Levy Economics Institute of Bard College

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

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

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PUBLICATIONS AND PRESENTATIONS

LETTER FROM THE PRESIDENT

To our readers:

This issue begins with a strategic analysis by Research Scholar Gennaro Zezza under the State of the U.S. and World Economies program. He finds that the increase in public sector aggregate demand in the United States last year was a result of the fiscal stimulus, without which the recession would have been much deeper. He confirms that strong policy action is required to achieve full employment in the medium term, including a persistently high government deficit in the short term. The alternative is an ongoing unemployment rate above 10 percent that would represent a higher cost to future generations. And since his scenario perpetuates international imbalances, Zezza expresses the need for a different growth strategy.

In a public policy brief under the Monetary Policy and Financial Structure program, Senior Scholar Jan Kregel provides an in-depth account of the 1933 Banking Act and concludes that a return to the Act's simple structure and strict segregation between commercial and investment banking is unwarranted. He suggests regulating deposit taking as a public utility or treating wealth and transaction services as a public service within a national giro payments system. In a policy note, Kregel identifies problems associated with bank size and claims that multifunctional banking is the leading source of financial crisis. Thus, the thrust of government regulatory reform is inadequate, resolving large banks will not solve the inherent problems, and past solutions may be inappropriate in reforming the financial system.

Five working papers are also included under this program. Research Associate Jörg Bibow evaluates the 10th anniversary of the euro and concludes that Europe should discard its price stability policy agenda, mind its domestic demand, and create a fiscal union to back the euro. In another paper, he proposes a "Bretton Woods III" regime that features a continuation of U.S. current account deficits that focus on upgrading U.S. infrastructure. He foresees a future where all players pursue domestic demand–led growth, without any specific currency playing the dollar's current role.

In a third paper, Kregel evaluates the financial crisis and determines that the lack of meaningful reform stemmed from the focus on liquidity and the failure to recognize that both the assets and the associated institutions were insolvent. In another paper, he identifies systemic changes that reform must redress and reverse, and concludes that it may be impossible to fully separate banks from capital market activities if securitization is maintained as the basic financial structure.

In a fifth paper, Yeva Nersisyan and Senior Scholar L. Randall Wray explain how the U.S. policy response to the crisis (bailout) has resulted in further concentration of the financial sector. These policies are doomed to fail, they say, because the solution lies in downsizing the financial sector by two-thirds or more.

Under the Distribution of Income and Wealth program, a brief by Nersisyan and Wray argues that the best solution to the employment-based pension system is to eliminate government support for pension plans and private savings, encourage pensions to invest only in (risk-free) Treasury bonds, and expand Social Security. In another brief, Marshall Auerback and Wray find that the U.S. health care "reform" measures actually promote the status quo. They prefer a reduced role for private insurers, an increased role for government funding, and a Medicare buy-in (public option) for people under 65.

In a working paper, Senior Scholar Edward N. Wolff finds skyrocketing indebtedness leading to a "middle-class squeeze," where most gains accrue to the uppermost quintile. Rising debt made the middle class vulnerable to income shocks, setting the stage for the mortgage crisis and financial meltdown.

Under the Employment Policy and Labor Markets program, a brief by Research Scholars Rania Antonopoulos, Kijong Kim, and Thomas Masterson, and Senior Scholar Ajit Zacharias points to the need for the U.S. government to select project investments that maximize job creation. They find that social sector investment generates significantly more jobs than infrastructure spending or investing in green energy. In a working paper, Tsu-Yu Tsao and Andrew Pearlman find that potential discrimination plays a small role in the racial wage gap among physicians.

As always, I welcome your comments and suggestions.

Dimitri B. Papadimitriou, *President*

Program: The State of the U.S. and World Economies

Strategic Analysis

Getting Out of the Recession?

GENNARO ZEZZA

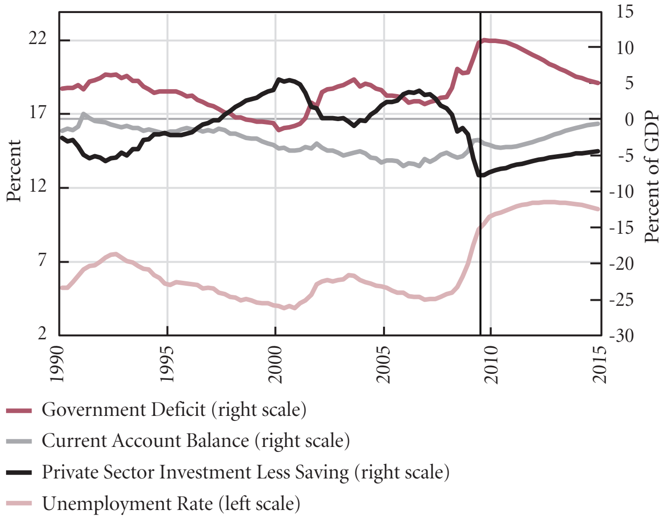
March 2010

Research Scholar Gennaro Zezza updates the Levy Institute's previous Strategic Analysis (December 2009) and finds that the 2009 increase in public sector aggregate demand was a result of the fiscal stimulus, without which the recession would have been much deeper. He confirms that strong policy action is required to achieve full employment in the medium term, including a persistently high government deficit in the short term. This implies a growing public debt, which is sustainable as long as interest rates are kept at the current low level. The alternative is an ongoing unemployment rate above 10 percent that would represent a higher cost to future generations.

The author's approach to the dynamics of real GDP is based on analyzing the components of demand, such as consumption, which needs to be financed by disposable income or borrowing. As expected, consumer and business borrowing remained negative throughout 2009, suggesting that households were engaged in reducing excessive indebtedness. Since the purchasing power of the wage bill fell despite an increase in real disposable income, that increase was the result of net government transfers to the private sector and profits.

Another component of demand is net exports, which depend on the dollar exchange rate. The depreciation of the dollar last year benefited U.S. exports to the eurozone and Japan, but the undervaluation of the yuan has mitigated any stimulus from U.S. net exports. Since the dollar has recently stopped depreciating, no further stimulus to demand can be expected from this component in the short term.

Figure 1 **U.S. Main Sector Balances and Unemployment in Baseline Scenario, 1990–2014**

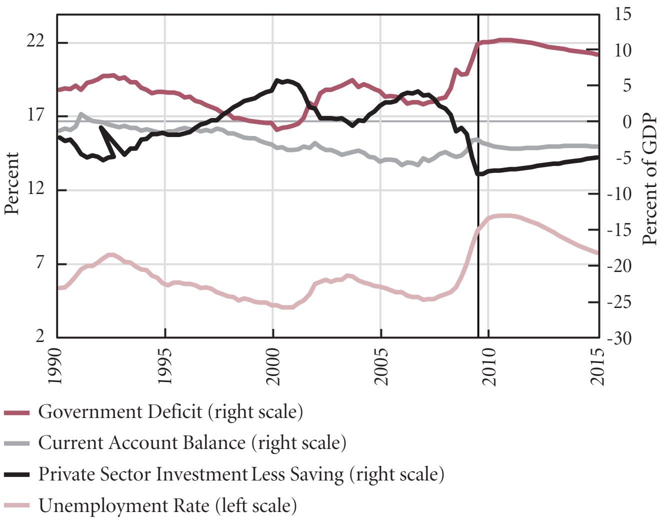


Sources: BEA; author's calculations

Using the latest projections by the International Monetary Fund for real GDP growth in major U.S. trade partners and by the Congressional Budget Office for government revenues and outlays under current policies, Zezza develops a baseline scenario using neutral assumptions such as the absence of any further crash in the stock market or housing sector (Figure 1). Insufficient growth in all components of aggregate demand imply that unemployment will hover around 10 percent, while output slowly recovers to a growth rate of 2.5 percent and the federal deficit declines to 5 percent by 2015. The government debt, however, will rise by 30 percent of GDP, since the deficit remains large relative to the GDP growth rate. This baseline scenario is unrealistic, says Zezza, because the projected path for fiscal policy under current legislation underestimates government deficits.

Using more plausible assumptions about fiscal policy, Zezza derives an alternative scenario that assumes permanent tax cuts and a larger increase in government outlays related to both expenditures and transfers to the private sector. As shown in Figure 2, the unemployment rate declines to 7 percent, output grows at least 3 percent after 2011, and the government deficit remains high relative to GDP, with public debt growing by 101 percent by 2015. Monetary policy is assumed to keep interest rates at a very low level and the recovery in output,

Figure 2 U.S. Main Sector Balances and Unemployment in Prolonged Fiscal Stimulus, 1990–2014



Sources: BEA; author's calculations

driven by public expenditure and transfers, results in the current account balance stabilizing at 4 percent of GDP.

The alternative scenario, where the growth in output comes from increasing public debt, is preferred to the baseline scenario, where unemployment is persistent. An expansionary fiscal policy will sustain output and employment, but it will also cause the external balance to deteriorate. And since this scenario perpetuates international imbalances, a different growth strategy is needed.

For the complete text, go to www.levy.org/pubs/sa_mar_10.pdf.

Program: Monetary Policy and Financial Structure

No Going Back: Why We Cannot Restore Glass-Steagall's Segregation of Banking and Finance

JAN KREGEL

Public Policy Brief No. 107, 2010

The U.S. Congress passed the Banking Act of 1933 (aka Glass-Steagall) to correct the abuses of the national banking system that stemmed from the involvement of commercial banks in securities underwriting, which allegedly contributed to the Great Depression by fueling rampant speculation. The purpose of the Act was to prevent the exposure of commercial banks to the risks of investment banking and to ensure stability of the financial system. A proposed solution to the current financial crisis is a return to the basic tenets of this New Deal legislation.

Senior Scholar Jan Kregel provides an in-depth account of the Banking Act, including the premises leading up to its adoption, its influence on the design of the financial system (e.g., formalizing the difference between the short-term and long-term use of funds), and the subsequent collapse of the Act's restrictions on securities trading (deregulation). He concludes that a return to the Act's simple structure and strict segregation between (regulated) commercial and (unregulated) investment banking is unwarranted in light of ongoing questions about commercial banks' ability to compete with other financial institutions. Another concern is the ability to adopt new regulations that would prevent a repeat collapse of the Act's original restrictions on securities trading. Moreover, fundamental reform—the (conflicting) relationship between state and national charters and regulation—was bypassed by the legislation.

In essence, the Act provided the unregulated investment banks with a monopoly over securities market activities. Moreover, both commercial and investment banks provide liquidity: the former by creating deposits and the latter by structuring the liabilities issued by borrowers. Thus, investment banks were functionally equivalent to the deposit and liquidity-creation business of regulated banks. While the Act provided monopoly protection for the commercial banks' business model, which was locked into issuing commercial loans, it did not give these banks a monopoly on the creation of liquidity. Over time, other financial sectors offered similar products with fewer restrictions and lower costs (e.g., through structures such as securitization, the commercial paper market, and money market mutual funds; and through the process of "riskless arbitrage").

The regulated banks sought to compete in the marketplace by expanding their lending into longer maturities. Ultimately, the Securities and Exchange Commission allowed these banks to operate affiliates that were neither regulated nor consolidated for financial reporting purposes, while other regulators provided a level playing field that included the ability to engage in (high risk) activities such as credit derivatives. When the liquidity crisis occurred in 2008, it resulted in a collapse of security values, an insolvency in securitized structures, and a withdrawal of short-term funding. The safety net that was created to respond to a run on bank deposits was totally inadequate to a capital market liquidity crisis.

Kregel observes that an alternative source of revenue has to be found for the regulated banks without undermining their protections, and that regulators, legislators, and the judiciary have to agree on a precise definition of, and the powers to carry out, permissible banking activities. One approach is to recognize deposit taking as a public service and to regulate it as a public utility, with a guaranteed return on regulated costs. Another approach is to treat wealth and transaction services as a public service by a regulated utility, such as a national giro payments system, thus eliminating the need for deposit insurance and the lender-of-last-resort function of the Federal Reserve. Both short- and long-term finance and funding would be provided by private investment funds or trusts monitored by securities regulations, but without the need for a government guarantee.

In spite of his proposed solutions, Kregel acknowledges that the conundrum of prohibiting regulated banks from engaging in the least costly method of short-term business financing, combined with the impossibility of legislating monopoly deposit protections similar to those in the 1933 Act without prohibiting competitive innovations by nonregulated institutions, remains unresolved.

For the complete text, go to www.levy.org/pubs/ppb_107.pdf.

Observations on the Problem of "Too Big to Fail/Save/Resolve"

JAN KREGEL

Policy Note 2009 / 11

Senior Scholar Jan Kregel identifies a number of problems associated with bank size, such as market concentration, interconnectedness, and global competitiveness. Moreover, the "Brandeis argument" points to an inherent conflict of interest associated with multifunctional banking that produces fraudulent, anticompetitive behavior.

According to Kregel, multifunctional banking is the leading source of financial crisis, while large size contributes to contagion and systemic risk. Thus, the current thrust of government regulatory reform is inadequate, resolving large banks will not solve the problems, and past solutions may be inappropriate in reforming the financial system.

Louis D. Brandeis argued that a system that allows financial institutions to combine the four distinct functions of banks—commercial banking, trust and insurance, corporate underwriting, and brokering—would not be conducive to market competition that serves the best interests of clients. The basic reason that banks no longer provide financing to the real productive sector of the economy is that profits are higher in capital market and trading activities. This argues in favor of limiting the scope of financial institutions, irrespective of size.

Bank concentration reduces the ability of market competition to ensure efficiency in providing banking services and allocating credit. In the regulatory sphere this is an antitrust problem concerning absolute size and market control. For example, the monopoly over deposits granted to insured commercial banks by the 1933 Banking Act led to antitrust legislation based on the banks' particular functions according to their dominance over defined geographical areas. When the 1999 Financial Modernization Act allowed the integration of diverse banking functions, the idea of a confined local market was no longer relevant. New antitrust regulations will be required to resolve the issue of bank size and concentration on market competition subsequent to the new legislation.

Interconnectedness has to do with the ability of a regulatory agency to rapidly resolve an institution exposed to a wide range of unrelated financial institutions operating in different financial markets. Since synergy and efficiency are presumed to justify large size, there is a linkage between multifunctional financial institutions and interconnectedness both within and across financial institutions. A related issue is the absence of formal resolution procedures within the Federal Deposit Insurance Corporation (FDIC) for noninsured, nonbank financial institutions. The FDIC's role as a provider of system stability in the event of bank failure is not conducive to its role as an insurer of deposit liabilities held by the public. This argues in favor of limiting the scope of financial institutions and setting the FDIC's goal in terms of the stability of depositors' claims rather than the stability of the financial system.

Kregel debunks a number of justifications for large bank size, such as the need to service large and complex multinational corporations. There is no evidence of synergy across financial services, nor of large global companies relying on one bank for all financial services. Moreover, the size and liquidity of the capital market, and the cost of hedging, are important for the successful primary issue of securities rather than the size of the capital that can be committed by the underwriter.

In terms of global competitiveness, the author notes that U.S. banks' global expansion was more the result of escaping Fed restrictions on domestic expansion than attempting to compete globally. The most important justification for large bank size is that it provides the necessary returns to equity. Multifunctional banking is supposed to diversify risk and earnings, and stabilize income, but there is scant evidence of higher returns or lower costs, low correlations of asset earnings across geographical areas, or greater profitability from economies of either scale or scope.

Evidence suggests that banks experience scale economies up to an asset size of approximately $1 billion, followed by diseconomies of scale thereafter. Furthermore, the argument that a decomposition of multifunctional banks would be too costly and disruptive is not credible, since over $10 billion has been spent to support these large financial institutions. The argument for preserving these institutions appears to mistake the benefits of size with the benefits of broad, deep markets, which are conducive to both liquidity and stability.

For the complete text, go to www.levy.org/pubs/pn_09_11.pdf.

The Euro and Its Guardian of Stability: The Fiction and Reality of the 10th Anniversary Blast

JÖRG BIBOW

Working Paper No. 583, November 2009

On the 10th anniversary of the euro, the European economy was in free fall and speculation about an imminent breakup of Euroland was rampant. According to Research Associate Jörg Bibow, Europe was not a victim of external shocks but of its own contributions toward the buildup of internal and global imbalances, including beggar-thy-neighbor policies that the euro was meant to ban forever. He advocates that Euroland discard its current policy regime, including its price stability agenda, and take steps toward minding domestic demand and creating a fiscal union to back the euro.

Bibow focuses on the roles of the European Central Bank (ECB) and the national central banks of European Union (EU) members that ensure the euro's stability. He highlights the peculiarities of the Maastricht regime in guiding economic policies and shows that regime flaws, rather than a common currency, are to blame for Europe's economic malaise. The Maastricht Treaty features a federal supranational monetary authority paired with national fiscal authorities, whereby members have surrendered their monetary sovereignty but not their fiscal sovereignty—in spite of public-debt financial constraints and a "no bailout" clause in the Stability and Growth Pact (SGP) designed to contain national solvency issues. According to Bibow, the SGP clause shows that the design of Europe's monetary union is ludicrous.

The ECB is the world's most independent central bank, with a mandate to maintain price stability. Thus, the euro is managed by a federal supranational central bank that is not properly accountable to national or European political authorities. There is no federal euro treasury and no proper coordination of national fiscal policies, aside from the asymmetric constraints arising from the SGP. As a result, Euroland's fiscal stance is the random outcome of national budget plans that compromise the region's policy instrument for dealing with asymmetric shocks, making common shocks the burden of monetary policy. In essence, there is no one to stabilize domestic demand and employment unless the central banks choose to do so.

Another critical issue concerns intra-Euroland real exchange rates, which affect competitive positions when wage or productivity trends diverge within the union. Since prudential supervision and responsibility for financial stability rests at the national level, solvency problems of financial institutions can be addressed only at the national level, so the ECB must fill the systemic void. Designers of the regime overlooked the fact that Europe's (supposedly) integrated financial system would be vulnerable at the systemic level, since it lacked an integrated financial supervisory role and a lender-of-last-resort function.

Bibow outlines the ECB's idiosyncratic views on monetary policy (e.g., it is not in the business of inflation targeting) and its failure to provide an explicit definition of price stability that could be used by policymakers. These features explain the ECB's asymmetry in setting interest rates and its preference for discretion. Moreover, the ECB's mandate allows it to avoid taking responsibility for any risks associated with its primary objectives and to maintain that price stability contributes to output (growth) and employment. Thus, the ECB fulfills its double mandate by reducing it to a single responsibility: price stability.

The ECB's guiding principles and Europe's official views are of German origin, and German central bankers have promoted the idea that an independent central bank would somehow be directly accountable to the general public. Their public relations strategy nourished hyperinflation fears, ignored the effects of deflation during the Great Depression, and distorted the picture of inflation, deflation, war, and savings losses by the German public. Thus, Euroland monetary policy reflects a conspicuous asymmetry in mindset and approach, with an antigrowth bias.

Bibow notes that stability-oriented policy worked well under the Bretton Woods regime, which established Germany's export-oriented growth strategy and the Bundesbank's claim to fame as an inflation fighter. By 1982, however, Germany officially ended demand management and policy was prioritized to balance the budget. The predictable result was domestic demand stagnation and rising unemployment that was periodically tempered by economic expansion in the United States and a strong dollar.

The author singles out three main policy blunders: (1) Euroland's business cycle based on export dependency; (2) the interaction between monetary and fiscal policies, which produced "tax-push inflation" and contributed to headline inflation and domestic demand stagnation; and (3) the Maastricht regime, which amplified divergences and imbalances within the EU. Massive capital inflows in countries other than Germany in the 2003–08 period have resulted in uncompetitive exchange rates, asset price bubbles, domestic demand booms, and huge current account deficits. Germany's wage deflation strategy could not work for Euroland as a whole, since one country's gain in competitiveness leads to serious intraregional imbalances. The lesson here is that substituting national wage deflation for EU macro policy greatly destabilizes the union. This approach to policy is unlikely to make Euroland a constructive player in fostering recovery from the current global crisis.

Bibow points out that Euroland contributed substantially to the buildup of global imbalances since the 1990s and to the global collapse through both its trade and finance channels. European banks were highly leveraged and exposed to U.S. mortgage-related credit risks, so Europe found itself at the center of the global financial crisis, as negative feedback loops from cross-border linkages amplified troubles throughout the region. The real question is whether better coordination between national and EU authorities will prevent future emergencies without foregoing growth. Bibow suggests that fiscal retrenchment featuring "tax-push inflation" is about to return to Euroland.

For the complete text, go to www.levy.org/pubs/wp_583.pdf.

The Global Crisis and the Future of the Dollar: Toward Bretton Woods III?

JÖRG BIBOW

Working Paper No. 584, February 2010

U.S. financial institutions have enjoyed a superior position in global finance because the global monetary order is centered on the dollar. However, this order has induced defensive (national) macroeconomic policies, as governments seek to control their own financial institutions and economic sovereignty. These policies include maintaining competitive exchange rates against the dollar, increasing current account surpluses, and accumulating foreign exchange reserves denominated in dollars.

According to Research Associate Jörg Bibow, the dollar's role must be a factor when assessing both the roots of the global financial crisis and the prospects for a sustained economic recovery. He points out that the world monetary and financial order influenced particular macroeconomic policies underlying international (and domestic) credit structures that subsequently led to global and domestic imbalances. He therefore proposes a "Bretton Woods III" regime that features a continuation of U.S. current account deficits driven by public spending, and public debt that focuses on upgrading U.S. infrastructure—an arrangement that would require the Federal Reserve and Wall Street to maintain low financing costs.

The gold standard lacked a mechanism to offset systemic deflationary pressures. This oversight contributed to the severity of the Great Depression. By contrast, the dollar standard is not physically constrained, and systemic deflationary pressures can be offset by a flexible response from U.S. macroeconomic policy. (The desire to export and accumulate dollar reserves produces strong deflationary forces in the United States that weaken labor markets and place downward pressure on wages and prices.) While the United States benefits from cheap imports and easy financial terms that stimulate domestic demand, observes Bibow, it also has a special responsibility under crisis conditions.

Bretton Woods II failed because it ignored the fact that the domestic counterpart to the U.S. external deficit was based on (toxic) private debts, particularly mortgage debt, rather than on (safe) public debts. Moreover, Bretton Woods II overlooked the rise in household indebtedness (leverage) as the U.S. personal saving rate declined. The true engine of growth underlying this system was the U.S. consumer's role as "borrower and spender of last resort." Moreover, this role was nurtured by the global monetary and financial order when both Japan and Euroland adopted a mercantile model of economic growth.

When global imbalances emerged in the early 1990s, U.S. macro policy was flexible in terms of monetary policy (e.g., lower interest rates) and fiscal policy was restricted to periods of recession. Rising household indebtedness (i.e., domestic imbalances) was acceptable as long as net worth continued to rise, but these internal trends were unsustainable. This was another feature that was ignored by Bretton Woods II. According to Bibow, the Bretton Woods II regime was doomed long before the demise of Lehman Brothers.

Bibow does not foresee the emerging-market consumer as the harbinger of global growth, nor does he believe that the U.S. consumer can resume his previous behavior. Rather, the new engine of growth could be Bretton Woods III, whereby U.S. public debt replaces private debt and the guard changes from monetary to fiscal policy. The only way to support domestic demand is to cut taxes in support of private income or to boost public spending. However, the private sector is retrenching, and the current trend toward global rebalancing may be short term.

Bretton Woods III implies a more lasting role for fiscal policy in sustaining domestic demand, and more permanent budget deficits may be needed in spite of rebalancing efforts. Bibow proposes that deficits of 3 percent may be perfectly manageable and that long-run U.S. net international investment positions could converge to (negative) 50 percent of GDP (under the assumption that nominal annual GDP growth averages 6 percent). Under this scenario, Fed policy would still be important in maintaining low interest rates and low financial costs for public debt.

The United States enjoys a rate-of-return advantage on its gross foreign assets relative to its gross foreign liabilities. Thus, leveraging its negative net foreign asset position could produce positive investment income that supports the notion of persistent trade deficits. Furthermore, dollar depreciation produces valuation (capital) gains.

Bibow foresees a future where all major regions and players pursue domestic demand-led growth, and exchange rates are adjusted to balance global trade without any specific currency playing the dollar's current role. Any alternative to the dollar's special status, however, will likely take decades to implement.

In spite of its capacity as the interim reserve currency issuer, Bibow suggests that the United States should design its macroeconomic policies to serve its own best interests and focus on infrastructure investment in order to sustain domestic demand-led growth and avoid another private debt–driven boom-and-bust cycle. Furthermore, a compositional shift in demand (e.g., energy conservation and security) may help to contain the U.S. current account deficit.

For the complete text, go to www.levy.org/pubs/wp_584.pdf.

Is Reregulation of the Financial System an Oxymoron?

JAN KREGEL

Working Paper No. 585, February 2010

The financial crisis has been attributed to the failure to apply existing regulations, a notion that has minimized fundamental reform of the financial system. The basic problem was believed to be the collapse of asset prices resulting from the disappearance of market liquidity. The response was to change existing regulations in an attempt to restore the normal functioning of the financial system in terms of, for example, subprime mortgages, capital adequacy, and liquidity.

Senior Scholar Jan Kregel outlines three distinct stages of the crisis and determines that the lack of meaningful reform stemmed from the failure to recognize that both the assets and the institutions holding the assets were insolvent. As long as policy focuses on providing sufficient liquidity with the hope that asset prices will return to levels that allow banks to remain solvent with minimum capital injections, says Kregel, there will be no meaningful reform or regulation of the financial system.

The first stage of the crisis related to the regulation and supervision of mortgage lending, and to mortgage affiliates. The banks were moving their capital exposure to mortgage lending off balance sheet through the creation of special purpose entities. Although mortgage affiliates were technically regulated, they had been declared outside the purview of Federal Reserve supervision. In response, approximately 13 percent of subprime loans by bank affiliates in the 2004–07 period were effectively unregulated. Moreover, the Fed failed to use its authority to investigate practices of predatory lending. According to Kregel, existing regulations were not applied and supervision was lax by design rather than by oversight. At this time, regulations were applied according to a model where financial instability was considered an exceptional event rather than a normal occurrence (as emphasized by Hyman P. Minsky).

The crisis's second stage related to mortgage securitization and (unregulated) off-balance-sheet affiliates. Many large financial holding companies had issued contingent liabilities to arm's-length special investment vehicles (SIVs). The absence of variable interest on SIVs on the reported balance sheet of banks and the absence of regulations governed accounting procedures. Kregel points out that there was no lack of formal regulation at this time because the SIVs were created in answer to reregulation that was supposed to prevent the abuses associated with the Enron scandal. Again, the government's response was to reinforce the application of existing regulations; that is, to replenish bank capital so that the banks could take the assets back onto their balance sheets. However, doubts about the value of the assets held by the SIVs led to difficulties in refinancing when investors failed to buy asset-backed commercial paper. This response led to further doubts about the ability of commercial banks to meet their lending commitments in support of subprime mortgage assets. At this time, the entire financial system operated on the basis of borrowing short-term funds to finance (long-term) mortgage assets under the belief that the subprime exposure problem was well contained.

The third stage of the crisis began in the investment-banking sector with the collapse of Bear Stearns and ended with the bankruptcy of Lehman Brothers and the upending of the entire financial system. The viability of an investment bank depended on the value of its inventory of assets and its ability to refinance those assets on a continuous short-term basis (collateral was repriced daily; that is, marked to market). During this stage, an uninsured financial institution could finance its asset holdings through a repurchase agreement with an insured commercial bank, which was lending short term to finance speculative holdings of government and other securities. Investment banks also lent the securities of hedge funds held as collateral. Thus, there was an increasingly long chain of short-term lending or financial layering supporting speculative positions in long-term assets, with increasing leverage in terms of both assets and liabilities. This system was extremely fragile and subject to collapse.

The Treasury and the Fed decided that a systemic solution was required to support asset prices, so they requested TARP funding from Congress, while the Fed also decided to lend to all institutions in order for them to meet short-term funding requirements. Kregel points out that this response is proof of Minsky's rule: the stability of an institution depends solely on its ability to sell assets for cash—and the Fed is the only body that can provide unlimited amounts of cash.

For the complete text, go to www.levy.org/pubs/wp_585.pdf.

Is This the Minsky Moment for Reform of Financial Regulation?

JAN KREGEL

Working Paper No. 586, February 2010

According to Senior Scholar Jan Kregel, the current approach to regulating the financial system is a series of cosmetic changes designed to remedy the conditions generated by a "Minsky moment." However, the recent financial crisis and instability in the mortgage markets are byproducts of increasing fragility in the financial system as a whole—not a "moment" but rather a "process," as described by Hyman P. Minsky's financial fragility hypothesis.

Kregel identifies two types of systemic changes that reform must redress and reverse: the way that business financing (capital market instruments) has integrated banking and finance functions, and the way in which these instruments, by increasing financial layering, have reduced system liquidity and heightened fragility. His analysis concludes that it may be impossible to fully separate deposit-taking "commercial" banks from capital market activities if securitization is maintained as the basic financial structure.

Minsky's analytical framework is beneficial to understanding why the mortgage structures were inherently fragile and preordained to generate financial instability and, ultimately, a crisis. Kregel begins by analyzing the evolution of the U.S. financial system since the New Deal legislation. The intent of Glass-Steagall was to separate the deposits of the public from exposure to capital market activities and to prevent member banks from dealing in equities. The problem is that it attempted to provide monopoly protection to ensure the stability of financial institutions rather than to protect the financial functions of the nonbank business sector. Moreover, in terms of the (traditional) role of banks, there was confusion between "deposit taking" (a high-cost activity) and "deposit making" (the granting of a loan through the creation of a deposit).

Nonbanks developed more cost-effective means of creating liquidity via asset securitization, which produced lower financing spreads through risk reduction and redistribution. Banks were forced to seek exemptions from their monopoly protections in order to offer similarly competitive loans to businesses. Legislation and administrative rulings by the Securities Exchange Commission (SEC) and the Federal Reserve eventually eliminated the separation of banking and finance. By 1985, the Fed allowed bank holding companies to acquire subsidiaries that offered both brokerage and investment advice to institutional customers. This action permitted banks to engage in asset securitization and to expand into short-term collateralized lending through repurchase agreements. The banks also used their commercial loans as collateral for securitized structures—special purpose entities that were neither regulated nor consolidated for financial reporting purposes—and engaged in the (unregulated) over-the-counter market in credit derivatives. This market contributed to the financial crisis as much as the credit default market. Thus, regulators aided and abetted the decline of bank stability.

Kregel notes that banks no longer "lend" to the nonbank business sector but to other financial institutions—a departure from the restrictions of the 1933 Banking Act. Thus, the collapse of liquidity was the result of financial institutions no longer lending to one another. A return to Glass-Steagall would be difficult because commercial banking now uses capital market instruments. Kregel also notes that liquidity created through "riskless" arbitrage is much more fragile structurally than liquidity based on the banks' ability to assess credit risk.

According to Minsky, banks' liabilities should have a higher liquidity premium than the assets they finance. A securitized lending structure, however, creates liquidity on the balance sheet of a separate institution that arbitrages higher-risk assets into lower-risk assets, and thus, lower-liquidity assets into higher-liquidity assets. This process focuses on identifying market mispricing rather than improving credit assessment and income is generated mainly from fees and commissions associated with loan origination and the underwriting of securities. System stability is therefore hostage to the search for lower-cost means of providing financing that produces higher returns, primarily through capital market activities.

An alternative to returning to Glass-Steagall involves regulating the creation of liquidity through capital market structures using measures similar to those applied to money market funds. Kregel recommends the following measures: (1) precluding deposit-taking banks from proprietary trading; (2) not allowing prudentially regulated institutions to coexist with market-regulated institutions; (3) recognizing the difference between liquidity created by bank net margin spreads and liquidity created by risk arbitrage, as well as the different income incentives between net interest margin banking and risk arbitrage banking (and returning credit evaluation to the business of banking); (4) terminating the exemption that excludes hedge funds from registering as investment companies; (5) breaking up the large banks and organizing them around related functions, since there are few synergies in having these functions within a single institution; and (6) eliminating SEC exemptions on financial contracts, such as private placements and derivatives.

For the complete text, go to www.levy.org/pubs/wp_586.pdf.

The Global Financial Crisis and the Shift to Shadow Banking

YEVA NERSISYAN and L. RANDALL WRAY

Working Paper No. 587, February 2010

The thrust of the U.S. policy response to the financial crisis has been to preserve what Hyman P. Minsky called the money manager phase of capitalism (i.e., financialization), with the bailout resulting in further concentration of the financial sector. These policies are doomed to fail, say the authors of this working paper, because the solution lies in downsizing the financial sector by two-thirds or more. The momentum for real change has been lost, and the policy response has sown the seeds for another crisis.

Yeva Nersisyan and Senior Scholar L. Randall Wray review the U.S. financial system and find that the long period of robust growth following World War II created the conditions for a return of financial crises. Contrary to New Deal reforms, the distinction between "finance" and "industry" disappeared, and the real economy became increasingly vulnerable to the instability of the financial sector. In recent years the financial sector contributed 20 percent to GDP but reaped 40 percent of corporate profits, so it appeared that this sector was more profitable than the "real" sector. However, the sector's outstanding debt grew much more rapidly than GDP or the income flows necessary to service the debt (indicating higher leverage, or "layering").

The trend toward globalization and securitization allowed many of the large domestic institutions to become even larger (e.g., the top four U.S. banks accounted for 40 percent of bank assets in 2007). Other transformations included the shift away from banks and toward managed money, as well as the trend toward credit market borrowing by asset-backed securities that allowed regulated banks to avoid capital and reserve requirements, and to increase leverage and return on equity.

Minsky argued that the fragility of the financial structure is based on the quality of loans made by bankers. Deregulation and financial innovations, however, separated risk from responsibility and contributed to a deterioration of loan quality. The authors note that in reaction to the shift to "shadow banks," the number of commercial banks has decreased by half in the past two decades (after remaining constant from 1934 to 1985). They also note that noninterest income from the off-balance-sheet activities of banks increased from 7 percent of total income in 1980 to 44 percent in 2007.

When bankers emphasize the value of collateral rather than expected cash flows, a fragile financial system emerges because loan viability depends on the expected market value of assets pledged. This is what happened when the banks originated mortgages. Moreover, the significant decrease in commercial and industrial loans (and increase in trading rather than lending to the productive sector) indicates that the large banks were not really making loans to businesses. Therefore, the notion that bailing out the largest banks will get credit flowing again is fundamentally flawed.

Securitization, including credit default swaps (CDSs), were two innovations that played an important role in the fragility of the financial system. The size of the CDS market is unknown, since the derivatives market is mostly unregulated (global estimates are as high as $70 trillion, or 10 percent of all derivatives sold). Size is important, because small losses on derivative holdings can wipe out bank capital (e.g., AIG).

When the government determines which institutions should be bailed out and which should be allowed to go under, it conducts a major redistribution of wealth and power, with far-reaching implications for the future. The authors note that the government has played a negligible role in the decision making of rescued firms and that banks continue to engage in risky practices. They suspect that most of the reported bank profits are the result of "quid pro quo" trades, whereby bad assets are bought at inflated prices so that companies can book large profits, similar to the actions of the thrift industry in the 1980s. They also doubt that the U.S. economy is in recovery because the recent large fiscal stimulus package is unlikely to be repeated and there are global deflationary pressures.

Nersisyan and Wray maintain that the government must not allow the financial industry to regulate itself nor its institutions to become "too big to fail." Furthermore, insolvent banks should be resolved according to two principles: ensuring the least cost to the FDIC, and downsizing in order to minimize the impact on the banking system. Other options include regulating securitized products, establishing a centralized clearinghouse for trading derivatives, forbidding banks to engage in securitization, creating a regulated exchange for financial derivatives—and prosecuting fraud.

The best proposal by the Obama administration—creating a Consumer Finance Protection Agency, which would protect consumers from deceptive practices and regulate mortgages, credit cards, and other consumer debt—is unlikely to pass, say the authors. Moreover, the proposed "Volcker rule," which would prohibit regulated and publicly insured financial institutions from operating hedge and private equity funds or from engaging in proprietary trading is a step in the right direction, but it is insufficient to safeguard the financial sector. Furthermore, we need debt relief for households, a stronger public retirement system, and real health care reform. *For the complete text, go to www.levy.org/pubs/wp_587.pdf.*

Program: The Distribution of Income and Wealth

The Trouble with Pensions: Toward an Alternative Public Policy to Support Retirement

YEVA NERSISYAN and L. RANDALL WRAY
Public Policy Brief No. 109, 2010

Pension funds have taken a big hit during the current financial crisis, with losses in the trillions of dollars. In addition, both private and public pensions are experiencing significant funding shortfalls, as is the U.S. government's Pension Benefit Guaranty Corporation (PBGC), which insures the defined-benefit pension plans of private companies.

Retirees suffer not only because of underfunding but also as a result of the transition from defined-benefit to defined-contribution plans and the decline in the proportion of the workforce covered by pension plans. With little or no control over their pensions, workers must now assume almost the entire burden of saving for retirement.

Yeva Nersisyan and Senior Scholar L. Randall Wray argue that the employment-based pension system is highly problematic, since the strategy for managing pension funds leads to excessive cost and risk in an effort to achieve above-average returns. The average fund manager, however, will only achieve the risk-free return. The authors therefore advocate expanding Social Security and encouraging private and public pensions to invest only in safe (risk-free) Treasury bonds, which, on average, will beat the net returns on risky assets. According to the authors, the best solution is to eliminate government support for pension plans and private savings, and to ensure that anyone who qualifies for Social Security will be rewarded with a comfortable retirement. And since Social Security is a federal government program, it cannot become insolvent.

In the early postwar period, Treasuries comprised a large portion of public and private pension plan portfolios, until factors such as competition and bankruptcies endangered firms' ability to meet pension liabilities and threatened the survival of "legacy" firms (and associated pensions). In response, firms sought higher rewards by investing in relatively higher-risk financial instruments such as corporate bonds, equities, and mutual funds.

Nersisyan and Wray point out that pension funds are part of what Hyman P. Minsky called "managed money," and that these funds are huge relative to the U.S. economy. They are large enough to destabilize asset prices (e.g., the boom and bust in the commodities markets) and any financial market they are allowed to enter. The willingness of government and employers to allow pension fund managers to risk retirement accounts meant that workers were subject to the whims of these money managers, and to the lack of government oversight and protection of these accounts. Innovations such as securitization, plus leverage, led to exceedingly risky positions in assets that ultimately collapsed. In order to restore funding levels, managed money has tried to continually innovate and speculate on new kinds of assets. Thus, financial firms on Wall Street not only create and market complex (risky) instruments but also design "risk management" instruments to hedge and diversify the risk, in addition to selling commodity futures indexes (to satisfy the demand they have created) and a host of other products. Workers are left with fees that drain their pension funds, and with massive counterparty risk. By charging fees for all of these instruments, the financial firms ensure that pension funds will, on average, net less than a risk-free return.

The financial industry can be justified only if pension fund management can beat the average risk-free return on Treasuries (including industry compensations), but this standard cannot be met, say the authors. Therefore, workers would be better off if they and their employers were required to return to a portfolio of safer, longer-maturity assets such as

Treasuries, which are automatically backed by the U.S. government. This approach would require a very small management staff, and would negate the use of fund managers and Wall Street sales staff.

For the complete text, go to www.levy.org/pubs/ppb_109.pdf.

Toward True Health Care Reform: More Care, Less Insurance

MARSHALL AUERBACK and L. RANDALL WRAY

Public Policy Brief No. 110, 2010

The United States has the most expensive health care system in the world, yet its system produces inferior outcomes relative to those in other countries. Moreover, it is the only country with a high per capita income that lacks universal health care coverage. Less than two-thirds of workers under age 65 have health insurance, while coverage varies greatly according to socioeconomic status.

Marshall Auerback and Senior Scholar L. Randall Wray examine the U.S. health care reform debate and argue that the fundamental structure of the health care system is unlikely to change. Both the House and Senate versions of the current health care bill entrench the centrality of private health insurance companies and contain no serious proposals to limit costs. “Reform” measures actually promote the status quo by pulling more people into an expensive health care system that is managed and funded by insurers. Since two-thirds of household bankruptcies are due to health care costs, forcing people to turn over an even larger portion of their income to an insurance company will further erode household finances and exacerbate the problem. Moreover, health care remains a function of employment, which preserves a significant cost disadvantage for U.S. corporations and is particularly unappealing during periods of double-digit unemployment.

The authors note that tying health insurance to employers was a historical accident that distorts the method of grouping individuals for the purposes of insurance. Since (private) insurance companies are in the business of maximizing profits, they attempt to reduce costs by denying coverage in consort with increasing exclusions. Prescreening and “denial management” costs are estimated to represent approximately 2 percent of GDP, while administrative overhead and profits represent almost one-third of health spending. And as health care costs have soared, legislators have backed off from enforcing mandates or financing new coverage for the poor.

According to the authors, the fundamental problem facing the U.S. health care system is the unhealthy lifestyle of many Americans. They would prefer to see a reduced role for private insurers and an increased role for government funding, along with greater public discussion of environmental and lifestyle factors. Minimal competition between private insurers means that premiums based on behavior modification that reduces health risk have not been adjusted downward. A campaign to promote healthy lifestyles would do more to improve outcomes and reduce costs than any of the proposed health care reforms.

Ideally, insurance premiums should be linked to individual risk, since 80 percent of health care costs are attributed to 20 percent of patients. Taxing current insurance holders and cutting Medicare to extend insurance to the uninsured should not be features of legislative reform.

In the authors’ view, insurance is best suited to cover unexpected losses. Furthermore, social policy dictates the losses that insurers must cover, and people need health care services on a routine basis. Since it is in the public interest to ensure that the entire population receives preventative and routine care, these services should not be subject to denial of coverage by the insurance companies.

The authors point out that Medicare is not really an insurance program but rather a universal-payer, pay-as-you-go system (there is no way to stockpile medical services for future use). An earlier version of the Senate’s proposed health care legislation featured a Medicare buy-in for people under 65—a feature that remains doable despite today’s political constraints. This “public option” provides more cost control (by competing with private insurance), helps to solve the problem of denying treatment based on preexisting conditions, expands the risk pool of patients, and enhances the global competitiveness of U.S. corporations. Thus, a Medicare buy-in would bring the U.S. health care system closer to the “ideal” low-cost, universal (single-payer) insurance plan.

For the complete text, go to www.levy.org/pubs/ppb_110.pdf.

Recent Trends in Household Wealth in the United States: Rising Debt and the Middle-Class Squeeze—An Update to 2007

EDWARD N. WOLFF

Working Paper No. 589, March 2010

Senior Scholar Edward N. Wolff updates his previous analysis of household wealth in the United States (see Working Paper No. 502) and finds skyrocketing indebtedness leading to a "middle-class squeeze." A rising debt-to-income ratio has reached its highest level in 25 years, while most gains in wealth and income continue to accrue to the uppermost quintile; particularly, the top 1 percent of the population. As a result of stagnating incomes, middle-class households have incurred more debt in order to finance normal consumption expenditures.

Wolff finds that the narrowing of racial disparities in wealth holdings in the 2001–07 period is the result of the gain in house prices relative to stock prices. He estimates, however, that mean and median wealth has declined considerably since 2007, while wealth inequality has risen sharply. Moreover, he estimates that almost 17 percent of homeowners are "underwater," meaning that their mortgage debt has exceeded their home's value.

Using data from the Federal Reserve's Survey of Consumer Finances since 1983, Wolff discusses the measurement of household wealth and presents wealth trends in terms of concentration, composition, race, and age. He also details stock ownership by demographic group and provides a partial update of household wealth trends to 2009. His principal concept is marketable wealth (net worth), which is the current value of all marketable or fungible assets less the current value of all debts. This measure reflects wealth as a store of value and therefore a source of potential consumption, and it provides a better understanding of household well-being. Wolff also uses a more restricted concept of wealth: nonhome wealth, which is defined as net worth minus net equity in owner-occupied housing. This concept is more liquid than marketable wealth.

Median net worth and median nonhome wealth declined between 2001 and 2004 as a result of a recession and a significant increase in household debt. These wealth measures subsequently experienced a strong recovery due to a combination of an increase in stock prices, a decline in the debt-to-asset ratio, and, perhaps, an expansion of middle-class savings. While average household income has stagnated since 1990, median net worth and median nonhome wealth have grown strongly in the 1990–2007 period, despite the setback between 2001 and 2004.

So far, this century has witnessed a moderate increase in income inequality, a small rise in wealth inequality, and a significant increase in nonhome wealth inequality. Wolff notes that nonhome wealth is more concentrated than net worth in the upper quintile. The reason that net worth inequality did not decline in the 2001–04 period is that it is positively related to the ratio of stock prices to house prices. This ratio fell sharply when household debt mushroomed. Since 1983, the richest 1 percent of the population has received more than one-third of the total gain in marketable wealth, while the top quintile has received 89 percent. The same pattern applies to nonhome wealth (e.g., stocks). Thus, economic growth is concentrated in a surprisingly small segment of the population.

Wolff outlines the marked difference in how middle-class and rich households invest their wealth. Most middle-class wealth is concentrated in home equity, while the rich invest mainly in real estate, businesses, corporate stock, and financial securities (three-quarters of the very rich own a business). Since 1983, there has been a sharp rise in the debt-to-equity ratio of the middle class (from 37 percent to 61 percent in 2007). The staggering debt-to-equity level of the middle class in 2007, however, was below its peak in 1995. Furthermore, the middle class debt-to-income ratio has risen from 67 percent to 157 percent. In the past two decades, families have used tax-sheltered mortgages, home equity loans, and credit cards, rather than consumer loans and other forms of consumer debt, to finance consumption.

Striking differences in the wealth holdings were also found in terms of race. White households have a much higher share of stocks in their portfolios, while black and Hispanic households have a relatively higher share of principal residences in their portfolios. Despite some progress this decade, the wealth gap between African Americans and Hispanics, on the one hand, and non-Hispanic whites on the other (approximately 50 percent) remains much greater than the corresponding income gap (20–25 percent). Median nonhome wealth among black and Hispanic households was virtually zero in 2007, while one-third of these households had zero or negative net worth, compared to 15 percent for whites (a difference that mirrors the gap in poverty rates). All racial groups have experienced an increase in their respective debt-to-asset ratios.

There has been a notable shift in relative wealth holdings by age group since 1983, including a shift in home ownership from younger to older households. Changes in relative net worth according to age are largely due to asset price movements between housing prices (younger households) and stock prices (older households). The fact that stock prices have fallen more than housing prices since 2007 means that wealth inequality has likely declined during the past two years. Nevertheless, there has been a marked deterioration in middle-class wealth (median wealth has plunged 36 percent to $65,400, which is synonymous with the 1992 level) and a fairly steep rise in wealth inequality (the Gini coefficient has risen from 0.834 to 0.865). Rising debt made the middle class vulnerable to income shocks, setting the stage for the mortgage crisis and financial meltdown in 2008–09.

For the complete text, go to www.levy.org/pubs/wp_589.pdf.

Program: Employment Policy and Labor Markets

Why President Obama Should Care about "Care": An Effective and Equitable Investment Strategy for Job Creation

RANIA ANTONOPOULOS, KIJONG KIM,
THOMAS MASTERSON, and AJIT ZACHARIAS
Public Policy Brief No. 108, 2010

In President Obama's State of the Union address he acknowledged the plight of unemployed Americans and promised to make jobs the number one focus in 2010. A move toward full employment, he said, would lay a new foundation for long-term economic growth and ensure that the U.S. government creates the necessary conditions for businesses to expand and hire more workers.

Past efforts by the Obama administration to save jobs have included stabilizing the financial system, tax cuts for small businesses and working families, and the American Recovery and Reinvestment Act. In spite of these efforts, however, one in 10 Americans still cannot find work, and seven million jobs have been lost over the last two years. Looking ahead, the president proposes building the infrastructure of tomorrow, supporting community banks, legislating new tax incentives for businesses, investing in clean energy, doubling exports over the next five years, and revitalizing the educational system.

According to Research Scholars Rania Antonopoulos, Kijong Kim, and Thomas Masterson, and Senior Scholar Ajit Zacharias, the government needs to identify useful projects that have the potential for massive public job creation, and to select investments that maximize job creation both immediately and equitably. They conclude that social sector investment, such as early childhood education and home-based care, generates more than twice the number of jobs as infrastructure spending and almost 1.5 times the number of jobs investing in green energy. In addition, it is relatively more effective in providing jobs to people with the least education. Thus, the social and psychological impacts of social care investment are beneficial for both the recipients and their communities.

Using input-output analysis and a microsimulation model, the authors analyze interindustry linkages, classify new direct and indirect jobs created in each industry by occupation, and match worker socioeconomic characteristics to the available jobs. They then simulate an investment of $50 billion on projects that enhance social care and compare the results with a commensurate investment aimed at infrastructure (construction). They find that the relatively high labor intensity of investing in the social sector is particularly beneficial for women (new jobs are concentrated in teaching, child care, and home health care), low-income households, and people with limited education. The social sector also creates more absolute jobs requiring some college education and geared toward the middle and top income groups.

The authors note that the government has focused on rescuing Wall Street and the banks—the main beneficiaries during times of economic prosperity—rather than low-income householders, who continue to lose their homes and their jobs. While Obama's proposals are part of the solution to mitigating double-digit unemployment, he seems to have overlooked the relative job creation effects of comparable investments in various sectors of the U.S. economy. The authors therefore recommend a second stimulus package, one aimed at state and local governments that currently lack the resources to deliver increased levels of social care.

For the complete text, go to www.levy.org/pubs/ppb_108.pdf.

Decomposition of the Black-White Wage Differential in the Physician Market

TSU-YU TSAO and ANDREW PEARLMAN

Working Paper No. 588, March 2010

A 1957 labor market study by Gary Becker titled *The Economics of Discrimination* showed that labor market discrimination in terms of minority earnings can originate from three sources: employers, coworkers, and consumers. It is important to disaggregate these sources in order to enact antidiscrimination legislation.

Tsu-Yu Tsao and Andrew Pearlman, Bard College, develop a general framework to quantify earnings differentials between black and white physicians, and to disaggregate the effects of firm versus consumer discrimination. They find that potential discrimination plays a small role in the racial wage gap among physicians and that firm discrimination may actually favor black physicians.

The authors note that Becker's model implies that wage disparity related to discrimination is likely to be a product of consumer behavior, since minorities can avoid firm discrimination. More recent literature, however, shows that both consumer and firm discrimination may lead to wage differentials when the job search is not frictionless. In this case, the question is how to quantify the effect of each type of discrimination.

Two claims are made at the outset. The first is that the difference in earnings between self-employed majority and minority groups accounts for the impact of consumer discrimination if there is no difference in productivity. The second is that the double difference in earnings captures the effect of firm discrimination if the nature of demand for the output provided by self-employed and salaried workers is similar and there is no difference in productivity within each racial group.

Using data from the Young Physicians Survey in 1987 and 1991, the authors develop a simple model to decompose wage differentials associated with discrimination, recognizing that there are both self-employed and salaried workers. The framework is empirically implemented by performing separate Blinder-Oaxaca decompositions for self-employed and salaried workers while controlling for consumer demand, worker productivity, and other demographic variables. The survey enables the authors to control for consumer demand and worker productivity, thereby isolating the effects of different types of discrimination in the physician market. The interpretation of the estimates is complicated by the possibility that black physicians are more likely to negatively self-select into self-employment. This selection process leads to overestimating the effect of consumer discrimination and underestimating the effect of firm discrimination.

Tsao and Pearlman find that black physicians have a greater tendency to specialize in pediatrics, obstetrics/gynecology, and psychiatry—fields that are ranked relatively lower in terms of average hourly earnings. They also find that single (male) physicians have lower wages and work fewer hours than their married counterparts. The lower probability of being married also contributes to the lower wages earned by black physicians. Surprisingly, the status of board certification (lower for blacks) does not appear to have a bearing on wage rates. Another surprising result is that salaried physicians are about 10 percent more productive than self-employed physicians.

The physician-to-population ratio is an advantage to blacks, but this advantage is negated by their lower per capita income, which is a result of their practice locations. However, this study is the first to document higher returns based on experience for blacks relative to whites. The authors offer three reasons for this unique result: sample homogeneity, exceptional talent, and psychology (e.g., whites hold black physicians in high esteem).

The wage difference between self-employed black and white physicians can be attributed to consumer discrimination, while the wage difference between salaried black and white physicians in excess of the difference between self-employed black and white physicians is attributed to firm discrimination. The results suggest that potential discrimination plays a small role in the racial wage gap among physicians. At most, discrimination lowers the hourly wage of black physicians by 3.3 percent.

For the complete text, go to www.levy.org/pubs/wp_588.pdf.

INSTITUTE NEWS

Upcoming Events

The 19th Annual Hyman P. Minsky Conference on the State of the U.S. and World Economies

After the Crisis: Planning a New Financial Structure

Ford Foundation, New York City

April 14–16, 2010

From his extensive research, Hyman P. Minsky was convinced that economic systems are prone to financial instability and crisis, and urged that lessons be learned from the crisis of 1929–33 so that "'it"—the Great Depression—could not happen again.

The focus of this year's conference draws upon many Minskyan themes, including, among others, reconstituting the financial structure; the reregulation and supervision of financial institutions; the relevance of the Glass-Steagall Act; the roles of the Federal Reserve, FDIC, and Treasury; moral hazard of the "too big to fail" doctrine; debt deflation; and the economics of "the big bank" and "big government." The conference will also compare the European and Latin American responses to the global financial crisis and proposals for reforming the international financial architecture. Moreover, central bank exit strategies, both national and international, will be considered.

Complete program and registration information is available on our website, www.levy.org.

The Hyman P. Minsky Summer Seminar

Levy Economics Institute of Bard College

Blithewood, Annandale-on-Hudson, N.Y.

June 19–29, 2010

The Levy Economics Institute is pleased to announce that it will hold the Hyman P. Minsky Summer Seminar in June 2010. The Seminar will provide a rigorous discussion of both theoretical and applied aspects of Minsky's economics, with an examination of meaningful prescriptive policies relevant to the current economic and financial crisis. The Seminar will consist of a Summer School from June 19 to 26, followed by an International Conference on June 27, 28, and 29, both to be held at the Levy Institute in Annandale-on-Hudson, N.Y.

For more information, visit www.levy.org.

PUBLICATIONS AND PRESENTATIONS

Publications and Presentations by Levy Institute Scholars

RANIA ANTONOPOULOS *Research Scholar and Program Director*

Publications: editor (with I. Hirway), *Unpaid Work and the Economy: Poverty, Time Use, and Gender in Developing Countries*, Palgrave Macmillan, 2010; "Social Protection for Women," *UN Chronicle*, Vol. 47, No. 1 (2010).

Presentations: "Crisis as Systemic Decomposition: Economic Challenges and Opportunities from a Gender Perspective," seminar on "The Global Crisis and Ecuador: Characteristics, Consequences, and Opportunities," organized by the Latin American University of Social Sciences (FLACSO) and the United Nations Development Fund for Women (UNIFEM), Quito, Ecuador. November 26–27, 2009; "Time Use, Public Policy, and Gender Equality," 2nd International Seminar on Gender and Poverty, National Statistical Office of Mexico (INEGI), Mexico City, January 27–28, 2010; panel on "The Global Job Crisis: How a Gender-equitable Perspective Will Benefit Policy Responses," organized by the Permanent Mission of Mexico in collaboration with the International Development Research Centre (Canada), 54th Session of the United Nations Commission on the Status of Women (UNCSW), U.N. Headquarters, New York, March 5; panel on "Women's Economic Empowerment in the Context of the Global Economic and Financial Crisis," organized by the U.N. Division for the Advancement of Women, Fifty-fourth Session of the UNCSW, U.N. Headquarters, New York, March 8.

PHILIP ARESTIS *Senior Scholar*

Publications: "Current Financial Crisis: Origins, and Economic Policy Implications," *Wolfson College Cambridge: Magazine 2008–2009*, No. 33 (2009); "Path Dependence and Demand-Supply Interactions in Macroeconomic Analysis" (with M. C. Sawyer), in P. Arestis and M. C. Sawyer, eds., *Path Dependency and Macroeconomics*, Palgrave Macmillan; "Current Account Deficits in the EMU and the International Financial Crisis" (with J. P. Gutiérrez), *Ola Financiera*, Vol. 1, No. 4 (September–December; in Spanish); "Special Symposium on 'Financial Instability and Crisis'" (with R. A. Blecker, M. Frangakis, and M. Lavoie), *Intervention: European Journal of Economics and Economic Policies*, Vol. 6, No. 2; "The True Worth of a Tobin Tax: Letter to the Editor" (with M. C. Sawyer), *The Observer*, December 20; "Flexible Rules cum Constrained Discretion: A New Consensus in Monetary Policy" (with A. Mihailov), *Economic Issues*, Vol. 14, Part 2 (December); *Housing Market Challenges in Europe and the United States* (with P. Mooslechner and K. Wagner), Palgrave Macmillan, 2010; "Introduction: Housing Market Challenges in Europe and the United States" (with P. Mooslechner and K. Wagner) and "Subprime Mortgage Market and Current Financial Crisis" (with E. Karakitsos), in P. Arestis, P. Mooslechner and K. Wagner, eds., *Housing Market Challenges in Europe and the United States*, Palgrave Macmillan; "What Economists Should Know about Public Policymaking?" (with Y. Kitromilides), *International Journal of Public Policy*, Vol. 6, No. 1/2 (January); "Inflation Targeting: Assessing the Evidence" (with A. Angeriz), *Investigación Económica*, Vol. 68, Special Number (in Spanish); "Hypocritical to Suggest Greece be Ejected from Eurozone: Letter to the Editor" (with T. Pelagidis), *Financial Times*, January 28; "Money and Information in a New Neoclassical Synthesis Framework" (with G. Chortareas and J. D. Tsoukalas), *Economic Journal*, Vol. 120, No. 542 (February); "Greece's Economic Problems and Euro Threads are Exaggerated: Letter to the Editor" (with T. Pelagidis), *The Guardian*, February 1.

Presentation: "Innovative Thinking on Economic Policy and the 'New Economics'" (with M. C. Sawyer), conference on "The New Economics as 'Mainstream' Economics," Murray Edwards College, Cambridge, UK, January 28–29.

JAMES K. GALBRAITH *Senior Scholar*

Publications: "The Roots of the Crisis and How to Bring It to a Close," in R. W. Kolb, ed., *Lessons from the Financial Crisis: Causes, Consequences, and Our Economic Future*, John Wiley & Sons, 2010; review of *The Relentless Revolution: A History of Capitalism* by Joyce Appleby, *Chicago Tribune*, January 4; "We Need Jobs, Not Deficit-cutting," *Progressive Governance* (February) and *The Guardian*, February 19.

Presentations: panel on "The Great Crisis and the American Model," conference on "The Post–Financial Crisis Era: Reform and Competition of Development Models," sponsored by the Rosa-Luxemburg-Stiftung and the China Center for Contemporary World Studies, Beijing, China, November 2–3, 2009; "Cognitive Disability, Inequality and Technology in an Age of Economic Uncertainty," Ninth Annual Coleman Institute Conference, University of Colorado Westminster, November 5; panel on "Taking Stock of the Causes and the Damage So Far," conference on "Financial Globalization: Culprit, Survivor or Casualty of the Great Crisis?" organized by President Ernesto Zedillo of Mexico and sponsored by the Yale Center for the Study of Globalization, New Haven, Conn., November 12–13; "Obama's Economic Policies Are Working Effectively," debate (with E. Spitzer, A. Meltzer, L. Mishel, S. Rattner, and M. Zandi) sponsored by Intelligence-Squared, New York, N.Y., November 16, 2009, and televised on Bloomberg; "Comments on the FASAB Exposure Drafts Relating to 'Comprehensive Long-term Projections for the U.S. Government (ED 1)' and to 'Accounting for Social Insurance (ED 2)'" (with L. R. Wray and W. Mosler), testimony presented to the Federal Accounting Standards Board, Washington, D.C., February 25, 2010.

GREG HANNSGEN *Research Scholar*

Publication: "Did the New Deal Prolong or Worsen the Great Depression?" (with D. B. Papadimitriou), *Challenge,* Vol. 53, No. 1 (January–February).

JAN KREGEL *Senior Scholar and Program Director*

Publications: "Mercados Financieros y Especialización en el Comercio Internacional: El Caso de los Productos Basicos," in *La crisis financiera y el comercio: Hacia una respuesta integrada en Latinoamerica y el Caribe selección de ponencias,* Centre of Concern and Sistema Económico Latinoamericano y del Caribe, 2009; "The Debt Trade Causality in Balance of Payments

Accounting," in A. Caliari, ed., *Debt and Trade: Making Linkages for the Promotion of Development,* South Centre and the Centre of Concern, 2009; "Why Don't the Bailouts Work? Design of a New Financial System versus a Return to Normalcy," *Cambridge Journal of Economics*, Vol. 33, No. 4 (July); "Mobilizing Domestic Resources: Employer of Last Resort as a National Development Strategy to Achieve the Internationally Agreed on Development Goals," *International Journal of Political Economy*, Vol. 38, No. 3 (Fall); "Keynes's Influence on Modern Economics: Some Overlooked Contributions of Keynes's Theory of Finance and Economic Policy," in B. W. Bateman, T. Hirai, and M. C. Marcuzzo, eds., *The Return to Keynes*, Belknap Press of Harvard University Press, 2010; "Background Considerations to a Re-regulation of the U.S. Financial System: Third Time a Charm? Or Strike Three?" in S. Griffith-Jones, J. A. Ocampo, and J. E. Stiglitz (eds.), *Time for a Visible Hand: Lessons from the 2008 World Financial Crisis*, Oxford University Press, 2010.
Presentations: "Minsky and Godley and the Future of Globalization," conference on "Financial Globalization: Culprit, Survivor, or Casualty of the Great Crisis?" Yale Center for the Study of Globalization, New Haven, Conn., November 12–13; "The Future of the Dollar and the International Financial System," Economists for Peace and Security symposium on "The Next Stage: Financial Reforms, Jobs and Housing, the Dollar and the International System," cosponsored by The Foundation for Human Progress's Initiative for Re-thinking the Economy, the New America Foundation, and the World Trade Center, Washington, D.C., November 13; "From Crisis to Re-regulation: Democratizing Governance in the International Financial System," conference on "Crisis Evolution and Recent Proposals for Re-regulating the Financial System: Obama Plan, U.N. Declarations, G20 Proposals, Basel II Revisions, among Others," Instituto Brasileiro de Análises Sociais e Econômicas, Rio de Janeiro, Brazil, November 16; "Savings Gaps, External Financing, and Debt Crises in Latin America: Recovering a Traditional Model of Financing Economic Development," conference sponsored by the Latin American Programme on Rethinking Development Economics, São Paulo, Brazil, January 11–15, 2010; "Is it Possible to Re-regulate Finance?" International Development Economics Associates (IDEAs), conference on "Reforming the Financial System: Proposals, Constraints, and New Directions," Muttukadu, Chennai, India, January 25–27; "Is There a Recovery?" and "The Future of Finance," IDEAs conference on "Recovery or Bubble? The Global Economy Today," New Delhi, India, January 29–30; "Fiscal Responsibility: What Exactly Does It Mean?" Will Lyons Inaugural Lecture, Franklin and Marshall College, Lancaster, Penn., February 23.

THOMAS MASTERSON *Research Scholar*
Presentations: "What Progress Has Been Made in Alleviating Racial Economic Inequality?" Baruch University Faculty Seminar, New York, N.Y., November 18, 2009; "What Progress Has Been Made in Alleviating Racial Economic Inequality?" Bard Prison Initiative, Eastern Correctional Facility, Napanoch, N.Y., January 19, 2010; "Distributional Impacts of the American Recovery and Reinvestment Act: A Microsimulation Approach," Eastern Economic Association 36th Annual Conference, Philadelphia, Penn., February 26.

DIMITRI B. PAPADIMITRIOU *President*
Publication: "Did the New Deal Prolong or Worsen the Great Depression?" (with G. Hannsgen), *Challenge,* Vol. 53, No. 1 (January–February 2010).
Presentations: interview regarding Senator Dodd's bill that would limit the Federal Reserve's role to monetary policy with Ron Fink, *CFOZone.com*, November 18, 2009; interview regarding the challenges of the Greek economy with *Eleftherotypia*, November 24; interview regarding small business lending with Paul Davis, *American Banker*, December 7; interview regarding U.S. gold holdings with Constance Gustke, *CBS Money Watch*, December 9; interview regarding the latest Strategic Analysis report and monetary policy with Ron Fink, *CFOZone.com*, December 15; interview regarding job elimination during the recession with Joe Gomez, KTRH Houston, January 12, 2010; "Global Imbalances after the Economic Crisis," International Development Economics Associates conference on "Reforming the Financial System: Proposals, Constraints, and New Directions," Muttukadu, Chennai, India, January 25–27; interview regarding what impact the Federal Reserve's raising the discount rate might have on banks with Paul Davis, *American Banker*, February 19; "Economic Outlook for the U.S. and Global Economy," University of Macedonia, Thessaloniki, Greece, March 22.

EDWARD N. WOLFF *Senior Scholar*

Publications: "The Superstar Inventors and Entrepreneurs: How Were They Educated?" (with W. J. Baumol and M. A. Schilling), *Journal of Economics and Management Strategy,* Vol. 18, No. 3 (Fall 2009); "The Squeeze before the Storm," *Pathways* (Fall).

Presentation: "The Middle-Class Squeeze," Social Policy Seminar, Columbia University School of Social Work, New York, N.Y., November 17.

L. RANDALL WRAY *Senior Scholar*

Publications: "Lessons from the Subprime Meltdown," in N. B. Rapoport, J. D. Van Niel, and B. G. Dharan, eds., *Enron and other Corporate Fiascos: The Corporate Scandal Reader*, 2nd ed., Foundation Press, 2009; "Macroeconomic Stability, Affordability, and Manageability of Employer of Last Resort Programmes," in P. Arestis and J. McCombie, eds., *Missing Links in the Unemployment Relationship*, Palgrave Macmillan, 2009; "Macroeconomics Meets Hyman P. Minsky: The Financial Theory of Investment" (with É. Tymoigne), in G. Fontana and M. Setterfield, eds., *Macroeconomic Theory and Macroeconomic Pedagogy*, Palgrave Macmillan, 2009; "Money Manager Capitalism and the Global Financial Collapse," in E. Hein, T. Niechoj, and E. Stockhammer, eds., *Macroeconomic Policies on Shaky Foundations: Whither Mainstream Economics?* Metropolis-Verlag, 2009; review of *Full Employment Abandoned: Shifting Sands and Policy Failures* by W. Mitchell and J. Muysken, *Journal of Economic Issues*, Vol. 43, No. 1 (March); "Financiarización y burbuja especulativa en materias primas," *Ola Financiera*, Vol. 1, No. 3 (May–August); "The Rise and Fall of Money Manager Capitalism: A Minskian Approach," *Cambridge Journal of Economics*, Vol. 33, No. 4 (July); "Minsky, the Global Financial Crisis, and the Prospects before Us," *Development*, Vol. 52, No. 3 (September); review of *Good Money: Birmingham Button Makers, the Royal Mint, and the Beginnings of Modern Coinage, 1775–1821* by G. Selgin, *Journal of Economic Issues*, Vol. 43, No. 4, (December); "An Alternative View of Finance, Saving, Deficits, and Liquidity," *International Journal of Political Economy*, Vol. 38, No. 4 (Winter 2009–10); "Minsky, the Global Money-manager Crisis, and the Return of Big Government," in S. Kates, ed., *Macroeconomic Theory and Its Failings: Alternative Perspectives on the Global Financial Crisis*, Edward Elgar, 2010; "The Social and Economic Importance of Full Employment," in H. Bougrine and M. Seccareccia, eds., *Introducing Macroeconomic Analysis: Issues, Questions, and Competing Views*, Emond Montgomery Publications, 2010; "Alternative Approaches to Money," *Theoretical Inquiries in Law*, Vol. 11, No. 1 (January).

Presentations: "Policy Advice for the Next Administration: Bigger Government, More Jobs, Greater Equality, and Euthanasia on Wall Street" (with S. Kelton), AEA/AFEE roundtable on "The Persistent Problem of Inequality," Allied Social Science Associations (ASSA) Annual Meetings, San Francisco, Calif., January 3, 2009; "A Minskian Alternative to the Big Government / Neocon Model," URPE panel on "The U.S. Financial Crisis: Heterodox Perspectives," ASSA Annual Meetings, San Francisco, January 4; "An Alternative Approach to Money," conference on "Money Matters: The Law, Politics, and Economics of Currency," Cegla Center for Interdisciplinary Research of the Law, Tel Aviv University, Israel, January 10–12; interview regarding job cuts and the continuing recession with Rob Roberts, *Kansas City Business Journal*, January 30; "Financial Markets Meltdown: What Went Wrong?" University of Missouri–Kansas City, February 10; "Comments on the FASAB Exposure Drafts Relating to 'Comprehensive Long-term Projections for the U.S. Government (ED 1)' and to 'Accounting for Social Insurance (ED 2)'" (with J. K. Galbraith and W. Mosler), testimony presented to the Federal Accounting Standards Board, Washington, D.C., February 25; "Can Euroland Survive?" conference on "The Euro: Between Politics and Economic Theory," University of Rome, La Sapienza, February 27; "February Layoffs Take a Toll," Minnesota Public Radio News, March 9; "Financial Crisis from the Post-Keynesian Perspective," Mundell–Huang Da Lectures on Economics, Renmin University of China, Beijing, March 13; "Employer of Last Resort: The Path to Full Employment and Currency Stability" and "Financial Markets Meltdown: A Minskian Analysis," International Business School, Shaanxi Normal University, Xi'an City, China, March 15–20; "A Reinterpretation of Pakistan's 'Economic Crisis' and Options for Policy Makers" (with W. Mitchell) and "Global Financial Crisis: An Alternative View of the Role of Finance, Saving, Deficits, and Liquidity," Asian Development Bank, Manila, Philippines, March 22; "The Rise and Fall of Money Manager Capitalism: A Minskian Analysis," Money and Markets Workshop on "Understanding the Financial Crisis," University of Chicago, Ill., April 10; John Ranlett Memorial Lecture: "The Rise and Fall of Money Manager

Capitalism: A Minskian Analysis" and "The Commodities Market Bubble," California State University, Sacramento, April 22; lecture on "The Global Financial Crisis," University of Kansas, May 1; series of lectures on "Macroeconomics for Beginners—Part 1," "Fiscal and Monetary Policy: The Basics and the Way Forward" (with W. Mitchell) and "The Rise and Fall of Money Manager Capitalism: From Buckaroos to Dollars—How Money Works," The University of Newcastle, Australia, May–June; participant, "Money and Individuality in Georg Simmel," Liberty Fund Socratic Seminar, Indianapolis, June 18–20; "Understanding Modern Money: How a Sovereign Currency Works," conference on "The History and Nature of Money," Berlin, Germany, June 26–28; lecture on "Reformation of the Global Financial System," Washington University, St. Louis, Mo., July 20; interview regarding the disenchantment with high finance, with João Solvestre, *Expresso* (Lisbon), August 8; interview regarding the failure of capitalism with Stephen Mihm, *Boston Globe*, September 14; "Money Manager Capitalism," workshop on "Financial Crises and Regulation," sponsored by the Ford Foundation, Siena, Italy, September 17–18; "Money as a Public Monopoly," Edie Miller Festschrift, Denver, Colo., September 26; "The Return of Big Government: Toward a Minskian New Deal," 4th Bi-annual Cross-Border Post Keynesian Conference, Buffalo State College, N.Y., October 8–11; "A Path to Full Employment: Options for Policy Makers in CAREC Countries" (with W. Mitchell) and "Macroeconomic Risk Assessment of the CAREC Countries in the Context of the Global Financial Crisis" (with W. Mitchell), CAREC Institute Research Workshop on "Is There a Case for Inflation Targeting in the Kyrgyz Republic?" Almaty, Kazakhstan, October 21–24; "Transformation of the Financial System under Money Manager Capitalism" (with Y. Nersisyan), 13th Conference of the Research Network Macroeconomics and Macroeconomic Policies (FMM), "The World Economy in Crisis—The Return of Keynesianism," Hans-Böckler-Stiftung, Berlin, October 30–31; "The Job Guarantee in Theory and Practice," World Academy of Science Teleconference, November 7; lectures on "The Return of Big Government: Toward a Minskian New Deal," Trinity College and Connecticut College, November 11–13; lectures on "Policy for Full Employment with Price Stability through a Job Guarantee," Legislative Assembly of the Federal District, Mexico, and "Minsky's Money Manager Capitalism: Crisis and Reform," Universidad Nacional Autónoma de México, Mexico City, November 23–25; interview regarding the possibility of tax increases leading to higher unemployment with Alma E. Muñoz, *La Jornada* (Mexico City), November 24; "The Causes of the Global Financial Crisis and the Lessons to Be Learned," 11th Path to Full Employment / 16th National Unemployment Conference, Centre of Full Employment and Equity, The University of Newcastle, December 3–5; "Transformation of the Financial System: Financialization, Concentration, and the Shift to Shadow Banking" (with Y. Nersisyan), 8th Annual Society of Heterodox Economists Conference on "Money Manager Capitalism and the Global Collapse," University of New South Wales, Australia, December 7; "Neoconservatives and the Money Manager Crisis," AFEE panel on "Neoliberalism, Markets, and Freedom," ASSA Annual Meetings, Atlanta, Ga., January 4, 2010; "Economic Crisis and a New Paradigm," AVM Economic Strategy Conference, West Palm Beach, Florida, January 14–15; "A General Policy Framework for Achieving Full Employment with Price Stability," Global Foundation for Democracy and Development, Santo Domingo, Dominican Republic, January 19; interview regarding financial crisis and recession with Betsy Webster, KCTV5, Kansas City, January 27; "Macroeconomic Policy, Unemployment, and Job Creation" (with M. Forstater), Carolyn Benton Cockefair Chair Lecture Series, University of Missouri–Kansas City, February 4; interview regarding health care reform with Meryl Lin McKean, WDAF-TV4, Kansas City, March 16.

AJIT ZACHARIAS *Senior Scholar*
"Gender and Unpaid Work in the Measurement of Well-Being and Deprivation," 2nd International Seminar on Gender and Poverty, Mexico City, Mexico, January 27–28, 2010.

GENNARO ZEZZA *Research Scholar*
Presentations: "Global Imbalances and International Currencies" and "U.S. Consumers and Medium-term Prospects for the U.S. Economy," conference on "The Recent Developments in Post-Keynesian Modeling," Centre d' Économie de l'Université Paris-Nord, France, November 20–21, 2009; "Income Distribution and Borrowing: A 'New Cambridge' Model for the U.S. Economy," conference on "The Global Crisis: Contributions to the Critique of Economic Theory and Policy," Faculty of Economics, University of Siena, Italy, January 26–27, 2010.

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