

Economics

Department Alumni Newsletter

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Bob Stonebraker, editor

The Land of the Econs

We econs are a much-maligned breed. Scattered about the country in academic enclaves, corporate suites and government cubicles, we suffer the slings and arrows of a misguided public that paints us as crass, rapacious, self-serving opportunists.

It's a bum rap. Economists are a quite generous and harmonious lot. In fact, recent studies find economists to be significantly more agreeable and more cooperative than colleagues in many other disciplines. Yes, we do understand self-interest. We are scholars of self-interest, purveyors of profit-seeking, mavens of maximized utility. But we also understand criteria for social efficiency and the need for markets to harness self-interest for the greater good.

More importantly, we are grounded in a reality that others prefer to ignore -- a reality of scarcity and opportunity costs and consequences. When others whine, "I want," we reply, "at what cost?" Others resist that. They want to ignore costs, to ignore constraints and consequences. They want it all. We know the folly, and it makes all the difference.

First, it makes us less likely to complain and more likely to roll up our sleeves and get to work. It frees us to accomplish what is possible rather than brood about what is not. And accomplish we do. We produce disproportionate numbers of leaders in government, in education, in private enterprise and in community organizations. You, our IUP graduates, make outstanding examples.

Second, it allows us to avoid the rancor and petty backbiting evident elsewhere. Trained to focus on aggregate rather than individual output, our egos are less likely to get in the way of dispassionate analysis of *group* costs and *group* benefits. We encourage each other's success instead of plotting their demise. Alas, not all are so lucky. The power brokers in some corporate and government offices squander scarce energy trying to scuttle their rivals rather than to advance the common good. What a waste of scarce resources. What a counterproductive waste. Life among the econs is so much more pleasant.

Do you want proof? Do you want evidence of the harmony and happiness we spread around McElhaney Hall? Assistant Professor of Economics Dr. Jim Jozefowicz and Assistant Professor of Economics Dr. Stephanie Brewer have announced their engagement. Yes, our two newest faculty members, strangers until they arrived on our academic doorstep in September 1999, are marrying this summer. A mere 16 months in the nurturing harmony of the IUP econs was enough. Ain't love grand?

Congratulatory graphs and equations are welcomed.

Bob Stonebraker, editor

Congratulations Karl!

Congratulations go to Karl McDermott ('76). Citing "his professional accomplishments as an international expert in public utility economics and regulatory affairs," Karl was named an IUP Distinguished Alumnus for 2001.

An impressive career

After earning an M.A at the University of Wyoming, Karl took a position as a staff economist with the Illinois Commerce Commission (ICC). He then completed his Ph.D. in Economics at the University of Illinois and, following an academic stint at the Illinois State University where he founded the Center for Regulatory Studies, Karl was appointed as a Commissioner of the ICC. As a commissioner, he led a series of successful efforts in telephone deregulation. His approach was later emulated by other state commissions and became the basis for parts of the landmark Telecommunications Act of 1996. While he enjoyed his six years "on the bench," he admits being occasionally frustrated by the political obstacles to economic reform. It was not, as he puts it, "all about setting prices equal to marginal cost."

Since leaving the ICC, Karl has become a vice president with National Economic Research Associates, Inc. (NERA), one of the most prestigious economic consulting groups in the world. Based in Chicago, Karl consults primarily on energy and telecommunication issues with a particular focus on developing performance-based regulation mechanisms and advising on strategic regulatory options. Does he find private consulting challenging and rewarding? Absolutely. However, he notes that: "I was always a public-interest type guy fighting the monopolist. Now the monopolies are my clients and I am trying to save them money!"

Karl did lament not having time for a "real" vacation -- one in which he can "just sit by the beach." Yet, he has found time to help his wife Deirdre run a boarding stable for show horses (Karl claims his primary job is to shovel) and raise their seven-year old daughter Katie. Katie is quite the young charmer and was able to accompany dad to IUP (while the rest of us endured salads and foreign-sounding entrees at the award banquet, I watched jealously as she feasted on her special meal of chicken fingers and fries). And, he did very little sitting during his visit. Claiming that he "misses the classroom," he taught my students about current regulatory issues in electricity, and gave a talk to Economics Club members about career opportunities in public utilities and regulatory commissions.

Indiana where?

Before returning to Illinois, Karl related a wonderful anecdote about his pride in IUP. He explained that early in his career he had applied for an opening as a regulatory economist with the city of New York. Impressed with his credentials, an aide to Mayor Ed Koch called to interview him. However, during the interview the aide remarked that Karl had mistakenly described his undergraduate *alma mater*. He explained to Karl that Indiana University was in Bloomington, not in Pennsylvania. Karl says that he paused, replied that he was not interested in working with anyone who thought he was so stupid that he did not know where he went to school, and hung up. Way to go, Karl!

Bush League Budgeting

Who would have thought? After decades of federal deficits, the Congressional Budget Office (CBO) now forecasts a string of surplus budgets -- a cumulative \$5.6 trillion surplus over the next ten years. Almost six *trillion* dollars? That's enough to buy a Sheetz dog (hold the mustard) for every man, woman and child in the U.S every day for the next ten years and still have \$1 trillion left over (for potato chips?). That's a lot of dogs.

How did this happen? How did Congress turn a budget drowning in deficits into a sea of surpluses? It was not some miraculous feat of political will. Although spending caps that limited discretionary budget increases helped, the unexpectedly strong economy was more important. More income means more taxes and, as incomes soared in the 1990's, extra tax dollars poured into the public coffers. Baby boomers did the rest. Now middle-aged executives, boomers are dumping taxes into the social security system faster than current retirees can pull them out. This mix will reverse in another 15 years when the boomers storm the retirement beaches in force. But, until then, social security ledgers will be swimming in black ink.

Partisan squabbles over the budget surplus have proved every bit as contentious as those formerly waged over deficits. President Bush insists we need a \$1.6 trillion tax cut. Democrats are also riding the tax cut bandwagon, but are trying to steer it to the left. As usual, the rhetoric is largely cosmetic; lots of bluster, but little substance.

Are we slipping into recession?

Bush bills his tax cut as a cure for recession. But what recession? Most economic variables remain remarkably robust. At 4.2 percent, the unemployment rate is well below historic norms and GDP continues to grow, albeit at a slower rate. Will it last? Is the recession hammer ready to fall? No one knows. Flip a coin. Some economic indicators do point to recession. Others do not. More importantly, short-run macroeconomic data are notoriously unstable. Monthly or even quarterly changes often signal nothing except statistical noise.

What we do know is that President's political hand-wringing stacks the deck against a continued economic expansion. His repeated threats of imminent recession help build a political case for tax cuts and help push the blame for any potential slowdown on his predecessors. But there is a downside. They make recession more likely. When rational consumers are told to expect an economic slowdown, they reduce spending. As they reduce spending, they create the very slowdown they feared. Expectations of the future drive current behavior. George W. seems more concerned about covering his presidential butt than about avoiding a recession.

Wait. It gets worse. If a recession does hit, do not expect the Bush tax cut to nurse us back to health. To counter a recession we must boost spending demand quickly. But under the Bush plan, most of the tax cuts are deferred until later this decade. Indeed, his original plan included *no* cuts for fiscal 2001. Promised tax cuts down the road have little impact on *current* demand. Moreover, the plan targets most of the cuts at high-income families -- families that are the most likely to save rather than spend their Bush bonanzas.

As an anti-recession policy, the Bush plan falls flat on its face. Of course, it was never intended to be an anti-recession policy. The plan first was developed several years ago in the midst of the economic boom. Originally touted as a supply-side stimulus for long-run productivity growth, Republicans played the recession card only after other arguments flopped in opinion polls. The recession scam is little more than a gigantic political ruse. If a recession does soon emerge, neither the Republicans nor Democrats seem equipped to respond adequately. Fiscal stimulus is likely to prove too slow and too encumbered by

political baggage to do much good. Monetary expansion will be the policy of choice.

What about economic growth?

The Bush plan fares no better with respect to long-run economic growth. Proponents rehash the same supply-side arguments advanced by Reaganites in 1980. They view taxes as chains that shackle the imagination and innovative power of American entrepreneurs. Unleash those chains, we are assured, and the economy will soar to new heights.

Rubbish. We traveled that road in 1981 and accumulated almost \$3 trillion of national debt in a decade. And the economy has grown faster in the last decade since the 1991 Bush (the other Bush) tax *increases* than it did during the decade following the Reagan tax *cuts*. When you hear a Bush (George W.) supporter complain that federal taxes account for an increasingly large share of GDP, point out that the relative federal tax burden for most families has fallen in recent years. Tax burdens are up for the very well-to-do, but that is because their soaring incomes have pushed them into higher tax brackets. In other words, the increased tax "burdens" are the *result* of economic growth, not an impediment to it.

The key to long-run growth is savings. Growth is driven by investments in technology and new capital goods; investments that enhance labor productivity and drive up output per person. Savings are a prerequisite for investment. If we do not save, we have no funds to lend firms trying to borrow and invest. Saving drives investment, and investment drives growth.

Alas. Personal saving in the U.S. is a disaster. Never very high by Japanese or European standards, personal saving rates in the U.S. have been in a steady decline ever since the Reagan tax cuts of the early 1980's unleashed a torrent of consumption demand. In 1980, Americans were saving about 8 percent of their disposable income. The rate now stands at about zero.

If personal saving dries up, where will we get the funds needed for new investment? There are two potential sources. The first is foreign funds. We can import savings -- and have been doing so since the early Reagan years. The second alternative is *a government budget surplus*. A surplus has the same impact as personal saving. When the government runs a deficit, it finances the deficit by selling bonds. Deficits make the federal government a net *demand*er of funds in financial markets. They draw monies out of the market that could have gone to finance private borrowing. Surpluses reverse the process. Budget surpluses turn the government into a net *supplier* of funds. A budget surplus allows the government to buy back outstanding government bonds and free up dollars to fund new investments. Do you want economic growth? Keep the surpluses. Do not cut taxes.

Are the projected surpluses real?

The final Bush tax cut defense rests on the sheer size of the projected surpluses. Surely, he insists, we can give back a paltry \$1.6 of the projected \$5.6 trillion in surplus. Unfortunately, the estimated sums are illusory. Most of the CBO estimates come from short-term surpluses in social security, medicare and government pension funds. But these retirement programs are woefully imbalanced in the long run. The federal budget shows them in surplus only because it counts the assets of these programs and ignores the accrued future liabilities that offset them.

CBO estimates also unrealistically assume that real federal spending in discretionary areas such as defense and education will remain at current levels. If we pull out the retirement funds and make more realistic assumptions about the path of discretionary federal spending, the projected \$5.6 trillion drops to \$1 trillion. If the pace of economic activity does slow down, the remaining \$1 trillion could easily

evaporate as well. It does give one pause.

What to Do with an Economics Degree: What's Your Story?

by

Stephanie Brewer

Students often express that they are not sure what career paths an economics degree will allow them to pursue. We tell our majors about the countless choices available, but they often need to hear about the careers of specific people.

This semester's IUP Economics Club activities included inviting alumnus Bill Mrozowski (1975) to share his insights and experiences. Bill described his job path that began as a bank examiner for the Department of Treasury and then shifted to trust work. Several promotions later, Bill is now President and CEO of the First Commonwealth Trust Company headquartered here in Indiana. First Commonwealth controls more than \$1 billion in assets.

As faculty, we know what we'd like our students to take to heart. Yet human nature suggests that the advice given by someone familiar (i.e., us) carries less weight than a similar idea shared by alumni guests. Bill's presentation provided us with a unique opportunity to ask questions and then sit back and smile, for low and behold, he communicated the very answers we wanted our students to hear! When asked about what skills an employer is likely to prioritize, Bill emphasized developing strong people and communication skills, the importance of being able to work with other people in team settings, embracing technology and change, and learning statistical and econometrics skills to analyze data.

Students commented that it was very beneficial to hear Bill's advice. In the future, we would like to be able to schedule more of these events. If you're going to be in the Indiana area, please let us know. Our students would love to hear your story....

South Africa's Recent Economic Experience?

by

Yaw Asamoah

Dr. Asamoah reports that the following is based upon recent readings in The Economist.

Although South Africa enjoys the highest per capita income on the continent, its income distribution is among the most unequal in the world. With white households earning on average about 12 times more than African households in the country, racial differences account for most of the inequality. Since South Africa's transition to democracy in 1994, the government has made an effort to improve the standard of living of its non-white citizens whose prosperity had been blocked during the apartheid

regime.

As you may recall, one effective way of reducing inequalities is by targeting the distribution of productive assets and human capital among the population. The apartheid regime pursued a deliberate policy of dispossessing black South Africans of their land, and excluding them from any meaningful education that would lay the foundation for acquiring human capital. The current South African government is trying to reverse these policies. For instance, land reform, involving a peaceful and orderly reversal of the apartheid-era concentration of 70% of the most fertile land in the hands of 15% of the farmers that are white, has just begun. The government has also begun to close the gaping inequalities in the distribution of educational resources that confined non-whites to schools that were among the worst in the world.

Similarly, the government has taken measures to address inequities in job opportunities. It has banned discrimination in hiring, while promoting the recruitment of non-whites in the private sector. Progress in this area has been somewhat thwarted by widespread unemployment among black South Africans, due in part to a sluggish inflow of foreign direct investment, the emigration of white-owned capital and entrepreneurial talent, and labor regulations that raise the price of labor and thus discourage job creation.

The spread of AIDS

One major impediment to this measured progress towards social and economic development is the scourge of AIDS, whose rate of infection in South Africa is estimated to exceed 10 percent per year. Why has the disease spread so rapidly in South Africa?

Explanations are truly multidisciplinary, and would make a good case study in a Liberal Studies Synthesis course on AIDS.

Anthropologists point out that public-awareness campaigns are difficult to mount because matters of sex are not a topic for public discussion in many traditional African societies. Sociologists emphasize that in a society where family structure has collapsed, and where migrant workers make up a large segment of the male labor force, men tend to patronize high-risk prostitutes. These men subsequently return home to infect their wives. Criminologists blame the high incidence of sexual violence in South Africa. Public health scholars report that many of the South African poor suffer from malnutrition and, therefore, have a low resistance to the disease. Political scientists blame the posture of the South African government—from an initial avoidance of the problem, to its outright refusal to accept that HIV causes AIDS, and its refusal to accept offers of anti-retroviral drugs at highly discounted prices. The *Economist* reports that although about 25 percent of pregnant South Africans are estimated to carry HIV, "until recently [when the government finally got the message], no treatment was allowed ... to reduce the transmission of HIV from mother to baby, ... [n]or were doctors allowed to treat even HIV-infected children." Economists, naturally, argue that all of these reasons have economic roots.

What impact is this epidemic likely have on the South African society and economy? The incidence of AIDS among the young—especially young women—is quite high, and, since husbands and wives infect each other, it is projected that there will be as many as 2 million orphans by the year 2010. The social impact of this will be devastating. Since these orphans are likely to be infected at birth, caring for such a large number of infected children will impose a huge burden on the extended family system that traditionally cares for orphans in African communities. In addition, the rapid increase in the number of HIV-infected orphans is certain to aggravate South Africa's reputation as one of the most violent countries in the world. Orphans, the *Economist* reports, are much more likely to become disaffected from South African society. "If they are also HIV positive, they may ... [be] more likely both to commit

crimes and to be fearless about being caught."

Economic costs

The economic consequences of the AIDS epidemic on South Africa are certain to be crushing as well. For the public health system, the crippling impact of caring for AIDS-afflicted patients, including the cost of treating AIDS-related illnesses, is predictable. This cost is projected to grow from the current 28 billion to 38 billion South African rand (about \$4.7 billion). Privately borne health care costs will also skyrocket. Under South African law, insurance companies are required to accept all health insurance applicants. This means that health insurance premiums will continue to rise and, without rate increases, the profits of the insurance companies will plummet. In addition, the cost of risk benefits (i.e., survivor benefits and disability pensions) will likely double.

Even more damaging, the economy is projected to lose 40 to 50 percent of its workforce. Capital-intensive industries seem to be more vulnerable to AIDS than labor-intensive ones because of the difficulty of replacing skilled workers who operate sophisticated equipment. The productivity of labor is expected to decline for a reason that might surprise most economists: "colleagues of [a dead worker] take time off to attend his funeral, possibly in a distant rural area." In addition, the distribution of wealth will become even more concentrated, as the poor bear the greatest burden of AIDS.

Not a pretty picture is it? While we Americans grouse about a stock market that is still above normal historic levels and about a recession that may or may not occur, South Africa wrestles with economic issues that dwarf our own. Want to trade places?

Good Intentions Gone Awry

I am a picky eater. Plain meat and potatoes. No sauces. Nothing that would appear on a menu written in French. Nothing that needs "presentation," and nothing with bright colors (except m&m's). My mother repeatedly tried to broaden my culinary range, but to no avail. My father more sympathetically claims it is a genetic flaw, inherited from paternal lineage.

At a recent church potluck dinner an elderly woman across the table, Mrs. Bittlemyer, urged my wife and me to try her rhubarb pie. Since I understood that rhubarb pie was merely a vegetable in disguise, I quickly declined. But my considerate and kind wife took a piece. Although she does not particularly care for rhubarb pie, she devoured it eagerly and, to the delight of the cook, with effusive praise.

Knowing my wife's culinary proclivities I was surprised, but held my tongue. Later that evening I asked if she had truly enjoyed the pie. She replied, "No, but I could not disappoint Mrs. Bittlemyer. I nodded in cautious concurrence and admiration. For a while. However, a few weeks later, we heard a knock at our front door. It was Mrs. Bittlemyer. And she was carrying a rhubarb pie. She explained that my wife had enjoyed the first piece so much that she baked a new pie, just for her. Now what? Do we fess up? No, it was too late. We accepted the pie with smiles and thank you's -- just as we have done for each of the rhubarb pies that have steadily been arriving on our porch ever since. *Good intentions gone awry.*

I should not have been surprised. After all, I know economics. I know that when people get a good price for their efforts -- either in terms of cold cash or warm fuzzies -- their eagerness to supply goes up. When potential buyers appear, sellers queue up quickly. It is like mail-order purchases. We cannot expect to buy one mail-order item without being flooded with catalogues from others. Or charitable

gifts. A \$50 check to one deserving group prompts a deluge of calls and mailings from others.

As a ten-year-old I sold raffle tickets to help support my cub-scout troop. When word leaked out that Mrs. Hartbuckle down the street had bought an entire book of tickets from our friend Steve, every boy in our troop began lining up, raffle tickets in hand, at the Hartbuckle's front door.

A firm "yuch" from my wife would have stopped Mrs. Bittlemyer dead in her tracks. A firm "no" to my friend Steve from Mrs. Hartbuckle could have saved her many dollars. They chose to be kind. *Good intentions gone awry?*

Sudanese slaves

Let's get serious. Rhubarb pies and cub scout raffle tickets are small potatoes. Slavery is not. And slavery persists in several pockets of the world, including Sudan. A poor country to the south of Egypt, Sudan has been ravaged by a brutal civil war between the Muslim-led Khartoum government in the north and rebellious, largely Christian tribes in the south. The war and attendant famines have claimed more than two million Sudanese lives since 1983.

Beginning in the early 1990s, government-backed militias began raiding southern villages to burn homes, steal food and animals, and slay the men. With husbands and fathers dead, the women and children are captured, shipped north and sold as slaves. Ugly stuff.

As word of Sudanese slavery leaked out into the international community, a predictable moral outrage began mounting. But what could be done? The war was an internal struggle caused by ethnic and religious tensions that had been burning for many generations. Military intervention by the United States or the United Nations was not likely to be either effective or welcomed. As long as the war raged, there was little that could be done to stop the slave raids.

Could the effects at least be muted? Perhaps the slaves could be freed. After all, Sudan is a woefully poor country and the going price for a slave was a mere \$15 in most northern markets. To a comparatively well-to-do American, \$15 is nothing, not even the price of a single meal at a reasonably fashionable eatery. Perhaps the freedom of Sudanese slaves could be bought.

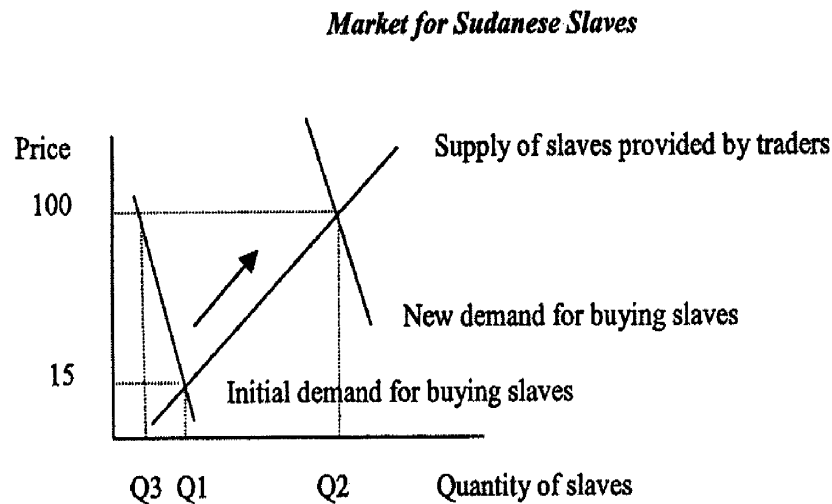
Humanitarian and Christian groups in the United States and Europe mobilized quickly to raise monies for slave redemption. Christian Solidarity International (SDI), a group based in Switzerland, has freed some 10,000 slaves by itself. Other groups have freed more. Church groups, schools, and private individuals from around the country have joined the effort.

Supply and demand

While noble in spirit, the redemption effort has split the human rights community and prompted scathing criticism from international agencies such as UNICEF. Why? Supply and demand. The redemption effort has raised the demand for slaves. As with any other product, increased demands create shortages. Shortages, in turn, drive up prices. So it is with Sudanese slaves. The demand from redemption groups has driven the going price for slaves from \$15 to anywhere from \$50 to \$100 per slave.

Do you want to see the graph? Of course! I cannot resist. Check out the one on the next page. Humanitarian redemption efforts have shifted the demand curve for slaves up and to the right. Because of this increased demand, the equilibrium price for slaves jumped from \$15 to \$100. Who gets the

financial spoils of the increased price? The slave traders. And, for what do they use their ill-gotten gains? According to opposition groups in the field, it is to buy more guns with which to conduct more raids and capture more slaves.



Do you see what happens to quantity? The initial quantity of slaves captured and sold was Q_1 . However, with the increased demand, the quantity of slaves captured and sold rises to Q_2 . That's right. The redemption effort has backfired. If you praise Mrs. Bittlemyer's pie, she will supply more pies. If you pay high prices to redeem slaves, the slave traders will eagerly capture more slaves to be sold.

And capture they do. Redemption sales have invigorated the market. Since redemption agencies often prefer to buy slaves in large groups, raiders have responded by capturing larger numbers of slaves at a time. One observer notes that they have turned slaving technology from a cottage industry into mass production. Moreover, in past years, slaves who became old or sick lost value to their captors and were released. Continued provision of food and shelter was not efficient. Not any more. It now makes more sense to hold on to such slaves until they can be sold to a redemption group.

Silver linings?

The silver lining is that the number of slaves *kept* in captivity does eventually go down. At the new \$100 price Sudanese buyers choose to keep only Q_3 slaves. The others are sold to the redeemers and ultimately released. However, the release process is often slow and, in the meantime, captured slaves are often subject to abuse, torture and mutilation. Perhaps more importantly, the raids themselves are violent and result in the brutal deaths of adult males in the targeted villages. Instead of curbing slavery, redemption efforts may merely have fueled additional violence, capture and death. *Good intentions gone awry.*

Note: Yes, Mrs. Bittlemyer is a fictitious name. And, the food in question was not rhubarb pie (which for some strange reason my wife actually enjoys). I changed the example to protect the feelings of the cook. You know, *good intentions*...

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