Report **February 1998**

Volume 8, Number 1

The Strong Arm of the IMF

"The International Monetary Fund has begun to draw fresh scrutiny from liberals and conservatives alike in Congress, many of whom have begun to question the role this powerful international organization is playing in managing the Asian financial crisis. The IMF's actions there have led to mounting criticism of its methods and of the potential economic, political, and social consequences. . . ."

Visiting Senior Scholar Jan Kregel asks, "How has the IMF transformed itself into the sole crisis manager of international markets and lender of last resort?"

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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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The *Report* is a quarterly publication of The Jerome Levy Economics Institute of Bard College and is produced by the Bard Publications Office.

Editor: Lynndee Kemmet
Text Editor: Judith Kahn
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The Levy *Report* Interview

Paula Stern Discusses Global Trade Policy

Paula Stern is president of The Stern Group, an economic analysis and trade advisory firm that she founded in 1988. She is a member of the Presidents Advisory Committee for Trade Policy and Negotiations (ACTPN) and the Advisory Committee of the U.S. Export-Import Bank. Stern is co-chairperson of the International Competition Policy Advisory Committee (ICPAC) of the U.S. Department of Justice Antitrust Division. She served on the U.S. International Trade Commission from 1978 to 1986 and was its chairwoman from 1984 to 1986. She has been a member of the Advisory Committee for U.S. and Foreign Commercial Service, the Committee for Economic Development, and the Inter-American Dialogue. Stern met with Assistant Director/Washington Liaison Sanjay Mongia on December 5, 1997.

Mongia: Is it possible to reconcile those who favor unencumbered trade liberalization with those who insist on enforceable environmental, labor, and human rights language in any future trade negotiations?

Stern: I do believe that a trade policy and its political components can advance labor and environmental goals while also removing trade barriers and enhancing economic growth among nations. I believe in, and have always argued for, placing a high priority on a series of labor-related issues, such as retraining and education. We must maintain a flexible workforce so that those who might be displaced by change, which is often ushered in by trade flows, would be able to find better, higher-paying jobs that require higher educational or technological components. For example, portability of pensions and health benefits is critical for maintaining a flexible workforce. Those are labor issues, and higher priority needs to be placed on these issues that accompany trade policy. Unfortunately, during the NAFTA debate it was regarded as fiscally imprudent in that budget environment to pursue a number of initiatives that relate to a flexible workforce, and that has come to haunt us. Some labor-related and environmental issues emerging from the NAFTA debate simply were not executed well. Critics of fast track said, "We don't like the way these things have been enforced or executed, and how can we trust you in the future if you haven't done what was put in place during the NAFTA debate?"

Another dimension in dealing with some of the labor issues is our role in the ILO [International Labor Organization]. We have not signed off on many of the conventions and agreements the ILO has hammered out over the years. We weren't serious participants for many years. During the Cold War the ILO was a battlefield between socialist countries and capitalist countries. It made itself irrelevant in U.S. labor policy by being an ideological battlefield. But, in the post-Cold War era, it is time to reexamine the ILO because it addresses so many of these problems that, when unresolved, get thrown to the WTO [World Trade Organization]. The WTO is not the best-equipped institution to cope with these matters.

Mongia: In the most general sense, is trade an effective and appropriate instrument to reform social policies in other countries?

Stern: That's the question that comes up in any discussion on unilateral sanctions. There is a natural tendency to use economic leverage on other countries when you are the world's most ideological nation. That's what is pressing this debate in our country. Other nations are less interested in the business of their neighbors, with the exception of military threats. After the demise of the Soviet Union, the U.S. became the most ideological nation in the world. We are a nation of immigrants, we care about what's going on across the globe, and our Constitution is an expression and model of human rights for all individuals. So we tend to have a very expansive notion of what is appropriate for one sovereign nation to tell another sovereign nation.

Mongia: Can't American policy, at the very least, lend moral support for those seeking to promote human rights and labor rights, say, the right of workers to organize?

Stern: You have to exercise economic leverage with a great deal of skill. You have to recognize the differences between your target countries. You have to recognize what it is that you are asking these other countries to do. You have to determine whether you are going to do this in public or in private diplomacy. There are a variety of factors involved in skillful execution of policy. The first question to ask is whether it's a legitimate interest of the U.S. government? The next question is how are we going to go about doing it without making matters worse, without shooting ourselves in the foot. By exercising economic leverage we are often making it more difficult for our own business people to be engaged in that target country. It's a balancing act, and I would argue that economic leverage is most effective when it's multilateral and not unilateral. Also, it's only effective when it's done without rubbing the target countries' officials' noses publically in our demands and embarrassing them.

But it's very hard to execute all of those components skillfully and effectively, particularly for the United States, which is a democracy and encourages the expression of many different voices in domestic politics. When we as a nation go it alone, it's a very messy affair, and I would say that we've had more disappointments than successes. Trade gets wrapped up in this debate and often is the instrument of choice used in foreign policy, which is easy to understand when the options are a nuclear bomb, conventional warfare, trade sanctions, or rhetorical pronouncements by diplomats.

Mongia: You have previously stated that trade is a means to escape the displacement costs of technological change. But will you concede that trade may have accelerated the elimination or movement of some jobs and some industries?

Stern: I think trade is a messenger. I'm also concerned that too much tinkering with specific industries or sectors will hamper freedom of access for consumers. Any effort that might undermine access of consumers in order to favor one particular producer group must be undertaken judiciously and selectively. Cutting off trade and trying to slow down the message of global technological change hurts the whole nation. We cannot close off the borders entirely and become autarkic. So why not adjust on a real time basis rather than taking a policy direction that says, "Trade is ushering in technological change at too accelerated a pace." The reality is that technological change is accelerating, and failing to adjust on a real time basis will leave us ill-equipped as a nation.

Mongia: Textbook economics doesn't always seem to reflect reality. Technology may one day render a job obsolete, but it is competition with lower wage markets that seems to contribute most to economic insecurity and an underlying sense of fear among Americans. What do you tell an American worker who feels threatened by the rapid globalization and trade? How do you equip a displaced 45-year-old worker who's spent the past 20 years in an auto plant to get another job at a comparable wage?

Stern: In the case of the adjustments in the 1970s and 1980s in the automobile industry, these workers enjoyed among the highest wages. These were jobs in corporations where the management had also made a lot of miscalculations. At a time when there was a dramatic shift in consumption from large cars to small, more fuel-efficient cars, U.S. manufacturers were not responding to the shift in demand and tastes. Trade, namely, the importation of foreign autos, served as a messenger and prompted the U.S. auto industry to meet consumer demand and become more efficient.

The fact that autoworkers at the time had these high wages producing a product that was not selling already says that that was an unsustainable proposition. Frankly, there are many more new jobs in this economy than the jobs lost by the auto industry. But it needs to be emphasized that we're describing a situation that occurred in the 1970s. Today, as a nation, we've got many jobs being created in new industries that were not envisioned 20 years ago. We have new start-up companies, and, in fact, new automobile factories thanks to investment by Japanese auto firms in our country. Trade ushers in and proliferates a dynamism of new ideas in technology and new opportunities. You don't want to deprive new generations of workers of these opportunities.

Mongia: "Corporate responsibility" entered the vernacular a few years ago, but the term has had a domestic focus: the obligations of American companies to American communities and workers. If one extends this to the actions of American firms operating abroad, what obligations should American firms bear?

Stern: Corporations, for the most part, have found that it is in the best interest of producers, consumers, and investors to exercise best practices in their manufacturing. Best practices include being more energy efficient, thus lowering emission of greenhouse gases and mitigating the accompanying environmental problems. Corporate America recognizes that if it cleans up after making a mess or minimizes its mess when making a new product, it will cost it less in the long run. Increased efficiency has led to more recycling, and that recapturing of waste actually becomes product for something else. So, were seeing an increasing adoption of best practices, which will lead to uniform corporate-wide codes.

Mongia: But there isn't a uniform code for working conditions and wages. GM operates in Mexico, but obviously doesn't offer the same wages in Mexico as in the United States. Meanwhile, does the Mexican autoworker have the same right to organize as his American counterpart?

Stern: I was referring to individual industry codes. What the critics might say is that there's no government-imposed code or international code with a bureaucracy to enforce it--which is ironic since these are often the same people who are most suspicious of international organizations. But you're talking about a set of practices, labor practices. I do believe that these are becoming increasingly uniform within firms, and this serves the interests of workers, producers, and consumers, particularly among international firms that are making products for the end user. Many firms are working on codes of conduct for their workers. This has transcended producers and now includes retailers, who have their own self-imposed, self-certified standards against child labor and excessive hours worked.

Mongia: So this should take the shape of an industrywide initiative?

Stern: It's already taking shape, and it's driven by the marketplace. The consumer is expressing concern, and if an apparel firm finds that it can sell more garments if its labels say that this garment was made in a factory that is subject to inspection, it will implement an inspection system. But I believe that, generally, self-certification is more efficient than having some big bureaucracy come in and certify.

Mongia: You're a strong proponent of global trade liberalization and have recently urged the Indian government to accelerate its trade liberalization initiative, launched in 1991. But much like American critics of trade liberalization, some Indian observers believe that the gains of trade liberalization are far too heavily concentrated. How do you respond to critics who argue that your policies only allow the rich to get richer and ignore the poor? What can be done to promote a dispersion of the benefits of freer trade?

Stern: Break up the concentration of economic and political power and end the special treatment accorded to public and private interest groups that have benefited from a concentration of power. That's the whole purpose of deregulation and of trade. When you introduce new and competing interests, it helps break up the cartels, the cabals, the special interest monopolies. Privatization will take power away from government interests that currently determine how public funds and resources are invested. Deregulation will remove bureaucrats and administrators from decisions about the distribution of goods and services.

Mongia: So, you're suggesting that there's a secular relationship between deregulation and, let's say, a reduction in the incidence of poverty?

Stern: I do believe that deregulation helps break up the concentration of resources, namely, money. Also, other reforms, such as privatization and trade liberalization, must accompany deregulation of domestic industries in developing countries like India. However, there is still the problem of bribery, which leads to wasted resources and inefficiency. It significantly increases the cost of conducting business, and the consumer bears that additional cost. The dirty little secret in many of these countries is corruption. Reversing this requires a staunch commitment to economic and political reform. Transparency is the key; sunshine is the best disinfectant against corruption and bribery.

Mongia: In recent weeks we've witnessed instability in Asian financial markets. Are you concerned that there will be some adverse effects for the American economy?

Stern: One can't dismiss the possible effects of Asia on the U.S. economy. Reports from the regional Federal Reserve banks are suggesting the first expressions of concern over a slowing of sales to these Asian markets. Certainly, import competition will be sharper from Asia. But, frankly, I believe that the U.S. economy is fundamentally strong. There was concern that we could not sustain this level of economic activity without inflationary impacts pressed by labor costs. We still have shortages of labor, skilled labor in particular. But lower imported costs for components or raw material or energy will moderate any inflationary impact from labor pressures.

Mongia: Among the likely results of devaluation of Asian currencies will be a swelling of our trade deficit. How will the rising trade deficit shape the domestic trade debate in an election year?

Stern: It will have a serious impact on it by fueling protectionist pressures. The increased trade deficit will reinforce the isolationist sentiments that were manifested last month in the congressional rejection of the president's authority for fast track trade negotiations. This comes after the U.S. Congress declined to fund the IMF, and our failure to keep our pledge to pay U.S. arrears to the United Nations. The collective impact of these circumstances sends a disturbing signal that the Congress, and presumably public opinion, does not appreciate what a fortunate arrangement the United States has with a terrific domestic economy and that we fail to recognize that our leadership position during the past 50 years has led to an unmatched prosperity. The rising trade deficit will make protectionists focus on the hole instead of the doughnut.

Mongia: What can free traders, particularly the administration, do to preempt the looming protectionist howls?

Stern: First, it has to be explained publicly that when the U.S. withdraws, the rest of the world shrivels. It is true that when the U.S. sneezes the rest of the world catches a cold, but the reverse is not true. The U.S. is the largest economic power in the world and can, if it falters, send shock waves throughout the world. The Asian flu can cause discomfort, but I do not believe that it risks apocalypse for America. It's essential for our leadership to explain this to the public. The problems in Asia are, however, a signal that the U.S. needs to take preventive care, which is precisely what the IMF stabilization fund was created to do 50 years ago and is doing at this time. What the IMF is doing today with respect to Asia is implementing preventive care. If the U.S. forsakes its leadership position in these institutions, we would eventually be burdened with having to administer the medicine to these Asian countries directly rather than through the IMF and other international institutions.

This is an extremely crucial period, but the administration has demonstrated great skill in working behind the scenes to resolve similar problems over the past few years. [Treasury Secretary] Rubin and [Deputy Treasury Secretary] Summers have not been duly credited for achieving a great success in coping with the Mexican peso crisis, and they have been instrumental in pushing the IMF to impose increased transparency requirements for the stabilization funds dealing with problems in Indonesia, Thailand, and South Korea. But fear of an isolationist backlash at home has made these American successes well-kept secrets. The efforts of the IMF and the administration have prevented the Asian contagion from spreading out of control. The impact could have been much more severe.

Mongia: Many Americans are skeptical about multilateral arrangements and institutions. The IMF is bailing out relatively mature Asian economies--certainly much more mature than they were only a quarter century ago. The countries often have trade surpluses with the United States, and their markets are often closed to foreign competition. Meanwhile, the conditions of the IMF bailout remain largely undisclosed. So, how is it in America's interest, for example, to help with the $57 billion IMF bailout of South Korea? Is it fair to ask American taxpayers to bear that burden and risk?

Stern: It is true that last Sunday Korea announced that there was an IMF agreement before the conditions were disclosed. The conditions this week are becoming increasingly disclosed. Looking forward, the institution can provide a framework to lend stability, liquidity, rules of the road, and nondiscriminatory treatment. Interestingly, the financial crisis in Korea is revealing what was often suspected, but rarely discussed: that it was statist, that it had a too-cozy cabal among the government, business, and banks, and that such an arrangement was not economically sustainable. During the Cold war South Korea was sheltered from such scrutiny and criticism, but the demise of the Soviet Union and the weakening of North Korea allowed for a more objective critique of the South Korean economy.

The more we expose and scrutinize these economies, the better off we will be over the long run, and there will be much less risk exposure to U.S. and IMF funds. Indeed, it's about time that we insist on transparency and remove the restrictions to foreign investment in these Asian economies. To the extent that U.S. funds are exposed, it's far cheaper and much less risky to aid with a stabilization package now than to come to the rescue with a full-scale bailout later. It's a prudent use of U.S. resources. What you must keep in mind is that this is not a bailout--a bailout would be necessary if we failed to help at this time and these countries went bankrupt. The IMF stabilization package is a preemptive loan, and it's very important for the purpose of an informed discussion to clarify those terms.

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Editorial

The Strong Arm of the IMF

By Visiting Senior Scholar Jan Kregel, The Jerome Levy Economics Institute

Reprint of a feature article in the Focus section of *The Sunday Boston Globe*, January 18, 1998

The International Monetary Fund has begun to draw fresh scrutiny from liberals and conservatives alike in Congress, many of whom have begun to question the role this powerful international organization is playing in managing the Asian financial crisis. The IMF's actions there have led to mounting criticism of its methods and of the potential economic, political, and social consequences.

Since the Mexican economic crisis of 1995, the IMF's public profile has reached unparalleled heights as it has helped to oversee the worldwide market economy that broke free with the end of the Cold War. The IMF does much of its work through loans backed by funds from developed nations intent on encouraging emerging trading partners.

But the IMF's rise to become the world's most powerful international financial player has had some troubling consequences, including serious social and political ramifications for some nations seeking its assistance. Having no alternative except default and possible shortfalls of essential imported goods, troubled countries have little choice but to agree to the IMF's terms.

As recently evident in South Korea and Indonesia, IMF strictures can have tremendous social and political impact. Misjudging the political reactions to the fund's demands can create unanticipated consequences in bailout plans, moving the fund's controls from the financial sphere, where its influence is supposed to rest, to the political one.

The power that the IMF wields over nations seeking its aid can help to undermine democratic institutions in some countries, since the organization can impose domestic belt-tightening that has not been ratified by the citizens. Yet, in the end, the IMF cannot be held accountable for damages even if its monetary policies fail to produce intended positive results.

In retrospect, there were early warning signals in the IMF's handling of the Mexican bailout.

First, in that case the IMF exceeded its own standard limits on lending to a single country. What was considered an exception then has now become the rule in the Asian crises. Second, resolving the Mexican crisis was not clearly within the IMF's rubric. Originally created to lend short-term amounts to countries whose cash reserves were too low to pay for their imports and services at fixed exchange rates, the IMF this time was intervening in a currency crisis caused by trade in government financial assets.

The Mexican Central Bank did not have enough dollars to repay the large banks and international investors who wanted to sell their holdings of Mexican government debt. Not only was the IMF then short of funds, but the organization appeared to stretch its own internal rules to cover other accounts.

In short, the IMF, in its new role as the dominant world financial organization, is acting as the lender of last resort to the international financial system. But the IMF is not a bank and does not issue currency. It can only lend other people's money.

Although a proposed increase in members' contributions and the IMF's lack of democratic accountability have drawn political attention, a more important question concerns how the IMF has subtly transformed itself into the sole crisis manager of international markets and lender of last resort.

How did the IMF rise to this role? A look at the past helps to explain.

When the United States suspended the covertibility of gold in 1971, the IMF lost its function as guardian of the fixed exchange rate system, pegged on the dollar. The biggest problem facing international financial markets in the 1970s, the recycling of the petrodollar surpluses of the Organization of Petroleum Exporting Countries, was handled outside the IMF by private international banks. With floating exchange rates and ample world liquidity, there was no role for the IMF to play.

But that quickly changed when U.S. monetary policy, managed by Federal Reserve chairman Paul Volcker, pushed up interest rates and the value of the dollar, sharply raising the rates and the value of loan principal to the point where some debtors could no longer repay. Since the outstanding loans were huge, default would have produced widespread bank insolvencies in debtor nations. The only viable solution then, particularly for Latin American borrowers, was for the banks to reschedule the debt to prevent collapse.

The IMF provided emergency short-term financing to these nations and imposed policies designed to ensure repayment. The approval of IMF money for these countries became a "Good

Housekeeping Seal of Approval" for rescheduling loans, and the IMF gained a pivotal position between private capital markets and government borrowers.

Since the best way for a country to earn foreign currency to repay loans is to increase exports over imports, the fund could now employ the same policies it had used to support fixed exchange rates: Cut government spending, raise interest rates, and reduce inflation. It also recommended liberalizing trade and the flow of capital, eliminating government economic activity, and deregulating financial markets.

In the 1980s, the debt crisis turned the IMF's attention toward investments in foreign financial markets and lending. The fund became a champion of mobile, international private capital, a position in direct opposition to the position it once had maintained as the defender of fixed exchange rates.

Now, the crisis in Asia has demonstrated that the IMF's long-held policies may no longer be appropriate. Most of the shaky Asian economies have high savings rates, government budgets in rough balance or in surplus, and trade accounts that also are in balance.

The Asian economic crisis was not caused by excessive imports of consumer goods on a base of government deficits. It was the result of excessive investment financed by private borrowing, with falling rates of return.

The IMF responded by imposing policies to reduce government spending in these countries and to tighten monetary policy, further reducing the expected returns on investment and raising the costs of short-term loans. The result has been debt deflation, in which the value of assets has been driven down (in the reverse of inflation) and companies have been driven to bankruptcy. The real issue was not the amount of money available, but rather formulating policies appropriate to the new deflation.

The IMF is attempting to act as an international central bank, while depending on member governments for its ability to lend. This has brought greater political scrutiny of the IMF's role, and here it is found wanting. In the end, the expansion of free markets depends on democratic accountability in the nations themselves. Such accountability implies choice: Whether the IMF's policies are appropriate or not--and they may not be--the policies imposed on countries do not provide for choice.

And IMF programs are never made public for discussion. In the current South Korean package, the fund took steps to ensure that all the candidates in that country's recent presidential election would accept the plan. But the plan's provisions were not discussed or debated by the political parties involved.

Democracy is not the norm in the fund's internal votes either. Democracy is based on equality, but voting within the organization is determined by quota contributions that reflect economic strength. With the best political will in the world, IMF decisions cannot avoid reflecting the interests of the largest money providers, rather than the narrow interests of the nations seeking help.

U.S. congressional committees are debating ways to increase accountability for IMF use of a proposed $18 billion increase. But at the moment, unemployed bankers in Thailand and Indonesia and autoworkers in Korea look on the IMF as the agency whose policies helped to close the companies that employed them.

In less than 25 years, the IMF has gone from an institution without a function to the policeman of the global financial system. What should be debated in Congress is not the size of U.S. funding for the IMF, but the creation of a more accountable institution of global financial governance to deal with the new order of free-flowing international capital, an era in which domestic economic policy for many nations has become increasingly divorced from domestic political accountability.

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Symposium

The Second Generation Then and Now: Education and Early Job Market Experiences

Scholars gathered at Blithewood on October 24 and 25 for a symposium organized by the Levy Institute as part of its program on immigration and ethnicity. The aim of the symposium was, as noted by its organizer Senior Scholar **Joel Perlmann**, to give scholars an opportunity to assess the state of research on the second generation. Summaries of the five sessions are presented below. Several of the papers are summarized later in this issue.

Session 1: A Way In--Past and Future
The first session focused on two papers: "Rethinking Assimilation Theory for a New Era of Immigration," by **Richard D. Alba**, professor of sociology and public policy at the State

University of New York at Albany, and **Victor Nee**, Center for Advanced Study in the Behavioral Sciences at Cornell University; and "Second Generation Decline: Children of Immigrants, Past and Present--A Reconsideration," by Perlmann and **Roger Waldinger**, Levy Institute research associate and professor of sociology and director of the Lewis Center for Regional Policy Studies at the University of California at Los Angeles. Commentators for this session were **Gary Gerstle**, Department of History, Catholic University of America, and RubÈn G. Rumbaut, professor of sociology at Michigan State University and visiting scholar at the Russell Sage Foundation.

The two papers, considering whether second-generation Americans are successfully assimilating into society, led symposium participants to suggest new questions for research, such as, what does assimilation mean? Gerstle pointed out that there are many forms of assimilation--language, culture, social class, and others. Rumbaut noted that researchers might want to redefine successful assimilation. It is often assumed that members of the second generation have successfully assimilated when they become like the dominant group in American society, but, Rumbaut asked, is this really what the second generation should aspire to? Other participants noted that because there are many different paths and barriers to assimilation, and both the paths and the barriers differ among immigrant groups, researchers should perhaps look more closely at individual immigrant groups, rather than lumping them into one, or a few, categories.

Session 2: Understanding Youth Orientations
This session featured three papers: "Exploring and Explaining the Variability: The School Performance of Today's Immigrant Students," by **Margaret Gibson**, associate professor of education and anthropology at the University of California at Santa Cruz; "Achievement and Ambition among Children of Immigrants in Southern California," by Rumbaut; and "The Cultural Psychology of the Second Generation," by **Carola Surez-Orozco**, lecturer in human development and psychology at Harvard University, and **Marcelo M. Surez-Orozco**, professor of human development and psychology and of learning and teaching at the Harvard University Graduate School of Education. Commentators were **Josh DeWind**, director of the International Migration Program of the Social Science Research Council, and **Philip Kasinitz**, associate professor of sociology at Hunter College and at the Graduate Center of the City University of New York.

These papers focused on factors affecting the ability of second-generation children to succeed in school, such as the attitudes of immigrant parents and their children toward education, peer pressure, ethnic and cultural identity, and the socioeconomic environment in which the children live. Much of the research for these papers involved interviews with immigrant parents and their children. While many participants agreed that such factors could play a role in determining whether immigrant children would be successful in school, they also asked whether these factors affect only the children of immigrants. They suggested further that future research should not only compare school-age children of immigrants with children of nonimmigrants, but also compare different immigrant groups with one another.

Session 3: Language, School and Work
In this session three papers were presented: "English First or English Only? Bilingualism and the New Second Generation," by **Alejandro Portes**, professor of sociology and public affairs at Princeton University and Emilio Bacardi Moreau Visiting Professor at the University of Miami, and **Lingxin Hao**, The Johns Hopkins University; "The Impact of Racial Segregation on the Education and Work Outcomes of Second Generation West Indians in New York City" by **Mary C. Waters**, professor of sociology at Harvard University; and "The School to Work Transition of Second Generation Immigrants in Metropolitan New York: Some Preliminary Findings", by **John Mollenkopf**, professor of political science and sociology at the Graduate Center of the City University of New York, Kasinitz, Waters, and **Nancy Lopez** and **Dae Young Kim**, both of the Graduate Center of the City University of New York. Commenting was **Nancy Foner**, professor of anthropology at the State University of New York at Purchase.

Papers in this session examined the effect of various factors, such as gender and race relations, on second-generation educational success and factors that determine whether immigrants' children retain their parents' native language. The research presented indicates a difference between genders in how they view education and deal with racism. Females seem to do better than males while in school and are less likely to be suspended, but they are not more likely to stay in school and graduate. Portes's research on language indicates a link for some groups between native language retention and "co-ethnic" association, that is, second-generation children are more likely to retain the native language when they associate with others of the same immigrant group. However, this is not true of all groups, and Portes said he did not yet know why this was the case. During the session participants broached other topics, suggesting that future research be expanded to explore the effects structural changes in the economy are likely to have on assimilation and to include regions outside of the major U.S. cities. Too little research is done on immigrant families living in smaller cities and suburban areas.

Session 4: Education and Work in the 1990 Census and Related Sources
This session featured three papers: "Education's Hispanic Challenge," by **George Vernez** of RAND; "Educational and Sociodemographic Incorporation among Hispanic Immigrants to the United States," by **Frank D. Bean**, Ashbel Smith Professor of Sociology and Public Affairs and director of the Population Research Center at the University of Texas, Austin; and "Some Early Indicators of Education and Early Career in the 1990 Census: Generations 1, 1.5, and 2," by Perlmann and Waldinger. Commenting for this session were **Joseph P. Ferrie**, associate professor of economics at Northwestern University, and **Suzanne Model**, associate professor of sociology at the University of Massachusetts Amherst.

The discussion of the 1990 census and other research sources brought to the fore a key concern of participants--the incompleteness of the data available for studies of the second generation. In much of the data used by researchers, such as census data and economic data on wages and incomes, children of immigrants are often not identified as members of the second generation, but are usually classified as native born. Also, data are often not broken down by immigrant groups within major categories. For example, the category Hispanic includes people of

Mexican, Cuban, Central American, and Puerto Rican descent, and these groups vary widely in terms of language, culture, attitudes, skill levels, and other aspects. To make valid research findings, researchers must attempt to sort out the diversity that lies within the ethnic and racial categories of the data.

Session 5: Historical Comparisons/General Reflections
The final session featured one paper: "Comments for 'The Second Generation Conference' at The Jerome Levy Economics Institute," by **Thomas Archdeacon**, professor of history at the University of Wisconsin. Several participants returned to the theme that if researchers want to improve their understanding of the second generation, they must rethink the concepts of assimilation, upward mobility, race, and ethnicity. For example, some suggested that the upward mobility achieved by turn-of-the-century immigrants might be a historical exception, and if this is so, researchers should stop asking why some immigrant groups of today do not achieve upward mobility and instead ask why immigrants of the past did. Some suggested that assimilation, which is so important in today's research, might cease to be important if ethnic and racial intermarriage creates a multicultural society. Perhaps researchers ought to replace the term assimilation with another term, such as Americanization or membership in American society. Participants also cautioned against using racial and ethnic categories in their research and argued that by using such categories, they may be perpetuating divisions in society. It was suggested that researchers should focus more on the commonality among groups than on the differences.

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New Working Papers

On Budget Deficits and Capital Expenditure
Malcolm Sawyer
Working Paper No. 208

Within the field of public finance is a concept some refer to as the "golden rule." It states that governments ought to have separate budgets for current expenditure and capital expenditure, with current expenditure financed by taxation and capital expenditure financed by debt. Visiting Scholar Malcolm Sawyer sees several problems inherent in this golden rule. It is difficult to arrive at a definition of a capital expenditure. Also, there is no way to finance a capital project that guarantees that those who benefit from it will pay for it because it is difficult to directly match benefits with capital investment.

Sawyer criticizes the golden rule on three grounds. First, spending for capital goods by government does not yield a flow of revenue the way spending for capital goods by businesses does. Second, the rule interferes with the government's use of deficit spending as a demand management tool. Third, it is not possible for the federal government budget to make a clear distinction between capital and current expenditure. For these reasons, making a distinction between current and capital spending is not useful. Instead, argues Sawyer, the case for a particular form of expenditure (whether capital or current) should be based on its social usefulness. The size of the deficit should then depend on the debt stability condition (according to which the real rate of interest on borrowed funds should not exceed the rate of economic growth) and the need to use deficit spending to stabilize aggregate demand.

Sawyer addresses three justifications for the golden rule. First, capital expenditure is said to be a large, one-time expense, making it reasonable to smooth its cost over time. Sawyer counters that although capital expenditure varies yearly, it is not a one-time expense; to have capital financing follow a smooth time pattern would require borrowing to cover capital expenditure over some "base" amount. Second, the rate of return on capital expenditure is said to justify the cost of finance. However, the social benefits of public investment do not generally yield any direct financial benefit to the government in the form of taxes, but only in the form of indirect cash flows generated through more business activity. Moreover, the government is simply not analogous to a large firm; the government does not run deficits or surpluses to maximize profit, but must consider the impact of its behavior on the macroeconomy. Third, borrowing for consumption is said to be wrong. However, Sawyer states, the social usefulness of a project, rather than whether it is classified as current or capital expenditure, should be the important issue. He concludes that the distinction between capital and current is arbitrary and that all public expenditure should be judged on its social usefulness and macroeconomic stability effects.

Cumulative Regional Decline, Institutional Inadequacy, and the "Democratic Deficit": Is European Monetary Union Economically and Politically Sustainable?

Andrew Paulson
Working Paper No. 209

Supporters of a European monetary union argue that a single currency will provide enormous economic benefits for those nations that join the union. One economic benefit commonly touted is that of reduced transaction costs, which might also result in lower prices across Europe for consumers. A second possible benefit of monetary union is the elimination of uncertainty in exchange rates, which could encourage more investment by risk-averse individuals.

Cambridge University Visiting Scholar Andrew Paulson challenges these economic arguments given in support of the EMU. With regard to reduced transaction costs, he notes that the likely gains are small--only one-quarter to one-half of a percent of the European Communitys gross domestic product. Any gains from elimination of exchange rates are likely to be just as small. Thus, a close look at the possible economic benefits of monetary union shows that the gains are unlikely to be greater than the potential costs.

The greatest cost to nations is likely to be the loss of sovereignty to deal with economic instability, such as a recession or depression. A monetary union will constrain the fiscal and monetary actions of member nations with the result that they will no longer be able to perform an important government function, namely, steering their national economies in the direction chosen by their citizens. The EMU cannot replace this important government function because it is not a political system. Paulson argues that some EMU supporters appear to be using monetary union as a way to achieve political union. If the real goal of EMU is political union, then European nations should address this issue directly. A monetary union that limits the power of national governments to deal with economic crises is likely to create more economic problems than it solves.

The Effects of Immigrants on African-American Earnings: A Jobs-Level Analysis of the New York City Labor Market, 1979-1989

David R. Howell and Elizabeth J. Mueller
Working Paper No. 210

The economic advancement experienced by African Americans in the 1960s and 1970s came to an end in the 1980s. Many have suggested that the halt in economic gain is due to the recent influx of low-skill immigrants, who have flooded the low-skill labor market, displacing native-born African Americans and depressing wages in this market. A number of reseachers have taken the position that this explanation is not valid, that immigrants are not the cause of declining income for African Americans. Research Associate David R. Howell and Elizabeth J. Mueller, both of the Robert J. Milano Graduate School of Management and Urban Policy at the New School for Social Research, challenge these researchers on methodological grounds. They argue that adequately measuring the possible effects of immigration on the income of native-born African Americans requires analysis at the job level.

Prior research has shown that ethnic groups, races, and genders tend to concentrate in certain job niches. Howell and Mueller first identify job niches and job contours (larger groupings of jobs defined by industry and occupation) in the New York City labor market in which native-born African American men and women tend to concentrate. They next examine the changing composition from 1979 to 1989 in these niches (the share of foreign-born workers in native-born African American niches) in an effort to learn the extent to which new immigrants have made inroads into these niches.

Howell and Mueller's research shows that immigrants have made gains in native-born African

American job niches, although in some cases it appears that immigrants replaced white workers more than African American workers. According to Howell and Mueller's analysis, this change in the ethnic mix within these job niches has negatively affected the wages of native-born African Americans, and thus they conclude that prior research claiming that immigrants have had no such negative effect is incorrect.

Income Distribution, Macroeconomic Analysis, and Barriers to Full Employment

Malcolm Sawyer
Working Paper No. 211

Income distribution is an important issue but one that is rarely discussed in mainstream macroeconomic analysis. Instead, such analysis has tended to focus on issues related to inflation and policies aimed at maintaining a low inflation rate. Visiting Scholar Malcolm Sawyer argues that there are relationships between macroeconomics and the distribution of income that warrant study by economists.

Sawyer examines three elements of macroeconomics and their links to income distribution--the nonaccelerating inflation rate of unemployment (NAIRU), the level of aggregate demand, and monetary policy. With regard to the NAIRU, he argues that if it is a barrier to full employment, it should be viewed as one arising from conflicts over the distribution of income. Regarding the level of aggregate demand, Sawyer notes that wage earners consume a larger proportion of their budgets than firms consume or invest out of profits, which could result in a level of aggregate demand too low to support full employment. He shows that profits have been rising over the past 15 years, but this has not resulted in increased investment or growth rates. Instead, it has resulted in stagnant economies and rising unemployment in many nations, which have affected income distribution. Finally, monetary policies have traditionally been viewed as having little or no distributional effect, but, Sawyer notes, much recent research indicates this view is false. Recent research shows that the effects of deflationary policy fall disproportionately on low-income workers, while its benefits accrue to creditors and bond market investors. It also shows that monetary policy has been instrumental in increasing the inequality of income, at least since the late 1970s.

An Efficiency Argument for the Guaranteed Income

Karl P. Widerquist and Michael A. Lewis
Working Paper No. 212

Despite its wealth and strong economic growth the United States has not been able to eliminate poverty. The disagreement among policymakers and researchers regarding the reasons why people are poor has resulted in further disagreement over the policies that ought to be adopted to alleviate poverty. Research Associate Karl P. Widerquist and Michael A. Lewis, of the SUNY School of Social Welfare at Stony Brook, point out that there are essentially five theories of why people are poor: inability to work, single parenthood, inadequate demand for labor, inadequate human capital, and poor work ethic. Many antipoverty policies target only one cause of poverty, but rarely do they consider the possibility that all five theories are at least partially correct.

Widerquist and Lewis examine six antipoverty strategies--promotion of economic growth, workfare, the minimum wage, separating the "deserving" from the "undeserving" poor, publicly guaranteed employment, and publicly guaranteed income--and argue that of them, the guaranteed income is not only the most efficient but also the most comprehensive policy.

Current attempts to solve the poverty problem through workfare are more likely to exacerbate the problem by pushing people off the welfare rolls and into the low-skill labor market, which will only depress wages and increase the number of working poor. The popularity of workfare results from belief in the theory that people are poor because they have a bad work ethic. Widerquist and Lewis argue that a program that guarantees that everyone has an income above the poverty line could be designed so that it would provide subsistence to those who do not work, but also reward those who do by allowing them to increase their income through work without losing an equal amount of their government support.

Government as Employer of Last Resort: Full Employment without Inflation

L. Randall Wray
Working Paper No. 213

It has long been argued that it is not possible to have both full employment and stable prices. Because of this belief, monetary policy in the United States has not been used to both control inflation and decrease unemployment. Instead, policymakers use higher unemployment as a means to maintain low prices. Senior Scholar L. Randall Wray argues that it is possible to have both full employment and stable prices.

Wray's solution to the theoretical dilemma is an employment policy where government is the employer of last resort (ELR). Under such a policy government would absorb those willing but unable to find work in the private sector and pay these workers a set wage. During periods when labor is in high demand, private employers could pull workers from this government labor pool by offering wages higher than those paid by the government. In periods of economic slowdown, employees who lose their private sector jobs could return to the government labor pool at the ELR wage. Such a system would help reduce economic fluctuations. If the government wage is higher than the minimum wage, the ELR might force private employers to raise private sector wages to avoid losing workers to the government; this, however, would be a one-time wage adjustment.

Some might question the need for the ELR at a time when states are already implementing welfare reforms, such as welfare-to-work programs. But while such programs can be somewhat successful during good economic times when state revenues are rising and unemployment is falling, Wray argues, they will not be successful during times of recession. When the economy heads into a recession, states will face rising welfare roles along with decreasing revenues. It is during a recession that the ELR program is most needed and only the federal government will be able to run the deficit necessary to operate such a program.

The School to Work Transition of Second Generation Immigrants in Metropolitan New York: Some Preliminary Findings

John Mollenkopf, Philip Kasinitz, Mary C. Waters,
Nancy Lopez, and Dae Young Kim
Working Paper No. 214

Immigration researchers have just begun to understand the experiences of those immigrants who arrived in the United States after 1965. But little is known about the children of these immigrants and the effects they have had, or will have, on the economic, social, and political fabric of the country. In an effort to better understand this second generation a study is underway of young adults (aged 18 to 32) living in New York City who are the children of post-1965 immigrants. The study contrasts the largest groups from the three major streams of immigration--Anglophone West Indians, Dominicans, and Chinese--with native-born young adult whites, blacks, and mainland-born Puerto Ricans with native-born parents. In this working paper, researchers John Mollenkopf, Philip Kasinitz, Mary C. Waters, Nancy Lopez, and Dae Young Kim present findings of a pilot study of this second generation.

Although the study is in its early stages, the preliminary research indicates that in order to understand the second generation and its impact, researchers must study distinct immigrant groups. Lumping all immigrant groups together leads to inaccurate conclusions regarding past and possible future impacts of the second generation. To understand the children of immigrants requires that they be considered within the context of their group identity. In addition, preliminary findings indicate that upward mobility may be a more likely scenario for many members of the second generation than earlier studies have indicated. And the path upward is more likely to come through school than through early experiences in the labor market.

Achievement and Ambition among Children of Immigrants in Southern California

RubÈn G. Rumbaut
Working Paper No. 215

The Children of Immigrants Longitudinal Study (CILS) is an investigation of the educational performance and social, cultural, and psychological adaptation of the children of immigrants. The study, headed by Alejandro Portes, professor of sociology and public affairs at Princeton University, and RubÈn G. Rumbaut, professor of sociology at Michigan State University and visiting scholar at the Russell Sage Foundation, has followed teenage youths, representing over 70 nationalities, in the San Diego and Miami/Fort Lauderdale regions. The youths were surveyed in junior high school and three years later, in 1995-1996. The results of the second survey, presented here by Rumbaut, shed light on factors that play a role in determining the educational performance and success of second-generation children.

Two key factors across many immigrant groups are family structure and socioeconomic status. Immigrant children from families that are more cohesive and stable and have greater socioeconomic resources tend to have higher scholastic scores, lower dropout and suspension rates, better self-esteem, and less depression. The influence of peers is also important. Youths whose friends drop out of school or have no college plans tend to follow the path of their friends.

Other factors examined are gender, work discipline, and ethnic identity. Males appear to have lower grades and more suspensions than females, but both genders do well when they have good work discipline and a clear sense of goals. Youths who by the age of 14 or 15 identify themselves as pan-ethnic (such as Latino) rather than as members of specific groups tend to show worse school performance than those who identify with specific groups.

The Impact of Racial Segregation on the Education and Work Outcomes of Second Generation West Indians in New York City

Mary C. Waters
Working Paper No. 216

Recent research hypothesizes that many children of post-1965 immigrants will face downward social mobility relative to their parents. As reasons for this downward mobility, it is sometimes argued that children of recent immigrants are often unwilling to take the low-skill jobs their parents accepted, even though they may lack the education and skills necessary to get the better-paying jobs they would like; that the number of well-paying low-skill jobs has declined; and that race plays a role in determining social standing.

In a study of second-generation West Indian youth in New York City, Mary C. Waters, professor of sociology at Harvard University, aims to learn just how race matters when these children of immigrants attempt to make the transition from school to work. In earlier work Waters argued that second-generation West Indians often develop a racial identity that leads them to refuse low-skill jobs in which they feel they must show deference to white supervisors. This earlier research also indicated that employers often discriminate against black Americans in favor of nonblacks or non-native-born blacks, which harms second-generation West Indians because they are viewed as native-born blacks by potential employers.

In this paper Waters focuses on a third way that race matters--the effects of institutional racism and segregation. She studies the effects of neighborhoods and neighborhood schools on the second generation and concludes that even families with the best of intentions face a battle providing their children with the skills and education needed to make it in the labor market.

West Indian immigrants have traditionally been segregated into poorer neighborhoods with declining schools. It is difficult for many second-generation youth to succeed because these schools lack the resources to deal with academically unprepared immigrant youth and are incapable of keeping out the violence that these youth must live with in the surrounding neighborhood.

The Economic Contributions of Hyman Minsky: Varieties of Capitalism and Institutional Reform

Dimitri B. Papadimitriou and L. Randall Wray
Working Paper No. 217

Hyman P. Minsky, who died in 1996, was a leading scholar in the area of financial systems. A part of his work aimed at developing policies that would promote a successful and democratic form of capitalism in an American-style economy. Executive Director Dimitri B. Papadimitriou and Senior Scholar L. Randall Wray summarize the key points of Minsky's arguments.

Minsky strongly believed that there are many varieties of capitalism, and therefore one could not develop general theories applicable to all forms of capitalism. Most importantly, he believed that one must consider the institutions through which an economy operates. Because institutions vary and change, theories must be developed for each specific economy being analyzed. His own work focused on developing policies effective for an evolving, developed, big-government capitalist economy with complex and long-lived financial arrangements--such as is found in the United States. The American economy of the 1990s is not the same as the economy of the early 1900s, he argued. Thus the policies of the past cannot be the policies of today.

Minsky's "agenda for reform" focused on four areas: government size, spending, and taxation; employment strategy; financial reform; and market power. With regard to government size, Minsky concentrated on ways that big governments could use their spending and taxing powers to offset swings of private investment. His employment research focused on strategies that would ensure that all who wanted to work could do so, with government play-ing an important role of providing employment when necessary. He also believed the Federal Reserve could play a greater role in regulating financial markets by encouraging stability-enhancing institutions and practices, and he promoted a number of policies designed to achieve such stability, such as lending practices that reward prudent bank practices. In the market Minsky favored policies that would reduce the current move toward "bigness" by providing greater support to small and medium-sized firms.

Selective Use of Discretionary Public Employment and Economic Flexibility

Mathew Forstater
Working Paper No. 218

Economic systems that are flexible are less likely to experience the sluggish growth or inflation that occurs when production does not match demand. For this reason, flexibility is a desirable feature of an economic system. But in many economic models flexibility is achieved by having a "reserve army of the unemployed" who can be brought into the production system when additional labor is needed and returned to the ranks of the unemployed when production slows. While unemployment is one way to achieve a flexible economic system, Visiting Scholar Mathew Forstater argues it is an economically costly and socially undesirable method for doing so.

Forstater considers another path to flexibility--public sector employment. Public sector employment would result in flexibility because it would act much as the reserve army of the unemployed but without the economic or social costs. This policy approach requires a distinction between public employees engaged in the regular, or necessary, activities of government and those currently unemployed who could be hired for discretionary public sector activities. As with regular public sector activities, discretionary activities can be things that also provide public benefit. However, they are goods and services that the public can do without, at least for a time. Thus, during periods when the private sector needs additional labor, it can draw that labor away from the discretionary public sector by offering better wages, benefits, or working conditions.

Because government does not operate in the same competitive environment as the private sector, there are other ways in which it can use discretionary activities to bring greater flexibility to the economic system. It can chose discretionary activities that increase or decrease the use of capital goods depending on what is most beneficial to the economy as a whole. It can also engage in discretionary activities that use natural resources less intensively. In addition, government can help reduce regional economic inequalities because it has more freedom in choosing locations for discretionary activities.

Linking the Minimum Wage to Productivity

Oren M. Levin-Waldman
Working Paper No. 219

Despite recent increases in the minimum wage, it is still too low to lift many families out of poverty. But each effort to raise the minimum wage has embroiled Congress in a bitter political debate. Resident Scholar Oren M. Levin-Waldman argues that, as a result, Congress is often reluctant to tackle the issue and, when it finally does, the increases granted are too little and too late. It would be far better if the minimum wage could be automatically adjusted without an act of Congress. Such adjustment would provide a mechanism that would help low-wage workers maintain a living wage and it would end the political debate that accompanies any attempt to increase the minimum wage.

Previous proposals for automatic adjustment of the minimum wage have suggested that the wage be tied to the consumer price index (CPI), but this proposal is problematic. Recent research indicates that the CPI overstates inflation and does not adequately measure increases in productivity. Increasing the minimum wage too much or when there is no increase in productivity could be inflationary. A better method, Levin-Waldman argues, would be to link minimum wage increases to private sector wage rates, which more accurately reflect changes in productivity. Two ways of doing this would be to index the minimum wage on the basis of median wages or to set increases in accordance with gains in the average wage of the lowest-skilled workers. Both methods essentially allow the private sector to determine productivity and thus wage increases rather than the government.

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Levy Institute News

Scholars Participate in Debates-Debates

Several Levy Institute scholars participated in recent segments of the national television program *Debates-Debates*. Policy Advisor **Edward V. Regan** took part in the segment "Does President Clinton deserve credit for the strong economy?"; **David A. Levy**, vice chairman and director of forecasting, participated in the debate "Should capital gains be taxed?"; Assistant Director/ Washington Liaison **Sanjay Mongia** argued on the question "Is chain migration the real problem?"; and Senior Fellow **Walter M. Cadette** participated in the segment "Should we privatize Social Security?"

Regan joined with Jim Miller, counselor for Citizens for a Sound Economy, and John Goodman, president of the National Center for Policy Analysis, in arguing that President Clinton does not deserve credit for the strong economy. Their position was that many other factors, such as the growth of global markets and the deregulation begun during the Reagan administration, are behind the current economic boom. In addition, credit for the decreased deficit should go to the Republican-controlled Congress rather than to Clinton. Those crediting Clinton were William Curry, a former Clinton adviser; Robert Kuttner, co-editor of *The American Prospect*, and Alicia Munnell, Peter F. Drucker Professor of Management Sciences at Boston College School of Management. They argued that Clinton is responsible for reducing the deficit and stabilizing the economy, which created an environment in which the private sector could prosper.

In the segment on capital gains taxes, Levy, Kuttner, and Munnell argued that capital gains should be taxed on the grounds that such gains are income and ought to be treated as such. In opposition were Goodman, Miller, and Grover Norquist, president of Americans for Tax Reform, saying that such a tax raises little revenue for the government, yet harms economic growth by discouraging saving and investment. Levy countered that it has not been shown that capital gains and economic output are linked.

Mongia sided with Virginia Abernathy, professor of psychiatry and anthropology at Vanderbilt University School of Medicine, and Mark Krikorian, executive director of the Center for Immigration Studies, in arguing that chain migration--the policy that allows immigrants to bring family members into the United States--is a serious problem. They argued that immigration policy should be directed toward allowing into the country those immigrants with the skills necessary to succeed in the American economy. In opposition were Frank Sharry, executive director of the National Immigration Forum; Francisco Rivera-Batiz, director of the Economic Policy Management Program at Columbia University; and Rita J. Simon, university professor at the American University. In supporting current immigration policy they argued that the United States is strong precisely because it is a nation of immigrants. It is the family unit that provides immigrants with the emotional support that helps them become successful, contributing members of American society.

In the segment on Social Security, Cadette, Munnell, and Robert Eisner, professor emeritus in economics at Northwestern University, argued against privatization of social security on the grounds that the existing system is not only sound, but also a necessary guarantee that older Americans will have some income support in later years. In favor of privatization were Goodman, Representative Nick Smith (R-Mich.), and Michael Tanner, director of Health and Welfare Studies at the Cato Institute. They argued that the system was not fiscally sound and would place a heavy tax burden on future generations of Americans.

David A. Levy Appointed to Presidential Capital Budget Commission

Vice Chairman and Director of Forecasting David A. Levy has been named to the bipartisan Presidential Capital Budget Commission. The commission will investigate the appropriate role of capital investments in federal budgeting and will review capital budgeting practices in the private sector, state and local governments, and other countries. Within a year the commission is to report to the National Economic Council on how best to reflect and encourage public investment while maintaining strict fiscal discipline in the federal budget.

Among others appointed to the commission are Stanley E. Collender, managing director of the Federal Budget Consulting Group at Burson-Marsteller; Carol O'Cleireacain, an economic and management consultant and adjunct associate professor at New York University's Robert F.

Wagner Graduate School of Public Services; Rudolph Penner, former director of the Congressional Budget Office and of Fiscal Policy Studies at the American Enterprise Institute; Herbert Stein, a senior fellow at the American Enterprise Institute; and Laura D'Andrea Tyson, former economic adviser to the president and currently Class of 1939 Professor of Economics and Business Administration at the University of California at Berkeley.

Scholars Brief Members of Congress

Levy Institute scholars met with congressional representatives and staff in Washington for the first in a series of briefings to inform policymakers about Institute research and to provide a forum for bipartisan discussion of significant policy issues. Topics reviewed at this meeting included innovative methods for financing infrastructure projects; policy alternatives to bring Social Security into long-run financial balance while ensuring its continuing delivery of basic benefits for all retired workers; tax system alterations to address the problem of the lack of access to health care for millions of uninsured workers; the role of profits in macroeconomic forecasting; and changes in the Fed's decision-making process as analyzed by Preston Martin, former vice chairman of the Federal Reserve Board of Governors and member of the Levy Institute Board of Advisors.

For more about the policies proposed at this briefing, click on What's New (on the navigation bar on the left) and then on Current Topics.

Levy Institute Conducts National Survey

A significant unknown factor in the 1996 welfare reform law is the extent to which the private sector is willing and able to hire workers off the welfare rolls. Much of the new program appears to be predicated on the assumption that many welfare recipients do not need significant training or development of skills, but they do need the cultivation of "work habits," which develop from having a job. However, potential employers who think otherwise may need an incentive to offer recipients an opportunity to work. Some form of subsidy could serve as such an incentive. There is, however, little empirical information about what business thinks, whether it would respond to a subsidy, and, if so, what type and size subsidy would be necessary. Other questions involve how businesses and workers react to a change in the minimum wage: Do employers hire fewer workers or lay off workers? Do workers who earn more than the minimum wage demand a wage hike? Because much of the responsibility for providing jobs to make the new welfare law successful will fall to small business, the Levy Institute is conducting a national survey of small businesses to find answers to these questions.

Wynne Godley on the Use of Modeling in Macroeconomic Analysis

Distinguished Scholar **Wynne Godley** discusses the use of modeling in guiding macroeconomic policy in "Using Figures to Guide Macroeconomic Policy," his chapter in *Applied Economics and Public Policy*, edited by Iain Begg and S. G. B. Hentry (Cambridge University Press, forthcoming). Godley makes some suggestions about how to reach well-grounded conclusions about macroeconomic policy and how such work can be rationalized, codified, taught, and evaluated.

Although Godley always uses a formal model of the economy to carry out strategic policy evaluations, he believes strongly that the idea of an economic model that in any real sense thinks for the analyst is anomalous; the purpose of a model is rather to enlarge the capacity of the mind to encompass a more complex system of interrelationships than would otherwise be possible. The main part of any forecasting exercise should consist of a careful analysis of the recent past that tries to identify which features of the present are the same as and which are different from earlier periods.

By dint of repeated numerical simulation, using a wide range of assumptions about policy, world trading conditions, behavioral responses, and other factors, an ordered series of logically and behaviorally possible scenarios regarding the future forms in the mind. Some of these are plausible, others not. Some carry strong, albeit conditional, implications for policy. And while there has to be an element of forecasting, the object is not to produce a forecast as such but to provide a navigational chart that lays down alternative courses to desirable destinations, making it possible to skirt hazards and prepare for surprises.

Book Review

Review of Dimitri B. Papadimitriou, ed., *Stability in the Financial System* (London and Basingstoke: Macmillan, 1996), by Ivan Cohen, South Bank University. Reprinted with permission from *Economic Journal*, January 1998.

This book is part of an ongoing research into financial stability sponsored by The Jerome Levy Economics Institute. The focus of the essays which make up the book is an historical comparison of recent reforms of the financial system with those undertaken during the 1930s, with a view to constructing proposals for the reform and modernization of the U.S. financial system. The pedigree of the authors is impeccable, as they are well-known within this area of the literature, coming both from academia and the financial sector, and in a few cases both together. Their writings are lucid and (occasionally) eloquent, eschewing the technical and arcane to focus primarily on the institutional framework, including the regulatory environment. If the book has a flaw, it is that it focuses a little too heavily on the banking system. I would have liked to see a little more on financial markets and (given my own predilections) possible reform of U.S. pensions. This book is written in such a way that the reader does not require a detailed knowledge of the U.S. financial economic history, although it will still have an appeal to those with such knowledge. That the essays tend to focus on the United States may be seen as a deterrent to some potential readers; this would be an egregious error in my view, as the lessons of the past and present offer constructive lessons for other times and other places. Given the global impact of the U.S. on the rest of the world economy, one hopes that U.S. legislators will familiarize themselves with this work before framing legislation in this area. Given the focus on the present and the future, it might reasonably be asked if the book will stand the test of time. The excellent work on financial stability in the past ensures the answer will be yes.

Publications and Presentations by Levy Institute Scholars

Senior Scholar **L. Randall Wray** recently published the paper "Deficits, Inflation, and Monetary Policy" in the *Journal of Post Keynesian Economics* (Summer 1997). He presented the paper "Government as Employer of Last Resort: Full Employment without Inflation" (Levy Institute Working Paper No. 213) at the Full Employment and Price Stability Conference at the University of Ottawa on October 17, at Columbia University on November 10, and at Lafayette College on November 5, where he also presented "Targeting Inflation: The Effects of Monetary Policy on the CPI and Its Housing Component" (Levy Institute Working Paper No. 164, written with Executive Director **Dimitri B. Papadimitriou**). At the Allied Social Science Association (ASSA) meetings in Chicago in January, he presented papers at two Association for Evolutionary Economics sessions, "Toward Full Employment in the 21st Century" and "Money and Taxes in Capitalist Economies."

Visiting Scholar **Mathew Forstater** presented the paper "Employment and Price Stability" at the University of Ottawa conference on October 17 and "Government as Employer of Last Resort: Outline of a Proposal for Full Employment with Price Stability" at the Leeds Postgraduate Conference, University of Leeds, on November 7. He presented "Employing the 'Reserve Army': Structural Implications" at the Association for Evolutionary Economics session "Toward Full Employment in the 21st Century" at the ASSA meetings in January.

Cambridge University Visiting Scholar **Stephanie Bell** was a discussant at the University of Ottawa conference in October and at the Association for Evolutionary Economics session "Money and Taxes in Capitalist Economies" at the January ASSA meetings. She will present the paper "The Role of the State and the Hierarchy of Money: Fiscal and Monetary Policy Implications of Paying Taxes in a Modern Economy" at the Eastern Economic Association meeting in New York City in February.

At the Social Science History Association meeting on October 17-19, Senior Scholar **Joel**

Perlmann presented "Second-Generation Decline? A Reevaluation," written with Research Associate **Roger Waldinger**.

Research Associate **Lynndee Kemmet** presented "U.S.-Mexican Border Relations: Water, Immigration, Trade, and the Role of Agricultural Interests in the California-Mexico Desert Region" at the Northeastern Political Science Association annual meeting in Philadelphia in November, and "From Agriculture to Tourism: Water and the Economic Transformation of California's Coachella Valley" at the Northeastern Agricultural and Resource Economics Association conference in Sturbridge, Mass., in June. Her article "Sustainability and Size: Are Small Farms More Sustainable?" written with Gerard D'Souza and John Ikerd, is to be published in *Sustainability in Agriculture and Rural Development* (Ashgate, forthcoming).

Research Associate **Karl P. Widerquist** and Michael A. Lewis, of the School of Social Welfare of the State University of New York at Stony Brook, presented "An Efficiency Argument for the Guaranteed Income" (Levy Institute Working Paper No. 212) at the annual meeting of the Society for the Study of Social Problems in Toronto in August.

Upcoming Events

April 23-24, Eighth Annual Hyman P. Minsky Conference on Financial Structure

May 8-9, Annual Conference on Employment Policy and Labor Markets

The conferences will be held at Blithewood, the home of the Levy Institute on the Bard College campus, Annandale-on-Hudson, New York. Program and registration information will be posted on the Events page of the What's New section of this web site (www.levy.org) as it becomes available.

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