

Summary

Spring–Summer 2002

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

The Summary is a quarterly publication of the Institute, intended to keep the academic community informed about the Institute's research. To accomplish this goal, it contains summaries of recent research publications and reports on other activities.

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To our readers:

This double issue begins with an account of an international symposium on gender-aware macroeconomics, held at the Levy Institute in May under the distribution of income and wealth program. Some 40 participants from various universities and international organizations presented their latest research and discussed future directions in research and policy. A gender wage gap was commonly found in developing countries, as were adverse impacts from international capital flows, trade liberalization, and globalization. The working group expressed the need for better data and models and expansion of gender-aware economics into other areas of economic study. A working paper by Senior Scholar Joel Perlmann under the same program confirms that Mexican-to-native wage ratios are worse today than those of comparable immigrants in 1910. He suggests that today's low-skilled immigrants may not be able to advance the same way that immigrants did in the first half of the 20th century.

The program on financial markets and monetary policy begins with an account of the 12th annual Hyman P. Minsky conference, held in New York City in April. Some 100 participants from industry, government, and academia discussed the current state of the U.S. economy and its future direction. Many of the speakers advanced the notion that the recession was over, that it was one of the mildest on record, and that a moderate economic recovery was unfolding. Others, including Wynne Godley, the Institute's Distinguished Scholar, expressed doubts pointing to a number of challenges ahead, e.g., record-high private sector debt, waning profits, high financial leverages, outlandishly flexible accounting, current account deficits, and the bubble mentality. Finally, some presenters noted the strong underlying structure of the U.S. economy and pro-growth economic policies that mitigated the impact of a number of shocks over a short period of time.

A working paper by Research Fellow Alex Izurieta explores a country's ability to undertake its own fiscal policies after dollarization of its economy and finds it inadequate to generate income, protect employment, and guard the financial stability of the economic system. Another working paper, by Kenneth H. Thomas, lecturer in finance at the Wharton School of the University of Pennsylvania, evaluates the Community Reinvestment Act (1977) and recommends reforms balancing consumer and industry interests, including a return to a focus on lending to the most needy low- and moderate-income individuals.

In a working paper under the program on federal budget policy, Research Associate Jamee K. Moudud investigates the effects of tax and expenditure policies on the warranted growth rate and proposes mechanisms for policymakers to raise the rate when there is long-run unemployment.

Three working papers are included under explorations in theory and empirical analysis. Research Fellow Ajit Zacharias disagrees with the notion that ex post definitions of income incorporate Hicks's concept and concludes that Hicks cannot be used as a theoretical starting point for a modern national income accounting system. Visiting Scholar Jörg Bibow of the University of Hamburg compares the monetary theories of Keynes and Friedman and finds the theory of interest and the dynamics of adjustment processes and expectation formation to be the key differences between them. He suggests that the current monetary system may be the worst of all possible worlds, since politically unchecked monetary dictators determine economic welfare in modern democracies. Research Associate Korkut A. Ertürk compares Keynes's interest rate theories and concludes that his earlier insights on the state of long-term expectations, described in his *Treatise on Money* (1930), greatly enhance Keynesian analysis of the business cycle.

This Summary concludes with a strategic analysis of prospects and policies for the U.S. economy by Godley and Izurieta. As always, I welcome your comments and suggestions.

Dimitri B. Papadimitriou, President

Program: Distribution of Income and Wealth

SYMPOSIUM: NEW DIRECTIONS IN RESEARCH ON GENDER-AWARE
MACROECONOMICS AND INTERNATIONAL ECONOMICS

This international symposium was organized with support from the Ford Foundation, the MacArthur Foundation, the University of Utah Economics Department, and the Levy Institute. It was held May 9–10, 2002, at the Levy Institute, Bard College, Annandale-on-Hudson, New York. Summaries of the speakers' remarks and sessions are given below.

Session 1. Gender Inequality, Growth, and Investment

Facilitator for this session was DIANE ELSON of the University of Essex. Participants were STEPHANIE SEGUINO of the University of Vermont, DAVID KUCERA of the International Labour Organization, WILLIAM DARITY JR. of the University of North Carolina at Chapel Hill, and Senior Scholar EDWARD N. WOLFF of New York University.

Mainstream theory holds that income equality and exports have stimulated growth in Asia. However, according to an analysis by Seguino, Asian economic growth and investment are functions of gender wage inequality: the wider the gap between men's and women's wages, the faster the economic growth. Using data for the period 1975 to 1995, Seguino analyzed the role of gender in influencing macroeconomic outcomes and found that inequality measured along gender lines has been a stimulus to growth in the region via its positive effect on both exports (by increasing access to technology) and investment.

Since the adoption of export-oriented strategies in Asian countries, young, single women have formed a rising share of the paid labor force. Within the manufacturing sector, women have been sequestered in labor-intensive industries that produce primarily for export, and receive significantly lower wages relative to men. In spite of correcting for productivity-related differentials, Seguino's study showed

that the gender wage gap remains large. Moreover, institutional structures, coupled with patriarchal gender norms and stereotypes, limit women's bargaining power, holding down their wage gains relative to men's. For example, in South Korea, the state condones widespread employer practices requiring women to quit work upon marriage. These practices limit women's job tenures, wage gains, and ability to organize or join trade unions. In Singapore, the state maintains an elastic labor supply by expelling low-paid female Malaysian export manufacturing workers during economic downturns.

Gender inequality serves the political goals of continued growth and social stability by bolstering profits, stimulating exports, and reinforcing the stability of a patriarchal gender system. Lower-cost women's labor substitutes for currency devaluation and makes exports more competitive. Productivity growth may also be enhanced because exports generate the foreign exchange needed to purchase the sophisticated technologies that raise productivity and stimulate growth. Furthermore, gender wage inequality may have positive effects on investment spending and men's real wages.

Seguino's study attempts to capture both interclass distribution of income (between women and capitalists) and intraclass (intrahousehold) distribution of income between women and men since household data could understate the degree of income inequality. The challenge in the future, she said, will be to adopt a set of policies and development strategies that stimulate economic growth and distribute the result fairly by class, gender, and ethnicity.

According to a study by Kucera, there is no solid evidence to support the conventional wisdom that foreign investors favor countries with lower labor standards. His analysis showed that foreign direct investment (FDI) tends to be greater in countries with higher labor standards because stronger freedom of association and collective bargaining

rights signify greater political and social stability, an important positive determinant of FDI location. Kucera's research employed newly constructed indicators of labor standards that focus on actual worker rights in a cross-country statistical analysis of labor costs and FDI in the 1990s for samples of up to 127 countries. His results were consistent with a recent survey of multinational executives and international experts by the United Nations. Although higher labor standards are associated with higher labor costs (a negative factor for FDI), they are also associated with greater stability (a positive factor), and the positive effects may well offset the negative.

Evaluating the determinants for FDI location is complicated by the fact that FDI is heterogeneous and undertaken for different reasons. Since Kucera's results are based on total FDI, they represent a macroeconomic average. The effects of labor costs on the location of total FDI depend on the relative importance of vertical FDI, which produces goods for exports, versus horizontal FDI, which facilitates domestic sales. According to the U.N. study, horizontal FDI is more important than vertical, particularly in the service sector relative to the manufacturing sector and for European and American firms relative to Japanese firms and those of newly industrialized Asian economies.

Consistent with previous studies, Kucera found that unionization rates were not strongly related to either labor costs or FDI inflows. Nor was there solid evidence that child labor or higher percentages of female industrial employment were associated with greater FDI inflows. Rather, FDI is greater in countries with greater gender equality. Enhancing human capital through greater gender equality and reductions in child labor had a direct positive effect on FDI location. Moreover, the market for unskilled labor was less relevant for multinational firms and FDI location.

Kucera noted that the effects of labor standards on FDI location cannot be determined solely by considering the labor cost to labor productivity nexus as a causal channel. He called for a broader view of the economics of labor standards and worker rights, since FDI location and economic growth may be transmitted by enhancing political and social stability and human capital development.

The discussants noted that the individual papers by Seguino and Kucera were at odds with one another in terms of the effect of income equality on economic growth.

Seguino's result, that gender income inequality stimulated growth and exports in Asia, was termed provocative. It was suggested that the result may have been affected by small sample selection issues and by the fact that her study focused on export-led economies. It was also noted that her study should have addressed the effects of immigrant labor, the sex trade, and ethnicity issues. An unanswered question related to the percentage of growth due to the gender wage gap. Kucera's work was seen to be limited to FDI and omitted indicators of equality, the effects of geopolitics and timing, and an adequate definition of net investment. In both cases, it was noted that the scholars should link their studies with Keynesian or any other economic theory, or identify the sectors leading economic growth. The results of their studies were questioned in light of the importance of structure, as exemplified by the differing composition of Asian and Caribbean countries.

Session 2. Gender Inequality and Trade I

Participants in this session were NILÜFER ÇAĞATAY of the University of Utah, CAREN GROWN of the International Center for Research on Women, IRENE VAN STAVEREN of the Institute of Social Studies in The Hague, and WILLIAM MILBERG of New School University.

Çağatay focused on the relationship between trade, gender, and poverty, within the context of the human development paradigm. She examined the impact of trade liberalization policies on gender inequality, and that of gender inequality on trade performance. Her main conclusions were that men and women are affected differently by trade policies and performance, gender-based inequalities impact trade policy outcomes differently, and gender analysis is essential to the formulation of trade policies that enhance gender equality and human development.

Mainstream trade theory suggests that expanding global trade is beneficial to all when countries produce specialized commodities in which they have a comparative advantage. This leads to a more efficient allocation of resources in the world economy and higher levels of output and growth. However, measures of development based on market criteria, such as income or consumption, are now being replaced by measures based on human well-being, including that of the poor, racial and other minorities, and women. Çağatay

maintained that trade must also be reevaluated according to social content such as class, gender, and race that forms the context in which trade policies are enacted (as opposed to the social impact of trade based on growth and market access). Any assessment of the impact of trade liberalization on gender equality must include the impact on the unpaid care economy as well as on women's paid employment opportunities and working conditions. The concept of poverty in terms of absolute income should be broadened to include such relative parameters as possession or lack of assets, dignity, autonomy, and time. The problem lies not only in unequal resource control within households, but in institutionalized gender biases in both the state and the market. Empowerment of poor people, particularly women, is essential to the elimination of human poverty.

Çağatay warned that patterns of defeminization may develop over time and called for more gender inequality studies related to trade theories and the development of alternative trade policies and labor standards. Macroeconomic support related to competition, income distribution, and growth is essential, as is more debate concerning gender, class, and national inequalities, and the different social relationships underlying poverty.

An answer to the central question about what set of feminist macroeconomic and trade policies should be advanced to promote and institute gender equity was provided by Grown. Her study (coauthored with Seguíno) sets forth general principles that can shift economies from a profit-led, export orientation to a wage-led, full-employment orientation. Her observation was that fiscal and monetary policies promoting gender equity are often an afterthought, and are constrained by financial liberalization (which increases macroeconomic volatility) and a government's ability to act on behalf of women. Therefore, increasing women's relative access to jobs, a major vehicle for improving gender equity, appears to be increasingly unobtainable in the era of globalization. In addition, Grown noted that there was evidence that the process of feminization reverses as the wage gap closes. Overall, women enter the paid economy under inferior conditions that cannot provide them with a secure income and that hamper their ability to improve their working conditions or their relative position in society.

Although feminization of employment may be beneficial to women in the short run, there are severe disadvantages in the long run, such as a lack of security. In order to counter the negative effects of globalization and financial liberalization on gender equity, Grown called for development and fiscal policies that encourage wage-led, full-employment growth with rising productivity, including creation of price-inelastic goods and services and restrictions on both inward and outward FDI.

Sensitivity of monetary authorities to gender equity, the ability of the export sector to produce inelastic exports, and willingness by the state to manage capital mobility are required to achieve gender equity. Therefore, Grown called for an expanded government role in managing economic outcomes through timely intervention of physical capital controls, financial capital flows, and industrial policy. At the same time, she noted, it is important to recognize different economic structures. The goal is to fundamentally alter power relations to ensure women's equitable access to market resources and expand their abilities to make lifestyle choices and care for their families. The solution, however, is not necessarily a win-win situation.

The discussants raised some issues with the papers' policy suggestions and questioned the cost of the care economy. Van Staveren noted a number of strengths in Çağatay's paper, which recognized the interaction between trade and gender and interpreted power issues at the household and international levels. Some hypotheses, however, did not address the gender composition of trade. Van Staveren recommended that future work link human development and gender capabilities and address a matrix of win/lose scenarios of trade-gender relationships. This process, she surmised, could help to clarify trade policies that benefit women and the poor. It was noted by participants that the wage-led economy proposed in Grown's paper may not be possible.

Session 3. Gender Inequality and Trade II

Facilitator for this session was RADHIKA BALAKRISHNAN of Marymount Manhattan College. Participants were MARZIA FONTANA of the International Food Policy Institute, JAYATI GHOSH of Jawaharlal Nehru University, MUMTAZ KEKLIK of the United Nations Development Programme, GROWN, and ELSON.

Fontana modeled the effects of trade on women in Bangladesh and Zambia. She employed a gendered, computable general equilibrium model with two innovative features—the allocation of both male and female labor over a 24-hour time frame, and the inclusion of social reproduction (household work) and leisure sectors. The model was based on a social accounting matrix, which included details on the gender composition of the labor market, household work, and leisure. Household types were distinguished by income level and location, and the model accounted for land ownership as well as capital. This level of detail permits the various effects of economic changes on women to be understood according to their individual characteristics and circumstances, and how they affect women's obligations and tasks within the household.

In a trade simulation in which the world price of copper was raised, Zambia suffered a contraction of domestic output and an improvement in two male-dominated sectors: capital-intensive manufacturing and commercial crops. Women with secondary and tertiary education gained more than other female workers in higher wages and more leisure time, and men in urban households assumed some female tasks in social reproduction. However, simulating the abolition of tariffs on manufactured imports resulted in lower employment and smaller wage gains for women than for men. The introduction of incentives in nontraditional agricultural exports showed that women were favored more by the expansion of horticulture and groundnuts than by commercial crops, which were more male-intensive. Reallocation of productive assets to “women's crops” made female workers more productive but reduced their leisure time.

In the case of Bangladesh, a simulated decline in garment exports resulted in a decline in time spent in the market economy relative to social reproduction and leisure activities. Less-educated women were subsequently absorbed into other market activities more easily than educated ones. Overall, the results showed that changes in trade policy affect men and women differently.

Fontana noted that the simulations showed how important it was to include social reproduction and leisure sectors in analysis, and to integrate women's time in the household with their work in the market economy. The greater the rigidity of gender roles and market structures, the smaller the

positive effect of better price incentives; therefore, it is important to design complementary policies that reduce the many competing demands on women's time and enhance their ability to respond to economic reforms.

According to Fontana, her model is limited in that the social reproduction and leisure sectors do not allow for differences in preferences and control over resources between family members (intrahousehold effects). Also, the use of multiple assumptions to derive time-allocation data may have resulted in somewhat unreliable data.

Ghosh examined women's employment in the export-oriented manufacturing sectors in India during the era of globalization. She noted that women are preferred employees in this area, primarily because they accept inferior conditions and pay and give employers greater flexibility in terms of less-secure contracts. In fact, the feminization of Southeast Asian export-oriented industries may be even more dependent than generally supposed on the relative inferiority of women's remuneration and working conditions.

In her review of Southeast Asian countries, Ghosh found that, despite a massive increase in the labor force participation rate of women in the period 1985 to 1997, and a slight narrowing of the wage gap during that time, there was a decline in the share of women employed in the export manufacturing sectors. Export industries had become the most important employer of women at the margin, so, with the economic downturn, their numbers declined. Since the early 1990s, aggregate manufacturing employment actually declined in South Korea, Singapore, and Hong Kong, and there was a corresponding decline in the share of female manufacturing employees over the latter part of the decade. The process of feminization of export employment peaked in the early 1990s, before the 1997 financial crisis and the 1997–99 recession. Since then, there appears to have been a shift to more insecure, very small, unit- or home-based employment of women in production chains dependent upon outsourcing by large final distributors.

In India, open employment of women in export-oriented factories is less apparent than it was in Southeast Asia during its major export boom. There has been a small rate of increase in the feminization of employment relative to Southeast Asian countries and a relatively low growth rate of aggregate employment (now at its lowest since independence). The

overall work participation rate of urban Indian women in the 1990s declined. Ghosh noted that a corresponding increase in the open unemployment rate is a very poor indicator of actual levels of job availability because the absence of public social security systems results in underemployment or disguised unemployment. For urban women, there has been an increase in regular work in the form of subsidiary activities such as domestic and other services and an increase in home-based work as part of a subcontracting system for export and domestic manufacturing. This has resulted in work and social reproduction occurring in the same place. These home-based subcontracting activities, which are poorly paid and lack nonwage benefits, may have substituted for both self-employment and more regular employment. There has been an increase in subcontracting by export-oriented and foreign manufacturing companies in India. Production processes that require more labor per unit of output are more likely to lead to organizational forms dependent on subcontracting at various levels.

Outsourcing coordinated by a chain of intermediaries constitutes an important challenge for social policy since home-based workers' opportunities for any kind of organization or collective bargaining are limited. Attempts to organize and improve conditions have been marginally successful. Moreover, outsourcing is more pronounced in sectors producing relatively low-valued goods, such as textiles, garments, leather goods, and plastics. Since private employers are not expected to provide decent labor conditions or viable material income standards, given the excess labor supply and low employment growth at best, a significant share of the burden of worker protection must fall upon the state. Software and information technology (IT) services, the fastest growing exports in the 1990s, produce products at the lower end of the scale, are highly transient, and are currently concentrated among the richer, English-speaking parts of urban India. Therefore, an excessive emphasis on IT could result in the diversion of resources away from more crucial expenditures for literacy and primary education.

The most basic requirement for workers in the Indian economy is food security and this, along with public health programs and public housing, must be a priority of the state. Improved access to food for a household disproportionately benefits girls and women. Decentralized planning, where local

representatives and inhabitants are given greater control in terms of investments, administration, and delivery of services, is essential in delivering needed public goods and services. Government policy previously ignored issues of social security but now recognizes the need for gender-specific measures.

Keklik, as a discussant, addressed Fontana's paper and questioned the application of the model's classical assumptions for Zambia, its inconclusive relationship between trade liberalization and growth, and the resulting negative social implications associated with a budget dedicating 40 percent of its expenditures toward debt-servicing costs. He noted that government revenues are important in less-developed countries and that tariff reductions affect government revenues and reduce public investment, which in turn negatively affect social policies and gender relations. Therefore, the model used by Fontana should consider other factors, such as government finances, especially when applied to Zambia. Grown responded to Ghosh's paper, saying that it led to questions of how to integrate feminization into settings other than India, or Asia in general, and whether the process was congruent with demographics. She pointed out that the issue of defeminization and reversals with respect to a shift in the production chain was especially important to India, which is different from southeast Asia. An important story to include is the increased competition from abroad leading to employment losses. Moreover, what is the role of the state in terms of rights and labor standards, and how can the state address social security? The differences between caste and class groupings should also be studied, as well as how to create more productive employment. Other respondents pointed out that Fontana, whose research addressed the issue of leisure time, may need a better definition and measurement of leisure and social structure, and that future research by both authors should include consideration of wealth inequality and disinvestment at the lower end of the chain.

Session 4. Gender Inequality and Trade III

Facilitator for this session was ELSON. Participants were GÜNSELİ BERİK of the University of Utah, SHAIANNE OSTERREICH of Ithaca College, ELLEN HOUSTON of New School University, GHOSH, and KUCERA.

Becker's theory of discrimination states that greater competition erodes wage discrimination against women. Past

studies linking gender wage differentials and increased exposure to competitive forces from international trade have yielded inconclusive results and the impact of globalization on the gender wage gap remains a puzzle. Berik tested Becker's theory in a study coauthored by Yana van der Meulen Rodgers of the College of William and Mary and Joseph E. Zveglic Jr. of the Asian Development Bank. They estimated the effects of greater competition from international trade on the gender wage gap in Taiwan and South Korea in the period 1980 to 1999. Two alternative models were used in the analysis—the long-differenced model, which estimates the effect of change in the trade ratio over time, and the levels model, which calculates the effect of variations in the level of trade openness—to identify gender wage gap changes.

Berik's industry-led wage gap regressions disproved Becker's theory. In Taiwan and South Korea, an increase in international competitiveness over time in concentrated industries was associated with a wider gender wage gap. The study controlled for gender differences in skills and the effect of firms' market powers in their own countries. Industries were categorized according to their domestic (concentration of firms across industries) and international (ratio of trade to domestic production) competitiveness. The residual rather than unadjusted wage gap was seen to be better suited to test Becker's theory. As opposed to other studies, the analysis explicitly tested for the effect of increasing competition on wage discrimination, integrating micro data on labor markets with macro data on industrial structure and trade.

In light of competitive forces from domestic market structures, unadjusted and residual wage ratios in Taiwan were higher in concentrated than in nonconcentrated industries. These same ratios were higher in South Korea after 1992. Taiwan's relatively greater market orientation (of industrial policy) and more competitive industrial structure formed a backdrop of rising wage inequality and mild recovery in both concentrated and nonconcentrated industries. By contrast, as a result of South Korea's less competitive industrial structure and policy, its residual wage ratio in nonconcentrated industries was relatively flat while its residual wage ratio in concentrated industries was rising. Competitive forces arising from greater exposure to imports relative to

exports had a stronger impact on the gender wage gap in concentrated industries.

In Taiwan, increasing trade openness and a highly competitive industrial structure are associated with rising gender wage inequality. South Korea's declining total trade, however, coupled with a less competitive industrial structure, is associated with a gradual narrowing of its manufacturing-sector gender wage gap. Therefore, Berik suggested, a relatively less open economy may better support gender equality. She called for a reevaluation of protective legislation for female workers in both countries to ensure that gains from globalization are shared more equally between men and women. Her findings were consistent with other studies that showed sex discrimination to be a tool for increasing export competitiveness.

The first presenter to deal with north-south comparisons was Osterreich. Her main thesis was that gender wage gaps in semi-industrialized middle-income countries were associated with a decline in manufacturing terms of trade relative to those of industrialized economies. Another thesis was that the unequal distribution of gains from trade is affected by patterns of female employment, providing a causal link to uneven development. Previous theories of trade neglected the significance of gender relations that affect both labor force participation patterns and labor market outcomes.

Gender represents one of the social parameters for the distribution of economic bargaining power, resources, and work burdens within society. A number of studies have demonstrated that export-oriented manufacturing is associated with female-intensive employment within and between countries. The purpose of Osterreich's research was to investigate linkages between gender inequalities in labor markets, terms of trade, and unequal exchange. Her model specification was derived from a standard classical version of price determination coupled with an engendered unequal exchange analysis. The net barter terms of trade (NBTT), or relative international prices, is a function of wages, productivity, and profit rates. Countries were chosen based on their export promotion in the manufacturing sector as a strategy to achieve growth, and their increasing reliance on exports since the mid 1970s. This sample was indexed according to each country's average of three export measures—exports as a percentage of GDP, annual export growth, and manufactured goods as a

percentage of exports—for the period 1975 to 1995. Wage ratios were calculated as the ratio of female to male earnings weighted by share of each manufacturing export sector, and wage gaps were adjusted for education, in line with work by Seguino. Northern (industrial) countries were selected according to their significance as trading partners for the sample southern (semi-industrial) countries. In light of wage data limitations, two sets of southern countries were used in the analysis—10 countries using five-year averages, and seven using annual gender wage data.

Osterreich hypothesized that the NBTT of the south would improve when women there became better off relative to women in the north. In addition, when the north-south productivity gap shrank, the south's NBTT would deteriorate. Her research results gave overall support to the primary hypothesis and explained the unequal exchange and development relationships between the two economies. Although the results relating to the secondary hypothesis were mixed, it was confirmed when she used a smaller sample size. Therefore, international wage ratios, when engendered, are contributing explanatory variables for the NBTT. Moreover, when women's bargaining power increases, it tends to improve the NBTT. This implies that feminization of the labor force of successful manufacturing, export-oriented countries is a contributing factor in the Prebisch-Singer hypothesis: that when the productivity of southern countries increases relative to northern countries, the NBTT of the south deteriorates. Emmanuel's labor market-based vision of unequal exchange, when engendered to explain international wage ratios, is also a reasonable theoretical explanation of uneven development.

Policy recommendations to escape unequal exchange (in light of the disincentive for southern countries to protect their workers) and patriarchal social relations that suppress wages to maximize profits include narrowing the technological and educational divide between men and women, and between countries. Such policy would allow more diversified exports, including those that embody more innovation and technology. Gender-aware educational and technological policies are also necessary to avoid occupational gender segmentation that inhibits relative gains for women, and to promote labor standards and female employees' rights through multilateral collective actions.

According to Houston, countries with greater gender inequality perform better. Her hypothesis was based on the facts that women are lower-cost substitutes for male workers and that there is segregation as well as a cyclical response to female employment (the buffer hypothesis). OECD data show a strong negative trend in the male/female employment gap and a narrowing gender wage gap in the period 1985 to 1999. Houston attempted to incorporate social policy (public social expenditures) into her social-gap model of international competitiveness and capture both the short- and long-run impacts of relative unit labor costs, technology, industrial relations, and gender inequality. Lacking good wage data, she tested the different variables and got ambiguous results relating to the interactive effects of gender and social equality.

In discussing Berik's paper, Ghosh said that some questions remain. For example, the research does not address the effects of the financial crisis of 1998–99, when there was a massive increase in unemployment; this must have made a difference in the wage gap even with no clear trend in the econometric analysis. In addition, the research does not take into account the impact of imports on the gender wage gap, or the social/political differences between countries. Ghosh noted that she disagreed with Osterreich's hypothesis since new entrants in the south category were diversifying with the same commodity and not enough countries were included in the study. Kucera agreed with the small sample bias of Osterreich's study and suggested dropping one country at a time in the econometric analysis to see how the coefficients changed in the process. It was noted that since women are employed in more mobile industries, which will relocate (e.g., from Taiwan to China) and subsequently reimport these same products, downward pressure is exerted on women's wages, as well as men's, leaving the wage gap constant.

Session 5. Gender-Sensitive Financial Reform and Monetary Policy: A Roundtable Discussion (Part I)

ELSON was facilitator for this session. Participants were AJIT SINGH of the University of Cambridge, ANNE ZAMMIT of the United Nations Research Institute for Social Development, KORKUT A. ERTÜRK of the University of Utah, and BRIGITTE YOUNG of the University of Muenster.

Zammit presented a capital accumulation model of South Korea that analyzed growth and structural changes to

show that during periods of cyclical instability, women are more affected than men. The country relaxed its financial regime in the period 1993 to 1996 (following liberalization of short-term capital flows in the late 1980s) and then experienced an intense financial crisis in 1997 when GDP declined, inflation increased, its currency devalued, and the government closed 15 large financial companies. Zammit noted that there was significant irregular employment for both males and females before the 1997 financial crisis. However, women's employment declined more than men's, and this disparity is unlikely to change in the future.

Within a relatively short period of time following the financial crisis, South Korea experienced a flowering economy. The associated change from recessionary to expansionary policies affected social policies. Zammit's model for this period took extended family income into account in determining benefits. Zammit recommended new countercyclical measures to deal with future crises, and advised that countries not depend on exports. She noted that central banks represent financial interests and are not really independent from the state. Therefore, they should represent women's interests.

Singh observed that in terms of international capital flows and gender, women are affected most by economic instability. Their wages decline and their unpaid burden increases when there is no social security system. Theory suggests that international capitalism promotes stability but that, for some countries, leads to instability. In such cases as Mexico and South Korea, OECD membership did not help.

In the case of Argentina, huge capital inflows occurred after inflation stabilized following a period of hyperinflation in 1989. However, money disappeared with unbalanced budgets and government policy sought to increase foreign capital. High unemployment and attempts to balance budgets on a monthly basis resulted in government spending cuts, rising deficits, and lower government salaries and wages. The International Monetary Fund (IMF) faulted the Argentinean government and assumed that the capital markets would require balanced budgets. However, output continued to decline. The question was, "who is willing to pay?" The only avenue left to the nation was import and exchange controls, which had serious implications for the world economic order. It is difficult for countries to take autonomous action and free trade is not compatible for all countries. Therefore,

asked Singh, what are the possibilities for national versus international action?

Ertürk spoke of currency crises, the movement of funds between current and capital accounts, and the risk of exchange rate drift. Developing countries have internal debt problems, so a decline in their money supplies by the end of the 1990s precipitated a liquidity crunch. Interest rates increased, public debt brought financial instability, and the countries faced insolvency. The IMF read the events incorrectly and viewed them as an attack on the currencies. As the developing countries experienced real exchange rate declines, banks extended credit at higher nominal interest rates. Therefore, there was an incentive for these nations to expand credit.

Ertürk suggested considering foreign currency deposits as a country's internal money supply. Reserve requirements for saving and checking deposits are the opposite in foreign currency accounts. The implications with regard to gender are the way in which the mechanisms underlying the financial system unravel as part of the effects of government policy intervention. He noted that speculative behavior expectations are different between men and women, and saw the need for concrete proposals, such as a Tobin tax (an excise tax on cross-border currency transactions), along with built-in stabilizers.

Young noted that it was difficult to include gender perspectives in concrete proposals relating to monetary policy, labor markets, and financial committees. Today, however, Germany requires they be considered in all areas of government policy. She listed 18 recommendations, which included applying feminist economics and gathering gender-specific statistical data. Young also recommended adoption of a Tobin tax.

Session 6. Gender-Sensitive Financial Reform and Monetary Policy: A Roundtable Discussion (Part II)

Facilitator for this session was ELSON. Participants were VAN STAVEREN, GERALD EPSTEIN of the University of Massachusetts, and GÜLAY CAGLAR of the University of Kassel.

Van Staveren focused on gender-based distortions in the financial markets. She noted that the burden of instability during a financial crisis is transferred to the care economy, resulting in negative feedback effects. Moreover, there is suboptimal resource allocation due to discrimination. Her

recommendations included the need for financial institutions to develop into transparent organizations and increase the number of women among their directors and senior staff; measures such as gender audits at various levels (inheritance and property rights, land reform programs) and raising public awareness to reduce gender-based distortions in financial markets; action to break the monopoly of the IMF on international policy advice; reconsideration of loans by the World Bank and regional development banks in favor of grants for human development (including gender aspects); and the need for microcredit programs for women to shift attention from increased loan access to increased loan control.

Caglar suggested that gender-sensitive budgeting could be incorporated into the existing economic paradigm and recommended including gender within the agenda of financial budgeting. In light of the role of society and power and the need to raise government and public consciousness, he recommended a link between political and economic analyses. A new economic paradigm could initially incorporate a Tobin tax.

Epstein raised the issue of central bank policy maintaining low interest rates to the exclusion of other goals, and suggested a targeting approach to manage capital flows. The impact of macroeconomic policy (economic and human development) on women and children should also be included in the discussions and in setting targets. For example, South Africa set its sights on foreign investment and lowered interest rates to get it; however, since the nation's jobless rate stands at 45 percent, its target should have been employment.

Epstein noted that FDI follows rather than leads economic development. There is no correlation between interest rates and economic development, and higher interest rates hurt the poor. However, employment targeting, in which the central bank sets the range and policies subject to an interest constraint (in light of the threat of hyperinflation), would involve everyone in society. It is important to understand the linkages between monetary policy and employment, and the central bank needs more instruments such as credit allocation techniques to conduct monetary policy. The search for such tools or techniques could lead to credit allocation and employment policies that are gender-sensitive.

Session 7. Gender-Aware Macroeconomics

YOUNG was facilitator for this session. Participants were HAROON AKRAM-LODHI of the Institute of Social Studies in The Hague, ISABELLA BAKKER of York University, CHARLES ABUGRE of the Integrated Social Development Center in Ghana, ROSANNA GALLI of the University of Lugano, and FONTANA.

Akram-Lodhi outlined the effects of Vietnamese government fiscal policy on gender. He noted that government decisions with respect to the nation's fiscal position were conservative, that the budget deficit was very low (limited to a maximum of 5 percent), and that there was no debt problem. A "unified" national budget was submitted as a five-year plan with a complicated and restricted underlying structure. A limited group drafted the plan and there was no formal mechanism for civil society to affect the budget.

The underlying structure of the budget showed that the government and various committees were extremely unequal in gender composition (with the exception of the vice presidents, who were powerless). The disparity worsened as one moved down the chain of command. Economic management was heavily weighted toward men, as were senior positions on committees to improve women's issues. Therefore, Akram-Lodhi maintained, women need to be mainstreamed into Vietnam's key economic ministries along with gender budgeting procedures. In addition, institutional mechanisms should be established and ongoing dialogue promoted between senior ministries and organizations representing women. He proposed mechanisms to overcome institutional constraints, including a requirement that ministries submit policy recommendations to a committee with the power to review policies for their gender impact (a "gender audit") and the creation of a budgetary submission process permitting women's organizations to make gender-aware policy proposals to the government.

Bakker's work dealt with conceptual links between unpaid work and macroeconomics. She focused on accountability and voice and noted that all budget processes were political. A wave of fiscal stabilization measures and laws in the 1990s signaled a return to pre-Keynesian orthodoxy, a shift that had implications for the changing accountability structures of fiscal policy.

Accountability and public policy pertain to all past, present, and future funded taxpayers, market participants

(by sustaining an appropriate business climate), and institutions that create budget deficits. Given these layers of accountability, discussions about participatory budget initiatives such as gender-responsive budgets must include accountability of the legal framework, domestic and international institutions, and capital markets (in the form of credibility, consistency, and confidence). Bakker noted that accounting frameworks were important in the context of balanced budget laws, and that the public had a limited ability to influence decision-making. Moreover, the low inflation bias (high interest rates, tight monetary policies, and fiscal restraint) emerging through liberalized financial markets reflects the ability of financial institutions and investors to exercise direct voice over macroeconomic policies through threats of canceled investments or capital flight. By contrast, the poor have limited voice since they are bound by location and restricted by unresponsive domestic and international structures. Therefore, women should analyze and develop gender-responsive budgets as useful instruments for accountability and to mitigate the impact of social programs fostering social and economic inequality, such as balanced-budget initiatives.

In the IMF financial programming model, growth is exogenous and there is no relationship between the distributional impacts of growth in terms of social structure and poverty. In light of these shortcomings, Abugre outlined his organization's attempt to build a dynamic economic model of Ghana. The objective is to link regional income and expenditure patterns and quality of life parameters with macroeconomic components in order to challenge the IMF model. Based on social accounting matrices of both flows of income and stocks of assets and liabilities, the model is intended to derive poverty reduction strategies for the country. When complete, household surveys will explicitly represent income flows and expenditure decisions—for example, food as a proportion of total expenditures—of different population groups and address the geographic dimensions of poverty by region, gender, income, and rural/urban parameters. The model will make it possible to, for example, estimate the number of poor female heads of household in rural Ashanti and the way they are affected by tight monetary policy. Regional poverty profiles can then be fed into a quality of life module addressing the effects of topical policy issues such as privatization, user fees,

taxes, subsidies, and the impact of budget allocations on access by the poor to health, education, and water.

The discussants, Fontana and Galli, noted the benefits each paper provided to the research on gender and economic policy. However, in commenting on the presentation by Abugre, Fontana questioned the development of a dynamic model, which was much more complex and ambitious than necessary, and suggested starting with a simplistic, static model with a defined main objective. She also expressed the need to include the care economy in the analysis and noted that women face higher transaction costs. The question of using limited sample surveys versus aggregated data was raised, as was the need to include intrahousehold consumption patterns.

Session 8. What Have We Learned and Where Do We Go from Here?

A roundtable discussion clarified some of the issues for current and future research. One issue was data problems—the wage gap data sets and U.N. data systems (e.g., the ILO)—and associated economic indicators. Another was the intersection of Keynesian, post-Keynesian, and feminist economics. A third was the weak link between empirical analysis and setting government policy, including the connectivity with power relations both internal to the economic system and in terms of a north/south orientation (which is associated with imperialism). A fourth issue was the focus of the papers on Asia and the North Atlantic regions, and the need for more regional variation in research (e.g., Latin America). Any subsequent symposium should include more researchers from southern countries, and gender studies should quote more research from southern analysts. A fifth issue was the need for more microanalysis at the intrahousehold level. The need to develop alternative models and determine the impact of technology and domestic structure was the sixth issue. Gender, class, and race issues, participants decided, should be addressed, and the relationship established between productivity and social reproduction. Further work is also required with regard to the gendered supply and demand of money and asset distribution, as is simplification of the terminology associated with gender research.

New levers of political intervention should include such instruments as a Tobin tax. They should also encompass labor

standard issues and counteract trade liberalization. Linkages and feedback effects should be explored to determine the effects of capital liberalization, internal debt, and crowding out. What happens when the buffering effects of stabilization policies are inadequate and the care economy becomes overloaded? These relationships and impacts should be linked to new growth theories and development issues, as well as the IMF and World Bank. Perplexing policy questions that are national in scope should be expanded to include the international level. The participants' conclusion was that a broad coalition is required to counter proponents of financial liberalization since economic growth parameters do not adequately account for gender and poverty issues.

Poles and Italians Then, Mexicans Now?

Immigrant-to-Native Wage Ratios, 1910 and 1940

JOEL PERLMANN

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Are wage ratios of recent immigrants compared to native white workers worse than comparable wage ratios during the great immigration wave of 1890 to 1920? Are today's offspring of low-skilled immigrants able to advance in the way that was possible in the period 1910 to 1950? Is the present like the past? A 2001 article by Christopher Jencks, based on work by George Borjas, claims that relative wage ratios of immigrant Mexicans to native white workers today are far worse than the relative wage ratios of immigrants in 1910. Since Mexican-born men earn less than half the wages of non-Latino whites, he calls for a reconsideration of U.S. immigration policy with respect to Mexico.

Using the Integrated Public Use Microdata Sample (IPUMS) census data sets, Senior Scholar Joel Perlmann tests the evidence used by Jencks and Borjas to describe the characteristics of the immigrant population at the turn of the 20th century. He analyzes the skills and wages of the southern-, central-, and eastern-European (SCE) immigrants (more specifically Poles, other Slavs, and Italians), who represented the largest low-skilled immigrant group and whose experiences most closely resemble the plight of Mexicans today, and constructs a more precise comparison of immigrant-to-native earnings in 1910. While he acknowledges that earlier

census data sets are often ambiguous, Perlmann nevertheless concludes that the data do not contradict Jencks's finding that Mexican-to-native wage ratios are worse than those of comparable immigrants in 1910.

Jencks contends that the economic gap between SCE immigrants and native white workers in 1910 was far smaller than folklore suggests since, according to Borjas, they typically earned about 88 percent of the wages of native white workers. He suggests that SCE immigrants prospered because they settled in cities sooner than did northern Europeans and their children had an educational advantage. Recognizing the imprecise nature of the comparison between past and present factors such as income and education, Perlmann proceeds to outline pitfalls in Jencks's approach, which stresses a national comparison of immigrants and natives and focuses on specific groups within Borjas's original work. The purpose of Jencks's study, he notes, was different from that of Borjas, who attempted to study the assimilation process of 32 immigrant groups over time. Moreover, recent discussions of Borjas's work have focused on issues of classification and projections that included groups whose unique discriminatory labor market experiences (such as Mexicans, Chinese, and Japanese) substantially affected the resulting forecasts of their process of assimilation. As a result, Perlmann accounts for Jencks's shortfalls in data interpretation, analysis, and manipulation of immigrant characteristics at the turn of the 20th century. He takes exception to recent sociological theories of segmented assimilation, suggesting that today's low-skilled immigrants may not be able to advance in the same way as was possible in the period 1910 to 1950.

Recognizing that before World War I, most SCE immigrant groups lived within three multinational empires, Perlmann classified all immigrant groups by place of birth and by mother tongue. He excluded Jews, who had a relatively better economic position, so that the analysis could focus on comparable low-skilled SCE groups. Noting the compressed nature of SCE immigration, Perlmann selected men in the 25–34 age group in 1910 to derive his second-generation birth cohort. Mean group incomes (occupational wage) were based on Borjas's report, which used the 1903 Commissioner of Labor report on the cost of living in 1899.

Perlmann notes a number of limitations in Jencks's calculation of immigrant wages: 1900 occupational wage

information was applied to 1910 data; other sources (and biases) in addition to the 1900 report were used to compute average occupational wages; farmers, farm tenants, and the self-employed were excluded from the data base; samples were limited to families and were not randomly selected; wages were limited to family heads (unattached men were underrepresented); national averages ignored regional and local variations in wages and age differences among workers; and wage-earnings ratios by category included both SCE and other white immigrant workers. Perlmann proceeds to construct a more accurate approach from which to estimate earnings ratios and identify ethnic differences in wages by occupation.

Using the 1940 census, the first that included individual income by occupation (but excluded the self-employed, and thus, many farmers), Perlmann considered indirect evidence about illiteracy, alternative ways that earnings ratios might be calculated, and the relevance of geographic differences. The 45–64 age group was selected to correspond approximately with the 25–34 age group in 1910 and to compare intra- and interoccupational wage ratios. In contrast to Jencks's comparison, which aggregated immigrants and native whites, Perlmann constructed four different models to control for age and residence (by region and metropolitan area). His

regression of wages on age, ethnicity and geographic controls showed that a north-south division of labor was not driving ethnic differences, and the net effect of metro differences was at least as large as the total effect of regional differences.

Perlmann also compared actual and occupational wages to capture immigrant wage disadvantages within and between occupations, and to construct various scales from numerous groups of workers. In 1940, men in the 45–64 age group earned remarkably similar wages across occupations. Although within-occupation ethnic differences in earnings were small, large racial inequality existed between and within occupations, partly accounted for by geography. All occupational wage and earnings ratios differed sharply from the 1900 occupational wage scale. Perlmann speculates that the comparatively higher ethnic earnings ratios in 1910 may have been the result of the differential effects of the Depression on various ethnic groups (rather than a reflection of data quality). He also surmises that the 1910 scale may have missed substantial within-occupation variations and that ethnic differences in remuneration stemmed from sharp differences in illiteracy. His review of 1950 earnings ratios showed both actual and occupational wages were higher than in 1940, a result that may have been a consequence of the postwar boom.

Program: Financial Markets and Monetary Policy

CONFERENCE

The 12th Annual Hyman P. Minsky Conference on Financial Markets, “Recession and Recovery: Economic Policy in Uncertain Times”

As part of its research program on financial markets, the Levy Institute organized a conference, held on April 25 at the Roosevelt Hotel in New York City, to discuss viewpoints on the current state of the U.S. economy and its future direction. Will current conditions in the U.S. financial system assist or hamper the general macroeconomic environment or other forces necessary to combat a slump and what implications will the answers

to this question have for public policy? Brief summaries of the speakers' remarks and sessions are given here.

Audio of the entire conference is available on the webcast archive page of the What's New section of the Institute's website.

WYNNE GODLEY

According to data released by the Congressional Budget Office (CBO), there was a tightening in the fiscal stance during the main period of economic expansion (1992–2000), a progressive deterioration in net export demand, and an unprecedented expansion of private expenditure relative to income (and escalating indebtedness). The consensus view

during this period was that the United States had acquired a New Economy, which had a much faster underlying growth rate and was immune to the business cycle. Thus, fiscal policy was discredited as a tool to manage the economy. However, the beginning of a recession in 2001 resulted in a large change in the stance of fiscal policy. Downward revisions to the CBO's assumptions about economic growth resulted in projections of budget deficits for 2002 and 2003 rather than the budget surpluses predicted only 15 months previously. In response, the federal government began to relax its overall fiscal stance along with the huge reduction of interest rates to counteract the slowdown in economic growth and rising unemployment rate.

Distinguished Scholar Wynne Godley and Research Fellow Alex Izurieta studied the CBO data and forecasts and concluded that economic growth in the period 1992 to 2000 occurred because there was unprecedented growth in private expenditures relative to income. Moreover, sustained growth in the future will depend on further expansion of private expenditures relative to income with an associated increasing burden of servicing the debt. Their forecast is based on official projections that maintain a tight fiscal stance, a strong dollar, and an implied deterioration of net export demand.

A decline in private sector expenditures relative to income in the fourth quarter of 2000 resulted in the current economic slowdown. The private balance remained in deficit in 2001 since the net flow of credit exceeded the growth of income. Therefore, rapid growth in the level of debt relative to income continued, facilitated by the huge reduction in interest rates. Notwithstanding the sharp fall in investment, corporate debt relative to cash-flow income rose rapidly, reaching record levels throughout the year.

Updating his analysis presented at previous Minsky conferences, Godley presented a "base run" scenario using the CBO's assumptions about growth and inflation over the next five years. The CBO assumed that GDP would grow at 1.7 percent in 2001–02 and 3 percent per annum thereafter, inflation would remain at 2 percent per annum, and unemployment and the dollar rate of exchange would stay at present levels. In this scenario, the general government budget moves from a small surplus in 2001 back into deficit in 2002 and does not return to a surplus position until 2006. The trade deficit resumes its deteriorating path after a brief

period of improvement (generated by the slowdown). Godley noted that the trade deficit could be worse than projected because of the relatively high import content of inventory accumulation compared to final sales, and the continued deterioration of the U.S. net foreign asset position.

Augmenting the CBO's assumptions and its forecast balance of payments deficit with an additional \$100–200 billion per annum net outflow of investment income would require total private expenditures relative to disposable income to grow and to become the motor for expansion over the next five years. Since a growing excess of expenditures over income requires a growing flow of net lending relative to income, the resulting level of private indebtedness would be more than twice the level of disposable income by 2007. In light of existing and projected levels of corporate debt, Godley maintained that the base run scenario forms an unsound basis for strategic thinking and fiscal planning. The growth of net lending (and expenditures relative to income) that drove the economy from 1992 to 2000 cannot continue to fuel future growth of aggregate demand indefinitely.

Godley next presented three scenarios that broadly characterize major problems likely to arise over the next five years and the alternative strategies that should be considered when dealing with them. The first scenario retains the CBO's assumptions about the fiscal stance and net export demand used to construct the base run, and includes more realistic assumptions about private sector indebtedness. The flow of net lending is assumed to decline during the next few years, causing the rise in indebtedness to taper off and the private sector deficit to revert toward zero. This implies a reduction in the average annual GDP growth rate to 1–1.5 percent (a "growth recession"), a rise in unemployment to 8 percent, and a general government deficit of at least 2.5 percent of GDP by 2007. The federal budget would therefore show a deficit rather than a surplus of 1.5 percent of GDP as projected in the base run. Since the U.S. private sector has never been in a deficit position for such a length of time in the postwar period, the situation could be far worse. For example, the United Kingdom and Scandinavia experienced large and intractable recessions following periods of private sector deficits.

The second scenario superimposes an extremely large fiscal relaxation on the first scenario in order to raise the GDP

growth rate back to the level assumed by the CBO. At a minimum, all of the relaxation this year and next (\$250–300 billion per year) would have to be reinstated in the following years. If the private sector's financial debt continues to fall, the fiscal stimulus would have to rise to about \$600 billion per annum (1996 prices) by 2007, and the general government and federal deficits possibly to 6 percent and 5 percent of GDP, respectively. Under this scenario, the balance of payments resumes its deterioration in the same way as the base run. With the private balance close to zero, and in the absence of new corrective measures, there would be “twin deficits”—an external and government deficit of about 6 percent of GDP.

In the third, “dream” scenario, improvement in net export demand is large enough to close the balance of payments deficit and generate sufficient growth with full employment without further fiscal expansion. All three balances converge toward zero over the next 5 years. This outcome could be achieved if the trade-weighted dollar was devalued by 25 percent at the beginning of 2003, if accelerated inflation did not reduce gains in competitiveness, and if world demand and output were not affected by improvement in the U.S. trade balance. Current U.S. consumption in excess of production would have to end in order to eliminate the deficit, and the country would have to cease to be the “importer of last resort.” Moreover, there would have to be active international coordination of trade and capital transactions as well as fiscal and monetary policy.

In sum, personal and corporate debt are both very high relative to income and this makes the economy unusually vulnerable to shocks. The government's fiscal stance as projected by the CBO will not stop unemployment from rising after 2003 unless private indebtedness, already a cause for concern, resumes a rapid rate of growth relative to income. A major relaxation of the fiscal stance after 2003 could generate adequate growth but only at the expense of large and growing balance of payment and budget deficits. Rapid expansion of net export demand could generate adequate growth and eliminate government and private sector deficits, but foreign countries would have to offset the resulting disinflationary shock with expansionary measures of their own. However, neither the institutions nor agreed principles that could carry out coordinated expansionary policies around the globe are presently in existence.

Note: The paper on which this presentation was based was published as *Strategic Prospects and Policies for the U.S. Economy*, Strategic Analysis, June 2002 (coauthored by Alex Izurieta).

Session 1. The State of the U.S. Economy:

A View from the Street

Moderator DAVID LEONHARDT, economics correspondent for the New York Times, noted that there have been two broad surprises in the U.S. economy over the past year and a half. The first was that the economy significantly underperformed relative to the expectations of most economists during the first, second, and third quarters of 2001. The second was that the economy did much better than expected during the fourth quarter of 2001 and first quarter of 2002.

ROBERT BARBERA, executive vice president and chief economist of Hoenig and Company, Inc., noted that in a geopolitically charged environment, personalities matter, and proposed that the basis of an economic forecast should start with that insight. According to Barbera, the U.S. economy currently faces two great challenges—operating without the benefit of outlandish flexible accounting, and operating amid periodic military shocks—as a result of Enron and 9/11. Conservative accounting and the war on terrorism end the ability to produce booming Brave New World growth rates. Barbera expects a modest recovery for the U.S. economy that is aided and abetted by “super-easy money” over the next 12 to 18 months.

In recent years, outlandish flexible accounting inflated reported corporate profits and permitted consumption and investment to boom simultaneously. According to Barbera, as opposed to the notion that Wall Street analysts hoodwinked everyone, there was widespread willingness by the Federal Reserve (Fed), White House, Senate, and Congress to permit this faulty set of accounting. Using two sets of books allowed the Brave New World boom to exist in the late 1990s. Comparing Standard & Poor's (S&P) operating profits and National Income and Product Accounts (NIPA) profits in the GDP accounts from 1997 to the first half of 2000, the former continued to grow rapidly and profit margins to expand, while the latter started to decline and profit margins fell precipitously. The main difference between these two measures of profit is their treatment of options. The NIPA numbers

correctly reported options as an expense, whereas they were not treated as a cost in income statements reported to shareholders. Therefore, operating income grew rapidly. Options contributed a full percentage point to wage and salary income growth (7.5 percent) over the three-year period, leading to a consumer spending boom. Thanks to good profit reports, the stock market rapidly increased and there was a capital spending boom. As spending exceeded production, the trade deficit widened and resulted in a very large external imbalance.

The conservative accounting to be used in the future means that the twin booms in consumption and production will not be reproduced—profits will be less interesting, and wage and salary income will not be boosted artificially. Barbera noted that over the past year, the CBO's outlook for the next decade's federal budget surplus was reduced by \$4 trillion. Initially, the CBO's underlying assumptions included permanent peace, no inflation, and an uninterrupted boom market for equities. However, periodic military incursions will have a negative impact on stock markets, which still have the vestiges of Brave New World price earnings ratios that depended on peace and prosperity.

In the short run, monetary policy can overwhelm valuation and liquidity matters. If secular headwinds kept the federal funds rate easy in the early 1990s, then geopolitical windshear confronting excessive equity market valuation will keep the federal funds rate very low. A soft landing for the slow deconstruction of the Brave New World outlook would be a stock market that struggles and goes sideways with super-easy money and an earnings pattern that slowly grows into those stock prices.

RICHARD BERNER, managing director and chief U.S. economist with Morgan Stanley Dean Witter, also forecast an economic recovery but outlined a number of challenges: profits and leverage (both financial and operating), restrictive financial conditions requiring easy money, current account deficits, and the bubble mentality (pertaining more to real estate than equities). Factors currently propelling the economic recovery include monetary and fiscal stimulus, an end to corporate cost-cutting, and a rebound in profitability (a leading indicator). However, profits reported to the IRS will be depressed by recent fiscal stimulus changes in the tax law that allow corporations to accelerate depreciation. As a result, the very healthy revival in profits seen this year will be significantly lower in

2003, even with a fairly robust economy. Thus, valuation, rather than earnings, is the stock market's problem.

Margins and the return on invested capital peaked in 1997. Since then, the latter has declined very sharply, notably in technology, which reached negative proportions. There was a buildup of operating leverage as a share of total business costs as corporations invested very heavily and improved productivity. This, however, came with a price tag: fixed costs relative to total costs were raised through higher depreciation and interest expense. A subsequent slowing in growth squeezed margins and triggered intense cost-cutting both in capital spending and in labor force payrolls, which produced the recession.

Financial leverage is also high by traditional measures. Corporate America is benefiting from tax cuts that support profitability, economic recovery, and capital spending. The personal sector financing gap (the difference between internally generated funds on a book basis and total capital spending investment as measured in the Federal Reserve Flow of Funds accounts) had widened dramatically but is now shrinking as a result of cutbacks in capital spending and declining prices of capital goods. Better price performance for capital goods could help to finance the revival of capital spending but financial leverage has led to highly restrictive financial conditions—a credit crunch. There may be a sharp decline in the demand for short-term credit when companies massively liquidate inventories. However, the U.S. banking system is healthy and able to finance a recovery. A comparison of bank spreads and treasury debt suggests that the market sees very little solvency risk in U.S. banks but much in the nation's telecommunications companies. A dozen debtors account for virtually all of the widening in average credit spreads. However, financing costs have started to decline as perceptions about credit quality improve and profitability rebounds, spurring both information technology and overall capital spending (but at only 60 percent of 1990's pace).

The current account gap, which has narrowed only slightly during the recession, will eventually be reduced by a combination of slower U.S. growth relative to the rest of the world, a big change in relative prices, or a change in the exchange rate, but the adjustment process will take time. The synchronous global recession will likely see a synchronous

global rebound. A decoupling of relatively cheaper markets abroad should lead to capital flows into those markets and a decline in the dollar.

The housing bubble is not a worry, says Berner, because favorable demographics such as immigration will continue to support housing demand, there is little inventory overhang in new construction, and no supply or land use constraints exist. Moreover, recovery dynamics in 2002 and 2003 predict a recovery in jobs and income, which supports consumer spending, profits, and capital spending.

MICKEY D. LEVY, chief economist for the Bank of America, agreed that the economic recovery was unfolding and noted that both monetarists and Keynesians would claim victory. From the monetarists' perspective, the economic response was a textbook example—the Fed pumped in monetary growth as interest rates came down, the yield curve steepened, the demand for money went up, velocity came down, and nominal GDP growth decelerated. As interest rates stabilized, velocity went up and the economy accelerated. Keynesians, on the other hand, could say that last year's tax relief was the "Worker Assistance Act of 2002," resulting in economic growth. Both perspectives indicate stimulation of the economy.

Levy pointed out that it was much more important to look at underlying spending and tax structures than changes in budget deficits or surpluses when measuring the effect of the fiscal stance on resource allocation and incentives. He noted that the CBO changed its potential growth projections in an ex-post, ad hoc way so that the gap or structural deficit explained what was happening. This approach, however, is not very helpful in forecasting. Rather than the cyclical behavior of monetary fiscal policy, Levy emphasized the strong structure of the U.S. economy—low inflation, low inflationary expectations, relatively low unit labor costs of production, very efficient capital markets and international capital flows, and an overly capitalized banking system. U.S. production processes, labor markets, and prices are extraordinarily flexible and there are pro-growth economic policies as well as credible policymakers, which together mitigate the impact of shocks on the real economy. The adjustment processes work; the underlying structure of the economy is very sound. Although there is currently a large inventory adjustment, there will be sustained growth in consumption

and demand. Therefore, Levy forecast a healthy, if not strong, rebound in the economy.

Levy noted that the recession followed a typical pattern except for one aberration: consumption did not decline. Since real consumption exploded during the initial stages of recovery following the past three recessions, the risk now is not that consumption will fall, but rather that consumer spending will rise and accelerate modestly. Consumption always leads employment and, according to internal Federal Reserve calculations, most of the growth in consumer indebtedness was in the highest and lowest quintiles of income. Prior models predicting consumer indebtedness overestimated defaults since consumer credit quality proved better than expected. Therefore, consumer spending should continue to rise and accelerate modestly.

In terms of fiscal policy, Levy's view was that last year's tax rebates were really advances on retroactive cuts in marginal rates rather than a fiscal stimulus. The public's sense that they were temporary means that the funds were probably saved rather than spent. This year's \$70 billion tax relief came through lower withholding schedules; these imply a sense of permanence and any refunds, therefore, would likely be spent, leading to an acceleration in nominal spending growth. The extra \$40 billion in emergency relief and national security authorized by Congress in late September is a government purchase that goes directly into GDP. Levy's belief that it was not enough was confirmed when Bush recently requested an additional \$48 billion in the federal budget.

Defense spending as a percentage of GDP is expected to rise for the next couple of years. It will add over a percentage point to GDP (about \$100 billion) over the next 12 to 18 months and will eventually crowd out other types of spending. After the Fed raises interest rates and nominal GDP growth stabilizes, private consumption and private investment growth are expected to become more constrained.

ANTHONY M. SANTOMERO

The current U.S. economic recession, according to Anthony M. Santomero, president of the Federal Reserve Bank of Philadelphia, is unique in terms of its extent and magnitude, and unusual in light of the number of negative shocks that affected the economy over a short period of time. The shocks

included a stock market contraction, the bursting of the tech bubble, 9/11, Enron and the ensuing debate over corporate governance, the financial crisis in Argentina, erratic oil prices, increasing unrest in the Middle East, and a global economic downturn. Nevertheless, the recession was one of the mildest on record.

Santomero outlined four factors that moderated the recession and made the economy resilient: the exceptionally timed stimulative policy mix, the increased responsiveness and capacity of the financial markets, the increased flexibility and productivity of businesses, and greater consumer confidence. He noted that the 475-basis-point reduction in interest rates in 11 different actions in 2001 was a typical Fed response during this business cycle. Moreover, he asserted, nothing fundamental had changed in the Fed's approach to monetary policy during the last year. Meanwhile, fiscal policy added extra stimulus by accelerating government spending (the most rapid increase in more than four decades) and cutting taxes. The swing in the federal budget from a large surplus to virtually nothing indicates the robustness of the government policy response. This response came in several stages, including a 10-year tax reduction program with cash rebates for individual taxpayers, federal spending in reaction to 9/11, extending unemployment benefits, and providing a tax incentive for business fixed investment. These measures were perfectly timed as countercyclical policy actions and helped to prevent a protracted recession.

The financial sector was also effective in insulating the economy. Banks entered the recession with strong balance sheets and well-positioned capital and therefore were able to lend during the early stages of the recovery. Moreover, diversification policies and strategic distribution of risks combined with alternative supplies of credit allowed them to continue to lend during the downturn. Spending for housing and consumer durables was sustained as long-term interest rates fell relatively early in the cycle. Furthermore, price responses to expectations of policy actions and subsequent economic activity helped market interest rates cushion the economic effects of the downturn. In this business cycle, fixed income markets responded to, and anticipated, the softening economy and the Fed's countercyclical measures. Short-term interest rates moved with monetary policy

actions, and long-term and foreign exchange rates moved as a direct result of the effects of the predicated policy response. Thus, the Fed's increased transparency allowed their policy actions to ripple through the economy since the financial markets had a clear and accurate expectation about the future direction of monetary policy.

This recession has been labeled a business recession because the collapse of business and investment spending was the catalyst to the early stages of the downturn. Developments in the nonfinancial sector, such as the bursting of the tech bubble and overcapacity in the telecommunications sector, resulted in plummeting general business spending when the economy decelerated. Businesses slashed inventories, drove down industrial production and employment, and amplified the impact of the recession on the manufacturing sector. However, these prompt actions may have helped to prevent a deeper and more prolonged recession by inciting businesses to cut prices, offer discounts, and move merchandise, which enhanced consumer spending. Moreover, businesses' ability to respond quickly was made possible by previous investments in new technology, allowing them to continue to improve productivity throughout the downturn (an unusual occurrence by historical standards).

The shallowness of the recession was a direct result of continued consumer spending sparked by confidence in price stability and economic growth. As the recession turns to recovery, consumer incentives to increase spending will come from rising incomes and better job opportunities rather than reduced interest rates and price discounts. Consumers have little pent-up demand and a fair amount of debt; therefore, only a modest recovery is forecast.

The current recession's moderating factors include the stimulative policy mix, the response of financial markets, the flexible business sector, and the confident consumer sector. Monetary policy will continue to be the dominant discretionary stabilization tool in the future. Future recessions will be milder, the result of permanent changes in the private sector economy (rather than changes in public policy). The financial sector, which is more effective than usual in the current recession, is likely to become a permanent feature in the modern economy as risk management systems remain relevant in the years ahead. The business sector's rapid

response to production and price cuts in light of a decline in final sales is a double-edged sword that is likely to remain. Technological progress with the support of good stabilization policies has given the economy the capacity for stronger, steadier economic growth. Currently, the public seems confident that this capacity will be realized. The challenge for the Fed is to provide a policy that is demonstrably supportive rather than disruptive to the market economy's adjustment processes. When the economy gains momentum, the Fed will have to shift from stimulating a recovery to a more neutral stance geared toward sustaining a long-term expansion.

Session 2. Macroeconomic Issues in the Recovery

At the outset, moderator LAURENCE H. MEYER from the Center for Strategic and International Studies noted what appears to be a very significant rebound in GDP for the first quarter of 2002, but significantly less momentum heading into the second quarter. As a result, he said, the strength of the overall recovery is questionable. Two main cross-current themes are the post-bubble hangover and well-maintained productivity numbers. The equity market correction and its negative wealth effect are restraining the economy from normal expansion, as are a dampening of consumer spending and the capital overhang. Moreover, financial conditions are not as accommodative as expected, as reflected by the equity price correction due to dollar appreciation during a period when it was expected to depreciate. On the other hand, productivity numbers relating to the pace of innovation and income growth over time support both consumer confidence and capital spending. Meyer also noted that we have been in an environment of disinflation over the past 20–25 years but are now close to the long-run inflation objective and therefore, in a maintenance rather than a disinflation program. What happens if inflation falls below the long-term objective, and how does the unusually low peak unemployment rate at the beginning of an expansion period affect the economic outlook and monetary policy?

LAKSHMAN ACHUTHAN, managing director of the Economic Cycle Research Institute, first noted that the National Bureau of Economic Research defines a recession as a significant decline in output, income, employment, and trade (as opposed to two consecutive quarters of negative GDP). He proceeded to compare the current downturn to

the previous seven in terms of how pronounced, persistent, and pervasive it was. Although the current decline is the shallowest and shortest on record, it is comparable to the 1980 recession in terms of duration. Industrial production, however, showed the fourth largest, and longest, decline. This recession's employment rate declined the least of the seven, but was close to those of 1969–70 and 1980. In addition, the decline in nonfarm payrolls exceeded that of all but the previous two recessions. Therefore, major indicators that define the state of the U.S. economy show that it was very firmly in a recessionary episode.

The most recent recession was not unique, Achuthan noted. Although the decline in manufacturing and trade sales was (by a narrow margin) the smallest of the seven, its persistence matched or exceeded that of three previous recessions. In terms of income, it is not unusual to have recessions with no cyclical declines. The pervasive loss of jobs was completely in line with the last three recessions. These overall comparisons show that the most recent economic slowdown was a classic, cyclical recession.

The fourth quarter, however, was an anomaly. GDP was positive because of post-9/11 factors, such as very aggressive rate cuts that allowed for 0 percent financing (on auto-related sales) and increased government spending. These each accounted for more than the rise in fourth quarter GDP. Therefore, absent these aggressive policy responses, fourth quarter GDP would likely have been negative.

The sequence of events, as described by the long leading, coincident, and lagging indices, was consistent with a cyclical downturn. The long leading index turned down ahead of the recession, the coincident index followed that downturn, and the lagging index confirmed the existence of a cyclical event and a recession. If we believe this was anything less, then we are likely to underestimate the risk of recessions in the future and continue to believe that the business cycle has been completely tamed, which is not true. The long leading index now suggests that there will be a durable, sustainable recovery through the end of 2002.

JAMES E. GLASSMAN, senior economist and managing director, J. P. Morgan & Company, expected the Fed to be a little less aggressive in response to expansions because over the past 20 years, it has worked to bring inflation down and now seeks to maintain the current zone. The combination of

Fed and fiscal policy is a potent mix and this, combined with an unusual inventory situation, suggests that something is about to happen.

For all the turmoil that has adversely affected the markets over the past year, there is deep-seated optimism underpinning the stock and currency markets in spite of a large current account deficit and a strong dollar. Recovery prospects are exceptional, fiscal policy changes are highly stimulative, and inventories have been drawn down at a record pace. Foreign investors believe there is something going on here. Moreover, as reflected in real bond yields, bond investors are quite optimistic about what is happening. Fed policy is highly stimulative, as demonstrated by short-term interest rates well below market rates and real interest rates close to zero. This is a key factor in helping to stabilize the economy. Combined with fiscal policy changes that rival Reagan's tax cuts and defense spending in the early 1980s, and an inventory depletion rate far below the final sales growth rate, said Glassman, there will be a decent recovery with above-trend growth over the coming years.

A slowdown in the pace of liquidation and an expected return toward growth of final sales will remove a huge drag from the economy. (However, the normal inventory sales level is not really known.) Capital spending, a key weakness last year, will also contribute to higher overall growth relative to 2001. In addition, profits are turning less negative—down 35 percent in the third quarter, 25 percent in the fourth, and 11 percent in the first quarter of 2002. Seasonally adjusted, this trend signals that something positive is unfolding, something not recognized by "The Street." There has been a very positive turn on the profit side, with the exception of a rise in hiring (which happens much later). When the pace of hiring picks up, the Fed will begin to withdraw from its accommodative stance. Rising interest rates are expected later in the summer.

Most investors and the public are not worried about inflation and do not think it will move lower. However, near-term disinflationary forces are at work in the economy. There may be a further small decline in inflation depending on the level of excess capacity. Economists tend to disagree about the level of full employment and the noninflationary level of unemployment, which appeared to be lower than expected as recently as the mid 1990s. (This may have been the result of favorable supply shocks and a strong dollar, or perhaps the

emergence of China. Both China and Japan are exporting their deflation, a situation that will continue as Asia and its emerging economies are integrated into the global community. This may help inflation in the United States.) It is unclear at this point whether the unemployment rate of the past decade has moved below the long-run natural rate. Since there is still some slack in the labor markets, cost pressures will decline. Therefore, unemployment at 5 percent or slightly lower is not much of a threat.

The level of investment relative to GDP was very high in the 1990s but was not based on unrealistic expectations since there was a real payoff in terms of productivity growth and technology. The most important story in our time, said Glassman, is what has happened to inflation. The Fed has room to be more accommodative, a stance that would enhance the efficiency of the U.S. economy and contribute to our good performance. Therefore, there may be another decade ahead of solid noninflationary growth.

In terms of the near-term outlook, CHRIS VARVARES, president of Macroeconomic Advisers, LLC, agreed that the recession was over and that we are currently undergoing a recovery. Inventory investment has contributed 2.5 percentage points to GDP growth so far this year (but is expected to slacken) and consumer confidence has rebounded following the events of 9/11. Consumption and capital spending growth, he thinks, will be sufficient to maintain final sales growth this year. However, a major concern is the sustainability of final sales growth, which has temporarily benefited from the weather, energy prices, 0 percent financing, tax cuts, and monetary ease. Varvares noted that, given little pent-up demand, potential drags on final sales (a weaker housing sector), a strong dollar and growing U.S. trade deficit, a reduction in federal spending, and adverse wealth effects, it was unclear whether the current trend would result in a new growth profile or return to a flat trend. Although higher federal spending is included in his forecasts, the potential remains for inadequate federal spending increases in 2003 followed by spending reductions thereafter. Therefore, the key to a sustainable recovery is a revival of capital spending in the second half of the year, along with continuing strong consumption and housing activity.

Productivity and profitability are expected to continue to surge during the first half of 2002, and then slow for the

next couple of years. Near-term forces for disinflation include a sharp, cyclical deceleration of unit labor costs (expected to decline another 4 percent in the first quarter of this year) and the effects of a strong dollar and a drop in energy prices last year on core inflation. In the period between late 1999 and early 2000, capital deepening contributed up to 2 percentage points to structural productivity growth. The subsequent slowdown in investment and capital stock growth is expected to take a full percentage point out of structural productivity growth. This decline has been offset by an acceleration in total factor productivity growth, which played little part in the structural productivity acceleration of the second half of the 1990s as a result of capital deepening. Therefore, Varvares forecasts an increase of just under half a percentage point in structural productivity growth.

Varvares forecast a short-term resumption of above-trend growth with the slack in the economy being absorbed very quickly. This growth rate would encourage reversal of the Fed's monetary policy by June. Unemployment is assumed to peak not much above the nonaccelerating inflation rate of unemployment (NAIRU), which he estimates to be 5.4 percent. The downside risk to the forecast is that there will be less than expected capital spending and business investment, and rising energy prices. The upside risk is that federal spending will be higher in 2003 and inventory investment will be higher than expected.

A rise in the use of market mechanisms to allocate resources, combined with globalization and deregulation, has allowed the United States to absorb shocks to its economy, which has become more flexible. Globalization has allowed specialization and the benefits of comparative advantage. Today's trend, therefore, is toward shorter, shallower recessions. In addition, sensitivity of the markets to changes in the economy has grown exponentially.

GARY H. STERN

According to Gary H. Stern, president of the Federal Reserve Bank of Minneapolis, uncertainty has significant implications for economic policy. As a monetary policy maker, he would like anticipatory policy to head off prospective economic problems and contribute to stability. However, long policy lags are synonymous with uncertainty, as forecasts are

often incorrect. Annual real GDP growth rates of 6 percent in the second half of 1999 and 4 percent in the first half of 2000 were far in excess of virtually every forecast. This period was followed by a slowing in the growth rate to about 1.5 percent annually, which was more dramatic and broadly based than anticipated. Similarly, modest expansion in the fourth quarter of 2001 was far better than expected. No one has a good record of forecasting the short-term performance of the U.S. economy. Therefore, in the face of substantial uncertainty, policy action should be modest and infrequent so that at worst, it is not destabilizing.

Over the past 20 years, the U.S. economy has been terrifically resilient, absorbing a number of shocks along the way—the 1987 stock market crash; financial crises in Latin America, Asia, and Russia; downsizing of the defense industry in the wake of the collapse of the Soviet Union; and the virtual demise of the savings and loan industry. Despite the litany of problems, economic growth proceeded. On average, surprises in the economy were largely on the upside, which, since they were accompanied by persistently low inflation, were easy to take.

Although forecasters estimate growth of at least 4 percent in the first quarter of this year, the business community remains cautious about the economy and its prospects. This divergence of views is speculated to be the result of businesses still adjusting to a low-inflation environment in which price increases to improve profits cannot be sustained. Rather, cost containment or outright cost reduction is critical to improving profitability.

Inflation is another challenge to short-term forecasters and monetary policy makers because it is a phenomenon only in the long run (5 to 10+ years). Variations of the Phillips Curve, usually involving the NAIRU, are based on the notion that unemployment is a reasonable proxy for labor market pressure, which ultimately translates into inflation. Significant upward pressure on wages, compensation, and unit labor costs is expected when actual unemployment drops below the NAIRU. However, in practice, the NAIRU models do not work well. Federal Reserve research suggests that unemployment has not contributed significantly to forecasts of inflation since 1984. Moreover, Phillips Curve NAIRU models did no better at forecasting inflation than a simple one that assumed one year's inflation rate equal to the

next. Forecasters have generally overpredicted the pace of inflation since the mid 1990s.

These circumstances exacerbate the degree of uncertainty and suggest taking a cautious monetary policy response to changes in forecasts. From about 1996 through 2000, there was, at most, minor tightening of monetary policy in spite of the fact that the economy was in its sixth year of expansion (by 1996) and the unemployment rate had dropped below 5 percent (by 1997) and continued to decline through 2000. At the time, the NAIRU estimates were in excess of 5 percent and as high as 6 percent.

Reservations about a persistent cautious policy prescription include the fact that caution runs counter to the desire to be preemptive, and it risks an inadequate response to a serious problem. These reservations, however, are not yet cause for concern. Much of the time, excesses in the economy self-correct; policy rarely has to try to save the day. Because of the fundamental soundness and strength of the U.S. economy, it is important, in most circumstances, that policy be approximately, rather than precisely, correct. The cost of overreacting is probably at least as great as the cost of proceeding with caution.

Dollarization: A Dead End

ALEX IZURIETA

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“Dollarization,” or the substitution of the U.S. dollar for a nation’s own currency, is seen as an option for developing countries following successive failures of exchange rate and monetary management. However, once exchange rate and monetary instruments have been set aside, do other policy options remain?

In this working paper, Research Fellow Alex Izurieta explores a country’s ability to undertake its own fiscal policies after dollarization of its economy. Using a simplified two-country closed model, he devises an analytical framework to emulate a dollarized economy in an inherently consistent accounting framework. By introducing an exogenous shock to this hypothetical economy, he investigates the extent to which remaining fiscal policy options allow it to adjust and finds that these options are inadequate to guard the financial

stability of the economic system. Policymakers are left with fewer financial sources, and the adverse effects of the shock on income and employment are exacerbated.

The study begins with the development of a theoretical, axiomatic stock-flow model that simplifies the complex process of economic adjustment by real-world countries facing real shocks. The model comprises two countries, North and South, which share the dollar issued by a sole central bank. The national product of each country is either consumed by government and households or traded. Aside from interest payments on government bonds, there are no other transfers. Government revenues consist of taxes paid out by households, who also earn interest on government bonds. The central bank issues dollars against bills disbursed by the government. Moreover, the central bank does not earn operating surpluses, and enterprises spend all of their receipts from sales. Thus, changes in assets and liabilities only take place between households and governments.

According to this simplified model, financial choices open to households in each country are changes in dollar balances and net acquisitions of perpetuity bonds. The total changes of bills (central bank assets and government debt) match total changes of money held by households (central bank liability against household wealth). Financial balance sheets represent the stock accumulation of flows plus holding gains due to changes in the price of government bonds outstanding at the beginning of the period. Thus, households’ wealth includes the stock of money and government bonds at current prices, while government debt is equal to the stock of bonds and treasury bills. The central bank balances the system by equaling money with bills.

Izurieta assumes that an expanded pool of countries outside his simplified model would not invalidate the proposition that disparities internal to the dollarized pool would tend to be perpetuated. Moreover, omitting commercial banks so that financing takes place directly among households, firms, governments, and the common central bank makes the stock-flow process more transparent, avoids other possible sources of instability, and allows focus on the consequences of fiscal imbalances. In addition, available sources of financing for current account and fiscal deficits are limited to borrowing from households; other options are seen to represent misleading or temporary solutions. The simplified set of options

used in this study serves to highlight the underlying structural problem. Other assumptions include the absence of relative price changes (which eventually become uniform in a common currency setting), the existence of excess capacity (to allow the demand multiplier to work effectively), and a steady-state baseline (to eradicate trade imbalances).

The use of perpetuity bonds allows the demand for money to be expressed as a residual after wealth is allocated to bonds, or as a fixed proportion of wealth. Critical to the model's solution is determining the amount of government treasury bills that can be accepted by the central bank (and recognizing that these cannot be negative, as the government does not loan to the central bank). In a dollarized regime, the central bank will not lend to governments beyond what households are prepared to hold as money (which is proportional to wealth). Since there is a limit to the extent to which governments can borrow from the central bank, they have to satisfy additional borrowing requirements by supplying bonds at attractive interest rates, which implies higher costs in the future and leads to instability. This is the core of the adjustment process in the model after an exogenous shock. The price of bonds is fixed in North and is allowed to fluctuate according to demand and supply in South. The final relevant characteristic of the model is that money supply cannot be different than money demand.

Izurieta first solves the model to verify its internal consistency and obtain a steady-state baseline. Data sets for the two economies match two conditions: consistent accounting structures and similar economies without anomalies such as high debt burdens. An exogenous shock to South is then inflicted by changing the import propensity from North, thus producing a trade and fiscal imbalance by lowering national income and eroding tax receipts in South. The implications of this shock are explored under two alternative scenarios. The first assumes fiscal self-determination, where government spending and tax rates are determined by policymakers and the model solves for the public sector borrowing requirement as a result of a lack of tax revenues. The second tightens the fiscal stance and balances the public sector while the model outlines the pace of convergence toward a current account balance and the effect on aggregate income and employment.

Under the first scenario, the South government initially draws bills from the central bank to finance the deficit and

then sells bonds in its domestic and "world" (North) markets at ever-increasing interest rates. After a relatively stable period, both the current account and public sector deficits start to explode as bond interest rates in South increase rapidly compared to those in North. The model yields an inherently unstable solution, as interest rates rise indefinitely.

Under the second scenario, policymakers set automatic controls by contracting spending or raising tax rates to facilitate a zero deficit. This tight rein on the public sector combined with net interest payments abroad weakens demand and the national incomes of both countries. The strain on the fiscal stance as a policy response to the external shock is recessionary since the external shock affects the balance of payments and leads to both lower national incomes and tax revenues. Although the initial drop in exports from South is compensated for by lower imports so that the current account imbalance disappears over time, the adjustment of spending (imports and exports) in both countries lowers aggregate demand and income and raises unemployment. Thus, tightening the fiscal stance in one country causes aggregate income of the system as a whole to deteriorate dramatically. South experiences a more drastic recession since North's import propensity affected its revenues in the first place. Izurieta's analysis shows that the impact on North and its subsequent feedback on South depends as much on the size of the multiplier as on the application of restrictive fiscal policies.

In conclusion, when exchange rate and monetary policies are dismantled, fiscal policy is no longer a tool with which to guard the financial stability of the system. This deprives policymakers of available policies to generate income and protect employment. Thus, irreversible dollarization is a dead end. Izurieta does not expect that more complex analytical frameworks would reverse the conclusions reached in his paper.

CRA's 25th Anniversary: The Past, Present, and Future

KENNETH H. THOMAS

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The Community Reinvestment Act (CRA) was enacted in 1977 to provide access to credit for the most needy low- and moderate-income (LMI) individuals. This lending safety net

was designed to balance the interests of regulators, banks and thrifts, and community groups (the CRA Triangle). Since its inception, the CRA has undergone a number of revisions in structure and mandate, with reactions from proponents and critics alike. In this working paper, Kenneth H. Thomas, lecturer in finance at the Wharton School of the University of Pennsylvania, evaluates past, present, and future CRA rules and regulations and recommends optimal reforms balancing consumer and industry interests. His reforms include a return to a focus on LMI lending, a reduction of grade inflation by regulators, expansion of the laws to include credit unions, and streamlining of institutional testing.

The CRA encourages federally insured banks and thrifts to meet the needs of communities, consistent with safe banking practices. Congress directs regulators—the Fed, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS)—to periodically assess banks and thrifts on their record of meeting community credit needs (a consideration when acting on deposit facility branch or other expansion applications). In the ideal model of the CRA Triangle, regulators act as impartial referees between community groups and banks, attempting to fashion a “socially optimal” result benefiting both parties. According to Thomas, continuous conflict and cooperation among the players creates dynamic tension and keeps the triangle strong, but such relationships have not always been equal.

In the first dozen years, the CRA and its ratings were not taken seriously and its powers were limited. A change in the congressional climate in the midst of the Savings and Loan scandal revived CRA interest. Beginning in June 1990 a bank’s CRA rating and a portion of its exam were made public. These disclosures afforded researchers an opportunity to study how examiners evaluated and graded banks. They discovered a high level of grade inflation. Regulators responded by compressing their ratings system and simplifying their data so that the vast majority of banks fell into the “satisfactory” range. Subsequent amendments by pro-CRA congressional Democrats requiring better documentation in the public performance evaluation process strengthened the Act.

These new disclosure requirements led banks and thrifts to take the CRA seriously. Cases of lending bias and “redlining” (the practice of geographic discrimination in granting

credit to qualified applicants) supported calls for a stronger CRA and agents such as community development banks. Both industry and community groups complained about overly subjective CRA exams and ratings emphasizing documentation and process over lending performance. President Clinton initiated the first major reform of CRA in 1993, followed by three different versions resulting from conflicts between the community and industry and among regulators. According to Thomas, the banking lobby, with the strategic help of the Fed, won most of the reform battles in the adoption of the “new” CRA regulations in May 1995. The most important change was a more performance-based exam and rating system, which included four tests based on an institution’s size and business strategy, and an overall rating based on lending (50 percent), investment (25 percent), and service (25 percent) tests of large retail banks (\$250 million or more in assets or affiliated with a \$1 billion or more holding company). Each institution was evaluated relative to its “performance context,” which included such factors as business strategy and constraints and community needs and opportunities. As a result, LMI lending was reduced to 50 percent of the total rating. There were few suitable CRA investments so Wall Street created a CRA investment industry (which did little to help LMI individuals) and the investment and service tests became a key source of grade inflation. Fully 71 percent of investment test ratings were inflated by one grade (compared to 32 percent and 29 percent for the lending and service tests). The 1990s saw an increase in bank consolidations and a subsequent major cutback in CRA exams.

According to Thomas, bankers (including regulators and congressmen opposed to the law regardless of its costs and benefits) perpetrated a number of CRA urban legends. Contrary to the charges that CRA did not work and such loans were unprofitable, it has had a favorable impact on LMI home lending and financial returns. LMI borrowers’ conventional home purchase loans jumped from 14 percent in 1990 to 25 percent in 2000 and they were less likely to prepay or refinance when interest rates dropped. Securitized CRA loans now represent a major sector of the secondary financial markets. Another urban legend is that the CRA’s main benefactors are minorities. In fact, 60 percent of LMI individuals are non-Hispanic whites. Although CRA compliance is often claimed to be very costly to banks, it incurs

only modestly higher costs, which public policy should seek to improve. According to a CRA loan profitability study by the Fed, CRA-related home purchases and refinancing activities were at least marginally profitable for most financial institutions.

Despite passage of a CRA “sunshine” provision requiring community groups to disclose funding sources (including banks), regulators made only limited data available. A series of Freedom of Information Act requests by Thomas to individual regulators showed that several prominent community groups received sizable funds from large banks. However, community groups and the nation’s most vocal CRA alliance, the National Community Reinvestment Coalition, do not have to report agreements or grants received from non-covered affiliates of other for-profit firms supplying CRA services or products to banks. Nor must they list their contributors in IRS filings. Thomas contends that all funding sources should be disclosed in order to illuminate the nature of the relationships within the CRA Triangle and improve CRA public policy.

One of CRA’s main attributes is that it is periodically reformed to keep it responsive to the current needs of both communities and banks. However, test infrastructure at the Fed and some large banks serves as a motivating force for them to maintain the status quo. Moreover, community

groups defend the nonlending tests and have significant financial incentives to maintain the investment test, as do Wall Street CRA profiteers. These factors, combined with grade inflation and LMI dilution, suggest that good public policy should reduce the investment and service tests to individual performance evaluation factors under the lending test as long as they are LMI credit-related. A new lending test, says Thomas, should count for all rather than half the overall CRA rating. Large banks with extensive CRA investments and services would continue to garner credit under a streamlined large bank exam and community groups to receive grants from banks. Moreover, doubling the minimum allowable size under which banks can qualify for the streamlined exam would represent significant time and cost savings.

Community groups requesting a race-based CRA could jeopardize the future of this needs-based law, lessen its public policy benefits, and reduce its strong bipartisan support. Thomas recommends that the assessment areas for banks and thrifts maintain the status quo rather than establish a new regulatory framework based on a few special circumstances. Furthermore, additional streamlining could come from eliminating the ill-conceived strategic plan option. In light of a perceived breakdown in the CRA Triangle, the OTS should merge into the OCC. Moreover, it may be time to consolidate the compliance functions of all four regulators.

Program: Federal Budget Policy

State Policies and the Warranted Growth Rate

JAMEE K. MOUDUD

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Rethinking the theory of economic fluctuations, Harrod formulated a dynamic equilibrium for income—the warranted rate of growth—to complement Keynes’s static equilibrium. This is the rate of growth produced by the rate of investment chosen by entrepreneurs, which is warranted in the sense of maintaining a rate of expansion of effective

demand consistent with entrepreneurial expectations and individuals’ autonomous decisions to save. Research Associate Jamee K. Moudud extends Harrod’s work by investigating the effects of tax and expenditure policies on the warranted growth rate and proposing two mechanisms to raise the rate when there is long-run unemployment: tax rate increases accompanied by an increase in aggregate government spending; and capacity-augmenting investment increases by state enterprises. Moudud discusses the role of the social saving rate (private plus government saving to GDP), explains why it regulates and has a positive effect on

the warranted growth rate, and shows that its role does not imply the pursuit of fiscal austerity policies.

In contrast to Keynes-Kalecki and neoclassical perspectives, Moudud uses the Harrod-Domar approach to provide an alternative way to model fiscal policy. Harrod-Domar recognized the capacity-creating effect of investment (it responds endogenously to eliminate discrepancies between actual and potential output), that growth is endogenous, that the multiplier relationship is short-run, and that the economy grows along the warranted path at the normal rate of capacity utilization in the long run. Policy analysis, therefore, revolves around a short-run cycle where the actual growth rate fluctuates around the warranted growth rate, and a long-run cycle where the warranted growth rate fluctuates around the natural growth rate (growth rate of the labor force plus the growth rate of productivity). Harrod's main concerns are the relationship among the actual, warranted, and natural growth rates; and the central paradox of expansionary fiscal policies—that measures influencing actual growth rates have the opposite effect on warranted growth rates.

An important problem following Harrod's formalization of the warranted growth path framework related to the existence of adjustment mechanisms to bring the natural rate closer to the warranted rate so that the economy could grow at full employment. Moudud's working paper proposes two policy mechanisms to satisfy the equality that the taxation-adjusted social saving rate divided by the capital-capacity ratio equals the natural growth rate. Convergence to the full employment growth path requires modulations of the saving and investment ratios by appropriate policies.

Moudud analyzes taxation policy (type of government spending) and public investment policy (composition of government spending) under the assumption that the warranted growth rate is stable and less than the natural growth rate. Under the simplest taxation policy scenario wherein capitalist households and the government save and the only tax category applies to capitalist households, a higher tax rate on capitalist income is shown to benefit growth—capitalist saving is reduced but public saving is raised by a greater amount. More elaborate tax functions show that any tax rate increase will raise the social saving and warranted growth rates, while increasing the government spending ratio has the opposite effect. A surprising implication, says Moudud, is that all tax

rates affect growth equally. These results suggest that there may be an optimal tax and spending policy where an increase in government spending is accompanied by a greater increase in tax rates. Increasing the social saving rate would also raise the warranted growth rate (and reduce the budget deficit).

Moudud's tax function can incorporate an appropriate tax policy mix, including a cut in profits taxes, which is consistent with an increase in the social saving rate, government spending ratio, and warranted growth rate. He notes that policymakers would benefit from separate indirect tax rates on capitalist household and working class consumption. Moreover, further manipulations of the tax rates could increase the government's spending-to-output ratio with a higher warranted growth rate. These policy outcomes, says Moudud, do not have to involve a trade-off between long-run economic growth and increased government expenditures on social spending. They can also be consistent with a falling budget deficit ratio and the national debt-to-GDP ratio.

Moudud wonders how to reconcile the unimportance of public investment within Keynes's multiplier framework, with its importance in regulating long-run output and employment, in light of Harrod's work showing that public investment actually lowers the warranted growth rate. He divides public investment into two components—autonomous public investment and induced investment by public sector firms—and proposes a public sector investment function where total government spending is comprised of public consumption, and autonomous and induced public investment. A relative decline in public consumption or autonomous investment entails an increase in induced investment, which raises the warranted growth rate. This policy does not augment demand but consists of a compositional change in government spending.

The conventional scenario (no split between current and capital budgets, increases in indirect or wage taxes, and possible cuts in business taxes) shows that a higher aggregate tax rate enables the government spending ratio to increase so that the higher warranted growth rate produces lower budget deficits and national debt ratios. The unconventional scenario (splitting current and capital budgets, expanding investment by public sector firms to supplement private investment, increasing the tax rate on profits), which goes

against neoliberal stabilization policies, provides policymakers with an additional tool to raise the warranted growth rate toward the natural rate when private investment is insufficient.

A policy stance separating a government's budget into current and capital accounts has never been implemented, notes Moudud. Rather, fixed budget deficits or balanced budget targets combined with some elements of exogenously fixed spending imply that a country has relatively little flexibility under current government policies, leading to austerity measures such as reducing public investment or cutting discretionary public expenditures. Moreover, Harrod's central paradox raises questions about expansionary fiscal policies

based on the multiplier and suggests that future research gauge the length of the short run empirically (how long are firms willing to ignore discrepancies between capacity and demand?) to allow policymakers to pursue traditional Keynesian expansionary policies.

The current debate on fiscal policy assumes either full employment or excess capacity in the long run. This working paper pursues a more conventional way of modeling the long run where unemployment coexists with a normal rate of capacity utilization. Moudud concludes that a broad-based policy program should allow for both excess and normal capacity and be adaptable to different circumstances.

Explorations in Theory and Empirical Analysis

A Note on the Hicksian Concept of Income

AJIT ZACHARIAS

Working Paper No. 342, February 2002

www.levy.org/docs/wrkpap/papers/342.html

The Haig-Simons-Hicks (HSH) concept of income is the maximum amount that can be consumed in a given period of time while keeping real wealth unchanged. This concept is the theoretical basis for defining personal and national income used by most government agencies and economists today.

Research Fellow Ajit Zacharias takes exception to the notion that ex post definitions of income effectively incorporate Hicks's concept of income. In his analysis, Zacharias notes that Hicks considered only subjective definitions of income theoretically meaningful. Moreover, Hicks's aim was to develop a theory of economic dynamics without using the concept of income (or related categories such as saving, investment, or depreciation), which he considered theoretically vacuous.

Zacharias evaluates Hicks's three approximations of the central meaning of income in relation to the conventional HSH concept. These successively take into account changes in expected interest rates and prices, and allow ex ante measurement of income but, according to Zacharias, do not effectively

permit ex post measurement of income because personal expectations cannot be observed from market transactions.

In addition, Zacharias points out that Hicks only considered income from the ownership of financial and physical assets, and did not address labor income sufficiently. Furthermore, he contends that the central meaning of income as formulated by Hicks is only relevant to property income. Within the context of Hicks's three approximations, he notes that it is impossible to construct ex post measures of labor income since the valuation of human capital is an internal process. By excluding labor income, Hicks's income concept is not applicable to modern capitalist economies where labor income is the predominant form, and where social insurance, complex codes of income taxation, and government services are present. Therefore, he reasons, the focus of income measurement must be broader than personal disposable income (itself a derivative concept) and modern national income accounting has little to do with Hicks's theoretical concept of income (which is limited to income from financial and physical assets).

Zacharias concludes that no Hicksian concept of income exists that can be used as a theoretical starting point for a modern national income accounting system. By excluding the importance of individual subjectivity

embraced by Hicks, current definitions of nominal and real income are more in line with the definitions put forward by Haig and Simons.

What Has Happened to Monetarism? An Investigation into the Keynesian Roots of Milton Friedman's Monetary Thought and Its Apparent Monetarist Legacies

JÖRG BIBOW

Working Paper No. 347, June 2002

www.levy.org/docs/wrkpap/papers/347.html

Has monetarism had a lasting effect on the theory and practice of monetary policy? In this working paper, Visiting Scholar Jörg Bibow of the University of Hamburg compares the works of John Maynard Keynes and Milton Friedman, the founding fathers of opposing schools of monetary thought, and examines their theories and proposals in light of current monetary policies. The key theoretical issue, says Bibow, is the theory of interest, which lies at the root of differences in their approach to money demand and liquidity preference. Regarding policy control, Keynes preferred a stabilized wage unit combined with a flexible central bank in charge of steering interest rates and aggregate demand, while Friedman favored a stabilized central bank with zero discretion combined with interest rates and employment levels freely determined by financial and labor markets, respectively. Bibow finds it puzzling that despite today's dominant market ideology, Friedman's idea of delegating interest rate control to the markets rather than independent central bankers enjoys little popularity.

The empirical origins of Friedman's monetarism lie in his studies (with A. J. Schwartz) on monetary factors in business cycles for the National Bureau for Economic Research, and his own research on consumption. Friedman's permanent income hypothesis describes consumption as a function of wealth rather than current income. He resurrected the quantity theory of money as a tool for theoretical and empirical research, where money is seen as the root cause of economic instability and secular prices. His main message, "money matters" (i.e., it has strong real effects in the short run), was perceived as an attack on Keynes's income-expenditure approach. Keynes's vision, however, included the possibility that money could constrain real activity. As a result, says Bibow, Keynes's

message was also that "money matters," so Friedman's initial theoretical position was not too different.

Friedman communicated his monetarist vision in quantity-theoretic, Wicksellian, and neo-Walrasian terms. Bibow points out that while he followed Keynes's analysis of the variables affecting money demand along Cambridge traditional lines, his analysis employed a broader concept of wealth and asset choice (including durable goods and human capital). He deemphasized the role of interest rates and related uncertainties as variables affecting the demand for money, while singling out inflation expectations as a key influence on velocity. Friedman assumed that equilibrium interest rates were determined by the real forces of productivity and thrift, as opposed to Keynes's conclusion that interest rates were determined independently within the financial system. The issue is whether market forces, left to themselves, will keep market rates of interest roughly allied with equilibrium rates or whether guidance from monetary authorities is required to establish a level of interest in financial markets compatible with equilibrium of the real economy.

Friedman relied on market adjustments of interest rates and wages to secure long-run equilibrium at full employment and warned against authorities' fine-tuning the economy (i.e., manipulating interest rates). Rather, policies should focus on the growth rate of some monetary aggregate. In terms of policy, Friedman parted company with Keynes and the "classics," a position that, says Bibow, amounted to a "relative stability hypothesis" and is far from postulating absolute stability of market economies along new classical lines. He believed that markets would deliver more favorable results without government intervention, in particular, interest rate manipulations by central bankers. Analysis of Friedman's policy proposals confirmed Bibow's findings related to his monetary theory: interest rate adjustments were key to Friedman's resurrection of the classical stability postulate.

According to Bibow, Friedman's analysis of money demand may have been inspired by Keynes's liquidity preference theory. However, Keynes firmly denied that changes in productivity and thrift would have any direct, immediate effect on interest rates, and he also denied the existence of the "loanable funds mechanism." The presumption that market forces (banks' profit motive) tend to move interest rates in the right direction might be correct under certain conditions,

says Bibow, but this equilibrium tendency would arise not along loanable funds lines, but Keynesian liquidity preference lines. Bibow sides with Keynes's conclusion that the loanable funds theory, which Friedman adhered to, is fatally flawed and that Keynes's theory of interest is logically correct and provides a valuable theoretical framework where interest rates (somehow determined within the financial system) set the pace of economic activity, rather than vice versa. Keynes's concern was that interest rates might not be sufficiently adjustable by deliberate policy.

Friedman believed that government should provide a monetary framework operating under the "rule of law" (legislated rules) rather than the discretionary authority of administrators. He proposed a monetary and fiscal framework for economic stability involving banking reform (separating money and credit) and monetary reform (directly linking monetary and fiscal policies), with monetary policy conducted by the Treasury. A second proposal, the k -percent rule, centered directly on monetary policy to minimize authorities' scope for discretion and stop them from manipulating interest rates. It would be implemented directly (not indirectly via interest rates) and the money supply would be controlled by the Fed in terms of the reserves available to the banking system, a more predictable benchmark than the federal funds rate. Monetary policy would mean buying securities (growing at k percent) each week in the open market without disturbing interest rates. Friedman's proposal to freeze the monetary base ($k = 0$) would effectively reduce central banker discretion to zero.

Politically, Friedman rejected concentration of powers free from direct political control. Economically, his key concerns were the dispersal of responsibilities for monetary and fiscal policies, the lack of overall accountability, policies dependent upon personalities rather than the law, and the susceptibility of independent central bankers to the "point of view of bankers." In addition, he viewed authorities' discretionary powers as a source of uncertainty, whereas precommitment to steady monetary growth promoted public confidence. From his perspective, taking away discretion by neutralizing the (unelected) central bank by a proper legislated rule offered a low-risk strategy.

Friedman presented his monetary thought in Hicksian IS-LM terms to document his belief that basic differences

among economists are empirical, not theoretical. Bibow rejects this belief, as the theory of interest was found to be the key dividing issue. Other key ingredients for stability, however, are empirical, such as the interest elasticity of expenditures. Moreover, Bibow's analysis of Friedman's interest rate adjustment process shows that automatic adjustments along loanable funds lines require implicit assumptions that are important empirical issues: negative linkages between falling aggregate demand and the demand for loanable funds must be small, interest rate expectations must move broadly in line with current yields, and the market-driven interest rate adjustment process must be appropriately forward-looking and compatible with the banks' ongoing profitability.

Bibow points out that evidence of huge damages caused by central bankers inspired both economists' work. However, they had opposite views on the feasibility of competent government intervention and the efficiency of markets. One may side with Keynes on the theory of interest (and against the absolute stability postulate) but still see the point in Friedman's relative stability hypothesis. Bibow concludes that Friedman viewed money as having direct effects over assets and prices in the broadest sense and did not follow Keynes's view that the role of liquidity preference was located within the financial system and indirectly affected the real economy in the context of interest rate determination. The theory of interest, therefore, is the key theoretical issue separating Keynes and Friedman, while the key empirical issues include the dynamics of adjustment processes and expectation formation.

Conventional monetary wisdom worldwide still consists of deliberate manipulations of short-term interest rates by central banks, notes Bibow. Interest rate settings are linked to policy goals by some more or less transparent reaction function—Keynesian "fine tuning"—through the use of feedback rules and often in the absence of any effective accountability. Inflation targeting and the Taylor rule, for example, require authorities to stabilize the economy at its full employment potential and at some target rate of inflation. The most paradoxical aspect, says Bibow, is the current fashion for central bank independence, which often goes far beyond control of the interest rate instrument and includes huge amounts of discretion regarding policy goals, particularly when central bankers focus only on price stability.

Bibow surmises that the current monetary system may be the worst of all possible worlds. Central bankers enjoy far more discretion than Keynes would ever grant them, while the risks associated with discretion as emphasized by Friedman are completely ignored. Instead of delegating policy to the markets, says Bibow, politically unchecked monetary dictators determine economic welfare in modern democracies. This state of affairs, while not a triumph of Keynesianism, is completely irreconcilable with monetarism.

Asset Prices, Liquidity Preference, and the Business Cycle

KORKUT A. ERTÜRK

Working Paper No. 348, June 2002

www.levy.org/docs/wrkpap/papers/348.html

In his *Treatise on Money* (1930), Keynes argued that the interest rate need not rise with rising levels of expenditure. The two main themes underlying his argument included elasticity of the money supply and the interaction between industrial and financial circulation. The first theme, however, was abandoned and the second reformulated in the liquidity preference theory of interest outlined in his *General Theory* some years later. Thus, the connection between expectations about asset prices and the money supply was severed. In this working paper, Research Associate Korkut Ertürk of the University of Utah examines Keynes's original argument in the *Treatise* and determines that reconsideration of his earlier insights on the state of long-term expectations greatly enhances Keynesian analysis of the business cycle.

In the *Treatise*, elasticity of the money supply depended on policies of the banking sector as a whole and the central bank. The impact of a fall (rise) in financial circulation was similar to a policy-induced increase (decrease) in the money supply. Industrial circulation was linked to the production and circulation of goods and services (roughly cash deposits), while financial circulation was linked to decisions involving titles to financial wealth (roughly saving deposits). Keynes defined four types of speculative markets in connection with different phases of the business cycle. His approach, says Ertürk, was consistent with the modern “noise trader” approach to finance, where riskless arbitrage is effective when it comes to the relative prices of assets but not to the prices of shares and bonds as a whole. When prices deviate from their

“true” values, no automatic mechanism exists in the short run to check their advance. Opinion (noise) moves prices. Thus, a rise in the bear position at a time when security prices are rising suggests the turning point of a business cycle expansion. A banking system's ability to accommodate a rising level of production becomes impaired when financial sentiment falters (i.e., profits fall short of expectations underlying asset prices), a bear position develops, financial circulation increases, and interest rates rise (often above the natural rate). Likewise, a decline in the bear position during a business upswing prevents the interest rate from rising with increasing levels of activity. Therefore, independent of the policy of the banking system, an increase in investment in excess of saving need not put any downward pressure on asset prices.

Ertürk speculates that Keynes's later responses to his critics ignored the role of asset price expectations in business cycle dynamics, because his *General Theory* theory of liquidity preference, centered on expected variations in the price of loan capital, had become much more restrictive. Variations of share prices were dealt with under the marginal efficiency of capital. Expected rates of return on capital were assumed to adjust to an equilibrium interest rate through variations in the scale of investment. Keynes's attention was focused exclusively on the portfolio choice between bonds and money. Bearish (bullish) sentiment referred to a heightened (reduced) sense of risk associated with illiquidity. The speculative demand for money referred to the quantity of liquidity demanded, holding liquidity preferences constant. Thus, speculative motives were separated into a desire to avoid capital losses and the importance of money balances as an insurance against unforeseen contingencies. This argument was eventually incorporated into orthodox portfolio theory, further weakening the link between liquidity preference and the bull and bear sentiments expressed in the *Treatise*.

Ertürk reformulates Keynes's *Treatise* argument in light of the IS-LM framework, where the supply of and demand for money is expressed as a function of income, the interest rate, and expected future prices of securities. He shows that monetary relief from a business downturn (in the form of a lower interest rate) comes about more from changed expectations about having hit bottom than from fewer transactions associated with decreased levels of activity. Ertürk's

formulation is able to show that the interest rate is determined by the dynamic interaction of the three variables emphasized in the Treatise: banking sector behavior, the state of bearishness, and the level of industrial circulation.

Ertürk notes that Keynes's treatment of investment in his General Theory weakened his liquidity preference argument

from the Treatise. Moreover, Keynes's penetrating insights on noise trading in the stock exchange are at odds with what "liquidity preference" now means in the economic literature. Ertürk suggests that the General Theory's implicit approach to finance was more orthodox mainly because of Keynes's methodological shift to equilibrium analysis.

Strategic Analysis

Strategic Prospects and Policies for the U.S. Economy

WYNNE GODLEY AND ALEX IZURIETA

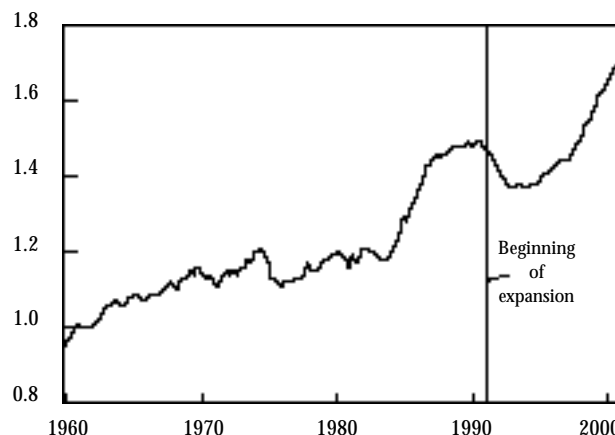
www.levy.org/docs/stratan/prospects.html

In 2000, the U.S. current account deficit reached a record 4.5 percent of GDP. Recently released CBO figures show that the government's fiscal stance by that year was tighter than at any time in the previous 40 years. These imbalances have been financed in recent years by dramatic increases in the level of private debt, which fueled the expansion of the 1990s. The ratio of private sector debt to disposable income showed rather rapid growth, reaching the 1990 peak of 1.49 in 1998 and continuing to rise to all-time highs thereafter (Figure 1). This trend cannot be sustained indefinitely.

Recent work by Distinguished Scholar Wynne Godley and Research Fellow Alex Izurieta has assessed the likely implications of the coming adjustments in private borrowing for the economy as a whole. Their new strategic analysis brings these projections up to date and evaluates possible policy responses.

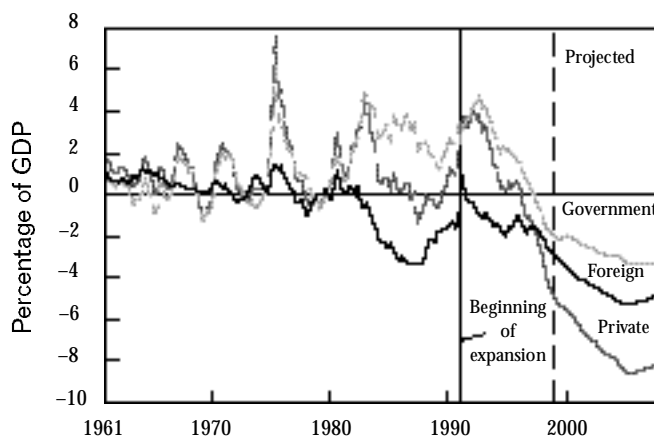
The private sector surplus reached historic levels early in the expansion (1991–92) before deteriorating to unprecedented deficits (projected to be -7 percent of GDP by year-end 2001) for a much longer period than at any previous time (Figure 2). The outlook for the next five or so years depends upon tentative assumptions regarding the future course of economic growth, current account deficits, and so on. If it is assumed that neither the federal deficit nor the current account deficit departs dramatically from its current trend, private debt would have to continue to burgeon, reaching a level of twice disposable income by 2007. In a more realistic

Figure 1: Total Private Sector Debt to Disposable Income Ratio, 1960–2001



Source: National Income and Product Accounts (NIPA), flow of funds, and authors' calculations.

Figure 2: Financial Balances by Sector, 1961–2007



Source: NIPA and projections using CBO assumptions. Sign is reversed for government sector.

scenario in which private borrowing reverted somewhat toward normal levels, the economy would fall into a “growth recession,” with unemployment reaching nearly 8 percent.

On the other hand, if the government were to attempt to avert a recession by further relaxing its fiscal posture, an inflation-adjusted infusion on the order of \$600 billion per year would be required. But a stimulus of that magnitude, in the absence of accompanying measures to reduce the nation's

deficit with the rest of the world, would bring about a 1980s-style “twin deficits” problem, with increased government borrowing being financed by foreign investors. The only viable solution is thus to somehow boost demand for U.S. exports, but no market forces exist that will automatically bring about such an adjustment. Moreover, a reduction in the trade deficit might bring dire consequences for other nations that rely on exports to the United States.

INSTITUTE NEWS

NEW BOARD MEMBERS

The Institute is pleased to welcome Nobel Laureate Joseph E. Stiglitz to its Board of Governors. He is corecipient of the 2001 Nobel Prize in Economics and was chief economist of the World Bank from 1997 to 1999 and chair of the President's Council of Economic Advisers from 1993 to 1997. In his academic career, Stiglitz has been a professor at Yale, Princeton, Oxford, and Stanford Universities. He is a fellow of the Econometric Society and a member of the National Academy of Sciences. He is also the recipient of the prestigious John Bates Clark Medal, awarded biennially to the American economist under the age of 40 who has made the most significant contributions to the field. He was a Fulbright Scholar and Tapp Junior Research Fellow at Cambridge University in 1970. Stiglitz received a B.A. degree from Amherst College and a Ph.D. from the Massachusetts Institute of Technology. He is currently a professor of economics, business, and international and public affairs at Columbia University.

The Institute is also pleased to welcome Janet Yellen to its Board of Governors. Yellen served as a member of the Board of Governors of the Federal Reserve from 1994 to 1997 and as chair of the President's Council of Economic Advisers from 1997 to 1999. She has been a Guggenheim Fellow, a fellow of the American Academy of Arts and Sciences, chair of the Economic Policy Council of the Organization of Economic

Cooperation and Development, and an adviser to the Congressional Budget Office. She is currently the Eugene E. and Catherine M. Trefethen Professor of Business and professor of economics at the University of California, Berkeley; a research associate at the National Bureau of Economic Research; a fellow of the Yale Corporation; and a member of the advisory boards of the Center for International Political Economy, Brookings Panel on Economic Activity, and Women's Economic Round Table. Yellen received a B.A. from Brown University and a Ph.D. from Yale University.

NEW RESEARCH ASSOCIATES

Rania Antonopoulos is an assistant professor of economics at New York University. She has two main areas of research interest: international competition and long-run determinants of foreign exchange rates, and gender and economics, which is different from the economics of gender in that it attempts to conceptualize the economy by incorporating gender as a key socioeconomic category within macro- and microtheoretic. Antonopoulos recently joined Nilüfer Çağatay, Diane Elson, and Karen Grown as a coprincipal investigator for “Knowledge Networking and Capacity Building on Gender, Macroeconomics, and International Economics,” a program funded by the Ford Foundation. She is currently investigating the gender dimensions of various

indices of economic well-being. Antonopoulos received a Ph.D. in economics from New School University.

Korkut A. Ertürk is an associate professor and chair of the economics department at the University of Utah. His general research interests include monetary theory, economic growth and development, gender and development, mathematical modeling, political economy, and the history of economic thought. He has served as consultant to the Institute for Training and Research of Women, the Commonwealth Secretariat, and the Department of Social and Economic Affairs of the United Nations General Secretariat, and was a member of the International Advisory Committee for the UNIFEM Biennial Report. Ertürk received a Ph.D. in economics from New School University.

NEW LEVY INSTITUTE BOOK

The New Race Question: How the Census Counts Multiracial Individuals

Joel Perlmann and Mary Waters, eds.

New York: Levy Institute and Russell Sage Foundation, 2002
(forthcoming)

Bitterly fought controversies surrounded U.S. censuses of the late 20th century, particularly the one of 1990, over population undercounts and possible adjustments. Census 2000 was equally controversial—yet Kenneth Prewitt, director of the Census Bureau during the 2000 enumeration, writes in *The New Race Question* that when historians look back on the census, the debates over undercounting will get only a footnote; the change in the race question, he predicts, will get a chapter. Indeed, the race question introduced in the 2000 census has opened the door to a new way of measuring and thinking about race. Allowing individuals to report identification with more than one race challenges long-held fictions and strongly defended beliefs about the very nature and definition of race in our society. This volume examines these monumental changes from a multidisciplinary perspective. The collected papers are the direct outgrowth of the September 2000 Levy Institute conference, “Multiraciality: How Will the New Census Data Be Used?”, organized by Perlmann and Waters. In addition to the

organizers, contributors are Reynolds Farley; David Harris; Sonya Tafoya; Josh Goldstein and Ann Morning; Roderick Harrison; Nathaniel Persily; C. Matthew Snipp; Barry Edmonston, Sharon M. Lee, and Jeffrey S. Passell; Matthew Jacobson; Werner Sollors; Margo Anderson; Hugh Davis Graham; Melissa Nobles; Nathan Glazer; Peter Skerry; Jennifer Hochschild; Kenneth Prewitt; and Clyde Tucker, Steve Miller, and Jennifer Parker.

UPCOMING EVENT

CONFERENCE

“Economic Mobility in America and Other Advanced Countries”

October 18–19, 2002

Blithewood, Annandale-on-Hudson, New York

Organizer: Edward N. Wolff, Levy Economics Institute and New York University

The main aim of this conference is to take stock of the knowledge gained regarding the economic aspects of economic mobility, both over a lifetime and intergenerationally, and its relationship to inequality. Various indicators of mobility—using income, earnings, or consumption as their basis—will be examined and the ramifications of the findings on directions for public policy explored.

“Economic Mobility in America and Other Advanced Countries” represents the Levy Institute’s commitment to research in the distribution of income and wealth and the quality of life. Levy Institute Senior Scholar Edward N. Wolff of New York University is coordinating the conference.

PRELIMINARY PROGRAM

FRIDAY, OCTOBER 18

8:30–9:00 a.m. CONTINENTAL BREAKFAST

9:00–9:15 a.m. WELCOME AND INTRODUCTION

Dimitri B. Papadimitriou, President, Levy Economics Institute

9:15–11:00 a.m. SESSION 1

Mobility in Economic Well-Being

CHAIR: Dimitri B. Papadimitriou

Jonathan D. Fisher and David S. Johnson, Bureau of Labor Statistics

“Consumption Mobility in the United States: Evidence from Two Panel Data Sets”

Conchita D’Ambrosio, Università Bocconi and DIW Berlin, and Joachim R. Frick, DIW Berlin

“Germans on the Move? Mobility in Well-Being in the 1990s”

DISCUSSANT: Thesia Garner, Bureau of Labor Statistics

11:00–11:30 a.m. BREAK

11:30 a.m. – 1:00 p.m. SESSION 2

Mobility in the Labor Market

CHAIR: Edward N. Wolff, Levy Economics Institute and New York University

Robert Haveman and Brian Knight, University of Wisconsin, Madison

“Effects of Labor Market Changes on Young Adult Employment, Labor Market Mobility, Living Arrangements, and Economic Independence: A Cohort Analysis”

Bruno Contini, Laboratorio R. Revelli, Centre for Employment Studies, and University of Torino

“Earnings Mobility and Labor Market Segmentation in Europe and the U.S.: Preliminary Explorations”

DISCUSSANT: Heidi Hartmann, Institute for Women’s Policy Research

1:00–2:30 p.m. LUNCHEON

2:30–4:00 p.m. SESSION 3

Poverty over the Life Cycle

CHAIR: Ajit Zacharias, Levy Economics Institute
Thomas L. Hungerford, Social Security Administration
“The Persistence of Hardship over the Life Course”
Fotis Papadopoulos and Panos Tsakloglou, Athens
University of Economics and Business
“Short-Term Poverty Dynamics in Europe:
A Comparative Analysis”
DISCUSSANT: TBA

4:00–4:30 p.m. BREAK

4:30–6:00 p.m. SESSION 4

Intergenerational Income Mobility

CHAIR: TBA
Paul A. Johnson, Vassar College
“A Nonparametric Analysis of U.S. Intergenerational
Dependence in Income”
Jo Blanden and Stephen Machin, University College
(London) and Centre for Economic Performance,
London School of Economics
“Cross-Country Comparisons of Changes in
Intergenerational Mobility”
DISCUSSANT: Barbara Wolfe, University of Wisconsin,
Madison, and Levy Economics Institute

6:00–9:00 p.m. RECEPTION AND DINNER

SATURDAY, OCTOBER 19

8:30–9:15 a.m. CONTINENTAL BREAKFAST

9:15–11:00 a.m. SESSION 5

Wealth Mobility I

CHAIR: TBA
Lisa A. Keister, Ohio State University
“Getting Rich in America: The Prevalence and
Determinants of Wealth Mobility”
Richard H. Steckel, Ohio State University, and
Jayanthi Krishnan, Temple University
“Wealth Mobility in America: A View from the
National Longitudinal Survey”
DISCUSSANT: Ngina Chiteji, Skidmore College

11:00–11:30 a.m. BREAK

11:30 a.m. – 1:00 p.m. SESSION 6

Wealth Mobility II

CHAIR: TBA
Seymour Spilerman and Florencia Torche, Columbia
University
“Wealth Transfers and Living Standards:
A Comparison of Chile and Israel”
Jay L. Zagorsky, Ohio State University
“Wealth, Mobility and Race: A Longitudinal Study
of U.S. Young Baby Boomers”
DISCUSSANT: Robert A. Margo, Vanderbilt University
and Levy Economics Institute

1:00–2:30 p.m. LUNCHEON

2:30–4:00 p.m. SESSION 7

Earnings Mobility

CHAIR: Heather Boushey, Economic Policy Institute
Steven J. Rose, ORC Macro International
“Earnings Mobility: Determining What Measure
to Use”
Jeffrey S. Zax, University of Colorado, Boulder
“Permanent, Transitory, and Life-Cycle Inequality”
DISCUSSANT: Jens Christensen, Mount Holyoke College

PUBLICATIONS AND PRESENTATIONS BY
LEVY INSTITUTE SCHOLARS

PHILIP ARESTIS Institute Professor and Senior Scholar

Publications: “The 1520-1640 ‘Great Inflation’: An Early Case of Controversy on the Nature of Money” (with P. Howells). *Journal of Post Keynesian Economics*, Winter 2001–02; “The Euro: Reflections on the First Three Years” (with M. C. Sawyer, A. Brown, and K. Mouratidis). *International Review of Applied Economics*, January 2002; “Financial Crisis in Southeast Asia: Dispelling Illusion the Minskyan Way” (with Murray Glickman). *Cambridge Journal of Economics*, March 2002; “The First Three Years of the Euro” (with M. C. Sawyer). *Oikonomikós Tachydromos* March 30, 2002; Guest Editor (with Peter Sinclair), Special Issue in memory of Maxwell John Fry, and author, “The Impact of Financial Liberalization Policies on Financial Development: Evidence from Developing Economies” (with P. Demetriades, B. Fattouh, and K. Mouratidis). *International Journal of Finance and Economics*, April 2002; “Geldpolitik im Eurosystem und Alternativen für Vollbeschäftigung” (with M. C. Sawyer). *WSI-Mitteilungen: Monatszeitschrift des Wirtschafts- und Sozialwissenschaftlichen Instituts in der Hans-Böckler-Stiftung* May 2002; Guest editor (with Jagjit Chadha) and author “Does Inflation Targeting Affect the Trade-Off between Output Gap and Inflation Variability?” (with G. M. Caporale and A. Cipollini). *The Manchester School* June 2002; “The Bank of England Macroeconomic Model: Its Nature and Implications” (with M. C. Sawyer). *Journal of Post Keynesian Economics*, Summer 2002; “Causes of Euro Instability” (with M. C. Sawyer, I. Biefang-Frisancho Mariscal, and A. Brown) and “Macroeconomics of Sterling and the Euro” (with M. C. Sawyer). In A. El-Agraa, ed., *The Euro and Britain: Implications of Moving into the EMU* London: Prentice Hall, 2002; “Conflict in Wage and Unemployment Determination in the U.K.” (with I. Biefang-Frisancho Mariscal). In S. C. Dow and J. Hillard, eds., *Post Keynesian Economics, Microeconomics and the Theory of the Firm: Beyond Keynes, Volume One*. Northampton, Mass.: Edward Elgar, 2002; “An Evaluation of the Tobin Transactions

Tax” (with M. C. Sawyer). In S. C. Dow and J. Hillard, eds., *Keynes, Uncertainty and the Global Economy: Beyond Keynes, Volume Two* Northampton, Mass.: Edward Elgar, 2002; “Fiscal Policies in the Eurosystem” (with M. C. Sawyer). In Arne Heise, ed., *Neues Geld—alte Geldpolitik? Die EZB im Makroökonomischen Interaktionsraum Marburg*, Germany: Metropolis-Verlag, 2002; “Third Way, New Labour, and the Challenges to Economic and Monetary Union Macropolicies” (with M. C. Sawyer). *Wirtschaft und Gesellschaft* 2002.

Presentations: “Economics of the Third Way: Labour and the Challenges to EMU Macropolicies,” Department of Economics, University of Bilbao, Spain, January 26, University of Ljubljana, Slovenia, April 19, Staffordshire University, April 25, Nottingham Trent University, May 1, and Oxford Brookes University, May 15; “Financial Policies and the Average Productivity of Capital: Evidence from Developed and Developing Economies” (with P. Demetriades and B. Fattouh), Eastern Economic Association, Boston, March 15–17; organized (with Georgios Chortareas) a one-day Conference on Transparency in Monetary Policy, Bank of England, London, May 10; “Credibility of EMS Interest Rate Policies and Implications for the EMU: A Markov Regime-Switching Approach” (with K. Mouratidis), 6th International Conference on Macroeconomic Analysis and International Finance, Rethymno, Crete, May 23–25, and 8th International Dubrovnik Economic Conference on Transition Economies, Cavtat, Croatia, June 26–29; “The Impact of Financial Globalisation on Employment,” International Symposium on Globalisation, New Technologies, and Employment, Haus Villigst, Schwerte, Dortmund, Germany, May 31 – June 2; “Inflation Targeting: What Have We Learned?,” University of Bilbao, Spain, June 14.

WALTER M. CADETTE Senior Scholar

Publications: “Social Security Privatization: A Bad Idea.” In Arno Tausch, ed., *The Three Pillars of Wisdom? A Reader on Globalization, World Bank Pension Models, and Welfare Society*, Huntington, New York: Nova Science, 2002; “Health Care

Finance: A Dysfunctional System.” Quarterly Commentary of Sanders Research Associates Limited, First Quarter, 2002, and Indicators, Fall 2002, “Lessons from September 11.” Quarterly Commentary of Sanders Research Associates Limited, Third Quarter, 2002; “How Stock Options Lead to Scandal.” Op-ed, New York Times, July 12, 2002.

Presentation: “Health Care Finance: A Dysfunctional System,” Ruth M. Shellens Memorial Lecture, Calvary Hospital, the Bronx, New York, February 28.

JAMES K. GALBRAITH Senior Scholar

Publications: “The Importance of Being Sufficiently Equal.” Social Philosophy and Policy, Winter 2002; Review of Michael Bernstein, *A Perilous Progress: The Economics Profession in the 20th Century*. Washington Monthly, January 2002; “Share Revenue, Save Jobs.” The Nation, February 11, 2002; “The U.S. Economy May Have Further to Fall.” Australian Financial Review, March 2002;

Presentations: “Rising Inequality in China: Supplementary Evidence from Official Sources” (with Qifei Wang), Association for Comparative Economic Studies, Atlanta, January 6; “The Economy and the Need for Action,” National Press Club, Washington, D.C., January 7.

DIMITRI B. PAPADIMITRIOU President

Presentations: “The U.S. Recession: Can the Federal Reserve Pick up the Tempo?”, The Stern School, New York University, New York City, February 22; “‘Rational Allocation of Resources’ or ‘Scarcity’ Are Not the Economic Problems,” Religious Belief and Economic Behavior, Bard College, Annandale-on-Hudson, N.Y., March 6; “Recession and Recovery: Guidelines for Policy,” International Applied Business Research Conference, Puerto Vallarta, Mexico, March 15.

JOEL PERLMANN Senior Scholar

Publication: “Comments on Second-Generation Transnationalism.” In Peggy Leavitt and Mary Waters, eds., *Second Generation Transnationalism*. New York: Russell Sage Foundation, forthcoming.

MALCOLMSAWYER Visiting Senior Scholar

Publications: “The Euro: Reflections on the First Three Years” (with P. Arestis, A. Brown, and K. Mouratidis). *International Review of Applied Economics*, January 2002; “The NAIRU, Aggregate Demand and Investment.” *Metroeconomica* February 2002; “The First Three Years of the Euro” (with P. Arestis). *Oikonomilos Tachydromos* March 30, 2002; “Geldpolitik im Eurosystem und Alternativen für Vollbeschäftigung” (with P. Arestis). *WSI-Mitteilungen: Monatszeitschrift des Wirtschafts- und Sozialwissenschaftlichen Instituts in der Hans-Böckler-Stiftung* May 2002; “The Bank of England Macroeconomic Model: Its Nature and Implications” (with P. Arestis). *Journal of Post Keynesian Economics*, Summer 2002; “Causes of Euro Instability” (with P. Arestis, I. Biefang-Frisancho Mariscal, and A. Brown) and “Macroeconomics of Sterling and the Euro” (with P. Arestis). In A. El-Agraa, ed., *The Euro and Britain: Implications of Moving into the EMU* London: Prentice Hall, 2002; “An Evaluation of the Tobin Transactions Tax” (with P. Arestis). In S. C. Dow and J. Hillard, eds., *Keynes, Uncertainty and the Global Economy: Beyond Keynes*, Volume Two Northampton, Mass.: Edward Elgar Publishing, 2002; “Fiscal Policies in the Eurosystem” (with P. Arestis). In Arne Heise, ed., *Neues Geld—alte Geldpolitik? Die EZB im Makroökonomischen Interaktionsraum* Marburg, Germany: Metropolis-Verlag, 2002; “Theory of Economic Dynamics: An Essay on Cyclical and Long-Run Changes in the Capitalist Economy.” In X. Greff, J. Lallemond, and M. de Vroey, eds., *Dictionnaire des Grandes Ouvres Economiques* Paris: Editions Dalloz, 2002; “Third Way, New Labour, and the Challenges to Economic and Monetary Union Macropolicies” (with P. Arestis). *Wirtschaft und Gesellschaft* 2002.

Presentations: “Budget Deficits and Economic Policy,” University of Linz, Austria, January 17; “Monetary and Fiscal Policy in the Eurozone,” Chamber of Labour, Vienna, January 18; “Monetary Policy in the U.K. and the Eurozone,” Atlantic Conference on Central Banking, Maritime Institute, Baltimore, March 2–3; “Investment, Aggregate Demand, and the NAIRU,” Seventh Post-Keynesian Conference, Kansas City, June 27.

EDWARD N. WOLFF Senior Scholar

Publications: "The Stagnating Fortunes of the Middle Class." *Social Philosophy and Policy*, Winter 2002, rpt. in Ellen Frankel Paul, Fred D. Miller Jr., and Jeffrey Paul, eds., *Should Differences in Income and Wealth Matter?* Cambridge, England: Cambridge University Press, 2002; "Inheritances and Wealth Inequality, 1989–1998." *American Economic Review*, May 2002; "The Impact of IT Investment on Income and Wealth Inequality in the Postwar U.S. Economy." *Information Economics and Policy*, June 2002; "Comparative Income and Wealth Distribution." In Malcolm Warner, ed., *International Encyclopedia of Business and Management*, Second Edition. London: Thomson Learning, 2002; "The Economic Status of Parents in Postwar America." In Sylvia Hewlitt, Nancy Rankin, and Cornel West, eds., *Taking Parenting Public: The Case for a New Social Movement* Lanham, Maryland: Rowman and Littlefield, 2002; *Top Heavy: A Study of Increasing Inequality of Wealth in America*. New York: The New Press, 2002.

Presentations: "Recent Trends in Living Standards in the United States," U.S. Basic Income Group Conference, New York, March 8–9, and Eastern Economic Association, Boston, March 15–17.

JÖRG BIBOW Visiting Scholar

Publications: "The Monetary Policies of the European Central Bank and the Euro's (Mal-)Performance: A Stability-Oriented Assessment." *International Review of Applied Economics*, January 2002; "The Markets versus the ECB, and the Euro's Plunge." *Eastern Economic Journal*, Winter 2002; "Market Failure or Central Bank Failure? The Case of the Euro and the European Central Bank." *Challenge*, March–April 2002.

Presentation: "What Has Happened to Monetarism?" European Society for the History of Economic Thought Conference, University of Crete, March 14–17.

QIYU TU Visiting Fulbright Scholar

Presentations: "Short-Term Costs vs. Long-Term Benefits? The Decision-Making of China's WTO Agreement," Harvard-Yenching Institute, Harvard University, Cambridge,

Massachusetts, January 11; "China's Economic Transition," Keck Center for International and Strategic Studies, Claremont McKenna College, Claremont, California, March 12; "The WTO and China's New March," Asian and Asian American Institute, California State University, Los Angeles, March 13; "China's WTO Membership and the New Strategy of Internationalization," Global Studies Project, California State University, Dominguez Hills, March 14.

AJIT ZACHARIAS, Research Fellow

Publication: "A Critique of Robert Brenner." *Review of Radical Political Economy*, Winter 2002.

WILLEM THORBECKE, Research Associate

Publications: "A Dual Mandate for the Federal Reserve: The Pursuit of Price Stability and Full Employment." *Eastern Economic Journal*, Spring 2002; "Budget Deficits, Inflation Risk, and Asset Prices." *Journal of International Money and Finance*, August 2002; "European Macroeconomic Policy Interdependencies" (with Christian Eigen-Zucchi). In Thomas L. Brewer and Gavin Boyd, eds., *Globalizing Europe* Northampton, Mass.: Edward Elgar, 2002.

Presentations: "Monetary Policy, Risk Management, and Bank Lending: Evidence from Turkey," Asian Development Bank Institute, Tokyo, December 26; "The Economic Outlook," LRI Institute, Fairfax, Virginia, January 29; "U.S. Structural Change, Macroeconomic Policy Issues," Center for Global Change and Governance, Rutgers University, Newark, New Jersey, March 15; "Parchment, Guns, and Liberty: Constitutional Insights in Churchill's History of the English-Speaking Peoples," APCS Annual Meetings, San Diego, California, March 24; "Linking Firm and Bank Behavior with Macroeconomic Shocks," Asian Development Bank Institute, Tokyo, May 28.

GWYNETH H. CROWLEY, Head of Information Services

Publication: "User Perceptions of the Library's Web Pages: A Focus Group Study at Texas A & M University" (with Rob Leffel, Diana Ramirez, Judith Hart, and Tommy S. Armstrong II). *The Journal of Academic Librarianship*, July–August 2002.

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