

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 (taylor@macalester.edu), or c/o *Journal of Economic Perspectives*, Macalester College, 1600 Grand Ave., Saint Paul, Minnesota, 55105.

Smorgasbord

Brian K. Bucks, Arthur B. Kennickell, Traci L. Mach, and Kevin B. Moore discuss “Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances.” “From 2004 to 2007, inflation-adjusted net worth (wealth)—the difference between families’ gross assets and their liabilities—rose strongly . . . The median rose 17.7 percent, and the mean rose 13.0 percent; the corresponding values for the period from 2001 to 2004 were 1.0 percent and 6.0 percent. Both the median and the mean have risen consistently over the period since 1998, but overall the mean has gained more—54.7 percent, compared with a 31.8 percent increase in the median.” “Unrealized capital gains were a particularly important factor in the increase in net worth over the 2004–07 period. The share of total assets attributable to unrealized capital gains from real estate, businesses, stocks, or mutual funds rose 5.1 percentage points, to 35.8 percent in 2007. Although the level of debt owed by families rose noticeably, debt as a percentage of

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assets was little changed. The largest percentage change in debt was in borrowing for residential real estate other than a primary residence.” *Federal Reserve Bulletin*, February 2009, p. A1–A55. At <http://www.federalreserve.gov/pubs/bulletin/default.htm>).

In *Rethinking Federal Housing Policy: How to Make Housing Plentiful and Affordable*, Edward L. Glaeser and Joseph Gyourko offer a highly readable overview. “[P]rice bubbles are more likely to form in highly regulated markets because a very tight, or inelastic, supply of homes is needed to support the increasingly large price increases that sustain a bubble whenever demand is rising. It is more difficult for home prices to become disconnected from their fundamental production costs in markets where plentiful supply is forthcoming whenever prices rise much above those costs.” “Today, local governments are making land-use decisions that may be in the interests of their own communities, but that are not in the interest of the nation as a whole. NIMBYism (not-in-my-backyard philosophy) may be locally popular, but it is a poor basis for national housing policy. The proper role of the federal government is to lean against the local tendency to block new projects.” “The policies that help the poor should not target spending on one market or another. The starkest example of the folly of such place-based aid can be seen in the unfortunate consequences of federal policies that created high-rise concentrations of poverty in our inner cities. The poor should have the greatest possible freedom to move wherever there is more opportunity. The best approach to achieving that aim is to directly provide them more resources, in the form of either cash or housing vouchers. What the poor truly need are those resources, not buildings in places determined by politicians or politically connected developers.” Released November 2008. Available as a free download or for purchase at the website of the American Enterprise Institute: http://www.aei.org/books/bookID.971,filter.all/book_detail.asp).

Charles A. Goldman, Krishna B. Kumar, Ying Liu, Sai Ma, and Neeraj Sood discuss “Asian Exchange: China and India Trade Lessons in Education and Health.” “India has focused on higher education for a few, while China has focused on basic education for the masses. . . . India can learn from China how to improve the efficiency of public education, particularly by providing appropriate incentives to teachers and schools, whereas China can learn from India how to expand private higher education. India is unusual, however, in that it has benefited from a broad base of English-speaking workers. The universal education strategy of China might be safer for other countries to emulate. . . . China should emulate two aspects of India’s health system: greater involvement of the private sector, where medical students increasingly prefer to work, and reduced regulation of prices. For example, the overutilization of newly marketed drugs in China is a very problematic issue that raises concerns about wasteful spending as well as quality of care. . . . India should emulate two aspects of China’s health system: greater spending on basic national health infrastructure, such as clinics and preventive care services at the village level, and greater efforts to reduce preventable deaths from communicable diseases and from poor maternal and infant health.” *Rand Review*, Fall 2008, at

(<http://www.rand.org/publications/randreview/issues/fall2008/exchange.html>). At the end of the article are links to detailed papers by subsets of the authors comparing health and education policies in India and China.

Blair Jenkins asks: “Rent Control: Do Economists Agree?” “My review of the rent-control literature indexed by EconLit (or cited by such indexed articles) finds that economic research quite consistently and predominantly frowns on rent control. My findings cover both theoretical and empirical research on many dimensions of the issue, including housing availability, maintenance and housing quality, rental rates, political and administrative costs, and redistribution. . . . If rent-control is such a ‘no-brainer,’ why bother to scrutinize the literature? The cluster of restrictions persists in roughly 140 jurisdictions in the United States as of 2001. As Hazlett (1982) notes, ‘economists have been notoriously thorough in convincing themselves of the destructive effects of rent control and notoriously inept at convincing anyone else’ ” . . . *Econ Journal Watch*, January 2009, pp. 73–112. At (<http://www.aier.org/ejw>).

The *Journal of Legal Studies* published, in a supplement to its June 2008 issue, a group of 11 articles on various aspects of happiness research. From the abstract of “Happiness Inequality in the United States,” by Betsey Stevenson and Justin Wolfers: “This paper examines how the level and dispersion of self-reported happiness has evolved over the period 1972–2006. While there has been no increase in aggregate happiness, inequality in happiness has fallen substantially since the 1970s. There have been large changes in the level of happiness across groups: two-thirds of the black–white happiness gap has been eroded, and the gender happiness gap has disappeared entirely. Paralleling changes in the income distribution, differences in happiness by education have widened substantially.” From “Happiness Research and Cost–Benefit Analysis,” by Matthew Adler and Eric A. Posner: “If people’s choices do not advance their happiness, and well-being is just SWB [subjective well-being]—a point that we dispute, but which happiness scholars often seem either to accept or at least not to vigorously question—then the basis of the market economy seems questionable. But nearly everyone shies away from the implications of this view, which is to replace the market economy with a system of pervasive government control, one that would prevent people from choosing and would instead force them to be happy. . . . we argue that the happiness literature does not undermine the normative basis of CBA [cost-benefit analysis]—does not even address it—and its empirical findings do not contradict the main empirical premises of CBA.” Other papers look at a range of policy, economic, and philosophical issues related to happiness research.

John S. Greenlees and Robert B. McClelland are “Addressing misconceptions about the Consumer Price Index.” “[S]pecial attention is paid to four common misperceptions, or myths, about the CPI: (1) that the BLS lowers the CPI to reflect consumers’ substitutions of hamburger for steak; (2) that the use of hedonic quality adjustment has substantially decreased the growth rate of the CPI; (3) that the 1983 change in the way the BLS measures homeownership costs lowered the rate of increase of the CPI; and (4) that Social Security payments are indexed to a CPI that

does not include food or energy.” *Monthly Labor Review*, August, 2008, pp. 3–19. At <http://www.bls.gov/opub/mlr/2008/08/art1full.pdf>.

The *American Journal of Economics and Sociology* has published in its November 2008 issue “A Symposium about the Early Formation of the Allied Social Science Associations.” After an introduction by Wilfred Dolfsma (pp. 969–71), it includes essays by John J. Siegfried on the “History of the Meetings of the Allied Social Science Associations since World War II” (pp. 973–83); by Betsy Jane Clary on “The Evolution of the Allied Social Science Associations” (pp. 985–1005); and by Michael A. Bernstein on “A Brief History of the American Economic Association” (p. 1007–1023). From Bernstein’s essay: “While the AEA’s contributions to economic knowledge through its periodicals . . . and in various other ways are undeniable, its services to the profession have perhaps been unnecessarily restricted because of the heterogeneity of its constituency, which has always included a substantial portion of nonacademic members, and its commitment to nonpartisanship. . . . Maintaining a dispassionate, scholarly tone while encouraging a wide and diverse readership was neither a simple nor an obvious task. Editor [of the *American Economic Review*] Davis Dewey put it well to the distinguished English theorist Francis Edgeworth in January 1911 when he wrote: ‘We are trying to appeal to a somewhat varied membership who are interested in current questions. We do not, however, wish to be popular in a commonplace way, but shall endeavor to have our articles prepared by men of scholarly standards.’”

Fiscal Policy

Alan J. Auerbach and William G. Gale discuss “The Economic Crisis and the Fiscal Crisis: 2009 and Beyond.” From the abstract: In 2009, the federal deficit will be larger as a share of the economy than at any time since World War II. The current deficit is due in part to economic weakness and the stimulus, and in part to policy choices made in the past. What is more troubling is that, under what we view as optimistic assumptions, the deficit is projected to average at least \$1 trillion per year for the 10 years after 2009, even if the economy returns to full employment and the stimulus package is allowed to expire in two years. The longer-run picture is even bleaker. We estimate a fiscal gap—the immediate and permanent increase in taxes or reduction in spending that would keep the long-term debt/GDP ratio at its current level—about 7–9 percent of GDP, or between \$1 trillion and \$1.3 trillion per year in current dollars.” Tax Policy Center, February 19, 2009. At http://www.taxpolicycenter.org/UploadedPDF/411843_economic_crisis.pdf.

Antonio Spilimbergo, Steve Symansky, Olivier Blanchard, and Carlo Cottarelli examine “Fiscal Policy for the Crisis.” From the Executive Summary: “The optimal fiscal package should be timely, large, lasting, diversified, contingent, collective, and sustainable: timely, because the need for action is immediate; large, because the current and expected decrease in private demand is exceptionally large; lasting because the downturn will last for some time; diversified because of the unusual

degree of uncertainty associated with any single measure; contingent, because the need to reduce the perceived probability of another ‘Great Depression’ requires a commitment to do more, if needed; collective, since each country that has fiscal space should contribute; and sustainable, so as not to lead to a debt explosion and adverse reactions of financial markets.” IMF Staff Position Note SPN/08/01, December 29, 2008. At <http://www.imf.org/external/np/pp/eng/2008/122308.pdf>.

The Financial Crisis

Felix Salmon lays out a “Recipe for Disaster: The Formula That Killed Wall Street.” A year ago, it was hardly unthinkable that a math wizard like David X. Li might someday earn a Nobel Prize. After all, financial economists—even Wall Street quants—have received the Nobel in economics before, and Li’s work on measuring risk has had more impact, more quickly, than previous Nobel Prize-winning contributions to the field. . . . He took a notoriously tough nut—determining correlation, or how seemingly disparate events are related—and cracked it wide open with a simple and elegant mathematical formula, one that would become ubiquitous in finance worldwide. For five years, Li’s formula, known as a Gaussian copula function, looked like an unambiguously positive breakthrough, a piece of financial technology that allowed hugely complex risks to be modeled with more ease and accuracy than ever before. . . . ‘The corporate CDO [collateralized debt obligation] world relied almost exclusively on this copula-based correlation model,’ says Darrell Duffie, a Stanford University finance professor . . . The damage was foreseeable and, in fact, foreseen. . . . During the boom years, everybody could reel off reasons why the Gaussian copula function wasn’t perfect. Li’s approach made no allowance for unpredictability: It assumed that correlation was a constant rather than something mercurial. Investment banks would regularly phone Stanford’s Duffie and ask him to come in and talk to them about exactly what Li’s copula was. Every time, he would warn them that it was not suitable for use in risk management or valuation. In hindsight, ignoring those warnings looks foolhardy. But at the time, it was easy.” *Wired*, February 23, 2009. At http://www.wired.com/techbiz/it/magazine/17-03/wp_quant?currentPage=all.

Luc Laeven and Fabian Valencia have written “Systemic Banking Crises: A New Database.” “Using this broad definition of a systemic banking crisis that combines quantitative data with some subjective assessment of the situation, we identify the starting year of systemic banking crises around the world since the year 1970. . . . [W]e exclude banking system distress events that affected isolated banks but were not systemic in nature. . . . In sum, we identify 124 systemic banking crises over the period 1970 to 2007. . . . Our preliminary analysis based on partial correlations indicates that some resolution measures are more effective than others in restoring the banking system to health and containing the fallout on the real economy. Above all, speed appears of the essence. As soon as a large part of the financial system is deemed insolvent and has reached systemic crisis proportions, bank losses

should be recognized, the scale of the problem should be established, and steps should be taken to ensure that financial institutions are adequately capitalized. A successful bank recapitalization program tends to be selective in its financial assistance to banks, specifies clear quantifiable rules that limit access to preferred stock assistance, and enacts capital regulation that establishes meaningful standards for risk-based capital. Government-owned asset management companies appear largely ineffective in resolving distressed assets, largely due to political and legal constraints.” IMF Working Paper WP/08/224, November 2008, at <http://www.imf.org/external/pubs/ft/wp/2008/wp08224.pdf>.

Mark Jickling has produced a table listing “Causes of the Financial Crisis.” “This report consists of a table that summarizes very briefly some of the arguments for particular causes, presents equally brief rejoinders, and includes a reference or two for further reading.” The list of causes includes: Imprudent Mortgage Lending, Housing Bubble, Global Imbalances, Securitization, Lack of Transparency and Accountability in Mortgage Finance, Rating Agencies, Mark-to-market Accounting, Deregulatory Legislation, Shadow Banking System, Non-Bank Runs, Off-Balance Sheet Finance, Government-Mandated Subprime Lending, Failure of Risk Management Systems, Financial Innovation, Complexity, Human Frailty, Bad Computer Models, Excessive Leverage, Relaxed Regulation of Leverage, Credit Default Swaps, Over-the-Counter Derivatives, Fragmented Regulation, No Systemic Risk Regulator, Short-term Incentives, Tail Risk, and Black Swan Theory. Congressional Research Service, January 29, 2009. At <http://openocrs.com/document/R40173>).

About Economists

The *Review of Political Economy* has published a “Special Issue Commemorating John Kenneth Galbraith’s Centenary.” His son James K. Galbraith offers an illuminating Essay: “The Abiding Economics of John Kenneth Galbraith.” “In the long run, his name will be recorded alongside those of Adam Smith, Karl Marx, Thorstein Veblen, and John Maynard Keynes, among the greatest *reform* economists of all time.” “Let me go on to some of the major points of Galbraith’s contributions as an economic theorist . . . (1) From *The Great Crash*, we have of course the conviction that financial panics affect real activity . . . Only in the higher reaches of academic life could such a thing ever be denied. (2) . . . In *The Affluent Society*, we find a logical demolition of the orthodox theory of consumer choice. It proceeds from the unassailable observation that stable preferences cannot exist for goods that do not exist. The process of innovation necessarily entails the creation of markets. . . . (3) Then we have the theory of economic organization in *The New Industrial State* . . . conveying understanding not only of the separation of ownership from control but also the significance of the specific bureaucratic processes that generate corporate decision-making and the interplay of company and state.” Other contributions look at Galbraith and the Post-Keynesian tradition, the nature of money, the dependence effect, and other themes. October 2008, vol. 20, issue 4.

Douglas Clement offers another well-done and insightful interview, this one with Kenneth Rogoff. Rogoff on exchange rates: “If you ask what we actually do know about exchange rates, the most powerful empirical regularity, for sure, is that purchasing power parity has some traction in the long run. . . . My read of the literature is that the half-life of PPP deviations is two to three years (so that over, say, 30 months, half of given deviation from PPP can be expected to damp out).” On financial globalization: “The first thing to say about the financial globalization literature is that the scientific empirical work doesn’t particularly support any polemic view of it. It’s certainly not clear that the direct benefits are necessarily huge. Neither is it incredibly clear that it’s the disaster some make it out to be. For the most part, the evidence is just too tepid to say anything.” On the financial bailouts: “Fortunately, adding a trillion dollars in debt is quite manageable for the United States. Of course, it is not a fun way to spend money, bailing out the financial system. We’d rather spend it on health, education, infrastructure or the environment. . . . The fact is that for all the railing against the Bush deficits, the United States grew decently until recently, so that our debt/GDP burden is still modest by European or Japanese standards. The rising debt burden will have some effect on growth. But I’m more concerned about what happens to our financial sector at the end of this, what’s left of it. I just don’t know what’s going to emerge after the political system works it over. I hope that we do not throw out the baby with the bathwater. If we rebuild a very statist and inefficient financial sector—as I fear we will—it’s hard to imagine that growth won’t suffer for years. . . . I would venture that the present financial crisis will have an effect on the future research in macro and finance similar to the influence the Great Depression had on several generations of economists.” *The Region: Federal Reserve Bank of Minneapolis*, December 2008, pp. 18–29. At (<http://www.minneapolisfed.org/pubs/region/08-12/rogoff.pdf>).

The *Economist* magazine highlights the work of eight young economists, all of whom have received their Ph.D.’s in the last decade, in “Emerging Economists: International Bright Young Things.” From the subtitle: “The next generation of economists do their best work somewhere between the field clinic and the dissection room.” Here’s a quick introduction to the work of Jesse Shapiro, Roland Fryer, Esther Duflo, Amy Finkelstein, Raj Chetty, Iván Werning, Xavier Gabaix, and Mark Melitz. December 30, 2008.

Discussion Starters

Patrick M. Callan, describes the main insights of the “2008 National Report Card: Modest Improvements, Persistent Disparities, Eroding Global Competitiveness.” “The United States’ world leadership in college access has eroded steadily. . . . In college completion, which has never been a strength of American higher education, the U.S. ranks 15th among 29 countries compared. The U.S. adult population ages 35 and older still ranks among the world leaders in the percentage

who have college degrees—reflecting the educational progress of earlier times. Among 25- to 34-year-olds, however, the U.S. population has slipped to 10th in the percentage who have an associate degree or higher. This relative erosion of our national ‘educational capital’ reflects the lack of significant improvement in the rates of college participation and completion in recent years.” National Center for Public Policy and Higher Education, *Measuring Up 2008: The National Report Card on Higher Education*. Released December 2008. At <http://measuringup2008.highereducation.org>).

Students might be interested in watching the hearings of the U.S. Senate Committee on Banking, Housing and Urban Affairs for President Obama’s three members of the Council of Economic Advisers: Christina Romer, Austan Goolsbee, and Cecilia Rouse. January 15, 2009. At <http://banking.senate.gov/public/index.cfm?Fuseaction=Hearings.Detail&HearingID=ab9dda7a-3a2f-41f9-bb69-5b0c7c4e10fb>). Of course, when looking for up-to-date economic statistics and figures, a readily available source is the monthly *Economic Indicators* published by the CEA, available at <http://www.gpoaccess.gov/indicators/index.html>).

The American Society of Civil Engineers has produced its “2009 Report Card for America’s Infrastructure.” “The Report Card is an assessment by professional engineers of the nation’s status in 15 categories of infrastructure. In 2009, all signs point to an infrastructure that is poorly maintained, unable to meet current and future demands, and in some cases, unsafe. Since the last Report Card in 2005, the grades have not improved. ASCE estimates the nation still stands at a D average. Deteriorating conditions and inflation have added hundreds of billions to the total cost of repairs and needed upgrades. ASCE’s current estimate is \$2.2 trillion, up from \$1.6 trillion in 2005.” Released January 28, 2009. At <http://www.asce.org/reportcard/2009/>).

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