

The Lowe Down

Lowe Institute of Political Economy

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Photo: Housing crisis paralyzes the U.S. economy.



The Ongoing Financial Crisis Part II: Recovery of 2009: Myth or Reality?

Dan Lockett '10

On February 16th, 2009, the Lowe Institute of Political Economy participated in a panel discussion at the Athenaeum. The event was monitored by Professor Filson and members of the panel included CMC's Professor Keil, Professor Blomberg, Professor Weidenmier, Dean Hess, and CGU's Dean Willett. As a sequel to the fall Athenaeum panel discussion about the financial crisis, where panel members

made predictions ranging from moderate to abysmal for the inevitable recession, there was unanimous agreement this time that the magnitude of this recession is catastrophic. This panel touched upon its various causes but it primarily focused on the policy and actions the government must take in order to get the economy back on the right track. Some of the discussion was focused on the possibility that the worst is ahead of us, not behind us. There was concern that government spending can have unforeseen long-term effects such as skyrocketing inflation, a government on the verge of bankruptcy, and eventually a substantial increase in taxes.

Professor Brock Blomberg alluded to how dangerous and risky the business of fiscal stimulus is by using Dean Willett's quote "It's different this time," which Willett used referring to

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Partisan Elections and Economic Cycles

By Seth McCormick '12



Photo: Lowe Research Assistant David Regalado '09

While working on his dissertation in 2003, Associate Professor Cameron Shelton of the Robert Day School of Economics and Finance began researching partisan political business cycles. Partisan political business cycles are defined as the fluctuations in macroeconomic variables over or between electoral cycles resulting from leaders having different policy objectives. These cycles are caused by the economic goals and ideology of different political parties. In short, the question of partisan political business cycles is what the effects of the election of a given party are on a macroeconomic scale. Though Shelton initially set out to simply differentiate between two existing theories, his inquiry has resulted in the genesis of a new and more complete alternative theory.

His research has since turned into a project that will likely result in two or three more

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Message from the Director

I hope that everyone has been able to endure the current economic recession without too much pain. At the Lowe Institute, we have had to cut our operating budget to ensure the long-run quality of our program. Despite the current economic crisis, we are excited about the recent accomplishments of Lowe faculty and students and are looking forward to next year. I would like to briefly summarize recent events and programs at the Lowe Institute and outline some of our new programs.

Over the 2008-2009 academic year, approximately 35 students have worked at the Lowe Institute on a variety of projects. About 10 students worked on public policy projects through the Lowe-RAND initiative under the direction of CMC Professor Eric Helland. The students are currently finishing up a project that examines the effect of pay on the quality of judges. Next year, students will examine various aspects of tort reform in the pharmaceutical industry.

The Lowe Institute is finishing its second year of the Lowe faculty- student scholars program. Faculty and students have published three papers in economics journals this year. Richard Burdekin published two papers with former CMC student Luke Redfern '08 on various aspects of Chinese asset prices. One of the papers was published in *Economics Letters*, a highly regarded journal that is often ranked among the top 20-30 economics journals. Brock Blomberg and Greg Hess published a paper with Hunter Jackson '08 on oil and terrorism in *Economics and Politics*, a leading interdisciplinary journal in the area of political economy.

The Lowe Institute also invited two speakers to come to campus to meet with students and faculty this spring. Daniel Hamermesh from the University of Texas came to the Athenaeum and spoke on "Beauty and the Labor Market." Hamermesh discussed the economic benefits of good looks and how it affects people's career choice. Over 100 students attended the lecture. A few weeks later, Vanguard Chief Economist and Lowe Board of Governors member Joseph Davis came to CMC to discuss applications of econometrics to the mutual industry as well as applying for jobs in the financial sector. More than 60 students from CMC attended the event.

Going forward, we plan to continue the Lowe faculty-student scholars program and the joint speaker series with the Athenaeum. We will focus on inviting local scholars to the College to help cut costs given the current economic environment. We are also excited about several new programs. The Lowe Institute has teamed up with the econometric classes to sponsor a competition called, "Can You Beat the Spread?" As one of their homework assignments, students will build a statistical model to predict the margin of victory in the 2010 NCAA basketball tournament games. The person with the best model will win a prize.

The Lowe and Rose Institutes are also planning to publish *The Inland Empire Economics and Public Policy Bulletin*. The quarterly newsletter will summarize economic and political conditions in the Inland Empire which is currently the fourteenth largest metropolitan area in the United States. We believe that the Inland Empire is an underserved market given that there is currently not an academic institution that focuses on economic development and political issues in the area. The Lowe Institute has started to assemble an editorial staff of CMC students as well as some students from the other Claremont Colleges to staff the newsletter. The bulletin will provide undergraduates an opportunity to write news articles on various economic and political issues in the Inland Empire and to apply their empirical and theoretical skills developed in the classroom. We plan to develop an email list so that we can send the quarterly newsletter to local governments and leading businesses in the Inland Empire.

We hope to use the bulletin as a springboard to jumpstart contract research at the Lowe Institute. With the help of the Rose Institute, the Lowe would like to work on economic projects for local businesses and governments in the Inland Empire. Topics include economic growth and development, environmental issues such as water rights, and transportation issues. Students will work under the direction of CMC Economics Professor Manfred Keil who has consulting experience in the Inland Empire and Coachella Valley on various economic issues.



Finally, I would like to thank all the students that have worked for the Lowe Institute over the last year. A special thanks to Kelly Spetnagel and Saul Sandoval for their administrative help. I would also like to thank the Board of Governors for their generosity during the current economic recession. To celebrate the end of the year, the Lowe Institute will hold its Annual Spring BBQ next to Green Hall on April 17. Burgers, hot dogs, veggie burgers, and drinks will be served. All students, faculty, and Board members are invited to attend. Hope to see you at the BBQ.

Regards,

Marc D. Weidenmier



Photo: Lowe events and announcements board

Weidenmier's Research Sheds Light on Energy Alternative

Chase Gray '12

With an ever-increasing dependence on foreign oil and costly alternative energy sources, Americans today face a serious problem regarding how and where they get their energy. The source of the energy that heats their homes and powers their cars is now a critical environmental, financial, and national security issue. In a well-researched and thought-provoking speech at the Athenaeum on September 30th of 2008, CMC professor Marc D. Weidenmier shed light on a viable, yet rarely mentioned, alternative fuel source: sugarcane.

Professor Weidenmier began with relevant context: a run-up in oil prices preceded nine out of ten American recessions since World War II, a trend further confirmed in 2008. He also pointed out that the United States currently imports between 60 and 70 percent of its crude oil, upwards of ten million barrels every day. With gas prices as high as they have been lately, it is hardly difficult to see how much money the U.S. is sending overseas on a daily basis to feed its oil addiction.

Weidenmier argued that America would be better off as an energy independent nation. During his speech, he noted the job and wage increases from domestic production and that the best economies during oil shocks are those with a large proportion of jobs and revenue in the energy sector. Weidenmier is not, however, solely an advocate of the "drill, baby, drill" mentality espoused by many Americans. Indeed, his talk centered on the subsidized sugarcane ethanol industry in Brazil and how the U.S. could combine imports from that country with other alternative energy sources to help kick its dependence on foreign oil.

In 1980, Brazil imported 70 percent of its oil. By 2008, through subsidization of the sugarcane ethanol industry and Petrobras, the state-owned oil company, that number fell to 10 percent. Naturally, when imports decrease, so does foreign debt. In Brazil's case, however, domestic debt became an even bigger problem than foreign debt by the mid-1980s due to their sugarcane subsidization. Instead of buying oil from foreign sources and amassing debt overseas, Brazil spent more money domestically and built up internal debt. Accordingly, Brazil restructured its domestic debt three times between 1982 and 1990. It is necessary, then, for the U.S. to use Brazil as an example and learn from the mistakes that Brazil

made, avoiding many of the pitfalls while still cashing in on the benefits of alternative energy.

There was one point

Professor Weidenmier spoke of that was incontrovertible, though politically unpalatable: the subsidization of the American corn ethanol industry has not worked. Politicians in Washington have subsidized corn ethanol solely for political clout and because of an underlying belief in the minds of many Americans that jobs here are worth more than jobs overseas. Sugarcane subsidization is better than corn subsidization, mainly because sugarcane ethanol is seven to eight times more productive than corn ethanol in terms of energy creation.

Unfortunately, one cannot apply too many explicit lessons from Brazil's case to the American energy sector. The U.S. sugarcane industry is just too small. The American industry yields 27 million tons annually, compared to 514 million tons in Brazil. While energy independence through sugarcane ethanol is not a viable alternative in the United States, it still affords a possible source of fuel that the U.S. could import from Brazil. More importantly, it can provide the U.S. with an example to lead it toward a cleaner and more economically reliable source of energy. Along with solar, wind, and other alternative energy sources, sugarcane could provide the U.S. with a solution to becoming less oil-dependent and thus less likely to experience a recession following a surge in oil prices.

Professor Weidenmier put forward an interesting plan and backed it up with strong ideas that he proved to have a strong factual foundation. All who attended the lecture were treated to a very insightful look at Weidenmier's research on this timely and critical issue.



Photo: Sugarcane harvest

CALENDAR OF EVENTS

Spring Meeting of the Lowe Institute Board of Governors

Monday, April 13, 2009—5:30 p.m.

California Club, Los Angeles

2009 Spring Lowe BBQ

Friday, April 17, 2009—noon

Burgers, hot dogs, cold beverages will be served.

Students with an interest in economics are encouraged to attend!

Is it the Weather?

By Mark Gose '11

A recent study examining the correlation between weather and stock returns inspired Professor Yaron Raviv and sophomore Matthew Beienburg to design a similar experiment. They are currently developing a linear model to test the effect of weather on auction prices. According to Raviv, "If you believe that people are fully rational, weather conditions should have no effect on auction prices. We are testing to see if people do, in fact, deviate from rational behavior."

They are using prices of auctioned paintings as their dependent variable and temperature, radiation, and precipitation as their three independent variables for measuring weather. Using an online database, they collected 40,000 observations of paintings sold in London from 1709 to 1913. Beienburg is now gathering information on daily weather conditions (i.e. temperature, radiation, and precipitation) in London during that same time frame. After the data has been fully collected, they will determine ...run a linear regression.

It will be interesting to see the outcome of this experiment. If a correlation is found, it will provide further evidence for the proposition that weather can affect economic behavior.



Photo: Matthew Beienburg '11

Interview with Matthew Beienburg '10

By Mark Gose '11

Q: Do you think that the weather has an effect on auction prices?

A: I have to admit, the question definitely seems like a long shot, and it will certainly be tough to prove a significant correlation. However, I think there is a good possibility we could get something given how large of a sample we are using in the study -- and I'm excited to see Professor Raviv work his magic when we do the regression models. Some of the other studies (e.g. "Does weather affect stocks?") came up with some really interesting as well as statistically significant results, so I'm certainly optimistic that we'll find a relationship in this study too.

Q: What has been the most difficult part in the data collecting process?

A: My two main sources of data have been the London Times' Online Archives and the British Met Office. The Met Office data was already sorted pretty well into columns, but I had to go through and filter out everything except for the specific dates and readings we wanted for each year. Unfortunately, digging through the London Times was a slightly less streamlined process: I had to actually open up each day's weather section and get the data one page at a time. Also, for a specific period of time weather stations in London did not report information on any of the three weather variables, so I have auxiliary columns for data from nearby stations (e.g. Oxfordshire) as well.

Q: What have you learned from this experience?

A: Working in Excel for as many hours as I have has helped sharpen my skills in that respect (filtering, organizing and rearranging data, etc.), and I've definitely learned to deal with the frustrations of missing, incomplete, and imperfect data sets much better. I also have a much greater appreciation for the sheer scope of research projects and the dynamics of working on a more independent project like this. At decision points no one is holding my hand when it comes to choosing or interpreting data, and there's just no way of getting around the amount of work needed to compile 2,500 data points with several columns for each of them.

Thanks to the Lowe Institute:

I'm extremely grateful for the chance to work with Professor Raviv and the Lowe Institute. After a semester with Professor Helland and his team of students last spring, this has been a great opportunity to take on more responsibility and work more independently when it comes to the direction and success of our project.

"I'm excited to see Professor Raviv work his magic when we do the regression models."

Lessons from the Great Depression: Brookings Event Sheds Light onto the Rationale for Obama's Recovery Plans



Photo: Sean Hannley '11

By Sean Hannley '11,
Lowe Institute Research Assistant

Being in Washington, D.C. for the semester gives one a lot of opportunities to hear about economic policy from those who are involved in its formulation. On March 9th, Christina Romer, the Chair of Obama's Council of Economic Advisors came to the Brookings Institution to discuss Obama's recovery plan and what lessons from the Great Depression are being used in the recovery. Very often in the news we are told that this is the worst recession since the Great Depression. While we are nowhere near a 25% reduction in GDP or a 25% unemployment level, the crisis is similar in that "today's downturn had its fundamental cause in the decline in asset prices and the failure, or near-failure, of financial institutions." The other similarity is the "worldwide nature of the decline" because rather than the rest of the world holding us up, "the fall in U.S. demand has had a devastating impact on export economies."

What lessons, then, can be learned from America's response to the Great Depression to get us out of this financial crisis sooner? For starters, a small fiscal expansion has only small effects. "Fiscal policy failed to generate recovery 'not because it doesn't work, but because it was not tried.'" While the Federal government did increase spending significantly, it did so with a higher than normal tax rate and the individual states engaged in "procyclical behavior" during which the decline in tax revenues leads to a decline in spending. The RRA (Reinvestment and Recovery Act), by comparison, is the "biggest and boldest countercyclical fiscal action in history" and is designed, in part, to prevent procyclical behavior in the individual states. Monetary Expansion can help to heal an economy even when interest rates are near zero. During the Great Depression, monetary expansion couldn't lower nominal interest rates because they were already around zero, however, it could break deflationary expectations. Deflationary expectations cause a drop in consumption and borrowing because prices will be lower in the future and interest rates are implicitly higher. Price stability, or inflation, brings down real interest rates and spurs consumption, especially "interest sensitive spending" such as car sales. Beware of cutting back on stimulus too soon. The mid-1930's saw very rapid growth; real GDP grew 11%, 9% and 13% in 1934, 35, and 36, respectively. This rapid recovery was cut short in 1937 because the Federal Reserve became concerned about inflation and began contractionary monetary policy while the Federal government worried about deficits created using fiscal policy. At some point, the recovery will "take on a life of its own," but until then, the government needs to be careful to keep up its stimulus efforts and not take away the economy's "crucial lifeline." Financial recovery and real recovery go together. Financial recovery is when banks

can start lending again normally without liquidity issues, and real recovery is when macroeconomic variables begin to improve, such as declining unemployment and positive GDP growth. Immediate financial system stabilization measures used during the Great Depression, such as the "1930's version of a 'stress test' [that] led to the permanent closure of more than 10% of the nation's banks, but improved confidence in the ones that remained" are crucial to achieve a full recovery. Also, the creation of the FDIC had dramatic immediate effects on the financial system. Despite these efforts, it wasn't until the real economy rebounded, which allowed banks to see profits again and thus, truly recover.

In the current crisis, TARP (Troubled Assets Relief Program) and the Financial Stabilization Plan are designed to work in concert with the RRA to stimulate both financial and real recoveries. Worldwide expansionary policy shares the burden and the benefits of recovery. Going off of the gold standard, and increasing the domestic money supply, were essential for economic recovery around the globe during the Great Depression. These actions, however, lowered the world interest rate and benefited every country. In this crisis, "[t]he more countries throughout the world that move toward monetary and fiscal expansion, the better off we all will be." The countries which have (such as China and the U.K.), and will pursue fiscal and monetary expansion, "are paving the way for a worldwide end to this worldwide recession." The Great Depression did eventually end. While the Great Depression did an enormous amount of damage to the economy, the country eventually recovered (which it would have done sooner if it weren't for the mistakes in 1937).

The question and answer session yielded some interesting dialogue. The stimulus is not going to bankrupt the country. If we tripled the stimulus, it wouldn't make our debt unmanageable. We didn't see this crisis coming because recessions are usually caused by monetary policy, not a fall in asset prices. Fixing the health care system will not be impeded by the financial crisis, and if we don't act now it will become a bigger problem. To quote president Obama, "we didn't do it in peace time, we didn't do it in prosperity, we didn't do it in war time, we need to do it now." When asked whether or not these government policies signaled a return to Keynesianism, Romer responded that she wasn't a Keynesian, but a good empirical economist.

"Being in Washington, D.C. for the semester gives one a lot of opportunities to hear about economic policy from those who are involved in its formulation."

International Economic Challenges of the Obama Administration

By Mark Gose '11

Marian Miner Cook Athenaeum --- On March 26th, 2009, Maurice Obstfeld, a renowned economics professor at the University of California, Berkeley, spoke about the international economic challenges facing the Obama Administration. He focused on four key topics: global trade imbalances, the role of China, emerging market meltdown, and most importantly, international cooperation in global financial markets. How President Obama responds to these "hot topic" issues will likely determine the future of world economic growth and stability.

According to Obstfeld, trade imbalances were a main cause of the current global financial crisis. For the past decade, the U.S. has been spending far more than it has earned, borrowing heavily from abroad to finance its investment and growth. Other nations became dependent on the U.S. demand for exports, and the U.S. became dependent on other nations for large inflows of credit. When the U.S. markets collapsed, demand for foreign goods fell, creating a ripple effect that has led to a tightening of credit throughout the world. President Obama calls for a future balance in international trade, emphasizing in a recent speech that the world must shift away from the situation where other nations are "only exporting and never importing."

In addition, since the U.S. is facing a multi-trillion dollar deficit and has essentially began to print money, China, by far the largest U.S. creditor, is beginning to question the safety of investing in U.S. treasury securities. Recently, they called for a new world reserve currency to replace the U.S. dollar, though President Obama quickly rejected the idea. Obstfeld proposed that China must be engaged not only on trade but also on global warming. Fostering a healthy relationship with China is not only necessary for stabilizing the U.S. economy but for balancing trade in the global markets as well.

Obstfeld's third point was how to deal with emerging markets that are largely facing insolvency, particularly in Eastern Europe. One main source of liquidity is the International Monetary Fund (IMF) which is an organization of 185 countries designed to help stabilize the world economy, facilitate international trade, and promote global monetary cooperation. The IMF provides emergency lending to countries in times of financial crises. However, its 250 billion dollar budget is not enough to adequately fix these stagnant and illiquid markets. Obstfeld expressed the need to reform the IMF and encourages countries with huge budget surpluses, like China and Japan, to offer their support.

Obstfeld concluded by emphasizing international cooperation in restructuring the global financial system. He listed several fundamental questions that arise in globalized finance: who should be the lender of last resort? who bears fiscal responsibility for rescues? what are the appropriate accounting standards, GAAP (Generally Accepted Accounting Principles) or IFRS (International Financial Reporting Standards)? and what should we do about currency mismatches? These issues, he explained, "call for a global regulatory framework – a level playing field with uniform, reliable rules of the game." Perhaps we are moving toward the creation of a more unified World Finance Organization, one that has enforcement power and allocates responsibility globally.



Photo: Professor Maurice Obstfeld, UC Berkeley

Interview with Dean Gregory D. Hess

A Quantitative Assessment of the Qualitative Aspects of Chairman Greenspan's Communications

Co-Authored by Gregory D. Hess and Michelle Bligh

By Ryan Bickler '10



Photo: Dean Gregory Hess

Q: What is the main testable hypothesis of this paper?

A: Our research builds upon the literature that examines how the statements, testimonies, and speeches given by the ex-Federal Reserve Chairman, Alan Greenspan, have affected financial markets. In the past, people have noticed that there is a lot more activity and volatility in financial markets when the FED speaks. We aimed to get at both the broad based issue of these changes, and an understanding of how to analyze the content of the speech which matters in terms of the tone that the FED is trying to set. The purpose of this paper is to establish the positive aspects of Chairman Greenspan's speeches, testimonies and Federal Open Market Committee (FOMC) statements on financial market variables. Examples of these variables are the federal funds rate, interest rates, the S&P500, and Treasury forward rates.

Q: How did you test your hypothesis?

A: I started working with Michelle Bligh, a professor at Claremont Graduate University, who has the unique ability and understanding to conduct linguistic analysis of how leaders communicate. The computer program we used is called DICTION 5.0 and it is, to our knowledge, the only existing content analysis program that has been specifically designed for public policy. Using daily data since mid-May of 1999, DICTION 5.0, and with the help of Justin Eskin (CMC '11), we were able to calculate for each method of communication a measure of its certainty, optimism, pessimism, jargon, immediacy, and activity. Although we can not measure these qualitative factors with absolutely certainty, we can get a rough handle on how the various variables can move markets and create a lot of change.

Q: What are the implications of your findings?

A: So far, the main implication of the study is that the Federal Reserve's methods of communication are really important. The language in monetary policy communications by Chairman Greenspan is informative and aids in the improved predictability of financial market variables. Often times, certain things like the short statements made by the FED after every meeting, can have big short-term changes in the market and even medium-term changes. Furthermore, we have also found that bigger projects like testimonies, which are normally 20-30 page documents, seem to have impacts on the predictability of markets at longer horizons. What this shows, is that people are looking for a more in-depth analysis and a comprehensive understanding of what is going on in the United States economy from the FOMC before bestowing credibility in them.

Q: Does this paper provide any insight into an existing theory?

A: Although this paper incorporates ideas used by Kohn and Sack (2003), and Ehrmann and Fratzscher (2004, 2005), I would have to say it is more on the novel side of existing theories. Our studies can be very useful to policy makers in terms of how they craft their statements. The language in communications, we have found, is a very significant predictor of daily movements in financial markets. I think that even though the Federal Reserve System is an independent entity, it still exists within the political realm. Therefore, I think the Chairman and the several appointed voting members of the FOMC should all be held accountable and responsible to answer questions, and give longer, more lucid explanations because it is important that their ideas and understandings are shared with everyone. Communication isn't just about talking; it's also about listening and trying to get some interaction. Thus, by enhancing the communications of the Federal Reserve, greater autonomy could be reached, and further justifications for their decision making can be delivered to the public.

Justin Eskind '11**Lowe Research Assistant**

By Ryan Bickler '10

I have worked at the Lowe Institute since the beginning of my sophomore year. Over that time, I have worked on three significant projects. Before I was able to begin doing research, it was required that I read previous papers published on the research topic of focus and either summarize them via a paper or show my understanding during a sit-down conversation. This forced me to have an in-depth understanding of the subject I was researching, and



Photo: Justin Eskind '11 in the Lowe lab

also enabled me to understand the subject at a level at which I would be able to solve a problem should one arise in the research. I am currently working for Dean Hess, who is doing extremely interesting research on Alan Greenspan. The research is based on analyzing the speeches, statements, and testimonies issued by the FED during Greenspan's era. A speech analysis program is used to give us data on various variables from the amount of pessimism to the amount of economic related terms in a specific speech. When these data points are regressed against economic data, Greenspan's understanding and reaction to the economic climate can be determined. An example is that when the market is in times of uncertainty, an increase in the amount of economic jargon is evident.

Having any job teaches you responsibility and time management, and working at the Lowe especially helped me develop these skills. I also learned a lot about the use of Microsoft Excel, which is one of the most important and powerful programs in the professional world today.

Various aspects of research projects I worked on or research that I was exposed to at the Lowe have appeared in several of my economics classes. For example, knowing some real-life applications and data definitely helped me out in my macroeconomics course. I anticipate that my work at the Lowe will be of tremendous importance throughout my career.

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the dangerous enthusiasm of people in finance during the years preceding the crisis. Blomberg believes these same four words can be said about the stimulus package because past fiscal stimulus efforts have not had consistent or significant results. According to Professor Weidenmier, fiscal stimulus spending in the 1930's was mostly ineffective, and overall he is critical of the governments current efforts for many reasons. One of these reasons is that rules and regulations for financial markets, financial institutions, and the bank bailout programs, need to be implemented before the fiscal stimulus or it will not work because banks will still not be lending. The government's poor track record in regards to efficient stimulus spending is a source of popular skepticism surrounding government efforts that represents a challenge that must be overcome in order to have a successful recovery process.

Weidenmier pointed to the fact that the recent stimulus will cost an average of \$200,000 per job that the government projects it will create, making it a bad deal for taxpayers given that the average income in the United States fluctuates between \$40,000 and \$50,000. The politicians that passed this legislation and the economists that advised them need to constantly show why this stimulus is, in fact, a good deal for the American people. Also, since this is a global recession, there are external factors that can continue to drag down the U.S. economy in the years to come, meaning this recovery will take longer than the recovery for a typical recession. There are a number of actions the government can take to resolve this crisis such as continuing to clean up and fix the financial sector. An example of cleaning up the financial sector is "stress testing" financial institutions, which if done correctly, will lead to the insolvency of some institutions but also the strengthening of others. During the Great Depression,

these tests led to the failure of more financial institutions, however, it turned out to be beneficial overall for the economy because people then had more confidence in the remaining banks. If the current "stress tests" result in more bankrupt banks and the government allows them to fail, it can boost the American people's confidence in remaining institutions. According to Professor Willett, "the quicker we face up to insolvencies the quicker the economy can be turned around."

Every professor at the discussion addressed the fact that financial sector regulation is poor and it needs to be fixed immediately. Treasury Secretary Timothy Geithner's recent proposal of the new rules and regulations for the financial sector is not popularly seen as a move in the right direction; his proposal was, at best, seen as arbitrary, but it was mostly viewed as lacking in detail and even as "pathetic." Dean Hess summarized three things that he and the panel believe need to get done as soon as possible. First, "we need to cowboy up," instituting principled regulatory framework even if it is not popular. After all, the Fed has 300 of the world's best economists and the panel believes they have been enormously silent. Secondly, the government needs to step up its efforts in trying to make the financial industry profitable again. Thirdly, Bernanke needs to demonstrate to the market that the Federal Reserve is in control of the situation and can build a better regulatory framework for financial markets as well as manage the massive government bailouts. Most importantly, the government needs to remember that stimulating the economy before fixing the financial markets and providing assurance to the public has never been a sound decision historically. In the words of Federal Reserve Chairman Ben Bernanke, "economic recovery hinges on the recovery of the credit markets."

Assuming the government restructures and fixes financial market

regulations, where should most of these government dollars go so that they are most effective? Professor Weidenmier, speaking for the panel, stated that stimulus dollars should be used to make sure that government workers are not laid off so that they can continue to consume, and the bailout dollars should primarily be used to pay back the debt weighing down financial institutions and companies with liquidity problems. He also gave a policy alternative to the bailouts and the stimulus package which would involve significantly cutting the corporate tax rate. Even though this policy would be politically impossible, it would be the most direct and effective way of allowing businesses to hire workers and invest in capital again.

The panel agreed that the fundamental element necessary to lift the economy out of this downward spiral is the rise of confidence in the markets and financial institutions. In other words, until there is confidence restored in the financial system, the credit crisis will not end. Right now, credit isn't flowing. In the 1930's the government successfully got credit flowing again due to the actions of the Reconstruction Finance Corporation. The RFC focused on establishing specific rules determining what banks and companies should receive "aid" or not (in the form of loans), as well as how much a qualified business should receive. All of the RFC's successful policies need to be taken into account by the government when creating current policy. In order for the U.S. economy to successfully recover from this recession, the government must spend responsibly while a strong, monitored, and well structured regulatory environment needs to be established in the near term.

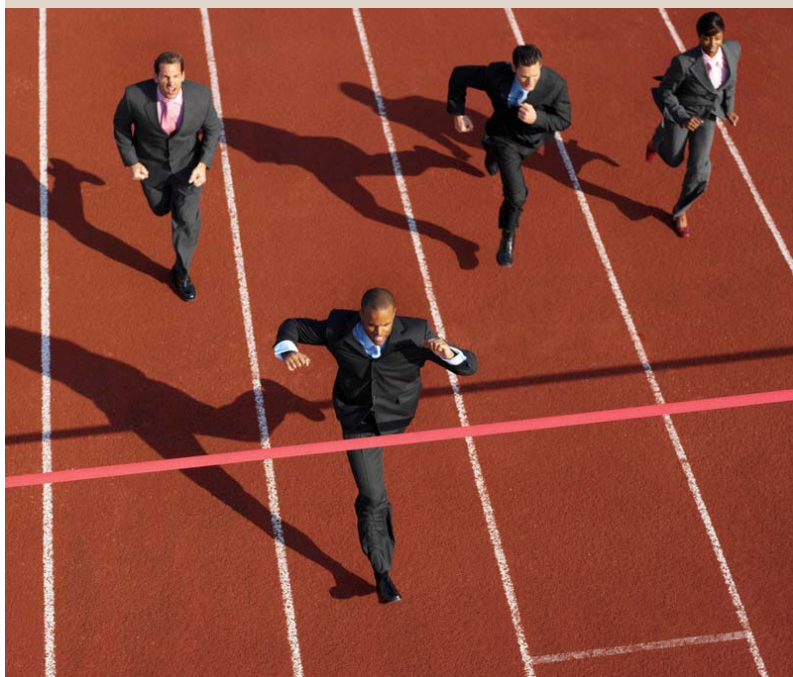
Econometrics in the Real World

By Mark Gose '11

On March 25th, 2009, Professor Keil's Econometrics class was privileged to hear Joe Davis, Lowe Institute Board member and Chief Economist at Vanguard Group – an international investment management firm – talk about the application of econometrics in the mutual fund industry. Davis is part of the Fixed Income Group, in which he oversees the construction and management of many of Vanguard's investment portfolios and is responsible for making macroeconomic forecasts to help project future asset returns. He focuses on key factors that will drive a portfolio's performance such as interest rates, the bond market sector, and industry selection, and then uses these economic indicators to construct a low-risk diversified portfolio designed to achieve the best relative value available in the markets. The type of quantitative analysis involved in creating these investment portfolios is largely based on econometric techniques, including time series sequence, error-correction models, and cross-sectional analysis. Another common method is matrix pricing, which is a technique for pricing bonds.

In addition to the importance of understanding these quantitative econometric techniques for a career in finance, Davis also emphasizes the need for intuition and common sense. He said that many job candidates in his industry are highly qualified quantitative thinkers with PhD's, but they lack intuition and practical reasoning skills. Davis reports that because of the current economic crisis, jobs in finance are scarce, so firms are now being even more selective and are seeking candidates who can combine quantitative skills with intuition and common sense.

Overall, many of the students who attended Davis' talk said it was nice for them to see a real world application of the material they are learning in class. In conclusion, he offered some words of advice: "Don't be discouraged if you don't get your desired job in finance, it is highly unlikely given the current state of the economy. What you should be looking for is a financial firm that allows for job mobility."



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papers, each an attempt to better explain the macroeconomic phenomena of partisan political business cycles.

Traditionally, these cycles have been analyzed in the simplistic terms of a Phillips Curve, whereby inflation is represented in its inverse relation to unemployment. It is this analysis that is the core of the "Traditional" theory of partisan political business cycles, which gives us several simplistic assertions. An example of this would be the assertion that should the left be elected, government spending will increase, unemployment will decrease, and so inflation will ultimately rise. The "Rational" theory of partisan political business cycles incorporates rational expectations and election outcome uncertainty.

For example, since the people do not know which party will win the next election, voters develop rational future expectations for the variables of inflation and unemployment. This is done by averaging the predicted levels of each variable associated with the hypothetical election of each party. Shelton wanted to determine whether the "Traditional" or the more complex "Rational" theory of partisan political business cycles is preferable based on some previously unaccounted for variable.

While researching these already established theories, Shelton found himself part of a group of economists that discovered both theoretical forms to be inadequate. So he set out in search of an alternative that would prove to be much more comprehensive. Instead of only inflation and unemployment, Shelton is also looking into the implications of partisan elections for the investment and consumption components of GDP, as well as interest rates in both the short and long run. His approach is also more complex in that he differentiates in his research between "formation of policy" or "policy cleavage," and the "propagation of policy" or "variety of capitalism." Shelton believes this is necessary because "policy is not uni-dimensional," explaining the need to account for things such as labor market regulation and policy matters other than simple fiscal stimulus. Also, the way in which a policy is propagated can vary greatly and have significant ramifications on a country's macroeconomic situation.

This differentiation is given further importance by the variety of capitalism found across the world, as stated in Shelton's paper, "The Information Content of Elections and Varieties of the Partisan Political Business Cycle." He states that these differences are due to the following: "(a) the political cleavage over economic policy is a function of the underlying organization of the economy in question and (b) the ability of a government to enact its platform is a function of the institutions of governance which are at least correlated and likely co-evolved with the economic institutions." With the help of Lowe research assistant David Regalado, Shelton is using the research of economists Ken Benoit and Michael Laver as well as principle component analysis to determine which elements are most important in each individual country. Ultimately, Professor Shelton expects his research to lead him to a comprehensive theory pertaining to partisan political business cycles.

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Photo: Professor Daniel S. Hamermesh

Professor Daniel S. Hamermesh

"Beauty in the Labor Market"

By Seth McCormick '12

At the Athenaeum on Thursday, March 5th, Professor Daniel Hamermesh of the University of Texas shared his unprecedented knowledge on the economics of beauty. According to Hamermesh, the reason for presenting on such a unique topic in economics is because he feels that "as long as I can think like an economist about a bizarre topic it is well worth doing." Whatever the reason, the audience certainly enjoyed the topic due to its ubiquity in everyday life.

Throughout his lecture Dr. Hamermesh addresses several questions surrounding beauty and its economic outcomes. The fundamental question that he addresses is "if there is a benefit to being good looking in the labor market, how much more do better than average looking people make compared to lesser than average looking people?" In his research, Hamermesh tested for looks in the labor market as well as the effect looks play with respect to each gender. As it turns out, there is a statistically significant correlation between one's salary and looks. He points out that it is essential that there is some agreement upon the question of what beauty is in order for this correlation to be significant. In other words, "is beauty in the eye of the beholder?" He concludes that "beauty may be in the eye of the beholder, but we behold things very similarly." Results from several studies show that what matters to the human eye when it comes to beauty is symmetry. The more symmetrical one's features, the more attractive they are in general. Since a similar idea of what beauty is does exist, the lecture then moved on to the effects of beauty.

By and large, one finds from many studies two consistent and significant results. First of all there is a larger penalty in terms of salary for being in the uglier 1/6th of the population than there is a premium for those in the top 1/3rd of the most attractive people. Secondly, it is found that the effects seem to be bigger for men than for women. However, there could very well be markets other than the labor market where looks play a greater role for women like in the marriage market. As a matter of fact, studies show that in the marriage market, uglier women marry men who have less income to share. Another research project of Professor Hamermesh looks into the effects of one's beauty in the labor market over the course of one's life. He brought to our attention that the results of this study found that the more seniority one gains in their professional career, the greater the effect "looks" will have on their earnings.

Interestingly, for his next point he quoted a super model: "It was God who made me so beautiful. If I weren't then I would be a teacher." He interprets this quotation to imply that people select into occupations based upon the returns to beauty. When he looked into beauty's effect on occupational choice, he discovered some staggering facts. For example, on average, better looking people work in litigation because this is a field where looks clearly pay off. Another example is that in the field of law, less attractive men tend to work in the public sector while more attractive men work in the private sector. Hamermesh explores several margins outside the labor market where beauty matters from game show eliminations to the grades a student receives. Briefly, he shows that investments in beauty products simply do not pay off and that beauty is typically inherent throughout one's life. In the end, he proposes the question that if the government protects for race and gender, then why doesn't it protect for beauty? As outlandish as this argument may seem, Hamermesh emphasizes that this is a perfectly logical argument and that his research has proven that these things are identical economically.

An Interview with Professor Heather Antecol

By Peter Meyer '12

Female Labor Supply Differences By Sexual Orientation: A Semi-Parametric Decomposition Approach

Q: What is the main testable hypothesis of your paper?

A: The general idea of the paper deals with the importance of accounting for household specialization in lesbian couples. In the exploration of this issue, the main testable hypothesis has two parts. The first part involves making the distinction between lesbian women who specialize in market production (primary earners) and lesbian women who specialize in household production (secondary earners). Secondly, this hypothesis investigates the role of children in explaining the mean labor supply gap by sexual orientation.

Q: How did you test this hypothesis?

A: Using U.S. Census data from the year 2000, we compared the labor supply gap between primary lesbian earners and married women to the gap between secondary lesbian earners and married women. We utilize a semi-parametric decomposition to demonstrate the effects of the observable differences between primary and secondary lesbian earners and married women, such as having children.

Q: What do you feel are the main implications of your findings?

A: Taking household specialization into account provides a lot of insight into the labor supply gap. First, primary lesbian earners are very different than secondary lesbian earners because they are more attached to the labor market. When a lesbian couple has children, the primary earner is not as likely as the secondary earner to leave the labor force to take care of a child. This is one of the main reasons why the gap in labor supply is much greater between primary lesbian earners and heterosexual married women than between secondary lesbian earners and heterosexual married women. Our research shows that children, as a determinant, are the most statistically significant explanation of these findings.

Q: Does your hypothesis contribute to any existing theories or is it set apart from the rest of the work in this field?

A: The research that has been done to date on lesbians, including mine, treats all lesbians the same irrespective of earner status and I think that this masks a lot of important things. What is distinctive about our work is the fact that while we look at labor supply gaps between heterosexuals and lesbians we acknowledge differences between secondary earner lesbians and primary earner lesbians. When you miss that distinction the results are not likely to be the same. In that respect, I feel that our study is more comprehensive because we avoided this common mistake and got significant results along with more interesting future research ideas.



Photo: Professor Heather Antecol and Joshua Redel '10

Interview with Joshua Redel '10

By Peter Meyer '12

Q: Describe your experience at the Lowe Institute.

A: I haven't physically worked at the Institute itself, since I can do all of my work on STATA in my room. However, Professor Weidenmier and his assistant, Kelly, have been nothing but friendly to me and I have experienced no complications in my relationship with the Lowe. Professor Antecol is not only one of the friendliest and most understanding bosses I have ever had, but she is a brilliant economist with innovative research methods coupled with an infinite amount of energy.

Q: What tools did you gain and what did you learn as a result of working at the Lowe Institute?

A: I now know how to use STATA well enough to write my thesis, or at least to comfortably run microeconomic data regressions and conduct analysis. Additionally, I have learned how to interpret and correctly order and organize data from IPUMS, which is a task much more complex than it would seem at first.

Q: How did working at the Lowe help you in your courses at CMC?

A: My time series course makes a lot more sense now that I've worked for the Lowe for a little over a semester. I can spot problems in my own coding and can follow along in class much more easily than if I had had no experience with STATA. I also know where to look for coding help and what kinds of questions to ask (and more importantly, answer) when speaking with a professor about coding. I am also much more adept at creating spreadsheets from my work in STATA.

Q: What are some of the projects you have worked on?

A: Professor Antecol and I first worked on the replication of Blau and Kahn's 2007 paper on the changes in labor supply of married women. We are now constructing analysis on the question of whether women with children under five really do participate in the labor force less than their childless counterparts. Obviously, the question is a little more complex than that, but the idea lies in that basic question.

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The New Lowe Board Member

—Daniel Lockett '10

CGU graduate and President of Global Financial Data, Inc., Bryan Taylor, has recently joined the Lowe Institute's Board of Governors. As a stock broker, Dr. Taylor started Global Financial Data in 1995 because, at the time, brokers and individuals only had access to information that was solely in the short-run. His vision was that one day, financial data going back further than 50 years would be available to the public so that long-term trends in the markets could be properly researched. This database provides financial information for those researching and/or investing in the markets in both the short- and long-run.

Over the course of several years, Dr. Taylor gradually began to collect data here and there. When the internet started to pick up, it provided his business with a cost efficient way to expand internationally. Now Global Financial Data provides services to most financial, private, and public institutions such as: central banks, international banks, investment banks and all of the top business schools in the United States. For example, CMC faculty members frequently use the database for research purposes. As a dedicated business leader and researcher, Dr. Taylor loves the fact that his company is always focusing on new things such as providing a long-term history for all individual equities. Recently, the database system has attained data on the NYSE dating all the way back to 1791. How is this done? After digging through the archives, Dr. Taylor's business essentially organizes the data so that it is more accessible to researchers and investors.

The Lowe Institute of Political Economy is honored and excited to have Dr. Bryan Taylor on its Board of Governors. Commenting on his new position, he stated that he "believes that I can provide a new perspective for

the Lowe because of my real world experiences and professional career, which will allow me to be a good bridge between the business- oriented and academic board members."

LOWE INSTITUTE OF POLITICAL ECONOMY

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Photo from left: Mark Gose, Pete Meyer, Chase Gray, Seth McCormick, Daniel Lockett, Ryan Bickler

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