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Recommendations for Further Reading

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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, with occasional exceptions, 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.

Smorgasbord

The Bank of International Settlements, in its 80th annual report includes a chapter on "Low Interest Rates: Do the Risks Outweigh the Rewards?" "Previous episodes of low interest rates suggest that loose monetary policy can be associated with credit booms, asset price increases, a decline in risk spreads and a search for yield. Together, these caused severe misallocations of resources in the years before the crisis . . . In the current setting, low policy rates raise additional concerns since they are accompanied by considerably higher long-term rates. This may lead to a growing exposure to interest rate risk and delays in the restructuring of the balance sheets of both the private and public sector. The situation is further complicated because low interest rates may have caused a lasting decline in money market activity, which would make the task of exiting from loose monetary policy

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more delicate. . . . [K]eeping interest rates very low comes at a cost—a cost that is growing with time." Other chapters discuss issues like fiscal stability and the future of the financial sector. *BIS Annual Report 2009/10* is available at ⟨http://www.bis.org/publ/arpdf/ar2010e.htm⟩.

The Council of Economic Advisors reports on "Work–Life Balance and the Economics of Workplace Flexibility." "[O]ver one-half of employers report allowing at least some workers to periodically change their starting and quitting times. However, less than one-third of full-time workers report having flexible work hours . . . [O]nly about 15 percent of workers report working from home at least once per week. . . . A factor hindering a deeper understanding of the benefits and costs of flexibility is a lack of data on the prevalence of workplace flexibility arrangements, and more research is needed on the mechanisms through which flexibility influences workers' job satisfaction and firm profits . . ." March 2010. At ⟨http://www.whitehouse.gov/files/documents/100331-cea-economics-workplace-flexibility.pdf⟩.

John Grimond describes the issues and complexities of water economics in "For Want of a Drink," a middle-of-the-issue special report in *The Economist.* "The number of people on Earth rose to 6 billion in 2000, nearly 7 billion today, and is heading for 9 billion in 2050. The area under irrigation has doubled and the amount of water drawn for farming has tripled. The proportion of people living in countries chronically short of water, which stood at 8% (500m) at the turn of the 21st century, is set to rise to 45% (4 billion) by 2050." "[T]he supply of water is finite. The world will have no more of it in 2025, or 2050, or when the cows come home, than it has today, or when it lapped at the sides of Noah's ark." "Of the 2½% of water that is not salty, about 70% is frozen, either at the poles, in glaciers or in permafrost. So all living things, except those in the sea, have about 0.75% of the total to survive on." "But if you drain a tank of water for your shower, have you used it? Yes, in a sense. But could it not be collected to invigorate the plants in your garden? And will some of it not then seep into the ground to refill an aquifer, or perhaps run into a river, from either of which someone else may draw it? This water has been used, but not in the sense of rendered incapable of further use. Water is not the new oil." "Yet over 60% of all the rain and snow that hits the ground cannot be captured because it evaporates from the soil or transpires through plants." "It [water] is a commodity whose value varies according to locality, purpose and circumstance." *The Economist,* May 22, 2010.

Lant Pritchett discusses what he calls "The Cliff at the Border." "In discussions of 'globalization and equity' I am a triply impolite guest. First, I dispute the premise that, from the point of view of developing countries, 'globalization' is a primary phenomenon of this time. Second, I argue that all of the issues discussed in the context of 'globalization and equity' around "everything but labor liberalization" are trivial compared with the one that is not discussed—cross-border flows of labor. Third, I argue that economists lack a coherent way of talking about equity that does not depend on an arbitrary advancement of 'nationality' to a first-rank justification of acceptable differences in well-being, which is an incoherent way of talking about globalization." Pritchett's essay appears as one of many interesting chapters in a book edited by Ravi Kanbur and Michael Spence, *Equity and Growth in a Globalizing World*. 2010. Available at the website of the Commission on Growth and Development: ⟨http://www.growthcommission.org/index.php?option=com_content&task=view&id=118&Itemid=221⟩.

Sam Allgood, William Bosshardt, Wilbert van der Klaauw, and Michael Watts ask: "Is Economics Coursework, or Majoring in Economics, Associated with Different Civic Behaviors?" "In this paper we use a unique data set of survey responses from over 2,000 graduates who attended one of four large public universities in 1976, 1986, or 1996. . . . To briefly preview our results, those who took more economics classes or who majored in economics or business were more likely to be members of the Republican party and less likely to join the Democratic party. Those findings hold even after controlling for the higher salary, higher equity in real estate holdings, and earning a graduate degree. Neither the number of economics classes taken nor majoring in economics are related to the decision to vote in the 2000 presidential election, or in the most recent state or local elections. Without controlling for salary, the value of real estate holdings, and graduate degrees earned, we found that with a higher number of economics classes taken increased the likelihood that a person had donated money to a political party or campaign. After controlling for those variables, the marginal effect of taking economics courses on the likelihood to donate is reduced by a third. Neither volunteering nor the number of hours volunteered is related to studying or majoring in economics; but business majors are less likely to volunteer, and when they do they donate fewer hours." Federal Reserve Bank of New York Staff Report no. 450. May 2010. At ⟨http://www.newyorkfed.org/research/staff_reports/sr450.pdf⟩.

Rethinking Macro and Finance

The Committee on Science and Technology of the U.S. House of Representatives held hearings on "Building a Science of Economics for the Real World," with testimony from Robert Solow ⟨http://democrats.science.house.gov/Media/file/Commdocs/hearings/2010/Oversight/20july/Solow_Testimony.pdf⟩, Sidney Winter ⟨http://democrats.science.house.gov/Media/file/Commdocs/hearings/2010/Oversight/20july/Winter_Testimony.pdf⟩, Scott Page ⟨http://gop.science.house.gov/Media/hearings/oversight10/july20/Page.pdf⟩, V. V. Chari ⟨http://democrats.science.house.gov/Media/file/Commdocs/hearings/2010/Oversight/20july/Chari_Testimony.pdf⟩, and David Colander ⟨http://democrats.science.house.gov/Media/file/Commdocs/hearings/2010/Oversight/20july/Colander_Testimony.pdf⟩. Solow argues: "It may be unusual for the Committee to focus on so abstract a question, but it is certainly natural and urgent. Here we are, still near the bottom of a deep and prolonged recession, with the immediate future uncertain, desperately short of jobs, and the approach to macroeconomics that dominates serious thinking, certainly in our elite universities and in many central banks and other influential policy circles, seems to have absolutely nothing to say about the problem. Not only does it offer no guidance or insight, it really seems to have nothing useful to say. . . . Especially when it comes to matters as important as macroeconomics, a mainstream economist like me insists that every proposition must pass the smell test: does this really make sense? I do not think that the currently popular DSGE models pass the smell test." Chari responds: "All the interesting policy questions involve understanding how people make decisions over time and how they handle uncertainty. All must deal with the effects on the whole economy. So, any interesting model must be a dynamic stochastic general equilibrium model. From this perspective, there is no other game in town. Modern macroeconomic models, often called DSGE models in macro share common additional features. All of them make sure that they are consistent with the National Income and Product Accounts. That is, things must add up. All of them lay out clearly how people make decisions. All of them are explicit about the constraints imposed by nature, the structure of markets and available information on choices to households, firms and the government. From this perspective DSGE land is a very big tent. The only alternatives are models in which the modeler does not clearly spell out how people make decisions. Why should we prefer obfuscation to clarity? My description of the style of modern macroeconomics makes it clear that modern macroeconomists use a common language to formulate their ideas and the style allows for substantial disagreement on the substance of the ideas. A useful aphorism in macroeconomics is: 'If you have an interesting and coherent story to tell, you can tell it in a DSGE model. If you cannot, your story is incoherent.'" July 20, 2010.

The London School of Economics convened a group of leading academics, financiers, journalists, and government officials to consider: "The Future of Finance: And the Theory that Underpins It." Richard Layard writes in the "Preface" to the conference report: "The central question is what the financial system is for? Standard texts list five main functions—channeling savings into real investment, transferring risk, maturity transformation (including smoothing of life-cycle consumption), effecting payments and making markets. But if we study how financial companies make their money, it is extraordinarily difficult to see how closely this corresponds to the stated functions, and it is often difficult to explain why the rewards are often so high. Any explanation must also explain why the system is so prone to boom and bust. . . . There are four aims of such a reform. The first is to prevent the financial system destabilising the real economy, as it has in the recent past. The second (closely related) is to protect tax-payers against the possible cost of bailouts. The third is to reduce the share of real national income which accrues as income to the financial sector and its employees for reasons not related to the benefits it confers—thus absorbing into the sector talent that could be more usefully used elsewhere. And all of this has to be done in a way that works." The conference was July, 14, 2010. The chapters of *The Future of Finance: The LSE Report* can be downloaded free, or the book ordered, at ⟨http://futureoffinance.org.uk/⟩.

John Geanakoplos offers an analysis of "Solving the Present Crisis and Managing the Leverage Cycle." "There are times when leverage is so high that people and institutions can buy many assets with very little money down and times when leverage is so low that buyers must have all or nearly all of the money in hand to purchase those very same assets. When leverage is loose, asset prices go up because buyers can get easy credit and spend more. Similarly, when leverage is highly constrained, that is, when credit is very difficult to obtain, prices plummet. This is what happened in real estate and what happened in the financial markets. Governments have long monitored and adjusted interest rates in an attempt to ensure that credit did not freeze up and thereby threaten the economic stability of a nation. However, leverage (equivalently, collateral rates) must also be monitored and adjusted if we are to avoid the destruction that the tail end of an outsized leverage cycle can bring. . . . Put bluntly, the market alone will not take care of outsized leverage. It is thus imperative that the Fed put outside limits on leverage. . . . The most direct way to regulate leverage might be by empowering a 'leverage supervisor' who could simply forbid loans at too high leverage in ebullient times, setting different leverage limits for different security classes. Banks would simply not be allowed to lend 97 percent of the value of the house, and repo lenders would not be allowed to reduce haircuts too far." Federal Reserve Bank of New York *Economic Policy Review,* August 2010, vol. 16, no. 1, pp. 101–131. At ⟨http://www.newyorkfed.org/research/epr/10v16n1/1008gean.pdf⟩.

James M. Buchanan reflects on "The Constitutionalization of Money." "[T]there is no economic reason why any money system, in an idealized setting, would allow for leverage at any level. No holder of a unit of money, as an entry in a balance sheet, should be authorized to lend more than the face value of this unit, quite independent of probabilistically determined expectations concerning potential redemptions. Why not? Because to allow separate banks to create short-term liabilities to a multiple of the base money on the asset side of the account removes from the issuing authority some of the control of the aggregate amount of that value treated as money in the economy without offsetting benefits, thereby making the financial structure vulnerable to unpredictable shifts among instruments, which, in turn, generate changes in real values. The modern dilemma is that we are left with a massive resource-using, financial-banking structure that has a functional purpose quite different from that which is widely accepted. The system in existence emerged from a historical process, the characteristics of which were partially appropriate for a monetary standard defined in terms of some commodity base, but which, ultimately, make no sense under a fiat system." *Cato Journal,* Spring/Summer 2010, vol. 30, no. 2, pp. 251–58. This issue and the Fall 2010 issue of the *Cato Journal* include nearly two dozen papers on the subject of "Restoring Global Financial Stability." As James Dorn writes in an "Editor's Note": "Even if it is unlikely that the Federal Reserve and other central banks would be abolished any time soon, it is useful to consider the properties of private, rule-based, market-friendly monetary regimes." Available at ⟨http://www.cato.org/pubs/journal/index.html⟩.

Government Deficits and Debt

Gene Steuerle describes "America's Related Fiscal Problems" and Henry Aaron responds with "How to Think about the U.S. Budget Challenge" in a point/counterpoint format, with responses to each other's essays. Steuerle sums up the debate: "Henry Aaron and I approach fiscal policy in many similar ways. Those who know us also know that we have collaborated on many issues and understandably might wonder why we are Point/Counterpointing here. That said, our approaches differ in two simple ways. From my perspective: 1. The deficit is a symptom of a larger problem. Gaining control over macroeconomic policy, reorienting our budget toward our greatest needs, investing in our children, and escaping our current political straightjacket first requires restoring much more "give" in the budget and leeway for future decision makers. 2. When it comes to policies toward retirement and health, government policy fails not because the annual benefits it provides are too high, but because it has morphed into supporting middle-age retirement, distinguishes inadequately between ability and income in assessing need, and fails to put all health subsidies into controllable, as opposed to open-ended, budgets." Aaron responds: "[W]hy do Steuerle's characterizations of the fiscal challenge and mine feel so different? More importantly, why are they so different? The reason, I think, is that Steuerle sees the fiscal imbalance as the manifestation of deep malaise within the American polity, and I do not. What Steuerle sees as problems, I see as achievements. What Steuerle sees as prodigality, I see as parsimony." *Journal of Policy Analysis and Management,* Fall 2010, vol. 29, no. 4, pp. 876–95. At ⟨http://onlinelibrary.wiley.com/doi/10.1002/pam.20540/pdf⟩, and also available at ⟨http://www.taxpolicycenter.org/press/enews_090910.cfm⟩.

Researchers at the IMF have been turning out a steady stream of papers on government debts and borrowing. For example, consider three IMF Staff Position Notes that were all released on September 1, 2010. Jonathan D. Ostry, Atish R. Ghosh, Jun I. Kim, and Mahvash S. Qureshi discuss "Fiscal Space." "Our hypothesis is that, when debt is in a moderate range, its dynamics are sustainable in the sense that increases in debt elicit sufficient increases in primary fiscal balances to stabilize the debt-to-GDP ratio. At high debt levels, however, the dynamics may turn unstable, and the debt ratio may not converge to a finite level. Such a framework allows us to define a "debt limit" that is consistent with the country's historical track record of adjustment in the sense that, without an extraordinary fiscal effort, any debt increment beyond this limit would cause debt to increase without bound. . . . Given the country's normal pattern of adjustment, *fiscal space* is then simply the difference between the debt limit and current debt. Applying our concepts to a sample of 23 advanced economies . . . Greece, Italy, Japan, and Portugal appear to have the least fiscal space, with Iceland, Ireland, Spain, the United Kingdom, and the United States also constrained in their degree of fiscal maneuver, the more so owing to the run-up in public debt projected in coming years. An absence of fiscal space should not be taken to mean that some form of fiscal 'crisis' is imminent, or even likely, but it does underscore the need for credible adjustment plans." SPN/10/11. At ⟨http://www.imf.org/external/pubs/ft/spn/2010/spn1011.pdf⟩.

Carlo Cottarelli, Lorenzo Forni, Jan Gottschalk, and Paolo Mauro argue that "Default in Today's Advanced Economies: Unnecessary, Undesirable, and Unlikely." "This note summarizes the main arguments put forward by some market commentators who argue that default is inevitable, and presents a rebuttal for each argument in turn. Their main arguments focus on the size of the adjustment and continued market concerns reflected in government bond spreads. The essence of our reasoning is that the challenge stems mainly from the advanced economies' large primary deficits, not from a high average interest rate on debt. Thus, default would not significantly reduce the need for major fiscal adjustment. In contrast, the economies that defaulted in recent decades did so primarily as a result of high debt servicing costs, often in the context of major external shocks. We conclude that default would not be in the interest of the citizens of the countries in question." SPN/10/12. At ⟨http://www.imf.org/external/pubs/ft/spn/2010/spn1012.pdf⟩.

Carlo Cottarelli and Andrea Schaechter discuss "Long-Term Trends in Public Finances in the G-7 Economies." "Today's record public debt levels in most advanced economies are not only a direct fall-out from the global crisis. Public debt had ratcheted up over many decades before, when it had been used, in most of the G-7 countries, as the ultimate shock absorber—rising in bad times but not declining much in good times." SPN/10/13. At ⟨http://www.imf.org/external/pubs/ft/spn/2010/spn1013.pdf⟩.

Discussion Starters

Jay P. Greene, Brian Kisida, and Jonathan Mills discuss "Administrative Bloat at American Universities: The Real Reason for High Costs in Higher Education." "Between 1993 and 2007, the number of full-time administrators per 100 students at America's leading universities grew by 39 percent, while the number of employees engaged in teaching, research or service only grew by 18 percent. Inflation-adjusted spending on administration per student increased by 61 percent during the same period, while instructional spending per student rose 39 percent. Arizona State University, for example, increased the number of administrators per 100 students by 94 percent during this period while actually reducing the number of employees engaged in instruction, research and service by 2 percent. . . . We base our conclusions on data from the Integrated Postsecondary Education Data System (IPEDS), which is sponsored by the U.S. Department of Education." Goldwater Institute Policy Report no. 239. August 17, 2010. ⟨http://www.goldwaterinstitute.org/file/4942/download/4944⟩.

Capgemini and Merrill Lynch Wealth Management present their *World Wealth Report 2010*, which focuses on High Net Worth Individuals, defined as those with more than $1 million in investible assets, and Ultra-High Net Worth Individuals with more than $30 million in investible assets. "The world's population of high net worth individuals (HNWIs) grew 17.1% to 10.0 million in 2009, returning to levels last seen in 2007 despite the contraction in world gross domestic product (GDP). Global HNWI wealth similarly recovered, rising 18.9% to US$39.0 trillion. . . . After losing 24.0% in 2008, Ultra-HNWIs saw wealth rebound 21.5% in 2009. At the end of 2009, Ultra-HNWIs accounted for 35.5% of global HNWI wealth, up from 34.7%, while representing only 0.9% of the global HNWI population, the same as in 2008."

June 22, 2010. Available (with free registration) at ⟨http://www.us.capgemini.com/DownloadLibrary/requestfile.asp?ID=810⟩.

Joel Kotkin writes about "The Broken Ladder: The Threat to Upward Mobility in the Global City." "A great city, wrote Rene Descartes in the 17th Century, represented 'an inventory of the possible,' a place where people could create their own futures and lift up their families. In the 21st Century—the first in which the majority of people will live in cities—this unique link between urbanism and upward mobility will become ever more critical. . . . Yet, in the longer term, the impacts of dense urbanization may not be universally useful at promoting either poverty alleviation or upward mobility. In advanced countries, this is already evident in large urban areas. . . . Similarly, in some developing cities—Mumbai, Bogota and Sao Paulo, for example—there may be a widening gap between economic success and population density, as growth shifts to places with better infrastructure, less congestion, and less crime." Kotkin particularly focuses his discussion on London, Mexico City, and Mumbai. Legatum Institute, May 2010. At ⟨http://www.li.com/attachments/The%20Broken%20Ladder%20-%20Joel%20Kotkin.pdf⟩.

Stephen Slivinski discusses "Economic History: The Lessons of Jamestown." In the years after the Jamestown settlement of 1607, the settlers often lacked food. "The company sent Sir Thomas Dale, a British naval commander, to take over the office of colony governor in 1611. Yet, upon arrival in May—a time when the farmers should have been tending to their fields—Dale found virtually no planting activity. Instead, the workers were devoted mainly to leisure and 'playing bowls.' . . . All land was owned by the company and farmed collectively. . . . The workers would not hope to reap more compensation from a productive farming of the land any more than the farmers would be motivated by an interest in making their farming operations more efficient and, hence, more profitable. Seeing this, Dale decided to change the labor arrangements: When the seven-year contracts of most of the original surviving settlers were about to expire in 1614, he assigned private allotments of land to them. Each got three acres, 12 acres if he had a family. The only obligation was that they needed to provide two and a half barrels of corn annually to the company so it could be distributed to the newcomers to tide them over during their first year. Dale left Jamestown for good in 1616. By then, however, the new land grants had unleashed a vast increase in agricultural productivity. In fact, upon returning to England with Dale, John Rolfe—one of the colony's former leaders—reported to the Virginia Company that the Powhatans were now asking the colonists to give them corn instead of vice versa." Federal Reserve Bank of Richmond *Region Focus*, First Quarter 2010, pp. 27–29. At ⟨http://www.richmondfed.org/publications/research/region_focus/2010/q1/pdf/economic_history.pdf⟩.