Levy Economics Institute of Bard College

Summary

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Contents

Continued on page 3 ▸

Scholars by Program

The State of the US and World Economies

DIMITRI B. PAPADIMITRIOU, President and Program Director
JAMES K. GALBRAITH, Senior Scholar
JAN KREGEL, Senior Scholar
L. RANDALL WRAY, Senior Scholar
GREG HANNSGEN, Research Scholar
GENNARO ZEZZA, Research Scholar
MARSHALL AUERBACK, Research Associate
CLAUDIO H. DOS SANTOS, Research Associate
JESUS FELIPE, Research Associate
MICHAEL HUDSON, Research Associate
ROBERT W. PARENTEAU, Research Associate

Monetary Policy and Financial Structure

JAN KREGEL, Senior Scholar and Program Director
DIMITRI B. PAPADIMITRIOU, President
PHILIP ARESTIS, Senior Scholar
JAMES K. GALBRAITH, Senior Scholar
L. RANDALL WRAY, Senior Scholar
MARSHALL AUERBACK, Research Associate
JÖRG BIBOW, Research Associate
STEVEN M. FAZZARI, Research Associate
JESUS FELIPE, Research Associate
MICHAEL HUDSON, Research Associate
THOMAS I. PALLEY, Research Associate
ROBERT W. PARENTEAU, Research Associate
SUNANDA SEN, Research Associate
WILLEM THORBECKE, Research Associate
ÉRIC TYMOIGNE, Research Associate

The Distribution of Income and Wealth

JAMES K. GALBRAITH, Senior Scholar
EDWARD N. WOLFF, Senior Scholar
DIMITRI B. PAPADIMITRIOU, President
AJIT ZACHARIAS, Senior Scholar
SELCUK EREN, Research Scholar
THOMAS MASTERSON, Research Scholar
BARRY BLUESTONE, Research Associate
ROBERT HAVEMAN, Research Associate
CHRISTOPHER JENCKS, Research Associate
SUSAN E. MAYER, Research Associate
BRANKO MILANOVIC, Research Associate
JACQUES SILBER, Research Associate
BARBARA WOLFE, Research Associate

Gender Equality and the Economy

RANIA ANTONOPOULOS, Research Scholar and Program Director
DIMITRI B. PAPADIMITRIOU, President
KIJONG KIM, Research Scholar
NILÜFER ÇAĞATAY, Research Associate
LEKHA S. CHAKRABORTY, Research Associate
PINAKI CHAKRABORTY, Research Associate
VALERIA ESQUIVEL, Research Associate
INDIRA HIRWAY, Research Associate
TAMAR KHITARISHVILI, Research Associate
FERIDOON KOOHI-KAMALI, Research Associate
EMEL MEMIS, Research Associate
IMRAAN VALODIA, Research Associate
TAUN TOAY, Research Analyst

Employment Policy and Labor Markets

DIMITRI B. PAPADIMITRIOU, President
JAMES K. GALBRAITH, Senior Scholar
JAN KREGEL, Senior Scholar
L. RANDALL WRAY, Senior Scholar
RANIA ANTONOPOULOS, Research Scholar
MARSHALL AUERBACK, Research Associate
VALERIA ESQUIVEL, Research Associate
MATHEW FORSTATER, Research Associate
FADHEL KABOUB, Research Associate
PAVLINA R. TCHERNEVA, Research Associate

Immigration, Ethnicity, and Social Structure

JOEL PERLMANN, Senior Scholar and Program Director
DIMITRI B. PAPADIMITRIOU, President
YUVAL ELMELECH, Research Associate
YINON COHEN, Research Associate
SERGIO DELLAPERGOLA, Research Associate
SANJAYA DESILVA, Research Associate
BARBARA S. OKUN, Research Associate
SEYMOUR SPILERMAN, Research Associate

Economic Policy for the 21st Century

JAMES K. GALBRAITH, Senior Scholar
DIMITRI B. PAPADIMITRIOU, President
RANIA ANTONOPOULOS, Research Scholar
PHILIP ARESTIS, Senior Scholar
MARSHALL AUERBACK, Research Associate
WILLIAM J. BAUMOL, Research Associate
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BARRY BLUESTONE, Research Associate
ROBERT E. CARPENTER, Research Associate
LEKHA S. CHAKRABORTY, Research Associate
PINAKI CHAKRABORTY, Research Associate
SANJAYA DESILVA, Research Associate
STEVEN M. FAZZARI, Research Associate
MATHEW FORSTATER, Research Associate
GREG HANNSGEN, Research Scholar
THOMAS KARIER, Research Associate
STEPHANIE A. KELTON, Research Associate
WILLIAM H. LAZONICK, Research Associate
MARY O'SULLIVAN, Research Associate
ROBERT W. PARENTEAU, Research Associate
JAMES B. REBITZER, Research Associate
MALCOLM SAWYER, Research Associate
WILLEM THORBECKE, Research Associate
W. RAY TOWLE, Research Associate and Editor
ÉRIC TYMOIGNE, Research Associate
L. RANDALL WRAY, Senior Scholar
AJIT ZACHARIAS, Senior Scholar

Equality of Educational Opportunity in the 21st Century

ELLEN CONDLIFFE LAGEMANN, Senior Scholar and Program Director
DANIEL KARPOWITZ, Research Associate

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.

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Contents (continued)

LETTER FROM THE PRESIDENT

To our readers:

This issue begins with two working papers by Research Associate Sunanda Sen under the State of the US and World Economies program. The first is a literature survey where she notes that trade theory has contributed to uneven power relations between rich and poor countries. The second finds that China's trade integration with the rest of Asia is a favorable factor in withstanding a potential collapse in its traditional export markets, but capital flows with the advanced economies make China vulnerable to outside shocks and sudden capital flight. In a third working paper, Jesus Felipe and Utsav Kumar analyze unit labor costs in the eurozone and disagree with notions that the region's competitiveness should be regained by decreasing the nominal wage rate. The most sensible option is a greater role for fiscal policy to develop more sophisticated (export) products.

The Monetary Policy and Financial Structure program begins with a brief (and includes an associated working paper) by Scott Fullwiler and Senior Scholar L. Randall Wray. They review the roles of the Fed and Treasury in the context of quantitative easing (QE) and find that the crisis has exposed the limited oversight of Congress and the limited transparency of the Fed. They conclude that the Fed has not learned how to efficiently implement monetary policy, and that policymakers should support a greater role for sustained fiscal policy. In a policy note, Research Associate Marshall Auerback uses the sectoral balances model devised by our late Distinguished Scholar Wynne Godley to determine that Germany would save its banking system, but destroy its export base and incur much larger budget deficits, if it reembraced the Deutschmark and regained its fiscal freedom.

There are seven additional working papers under this program. Research Associate Pavlina R. Tcherneva reviews Federal Reserve Chairman Ben Bernanke's contradictory views on government spending and finds that he is unable to reconcile the mainstream view of government finance with traditional crowding-out arguments. In two other papers, Tcherneva calls for a fundamental reorientation of fiscal policy toward closing the labor-demand gap rather than the output gap (by direct job creation) and incorporating objectives such as full employment, better income distribution, and poverty alleviation. Research Associate Éric Tymoigne proposes a regulatory framework and underlying philosophy that centers on the detection of financial fragility and on proactive policies with a strong supervisory component. Research Associate Michael Hudson finds that QE is a form of financial aggression that can only be mitigated by erecting capital controls that block foreign speculators from deranging the currency and financial markets. In our examination of debt limits and unlimited spending by the US government, Research Scholar Greg Hannsgen and I argue that there are few "affordability" constraints on further Keynesian stimulus or government debt. Also, we concur with Hudson about the merits of capital controls; the greatest need at a time of economic stagnation is to adjust the global economy toward full employment and away from deflation. In another paper, Wray builds a theory on money and links his theory to common themes in the heterodox literature.

In a working paper under the Immigration, Ethnicity, and Social Structure program, Senior Scholar Joel Perlmann explores how demographic factors affected German immigrants, with a focus on intermarriage across four generations. In another paper, he focuses on the key researchers within the US Immigration Commission and the US Census Bureau who determined the meaning of race, country of origin, and mother tongue for US immigrants.

The Economic Policy for the 21st Century program includes four working papers. Felipe, Kumar, and Arnelyn Abdon examine India's export basket and find that it is both more sophisticated and more diverse than expected for a country at its stage of development. In a second paper, they empirically analyze exports worldwide and find that most countries are in a low product trap. Timothy Azarchs and Research Associate Tamar Khitarishvili study the "resource curse" and find that resource abundance contributes positively to resource dependence and export dependence has no significant empirical effect on economic growth. Felipe and John McCombie conclude that many assumptions, theories, and statistical techniques underlying Neoclassical economics cannot be applied toward understanding the Chinese economy.

As always, I welcome your comments and suggestions.

Dimitri B. Papadimitriou, *President*

Program: The State of the US and World Economies

International Trade Theory and Policy: A Review of the Literature

SUNANDA SEN

Working Paper No. 635, November 2010

Research Associate Sunanda Sen provides a survey of the literature on trade theory—from the classical example of comparative advantage to the New Trade theories (NTT) used by many advanced countries to direct industrial policy and trade. She concludes that the evolution of trade theory has impacted policy at two levels. The first relates to the free-trade doctrine of developed countries and multilateral institutions, such as the International Monetary Fund (IMF) and the World Trade Organization (WTO). The second relates to policies that rely on NTT. Sen notes that trade theory has contributed to uneven power relations between rich and poor countries, and policymakers have neglected the macroeconomic issues at both the national and international levels.

Adam Smith and David Ricardo formulated free-trade theories based on England's success in the fields of industry and trade, and as a route to production efficiency worldwide. Commodity specialization with comparative advantage in terms of labor per unit of output ensured mutually gainful trade between nations. Subsequent theories introduced the role of demand and replaced the Ricardian notion of fixed labor–time inputs with "real costs," under the assumption that all costs are irreversible.

The Austrian school provided the basis for the Herkscher-Ohlin (and later Samuelson) (HOS) version of the free-trade doctrine. The balancing act between the forces of supply and demand was incorporated within the notion of opportunity costs (defined in terms of the utility of foregone consumption). This theory used the concept of marginal rates and turned the classical theory of trade on its head, observes Sen. At this time, the defense of free trade was based on the belief that it was Pareto-optimum; that is, optimizing production, consumption, and exchange between trading partners at equilibrium. This version of neoclassical trade theory appeals to economists championing free trade today.

The neoclassical economists set the stage for the factor endowment–based theory of free trade, where consumer preference or demand was determined by commodity and factor prices at the pretrade stage. Thus, disparities in factor endowments determine the price competitiveness of traded goods, and the equalization of commodity prices leads to the equalization of factor prices across countries (currency differences were ignored). The HOS model failed to address the real world, says Sen, so a reinterpretation was needed to validate its central argument relating to factor-price equalization.

NTT introduced three deviants—scale economies, imperfect markets, and product differentiation—that set it apart from the old trade models of the HOS variant and negated the capacity of the HOS model to predict patterns of trade based on pretrade commodity and factor prices. Imperfect markets with the potential for reciprocal (subsidized) dumping of exports led to the notion of "strategic trade," which gained currency in public policy during the 1980s (especially in the United States). This led to the notion that governments should intervene to shift resources from "sunset" to "sunrise" industries in order to generate high value–added products.

But NTT as well as the traditional doctrines failed to address the dynamic implications of trade (e.g., changing income distributions) and the uneven development of trading nations. Terms of trade resurfaced in the literature as a powerful tool to demonstrate trade inequities for developing countries (e.g., the core-periphery distinction). According to Sen, liberalization generated some specific tools for policymakers that would justify deregulation in the global economy, but there were a number of problems associated with this approach.

The "product-lifecycle" (PLC) theory of (technology-driven) foreign trade incorporates both product differentiation and market imperfections. The basic premise of PLC and other neotechnology models rests on the transfer of technology across countries, and it seems to provide a platform for an integrated approach to trade, technology, and foreign direct investment. While earlier trade models were location-specific, PLC theory introduced product-specific characterizations and organization-specific factors.

In Sen's view, advances in trade theory have not kept pace with the issues guiding policy in developing countries, and they fail to provide guidelines that avoid conflicting interests in trade. Furthermore, unemployment and an oversupply of domestic goods are seen to be related to labor-market distortions, cheap foreign goods, or overvalued currencies. Little attention is paid to deficiencies in domestic demand.

Sen notes several discriminatory practices associated with global trading regimes such as regional trading blocs (e.g., NAFTA and the European Union) and trade exemptions within GATT. In addition, there are unfulfilled promises associated with the Doha Development Round (2001) in terms of market access to the advanced countries (e.g., agricultural products). The clock has been turned back, says Sen. Trade liberalization is operating in the developing countries but not in the developed countries, where protectionist subsidies rule. Furthermore, the IMF, World Bank, and Bank for International Settlements continue to exercise control and impose regulations in the interest of finance, which significantly impacts world trade.

www.levyinstitute.org/pubs/wp_635.pdf

China in the Global Economy

SUNANDA SEN

Working Paper No. 642, December 2010

The integration of China in the global economy has raised concerns about the first- and second-round effects of the economic downturn on that country. China's unique position as a developing country stems from its large volume of exports and trade surplus, its investment links and imports of intermediate goods from other Asian countries, and its stable financial sector.

Research Associate Sunanda Sen traces China's (changing) pattern of trade and finds that its entry into the global financial market can be defined by two distinct phases: a pre-2005 period of relatively strict controls, followed by a period of relaxed controls and regulations. According to Sen, the earlier period represents an example of "guided finance"—financial sector liberalization with close state monitoring. She finds that trade integration has been directed more to the rest of Asia than to the advanced industrial countries, a potentially favorable factor in withstanding a collapse in its traditional export markets. However, capital flows remain closely integrated with the financial markets of advanced economies, making China vulnerable to outside shocks and sudden capital flight.

China's global integration is the result of exports and foreign direct investment (FDI), which contribute to output, employment, and foreign exchange; and short-term capital flows. Its trade pattern has changed dramatically since 1990 and now favors the developing countries, with the rest of Asia becoming a major export destination and import source. The United States continues to contribute the most to China's trade surplus and even finances China's deficits with other countries. Nevertheless, the value of goods exported in 2009 was down 16 percent, while imports decreased 11 percent. Thus, a recession in the advanced economies impinges heavily on exports and China's accumulation of official foreign exchange reserves. Nevertheless, reserves were up 18 percent (2008–09) and exceeded $2.13 trillion as of June 2009.

Despite an upward appreciation of the renminbi-dollar exchange rate since 2005, hot-money flows into China have been revived due to the near-zero interest rate policy in the United States, combined with a moderate drop in the dollar exchange rate. This has compelled China to reactivate its credit restraints, including higher reserve ratios and open-market policies in the bond market (interest rates have not been used as a tool of monetary management). Although China cannot dictate its own monetary policy, it has withstood a 40 percent drop in export earnings by means of credit and fiscal expansions. And despite having access to the securities market, state-owned enterprises continue to rely on banks rather than the stock market for finance, while Chinese banks are closely guided by the State Committee.

Stock market capitalization (net of nontradable shares) as a percentage of GDP has been low compared to countries such as Korea, Malaysia, and Singapore. Stock exchanges in Shanghai and Shengen began with a bifurcated structure in terms of distinct share categories (e.g., A-shares denominated in renminbi and B-shares denominated in dollars) and were driven by the domestic banks and FDI, which benefited industry and finance. So far, the stock market has been very volatile and has little to do with fundamentals.

China's high export-to-FDI ratio (10) has persisted throughout the 2000–07 period. However, exports are likely to face a second-round shock if FDI flows, which are important to China's gross domestic capital formation, falter as a result of the crisis. The country's regulatory institutions for banking, securities, and insurance have wide-ranging powers that allow them to keep a close vigil on the functioning of both finance and industry (a reminder of segregated banking and the Glass-Steagall Act in the United States).

Like other developing countries, China faces the "impossible trilemma": managing its exchange rate with a monetary policy of (open) capital mobility and national autonomy. Concerns about the trade-displacing effects of cheap exports appear exaggerated, says Sen, because China is also a large importer, especially of intermediate goods. The growing alliance between China and other Asian countries portends a decoupling tendency between the developed and developing nations. And government spending seems to be functioning better, as China uses expansionary fiscal policy ($586 billion) to bolster domestic demand and counter shrinking export demand. This response is helping to avert another global recession, but it is unclear how such government spending is helping the "jobless recovery" or the situation of migrant workers.

www.levyinstitute.org/pubs/wp_642.pdf

Unit Labor Costs in the Eurozone: The Competitiveness Debate Again

JESUS FELIPE and UTSAV KUMAR

Working Paper No. 651, February 2011

Policy discussions about regaining competitiveness in the eurozone have focused on unit labor costs (and a decrease in the nominal wage rate). According to Jesus Felipe and Utsav Kumar, Asian Development Bank, Manila, Philippines, the debate overlooks the lack of empirical evidence concerning the (supposed) relationship between unit labor costs and output (e.g., Kaldor's paradox). Using aggregate data to calculate unit labor costs for a particular country is misleading, they say, because there is no physical equivalent of output (value added is used instead). The most sensible option to counter the current crisis is reform that allows a greater and more active role for fiscal policy to upgrade production, particularly for the PIIGS (Portugal, Ireland, Italy, Greece, and Spain).

Kaldor's paradox states that countries with the greatest decline in price competitiveness (i.e., the highest increase in unit labor costs) also experience the greatest increase in market share. As a result, the belief that low nominal wage growth vis-à-vis productivity will restore competitiveness is too simplistic, say the authors, and a decrease in the nominal wage rate is not a solution to the current crisis.

Felipe and Kumar analyze 12 countries in the eurozone for the 1980–2007 period. They find that unit labor costs increased at a greater pace than labor productivity in all countries (due to an increase in the price deflator for calculating labor productivity). Moreover, unit labor costs in the PIIGS increased at a faster rate than in Germany. And since Germany's (complex) export basket is significantly different from that of most southern European countries, any comparison of aggregate unit labor costs is misleading. The problem is that these countries are trapped into using midlevel technologies. Thus, wage reduction will not solve the problem.

Parallel to the notion of unit labor costs, the authors define unit capital costs (the ratio of the nominal profit rate to the productivity of capital). With the exception of Greece, they find an increasing share of capital in the total value added for nine countries (and a constant share in Belgium and Portugal). The finding that unit capital costs increased faster than unit labor costs has important macroeconomic implications. It indicates that the "loss of competitiveness" by some countries is not just a question of nominal wages increasing faster than labor productivity. Rather, nominal profit rates decreased at a slower pace than capital productivity. Moreover, the nontradable sector of economies has been gaining on the tradable sector.

The problem with using unit labor costs as a policy variable is that competitiveness is considered from the firm's point of view; analyses of unit labor costs and real wages may send different signals. Using real average labor compensation data as a proxy for real wages, the authors find that unit labor costs increased faster than "real wages." They also find that labor productivity grew faster than real wage rates in all countries with the exceptions of Greece and Portugal.

At the theoretical level, a higher labor share does not necessarily lead to a less competitive economy. The relationship between labor share and growth is more complex (and probably nonlinear). What happens when the distribution of income shifts toward capital (as in most of the eurozone)? Although there is an initial increase in investment, a prolonged income shift toward capital will induce a mismatch between supply and demand, and a decline in consumption, capacity utilization, income, production, and employment (an underconsumption crisis). In contrast, a wage-led economy (with higher real wage rates or labor share) stimulates demand and leads to an increase in the equilibrium capacity utilization rate, the growth rate of capital stock, and economic growth. Thus, policies that reduce unit labor inputs lead to a sharp decline in domestic demand—an outcome that is overlooked in policy discussions.

One policy option for the eurozone is to implement across-the-board austerity programs (internal devaluation) that reduce the wage bill and workers' benefits, which may stabilize the economy but at the expense of a painful recession. If this option is adopted, firms should share the burden by acknowledging that unit capital costs have increased significantly. An alternative is to exit the euro and return to a national currency system, but this is unlikely to be politically feasible. A third possibility that has the support of the authors is a greater role for fiscal policy, including a (long-term) strategy where the PIIGS replicate Germany in terms of developing more sophisticated (export) products.

www.levyinstitute.org/pubs/wp_651.pdf

Program: Monetary Policy and Financial Structure

It's Time to Rein In the Fed

SCOTT FULLWILER and L. RANDALL WRAY

Public Policy Brief No. 117, 2011

In this brief, Scott Fullwiler, Wartburg College, and Senior Scholar L. Randall Wray review the roles of the Federal Reserve and the Treasury in the context of quantitative easing (QE). They find that the crisis has highlighted the limited oversight of Congress and the limited transparency of the Fed. And since a Fed promise is ultimately a Treasury promise that carries the full faith and credit of the US government, the question is whether the Fed should be able to commit the public purse in times of national crisis.

According to the authors, the Fed has not learned how to efficiently implement monetary policy. QE can only work through price effects, not through quantity, and it is probable that a second round—QE2—could be deflationary. Since fiscal policy is the only possible engine of growth to lead an economic recovery, policymakers must rely on domestic measures to reverse job loss. Otherwise, there is a real danger that the United States will slip back into recession.

When the global financial crisis began in 2007, the Fed provided liquidity and created extraordinary standing facilities, which provided short-term credit in the money markets. The Treasury also intervened to provide funds and guarantees. Though the total amount of government commitments is estimated at more than $20 trillion, only a very small portion was explicitly approved by Congress, and much of the detail surrounding these commitments is unknown.

The Fed's focus on fighting inflation seems to have diverted attention away from its core responsibilities. The crisis demonstrates the wisdom of returning the Fed to its original mission, as amended by Congress: to pursue a dual mandate of full employment and reasonable price stability, provide an elastic supply of currency and act as lender of last resort to banks, and regulate and closely supervise financial institutions.

The belief that QE encourages banks to lend excess reserves is clearly mistaken. Another fallacy is that banks need excess reserves in order to induce loans to firms and households. Moreover, it makes little sense to increase debt or reduce saving when there is record private sector debt. Furthermore, the stimulative effects of QE are insignificant, since there is no guarantee that market forces will reduce yields based on a particular quantity of Treasuries purchased by the Fed.

The authors disagree with Fed critics who are concerned that QE will lead to inflation and dollar depreciation, and they do not support the strategy to pressure US trading partners to appreciate their currencies. Rather, the Fed and the Treasury should announce their intention not to depreciate the dollar, and US policymakers should focus on domestic policy measures to end the crisis. In addition, the belief that monetary policy alone can stabilize the US economy is erroneous and dangerous. Monetary policy played a major role in pumping up asset prices, which subsequently collapsed in a speculative bust. Meanwhile, the neglect of fiscal policy generated macroeconomic imbalances—for example, a record level of household indebtedness as borrowing substituted for jobs and income growth.

QE1 mitigated the economic downturn in spite of some ill-conceived spending and tax cuts, say the authors. The major problem was that the stimulus package was too small, as well as temporary. And in light of the similar effects of the financial crisis in the United States and Japan, they support a larger and more permanent fiscal policy to deal with the recession. The first task of fiscal policy at this time is to reverse job loss.

Although the authors' position is at odds with current attempts to reduce the US budget deficit, they note that the deficit is mostly due to collapsing tax revenues, combined with automatic stabilizers such as unemployment compensation. The deficit will decline rapidly when the economy recovers, they say. Thus, reactive policies such as spending cuts and higher taxes during normal deficit expansions would be a mistake.

Another reason to reject undue reliance on monetary policy is that those in charge are not subject to the same degree of democratic accountability as those in charge of fiscal policy. While the Fed is accountable to Congress, current law does not provide Congress with substantive control of the Fed. There is an inherent conflict between the need for oversight and transparency associated with public spending, and the need for independence and secrecy in formulating monetary policy and supervising regulated financial institutions.

The bailouts have been uncoordinated and largely executed in secret—by the Fed. And the massive, mostly off-budget support of Wall Street has proven to be a tremendous barrier to formulating another stimulus package for Main Street.
www.levyinstitute.org/pubs/ppb_117.pdf

What Happens if Germany Exits the Euro?

MARSHALL AUERBACK
Policy Note 2011 / 1

The recent turmoil in Europe has given rise to the idea that the euro might be reversible, and that one or more countries might revert to a national currency. Research Associate Marshall Auerback applies the sector financial balances approach to national income accounting in order to determine what would happen if Germany decided to reembrace the Deutschmark and regain its fiscal freedom. While Germany would likely emerge with a strong global "safe haven" currency that would save its banking system, such currency appreciation would destroy its export base (external sector) and result in much larger budget deficits.

The sectoral balances model was devised by the late Distinguished Scholar Wynne Godley and is detailed in the Institute's Strategic Analysis series. The economy is divided into three main sectors: the domestic private sector (including households and businesses), the government sector, and the foreign sector (imports and exports). At the end of any accounting period, the sum of the sectoral financial balances must net to zero.

By returning to the Deutschmark, Germany would become the issuer, as opposed to the user, of a currency and fully sovereign with respect to its fiscal and monetary policy. A budget deficit per se would not cause any problems per se for Germany, as it would no longer have any external constraint. But historically, Germany has embraced an export-based model at the expense of curbing domestic consumption.

In response to a trade shock, German policymakers would face a choice: to proactively offset the decline in its current account surplus via a more aggressive fiscal policy by choice (in search of a full employment policy) or to reactively respond to rising deficits via growth in the automatic stabilizers. According to national income accounting, the systematic pursuit of government budget surpluses is dollar-for-dollar manifested as declines in non-government surpluses. One has never seen the merits of eliminating government debt simply to force the private sector into greater deficit, notes Auerback.
www.levyinstitute.org/pubs/pn_1_11.pdf

Bernanke's Paradox: Can He Reconcile His Position on the Federal Budget with His Recent Charge to Prevent Deflation?

PAVLINA R. TCHERNEVA
Working Paper No. 636, November 2010

Federal Reserve Chairman Ben Bernanke has made two contradictory statements: the "fiscal components" of monetary policy for fighting deflation can be financed without limit; and government deficits can become too large and must be reversed to preserve fiscal responsibility. Research Associate Pavlina R. Tcherneva attempts to resolve this paradox by reviewing Bernanke's (unorthodox) policy recommendations and his views on government spending. She finds that the paradox stems from Bernanke's inability to reconcile the mainstream view of government finance with traditional crowding-out arguments. If Bernanke insists on reversing the budgetary stance, it would have a devastating impact on the US economy, employment, and output, says Tcherneva.

Bernanke's policies in 2008–09 closely followed a blueprint that he developed within the context of the Japanese crisis during the 1990s. According to Bernanke, the monetary authority has all of the necessary tools to fight deflation. His solution includes four key policy moves: (1) the monetary authority must articulate its steadfast commitment to a zero-interest-rate policy and a specific inflation target; (2) exchange rate depreciation; (3) money-financed fiscal transfers; and (4) nontraditional discount window and open-market operations. This framework suggests a new view of the effectiveness of both monetary and fiscal policy, and new implications for central bank independence.

Tcherneva outlines the role and meaning of the "fiscal components" of monetary policy. Exchange-rate depreciation, money-financed fiscal transfers, and nontraditional open-market operations are not monetary operations because the Fed cannot pursue these options without explicit sanction from the fiscal authorities—Congress and the Treasury (i.e., the fiscal agents empower monetary policy). Buying foreign currency (a byproduct of swap-line arrangements) and toxic assets, or financing government expenditures, has a fiscal component because it increases reserves in the hands of the public, which subsequently boosts expenditures, producing an increase in output and prices.

According to Tcherneva, Bernanke's position seems to be that monetary policy is neither omnipotent nor independent in times of crises, and largely enabled by fiscal policy. She concludes that the effectiveness of monetary policy depends on the size of the fiscal components, and that there are no technical limits to government spending. The implication of the fiscal components is that foreign exchange intervention or purchases of financial assets are not purely monetary policy levers, but fiscal levers financed by the Federal Reserve.

Bernanke and other New Consensus economists seem to argue that fiscal and monetary policy are operationally independent in normal economic times but can be integrated during severe recessions when financing government expenditures. Moreover, fiscal policy is not only effective but it is also more potent during a recession. More importantly, the Fed cannot expand the money supply exogenously *without* government spending. According to Bernanke's new interpretation of monetary easing, there are no technical limits to financing the fiscal components of monetary policy.

A key proposition of the Modern Money approach is that the limits to policy effectiveness are not financial in nature. Some of the arguments used by adherents of this approach include: all debts are ranked in a hierarchical fashion; taxes and bonds do not finance government liabilities in modern monetary systems that use nonconvertible free-floating currencies; and taxes create demand for otherwise useless token money and regulate spending and investment. Similarly, bond sales are not undertaken to raise government revenues but to drain reserves. And since reserves and securities are liabilities of a sovereign government denominated in the domestic currency, there is no limit to their issuance by the Federal Reserve and Treasury. By contrast, monetary policy in the European Union is completely devoid of fiscal components and largely impotent in dealing with deflationary forces.

The crux of the paradox is that Bernanke's recipe for deflation fighting can be implemented in sovereign currency regimes without financial limitations, but he has expressed strong concern about the sustainability of ballooning government debts and deficits. His position is based on the argument that rising debts and deficits discourage private creditors from lending to the US government and place an upward pressure on interest rates, thus inhibiting capital formation and growth. This (flawed) theoretical argument runs counter to the basic operation of sovereign currency nations and is in direct conflict with Bernanke's own view of government financing. Deficit spending does not crowd out private spending and investment but rather generates a crowding-in effect that puts downward pressure on interest rates.

The Modern Money literature can help to resolve Bernanke's paradox, says Tcherneva. There are three ingredients to understanding the nature of government spending: (1) there is no inherent operational limit to government spending for governments that pay in their own liabilities; (2) government deficit spending creates an equivalent amount of surpluses in the nongovernment sector; and (3) the central bank cannot choose which government payments to clear. It is logically incoherent to argue that the government relies on tax collections for its spending during normal times but not during times of crises.

The primary criteria to measure policy effectiveness are not the size of debt-to-GDP ratios or the availability of reserves in the banking system. Rather, they are high (full) employment, more equitable income distribution, stable profit expectations, and viable private and public investment. There is no reason why Bernanke's recipe for stabilization should favor money-financed tax cuts as opposed to alternative fiscal policies such as public investment and job creation by the government.

www.levyinstitute.org/pubs/wp_636.pdf

Financial Stability, Regulatory Buffers, and Economic Growth: Some Postrecession Regulatory Implications

ÉRIC TYMOIGNE

Working Paper No. 637, November 2010

Free-market ideas related to risk management, self-regulation, and market discipline have justified an extended period of financial deregulation. The overriding goal of regulators during this period has been to avoid limiting the creativity of financial institutions. Moreover, the primary aim of regulating financial institutions in response to the Great Recession has been to improve the existing regulatory framework.

Research Associate Éric Tymoigne maintains that the core problem related to reregulation is that the analytical framework and underlying economic principles failed. The focus is on economic growth, liquidity and flexible capital requirements, mandating maximum leverage ratios, and increasing the size of common equity. Instead of a new regulatory direction, we have a patchwork of reforms focusing on expanding existing buffers or creating new buffers against future crises.

Tymoigne proposes a different type of regulatory framework and underlying philosophy that centers on the detection of financial fragility and on proactive policies with a strong supervisory component. High profitability, low default rates, rising net worth, and strong economic growth are not good indicators of financial robustness, he says. A much more radical reform of financial regulation is needed to account for the intrinsic instability of market economies. An assessment of financial stability should focus more on broader measures of social well-being and less on (traditional) parameters of economic growth. And it may be necessary to change the management of our economic affairs in order to achieve broad sustainability.

The free market approach to economic affairs suggests that financial crises are rare events, promotes financial stability by aiming for perfect competition, and calls for protection against random shocks. And with the help of market signals, bankers are the most qualified to set the appropriate buffers (e.g., Basel II). The primary goal is not social provisioning but economic growth, and includes the notion that regulating innovation would constrain economic growth, profitability, social well-being, and national competitiveness.

Tymoigne notes that capital and liquidity buffers are too small and set too low to sustain financial stability, and that they provide an inaccurate picture of the financial health of an economic system. Moreover, constraints such as leverage ratios and asset quality are bypassed when financial institutions must maintain their return on equity. As a consequence, financial fragility can emerge during a period of economic stability. Therefore, regulators should not wait for declining profitability and net worth, or other signs of payment difficulties, prior to taking strong actions. Otherwise, the entire economic system is at risk when growing financial fragility has served as the foundation for widespread profitability and economic growth. Instability rather than market efficiency is the inherent result of a market economy performing well for a relatively long period of time.

According to Hyman P. Minsky's financial fragility hypothesis (hedge, speculative, and Ponzi finance), the goal should be to detect and prevent financial fragility rather than to protect against financial crises. This implies a change in perspective about what constitutes a "healthy" financial institution when regulating the financial system. The key is to see how balance sheets are affected by financial practices—an approach requiring alternative indictors such as Ponzi finance. When Ponzi finance is defined in terms of position-making operations (i.e., from a balance-sheet viewpoint), its detection does not require the measurement of cash flows but the interaction of debts and asset prices. Financial fragility should be based on an analysis of balance sheets, cash flow, underwriting procedures, and the underlying assets. The point is to understand how economic units finance and fund activities, regardless of their merits.

Since financial institutions have a strong incentive to bypass regulations, regulators must keep up with their innovations and no innovation should be unregulated or unsupervised, says Tymoigne. Income-based Ponzi finance may be tolerated in government-insured activities but collateral-based Ponzi finance should be forbidden in all activities that have an implicit or explicit government guarantee. Regulatory follow-up is also important because financial innovations change over time. There is also a vital role for the central bank in protecting banks and the payment system from competition (e.g., the cost of funding should be kept low and stable). At the same time, more emphasis should be put on the Federal Reserve's discount window in order to grasp the changes and influence the business practices of financial institutions. It might also be useful to reward high-quality financial innovations such as hedge finance by instituting a patent system. And when a Ponzi process collapses, the company responsible should be allowed to be dismantled in an orderly fashion (e.g., receivership).

Tymoigne notes that there has been no significant improvement in US economic welfare since the mid-1970s because rising socioeconomic and environmental problems have outweighed gains in output. He also notes that the widespread emphasis on investment-led growth is prone to economic instability (and Ponzi finance), so economic growth should focus on domestic consumption that is socioecologically durable and "sustainable" in the long term.

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US "Quantitative Easing" Is Fracturing the Global Economy

MICHAEL HUDSON

Working Paper No. 639, November 2010

According to Research Associate Michael Hudson, the global financial system has decoupled from trade and investment, and shifted economic planning into the hands of finance-sector lobbyists. Moreover, the US government has attempted to bail out the banks by reinflating the real estate, stock, and bond markets (leading to more debt creation). This approach, in combination with a second round of quantitative easing—QE2,—is saving the banks from negative equity, while flooding the global economy with cheap US dollar "keyboard credit" and destabilizing the global financial system.

In essence, QE2 is a form of financial aggression, says Hudson, and Federal Reserve policymakers have not acknowledged a number of problems with the program. For example, the bank bailouts and liquidity from the Fed and Treasury have been used to increase profits and to continue to pay high salaries and bonuses. And asset price inflation is increasing the power of property over labor and production, thus elevating the FIRE (finance, insurance, and real estate) sector over the "real" economy. Moreover, banks are sending the Fed's tsunami of credit abroad and engaging in interest-rate arbitrage (the carry trade) as well as currency and commodity speculation, and buying foreign companies in place of domestic lending.

The Fed's liquidity policy is wrongheaded, says Hudson. "Restoring the flow of credit" is a euphemism for retaining high debt levels rather than writing them down. New borrowing is not happening, since banks are tightening their loan standards and debtors are paying off their debts (i.e., the savings rate is rising). Banks are sending the Fed's credit abroad and forcing targeted currencies to appreciate against the dollar. Such financial aggression can only be mitigated by erecting capital controls that block foreign speculators from deranging the currency and financial markets.

What makes the speculative capital inflows abroad so unwelcome is that they do not contribute to tangible capital formation or employment. Hudson proposes longer-term and more radical institutional changes in order to restructure the global financial system, including dual exchange rates for trade and capital movements, currency-swap agreements for bilateral trade, and a BRIC (Brazil, Russia, India, and China)-centered system that reverses the policy of open and unprotected capital markets put in place after World War II.

The 1945–2010 period of open trade, capital movements, and foreign exchange markets is being destroyed by a predatory financial opportunism that is breaking the world economy into two spheres: a dollar sphere of central bank reserves that is declining in value; and a BRIC-centered sphere that runs trade surpluses. Foreign countries are expected to serve as markets for greater US industrial exports and for US banks and speculators at the expense of foreign central banks trying to stabilize their currencies. Moreover, the FIRE sector's overhead has become a structural problem that has made the cost of living so high that the US industrial labor force is uncompetitive in global markets. And as long as the US economy remains locked in debt deflation, it will be unable to produce the traditional form of economic surplus needed for a genuine recovery. Thus, foreign economies are expected to help US banks earn their way out of negative equity.

Speculative capital inflows push foreign currencies up against the dollar, pricing exporters out of global markets and disrupting domestic employment and trade patterns. Financial gambles rather than basic production costs are setting today's exchange rates, but this currency speculation is the most aggressive, predatory, and destructive aspect of US financial behavior (an upward revaluation of China's renminbi would be a bonanza for speculators). Other countries, therefore, are taking defensive measures against speculation and "free credit" takeovers.

Historically, countries have stabilized their exchange rates by recycling dollar inflows and other foreign currency into US Treasury securities. Now countries are trying to shape the "market" of international speculation by imposing, for example, a withholding tax on interest payments to foreign investors. While such measures may discourage interest-rate arbitrage via the bond market, they leave the foreign currency play intact. (Malaysia blocked foreign purchases of its currency during the 1997 Asian crisis, and this control measure worked.) Furthermore, countries are trying to free themselves from the International Monetary Fund and its destructive, neoliberal, financial austerity programs.

The flight out of the US dollar into Asian and other third world currencies is changing the global economy's orientation by restoring financial dominance to nations' running balance-of-payments surpluses and whose currencies promise to rise against the dollar (their economic base is less dependent and indebted than in the past). The major question is how such national economies can gain greater stability by insulating themselves from predatory financial practices.

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The Central Bank "Printing Press": Boon or Bane? Remedies for High Unemployment and Fears of Fiscal Crisis

GREG HANNSGEN and DIMITRI B. PAPADIMITRIOU
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Trillions of dollars in excess government expenditures in the United States and Europe have been committed to maintain a stable financial system. Does the United States risk a fiscal crisis based on its ability to borrow and spend without limit? Research Scholar Greg Hannsgen and President Dimitri B. Papadimitriou examine this question in light of suggestions that the federal government has debt limits. They argue that there are few "affordability" constraints on further Keynesian stimulus or government debt. Current limits to fiscal stimulus posed by the scarcity of real resources, especially when demand is sufficient, are irrelevant because unemployment rates remain close to 10 percent.

The authors suggest using capital controls such as taxes on capital flows, foreign currency trades, or other key financial assets to restrict international capital movements. This would reduce the tendency for financial markets to punish expansionary policies, as well as reduce the fragility of foreign exchange and other financial markets. They also suggest that the international financial system should be reformed to fight imbalances, along with the destabilizing effects of "hot money." Such reform should force countries with chronic current-account surpluses to generate more aggregate demand (as proposed by John Maynard Keynes after World War II). Furthermore, no particular product should be singled out for trade restrictions. The greatest need at a time of economic stagnation, they say, is to adjust the global economy toward full employment and away from deflation.

The possibility of default that threatens the eurozone is unlikely to happen here because the United States can borrow in its own currency using the power of the Federal Reserve's "printing press" (i.e., quantitative easing). By comparison, eurozone countries such as Greece must raise revenues or borrow funds on the international credit markets (issuing bonds denominated in euros). These countries have had to resort to emergency loans because they lack a truly independent fiscal policy. And to prevent default, the European Central Bank has taken on a role similar to the Fed—monetizing the debt of some

European governments. This action props up the market for government securities and keeps longer-term interest rates low.

Hyman P. Minsky and banking expert Walter Bagehot argued that central banks and finance ministries worldwide *must* act as backup spigots for large banks in order to prevent bank runs and panics. In contrast to these financial economists' insights, however, governments accepted nearly worthless assets from the financial institutions' books as collateral, and adopted a costly "second-best" solution when they bailed out huge institutions after they failed (and sound regulation was lacking in the banking system).

This "unified federal sector" bailout, which includes the Fed, Treasury, and government-sponsored entities, is unimportant from a fiscal point of view, say the authors. The United States has contained its crisis using familiar policy tools, while the European system has been forced to abandon its policy commitments (e.g., fiscal deficit limits), which were expected to control inflation and stabilize the economy. Keeping monetary policy separate from the political power of the purse has proven unworkable, and officials have recognized that the costs involved in a bailout could be handled only by the central banks and the International Monetary Fund.

In light of the merits of a country issuing its own currency, Hannsgen and Papadimitriou consider the advantages of a currency bloc or pegging a currency to the dollar, the impact of excessive government debt, the effects of alternative monetary and fiscal systems in the United States, and the use of novel policy tools such as capital controls or currency devaluations to fight unemployment. They note that when the Fed purchases Treasury bonds and immediately removes them from the private sector, the government can continue to borrow without driving mortgage rates or other long-term interest rates up. Moreover, the inflation potential in the wake of excessive deficits is irrelevant because of high unemployment and an unstable recovery, while inflation enhances the federal government's ability to meet its debt-repayment obligations. The only way to choose fiscal and monetary policies, while controlling their impact on the exchange rate, is to implement capital controls.

A sharp reduction in demand for US securities and money is likely to leave all pegged exchanged rates and targeted interest rates intact (e.g., the exchange rate of the dollar to the renminbi has weakened slowly). The economic consequences of depreciation against unpegged foreign currencies, however, can be significant. Therefore, it is important to keep monetary and fiscal options open when policy actions on the foreign exchange markets are unclear.

One should encourage nations with underemployed workforces to lower interest rates and increase deficits rather than increase exports. A country such as Germany that is part of a currency bloc as well as an export powerhouse must maintain demand for its currency or debt securities in place of relying on a central bank to buy its sovereign debt. A strategy emphasizing exports, however, is futile when many countries contest a saturated market. Meanwhile, a race to the bottom causes domestic and foreign markets to evaporate.

Countries adopt a currency peg when they are small, open economies (e.g., Luxembourg) or if they have experienced hyperinflation when setting their own macro policies (Argentina). And it must be recognized that the state's ability to create its own money cannot generate unlimited wealth or unlimited benefits at no cost. Readily available credit is likely to lead to overinvestment in unproductive ventures.

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Quantitative Easing and Proposals for Reform of Monetary Policy Operations

SCOTT FULLWILER and L. RANDALL WRAY

Working Paper No. 645, December 2010

Some estimates place the total amount of US government loans, purchases, spending, and guarantees provided during the financial crisis at more than $20 trillion. Only a small portion of this amount was approved explicitly by Congress, and much of the detail surrounding commitments by the Federal Reserve remains unknown. The bailouts in this crisis have been uncoordinated, mostly off-budget, and done largely in secret by the Fed.

Scott Fullwiler, Wartburg College, and Senior Scholar L. Randall Wray review the roles of the Fed and Treasury in the context of quantitative easing (QE). They find that the crisis has highlighted the limited oversight of Congress and the executive branches, and the limited transparency of the Fed. The question is whether the Fed should be able to commit the public purse in times of national crisis (the Fed's promises, which are made without congressional approval, are ultimately Uncle Sam's promises). They encourage policymakers to explore a number of issues regarding transparency and accountability, and to pursue domestic policy measures to end the crisis.

The authors conclude that the Fed has not learned how to efficiently implement monetary policy. They note that QE can only work through price effects, not through quantity, and it is probable that QE2 could be deflationary (by reducing income and spending). They also conclude that the excess reserves in the banking system will not pose a challenge to policymakers, the threat of inflation is erroneous, and there is little justification to fear a depreciating dollar. Moreover, the pressure placed on US trading partners to appreciate their currencies is a mistake. And since fiscal policy is the only possible engine of growth, policymakers must rely on domestic measures to reverse job loss. Otherwise, there is a real danger that the United States will slip back into recession.

When the Fed focused on managing inflation expectations, it ignored the growth of systemic risk and downplayed its mandate to regulate the financial sector or pursue full employment. According to Fullwiler and Wray, the Fed should return to its original mission: acting as lender of last resort, regulating and supervising the financial system, and pursuing a dual mandate of full employment and price stability.

Quantitative easing is a policy of asset purchases by the central bank to create excess reserves in the banking system, thus enabling the banks to make loans and earn more interest. This policy is expected to encourage spending, stimulate growth and job creation, and lower yields on longer-term assets. The authors note that the Fed's purchases ($1.75 trillion) lowered the term premium by up to 52 basis points, and that QE2 ($600 billion) may reduce the term premium by up to 21 basis points more. However, long-term Treasury yields will likely fall by less than 18 basis points because the Fed does not plan to buy mortgage-related debt. Thus, the impact of QE2 on interest rates will not be large and the impact on private spending will be trivial (e.g., Treasury rates have increased slightly since the announcement of QE2).

The belief that QE encourages banks to lend excess reserves is clearly mistaken, say the authors. Banks can only lend reserves to other institutions holding reserves at the Fed, and since there are already excess reserves, there is no need to provide more funds. The argument that banks need excess reserves before making loans to firms and households is fallacious, they say. And it does not make sense to encourage more lending and borrowing when the nation is overindebted. Therefore, QE2 will not increase the banks' ability to create loans or encourage the private sector to spend more. Rather, QE2 will replace longer-term Treasuries with shorter-term investments within private portfolios, which, on balance, reduces income received by the private sector.

Monetary policymakers have pursued macro policy on the highly dubious claim that they can fine-tune the economy. Yet every chosen tool and target has failed in that task—from former Chairmen Paul Volcker and Alan Greenspan, to Chairman Ben Bernanke. Median real wages stopped growing when monetary policy was favored over fiscal policy, which is particularly important in a deep recession and financial crisis. Since export-led growth is unlikely to bring recovery in the United States, fiscal policy is the only engine of growth. The major problem with the government's stimulus package is that it was too small and temporary (e.g., as exemplified by the current status of state and local government finances).

The large national budget deficit is mainly due to collapsing tax revenue and transfer spending (e.g., unemployment compensation), a result of the economic downturn. The cyclical nature of the budget is a function of automatic stabilizers rather than discretionary policy. The budget deficit will quickly disappear when the economy recovers and if there is full employment. Therefore, policymakers need a more aggressive stimulus, including a greater role for sustained fiscal policy. Another reason to favor fiscal policy over monetary policy is that it is subject to more (democratic) accountability.
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Money

L. RANDALL WRAY

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What is money, what role does it play, and what should policy do about it? Senior Scholar L. Randall Wray builds a theory on money and links his theory to common themes in the heterodox literature based on three fundamental propositions: (1) Robert Clower's (1965) insight that money buys goods and goods buy money, but goods do not buy goods; (2) money is always debt; and (3) default on debt is possible.

The important thing about the origin and historical transformation of money is the view of money's role. For example, the presumption that money must be neutral in the long run is a mistake. Wray observes that Clower's insight must underlie John Maynard Keynes's view of a monetary economy; that is, the purpose of production is to accumulate money. The claim that a capitalist economy is a "monetary production economy" is also adopted by Karl Marx and Thorstein Veblen, as well as by Wynne Godley's sectoral balances and stock-flow consistency model, and Michal Kalecki's profits equation.

An accounting unit is needed to aggregate heterogeneous items such as wages, profits, rents, investment, consumption, government spending, and so on. As Keynes argued, there are only two obvious units of account: labor hours or the money wage unit. Money is the object of production and not merely the way we measure the value of output. Commodities obtain their value and become commodities when they are exchanged for the universal representation of social value (money). The production process begins with money, on the expectation of ending up with more money.

In terms of the "economy," commodity sales for money lead to "points" credited to the "score" that is (mostly) kept by financial institutions. Unlike a game of sport, every "point" awarded to one player is deducted from the "score" of another (either reducing the payer's assets or increasing the payer's liabilities so that the financial accounts always balance). Thus, money is not a "thing" but rather a unit of account in which we track all debits and credits. Production begins with money, which is a "score" that represents an IOU (typically a demand deposit liability at a bank that is matched on the other side of the bank's balance sheet by a loan, which represents the debt of the borrower in whose name the bank's IOU is issued). In this process, we have to account for the profits of producers and the interest (profits) earned by banks. Joseph Schumpeter focused on the role played by banks in financing innovation—providing credit to allow the entrepreneur to claim social productive resources for a new production process that will increase social production. In conclusion, money is debt: it does not need to have any physical existence other than some form of record, which is mostly a keyboard entry on a computer.

According to Hyman P. Minsky, if money is debt, then anyone can create money by issuing an IOU denominated in the social unit of account. The problem is finding a creditor to hold the IOU and not ignoring default risk and liquidity. It is important to note that a promise to convert is voluntary and not fundamental to the issue of an IOU (e.g., modern "fiat" currencies on floating exchange rates are accepted without a promise to convert, and they readily circulate with or without legal tender laws). Fiat currencies mean that there is no government promise to redeem them for precious metal and there is "nothing" backing the currencies. Government currency is accepted because the sovereign government has the authority to collect taxes, which are levied in the national money of account.

Private banks intermediate between taxpayers and government, and make payment in currency and reserves on behalf of taxpayers. The government's fiat currency is accepted because high-powered money (HPM)—currency plus reserves—is the main thing accepted by government in the payment of taxes. Neither reserves of precious metals (or foreign currencies) nor legal tender laws are necessary to ensure acceptance of the government's currency. All that is required is the imposition of a tax liability to be paid in the government's currency. Like all debtors, government must accept its own IOU when presented. Thus, *taxes drive money*.

Money IOUs are often made convertible to the state's IOUs (HPM), but there is the problem of additional default risk and liquidity. Bank liabilities are widely accepted because default risk on a bank's IOU is small (and nonexistent in the case of government-guaranteed deposits). Banks also intermediate by accepting borrower IOUs and issuing their own. For this service, banks earn profits in terms of (higher) interest rates as a reward for parting with liquidity and compensating for default risk.

Banks are special because most of their assets are purchased by issuing IOUs (they finance their position in assets by issuing debt). They operate with very high leverage ratios because they have guaranteed access to the central bank and government insurance. And they are true "intermediaries" because their profits are derived from providing the liquid "money" needed for rather than from commodity production. Since "money" is commonly associated with the transferability of debt among third parties, it is not surprising that government currency as well as bank liabilities are often included in definitions of money. In contrast, a layperson has a narrower view of money: something that can be used in a market as a medium of exchange—to buy a commodity.

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Fiscal Policy Effectiveness: Lessons from the Great Recession

PAVLINA R. TCHERNEVA

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John Maynard Keynes linked the goal of macroeconomic stabilization to the goal of full employment, which equates to an unemployment level of less than 1 percent. He identified unemployment as a problem of deficient *effective* demand rather than deficient aggregate demand that should be resolved by direct job creation through public works.

According to Research Associate Pavlina R. Tcherneva, Keynes provided a crucial tool for dealing with the Great Recession as well as a policy for addressing unemployment at all phases of the business cycle. What is required is a fundamental reorientation of fiscal policy toward closing the labor-demand gap rather than the output gap.

The conventional view of fiscal policy is based on the "leaky bucket" analogy (i.e., not all government expenditures and other measures such as tax cuts reach the poor and unemployed). This analogy stems from Okun's Law: a 1 percent increase in unemployment generates a 3 percent decline in GDP growth. This law has been flipped and used as a policy guide that supports broad-based, pro-growth policies in spite of a weak GDP-to-unemployment relationship. Moreover, it is unclear what rate or type of growth is required to substantially reduce unemployment.

Boosting aggregate demand has been the policy response of the Bush II and Obama presidencies in the aftermath of the September 2008 financial crisis. There were also government expenditures not commonly used as countercyclical stabilization measures such as purchasing nonperforming financial assets from the balance sheets of ailing banks (the first Troubled Asset Relief Program, or TARP, under the Bush administration). The second part of the fiscal stabilization plan was the American Recovery and Reinvestment Act (ARRA), under the Obama administration. While the TARP and ARRA budgets constituted 10 percent of GDP, they were inadequate in size and direction because their net effect on growth and employment was small.

There was a misplaced faith in pump-priming policies, says Tcherneva, leading to a mass exodus of discouraged workers from the labor market, a declining labor force participation rate (the employment-to-population ratio has collapsed to 58 percent), the wholesale destruction of full-time jobs, and record levels of long-term unemployment (which has been on a secular uptrend for the last four decades). While the fiscal push during this recession has placed a floor on aggregate demand, it has not generated a vigorous job recovery. Thus, an entirely new approach is necessary to solve the unemployment problem.

Reexamining the role of public works suggests that genuine full employment can be achieved via a policy of permanent "on-the-spot" employment programs open to all who are ready, willing, and able to work. Targeting employment directly is the only method for stabilizing the economy and simultaneously generating full employment over the long run. Since unemployment is a monetary phenomenon, aggregate-demand management has specific drawbacks during recessions (failing to stabilize expectations fast enough) and expansions (failing to make expectations consistent with true full employment). There is an incrementally smaller employment-creation effect during an expansion because part of the increase in aggregate demand is captured by an increase in price. Inflation and income-distribution distortions prompt policymakers to abandon aggregate-demand policies, leaving the economy below full employment (dubbed, the "natural rate of unemployment").

Policy has become very effective in stabilizing aggregate incomes, profits, and cash flows, but not employment. The improvement in the balance sheets of firms is unlikely to boost hiring, while state governments and households are still too weak to lead a recovery. The onus, then, is on the stimulative policies of the federal government, but what type of fiscal policy can ensure full employment?

Among alternative fiscal policies, the direct job-creation approach has three main benefits: (1) it creates the highest employment impact; (2) it circumvents the problem of fixing the point of effective demand at full employment (by managing the independent factors of consumption and investment, and hiring the unemployed directly); and (3) it deals with structural unemployment directly. The goal of this approach is to provide decent jobs in terms of public goods and services that do not compete with private-sector pay or output. This approach would enhance human capital and simultaneously increase aggregate demand and aggregate supply. Moreover, it does not rely on boosting aggregate demand to produce full employment.

Tcherneva points out that Keynes did not advocate the creation of useless projects for the sake of job creation. Rather, he favored a carefully planned long-term, full-employment program that could be executed through public-private partnerships. In terms of dealing with inflation pressures, supporting programs should defer payments or encourage thrift, but not slash jobs. Policy should take workers as they are and tailor the jobs so that workers enhance their skills and gain work experience (for the private sector). Targeting spending directly to households is a genuine bottom-up approach to economic recovery.

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Fiscal Policy: Why Aggregate Demand Management Fails and What to Do about It

PAVLINA R. TCHERNEVA

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The aggregate demand model is designed to place a floor under collapsing demand by improving aggregate incomes, cash flows, and balance sheets. However, this model does not alleviate the problems of unemployment, income inequality, and poverty. Research Associate Pavlina R. Tcherneva calls for implementing concrete fiscal policies throughout the business cycle rather than focusing on the size of (countercyclical) government spending. The specific objectives of fiscal policy must include full employment, better income distribution, and poverty alleviation, she says.

John Maynard Keynes emphasized direct employment and structural reform, and he favored a broader socialization of investment as the solution to macroeconomic stability. According to Tcherneva, Keynes's strategy can be found in his writings: direct job creation, both in recessions and in expansions, with special attention to specific (distressed) regions. The recipe for full employment and macroeconomic stability consists of boosting the government's demand for labor rather than output.

Tcherneva considers three shortcomings of the aggregate-demand approach: the failure to produce and maintain full employment, the tendency to erode income distribution, and the reinforcement of the poverty cycle. She notes that, after seven decades, postwar aggregate demand management policies in the United States have failed to produce true full employment, while there has been a clear upward trend in the long-term unemployment rate. This failure can be attributed to the inherent subjectivity of consumer behavior, investor expectations, liquidity preference of the community as a whole, and the heterogeneity of labor. Moreover, the aggregate-demand measures fail because they work through a fundamentally flawed trickle-down mechanism in the labor markets. Furthermore, these measures are fraught with inflationary pressures because they boost the wages of workers at the top of the income distribution first and those at the bottom last, while financing capital assets. As a result, policymakers abandon the aggregate-demand approach before full employment. The approach also aggravates the inequality between the labor and capital shares of income by favoring rentier incomes and profits, and high-wage workers. And since capital income is distributed more unevenly than labor income, it contributes to overall inequality. By contrast, the Keynesian targeted-demand approach directly increases and stabilizes the share of labor income in production, and improves incomes at the bottom of the income distribution relative to incomes at the top (by employing workers in the production of public goods and services).

Institutionalizing long-term unemployment and income inequality institutionalizes poverty. Thus, a key strategy should

foster "labor force attachment," since a job guarantee helps eliminate poverty. The current pro-growth, pro-investment aggregate demand approach is bankrupt from a moral and an economic perspective, says Tcherneva, and more government spending cannot be a proper policy objective. Rather, meaningful academic and political discourse should focus on the *type* of government spending.
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Program: Immigration, Ethnicity, and Social Structure

A Demographic Base for Ethnic Survival? Blending across Four Generations of German-Americans

JOEL PERLMANN

Working Paper No. 646, December 2010

Ethnic blending is a distinguishing feature of American society. As pointed out by Senior Scholar Joel Perlmann, even fairly low levels of out-marriage in the first and second generations will produce a considerable proportion of mixed-origin couples and their children. He explores how demographic factors affected German immigrants arriving in the United States in the late 1800s, with a focus on intermarriage across four generations. He finds a high level of out-marriage with successive generations and dramatic differences in marital patterns across geographic areas. He also finds that cultural processes were the determining factor leading to the fading of German ethnicity over time.

Three factors can prolong the demographic basis for ethnic survival: the cumulative effect of fertility rates; second-generation members marrying recent immigrants during periods of high immigration ("replenishment"); and geography with respect to ethnic concentration and associated institutions. Perlmann uses the US Census datasets of the Integrated Public Use Microdata Series from the (full-count) 1880 census in combination with the Linked Representative Sample (LRS) to capture the same individuals (males 0–14 years of age) in the later censuses. This dataset also allowed him to compute the population concentration of Germans in 31,000 local areas. Tracing immigrant blending remains an elusive goal, says Perlmann, because complete ethnic information is restricted to no more than two generations.

In-marriage refers to marriage with anyone having German origins. *Single-origin individuals* are descended from four grandparents born in Germany. *Second generation* refers to anyone born in the United States to one or two German immigrants; *third generation*, to individuals born in the United States to at least one US-born parent who in turn had at least one immigrant parent born in Germany. Since a person can have both second- and third-generation German origins (if a second-generation parent married a German immigrant), an exclusively third-generation individual is a person whose German origins are derived only from their German-immigrant grandparents.

In terms of national trends, the paper confirms the author's earlier finding: high levels of ethnic blending are evident by the third generation. He compares how German-Americans with different origins made marital choices net of the local marriage market; marital choice affects a person's family life and the prospects that ethnicity will remain relevant into the next generation. He finds that only a quarter of the exclusively third-generation individuals were of single origin, as opposed to mixed origin, but two-fifths were the product of unions between second-generation and immigrant parents. He notes that some individuals may have unobserved German origins in their family tree from much earlier immigrations.

The analysis includes the LRS male subjects in the 1866–80 cohort who were identified and found to be married in the later census year. A multinominal logit analysis of marital choice deals with the odds of marrying-in versus marrying-out, and the odds of marrying a single-origin German woman versus anyone else. Perlmann finds that the odds of marrying a woman of German origin increase with rising German concentration. Moreover, the odds of marrying a woman of German origin for the US-born son of two German immigrants were 31 times greater than that for a non-German. Accounting for the concentration of Germans at the local level, the odds fall to 11 times greater. The difference between the central cities versus rural areas was statistically insignificant. The independent effect of concentration, not location in the rural-urban continuum, matters for marital choice.

The fundamental conclusion is that generational standing, more than single origin, is the critical determinant of ethnic marital choice among men. The proportion of men with third-generation single-origins who married women with the same background was miniscule. The impact of immigration on preserving the demographic base for German ethnicity cannot be overstated, says Perlmann.
www.levyinstitute.org/pubs/wp_646.pdf

Views of European Races among the Research Staff of the US Immigration Commission and the Census Bureau, ca. 1910

JOEL PERLMANN
Working Paper No. 648, January 2011

The List of Races and Peoples classification system was adopted by the US Immigration Commission and the US Census Bureau at the beginning of the 20th century. Senior Scholar Joel Perlmann focuses on the key researchers who analyzed the classification issues and determined the meaning of race, country of origin, and mother tongue for US immigrants. A main concern was to formulate applicable questions and categories in order to determine the immigrants' impact on the country as a prelude to legislating immigration policy.

Perlmann finds a dramatic range of contradictory views among the highest level of researchers, including a wide range of issues under consideration (e.g., an excess of unskilled laborers). He also finds that the recommendations of the Commission related more to restricting immigration, as voiced by the commissioners prior to their appointment, than to the findings of various reports. Thus, the balance between research and politics at the Commission was different than that at the Census Bureau, which was not expected to provide explicit policy recommendations for congressional legislation.

Ellis Island officials, immigrant associations, social workers, and the like urged the adoption of a classification system that went beyond "country of origin." For some Jewish organizations, "Hebrew" was strictly a religion, not a race, and this classification explicitly violated the separation of church and state. And there were some individuals who believed that racial differences would not disappear in the foreseeable future, and that it was socially dangerous to mix discordant stocks.

Franz Boas was a prominent research professor of anthropology associated with the Commission who was interested in empirical studies of racial stability and change. He was outspoken about the connection between race prejudice and immigration restriction, and wanted more data on all aspects of racial intermarriage. Emmanuel A. Goldenweisser, a research economist at the Commission, showed that racial characteristics are entirely subordinate to the environment and opportunity in determining the immigrants' mode of life. He refuted the (famous) argument that immigration causes race suicide because poor immigrants drive down wages and native workers respond by restricting fertility; that is, high immigration correlated with low native fertility. Another analyst opposed to the Commission's final pronouncements on restricting immigration was Roland P. Falkner, who served as assistant director at the Census Bureau.

In contrast, the Commission's most important senior researcher was Daniel Folkmar—author of *The Dictionary of Races and Peoples* (1911). Folkmar believed that physical differences among European races were crucial to their mental characteristics (a popular sentiment). Race was a more fundamental factor in a person's social life and in America's future than a person's country of birth, and mother tongue was indicative of ethnic stock. Although Boas was the most important critic of racial determinism and had been invited to help chart the course for the *Dictionary*, he did nothing directly to shape or stop it.

According to Folkmar, there was a close connection between anthropology (the survival of the fittest) and legislating (practical) immigration policy. He therefore favored adding the "race or people" question to the census enumeration. The Census Bureau subsequently placed Folkmar in charge of interpreting the mother-tongue information gained in the 1910 census (underscoring the connection between race and mother tongue).
www.levyinstitute.org/pubs/wp_648.pdf

Program: Economic Policy for the 21st Century

Explorations in Theory and Empirical Analysis

Exports, Capabilities, and Industrial Policy in India

JESUS FELIPE, UTSAV KUMAR, and ARNELYN ABDON

Working Paper No. 638, November 2010

In association with Working Paper nos. 624 and 626 (see Winter 2011 *Summary*) concerning India's manufacturing sector, Jesus Felipe, Utsav Kumar, and Arnelyn Abdon, Asian Development Bank, Manila, Philippines, examine the sophistication and diversification of India's export basket since the 1960s. They find that the country's export basket is both more sophisticated and diverse than expected for a country at its stage of development. Core products such as metals, machinery, and chemicals were above expectations, given India's per capita income, and were also relatively high in terms of their share of total manufacturing products exported with revealed comparative advantage. In spite of abundant labor, India has diversified in the skill- and capital-intensive sectors. This trade focus is at odds with China, which embraced its comparative advantage and focused on labor-intensive commodity exports.

The key objective of India's new leadership after independence was to be self-sufficient in all sectors of the economy. The public sector was actively involved in industrial development in order to promote such objectives as the equitable distribution of income and wealth, and balancing regional development. Meanwhile, the private sector was regulated and controlled with instruments such as industrial and import licensing (the *license-permit raj*) so that it conformed with government priorities (e.g., the government could dictate the location and scale of a manufacturing plant). Import substitution was encouraged to reduce dependence on foreign exchange and to achieve self-reliance, and labor-intensive small-scale enterprises were protected from foreign and domestic competition. This system, however, led to inefficiencies and severely constrained business expansion, foreign collaboration, and investment. Furthermore, stringent labor laws prevented restructuring and reallocation of resources. The manufacturing sector was held back by policy as well as by a lack of physical and social infrastructure.

Reform in the 1980s led to a dismantling of the licensing regime and a liberal trade regime. A second wave of reforms in 1991 extended industrial deregulation and introduced sweeping trade liberalization measures such as the progressive reduction of tariff and nontariff barriers. India was now committed to promoting free trade, while its industrial policy negatively affected the labor-intensive categories.

The sophistication of a country's export basket is calculated as the weighted average of the level of sophistication of the products that the country exports. Diversification is measured as the absolute number of products that a country exports with revealed comparative advantage, which is the ratio of the export share of a given product in the country's export basket to the same share at the world level. In the period 2001–07, China and India exported 257 and 246 products with revealed comparative advantage, respectively. No other lower-middle-income countries exported as many products with this designation.

The authors' findings are consistent with the notion that India's manufacturing sector is biased toward large-scale (capital-intensive) and skilled labor–intensive sectors. In spite of significant reforms, the country's labor-intensive manufacturing sector did not experience any major gains in the post-reform period. This is where India lags behind China, say the authors. By making heavy industry a focal point of its industrial development strategy, India established a presence in core commodities and built up capabilities in producing and exporting sophisticated products.

India's policymakers defied comparative advantage by establishing skill-intensive activities related to scientific and technical infrastructure, higher education (especially in engineering and management), and information technologies. These activities have not harmed India's long-term growth prospects since they have provided highly skilled low-cost labor for industrial development, particularly in core products.

www.levyinstitute.org/pubs/wp_638.pdf

Disaggregating the Resource Curse: Is the Curse More Difficult to Dispel in Oil States than in Mineral States?

TIMOTHY AZARCHS and TAMAR KHITARISHVILI

Working Paper No. 641, December 2010

The resource curse is based on the hypothesis that natural-resource wealth leads to slower economic growth. Timothy Azarchs and Research Associate Tamar Khitarishvili disaggregate resources by type in order to shed light on the mixed economic outcomes of resource-abundant countries, including a country's ability to transform its institutional and economic infrastructure. Their findings are in line with similar studies using an aggregate resource stock measure: that resource abundance contributes positively to resource dependence and export dependence has no significant empirical effect on growth.

Using a disaggregated resource stock, the authors provide new insights—for example, oil is the only resource to affect institutions negatively, and different resources have different effects on resource dependence. These results highlight the importance of disaggregation and the need to understand the relationship between resource type and a country's ability to improve its economic and institutional performance. However, there has been very little headway in dispelling the resource curse.

The authors' contribution to the literature lies in differentiating between measures of resource abundance and resource dependence. Resource abundance represents the stock of resources, whereas resource dependence represents the importance of resource extraction to the economy (it is potentially endogenous in the growth equation). Their findings lend support to the use of ordinary least square regressions for testing the effect of resource dependence on growth.

Azarchs and Khitarishvili disaggregate mineral resources into four categories (oil, natural gas, coal, and nonfuel), focus on two channels (resource dependence and institutional quality), and compare the economic performance of countries in 1970–89 and in 1996–2008. Instrumental variable regressions are used to evaluate the potential endogeneity of resource dependence and institutional quality in the growth equation. They find that oil affects institutional quality and resource dependence negatively but has no significant direct effect on economic growth. Oil-rich countries have a particularly difficult time diversifying their economies and reforming their institutions. Natural gas appears to affect growth through channels other than resource dependence or institutions, and to be a boon in the most recent period. Coal abundance may be associated with a decrease in resource dependence and affect growth directly and positively. The impact of nonfuel minerals (an aggregate of 35 metals) is greater resource dependence, and is insignificant respecting institutional quality or economic growth. With the exception of natural gas, countries have not improved their handling of resources.

Avenues for future research include why different resources have different effects (e.g., public ownership and industrial characteristics) and which natural gas channels affect growth (e.g., human capital and output volatility).

www.levyinstitute.org/pubs/wp_641.pdf

Modeling Technological Progress and Investment in China: Some Caveats

JESUS FELIPE and JOHN MCCOMBIE

Working Paper No. 643, December 2010

Jesus Felipe, Asian Development Bank, Manila, Philippines, and John McCombie, Cambridge Centre for Economic and Public Policy, question the methodologies used to model the Chinese economy. Many assumptions, theories, and statistical techniques underlying neoclassical economics cannot be applied toward understanding the Chinese economy, they say.

The authors review three models: the methods proposed by Guang H. Wan (1995) and Gregory C. Chow (1993) to quantify technical progress; and the neoclassical investment model proposed by Xinhua He and Duo Qin (2004). They determine that these empirical exercises approximate accounting identities; for example, expressions can be rewritten as the income accounting identity—value added equals the wage bill plus total profits. For this reason, the estimations work empirically and produce sensible results, but testing does not allow for statistical rejection (e.g., the null hypothesis).

Wan proposes an assumption-free nonparametric approach to estimate the rate of total factor productivity growth in China. His rationale is two-fold: the derivation of the traditional growth accounting equation depends on assumptions such as profit maximization and perfect competition (and is inappropriate for a centrally planned economy); and the conventional approach requires the explicit introduction of time in the production function (and precludes the possibility of cross-sectional technical change). However, Wan's results are derived by manipulating the National Income and Product Accounts (NIPA) accounting identity in growth rates and transforming the value-added accounting identity into an equivalent form. Since the rate of technical change cannot be inferred solely from an identity, his method suffers from serious limitations.

Chow estimates Cobb-Douglas aggregate production functions and the rate of total factor productivity growth, and concludes that technical progress in China was absent during the 1952–80 period. His regressions for total output exclude 1958–69, a period of upheaval marked by the Great Leap Forward and the Cultural Revolution. This is an exercise in data mining, say Felipe and McCombie, as the excluded years should not have affected the parameters of the production function. Chow's assertion that his results are meaningful because they agree with other findings is dubious because the studies are not comparable, his approach undermines the rationale for estimating aggregate production functions, and he interprets his results in the standard manner. Furthermore, Chow's regressions can be derived as an algebraic transformation of the NIPA accounting identity. Moreover, his argument about the lack of total factor productivity growth in the Chinese economy is based on a peculiar misspecification problem (an incorrect approximation to the income identity) that conforms to the NIPA identity, leading him to (falsely) believe that neoclassical production theory can explain growth and productivity in China.

He and Qin define the driving forces behind China's fast-growing domestic (business and government) investment using the neoclassical model. Government investment is modeled as a mixture of policy targets and supply-side constraints, while government direct investment is added as a new explanatory variable for the business sector. He and Qin conclude that aggregate business investment in China is now largely market-driven. However, their investment model is based on an accounting identity derived from two separate accounting identities, so it is not falsifiable and their conclusion is unwarranted. Moreover, He and Qin cannot model government sector investment according to the neoclassical model (due to a lack of sound theory), but they interpret their results within this framework. Also, their production function respecting government sector investment in neoclassical terms misses an important feature of the Chinese economy: technological progress.

Felipe and McCombie recommend that the neoclassical aggregate production function relating to the role of technological progress (with its emphasis on splitting the alleged contributions of factor accumulation and technical progress to overall output growth) should be discarded. They also recommend that investment modeling in China consider aggregate investment as a meaningful economic concept outside the realm of neoclassical economics and incorporate applicable elements from development theory, the role of expectations, and the role of profits as an investment source. Economists must pay attention to their theories and statistical techniques in order to improve their knowledge about the Chinese economy, they say.
www.levyinstitute.org/pubs/wp_643.pdf

How Rich Countries Became Rich and Why Poor Countries Remain Poor: It's the Economic Structure . . . *Duh!*

JESUS FELIPE, UTSAV KUMAR, and ARNELYN ABDON
Working Paper No. 644, December 2010

Some countries achieve sustained growth but most countries are in an economic trap. Jesus Felipe, Utsav Kumar, and Arnelyn Abdon, Asian Development Bank, Manila, Philippines, empirically analyze the export baskets of 154 countries and 779 products in terms of sophistication and connectivity. They determine that only 34 countries export mostly sophisticated and well-connected products, 28 countries are in a middle product trap, 17 countries are in a middle-low product trap, and 75 countries are in a low product trap. Solving the fundamental development problem requires an understanding of the relationship between poverty and the structure of production, and implementing appropriate economic policies.

The development literature consists of three strands: poverty-trap models showing that per capita income is permanently depressed as a consequence of population growth exceeding income growth; structural transformation and the accumulation of capabilities; and firm capabilities in combination with the ability to earn higher real wages. The authors discuss the concept of capabilities in the context of product space and a country's growth prospects, and the concepts and methodology used to classify products and countries. They find that many countries export "bad" products—products with low sophistication that are not well connected to other products.

Structural transformation results from changes in underlying fundamentals such as education, financial resources, and overall productivity. The authors point out that export diversification and upgrading are not easy because new activities entail uncertainty about profits and may require complementary large-scale investments, as well as externalities such as information and coordination.

Capabilities refer to human and physical capital needed to produce a product, industrial "know-how" at the level of the firm, and the organizational abilities of people. They are largely nontradable inputs because their transfer is a slow, expensive, and painstaking process. A country's ability to foray into new products depends on whether the set of existing capabilities can be deployed easily to produce and export new products. When products use similar capabilities, there is a high probability that a country can export these products with comparative advantage. A country's position within product space signals its capacity to expand into more sophisticated products, thus laying the groundwork for future growth.

The authors use a country's position in product space to classify the country according to two product characteristics: sophistication and connectivity. This method enables them to delimit the necessary policy interventions required to replace unsophisticated and unconnected products, and undertake structural transformation. Accumulated capabilities are critical for a country's development prospects, and new activities depend on accumulated capabilities; that is, the process is path dependent and involves a mix of learning and building institutional capacity within an appropriate business environment that includes targeted government-policy interventions.

The sophistication level of a product is calculated as the weighted average of the GDP per capita of countries exporting the product. Products are also segregated based on the ease with which their capabilities can be redeployed and used to export other products (the notion of proximity and its distribution in product space). The concept of proximity is based on trade outcomes, not on the products' physical characteristics.

Based on the distribution of products according to their level of sophistication, the authors classify the products into high, mid, and low levels, and assign each product to one of nine cells in a sophistication-proximity matrix. The most sophisticated (core) products such as metal products, machinery, and chemicals are also the best connected and tend to be man-made. The least sophisticated product groups are tropical agriculture, cereals, and petroleum (the least connected product) and tend to be nature-made. The authors subsequently classify the countries according to the products exported with revealed comparative advantage.

High-core countries are deemed to have a share of core commodities exported with revealed comparative advantage above 30 percent, and include the United States and European countries such as the UK, Germany, Switzerland, and Norway. Countries in the middle product-trap category include the BRICs (Brazil, Russia, India, and China), Mexico, and Malaysia. Low-core countries in the low product-trap category include Australia, Chile, and Nigeria; while low-core countries in the middle-low product-trap category include oil-exporting countries in the Middle East.

Countries in the low product-trap category need to industrialize, generate an advanced service sector, raise per capita incomes, reduce population growth, plan for a large-scale expansion of a wide range of economic activities, encourage significant government intervention in the development of new economic sectors, and focus their efforts on accumulating new capabilities.

www.levyinstitute.org/pubs/wp_644.pdf

Upcoming Events

20th Annual Hyman P. Minsky Conference on the State of the US and World Economies

Financial Reform and the Real Economy

Ford Foundation, New York City
April 13–15, 2011

The 20th Annual Minsky Conference will address the ongoing effects of the global financial crisis on the real economy, and examine proposed and recently enacted policy responses. Should ending too-big-to-fail be the cornerstone of reform? Do the markets' pursuit of self-interest generate real societal benefits? Is financial sector growth actually good for the real economy? Will the recently passed US financial reform bill make the entire financial system, not only the banks, safer? This conference is organized by the Levy Economics Institute of Bard College with support from the Ford Foundation. Additional information, including how to register, is available at www.levyinstitute.org.

Wednesday, April 13

8:00–9:00 a.m. **Breakfast and Registration**

9:00–9:30 a.m. **Welcome and Introduction**
LEONARDO BURLAMAQUI, Ford Foundation
DIMITRI B. PAPADIMITRIOU, Levy Institute

9:30–11:00 a.m. **Session 1**
The Ford–Levy Institute Project on Reregulating Financial Institutions and Markets
Speakers:
JAN KREGEL, Levy Institute and Tallinn Technical University
L. RANDALL WRAY, Levy Institute and University of Missouri–Kansas City
ÉRIC TYMOIGNE, Levy Institute and Lewis and Clark College

11:00–11:15 a.m. **Coffee Break**

11:15 a.m. – 1:00 p.m. **Session 2**
Financial Journalism and Financial Reform: What's Missing from the Headlines?
Moderator: JOHN CASSIDY, *The New Yorker*
Speakers:
JEFF MADRICK, *Challenge*, Roosevelt Institute, and The New School
JOE NOCERA, *The New York Times*
FRANCESCO GUERRERA, *Financial Times*
STEVE RANDY WALDMAN, Interfluidity.com

1:00–2:45 p.m. **Lunch**
Speaker: GARY GENSLER, US Commodity Futures Trading Commission

2:45–3:45 p.m. **Speaker**
STEPHEN S. ROACH, Morgan Stanley and Yale University

3:45–4:00 p.m. **Coffee Break**

4:00–5:00 p.m. **Session 3**
Swaps Regulation
Moderator: JUSTIN LAHART, *The Wall Street Journal*
Speakers:
JOSÉ GABILONDO, Florida International University
MICHAEL GREENBERGER, The University of Maryland
MICHAEL W. MASTERS, Masters Capital Management, LLC

5:00 p.m. **Reception and Dinner**
Speaker: PAUL MCCULLEY, Society of Fellows, Global Interdependence Center; formerly, Managing Director, PIMCO

Thursday, April 14

8:30–9:00 a.m. **Breakfast**

9:00–10:15 a.m. **Speaker**
ANDREW SHENG, China Banking Regulatory Commission and Tsinghua University

10:15–11:15 a.m. **Session 4**
Financial Reform and the GATS: Challenges and Opportunities
Moderator: ROGER LOWENSTEIN, *The New York Times,* and author, *The End of Wall Street*
Speakers:
WILLIAM H. JANEWAY, Warburg Pincus and Cambridge in America
PHILIP SUTTLE, The Institute of International Finance
LORI M. WALLACH, Global Trade Watch, Public Citizen

11:15–11:30 a.m. **Coffee Break**

11:30 a.m. – 12:30 p.m. **Speaker**

PHIL ANGELIDES, Financial Crisis Inquiry Commission

12:30–2:15 p.m. **Lunch**

Speaker: CHARLES I. PLOSSER, Federal Reserve Bank of Philadelphia

2:15–3:30 p.m. **Session 5**

Fiscal Constraints and Macro Perspectives

Moderator: LOUIS UCHITELLE, *The New York Times*

Speakers:

RICHARD BERNER, Morgan Stanley

PETER HOOPER, Deutsche Bank Securities

ROBERT W. PARENTEAU, Levy Institute and MacroStrategy Edge

MARSHALL AUERBACK, Levy Institute and Roosevelt Institute

3:30–4:30 p.m. **Speaker**

GARY B. GORTON, Yale University and National Bureau of Economic Research

4:30–4:45 p.m. **Coffee Break**

4:45–6:15 p.m.

Policy and Regulatory Responses of Emerging Markets: Latin America

Speaker: MERCEDES MARCO DEL PONT, Central Bank of Argentina

Discussion: ARTURO O'CONNELL, Central Bank of Argentina

6:15 p.m. **Reception and Dinner**

Speaker: PAUL TUCKER, Bank of England

Friday, April 15

8:30–9:00 a.m. **Breakfast**

9:00–10:00 a.m. **Speaker**

ATHANASIOS ORPHANIDES, Central Bank of Cyprus and European Central Bank

10:00–11:00 a.m. **Speaker**

VÍTOR CONSTÂNCIO, European Central Bank

11:00–11:15 a.m. **Coffee Break**

11:15 a.m. – 12:15 p.m. **Speaker**

CHARLES L. EVANS, Federal Reserve Bank of Chicago

12:15–2:30 p.m. **Lunch**

Speaker: SHEILA C. BAIR, Federal Deposit Insurance Corporation

2:30–3:45 p.m. **Session 6**

Reregulating the US Financial System: Beyond Dodd-Frank

Moderator: ERIC DASH, *The New York Times*

Speakers:

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

ROBERT A. JOHNSON, Institute for New Economic Thinking

ALEX J. POLLOCK, American Enterprise Institute for Public Policy Research

3:45–4:15 p.m. **Speaker**

MARTIN MAYER, The Brookings Institution

4:15–5:15 p.m. **Reception**

The Wynne Godley Memorial Conference

Contributions in Stock-flow Modeling

Levy Economics Institute of Bard College
Annandale-on-Hudson, New York
May 25–26, 2011

Wynne Godley's work focused on the strategic prospects for the US, UK, and world economies, and the use of accounting macroeconomic models to reveal structural imbalances. This conference will provide scholars profoundly influenced by his work the opportunity to celebrate his contributions to the field of economics. Topics will include fiscal policy and stock-flow consistent models; unsustainable processes and the role of the dollar in fostering global imbalances; stability and convergence programs; trade and current account imbalances and international currencies; financial integration, intrazone credit, and stabilization in a monetary union; debt-deflation traps within small open economies; and the UK and US private expenditure function.

The Hyman P. Minsky Summer Seminar

Levy Economics Institute of Bard College
Annandale-on-Hudson, New York
June 18–26, 2011

The second annual Minsky Summer Seminar will provide a rigorous discussion of both the theoretical and applied aspects of Minsky's economics, with an examination of meaningful prescriptive policies relevant to the current economic and financial crisis. The Seminar program will be organized by Jan Kregel, Dimitri B. Papadimitriou, and L. Randall Wray, and will be of particular interest to recent graduates, graduate students, and those at the beginning of their academic or professional careers. Teaching staff will include well-known economists concentrating on and expanding Minsky's work. For additional information, visit our website.

PUBLICATIONS AND PRESENTATIONS

Publications and Presentations by Levy Institute Scholars

RANIA ANTONOPOULOS *Research Scholar and Program Director*

Publications: "Macroeconomic Implications of HIV/AIDS: From Unpaid to Paid Care Work" (with T. Toay), in V.-K. Nguyen and J. Klot, eds., *The Fourth Wave: An Assault on Women—Gender, Culture, & HIV in the 21st Century*, UNESCO/SSRC 2010; "Responding to the Crisis, Promoting Gender Equality: Stimulus Packages and Public Job Creation" (with K. Kim), in S. Dullien et al., eds, *The World Economy in Crisis—The Return of Keynesianism?* Metropolis-Verlag, 2010; *Employment Guarantee Policies*, Policy Brief No. 2, Gender Equality and Poverty Reduction series, UNDP, April, 2011.

Presentations: "Macroeconomics and Gender Equality: Enhancing Capacity Building and Knowledge Sharing in CEES and CIS Countries," seminar hosted by the Heinrich Böll Foundation, Warsaw, Poland, April 28–29; "How Is an Employment Guarantee Policy Different than Other Social Development Support Interventions?" ministerial meeting on "The Global Jobs Pact: Crisis Recovery through Women's Economic Empowerment," organized by the International Labour Organization and the United Nations Development Programme (UNDP) as part of the UN Economic and Social Council (ECOSOC) 2010 sessions, UN Headquarters, New York, June 29; "Programmes and Public Policies Based on Valuation of Care Work," VIII International Meeting of Experts on Time-Use Surveys and Public Policies, United Nations Development Fund for Women (UNIFEM) and National Institute of Statistics of Mexico (INEGI), Mexico City, Mexico, June 30–July 2; "Women's Economic Empowerment: What Policies for the Most Vulnerable Groups?" XI Regional Conference on Women in Latin America and the Caribbean. United Nations Economic Commission for Latin America and the Caribbean, Brasilia, Brazil, July 13–16, 2010; "Key Themes of the International Experience" and "Macroeconomic Impacts of Public Works Investment in Social Services," seminar on "Social Policy and Economic Citizenship: Direct Employment Creation for Inclusive Development and Women's Economic Empowerment," United Nations Development Program and National Institute of Women, Government of Mexico, Mexico City, August 5–6; "The Economic Agenda," expert meeting on "Strengthening National Mechanisms and Ministries for Gender Equality and the Empowerment of Women," organized by the Commission on the Status of Women, UN Headquarters, New York, October 6–8; "Rural Poverty: Social Policies to Address the Challenge of Low Levels of Female Labour Force Participation," seminar organized by the Secretariat of Planning, Government of Turkey, Ankara, October 11; "Women's Economic Empowerment: Cash Transfers or Employment Guarantee?" International Symposium on Poverty Alleviation Strategies: Experiences and New Ideas," organized by the Office of the Prime Minister and the Ministry of Social Development, Istanbul, Turkey, October 13–15; "After the Great Recession? The Reemergence of Conservative Economic Policies," panel on "The Impact of the Systemic Crisis on Women: Responses to Date and Feminist Alternatives," held in parallel with the 55th Session of the United Nations Commission on the Status of Women, UN Headquarters, New York, March 1, 2011; "Poverty Reduction: What Policies?" International Convention on Gender Equality: "Role of Equality Commissions for a More Equal World for All," organized by the UNDP-Turkey and the National Equal Opportunities Commission of Turkey, Istanbul, March 24–25.

PHILIP ARESTIS *Senior Scholar*

Publications: "Economic Policies after the New Consensus Macroeconomics," in S. Dullien et al., eds., *The World Economy in Crisis—The Return of Keynesianism?* Metropolis-Verlag, 2010; *21st Century Keynesianism* (with M. C. Sawyer), Palgrave Macmillan; *The Post "Great Recession" US Economy: Implications for Financial Markets and the Economy* (with E. Karakitsos), Palgrave Macmillan; "Interview with Philip Arestis," *Intervention: European Journal of Economics and Economic Policies*, Vol. 7, No. 2 (Autumn); "Financial Structure and Economic Growth: Evidence from Time Series Analyses" (with A. D. Luintel and K. B. Luintel), *Applied Financial Economics*, Vol. 20, Nos. 19–21 (October–November)); "Absurd Austerity Policies in Europe" (with T. Pelagidis), *Challenge: The Magazine of Economic Affairs*, Vol. 53, No. 6 (November–December); "European Integration and the 'Euro Project" (with M. C. Sawyer), in J. Michie, ed., *The Handbook of Globalisation*, Edward Elgar, 2011; *The Financial Crisis: Origins and Implications* (with R. Sobreira and J. L. Oreiro), Palgrave Macmillan; *An Assessment of the Global Impact of the Financial Crisis* (with R. Sobreira and J. L. Oreiro), Palgrave Macmillan; "Raising Interest Rates Is a Poor Tool to Fight Inflation" (with M. Sawyer), *Financial Times*, February 2.

Presentations: "A New Paradigm for Macroeconomic Policy" (with M. Sawyer), conference on "Economic Policy: In Search of an Alternative Paradigm," Middlesex University, London, England, December 3, 2010; "Can the Euro Survive after the Greek Tragedy?" (with M. Sawyer) and "The 'Great Recession' and Economic Policy Implications," conference on "The Greek and the Euro Area Crises," Department of Applied Economics V, Faculty of Economics and Business, University of the Basque Country, Bilbao, Spain, December 17; "Critique of Financialization and the US Unemployment Gender Gap" (with A. Charles and G. Fontana), Association for Social Economics panel on "Social Economics of the Financial Crisis," and "New Economics from an Institutional Perspective" (with M. Sawyer), Association for Evolutionary Economics panel on "New Thinking in Economics: The Theoretical Premise," Annual Meeting of the Allied Social Science Associations, Denver, Colorado, January 7–9, 2011; "Critique of Financialization and the US Unemployment Gender Gap," staff seminar, Department of Economics, University of Glasgow, Scotland, January 27.

JAMES K. GALBRAITH *Senior Scholar*

Publications: "The Generalized Minsky Moment" (with D. M. Sastre), in D. B. Papadimitriou, ed., *The Elgar Companion to Hyman Minsky*, Edward Elgar, 2010; "Attack on the Middle Class!!" *Mother Jones* (November–December); "Actually, the Retirement Age Is Too High," Special Report: Unconventional Wisdom, *Foreign Policy* (January–February 2011); "Early Retirement as a Fix for Unemployment," *The American Prospect*, February 17.

Presentations: "The Great Crisis, The Keynesian Rising, and the Great Neo-Liberal Counter-Attack: A Study in the Power of the Predator Style," Associazione Nazionale fra le Banche Popolari, Rome, Italy, November 15, 2010; "The Scourge of the Deficit Hawks," Penn State Berks, Reading, Penn., December 1; "One Crisis: Implications of Financial Developments in the United States for Europe and the World," conference on "Europe in Crisis," sponsored by Oesterreichische Nationalbank for the Huffschmid Conference, Vienna, Austria, December 10; Speaker: "Mainstream Economics after the Crisis," American Economic Association panel on "What's Wrong (and Right) with Economics? Implications of the Financial Crisis," Annual Meeting of the Allied Social Science Associations (ASSA), Denver, Colo., January 7, 2011; "A Precise Understanding of the Interactions Among Institutional Structures, Policies, and Changing Environment" (with J. Chen), Association for Evolutionary Economics panel on "New Thinking in Economics: The Policy Dimension," ASSA Annual Meeting, January 9; "A Profession in Disgrace," Association for Social Economics panel on "New Directions in Macro: Where Is the Real World Pulling Us?" ASSA Annual Meeting, January 9.

JAN KREGEL *Senior Scholar and Program Director*

Publications: Foreword to L. Fernando de Paula, *Financial Liberalization and Economic Performance: Brazil at the Crossroads,* Routledge, 2010; "The Natural Instability of Financial Markets," in J. Toporowski, ed., *Financial Markets and Financial Fragility*, Vol. II, Edward Elgar; "The Report of the Commission of Experts on Reform of the International Monetary and Financial System and Its Economic Rationale," in K. S. Jomo, ed., *Reforming the International Financial System for Development,* Columbia University Press.

Presentations: "Structured Derivatives Contracts, Hedging Exchange Appreciation, and Financial Instability: Brazil, China, and Korea," conference on "Financialization, Financial Systems, and Economic Development," Renmin University of China, Beijing, November 8–9, 2010; "Minsky and Regulation of an Unstable Financial System," XLV Reunión Anual de la

Asociación Argentina de Economía Politíca, Buenos Aires, Argentina, November 15–19; "Resolving the Crisis: Politics Dominates Economics in the New Political Economy," roundtable on "La Crisi della Macroeconomia," Accademia Nazionale dei Lincei, Rome, Italy, November 30; "Evolution versus Equilibrium," Veblen-Commons Award Lecture, Annual Meeting of the Association for Evolutionary Economics, Denver, Colo., January 7, 2011.

THOMAS MASTERSON *Research Scholar*

Publication: "Statistical Matching Using Propensity Scores: Theory and Application to the Analysis of the Distribution of Income and Wealth" (with H. Kum), *Journal of Economic and Social Measurement*, Vol. 35, No. 3–4 (2010).

Presentations: "Economic Inequality in the US: An Alternative Perspective" (with E. N. Wolff and A. Zacharias), Union for Radical Political Economists (URPE) panel on "Inequality and Worker Well-Being in the US," and "New Estimates of Economic Inequality in America, 1959–2004," URPE panel on "Inequality in North America," Annual Meeting of the Allied Social Science Associations, Denver, Colo., January 8–9, 2011.

DIMITRI B. PAPADIMITRIOU *President*

Publications: "2011: Jobs versus the Deficit," *Truthout* and *New Geography*, December 29, 2010; "Mortgage Meltdown: How Underwriting Went Under," *New Geography*, February 15, 2011; "The Printing Press and the Euromess," *Truthout*, March 13.

Presentations: "The Greek Crisis and the Future of the Euro Project," World Affairs Council of the Mid-Hudson Valley, Poughkeepsie, NY, March 10, 2011; interview regarding long-term developments facing the future of monetary policy and inflation with Michael S. Derby, Dow Jones, March 10.

JOEL PERLMANN *Senior Scholar and Program Director*

Publication: "Ethnic Group Strength, Intermarriage, and Group Blending," in E. Lederhendler, ed., *Ethnicity and Beyond: Theories and Dilemmas of Jewish Group Demarcation*, Studies in Contemporary Jewry, Vol. 25, Oxford University Press, 2011.

EDWARD N. WOLFF *Senior Scholar*

Publication: "Recent Trends in Household Wealth, 1983–2009: The Irresistible Rise of Household Debt," *Review of Economics and Institutions*, Vol. 2, No. 1 (Winter 2011).

Presentations: Comments on R. Chakrabarti et al., "Household Debt and Saving during the 2007 Recession," and J. Bricker et al., "Drowning or Weathering the Storm? Changes in Family Finances from 2007 to 2009," conference on "Wealth, Financial Intermediation and the Real Economy," sponsored by the Conference on Income and Wealth, National Bureau of Economic Research, Washington, DC, November 12–13, 2010; "Economic Inequality in the US: An Alternative Perspective" (with T. Masterson and A. Zacharias), Union for Radical Political Economists panel on "Inequality and Worker Well-Being in the US," Annual Meeting of the Allied Social Science Associations, Denver, Colo., January 8, 2011.

AJIT ZACHARIAS *Senior Scholar*

Presentation: "Economic Inequality in the US: An Alternative Perspective" (with T. Masterson and E. N. Wolff), Union for Radical Political Economists panel on "Inequality and Worker Well-Being in the US," Annual Meeting of the Allied Social Science Associations, Denver, Colo., January 8, 2011.

GENNARO ZEZZA *Research Scholar*

Presentations: "Global Imbalances and International Currencies," conference on "Stabilising an Unequal Economy? Public Debt, Financial Regulation, and Income Distribution," Hans Böckler Stiftung, Berlin, Germany, October 29–30, 2010; "A Financial Crisis, or a Crisis in the Growth Model?" seminar, University of Pavia, Italy, December 15; " Global Imbalances and International Currencies," Union for Radical Political Economists panel on "Global Real and Financial Imbalances," Annual Meeting of the Allied Social Science Associations, Denver, Colo., January 7, 2011; "Modeling International Markets and Institutions with a Stock Flow–Consistent Approach," 37th Eastern Economic Association Annual Meeting, New York, NY, February 26.

Recent Levy Institute Publications

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December 2009

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