

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

### Potpourri

William Easterly delivered a lecture on “Planners vs. Searchers in Foreign Aid” to the Distinguished Speakers Program of the Asian Development Bank. He begins: “Seventeen years after the fall of the Berlin Wall, there is only one major area of the world in which central planning is still seen as a way to achieve prosperity—countries that receive foreign aid. Behind the Aid Wall that divides poor countries from rich, the aid community is awash in plans, strategies, and frameworks to meet the very real needs of the world’s poor. These exercises only make sense in a central planning mentality in which the answer to the tragedies of poverty is a large bureaucratic apparatus to dictate quantities of different development goods and services by administrative fiat. . . . This is bad news for the world’s poor, as historically poverty has never been ended by central planners. It is only ended by “searchers,” both economic and political, who explore solutions by trial and error, have a way to get feedback on the ones that work, and then expand the ones that work, all of this in an unplanned, spontaneous way. Examples of searchers are firms in private markets and democratically accountable

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politicians.” Asian Development Bank, January 18, 2006, ([http://www.adb.org/Economics/speakers\\_program/easterly.pdf](http://www.adb.org/Economics/speakers_program/easterly.pdf)).

Lant Pritchett writes: “The Quest Continues: After decades of growth research, what can academic economists really say about policy?” “While the contribution of the new growth models to the internal logic of the economics discipline has been lasting, the bloom came off the rose of the explicit use of new growth models for policy purposes in developing countries relatively quickly. . . . The new growth literature focused on the very long run and on incentives for expanding the technological frontier—not particularly useful for most developing countries, whose primary interest was in restoring short- to medium-term growth and accelerating technological catchup by adopting known innovations. . . . Given the dramatic failures in growth research, I would like to conclude by pointing to a new direction for future research. . . . All of the empirical stylized facts about cross-national growth can be matched with an encompassing model with five states. Each state is characterized by the typical rate of growth and level of income: advanced industrial (high income, steady growth) and poverty trap (low income, no growth) are two extremes, with low- and middle-income countries having three other possible states: rapid convergence, nonconverging growth, and collapse. . . . This is an ambitious agenda for growth research because rather than a single growth theory, there is a collection of growth theories (for each state) and transition theories (potentially one theory from each state to each other state).” *Finance and Development*, March 2006, pp. 18–22. At (<http://www.imf.org/external/pubs/ft/fandd/2006/03/pritchet.htm>).

In the face of the conventional wisdom about the merits of inflation targeting by central banks, William R. White asks, “Is price stability enough?” “It will be argued in this paper that price stability is indeed desirable for a whole host of reasons. At the same time, it will also be contended that achieving near-term price stability might sometimes not be sufficient to avoid serious macroeconomic downturns in the medium term. . . . The core of the problem is that persistently easy monetary conditions can lead to the cumulative build-up over time of significant deviations from historical norms—whether in terms of debt levels, saving ratios, asset prices or other indicators of ‘imbalances’. The historical record indicates that mean reversion is a common outcome, with associated and negative implications for future aggregate demand.” Bank for International Settlements, BIS Working Papers No. 205, April 2006, (<http://www.bis.org/publ/work205.pdf>).

The *International Productivity Monitor* presents a “Symposium on the Boskin Commission Report after a Decade,” with contributions from Jack E. Triplett, Robert J. Gordon, John S. Greenlees, Ernst R. Berndt and Martin Neil Baily. Gordon, who was a member of the Boskin commission, writes: “Thus my own retrospective view is that the upward bias in the CPI in 1995–96 was if anything higher than the Boskin estimate of 1.1 percentage points and was perhaps 1.2 or 1.3 percentage points. . . . What is my own estimate of the current CPI bias? . . . [E]vidence suggests that category and item substitution bias appears to remain at about 0.4 percentage points per year, outlet substitution bias remains at about 0.1 percentage points per year, and bias attributable to quality change and new

products has been reduced . . . [to] perhaps 0.3 percentage points primarily as a result of the switch from input prices to treatment prices for medical care. This sums to 0.8 percentage points per year.” Spring 2006, (<http://www.csls.ca/ipm.asp>). This issue of the *International Productivity Monitor* provides a useful follow-up to two previous JEP symposia on measurement of the Consumer Price Index: the “Symposium on Measuring the CPI” in the Winter 1998 issue, in the aftermath of the Boskin report, and the “Symposium on the Consumer Price Index” in the Winter 2003 issue.

In “Who Pays the Property Tax?” George R. Zodrow contrasts the “Benefit Tax View” that “Property tax is effectively an efficient user charge for local public services” with the “Capital Tax View” that “Property tax is a distortionary tax on the use of capital.” He concludes: “Instead, the key issue is whether the zoning restrictions or other mechanisms stressed by proponents of the benefit tax view are sufficiently binding to preclude the long-run adjustments in housing capital predicted by the capital tax view. This issue promises to be a fertile topic for future research, which may help clarify the answer to the long-standing and critical question of who pays the residential property tax.” *Land Lines*, Lincoln Institute of Land Policy, April 2006, pp. 14–19. (<http://www.lincolninst.edu/pubs/pub-detail.asp?id=1115>).

The Government Accountability Office investigates “Employee Compensation: Employer Spending on Benefits Has Grown Faster than Wages, Due Largely to Rising Costs for Health Insurance and Retirement Benefits.” The report begins: “Private employers’ average real cost of total compensation (comprising wages and benefits) for current workers grew by 12 percent between 1991 and 2005. The real costs of benefits grew by close to 18 percent, while real wages grew by 10 percent. Wages and benefits increased by about the same percentage for most of the period until 2002, after which time real wages began to stagnate and real benefit costs continued to grow.” GAO-06-285, February 2006. At (<http://www.gao.gov/new.items/d06285.pdf>).

The Federal Trade Commission and the U.S. Department of Justice have jointly published a “Commentary on the Horizontal Merger Guidelines.” The commentary is divided into four sections: Market Definition and Concentration; The Potential Adverse Competitive Effects of Mergers; Entry Analysis; and Efficiencies. Throughout the discussion, the current thinking of the antitrust enforcement agencies is illustrated with brief case histories. March 2006, (<http://www.ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch2006.pdf>).

*Theoretical Economics*, a new web-based journal in economic theory, published its first issue in March 2006. The journal is open access, which means that all articles are freely available. It is funded by memberships in the Society for Economic Theory and by submission fees. The coeditors are Jeffrey C. Ely, Edward Green, Barton L. Lipman and Martin J. Osborne. At (<http://econtheory.org>).

## The New Paternalism

*The Economist* magazine highlights “the new paternalism.” “The behaviouralists claim to understand people as they are, not as economists hitherto assumed them

to be. Because of ignorance or intemperance, lack of willpower or brainpower, people choose badly. Predictably so. . . . There are many ways for a government to queer the pitch in favour of one social result (more saving, less smoking) or another. . . . Something must serve as the default option, something must come top of the menu, and information, if it is to be provided at all, must be framed in one way or another. The soft paternalists want the government to use these tools knowingly, in favour of the outcome its citizens themselves would prefer if only they had the necessary discipline and discernment.” April 8, 2006, pp. 67–69.

In “Improving Opportunities and Incentives for Saving by Middle- and Low-Income Households,” William G. Gale, Jonathan Gruber and Peter R. Orszag present a proposal to encourage personal saving in this way. From the abstract: “First, we would require every firm (with possible exceptions for the smallest businesses) to enroll its new workers automatically in at least one plan: a traditional defined benefit plan, a 401(k), or an IRA. Businesses also would be required to set various features of the plans in a “pro-saving” manner, although workers always would have the option to override those “pro-saving” defaults. Second, our proposal would replace current tax deductions for contributions to tax-preferred retirement accounts with a new program providing universal matching contributions from the government for household deposits to 401(k)s and IRAs.” (Full disclosure: I was an outside editor on this paper.) *Hamilton Project White Paper 2006-02*, April 2006. At [http://www.brookings.edu/views/papers/200604hamilton\\_2.pdf](http://www.brookings.edu/views/papers/200604hamilton_2.pdf).

On the other side, Glen Whitman offers some cautionary words in “Against the New Paternalism: Internalities and the Economics of Self Control.” From the Executive Summary: “Specifically, internality theory in its current form unjustifiably “takes sides” when it chooses to favor some personal interests over others. Furthermore, it ignores the possibility of within-person bargaining and other private solutions to self-control problems. Finally, it gives insufficient attention to the possibility of government failure. Taking those objections into account severely damages the case for paternalistic government intervention to address problems of self-control.” Cato Institute Policy Analysis No. 563, February 22, 2006. At [http://www.cato.org/pub\\_display.php?pub\\_id=5531](http://www.cato.org/pub_display.php?pub_id=5531).

## **From International Institutions**

The World Bank asks *Where is the Wealth of Nations? Measuring Capital for the 21st Century*. The report provides “what could be termed the *millennium capital assessment*: monetary estimates of the range of assets—produced, natural, and intangible—upon which development depends.” Estimates are provided for 120 countries. A number of interesting results emerge. For example, for low-income countries, excluding oil states, “natural capital is an important share of total wealth, greater than the share of produced capital.” Also, the “wealth estimates suggest that the preponderant form of wealth worldwide is intangible capital—human capital and the quality of formal and informal institutions.” 2006. At <http://siteresources.worldbank.org/INTEEI/214578-1110886258964/20748034/All.pdf>.

In the April 2006 volume of its *World Economic Outlook*, the International Monetary Fund focuses on “Globalization and Inflation.” Chapter 2 offers an interesting discussion of “Oil Prices and Global Imbalances.” “The increase in the oil-import bill between 2002 and 2005 amounted to almost 4 percent of GDP for China, and over 1 percent of GDP for the United States, other advanced economies, and other developing countries. From the perspective of the global economy, nevertheless, the current shock is smaller than in the 1970s, whether measured relative to world GDP, private capital flows, or the size of financial markets. . . . [O]ver the past two years, higher oil prices account for one-half of the deterioration in the U.S. current account deficit.” At <http://www.imf.org/external/pubs/ft/weo/2006/01/index.htm>.

An Independent Expert Group on R&D and Innovation, headed by former prime minister of Finland Esko Aho, has published a report on “Creating an Innovative Europe” as background reading for the European Commission. “Europe must break out of structures and expectations established in the post-WW2 era which leave it today living a moderately comfortable life on slowly declining capital. This society, averse to risk and reluctant to change, is in itself alarming but it is also unsustainable in the face of rising competition from other parts of the world. For many citizens without work, or in less-favoured regions, even the claim to comfort is untrue.” January 2006. This report and related papers are available at the “Investing in Research” webpage of the European Union at <http://europa.eu.int/invest-in-research>.

## From the Federal Reserve Banks

In a paper that can serve as an accompaniment to the “Symposium on American Employment” in this issue, Todd E. Clark and Taisuke Nakata discuss “The Trend Growth of Rate of Employment: Past, Present, and Future.” From the summary: “They conclude that declines in the growth rates of population and labor force participation have caused the trend growth rate of employment to slow. Over the next ten years, a reasonable baseline projection for trend job growth is 1.1 percent per year, or about 120,000 jobs per month.” *Economic Review: Federal Reserve Bank of Kansas City, First Quarter 2006*, 91:1, pp. 43–85. <http://www.kc.frb.org/publicat/econrev/ermain.htm>.

Michael D. Bordo discusses “Globalization and Imbalances in Historical Perspective.” From the summary: “Global imbalances associated with the U.S. current account deficit have given rise to speculation about the nature of the impending adjustment: Will it be smooth and gradual, or will it be sudden and costly? This *Policy Discussion Paper* summarizes the two views and then considers three historical periods with similar pressures—an earlier era of globalization from 1870 to 1914, the interwar gold standard, and Bretton Woods. A comparison of the periods and their outcomes suggests current global imbalances might resolve themselves quietly.” Federal Reserve Bank of Cleveland, Policy Discussion Paper Number 13, January 2006. At <http://www.clevelandfed.org/Research/PolicyDis/PDP13.pdf>.

## About Economists

In an interview with Nathan Gardels, Milton Friedman offers characteristically strong comments on a range of issues. “The euro is going to be a big source of problems, not a source of help. The euro has no precedent. To the best of my knowledge, there has never been a monetary union, putting out a fiat currency, composed of independent states.” “It doesn’t worry me a bit that China and Japan hold so much US debt. In a way, it seems foolish for them to do it because they get lower returns than they might elsewhere. But that is their business.” “The only reason free markets have a ghost of a chance is that they are so much more efficient than any other form of organization. When you argue for free markets, you are arguing against the trend. When something goes wrong, the natural tendency is to say, ‘By God, we need to pass a law and do something.’ The argument for the free market is a complicated and sophisticated one and depends on demonstration of secondary effects. I have confidence market efficiency will win out. But . . . there is no doubt there will be tremendous pressure to pull in the government as the answer.” “Free Markets and the End of History,” *New Perspectives Quarterly*, Winter 2006, ([http://www.digitalnpq.org/archive/2006\\_winter/friedman.html](http://www.digitalnpq.org/archive/2006_winter/friedman.html)).

For more Milton Friedman, this time jousting with Robert Kuttner over health care, monetary policy, tax cuts, school vouchers and more, see “Agreeing to Disagree,” in the *American Prospect Online*, January 5, 2006, (<http://www.prospect.org/web/printfriendly-view.wv?id=10764>).

Aaron Steelman conducts an “Interview” with Tyler Cowen, whose research often focuses on the economics of culture. “In the mid-1960s, William Baumol and William Bowen advanced the hypothesis that the arts would experience lower productivity gains than other sectors of the economy, and therefore would suffer from the “cost disease.” The analysis gets a little complicated, but one thing I have tried to argue is that the initial assumption that productivity gains would be low simply isn’t true. If you look at music, in the last century we have seen the introduction of radio, compact discs, and now MP3 files. In addition, it’s easier than ever to order music through places like Amazon, and it’s cheaper to sample many different types of music. Also, the reduced cost of travel has made it more affordable to go to concerts and experience live music. So I think the cost of consuming music has fallen dramatically.” “I think that the American way of subsidizing the arts has mostly been indirect, through the tax treatment of nonprofit organizations, through the public funding of universities, through copyright laws. Those policies have done quite a bit to remedy the market failure problems that do, in fact, exist in the arts. But direct subsidies have not been at the forefront of the approach. And those direct subsidies, in purely quantitative terms, are very small.” Cowen also discusses his *Ethnic Dining Guide to the Washington D.C. Area*, now in its 19th edition, and the weblog at (<http://www.marginalrevolution.com>) that he runs with his colleague Alex Tabarrok. *Region Focus*: Federal Reserve Bank of Richmond, Winter 2006, pp. 50–55. At ([http://www.richmondfed.org/publications/economic\\_research/region\\_focus](http://www.richmondfed.org/publications/economic_research/region_focus)).

Edward L. Glaeser is profiled in “Home Economics,” by Jon Gertner.

Gertner writes: “Edward L. Glaeser . . . recently moved with his wife and young son to a house on six and a half acres in the affluent suburb of Weston, Mass. To Glaeser, this last move has been a big adjustment. For one thing, he is not a good driver, and the new commute has prompted him to leave his house by 6 a.m. so as not to get ensnared in the morning rush hour. For another, Glaeser and the suburbs are clearly an unholy marriage of sensibilities, especially since his new house is bordered by about 600 acres of conservation land. ‘I wake up every day, thinking, My goodness, how many units of housing could you build here?’ he says. Glaeser is a creature of density. . . . Unlike that of most other housing economists, Glaeser’s recent work on real estate addresses the issues of supply rather than of demand. He is far more interested in the forces shaping land development and residential building in the United States than in the forces shaping buyers’ motivations and actions. He views supply as crucial to appreciating what has happened to the U.S. real-estate market over the past 30 years.” *New York Times Magazine*, March 5, 2006. At <http://www.nytimes.com/2006/03/05/magazine/305glaeser.1.html?ex=1299214800&en=2c54fd804ddaf7ae&ei=5088&partner=rssnyt&emc=rss>).

Conny Lotze profiles Nora Lustig in “Economics with a Social Face.” Lustig says that in the past, “there was a sense that poverty reduction had to be done through growth, which seemed to imply that policy measures that aimed directly at poverty reduction weren’t as important. . . . But I think that we have shown that both are very important. If you want to reduce poverty more quickly with growth, you need policies that have a very profound impact on equalizing opportunities in many respects.” *Finance and Development*, December 2005, pp. 4–7. At <http://www.imf.org/external/pubs/ft/fandd/2005/12/people.htm>).

## Discussion Starters

In “Repopulating New Orleans,” Mason Gaffney discusses how Henry George’s land tax helped San Francisco regenerate after its epic fire of 1907. “Consider born-again San Francisco, 1907 to 1930, as a case study in success. What can it teach New Orleans? It had no state or federal aid to speak of. . . . Unlike Los Angeles (whose smog lay in the future) it had cold fog, cold-water beaches, no local fuel nor easy mountain passes to the east. Its rail and shipping connections were inferior to the major rail, port, and shipbuilding complex in rival Oakland, and even to inland Stockton’s. It was hilly; much of its flatter space was landfill, in jeopardy both to liquefaction of soil in another quake and to precarious land titles. Its great bridges were unbuilt, so it was more island than peninsula. It was known for eccentricity, drunken sailors, tong wars, labor strife, racism, vice, vigilantism, and civic scandals. . . . How did a city with so few assets raise funds to repair its broken infrastructure and rise from its ashes? It had only the local property tax, and much of this tax base was burned to the ground. The answer is that it taxed the ground itself, raising money while also kindling a new kind of fire under landowners to get on with it or get out of the way. . . . We do know, though, that in 1907 San Francisco elected a

reform mayor, Edward Robeson Taylor, with a uniquely relevant background: he had helped Henry George, more than anyone else, write *Progress and Poverty* in 1879. . . . San Francisco bounced back so fast its population grew by 22% from 1900 to 1910, in the very wake of its destruction; it grew another 22% from 1910 to 1920 and another 25% from 1920 to 1930, becoming the tenth largest American city. It did this without expanding its land base, as rival Los Angeles did, and without stinting its parks. On its steep gradients it housed, and linked with publicly-owned mass transit, a denser population than any city except the Manhattan borough of New York. . . . In other words, San Francisco had adopted most of Henry George's single tax program de facto, whether or not they said so publicly." *Dollars and Sense*, March/April 2006, (<http://www.dollarsandsense.org/archives/2006/0306gaffney.html>).

In "Annals of Economics: Relatively Deprived," John Cassidy reviews the story of how Mollie Orshansky invented the official U.S. definition of poverty and argues that poverty should now be redefined in relative terms. "Academics have proposed a relative-poverty line before; notably, the British sociologist Peter Townsend, in 1962, and the American economist Victor Fuchs, who is now an emeritus professor at Stanford, in 1965. . . . Unfortunately, few politicians and poverty experts agree. Liberals fear that shifting the focus of policy away from hunger and physical need would make it even harder to win support for government anti-poverty programs; conservatives fear that adopting a relative-poverty rate would be tantamount to launching another costly war on poverty that the government couldn't hope to win. Neither of these fears is justified." *The New Yorker*, April, 3, 2006. At ([http://www.newyorker.com/fact/content/articles/060403fa\\_fact](http://www.newyorker.com/fact/content/articles/060403fa_fact)).

Roger Lowenstein asks, "Who Needs the Mortgage Interest Deduction?" "Economists don't agree on much, but they do agree on this: the interest deduction doesn't do a thing for homeownership rates. If you eliminated the deduction tomorrow, America would have the same number of homeowners, the same social networks, the same number of gardens. The deduction might help some people (like me) to purchase bigger homes than they otherwise would. And it certainly helps people who are selling mansions to get a higher price. But it is hardly the democratic subsidy people think. . . . This year, it is expected to cost the Treasury \$76 billion. And the rewards are greatly skewed in favor of the moderately to the conspicuously rich. . . . And according to the Joint Committee on Taxation, a little over half of the benefit is taken by just 12 percent of taxpayers, or those with incomes of \$100,000 or more." *New York Times Magazine*, March 5, 2006. At (<http://www.nytimes.com/2006/03/05/magazine/305deduction.1.html?ex=1299214800&en=e789e97b669d2f3f&ei=5088&partner=rssnyt&emc=rss>).

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