The Levy Economics Institute of Bard College

Summary

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

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

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LETTER FROM THE PRESIDENT

To our readers:

Recent attempts by the U.S. Treasury and the Federal Reserve (Fed) to counter the worst financial and economic crisis since the Great Depression have brought into question the role of the government and the effectiveness of its rescue package. Levy Institute scholars foresee an extended period of stagnation and possibly deflation if the government does not take a more active role in terms of fiscal policy, direct homeowner relief, and regulatory system reform.

Under the Monetary Policy and Financial Structure program, four policy notes outline more effective approaches to dealing with the financial crisis. Senior Scholar L. Randall Wray favors rebuilding U.S. public infrastructure, with the federal government acting as employer of last resort, along with a New Deal–style institution to support homeownership patterned after President Roosevelt's Home Owners' Loan Corporation. According to Senior Scholar Jan Kregel, Washington's solution starts at the wrong end—with the devalued assets resulting from debt deflation rather than the absolute liquidity preference caused by the failure to assess counterparty risk with confidence. He proposes that the Fed play the same role as the exchange clearinghouse in the interbank market, so that the Fed guarantee would take the place of the Treasury's $700 billion bailout. Building on Hyman P. Minsky's preference for bank holding company structures, Kregel also proposes the creation of numerous types of (limited) subsidiaries within the holding company model. In our joint policy note, Wray and I maintain that the primary responsibility for economic recovery must be in the hands of the Treasury (not the Fed), and that more jobs and rising incomes are the ticket for policy formation by the forthcoming Obama Administration.

Two public policy briefs continue the discourse about the instability of the financial markets and the prospect of a prolonged crisis in the absence of adequate policy interventions. Pedro Nicolaci da Costa focuses on the failures of the Fed as a regulatory body during asset bubbles, and contends that central bankers who accept self-policing as a basis for sound regulation are setting the global economy up for a real disaster. Wray shows how money market capitalism (financialization) has destabilized subsequent asset classes, and maintains that policymakers must fundamentally change the structure of our economic system and break the cycle of booms and busts.

Five working papers under this program are also reviewed. Wray and Éric Tymoigne present an alternative to the "efficient markets hypothesis," noting that policy has to continually adapt, while recognizing how investment financing leads to cyclical behavior that could degenerate into a debt deflation rivaling the Great Depression. Senior Scholar Philip Arestis, Luiz Fernando de Paula, and Fernando Ferrari-Filho examine inflation targeting in Brazil and find no evidence that it improves economic performance in emerging economies. Tymoigne reviews Minsky's theoretical framework and finds that there never was a Keynesian revolution in economic theory or policy associated with the Roosevelt and Kennedy/Johnson Administrations. Luisa Fernandez, Fadhel Kaboub, and Zdravka Todorova examine Minsky's theory (that stability breeds instability) in relation to the subprime housing crisis, and determine that inequality also breeds instability and is the real cause of financial crisis. The only viable means of achieving both higher homeownership rates and economic stability is an updated version of Minsky's employer-of-last-resort program. Jan Toporowski observes that the internal liquidity of large companies, not monetary policy, is the key factor in nonfinancial business investment.

There are three working papers under the Gender Equality and the Economy program. Zahra Karimi finds that female carpet weavers in Iran are among the principal losers in the rapid expansion of international trade, Research Scholar Rania Antonopoulos provides a comprehensive overview of current research about gender disparities in paid and unpaid work, and Research Scholar Thomas Masterson finds some evidence of a pro-male bias in education expenditures in Paraguay.

In a working paper under the Employment Policy and Labor Markets program, Research Associate Pavlina R. Tcherneva concludes that Keynes favored employment schemes in the form of public works during times of both recession and expansion. In another working paper, I outline the merits of direct government job creation programs that can provide a universally accessible social safety net, while contributing toward the achievement of the United Nations' Millennium Development Goals.

Under the Economic Policy for the 21st Century program, a working paper by Research Scholar Greg Hannsgen finds that the distributions of the innovations in monetary structural vector autoregressions have infinite variances.

As always, I welcome your comments and suggestions.

Dimitri B. Papadimitriou, *President*

Program: Monetary Policy and Financial Structure

What's a Central Bank to Do? Policy Response to the Current Crisis

L. RANDALL WRAY

Policy Note 2008/3

Homeowner equity continues to disappear, wiping out wealth and generating skyrocketing defaults on home equity and other types of loans against real estate. Senior Scholar L. Randall Wray offers an alternative view to the Federal Reserve's (Fed) policy model, which is not working—mainly because policymakers do not recognize the underlying forces driving the crisis.

Based on Hyman P. Minsky's approach, Wray's framework for policy formation includes rebuilding U.S. public infrastructure, with the federal government acting as employer of last resort, along with a New Deal–style institution to support home ownership patterned after President Roosevelt's Home Owners' Loan Corporation. The Treasury explicitly guarantees the debts of government-sponsored enterprises, such as Fannie Mae and Freddie Mac, and similar rules and supervision are imposed across all types of institutions that are allowed to operate in the same markets. Wray also recommends the elimination of cheap dollar/mercantilist policy and the removal of government-supported managed money from the commodity markets. Since the "Big Bank" Fed cannot do much more than it has already done, the rest is up to what Minsky called "Big Government" policy operating in the public interest.

The "new consensus" economic model used by central banking advocates activism, whereby the central bank (favoring a modified Taylor Rule) reacts to demand gaps by adjusting the target interest rate. The bank believes that there is a "neutral" interest rate consistent with a "Goldilocks" performance. However, the neutral rate varies over time and is only discovered after the fact, and policymaking is difficult because of lags and inertia. In seeking the neutral interest rate, the Fed must manage inflation expectations; it therefore reduces inflation so that inflation plays no role in economic decision-making (i.e., "the Great Moderation"). However, the financial markets responded with innovative practices that increased homeownership rates and reduced the need for New Deal programs like welfare and Social Security, and fiscal policy. Expectations management, therefore, could not prevent bubbles, slow inflation, or jump-start a faltering economy.

The Fed's low interest rate policy did not reassure financial markets outside the United States. There was a movement away from the dollar and a rapid depreciation of exchange rates, which spurred U.S. exports but increased the price of imports (e.g., oil). Minsky argued, however, that growing exports are inflationary because a smaller portion of total production is available for domestic consumption, so domestic prices must rise to prevent residents from consuming the goods destined for export. Thus, as inflation climbed and the run to commodities was encouraged, prices rose in a virtuous cycle. We are now waiting for the collapse of commodity prices, says Wray, adding that the collapse appears to be already under way.

Stagflation has reentered the lexicon as U.S. inflation rates climb and economic growth slows. Indeed, previous experiences with accelerating inflation were led by rising food, energy, and housing costs. Even as real estate prices collapse, housing's contribution to CPI inflation will not necessarily diminish. We have a recipe for sustained inflation even in a recession, observes Wray. The Fed's interest rate cuts will not do much to restore economic growth or quell financial market unrest. Lower rates have fueled pass-through inflation from dollar depreciation and rising oil prices due in part to depreciation. The Fed's interventions have done little to settle markets because the problem is not simply one of liquidity but also solvency, which cuts off credit. The most recent fiscal stimulus, in the form of tax rebates, will not stop the carnage because it will not restore the housing sector and employment, or eliminate the debt overhang. We can expect an extended period of stagflation because slow growth will not reverse the dollar's fortunes or sufficiently moderate commodity prices.

Relief would come by dealing with the sources of the problem: the purchases of commodity futures by managed money funds and oligopoly pricing by oil producers. Measures include removing all tax advantages for funds that purchase commodities, prohibiting purchases of such assets by funds that benefit from government guarantees, drawing down the U.S. Strategic Petroleum Reserve to increase supply in spot markets, and stopping the administration's "cheap dollar" mercantilist policy. The United States is too large and too rich to rely on export-led growth.

Expanding the nation's infrastructure could generate enough jobs and consumer demand to keep the economy close to full employment for the next decade. The biggest policy challenge is what to do about "money manager capitalism" (pension, insurance, and hedge funds), because money managers are certain to create another asset price boom that will renew and extend all of the financial practices that caused the current crisis. Given the government guarantees behind many of the liabilities of the regulated sectors, there is justification for the government to regulate, supervise, and prohibit activities considered too risky or against the public interest. Thorough reform is needed to make it more difficult for banks and thrifts to participate in the next speculative boom or collapse.

For the complete text, go to www.levy.org/pubs/pn_3_08.pdf.

A Simple Proposal to Resolve the Disruption of Counterparty Risk in Short-Term Credit Markets

JAN KREGEL

Policy Note 2008/4

According to Senior Scholar Jan Kregel, Washington's solution to the imminent collapse of the financial markets starts at the wrong end—with the devalued assets resulting from debt deflation, rather than the absolute liquidity preference caused by the failure to assess counterparty risk with confidence. He proposes that the Federal Reserve (Fed) could play the same role as the exchange clearinghouse in the interbank market, whereby banks could hold deposits with the Fed in order to build liquidity. Since the Fed would be the counterparty for banks, the banks would not have to assess the counterparty risk of borrowers. The Fed, as counterparty, eliminates the associated risks of interbank lending, thus reducing short-term interest rates and restoring confidence in the interbank market. The Fed guarantee would take the place of the Treasury's $700 billion bailout.

This proposal should resolve the problem of assessing counterparty risk, says Kregel, and restore short-term lending without government funding, asset pricing, or approval of a bailout package. The problem of recapitalizing and reviving banks can be approached by the Federal Deposit Insurance Corporation (FDIC) or by an agency similar to the Hoover-era Reconstruction Finance Corporation, while home foreclosures could be dealt with through an agency modeled after the Home Owners' Loan Corporation of the 1930s.

The new financial architecture, which buttressed the "new consensus" in monetary theory, was to have eliminated the possibility of a 1930s-style business cycle by providing a more rational and efficient distribution of risk through the use of new risk-based capital requirements and new risk-specific instruments. It is clear that this system has broken down, says Kregel, and there is general distrust of counterparties to any financial transaction. As pointed out by Hyman P. Minsky, this situation leads to a process of asset liquidation and debt deflation, which quickly devolves into systemwide insolvency and bankruptcy. Given the difficulties in raising capital under the current (abysmal) conditions, capital can only be increased by reducing the size of balance sheets further; that is, less lending, rather than more.

A supplement to Kregel's proposal would include support of the banks' core deposit base by removing the FDIC limit in order to match the unlimited guarantee recently given to money market funds. Additionally, member banks should be allowed to borrow from the Fed an unlimited amount without collateral, to eliminate the possibility that larger banks could dominate the market for retail deposits at the expense of smaller banks. Kregel's approach would also clear the way for policy to prevent the decline in employment from rationalizing the financial sector by supporting employment in the manufacturing and service sectors. Minsky would suggest a government employment guarantee program that provides direct income support while increasing the production of useful goods. It would be particularly appropriate to resolve the infrastructure gap in the U.S. economy.

For the complete text, go to www.levy.org/pubs/pn_4_08.pdf.

Will the Paulson Bailout Produce the Basis for Another Minsky Moment?

JAN KREGEL

Policy Note 2008/5

As the House Committee on Financial Services meets to hear the expert testimony of witnesses concerning the regulation of the U.S. financial system, the measures that have been introduced to support the system are laying the groundwork for a new domestic financial architecture (e.g., the disappearance of all the major investment banks and their reappearance as financial holding companies). The Federal Reserve and U.S. Treasury seem to be supporting a model in which the funds made available through the Emergency Economic Stabilization Act (2008) are used by stronger holding companies to merge with weaker financial institutions.

Hyman P. Minsky was not in favor of returning to a Glass-Steagall system of bank segregation, and he emphasized that money managers of large institutional investors had replaced the loan officer in decisions concerning the extension of credit. He suggested that the basic principle behind any reformulation of the regulatory system should limit the size and activities of financial institutions, and should be dictated by the ability of supervisors, examiners, and regulators to understand the institutions' operations. Minsky favored bank holding company structures because each subsidiary would have a relatively well-defined function, thereby making it easier to understand the operations of the business. The reorganization of the financial system that appears to be taking place does not seem to respect this principle.

Building on Minsky's preferred approach, Senior Scholar Jan Kregel proposes the creation of numerous types of subsidiaries within the bank holding company, but with tighter limitations on the range of activities allowed each subsidiary. The aim would be to limit each type of holding company to a range of activities that were sufficiently linked to their core function, and to ensure that each company was small enough to be effectively managed and supervised.

Kregel points out that there is clear evidence that the current financial crisis is due in part to the fact that regulators as well as top bank managers were unable to understand and evaluate the risks undertaken by financial institutions. Former Federal Reserve Board Chairman Alan Greenspan has admitted that the attempts to use self-regulation and counterparty surveillance have also failed. Moreover, if the present trend of bank mergers continues, the resolution of the crisis will likely produce sizable financial institutions that cannot be regulated or managed; and, as Minsky predicted, this "resolution" will lay the basis for another financial crisis. Government ownership and participation in banks will do nothing to alleviate the problem.

For the complete text, go to www.levy.org/pubs/pn_5_08.pdf.

Time to Bail Out: Alternatives to the Bush-Paulson Plan

DIMITRI B. PAPADIMITRIOU and L. RANDALL WRAY
Policy Note 2008/6

Former Federal Reserve (Fed) Chairman Alan Greenspan now admits that he could never have imagined that government deregulation would lead to a financial and economic crisis of biblical proportions. In the meantime, Secretary Henry M. Paulson has confirmed the worst fears of conspiracy theorists: the bailout is an opportunity to consolidate control of the nation's financial system by a few large (Wall Street) banks.

According to President Dimitri B. Papadimitriou and Senior Scholar L. Randall Wray, we are moving into a deep recession, and the government should not rely on more borrowing by the private sector to pull us out of it. Resolving the liquidity crisis (mission almost accomplished) and preventing financial institutions from growing too fast (by making unsound loans) is the best strategy. More jobs and rising incomes are the ticket for policy formation by the soon-to-be Obama Administration.

The authors call for a bigger role for fiscal policy (e.g., a temporary suspension of payroll taxes and spending increases) and direct homeowner relief; that is, putting $700 billion into keeping Americans in their own homes rather than handing the money to the financial "geniuses" who created the mess. The main responsibility for economic recovery must be in the hands of the Treasury (not the Fed), they say, and the country can afford the trillions of dollars it will take to counter the worst financial and economic crisis since the Great Depression.

The Bush Administration has been ill prepared to deal with the financial crisis, as exemplified by the numerous Paulson Plans and the final decision to inject capital—a strategy adopted abroad, but with an American twist: Treasury would not exercise any ownership rights, such as replacing the corporate management that created the mess. The authors are troubled by the prospect that the rescue package will be used to help consolidate the nation's financial system, since Wall Street banks can pick the takeover targets by downgrading the outlook of the financial institutions that they would like to own.

The authors note that policymakers have confused liquidity with solvency issues, and lending with spending. The Fed and the FDIC took a long time to recognize the proper policy response to the liquidity crisis, but they are now close to a resolution. To complete the "lender-of-last-resort" intervention, the authors suggest that the Fed should remove all collateral requirements in order to quell the run to liquidity, stabilize interest rates, and provide loans to suit the borrower. Moreover, the FDIC should eliminate any caps on its insurance to include all demand and time deposits in member institutions. The new financial instruments that are the product of Wall Street's financial engineers are described appropriately as "toxic waste" by insiders and regulators. In terms of insolvency, if the U.S. Treasury pays anything near to "true" value for the bad assets, banks are actually worse off. And rather than pretend that any overpayment represents true market value, the same result could be accomplished with no purchases at all: Treasury can declare that all assets are good and business can go on as usual. Unlike a liquidity problem, issues of insolvency do not have to be resolved in haste. Rather, a number of accounting sleights of hand can be used to keep the banks open (e.g., let banks value assets at the original price paid or temporarily lower capital requirements).

Since the rescue plan has offered little for homeowners saddled with mortgage debt they cannot afford, the government has to take a more active role. An alternative favored by the authors is to offer a 5 percent, 30-year mortgage provided directly by Fannie Mae and Freddie Mac to all comers (with homeowners providing a down payment of 10 percent based on grants by the federal government equal to the original down payment, plus any fees already paid). Another alternative would reduce mortgage payments to no more that one-third of household income. In any event, a moratorium on foreclosures is necessary because it will take some time to implement any of these approaches. Mortgage relief and restoring economic and social stability to neighborhoods will bring about recovery faster than Paulson's plan, which is trying to push credit on a string.

Whatever package of policies is adopted, we will know when the Treasury has spent enough because the economy will start growing again toward full employment and the financial markets will recover. Once the expansion is under way, tax revenues will rise and the government will be able to cut back on its own spending, which will automatically reduce the budget deficit. The financial system likely to emerge will be smaller and simpler, more closely regulated, less highly leveraged, and based on sound underwriting.

For the complete text, go to www.levy.org/pubs/pn_6_08.pdf.

Shaky Foundations: Policy Lessons from America's Historic Housing Crash

PEDRO NICOLACI DA COSTA
Public Policy Brief No. 95, 2008

Levy Institute scholars have recently published many articles that outline the imbalances in the U.S. economy, analyze the instability in the financial markets, and conclude that a prolonged crisis is imminent in the absence of adequate policy interventions (see, for example, the policy note by L. Randall Wray on pp. 6–7). This brief by news analyst Pedro Nicolaci da Costa continues the discourse by focusing on the actions of the Federal Reserve (Fed) during asset bubbles. He finds that central bankers who accept self-policing as a basis for sound regulation are setting the global economy up for a real disaster.

The author notes that the "Big Banks" only react when asset bubbles burst, thereby creating a self-perpetuating cycle of perverse incentives and moral hazard that gives rise to subsequent bubbles. Contrary to the Fed's current premise that policymakers cannot and should not target asset bubbles, recent experience has bolstered the view that asset prices must come under the central bank's purview in order to maintain a stable economy. The prevailing belief that bubbles are impossible to spot ahead of time is untrue, because the housing market crash has been a train wreck in slow motion. There was plenty the Fed could have done to discourage speculative behavior and stop predatory lending in the residential mortgage sector. Furthermore, attitude changes among regulators are more important than shifts in mandate in ensuring that regulatory bodies like the Federal Reserve do their job properly.

Rather than talking down the frothy housing and mortgage bond sectors, the Fed failed to employ its most effective policy tool: the power of persuasion. Under former Fed Chairman Alan Greenspan's leadership, it embraced fads like the "new economy" and "financial innovation" (e.g., securitization) that were little more than euphemisms for overvalued stock and home prices. The Fed's most egregious failures as a regulatory body were its readiness to embrace these fads, to approve a runaway process of credit creation, and to enable excess risk taking and fraud in the mortgage market. As a result, Greenspan presided over the most reckless debt binge in history.

The housing and credit crisis forced the Fed to slash interest rates and pump vast sums of liquidity into the financial system—measures that led to speculative excesses in the commodity markets. Thus, the greatest expansion of credit in modern history was ultimately regressive, because it trapped its poorest and most fragile recipients in a vicious cycle of personal indebtedness that could take decades to unwind. The Fed's willingness to feed the borrowing frenzy ultimately deprived some of the world's vulnerable populations of basic resources as a result of subsequent price hikes in the cost of nondiscretionary goods like food and fuel. (The food riots of the past year have revealed the dark underbelly of global interconnectedness.) Inflating and reflating asset bubbles is no way to run a stable economy in the long term.

The sheer magnitude of the housing and debt crisis offers a unique opportunity for the Fed to reconsider its view that bubbles remain outside its policy mandate. The problem requires proactive solutions by a federal government that recognizes the need for greater regulatory scrutiny in spite of a pervasive ideological aversion to regulation. Evidence suggests that regulation often enhances business confidence because it provides a set of ground rules that are determined with broader social interests in mind. Improved regulatory oversight would enhance policymakers' ability to fend off financial instability before it reaches crisis levels and threatens to engulf the entire (global) system.
For the complete text, go to www.levy.org/pubs/ppb_95.pdf.

The Commodities Market Bubble: Money Manager Capitalism and the Financialization of Commodities

L. RANDALL WRAY

Public Policy Brief No. 96, 2008

Money manager capitalism is characterized by highly leveraged funds seeking maximum returns in an environment that systematically underprices risk. This type of capitalism has resulted in a series of boom-and-bust cycles in equities, real estate, and commodities. Because subsequent cycles have been increasingly damaging to the U.S. economy, we are now at the point where we are experiencing the most severe financial crisis since the Great Depression. Hasty interventions (bailouts) by Congress, the Treasury, and the Federal Reserve are attempting to keep the financial industry solvent, in the belief that government inaction would result in a prolonged recession.

Levy Institute scholars have recognized the problems confronting the U.S. economy for some time, and we have warned about severe market disruptions in the absence of public policy reform. In this topical brief, Senior Scholar L. Randall Wray shows how money manager capitalism (financialization) has destabilized one asset class after another. He concludes that policymakers must fundamentally change the structure of our economic system, break the cycle of booms and busts, and reduce the influence of managed money, as well as prevent the next speculative boom in yet another asset class.

Wray analyzes various explanations for the recent explosion in commodity prices, which has been unprecedented in size and scope: supply and demand, market manipulation, and financial speculation. He finds that the rise of investments in the commodity futures markets ("index speculation") has contributed the most to higher prices. He criticizes the Commodity Futures Trading Commission (CFTC), which actively promoted the notion that commodity futures are an asset class while ignoring both the price effects from speculative inflows of managed money and its congressional mandate to ensure that commodity prices reflect the laws of supply and demand.

Traditionally, futures markets have been used to hedge price risk and for "price discovery." However, in opposition to traditional economic theory, price changes in the commodity markets originate in the futures markets and are transmitted directly to the spot markets. And, in contrast to prior commodity booms, futures prices have been above spot prices. When spot prices are set in reference to futures prices, a speculative boom is triggered, because rising spot prices validate expectations and fuel greater demand for futures contracts. This response suggests a market dominated by speculative demand (i.e., managed money from index speculators).

Commodity markets deviate from the perfectly competitive models of economic theory and generate perverse incentives to incur excess risk. There is substantial evidence that prices are administered rather than set by the fundamental forces of supply and demand. Many reinforcing factors have created a perfect storm in which all participant interests are in continued price gains.

Wray determines that speculation, not fundamentals, dominates the boom in the commodity futures markets (contrary to the notions of both NYMEX and the CFTC). Supply is largely controlled in order to set the price, while demand from end users is supplemented by the demand from arbitragers, manipulators, hedgers, speculators, and index "investors." Furthermore, CFTC regulations have allowed pension and other passive investment funds to surge into the commodity markets. End users cannot win by hedging because they continue to pay progressively higher prices. Moreover, the dominant players in the futures markets have no interest in taking possession of the underlying physical commodities.

Policymakers should not allow money managers to drive commodity prices beyond the reach of consumers, says Wray. He recommends an increase in the CFTC budget so that the agency can broaden its mission, provide greater transparency, and limit the effects of speculation on prices. He also recommends that Congress begin considering its response to the collapse of commodity markets.

Wray believes that bailouts will be needed, but with strings attached in the form of regulatory constraints. The proposed Commodity Speculation Reform Act (July 2008) to amend the Commodity Exchange Act of 1936 would accomplish several of the objectives outlined in this brief. However, the bill does not address the bigger problem: the propensity of managed money to destabilize one market after another.

For the complete text, go to www.levy.org/pubs/ppb_96.pdf.

Macroeconomics Meets Hyman P. Minsky: The Financial Theory of Investment

L. RANDALL WRAY and ÉRIC TYMOIGNE

Working Paper No. 543, September 2008

The standard approach to the financing of investment in a modern capitalist economy is based on the "efficient markets hypothesis," which presumes that money is neutral. Minsky, however, believed that money is not neutral in an economy with complex, expensive, and long-lived capital assets. Rather, the method used to finance positions in assets is critically important, both for theory and for real-world outcomes.

According to Senior Scholar L. Randall Wray and Research Associate Éric Tymoigne, the financial crisis that began with the collapse of the U.S. subprime mortgage market provides a compelling reason to show how Minsky's approach explains the workings of financial capitalism. The authors present an alternative to the standard approach based on the addition of Minsky's financial theory of investment to John Maynard Keynes's "investment theory of the cycle." (See chapter 17 of Keynes's *General Theory*; the investment decision is incorporated within his liquidity preference theory of asset prices, which is inextricably linked to the theory of the multiplier and thus, the theory of effective demand.) Minsky believed that Keynes's theory was incomplete because it does not analyze *how* investment is financed when the marginal efficiency of a capital asset exceeds the marginal efficiency of money. Since the prospective income stream is uncertain, it depends on subjective expectations. Minsky argued that the price that one is willing to pay depends on the amount of external finance, so "borrower's risk" must be incorporated into demand prices. (This "cost" is subjective and not written into any contracts.) Investment can proceed only if the demand price (adjusted for borrower's risk) exceeds the supply price (adjusted for lender's risk) of capital assets. Because these prices include margins of safety, they are affected by expectations concerning unknowable outcomes. The complex temporal relation in Minsky's approach to investment could be easily disturbed, resulting in a downward economic spiral into a deepening recession.

Minsky recognized the futility of Fed attempts to control the money supply. Although government interventions may be necessary, they encourage nonbank financing as well as innovative bank practices, all of which increase fragility. Together with countercyclical deficits to maintain demand, lender-of-last-resort policy not only prevents recession but also creates a chronic bias toward speculatory booms by market participants who believe that the government will always intervene to bail them out.

Asset prices play a crucial role in determining investment levels because, contrary to the monetarist view, all assets are not perfectly substitutable (the logic of capitalism and uncertainty creates a preference for liquid assets, such as money); and there is also an arbitrage between old and new capital assets (low prices for existing assets can depress the production of new assets). Moreover, asset pricing is the outcome of mass psychology of a large number of (ignorant) individuals because the future is fundamentally uncertain. Thus, fundamentals created through social interactions in order to provide a vision of the future justify current decisions (a self-fulfilling process). In conformity with Keynes, Minsky applied the conventional approach to the liquidity preference theory of asset prices, and noted that conventional behaviors and liquidity preference go hand in hand in an uncertain world—a world that rewards monetary accumulation.

The "normal" price of an asset is socially determined through an imitation process that rests on anticipating the average opinion regarding the appropriate market price (as in Keynes's famous "beauty contest" analogy). Hence, the convention of a normal price provides an alternative to "inherent" fundamentals in determining expectations of price movements. If individuals expect that structural changes have created an environment in which the normal price should be much higher, then a speculative boom could follow, justifying the expectations and fueling more euphoria.

Aside from the theory of asset pricing, recent financial system developments must be incorporated within the financial theory of investment. For example, the "originate and distribute" banking model adds two novelties to the dynamics of the margins of safety: financial fragility proceeds at an accelerated pace, and credit-enhancement techniques may result in significant Ponzi financing.

Two fundamental flaws of the capitalist system are its inability to achieve full employment and excessive inequality. Minsky emphasized a third flaw: instability is a normal result of modern financial capitalism (even with appropriate policy) so policy has to continually adapt to changing circumstances. According to Minsky, the development of money manager capitalism during the postwar period is a much more unstable version of modern capitalism. Two decades ago, he predicted the explosion of home mortgage securitization (and the originate-and-distribute banking model) that eventually led to the U.S. subprime crisis in 2007.

Securitization resulted from the globalization of finance and the erosion of banks in favor of "markets," which operated with much lower spreads because they were exempt from required reserve ratios, regulated capital requirements, and much of the costs of relationship banking (i.e., free from the New Deal regulations that had made financial markets safer). Competition from these "markets" forced policymakers to relax regulations on banks, while managed money (e.g., pension and hedge funds) operated with high leverage ratios. These developments exacerbated the fragility of the financial system. When firms increased their use of external funds during the recent economic expansions, debt ratios grew. Thus, the "innovations" in home mortgage finance leading up to the speculative boom recreated the same conditions that contributed to the Great Depression.

The financial innovations greatly expanded the availability of credit, which pushed up asset prices and fueled a debt frenzy and greater leveraging. The actions of the Fed (e.g., interest rate reductions) tipped the balance of sentiment away from fear and toward greed. The rosy analyses during the boom were based on modern orthodox finance theory that was incorporated into complex models of market behavior based on past experience. However, risks were neither shifted nor reduced. Therefore, the authors maintain that it is necessary to recognize how investment is financed and how this action leads to cyclical behavior that, in the absence of government intervention and apt policymaking, could degenerate into a debt deflation rivaling the Great Depression.

For the complete text, go to www.levy.org/pubs/wp_543.pdf.

Inflation Targeting in Brazil

philip arestis, luiz fernando de paula, and
fernando ferrari-filho

Working Paper No. 544, September 2008

Inflation targeting (IT) is a new monetary policy framework that has been adopted by many countries. Senior Scholar Philip Arestis; Luiz Fernando de Paula, University of the State of Rio de Janeiro, Brazil; and Fernando Ferrari-Filho, Federal University of Rio Grande do Sul, examine Brazil's adoption of the IT strategy. They find that both IT and non-IT countries have been successful in taming inflation, but inflation and interest rates during Brazil's IT period have been high, while economic growth has been relatively low. They also find that the pass-through from exchange rate changes to inflation is more significant in Latin America because it has a substantially higher degree of openness, a history of high inflation, low central bank credibility, and large mismatches between foreign currency assets and liabilities. As a result, Latin American countries are more susceptible to supply shocks.

A main theoretical element of IT is that it is a monetary policy framework with official inflation targets over a set time horizon. The primary long-term objective is price stability, along with credibility, flexibility, and legitimacy (public and parliamentary support). In this framework, monetary policy is the main instrument of macroeconomic policy, which is operated by experts in the form of an independent central bank. With respect to formulating monetary policy, there should be a mechanism for openness, transparency, and accountability.

In the case of an open economy, exchange rate considerations are crucial because they transmit the effects of changes in policy, interest rates, and foreign shocks. IT operational framework issues include the establishment of inflation targets (a specific point or a band target), the (symmetrical or asymmetrical) response to the central target, the derivation of a model or methodology to forecast inflation, the measurement of inflation (i.e., the chosen price index), and the application of monetary rules (e.g., the Taylor Rule).

The authors outline the Brazilian experience with respect to stabilization programs and the adoption of IT in 1999, following the transition to a floating exchange rate regime in response to a currency-depreciation shock. Since the economy is exposed to serious supply shocks, a range of 2.0 to 2.5 percentage points above and below the central point target was chosen to help the Central Bank of Brazil achieve its inflation target. During the 1999–2007 period, annual inflation was within the set range only three times (when exchange rate appreciation helped to control inflation). The average inflation rate was high (7.2 percent), the average growth rate was relatively poor for a developing country (3.0 percent), there was a "stop-go" (high variation) growth pattern, and the average nominal basic interest rate was very high (18.3 percent). Moreover, the average real interest rate was 10.3 percent because monetary policy tried to keep inflation under control and stabilize the exchange rate.

According to the authors, the reaction function of the central bank during the IT period was asymmetric. Brazil's experience shows that external capital flows can cause periods of intense exchange rate instability that jeopardize efforts to achieve inflation targets in countries with a high level of external debt and a fully liberalized capital account. Under these conditions, monetary policy may have some effect on market-determined prices, but it is not very effective in controlling administered prices. In Brazil, inflation has been mainly determined by cost and explained by supply shocks, as well as by partial inertia due to the indexation of administered prices.

The authors compare Brazil with other emerging countries that have adopted IT (e.g., Chile, Mexico, and South Africa) and with countries that have not adopted the strategy (e.g., Argentina, China, India, and Russia). Although theory suggests that "flexible" IT stabilizes both inflation and output, the authors find that there is no clear evidence that emerging countries that have adopted IT have higher GDP growth rates than those that have not adopted IT. As measured by the behavior of inflation and output, there is no evidence that inflation targeting improves performance in emerging economies.

These results conform with other recent contributions to the IT experience in Latin America, where economies are exposed to both financial and international commodity shocks, liabilities are associated with the dollar, and policymakers lack credibility. The external shocks affect the exchange and inflation rates, leading to interest rate increases in an effort to curb the inflationary pressures. The authors conclude that IT may not be effective in countries that are susceptible to supply shocks rather than demand shocks.

For the complete text, go to www.levy.org/pubs/wp_544.pdf.

Minsky and Economic Policy: "Keynesianism" All Over Again?

ÉRIC TYMOIGNE

Working Paper No. 547, September 2008

Hyman P. Minsky promoted a form of (Keynesian) capitalism that significantly involves the government because of structural problems associated with market mechanisms (e.g., unfair distribution of wealth, economic instability, and unemployment). Research Associate Éric Tymoigne reviews Minsky's theoretical framework and the supposedly "Keynesian" agenda of the Roosevelt and Kennedy/Johnson Administrations. The current perception is that these administrations employed Big Government capitalism even though monetary and fiscal discretions were used to fine-tune the economy. Tymoigne finds that the policies of Irving Fisher rather than those of John Maynard Keynes are more closely aligned with these administrations. There never was a Keynesian revolution in economic theory or policy, he says.

According to Keynes, a real-exchange (barter) economy does not apply to capitalism, which is a monetary-production economy that is highly dynamic and forever changing. The dialectical nature of capitalism means that both market forces (competition, innovation, and banks) and government may promote stability and instability. For example, competition promotes (short-term) economic growth as well as conformism, while Big Government promotes economic stability but also inflationary pressures and moral hazard.

Kalecki's profit equation shows the direct impact of government spending and taxes on the private sector, as well as the peculiar circularity that is part of the internal flaw of any capitalist economy. There is a destabilizing feedback loop in which current investment is based on the expectation of future investment. This produces long-term explosive patterns by increasing future production capacities without increasing future demand. Thus, an economic plan for long-term full employment and price stability cannot be based on private investment, which creates inflationary pressures and income inequality.

In a controlled economy, the government acts as a planner to determine the level of employment (Minsky promoted an employer-of-last-resort program) and the level and composition of (social) investment projects—for example, community development banks and housing. The government also controls income growth through a generalized income policy (e.g., Minsky proposed that a regulator control the payout ratio of banks) in order to dampen inflation and bolster financial stability, as well as the growth and distribution of the assets of all financial institutions.

Minsky viewed government as a complement to the profit-oriented sector that supports structural macroeconomic programs that directly manage the labor force, pricing mechanisms, and investment projects, and as a monitor of financial developments. These actions would eliminate problems of lags, credibility, and time inconsistency while retaining discretion within the set of rules and structures. For Minsky, therefore, the concept of Big Government was not incompatible with the economic freedom of the individual.

In the United States, "Big Government" means a federal government that represents about 20 percent of GDP. It should complement the private sector rather than fine-tune the economy or exert massive state control. Tymoigne finds that a bigger government has helped to stabilize U.S. economic growth. In the 1920s and 1930s, the federal government was too small to compensate for broad swings in investment. Since 1929, it has more than tripled in size (to more than 30 percent of GDP in 2007), with most of the growth coming from the expansion of entitlement programs (e.g., Social Security and welfare payments). Since the early 1980s, however, federal government purchases have declined in favor of state and local governments, which are unable to deal with macroeconomic issues because of regressive tax structures. Minsky critiqued the expanding role of transfer payments (along with declining regulation), as they promote inflationary tendencies and financial instability, respectively.

Keynes was in favor of direct government participation through specific fiscal and monetary measures (i.e., planning via cooperation between the private and public sectors), maintenance of low interest rates that reward only risks and skills (the euthanasia of rentiers), and a progressive tax policy that favors consumption. While Keynes applauded most of the New Deal policies of the Roosevelt era, he was also very critical of the administration's "sound finance" policy and lack of engagement in recovery efforts (e.g., federal government spending stagnated or grew very slowly). Keynes wanted massive deficit spending through large-scale government expenditures in housing, unemployment relief programs, and aid (to farmers and through public works), and a policy of cheap money that directly influenced the entire yield curve.

Roosevelt was skeptical of fiscal-led stimulus, but World War II led to major government involvement that had the unintended consequence of strongly supporting the U.S. economy. The monetary measures proposed by Keynes, however, were only implemented because of the war and were subsequently abandoned. The Employment Act of 1946 did not establish a long period of Keynesianism, but rather transformed the U.S. government into a full-fledged fine-tuner in order to make employment consistent with business interests. Thus, the government was unable to manage both price stability and employment.

Irving Fisher is the economist most closely aligned with the policies of the 1930s, says Tymoigne. He advocated reflating and then stabilizing prices by controlling the money supply and the velocity of money in order to manage aggregate spending. There was no conversion to the Keynesian principles of using fiscal and monetary policies to achieve stable full employment. The Kennedy/Johnson era was also more consistent with Fisher's ideal of government intervention. This era focused on stimulating investment and economic growth, and emphasizing tax incentives, while initiating the War on Poverty, which merely redistributed poverty.

Minsky noted that in terms of tax incentives, the method of stimulating employment is highly indirect. The correlation between the fiscal position of the federal government and unemployment is approximately zero. The only way to reach true full employment and shared prosperity is by orienting some government spending toward hiring the unemployed. However, policymakers during the Kennedy/Johnson era resisted government spending, refused government employment programs, and favored the fine-tuning of economic growth by tax incentives according to the Council of Economic Advisers (under the influence of James Tobin and Paul A. Samuelson). In contrast, Keynesianism is all about systematic, decentralized planning rather than discretionary, incoherent fine-tuning.

For the complete text, go to www.levy.org/pubs/wp_547.pdf.

On Democratizing Financial Turmoil: A Minskyan Analysis of the Subprime Crisis

LUISA FERNANDEZ, FADHEL KABOUB,
and ZDRAVKA TODOROVA
Working Paper No. 548, November 2008

A White House document in August 2004 stated that the U.S. homeownership rate had reached a record 69.2 percent (73.4 million homeowners), including a majority of minority households (the "democratization of homeownership"). According to Hyman P. Minsky, stability breeds instability, as represented by the recent record-high foreclosure rate and subprime financial crisis, along with rising unemployment, sluggish economic growth, and an unprecedented climb in commodity prices. According to Luisa Fernandez, Alvarez & Marsal Taxand; Research Associate Fadhel Kaboub; and Zdravka Todorova, Wright State University, inequality also breeds instability. Inequality is the real cause of financial crisis, they say, because the so-called democratization of homeownership represented a fictitious increase in housing demand that was fueled by innovative financing schemes. In essence, economically disadvantaged households were used to ride a wave of Wall Street speculation. The authors conclude that the only viable means of achieving both higher homeownership rates and economic stability is a full employment program with stable work opportunities, decent wages, and benefits.

The mainstream explanations of financial instability are irrational exuberance, mania, and asset bubbles. The common response to instability is the bankrupting of financial agents, since the economic system is naturally stable. A contrary view is associated with John Maynard Keynes and Minsky, as well as Levy Institute scholars such as Jan Kregel and L. Randall Wray. They emphasize the natural instability of financial markets that is systematically embedded in the (financial) system. For example, the ability of banks to earn fees for loan origination yet avoid the risk of default by selling the loans through securitization is a major element of the current problem, along with the notion of adjustable-rate mortgages, the role of credit-rating agencies, and deregulation.

Minsky recognized the destabilizing effects of securitization as early as 1986, and that these effects adhere to his financial instability hypothesis. Investors are motivated to purchase securitized assets as a result of optimistic expectations under conditions of expansion. Debt deflation follows in response to increased incidents of homeowner defaults. Globalization has stimulated and expanded the practice of securitization.

Keynes identified economic inequality as a major destabilizing feature of the capitalist system. The authors argue that the buildup and persistence of economic inequality since 1980 was a major contributing factor to aggressive subprime lending practices in the United States. Real average hourly wages have stagnated, even though productivity has increased substantially, and the Gini coefficient has risen steadily commensurate with the regressive turn in tax policy (i.e., the payroll tax rate increased while the top federal tax rates on capital gains and estate taxes declined).

The Federal Reserve (Fed) failed to recognize the destabilizing effect of economic policy, while its policymakers kept workers in check through "employment insecurity" in order to dampen inflationary pressures. Under former Fed Chairman Alan Greenspan, workers experienced a real wage freeze while watching their payroll taxes rise, and the Fed fueled the biggest housing bubble in U.S. history. These events led to a much higher consumer-debt-to-income ratio (125 percent in 2007, versus 65 percent in 1980) when easy access to mortgages, home equity lines of credit, home equity loans, and credit cards increased consumer debt service burdens. The destabilizing effects of inequality led to financial innovation, predatory lending, and economic turmoil.

The hardcore unemployed and economically disadvantaged were unable to benefit from the Clinton-era economic expansion. Ironically, this group was used to prevent a prolonged recession in 2001, when easy money and loose lending practices enabled them to qualify for a (subprime) mortgage and buy a house. At the same time, the financial schemes to promote growth sowed the seeds for the subprime meltdown. Late payments on home equity lines of credit soared to a 21-year high, while the delinquency rate was the highest since data collection began in 1987. The authors suggest that the main catalyst for further economic problems will be higher unemployment (and greater inequality).

The only viable solution for the *real* democratization of homeownership is an updated version of Minsky's employer-of-last-resort (ELR) program, say the authors. There is no market-based solution for boosting homeownership, but the ELR approach would stabilize the mortgage-backed securities market (putting a floor to levels of income and aggregate demand), as well as wages and inflation (by creating a buffer stock of labor).

The authors note that the cost of implementing an ELR program in the United States is approximately 1 percent of GDP, and several government assistance programs would become redundant as a result (at substantial cost savings).

An ELR program would stabilize expectations, but it would require tight coordination between the Fed and the Treasury with regard to fiscal and monetary policies. While the massive government bailout of Wall Street firms is necessary, it is a temporary solution that does not deal with the root cause of the problem. A job guarantee program would achieve full employment, economic stability, rising standards of living, and higher homeownership rates.

For the complete text, go to www.levy.org/pubs/wp_548.pdf.

Excess Capital and Liquidity Management

JAN TOPOROWSKI

Working Paper No. 549, November 2008

Theory presupposes that firms limit their financial needs when undertaking profitable ventures in nonfinancial activities. According to Jan Toporowski, School of Oriental and African Studies, University of London, and the Research Centre for the History and Methodology of Economics, University of Amsterdam, firms may hold excess capital (in financial assets) relative to the capital needed to undertake production in order to manage liquidity. Thus, the internal liquidity of large companies, not monetary policy, is the key factor in nonfinancial business investment. In a financially advanced economy, interest is a purely monetary phenomenon.

According to neoclassical theory, the rental cost of excess capital (an overhead cost for the firm) rises more rapidly than the amount of excess capital, so there is a competitive disadvantage to holding excess capital. When market conditions are not competitive, the rental cost of capital is the means by which banks (and holding companies) extract profits from the firms that they control and obtain a share of the total profits in the economy.

For an overcapitalized firm, the return from its excess capital may be divided into an income return and a speculative return. The return on excess capital is equal to the rental cost of excess capital plus the proceeds of the sale of excess financial assets, less the cost of purchasing the assets. In this case, the rental cost of excess capital reflects the costs of intermediation. The change in the value of the financial assets in which the firms' excess capital is invested is now added to this construct. When firms vary the rental cost of capital and their speculative return on capital by shifting the financing and investment of their excess capital along the yield curve, they engage in maturity transformation, making them more speculative and dependent upon the liquidity of financial markets.

A process of capital market inflation (i.e., rising values in securities markets) facilitates overcapitalization in search of speculative returns. This has important implications for the theory of speculation and the policies for controlling speculation by raising and keeping interest rates high. Monetary policy can only be effective in regulating speculation (by varying the speculative return on excess capital) if the yield curve maintains a constant upward slope. However, when a firm has liquid assets and engages in speculation, it does not have to borrow in order to finance its (financial market) operations. The profile of an economy's monetary and credit system is determined not only by the government, central bank, and banking liabilities but also by the liabilities of the corporate sector.

Excess capital allows large companies to undertake productive investment without expanding their financial liabilities (and to possibly initiate and sustain an investment boom). In this way, the rate of interest is decoupled from the (real) investment process and becomes a purely monetary phenomenon (i.e., the significance of the rate of interest as a policy instrument is confined to the sphere of financial intermediation). Furthermore, excess capital does not require additional prior saving but that firms or intermediaries hold one another's capital or exchange capital obligations in the course of financial market operations and balance sheet restructuring.

The ideas in this paper are connected with the industrial economics of Michal Kalecki and Hyman P. Minsky, as well as the monetary economics of Kalecki. The author's analysis extends the view of excess capital by John Maynard Keynes (his theory of "own rates of interest") using three modifying assumptions: (1) the carrying cost of excess capital is negligible; (2) there is no "liquidity premium" that the company would be willing to pay for "power of disposal" over the excess capital; and (3) companies manage their own liquidity and keep an amount of liquid assets equivalent to Keynes's "liquidity premium" in their overall balance sheets.

For the complete text, go to www.levy.org/pubs/wp_549.pdf.

Program: Gender Equality and the Economy

The Effects of International Trade on Gender Inequality: Women Carpet Weavers of Iran

ZAHRA KARIMI

Working Paper No. 540, July 2008

Globalization has been associated with declining labor standards, especially in developing economies. The search for greater flexibility and lower costs has led to a race to the bottom and the exploitation of cheap female labor. Zahra Karimi, University of Mazandaran, Iran, investigates the condition of carpet weavers in Kashan and finds that carpet weaving as a profession has become a sign of poverty. Harsh competition between developing countries has suppressed real wages, maintained the subordinate position of female workers within households, and led to the substitution of Iranian weavers by Afghan-immigrant households.

In the 1970s, more than 58 percent of home-based production units and one-third of Iran's rural areas were engaged in carpet weaving. Today, Iran's share of the international carpet trade has fallen from 60 percent to 30 percent because of declining carpet prices due to competition from countries with the lowest production costs, such as China and India. In response, most middle-income weavers in Iran have left the industry, so that the poorest families, particularly Afghan women and children, are engaged in low-paid weaving.

Karimi's 2006 survey consisted of 68 carpet-weaving households, for a total of 96 weavers (80 women and 16 men). Afghan weavers made up more than 40 percent of the sample. The principal research tool was a questionnaire about wages, working hours, job preferences, and demographics. Using a "snowball sampling" method, weavers at a particular site introduced the author to weavers at other sites.

Among her findings is that carpet weaving is generally a women's job because it is compatible with child care and the performance of domestic tasks, while wages for construction work are three times higher. In response to insufficient household income, child labor (particularly in Afghan families) is used in the home and in carpet production workshops to bridge the income gap. Most female weavers have little schooling; in particular, the Afghan weavers, who have limited access to educational opportunities in Iran.

Karimi also finds that carpet weavers have implicit, verbal contracts and generally receive advance payment during the long process of weaving a carpet. Although it is more profitable to weave carpets independently rather than for the carpet traders, most weavers are from low-income families and cannot work without payment in advance. While all Iranian men in the sample were independent carpet weavers, all Afghan men were wage earners (at 20 cents an hour). Only one Afghan woman was an independent weaver.

The survey suggests that participation in carpet weaving does not necessarily improve the status and (subordinate) role of women in the household. Female carpet weavers bear a double workload, Karimi observes, as traditional gender roles within the household have not changed. Weaving is considered a hobby and earnings go unrecognized (most female weavers have no access to their wages). As the profit margin of investment in Persian carpets continues to shrink, Iran's female carpet weavers find themselves among the principal losers in the rapid expansion of international trade.

For the complete text, go to www.levy.org/pubs/wp_540.pdf.

The Unpaid Care Work–Paid Work Connection

RANIA ANTONOPOULOS

Working Paper No. 541, July 2008

Despite progress toward narrowing the socioeconomic gap between men and women, gender inequalities persist. Research Scholar Rania Antonopoulos provides a comprehensive overview of current research about gender disparities in paid and unpaid work. We have to address the fact that it is neither "normal" nor "natural" for women to perform most of the unpaid labor, she says, and that these hidden subsidies to the economy are exploitative, effectively imposing a time-tax on women throughout their life cycle.

Antonopoulos examines the division of labor between paid and unpaid work, the relationship of unpaid work to the economy, domestic work and the global care chain, poverty and unpaid work, the role of the state in the context of unpaid care work, and the importance of time-use surveys. Unpaid work includes all nonremunerated work activities, lacks social recognition, and depends on many socioeconomic factors. Public sector infrastructure and state provisioning also play a role in the time spent on unpaid tasks. Women are disproportionately engaged in unpaid work—a gender gap that ranges from two to five hours per day.

The terms unpaid work, unpaid care work, household production, and household reproduction are used interchangeably but mean different things and may misrepresent the issues. According to the United Nations System of National Accounts (SNA), unpaid work consists of both economic and uneconomic work. Unpaid care work signifies the sum of child, elder, and sick care. Antonopoulos suggests that a more appropriate usage of the term "unpaid care work" should be constructed around the concept of unpaid social reproduction work (direct unpaid care work plus indirect care work), which excludes unpaid work that produces goods for sale in the market.

Households produce goods and services through unpaid work and are linked to the macro economy by their production capacity (especially in developing countries). Time-use data, which provides improved estimates of workers engaged in the informal economy, have facilitated the construction of satellite accounts that capture production outside SNA boundaries. The value of satellite accounts ranges from 20 to 60 percent of GDP, so the household production sector is a fundamental building block that acts as a subsidy to the state and bridges the infrastructure gaps. Therefore, the measurement of GDP should include the value of unpaid work.

When paid work is combined with unpaid work, women are found to work longer hours than men in most countries (two to five hours per day). The disparity is higher in rural areas, and declines with the level of economic development. The author encourages people to pressure companies and governments to enforce international standards so that women are compensated for their unpaid and informal work, and receive equivalent (men's) wages for their paid work. Globalization has intensified the role of women as home-based workers engaged in informal employment and as part-time workers with high pay penalties. Women tend to work in sectors that resemble the characteristics of unpaid care work, provide more temporary and lower-paying jobs than men, and exhibit occupational segregation. As a result, women's work is often undervalued and invisible.

There is general agreement that trade liberalization and foreign direct investment has been accompanied by expanded employment for women and a more flexible and cheaper labor force. However, there is mixed evidence whether there has been a reduction of gender wage differentials and wage discrimination, and whether women employed in export-oriented industries are victims of globalization or beneficiaries of increased autonomy and bargaining power. There is a care deficit when women engage in paid work or migrate to other countries (where they provide care work). Often, there is discrimination against domestic workers, who are engaged in an unstable job market with low wages, no social services, and poor working conditions. Nevertheless, remittances in 2005 corresponded to almost three times the world's combined foreign-aid budgets ($104 billion).

Basic needs are secured through a combination of paid and unpaid work in four key areas: the market, the state, households, and nongovernment organizations (nonprofits). Little is known about how the poor spend their time because of inadequate labor force surveys and a lack of time-use data. The working poor must endure substantial "time poverty," whereby time use forms and structures poverty, while poverty shapes time use. Although women have unequal access to goods and services, and productive resources, they play a significant role in reducing poverty within the household.

The contribution of unpaid work differs between countries and between households, and depends on the prevailing welfare-state policy regime as well as access to public services. Therefore, distinct policy interventions are needed for different groups of women. Neoliberal government policies have reduced public goods provisioning, while economic outcomes have increased inequalities when social protection policy focuses on compensatory measures rather than entitlements. Structural reforms associated with the Washington Consensus did not result in economic growth that met people's needs. The emergence of a "post–Washington Consensus" consensus has opened up space for policy reversals, such as increased government spending.

The author outlines the effectiveness of various policy options for women performing unpaid work: universal provisioning by the state (the Nordic model); government employer-of-last-resort programs; and targeted family-based cash transfers (investing in human capital in terms of educational and health services). Newly created employment opportunities and family-work reconciliation policies can reduce women's unpaid work burden and alter the paid-unpaid gender division of labor (by setting a wage floor, contributing to pro-poor development, and acting as a powerful redistributive policy of unpaid work burdens).

The author notes an absence of standard methodologies to value unpaid SNA and non-SNA work. It is essential to value unpaid work, she says, because it contributes to well-being, makes unpaid work visible (in official statistics, macroeconomics, and policymaking), is an economic good, justifies measures to promote gender equality and poverty reduction, and improves women's claims to entitlements.

Antonopoulos stresses the need for better time-use data, as well as new indicators and mechanisms to monitor the impacts on unpaid work (e.g., gender-aware time and value input-output tables for social accounting matrix analysis); an analysis of family-work reconciliation policies and unpaid care work (to create alternatives to family-centric social reproduction); an exploration of the importance of employment guarantee policies in alleviating unpaid work burdens; and a greater focus on the kinds of social protection required by paid, informal-care workers.

For the complete text, go to www.levy.org/pubs/wp_541.pdf.

An Empirical Analysis of Gender Bias in Education Spending in Paraguay

THOMAS MASTERSON

Working Paper No. 550, November 2008

Gender affects household spending as a result of female bargaining power and in terms of spending on children. Research Scholar Thomas Masterson assesses the impact of objective and subjective gender patterns on intrahousehold decision-making processes related to education expenditures in Paraguay. He observes what appears to be a pro-male bias, but his findings are inconsistent between rural and urban areas, and between age groups. Also, gender patterns seem to be more pronounced at the household level than at the individual level—a result that is contrary to a similar study conducted in India by Geeta Gandhi Kingdon in 2005.

Gender patterns in decision making can be divided into systematic differences in economic decision making between the sexes (subjective), and in the allocation of resources depending on the sex of recipients (i.e., gender bias, which is objective). Objective gender patterns are usually inferred because of a lack of data. Moreover, it is difficult to test for gender patterns in intrahousehold allocations for the same reason.

Masterson notes that bargaining models using income measures are often relied upon to identify the gender balance of power. The general conclusion is that greater female income leads to additional spending on household welfare (food, health care, and education). In this study, the author tests the theory that control over land (and other assets) by women should have a similar effect. He also notes that few studies attempt to analyze the impact of both income and assets simultaneously.

The author uses data from the 2000–01 Encuesta Integrada de Hogares (EIH) survey, which is modeled after the World Bank Living Standards Measurement Survey. The framework consists of two strata (rural and urban), and the sample consists of approximately 2,100 households where there is data on consumption expenditures and where there are children. There was a lack of information in the EIH survey, however, about the ownership of specific assets or about decision making within the household.

Masterson uses the same comparative approach as Kingdon. The presence of objective gender patterns is tested using a set of variables for the age-sex composition of households. Additional variables acting as proxies for female bargaining power (e.g., female ownership of assets and the share of household income earned by the female spouse or partner) are used to test for subjective gender patterns. The model allows the author to detect both objective and subjective gender patterns in the allocation of consumption expenditures for food and education.

Masterson finds that there are gender differences in educational outcomes in Paraguay. Illiteracy is significantly higher among women and in rural households, where the average share of educational expenditures is significantly lower (less than half) and the number of dependents higher than in urban households. He compares the share of household expenditures allocated to education by area and by certain gender variables, and finds evidence consistent with an objective gender pattern in rural households. Rural households with female land rights and homeownership spend more on education, while urban households spend significantly less (i.e., bargaining power is more affected by income than by asset ownership).

The results show that asset ownership by women has a significant impact on the decision to spend on education, but not on the share of expenditures directed toward education. Interestingly, the direction of the effect is negative for landownership but positive for homeownership. In urban households, the estimated marginal effects of expenditures per capita, household size, and landownership all significantly increase spending on education, while higher education of the household head is associated with significantly decreased spending on education (in contrast to the rural areas). In rural households, the presence of male children up to the age of 14 reduced education spending, while the opposite was true in urban households. In sum, the author finds that the evidence for subjective gender patterns is not only scant in the case of rural households but also contradictory.

Masterson continues his regression analysis using spending data that is disaggregated at the level of the individual. He finds that spending is significantly lower in rural areas for every age-sex combination, and that average spending on boys is greater than average spending on girls in urban areas. The measure of objective gender patterns reveals two significant impacts: a greater likelihood of education spending for male children between the ages of 10 and 14, and less spending for male children between the ages of 15 and 19. There is no evidence of subjective gender patterns in rural areas, while the patterns are mixed in urban areas. In addition, there is only thin evidence of objective gender patterns in urban areas.

The author finds few consistent results for objective gender patterns at the individual level. At the household level, however, education spending for boys aged 10 to 14 was greater than that for girls in both urban and rural households. On balance, there seems to be a pro-male bias in education spending, but this bias is not consistent across areas and age groups. Furthermore, there is limited uniformity regarding objective and subjective gender patterns between urban and rural areas. Moreover, gender patterns seem to be more pronounced at the aggregated household level than at the individual level.

More information about asset ownership and decision making is needed before there can be effective policy interventions, says Masterson. It is difficult to see the relationship between women's economic empowerment within the household and their bargaining power, at least in terms of spending on education.

For the complete text, go to www.levy.org/pubs/wp_550.pdf.

Program: Employment Policy and Labor Markets

Keynes's Approach to Full Employment: Aggregate or Targeted Demand?

PAVLINA R. TCHERNEVA

Working Paper No. 542, August 2008

Research Associate Pavlina R. Tcherneva revisits John Maynard Keynes's view of employment policy, and argues against the mainstream view that the Keynesian solution for full employment is to boost aggregate demand (i.e., "plug the gap"). Rather, Keynes had a targeted approach to full employment in her view, and favored employment schemes in the form of public works during times of both recession and expansion.

The principle of effective demand was truly innovative in Keynes's work, says Tcherneva. She examines the differences between effective demand and aggregate demand; why fixing the point of effective demand at full employment is not possible, and how a policy of public works circumvents this problem; and what role plugging the gap plays in Keynes's analysis.

Keynes's theory of effective demand is a theory about the *factors* that determine investment in a monetary production economy, while the theory of aggregate demand is a theory of boosting *current expenditures* (private and public) to secure some numerical measure of potential output. Keynes's aggregate demand curve is a curve of expected future expenditures, which validate entrepreneurs' decisions to produce and employ people today. Thus, unemployment is a result of deficient effective demand, not deficient aggregate demand.

Policy can attempt to influence the marginal propensity to consume, the marginal efficiency of money, or the marginal efficiency of capital, and to boost either private or public investment (e.g., reducing the interest rate, supporting income redistribution schemes, and increasing current money expenditures via aggregate demand). However, it is difficult to fix the point of effective demand at full employment. Working with the marginal efficiency of money to influence private investment in the face of depressed expectations may be like "pushing on a string," while boosting the marginal efficiency of capital is limited because it is not under the direct control of policy.

Support for aggregate demand management policies is strong during severe economic slumps, but these policies create different levels of employment. Moreover, when the economy approaches full employment, an increase in aggregate demand brings inflationary and distributional problems because of the structure of production. What is needed, therefore, is appropriately distributed demand and targeting the unemployed directly via public works. According to Keynes, the problem is structural unemployment.

In the context of maintaining full employment after World War II, Keynes proposed to transform public works from a military focus during a time of war to a peacetime industry while simultaneously retraining workers for the needs of the civilian population. Public works circumvent the problem of relying on private spending and investment for full employment, and impart stability to the economic system in the long run. In response to the threat of inflation, Keynes's solution does not sacrifice employment, as advocated by mainstream economists on the basis of the Phillips curve. Rather, his method favors a reduction in certain types of spending and an increase in "desired" net saving (thrift) to close the inflationary gap, while supporting a regional (targeted-demand) approach to maintaining full employment.

The textbook method for solving unemployment by closing the output gap (Okun's Law) has given rise to broad-based, pro-growth policies (e.g., private-investment stimuli), in spite of the finding that the relationship between growth and unemployment is very weak. Since the economy is organic—that is, the character of investment and consumption changes continuously—employment policies that attempt to push growth beyond potential output are wrongheaded, says Tcherneva. Potential output offers no useful guide about the capacity of the economy beyond some brief period of time. Thus, attempts to plug the output gap are wholly misguided as employment policy unless they are based directly on plugging the labor demand gap using an "on the spot" approach, which solves the problem of unemployment via direct job creation, irrespective of the business cycle (i.e., public works).

Keynes emphasized the shortfall in the demand for labor, not for output, as measured in current prices. His measure of income and output was in wage units, and he attempted to guide budgetary expenditures that would sustain full employment. Thus, any output gap was measured in terms of the number of unemployed. In order to reinstate the link between fiscal policy and full employment, it is necessary to embrace Keynes's methodology of measuring output.

Current policy, which sacrifices the goal of full employment in the name of maintaining price stability, is doomed to fail because of inappropriate tools, says Tcherneva. Growth and full employment are two different objectives that may require different (nonconflicting) policies. Keynes flatly rejected calculations of potential output, which is extremely misleading as a concept in the long run (his national output definition is in terms of man-hours). Thus, modern output gap analysis is wholly inconsistent with Keynes's method for producing full employment via public works.

For the complete text, go to www.levy.org/pubs/wp_542.pdf.

Promoting Equality Through an Employment of Last Resort Policy

DIMITRI B. PAPADIMITRIOU

Working Paper No. 545, October 2008

Many economists assume that an unemployment rate below the natural rate of unemployment creates inflation. President Dimitri B. Papadimitriou outlines the merits of government job creation programs that would satisfy the noninflationary criteria, and finds that an effectively designed program can provide a universally accessible social safety net while contributing toward the achievement of the United Nations' Millennium Development Goals (MDGs). He also finds that full employment is a necessary ingredient for equitable growth outcomes.

Employment policy should not lead to inflation, interfere with the microdecisions of firms, replace existing jobs, or rely upon the fine-tuning of aggregate demand to achieve outcomes. Several options appear to meet these criteria: work-time reduction, employment subsidies, and government job creation programs. The first two options have been used extensively, with mixed outcomes. Papadimitriou focuses on the third option—government direct job creation programs—first proposed by Hyman P. Minsky in response to the failure of the War on Poverty program in the 1960s.

The War on Poverty was born out of neoclassical theory, in which the poor, not the economy, were to blame for poverty. Minsky's proposal was based on a targeted jobs program with decent wages that would reduce poverty among the nonelderly in a politically digestible manner. He advocated an employer-of-last-resort (ELR) policy, as outlined in his book *Stabilizing an Unstable Economy* (1986), where full employment is not based on subsidizing demand but on a strategy that does not lead to instability, inflation, or unemployment. His proposal, which has been further developed by Levy Institute scholars, ensures full employment with price stability, where the government is the only entity that can divorce profitability from hiring and create an infinitely elastic demand for labor.

Lessons from the New Deal programs during the Great Depression proved that government could successfully fulfill the ELR role by offering decent jobs that engaged people in socially and economically useful activities that did not compete with the private sector. These programs helped to reverse the country's deep economic slide, and led to the "golden period" of American capitalism. The cost to implement a similar approach today would represent only 1.0 to 3.5 percent of GDP, while the potential benefits (including the multiplier effects) would extend far beyond the cost of the program budget and wage bill.

In regard to fiscal policy, private sector debt or saving is intrinsically related to the government deficit or surplus. In regard to monetary policy, government spending increases commercial bank reserves, while the government as borrower of last resort can effectively fix the overnight interbank lending rate. Thus, interest rates are not constrained by the willingness of the private sector to buy government debt or by the size of the government deficit. Moreover, it is possible to finance an employment guarantee program in the same manner as other government expenditures. Thus, if demand in the private sector is insufficient to provide full employment, governments should use domestic policy space to mobilize labor resources and engage communities in socially and economically meaningful activities.

There has been extensive international implementation of direct job creation programs that address specific economic motivations (e.g., responding to a financial crisis and ameliorating the effects of structural adjustment). The social and economic consequences of Argentina's *Plan Jefes y Jefas de Hogar Desocupados* (2002–03) reveal that even limited employment guarantee programs can have a substantial impact on the quality of life in local communities. The program was unique in that it did not set an artificial cap on the number of beneficiaries. Nearly two million households (5 percent of the population and 13 percent of the labor force) were engaged in socially meaningful work. The program targeted poor, uneducated, and female-headed households with children, and met basic needs such as sanitation and housing. It provided both a social and an economic context that contributed toward stabilizing the exchange rate, producer and consumer prices, and economic recovery. The decentralized model of administration effectively empowered communities and allowed them to address deficiencies in local service delivery and infrastructure. On the negative side, the program did not pull households above the poverty line or impact the country's Gini coefficient. However, as the economy recovered, beneficiaries exited the program for work in the (higher-paid) private sector.

India's employment guarantee program in the state of Maharashtra, implemented in 1972, has generated supplementary income for many (rural) workers, improved agricultural productivity and rural infrastructure, and strengthened the organization of workers (e.g., the National Rural Employment Guarantee Act). Assessment of the program's overall effectiveness, however, has been mixed in light of corruption and administrative costs.

The author notes that the employment strategy used in Argentina requires financing by a sovereign federal government, as well as floating exchange rates, to effectively engage domestic policy. For nonsovereign currency countries with floating exchange rates (e.g., the Eurozone), as well as sovereign currency countries with fixed exchange rates, the notion of "sound finance" should replace that of "functional finance," while sound finance combined with international aid is more appropriate for middle- and low-income countries. The author also notes that resource revenues can be used to finance ELR programs in countries such as Iran, Iraq, Russia, and Brazil.

In developing countries, the implementation of an ELR program is particularly challenging. However, a properly designed and staged program can contribute toward realizing the MDGs if the program's monetary wage is equal to the average wage in the informal sector and includes some market provision for domestically produced basic services (e.g., food, clothing, and shelter). Furthermore, priority needs to be given to infrastructure development in order to reduce business costs and attract private investment, and international aid should be directed toward domestically produced goods with no impact on goods imports. Moreover, community projects should be administered locally and should not compete with the private sector.

For the complete text, go to www.levy.org/pubs/wp_545.pdf.

Program: Economic Policy for the 21st Century

Explorations in Theory and Empirical Analysis

Do the Innovations in a Monetary VAR Have Finite Variances?

GREG HANNSGEN

Working Paper No. 546, October 2008

Economists use monetary structural vector autoregressions (VARs) to measure the effects of policy changes and to test models. Stable distributions with infinite variances are less well known by macroeconomists, but they were studied by scholars such as Benoit Mandelbrot and Eugene Fama in the 1960s and 1970s. When a stable distribution has a finite variance, it is a normal distribution and has a "characteristic exponent" of two; when it has an infinite variance, the characteristic exponent is greater than zero and less than two. In this working paper, Research Scholar Greg Hannsgen estimates the characteristic exponents of innovations in a monetary VAR, and finds that the distributions of the innovations have infinite variances. Therefore, structural factorizations of innovation variance-covariance matrices are impossible.

Hannsgen develops a six-variable monetary VAR that is similar to many of those found in the monetary VAR literature. The variables are industrial production, the consumer price index for all urban consumers (CPI), the crude materials producer price index (PPI), the federal funds rate, and the Federal Reserve's nonborrowed reserves and adjusted total reserves series. Using monthly data for the January 1959 to November 2007 period, Hannsgen demonstrates that his VAR is typical (e.g., the response of industrial production to a contractionary federal funds rate is long-lived, negative, and statistically significant).

While Hannsgen's VAR leads to typical impulse-response functions, diagnostics show that the innovations have thick-tailed distributions. Engle (1982) tests indicate weak but statistically significant autoregressive conditional heteroscedasticity (ARCH) effects (i.e., of unequal variance). In terms of the key purposes of VARs, as well as Hannsgen's VAR, the *unconditional* distribution of the innovations is relevant for the purpose of identifying the structural residuals.

This paper examines the implications of infinite variances of innovations for structural monetary VARs. The key uses of structural VARs are impulse-response functions (i.e., moving average representations), which measure the effects of a one-time shock to an element in the structural disturbances; and forecast error variance decompositions, which show the variation of the economic and monetary variables due to random shocks in each element of the structural disturbances.

When at least one error term in a VAR has a stable, non-Gaussian distribution, it is impossible to construct meaningful impulse-response functions and variance decompositions. Both of these tools require some form of structural factorization of the innovation variance-covariance matrix, and this operation is undefined or nonsensical for a matrix that has infinite diagonal elements. Hannsgen's histograms give the impression that a non-Gaussian distribution is likely because there is excess kurtosis and skew, along with clusters of volatility. Hannsgen also uses diagnostic tools to determine if the data are consistent with a hypothesis of stability, and finds that the maximum likelihood estimates result in very good fits for all six series of innovations.

A way to test the hypothesis that heteroscedasticity (i.e., when the variance of the error term in a regressive equation does not remain constant between observations) is responsible for the appearance of non-normality is to focus on subsample estimates that appear homoscedastic (of equal variance). The author finds that the sample splits are unevenly effective in removing the non-normality of the data. He also finds that a model that divides the sample into two subperiods, including a third subperiod representing the intervening years, would succeed in removing non-normality in all subperiods for, at most, two variables: IP and CPI. The effort to explain away the excess kurtosis in the distributions with time-varying variances does not completely succeed, at least when heteroscedasticity is modeled with an ARCH or a generalized ARCH process.

For the complete text, go to www.levy.org/pubs/wp_546.pdf.

New Research Scholar

SELCUK EREN has joined the Levy Institute as a research scholar in the Distribution of Income and Wealth program. Eren's fields of specialization are demographic economics and labor economics. His current research interests include the internal and international migration of labor, income and educational mobility in developing countries, and the measure of households' housing wealth, among other topics in applied microeconomics. Formerly a visiting assistant professor of economics at Hamilton College, Eren has taught courses on micro- and macroeconomics, health economics, and the economics of immigration. He is a member of the Econometric Society, American Economic Association, Society of Labor Economists, Eastern Economic Association, and Southern Economic Association. Eren received a B.A. in economics from Istanbul Bilgi University and an M.A. and a Ph.D. in economics from the State University of New York at Stony Brook.

New Research Associates

Research Associate FATMA GÜL ÜNAL is a member of the faculty of Bard College at Simon's Rock. She has taught economics at Bucknell University and at the University of Massachusetts Amherst, where she is a staff economist at the Center for Popular Economics. Ünal's research interests include the political economy of gender, asset and income inequality, poverty within the context of rural economies, and environmental and resource economics. She has received fellowships from The University of Manchester, Cambridge University, and the University of Utah to participate in workshops on development economics, inequality, poverty, and gender, and has taught economics classes for women's organizations and unions. Ünal holds a Ph.D. in economics from the University of Massachusetts Amherst.

Four new research associates have joined the Levy Institute as part of the Research Group on Israeli Social Structure and Inequality, a new initiative under the Immigration, Ethnicity, and Social Structure program.

YINON COHEN is Yosef H. Yerushalmi Professor of Israel and Jewish Studies at Columbia University. Cohen's research centers on international migration, social stratification, and labor markets. Recent research projects include patterns of self-selection and earnings assimilation of immigrants in Israel, Germany, and the United States; the development of socioeconomic ethnic and gender gaps in Israel; rising income inequality in Israel; and the transformation of the Israeli industrial relations system. Cohen received his B.A. from The Hebrew University of Jerusalem, and his M.A. and Ph.D. from the State University of New York at Stony Brook.

SERGIO DELLAPERGOLA is a professor of population studies at The Hebrew University's Harman Institute of Contemporary Jewry, where he currently holds the Shlomo Argov Chair in Israel-Diaspora Relations. He is also a senior fellow at the Jewish People Policy Planning Institute, an independent think tank based in Jerusalem. A specialist on the demography of world Jewry, DellaPergola has served as senior policy consultant to the President of Israel, the Israeli Government, the Jerusalem Municipality, and numerous national and international organizations. He holds an M.A. from the Università degli Studi, Pavia, and a Ph.D. from The Hebrew University.

BARBARA S. OKUN is an associate professor on the faculty of social sciences at The Hebrew University of Jerusalem, and former chair of the university's department of population studies. She is a past fellow of the Woodrow Wilson School of Public and International Affairs, the National Science Foundation, and the Rashi Foundation, Israel. Okun's research interests include family structure and labor market behavior, and the impact of intermarriage on ethnic and racial stratification. She is currently a reviewer for *Demography* and *Population Research and Policy Review*, among other journals. Okun received a B.A. in applied mathematics from Harvard University, and an M.A. and a Ph.D. in economics from Princeton University.

SEYMOUR SPILERMAN is Julian C. Levi Professor of Sociology and codirector of the Center for the Study of Wealth and Inequality at Columbia University. He has taught at The Hebrew University, Tel Aviv University, and the University of Wisconsin, and is the former director of policy analysis research at the Russell Sage Foundation. A focus of his research is the structure of work careers in corporate settings, examining the ways in which educational attainment, labor market experience, race, and gender influence work career features. He is also involved in cross-national research on issues of income and wealth inequality, and on intergenerational wealth transfers. Spilerman holds an M.A. in mathematics from Brandeis University and a Ph.D. in operations research and sociology from Johns Hopkins.

The Research Group on Israeli Social Structure and Inequality includes Senior Scholar Joel Perlmann and Research Associate Yuval Elmelech. The group will focus on three domains of inequality within Israel: the roles of ethnic origin and immigration status in shaping the system of social stratification; shifting income and wealth distributions in a time of increasing privatization and globalization; and the connection between Israel's massive restructuring of its higher education system and returns to schooling.

Conference

The Financial Crisis, the U.S. Economy, and International Security in the New Administration

Economists for Peace and Security, the Charles Léopold Mayer Foundation Initiative for Rethinking the Economy, and The Levy Economics Institute hosted a conference on November 14, 2008, at the Schwartz Center for Economic Policy Analysis, New School University, in New York City. The objective of the conference was to analyze President-elect Barack Obama's economic policies and offer actionable recommendations for his administration on how to deal with the financial crisis that has crippled the U.S. economy. Issues ranged from the nature of the current crisis, economic policy challenges facing the United States, and the design of a new domestic and international financial architecture.

Featured international financial experts included James K. Galbraith, Jeff Madrick, Bernard Schwartz, Allen Sinai, Joseph E. Stiglitz, and many others.

An overview of the conference and its participants can be found on the Economists for Peace and Security website at www.epsusa.org.

Research Grants

The Levy Institute has received an underwriting grant from the FORD FOUNDATION in support of research to examine financial instability and reregulation in light of the current global financial crisis. The rapidity with which the crisis in the U.S. subprime mortgage market spread to financial markets in all the major financial centers, developed as well as emerging, was a clear representation of the fact that financial institutions are no longer limited to their home markets. This suggests a systemic fault in the current business model of these institutions, and in the regulation and supervision of domestic and global financial markets. The goals of the Institute's project are to determine the policies needed to bring about a rapid resolution of the crisis; to formulate proposals for the reform of mortgage finance and a new regulatory framework for the financial system as a whole; and to assess the implications of domestic reregulation on the global financial system. Another of the project's aims is the formation of a worldwide research network with the common objective of creating a global agenda for reform, leading to a cohesive program of reforms at both the national and the international level. Senior Scholar Jan Kregel, director of the Institute's Monetary Policy and Financial Structure program, will head the Levy research team.

The ALFRED P. SLOAN FOUNDATION has awarded the Institute a generous grant in support of ongoing research within the Levy Institute Measure of Economic Well-Being (LIMEW) program. Standard measures of national income and product indicate that the United States is considerably ahead of the rest of the world; its rate of conventionally measured productivity growth is now ahead of most other Organisation for Economic Co-operation and Development (OECD) countries. However, it is not clear that the United States would maintain its lead in terms of a comprehensive measure of household income such as the LIMEW. The first stage of the project will be to develop comparable measures of economic well-being in four other OECD countries, all with widely varying political-economic systems: Canada, Germany, France, and the United Kingdom. Comparative analysis of the LIMEW measure among these countries will provide a much broader context for evaluating the United States' performance. The project will be co-directed by Senior Scholars Edward N. Wolff and Ajit Zacharias.

As a complement to its ongoing work on gender and poverty, the WORLD BANK has awarded the Levy Institute a grant to study child-gender bias effects in household consumption patterns in Ethiopia. The study, which analyzes data contained in the national Household Income and Consumption Expenditure Survey, applies an innovative approach to the Rothbarth model of the intrahousehold distribution of income that considers both the influence of household type (nuclear/extended), and a selectivity mechanism of gender bias based on the number of children. The author of the study is Feridoon Koohi-Kamali, research associate and editor.

Upcoming Event

The 18th Annual Hyman P. Minsky Conference: The Financial Crisis and Its Effects on the U.S. and Global Economies

April 16–17, 2009

The topics of this year's conference will include the causes and consequences of the "Minsky moment"; the impact of the credit crunch on the economic and financial market outlook; dislocations and policy options; the rehabilitation of fiscal policy; margins of safety, systemic risk, and the U.S. subprime mortgage market; lessons from earlier times to rehabilitate mortgage financing and the banks; financial markets regulation-reregulation; the inefficiency of computer-driven markets; currency market fluctuations; and exchange rate misalignment.

Further information about the conference, its location, and how to register will be posted at www.levy.org as it becomes available.

PUBLICATIONS AND PRESENTATIONS

Publications and Presentations by Levy Institute Scholars

RANIA ANTONOPOULOS *Research Scholar*

Publication: "State, Difference, Diversity: Toward a Path of Expanded Democracy and Gender Equality," in *Democracy, State, and Citizenship in Latin America*, Vol. II (in Spanish), Project on Democratic Development in Latin America, Lima (Peru): United Nations Development Programme (UNDP), 2008.

Presentations: "Employment and Gender Issues," seminar on "Contributing to Employment-anchored Inclusive Development: Focusing on Employment Diagnostics, Promising Approaches, and MDG-Scaling-up," Bureau for Development Policy (BDP), UNDP, New York, N.Y., September 23; "Why Employment Matters," conference on "Well-Being: Are We Happy With Our Standard of Living?" Cassino, Italy, September 26–27; "Economic and Social inclusion: The Role of Work in the Face of Displacement," seminar on "Employment Alternatives for Economic Inclusion in Bogotá," sponsored by the Mayor's Office of Bogotá, Colombia, October 29; "Public Works Programmes and Unpaid Care Work," Expert Group meeting on "Unpaid Work, Economic Development, and Human Well-Being," BDP, UNDP, New York, N.Y., November 16–17, 2008; "Women's Right to Work, Employment Guarantee Policies, and Gender Equality," conference on "Decentralization, Local Power, and Women's Rights: Global Trends in Participation, Representation, and Access to Public Services," sponsored by the Government of Mexico and the International Development Research Centre, Mexico City, November 18–21; "Scaling Up South Africa's Public Job Creation Programme: Impact on Gender Equality and Pro-poor Economic Development," Political Economy Seminar Series, Graduate School of Economics, University of Massachusetts Amherst, November 25.

JAMES K. GALBRAITH *Senior Scholar*

Publications: *The Predator State: How Conservatives Abandoned the Free Market and Why Liberals Should Too*, New York: The Free Press, 2008; "Colapso del monetarismo e irrelevancia del nuevo consenso monetario," *Ola Financiero*, No. 1, September–December; "Predatory Pachyderms: Government of Big Business, By Big Business, and For Big Business," *The Texas Observer*, September 5; "A Bailout We Don't Need," *Washington Post*, September 25; "Plan," *Harper's Magazine*, a contribution to the *How to Save Capitalism* Forum, November; "Policy and Security Implications of the Financial Crisis: A Plan for America," *Challenge,* Vol. 51, No. 6, November–December.

Presentations: "The Predator State: How Conservatives Abandoned the Free Market and Why Liberals Should Too," presented at the New America Foundation, Washington, D.C., and the Yale Club of Washington, D.C., October 6; introduction to the opening of the John K. Galbraith Papers, John F. Kennedy Presidential Library and Museum, Boston, Mass., October 12; speech given as part of the John K. Galbraith Centennial, Dutton, Ontario, Canada, October 18; "The Predator State," Schwartz Center for Economic Policy Analysis, New School University, New York, N.Y., October 20; "What Is the Predator State?" The Chapman Dialogues Distinguished Lecture Series, Chapman College School of Law, Orange, Calif., October 27; "Policy and Security Implications of the Financial Crisis: A Plan for America," Global Financial Crisis Meeting, Columbia University, New York, N.Y., October 28; "The Predator State," Global Affairs Lecture Series, Occidental College, Los Angeles, Calif., October 28; "The Predator State," Texas Book Festival, Austin, November 1; "Better 'Bail-out' and 'Bail-in' Packages," conference organized by the Political Economy Research Institute, University of Massachusetts Amherst, at the Schwartz Center, New York, N.Y., November 21.

FERIDOON KOOHI-KAMALI *Research Associate and Editor*

Publication: "Intrahousehold Inequality and Child Gender Bias in Ethiopia," Policy Research Working Paper WPS 4755, The World Bank, October.

JAN KREGEL *Senior Scholar*

Publications: *METU Studies in Development*, Vol. 35, No. 1, 2008; "Using Minsky's Cushions of Safety to Analyze the Crisis in the U.S. Subprime Mortgage Market," *International Journal of Political Economy*, Vol. 37, No. 1, Spring; "The Discrete Charm of the Washington Consensus," *Journal of Post Keynesian Economics*, Vol. 30, No. 4, Summer.

Presentations: "Inflation Targeting and Alternative Approaches to Monetary Policy," Central Bank of the Argentine Republic Money and Banking Seminar, "Financial Turmoil: Its Effects on Developed and Emerging Economies," Buenos Aires, Argentina, September 2; "Combining Full Employment with Inflation Control—Replacing Inflation Targeting," 10th Congress of Economists of Latin America and the Caribbean, Bogota, Colombia, September 4; "The Keynesian Roots of Patnaik's Value of Money," plenary presentation, conference on "The Value of Money in Contemporary Capitalism," New Delhi, India, September 12–13; "The Social Impact of Globalization," seminar on "Globalización y distribución del ingreso: Problemas y desafíos de política," sponsored by the Argentine Ministry of Labour and Social Security, International Labour Organization, United Nations Development Programme, and the Economic Commission for Latin America and the Caribbean, Buenos Aires, Argentina, September 22–23; "The Global Financial Crisis and Developing Economies," conference on "The Emerging Global Economy: Is There a Challenge from the South?" Faculty of Economic Sciences, University of Buenos Aires, Argentina, September 24–25; "Managing Uncertainty in a Volatile World," conference on "Beyond Bretton Woods: The Transnational Economy in Search of New Institutions," sponsored by the Instituto de Investigaciones Economicas, Universidad Nacional Autonoma de Mexico (UNAM), Mexico City, the Observatoire de la Finance, Geneva, Switzerland, and the Pacific Asia Resource Center, Tokyo, Japan, at UNAM, October 15–17; "From U.S. Subprime Crisis to Global Meltdown: Implications for the Baltic Capital Importing Countries," presented at the Estonian Development Fund, Tallinn, Estonia, October 30.

DIMITRI B. PAPADIMITRIOU *President*

Publications: "The Economic Contributions of Hyman Minsky: Varieties of Capitalism and Institutional Reform" (with L. R. Wray), in S. Pressman, ed., *Leading Contemporary Economists: Economics at the Cutting Edge,* Routledge, 2008; "The Economic Crisis and Beyond," *Kathimerini*, October 18.

Presentations: "The U.S. Economy: The Road Ahead," Lifetime Learning Institute, Bard College, Annandale-on-Hudson, N.Y., September 9; interview regarding the federal funds rate with Daniel Sturgeon, *Tokyo News*, September 16; interview regarding the financial crisis on Wall Street with Javier Salinas, *Getty Images*, September 16; interview regarding the long-term effects of only a few commercial banks dominating the banking industry with Matthias Rieker, *Dow Jones*, September 17; interview regarding the Federal Reserve's expanding balance sheet and its implications with Neil Roland, *Financial Week*, September 18; interview regarding the Treasury's bailout plan with Greg Robb, *Marketwatch.com*, September 22; interview regarding the Emergency Economic Stabilization Act of 2008 with Matthias

Rieker, *Dow Jones*, September 28; interview regarding the economy with Sarah Bradshaw, *Poughkeepsie Journal*, September 29; "Contemporary Economic Issues," Center for Lifetime Studies, Marist College, Poughkeepsie, N.Y., October 7; interview regarding the connection between the market and the presidential election with Karin Price Mueller, Fidelity Interactive Content Services, October 8; interview regarding the implications of the financial crisis with Alejandro Rebossio, *La Nación*, October 8; interview regarding the Bank of England and the recapitalization of banks with Matthias Rieker, *Dow Jones*, October 8; interview regarding the current economic crisis and the measures taken by the government with Zehra Altayli, *Six News* (Turkey), October 13; interview regarding the U.S. economy and recession with Andy Robinson, *La Vanguardia*, October 23; interview regarding alternative stimulus ideas with Michael S. Rosenwald, *The Washington Post*, October 29; interview regarding what's next in the credit crisis with Mary Kane, *The Washington Independent*, November 3; interview regarding the economic challenges facing Barack Obama during the first few months of his presidency with Michael E. Kanell, *The Atlanta Journal-Constitution*, November 6; interview regarding general predictions for the economy going into the new year with Emily Schmall, *La Voz*, November 10; session participant, "A New Domestic Financial Architecture," conference on "The Financial Crisis, the U.S. Economy, and International Security in the New Administration," organized by Economists for Peace and Security, the Charles Léopold Mayer Foundation, and The Levy Economics Institute, Schwartz Center for Economic Policy Analysis, New School University, New York, November 14; member, panel on the economy, Bard College at Simon's Rock, Great Barrington, Mass., November 19; participant, working meeting on financial restructuring and re-regulation, organized by the Political Economy Research Institute, University of Massachusetts Amherst, at the Schwartz Center, New York, N.Y., November 21.

EDWARD N. WOLFF *Senior Scholar*

Presentation: "Long-Term Trends in the Levy Institute Measure of Economic Well-Being (LIMEW), United States, 1959–2004," Wealth and Inequality Seminary Series, Princeton University, Princeton, N.J., October 22.

L. RANDALL WRAY *Senior Scholar*

Publication: "The Economic Contributions of Hyman Minsky: Varieties of Capitalism and Institutional Reform" (with D. B. Papadimitriou), in S. Pressman, ed., *Leading Contemporary Economists: Economics at the Cutting Edge*, Routledge, 2008.

AJIT ZACHARIAS *Senior Scholar*

Presentation: "Measuring Long-Term Trends in Economic Well-Being in the United States: A New Perspective," conference on "Well-Being: Are We Happy With Our Standard of Living?" Cassino, Italy, September 26–27.

GENNARO ZEZZA *Research Scholar*

Presentations: "Life Satisfaction in a Survey of Italian Households" (with M. Malgarini and M. Pugno), conference on "Well-Being: Are We Happy With Our Standard of Living?" (organizer), Cassino, Italy, September 26–27; "Fiscal Policy in a Model of the U.S. Economy," conference on "Macroeconomic Policies on Shaky Foundations," Berlin, Germany, October 31 – November 1; "Empirical Stock-flow Consistent Modeling," seminar at IMK, Dusseldorf, Germany, November 4.

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