

# E NEWS

THE ECONOMIC NEWSLETTER OF EAST STROUDSBURG UNIVERSITY

FALL 2010

## Second Quarter GDP

By: Katherine Wolosz

For the second quarter 2010, real GDP increased at an annual rate of 1.6 percent, compared to a first quarter increase of 3.7 percent. The United States Department of Commerce Bureau of Economic Analysis calculates real GDP as the market value sum of all goods and services provided by the national economy that is adjusted for inflation. The lower growth rate of the second quarter was due to an increase in imports and a decrease in inventory investment. On the other hand, both residential and nonresidential investment increased, and government expenditures also grew at higher rates.

Personal consumption increased 2.0% in the second quarter of 2010, compared to 1.9% in the first quarter. The increase in services consumption, which added 0.56 percentage points to real GDP in the second quarter compared with 0.03 percentage points in the first, was offset by a slowdown in spending on both durable and nondurable goods. American consumers spent more on motor vehicles, gasoline, housing utilities, health care, financial services, and insurance.

Gross private domestic investment increased 25% in the second quarter due to acceleration in both nonresidential and residential fixed investments. Nonresidential fixed investments had the largest quarterly percentage change since the first quarter of 2006, with a 17.6% increase from first quarter of 2010. Equipment and software increased by 24.9% from the first quarter and has been accelerating since the second quarter 2009. This accelerated rate contributed to a 1.53% increase in real GDP. Residential fixed investments grew 27.2% in the second quarter, compared to a decrease of 12.3% in the first quarter.

Goods and services exported contributed to a positive 1.08% change in real GDP in the second quarter, compared to positive 1.30% in the first quarter. Imports increased 32.4% in the second quarter compared to only 11.2% in the first. Goods and services imported contributed a negative 4.45% change in real GDP, compared to a negative 1.61% in the first quarter.

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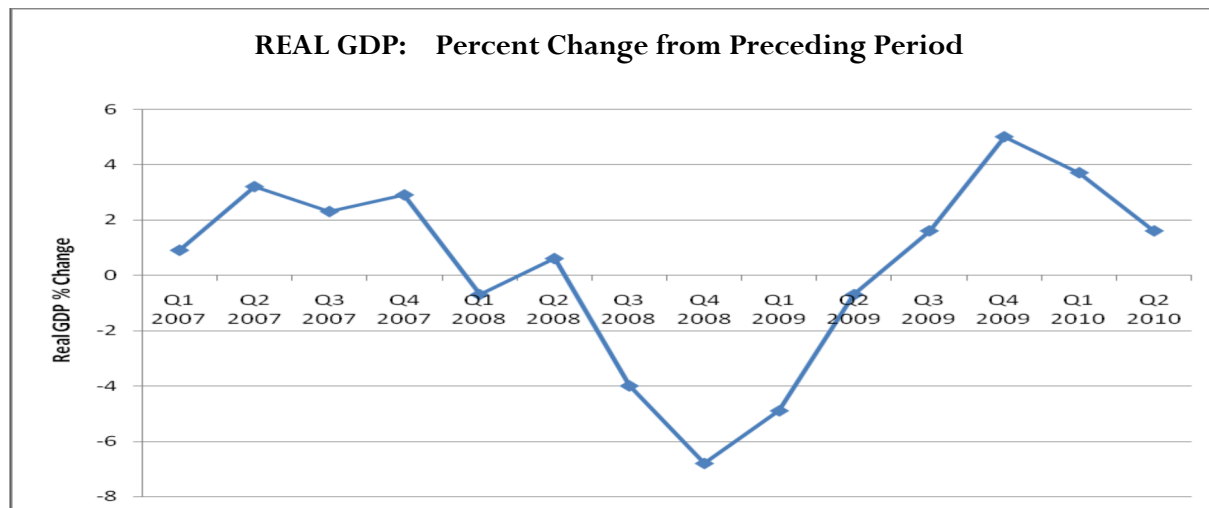
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Government spending increased by 4.3% in the second quarter, compared with a negative 1.6% in the first quarter. Federal spending rose 9.1% in the second quarter, compared to a miniscule 1.8% increase in the first. State and local government spending contributed a positive 0.14% to the GDP growth rate after a negative contribution of 0.48% in the first quarter 2010.

After increasing by 1.3% in the first quarter of 2010, real disposable personal income increased by 4.4% in the second quarter.

The personal savings rate of U.S. households continued to increase reaching 6.1% of DPI in the second quarter, up from 5.5% in the first quarter. Apparently, households are saving at higher rates in the aftermath of the recession despite decades of low and even negative savings rates.

In spite of the slower reported growth rate in the second quarter of 2010, real GDP has been growing since the reported ending of the recession in June 2009. As seen in the below diagram, the greater negative growth rate occurred at the end of 2008 and remained negative until the middle of 2009.



### The Unemployment Situation

By Peter Falcone

The unemployment situation has gone unchanged from the month of September. It has stayed at 9.6% (12.8 million) in the United States. The nonfarm payroll went down by about 95,000 jobs, and government employment dropped by about 159,000 jobs. On the other hand, there was a 64,000 job gain in the private sector. The job loss in the government sector reflects more temporary job loss from things such as census work and local government. The additional job gains in the private sector show that many people are moving from the temporary jobs to more permanent long term jobs.

With respect to the unemployment rate of different working groups in the United States; adult men stayed around 9.8%, adult women remained unchanged at 8.0% and teenagers were at 26%. Whites were unemployed at the rate of 8.7%, Blacks at 16.8%, Hispanics at 12.4 %, and Asians at 6.4%.

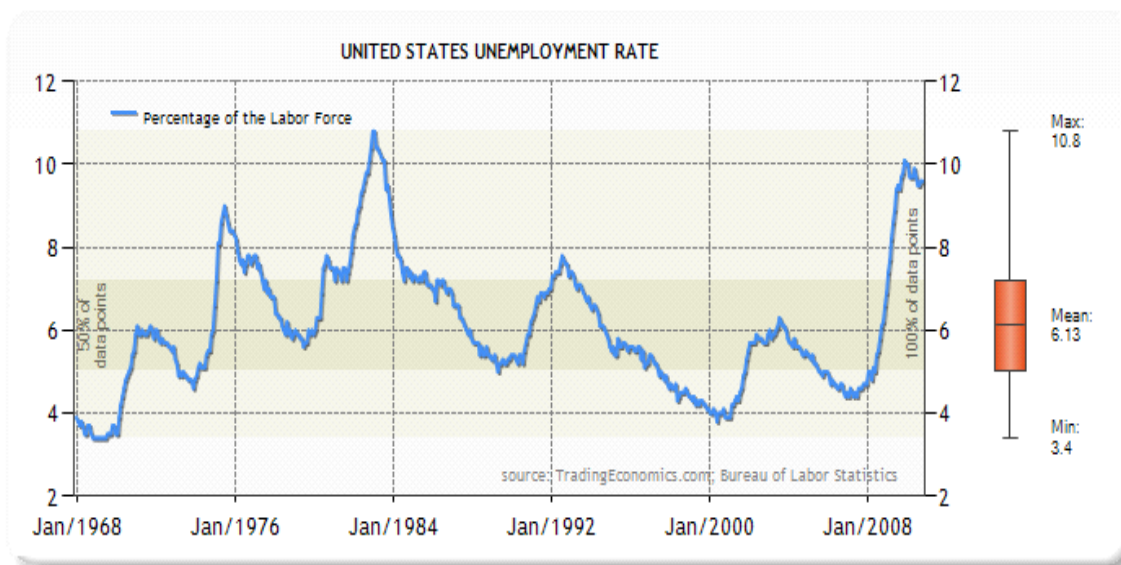
In September, the civilian labor force population rate stayed at 64.7%, and the employment to population ration also remained unchanged at 58.5%. Also the number of long term unemployed Americans (longer than 27 weeks) remained relatively unchanged at 6.1 million. However, since a series high in May, it is down 617,000.

Over the past month, the number of involuntary part-time workers increased by about 612,000 reaching 9.5 million. In the past two months, this number increased by approximately 943,000 workers. These are individuals who want to work full time but cannot find a full-time job and therefore choose a part-time job during this time.

In the different sectors of employment, there have been many reductions and improvements. In the area of health care during the month of September, employment increased by 24,000 jobs. For the year, the health care sector experienced an average employment increase of 21,000 jobs per month. In business services, employment added an additional 28,000 jobs for the month of September. However, temporary help services jobs accounted for the majority of this increase. Both the leisure and hospitality industry and food and service industry experienced an increase of approximately 34,000 jobs in the month of September. Both industries have seen a constant gain reaching a total gain of around 104,000 for 2010. Mining also continued to grow slowly with the addition of 6,000 jobs in the past month. Employment in the manufacturing business has remained constant in the past month and shows no net change for the year.

The Unemployment situation does not always tell the full story. The 9.6 percent unemployment in the United States makes several assumptions that exclude certain unemployed groups. To more accurately depict the situation, we must account for the total unemployed population, the people that are marginally attached to the labor force and those working part time for economic reasons. This shows the full effect of how the recession has negatively impacted so many individuals. Since many people have shown no interest in full time employment during the past year, a large portion of the population would not be represented in the 9.6 percent unemployment rate. A more realistic reflection that includes both unemployment and significant employment reductions is closer to 17.1% unemployment. This is a drastic gap from the official unemployment rate of 9.6%.

Since the 1970s, we have seen many increases in unemployment, but we have also seen it drop back down to the more normal rates. Since 1970, the average yearly unemployment rate has been 6.27%. As the graph shows, in 1975, there was an unemployment rate of 8.5 %. In 1982, there was another recession and another rise in unemployment reaching a rate of 9.7%. With each recession and respective recoveries, the unemployment rates experienced slow rates incline and decline. Today, the United States has once again seen the economy turn south and struggle through a recession.



With the current unemployment rate at 9.6% (as of September of 2010), many consider this to be the worst recession ever and doubt whether the economy will ever recover. Fortunately, the modern era of unemployment shows otherwise. Even though that there was historical increases of unemployment for 2009 into 2010, there is now hope for recovery.

## The Fisher Equation

By: John Tinney

The Fisher equation, created by the famous monetary economist, Irving Fisher, can be used to explain why we must abandon the standard 2% inflation rate and move to a 4% inflation rate as a monetary policy target. The federal funds interest rate was hovering just above zero at .19% at the end of the second quarter in 2010. Through the application of the Fisher Equation,  $i = r + \Pi$  (where  $i$  = the federal funds interest rate,  $r$  = the real federal funds interest rate, and  $\Pi$  = CPI inflation rate), it can be shown that if inflation is held at 2%, then our real federal funds interest rate would be -1.81%.

The IS/LM model, created in 1936, is a macroeconomic tool that portrays the relationship between interest rates versus both the goods and services market and the money market. Using this model with a statically set unemployment rate of 5%, we can see why during the past recession, the 2% interest rate will inevitably cause a significant decrease in real GDP. This phenomenon increases unemployment rate, which results in a downward spiral that ultimately expands the gap between these two statistics. The only way to combat this downward spiral is to abandon the standard 2% inflation rate and move to a 4% target inflation rate. This will drive the RFFIR down close to -4%, keeping the FFIR at 0%. This will contribute to an increase in RGDP and a decrease in unemployment.

In a monetary trends article, William T. Gavin (Vice President and Review Editor of the Federal Bank Reserve of St. Louis), stated that, "if the real economy is currently rebounding... the real interest rate will rise and the only outcomes possible will be either a higher nominal federal funds rate or a negative expected inflation rate." Negative expected inflation rate is obviously deflation, which has been strongly tied with disasters such as the Great Depression, where banks defaulted on their deposits due to a lack of sufficient funds. Deflation causes the real purchasing value of money to increase, allowing consumers to buy more goods with the same amount of money as previous years. Consequently, this would increase the price of American exports, which decreases the demand of American exports. The decrease in American exports combined with the increase in foreign imports directly contributes to our trade deficit.

In the 1980s Gross Domestic Product increased by 909.74 billion dollars each year. In the 1990s, GDP increased an average of 1157.57 billion dollars each year. In the 2000s, GDP only increased by 840.3 billion dollars each year. This is inflated due to the high increase in GDP from 1999 to 2000 and the steady economic growth between 2004 and 2006. From 2007-2008, GDP did not change, but instead fell by 1.393 trillion dollars in 2008-2009. The boom in GDP increase every year in the 1990s coupled with a FFIR of 5.15% and an inflation rate that averaged 2.97% can certainly illuminate the problem we are facing today. The FFIR is set at almost 0% and our inflation is 2%, set in December of 2008. Since December of 2008 our unemployment rate has increased from 7.4% to 9.6%, with double digit monthly averages of 10% from October 2009 to December 2009.

By increasing the inflation mark to 4%, our economy will be able to avoid this downward spiral effect. Under the assumption that the monetary transmission mechanism works properly, the 4% target rate can be attained through higher monetary growth. In theory, this will lead to steadily increasing RGDP and steadily decreasing unemployment rate. Such a reversal of the described downward spiral will shift our Investment Savings curve back to the right, thereby allowing inflation to slowly reach back to the 2% benchmark after the recession. This increase in GDP and decrease in unemployment would set the pace for our economic growth to return to its optimal rate of the 1990s.

## U.S. Economy vs. Chinese Economy

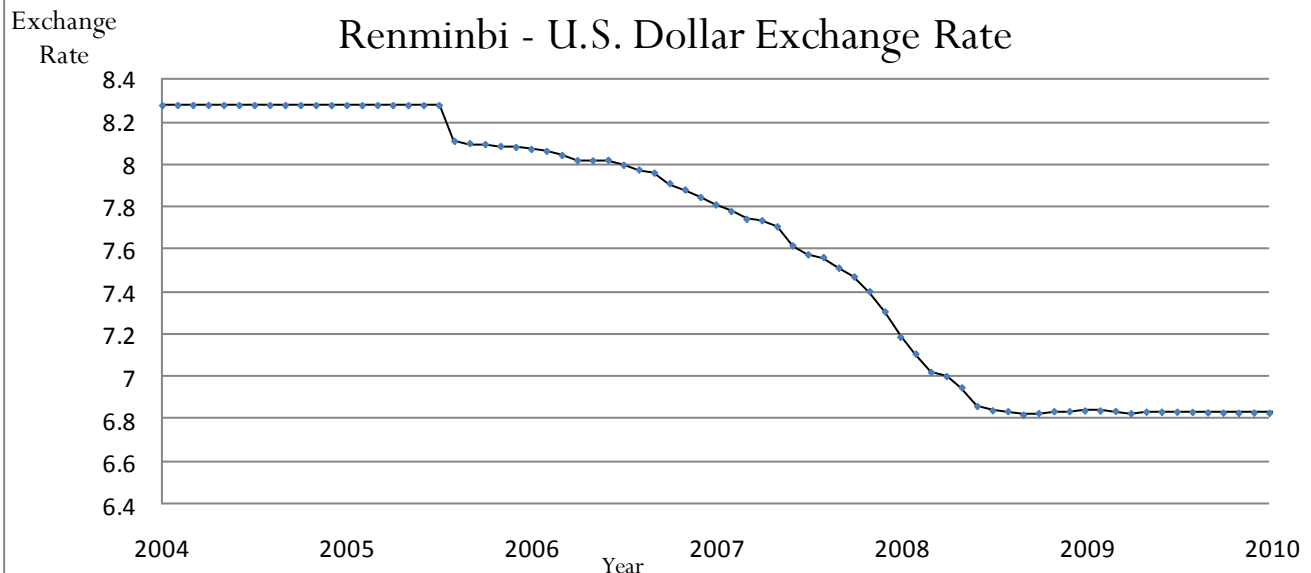
By: Justin Kimbrough

For a while now, China's currency has been the Renminbi, with its main unit being the Yuan. This unit, fluctuating slightly in recent years, is worth roughly about 15 cents. Nevertheless, China has been progressively moving forward, growing at a faster rate than any state in the world. Although many experts believe it will not surpass the United States as the world's largest national economy, the People's Republic of China continues to hold the title as the second largest national economy, gradually decreasing the gap between the two richest countries in the world.

Currently, the United States is exporting roughly \$7 billion per month to China, while importing about \$35 billion, causing a trade balance of about -\$28 billion. In return for purchasing Chinese-made products, China has been aiding our economy with the purchasing of U.S. Treasury Bills in an attempt to lower our record-high national debt. However, China has been fiddling with our method of exporting.

Recently, a bill was approved by the House Ways and Means Committee to end China's currency manipulation. The Ryan-Murphy currency bill (HR 2378), still requiring the approval of the House of Representatives, would give permission to the Commerce Department to handle currency manipulation as an illegal subsidy for China. The Chinese economy has manipulated CNY (yuan) by forcing exporters to trade dollars earned for Yuan (CNY) at China's central bank, which in return will "sterilize" them by applying them to U.S. Treasury securities instead of U.S. goods. After this takes place, the price of dollars increases, thus lowering the price of yuan, by an increased demand for dollars, which does not include the purchasing of American exports.

Many fear that a sudden conflict between the U.S. and China, such as the offering of our aid to Taiwan, could result in our nation's economy plummeting further. This notion could result in China throwing away U.S. Treasury Bills, thus depressing the value of the dollar and weakening our economy. Would China really consider such an act? After all, we are their biggest consumer. If China decides to sell off U.S. debt, it would weaken its own national wealth.



### Okun's Law

By: Michael Prestoy

Okun's law describes the relationship between the change in unemployment and real GDP. Arthur Okun (the founder of Okun's law), presented the actual theory and quantitative evidence in 1962.

The mathematical formula for Okun's law is :

$$(Y_F) / Y_A = C (UN-U)$$

A more common formula for Okun's law:

$$\text{Change } Y = K - C (\text{change in } U)$$

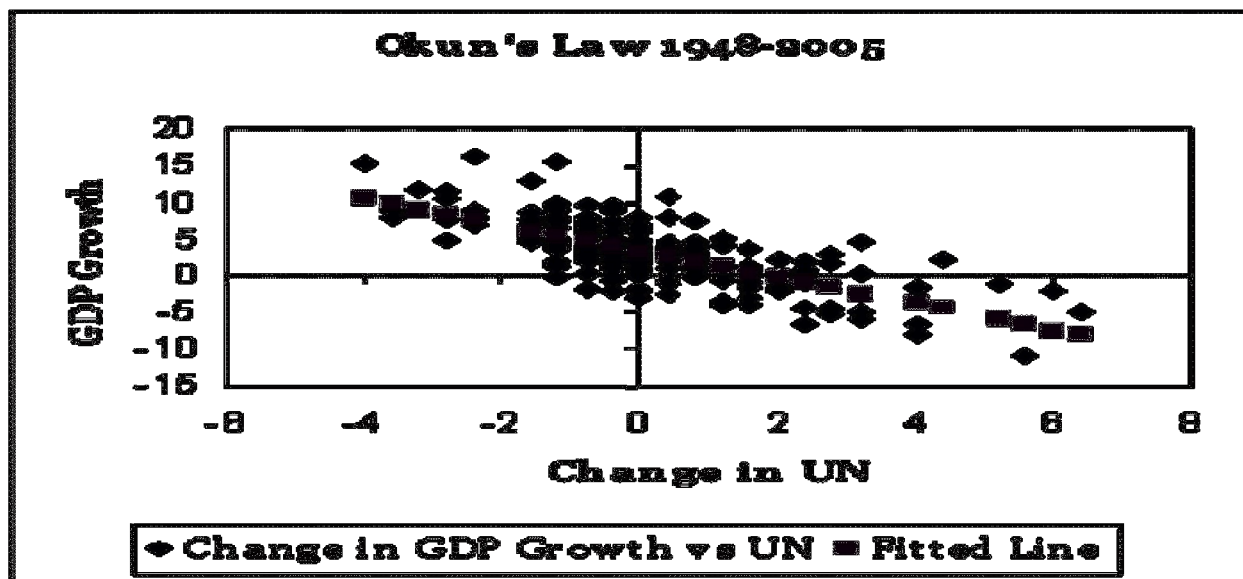
$Y_F$  gives full employment level of output

$Y_A$  gives actual output UN represents natural rate of unemployment; U represents actual unemployment rate

C is the factor that is related to ratio showing unemployment change to output change

These formulas are used to represent the relationship between the change in unemployment and change in GDP. Change in Y is the change in actual level of output from one year to another. Change in U means change in unemployment from one year to another. K gives the average yearly growth rate of full employment output.

The following graph represents the past 60 years of GDP growth and unemployment. During this time period, Okun's law works fairly well. As GDP increases, unemployment decreases.



The question is how vigorously the unemployment rate responds to GDP. The equation of the regression line is:  $\text{Change } Y = 3.40 - 1.78 (\text{change in } UN)$ .

The most recent (1983-2005) data is more spread out and open, while the earlier data (1948-1982) appears to confirm Okun's law with less deviation. Both time periods follow Okun's law, but the correlation coefficient decreases with time. One possible explanation is that the fixed assets of companies have gone up in the last few decades. The increased use of expensive technology decreased the need for human capital. Therefore, even if production or GDP increases, unemployment will not decrease as much as it did in the past. In fact, during the 2008-2009 downturn, the unemployment increased 2.6 percent; Okun's law would have predicted less than one percent. Companies are much quicker to lay off workers, and they can use the workers they have left to use the fixed assets in manufacturing.

### NEPA Initial Unemployment and The Labor Market in Monroe County

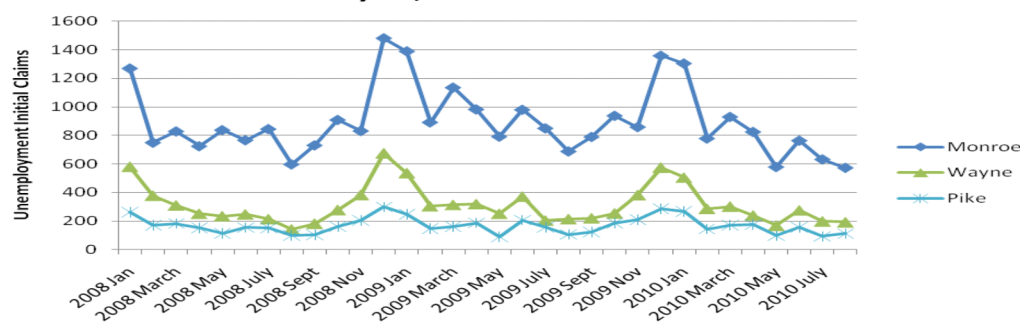
By: Katherine Wolosz

Initial unemployment claims have been slowly decelerating in Monroe, Wayne, and Pike Counties for every month in 2010, according to the Pennsylvania Department of Labor & Industry's Center for Workforce Information and Analysis.

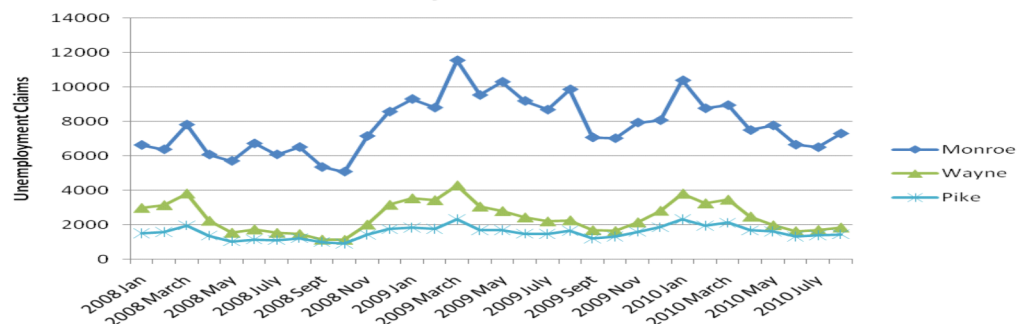
Initial unemployment claims are a measure of the number of unemployment claims filed by individuals seeking to receive state unemployment benefits. Initial claims help to indicate the rate at which companies are laying off workers, companies' willingness to hire, the attitude of the unemployed, the condition of the job market, and the economy as a whole.

On the other hand, unemployment claims are the number of continuing claims that still qualify for benefits under unemployment insurance. Unemployment continuing claims were lower this year in Monroe, Wayne, and Pike counties when compared to the same month in 2009.

**Chart 1: Unemployment Initial Claims Monroe, Wayne, and Pike Counties**



**Chart 2: Unemployment Claims Monroe, Wayne, and Pike Counties**



### The Labor Market in Monroe County (East Stroudsburg Micropolitan Area)

By: Katherine Wolosz

Monroe County is currently experiencing an unemployment rate of 10.1%, which has remained unchanged since July 2010. Job losses in the county were reported by the U.S. Federal government, local government, and service-providing arenas. Establishments that experienced a positive net change in employment in July 2010 included professional and business services and "other" services. Monroe County currently has a labor force of 84,900, with a total of 76,300 employed and 8,600 unemployed.

Pennsylvania has the 20<sup>th</sup> highest unemployment rate in the U.S., with a rate of 9.2% in August 2010, compared to 9.3% in July 2010. This unemployment rate is below the current national rate of 9.6%.

### **The Local Economy's Disappearing Building Activity**

By: Constantinos Christofides

Unemployment rates remained relatively high in Monroe County and its surrounding areas. There may be some hope for improvement in the near future as initial unemployment claims have continued to decrease for every month of 2010 in all of the Pocono counties.

In August 2010, initial claims in Monroe County were recorded as 574, compared to 689 in August 2009. Similar decreases were recorded in the previous months. If the trend continues until the end of the year, the total number of initial claims for 2010 will be the lowest since 2007.

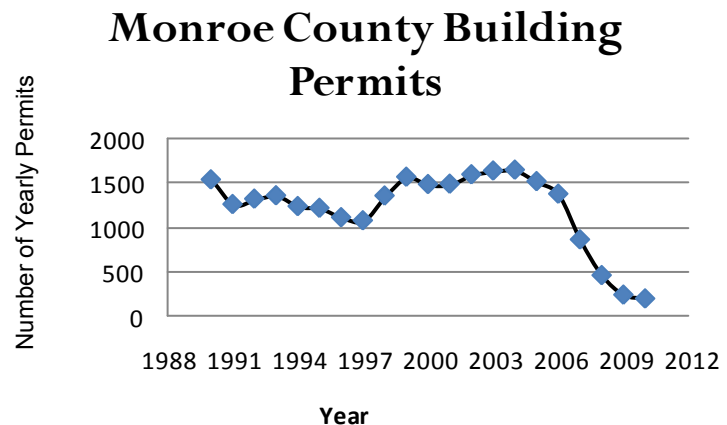
The encouraging labor market trends in the county are not reflected in the construction industry. In fact, building activity in the county has virtually stopped. The number of building permits issued by the various townships in the county continued a six-year downward spiral

The conservative forecast for the total permits issued in 2010 is 183, which is the lowest number in many decades. The

collapse of the construction industry began in 2004 and has continued to the present time.

Since building permits are a reliable leading indicator for actual construction, the outlook for 2011 is not optimistic. It appears that the building industry in Monroe County will continue to be depressed next year.

As seen in the chart below provided by the Monroe County Commissioner's Office, the number of building permits peaked at 1664 in 2004. This was followed by a 7.8% decrease in 2005, another decrease of 9.4% in 2006 and a massive drop of 37.7% in 2007. As the national housing crisis continued, building permits in Monroe County continued to decline by 48% and 49% in 2008 and 2009. The projected number for 2010 is 186, which is roughly 20% less than the dismal low of 2009.

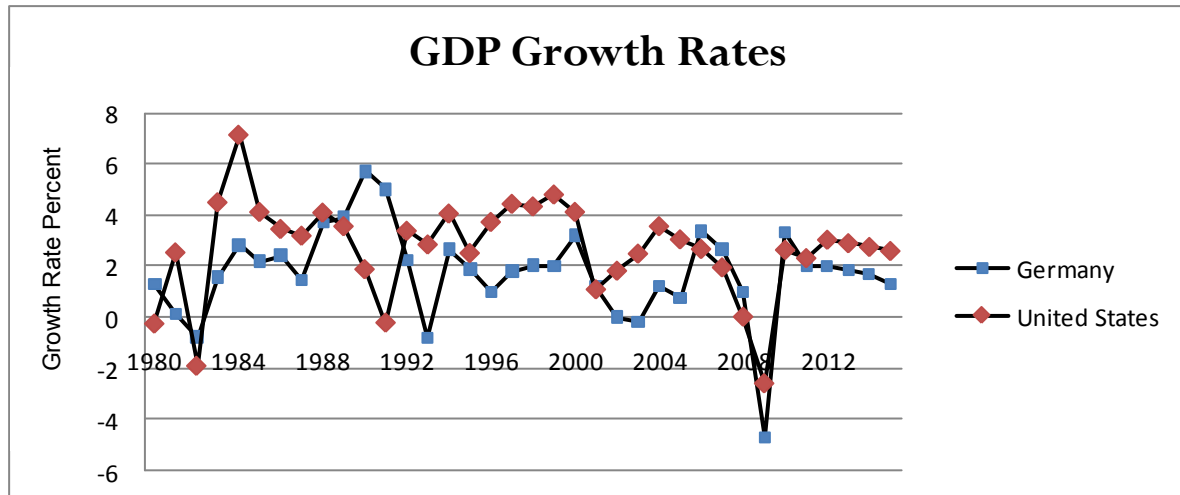


### **The International Angle**

By: Phillip Domschke

Right now, you hear people in all professions and trades complaining about the United States' gross domestic product (GDP). Europeans would be celebrating such an impressive track record as a new economic revolution if they had it. When it comes to GDP growth rates, European markets and industries have been struggling for decades with no immediate solution in sight. The average growth rate for the United States was 2.68% from 1980-2009, compared to a modest 1.69% in Germany. This one percent advantage must be put into perspective. Germany is by far the best performing country in the European Union. Rigorous reforms and tough negotiations with unions over recent years have left their mark on Germany's citizens, but also saved the economy from total stagnation. Germany is among the biggest winners of the European Union (EU). The EU eliminated tariffs and quotas between member states and created a larger free trade market. According to the Central Intelligence Agency (CIA), Germany was the world's second biggest exporter of goods, second only to China. The free trade among EU member states has helped Germany to maintain an international trade surplus. If one looked at the GDP rates, you would find that the U.S growth rate is actually 63.03% higher than the German growth rate. This is quite impressive considering Germany's leading position in the EU and worldwide in various economic, political and social measures.

The future is more important than the past, and the outlook for both countries looks promising with an increasing U.S. advantage. The Gross Domestic Product of the U.S. is expected to grow 2.71% on average each year until 2015. On the other side of the Atlantic, Germany is expected to average about 2.03% a year. This implies that the United States' economy will grow 74.87% faster than Germany's and will rebound a lot faster from the recession.



As you can tell from the above graph, Germany's GDP growth rate is historically lower than the United States. This did not hinder Germany from emerging as a powerful economic and political world leader, while serving as a role model of capitalism with a human touch. Bigger isn't always better. It is not all about the growth rate — it is about the right balance and the openness to adjust the current system to recent developments in our increasingly globalized world.

### 2010 Nobel Prize Winners

By: Brian Caiazzo

The Sveriges Riskbank Prize in Economic Sciences in Memory of Alfred Nobel is the most prestigious award for any economist. The 2010 prize was jointly awarded to Peter A. Diamond, Dale T. Mortensen and Christopher A. Pissarides for their analysis of markets with search frictions.



**Peter A. Diamond** is an American economist and professor at the Massachusetts Institute of Technology. In 1960 he earned his bachelor's degree in mathematics from Yale University. Just three years later, he received his Ph.D. from MIT.

After working a year at Berkeley, he returned to MIT where he was promoted to full professor and named head of the

Economics Department. In 1968, Diamond was elected and served as president of the American Economic Association. In addition to being a Fellow of the American Academy of Arts and Sciences, Diamond is one of the founding members of the National Academy of Social Insurance. As advisor to the Advisory Council on Social Security during the 1980-1990's, he became well known for his analysis of American Social Security policies. Much of his work is included in his book titled *Saving Social Security*. Diamond profoundly impacted the field of economics in a variety of areas, including capital accumulation, government debt, risk sharing, and social insurance.



**Dale T. Mortensen** is a professor of Economics at Northwestern University and the Kellogg School of Management. After receiving his B.A. degree from Willamette University, he earned his Ph.D. in Economics

from Carnegie Mellon University. Before winning the 2010 Nobel Prize, Mortensen already earned the Alexander Henderson Award, the IZA Prize in Labor Economics, and fellowships with the Econometric Society and the American Academy of Arts and Sciences. During his career in academia, Mortensen published eight papers focusing on economic theory, macroeconomics and labor economics. In a collaborative effort, Mortensen and Pissarides wrote one of the most influential papers in the field of economics, titled "Job Creation and Job Destruction in the Theory of Unemployment". Dale Mortensen will be best remembered for innovative work on the search and matching theory of friction unemployment.



**Christopher A. Pissarides**, originally of Cyprus, is an economist from the London School of Economics. He currently holds the Norman Sosnow Chair in Economics and is the Director of the Research Programme on

Macroeconomics at the Centre for Economic Performance. Pissarides received his B.A. and his M.A. in Economics from the University of Essex. In 1973, he received his Ph.D. from the London School of Economics, under the supervision of Michio Morishima. In addition to publishing five papers and a book, Pissarides received the IZA Prize in Labor Economics and fellowships with the Econometric Society and the British Academy. Pissarides will be remembered for his pioneering work on the theory of search friction and his contributions to the search and matching theory. He also assisted in the development of the matching function, which describes the flow of unemployment to employment as a continuous function of time.

Our three 2010 Nobel Prize winners have made numerous and profound contributions to the field of Economics. Their hard work and determination have resulted in their respective accomplishments and successful careers.

From this day forth, the entire field of economics will undoubtedly be influenced by the works of Peter A. Diamond, Dale T. Mortensen, and Christopher A. Pissarides.



*Jean Baptiste-Colbert*

## How would a Mercantilist Feel About the Economy Today?

By: Matthew Khela

The mercantile system bases the wealth of a nation on how much precious metal (gold and silver) the nation possesses. They believe the most efficient way to accomplish great wealth is to maximize exports and minimize imports. There are seven major tenets of the Mercantilist School: Wealth of the nation, nationalism, duty free imports of raw materials, colonization, opposition of internal taxes/tolls, a strong central government and great importance on a large, hard-working population. Out of the seven tenets, I believe that three in particular relate to today's society.

If the mercantilists were around today, their first objection about the United States would be about the wealth of the nation. We do not stress "hoarding bullion and gaining gold". They felt that it is pertinent for a country to obtain as much gold as possible. The international trade situation would not go over well in their opinion. One of their fundamental points is the fact that we import too much.

By looking at the Bureau of Economic Analysis's data, one can see that our imports exceed our exports and in the later years creates an extremely large gap. The mercantilists would be strongly against the movement in the United States trade position over time. By far, they would consider this a bad trend.

Any policy recommended to deal with the trade deficit may seem impossible by today's standards. For instance, a possible solution would be to enact high tariffs to restrict imports and promote exports. If this type of policy were applied we would not have as many luxuries as we do now from foreign (Chinese) imports—aside from how much we are in debt to China.

A strong central government and a large, hard working population would also be very important for the mercantilists. They would want to promote agricultural mining and basic manufacturing through subsidies. They would also want to have an abundance of people for the army and navy. A large working class implies low wages, which in turn, signifies low prices.

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**DEPARTMENT NEWS:**

The faculty and students have been busy, not only with their academic work, but trying to find time to develop and enjoy some extra-curricular activities.

The Economics Department is pleased to be working with the **ESU Office of Career Services** to launch the Career Leadership Program (CLP) program to help Economics majors prepare for employment. Career Services offers a variety of personalized, career-focused activities such as career planning, networking opportunities, resume writing workshops, practice interviews and career fairs and events. Economics faculty advisors and Career Services advisors will meet with each student to provide one-on-one help and service.

We are hopeful that this will help develop a network of internship opportunities for our students and enhance their employability upon graduation.

The **Economics Club** now boasts an impressive number of members. The club promotes awareness of economic research and career opportunities. They also host events such as panel discussions, speaker series and trips. Their latest trip was to Philadelphia where they spent the day visiting the city and its various historical points of interest. The club is also working hard on fundraisers, selling candy bars and t-shirts to finance a trip in spring 2011 to Washington, D.C.

The department is sad to say farewell to **Dr. Seewoonundun Bunjun**, who retired at the end of May. Dr. Bunjun will be leaving soon for a trip to his home country of Mauritius, but not before he attends the Diwali Festival of Lights to be held on November 13, 2010. Dr. Bunjun is clearly much loved and appreciated by his students and colleagues, who turned out en masse at his retirement reception this summer.



Dr. Bunjun, who was also given the Great Teacher Award by the ESU Alumni Association for his exemplary teaching and service to ESU, has been a faculty member at ESU for 31 years. He served as a mentor and volunteer in many campus activities and clubs.

His cheerful personality and smile will certainly be missed by all who know him.

Thank you for your interest in ESU's Economics Department newsletter.

- Dr. Pats Neelakantan, Professor and Department Chairperson

This issue of the E News marks the beginning of the 13th year that our students, faculty and editors have worked to publish this newsletter. We are pleased and proud to say that circulation has grown to over 2,000 people who receive the print version and more who read it on line.

Unfortunately, due to the cost of printing and mailing we are forced to cut down on the amount of copies we send.

Therefore, If you have been able to view the E News on line and do not need the paper copy, we would appreciate your telling us. If, however, you do wish to continue to receive the paper copy, we will happily keep you on the mail list.

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