The Levy Economics Institute of Bard College

Summary

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

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

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INSTITUTE NEWS

PUBLICATIONS AND PRESENTATIONS

LETTER FROM THE PRESIDENT

To our readers:

This issue begins with a strategic analysis by me and my collegues, Research Scholars Gennaro Zezza and Greg Hannsgen, on the state of the U.S. and world economies. We believe that the most important economic policy issue is the prospect of a growth recession in the United States. Our main concern is aggregate demand, and we conclude that any potential remedy for the imbalances in the U.S. economy depends on three events: foreign saving must fall, U.S. saving must rise, and the dollar must devalue. Developments in the housing sector will be crucial in the coming months and we foresee a housing-led decline in the U.S. economy. The consequences of the imbalances are also addressed in a brief by Research Associate Robert W. Parenteau. He finds that a credit crunch could sharply curtail household credit growth, which would jeopardize economic growth at home and abroad.

Under a new program entitled monetary policy and financial structure, a working paper by Senior Scholar L. Randall Wray outlines a socioeconomic approach to the concept of money that leads to new directions for monetary, fiscal, and exchange rate policies. He maintains that the perceived need of U.S. foreign saving in order to finance the persistent U.S. trade deficit makes no sense for a sovereign nation operating on a flexible exchange rate. In another working paper, Research Associate Jörg Bibow finds that the Maastricht regime fosters fragility and divergence across the euro area. There has been an unprecedented divorce between the main monetary and fiscal authorities, and the official euro area doctrine is doomed to failure, he says.

A brief by Research Associate Thomas I. Palley reviews the theory of comparative advantage and finds that it is driven by technology, which can be influenced by human action and policy (e.g., exchange rates should be considered when formulating trade policy). The United States is losing industry and experiencing large trade deficits because it is being outgamed by other countries, he says. A working paper by Giuseppe Fontana evaluates monetary policy within the central bank and finds that the New Consensus notion that money and monetary policy are neutral is untenable in both the short and long run.

Two working papers are included under the gender equality and the economy program. Senior Scholar Caren A. Grown outlines a menu of quick impact initiatives for achieving the United Nation's millennium development goals that focus on gender equality and women's empowerment in low- and middle-income countries. In a related paper, Grown, Chandrika Bahadur, Jessie Handbury, and Diane Elson extend the methodology developed by the millennium project to estimate the cost of promoting gender equality and the financing gaps in low-income countries.

Another new program entitled employment policy and labor markets includes our October conference on employee guarantee policies. The conference focused on government policy initiatives that can create a safety net through public service employment for individuals who are ready, willing, and able to work. Participants from academia, government, and international organizations related how employer of last resort (ELR) programs provide economic, political, social, and regional advantages. For example, decentralized job creation schemes in Argentina (Jefes) and India were shown to have positive outcomes in improving the human condition. The participants challenged the notions that unemployment and poverty are the cost of maintaining macroeconomic stability and that ELR programs are too expensive and threaten price and currency stability. The participants agreed that full employment should be at the center of macro and social policy, and that the state should be the ELR. Nine working papers were received from participants in the conference on government spending on the elderly, which was held in April and covered in the Fall 2006 Summary.

A brief by Senior Scholar James K. Galbraith finds that European ideals require convergence but European policy imposes divergence, which could destroy the economic promises of the European Union for its poorer regions and the accession countries. European policymakers should recognize the true roots of U.S. success in fiscal federalism and Keynesian economics, he says. A working paper by Palacio-Vera et al. presents new empirical evidence that supports the claim that the aggregate capital-output ratio, the real price of imports, and capacity utilization are significant in the determination of the nonaccelerating inflation rate of unemployment in the U.S. economy.

Under explorations in theory and empirical analysis, a working paper by Research Associate Korkut A. Ertürk finds that Hyman P. Minsky overlooked elements in Keynes's *Treatise* that supported his turning point of business cycle expansions.

As always, I welcome your comments and suggestions.

Dimitri B. Papadimitriou, *President*

Program: The State of the U.S. and World Economies, and Strategic Analysis

Can Global Imbalances Continue? Policies for the U.S. Economy

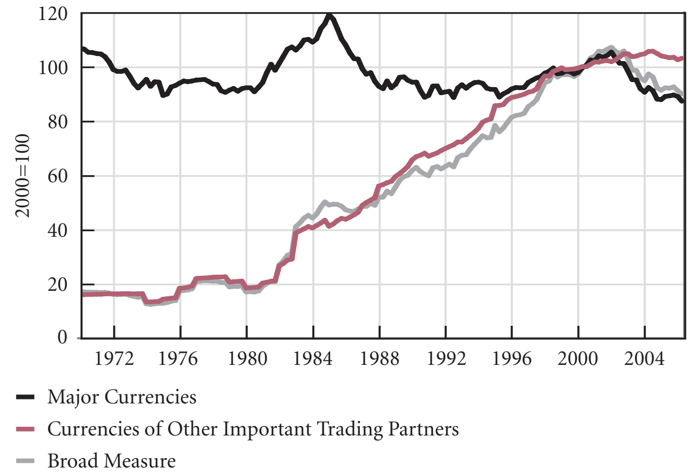
DIMITRI B. PAPADIMITRIOU, GENNARO ZEZZA, and GREG HANNSGEN
Strategic Analysis, November 2006
www.levy.org/pubs/sa_nov_06.pdf

According to President Dimitri B. Papadimitriou and Research Scholars Gennaro Zezza and Greg Hannsgen, the most important economic policy issue facing policymakers is the prospect of a growth recession in the United States. Using the Levy Institute's macro model, the authors analyze the imbalances in the U.S. economy and conclude that any potential remedy for the imbalances depends on three events: foreign saving must fall, U.S. saving must rise, and the dollar must devalue. A way out of the current account bind (without stifling aggregate demand) involves a stimulation of macroeconomic policy abroad, an orderly devaluation, and an increase in the saving of U.S. households.

The authors note that there is no general consensus to the notion that a large and rising U.S. current account deficit poses a threat and requires a policy response. They also note that historical experience does not offer much guidance in today's unprecedented economic climate. They point out that Levy Institute scholars have recognized for some time that the current account and private sector imbalances would eventually bring the U.S. economy into an unsustainable position, unless corrective actions were taken.

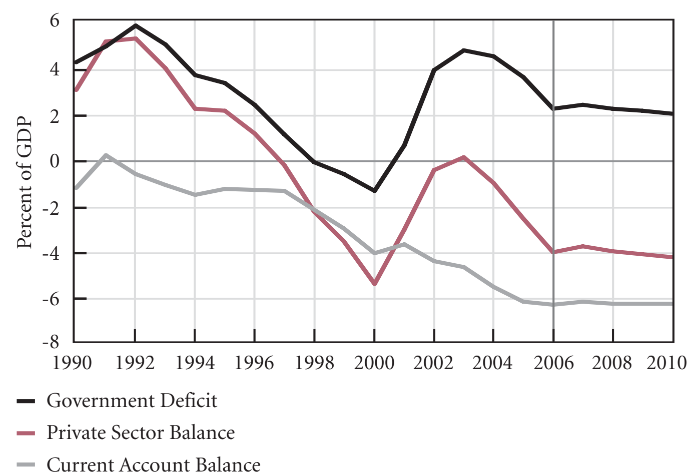
Household net worth is an important variable driving consumer expenditures. The authors find that the U.S. economic expansion has never been so dependent on home equity loans and cash-out mortgage refinancing. The economy, therefore, is more vulnerable than ever to falling house prices, as rising interest rates and declining property values could have a synergistic negative effect on household expenditures.

Figure 1 **Measures of U.S. Dollar Exchange Rate**



Sources: Federal Reserve and authorsí calculations

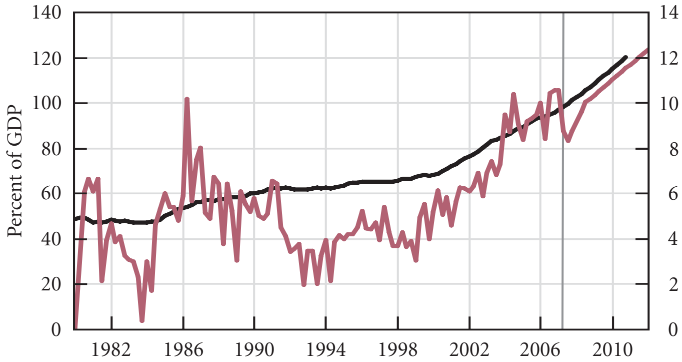
Figure 2 **Main Sector Balances in Baseline Scenario**



Sources: Bureau of Economic Analysis and authors' calculations

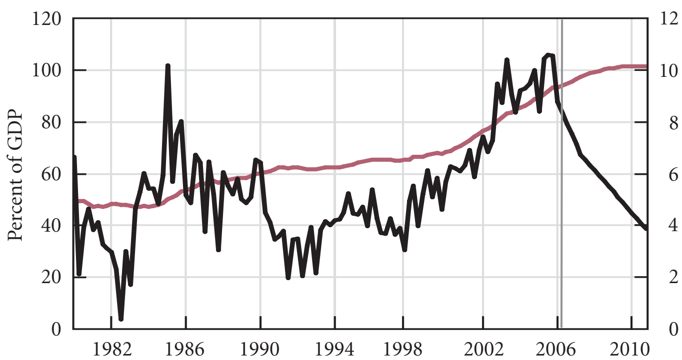
The authors also find that the recent record current account deficit does not indicate a change in trend and remains stubbornly high, which can be explained by a number of factors. For example, since most of the U.S. debt is denominated in dollars and most of U.S. foreign assets are denominated in foreign currency, the U.S. net asset position rises when the dollar devalues. The dollar has fallen against the major currencies, while remaining stable with other currencies (Figure 1). The authors view devaluation as both part of the problem and the solution to chronic current account imbalances. Devaluation could raise

Figure 3 **Household Debt and Borrowing in Baseline Scenario**



Sources: Federal Reserve, Bureau of Economic Analysis, and authors' calculations

Figure 4 **Household Debt and Borrowing in Scenarios 1 and 2**



Sources: Federal Reserve, Bureau of Economic Analysis, and authors' calculations

interest rates and the cost of servicing the national debt, but would increase the demand for domestically produced goods.

The authors' main concern is aggregate demand rather than inflation or disorderly adjustment. Private sector and government borrowing have been driving the U.S. economy, so a drop in borrowing will reduce the demand for goods and services at home and abroad, and raise the specter of recession. The authors advocate a multilateral solution to improving the demand for imported goods in export-oriented countries and to devaluing the dollar, but they question the willingness of players to achieve a solution. In terms of current international proposals, they support exchange rate flexibility and increased demand abroad, but doubt the effectiveness of structural reforms (e.g., scaling back social programs, labor market protections, and regulations in order to spur domestic investment). Export demand is crucial, they say. Nonselective tariffs could be used as a last resort and looser monetary policy might help.

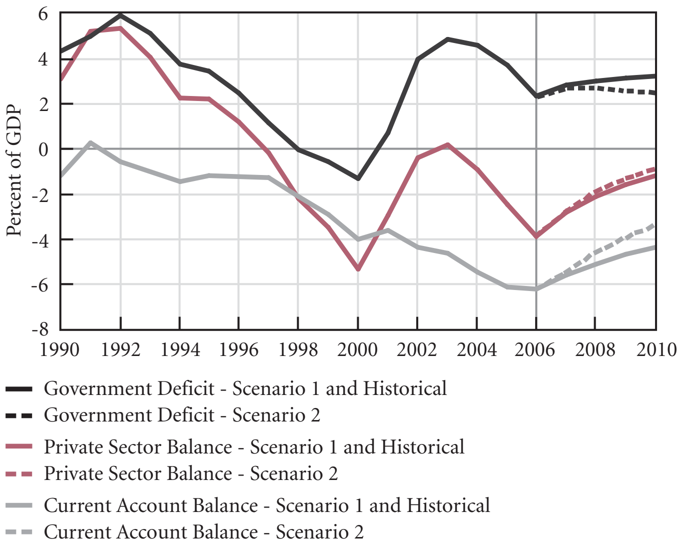
The entire deficit of the private sector relates to its personal rather than its corporate component. Borrowing remains very high and the rising debt-service ratio indicates that pressure is mounting for U.S. consumers. The primary concern is that reduced spending will cause the economy to fall into recession and households will be caught in a vise of financial obligations and insufficient income. Developments in the housing sector will be crucial in the coming months, say the authors, but current indexes are negative. The authors outline the case for a housing-led decline in the U.S. economy.

The authors conduct five-year forecasts for scenarios that explore several hypothetical situations under relatively conservative assumptions regarding interest rates, oil prices, asset prices, and exchange rates. Their baseline scenario uses Congressional Budget Office (CBO) projections for the growth rate of economic output, inflation, and fiscal policy under the assumptions of stable interest rates and no dollar devaluation. To achieve the CBO's growth path, the financial balances would flatten out over the next four years (Figure 2) and there would be a sharp rise in household borrowing and debt (Figure 3). This result is implausible, they say.

The first scenario includes a retrenchment of the private sector (Figure 4) and continued international inaction. A steady drop in domestic demand leads to a moderate growth recession (below 2 percent before rising to 2.3 percent) and the possibility of serious unemployment. However, both the current account and private sector balances would improve dramatically (Figure 5).

A second scenario investigates the consequences of more optimistic growth assumptions in the rest of the world and dollar devaluation against the euro and pound (10 percent per year over the next two years), and against the currencies of the United States's main Asian trading partners (5 percent per year). The U.S. growth rate recovers more rapidly and the current account moves toward balance faster than in the previous scenarios (Figure 5). (The authors point out that the move toward balance could be faster than indicated because devaluation lowers the dollar value of net foreign debt, while income flows from these assets rise when measured in dollars.)

Figure 5 Main Sector Balances under Alternative Assumptions



Sources: Bureau of Economic Analysis and authors' calculations

The authors believe that there is ample room for more expansionary fiscal and monetary policies in Asia and Europe to correct the world imbalances. The current concern about external imbalances is largely misplaced within the context of four to five years, they say. The concern should be that the deficit is subtracting 6.5 percent from total demand and that personal income less personal expenditure is deeply negative. The authors expect a large drop in net lending and a recession without a "bounce back" response because the saving ratio is only returning to normal. If faced with rising unemployment, the government may be forced into renewed stimulus from fiscal policy, they say.

U.S. Household Deficit Spending: A Rendezvous with Reality

ROBERT W. PARENTEAU

Public Policy Brief No. 88, 2006

www.levy.org/pubs/ppb_88.pdf

Over the past decade, deficit spending of U.S. households has supported the U.S. economy. Research Associate Robert W. Parenteau, RCM, analyzes the financial balance of U.S. households and finds that the pace of deficit spending is likely to stall and, possibly, reverse course. This reversion will jeopardize U.S. profit and economic growth, as well as the growth of countries dependent on export-led development strategies. His research supports the position of other Levy Institute scholars who have urged U.S. policymakers to recognize the consequences of current imbalances in the U.S. economy.

Parenteau observes that the U.S. household financial balance has been deteriorating since 1997 and that the rate of decay has accelerated since early 2005. Although persistently increasing private sector deficits can be sustained, the conditions for avoiding debt-trap dynamics no longer exist. What may be happening in the U.S. household sector, says Parenteau, is what the late economist Hyman P. Minsky would recognize as a form of Ponzi finance. Since the primary financial surplus is exhausted, and income growth is below the average interest rate paid on household debt, household borrowing against the value of existing assets is required to sustain rampant deficit spending and service prior debt commitments. Thus, household deficit spending is predicated on sustaining asset bubbles, but we may soon enter a period of house price deflation and declining household spending, which would have profound implications for export-led economies.

The gap between personal saving and the acquisition of net financial assets has to do with massive mortgage equity withdrawals. The household gross savings rate has overshot to the downside, irrespective of the elevated ratio of net worth to disposable income. Even under very favorable assumptions for income growth and household net worth appreciation, Parenteau expects that the implied rate of real consumer spending will drop at a rate that is rarely seen outside of recessions.

Debt-trap equations are rarely applied to private sector deficit spending. When the equations are applied to the U.S. household sector, there is an explosive household debt-to-income trajectory that can only be sustained by an equally explosive appreciation of asset prices that lifts them far from their fundamental values.

Parenteau's review of key lines of credit extended to the U.S. household sector shows a noticeable slowdown: home equity lending by commercial banks has come to a full stop, mortgage applications for loans to purchase houses have dropped considerably (this source of mortgage equity has dried up), consumer bank loans that are not related to real estate have also dried up in the past year, and credit card usage has declined over the past three quarters. Most of the slower household credit growth has been a demand-side response to slower house price appreciation.

Furthermore, credit restrictions have yet to appear on the scene, so a credit crunch could sharply curtail household credit growth and force a dramatic reversal of household deficit spending. A rendezvous with reality for U.S. household financial imbalances appears to have arrived, he says.

Program: Monetary Policy and Financial Structure

Banking, Finance, and Money: A Socioeconomics Approach

L. RANDALL WRAY
Working Paper No. 459, July 2006
www.levy.org/pubs/wp_459.pdf

The orthodox approach to the origins of banking, finance, and money is that these mechanisms were created to improve market efficiency. Money is a "natural" phenomenon that reduces transaction costs and lubricates the market mechanism. Senior Scholar L. Randall Wray, University of Missouri–Kansas City and director of research, Center for Full Employment and Price Stability, rejects the orthodox approach based on socioeconomics and historical evidence. He finds that the market is a clearinghouse for debts and credits rather than a place where goods are exchanged. The value of each marketed commodity is denominated in the commodity chosen as the medium of exchange through the asocial forces of supply and demand. His alternative view of money leads to different conclusions and new directions for monetary, fiscal, and exchange rate policies.

Wray reviews the rationale and foundations of the monetarist approach, new classical theory, modern theories of finance, and the evolution of mainstream economic theory. He concludes that economics students face unrelated special-purpose models that shed little light on banking, finance, and money.

Historians and anthropologists have emphasized the important role played by authorities in creating and organizing markets. Money is social in nature, consisting of a complex social practice that includes power and class relationships, socially constructed meaning, and abstract representations of social value. It is almost certain that (tribal) wergild fines were gradually converted to payments made to an authority (e.g., tithes and tributes, and eventually, taxes) with the rise of some sort of ruling class, says Wray. The next step was the standardization of the obligations in a unit of account (e.g., all early money units were expressed in terms of grain weights). Once there was the universal unit of account, credits and debts could be denominated in "money." Banks emerged to allow creditors and debtors to clear accounts between banks and their customers and to act as clearing facilities between the state and its taxpayers. As opposed to the orthodox story, bank reserves are viewed as the government liability held by banks to facilitate clearing. In contrast to the orthodox view that nothing backs the government liability, Wray observes that the tax system stands behind the state's currency and the state is obligated to accept its own currency in payment of taxes (i.e., there is sovereign power behind state money).

Wray focuses on a number of directions for alternative thinking about policy in terms of government budget constraints, the central bank's control of money and inflation, and international financial flows and exchange rate regimes. He believes that the state can take advantage of its role in the monetary system to mobilize resources in the public interest (without worrying about the "availability of finance") and that the central bank should not attempt to control the money supply. He notes that empirical studies are unable to find consistent evidence in favor of conventional views about the relationships between interest rates, spending, and inflation.

The perceived need of U.S. foreign savings in order to finance the persistent U.S. trade deficit makes no sense for a sovereign nation operating on a flexible exchange rate, concludes Wray. A good place to start in terms of further research that would develop a truly socioeconomics approach to the issues is the nature of sovereign power and credit-debt relations.

How the Maastricht Regime Fosters Divergence as Well as Fragility

JÖRG BIBOW
Working Paper No. 460, July 2006
www.levy.org/pubs/wp460.pdf

According to optimum currency area theory, increasing the properties shared by members of a currency union reduces nominal exchange rate adjustments in achieving internal and external balance. The most important property is business cycle synchronicity, and the main causes of macroeconomic divergence are asymmetric shocks and structural factors. Research Associate Jörg Bibow, Skidmore College, evaluates the persistent macroeconomic divergence across the euro area and concludes that the Maastricht regime itself (not shocks or structural factors) features powerful built-in destabilizers that foster fragility and divergence. The official euro area doctrine that substitutes structural reform and flexibility for proper demand management is doomed to failure, he says.

The euro area relies on wage and price flexibility, and supply-side (structural) reforms of market institutions, to stabilize its economy (the United States and the United Kingdom use demand management policies). Bibow notes that persistent inflation and economic activity (real GDP growth rate) differentials are not new to Europe and that pronounced cyclical divergence with protracted stagnation has characterized the euro area since the 2001 economic downturn. He also notes that a lack of business cycle synchronization among countries reduces the optimization of common monetary policy and the external exchange rate within the European Monetary Union (EMU).

The fact that Germany's growth has been driven by foreign trade is crucial in view of the proposition that flexible wages and prices should provide the key adjustment mechanism in the EMU. But EMU members have surrendered their ability to use national monetary and exchange rate policies, while the "one-size-fits-all" policy stance becomes less fitting the more that the members drift apart. The issue is whether automatic market mechanisms or deliberate policy measures can equalize the adjustment process.

According to Bibow, the official euro area flexibility doctrine offers misguided advice in stressing the role of the competitiveness channel (real exchange rates) in rebalancing divergences in inflation and economic activity. The competitiveness channel is ineffective in fostering internal balance in the short run and causes persistent divergences and the build-up of external imbalances. These results are especially true in large economies, where reliance on the competitiveness channel comes at the expense of depressing domestic demand (e.g., Germany's export success is derived by spreading its problems to its trading partners). The doctrine ignores the fundamental insights of R. A. Mundell and J. M. Keynes. Mundell stresses the use of the competitiveness channel to rebalance countries if the countries are hit by asymmetric demand shocks. However, this channel was not mutually beneficial, because the euro area experienced a symmetrical common shock that required a common policy stance in response to the 2001 global slowdown. Keynes taught that downward wage flexibility only works by inducing timely and well-measured monetary easing; otherwise, this strategy is risky and leads to stagflation or deflation.

Bibow rejects the roles of migration, labor and capital mobility, and mergers and acquisitions in contributing to the macroeconomic adjustment process in the euro area. In spite of a fairly advanced state of financial integration, he also rejects capital mobility as an avenue for convergence and long-run equilibrium. Finance may not only facilitate imbalances, but it may actually amplify divergences, he says.

Fiscal policy is the key policy instrument relating to optimum currency area theory. However, the current degree of fiscal integration in the euro area is minuscule, as budgets and fiscal policy are under national sovereignty. Since monetary policy has failed, fiscal policy is the only traditional stabilization policy tool left to members of the EMU. The Stability and Growth Pact (SGP) is unlikely to deliver either stability or growth.

Flexible wages and prices between EMU members are supposed to drive diverging euro area economies back to their converging steady-state growth paths. What is overlooked, says Bibow, is that other forces are at work that actually amplify growth and inflation divergences domestically, both directly and indirectly (e.g., the effects of the SGP in Germany versus Spain). Diverging inflation trends in a monetary union with common nominal interest rates imply that real interest rates can be highest in countries with already weak economies (and these rates become another force of divergence). He identifies "tax-push" inflation as a symptom of ill-guided macroeconomic policies that has caused macroeconomic fragility in the euro area. A crucial insight is that the forces of divergence are not independent, but reinforce one another.

There has been an unprecedented divorce between the main monetary and fiscal authorities in the euro area, says Bibow. When a large country like Germany follows the flexibility prescription, the forces of divergence increase because the competitiveness channel is not the only channel at work. Bibow recommends the alignment of wage inflation in the larger economies of the euro area, with persistent divergences in productivity trends and external imbalances justifying deviations from the established wage norm.

Rethinking Trade and Trade Policy: Gomory, Baumol, and Samuelson on Comparative Advantage

THOMAS I. PALLEY
Public Policy Brief No. 86, 2006
www.levy.org/pubs/ppb_86.pdf

The theory of comparative advantage says that there are gains from trade for the global economy as a whole. In this second of a three-part study of the international economy (see Public Policy Brief No. 85), Research Associate Thomas I. Palley observes that comparative advantage is driven by technology, which can be influenced by human action and policy. These associations have huge implications for the distribution of gains from trade and raise concerns about the future impact of international trade on the U.S. economy. Palley calls for strategically designed U.S. trade policy that can influence the nature of the global equilibrium and change the distribution of gains from trade.

Recent works by Ralph Gomory and William Baumol and by Paul Samuelson use pure trade theory to question the distribution of trade gains across countries over time and to challenge commonly held beliefs. These microeconomic and trade theorists identify a new issue: the dynamic evolution of comparative advantage and its impact on the distribution of gains from trade, which depends on changing global demand and supply conditions.

Palley reviews the tenets of trade theory and reasons that it is only by chance that the prevailing equilibrium maximizes global output; i.e., the allocation of production across countries may be globally inefficient. He also reasons that increasing returns to scale can give rise to trade conflict as country incomes converge. In light of dramatic implications when countries lose their industrial base or when industries relocate to other countries, Palley sees a need to redefine trade policy in terms of the forces driving industrial and technological development within countries, and strategic policy rivalry between countries.

Palley questions the wisdom of international outsourcing when company and national interests diverge. Although profit maximization by firms contributes toward maximizing global output, it does not necessarily maximize national output. This potential outcome is not understood by national policymakers, he says. There is a need for a new national policy agenda that realigns the business objectives of corporations with the national interest (an approach taken by the government of China), as well as a need for international labor and environmental standards.

Palley recommends that the U.S. government bolster public expenditures on science education and research and development (and change its tax laws accordingly), and invest in the latest technologies and equipment. These investments were formerly viewed as domestic policy, but they are now part of trade policy in the era of globalization.

Since exchange rates are extremely important for global production and employment outcomes, they should be considered when formulating trade policy. In a world of increasing returns to scale, countries can use undervalued exchange rates to move down average cost schedules and acquire ruling competitive advantage. This action can permanently change the equilibrium and lock in new patterns of global production. Although exchange rates are central to trade policy and trade agreements, U.S. policymakers reject this approach, so the United States is being outgamed by other countries (especially those in East Asia). The result is a loss of industry and large trade deficits that carry future burdens.

The United States may now lack the capacity to produce the manufactured goods that it now imports. The effects on manufacturing jobs and investment provide concrete support for the concerns raised by Gomory and Baumol, and Samuelson. Moreover, export-led growth by other countries raises a host of controversial issues that can adversely change the character of global economic competition: global financial imbalances, a race-to-the-bottom style of competition, and global deflation. These impacts are not addressed in standard microeconomic trade theory.

The "New Consensus" View of Monetary Policy: A New Wicksellian Connection?

GIUSEPPE FONTANA
Working Paper No. 476, October 2006
www.levy.org/pubs/wp476.pdf

The New Consensus view in macroeconomics includes a non-quantity theoretic approach to monetary policy. This view corresponds to the old Wicksellian idea of eliminating high levels of inflation by adjusting nominal interest rates to changes in the price level. Giuseppe Fontana, University of Leeds and Università del Sannio, Benevento, Italy, evaluates the theory and practice of monetary policy in terms of the monetary policy instrument controlled by the central bank and the macroeconomic variables affected by monetary policy in the short and long run. He finds that the New Consensus approach to monetary policy has failed to achieve the full potential of the Wicksellian monetary analysis because it adheres to the most influential conclusion of the classical theory of money—monetary policy is neutral in the long run. This notion represents the main limitation and possibly the most important challenge for the future development of the modern mainstream approach to money and monetary policy, he says.

According to M. Woodford, the New Consensus view updates Wicksell's two-interest rate analysis and his "pure credit economy," which explains the general movement of prices via the distinction between the natural real interest rate (a pure commodity rate that is determined by the scarcity of saving [capital]) and the loan interest rate (set by banks when granting credit to entrepreneurs). Banks set the loan interest rate equal to the natural real interest rate, but this equilibrium condition is only obtained by chance because fixing the loan rate is discretionary. The difference between the two rates is the main explanation for the change in the price level. (According to Wicksell, the difference between investments and savings is the main cause of changes in the price level.) Contrary to the conclusions of the quantity-theoretic analysis of inflation, an inflationary or deflationary process is triggered when banks set the loan rate lower or higher than the (exogenously shifting) natural real interest rate.

Several features of Wicksell's two-interest rate analysis of inflation concern modern monetary economists. One feature is that money is endogenous rather than exogenous, which means that the stock of money is not controlled by the central bank, but is the natural outcome of the production process. Woodford notes that modern central banks have vindicated Wicksell's monetary analysis by replacing a rule for base money growth with an interest rate rule. Another feature is the distinction between equilibrium and disequilibrium conditions. The normal case is an out-of-equilibrium situation where the gap between the natural real interest rate and the loan rate produces an imbalance between investments and savings. The imbalance is accommodated by commercial banks, which can change ex nihilo the supply of loans. The nature of modern monetary economies (where banks and credit play a key role in the production process) is responsible for any inflationary or deflationary process. It is extraordinary that the New Consensus view has rejected the quantity-theoretic analysis in favor of Wicksell's two-interest rate analysis, but omitted an important feature of Wicksell's analysis—the role of commercial banks—in explaining the production and money supply processes, observes Fontana.

Whereas Wicksell's monetary analysis is claimed to be the foundation for the current mainstream approach to money and monetary policy, the New Consensus view has missed potential venues for further development of the nonquantity theoretic approach to money and monetary policy. As noted by Fontana, monetary aggregates do not appear in any New Consensus equations that describe the dynamics of interest rates, output, and inflation. The equation describing the policy strategy of the central bank should be replaced by a type of LM-curve equation in order to have some consistency with the quantity theory of money, he says.

In Wicksell's two-interest rate analysis, inflation represents the state of imbalance of the economy, so the banking system does not need to ascertain the natural real interest rate before setting the loan rate. In the New Consensus view, central banks can be confident that the market rate matches the natural real interest rate, as long as the inflation rate is constant. These positions maintain that the potential level of output is not affected by aggregate demand and does not respond to changes in the real interest rate.

In mainstream monetary policy, the short-run real interest rate does not have any effect on its natural real interest rate. Fontana notes that Wicksell ultimately accepted the possibility of the interdependence between the two different interest rates. Analyses by E. Lindahl and the "endogenous money" view suggest that monetary policy could have long-run effects on output and employment. Demand-led growth and hysteresis models indicate that the central bank can produce short- and long-run effects in the economy by changing the interest rate. These models also show that central banks may permanently alter the labor and capital markets by curbing aggregate demand. Therefore, the axiom of neutrality of money and monetary policy is untenable in both the short and long run.

Program: Distribution of Income and Wealth, and the LIMEW

April 2006 Conference, Government Spending on the Elderly, Working Papers

Wage Growth and the Measurement of Social Security's Financial Condition

JAGADEESH GOKHALE
Working Paper No. 461, July 2006
www.levy.org/pubs/wp_461.pdf

A summary of this working paper appears in session 5 of the write-up for the conference on government spending on the elderly in the Fall 2006 *Summary*, Volume 15, No. 3, pages 16–17.

Working for a Good Retirement

BARBARA A. BUTRICA, KAREN E. SMITH, and C. EUGENE STEUERLE
Working Paper No. 463, July 2006
www.levy.org/pubs/wp_463.pdf

A summary of this working paper appears in session 3 of the write-up for the conference on government spending on the elderly in the Fall 2006 *Summary*, Volume 15, No. 3, pages 13–14.

Differing Prospects for Women and Men: Young Old-Age, Old Old-Age, and Elder Care

LOIS B. SHAW
Working Paper No. 464, July 2006
www.levy.org/pubs/wp_464.pdf

A summary of this working paper appears in session 2 of the write-up for the conference on government spending on the elderly in the Fall 2006 *Summary*, Volume 15, No. 3, pages 12–13.

Net Government Expenditures and the Economic Well-Being of the Elderly in the United States, 1989–2001

EDWARD N. WOLFF, AJIT ZACHARIAS, and HYUNSUB KUM
Working Paper No. 466, August 2006
www.levy.org/pubs/wp_466.pdf

A summary of this working paper appears in session 2 of the write-up for the conference on government spending on the elderly in the Fall 2006 *Summary*, Volume 15, No. 3, pages 11–12.

Global Demographic Trends and Provisioning for the Future

L. RANDALL WRAY
Working Paper No. 468, August 2006
www.levy.org/pubs/wp_468.pdf

A summary of this working paper appears in session 1 of the write-up for the conference on government spending on the elderly in the Fall 2006 *Summary*, Volume 15, No. 3, pages 10–11.

The Changing Role of Employer Pensions: Tax Expenditures, Costs, and Implications for Middle-Class Elderly

TERESA GHILARDUCCI
Working Paper No. 469, August 2006
www.levy.org/pubs/wp_469.pdf

A summary of this working paper appears in session 4 of the write-up for the conference on government spending on the elderly in the Fall 2006 *Summary*, Volume 15, No. 3, pages 14–15.

Retiree Health Benefit Coverage and Retirement

JAMES MARTON and STEPHEN A. WOODBURY
Working Paper No. 470, August 2006
www.levy.org/pubs/wp_470.pdf

A summary of this working paper appears in session 4 of the write-up for the conference on government spending on the elderly in the Fall 2006 *Summary*, Volume 15, No. 3, pages 15–16.

Population Forecasts, Fiscal Policy, and Risk

SHRIPAD TULJAPURKAR
Working Paper No. 471, August 2006
www.levy.org/pubs/wp_471.pdf

A summary of this working paper appears in session 5 of the write-up for the conference on government spending on the elderly in the Fall 2006 *Summary*, Volume 15, No. 3, page 16.

The Adequacy of Retirement Resources among the Soon-to-Retire, 1983–2001

EDWARD N. WOLFF
Working Paper No. 472, August 2006
www.levy.org/pubs/wp_472.pdf

A summary of this working paper appears in session 6 of the write-up for the conference on government spending on the elderly in the Fall 2006 *Summary*, Volume 15, No. 3, pages 17–18.

Program: Gender Equality and the Economy

Quick Impact Initiatives for Gender Equality: A Menu of Options

CAREN A. GROWN
Working Paper No. 462, July 2006
www.levy.org/pubs/wp462.pdf

Quick Impact Initiatives (QIIs) for achieving the Millennium Development Goals (MDGs) are interventions that are implemented in the early years of a scale-up strategy and generate results within three years. Senior Scholar Caren A. Grown outlines some criteria that donors and government can use to identify initiatives for gender equality and shows how these criteria can be used to develop a broader menu of QIIs for gender equality and women's empowerment in low- and middle-income countries.

Grown notes that QIIs have been proven to work in a short time, so they can help to build confidence in efforts to achieve the MDGs and can be the fulcrum for longer-term efforts and investments to empower women. Her paper summarizes seven interdependent strategic priorities for achieving gender equality and women's empowerment. The priorities relate to postprimary education; sexual and reproductive health, and rights; infrastructure investments; property and inheritance rights; employment; political representation; and violence against women. She proposes six criteria for identifying gender-sensitive QIIs, with a focus on improving economic opportunities.

Based on a review of the literature and in consultation with gender experts from policy research institutes and donor agencies, Grown outlines her criteria for identifying gender-sensitive QIIs that promote economic opportunities directly (e.g., postprimary education for girls) and indirectly (e.g., sexual and reproductive health, and rights). Although most interventions have the potential to be financially sustainable, external subsidies are often required, especially at start-up.

Grown outlines some empirical examples that illustrate what can be accomplished with political commitment and adequate resources. Secondary and higher levels of education have the greatest payoff for girls. Approaches that can increase female participation in school include the elimination of user and other fees, closer proximity of schools, improvements in safety and infrastructure, and more flexibility regarding scheduling and participation.

A reduction of time burdens as a result of infrastructure deficits, such as a lack of water, fuel, and electricity, includes the introduction of low cost, energy-related technologies that also enable women to earn income. Grown outlines case studies in Bangladesh, Mali, Morocco, and Brazil. It is important to identify an energy services approach that starts with an analysis of what people need rather than the technology, she says. It is also important to pay attention to such issues as availability (e.g., kerosene and liquefied petroleum gas), affordability, and safety. In the absence of electric power, appropriate technologies in rural areas may be decentralized village power systems using diesel-powered mini grids for charging batteries and multifunctional platforms powered by diesel engines for low-cost rural motive power.

According to Grown, the use of alternative technologies must be context-specific and business models should be adopted in project design. Short-term public policies may be needed to subsidize initial costs and to provide innovative financing and credit arrangements for investment in energy equipment. Capacity building (technical business and skill training) is critical to strengthen involvement of women and there should be attention to women's concern throughout all levels of policymaking, planning, and project implementation.

Two MDG strategies to reduce gender inequality in employment are increasing women's control over economic assets and improving women's access to employment. Credit access is a key channel for enhancing women's asset ownership and saving (e.g., substituting character-based lending for collateral-based lending and microfinance programs), while public employment guarantee schemes that are gender sensitive are important in providing women with labor market opportunities (e.g., the Maharashtra Employment Guarantee Scheme in India). Gender-sensitive design features should consider the distance between employment sites and women's homes, the availability of day care centers, the mode of payment, and government directives for equal pay. Furthermore, employment in enterprises providing services or products and community participation are as important as the construction of infrastructure (e.g., the Jefes program in Argentina).

Grown observes that a number of schemes meet the criteria of QIIs and that there is wide variation in the implementation of QIIs. She recommends that donors document the impact of their initiatives so that there is a database from which to improve impact evaluations and programs, as well as the QIIs, and to achieve the MDGs (e.g., the PROGRESA program in Mexico benefitted from a multipronged, evaluation effort). Because financial information is crucial for project planning and budgeting, Grown has developed a methodology that can estimate the costs of intervention to finance gender equality and empower women. Her methodology can be used by the Ministry of Finance and various line ministries for country-level budget and planning exercises (Grown et al. 2006. "The Financial Requirements of Achieving Gender Equality and Women's Empowerment." Paper prepared for the World Bank, Washington, D.C.).

The QIIs represent an immediate and feasible set of options that can begin today, says Grown. With adequate resources and political will, the world community can make some real progress by 2015.

The Financial Requirements of Achieving Gender Equality and Women's Empowerment

CAREN A. GROWN, CHANDRIKA BAHADUR,
JESSIE HANDBURY, and DIANE ELSON
Working Paper No. 467, August 2006
www.levy.org/pubs/wp467.pdf

Although the Millennium Development Goals (MDGs) have been reaffirmed in global forums, they have not been incorporated into operational planning within governments or international organizations. Achieving the MDGs requires long-term planning, as well as short-term expenditure and policy formation. After five years, progress toward the MDGs is mixed. The goals of reducing maternal mortality and achieving gender equality and women's empowerment face the greatest challenges across all countries.

Senior Scholar Caren A. Grown, Chandrika Bahadur and Jessie Handbury, U.N. Millennium Project, and Diane Elson, University of Essex, United Kingdom, extend the methodology developed by the U.N. Millennium Project to estimate the cost of interventions aimed at promoting gender equality and women's empowerment, as well as the financing gaps, in Bangladesh, Cambodia, Ghana, Tanzania, and Uganda. The cost estimate is then applied to other low-income countries.

MDG Task Force 3 (MDG3) provides the intellectual framework for the gender analysis. Its strategic policy and intervention priorities are outlined in Working Paper no. 462 by Grown. The authors note that cost intervention calculations are difficult because gender equality is not a stand-alone sector. They also note that most strategies to achieve gender equality require a mix of investments and changes in legislation, political and administrative rules, social attitudes, and norms. They further note that previous attempts to develop cost estimates for achieving the MDGs at the country level have not addressed the needs of gender equality adequately (e.g., the economic value of unpaid work).

The authors classify the interventions according to whether the main objective is to promote gender equality or another goal (e.g., the construction of rural roads or health clinics). Based on this classification, they calculate the proportion of the cost of each intervention that can be attributed to promoting gender equality. The interventions are also classified according to MDG3-specific or gender mainstreaming interventions. It is important for donors and line ministries to see the costs disaggregated in this way, they say. The authors set sector targets, which are based on MDG targets, while resource estimates are based on local or regional unit costs. The results of all sectors are aggregated and revised to eliminate double counting and to account for synergies in provision and impact. The total cost is the sum of all interventions and the share of nontargeted sectoral interventions that promote gender equality.

The authors recognize that their methodology may not represent a comprehensive needs assessment for all countries and that their analysis requires the input of all key stakeholders. Moreover, their assessment represents the minimum requirement to meet the goals of gender equality.

The average annual per capita cost of achieving gender equality ranges from $37.24 in Bangladesh to $56.88 in Tanzania (35 to 52 percent of total MDG costs). Total intervention costs consist of MDG-specific interventions (6–10 percent), which are critical to achieving gender equality, gender-mainstreaming interventions (16–24 percent), and costs apportioned to gender equality in each sector (69–77 percent). The total cost for the 2005–15 period ranges from $6.5 billion in Cambodia to $50.3 billion in Bangladesh.

The authors calculate the financing gap based on direct gender equality interventions across all MDG sectors and according to three broad sources of financing (household contributions, government resource mobilization, and external financial resources). They estimate that 40–47 percent of all MDG needs will be raised domestically, so the financing gap is $60–73 per capita per year. Since MDG3-specific and gender mainstreaming costs are a critical part of an overall financing strategy to achieve all of the MDGs, donors should pay particular attention to this portion of the financing gap, they say.

The authors calculate that the MDG financing gap for all low-income countries is $73 billion in 2006, rising to $160 billion in 2015. Based on different scenarios about how the MDG3 costs might be financed, the financing gap in 2006 ranges from $8.6 billion to $30 billion. The gap in 2015 ranges from $23.8 billion to $83 billion.

Even if governments assume an increasing share of costs, they continue to rely on donor assistance to promote many gender equality interventions. This reliance is not a viable scenario in the long-term, so countries must assume greater responsibility for mobilizing domestic resources, which are particularly important for gender equality. The authors support the scenario where government resources are proportional to the share of gender equality intervention costs in the total MDG costs. This is an example to strive for by governments and donors in the long term, they say. In the short term, external resources are important to jump-start the allocation of domestic resources for gender equality interventions in low-income countries.

The authors conclude that both MDG3-specific and gender mainstreaming interventions should be included systematically when scaling-up strategies to achieve the MDGs. They recommend that donors set up a special fund (approximately $13 billion per year over the next five years) to accelerate implementation of interventions in low-income countries and that these countries ramp up their financing to $34 billion per year. These investments are affordable, given existing commitments by donor governments, and gender equality interventions should be part of a broader, comprehensive effort by national governments to achieve the MDGs.

Program: Employment Policy and Labor Markets

Conference, Employment Guarantee Policies: Theory and Practice

The conference was held at Blithewood, Annandale-on-Hudson, New York, on October 13–14, 2006. The focus of the conference was on government policy initiatives that can create a safety net through public service employment for individuals who are ready, willing, and able to work but find themselves in an economic environment that does not offer employment opportunities.

The premise of the Levy Institute is that unemployment and involuntary "inactivity" are structural macroeconomic problems of both developed and developing economies. The negative effects of unemployment reach beyond the immediate economic losses to individuals and their families, and to the suboptimal growth of the economy. Joblessness is often accompanied by poor health and psychological problems, depreciation of human capital, social exclusion, and overall lack of motivation for future work.

Access to employment is important for all countries in that it can be a contributing factor in ameliorating poverty and promoting economic development. For other countries, achieving the Millennium Development Goals provides a timely opportunity to assess the impact that employment guarantee schemes have had thus far, and to analyze their potential impact for the future.

Welcome and Introduction

President DIMITRI B. PAPADIMITRIOU noted that Hyman P. Minsky wrote about employer of last resort (ELR) policy and that Minsky was skeptical of policies based on wage subsidies to deal with the plight of the unemployed. The War on Poverty in the 1960s tried to change the poor, not the economy, and Minsky observed that there was no government commitment to full employment. He believed that a jobs program that paid decent wages would successfully fight poverty in a politically digestible manner. Minsky's response to the War on Poverty and his views about ELR policy are articulated in his book, *Stabilizing an Unstable Economy* (1986).

According to Minsky, policy should include a strategy for full employment that does not lead to instability, inflation, and unemployment. The main instrument of policy is to create an infinitely elastic demand for labor at a fixed wage that does not depend on long- and short-term profit expectations. Only government can divorce the offering of employment from the profitability of hiring workers and create an infinitely elastic demand for labor.

Papadimitriou noted that the idea of government acting as an ELR dates back to the 17th century during the Industrial Revolution, when it was recognized that capitalist economies were not inherently capable of creating full employment. He also noted that a more recent and successful experiment to establish an ELR program was Franklin D. Roosevelt's New Deal. Although short in duration, the New Deal established that the government can act successfully as an ELR in offering decent jobs that do not compete with private business and that are socially and economically useful. He further noted that an ELR employment strategy is not inflationary.

Papadimitriou provided an overview of the forthcoming presentations, particularly the job creation schemes in Argentina and India, whose programs limit the participation and employment time of workers. These programs, however, establish that employment is a legal right, and have had unprecedented positive outcomes in improving the human condition, increasing human capital and social inclusion, decreasing poverty, and empowering women. In addition, other country studies and experiences with public works programs show that the degree of success is correlated to institutional and legal characteristics, as well as the conditions imposed by funding sources.

According to the famous British economist William Beveridge, full employment exists only when the number of job vacancies exceeds the number of people looking for work. Papadimitriou noted that the current low unemployment rate in the United States (4.7 percent) does not represent full employment because the number of job openings is much lower than the number of people seeking work or the number of people who would look for work if they thought that they would find a job. It is important to give people an opportunity to work because it provides income and self-respect, as well as a sense of active membership in a civil society, he said.

Session 1. Employment Guarantee Policies

Chair: REBECA GRYNSPAN, United Nations Development Programme (UNDP). Speakers: MATHEW FORSTATER, University of Missouri–Kansas City; DANIEL KOSTZER, UNDP; and STEVEN MILLER, International Labour Organisation (ILO).

The fundamental theorem of welfare political economics within the present institutional framework of modern capitalist society is that there is no single policy that carries with it more potential benefits than true full employment or a guaranteed job for everyone ready and willing to work (at a living wage–benefits package).

FORSTATER outlined the costs of unemployment, as well as the social and economic benefits of employment guarantee schemes. He noted that the direct and indirect economic benefits are both microeconomic and macroeconomic, and that there is an important mutually reinforcing relation between the economic and social benefits.

The three aspects of employment are income, production, and recognition. When members of a community are employed at productive jobs, there are rising incomes and increased spending throughout the community that stimulate output, income, consumption, and investment. The associated social multipliers also benefit the community in terms of decreased crime, better education and health care, and environmental protection.

Job creation increases financial security, promotes higher living standards, is a key to good physical and mental health, and is the best weapon in the battle against poverty. It promotes healthy state and local government budgets, benefits the elderly, improves income distribution and reduces inequality, and spurs technical and organizational innovation. Further benefits arise in terms of reducing racial tensions and other social costs, social and political stability, and stable business expectations. According to Forstater, the principle of cumulative causation may apply, in which positive feedbacks and reinforcing dynamics comprise a virtuous cycle of socioeconomic benefits (e.g., productivity growth).

In terms of strategies for attaining and maintaining full employment, Forstater noted some problems with the conventional approach to stimulating aggregate demand: the effectiveness of fiscal and monetary policies to achieve true full employment, and how the economic system would deal with the loss of flexibility and functionality associated with full employment.

The traditional Keynesian view is that unemployment is normal, but irrational, and should be eliminated through policy. Other economists have identified the functionality of unemployment and the obstacles to reducing or eliminating unemployment, such as holding down wages, disciplining workers, providing a pool of unemployed workers during an economic expansion, and maintaining the flexibility to respond to structural and technological changes.

According to Forstater, the approach to full employment through employment guarantee programs is an effective strategy for eliminating involuntary unemployment and addressing the functionality and flexibility issues. A well-designed program can serve as a powerful automatic stabilizer and ensure manageable government budget deficits that assist in preventing unemployment and inflation. Public employment may be directed toward public works and other infrastructure that promote private sector productivity growth and human capital, and reduce social costs and unnecessary expenditures. Public works tend to be less inflationary than the "dole" because they increase both aggregate supply and demand, observed Forstater. He also observed that inflationary bottlenecks and other rigidities may be avoided, and that firms may continue to maintain reserve capacity.

Employment guarantee programs are the only means of achieving the right to employment, as well as other rights expressed by governments and the United Nations, said Forstater. The right to employment is the basis for rights such as a decent standard of living, living free from crime and discrimination, and living a long life with good health.

KOSTZER was adamant that full employment policy is the best social policy and that employment (the labor market) is the only way to link the economy with the well-being of households. In less developed economies, it is important to account for the structural and household characteristics of the economy because these characteristics define the levels of inequality and poverty, he said.

The labor market is characterized by economic, social, and political dimensions, and by social, sectoral, and regional integration. The economic dimension can be limited by such factors as external shocks, the deterioration of terms of trade, and internal monopolistic structures that generate financial fragility. In the 1990s, the responses to the limitations included foreign trade and domestic market deregulation, as well as the free flow of funds, supply-side strategies, lower taxes, and growth of the informal sector. The social dimension was affected by the changes, as wages became merely a cost of production and firms starting targeting foreign markets and higher income groups that created higher (not frictional) unemployment. There was more outsourcing and integration of productive processes at the international level, as well as the removal of backward and forward linkages. Nobody was willing to take the role of investor of last resort.

As social and sectoral programs were dismantled at the regional and local levels, the regions lost productive capacity and financial support. There was a failure to target social policies and supply-side responses. The problem of supply was attributed to labor market failures and the poor. According to Kostzer, the core problem was unemployment of the head and other members of the household. He pointed out that in most Latin American countries (particularly, Argentina), there has been a very high economic growth rate without commensurate employment.

Since the problems of the labor market are at the core of the macro economy, full employment should be at the center of macro and social policies and the state should be the employer of last resort (ELR), concluded Kostzer. The economic advantages of an ELR program are that it improves aggregate demand and income distribution, fixes a minimum wage for the formal and informal sectors, and is countercyclical. Furthermore, there are political advantages (e.g., it can be part of a global strategy against poverty and a scheme for social protection), social advantages (it solves the basic-needs problem of households), and regional advantages (it improves infrastructure and services at the local level).

Some tools for complementing ELR programs include further education, health insurance, elderly support, and child allowances. Kostzer noted that the number of females involved in these programs is very high. He recommended that within the institutional setting, registration of beneficiaries should be transparent and well publicized (e.g., at schools). Also, the work should be decentralized at the local level (with community participation) in order to assign priorities and avoid repetition and competition between projects. He also recommended that ELR programs should not be assessed in the same way as private sector projects because the assessment should include social criteria. Unions can be important in boosting "on the job" training and public employment services can audit the performance of projects and assess the needs of the private sector at the local level in addition to being a repository of resumes.

MILLER presented employment-intensive investment strategies in the context of linking sustainable infrastructure developments and social transfers. He wondered why employment guarantee programs were not implemented in spite of the advantages of full employment and recommended that participants of the conference identify the potential weaknesses in order to improve the programs.

Miller outlined the various employment schemes that have been embraced by the ILO over the past 25 years. The organization is focusing more on broader investment policies and public investments in infrastructure that create more employment and reduce poverty. These initiatives include local economic development policies and the integration of economic and social policy. There is a new commitment to placing employment at the center of macroeconomic policies, he said.

The ILO is confronting the fears associated with labor-intensive, public works programs (i.e., make-work programs using low-quality employment) and dealing with the fears in a scientific way. Miller noted that there have been major new commitments to employment and infrastructure within various international mandates. The ILO has focused on schemes characterized by productive, social, and urban infrastructures. It wants to know how employment is integrated within assessments of investment so that it can conduct employment impact assessments, which incorporate rigorous methodologies that can be sold to the political establishment. Studies show that a road built by light equipment could create three to five times more direct employment than a road built by heavy equipment using the same investment budget. Moreover, additional labor creates significantly higher multiplier effects in the local economy and significant savings in foreign exchange. Investment budgets are expected to dedicate approximately 30–40 percent to labor, but the unskilled labor portion of the budget could be as high as 60 percent (e.g., the employment guarantee legislation in India).

A challenge for the ILO is to assist in the development of private sector capacity and to bridge the gap between a single worker and a large multinational company. Other challenges relate to community contracting and the integration of employment criteria into the lending policies of international financial institutions. Some implementation issues that need to be taken seriously include the lack of sustainable impacts on employment when programs end and the institutional arrangements made when subsidies are targeted (e.g., South African housing policy). Miller outlined a successful example of upgrading skills in Kenya. Women with no infrastructure experience acquired technical expertise (managerial skills) and created small contracting enterprises that led to subcontracting work from development firms engaged in major infrastructure.

Another key issue is remuneration. Based on personal experience in countries such as Burkina Faso and Tanzania, Miller found that programs based on self-help or unpaid labor were more expensive than programs based on paid labor because productivity and quality were low. Therefore, the ILO supports the idea of productivity-based remuneration systems. Moreover, employment impact assessments of projects in countries such as Uganda and Zimbabwe show that certain types of infrastructure can be built with equal quality and lower cost by using more labor. The potential to reduce the unemployment rate can be as high as 10 percent, he said.

Input-output matrix simulation models show that the income and employment multiplier effects from labor-based projects are much higher than equipment-based projects. The next step in the modeling process is a full-fledged social accounting matrix. The ILO supports the development of methodologies that are easily applied as political and technical tools. It also supports the creation of employment investment policy units within finance ministries that consider employment when analyzing public investment budgets. Further ILO initiatives include national and regional training centers for labor-based infrastructure development and employment-intensive programs as a starting point for national-action plans on youth employment.

Speaker: Senior Scholar JAMES K. GALBRAITH

Galbraith, University of Texas at Austin and director of the University of Texas Inequality Project, outlined the process of drafting the Hawkins-Royce bill (H.R.50, 1977), which was a comprehensive planning and public employment law that was originally designed to change the derivation of economic policy and the interactions between the Executive Branch and Congress. Its signature clause was to replace the language of the

Employment Act of 1946, which called for maximum employment production and purchasing power, with a clarion call for full employment (and return to the undiluted language of the Full Employment Bill of 1944). However, the Senate version of H.R.50 included *full* employment, balanced growth, and *reasonable* price stability, and excised all of the planning elements. What finally passed as the Humphrey-Hawkins Full Employment and Balanced Growth Act of 1978 contained not much more than a statement of goals and a very obscure provision amending the Federal Reserve Act (the obligations of the Federal Reserve were codified to report on the progress of various economic targets to Congress).

According to Galbraith, the two enduring virtues of the Humphrey-Hawkins Act were its long-term effect on the composition of the Federal Reserve (e.g., transparency and accountability), including the constitutional authority of Congress over the Federal Reserve system, and its recognition that full employment and reasonable price stability were compatible objectives. The economics profession, however, had decided that full employment was incompatible with price stability and hyperinflationary. Thus, we entered into the era of the nonaccelerating inflation rate of unemployment (NAIRU) when only a few economists (including Galbraith) opposed the notion of a natural rate of unemployment.

Galbraith suggested a broader reconsideration of the theory of unemployment. Keynes's involuntary unemployment stemmed from an insufficiency of aggregate effective demand under the assumptions that sufficient capital equipment exists to employ all people who are willing to work and that the effective supply of labor was also relatively fixed. Keynes's world postdated the decline of agricultural labor and predated the rise of women in the labor force and the effect of globalization on migration. Therefore, there is a vast elastic reserve of labor supply, so we need to consider the effect of demand on the supply.

Models of development theory, such as those by Harris and Todaro (1970), show a close association between the problems of unemployment and economic inequality. Workers facing a higher state of inequality in structural conditions will abandon low-wage jobs in favor of the possibility of better jobs (e.g., the "floating population" of 135 million rural Chinese who seek work in the urban coastal areas). Galbraith noted that there is a very stable relationship between inequality in pay structures and unemployment rates, but the relationship is opposite of predictions according to classical labor market theory. The most egalitarian European countries with the most compressed wage structures experience lower unemployment rates, and the same relationship holds for the United States. Full employment in the 1990s coincided with an improvement in the egalitarian character of U.S. labor markets.

Galbraith explained that his comparison focused on pay rather than on income, which is irrelevant to the discussion, and was only valid when comparing the United States with Europe as a whole. He noted that Europe is an integrated economic entity with a single currency and without barriers to trade, capital, or labor. Inequality is much higher in Europe than in the United States because the United States has benefited from convergence since the New Deal (e.g., Social Security, a minimum wage, and a national system of higher education and health care) and a national system of public spending. Europe's high unemployment today is consistent with its current burden of economic inequality. (For a more complete account of convergence and full employment in Europe and the United States, see Public Policy Brief no. 87.)

Employment of last resort (ELR) programs fit rather well into the general framework for reducing unemployment, said Galbraith. ELR provides jobs and minimum wages reduce unequal pay structures. However, ELR programs are not a panacea, as they are limited by a state's fiscal capacity, which, in turn, is limited by a state's politics. We should recognize that the United States was able to overcome the problem of a politically imposed fiscal constraint by working through the credit markets and moving to full employment in the late 1990s. The deficit of the private sector was used to create a temporary surplus in the public sector so that the economy as a whole experienced a Keynesian expansion that was not constrained by forces of fiscal austerity and budget balance. The great tradition of the Levy Institute has been to examine the functioning of the credit and financial markets in a capitalist economy and to incorporate the governance of those markets into a full-fledged strategy for the achievement of full employment.

Session 2. Employment Guarantee Policies: Budgetary Implications and Price Effects

Chair: MARTHA MELESSE, International Development Research Centre (IDRC). Speakers: PHILIP HARVEY, Rutgers University School of Law; Senior Scholar L. RANDALL WRAY, University of Missouri–Kansas City; and SANTOSH MEHROTRA, Planning Commission of the Government of India. Comments: AHMED

EL BOUAZZAOUI, Ministry of Finance, Morocco and the International Working Group on Gender, Macroeconomics, and International Economics (GEM-IWG).

HARVEY examined the differences in analytic approaches and opinions among advocates of job guarantee proposals. The post-Keynesian focus is the role of job guarantee programs as macroeconomic policy measures. Harvey's focus is social welfare benefits. Nevertheless, he found compatibility between the two approaches and complementary insights into the strengths of job guarantee strategies. Both approaches emphasize that additional taxation and borrowing are unnecessary and that it is possible to achieve full employment with price stability when funding job guarantee programs.

According to Harvey, a well-designed job guarantee program could be fielded without increasing aggregate demand relative to aggregate supply. Also, the program provides a credible alternative to the current practice of using involuntary unemployment to maintain acceptable levels of price stability.

Harvey noted two differences between his work on job guarantee programs and the works of post-Keynesian economists such as Hyman P. Minsky: wage policy and funding. Post-Keynesians embrace the argument that currency-issuing governments should base their spending, taxing, and borrowing decisions on macroeconomic effects rather than on the notion that government spending must be financed with taxes or borrowing. A job guarantee program (combined with increased deficit spending) would create a buffer stock of qualified labor whose availability for hire at a constant wage level would restrain the wage inflation that normally occurs as labor markets tighten and create upward pressure on costs of production and product prices. A job guarantee program would move the economy toward full employment by creating jobs in the program itself and increasing aggregate demand. However, program spending may have to be accompanied by measures to restrain the growth of aggregate demand (e.g., increased taxation).

Harvey analyzed how to fund a job guarantee program without relying on increased deficit spending by government. He developed a model that secured the right to work recognized in the Universal Declaration of Human Rights in the United States. He then estimated the budgeted cost of the program, the savings in transfer benefit expenditures, and the tax receipts on program wages for the period from 1977 to 1986 (when the U.S. unemployment rate averaged 7.0 percent). He found that 82 percent of the program's budgetary cost would have been covered without resorting to additional funding sources or deficit spending. The funding deficit would have been further reduced if the analysis had accounted for other sources of savings or revenue, which functioned as the equivalent of tax increases (e.g., the countercyclical effect of the program during periods of recession, the indirect savings on medical and social problems, and the sale of goods and services produced by the program). Harvey concluded that a government-funded job guarantee program would not require additional deficit spending by government or any additional redistribution of income (e.g., taxation). He noted that none of his funding sources would cause a contraction in private sector activity and that only countercyclical deficit spending during recession would cause an expansion in private sector spending.

Although a job guarantee program would not have to be funded in a budget neutral manner, there are political and economic reasons to do so, said Harvey. A political reason is that budget neutrality helps to win public support for the program and the public should realize that a job guarantee program not only helps the unemployed, but it also distributes more money to society as a whole. An economic reason is that budget neutrality would reduce the inflationary effects by not increasing aggregate demand.

Harvey recommended that fiscal policy planning and implementation should be separate from the administration of a job guarantee program so that the public is not confused about the role of the program in achieving full employment. He speculated that any long-term redistributive effects of a job guarantee program would fuel some employer opposition in spite of no short-run distributions. However, there would be no opposition among general taxpayers if the program does not rely on additional income redistribution to pay for it.

WRAY reviewed the feasibility of an employer of last resort (ELR) program and noted that government is the only institution that can provide a "perfectly elastic" demand for labor. His preferred ELR version followed Minsky's proposal that the government would offer to provide a job to anyone of legal working age who is ready and willing to work. The program would pay a uniform wage and provide a uniform benefit package, which would anchor labor costs. Compensation would be "fixed but adjustable," with periodic increases to catch up to inflation. Training would be a part of every job and the ELR experience would better equip workers for post-ELR work. Wray also noted that Argentina recently adopted the Jefes job creation program that is explicitly based on a proposal from researchers associated with the Center for Full Employment and Price Stability at the University of Missouri–Kansas City.

Wray challenged the notions that unemployment and poverty are the cost of maintaining macroeconomic stability and that ELR threatens price and currency stability. He argued that ELR anchors a country's currency and increases macroeconomic stability. Using the example of Australia's wool-price support program, Wray observed that ELR could be analyzed as a buffer stock for labor program, which would be closely tied to the business cycle. The role of the government would be countercyclical and act as an automatic stabilizer. He acknowledged that the initial effect of a buffer stock program could raise consumption and imports by setting a floor price above the prevailing market price. However, once the program is in place, it would not be inflationary or pressure the exchange rate but would stabilize prices, incomes, consumption, and imports.

Two complications as a result of behavioral changes after the adoption of an ELR program relate to an increase in the size of the labor force and a change in the wage bargaining process. Wray reasoned that a larger labor buffer stock would counter wage pressures and that the effect of higher wage demands would not be large. The ELR wage would serve as a wage and price anchor that would stabilize the effective minimum (base) wage and unit labor costs, and lead to greater price stability.

Wray argued that a sovereign government operating with its own currency and a floating exchange rate could always afford an ELR program because its payments are not constrained by revenues. Nonsovereign state and local governments, however, must obtain money (tax revenues) before they can spend, so their spending is procyclical and can add to the unemployment problem. A floating exchange rate provides the "degree of freedom" that allows the government to spend without worrying that increased employment and higher demand will threaten an exchange rate peg. Thus, fiscal and monetary policy is free to pursue other objectives, such as full employment.

Wray explained that the sale of treasuries drains any excess reserves created by deficit spending and that the sale should not be thought of as a borrowing operation. He also explained that the interest rate paid on treasury securities is not subject to normal "market forces" and that it is false reasoning to believe that the size of the sovereign government deficit affects the interest rate paid on securities.

The Jefes program in Argentina is a limited ELR program that provides part-time work at very low pay to one member of qualifying poor families with children. It shows that a huge program can be implemented quickly without major problems and under conditions of economic, political, and social instability. Within four months, the program created jobs for 2 million participants (13 percent of the labor force) with spending equal to approximately 1 percent of GDP.

The Jefes program helps to quell social unrest and provides income to Argentina's poorest families. It provides needed services (e.g., social and community services) and new public infrastructure that encourages additional private sector spending. Local and municipal governments who are most familiar with the economic needs of their communities administer the program. The federal government finances no more than 80 percent (usually 60 percent) of the Jefes projects and the Jefes wage has become the effective minimum wage. The program has not generated uncontrolled inflation or currency depreciation.

After dropping its currency peg to the dollar, currency sovereignty allowed Argentina to use fiscal and monetary policy to create jobs in the private and public sectors. The response of beneficiaries to the Jefes program has been extremely positive. The program proves that people will work at very low wages and that it is able to move people from the informal to the formal sector of the economy. A surprising result is the significant influx of women into the program.

The Jefes program demonstrates that a decentralized program can be used to increase political participation and foster grassroots democracy among groups that were traditionally marginalized. It also demonstrates that Argentina's macroeconomic conditions have improved along with the Jefes experience. Thus, many of the fears of the critics of ELR are fallacious, said Wray. He suggested that a Jefes-type program might be suitable in America because of similarities between the poor in Argentina and the poor residing in certain areas of the United States (e.g., the urban core).

MEHROTRA spoke about the National Rural Employment Guarantee (NREG) scheme in India that came into effect in February 2006. The scheme currently covers approximately 200 of 607 districts and is expected to cover the entire country and cost about 1 percent of GDP in five years. The state is the employer of last resort and workers are offered 100 days of employment annually at the minimum wage. It is possible that at least half of the population currently below the poverty line will rise above it, said Mehrotra.

Mehrotra noted that there were three main levels of government (state, district, and local), as well as the block and village council levels at the district level. He reviewed the history and problems of public employment guarantee programs over the past 45 years (11 programs by the central government). The untimely release of funds allocated to employment in rural areas resulted in underutilization of funds and previous programs focused on capital-intensive activities, which do not generate much employment. Moreover, beneficiaries received less than 30 days of wage employment and included the nonpoor, and the programs created few durable assets. Furthermore, the programs encouraged both political and administrative corruption. Another public employment program was needed, he said, because of political and economic imperatives (promises of the newly elected central government in 2004 and rising income differentials between rural and urban incomes as a result of the declining growth rate of agriculture).

At least 35 percent of the rural labor force are landless laborers, so the demand for public works is high, particularly outside the harvest season. The new aspects of the NREG are that there is a legal guarantee of employment, it is a demand-driven program, and it is the first step in the planning process that is carried out by the village council (eliminating middlemen and contractors). Although many design problems of earlier programs have been addressed, problems remain (e.g., creating durable assets). It is critical that there is convergence of the NREG with the Build India program, said Mehrotra. Other significant challenges include the lack of planning capacity at the village council level, particularly in the poorest and most backward states, and financial management (e.g., high-performing village councils are penalized when they cannot access funds because their block-level fund-utilization rate is less than 60 percent). Moreover, funds should be released proactively because the NREG is a demand-based program.

Mehrotra recommended that funds and functionaries should be transferred from the state to the local government in order to complete the process of decentralization and local self-government. He observed that the Right to Information Act, which came into effect a year ago, is an opportunity to deter the problems of corruption that affected earlier programs.

Session 3. Modeling Employment Guarantee Policy

Chair: SAUL WEISLEDER, Permanent Mission of Costa Rica to the United Nations. Speakers: Research Scholar RANIA ANTONOPOULOS and Research Scholar MARZIA FONTANA, IDS; SCOTT T. FULLWILER, Wartburg College; and FADHEL KABOUB, Drew University. Comments: HAMIDOU POUFON, Cameroon School of Public Administration and GEM-IWG.

ANTONOPOULOS and FONTANA suggested that employment guarantee policies can promote gender equity and pro-poor development. They proposed an analytical framework in the form of a gender-aware social accounting matrix (SAM) to model the macroeconomic effects of public job creation, including the interactions between unpaid work and the market economy. When linked to unpaid work, a policy instrument that targets the employment deficit has the potential to also promote gender equality and pro-poor growth.

Time-use survey data reveals that household members spend long hours performing unpaid work in order to sustain their families and communities. Unpaid work generates goods and services that dramatically increase GDP, but this work is undervalued, undercounted, and unprotected. The authors noted that "stable" economic policy, coordinated fiscal and monetary policy measures, and recent trends in globalization and private sector investment have not improved the jobs deficit conundrum (i.e., jobless growth), particularly for women and the poor.

According to the authors, the dualism of economic versus social policy and the emphasis on market-driven growth (at all costs) have made social protection advocacy imperative. The main issue is that there is disconnect between instruments and targets. Social policy must be rooted in economics because economic policies have a social content, both explicitly and implicitly. Therefore, social benefits and costs are not distributed symmetrically across all segments of the population. The banking sector is an example where institutional arrangements and corrective interventions enable it to function smoothly and to socialize the cost of private bank failures or crises across the entire population (as lenders of last resort). There are sound arguments for government to be the employer of last resort, they said.

The detailed structure of SAM-based multiplier models enables the models to outline the connection between output and income of specific socioeconomic groups in accordance with the vision of the modelers. It is difficult to conduct an impact assessment analysis without modeling unpaid work, said the authors. A SAM analysis is an effective way to examine the interconnection between unpaid work and the market economy. Estimates of the contribution of household production in a country's economy range from 20 to 60 percent of GDP. Since households, markets, and government are structurally interlinked at the economic level (including the NGO sector in some countries), the household production sector is a fundamental building block that should be included in studies of the processes occurring within an economy.

The nonmonetized household sector subsidizes public sector provisioning and fills in infrastructural gaps, such as employment. This situation is both inequitable and inefficient. The authors noted that, irrespective of the costs of eliminating unemployment, public expenditures for job creation is an issue of ethics, justice, and social inclusion. They also noted that programs such as the Jefes program in Argentina enhance employment opportunities for women. Many other programs, however, have not adequately provided for social service jobs, or jobs that target the efficiency of public goods delivery. Furthermore, there is inadequate cross-country evaluation of the design and implementation of the gender aspects of programs. The authors maintained that a well-designed economic policy could create an environment that uses everyone's productive abilities.

The authors outlined four areas in which to explore the economic implications of gender-aware public job creation: household income poverty and gender relations within the household; unpaid work and gender equality; paid work and gender equality; and macroeconomic outcomes. Their future work will include a fully developed and computable general equilibrium model in order to analyze the impact of employment guarantee schemes in the economy as a whole.

FULLWILER modeled the potential macroeconomic stabilization properties of an employer of last resort (ELR) program using the Fairmodel, which is a structural econometric model of the U.S. economy developed in the 1970s. His simulations demonstrated the logic of an ELR program given historical relationships among macroeconomic variables and the constraints provided by NIPA and Flow of Funds accounting identities. The ELR program is modeled as a federal program during the 1985–2005 period, which includes two complete business cycles. The program is phased in over the first two years so that the total number of unemployed is completely employed by the end of 1987. ELR workers are assumed to work 34 hours per week on average. Fullwiler noted that his treatment errs on the side of overstating the costs and understating the stabilizing properties of the program.

The results were consistent with the contention that ELR workers moving between ELR and other jobs would create an effective buffer stock. The model showed that an ELR program moves the U.S. economy to a permanently higher level of real GDP and that swings in GDP levels due to exogenous shocks are less pronounced. After a modest increase in inflation, the initial effects of inflation evaporate over time, even when the economy expands.

During the 1990s expansion, simulated inflation rates were slightly below base values since ELR workers take private sector jobs and reduce ELR-related government spending. An ELR program was shown to provide modest countercyclical stabilization to inflation rates; a finding consistent with arguments by proponents of the program and with recent heterodox research suggesting that a Phillips curve relating actual inflation and unemployment rates can be horizontal across a wide range of capacity utilization.

An ELR program was also found to have modest budgetary impacts (0.6 to 1.25 percent of GDP). The smallest percentage was in the late 1990s, after economic expansion had been in progress for several years and when the number of ELR workers was at its lowest level during the simulated period. Another finding was that an ELR program does not necessitate government deficits, as state and local budgets improve due to the economy's enhanced stability and higher real GDP. Notably, the ELR simulations showed that the fiscal crisis encountered by states in the early 2000s would have been significantly less severe.

Compared to the base simulation, the results of the simulations were consistent with the notion that greater emphasis on stabilizing inflation by the Fed has not led to greater macroeconomic stability, and with the view of the post-Keynesians, who consider inflation to be caused by factors other than monetary policy. The simulations also suggested potential for fiscal policy to stabilize the economy. ELR was found to be the only policy that reduces variability in both real GDP and real GDP growth and stabilizes real GDP both within and across time periods. Taken together, the simulations suggested that an ELR policy can stabilize properties similar to other fiscal policy stabilization rules, particularly real GDP. The greater the responsiveness of the buffer stock and the productivity of ELR workers, the larger the stabilization effects on GDP.

Whereas the Fed attempts to achieve macroeconomic stability via reduced variability in the unemployment rate, ELR policy raises and stabilizes total employment, which enables fluidity between public and private sector employment (via the buffer stock of ELR workers). The results of the simulations provided evidence that countercyclical fiscal policies, including ELR, can play a significant role in promoting both full employment and price stability.

Fullwiler noted that it would not be easy to implement an ELR program that effectively offsets business cycles and provides (countercyclical) price stability via a buffer stock of employees and employs ELR workers in useful activities that generate productive output. There were logistical, administrative, and political complexities. However, the complexities relate to the program's potential strengths vis-à-vis other policy rules: its stabilization effects could be automatic if the ELR program is effectively implemented and sustained. Moreover, the effects would not depend on the ideological leanings of policymakers, but on the perspectives of policymakers regarding the relationship between policy instruments and objectives.

KABOUB proposed an ELR plan for Tunisia based on the solidarity network, which includes the National Solidarity Fund (1992), the Tunisian Solidarity Bank (1997), and the National Employment Fund (1999). The unemployment rate in Tunisia is 14 percent, and half of the unemployed have been unemployed for more than 12 months. Two-thirds of new job seekers have a university degree as a result of the government's massive investment in human capital. The decline of the textile industry is another serious problem, as well as the rapid rise in the country's international debt (and foreign direct investment) since the 1970s.

The solidarity network represents a series of government initiatives in response to rising poverty due to structural-adjustment policies (i.e., a safety net for the very poor). The network focused on extremely impoverished areas and provided micro financing and training programs. The various agencies, however, were not full employment programs, said Kaboub. Moreover, government policy is giving up on the informal sector in favor of university graduates (as shown by the decline in the labor force participation rate). His plan was to progress from the solidarity network, which has been effective in accessing the unemployed throughout the country, to a true full employment program.

Kaboub's plan includes three phases: (1) employ the unemployed heads of household (20,000 people) in the first two years; (2) employ everyone who has been unemployed for more than 12 months (216,450 people) by the third year; and (3) employ everyone (432,900 people) by the sixth year. The third phase is a full-fledged ELR program. Because of the composition of the labor force, as well as social and political reasons, Kaboub proposed a three-wage ELR structure: three times the minimum wage for highly skilled workers, twice the minimum wage for semiskilled workers, and the minimum wage for unskilled workers (i.e., wage differences that reflect the private sector). The program would be financially sound because the wage bill would represent 2.7 percent of GDP by year six, which is less than 10 percent of government spending.

Kaboub noted that ELR was just one part of the solution because there were many political and financial issues, and there was pressure from international organizations to change the country's strict labor laws. He believed that his ELR program created a flexible system without sacrificing labor rights, so it would satisfy the conditions of the World Bank. He also noted that the highly skilled workers could be engaged as public school tutors and health care consultants, and in projects designed specifically for conservation and environmental protection.

Speaker: AMIT BHADURI

Bhaduri, Jawaharlal Nehru University, India, and University of Pavia, Italy, spoke on the institutional and legal requirements for effective demand management relating to employment. He wondered why countries with many poor people are reluctant to implement employment guarantee programs. Bhaduri outlined the background to the Right to Information Act and the National Employment Guarantee Act in India, including government promises for more transparency and jobs. The politicians and high-level bureaucrats were indifferent to the notion that the two acts were not working or reinforcing one another.

Bhaduri outlined three main elements affecting the success of the employment guarantee scheme in India. The first element relates to the process of globalization, which means a shift in the importance of the domestic market in favor of the external market. In order to get a larger share of the foreign market, one has to behave like a corporation and cut costs because of a lack of control over the total size of the market (e.g., increasing labor market flexibility and efficiency by downsizing the labor force, and not increasing wages). We should place greater emphasis on India's internal market, said Bhaduri.

The second element is keeping the financial markets happy. More than half of Indian stock market financing comes from outside the country and there is no disclosure relating to investors of participatory notes. In order to maintain an atmosphere for investment, one must play by the rules of the World Bank and the International Monetary Fund in order to have a high credit rating. The trap is that economic policies are overturned or changed because they do not align with keeping the financial markets happy.

The third element is decentralization under the guise of a three-tiered government. However, implementation of the National Employment Guarantee Act is assigned to local governments, but they are not given financial autonomy because of factors such as the power of patronage. As a result, the (national) government focuses on gigantic projects, which only benefit a small segment of the middle and upper-middle classes, and people are displaced in enormous numbers and create a much larger employment problem. This style of development is totally incompatible with an employment-centered program, so the employment growth rate in India has never been lower in its postindependence history. Bhaduri believed that maintaining this style of development is the hidden economic agenda of the present government. In response, there has been increasing resistance to government policy and projects throughout the country.

Meaningful employment guarantee schemes and local projects require decentralization and financial devolution, concluded Bhaduri, but political parties are unwilling to accept these developments because they fragment power. Nobody talks about incentive compatibility where the incentives of opposite sides are brought together. And nobody recognizes that work quality comes from self-supervision, not monitoring from the central government. In order to counter state resistance, employment guarantee schemes should be promoted as the right of groups rather than the right of individuals.

Session 4. Institutional Arrangements

Chair: Research Scholar RANIA ANTONOPOULOS. Speakers: JAN KREGEL, University of Missouri–Kansas City; and Research Associate INDIRA HIRWAY, Centre for Development Alternatives, Ahmedabad, India, and GEM-IWG. Comments: RATHIN ROY, UNDP.

KREGEL focused on ELR as an alternative national development strategy that incorporates a majority of the Millennium Development Goals (MDGs). The traditional approach in the United Nations (UN) identifies the constraints to development (e.g., the domestic savings gap, scarcity of domestic resources, and external resource requirements) and then attempts to overcome the constraints by importing foreign savings or resources. A goal of the UN's development decades was to transfer 1 percent of the GDP of developed countries to developing countries (0.7 percent from official government transfers and 0.3 percent from private sources) and achieve a 5 percent GDP growth rate in the latter. Success was to be measured according to the positive net transfers of real resources from developed to developing countries, but all development decades experienced negative net transfers and private investment became the dominant source of development financing. This particular strategy has been a clear failure, said Kregel.

The Millennium Declaration replaced the fifth development decade in 2000. There is a reduced emphasis on resource transfers and a focus on a directed aid strategy that is designed to meet time-bound, measurable social development goals. These goals, which are symptoms of underdevelopment, do nothing to solve the problems of development and require substantial resources ($100 billion per year to 2015), observed Kregel. He questioned what would happen after 2015.

The Monterrey Consensus (2002) has become the framework for interpreting the MDGs. Developing countries continue to be responsible for their own development (using their own domestic resources), so financing is derived by mobilizing domestic resources and developed countries provide additional resources that support sound national development strategies. According to the traditional approach, this means an increase in domestic savings. However, the major domestic (mobile) resource is unemployed and underqualified domestic labor, so the key to domestic resource mobilization is employment. However, even if developing countries are successful in mobilizing their unemployed labor force, they find that employment does not grow as rapidly as output.

Kregel noted that labor resources were not a specified goal until the 2005 Summit Outcome and that employment finally became recognized and formally proposed within the MDGs in 2006. He further noted that full mobilization of domestic labor resources requires suitable employment opportunities, adequate basic education, vocational and occupational training, unemployment benefit schemes, and migration policy. The traditional approach would undermine domestic mobilization and create unemployment (e.g., private flows and official aid create debt-service obligations and the need to earn foreign currency). Not only is a developing country transferring real resources, but the cost is much higher because of lost output associated with the resources that have not been mobilized. Furthermore, the World Bank and the IMF create conditions whereby countries can totally ignore the domestic costs in terms of unemployment and lost output.

Kregel outlined why domestic policy requires fiscal and monetary sovereignty. Interest rates would not be constrained by private sector willingness to buy government debt or by the size of the deficit, and the government would not have to borrow or issue debt in order to spend, while generating a deficit. If private sector demand is insufficient to provide full employment, the government could provide employment at the prevailing informal sector wage. This kind of initiative increases labor force flexibility by creating a ready supply of labor to meet the demand. The government could also be the borrower of last resort in the money market (and set the interest rate where it wants it to be). In this way, the government uses monetary policy to mobilize domestic resources and control its debt servicing, which is one of the greatest difficulties facing developing countries. The net result is that the government can use fiscal policy to support domestic resource mobilization and monetary policy to control the level of indebtedness.

A successful version of ELR is the Jefes program in Argentina, which depends on the local government for implementation and the federal government for financing. The program does not include all aspects of what one would want in an employment guarantee program, observed Kregel. He suggested that a suitably designed ELR can build on the success of the Jefes program and provide the resource mobilization that is required to meet the MDGs and integrate the MDGs and other international development goals (e.g., eradicating extreme hunger and poverty, promoting universal primary education and gender equality, and reducing child mortality).

HIRWAY examined how employment guarantees are expected to reduce poverty and direct an economy toward pro-poor growth in developing countries. The expected roles of an employment guarantee scheme include a guarantee of unskilled wage employment at a legal minimum wage rate, a reduction in distressed migration of the poor, and empowerment of the poor. Expected labor market outcomes include a rise in the market wage rate, an integration of the labor market (removal of wage differentials), a reduction of seasonal fluctuations in wages, and the removal of labor market segmentation between local and migrant labor.

Hirway noted that employment guarantee programs are transitional programs that transform a labor surplus economy into a full employment economy in the long run. She also noted that productive assets expand employment and incomes, and improve the quality of life and the productivity of workers in multiple ways. Therefore, the programs should construct basic socioeconomic infrastructure, regenerate the ecology, strengthen the asset base of the poor, contribute to gender equity, and generate purchasing power that raises aggregate demand in the (local) economy. One way to address possible inflationary pressures is to finance the programs through a special tax or levy, and select assets that generate ample employment later on. Hirway also noted that these programs may be a powerful instrument for the mobilization and empowerment of women. She further noted that employment guarantee programs are not neoliberal policies—they challenge the established development paradigm by underscoring the critical role of the state as an employer of the poor.

The National Rural Employment Guarantee Act in India (2005) ensures that every rural household living in the most backward 200 districts of the country is guaranteed at least 100 days of wage employment in unskilled manual work. Hirway outlined the major issues and concerns that arose in the first six months of implementation of the act in the state of Gujarat: reaching the poor (how to make poor people demand work under the scheme), enforcement, ensuring the payment of minimum wages (in the face of noncommitment and corruption of the administration), and sound planning. Several problems at the field level included planning from the top down rather than the bottom up, ad hoc projects, a lack of long-term goals and integration with multilevel and macro development schemes, and insufficient material inputs to ensure asset durability.

A positive aspect of the employment guarantee scheme in Gujarat was that women constituted 55 to 60 percent of total workers. However, their wages were directed to the head of the household, so they were not empowered by employment. Hirway observed that an important component of the scheme is a social audit by vigilance committees at the village, block, and district levels that include representatives of the poor and mitigate the exploitative structure of rural society.

An example of a success story is Ralegan Siddhi in Maharashtra state, which introduced an employment guarantee scheme in 1972. In this case, natural resource management, accompanied by social mobilization, transformed a drought-prone, poor village into a self-reliant, prosperous village. Ralegan Siddhi avoided common watershed development weaknesses and combined the strengths of the scheme with the development program. The village was able to access employment guarantee funds on a large scale to generate employment and regenerate the common lands and resources. It provided massive employment to the poor at the minimum wages and also ensured fuel wood, fodder, and water to local households. In the process, it reduced the drudgery and hardship of women. The critical factors in the village's success story were the generation of massive wage employment, systematic planning, the building of participatory institutions for economic and social activities, and visionary leadership.

Hirway concluded that the successful enforcement of guarantee work programs in the short and long run requires government commitment, administrative competence, and social mobilization.

Session 5. Country Experiences: Morocco and Argentina

Chair: DANIEL KOSTZER, UNDP. Speakers: HIND JALAL, Ministry of Finance, Morocco, and GEM-IWG; PAVLINA R. TCHERNEVA, Bard College; and CORINNE PASTORET and MARTHA TEPEPA, University of Missouri–Kansas City. Comments: VALERIA ESQUIVEL, Universidad Nacional de General Sarmiento and GEM-IWG.

JALAL presented the objectives and actions of La Promotion Nationale (PN), a public entity in charge of mobilizing an underemployed and unemployed labor force in Morocco. The PN was created in 1961 and its programs continue to be the most efficient mechanism for social protection in the country.

Based primarily on the intensive use of labor, the objectives of PN aim to mobilize the labor force of the poor rural population (and attenuate rural migration) by focusing on water resource management. The PN also applies to the urban population by improving the quality of life and the environment, and supporting projects within the framework of the country's social development strategy. The annual participation rate is approximately 50,000 persons, and women represent nearly 20 percent of the total. Scaled remuneration (unqualified, semiqualified, and qualified) is based on the guaranteed agricultural minimum wage and the guaranteed interprofessional minimum wage. Projects are formulated at the local level, selected at the provincial level, and decided at the central level. PN projects contributed approximately 14 million working days in 2005.

The PN acts through a number of programs (e.g., the community program and the Saharan provinces development program) and many of its projects are undertaken in partnership with other government departments (especially the technical ministries, in order to guarantee quality). Infrastructure projects were the most significant activity in the 1960s, while the equipment and Sahara programs are relatively more important today. Financing is ensured by the state budget through a special appropriation account, which represented 0.2 percent of GDP in 2002.

The direct effects of PN projects include an acceleration of monetizing the economy in poor areas, an improvement in the purchasing power of marginal zones, an improvement in human development (e.g., schools), a reduction in the cost of hydro/agricultural works, a deceleration of rural migration to the cities, and an improvement of the environment. During the first two decades of the program, some projects upset the balance of traditional trade via localized inflation.

Jalal found that PN expenditures per capita at the provincial level have not been correlated with poverty. A large part of the PN budget is directed to urban nonpoor zones as opposed to rural poor zones. Moreover, 40 percent of the budget is directed to urban households within permanent employment programs. Technical supervision (in the past) and human resources (today) are the principal factors hindering the actions of PN. The three principle limitations facing public institutional programs relate to public financing, multilateral assistance, and centralized public management.

PN's mandate now exceeds the public works programs in terms of labor intensity. Human investment that is channeled toward economic development can be highly profitable, noted Jalal. She recommended that the current information system should be expanded to allow a gender analysis of PN projects and that constraints should be removed to counter the weak turnover of beneficiaries in the program, particularly in urban areas. Since PN staff costs are a drain on the budget, the community program budget should be reallocated to the equipment of rural areas. Jalal concluded that there was a need for better targeting of poor populations. Employment guarantee schemes remain one of the last public tools to counter inequalities and are a social stabilization tool in periods of economic and climatic crises.

TCHERNEVA outlined the specific lessons that can be learned from the Jefes program in Argentina in terms of how public service employment can address certain economic ventures that produce gender inequalities. She interviewed the architects of the Jefes program, visited a number of projects, and spoke with beneficiaries of the program in August 2005. The general criticisms of public sector employment (PSE) programs were that they are unmanageable and directed by inefficient government administrations, and that they employ unskilled people with no work culture who artificially increase the labor force. The private sector views the Jefes program as a negative skill when recruiting employees, and the public sector also stigmatizes beneficiaries of the program. Another criticism is that there is insufficient infrastructure and institutional support for large-scale PSE programs.

The Jefes program provides four hours of work per day to unemployed heads of household at a wage of $50 per day. Other distinctive features are that three quarters of participants are women, 87 percent of activities are community projects, and the government finances a maximum of 60–80 percent of the cost of individual projects (the remainder is financed by the community and organizations, such as NGOs). The administration of the program is decentralized (which enhances participatory democracy), there is community initiative in terms of the work to be done, and there are training and educational components. Examples of projects include food kitchens, bakeries, tailor shops, agricultural cooperatives, multiproject housing complexes, and other micro enterprises.

Tcherneva noted that the Jefes program was operating in less than four months, required less than 1 percent of GDP, and represented a policy with the people in mind. She found that the beneficiaries of the program, who were mostly women, wanted to work in the various projects because it gave them a sense of worth, more involvement in the community and with their neighbors, and an opportunity to learn new skills. Women's work was seen as a public good. There was a preference for public sector jobs because of proximity to homes and access to social services, such as child care and literacy programs.

We need to make policymakers understand that the projects associated with PSE programs represent socially useful work that deserves remuneration and that women need to be provided with auxiliary services in order to access paid employment, said Tcherneva. These programs do not emulate modern welfare programs with punitive means tested measures, but give women the opportunity to be employed in decent jobs if they want to work.

PASTORET and TEPEPA presented a gender-oriented perspective of the Jefes and Jefas program in Argentina based on an August 2006 survey. The program derives from an emergency employment policy that was created after the 2001 crisis to provide jobs to the poorest households. Although the economy of Argentina is recovering, an ELR program is still needed to promote sustainable development, they said. They observed that 70 percent of the main beneficiaries of the program were women and that women were responsible for the success of welfare-enhancing community projects.

Pastoret and Tepepa interviewed 45 participants of the program (at work, at home, and in the employment offices). They also visited a number of the micro-entrepreneurial activities and projects, particularly those in Lomas de Zamora municipality, which is a model for linking ELR and community development. They found that women relied on social networks to survive within very hostile environments of high unemployment, insecurity, violence, and malnutrition. Women played a major role in maintaining their families and communities by developing an alternative economy based on solidarity and new institutions. The Jefes and Jefas program provided the financial means and the infrastructure for individual projects that promoted education, training, and productive activities.

The state, communities, and individuals worked together and complemented one another. However, there was a clear division of labor between men and women within the community because men believed that the program was associated with women's duties. The men in the program were ashamed to be there, except when receiving education and training in some of the micro enterprises.

The success of the Jefes and Jefas program was based on ready access to work, which was close to the homes of participants, combined with the motivation of women for their children. The work empowered the women, provided psychological and emotional stability, as well as respect, and gave women better access to the private sector by developing new skills. Children were not a real constraint in preventing women from finding a job and women were able to reclaim their place in society.

Speaker: LYDIA SANTOVA SHOULEVA

Shouleva, member of the 40th National Assembly of Bulgaria and observer in the European Parliament, presented an account of the positive experience in curbing unemployment in Bulgaria. When she became Minister of Labor and Social Policies in 2001, the main problems were unemployment (19 percent) and poverty. Half of the unemployed were long-term unemployed (more than three years). The question was how to combine economic, employment, and social policy and ensure sustainable economic development, as well as social cohesion. There was the need for a new social policy model, she said, and the main goal was to change the attitude of the people toward labor.

The "From Social Assistance to Employment" model was designed to create job opportunities for the long-term unemployed. The program focused on people currently receiving social benefits, so that they would receive wages and social and health insurance, and included vocational training in order to upgrade skills. People refusing a job offer lost the right to receive social benefits. Municipalities were the main employers who applied for funding on a competitive basis. According to Shouleva, the model was more effective and efficient in terms of budget finance, and there were substantial savings in social assistance and long-term beneficial impacts on the local and national economy.

The municipalities were responsible for defining the projects and overseeing the performance of activities. Initially, there was resistance to the added responsibility delegated to local administrations and the difficult task of handling the long-term unemployed with low qualifications. The municipalities soon recognized the merits of participation, however, in terms of the benefits for local budgets and people. The development of the program also attracted private employers and the formation of public/private partnerships.

Since program implementation, the number of long-term unemployed has decreased from 330,000 in 2002 to 185,000 and the time without work has fallen to less than two years. The economy has developed more rapidly and foreign direct investment has increased, creating new jobs and reducing poverty. Unemployment is no longer the main problem in Bulgaria, as it has fallen from 18.8 percent in 2001 to 8.7 percent. The program has met the three key challenges of unemployment in accordance with the Lisbon strategy: increasing the adaptability of workers, promoting employment, and investing more in human capital and lifelong learning.

Shouleva noted that Bulgaria will become a full member of the European Union on January 1, 2007, and that her country's social policy will be interdependent with those of Europe. She also noted that properly designed social policy is a productive factor of economic growth and prosperity. She further noted that she was recognized for her contribution toward achieving the Millennium Development Goals.

Session 6. Country Experiences: South Africa, Sri Lanka, and Bangladesh

Chair: RAMAA VASUDEVAN, Barnard College and GEM–IWG. Speakers: OLAGOKE AKINTOLA, University of KwaZulu-Natal, South Africa; SANJAYA DESILVA, Bard College; and MEHNAZ RABBANI, BRAC, Bangladesh and GEM-IWG. Comments: BOLA AKANJI, Nigerian Institute of Social and Economic Research and GEM-IWG.

AKINTOLA outlined public works programs and unpaid care work in South Africa, including the effects of HIV/AIDS. He wondered if job creation could be the main thrust of the government's AIDS care policy and if current AIDS volunteers meet the criteria for paid employment.

Akintola noted that South Africa has one of the highest poverty and inequality rates in the world and that the poverty rate was closely related to the unemployment rate (49.9 and 26.5 percent, respectively). Job creation, therefore, is crucial for mitigating these rates. He also noted that Africans had the highest poverty and unemployment rates (61 and 31 percent, respectively) because of previous apartheid policies. He further noted that government policy on home care has placed unpaid care work in the public sphere and in the hands of volunteers, who are also being recruited to provide unpaid care in homes with HIV/AIDS. Given the poverty of caregivers and the critical role that they play in the health system, Akintola foresaw a window of opportunity for the government to make public job creation a policy priority for the care of people living with HIV/AIDS.

South Africa's response to tackling the problems of poverty and unemployment was the (community-based) National Public Works Programme, which was an initiative of the National Economic Forum (business and labor) in 1992. Funding was based on criteria of labor intensity, job training, and community participation, and most projects were in the construction industry. The program created approximately 20,000 temporary jobs per year. The main problem was targeting projects to the poorest among the poor and the short-term nature of jobs, so there was minimal reduction in poverty levels among participating households. The expanded public works program, which was launched in 2004, aims to create additional work opportunities and improve worker skills for a minimum of 200,000 people per year between 2004 and 2009.

Akintola outlined the relationship between poverty and HIV/AIDS, which has a deleterious impact on individuals, households, communities, and the economy. Coping with AIDS-related illnesses can cause a fall in income of 66 to 80 percent and pose a major threat to food security in households. Previous studies have failed to identify those who are most affected within the household and community—i.e., caregivers who incur the physical, emotional, and economic burdens of care and are mostly women who are unemployed, poor, and unmarried. The demands of home care preclude caregivers from participating in paid employment and contribute to the increase in the number of unemployed.

Akintola outlined several reasons why volunteers should be included in public works programs: job guarantee programs lift people out of poverty; unpaid care creates time poverty; volunteers support the health care system of the country and are motivated, able, and willing to work; and most volunteers would choose paid employment if given the option. Moreover, the inclusion of volunteer caregivers in public works programs could have multiple benefits and multiplier effects (e.g., targeting poor communities and unemployed women). Since the jobs created by the program would be long term, there would be funding issues, he said. The programs must also be flexible and accommodate the circumstances of volunteers. A major spin-off would be the reduction of apathy among men about providing care and support for people living with AIDS.

DESILVA presented a political-economic analysis of the root causes of youth employment problems in Sri Lanka. Previous studies by organizations such as the ILO and the World Bank have presented various hypotheses about the causes of Sri Lanka's youth unemployment and expressed a concern that youth aspirations, which are orientated toward public sector and white collar employment, are not in line with the needs of the economy. Policy prescriptions, such as sweeping educational reforms to strengthen the vocational orientation of general education and the liberalizing of public and private sector labor markets, have failed to change attitudes and reduce unemployment.

Meaningful educational reforms and a more comprehensive approach is needed, said DeSilva. It is important to recognize that a productive skill base is a prerequisite for economic growth and that the Sri Lankan educational system and society at large have failed to promote productive self-employment and entrepreneurship. Effective policy must understand the interrelationships between the education system and the labor market, and account for the social, political, and economic institutional structure that has created a dysfunctional education-employment nexus.

Sri Lanka has a highly regulated labor market and its people fervently espouse social mobility through the free educational system, which is the most important foundational pillar of modern society. Therefore, rapid liberalization and privatization in the absence of complementary attempts to reform education and aspirations of the youth could aggravate youth frustrations and escalate into civil unrest and violence.

DeSilva revised the "skills mismatch" hypothesis that faults the educational system for raising employment expectations without giving students the skills valued by employers. He argued that the contemporary labor market demands a broad base of cognitive and affective abilities from which a fluid set of job-specific skills can be developed on the job. He also retained individual control over the choice of educational attainment, as well as individual time allocation toward education. Rather than placing the onus on the education system or the labor market, DeSilva sought to understand how skills, aspirations, and opportunities are generated by the educational system and by the labor market. A successful job search must match both the skills and aspirations of the applicant with the opportunities in the labor market. A well-functioning job market must include informational and incentive links between skills, aspirations, and opportunities to ensure that the job market reaches an efficient equilibrium.

DeSilva concluded that several textbook assumptions must be modified in light of the real-world situation in contemporary Sri Lanka. The assumptions relate to supply bottlenecks in the educational system, distorted labor markets, strong job preferences at the societal level, and informational problems in the education sector and the labor market. He noted that his presentation was part of a research project that would recommend policies based on his revised assumptions.

RABBANI reviewed the Rural Maintenance Program (RMP) in Bangladesh, where income poverty is a persistent problem and 20 to 30 percent of the people live in extreme poverty. Despite economic growth and advances in human development, there are insufficient and inequitable employment opportunities in the country. Moreover, there are no plans to change the national strategy and the growth-employment links that focus on self-employment.

Rabbani outlined how households diversify both occupationally and spatially as a strategy to improve their livelihoods. She concluded that the major hurdles for the rural unemployed are improving technologies and skills. The failure to coordinate investment has led to a rural labor market that is focused on agriculture and characterized by low productivity, low wages, short-term contracts, and a large informal sector (90 percent of the labor force).

Public works programs have been a government strategy to reduce poverty. Both government and nongovernment policies have focused on self-employment, but the extremely poor have limited access to microfinance. Furthermore, the policies have lacked an adoptive capacity for new technologies and innovative managerial skills. In addition, the government has been characterized by poor management, heavy bureaucracy, and political influence.

The RMP was conceived in 1983 and is the largest wage-employment project in Bangladesh. Its main task is to maintain rural earthen roads and provide paid employment for four years to poor women in rural areas. Over the years, it has changed its vision from a relief program to a development program. Workers are given intensive training in numeracy, income diversification, and business management skills. As of May 2006, the RMP had employed more than 181,000 destitute women. Cost benefit analyses show positive effects in terms of income, literacy, social awareness, and gender empowerment. The strengths of the RMP model include cheap and effective targeting (the most destitute of rural communities); close interaction and involvement between the community, NGO, and government agencies; good governance and efficient management; wide acceptance in communities; accessibility; confidence-building through life skills training; and positive impacts in the lives of the poor.

Some fundamental problems with the RMP model are that it promotes self employment for all workers and fails to recognize the heterogeneity of the extremely poor; does not mobilize private resources; continues to be perceived as a relief-based program; does not guarantee sustainable impacts on households; is low in coverage; and lacks the innovation to produce higher quality outputs and generate more employment. Rabbani outlined the problems of handing over the RMP project to the government in July 2006 and the waste of resources by initiating a new government project (Rural Employment Opportunities for Public Assets) that is expected to replace the RMP by 2010. She also outlined projects where factories employ unskilled poor women, local inputs, and low-cost technology to produce marketable products. She recommended these projects as models for investing development funds on sustainable employment generation and attracting private resources to rural underdeveloped areas. The challenge facing the RMP is to retain its strengths but ensure flexibility for greater coverage and improved efficiency where sustainable employment generation is the main objective.

The main points to consider when redesigning RMP include local and diverse demand-driven manufacturing activities that include a varied group of workers; financial sustainability to ensure pro-poor employment; and strong partnerships between the government, NGOs, and communities, as each faction specializes in different tasks. Focusing on sustainable wage employment and diversity in activities based on local market strengths can provide the most benefits for the army of unskilled labor in Bangladesh, said Rabbani.

Maastricht 2042 and the Fate of Europe: Toward Convergence and Full Employment

JAMES K. GALBRAITH

Public Policy Brief No. 87, 2006

www.levy.org/pubs/ppb_87.pdf

Unemployment in the European Union (EU) is a serious problem that threatens to disrupt the integration of accession countries, the character of individual countries, and the continued existence of the EU. According to Senior Scholar James K. Galbraith, University of Texas at Austin and the University of Texas Inequality Project, European integration poses a huge conundrum for European employment because the conventional theory explaining unemployment in Europe—labor market rigidities—is wrong. The application of this policy will not cure European unemployment, but it could destroy the economic promises of the EU for its poorer regions and the accession countries.

Expanding upon Public Policy Brief no. 72, Galbraith sets forth a concrete strategy of earnings convergence for the EU that is compatible with a high employment strategy and achievable productivity growth. He finds that countries and regions that are more egalitarian systematically enjoy more employment; this relationship is in accord with correct principles of economics. Furthermore, the relationship of inequality to unemployment in the United States is the opposite of the rigidities framework: in periods of full employment, pay inequality declines. Pay inequalities, therefore, are relevant to the theory of labor market adjustment. The European paradox is that European ideals require convergence, but European policy imposes divergence, which, if rigorously pursued, will result in declining relative pay rates in the poor regions of Europe.

A surprising finding is that intersectoral industrial pay inequalities are larger in Europe than in the United States and that average European incomes are dramatically more unequal than those in the United States when measured across continental distances. Measured across the EU–25, the European cross-regional Gini coefficient is more than twice the analogous value across the United States.

Galbraith calculates the relative growth rates of wage incomes that would be required to achieve income convergence and reduce the interregional inequalities in the EU to American levels by 2042, the 50th anniversary of the Maastricht Treaty. Convergence policy, he says, is the only way for Europe to approach full employment without serious inflation, and to preserve European ideals.

Otherwise, the EU faces significant unemployment, unmanageable internal migration, and social dislocation.

Galbraith suggests that an egalitarian growth policy that raises relative growth rates in the poorer regions of Europe is the most powerful medium-term measure for reducing unemployment. He recommends an expansion of regional funds as well as new instruments that support the continental integration of social welfare policy. Continental integration, not flexible labor markets, accounts for America's relative success against entrenched structural unemployment (e.g., Social Security, Medicare, and minimum-wage laws). Galbraith's other suggestions for effective redistributive policy include the creation of a European Pension Union, interregional personal income convergence, directly raising the pay and purchasing power in the nontraded-goods sectors of peripheral Europe, and building European universities to rival higher education in the United States.

Galbraith notes that monetary policy has a limited role in a convergence strategy, and he supports a major strategic objective that limits the ability of the European Central Bank to undermine the convergence process. He says that European policymakers should recognize the true roots of U.S. success in fiscal federalism and Keynesian economics.

Capital Stock and Unemployment: Searching for the Missing Link

ALFONSO PALACIO-VERA, ANA ROSA MARTÍNEZ-CAÑETE, ELENA MÁRQUEZ DE LA CRUZ, and INÉS PÉREZ-SOBA AGUILAR
Working Paper No. 475, August 2006
www.levy.org/pubs/wp475.pdf

The conventional wisdom is that persistent unemployment is due mainly to labor market rigidities, notwithstanding the reduction of rigidities and the concomitant rise in the unemployment rate in Europe in the 1980s and 1990s. Alfonso Palacio-Vera, Ana Rosa Martínez-Cañete, Elena Márquez de la Cruz, and Inés Pérez-Soba Aguilar, Universidad Complutense de Madrid, Spain, examine the proposition that capital formation is an important variable in the determination of unemployment in the economy of the United States.

The authors' empirical results lend strong support for the hypothesis that the aggregate capital-output ratio is a significant determinant of the nonaccelerating inflation rate of unemployment (NAIRU) in the United States. Their results also show that the real price of imports and aggregate capacity utilization are also significant determinants of the NAIRU, while technical change and long-term unemployment are not.

Palacio-Vera et al. review the works of authors who have examined the role of capital in explaining unemployment. They note that the authors impose restrictions on the price and wage equation, whereby the unemployment rate is unaffected by technical progress and changes in the aggregate capital-labor ratio. The authors suggest that the NAIRU may exhibit a trend over several decades and that a possible source is change in the aggregate capital-output ratio; i.e., a higher capital stock relative to output (or labor) raises labor productivity and mitigates inflationary pressures, which allows the economy to operate at a lower unemployment rate.

The authors develop a theoretical model to explain the determination of the unemployment rate in the presence of trade unions and imperfectly competitive product markets, and to show the effect of capital stock on unemployment. Contrary to studies that postulate that the long-run impact of capital accumulation on the unemployment rate occurs through the impact of capital accumulation on the mark-ups of firms, the authors postulate a framework in which capital stock affects unemployment mainly through its effect on the marginal product of labor. Their approach to wage determination starts from the notion that both workers and firms have some bargaining power and the reservation wage (including the "aspiration" for a steady improvement in living standards) may depend on factors such as the level and growth rate of wages in the past. In the model, the NAIRU depends positively on long-term unemployment and the real price of imports, and negatively on the capital-output ratio, which is a positive function of the ratio of the real wage to the rental price of capital services. The model thus predicts a positive relationship between real interest rates and the NAIRU.

The theoretical model is estimated using data from the Eco Win Pro database, which includes data from the U.S. Bureau of Economic Analysis, the Bureau of Labor Statistics, and the Federal Reserve, and NAIRU data from the Organisation for Economic Co-operation and Development (quarterly and seasonally adjusted data for the period from the second quarter of 1964 to the first quarter of 2003). A cointegrated VAR model empirically tests whether there is a long-term equilibrium relationship between the NAIRU and the aggregate capital-output ratio after controlling for other variables embedded in the model.

The authors find that larger increases in the capital-output ratio in previous periods lead to lower increases in the NAIRU in the current period, both in the short- and long-run. They note that current period dynamics are positively influenced by capacity utilization in the preceding period and that an increase in the capital-output ratio reduces the current increase of capacity utilization, and vice versa.

The paper presents new empirical evidence that supports the claim that the aggregate capital-output ratio, the real price of imports, and capacity utilization significantly determine the NAIRU in the U.S. economy. In particular, increases in the aggregate capital-output ratio and capacity utilization, and decreases in the real price of imports are associated with significant reductions in the NAIRU. Contrary to conventional wisdom, insofar as the aggregate capital-output ratio is affected by changes in real interest rates, the stance of monetary policy has a considerable impact on the NAIRU. Thus, interest rate policy has supply-side consequences in that policy can only deliver low inflation through low economic growth and high unemployment.

Explorations in Theory and Empirical Analysis

On the Minskyan Business Cycle

KORKUT A. ERTÜRK

Working Paper No. 474, August 2006

www.levy.org/pubs/wp474.pdf

Two of Minsky's central propositions in relation to business cycle turning points are that: (1) financial fragility increases gradually over an economic expansion; and (2) the interest rate increases, sooner or later, and sets off a downward spiral, bringing the expansion to an end. According to Research Associate Korkut A. Ertürk, University of Utah, Minsky's propositions have not been fully persuasive. However, Keynes's views on the alternation of bull and bear sentiment and asset price speculation over the business cycle provide a satisfactory explanation of Minsky's propositions.

Ertürk outlines the conceptual structure of Keynes's argument in the *Treatise* and discusses the role that asset price speculation plays over the business cycle. He focuses on some of the theoretical implications of the argument with respect to the conditions under which speculation can be both stabilizing and destabilizing. He then situates Minsky's contribution in the historical context of the marginalization of the "two-price" theory in the *Treatise* (i.e., separate principles to determine the investment and consumer goods prices).

The author notes that Minsky's seminal contribution was to underscore the importance of speculation in economic activity and reintroduce asset prices into Keynesian theory of investment. Although Minsky revived much of Keynes's analysis in the *Treatise*, he ignored the role that asset price speculation played in Keynes's analysis of the business cycle and refrained from crediting the *Treatise* as the source of his two-price theory. Ertürk's objective is to make the connection between Keynes's *Treatise* and Minsky's account of how a business cycle expansion ends.

The essential insight that Minsky drew from Keynes was that optimistic expectations about the future create a margin (reflected in higher asset prices) that makes it possible for borrowers to access finance in the present. Once the view that asset prices are excessive takes hold in financial markets, higher asset prices cease to be a stimulant and turn into a drag on the economy. Initially debt-led, the economy becomes debt-burdened, and there is pressure on the banking system to raise interest rates. What ultimately impairs the ability of the banking system to accommodate a rising level of economic activity is that, at some point during an expansion, the financial sentiment falters, so the interest rate rises. This result is consistent with Minsky's view.

Ertürk examines how Keynesian theory strayed away from the two-price theory in the *Treatise* after the publication of the *General Theory*. Minsky reestablished that Keynes was essentially about "an investment theory of fluctuations in real demand and a financial theory of fluctuations in real investment." However, Minsky overlooked elements in the *Treatise* that supported his argument—that Keynes's account of how financial sentiment shifts over the business cycle provides a satisfactory explanation of the turning point of his business cycle expansion.

New Research Associates

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Palley is the author of *Plenty of Nothing: The Downsizing of the American Dream and the Case for Structural Keynesianism* (Princeton University Press, 1998) and *Post Keynesian Economics* (Macmillan Press, 1996). His recent policy articles include "External Contradictions of the Chinese Development Model" in *Journal of Contemporary China*, February 2006; "The Questionable Legacy of Alan Greenspan" in *Challenge*, November–December 2005; and "The Economic Case for International Labor Standards" in *Cambridge Journal of Economics*, January 2004. He has also published in numerous magazines, including the *Atlantic Monthly*, *American Prospect*, and *Nation*. He holds a B.A. degree in modern history and economics from Oxford University and an M.A. in international relations and Ph.D. in economics from Yale University.

ROBERT W. PARENTEAU is the chief U.S. economist and investment strategist at RCM, an investment management company of Allianz Global Investors. He employs macroeconomic insights to drive U.S. equity and global balanced portfolio strategy. In this effort, he guides the global and domestic asset allocation, sector, factor, and industry selection decision making of RCM portfolio managers and equity analysts. Parenteau has served as a regular lecturer for all three levels of the Security Analysts of San Francisco CFA preparation course. He has presented several papers at our annual conference on financial structure that applied Hyman P. Minsky's financial instability hypothesis to the late 1990s technology bubble. He further explored the macrodynamics of financial imbalances in papers that have been published as chapters in *Contemporary Post Keynesian Analysis* (L. R. Wray, ed.) and *Financialization and the Global Economy* (G. A. Epstein, ed.). Parenteau holds a B.A. in political economy with honors at Williams College, as well as a chartered financial analyst degree.

New Levy Institute Book

International Perspectives on Household Wealth
EDWARD N. WOLFF
December 2006
Edward Elgar Publishing, in association with The Levy Economics Institute

The contributors to this comprehensive volume analyze the assets and debts of households in the United States, Canada, Germany, Italy, Sweden, and Finland during the 1990s and into the 21st century. In their analyses of the United States, the authors highlight trends in wealth holdings among the low-income population, changes in wealth polarization, racial differences in wealth holdings, and the dynamics of portfolio choices. The consensus among the contributors is that wealth inequality has generally risen in the OECD countries since the early 1980s, although Germany stands out as an exception. In the case of the United States, the authors note, wealth holdings have generally failed to improve among low-income families, and the racial wealth gap widened during the late 1980s.

The book also contains new results on a number of topics, including wealth polarization and assets held by households in the United States, as well as the effects of parental resources on asset holdings in Chile.

Academic, government, and public policy economists in OECD and middle-income countries will find the book engaging. It will also appeal to specialists in international and welfare economics and other social scientists interested in the issues of inequality.

Levy Institute Awarded Grant from UNDP

Research Scholar Rania Antonopoulos has received support from the United Nations Development Programme (UNDP) to lead a research project on the impact of public employment guarantee schemes (EGS) on pro-poor development and gender equality. The project consists of a pilot study, which will explore the synergies between EGS and unpaid work, including unpaid care work, for India and South Africa.

In developing countries, the call for compensating the private investment gap by increased public investment has recently received wide endorsement. At the same time, EGS has been used in rural areas of several developing countries to create a safety net by providing public employment for people who are willing and ready to work but unable to find a job. Public employment generates income for the poor and also results in asset creation and improvements in human development. The extensive worldwide participation of women in EGS, however, points to the fact that substitution of unpaid work with public jobs can be instrumental for gender equity by simultaneously creating much needed employment and alleviating the time burdens of women.

UNDP supports the development of cutting-edge products for promoting gender equality and pro-poor programs. Our research project is expected to contribute to current policy dialogues and provide empirical evidence for policymakers to initiate innovative poverty alleviation schemes.

The Levy research team will include Research Scholars Rania Antonopoulos and Marzia Fontana, Research Associates Indira Hirway and Valeria Esquivel, and President Dimitri B. Papadimitriou.

PUBLICATIONS AND PRESENTATIONS

Publications and Presentations by Levy Institute Scholars

RANIA ANTONOPOULOS *Research Scholar*
Publication: "Asset Ownership Along Gender Lines: Evidence from Thailand," *Journal of Income Distribution,* Vol. 13, No. 3–4.
Presentations: "Gender and the Continuum of Paid and Unpaid Work," panel discussion with political philosopher Linda Hirshman, author of *Get to Work: A Manifesto of Women of the World*, Bard College, September 21; "From Unpaid Work to Gender-aware Job Creation," research workshop on Labour Markets and Growth: Better Jobs under Globalization? International Development Research Center, and Carleton University, Ottawa, Canada, November 15–16.

PHILIP ARESTIS *Senior Scholar*
Publication: "Financial Development and Productive Efficiency in OECD Countries: An Exploratory Analysis" (with G. Chortareas and E. Desli), *The Manchester School of Economic and Social Research*, Vol. 74, No. 4, Special Issue, 2006.
Presentations: "Monetary Policy in the U.K." (with A. Angeriz), Evaluating the Economics of New Labour workshop, St. Catherine's College, Cambridge, September 12; "Assessing Inflation Targeting through Intervention Analysis" (with A. Angeriz), annual conference of the Money, Macro, and Finance (MMF) Research Group, September 14.

JAMES K. GALBRAITH *Senior Scholar*
Publications: *Innovation, Evolution, and Economic Change: New Ideas in the Tradition of Galbraith*, J. K. Galbraith, B. Laperche, and D. Uzinides, eds., New Directions in Modern Economics, Cheltenham, U.K., and Northampton, Massachusetts: Edward Elgar Publishing Ltd., 2006; "La Prédation économique moderne: guerre, fraude d'entreprise et cruelle chimère des réformes du marché du travail," *A Contrario*, Vol. 4, No. 1; "Unemployment in Europe: Some American Suggestions," *Journal of International Politics and Society*, 1; "Endogenous Doctrine, or Why Is Monetary Policy in America So Much Better Than in Europe?" *Journal of Post Keynesian Economics*, Spring, Vol. 28, No. 3; "Taming Predatory Capitalism," *The Nation*, April 17; "Withdrawal Symptoms" and "The Predator State," *Mother Jones*, March-April and May-June; "Economic Equality and Victory in War: An Empirical Investigation" (with C. Priest and G. Purcell), UTIP Working Paper No. 37, June 13; "Pay Inequality in Cuba: The Special Period and After" (with L. Spagnolo and D. Munevar), UTIP Working Paper No. 38, June 13.

CAREN A. GROWN *Senior Scholar*
Presentations: "Gender and Trade Liberalization: Framing the Issues," New School Graduate Program in International Affairs, New York, October 17; "The Gender Asset Gap," UN-DESA Forum on Eradicating Poverty, New York, November 15–16.

GREG HANNSGEN *Research Scholar*
Publication: "Borrowing Alone: The Theory and Policy Implications of the Commodification of Finance" in B. J. Clary, W. Dolfsma, and D. M. Figart, eds., *Ethics and the Market: Insights from Social Economics,* New York: Routledge, 2006.
Presentation: "The Gibson Paradox: Modelling a Conundrum of Tight Money," Second Biennial Post-Keynesian Conference, University of Vermont, Burlington, September 23.

DIMITRI B. PAPADIMITRIOU *President*
Presentations: Interview with Jonathan Peterson regarding the growing household debt held by older families and its potential concern, *Los Angeles Times*, July 14; interview with Mara Der Hovanesian regarding the sustainability of housing prices, household debt, and growth, *Business Week*, July 26; interview with Alix Stuart regarding credit derivatives, *CFO Magazine*, August 2; interview with Steve Johnson regarding foreign reserve diversification and the U.S. current account deficit, Reuters, August 3; interview with Tom Ramstack regarding the effect of rising interest rates on borrowers with adjustable rate mortgages, *The Washington Times*, August 8.

EDWARD N. WOLFF *Senior Scholar*
Publications: *International Perspectives on Household Wealth*, Cheltenham, U.K.: Edward Elgar Publishing Ltd., 2006; "International Comparisons of Wealth: Methodological Issues and a Summary of Findings," "Changes in Household Wealth in the 1980s and 1990s in the U.S.," and "Is Wealth Becoming More Polarized in the United States?" (with C. D'Ambrosio) in *International Perspectives on Household Wealth*; "The Vintage Effect in TFP-growth: An Analysis of the Age Structure of Capital" (with M. Gittleman and T. ten Raa), *Structural Change and Economic Dynamics,* Vol. 17, Issue 3, September; "The Distribution of Wealth in the USA: Trends and Contributory Factors" in *Steigende wirtschaftliche Ungleichheit bei steigendem Reichtum?* G. Chaloupek and T. Zotter, eds., Austrian Federal Chamber of Labour, 2006; "An Overall Assessment of the Distributional Consequences of Government Spending and Taxation in the U.S., 1989 and 2000" (with A. Zacharias) in *The Distributional Effects of Government Spending and Taxation*, D. B. Papadimitriou, ed., Houndmills, Basingstoke, Hampshire, U.K., and New York, N.Y.: Palgrave Macmillan, 2006; "Information Technology and Growth: The U.S. Experience" in *Growth, Capital and New Technologies*, P. Schreyer and M. Mas, eds., Fundación BBVA, 2006; "The Growth of Information Workers in the U.S. Economy, 1950–2000: The Role of Technological Change, Computerization, and Structural Change," *Economic System Research*, Vol. 18, No. 3, September.

Presentations: "The Growth of Information Workers in the U.S. Economy, 1950–2000: The Role of Technological Change, Computerization, and Structural Change," NBER Summer Productivity Workshop, July 18–21; "Net Government Expenditures and the Economic Well-Being of the Elderly in the United States, 1989–2001," "Class and Household Economic Well-Being in the United States, 1989–2002," and "Estimating the World Distribution of Household Wealth," 29th General Conference, International Association for Research in Income and Wealth, Joensuu, Finland, August 20–26.

L. RANDALL WRAY *Senior Scholar*

Publications: *Money, Financial Instability and Stabilization Policy* (with M. Forstater), eds., including chapter 3, "System Dynamics of Interest Rate Effects on Aggregate Demand" (with L. Tauheed), Cheltenham, U.K.: Edward Elgar Publishing Ltd., 2006; "What a Long, Strange Trip It's Been: Can We Muddle Through Without Fiscal Policy?" (with S. Kelton) in *Post-Keynesian Principles of Economic Policy*, C. Gnos and L.-P. Rochon, eds., Cheltenham, U.K.: Edward Elgar Publishing Ltd., 2006; new introduction and chapter for a Mexican (Spanish language) edition of *Understanding Modern Money*, UNAM, October 2006.

Presentations: Radio interview with Mike Norman, BizRadio Network KXYZ-AM, August 8 and November 2; paper on the contributions of Basil Moore, 9th International Post- Keynesian Conference: A Celebration of the Impact of Keynesian Economics on Policy, UMKC, September 15–18; "Demand Constraints, Secular Stagnation, and Big Government: The Contributions of Harold G. Vatter," Harold Goodhue Vatter Memorial Lecture in Economics, Portland State University, October 25.

AJIT ZACHARIAS *Senior Scholar*

Publication: "An Overall Assessment of the Distributional Consequences of Government Spending and Taxation in the U.S., 1989 and 2000" (with E. N. Wolff) in *The Distributional Effects of Government Spending and Taxation*, D. B. Papadimitriou, ed., Houndmills, Basingstoke, Hampshire, U.K., and New York, N.Y.: Palgrave Macmillan, 2006.

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