The Levy Economics Institute of Bard College

LEVY INSTITUTE

Summary

Summer 2003 Volume 12, Number 3

CONTENTS

Summary

Summer 2003 **Volume 12, Number 3**

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.

W. RAY TOWLE, *Editor*
GEORGE PATTISON, *Text Editor*

The *Summary* and other Levy Institute publications are available on the Institute's website. To comment on or inquire about publications, research, and events, contact the Institute online at www.levy.org.

THE LEVY ECONOMICS INSTITUTE OF BARD COLLEGE
Blithewood
Annandale-on-Hudson, NY 12504-5000
Phone: 845-758-7700, 202-887-8464 (in Washington, D.C.)
Fax: 845-758-1149 *E-mail:* info@levy.org
Website: www.levy.org

Printed on recycled paper

To our readers:

This issue begins with a strategic analysis by Distinguished Scholar Wynne Godley. He believes that personal debt levels in the United States cannot continue and that the U.S. balance of payments deficit has largely been ignored by the government and the public. He foresees an era of growth recession characterized by rising unemployment and the risk of financial implosion.

The program on the distribution of income and wealth begins with a working paper by Senior Scholar Edward N. Wolff and Research Scholar Ajit Zacharias. They outline a model—the Levy Institute Measure of Economic Well-Being (LIMEW)—which is designed to assess economic well-being among significant demographic groups in the United States. LIMEW may ultimately complement the Levy Institute macroeconomic model of the U.S. economy.

A working paper by Günseli Berik, Yana van der Meulen Rodgers, and Joseph E. Zveglich Jr. studies the impact of international competitiveness on industry-level gender wage gaps in two highly successful exporting countries, Taiwan and South Korea. The authors find that greater international competition is associated with larger wage gaps between men and women and does not ensure an improvement in women's relative economic status. They recommend the development of antidiscrimination legislation to remedy persistent gender wage inequality.

Research Director and Senior Scholar Thomas L. Hungerford expands the study of the adequacy of retirement income for U.S. workers by using nationally representative data. He examines workers' pension investment choices and finds that certain demographic groups, such as minorities, tend to invest their pension assets conservatively. Workers with no pension coverage would tend to be conservative investors, if they were covered by a 401(k) pension plan, while individuals who are able to direct their own pension plans invest more aggressively.

A working paper about Mexican immigration and intermarriage in the United States by Senior Scholar Joel Perlmann finds that intermarriage patterns among second-generation Mexican immigrants compare favorably with other ethnic groups, suggesting a trend toward full incorporation into mainstream U.S. society.

A policy note by Senior Scholar Walter M. Cadette warns of a national crisis if the medical profession is unable to deal more successfully with the health problems of the elderly. A majority of the institutionalized disabled elderly receive care that is funded by Medicaid, a program intended for welfare recipients. Consequently, budgets are diverted from the poor as nonindigent families resort to "creative accounting" that amounts to welfare fraud. The best solution, says Cadette, is to extend Medicare payments for short-term care and to use private insurance for longer-term stays in nursing homes.

The 13th Annual Hyman P. Minsky Conference on the State of the U.S. and World Economies opens the program on financial markets and monetary policy. The presenters note that the recent U.S. and world economic recession and recovery are atypical, that economic imbalances and deflationary pressures persist, and that a high degree of economic uncertainty exists in light of geopolitical events, the financial markets, and consumer confidence levels. The participants express differing opinions about the underlying strength of the U.S. economy, particularly in the short term; the role of the U.S. economy in stimulating world economic growth; and the threat of a double-dip recession.

A policy note and working paper by Institute Professor Philip Arestis and Senior Scholar Malcolm Sawyer evaluate the role of monetary policy. In the former, the authors find that monetary policy in the European Union suffers from a deflationary bias; they therefore recommend the formulation of institutional arrangements between monetary and fiscal policies that consider growth and employment along with inflation. In the latter, Arestis and Sawyer analyze the use of interest rate policy to control inflation and endorse a combination of fiscal policy to regulate aggregate demand and monetary policy to control the exchange rate.

As always, I welcome your comments and suggestions.

Dimitri B. Papadimitriou, *President*

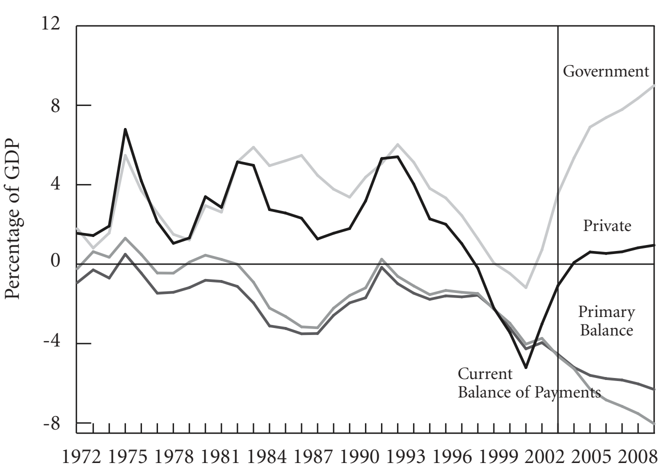
Strategic Analysis

The U.S. Economy: A Changing Strategic Predicament
WYNNE GODLEY
Strategic Analysis, March 2003
www.levy.org/docs/stratan/stratpred.html

In spite of an expansionary fiscal policy and a relaxation of monetary policy, the U.S. recovery from the 2001 recession has not been robust. Distinguished Scholar Wynne Godley foresees a new strategic predicament as a result of the vast and growing balance of payments deficit, which has largely been ignored by government and the public.

Godley notes that the primary balance of payments in the fourth quarter of 2002 was approximately 5 percent of GDP, a postwar record. Using projections and assumptions from official U.S. documents (including the Economic Report of the President [ERP]), he estimates that by 2008, the overall balance of payments deficit will rise to 8.5 percent of GDP and the budget deficit to perhaps 9 to 10 percent of GDP (*see* Figure 1). These deficits, however, do not reflect a credible scenario, he says. Rather, it is more likely that the U.S. economy will enter a prolonged period of "growth recession." A lasting economic solution would be expansion of net export demand for an extended period, but it is questionable how this would be achieved.

Figure 1 **Financial Balances, Actual and Projected**



Sources: NIPA and author's calculations

Reviewing the accounting identities and balances within the National Income and Product Accounts (NIPA), Godley delineates how the three main financial balances have moved historically relative to GDP, and how their configuration during the 1990s was unique. Expansion of aggregate demand was driven by unprecedented growth in private expenditure relative to disposable income, which resulted in a huge accumulation of debt by the private sector. The economy would have eventually suffered a severe recession when private expenditures declined, had the government not intervened with a series of fiscal stimulation measures (e.g., reduced interest rates, which encouraged households to borrow and spend). Nevertheless, the U.S. balance of payments continued to deteriorate during this period.

The income elasticity of demand for imports in the United States is very high, far exceeding the foreign income elasticity of demand for U.S. exports, Godley observes, noting that a point of saturation must eventually be reached. Using conservative assumptions in combination with ERP economic growth rates and a primary deficit that is expected to deteriorate to 6.4 percent of GDP, he estimates that by 2008, net foreign debt will rise from 25 percent to 60 percent of GDP (nearly $8 trillion), and the overall deficit in the current balance of payments will equal 8 to 9 percent of GDP.

Godley discerns nothing unusual in the behavior of the corporate component of the total private balance since 1992, although corporate debt has risen to record levels, partly because corporations have borrowed in order to buy back equity. The behavior of the personal component, however, has been exceptional, as personal expenditures during the past 10 years were financed by higher net lending until the third quarter of 2002. He maintains that the rate of increase in the debt cannot continue, so further lending cannot be an abiding motor for economic growth. Rather, net lending must fall from 10 percent of disposable income to perhaps 4 or 5 percent, as the personal component's financial balance sheet reverts toward its historical norm. The overall private sector balance sheet is therefore expected to rise to about 1 percent of GDP by 2008, which is still far below its long-term average.

If the various financial balances behave according to Godley's expectations, by accounting identity the general government deficit must reach 9 to 10 percent of GDP—a picture of twin deficits with a vengeance—and the balance of payments deficit will act as a formidable drag on demand. Godley believes that overwhelming political obstacles and a highly unstable economic position make the scenario depicted in Figure 1 implausible. The most likely outcome, he says, is that the U.S. economy will enter a long, depressing era of growth recession characterized by rising unemployment and an ever-present risk of financial implosion.

The only antidote to this predicament is the emergence of net export demand as the motor for sustained growth in the future. For this to occur, however, Americans would have to stop consuming 5 percent more goods and services than they produce, and fiscal policy would have to become tighter rather than looser, since the rest of the world, experiencing economic stagnation, expects the United States to induce its own growth. Devaluation of the dollar, the classic remedy for chronic external imbalances, is impractical, since real short-term interest rates are close to zero. (Although the dollar has fallen against the euro in recent months, it has hardly declined in terms of its "broad" index since the beginning of 2002.) Godley doubts that a significant devaluation of the dollar could generate the required rise in net exports, given the stagnant state of the world market, so protective tariffs might be the only solution to the problem. Such a solution, however, poses grave consequences for the rest of the world, the author warns.

Program: Distribution of Income and Wealth

The Levy Institute Measure of Economic Well-Being

EDWARD N. WOLFF and AJIT ZACHARIAS

Working Paper No. 372, February 2003
www.levy.org/docs/wrkpap/papers/372.html

A number of approaches attempt to measure household income and determine a household's economic well-being. According to Senior Scholar Edward N. Wolff and Research Scholar Ajit Zacharias, the standard official measure—gross money income—is not a comprehensive measure of the level and distribution of economic well-being. As a result, these scholars are developing the Levy Institute Measure of Economic Well-Being (LIMEW), an extended income concept, in order to enhance the formulation and evaluation of a variety of social and economic policies.

In the absence of an ideal, unified database from which to measure household economic well-being, LIMEW uses various information sources, including data from the March CPS Annual Demographic Supplement, other household surveys, and official government agencies. LIMEW is designed to investigate two issues: the extent to which economic well-being has increased in the United States (and its regions) during the postwar period, and how U.S. economic well-being compares with that in other countries belonging to the Organisation for Economic Co-operation and Development (OECD). The crucial characteristics of LIMEW are that all components are measured in monetary terms and that it is a household-level measure constructed for different deciles or quintiles of income distribution.

The authors note that an individual's access to daily economic necessities and conveniences is mediated by three key interdependent institutions—market, household, and state—that fundamentally shape a household's economic well-being. While a household's income approximates the magnitude of its access, income should include such elements as household production and noncash transfers from the government, say the authors. LIMEW thus accounts for factor incomes and wealth; the net effects of taxes, transfers, and some types of public expenditures; and household production.

LIMEW's money income component differs from official measures of money income primarily in the treatment of income from assets. The authors replace property income with the sum of two components: imputed rent from owner-occupied housing and imputed annuity from net worth (excluding housing). In its treatment of taxes LIMEW does not use a specific theoretical model of tax incidence (the eventual distribution of the burden of tax), nor does it attempt to assess welfare or deadweight losses. The authors also question some of the underlying assumptions of existing empirical studies, such as the presence of continuous full employment or perfectly competitive markets. Rather than comparing equilibrium positions, LIMEW uses a social accounting approach to tax incidence (the distribution of actual taxes and government expenditures among employees, employers, and consumers).

In the measurement of gross money income, government expenditures such as old-age pensions are included as cash transfers; the income value of noncash transfers (e.g., medical, housing, energy, and food benefits) and public expenditures such as education are imputed using methods similar to the government-cost approach. However, public expenditures are considered only if they are incurred directly on behalf of households and if they expand potential consumption.

Household production includes three broad categories of unpaid activities: core production activities (e.g., cooking, cleaning), distribution activities (shopping), and childcare. These activities are included because they can generally be assigned to other people. The method for placing a value on household production uses national surveys of time-use patterns and the replacement-cost approach (measuring compensation of a private household employee).

Compared to other comprehensive income definitions, LIMEW differs in its treatment of nonhousing wealth (as an annuity), public expenditures allocated to households (added), and indirect taxes paid on personal consumption (subtracted). According to the authors, LIMEW includes more categories of public expenditures, measures the total effect (in an accounting sense) of government intervention on economic well-being, and recognizes the importance of services produced by nonmarket activity within the household.

The authors expect that LIMEW will be used in the formulation and evaluation of social and economic policy because it is constructed for significant demographic groups. In addition, the underlying dataset can be employed to analyze how LIMEW's various components shape well-being and interact with demographic and economic characteristics. Wolff and Zacharias intend to study such matters as job satisfaction, leisure time, the relationship between health status and extended incomes for households in specific regions and demographic groups, and factors affecting environmental quality, such as air pollution. Since policies aimed at influencing aggregate economic performance affect household economic well-being and vice versa, the authors suggest that LIMEW may ultimately complement the Levy Institute macroeconomic model of the U.S. economy by permitting analyses of the distributional impact of various fiscal, monetary, and trade policies.

Does Trade Promote Gender Wage Equity? Evidence from East Asia

GÜNSELI BERIK, YANA VAN DER MEULEN RODGERS, and JOSEPH E. ZVEGLICH JR.

Working Paper No. 373, February 2003
www.levy.org/docs/wrkpap/papers/373.html

According to neoclassical theory based on Gary Becker's theory of discrimination, increased competition from international trade reduces employers' incentives to discriminate against women. However, an econometric analysis of the impact of international competitiveness on industry-level gender wage gaps in Taiwan and South Korea, by Günseli Berik of the University of Utah, Yana van der Meulen Rodgers of the College of William and Mary, and Joseph E. Zveglich Jr.

of the Asian Development Bank, does not support Becker's theory. The authors find that greater international competition is associated with larger wage gaps between men and women; they recommend the development of antidiscrimination legislation to remedy persistent gender wage inequality.

The authors note that previous studies of the relationship between increased competition (resulting from factors such as deregulation, the entry of new firms, and cheaper imports) and wage discrimination unsatisfactorily treat discrimination as an unexplained residual effect, lack controls for worker productivity characteristics, are limited in geographical coverage, and are inconclusive. The authors' empirical strategy thus controls for differences in market structure across industries, in order to isolate the effect of competition related to international trade from other, unrelated, contemporaneous shocks. The analysis is complicated by the confluence of certain developments, including trade competition, outward foreign direct investment, and technological upgrading, which were undertaken in several industries in Taiwan and South Korea over the last two decades in an effort to maintain competitiveness at the firm and industry levels.

A model (estimation equation) tests the idea that changes in competitiveness over time affect changes in wage gaps over time. It uses average unadjusted and average residual wage gaps, categorized by industry. The residual wage gap (the portion of the wage gap that cannot be explained by observed productivity differences between men and women) is commonly attributed to wage discrimination against women. An industry-specific measure of domestic competitiveness is constructed using Pareto function estimates of domestic concentration across revenue size categories.

The authors' descriptive analysis of employment shares by gender, wage ratios, and trade shares across sectors for the period 1980 to 1999 shows that within manufacturing, female and male employees recorded dramatic shifts out of low-skill jobs (e.g., in the textiles industry) into higher-skill jobs (e.g., in the electrical and electronic equipment industries). Major structural shifts due to capital mobility, trade, and technological restructuring affected not only changes in labor demand across sectors, but also persistent pay inequities between men and women within sectors. In Taiwan, rising trade openness and a continued highly competitive industrial structure were associated with a rising gender wage inequality. By contrast, South Korea's declining total trade openness and less competitive industrial structure was associated with a gradual narrowing of the manufacturing sector gender wage gap.

At 58 percent, South Korea has one of the lowest gender wage ratios in East Asia. Without adjusting for gender differences in skills, the female-to-male wage ratio in manufacturing declined from 66 percent in 1981 to 60 percent in 1993, before rising to 67 percent in 1999. Women's relative wages in nonmanufacturing industries remained fairly stable, at 71 percent, until the mid 1990s, before climbing at a rate of 1 percentage point a year. Unadjusted wage ratios are quite low in South Korea relative to Taiwan, while residual wage ratios are considerably higher, since observed worker characteristics explain a larger portion of the gender wage differential. Like Taiwanese women, South Korean women experienced lower relative wages in manufacturing than in nonmanufacturing industries, but female-to-male wage ratios rose fairly steadily throughout the period of the study. The authors note that a number of studies have presented evidence that employment segregation by gender in Taiwan and South Korea was a result of employer and state hiring, training, employment, and labor control policies enacted within a context of patriarchal gender norms. The authors cite the suppression of collective bargaining in export industries where female employment is concentrated as an example of this phenomenon.

In Taiwan, the period of falling residual wage ratios coincided with a fairly steady increase in trade ratios, while the recovery in women's relative residual wages toward the end of the period coincided with a flattening in both ratios. These patterns suggest that increasing openness over time is negatively related to patterns in women's relative earnings.

In South Korea, a steady increase in the residual wage ratio in concentrated industries, such as textiles and electronics, contrasted with a decline in the aggregate export ratio for most of the period, while there was no clear relationship with imports. Competitive forces from domestic market structures may have played a role in determining women's relative wages in the manufacturing sector. In Taiwan, the unadjusted and residual wage ratios were higher in concentrated industries, where wage levels are higher, than in nonconcentrated industries. Similar wage ratio trends over time for both industries suggest that wage trends are shaped by forces other than changes in industrial policy or industrial structure.

Regression analysis of changes in the male-female wage gap showed a significant result for Taiwan: an increase in international competitiveness over time in concentrated industries, associated with a widening in the gender wage gap (when trade openness is measured using the ratio of imports to output by sector). Controlling for worker productivity characteristics, an increase in international competitiveness from imports in concentrated industries was associated with a statistically significant increase in the residual wage gap. These results may be explained by restructuring developments—such as the movement of foreign direct investment away from Taiwan and toward China—in Taiwan's labor-intensive export-oriented industries, and are not sensitive to any spillover effects from the 1997 financial crisis. The same conclusion holds for South Korea, but the findings were less significant, as a result of slightly weaker international trade pressures and greater competition from exports than from imports. In both countries import competition in textiles and apparel was associated with a greater decline in job opportunities for women than for men.

The comparative analysis of two highly successful exporting countries shows that increasing international openness does not ensure an improvement in women's relative economic status.

U.S. Workers' Investment Decisions for Participant-Directed Defined Contribution Pension Assets

THOMAS L. HUNGERFORD

Working Paper No. 375, March 2003
www.levy.org/docs/wrkpap/papers/375.html

The adequacy of retirement income for U.S. workers may depend on two developments: the growth of 401(k) pension plans and the possible "privatization" of Social Security, whereby individual accounts would include stocks and future benefits would depend on the performance of an individual's investments. Research Director and Senior Scholar Thomas L. Hungerford examines workers' pension investment choices and finds that certain demographic groups, such as minorities, tend to invest their pension assets conservatively, favoring fixed-income assets. He also estimates that workers with no pension coverage would tend to be conservative investors if they were covered by a 401(k) pension plan.

Hungerford notes that workers without pension coverage are most likely to have lower earnings and to experience more unemployment. Under a self-directed contributory retirement income plan, these workers would be at greatest risk of low account balances at retirement. Uninformed investment decisions could aggravate this problem.

The paper studies the allocation of pension assets of workers who make investment decisions regarding their own contributions. It differs from previous studies by using nationally representative data, obtained from the Federal Reserve Board's 1995 and 1998 Surveys of Consumer Finances (SCF). The SCF sampled approximately 4,000 households per year, yielding data that allowed Hungerford to create a time series of cross-sectional data sets comprising information on assets and debts, employment, pensions, demographics, and unemployment. He also creates a sample of 5,516 workers, which includes all primary respondents and spouses, except the self-employed, between the ages of 21 and 64. The sample is divided into four groups: workers who make investment decisions in their defined contribution (DC) pension plan; workers covered by traditional DC pension plans, in which employers make contributions and investment decisions; workers covered by a defined benefit (DB) plan; and workers not covered by a pension plan. In the first group, investments were roughly split 60/40 between stocks and bonds. Allocation strategies varied markedly by demographic group: men were more aggressive investors than women, minorities were more conservative than whites, and people with higher income and education levels invested more in stocks than did those with less income and education.

Both conventional wisdom and theoretical results suggest that pension asset investment strategies depend on age, on whether a worker is covered by a pension plan, and on unobserved factors affecting their attitudes toward risk, says the author. Since the SCF provides only qualitative information on pension investments, Hungerford posits a basic-investment, DC-pension asset allocation model, specified as an ordered probit model, whose explanatory variables are demographic characteristics, attitudes toward risk, and risks faced by an individual. The coefficient estimates are then used to calculate predicted probabilities for all workers in the sample.

The basic model produced results similar to those of previous research, finding that women are more conservative investors than men, educated workers more aggressive investors than uneducated ones, workers also covered by a DB pension plan more aggressive investors than workers with no additional pension coverage, and blacks and Hispanics more conservative investors than other racial/ethnic groups. Age, marital status, a spouse's pension coverage, employer contributions, and job tenure have little effect on asset allocation; a finding at odds with previous studies is that net worth also has little effect on asset allocation. Workers appeared to be more aggressive investors in 1998 than in 1995, a result, perhaps, of continued high stock market returns between those years.

Hungerford also specifies a pension asset allocation model with two selection equations: whether a worker has pension coverage; and, if so, the type of coverage. The explanatory variables include both employer and employee characteristics. The results of the multiple-equation model suggest that there is selection bias. Hungerford finds, however, that selection bias in asset allocation, while statistically significant, is not economically important. He also finds that workers with no pension coverage have both observed and unobserved characteristics associated with slightly more conservative investment decisions.

The study shows that, while DC pension participants are different from other workers in both observable and unobservable ways, projections of retirement income under different scenarios may not differ much if selection is ignored. Therefore, the basic probit model can be used as an effective substitute for the multiple-equation probit model.

Mexicans Now, Italians Then: Intermarriage Patterns

JOEL PERLMANN

Working Paper No. 376, April 2003
www.levy.org/docs/wrkpap/papers/376.html

A question about contemporary immigration in the United States is whether the descendants of immigrants will improve upon the conditions of their parents. The theory of segmented assimilation suggests that the children of current nonwhite immigrants who enter U.S. society at the bottom rungs of the socioeconomic ladder will fare worse than previous generations. Previous research by Senior Scholar Joel Perlmann challenged this theory. In this paper he extends that research to include Mexican immigration and intermarriage. One important measure of assimilative tendencies, he says, is intermarriage, also called "outmarriage." Perlmann's study finds that the rate of outmarriage among the second generation of Mexican immigrants compares favorably to that of other ethnic groups, suggesting a trend toward full incorporation into mainstream U.S. society.

Perlmann uses data from the March files of the Current Population Survey (CPS) for the period 1998 to 2001. He focuses on people who were born between 1966 and 1980 and were married to a spouse living in the same household. The ethnic origins of the first- and second-generation Mexican Americans are divided into four groups: two groups of foreign-born Mexicans (who came to the United States before and after the age of 10); and two groups of U.S.-born children (with one or both parents having been born in Mexico).

The Mexican groups are compared to four groups of non-Mexicans: native-born non-Hispanic whites of native parentage, native-born non-Hispanic blacks of native parentage, other Hispanic immigrants, and children of at least one other Hispanic immigrant.

Perlmann notes that the unweighted CPS samples of second-generation Mexicans include only 171 men and 247 women, making it difficult to determine a meaningful basis for statistical inference. He suspects that outmarriages have been more common in successive generations, and that women have lower outmarriage rates than men. The group through which Mexican outmarriage can be best understood, he says, is that of "true" second-generation Mexican Americans, i.e., U.S.-born children of Mexican-born parents.

The author finds that approximately a quarter of second-generation Mexicans have a spouse who is only partly Mexican, and that pan-Hispanic marriages occur infrequently. He also finds that second-generation outmarriages are uncommon, involving only 18 to 20 percent of men and 8 to 11 percent of women, or 15.5 percent of all subjects. The total rate of outmarriage is significantly higher (45 percent of men and 27 percent of women) if the third generation is included in the analysis.

Perlmann notes that the proportion of mixed-origin couples will always be higher than the rate at which individuals chose to outmarry because the ethnic origins of successive generations result from the rate at which couples form, rather than the rate at which individuals outmarry. His results are lower than those of other studies of second-generation outmarriage rates because he excludes children with only one Mexican parent. (This group is the same size, and has outmarriage rates more than twice as high, as the "true" second-generation group.)

The segmented-assimilation theory suggests that race and culture will channel the second-generation group into a unified nonwhite "underclass." Perlmann attempts to test the theory by studying intermarriage patterns, but the unlikelihood of marriages between second-generation Mexican-Americans and native-born whites of native parentage or native-born blacks of native parentage, coupled with the study's small sample size, makes meaningful, statistically significant trends impossible to detect. The author therefore compares the Mexican-American experience to that of Italians. He notes that outmarriage among second-generation Italian women increased sharply when there was a reduction in Italian immigration, depression, and war—factors not common to Mexicans today. He also notes that current Mexican outmarriage constraints are equal to, or smaller than, those faced by the Italians. Perlmann observes that a significant difference between the two periods of Mexican and Italian immigration is that marriage is less prevalent today, but he doubts that accounting for this difference would affect his main conclusions.

Caring for a Large Geriatric Generation: The Coming Crisis in U.S. Health Care

WALTER M. CADETTE

Policy Note 2003/3

www.levy.org/docs/pn/03-3.html

The United States is facing a serious economic problem arising from an aging population and a sharp decline in the birth rate. The ratio of workers to retirees has fallen to three to one and is expected to drop to two to one in approximately 30 years. Senior Scholar Walter M. Cadette warns of a national crisis if the medical profession is unable to deal more successfully with the health problems of the elderly.

Cadette notes that, with the exception of Medicaid, which was designed to pay for the acute care of the most indigent families, there is no current mechanism for financing long-term care. The government is currently the dominant payer of nursing home care (61 percent of expenditures in 2001), through its Medicaid and Medicare programs. Cadette further notes that private insurance covers only a fraction of this cost; few families can afford to pay independently for nursing home care or equivalent at-home care. Meanwhile, says Cadette, no serious national debate has taken place about the consequences of Medicaid financing.

The extent to which long-term care depends on public financing depends on which measurement parameters are used and on whether a distinction is made between long-term custodial care (funded mainly by Medicaid) and short-term rehabilitation (funded mainly by Medicare), says the author. Two-thirds of nursing home residents receive Medicaid, which pays approximately 80 percent of the cost of their care, as measured in resident-days. Thus a majority of the institutionalized disabled elderly receive care that is funded by a program intended for welfare recipients and governed by traditional welfare rules (e.g., asset and income limits). Medicaid in effect has become a nearly universal form of long-term-care insurance. Since few families can pay out of pocket and the insurance market is underdeveloped, most patients easily qualify for Medicaid when admitted to a nursing home.

The existing system has several consequences. Nearly a quarter of the Medicaid budget is diverted from the acute-care needs of the indigent population. A two-tier structure of care has emerged, one effect of which is that the nursing home admission process depends on the ability to pay. The system often provides second-rate care, as nursing homes, operating within payment limits set by the state and federal governments, receive inadequate reimbursement and resources. Families increasingly seek to transfer assets in order to qualify for Medicaid, leading to "creative accounting" that actually amounts to welfare fraud. The financial burden placed on spouses often makes independent living difficult for them to achieve or enjoy.

Cadette notes that this "welfare model" undermines the creation of an insurance model for which long-term care is ideally suited. Medicaid can be relied upon to pay for long-term care, and many people incorrectly believe that Medicare coverage extends to such care, while the cost of private insurance remains high. Although a publicly funded insurance system would have low administrative costs, steep increases in payroll or other taxes would be required to subsidize such a system in addition to the Medicaid and Medicare programs. More widely available private insurance would be similarly costly.

The best solution, says the author, would be to extend the principle of Medicare payment for some short-term services. He recommends that longer-term stays in nursing homes be covered by private insurance, which would be subsidized by tax credits scaled to income, in order to make premiums affordable. He also suggests that the government tighten Medicaid eligibility by lengthening the waiting period for coverage when applicants transfer assets to their heirs.

Program: Financial Markets and Monetary Policy

THE 13TH ANNUAL HYMAN P. MINSKY CONFERENCE ON THE STATE OF THE U.S. AND WORLD ECONOMIES

Economic Policy for Sustainable Growth

As part of its research program on financial markets, the Levy Institute organized a conference, held on April 15 at the Hilton New York in New York City, to discuss viewpoints on the current state of the U.S. and world economies and their future direction. Uncertainty about the resilience of the U.S. economy and the strength of its recovery carries implications for the global economy. What are the monetary and fiscal policy prescriptions for renewed growth, employment, and price stability, and what implications will the answers to this question have for public policy? Brief summaries of the speakers' remarks are given here.

Session 1. The State of the U.S. and World Economies: A Wall Street Perspective

The session was moderated by CONSTANCE MITCHELL FORD, Economics Editor, *Wall Street Journal*. Presentations were made by LAKSHMAN ACHUTHAN, Managing Director, Economic Cycle Research Institute; WILLIAM C. DUDLEY, Managing Director and Director of U.S. Economic Research, Goldman Sachs & Co.; JOHN LIPSKY, Chief Economist and Global Head of Economic Policy Research, JP Morgan Investment Bank; and JAMES W. PAULSEN, Chief Investment Strategist, Wells Capital Management.

LAKSHMAN ACHUTHAN noted one of the main points made at the previous year's Minsky conference: If we did not believe that there was a recession in 2001, we are likely to underestimate the probability of future recessions. Denials about recession had been voiced by individuals who considered the economy recession proof, but Achuthan deemed the 2001 recession a foreseeable downturn that stemmed from cyclical economic fundamentals. Asynchronous growth of the world economies and excess capacity abroad in the 1990s had produced low inflation growth in the United States. A popular explanation for low inflation growth was the new paradox created by the information technology (IT) –enhanced economies: strong productivity growth enables inflation-free growth, which lowers the risk of recession. This explanation helped support higher "new economy" valuations and investment. However, when the world's central banks hiked interest rates in sync in 1999, as the Japanese economy expanded, inflation pressures began to rise. This event upset the global demand relationships at the margin, so the United States had less imported disinflation. The lagged effect of the interest rate hikes, combined with an oil price spike, triggered a sharp deceleration in global growth. This event was accompanied by an IT sector bust; IT investment represented almost half of all capital investment in the United States, and IT had become a notably cyclical industry. Therefore, a cyclical triple whammy (interest rate hikes, oil price spike, lower IT investment) rather than a combination of freak events caused a global recession.

Achuthan observed that the volatility of the business cycle decreased dramatically after World War II. A number of rationales were proposed to support the view that the business cycle was at an end (i.e., the decline in cyclical volatility was here to stay): the secular shift to a service-oriented economy reduces the impact of the inventory cycle; just-in-time supply-chain management systems eliminate inventory cycles; deregulation and derivatives increase market efficiency; better monetary policy mitigates the boom-bust cycle; a larger government sector and higher taxes stabilize the business cycle; the technology sector is immune to cyclical forces that buffet the old economy; the trend toward globalization may smooth out business cycles; and in the short run, a prevalent view becomes a self-fulfilling prophesy.

Achuthan countered the various rationales by observing that many discretionary services remain highly cyclical (e.g., advertising, consulting, some financial services); supply-chain management systems—the producers of the equipment that should have eliminated the inventory cycle—become the foremost victim, since a lack of information about upcoming cyclical turns raises volatility, which may be triggered by factors such as terrorism or supply disruptions; derivatives may increase volatility (consider, for example, the case of Long Term Capital Management, the Asian currency crisis, or the Russian bond default); just-in-time monetary policy allows a buildup of imbalances; smaller government and lower taxes reduce stabilizing effects and raise volatility; technology is more cyclical than are many "old economy" businesses; globalization often increases the synchronization of business cycles, leading to more pronounced upturns and downturns in the economy, with the 1990s the exception to the rule; and the self-fulfilling prophecy becomes a self-negating prophesy, i.e., behavior resulting from the lack of an economic downturn creates excesses that ensure an economic downturn.

U.S. and global cyclical volatility, which has been in a long-term decline since World War II, reached a record low in the late 1990s. It has risen noticeably since then, observed Achuthan, so more recessions, recoveries, and turning points may occur. This pattern would affect budget deficits and the stock market: the equity risk premium is linked to cyclical volatility. The coexistence of positive economic growth and a declining stock market in 2002 may partly be the result of a changing equity risk premium as volatility shifts in the business cycle. Although cyclical volatility has fallen during all of our adult lives, there are reasons to believe that the downward trend may have reached the end of the road.

WILLIAM C. DUDLEY stated that the U.S. economy will continue to grow, but the rebound will be relatively slower over the next year. Stock market weakness has set in motion very large balance sheet adjustments by corporations, households, and state and local governments. While the corporate adjustment is advanced, the household adjustment is less than half complete and the state and local government adjustment is just beginning. Government policy has sought to offset these balance sheet adjustments and strengthen the economy, so most of the effects of monetary policy have already occurred. Therefore, the 2002 fiscal impact on such interest-rate-sensitive sectors as housing and automobiles was much more powerful than what we can expect in 2003.

Dudley anticipates an acceleration in the U.S. economy between the second and third quarters of 2003 because the end of the Iraq war should prompt an above-trend rebound in economic activity, as a result of pent-up demand. However, he also expects the economy to return to its relatively weak underlying trend. The current business cycle (an investment boom/bust cycle or a stock market bubble/burst cycle) is not normal, he says, noting that this is the only recovery episode since World War II in which the stock market has continued to decline.

The corporate sector will probably not amount to a significant drag on future economic activity, but it is unlikely to contribute much to economic growth. Incentives currently facing corporate America, such as maximizing free cash flow, are different from those of a few years ago, when maximizing EBITDA (earnings before interest, taxes, depreciation, and amortization) was an objective. Such changes translate into a negative corporate financing gap, since capital spending will not exceed cash flow. Productivity growth generally fares well during the early stages of the business cycle but subsequently slows significantly, a pattern that is likely to occur in the next quarter (contrary to Alan Greenspan's argument that because productivity growth is very high, capital spending will recover quickly).

On the consumer side, the main effects of mortgage financing and mortgage equity withdrawals (which amount to more than 3 percent of disposable income) on economic growth have already occurred and are likely to subside. Consumers have not yet fully repaired their balance sheets, so the saving rate will likely return to approximately 8 percent of disposable income, from 4 percent today, and consumption will grow more slowly than income for a sustained period of time. The adjustment process will be complete and the economy will be poised for rapid growth when the private sector balance returns to normal.

Future contributions from government policy are likely to be less substantial than in the recent past. The Congressional Budget Office's standardized budget balance, which measures the fiscal impulse, was enormous in 2002 but will be much smaller in 2003. Considerations of monetary policy must include not only the federal funds rate, but how this rate affects financial conditions. Monetary policy works through three channels: the interest rate, wealth, and dollar trade. The interest rate channel has functioned well, but the wealth channel has moved in the wrong direction and the dollar channel has been constrained by the strength of the U.S. dollar.

Goldman Sachs's financial conditions index, which captures the effects of these channels, suggests that financial conditions today are no different from their status in January 2001 when the Federal Reserve began aggressively to ease monetary policy. The Fed has failed to accomplish much because the stock market has been of little help. Since the positive effects of the interest rate channel have already occurred, the other two channels must begin to exert their effects before monetary policy can boost the U.S. economy, i.e., through a rise in the stock market and a drop in the strength of the dollar, so that wealth and trade move in a positive direction. This may happen later, but definitely not in 2003.

According to JOHN LIPSKY, the U.S. and global economies will improve only temporarily as a result of the aftermath of the Iraq war. GDP growth in the United States will accelerate at an annual rate of 3.5 to 4.0 percent in the second half of 2003, with some upside and downside risk—recent events have been disinflationary—and there will be an additional modest decline in the U.S. dollar.

The growth gap between the United States and the rest of the world during most of the 1990s disappeared briefly in 2001, but reappeared with a vengeance in 2002. Although he has more confidence in the prospect of continued economic expansion in the United States than abroad, Lipsky expects the gap to disappear over the next year. His data suggest that structural problems related to the U.S. current account deficit have disappeared, and there is no evidence that income elasticities of import demand differ between the United States and other countries. Therefore no competitive or dollar valuation problems exist; rather, a period of below-potential growth has persisted in the rest of the world.

Lipsky expects consumer prices in the G7 nations to continue to be disinflationary. He noted that consumer price inflation in the industrial countries is at a 40-year low. On a broad, trade-weighted basis, the exchange rate of the dollar has remained stable since the mid 1990s because the United States trades less with the euro zone compared to areas that manage their currencies relative to the dollar.

A review of the components of GDP growth shows that the last recession was entirely a business phenomenon—household and government spending remained intact—and thus atypical. Three factors made it so. First, household spending grew at the same time as the saving rate rose during a period of contraction (no job growth) in the business sector. This occurred as a result of stronger-than-anticipated productivity gains (the "new economy" was not completely a pipe dream), which led to higher real wages during a time of increasing profit margins. Second, an unprecedented amount of fiscal and monetary support for household income resulted in higher spending and higher saving at the same time. Third, a substantial change has occurred in the financial underpinnings of the U.S. corporate sector, which has increasingly relied on the issuance of corporate bonds as the primary means of raising funds (i.e., selling marketable securities to investors who mark their balance sheets to market). Thus no net borrowing by U.S. corporations was seen in the 1990s, as corporations were net purchasers, rather than net sellers, of equities. Corporations today face greater pressure to show profits and thus convince investors to hold their debt at sensible interest rates. Only 12 percent of U.S. corporate borrowing relates to traditional bank lending, compared to 90 percent in the euro area, noted the speaker.

Lipsky is moderately optimistic about the future because of two basic assumptions. The first is that household spending growth will continue, but will lag slightly behind income gains, yielding a continued modest rise in the saving rate—meaning that households have acted, and will continue to act, normally. The second is that a gradual acceleration in the growth of business inventories will occur. He noted that spending on capital equipment and software grew last year at about the pace of the overall economy, and that the large decline in the inventory sales ratio in the 1980s and early 1990s did not continue in the remaining years of the 1990s. He presumes a return to a more normal relationship between inventory levels and real final sales.

The latest data show that corporate bonds represent 55 percent of all corporate debt. This phenomenon, which is not present in other economies, has produced a sharp rebound in manufacturing profits. According to Lipsky, pessimists about capital spending have been wrong. Business capital spending on equipment and software in 2002 was at the fourth highest annual rate since 1968, despite the investment boom and bust of the late 1990s. Higher productivity has been the result of massive capital spending, which has begun to grow once again. He noted that 70 percent of business capital spending is in the service sector, the relative price of capital goods is rapidly declining, and interest rates are low.

The big surprise and disappointment in the global economy last year was weak growth in the European Union. According to the Taylor Rule, the Fed has been doing what is expected of it in the realm of monetary policy. In the same area, the European Central Bank has been fairly aggressive, as a result of relatively low potential growth and high inflation. In terms of fiscal policy, however, marked differences between the United States and the euro area have been evident since 1995, as the U.S. surplus has allowed more aggressive fiscal action without creating an unbalanced policy.

The financing gap—the percentage of capital spending not covered by internal cash generation—spiked at the beginning of the last recession, but quickly reverted to its normal range. By contrast, the euro area's corporate sector has just begun to adjust, despite the presence of economic imbalances as large as those seen in the United States. Faster adjustments in growth and profit margins have occurred in the United States. The risk is that the euro area's employment adjustment in the corporate sector is unfinished.

Lipsky found that the correlation between the business cycles of the United States and emerging Asia has tightened, while such a correlation hardly exists between the euro area and emerging Asia. This difference is creating a two-speed globalization, in which less than 20 percent of U.S. bilateral deficits are with countries whose currencies float against the U.S. dollar. That explains why the expansion in the current account deficit has been easily financed. Lipsky noted that the current account balance and the federal budget balance (the "twin deficit" problem) are unrelated and therefore are poor predictors of the economy. Net capital outflows from American investors have declined sharply, mitigating the decline in foreign investment in the United States.

JAMES W. PAULSEN observed that the economic outlook for the U.S. economy in the near term is very different from that in the long term. His historical review of the stock market since 1800 showed that the market declined during only one four-year interval. Therefore, he said, the probability that the stock market will fall this year is one-half of one percent, noting that the government has launched a policy assault to alleviate the dotcom meltdown and the 2001 recession.

The most notable development in the past year has been a change in government policy. Previously, there had been, essentially, one "easy" policy and three "tight" policies. After the dotcom stock market peaked in March 2000, nine months elapsed before a problem—its steady decline—was evident, followed by a year and a quarter during which monetary easing was the only policy used to stimulate the economy. Finally, in 2002, policies in the form of fiscal stimulus, a weaker dollar, and lower long-term Treasury yields were enacted. If it seems that these policies are not working, it is because a lag must occur before their effects are apparent.

The focus in the past 10 years has been on the Fed (i.e., monetary policy) rather than on the total impact of policy on the economy. By combining monetary, fiscal, and trade stimuli into one variable, as a percentage of nominal GDP, Paulsen shows that there was a very tight range, 55 to 65 percent, for this variable from 1960 to the mid 1990s. Thereafter, the variable declined to a highly contractionary level, reflecting extraordinarily tight policies and resulting in the 1997 East Asia crisis, the dotcom meltdown, and the 2001 recession. The new corporate culture had no pricing flexibility and was constantly cutting costs, leading to deflation. Fortunately, this situation has begun to improve. The Goldman Sachs nonenergy commodity price index (with a three-year lag) indicates that core pricing is likely to rise, implying a more normal policy response and recovery in the coming year.

On the subject of economic traction, Paulsen cited the turnaround and growth in industrial production, commodity prices, personal disposable income, and total (household survey) employment. In addition, he noted higher annual growth in S&P 500 operating earnings, capital spending, inventories, and bank loans. The economy, he concluded, is in better shape than news reports might suggest.

The trade deficit (5.25 percent of GDP) is distorting the interpretation of the economic recovery. Since real GDP growth is weak by historical standards, employment, income, and profits are also weaker. A comparison should not be made between policy and the economy, but between spending and production. Real gross domestic purchases are growing at an annual rate of 4 percent, but nearly 1 percent goes overseas, as a huge trade leakage affects production, jobs, and income in the United States. The trade deficit is having such a substantial impact at this time because 22 percent of total demand is lost abroad—a percentage that is more than twice as high (and more than 3 to 4 times higher in nominal terms) as the average during the first five quarters of expansion after recession. However, because the dollar has declined by approximately 20 percent on a trade-weighted basis, some improvement in the import-to-export ratio is likely to occur in the next year. Even if the trade deficit remains flat, real GDP will likely rise, along with jobs and income. The task is not to stimulate spending, but to close the trade window.

On a net basis, no jobs have been created for the past three years. According to Paulsen, jobs are perhaps overrated in terms of their impact on consumption because as a result of deflation, households have enjoyed two unique forms of stimulus in this cycle: an absence of CPI inflation (with tremendous growth in the real purchasing power of wages and real consumption) and lower mortgage payments. Consumers thus are expected to contribute their standard 2 to 2.5 percent to economic growth this year. Swing factors in other sectors of the economy may help produce a relatively high real GDP growth rate in the second half of the year.

Paulsen foresees a couple of years of optimism and stronger growth before worries about inflation again set in. The current, massive policy stimulus is postponing a confrontation with several secular disinflationary problems (e.g., aging demographics, indebtedness, lack of saving) that have so far resisted solution.

Speaker: MARC FABER

A number of imbalances have developed in the world economy and may cause problems in the future. If an asset class substantially increases in value over an extended period of time, more money flows and borrowing are directed toward acquiring that asset class. According to MARC FABER of Marc Faber Limited, the end result is likely an investment mania, which will eventually burst, followed by a change in leadership, as when the gold and commodities mania of the 1970s shifted to financial assets. Faber pointed out, however, that a mania in one sector of the economy means that underevaluation exists in another sector. He also observed that interest rates tend to rise during a period of rising commodity prices, and vice versa. The “golden age” of capitalism, from 1950 to 1980, was characterized by accelerating inflation, rising interest rates, mild recessions, and very strong real wage growth. Since then, inflation rates, commodity prices, and interest rates have been declining. The question is how much longer this trend will last.

Faber noted that all major waves of innovation occurred during periods of weak price structures and falling interest rates, leading to investment manias; the advent of the railroads in the United States at the end of the 19th century, for example, had a devastating impact on world agricultural commodity prices. Rising real wages result in a deflationary boom. Today, as China and India exert tremendous pricing pressures on the Western industrialized nations, a strong deflationary bias persists in some sectors of the economy. The problems of deflation relate to only the preceding period of inflation and debt accumulation, e.g., excessive borrowing in the United States. There is a very close correlation between the movement of interest rates and refinancing activity. The U.S. economy is thus caught between two trends: further deflationary pressures amid a continued weak economy, or a strengthening economy with rising interest rates and the end of the refinancing boom. Credit growth in the United States has been lopsided, said Faber: in the last two quarters 80 percent of growth has come from mortgage debt and consumer credit, while the corporate sector has contributed relatively little.

According to Faber, from an economic viewpoint, U.S. monetary policies are suicidal because they stimulate borrowing and spending but not industrial production. For example, appliance sales related to the housing boom promote capital spending and industrial production in countries outside the United States, such as China, India, and Vietnam. This situation is creating imbalances in the global economy. China has doubled its real per capita income every 10 years for the past 25 years, compared to a span of 40 to 50 years that was required for comparable income growth in Great Britain and the United States in the 19th century. As a result of outsourcing in this age of worldwide instant communication, a significant transfer of high technology and information to emerging countries has occurred almost overnight.

China's share of U.S. and Euroland imports has grown rapidly, at the expense of Japan, South Korea, and Taiwan. This development, said Faber, will not necessarily have a negative effect on the stock markets, but will have a decidedly negative impact on future economic growth in the United States and Europe compared to the emerging economies. U.S. competitiveness has diminished dramatically while the nation's trade imbalance with China, which now includes electronic and high-technology products as well as footwear and textiles, has continued to grow. The U.S. trade and current account deficits have prompted a huge transfer of wealth into the Asian economies.

Until 1987 the United States had a positive net investment position. Americans owned more assets overseas relative to foreign-owned assets in the United States. After 1987 the U.S. net investment position deteriorated badly, reaching negative status wherein foreigners now own $2 trillion more in the United States than Americans own abroad. As a result, the U.S. economy has become increasingly susceptible to the effects of foreign capital flows, including those of the bond market, stocks, and real estate, and to the whims of foreign investors. In addition, many major world paper currencies are considered undesirable, while the Chinese renminbi is probably the most favored paper currency for long-term ownership.

Faber noted that dramatically shifting balances in the U.S. and world economies have important implications for the housing and commercial markets, tourism, and the leisure industry in China. Since China is relatively poor in natural resources—it has been dependent on oil imports since 1993—it must import needed products from resource-rich countries. Commodity prices started to rise last year despite the weakest global economic growth in 30 years, suggesting, he said, an increasing demand for raw materials from China and other East Asian countries, whose rising standards of living will create a markedly increased demand for food products, as well.

During periods of rising commodity prices, financial assets tend not to fare well, while emerging economies (e.g., Brazil, Russia, Indonesia, Australia) do much better and their currencies strengthen against the dollar. Faber proposed that some other presentations at the conference might have viewed the U.S. economy too optimistically. A genuine recession, once it arrives, may become virulent in the years ahead, as U.S. monetary policy combined with a weak economy produces high inflation rates, he said.

Faber recommended shorting bonds and going long in Japanese stocks if commodity prices rise, since stocks as a percentage of market capitalization are at an extremely low level in Japan. He cautioned against owning financial stocks in the United States, predicting that the stock markets, after trading within a certain range for several years, will undergo a major collapse brought about by currency factors or deteriorating economic conditions that deflate financial assets. On the other hand, over the next 10 years commodity prices may fare relatively well and Asian economies may outperform Western economies by a wide margin.

Faber considers the expansion of the European Monetary Union to be a favorable development, leading to bull markets and arbitrage effects. The real estate market should rise in Eastern Europe and stagnate in Western Europe, with money eventually flowing out of the United States, creating weaker economic conditions and a weaker dollar. Although the dollar is unlikely to fall against the euro and the yen, it may decline against hard assets and commodities. Asia, including Japan, will prove increasingly attractive to investors, he suggested.

Keynote Speaker: ERNST WELTEKE

According to ERNST WELTEKE, president of the Deutsche Bundesbank, the present state of the world economy is characterized by an unusually high degree of uncertainty, as a result of the Iraq war, fickle financial markets, and a lack of confidence among businesses and consumers. He noted that uncertainty due to geopolitical strife was deflecting attention from some fundamental macroeconomic imbalances that need to be redressed before sustainable growth can occur. The world economy depends too heavily on the United States, he said, and the euro area and Japan must improve their ability to generate self-sustained economic growth.

The expectation that the world economy will return to a healthy and stable growth path is unrealistic. In the euro area, structural weaknesses have grown increasingly severe for more than a decade; the central such weakness is labor market inflexibility. In a currency union, market flexibility is crucial because exchange rates cannot cushion asymmetric shocks. The fragile world economy conveys the message that Europe should improve its ability to grow on its own and assume a leading role in the political, financial, and economic arenas. Europe is prepared to do this, says Welteke, because its framework for economic and monetary union is sound, as evidenced by the competitiveness of European products despite the appreciation of the euro against the dollar. He noted that structural weaknesses arising from the sluggish world economy and the crisis in confidence present an opportunity for reforms in public finance, social security, and labor markets. Reforms can occur if the willingness of individuals to take risks and develop initiatives can be strengthened, he said.

Citing differences between Germany and Japan, Welteke disagreed with the proposition that the German economy could deteriorate as Japan's has. The German economy, he said, is strong—highly productive and competitive. Welteke noted that Germany still suffers from economic policy mistakes made during the unification process, e.g., the boom-bust events triggered by generous tax incentives in the construction sector. The banking sector is not in crisis because it is well-capitalized, its supervision is efficient, and a real estate bubble never existed in Germany, as it did in Japan. Faced with less profitable financial market activities and rising loan provisioning, German banks have enacted deep cost-cutting measures and appear to be free from any systemic risks. The argument that Germany is becoming another Japan is therefore utterly unconvincing. Germany has learned from Japan that postponing structural reforms is a mistake to be avoided.

From a European perspective the foundations for sustainable growth are macroeconomic policy geared toward stability, structural policy geared toward growth, and a sound financial sector, said Welteke. Price stability with a well-functioning price mechanism is a precondition for efficiency, economic growth, and a high standard of living. (The Governing Council of the European System of Central Banks has defined price stability as an annual increase of 2 percent or less in the general price level.) Since price stability is recognized as the superior concept of monetary policy on a global scale, the prospects for the world economy in this respect are highly favorable.

The European stability consensus aims to underpin price stability with an equally stability-oriented fiscal policy, e.g., the Stability and Growth Pact (SGP). Sound public finances contribute to sustainable growth and foster confidence. The SGP is designed to automatically stabilize the economy over the course of the business cycle—its main tools are the social security systems—and is a major improvement over discretionary stimulus packages. It is flexible and allows for a large macroeconomic stimulus. The problem, said Welteke, is that some governments want to apply the SGP asymmetrically; this bias is the reason for limiting the deficit to 3 percent of GDP.

The United States and the euro area have begun to pursue fiscal policies with divergent approaches—fiscal stimulus and planned fiscal consolidation, respectively—aimed at rebuilding confidence. The makers of economic policy should design a framework conducive to economic growth, said Welteke. The unsatisfactory growth performance in Europe is mainly the result of inflexible labor markets, which are the responsibility of national governments. In Germany the combination of high labor costs and generous welfare benefits has crowded out low-wage jobs for the low-skill labor segment. Hence, Germany is revamping its unemployment benefits and welfare assistance and will have to tolerate a higher degree of wage differentiation. Wage negotiations, currently centralized, will become open to company-specific deals. More differentiation is a crucial feature of progrowth policies. In addition, nonwage labor costs will have to be reduced in order to reform the labor market and social security systems, while pension reform remains unfinished business. Progrowth policies must also encompass a liberal trade policy.

A sound financial system is a prerequisite for attaining the growth potential. Europe is becoming less reliant on its banking system to allocate funds, as capital markets play an increasingly prominent role in providing diverse financing options. Welteke noted that safeguards such as effective financial regulation and supervision are needed. Deeming the world financial system resilient following the shock of 9/11, he said that a robust market infrastructure would be a necessary ingredient in achieving steady and sustainable growth. He called for the development of a more resilient and balanced world economy and for cooperation between the United States and Europe.

Session 2. The Macroeconomic Prospects for the U.S. Economy

The session was moderated by MICHAEL MANDEL, Chief Economist, *Business Week*. Presentations were made by J. ALFRED BROADDUS JR., President, Federal Reserve Bank of Richmond; RANDALL S. KROSZNER, Member, President's Council of Economic Advisers; MARTIN MAYER, Guest Scholar, Brookings Institution; and WILLIAM POOLE, President and CEO, Federal Reserve Bank of St. Louis.

According to J. ALFRED BROADDUS JR., the near-term outlook for the U.S. economy is extremely uncertain, and financial market perceptions are extremely volatile. The latest Blue Chip consensus forecast is for real GDP to increase at an annual rate of 1.8 percent in the first quarter of 2003, 2.2 percent in the second quarter, and more than 3.5 percent in the second half of the year and in 2004. The unemployment rate will rise modestly before declining gradually to 5.5 percent, and the inflation rate (the chained GDP price index) will remain steady at 1.5 to 2.0 percent. However, said Broaddus, the probability that the economy could be appreciably weaker or stronger than the consensus is higher than usual.

A weaker economy could result from geopolitical risks, perhaps related to Iraq or North Korea; negative economic fundamentals, as in a loss of financial wealth by businesses and households; lower company earnings and stock prices; excess productive capacity; and high productivity growth rates that restrain job growth. In the view of some economists, the recent spate of soft monthly economic reports is evidence of an eroding recovery.

In contrast, a stronger economy could result from considerable monetary and fiscal policy stimulus, with a zero or possibly negative real funds rate; favorable financial conditions, such as stronger household balance sheets due to refinancing of mortgages; and favorable lending conditions for banks (i.e., they are well-capitalized, profitable, liquid, and free from significant credit problems).

In terms of monetary policy, the Fed must be particularly vigilant and anticipatory. Broaddus noted that the Fed has developed an increasingly well-defined strategy for monetary policy that consists of two interdependent elements: a strong commitment to maintaining permanent price stability, and active interest rate management to stabilize the economy in the short run. A credible commitment to long-term price stability is a necessary condition for effective short-term stabilization policy, he said. Broaddus credited the Fed's monetary strategy for the two exceptionally long business expansions that have taken place in the United States over the past 20 years, and voiced the expectation that this strategy would maximize U.S. economic growth in the long run. The strategy has already reduced the effect of recent shocks to the economy, he said.

Convincing evidence of price stability reflects public confidence that inflation will be contained and excessive disinflation or deflation successfully confronted. Broaddus observed, however, that credibility about inflation does not necessarily extend to disinflation and deflation. The absence of a track record and the current proximity of the funds rate to the zero level are obstacles to full antideflationary credibility.

Broaddus noted a number of steps that the Fed has taken to enhance the credibility of its opposition to deflation. These include participation in public conferences and discussions about the merits of various approaches, such as reducing longer-term interest rates by purchasing large quantities of longer-term Treasury securities in the open market, and substantially increasing the volume of cash by purchasing Treasury Bills and other short-term securities. A drawback to the former approach is the practical difficulty of holding down the Federal funds rate. A shortcoming of the latter approach is its minimal impact as short-term rates reach zero: cash and Treasury Bills would become perfect substitutes at zero nominal interest rates. In Broaddus's view, purchasing long-term Treasury securities is probably the most effective way for the Fed to undercut deflation at the zero level, as it would increase broad liquidity and stimulate economic activity via portfolio rebalancing and the credit channels of monetary policy transmission. If this approach were employed, it would be important to ensure that the supply of Treasury bonds was sufficient to meet the Fed's needs; Broaddus considers the current outstanding supply sufficient. Alternative approaches would involve Fed decisions regarding the allocation of credit across the U.S. economy and would risk undermining the efficiency of the private credit markets and jeopardizing the Fed's independence in conducting monetary policy.

RANDALL S. KROSZNER noted that the April Blue Chip forecast showed uneven but positive growth in 2002: weaker-than-potential growth in the first half, stronger-than-potential growth in the second half. He stated that one of his duties at the President's Council of Economic Advisers was the preparation of a 10-year economic forecast, using an interagency process. The forecast is set in early December and is based on the following February's budget. Kroszner estimated a long-term growth rate of 3.1 percent annually, of which 1 percent would result from an increase in labor hours and the remainder from productivity.

A number of challenges and downside risks confront the U.S. economy, which is in a recovery, but one that lags behind typical postwar recoveries, he said. Whereas the equipment and software sector has begun to recover, structured investment has fared poorly and employment growth has been tepid. According to the nonfarm payroll survey, employment growth was negative over the past two months. Kroszner noted that manufacturing employment is in a very long-term decline, and that the overall unemployment rate has been essentially unchanged, as the size of the labor force has shrunk.

Consumer spending has been stronger than is typical of postwar business cycles, but a decline in consumer confidence ratings is a cause for concern. The challenge, he said, is to maintain consumption levels.

According to Kroszner, one way to meet the challenges faced by the U.S. economy is to raise investment. He noted that capital taxation is more distortionary than the taxation of labor because it leads to less capital accumulation and formation, amounting, in effect, to a tax on business investment and growth. Double taxation of dividends therefore is a double taxation on economic activity, which distorts corporate investment decisions and adversely affects productivity. Capital taxation also may confound corporate governance because the tax system introduces a bias into business decisions about retaining earnings or paying them out in the form of dividends. Decisions should be based on sound economics rather than tax implications, which involve factors such as earnings reports, free cash flows, and audits. Thus, he said, double taxation is bad for capital, corporate governance, and workers.

Other government measures aimed at stimulating the U.S. economy include an increase in the expensing limit for small and medium-sized firms (from $25,000 to $75,000) and a reduction of the marginal tax rates, achieved by accelerating the tax cuts passed in 2001.

One innovative approach to alleviating unemployment relates to how people respond to incentives; for example, when their unemployment benefits are about to expire, their success in finding a job increases markedly. The administration has thus proposed the creation of personal "reemployment accounts" for the long-term unemployed. These accounts, containing approximately $3000, could be used in any way that is compatible with finding a job (e.g., for training, relocation, or childcare). Similar small-scale experiments, in such states as New Jersey, have lent credence to this approach.

Short-term measures proposed by the government to put cash in people's pockets include accelerating the elimination of double taxation on marriage and child-care credits, in addition to lowering the marginal tax rates. If the administration's job and growth package is ratified by Congress, GDP growth (on a fourth-quarter-to-fourth-quarter basis) is expected to rise by an additional 1 percentage point in 2003 and a 0.8 percentage point in 2004, translating into approximately 500,000 additional jobs this year and 900,000 next year.

By improving the tax structure, devising new back-to-work incentives, and putting cash into people's pockets in the short run, an environment for a robust economic recovery can be created, said Kroszner.

In response to previous presentations, MARTIN MAYER stated that if corporations could account for dividends as payments of interest on debt, distortions in the current tax system would be eliminated. He expressed doubt that corporate executives would change their behavior if dividend tax breaks were given to shareholders. Institutions can pressure corporate management, but they have no stake in the government's proposal to eliminate the double taxation of dividends. Eliminating double taxation should therefore occur on the corporate rather than the personal side.

Mayer noted that the avoidance of inflation in the United States is closely related to imports' exceeding exports by about 4 percent of GDP. This imbalance was financed by autonomous capital flows into the U.S. marketplace, but Treasury paper held by the Federal Reserve Bank of New York for foreign official accounts ($800 billion) has increased in value by more than 1 percent of GDP in the past year. It is unhealthy for foreign central banks and governments to hold more Treasury securities than the Federal Reserve, and the notion that the Fed should purchase Treasury paper and fund the deficit through the central bank violates every modern rule of central banking, he said.

Mayer considered the question of why monetary policy works and surveyed some targets chosen by central banks, such as free reserves, exchange rates, and interest rates. Whether the Fed should target asset prices has recently been debated. The "official" view is that this target violates the "laws of nature" because the government cannot ascertain the correct level of asset prices. Mayer pointed out, however, that changes in asset prices occur when the central bank changes interest rates and, subsequently, the price of short-term paper.

The period of the 1950s was the Fed's heyday because its tools exactly matched its tasks. The banking system was controlled by the Fed and accounted for 60 percent of U.S. financial intermediation, so actions that changed the behavior of banks rapidly changed spending patterns. Changing reserve requirements, lending at the discount window, or open market operations activated multipliers that affected the total economic system to a predictable degree. The key was that 50 percent of banking assets were in Treasury securities. Lower interest rates induced the sale of Treasury paper, which increased profits, funded loans, and financed economic expansion. Higher interest rates choked off the credit supply. The target of Fed policy was a change in asset prices, an approach that does not suit present theories and is therefore absent from current textbooks.

Banks today account for one-seventh of the nation's financial intermediation; large banks fund themselves by borrowing rather than soliciting deposits; the repo market is unimaginably large; the discount window and the power to change reserve requirements are gone; the multiplier is virtually infinite; and the money supply is unmeasurable. When the Fed pumps money into the economy to lower the interbank overnight lending rate, four outcomes are possible: (1) economic activity may expand; (2) consumer prices may rise (people spend but the supply does not increase); (3) asset prices may rise (people spend on securities or real estate); and (4) the income velocity of money may drop, leaving the real economy and price levels the same. There is no way to predict which outcome, or combination thereof, may result from a change in the interbank overnight interest rate. A fifth possibility—an increase in the trade deficit and a reduction in the exchange rate of the currency—is determined more by capital flows than by trade flows, noted Mayer, so interest rates are a very blunt tool for influencing capital flows. He further noted that a decline in the dollar exchange rate benefited the United States more than other countries.

The Fed's problem, he said, is to find the factors that will determine how, at given times, a change in the price of short-term financial assets will affect the prices of other assets, including the value of collateral. When dealing with human opinions, beliefs, and fashions, however, the correlations between monetary policy and its effects are unstable. Historical responses are not indicative of how changes in monetary policy will influence economic activity, consumer prices, asset prices, or income velocity. The Fed thus requires disposable models, so that its policy prescriptions are less doctrinaire, more flexible and effective, and less prone to disaster.

WILLIAM POOLE focused on the shocks that have affected the U.S. economy (e.g., terrorism, corporate governance scandals, and bankruptcies) and the economy's resilience as a result of four features: (1) vigorously competitive markets, which promote an adjustment to new circumstances; (2) a robust financial system; (3) a sound fiscal position despite current deficits; and (4) low inflation and monetary stability.

Poole views a continuation of modest economic growth, as experienced in 2002, as the most likely outcome for the U.S. economy. He noted that none of the 53 members of the Blue Chip panel of economic forecasters expected a decline in real GDP this year or next. Monetary policy is working, he said, citing such indicators as zero-interest financing and the persistence of the housing and mortgage-refinancing boom. An entrenched environment of low and stable inflation rates over the past five years, along with remarkably low inflation expectations, has played a central role. Disciplined monetary policy has created a conviction that inflation will remain low because the Fed will do what is necessary to achieve that result. Free from uncertainty regarding inflation, the economy has adjusted quickly and efficiently. Survey evidence on inflation expectations and the yield spread between conventional and indexed Treasury bonds does not support the view that deflation concerns have affected the way people behave.

An important positive shock to the U.S. economy is the sustained growth in labor productivity in spite of a slowdown in 2000, a recession in 2001, and a slow recovery in 2002. Given the pace of output growth, the productivity performance meant that employment growth was significantly negative during the recession and flat last year, but it bodes well for employment and output growth in the long run.

Poole subscribes to the belief that the Fed responds as needed to changing circumstances, in order to maintain low inflation and a financial environment consistent with maximum sustainable growth in employment and output. Monetary policy and its direction are driven by new information, such as statistical releases, anecdotal reports, and new research. Better economic conditions will arrive, he said, but when more rapid growth will begin is unknown.

Reforming the Euro's Institutional Framework

PHILIP ARESTIS and MALCOLM SAWYER

Policy Note 2003/2
www.levy.org/docs/pn/03-2.html

Since early 2001 the eurozone has experienced rising unemployment, falling output, and inflation higher than the European Central Bank's (ECB) target level. According to Institute Professor Philip Arestis and Senior Scholar Malcolm Sawyer, the eurozone system's fundamental problem is its inherent deflationary bias. They recommend scrapping the Stability and Growth Pact (SGP), removing artificial limits on budget deficits, permitting borrowing for capital investment, and curtailing "one-size-fits-all" policies so that EU members can establish appropriate fiscal policies for themselves. They also recommend new and stronger institutional arrangements that are designed specifically for the operation of EU fiscal policy and that coordinate the various national fiscal policies. The objectives and operation of the European Central Bank (ECB) must be changed, they say, so that growth and employment are considered along with inflation.

The general stance of the SGP—an overall balanced budget and a maximum annual deficit of 3 percent of GDP—and its management are deeply flawed, say the authors. A balanced budget does not allow governments to borrow to fund capital investment projects, and maintaining government deficits below 3 percent of GDP during a recession will likely cause economies to slump further. The contention that a balanced budget is compatible with high levels of employment cannot be justified, they say, adding that the European Monetary Union (EMU) sometimes does not adhere to its own rules, thus undermining its credibility.

The authors note that the European Commission criticized countries such as Ireland and Britain when their output exceeded the trend rate of growth. Countries differ in terms of output variations and sensitivities during the course of the business cycle, however, and balanced budgets are negatively linked to GDP growth. A 1-percentage-point decline in GDP increases the deficit-to-GDP ratio by an average 0.5 percentage points at the EU level; the effect varies widely among individual EU countries.

The view that fiscal policy has an important role to play is gaining ground, say the authors. They suggest that increased private sector expenditures could have effects similar to public expenditures. Contrary to arguments by the ECB that relaxing SGP rules would damage the credibility of the euro, Arestis and Sawyer propose that the opposite may be true. Many more fiscal policy reforms are needed, they say, before the eurozone can achieve a true economic recovery.

Problems including slow decision making on policy matters, operations that have confused the financial markets, and an uncertain reference value attached to the M3 money supply have compromised the potential efficacy of ECB monetary policy. The annual inflation target of 0 to 2 percent is too low, and the ECB is reluctant to manipulate interest rates despite abundant evidence that such maneuvers are necessary, the authors say. Unfamiliarity with the transmission mechanism of monetary policy and uncertainty about the impact of interest rates on private and public expenditures have led to reservations about the ECB's efficacy. The authors note that EU monetary policy suffers from major defects (e.g., the limited effect of interest rate changes on aggregate demand), but the ECB's president nevertheless defends EU policy and claims that its economic results are favorable—a claim that is not supported by a comparison of the respective effects of ECB and Federal Reserve policies.

The economic slowdown in the eurozone has exposed serious fault lines in the SGP, so policies based on SGP rules are untenable in the long term, argue the authors, who maintain that an inflexible interpretation of the SGP and adherence to its balanced budget requirement will turn the SGP into the "Instability and No-Growth Pact."

The Nature and Role of Monetary Policy When Money Is Endogenous

PHILIP ARESTIS and MALCOLM SAWYER

Working Paper No. 374, March 2003

www.levy.org/docs/wrkpap/papers/374.html

The demise of monetarism, along with difficulties associated with targeting the stock of money, has led monetary policy to treat money endogenously by focusing on a key interest rate, such as the central bank discount rate. Using interest rates as the key element of monetary policy raises the issue of their effectiveness in controlling inflation. Institute Professor Philip Arestis and Senior Scholar Malcolm Sawyer analyze this issue according to two schools of thought: the "new consensus" view and the Keynesian view. In terms of the new consensus view, they find that interest rates are relatively ineffective in controlling inflation and impractical in combating major shifts in aggregate demand. In terms of the Keynesian view, money is generated within the inflationary process, but does not cause inflation. The authors recommend a combination of fiscal policy to regulate aggregate demand and monetary policy to control the exchange rate.

Endogenous money plays an important role in the causal relationship between investment and saving. The new consensus views the stock of money as a residual, so it has no causal significance (changes in the money supply do not affect inflation) and the interest rate set by the central bank is not determined by the market. The Keynesian view provides a theory of endogenous, essentially bank, money; unlike the new consensus, this view pays a great deal of attention to the process by which loans and deposits are created and destroyed and to the causal links between investment expenditures and loan creation and between inflation and the creation of money.

The new consensus model is outlined by the authors in Working Paper no. 363. The model treats the setting of interest rates as a domestic matter and strongly suggests that inflation can be tamed through interest rate policy, using demand deflation. It also suggests the existence of an equilibrium or "natural" interest rate that can balance aggregate supply and demand and lead to a zero output gap. The authors find the argument that new consensus monetary policy as currently practiced has reduced and controlled inflation to be theoretically weak and empirically unfounded, however. Changing the real rate of interest cannot accommodate a significant change in the level of aggregate demand (e.g., a 1-percentage-point change in the interest rate results in a 0.45 to 0.60 percent change in GDP). Therefore, normal interest rate changes of 0.25 to 0.50 percentage points have little effect in offsetting changes in autonomous demand.

In the Keynesian approach, the central bank is perceived to be able to set a discount rate that generates a spectrum of interest rates that balance saving and investment at a level of employment corresponding to capacity output (where inflation is constant). The authors cite a number of circumstances that would upset this perception, such as when the equilibrium rate of interest is so low as to be unattainable or when the central bank cannot calculate or attain the equilibrium rate of interest. The key factor, which is often neglected, they say, is the forces that influence the central bank interest rate in the long term.

While the new consensus views inflation as driven by excess demand and inflationary expectations, the Keynesian view maintains that inflation can arise from a variety of sources, including cost-push pressures (e.g., wages, imported prices) and inadequate productive capacity. The authors note that the macroeconomy is subject to shocks from supply and demand, with substantial variations in the level of economic activity over the business cycle. Since, they say, the transmission of monetary policy depends on the expectations and behavior of a number of agents, changes in monetary policy may affect a range of economic variables aside from the inflation rate, such as the availability of credit, asset prices, and the exchange rate.

The authors point out that the rate of return that is relevant for foreign exchange dealings (on the capital account) is not the central bank discount rate, but the expected rates of return on such financial assets as bank deposits and bonds, and the overall return on equity. They also observe that, contrary to the interest rate parity theorem—that is, high interest rates are associated with the expectation of currency depreciation—raising domestic interest rates often raises the exchange rate. Therefore, monetary policy can influence real and nominal exchange rates and have short-term and long-term effects on the economy.

The authors contend that fiscal policy has a crucial role to play in terms of aggregate demand (which affects the rate of inflation, the level of economic activity, employment, and output) and as an automatic stabilizer when the government's budget deficit moves countercyclically. Monetary and fiscal policies thus should be coordinated so that monetary policy is set in recognition of its effect on such real variables as investment and the exchange rate, and fiscal policy in recognition of its effect on aggregate demand.

The authors recommend that the overall effect of interest rates, including their long-lasting side effects, be fully accounted for in the decision-making process. They advise against frequent adjustments in the interest rate, which have a limited effect and can entail costly decision-making and implementation procedures. An active policy of credit rationing would not be effective, they say, but, under certain circumstances credit controls might be helpful.

UPCOMING EVENT

International Perspectives on Household Wealth

A Conference of The Levy Economics Institute of Bard College
October 17–18, 2003
Updated information and registration materials will be posted on the Levy website under "Events."

Friday, October 17

8:30–9:00 a.m. **Continental Breakfast and Registration**

9:00–9:15 a.m. **Welcome and Introduction**
Dimitri B. Papadimitriou, President, Levy Institute

9:15–11:00 a.m. **Session 1. Wealth Changes in the United States over the 1990s**
Chair: **Dimitri B. Papadimitriou**, Levy Institute
Arthur Kennickell, Board of Governors, Federal Reserve System
"Wealth Trends in the U.S., 1998–2001: Evidence from the Survey of Consumer Finances"
John Czajka, Scott Cody, and **Daniel Kasprzyk**, Mathematica Policy Research, Inc.
"Who Shared in the Growth of Wealth in the 1990s? Subpopulation Trends in U.S. Household Wealth Holdings"
Discussant: **Timothy Smeeding**, The Maxwell School, Syracuse University

11:00–11:30 a.m. **Break**

11:30 a.m – 1:00 p.m. **Session 2. Wealth Inequality in Scandinavia**
Chair: **Edward N. Wolff**, Levy Institute and New York University
N. Anders Klevmarken, Uppsala University
"On Household Wealth Trends in Sweden over the 1990s"
Markus Jäntii, Statistics Finland
"Recent Wealth Trends in Finland"
Discussant: **Lars Osberg**, Dalhousie University

1:00–2:30 p.m. **Luncheon**

2:30–4:00 p.m. **Session 3. Wealth Trends in Europe**
Chair: **Ajit Zacharias**, Levy Institute
Andrea Brandolini, **Luigi Cannari**, **Giovanni D'Alessio**, and **Ivan Faiella**, Bank of Italy
"Household Wealth Distribution in Italy in the 1990s"
Richard Hauser and **Holger Stein**, Goethe University, Frankfurt am Main
"Inequality of the Distribution of Wealth in Germany 1973–1998"
Discussant: **Jay Zagorsky**, Ohio State University

4:00–4:30 p.m. **Break**

4:30–6:00 p.m. **Session 4. Wealth Trends in America**

Chair: **Philip Arestis**, Levy Institute

René Morissette, **Xuelin Zhang**, and **Marie Drolet**, Statistics Canada

"The Evolution of Wealth Inequality in Canada, 1984–1999"

Seymour Spilerman and **Florencia Torche**, Columbia University

"Parental Wealth and Children's Outcomes: Results from Chile"

Discussant: **Dalton Conley**, New York University

6:00–9:00 p.m. **Reception and Dinner**

Saturday, October 18

8:30–9:15 a.m. **Continental Breakfast**

9:15–11:00 a.m. **Session 5. Savings Behavior**

Chair: **W. Jean Yeung**, New York University

Erik Hurst, University of Chicago, and **Annamaria Lusardi**, Dartmouth College

"Entrepreneurship and Liquidity Constraints"

Ngina Chiteji, Skidmore College, and **Darrick Hamilton**, New School University

"Poverty in the Family, Saving, and Wealth Accumulation"

Discussant: **Maury Gittleman**, Bureau of Labor Statistics

11:00–11:30 a.m. **Break**

11:30 a.m. – 1:00 p.m. **Session 6. Wealth Mobility and Public Policy**

Chair: **Thomas L. Hungerford**, Levy Institute

Lisa A. Keister, Ohio State University

"Religion and Wealth: The Role of Religious Affiliation and Participation in Early Adult Asset Accumulation and Mobility"

Pierre Pestieau, University of Liège, and **Helmuth Cremer**, University of Toulouse

"Wealth Transfer Taxation: A Survey"

Discussant: **Robert A. Margo**, Vanderbilt University

1:00–2:30 p.m. **Luncheon**

2:30–4:00 p.m. **Session 7. Wealth Among the Low-Income Population**

Chair: **Mark Wilhelm**, Indiana University-Purdue University Indianapolis

Frank Stafford, **F. Thomas Juster**, and **Elena Gouskova**, University of Michigan

"Wealth Vulnerability: Evidence from the Health and Retirement Study, Panel Study of Income Dynamics, and the Survey of Consumer Finances"

Asena Caner, Levy Institute, and **Edward N. Wolff**, Levy Institute and New York University

"Asset Poverty in the United States, 1984–1999: Evidence from the Panel Study of Income Dynamics"

Discussant: **Howard Iams**, Social Security Administration

4:00 p.m. **Reception**

PUBLICATIONS AND PRESENTATIONS BY LEVY INSTITUTE SCHOLARS

PHILIP ARESTIS *Institute Professor of Economics*

Publications: "The Decline of the Euro in Its First Two Years: Is There a Satisfactory Explanation?" (with I. Biefang-Frisancho Mariscal, A. Brown, and M. C. Sawyer), in Louis-Philippe Rochon and Mario Seccareccia, eds., *Dollarization: Lessons from Europe and the Americas*, London: Routledge, 2003, pp. 15–29; "Asymmetries of Demand for Money Functions Amongst EMU Countries" (with I. Biefang-Frisancho Mariscal, A. Brown, and M.C. Sawyer), *Investigasion Economica*, No. 245, July–September, 2003; "Reinventing Fiscal Policy" (with M. C. Sawyer), *Journal of Post Keynesian Economics*, Vol. 25, No. 4, Summer 2003; "Does the Stock of Money Have Any Causal Significance?" (with M. C. Sawyer) *Banca Nazionale Del Lavoro Quarterly Review,* 2003, Vol. LVI, No. 225, pp. 113–136, "The Euro and the Level of Public Expenditure," memorandum submitted by Philip Arestis and Malcolm Sawyer to the Treasury Select Committee and printed as Appendix 27 of Sixth Report, "The UK and the Euro," HC 187-II.

Presentations: "The 'Third Way' and the European Monetary Union," Department of Economics, Trinity College, Hartford, April 30; "Macroeconomic Policies of the Economic and Monetary Union: Theoretical Underpinnings and Challenges," Department of Economics, New School University, New York City, May 12.

WALTER M. CADETTE *Senior Scholar*

Publications: "An Economist's Perspective on Expensing Stock Options," New York: The Interfaith Council on Corporate Responsibility, July 2003; "The Economics of Long-term Care," Germantown, N.Y.: Avila Institute of Gerontology, Winter 2002.

Presentation: "U.S. Fiscal Policy: The Clash Between the Short- and the Long-Term," Putting Returns Back on Capital, conference sponsored by Sanders Research Associates (SRA) Institute of Directors, London, June 6.

DIMITRI B. PAPADIMITRIOU *President*

Presentations: Panelist, "Globalization and the Myths of Free Trade," conference at New School University, New York City, April; panelist, conference on macroeconomics and gender, University of Utah, June.

MALCOLM SAWYER *Senior Scholar*

Publications: "Post Keynesian Price Theory" (with Nina Shapiro), *Journal of Post Keynesian Economics*, Spring 2003, Vol. 25 (3), pp. 355–366; "The Decline of the Euro in Its First Two Years: Is There a Satisfactory Explanation?" (with P. Arestis, I. Biefang-Frisancho Mariscal, and A. Brown) in Louis-Philippe Rochon and Mario Seccareccia, eds., *Dollarization: Lessons from Europe and the Americas*, London: Routledge, 2003, pp.15–29; "Contribución al análisis del dinero endógeno" in Leticia Campos Aragón, ed., *La Realidad Económica Actual y Las Corrientes Teóricas de su Interpretación: Un Debate Inicial*, Mexico City: UNAM, pp. 435–454; "The Private Finance Initiative: A Critical Assessment" in Dan Coffey and Carole Thornley, eds., *Industrial and Labour Market Policy and Performance*, London: Routledge, 2003, pp.171–189; "Money: Means of Payment or Store of Wealth?" in L. P. Rochon and S. Rossi, eds., *Modern Theories of Money*, pp. 3–17; "The Euro and the Level of Public Expenditure," memorandum submitted by Philip Arestis and Malcolm Sawyer to the Treasury Select Committee and printed as Appendix 27 of Sixth Report, "The UK and the Euro," HC 187-II; "Does the Stock of Money Have Any Causal Significance?" (with P. Arestis), *Banca Nazionale Del Lavoro Quarterly Review*, Vol. LVI, No. 225, pp. 113–136, 2003; "Asymmetries of Demand for Money Functions Amongst EMU Countries" (with P. Arestis, I. Biefang-Frisancho Mariscal, and A. Brown), *Investigasion Economica*, No. 245, July–September 2003; "Reinventing Fiscal Policy" (with P. Arestis), *Journal of Post Keynesian Economics*, Vol. 25, No. 4, Summer 2003.

Presentations: "The Private Finance Initiative: A Critical Assessment, Public Services and European Economic Integration," Universita degli Studi di Milano, Milano, June 6–7;

"An Economic Evaluation of Alternative Arrangements for Retirement Pensions," Privatisation of Public Pension Systems—Forces, Experience, Prospects, Chamber of Labor, conference in Vienna, June 19–21.

RECENT LEVY INSTITUTE PUBLICATIONS

WORKING PAPERS

Does Trade Promote Gender Wage Equity? Evidence from East Asia
GÜNSELI BERIK, YANNA VAN DER MEULEN RODGERS, and JOSEPH E. ZVEGLICH, JR.
No. 373, February 2003

The Nature and Role of Monetary Policy When Money Is Endogenous
PHILIP ARESTIS AND MALCOLM SAWYER
No. 374, March 2003

U.S. Workers' Investment Decisions for Participant-Directed Defined Contribution Pension Assets
THOMAS L. HUNGERFORD
No. 375, March 2003

Mexicans Now, Italians Then: Intermarriage Patterns
JOEL PERLMANN
No. 376, April 2003

STRATEGIC ANALYSIS

The U.S. Economy: A Changing Strategic Predicament
WYNNE GODLEY
March 2003

POLICY NOTES

The Big Fix: The Case for Public Spending
JAMES K. GALBRAITH
2003/1

Reforming the Euro's Institutional Framework
PHILIP ARESTIS AND MALCOLM SAWYER
2003/2

Caring for a Large Geriatric Generation: The Coming Crisis in U.S. Health Care
WALTER M. CADETTE
2003/3

PUBLIC POLICY BRIEFS

Can Monetary Policy Affect the Real Economy?
The Dubious Effectiveness of Interest Rate Policy
PHILIP ARESTIS AND MALCOLM SAWYER
No. 71, 2003 (Highlights, No. 71A)

What is the American Model Really About?
Soft Budgets and the Keynesian Devolution
JAMES K. GALBRAITH
No. 72, 2003 (Highlights, No. 72A)

Asset and Debt Deflation in the United States
How Far Can Equity Prices Fall?
PHILIP ARESTIS AND ELIAS KARAKITSOS
No. 73, 2003 (Highlights, No. 73A)

The *Summary* and all other Levy Institute publications are available online on the Levy Institute website (www.levy.org).

To order any of the above publications, call 845-758-7700 or (in Washington, D.C.) 202-887-8464, fax 845-758-1149, e-mail info@levy.org, write The Levy Economics Institute of Bard College, Blithewood, PO Box 5000, Annandale-on-Hudson, NY 12504-5000, or visit our website at www.levy.org.

THE LEVY ECONOMICS INSTITUTE
OF BARD COLLEGE

Blithewood
PO Box 5000
Annandale-on-Hudson, NY 12504-5000