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Recommendations for Further Reading

Timothy Taylor

This section will list readings that may be especially useful to teachers of undergraduate economics, as well as other articles that are of broader cultural interest. In general, the articles chosen will be expository or integrative and not focus on original research. If you write or read an appropriate article, please send a copy of the article (and possibly a few sentences describing it) to Timothy Taylor, preferably by e-mail at ⟨taylort@macalester.edu⟩, or c/o Journal of Economic Perspectives, Macalester College, 1600 Grand Ave., Saint Paul, Minnesota, 55105.

Hors d'Oeuvres

Carolyn L. Engelhard, Arthur Garson, Jr., Stan Dorn discuss "Reducing Obesity: Policy Strategies from the Tobacco Wars." "The obese and overweight experience chronic illness, poor health, and more than 100,000 preventable deaths each year. For the average affected individual, obesity has a much greater impact on health status and health care costs than either smoking or heavy drinking. . . . If recent trends continue, 40 percent of adults will be obese in just 6 years and, for the first time in history, Americans' average life span will shrink rather than grow. In attacking the epidemic of obesity, policymakers can turn for guidance to the country's long-term effort to combat another, equally pressing public health problem—tobacco use. The share of adults who smoke fell from 42.4 percent in 1965 to less than 20 percent in 2007. . . . Aggressive public policy interventions that helped bring down tobacco use could be modified and applied to fight obesity, including imposing excise or sales taxes on fattening food of little nutritional value, as the tax

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on cigarettes has proven to be the single most effective weapon in decreasing tobacco use . . ." Urban Institute, July 2009, at 〈http://www.urban.org/publications/411926.html〉.

The *Arab Human Development Report 2009* has the theme: "Challenges to Human Security in the Arab Countries," which is taken to cover a range of topics including environmental, poverty, malnutrition, governance, and others. "According to UN estimates, the Arab countries will be home to some 395 million people by 2015 (compared to about 317 million in 2007, and 150 million in 1980). In a region where water and arable land are shrinking, population growth at these rates while falling, will still put intense pressures on the carrying capacity of Arab countries' lands and further threaten environmental sustainability. Urban growth poses particular challenges." "Unemployment is a major source of economic insecurity in most Arab countries. Data from the Arab Labour Organization (ALO) show that in 2005 the overall average unemployment rate for the Arab countries was about 14.4 per cent of the labour force compared to 6.3 per cent for the world at large. . . . These trends in unemployment, coupled with population growth rates, indicate that Arab countries will need about 51 million new jobs by 2020." At 〈http://www.arab-hdr.org/contents/index.aspx?rid=5〉. The report offers additional context and perspectives to "The Three Arab Worlds," by James Rauch and Scott Kostyshak, which appeared in the Summer 2009 issue of this journal.

Reactions to the Financial Crisis

The *Cambridge Journal of Economics* has devoted the July 2009 issue to 16 papers as a "Special Issue: Global Financial Crisis." While the issue is full of interesting papers, I was especially attracted to Axel Leijonhufvud's comments in his paper: "Out of the Corridor: Keynes and the Crisis" (pp. 741–57). "The most important lesson from the life and work of John Maynard Keynes may be that the macroeconomist should start from the important problems of the day. . . . There are some things that Keynes would not have us do. He would not have us try to deduce how the world works from a small set of doubtful 'axioms' about tastes and technologies. And he would not approve of strenuous attempts to squeeze every current issue into some such preconceived framework. Nor would he be happy to see economists get absorbed in scholastic disputes over the economic thought of 70 years ago. . . . Intellectual humility was not a character trait that his contemporaries noted in John Maynard Keynes. He did not suffer fools gladly and did not suffer many economists all that willingly either (perhaps the distinction sometimes escaped him). . . . The economist of today has the tools to slap together a model to 'explain' any and all phenomena that come to mind. The flood of models is rising higher and higher, spouting from an ever increasing number of journal outlets. In the midst of all this evidence of highly trained cleverness, it is difficult to retain the realisation that we are confronting a complex system 'the working of which we do not understand.' Humility in the face of the reality we seek to explain is also a lesson to be learned

from Keynes. That the economics profession might be humbled by recent events is a realisation devoutly to be wished."

Critical Review has published a mid-2009 issue with a dozen papers devoted to "Causes of the Financial Crisis." Here are highlights from three of the abstracts: From "The Crisis of 2008: Lessons For And From Economics," by Daron Acemoglu: "The financial crisis is, in part, an embarrassment for economic theory. Economists tended to think that severe business cycles had been conquered; that free markets require no regulations to constrain self-interest; and that large, established companies could be trusted to monitor their own behavior so as to preserve their reputational capital. These three beliefs have proved to be inaccurate." From "The Anatomy of a Murder: Who Killed America's Economy?" by Joseph E. Stiglitz: "The main cause of the crisis was the behavior of the banks—largely a result of misguided incentives unrestrained by good regulation. Conservative ideology, along with unrealistic economic models of perfect information, perfect competition, and perfect markets, fostered lax regulation, and campaign contributions helped the political process along. The banks misjudged risk, wildly overleveraged, and paid their executives handsomely for being short-sighted; lax regulation let them get away with it—putting at risk the entire economy." From "Economic Policy and the Financial Crisis: An Empirical Analysis of What Went Wrong," by John B. Taylor: "The financial crisis was in large part caused, prolonged, and worsened by a series of government actions and interventions." Volume 21, numbers 2 and 3.

Peter Stella provides a highly useful overview of "The Federal Reserve Balance Sheet: What Happened and Why It Matters." "The consolidated balance sheet of the combined U.S. Federal Reserve Banks (FRB or Fed) more than doubled during 2008 to $2.2 trillion. . . . Its response to the financial market crisis has transformed it from a key, though small, U.S. money market participant into the largest actor and fundamental linchpin of that market and, indirectly, of the world financial system. The transformation of the Fed, from what Benjamin Friedman once called an 'army with only a signal corps,' to a truly *central* bank, is even more dramatic than the headline numbers suggest. . . . By this metric, FRB liability expansion since 2006 has been approximately 4,500 percent. Excess commercial bank reserves—reserves that are not required to meet the regulatory reserve requirement—rose from $1.8 billion at end-2007 to $798.5 billion at end-2008." International Monetary Fund Working Paper WP/09/120, May 2009. At ⟨http://www.imf.org/external/pubs/ft/wp/2009/wp09120.pdf⟩.

Michael S. Barr, Sendhil Mullainathan, and Eldar Shafir discuss the possibilities for "Behaviorally Informed Financial Services Regulation." "Regulation is largely stuck in two competing models—disclosure, and usury or product restrictions. . . . By contrast, behaviorally informed regulation would take account of the importance of framing and defaults, of the gap between information and understanding, and between intention and action, as well as of other psychological factors affecting how people behave. . . . We have sketched here ten policy suggestions derived from our conceptual model. In particular, in the home mortgage market, we have focused on a standards-based truth in lending law, a requirement of full

disclosure of information favorable to the borrower, changing the incentives in the relationship between brokers and borrowers, and a new, opt-out home mortgage system. With respect to credit cards, we have explored more salient disclosures, an opt-out payment plan, an opt-out credit card, and regulation of late fees. We have also suggested ways in which behaviorally informed policy might promote basic banking and savings beyond the retirement world, for example, through an opt-out direct deposit account set up at tax time, or through tax incentives to firms to offer low-cost accounts." New America Foundation, October 2008. At ⟨http://www.newamerica.net/files/naf_behavioral_v5.pdf⟩.

Discussion Starters on Health Care Policy

Melinda Beeuwkes Buntin and David Cutler discuss "The Two Trillion Dollar Solution: Saving Money by Modernizing the Health Care System." "Two sorts of savings are possible in health care. The first is eliminating waste and inefficiency. The most commonly cited estimate is that 30 percent of the money spent on medical care does not buy care worth its cost. Medicare costs per capita in Minneapolis, for example, are about half those in Miami, yet Miami does not have better health outcomes. International comparisons yield the same conclusion. . . . Second, reform might stimulate cost-reducing innovation instead of the continuous cost increases that accompany current innovation. For nearly 20 years, scholars have argued that generous reimbursement policies for medical care have led to innovations that almost always increase health care costs. Changing that dynamic by investing in research about what works and rewarding health care providers who choose efficient treatments could have a dramatic effect on cost growth. . . . Reducing costs by 30 percent will take time and effort, but it is not inconceivable over the long term. Experience in the health care sector and other industries suggests that cost reductions on the order of 1.5-to-2.0 percentage points per year are within reach." Center for American Progress, June 2009. At ⟨http://www.americanprogress.org/issues/2009/06/pdf/2trillion_solution.pdf⟩.

John C. Goodman, Linda Gorman, Devon Herrick, and Robert M. Sade inquire into "Health Care Reform: Do Other Countries Have the Answers?" "The average annual rate of growth of real per capita US health care spending is slightly below OECD average over the last decade (3.7% vs. 3.8%), and over the past four decades (4.4% vs. 4.5%). Despite common perceptions, a country's financing method—public vs. private financing, general revenue vs. payroll taxes, third-party vs. out-of-pocket spending—is unrelated to its ability to control spending." "Aneurin Bevan, father of the British NHS, declared, 'the essence of a satisfactory health service is that rich and poor are treated alike, that poverty is not a disability and wealth is not advantaged.' More than thirty years after the NHS founding an official task force found little evidence that the creation of the NHS had equalized health care access. Another study fifty years after the NHS founding concluded that access had become more unequal in the years between the two studies." National Center

for Policy Analysis. March 10, 2009. At ⟨http://www.ncpa.org/pdfs/sp_Do_Other_Countries_Have_the_Answers.pdf⟩.

Robert Fogel writes about "Forecasting the Cost of U.S. Healthcare." "[T]he long-term income elasticity of the demand for healthcare is 1.6—for every 1 percent increase in a family's income, the family wants to increase its expenditures on healthcare by 1.6 percent. This is not a new trend. Between 1875 and 1995, the share of family income spent on food, clothing, and shelter declined from 87 percent to just 30 percent, despite the fact that we eat more food, own more clothes, and have better and larger homes today than we had in 1875. All of this has been made possible by the growth in the productivity of traditional commodities. In the last quarter of the 19th century, it took 1,700 hours of labor to purchase the annual food supply for a family. Today it requires just 260 hours, and it is likely that by 2040, a family's food supply will be purchased with about 160 hours of labor. Consequently, there is no need to suppress the demand for healthcare. Expenditures on healthcare are driven by demand, which is spurred by income and by advances in biotechnology that make health interventions increasingly effective. Just as electricity and manufacturing were the industries that stimulated the growth of the rest of the economy at the beginning of the 20th century, healthcare is the growth industry of the 21st century. It is a leading sector, which means that expenditures on healthcare will pull forward a wide array of other industries including manufacturing, education, financial services, communications, and construction." *The American,* September 3, 2009. At ⟨http://american.com/archive/2009/september/forecasting-the-cost-of-u-s-healthcare⟩.

Atul Gawande lays out "The Cost Conundrum: What a Texas town can teach us about health care." "It is spring in McAllen, Texas. The morning sun is warm. The streets are lined with palm trees and pickup trucks. McAllen is in Hidalgo County, which has the lowest household income in the country, but it's a border town, and a thriving foreign-trade zone has kept the unemployment rate below ten per cent. McAllen calls itself the Square Dance Capital of the World. 'Lonesome Dove' was set around here. McAllen has another distinction, too: it is one of the most expensive health-care markets in the country. Only Miami—which has much higher labor and living costs—spends more per person on health care. In 2006, Medicare spent fifteen thousand dollars per enrollee here, almost twice the national average. The income per capita is twelve thousand dollars. In other words, Medicare spends three thousand dollars more per person here than the average person earns." *The New Yorker,* June 1, 2009. At ⟨http://www.newyorker.com/reporting/2009/06/01/090601fa_fact_gawande⟩.

Education and Inequality

Claudia Goldin and Lawrence F. Katz explain "The Other Reason Education Matters So Much: The Future of Inequality." "[T]here is solid evidence that the ups and downs in wage inequality across the century can be explained almost entirely

by what amounts to a race between technological change and educational attainment. Technological change has increased the relative demand for skilled and educated workers, while access to education has increased the relative supply of skilled and educated individuals. And here's the kicker: the big variable appears to be changes in the pace of educational attainment rather than changes in technological progress. . . . On average, educational attainment increased by almost one year per decade for cohorts born from 1875 to 1950. The increase in educated Americans was so great that the relative supply of educated workers outran or kept pace with demand, and continued to do so until fairly recently. But something happened in the 1970s. A sharp slowdown in the increase in educational attainment and high-school graduation rates occurred for those born after 1950. College graduation rates began to slow and high school graduation rates reached a plateau. The United States, once the world leader in the proportion of people finishing high school, has fallen to near the bottom of the (rich and relatively rich) nations that belong to the Organization of Economic Cooperation and Development. And while the United States is still a leader in college attendance, its college-completion rates for recent cohorts are lagging other nations." *Milken Institute Review*, Third Quarter 2009, pp. 26–33. At ⟨http://www.milkeninstitute.org/publications/⟩.

The McKinsey Global Institute takes on "Changing the Fortunes of America's workforce: A Human Capital challenge." "Seventy-one percent of US workers are in jobs for which there is low demand from employers, an oversupply of eligible workers, or both." "Incomes and employment for the top-earning 22 percent of workers grew fast, mostly because new technologies and new opportunities in global markets ramped up demand for advanced skills." "Unless the mass of America's workers can develop new skills in the next ten years, the nation risks another period in which growth resumes but income dispersion persists, with Americans in the bottom and middle-earning income clusters never really benefitting from the recovery. The redevelopment challenge is enormous." June 2009. At ⟨http://www.mckinsey.com/mgi/publications/changing_fortunes/index.asp⟩.

Interviews with Economists

Aaron Steelman offers an "Interview" with Allan Meltzer. Meltzer on "too big to fail": "How would I get rid of too big to fail? I would have bank reserves rise with the size of the bank. I think it's in the public interest to say, if you want to be big, you must hold more reserves so that you will be forced to bear a loss if you make a mistake." On a financial super-regulator: "The administration's proposal to make the Fed a super-regulatory body is a mistake for two reasons. The first is the Fed has a poor record of anticipating crises. The second is it would further remove responsibility from the banks. A regulator of last resort would worsen the too big to fail problem." On the World Bank: "I think the World Bank should close. . . . The World Bank is full of people who want to do good things for the poor people of the world. But they don't understand which things will help them and which things

won't. They do not generally appreciate that the only system that produces growth and freedom is capitalism. Also, they have no follow-up on their programs. Their whole system is geared to the idea that a program is successful once the final set of funds has been discharged." *Region Focus,* Spring 2009, vol. 13 no. 2, pp. 32–36. At ⟨http://www.richmondfed.org/publications/research/region_focus/2009/spring/pdf/interview.pdf⟩.

Douglas Clement sits down for an "Interview with Kevin M. Murphy." Murphy on technological change and wages: "If you look over the last 30 years, the nature of that technological change has changed somewhat. In the 1970s and 1980s, we saw rising demand for what you might think of as the top half of the skill distribution relative to the bottom half. And we saw that as expanding inequality throughout the range of wages. As we moved into the 1990s and then into the 2000s, much more of the contrast in demand was happening at the very high end of the skill distribution, between workers in the top 20 percent and the bottom 80 percent, between people with graduate degrees and people with college degrees. So we've had this long-run process of growing demand for skilled workers, but the nature of that demand shift hasn't remained constant." Murphy on economic growth and health: "I'm going to take you from the year 2009 back to 1909, and I'm going to give you a choice. You can take one thing with you on your trip: You can take either today's health and longevity, or today's wealth. That is, you can either have the added income that we got over those 100 years, or you can have the improvements in health and longevity. And the question is, which one would you take? You'd be giving up 20-plus years of life expectancy going back to then, or you could give up the very substantial growth in real income we have seen over the last 100 years. Our analysis says, that's a horse race, that probably the health is worth more than the wealth, but it's close." *The Region.* June 2009, vol. 23, no. 2, pp. 14–23. At ⟨http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=4208⟩.

Mike Rorty carries out an interesting interview with Perry Mehrling on "Shadow Banking: What It Is, How It Broke, and How to Fix It." "The idea of the shadow banking system was in some way, not only tolerated by regulators, but encouraged by regulators. They thought, 'Let's get some of these risks off the balance sheet of the traditional banking system. Let's get interest rate risk off the balance sheet of the traditional banking system. Let's get credit risk off the balance sheet of the traditional banking system.' They thought that would be a good thing. The traditional banks became an originator of loans which they packaged, securitized, and then sold to the shadow banking system, which then raised funds in the money market from mutual funds and asset-backed commercial paper that they issued to whomever. It was avoiding the traditional banking system entirely in this regard, and also avoiding all the regulation of the traditional banking system as well as all the regulatory support of the traditional banking system. But of course it had the same risks. You aren't actually getting rid of liquidity risk or getting rid of solvency risk; you are just moving them into a different place." *The Atlantic,* July 13,

2009. At: ⟨http://business.theatlantic.com/2009/07/exclusive_interview_what_is_shadow_banking_and_how_did_it_fail.php⟩.

Barron's presents "An Interview with Burton Malkiel." Malkiel on being over-invested in certain stocks during a bubble: "There is no question that it is a rap on indexing—that at the peak of the market in 2000, you had more Internet stocks than you should have had, in retrospect. But active managers had an even a greater proportion than did the index funds. . . . So you are quite right that, with an index fund, you will be invested in what turns out to be the most overvalued part of the market. But you will also be invested in what turns out to be the most undervalued part of the market." On behavioral finance: "I teach behavioral finance in my course on financial markets, and I believe the contributions are really very great. Now, behavioral finance doesn't give you a way to beat the market. But it teaches us a lot of lessons about how to avoid mistakes. The behaviorists teach about overconfidence—that we've got some illusion of control, and that we tend to trade too much. And that's absolutely right; it's a wonderful lesson for investors." On investing in China: "At official exchange rates, China has 5% of the world's GDP. If you did a purchasing-power adjustment, they've got 10% of the world's GDP. Almost no equity investors have anything like that percentage in China. China is only about 1.5% of the world's index funds. So if you just put an economic weight on it, people ought to have 5% to 10% in China, but they have nothing like that now." July 7, 2009. At ⟨http://www.smartmoney.com/investing/mutual-funds/an-interview-with-burton-malkiel⟩.

■ *Thanks to Larry Willmore for his steady stream of suggestions.*