Economics

Department Alumni Newsletter

Indiana, PA 15705 (724) 357-2640
Issue #20, Spring 1994
Bob Stonebraker, editor

Snowed Out

What a winter! After being freeze-dried by an arctic front in January, we've been buried beneath record snow and ice for three months. Students are on Spring Break and the Buc's are loosening up in Bradenton for another run at the National League pennant; but there's nary a crocus in sight in Indiana.

IUP canceled classes twice; we lost one day in late January and two in early March. Rolling power blackouts and a Pennsylvania state-of-emergency caused the first cancellation; the second occurred during a blizzard-in-progress last week. Those of us in town could have made it. We just tie on boots and slog through the drifts. But most commuters were stranded and those who did manage to reach campus could not park. With snow falling faster than IUP crews could plow, the local lots were impenetrable.

Of course, students are justifiably outraged. Having prepaid a full-semester's tuition, they are insisting on a full-semester's education. With the regional job market still mired in recession, they contend that material missed in the canceled classes is critical to their drive for professional success. After an emergency rally organized by Student Congress, thousands of IUP undergraduates march on Sutton Hall demanding that the semester be extended. Chanting *"we want to learn, we want to learn,"* students burned effigies of senior administrators and threatened to boycott all campus social and athletic events until the lost days were restored.

No, I'm not serious. But, I did hope to string you along for a few sentences until you notices --- did it work? Most students reacted just as you would have reacted — and just as we faculty would have reacted in our own undergraduate days. They slept late, checked out some TV game shows, tossed around a few snowballs, and gave thanks for their windfall vacation.

Elsewhere, the controversies of the day are classroom attendance (should it be required?) And parking. The campus parking shortage had turned increasingly nasty. Students and staff often used the surrounding borough streets as an overflow parking lot, but a new borough "permit parking" system has bounced non-resident cars off the streets. Buses shuttle to campus from an expanded lot at the old Robertshaw plant, but they don't help students and faculty who want to motor in five minutes before their class begins. When the Field House lot is demolished to make way for the new College of Business building, tempers are likely to flare. Using prices to allocate scarce spaces might help, but such crass economic ideas remain unpopular.

In the meantime, keep those cards and letters coming. We enjoy *and need* your input and ideas. Both kudos and complaints are cheerfully accepted.

Bob Stonebraker, editor

The Times, They are a Changing...

Many of you who visit ask the same question: *have students changed?* And, I always answer *"yes"*. Most instructors on most college campuses would agree. *"Students just aren't as good anymore,"* is a common refrain. And, it's true. Each year more and more students attend college. As larger and larger percents of the population attend, the average ability level will inevitably fall. If we want to send everyone to college instead of only the academically elite, the average student will simply not be as bright.

When ability levels fall, faculty must either award lower grades or lower standards. Most have lowered standards. Those of you who graduated with a "C" average twenty years ago should take heart. In many of today's classrooms, your efforts might bring B's and A's.

But, the drop in innate ability is trivial. Most students continue to be very able and creative. To lessen the tension of final exams, I often include nonsensical trivia questions (for no credit, of course). Last Fall I asked my Principles of Economics students to identify *heffalumps.* Many students ignored the question -- after all, it offered no credit -- and several answered it correctly (the hallucinatory character from *Winnie-the-Pooh* pictured to the right). But, the incorrect answers were wonderfully imaginative. Want a sample? Heffalumps are:

"the special at the cafe"

"things that accumulate on your head after turning in final exams. They are caused by pounding your head on the wall after remembering the correct answers"

"the accumulations of cut grass deposited on the ground after the lawn mower has passed over a particular spot"

"knots you get on your fingers after holding a pencil through a two-hour exam (ouch!)"

"the fuzz balls around my room by the end of the semester"

"very portly puffalumps"

"contagious disease usually caused by economics"

These are intelligent, creative young people. They have ability, what's often missing is interest.

In the past, students faced a wide variety of promising career paths not requiring a college degree. Students unexcited by scholarly pursuits opted out of academia. But, employees without diplomas today are often stuck in unchallenging low-paid positions with little or no hope of advancement. Today's students understand that college degrees have become the price of admission to good jobs, even those jobs that don't require mastery of college-level material. They understand that what often matters is the degree, the *credential;* not knowledge. Most still come because they want to learn. But, more and more come because they have to come. Those hoping to avoid dead-end employment have little choice.

Unmotivated students are less likely to attend class and less likely to learn. Each semester I warn students they are likely to fail if they skip more than an occasional class. Each semester a significant minority of students skip anyway; and each semester they fail.

For my Principles of Economics I students, lack of attendance is the primary cause of poor performance. In statistical tests, measures of ability such as College Board test results or high school class rank are very poor predictors of exam scores. Differences in ability explain only about ten percent of the differences in student grades. On the other hand, differences in class attendance account for almost 40 percent of differences in grades. Each class a student misses lowers his/her final average by about three percentage points. Since the "typical" student misses almost 20 percent of the classes, that adds up to a mess of D and F grades.

Other researchers report similar results. Attendance matters. Yet, attendance levels are falling over time. What should we do? We can try to make our classes interesting and worthwhile, but even the most popular instructors lecture to empty seats. Should we *require* attendance? Should we *force* students to come to class?

Current IUP policy forbids faculty to use attendance in determining grades. Faculty can circumvent this by giving unannounced quizzes, but we are not allowed to require students to attend class. This semester the University Senate will consider a new policy that would permit faculty to lower the grades of students who skip class. Many faculty members would continue the current *laissez faire* policy and grade solely on such factors as test scores, quizzes and papers, but others would implement penalties for non-attendance *per se*.

Should they? Some contend students are irresponsible; that we should require attendance to protect them from themselves. Economists are skeptical. Poor attendance might be perfectly rational behavior. Perhaps a student can master course material merely by reading the textbook. Perhaps a student has family or job obligations more important than class attendance. Perhaps some instructors ramble incoherently or simply read "lectures" from the text. Should we force students to attend anyway? Learning to make choices and to accept the consequences of those choices is part of growing up. If we wipe out students' freedom to choose, will an important lesson be lost?

Economists generally advocate markets in which consumers make free choices about what to buy or not to buy. We frown on restricting choice unless there is some compelling reason to believe that free choices will damage others. Might such damage occur in the "market" for class attendance? Maybe. Sporadic attendance can impede class discussions and slow the pace at which material can be covered. The best classrooms are those in which students and faculty share in the pursuit of knowledge. But, a sense of shared exploration is difficult to build or maintain when students pop in and out at will. Students who skip classes, ask off-the-wall questions that were explained last week, and then leach missed notes and material from conscientious classmates can poison the academic environment.

Taxpayers share the damage. Since state appropriations and government-funded financial aid cover most of the educational costs at IUP, students who sleep in and blow off class are wasting *taxpayer* money. If we expect the government gravy train to continue, we'd better ensure that its dollars are used wisely.

Are there good arguments to protect the students' freedom to choose? *Yes*. Are there good arguments to restrict that choice? *Yes*. What should we do?

Alternative Fiscal Policies: Campaign '92

by
Will Radell

During the campaign of 1992 there was much confusion about the impact of the Perot, Clinton, and Bush economic plans. Two specific areas of concern were the impacts on economic growth and on federal deficits. Using simple tax and expenditure multipliers taught in any principles of macroeconomics class, it is possible to map the Perot, Clinton, and Bush economic campaign promises on a single comparative graphic.

The analysis behind the graphic focuses on how the economy works rather than how each candidate wished the economy worked. For example, an assertion by one of the candidates that cuts in government spending coupled with increases in taxes will stimulate the economy cannot be seen on the attached graph because it is contrary to observed reality. Tax increases and spending decreases tend to shrink the economy and tax decreases and spending increases tend to expand it. In the simple model behind the graphic, spending changes have a greater impact then tax changes. So, if taxes and spending are cut equally, the economy will shrink and, if they are increases equally, it will expand.

Candidates' economics plans were contained in *Agenda for American Renewal* (Bush), *Putting People First* (Clinton), and *United We Stand* (Perot). Perot's plan specified a combination of tax increases of $363 billion and government spending cuts of $340 billion over five years. Bush's plan offered equal cuts in government spending and taxes of $132 billion over five years. Clinton proposed increasing spending by $80 billion and increasing taxes by about $154 billion. The table below shows their impact assuming a simplified tax multiplier of -1.5 and an expenditure multiplier of 2.5. More sophisticated analysis would narrow the gap between these two multipliers, but the main premise is nevertheless intact as most economists believe that there is a gap between the absolute values of the two multipliers.

	Change in Gross Domestic Product	*Change in Short-Run Deficit*
Bush	-$132 billion	No Change
Clinton	-$31 billion	$75 billion less
Perot	-$1,400 billion	$703 billion less

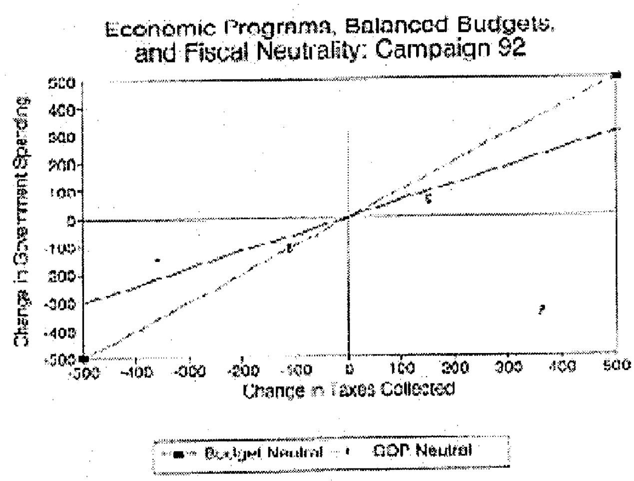
Translating this into the graph below involves two reference lines in four quadrants. The dotted line shows combinations of changes in government spending and taxes collected that are deficit neutral (producing no short-run change in the deficit). Point "B" (Bush) is right on the dotted line because he proposed to cut government spending and taxes by the same amount, producing no change in the intended deficit. Points below the dotted line show deficit reduction and above it show combinations of tax and government spending changes that increase the deficit. As can be seen, no candidate in 1992 proposed increasing the deficit. Bush was on the line, Clinton was slightly below it (advocating modest deficit reduction), and Perot was way below it (proposing radical deficit reduction).

The solid diagonal line shows combinations of tax and government spending changes that have no effect on Gross Domestic Product (GDP). Points below the solid diagonal line indicate a tendency toward lower GDP and points above it indicate combinations that nudge the economy up. Perot's plan (P) was way below the solid line, deep inside the negative growth quadrant. Bush's plan (B) was a little below the solid line making it mildly recessionary. Clinton's plan (C) was closest to the solid line, but on the recessionary side.

It is often send that with our huge recent deficits (around $200 billion), we could not stimulate the economy out of a severe recession. That can be seen as wrong by examining the center piece of the northeast (NE) quadrant. Inside the center wedge we can have both economic expansion (above the solid line) and deficit reduction (below the dotted line). If the center wedge of the NEW quadrant exists, why haven't any politicians proposed plans inside the wedge?

Politicians avoid the upper right wedge because it would require positions that would make it difficult for them to get elected. Any point in the upper right quadrant requires advocating increases in government spending and taxes, which are both taboos of modern political life. It was surprising that Clinton was able to get elected by being in that quadrant, but he didn't advocate a big enough increase in government spending to climb into the wedge. Bush advocated two popular positions, decreases in taxes and government spending, while Perot advocated one popular (cut government spending) and one unpopular (increase taxes) position.

The fear in Washington that the economy can only be stimulated by increasing the deficit is only true outside the NE quadrant. Inside the wedge in the NE quadrant, it is possible to stimulate the economy while reducing the deficit.



CONTEST! CONTEST!

Despite the ever-increasing importance of economic events, the level of economic sophistication among the general public remains appallingly low. A recent letter to Dear Abby epitomizes our plight:

DEAR ABBY: *Could you please answer this question we are baffled over at work? Why doesn't the U.S. Mint simply print enough money to just pay off our government's debts; feed the hungry and house the homeless? We know there must be a logical answer. We just don't know what it is.*

BAFFLED

Abby, apparently not too sure of the answer herself, checked with an anonymous source in the U.S. Treasury Department and dutifully drafted an acceptable, though uninspired response. As economic majors, you probably get zinged with similar questions all the time. How would you have answered? Send in your replies. The winning respondent will get a gold star affixed to his/her next newsletter!

Food for thought: When you read the above letter, did you attach an implied gender to "baffled"? Was it male or female? Why?

Pornograph Convicted on Six Counts

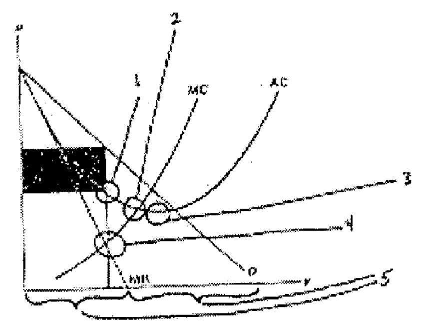
Dr. Graphman (W. W. Radell)

Last semester's pornorgraph, reproduced below, was from Hal R. Varian's *Microeconomic Analysis,* 1978, p. 67. For new readers, a "porno-graph" is my term for a visual diagram that is distorted in a way that makes it lack educational value. Graphs are used in economics to make complex concepts and systems easier to understand and analyze. If those graph become too distorted and divergent from the systems they are supposed to describe, then they obscure true communication and serve to block meaningful education. What makes last semester's pornograph special is that it contains an usually large number of errors (listed below). There isn't much right about this graph. It is a classic pornograph.

1. The southeast corner of the shaded profit box is above the AC function.
2. MC intersects AC above the minimum of AC.
3. MC doesn't intersect AC at the minimum of AC.
4. The vertical guideline misses the intersection of MR and MC.
5. The MR function is too steep. It must be only twice as steep as D. If MR has the proper slope, the bracketed segments on the horizontal axis will be equal to each other. They aren't even close.
6. Since the slope of MR is wrong: the price identified as profit-maximizing is not; the quantity shown as profit-maximizing is not; the shaded profit area is wrong.

No one wrote in about last semester's pornograph. I take that as a sign that readers have tired of reading about this seamy side of economics. Therefore, Dr. Graphman will retire for awhile and let the thousands of pornographs circulating in the journals and texts of economics live safe from my compass and straightedge. It is hoped that many of you readers have been inspired to examine graphic information with a more critical eye.

After 15 years of doing battle with pornographs in economics, it seems that the profession is, if anything, more tolerant of graphic nonsense than it used to be. The numbers of bizarre pornographs seem to be increasing. A verbal statement: "Marginal Revenue: It are made by been below Average Revenue with some slope and it do intersect at some quantity," would be detected and condemned by all but the most inept readers. But draw monopoly graphs with marginal revenue having arbitrary slop and arbitrary intersection with average revenue, and you will have a text that goes through multiple editions and makes you a millionaire.



My advice to younger economists is that if you get an illogical, nonsensical idea, don't express it in words or equations — the editors and referees will see it right away. Express the nonsense in geometric form as a pornograph and you've got a good chance of getting away with it.

Bah, Humbug!

Economics keeps changing. With promotions and prestige skewed to those who publish, professional journals churn out thousands of new theories and statistical articles each year. Trying to stay on top of the current research is like trying to hold back the Mississippi River floods. Spending a week in the back stacks of the library throws a new row of sandbags on the academic levee, but I eventually get washed out anyway.

Although most articles are arcane and of limited value, occasionally I stumble upon a gem that applies economics in a new way and makes me think; something like Joel Waldfogel's "The Deadweight Loss of Christmas" (*American Economic Review,* December 1993). It is no secret that Christmas has become big business; that its sacred message is often swamped by a secular marketing barrage. Waldfogel concludes this commercialization creates enormous economic costs as well. Not only does the frenzy of gift giving detract from the religious spirit of the day, it throws big bucks down the economic toilet.

Each Christmas, millions of Americans hit the malls looking for that perfect gift. We roam the aisles and thumb through catalogues. The pressure is to avoid the overly practical -- only the most prosaic can savor a Christmas morning spent unwrapping underwear. Most us search for something "special", something our intended recipient "wouldn't buy for him(her)self".

Occasionally we hit the jackpot and uncover that unique, special gift. But, it takes luck. It usually means we found something the other person did not know existed; a difficult chore since our friends and family usually roam the same aisles and thumb through the same catalogues as us. More often our search for something special fails. We buy something they "wouldn't buy for themselves," but only because they don't want it. *Bah, humbug.*

The result? Despite the stress, bother and additional hair loss, our gifts are often the wrong size, the wrong color, the wrong style, or the wrong flavor. Gifts so lovingly picked and graciously received end up being unused, abandoned, or relegated to attic shelves and basement boxes. We shouldn't worry; *it's the thought that counts.* But, we worry.

None of this should surprise an economist. Economists presume consumers have already allocated their income in an optimal way; they've already bought the items generating the most value per dollar. Even if our gifts are extravagant and beyond the means of our recipients, consumer theory says the best we can hope for is to duplicate what they would have purchased themselves with the cash. Paying more for gifts than recipients think they're worth is inevitable.

That's the economic cost. If we spend $25 for a gift that recipients value only at $21, we've created a "deadweight" welfare loss of $4. We've tossed $4 of potential economic value into an irretrievable black hole.

After surveying his microeconomic students at Yale (an admittedly unrepresentative sample), Waldfogel contends that this deadweight loss is surprisingly high. His students estimated the 1992 holiday gifts they had received cost family and friends an average of $438 *(remember, these are Yale undergraduates),* but that they only would have paid $313 for them -- that's a $135 loss per student! Other valuation methods revealed smaller gaps, but Waldfogel concludes that the total deadweight loss is somewhere between 10 and 35 percent of the value of the holiday gifts purchased.

Wow. That's big bucks. U.S. families spent about $40 billion on Christmas and Hanukkah gifts in 1992. If 10 to 35 percent of that was wasted, we flushed between $4 and $14 billion down the tubes. And that's only Christmas and Hanukkah. It ignores similar costs for Valentine's Day *(do women really want all those heart-shaped boxes of candy?),* Easter *(how many chocolate bunnies and jelly beans have you tossed out?)*, and birthdays *(wouldn't you rather have the cash?).*

Of course, not all gifts generate the same losses. The losses grow as the "social distance" between the givers and recipients grow. Waldfogel found that gifts from close friends and significant others had the smallest losses, followed by gifts from parents and siblings. Gifts from grandparents, aunts and uncles had the largest losses, which explains why well-meaning distant relatives often choose cash gifts instead.

But, wait. What about sentimental value? Waldfogel deliberately asked students to ignore any sentimental value of their gifts. Don't we often attach extra value to gifts *because* they are gifts? Yes, but it doesn't necessarily invalidate his conclusions. A new sweater from my wife takes on added value *because* it's from my wife. Even if I don't like the sweater, I value it because it's from her. But, sentimental value accrues to sweaters I *do* like as well. Given the choice between a sentimental sweater I like and one I don't like, I'll choose the one I like every time.

The Death of GNP

Rats. In Principles I, and again in Macroeconomic Analysis, we beat you over the head with GNP. We made you memorize it, graph it, critique it and calculate it. And now it's dead. *Gross National Product* has vanished from the face of U.S. Department of Commerce reports; relegated to a statistical landfill and replaced by an upstart concept termed *Gross Domestic Product or GDP*. Have you noticed?

Luckily, not all you learned is lost *(assuming you still remember any of it!)*. The two measures are quite similar. GNP measured the value of final goods and services produced by U.S. citizens ("nationals") in a year while GDP measures the value of final goods and services produced within the U.S. ("domestically") in a year. What mattered for GNP was who produced the output (a U.S. national or not); what matters for GDP is *where* the production occurs (within the U.S. or not). For example, output produced by Americans working in Mexico was included in GNP (because it was produced by U.S. nationals), but is not counted in GDP (it isn't produced within the U.S.). On the other hand, output produced by Mexican citizens working within the U.S. is included in our GDP, but would not have counted in our GNP.

Does it matter? Statistically, the two measures are almost identical. What U.S. citizens and firms produce in other countries is about the same as what foreign citizens and firms produce within the U.S. In 1990, our GNP was $5,465 billion while GDP was $5,514 billion. The two measures are only 1 percent apart. Granted, that's almost $50 billion, but what's $50 billion among friends?

Using GDP will ease comparisons with other countries which have used GDP for years. But, both GDP and GNP are pathetic measures of economic well-being. Both suffer from widespread misreported income (tax evasion is alive and well); both mistakenly assume that a U.S. Senator earning $135,000 produces output worth exactly $135,000; both ignore the value of leisure time and clean air; both misstate the amount of true economic growth that occurs.

Remember that "household production" is largely ignored in National Income Accounts. When I launder my own clothes and cook my own meals, production takes place. However, since I don't "pay" myself for these services, their value is not measured and never appears in either GDP or GNP. The growth of single-parent and dual-earner families has moved production out of the home (where it was *excluded* from GDP and GNP) and into the marketplace (where it is *included*). With no one at home to cook and clean and care for little Tommy and nurse Grandma Mary, families must purchase these services.

Instead of producing these services within the home, we increasingly pay for them. We *pay* the day-care center, we *pay* the restaurant, we *pay* the laundry, we *pay* the convalescent home. Such payments generate reported income and increase GDP, but the increase is a sham. It's caused by a change in the *way* services are produced, not by a change in *how much* is being produced. Recent reported growth rates have been disappointingly low; more accurate data might make them even worse.

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I'm reminded of a quote attributed to Robert Kennedy during his 1968 run for the presidency:

[GDP] does not allow for the health of our children, the quality of their education, or the joy of their play. It does not include the beauty of our poetry or the strength of our marriages, the intelligence of our public debate or the integrity of our public officials. It measures neither our courage, nor our wisdom, nor our devotion to our country. It measures everything, in short, except that which makes life worthwhile, and it can tell us everything about America except why we are proud that we are Americans.

Overblown political rhetoric? Yes. Does it ring a bit hollow coming from someone about as familiar with economic hardship as a cow is with calculus? Yes. But, interesting intellectual fodder nonetheless.

Where There's Smoke, There's Controversy

Tobacco's coming under increasing fire from all sides. Heavily taxed and barred from television advertising for years, the industry now faces strident opposition to its print ads as well. Child advocacy groups have raked Joe Camel over the coals and minority activists have lobbied to oust cigarette billboards from inner city neighborhoods.

Smoker's themselves encounter overt hostility as soon as they reach for a cigarette. Shut out of airlines and quarantined to restaurant ghettos, they find **NO SMOKING** signs everywhere they look. State governments are banning smoke from all public buildings and even McDonald's has turned a cold shoulder to its erstwhile smoking customers. As of this month, Happy Meals for smokers are take-out only.

Adding more fuel to the fire, new chief commissioner of the Food and Drug Administration (FDA) David Keslar threatens to regulate tobacco as if it were a drug. If the FDA follows through and forces tobacco to meet the same "safe and effective" standards as pharmaceuticals, tobacco products could be pulled from the market. The Marlboro Man is on the run.

The *coup de grace* may be Clinton's tax plan. To finance his health care package, the President has asked for a threefold increase in the federal excise tax on tobacco products. This tax has climbed rapidly in recent years -- from eight to 16 cents per pack in 1983, to 20 cents in 1991 and 24 cents in 1992. Clinton would drive it above 70 cents per pack.

Why this sudden bandwagon for increased *sin taxes?* Changing political winds offer part of the answer. Tobacco taxes have always been especially popular among non-smokers *(hmmmm)*. When large percents of American adults smoked and cigarettes were hawked by Hollywood's finest, smokers held the upper hand. But, as health concerns move more and more voters into the non-smoking section, tobacco becomes an increasingly vulnerable target.

When economists endorse increased tobacco levies, they cite the "external costs" smokers impose on others. Cigarettes irritate many and at some recent studies list second-hand smoke as a threat to the health of innocent bystanders. More importantly, smoking damages the health of the smokers themselves. Since the medical care they subsequently seek often is heavily subsidized by government programs such as Medicare and Medicare, smokers are a drain on the public coffers. Indeed, Clinton has justified the rate hike as fair compensation for the extra costs smokers impose on our medical care sector.

But, respected University of Georgia economist Dwight Lee argues that these external costs are unproven. He disputes the studies warning of danger from second-hand smoke and contends that smokers *are not* responsible for increased medical costs. True, smoking is highly correlated with a variety of dangerous and expensive maladies. But, argues Lee, smokers have shorter life spans. Although they use more medical resources per year, they live fewer years. As a result, there is no clear evidence that smokers "cost" more than longer-lived non-smokers. If so, higher tobacco taxes are unwarranted. Interesting twist. I wonder if Lee smokes.

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