

THE LOWE DOWN

LOWE INSTITUTE OF POLITICAL ECONOMY

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Southern California Conference in Applied Microeconomics in the Hampton Room at Scripps College.

CMC's Southern California Microeconomics Conference

By Laura Hagen '11

On April 16th, CMC hosted the first Southern California Conference in Applied Microeconomics. It was jointly sponsored by the Lowe Institute, the Berger Institute, and the Robert Day School of Economics and Finance. Over 30 economists from universities across Southern California gathered to exchange ideas and encourage substantive discussion on various topics in microeconomics.

The conference was broken down into six sections that featured different issues which included the following: Crime and Affirmative Action, Housing and Mortgage Default, Pharmaceutical and Healthcare, Education and Wages, Schooling and Local Government, and a Graduate Student Section. During each session, two working papers were presented and followed by a commentary presentation from another economist as well as a round of questions. Through this process, the economists were able to gain constructive feedback on their working papers and ideas for future papers based on their research.

One of the more lively discussions occurred during the Housing and Mortgage session, where Michelle White addressed the following question: "Did bankruptcy contribute to the mortgage crisis?" In 2005, new bankruptcy laws went into effect that raised the cost

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Professor Manfred Keil on the Great Recession, the Great Stabilization, and the Shape of the Recovery

By Jennifer Good '13

At the Marian Miner Cook Athenaeum on February 17th, Professor Manfred Keil analyzed the prolonged recovery of the U.S. economy from the latest recession. Professor Keil addressed the following question during his lecture: "Do the models still hold or do we live in a brave new world?" He concluded that though this recession was markedly different than previous recessions in terms of severity and the role of unemployment, established economic models are still effective predictors.

Keil acknowledged that this recession was difficult to foresee. In fact, in the fall of 2008, when Keil participated in a panel discussion at the Athenaeum, entitled "Recession of 2008: Myth or Reality", only one economist on the panel surmised that the recession had already begun. He explained that this past recession was not obvious at the time because unemployment levels remained fairly constant.

The current recession was drastically different than past recessions in terms of severity. Professor Keil labeled the past two recessions as "great moderations" due to how mild they were. It also differed from the other two in terms of its impact on the unemployment rate. In 2009, the national real gross domestic product declined by 2.4%, while the unemployment rate declined by 3.7%. This was a much greater drop in unemployment than was predicted by Okun's Law and cited by Christina Romer, who is the Head of

Professor Keil—Continued on Page 7

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Message from the Director

The current issue of the *Lowe Down* marks the last issue that will be edited by founding editor, Dan Lockett '10, who is graduating this semester. Dan has done a wonderful job, has taken full ownership of the *Lowe Down* and demonstrated extraordinary leadership these past two years. He has spent numerous hours editing the *Lowe Down*, hiring students, and organizing the publication. We would like to thank Dan for his work and wish him the best of luck in the real world!

The Lowe Institute will host a regional forecasting conference with UCLA Anderson School this fall in the Inland Empire. UCLA will provide the forecast for California and the United States while the Lowe Institute will provide the forecast for the Inland Empire region. Student research assistants at the Lowe under the direction of Professor Keil have developed an index of leading economic indicators to predict economic activity in the Inland Empire. The new index is introduced and discussed in the latest issue of the *Inland Empire Outlook*.

We introduced the first annual NCAA Lowe March Madness game this spring. In conjunction with Professor Keil's statistics classes, students built point-spread models to predict the outcomes of the Men and Women's 2010 NCAA Basketball Tournament Games. The exercise provides students with an opportunity to learn how to develop and use regression models in the real world. We will also introduce the NFL Challenge in the fall where students will build point-spread model to predict the outcomes of football games.

The Lowe Institute, in conjunction with the Berger Institute and Robert Day School of Economics, sponsored the first annual Southern California Conference in Applied Microeconomics (SCCAM) at Claremont. The event attracted more than 30 economists from Southern California including faculty from top research universities such as UCLA, UC-San Diego, USC, and UC-Santa Barbara. Professor Francine Blau of Cornell University gave the keynote address on gender and immigration. More than 30 students attended the keynote address and conference.

Aanchal Kapoor and Aditya Bindal, two CMC undergraduates, approached Salvatori and Lowe Institutes last fall about starting a program called CIVITAS. The two institutes sponsor a series of documentaries and discussions that are attended by students and faculty in the evening over pizza and soda. The Institute also had its spring BBQ in early April to thank faculty and students for participating in the programs of the institute.



The Lowe Institute will be sponsoring 10 different research projects over 2010-2011 academic year. Some of the topics include debt and interest rates, liquidity and stock returns, terrorism, and the Asian financial crisis.

We wish everyone a fun and relaxing summer.

Best,

Marc Weidenmier



Mark Gose '11, Dan Lockett '10, and Peter Meyer '12 at the Lowe Institute Barbecue on April 17, 2009.

Interview with Professor Graham Bird

The International Monetary Fund: A Lifetime of Research

By Laura Hagen '11



Photo: Professor Bird

Graham Bird has been a visiting professor at CMC since 2005. His primary research interest is the International Monetary Fund, and he is widely respected as an IMF scholar. At the Harvard Institute for International Development, Bird was an expert adviser to the IMF's Independent Evaluation Office, a visiting research scholar with the IMF's research department, as well

as an adviser to the World Bank and several other international organizations. He has published more than 20 books and monographs and has written nearly 200 articles for academic journals. Below, Bird discusses some of his general findings on the IMF, through which he exemplifies the need to understand the important relationship between political science and economics.

Q: What attracted you to this particular area of research?

A: Studying the IMF provided me with an opportunity to straddle conventional disciplinary boundaries, combining economics and political science. Moreover, given the Fund's wide membership of countries as well as its key role in the global financial system and in economic development, research aimed at improving the Fund's operations can beneficially impact the lives of many people.

Q: What are the implications of the Financial Crisis on the IMF?

A: At the beginning of 2008, some commentators raised doubts about the IMF's relevance. The Fund's portfolio of loans was at a very low level, and critics claimed that it exerted little meaningful influence over the conduct of economic policy in the countries that borrowed from it. Another criticism was that it had done nothing to help eliminate the global economic imbalances that led to international financial instability.

In the aftermath of the global financial crisis, international attention has refocused on the IMF. The G20 summit in London during April of 2009 granted more resources to reinvigorate the institution. If the crisis was good news for anyone, it seemed to be good news for the IMF. We'll see how the Fund responds to this challenging opportunity. There are many critical issues that need to be addressed.

Q: Can you give a few examples of the research questions you have worked on?

A: A primary example of a research question is "why do some

countries turn to the IMF for help while others do not?" Early research, including some of my own, attempted to construct a universal model integrating economic, political and institutional determinants to explain IMF lending. These attempts had only limited success. More recently, my long term research collaborator Dane Rowlands of Carleton University in Canada and I have established that one model does not fit all countries and that to some extent, this accounts for the disappointing results from previous large sample studies. In short, the whole thing is more complex than it was originally believed to be.

Dane and I also investigated the episodic nature of overall IMF lending to see if regular patterns can be established. Can aggregate IMF lending be explained and is it possible to forecast it? We discovered that there are real difficulties here. This is an important issue when there are discussions about ensuring that the IMF has sufficient lending capacity and the possibility of moving over to an automatic quota formula to determine IMF resources.

Another question we looked at is why some programs are more fully implemented than others. Why this is important is because the track record on implementation has generally been rather poor. There is no point in negotiating a detailed program of policies if it is not then put into effect. We discovered that a political economy explanation was needed. Our findings were that implementation depended not only on the openness of economies and the amount of support offered by the Fund, but also on the political power of influential nations. Professor Alex Mandilaras of Surrey University and I have a paper coming out that empirically tests the argument that the large accumulations of international reserves in many emerging economies observed in recent years has been motivated by a desire to avoid having to borrow from the Fund in the event of a crisis. We found that there is a significant and positive IMF effect that lasts for a considerably long time.

Q: Does it follow that it is difficult to make clear policy prescriptions?

A: I think that one of the policy conclusions that has emerged from this research is that the Fund needs to have a flexible approach to things such as the conditionality it attaches to its credits. Additionally, there needs to be a more flexible approach to providing the IMF with resources. In most of my research, I spend quite a bit of time exploring the policy implications and the political economy of reform, but unfortunately economists often neglect these issues.

Interview with Professor Keil

Brightening the Outlook for the Inland Empire

By Jennifer Good '13



Photo: Professor Keil

Q: What progress has been made on the *Inland Empire Outlook* Project in the past semester?

A: We published the first edition of the *Inland Empire Outlook*. It focused on major aspects of the Inland Empire's economy such as unemployment, recent developments, as well as its main industries such as construction, housing, and distribution.

Q: How was the first issue received?

A: We were on the front page of the *Inland Valley Daily Bulletin*, and this generated inquiries from businesses. Ultimately, our goal is to gain publicity because we are hosting a conference next fall for 500 business leaders and politicians from the area.

Q: What were the main conclusions about the Inland Empire's economy in the first issue?

A: Almost all of the United States and most of California has recovered from the recession, but the Inland Empire is still suffering. We found that the recession was particularly severe in the Inland Empire due to the crash of the housing market, which eliminated many construction jobs. Also, layoffs in both Los Angeles and Orange County hurt the Inland Empire's large commuter population. Worsening the situation, the economies of California and the United States grinded to a halt, bringing a stop to the Inland Empire's vital logistics industry.

Therefore, the Inland Empire's only way out of this recession is for the United States, California, and Los Angeles County economies to recover, which is beginning to happen. However, the housing industry is still a complete mess. There are warning signs that the worst is yet to come because interest rates for a majority of Adjustable Rate Mortgage (ARM) loans will not be adjusted until late 2011 or early 2012. Even more

properties may face foreclosures when this happens. Also, due to the current surplus of housing, there is no desire to build in the Inland Empire.

Q: What public policy prescriptions come from these findings?

A: Our work will give local politicians and businessmen an understanding of the economic situation so that they can have a better plan once the economy turns around. This plan will presumably focus on luring better paying jobs to the Inland Empire. For this to happen, the population needs to be better educated. However, with the state budget in shambles, public education is not getting enough funding. The other hope is that solar or wind-powered energy could be generated in the desert, which would provide more employment opportunities for those in the Inland Empire.

Q: What is the *Inland Empire Outlook* working on now?

A: The second issue of the *Inland Empire Outlook* will include indices of leading economic indicators, logistics, and commercial and housing properties. These indices will be the first of their kind created for the Inland Empire.

A leading economic indicators index combines multiple economic theories to forecast changes in the economy. For the Inland Empire, we are including things like housing stocks and consumer sentiment. The housing and commercial indices will compare the current selling values to the previous selling prices of the same properties. To assess the health of the distribution industry, the logistics index will monitor the number of trains and trucks moving in and out of the Inland Empire.

Q: What role will students play in the future for this project?

A: We will hire ten students to work on this project full time this summer and part time next year. We will then decide what the next projects should be — perhaps an analysis of the role of casinos, the Coachella Valley, and education.

Meghana Reddy '10 Studying the Financial Crisis as it Happened

By Anna Eames '13

Q: Describe your experience at the Lowe Institute.

A: I first began working for the Lowe in the summer of 2008. I worked on two primary projects that summer; the first of which was with Professor Weidenmier and I was responsible for creating a data set of the money supply in the United States during the Great Depression. I also worked with Professor Helland on a database that involved cataloging expert witness testimony in a quantifiable way.

Last summer, Dean Hess and I performed a comprehensive search and review of economic literature related to the Federal Reserve's involvement with Fannie Mae and Freddie Mac. I also helped Dean Hess analyze different monetary policies the Fed could enact in order to pull the economy out of the current recession, as well as the most effective way for the Fed to rollback some of the policies it implemented in its efforts to mitigate the financial crisis.

Q: What did you learn as a result of working at the Lowe?

A: I really enjoyed working with Professor Weidenmier, Professor Helland, and Dean Hess. My time at the Lowe has been a rewarding experience and I have had the unique opportunity to learn a lot from the faculty. They all work closely with their research assistants and give them a great deal of responsibility, which is conducive to building strong relationships with the students they employ. I also became adept with several statistical programs and with analyzing data, which certainly enhanced my research capabilities. Overall, I am very happy with the time I spent at the Lowe.

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

A: I am an Economics-Philosophy major, so I am interested in both finance and public policy. Both of my majors incorporate a lot of econometric and statistical tools. Working at the Lowe was very helpful because I learned about what to look for in academic and economic literature as well as how to apply statistical models. Additionally, I learned a lot about how data is collected and where it originates. When you know where a statistic comes from, you can fully understand it and therefore criticize it much more effectively. I am fairly analytical, so I am looking for a job that will put those skills to use.

Q: What was the most difficult part of the data collection process?

A: It depends on the project. The research I conducted with Professor Weidenmier required a lot of tedious work on Excel. With Dean Hess, however, I really enjoyed the data collection process because I read many articles about the financial crisis which allowed me to develop an in-depth understanding of it. I enjoyed delving deeply into this topic, and I wouldn't have had this opportunity if I had never worked at the Lowe.

Interview with Aaron Champagne '10 Building an Industrial Production Index

By Peter Meyer '12

Q: What is the current project you are working on at the Lowe Institute?

A: The purpose of my current project is to create a monthly industrial production index for the United States within four different regions: east, south, west, and midwest. In particular, the index concentrates on data from the 1800s and the early 1900s, a time during which the United States went through several recessions. The data will hopefully reveal which areas were immune to, and which areas were most affected by, recessions of the late 1800s. After the industrial production index is completed, it will likely form the basis for a series of papers over the next couple of years.

Q: How is the project progressing?

A: As of right now, the project is in the data compilation stage. Gathering the data has been a pretty long process, as the data we need is quite extensive. One challenging aspect of this process is the legwork that goes into acquiring all of the necessary information. Last semester, I was on a team of four or five research assistants who started this project and now I have been going back to fill in the data that we could not find online. In order to collect the necessary historical data, I traveled to New Orleans a few weeks ago and I have also been making trips to San Francisco.

Q: What sort of findings do you expect from your research?

A: It is difficult to make predictions about our data as the project is still in its early stages. We are not quite sure what we will find because no one has ever created a comparable monthly industrial production index. One possible result given our data so far, however, is that the western United States was immune to a lot of the recessions that occurred during the 1800s. Upon completion, the industrial production index should be able to provide more insights similar to this.

Q: Have you worked on any other projects at the Lowe Institute?

A: Yes, I have worked at the Lowe Institute for a couple years now, mostly with Professor Weidenmier and Professor Eric Helland. One project I worked on previously with Weidenmier examined the economic impact of the Civil War on the southern United States, specifically the effect it had on New Orleans. In several respects, the project we are currently working on grew out of our examination of the Civil War and its economic impacts. This first paper sparked our interest in the 1800s, and we eventually decided to expand our examination of this era.

Francine Blau on Immigrant Women in U.S. Labor Markets

By Laura Hagen '11



Marian Miner Cook Athenaeum — On Friday, April 16th, Francine D. Blau gave the keynote address at the Southern California Conference in Applied Microeconomics. Blau spoke on the effect of culture on the ability of female immigrants to assimilate into the U.S. labor force. She looked specifically at assimilation because she believes it can not only provide insight into what is currently happening in the labor market but also, more importantly, what will happen in the future as current immigrants fully integrate into the U.S. work force.

The composition of immigrants began to change between 1970 and 2000. Originally, most immigrants came from Europe and Canada, but today the most popular regions people come from are Asia and Latin America. These two regions have much more traditional divisions of labor than the U.S. in terms of having conventionally male or female jobs. Through her study, Blau hopes to “get behind the black box of taste and preference” – that is, to explain the direct impact of culture, specifically in terms of gender roles, on the labor market.

At the beginning of her talk, Blau admitted that it is nearly impossible to definitively quantify something as abstract as culture, but her evidence strongly suggests that it plays a role in an immigrant woman's assimilation into the U.S. labor market. Blau uses statistics from the U.S. Census from 1980-2000 to focus on two indicators of a cultural impact on the work force: female labor force participation relative to men as well as fertility rates. She tried to isolate these indicators by controlling for other factors that could impact the labor supply. These factors include income, education, whether the country is English speaking, and several others. She also focused on married immigrants because their gender roles are the most pronounced and on immigrants who came to the U.S. after the age of 18 because they are more sensitive to their home country's culture.

One major result of the study was that women from countries with less pronounced gender roles can integrate faster into the U.S. labor market. If immigrant women come from countries where females work relatively more hours, it takes them 6-10 years before they work as many hours as women in the United States. On the other hand, immigrant women from countries where females work fewer hours on average never work as many hours as U.S. women. Yet, as they continue to live in the U.S., they do eventually work more hours than they would have in their home country. For men, the amount of time it takes to work as many hours as U.S. citizens once they emigrate does not depend on the labor supply of women in their home country, which supports the notion that gender roles are the primary determinant of these results.

Similar results were found when she examined fertility rates. Overall there was a negative correlation between fertility rates in native countries and participation of immigrant women from those countries in the U.S. labor market. This further supports her conclusion that gender roles are important determinants of the participation of immigrant women in the work force.

Blau believes that source country gender roles will change in offsetting ways in the near future. In terms of fertility, world rates are falling relative to those in the United States. This could signal faster integration of women into the U.S. labor market in the future. Female labor force participation is also increasing world-wide, but not as quickly as the participation of female U.S. citizens in domestic labor markets. However, the increase of female participation in the U.S. labor force is starting to plateau, which could allow immigrant women to catch up in terms of participation rates. How these trends develop will determine the future ability of immigrant

2009-2010 Research Assistants

Candace Adelberg '10
 Gabriele Andrade '12
 Kristina Bergess '12
 Aditya Bindal '11
 Emily Brister '09
 Aaron Champagne '10
 Nathan Doctor '11
 Anna Eames '13
 Justin Eskind '11
 Jennifer Good '13
 Mark Gose '11
 Chase Gray '12
 Hannah Gregg '12
 Laura Hagen '11
 Sean Hannley '10
 William Heinke '10
 Travis Hull '10
 Jesse Huston
 Aanchal Kapoor '11
 Will Li '12
 Xiaotong Li '12
 Erin Liu '09
 Dan Lockett '10
 Rosabella Magat '12
 Noah McCormack '09
 Seth McCormick '12
 Peter Meyer '12
 Vishnu Narasimham '12
 Andrew Oetting '12
 Grant Parker '11
 Saul Sandoval Perea (CGU)
 Meghana Ponnaluru '10
 George Posner '12
 Joshua Redel '10
 Jake Richardson '10
 Jennifer Ringoen '12
 Elizabeth Rose '11
 Sandy Russell '10
 Aisling Scott '12
 Ryan Shaffer '12
 Mitchell Skotarczyk '11
 Joseph Swartley '11
 Carissa Tudor '09
 Kevin Wallentine '12
 Sze Wai Yuen '12

March Madness at the Lowe Institute

By Chase Gray '12

This March, the Lowe Institute held its first annual March Madness Game. Intended to encourage students to apply statistical models to real-world scenarios, the competition allowed students to create models to predict the outcome of every game in the men's and women's NCAA basketball tournaments. Open to all CMC students, cash prizes were awarded for first and second place finishes in both contests. First place won \$200 while second place took home \$100.

Overall, this year's event proved to be a strong pilot for a competition that organizers Professor Marc Weidenmier and Aaron Champagne (CMC '10) hope to expand next year. According to Champagne, more than 20 teams entered the competition.



Weidenmier and Champagne primarily hope that the March Madness Game introduces students to the application of statistical modeling in an enjoyable way. Since many students already select bracket winners and enter tournament pools, they believe that encouraging students to use statistical models to help their predictions will give them valuable practice using the methodology. Professor Weidenmier also hopes to find the

venture profitable when he takes this year's winning model to Vegas for the 2011 NCAA tournament.

All students who have taken a statistics or upper-level economics course at CMC were encouraged to enter. The Lowe held an informational demonstration session before the models were due so introductory statistics students could learn

how to create an effective model. Champagne even created a sample model for students to use as an example. To maintain an even playing field, only linear regression models were allowed.

Students were able to use a wide variety of information to build their models. Champagne created an online database of information from the whole season, including outcomes of games and many other statistics on every team in col-

lege basketball. The models that students created based on this information allowed them to simulate tournament games to try to determine which team loses, which team wins, and by how much.

Although Champagne and Weidenmier hoped for greater participation, it was difficult to attract more students due to unfortunate timing: the first round of the NCAA tournament was held during the same week as the March Madness competition. *March Madness — Continued on Page 11*

Professor Keil — Continued from Page 1

Obama's Council of Economic Advisors, as well as by the Director of the National Economic Council Larry Summers. According to Keil, this change in unemployment was over two standard deviations away from the expected level.

Interestingly, Professor Keil explained that this recession was not markedly different from these other recessions until October of 2008. At that point, unemployment drastically increased. Keil attributed the rising level of unemployment to the collapse of Lehman Brothers in September 2008. This bankruptcy had a devastating impact on the economy. Keil showed that after the fall of Lehman, the consumer sentiment index dropped significantly, which created a ripple effect of fear that sparked a global credit crisis and led to many other bank failures.

Another reason the economy suffered from much higher levels of unemployment in this past recession was due to the large increase in the Federal Minimum Wage in 2006. Due to the fact that the economy was in a boom, Congress decided to raise the minimum wage by an unprecedented 4.1% over three years. Although economists in the nineties hypothesized that increasing the minimum wage does not cause unemployment, Keil argued that the high level of teenage unemployment in this

recession proved their assumption to be false. An increase in the minimum wage does cause unemployment, especially for teenagers.

Now that the recession on the national level has been over since June of 2009, Keil predicts that the shape of the recovery will be a "Verizon V," or a sharp downturn followed by a slow recovery. He believes that there is risk of a "W" shaped recovery, or a "double dip recession," where the economy begins to recover, falls again, and then rises. The catalyst for this second downturn may be the Adjustable Rate Mortgage (ARM) loans. ARMs are initially priced at very low interest rates and then adjusted back to market prices several years later. People thought that housing prices would continue to rise into the unforeseeable future, so they reasoned that they would be able to re-finance with the new price of their homes or sell their houses for a profit. However, since these houses are now worth substantially less, many people will not be able to afford to pay their loan payments. ARM loans will change to market prices in late 2011 and early 2012, which will most likely cause more foreclosures. However, Keil believes that by then, the stock market will have also adjusted to partially compensate and mitigate the effects.

Emily Case SC '10 Senior Thesis:

Analyzing the NYSE Clearing House and Counterparty Risk

By Mark Gose '11

Q: What is the testable hypothesis of your paper?

A: I tested the extent to which the New York Stock Exchange Clearing House helped to mitigate counterparty risk when it was implemented in May of 1892. A clearing house is a financial institution that provides clearing and settlement services for derivatives and securities transactions. I hypothesized that stock volatility would decrease in the post-Clearing House period and expected bid-ask spreads to narrow because the Clearing House saves both time and labor while increasing transparency. Changes in bid-ask spreads reflect changes in transaction costs and are indicative of the overall impact on market efficiency. Lastly, I predicted that market share would also increase. Traders, once they understood the positive benefits of the NYSE Clearing House, would begin trading more frequently on the NYSE.

Q: How did you test the hypothesis?

A: I used a t-test to analyze changes in the level of volatility of 50 stocks that were traded through the Clearing House, which I consider to be a proxy for counterparty risk. I also made sure to control for economy-wide volatility. In addition, a regression of panel data on 30 stocks (stock data was collected from stock quotes in the New York Times) was run to test for changes in bid-ask spreads as well as market share.

Q: What are your key findings?

A: The primary hypothesis that we tested was confirmed. Volatility of those stocks that were traded through the Clearing House was 25 percent lower, indicating that the Clearing House lessened the risk of default by counterparties. Bid-ask spreads also narrowed in the post-Clearing House period by roughly five percent, but market share was only shown to increase significantly for certain stocks. We can conclude, then, that the Clearing House provided a secondary benefit beyond risk management in the form of a decrease in transaction costs.

Q: What are the implications of your findings?

A: While the New York Stock Exchange Clearing House may appear to be an arcane relic of the past,



it provides us with a unique opportunity to study the extent to which clearing and settlement systems help to mitigate counterparty risk. This issue has become increasingly relevant in the past few years, as debate has swirled around the implementation of centralized clearing parties in the market for credit default swaps. Many experts have argued that high levels of counterparty risk in this largely unregulated and interconnected market helped lead us into the recent credit crisis. However, little quantifiable evidence exists to either prove or disprove these hypotheses. Proponents have touted the benefits of clearing systems, but few researchers have used actual data to support these broad claims. My study is one of the first to do so, and provides conclusive evidence that central clearing and settlement systems do, in fact, regulate counterparty risk to a significant extent, while conferring additional benefits as well.

Q: Does your research provide any public policy prescriptions?

A: Yes. While the scope of my study is limited, the results suggest that clearing and settlement systems provide a sizable benefit to investors and consumers, particularly in the reduction of counterparty risk. My data supports the conventional theory surrounding these institutions. Although details regarding the implementation of centralized clearing parties in the market for credit default swaps today must still be ironed out, such initiatives cannot be ignored.

Interview with Dean Gregory Hess

The Federal Reserve's Exit Strategy

By Anna Eames '13



Photo: Dean Hess

Since the summer of 2009, Dean of Faculty Gregory Hess has been commenting on how the Federal Reserve should find a way out of the financial crisis. Over last summer, Dean Hess worked with the Lowe Institute to prepare a presentation for policymakers and journalists. In it, he stated that the Fed needs to adopt an inflation target and more effectively guide public expectations

regarding monetary policy in order to pull the country out of its current recession.

As a twelve-year member of the Shadow Open Market Committee (SOMC), which is an expert, independent advocacy group that comments on Federal Open Market Committee (FOMC) decisions, Dean Hess works with the group's five other members to encourage disciplined monetary policy and a low inflation rate. The group's role is to help improve public policy as well as political discussion among the general public, journalists, and policymakers through research as well as communication.

Dean Hess points out that "over the last five to ten years, we brought to light a lot of important issues about monetary policy that the Fed de-emphasized or did not highlight." This includes research throughout the past decade on the problems that Fannie Mae and Freddie Mac brought to the financial system, as well as criticism in the early 2000s that monetary policy was too accommodative.

The SOMC holds regular meetings, occasionally

with members of the FOMC participating, to provide commentary on FOMC decisions and, at their most recent meeting, to discuss possible actions that could be taken to relieve the stressors of the recession. Dean Hess believes that Federal Reserve Chairman Ben Bernanke has been instrumental in encouraging the Fed to be more communicative and responsive. Over the past decade, however, the Fed maintained a hugely accommodative stance on monetary policy. Currently, the SOMC's main goal is to argue in favor of reducing the Fed's balance sheet and tighten the money supply so that bank activity and inflation remain at preferred levels.

According to Dean Hess, the Fed made "a far greater contribution to the current financial crisis than they will admit to, but I think in due time they will see that they were a contributing factor." Hess believes that the Fed will begin to slowly tighten monetary policy around the third quarter of this year.

During the SOMC's most recent meeting with the FOMC, Dean Hess discussed Federal Reserve independence and advocated that central bank decisions be made within an apolitical environment. When the Fed becomes involved in private sector activity and accumulates a lot of non-Treasury assets, like it has recently with Fannie Mae and Freddie Mac, it becomes vulnerable to outside influences. The Fed also needs to be independent of legislative and administrative political forces.

Hess warned that a "lack of Federal Reserve independence could also lead to a far lower level of trust in the dollar, and that could be just as devastating to the U.S. economy as the financial crisis. Independence is the best way to restore trust in the system."

CALENDAR OF EVENTS

Lowe Barbecue
Friday, April 9, 2010
Appleby Picnic Area, CMC

SCCAM Conference
Friday, April 16, 2010
Hampton Room, Scripps College

Board of Governors Meeting
Monday, April 19, 2010
California Club, Los Angeles

Interview with Board of Governors Member Joe Matt '99

By Mark Gose '11

Joe Matt (CMC '99) joined the Lowe Institute Board of Directors in 2007. He is currently a Vice President at Capital Research Global Investors in Los Angeles. Mr. Matt is an alumnus of CMC and a former research assistant at the Lowe Institute where he was a Baker Lowe Scholar.

Q: Why did you decide to major in Economics?

A: Initially, I was interested in the global focus of the college and planned to major in International Relations. After taking some introductory economics courses and doing research for the Lowe Institute, I realized that I had a passion for economics. I really enjoyed the analytical side of the field, especially solving and quantifying difficult political and economic policy questions.

Q: How did your work at the Lowe impact your professional career?

A: When I attended CMC the Lowe Institute primarily focused on international trade and finance, so my work for the Lowe gave me a more global economic perspective which ultimately sparked my interest in international economics. The Lowe also provided me with the opportunity to intern with the OECD (Organization for Economic Cooperation and Development) in Paris, where I conducted research and worked with currency traders. Through my work at the Lowe and my experience in Paris, I became passionate about the global economy, particularly emerging market economies. It became the topic of my senior thesis, in which I examined the impact of the currency crises in the 1990s on emerging markets. The analytical and research skills that I developed while working at the Lowe and the extensive knowledge I gained about emerging markets helped me land my first job at the consulting firm McKinsey & Company, where I worked in a department that specialized in emerging economies.



Q: What did you do after graduating from CMC?

A: I worked at McKinsey & Company for two years so I could pay my way through Stanford Business School. After I earned my MBA, I ended up starting eTelecare Global Solutions in the Philippines. Later on I was hired by Capital Group, which is where I work now.

Q: What is Capital Group, and what are your main responsibilities there?

A: Capital Group is one of the world's largest money manage-

ment companies. It has over \$1 trillion in assets and oversees the American funds, which are the largest mutual funds in the United States. Also, it has one of the largest private equities that focuses on emerging markets and fixed income. I am the manager of the mutual fund group where I am responsible for managing investments in consumer staples, which are essentially anything that can be found in a grocery store. Additionally, I am in charge of advising portfolio management.

Q: Do you have any words of advice for CMC students?

A: Don't worry too much about your future. Sometimes students will get caught up planning each step of their careers instead of focusing on building the fundamental skills that will help them excel as professionals in any field. Students need to focus on developing their oral and written communication skills as well as their analytical skills. These tools are necessary for achieving success.

Microeconomics Conference — Continued from Page 1

of filing for bankruptcy. White hypothesized that this added cost would make indebted homeowners more likely to default than file for bankruptcy, causing the default rates to rise. She estimated that bankruptcy reform caused around 360,000 additional mortgage defaults per year, which significantly increased the severity of the 2008 mortgage crisis.

Another hot-topic paper was authored by CMC Professor Darren Filson, who presented on the impact of important judicial decisions on patent lives within the pharmaceutical industry. The paper focused on the Hatch-Waxman Act of 1984, which extended the patent life of new pharmaceutical drugs but permitted rapid entry of generic drug companies into the market once the patent life is over. However, two judicial decisions in 1998 and 2000 made it easier for generic companies to challenge the patents of new pharmaceutical drugs. If a challenge is successful, the generic company will get a 180-day exclusivity period where no other generic companies can sell the drug. This exclusivity period generates huge profits for generic companies. Seeing falling profits, larger companies and start-up companies have less motivation to innovate new drugs.

Overall, these are just a few examples of the strong papers that kept the discussion interesting and made the conference a success. By creating a "fun" forum for prominent southern California economists to gather as a community to exchange and discuss ideas, the Conference will help provide insight into economic trends and produce more effective economic policy. Marc Wiedenmier, the organizer of the event, hopes that this conference will become an annual event that will continue to unite economists of southern California.

March Madness — Continued from Page 7

ment falls each year during CMC's spring break. Since models were submitted round by round, it was impossible for students to enter if they did not have access to a computer. Next year, Champagne hopes to eliminate that problem by offering students the opportunity to participate in a separate competition that includes only the sweet sixteen, elite eight, final four, and championship game, which all take place after students have returned to campus.

Creating a smaller bracket option is just one of the changes that Weidenmier and Champagne plan to make in the future. Champagne explained, "next year we are going to expand it to all of the 5Cs. This year we limited it to CMC as a trial program, but next year we hope to have competitors from each school to see which school can make the best model." They also plan to expand the competition to NFL games and other sporting events.

By the time this year's men's tournament had come down to Duke, Michigan State, West Virginia, and Butler, four students remained in the hunt for victory. When the point leader going into the final four calculated Michigan State and West Virginia to win, first place was suddenly up for grabs. Although every model picked Duke to beat Butler in the championship, no model predicted that it would be as close as it was. The median margin of victory predicted by the models was 9 points, with no model predicting a Duke victory of less than 6.5 points. In reality, Duke held on to beat Butler 61-59. Nik Miller (CMC '10) took first place, with Nathan Doctor (CMC '11) coming in a close second.

Miller's model proved to be doubly successful, as he also finished second in the women's tournament, losing only to Raghav Dhawan (CMC '10). Not surprisingly, the models submitted for this tournament predicted the results better than the models for the men's contest. As there were very few upsets in the women's tournament this year, especially when compared to the large number of upsets in the men's tournament, a simple model was quite effective.

Overall, Champagne was pleased with the success of the Lowe's first March Madness Game. He mentioned that feedback from students was overwhelmingly positive, and that they enjoyed applying statistics to something they already followed. The first annual event will likely prove to be a successful pilot program for what will become a Lowe Institute tradition.

Men's:

1st Place, \$200 Prize: Nik Miller '10

2nd Place, \$100 Prize: Nathan Doctor '11

Women's:

1st Place, \$200 Prize: Raghav Dhawan '10

2nd Place, \$100 Prize: Nik Miller '10

Congratulations, Modelers!

Interview with The Editor: Dan Lockett '10

By Chase Gray '12

Q: How did you first become involved with the Lowe Institute?

A: My freshman and sophomore year, I was the chef for the Lowe Institute's bi-annual barbeque. At the beginning of my sophomore year, Professor Weidenmier asked me if I was interested in starting a newsletter for the Lowe. I was very appreciative of the offer and jumped at the opportunity to create, organize, and manage the Lowe Institute's bi-annual newsletter, the *Lowe Down*.

Q: How did you go about creating the Lowe Down?

A: With the help of Professor Weidenmier and his administrative assistant, Kelly Spetnagel, I began by hiring a reliable newsletter staff. The first semester was by far the most difficult because I had to simultaneously design and implement a process for creating each edition of the newsletter. After the first issue, I developed a much more efficient strategy that I have continued to develop with each successive issue.

Q: Over the last two years, what have your responsibilities been?

A: At the beginning of every semester, I have a meeting with Professor Weidenmier and Kelly Spetnagel to discuss the substance of that semester's edition of the newsletter. After they provide me with content pertaining to each individual article, I am given the responsibility to exercise administrative authority, write multiple articles, and extensively edit the entire newsletter. I also interview, hire, and assign each staff member their respective tasks. Essentially, I am solely responsible for the final edition of the newsletter every semester.

Q: What have you learned from working at the Lowe Institute, and what do you envision for the Lowe Down's future?

A: While working at the Lowe Institute over the past two years, I have had the unique opportunity to create something from the ground up. A lot of my time and hard work has been devoted to ensuring that every edition of the *Lowe Down* is of the highest quality possible. As a result of my experience at the Lowe, I have continuously developed my communication, organization, and administrative skills. From developing an approach for each article to producing the final layout, my job as editor has been frustrating at times, but it has overall been a rewarding experience that I am extremely grateful for. In order to have a successful newsletter in the future, the staff will have to continue to develop their skills while the new editor(s) must be willing to take on a lot of responsibility and be willing to go the extra mile.

*On a personal note, I would like to thank Professor Weidenmier, Kelly Spetnagel, and the *Lowe Down* staff for their support and hard work. Mark Gose and Chase Gray have done a fantastic job editing this semester's edition of the *Lowe Down*.

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CIVITAS - A Student Initiative

By Aanchal Kapoor '11 and Aditya Bindal '11

CIVITAS is a society established to encourage discussion and increase awareness of central issues in economics and politics. It will feature several documentaries on political economy throughout the semester. Each documentary will be followed by a short lecture and discussion with a faculty member.

In the spirit of Claremont McKenna College's motto – *Crescit cum commercio civitas* ("Civilization prospers with commerce") – CIVITAS seeks to gain more extensive knowledge of the economic and political issues that face a free society. To tackle these issues, we must develop a better understanding of the institutions and mechanisms of a market economy. Due to the recent economic crisis, the stability and endurance of this system has been seriously questioned. CIVITAS hopes to provide a forum to discuss the virtues and limitations of these institutions by studying their evolution and history.

We began this semester by featuring two episodes from Professor Niall Ferguson's "Ascent of Money." After the first episode, Professor Weidenmier gave a presentation on public finance, American economic history, and the economic constraints during war. We then followed Niall to the recent financial crisis and the global savings glut for the our second event, after which Professor Richard C. K. Burdekin introduced students to global imbalances, currency crises, and hyperinflation. For our third event this semester, we had the privilege of hosting Dr. Joshua Muravchik for the screening of his very own documentary, "Heaven on Earth – The Rise and Fall of Socialism." This rare opportunity allowed students to meet and discuss an excellent documentary with its creator.

In the future, we hope to screen Daniel Yergin's "Commanding Heights – Battle for the World Economy", Milton Friedman's "Free to Choose", and more episodes of Niall Ferguson's "Ascent of Money." Potential discussants for these events include Professor Eric Helland, Professor Colin Wright, and Professor Thomas Willett.

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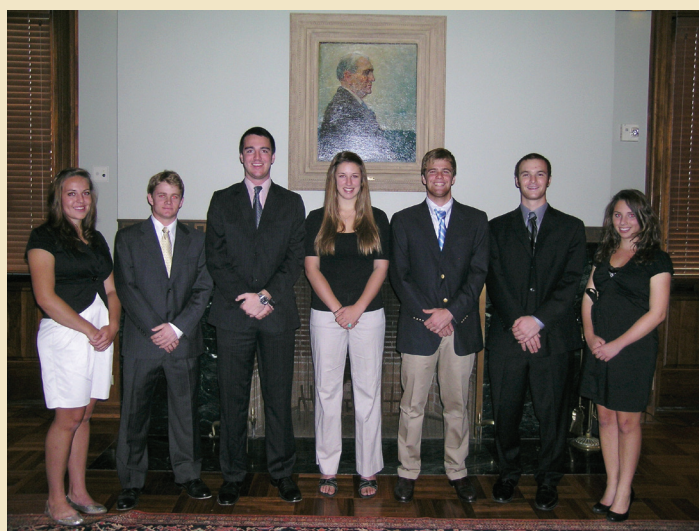
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From left: Laura Hagen, Mark Gose, Chase Gray, Anna Eames, Peter Meyer, Dan Lockett, Jenn Good

Thank you to our Spring 2010 Newsletter Staff:

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