Economics

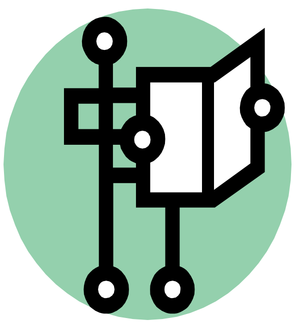
Department Alumni Newsletter

Department of Economics, Indiana University of Pennsylvania, Indiana, PA 15705-1087 ph. (724) 357-2640

Issue 39, Spring 2006

Editor: Jack D. Julian, Jr.

Department of Economics



Inside this issue:

What are you reading?

We all love a good story. Humans have a long history of telling stories to carry on oral histories or legends. We also find great escapes in reading books, watching television and going to movies. When we think about it, much of what we learn is akin to storytelling. Economists often think of themselves as storytellers. The stories told are endless. Stories are good when there is clever or engaging plot and character development. Some stories are unrealistic but are great escapes. Some are realistic and give us pause for reflection on their application to our lives. Some are just plain bad, full of untruths or poor plot development and come off as totally unbelievable, attempting to deceive their readers.

This issue of the newsletter features a discussion of some of the tales that are told about how the economy works. Dr. Willard Radell reviews a few prominent books that seek to influence economic and social policy. We find that we cannot always trust the storyteller or his or her agenda. Dr. Jack Julian reviews two popular books where the storytellers offer insight as to how people behave in diverse settings with no agenda but their own. You will certainly come to identify with some of the characters and you will certainly find yourself having experiences along their plot lines.

We hope you continue to read works related to economic ideas. The tools learned as a student may become dull if they aren't sharpened from time to time. We often need to be reminded of the good stories we heard and read while in class. You may be surprised by how much you remember. We hope we can add something to your summer reading list.

Faculty awarded research grant

Two faculty members of the Department of Economics were recently awarded a $35,000 grant to study problems in rural Pennsylvania. **Dr. David Yerger** and **Dr. Jack Julian** received the grant to fund research on the status of unemployment and underemployment in rural counties. Drs. Yerger and Julian will examine the causal links between self-reported underemployment and a variety of socio-economic variables. The results will be used to tabulate age-adjusted estimates of unemployment and underemployment at the county level. The grant comes from the Center for Rural Pennsylvania, a bipartisan, bicameral legislative agency that serves as a resource for rural policy within the Pennsylvania General Assembly.

The results of the study should serve many purposes. Primarily, it should increase our understanding of the changing worklife in Pennsylvania. In addition, specific policy recommendations are expected for consideration by the state legislature.

(from left) Ms. Mary Kandray Gelenser (Center for Rural PA), Dr. David Yerger, Dr. Jack Julian, Mr. Barry Denk (Center for Rural PA).

A World Without Economists?, Part 1

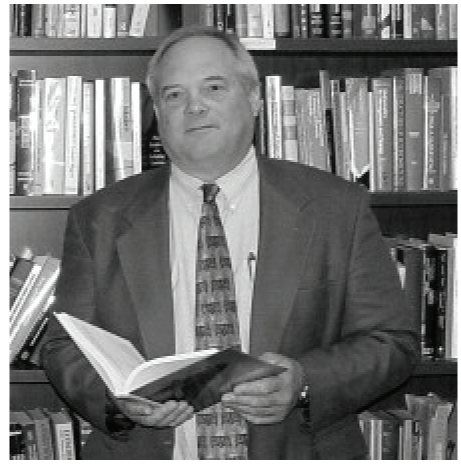
Willard W. Radell

What does a business executive with a Master's degree in English, a Senator who lost an election while getting over 500,000 more votes than his opponent, and a mechanical engineer from Michigan have in common? Answer: they were all non-economists who viewed professional economists as some combination of incompetent, obtuse, dishonest, ignorant, or "almost always wrong." I'll deal separately with each of these writers who, by their ways and words, thought they were launching a "frontal assault on economics (Hudson)." Each felt that acknowledged success in their chosen fields qualified them to pass judgment on economics and economists. And each showed at least a touch of resentment at the respect that economists have had in some circles.

William J. Hudson's *Business Without Economists (BWE)*, American Management Association (AMA), 1987, is one of the silliest of the silly books and articles ever written about economics. It is sad that the AMA lent its credibility to the musings of an English major turned expert on economics. At the time *BWE* was written, Hudson was Manager of Market and Economic Research for a privately held grain trading company.

To amplify his central thesis that "economics doesn't work," Hudson used the same phrases throughout the book. "Economics doesn't work" was repeated at least 14 times; "forecasts are almost always wrong" was repeated at least three times; "economics is not a scientific undertaking" was repeated at least six times. These sweeping statements were largely unsupported, as if Hudson believed that by repetition they could be made true.

His bad example of models of "economics" was the infamous "Club of Rome: The Limits to Growth Model." That was the model that predicted the collapse of industrial economies by 1990 at the then current rates of growth. Somehow Hudson missed the fact that the Club of Rome model was an environmental model, with no interest rates and no prices. When the Club of Rome model was released (1972), it was almost universally condemned by economists. Economists correctly argued that environmental collapse would not come in the twentieth century because price mechanisms would be triggered, forcing resource substitution, averting a general crisis. Economists were arguing from core economics and they were right.



Hudson saved some of his sharpest barbs for econometrics. An amusing quirk in his attack on econometrics was his belief that "simple models, limited to two or three variables at a time, may help managers understand markets and do their job of forecasting better." Hudson seemed to be unaware of specification and omitted variable errors. (In my managerial economics class I often use a real data set in which including one more explanatory variable and selecting a non-linear functional form cause a statistically significant change in sign of another variable's coefficient. Thus, a misleading model with bad predictions is transformed into a useful model with good predictions.)

The horrible example Hudson used in macroeconomics was the Office of Management and the Budget's (OMB) understating the huge budget deficit projections for 1983. The OMB in the Reagan White House was headed by a non-economist, David Stockman (I believe he had a divinity degree), who was a crude, quasi-economic supply-sider, believing that tax cuts would so quickly stimulate the economy that deficits would be lower. What really happened was that the OMB models were predicting huge deficits and OMB economists were concerned. When Stockman (the non-economist) saw the projections, he declared the models developed by economists defective, and ordered the programmers to change the equations to show tax revenue rising when tax rates were cut. Miraculously, the huge deficit projections disappeared from the OMB macroeconometric forecasts. Unfortunately, the real budget deficits did not similarly disappear.

Did economists who were free to express themselves do any better? Hudson didn't mention that at the same time, over at the Congressional Budget Office (CBO), directed by Alice Rivlin, Ph.D. in economics, accurate deficit forecasts were being made eighteen months forward. What made the difference? Correct CBO forecasts were

(Continued on page 3)

A World Without Economists? continued

(Continued from page 2)

the result of good, solid economic modeling without the interjection of the political correctness that was short-circuiting the OMB models of the early Reagan administration. It is ironic that Hudson used the conspicuous failure of David Stockman, a non-economist, as evidence that economists didn't know what they were doing, while ignoring the successful forecasts of Alice Rivlin, an economist.

Theodore R. Thoren's, "Space Age Technology Can Correct the Money System," *The Bent of Tau Beta Pi* (Engineering fraternity), expressed the idea that economists are responsible for every inflation wave and every recession. Thoren, a mechanical engineer, stated that economists built a "defective bridge" in 1913 (the monetary system under the Federal Reserve) and it "collapsed in 1920, 1929, 1958, 1962, 1973, and 1980-82." Thus, economists were obviously incompetent and should become more like "professional engineers" who "are required to be right." Our system is defective, according to Thoren, because banks create money by loans, thus creating a huge overhang of debt and "usury." If only we could think like engineers, we economists would expand the money supply by a scientific formula, end money creation by the fractional commercial banking system, eliminate the national debt and live happily ever after in a world without recessions and inflation. All we need to do is to turn economics over to the engineers (whose nuclear plants never fail, whose bridges never collapse, whose spacecraft never disintegrate, whose dams never break, and whose aircraft never crash).

Al Gore's, 1992 book, *Earth in the Balance*, had a chapter titled "Eco-nomics: Truth or Conse-quences," in which he gave the impression that economists were unaware of the limitations of their economic analysis. Listing national income accounting shortcomings already known to all competent economists, he attributed the existence of negative externalities to economists and faulted economists for ignoring pollution and waste.

"We posit … assumptions as polar premises to discover how markets will operate when those conditions hold and do not hold."

-Willard Radell

Economics textbooks, Gore charged, do not "...address ... pollution...." Why do we do that? According to Gore, we economists believe "supply is limitless" and that we "don't consider the possibility of negative consequences of consumption" (p. 187). Like "alchemists" of old, we believe in "powerful magic" that neutralizes pollution, depletion and bad consequences of consumption, getting rid of "the bad things economists want to ignore while [we] … meas-ure the good things." How do we do that? By practicing "a form of dishonesty," like "racism" and "anti-Semitism," "the bad things are simply defined away as external to the process and called externalities" (p. 189). Senator Gore did not seem to know that the reason economists invented the concept of negative externalities was so that we could estimate the external costs, put a price on them, and specify an optimal tax that wraps the external cost into the price of the product. In that way, products with large external costs are not over-produced. Gore missed that, asserting that we believe "...the cost [of pollution] should be placed at zero." Because "clean air" and "fresh water" have "no price," economists view them as "worthless" (p. 190). Did he misunderstand economics, or what?

There is much more. According to Gore, economists make unrealistic assumptions (like perfect information) and we use discount rates in benefit/cost studies to cheat future generations. Senator Gore did not seem to under-stand that economists do not believe that perfect information and mobility exist in most markets. We posit those assumptions as polar premises to discover how markets will operate when those conditions hold and do not hold. And he did not understand that the time value of money (using an appropriate discount rate) is a real phenomenon. You get the idea.

Part II (in the next newsletter) will be a little more unpleasant. It will deal with Frederick Soddy, a Nobel Laureate in Chemistry and Arthur Kitson, an inventor and industrialist, who, like Thoren, decided that economics and econo-mists needed to be straightened out by good "scientific" thinking. Their critiques of economics and economists rested, in part, on their belief that periods of inflation and recession are caused by a conspiracy of bankers. Part II is about what Keynes labeled, "monetary cranks," and misguided current attempts to resurrect their ideas. Until next time….

Faculty Notes

The Department of Economics is deeply saddened to report that **Mr. Stephen B. Ware** passed away in February 2006. Steve, known for his love of tennis and dogs, was a vital part of the Department from 1969 to his retirement in January 1999. He will be missed.

Marvin Huff recently stopped by the Department to say hello. He is enjoying his retirement (10 years this year!) by traveling, shooting, fishing, and crabbing. Marvin and his wife Edna now reside in sunny Florida.

Dr. Todd Potts and **Dr. David Yerger** presented "Changes Over Time In Texas' Responsiveness to Monetary and Oil Price Shocks" at the Southwestern Economics Association annual meeting in San Antonio, TX, in April. Dr. Potts also served as chair of the session on Energy and Petroleum Economics at the meetings.

At the Southern Economic Association's annual conference in November 2005, **Dr. Stephanie Jozefowicz** and junior **Zoë Thorkildsen** presented "The Importance of State-Level Analysis of Educational Production Functions." Also at the Southern meetings, **Dr. James Jozefowicz** and senior **Vanessa Wayne** presented "Bringing Faith Into the Picture: Socioeconomic and Religious Determinants of Youth Alcohol Consumption and Binge Drinking."

Dr. Todd Potts "Money, Consumer Durables, User Costs, and the Forward-Looking Theory of Consumption" forthcoming in *Journal of Economic Dynamics and Control* (with William D. Lastrapes, University of Georgia).

Dr. David Yerger and **Dr. Todd Potts** "Province Specific Measures of U.S. Growth and Linkages with Provincial Exports" (with Gary Sawchuck) forthcoming in *Pennsylvania Economic Review* (June 2006).

Dr. David Yerger presented "International Trade Growth and Changes in U.S. Manufacturing Concentration" and "Threshold Effects Between German Inflation and Productivity Growth" (with Donald Freeman) at the International Academy of Business Conference in San Diego, CA, April 2006. Both papers are published in Business Yearbook: Global Business Perspectives, Volume XIII 2006.

Dr. David Yerger and **Dr. Todd Potts** "Changes in the Regional Responsiveness to Federal Reserve Policy Shocks and the Declining Importance of Interest Sensitive Industry Sectors" forthcoming in *Journal of Business and Economics Research.*

Dr. Yaya Sissoko "The Exchange Rate System and Macroeconomic Fluctuations in Sub-Saharan Africa" (with Selahattin Dibooglu), forthcoming June 2006 in the journal *Economic Systems*.

Alumni Notes

See print edition!

News from the Center for Economic Education

The IUP Center for Economic Education is an outreach division of the IUP Department of Economics. Affiliated with *EconomicsPennsylvania,* and the National Council on Economic Education (NCEE), the central purpose of the network is to promote economic literacy. The network strives to develop curricula and programs to equip teachers, grades K-12, with the necessary tools to get economics and personal finance into classrooms and to motivate students to apply sound decision making to their lives. The IUP Center services Cambria, Indiana and Westmoreland counties.

Center for Economic Education Co-Director, Dr. Stephanie M. Jozefowicz, at EconFest Day in October 2005.

The Center is led by co-directors Dr. Jim Jozefowicz and Dr. Stephanie Jozefowicz, both associate professors in the Department of Economics. Ms. Carol Occhuizzo has come on board this year as Field Consultant. Carol brings abundant talents, first-hand high school teaching experience, and a charming personality. (See news item in the Fall 2005 newsletter.) The IUP Center, as well as the other 13 Centers for Economic Education across Pennsylvania, offer myriad programs for teachers and students throughout the year. Annual programs include The Stock Market Game (SMG) (fall/spring), the Business Plan Competition (spring), and the Economics Challenge (spring). Teacher workshops are planned throughout the year at various sites in the Center's service area and in conjunction with nearby Centers. Act 48 credit (continuing education required for teaching certification renewal in Pennsylvania) is granted to workshop attendees. Workshops feature interactive lesson demonstrations, and showcased curricula are given to participants.

Carol Occhuizzo has met with Westmoreland and Indiana County curriculum directors and superintendents to strengthen the relationships among the schools, administration, and the Center. Area political leaders including Rep. Dave Reed, Sen. Don White, and Rep. Jess Stairs have partnered with schools in their respective districts as part of the SMG competition this spring. Summer plans for the Center include the Summer Honors Program in Economics, for which high school students come to campus for a week-long residential program to gain exposure to a broad range of economic concepts and applications.

The Center is also developing a curriculum package that explores economics in multicultural children's literature. Jim and Stephanie Jozefowicz, who also serve on the National Association of Economic Educators (NAEE) Professional Development Committee, presented this material at a session of the NCEE annual conference back in October.

This year's teacher workshop activities includes partnering with the Philadelphia Federal Reserve Bank to deliver two days of workshops held in Johnstown, SMG workshops held at both IUP and the *Indiana Gazette* (a partnership with the *Gazette's* Newspapers in Education program), EconFest and Economics in Action workshops held in Upper St. Clair and Butler, district in-service workshops held at Ligonier Valley School District and Southmoreland School District, *Virtual Economics* and Economics for Elementary Teachers workshops held at the Indiana County Country Club, Business Plan seminars held in the Homer Center and Punxsutawney schools, and a *Bringing Home the Bacon* workshop held at IUP's new Northpointe facility. To keep up with all Center events click to the Center's website at www.chss.iup.edu/economics/more/mission.shtm.

Unlocking the Mysteries

Book Reviews by Jack Julian

It is not always easy to recommend economics readings to my non-economist friends. There are some good ones, writers such as Paul Krugman have even achieved some notoriety. However, many of his writings (both books and his *New York Times* column) have strong policy implications which opens him to accusations as being one that has an axe to grind and seeking some political action. Policy implications are a large part of what economists do, but not the only part. Students may recall extensive lectures on marginal cost and marginal benefit without worrying a thing about the role of government. What the student perceives they study is actually more mundane. Economics is mostly about "mankind in the ordinary business of life" (Alfred Marshall).

As a teacher I'm fond of textbooks. Not because they are easy to read and entertaining but because they are the books I think are most informative, or accurate, or offer good reasoning without bias or predilection. However, textbooks are often filled with diagrams, equations, notation, and language that require some skill and training to decipher. Such books are designed for study, to which one does not necessarily wish to allocate time. Alternatively, if economists try to simplify their arguments they either seemingly invoke heroic assumptions or they clarify a point but do not offer what I, as an academic economist, would want offered: a toolkit or method of analysis in which the reader could adapt to a larger set of problems and applications.

In the past year or so, however, we have seen two of the fresher approaches to writing about economic ideas and issues without burdening the reader with excessive technical analysis. Steven Levitt (with co-author Stephen Dubner) and Tim Harford have each produced books that are a must read for those interested in problems of society and the approach of economists.

Levitt and Dubner have written *Freakonomics: A Rogue Economist Explores the Hidden Side of Everything*, a *New York Times* Bestseller. Levitt is the Alvin H. Baum Professor in the Department of Economics at the University of Chicago. Dubner is a writer and journalist. More recently focusing on books (*Freakonomics*, best-seller *Turbulent Souls: A Catholic Son's Return to His Jewish Family* and *Confessions of a Hero-Worshiper*), Dubner remains a regular contributor to the *New York Times Magazine*. He has also written for the *New Yorker*, *Time*, the *Washington Post*, and as a correspondent for PBS.

Freakonomics has received accolades from the review press, and rightfully so. It is a compelling read. *Freakonomics* takes an inquiry-based approach to its arguments. The authors ask questions to both discover evidence and to interpret evidence. (For those who watch *House* on FOX, they are much the puzzle solvers like Dr. House, but much less abrasive.) Topics of discussion are cheating by teachers, cheating by sumo wrestlers, the crafty deal-making of real estate agents, the incentives and actions of criminals, and the role of parenting in child rearing. To give Levitt and Dubner the benefit of the doubt, economists tend to be a conservative lot. That is, they like to restrict plying their trade to those things which they can reasonably discuss: prices, costs, and production and consumption choices. We also hope that with some basic tools and statistics we can predict with some confidence.

These can be applied to all kinds of goods, services, and assets in all kinds of markets. Even when there is not a formal market, or when markets fail, the economist can offer insight. In academia, we try to restrict ourselves to the positive approach: explaining "what is" rather than "what ought to be." Levitt and Dubner are careful to maintain this positive approach, much to their credit. But the economics of sumo wrestling? Are we not overstepping our bounds here? Let Levitt and Dubner certainly make their case. Sumo wrestling is an economic endeavor as much as it is a sport and a cultural phenomenon. If you are a professional, you wish to win. If you are a team member, you wish for your team to win. When how you behave (or play, or win) affects the outcome of a team member, you may find the incentive to defer to the team member for the team's benefit. In that case, one may wish to "lose" so the other may win.

Some call Levitt and Dubner's insights astonishing or dazzling. It is worthy of the praise, and care must be taken to not oversell the story. These stories of Levitt and Dubner are indeed clever and insightful. They'll certainly find more stories to tell and further volumes of *Freakonomics* will certainly get published. But it may not be so easy to see how generalizations can be drawn from their evidence. This is where *The Undercover Economist* does his job better.

Tim Harford is a writer for the *Financial Times*. His column, Dear Economist, also gets picked up by the online newsmagazine *Slate*. Harford's book, *The Undercover Economist*, is superior in the sense that common well accepted economic theory is developed and employed throughout. The book opens with a chapter seeking to explain why the cost of a Starbucks coffee is more dear than what you might find in a fast food establishment or some other diner situation. The story is one about marginal decision-making and market power. Sure, Starbucks isn't the cheapest cup of coffee, but if it is the first stop off the subway on your way to the office, its convenience is worth it. But Starbucks are often located in high rent districts, so it isn't only

(Continued on page 7)

Unlocking the Mysteries, cont'd

(Continued from page 6)

Starbucks making money. Starbucks must be able to pay the rent in such a neighborhood or else that property will be employed in some other endeavor. Harford skillfully handles the adverse selection problem with the classic Akerloff's Lemons problem, that is the problem of asymmetric information. Given sellers know more about a used vehicle than prospective buyers, given the information (or lack thereof), the buyers' risk adjusted valuation is often less than the value to the sellers, who would wind up retaining the vehicle, leaving a larger than average share of poorer used vehicles (lemons) being bought and sold.

Harford adds insight on the application of microeconomic behavior with the alternative development cases of China and Cameroon. Institutional rigidities (or lack thereof), such as legal restrictions, rent seeking (bribery), and property protection are key features to the success or struggle of developing economies. In many cases we see Harford as defender of the functions of the price system.

If you are going to read one book, read *Freakonomics*. You will enjoy it. But you will benefit more by following that with *The Undercover Economist*. You will be surprised how much you remember and your skills will be sharper.

Alumni Notes, cont'd

See print edition!

Stay in Touch

The Department of Economics at IUP considers its alumni a valuable resource. 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.

IUP
Department of Economics

Alumni Information

The Department of Economics is trying to complete and maintain a current contact list of all of our alumni. Please let us know your current whereabouts!

Name

Address

Phone Email Address

Graduation year, degree earned

Current Employer Work Phone

Position and duties

Interesting tidbits about yourself since IUP

- ☐ This is an updated address
- ☐ This is an updated employment situation
- ☐ Please add me to your mailing list
- ☐ Please remove me from your mailing list

Send to:
Alumni News
Department of Economics
213 McElhaney Hall
Indiana University of Pennsylvania
Indiana, PA 15705-1087

Or visit: http://www.chss.iup.edu/economics/More/alumni/alumform.shtm

Indiana University of Pennsylvania
Department of Economics
213 McElhaney Hall
441 North Walk
Indiana, PA 15705-1087

111501-285401-71210-114506

Non-Profit Org.
U.S. Postage
PAID
Permit No. 198
Indiana, PA 15701

We're on the web
http://www.chss.iup.edu/economics/

Alumni News

Department of Economics ◆ Indiana University of Pennsylvania

In this issue

- *Summer Reading*
- *Activities in the Department of Economics*
- *More Alumni Notes*
- *Faculty Activities*
- *And more!*