

# The financial instability hypothesis and the paradox of debt: a microeconometric approach for Latin America

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## Abstract

Hyman Minsky's financial instability hypothesis (FIH) argues that as part of the normal functioning of capitalist economies robust financial structures tend to evolve into highly leveraged fragile financial structures. The paradox of debt challenges the very foundation of Minsky's FIH as it maintains that the upward and downward phases of business cycles need not be characterized by processes of respective leveraging and deleveraging. Using a panel of firm-level data and seemingly unrelated regressions we analyse the relationship between debt and investment for 12 Latin American countries for the years 2005 (expansion) and 2009 (contraction). We reject the paradox of debt in favor of the FIH, regardless of our model specification or the choice of external financing. The FIH seems to intensify in expansions with respect to recessions, and its intensification during expansions is explained by a larger fraction of firms acquiring debt and new investment projects, rather than from further leveraging for those firms already engaged in fixed investment.

## Palabras clave

Palabras clave de autor: [Minsky](#); [financial instability hypothesis](#); [paradox of debt](#); [Latin America](#)

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