange. Reliance on external financing imposes costs through future repayment obligations, so expected returns must justify borrowing. Under pervasive uncertainty, such returns are not guaranteed, heightening borrowing and lending risks, which in turn constrain the supply and demand for investment goods, and affect overall investment levels.

Minsky further contends that financial disturbances have tangible repercussions for the real economy, thereby rejecting the notion that financial phenomena can be considered independent of real economic activity. He advocates for a transformation of the financial system aimed at redirecting focus away from financial securitisation and speculative activities toward the productive capital development of the economy.

An unstable system

Minsky developed a distinctive analysis of financial instability by integrating the interactions between finance and macroeconomics. His most notable contributions include the *Financial Instability Hypothesis* (FIH) (Minsky 1992) and his seminal work *Stabilizing an Unstable Economy* (Minsky 1986). Minsky posits that economic stability paradoxically engenders instability, a phenomenon he terms the 'paradox of tranquillity', with investment volatility identified as the primary driver of financial instability.

He challenges the traditional notion of economic equilibrium, a cornerstone of mainstream economic theory. Rather than a state of equilibrium, Minsky argues that the economy is perpetually in transition or cyclical flux. Echoing Fisher, he contends that the economy experiences intervals of tranquillity rather than true equilibrium, thus rendering the economy either permanently in disequilibrium or devoid of any equilibrium altogether. Minsky conceptualises economic cycles as processes wherein 'success breeds excess which breeds failure', or as he succinctly puts it, 'the more things change, the more they remain the same' (Minsky 1993). This endogenous success fosters financial expansion and innovation, creating an environment conducive to speculative finance driven by expectations of capital gains.

Contrary to conventional wisdom, which holds that markets generally function efficiently, Minsky asserts that the current financial system is fundamentally flawed (Minsky 1986, 287). He famously argued, 'there is no possibility that we can ever set things right once and for all; instability, put to rest by one set of reforms, will, after time, emerge in a new guise' (Minsky 1986, 333). Thus, the emergence of instability is contingent upon the structural characteristics of financial markets. Minsky further emphasises that structural transformations within the financial system typically occur during euphoric phases, exemplified by the period of 1922–1929 (Galbraith 1955).

The FIH constitutes a theoretical framework explaining economic dynamics under conditions of financial laissez-faire. Minsky describes the FIH as 'an interpretation of the substance of Keynes's General Theory' (Minsky 1992, 1). The hypothesis draws intellectual lineage from Fisher's (1933) debt-deflation theory and Schumpeter's (1934) credit theory of money and finance. It may be regarded as a financial theory of investment that underscores the pivotal role of debt within the financial system and the mechanisms through which it is sustained.

According to Minsky, the financial system is inherently unstable and becomes increasingly fragile during prosperity periods. The FIH asserts that free-market operations

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do not lead to full-employment equilibrium and that economic cycles and crises arise endogenously from 'financial attributes that are essential to capitalism' (Minsky 1986, 173). Papadimitriou and Wray (2008) note that the FIH operates within a dual-price system: one concerning labour and current output prices, and another concerning financial and capital asset prices. Traditional economic theory tends to marginalise the latter, treating it primarily as a variable within the trade sector. In contrast, Minsky insists on the equal significance of the financial sector within macroeconomic analysis, critiquing the reduction of macroeconomics to a mere aggregation of microeconomic behaviours that overlook financial dynamics.

Modern economic activity is initiated through negotiations between financial institutions and entrepreneurs to finance investment projects aimed at future profits. Contemporary economic operations fundamentally involve the exchange of present capital for future capital; present capital finances current production, while future capital represents profits accrued to service prior debts. Consequently, key economic variables encompass total liabilities, the structure of loans and credit, and asset holdings – both contemporaneously and prospectively. This long-term perspective is crucial, as the transition toward economic fragility and disequilibrium is a gradual accumulation of events rather than an abrupt occurrence.

Financial institutions extend credit that supports aggregate demand (Minsky 1986). Loan repayment obligations require firms to generate sufficient profits, linking past, present, and future through production and financial interdependence. Monitoring the circular flow of income in an open economy is essential to assess debt sustainability, as fulfilment or default of obligations shapes expectations, with positive expectations reinforcing stability and negative expectations increasing economic vulnerability. Therefore, uncertainty and expectations drive the decision-making processes of firms and households, particularly regarding investment. As Kalecki (1965) observes, fluctuations in investment levels are the principal determinants of aggregate demand. In addition to output and employment, variations in investment critically affect profit flows, rendering profits and investment complementary. Changes in profit levels, in turn, significantly impact debt sustainability, asset prices, and the capacity of borrowers to service outstanding loans.

Hedge, speculative or Ponzi?

Minsky identifies the financial positions of hedge, speculative, and Ponzi. Hedge finance promotes stability, whereas speculative or Ponzi finance fosters instability. Positive expectations under hedge finance encourage indebtedness, and during euphoria, the system can shift to speculative finance through higher risk tolerance and easy credit. This incentivises debt refinancing over reduction, causing the financial system to oscillate between stability and instability.

Minsky (1986) describes the evolution from hedge to speculative and Ponzi finance. In the hedge phase, firms conservatively finance operations, covering interest and principal. Financial innovation expands to meet credit demand, making the money supply endogenous. Economic growth encourages greater leverage, anticipating higher profits, and successful strategies prompt imitation among other market participants. Yet, 'success breeds a disregard of the possibility of failure: the absence of serious financial difficulties over a substantial period leads to the development of a euphoric economy in which increasing short-term financing of long positions becomes a normal way of life' (Minsky 1986, 213).

Overoptimistic borrowing and lenders' readiness to extend credit indicate weakening market discipline, initiating the speculative finance phase, where borrowers can cover interest but must refinance principal. Rising profits attract participants, escalating

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indebtedness to Ponzi finance, where debt service requires continuous borrowing, and neither principal nor interest can be met, leaving asset liquidation as the only alternative (Minsky 1982, 1986). As this phase concludes, credit contracts, liquidity falls, and deleveraging begin. Highly leveraged firms-agents default, triggering contagion across the financial system. The speculative finance phase aligns with economic booms, whereas the Ponzi phase signals the onset of recession.

The Minsky moment

The onset of a disruptive phase becomes evident when borrowers are no longer able to service their debts through conventional means (Minsky 1977). A period of moderate economic prosperity may swiftly escalate into an expansionary phase, which can then rapidly unravel into a severe recession (Minsky 1986, 1992). This critical juncture, commonly referred to as *the Minsky moment,*[2] occurs when it becomes widely recognised that indebtedness has peaked, and debt repayments can no longer be sustained with ease. It is at this point that collective expectations undergo a profound shift. Magnus (2007) characterises the Minsky moment as the stage at which credit availability tightens significantly, prompting central bank intervention aimed at mitigating potential financial distortions.

Minsky observes that while the process of extending debt structures through market experimentation may persist for years as a gradual testing of market boundaries, the subsequent revaluation of acceptable debt levels can be abrupt and precipitous once disruptions arise (Minsky 1982, 67). Consequently, the economy may experience a financial crisis, the severity of which is contingent upon the depth of financial integration, the complexity of interrelationships among economic agents, and the extent of official policy responses. The resultant effects commonly include a contraction in aggregate demand or, in extreme cases, the initiation of a debt-deflation spiral. Minsky underscores that the adverse consequences of such crises tend to be significantly exacerbated in the absence of timely and effective official intervention (Minsky 1986, Mishkin 1991).

Recent applications of Minsky's theory

Since its inception, Minsky's theory has been extensively examined and expanded through diverse empirical and modelling approaches. Interest in formalising Minsky's ideas led to several attempts, including:

(a) *dynamic models* employing differential equations and nonlinear systems to represent debt-driven cycles (e.g. Asada 2012; Charles 2008; Charpe et al 2011; Delli Gatti and Gallegati 1995; Ferri 2011; Franke and Semmler 1989; Jarsulic 1990; Keen 1995; Nasica 2000; Semmler 1987; Taylor and O'Connell 1985).

(b) *agent-based models* simulating Minskyan dynamics such as herd behaviour, leverage accumulation, and financial collapse (e.g. Delli Gatti et al 2010; Fagiolo and Roventini 2017; Hommes 2013; Iori et al 2006; LeBaron 2006).

(c) stock-flow consistent models, which rigorously account for sectoral financial interactions and are widely used within post-Keynesian economics (e.g.) (Dos Santos and Zezza 2008; Godley 1999; Godley and Lavoie 2007, 2012; Kinsella et al 2011; Lavoie 2014; Nikolaidi 2014).

Since the GFC, there has been a marked resurgence in research applying and extending Minsky's theory, employing diverse methodologies ranging from empirical analysis and agent-based modelling to macroeconomic and system dynamics modelling. Barnes (2007) examines the financial crises in the UK during 1866 and 1987, demonstrating that

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accounting practices and information asymmetries play a critical role in interacting with financial instability. He argues that these factors must be systematically incorporated within the FIH framework. This line of inquiry is further developed by Barnes (2011), who investigates the 2007–2009 financial crisis in both the UK and the US. His analysis reveals the influence of accounting conventions, particularly mark-to-market valuation, on the boom-bust cycles, thereby extending the explanatory capacity of Minsky's hypothesis.

Mehrling (1999) portrays Minsky as a thinker, not just as a theorist, of capitalist economies whose work highlights financial fragility, institutional roles, and the interaction of finance with macroeconomic stability by integrating history, institutions, and monetary theory. Delli Gatti et al (2010) formalise feedback mechanisms within evolving credit networks, illustrating how interconnections among financial actors amplify shocks, consistent with Minsky's focus on systemic risk propagation. Delli Gatti et al (2012) develop an agent-based computational model simulating interactions among firms and banks within a credit network to explore the endogenous emergence of financial fragility. Their results corroborate Minsky's prediction that the proportion of speculative and Ponzi finance units tends to increase during economic expansions, ultimately precipitating financial crises.

From a sectoral and cross-industry perspective, Mulligan (2013) provides empirical evidence for North American industries over the period 2002–2009. Utilising quarterly data from thousands of firms, Mulligan classifies them according to Minsky's tripartite taxonomy, demonstrating an increase in speculative and Ponzi finance entities preceding the 2008 recession, alongside rising debt-to-equity ratios. Sectoral adherence to the FIH patterns varies, with some sectors exhibiting greater conformity. Caballero and Simsek (2013) emphasise the exacerbating role of financial complexity in crises, detailing how intricate financial instruments and interconnections amplify systemic risk, thus offering a contemporary extension of Minsky's foundational ideas. Ryoo (2013) advanced theoretical integration by unifying Keynesian and Minskyan macroeconomic perspectives within a growth cycle model. His framework captures the interplay among income distribution, financial instability, and economic cycles, demonstrating that escalating financial fragility can destabilise growth trajectories even in the absence of exogenous shocks. This synthesis provides novel insights into the structural origins of financial crises. Paulus (2014) offers a concise monograph that summarises Minsky's hypothesis and applies it to the recent GFC, highlighting its enduring explanatory power. Borio (2014) empirically identifies pronounced financial cycles preceding macroeconomic downturns, further substantiating the practical relevance of the FIH in contemporary economies.

Solomon and Golo (2014) introduce concepts of network effects and interscale feedback within financial systems, linking Minsky's insights to percolation theory and disequilibrium models, thereby elucidating how localised shocks may propagate into systemic crises. Golo et al (2015) offer empirical support for an autocatalytic interpretation of the FIH, revealing that dynamic feedback loops within the financial system contribute significantly to financial instability.

Van and Zhang (2014) analyse equilibria within Keen's model of financial instability, identifying conditions under which economic collapse or stable steady states may emerge, thus refining the understanding of stability boundaries. Beshenov and Rozmainsky (2015) examine Greece's economic trajectory from 2001 to 2014, focusing on both public and private sector behaviour. Their study demonstrates that numerous Greek firms adopted increasingly fragile financial structures during this period, highlighting the adverse effects of austerity policies in reinforcing financial fragility.

Keen (2015, 2020) has been instrumental in advancing Minsky's FIH through his exploration of debt-driven economic dynamics. In 2015, he engaged with post-Keynesian crisis theories, emphasising private debt as a primary driver of financial instability. In 2020, Keen derived the FIH directly from macroeconomic definitions, providing a formal

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mathematical foundation for the hypothesis. Keen (2016) notably extended Minsky's FIH by developing formal models capturing the endogenous creation of money via bank lending and its effects on aggregate demand and financial fragility. Through system dynamics modelling, he elucidates how rising private debt precipitates economic booms and busts, thereby rendering financial instability an intrinsic characteristic of capitalist economies. Keen (2020) critically examined the widely utilised Samuelson multiplier-accelerator model for economic cycles, arguing that it oversimplifies the complex dynamics of capitalist economies by neglecting essential financial factors such as debt accumulation and investment behaviour. He advocates for the revival of Goodwin's growth cycle model, embedding it within Minsky's financial instability framework. This synthesis offers a more realistic representation of the interactions among financial instability, investment cycles, and labour market dynamics, thus providing deeper analytical insights into the causes and nature of crises.

In his earlier scholarship, Wray contextualised Minsky's hedge – speculative – Ponzi financing schema within the evolution towards '*money-manager capitalism*' as a means of interpreting the 2007 GFC (Wray 2011). Subsequently, he developed this analysis by linking Minsky's conception of endogenous money and banking dynamics to the principles of modern monetary theory and the financing of investment (Wray and Tymoigne 2008; Wray 2015). In more recent work, Wray extends Minsky's framework to a broader investigation of the nature of money and value, synthesising insights from Minsky, Keynes, Marx, and Sraffa to challenge orthodox monetary theory (Wray 2024). Collectively, these contributions underscore Wray's emphasis on the institutional configurations and policy interventions required to mitigate systemic instability, aligning with Minsky's normative commitment to financial and macroeconomic reform.

Grasselli and Costa Lima (2012) indicate that the Keen model (1995) can exhibit stable, cyclical, or unstable dynamics depending on key parameters, showing that credit expansion and rising asset prices can lead to financial fragility and potential economic collapse when debt growth outpaces productive capacity. Costa Lima et al (2014) incorporate more detailed debt and investment dynamics, demonstrating the potential for multiple equilibria and path-dependent outcomes in financial cycles. Giraud and Grasselli (2019) further elaborate on these dynamics by providing analytical and numerical solutions characterising complex oscillatory behaviours and collapse scenarios.

Guttmann (2016) provides a comprehensive synthesis of empirical evidence testing the FIH across diverse economic settings, affirming its robustness and adaptability as a framework for analysing financial fragility. Barrett (2017) investigated the stability of zero-growth economic scenarios employing a Minskyan modelling framework, concluding that both growth and zero-growth economies are susceptible to instability. His analysis underscored the critical roles of debt dynamics and wage share distribution in determining overall economic stability.

Grasselli and Nguyen-Huu (2018) conclude that when firms finance investment through debt and simultaneously manage production and inventories in response to expected sales, the resulting five-dimensional system can display both shorter-term cyclical behaviour and longer-term destabilising dynamics, thus linking inventory fluctuations, debt accumulation and business-cycle dynamics. Borio et al (2018) adopted a macroprudential perspective to analyse credit booms and busts in advanced economies, identifying increases in Ponzi financing and deteriorating credit quality during boom phases as phenomena consistent with the FIH.

Pietronero et al (2019) contributed a notable analysis of financial fragility utilising network theory. By modelling the economy as an interconnected system of firms and banks, they demonstrate how Ponzi units propagate financial distress through network effects, thereby precipitating systemic instability. This approach enriches Minsky's hypothesis by emphasising the critical role of interdependencies and systemic risk

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transmission. Neilson (2019) offers a concise account arguing that Minsky's theory is not marginal but central to understanding modern crisis-ridden economies. He shows how 'stability is destabilising' reframes finance, institutions and macroeconomics as inherently interconnected rather than exceptional. Ferri (2019) sought to formalise Minsky's concepts through dynamic models incorporating regime-switching mechanisms, aiming to bridge theoretical constructs with observed cyclical phenomena in financial markets. Bassett et al (2019) employed machine learning methodologies to classify firms across multiple countries and sectors according to Minsky's categories (hedge-speculative-Ponzi). Their approach facilitates automated identification and real-time monitoring of financial fragility, thereby operationalising Minsky's theory within empirical finance and enhancing its applicability to large-scale datasets.

In the context of emerging markets, Chaudhary and Mishra (2020) analysed Indian corporate financial fragility following the 2008 crisis using firm-level data. Their findings confirm that rising leverage and declining interest coverage ratios serve as significant predictors of Ponzi-like financial behaviour, thereby extending the geographical and contextual scope of FIH applications.

Rozmainsky et al (2021) examine private non-financial firms over the period 2013–2017. They observed the persistence of fragile financing structures despite an increase in hedge-type firms, suggesting the difficulty of recovering from financial fragility under austerity conditions. Complementary empirical work by Rozmainsky and Selitsky (2021) applied FIH criteria to private non-financial firms in South Korea, identifying episodes of heightened financial fragility within firm panels, thereby confirming the hypothesis's applicability across diverse economic contexts.

Further development is offered by Ferrante (2021), who explores endogenous credit cycles and heterogeneous agents as amplifiers of financial instability. His model integrates behavioural finance elements to account for phenomena such as irrational exuberance and herding behaviour. Ninomiya (2022) develops macrodynamic models incorporating Minskyan financial classifications to analyse financial instability and cyclical behaviour. His results emphasise the burden of interest-bearing debt as a pivotal determinant of financial cycles, with patterns of escalating financial fragility.

Rozmainsky, Kovezina, and Klimenko (2022) conducted a comprehensive empirical study of Dutch private non-financial firms from 2005 to 2019. Utilising several financial fragility indices, they classified firms into hedge, speculative, and Ponzi, and employed the Nishi index within logistic regression models to identify determinants of Ponzi status transitions. Their findings reveal that firm profitability, interest rates, industry output, and crisis episodes significantly influence financial fragility transitions, thereby supporting the FIH in the Dutch context. Likewise, Bryleva and Rozmainsky (2022) applied the FIH framework to Spanish private non-financial firms during 2011–2017. They constructed similar indices and found that, although austerity measures constrained economic activity and profitability, the Spanish economy was gradually emerging from financial fragility. Perepelkina and Rozmainsky (2023) undertook an empirical assessment of Russian enterprises using multiple fragility indices, including those developed by Mulligan (2013). Their analysis confirms substantial financial fragility among many firms. Phan et al (2024) conducted an analysis of the FIH covering the period 1945–2023. Employing nonparametric statistical methods and binomial testing on financial debt ratios, they indicated that conditions conducive to financial instability, such as rising debt ratios, frequently preceded recessions. Rozmainsky (2025) offers a comprehensive retrospective survey of theoretical and empirical research testing and extending FIH over its fifty-year evolution. A persistent empirical regularity is that private firms tend to accumulate financial fragility during expansions, with a growing share shifting toward speculative and Ponzi financing regimes, thereby exemplifying Minsky's dictum that 'stability is destabilising.'

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Significant efforts have been made to operationalise Minsky's theory within contemporary macroeconomic modelling. A prominent example is the *Applied Modern Macroeconomic Tools (MMT)* framework, which employs a system-dynamics model of the U.S. economy grounded in Minsky's insights. Tyrone Keynes utilises the Minsky software platform to simulate interactions between real and financial sectors, asserting that instability is an inherent outcome of credit-driven growth. Keynes advocates for macroprudential policies that address embedded leverage and financial fragility. Another notable contributor, James Young, disseminates empirical analyses primarily via social media platforms, notably Twitter (now X). His work empirically supports a credit-based interpretation of Minsky's hypothesis, highlighting that expansions in credit and leverage systematically precede downturns in asset valuations and real economic activity.

Collectively, these contributions advance the understanding of Minsky's theory by integrating formal theoretical models, empirical analyses, institutional insights, and policy implications. They underscore the framework's enduring significance in financial crisis analysis and regulatory policy.

Critical perspectives on Minsky's theory

While Minsky foregrounds behavioural dynamics and institutional evolution, neoclassical critics remain sceptical of his premise that instability is systemic, favouring models predicated on optimising behaviour and exogenous shocks. Bernanke (2000) acknowledges the foundational contributions of Minsky (1977) and Kindleberger (1978)[3] regarding the inherent instability of the financial system, which fundamentally challenges the classical assumption of fully rational economic behaviour. Nevertheless, Bernanke focuses his research primarily on the real costs of credit intermediation during financial crises, a dimension that Minsky and Kindleberger have not prominently emphasised. Crucially, Bernanke advocates for a research strategy that upholds the assumption of rationality to the greatest extent possible, even while conceding that irrational behaviour may have a role in economic phenomena. He explicitly asserts that, despite the possible influence of irrationality, 'the best research strategy is to push the rationality postulate as far as it will go' (Bernanke 2000, 24).

Building upon this foundation, scholars such as Geanakoplos (2009) have developed models incorporating credit market imperfections and leverage cycles within a rational expectations framework, thereby aligning closely with Bernanke's focus. Reinhart and Rogoff (2009) provide extensive empirical documentation of the systemic costs and recurring patterns of financial crises spanning several centuries. Collectively, these perspectives suggest that a comprehensive understanding of financial instability necessitates both an acknowledgement of behavioural deviations and a rigorous analysis of credit market frictions under rational expectations paradigms.

The rational expectations school has generally rejected Minsky's assertion that financial instability is endogenous to the system. Economists such as Lucas (1977) and Sargent (1987) argue that macroeconomic fluctuations primarily originate from exogenous shocks, policy changes, or perceptual errors, rather than from intrinsic dynamics within the financial sector. They maintain that well-specified models comprising rational agents with stable expectations are sufficient to explain economic cycles without recourse to financial fragility. Lucas (1976) advanced the influential *Lucas Critique*, which posits that macroeconomic models must be grounded in rational expectations and microfoundations. He contended that frameworks rooted in institutional fragility and non-rational behaviour lack the requisite predictive capacity and theoretical rigour for effective policy analysis (Lucas 1976). Similarly, Kydland and Prescott (1977) criticised discretionary policy approaches, advocating instead for rule-based frameworks underpinned by rational

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expectations, thereby implicitly rejecting the notion that financial systems inherently evolve toward fragility.

Although not directly addressing Minsky's hypotheses, Friedman developed monetarist theories that prioritised stable monetary policy and inflation control as cornerstones of macroeconomic stability. Friedman's emphasis on money neutrality and his relative disregard for financial sector dynamics stand in marked contrast to Minsky's focus on credit cycles and speculative finance (Friedman 1953).

Hall (1988) criticises Minsky's framework for lacking sufficient microfoundations compatible with mainstream macroeconomic modelling. Blaug (1992) critiques Minsky's approach for its lack of formal modelling and testable predictions, thereby limiting its scientific rigour. Laidler (2003) highlights the insufficient recognition of monetary policy and central bank interventions in stabilising financial markets, a point that contrasts with Minsky's more crisis-centred narrative. Additionally, economists such as Campbell (1995) and Woodford (2003) emphasise the necessity of integrating financial instability within dynamic stochastic general equilibrium (DSGE) models to enhance empirical applicability – an integration that Minsky's original work did not accomplish. Palley (2009) contends that the FIH remains incomplete without a broader institutional and distributional analysis. He critiques the FIH for insufficiently addressing the macroeconomic growth regime and regulatory environment within which financial behaviours evolve.

White (2015) questions the historical and theoretical underpinnings of Minsky's claim that financial systems naturally gravitate toward fragility, arguing instead that such instability frequently results from regulatory distortions rather than endogenous mechanisms. He asserts that 'banking history and theory cast doubt on Minsky's FIH', emphasising that endogenous instability is not an inherent characteristic of capitalist finance (White 2015, 106). Nabeshima (2015) offers a meta-analysis of the reception of Minsky's work among American radical economists, noting that although the FIH contributes important insights into endogenous financial instability, it occasionally suffers from a lack of empirical granularity and causal clarity. Finally, Marshall (2021) contends that fraudulent behaviour – often a critical factor in the genesis of financial bubbles – is insufficiently theorised within Minsky's framework. While Minsky's typology of hedge, speculative, and Ponzi finance effectively captures escalating financial risk, it does not explicitly address the role of deceptive practices that can further destabilise financial systems.

Why has Minsky been ignored?

When Minsky published his seminal works (1975, 1982, 1986), his contributions did not receive the recognition they arguably deserved. This neglect extended beyond academic and scientific communities, permeating the political sphere – particularly in the formulation, adoption, and implementation of policies during periods of financial turmoil. Adopting a critical interpretive stance, the subsequent analysis of this article seeks to examine the potential underlying causes of this exclusion.

A significant factor underlying this marginalisation can be attributed to Minsky's distinctive epistemological and methodological perspective. He did not regard economics as an autonomous discipline but rather as an integral component of the broader social sciences. Minsky asserted that, ideally, economics education should be embedded within the context of social sciences and history, rather than taught as an isolated, technically focused subject. He famously contended that the prevailing mode of instruction produces economists who are 'well trained but poorly educated' (Minsky 1985, 205). He argued that economic theory should be closely aligned with social policy and real-world phenomena, thereby facilitating a clearer understanding of how individuals and societies operate and

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interact. This approach remains salient today, as it provides valuable insights into shifts in norms and conventions. Concepts such as rationality, irrationality, and uncertainty remain inadequately addressed within mainstream economics. Irrationality manifests when economists adopt theories that fail to explain economic realities and thus inform ineffective policies. Economic theories must analyse and elucidate stylised facts of the real world; failure to do so constitutes irrationality, rendering decision-making within such theoretical frameworks precarious.

Minsky developed his insights through a conceptual methodology grounded in empirical observation and logical reasoning. He synthesised recurring patterns in economic and financial history with the evolving characteristics of contemporary finance into a unified theoretical framework. This approach echoes the tradition of influential economists such as Smith, Ricardo, Marx, Mill, Keynes, and Schumpeter, who built their theories on observation and lived experience. Minsky was adamant that economic theories must remain rooted in empirical reality, arguing that 'in sciences theory is a servant of observations, contrary to neoclassical economics, where theory determines the acceptability of observations' (Minsky 1985).

One factor that may have contributed to the limited early acceptance of his theories is their relative divergence from conventional mathematical formalisation. Neoclassical models gained widespread acceptance for their mathematical elegance and formal consistency, often relying on tools such as DSGE models, constrained optimisation, and rational expectations. By contrast, Minsky's work was based on institutional and historical analysis. Drawing on real-world phenomena such as the Great Depression, post-war financial evolution, and banking practices, he favoured narrative explanation over abstract equations. This led to a methodological mismatch: Minsky's theories, while insightful, were not easily testable or expressible within the dominant neoclassical framework. As a result, mainstream economists often dismissed his contributions as *unscientific* or *impressionistic*.

The increasing mathematical formalism in post-war economics has itself been a target of critique from post-Keynesian and other heterodox schools, which argue that it frequently neglects empirical relevance. Even Adam Smith emphasised that scientific inquiry should be driven by attempts to solve observable problems, with mathematics serving as a tool, not a foundation. Fleischacker (2004) notes that Smith prioritised practical reasoning and common sense over abstract formalism in political economy.

Modelling dynamic business cycles presents inherent challenges; however, Minsky abandoned his early attempts to build a mathematical model, reducing testability and rigour.[4] Yet the economics profession increasingly demanded mathematical proof as a prerequisite for theoretical credibility. By the mid-to-late twentieth century – especially after World War II – economics had become dominated by models that were valued as much for their technical rigour as for their explanatory power. Within this context, Minsky's narrative-driven, historically grounded, and behaviourally informed work moved away from this tendency. His *Financial Instability Hypothesis*, though coherent and deeply insightful, remained largely conceptual and verbal. Key ideas such as hedge, speculative, and Ponzi finance were richly descriptive but not easily translated into the formal mathematical language of mainstream economics. Although some aspects of Minsky's theory are amenable to formal modelling, scholars such as Foley (Foley 2001, 54) have warned that such efforts risk stripping away the theory's complexity and interpretive richness.

Additionally, the prevailing academic standard demands validation through statistical or econometric testing. However, these methods still depend on specific datasets that can be selectively structured to suit specific purposes. Researchers may choose countries, timelines, agents, or variables to produce results that conform to mathematical constraints and assumptions, often without adequate scrutiny. Consequently, it is relatively facile to obtain desired outcomes by adopting convenient methodologies. The

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extensive array of statistical and econometric techniques available to researchers can generate widely varying results, sometimes fostering more controversy than clarity. The essential challenge remains achieving a comprehensive understanding and interpretation of economic phenomena through a broadly accepted approach. Minsky recognised this issue and adopted an inclusive methodology centred on observation rather than abstract formalism.

Minsky was never embraced as a mainstream economist, and his theory thus faced significant barriers to acceptance. He implicitly challenged foundational assumptions such as the efficient market hypothesis and money neutrality that underpin standard macroeconomic theory. His framework was grounded in empirical observation, even when findings contradicted orthodox views. Neoclassical economics dominated the twentieth century, based on core assumptions of rational agents, efficient markets, micro-foundations, and equilibrium models. These assumptions shaped economic models, policies, and pedagogy for decades, especially within elite institutions, central banks, and international organisations. Minsky's FIH directly contradicts many of these assumptions. Instead, Minsky argued that agents become overly optimistic during booms, ignoring risk (i.e. irrational exuberance), that credit markets become distorted by speculation and herd behaviour, and that stability is destabilising – calm periods encourage risk-taking that ultimately leads to instability. He contended that crises are endogenous, arising from within the financial system itself. Thus, rather than assuming financial markets are inherently stable and efficient, Minsky posited that they are intrinsically prone to cycles of boom and bust, driven by debt accumulation and speculative behaviour.

Many academic journals, research grants, and economics departments were dominated by neoclassical economists, creating a form of intellectual lock-in. Graduate students were trained exclusively in neoclassical models. Publication in top journals required conformity to neoclassical standards, and policy institutions relied on models that ignored financial instability (e.g., central banks employing DSGE models lacking a banking sector). Top economics departments and funding bodies often exhibited explicit or implicit biases against heterodox approaches. Heterodox economists frequently struggled to publish in leading journals, secure grants, or participate in policy discussions. Minsky himself faced challenges in garnering widespread attention, partly due to this structural bias. As a result, his ideas did not fit within the prevailing models and institutional frameworks.

Moreover, the FIH has been perceived as a pessimistic theory, casting doubt on the efficiency of financial markets. The theory issues serious alerts about potential financial crises, and warnings are frequently ignored during periods of economic euphoria characterised by rising GDP growth, investment, consumption, profits, and output. In such times, positive expectations dominate, rendering the intellectual climate unreceptive to theories highlighting latent risks and advocating prudential stabilisation. Despite the recurring nature of financial crises throughout history, such episodes persist unabated. Minsky emphasised that instability is an inherent feature of the contemporary financial system. Markets possess short memories and repeatedly deceive themselves into believing that adverse outcomes can be averted. Within this context, it is easier to embrace optimistic projections than to heed Minsky's cautionary insights.

An additional reason for the marginalisation relates to the historical timing of Minsky's work. Much of his key theoretical development preceded the era of liberalised international capital markets and the intensification of global financialisation. Following the collapse of the Bretton Woods system in the early 1970s and the onset of successive oil shocks, the post-war Keynesian consensus began to unravel. The post-war prosperity of *'Golden Age'* came to an end, giving way to a new economic paradigm characterised by a retreat from state intervention and the embrace of neoliberal ideologies. This shift promoted deregulation, privatisation, financial liberalisation, and a reduced role for government in managing economic activity. During this transition,

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political systems across advanced economies increasingly adopted market-oriented reforms, encouraging rising levels of private indebtedness and facilitating greater integration into global financial markets. These changes coincided with a fundamental reorientation of macroeconomic theory and policy. The 1980s marked a decisive departure from the Keynesian framework, which had underpinned economic policymaking in the post-war era, and witnessed the ascendancy of monetarism and the marginalisation of heterodox economists like Minsky (Blinder 2008).

Monetarism, most closely associated with Friedman and the Chicago School of Economics, presented a coherent alternative to Keynesianism. Central to the monetarist view was the assertion that inflation is primarily a monetary phenomenon and can be effectively managed through regulation of money supply growth (Friedman 1968). Monetarists were critical of discretionary fiscal policy, arguing that its implementation was subject to uncertain time lags and inefficiencies. Instead, they advocated for rule-based, non-interventionist monetary policy aimed at ensuring price stability and anchoring expectations. The adoption of monetarist principles was further reinforced by political developments, particularly the rise of conservative governments such as those led by Ronald Reagan in the United States and Margaret Thatcher in the United Kingdom. These administrations implemented policy agendas grounded in fiscal austerity, deregulation, and limited government intervention – principles that closely aligned with monetarist doctrine (Harvey 2005).

Thus, the dominance of monetarism in the 1980s can be interpreted not only as a response to the empirical failures of Keynesian policy, particularly its inability to address the stagflation of the 1970s, but also as a reflection of deeper ideological and methodological transformations within the economics profession. As monetarist theory reshaped central banking and macroeconomic governance, alternative frameworks that emphasised financial instability, institutional dynamics, and non-equilibrium processes were largely sidelined. The prevailing orthodoxy left little space for theoretical approaches that could not be readily expressed within the formal, equilibrium-based models then dominating the discipline.

At the time of Minsky's writings, the trend toward financialisation was already discernible and subsequently accelerated over the ensuing decades. Wray (2011) notes that in the U.S. economy, finance 'became too big', capturing approximately 40% of corporate profits and roughly one-fifth of GDP value added at its 2008 peak. Household debt to GDP in the U.S. rose from 48% in 1980 to 100% in 2008; private sector debt increased from 123% to 290%; and financial sector debt grew from 22% of GDP in 1981 to 117% in 2008 (Crotty 2008). Large banks also increased their scale dramatically, with the top 25 global banks' assets rising from approximately USD 7 trillion in 1990 (about 30% of world GDP) to nearly USD 40 trillion in 2007 (around 70% of world GDP) (Dombret and Lucius 2013). Overall, domestic credit to the private sector in high-income countries grew from 84% of GDP in 1981 to 154% in 2024.[5] The financial sector has thus become dominant in capital accumulation and consequently exerts significant influence over the real economy.

Contrary to these developments, Minsky advocated restructuring the financial system to ensure stable investment levels without unchecked expansion. He championed an active role for a *big government* and a *big bank* in operational procedures and interventions. These institutions are vital for mitigating the endogenous instabilities of the financial system and restoring macroeconomic stability. Minsky consistently emphasised the necessity of a robust government acting as an automatic stabiliser, alongside a central bank serving as lender of last resort to support minimum asset prices. By the 1990s, he lamented the weakening of these institutions, which increased the likelihood of financial crises. Many economies shifted away from full employment policies toward inflation-targeting regimes. Minsky criticised modern monetary theory for reducing financial crises merely to bank panics (Schwartz 1988, 1998).

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While Minsky was marginalised for focusing on crises, neoclassical models entirely missed the buildup to the 2008 financial crisis. As former Federal Reserve Chair Alan Greenspan (2008) admitted post-crisis, 'The whole intellectual edifice . . . collapsed'. In hindsight, the failure to incorporate Minsky-style thinking into mainstream economics represents a critical blind spot. Despite eventual recognition decades later, the prevailing economic orthodoxy during his lifetime remained unreceptive to calls for regulation, intervention, and government oversight. Minsky's FIH briefly regained attention after the GFC. DSGE models that overlooked financial dimensions were criticised, and macro-prudential policies were introduced. However, theoretical developments grounded in Minsky's framework – such as post-Keynesian macrodynamic models and stock-flow consistent approaches – have not displayed mainstream economic paradigms. They are external to the core frameworks accepted by most economists and policymakers. The marginalisation and underestimation of Minsky's theory can be better understood as a structural issue rooted in the enduring dominance of mainstream economics, rather than a phenomenon specific to the 1980s and 1990s.

Finally, it is inherently challenging for theories that diverge from established paradigms to gain acceptance within the mainstream. Conventional economic models often depict the financial system as inherently stable and self-correcting, a view that stands in stark contrast to Minsky's assertion that periods of stability are themselves destabilising, as they encourage risk-taking and financial fragility. Ironically, Minsky's theoretical contributions received renewed attention only after the onset of the GFC in 2008, a development that closely mirrored the patterns of instability he had long described. In this sense, Minsky may be likened to visionary artists whose work is recognised only posthumously. Despite the profound relevance of his insights, and in common with many economists[6] who challenged orthodox thinking, Minsky was never awarded the Nobel Memorial Prize in Economic Sciences.

Conclusion

Traditional macroeconomic theory has been insufficient in explaining capital market imperfections and asymmetric information, phenomena that have become central to financial crises. Predominantly grounded in steady-state models and questionable assumptions, conventional theory tends to view economic disturbances as exogenous and transient, thereby neglecting the intrinsic cyclical nature of the economy. Alternative theoretical frameworks, however, contribute valuable insights toward addressing critical economic and financial challenges such as unemployment, inequality, and financial instability.

The alignment of theory with empirical facts remains a fundamental concern in modern economics, especially given the widespread belief that the financial sector and the real economy should grow steadily and in tandem. Minsky emphasised the pivotal role of the financial sector in reinforcing the interdependence between real and financial variables. The core implication of the financial instability hypothesis is its identification of the underlying causes that render the financial regime either stable or unstable.

Minsky's framework moves beyond simple cyclical analysis to examine the economy as a process shaped by evolving expectations and behaviours. Rather than being a purely cyclical theorist, he highlights the interplay of financial accelerators, regulatory erosion, behavioural factors, and shifting expectations, challenging the traditional notion of rational expectations. Integrating banking, finance, and monetary dynamics, Minsky emphasises the central role of credit and debt in economic development, where innovation and evolution are most visible in financial markets. As he noted, 'finance cannot be left to free markets' (1986, 292).

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Although Minsky articulated his views in the early 1980s, his theory was largely disregarded for many years, primarily due to its incompatibility with the emerging global economic paradigm. Minsky's ideas were largely sidelined during a period when economic theory increasingly prioritised technical elegance over empirical complexity. The vindication of his insights came with the onset of the GFC, which starkly revealed the risks inherent in highly integrated financial markets and institutions operating within a globalised system. The crisis underscored the necessity for international policy coordination and a more sceptical reassessment of economic theory to better align with stability and empirical reality.

Stabilising an inherently unstable economy is a formidable challenge, as Minsky argued in his efforts to raise awareness about the systemic risks of instability. A seemingly stable system may simply reflect prevailing norms, positive expectations, or encouraging macroeconomic indicators. However, these conditions can often be sustained not by genuine increases in production or economic welfare but through rising indebtedness. The phenomenon of Minsky's 'euphoria' cultivates instability in subtle and imperceptible ways. The imperative to stabilise an unstable system remains relevant today as a critical step toward understanding the true condition of the financial system, independent of prevailing norms, perceptions, and expectations. Herein lies the significance of Minsky's approach, particularly within the current context of globalisation and the interdependence of national economies.

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Notes

1 Fisher's 'Theory of Interest' continued as the economic theory of how asset prices are determined. He supported that the interest rate 'expresses a price in the exchange between present and future goods', 'the market must be cleared, and 'the debts must be paid' (Fisher 1930).

2 *The Economist* (2016) noted that the term 'Minsky moment' became ubiquitous after the 2008 turmoil and that economist Hyman P. Minsky's influence was until then limited. A related account is documented by Lahart (2007) in *The Wall Street Journal.*

3 Minsky's work on financial fragility gained wider recognition through Kindleberger's (1978) book *Manias, Panics and Crashes: A History of Financial Crises*, which popularised aspects of Minsky's financial instability framework (he gives Minsky a prominent role in the opening of the book). The theme was later developed by Bernanke on the breakdown of financial intermediation during the Great Depression (Bernanke 1983). King (1993) also addressed related issues in his Presidential Lecture to the European Economic Association, *Debt Deflation: Theory and Evidence*.

4 A central component of Minsky's PhD thesis was his endeavour to formalise his theory through a modification of the Hicks-Hansen-Samuelson 2nd order difference equation multiplier-accelerator model (Minsky 1982, 238). This approach failed because it assumes the equation of actual savings with desired investment, two conceptually distinct variables that no economic theory claims to be equal. By embedding this flawed assumption, Minsky's model does not fully capture the dynamics of financial instability, notably neglecting the roles of credit creation, private debt accumulation, and the financial sector's interaction with real investment (Keen 2020).

5 World Bank (2024) *Domestic credit to the private sector (% of GDP). World Bank Open Data*. Washington DC: World Bank. Available at https://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS

6 Joan Robinson, Nicholas Kaldor, Michal Kalecki, Mariana Mazzucato, Paul Davidson, Thomas Piketty, James Galbraith, John Kenneth Galbraith, Ha-Joon Chang, Anwar Shaikh, Michael Hudson, Nicholas Georgescu-Roegen and Albert O. Hirschman are some representative examples.

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