Alumni News

Department of Economics

Indiana University of Pennsylvania ❧ Indiana, PA 15705–1087

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The Economy Today

It is difficult to get through the news these days without some discussion of the status of the economy. You have questions. We have answers. Questions were posed to the faculty of the Department of Economics at IUP. Here are some of the answers, both humorous and serious.

Editor: Jack D. Julian, Jr.

How would you characterize the current economic climate? Is the economy in a recession? If so, how might individuals be impacted?

[Yaya Sissoko] The current economic climate is nothing like the crash of the stock market of the late 1920s (helping trigger the Great Depression) or the deep economic downturns of 1973-1974 and 1981-1982 (with rising oil prices and falling stock prices) or the commercial banking crisis of the late 1980s (from 1988 to 1992 there were 905 bank failures) or even the 1997-1998 Asian financial crisis. It involves the entire financial system, not just depository institutions and it is more mystifying (because of the credit bubble - rampant borrowing of money causing consumers, businesses or government to be over indebted) than any of its predecessors.

[David Yerger]: I believe we are in a recession and that it will be dated as having begun in December 2007. In many important ways, however, it matters little whether Real GDP actually is declining slightly or if Real GDP growth is barely positive. Since 1949 there have been about 14 years in which Real GDP growth was less than 2%, unemployment rose in all but one of those years. Once Real GDP growth is less than 1%, the rise in unemployment closely mirrors what happens in formal recessions. I very much doubt that 2008 will have Real GDP growth above 2%, and would be willing to bet it is less than 1%.

[Sarah Jackson]: The last of these questions is actually the most important (though this may be my microeconomic-bias showing). How an individual is impacted by a recession is going to depend on the industry she works in, the type of job she holds, the extent of her savings and debts, and what stage in life she is at. Whether or not we are currently in a recession, there will be one in the future. Either way, the nature of recessions in the U.S. is such that a recession will likely be over before we can confirm that it occurred. This means that minimizing the impact of a recession will be easier the further ahead you plan. College graduates are better able to weather economic downturns because they are less likely to be laid off and find it easier to obtain a new job if they are laid

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From left to right. Todd Potts, Jack Julian, David Yerger, Willard Radell, Yaya Sissoko, Sarah Jackson, James Jozefowicz, and Stephanie Jozefowicz.

Faculty Q&A

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off. Despite the current economic uncertainty, employers report that they plan to hire more recent college graduates this year than last. Our new graduates should take advantage of their advantageous position to further insulate themselves from the affects of a downturn by avoiding debt and making saving a priority.

Briefly explain how this "mortgage" or "housing" crisis has developed. And how has it contributed to our current economic quandary?

[David Yerger]: Briefly? People unable, or unwilling, to understand math asked for mortgages they hadn't a prayer of repaying unless their family income managed to rise A LOT over the first two years of their mortgage. Not wanting to miss out on the fun, other folks already in homes refinanced them to withdraw large chunks of their new equity gains in order to fund current consumption, ignoring the question "how will I pay off the new refinanced mortgage?" Such folks always have been part of the economic landscape, what changed was that the financial sector collectively developed an extreme case of the stupids (see box on this page) and threw large bucketfuls of money at these folks.

The mortgage crises will continue to impact the real economy through its impact on the availability of credit throughout the U.S. financial system. In late February, the Federal Reserve estimated that mortgage losses by commercial banks are likely to force about a $1 trillion (yes, trillion) reduction in bank lending over the next year or so as banks rebuild their balance sheets. In mid April, the IMF stated that the U.S. financial system is under the greatest stress since the Great Depression. Credit crunches as severe as the one that has unfolded since late Spring 2007 nearly always lead to a significant economic recession, hence the growing pessimism within the Dismal Science regarding the 2008 and 2009 prospects for the U.S. economy.

[Yaya Sissoko] This "housing" crisis started with non traditional commercial banks (e.g. investment banks) making loans to "weaker" borrowers known as "subprime" mortgages. Recent estimates of subprime losses range from $285 to $400 billion including the collapse of Bear Stearns, the fifth largest investment bank of our economy, which was sold to J. P. Morgan for almost nothing at $236 million for a firm valued at $20 billion in January 2007. This leads a major credit crunch in the economy with banks either asking for more collateral or calling in their loans (i.e. not renewing the loans at maturity). As a result, the processes of extending credit for the economy and of trading - for stocks, bonds, foreign exchange - may also collapse. This uncertainty over the credit lifeblood and the securities portfolio contributes to the further weakening of the economy.

[Sarah Jackson] Economists recognize that the market does not always provide an economically efficient outcome. One reason that the market system may fail is due to imperfect information. Incomplete information was a significant contributor to the current mortgage crisis. We need to understand why so many people found themselves with mortgages they cannot pay and may not be able to pay off even with the sale of their house because of the decreasing home values. To get a full understanding of this, we need to look at it from both the demand and supply sides. The demand-side is sticky; perhaps people were overly optimistic about their earnings potential or their ability to refinance or did not fully understand the terms of the loan. No matter the reason, it is unreasonable to think that the government should do anything to prohibit people from voluntarily entering into contractual obligations. The supply-side is more straightforward. Companies which funded the mortgages were willing to do so because they

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A Simplified Outline of the Financial Sector's "Outbreak of Stupids"

Commercial and investment banks bought mortgages originated by mortgage brokers who make money only on commissions. These banks thought they had their risk exposure to bad mortgages covered by agreements with the brokers to take back non-paying mortgages once the share of such notes reached contracted thresholds. Of course, the banks didn't think through the very plausible possibility that if many of the mortgages sold to me by broker X are going bad, then there is a good chance many of the total mortgages sold by broker X are going bad. If so, broker X will not have enough funds to take back my stinky mortgages, and broker X's promise to do so is not risk management, it is wishful thinking.

The banks then bundled these mortgages into pools of securities backed by the promised mortgage payments, and got busy selling them to pension funds, each other, hedge funds, insurance companies, mutual funds, etc. The folks buying these mortgage-backed-securities (MBS) did not bother doing any meaningful risk assessment. Instead, the response was "Oh, these bonds are insured so there is no risk". The MBS buyers did not ask "If my MBS defaults, then it is likely that many other MBS will default. If so, do these bond insurers have anything close to enough capital to handle the defaults?" Answer is: No.

Many of these MBS ultimately will be worth only half or so of their original value. What remains to be seen how these losses end up distributed across the financial system and the taxpayer.

—David Yerger

Faculty Notes

Dr. Yaya Sissoko presented the paper "Role of Monetary Policy in Economic Instability," co-authored with Mete Feridun, at the 34th Eastern Economics Association (EEA) Annual Conference held in Boston, MA, March 7 – 9, 2008. Dr. Sissoko also received a travel grant from the University Research Committee Award to present the paper at the EEA meetings.

The paper investigates the effectiveness of Turkish monetary policy in controlling the inflation rate and the stability of the exchange rate using the Rational Expectations Model that incorporates the fiscal role of the exchange rate. Using quarterly data from 1983:4 to 2003:4, the analysis affirms that the effort of the Turkish monetary policy at influencing the finance of government fiscal deficit through the determination of the inflation-tax rate, to some extent, affects both the rate of inflation and the real exchange rate, thereby causing volatility in their rates.

Dr. Sissoko also served as a discussant on two papers at the 2008 EEA Conference: “Analyzing the Present Sustainability of Turkey’s Current Account Position” by Ayla Ogus and Niloufer Sohrabji; and “Exchange Rate Volatility and Employment Growth in Developing Countries: Evidence from Turkey” by Firat Demir.

Dr. Stephanie M. Jozefowicz and **Dr. James J. Jozefowicz** attended the Third National Summit on Economic and Financial Literacy at the National Press Club in Washington, DC, on February 27, 2008. They also attended the National Association of Economic Educators Professional Development Conference in Baltimore, MD, on February 28, 2008. Stephanie serves as the secretary of the Executive Committee and Jim co-chairs the NAEE Professional Development Committee and helped to organize the conference.

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"The Effects of Environmental Factors on Cancer Prevalence Rates and Specific Cancer Mortality Rates in a Sample of OECD Developed Countries," coauthored by **Dr. James J. Jozefowicz** and **Shannon M. Stare ('07)**, has been accepted for publication by the *International Journal of Applied Economics*.

Dr. Sarah Jackson presented "Foreign Aid: Governmental Aid, Private Aid, and Free Trade" as part of the Great Discussions 2008 program on April 1, 2008, at the Court at St. Andrew's Village in Indiana. This was the final session in the 2008 series of discussions on world issues and problems. The series is offered through the IUP School of Continuing Education.

Dr. Sarah Jackson presented "Using Basic Economic Concepts to Construct an Effective Syllabus" at the 19th Annual Teaching Economics Conferences held February 14-16, 2008, at Robert Morris University in Moon Township, PA.

Dr. James Dyal was recently honored for his 30 years of service at IUP. His gift clock is proudly displayed on his bookcase.

Economic Education

IUP Center for Economic Education is Renamed

First Commonwealth, EconomicsPennsylvania, and IUP are committed to helping students make sense of economics. On January 30, 2008, officials from all three organizations signed a memorandum of understanding to formally establish the **First Commonwealth Center for Economic Education at IUP**.

"The mission of EconomicsPennsylvania is to ensure that every young person in Pennsylvania understands essential economic concepts, is able to use economic ways of thinking and problem-solving, and has a solid grasp of the nature and structure of the national and global economy," explained EconomicsPennsylvania President and CEO Fritz Heinemann.

IUP Economics faculty members have worked with EconomicsPennsylvania for the past several years to offer summer programming to high school students and teachers to enhance economics education at the secondary level.

With this new financial support from First Commonwealth, the First Commonwealth Center for Economics Education at IUP will expand and grow to increase community awareness and teacher and student participation in all of EconomicsPennsylvania economic, financial, and investment literacy initiatives.

IUP President Dr. Tony Atwater remarked, "IUP is in a unique position to serve as a resource for enhanced economics education for the western Pennsylvania community. First Commonwealth has a pattern of outstanding support for IUP and for enhanced educational opportunities for this region through the University, most recently in the establishment of the First Commonwealth Endowed Lecture Series. The First Commonwealth Center for Economics Education is another demonstration of First Commonwealth's commitment to this region and enhancing the teaching and learning experience for the Commonwealth."

"First Commonwealth always exemplifies our dedication to the people and communities in which we live, work and raise our families. We are financial stewards for those we serve," said T. Michael Price, President, First Commonwealth Bank. "We are proud to partner with EconomicsPennsylvania and IUP, providing students and teachers with the knowledge and capability to be financially successful throughout their lives."

EconomicsPennsylvania was launched as a not-for-profit organization in 1978. The board of directors consists of representatives from business, education, labor, agriculture and government. One of the most well known curriculum initiatives developed by EconomicsPennsylvania is the Stock Market Game. The First Commonwealth Center for Economic Education is directed by Dr. Stephanie M. Jozefowicz and Dr. James J. Jozefowicz.

Front row: Fritz M. Heinemann, President and CEO of EconomicsPennsylvania; IUP President Dr. Tony Atwater; First Commonwealth President T. Michael Price. Back row: Dr. James J. Jozefowicz, Dr. Stephanie M. Jozefowicz, co-directors of the First Commonwealth Center; Dr. Robert C. Camp, Dean of Eberly College of Business and Information Technology; Dr. Mary-Ann Rafoth, Dean of the College of Education and Educational Technology; Dr. Nicholas Karatjas, chair of the Department of Economics; Dr. Yaw Asamoah, Dean of the College of Humanities and Social Sciences; and Sue McMurdy, executive VP and CIO at First Commonwealth.

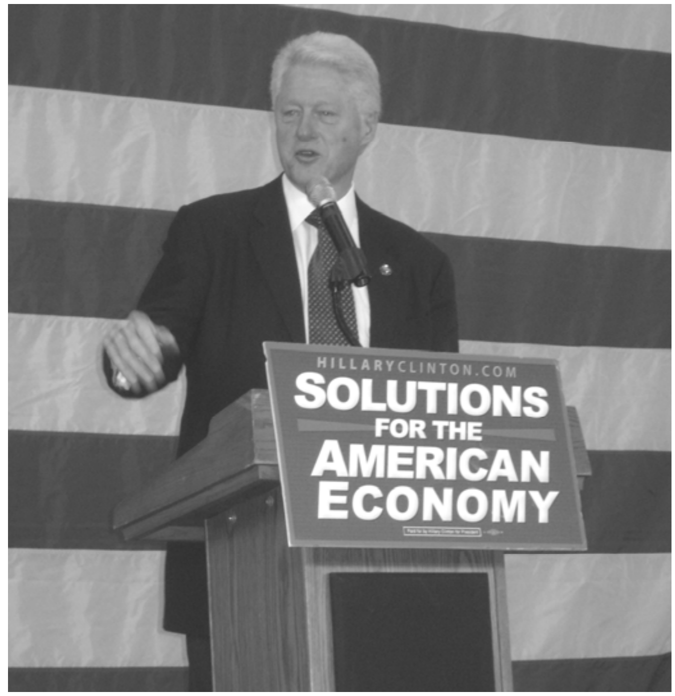
A Special Visit

Former President Bill Clinton visited campus on April 16, 2008. The stop was a part of the presidential campaign of his wife, Hillary Clinton. Many of the capacity crowd at Memorial Field House waited hours to claim choice spots on the floor and the bleachers. President Clinton is the first presidential visit to IUP since former President Jimmy Carter in 1989.

Although the focus of the 45-minute speech was geared toward inspiring the voters to cast votes for Hillary Clinton in the upcoming primary election, Mr. Clinton chose to focus on the economic problems of Western Pennsylvania as well as the country overall. Noting that the economy appears to be in troubled times, he argued that the current situation is due in large part to economic policies of the current White House administration.

Some key proposals received some of the strongest acclaim from the audience: funding research on 100 mile-per-gallon vehicles and increased student loans and grants, including a student borrower's "bill of rights."

Winning solidly in Pennsylvania was seen as key to the continuation of Hillary Clinton's presidential campaign. Pennsylvania voters went to the polls on April 22.



Former President Bill Clinton speaks at Memorial Field House April 16, 2008.

Student Notes

Lauren Venturino (senior) won "Best in Session" at the IUP Undergraduate Scholars Forum held on Tuesday, April 1. Lauren's paper title: The Practiced and the Preached: An Analysis of State Divorce Rates and Religious Participation Levels was featured in the forum's session entitled Economic and Social Analysis.

The IUP chapter (Alpha Gamma) of Omicron Delta Epsilon, the international honors society in economics, announces the following inductees for 2007: **Joshua Gerwick**, **William Neel Lauer**, **Wanzhi Li**, **Odinaka Onovo**, **Sarah Reid**, **Audrey Tetu**, and **Craig Wilson**. Members of OΔE must have twelve credit hours in economics with a 3.0 GPA in both the economics courses and overall. Students do not have to be economics majors, but must have a genuine interest in economics in addition to meeting the above requirements.

*So far this semester year, the **Economics Club** has hosted the following alumni speakers:*

Luke Summerfield ('98) - Assistant Vice President Secured Credit Officer at S&T Bank
Zoë Thorkildsen ('07) - Ph.D. student at University of Maryland-College Park
Kerri Hoopes ('06) - Portfolio analyst at Strategic Energy in Pittsburgh

If you plan to be in the area (or live in the area) and would be interested in speaking to the Economics Club, please contact Jim Jozefowicz at James.Jozefowicz@iup.edu.

Alumni Notes

See print version.

Keep in Touch!

The Department of Economics at IUP considers its alumni a valuable resource. Please keep us posted on your work and well-being. We encourage former students to share with current students how they apply their economic studies in their jobs and their lives. If you plan to be in the area and wish to meet with students, please contact Dr. Nicholas Karatjas (Nicholas.Karatjas@iup.edu) or call (724) 357-2640. Also, visit our alumni webpage at http://www.chss.iup.edu/economics/More/Alumni/index.asp

Faculty Q&A cont.

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could do so profitably. They were able to profit because they greatly increased the volume of mortgages they funded by making riskier and riskier loans, but were able to bundle mortgages together and sell the securities without divulging the risk associated with individual mortgages. Investors were willing to purchase these securities because they did not have full information about the degree of risk they were undertaking. Now that investors have been smacked in the face with the importance of understanding underlying loan conditions which affect risk, they will insist on a process of disclosure before they are willing to purchase securities again. However, while the disclosure process is sorted out, investors are unwilling to purchase new securities, therefore companies are unwilling to fund new securities, hence the credit crunch. Though the market will eventually establish a disclosure process on its own (now that the need for it is recognized), government regulations could speed up the process. As with all things, there is a trade-off associated with government intervention. Though the process may be sped up, the outcome may not be as efficient as it would be if the market was left to figure it out.

Is there anyone to blame? Are there more things to blame than the mortgage crisis? Explain briefly.

[David Yerger] Yes, all the financial sector "experts" who failed to follow basic risk management principles. There also should be a special place in heck, or the federal prison system, for those financial officers proved to have engaged in outright fraud. There will be many stories of actual, or borderline, "predatory lending" by the time this crisis ends.

That said, I have minimal sympathy for folks who should know better (anyone capable of basic addition, subtraction, multiplication, and division while using a calculator) taking out mortgage loans at 4 times or 5 times or more their expected annual income. These folks made a highly leveraged bet that their housing asset would continue to rise in value. I didn't make such a bet, and I don't feeling like bailing out someone who did. I doubt very much these folks would be sharing their equity with me if housing prices had continued to rise.

There have been many policy proposals: the fiscal stimulus of sending out checks to taxpayers, bailing out financial institutions, increased regulation, decreased regulation. Do you think any of these will do any good? Are any better than others? What would you recommend?

[David Yerger]: Fiscal stimulus from the rebate checks will lead to about $80 billion in initial new spending (forecasts from major economic consulting shops). This is helpful, but it will be swamped by the drop in household sector spending caused by declining home prices. I expect the Mortgage Equity Withdrawals (MEW) for 2008 will be at least $300 billion less than in 2007. MEW had been a key piece driving growing household consumption, rising from about $200 billion per year pre housing bubble to nearly $800 billion in 2005, $700 billion in 2006, and $600 billion in 2007. So, the rebate checks will cover about a quarter of the drop this year in new consumer spending caused by falling MEW.

Regarding regulation, if investment banks now are going to be given access to funding from the Federal Reserve (a move I support given the circumstances), then these firms will need to be subject to more regulatory oversight. If not, then they truly are getting to gamble with the taxpayers' money. There are already enough "moral hazard" problems in the financial sector without creating the impression on Wall Street trading desks that the Fed will cover really bad bets gone bad.

As we go to press, the presidential primary election in PA has not yet taken place. What question (particularly of economic relevance) would you like the candidates to answer?

[David Yerger] As I answer these questions, it is the day before the Primary Election. At this point, I just want the candidates to go away, have their staffers stop calling the house, visiting the house, etc.....

[Jim & Stephanie Jozefowicz]: Under the Bush administration, a new President's Advisory Council on Financial Literacy was established by Executive Order of the President of the United States on January 22, 2008. According to a National Council on Economic Education (NCEE) newsletter (March 28, 2008), "The goals of the President's Council address the challenging fact that responsibility for personal financial security - affecting families, communities, and the nation - has been transferred, for the most part and in a relatively short time-frame, from institutions to individual Americans. At its first meeting, the President's Council moved to form four action-oriented committees focused on youth and education; reaching underserved populations; financial education in the workplace; and research on the issue, best practices, and assessment."

As co-directors of the IUP Center for Economic Education, we would like to know what plans the current Presidential candidates have for improving the economic and financial literacy of the population through K-12 education. In light of the mortgage crisis, negative saving rate, and mounting debt burden faced by many Americans, there is an obvious need to better prepare American citizens for making decisions in the global economy. While the candidates have offered their ideas regarding general education in the United States, we are particularly interested in their intentions for economic and financial literacy.

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