



# Summary

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Spring 2008

Vol. 17, No. 2

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

The *Summary* is published three times a year (Winter, Spring, and Fall) and is intended to keep the academic community informed about the Institute's research. To accomplish this goal, it contains summaries of recent research publications and reports on other activities.

Editor: W. Ray Towle  
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## LETTER FROM THE PRESIDENT

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### To our readers:

This issue begins with four working papers under the Monetary Policy and Financial Structure program that analyze the current instability within the U.S. financial industry. In the first of these papers, Senior Scholar L. Randall Wray, writing on the recent meltdown in the subprime mortgage market, determines that the impact of the financial crisis on overall economic growth could mean the loss of three million jobs. He warns that the fallout could dwarf that of the savings-and-loan industry crisis in the 1980s. Senior Scholar Jan Kregel notes that the central focus of banking has changed from holding assets to moving assets. He concludes that the financial system is poised for a Minsky-Fisher style debt deflation, and that interest rate reductions by the Federal Reserve will be powerless to stop it. In his paper on financialization, Research Associate Thomas I. Palley finds that the increasing importance of the financial sector may put the economy at risk of debt deflation and prolonged recession. All three authors call for policy and political reform, including reregulation of the financial system, in order to prevent “it” (the Great Depression) from happening again.

In the fourth paper under this program, Kregel reviews the basis of the historically high international trade and financial imbalances. He finds that traditional balance-of-payments adjustment theory does not apply to developing countries, and that we do not have a good idea of the dimension of the problem. In a related public policy brief, Kregel concludes that the current crisis cannot be explained in terms of Hyman P. Minsky’s financial fragility hypothesis. He also concludes that the subprime mortgage crisis is the result of insufficient margins of safety based on how creditworthiness is assessed in the new “originate and distribute” financial system; that is, credit rating agencies have replaced bank loan officers and credit committees. Total credit losses could be as high as \$900 billion, Kregel says, and the offset of an increase in exports due to the dollar’s decline would not be sufficient to prevent a recession.

In a working paper under the Distribution of Income and Wealth program, Joseph Deutsch and Research Associate Jacques Silber extend Ronald Oaxaca’s approach to decomposing the relative wage gap between population subgroups, using data from income surveys in Israel.

Under the Gender Equality and the Economy program, a working paper by Research Associate Pavlina R. Tcherneva and Wray examines Argentina’s *Jefes* program (a limited job guarantee program) and concludes that recent government attempts to dismantle the program in favor of *Familias* (designed for unemployed mothers with no work option) represent a huge step backward with respect to reducing gender inequality.

Three working papers under the Employment Policy and Labor Markets program are reviewed. Kregel provides a critical retrospective of Ragnar Nurkse’s contribution to development economics, written on the 100th anniversary of his birth. Hind Jalal reviews the effectiveness of Morocco’s *Promotion Nationale* public program in countering unemployment and developing its poorer provinces in the Sahara. The author finds that the program is one of the last remaining social stabilization tools to counter inequalities in the country, and that it could be improved to develop the poor (rural) areas. Zahra Karimi observes a rapidly increasing workforce combined with a lack of employment opportunities in Iran. She recommends government employment guarantee schemes that could be financed using the country’s Oil Stabilization Fund.

Under the Immigration, Ethnicity, and Social Structure program, a working paper by Senior Scholar Joel Perlmann analyzes the American Jewish Committee surveys and finds that American Jews favor compromise about proposed changes in the West Bank if the status of Jerusalem is excluded from the debate.

As always, I welcome your comments and suggestions.

Dimitri B. Papadimitriou, *President*

## Program: Monetary Policy and Financial Structure

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### Lessons from the Subprime Meltdown

L. RANDALL WRAY

Working Paper No. 522, December 2007

[www.levy.org/pubs/wp\\_522.pdf](http://www.levy.org/pubs/wp_522.pdf)

The current Big Government, neoconservative (neoliberal) economic model promotes deregulation, reduced supervision, privatization, and consolidation of market power, while favoring markets over banks. These features are biased against full employment and adequate growth to generate rising living standards, and the financial crisis in the housing sector is a prime example of the damage that can be done. According to Senior Scholar L. Randall Wray, the works of Hyman P. Minsky provide guidance for a more sensible model with enhanced oversight of financial institutions, along with monetary policy that stabilizes interest rates and controls credit. We turned home finance over to Wall Street, which operated the industry as if it were a casino, says Wray. It is time to rethink the New Deal reforms, to create new institutional constraints that will prevent “it” (the Great Depression) from happening again.

Wray reviews the origins of the current financial crisis whereby financial institutions made the supply of credit more elastic, the Federal Reserve (Fed) and policymakers allowed banks and thrifts to compete in the marketplace, and deregulation allowed increasingly risky innovations. According to Minsky, securitization was a response to policy (i.e., monetarism) initiated by former Fed Chairman Paul Volcker in 1979. Mortgages were packaged into a variety of risk classes with differential pricing, and regulated financial institutions could earn fee income for originating loans, assessing risk, and servicing the mortgages. Minsky argued that securitization reflected the globalization of finance and the relative decline of banks in favor of (unregulated) “markets.” Banks and thrifts moved the mortgages off their books, while investment banks purchased and securitized the mortgages prior to selling them to investors.

The investment banks paid ratings agencies for favorable ratings and developed models to show that interest earnings more than compensated for the risks.

The incentive structure of the mortgage originators enabled securities backed by subprime mortgages to receive the investment-grade ratings necessary for insurance and pension funds to buy them (credit enhancement). Risky mortgages were pooled and sliced into a variety of tranches to meet the risk and return profiles desired by investors, who seemed to show no reluctance to purchase securities with the riskiest underlying debt.

By 2000, the real estate financial market had become more fragile as the growth of securitization resulted in much higher leverage ratios. Home finance was an unsupervised, highly leveraged, and speculative activity that depended on continued real estate appreciation, and many loans (e.g., “Ninja” and “liar” loans) were Ponzi schemes in which payment commitments exceeded income.

Wray notes that home mortgage liabilities have risen faster than household real estate values, the number of vacant homes for sale has risen significantly, house prices are falling, and three million homeowners with subprime mortgages will face higher interest rates after resets over the next two years. He also notes that the value of subprime originations has grown from 8.6 percent to 20 percent of the market for total originations between 2001 and 2005, and that adjustable rate mortgages, the riskiest type of subprime mortgage, were favored among securitizers. Therefore, delinquency rates will worsen and the number of foreclosures and vacancies will increase.

No one knows who is bearing all of the risks. Since securitized mortgages are selling below face value, banks now face losses for loans they did not hold or originate. The top 10 global banks wrote off more than \$75 billion in bad loans in 2007, and problems are spilling over into the commercial paper and real estate markets, the money market funds, and local government finances. The impact on overall economic growth will be significant and could ultimately mean the loss of three million jobs. The fallout could dwarf that of the savings and loan industry crisis in the 1980s, which required a \$125 billion government bailout, warns Wray. Moreover, the current crisis continues to spread internationally, since everybody invested in the same assets and employed the same strategies.

It is difficult to project the impact of the subprime meltdown and the availability of credit as a rolling credit crunch hits subsequent markets and regions. The next shoe to drop could

be the downgrading of investment banks. It is clear that the Fed's recent rate reductions have more to do with financial and real estate markets than with "fundamentals," says Wray. Moreover, there is a fairly large body of evidence that housing downturns precede recessions. The household sector has spent more than its income and run up huge debts since 1996 (as outlined in several Levy Institute Strategic Analysis publications), so there could also be significant consumer retrenchment.

Wray outlines and comments on the current initiatives to deal with the financial crisis: the setting up of funds by the financial sector to maintain liquidity for mortgage securities and asset-backed commercial paper (it is unlikely that losses can be contained), lower interest rates (which will not help much), the growth of aggregate demand (spending programs and tax cuts are unlikely), the modification of mortgage terms (the recent "reform" of bankruptcy law must be amended to preserve homeownership and not to protect real estate speculators), placing a freeze on mortgage interest rates (needs to be retroactive, as "teaser rate" hybrid loans have already reset), creation of a government agency in line with Franklin D. Roosevelt's Home Owners' Loan Corporation to save small homeowners (refinance is preferable to foreclosure), counseling delinquent borrowers to prevent foreclosure, and a politically engineered solution. He notes that Minsky argued that a financial crisis is not the correct time to try to teach the markets a lesson.

Wray suggests some policy initiatives to prevent "it" from happening again: regulating mortgage originators (e.g., borrower incentive restrictions), limiting the marketing of value-at-risk models and hybrids to low-income borrowers and first-time buyers, simplifying loan disclosure terms, banning predatory lending practices, regulating mortgage brokers, balancing monetary policy between market discipline and government regulation, protecting holders of financial institution liabilities but not of equity, and avoiding the consolidation of financial institutions. He also suggests policy initiatives such as the temporary "nationalization" of failing institutions during the 1930s and as advocated by Minsky during the 1980s thrift crisis, along with the creation of community development banks.

## The Natural Instability of Financial Markets

JAN KREGEL

Working Paper No. 523, December 2007

[http://www.levy.org/pubs/wp\\_523.pdf](http://www.levy.org/pubs/wp_523.pdf)

The essence of Keynesian economics is that the expectation of uncertain future events determines present decisions to enter into economic activity. The most important question is not whether prices contain all information (as in the efficient markets hypothesis), but how to prevent the natural transaction failures caused by unforeseen future events from creating chronic instability.

Senior Scholar Jan Kregel explains how the business of banking has changed from *holding* assets (generating income from interest rate spreads) to *moving* assets—the traditional activity of brokers and investment banks. The role of banks as specialized evaluators of credit and providers of liquidity has been lost. Herein lies much of the explanation for the current round of instability, says Kregel. He concludes that the U.S. financial system is poised for a Minsky-Fisher style debt deflation (falling asset prices and defaults on debt) that further interest rate reductions will be powerless to stop.

An alternative to the classical approach (regulation) and the efficient markets paradigm (complete and perfect markets) regarding financial instability is Hyman P. Minsky's financial instability hypothesis—that periods of successful completion of financial commitments lead to an increasing uncertainty of completion; in other words, an endogenous process increases financial fragility. Fragility results from changes in the liquidity preferences of bankers and businessmen as represented by changes in the margins of safety required on liquidity creation produced by maturity transformation (maturity mismatching remains constant as bankers lend against ever riskier assets). Kregel notes that the New Deal legislation of the 1930s did little to eliminate the potential for financial fragility, but regulation may play a role in preventing the transformation of fragility into major instability, with a "Big Government" acting as spender-of-last-resort to support business and household balance sheets, and a "Big Bank" acting as lender-of-last-resort to support the financial institutions' balance sheets.

The U.S. financial system is "market based." There is an implicit financial structure in which firms' short-term financial liabilities are held in bank portfolios and their long-term liabilities are held in household portfolios, along with the banks'

short-term demand deposit liabilities. The mismatching of maturities that is supposed to be a source of instability does not appear on the balance sheet of financial institutions but is transferred to the investing public. Therefore, maturity mismatching cannot be the underlying cause of a breakdown in the financial system.

Kregel reviews the historical record of the 1920s and 1980s, and finds that in each case the basic cause leading to the breakdown in the U.S. financial system was the deterioration of asset quality held by financial institutions. The deterioration was linked to the excessively rapid expansion of bank resources due to international factors, as well as fraud and misrepresentation. The banks that failed had increased their ratio of loans and discounts to deposits, increased their lending to real estate, and maintained a higher ratio of equity to liabilities relative to the successful banks. The boom in bank stocks created cheap funding that was used to finance the boom in real estate, and the rapid increase in bank resources led to increased laxity in lending criteria. This progression resulted in a decline in asset quality when the growth rate of resources fell (a scenario that comes close to Minsky's definition of financial fragility). The fall in the rate of expansion in lending caused prices to fall and resulted in debt deflation. The change in liquidity preferences of banks, not maturity mismatching, stopped the creation of liquidity and caused fragility. This process is in operation today.

The New Deal banking and securities legislation of the mid-1930s changed the transmission process, restricting the lending practices of banks in order to control the transformation of fragility into instability and crisis. Since the mid-1980s, deregulation has eroded the limits of regulatory segmentation, so that the banking system now relies on the ability of its proprietary trading desks to generate profits and (Section 20) affiliates to produce fee and commission income. Furthermore, the Gramm-Leach-Bliley Financial Services Modernization Act of 1999 allows banks to engage in a much wider range of financial activities and to provide a full range of products and services without regulatory restraint. Banks are no longer the direct source of financing for businesses or households. They have become "originators" who create financial assets and sell them to subsidiaries, which in turn sell the assets in the capital market to nonbank financial institutions (e.g., pension funds, insurance companies, or the general public).

Asset securitization is the major tool used in moving assets off the banks' balance sheets. It is a technique that involves the

creation of an independent special-purpose entity that issues liabilities whose proceeds are used to acquire fixed income assets. Kregel outlines how asset securitization (and overcollateralization) is used to create a pool of noninvestment-grade assets that is then used to issue investment-grade securities. This technique produces fragility, as exemplified by subprime and Alt-A mortgages. The undervaluation of risk and the declining cushions of safety, combined with the overvaluation of potential returns and valuations, resemble a Ponzi scheme. Moreover, the credit rating agencies experience a Minsky-style decline in credit standards that reinforces the declining cushion of overcapitalization. Ultimately, issues of commercial paper are returned to the banks' balance sheets in order to avoid insolvency.

The model of funding long-term mortgage assets with short-term commercial paper is not restricted to the United States. Estimates of global bank risk exposure in asset-backed commercial paper are as high as \$900 billion. This exposure will likely result in a sharp upward spike in short-term interest rates in response to a dramatic decline in outstanding commercial paper, and an acute liquidity crisis.

The U.S. financial system is highly fragile, with narrow margins of safety and impaired liquidity due to the increased use of security affiliates. The stage is set for a typical debt deflation, and the damage will be widespread across a number of different sectors, says Kregel. The underlying assets will have to be sold in order to repay investors, and this response will take place in illiquid markets, leading to more rapid price declines. Lowering short-term interest rates has little impact in this environment. The government's proposed Super Special Purpose Entity may solve the problem of banks holding "senior" tranches, but it does not solve the problem of hedge funds holding the other tranches that may be worthless. The risk appears to be highly concentrated in core money-center banks, and these are, at present, increasingly unable to bear the risk. A remedy in line with the chartering of the Reconstruction Finance Corporation in 1932, along with reregulation of the system, seems to be the most efficient means to prevent "it" (the Great Depression) from happening again.

## Financialization: What It Is and Why It Matters

THOMAS I. PALLEY

Working Paper No. 525, December 2007

[www.levy.org/pubs/wp\\_525.pdf](http://www.levy.org/pubs/wp_525.pdf)

Financialization refers to the increasing importance of the financial sector in the operation of the economy and governing institutions. There are reasons to believe that financialization may put the economy at risk of debt deflation and prolonged recession. Research Associate Thomas I. Palley calls for a multifaceted agenda, including policy and political reform, to counter financialization.

According to Palley, conventional economic theory has played an important role in the promotion of financialization. It suggests that the expansion of financial markets enhances economic efficiency and it dismisses problems of financial speculation (i.e., speculation is stabilizing by driving prices back to levels warranted by fundamentals). Thus, managers are challenged to maximize profits on behalf of shareholders and to align their interests with those of financial market participants. The sole purpose of corporations is to maximize shareholder returns within the confines of the law.

The behavioral finance approach (e.g., rational expectations theory and the effect of noise traders) challenges the conclusions of conventional economic theory. Although critiques of conventional theory have shown that financial markets can generate inefficient outcomes, they have had little impact on conventional thinking about financial markets or the direction of policy. The belief that deregulation and the expansion of financial markets is welfare enhancing remains.

The financial sector in the United States has grown substantially, representing 20.4 percent of GDP in 2005. The defining feature of financialization has been an increase in the volume of debt. Total credit market debt outstanding increased from 140 percent to 329 percent of GDP between 1973 and 2005. Financial sector debt has grown much faster than nonfinancial sector debt, in particular, the increase in mortgage and household sector debt. Palley notes that average annual economic growth rates during the era of financialization (after 1979) have fallen in all countries except the United Kingdom. The headline changes in levels of debt and the composition of macroeconomic activity have been accompanied by changes in wages and in the distribution of income. In the United States, the wages of production and nonsupervisory workers have flat-

lined while productivity has grown, leading to rising income inequality.

The era of financialization has been marked by (1) a shift in income from labor toward capital, (2) a change in the composition of payments to capital that has increased the interest share, and (3) an increase in the financial sector's share of total profits. There is also evidence that there has been a shift in the wage share from workers to managers and an increase in wage inequality.

The influence of the financial sector works through three distinct conduits that also interact with one another: the structure and operation of financial markets, the behavior of nonfinancial corporations, and economic policy. Managerial stock option pay, the destruction of union power, and debt finance are examples of changes in corporate behavior that have led to increased dominance of the financial markets. Since 1980, when the pattern of new equity issuance turned negative, the stock market has been a net drain of finance. Corporate borrowing is now focused on equity buybacks rather than investment spending because of tax advantages (and leverage, which allows higher rates of return on equity), and this action has contributed to the rise in the debt-to-equity ratio.

The new economic policy framework endorses globalization (e.g., free trade, capital mobility, and the Washington Consensus development policy), small government (e.g., deregulation, tax cuts, and pension reform such as 401[k] retirement saving plans), labor market flexibility (i.e., weaker unions and the erosion of employment protections as well as employee rights), and the abandonment of full employment (macroeconomic policy has changed its priorities in favor of low inflation and central bank independence). The combination of increased access to credit and the new framework has created a new business cycle that is characterized by an overvalued dollar, trade deficits, low inflation, manufacturing job losses, asset price inflation, and rising household and corporate indebtedness.

The foundation of the new business cycle is a financial boom and cheap imports that support debt-financed spending combined with borrowing to fuel consumption and demand growth. The policy attitude toward a trade deficit is no longer deemed a serious problem. Moreover, asset prices have replaced real wages as a primary concern of monetary policy. For example, the Federal Reserve is obliged to prevent asset price declines resulting from the U.S. subprime mortgage crisis from inflicting broad macroeconomic damage.

Remedying the failings of financialization and the new business cycle requires a fundamental change of policy that restores an effective control over the financial markets. Palley suggests complementing interest rate policy with a new financial sector regulatory framework based on asset-based reserve requirements. He also calls for restoring full employment policy, allowing more policy space and equitable development in response to globalization, and reforming the labor market flexibility agenda.

Palley suggests three distinct policy agendas in order to deal with the corporations: (1) ensuring mainstream corporate accountability (e.g., reining in excessive CEO pay and realigning incentives within firms), (2) reframing the legal purpose and obligations of corporations to include the interests of stakeholders, and (3) aligning the incentives of money managers with the interests of savers in mutual funds. There is also a need for political reform, and a need to link politics and economic policy.

### **Financial Flows and International Imbalances—The Role of Catching Up by Late-industrializing Developing Countries**

JAN KREGEL

Working Paper No. 528, February 2008

[http://www.levy.org/pubs/wp\\_528.pdf](http://www.levy.org/pubs/wp_528.pdf)

Current international trade and financial imbalances across countries are exceptional by historical standards. Senior Scholar Jan Kregel reviews traditional balance-of-payments adjustment theory and finds that the theory does not apply to developing countries attempting to industrialize in the modern era. Multinational corporations operate global production chains that are financed by private institutions dealing in international financial markets. The lack of an effective adjustment mechanism has contributed to the creation of large international imbalances and to the importance of monetary variables such as relative wages, productivity, profit rates, and interest rates. The principal question is how to manage the imbalances and support the policies of developing countries so that they can integrate into the global trade and financial system.

Kregel reviews the international adjustment mechanisms associated with the gold standard, the dollar standard, and the Bretton Woods system. He notes that the dollar is a national currency whose supply depends on the U.S. external balance,

while gold is not a national currency and has a relatively inelastic supply. He also notes that the role of private financial institutions was retained under Bretton Woods, contrary to John Maynard Keynes's plan to eliminate private market-currency trading. The breakdown of the gold standard and the Bretton Woods system was due to the lack of a functional, symmetric adjustment mechanism combined with the ability of deficit countries to circumvent the multilateral adjustment process using private financial flows. Adjustment in response to the substantial increase in accumulated international imbalances came in the form of default in the 1980s and financial crisis (currency depreciation) in the 1990s.

Kregel questions whether there are any natural limits on the level of imbalances in a global system dominated by private international capital flows. Based on his review of the works of Keynes and Evsey Domar, he concludes that the limit on the size of the surplus is the point at which capital reversal and crisis occur when the capital markets are no longer willing to finance increasing deficits.

According to Kregel, developing countries in Asia have a de facto dual exchange rate policy—flexibility relative to the yen and euro, and relative stability with the dollar and within the Asian region. These countries acquire foreign technology and loans to support their export surpluses and achieve their domestic policy objectives. The trade surpluses are balanced by capital outflows that generate counterflows of capital service earnings, thus strengthening their current account balances. Lending is a substitute for public sector domestic or foreign borrowing that supports domestic expenditures and maximizes employment.

The inability of the International Monetary Fund to prevent financial and economic collapse led new developing countries to use their current account surpluses to build up foreign exchange reserves. Kregel questions the use of traditional measures associated with the cost of holding these excess reserves. He finds that it is more appropriate to compare the cost of excess reserves with the gain that accrues when labor transfers from rural to urban manufacturing employment. Current policies of developing economies appear to result in a net gain.

Kregel points out that China's regional trading position is markedly different from its major extraregional position. The country is running increasing surpluses relative to the United States and Europe, but nearly offsetting deficits with its regional trading partners. Contrary to diversifying investments away from the dollar, China and other Asian countries have diversi-

fied their holdings of dollar assets; in particular, nongovernment securities.

European policy is guided by inflation, public sector borrowing, and debt-to-GDP targets. Europe, therefore, cannot have a formal exchange rate policy, and it has adopted the same policies as Asia—net exports that support demand and employment. Since there is no operative international adjustment mechanism, it is preferable that the United States is the major debtor because it is the key currency country, which can always meet its obligations.

Traditional balance-of-payments accounting procedures presume that exports derive from vertically integrated production and may not be appropriate, says Kregel. International accounts emphasize the exchange of final goods and ignore the dominant role of interindustry trade, the increasing importance of semifinished intermediate goods, and the importance of private autonomous capital flows and their impact on factor service payments. The changes in the global structure of production within national firms have distorted recorded trade figures (i.e., inflating the rate of growth of trade volumes and values). These accounting problems are further complicated by the influence of national taxation regimes on the location of profit accruals.

For example, the U.S. external accounts do not reflect the increase in the export of technology that enhances the profitability of U.S. companies operating in the global market. According to the Bureau of Economic Analysis, the U.S. deficit on goods and services in 2005 was \$134.4 billion less than the \$716.7 billion deficit recorded in the conventional international accounts framework. Furthermore, direct exports of European goods to the United States have been increasingly displaced by the production and sale of goods produced by European affiliates operating in the United States (using imported semifinished inputs). Thus, currency depreciation is unlikely to have much of an impact on the European share of the U.S. bilateral deficit. Any analysis of the impact of international trade imbalances should realize that we do not have a good idea of the dimension of the problem, says Kregel.

## **Minsky's Cushions of Safety: Systemic Risk and the Crisis in the U.S. Subprime Mortgage Market**

JAN KREGEL

Public Policy Brief No. 93, 2008

[www.levy.org/pubs/ppb\\_93.pdf](http://www.levy.org/pubs/ppb_93.pdf)

The current crisis in the financial systems of developed countries is often explained in terms of Hyman P. Minsky's financial fragility hypothesis. Minsky was an economist at the Levy Institute and the foremost expert on credit crunches. His hypothesis was that the structure of a capitalist economy becomes more fragile over a period of prosperity; that is, endogenous processes breed financial and economic instability.

In this brief, Senior Scholar Jan Kregel explains how the current crisis differs from the traditional Minsky hypothesis. He reviews Minsky's concept of a margin or "cushion" of safety, financial fragility, and debt deflation. He concludes that, while the current subprime mortgage crisis involves both Ponzi financing and declining margins of safety, these conditions are not the result of endogenous processes. Rather, the crisis is the result of insufficient margins of safety based on how creditworthiness is assessed (the undervaluation and mispricing of risk) in the new "originate and distribute" financial system.

Contrary to the restrictions of the Glass-Steagall Act of 1933, the banking system that emerged from the 1980s real estate crisis was based on the ability of the banks' proprietary trading desks to generate profits, and on affiliates to produce fee and commission income. The Gramm-Leach-Bliley Act (1999) and Basel II (2004) further expanded the role and activities of banks.

Kregel reviews the choices that the new financial system offered lenders, such as the securitization of nonconforming mortgage loans (subprime and Alt-A loans), the creation of "special purpose entities," highly leveraged structured investment vehicles, adjustable rate mortgages, layering, and the transfer of credit risk. He also explains how the credit rating agencies have replaced bank loan officers and credit committees in determining the appropriate margins of safety. This feature represents one of the basic differences between the new banking model and Minsky's original analysis of declining safety margins.

The new financial system means that the current crisis will differ from Minsky's traditional explanation and mitigation of financial fragility. Credit evaluation no longer incorporates the accumulation of knowledge about borrowers over time in stable conditions, and investors are unable to adequately assess

credit-risk differences among investments. Moreover, the securitization structure has relied on a number of different risk classes of liabilities, leading to overcollateralization. Also, the credit rating agencies have assigned investment-grade ratings to securities backed by subprime mortgages that resemble Ponzi financing schemes. Thus, the narrowing of the margin of safety and the increase in fragility have been due to the composition of the pool of assets and defaults, not the behavior and credit history of borrowers.

In light of the unexpected increase in prime mortgage defaults, Kregel estimates that total credit losses among borrowers, creditors, and banks could be as high as \$900 billion. These losses would also have a significant impact on short-term money markets and consumer lending. The offset of an increase in exports due to the dollar's decline would not be sufficient to prevent a recession.

Kregel questions the ability of the Federal Reserve to ensure stability and control the growth rate of the money supply. He recommends that banking regulators find a way to bring off-balance-sheet (bank) affiliates under the effective control of financial supervisors. The task that confronts the U.S. financial system today is to eliminate fragility that emerges as a direct result of flaws in the structure and the regulation of the system itself.

## **Program: The Distribution of Income and Wealth**

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### **Earnings Functions and the Measurement of the Determinants of Wage Dispersion: Extending Oaxaca's Approach**

JOSEPH DEUTSCH and JACQUES SILBER

Working Paper No. 521, November 2007

[www.levy.org/pubs/wp\\_521.pdf](http://www.levy.org/pubs/wp_521.pdf)

In a pathbreaking paper, Ronald Oaxaca (1973) proposed a technique to decompose the relative wage gap between two population subgroups. Joseph Deutsch and Research Associate Jacques Silber, Bar-Ilan University, Israel, extend Oaxaca's approach to include any number of groups and to combine techniques used in the fields of income inequality measurement and labor economics (Mincerian earnings functions) that

can analyze the determinants of the overall wage dispersion over time. The authors are able to determine the exact impact of three elements (group differences in the average values of the explanatory variables, the coefficients of these variables in the earnings functions, and the unobservable characteristics) on the overall wage dispersion, the dispersion within and between groups, and the degree of overlap between the wage distributions of various groups.

The authors' empirical illustration uses data from income surveys in Israel in 1982, 1990, and 1998, and emphasizes the comparison between the earnings of new immigrants and the remainder of the population. They limit their analysis to the Jewish male population according to area of birth: Israel, Asia or Africa, and Europe or America (immigrating before and after 1972).

Deutsch and Silber note that several Western countries experienced increasing wage dispersion during the latter decades of the 20th century as a result of the greater demand for high-skilled labor due to increased trade openness (globalization) and skill-based technological change. They suggest that immigration and institutional factors (e.g., the size of the public sector) may play a role here. The authors also note that Israel experienced massive immigration in the late 1940s and the early 1990s, so supply-side effects should be important. The latter period was characterized by mass migration from the former Soviet Union and an influx of immigrants with an exceptionally high level of education. The authors expected that their analysis would show that the between-groups wage gaps would widen, and that they would be related more to differences in rates of return than human capital. Since Israel is an open and developed economy (where demand-side effects such as skill-based technological change play a role), the authors predicted that wage dispersion as a whole must have increased between the early 1980s and the late 1990s.

The authors provide a methodological framework to improve the estimate of the impact of immigration on wage dispersion and to compute the contribution of each population subgroup to the value of the three components of the overall wage dispersion (i.e., the between-groups dispersion, the within-groups dispersion, and the overlapping term). They find that the period of the 1980s was very different from the 1990s. There was a significant increase in the overall dispersion during the 1990s, and the wage gap between married and single men decreased significantly between 1982 and 1998.

Whereas the between-groups dispersion decreased, while the within-groups dispersion and the overlapping term increased during the 1980s, the between-groups dispersion increased and the overlapping term decreased during the 1990s. These changes may be explained by two factors: the increase in wage dispersion in several Western countries and massive immigration from the former Soviet Union, which increased the degree of stratification in Israeli society.

Deutsch and Silber analyze the respective roles played by the explanatory variables and their coefficients, and the unobserved characteristics, to the wage dispersion. It appears that, over time, the contribution of the explanatory variables increased in absolute value, while the contribution of unobserved characteristics did not vary much and the contribution of the regression coefficients was low and unstable. For the between-groups dispersion, only the explanatory variables and their coefficients play a role. For the within-groups dispersion, only the explanatory variables and the unobserved characteristics play a role. For the overlapping component, all three factors play a role.

The authors extend their analysis and show how it is also possible to decompose changes over time in the dispersion of wages and its components, in the 1990s, for example, more than half of the increase in the overall wage dispersion was the consequence of an increase in the contribution of the regression coefficients. They then explain how to compute the contribution of the different population subgroups to the three components of the overall wage dispersion and how to compute the contribution over time. The immigrants from Europe or America after 1972 played an important role in the changes associated with the dispersion of the regression coefficients, the relative size of the various groups, and the overlapping component. The increase in the overall wage dispersion between 1990 and 1998 was strongly connected to the increase in the between-groups dispersion, which was related to the dispersion of the regression coefficients following massive immigration.

## Program: Gender Equality and the Economy

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### Public Employment and Women: The Impact of Argentina's *Jefes* Program on Female Heads of Poor Households

PAVLINA R. TCHERNEVA and L. RANDALL WRAY

Working Paper No. 519, November 2007

[www.levy.org/pubs/wp\\_519.pdf](http://www.levy.org/pubs/wp_519.pdf)

Research Associate Pavlina R. Tcherneva and Senior Scholar L. Randall Wray examine Argentina's *Jefes* program in terms of its operations, macroeconomic effects, and impacts on program participants. They find that the program addresses important community problems and serves the needs of (poor) women particularly well. They conclude that recent government attempts to dismantle the program in favor of *Familias*, a government program for unemployed mothers with no work option, represents a huge step backward with respect to reducing gender inequality.

*Plan Jefes y Jefas de Hogar Desocupados* (Program for the Unemployed Male and Female Heads of Households) was implemented as a limited job guarantee program after Argentina's economic meltdown in 2001–02. By 2005, the program included two million workers (approximately 5 percent of the population, or 13 percent of the labor force) and women represented almost three-quarters of those participating.

Formal surveys indicate that the *Jefes* program is well targeted toward poor households with children, highly popular among participants, and provides needed services and infrastructure projects in poor communities (e.g., agricultural microenterprises, water and sewage systems, and food kitchens). The organization of projects by community activists not only provides a range of services but also enhances social cohesion and participation in community life. The authors note that limited entry into the program has prevented further reductions of unemployment and poverty rates because the program restricts participation to heads of household and provides income below the official poverty line.

The authors visited *Jefes* sites and interviewed participants and government officials in the urban and suburban areas of Buenos Aires in 2005. Their sites included a butcher shop, bakery, supermarket, sewing cooperative, agro-cooperative, and

multipurpose facility. They found that all participants preferred to work for wages rather than receive government transfer payments (welfare) without a work option. They also found that most women participating in the *Jefes* program would not find paid employment if the program were discontinued, because of the difficulty of transition to paid work in the formal private sector.

The authors further found that the government administrators believed that the *Jefes* program needed substantial reform in light of concerns such as corruption, insufficient training, allocation problems, program costs, and poorly designed and mismanaged projects. The government officials also noted dwindling political support for the program.

According to the authors, there appeared to be a bias regarding what is considered useful and productive. The government officials favor profit-making enterprises rather than socially beneficial activities, and a free market ideology that encourages moving people into formal paid work. Further reform involves phasing out the job creation component of *Jefes* and replacing it with a universal child allowance and limited-term unemployment insurance. The officials question whether Argentina possesses the institutions, resources, and infrastructure to create and manage projects such as *Jefes* on the required scale.

The government concerns are in stark contrast to the authors' observations. The authors, therefore, recommend a much wider range of indicators and alternative measures of outcomes to gauge program success. What seems to be lacking is an appreciation of the contribution that *Jefes* makes by "taking workers as they are" and giving them a chance to work, the authors say. Moreover, there seems to be a gender bias about the productivity and remuneration of "women's work." It is apparent that government officials are particularly unaware of the needs and desires of poor mothers.

The authors caution that the current "reform" will mean that many women will return to relative isolation within their substandard houses and communities. The success of *Jefes* projects, including the results of quality-of-life studies, should be publicized because there is a lack of understanding of the substantial benefits of the *Jefes* program.

## Program: Employment Policy and Labor Markets

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### Nurkse and the Role of Finance in Development Economics

JAN KREGEL

Working Paper No. 520, November 2007

[http://www.levy.org/pubs/wp\\_520.pdf](http://www.levy.org/pubs/wp_520.pdf)

Ragnar Nurkse was a theorist of economic development who questioned orthodox Ricardian trade theory as the basis for development policies. He believed that development was demand constrained and that "balanced" growth should support the industrialization of "undeveloped" economies. On the 100th anniversary of Nurkse's birth, Senior Scholar Jan Kregel provides a critical retrospective of his contribution to development economics; in particular, his views on the importance of employment policy in mobilizing domestic resources and the difficulties of using external resources to finance development.

According to Kregel, a review of Nurkse's theory might be beneficial in discovering the lacuna in the current mono-economics of development; that is, the belief that a single economic analysis can be applied to all economic problems. The Washington Consensus appears to align itself with the 19th-century development pattern of growth through trade, which is based on an optimal allocation through international market-driven comparative advantage. Kregel states that the idea that countries could develop on the basis of eliminating barriers to trade and liberalizing financial markets was not justified theoretically (e.g., the assumption that immobile productive factors such as capital and labor are fully utilized). Moreover, in response to changes in the international conditions in the 20th century (e.g., the mismatch between the growth of primary exports and population growth), it is imperative that developing countries find an alternative strategy to exports of primary commodities as determined by comparative advantage and financed by capital inflows from the industrialized countries.

Nurkse proposed that developing countries embark on a path of internally led growth through domestic industrialization. He recognized the presence of widespread "disguised unemployment" among a country's domestic resources that also represents the potential for "disguised saving." The problem is to create the inducements to mobilize the potential savings

for capital accumulation. Mobilizing the disguised unemployment into productive employment creates capital without reducing consumption or increasing saving via the multiplier and counters the notion that development is supply constrained.

Nurkse introduces the idea of “balanced expansion”—that investment in a range of activities will produce incentives in terms of sales and profits, and scale economies. The basic problem facing developing economies is the small size of the market due to low income levels. The solution is the general application of capital to a range of different industries, whereby people involved in complementary projects become each other’s customers (i.e., balanced growth creates externalities and provides internal markets for each sector of production) and the overall growth rate of output in accordance with domestic income elasticities creates a “virtuous circle of development.”

His analysis is built around the concept of “disguised” unemployment in agriculture and the ability of the agricultural sector to produce a surplus to provide demand for the industrial sector. Nurkse emphasizes the impact on demand of unequal wealth and income distribution between developed and developing countries, and the operation of the international adjustment mechanism. There is a natural tendency toward disequilibrium in the balance of payments between rich and poor countries that is caused by the difference between the poor country’s propensity to spend and its capacity to produce. Nurkse’s conclusion is that foreign investment does not have a role to play until the process of mobilizing disguised unemployment into capital accumulation is under way.

Nurkse notes that capital should be the focus of the factors of production. He also notes the reciprocal nature of the conditions facing the developed creditor country and the undeveloped debtor country. The creditor country must be willing to adopt a liberal commercial policy that allows the debtor country to access its markets. In terms of unilateral transfers, such as aid, these financial options should be used to support additional capital formation. Interregional income transfers is one mechanism to transfer resources from the rich to the poor.

Nurkse’s analysis provides an alternative to current mono-economics, which emphasizes the demand rather than the supply constraints to development. Kregel points out that mobilizing underutilized domestic labor resources is now reflected in official documents such as the 2005 Global Summit Declaration. He also notes that the Center for Full Employment and Price Stability, University of Missouri–Kansas City, proposes a statu-

tory program of guaranteed government employment as a mechanism in keeping with Nurkse’s recommendation to mobilize unemployed resources and to provide internal finances for the good of the community.

Although Nurkse’s export industrialization strategy has been followed by the most successful developing countries in Asia, this strategy may have to shift to more dependence on domestic market growth, says Kregel. The problem is how to shift from external to domestic demand-driven growth when high capital accumulation and savings are no longer necessary and Keynesian domestic demand policy becomes relevant.

### **Promotion Nationale: Forty-Five Years of Experience of Public Works in Morocco**

HIND JALAL

Working Paper No. 524, December 2007

[www.levy.org/pubs/wp\\_524.pdf](http://www.levy.org/pubs/wp_524.pdf)

Hind Jalal, Ministry of Economics and Privatization, Morocco, reviews the mandate and history of Morocco’s *Promotion Nationale* (PN) public program and its effectiveness in countering unemployment and developing the poorer provinces of the Sahara. Since the program budget now targets the nonpoor urban zones, she recommends ways that it can be improved to develop the poor (rural) zones. Jalal says that this program is one of the last remaining social stabilization tools to counter inequalities within Morocco.

PN was created in 1961 and is in charge of mobilizing the underemployed and unemployed labor force for the implementation of low capital-intensive projects (e.g., water resource management, roads, and reforestation). It aims to provide provisional employment, foster collective working methods, generate investments for infrastructure, develop rural facilities, and attenuate rural migration. PN projects employ approximately 50,000 persons per year, and women represent about 20 percent of those employed. Remuneration is indexed to the guaranteed agricultural and guaranteed interprofessional minimum wages. Projects are formulated at the local level, selected at the provincial level, and decided at the central (national) level.

PN acts through the main government programs, such as the communities program (public services), the equipment program (local infrastructure), the Saharan provinces program, the social priorities program (implementing the social development

strategy), the South provinces program (promoting employment), and the social proximity action program (targeting populations with special needs). The technical ministries are always associated with PN projects in order to guarantee quality. A fundamental aspect of the projects is to integrate public works within geographical and economic contexts—initiatives in urban areas, for example, focus on health care centers and park maintenance.

In the 1990s, employment in a PN project averaged the equivalent of US\$4 per day. Approximately 40 percent of jobs were in civil engineering works that were labor intensive and employed unskilled workers who were paid at the minimum wage. The general administrative expenses were very low (6 percent of investment costs) and the investment budget ranged from \$40 million to \$100 million. The higher budgets were in response to increased transfers to the rural zones during years of drought. Financing is ensured by the state budget through a special appropriation account.

Jalal notes that the direct effects of PN projects include the acceleration of monetization in the national economy, increased purchasing power in the marginal zones, improved education, lower costs relative to private company projects, deceleration of rural migration, and betterment of the environment. During the first two decades of the program, some projects upset the balance of traditional trade via localized inflation and threatened to destabilize the fragile agro-economic balance in rural areas. Jalal also notes that program expenditures at the provincial level show that some of the urban nonpoor zones receive much higher funding per capita than the poorest provinces. Moreover, 40 percent of the PN budget is now allocated toward the permanent employment of urban households, which runs counter to the program's aim to provide provisional employment. She further notes that human resources, such as welfare benefits and social protection, are the principal obstacles hindering PN actions today.

Jalal observes the need for better data from which to analyze the beneficiaries of PN projects (e.g., by gender), lower staff costs, provisional rather than permanent employment programs, reallocation of the communities program budget to the equipment of rural areas, and more targeting of poor populations. She notes that in 2008 PN intends to enroll the beneficiaries of its programs in Morocco's health insurance program, to ensure that individuals with no regular income have medical insurance.

## **Financing Job Guarantee Schemes by Oil Revenue: The Case of Iran**

ZAHRA KARIMI

Working Paper No. 527, January 2008

[www.levy.org/pubs/wp\\_527.pdf](http://www.levy.org/pubs/wp_527.pdf)

Generously subsidized loans to the private sector by state-owned banks have not been successful in generating sufficient employment opportunities for a rapidly increasing workforce in Iran. In 2006, three million persons—12.75 percent of the labor force—were unemployed, and the unemployment rate for women was more than 23 percent. In order to prevent a social disaster, Zahra Karimi, University of Mazandaran, Iran, recommends government employment guarantee schemes (EGS), which could be financed using the country's Oil Stabilization Fund.

The author notes that credit policy has been promoted as the most important mechanism in poverty alleviation and job creation—for example, in the 1990s—but it is inflationary. She also notes that according to Hyman P. Minsky, there is no internal mechanism in market economies to match jobs with people and therefore, government intervention is necessary to reach the goal of full employment. She further notes that many economists believe that EGS promotes pro-poor development. These schemes modify the economic growth path by including segments of the population that are excluded from productive employment, and reduce social and economic costs.

The rapid increase in unemployment after 1996 reflects a major shift in the composition and structure of both the demand and supply of labor. The expansionary policies of the government (e.g., subsidized loans to encourage private-sector investment) during the past two decades have had a negligible effect in reducing unemployment. Moreover, employment emergency measures have created a limited number of unstable jobs and caused inflationary pressures on the economy.

Iran's labor force is projected to increase at an annual rate of 3.4 percent during the country's Fourth Development Plan (2005–09). The economy must provide nearly 4.5 million new jobs by the end of 2009 to avoid an unemployment crisis, says Karimi. Rapid growth of the labor supply, increased capital mobility, and the accelerated pace of technological change pose serious challenges for the workforce.

During the current Plan, the central bank is obliged to use up to 3 percent of commercial banking reserves for financing

projects that create employment in the private sector. Job creation credits can be given to finance labor-intensive projects, establish small- and medium-size enterprises, motivate private sector investment in the deprived regions, and promote non-oil exports. State banks must finance investment of small enterprises whose plans are confirmed by provincial employment councils.

The banking system provided at least 50 percent of total deposits to small businesses in 2007, but there was widespread corruption in providing loans to small, influential groups and it is not clear how many jobs were actually created (there was no efficient mechanism to control the use of loans). A large part of the credits were used for real estate and did not create jobs (e.g., more than one-third of the total number of cooperatives registered to receive loans were inactive).

The Fourth Development Plan accentuates the basic rights to productive employment. The author maintains that EGS policy is applicable in Iran and that EGS employment will increase production and eradicate poverty in the poor, remote areas of the country. Moreover, EGS will stimulate private investment by increasing aggregate demand, improving the infrastructure, and providing job training.

According to the Plan, the government is allowed to use up to 50 percent of the Oil Stabilization Fund to invest in productive projects and encourage private entrepreneurship. Rising international oil prices allow the implementation of EGS without pressuring interest rates and private investment. The total cost would be less than \$5 billion and easily financed by the Fund. The complete package of programs represents less than 10 percent of government expenditures and less than 2 percent of GDP.

Karimi suggests that the first stage of EGS implementation should focus on the seven provinces with the highest unemployment rates, as well as labor-intensive infrastructure and maintenance works. All jobs would be part-time (five hours of work per day), temporary, and pay a monthly salary equivalent to US\$100, approximately half of the formal minimum wage. The short-term and relatively low-paid work would be offered to one person per family. Two million people could be employed in this scheme at any one time, and it would support the buffer stock of employment. Karimi expects that a significant number of women would participate in the scheme, similar to the *Jefes* program in Argentina. The experience in Argentina, as well as that in India, provides hope that EGS can be applied successfully in Iran.

The successful implementation of EGS requires close cooperation between the local government officials, especially town and village councils, and nongovernment organizations. The author warns that political manipulation of funds could be a major problem, so there should be transparency and accountability. Since there are few job opportunities for women in most economic sectors, it would be necessary to design jobs for them in health and elderly care centers and libraries, and in accounting.

## Program: Immigration, Ethnicity, and Social Structure

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### American Jewish Opinion about the Future of the West Bank: A Reanalysis of American Jewish Committee Surveys

JOEL PERLMANN

Working Paper No. 526, December 2007

[www.levy.org/pubs/wp\\_526.pdf](http://www.levy.org/pubs/wp_526.pdf)

There is little systematic research on American Jewish public opinion about the Arab-Israel conflict; in particular, the issue about the future of the West Bank, including East Jerusalem. Senior Scholar Joel Perlmann analyzes annual surveys carried out by the American Jewish Committee (AJC) during the 2000–05 period that show individual-level datasets. He finds that American Jews favor compromise about proposed changes in the West Bank (e.g., support for a Palestinian state and the dismantling of Jewish settlements) if the status of Jerusalem is excluded. With Jerusalem in the mix, however, their opinions are divided.

Perlmann notes that the AJC surveys are limited—there is an inadequate account of survey methods, questions need to be reworded or expanded, and only people who identify themselves as Jewish by religion are selected to participate. A major question for future surveys is how to treat the offspring of intermarried couples, who make up two-thirds of people with recent Jewish origins but who do not identify themselves as Jewish by religion.

Perlmann examines opinions about the West Bank in terms of seven basic background characteristics: Jewish (emotional) attachment, traditional religious orientation, general political

orientation, age, place of residence, gender, and household income. He also explores the associations with emotional attachment to Israel and concerns about Israel's vulnerability in the Middle East. He separates the views of Orthodox Jews from those of the rest of the population because of their strong sentiments against any proposed changes in the West Bank. Eliminating the Orthodox views, for example, shows that religious differences are strikingly less important in explaining the diversity of political opinion. More than 90 percent of American Jews are not Orthodox and their opinions vary relatively little *across* compared to *within* traditional categories of religious orientation.

A puzzling finding is that party affiliation has no impact on the acceptance of West Bank territorial compromise. In terms of place of residence, New York metro-area residents are moderately less likely than other non-Orthodox Jews to support the proposed West Bank changes. Men and people with higher household incomes are more likely to support the changes. When the four demographic and the three cultural-political characteristics are combined in a regression model, the coefficients remain virtually unchanged.

In terms of the non-Orthodox views, the author finds a weak negative association vis-à-vis traditional religious orientation and Jewish attachment, while the other factors matter to a moderate extent. The variable associations were found to align with expectations, with the exception of age. Perlmann hypothesized that age would be negatively associated with the acceptance of a West Bank compromise, but the association was statistically significant in a positive direction.

The combined impact of the explanatory variables appears to explain a modest proportion of the diversity of views. A substantial percentage of the diversity in non-Orthodox acceptance of proposed West Bank changes cannot be explained, however. The diversity of feeling about Israel's basic vulnerability or the respondents' emotional attachment to Israel might well be associated with the diversity of acceptance of proposed West Bank changes. However, there are no survey questions that deal directly with a concern about Israel's vulnerability.

Perlmann calls for more refined and systematic work on American Jewish opinion of the Arab-Israel conflict.

## INSTITUTE NEWS

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### Upcoming Event

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#### **17th Annual Hyman P. Minsky Conference Credit, Markets, and the Real Economy: Is the Financial System Working?**

April 17–18, 2008

Blithewood

Annandale-on-Hudson, New York

This year's conference focuses on the current economic and financial crisis in the U.S. and its effects on the world economy. Topics include: causes and consequences of the "Minsky moment"; the impact of the credit crunch on the economic and financial market outlook; dislocations and policy options; the rehabilitation of fiscal policy; margins of safety, systemic risk, and the U.S. subprime mortgage market; lessons from earlier times to rehabilitate mortgage financing and the banks; financial market regulation-reregulation; the inefficiency of computer-driven markets; currency markets fluctuations; and exchange rate misalignment.

The current conference program is outlined below. For registration information, visit [www.levy.org](http://www.levy.org).

#### **Preliminary Program**

##### **Thursday, April 17**

**9:00–10:00 a.m.**

##### **Breakfast and Registration**

**10:00–10:45 a.m.**

##### **Welcome and Introduction**

DIMITRI B. PAPADIMITRIOU, Levy Institute

**11:00 a.m. – 12:45 p.m.**

##### **Session 1**

##### ***Historical Precedent and Solutions to the Mortgage Market Crisis***

"Broken Systems: Agendas for Financial and Monetary Reform."

JANE D'ARISTA, Financial Markets Center

"Wizards of Oz? The Politics and Economics of Bailouts in the New Deal and Now." THOMAS FERGUSON, University of Massachusetts Boston.

“The Logic of the Bubble, the Logic of the Bust.” ALEX J. POLLOCK, American Enterprise Institute.

“Plans from the 1930s to Rehabilitate Both Mortgage Financing and the Banks.” WALKER F. TODD, American Institute for Economic Research.

**12:45–2:30 p.m.**

**Lunch**

**Speaker:** PAUL MCCULLEY, PIMCO

“A Reverse Minsky Journey”

**2:45–4:15 p.m.**

**Session 2**

***Minsky and the Crisis***

“Using Tools from the Financial Instability Hypothesis to Understand the Subprime Crisis.” JAN KREGEL, Levy Institute and University of Missouri–Kansas City.

“Minsky for More Than a Moment: Why You Can’t Get There from Here.” ROBERT W. PARENTEAU, MacroStrategy Edge.

“Financial Markets Meltdown: What Can We Learn from Minsky?” L. RANDALL WRAY, Levy Institute and University of Missouri–Kansas City.

**4:15–4:45 p.m.**

**Coffee Break**

**4:45–6:15 p.m.**

**Session 3**

***Impact of the Crisis on the Economic Outlook***

“Money and Credit Markets: Dislocations and Policy Options.”

RICHARD BERNER, Morgan Stanley.

BRUCE KASMAN, JPMorgan Chase\*

“Economic and Financial Market Outlook.” JAMES W. PAULSEN, Wells Capital Management.

“Financial Crisis: Prospect of a Second Wave.” FRANK VENEROSO, Veneroso Associates, LLC.

**6:30–7:15 p.m.**

**Reception**

**7:15 p.m.**

**Dinner**

**Speaker:** EDWARD CHANCELLOR, Grantham, Mayo, van Otterloo, LLC

“Hyman Minsky and the Great Moderation”

**Friday, April 18**

**9:00–9:30 a.m.**

**Breakfast**

**9:30–10:15 a.m.**

**Speaker:** JAMES K. GALBRAITH, Levy Institute and University of Texas at Austin

“The Generalized Minsky Moment”

**10:15–11:00 a.m.**

**Speaker:** ROBERT BARBERA, ITG

“Has Greenspan’s Conundrum Morphed into Bernanke’s Calamity?”

**11:00–11:15 a.m.**

**Coffee Break**

**11:15 a.m. – 12:45 p.m.**

**Session 4**

***Financial Market Regulation–Reregulation***

“Minsky’s ‘Ponzi’ Phase Is Descriptive, Not Metaphorical: The Epidemic of ‘Control Fraud’ That Hyperinflated the Housing and Mortgage Finance Bubbles.” WILLIAM KURT BLACK, University of Missouri–Kansas City.

ALAN S. BLINDER, Princeton University\*

“Unintended Consequences: The Inefficiency of Computer-driven Markets.” MARTIN MAYER, Brookings Institution.

**12:45–2:00 p.m.**

**Lunch**

**Speaker:** MAURICE HINCHEY, U.S. House of Representatives (New York)

“Weapons of Mass Economic Destruction”

\*Invited

## PUBLICATIONS AND PRESENTATIONS

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### Publications and Presentations by Levy Institute Scholars

**JAMES K. GALBRAITH** *Senior Scholar*

**Publications:** “Sons of Affluence,” review of *Consumed: How Markets Corrupt Children, Infantilize Adults, and Swallow Citizens Whole* by B. Barber and *Deep Economy: The Wealth of Communities and the Durable Future* by B. McKibben, *The Washington Monthly*, July–August 2007; “Global Inequality and Global Macroeconomics,” *Journal of Policy Modeling*, Vol. 29, No. 4, July–August; “Economic Equality and Victory in War: An Empirical Investigation” (with C. Priest and G. Purcell), *Defense and Peace Economics*, Vol. 18, No. 5, October; “Between-sector Earnings Inequality in the United States” (with T. Hale), UTIP Working Paper No. 43, December 10; “Is China Really Running a Trade Surplus?” (with S. Hsu and J. Li), UTIP Working Paper No. 45, December 30.

**Presentations:** “Death of the NAIRU,” Southern Economic Association Meeting, New Orleans, November 19, 2007; “The Evolution of Inequality in America and the World: New Facts for a Stalemated Debate,” The Frank M. Covey Jr. Loyola Lectures in Political Analysis, Chicago, February 5, 2008; “The Political-Economy of U.S.–China Relations,” conference on “The Revival of Political Economy,” Drew University, Madison, N.J., February 9.

**GREG HANNSGEN** *Research Scholar*

**Publication:** “The Welfare Economics of Macroeconomics and Chooser-dependent, Non–Expected Utility Preferences: A Senian Critique with an Application to the Costs of the Business Cycle,” *The Journal of Socio-Economics*, October 2007.

**JAN KREGEL** *Senior Scholar*

**Publication:** “Rethinking Debt Sustainability in the Context of the Millennium Development Goals,” *Banca Nazionale del Lavoro Quarterly Review*, Vol. 60, No. 242, September 2007.

**Presentations:** “Financial Innovation and Crises: A Post-Keynesian–Minskyan Perspective,” seminar on “Financial Crises in Capitalism: The Market Economy and Financial Crises, a Recurrent Theme,” organized by the Norwegian Institute for Strategic Studies (NORISS), ResPublica, and The

Other Canon, Siggerud, Norway, August 27; “Nurkse and the Role of Finance in Development Economics,” conference on “Ragnar Nurkse (1907–2007): Classical Development Economics and Its Relevance for Today,” Estonian Academy of Sciences, Tallinn, Estonia, August 31–September 1; “Financial Flows and International Imbalances: The Role of Catching Up by Late-industrializing Developing Countries,” presented at “Finance-led Capitalism? Macroeconomic Effects of Changes in the Financial Sector,” 11th Workshop of the Research Network Macroeconomic Policies, Berlin, Germany, October 26–27; “The Natural Instability of Financial Markets,” conference on “The Political Economy of Financial Markets: A Methodological Account of a Multidisciplinary Approach,” Tjalling C. Koopmans Institute, Utrecht, Netherlands, November 16; “Sovereign Wealth Funds: Stealthy State Socialism or Lender of Last Resort?,” conference on “Global Macro Economy: Imbalances or Passive Outcomes,” Valance Co., Christiansted, St. Croix, U.S. Virgin Islands, January 11, 2008; “Will the U.S. Recession Lead to Global Slowdown? What Role for China and India?,” workshop on “India, China, and the World Economy,” International Development Economics Associates (IDEAs), New Delhi, India, January 24; “Global Financial Flows: Financing for Development,” ActionAid/IDEAs Global Economic Literacy and Budget Accountability Practitioners Workshop, Gurgaon (New Delhi), India, January 27; “Minsky’s ‘Cushions of Safety’: Systemic Risk and the Crisis in the U.S. Subprime Mortgage Market,” seminar on “Economic Structures, Growth, and Development,” Centre for Economic Studies and Planning, Jawaharlal Nehru University, January 31; “Savings Gaps, External Resources, and Debt Crises in Latin America: Towards a New Model of Development in Latin America,” conference on “The Revival of Political Economy,” Drew University, Madison, N.J., February 9.

**THOMAS MASTERSON** *Research Scholar*

**Presentation:** “Gender Bias in Household Expenditures on Food and Education in Paraguay, 2001,” Allied Social Science Associations Meeting, New Orleans, January 4–6.

**DIMITRI B. PAPADIMITRIOU** *President*

**Publications:** Hyman P. Minsky bibliographic entry, *International Encyclopedia of the Social Sciences*, 2nd edition, W. A. Darity Jr., ed., Detroit: Macmillan Reference USA, 2008; Introduction (with L. R. Wray), *Stabilizing an Unstable*

*Economy and John Maynard Keynes* by H. P. Minsky, New York: McGraw-Hill, 2008.

**Presentations:** Keynote speaker, 12th Regional Seminar for Labor-based Practitioners, “Prioritising Employment Creation in Government Policies, Programmes, and Investments,” sponsored by the International Labour Organization, Durban, South Africa, October 8–12, 2007; speaker, 11th Research Network Macroeconomic Policies Workshop, “Finance-led Capitalism? Macroeconomic Effects of Changes in the Financial Sector,” Berlin, Germany, October 26–27; interview regarding Federal Reserve rate cuts with Nicholas Rummell, *Financial Week*, November 30; interview regarding the declining markets in the United States and overseas despite Federal Reserve rate cuts with Paul Kirby, *Daily Freeman* (Kingston, N.Y.), January 22, 2008; interview regarding Federal Reserve supervisory and regulatory authority with Craig Torres, *Bloomberg*, January 24; interview regarding the economy and recession with Sarah Bradshaw, *Poughkeepsie Journal*, January 29; interview regarding economic issues and the presidential primary with Laura Mandaro, *MarketWatch*, February 4; interview regarding the economics and finance dual-degree program at Bard College with Alison Damast, *BusinessWeek*, February 7; interview regarding Basel II and securitization with Marine Cole, *Financial Week*, February 12; interview regarding the economic timelines for the presidential frontrunners with Lenny Broymann, *RiskCenter*, February 22.

**JOEL PERLMANN** *Senior Scholar*

**Publication:** *Italians Then, Mexicans Now: Immigrant Origins and Second-generation Progress, 1890 to 2000*, paperbound ed., New York: Russell Sage Foundation and Annandale-on-Hudson, N.Y.: The Levy Economics Institute, 2007.

**Presentations:** Lecture on *Italians Then, Mexicans Now* and workshop on the use of the IPUMS census database, Teaching American History Professional Development Project, Bristol Community College, Massachusetts, November 19, 2007; “Americans of Jewish Origin in an Era of Inter-marriage: An Overview,” conference on “Social Statistics and Ethnic Diversity: Should We Count, How Should We Count, and Why?,” Université du Québec à Montréal, Canada, December 6–8.

**EDWARD N. WOLFF** *Senior Scholar*

**Publications:** “Introduction and Comments,” Part V, *Entrepreneurship, Innovation, and the Growth Mechanism of the*

*Free-Enterprise Economies*, E. Sheshinsky, R. J. Strom, and W. J. Baumol, eds., Princeton, N.J.: Princeton University Press, 2007; “Racial and Ethnic Differences in Wealth” (with M. Gittleman), in *Race and Economic Opportunity in the Twenty-First Century*, M. Kim, ed., New York: Routledge; “Rate of Profit” and “Inequality, Wealth,” in *International Encyclopedia of the Social Sciences*, 2nd edition, W. A. Darity Jr., ed., Detroit: Macmillan Reference USA, 2008; review of *Capitalism Unleashed: Finance, Globalization, and Welfare* by A. Glyn, *Economic Journal*, Vol. 118, February.

**Presentations:** “How Well-Off Are America’s Elderly? A New Perspective” (with A. Zacharias), Allied Social Science Associations Meeting, New Orleans, January 4–6.

**AJIT ZACHARIAS** *Senior Scholar*

**Presentations:** “Gender Disparities in Employment and Aggregate Profitability in the United States” (with M. Mahoney), “Caste and Wealth Inequality in India” (with V. Vakulabharanam), and “How Well-Off Are America’s Elderly? A New Perspective” (with E. N. Wolff), Allied Social Science Associations Meeting, New Orleans, January 4–6.

**GENNARO ZEZZA** *Research Scholar*

**Presentations:** “U.S. Growth, Households Debt, and the Distribution of Income,” 4th International Conference on Developments in Economic Theory and Policy, Bilbao, Spain, July 5–6, 2007; 11th Research Network Macroeconomic Policies Workshop, “Finance-led Capitalism? Macroeconomic Effects of Changes in the Financial Sector,” Berlin, Germany, October 26–27; and conference on “The Institutional and Social Dynamics of Growth and Distribution,” Lucca, Italy, December 10–12.

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