The Levy Economics Institute of Bard College

Summary

Fall 2007 Vol. 16, No. 3

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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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LETTER FROM THE PRESIDENT

To our readers:

This issue begins with the 16th Annual Hyman P. Minsky Conference, held in April as part of the State of the U.S. and World Economies program. Top policymakers, economists, and analysts explored the impact of global imbalances and whether or not the United States economy was headed for a hard or a soft landing. They noted that international finance now dominates trade, that emerging countries and world output represent a radical transformation from past economic cycles, that increasing fragility within the current business cycle resembles a Minsky (Ponzi) finance event, and that current imbalances largely represent policy decisions in Asia. The question is, how will macroeconomic rebalancing of the world economy play out in the long run in terms of inflation expectations, currency valuations, housing, the U.S. household financial balance, employment, business investment, monetary policy, liquidity, real consumption spending, financial liberalization, and a slowing U.S. economy?

In a new working paper, Distinguished Scholar Wynne Godley and Marc Lavoie use a simple stock-flow consistent model to show that, in theory, fiscal policy can achieve stable growth and is relevant within the framework of mainstream economics. In another working paper, I and Research Scholars Greg Hannsgen and Gennaro Zezza foresee the likelihood of a U.S. growth recession and more than one million foreclosures on recent first mortgages. We suggest that the Fed should be ready to step in as a lender of last resort.

In a strategic analysis, Godley, Zezza, and I refute Congressional Budget Office projections for the U.S. budget deficit. Simulations of the Levy Institute macroeconomic model suggest that government policy favoring a significant rise in the public sector deficit will allow the current account deficit to reexpand, indefinitely postponing a rebalancing of the world economy.

Under the Distribution of Income and Wealth program, my working paper about the aging U.S. population calls for immediate action to deal with fiscal pressures on the federal budget and economic growth in order to forestall more difficult choices later on. I also summarize my edited volume of essays identifying key issues profoundly affecting the aging population (*Government Spending on the Elderly*, 2007). In another working paper, Senior Scholar Edward N. Wolff finds evidence of the U.S. middle-class "squeeze" in the explosion of household debt and unprecedented decline in median wealth, despite economic expansion.

A LIMEW report by Wolff, Senior Scholar Ajit Zacharias, and Hyunsub Kum analyzes the economic welfare of the elderly and shows that the official measures drastically understate their level of economic well-being. Government policies and programs that favor the elderly are misdirected, the authors say, and universal health care and social welfare programs should be extended to the nonelderly.

The Gender Equality and the Economy program begins with an April workshop organized with the support of the United Nations Development Programme. The workshop proposed a gendered social accounting matrix in response to issues relating to the research project "Impact of Employment Guarantee Programs on Gender Equality and Pro-Poor Economic Development."

Four working papers in this program area are reviewed. Research Scholar Rania Antonopoulos and Francisco Cos-Montiel examine the role of the state in promoting policies of equality and recommend not only infrastructure investment that alleviates time burdens for women but also permanent public employment guarantee programs. Marcelo Medeiros, Rafael Guerreiro Osório, and Joana Costa study work shifts in Bolivia and find that women work more than men and incur "time deprivation." Research Assistant Melissa Mahoney and Zacharias investigate gender disparities in pay and the feminization of employment on aggregate profitability in the United States. Research Scholar Thomas Masterson studies women's land rights in Paraguay and finds further evidence that women are disadvantaged in terms of agricultural income. The explanations for this, however, remain elusive.

Under the Employment Policy and Labor Markets program, two working papers by Fadhel Kaboub find that the benefits of employer-of-last-resort schemes far outweigh their costs. A working paper by Research Associate Pinaki Chakraborty surveys the formidable challenges in the implementation of the National Rural Employment Guarantee Act in India.

The Immigration, Ethnicity, and Social Structure program includes two working papers by Senior Scholar Joel Perlmann that suggest modifications to address issues related to American Jewish opinion surveys.

Under the Economic Policy for the 21st Century program, Hannsgen examines the validity of using a consumer utility function to make inferences about the appropriate priorities of public officials. Research Scholar Claudio H. Dos Santos and Zezza show that a simplified Post-Keynesian stock-flow consistent growth model allows for a natural integration of short and long periods, if one correctly understands the dynamics of short-term balance sheets.

As always, I welcome your comments and suggestions.

Dimitri B. Papadimitriou, *President*

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

The 16th Annual Hyman P. Minsky Conference
Global Imbalances: Prospects for the U.S. and World Economies

The Levy Institute organized a conference, held April 19–20, 2007, at Blithewood on the campus of Bard College in Annandale-on-Hudson, New York, to explore the impact of global financial imbalances. Last year, the U.S. trade deficit climbed to a record $763.6 billion. The U.S. housing market has continued to fall, triggering a financial crisis in the subprime mortgage sector and threatening to undermine consumption by heavily indebted American households. Meanwhile, Federal Reserve Chairman Ben Bernanke has repeatedly warned Congress to address unsustainable federal budget deficits. Amid this news, major financial markets are becoming more turbulent this year.

Presenters at the conference were top policymakers, economists, and analysts who are uniquely qualified to offer their insights and policy guidelines on these issues. Summaries of the speakers' remarks are given here.

Welcome and Introduction. Global Imbalances: The United States and the Rest of the World

President DIMITRI B. PAPADIMITRIOU noted that Hyman P. Minsky was a distinguished scholar at the Levy Institute from 1990 to 1996 and that Minsky's economic theories have become more relevant every year.

Papadimitriou presented figures showing the monthly U.S. trade deficit in goods since 1990. The deepest troughs were $71.4 billion in August 2006 and 6.6 percent of GDP in November 2005. The effect of petroleum goods has significantly contributed to the growing trade deficit over the past few years, but the deficit began to narrow in 2006. Between 2005 and 2006, the trade deficit increased with countries such as China (15 percent), OPEC (13 percent), Mexico (29 percent), and Japan (7 percent), and decreased with countries such as Canada (7 percent), South Korea (16 percent), and Great Britain (35 percent). Trade with the Eurozone remained unchanged despite the decline of the dollar relative to the euro.

The U.S. residential real estate market with its explosive growth in the subprime mortgage market represents contemporary evidence that fits Minsky's financial instability hypothesis: stability is destabilizing. Risk reduction creates its own risk, as people feel euphoric and are encouraged to assume more debt.

Papadimitriou observed that any improvement in the current account balance linked to a cut in the government budget would only come about if the fiscal restriction caused a recession. The balance between saving and investment in the economy as a whole is not a satisfactory concept because it lumps the government and private sectors together even though these two sectors are driven by different incentives.

The accounting identity within the Institute's macro model divides the U.S. economy into three sectors: the current account balance (external financial balance) is equal to the government balance plus the private sector balance (net saving). In 2006, the private sector balance was minus 3 percent of GDP and the government balance was minus 2.4 percent of GDP, so the current account balance was minus 5.4 percent of GDP.

Papadimitriou presented the Levy Institute's latest Strategic Analysis report, titled *The U.S. Economy: What's Next?* (April 2007), a summary of which appears on pp. 23–24.

He noted that the long-term fix that permits full employment without massive imbalances in trade is unlikely to happen without international cooperation and major structural changes in China and Japan that allow them to sustain high employment without running monstrous trade surpluses. He also stated that he does not foresee a decoupling of the U.S. economy from the rest of the world. A decrease in the U.S. current account deficit must be matched by reductions in current account surpluses or increases in deficits elsewhere. It is therefore necessary to formulate a global strategy for managing global imbalances that can perhaps be achieved with discussions on a multilateral basis.

Session 1. The State of the U.S. and World Economies

Moderator: President DIMITRI B. PAPADIMITRIOU.

Speakers: LAKSHMAN ACHUTHAN, Economic Cycle Research Institute; and Research Associate ROBERT W. PARENTEAU, RCM.

Although there is sustained global expansion and the world's major economies are growing in a synchronous fashion, ACHUTHAN also recognized the presence of global imbalances. He stated that we are in the middle of a very big shift in economic history: the entry of India, China, and the former Soviet bloc into the global market economy. While some new entrants to the global capitalist system are prospering, the losers seem to be the vast middle classes in America and Europe, where job security is a real issue. In Achuthan's view, we have returned to the unemployment situation observed by Jerome Levy a century ago, and we still have not figured out how to maintain full employment and a favorable balance of trade.

Achuthan noted that the late Senator Patrick Moynihan stated that our greatest accomplishment in the 20th century was taming the business cycle (declining cyclical volatility). Problems persist, however, such as an inability to predict recessions so that policymakers can take preemptive action. He also noted that forecasters systematically make large errors relating to economic cycle turning points even though the leading indicator data relating to turning points is known. Typical leading index approaches fail because they are oriented toward the past, with underlying assumptions that cyclical leading indicators vary by country and time period. However, there is a viable alternative to data fitting that succeeds at predicting recessions in real time.

The first cyclical leading indicator data in the United States was collected about 1938 at the request of the Secretary of the Treasury. In 1950, Jeffrey Moore constructed the first list of leading indicators (i.e., sensitive commodity prices, average manufacturing workweek, commercial and industrial building contracts, new incorporations and orders, housing starts, stock prices, and business failure liabilities) in an attempt to understand the basic drivers of the business cycle. Using data before 1938, Moore found that the average lead before a peak or trough was four months. Achuthan subsequently found that the same leading indicators that correctly predicted the turning points in the post–Civil War period also predicted the turning points in the second half of the 20th century in spite of structural changes. Moreover, his model held for 10 major economies abroad, including the G7 countries and structurally diverse economies such as Germany, South Korea, New Zealand, India, and China.

Achuthan's long leading and coincident indices for the United States from1919 to the present showed that a recession is triggered when weaknesses in the endogenous drivers of the business cycle combine with an endogenous shock to the economy. For example, the market crash in 1987 was not coincident with collapsing indices, as the cyclical vulnerability was not present to knock the economy into recession. In 1990, however, the indices turned down and were followed by a shock—Iraq's invasion of Kuwait—that triggered a recession. Since the leading indices are not turning down in 2007, a recession or hard landing forecast right now would be crying wolf. The way to stop crying wolf is to resist the temptation to forecast by analogy (i.e., the present resembles earlier periods) or to proclaim a new paradigm or parameter drift.

Using growth rates to highlight economic slowdowns rather than recessions, Achuthan showed that the long leading index leads the weekly leading index by about one quarter on average, and that the weekly leading index leads the coincident index by a couple of quarters. There is a sequential relationship in the economic cycle when there is a pronounced, pervasive, and persistent decline or upturn in the long leading index. Presently, the coincident index appears to have bottomed out, while the leading indices have turned upward. Achuthan hoped that his work would help policymakers to smooth out the business cycle.

PARENTEAU observed that Minsky and John Maynard Keynes are largely ignored by the economic mainstream, yet they diagnosed systemic vulnerabilities both theoretically and in real time, and designed institutions and proactive policy responses that would improve the economic system. According to Minsky, there is an endogenous dynamic that transforms an economic system from a robust financial structure into a fragile one. Parenteau cautioned not only against crying wolf but also against dealing with fairy tales (the Goldilocks economy) and "investment porn" (passive institutional investments in indexes rather than companies).

Four key macrofinancial questions were posed to determine if we are approaching a "Minsky moment" (an episode of financial instability and recession): (1) Is U.S. household deficit spending on a sustainable trajectory? (2) Is the U.S. economy headed for a soft or hard landing? (3) Is the new financial architecture an efficient risk distributor or an incentive distorter? and (4) Are intelligent responses based on coherent or incomplete macro and policy frameworks? The first question is answered by focusing on household financial imbalances in terms of conventional debt trap equations. The second involves an examination of six decoupling arguments that supports the soft-landing camp. In terms of the third and fourth questions, Parenteau noted that we have replaced a bank-centered financial system with an institutional investor–oriented system, and that the Levy Institute is one of few places where there is a coherent policy framework concerning the macro issues.

U.S. household sector expenditures are at a secular 50-year high despite the decay in the household income share of nominal GDP. The household sector was a net saving sector historically but is now a deficit spending sector, in spite of the bursting of the New Economy bubble. Parenteau reviewed the probability of perpetuating deficit spending (e.g., selling existing assets or issuing new liabilities) to determine whether this pattern was sustainable. According to Evsey Domar's debt-trap equation, there is a condition to support an explosive rise in the household debt-to-income ratio (e.g., strong appreciation of assets and the replacement of one asset bubble with another), but since the housing boom has gone bust, the household deficit spending trajectory is unsustainable. The real rate of home price appreciation seems to have mattered a lot to the household financial balance, and we are facing a dramatic reversal of this balance.

Parenteau outlined and debunked six decoupling arguments by the consensus that support the view that the U.S. economy is headed for a soft landing: the decoupling of (1) housing construction from home prices, (2) the housing market from housing-related finance, (3) consumer spending from housing, (4) capital spending from the consumer, (5) corporate profits from expenditure growth, and (6) the global economy from U.S. economic momentum. He noted that home price appreciation and housing starts have already peaked, and only one-third of the normal correction related to the housing share of the economy has taken place. Therefore, it is premature to expect that housing will not be a drag on the U.S. economy in the second half of 2007. Moreover, loan delinquency rates have risen for both subprime and prime adjustable rate mortgages. Furthermore, the housing slowdown has discouraged homeowners from using their homes as ATM machines.

Parenteau also noted that there has been a deceleration of the nominal retail sales growth rate (from almost 8 percent to 2.5 percent) and a decline in sales tax receipts, and the retail sector is already shedding employees. These profiles are remarkably similar to those prior to the last recession, and it is undeniable that the consumer is pulling back. There is no delinkage between consumer expenditures and housing construction, and the household financial balance bears a unique resemblance to mortgage equity withdrawals. In addition, CEO confidence indicators are declining; companies are shrinking their share base (and raising their own share prices), and are unwilling to engage in capital spending. We are on the verge of negative year-over-year retail sales and industrial production, which is consistent with the profile of the last recession. With both capital and consumer spending decelerating, it will be hard to avoid a hard landing.

Although profit margins are near all-time highs, Parenteau pointed out that they tend to increase when the personal saving rate out of wages falls, so profit margins are tied to household deficit spending. He also pointed out that there is a mistaken correlation between the fiscal and trade balances. The real twin of the trade balance is the household financial balance (i.e., household purchases of goods from abroad).

Parenteau noted both the qualitative change in the financial structure (the new financial architecture) and the corruption of the private credit allocation mechanism. There has been a redistribution and repackaging of risk, and a reduction of incentives for credit analysis. Although there is a very efficient risk-distribution system, there is a very inefficient risk-estimating system. For example, the securitization of mortgage loans by banks reduces their incentive to be gatekeepers with respect to credit (i.e., "Not on my balance sheet") and increases their interest in volume and fees. Moreover, the diversified nature of securitized debt packages reduces the incentive of institutional investors to analyze the creditworthiness of individual loans. Furthermore, the proliferation of credit default swaps allows further distribution of default risk away from the credit originators. In this world, no down payment, low documentation, and option adjustable rate mortgages can proliferate.

Parenteau observed that financiers are overreliant on quantitative methods and suggested that seemingly hedged positions are really unhedged, and that there has been an increase in the overall incentive to take on risk. He concluded that the changing asset class correlation structure appears ripe for financial instability. Too much capital is chasing too few deals. An excess of liquidity stems from the broker-dealers and the investment banks through leveraged instruments, not from the Federal Reserve. The Fed, however, introduces an element of moral hazard when it pursues asymmetric policies toward asset bubbles and does not help to contain the risk of the new financial architecture. In Parenteau's view, we are in fact entering a Minsky moment, and if a recession unfolds, the easing of interest rates by the Fed will be less effective this time around. We will have to rely on a fiscal solution and encourage domestic demand–linked growth in the rest of the world, but this kind of growth is not on the agenda. The Levy Institute macro-model framework is one of the few coherent ways that is available to consider what policy directions are needed to contain the damage.

Speaker: WOLFGANG MÜNCHAU

Münchau, *Financial Times*, addressed the question of whether or not the European economy could decouple from the United States. He noted some confusion about the meaning of decoupling, and based his approach on the Levy Institute scenario of a fall in U.S. economic growth (a hard landing) along with a rebalancing of the U.S. current account deficit.

Those who argue in favor of decoupling use a trade argument (the Eurozone as a whole is trading less with the United States), the regime shift in the Eurozone (to a large monetary union), the robust performance of the Eurozone (and more optimistic expectations of economic growth), and economic reforms (e.g., welfare reform in Germany, where labor market rules were tightened). According to Münchau, trade is not the issue, because the main transition channel to Europe is the financial sector. The United States has a very strong impact on stock price movements in Europe, so any equity or credit market downturn in the United States would be felt in Europe.

Although there is no causal link in the property markets, property prices are correlated because of common shocks to the two economic systems and the movement in interest rates. Geography is also similar in terms of housing. The western (coastal) and eastern European markets have had extreme housing price inflation, while prices in mid-Europe have been flat. Mortgages in Hungary, for example, are denominated in foreign currencies, such as the Swiss franc, or they are secured through Austrian banks. There are also regional property market bubbles (e.g., Spain) and lending practices that mirror the subprime mortgage situation in the United States (e.g., Spain, Ireland, and the U.K.). An increase in credit spreads or contagion in the credit markets means that there is absolutely no chance of decoupling Europe from the United States.

Münchau expressed surprise that recent optimistic economic assessments in Europe have not mentioned exchange rates, because increases in the euro against the dollar means that there will likely be falling European exports later this year. Currently, there is European complacency because politicians take the view that the economy is doing well. He noted that it would be difficult to make the rest of the world consume more in order to mitigate the impact of an adjustment in the U.S. current account balance. The German economic boom was based on cost cutting, whereby nominal wages fell (a rare economic event), and there was no deregulation of the services sector. Therefore, the only thing to sustain the German and Eurozone economies is the export sector, which would be difficult if the U.S. current account were rebalanced with a depreciation of the dollar.

Although policy could be used to mitigate interest rates and increase government deficits, the response of the European Central Bank is slow, and fiscal policy is very lethargic in the way it responds to events. All of these factors—the spillover of stock markets, the credit markets, property, the exchange rate, the inability to shift from an export-led to a consumption-based growth model, and policy responses—led Münchau to conclude that a hard landing in the U.S. economy would lead to a similarly difficult period in the Eurozone.

Session 2. Monetary Policy in the U.S. Economy

Moderator: Research Scholar GREG HANNSGEN.
Speakers: TORSTEN SLOK, Deutsche Bank Securities, Inc.;
and ROBERT Z. ALIBER, University of Chicago.

Drawing on a project with colleague Peter Hooper, SLOK presented an analysis of inflation in terms of trends and volatility, the implications of inflation stabilization, and the causes of the great inflation and disinflation eras. He noted that the Phillips curve has broken down and that the output gap has become less important. He also noted that the world is in a low inflation environment, which is creating surprise bubbles that require a state reaction. The question is whether the low inflation environment is permanent, or could the great inflation era arise again?

Slok reviewed the history of inflation and observed that it has been outside the Fed's comfort zone (between 1 and 2 percent year-over-year) since 2004. He also observed that U.S. inflation has been much higher in the past, and that global inflation trends and volatilities have fallen dramatically since the 1980s. Low inflation and volatility matter in terms of the anchoring of expectations, the inflation risk premium, and real interest rates. Inflation expectations have been anchored at a low level for the past decade. Real interest rates have also trended lower since the 1980s. However, the economic growth picture suggests that interest rates should go down, but the inflation picture suggests that interest rates should go up.

The U.S. consumer has been very resilient. The personal saving rate continued downward in spite of a recession and in response to an increase in the household wealth-to-income ratio. However, what would happen if the saving rate returned to historical levels? Slok expected that the wealth effect would not be as severe as the turnaround in 2000, so he was not worried about the well-being of the U.S. consumer.

The causes of the great inflation and disinflation eras were accommodative monetary policy in the face of inflationary demand and supply shocks, combined with monetary tightening and behavior consistent with rules-based policy. Slok noted that deviations from the standard Taylor rule over time indicated major policy mistakes in the 1970s, but that monetary policy has become better at understanding the economy, particularly over the last 10 years. A review of the trend core PCE inflation and policy rate deviations from the Taylor rule suggests that these deviations (and policy mistakes) were related to the trend in inflation.

Rising inflation and volatility could come from political, demographic, and global factors. Barney Frank, an opponent of inflation targeting, believes that the Fed should hold interest rates down to allow wages to rise. This position is an echo of the Wright Patman era (1964–75) when interest rates were held at a low level and employment increased, but inflation went up. However, Federal Reserve Chairman Ben Bernanke has gotten Frank to acknowledge that real rather than nominal wages matter. It was Slok's opinion that Bernanke might settle for something less than a formal inflation target.

Slok outlined the implications of the aging baby boomers that could unanchor inflation: slower growth of the labor force and potential output, a massive increase in Social Security and health care costs, and higher interest rates. There will be huge fiscal implications, such as rising medical costs, that will weigh on the budget and eventually affect inflation. In addition, global factors could cause the inflation trend and volatility to increase. These factors include the growing trade imbalances between the United States and other countries, the rapidly growing U.S. net external debt, China's soaring foreign exchange reserves, and higher inflation and bubble (asset and stock) markets in China. A reversal of the globalization trend would generate even higher inflation in the United States through import prices. Although U.S. import prices from Asia have restrained inflation, the effect is small and diminishing.

In Slok's view, the globalization era that provided inexpensive products from Asia and had huge benefits for U.S. inflation is probably over. He concluded that inflation and disinflation are monetary phenomena, that the current inflation trend and volatility are near a low point, that the longer-term risk for inflation and interest rates is largely to the upside, and that the current low and stable inflation expectations do not afford complacency at the Fed.

ALIBER noted that the last 35 years have been the most tumultuous in monetary history. He proceeded to review the sequence of asset price bubbles and financial collapses from the point of view of Minsky. The period included the collapse of many national banking systems, the widest swings in exchange rates, the greatest increases in price levels, and much larger deviations from purchasing power parity under floating as compared to pegged currencies.

Aliber outlined four asset price bubbles: Japan, as well as three Scandinavian countries, in the 1980s; Thailand and associated countries in the mid-1990s; U.S. and other global stocks in the latter half of the 1990s; and residential real estate in most Anglo-Saxon countries, plus Ireland and Spain, today. The Japan bubble affected Hawaii, Korea, and Taiwan through the income transmission mechanisms, and Japanese banks set up branches and subsidiaries in the United States and Europe in order to buy loans and avoid pressures toward appreciation of the yen. The Thailand bubble ended with the Asian financial crisis in 1997 that was the flip side to the Asian financial bubble. The U.S. bubble pulled up stocks in most of the OECD countries, but the timing and magnitude of the residential real estate bubble has not been led by the United States.

Japan imploded at the same time as the consolidation of Brady bond bank loans to developing countries, so the traditional recession there did not result in depreciation of the yen. Rather, the buildup of industrial capacity in Japan during the bubble period resulted in a shift to the right of the export supply function, an appreciation of the yen, and a hollowing out of the Japanese economy when Japanese firms began to source in South Asia. The implosion of the Asian bubble and the depreciation of Asian currencies diverted funds into the United States from abroad. According to the accounting identity, the adjustment was in terms of consumption spending (the invisible hand) that led to an increase in U.S. asset prices and a reduction in the U.S. saving rate. Thus, the future adjustment process that will occur when the U.S. economy slows is a frightening one, Aliber said.

Three things operating in the U.S. residential real estate bubble included the change in Fed policy (negative real interest rates), innovation in the mortgage market, and speculative purchases. In terms of the global phenomenon in residential real estate, the generic features include a high rate of economic growth and a current account deficit (except Japan). Countries with an asset price bubble have been importers of foreign funds, which increase asset prices and decrease the current account balance. The output effects of the asset price bubble in British housing are actually felt in Spain, said Aliber.

Until recently, the uniqueness of the last 35 years includes declining real interest rates, much longer economic expansions, and less frequent recessions. One explanation for longer expansions is that all countries with increasing current account deficits had appreciating currencies, which increase the supply of goods and put downward pressure on domestic prices. Another explanation is that lower inflation in a period of floating exchange rates allowed central banks to be more relaxed in their efforts to maintain a very low price level than in a period of pegged exchange rates. Aliber observed that almost all bubble episodes, including the developing-country debt crisis in the 1970s, involved Ponzi finance. He therefore questioned why current lenders have failed to think about the adjustment process, since most endgames result in a hard rather than a soft landing.

Session 3. Financial Instability in a Global Economy

Moderator: Resident Research Associate W. RAY TOWLE.

Speakers: Research Associate KORKUT A. ERTÜRK; Senior Scholar JAN A. KREGEL, University of Missouri–Kansas City; and Senior Scholar L. RANDALL WRAY, University of Missouri–Kansas City.

ERTÜRK noted a systemic relationship between the economies of the United States and Asia. He also noted that it was difficult to determine causation related to the accounting identities. From the point of view of the surplus side of sector-balance equations, the collapse of investment during the Asian crisis was caused by the private savings glut, and the trade surpluses reflected the private sector surpluses. The Asian countries ran trade surpluses as the ultimate protection against the threat of another currency crisis, and these surpluses were the source of the funds directed toward the United States. These imbalances created an endogenous system of liquidity and reduced the fear of a currency attack, which was an important constraint on a rise in domestic spending.

A rise in domestic spending in Asian countries can take the form of more private investment, an increase in consumption, or a wave of investment and infrastructure expansion. Ertürk hypothesized that the glut of savings would turn into a glut of dollars as the trade surpluses disappeared. Using Kaldor's two-sector construct of a world economy (a balance between manufacturing goods and raw materials) along with liberalized capital flows, he expected an unsustainable situation and instability because of imbalances in capital flows, currency valuations, and growth rates. A stable adjustment is questionable because monetary policy and banks in the United States are becoming irrelevant in terms of the credit creation mechanism. The new liberal regime was kept intact because of its deflationary bias with respect to developing countries and the fear of a currency crisis. However, excess liquidity has reduced the possibility of a currency crisis, so the buildup of reserves in Asian countries has outrun its usefulness. Therefore, an important constraint against a domestic spending increase in Asia is becoming less of an issue. The question is, which component of domestic spending will increase?

If trade surpluses disappear, then the financial climate in the United States will worsen because of inflationary pressures resulting from a depreciating dollar, the difficulty in financing the current account deficit, and the higher interest rates necessary to counter the inflationary pressures and attract foreign savings. This is not a winning scenario, said Ertürk. He recommended something in the form of special drawing rights or a new basket of currencies as the reserve currency to replace the dollar. This approach, if taken now rather than when things begin to unravel, would be in the best interests of the United States because it would give this country more power and input in terms of the details of the arrangement.

KREGEL used Minsky's framework to analyze current global imbalances and to determine the probability that the imbalances would be corrected in the medium term. He noted that the stability of the financial structure derives from the balance sheets of firms, banks, households, and the rest of the world, and that imbalances pertain to how the rest of the world interacts with the United States. The policy actors in the system are the balance sheets of central banks and governments. Kregel also noted that different balance sheets have dominated the international system since the time of Minsky. Households and the rest of the world have become more important, and there has been a marked difference between assets and liabilities. He further noted that Minsky's financial profiles are really profiles of the expectations of bankers, investors, and households about incomes and liabilities, and that there has been a shift toward a speculative Ponzi accounting system.

Kregel reviewed the statistical accuracy of balance sheets and the new financial architecture, and observed an uncertainty about the financial structure or exposure of firms. Moreover, banks no longer have assets, and there are no measures that accurately account for leverage and exposure. The Fed has virtually no way of influencing the banks and the amount of credit generated in the system, except by influencing the expectations of private capital markets. In addition, balance sheets can change radically as a result of exchange rate fluctuations, and there is uncertainty about the accuracy of government agencies accounting for the effects of transnational corporation subsidiaries. Furthermore, a large proportion of knowledge-based goods (a major U.S. export) never gets recorded in the balance of payment statistics (e.g., chip-producer designs transferred over the Internet). In sum, we really do not have a clue what our position is in terms of international imbalances, said Kregel.

Currently, balance sheets tell us that finance dominates domestic production. However, it is obvious that U.S. corporations are investing outside the United States and that international finance dominates trade today. Chinese households are engaged in excess saving, while U.S. households are engaged in excess consumption. After the Asian crisis (1996–97), there was a very strong expansion in net capital flows into the United States in the form of foreign direct investment (FDI) and purchases of government securities from Asia and Latin America. After dollar devaluation against the euro, the Europeans returned and bought U.S. corporations (a factor that stabilizes the exchange rate).

In terms of medium-term stability, Kregel made three basic points: (1) imbalances are normal; (2) they are part of the development process; and (3) they are almost always between countries at different levels of development. Current imbalances, however, are different in terms of their much larger size (due to capital account liberalization) and in terms of their geographical or horizontal distribution of production. They are also different because of various development policy decisions or preferences between countries, so it is unlikely that market mechanisms or exchange rate adjustments would eliminate imbalances. Rather than financing development in terms of positive net resource flows (from developed to developing countries), negative net resource flows have been the dominant pattern throughout the postwar period.

Net negative resource flows (trade surpluses) can be generated by positive rates of expansion or debt deflation. The developing countries in Asia and Latin America, as well as Europe, have moved toward negative net resource flow policies in order to support domestic employment. Stability in China depends on extremely rapid employment growth, while Europe has chosen price stability in the form of export-led growth by compressing domestic demand and wages. There is mutual interest in Europe, Asia, and the OPEC countries to continue export-led policies (and excess savings) and, in essence, to vendor-finance their own exports (i.e., lending abroad in order to maintain their export surpluses). Otherwise, China loses political control, Europe stops growing, and the United States falls into recession.

A review of the so-called bilateral balance between China and the United States distorts the problem. Since China has an increasing deficit with the rest of Asia, eliminating the U.S. deficit with China would directly impact China's ability to import from the rest of Asia. Moreover, the United States has a deficit with Europe comparable to that with China, and it has imbalances with virtually every region. Since trade flows are determined by financial flows, any adjustment has to come from finance. And since most exchange rates are fixed (with the exception of Japan, Europe, and the United States), an exchange rate adjustment will have to occur between the U.S. dollar and the euro. The potentially negative impact of euro appreciation on the foreign production earnings of European companies means that they, along with Asia and Japan, will have to vendor finance and that their current accounts will become dominated by debt service repayments.

According to the tenet of Evsey Domar, all negative net resource flow policies are Ponzi financing schemes. Since all regions continue to support the U.S. trade imbalances, fragility increases as the rate of increase of financial outflows falls below interest rates. Eventually, the system shifts from fragility to instability and the risk increases that any small change will collapse the system. Although the United States will always be able to meet its external claims (because U.S. capital flows are denominated in U.S. dollars), it may not be able to do so at a stable exchange rate. The interesting thing about a depreciation of the U.S. dollar is that it improves the U.S. balance of payments and encourages more FDI flows. Rather than a sharp collapse in the dollar, there may be a sharp disruption in the balance sheets of both households and financial institutions operating in the global market.

WRAY summarized one of Minsky's main themes: innovation is endogenous; it responds to profit opportunities and stretches liquidity, which increases fragility. This process leads to intervention by institutions that constrain endogenous instability by acting as ceilings and floors. In the 1960s and 1970s, Minsky added three important concepts to his work: (1) the financial theory of investment and the Keynesian investment theory of the cycle; (2) the Kalecki view of profits (investment creates profits); and (3) the financial instability hypothesis (apparent stability changes expectations and behavior in a way that generates fragility). The policy problem is to devise institutional structures and measures that attenuate the thrust to higher inflation, more unemployment, and slower improvements in the standard of living, without increasing the likelihood of a deep depression. The 1975 and 1982 recessions did not become depressions because of the role of big government and the Treasury (i.e., the budget deficit helped to maintain income and profits).

Wray extended Minsky's approach to more recent examples where the growth of government drove profits and expansions without investment (the budget surplus of the Clinton years was an anomaly and driven by private sector deficits). His current work focuses on money-manager capitalism and the real estate bubble, which resembles a Minsky and Ponzi finance event. Having learned from the savings and loan fiasco, banks and mortgage lenders sell securitized mortgages in order to earn the fee income and avoid having mortgages on their books. Some of the financial innovations and new frontiers in lending include subprime, interest-only, and home equity loans. The result is that the mortgage security market ($6.5 trillion) is larger than the Treasury market. Debt is growing many times faster than income, and, despite historically low interest rates, the financial obligations ratio will climb rapidly as mortgages are reset. The explosion of debt arises as innovations increase the availability of credit (which increases asset prices) and "good" managers take on more debt. The Clinton boom and the shallow Bush recession led to a revised view of economic growth, from stability to a virtuous cycle of innovation plus competition, leading to rising leverage ratios and increasing credit availability and asset prices, which fuel more innovation.

Bernanke implies that the world is more stable due to better monetary management, globalization, information technology, rising profits, and declining corporate leverage, as well as securitization and derivatives that ensure against risk. According to Wray, this view is a radical suspension of disbelief that "it" (the Great Depression) can happen again and that increased leverage ratios are not risky. This view is based on low volatility, narrow corporate bond spreads, declining business failures, underpriced stocks, the resurrection of Irving Fisher's tenets that asset prices can only go up, and the campaign to increase competitiveness and efficiency by reducing regulation at the peak of Ponzi financing.

A few cracks are beginning to appear in the system: tightening credit for mortgages, rising mortgage delinquencies, and falling house prices. Although things are different today, Minsky's agenda for reform is still worth considering, said Wray. The solution is not free market ideology, more competition, and less regulation. The current macro challenges are a very large trade deficit that has to be matched by budget deficit injections, growing inequality, a continuing budget shift toward transfers (e.g., Social Security), and barriers to work. There is a fiscal squeeze because the growth of tax revenue is climbing at a rate that is three times faster than income, and this channel is draining more income out of the already burdened household sector.

Minsky argued for a high wage and consumption economy, but we are moving in the opposite direction, observed Wray. An aging society, rising defense spending, consumption financed by debt, and high investment increase markup and inflation. That is why Minsky wanted to shift income to wages and promote high consumption, because these things are not inflationary. For example, eliminating the payroll tax and taxes on seniors who want to work would be deflationary. Moreover, the government, as the employer of last resort, would offer a perfectly elastic demand for labor at a minimum wage by hiring everyone who could not get a job in the private sector.

Wray concluded that the U.S. private sector is fragile and Ponzi, and he noted that it does not matter who owns the debt (domestic or foreign creditors). The U.S. government cannot be Ponzi because its debt is in floating dollars and can always be serviced. There is a need to allow retrenchment of the private sector toward a balanced budget and perhaps toward net positive savings—that is, changing the stance of fiscal policy to allow for a more relaxed budget deficit. Since the United States continues to run a significant current account deficit, it needs a budget deficit that offsets the deficit in the current account and allows the private sector to balance its account or run a surplus in order to restore positive net financial wealth.

Speaker: Senior Scholar JAMES K. GALBRAITH

Galbraith, University of Texas at Austin and director of the University of Texas Inequality Project, outlined a quartet of economic policy doctrines stemming from Reaganomics and repackaged as the "Washington Consensus" that have enduring appeal despite having not worked out very well: monetarism, supply-side economics, deregulation, and balanced budgets. The experience of countries that never played by the Washington Consensus—such as Malaysia, South Korea, Russia, Argentina, and China—leaves no doubt that successful economic policy in a postcrisis environment is a pastiche of broken rules; that is, the right rules are not as well defined or understood as the given rules.

Galbraith noted that the theory behind these doctrines is in tatters, the empirical record is very disappointing, and there is absolutely no coherent foundation to support them. He surmised that the reason for their enduring power lies in the cult of the number zero (a great Mayan mystical invention): zero deficits in the public accounts, zero intervention in the free market, zero taxation on savings and investments, and (nearly) zero excess growth of the money supply. However, a zero budget deficit and a balanced current account do not necessarily represent a desirable or sustainable position. For example, an equilibrium current account might be zero under a gold standard with no discovery, but it is not zero in a credit economy where one country supplies the reserve asset. The equilibrium in the latter case is simply whatever the creditor community wants to hold in terms of a given configuration of interest rates and alternative assets.

Galbraith proceeded to dispose of zero taxation on savings and zero intervention in the free market. In terms of zero inflation, or price stability, he observed that monetarism lasted approximately two years before initiating the debt crisis and a number of other consequences that we are still grappling with today (e.g., the strong dollar, the revival of the dollar reserve system, and the chronic U.S. trade deficit). The two-year period was pivotal in changing the structure of the economic system: it engendered the permanent demise of inflation, despite highly variable monetary policy. There is no systematic record of inflation targeting by the Fed, said Galbraith. If the Fed targets expected rather than actual inflation, as recently hinted by Chairman Bernanke, then inflation would drop out of the Taylor equation, and for all practical purposes the Fed would be left with a single mandate—to target unemployment.

Budget deficits tend to disappear at full employment, but the current account deficit does not, leaving two issues of sustainability, that of private household debt (and asset bubbles in the lower tranches of the housing market) and the foreign acquisition of U.S. bonds (and the U.S. dollar). In terms of the latter issue, Galbraith observed that the global financial system (and its anchor, the U.S. dollar) had much more inertia than current thinking about the "animal spirits" of foreign-exchange speculators normally takes into account. The issue of international unsustainability does not turn on numerical questions because a historically unprecedented number does not mean that it cannot remain unchanged for quite a while. The issue is whether or not the system serves the purposes of the participants.

China holds over a trillion dollars of U.S. securities as reserves, a situation that is incidental to a larger set of purposes. The major policy challenge facing China today is not in the international arena but rather its internal transformation from a rural peasant population to an urban, substantially middle-class population. This process entails a vast internal migration combined with enormous construction that can only be accomplished over a very long period of time and in a climate of comparative isolation from the financial instabilities of the global marketplace. The Chinese are largely funding construction out of their own internal savings, while their former system of central planning has led to an emphasis on the development of export industries. The world market provides standards of quality and sources of technology that cannot be provided by the domestic market.

China has a tremendous amount of excess production partly because firms do not go bankrupt and the banking system, courtesy of state ownership and the previous system of capital controls, is insulated from external pressures. The quality of the system is improving and real wages are rising as the prices of wage goods decline. Moreover, public entities do a great deal of public investment and housing construction, financed by their access to state credit. Thus, the current system serves Chinese interests, so long as they are able to maintain social stability in a dynamic environment and reduce the urban bias of previous policies. The Chinese face the problem of exchange rate management and the management of inflow of foreign capital (e.g., a rise in reserves serves to sterilize the inflow of foreign capital and expand textile exports).

A possible disturbance to the Chinese equilibrium is the ongoing process of financial liberalization. Twelve years ago, Galbraith and Bob Eisner talked the Chinese out of liberalizing their capital account, which protected them from the Asian crisis in 1997, and growth continued for a significant period of time. Galbraith wondered if growth would continue as a result of Chinese commitments under the World Trade Organization. The United States is strongly implicated if there is a serious risk of disruption to the dynamic stability of the Chinese system because it involves the accumulation of U.S. assets and the sustainability of the U.S. current account position. Another concern is the possibility of a political upheaval that would disrupt the symbiotic relationship between China and the United States (e.g., an attack on Iran that disrupts China's access to external energy supplies, or a war over the Taiwan Strait). China does not entirely control these political eventualities, but we know who does, said Galbraith. In the immortal words of Pogo: "We have met the enemy and he is us."

Session 4. The Macroeconomic Prospects for the U.S. Economy

Moderator: Senior Scholar AJIT ZACHARIAS.

Speakers: JAMES W. PAULSEN, Wells Capital Management; ROBERT J. BARBERA, ITG; and JAMES E. GLASSMAN, JPMorgan Chase & Co.

Conventional investment wisdom over the past few years has assumed a major economic slowdown, but the world economy continues to grow in excess of 5 percent per year. PAULSEN outlined four exceptions related to the current recovery cycle: (1) excess liquidity won't go away; (2) bond yields won't go up; (3) stock prices are up but earnings are rising faster than stock prices; and (4) this is a G25 rather than a G7 recovery (a new world order). We have never produced a recession without taking away excess liquidity and raising bond yields, Paulsen said. Moreover, the most unique aspect of this recovery is that it has not produced confidence.

In the past year, housing and automobiles made up 9 percent of the U.S. economy and declined by 10 percent in real terms. These items have been getting 99 percent of the media attention while the remaining 91 percent of the economy has been accelerating, with an annual real GDP growth rate of 4.3 percent. By the fall, the Fed will either ease or tighten interest rates, depending upon what happens with housing. The evidence suggests that housing has bottomed out, Paulsen said, so in his view the Fed will tighten.

The housing news is about what has already happened. The reason people are worried is that housing and real consumption spending were in lockstep with each other from 1970 to the mid-1990s. It is possible to liquidate housing without lowering consumption because these two indicators have been negatively correlated in the last decade. Both housing and jobs were once correlated with consumption, but housing is no longer correlated because of mortgage equity withdrawals, which have absolutely no relationship with personal consumption. Thus, there is no reason to suspect that the decline in net equity withdrawals will kill consumption, although it does appear to be dragging down housing. This could lead to a unique situation where housing is liquidated without lowering consumption.

Fed policy can do three main things: raise short-term interest rates, hope to raise long-term interest rates, and restrict liquidity. Since the Fed has pursued only one of these courses (raising short-term interest rates), monetary policy can still stimulate this economic cycle. Moreover, short-term interest rates remain comparatively low (5.25 percent), and they are not overly restrictive. According to Paulsen, the Fed continues to raise interest rates until something blows, so the catch is that the system has to experience some pain before any gain is realized (e.g., a rise in 10-year Treasury bond yields). He noted that there have been some exceptions to the relationship between the growth of nominal GDP and liquidity. In the 1970s, for example, liquidity grew much faster than the economy and resulted in the biggest inflationary blow-off in U.S. history. In the 1980s and 1990s, liquidity grew slower than the economy and resulted in the most hyperactive price-competitive corporate environments since the Great Depression.

In the past decade, liquidity has been growing faster than the economy. Prices are rising and chasing little yield. The real risk is an overheated situation because of our monetary stance. Although there is unlikely to be an inflationary blow-off comparable to the 1970s, there is a massive resource bind around the globe, which could lead to a brief yet nasty cyclical inflationary period in the United States. Paulsen noted that there has been significant policy stimulus in terms of growth in the U.S. money supply, a decline in the trade-weighted dollar index and the 10-year Treasury bond yield, and an increase in the mortgage bankers' refinancing applications index. He also noted that there have been three major global merger-and-acquisition (M&A) cycles in the last three decades that have been predicated on debt (leading to the savings and loan crisis), equity (the dot-com meltdown), and cash. The cash-based M&A cycle will end in the liquidation of cash by inflation and the destruction of the real purchasing power of cash (e.g., a lower dollar).

Real GDP world output is increasing in the sixth year of an economic recovery at a much higher rate than the U.S. economy, while the Fed has been tightening for two and a half years. These events are a radical transformation from past cycles. Emerging countries now account for 51 percent of global GDP, and they are expected to comprise two-thirds of world GDP in 20 years. The United States is losing its economic leadership position, which could also be followed by a loss of political and military leadership. We did this to ourselves, said Paulsen, because of our trade deficit for the past 15 years. As a result, emerging market dollar-based consumption has exceeded U.S. consumption for the past five years, so our fear in 1999 that the U.S. consumer would be the sole locomotive for world growth is no longer valid. Our quest, therefore, is to get the emerging market consumer to come to our shores by contracting the trade deficit and devaluing the dollar. The biggest loser as a result of our trade policy has been manufacturing, but in the next two decades it could become the biggest winner.

BARBERA stated that Minsky's insights have stood up relative to developments in the macroeconomic community, and that his work, particularly the 1975 book *John Maynard Keynes*, is the best road map for negotiating one's way through the business cycle. Barbera also stated that practicing economists should codify the few things that they truly know because the next major monetary policy decision will be made in China. These things include the notions of a downward-sloping IS curve (the inverse relationship between interest rates and levels of national income/investment) and a short-run Phillips curve (the inverse relationship between wage rates/inflation and unemployment) in association with the Taylor rule. The Fed funds rate over the past 10 years can be roughly explained by these two notions. However, the Fed funds rate has been more volatile than the Taylor rule would suggest. According to the Minsky addendum to the rule, violent changes in expectations about future cash flows require a radically different interest rate at (business) turning points. The business cycle has a financial overlay in which exaggerated changes in the Fed funds rate are now the rule rather than the exception.

The Minsky model is very important because monetary policy officials in China have an exclusive fascination with prices rather than asset prices. These officials do not appreciate the consequences of excessive prices nor do they take the needed adjustments. For example, Japan let asset price excesses run for a long time, and paid the price of no growth for 15 years. The mismatch of monetary and fiscal policy in the United States in the mid-1980s produced a skyrocketing dollar and very large external imbalances. When the Fed eased interest rates in the second half of the 1990s, they anticipated that a large decline in interest rates would result in a decline in the dollar and a narrowing of the trade deficit. What happened is that the dollar fell against the European currency but not against the Chinese currency, so the trade deficit continued to rise dramatically. Unlike the imbalances of the mid-1980s, current imbalances are manufactured largely by policy decisions made in Asia, not the United States. These imbalances, therefore, will adjust in the opposite direction based on Asian policy decisions, so the heir apparent to Alan Greenspan is Chinese President Hu Jintao.

The above conclusion is based on a review of the U.S. inflation rate and its component parts over the last 10 years. Energy and food represent 23 percent of the U.S. consumer price index (CPI), and China is driving energy and food prices. Core goods represent 22 percent of CPI and prices have been falling because we buy most of our goods from China, courtesy, for example, of Wal-Mart. Core goods prices are significantly lower than core services prices and are slightly negative (year-on-year). Owners' equivalent rent (23 percent of CPI) is driven by the boom-and-bust housing cycle, which is affected by China and the rest of Asia. Asian countries bought U.S. bonds worth $3 trillion in order to steady the dollar, and the resulting very low long-term interest rates created an enormous housing boom. Thus, the only part of the CPI that is insensitive to Asia is core services (32 percent).

Barbera observed that the last several business cycles looked less like swings in wages and prices and more like the Minsky model. The asset bubble in 2000 burst, and the resulting 2001 recession wrecked the tech sector and included a much more significant decline in business equipment investment relative to other cycles. Housing was not affected by the recession, and it created a second asset inflation that is in the midst of unwinding. The interest rate structure of the past 10 months (e.g., the two-year Treasury note) is very low relative to the Fed funds rate and reflects the liquidity from Asia (e.g., the willingness of the Japanese to borrow yen and buy dollar-denominated assets because there appears to be no currency risk).

Barbera observed that the appreciation of the renminbi would enfranchise 400 million Chinese who live in the cities and earn approximately $5,000 per person per year, but it would be a real problem for the 700 million Chinese who live in rural areas. Thus, the tactic of China after the Thai baht crisis was to keep the dollar steady, but that strategy is generating excesses and asset prices are soaring. China has a volatile economy that is no longer command-based. We have to square that circle, Barbera said.

GLASSMAN focused on global imbalances, the state of the U.S. economy, recession risks, and the end of an era of asset-driven demand in the United States. He mentioned three great moments of our time: the Fed's (Paul Volker's) high interest rate policy, the economic and financial liberalization of the U.S. economy, and the awakening of China and India.

According to Glassman, global imbalances have nothing to do with the United States. Rather, they reflect an economic miracle unfolding in Asia. The developing countries are saving their surpluses because they feel vulnerable to an open capital market. The U.S. trade deficit has been deteriorating because its key trading partners (Europe and Japan) have been growing too slowly. This situation, however, is changing as the growth rates of the United States' trading partners increase and the U.S. trade deficit stabilizes. The great fear has been the bursting of the housing bubble, which would damage households across the United States, but we have been looking for bubbles in all the wrong places, said Glassman. The bubble was on Wall Street and then in the pricing of subprime mortgage debt, which has affected home building businesses more severely than the broad real estate market.

Glassman outlined the need to reconcile four trends: (1) the balance sheets of the household sector (household net worth is at a very high level, wealth is concentrated, and house prices have flattened but not crashed); (2) home builders are in a recession (housing starts are sharply lower); (3) credit is being repriced and credit spreads are back to a zone that represents the best of times (the problems in the subprime mortgage market are fairly confined); and (4) low and falling unemployment suggests that the economy is doing better than the numbers suggest.

The mispricing in the subprime mortgage market is mostly hitting new home builders. Since the resale housing market rose the most in the West, the West is the region experiencing the biggest declines; the rest of the country is experiencing very modest declines. In contrast, new home sales at the low end of the market are down sharply across the country as a result of credit conditions. Contrary to our fears, the real estate market is not having a broad systemic impact, and the historical link between housing and national recessions in the United States is not indicative of the current situation: a mispricing of credit. That is why the home building business is correcting and unlikely to trigger a broad recession.

Glassman noted three other things to consider regarding the likelihood of recession. First, the developing world is growing rapidly and could grow fast for decades, and global growth is at its fastest pace since the early 1970s. Second, corporate profits are at record levels, while labor income is at its lowest level since 1970 (there is no need to worry that tight labor markets and costs will cause inflation). Third, we are at the end of an era. It is not normal that consumer spending has been growing half a point faster than income for the past 20 years. The great asset boom was reflected in the U.S. economy (an equity market and financial asset power), the opening up of the world economy, and the great disinflation. We are now entering an era of more normal gains in asset and real estate markets, and interest rates are no longer declining because inflation has declined enough. Since stable interest rates do not allow an increase in leverage (debt), household savings will improve. Therefore, demand growth in U.S. consumer spending will be more in line with income. This result is reflected in the markets, and is the reason why real interest rates, on average, are low.

Speaker: FREDERIC S. MISHKIN, *Federal Reserve Board*

The U.S. Economic Outlook

Governor Mishkin's speech is reproduced here in full.

Thank you for inviting me to participate in this conference and offer my views on prospects for the U.S. economy. I should note that the opinions I will express today are my own and not necessarily those of my colleagues on the Federal Open Market Committee (FOMC).

We are now almost five and a half years into the current economic expansion. A slow start in 2002 was followed by three years of strong gains in real (that is, inflation-adjusted) economic activity and a substantial decline in unemployment. Initially, monetary policy was very accommodative as the FOMC focused on providing support for the recovery and avoiding an unwelcome disinflation. From early 2003 to early 2006, real gross domestic product (GDP) rose at an annual rate of 3.5 percent—well above consensus estimates of its underlying sustainable rate—and the unemployment rate declined to 4.75 percent.

Since the spring of 2006, however, the expansion of the U.S. economy appears to have been undergoing a transition to a more moderate and sustainable pace. Although such a transition will no doubt be marked by some bumps in the road, it represents a desired macroeconomic rebalancing that over the longer run can help ensure sustained noninflationary growth. One of the fundamental factors underlying the deceleration in real activity is the lagged effect of the FOMC's removal of monetary policy accommodation between June 2004 and June 2006. Another source of the rebalancing is the substantial correction in housing markets that has been under way since last spring as the unrealistic expectations about home price appreciation that fueled the extended boom in home building have been unwinding.

Looking ahead, the most likely outcome for the coming quarters is, in my judgment, a continued moderate rate of economic expansion accompanied by some easing of pressures on resources. With inflation expectations contained, I would expect such an economic environment to foster a gradual slowing over time in the rate of core consumer price inflation. However, the actual path for economic activity and inflation could, at times, be uneven; and as is the case for all forecasts, it involves a number of risks and uncertainties on both the downside and the upside.

Turning first to the prospects for economic activity, two particular areas have emerged recently that have heightened uncertainty about the near-term outlook. The first area is housing: where do we stand in the housing adjustment, and what effect will recent developments in subprime lending have on that adjustment? The second area is business investment: how should we interpret the incoming data showing that business spending on equipment and software has been weak this year?

Regarding the housing adjustment, new single-family homes were started at an average annual rate of a bit under 1.2 million units in the first three months of this year—a pace roughly one-third below the unsustainable peak in new construction reached in mid-2005. At the beginning of the year, the ongoing cutbacks in starts of new homes, together with a lowered but fairly steady pace of home sales, were beginning to reduce the elevated backlog of new homes for sale. However, a further weakening in sales of new homes in January and February reversed some of the progress in reducing those inventories. As a result, cutbacks in new residential construction may well persist for a while.

More recently, developments in the subprime mortgage market have raised some additional concern about near-term prospects for the housing sector. The sharp rise in delinquencies on variable-interest-rate loans to subprime borrowers and the exit of a number of subprime lenders from the market have led to tighter terms and standards on such loans. While these problems have caused undeniable hardship for many families and communities, spillovers to other segments of the mortgage market or to financial markets in general appear to have been minimal. Variable-interest-rate loans to subprime borrowers account for a bit less than 10 percent of all mortgages outstanding, and at this point the expected losses are relatively small. Moreover, because most subprime mortgages are securitized, the risks associated with these loans are spread widely. Banks and thrift institutions that hold mortgages are well capitalized, and exposures of individual banks to possible subprime losses do not appear to be large. On the whole, some borrowers may find credit more difficult to obtain, but most borrowers are not likely to face a serious credit constraint.

Indeed, I should note some positive news for the housing sector. Sales of existing homes strengthened a bit during January and February, and the Mortgage Bankers Association index of applications for home purchase suggests that demand has been fairly steady through early April. Also, mortgage rates are still at historically low levels, and mortgages to prime borrowers and fixed-rate mortgages to all classes of borrowers continue to show low rates of delinquency.

The second major area of concern in the near-term outlook, and one that perhaps could pose noticeable downside risks, is business investment. Real outlays for new equipment and software weakened in the final quarter of 2006, and the recent data on orders and shipments of nondefense capital goods suggest that the softness in demand has extended into early this year. Part of the weakness can be clearly traced to a decline in demand for investment goods that are used heavily in residential construction. In addition, demand for goods used by the motor vehicle industry also has softened of late. But, demand for other types of non-high-tech business equipment also appears to have slowed recently, raising more fundamental questions about business views on the current and prospective environment for capital spending.

To be sure, the pace of output has moderated, which typically would lead to some deceleration in capital spending. But the magnitude of the recent pullback seems to be greater than would be expected. Adding to the puzzle has been a weakening in demand for non-high-tech equipment even as financial conditions for investment have remained generally favorable. In particular, business balance sheets are strong, and although profits have slowed, profit margins remain elevated. Interest rates and credit spreads are relatively low, and firms appear to have ample ability to raise funds at a reasonable cost.

The unwillingness of businesses to invest might be due to concerns about the prospects for long-term productivity growth and the expected rate of return on capital investment. Moreover, businesses may be anticipating a more pronounced deceleration in sales than would be consistent with the moderate expansion that I am expecting. Respondents to the Blue Chip Economic Indicators survey suggest that the recent reluctance to invest reflects greater uncertainty about the outlook for sales and earnings. If so, the continuation of a moderate economic expansion is likely over time to restore confidence and lead to a firming in business investment.

Not all of the recent news on business spending has been to the downside, however. Demand for high-tech equipment appears to have picked up early this year after leveling off in the final quarter of 2006. Demand for computers, which was likely boosted by the introduction of the Windows Vista operating system, seems to be advancing at a healthy pace. Technological innovations—such as circuitry that boosts computer performance and lowers energy consumption—appear to be generating demand to upgrade equipment in data centers. In addition, major U.S. cable companies are forecasting a step-up in capital spending, and telecommunications carriers are planning a further expansion of fiber-optic networks.

Although questions related to the prospects for housing and business spending appear to have widened the range of uncertainty about the near-term outlook, developments in other areas appear to support a continued moderate rate of economic expansion. Monthly gains in employment, while down some from last year's pace, remain solid; the average monthly increase in nonfarm payrolls over the first three months of this year was about 150,000, compared with about 190,000 in 2006. To date, job cutbacks have been centered in industries related to residential construction and manufacturing, with no indication—either from the monthly labor market reports or the weekly unemployment insurance data—of widening weakness.

In addition, the incoming information on consumer spending has been consistent with a moderate pace of demand. The steady labor market has been generating income; and despite the ups and downs in energy prices, real disposable income has been trending up at about a 2.75 percent rate since early 2006. In addition, household credit quality remains generally favorable. As is the case for prime mortgages, delinquency rates on consumer loans are low. And despite the deceleration of house prices, the ratio of household net worth to disposable income is still elevated.

Economic activity also should be supported by fiscal policy, which is likely to remain mildly stimulative this year. At the federal level, that stimulus is likely to continue to come from defense spending rather than from other outlays, which are expected to change little in real terms. Although defense outlays tend to be volatile from quarter to quarter, the available and expected appropriations should keep real defense spending on a moderate uptrend. At the state and local government levels, the economic expansion in recent years has broadly restored fiscal health. Many of these governments have been spending at a moderate rate while also building their rainy-day funds, and this year they appear poised for further hiring and more construction spending.

On the international trade front, recent readings on economic activity abroad have been positive, which suggests that the demand for U.S. exports of goods and services will continue to be solid. Prospects for further economic expansion in Europe and Japan appear good in the near term. And despite indications of moderation in some countries, the overall pace of economic activity in emerging economies, including China, appears to be strong.

Turning now to the inflation outlook, in February the 12-month change in core personal consumption expenditure (PCE) prices was 2.4 percent, and in March the year-over-year change in the core consumer price index (CPI) was 2.5 percent. Each of those readings was higher than the corresponding result for early 2006. Increases in market rent and in owners' equivalent rent account for much of that acceleration. Prices of consumer goods in both the PCE and CPI measures have been relatively flat for the past two years, while prices of services other than energy and shelter have been rising at about a 3 percent rate. My forecast of a gradual slowing in inflation reflects my view that making further progress in lowering inflation is desirable. Although I expect that core inflation will drift down, I recognize that achieving further reductions in inflation may take time. In the near term, the recent rebound in prices for gasoline and other petroleum-based goods is likely to put upward pressure on the costs of many nonenergy goods and services. Moreover, the evolution of shelter costs, which have boosted core inflation over the past year, is difficult to predict. Here, my expectation is that as the supply of rental units increases and the market for owner-occupied housing stabilizes, the rise in rent will slow.

Other concerns about prospects for inflation are related to developments on the supply side of the economy. Since last fall, the jobless rate has been hovering around 4.5 percent, a relatively low level by historical standards, and it fell to 4.4 percent this past month. With the labor market that tight, I am not surprised that our business contacts have been reporting shortages of workers in some occupations—both skilled and unskilled, depending on the region—and some associated wage pressures. To date, various measures of worker compensation are giving mixed signals on whether wages are accelerating. The narrowest measure, the average hourly earnings of production or nonsupervisory workers, shows a noticeable pickup in wage inflation from 3 percent in 2005 to around 4 percent more recently; another measure, hourly compensation in the nonfarm business sector rose in 2006 at close to 5 percent, also faster than a year earlier. But the employment cost index has been rising at a moderate 3 percent rate for the past two years.

Whether a pickup in nominal labor compensation will lead to upward pressure on inflation will depend on several factors. Importantly, an acceleration in compensation might be offset by higher labor productivity; indeed, during most of this expansion, strong gains in labor productivity have checked the rise in unit labor costs. And, with profit margins wide, businesses might accommodate increases in labor compensation without passing them on to consumers in the form of higher prices. In these circumstances, gains in nominal compensation for workers would translate into gains in real compensation.

So how is labor productivity doing? During the first three years of the current expansion, output per hour in the nonfarm business sector rose 3 percent per year; in the past two years, it has decelerated to 2 percent. I suspect that this slowdown does not represent a fundamental weakening in the longer-run trend, but is rather a normal cyclical transition from an above-trend rate of increase to a more sustainable rate. Of course, I also recognize a potential downside risk to the outlook for productivity, especially given the weakness in business investment that I noted earlier. Nonetheless, averaging through the entire expansion to date, the underlying rate of productivity advance still seems to be close to the 2.5 percent rate that has prevailed since the mid-1990s.

More fundamentally, I believe that long-run inflation expectations remain a key determinant of the path of inflation. But what are the current expectations for long-term inflation? Unfortunately, that is not an easy question to answer. The results from the Survey of Professional Forecasters, readings on household opinion such as the Reuters/Michigan survey, and the spread between standard Treasury securities and Treasury inflation-protected securities—taken together—suggest that long-term inflation expectations are currently around 2 percent, although this guess is far from certain.

Given my estimate of the current level of long-run inflation expectations as well as the likelihood of some easing of resource pressures in labor and product markets, I expect that core inflation will slow to around 2 percent over the next couple of years. Although I believe that inflation expectations will play a primary role in determining the course of inflation, I want to emphasize that neither economists nor policymakers understand the expectations-formation process very well. However, one aspect of expectations formation that we have come to regard as crucial is the credibility of monetary policy. Consistent with its dual mandate to foster maximum sustainable employment and price stability, the Fed must therefore continue to respond aggressively to shocks that have potentially persistent adverse effects on both inflation and real activity. And we need to monitor long-run inflation expectations closely to avoid losing credibility with the markets.

In closing, I want to emphasize that the Federal Reserve will continue to play its part in ensuring the longer-run health of the economy by implementing policies designed to achieve its dual mandate. As you know, since last June the FOMC has left its target for the federal funds rate at 5.25 percent. I recognize that uncertainties surrounding the economic outlook have increased recently, and I remain concerned that the persistence of inflation at the recent elevated rate could have adverse consequences for economic performance. However, I continue to believe that the current stance of monetary policy is likely to foster sustainable economic expansion and a gradual ebbing in core inflation. As always, future policy adjustments will depend on the evolution of the outlook for both inflation and economic growth as implied by incoming information.

Fiscal Policy in a Stock-flow Consistent (SFC) Model

WYNNE GODLEY and MARC LAVOIE
Working Paper No. 494, April 2007
www.levy.org/pubs/wp_494.pdf

The New Consensus maintains that interest rates need to be set correctly in order to achieve noninflationary growth at full employment. Using a simple stock-flow consistent (SFC) model, Distinguished Scholar Wynne Godley and Marc Lavoie, University of Ottawa, Canada, show that, in theory, fiscal policy can also achieve stable growth without inflation or unemployment. Their analysis draws two unconventional conclusions: (1) an economy with a real rate of interest (net of taxes) that exceeds the real growth rate will not necessarily generate explosive interest flows; and (2) it cannot be assumed that a debtor country requires a trade surplus in order to avoid explosive interest payments on debt.

The authors note that the New Consensus shows that monetary policy can provide full employment at some target (low) inflation rate over a short period, but not over the long run within a stock-flow consistent framework. Their model accounting structure outlines transaction flows within a closed economy in terms of households, firms, and government, using variables such as private and government expenditures, income (GDP), taxes, interest, and changes in wealth/debt. The objective is to ascertain the fiscal stance of an economy at full employment on average.

The model is solved for the level and growth of government expenditures and the budget deficit, conditional on any configuration of policy variables, (e.g., the nominal interest rate and nominal taxes as a proportion of nominal private factor income) and other assumptions (e.g., the growth rate of the economy and the rate of price inflation). Godley and Lavoie focus on solutions that describe growing steady states in which all real stocks and flows are growing at the same rate, while all nominal stocks and flows are growing at higher and different rates. In their baseline model, full employment and a zero output gap is reached when pure government expenditures represent 25.9 percent of GDP and the government runs deficits. The results do not change much unless there are very large changes in the assumptions about the exogenous variables.

A usual assertion for sustainable debt dynamics is that the real rate of interest must be lower than the real rate of economic growth for a given primary budget surplus–to-GDP ratio. Otherwise, the government needs to pursue a discretionary policy that aims to achieve a sufficiently large primary surplus. No such requirement, however, is needed in a fully consistent stock-flow model. The only behavioral requirement imposed upon the public sector is a high enough level of pure government expenditures, such that full employment output is verified in each period.

The authors conclude that it makes no sense to put limits on deficit and debt ratios, as in the Maastricht rules and Gordon Brown's "golden rules," outside the context of how any economy actually works. They note the time lag associated with both monetary and fiscal policy, and suggest a need for institutional changes whereby government expenditures and investments, and public service employment programs, are ready to be implemented when required.

The authors also add behavioral equations to their model and demonstrate that fiscal policy is relevant within the framework of mainstream economics. Their experiments show that the behavior of the model hardly changes when nominal or real interest rates are the exogenous variables. The model returns to a stable, steady-state position whether the central bank adjusts its inflation target or dramatically raises the real rate of interest, or whether households raise their propensity to consume out of disposable income, and despite the fact that the real rate of interest after taxes may be much higher than the trend real rate of economic growth. They note that by bringing back fiscal policy as the main tool to affect aggregate demand, monetary policy would have an additional degree of freedom to set the real interest rate, which is a key determinant of distribution policy.

In an open economy, the SFC model converges to stable ratios when the current account balance approaches minus 2.5 percent of GDP. This result contrasts with the commonly held assumption that if a country is indebted to the rest of the world, then stability can only occur if the balance of trade is positive. Moreover, a chronic current account deficit implies a budget deficit 2.5 percentage points higher than it would otherwise be.

The Effects of a Declining Housing Market on the U.S. Economy

DIMITRI B. PAPADIMITRIOU, GREG HANNSGEN, and GENNARO ZEZZA

Working Paper No. 506, June 2007
www.levy.org/pubs/wp_506.pdf

There are numerous signs that falling house prices in the United States might hamper economic growth, generate social dislocations, and lead to a full-blown financial crisis. Contrary to Federal Reserve Chairman Ben Bernanke's cautiously optimistic view of recent financial developments, President Dimitri B. Papadimitriou, Research Scholar Greg Hannsgen, and Research Scholar Gennaro Zezza, University of Cassino, Italy, foresee the increasing likelihood of a growth recession. The effects of the recent decline in home prices on real private expenditures is expected to persist, along with the inability of wages to keep up with inflation. Macroeconomic policy will be critical, they say, and the Fed must be ready to step in as a lender of last resort.

In spite of mixed economic signals over the past few months, the household sector could give in to the pressures of rising gasoline prices, a weaker housing market, and a large debt burden. The seasonally adjusted real median price of existing homes lost 9 percent of its value in the first quarter of 2007. Serious mortgage delinquencies and bankruptcies are spreading from the subprime mortgage market to Alt-A mortgages. Tighter lending standards, upward interest rate adjustments, and rising mortgage interest rates will curtail the demand for homes. These adjustments could result in more than one million foreclosures on first mortgages that originated in the 2004–06 period.

Adverse effects in the housing market affect household consumption and depress economic growth. Home equity is a component of permanent income (a balance sheet item that determines the total amount of household consumption), and it also acts as a source of cash (e.g., home equity lines of credit).

The authors use the Levy Institute macroeconomic model to evaluate the impact of the housing market slowdown on the U.S. economy. They find that the elasticity of real private expenditure to the median home price is low initially after a shock but rises when the shock is absorbed, with a mean lag of five months. The decline in house prices and household borrowing in the first quarter of 2007 implies a 0.4 percent decline in expenditure in the second quarter of 2007 and a 0.9 percent decline in the long run.

Two recent developments in the way homes are financed will determine how the current situation plays out: (1) mortgage-backed securities, such as Freddie Mac and Fannie Mae (government-sponsored entities), along with the resale of various "tranches" of mortgage-backed securities and credit derivatives; and (2) the expanded use of "exotic" (e.g., no down payment) and subprime mortgages, and the general trend toward higher loan-to-home-value ratios. There is no complete accounting of risk associated with many new financial products, since they are not as heavily scrutinized by regulators as traditional financial intermediaries (e.g., banks). Lightly regulated lenders have been taking undue risk, say the authors.

Optimists point to three key themes in the rapidly growing and innovative financial markets: democratization (bringing credit to those who lack collateral and connections), reduced borrowing costs, and the spreading of risk. According to Hyman P. Minsky's financial fragility theory, however, the increasing availability of credit and the proliferation of new financial products represents the unsustainable upward phase of a potentially unstable cycle. Minsky showed how the economy is subject to one crisis after another, and has been ever since consumer credit became widely available early in the 20th century. Present lending standards have been very lax relative to historical norms, and the ratio of house prices to rents remains relatively high. Thus, the social costs of foreclosures will be borne by the very people who have apparently been the beneficiaries of democratization.

History shows that the solution lies partly in a regulatory response. The authors argue that the stage has been set for very serious and widespread economic difficulties, so the prevention of job losses, which are the main contributors to foreclosures, is critical. They observe that proposed rules by Congress and the Fed focus narrowly on the mortgage problem, and that an effective job-creation method could be some form of employer-of-last-resort program that offers government jobs to all workers who request them. They also observe that pension funds that include large direct and indirect mortgage-related investments may be as exposed to risk as the banks.

Although home ownership has been the most important form of personal saving, this avenue may no longer be the case in light of the rise in home-equity withdrawals and the decline in home values. Thus, Social Security will become more important than ever.

Strategic Analysis

The U.S. Economy: What's Next?

WYNNE GODLEY, DIMITRI B. PAPADIMITRIOU, and GENNARO ZEZZA

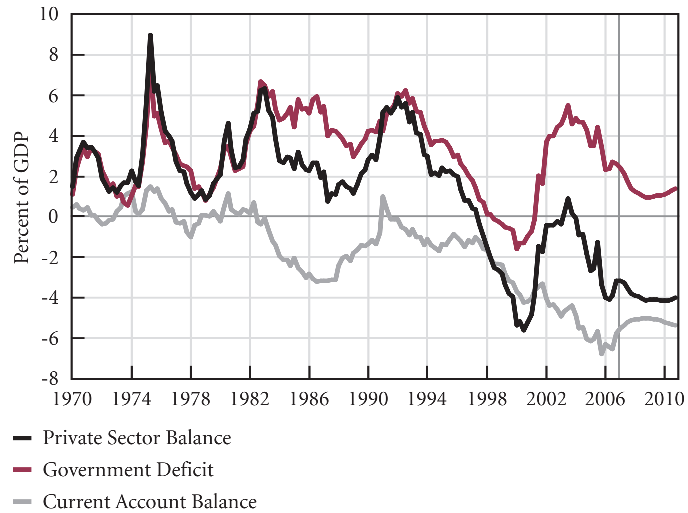
Strategic Analysis, April 2007
www.levy.org/pubs/sa_apr_07.pdf

The January 2007 annual report of the Congressional Budget Office (CBO) includes projections for the U.S. budget deficit between now and 2010, based on the assumption that the economy will grow at an average rate of 2.85 percent. Using the Levy Institute macroeconomic model of the U.S. economy, Distinguished Scholar Wynne Godley, President Dimitri B. Papadimitriou, and Senior Scholar Gennaro Zezza find that the CBO's assumptions are wildly implausible if viewed as predictions. Based on likely changes in the financial balances of the three major sectors of the U.S. economy—government, foreign, and private—they determine that output growth will slow down almost to zero sometime between now and 2008 before recovering toward 3 percent in 2009–10, and that unemployment will start to rise significantly.

Figure 1 shows the CBO projection for the U.S. budget deficit based on its (optimistic) average growth rate for the U.S. economy. If the CBO growth rate holds true, the authors determine that the current account balance will improve dramatically due to a large positive response of export volumes to dollar depreciation, while the large private sector deficit will remain. This result is highly implausible, they say, given the multifaceted implosion of the housing market. Personal debt relative to GDP cannot continue to accelerate, while net lending has been falling rapidly since the beginning of 2006. Based on the authors' assumption of stabilizing household debt, the private sector net saving rises substantially, the current account balance improves more decisively than that implied by the CBO growth rate, and there is a small but significant increase in the budget deficit (Figure 2).

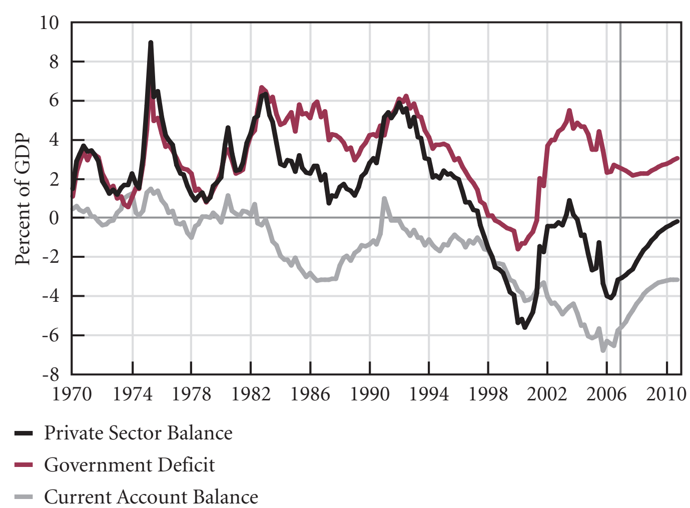
In Figure 3, the authors consider two alternative scenarios in the context of policy responses: (1) a further substantial depreciation of the dollar (perhaps 30 percent); and (2) expansionary fiscal policy. These scenarios, however, are unlikely in light of long lags between changes in the exchange rate and changes in real exports and imports, the inflationary consequences of the U.S. dollar's great fall in value, and a further increase in the budget deficit (to 4.6 percent of GDP in 2010), which is contrary to the present intension of the Bush administration and the Democratic Congress. The authors believe, however, that government policy will adjust, as it did in the 2000–03 period, and allow the current account deficit to reexpand, indefinitely postponing a rebalancing of the world economy. Thus, fiscal policy is the leading alternative to keep the

Figure 1 **U.S. Main Sector Balances with CBO Assumptions**



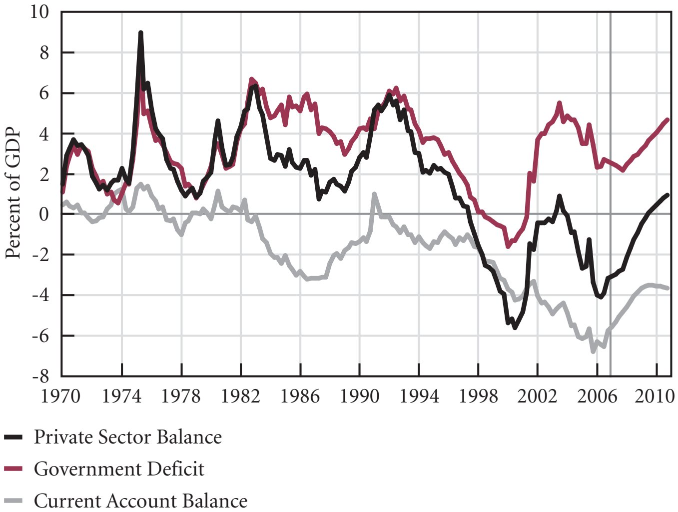
Sources: NIPA and authors' calculations

Figure 2 **U.S. Main Sector Balances under the Assumption of Stabilizing Household Debt**



Sources: NIPA and authors' calculations

Figure 3 **U.S. Main Sector Balances under the Assumptions of Further Dollar Devaluation and Expansionary Fiscal Policy**



Sources: NIPA and authors' calculations

expansion on track, implying a significant rise in the public sector deficit (e.g., an additional increase of 3.2 percent of GDP, or $540 billion).

Program: The Distribution of Income and Wealth

Economic Perspectives on Aging

DIMITRI B. PAPADIMITRIOU

Working Paper No. 500, May 2007

www.levy.org/pubs/wp_500.pdf

According to the U.S. Census Bureau, the fraction of the elderly (ages 65 and over) in the total population is projected to increase from 12.5 percent in 2002 to 16.3 percent in 2020, while the fraction of the working age population (ages 20–64) is expected to decline from 59.0 to 57.2 percent in association with decreasing rates of fertility and increasing life expectancies. These demographic changes imply a significant expansion of federal entitlement programs, observes President Dimitri B. Papadimitriou, and existing benefit rules and rapidly escalating health care costs are expected to lead to fiscal pressures on the federal budget, and to pose challenges for economic growth. Federal expenditures for Social Security, Medicare, and Medicaid represented almost 40 percent of the federal budget in 2006 (8.5 percent of GDP), and the cost of these entitlement programs could increase to 15 percent of GDP by 2030. Moreover, the effects of demographic change will differ for each program.

Papadimitriou notes that various pundits warn of a generational storm and a fiscal crisis as a result of higher taxes, lower retirement and health benefits, higher inflation and unemployment, a depreciating dollar, and political instability. He also notes that the United States is not alone in confronting this demographic transition. The problem is more severe in Germany, for example, where the elderly already represented 16 percent of the total population in 2000, and old-age pension spending relative to GDP is at least twice as high in Germany, Sweden, Finland, and Japan as in the United States. Nevertheless, an aging U.S. population requires action in the near term to forestall more difficult choices in the long term. In the author's view, it is absolutely essential to assess the forces that drive government spending on the elderly, to examine how retirement and health care might be financed, and to measure the potential impact of different proposals for reform.

The generosity of a country's welfare system toward the elderly has profound implications for the composition of government budgets. Policymakers need to have a set of clear ideas about the dimensions of the emerging problem and the relative uncertainties surrounding the projections of assumptions (e.g., the uncertainty about the growth of immigration versus expected fertility rates). Papadimitriou cautions that small changes in the variables included in the 75-year projections of the Trustees of Social Security and Medicare can yield significant changes in the actuarial results, and most analyses confuse the difference between real and financial provisioning for retirees. If the problem is real, it requires a fiscal policy stance that is biased toward increasing productive capacity. If the problem is financial, some options include reducing the share of discretionary spending, altering the benefit formulas, and raising payroll and income taxes.

An important issue that has not been studied sufficiently is whether future retirees will be able to maintain a decent standard of living. The debt burden of the elderly grew substantially in the 1990s, outright home ownership for the group as a whole has declined, and there appears to be a shortfall of available resources. Papadimitriou observes that there is a general consensus that government spending on retirees reduces overall inequality in annual income. Areas of research important for the evaluation of reform proposals and their implications for public finance include lifetime comparisons of benefits and contributions, as well as retirement behaviors. Why and when individuals retire, the changing trade-off between retirement and work, and the policy implications of the interaction between the formation of social norms and the institutional environment are other important areas of research. While most discussions about the potential fiscal imbalances that result from population aging focus on how changes in benefits or taxes on workers can help alleviate the situation, there is a need for more systematic study of how changes in employment contracts and global competitive pressures contribute to the process and place pressures on the physical and economic well-being of the elderly (e.g., a reduction in the liability of employers for health care costs).

Noncash transfers and wealth play a crucial role in shaping the economic well-being of the elderly, but noncash transfers are excluded from the official measure of gross money income (the most widely used measure of economic well-being). More comprehensive measures, such as the Levy Institute Measure of Economic Well-Being, enable policymakers to gain better insight into the relative importance of different income sources in sustaining the economic well-being of the elderly, and the forces shaping inequality among the elderly. Equity considerations should not only differentiate individuals according to their earnings, but also in terms of mortality rates among demographic groups, variations in family type, and gender. For example, 60 percent of the elderly are women, and there are huge gaps in living arrangements between elderly women and men. Therefore, reform proposals must be evaluated in light of the changes that have taken place in women's relation to paid work and to changes in household structure and composition.

The paper concludes with a summary of *Government Spending on the Elderly* (2007), a volume of essays edited by Papadimitriou. Addressing the subject of retirement wealth and the overall well-being of the elderly in the United States and other parts of the world, the essays present conceptual and empirical studies that identify key issues dealing with various aspects profoundly affecting the aging population.

Recent Trends in Household Wealth in the United States: Rising Debt and the Middle-Class Squeeze

EDWARD N. WOLFF

Working Paper No. 502, June 2007
www.levy.org/pubs/wp_502.pdf

In previous works, Senior Scholar Edward N. Wolff, New York University, presented evidence of a sharp increase in household wealth inequality in the 1980s, followed by a modest rise in inequality in the 1990s. The richest households experienced large gains in wealth, while overall indebtedness rose among U.S. families. Wolff updates his earlier analyses for the 2001–04 period and finds an explosion of household debt and an unprecedented decline in median wealth, despite economic expansion. Moreover, wealth inequality rose slightly, income inequality declined, and the percentage increase in net worth was much greater for the top income and wealth groups.

The author uses as his starting point the Federal Reserve Board's Survey of Consumer Finances, which consists of a core representative sample combined with a high-income supplement. Because there are discrepancies between the total balance sheet value computed from the survey sample and the Flow of Funds data, he adjusts the original asset and liability values in the surveys to conform with the corresponding national balance sheet data. It is important to make these adjustments when comparing changes in mean wealth, Wolff says.

The principle wealth concept used in the paper is marketable wealth, or net worth, which is the current value of all marketable or fungible assets less the current value of debts. This measure reflects wealth as a store of value and a source of potential consumption, and it is a better reflection of the level of well-being associated with a family's holdings. Wolff also uses a more restricted concept of wealth: nonhome wealth, defined as net worth minus net equity in owner-occupied housing. Nonhome wealth reflects the resources that may be immediately available for consumption expenditure or for various forms of investment.

The wealth of households in the middle of the distribution (median wealth) fell by 0.7 percent between 2001 and 2004 in spite of a rapid rise in housing prices (17.9 percent in real terms), a result of the enormous increase in household debt. Median nonhome wealth declined a staggering 26.5 percent in response to falling stock prices and rising nonmortgage debt as a share of total assets.

Wolff notes that wealth inequality remained virtually unchanged from 1989 to 2004, while higher nonhome wealth inequality reflects the increase in the share of households with zero or negative nonhome wealth. The sharp decline in income inequality parallels a substantial downturn in realized capital gains relating to the top 1 percent of the population. Although wealth inequality is positively related to the ratio of stock prices to house prices, the reason that net worth inequality did not decline from 2001 to 2004 is that household debt mushroomed over the period.

Wolff also notes that the richest 1 percent received over one-third of the total gain in marketable wealth, while the top quintile accounted for 89 percent of the total over the 1983–2004 period. Despite the relative stability of net worth inequality and the decrease of nonhome wealth inequality during the 1990s and early 2000s, growth in the U.S. economy has been concentrated in the top quintile. He further notes changes in the composition of household wealth: the steep rise in the share of gross housing wealth (33.5 percent of total assets in 2004), the net equity increase in owner-occupied housing (21.8 percent of total assets in 2004), the near-record increase in overall indebtedness (a debt-to-equity ratio of 18.4 percent in 2004), and the record surge in the debt-to-total-income ratio (to 115 percent in 2004). A huge increase in the debt-to-income ratio for the middle three wealth quintiles (from 110.3 to 141.2 percent) and a doubling of the debt-to-equity ratio (from 31.7 to 61.6 percent) are evidence of the middle-class "squeeze" during the 2001–04 period.

Wolff finds marked class differences in how middle-class families and the rich invest their wealth and that a high percentage of the very rich own a business. He also finds that the racial disparity in wealth holdings, after widening in the late 1990s, narrowed in the 2001–04 period. He further finds striking differences in the wealth holdings of different racial and ethnic groups (e.g., white household portfolios have a much higher share of stocks than other groups, while black household portfolios have a much higher share of principal residences). Despite some progress, the respective wealth gaps between African-Americans, Hispanics, and non-Hispanic whites in 2004 were still much greater than the corresponding income gaps.

The value of total stocks owned as a share of total assets tumbled to 17.5 percent in 2004. Overall stock ownership retrenched due to a sharp drop in the stock market (2000–01) that was followed by an anemic economic recovery. Stock ownership is highly skewed by wealth and income class, and substantial stock holdings have not penetrated much beyond the upper and upper-middle classes. Blacks and Hispanics, however, have recently benefited from stock ownership.

Black households experienced a decline in their debt-to-asset ratio during the 2001–04 period, while Hispanics and whites experienced an increase. Wolff finds that the cross-sectional age/wealth profiles follow the predicted hump-shaped pattern of the life-cycle model, and that there has been a relative shift in home ownership, from younger to older households.

Levy Institute Measure of Economic Well-Being

How Well Off Are America's Elderly? A New Perspective

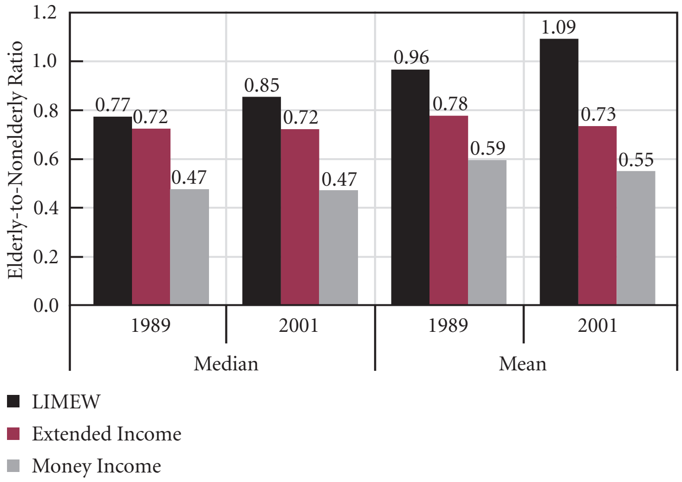
EDWARD N. WOLFF, AJIT ZACHARIAS, and HYUNSUB KUM
Levy Institute Measure of Economic Well-Being, April 2007
http://www.levy.org/pubs/limew0407.pdf

Given the aging of the U.S. population and the widening gap between rich and poor, not to mention the controversy surrounding the future viability of Social Security, the economic welfare of the elderly is an extremely topical issue. Senior Scholar Edward N. Wolff of New York University, Senior Scholar Ajit Zacharias, and Hyunsub Kum, Seoul National University, South Korea, provide a new look at America's elderly, and show that the official measures drastically understate their level of economic well-being.

The authors define an elderly household as one in which the householder is age 65 or over. They find that extended income (EI) and money income (MI), the conventional measures of well-being, do not adequately reflect income from wealth and net government expenditures. In the period from 1989 to 2001, there was an extraordinary increase in income from nonhome wealth, as well as a widening gap in net government expenditures between the elderly and nonelderly. Home wealth climbed very sharply for the elderly, but declined for the nonelderly because of rising mortgage debt.

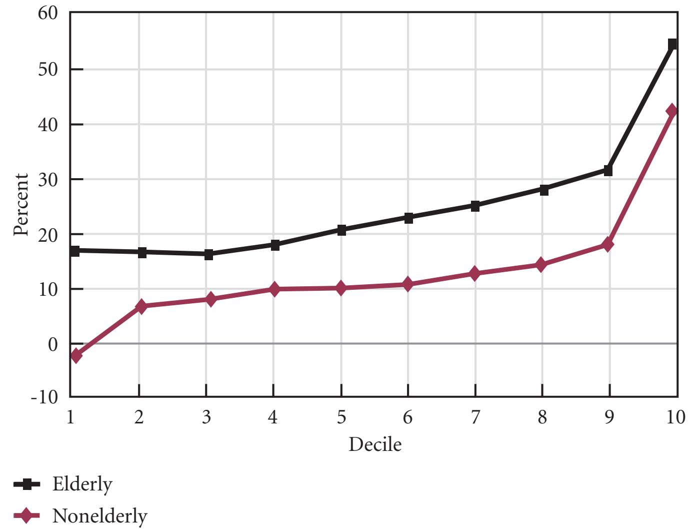
The disparity in income from nonhome wealth between elderly and nonelderly households is even greater than that for home wealth (a ratio of 3.37 in 2001). Income from nonhome wealth climbed by 77 percent for the elderly and 74 percent for

Figure 1 **Relative Well-Being of the Elderly by Income Measure**



Source: Authors' calculations

Figure 2 **Percent Change in the LIMEW by Decile, 1989 to 2001**



Source: Authors' calculations

the nonelderly over the 1990s, a result of the surging stock market. Moreover, the ratio of government cash transfers between the two groups was 5.6 in 2001, while the ratio of noncash transfers was 3.6.

The authors note that public consumption (educational expenditures) and taxes are much higher among the nonelderly. The elderly are a net beneficiary of the fiscal system, while the nonelderly are a net payer. Moreover, the government spending gap between the two groups widened between 1989 and 2001 (from $21,363 to $26,731).

On the basis of the Levy Institute Measure of Economic Well-Being (LIMEW), a more comprehensive measure of income than either EI or MI, the economic disadvantage of the elderly relative to the nonelderly appears to be less severe (Figure 1). Income from the nonhome wealth component is the primary factor in the difference between the measures. Nevertheless, inequality has continued to widen within both groups.

Elderly households in the top and bottom deciles were substantially better off than their respective nonelderly households in 2001. The relative well-being of elderly households appears to have improved throughout the distribution between 1989 and 2001, as each decile experienced substantially higher growth in well-being than their nonelderly counterparts (Figure 2). The base income and income from nonhome wealth components of the LIMEW were the major contributors to inequality among the nonelderly and elderly, respectively.

The results suggest that government policies and programs that favor the elderly over the nonelderly are misdirected. Rather than cutting back on these programs or redirecting policy, however, the authors advocate the extension of similar programs to the nonelderly, such as universal health care, as well as more generous provisions for the nonelderly in existing social welfare programs.

Program: Gender Equality and the Economy

Workshop: From Unpaid Work to Employment Guarantee Policy: A Social Accounting Matrix Exercise

This workshop, held April 27–30 at the Levy Institute in Annandale-on-Hudson, New York, dealt with data and methodological issues relating to the research project "Impact of Employment Guarantee Programs on Gender Equality and Pro-Poor Economic Development." This project, coordinated by Research Scholar Rania Antonopoulos and generously supported by the United Nations Development Programme, has two aims.

The first is to create a gender-informed analytical model that makes transparent the linkages between unpaid work and the monetized parts of the economy, based on a Social Accounting Matrix (SAM) incorporating unpaid work from time-use surveys. In this, it extends the earlier pioneering work of Research Scholar Marzia Fontana. The project's second aim is to make use of this empirical tool in order to assess the impacts of employment guarantee policies on the economy.

The workshop consisted of presentations and discussions for the pilot case studies of South Africa and a village in the state of Gujarat, India, in connection with three areas: (1) desired features of a gender-aware SAM structure, (2) combining time-use data with other survey data, and (3) modeling and simulations. The choice of these pilot studies has been based on the fact that both governments have current budgetary commitments for public guaranteed employment schemes, under the Expanded Public Works Programmes in South Africa and the National Rural Employment Guarantee Act in India.

In addition to Antonopoulos and Fontana, participants included Cecilia Punt, team leader of the Provincial Decision-making Enabling (PROVIDE) SAM model, Western Cape Department of Agriculture, South Africa; Kalie Pauw, formerly senior researcher at the Western Cape Department of Agriculture; Olagoke Akintola, an expert on the social impacts of HIV/AIDS home-based care in South Africa; M. R. Saluja, an expert in input-output techniques and social accounting matrices; Research Associate Indira Hirway, director of the Centre for Development Alternatives, Ahmedabad, India, who has written extensively on both time use and employment guarantee schemes in India; Rudi von Arnim of the New School for Social Research, who has considerable experience with SAMs and structural computable general equilibrium models; and Taun Toay, a research assistant to the project. Dimitri B. Papadimitriou, President of the Levy Institute, and Haider Khan of the University of Denver attended in an advisory capacity. The workshop proposed a gendered SAM, with household and production classifications suitable for examining a set of employment-based interventions and the distributional implications of such interventions by gender, income level, and urban/rural sector, as well as the indirect, "multiplier" effects resulting from newly created paid employment.

State, Difference, and Diversity: Toward a Path of Expanded Democracy and Gender Equality

RANIA ANTONOPOULOS and FRANCISCO COS-MONTIEL

Working Paper No. 493, March 2007

www.levy.org/pubs/wp_493.pdf

Statehood in its liberal democratic form is built upon the notion that all citizens must be treated equally, according to identical values and principles. Diversity of citizens, however, requires the acknowledgment of differences. Research Scholar Rania Antonopoulos and Francisco Cos-Montiel, The London School of Economics, review the role of the state in promoting policies of equality within the context of acknowledging diversity among its citizens. A crucial step by the government, they say, is to construct public investments and economic policies that diminish unpaid work obligations for women, and to create employment for citizens who cannot find work.

The authors note that liberal democratic states should safeguard individual freedoms and uphold political and legal rights, and that they should not interfere in the private sphere so that individual choices reveal private preferences. However, they also note that the strengthening of political rights in Latin America has taken place alongside serious economic and social problems, with concurrent deficits in civil and social citizenship (e.g., educational disparities between social groups). They further note that policy intervention will depend upon differences that are interpreted as either individual or group concerns.

Immediately following the Great Depression, the central role of the modern liberal state over a citizen's life cycle reconciled market functions and social cohesion in three domains: (1) the entitlement of public provisioning in terms of basic needs (e.g., education and health care); (2) the provision of countercyclical economic stabilization policies; and (3) the augmentation of social protection programs and the provision of jobs. This role provided a framework for the state to enable individuals to pursue economic goals, while protecting group interests. Government policies shaped by political and economic ideas in the 1980s and 1990s, however, combined with the reduced role of the state, perpetuated social exclusion. Although some groups were net gainers, the majority lagged behind (e.g., Latin America has one of the highest levels of social and economic inequality in the world). In order to counter deeply rooted inequalities and enhance social citizenship, there need to be redistribution policies relating to resources, entitlements, budgets, and political power.

Antonopoulos and Cos-Montiel recommend that liberal democratic states move away from neoliberal policies and bridge the gap between the agendas of citizens and political parties in order to address the needs of disenfranchised groups. In terms of women in Latin America, the issues relate to violence, health, education, employment, the indigenous population, political representation, and inheritance rights. The authors note that gender identities and gender-based inequalities are socially constructed. An important aspect of the politics of inclusion is to trace the distinct asymmetries between women (e.g., race, ethnicity, economic status, and cultural group) and analyze how those asymmetries impede diverse groups of women from being treated as full citizens.

What turns gender diversity into inequality? One specific area of importance is social reproduction, which includes unpaid, undervalued, and unprotected work (e.g., household maintenance, child care, and family health care). The authors suggest that the liberal democratic state promotes social inclusion and citizenship, and addresses gender-based inequalities, in two policy areas: budgetary allocations that reduce time burdens for women, and public employment guarantee policies.

Economic policy based on the belief that markets alone will generate high growth rates and employment levels has not resulted in these expected outcomes. Hence, there should be a renewed emphasis on public investment combined with monitoring its success in terms of the growth rate of employment and income for the lowest quintile, and the fulfillment of basic needs based on personal income as well as the money equivalent of public goods and services. From a pro-poor, gender perspective, two simultaneous public policies should be infrastructure investment that alleviates time burdens for women, and permanent public employment guarantee programs (e.g., the National Rural Employment Guarantee Act in India).

Gender Inequalities in Allocating Time to Paid and Unpaid Work: Evidence from Bolivia

MARCELO MEDEIROS, RAFAEL GUERREIRO OSÓRIO, and JOANA COSTA

Working Paper No. 495, April 2007

www.levy.org/pubs/wp_495.pdf

The sexual division of labor in Bolivia is characterized by differences in the duration of paid and unpaid work shifts. This observation emanates from a study by Marcelo Medeiros, International Poverty Centre and Cambridge University, and Rafael Guerreiro Osório and Joana Costa, International Poverty Centre and University of Brasília. The authors examine the urban population in Bolivia where more than two-thirds of the adult female population have a paid job and most men engage in some domestic work. They find, however, that women work more than men and tend to incur double work shifts and "time deprivation." Despite the gender-based division of labor, there is much within-group inequality in time allocation as a consequence of other factors.

The study is based on the 2001 Bolivian general household survey by the Instituto Nacional de Estadistica and expands upon a paper presented at a Levy Institute/UNDP global conference on unpaid work and the economy in 2005. The authors note that the classification of "domestic work" (unpaid work for a family's own consumption) and "work for production of goods and services" (paid, market-oriented work) is somewhat arbitrary because domestic work may involve the production of goods and services. They also note data limitations for tackling issues such as child and farm labor, and community work. Time use is based on two important benchmarks: the total time available in one week, and the maximum time available for work in one week (98 hours). The authors impose a ceiling of 112 hours per week for both paid and unpaid labor time. Adults included in the study were between the ages of 20 and 59.

The authors find that adults spend about one-third of their time working as market-oriented paid labor (33.6 hours per week) or unpaid domestic labor (22.7 hours per week). On average, more Bolivians are engaged in unpaid work, but for less time, and women work 10 hours more per week than men. According to the Lorenz curve, the cumulative workload of women is always higher than that of men: there is a four-hour gap, which tends to increase with the share of the population. The average Bolivian woman commits 26 hours per week to paid labor and 35 hours per week to unpaid labor, whereas the average Bolivian man commits 42 hours per week to paid labor and 9 hours per week to unpaid labor. The duration of the shifts of unpaid work is the principle factor that influences the gender inequality in workloads, followed by the incidence and the intensity of paid work.

The study finds high within-group inequalities in the distribution of time allocated to paid and unpaid labor for both men and women. Time in paid labor is most unequal among women, while time in unpaid labor is most unequal among men. Almost 40 percent of women do not take part in the labor market and many have only part-time jobs. About one-fifth of men do not engage in any unpaid work, and men reduce their unpaid work shifts due to paid work. The Lorenz curves for the distribution of total work time for men and women have a similar shape because of the partial trade-off between paid and unpaid work. Since the substitution of activities is not complete, there is a gender gap in the total workload, which is consistent with findings in other countries.

Besides gender, time allocation is influenced by other dimensions of social stratification. Using the Theil-T index, the authors find that 34 and 6 percent of total time inequality in unpaid and paid work, respectively, is due to net differences in the allocation of time between men and women. Within-group differences, therefore, are more important than gender in explaining overall inequality in the allocation of total work time. Unpaid and paid work time among women account for 43 and 57 percent of total inequality, respectively. Inequalities are likely to be related to the demographic composition of families and class structure.

The authors note that 34 percent of total inequality in unpaid work time accounted for by gender is a very high share for a single variable in a binary division of the population. They also note that, although gender accounts for a small share of total inequality, the consequences of gender differences for total time allocation is not negligible (i.e., the difference between women and men is 10 hours per week). They further note that their decomposition analysis does not account for several variables that could affect time allocation.

Gender Disparities in Employment and Aggregate Profitability in the United States

MELISSA MAHONEY and AJIT ZACHARIAS
Working Paper No. 496, April 2007
www.levy.org/pubs/wp_496.pdf

The empirical work on aggregate profitability often neglects the potential macroeconomic effects of gender relations. Research Assistant Melissa Mahoney, New School for Social Research, New York City, and Senior Scholar Ajit Zacharias investigate the importance of gender disparity in pay and the feminization of employment on aggregate profitability in the United States. They find that the decline in the share of labor in national income played a much more important role in the profitability boom during the 1980s and 1990s compared to the boom during the 1950s and 1960s. The growing incorporation of women into market work during the 1982–97 period contributed to the decline in the aggregate wage share and thereby played a role in sustaining the rise in the profit rate. The overwhelming bulk of the decline was attributed to distributional shifts within the major sectors of the private economy; in particular, the durable goods manufacturing sector.

The authors use a decomposition methodology to separate the effects of gender wage disparity and the female share of employment on the labor share and the general rate of profits. They employ gross and net profit rates, and find that both measures result in similar figures. There were two distinct periods of sustained growth in profitability: 1958–66 (the "golden age") and 1982–97 (the "leaden age"). The driving force behind the rise in profitability in both periods was the rising ratio of wages to capital (more than 6 percentage points). However, there was a stark difference in the contribution of the profit-wage ratio between the two ages (0.05 versus 3.81 percentage points). A fundamental shift had occurred in the social and political arrangements governing the distribution of productivity gains between capital and labor, apparently in favor of capital.

Mahoney and Zacharias assess the gender effects of pay disparity and share of employment on the changing functional distribution of income and rising profitability during the leaden age. The surge in profitability was associated with a marked decline in the wage share. The authors disaggregate the National Income and Product Accounts (NIPA) of employee compensation and hours of work by sex by estimating the gender components of the variables from the Annual Demographic Supplement (ADS) of the Current Population Survey. They note that using the ADS proportions to split the NIPA compensation data by sex may overestimate the share of women in total compensation. They find that there was some substitution of female for male labor at the aggregate level during the leaden age, as supported by notable growth in the female share of employment and aggregate hours worked. Nevertheless, the narrowing gap between female and male hourly compensation rates and the rise in gender pay parity did not prevent a decline in the wage share, nor did it pose a threat to the overall increase in profitability.

The authors analyze whether the decline in the manufacturing sector and the rise of the services sector accounted for the decline in the aggregate wage share between 1982 and 1997. They find that the change in the sectoral composition of output contributed only 10 percent of the decline, while sectoral wage shares contributed 90 percent. The authors dismiss the possibility that the decline stemmed from either changes in the degree of feminization or the distributional shifts within the sectors where women accounted for the majority of hours worked (e.g., finance, insurance, real estate, and services).

Female Land Rights, Crop Specialization, and Productivity in Paraguayan Agriculture

THOMAS MASTERSON

Working Paper No. 504, July 2007

www.levy.org/pubs/wp_504.pdf

Land rights for women is a key determinant of welfare in rural settings throughout the developing world. Research Scholar Thomas Masterson seeks to answer the question, Why do Paraguayan farms with female land rights have lower farm income? He relates crop specialization, crop yields, and productivity to measures of women's land rights and finds further evidence that women are disadvantaged in terms of agricultural income. Women tend to have lower net farm incomes, lower net farm incomes per hectare, and lower rates of return on assets. The explanations, however, remain elusive.

The author uses the MECOVI Living Standards Measurement Survey for the period September 2000 to August 2001. Although the survey is the first to include data on ownership of land by individuals in Paraguay, where the impact of women's land rights can be assessed directly, plot-level data on ownership is not available, and there is no way to determine independent control over land.

Paraguayan women have land rights in only 12 percent of rural owner-operated farms, operate farms less than half the size of the average farm, and generate one-half the overall average net farm income. In terms of net farm income per hectare, however, farms with female land rights are 62 percent above the overall average. The author tries to explain why Paraguayan farms with female land rights have lower farm incomes by testing the hypothesis that productivity differences cannot be the factor responsible for this result.

Masterson reviews the literature on the intersection of gender and agricultural productivity and discusses two crucial methodologies related to measuring women's land rights and productivity. He notes a wide body of literature focusing on the impacts of gender discrimination on women's access to resources in general and to inputs into agricultural production. Effective women's land rights require legal ownership of land by women, societal recognition of ownership, and effective control by women over the land that they own. Since there is a lack of data associated with these requirements, studies that assess the impact of gender have to use measures that are less than satisfactory. An ongoing problem is that household work is not valued, which implies a bias against women in productivity measurements—for example, the total agricultural household production related to female-headed and small (farm) households.

The author investigates crop specialization and patterns by three gender variables: female household head, female ownership, and female management. Crop yields are then tested on the gender variables to see if women have a productivity advantage in the crops that they grow versus the crops that men grow. He finds no significant differences by gender at the level of individual crops among farms. He also finds that female-headed households and households with female land rights are less likely to sow both food and cash crops than male-headed households (women concentrate more on livestock and associated byproducts). When women hold positions of greater importance than men in rural Paraguayan farm households, the emphasis on production is food rather than cash crops. The overall picture of agricultural ownership, production, and income shows clear patterns along gender lines, but there is no evidence of gender differentiation in crop yields.

Masterson uses two measures of productivity to determine if differences in overall productivity can explain lower farm incomes for households with female land rights: land productivity and the rate of return on assets. Households with female land rights are significantly worse off than those in other ownership categories in terms of the rate-of-return measures. He surmises that something related to ownership of land is a barrier to women earning higher incomes from farming activities. Inadequate farming skills, however, is not the explanation. Perhaps lack of control over land rather than its ownership is the cause of the disparity in incomes, he says.

The results suggest that further studies should focus on animal husbandry in the rural sector and that there should be more information about ownership by plot, decision-making by activity and plot, and production costs and their allocation among different activities and plot. In addition, there should be more cross-country studies, since context is crucial to understanding the gender dimensions of agricultural productivity.

Program: Employment Policy and Labor Markets

Employment Guarantee Programs: A Survey of Theories and Policy Experiences

FADHEL KABOUB

Working Paper No. 498, May 2007

www.levy.org/pubs/wp_498.pdf

Capitalist economies lack an inherent mechanism to create full employment, and the worst episode of the capitalist system's failure was the Great Depression. Fadhel Kaboub, Drew University, Madison, New Jersey, surveys the theoretical underpinnings for various employment guarantee schemes, and the full employment policy experiences in the United States, Sweden, Argentina, India, and France. He finds that the greatest obstacles to maintaining full employment in capitalist societies are business opposition, labor disorganization, lack of political support, and misunderstanding of the working of government finances. He also finds that employer-of-last-resort (ELR) schemes can deliver high employment levels, without inducing accelerating inflation, and that their benefits far outweigh their costs.

Neoclassical economists consider unemployment to be a transitory phenomenon. They argue that government should not only avoid interfering with the labor market but also reduce federal spending and encourage downward wage flexibility. Policymakers came to realize during the Great Depression that laissez-faire economics was not the solution, and that the government had to act as the ELR. In 1933, President Roosevelt introduced the New Deal program, along with public employment agencies. The New Deal was not a true ELR program, since it did not provide an infinitely elastic demand for labor, but it showed that the government could act as an ELR and provide useful jobs that do not compete with the private sector. Full employment and price stability, however, were achieved only during wartime.

Kaboub reviews John H. G. Pierson's economic performance insurance proposal (the government should adopt a policy of guaranteed full employment), John Philip Wernette's full employment standard (the establishment of a Federal Stabilization Board), and Abba Lerner's functional finance theory, which is a taxes-drive-money approach that has been one of the cornerstones of most ELR policy proposals. Kaboub also reviews the Swedish full employment model (highly centralized wage bargaining, active labor market policies, and equitable income distribution), Argentina's Plan Jefes de Hogar, India's National Rural Employment Guarantee Act, and France's professional transition contracts.

According to Hyman P. Minsky, ELR programs can create "an infinitely elastic demand for labor at a floor or minimum wage that does not depend upon long- and short-run profit expectations of business," and government is the only means of creating an infinitely elastic demand for labor. Building on Lerner's functional finance theory, ELR proponents argue that the size of the national deficit and debt to maintain full employment is irrelevant. Tax payments do not and cannot finance government spending because at the aggregate level, only government can be the "net" supplier of fiat money.

Kaboub notes that an ELR can provide a systematic preventative program to minimize the effects of structural and technological change, which is a constant feature of capitalist economies. In response to ELR critics who suggest that there is the threat of inflation, he also notes that full employment is guaranteed regardless of the level of aggregate demand and that an ELR program is financed like other government programs (by crediting bank accounts), so ELR spending will simply increase bank reserves. Moreover, the cost of financing an ELR scheme relative to GDP is too small to be considered inflationary.

ELR-led Economic Development: A Plan for Tunisia

FADHEL KABOUB

Working Paper No. 499, May 2007

www.levy.org/pubs/wp_499.pdf

A summary of this working paper appears in Session 3 of the write-up for the conference on employment guarantee policies in the Winter 2007 *Summary*, Vol. 16, No. 1, page 25.

Implementation of the National Rural Employment Guarantee Act in India: Spatial Dimensions and Fiscal Implications

PINAKI CHAKRABORTY

Working Paper No. 505, July 2007

www.levy.org/pubs/wp_505.pdf

The National Rural Employment Guarantee Act (NREGA) in India (2005) goes beyond poverty alleviation and recognizes employment as a legal right. Research Associate Pinaki Chakraborty, National Institute of Public Finance and Policy, New Delhi, India, reviews the Act and finds formidable challenges in implementation and insufficient institutional arrangements for poorer states. There is an urgent need for both vertical and horizontal coordination across levels of state government, he says, including the need for defining roles and responsibilities, capacity building of agencies at the Panchayat (local council) level, and training.

The paper highlights the implementation and performance differentials between states and examines the budgetary incidence and spatial dimensions of the Act. Chakraborty notes the various provisions of the NREGA (e.g., 100 days of guaranteed wage employment per year at a wage rate specified by the state government) and its liaison with the National and State Employment Guarantee Funds. The structure of authority for implementing and monitoring the NREGA indicates that a coordinated approach by the different tiers of government, along with vertical and horizontal coordination, is critical if the NREGA is to be successful.

The enactment of the NREGA was appropriate and timely in light of the slowdown in the growth rate of employment, the sharp cutback in public spending on rural employment programs, and inadequate wage rates to counter income poverty. The applicable wage rate is of paramount importance, as it should provide livelihood security yet not be significantly higher than the market wage rate. The NREGA offers a statutory minimum wage rate for agricultural laborers that is much lower than the market wage rate in many states.

Individual state governments have to evolve a well-coordinated approach to equate supply of employment with demand or they risk payment of unemployment allowances without contributions from the central government. This requires in-depth understanding of labor demand by region in order to satisfy a demand-based scheme of projects. There is a need, therefore, to strengthen institutional structures at the local level so that resources can be used optimally. A clear mechanism for the release of funds in response to demand rather than through the normal bureaucratic channels is needed, says Chakraborty. Since the capacity to formulate the Annual Work Plan and Budget Proposal is low in poorer states, actual release of funds may fall far short of potential demand for funds.

The NREGA has been implemented in more than 200 backward districts in 27 states; the majority of these districts are concentrated in seven rural states that rank low in socioeconomic development and high in poverty. Chakraborty notes a number of constraints (e.g., nonexistent or nonfunctioning Panchayats in some districts) that affect the design and implementation of the NREGA. He also notes that NREGA enrollment as a percentage of rural households varies widely across states, and that the fund utilization ratio remains low, particularly in the poorer states (i.e., only half of the total available funds were used during the first year). The states that were better at assessing demand obtained more resources. He further notes that direct expenditures on rural employment represented only 0.33 percent of GDP in 2006–07, even after the introduction of the NREGA program.

The author recommends that the rural local bodies, particularly the village Panchayats, engage in demand-based budgeting, advance planning to offer work on demand, capacity building, and holistic and intersectoral planning of projects to avoid duplication (convergence of asset creation and management).

Program: Immigration, Ethnicity, and Social Structure

Surveying American Jews and Their Views on Middle East Politics: The Current Situation and a Proposal for a New Approach

JOEL PERLMANN

Working Paper No. 497, May 2007

www.levy.org/pubs/wp_497.pdf

Senior Scholar Joel Perlmann addresses two issues related to American Jewish opinion surveys. One involves choosing a definition of a Jew that is likely to reflect the complexities and various shades of American Jewish opinion on Israel and the Middle East. The other is designing a survey that, while representative, avoids the huge costs associated with a random-sample survey. The author notes that intermarriage has resulted in a majority of young Jewish Americans of today having one Jewish-born parent, and for whom Jewishness is one among many other ethnic and religious identities. Existing surveys of American Jews do not fully reveal such a multifaceted identity. Such surveys are of two types: those conducted by local Jewish communities, and the more costly random surveys. Perlmann asserts that the former are of uneven quality because of differences in funding and expertise, that they cover limited regions, and that areas outside the major cities receive insufficient coverage. The National Jewish Population Survey (NJPS) includes in its sample anyone born to a Jewish parent, or anyone who chose to join the Jewish people. Since there is evidence that many who think of themselves as Jews are not religiously observant, the NJPS is a truncated survey. The national American Jewish Identity Survey (AJIS) specifically accounts for the underrepresentation of secular Jews in the NJPS by including those who regard themselves as Jews but who are not observant.

Perlmann argues that the absence of hard questions about the diversity of American Jewish opinion on Israeli foreign policy and American Middle East policy are particularly significant shortcomings of the existing surveys. He suggests that a good guide is the monthly polling of the Israeli population by the Center for Peace Studies at the University of Tel Aviv, which does not shrink from reporting both the rise and fall of its monthly "Peace Index," which is based on both Jewish and Arab opinion. He further proposes to combine the strengths of the NJPS, the Peace Index, and the U.S. Population Survey. The government's survey adds new subsamples of the population to a panel of respondents each month and rotates out older subsamples after 18 months. Adopting its method for a Jewish opinion survey has some advantages. The huge screening out of the non-Jewish population—98 percent of the population total—is spread out over time, since the survey requires a much smaller number of new respondents after the first year. Another is that keeping the respondents on the panel over a period of months allows sampling of their political outlooks as conditions change. Perlmann concludes by recommending that such a survey be based in an academic center rather than a local community to enhance its authority.

Two National Surveys of American Jews, 2000–01: A Comparison of the NJPS and AJIS

JOEL PERLMANN

Working Paper No. 501, May 2007
www.levy.org/pubs/wp_501.pdf

Senior Scholar Joel Perlmann compares two national surveys of American Jews, the National Jewish Population Survey (NJPS) and the American Jewish Identity Survey (AJIS), to highlight the problems they reveal in understanding the American Jewish identity, and the survey modifications needed to resolve them.

Both surveys cover 2000–01 and are based on the same four screening questions: What is your religion, if any? Was your mother or father Jewish? Were you raised Jewish? Do you consider yourself Jewish for any reason? The author notes that the NJPS does not include anyone on the basis of the fourth screening question alone; therefore, respondents answering "yes" to this question should be excluded from the AJIS to allow comparison between the two surveys. Given this, the samples generally agree on the basic demographic features and education of the respondents and measures of cultural orientation (e.g., political party support or attachment to Israel). The most notable difference between them is a strikingly higher proportion of households with a total annual income of above $100,000 a year in the AJIS. Perlmann's examination of economic data from the 2004 General Social Survey shows it to be decidedly closer to the AJIS data. Another difference is that the proportion of people regarding themselves as Jewish by religion is notably higher in the NJPS than in the AJIS.

The single most important insight of these surveys is the demonstration of the high rate of Jewish intermarriages since 1970; in both samples, a large fraction of those interviewed classified themselves as having only one Jewish parent. In the NJPS, respondents were given a choice of two classifications, those having one Jewish parent and those having two, while the AJIS included a third classification, that of "other" (e.g., those who converted to Judaism). Perlmann's comparison between the two surveys has to ignore this difference, although he finds that the excluded group is more similar to that reporting one Jewish-born parent. Indeed, the AJIS includes more people of Jewish origin who do not identify themselves as Jewish by religion. The author concludes that it is important for capturing the diversity of American Jewish opinion that all respondents who did not declare themselves Jewish by religion be asked whether they consider themselves Jewish in any way.

Program: Economic Policy for the 21st Century

Explorations in Theory and Empirical Analysis

Are the Costs of the Business Cycle "Trivially Small"? Lucas's Calculus of Hardship and Chooser-dependent, Non–Expected Utility Preferences

GREG HANNSGEN

Working Paper No. 492, March 2007

www.levy.org/pubs/wp_492.pdf

In his presidential address to the American Economic Association in 2003, New Classical economist Robert E. Lucas made an astounding claim. He argued that the costs of the business cycle to U.S. residents amounted to the equivalent of only 0.05 percent of U.S. consumption. In a new working paper, Research Scholar Greg Hannsgen looks at this claim from the perspective of social economics.

What exactly did Lucas mean when he said that the "costs" of the business cycle were so small? Lucas was looking at the economy as if it were made up of one individual who consumes the same amount as the average U.S. consumer. He assumed a particular utility function (which gives consumer satisfaction or utility as a function of the amount of consumption) that he then used to calculate the utility of his hypothetical consumer using actual data on per capita consumption. Next, he compared this figure with the utility of the same consumer under the assumption that consumption follows a steady upward trend rather than fluctuating with the business cycle. For Lucas, the costs of the business cycle equal the percentage increase in the actual consumption amounts that would be required to bring utility up to the level it would have achieved if consumption had in fact followed the steady, nonfluctuating upward path.

Hannsgen examines the validity of using a consumer utility function—normally used to study the behavior of individual private consumers—to make inferences about the appropriate priorities of public officials (e.g., whether taming the cycle is an important goal). To analyze this issue, he borrows from another Nobel laureate, Amartya Sen, the concept of "chooser dependent" preferences. The idea can be explained with an example used by Sen in a 1997 article. Suppose you were eating dinner at a friend's house, and you were offered a choice of two slices of cake from a plate. From the perspective of your own hunger, you might prefer the larger slice. Indeed, if the host were serving the slices, you might hope to be given the largest. But you might not select the larger piece off the plate, simply out of courtesy to the host and to avoid appearing "grabby." So which slice of cake you wind up with might depend on whether you or the host were making the choice.

It is not a huge leap from this example (and, indeed, Sen makes the same point in his article) to the notion that consumers might feel differently about choices they make for themselves and those made by policymakers. Hannsgen offers two leading arguments along these lines: (1) that policymakers might have "fiduciary" duties to avoid imposing risk on others; and 2) consumers might resent fluctuations in consumption more when they do not have some control over them, as they do when making personal decisions about saving or spending.

A Simplified "Benchmark" Stock-flow Consistent (SFC) Post-Keynesian Growth Model

CLAUDIO H. DOS SANTOS and GENNARO ZEZZA

Working Paper No. 503, June 2007

www.levy.org/pubs/wp/503.pdf

Research Scholar Claudio H. Dos Santos of the Institute for Applied Economic Research, Ministry of Planning, Brazil, and Research Scholar Gennaro Zezza of the University of Cassino, Italy, present a new version of Working Paper no. 421 (see Fall 2005 *Summary*, pp. 33–34). Their simplified Post-Keynesian stock-flow consistent (SFC) growth model is designed to shed light on more complex heterodox SFC models; particularly, to understand how Post-Keynesians have conceptualized dynamic trajectories of real economies within the context of the role of financial markets (notably stock and credit markets) in determining the demand price for capital goods and the financing of investment decisions.

The authors believe that modeling stock-flow relations provides a natural (and rigorous) link between short-term periods, and that the SFC approach allows for a natural integration of short and long periods. It is important, however, to understand correctly the dynamics of short-term balance sheets. Their model is outlined in the short run in terms of aggregated assets and liabilities for four institutional sectors (households, firms, banks, and government) and various simplifying theoretical assumptions (e.g., all transactions are paid with bank checks; households do not get bank loans and keep their wealth in bank deposits and equities). Firm financing is important because the Modigliani-Miller theorem does not hold in their model construct.

The authors note that investment expenditures in physical capital by firms imply a change in financial or capital assets and are therefore capital transactions. They stress the idea that firms buy their capital goods from themselves, which is an obvious feature in the real world. They proceed to outline "current" transactions and flows of funds in an artificial economy that is familiar to most macroeconomists in the broad Post-Keynesian tradition. Banks play a crucial role in ensuring that the interrelated balance sheet changes are mutually consistent. The authors close their model with familiar Keynes/Kalecki hypotheses.

The main goal is to provide a benchmark that will facilitate discussion among economists of various Post-Keynesian and related traditions. In most cases, the model converges to a long-run equilibrium, where stock ratios are constant for given interest rates and imply steady growth. The long-term steady-state condition of the model is the point at which all stocks and flows are growing at the capital stock growth rate and the equilibrium conditions are used to assess the model's response to shocks—for example, a standard Keynesian shock to government expenditures (deficits), where the major long-run effects operate through the multiplier-accelerator effect. A second-order effect is obtained through a change in the composition of wealth. Models that neglect this effect will underestimate the impact on growth of expansionary fiscal policy.

The authors concur that Keynes's long-term equilibrium is nothing more than a useful ceteris paribus view of where an economy is heading at any given point in time. Nevertheless, analyzing the properties of the long-term equilibrium has important normative implications because it reveals the characteristics of internally consistent dynamical trajectories and sheds light on what will have to happen in true historical time (and whether parameters will have to change to prevent certain outcomes). The authors note that achieving the ideal approach championed by Peter Skott and Wynne Godley is extremely difficult. Addressing the nature of disappointed expectations in the context of formal models of "complete" monetary economies requires very complex constructs with a large number of variables (and reaction functions) that are often without clear empirical counterparts.

The most controversial issue in the current heterodox debate on macrodynamics is the assumption that the economy tends to some sort of "normal capacity utilization" in the long run. The authors simplify and extend the Godley–Marc Lavoie (GL) model in order to get long-term results and to discuss fiscal and monetary policies. Since they have no significant methodological differences with GL, the authors focus on why it is so difficult to understand the nature and dynamics of GL's long-term equilibria. The differences between the models relate to the feedbacks from financial markets to growth, which are simplified in order to achieve analytically tractable long-run solutions. The authors conclude that understanding the dynamics of (normalized) balance sheets and the nature of long-term equilibria are more useful than conventional wisdom holds.

INSTITUTE NEWS

New Board Member

The Levy Institute is pleased to announce the appointment of BRUCE C. GREENWALD to its Board of Governors. Greenwald is the Robert Heilbrunn Professor of Finance and Asset Management, Columbia University, and academic director of the Heilbrunn Center for Graham & Dodd Investing. A recipient of the Columbia University Presidential Teaching Award for educational excellence, he is an authority on value investing, with additional expertise in productivity and the economics of information.

Greenwald holds M.S. and M.P.A. degrees from Princeton University, and a B.S. and Ph.D. from the Massachusetts Institute of Technology.

New Research Associates

PAVLINA R. TCHERNEVA has joined the Levy Institute as a research associate working in the Employment Policy and Labor Markets program. She is a visiting instructor of economics at Bard College and was formerly associate director for economic analysis at the Center for Full Employment and Price Stability in Kansas City, where she remains senior research scholar. Tcherneva works chiefly on public employment programs and has collaborated with policymakers from Argentina, Bulgaria, Turkey, and other countries. She is co-editor (with M. Forstater) of *Full Employment and Price Stability: The Macroeconomic Vision of William S. Vickrey* (Edward Elgar, 2004). Tcherneva holds a B.A. in economics and mathematics from Gettysburg College and an M.A. in economics from the University of Missouri–Kansas City, where she is a Ph.D. candidate.

FERIDOON KOOHI-KAMALI has joined the Levy Institute as a resident research associate and editor of the *Report* and other publications. He has taught economics at Oxford University, and worked as an economic and financial journalist for a number of years. Koohi-Kamali's broad research field is consumption and analysis of the household budget in developing economies, including topics such as welfare, poverty, and demographics; gender bias and expenditure patterns; price behaviors in tight food markets; and consumption in war economies. He holds a D.Phil. in economics from Oxford University.

Event

Economists for Peace and Security Conference

War and Poverty, Peace and Prosperity

The first stand-alone conference hosted by Economists for Peace and Security (EPS) in over ten years was held at the Levy Institute May 30–June 1, 2007. The conference brought together international leaders in economic thinking, as well as policy analysts, scholars, entrepreneurs, media, and citizens from diverse viewpoints, to present research findings and exchange views.

Economic issues of security are often narrowly understood as pertaining to the military, police, and other state security services. These are legitimate topics, but they offer a restricted view of the causes and consequences of conflict and of possible ways to prevent or end it. At its broadest, security can be defined as freedom from pervasive threats to people's rights, safety, or lives, involving both protection for people from violent threats, such as organized conflict, gross violations of human rights, terrorism, and violent crime; and safety from nonviolent threats, such as environmental degradation, economic crises, illicit drugs, infectious diseases, and natural disasters.

Some of the questions addressed included: What are the economic conditions that guarantee a secure population? How do monetary policy, full employment, investment in infrastructure, and poverty reduction measures contribute to creating lives that people have reason to value? How can a government provide a peaceful environment for its citizens? Session topics included:

- The Comparative Economics of Global Security;
- Poverty, Conflict, and Agriculture (session co-organized by the Dutch/Flemish Chapter of EPS and the Households in Conflict Network);
- The Economics of Warfare and the Costs of War;
- Rethinking Post–Cold War U.S. Security Policy: What Went Wrong? How Do We Get It Right? (session co-organized by Carl Conetta of the Project on Defense Alternatives);
- Space Economics and the Diseconomies of Space Weapons (session sponsored by the Arsenault Family Foundation);
- Avoiding War;
- Constructing Peace in Post-conflict Zones with Innovative and Entrepreneurial Tools (session sponsored by the Ewing Marion Kauffman Foundation); and
- Building a Secure America at Peace

Keynote addresses were delivered by Michael Lind of the New America Foundation, Linda Bilmes of the Kennedy School of Government, Harvard University, and Barbara Bergmann, emerita of American University and the University of Maryland.

For additional information, contact EPS via its website (www.epsusa.org) or e-mail its executive director, Thea Harvey (theaharvey@epsusa.org).

Publications and Presentations by Levy Institute Scholars

RANIA ANTONOPOULOS *Research Scholar*

Publication: Commentary on "Differing Prospects for Women and Men: Young Old-Age, Old Old-Age, and Eldercare" by L. B. Shaw, in *Government Spending on the Elderly*, D. B. Papadimitriou, ed., Houndmills, Basingstoke, Hampshire, U.K., and New York: Palgrave Macmillan, 2007.

Presentations: "Macro-Modelling Using Time Use Data," International Seminar on Mainstreaming Time Use Surveys in National Statistical Systems, Centre for Development Alternatives, Goa, India, May 24–25 (presented by M. Saluja); "Estado, Diferencia, Diversidad: Buscando un Camino con Mayor Democracia e Igualdad de Género" (State, Difference, Diversity: Toward a Path of Expanded Democracy and Gender Equality), Seminar on Democracy in Latin America: Contributions to the Debate, Project for Democratic Development in Latin America, United Nations Development Programme, Buenos Aires, May 29 (presented by coauthor F. Cos-Montiel); "Employment Guarantee Policies and Gender," Eighth International Conference on Engendering Macroeconomics and International Economics (GEM-IWG), Bosphorus University, Istanbul, July 20–22.

PHILIP ARESTIS *Senior Scholar*

Publications: *Advances in Monetary Policy and Macroeconomics* (with G. Zezza, ed.), New York: Palgrave Macmillan, 2007; *Aspects of Modern Monetary and Macroeconomic Policies* (with E. Hein and E. Le Heron, eds.), Houndmills, Basingstoke, Hampshire, U.K., and New York: Palgrave Macmillan, 2007; *Economic Growth: New Directions in Theory and Policy* (with M. Baddeley and J. McCombie, eds.), Cheltenham, U.K., and Northampton, Mass.: Edward Elgar Publishing, 2007; "Inflation Targeting: Assessing the Evidence" (with A. Angeriz) and "Credibility of Interest Rate Policies in Eight European Monetary System Countries: An Application of the Markov Regime-Switching of a Bivariate Autoregressive Model" (with K. Mouratidis), in *Issues in Finance and Monetary Policy*, J. McCombie and C. R. Gonzales, eds., New York: Palgrave Macmillan, 2007; ed., *Is There a New Consensus in Macroeconomics?,* Palgrave Macmillan, 2007; "Economic and Monetary Union: The Problematic Nature" (with M. C. Sawyer), *Journal of Financial Transformation*, Vol. 19, No. 1, April; "The Relationship between Capital Stock, Unemployment, and Wages in Nine EMU Countries" (with M. Baddeley and M. C. Sawyer), *Bulletin of Economic Research*, Vol. 59, No. 2, May; "US-Hausmarkt und Zinspolitik" (with E. Karakitsos), *Financial Times Deutschland*, May 7.

Presentations: "Modelling the U.S. Housing Market" (with E. Karakitsos), "Fiscal Policy within the New Consensus Macroeconomics Framework," and "The U.S. Housing Slump and the Consumer" (with E. Karakitsos), 4th International Conference on Developments in Economic Theory and Policy, Institutions, and European Integration, Bilbao, Spain, July 5–6.

JAMES K. GALBRAITH *Senior Scholar*

Publications: "Global Macroeconomics and Global Inequality," in *Global Inequality: Patterns and Explanations,* D. Held and A. Kaya, eds., Cambridge: Polity Press, 2007; "What Is the American Model Really About? Soft Budgets and the Keynesian Revolution," *Industrial and Corporate Change,* Vol. 16, No. 1, February; "What Kind of Economy?" *The Nation*, March 5, 2007; "Economic Inequality and Political Power: A Comparative Analysis of Argentina and Brazil" (with L. Spagnolo and S. Pinto), *Business and Politics* (Berkeley Electronic Press), Vol. 9, No. 1, April.

GREG HANNSGEN *Research Scholar*

Presentations: "Are the Welfare Costs of the Business Cycle 'Trivially Small'? A Critique of Robert Lucas's Calculus of Hardship," Association for Social Economics sessions at the Southwestern Economic Association annual meeting, Albuquerque, New Mexico, March 14–17; "Are the Welfare Costs of the Business Cycle 'Trivially Small'? A Critique of Robert Lucas's Calculus of Hardship," World Congress of Social Economics, Amsterdam, June 7–9.

JAN KREGEL *Senior Scholar*

Presentations: "Strategies for Economic Justice under Globalisation," World Social Forum, Nairobi, January 21–25; "Improving Global Economic Patterns of Growth and Employment," conference on "Sustainable Employment Generation in Developing Countries: Current Constraints and Alternative Strategies," University of Nairobi, January 25–27;

"Explaining Global Imbalances," panel with J. Stiglitz and J. Ocampo, Annual Meeting of the Eastern Economic Association, February 24–26; co-convenor, "Financial Liberalization and Global Governance: The Role of International Entities," Expert Meeting of the Ford Foundation Research Group, Brazilian Institute of Social and Economic Analyses (IBASE), Rio de Janiero, March 19–20; "The Return of Interest in the Minsky Approach to Financial Instability and Possible Applications to Mexico," Independent National University of Mexico (UNAM), Mexico City, May 31; "Development Policy in an Unequal World," workshop on "Policy Perspectives on Growth, Economic Structures, and Poverty Reduction," Tsinghua University, Beijing, June 3–5; "Can Identifying the Causes of Poverty Give Insight into Eliminating Poverty?" conference on "Policy Perspectives on Growth, Economic Structures, and Poverty Reduction," June 7–9; "Growth and Development with Special Reference to Latin America," XVI Cycle of Economic Lectures, Bank of Guatemala, Guatemala City, June 21; "The International Monetary and Financial Outlook," monthly meeting of the Círcolo de Empresarios, Bilbao, Spain, July 5; "Recovering Keynes's Approach to Economic Policy," Fourth International Conference on Developments in Economic Theory and Policy, Special Session on Economic Policy, University of the Basque Country, Bilbao, Spain, July 5–6; "Latin American Financial Crises and Recovery," conference on "A Decade After: Recovery and Adjustment since the East Asian Crisis," Bangkok, July 12–14; "The Crisis of Multilateral Institutions of Global Financial Governance," presented at "Understanding Global Finance, Building International Resistance: A Conference on International Finance, Corporate Globalisation, and Alternatives," Chulalongkorn University, Bangkok, July 15–17; "Employer of Last Resort: An Alternative Path to Development in the Context of MDGs," Eighth International Conference on Engendering Macroeconomics and International Economics (GEM-IWG), Bosphorus University, Istanbul, July 20–22.

THOMAS MASTERSON *Research Scholar*

Presentations: Overview of the Levy Institute Measure of Economic Well-Being (LIMEW), U.S. Social Forum, Atlanta, June 27–July 1; "Female Land Rights, Crop Specialization, and Productivity in Paraguayan Agriculture," Second Meeting of the Society for the Study of Economic Inequality (ECINEQ), Berlin, July 12–14.

DIMITRI B. PAPADIMITRIOU *President*

Publication: "Economic Perspectives on Aging: An Overview," in *Government Spending on the Elderly*, D. B. Papadimitriou, ed., Houndmills, Basingstoke, Hampshire, U.K., and New York: Palgrave Macmillan, 2007.

Presentations: Interview regarding the alternative minimum tax (AMT) with Patrice Hill, *Washington Times*, March; interview regarding Basel II and its impact with Nicholas Rummell, *Financial Week*, April 4; "Full Employment Policy: Theory and Practice," Eighth International Conference on Engendering Macroeconomics and International Economics (GEM-IWG), Bosphorus University, Istanbul, July 20–22.

JOEL PERLMANN *Senior Scholar*

Publication: "Assimilation and Intermarriage" (with M. C. Waters), in *The New Americans,* R. Ueda and M. Waters, eds., Cambridge, Mass.: Harvard University Press, 2007.

Presentation: "The American Jewish Periphery," talk delivered at the Institute for Contemporary Jewry, The Hebrew University of Jerusalem, March 6.

EDWARD N. WOLFF *Senior Scholar*

Publications: "The Transformation of the American Pension System," in *Work Options for Mature Americans,* T. Ghilarducci and J. Turner, eds., Notre Dame, Ind.: University of Notre Dame Press, 2007; "The Retirement Wealth of the Baby Boom Generation," *Journal of Monetary Economics,* Vol. 54, No. 1, January; "Die ausgepresste Mitte: Amerikas Reichen geht es gut," *Die Zeit,* February 15; "Occupational and Industrial Mobility in the United States" (with E. Parrado and A. Caner), *Labour Economics,* Vol. 14, No. 3, June; "The Global Distribution of Household Wealth" (with J. Davies, S. Sandström, and A. Shorrocks), *Poverty in Focus: The Challenge of Inequality,* No. 11, June; "Measures of Technical Change and Structural Change in Services in the U.S.: Was There a Resurgence of Productivity Growth in Services?" *Metroeconomica,* Vol. 58, No. 3, July.

Presentations: "The World Distribution of Household Wealth," seminar at the United Nations Department of Economic and Social Affairs, New York, March 29; "Stagnating Wages and Rising Profits," New School Conference in Memory of David Gordon: A Realistic Growth Policy for Our Times, New School for Social Research, New York, April 13; "The Middle Class Squeeze," Marxist Theory Colloquium, New York University, April 27; "Measures of Technical Change and Structural Change in Services in the U.S.: Was There a Resurgence of Productivity Growth in Services?" Sixteenth International Conference on Input-Output Techniques, Istanbul, July 1–6; "Household Wealth and the Measurement of Economic Well-Being in the United States," Second Meeting of the Society for the Study of Economic Inequality (ECINEQ), Berlin, July 12–14.

AJIT ZACHARIAS *Senior Scholar*
Publication: "Impact of Wealth Inequality on Economic Well-Being" (with E. Wolff), *Challenge*, Vol. 50, No. 4, July–August.
Presentations: "Household Wealth and the Measurement of Economic Well-Being in the United States," The Eastern Economic Association, New York, February 23–25, and Second Meeting of the Society for the Study of Economic Inequality (ECINEQ), Berlin, July 12–14; "Caste, Occupational Status, and Wealth Inequality in India," Second Meeting of the Society for the Study of Economic Inequality (ECINEQ), Berlin, July 12–14.

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