

**Report****November 1998***Volume 8, Number 4*

*Scholars gather at a Levy Institute symposium to discuss the persistence of poverty in the United States and policies to reduce it (see page 3). From left to right: Vernon M. Briggs Jr., Cornell University; Henry Farber, Princeton University; Edward N. Wolff, New York University and the Levy Institute; and Mathew Forstater, the Levy Institute.*

- **Leon Levy talks about weaknesses in the American economy that make it--and the stock market--vulnerable to downturns.**
- **James K. Galbraith and George Purcell trace the chain of worldwide events that followed from the Fed's failure to pursue interest rate cuts.**
- **Researchers and policymakers looking for the causes of the Asian financial crisis should take a closer look at the role played by derivatives, argues Jan A. Kregel.**
- **Poverty is commonly defined in terms of income, but Robert Haveman and Andrew Bershadker propose a new definition, based on the capacity to be self-reliant.**

**CONTENTS**

## Symposium

- [Employment Policies to Reduce Poverty](#)

## The Levy *Report* Interview

- [Wall Street Blues: An Interview with Leon Levy by Jeffrey Madrick](#)

## Editorial

- [The Butterfly Effect, by James K. Galbraith and George Purcell](#)

## New Working Papers

- [An Ethical Framework for Cost-Effective Medicine: Confronting the Risks in Managed Care](#)
- [The Place of Cultural Explanations and Historical Specificity in Discussions of Modes of Incorporation and Segmented Assimilation](#)
- [Optimal Financing by Money or Taxes of Productive and Unproductive Government Spending: Effects on Economic Growth, Inflation, and Welfare](#)
- [Money and Credit in a Keynesian Model of Income Determination](#)
- [State Type and Congressional Voting on the Minimum Wage](#)
- [Can Taxes and Bonds Finance Government Spending?](#)
- [Reciprocity and the Guaranteed Income](#)
- [Derivatives and Global Capital Flows: Applications to Asia](#)
- ["Inability to Be Self-reliant" as an Indicator of U.S. Poverty: Measurement, Comparisons, and Implications](#)
- [Can Expenditure Cuts Eliminate a Budget Deficit? The Australian Experience](#)
- [The American Wage Structure, 1920-1947](#)
- [Explaining Long-Term Exchange Rate Behavior in the United States and Japan](#)
- [Paul Davidson's Economics](#)

## New Policy Notes

- [Small Business and the Minimum Wage](#)
- [Small Business and the New Welfare](#)

## Levy Institute News

- [Lecture: Benjamin Lipstein, In Defense of Small Samples](#)
  - [Scholars Brief Members of Congress](#)
  - [Participants in \*Debates-Debates\*](#)
  - [Upcoming Conferences on Financial Structure](#)
  - [Presentations and Publications by Levy Institute Scholars](#)
-

The Jerome Levy Economics Institute of Bard College, founded in 1986, is a nonprofit, nonpartisan, independently funded research organization devoted to public service. Through scholarship and economic forecasting it generates viable, effective public policy responses to important economic problems that profoundly affect the quality of life in the United States and abroad.

S Jay Levy, *Chairman*  
Dimitri B. Papadimitriou, *Executive Director*

The *Report* is a quarterly publication of The Jerome Levy Economics Institute of Bard College and is produced by the Bard Publications Office.

Editor: Lynndee Kemmet  
Text Editor: Judith Kahn  
Photography: Douglas Baz,  
Charles Harbutt

---

## Symposium

---

### Employment Policies to Reduce Poverty

The United States economy has grown tremendously in the past few years. Thousands of new jobs have been created, the unemployment rate is at its lowest level in decades, and millions of Americans have seen their income rise. But not all have shared in this new prosperity. As successful as the American economy has been in recent years, it has not been successful in distributing these economic gains equitably among American workers. Many have seen only minimal gains, many have seen no gains, and many continue to live in poverty.

In an effort to understand this persistence of poverty in the face of economic growth, the Levy Institute hosted a symposium on September 24 at which policymakers and scholars sought to uncover the causes of poverty and to propose policies to end it. Executive Director Dimitri B. Papadimitriou opened the symposium saying that poverty's continued existence in the United

States is not only unhealthy but immoral, and ways to eliminate or at least reduce it must be found. Brief summaries of participants' remarks follow, starting with the keynote speech by Chairman S Jay Levy.

## S Jay Levy

In his speech, "Ethics and Markets," S Jay Levy addressed some of the problems that emerge when one views a market economy in relation to an ethical concept. For example, it is a principle of our capitalist system that markets ought to price equitably whatever is sold. However, many people today are bothered by the large and widening gap between the incomes of the most generously compensated and those who are paid less than the median wage. Are the richest among us overcompensated? Star professional athletes earn millions of dollars for playing games and additional millions for advertising sneakers and breakfast cereals. A star biochemist who is spending 60 hours a week in a laboratory developing a cure for brain tumors might be paid \$135,000 a year. Is the scientist worth as much to society and to future generations as an all-pro quarterback? The market says no. We could decide that no person is worth more than \$2 million a year and we could then impose a tax of 95 percent or more on incomes above that amount. But if a quarterback is selling billions of dollars of foodstuffs and athletic shoes, the market may be right and equitable.

Some households have lost purchasing power in the past two decades. Part of the blame rests with the growing class of retirees, who take bigger and bigger bites of the economic pie, leaving less for those who actually produce goods and services. If the bite taken out of the 1994 pie by households 65 years old and older had been no larger than the one in 1980, the real income of households 64 years old and less would have been about \$2,000 more than it actually was.

Part of a cure for these problems would be a higher rate of employment. But if the market has a role in providing high employment, it is not playing it well. To deny a job to a person who is willing and able to work is a gross inequity. It is tantamount to saying, "Society has no use for you. You have no reason to exist."

The problem of unemployment in a capitalist system results from inadequate profits or an unequal distribution of profits. Industrial economies such as that of the United States produce enough profits to support full employment. Businesses will hire everyone in sight if they can make a profit doing it. The American economic system is supposed to follow a strict ethic: Profits shall go to those who contribute to the production of goods and services. Each firm's profits should reflect its contribution to the gross domestic product. But profits are wasted. Powerful groups in society often siphon off a greater share of profits than they deserve, leaving too little for others. The result is a lack of incentive for the production that would reduce joblessness and raise the standard of living.

Wasted profits are also seen in real estate markets. Since 1990 in the European Union the cost of shelter has increased twice as fast as the consumer price index in every major economy except

the United Kingdom. The beneficiaries of this increase are the owners of rental property and the holders of mortgage loans who realize gains without making any additional contributions to the production of goods and services and therefore to more employment. Those who must spend more for their housing have less to spend in stores and so stores and their suppliers need fewer employees. The "market" economy is really a profit- motivated economy, or in other words, a profit system.



*From left to right: Oren M. Levin-Waldman, Karl Widerquist, Marc-André Pigeon, L. Randall Wray, and Dimitri B. Papadimitriou, all of the Levy Institute.*

## Session 1. The Effects of Structural and Institutional Factors on Poverty

The first session was moderated by **Mathew Forstater**, Levy Institute visiting scholar. Participants were **Vernon M. Briggs Jr.**, professor of labor economics, New York State School of Labor and Industrial Relations, Cornell University; **Edward N. Wolff**, professor of economics, New York University, and Levy Institute research associate; and **Henry Farber**, Hughes-Rogers Professor of Economics, Princeton University.

Because of the big impact immigration has on the U.S. labor market, Briggs said, immigration policy should be viewed as a component of employment policy. Current U.S. immigration policy, with its focus on family reunification, has allowed more low-skill workers into the country than the economy can absorb. As a result, these immigrants compete with native-born Americans for low-skill jobs and the poor suffer adverse effects. Briggs said that reform of immigration policy is essential if the United States hopes to solve its poverty problem; those immigrants possessing skills needed by the U.S. economy should have precedence over family members of immigrants who are already here. Immigration should be used as a method to supplement the employment needs of the U.S. economy.

The current low unemployment rate in the United States seems to indicate that the market has improved for workers, but Wolff has found that the picture is not quite so positive if one looks at another measure of unemployment--duration of unemployment. Research conducted by Wolff and Research Associate William J. Baumol shows that the length of time that people are between jobs has been on the rise. In the early post-World War II years only about 5 percent of those who became unemployed were out of work for more than 27 weeks. That figure has now risen to about 20 percent. Wolff cited the rapid pace of technological change as a cause of the increased periods of joblessness. Rapid advances in technology mean that some jobs are taken over by computerization and that employers must spend more for retraining because workers' skills become obsolete more quickly. As a result, employers are reluctant to hire less-skilled, less-educated, or older workers who might need more retraining. Wolff suggested that this increase in duration means that government needs to consider lengthening the time that the unemployed can receive some form of unemployment insurance because many are using up their benefits before they find new employment. Government policy should also include retraining programs and subsidies to employers for retraining.

The current economic expansion in the United States has resulted in job growth, but many scholars and policymakers complain that the jobs created are not quality jobs. They lament the passing of an era during which jobs both paid well and provided workers with lifetime employment. Farber argued that this era has not really passed. His examination of data and surveys on job creation and job loss has led him to conclude that things are not quite as bad as many believe. Although benefits packages are not as good as in the past, starting salaries and working conditions are. Farber questioned the validity of the use of data on job tenure to support the contention that lifetime employment no longer exists. The data seem to indicate that workers do not remain in one job as long as workers did in the past, but the decrease in the median job tenure can be attributed to the increase in the number of new workers that firms have hired during recent economic expansion. With regard to job loss and earnings, Farber said research indicates that many workers actually recover quite quickly from job loss, although there is variation in how well they recover. The most educated are least likely to lose their jobs and when they do, they are most likely to find new jobs with good pay. The less educated find it more difficult to recover from job loss.

## Session 2. The Effects of Current Policy and Business Conditions on Poverty

**Frances M. Spring**, Levy Institute assistant director, moderated this session. Participants were **William A. Niskanen**, chairman of the Cato Institute; **Robert I. Lerman**, professor of economics, American University, and director of the Human Resources Policy Center, Urban Institute; and **Oren M. Levin-Waldman**, Levy Institute resident scholar.



For most Americans living in poverty the situation is only temporary, Niskanen said. Many of these people--the young who are just starting careers or better-off Americans experiencing a temporary drop in income--can usually work their way out of poverty. Government policy should focus instead on those in chronic poverty. Most in this group lack the skills or work attitudes needed to rise out of poverty. What the chronically poor need is better work incentives and education. Niskanen said the minimum wage is not a solution because most who earn it are not the main income earners in the home. The earned income tax credit (EITC) is a far better

method because it tends to help the heads of households and, since it can be earned only if one works, it encourages people to work. Government should also get rid of any regulations, such as the minimum wage or requirements to provide certain benefits, that discourage employers from hiring. The chronically poor's need for a better education requires serious reform of the American educational system. Public funds should be used to support private schools, such as religious schools, which often provide a better education.

The amount of money the United States spends on programs for the poor has been growing and now stands at about 5 percent of gross domestic product. Although this increased spending has not solved the problem of poverty, according to Lerman, without it the problem would be worse. Recent welfare reforms might improve the situation. Unlike in the past, when welfare policy penalized people for working by reducing their benefits and thereby cutting their total income, policy is now moving in the direction of encouraging people to work as much as possible and then supplementing what they earn. There is, however, room for more reform in the welfare system. Welfare policies need to focus more on welfare-to-work programs, even at the school level. Schools could get more involved in programs to provide students with work skills and the opportunity to see what the work world is like. Such programs might encourage students to follow the work road rather than the welfare road.

Levin-Waldman presented findings from a Levy Institute survey of small businesses that sought to learn more about their hiring and employment practices, such as their willingness to hire welfare recipients, what they look for in prospective employees, and how an increase in the minimum wage and government subsidies would affect their hiring practices. Survey responses indicate that previous work experience, a general education, and vocational education are important to many small businesses, which suggests a better education and more job training would help the unemployed find work. The businesses surveyed also expressed a willingness to hire welfare recipients and provide them with on-the-job training, especially if the government provided wage and training subsidies. Another important finding was that 89.4 percent of surveyed businesses said that the most recent increase in the minimum wage did not affect their hiring decisions and 75.6 percent said that a further increase, to \$6.00 an hour, still would not affect their hiring decisions.

## Session 3. Where Do We Go From Here?

Executive Director **Dimitri B. Papadimitriou** moderated this session. Participants were Senior Scholar **L. Randall Wray** and Research Assistant **Marc-André Pigeon**, Resident Scholar **Oren M. Levin-Waldman**, and Research Associate **Karl Widerquist**, all of the Levy Institute.

With the strong growth of the American economy new jobs have been created and the unemployment rate has dropped, but Wray and Pigeon's research indicates that the benefits of this employment growth are not shared across the labor force. The economic expansion, while creating opportunities for workers with at least some college education, is not creating opportunities for less-educated workers. Hardest hit are high school dropouts. Employment data appear to indicate that the employment gap has narrowed between those without a high school diploma and those with at least some college, but Wray and Pigeon argue that what has actually happened is that there has been a decline in the number of high school dropouts (due to a population decline of people in that educational category) rather than an increase in their employment level. They estimate that there are about 15 million people between the ages of 25 and 64 who have never attended college but are potentially available for work. They argue that active labor market policies are needed to bring these people into the labor force. Such policies should include programs to reduce the high school dropout rate, programs to provide alternative paths to employment (such as apprenticeship programs), wage subsidies to encourage employers to hire, day care and other services that will make it possible for many to work, and a government employment program that hires all those willing and able to work.

One important purpose of the minimum wage is to ensure that low-wage workers earn enough to support their families, but inflation tends to erode the value of the wage over time. Levin-Waldman proposed that automatic adjustment of the minimum wage would eliminate this erosion, thereby helping low-wage workers to maintain their living standards. Automatic adjustment would also prevent the enactment of wage increases from being mired in political battles. Some researchers and policymakers have suggested that the minimum wage should be indexed to the consumer price index. Levin-Waldman argued that the CPI is not a good measure because it can overstate inflation. A better method would be to link the minimum wage to the median hourly wage of the lowest-wage sector in the economy; the minimum wage would increase by the same percentage as wages in this sector. Under this method, the private sector determines the rate of increase in the minimum wage and it is more likely that increases in the minimum wage would be tied to increases in productivity.

Widerquist argued that the most efficient way to reduce poverty is to provide everyone with a guaranteed income. The government would guarantee that no one's income falls below a certain level regardless of whether a person worked or not. Policies aimed at reducing poverty so often get caught up in the debate over what causes poverty and how to eliminate those causes. Because researchers and policymakers cannot settle this debate, successful policies to end poverty cannot be developed. A guaranteed income would end this debate. Such a system would provide workers with an additional benefit--it would give them the security to leave a job with bad working conditions and search for a new job.



*A more detailed summary of participants' remarks will be published in the symposium proceedings. To obtain a copy, see ["How to Order"](#) page in the "About the Institute" section.*

[Back to Contents](#)

## The Levy Report Interview

### Wall Street Blues: An Interview with Leon Levy by Jeffrey Madrick

*Reprinted with permission from The New York Review of Books, October 8, 1998. Copyright © 1998, NYREV, Inc. Jeffrey Madrick is the editor of Challenge magazine and author of The End of Affluence.*



Leon Levy started his career on Wall Street as a security analyst and became chairman of Oppenheimer & Company in 1953, then a small brokerage firm. He and his partner, Jack Nash, built the firm into one of the leading brokerage and mutual fund companies in the nation. They sold Oppenheimer in 1982 and formed the investment partnership Odyssey Partners. Odyssey is currently being liquidated after producing one of the highest rates of return to investors of any such partnership over more than 15 years. Levy is currently the chairman of Oppenheimer Funds, Inc., a position he has held for more than 40 years. He is also president and founder of The Jerome Levy Economics Institute of Bard College.

**Madrick:** With the U.S. economy widely considered strong by most conventional measures, many people are confused by how the turmoil in financial markets overseas--from Asia to Russia to Venezuela--could do so much damage to the U.S. stock market. As we are talking in early September, the Dow Jones Industrial Average stands nearly 18 percent below its high of the year. Did you think foreign events could precipitate such a decline?

**Levy:** You never know what will trigger a decline in the stock market. That word *precipitate* is an interesting one. When you keep piling up bags on a scale, finally at some point you might put a few too many bags on the scale and break it. What caused the problem? These international markets may be the immediate issue, and problems there do affect the U.S. But did they precipitate the market decline? That's way too simple. The causes of America's problems are deeper and more complex. The U.S. economy is vulnerable, and has been for some time, and that's the main point that is getting lost amid all these analyses. The stock market usually reflects--at least over time--the course of the nation's economy.

**Madrick:** Nevertheless, all eyes seem to be on the international scene. Some people say that, while the collapse of the Russian ruble may have started the recent turmoil in the U.S. stock market, the Japanese recession is the main problem. Is it the linchpin?

**Levy:** I don't think so. But that doesn't mean the problems aren't severe. Japan attracts the most attention. It's the largest economy in the Pacific Rim. It went down first. But I think its problems are typical of the region. I think the same thing happened in Malaysia, Thailand, Korea, wherever you go in East Asia. They are all overextended.

**Madrick:** In what ways are they overextended?

**Levy:** Start with Japan. The solvency of its banks, some experts whom I respect tell me, is largely questionable. In the late 1980s, when so many people thought that Japan was economically invincible, it was spending as much as 30 percent of its gross domestic product on capital investment. A lot of this was financed by huge loans from banks. As you know, economists think capital investment is almost always good. But, typically, businessmen go too far, especially if they can raise capital when the stock market is high. There is no way Japan can use that many new buildings, that much new plant, that much new machinery. The overexpansion of capital goods is often the great cause of recession or even depression.

**Madrick:** Few people were saying this in Japan's heyday.

**Levy:** You never know for certain when capital spending is too high. Only afterward. Take New York City, for example. If you own an office building, and rents are high, and everybody wants to move in, things are fine. But if the stock market should not be as expansive, which is what happened in Japan and may be happening here, then a firm may decide to rent much less space. Suddenly, conditions are not tight. It now looks as if you have overspent on your building.

**Madrick:** And this happened more or less across East Asia?

**Levy:** Yes. It's pretty typical of human nature. Why should the East Asians be any different? Remember the real estate market was way too high in Thailand. It collapsed a couple of years ago. If Japan were stronger, maybe it could have done more to bail these countries out. But that would have occurred after a lot of damage had been done. These countries are now all in serious disarray, I would say depression.

**Madrick:** How do their problems directly affect the U.S. market?

**Levy:** They stop buying our exports, first of all. That might not be so bad if we had a strong trade balance. But we don't. We import more than we export. This is getting worse. The trade deficit is setting new records all the time. Then, other markets around the world get nervous

even at the smallest sign of trouble. Investors want higher rates of return, which weaken economies further. Russia is in bad shape but it is in no way the trigger for our problems either. It is only a small part of our trade, even though German and U.S. banks are apparently losing a lot of money on their investments there. More important, profits of many other U.S. companies are reduced as sales fall to all these regions. The U.S. market gets more nervous as a result, and stock prices fall further.

As you can see, these market declines have two effects. They have an effect in the real economy when interest rates rise, as they have in many countries abroad. And they also affect the business mood, which can also then have an effect in the real economy. It makes people less willing to undertake an activity. They hesitate to buy something or build a plant or expand their business in other ways. This is true in the U.S. as well.

**Madrick:** What should Japan do to solve its problems?

**Levy:** It should use deficit spending to try to stimulate the economy and it may have to do something drastic to save its banks. If the problems in Russia could be solved, that would be helpful also. But what's going on is no surprise there either. I feel terrible for the Russians. But they lived under the tsar and they lived under communism. To bring about a deep social change, how long does it take to reeducate a people? I think that takes a few generations. But let's be clear about this. The U.S. has more of its own internal problems than those posed by these foreign economies, and that's why our market is falling so fast in response to them.

**Madrick:** As you well know, many people believe quite the contrary. The U.S. economy is strong, we are told over and over again. Unemployment and inflation are low. Interest rates are also low. Profits are up. Capital spending is strong.

**Levy:** All of this is true. I've been worried about the economy for a while, and it's kept growing. But all these things you mention tell us what the economy has done, not what it is going to do. They are mostly lagging indicators. Unemployment is a lagging one. Corporate profits can be a leading indicator, because they can stimulate investment, but we are usually talking about last quarter's profits. We don't know about next quarter's.

**Madrick:** Is a recession in the U.S. possible?

**Levy:** More than possible. I think it is likely. And it could occur within six months. That doesn't mean I know that it will occur. I've been wrong before, as I said. But I think we could get a lot of unemployment as a result. And I think it may be hard to pull out of such a recession for a while.

**Madrick:** Then let's talk about the weaknesses of the U.S. economy that might lead to recession. What are they?

**Levy:** I think there are three major ones. First, there is the trade deficit. It is growing worse. It reduces growth because sales are going to foreign countries. It makes the U.S. even more vulnerable to declines in overseas economies because they will buy less from us and sell more to us at lower prices. So that's a big problem. And now we may get more competitive devaluations in East Asia and Russia and maybe elsewhere. They cut the values of their currencies. That will drive the price of their exports even lower and make our exports relatively more expensive.

**Madrick:** What are the other factors?

**Levy:** Americans are saving very little money. On average, people spend almost everything they earn. While some invest in retirement funds, others borrow a lot. As you know, the government revised the savings numbers down recently to an almost negligible amount. Now there may be some troubles with how that's measured. But it's clear that one reason the economy has been strong recently is that people are spending so much on goods and saving so little. That can't continue.

**Madrick:** Why not?

**Levy:** The big reason may be that they feel free to spend because their stocks are doing so well. If people have more and more money in the stock market, and stock prices keep going up, why should they bother to save? Or why should they deny themselves something that they would like to have? This is called the wealth effect.

**Madrick:** It only works when the market is up.

**Levy:** Yes. But what makes it particularly dangerous today is that so many people own stocks and the savings rate is so low. We made a very thorough study of this in 1962 when the stock market was down 30 percent. At that time, we discovered there was no wealth effect at all. But that has all changed because of the remarkable promotion of mutual funds and other kinds of equity savings instruments. In other words, as people felt richer, because their mutual funds were going up or their IRAs were going up, they felt they didn't have to set aside as much money for their retirement or their kid's college expenses--which, by the way, are the two main reasons for savings.

As stock prices start going down, will this make people spend less money? I daresay it will. The man who is building the largest house in the Hamptons may have second thoughts if he suddenly loses \$10 million in the stock market. The same will be true for the average investor. He may not buy a car or eat out as often or spend as much at Christmas. And by now some may think they own enough goods. In the twenties there were so many products just coming into existence--autos, the radio, washing machines, refrigerators, electricity in general. Today we have electronics products. I don't know how many more we need. I have a number of friends who keep on buying new computers, and they finally get machines that are more powerful than they need.

**Madrick:** You say there is a third potential weakness in the economy?

**Levy:** The third problem with the American economy may be that there is just too much capital investment--an investment bubble. I think this is hard to measure. As we said, you never know when capital investment is overextended until the economy begins to slow down. But I know the world can make more automobiles than it needs. I am told it can make more computer chips than it needs. I think there may be too much investment in high technology. As I say, only when the economy starts to slow does this become obvious. Until then, everything always looks great.

**Madrick:** Economists typically think of capital spending as the main source of the economy's strength. The more the better.

**Levy:** Yes, that's what many said about Japan. I am not sure that economics has made all that much advance since John Maynard Keynes. I am not an economist, so I won't push the argument too far. But you have to know the causal relationship. Capital investment may improve productivity, but new opportunities may also stimulate capital investment. So what is causing that? It doesn't mean that if you just keep investing, productivity will also keep going up.

**Madrick:** At some point, you're saying, certain kinds of capital investment simply become the fashionable thing to do and that's how economies get overextended.

**Levy:** If you can raise the money, which you can do these days, someone will come along with an idea about what to do with it. But it may not be a very good idea. That's what happened to Japan. But we are not as overextended as they were--that should be made clear.

**Madrick:** Let me give the conventional argument here, about which I am dubious. A lot of analysts point to the degree of high-technology investment and the computer revolution and say that they will be the source of new growth and rising productivity.

**Levy:** Well, we've had a lot of electronics investment for a long time. It's probably improving productivity, but it won't raise it by a quantum leap. And we may now be investing too much in these things. As I said, some people tell me their computers are too powerful.

**Madrick:** So, in sum, whatever the trigger, the American economy is vulnerable to a downturn.

**Levy:** Exactly. As I said, I think a recession is getting increasingly likely.

**Madrick:** What does that mean for the stock market?

**Levy:** It could mean a serious decline. It's already been serious, remember. Small stocks are way down.

**Madrick:** How overvalued do you think the stock market is?

**Levy:** Well, I've thought it's been overvalued for some time. And it just kept going up. All markets overshoot. If something's working, you want to buy more.

**Madrick:** How do you analyze the value of the market?

**Levy:** By the way, I don't think the odds of being right about the market are remarkably large, though at some times trends are easier to see than at others. Perhaps this is one of those times. In evaluating companies in the market, I try to determine what you would pay to buy the whole company, based on its actual performance--its products, its sales, its earnings, and its prospects. Then I compare it to the current market value based on the stock price--the price of the shares times the number of shares. Given the way the stock market has been, it's been a long time since I've been able to find many companies I would want to buy.

**Madrick:** In some 50 years in the business, do you think this market is about as exuberant a stock market as any you have ever seen?

**Levy:** I don't think any of us really remember how we felt at different times of our life about different things. I've noticed people always think that this time is the worst. When you're younger, you are more inclined to believe that the profits you make in the market are due to your own wit or talent. Then you get older, maybe you get a little wiser, and discover that it's exogenous forces that are making you all that money.

That being said, today's market is clearly more exuberant in this one sense. A relatively small part of the population was involved in the stock market in the sixties. Now, for all intents and purposes, everybody who is middle class is, in some way or another--even in the pensions managed by his employer--involved in the stock market.

**Madrick:** For example?

**Levy:** With all the attention on increases in corporate earnings these days, I am worried that companies may be getting too liberal with their accounting. Earnings may not be quite as strong as they appear. You know, accounting is not a science. The temptation to put a good face on things seems part of human nature. As much as we want to believe times are now different, human nature has not fundamentally changed in the 1990s.

**Madrick:** Many economists believe that a recession simply cannot get too far out of hand because the Federal Reserve will pump up the money supply by bringing down interest rates. Should the Fed be lowering interest rates right now?

**Levy:** I think the Fed has a few problems, which are inherent in its nature. First of all, it has only one tool, really. That is adjusting interest rates. If you have only one machine, you tend to

think it's more important than it really is. Sometimes you hesitate to use it when you should. Second, it is a conservative institution. It generally acts after the fact. I can hardly ever think of a time when it seriously anticipated what was going to happen in the economy. But I do think that it is very close to the point where it is going to cut rates.

**Madrick:** Are you as convinced as many economists that the Fed will save the day if the economy falls into a serious recession?

**Levy:** I think it has less power than many believe. Let's go back to the experience of the thirties. Even if it tries to pump up money, who's going to spend the money on capital goods when things are bad? Who's going to spend the money on other things if the Fed makes money easier? Japan has the easiest money in the world. And the economy is on its back. So, no, it won't always be a panacea.

**Madrick:** What else can be done?

**Levy:** Contrary to what a lot of people say, I think we should have a serious government spending program. My real worry is quite the opposite of the worry of many people on Wall Street. Suppose the gloomy picture I am painting corresponds to what will happen--which of course it may not. And suppose tax receipts fall rapidly as personal income falls. And suppose we then show a government deficit. Given current attitudes about balancing the budget, would the government then be willing to spend more money to stimulate the economy? Would Congress and this administration and the electorate? How long will it take to convince them? This is what the Clinton administration is recommending for Japan, with which I wholeheartedly agree. But will we take our own advice?

**Madrick:** So how bad could it get?

**Levy:** Well, having said all that, let's remember that we now have all the government programs that keep some income flowing--automatic stabilizers, as they are called, unemployment insurance, Social Security. We didn't have any of that in the 1930s. So there is a higher floor. And I am certainly not saying all that could go wrong will go wrong.

**Madrick:** Will it take a long while for this stock market to fall to the full extent it might because there is so much optimism around?

**Levy:** Oh, I think so. I think all markets take a long time to make their moves, up or down. It always takes a while for the mood to change. Look how optimistic everybody was in June or July. A few months ago. Many people running money today never lived through a bear market. Any time the market falls, they think stocks are now selling at a bargain price. And so they buy. Every rally is said to be the end of the problem. We had a great stock rally from 1929 to the spring of 1930. Then stocks really collapsed. Not that I remember this personally, I want to

stress. Nor am I saying this will happen the same way this time around. I certainly don't think, as I tried to make clear earlier, that we are headed to anything as severe as the Great Depression. But things could get rougher than most anticipate.

**Madrick:** What investment strategy are you adopting?

**Levy:** My investment decisions are essentially very conservative. I have been inclined to sell stocks from the portfolio and put the money into U.S. Treasury bonds.

**Madrick:** In this day, many would find that too conservative a strategy.

**Levy:** Well, it isn't simply defensive. I think we are going to get a big move up in Treasury bonds because interest rates will come down more as the economy weakens.

**Madrick:** How far could interest rates fall?

**Levy:** This is the question I am asking myself these days. It would not surprise me to see rates on long-term government bonds fall to 3 or 4 percent from their current 5.2 or 5.3 percent or so. That would represent a rise in the price of the bond of 20 percent or more.

**Madrick:** That's serious "upside potential," as they say.

**Levy:** Yes. So it's not the worst thing in the world to sell stocks and put money into long-term Treasury securities. You could make a lot of money--maybe.

**Madrick:** You generally stress the uncertainty in economic behavior. It is an issue that I am also concerned with. Professional economists are typically looking for universal answers. But every period of time is unique in important ways, it seems to me. In the 1990s, a fall in interest rates seems to me to have been highly stimulative. Thus we could grow even as the stimulus from federal spending was reduced. Such a fall in rates in a different period of time may not have been as stimulative.

**Levy:** Yes. The thing that makes the task of predicting so damned difficult is that all of the variables change in importance each time. In other words, you look back to past history and you may think you have a perfect grasp of what happened, which nobody could have had back then. But that wouldn't help you much today. Because all the variables in the equation, as it were, would carry different weight today. My big fear is that we are nearer the beginning of the current turn in history than we are near the end.

[Back to Contents](#)



# Editorial

---

## The Butterfly Effect

By James K. Galbraith, Senior Scholar, and George Purcell

*Originally appeared in the Financial Markets Center Newsletter, FOMC Alert, June 30-July 1. Reprinted with permission. James K. Gallbraith and George Purcell are at the Lyndon B. Johnson School of Public Affairs, University of Texas at Austin.*

Small actions can have large consequences. The mathematics of chaos teaches that a butterfly, flapping its wings in Brazil, can set off a chain of events leading to a hurricane at Cape Fear. They call this the "butterfly effect."

On March 24, 1997, the butterfly was named Alan Greenspan. That day, he flapped his wings just once, raising the interest rate by one-quarter of one percentage point, about 5 percent of then-prevailing values.... Global currency instability started just about then. . . . The Thai crisis hit three months later amidst speculation that the Fed might act again. After that, [the Euro-index, the yen, the Australian and Taiwan dollars, and the national currencies of the Philippines, Malaysia, Thailand, Korea, and Indonesia] declined, leaving only the pound and the dollar flying high.

Thus, the so-called Asian crisis was not restricted to Asia. Nor did markets suddenly discover that particular countries suffered from inefficiency, corruption, deficits, inflation, or other internal disorders. Instead, Asian and non-Asian currencies have moved in striking parallel, often day by day. The differences were of degree: since March 1998 the currencies of Europe, Japan, Australia, and Taiwan have fallen about 20 percent; a cluster of the Philippines, Malaysia, Korea, and Thailand 40 percent; and Indonesia 80 percent.

In short, currencies collapsed in proportion to their dependence on American capital. Those hit hardest were those that have relied most on our investments, that had the least resident wealth of their own, that were most caught up in construction booms financed by short-term inflows. When U.S. interest rates started to rise, dollar-sensitive investors came home. The dollar went up, and its closest dependencies, like Suharto's rupiah, were the greatest victims. This is a crisis of the American empire.

It is also a crisis of the "Washington consensus," that doctrine of deregulation and open capital markets. Much nonsense has been written about the collapse of the Asian development model--a collapse which, for unexplained reasons, has not taken down Taiwan or China. Reforms in Seoul and Djakarta may be necessary, but they alone cannot cure a problem caused primarily by policies in the large financial centers.

Since the Fed's action triggered vast capital inflows into the United States, it assuredly helped to fuel the stock market boom. But the rising demand for dollars hurt our productive economy, and the effects are now surfacing in an increased U.S. trade deficit, as exports tumble and cheapened imports flood our markets. These consequences will multiply if we fail to act quickly--and correctly.

Today, some say U.S. interest rates should rise. Rate-increase enthusiasts claim this would deflate our stock bubble. But the short-run effect could be the opposite; a higher interest rate could drain more capital from overseas and push stocks upward. And that effect would come at the cost of yet more collapse in the world economy and a larger trade deficit for the United States.

In the end, down this path lies disaster. If the first dose fails and rate increases are repeated, eventually the structure of U.S. household debts, already at dangerous levels, is bound to crack. The collapse that would follow would be long-lasting. It could mean the end of the dollar era, the end of the postwar growth age, and the end of the global markets for aircraft, computers, communications systems, and other products that give America its technological edge in the world economy today.

Alan Greenspan seems aware of these dangers: he spoke of them vividly in an important speech six months ago. But there remains an intransigent faction at the Federal Reserve that favors higher interest rates under all conditions. And so the debate is between those who say "raise rates" and those who say "not yet." Under these conditions, to hold the line is the best Greenspan can do, and such a stalemate must always end in a rate hike--never, until much too late, in a rate cut.

Today, global stability and domestic prosperity demand that interest rates come down. Further actions are necessary as well. A Tobin tax on capital flows and speculative transactions, long recommended by many economists, could help steady the global markets--but we are more likely to get destabilizing tax cuts on capital gains. Special steps toward Russia are urgently needed as that giant country, a security issue for the entire globe, continues its slide toward disaster. Treasury's recent intervention to bolster the Japanese yen was one good initiative, but more may be required.

By stemming capital inflows and stabilizing our trading partners, the actions we recommend might send U.S. stock prices downward at first--a boom based mainly on capital inflows will not continue when they stop. But over a longer time frame, stock prices will recover if our economic growth is sustained by an early recovery of the world economy, of other currencies, and of our export markets. The alternative--more global instability and more of our own debt-driven bubble, followed by a prolonged collapse--could be chaos.

[Back to Contents](#)

## New Working Papers

---

### **An Ethical Framework for Cost-Effective Medicine: Confronting the Risks in Managed Care**

Walter M. Cadette  
Working Paper No. 239

Managed care systems, such as health maintenance organizations (HMOs), have been quite successful in reining in health-care costs. Health care as a percentage of gross domestic product had been steadily rising in the past decade but now seems to have stabilized at 15 percent of GDP. This reduction in price increases has been good news for the federal budget, one-fifth of which goes to Medicare and Medicaid expenses. But what is not certain is whether the cost reductions have been good for patients. In this working paper Senior Fellow Walter M. Cadette examines the managed care system and suggests possible methods for maintaining its cost effectiveness without sacrificing patient care.

Supporters of managed care argue that it has not only reduced costs by eliminating expensive, yet marginally beneficial, procedures, but it has also shifted the focus of care to prevention, which is better for patients. Opponents of managed care counter that the system's focus on cost cutting has forced health care providers to cut corners in patient care, often by avoiding procedures that could greatly benefit patients. Patients are often not even aware of possible alternative procedures because managed care systems discourage physicians from suggesting expensive treatment options.

Government has taken some steps to protect health care consumers, for example, legislating the length of hospital stay after childbirth. But Cadette warns that such micro-management is far too cumbersome a role for government to play. He suggests that it is government's role to formulate policy on the larger issues involved in managed care systems. For example, policy should seek to alter the financial incentives in managed care systems that encourage doctors to cut costs at the expense of patient care. It should ensure that patients know what these incentives are and how they might affect the care that patients receive. Policy should also try to remove the barriers that prevent physicians from discussing alternative, but expensive, treatment options with patients. It should find means by which health plans could be held responsible for decisions to withhold care that result in harm to patients.

## **The Place of Cultural Explanations and Historical Specificity in Discussions of Modes of Incorporation and Segmented Assimilation**

Joel Perlmann

Working Paper No. 240

Researchers who study ethnicity have proposed biological, racial, and cultural reasons to explain differences in ethnic group behavior. Cultural explanations attribute behavioral differences to differences in attitudes, outlooks, and values of groups. Critics of this view have argued that ethnic group behavior is not the result of culture but a reaction to the discrimination groups face in society and a result of the status of groups on the social class ladder.

Senior Scholar Joel Perlmann examines some of these explanations for ethnic behavior, including newer explanations such as the modes of incorporation perspective offered by Alejandro Portes and Ruben Rumbaut in their 1996 work *Immigrant America*. Although Perlmann sees some value in many of these explanations, he feels that none adequately captures all of the possible factors that might explain behavioral differences. For example, the modes of incorporation explanation fails to consider fully the effects a group's historical experiences might have on the group. Perlmann concludes his analysis by offering some thoughts on methods researchers might consider when seeking to understand differences in ethnic behavior.

## **Optimal Financing by Money or Taxes of Productive and Unproductive Government Spending: Effects on Economic Growth, Inflation, and Welfare**

David Alan Aschauer

Working Paper No. 241

Researchers often distinguish between two types of government spending--productive and unproductive. Productive spending consists of expenditures for such things as education, research and development, job training, and physical infrastructure. This type of spending provides services to the private sector that enhance its production activities. Unproductive spending provides no benefit to private sector production; it includes such spending as government consumption expenditures. Research Associate David Alan Aschauer argues that this distinction between types of spending is important because the two types should not be financed the same way.

Aschauer develops a model to assess the impact on economic growth, inflation, and social welfare of two methods for financing government expenditures--income taxation and money creation. He concludes that the better method for financing productive government spending is money creation, while the better method for financing unproductive expenditures is income

taxation. Aschauer argues that his findings suggest that monetary policy should not have as its sole goal the controlling of inflation. It should also be seen as a means to increase the funding for productive government expenditures.

## **Money and Credit in a Keynesian Model of Income Determination**

Wynne Godley

Working Paper No. 242

A problem with many of the models developed by various schools of economic thought is that they leave out variables that play important roles in the functioning of a real world economy. For example, Keynesian models of the postwar era often ignored the role of money. This oversight was reflected in the rise of monetarism in the 1970s. Monetarism, with its concept of an exogenously determined money supply, in turn gave rise to the endogenous money school, which argues that money is generated by the creation of credit--a process that is essential to the functioning of a real world economy since production and distribution take time and the future is always uncertain.

Distinguished Scholar Wynne Godley believes that the concept of money creation by credit developed in the endogenous money school is important for understanding the functioning of a whole economy. He incorporates this idea into a model he is developing that can describe the evolution of a whole economy through real time. Godley's model has four sectors--firms, households, the government, and banks. He runs a variety of simulations designed to explain the behavior of the four sectors under different economic situations in order to understand why economies function as they do and how certain policies can affect them. From his examination of the concept of money supply, Godley draws the conclusion that there is no such thing as a supply of money distinct from the money that agents hold. He also concludes that because expectations of economic conditions, such as expectations of sales and income, are often wrong, a modern economy cannot function without a banking system that allows loans and money balances to fluctuate.

## **State Type and Congressional Voting on the Minimum Wage**

Oren M. Levin-Waldman

Working Paper No. 243

Although research on the effects of minimum wage increases may influence how members of Congress vote on increases, Resident Scholar Oren M. Levin-Waldman believes that politics plays a greater role. Levin-Waldman reviews congressional voting patterns on minimum wage increases from 1949, the year of the first vote to increase the wage, to 1996, the year of the last increase. He finds that members of Congress who are from states in which union membership is

strong tend to vote in favor of a minimum wage increase regardless of whether they are Republicans or Democrats. Representatives from states with low union density, especially those from states with right-to-work laws that make union organization difficult, are more likely to vote against an increase, again regardless of their party. Related to this influence of state type on voting patterns is Levin-Waldman's additional finding that support in Congress for minimum wage increases has declined as union strength has declined.

## **Can Taxes and Bonds Finance Government Spending?**

Stephanie Bell

Working Paper No. 244

Most economists and policymakers agree that there are three options for financing government spending--taxation, the sale of bonds, and printing money--but they disagree over which of these options, or which combination of them, is best. Cambridge University Visiting Scholar Stephanie Bell argues that there is really only one way in which governments finance their spending--the creation of high-powered money (HPM), which she defines as member bank deposit balances at the Federal Reserve plus total currency outstanding.

Through a study of reserve accounting practices at the central bank, Bell concludes that taxation and bond sales are methods that are used by the government to control member bank reserves, which in turn is a way of controlling the federal funds rate. When the banking system has excess reserves, it is difficult for banks to find bidders for these reserves and the federal funds rate falls. To prevent this fall, the government uses taxation to drain excess reserve. Taxation reduces bank reserves when taxpayers withdraw funds from their bank accounts to pay the government.

Government can increase reserves by spending money, but deficit spending can create its own problem because it can result in a net increase in aggregate bank reserves. To avoid this, the government can sell bonds to drain off what would otherwise become excess reserves. Bond sales and taxation are incapable of raising the funds needed to finance spending, but they are capable of draining excess reserves to prevent the federal funds rate from falling. The question researchers should ask, therefore, is not whether bond sales and taxation are the best options for financing government spending, but only whether they are the best methods for draining reserves.

## **Reciprocity and the Guaranteed Income**

Karl Widerquist

Working Paper No. 245

The principle of reciprocity is essentially that what is applied to one must be applied to all (in legal terms it implies that all are equal before the law), but Research Associate Karl Widerquist argues that reciprocity does not exist in most modern economies where assets are privatized. Many citizens face the choice of either working, often at exploitive wages, or starving, but not

all face this choice. Because owners of assets such as land and capital do not have to make this choice, the principle of reciprocity is violated.

Widerquist proposes that a guaranteed income would eliminate this violation of reciprocity because it would ensure that no citizen had to choose between working or starving. There are various ways in which a guaranteed income could be designed, but the essential feature must be that it guarantees that all citizens receive a living wage whether or not they work. In order to preserve the work incentive, work must pay more than the guaranteed income. Thus, those who do choose to work should be rewarded with a higher income. An additional benefit of a guaranteed income is that it can improve workers' labor market position by making them able to afford to refuse to work at exploitative wages

## **Derivatives and Global Capital Flows: Applications to Asia**

Jan A. Kregel Working Paper No. 246

In the recent spate of economic research to discover the causes of the financial crisis in Asia and the means to avoid similar ones in the future, little or no role has been ascribed to financial derivative contracts. However, reports of U.S. money-center banks for the fourth quarter of 1997 and the first quarter of 1998 show that most of their early losses due to the Asian crisis were related to derivative-based credit swap contracts. An examination of the role of derivatives in Asian financial markets leads Visiting Senior Scholar Jan A. Kregel to take issue with the view that derivatives had little to do with the crisis.

Although his analysis of the role of derivatives in the crisis is not yet complete, Kregel finds enough evidence already to indicate that they played an integral part in the rise in the flow of short-term funds to the Asian region. He does not blame all of Asia's financial difficulties on the use of derivatives, but points out that their existence challenges a commonly held belief that private capital markets are self-regulating in terms of risk assessment and ability to allocate capital efficiently. Asian markets were not as successful as many had thought in directing resources to their most productive uses.

## **"Inability to Be Self-reliant" as an Indicator of U.S. Poverty: Measurement, Comparisons, and Implications**

Robert Haveman and Andrew Bershadker  
Working Paper No. 247

Although the reduction of poverty is a stated goal of many nations, there is no agreement on how to define or measure it. One definition in economic terms is having an income below some level estimated to be needed to attain a minimal standard of living. The official poverty statistics in the United States use income as an indicator. Research Associate Robert Haveman and Andrew Bershadker, of the Department of Economics at the University of Wisconsin, Madison, have developed a new indicator of poverty, a measure based on the capacity to be self-reliant.

Haveman and Bershadker calculate the income an individual could earn if he or she worked full-time, full-year and was paid wages known to be paid to individuals of the same age, education, and other characteristics. Individuals are defined as self-reliant if this calculated earnings capacity falls above the official poverty line and as poor if it falls below. The authors argue that a self-reliance indicator of poverty is better than an income indicator because it measures the long-term potential earnings of people rather than their income in one period of time.

Haveman and Bershadker find that self-reliance poverty has grown more rapidly in the United States than has official poverty and the greatest growth has been occurring among groups that traditionally have the lowest poverty rates--families headed by men, whites, and individuals with some college. The authors suggest that this could be a reflection of the relative decline in wage rates for men and whites, the decline in wages for workers with little education, and the growth in the number of Americans with college education. If, as their research indicates, a growing number of Americans lack the capacity to be self-reliant, then it may be necessary for the government to direct its antipoverty policies toward increasing the ability of individuals to be self-reliant, such as through training and education, and toward increasing the return that the least capable members of society receive for their efforts, such as through increased wages or wage subsidies for low-wage workers.

## **Can Expenditure Cuts Eliminate a Budget Deficit? The Australian Experience**

George Argyrous

Working Paper No. 248

Since the late 1970s the Australian government has sought to maintain a balanced budget through a policy of accumulating surpluses in expansionary times that are then used, along with expenditure reductions, to offset deficits in recessionary times. This policy rests on the neoclassical assumption that deficits reduce economic growth because they crowd out private investment. In an examination of the Australian budget since the mid 1970s, George Argyrous, of the School of Social Science and Policy at the University of New South Wales, argues that this policy, known as fiscal consolidation, has not been successful.

Argyrous finds that in Australia fiscal consolidation actually exaggerates downturns in the business cycle. The resulting drop in private sector activity then decreases government revenue. The reduction in revenue leads the government to reduce expenditures of capital outlays rather than current outlays, and the cut in capital expenditures causes a decline in future productivity. In addition, the overall economic decline forces the government to increase expenditures on unemployment programs. Argyrous concludes that expenditure cuts do not eliminate deficits, and governments, therefore, should not intentionally aim for balanced budgets.



## **The American Wage Structure, 1920ú1947**

Thomas Ferguson and James K. Galbraith  
Working Paper No. 249

The period from the end of World War I to the end of World War II was one of dramatic economic, technological, political, and social change in the United States. Many scholars have thus found it an interesting period for labor market studies of the factors that determine wage rates. Thomas Ferguson, of the Department of Political Science at the University of Massachusetts Boston, and Senior Scholar James K. Galbraith challenge the conclusions of many of these scholars. They draw on extensive data from a variety of sources in an effort to examine all of the factors, including political events and economic policies, that may have affected the wage structure between 1920 and 1947.

Their research reveals a relatively egalitarian wage structure emerging briefly after World War I, disintegrating in the recession of 1920 to 1922, reemerging shortly after, and again deteriorating from 1929 to 1932. The deliberate policy of dollar depreciation in 1933 exacerbated the problem, although Ferguson and Galbraith note that a positive aspect of the depreciation was that it may have contributed to increased activism and strength of unions, which worked to reduce wage inequality. By 1946 the American wage structure once again resembled the egalitarian structure of the immediate postúWorld War I years and in fact was even more egalitarian. Some researchers claim this return of wage equality resulted from higher education and skill levels among American workers, but Ferguson and Galbraith credit government policies aimed at full employment, collective bargaining rights, and rising wage standards.

## **Explaining Long-Term Exchange Rate Behavior in the United States and Japan**

Anwar Shaikh and Rania Antonopoulos  
Working Paper No. 250

Conventional exchange rate models, such as those developed by adherents of theories of comparative advantage or purchasing power parity, generally assume that in the long run real exchange rates will move in such a way as to make countries equally competitive. Therefore, in the long run trade between countries will be balanced. Anwar Shaikh, of the Department of Economics graduate faculty of New School University, and Rania Antonopoulos, of the General Studies Program at New York University's School of Continuing Education, argue in a study of long-term exchange rate behavior in the United States and Japan that these conventional models are wrong. Since World War II the United States has consistently run a trade deficit while Japan has run a trade surplus. Conventional models cannot explain this fact.

Shaikh and Antonopoulos argue that one must view international competition much as one views domestic competition. Domestic competition is driven by absolute costs; firms with lower

absolute costs of production have the competitive advantage. Competition between countries is not based on comparative advantage, as many researchers have argued, but on absolute advantage. In applying this theory to the United States and Japan, Shaikh and Antonopoulos find that long-run real exchange rates are a reflection of a country's relative international competitive position, and the price of a nation's products--which is mostly determined by unit labor costs--affects its competitive position. Rather than being free to move to make nations competitive, the real exchange rate is pinned by cost differences. Based on these findings, the authors argue that nations can improve their competitive positions better by improving productivity rather than by attempting to manipulate exchange rates.

## **Paul Davidson's Economics**

Richard P. F. Holt, J. Barkley Rosser Jr., and L. Randall Wray  
Working Paper No. 251

Paul Davidson's work has not always received the attention given to that of other post-Keynesians, but Richard P. F. Holt, of Southern Oregon University, J. Barkley Rosser Jr., of James Madison University, and Senior Scholar L. Randall Wray argue that of all economists who consider themselves followers of Keynes, Davidson is the truest Keynesian. Someone seeking a true interpretation of Keynes is most likely to find it in the work of Davidson.

Davidson has sought to separate himself from many who consider themselves Keynesians because he does not consider them true adherents to Keynes's ideas. Holt, Rosser, and Wray examine Davidson's work on monetary theory, the international monetary system, and aggregate supply, as well as on environmental and resource economics--an area for which Davidson is not well known. The authors point out numerous differences between Davidson and other Keynesians in economic theory, methodology, and economic policy. It is Davidson's strict adherence to the tenets of Keynes that perhaps explains the neglect of his work. While political views have shifted to the right, Davidson has remained on the left of the political spectrum. The authors predict that in the long run Davidson's work will receive the attention it is due.

[Back to Contents](#)

## **New Policy Notes**

---

### **Small Business and the Minimum Wage**

Oren M. Levin-Waldman and George W. McCarthy  
1998/3

## Small Business and the New Welfare

Oren M. Levin-Waldman and George W. McCarthy  
1998/4

In these two policy notes Resident Scholars Oren M. Levin-Waldman and George W. McCarthy present findings from a Levy Institute nationwide survey of 568 small businesses. The firms were asked about their willingness to hire welfare recipients, characteristics they look for in prospective employees, and the effect of increases in the minimum wage and government subsidies on their hiring and employment practices. The findings on business reactions to increases in the minimum wage, which are presented in Policy Note 1998/3, challenge the common belief that increases in the minimum wage have adverse employment effects because they cause businesses to lay off workers or not hire new ones. However, of the firms surveyed, 89.4 percent said that the most recent increase in the minimum wage, to \$5.15 an hour, did not affect their hiring decisions, and 75.6 percent said that an increase to \$6.00 would still not affect their decisions.

The findings on the effects of welfare reforms, presented in Policy Note 1998/4, indicate that lack of work experience might be a key reason some welfare recipients find it difficult to get jobs. Survey respondents most often listed experience as the most important characteristic for a potential employee, followed by specialized skills. The firms expressed a willingness to hire welfare recipients and to provide them with on-the-job training, especially if the government provides wage and training subsidies.

[Back to Contents](#)

## Institute News

---

### Lecture

**Benjamin Lipstein: In Defense of Small Samples** Surveys that are designed to do such things as measure public opinion or gather demographic information are often rife with errors. In an effort to make such surveys more accurate their creators frequently fall prey to the belief that a larger sample is better. Rather than surveying a hundred people, they survey thousands. Rather than asking a few questions, they ask dozens in hopes that detail will result in accuracy. In a lecture at the Levy Institute on August 21, Benjamin Lipstein, professor emeritus of marketing at New York University's Stern School of Business, argued that bigger is not necessarily better.

It is more important to ask good questions than many questions, Lipstein said. Surveys should

be short and simple and the questions should be as unbiased as possible. Surveys with many and difficult questions will often cause respondents to give any answer in hopes of getting the survey done as quickly as possible. A well-designed survey does not need a large sample of respondents in order to be accurate. Researchers often forget that every survey starts with a sample of one--the researcher. Those who create surveys should ask themselves how they feel about the issue and how they would respond to the questions in the survey. This will help them design better surveys.

## Scholars Brief Members of Congress

Levy Institute scholars met with congressional representatives and staff in Washington for another in a series of briefings to inform policymakers about Institute research and to provide a forum for bipartisan discussion of significant policy issues. Topics covered at the meeting included Federal Reserve interest rate policy; the inability of official unemployment statistics to measure the true labor supply; the effect of technological change on the duration of unemployment; automatic adjustment of the minimum wage; the outlook for the U.S. economy; the need for well-targeted, active labor market policies to aid lower-skill workers who have been left behind by the economic boom; and results of a Levy Institute survey on small business hiring practices and the effect on those practices of such things as increases in the minimum wage and government subsidies for the hiring or training of workers.

## Participants in *Debates-Debates*

Several Levy Institute board members participated in recent segments of the national television program *Debates-Debates*. Vice Chairman and Director of Forecasting **David A. Levy** and **Eugene H. Rotberg**, a member of the Levy Institute Board of Advisors, participated in the segment asking "Should the U.S. Back Bailouts When Countries Get into Trouble?" In arguing yes, Levy was joined by Robert Kuttner, editor of *The American Prospect*, and Ed Rubenstein, director of research for the Hudson Institute. Rotberg argued no. Joining him were William Niskanen, chairman of the Cato Institute, and James Glassman, holder of the DeWitt Wallace Reader's Digest Chair in Communications in a Free Society at the American Enterprise Institute.

In the segment "Is It a Good Thing That Alan Greenspan Has Lowered Interest Rates?" Levy and Rotberg both argued yes. They were joined by Kuttner. Arguing no were **Alan S. Blinder**, a member of the Levy Institute Board of Advisors; Mickey Levy, chief economist for NationsBanc Montgomery Securities; and Niskanen.

Rotberg also participated in the segment "Is the Euro a Big Mistake?" He argued yes and was joined by Kenneth Rogoff, professor of economics and international studies at Princeton University, and Jagdish Bhagwati, professor of economics and political science at Columbia

University. Arguing no were Peter Kenen, professor of economics and international finance at Princeton University; Robert Hormats, vice chairman of Goldman Sachs International; and John Lipsky, director of research at Chase Global Bank.

**Ned Regan**, policy advisor and a member of the Board of Advisors, participated in two segments. In the first, "Does BIG Money Have Too Much of an Impact on Elections?" Regan joined with Martha Burk, co-founder and president of the Center for Advancement of Public Policy, and Ted Cruz, an attorney with the Washington, D.C. firm of Cooper, Carvin, and Rosenthal, in arguing no. Arguing yes were William Curry, a former adviser to President Clinton; E. Joshua Rosenkranz, executive director of the Brennan Center for Justice at New York University Law School; and Micah L. Sifry, senior analyst with Public Campaign.

Regan also participated in the debate asking "Is It Healthy That the Mammoth Funds Are Calling the Tune for Corporate America?" Regan argued yes along with Nell Minow, a principal with LENS, and Richard Lambert, editor of *Financial Times*. Arguing no were Larry Chimerine, chief economist with the Economic Strategy Institute; Dean Baker of the Economic Policy Institute; and Kenneth McLennan, president of the Manufacturers Alliance.

**Leon Botstein**, a member of the Levy Institute Board of Governors and president of Bard College, argued yes in the segment asking "Should Public and Private Colleges Fund Controversial Conferences?" Joining him were Carlin Meyer, a professor at the New York Law School, and Roger Bowen, president of the State University of New York at New Paltz. Arguing no were Candace de Russy, a trustee of the State University of New York; Rev. Louis P. Sheldon, chairman of the Traditional Values Coalition; and Tom Carroll, president of CHANGE-NY.

## Upcoming Conferences on Financial Structure

conference on the work of Hyman P. Minsky will be held on April 21 and 22, 1999. It will be followed by the Ninth Annual Hyman P. Minsky Conference on Financial Structure on April 22 and 23. See the Levy Institute web site ([www.levy.org](http://www.levy.org)) and the next issue of the *Report* for program and registration information.

## Presentations and Publications by Levy Institute Scholars

### Distinguished Scholar Wynne Godley

*Publications:* "Motor Starts to Sputter," *Financial Times*, July 10, 1998; "Don't Let Gordon Off--He Is Not God," *The Observer*, August 23, 1998.

### Senior Fellow Walter M. Cadette

*Publication:* "Privatizing Not the Answer for U.S. Social Security," Bridge News, July 22,

1998.

*Presentation:* "Social Security: The Challenge of Financing the Baby Boom's Retirement," Columbia University School of International and Public Affairs, September 21.

### **Senior Scholar L. Randall Wray**

*Publication:* (new title for forthcoming book) *Understanding Modern Money: The Key to Full Employment and Price Stability* (Elgar, 1999).

*Presentations:* "Theories of Value Appropriate to the Modern Economy," European Association of Evolutionary Political Economy, Lisbon, November 5–8; "Modern Money," Conference on Full Employment, University of Newcastle, Australia, December 2–3.

### **Visiting Scholar Mathew Forstater**

*Publications:* "Lowe's Instrumental Method" and "Heilbroner's Worldly Philosophy" in *Encyclopedia of Political Economy*, edited by Phillip O'Hara (Routledge, forthcoming); "Functional Finance and Full Employment for the 21st Century," *Thinking Economics at the Close of the Twentieth Century: Reflections, Current Trends, and New Directions*, edited by Eiman Zein-Elabdin (Routledge, forthcoming).

*Presentations:* "Robert Heilbroner on Orthodoxy, Dissent, and Economic Policy," The Commitment to Full Employment: Conference in Memory of William Vickrey, Columbia University, November 5–6; "Full Employment without Structural Rigidity," Conference on Full Employment, University of Newcastle, Australia, December 2–3.

### **Research Associate Karl Widerquist**

*Presentation:* "The Public Commodities Problem: The Median Voter in a Polarized Electorate," Atlantic Economic Association, Boston, October 8–11.

### **Research Associate Ajit Zacharias**

*Presentation:* "Political Economy of Globalization," 97th Annual Meeting of the American Anthropological Association, Philadelphia, December 2–6.

### **Research Assistant Marc-André Pigeon**

*Presentation:* "Did the Clinton Rising Tide Raise All Boats?" Third Post-Graduate Economics Conference, Leeds, England, November 13.

*Discussant:* Atlantic Economic Association, Boston, October 8–11.

[Back to Contents](#)