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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, 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

K. Jack Riley considers "Flight of Fancy? Air Passenger Security Since 9/11." He has been thinking over the time and cost tradeoffs of airline passenger security. "There is very little reason to be concerned about suicide bombers being present on flights originating in the United States. The security improvements noted above—passenger vigilance, cockpit security, and visa screening—go a long way toward preventing radical jihadists from entering the country or, having entered, from being able to commandeer a plane to conduct a spectacular attack. . . . Recognizing the security of flights originating in the United States and thus returning all passengers to the domestic procedures that existed before the recent additions would save, at minimum, about $1.2 billion annually. . . . It would also reduce the deadweight losses that domestic travelers incur from arriving at airports early, waiting in lines,

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and undergoing intensive scrutiny." "The current security regime applies the same procedures to all 700 million passengers who board planes each year in the United States. That we have not developed a reasonable way to reduce that inspection workload is perhaps the biggest missed opportunity of the past decade. A trusted traveler program could be configured in a variety of ways." "Researchers have estimated that the 9/11 attacks generated nearly 2,200 additional road traffic deaths in the United States through mid-2003 from a relative increase in driving and reduction in flying resulting from fear of additional terrorist attacks and associated reductions in the convenience of flying. If the new security measures are generating similar, or even smaller, substitutions and the driving risk has grown as hypothesized, the new methods could be contributing to more deaths annually on U.S. roads than have been experienced cumulatively since 9/11 from terrorism against air transportation targets around the world." Riley's essay appears as Chapter 12 of *The Long Shadow of 9/11: America's Response to Terrorism,* edited by Brian Michael Jenkins and John Paul Godges, and available as an e-book at ⟨http://www.rand.org/content/dam/rand/pubs/monographs/2011/RAND_MG1107.pdf⟩. A shorter version of the argument appear as "Beyond the Shadow of 9/11: Air Passenger Security at a Reasonable Cost," in the Summer 2011 issue of the *Rand Review* at ⟨http://www.rand.org/publications/randreview/issues/2011/summer/shadow4.html⟩.

John E. Roemer examines "The Ideological and Political Roots of American Inequality." "Economists have long realized that markets perform two functions: they coordinate economic activity, and they provide incentives for the development of skills and innovations. . . . In the last thirty or forty years, the economic theorist's view of the market has changed, from being an institution which performs primarily a coordination function to one that is primarily harnessing incentives. Indeed, the old definition of micro-economics was the study of how to allocate scarce resources to competing needs. This is entirely a coordination view." "The punch line I am proposing is this: to the extent that the market is primarily a device for coordination, taxation can redistribute income without massive efficiency costs. But if the market is primarily a device for harnessing incentives, the efficiency costs of redistribution may be high. . . . Although economic theory has shifted on this question during the last generation, it is far from obvious that the shift is empirically justified . . ." "I have argued that these high incomes are inefficient, because of risk-taking externalities that they induce, that they are unnecessary for incentive provision, and that they create a class with disproportionate political power. Finally, there is the very important negative externality of the creation of a social ethos which worships wealth. . . . In sum, the positive social value of the institution of extremely high salaries that the leaders of the corporate world, and in particular, of the financial sector, receive, is a big lie. It may well be a competitive outcome, but it is a market failure which could be corrected by regulation or legislation." GINI Discussion Paper 8, March 2011. At ⟨http://www.gini-research.org/system/uploads/249/original/DP_8_-_Roemer.pdf?1308736281⟩. A revised version of the presentation as an article with the same title is in the September–October 2011 issue of *Challenge* magazine.

Narayana Kocherlakota writes on “Labor Markets and Monetary Policy.” “The impact of any macroeconomic shock can be divided into two components. One component is the effect of the natural demand and supply adjustments that would occur if prices and their expectations were to adjust continuously. Monetary policy cannot be used to offset this natural consequence of the shock without creating inflation that is either too high or too low. The other component is the consequence of what economists call nominal rigidities—the sluggish adjustment of prices (including wages, the price of labor) and price expectations. Monetary policy can be used to offset this latter component of the shock’s impact without creating undue pressures on inflation. The challenge for monetary policymakers is to figure out how to divide the observed movements in the unemployment rate into these two components.” In the 2010 Annual Report of the Minneapolis Fed, pp. 9–23. At ⟨http://www.minneapolisfed.org/pubs/region/11-07/2010_Annual_Report.pdf⟩.

Peter Boone and Simon Johnson look at “Europe on the Brink.” “The problem the euro area faces is that creditors lent money to banks and the sovereign under the assumption that they would all be supported fully during periods of trouble. Led by Germany, the euro area is now switching from a ‘moral hazard’ regime to new arrangements under which all nations must fend for themselves. The stated reason is that these nations will otherwise spend too much and become insolvent. . . . It becomes increasingly likely that no lender of last resort exists in the euro area, making it more like a typical emerging market than a developed nation. Emerging markets succumb to defaults because they borrow in currencies which they cannot print. The defaults occur when the nation runs out of foreign currency with which to make payments on its debt. Such nations typically have low debt levels relative to income and modest short–term debt, compared with the 85 percent debt/gross domestic product average in the euro area. If the Germans get their way, we should compare euro area deficits and debt levels to emerging markets, not to other developed nations with their own printing presses and domestic debt.” Peterson Institute for International Economics Policy Brief Number PB11-13, July 2011. At ⟨http://www.iie.com/publications/pb/pb11-13.pdf⟩.

Anthony P. Carnevale and Stephen J. Rose discuss the problem of “The Undereducated American.” “For many years, the United States was the undisputed leader in educational expansion and had a significantly higher rate of college completion than any other country. . . . As other countries expanded their educational systems, our advantage narrowed. . . . More significantly for our future, the picture is bleaker for the United States among the 25–34 age group, which includes the majority of recent college graduates. Here, the United States ranks seventh in Bachelor’s degree completion (Norway is again first) and ninth in all tertiary degrees . . . Forty-two percent of U.S. 25- to 34-year-olds have college degrees, far below the 55 percent college degree completion rate attained by young adults in Canada, Japan, and South Korea. A clear trend has emerged: The United States is losing ground in postsecondary education relative to our competitors.” “Without enough talent to meet demand, we are losing out on the productivity that more postsecondary-educated workers contribute to our economy. Moreover, scarcity has driven up the cost of

postsecondary talent precipitously, exacerbating inequality." Georgetown University Center on Education and the Workforce. June 2011. At ⟨http://www9.georgetown.edu/grad/gppi/hpi/cew/pdfs/undereducatedamerican.pdf⟩.

The Council of Economic Advisers lays out the facts on "U.S. Inbound Foreign Direct Investment." "The United States continues to receive the most foreign direct investment (FDI) of any country in the world. . . . . U.S. 'majority-owned' affiliates of foreign corporations owned $11.7 trillion in U.S. assets and had $3.5 trillion in annual sales in 2008, according to the most recently available data from the Bureau of Economic Analysis. Their value-added production within the United States was $670 billion in goods and services, which accounted for 5.9 percent of total U.S. private output. These firms employed 5.7 million U.S. workers, accounting for 5.0 percent of employment in the U.S. private workforce. . . . The U.S. affiliates of multinational companies are typically high-productivity firms that are major private-sector contributors to national efforts to innovate and build." June 2011. At ⟨http://www.whitehouse.gov/sites/default/files/microsites/cea_fdi_report.pdf⟩.

Mark J. McCabe discusses "Online Access and the Scientific Journal Market: An Economist's Perspective." "Online access to the scientific literature has transformed the distribution of the scientific literature. This literature is now easier to search and read, especially for the producers of new articles: the scientist authors affiliated with research institutions. Unfortunately, the cost of supporting this enterprise has not declined. Ironically, the same technologies that enable immediate access for readers also facilitate bundling and pricing policies by the major commercial publishers that exacerbate rather than alleviate the inflationary pricing trends of the pre-internet era." June 2011. ⟨http://sites.nationalacademies.org/PGA/step/PGA_063400⟩. In case you haven't heard, the American Economic Association decided earlier this year to make the *Journal of Economics Perspectives* freely available to all at the ⟨http://e-jep.org⟩ website—including the current issue and archives going back to the late 1990s.

International Trade

The U.S. International Trade Commission published the seventh update of its occasional report: *The Economic Effects of Significant U.S. Import Restraints*. "The United States is one of the world's most open economies. In 2010, the average U.S. tariff on all goods remained near its historic low of 1.3 percent . . . U.S. economic welfare, as defined by total public and private consumption, would increase by about $2.6 billion annually by 2015 if the United States unilaterally ended ('liberalized') all significant restraints quantified in this report. Exports would expand by $9.0 billion and imports by $11.5 billion. These changes would result from removing import barriers in the following sectors: sugar, ethanol, canned tuna, dairy products, tobacco, textiles and apparel, and other high-tariff manufacturing sectors." The report also includes a chapter on "U.S. and Global Supply Chains." "The value of U.S. manufacturers' purchases of imported inputs as a fraction of their total input

costs roughly quadrupled between 1980 and 2006. According to available data and Commission calculations, imported inputs account for over one-fifth of all intermediate inputs used in the most integrated U.S. industries, such as apparel, motor vehicles, and computers and electronic products. Since many of these goods are subsequently exported, the share of imported inputs that were embodied in U.S. merchandise exports more than doubled between 1977 and 2002." August 2011, ⟨http://www.usitc.gov/publications/332/pub4253.pdf⟩.

The Strategy, Policy, and Review Department of the IMF describes "Changing Patterns of Global Trade." "World trade has grown steadily since World War II, with the expansion accelerating over the past decade. Despite a post-crisis dip, the current level of world gross exports is almost three times that prevailing in the 1950s . . . With the exception of commodity-price booms in the 1970s and more recently in 2004–2008, commodity trade accounted for a declining share of this growth, with the share of noncommodity trade rising to more than 20 percent of global GDP in 2008." "[T]he foreign content imbedded in gross exports, also referred to as foreign value-added (FVA) exports as opposed to domestic value added (DVA) exports, has almost doubled since 1970, to 33 percent in 2005. . . . Growth in vertical specialization has accelerated more recently, increasing by more than 20 percent in the ten-year period up to 2005." "Trade in high-technology products tends to grow faster than average, and has larger spillover effects on skills and knowledge-intensive activities. The process of technological absorption is not passive but rather 'capability' driven and depends more on the national ability to harness and adapt technologies rather than on factor endowments." June 15, 2011. ⟨http://www.imf.org/external/np/pp/eng/2011/061511.pdf⟩.

Greg Linden, Jason Dedrick, and Kenneth L. Kraemer discuss "Innovation and Job Creation in the Global Economy: The Case of Apple's iPod." "[W]e analyze the iPod, which is manufactured offshore using mostly foreign-made components. In terms of headcount, we estimate that, in 2006, the iPod supported nearly twice as many jobs offshore as in the United States. Yet the total wages paid in the United States amounted to more than twice as much as those paid overseas. Driving this result is the fact that Apple keeps most of its research and development (R&D) and corporate support functions in the United States, providing thousands of high-paid professional and engineering jobs that can be attributed to the success of the iPod." *Journal of International Commerce and Economics*, May 2011, pp. 223–40. ⟨http://www.usitc.gov/journals/08_LindenDedrickKraemer_InnovationJobCreationiPod.pdf⟩.

Interviews with Economists

Tom Keen interviews Nouriel Roubini. On the U.S. exchange rate: "Countries running current account surpluses can keep on accumulating reserves, and thereby prevent the appreciation of their currencies. By contrast, countries with deficits eventually run out of foreign exchange reserves, or the bond vigilantes impose discipline. The one exception is the United States: because the dollar is the major reserve

currency, we can run larger deficits for longer. If the dollar didn't have reserve status, it would have collapsed a long time ago." On overinvestment in China: "In China today, half of GDP is in the form of fixed investment, while consumption is only 35 percent—and falling. That is not sustainable because no country can productively invest half its GDP for very long. Historically, every case of over-investment—the Soviet Union, East Asia in the 90s—has ended in a hard landing." On U.S. corporate investment: "Corporations have used the crisis to cut costs, especially labor costs. They're highly profitable and productive: earnings are going to be surprising. They are sitting on $2 trillion in cash in the U.S. alone. But they are not spending it. And even if they start to spend, it's not clear why they'd choose to invest in slow-growing advanced economies rather than fast-growing emerging markets. One reason they're not spending more is excess capacity: roughly a quarter of industrial capacity is currently not used. Why would you want to do a lot of investment where there is excess capacity?" An edited transcript is at "Thinking Globally with Nouriel Roubini," *Milken Institute Review,* Third Quarter 2011, pp. 65–74, which is available (with free registration) at ⟨http://www.milkeninstitute.org/publications/⟩. Or you can watch the entire interview at ⟨http://www.milkeninstitute.org/events/gcprogram.taf?function=detail&EvID=2569&eventid=GC11video⟩.

Douglas Clement does an "Interview with Ricardo Caballero." Here's Caballero on why it makes no sense to address moral hazard concerns in the middle of a financial crisis: "I draw an analogy between panics and sudden cardiac arrest. We all understand that it's very important to have a good diet and good exercise in order to prevent cardiac arrest. But once you're in a seizure, that's a totally secondary issue. You're not going to solve the crisis by improving the diet of the patient. You don't have time for that. You need a financial defibrillator, not a lecture. . . . This moral hazard perspective is the equivalent of discouraging the placement of defibrillators in public places out of concern that, upon seeing them, people would have a sudden urge to consume cheeseburgers because they would realize that their chances of surviving sudden cardiac arrest had risen as a result of the ready access to defibrillators. But actual behavior is less forward-looking and rational than is implied by that logic. People indeed consume more cheeseburgers than they should, but this is more or less independent of whether or not defibrillators are visible. Surely there is a need for advocating healthy habits, but no one in their right mind would propose doing so by making all available defibrillators inaccessible. Such a policy would be both ineffective as an incentive mechanism and a human tragedy when an episode of sudden cardiac arrest occurs." *The Region,* Federal Reserve Bank of Minneapolis, June 2011, pp. 29–41, at ⟨http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=4665⟩. This issue of *The Region* also contains some discussion of Caballero's article "Macroeconomics after the Crisis: Time to Deal with the Pretense-of-Knowledge Syndrome," which ran in the Fall 2010 issue of the *Journal of Economic Perspectives.*

David A. Price interviews Bruce Yandle, who tells the story of his "bootlegger and the Baptist" metaphor for regulation. "That was the story of two groups who favor restrictions on the sale of alcoholic beverages on Sunday. The Baptists take

the moral high ground; they would like to see a diminution in the consumption of alcoholic beverages. The bootlegger just wants to get rid of competition one day a week. I called it bootlegger and Baptists for alliterative purposes. It could have been called 'bootlegger and Methodists' and you would have the same story." "I was working on the White House staff reviewing newly proposed regulations during the end of the Ford administration and the first part of the Carter administration, in a unit of the Council on Wage and Price Stability. My beat was the EPA. I reviewed the copper smelter standards. I would get their big regulatory bundles and review them, and we would make comments in an attempt to try to reduce the cost of accomplishing the goal. EPA had an excellent economic analysis. The last section said when this regulation becomes final, there will never be another copper smelter built in the United States of America. How would you feel if you had a copper smelter? You'd just been told you will never have any new competition." "Interview: Bruce Yandle," *Region Focus,* Federal Reserve Bank of Richmond, Second Quarter 2011, pp. 32–35, at ⟨http://www.richmondfed.org/publications/research/region_focus/2011/q2/pdf/interview.pdf⟩.

Discussion Starters

Michael Giberson offers a nice readable essay on "The Problem with Price Gouging Laws." State laws against price gouging are a fairly recent development: "The first state law explicitly directed at price gouging was enacted in New York in 1979, in response to increases in home heating oil prices during the winter of 1978–1979. . . . Just three states passed similar laws in the 1980s: Hawaii in 1983, and Connecticut and Mississippi in 1986. Then, 11 more states added anti-price gouging laws or regulations in the 1990s and 16 states followed in the 2000s." "If prices rise during an emergency, people have an incentive to buy only what they need, and not to stock up. . . . Imagine a situation in which prices of hotel rooms are not allowed to rise, at a time when many evacuated families are looking for a room. A large family might reserve two rooms at the capped rate, but decide to crowd into one room at a higher rate–thus leaving a room available for another family." "Price gouging laws . . . impose larger costs on smaller firms, who have a harder time getting resupplied, than they do on large national chains that have a built-in ability to shift supplies from elsewhere." *Regulation*, Spring 2011, pp. 48–53. At ⟨http://www.cato.org/pubs/regulation/regv34n1/regv34n1-1.pdf⟩.

Carmen M. Reinhart, Jacob F. Kirkegaard, and M. Belen Sbrancia make a case for "Financial Repression Redux: Governments Are Once Again Finding Ways to Manipulate Markets to Hold Down the Cost of Financing Debt." "Financial repression occurs when governments implement policies to channel to themselves funds that in a deregulated market environment would go elsewhere. . . . One of the main goals of financial repression is to keep nominal interest rates lower than they would be in more competitive markets. Other things equal, this reduces the government's interest expenses for a given stock of debt and contributes to deficit reduction.

However, when financial repression produces negative real interest rates (nominal rates below the inflation rate), it reduces or liquidates existing debts and becomes the equivalent of a tax—a transfer from creditors (savers) to borrowers, including the government . . ." "Financial repression contributed to rapid debt reduction following World War II. . . . It seems probable that policymakers for some time to come will be preoccupied with debt reduction, debt management, and efforts to keep debt servicing costs at a reasonable level. In this setting, financial repression, with its dual aims of keeping interest rates low and creating or maintaining captive domestic audiences, will continue to find renewed favor, and the measures and developments we have described and discussed are likely to be only the tip of a very large iceberg." *Finance & Development*, June 2011, pp. 22–26. At ⟨http://www.imf.org/external/pubs/ft/fandd/2011/06/reinhart.htm⟩.

Leo Melamed tells the story of "Milton Friedman's 1971 Feasibility Paper": "In 1971, as chairman of the Chicago Mercantile Exchange, I had an idea: a futures market in foreign currency. It may sound so obvious today, but at the time the idea was revolutionary. I was acutely aware that futures markets until then were primarily the province of agriculture and—as many claimed—might not be applicable to instruments of finance. Not being an economist, the idea was in need of validation. There was only one person in the world that could satisfy this requisite for me. We went to Milton Friedman. We met for breakfast at the Waldorf Astoria in New York. By then he was already a living legend and I was quite nervous. I asked the great man not to laugh and to tell me whether the idea was 'off the wall.' Upon hearing him emphatically respond that the idea was 'wonderful,' I had the temerity to ask that he put his answer in writing. He agreed to write a feasibility paper on 'The Need for Futures Markets in Currencies,' for the modest stipend of $7,500. It turned out to be a helluva trade." The Fall 2011 issue of the *Cato Journal* includes both Melamud's short reminisce and publishes Friedman's 1971 paper, "The Need for Futures Markets in Currencies," for what I think is the first time. Available at ⟨http://www.cato.org/pubs/journal/⟩.