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Undergraduate Newsletter

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QUESTIONS? FIND US AT:

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Economics Programs Classified as STEM

Beginning with the Fall 2019 graduating class, UCLA's Economics and Business Economics Bachelors, Master of Applied Economics, and Economics PhD programs will be officially classified as STEM. STEM stands for Science, Technology, Engineering, and Mathematics. This designation reflects the emphasis of these programs on rigorous analysis and mathematical modelling. Students learn to understand economics with a toolkit based on statistics and computer programming. This new classification is expected to open up more job placement and grant opportunities for students.

Pablo Fajgelbaum's Research Featured in National News

A paper written by associate professor Pablo Fajgelbaum, with collaborators from Yale, UC Berkeley and Columbia, was featured in a number of major US news outlets, including The New York Times, The Wall Street Journal, Bloomberg, and The Washington Post. This paper, titled "The Return to Protectionism", analyzes the aggregate, regional, and sector-specific impacts of the 2018 trade war on the US economy. It found that the trade war has so far brought a net aggregate real income loss of $7.2 billion, or 0.04% of the total US GDP.

Tomasz Sadzik Wins Scoville Distinguished Teaching Award

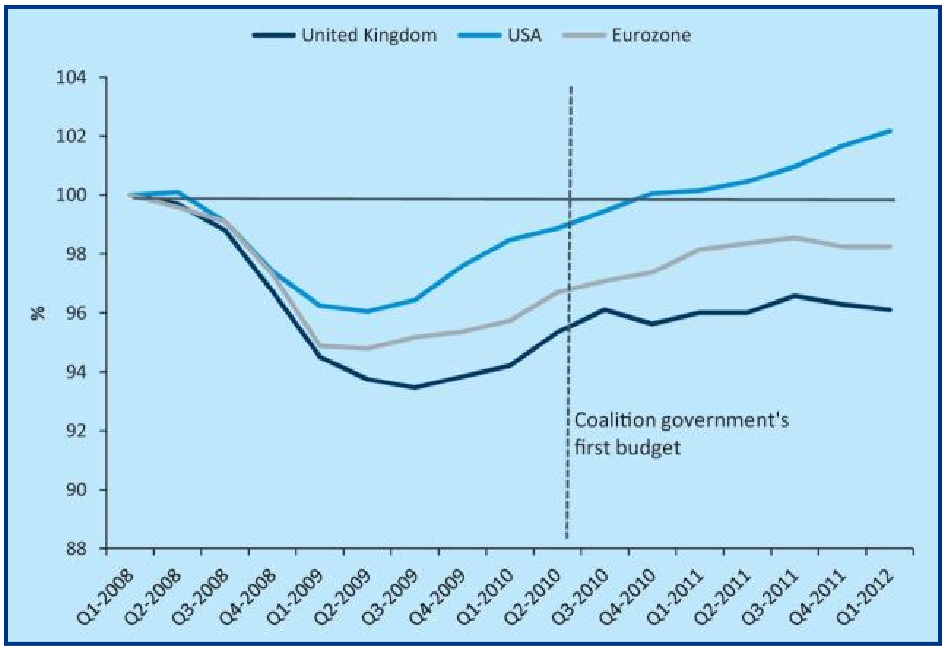
We would like to congratulate assistant professor Tomasz Sadzik on winning the Scoville Award for best undergraduate teaching in Spring 2019 for his Econ 160G class, Introduction to Game Theory. Game Theory studies how economic agents interact strategically when their profits depends on the actions of other agents. This class introduces basic concepts of this subject, including Nash Equilibrium, dominant strategies, and backward induction, and then applies them in real-world settings. This is Professor Sadzik's third time winning this award.

Austerity: the Right Medicine?

Contributed by Akhil Rastogi, UCLA Undergraduate Economics Student

Lebanon currently faces a nefarious financial crisis. Moody's estimates the government's domestic assets to be valued at around $10 Billion, which shies in the face of maturing debts and a budget deficit of 11.5% of GDP. As politicians scramble to international conferences and debate conditions on mitigatory loans, the lenders have the usual elephant of a reply—austerity!

The idea is almost obvious. In order to assure lenders of return, the borrowing nation must put into place economic reforms which decrease deficits, usually by cutting public sector spending and increasing tax revenue. Perhaps the most famous case of these measures was the Greek debt crisis of 2009. In order to secure bailouts from European banks and the IMF, Greece had to accept strict 'austerity packages' which involved actions such as setting limits to public employee bonuses, heavily increasing Value Added Tax, and decreasing pension payments. These measures would be considered worthy of the loans—if there would be a resulting fall in the budget deficit and eventually a stable balance sheet and inflation level. That never happened. In fact, looking as the history of public finance, austerity has hardly ever worked the way borrowers want it to.



Change in Gross Domestic Product (GDP), indexed on Quarter 1, 2008.
Calculated from Organisation for Economic Co-operation and Development (OECD) data.
Source: ncbi.nlm.nih.gov

The first reason why austerity is not considered a suitable response to public debt crises is more of a social and moral one. Massive public debt often entails rising prices due to quantitative easing and low industrial growth. An already difficult life is doubled down on when budget cuts, bonus and pension reductions, high taxes on imported goods, and usually any other austerity measures come rolling in. The same way the Greeks took to the streets when pensions were reduced, the Lebanese Prime Minister met the fury of his people when he attempted to implement a tax regime, including taxes on WhatsApp and Messenger calls. The protesters complained that the crisis, a result of corruption and mismanagement, was being balanced on the shoulders of ordinary hard-working citizens.

Beyond the moral reason, there exist macroeconomic counters to the performance of austerity packages. Large spending cuts and tax hikes constitute most of these packages. However, in the name of financial health, a fall in government spending is often paired with shrinking aggregate demand in the economy. This, according to the classical Keynesian theory, is exactly what the government should fight to prevent. Several macroeconomists argue that a lack of stimuli is far worse than the some of it, even at snail-like pace. Consider the differing responses to the 2008 financial crisis by the UK and the US. In light of the IMF suggesting a 2% fiscal stimulus package, the US government heavily cut taxes for the middle class; and, initially, so did the UK. However, as a new government took power in the UK in 2010, economic policies turned stringent and austerity-centered. The goals of both nations were the same—become financially stable again and gradually raise real output. As shown in the graph (on last page), the UK's policies ended up much less effective.

Apart from reduction in real output and a dip in employment, these cuts lead to two major concoctions of economic demise—tax revenue reductions and heavy deflation.

Consider the case of Japan's Lost Decade—a period of economic stagnation in the 1990s. It has become a classical example of misguided economic policies by the government. Due to marginal improvements by fiscal stimuli, the Japanese government decided to employ austerity instead to manage their debt. As this entails both low aggregate demand *and* high taxes, Japan was essentially taxing a shrinking economy. Austerity measures often counteract one another on either side of the balance sheet. The run-off problem of deflation is also related to how the economy, specifically the private sector, reacts to an already gloomy economic atmosphere.

Economist Richard Koo observed this bewildering phenomenon in post-asset bubble Japan—despite real interest rates approaching zero, private sector debt was decreasing instead of increasing. This implies that net savings of industries and financial institutions were rising. Koo termed this a "balance sheet recession." In post-bubble economies, private players fear sudden bankruptcy and tend to pay off debt rather than taking more on. The increase in net savings in a time when the government is drowning interest rates creates a deflationary gap, and a recession looms. The only way to escape this is rejuvenating fiscal stimuli, which is held at bay by austerity policies.

So, is austerity entirely useless? Not quite either. Austerity certainly helps restore financial stability, but it must be carefully targeted and timed. Tax hikes and spending cuts must focus on temporarily expendable areas. For example, in the case of India in 1991, tax hikes focused exclusively on luxury goods while tax deductions for most of the economy shot real output and the government quickly coffered up. Furthermore, if there has to be blanket tax hikes and spending cuts, an emphasis must be placed on sustaining government operations over payment of debt. Despite most of Greece's initial austerity measures aiming at loan repayment, Greece found itself in a debt trap due to a shrinking economy and turbulent public reactions. Thus, as Lebanese politicians bargain over interest rates for mitigatory loans, they must keep in mind the shackles that austerity brings with it.

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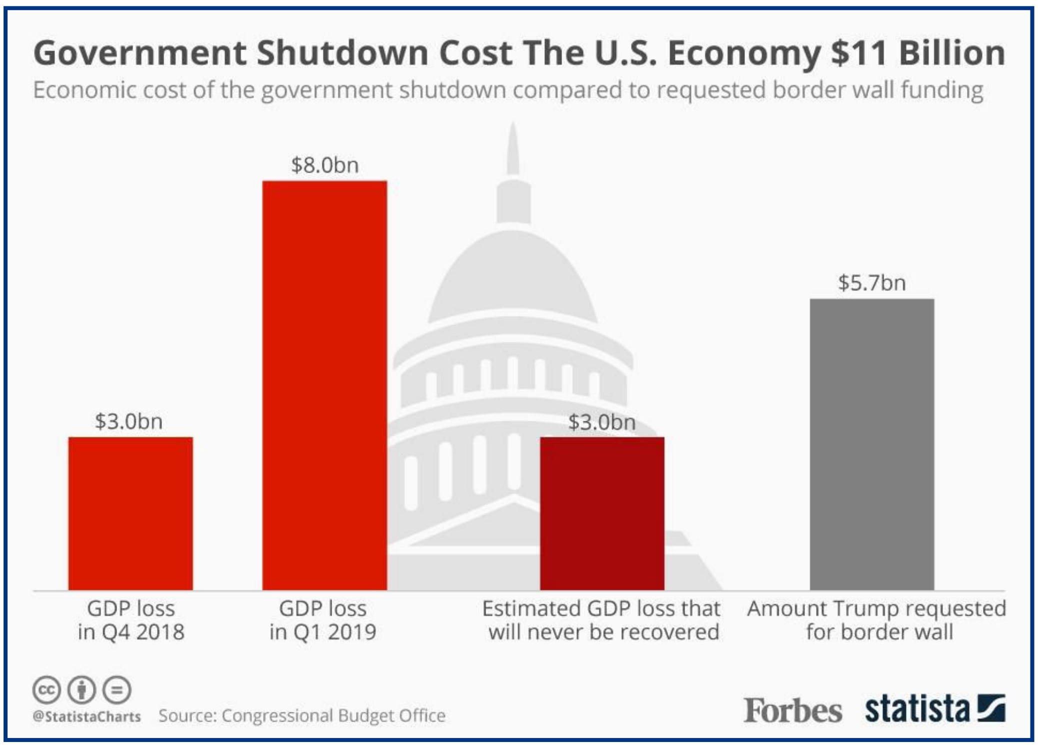
Economic Uncertainty Surrounding Government Shutdown

Contributed by Ng Xiang Yang, UCLA Undergraduate Economics Student

It has been one year since the US federal government shutdown last December, and the government appears to be embroiled in no less problems and disputes. What are the ultimate economic consequences of a government deadlock, and how will they potentially affect us? It is worth looking at this reflection on the economic side of the last government shutdown.

—Editor's note

In December 2018, the United States experienced the longest government shutdown in history, which lasted for 35 days. Approximately 800,000 federal employees were furloughed or forced to work without pay. The impasse was caused by President Trump and Congress not being able to agree on appropriating funding for the federal government for 2019. Specifically, the center of this disagreement is funding for the construction of a US-Mexico border wall that the President persistently demanded, which would cost $5.7 billion. Although a stopgap bill passed on January 25 temporarily ended the government shutdown, the cost was severe to the workers directly affected as well as the US economy as a whole.



Source: forbes.com

The livelihood of many of the 800,000 federal employees were impacted, to the extend that many were not able to pay for mortgages, food, and other essentials. While they could withdraw from their savings in the beginning, many would deplete their accounts quickly and inevitably reduce spending as this crisis lasted. In one instance, a tax examiner working for the Internal Revenue Service did not buy his penicillin due to uncertainty of when his next paycheck will arrive. Some had to use their credit cards and withdraw from their pension funds, both of which would accrue interest debt. All in all, even though these employees would eventually receive back pay, the shutdown had led to unnecessary losses that they never had to shoulder if it did not happen.

Indirectly, the economy at large also suffered losses, some of which could not be recouped. The CBO (Congressional Budget Office) estimated that the 5-week shutdown led to $11 billion of reduced GDP. Although subsequent quarters in 2019 would compensate approximately $8 billion, the US economy permanently lost $3 billion, which was roughly estimated to be 0.02% of projected GDP in 2019. These, however, are only costs that can be estimated tangibly; there are still other negative side effects. For example, some private enterprises which depend on the federal government's services might lose income because of the shutdown. Fitpacking, a business hosting backpacking vacations, lost sales since National Parks were closed or limiting their services. Furthermore, since the Small Business Administration was closed, small businesses could not obtain loans. The US economy as a whole, therefore, was far from escaping this episode unscathed.

Apart from political implications, this crisis serves as a reminder of how deeply the economy could be affected by decisions and disagreements within the government. Federal employees and businesses had no power to improve their financial situations and had to rely on their own ingenuities to stay afloat, which for some cost dearly. To prevent similar consequences from happening again, the public ought to be more prepared for the possibility of a government shutdown in terms of their financial planning. But more importantly, politicians should start to devise mechanisms to eliminate this defect in the design of the government or at least curb its effects. After all, this is the direct opposite of a win-win.

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