

## Recommendations for Further Reading

Timothy Taylor

**T**his 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, c/o *Journal of Economic Perspectives*, Macalester College, 1600 Grand Ave., Saint Paul, Minnesota, 55105.

### Reports

The *World Development Report 2005* from the World Bank takes as its theme, “A Better Investment Climate for Everyone.” “Costs associated with weak contract enforcement, inadequate regulation, crime, corruption and regulation can amount to over 25 percent of sales—or more than three times what firms typically pay in taxes.” The findings draw from two new surveys recently launched by the World Bank. The Investment Climate Surveys cover more than 26,000 firms in 53 countries, which together employ 4.8 million people. The Doing Business Project “reports on the costs of doing business for a defined hypothetical firm and transaction based on the views of selected experts (lawyers, accountants)” in over 130 countries. Available at (<http://econ.worldbank.org/wdr>).

The Food and Agriculture Organization publishes an annual “The State of Food Insecurity in the World.” Jacques Diouf, the Director General of the FAO, writes in the Foreword: “[O]ne child dies every five seconds as a result of hunger

■ *Timothy Taylor is Managing Editor, Journal of Economic Perspectives, based at Macalester College, Saint Paul, Minnesota. His e-mail address is <[taylorl@macalester.edu](mailto:taylorl@macalester.edu)>.*

and malnutrition . . . . Every child whose physical and mental development is stunted by hunger and malnutrition stands to lose 5 to 10 percent in lifetime earnings. On a global scale, every year that hunger persists at current levels causes deaths and disability that will cost development countries future productivity with a present discounted value of \$500 billion or more.” Despite gains against hunger in China and India, “[d]uring the second half of the [1990s] decade, the number of chronically hungry in developing countries increased at a rate of almost 4 million a year . . . .” Available at [http://www.fao.org/sof/sofi/index\\_en.htm](http://www.fao.org/sof/sofi/index_en.htm)).

The World Trade Organization has published its *World Trade Report 2004*, with the theme “Exploring the Linkage Between the Domestic Policy Environment and International Trade.” It includes chapters relating trade to domestic policies on macroeconomics, infrastructure, competition and governance. It also includes an interesting essay (pp. 46–71): “The liberalization of services trade through the temporary movement of natural persons,” which the WTO calls “Mode 4 trade.” “There are a variety of measures that constitute barriers to Mode 4 trade. With a view to protecting local labor markets, many countries have introduced quantitative restrictions on the movement of workers and/or economic needs tests . . . . The issuance and renewal of visas and work permits is often cumbersome and expensive, resulting in costs for both employers and foreign employees . . . . Estimates of the economic impact of trade liberalization suggest the possibility of annual gains from Mode 4 liberalization ranging between \$150 billion and \$200 billion . . . .” Available at [http://www.wto.org/english/news\\_e/pres04\\_e/pr385\\_e.htm](http://www.wto.org/english/news_e/pres04_e/pr385_e.htm)).

The National Commission on Energy Policy has published “Ending the Energy Stalemate: A Bipartisan Strategy to Meet America’s Energy Challenges.” The report is structured around a revenue-neutral list of policy proposals, including: “Increase and diversify world oil production and expand global network of strategic petroleum reserves”; “Reform and significantly strengthen vehicle efficiency standards”; “Establish a mandatory, economy-wide, tradable permits program to limit greenhouse gas emissions”; and “Update and expand efficiency standards for new appliances, equipment and buildings.” William A. Pizer of Resources for the Future served as the Senior Economist for the report. December 2004. The report is available at <http://www.energycommission.org>. The website also includes links to technical appendices, including an “Economic Analysis of Commission Proposals” that offers some discussion of the National Energy Modeling System of the Energy Information Administration, as well as dozens of internal staff analyses and white papers by outside experts.

## **Smorgasbord**

In a useful pro and con, Frederic S. Mishkin argues for “Why the Federal Reserve Should Adopt Inflation Targeting,” and Benjamin M. Friedman responds, “Why the Federal Reserve Should Not Adopt Inflation Targeting.” Mishkin argues: “Inflation targeting has many of the useful features of the current Federal Reserve

approach. It is forward-looking, uses all information in deciding on the setting of policy instruments and does focus on achieving long-run price stability. However, it goes beyond the current Federal Reserve approach and this provides several advantages . . . . Framing the discussion of monetary policy around an inflation goal makes it easier for the Federal Reserve to communicate with the public and the markets . . . . It can help focus the public debate on what a central bank can do in the long-run—that is, control inflation, rather than on what it cannot do, which is permanently increase economic growth and the number of jobs through expansionary monetary policy.” Friedman answers: “The empirical case for the value added by inflation targeting in terms of a country’s macroeconomic performance, especially for a country that is already experiencing low inflation to begin with, is unproved to say the least. More importantly, I believe the claims made for inflation targeting at the conceptual level—in particular, that inflation targeting usefully enhances the transparency of monetary policy—are not just unproved, but false. To the contrary, as actually practiced, inflation targeting is a framework not for communicating the central bank’s goals but for obscuring them.” *International Finance*, Spring 2004. Also available at the Council on Foreign Relations website at <http://www.cfr.org> by clicking on “Economics, Finance and Trade.”

James J. Heckman and Dimitriy V. Masterov present “The Productivity Argument for Investing in Young Children” in a paper written for the Committee on Economic Development. “Early environments play a large role in shaping later outcomes. Skill begets skill and learning begets more learning. Early advantages cumulate; so do early disadvantages . . . . At current levels of public support, America under-invests in the early years of its disadvantaged children. Redirecting additional funds toward the early years, before the start of traditional schooling, is a sound investment in the productivity and safety of our society.” October 4, 2004. For the paper by Heckman and Masterov, see [http://www.ced.org/docs/report/report\\_ivk\\_heckman\\_2004.pdf](http://www.ced.org/docs/report/report_ivk_heckman_2004.pdf).

In a shorter September 2004 Working Paper, the Committee for Economic Development also published “A New Framework for Assessing the Benefits of Early Education.” “The current cost-benefit analyses of early education provide a good ‘first look’ . . . [but] these analyses exclude some of the conceptually important benefits . . . . However, the broader analytical framework suggests that additional social benefits—such as dynamic family, community, and intergenerational benefits, stronger tax bases, and health and happiness of participants—may exist.” Available at [http://www.ced.org/docs/report/report\\_preschool\\_2004\\_assessingbenefits.pdf](http://www.ced.org/docs/report/report_preschool_2004_assessingbenefits.pdf).

In “Measuring Labor’s Share of Income,” Paul Gomme and Peter Rupert argue: “Recent Bureau of Labor Statistics (BLS) data show labor’s share of income at a historic low. . . . While data limitations prohibit replication of the BLS series, alternative measures of labor’s share of income, based on either the nonfinancial corporate business sector or the macroeconomy more generally, are near their historic averages, quite unlike the BLS series.” Federal Reserve Bank of Cleveland, Policy Discussion Paper, November 2004, Number 7.

The Council of Economic Advisers has published "Growth-Indexed Bonds: A Primer." "This paper discusses a proposal for countries to issue growth-indexed bonds, an instrument that could stabilize economic growth rates, reduce vulnerability to external shocks, and improve long-term development prospects." November 22, 2004. Available at (<http://www.whitehouse.gov/cea/pubs.html>).

In "The Fable of Federal Environmental Regulation: Reconsidering the Federal Role in Environmental Protection," Jonathan Adler argues: "The conventional fable is that federal environmental regulation was necessary because states failed to adopt adequate environmental measures. This account ignores the substantial environmental progress in many areas prior to the enactment of most major federal environmental laws. The EPA's first national water quality inventory, conducted just one year after adoption of the Clean Water Act, found that there had been substantial improvement in water quality in major waterways over the preceding decade . . . . There are similar patterns of state and local action preceding federal action in other areas as well . . . . Several studies of air pollution find evidence of significant environmental improvement prior to the adoption of federal environmental regulation." Adler concludes: "It is in some senses an historical accident that state leadership in environmental policy was supplanted by federal regulation, and environmental policy could be improved if states regained more of their historic role." *Case Western Reserve Law Review*, Fall 2004, 55, 93–113.

The Fall 2004 issue of *JEP* included a Policy Watch column by Howard Kunreuther and Erwann Michel-Kerjan on "Challenges for Terrorism Risk Insurance in the United States." In January 2005, the Congressional Budget Office published "Federal Terrorism Reinsurance: An Update," which analyzes the effects of the Terrorism Risk Insurance Act passed into law in November 2002 and scheduled to expire at the end of 2005. "In sum, as the Congress considers whether to extend TRIA (and in what form), it is useful to consider what has changed in the two years since the law was enacted. The most significant development seems to be a growing sense that the terrorism threat to the United States will continue for the foreseeable future. That development suggests that the economy, especially the stock of physical capital, needs to be responsive to the prospective losses from terrorist attacks. For example, new construction might be designed, located, and built to withstand such attacks. Existing structures might need to be retrofitted with safety features. Those needs argue against extending the TRIA program in its current form, which subsidizes insurance and dampens incentives for mitigation activities."

The Spring 2004 issue of this journal included a two-paper symposium on consumer confidence. In "The Political (and Economic) Origins of Consumer Confidence," Suzanna De Boef and Paul M. Kellstedt present evidence while economic factors play a large role in explaining consumer confidence, political factors matter, too. For example, "Controlling for economic conditions, news coverage of the economy affects how citizens view the president's ability to manage the economy, which in turn has both a long-run and a short-run effect on consumer sentiment." *American Journal of Political Science*, October 2004, 48:4, 633–649.

A new electronic journal, *Economists' Voice*, "is a non-partisan forum for economists to present innovative policy ideas or engaging commentary on the issues of the day. Readers include professional economists, lawyers, policy analysts, policy-makers, and students of economics. Articles are short, 600–2000 words, and intended to contain deeper analysis than is found on the Op-Ed page of the *Wall Street Journal* or *New York Times*, but to be of comparable general interest." As a supplement to the symposium on Social Security in this issue of *JEP*, Paul Krugman contributes "Confusions about Social Security" on December 29, 2004, while Edward P. Lazear counters with "The Virtues of Personal Accounts for Social Security" on January 24, 2005. The journal's home page is (<http://www.bepress.com/ev/>).

## Outsourcing

In the Fall 2004 issue of *JEP*, Jagdish Bhagwati, Arvind Panagariya and T.N. Srinivasan wrote about "The Muddles over Outsourcing." Many other authors have recently tackled the subject, as well.

Mary Amityi and Shang-Jin Wei have written "Demystifying Outsourcing: The numbers do not support the hype over job losses." They point out that while the U.S. economy has the largest absolute level of imports and exports of business services of any country, it is by no means the highest in relative terms. "U.S. business service imports as a share of GDP [are] . . . 0.4 percent in 2003. In the United Kingdom, the share is about 1 percent of GDP. India, reported to be the recipient of significant outsourcing, itself outsources a large amount of services. Its [imports of] business services grew from 0.5 percent of GDP in 1985 to almost 2.5 percent of GDP in 2003." *Finance and Development*, December 2004, 36–39.

Martin N. Baily and Diana Farrell address the question: "Is your job headed for Bangalore? The Myths and Realities of Outsourcing." "We looked into what happens to a dollar of U.S. corporate spending when a company moves a service job to India. We found that, far from being a zero-sum game, offshoring is a story of mutual gain, benefiting both countries . . . Thus, far from being bad for the United States, offshoring creates net value for the economy—to the tune of \$1.12 to \$1.14 for every dollar that goes abroad." *Milken Institute Review*, Fourth Quarter 2004, 33–41.

*The Economist* chips in with one of its sterling surveys: "A world of work: A survey of outsourcing." In the course of arguing that "The global deployment of work has its critics, but it holds huge opportunities for rich and poor countries alike," author Ben Edwards offers a number of intriguing comments and anecdotes about specific firms involved in both domestic and foreign outsourcing of goods and services. For example, "ADP, a payroll-outsourcing company, pays one in six private-sector workers in America." "[A]lthough the opportunity to source large amounts of white collar work from low-cost countries has arisen quite suddenly, the work will in fact move over gradually. This will give rich economies time to adjust to new patterns of work, and should keep the politics of change manageable. But from time to time, ugly protectionism is sure to flare up again." November 13, 2004.

In the *Regional Review* published by the Federal Reserve Bank of Boston, Jane Sneddon Little discusses “Outsourcing jobs overseas: A cause for concern?” “Foreign outsourcing has also helped U.S. firms to lower their computer hardware, software, and other input costs by obtaining these items offshore. These cost reductions have given the U.S. economy an indirect boost by allowing firms to attract business they otherwise would not have had and therefore to employ people they otherwise would not have employed. Analysts do not know how many outsourcing-related hires have offset the 1 million outsourcing-related layoffs over this period. But it is clearly wrong to compare the estimated 1 million gross layoffs caused by outsourcing with the net loss of 2 million jobs [for the U.S. economy as a whole] between late 2000 and late 2003. This would be like comparing an apple with half an orange.” Q2/Q3, 2004, 3–6.

## **The Neutral Federal Funds Rate**

How high does the federal fund interest rate need to rise to reach its “neutral” or “equilibrium” rate? After raising the target for the federal funds rate to 2.5 percent on February 2, 2005, the Federal Open Market Committee stated at <http://www.federalreserve.gov/boarddocs/press/monetary/2005/20050202> that “even after this action, the stance of monetary policy remains accommodative” and “that policy accommodation can be removed at a pace that is likely to be measured.”

The *OECD Economic Outlook* cites one estimate for the neutral federal funds rate: “In the U.S. case, the Kalman filter methodology applied on four decades of data suggests that since the 1960s the neutral short-term [real] interest rate has fluctuated between 2 and 5 per cent, and that in the third quarter of 2004 it stood at 2.1 per cent.” “I: General Assessment of the Macroeconomic Situation,” December 2004, 76, 8–66.

However, Federal Reserve Vice Chairman Roger W. Ferguson Jr., in a lecture on “Equilibrium Real Interest Rate: Theory and Application,” emphasizes that “while the concept of the equilibrium real rate is a useful aid in thinking about setting monetary policy, it is not measured and observed with such precision as to provide a practical guide to the appropriate stance of policy. October 29, 2004. Available at: <http://www.federalreserve.gov/boarddocs/speeches/2005/>).

## **About Economists**

Laura Wallace interviews Amartya Sen and then writes of his life and career in “Freedom as Progress.” Sen takes the opportunity to clear up some misunderstandings: “I am often misquoted, but I am not antiglobalization. I am very proglobalization! I believe that globalization is such a good thing that it would be awfully bad if only some people benefited from it and not others. We need to improve the

distribution of benefits between and within countries, between classes, and between urban and rural areas—and that can be done by expanding opportunities.” When asked why he has typically avoided counseling governments directly, Sen answers: “I like arguing rather than dispensing privileged advice, but I also think social change comes best from public argument.” *Finance and Development*, September 2004, 4–7.

Gary Stern has a far-ranging and cordial “Interview with Jean-Claude Trichet,” president of the European Central Bank. On the issue of the ECB’s annual inflation targets, Trichet says: “[W]e had to clarify that last year because there was some academic guessing that it could mean a band of zero to 2 [percent annual inflation], with a medium point at 1 . . . . We clarified that it meant less than 2 and close to 2, in the medium run.” When asked whether Europeans work fewer hours because of personal choice or as a reaction to taxes and regulations, Trichet answers: “I would place more weight on labor laws, government regulations and taxation than on the free decision by the people. Perhaps there is nevertheless some cultural divide that might be part of the explanation.” When asked about the growing role of China and India in the world economy, Trichet states: “[I]t is key to have better participation of China, India and a number of other emerging economies in our own discussions. As we do, at the level of central banks, in the global economy meeting that we hold every two months in Basel . . . . The fact that China and India have at present their own specializations, that one is more specialized in manufacturing goods and the other is more inclined toward services and IT [information technology] services is also very striking . . . .” *The Region*, Federal Reserve Bank of Minneapolis, December 2004, 15–23.

Seymour Melman, the Columbia University economist who was well-known for his arguments against defense spending and in favor of economic conversion, died on December 16, 2004. The *New York Times* obituary notes that he popularized the use of the word “overkill” in referring to the buildup of nuclear weapons. He wrote in a letter to the *Times* in 1964: “Isn’t 1,250 times overkill enough? Since the Soviets by similar calculation can overkill the United States only 145 times, are we to believe that any advantage exists here for either side?” Soon after his death, the Department of Industrial Engineering & Operations Research at Columbia published a notice that included this quotation from Melman: “The joy of accomplishing production. It’s a great thing. The work I’ve been doing for some time is writing an article, writing a book, or researching something. It’s an accomplishment. It’s a great thing. No, more exactly, it’s living. It’s being alive. To be productive is to be alive.” Jennifer Bayot, “Seymour Melman, 86, Dies; Spurred Antiwar Movement.” *New York Times*, December 18, 2004.

Roger W. Garrison, who served as president of the Society for the Development of Austrian Economics in 2004, offers “A Roundabout Approach to Macroeconomics: Some Autobiographical Reflections.” He describes a roundabout career path: a BS in electrical engineering and working for an electrical utility; four years as a systems engineer in the Air Force during the Vietnam war; an attempt to reenter the civilian economy by getting a master’s degree in economics; writing a paper on Austrian macroeconomics that caught the attention of Murray Rothbard; a job at



the Kansas City Federal Reserve in the division “where applications for the acquisition of banks by bank holding companies were processed”; the Ph.D. program at the University of Virginia, where he studied with Leland Yeager; and then on to Auburn University. As he writes: “The progression of my own studies from the sinusoidal rhythms of alternating current to the cyclical fluctuations of a mixed economy was a roundabout one . . . .” *American Economist*, Fall 2004, 48:2, 26–40.

### **From the Popular Press**

“Less than two weeks after a 40-foot wave flattened massive swaths of Southeast Asia, the United States slapped a tariff on millions of dollars worth of seafood imports from India and Thailand. As the federal government promised \$350 million, and private citizens pledged even more, the message to surviving shrimp farmers was clear: Have our marines, our pity, and our cash, but for the love of God, do not send us your cheap shrimp.” Kerry Howley, “All That Have Not Fins and Scales,” *Reason Online*, January 20, 2005. Available at (<http://www.reason.com/links/links012005.shtml>).