Levy Economics Institute of Bard College

Report

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19th Annual Hyman P. Minsky Conference on the State of the U.S. and World Economies

AFTER THE CRISIS: PLANNING A NEW FINANCIAL STRUCTURE

The Levy Economics Institute, with support from the Ford Foundation, held its annual Hyman P. Minsky conference at the Foundation's headquarters in New York City on April 14–16. This year's conference focused upon many Minskyan themes, including reconstituting the financial structure; the reregulation and supervision of financial institutions; the relevance of the Glass-Steagall Act; the roles of the Federal Reserve, Federal Deposit Insurance Corporation, and Treasury; the moral hazard of the "too big to fail" doctrine; debt deflation; and the economics of the "big bank" and "big government." In addition, participants at the conference compared the European and Latin American responses to the global financial crisis, and the proposals for reforming the international financial architecture. They also considered both national and international central bank exit strategies.

Minsky studied the conditions that produced a sequence of economic booms and busts, and his proposals for reforming the financial sector were wide ranging and far reaching. He helped us understand how financial innovation reinforces the dynamics of speculative finance that decrease debt quality and increase volatility, both of which are characteristic of current times. And he predicted in 1987 the explosion of home mortgage securitization that eventually led to the meltdown

Paul A. Volcker Jr., chairman of the Economic Recovery Advisory board, speaking at the 19th Annual Hyman P. Minsky Conference in New York City, April 15, 2010

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

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19th Annual Hyman P. Minsky Conference *Continued from page 1*

of the mortgage-backed securities market. Unlike other analysts who looked to causes relating to shocks and foolish policy, Minsky argued that the processes generating financial instability are natural and endogenous to the system. He was convinced that economic systems were prone to financial instability and crisis, and urged that lessons be learned from the crisis of 1929–33, so that "it"—the Great Depression—could not happen again.

Minsky offered a number of proposals for reforming the financial system. He preferred policies that encourage equity finance rather than debt finance and support small- to medium-size banks. He cautioned against banks being allowed to move activities off their balance sheets and was a strong supporter of the Federal Reserve's increasing its oversight of banks by expanding the use of its discount window. He also advocated the creation of a system of community development banks that would provide financial services to underserved neighborhoods, and favored the institution of a system of narrow banks that would offer deposits while holding only the safest of assets, such as Treasury securities.

Presenters at the conference were top policymakers, economists, and analysts from government, industry, and academia who offered their insights into and policy guidelines for the extraordinary challenges posed by the global financial crisis. For the complete text of the speakers' presentations and a summary of the various sessions, visit the News & Events section at www.levyinstitute.org for the 19th Annual Hyman P. Minsky Conference and Proceedings.

New Public Policy Briefs

Deficit Hysteria Redux? Why We Should Stop Worrying about U.S. Government Deficits

YEVA NERSISYAN and L. RANDALL WRAY
Public Policy Brief No. 111

This brief by Yeva Nersisyan, University of Missouri–Kansas City, and Senior Scholar L. Randall Wray argues that deficits do not burden future generations with debt, nor do they crowd out private spending. The authors base their conclusions on the premise that a sovereign nation with its own currency cannot become insolvent, and that government financing is unlike that of a household or firm. Moreover, they observe that automatic stabilizers, not government bailouts and the stimulus package, have prevented the U.S. economic contraction from devolving into another Great Depression. The authors dispense with the (unsubstantiated) concerns about deficits and debts, noting that they mask the real issue: the unwillingness of deficit hawks to allow a (democratic) government to work for the good of the people.

It is important to explain why sustained budget deficits are not a threat since further fiscal expansions may be required, resulting in larger and more prolonged deficits than those projected. In reality, we leave our grandchildren with government bonds that represent net financial assets and wealth. Moreover, deficits today do not condemn future generations to higher taxes. The historical approach is to retain inherited debt and rely on a growing economy to reduce the debt ratio.

Fears that countries such as China will suddenly stop buying Treasuries, and thus no longer "finance" the U.S. economy, are misplaced, since the United States is willing to simultaneously run trade and government budget deficits. The complex linkages between balance sheets and actions will ensure that transitions are moderate and slow.

In terms of the notion that balanced budgets are desirable for households and firms, and therefore governments, the authors point out that households and firms, unlike most governments, have a relatively limited lifespan, and that they do not have the power to levy taxes, issue currency, or demand that taxes be paid in the currency issued. They also point out that almost every significant reduction in the outstanding U.S. debt has been followed by a depression, as budget surpluses reduce nongovernment sector net saving, income, and wealth.

The U.S. federal government can always service its debt, and thus, perpetual budget deficits are "sustainable." Moreover, large (nondiscretionary) budget deficits almost always result from recessions because automatic stabilizers (not discretionary spending) place a floor under aggregate demand. As a result, the authors caution, taxes should not be raised while there is still danger of further unemployment and deflation.

Guided by flawed economic thinking, governments worldwide have imposed unnecessary constraints on their fiscal

capacity to fully utilize their labor resources. Deficit critics fail to understand the differences between the monetary arrangements of sovereign and nonsovereign nations, and that eurozone countries such as Greece have given up their monetary sovereignty and relinquished their public sector's capacity to provide high levels of employment and output. In lieu of exiting the eurozone and regaining control of domestic policy space, Nersisyan and Wray suggest that the eurozone countries create a supranational fiscal authority similar to the U.S. Treasury that is able to spend like a sovereign government.
www.levyinstitute.org/pubs/ppb_111.pdf

The Great Crisis and the American Response

JAMES K. GALBRAITH
Public Policy Brief No. 112

Senior Scholar James K. Galbraith addresses the nature of the financial crisis in the United States, and, in particular, its relationship to the role played by the economics profession. The global abatement of the inflationary climate of the past three decades, combined with continuing financial instability, helped to promote the worldwide holding of U.S. dollar reserves as a cushion against financial instability outside the United States. This was a period of remarkable price stability and reasonably stable economic expansion in the United States.

For the most part, the economics profession viewed these events as a story of self-stabilizing free markets and hands-off policymakers motivated by doing the right thing—what Galbraith calls "the grand illusion of the Great Moderation." Galbraith discusses the approaches of former Levy Distinguished Scholars Wynne Godley and Hyman P. Minsky, including Godley's correlation of government surpluses and private debt accumulation, and Minsky's financial stability hypothesis. Galbraith himself argues the fundamental illusion of viewing the U.S. economy through the free-market prism of deregulation, privatization, and a benevolent government operating mainly through monetary stabilization. The real sources of American economic power, he says, lie with those who manage and control the public-private sectors—especially the public institutions in those sectors—and who often have a political agenda in hand. Galbraith calls this the predator state: a state that is not intent upon restructuring the rules in any idealistic way but upon using the existing institutions as a device for political patronage on a grand scale. And it is closely aligned with deregulation.

In the last decade, as clear signals were sent that previous laws, regulations, and supervisory standards would be relaxed, the financial industry was overrun by the most aggressive practitioners of the art of originating and distributing mortgages *that were plainly fraudulent*. The game came to an end in September 2008, with the failure of Lehman Brothers. The Troubled Asset Relief Program effectively quelled a panic, but at the price of forestalling restructuring and reform that would get at the root of the financial crisis. And even though we have managed to sidestep a second Great Depression, that success is marked by a decimated housing sector and a reeling middle class; by the functional dismantling of the major institutions of the American welfare state; and by a loss of trust in the financial sector that cannot be regained until those responsible for the mortgage fraud are identified and prosecuted, in full.

And there is the issue of Europe. The diverging spreads between Greek and German government bonds are not related to Greek profligacy but to the crisis in the United States and a generalized flight to safety. Still to be resolved is the political game between the bond markets and the European Union and European Central Bank over whether the latter entities will relieve the large financial institutions of their losses. In Galbraith's view, the only way this game *can* be resolved is with the capitulation of the authorities and the Europeanization of Mediterranean debts. This leaves Europe with a situation very similar to what we have in the United States, in which the banks have been effectively rescued but the economies have not, and the price is paid by relentless rounds of fiscal austerity—with the possibility that the economies on both continents may be unable to move back to a pattern of constructive growth.
www.levyinstitute.org/pubs/ppb_112.pdf

Endgame for the Euro? Without Major Restructuring, the Eurozone Is Doomed

DIMITRI B. PAPADIMITRIOU, L. RANDALL WRAY, and YEVA NERSISYAN

Public Policy Brief No. 113

In this brief, President Dimitri B. Papadimitriou, Senior Scholar L. Randall Wray, and Yeva Nersisyan, University of Missouri–Kansas City, observe that the success of the trillion-dollar rescue package European leaders aimed at the continent's growing debt crisis was short-lived, as markets fell on the realization that the bailout would not improve government finances going forward. No rescue plan can address the central problem: that countries with very different economies are yoked to the same currency. Lacking a sovereign currency and unable to devalue their way out of trouble, they are left with few viable options—and voters in Germany and France will soon tire of paying the bill.

Critics argue that the current crisis has exposed the profligacy of the Greek government and its citizens, yet Greece has one of the lowest per capita incomes in the European Union, and its social safety net is modest compared to the rest of Europe. It has reduced its budget deficit by 40 percent since January (largely through spending cuts), but slower growth is causing revenues to come in below targets, and fuel-tax increases have contributed to growing inflation. As the larger troubled economies like Spain and Italy also adopt austerity measures, the authors say, the entire continent could find government revenues collapsing.

Basically, Greece needs more favorable credit terms: lower interest rates and a longer period in which to pay. This is a viable short-term fix, say the authors, but a more far-reaching solution is needed. It's time to start thinking about a major reconstruction of the European project, along two possible paths: (1) an amicable divorce, which would result in a more inefficient, fractured system; or (2) a more perfect union. Immediate relief could be provided by the European Central Bank, which would create and distribute 1 trillion euros across all eurozone nations on a per capita basis. Over the longer term, a permanent fiscal arrangement, through which the central eurozone authorities could distribute funds to member states, would be necessary. Ideally, this should be overseen by the equivalent of a national treasury responsible to an elected body of representatives—in this case, the European Parliament. This arrangement would relieve pressures to adopt austerity measures, and limit the necessity of borrowing from financial markets in order to finance deficits.

www.levyinstitute.org/pubs/ppb_113.pdf

Debts, Deficits, Economic Recovery, and the U.S. Government

DIMITRI B. PAPADIMITRIOU and GREG HANNSGEN

Public Policy Brief No. 114

This brief by President Dimitri B. Papadimitriou and Research Scholar Greg Hannsgen evaluates the current path of fiscal deficits in the United States in the context of government debt and further spending, economic recovery, and unemployment. They are adamant that there is no justification for the belief that cutting spending or raising taxes by any amount will reduce the federal deficit, let alone permit solid growth. The worst fears about recent stimulative policies and rapid money-supply growth are proving to be incorrect once again. We must find the will to reinvigorate government, they say, and to maintain Keynesian macro stimulus in the face of ideological opposition and widespread mistrust of government.

Very high deficits are necessary for at least a few more years because of a dire economic situation. Moreover, there is a need to prevent another crisis by tightening regulation of the financial industry. Fiscal policy, while highly potent, has limited power, so we must strive for more profound reforms—for example, preventing loans that are likely to lead to bankruptcy, strengthening the bond-rating system, preventing dubious assets from being moved off the balance sheets of financial companies, encouraging financially stressed banks to use the discount window under a wider range of contingencies, and fostering community-development financial institutions that address the needs of economically distressed communities.

The authors note that the financial boom-bust cycle observed by Hyman P. Minsky is still very much in evidence. America's current fiscal stance is part and parcel of the recession and financial crisis, and not the product of political whims. Moreover, the deficit cannot be treated as a policy problem when it is a nearly inevitable result of low economic growth, which reduces tax revenues. Furthermore, deficit spending helps the private sector, and the effects of higher deficits have moderated, and ultimately ended, most postwar U.S. recessions.

A good fiscal policy takes advantage of the benefits of automatic stabilizers (income taxes and unemployment benefits) that lead to increased spending during recessions without special legislation or government stimulus packages. In fact, Minsky was an early proponent of what the authors regard as a nearly ideal automatic stabilizer—an employer-of-last-resort program. However, they remain pessimistic about employment recovery in light of the narrow focus of the fiscal policy stance combined with the near absence of many stabilizers that helped in the past.

The authors find that federal government and Federal Reserve liabilities as a percent of quarterly GDP are much less now than they were at the beginning of 1947, so we are not in uncharted territory. On the other hand, government-sponsored entities and their mortgage pools have added more than 40 percent to federal sector liabilities. The mortgage-backed securities on the Fed's books are there to reduce interest rates on mortgages.

It is time to mend some of the holes in the U.S. social safety net. Poverty and unemployment rates are trending upward, and these adverse effects of the recession are strongly affecting many of the poorest groups, including minorities. Initiatives that address key economic problems at the household level—such as an employer-of-last-resort program—can never bankrupt a sovereign nation like the United States.
www.levyinstitute.org/pubs/ppb_114.pdf

New Policy Notes

Economic Policy for the Real World

CHARLES J. WHALEN
Policy Note 2010 / 1

According to Charles J. Whalen, Utica College and Cornell University, the United States is facing not simply a cyclical or an employment crisis, but rather a standard-of-living-and-economic-opportunity crisis—that is, the latest phase in a decades-long "silent depression." Any policy response must recognize that we are dealing with a deep-seated structural problem that is rooted in the evolution of economic development.

Whalen's agenda includes another fiscal stimulus with a major assistance package for state and local governments, more relief for the unemployed and people facing home foreclosures, and financial-sector and fiscal reforms. Legislation should include tougher and broader supervision, contain innovations that threaten financial stability, and address the "too big to fail" problem. Fiscal reform should include stronger automatic stabilizers such as enabling the government to serve as employer of last resort.

An important area of concern is working families. Policymakers should foster economic opportunities, address resource depletion and environmental sustainability, keep aggregate demand high, and strive to generate a hot labor market. In addition, reform should strengthen retirement security, such as reducing the eligibility for Medicare to age 55 (as suggested by Senior Scholar James K. Galbraith), encouraging a return to defined-benefit pension plans, and elevating worker and labor standards according to international agreements.
www.levyinstitute.org/pubs/pn_1_10.pdf

Global Central Bank Focus: Facts on the Ground

PAUL MCCULLEY
Policy Note 2010 / 2

The developed world faces a cyclical deficiency of aggregate demand, the product of a liquidity trap and the paradox of thrift, in the context of headwinds born of ongoing structural realignments. According to Paul McCulley, PIMCO, front-loaded fiscal austerity would only add to that deflationary cocktail. This is why the market vigilantes are fleeing risk assets, which depend on growth for valuation support, rather than the sovereign debt of fiat-currency countries.

McCulley bases his outlook on the financial balances approach (double-entry bookkeeping) pioneered by Wynne Godley. In McCulley's view, Godley's analytical framework should be the workhorse of discussions on global rebalancing.

The notion that fiscal austerity in the developed world will not be a cyclical drag on global aggregate demand rests on the presumption that the private sector (households and businesses) in the developed world will reduce its surpluses and/or the emerging world will reduce its surpluses with the developed world. According to McCulley, this notion ignores the fact that the private sector is running a financial surplus because of deflated asset prices and the desire to get its financial house in order—a profound structural change. Therefore, the only way to avoid risking a deflationary depression is for the developed-country governments to continue to run large financial deficits and/or the emerging countries to reduce their financial surpluses.

Current fiscal deficits in fiat-currency countries are not the cause but the consequence of the Great Recession. Without these deficits, we would be in a second Great Depression, says McCulley. Fiscal deficits are not crowding out private sector borrowing but rather facilitating saving by the private sector (the government sector's liability is the private sector's asset). And fiat-currency countries can roll over debt. Inflation is not a concern because the developed world is far from full employment; moreover, full employment means lower fiscal deficits. Thus, front-loaded fiscal austerity makes absolutely no sense.
www.levyinstitute.org/pubs/pn_2_10.pdf

New Working Papers

Determining Gender Equity in Fiscal Federalism: Analytical Issues and Empirical Evidence from India

LEKHA S. CHAKRABORTY
Working Paper No. 590

India was the first country to institutionalize gender budgeting within its Ministry of Finance. Research Associate Lekha S. Chakraborty focuses on incorporating gender-sensitive fiscal policies at the local level, against the backdrop of fiscal federalism and the Thirteenth Finance Commission of India. This approach to financial devolution would help to identify unique spatial gender needs that depart from one-size-fits-all budgeting policies.

The author recommends that fiscal transfers be calculated on a per capita basis with relative adjustments for regional poverty. Moreover, states with adverse juvenile sex ratios should be penalized, she says, given the magnitude of "missing girls" in India. The best approach is to integrate gender concerns into the local budgetary process, ensure transparency and accountability through better governance, and enhance women's participation and "voice" so that they have more power to influence public expenditures.

Chakraborty outlines some key initiatives on gender-sensitive fiscal policy, such as the positive effect of public education and health spending on the Gender Development Index. Decentralized gender-budgeting policies lead to social multiplier effects related to the care economy, but local government mandates are often poorly funded. Population is the predominant criterion of fiscal devolution, but this measure ignores income disparities between states. Incorporating indices of deprivation, including the percentage of households fetching water or living without sanitation facilities, and supporting public infrastructure investment can have positive social externalities in terms of educating girls or improving the health and well-being of households.

The author concludes that fiscal transfers should be conditional. She suggests a simple method that would attach some weight for the female population in the tax devolution formula of the finance commissions, in the allocation of central assistance for state plans, and in need-based equalization transfers. Thus, the transfer system can and should play a role in upholding the right to life for females in India.

Chakraborty notes that there is growing recognition that fiscal policy can redress intrahousehold inequalities in terms of the division of labor by reducing the amount of time women spend in unpaid work, since time poverty affects income poverty.
www.levyinstitute.org/pubs/wp_590.pdf

Global Imbalances, the U.S. Dollar, and How the Crisis at the Core of Global Finance Spread to "Self-Insuring" Emerging Market Economies

JÖRG BIBOW
Working Paper No. 591

This paper by Research Associate Jörg Bibow investigates the spreading of the global financial crisis to emerging market economies and the systemic deficiencies in the global monetary and financial order. When the bubble burst, the effectiveness of self-insurance and secure policy space was limited, resulting in a massive macro policy response worldwide. As exports stalled, developing countries had a strong self-interest to stimulate domestic demand, while international cooperation helped to forestall recourse to beggar-thy-neighbor policies.

The key issue for developing countries is reform of the global order (e.g., an alternative to the U.S. dollar, an international currency regime, or unfettered global finance), but such reform does not appear to be forthcoming. Bibow advises developing countries to pursue comprehensive capital account management policies (as in China and India), which contain rent extraction through foreign (indirect) investment, along with financial liberalization. This approach is in direct opposition to the preaching of the International Monetary Fund.

The analysis begins with an overview of the channels of transmission and crisis contagion. The belief that the turmoil might be contained, as emerging market economies "decoupled" from declining growth in the advanced economies, was dashed for a number of reasons, including the abrupt shrinkage of private capital flows to emerging markets and the trade credit squeeze. Global finance proved to be both nonneutral and an agent of contagion, helping to spread rather than contain the crisis.

The general tendency for countries to self-insure (e.g., by exporting and accumulating dollar reserves) produces strong deflationary forces. Overall, emerging markets experienced the repercussions of the crisis as a common event in terms of the deleveraging of key global banks, the repatriation of portfolio investments, and the depreciation of currencies against the U.S. dollar. Neither current account surpluses nor large foreign exchange holdings insulated countries from the external shock. And self-insurance strategies did not reduce global systemic risk.

Global liquidity is not constrained because of the international U.S. dollar standard and the unlimited supply of dollars. It is therefore unclear that U.S. current account deficits inevitably pose a risk to global stability. The global monetary and financial order nurtured the U.S. consumer's role as borrower and spender of last resort even as U.S. household balance sheets became increasingly leveraged and fragile. In sum, the global dollar glut sponsored the record five-year global boom (2003–07). The subsequent dollar shortage was key in transmitting the financial crisis from advanced economies to developing countries.

www.levyinstitute.org/pubs/wp_591.pdf

The Global Financial Crisis and a New Capitalism?

LUIZ CARLOS BRESSER-PEREIRA
Working Paper No. 592

The banking and social crisis that began in 2007 represents a turning point in the history of capitalism. Author Luiz Carlos Bresser-Pereira, Getúlio Vargas Foundation, Brazil, summarizes the major changes in the world financial markets since the end of Bretton Woods (i.e., financialization and neoliberalism), and argues that these perverse developments, along with deregulation and the refusal to regulate financial innovations, caused the crisis. And despite the worldwide Keynesian response, he says, the consequences will be particularly harmful to the poor.

Bresser-Pereira foresees greater income inequality in rich countries but declining global inequalities as a result of redistribution to the developing countries; mitigation of capitalism's instability as a result of reregulation; and the emergence of stronger middle-income countries under a new development strategy. Global capitalism will change for the better because it will be neither financialized nor neoliberal.

The author notes that between 1980 and 2007 global financial assets outgrew real wealth (GDP) at a rate of four to one and the frequency of financial crises increased, resulting in a permanent crisis rather than cyclical crises. Financial liberalization undermined the foundations of world financial stability as financial operations became highly risky, opening the way for pervasive fraud and instability. This retrogression was the result of two irrational causes of neoliberalism: the fear of socialism and the transformation of neoclassical economics into mainstream economics. Neoliberalism dominated because it represented the interests of a powerful coalition of rentiers and financialists within the professional class.

Domestically, decisions to increase liquidity, recapitalize the major banks, adopt major expansionary fiscal policies, and reregulate the financial system were the correct political response. Global financial regulation and economic coordination, however, have been insufficient, focusing as they have on the banking crisis and excluding the foreign-exchange and balance-of-payments crises affecting developing countries. Although decisive fiscal actions by government have avoided a depression, the crisis will not end soon, and the problem of insufficient demand worldwide will continue.

www.levyinstitute.org/pubs/wp_592.pdf

A Contribution to the Theory of Financial Fragility and Crisis

AMIT BHADURI

Working Paper No. 593

Two general features in a crisis are a loss of confidence in the financial sector and the transmission of the crisis to the real economy through aggregate demand. Using a schematic model driven by debt-financed consumption, author Amit Bhaduri, Jawaharlal Nehru University, Delhi, formally integrates the mechanism of interaction between these features in a developed market economy.

A loss of confidence can arise in two analytically distinct ways: the financial sector may lose the borrowing public's confidence when the public is increasingly burdened with debt; or, in contrast, confidence may collapse when the "fragile" financial sector is unable to cope with its own liquidity requirements (i.e., there is overborrowing by the public in the real sector and overlending by the financial sector). The author notes that his simple model should be judged by its ability to isolate and capture some crucial mechanisms that cause financial confidence to collapse, thus paving the way to crisis.

Bhaduri outlines how debt-financed consumption drives both the expansion and the contraction of output and economic activity in the real economy. Using plausible assumptions about the lending behavior of financial firms, he outlines how similar fluctuating patterns in the level of debt and income can occur. He also points to illiquidity in the system as the origin of financial fragility.

Bhaduri's model highlights a simple mechanism of fluctuations in debt and income based on a stock-flow approach. The emphasis is on the stock and flow of debt, and its contradictory impact on consumption rather than investment. The financial positions of firms and households undergo change by relying on sustained capital gains rather than regular income to service debt (i.e., a process of transition from speculative to Ponzi finance).

This system becomes particularly vulnerable to unanticipated defaults, even on a small scale, because obligations to repay are augmented through a highly leveraged loan structure created by credit expansion and liquidity that is inadequate to meet these obligations immediately. While expansion of credit is stimulated by rising asset prices, the tendency toward a credit freeze is encouraged by falling asset prices. Another important source of a loss of financial confidence is growing international indebtedness.

www.levyinstitute.org/pubs/wp_593.pdf

Revisiting "New Cambridge": The Three Financial Balances in a General Stock-flow Consistent Applied Modeling Strategy

CLAUDIO H. DOS SANTOS and ANTONIO C. MACEDO E SILVA

Working Paper No. 594

The New Cambridge School articulated the comprehensive empirical modeling strategies associated with the theoretical views of Post Keynesians, and it played an important role in the British macroeconomic policy debate in the 1970s. This school of thought was subsequently adopted by the Levy Economics Institute, whose Macro-Modeling Team, under the leadership of Distinguished Scholar Wynne Godley, anticipated the problems now facing the U.S. and world economies.

Research Associate Claudio H. Dos Santos and Antonio C. Macedo e Silva, University of Campinas, Brazil, base their applied macroeconomic modeling strategy on the New Cambridge three-financial-balances approach, which includes the private, government, and external sectors (and associated agents). The private sector consists of three institutional sectors (households, firms, and banks) and illuminates the Minskyan theme of financial fragility (i.e., financial balances can be interpreted as proxies for changes in the sectors' liquidity). For example, the emphasis by the Levy Institute on the negative U.S. private financial balance after 1997 (and the continuous reduction in liquidity) meant an increase in private financial fragility that proved detrimental when capital gains became losses in the real estate markets. However, financial balances do not tell the whole story about balance sheet dynamics, so a (flexible) stock-flow consistent (SFC) model is required to describe the assets and liabilities of each agent (which has its own specific behavioral functions).

The authors argue that modified versions of the New Cambridge approach to macroeconomic modeling are compatible with modern Post Keynesian SFC macroeconomic models, and an important addition to the tool kit for applied macroeconomists. New Cambridge–type models are much simpler than SFC models, and they are designed to shed light on medium-term trends of capitalist economies and to guide policymaking.

The authors favor an applied modeling strategy that combines direct estimates of the three New Cambridge financial balances with (1) nonmodel information about household, firm, and bank financial balances and balance sheets; and (2) a stylized (but detailed) theoretical SFC model of the economy. This is the strategy that has been adopted by the Levy Institute's Macro-Modeling Team.

www.levyinstitute.org/pubs/wp_594.pdf

The Recycling Problem in a Currency Union

G. E. KRIMPAS

Working Paper No. 595

G. E. Krimpas, National University of Athens, considers the currency recycling problem in terms of the European Monetary Union (EMU). According to Krimpas, the union's architects overlooked the intra-union imbalance problem. National accounts with nominal uniform currencies do not account for competitive differences and imbalances as a result of "real" exchange rates (in spite of balanced budgets). The question is how to devise rules that counteract this problem.

The EMU is in a marginal surplus position with the rest of the world (i.e., imbalances are internal) and the Maastricht rules work only when there are fiscal imbalances, which lead to falling real wages and employment. Thus, oligopolistic power makes the union disinflationary in terms of, for example, unit labor costs.

Since all flows are denominated in the same currency, the union effectively consists of surplus and deficit "countries." And since surplus units are more creditworthy than deficit units, surplus-country profits are retained and cannot be recycled to benefit the deficit country, nor can the deflationary impact on the deficit country be recycled.

Krimpas proposes combining the Currency Union Central Bank and European Investment Bank (EIB) to create an entity that is more than a lender of last resort to the financial system, since it will also be a spender of first resort based on commercial rather than distributional criteria (i.e., the Maastricht principles are not disturbed). EIB principles remain intact and creditworthiness is enhanced, since, like any central bank, the EIB can expand credit autonomously. Furthermore, it obviates the need for a deficit government to borrow from the market (at higher rates than a surplus country). Recycling from the surplus to a deficit fiscal authority is not a redistributive transfer or bailout but a straightforward application of Keynes's banking principle.

www.levyinstitute.org/pubs/wp_595.pdf

Infinite-variance, Alpha-stable Shocks in Monetary SVAR

GREG HANNSGEN

Working Paper No. 596

Macroeconomists have used structural vector autoregressions (SVARs) to quantify the economic effects of monetary policy shocks. Research Scholar Greg Hanngen extends Working Paper No. 546 in an attempt to find out whether one or more innovations (i.e., shocks or error terms) in a monetary SVAR have infinite unconditional variance. He finds evidence supporting the hypothesis that for one or more equations, the error term has an alpha-stable, infinite-variance distribution.

This paper provides a background on alpha-stable distributions; presents a standard SVAR model; discusses the literature on alpha-stable distributions, macro SVARs, and their interconnections; discusses Hannsgen's six-variable monetary SVAR; reports estimates of the characteristic exponent of the error term in each equation of the VAR; and assesses the fit of the estimated alpha-stable distributions.

By examining residuals from his monetary VAR, the author finds evidence suggesting that all of the variances in *V* are infinite. He also finds evidence that a better model than SVAR for some macro data might combine time-varying dispersion with stable, non-Gaussian shocks. And since the empirical generality of the findings is not yet known, Hannsgen suggests that one should be cautious when using SVARs.

www.levyinstitute.org/pubs/wp_596.pdf

Bretton Woods 2 Is Dead, Long Live Bretton Woods 3?

JÖRG BIBOW

Working Paper No. 597

According to the Bretton Woods 2 hypothesis, global current account imbalances reflect a symbiosis of interests among deficit and surplus countries (as exemplified by the United States and developing countries, respectively). The global crisis, however, shows that the U.S. domestic counterpart to its external deficit was based on toxic (private) debts.

A return to precrisis trends is unlikely because of U.S. household indebtedness, says Research Associate Jörg Bibow. He rejects the global savings glut hypothesis: that excess saving flows from developing countries were channeled into the U.S. mortgage markets, causing the housing boom and bust. Since the U.S. dollar is the key global reserve currency, defensive macro policies in the rest of the world prompted expansionary Federal Reserve policies and a global dollar glut. Thus, a Bretton Woods 3 regime could arise where U.S. current account deficits continue, driven by public spending and debt, and safe assets abroad sponsor U.S. spending in excess of income.

The true engine of growth behind Bretton Woods 2 was the U.S. consumer, who acted as both borrower and spender of last resort. Bretton Woods 3—whereby public debt replaces private debt, the rest of the world resumes a policy of current account surpluses and dollar reserve accumulation, and the United States continues to serve as key reserve currency issuer—implies a more lasting role for U.S. fiscal policy in sustaining domestic demand. However, there are concerns about the sustainability of Bretton Woods 3 relating to rising public and external debts, and the role of the United States in sponsoring global growth. The real issues, however, are how U.S. policies affect investment and growth, and whether tax rates become detrimental due to a rising debt (interest) burden.

Bibow concludes that the United States will likely be able to run permanent primary budget deficits in the aftermath of the crisis, even as the debt ratio stabilizes at 100 percent in the medium term. Under Bretton Woods 3, Fed policy will still be important in keeping interest rates and U.S. external financing costs low, while dollar leveraging will continue to play a crucial role in keeping the U.S. income balance and net foreign asset position in check.

According to Bibow, the bancor plan proposed by Keynes, which aims to establish an international monetary order that would enable countries to replace mercantilist strategies with domestic demand–led growth through deliberate management of their economies, continues to offer guidance. Moreover, a post-dollar standard such as the euro is not a near-term prospect.

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The Economic and Financial Crises in CEE and CIS: Gender Perspectives and Policy Choices

FATMA GÜL ÜNAL, MIRJANA DOKMANOVIC, and RAFIS ABAZOV

Working Paper No. 598

Research Associate Fatma Gül Ünal, Mirjana Dokmanovic, and Rafis Abazov, Columbia University, review the countries in Central and Eastern Europe (CEE) and the Commonwealth of Independent States (CIS)—economies that have been seriously impacted by the monetary and financial crisis. They emphasize that fiscal policies must target the lower-middle class, which has been most affected by the global downturn. They also recommend that poverty should be addressed through both short-term programs (e.g., cash transfers and child allowances) and long-term programs (e.g., public/private cooperation in employment generation and social protection systems), and that women should be involved in developing policy. Moreover, economic stimulus packages should prioritize job creation through employment guarantee programs in both the private and public sectors.

The high contraction of GDP in 2009 that took place in the CIS and CEE countries has been attributed to the nature of the transition to a market economy: financial liberalization, financial fragility (foreign investment and unsustainable current account deficits), pegged exchange rates, and the International Monetary Fund's procyclical recipe of government spending cuts. The World Bank estimates that almost 40 percent of the 480 million people in the CEE/CIS region are poor or vulnerable—a number that is expected to rise along with unemployment.

The global crisis has had a dramatic effect on the region's economic output because of its dependence on international trade, foreign direct investment, and remittances. Moreover, economic downturns affect women more than men because of the former's limited access to social benefits and employment in such (hard-hit) sectors as agriculture and export-oriented industries. Privatization of sectors such as education and health care has a negative impact on women's paid labor compensation, while increasing women's unpaid work burden. Meanwhile, there is a persistent gender pay gap.

Gender equality and women's empowerment are essential to achieving equitable and effective development, and to foster a vibrant economy, say the authors. Anticrisis policy responses, stimulus packages, and other measures should account for differentiated impacts based on gender. Furthermore, expansionary fiscal policy should be countercyclical, progressive tax systems should compensate for gender biases, minimum wage regulations should be part of the policy mix, public spending should support gender-sensitive investments in infrastructure, joint initiatives between countries should protect the rights of migrant workers, and financial sector reform should ensure that small producers can access credit from formal institutions.
www.levyinstitute.org/pubs/wp_598.pdf

Racial Preferences in a Small Urban Housing Market: A Spatial Econometric Analysis of Microneighborhoods in Kingston, New York

SANJAYA DESILVA, ANH PHAM, and MICHAEL SMITH
Working Paper No. 599

The divergence of U.S. housing prices across neighborhoods has been associated with race. However, there is a race-amenity correlation with historical links to prejudice, discrimination, and state-sanctioned segregation. The goal of this paper by Research Associate Sanjaya DeSilva, Anh Pham, University of California, San Diego, and Michael Smith, Boston College, is to study the consequences rather than the causes of this correlation.

The authors test for the presence of racial preferences in the small urban housing market of Kingston, New York, and find that price discounts in black neighborhoods and the spatial dispersion of black and white households are caused by the demand for amenities, not by racial prejudice. The goal of policymakers should not necessarily be racial integration but rather the elimination of amenity and price differences that have persisted along racial lines, say the authors—a self-perpetuating cycle that cannot be broken without a concerted investment in schools, parks, libraries, and community policing within inner-city black neighborhoods.

The authors use a unique dataset comprising city records of home sales, block group–level data from the U.S. Census Bureau, and spatial location data from GeoLytics, Inc. Contrary to previous studies, households represent a relatively homogeneous housing stock that shares the same labor market, school district, cultural amenities, and transportation infrastructure.

The study's primary methodological contribution is the use of spatial econometric methods to account for the spatial dependence of unobserved neighborhood characteristics. The authors' dataset has two additional advantages: the ability to disentangle race effects from income and amenity effects, and the ability to overcome problems related to the interpretation of hedonic model coefficients as the capitalization of racial preferences in the housing market.

A key result of the analysis is that the finding based on ordinary least square (OLS) regressions—racial preferences in hedonic pricing models in the presence of spatially correlated unobserved heterogeneity—is incorrect. In fact, their model rejects the OLS conclusion that racial preferences are capitalized in the housing market.
www.levyinstitute.org/pubs/wp_599.pdf

Time and Poverty from a Developing Country Perspective

RANIA ANTONOPOULOS and EMEL MEMIS
Working Paper No. 600

Poverty thresholds and deprivation measures do not incorporate the availability and distribution of time across and within households. According to Research Scholar Rania Antonopoulos and Research Associate Emel Memis, time availability affects living standards. But this notion has been overlooked in traditional poverty measures, and it has not been studied in the context of developing countries. Traditional measures do not capture the time-use dimensions of both paid and unpaid work, nor some of the income-poor and time-deprived households. Due to the close association of the unpaid work burden and poverty, the authors find that a nonsubstitutable amount of unpaid work time (e.g., water and fuel collection) can be as binding as paid work time, while hindering participation in paid work.

The authors conduct a literature review of time-adjusted poverty thresholds and develop a modified analytical framework for developing countries, with a focus on South Africa. Time-poverty and poverty measures have been blind with respect to the time dimension of poverty, inequalities among people, and the allocation of time as a limited resource, say the authors. In developing countries, there are several unpaid work activities where market substitutes or state provisioning options do not exist.

Slightly more than half of South Africa's population lives in poverty, and the unemployment rate (including the economically inactive) is 30 percent. The authors calculate the average minimum for unpaid work in order to derive the time deficit/surplus for South Africa. The results show that 18 percent of the population faces a time deficit, which implies that households need more money income to substitute for the unpaid work time they lack. Single-adult households are more likely to be time poor.

The authors set up a new time-adjusted poverty threshold by adding the monetized value of the time deficit to the traditional poverty threshold for households with a time deficit. They find that people who are both income poor and time deprived are likely to be female, African, living in the ex-homelands, elderly, living in single-adult households, or having at least two children.

Almost 10 percent of the South African population is living under income poverty in combination with being time deprived. The unaccounted-for households that belong in this group (i.e., those who appear time wealthy but are actually time deprived) spend almost twice as much time on unpaid work as the average household.

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Too Big to Fail in Financial Crisis: Motives, Countermeasures, and Prospects

BERNARD SHULL

Working Paper No. 601

The persistence of "too big to fail" policies such as forbearance and bailouts in the face of supervisory and regulatory reforms, and mitigating systemic threats, raises questions about the motives of U.S. authorities during the financial crisis. Bernard Shull, Hunter College, CUNY, concludes that structural reforms should limit further increases in concentration among the largest financial companies. He suggests restricting specific activities, revising bank merger policy, and, perhaps, divestiture.

The author notes that legislative and regulatory modifications have failed to contain too-big-to-fail policies over the last four decades. Concern about the insolvency of savings-and-loan institutions and commercial banks in the 1980s and early 1990s led to the passage of the Financial Institutions Reform, Recovery, and Enforcement Act (1989) and the FDIC Improvement Act (1991), strengthening supervision and regulation, with the aim of limiting forbearance and bailouts. However, banks whose failure posed a systemic threat were exempted from certain restrictions, and the Acts' lack of success was clear when the hedge fund Long-Term Capital Management was not closed immediately in 1998 out of concern for the solvency of other large financial institutions.

The explicit justification by bank regulators (and Congress) for the bailout of large financial firms was to preclude systemic threats (under the belief that these firms served a public interest). If the motivation is to forestall systemic threats, then measures that constrain risk, require more rigorous supervision, and prevent bank failures are in order, says Shull. Reforms, however, are futile if the survival of the largest financial companies is deemed to be in the public interest. In this case, the remedy is structural. Recent proposals have favored breaking up the largest companies, restoring commercial banking to a status consistent with the Glass-Steagall Act, or enacting the Volcker rule, which would prohibit proprietary trading or investing in hedge funds and private equity funds. Activity and merger restrictions help, says Shull, but they will not solve the problem entirely.

There are a number of proposals that would mitigate the too-big-to-fail problem: (1) requiring a more complete analysis of mergers by the Fed and other banking agencies; (2) amending the Riegle-Neal Act to further restrain state and national deposit limits; (3) restricting negotiated divestitures; (4) imposing higher capital requirements and deposit insurance premiums on large banks; and (5) requiring annual Congressional reports (and public hearings) on banking and financial structure by federal banking agencies and the Justice Department that are comparable to the Fed's monetary reports.

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Fiscal Responsibility: What Exactly Does It Mean?

JAN KREGEL

Working Paper No. 602

The U.S. deficit and debt are currently in the midrange of postwar experience. Nevertheless, popular opinion is divided about the merits of the government's stimulus policies, which have provided a floor under the potential collapse of income and employment.

Senior Scholar Jan Kregel discusses fiscal responsibility in light of the failure to recognize the need for additional stimulus measures. He observes that the best policies would have affected balance sheets and the flow of funds, so that household mortgage liabilities could have been written down at the same time as the banks' housing assets and households could have had a minimum credit position by means of a government-guaranteed employment program. These measures would have cost less than the stimulus package, says Kregel. Moreover, it would be irresponsible for the government to reduce its outstanding indebtedness when households, firms, and institutions are attempting to increase their savings.

The assumption that government should act like a household (i.e., operating a fiscal policy that generates a budget surplus) is false, says Kregel, and a clear contradiction of the classical role of government in ensuring that private vices produce public benefits. Also false is the notion that restitution of the debt will burden "future generations," since future consumption will be determined by future national income, irrespective of the inherited debt. In a consistent flow-of-funds accounting framework, household savings correspond to firm losses; that is, household virtue leads to firm bankruptcy, loss of employment and household income, and a decreased ability to save. In a market-based economy, firms can exist only if they make profits (i.e., they must save), which implies that households must spend (by borrowing) and will be unable to repay their debts. An escape from this catch-22 caused by unintended consequences is to introduce autonomous investment.

Government fiscal policy is not bound by pure market principles and budget constraints, and thus can support private sector decisions that lead to public good. For example, a responsible government can deficit spend when the private sector is frugal. Government can influence the budget constraint or the size of credits for both households and firms by creating a sufficiently large debit in its flow-of-funds account. However, there is no strict connection between government deficits and employment (e.g., unemployment continued to rise despite the nearly $800 billion stimulus package).

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Does Excessive Sovereign Debt Really Hurt Growth? A Critique of *This Time Is Different*, by Reinhart and Rogoff

YEVA NERSISYAN and L. RANDALL WRAY

Working Paper No. 603

A study by Carmen Reinhart and Kenneth Rogoff (*This Time Is Different: Eight Centuries of Financial Folly*, 2009) provides empirical evidence of the relations between debt, financial crises, inflation, currency and stock market crashes, sovereign government defaults, and long-run economic growth. Yeva Nersisyan, University of Missouri–Kansas City, and Senior Scholar L. Randall Wray find that Reinhart and Rogoff do not apprehend fundamental monetary operations and the conditions that make sovereign governments "default proof," that they have an incomplete understanding of government debt, and that their results are not relevant for the United States.

According to Nersisyan and Wray, the main problem is that the Reinhart and Rogoff study simply aggregates, over time, small governments operating on a gold standard and large governments with a nonconvertible currency and a floating exchange rate regime. A government operating with a nonsovereign currency and issuing debt either in a foreign currency or a domestic currency pegged to a foreign currency (or precious metals) faces operational and solvency risks. By contrast, the issuer of a sovereign currency cannot be forced into default because it can always spend by crediting bank accounts (something that is recognized by markets and credit raters alike).

Reinhart and Rogoff determine that growth suffers when the sovereign debt-to-GDP ratio exceeds 90 percent (and that the debt threshold is much lower for emerging countries). However, they do not explain why the average growth rate for both advanced and emerging economies with midrange levels of debt (60–90 percent of GDP) is higher than economies with a lower level of debt, and that some countries with debt levels in excess of 90 percent of GDP do not experience declining growth rates. The main drawback of Reinhart and Rogoff's method is that average and median values across different countries and time periods are used to draw their conclusion about the correlation between high debt ratios and low growth.

Nersisyan and Wray explain why "sovereign debt" issued by a country that adopts its own floating, nonconvertible currency does not face default risk. Moreover, bond issues by a sovereign government are voluntary and irrelevant concerning matters of solvency and interest rates. The authors could not find a single case of default when a country issued but did not peg its own currency.

Another problem with the Reinhart and Rogoff study is lumping public and private external debts. Whereas private debt is *debt*, government debt results in net financial asset creation (wealth) for the private sector. And since public debt denominated in a foreign currency can create serious problems for the government, this option should not be pursued.

Nersisyan and Wray maintain that lower taxes and more government spending are not inflationary when an economy is operating well below full capacity. Moreover, the government deficit is too low when people are involuntarily unemployed, so the government should either cut taxes or increase spending in order to mobilize the nation's resources.
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Three Futures for Postcrisis Banking in the Americas: The Financial Trilemma and the Wall Street Complex

GARY A. DYMSKI
Working Paper No. 604

Now is an opportune moment to reshape banking systems in the Americas, says Gary A. Dymski, University of California, Riverside. Doing so, however, will involve overcoming three major barriers: (1) the lack of an alternative vision for a functioning financial system; (2) the constraints of regional economic compacts such as the North American Free Trade Association and the World Trade Organization, and of multinational banks operating within domestic markets; and (3) the disparities between Wall Street and community banks in the United States.

The efficient market hypothesis is premised on a one-size-fits-all approach and the elimination of regulatory barriers, and is embedded in the financial models of the World Bank and the International Monetary Fund. Policy responses to crises include privatizing public banks, eliminating state planning agencies and development banks, and opening up markets to foreign entry. Although there is now some skepticism about this hypothesis, analysts have not embraced an alternative financial system. Rather, the focus has been on how to improve regulations.

Most financial systems are subject to a bank-regulation trilemma, which dictates that either monetary policy or exchange rate stability must be sacrificed when there is a financial crisis. A (developing) country cannot simultaneously be part of an integrated regional compact, have a large share of its market controlled by foreign megabanks, and be free to make its own financial rules and regulations. In effect, countries outside the global financial centers must replace risk regulation with risk compensation.

The dilemma in the United States is between the megabanks and community banks. A decentralized (state) system has permitted excessive risk taking, resulting in a regulatory policy that favors mergers as a means of encouraging banking efficiency and limiting risk. Dymsky notes the contrast between mega- and community banks in terms of risk taking related to off-balance-sheet activities. He also notes that small bank business models depend on local economies and small businesses, while megabank models depend on global finance (e.g., securitization). The dilemma is that there is a mismatch between social functionality and subsidy when countries give "special treatment" to megabanks, domestic or foreign, especially in times of crisis.

Dymski outlines several outlooks whereby Latin America becomes the site of a struggle for global megabank supremacy (and the future of the dollar) or the site of global competition for scarce resources and income. A third outlook is the adoption of a new financial structure based on social and economic functions to serve the needs of national and regional development. This would require modifying regional-compact rules that establish rights of market access for nondomestic financial firms.
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Detecting Ponzi Finance: An Evolutionary Approach to the Measure of Financial Fragility

ÉRIC TYMOIGNE

Working Paper No. 605

In this working paper, Research Associate Éric Tymoigne shows that it is possible to detect financial fragility using macroeconomic data. He finds that the quality rather than the quantity of leverage plays a central role in the growth of financial fragility, and that quality is unrelated to capital equity or profitability. Ponzi finance involves collateral-based lending, so reform leading to financial stability requires a return to sound underwriting practices based on income.

Tymoigne outlines an approach to detect Ponzi finance using Hyman P. Minsky's evolutionary framework of financial fragility (i.e., a crisis is endogenous to an economic system rather than the result of exogenous shocks). He develops an index of Ponzi finance for the U.S. residential housing sector and finds two periods characterized by Ponzi processes: 1989–90 and 1999–2007. He concludes that Ponzi processes can be detected well in advance of a crisis, when bank balance sheets look strong, the net worth of households and businesses is rising, and unemployment is declining.

Fragility and instability are not the same thing, says Tymoigne. Financial instability refers to the propensity of financial fragility to affect the economic process, and it materializes in terms of a debt deflation process. Thus, the goal is to preempt instability by constraining the growth of fragility. Since the (static) models do not account for the underlying problems and processes, policy responses arrive too late to avoid a crisis. A more productive analysis would focus on the growth of fragility during periods of economic stability. The goal is to identify the worsening of financial and funding quality (not quantity) early on in order to take preemptive measures. This circumstance is clearly illustrated by the last U.S. housing boom, when Ponzi finance dominated both prime and subprime mortgage lending.

Which variables to check will depend on the monetary regime as well as the economic sector of interest, and it is best to look at how these variables behave simultaneously (e.g., a rising debt-to-income ratio does not necessarily mean that an economic unit is more fragile, and traditional liquidity ratios can be misleading). There should be more emphasis on cash-flow analysis in order to assess funding structures, liquidity needs, and alternative funding sources (as advocated by Minsky in 1975).

Two central features of Ponzi finance related to cash flows are a growing need for refinancing and shrinking liquidity buffers. These features, together with a rising cash-flow ratio, are better indicators of Ponzi finance than other approaches. It is also important to differentiate between sovereign and nonsovereign monetary regimes, and to use nominal values, when analyzing financial fragility.

Ponzi underwriting practices are based on expectations of refinancing or liquidation rather than on expectations of operating net cash inflows. In order to detect these processes, it is important to check if there is a strong interaction between an asset and a specific debt within a sector's balance sheet, and to be aware that some forms of Ponzi finance are more dangerous than others.

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Changes in Central Bank Procedures during the Subprime Crisis and Their Repercussions on Monetary Theory

MARC LAVOIE

Working Paper No. 606

Mainstream monetary theory has not explained adequately the response of central banks to the financial crisis. Marc Lavoie, University of Ottawa, Canada, analyzes the implications of changes in the operating procedures of the Federal Reserve since August 2007. He finds that the Fed lost control over the federal funds rate following the failure of Lehman Brothers, and that the causal mainstream link between reserves, money, and prices was broken. Most mainstream monetary theory that applies to central banking is worthless, says Lavoie, including the notion of a money multiplier and the presumed causal relationship between bank reserves at the central bank and price inflation. It therefore cannot be claimed that sizable excess reserves have a potentially large inflationary effect.

In September 2007 the Fed made the first of many reductions in its target funds rate. It then adopted more permanent credit-easing operations by introducing the Term Action Facility, which allowed banks to take collateralized loans from the central bank for a one to three month period. To keep the federal funds rate near its target rate, the Fed conducted open market operations by engaging the repo market and selling Treasury bills to the private sector (thus keeping its balance sheet constant and satisfying its compulsory reserve requirements).

When Lehman Brothers declared Chapter 11 bankruptcy in September 2008, the size of the Fed's balance sheet rose precipitously and the spread between the effective and target federal funds rate rose to unprecedented levels (62 basis points). In order to regain control, the Fed tried a number of measures that failed to narrow the gap between the effective and target rates. When the Fed subsequently set the primary credit rate at 0.5 percent and the deposit rate on all reserves at 0.25 percent, and announced that its target rate would be between 0 and 0.25 percent (since it did not fully control short-term interest rates), the spreads between the effective and target rates returned to historical levels.

With the adoption of the floor system, Lavoie observes, the separation between reserves and interest rates is complete—the interest rate can be raised simply by raising the lending and deposit rates. Moreover, fluctuations in reserves are not a concern since excess reserves will keep the overnight rate at the floor level and hence, at the target overnight rate (the decoupling principle). The main advantage of a floor system is that the central bank does not need to neutralize operations or to forecast the demand for reserves. Other advantages include a reduction in the risk of gridlock and the fact that large excess reserves during a recession will induce banks to make more loans (paying interest on reserves does not discourage banks from lending to the nonbanking sector).

The fiscal implications of these findings is that the federal government can be indifferent in terms of deficit financing, either by issuing government securities or by forcing banks to hold reserves at a deposit rate that is close to the interest yield on Treasury bills.

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Extrinsic Rewards and Intrinsic Motives: Standard and Behavioral Approaches to Agency and Labor Markets

JAMES B. REBITZER and LOWELL J. TAYLOR
Working Paper No. 607

The principal agent model supports the idea that extrinsic rewards can be an efficient means of motivating agents. The strategies firms adopt to resolve agency problems (such as conditioning pay on observed productivity) can have profound effects on labor markets by impacting gender and racial inequality, labor market segmentation, and unemployment.

Research Associate James B. Rebitzer and Lowell J. Taylor, Carnegie Mellon University, analyze the principal agent model from a behavioral perspective. Conventional models assume that an agent has utility that is increasing in earnings and decreasing in the provision of effort. Behavioral models employ the same structure as conventional models but modify the agent's utility function to include additional psychological factors.

The authors present a standard principal agent model and then consider the complications that arise when the agent/principal relationship is placed within the context of a firm or labor market. They subsequently introduce the problem of extrinsic rewards with "double duty" incentives in terms of CEO compensation, personnel problems in a firm, and unemployment and labor market segmentation. In each application, the presence of double-duty incentives greatly alters the market outcomes and employment relationships.

The authors then introduce behavioral features to their agency model in the context of double-duty incentives. The most interesting question is whether extrinsic rewards "crowd out" valuable intrinsic motivations. Rebitzer and Taylor find that the introduction of behavioral features into agency models leads to novel and important results: for example, professional norms can protect consumers from exploitation, and this effort can be reinforced by properly designed incentives.

The application of behavioral economics to agency in employment relationships is relatively new. The authors outline promising areas of future research—for example, determining the behavioral foundations of conflicts of interest, given the pivotal importance of professional norms for well-functioning markets in health care and financial services; and understanding the relationship between public policy and income and effort

norms (e.g., high-powered financial incentives in health care, corporate governance, and education could undermine employee motives to do the right thing).
www.levyinstitute.org/pubs/wp_607.pdf

Assessing the Returns to Education in Georgia

TAMAR KHITARISHVILI
Working Paper No. 608

The highly educated workforce of former Soviet Union countries has not guaranteed a successful transition from a socialist to a market-based economy. Research Associate Tamar Khitarishvili finds that education in Georgia has contributed little to workplace earnings and that returns to education are very low compared to other transition countries. In addition, there is little evidence of an increasing trend in returns despite economic expansion. Rather, education provides a higher probability of finding a job as opposed to raising wages (an issue that has been overlooked in the transition literature). The Georgian economy has expanded in state-financed industries such as public administration and education that employ a highly educated workforce but pay relatively low wages.

The author notes that workers with a post-Soviet education are less productive than those who were educated and trained during the Soviet era, the Georgian economy in 2008 had not recovered to pre-1991 levels, and state financing of education remains well below countries at a similar level of development. In response to the establishment of private educational institutions in 1991, there has been a transition away from a Soviet emphasis on industrial skills and toward service and management-oriented occupations that serve a market-based economy. Moreover, the total number of students enrolled in private and public institutions has fallen dramatically since 2004.

Using the Georgian Household Budget Survey, Khitarishvili focuses on hired workers in order to place the results of the analysis in the context of the transition literature and to reduce any bias arising from, for example, income underreporting. And the different characteristics between the working-age group and the hired-worker subsample suggest a need to account for sample selection bias.

In order to compare Georgia with other countries, Khitarishvili uses the ordinary least squares (OLS) approach in combination with an instrumental variable (IV) approach to estimate a Mincerian earnings equation. She finds that an additional year of education raises earnings by 3.12 percent—a very low value compared to other transition countries. Furthermore, the returns to all levels of educational attainment have declined since 1996–97. The likely culprit is the decline in the quality of education at both the secondary and tertiary levels.

The results of various analyses do not show rising rates of return during the economic expansion in 2000–04. Although the proportion of the population with a Soviet-era education is diminishing, substitution by the next generation has not been successful, which explains the absence of an increase in returns to education during the post-Soviet era.
www.levyinstitute.org/pubs/wp_608.pdf

Using Capabilities to Project Growth, 2010–30

JESUS FELIPE, UTSAV KUMAR, and ARNELYN ABDON
Working Paper No. 609

Structural transformation is the process by which countries change what they produce, resulting in shifts in output and employment structures, and leading to high-productivity and high-wage activities. Jesus Felipe, Utsav Kumar, and Arnelyn Abdon, Asian Development Bank, Manila, Philippines, use a cross-country growth regression model to project long-term annual average growth rates for 147 countries over the 2010–30 period. They determine that China will be unable to grow at its current 9–10 percent annual pace because of a deceleration in the rate of accumulation of capabilities. India, on the other hand, will surpass China's growth rate.

The authors use a set of variables that measure a country's fundamental capabilities in determining long-term growth: the sophistication and diversification of the export basket (core commodities are chemicals, machinery, and metals), and the opportunities for future growth based on the existing set of capabilities. These conditional opportunities capabilities (referred to as "Open Forest") are used to gauge the potential for structural change. Open Forest reflects the (expected) value of the goods that a country could potentially export. Density (distance) measures how close a (potential) export commodity is to current export commodities with comparative advantage. It is a proxy for the probability that a country can successfully export a "new" product.

Developed countries have comparative advantage in sophisticated products that are "close" to other sophisticated products, so there is a high probability of export and a high Open Forest. Developing countries, however, depend on their current export baskets and lack the capability to export (new) products—hence, they have a low Open Forest. The authors find that countries with a relatively low GDP per capita in 1962 grew faster over the next 45 years (i.e., there was conditional convergence). And countries with a greater share of acquired complex capabilities at the start of the period also grew faster. They also find that the relationship between Open Forest and GDP per capita is U-shaped, and a one-percentage-point increase in the investment-to-GDP ratio adds 0.03 percentage points to the average annual growth rate.

Population growth rates are added to the GDP per capita growth rates to generate a range of growth rates by country. Projections show that China's growth rate will be in the range of 4.2 to 5.1 percent, while India's will be 5.8 to 7.0 percent. China is unable to accumulate capabilities at its current pace due to a deceleration in the rate of accumulation of capabilities. China's growth projection is comparable to that of other studies, while India's is slightly higher. Russia is projected to grow at a low rate of 1.0 to 1.2 percent, while the United States will expand at a rate of 2.1 to 2.6 percent—higher than the growth rates of Germany and Japan. The authors caution against adopting their approach to project growth rates for the short and medium terms.

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Investing in Care: A Strategy for Effective and Equitable Job Creation

RANIA ANTONOPOULOS, KIJONG KIM,
THOMAS MASTERSON, and AJIT ZACHARIAS
Working Paper No. 610

This working paper was used as the background information and data for Public Policy Brief no. 108. A write-up of the brief headlines the April 2010 *Report* (Vol. 20, No. 2).

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Why China Has Succeeded—and Why It Will Continue to Do So

JESUS FELIPE, UTSAV KUMAR, NORIO USUI, and
ARNELYN ABDON
Working Paper No. 611

China's high output growth rates are a result of capital accumulation, export-led growth policies, and industrialization. Jesus Felipe, Utsav Kumar, Norio Usui, and Arnelyn Abdon, Asian Development Bank, Manila, Philippines, analyze the evolution of Chinese exports since the 1960s, focusing on the sophistication of China's export basket and the number of products with comparative advantage (diversification). They find that China's productive structure in the 1960s was already complex, setting the stage for high growth with comparative advantage in both labor-intensive and sophisticated (core) products.

The authors observe that some form of government intervention underlies all successful cases of structural transformation. China's spectacular performance is the result of industrial policies that allowed the accumulation of product-specific capabilities. Moreover, the country is positioned to continue performing well if policymakers focus more on employment creation and structural transformation than on growth targets.

The authors find that China's export package is unique, given its income per capita, and that the true driver of growth has been the increase in sophistication of the country's export basket (with a transition from animal and capital-equipment products to machinery). By 2006, the number of exports with comparative advantage (269) was only marginally below that of Italy and Spain—some of the most diversified countries in the world—and higher than that of Japan and Korea. Many of these products (100) represented "core" commodities (e.g., machinery and metal products).

The product space model is a path-dependent process that uses network theory to produce a graphical representation of all products exported worldwide. Peripheral products that are weakly connected to other products (e.g., raw materials) provide countries with nature-based comparative advantage. Core products that are closely connected with other products lead to man-made comparative advantage. A country's position in product space signals its capacity for structural transformation.

When China began to produce core products, it diversified and upgraded its export basket quickly.

According to the authors, the most remarkable change occurred in the 1985–90 period, when China began to manufacture electronics. This and other events fostered an increasing capacity to master and accumulate capabilities, along with the role played by industrial policies such as "export processing zones" (a key strategy to learn from foreign firms) and participation in global value chains. Although socialist controls and regulations inhibit private enterprise, they provided a solid foundation for growth (e.g., economic decentralization, egalitarian land distribution, access to education, and a high female labor force–participation rate).

The authors note that there is room for China to continue to increase the number of exports with comparative advantage and that growth will remain strong. However, inequalities are rising, there are serious environmental concerns, and its "market" economy does not include the allocation of capital. They recommend that the government tailor policies and tools by sector, and implement policies in collaboration with the private sector in order to increase the chances of success.
www.levyinstitute.org/pubs/wp_611.pdf

What Do Banks Do? What Should Banks Do?

L. RANDALL WRAY

Working Paper No. 612

Senior Scholar L. Randall Wray examines the later works of Hyman P. Minsky, with a focus on Minsky's general approach to financial institutions and policy. Minsky insisted that the proper role of the financial system was to create a financial structure that would be conducive to economic development in order to improve living standards.

According to Minsky, a capitalist economy can be described by a set of interrelated balance sheets and income statements. All economic units—households, firms, financial institutions, and governments—take asset positions by issuing liabilities with margins of safety related to income, net worth, and liquidity. In terms of financial institutions, Minsky distinguished between traditional commercial banking, investment banking, universal banking, and public holding company models. He recognized that the development of money manager capitalism led to a convergence of models—an insight that helps to explain the current economic crisis.

Investment banking separates the proximate owners of real capital assets (corporations) from the ultimate owners (investment banks or households), so that all corporate liabilities are assets of other economic units. The layering of financial commitments on top of real assets, which generate income, created what Minsky called finance capitalism, where a shortfall in gross profits sets in motion behaviors that threaten the individual firm, and the system as a whole, with debt deflation dynamics (as exemplified by the Great Depression).

Money manager capitalism represents a return to finance capitalism, where the real problem is the demise of underwriting standards, combined with the government's endorsement of private obligations. The current situation is worse than in 1929 because the investment banks have gone public, total U.S. financial liabilities amount to five times GDP, income flows have taken a backseat to higher capital leverage ratios, and there are unknown risks entailed in counterparties. And in spite of the government's efforts to save money manager capitalism, it has not found a way out of the morass.

With help from the government, power was consolidated in a handful of financial behemoths. Brokers no longer had a fiduciary responsibility to account for their clients' best interests, while financial institutions bet against households, firms, and governments. Banking, as practiced in the first decade of the new millennium, had strayed from the (Minskyan) notion that it should promote "capital development" of the economy, says Wray.

Minsky insisted that reforms account for accelerated innovations in both financial intermediation (i.e., relationship banking) and the payments mechanism. Since economies of scale favor relatively small banks, he advocated a proactive government policy to support a network of community development banks (public-private partnerships) that would provide a full range of services. He also recognized that capital development can be negatively affected by a misallocation of investment or by insufficient investment, leading to low aggregate demand that cannot support high employment.

Government protection of banking activities relates to liquidity and solvency. Minsky favored extending the Fed's discount window to include the broad spectrum of financial institutions. If the Fed had lent reserves without limit when the crisis hit, it is probable that the liquidity crisis could have been resolved more quickly, says Wray. In addition, Minsky saw that there is no need to cap deposit insurance. In fact, it would be simpler if the government (without bank partnerships) directly financed activities it perceived to be in the public interest.

Minsky also argued that policy should make the payments system a profit center, so that banks could compete with the money funds. In addition, transaction taxes could be placed on payments made through managed funds, and banks could be subsidized for using the Fed's clearing system. Minsky would have increased the Fed's role and used the discount window as an important tool for oversight, says Wray. Moreover, downsizing the financial industry and reducing its share of corporate profits are necessary in order to serve the public purpose.
www.levyinstitute.org/pubs/wp_612.pdf

As You Sow So Shall You Reap: From Capabilities to Opportunities

JESUS FELIPE, UTSAV KUMAR, and ARNELYN ABDON
Working Paper No. 613

In association with Working Paper nos. 609 and 611, Jesus Felipe, Utsav Kumar, and Arnelyn Abdon, Asian Development Bank, Manila, Philippines, develop an "Index of Opportunities" based on a country's accumulated capabilities to undergo structural transformation. This index measures a country's export basket and its position in product space. In the long run, a country's income is determined by the variety and sophistication of its products, and by the accumulation of new capabilities with comparative advantage.

The authors find that countries such as China, India, Poland, Thailand, Mexico, and Brazil have a significant number of capabilities today that portend positive economic performance in the long run. Good policies and incentives, however, should supplement their capabilities. Countries with poor scores, such as Guinea, Malawi, and Haiti, are in urgent need of policies that lead to the accumulation of capabilities.

The export baskets of China and India are more diversified and unique than expected, given the countries' income levels, and these countries stand out compared to other developing (non–high income) countries. In fact, the index shows that China is third behind Germany and the United States, while India is fifth, just behind Japan. On the other hand, Russia has comparative advantage in fewer products than expected and lower opportunities for further diversification given the sophistication if its export basket. Oil-rich countries have a high level of sophistication but a low diversification of their export baskets.

Developing countries need to acquire more capabilities by increasing the absolute number of core commodities in which they have a comparative advantage, and by shifting their product composition with comparative advantage toward core commodities.
www.levyinstitute.org/pubs/wp_613.pdf

The "Keynesian Moment" in Policymaking, the Perils Ahead, and a Flow-of-funds Interpretation of Fiscal Policy

ANDREA TERZI
Working Paper No. 614

John Maynard Keynes's approach to long-run policy sought ways to let the economy permanently adjust to a higher level of activity. According to Andrea Terzi, Franklin College, Switzerland, Keynes's vision has been misrepresented by government policies that are merely "short-term fixes" aimed at reversing the business cycle during economic crisis. She claims that government actions only marginally reflect Keynes's theoretical framework and are destined to be ineffective if the political tolerance for fiscal deficits is too low for full employment. The euro area, for example, is moving along a deflationary path that will make it a very precarious region in economic terms.

The broad consensus is that a lack of demand caused the global recession. The point, says Terzi, is that the precrisis policy regime had no strategy to deal with a sudden and major fall in aggregate demand. The response reflected a "moment of political emergency." She summarizes Keynes's model and notes that allowing prices and wages to adjust downward will not restore employment and growth, addressing a lack of domestic demand with an export-oriented policy is a socially harmful strategy, and raising interest rates is not a solution to curb "overinvestment." An effective way to end a financial crisis and repay debts is to increase employment, since there is a strong link between demand, employment, and the financial health of the private sector.

Keynes endorsed fiscal policy as a key function and his economic theory (with some qualifications) does not contradict the idea that savings are associated with growth. According to Keynes, however, there is a fundamental difference between monetary and fiscal policy: the former modifies the forward price of money (i.e., the interest rate), while the latter modifies disposable incomes and the net worth of the private sector. In Keynes's model, fiscal expansion is limited by production possibilities associated with the available human and material resources (not in the financial constraints of monetary flows).

Using a simple flow-of-funds model, Terzi demonstrates that only the public sector can bring about a net increase in private-sector financial wealth without a loss of real national wealth. Government fiscal deficits are unconstrained when a sovereign state currency is used, so there is no obstacle to full employment. She assesses the monetary arrangements in the euro area, where institutional constraints to the supply of central bank credit have reintroduced national solvency risks. The limit on deficits has no theoretical foundation, she says, and euro area governments have lost their monetary sovereignty without having a corresponding federal alternative. As a result, these (national) governments are forced to apply procyclical policies when fiscal deficits increase during a slowdown.

In sum, Terzi provides evidence that the prevailing policy regime is at variance with Keynes's policy guidelines; private financial resources are a consequence, not a condition, of government deficits; and the euro area exemplifies a self-constrained approach to fiscal policy where the aim to provide a virtuous currency has backfired. Governments have a real option to act for or against full employment, she says.

www.levyinstitute.org/pubs/wp_614.pdf

INSTITUTE NEWS

The Hyman P. Minsky Summer Seminar and Conference

Levy Economics Institute of Bard College
Blithewood, Annandale-on-Hudson, N.Y.
June 19–29, 2010

The Levy Institute held its first Minsky Summer Seminar and Conference under the leadership of President Dimitri B. Papadimitriou and Senior Scholars Jan Kregel and L. Randall Wray. More than 50 scholars worldwide attended the weeklong seminar, while more than 100 participants attended the three-day international conference that immediately followed.

The seminar provided a rigorous and intensive discussion of both theoretical and applied aspects of Minsky's economics, with an examination of meaningful prescriptive policies relevant to the current economic and financial crisis. The instructors included well-known economists concentrating on and expanding Minsky's work. The conference provided a forum for the presentation and discussion of various Minskyan themes: financial fragility; reconstituting the financial structure; modern money, money endogeneity, and functional finance; asset bubbles; employment of last resort and macroeconomic stability; stock-flow consistent modeling and policy simulations; and the Levy Institute's macroeconomic models.

Upcoming Event

The Hyman P. Minsky Summer Seminar

June 18–26, 2011

The second annual Minsky Summer Seminar will be held at Blithewood, the Institute's main research and conference facility in Annandale-on-Hudson, N.Y., from June 18 to 26, 2011. Applications may be made to Susan Howard at the Levy Institute (howard@levy.org), and should include a current curriculum vitae. Admission will include provision of room and board on the Bard College campus, and a limited number of small travel reimbursements will be available to participants.

The deadline for applications is March 31, 2011. For further information, visit www.levyinstitute.org.

New Research Associate

Sunanda Sen has joined the Levy Institute as a research associate in the Monetary Policy and Financial Structure program. Sen is a national fellow of the Indian Council of Social Science Research and a visiting professor at the Institute for Studies in Industrial Development, Delhi; Jamia Millia Islamia University, Delhi; and the Institute of Development Studies Kolkata, among other institutions. She previously taught for nearly three decades at the Centre for Economic Studies and Planning, Jawaharlal Nehru University, Delhi. In 1994, she held the Joan Robinson Memorial Lectureship at Cambridge University, and she is a life fellow of Clare Hall, Cambridge.

Sen's current research relates to global finance, money, development, labor, economic history, and gender studies. Her published works include the books *Unfreedom and Waged Work: Labour in India's Manufacturing Industry* (with B. Dasgupta), 2009*; Globalisation and Development*, 2007; *Global Finance at Risk: On Real Stagnation and Instability*, 2003; and *Trade and Dependence: Essays on the Indian Economy*, 2000.

Sen holds a Ph.D. from the University of Calcutta, India.

PUBLICATIONS AND PRESENTATIONS

Publications and Presentations by Levy Institute Scholars

PHILIP ARESTIS *Senior Scholar*

Publications: *The Post 'Great Recession' US Economy: Implications for Financial Markets and the Economy* (with E. Karakitsos), Palgrave Macmillan, 2010; ed. (with M. C. Sawyer), *21st Century Keynesianism*, Palgrave Macmillan; "21st Century Keynesian Economic Policies" (with M. C. Sawyer), in P. Arestis and M. C. Sawyer, eds., *21st Century Keynesianism*, Palgrave Macmillan; "Capital Account Liberalisation and Poverty: How Close Is the Link?" (with A. Caner), *Cambridge Journal of Economics*, Vol. 34, No. 2 (March); "Financial Globalisation and Crisis, Institutional Transformation and Equity" (with A. Singh), *Cambridge Journal of Economics*, Vol. 34, No. 2 (March); "The Mediterranean Countries Are Being Condemned to High and Rising Unemployment" (with M. Sawyer), in "Beyond the Public Debt Crisis: The European Union at a Crossroads," special issue, *Re-public*.

Presentations: "Origins of the August 2007 Financial Crisis," public lecture sponsored by the School of Economics and Business Studies, Complutense University, Madrid, Spain, April 8; "Economic Policies to Tackle 'The Great Recession,'" public lecture sponsored by the Hispanic-British Foundation, Madrid, May 11; "Economic Policies for the Post-crisis Era," public lecture sponsored by the Barclays Foundation, Madrid Stock Exchange, May 12; "Estimating Monetary Policy Preferences of the ECB" (with M. Karoglou and K. Mouratides), conference on "Macro and Financial Economics," organized by the Brunel Macroeconomic Research Centre and Quantitative and Qualitative Analysis in Social Sciences, Brunel University, London, England, May 27, and the 17th Annual Meeting of the Multinational Finance Society, Melia Barcelona, Barcelona, Spain, June 27–30; "The Current Crisis and Economic Policy Implications," conference on "Beyond the Headlines—The Political Economy of the Crisis," organized by the Political Economy Research Group, Kingston University, London, June 15, and conference on "Financial and Economic Crisis: The Return to Stability," organized by the Scholars' Association of the Alexander S. Onassis Public Benefit Foundation, Athens, Greece, June 21; "The Economic Policies of the Political Economy of the Australian Patriot and Cambridge Economist," "Economic Policies of the 'New Economics,'" and "Time to Say Goodbye to the Euro?" (with M. Sawyer), 7th International Conference on Developments in Economic Theory and Policy, Institutions and European Integration, Bilbao, Spain, July 1–2.

JAMES K. GALBRAITH *Senior Scholar*

Publications: "Pay Inequality in the Turkish Manufacturing Sector by Statistical Regions: 1980–2001" (with A. Y. Elveren), UTIP Working Paper No. 59, March 4, 2010; "In Defense of Deficits," *The Nation***,** March 22; "Twelve Things the World Should Toss Out: The Congressional Budget Office," *The Washington Post*, May 6; "Don't Fear the Debt," *The New York Times*, May 12; "A Financial Crisis, Not a Deficit Crisis," *Campaign for America's Future*, June 30; "Why the Fiscal Commission Does Not Serve the American People," *The Huffington Post,* June 30; "Tremble, Banks, Tremble," *The New Republic*, July 19.

Presentations: panelist, "Wealth, Empire and the Future of America: An Exploration of the Deep Politics of War," New York Open Center, New York, N.Y., March 13, 2010; panelist, "Rebuilding America: How to Do It and How to Pay for It," EPS Bernard Schwartz Symposium on "Jobs, Investment, and Energy: Meeting President Obama's Challenge," sponsored by Economists for Peace and Security, Washington, D.C., March 23; "Macro Economic Issues & Monetary Policy Implications," The Health Management Academy Treasurers Forum, Irving, Texas, April 6; "Inequality and Economic and Political Change: A Comparative Perspective," Inaugural Conference, Institute for New Economic Thinking, Kings College, Cambridge, UK, April 10; "The Predator State and the Great Crisis," Clifford and Virginia Durr Memorial Lecture, Auburn University, Montgomery, Alabama, April 17; panelist, "Future Crises in the World Economy and Geopolitical Consequences," CISS Second Annual Symposium: "The Geopolitical Implications of the Financial Crisis," Center for International Security Studies, Princeton University, Princeton, New Jersey, May 13–14; "The New Normal: Doing Less with Less," 18th Biennial Forum of Government Auditors: "Transparency in Government: Lighting the Way Forward," San Antonio, Texas, May 18–20; "The Great Crisis and the American Response," 57th Conference of the German-American Studies Association, Humboldt University, Berlin, Germany, May 27; "The Imperative of a Green New Deal," Institute for Interdisciplinary Social Research, Friedrich Schiller University of Jena, Jena, Germany, June 4; "The Great Crisis and the American Response," Athens Economics University, Athens, Greece, June 8; commentary on "The Slump, the Recovery and the New Normal" by E. S. Phelps, conference on "Challenges of the Global Crisis to Macroeconomic Theory and International Finance," Helsinki, Finland, June 11; "The Necessary Future of Social Democracy," Bruno Kreisky Forum, Vienna, Austria, June 14; testimony on the financial crisis, and especially the role of fraud, before the Commission de Finances, Sénat de la Republique Française, Paris, France, June 18; panelist, "The Links between the Real Economy, Fiscal Sustainability, and Financial Markets: Has Enough Been Done?" conference on "What Social Democratic Solutions Can We Have to the Current Economic Situation?" Foundation for European Progressive Studies, Lisbon, Portugal, July 9–10.

JAN KREGEL *Senior Scholar and Program Director*

Publications: "A New Triffin Paradox for the Global Economy," in A. Birolo et al., eds., *Production, Distribution, and Trade: Alternative Perspectives, Essays in Honour of Sergio Parrinello,* Routledge, 2010; "Can a Return to Glass-Steagall Provide Financial Stability in the U.S. Financial System?" *PSL Quarterly Review*, Vol. 63, No. 252 (March).

Presentations: "Mercados financieros y especialización en el comercio internacional: El caso de los productos básicos," Encuentro Internacional de Economistas: Globalización y Problemas del Desarrollo, Havana, Cuba, March 2; "Regulating the Size of Financial Institutions," X IIEc-UNAM Seminario de Economía Fiscal y Financiera: "Banca global: Regulación y cambio institucional para el desarrollo," Mexico City, Mexico, March 16–18; "Modernisation of the Russian Economy: Financing Innovation and Modernisation of the Russian Economy," Expert–Other Canon Conference, Gonville and Caius College, Cambridge, UK, March 28–30; "Financiamiento y políticas de desarrollo: Elementos para una regulación más eficaz del sistema financiero argentine: The Minsky Alternative to Financial Reform in Finance Development," Buenos Aires, Argentina, April 5; "Why Bailouts Aren't Working and Why a New Financial System Is Needed," Caribbean Business Executive Seminar: "The Future of the Financial Services Industry after the Crisis," Port of Spain, Trinidad and Tobago, April 30; "The Architecture of the International Monetary (Non-)System: What Is Unsustainable? What Is Missing?" "Initiative Triffin 21: Towards a World Reserve Currency," Triffin International Foundation, Turin, Italy, May 13–15; "Financing Growth with Financial Stability and the New Developmentalism," Fundaçao Getulio Vargas, Sao Paulo School of Economics (EESP), Sao Paulo, Brazil, May 24–25; "Urgent Policy Responses and Congressional Proposals for Reform of the U.S. Financial System," Commission de Finances, Sénat de la Republique Française, Paris, France, June 17; "Financial Liberalization and Global Governance: Taking Stock of the Role of International Entities," IBASE–Ford Foundation Conference, Ipanema, Brazil, July 5–6.

ELLEN CONDLIFFE LAGEMANN *Senior Scholar and Program Director*
Publication: *Preparing Teachers: Building Evidence for Sound Policy*, final report of the National Research Council's Committee on the Study of Teacher Preparation Programs (E. C. Lagemann, chair), National Academies Press, 2010.

THOMAS MASTERSON *Research Scholar*
Publication: Ed. (with E. Kawano and J. Teller-Elsberg), *Solidarity Economy I: Building Alternatives for People and Planet*, Center for Popular Economics, 2010.
Presentations: "Trends in American Living Standards and Inequality, 1959–2007" workshop on "Income Inequality: A New Threat to Globalizing Economies," organized by Kyoto Sangyo University and Nagoya University, Kyoto, Japan, April 10; "The United States in a Global Economy," symposium on "Income Inequality: A New Threat to Globalizing Economies," organized by Kyoto Sangyo University and Nagoya University, Kyoto, Japan, April 12.

DIMITRI B. PAPADIMITRIOU *President*
Publications: "Promoting Economic Growth and Development through an Employment of Last Resort Policy," *Bulletin of Political Economy*, Vol. 3, No. 2 (December 2009); joined the editorial advisory board of the *Journal of Economic Analysis*, 2010; "A New 'New Deal' for Job Creation" (in Greek), *Kathimerini*, January 24; "Holiday from the Eurozone Would Bankrupt Greece," *Financial Times*, February 19; "How the Wall Street Investment Banks Sank Greece" (in Greek), *Kathimerini*, March 7; "The Future of the Euro: Europe's Threat and Pity," *Kathimerini*, May 2; "The European Mega Loan Fund Is No Panacea," *Kathimerini*, May 16; "Greek Debt Restructuring Unavoidable," *Kathimerini*, June 6; "Spending Cuts and Tax Increase Will Not Decrease the Budget Deficit," *Kathimerini*, June 27; "The Faulty Structure of the Eurozone," *Kathimerini*, July 11.
Presentations: Interview regarding socially responsible investing in lieu of the market crash of early 2008 with Jesse Ordansky, *Chronogram*, March 16; interview, Sky TV Greece, March 22; interview regarding the consumer price index in relation to cost-of-living trends with Sarah Bradshaw, *Poughkeepsie Journal*, March 31; interview regarding the powers of the European Central Bank with Ron Fink, CFOZone, May 7; interview regarding the proposal to restructure the financial system with Sewell Chan, *The New York Times*, June 4; interview regarding obstacles to private sector investment with Stuart Varney, *Varney and Company*, Fox News, July 27.

JOEL PERLMANN *Senior Scholar and Program Director*
Publication: "Secularists and Those of No Religion: It's the Sociology, Stupid (Not the Theology)," *Contemporary Jewry*, Vol. 30, No. 1 (June 2010).

EDWARD N. WOLFF *Senior Scholar*
Publications: "Review of *Transmitting Inequality: Wealth and the American Family* by Yuval Elmelech," *Journal of Contemporary Sociology,* Vol. 39, No. 2 (2010); "Rising Profitability and the Middle Class Squeeze," *Science & Society,* Vol. 74, No. 3 (July).
Presentations: "Rising Profitability and the Middle Class Squeeze," NYU Colloquium on the Economic Crisis, February 24, and New School for Social Research Student Economics Conference, March 5; "Spillovers, Linkages, and Productivity Growth in the U.S. Economy, 1947 to 2007," CESIS Workshop on Innovation and Productivity, Vienna University of Economics and Business, Vienna, Austria, April 6–8.

GENNARO ZEZZA *Research Scholar*
Presentations: "Income Distribution and Borrowing: A 'New Cambridge' Model for the U.S. Economy," seminar, Universite Paris XIII, Villetaneuse, France, April 16, 2010; "Getting Out of the Recession? Strategies for Sustainable Growth," conference on "The Global Crisis, Policy Failures, and the Road to Prosperity," Lugano, Switzerland, April 20; "Tracking the U.S. Economy with a Post-Keynesian Model," Seminari di Economia della Sapienza, Rome, Italy, May 27.

Recent Levy Institute Publications

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The Great Crisis and the American Response
JAMES K. GALBRAITH
No. 112, 2010 (Highlights, No. 112A)

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JAN KREGEL
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