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Jerry Jasinowski, president of the National Association of Manufacturers (left), and Robert Hormats, vice chairman of Goldman Sachs (Intl.), argue that the marketplace is not a social enemy in a Firing Line debate at the Levy Institute

INSIDE:

- **Is the marketplace a social enemy? Is there a role for government intervention? Is downsizing good or bad? These were among the questions considered in a recent Firing Line debate taped at the Levy Institute.**
- **As a panelist on a new PBS television show, Debates-Debates, taped at the Levy Institute in May, Assistant Director Sanjay Mongia argued for greater emphasis on the skills criterion to make U.S. immigration policy more consistent with labor market needs.**
- **In a forum on immigration and ethnicity, David Card, Theodore A. Wells Professor of Economics at Princeton University, concluded that it may be difficult to do empirical research that determines unequivocally whether immigrants harm natives.**
- **In an interview with Executive Director Dimitri B. Papadimitriou, Senator Bill Bradley stated, "America is a three-legged stool: one leg government, one leg private sector, and one leg civil society."**
- **In the final lecture of the spring series, Susan G. Regan, an attorney with Magavern, Magavern, & Grimm, warned that legislation and regulation of the health care industry are not keeping pace with changes in the industry.**

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Recent Levy Institute Publications

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

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Editor: Theresa Ford
Text Editor: Judith Kahn

Photography: Stephen Shore; Don Hamerman,

The Jerome Levy Economics Institute of Bard College
Blithewood
Annandale-on-Hudson, New York 12504-5000
845-758-7700, 202-737-5389 (in Washington, D.C.)
E-mail: info@levy.org
Web site: http://www.levy.org

Firing Line

The economy is doing well, we are told. The stock market has been booming, jobs are being created, inflation is low, and corporate profits are high. Nonetheless, corporations are still announcing massive layoffs. One of the most widely reported downsizings was AT&T's announcement this year that it was shedding 40,000 workers, but at the same time its CEO received a substantial raise in compensation and stock options. In fact, many CEOs have received handsome raises in recent years, whereas wages of most workers have been stagnant or falling since the 1970s, circumstances that give rise to the concern that workers are not sharing in the wealth. Two recent *Firing Line* shows, taped at the Levy Institute in May, considered these issues. Host **William F. Buckley Jr.** opened the first show with the question "Is downsizing good or bad?"

Is Downsizing Good or Bad?

The panelists who argued that corporate downsizing has had good effects were **Robert Hormats**, vice chairman of Goldman Sachs (Intl.); **Jerry Jasinowski**, president of the National Association of Manufacturers; **David A. Levy**, vice chairman and director of forecasting of The Jerome Levy Economics Institute; and **Robert Shrum**, Democratic strategist and media consultant. The panelists who disputed the "goodness" of corporate downsizing were **Mark Green**, New York City public advocate; **Robert Kuttner**, founder and co-editor of *The*

American Prospect; **Edward Luttwak**, senior fellow at the Center for Strategic and International Studies; and **Andy Stern**, president of the Service Employees International Union of the AFL-CIO.

Stern responded to Buckley's insistence that it was the responsibility of shareholders of corporations to make decisions about downsizing with an equally vigorous insistence that it was also the responsibility of communities. Although Levy argued that part of the problem was that shareholders were not being well represented, he noted that the market was beginning to address the problem.

Avoiding the blame game, Shrum urged that workers must become stakeholders in the corporation and proposed a simple two-tiered corporate tax system. Corporations that shared profits with workers would be taxed at a lower rate than those that did not. Jasinowski argued that tax incentives should be eliminated altogether and went a step further arguing that Washington should be kept out of the business of sharing the wealth. Furthermore, he pointed out that the market system has done a remarkable job in making manufacturers more competitive. Kuttner noted that no model of the market is permanent. The market model that in the past allowed working people to share in the gains of corporations differed from today's market in that it had stronger unions, less global competition, and more regulation and oligopoly. Luttwak added that the regulated market system was the profitable system of the past, the American market system that resulted in stability through saving and investment.

Green commented that 90 percent of all productivity gains has been going to the top 1 percent of managers; last year the stock market gained, productivity rose, profits were high, and the median real wage declined. He asked Hormats what he proposed to avoid the wage gap. Hormats responded that a new model of productivity was needed, one that included worker incentives and emphasized training and education.

When Buckley noted that labor received 64 percent of all corporate proceeds in 1970 and today enjoys 66 percent, Stern responded with other statistics: The average worker has lost 9 percent of his income in the last 20 years. Jasinowski quipped that Stern should stop portraying the worker as a victim and focus instead on growth, education, incentive pay, and tax reductions. Kuttner conceded that slow growth does exacerbate inequality, but noted that the decline of unions, a decrease in international trade, and reduced regulation were also part of the problem.

Buckley asked how removing the wages of people who grew up in single-parent households would affect the average wage, since someone growing up in a single-parent household is 600 percent more likely to live in poverty. Although there has been relentless growth in the number of single-parent households in the last 30 to 35 years, Kuttner disagreed with Buckley's implication that there is a simple correlation between the growth of single-parent households and widening income disparity. Luttwak added that even after you remove the underclass from the statistics, there is still a sinister division in which the top two quintiles of the population [by income] are doing well and the bottom three quintiles are not. Hormats pointed out that 80 percent of the top quintile are two-parent households and 80 percent of the bottom quintile are single-parent households. In his view the economy did not create the imbalance in households; it is a problem of education and families.

Green's program for change included giving workers not only income and benefits, but also stock in the companies where they work. Hormats stated that many companies have done this and Jasinowski added that many are doing it or moving toward incentive compensation systems. Green noted that only 10 percent of companies allow their workers to be stockholders. Stern's program for workers included a raise in the minimum wage, in their share of corporate gains, and in health care benefits; more power in collective bargaining; and the opportunity for the poor to go to college.

Luttwak remarked that in a capital-short country the system that generates saving breaks down. As a result, instead of capital chasing labor, labor is chasing scarce capital. Jasinowski noted that more regulation does not lead to an increase in investment and growth. Hormats added that investment comes into the United States from around the world because the United States has the least regulated system in the world. Levy noted that regulated markets were necessary to ensure quality and safety on a case-by-case basis, but did not view regulation as a macroeconomic issue.

Shrum summed up the dispute by pointing out that they all seemed to be in agreement that some regulation was good, but disagreed over the degree to which the government should regulate. He concluded with the question, should the government take its regulatory power one step further to empower labor unions and create incentives for profit sharing.

Resolved: "The Marketplace Is Not a Social Enemy."

Shrum moderated the debate of the second show. Buckley, Hormats, Jasinowski, and Levy agreed that the marketplace is not a social enemy. Green, Kuttner, Luttwak, and Stern believed otherwise. All of the panelists seemed to agree that the marketplace was necessary in a capitalist democracy, but differed in their view of the appropriate mix of market and regulation.

Buckley stated that it is obvious that the marketplace is not a social enemy. It provides jobs for 114 million Americans. In addition, automation and innovation have improved American lives. He would eliminate the business tax to help workers. Kuttner responded that markets often price things incorrectly; for example, the price of pollution is too low and of education too high. Markets also produce extremes of wealth and poverty. He noted that industry has benefited from a regulated market.

Stern contended that the marketplace serves the wealthy at the expense of working families. Over the last six years corporate profits have risen 64 percent, while workers' wages have declined 3 percent. Instead of trying to improve the lives of workers, corporations are shifting jobs overseas and spending millions of dollars fighting an increase in the minimum wage, changes in health care, and workers' right to organize. Jasinowski pointed out that the fall in wages actually reflects an increase in benefits from 20 to 40 percent of payroll. Jasinowski's program involved the adoption of incentive compensation schemes as well as an increase in growth.

According to Hormats, the American market system has produced vigorous growth, a wide range of goods and services, and opportunity for economic advancement. He reiterated his call for more worker education and training and added improved management techniques and incentives for workers as the components of his three-part program to improve productivity.

Green considered the resolution to be "wildly overstated." The market has over time tolerated or encouraged racism, price-fixing, collusion, child labor, nearly slave wages, and dangerous products. In Green's view it is only when the marketplace is accompanied by regulation that it is not a social enemy.

Levy agreed that the market system is not perfect and economic injustices do occur, but asserted that the marketplace is not a social enemy. Levy noted that to reject the resolution is the equivalent of "asserting that the system is on the whole in some way harmful, that we have an immoral, poorly based society." Luttwak contrasted this view of the market with his own description, "a moderately turbo-charged capitalism in which [the market] works to deliver for the top 15 percent and doesn't deliver for the rest." Much stability has been sacrificed for a little innovation.

In his closing remarks Kuttner commented that the *laissez-faire* marketplace is a social enemy. The mixed economy of the postwar period succeeded in balancing the dynamism of the pure market and the stability and predictability necessary for a civil society. Today, chief executives have been empowered and ordinary employees have been disempowered. Many areas of society work much better under regulated competition than under unregulated competition. Pure markets do not work in pollution control, education, research and development, and many other sectors of the economy.

Buckley presented the closing arguments for his side. Having stated that the corporation is not a philanthropic institution, Buckley noted that it is the job of labor unions and a provocative press to spotlight abuses. Corporations "collect people who have energy, produce goods, service the marketplace, and give us 95 percent employment."

Debates-Debates

Resolved: "The United States Is Admitting the Right Immigrants."

Immigration is a contentious issue for many reasons. It is multidimensional, touching on race, poverty, health care, welfare, jobs, and inequality. Propositions involving aspects of immigration have been prominent in popular elections and court cases in which states have brought suit against the federal government have gone as far as the U.S. Supreme Court. Immigration is also increasingly a favorite topic of politicians at all levels of government. Because of its complexity immigration generates much debate and controversy.

Richard Estrada, member of the U.S. Commission on Immigration Reform and associate editor of the Dallas Morning News

In May the Levy Institute hosted a session of a new PBS television show, *Debates-Debates*, in which the resolution was "The United States is admitting the right immigrants." The panelists who argued in favor of the resolution were **Leon Botstein**, president of Bard College; **Robert Kuttner**, founder and co-editor of *The American Prospect*; and **Cecilia MuÒoz**, of the National Council of La Raza. Arguing against the resolution were **Richard Estrada**, member of the U.S. Commission on Immigration Reform and associate editor of the *Dallas Morning News*; **Sanjay Mongia**, assistant director of the Levy Institute; and **Robert Shrum**, Democratic strategist and media consultant. Botstein, Kuttner, and MuÒoz wanted to preserve current legal immigration policy, which allows into the country a mix of immigrants admitted on the basis of labor market skill needs and on the basis of family reunification. Botstein based his arguments on the historical commitment to immigration in the United States. He noted that the diversity of the U.S. population has contributed to a creativity and prosperity that is unmatched in the rest of the world. Kuttner pointed out that immigrants' economic impact at the national level is negligible. He also asked whether consumers would be willing to bear the higher costs of certain goods and services that would result from the higher wages that would be demanded by natives with a decreased supply of immigrants in the labor force. MuÒoz argued vociferously that the family reunification criterion in the current policy should be preserved and that it was wrong to deny adult children preferential treatment. She also commented that the changing composition of immigrants was fueling much of the antiimmigrant fervor in the country.

On the opposing side of the debate, Estrada conceded that at the national level the economic impact of immigration may be negligible, but asserted that at the state and local levels there is a cost. Some states are disproportionately affected and are receiving little relief. Mongia argued that U.S. legal immigration policy had to be altered to be more consistent with U.S. labor market needs. He proposed a modest decline in the aggregate number of legal immigrants, greater emphasis on the skills criterion, and a tightening of the family reunification criterion to confine it to immediate family members. Shrum stated that immigration policy must have defining standards, just as colleges have standards for admitting students. He agreed that a modest reduction in overall immigration and a narrowing of the family reunification preference were reasonable standards.

Forum: Immigration and Ethnicity

As one component of its research initiative "Ethnicity and Economy in America-Past and Present," guided by Senior Scholar Joel Perlmann, the Levy Institute organized a series of forums on immigration and ethnicity. The first two forums were summarized in the June *Report*. The final forum, held on May 3, 1996, concentrated on the status of scholarly research on the economic effects of immigration and the current debate over immigration reform. Speaking on the state of research were **David Card**, Theodore A. Wells Professor of Economics at Princeton University, and **Stanley Engerman**, professor of economics and history at the University of Rochester. Addressing immigration reform were **T. Alexander Aleinikoff**, executive associate commissioner of the U.S. Immigration and Naturalization Service (INS); **Frank D. Bean**, Ashbel Smith Professor of Sociology and Public Affairs and director of the Population Research Center at the University of Texas; and **Muzaffar A. Chishti**, director of the Immigration Project of the Union of Needletrades, Industrial, and Textile Employees. A synopsis of their remarks follows.

Card discussed the theoretical and empirical approaches to studying immigration that economists have taken. He noted two important questions that are directing theoretical research: Is the skill composition of immigrants different from that of the native population? Are immigration inflows outpacing the rate at which the capital stock is replenished? Several other questions focus on the effects of the concentration of immigrants in a small number of local labor markets: What is the result of the unequal dispersion of the immigrant population? Is a significant inflow to the cities they go to necessarily an advantage or a disadvantage to those cities? How do urban economies respond to the immigration influx?

Card described the two primary methodologies in the empirical literature. Some studies employ a cross-market analysis, while others view the United States as a single market. Card compared the immigrant population to the native population using the *Current Population Survey* of March 1994 and 1995. He observed that immigrants are somewhat less skilled than the population as a whole, but there are many highly skilled immigrants; immigrants are geographically concentrated in a few major cities; and immigrants are not doing as well as natives in the labor market, but are not doing too poorly. Card concluded that it is difficult to find consistent and strong evidence and to do empirical research that determines unequivocally if immigrant inflows harm natives.

Engerman provided a survey of debates on the economic impact of immigrants throughout the history of the United States, emphasizing the debates that ended in major overhauls of American immigration policy, namely, the introduction of the literacy test in 1917 and the implementation of quotas by country and restrictions on immigrant level in the 1920s.

The pattern of U.S. immigration was unique in the Americas at the start of the twentieth century because of the large share and national diversity of the white population, the limited number of Native Americans on the mainland, and the exceptional growth of both white and black populations. The huge amount of undeveloped land permitted policymakers to encourage immigration, and immigrants could serve as an industrial labor force. The major change in U.S. immigration policy occurred in the 1920s with the establishment of absolute quotas by country of origin. The quotas were intended to increase the relative share of immigrants originating from Western Europe and to reduce the number of immigrants from Eastern and Southern Europe, but had the effect of reducing the absolute number of immigrants and the rate of immigration. This change in policy reflected the desire for a more homogeneous society.

Why has the recent pattern of immigration given rise to such politically conspicuous debates? First, the level of immigration is higher than it was in the 1920s, even though the rate of immigration is lower. Second, because of a declining fertility rate and a declining rate of increase in the total population, the ratio of immigrants to total population resembles that of earlier periods. Third, the geographical concentration of new immigrants in urban areas makes the effects of immigration on social expenditures, such as welfare, appear dramatic. Fourth, it is argued that the economy has changed, allowing fewer opportunities today and limited hope for the future. Fifth, the point of origin of immigrants has shifted from Europe to Asia and elsewhere in the Americas.

Do immigrant inflows necessarily mean a decline in opportunity for native-born workers? Engerman noted that a dramatic rise in wages followed the cessation of immigration in the 1920s. However, real wages have risen and unemployment rates have declined during some periods of high immigration and the reverse has occurred during some periods of low immigration.

Bean pointed to some possible consequences of a confluence between immigrant inflows and relatively poor economic conditions. For example, the 1910s, the years following the largest immigrant inflows of the century, were not good years economically. While not suggesting that immigrant inflows caused the economic problems of the 1910s, Bean asserted that we must at least consider the fact that when these two events occur together, the economic consequences may be more severe than when they do not.

Bean noted that the optimal size of immigration inflows for purposes of setting policy is difficult to determine. Currently, the U.S. population is growing at about 1 percent per year, of which 35 to 40 percent is due to immigration. He estimated that immigrants account for approximately 45 percent of employment growth. The key variable in such a calculation at any time is job growth. When job growth is minimal, despite the amount of flexibility in the labor market, the addition of a million new immigrants a year will cause a difficult social and political situation.

Bean observed that when we speak of immigration policy, we usually mean legal immigration policy. There are, however, policies about illegal immigration that do not get discussed often. One could argue that since World War II, U.S. policy on illegal immigration has been to give the appearance of trying to control it while looking the other way. However, illegal immigration has recently come to the fore as a pressing issue. According to Bean, a society wishing to operate on the basis of rule of law must deal with this phenomenon before trying to make any substantial change in immigration law.

Aleinikoff spoke about the complexities of facilitating lawful immigration and enforcing immigration laws. He noted that in recent years in the United States there were about 500 million legal border crossings, the entry of about 700,000 to 800,000 permanent resident aliens, and the entry of about 100,000 refugees per year. Last year 1.2 million people were apprehended trying to cross the southwest border illegally, about 100,000 criminal aliens were incarcerated, and about 40,000 criminal aliens were deported by the INS. Moreover, half of illegal immigrants are visa overstayers.

The House and the Senate have passed immigration bills that are largely concerned with enforcement, for example, increasing the number of border patrol employees, establishing stiffer penalties for smuggling and other criminal conduct, and cracking down on false documents. The administration believes, and the House and Senate bills confirm, that enforcement of immigration laws is a federal responsibility and that an effective enforcement strategy should focus on the border, the work site, and the removal of criminal aliens.

There are, however, some areas of controversy, for example, the 1986 law that imposes sanctions on employers who hire aliens not authorized to work in the United States. Although there is a high degree of compliance with the law, there is a low degree of deterrence because of a lack of resources to enforce the law and the rise of false documentation. For employer sanctions to work requires a system by which employers can verify worker documentation. Such a system, however, has been opposed by people on both sides of the political spectrum. The INS has responded to this opposition by conducting pilot projects in California, the Midwest, and Miami, with plans to expand the program to New York and elsewhere. After a couple of years the INS will evaluate the verification system for cost effectiveness, increases in discrimination, and adequate protection of privacy.

Chishti stated that immigration policy generally is not the result of studies of immigration and its effects: "It is amazing how little research has an impact on immigration policy." Policy is framed by the media and the popular mood in the country. Although the United States is the "consummate immigrant nation," there is a continuing debate that indicates a lack of consensus on that point. According to Chishti, the most recent stage of the debate began during the 1992 presidential campaign with statements that certain immigrants are unable to assimilate to U.S. culture and society. A series of high-profile events have framed the public's negative perception about immigration, culminating in California's Proposition 187.

According to Chishti, Proposition 187 also was the turning point in the debate. The antiimmigrant fervor at the national level mobilized the proimmigrant lobby, which drew a sharp distinction between legal and illegal immigration and the policies governing the two. The recently passed immigration bill reflects that distinction by not reducing legal immigration and retaining the refugee program.

Chishti cited three reasons for the swift turnaround in attitude: (1) the proimmigrant lobby made its message extremely simple by advocating the separation of legislation about legal immigration from legislation about illegal immigration; (2) it found support for splitting the bill from conservative Spencer Abraham (R-Mich.) on the Senate Judiciary Committee; and (3) it formed a redoubtable coalition that included unions, the National Association of Manufacturers, Americans for Tax Reform, the Christian Coalition, and civil libertarians. Chishti concluded that the success of the coalition proved that immigration is too complex to be relegated to the fringe of the policy arena.

[To request a copy of the forum proceedings, call 845-758-7700, 202-737-5389 (in Washington, D.C.), fax 845-758-1149, e-mail info@levy.org, or write The Jerome Levy Economics Institute of Bard College, Annandale-on-Hudson, NY 12504-5000.]

The Levy *Report* Interview

Senator Bill Bradley Discusses Domestic and International Economic Policy, Race, Aging, and Public Disenchantment with Government

Bill Bradley, U.S. Senate

Bill Bradley graduated from Princeton University, went on to Oxford University as a Rhodes scholar, won an Olympic gold medal, and played professional basketball with the New York Knicks. He was thrice elected to the U.S. Senate, most recently in 1990 with a narrow victory over Christine Todd Whitman, who went on to become governor of New Jersey. Reflecting on the 1990 election Bradley remarked, "For 12 years, I was very cautious and I spoke primarily from my mind. After 1990, I decided to speak from my heart as well as my mind." Since his announcement that he would not seek reelection, Bradley has followed the dictates of his heart while speaking out about campaign finance reform, racial polarization, restoring faith in government and personal responsibility, and the changing economy. In his memoir, Time Present, Time Past, Bradley wrote, "I was reminded that I am in politics to take action, to stop the suffering, and to promote opportunity."

In an interview with Executive Director Dimitri B. Papadimitriou on June 21, 1996, Bradley said that although he is retiring from the Senate, he will remain in public life. He discussed many of the troubling economic, social, and political problems facing the nation and offered his prescriptions for a better America.

Papadimitriou: The most recent *Economic Report of the President* conveys a sense that the economy is well balanced and in good health. Do you agree with that assessment?

Bradley: In terms of the overall macroeconomic numbers, the only number that is not as good as I would like it to be is growth. I would like to see higher economic growth than we have had over the last several years. In terms of inflation, unemployment, and many other indicators, it is a solid economy. What is not reported is underemployment, and I believe that is the real problem in America today. It isn't that people don't have jobs, but that they are working in jobs that pay them less than the job they had 5 or 10 years ago and that wages have been generally stagnant for the last 20 years.

Papadimitriou: In the last decade the long-term rising trend in living standards has been interrupted. Various assessments show this to be the result of competitive pressures from countries with low-wage labor; of institutional factors, such as the decline in labor union membership; or of technological changes, which have created a need for skilled labor at the expense of unskilled labor. Has any one factor played a more significant role than others?

Bradley: I believe that the technological revolution and the decline in labor union membership are infinitely more responsible for wage stagnation than is competition from low-wage labor in foreign countries. We spend only 2 percent of our national income on imports from low-wage countries; clearly, that is not the major problem. Because only 11 percent of private sector workers are represented by unions, the leverage that workers have in the employer-employee relationship has eroded.

Although union membership decline is significant, the most significant factor is the technological revolution. Corporate leaders are acting rationally. Their objective is to maximize profits for their shareholders; if they don't, they can be sued. In company after company there is a dramatic move toward shrinking the workforce as a way to improve profits. The bulk of capital investment in information technology was made in the 1980s and the payoff, in terms of improved productivity, occurred in the 1990s. The subsidiary effect is the downsizing taking place in America; corporations are shrinking because they are able to do the same or more with fewer workers. I do not think that this is going to lessen; if anything, it will broaden. Until now it has affected only large firms-General Electric, Boeing, AT&T, and others-but downsizing is not going to take place only in big companies. If you are running a small company and you can replace four people with one computer, why would you not do that?

As information technology becomes more accessible and more user friendly, it will proliferate and continue the downward pressure on wages. The real question is whether enough new jobs will be created to offset the increase in jobs lost. To date, as the unemployment numbers indicate, we have indeed created many new jobs, but for wages much lower than the wages workers made with a larger company a few years ago. This is the problem that is eating away at our political economy and our culture.

The production or nonsupervisory wage was $315 in 1973 and $256 in 1994 [measured in real terms]. Clearly, people are working longer for less. Additionally, another spouse has entered the workforce and nobody is home when the kids come home from school, and the community has not yet found a way to help families in this situation. Sixty-five percent of children in America live in two-parent families where both parents work or single-parent families where the parent works-an uncertain and ominous development for the future of the country. You cannot earn a decent living with one person in the workplace. Millions of Americans have simply abandoned the idea that they are going to be able to take care of their family with a single breadwinner. That is the central problem in the country today.

Papadimitriou: With downsizing or rightsizing and its effects on workers and the nation in general, is it appropriate and possible to impose citizenship responsibilities on corporations? In addition, can the interests of shareholders and workers be compatible in this environment of domestic restructuring and global competition?

Bradley: The big question is who gets the productivity bonus? Information technology generates improved productivity and that, in turn, generates more wealth. Right now the wealth is being shared by chief executive officers and shareholders. How we push it further down within the corporation and spread it through the community is the challenge for political leaders at this time. If you have fewer and fewer people working and those working are making less and less money, at some point you will have reduced purchasing power, which will be a problem in the economy.

We need to judge corporations on a broader set of criteria than we now use to judge them. I start with the premise that the public created "the corporation" and gave the corporation something very valuable-limited liability. Because the public created the corporation, it is legitimate for us to ask how well we are being served by it.

Currently, the only way we judge corporations is by the bottom line, the financial balance sheet. Laying off workers, taking shortcuts on pollution, and not caring about the communities that they leave reflect positively on the one criterion: they improve the financial balance sheet. We need to have other criteria, such as the impact of the corporation on its workers, on the community, and on the environment. One of the challenges is to develop worker, community, and environmental balance sheets similar to financial statements developed by the Financial Accounting Standards Board. Simply making this information accessible to the public would generate tensions and pressures that would change the nature of today's corporation.

I think that the power of pension fund managers today is quite significant; if they were provided with more information, the market would function to produce the right result. If they were making a choice between company a and company b and had the various balance sheets, they could choose the one that was the better on all four criteria.

In the past wealth was basically derived from natural resources, abundant labor, and capital; increasingly, it will be derived from knowledge. Microsoft is the best example. Fifteen or 20 years ago it was a couple of kids in a garage; now capital is inundating Microsoft because of their knowledge. Once workers understand that capital follows knowledge in the new economy and have the new balance sheet information, they can determine whether they will work for a corporation that pollutes or that does not care about its workers or its community. Workers, with their knowledge-their work, will have the power to reward those companies that are good on all those criteria that will attract capital for the growth of the corporation. The mechanism will be put into play for improving the quality of the environment, the workers' situation, and the community.

Papadimitriou: Should the Federal Reserve have the monolithic goal of price stability?

Bradley: No, it should not. I think there is a preoccupation with inflation, which is really a preoccupation that is engendered essentially by money managers. The other purpose or mission of the Federal Reserve is job creation and growth, and the Fed has not pursued those goals in recent years as much as it should. I don't think that we are in a period of inflationary pressure; I think we are in a period of deflation or in a period of growth that is far below what the normal path should be, given the basic economic indicators.

Papadimitriou: Then you would oppose the repeal of the Humphrey Hawkins act of 1978?

Bradley: Definitely.

Papadimitriou: As one of the architects of the Tax Reform Act of 1986, what do you consider to be the most critical goals of the U.S. tax code? Should the tax code be viewed as an instrument of social engineering?

Bradley: The tax code should not be used as a tool of social engineering and should be simple, efficient, and fair. Our income tax should have lower rates and fewer loopholes. I would like to see us return to a system similar to the one we ended up with in 1986. It could be a two- or three-rate system with the top rate around 30. Some deductions and exclusions should be kept: deductions for charitable contributions, mortgage interest, and property taxes and exclusions for inside buildup on pensions and for health coverage. The remaining deductions and exclusions should be eliminated. Doing so would create a much more efficient allocation of capital. You wouldn't have the bizarre circumstance in which money flows to the tax-favored investment; rather, money would flow to the best economic return, thereby benefiting the whole economy. Since 1986 the rates have climbed back up to 39 percent and many loopholes have reappeared, thereby returning to the situation that we tried to eliminate in 1986 in which equal incomes pay unequal taxes.

I think the flat tax is a nonstarter. The effective tax rate for 85 percent of the people in this country is a little over 16 percent. A flat tax would have to be 21 percent to be revenue neutral and not increase the deficit. That is a significant tax increase for most people. In addition to its destabilizing impact, removing deductions for mortgage interest, when most people save through their homes and property, and for charitable contributions, when civil society should be engendered, would make it more difficult to have a robust civil sector.

Replacing the income tax with a value-added tax or an integrated consumption tax is also not a wise idea. In order to make these taxes progressive, they would have to be made so complicated that they would probably have a counterproductive impact. Moving to an entirely new tax system would be fundamentally disruptive to the economy. During the political process there would be a plethora of exceptions for groups of people, companies, and industries resulting in a crazy quilt system that would reduce the efficient allocation of capital.

Papadimitriou: President Clinton has recently recommended another one-year extension of most-favored-nation (MFN) trading status to China. Do you support this decision?

Bradley: I support the decision to extend MFN and would like to eliminate the annual review of MFN for China. The annual review creates all kinds of pressures and tensions that are unnecessary. It is not a particularly effective negotiating tactic, because the Chinese see that it is as much in our interest as it is in theirs to extend MFN. We have a good, big relationship with China. China will become increasingly important in the world economy and we are China's most important trading partner.

Linking MFN to human rights, nuclear proliferation, or other things is counterproductive. If we want China to be open, the more trade and the more contact with the outside, the better. China is betting that it can control the information revolution to a certain extent and that it can be immune to the impact of much broader trade and investment relationships with the rest of the world. I'm betting that it cannot be immune to those contacts. Once the democratic germ is planted in the body politic, the more contact there is, the more likely that democracy will bloom in China. It will not happen overnight; these are long-term objectives.

At the same time we should never hesitate to be blunt about who we are, why human rights are important, and why China will never be able to assume its role as one of the great countries of the world as long as it denies people basic human rights. There are many ways to express our opposition to Chinese repression without curtailing one of the main sources of opening China up, which is greater trade and contact with the outside.

Papadimitriou: In your recent memoir you wrote, "the more affirmative action is rooted in the search for a spiritually transformed civil society, the easier it will be for all people to understand what is being affirmed." How do we achieve this type of society?

Bradley: We have to recognize that the promise of the civil rights movement was a spiritually transformed America and that equality among the races was the means to that end. Affirmative action is a secondary issue; the first issue is continuing discrimination or, as the recent church burnings indicate, outright racism.

What do we do about discrimination and racism? Right now there is no adequate remedy for individual discrimination. If someone feels he or she has been discriminated against in the workplace, the remedy is to file a complaint with the Equal Employment Opportunity Commission (EEOC), but there are 97,000 cases backlogged at the EEOC. A person realizes after three or four years that the EEOC is not an effective remedy. The court system is a four- or five-year journey and a very expensive one. In effect, somebody who is discriminated against has to be prepared for a seven- or eight-year wait before he or she will be able to get the raise or promotion deserved eight years earlier. The reality is that few people go through that process. The reality is that there is no adequate remedy.

There are institutions in this society that resist change, but some change has occurred. The military is a good example. In the 1970s its officer corps was white and male; it had no black, Latino, Asian, or any person of more diverse background. Then Clifford Alexander, who was President Carter's army secretary, changed the way promotions were calculated so that if a person showed racial bias, that person's chance of advancement was reduced. As a result, bias decreased, talent was recognized, and people of all races entered the general officer corps. Ask Colin Powell if that is what happened; he is the ultimate product of that change, which allowed his talent to be recognized.

One answer is to tighten up, empower, and strengthen the EEOC so that it can bring cases to a close. You do that by giving it cease and desist authority. Affirmative action orders can play an important role by reaching out to the broadest possible community to recognize talent wherever it is. You allow all people of talent to be considered and selected on the basis of that talent. Some programs masquerade as affirmative action. Giving special tax breaks to firms that buy radio or TV stations because they have a minority participation is not affirmative action; it's a tax giveaway.

However, the opening of institutions through affirmative action is secondary to the primary need to have a remedy for individual discrimination. If we were able to remedy individual discrimination and to have a positive affirmative action program consistent with the purposes of those who originated the idea, then we would move several steps closer to realizing the spiritually transformed America that was the promise of the civil rights movement. Ultimately that depends on each of us.

Papadimitriou: Present immigration policy results in immigrants' taking jobs from the less skilled and the poor-especially African Americans in urban areas most affected by immigration. Is it possible to have an immigration policy and an urban policy that are not at odds with one another?

Bradley: Yes, I think it is possible. If you compare New York City in the 1980s and today, you see that it is a city that has once again been saved by immigrants. Cities with fewer immigrants are much less dynamic. The dynamism of immigrants coming to America to build a life for themselves and their families, whether they are Haitian, Indian, Palestinian, Russian, or Irish, is playing out once again in America. Cities that have many immigrants have a bigger tax base and, in many cases, stable neighborhoods.

You have to distinguish between legal and illegal immigrants. Illegal immigrants work for less than the minimum wage in sweatshops, taking jobs from people who should be getting those jobs at the minimum wage. A necessary part of an immigration policy is a strict policy on illegal immigration. It means putting some teeth in the employer sanctions that we passed in 1986. An employer who hires an illegal immigrant is subject to a $10,000 fine; an employer who has an established pattern of hiring illegal immigrants can be sentenced to jail for three years. This law has not been enforced and we need to enforce it. If we remove the incentive and impose a penalty for employing illegal immigrants, we will find that the people employed in those businesses that had hired illegal workers would be American residents entering at the minimum-wage level.

In addition, about half of the illegal immigrants come into the country on visitors' visas. Given today's information technology, we can have computer checks to identify visitors and their whereabouts and to alert us when they are supposed to leave. If they do not leave by their departure dates, we should find them and force them to leave.

We need ways to regulate the flow of immigrants, to enforce employer sanctions, and to run computer checks at airports. If we take these three actions, there will not be a conflict between the economic welfare of urban residents who are citizens and urban residents who are immigrants.

Papadimitriou: As a member of the special committee on aging, what do you regard as the important socioeconomic implications of a demographic shift toward older Americans? Do we have policies in place that are contributing to generational warfare?

Bradley: We need to invest in our children as much as we invest in our elderly. We need to encourage savings and to make sure children understand the principle and benefits of compound interest by the time they are 15 years old. We have a public pension system that taxes those who work for benefits that go to those who are retired. Recipients of these benefits get a disproportionate share of the public budget. We have to ask ourselves if over the long term that is the way we want to divide the budget.

Papadimitriou: Recent assessments show that the Social Security trust fund will be depleted in a few years. Is it appropriate to consider privatizing Social Security?

Bradley: I think the idea of privatizing Social Security merits further study and possible testing, but I would not adopt privatization without further study.

Papadimitriou: Americans have never had blind faith in government, but some observers allege that the public's hostility is reaching crisis stage and that Americans have lost faith in all institutions. What steps must public officials take to restore public confidence and reverse this pattern of rising discontent?

Bradley: I think rising wages and economic growth would solve a lot of those problems. The conflicts would be eased by championing tolerance and reinforcing the recognition that America is a three-legged stool: one leg government, one leg private sector, and one leg civil society. Our politics disproportionately emphasize government and the private sector; we do not accord enough respect to the institutions of civil society, the community upon which all the rest sits.

People whose wages are stagnant, who have lost their health care, and whose pensions are in danger are not going to believe any politician and are not going to change their attitudes until their circumstances change. Who can blame them, since so many politicians for so many years have spoken words that have produced no change in their circumstance? If you had been making $45,000 a year and now are making $30,000, and you get a $300 tax cut, you will take it, but you would rather have your $45,000 a year job back. Nobody has been able to produce an economy that grows at a rate fast enough to produce enough of the $45,000 a year jobs. People need results, not rhetoric.

Papadimitriou: What are the requisites for effective executive branch leadership?

Bradley: I think you have to understand the country and to have absorbed its rhythms. You have to understand that America is part of a world economy and that the world is becoming smaller. You have to have an idea of what your core beliefs are and a strategy before you assume office. You have to have a team that can execute your plans and has confidence in one another. That rarely, if ever happens, but there are times in our history when that is precisely what is needed and I think we are living in such a time.

Papadimitriou: You end your book, *Time Present, Time Past*, stating that you have always preferred moving to standing still. What is your next move?

Bradley: I am leaving the Senate, but I am not leaving public life. People do not understand how much work is involved in being an effective senator. There are committees, subcommittees, caucuses, and travel back and forth to your state. It does not leave sufficient time to do other things that are in the public interest, such as energizing movements for campaign finance reform. I think money is distorting democracy at this point in our history. I will be thinking through the next chapter of the American story in relation to economic transformation and racial healing and in relation to the search I sense out there in people for something deeper than the material in their lives. I am leaving the Senate, which I think is the best elective job in the world, to spend time on these other issues. I could have asked the people in New Jersey to reelect me and when I got reelected, spent time on these other issues, but I did not think that was the honest thing to do. I have chosen to leave the Senate in order to find solutions to some of these problems and to give people the ability to locate themselves in the emerging American story and, in so doing, to recapture that which most people have lost at this stage: hope and optimism about our collective future.

Lecture Series

SUSAN G. REGAN: Ethical Problems in Managing Health Care: Onions in the Petunia Patch

The managed-care revolution in the health care industry has brought about a reversal of financial incentives for physicians from incentives to overtreat patients to incentives to undertreat them. Market pressures are encouraging the development of managed care; simultaneously, because of the incentive to undertreat, there is tremendous pressure to regulate. The breakneck pace of change has, however, made it difficult to gather appropriate information to craft effective legislation and regulation. In the final lecture of the spring series, Susan G. Regan, an attorney with Magavern, Magavern, & Grimm, noted that the legislation that has been adopted has become so cumbersome that an entirely new specialty in the legal profession has developed to deal with it. As a result only sophisticated consumers who are knowledgeable about the law and who know what to ask can shield themselves from fraud and abuse.

In the 1960s Medicare and Medicaid established the fee-for-service and cost reimbursement system that characterized the health care industry before the managed-care revolution. According to Regan, these programs were also a revolution in that a limitless amount of money was provided by the government. Because under a fee-for-service system, the more physicians do, the more they get paid, the incentive is to overtreat and thus to raise costs. Regan argued that this kind of incentive also results in less quality care.

Because under a managed-care system, more treatment adds to physicians' costs, not their profits, the incentive is to treat less. Regan described three basic types of health maintenance organizations (HMOs): independent practice, group, and capitation payment. An independent practice HMO is still a fee-for-service arrangement; the insurance company withholds a portion of the fee and physicians may lose this portion if they make more referrals than budgeted for by the insurance company. In a group HMO physicians are usually employed in a clinic arrangement and have bonuses and productivity incentives. In an HMO with capitation payments physicians receive a fee for each enrollee; if the cost of treating an enrollee is less than the fee, physicians pocket the difference, but if the cost is more than or equal to the fee, they sacrifice the fee. The market is producing many different varieties and combinations of the three basic HMO types.

The medical and legal professions have both failed in properly regulating the industry. Regan noted that the American Medical Association (AMA) has a history of being rather lax with its members in matters of conflict of interest, such as physicians' owning pharmacies, selling or patenting medical products, or hiring third parties to refer patients to themselves. Instead of prescribing its own sanctions, the AMA relies on state licensing boards, which are very spotty in their enforcement, to enforce standards.

Since Medicare and Medicaid were initiated, criminal and civil (antikickback) laws against receiving payments for self-referrals have been passed, but they have been difficult to enforce.

Furthermore, these laws have been unable to manage the conflicts of interest that arose in the 1970s and 1980s when doctors and hospitals began to get involved in joint ventures. Studies show that physicians refer a higher percentage of their patients to facilities in which they have some ownership than to facilities in which they have no ownership. Congress has attempted to enact statutes that make it illegal for physicians to refer patients to entities in which they have a financial interest.

In 1990 the Department of Health and Human Services (HHS) reported to Congress that there is evidence that financial incentives affect physicians' behavior, but there is no evidence that the new health plans result in unacceptable levels of care or that some financial incentives have greater influence on physicians than others. The major concern was that some physicians were bearing too much risk so that the incentives to reduce costs were too strong. Congress ordered HHS to gather information to identify inappropriate arrangements and to issue regulations. HHS more succinctly defined "substantial risk" and ordered plans and groups to disclose more details about their practices to HHS. In cases where substantial risk was identified, HHS ordered further disclosure to enrollees and required additional insurance to be purchased to protect physicians. In the meantime the AMA issued a statement on ethics in managed care, but, Regan noted, hardly anyone was aware of the pronouncement.

Regan concluded that "we have a very unsatisfactory law because we simply do not have the data to support anything more precise." Punitive laws have not worked and ethical pronouncements do not encourage physicians to behave other than in their own best financial interest. In addition most of the regulations do not apply to private plans. As a result "we don't have the means to stop the bad actors from acting bad," said Regan.

Regan pointed out that the availability of outcome data and a system of assessing when care is medically necessary will alleviate the current situation. With such data and standards perhaps the dual goals of the U.S. health care system could be achieved: providing medically necessary care at a reasonable cost that society can afford.

New Working Papers

Assimilation: The Second Generation and Beyond, Then and Now

One aspect of the current debate on immigration deals with assimilation of today's immigrants. Some argue that recent immigrants are unable to assimilate into U.S. society as easily as the immigrants of the past were able to. Others argue that the pressures against assimilation today are not as strong as commonly thought. In **Working Paper No. 168, Joel Perlmann**, Levy

Institute senior scholar, and **Roger Waldinger**, professor of sociology at the University of California at Los Angeles, confront this issue. They argue that instead of studying assimilation as an outcome alone, assimilation dynamics, such as timing and process, are important in their own right.

The authors focus on process to explain how outsiders become insiders and to explore the social closure, or exclusion, strategies that insiders pursue. Perlmann and Waldinger compare first-generation Jewish youths around 1920 and Asian youths around 1980 who sought admission to U.S. colleges and universities. When the share of Jewish youths began to swell, especially at elite colleges and universities, a backlash occurred and deliberate policies were established to limit their enrollment. These policies were not reversed until threats were made and laws were passed against discrimination in higher education based on race or religion. Sixty years later, the Asian case differed. Asians had some political clout and established social organizations. They were able to mobilize around the issue until the policy was reversed. In the case of Jewish youths, acculturation proceeded rapidly because of the speed with which they acquired skills and became educated. Yet, structural assimilation proceeded more slowly because of exclusionary practices. Because of the earlier struggles of the Jews against discrimination, Asians had more leverage within the affected institutions and broader ability to mobilize outside them.

Perlmann and Waldinger then focus on race and discuss how past European immigrants came to be defined as white. The authors remind us that race is a social construct that for past immigrants was based not only on skin color, but also on other physical attributes. Southern and eastern European immigrants were originally considered distinct races, but these European ethnics eventually assimilated and used social closure strategies that maintained black exclusion. The authors speculate how the process may be working today and describe both pessimistic and optimistic scenarios. The pessimistic scenario builds a racial divide between blacks and all others. The authors contend that the only missing link from this scenario is a term to replace white that can include Asians and Hispanics. The optimistic scenario rests on the evolution of black-white relations in the direction of more equality.

Because social mobility is a key feature in the process of assimilation, the authors ask what the prospects of mobility for present immigrants are if low-skilled manufacturing jobs, which were crucial to the social mobility of past immigrants, are disappearing. Historical studies of social mobility tend to show that ethnic differences in the economic standing of groups remained important into the second generation; ancestry, or outcome, studies show that these differences eventually disappeared. The authors note that the socioeconomic prospects of those entering at the bottom may be worse than in the past because of labor market transformations. However, jobs in the service sector may serve the same function that low-skilled manufacturing jobs served for past immigrants. Another aspect of economic change that may make mobility more difficult for today's immigrants is increasing income disparity.

Acculturation of the second generation has two parts: convergence with the cultural patterns of mainstream society and convergence with economic expectations and standards of mainstream society. The controversy here rests on whether there is continuity between yesterday's and today's second generations or whether there is a difference because of the mismatch between second-generation expectations and labor market realities. According to Perlmann and Waldinger, the evidence implies that a second-generation revolt, or oppositional or adversarial culture, can emerge without exposure to native-born minorities and therefore points to more continuity in the experiences of past and present immigrants. Perlmann and Waldinger note that a discussion of class is also missing from the current debate.

The authors conclude that the process of assimilation under conditions of replenishment are likely to differ from conditions of nonreplenishment, but argue that the differences may be smaller than observers think.

Money, Finance, and National Income Determination: An Integrated Approach

In **Working Paper No. 167**, Distinguished Scholar **Wynne Godley** rejects the standard macroeconomic models and offers his own theoretical model of how a modern monetary economy works. Several features distinguish Godley's model from mainstream neoclassical ones, and methodology distinguishes his model from the radical macroeconomic tradition. He departs from the standard models by including the notions that agents act under conditions of uncertainty and that there is a systematic need for financing over time. He enhances the macroeconomic models set forth by Keynes, Kaldor, and Hicks by adopting the methodology initiated by Tobin, in which a whole model is established formally and is then simulated numerically. By employing Tobin's methodology, he facilitates the reliable and rigorous teaching of Keynesian and post-Keynesian models and contributes to the debate about "what Keynes really meant."

Casting away the assumption that governments, firms, banks, and households act independently at any moment in time, Godley assumes that the behavior of these four entities evolves interdependently under conditions of uncertainty. Unlike Walrasian and Marshallian equilibrium models, in which price is directly determined by supply and demand, Godley accounts for changes in stocks and flows over time by using the demand and supply equation in a recursive manner.

Godley faults the conceptual framework of the standard models for omitting financial institutions, which provide financing for investment in fixed and working capital and for fluctuating inventories. At the same time these institutions finance the asset accumulation and allocation needs of the housing sector under conditions of uncertainty similar to but distinct from those of the firm. Godley's model reveals how the banking system is motivated to carry out these roles simultaneously and how it can be profitable as long as its debtors do not default. The model also shows how prices determine the distribution of income and wealth.

The Minimum Wage and the Path Toward a High-Wage Economy

Even with Republican majorities in both houses of Congress the minimum wage became a legislative policy issue in 1996. Not surprisingly in this election year, it has been one of the few votes taken in the 104th Congress in which a substantial number of Republicans abandoned the majority and voted with the minority. In **Working Paper No. 166**, Resident Scholar **Oren M. Levin-Waldman** remonstrates against the scope of the current debate. He sides neither with those who view the minimum wage in terms of employment displacement or labor-capital substitution nor with those who view it in terms of poverty or welfare. Instead he would prefer to discuss it as part of a broader traditional labor market issue, that is, he would focus the debate on productivity, with the minimum wage viewed as one tool for achieving high productivity.

Opponents of an increase in the minimum wage argue that most minimum-wage workers are not poor and an increase in the minimum will have a disemployment effect in the teen labor market. Firms unable to pay the higher labor costs will reduce employment or benefits or substitute technology for labor. Proponents of an increase in the minimum wage note that because of inflation minimum-wage workers now are below the poverty level. Although Levin-Waldman finds merit in both arguments, he asserts that they are too narrow and miss the point. Both sides focus on only one segment of the labor market-either teenagers or the working poor. Moreover, the proponents' focus on alleviating poverty makes minimum wage policy politically inviable in the current social climate.

Levin-Waldman justifies increasing the minimum wage with a broader labor market argument, one that he believes would lead to the creation of a high-wage economy. By exploiting the substitution effect (normally a labor-technology trade-off) of an increase in the minimum wage, firms would invest in human capital by training low-skilled workers to become high-skilled workers. As a result, overall productivity would increase. Encouraging firms to adopt this "high-road" strategy could be accomplished by legislating an increase in the minimum wage. Ultimately, the nation would be placed on a path toward the presently elusive high productivity and high-wage economy.

Comparing Alternative Methods of Adjusting U.S. Federal Fiscal Deficits for Cyclical and Price Effects

With deficit reduction topping the campaign agendas of the leading presidential contenders, now is an opportune moment to consider measurement problems associated with the federal budget deficit. In an empirical analysis in **Working Paper No. 169**, Resident Scholar **Neil H. Buchanan** uses several statistical techniques to assess alternative measures of the federal budget deficit and to determine the applicability of such measures in analyses of the macroeconomy. His findings support recent research that indicate that price adjusting the deficit usually improves its measurement and that long time-series analyses may be inappropriate in the evolving economy.

Buchanan examines six deficit measures. The first two are cyclically adjusted deficit series published by the government: (1) the Bureau of Economic Analysis's high-employment deficit (HED), based on a constant standard of unemployment, and (2) the Congressional Budget Office's standardized employment deficit (SED), based on a varying standard of unemployment. HED and SED are then price adjusted (adjusted for inflation) in two ways to create the remaining four series. The simpler method of adjustment involves multiplying the year-end par value of outstanding debt by the inflation rate; two hybrid series are created: PAHED and PASED1. The second and more intricate method, pioneered by Eisner, involves a market valuation of debt and an accounting for the timing of inflation's effect on prior debt, creating two additional hybrid series: PAHED1 and PASED.

Using a multiple regression analysis, Buchanan contrasts the various series to test the macroeconomic relationships, namely, the growth-deficit and the unemployment-deficit relationships. Initially he finds the unemployment-deficit relationship to be the stronger of the two. An analysis using shorter time periods weakens the dominance of the price-adjusted series over the unadjusted series and also calls into question the growth-deficit relationship. Buchanan finds that the simpler method of price adjustment produces statistically insignificant results. This finding contrasts with Eisner's that both methods of price adjusting produce similar results. Using more advanced statistical techniques, Buchanan finds that HED is generally a better measure of the deficit than SED and gets mixed results on the performance of the two price-adjustment methods.

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