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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. It depends on the financial support from individuals, corporations, and private foundations to carry out its scholarship and economic research generating viable, effective public policy responses to important economic issues.

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LETTER FROM THE PRESIDENT

To our readers:

This issue begins with a strategic analysis by Research Scholars Greg Hannsgen and Michalis Nikiforos and me under the State of the US and World Economies program. We examine the most recent CBO forecast and conclude that the US economy is more likely to experience increases in GDP and employment based on an increase in private borrowing, net exports, and modest, targeted government stimulus. We observe that the connection between economic growth and job creation has weakened during the past three decades, which complicates any effort to reduce unemployment through economic growth policies. We strongly recommend that US policymakers avoid austerity measures, as the results have been consistently disastrous in other countries.

Two policy notes under this program address various aspects of the Greek crisis. Research Associate and Policy Fellow C. J. Polychroniou revisits what he terms the "economics of social disaster," and offers a review of the historical trends and recent events that have pushed Greece to the brink of a humanitarian crisis. Research Associate Giorgos Argitis examines the "Greek deal" of November 2012. He concludes that the new agreement contains much fantasy but very little realism, and is unlikely to heal the Greek economy. In a working paper, Robert J. Barbera and Gerald Holtham reflect on the policy choices made by the United States and the eurozone in the wake of the global financial crisis—countercyclical fiscal policy in the former and austerity in the latter—and analyze the forces that shaped these choices.

The Monetary Policy and Financial Structure program begins with a working paper by Research Associate Philip Arestis, Ana Rosa González, and Óscar Dejuán in which they examine the physical capital accumulation process and the growth of the financial sector. The authors present a model of the accumulation process and empirical results for 14 OECD countries. Turning to the Federal Reserve, Research Associate Thorvald Grung Moe provides a detailed discussion of the role of Marriner S. Eccles in the creation of the 1951 Federal Reserve–Treasury Accord. He concludes that the central bank's history, and many of Eccles's choices, hold lessons for today's Fed. Arestis and González contribute a working paper that examines the linkages between the housing market and bank credit. Continuing the theme of historical analyses of the Federal Reserve, Thomas M. Humphrey reviews the Fed's actions during and after the financial crisis of 2007–09 in light of the classical doctrine for central banks established by Walter Bagehot and Henry Thornton in the 19th century. Humphrey's critical review of recent Fed actions provides ample basis for renewed public debate. Barry Z. Cynamon and Research Associate Steven M. Fazzari take up the seeming paradox of rising income inequality and increased consumer spending in the decades leading up to the crisis in 2007. The authors hypothesize that consumers undertook additional debt to maintain "consumption norms." Fittingly, the final working paper under this program offers a defense of Hyman P. Minky's financial instability hypothesis by Eugenio Caverzasi, who employs a stock-flow perspective to argue for the logical consistency of Minsky's work.

Under the Gender Equality and the Economy program, Senior Scholar and Program Director Rania Antonopoulos discusses social protection initiatives in the context of developing countries and explores the opportunities they present for promoting a gender-equality agenda and women's empowerment. Her working paper is accompanied by an annotated bibliography as a resource for scholars and practitioners.

The Immigration, Ethnicity, and Social Structure program includes a working paper by Research Associate Sanjaya DeSilva on gender differences in the benefits of temporary labor migration. His analysis reveals opportunities to craft policies to reduce the economic pressures on rural women to seek employment abroad.

Eight working papers are included under the Economic Policy for the 21st Century program. In the first of these, Egmont Kakarot-Handtke demonstrates the emergence of secondary markets from the flow part of the economy. Research Associate Lekha S. Chakraborty provides an empirical investigation of the potential connection between fiscal deficits and interest rates. Contrary to the accepted wisdom in many policy circles, she finds that an increase in the fiscal deficit does not cause a rise in interest rates. Eugenio G. Caverzasi and Antoine Godin provide a thorough and thoughtful review of the development and themes of the literature on stock-flow consistent models. Eckhard Hein examines the redistribution of income under finance-dominated capitalism from a Kaleckian perspective. He finds that the labor share of income in 15 advanced capitalist economies has fallen since the early 1980s as a result of neoliberal policies and financialization. Chakraborty, Yadawendra Singh, and Janet Farida Jacob present their preliminary findings of the incidence of health benefits in India. They find evidence of both equitable and regressive distribution in health services but resist making conclusions given the uneven nature of the country's health system. Esteban Pérez Caldentey, Daniel Titelman, and Pablo Carvallo compare the historical patterns in business cycles across 83 countries worldwide. They find that the business cycles of Latin America and the Caribbean exhibit two distinct traits: weak economic expansions and economic contractions that are roughly equal in duration and intensity to the rest of the world. Olivier G. Giovannoni examines the determinants of US economic growth with a model of consumption, investment, and government spending for the period 1955–2007. His analysis provides evidence for the role of consumption and government spending as the long-term drivers of economic growth. Michael A. Valenti and Giovannoni present a literature review and synthesis undertaken for the Club de Madrid around the topic of "shared societies." The literature is organized around four themes: the effects of trust and social cohesion on growth and output, the effect of institutions on development, the costs of fractionalization, and policies of social inclusion from around the world.

Finally, I am pleased to call to your attention to a new collection of Hyman P. Minky's work titled *Ending Poverty: Jobs, Not Welfare.* This volume contains seven papers, four of which are appearing in print for the first time. We hope this new volume will stimulate interest in Minsky's work on poverty and employment and support the efforts of scholars and policymakers alike.

As always, I look forward to your comments.

Dimitri B. Papadimitriou, *President*

Program: The State of the US and World Economies

Strategic Analysis

Is the Link between Output and Jobs Broken?

DIMITRI B. PAPADIMITRIOU, GREG HANNSGEN, and MICHALIS NIKIFOROS
Strategic Analysis, March 2013

Levy Institute President Dimitri B. Papadimitriou and Research Scholars Greg Hannsgen and Michalis Nikiforos present their findings and policy proposals for the US economy through the end of 2016. Using the Levy Institute's macroeconomic model, they present projections based on four scenarios for the US economy to the end of 2016, and argue for a mixed approach to economic recovery that emphasizes private borrowing, increased exports, and modest, targeted stimulus spending. The authors note that the increasingly weak link between economic growth and job creation complicates efforts to reduce unemployment. The analysis emphasizes policy strategies that fall within the scope of the current budget debate. The authors begin with an analysis of the Congressional Budget Office's (CBO) February 2013 economic projections.

The authors first develop a baseline scenario that uses the CBO projections merely as a benchmark. The baseline simulations using the Levy macro model attempt to reproduce the GDP growth rates and government deficits projected by the CBO. The authors find the CBO projections implausible given the necessary decline in the private sector surplus that would be required to achieve the CBO's projected growth rates: a decline from 5.4 percent of GDP in 2012Q4 to 1.6 percent in 2015Q1.

The authors' baseline case assumes a moderate increase in average US home prices and uses the International Monetary Fund's projections for improved growth in the rest of world. Under the baseline case, fiscal deficits fall to 3.8 percent by 2015. The private sector surplus falls from 5.4 percent to approximately 1.5 percent by 2015Q1 and thereafter remains constant at 2 percent of GDP. The current account balance rises gradually from –2.9 percent to –2 percent. GDP growth hovers around 1.25 percent for most of 2013, passes 3 percent in 2014Q2, and remains stable until the end of the simulation period. The authors conclude that the baseline case does not produce levels of economic growth sufficient to bring about a full recovery given typical rates of population increase and productivity growth.

The first scenario estimates the level of stimulus needed to achieve a 6.5 percent unemployment rate in roughly two years. Scenario 1 assumes a slight decrease in the private sector surplus, a slightly smaller increase in taxes on wages and salaries than was assumed in the baseline, a slight increase in direct taxation, and an increase in real government purchases of final goods and government transfers to the private sector. In this first scenario the authors are forced to assume relatively high levels of stimulus in order to achieve sufficient increases in employment, recognizing that this is unlikely given the current climate in Washington. The deficit declines in scenario 1 but nevertheless remains in excess of 5.7 percent throughout the simulation period. The private sector surplus stays below 3.1 percent. With higher government borrowing compared to the baseline scenario, the private sector accumulates more assets. The foreign balance reaches –2.6 percent by the end of 2016.

In scenario 2, the authors use the same assumptions as in scenario 1 to examine a fiscal stimulus approach to achieve a 5.5 percent reduction in unemployment by the end of 2014. The projections assume that the two types of government outlays (i.e., real government purchases of final goods and government transfers to the private sector) grow by 11 percent annually after inflation in 2013 and 2014. This causes deficits to remain above 7.3 percent throughout the simulation period. The private sector surplus ends the projection period at 3.5 percent after hovering at 5 percent for much of the simulation period, and current account balances range between –2.9 and –3.9 percent of GDP. As a result, GDP growth reaches 6.9 percent in 2014Q4 and generally is higher than in the baseline scenario and scenario 1. Thus, scenario 2 produces the largest and most rapid gains in employment but with very high levels of stimulus spending given the current climate.

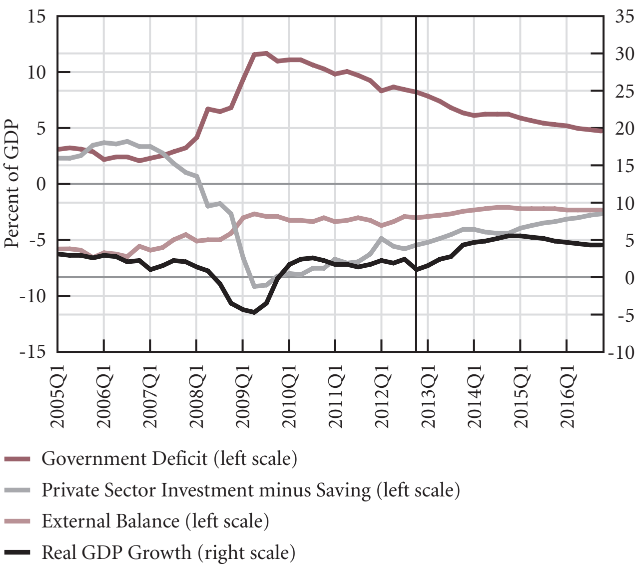
Scenario 3 builds on positive signs in areas such as bank lending to nonfinancial businesses, consumer credit, and household sector debt, and favorable indications of increased exports to US trading partners. Thus, scenario 3 assumes modest growth in government spending, an increase in private sector net borrowing, and greater export demand. The results of scenarios 1 and 2 showed that the level of stimulus needed to achieve target unemployment levels is large relative to policymakers' appetite for increased government spending. Thus, this scenario relies on aggregate demand growth in all three sectors. Under these assumptions, the government deficit falls to 4.8 percent of GDP, the private sector balance reaches 2.6 percent of GDP, and the current account balance reaches –2.6 percent of GDP by the end of the simulation period. Finally, real GDP growth rates stay close to 5 percent, which is sufficient to significantly reduce the unemployment rate. Thus, scenario 3 (Figure 1) provides the most likely pathway to economic recovery of the scenarios investigated.

The authors note that the weakening link between economic growth and job creation in the last three decades complicates the reduction of unemployment in all of the scenarios. A comparison of the reduction in unemployment (Figure 2) shows that scenario 2 offers the fastest path to reduced unemployment, but even in this case unemployment levels do not fall below precrisis levels during the forecast period. The authors calculate that in 1970 a 1 percent increase in GDP led to a 0.714 percent increase in employment. In contrast, between 2009 and 2012, a 1 percent increase in GDP yielded a 0.288 percent increase in employment. They find that higher rates of growth have higher rates of job creation and thus have a twofold effect of reducing unemployment and increasing labor force participation.

In conclusion, Papadimitriou, Hannsgen, and Nikiforos observe that unemployment in the United States is persistent, severe, and cyclical. Austerity policies must be foresworn, as they have wreaked havoc on employment everywhere they have been implemented. Likewise, tax increases of any sort are inadvisable at present. An employer-of-last-resort policy is a prudent and effective strategy but remains, for the moment, outside the scope of the current policy debate. Thus, a mixture of increased private investment, increased export demand, and light stimulus with supporting policy changes (e.g., corporate tax reform and investments in R&D) to achieve the synergies necessary to spur growth and reduce unemployment represent a viable way forward.

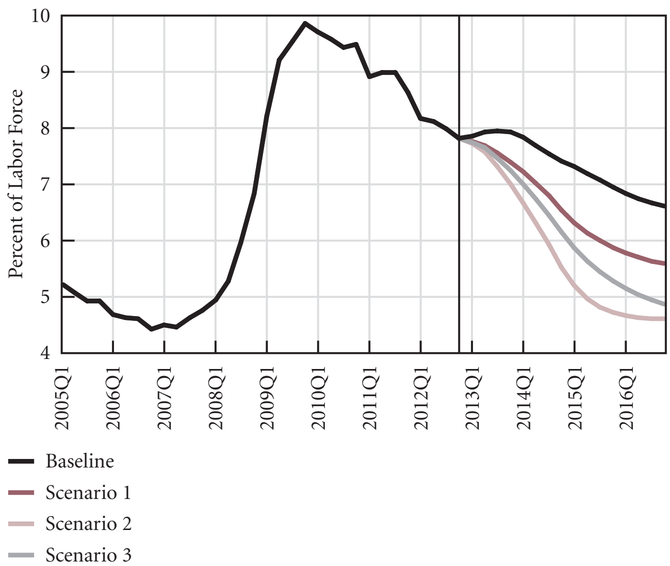
http://www.levyinstitute.org/pubs/sa_mar_13.pdf

Figure 1 **Scenario 3: US Main Sector Balances and Real GDP Growth, 2005Q1–2016Q4**



Sources: BEA; authors' calculations

Figure 2 **Unemployment Rate, 2005Q1–2016Q4**



Sources: Bureau of Labor Statistics; authors' calculations

The Tragedy of Greece: A Case against Neoliberal Economics, the Domestic Political Elite, and the EU/IMF Duo

C. J. POLYCHRONIOU

Policy Note 2013/1

Research Associate and Policy Fellow C. J. Polychroniou extends his critique of the neoliberal "economics of social disaster" that continues to plague Greece. In this policy note, he argues that the current catastrophe is a confluence of both historical trends and recent events. In particular, he identifies the European Union (EU) and the International Monetary Fund (IMF) as "the twin monsters" of neoliberal capitalism that have demanded policies that have brought about the current tragedy. The failure of mainstream economics to embrace the lessons that history offers, the inept and often corrupt efforts of the Greek government, the demands of foreign creditors, the neoliberal organizational framework of the EU, the free-market dogma of the IMF, and the decline of Greek political culture are some of the factors the author surveys in what may well become a humanitarian crisis. Greece and Europe as a whole should, Polychroniou argues, turn aside from the economic and social devastation the neoliberal policy agenda will inevitably bring. The Greek people, using democratic and nonviolent means, must stand against the austerity policies that have brought economic and social hardship to Greece.

Polychroniou begins with a broad discussion of the antecedents of the crisis in Greece. He observes that the inability of mainstream economics to predict or analyze the events and processes it studies is exceeded only by its reliance on such suspect approaches as dynamic stochastic general equilibrium models and the rational expectations hypothesis. For example, as Lehman Brothers collapsed and the global financial system headed deeper into crisis, nary an economist had predicted a system-wide crisis. Despite the history of the real economy reasserting itself time and again over speculative bubbles, mainstream economists had little to offer. They continue to ignore the likes of Marx, Marshall, Keynes, and Minsky in favor of mathematical economics and narrow econometric analyses. Ironically, it is only the intervention of the very same institution that neoliberals decry (i.e. the state) that prevents the collapse of capitalism.

Polychroniou cites the IMF as the clearest example of the failure of the neoliberal paradigm. Despite the IMF's history of flawed economic forecasting and a record of imposing one-size-fits-all, antigrowth "structural adjustment" programs that typically result in economic devastation, it remains wedded to its free-market approach. The economic catastrophe in Greece is the latest example of what the neoliberal IMF, in partnership with the neoliberal EU (under the direction of Germany and its northern allies), creates.

Part of the blame for the current crisis clearly rests with the Greek governments of the last 30 years, which the author describes as being as "incompetent and corrupt as any government on earth could be." Today, Polychroniou sees a political culture that emphasizes personal gain, a lack of social responsibility, and the withdrawal of a large and growing segment of the population from political life. He finds that the Greek crisis is the result of a severe, decades-long fiscal and public debt crisis, dysfunctional trade and financial relationships within the eurozone, and the neoliberal agenda that lies at the heart of the IMF and the EU's operational framework.

The bailout of 2010 was orchestrated by the EU and IMF, and ensured that foreign creditors, including highly exposed German banks, were paid. The prescription was savage austerity rather than economic assistance. Two years later, a second bailout required yet more of the same prescription. Today, Greek unemployment stands at 27 percent (62 percent for youth), up from 12 percent in May 2010. Poverty, notably among children, is rising. Income levels are declining as a result of wage suppression. The EU/IMF "structural adjustment" program aims at total liberalization of the Greek labor market and a potential ban on strikes. Polychroniou argues that Greece had a moment at the beginning of the crisis to negotiate a better deal but the inept leadership of the time failed to act. He concludes that the economics of social disaster have no place in Greece or the EU as a whole and must be rejected.

http://www.levyinstitute.org/pubs/pn_13_1.pdf

Greece: Caught Fast in the Troika's Austerity Trap

GIORGOS ARGITIS

Policy Note 2012/12, December 2012

Research Associate Giorgos Argitis analyzes the most recent "Greek deal," offered by the European Union (EU), European Central Bank (ECB), and the International Monetary Fund (IMF) in November 2012. The deal, Argitis writes, contains "much fantasy, but little realism." Greece is caught in a cycle of tight fiscal and wage policies leading to economic recession, which undermines its ability to meet its debt obligations. The Greek economy is suffering from what Argitis refers to as a "default trap," which increases the fragility and instability of the Greek banking system.

The latest deal between Greece and the EU, ECB, and IMF—the "troika"—requires Greece to adopt fiscal cuts and privatization. These policies institutionalize austerity measures, impoverishing Greek workers and constraining domestic policymakers. The deal also restructures creditors' claims as a means of reducing Greece's financing gap and borrowing needs. The result of the bailouts to date has been to severely reduce Greek domestic demand, deepen the recession, and constrain the country's ability to repair its finances. The current situation, the author concludes, is a self-defeating cycle that leaves Greece in a "default trap."

Argitis offers three recommendations to restore the Greek economy and escape this trap. As a first step, Greece's debt must be restructured. This will require a substantial haircut of its current stock of debt, near-zero interest rates, and a much longer repayment period. Repayment of Greece's debt requires an economy that can produce sustainable primary surpluses. Thus, austerity policies that depress the economy are counterproductive. Furthermore, austerity measures will delay the implementation of needed structural reforms in Greece's production system, and continued economic weakness will discourage investment and delay the Greek recovery.

Argitis recommends an employer-of-last-resort (ELR) initiative in the form of an employment guarantee program (EGP) targeting specific geographic regions, younger workers, and women. EGPs would be financed from an ELR fund using revenues from sources such as increased tax collections from tax evaders, utilization of public property, a percentage of the primary surplus, and EU structural funds. EGPs, Argitis argues, represent a way out of recession and the default trap. EGPs will promote economic stability, reduce the ratio of public debt to GDP, and increase the country's financial stability, solvency, and credibility.

Finally, Argitis argues that Greece must adopt a new growth model that emphasizes exports and greater structural competitiveness. Resources must be reallocated to modern industries (e.g., green energy and organic agriculture) and import-substitution industries. However, the most important economic development challenge is to transform the dominant culture of Greek entrepreneurship. The new entrepreneurial culture must emphasize investing in research and development, expanding production and market share, and supporting export-oriented activities that target capital accumulation.
www.levyinstitute.org/pubs/pn_12_12.pdf

ECB Worries / European Woes: The Economic Consequences of Parochial Policy

ROBERT J. BARBERA and GERALD HOLTHAM

Working Paper No. 742, December 2012

In this working paper, Robert J. Barbera, Johns Hopkins University, and Gerald Holtham, Cardiff University Business School, discuss the differences in how US and EU policymakers have responded to financial crises in recent decades. They compare the policy responses in light of their outcomes in these two economies. The paper also includes a discussion of the insights of Hyman P. Minsky, postwar economic stabilization policies, and historical factors that may have influenced the EU and US responses to the most recent crisis.

Minsky observed that when financial crises erupt, it is a "big government" and a "big bank" that can prevent the development of an economic depression. Minsky's insights regarding financial instability, the authors observe, while published in the 1970s, were remarkably prescient, especially with regard to the financial crisis of 2007–09. Minsky's stabilization policies have played a central role in the US response to the most recent financial crisis, while Europe largely chose to follow another path. The US, despite persistent calls for austerity policies, has thus far restored a modicum of growth and stability to its economy. In contrast, the euro nations, due to institutional limitations and policymaker biases, have slid closer to repeating an economic depression than any developed economy since the 1930s.

Among the depression-fighting policy responses described by Minsky, deposit insurance and central bank backstopping sovereign debt are central. Europe may have one currency, but it has 17 deposit insurance schemes. From 2011 to the first half of 2012, the authors report, Europe experienced a silent bank run. It was not visible because euro-area nations use the "TARGET II" system to reconcile bank flows. Further, the absence of a central bank to guarantee sovereign debt may lead to a self-fulfilling prophecy of crisis and increased risk of default in countries such as Italy. Given the results of EU policies in the last several years, why, the authors ask, did policymakers select this approach, and why do they continue with what are clearly failed policies? The authors argue that a combination of received economic theory, the experience of economists, and vested interests has contributed to the current debacle.

The authors contend that mainstream macroeconomic theory in the last 40 years has advocated policies that rely on unrealistic assumptions. They suggest that the real world is a more turbulent place than the world of the dynamic general equilibrium model, and that we ignore this fact at our peril. In addition, German policymakers' experience during the postwar era reinforced their belief that what had worked in the past (e.g., inflation control) would work in the future. Since 1985, the authors observe, recessions have been caused by financial instability, not government responses to rising inflation. Finally, the Great Depression of the 1930s figures more prominently in the memory of US policymakers than in their European counterparts, who recall the inflation of the 1930s and devastation of World War II more keenly.

European denial of the results of the last three years of austerity may have a deeper cause: collective cognitive dissonance. The authors compare public support for austerity policies with the global warming debate in the United States. Citing a recent Bloomberg News poll, the authors observe that when people do not associate a problem with human agency, there is no logical role for governments to play. Germany's focus on low inflation, fiscal rectitude, and competitiveness leaves no room to consider the collective welfare of Europe.

The best hope for Europe, argue the authors, is Mario Draghi. They recommend that Draghi continue to tow the Bundesbank line but find ways to implement Minsky-inspired depression-fighting policies. They also call for a unified banking system with generalized deposit insurance as an essential first priority.

www.levyinstitute.org/pubs/wp_742.pdf

Program: Monetary Policy and Financial Structure

Investment, Financial Markets, and Uncertainty

PHILIP ARESTIS, ANA ROSA GONZÁLEZ, and ÓSCAR DEJUÁN

Working Paper No. 743, December 2012

The process of financial liberalization began in the 1970s. Financial markets and financial investment have evolved dramatically in the decades since, and have become one of the fundamental pillars of the current system. During this same period, the majority of the Organisation for Economic Cooperation and Development (OECD) states have seen increased profits shares, but with a slower rate of accumulation of physical capital. From a theoretical standpoint, higher profits should create more internal resources for investment. However, the higher level of internal funds has not produced the increase in physical capital accumulation that economic theory tells us to expect. This raises the question of whether or not financial investment is crowding out physical investment. Crowding out of physical investment has clear implications for effective demand and long-term growth. In addition, the increased reliance on financial activities also has important implications for the accumulation process via increased uncertainty.

In this working paper, Senior Scholar Philip Arestis, Ana Rosa González, University of the Basque Country, and Oscar Dejuan, University of Castilla–La Mancha, examine the accumulation process in capitalist economies. The authors examine correlations between physical and financial investments and how the latter may affect the former. Equities and bonds are analyzed, which allows the authors to compare short-run risk taking with uncertain returns with long-run commitments with known returns. Interest rates are used to represent the cost of external finance and exchange rates as a proxy for financial uncertainty. Thus, the analysis includes the Keynesian notion of conventions in the investment decision. The authors provide a theoretical framework for the accumulation process and an empirical analysis of the development of financial markets. Their theoretical framework is tested using a sample of 14 OECD economies for the period 1970–2010. The paper offers a novel approach in the attention paid to financial markets and the presence of uncertainty, variables that have not previously been accounted for in the investment relationship.

The authors begin with the Kaleckian investment function with labor constraints. This approach accounts for the effects of labor constraints on the pace of accumulation in mature economies. They then amend the investment model to include entrepreneurs' expectations and uncertainty. The idea of a conventional or normal level is applied to capacity utilization, which is the proxy for the level of economic activity. The model makes use of the deviation of the exchange rate from its conventional level as a measure of uncertainty, and includes the deviation of the stock market index from its conventional level as a new explanatory variable for expectations. Finally, the authors include the yield of long-term US Treasury bonds as a means to consider the risk aversion of some entrepreneurs and to analyze the relationship between physical investments (i.e., long-run commitment with uncertain results) and bonds (long-run commitment with a known yield).

The authors apply the difference GMM (generalized method of moments) and system GMM techniques to test their framework. The analysis is tested against data that begins in 1970 and ends in 2010. The preferred estimation of the model shows a positive impact for expectations about future demand, profit shares, and the deviation of capacity utilization on accumulation, and shows that the labor constraint depresses investment as anticipated. Interest rates, bonds, and uncertainty also depress investment. Deviations in the stock market are found to have a remarkably negative effect, which lends weight to the authors' hypothesis that the development of the stock market crowds out physical investment.

Overall, the econometric results support the authors' theoretical framework. The study reinforces the role of the accelerator term as the core of the investment decision. Profit shares and deviations of capacity utilization are also found to accelerate the process of capital accumulation. The results also confirm the inverse effect of uncertainty, and the stock market is shown to exert a strong, negative influence on accumulation. The results for the long-term Treasury bond yield also exert a depressive effect. In conclusion, the results indicate that crowding out occurs between financial and physical investment within the context of a financialized economy.
www.levyinstitute.org/pubs/wp_743.pdf

Marriner S. Eccles and the 1951 Treasury–Federal Reserve Accord: Lessons for Central Bank Independence

THORVALD GRUNG MOE
Working Paper No. 747, January 2013

The global financial crisis has generated renewed interest in the 1951 Treasury–Federal Reserve Accord and its lessons for central bank independence. In this working paper, Research Associate Thorvald Grung Moe revisits the Accord and provides a detailed examination of the role that Marriner S. Eccles played in the events leading up to the Accord. The paper offers a broad and balanced interpretation of Eccles's role at the Fed as well as observations relevant to current Fed policy.

Moe argues that Eccles's role in shaping the Accord has been too narrowly characterized by many historians of the Fed. A broader perspective yields a more nuanced view of Eccles's contributions to the Accord and his policy perspectives on the role of the central bank. Eccles, according to Moe, saw central bank independence as important but not as an absolute virtue. While some scholars have characterized Eccles as a "weak" or inconsistent chairman, Moe finds that Eccles's actions reflect a clear and consistent view of the central bank's role. Eccles favored a coordinated approach to monetary and fiscal policy in which central banks pursued policies that led to price stability and full employment. Under Eccles, the central bank supported fiscal policy in times of economic depression. Later, he fought to maintain a degree of independence for the central bank in order to combat inflationary pressures. Eccles's positions are not, in Moe's view, an indication of "weakness" but rather a reflection of the needs of the day. Further, Moe argues that Eccles's approach was informed by a strong moral stance on the role of central banks as a part of the government.

Eccles has been criticized for his apparent change from New Dealer under Roosevelt to a conservative under Truman. However, history shows that Eccles advocated policies that consistently responded to the economic challenges of the day as required by the Fed's mandate. Under Roosevelt, Eccles's policies were in accord with the Treasury, and later, under Truman they were not. Moe argues that Eccles's role in the events that led up to the Accord were a tactical choice intended to resist pressure from the Treasury for inflationary war financing. Eccles, in Moe's view, did not advocate for central bank independence for its own sake but as a means to preserve the ability of the central bank to fulfill its dual mandate.

Moe draws several lessons from his analysis of Eccles and the Accord. The first lesson is that central bank and treasury policies are normally coordinated, and that an independent central bank focused exclusively on price stability is but one of many configurations. Thus, the Accord can be seen as the solution to a specific coordination problem. The second lesson is that there is an enduring need for coordination of fiscal and monetary policy. The recent global financial crisis underscores the urgency of finding the right balance in this relationship. Central banks, Moe finds, are best seen as "independent within the government." Central banks must support stability by fighting inflation and preventing deflation. In the current environment, Moe observes, Eccles would have supported fiscal expansion supported by central bank monetization. Further, central banks must regain control of the money supply, since control of private finance is essential to financial stability. Eccles argued that only government has the money-creating powers to combat economic depression. In Eccles's view, it is the role of central banks to support compensatory fiscal policy during a depression. Finally, monetary policy must be flexible and our central banking paradigm must be adaptive. Today, the paradigm in which central banks target a narrow price goal is in question, as many see this model as an obstacle to optimal policy implementation.

Moe concludes that the history of the Accord, and Eccles's choices, should lead central bankers to a balanced, flexible view. The renewed interest in the balance between monetary policy and debt management makes this paper a timely contribution to the current macro policy discussion.

www.levyinstitute.org/pubs/wp_747.pdf

Endogenous Bank Credit and Its Link to Housing in OECD Countries

PHILIP ARESTIS and ANA ROSA GONZÁLEZ

Working Paper No. 750, January 2013

The "Great Recession" highlighted the importance of bank credit, yet "New Consensus Macroeconomics" completely ignores this important variable. In this working paper, Philip Arestis, Research Associate, and Ana Rosa González, University of the Basque Country, propose to endogenize the volume of bank credit and track its evolution by means of a detailed analysis of the variables relevant to the real estate market.

The authors' approach stands in contrast to much of the traditional housing literature, which assigns the supply of credit a prominent role. Their model is rooted in the Banking School approach and views the supply of credit as a residual element. Credit is demand-driven and the supply of money-credit is horizontal at the level of interest rates set by the central bank. Thus, the volume of bank credit is determined by demand from the private sector and provided by commercial banks within the credit standards established by the central bank.

The authors first construct a theoretical model composed of three groups (households, firms, and the banking system) within a simplified economy that does not include foreign or public sectors. The model is a modification of the "monetary production economy" in which the housing market and the creation of credit are included to show how the factors that determine equilibrium in the housing market explain the evolution of credit in the private sector. This theoretical framework defines the demand for housing as a function of real disposable income; the supply of housing as influenced by housing prices; how the determinants of housing prices show how disposable income and increases in household financial wealth fuel the demand for housing; and how increasing mortgage rates reduce housing price appreciation. The authors' framework demonstrates that the volume of bank credit is positively related to housing prices, real disposable income per capita, real residential investment, and share prices, and negatively related to the mortgage interest rate.

Among the dynamics identified by the authors, housing prices are shown to influence the level of bank credit directly through affordability and indirectly through what they refer to as the "collateral" channel. Specifically, as housing prices rise, household wealth increases, which leads lenders to relax borrowing standards as the underlying asset has a greater value. These conditions can lead to even greater demand for housing, which serves to intensify what the authors describe as "a loop between credit and housing prices." This has the result that rising asset prices create both greater household demand for credit and more weakness in these loans, since they rely to large degree on asset appreciation rather than household wages.

The empirical investigation of the model relies on standard cointegration techniques using sample data drawn from various sources such as the World Bank and the annual macroeconomic database (AMECO) for 15 Organisation for Economic Co-operation and Development (OECD) countries between 1970 and 2011. In terms of long-run results, the authors find a direct relationship between housing prices and the volume of bank credit. Specifically, the strength of the "collateral channel" is most remarkable in those countries that suffered a devastating collapse in their housing markets. The authors' analysis highlights a strong, positive correlation between the financial wealth of households and the volume of bank credit.

The empirical results confirm the authors' theoretical expectations. The most important variable in the explanation of bank credit is the price of housing. By assuming a monetary production economy wherein money-credit is created by commercial banks in response to the demand for credit, bank lending is endogenized by framing household investment in housing as the key factor that drives households to take on debt. In conclusion, the authors caution monetary authorities to adopt prudential policies to avoid problems in the financial system. Commercial banks should focus on identifying creditworthy household borrowers rather than manipulating interest rates or profiting from loan defaults. Finally, policymakers should consider the evolution of asset prices, since the provision of mortgages often relies on these same assets to guarantee debt.
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Arresting Financial Crises: The Fed versus the Classicals

THOMAS M. HUMPHREY
Working Paper No. 751, February 2013

Thomas M. Humphrey, former senior economist and research adviser at the Reserve Bank of Richmond, cautions against confusing two disparate versions of the lender of last resort (LLR) policy—the classical British 19th-century version and the Fed's. While some observers deem the actions taken by the Fed in the wake of the financial crisis of 2008–09 as a "classical" response, Humphrey finds that the Fed's actions depart from the classical definition in a number of ways. This working paper reviews the classical definition of the role of the central bank as the LLR and evaluates the Fed's deviations from this standard. Humphrey briefly reviews the history of the classical LLR policy and summarizes the contributions of Henry Thornton and Walter Bagehot in 10 LLR policy principles; he then assesses the Fed's performance in light of these 10 principles. The author concludes with recommendations that the Fed reorient its activities along more classical lines in the interest of financial and macroeconomic stability, as well as to ensure the separation of the Fed's monetary authority from the Treasury's fiscal authority.

Classical LLR policy, as set forth by Thornton and Bagehot, defines the role of central banks as lenders of last resort to solvent banks facing massive withdrawals to avert financial crisis and panics (i.e., liquidity crises that may become solvency crises). Classicals viewed the LLR function as part and parcel of the central bank's broader responsibilities. In contrast, the Fed has drawn a clear line between monetary policy and LLR policy.

Though the Fed was created in part to serve as a lender of last resort for the US banking system, Humphrey finds its commitment to LLR policy has been honored in the breach as much as in the observance. In the early 1930s, the Fed famously failed to act, which, according to some scholars, contributed to the depth and severity of the Great Depression. In contrast, the Fed has at times applied the classical model, as it did following the October 1987 stock market crash and the attacks of September 11, 2001. Humphrey describes the response of the Fed to the financial crisis of 2008–09 as a mixture of adherence and departure from classical principles. The Fed certainly injected enormous amounts of liquidity into the economy and loaned money to a wide variety of financially sound institutions, often against unconventional collateral. Nonetheless, Humphrey finds that the Fed violated no less than six of the classical LLR policy principles.

Humphrey notes that the Fed departed from Bagehot's advice following the recent crisis by making loans against assets that were often complex, illiquid, opaque, and risky—in short, hardly good security. The Fed also made outright purchases from banks and other financial institutions of such things as commercial paper and securities backed by credit cards, student loans, and mortgage-backed securities. Finally, it guaranteed the debt of Citigroup and extended loans to AIG, both of which were insolvent and deemed "too big to fail."

Humphrey finds the actions of the Fed, in addition to its unwillingness to precommit to ending future crises or specify an exit strategy, less than benign. The author concludes that the Fed's actions following the most recent crisis generated uncertainty, inefficiency, moral hazard, and potential losses to the Fed and the US taxpayer, all without offsetting benefits. Humphrey ends the paper with a call for the Fed to scale back its operations to those that comport with the classical role and function of a central bank. The Fed should emphasize its crisis management goal as one of protecting and stabilizing the money stock and therefore the price level. The traditional, classical model has proven itself sufficient to quell crises in the past. Such a return would also be consistent with the traditional division of monetary tasks for the central bank and fiscal tasks with the Treasury.

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Inequality and Household Finance during the Consumer Age

BARRY Z. CYNAMON and STEVEN M. FAZZARI

Working Paper No. 752, February 2013

Barry Cynamon, visiting scholar at the Federal Reserve Bank of St. Louis, and Research Associate Steven M. Fazzari contribute to a growing literature linking changes in the US income distribution to instability in the broader economy. They examine how rising income inequality, household spending, and consumer debt interacted during the historic household spending boom ("Consumer Age") beginning in the mid-1980s and ending in 2007. The boom in household spending drove down unemployment in the United States and spurred global trade through the US trade deficit, only to end in the Great Recession. The authors take up a seemingly paradoxical set of events: how could consumption spending rise so quickly during a period when most of the population experienced stagnant income growth and rising income inequality? The authors address this question with an analysis of the distribution of income and consumer behavior, and of consumer spending and debt by income group. They offer a behavioral explanation of these trends and discuss the implications of their findings for the US economic recovery.

Cynamon and Fazzari analyze the historical income distribution and consumption behavior of US households. They disaggregate demand, income, and saving across two broad groups: the top 5 percent and bottom 95 percent of the income distribution. Their analysis is based on measures of household demand and savings rates that integrate the National Income and Product Accounts (NIPA) statistics on personal consumption with residential construction spending between 1959 and 2011. The authors find that the saving rate declined dramatically and debt levels exploded for the bottom 95 percent, while their income share declined. The level of debt and saving for the top 5 percent showed little change during this same period. By the authors' calculations, for the bottom 95 percent to return the same savings rates as in the mid-1980s would have required an 8 percent withdrawal of demand by the mid-2000s. Notably, the demand accounted for by the decline in the saving rate for the bottom 95 percent was roughly equal to the decline in income experienced by this same group.

The authors then examine the paradox of rising income inequality and higher consumer spending. Using adjusted NIPA data on household income and spending, they present demand relative to household income between 1959 and 2011. The results of their analysis indicate that the top 5 percent spent a smaller share of their income compared to other groups. In contrast, the bottom 95 percent spent more than 100 percent of their income for almost a decade. This behavior took place in the presence of supply-side increases in available credit. The authors offer the concept of "consumption norms" as a possible explanation of consumer decisions, thus introducing behavioral and social dimensions into their explanation. They observe the household debt increased by roughly the amount that incomes declined in the bottom 95 percent. These households were trying to maintain their "consumption norm." The coincidence of rising income inequality and increasing access to credit both contributed to debt-fueled consumption.

Cynamon and Fazzari observe that the debt-fueled consumption of the 95 percent in a sense rescued the US economy from the consequences of rising income inequality, but only temporarily. The authors' results suggest that rising income inequality contributed substantially to the financial fragility of households during the Consumer Age which in turn contributed to the Great Recession. The authors argue that the loss of the debt-fuelled consumption that characterized the Consumer Age is an important explanation of the slow pace of the recovery of the US economy since 2009.

The authors' findings raise questions as to whether or not adequate demand growth to achieve full employment can occur in the presence of the income inequalities that prevail in the United States today. The best course, they argue, would be to reverse or at least stabilize income inequality trends. They suggest that redistributive tax policy or tying wage growth across the income distribution to productivity increases are two possible approaches. While the authors acknowledge that the implementation of such policies is far from obvious, there may be no other way to escape economic stagnation in a sustainable manner.

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The Missing Macro Link

EUGENIO CAVERZASI

Working Paper No. 753, February 2013

In this working paper, Eugenio Caverzasi, University of Pavia, argues for a "missing macro link" in the financial instability hypothesis (FIH) of Hyman P. Minsky. The paper offers a response to a criticism of the FIH first raised by Marc Lavoie and Marco Seccareccia in 2001, and since echoed by others. Minsky's critics argue that higher debt ratios are not a necessary consequence of higher business investment. In this vein, empirical analysis of procyclical leverage ratios offered mixed support for the FIH. The core of this critique of the FIH relies on a Kaleckian framework, which, broadly stated, anticipates that the investment expenditure of firms is simultaneously a source of income for those firms producing capital goods. Thus, there is no change in the overall level of indebtness of firms because the debts incurred by firms making investments are balanced by the income of the firms that are producing the capital goods. Minsky's critics have described his application of micro-level analysis of investment to the macro level as a fallacy of composition.

Caverzasi's intention is not to dispute Lavoie and Seccareccia's argument or the empirical results they presented. There may be a lack of empirical rigor in Minsky's argument, and the way that firms finance investment has no doubt changed over the years. Caverzasi argues that the critique of Minsky's argument obtains only in the presence of some debatable assumptions. Absent these assumptions, the logical consistency of the FIH is upheld.

Caverzasi employs a stock-flow consistent (SFC) framework and an analysis of savings based on the work of Michal Kalecki and Josef Steindl. The accounting components of his SFC model are used to analyze changes in the financial stability of the firms sector, along with changes in debt-financed investments. His evaluation of firm finances relies on the liquidity ratio and the leverage ratio. The author aims to show that if the profits made from investments are distributed, then the level of indebtedness of firms depends on the saving decisions of households. Further, he seeks to demonstrate that if firms finance their investments using debt and households save part of the distributed profits, the debt level of firms will increase via capital accumulation. This finding would be consistent with Minsky's FIH.

The author begins with a model of a simplified economy. He examines the consequences of debt-financed investment at the macro level for the financial structure of an aggregate economy using four scenarios: debt financed with no distributed profit; debt financed with distributed profits; debt internally financed with no distributed profits; and debt internally financed with distributed profits. The author's use of the accounting framework allows for an analysis of the balance sheets of the aggregate sectors, while the stock-flow relationships permit an analysis of the impact of debt-financed investment on the firms sector.

In the first case, where households are assumed to consume all of their income and firms finance all of their investments only through debt, the author finds the critique of the FIH holds only if we assume that either the interest rate differential is zero or banks distribute all of their profits. In the second scenario, firms decide what percentage of their profits they will distribute and households determine how much of their investment income to consume. The author finds that when profits are distributed, the propensity of households to save becomes the most important factor. His analysis also shows that firms' liquidity tends to decrease as leverage increases. The financial condition of firms worsens as measured by both liquidity and leverage. Thus, within this scenario, it is shown that debt-financed investment does not lead to a worsening of the financial position of firms only when it is assumed that firms do not distribute profits, households have zero propensity to save, and the interest rates paid to banks are negligible. If these assumptions do not hold, the author concludes, the FIH remains logically consistent.

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Program: Gender Equality and the Economy

Expanding Social Protection in Developing Countries: A Gender Perspective

RANIA ANTONOPOULOS

Working Paper No. 757, March 2013

In this working paper, Senior Scholar and Program Director Rania Antonopoulos discusses social protection (SP) initiatives in the context of developing countries and explores the opportunities they present for promoting a gender-equality agenda and women's empowerment. The paper begins with a brief introduction on the emergence of social protection and how it is linked to economic and social policy. Next, it reviews the context, concepts, and definitions relevant to SP policies and identifies gender-specific social and economic risks and corresponding SP instruments drawing on country-level experiences. The thrust of the paper is to explore how SP instruments can help or hinder the process of altering rigid gendered roles, and to offer a critical evaluation of SP interventions from the standpoint of women's inclusion in economic life. Conditional cash transfers (CCTs) and employment guarantee programs (EGPs) are discussed in detail. This analysis is offered as a contribution to the renewed discussion of social protection policies (e.g., the 2009 UN Social Protection Floor Initiative, or SPFI), with a focus on the gender dimensions of locally adapted interventions.

Social protection policy is part of an inclusive-growth framework that ensures economic participation leads to an equitable distribution of benefits and reduces or removes gender barriers to economic participation. Historically, SP policy, especially in developing countries, has been seen as a "social safety net" to protect households and individuals in or near poverty from shocks. This approach has begun to change, as recognition that the stopgap, short-term focus of these programs often reinforces rather than relieves the underlying issues that have placed people in vulnerable positions. The global financial crisis highlighted differences in outcomes between countries with short-term approaches and those with well-integrated SP systems.

Antonopoulos analyzes four main categories of SP initiatives: CCTs; EGPs; subsidized or free access to such things as food, education, productive inputs, and so on; and social pensions for aged, orphaned, or disabled populations. The author examines each of these four categories with a focus on opportunities to promote gender equality through such initiatives. As many countries are in the process of expanding their social assistance measures, and consistent with the SPFI, there is an opportunity to examine how current practices at the national and international levels impede or advance women's empowerment.

Antonopoulos observes that the differences between men and women, and among women themselves, in gendered roles and responsibilities, geographic location, health and employment status, cast, ethnicity, et cetera produce distinct risks and vulnerabilities and require interventions that reflect this diversity. SP initiatives, the author notes, can be leveraged to reduce gender-specific risks and simultaneously promote women's autonomy, equality, and voiced influence.

For example, CCT policies that designate mothers as the beneficiaries of the program have been shown to provide positive results but tie women's empowerment gains to their status as mothers, and thus configure benefits along ideological lines. Such policies may have the effect of limiting women's choices. The next generation of CCT designs, Antonopoulos argues, should use CCT as a component of a broader package of integrated interventions.

In a similar vein, EGP initiatives address large populations and close income gaps through the expansion of livelihood options via noncontributory employment security. However, issues remain as to whether or not women gain access to work in an equitable manner, how the gendered nature of work assignments may exclude women from some jobs, and why there is underrepresentation of women in semiskilled work, subcontracting, and supervisory roles. Further, public works projects typically focus on physical rather than social infrastructure. Antonopoulos suggests that an emphasis on public works jobs that focus on social infrastructure could narrow gender based inequalities. She identifies social infrastructure employment as "hidden vacancies"—socially beneficial work that leverages women's skills and transforms perception of the value of this type of work.

The paper is accompanied by an annotated bibliography as a resource for researchers and practitioners. The bibliography contains over 70 publications by experts in the field of gender and social protection.

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Program: Immigration, Ethnicity, and Social Structure

Long-Term Benefits from Temporary Migration: Does the Gender of the Migrant Matter?

SANJAYA DESILVA

Working Paper No. 756, February 2013

Temporary migrant workers have become a major source of foreign exchange for several South and Southeast Asian countries, and the income earned abroad is an important source of income for these workers and their families. Women are a large and increasing proportion of this migrant workforce. Research Associate Sanjaya DeSilva examines the gender differences in the long-term impact of temporary worker migration from Sri Lanka to the Middle East. Because migration to the Middle East is nearly always temporary, economic gains for migrant-worker families tend to be short-lived unless they can find a way to convert short-term income gains into long-term improvements in their living standard.

DeSilva uses household level data from Sri Lanka to examine the impacts of temporary migration on households. He examines changes in income, expenditures, and investments on education, housing, asset accumulation, and business ventures. He uses a propensity score matching (PSM) model to estimate long- and short-term differences among households. The analysis compares households with returned migrants by gender to equivalent nonmigrant households. He also computes the differences between households with current migrants and nonmigrant households.

The study adopts a broad definition of household investment that emphasizes housing stock and household amenities. DeSilva's analysis relies on data from the Sri Lanka Integrated Survey, a nationally representative household-level dataset from one of the few countries where the majority of migrant workers is female. His approach compares migrant and non-migrant household outcomes and puts remittance revenue in the broad context of how migration affects households.

DeSilva observes that income and expenditures from migrant work are important measures but they do not adequately describe the long-term impacts of migrant work. The author finds that female migration results in a substantial long-term increase in household expenditures and the value of durables, no permanent increase in income, and a temporary increase in adult-goods consumption during the woman's absence (working abroad). Significant but more modest gains are also observed in housing quality and home amenities over the long run. The most notable gains are in the more than doubling of nonfarm asset holdings, and the purchase of farm land. Female migrants do not show long-term gains in business activity. Temporary worker migration by males brings similar increases in expenditures and a dramatic increase in durables held. There is a temporary decrease in adult goods consumption during a man's absence. In the long run, male migration results in modest gains in home ownership, significant gains in home value, and an increase in the rate of business ownership. Income gains tend to be low over the long run but the permanent increases in household expenditures and the accumulation of durables appear to be a result of increases in nonfarm assets and farm land for women and additional housing assets and business ventures for men.

DeSilva's study also documents investments by migrant workers in their homes and in the education of their children. These are two areas often emphasized by female migrants but frequently overlooked by impact studies. Female migrant workers' spending on improvements in the home environment, acquisition of assets, and investments in education are important long-term goals of migration, and often reinforce other goals such as health outcomes. Unless these goals are taken into account, researchers and policymakers will likely underestimate the long-term benefit of female worker migration. In addition, female migration appears to be a poverty-reduction strategy of households that have surplus of female members and a shortage of productive assets. DeSilva concludes that, if domestic policies are enacted to create employment and asset-accumulation opportunities for rural women, the much-documented costs of migration, for both women and their families, could be reduced. *www.levyinstitute.org/pubs/wp_756.pdf*

Program: Economic Policy for the 21st Century

Explorations in Theory and Empirical Analysis

Primary and Secondary Markets

EGMONT KAKAROT-HANDTKE

Working Paper No. 741, December 2012

In this working paper, Egmont Kakarot-Handtke, Institute of Economics and Law, University of Stuttgart, develops a set of structural axioms to demonstrate the emergence of secondary markets from the flow part of the economy. The author proceeds from the position that behavioral axioms, no matter how rational, are an inadequate basis for theoretical economics. Therefore, this paper relies exclusively on structural axioms.

Kakarot-Handtke begins with structural axioms for income, production, and expenditures in a period of one calendar year. The model of the economy is minimalistic, with one world economy, one firm, and one product. His configuration is a pure consumption economy, wherein all of the variables are measurable, and none rely on nonempirical concepts (e.g., rationality, equilibrium, and so on). The author observes that production and consumption are rarely equal and thus give rise to residuals, which become stocks. Stocks are therefore defined as the difference between output and consumption; the household stock of money is defined as the difference between income and consumption.

Kakarot-Handtke then models the essentials of monetary phenomena using a single central bank. The stock of money becomes either current deposits or current overdrafts. He then demonstrates that money and credit are symmetrical (e.g., current household deposits are equal to current business overdrafts). The author defines "saving" in two parts—financial and nonfinancial. Financial saving is defined as the difference between income and consumption expenditures. The definition of nonfinancial saving requires a new variable: real consumption, which allows the author to include the idea of durable goods. Household stocks are divided into stocks that appreciate over time and those that depreciate over time. Nonfinancial saving is shown to be the difference between consumption expenditures and consumption plus any appreciation of remaining household stocks.

The structural framework of the secondary market consists of current deposits and nonfinancial assets derived from the structural axiom set and only concerns households. The author argues that "value" is a social construct that begins with individual taste and judgment, and is validated by subsequent money transactions. The appreciation of a given object (for sale) does nothing to the stock of money or commodities. The continued appreciation relies on the presence of the next buyer, without whom a loss occurs. Thus, the growth in the household sector's net worth is based solely on the willingness of other buyers to pay more. In this sense, the author finds, wealth is created out of nothing.

Kakarot-Handtke extends the set of structural axioms to define business profit, which consists of a financial and a nonfinancial component. In the simplest case, consumption expenditures must be greater than wages (i.e., profit results from households running a deficit for at least one period), which requires the presence of a financial sector to furnish credit. Profits can be either distributed or retained by firms. Household financial saving and retained profits by firms move in opposite directions. Nonfinancial profits represent the change in the value of the stock of products in terms of prices or quantities held.

Commercial banks and financial markets emerge to handle lender-borrower relationships, which makes sense given the hypothetical central bank's limited role as a transaction-clearing entity. Households with deposits become the source of financing for the business sector. A financial asset market develops with a similar structure to the commodity market, with the important exception that expectations regarding future payments (dividends, interest, etc.) become a major feature of pricing. In the case of long-term durable goods, such as housing, mortgage financing arises with the result that, within this stylized economy, mortgage finance is equal to the financial profits of the business sector. Kakarot-Handtke concludes that secondary markets arise out of the flow part of the market as a result of real and nominal residuals. Thus, real and nominal "disequilibria" create economic reality.
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Interest Rate Determination in India: Empirical Evidence on Fiscal Deficit – Interest Rate Linkages and Financial Crowding Out

LEKHA S. CHAKRABORTY
Working Paper No. 744, December 2012

Until the early 1990s, India's financial system had an administered interest rate structure. In 1991, financial deregulation was implemented. The deregulation of India's financial system was intended to create a more market-oriented environment. Today, debate continues concerning the presence or absence of a functional relationship between fiscal deficits and interest rates. The lack of an empirical model prior to deregulation limited the debate on the policy change, and the controversy continues. Contrary to popular belief, administered (i.e., regulated) interest rates in developing countries have been shown to be responsive to market signals. Thus, the decision of central bankers to set monetary policy based on fiscal deficits has an uncertain empirical basis.

In this paper, Research Associate Lekha S. Chakraborty presents a model that controls for capital flows. Chakraborty investigates the question of whether there is a link between fiscal deficits and the determination of interest rates in India. The author finds that, contrary to what many policy experts argue, an increase in fiscal deficits does not lead to an increase in interest rates. Using high-frequency macro data, she finds little evidence to support the proposition that financial crowding out results from fiscal deficits. Chakraborty employs an asymmetric vector autoregressive model to analyze the interaction of interest rates with changes in the reserve currency, inflation expectations, volatility in capital flows, and fiscal deficits. Her results show that there is no significant relationship between rising fiscal deficits and higher interest rates in India between 2006 and 2011. However, increased interest rates are shown to increase deficits by increasing debt servicing costs.

The paper contributes to the literature on interest rates and fiscal deficits by incorporating capital flows in the macro model of interest rate determination. Building on earlier work that showed no evidence of direct crowding out (see Levy Working Paper No. 518), the author examines whether financial crowding out may occur when upward pressure on interest rates results from debt financing of fiscal deficits in India. If fiscal deficits are found to drive interest rates, it would provide evidence of financial crowding out.

Chakraborty begins with a brief review of the neoclassical, Keynesian, and Ricardian literatures that focus on the relationship between interest rates and fiscal deficits, noting that much of the literature concerns developed, not developing, countries. There are relatively few studies on developing countries that take up the relationship between interest rates and fiscal deficits. Building on the work of Thomas J. Sargent, Chakraborty presents a theoretical model of interest rates in an open economy. The model is estimated using a high-frequency series of macro variables drawn from the Reserve Bank of India data archives. Her model shows that the interest rate is affected by the unanticipated components of high-powered money, expected inflation, and fluctuations in capital flows. However, the results show that in the context of recent financial liberalization and deregulation of interest rates, deficits do not increase interest rates. Rather, the results show the causal direction runs from interest rates to deficits. These results conform to recent trends in Indian public finance, wherein the share of noninterest public expenditures has been declining because of rising debt-servicing costs due to higher interest rates. Within this deregulated regime, interest rates reflect

expectations for inflation in the economy. Chakraborty's results lend weight to the argument that short-term and long-term interest rates are not determined by fiscal deficits in India. Yet Indian central bankers have cited high fiscal deficits as a primary reason for leaving rates unchanged, a policy decision that, in turn, has negative implications for economic growth. While many central banks have reduced interest rates, the Reserve Bank of India has not cut interest rates, citing fiscal deficits as its reason.
www.levyinstitute.org/pubs/wp_744.pdf

Stock-flow Consistent Modeling through the Ages

EUGENIO G. CAVERZASI and ANTOINE GODIN
Working Paper No. 745, January 2013

In this working paper, Eugenio G. Caverzasi and Antoine Godin, University of Pavia, provide an overview of the current stock-flow consistent (SFC) literature. The authors offer some general findings concerning the SFC literature, its contributors, and scholarly networks, and provide a brief historical survey of the development of SFC models. The paper covers some of the theoretical and methodological issues surrounding SFC models, including how to approach the solution of the model, the role of time, and micro foundations. The authors then turn to recent contributions to the SFC literature, which they divide into two categories: subject and methodology. The paper offers conclusions and suggestions for future research and the elaboration of SFC models, providing a compact summary for academics and practitioners of SFC alike.

The paper begins with a graphical representation of the connections between scholars in the SFC literature. They also present a graphical representation of the frequency of bibliographic references to specific assets and sectors, a novel approach that provides a visual guide to the scholars and scholarship. The authors then begin their review of the literature with Morris A. Copeland's work on "moneyflows," published in 1949, moving on to Jean Denizet, who based his analysis on a framework that implied the SFC model approach. However, it was not until the 1980s that James Tobin provided an explicit treatment of the SFC methodology and the late Levy Institute Distinguished Scholar Wynne Godley systematically specified the methodology. In 2007, Godley and Marc Lavoie published "Monetary Economics: An Integrated Approach to Credit, Money, Income, Production and Wealth," which remains the primary SFC reference text.

Caverzasi and Godin next review three debates pertaining to theoretical or methodological issues concerning SFC models. Traditionally, economic models are solved either numerically or analytically; this paper includes a third, discursive approach to developing a solution. Numerical solutions, the authors find, are the most common approach in the literature, followed by the analytical solution, which often leads to a simplified approach but can nonetheless yield interesting results. The paper touches on such issues as the role of time and the rationality of analyzing steady states in SFC models. The authors call attention to the development of combined agent-based modeling approaches, which provide greater flexibility and a better micro foundation for macro phenomena; however, they caution that the complexity of these models can make them difficult to interpret. The third strand in the SFC literature is based exclusively on the accounting part of the model. The potential for formally tracking economic flows makes this approach especially powerful for the analysis of monetary theories.

The authors examine the literature that relies on numerical solutions to SFC models, in the areas of financialization, open economies, policy, and efforts to create a common language for the SFC enterprise. Lastly, they turn to a survey of empirical models. The first use of an empirical SFC model was by Godley and Research Scholar Gennaro Zezza in 1986. Today, there are two groups of authors working with fully empirical models: researchers affiliated with the Levy Economics Institute (Zezza, Research Scholars Greg Hannsgen and Michalis Nikiforos, and President Dimitri B. Papadimitriou), and the model under development by Stephen Kinsella and Gnanonobodom Tiou-Tagba Aliti of the University of Limerick.

Caverzasi and Godin conclude with four possible directions for the development of SFC models: micro foundations, SFC as a vehicle for building consensus among post-Keynesians, greater use of empirical and policy-focused models, and greater efforts to model the financial and real sides of the economy. The authors also suggest that SFC models are useful tools for teaching and communicating economic dynamics and interdependencies.
www.levyinstitute.org/pubs/wp_745.pdf

Finance-dominated Capitalism and Redistribution of Income: A Kaleckian Perspective

ECKHARD HEIN

Working Paper No. 746, January 2013

The global financial and economic crises that occurred in 2007–2012 are widely understood by nonorthodox economists as rooted in malfunctioning deregulated financial markets, changes in income distribution in recent decades, and emerging current account imbalances in the euro area. In this working paper, Eckhard Hein, Berlin School of Economics and Law, examines the distribution channel under finance-dominated capitalism beginning in the early 1980s, using empirical data on 15 advanced capitalist economies.

Hein first examines the trends in the income distribution in the major founding countries of the euro area (Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal, and Spain), two non-EU countries (Sweden and the UK), the United States, and Japan. Since the 1980s, income redistribution under finance-dominated capitalism has shifted, at the expense of labor, toward broad capital income. In the same period, with few exceptions, personal income distribution has become increasingly unequal, and there have been notable increases in inequality in Finland, Germany, Portugal, the UK, and the United States. Hein observes that the States and the UK have seen an explosion in the income share of the top 0.1 percent, while most other countries also show increases in top incomes. The trend in income inequality in the United States shows that the increase in incomes for the top income groups has been significant. The largest income share gains have been among the "working rich" (i.e., top management). Top management salaries are typically included in the national accounts and thus distort the average wage share. Excluding top management salaries from the wage share causes the "ordinary labor" share to fall markedly in the United States, Spain, and the Netherlands, and to a lesser extent in all of the other countries analyzed.

Hein applies a Kaleckian approach in his review of the long-term effects of neoliberalism and financialization on income distribution. Accordingly, the determinants of the mark-up include the degree of concentration within an industry or sector, the relevance of price competition compared to other forms of competition, the power of trade unions, and overhead costs, to the extent that these affect the degree of monopoly and thus mark-up.

Drawing from the literature, the author presents potential channels through which financialization can affect the income distribution. These channels include increased shareholder value orientation and short-termism by management; larger dividend payments; higher interest rates and interest rate payments; bigger salaries for top management; greater importance of the financial sector (and financial investments) relative to the real sector (nonfinancial investments); hostile takeovers, mergers, and acquisitions; and the liberalization and globalization of finance and trade. From his own observations, Hein adds to this list the deregulation of labor markets and pressure to reduce the share of government in real GDP; reduced government intervention in the economy; and reduced government aggregate demand management.

Hein analyzes each of these channels, drawing on evidence from the empirical and econometric literature. He finds that there is some evidence that financialization and neoliberalism have contributed to the declining labor income share since the 1980s. This has occurred through three main channels: the shift in the sectoral composition of the economy away from the public sector and the nonfinancial business sector toward the financial business sector has contributed to a lower labor income share for the economy as a whole; the increase in management salaries and rising profit claims of rentiers have been associated with a falling labor income share; and financialization and neoliberalism have weakened trade union bargaining power through several channels. Hein observes that these developments have not only triggered falling labor income shares but also contributed to increasing inequality in personal and household income shares under finance-dominated capitalism. These relationships, the author concludes, require further study.

www.levyinstitute.org/pubs/wp_746.pdf

Analyzing Public Expenditure Benefit Incidence in Health Care: Evidence from India

LEKHA S. CHAKRABORTY, YADAWENDRA SINGH, and JANNET FARIDA JACOB

Working Paper No. 748, January 2013

Evaluating the effectiveness of public spending is often complicated by the lack of empirical information about who benefits from public programs. In this working paper, Research Associate Lekha S. Chakraborty, and Yadawendra Singh and Jannet Farida Jacob, Jawaharlal Nehru University, apply benefit incidence analysis (BIA) to assess the incidence of health benefits at the subnational level in India. This preliminary analysis reveals a range of utilization patterns, some seemingly equitable and others that appear regressive. The authors caution that these results must be regarded as preliminary because the development of private inpatient health services in some states is far less developed than in others. The study finds that only upper-income groups have the option to "vote with their feet" and choose better private services. The authors' findings also suggest a degree of polarization in the public provisioning of health-care services.

The authors begin with a review of the analytical framework of BIA, outline a methodology to derive benefit incidence, and provide a review of the BIA literature. Benefit incidence calculation includes four steps: estimating unit cost, identifying users, aggregating users into groups, and calculating benefit incidence. The authors analyze hospitalization data for inpatient and outpatient services using monthly per capita expenditures quintiles by gender, geography, and ethnicity, with additional analysis of urban and rural areas. The data for the analysis include public spending data drawn from national and subnational government finance accounts, household data, and health-sector utilization data (inpatient and outpatient hospitalization data).

The combined analysis of inpatient and outpatient services reveals that public spending on the health sector is highly regressive. The authors examine inpatient services and find that the majority of the poor in India use the public health care system rather than the private system or a mixture of the two systems. The results of their analysis suggest that utilization of the public system decreases as income rises. Higher income allows relatively affluent people to exit the public health system by purchasing private health-care services.

The authors also provide a spatial analysis of benefit incidence using concentration curves to determine if public provisioning is pro-poor or pro-rich in individual Indian states. The authors identify five states with a regressive pattern of public spending. Ten states are found to have pro-poor spending patterns in rural areas. However, a pro-poor pattern was not found in the urban areas for most of these 10 states. States with concentration curve crossovers for high-income quintiles were also observed in several states indicating a pattern of utilization of public health care that is not pro-poor in its targeting.

The analysis shows that the publicly financed health-care system provides the majority of services to lower-income and poor people in rural areas. The authors identify three important factors that drive the incidence pattern in subnational governments: the variations in per unit costs of health spending across states; health-care access problems in rural areas; and the household behavior of revealed utilization of a particular system of health care. The authors then examine the behavioral and demographic differences by income quintile in the utilization of public-versus-private health-care services to describe the incidence of benefit when weighted by the relative need of different behavioral and demographic groups. Finally, they explore alternative methodologies to measure incidence based on average benefits such as marginal odds of participation and polarization ratios.

The authors conclude that, while it is difficult to measure public spending targeting errors using BIA, the method can help to minimize targeting errors. In closing, they call for more research in the area of benefit capture.

www.levyinstitute.org/pubs/wp_748.pdf

Weak Expansions: A Distinctive Feature of the Business Cycle in Latin America and the Caribbean

ESTEBAN PÉREZ CALDENTEY, DANIEL TITELMAN, and PABLO CARVALLO

Working Paper No. 749, January 2013

As a region, Latin America and the Caribbean have seen lower levels of long-term growth and greater volatility compared to other regions during the last three decades. In this working paper, Esteban Pérez Caldentey, Daniel Titelman, and Pablo Carvallo, Economic Commission for Latin America and the Caribbean, Financing for Development Division, analyze the business cycles of Latin America and the Caribbean using two standard business-cycle methodologies: classical and deviation. The authors find two distinctive features of the region's business-cycle behavior: expansions tend to be shorter and weaker than in the other regions analyzed, and contractions conform in terms of duration and amplitude to those in the rest of the world.

The authors compare business cycles in Latin America and the Caribbean with 83 countries, of which 44 are emerging-market economies and 39 are considered developed economies, using quarterly data for the period 1989–2012. The dataset is one of the largest and most representative, including data on the Latin America and Caribbean regional and subregional level. Unlike many other analyses, this study includes most of the countries in South and Central America and the Caribbean, which minimizes subregional bias in the results. The authors find that expansions in Latin America and the Caribbean tend to be weaker than those in other countries, notably those in the East Asia and Pacific region. Further, the full cycle of expansions tends to be shorter and have smaller amplitude for Latin America and the Caribbean as compared to the rest of the world. This pattern is also reflected in variables such as productivity and investment, which are linked to long-run growth. The evidence further suggests that the level of public capital formation that occurs during expansionary periods is less than the decline during contractions, which leads to a cumulative decline in the level of public investment over the full business cycle.

Traditionally, cycle patterns are treated as short-run demand-led phenomena with little or no bearing on long-run growth trends. The authors argue that the features of these cycles are not limited to the short run. They show that conditions particular to the region, such as weak expansions in output and productivity, may explain why expansions in Latin America and the Caribbean have not kept pace with other regions such as East Asia and the Pacific.

Using the classical-cycle methodology, the length and duration of an entire cycle is roughly 17 quarters for Latin America and the Caribbean. In contrast, in East Asia and the Pacific the cycle lasts 36 quarters, or nearly five years longer. These results are not significantly different when analyzed using the deviation-cycle method. In addition, the amplitude of the cycle in East Asia and the Pacific is found to be 60 percent greater than that of Latin America and the Caribbean. The latter region, regardless of the cycle methodology employed, has one of the shortest expansions in productivity growth of all the areas analyzed. Taken together, these differences may explain the gap in the cumulative gains between Latin America and the Caribbean and other regions. Contractions in public investment, the authors observe, can have short-run impacts on aggregate demand and long-run effects on the trajectory of the economy.

The authors conclude by recommending that, going forward, cycle analysis should focus on developing a better understanding of the nature and behavior of expansions. A better understanding of the underlying dynamics of expansion will improve our understanding of growth rates and development levels. In addition, policymakers should reconsider their approach to stabilization policies, since the effects of aggregate demand management appear to persist beyond the short run. The business-cycle management policies have important implications for market volatility. Policymakers should review stabilization policies and their effects, with an eye to how best to coordinate supply-side and demand-side policies.
www.levyinstitute.org/pubs/wp_749.pdf

Growth Trends and Cycles in the American Postwar Period, with Implications for Policy

OLIVIER G. GIOVANNONI

Working Paper No. 754, February 2013

In this working paper, Olivier Giovannoni, Bard College, examines the determinants of US output, excluding taxes and trade, between 1955 and 2007. Specifically, he takes up the question, Do all types of demand matter equally for economic growth? His analysis, which is based on a cointegrated vector autoregressive (VAR) model, focuses on the roles of consumption, investment, and government spending. The paper speaks to the current debate regarding the scale and efficacy of competing economic policies to foster economic growth.

Giovannoni identifies broad strands in the growth theory literature. The well-defined and respected consensus ascribes growth to "investment." Clearly, investment, and its determinants, is very much at the center of the Keynesian literature. A second strand in the literature concerns the roles of consumption and government spending, leading the author to the question, Is growth investment-led or consumption-led? He then draws a third strand of growth theory from empirical studies, which he divides into two categories. Giovannoni notes that empirical analyses prior to the 1990s suffered from methodological weaknesses that made it difficult to distinguish between short- and long-run phenomena. These studies tended to favor an investment-led explanation of growth. Since the 1990s, much of the research has coalesced around the idea that growth originates from productivity shocks, and that investment and output adjust passively. Building on the empirical research, the author adds three additional tasks to his investigation: the role of government spending, the role of investment, and how the revised empirical model fits within the econometric literature on growth.

Giovannoni begins with a model in which economic growth is determined by consumption, investment, and government spending, using data drawn from the 2003 comprehensive revision of the national income and product accounts for 1955–2007. He examines whether all spending is equally important in the determination of output; if different types of spending play different roles in the determination of output; and if, based on these findings, a more empirically defensible theory of growth can be advanced. The author employs a modeling framework that provides the means to distinguish between trend and cycle variables. For the period 1955–2007, he concludes that economic growth can be decomposed into short-run cycles around a long-run trend explained by consumption shocks and government spending. The estimated fluctuations coincide with the business cycle and are highly correlated with both labor and capital capacity utilization. The long-run multipliers indicate a large induced investment phenomenon and a small, but positive and significant, government spending multiplier. Consumption is thus found to be more important for long-run growth, but government spending is a significant and positive contributor. In contrast, investment has only transitory effects on output, which indicates that investment will only shift the system upward in the short run. This finding contradicts the mainstream investment-led theory of growth. The postwar period is therefore best characterized as being led by consumption and government spending in the long run, with investment over- and underreacting to these trends. The author also finds that investment is strongly affected by the cointegrating relationship and consumption, which he investigates in more detail.

Giovannoni finds empirical evidence that the cointegrating relationship represents more than an "error term." This relationship is found to react to investment and consumption but not government spending, and can be understood as a business cycle/capacity indicator. Turning to an analysis of the model's dynamic and causal properties, he estimates a compact "partial model" for investment and finds that investment is conditioned by consumption and government spending.

Giovannoni offers several observations regarding the current US economy based on his findings. First, the results suggest that we should take care to distinguish between short- and long-run effects. Consumption and government spending drive long-run growth. Government spending works hand in hand with consumption and is shown to have a stabilizing effect. The author argues for a policy-led recovery using both monetary and fiscal policies aimed at restoring household balance sheets rather than fostering a more short-lived, investment-led expansion.

www.levyinstitute.org/pubs/wp_754.pdf

The Economics of Inclusion: Building an Argument for a Shared Society

MICHAEL A. VALENTI and OLIVIER GIOVANNONI
Working Paper No. 755, February 2013

Michael A. Valenti, Economists for Peace and Security, and Olivier Giovannoni, Bard College, present a summary of their extensive literature review, which focused on finding an economic rationale for the idea of "shared societies." As defined by the Club de Madrid, shared societies are societies in which people hold an equal capacity to participate in and benefit from economic, political, and social opportunities regardless of race, ethnicity, religion, language, gender, or other attributes; and where, as a consequence, relationships between groups are peaceful. Their review centers on four themes: the effects of trust and social cohesion on growth and output, the effect of institutions on development, the costs of fractionalization, and research on the policies of social inclusion around the world. The authors conclude with a summary of their findings and offer directions for further research based on their review of the literature.

The authors' task is complicated by the fact that "shared societies" is a relatively new concept. As such, it does not fall neatly into any particular area of economic research, nor does it readily avail itself of any quantifiable definition. Thus, much of the literature addresses qualitative concerns. Valenti and Giovannoni suggest that the principles of a shared society correspond well with certain quantifiable proxy variables extant in the economic literature. Measures of social cohesion, relationships between institutions, and economic growth and productivity, for example, are consistent with the principles of a shared society.

The authors begin with a review of the literature on "social inclusion," with the goal of identifying any economic benefit associated with the concept. While they find little empirical evidence demonstrating a direct economic benefit from enacting socially inclusive policies, they do find that trust and institutions interact to foster environments favorable to social inclusion.

"Trust" is the idea related to shared societies that is most frequently discussed in the economic literature. The authors report that a shared society is one in which there is a high degree of trust, also referred to as social cohesion. The literature on social cohesion uses trust and civic cooperation as two measures of a society's level of social capital. For example, some research shows that trust facilitates transactions, which in turn promotes economic growth. The absence of trust increases transactions costs and thus reduces economic activity. The authors find that civic norms, a related concept that can be quantified, are strongly and positively related to economic growth.

The authors find that there is a substantial literature devoted to the idea that national and regional institutions are important for both economic growth and to support social cohesion. The rule of law, legislative constraints on executive power, and measures to eliminate corruption in government and the legal system have profound impacts on long-run economic development. Likewise, equal access to institutions, public goods (such as education), and labor markets creates incentives to participate in a shared society.

Institutional failure and the cost of fractionalization is the last theme examined in this paper. The literature indicates that fractionalized societies impede economic growth, stifle innovation, increase corruption, and prompt agents to use racial and ethnic differences for rent-seeking purposes. Fractionalized societies have less incentive to put their faith in institutions that exclude them and are more likely to turn to such things as mafia formation, tax evasion, and black markets. The authors observe that while the link between fractionalization, institutions, and economic growth is clear, how these factors interact remains ambiguous. For example, ethnic fractionalization can be linked to huge economic losses in some countries, while it does not impede economic progress in others. The authors conclude that shared societies may emerge from a variety of factors and conditions but require equitable institutions and a foundation of trust in order to succeed.
www.levyinstitute.org/pubs/wp_755.pdf

INSTITUTE NEWS

New Levy Institute Book

Ending Poverty: Jobs, Not Welfare

HYMAN P. MINSKY
Preface by Dimitri B. Papadimitriou; Introduction by L. Randall Wray
Published by the Levy Economics Institute; available through Amazon.com
March 2013

The Levy Economics Institute is pleased to offer a new collection of essays by the late financial economist and Levy Distinguished Scholar Hyman P. Minsky. Made possible in part through the generous support of the Ford Foundation and Andrew Sheng of the Fung Global Institute, this collection of Minsky's writings on poverty and employment spans nearly three decades, and speaks to current challenges in the areas of poverty, employment, and financial instability. The volume contains seven essays by Minsky, four of which are appearing in print for the first time, with a preface by President

Dimitri B. Papadimitriou and an introduction by Senior Scholar L. Randall Wray.

Papadimitriou observes that Minsky concerned himself with the issues of poverty and employment as much as he did with financial fragility. The present volume is offered with the hope that Minsky's thoughts on how to address the problems of poverty and employment will meet with as much success in transforming the policy debate as has his more well-known work on financial instability. In his introduction, Wray sets Minsky's critique of the War on Poverty squarely within the context of a critique of specific policies and the mainstream economic theory of the day. Wray notes that Minsky saw poverty as fundamentally an employment problem— tight full employment is the best path to raise the incomes of people at the bottom of the economic ladder. Nearly half a century after the War on Poverty began, Wray observes, we have yet to commit to Minsky's approach, and the results speak for themselves.

In the first chapter, "The Role of Employment Policy" (1965), Minsky advances his argument for achieving "tight full employment" (i.e., unemployment in the neighborhood of 2.5 percent) through job creation rather than the policy prescriptions offered for economic growth, transfers, and training. Minsky understood the failure inherent in this latter approach and argued for employer-of-last-resort (ELR) programs to provide jobs for anyone willing and able to work. In chapter 2, "Effects of Shifts of Aggregate Demand upon Income Distribution" (1968), Minsky explains that stimulating aggregate demand through tax cuts and investment incentives will create inflation and financial instability well before they create full employment. In chapter 3, "Policy and Poverty" (1969), he addresses the barriers to achieving poverty reduction through income redistribution and discusses the dangers of inflation in detail.

In chapter 4, "The Macroeconomics of a Negative Income Tax" (1969), Minsky analyzes the macroeconomic implications of the "negative income tax." He cautions that such policies can lead to "inflating out" effects that undercut any lasting benefits to the poor and near poor. In chapter 5, "Where the American Economy—and Economists—Went Wrong" (1972), Minsky offers a critique of the "neoclassical synthesis," which he regarded as a major theoretical obstacle to reorienting economic policy toward full employment.

In chapter 6, "The Poverty of Economic Policy" (1975), Minsky integrates his ideas of financial fragility and instability with his discussion of poverty and full employment. Minsky did not oppose the welfare state but found it woefully incomplete, in large part due to the lack of a commitment to full employment. As he explains, the evolution of the economy toward financial instability and the challenges associated with full employment are intimately connected, as is shown throughout this volume.

The tension between capitalism and full employment, and therefore poverty reduction, is the subject of the last chapter, "Full Employment and Economic Growth as an Objective of Economic Policy: Some Thoughts on the Limits of Capitalism" (1994). Here, Minsky finds that capitalism consistently fails to reach and sustain full employment, instead relying on a financial system that tends toward debt deflation and economic depressions. He argues for overhauling capitalism, with a return to the broad model of the New Deal, financial reregulation, and job creation programs to create tight full employment. Minsky's prescription is as timely for the Obama administration as it was for the Clinton administration.

Minsky's insights continue to stimulate scholarly research, contribute to our understanding of macroeconomic theory, and challenge contemporary policymakers to reach beyond mainstream thinking to find policy solutions that are both humane and grounded in sound economic theory.

New Master's Degree Program in Economic Theory and Policy

Starting in fall 2013, the Levy Economics Institute will begin offering the Master of Science in Economic Theory and Policy, a two-year degree program designed to meet the preprofessional needs of undergraduates in economics and finance.

Headed by Senior Scholar and Program Director Jan Kregel, this innovative program draws on the expertise of Institute scholars and select Bard College faculty, and emphasizes empirical and policy analysis through specialization in one of four key research areas: macroeconomic theory, policy, and modeling; monetary policy and financial structure; distribution of income, wealth, and well-being, including gender equality and time poverty; and employment and labor markets.

The Levy Economics Institute Master of Science in Economic Theory and Policy degree program offers students a marketable set of skills and a strong understanding of economic and policy models at both the macro and micro levels, with direct application to a broad range of career paths. Thanks to the close links between our research agenda and the program's core curriculum, students experience graduate education as a practicum, and all students participate in a graduate research assistantship at the Institute. There is also a 3+2 dual-degree option for undergraduates that leads to both a BA and the MS in five years.

For more information, visit www.bard.edu/levyms.

New Research Scholar

The Levy Institute is pleased to welcome Fernando Rios-Avila as a research scholar working on the Levy Institute Measure of Economic Well-Being under the Distribution of Income and Wealth program. Rios-Avila's research interests include labor economics, applied microeconomics, development economics, and poverty and inequality. A Ph.D. candidate at Georgia State University, he completed his dissertation, "Essays on Unions, Wages and Productivity: Evidence from Latin America," in 2012.

Rios-Avila formerly served as a research assistant at the Federal Reserve Bank of Atlanta and as a consultant to the Bolivian government's Social and Economic Policy Analysis Unit (UDAPE). His publications include "Assessing the Welfare Impact of Tax Reform: A Case Study of the 2001 US Tax Cut" (2012) in *The Review of Income and Wealth* and "Segmentación en el mercado matrimonial" (2004) in *Revista Latinoamericana de Desarrollo Económico*. He is also the co-author of a series of books on the rights of and social investment in children and adolescents, published by UDAPE-UNICEF.

Rios-Avila holds a Licenciatura en Economia from the Universidad Católica Boliviana and an M.Sc. in international economics from Kiel University.

Economic Forum in Athens

Exiting the Crisis—The Challenge of an Alternative Policy Road Map

Athinais Cultural Centre, Athens, Greece
March 8–9, 2013

Organized by the Athens Development and Governance Institute and the Levy Economics Institute of Bard College

This two-day forum drew academics, journalists, and policymakers from throughout the United States and the European Union (EU), including the Levy Institute's Dimitri B. Papadimitriou, Rania Antonopoulos, James K. Galbraith, and Jan Kregel. Topics included postcrisis challenges and policy choices in the EU; national strategic and security challenges in southeast Europe and the eastern Mediterranean; democratic governance, accountability, and social oversight; sustainable development; social cohesion; and prerequisites and priorities for social change.

Upcoming Events

22nd Annual Hyman P. Minsky Conference

Building a Financial Structure for a More Stable and Equitable Economy

Ford Foundation, NYC
April 17–19, 2013

A conference organized by the Levy Economics Institute of Bard College with support from the Ford Foundation

In 2008–09, the world experienced its worst financial and economic crisis since the Great Depression. Global employment and output collapsed, and an estimated 84 million people fell into extreme poverty. Given the fragility and uneven progress of the economic recovery, social conditions are expected to improve only slowly. Meanwhile, austerity measures in response to high government debt in some of the advanced economies are making the recovery even more uncertain.

It's time to put global finance back in its proper place as a tool to achieving sustainable development. This means substantial downsizing, careful reregulation, universal social protections, and an active, permanent employment-creation program. Therefore, the 2013 Minsky Conference will address both financial reform and poverty in the context of Minsky's work on financial instability and his proposal for a public job guarantee. Panels will focus on the design of a new, more robust, and stable financial architecture; fiscal austerity and the sustainability of the US economic recovery; central bank independence and financial reform; the larger implications of the eurozone debt crisis for the global economic system; improving governance of the social safety net; the institutional shape of the future financial system; strategies for promoting poverty eradication and an inclusive economy; sustainable development and market transformation; time poverty and the gender pay gap; and policy and regulatory challenges for emerging-market economies.

For more information, including the events program and participants list, visit our website, www.levyinstitute.org.

The 2013 Hyman P. Minsky Summer Seminar

Levy Economics Institute of Bard College
Annandale-on-Hudson, New York
June 14–22, 2013

The Levy Institute will hold the fourth annual Minsky Summer Seminar in 2013. The Seminar will provide a rigorous discussion of both the theoretical and applied aspects of Minsky's economics, with an examination of meaningful prescriptive policies relevant to the current economic and financial crisis. Organized by Jan Kregel, Dimitri B. Papadimitriou, and L. Randall Wray, the Seminar program will be of particular interest to recent graduates, graduate students, and those at the beginning of their academic or professional careers.

For additional information, visit our website.

PUBLICATIONS AND PRESENTATIONS

Publications and Presentations by Levy Institute Scholars

RANIA ANTONOPOULOS *Senior Scholar and Program Director*
Publications: "Grecja potrzebuje oddechu" (Greece needs breathing room), in *Gra o Europ* (Gameplan for Europe), Strefa Zieleni Foundation, 2012 (in Polish); "The Importance of the Policy of 'Employer of Last Resort' for Greece Today," *Kathimerini*, January 13, 2013 (in Greek); Why an Employer of Last Resort Policy?" *Eleftherotypia*, January 20 (in Greek); "Misplaced Government Responses Will Not Be Able to Contain the Specter of Unemployment in Greece," *Avgi*, Friday, March 8 (in Greek).
Presentations: "Household Production: Policy Relevance," workshop on "A Guidebook for Mainstreaming Gender Perspectives and Household Production into National Statistics, Budgets and Policies in Africa," organized by the African Centre for Gender and Social Development, United Nations Economic Commission for Africa, Harare, Zimbabwe, November 26–28, 2012; "Job Guarantee Investments in the Social Sector," presented as part of "Recent Developments in the Role and Design of Social Protection Programs," a policy dialogue organized by the International Policy Centre for Inclusive Growth, United Nations Development Programme, Brasilia, Brazil, December 3–5; "Crisis and Gender Dimension: The Case of Greece," symposium on "Critical Perspectives on Financial and Economic Crises: Why Gender Matters," organized by UN Women and the International Association of Feminist Economics, United Nations, New York, January 21–22; "Catastrophic Unemployment as a Result of Austerity: What Policies?" forum on "The Future of Greece and the Eurozone," Columbia University Law School, New York, January 24; "Labor Rights Retrogression in Greece," panel on "Progress Denied: The Impact of Inequalities on Development," organized by the International Labour Organization and the Permanent Mission of the Kyrgyz Republic to the United Nations, United Nations, New York, February 7; "The Greek Crisis: Why the Attack on Labor Rights and Living Standards has Pushed the Country to a Depression," seminar on "Full

Employment, Social Welfare, and Equity," Columbia University, New York, February 11; "Social Cohesion in the Midst of the Greek Crisis: The Specter of Unemployment," forum on "Exiting the Crisis: The Challenge of an Alternative Policy Road Map," organized by the Athens Development and Governance Institute and the Levy Economics Institute, Athens, Greece, March 8–9; interview regarding unemployment policy in Greece and possible alternatives, Skai TV, Athens, March 11; interview regarding Greece's proposed youth unemployment policy with Kostas Kalloniatis, *Eleftherotypia*, March 17; interview regarding the Greek crisis with Nefeli Lygerou, *Ependytis* (The Investor) March 17.

JAMES K. GALBRAITH *Senior Scholar*

Publications: "First, Define 'Normal'" *The International Economy*, Fall 2012; "Cloudy with No Chance of Normal," *Pacific Standard*, January–February 2013; "Is This the End for the Deficit Drones?" *AlterNet*, Janury 23; "Europe Must Be Saved," *Deutsche Welle*, January 24.

Presentations: "A Question of Institutions: Why in Spite of Reactionary Ideas Did the United States Survive the Great Crisis while Europe Has Not?" conference on "The Return of Full Employment Policy," Helsinki, Finland, December 3, 2012; "Beyond Candide and Cassandra: The Economics We Need for an Age of Crises that Isn't Going to End," presented at the International Congress of IG Metall–German Trade Union, Berlin, Germany, December 6; "The Crisis in the United States and Europe: A Grim Appraisal," presented at the monthly forum of the European Trade Union Institute, Brussels, Belgium, December 12; AFEE President's Lecture, "The Third Crisis in Economics," presented to the Association for Evolutionary Economics, 2013 Annual Meeting of the Allied Social Science Associations, San Diego, Calif., January 5, 2013; panelist, "The Possibilities and Limits of Macroeconomic Policymaking," presented at the "Trans-Atlantic Agenda for Shared Prosperity," an economic summit sponsored by the Friedrich Ebert Stiftung, Washington, D.C., February 11; guest speaker, "The Discipline Series: The Idea of Development," cosponsored by Columbia University and the Institute for New Economic Thinking, New York, February 22.

GREG HANNSGEN *Research Scholar*

"Europe Is Now Stuck in a Fiscal Trap, Brought About by the Failure of Orthodox Economics to Provide an Effective Strategy for Economic Growth" (with D. B. Papadimitriou), EUROPP Blog, December 7, 2012.

DIMITRI B. PAPADIMITRIOU *President*

Publications: "Strefa euro to niedoko czony projekt" (The euro area is an unfinished project), in *Gra o Europ* (Gameplan for Europe), Strefa Zieleni Foundation, 2012 (in Polish); **"**Europe Is Now Stuck in a Fiscal Trap, Brought About by the Failure of Orthodox Economics to Provide an Effective Strategy for Economic Growth" (with G. Hannsgen), EUROPP Blog, December 7; "Spending Cuts of 13.5 Billion Euros and Tax Increases Will Reduce Greek GDP by 11 Percent," *Express* (Athens), December 16; "The Need for a New Political and Social Agreement," *To Vima*, January 12; "Dramatic Increase of Debt," *Eleftherotypia*, January 13; "The Great Depression of '29 Is Repeated in Greece Today," *Ethnos*, January 27; "What Is Needed in Greece Is a Change of Mentality: A Profile," *Kathimerini*, January 27; "The Myths of the Crisis and the 'Excessive' Expenditures," *Kathimerini*, February 10; "2013 and 2014 Will Be Even More Turbulent than 2012 for the Greek Economy," *Avgi*, February 17; "Legends of the Greek Fall," *The Huffington Post*, February 20; "Major Challenges and Policy Choices for the Eurozone and Greece," *Avgi*, March 10.

Presentations: Interview regarding perspectives on the US economy in 2013 with Paula Selmi Herrmann, *Agência Leia*, December 5, 2012; interview regarding the fiscal cliff with Michael Rapoport, *The Wall Street Journal*, December 28; interview regarding perspectives on the US real estate market in 2013 with Ivan David Ryngelbaum, *Agência CMA*, January 22, 2013; interview regarding shrinkage of US GDP in the fourth quarter of 2012 with Ian Masters, *Background Briefing*, January 30; **s**peaker, forum on "Exiting the Crisis: The Challenge of an Alternative Policy Road Map," co-sponsored by the Athens Development and Governance Institute and the Levy Economics Institute of Bard College, Athens, Greece, March 8–9; interview regarding the effectiveness of the Greek austerity program with Alexis Papahelas, "Οι Νεοι Φακελοι" (The new files), Skai TV (Athens), March 12.

AJIT ZACHARIAS *Senior Scholar*

Presentation: "Satellite Accounts of Household Production," seminar on "Measuring the Contribution of Women and Men to the Economy," 44th Session of the United Nations Statistical Commission, New York, February 28, 2013.

GENNARO ZEZZA *Research Scholar*

Publications: "Reforming the International Monetary System: A Stock-flow Consistent Approach" (with S. V. Halporn), in M. C. Marcuzzo, ed., *Speculation and Regulation in Commodity Markets: The Keynesian Approach in Theory and Practice*, Dipartimento di Scienze Statistiche, 2012; "Abbandonare l'Euro per ritrovare l'Europa" (Leaving the Euro to Rediscover Europe), *Micromega*, December 14.

Presentations: "SFC+ABM=NP? (Stock-flow-consistency + Agent Based Modeling = New Paradigm?)," INET workshop, Waterloo, Canada, November 16; "Austerity and Growth," INET-CIGI conference on "False Dichotomies," Waterloo, Canada, November 17; "I saldi finanziari in Grecia" (Financial balances in Greece), workshop on "Euro, mercati, democrazia" (Euro, markets, democracy), University of Pescara, December 1; "Can We Predict Economic Crisis?" workshop on "Can We Predict the Future? Role and Limits of Science," Rome, Italy, December 10; participant, seminar on "Stock-flow Consistent Modeling," Università di Verona, February 11, 2013; "The Case for Reforming the International Monetary System," workshop on "Prudence vs Liquidity," Bocconi University, March 1.

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