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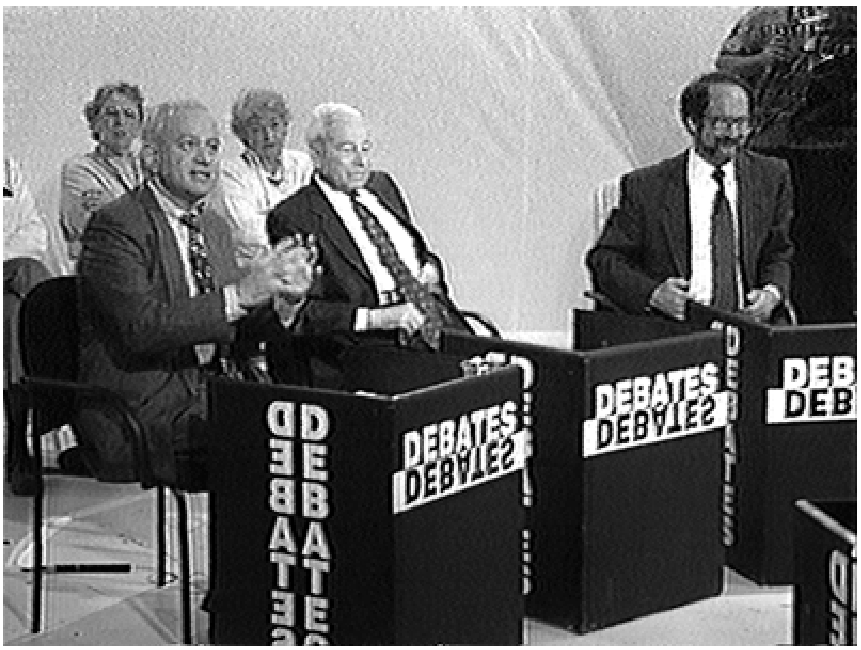

Executive Director Dimitri B. Papadimitriou (left) makes a point during a recent Debates-Debates. *His teamates in the debate about the Dole tax plan are Robert I. Eisner (center), professor of economics at Northwestern University, and Robert L Kuttner (right), co-editor of* The American Prospect.

INSIDE:

A segment of the PBS television program *Debates-Debates* pits Executive Director Dimitri B. Papadimitriou, Robert I. Eisner, and Robert L. Kuttner against Ed Rubenstein, Bruce Bartlett, and Dan Mitchell in a debate about the advisability of the Dole tax plan.

Katherine Newman, a cultural anthropologist and professor of public policy at the Kennedy School of Government at Harvard University, dispels some of the common misperceptions about the working poor and their ability to find work in the inner city.

In his lecture on Japan's financial sector, Eugene R. Dattel, former investment banker and author of *The Sun That Never Rose*, presents the case that the sector suffers not from momentary problems, such as the large losses incurred by Japanese financial institutions, but from systemic flaws.

In a new working paper, Resident Scholar Oren M. Levin-Waldman argues that support of or opposition to the minimum wage is based more on politics than on economic analysis.

Tax proposals designed to induce saving and therefore investment will do neither, argues Resident Scholar Neil H. Buchanan in a new working paper.

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

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Debates-Debates

Tax Cuts: Reducing the Burden or Robin Hood for the Rich?

A recent segment of the PBS television program *Debates-Debates* featured discussion about the advisability of implementing a tax cut. Although the specific topic of debate was the tax plan advocated by Senator Robert Dole during his presidential campaign, the discussion remains relevant because tax restructuring continues to be a hot topic on the political agenda. Those arguing that the Dole plan could work were **Ed Rubenstein**, economics writer for *National Review*; **Bruce Bartlett**, senior fellow at the National Center for Policy Analysis and member of the Treasury Department during the Reagan administration; and **Dan Mitchell**, senior fellow at the Heritage Foundation and moderator of the WNET television program *Mitchell in the Morning*. Those arguing that the plan could not work were **Robert L. Kuttner**, *Business Week* columnist and co-editor of *The American Prospect*; **Robert I. Eisner**, professor of economics at Northwestern University, whose most recent book is *The Misunderstood Economy*; and Levy Institute Executive Director **Dimitri B. Papadimitriou**. Those who favored the plan argued that its tax cuts would raise income levels, stimulate economic growth, and reduce an overly heavy tax burden. Those arguing against the plan asserted that the tax cuts would widen the distribution of income and increase the deficit.

Effect on Income Distribution

Rubenstein expressed his belief that the Dole tax plan was needed to raise income levels, especially those of the poor. He stated that after-tax incomes are lower now than they were at the end of the last recovery and the poor have gotten poorer. During the 1960s and 1980s tax cuts resulted in a rise in the real incomes of the poor; today, nearly seven years after the beginning of the current recovery, those needing help still lag behind.

Kuttner asserted that the tax cuts in the Dole plan would benefit not the poor, but the upper 1 percent of the population. Papadimitriou agreed, stating his belief that the plan is regressive. When the benefits of the capital gains tax are included, the plan is even more highly skewed in favor of those making over $100,000 in average annual earnings. Further, similar cuts enacted in the 1980s resulted in a wider distribution of income, an increase in the debt load from $906 billion to $2.6 trillion, and a decline in the saving rate from 8.2 to 4.8 percent.

When questioned on the tax increases of 1993, Kuttner defended them on distributional grounds, noting that people in the highest income bracket "could not be hurting much," in view of current conditions of rising productivity, a growing stock market, and improving housing values. Kuttner was asked whether imposing high taxes on the rich was the best way to lift the economic condition of the poor. (Rubenstein claimed there is a 52 percent marginal tax rate on the rich, when state and local taxes are included.) Kuttner replied that, given the loopholes in the system, those at the upper boundary of the income scale rarely pay the highest nominal rate, but a progressive graduated tax code is not a solution, merely one policy among many to combat the problem. The weakness of the whole supply-side view is that it assumes that individuals' behavior is determined solely by the tax code. The economy is much more complicated, however.

Papadimitriou was asked to explain why, even though both President Bush and President Clinton raised taxes on the rich, the rich have gotten richer and the poor have gotten poorer. Doesn't that suggest that higher taxes on the rich are not good for the poor? Papadimitriou did not agree, stating that a tax cut implemented while maintaining a balanced budget must necessarily be regressive. If a balanced budget is removed as a condition, it would be possible to cut taxes and target policies at the working poor that would alter the distribution of income.

Rubenstein defended cutting the capital gains tax rate on the grounds that doing so would "unlock a tremendous reservoir of income that is withheld from taxation." Although there is a concentration of wealth, when the rich get richer, the economy grows fast enough so that the benefits of such gains "percolate" to the poor. He asserted that evidence from the 1980s makes it clear that the Dole tax plan would benefit the poor. During that period the bottom 20 percent in the income distribution experienced an increase in their after-tax income, primarily because those who had previously not had a job were able to find work. In addition, the poverty rate in 1989 was lower than the rates in 1982 and 1983.

Mitchell stated that even with the Dole tax cuts, government "would be $200 billion larger in 2002." He asked Papadimitriou whether it was then a bad thing to limit the growth of the government sector to, say, 2 percent per year, even if inflation was rising by 3 percent? Papadimitriou stated his misgivings about these estimates, noting that they were the result of dynamic scoring methods. Of greater concern, however, is the fact that such tax cuts implemented in the past have resulted in a more highly skewed distribution of income and wealth. During the 1980s, for example, tax revenue growth did not outpace income or wealth growth. Moreover, under the Dole plan, taxpayers in the 15 percent tax bracket, for example, would experience a smaller effective tax cut than the plan's 15 percent rate because they would likely lose some benefits of the EITC. Under these circumstances, limiting the size of government would come at the expense of those who would most need government assistance.

Effect on the Deficit

Speaking about the effect of the plan on the deficit, Mitchell asserted that the tax cut could be enacted and the budget still balanced by the year 2002 as long as spending growth is limited to 2.1 percent per year. Moreover, he claimed that tax cuts enacted in the 1920s, 1960s, and 1980s resulted in economic growth, higher employment, and increased revenues, while tax increases enacted in the 1930s and 1970s resulted in subpar economic performance.

Kuttner noted that, given stated intentions to preserve Medicare and Social Security, the tax cut would increase the deficit. Eisner cited Joint Economic Committee estimates that the tax plan would, by the year 2002, increase the deficit by $130 billion per year. He also voiced concern that the economy would be damaged by the degree to which essential programs (such as health, education, research, and welfare-to-work programs) would likely be cut in order to prevent the deficit from skyrocketing in the face of these tax cuts. He also asserted that current rates of output and productivity growth are sufficient to sustain the current level of benefits paid to Social Security and Medicare recipients without raising payroll taxes (assuming the Dole tax cut is not implemented).

Eisner stated that balancing the budget, as the budget is currently measured, should not have a high priority and is potentially dangerous to the poor and middle classes because of the size of spending cuts necessary to achieve balance. When asked whether by spending cuts Eisner meant that spending growth would be restrained, he responded that in a growing economy cutting spending growth means that there is less support for programs for each dollar earned.

Changes in the Tax Burden

Bartlett, speaking about changes in the tax burden resulting from the tax cut, cited government statistics that federal tax revenues as a share of GDP are at their highest level ever (20.8 percent) to support his opinion that the Dole tax cut is not only essential, but, in fact, too moderate. He conceded that the tax burden is lighter in the United States than in most other OECD countries, but noted that the distribution of taxes is different. In almost all of the OECD countries the rates on capital gains and income are lower and the rates on consumption are higher than in the United States. He felt that the current level of capital gains taxes is not adversely affecting the stock market, but is having a detrimental effect on the economy in terms of slower rates of new business formation and venture capital flow. Moreover, despite the fact that job creation has risen, real average weekly wages have been stagnant and at times have fallen under the Clinton administration.

Alternative Policies

Could other policies be enacted that would have a positive effect on economic growth? Papadimitriou asked whether, if economic growth is indeed the intended outcome, it would not be better for the Federal Reserve to reduce interest rates, thereby increasing employment and lowering the servicing costs of the national debt. Mitchell asserted that today's anemic growth has been caused by an oppressive tax system, an intrusive regulatory system, and excessive federal spending, not by monetary policy. The only job of the Fed should be "price stability, zero inflation."

Eisner stated that the debate is not about whether there should be a tax cut, but about what type and size of cut should be implemented. Tax cuts should be targeted toward human capital investment, through better education or training. Such training makes people more productive and business more likely to invest. He agreed with Papadimitriou that monetary policy should be eased.

Rubenstein advocated lowering taxes on the rich, thereby giving them an incentive to invest in productive capital that would increase the productivity of the average worker and sustain an economic recovery.

Kuttner advocated providing tax relief to working families. The Dole plan would increase the deficit, which would lead the Fed to increase interest rates, which, in turn, would slow the economy.

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Lecture Series

RACHEL FRIEDBERG
Russian Jews, Palestinians . . . and Thais: Immigrants, "Guest Workers," and the Undocumented in Israel

Reporting the findings of her recent five-year study, Rachel Friedberg, assistant professor of economics at Brown University, explained how the most recent wave of immigrants to Israelfrom Palestine, Russia, and, most recently, Thailand, Romania, the Philippines, and Africahas affected the growth of the Israeli economy and job opportunities for Israelis. She noted that there has been a dramatic change in the type of workers employed in Israeli agriculture, construction, and many other manual labor jobs. In Israel, as in other countries, there is a fear that immigrants steal jobs from natives or bid down wages because they are willing to work for less and because their large numbers swell the labor supply.

Although Israel was not recognized as a nation until 1948, settlement there by Jews from Europe, motivated by the ideology of Zionism, began during the nineteenth century. There were many types and shades of Zionism. Religious Zionism emphasized settling in the land given to the Jews by God; the goal of socialist Zionism was to establish a truly socialist nation in Israel; and labor Zionism, the branch of Zionism espoused by Israel's founding fathers, sought solutions for what it saw as two major problems in the situation of European Jews: (1) that Jews lacked political self-determination and (2) that Jews were perceived as having become alienated from real physical work and from the land. Friedberg noted that the problems stemmed from Jews' being denied the right to own land. The first Zionist settlements, then, were collective farms (kibbutzim).

Over the decades, as the kibbutzim grew in scale and became richer, the hiring of labor became a hotly debated issue. Some Israelis believed it would be sensible to hire temporary, outside labor at planting or harvesting time, when extra help might be needed. Others, however, thought that the Zionist experiment was over once a kibbutz allowed other people to do its work. Gradually, all but the most dogmatic kibbutzim started to hire outside labor at least occasionally, but the issue still generates tension. The debate over the presence of Arab workers in Israel is an extension of this same issue. In addition, the arrival of large numbers of foreign workers raises the question of what it really means to have a Jewish state.

According to Friedberg, Palestinians entered the Israeli labor market as a result of the 1967 Six-Day War, when Israel gained control of territory in the Golan Heights, the Sinai Peninsula, the Gaza Strip, the West Bank, and East Jerusalem. The Golan Heights was relatively unpopulated, but Gaza and the West Bank had a large Palestinian population. Israeli employers discovered that Palestinians were willing to work for lower wages than Israelis and began to hire them primarily to do manual labor in construction and agricultural jobs. (Generally, Israelis perceive

Palestinian workers in Israel as doing the types of jobs that the Israelis do not want to do. Friedberg stated her belief, however, that it is not the type of work that prevents Israelis from performing these jobs, but the low wages associated with them.) Almost all Palestinians working in Israel are men and typically are hired on a day-to-day basis. In 1994 about 150,000 Palestinian workers from the West Bank and Gaza worked in Israel each day; today, as a result of border closings instituted by Israel, there are about 30,000 such workers in Israel. The closure policy resulted in a shortage of labor, especially in agriculture and construction, and led to the replacement of Palestinians in these jobs by Romanian and Thai immigrants.

Through most of the 1980s about 1,000 people a month immigrated to Israel. At the end of 1989, as a result of the mass immigration of Jews from the former Soviet Union, immigration shot up dramatically. At its peak, 36,000 former Soviets immigrated to Israel in one month. From the beginning of the immigration wave through today, about 250,000 people have immigrated from the former Soviet Union to Israel. Taking this period as a whole, this translates into a 1.4 percent annual rate of population growth due to immigration. Friedberg put this figure in perspective by noting that during the peak of immigration to the United States at the turn of the century, the rate of annual population growth due to immigration was 1 percent, or 40 percent less than the rate of growth experienced by Israel.

Why do the Russians Jews leave the former Soviet Union? Friedberg cited the uncertain economic and political climate there as the reason for migration. Why do they come to Israel? Perhaps not coincidentally, at the same time Jews were being allowed out of the Soviet Union, the United States changed its laws to reduce immigration. Many Russians see Israel as a temporary stop on the road to the United States. This attitude affects how Russians are perceived by Israelis. Israelis feel that the Russians should be more grateful and resent them because "they're not more admiring, they're not Zionists, and they're not particularly Jewish." Russians also are perceived as having brought crime, especially prostitution, to Israel via the Russian mafia. Russian immigrants also are older and more educated than the Israeli population as a whole, which is very unusual in migration flows. Despite this level of education and experience, the average hourly wage of Russian workers is only about half that of Israeli workers, or about 13 sheckels per hour compared to 24 for Israelis. Russians also are less likely to be managers or clerks and are more likely to hold blue-collar jobs. Friedberg noted that the wage gap might close over time for a variety of reasons, for example, as Russian immigrants learn Hebrew or find jobs that better match their skills.

Until 1993 the Israeli government attempted to induce Israelis to fill construction and agricultural job vacancies by, for example, offering wage subsidies to employers and cutting off unemployment benefits to any unemployed Israeli who refused a job in these sectors. However, the labor shortage continued. Under pressure to solve the dilemma, in 1993 the Israeli government began issuing more short-term (one- to two-year) work permits to foreign workers. Prior to this increase, about 6,000 such permits were issued; by 1994 about 72,000 work permits were being issued to foreign workers annually and 200,000 foreign workers were employed in Israel.

Who are these "guest workers"? Guest workers come mainly from Romania, the Philippines, Thailand, and Africa. (Exact figures are difficult to obtain because of the large number of illegal workers.) Romanians typically are male, come without their families, and work in the construction sector. Friedberg contended that because of problems of drunkenness, violence, prostitution, and crime, Romanians are not well regarded by Israelis. Guest workers from the Philippines typically are female and work at service jobs, primarily house cleaning and elder care. They are considered "model citizens" because they do not "cause trouble," and, because a large number of them work in Israeli homes, Philippine workers are not regarded with the same degree of mistrust as Romanian workers are. Thai workers are primarily males who work in agriculture. Often the Thais stay for the course of their permit, return to Thailand, and then return to Israel for another round of employment. The two largest groups of African workers come from Ghana and Nigeria. They typically come as families and are employed as domestic workers in Tel Aviv. Many of these African workers are religious Christians who are well-thought-of by Israelis because of their ideological reason for coming to Israel (as their Holy Land), because they provide good services at much lower wages than Israelis would charge, and because they are "model citizens."

Israel is now facing the same issues other countries with large inflows of immigrants must face: making sure that immigrants pay their fair share of taxes and do not receive an unfair share of benefits from public spending (for example, in the form of schooling and health care).

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Lecture Series

EUGENE R. DATTEL
Cultural Captivity: Japan's Financial Dinosaurs Resist Change

Until 1995 the U.S. media portrayed the Japanese financial sector as robust and growing and often as a scapegoat for problems within the U.S. economy. The United States was described in the media as dependent on Japanese financial institutions (JFIs) due to the large amount of government debt (over $250 billion in U.S. government bonds) held by JFIs. The success of Japan's technology and manufacturing sectors and its anticipated "conquest" of the world's financial sector were attributed to Japanese cultural traits. According to this view, crises experienced in the Japanese financial sector are mere "bubbles," a series of separate and unrelated events, and not symptoms of systemic afflictions. Eugene R. Dattel, former investment banker and author of *The Sun That Never Rose*, disputed the media's representation of Japan's financial sector as free of such afflictions, presenting the case that the sector is far from invincible and suffers not from momentary problems, such as the large losses incurred by JFIs (which could be absorbed by the Japanese economy), but from flaws in the structure of the JFIs.

Moreover, Japanese cultural traits, rather than leading to conquest, may well exacerbate problems within the financial sector due to these structural flaws.

Dattel's contentions run counter to the American perception that Japan's financial sector is invincible. He cited several reasons for the pervasiveness of this common misperception. The media have created images of invincibility based on little or no hard evidence. Their portrayal of JFIs as structurally superior stems from an analogy to the supposed superiority of technology and manufacturing firms. However, unlike technology and manufacturing firmsfirms that must compete internationallyJFIs are not competitive, and the problems associated with such noncompetitiveness are only made worse by the presence of *keiretsu*, groups of interwoven and cooperative Japanese firms.

The media have portrayed recent crises in the Japanese financial sector as aberrations, with their resulting claim that JFIs will emerge triumphant from these crises. Dattel asserted that a triumph is unlikely because the crises are the result of continuing structural flaws.

JFIs' powers are often interpreted as being derived from their size, superior management, and government regulation. Dattel noted that the size of JFIs is the result of the size of the Japanese economy and limits on the number and types of firms allowed to operate. Moreover, economies of scale, a major advantage of large and centrally organized institutions, do not exist in the operation of firms in the financial market.

The systemic structural problems of JFIs cited by Dattel include the rotation system, provincialism, centralization of authority, and a large bureaucracy. In the Japanese rotation system, individuals change jobs within an institution every three years. The system cultivates generalized talents, but prevents the development of the specialized technical and managerial skills necessary for the smooth and efficient operation of a complex organization. The short duration in any one position also eliminates individuals' need to succeed or even perform well, since their responsibility for past mistakes dissolves once they leave one position for another.

The Japanese manufacturing and technology sectors generally purchase or copy necessary expertise from foreigners. However, the provincialism of the Japanese financial sector has prevented it from obtaining such expertise. JFIs are reluctant to go outside their culture and tend to believe that there is no foreign system suitable for them to emulate. The U.S. system is thought to be too rational and uncaring, leaving few alternatives as models for changes in JFI structure.

The centralization of authority in JFIs might be expected to lead to a highly coordinated system. However, JFIs (and the Ministry of Finance, which oversees JFIs) lack adequate risk-monitoring activities and set up departments according to administrative centers rather than profit centers.

Finally, JFIs and the Ministry of Finance suffer from the outgrowths of a highly bureaucratized structure. The lack of accountability removes checks from the system. An absence of critical thinking and a lack of objectivity result in the inability to analyze credit risk. Because the Japanese media portray bureaucrats as talented and public-spirited, no one in Japan questions the actions of the Ministry of Finance, which Dattel contended uses regulation to manipulate the market.

Dattel noted that some of the cultural factors pointed to by the media as reasons for Japanese success in other areas are the very factors that exacerbate problems in the structure of JFIs. Such factors include an isolated culture, an educational process that concentrates on rote memorization rather than analytical or critical thinking, and an avoidance of confrontation. The Japanese culture is such that it does not challenge the existing structure.

Dattel was asked how the manufacturing sector managed to bypass the cultural roadblocks he spoke about and become successful in international markets, while JFIs appeared to be crippled by them. Dattel responded that all parts of the Japanese system are not alike. In manufacturing, for example, an outside focus provides feedback and forces Japanese firms to adapt. In contrast, the Japanese financial sector is isolated and receives no such feedback. According to Dattel, JFIs are inflexible, old-style institutions that have "squandered Japan's economic growth."

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Lecture Series

KATHERINE NEWMAN
The Working Poor in the Inner City

Katherine Newman, professor of public policy,
Kennedy School of Government, Harvard University

In her lecture, Katherine Newman, a cultural anthropologist and professor of public policy at the

Kennedy School of Government at Harvard University, dispelled some of the common mistaken beliefs about the working poor and their ability to find work in the inner city. She reported on her examination of labor markets in the inner city based on a comparative study of New York City (focusing on central Harlem) and Oakland, Californiacities that had a strong manufacturing base that is now deteriorated, were the site of military bases that were progressively shut down, have experienced depopulation, and are surrounded by considerable wealth. Her lecture concentrated on her findings for central Harlem.

Newman found that despite the high incidence of poverty in central Harlem (over 40 percent of households), 67 percent of households have at least one member who works full-time. About one-third of these workers have administrative or professional jobs, another one-third have clerical jobs, one-quarter are employed in the service sector, and one-tenth work in manufacturing. Newman studied workers in the service sector because jobs in this sector have become the gateway to the working world for most people, replacing the manufacturing, military, and public sector jobs that are no longer as available as they once were. Because of the role service jobs now play, an understanding of working poverty and ghetto life in the 1990s depends on studying service sector workers and filling in the gaps in knowledge about job search patterns, job mobility patterns, and the racial ordering of the service sector labor market.

Newman followed employees at eight fast-food restaurantsthe canonical employer of entry-level workers. Her team conducted an intake study of 400 employees. From these, a stratified random sample of 120 was selected for intensive life interviews, including workers' perceptions of the labor market and the racial ordering of the economy. Of the 120, 20 were tracked day-by-day. Each of the 20 also kept a diary from which their perceptions of daily life might be gleaned. Members of the research team spent about four months working in the fast-food industry, assessing the job's necessary skills, interviewing managers, observing promotion patterns, and studying the racial breakdown of workers. An additional studycomparing applicants for fast-food jobs who were rejected during a five-month period (a random sample of 130 from a pool of 300 people) to applicants who succeeded in obtaining a job but had been employed for less than a yearwas conducted to examine possible reasons why people did not obtain employment.

Newman wished to answer four basic questions. First, given that wages are so low, the underground economy so tempting and flourishing, and public assistance so easy to obtain, why would people choose to work at all? She found that work was considered a means of escaping the dangers of the streets and reaching a place of order and structure amidst chaos. There was a strong belief in the value of work and the dignity of being a working person. There also was a compelling sense of responsibility toward the natal family. About half of the working sample took their first job before the age of 15 to handle the marginal costs of their presence in their household. Given the low wages and the fact that some workers had children of their own, workers often could not create an independent household, but could contribute to the central coffer of their natal household. Finally, work was a self-funding financial aid system for those who were trying to stay in school. About half the fast-food workers in central Harlem had high school diplomas, half of the high school graduates were enrolled in some form of posthigh school educational program, and most of those without a high school diploma were enrolled in some type of course work. Entry-level jobs made possible that type of investment in human capital.

The second question addressed by Newman was, How hard is it to obtain a low-wage job and how do workers go about it? Conservatives contend that there are jobs that are easy to come by and have no skill requirement; therefore, if a person does not work, he or she must not want to work. Liberals contend that ghetto unemployment is the result of social isolation, an evaporation of social networks. Is either of these views true? Newman's study of rejected job applicants in central Harlem suggests that it is not too easy to find a job in the inner city.

She found that rejected workers looked hard to find work. About 73 percent were still unemployed one year after they had applied for jobs at fast-food restaurants. Even the youngest among them had applied for four or five other jobs outside of fast food. Moreover, as a group they were experienced workers, having held an average of three jobs in the past. And contrary to the findings of some researchers, these workers' lack of employment was not based on expectations of high wages; Newman found that reservation wages in central Harlem were close to the minimum wage. Rather, lack of employment was the result of there being too many people for too few openings. There were, however, several characteristics that distinguished those who were successful in obtaining employment from those who were not. Hiring owners and managers preferred

Older workers to younger workers

- Workers of almost any race to African American workers (no whites were included in this sample)
- Outsiders (those not living in the immediate neighborhood) to locals (this was true even when holding race, immigration, and human capital constant)
- Workers who knew others already working in the restaurants to workers without such contacts
- Immigrants to natives
- Workers who reported they were not receiving any welfare benefits to those who reported they were receiving any type of aid

Owners gave as a reason for preferring outsiders that friends of employees can cause disruptions when they visit employees. However, the fact that studies of other industries have shown the same preference for hiring nonlocals gave Newman pause. She associates this preference with a phenomenon she calls "the ghetto you don't know," that is, the ghetto an employer does not see somehow looks more appealing than the ghetto in which he or she lives or works. Accordingly, employers and managers exercise preferences excluding people from the immediate neighborhood in favor of others who look the same and have the same skills but come from outside the neighborhood. Newman noted that this phenomenon has implications for policies regarding empowerment zones targeted at employment. The policies establishing these zones should specify exactly who is to be hired because, while such zones may stimulate employment, the jobs may be going to nonlocals.

Newman's third question was, What are the social and cultural consequences of getting a job, particularly for young people? Newman found that a combination of the stigma associated with jobs and increased time demands created both problems and opportunities for working youth. She found that workers are teased and looked down upon by other youth from their neighborhood for wearing a uniform, having to display deference, and earning low wages. To avoid stigmatization, working youth will often commute long hours to work outside their own community.

Time demands may create a sense of order, structure, and purpose for workers that spill over into school and other parts of life. Contrary to much of the school-to-work literature, which argues that work is not good for young people because it disengages them from schooling, Newman found that for most workers from central Harlem, many of whom are not college bound, going to work has major, positive ramifications for their school life and performance.

The twin pressures of stigmatization and time demands cause workers to pull away from nonworking friends in favor of friends from work, so that their social life is increasingly dominated by associations in the workplace. These associations reinforce their identity as a working person and their definition of themselves in terms of the mainstream working world. The tightening of social connections among workers has important consequences, especially for young women from inner city areas, in which out-of-wedlock pregnancy is a large contributing factor to poverty. Women included in her study who became pregnant faced a choice between welfare and work. Newman found that those who chose to terminate their pregnancies did so in order to protect their work status. Most of those who chose single motherhood had a partner who was working.

Newman's fourth question was, Do these low-wage jobs lead anywhere, and, if not, why not? In Newman's study workers were tracked for only 18 months, which is too short a period on which to base answers to this question. Nevertheless, she chronicled the workers' attempts to find better jobs. Most of these attempts fail. The workers who find better jobs are those with no demands by others on their income or time; they can put their earnings toward education or obtaining meaningful credentials. However, most employees working at the low-end of the wage scale have to contribute financially to their household and cannot afford to drop out of the labor force to obtain training. They still attempt to find better jobs, but given the constraints on their time and income and the inability of the social networks linking the working poor to facilitate upward mobility, few are able to procure higher-paying jobs.

Newman concluded by suggesting several directions that policy might take to help the inner city working poor. She advocated creating better networks to facilitate mobility for these workers, such as school-to-work networks. In Japan high school graduates obtain jobs through such school-based networks. She recommended increasing the funding and improving the management of the remaining summer youth jobs programs. These programs could be linked to the private sector labor market, for example, through business improvement districts. She suggested using local employer consortiums to address the problem of job ladders. In such consortiums, minimum-wage jobs would serve as training camps and proving grounds for workers. Employees who proved themselves would be "passed along" to employers who needed workers in better positions. Such a consortium links employers (who have interests and experiences in common and are likely to trust one another's judgments) rather than linking employees (who may have little knowledge about new jobs). It also removes the need for employee contacts in hiring.

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New Working Papers

Selective Migration as a Basis for Upward Mobility? The Occupations of the Jewish Immigrants to the United States, ca. 1900

The upward mobility of Jews who migrated to the United States at the turn of the nineteenth century has been explained as a function of premigrational cultural characteristics (such as a tradition of learning) or premigrational structural attributes (skills in certain industries and occupations that could be applied in the new country). In **Working Paper No. 172**, Levy Institute Senior Scholar **Joel Perlmann** does not discount either of these explanations, but suggests that more attention should be paid to the rapid rate of entry of Jews into trade.

The entry of Jews into trade upon coming to the United States could be explained in several ways; for example, they had prior experience and knowledge garnered while employed in a specific occupation (such as in the garment industry), which provided a background for work in trade, or they had prior experience or knowledge about trade itself. In examining the relative importance to mobility of a background in manufacturing versus in trade, Perlmann finds that Jewish immigrants in manufacturing were overrepresented and those in trade underrepresented compared to the population in the country of origin. Such selectivity will have an effect on the strength of the argument that upward mobility was a result of commercial experience. Perlmann, using immigration data that only recently have become available, examines this selectivity by comparing the occupations of Russian Jewish immigrants to the occupations of the base population from which they came, that is, the Jews in the Russian Pale of Settlement. He uses Russian and U.S. data, focusing on detailed data from the 1897 Russian Census and data on Jewish immigrant arrivals at the Port of New York from 1899 to 1900 and from 1907 to 1908 (now available at the individual immigrant level by country of origin, gender, age, occupation, etc.). Perlmann also considers whether information reported by immigrants was inaccurate due to misunderstandings or deception.

Perlmann finds that Jews who immigrated to the United States from the Pale came primarily from seven provinces and that these provinces had a distinct occupational structure (a greater proportion employed in handicrafts than in commerce) and were experiencing slow economic growth. In addition, immigrants were disproportionately younger than the overall Jewish population from which they came. After adjusting for regional and age variations and making separate comparisons for each gender group, Perlmann finds that although the adjustments reduce the degree to which trade is underrepresented among immigrants (because the percentage of those occupied in trade in the provinces from which most immigrants came was lower than in the Pale as a whole), they cannot explain the remaining degree of underrepresentation among immigrants of those employed in the trade occupations (28 percent in the Pale versus 11 percent of immigrants to the United States).

What, other than selective migration, might explain the variations in occupational representation among immigrants? Did immigrants lie about their occupation upon entry to the United States? Did the method of reporting change from one year to the next? Did immigrants report the occupation they had practiced in their country of origin or the occupation into which they wished to gain entry upon arrival?

To answer these questions, Perlmann first examines the claim that immigrants misreported their occupation. He then takes a closer look at the data; he examines the passenger list data for internal reporting consistency over time, checks the consistency of this source with another source at that time (the U.S. Immigration Commission *Reports)*, and compares the passenger list data to reports on stated occupations among the same population at a later time (the 1910 U.S. Census *Public Use Microdata Samples* [PUMS]). The passenger list data appear to be internally consistent, at least for male occupations. However, the occupational mix taken from the passenger list data does not appear to be consistent with the data of either the Immigration Commission or the Census, while those two sources are more consistent with each other. The Immigration Commission and Census data indicate that Jewish immigrants working in manufacturing in the United States had at least some prior experience in trade in their native country, which lends some credence to the structural idea that the upward mobility of Jewish immigrants in trade was at least in part the result of prior skills in trade itself (rather than that their work in manufacturing provided Jewish immigrants with the basis for entering trade). Perlmann notes that the passenger list data and other data cannot be easily reconciled. A simple way to deal with the disparity would be to assume that the passenger list data are incorrect despite their internal consistency for male immigrants. If this hypothesis is not accepted, the inconsistency of the data sets still requires reconciliation.

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New Working Papers

A Critique of Competing Plans for Radical Tax Restructuring

At almost any time there exists a plan to alter the structure of taxation, and the number of such plans seems to increase during election years. In **Working Paper No. 173**, Resident Scholar **Neil H. Buchanan** analyzes a number of tax proposals in terms of their effects on the budget deficit, on different groups of taxpayers, and on taxpaying households as a whole. He groups the tax plans into three general categories: simplifying payment of income taxes, switching to a national sales tax or value-added system, and altering the current taxation of savings or labor incomes. The tax plans Buchanan examines are the Gephardt plan, the Lugar plan, the USA Tax plan, the Armey-Shelby flat tax plan, and flat tax proposals in general.

The plan proposed by Representative Richard Gephardt (DMo.) imposes a 10 percent tax on all types of income, with the marginal rate increasing for incomes above $59,950 (gross income for a family of four) to a top marginal rate of 34 percent. All deductions except the home mortgage deduction are eliminated. The plan proposed by Senator Richard Lugar (RInd.) repeals the entire tax code and replaces it with a 17 percent national sales tax on the purchase of all final goods and services. The USA Tax plan, proposed by Senators Sam Nunn (DGa.) and Pete Domenici (RN.Mex.), is a savings-exempt plan that allows unlimited funds to be put into savings, with tax payments levied only when those funds are withdrawn. The deduction for state and local taxes is eliminated, but higher education costs are treated as an "expensable investment" rather than as consumption and a deduction for payroll taxes is allowed. Taxes are imposed at rates of 15, 20, and 40 percent; deductions and credits, however, reduce effective rates to 11, 19, and 32 percent. Businesses pay a flat 11 percent rate on net cash flow. The plan proposed by Representative Richard Armey (RTex.) and Senator Richard Shelby (RAla.) eliminates all deductions and replaces them with high personal exemptions, with the remaining income taxed at a flat rate of 17 percent. Only labor income is subject to the tax. Business taxes are levied on net cash flow at a rate of 17 percent, with investment costs fully expensed in the year they are incurred.

Flat tax plan proposals in general exempt earnings on saving from taxation and tax all the remaining income at a single, flat rate. Proponents of flat tax plans assert that generous exemptions can preserve some progressivity in the tax structure. Some proponents claim that by lowering the "cost of saving," a flat tax would result in lower interest rates. Buchanan notes that these plans are problematic in that they do not state how financial services, which are in the business of handling large cash flows, would be taxed.

According to Buchanan, all of the plans examined here fail to recognize that the federal income tax is but one component of the federal tax system and the federal tax system is but one component of the overall tax system and that it is impossible to devise a tax system that does not distort the economy in some manner. The large number of taxing jurisdictions nationwide and their interactions with the federal system make it difficult to devise a federal system that is both simple and efficient. For example, a tax plan must take into account the regressive nature of the Social Security tax system. Buchanan asserts that, in view of the regressivity of certain components of the tax system, the goal of a new tax structure should be to make the federal tax system as or more progressive than it is today. Buchanan also explains that no tax system can be free of distortionary effects. He notes that proponents of the flat tax are wrong when they assert that the flat tax would not change preferences with respect to trade-offs between any set of goods because they are ignoring income effects and possible changes in labor-leisure choices.

According to Buchanan, economic policy should focus on creating both long-term and short-term prosperity and this is most easily accomplished when there is a degree of flexibility in policy making. Therefore, plans that have supermajority requirements for changing the tax code (such as the Gephardt plan) should be avoided. Moreover, some flat tax plans have the supermajority requirement for the rate, but not for the standard deduction, and changes in the deduction would affect the progressivity of a flat tax system.

Buchanan notes the transition from one system to another will have serious consequences for some individuals. For example, it has been estimated that elimination of the home mortgage deduction would result in a drop of 15 to 20 percent in the real value of residential real estate. This implies not only that the total value of the asset would decline by that amount, but that people who held less than 15 to 20 percent equity in their home would lose their entire stake. A transitional effect of switching from an income to a consumption tax raises the issue of "general fairness" to workers at or near retirement age. These workers, after having paid into a system of income taxes, would be subject to consumption taxes just when they are becoming "heavy consumers."

Proponents of some plans assert that their plan would reduce the complexity of the current system. Buchanan argues that "while these and other issues are important in their own right, they are simply arguments for `some kind of change' rather than arguments for any specific alternative." He claims that oft-heard estimates of a $300 billion cost of complying with the current tax system "stretch credulity." Moreover, the current 1040EZ form has only 12 lines and accounts for more items (such as the EITC, taxable interest income, and unemployment compensation) than the simpler "postcard-sized" forms that have been promoted by advocates of tax simplification. Finally, however, simplicity does not in itself provide justification for the substance contained in any of the plans, such as the elimination of tax brackets or the exemption of saving from taxation.

Buchanan concludes that all of the plans currently being considered suffer from significant shortcomings, such as "speculative" revenue effects and claims of economic neutrality. In addition, some place unwise limitations on future fiscal policy actions and create significant problems in the transition to the new system.

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New Working Papers

The Politics of the Minimum Wage

With regard to the minimum wage, policymakers base their decisions on political rather than economic arguments, says Resident Scholar **Oren M. Levin-Waldman** in **Working Paper No. 176.** Lack of adequate data and a prevailing negative view of poverty programs have allowed politics to interfere with economic analysis. Rather than basing minimum wage decisions on economic arguments, members of Congress are more likely to consider the views of various interests, such as labor unions, in their home districts and states. The result is that policymakers pay little attention to the economic questions, such as whether or not increases in the minimum wage help the poor and how the wage floor affects the labor market. Instead they are concerned with whether their constituents support or oppose the minimum wage. Before any meaningful discussion of the minimum wage can occur, the debate must refocus on economic issues.

Economic studies on the effects of raising the minimum wage center around two competing models. The "demand- constrained" model focuses on the reaction of employers. A rise in the minimum wage leads to higher wage costs for employers, who react by reducing their demand for labor, which results in an increase in unemployment. Most research using the demand-constrained model has focused on the youth labor market and seems to indicate that the model holds true among this group. The "supply-constrained" model focuses on the reaction of potential employees. An increase in the minimum wage attracts more individuals to the labor market, thus expanding the labor supply. There is far less evidence that the supply-constrained model holds true.

What is really needed to test both models is more information about other areas and more sophisticated data. At present, we seem to know very little about the effects of the minimum wage. Some studies suggest its effects, whether positive or negative, are minimal. All we seem to know, because studies have focused on youth employment, is that increases in the minimum wage tend to result in decreased employment for teenagers. We don't know if those increases help the poor.

There could be numerous reasons for this focus on youth, rather than the poor. Some researchers have suggested it may be due to a publication biasstudies of the effect of the minimum wage on teenagers are more likely to yield statistically significant results, which editors prefer. But this focus on youth could also be explained by the general political assault on poverty programs. When viewed as a poverty issue, attempts to increase the minimum wage are bound to fail. They are more likely to succeed when the minimum wage is viewed as a labor issue and has the support of organized labor. As long as the debate centers on benefits to the poor, policymakers will fail to consider the bigger picturethe long-term and widespread effects on the labor market.

A review of minimum wage debates in Congress since the 1950s reveals that voting on this issue seems to be determined by party affiliation and by two factors: geography and labor union density. Indeed, the two factors can be more important than party affiliation. Political representatives from regions in which wages are low are less likely to support a minimum wage increase. This is because the increase could significantly raise wages and thus labor costs, causing the region to be less competitive from a business perspective. In high-wage regions, an increase in the minimum wage is likely to have little effect. Policymakers from these regions can support an increase without fearing that it might harm the regional economy. Political representatives from a region with a large concentration of unionized workers tend to follow the unions' lead. In the past, minimum wage increases have tended to occur when organized labor supported the increase and unions were powerful.

In the absence of conclusive data regarding the effects of the minimum wage, politics has taken over the debate. What has mattered most is the stand taken by various interests on the issue. By refocusing the debate on the economic analysis, it will be more clearly seen how the minimum wage affects everyone.

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New Working Papers

Taxes, Saving, and Macroeconomics

Tax proposals designed to induce saving and therefore investment will do neither, argues Resident Scholar **Neil H. Buchanan** in **Working Paper No. 177**. Research has shown that tax reductions do not necessarily lead to increased saving. And even if they do, the increase in saving is more likely to result in an economic slowdown than in increased investment and production. Where the ultimate goal is economic production, it would be better to use political and economic resources to promote innovation and increase worker skills than to revise tax policies.

A problem with the saving debate is that there is no clear evidence that the rate of saving is too low. Some research indicates that personal saving is not falling. Even if it is, the United States might still have sufficient saving. But this is unknown, because there is no clear consensus regarding how much saving any one nation ought to have. Even if an acceptable level of saving could be agreed on, there remains the problem of definition. A person's saving is commonly calculated by subtracting consumption, interest payments, and money sent abroad (often to family members) from disposable income. The widely used personal saving rate is then determined by dividing a person's saving by total take-home pay. The problem with this method is that it includes in the consumption category expenditures for durable goods such as automobiles and furniture and expenditures for medical care and education. These expenditures are actually investments in an individual's long-term economic well-being. Perhaps a better definition of saving would be the one currently used to define investmentresources produced in the economy in a given year that are not consumed today, but are used in ways to provide future economic returns.

A second problem with most saving calculations is they fail to consider business saving. Research shows that business saving has been relatively constant as a percentage of disposable income (or of GDP). Thus, it is not true that saving has decreased, at least if one considers business saving. This form of saving not only represents the bulk of saving, but also is the source for most investments in productive capital. And the current tax code already encourages the use of such saving for investment.

Even if it were certain that personal saving ought to be increased, there is no guarantee that a tax policy aimed at encouraging this would work. The main idea behind such policies is that if one makes consumption more costly or saving more profitable, saving will increase. This might not be so. If interest rates on saving go up, it is possible that people will actually save less. For example, $100 in the bank at 5 percent becomes $105 in a year. If the interest rate goes up to 10 percent, it will take only $96 in the bank to have $105 in a year. Evidence suggests that Americans will do much to maintain their current level of consumption. Thus, changes to encourage saving are unlikely to alter consumption. The best chance of inducing people to save more is to encourage a change in behavior as incomes rise, that is, as people make more, encourage them to save more. It is unlikely that policies will induce them to reallocate their current income from consumption to saving. The only other alternative policy is to shift income from nonsavers to savers. Savers tend to be higher-income households. Thus, such a policy could place a greater tax burden on lower-income groups.

If a policy could be designed that did increase saving, there is still no guarantee it would result in increased investment. A basic view of this relationship between saving and investment is that as more money is saved, interest rates on loans to business decrease, and business then borrows more for investment. This simple view fails to consider the actions of the Federal Reserve. In addition, it is not known if there is a direct link between interest rates and investment. The state of the economy appears to play a greater role in investment decisions than interest rates. It is even possible that increased saving could have negative economic effects. If people save more, they might buy fewer goods. Businesses would sell fewer products, which could lead to lower investment and more layoffs. People would then have less income from which to save. In this "paradox of thrift" more saving might eventually lead to the same amount of saving as before.

Economists often argue against this paradox by claiming it is only a short-run phenomenon. In the long run, the economy will move toward "full-employment equilibrium." Therefore, more saving, or lower spending, will not result in lower output in the long run. But this is not necessarily so. The economy's long-run tendency toward full employment does not prevent the economy from being moved onto a permanently lower growth path by the occasional loss of capital accumulation. In this case, the economy could become poorer over time by short-run deviations from full employment. One must also consider that any tax policy designed to induce saving, and thus investment, might also cause a reaction from the Federal Reserve. Tax and monetary policies are inseparable. Tax policy has impacts on the macro economy, to which the Federal Reserve either reacts or fails to react. It would be possible for the Federal Reserve to react to contractionary fiscal policies in such a way that the economy is further damaged.

A desire to simplify a currently complicated tax system may justify changing the tax code. But there is no justification for rewriting an entire tax code solely to increase saving. The current tax system already encourages much saving, and there is no clear evidence that this saving is insufficient. Even if it were, there is no guarantee that saving could be increased by changing the tax code. Saving is simply not responsive to the tax system. This is actually fortunate, because if a tax change did occur, the economy would likely slow down, and it is unlikely the Federal Reserve would step in to offset the negative effects of the tax policy.

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