



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

Potpourri

David Greenlaw, Jan Hatzius, Anil K Kashyap, and Hyun Song Shin discuss “Leveraged Losses: Lessons from the Mortgage Market Meltdown.” “[T]he credit crisis was not an across-the-board deterioration of all credit markets, but—at least in its early stages—an acute crisis that affected certain markets while leaving others virtually unscathed. At the epicenter of the turmoil are mortgage-related securities . . . [T]he *incidence* of the losses (i.e., who bears the losses) is as important as how large those losses are. The characteristic feature of the financial intermediary sector is that it is composed of leveraged institutions whose capital is a small proportion of the total assets they hold. Credit losses deplete their capital cushion. We show that in past episodes, when faced with capital losses, intermediaries have scaled back their leverage and tried to rebuild their capital. Consequently, the overall decline in lending following the losses depends not only on the size of the initial shock, but also on the ability to raise new capital and on the extent to which the

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intermediaries reduce their target level of leverage. We provide a range of possible adjustments, but as a rule the overall lending reduction is many times larger than the capital losses. Our baseline estimates imply a \$2.3 trillion contraction in intermediary balance sheets, of which roughly \$1 trillion would represent a decline in lending to households, businesses and other non-levered entities Our baseline estimates imply that the *independent effect* of the decline in credit due to the mortgage market losses will be to reduce GDP growth over four quarters by roughly 1.5 percentage points.” U.S. Monetary Policy Forum Report no. 2, February 2008, available at <http://research.chicagogsb.edu/igm/events/conferences/2008-us-monetaryforum.aspx>).

James J. Heckman and Paul A. LaFontaine consider “The American High School Graduation Rate: Trends and Levels.” “After adjusting for multiple sources of bias and differences in sample construction, we establish that (1) the U.S. high school graduation rate peaked at around 80 percent in the late 1960s and then declined by 4–5 percentage points; (2) the actual high school graduation rate is substantially lower than the 88 percent estimate of the status completion rate issued by the NCES [National Center for Education Statistics]; (3) about 65 percent of blacks and Hispanics leave school with a high school diploma and minority graduation rates are still substantially below the rates for non-Hispanic whites. In fact, we find no evidence of convergence in minority–majority graduation rates over the past 35 years.” IZA (Institute for the Study of Labor), December 2007, Discussion Paper no. 3216, at <http://ftp.iza.org/dp3216.pdf>.

Dani Rodrik and Arvind Subramanian ask: “Why Did Financial Globalization Disappoint?” From their conclusion: “Financial globalization has not generated increased investment or higher growth in emerging markets. Countries that have grown most rapidly have been those that rely less on capital inflows. Financial globalization has not led to better smoothing of consumption or reduced volatility. If you want to make an evidence-based case for financial globalization today, you are forced to resort to fairly indirect, speculative, and, in our view, ultimately unpersuasive, arguments As long as the world economy remains politically divided among different sovereign and regulatory authorities, global finance is condemned to suffer from deformations far worse than those of domestic finance. Depending on context and country, the appropriate role of policy will be as often to stem the tide of capital flows as to encourage them.” This article offers a counterpoint to the paper in this issue by Eswar S. Prasad and Raghuram G. Rajan on “Practical Approaches to Capital Account Liberalization.” March 2008. Available at the website of the Peterson Institute for International Economics at <http://www.iie.com/publications/papers/subramanian0308.pdf>.

The Copenhagen Consensus 2008 has published “challenge papers” that seek to offer cost–benefit analysis on ten globally important public policy topics, available at <http://www.copenhagenconsensus.com/Default.aspx?ID=1143>). Here are three examples:

Kym Anderson and L. Alan Winters write on “The Challenge of Reducing International Trade and Migration Barriers.” From the Executive Summary: “Over-

all, it seems that countries that have liberalized their trade have enjoyed on average an additional 1.5% growth. Although causality can be difficult to assign, no autarkic markets have enjoyed sustained economic growth A number of estimates have been made of the effect of removing all barriers to trade in goods, together with agricultural subsidies. The simplest one projects the baseline year from 2005 to 2015 and then compares that baseline with what it would be following a phased withdrawal of all trade barriers and agricultural subsidies. The economic welfare gain (in 2001 dollars) comes to \$287 billion per year, with \$86 billion accruing to developing countries. These should be considered as lower-bound figures. At the other extreme, there is a figure of \$2,616 billion annually, in a model which includes liberalization of services and allows for various real-world imperfections to competition in the economic system. Other results fall between these bounds . . .” February 29, 2008.

Todd Sandler, Daniel G. Arce, and Walter Enders look at “Terrorism.” “[T]he number of lives lost or ruined by transnational terrorism is rather minor compared with other challenges considered by the Copenhagen Consensus. On average only 420 people are killed and another 1249 are injured each year from transnational terrorist attacks. Nevertheless, the public in rich countries views transnational terrorism as one of the greatest threats. This is rather ironic since over 30,000 people die on US highways annually, yet highway safety is not as much of a public concern Three of the five ‘solutions’ proposed here—business as usual, increased proactive responses, and enhanced defensive measures—have very adverse benefit–cost ratios (BCRs) under a wide range of scenarios, *even when the most promising assumptions are invoked.*” February 2008.

Gary W. Yohe, Richard S. J. Tol, Richard G. Richels, and Geoffrey J. Blanford assess policy options for “Global Warming.” “In our assessment of the options, we conclude that the portfolio approach—option (5) that combines annual mitigation, investment in carbon-saving and carbon sequestering technology, and additional adaptation measures to combat potential increases in the incidence of some infectious disease—is the best choice We must admit, though, that none of our policies ‘solve the climate problem’ . . .” April 3, 2008.

The Commission on Growth and Development is chaired by Michael Spence, and funded by the Hewlett Foundation, the governments of Australia, the Netherlands, Sweden, and the United Kingdom, and the World Bank. In May 2008, the Commission produced “The Growth Report: Strategies for Sustained Growth and Inclusive Development.” “We do not know the sufficient conditions for growth. We can characterize the successful economies of the postwar period, but we cannot name with certainty the factors that sealed their success, or the factors they could have succeeded without. It would be preferable if it were otherwise. Nonetheless, the commissioners have a keen sense of the policies that probably matter—the policies that will make a material difference to a country’s chances of sustaining high growth, even if they do not provide a rock-solid guarantee The policies we explore fall into several loose categories: accumulation; innovation; stabilization; allocation; and inclusion.” The website also offers several dozen papers by

leading experts on a variety of subjects: for example, Paul Collier on “Growth Strategies for Africa”; Gordon Hanson on “International Migration and Development”; David Wheeler on “Environment and Growth”; Daron Acemoglu and James Robinson on “The Role of Institutions in Growth and Development”; and John Williamson on “Exchange Rate Economics.” “The Growth Report” is available at http://www.growthcommission.org/index.php?option=com_content&task=view&id=96&Itemid=169.

Robert T. Jensen and Nolan H. Miller discuss “Giffen Behavior: Theory and Evidence.” “We find strong, clear evidence of Giffen behavior among poor households in Hunan, China, and somewhat less robust evidence in Gansu. To the best of our knowledge, this is the first rigorous, real-world empirical evidence of Giffen behavior. It is ironic that despite a long search, in sometimes unusual settings, we found examples in the most widely consumed foods for the most populous nation in history. However, the examples were found exactly where theory would predict they should occur: impoverished (but not too impoverished) consumers, heavily dependent on a staple good, with limited substitution possibilities. And while our experiment focused on two areas of China, our framework and analysis suggest that Giffen behavior may not be rare at all.” NBER Working Paper 13243, revised December 2007.

W. Michael Cox and Richard Alm discuss “Opportunity Knocks: Selling Our Services to the World.” “Over the past century, the U.S. has developed a deep, diverse pool of skilled, productive and well-paid service providers. They’re part of a sprawling service sector—fully four-fifths of our economy—that incorporates skills and talents honed in the highly competitive U.S. market. We’re world-class providers of financial, legal, medical, construction and industrial engineering services. We excel in supplying entertainment, education and information management. We lead in telecommunications, management and consulting, travel services and tourism. Thanks to fundamental shifts in the global marketplace, America’s services expertise can now exert itself worldwide. The Internet, satellites and fiber-optic transmission lines have bound economies together by making it cheaper and easier to collect, process and distribute information, a key component in supplying sophisticated services. Many services, once limited to domestic markets, now trade internationally.” Federal Reserve Bank of Dallas, *2007 Annual Report*, pp. 6–27. At <http://www.dallasfed.org/fed/annual/2007/ar07b.pdf>.

Christopher T. Hill argues that the United States is becoming “The Post-Scientific Society.” “Just as the post-industrial society continues to require the products of agriculture and manufacturing for its effective functioning, so too will the post-scientific society continue to require the results of advanced scientific and engineering research. Nevertheless, the leading edge of innovation in the post-scientific society, whether for business, industrial, consumer, or public purposes, will move from the workshop, the laboratory, and the office to the studio, the think tank, the atelier, and cyberspace.” *Issues in Science and Technology*, Fall 2007, at http://issues.org/24.1/c_hill.html.

CBO and the Health Care System

Our national debate over reform of the nation's health care system would be vastly improved if all participants familiarized themselves with recent Congressional Budget Office reports on the subject. Here are some examples:

"The Long-Term Outlook for Health Care Spending" describes factors that will drive health care costs over the next 75 years. "[I]n the absence of changes in federal law: Total spending on health care would rise from 16 percent of gross domestic product (GDP) in 2007 to 25 percent in 2025, 37 percent in 2050, and 49 percent in 2082. Federal spending on Medicare (net of beneficiaries' premiums) and Medicaid would rise from 4 percent of GDP in 2007 to 7 percent in 2025, 12 percent in 2050, and 19 percent in 2082." November 2007. At <http://cbo.gov/ftpdocs/87xx/doc8758/11-13-LT-Health.pdf>.

A February 2008 report discusses "Geographic Variation in Health Care Spending." "Per capita health care spending varies widely across the United States. In 2004, as an example, per capita spending ranged from roughly \$4,000 in Utah to \$6,700 in Massachusetts. The variation is even greater among smaller geographic units and among individual medical providers. Among large hospitals in California from 1999 to 2003, Medicare spending per patient in the last two years of life ranged more than fourfold, from less than \$20,000 to almost \$90,000. Researchers affiliated with the Dartmouth Atlas of Health Care estimate that among groups of Medicare beneficiaries who are otherwise similar, individuals who live in high-spending areas receive approximately 60 percent more in services than do those who live in low-spending areas." At <http://cbo.gov/ftpdocs/89xx/doc8972/02-15-GeogHealth.pdf>.

A January 2008 report explores the connections between "Technological Change and the Growth of Health Care Spending." "Technological innovation can theoretically reduce costs and, for many types of goods and services, often does. Historically, however, the nature of technological advances in medicine and the changes in clinical practice that followed them have tended to raise spending Breaking down the long-term growth in spending into its various components leaves much of the increase unaccounted for by measurable factors such as the aging of the population or rising personal income. Table 2 shows estimates from three studies of the contributions of selected factors to the long-term growth of health care spending in the United States. Overall, those factors [aging of the population, changes in third-party payment, personal income growth, prices in the health care sector, administrative costs, defensive medicine and supplier-induced demand] appear to account for no more than half of that growth. Analysts generally attribute the rest of the growth to increases in the technology-related changes in medical practice." At <http://cbo.gov/ftpdocs/89xx/doc8947/01-31-TechHealth.pdf>.

"Research on the Comparative Effectiveness of Medical Treatments: Issues and Options for an Expanded Federal Role" explains: "More recently, the Agency for Health Care Research and Quality (AHRQ) has been the most prominent federal

agency supporting various types of research on the comparative effectiveness of medical treatments. Established in 1989, . . . [i]t currently has a staff of about 300 and an annual budget of over \$300 million, which primarily funds research grants to and contracts with universities and other research organizations covering a wide range of topics in health services.” December 2007. At (<http://cbo.gov/ftpdocs/88xx/doc8891/12-18-ComparativeEffectiveness.pdf>).

“Evidence on the Costs and Benefits of Health Information Technology” arrived in May 2008. “Many analysts and policymakers believe that health IT [information technology] is a necessary ingredient for improving the efficiency and quality of health care in the United States. Despite the potential of health IT to increase efficiency and improve quality, though, very few providers—as of 2006, about 12 percent of physicians and 11 percent of hospitals—have adopted it.” At (<http://www.cbo.gov/ftpdocs/91xx/doc9168/05-20-HealthIT.pdf>).

Economists and Economics

Aaron Steelman interviewed Susan Athey, the most recent winner of the John Bates Clark Medal. Athey on mentoring: “The question of how mentoring affects diversity in organizations was the first problem that I posed independently as a scholar. I started on it in my second year of grad school. The work was motivated by a simple observation. A lot of male graduate students played in regular basketball games with male faculty members. But women and nonathletic males were not particularly welcome. It turned out that a pretty high share of the students who played in these games got plum research assistant positions over the summer. So I started thinking about why that was happening and what the impact was on eventual outcomes for students, schools, and the profession.” Athey on anticompetitive collusion: “Typically, tacit collusion, where firms do not make formal agreements, tends not to get prosecuted. The prosecutions that take place typically occur because firms have gotten together and done something explicitly illegal—like fixed a bid or met in a smoke-filled room and exchanged side payments. My research addresses the following questions: If that’s the main way firms get caught, why do they take that risk? Why can’t they do pretty well with tacit collusion? My research suggests that bribes and communication can be helpful for firms in achieving the most efficient cartel. So, in principle, if they are very patient and sophisticated, they may be able to arrive at a scheme of tacit collusion that does allocate efficiently. But if firms are less patient, they may not get there. Bribes can help them settle up today to compensate those who give up market share.” The Federal Reserve Bank of Richmond’s *Region Focus*, Fall 2007, pp. 30–35. At (http://www.richmondfed.net/publications/economic_research/region_focus/fall_2007/pdf/interview.pdf).

Prakash Lougani provides an overview of John Taylor’s career in “The Quest for Rules.” On Taylor’s experience at the Council of Economic Advisers in 1976–77: “One of the major achievements of the CEA during this time, he says, was to

bump up the estimate of the U.S. natural rate of unemployment from 4 percent to 4.9 percent. ‘The political people were scared of going up to 5 percent,’ Taylor says with a laugh. ‘It was a bit like gas stations pricing gasoline at \$1.995 a gallon instead of \$2.’” On why the “Taylor rule” gained acceptance so quickly: “One reason was Taylor’s reputation as someone who had worked on much larger-scale and more complicated multicountry models of the global economy . . . Andrew Levin, one of a number of Stanford graduate students nurtured by Taylor who are in senior positions in the Fed system, says that Taylor was always known for ‘pushing the limits of the Stanford supercomputer’ to solve his models. That such a person was proposing a simple rule gave it a credibility that it might not otherwise have had.” *Finance and Development*, March 2008, vol. 45, no. 1. At <http://www.imf.org/external/pubs/ft/fandd/2008/03/people.htm>.

Andrew J. Oswald and Hilda Ralsmark present “Some Evidence on the Future of Economics.” “This short paper collects and studies the CVs of 112 assistant professors in the top-ten American departments of economics First, we find evidence of a severe brain drain—what one might call a funnelling of talent into the United States—at the bachelor-degree level. The typical assistant professor has a BSc from outside the USA and a PhD from inside the USA. Second, contrary to numerous gloomy assessments of the state of academic economics . . . the great majority of these young economists are doing empirical work The future of economics in the elite American universities seems likely to be heavily applied, not abstractly theoretical. Third, we show that the male-to-female ratio among assistant professors is now approximately 3 to 1, and that the most-studied areas of economics are now macroeconomics, econometrics, and labour economics (though these days this encompasses topics only obliquely related to labour markets).” *Warwick Economic Research Papers*, no. 841, February 2008. At http://www2.warwick.ac.uk/fac/soc/economics/research/papers/twerp_841.pdf.

Discussion Starters

Benjamin E. Hippen discusses “Organ Sales and Moral Travails: Lessons from the Living Kidney Vendor Program in Iran.” “[I]n 1984, an overzealous entrepreneur testified before Congress that he was planning to import impoverished denizens from developing nations, remove their organs, transplant them into American patients, and then return the ‘donors’ to their homelands with a pittance to show for their efforts. A horrified Congress passed the National Organ Transplant Act, including a prohibition against ‘knowingly acquir[ing], receiv[ing], or otherwise transfer[ring] any human organ for valuable consideration for use in human transplantation if the transfer affects interstate commerce.’ Two decades later the United States and most of the world is still laboring under the ill-conceived notion that the sale of organs should be prohibited under all circumstances, and the number of people dying on dialysis while waiting for an organ that never comes continues to steadily increase. Meanwhile, in 1988 Iran began providing remuner-

ation for unrelated donors, and its list of patients awaiting transplants steadily decreased.” This report should be of particular interest to readers of the Summer 2007 symposium on “Organ Transplants” in this journal. Cato Institute Policy Analysis no. 614, March 20, 2008. At <http://www.cato.org/pubs/pas/pa-614.pdf>.

Robert Driskill asks, “Why Do Economists Make Such Dismal Arguments about Trade?” “At bottom, trade is responsible for creating opportunities in some sectors of the economy and reducing opportunities in others. By the same token, restriction of trade reduces opportunities in some sectors and expands them in others. Without a doubt, this means that trade helps some people and hurts others. In such a situation, why do economists claim that trade is good for the country? After all, the Joe Sixpacks are citizens of the country, and their losses are often large, painful, and traumatic, requiring dramatic life changes. Why should people think economists can be, in effect, high priests who tally up benefits and losses to different individuals and pronounce the outcome good or bad for the group as a whole?” *Foreign Policy*, posted May 2008, at http://www.foreignpolicy.com/story/cms.php?story_id=4320.

Alan D. Viard offers “Three Cheers for the Decline of the Corporate Income Tax.” “In recent years, governments around the world have slashed corporate tax rates—with the average rate falling from 38 to 27 percent from 1992 to 2006 in a large sample of countries—in response to global competitive pressures. Fearing that governments will lose a valuable revenue source, some observers have called for international cooperation to protect the corporate income tax from competitive pressures. These calls should be rejected. The corporate income tax causes needless distortions by penalizing saving for the future and penalizing particular kinds of financial securities issued by particular kinds of firms. Rather than colluding to maintain the corporate income tax, countries should switch to better-designed revenue sources.” American Enterprise Institute Tax Policy Outlook, April 2008, no. 2. At http://www.aei.org/publications/pubID.27770/pub_detail.asp.

Benjamin Powell writes “In Defense of ‘Sweatshops.’” “Sweatshops have deplorable working conditions and extremely low pay—compared to the alternative employment available to me and probably you. That is why we choose not to work in sweatshops. All too often the fact that *we* have better alternatives leads first world activists to conclude that there must be better alternatives for third world workers too Not only are sweatshops better than current worker alternatives, but they are also part of the process of development that ultimately raises living standards. That process took about 150 years in Britain and the United States but closer to 30 years in the Japan, South Korea, Hong Kong, and Taiwan Meanwhile, what the third world so badly needs is more ‘sweatshop jobs,’ not fewer.” Library of Economics and Liberty, June 2, 2008, at <http://www.econlib.org/Library/Columns/y2008/Powellsweatshops.html>.

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