

# ECONOMICS & Business

## Students Work One-on-One with Professors



Martha Osier '06 (pictured above), economics and business major, is continuing research she began this summer working with Howard Bodenhorn, professor of economics and business. They are using census information to track free African Americans from 1850 to 1860 in an attempt to understand the factors that affected their economic condition. Considering the upward mobility of this small ethnic group within a developing country will establish the basis for comparisons to ethnic groups in developing areas elsewhere in the world. A particularly important source of socioeconomic mobility turns out to be migration from country to city.

Peggy Johnson '05, biochemistry and French major, is working with Rosie Bukics, Jones Professor of Economics and Business, and Roxanne Lalande, professor of foreign languages and literatures, on a text designed to introduce U.S. students to the world of French business. While most existing textbooks have a vocabulary-based approach, this text will examine the principal subdisciplines of business (accounting, marketing, human resources) and explain how they interact in support of successful French businesses. Johnson is currently analyzing European Union laws and regulations, particularly those related to the financial operations of French firms.

Michael Tortora '06, economics and business major, worked with Christopher Ruebeck, assistant professor of economics and business, over the summer. Using a variety of economics-gear computer programs, he compiled the salaries of chief executive officers, those directly below them, and so on down the salary chain. From those datasets, comparisons were made between big and small companies. Tortora also looked at the difference in the amount of incentive pay given to employees in larger firms compared to the bonuses received by those with the same responsibilities at

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### Issues in the News

## The New Comparative Economics ■ by Howard Bodenhorn

The collapse of the Berlin Wall signaled momentous changes in politics, culture, and economic systems. It also fundamentally changed the subdiscipline known as comparative economics. Between the 1930s and the 1980s, comparative economics explored the merits of capitalism and socialism, most notably the tradeoffs between economic efficiency and social equity. By the

time socialism collapsed, however, the debate had lost much of its vibrancy. A reinvigorated comparative economics, however, shares with its predecessor a fundamental concern for the operation of alternative economic systems, except the focus now is on alternative capitalist models.

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## Crain Selected for William E. Simon Chair

Mark Crain has joined the department in the William Simon Chair of Political Economy. He comes from George Mason University where he was director of the Center for Study of Public Choice and professor of economics.



*1. Up to now, you have taught at large state universities. What did you find attractive about a small private college?*

Several features attracted me to Lafayette. I liked the idea of a private institution, largely independent of the volatility of state government finances and insulated from the politics that occasionally affect the operations of state-funded organizations. I found it appealing that Lafayette students were by-and-large dedicating a four-year period of their lives to a full-time academic experience. The relatively small class sizes offered a setting for continuous communication and feedback, especially on written assignments and classroom presentations.

*2. Most of your research concerns "public choice" economics. Could you explain what that is and why it is important?*

Public choice scholarship has profoundly influenced thinking in the scientific community and the formation of public attitudes. Economics traditionally focuses on the behavior of firms and consumers and how individuals interact in market settings. As a research program, public choice extends the tools of economics to analyze the behavior of

*(continued on page 8)*

## College Fed Team Wins Regional Championship

Competing in a field of 12 teams that included last year's champion, Lafayette's College Fed Challenge team won the regional competition at the Baltimore Branch of the Federal Reserve of Richmond Nov. 15-16. This is just the second year that Lafayette participated in the event. The team advanced to the College Fed Challenge National Championship Nov. 30 in Washington, D.C. where they placed third behind Northwestern and Rutgers Universities.

The Fed Challenge team includes economics and business majors Peter Gagliano '05, Jennifer Rute '05, Shreedhar Sasikumar '05, Samantha Schackman '05, Daniela Simova '06, Katelyn Wilkins '05, and Dogan Yiginer '06, and international affairs major Vijay Krishnan '07. Rute has a second major in art, Sasikumar has a second major in international affairs, Simova is also pursuing a B.S. biology degree, and Yiginer is adding a B.S. in mechanical engineering.

The students were mentored by James DeVault and Edward Gamber, associate professors of economics and business.

"These students have worked really hard," says DeVault. "We were extremely excited to learn the results. It's a great educational experience that teaches the students a tremendous amount."

The College Fed Challenge is an academic competition designed to promote student understanding of the Federal Reserve System and U.S. monetary policy. Teams of students from different colleges and universities are each given 20 minutes to present their short-term recommendations for U.S. monetary policy as well as the rationale for their recommendations. Each team is then questioned by three judges for approximately 15 minutes. The judges score students based on a variety of factors, including their knowledge of U.S. monetary policy, the quality of their research, the organization and creativity of their presentation, and their ability to respond to questions. ■

## From the Department Head

Due to the sabbatical leave of Susan Averett, I resume the duties and responsibilities of department head for the current academic year. We wish Susan well on her sabbatical in Paris, where she is pursuing her research.

The Simon Center takes on new life each fall. The students, who seem younger every year, are eager to pursue their studies in pursuit of individual goals. This fall, we offered 13 different electives in addition to the core requirements in the major and independent research options. In that capacity, we have over 10 students pursuing honors work with various faculty members, as well as many others who are conducting independent study research projects or participating in the annual Fed Challenge. A significant number of students are also participating in internships at area businesses to experience the work environment firsthand.



To learn more about working on Wall Street, the Investment Club with the department cosponsored a Finance Day in New York City with Career Services in October. Attended by over 60 students and aided by many alumni who generously gave their time, the students had the opportunity to talk with individuals from the various fields within the world of finance. The most successful ventures we offer encompass the interactions between our strong and committed alumni and our young, bright, and energetic students. We thank the alumni who participate in events such as this one, or the externship program in January.

We also welcomed two new faculty members this year—Mark Crain arrived in August as William E. Simon Professor of Political Economy. He comes to Lafayette from George Mason University where he was director, Center for Study of Public Choice. He is teaching courses in public finance and political economy.

Visiting the department this year is Nicole Verrier Crain from the National Defense University of the Industrial College of the Armed Forces. She is teaching introductory economics as a visiting assistant professor.

We ask you to join us in extending our sympathy to Rexford Ahene on the sudden death of his wife, Frances. A former employee of the office of development at the College, she was always the first to provide students and colleagues with her hospitality, often opening her home as a second home for many students. Her wonderful smile, keen intellect, and her generosity and graciousness will be missed by all who knew her.

We enjoy hearing from alumni and hope you find this newsletter informative.

A handwritten signature in black ink that reads "Rose Marie L. Bukics". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Rose Marie L. Bukics  
Thomas Roy and Lura Forrest Jones Professor of Economics and Business



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## Economics Can Predict Presidential Elections ■ by Ed Gamber

In his recent book *Predicting Presidential Elections and Other Things* (Stanford University Press, 2002), Ray Fair shows how economics can be used to predict a wide variety of interesting phenomena. He begins with how economics may determine the outcome of presidential elections. According to Fair, higher growth and lower inflation make it more likely that people will vote for the incumbent in a presidential election. At the time I am writing this review, Fair's presidential model predicts that George Bush will win 57.48% of the popular vote. Regardless of the outcome, Fair's model correctly predicted 20 of the last 22 elections. It wrongly predicted a Nixon victory in 1960 and a Bush victory in 1992. On average his model misses the percent of the popular vote going to the incumbent by only 2.2 percentage points.

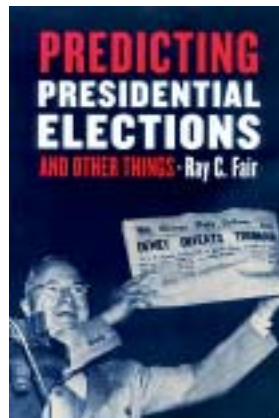
Noneconomists might think this model overly simplistic because it does not capture all the complex and varied issues surrounding each election. Fair might agree to a point—his model is simple—but not too simple. The proof is that it predicts well. Fair does not claim that other issues, such as the candidates' stances on foreign policy, do not matter, but at the margin, the issue that pushes one candidate ahead of another is the economy.

The book is really about how economists model choices and make predictions. His second chapter contains a seven-day crash course on modeling and forecasting beginning with economic theory (day 1) and ending with prediction (day 7). Although this quick route cannot substitute for a rigorous course in econometrics, it is an excellent complement to such a course. Fair describes, at an intuitive level, degrees of freedom, standard error, missing variable bias, and a whole host of other concepts from econometrics.

The remainder of the book is concerned

with applying the seven lessons to a variety of forecasting situations. He forecasts time spent in extramarital affairs, the price of fine wines, college grades, and marathon times. One of Fair's purposes is to show how modeling and forecasting tools used by economists can be used for predicting phenomena that are generally thought to be outside of economics.

So what do economists have to say about extramarital affairs? Using standard microeconomic theory, Fair predicts that an increase in wages has two effects: people want to work more (the substitution effect) and enjoy



more leisure (the income effect). Leisure activities could include spending more time having an extramarital affair. Of course a person cannot work more and enjoy more leisure at the same time (there are only

24 hours in a day) so economists say that the net effect of a rise in income on leisure activities is "theoretically ambiguous." The issue is settled by looking at the data. He finds that higher income does in fact lead to more time spent in extramarital affairs. The model does not predict who will have an affair, but that those already involved will remain involved for a longer time the higher their income.

In a chapter on wine, Fair applies an econometric model to forecast the price of premier cru wines from the Bordeaux region. His equation, based on temperature and

rainfall, does a good job of forecasting wine prices many years after the harvest. Who needs Robert Parker (renowned wine critic)? Just plug weather and rainfall into Fair's equation and predict the price—if the price in the store is less than the prediction then buy the wine, if it is more then pass. Sometimes economists are accused of taking the subtlety and joy out of living!

The chapter on predicting marathon times is interesting not just for long-distance runners but also for anyone growing old because it is really a model of slowing down. The good news is that people slow down linearly before the age of 60. For each additional year up to age 60 it takes a person 0.62% longer to run a marathon (walk a mile, cook a gourmet meal). The bad news is that after age 60 the rate of slowdown increases each year by 0.12%. Not only do we slow down, but every year after 60 the percentage lost is larger than the previous year. A 61-year-old is 0.74% slower than a 60-year-old; a 62-year-old is 0.86% slower than a 61-year-old.

While Fair's older readers are mourning the loss of their youth, younger readers are learning about the costs of enjoying their youth. He presents a model of college grades that includes several measures of student aptitude and hours spent studying, as well as a measure of the number of classes missed during the semester. For a given level of aptitude and studying, average grades drop by half a letter grade after a student misses more than 4 classes during the semester.

At one level this book is just a fun read; at a deeper level it gives a peak inside economics sausage-making machinery. His discussion of how economists modify theory in response to forecast errors gives insight into the real purpose of forecasting, which is to test ideas about how the economy works and to learn from the mistakes when the forecasts are wrong. ■

## Students Work One-on-One

(continued from page 1)

smaller firms. Executives in the retail sector use such information to predict and establish salaries, but creating such a comprehensive database could benefit others.

Katharine Wolchik '05, a dual degree candidate in mathematics and economics, and Christopher Ruebeck continue working on a project they began over the summer. They are using the computer program *Mathematica* to model interactions between

people that try to imitate successful behavior. The project's goals are to describe how the behaviors in such a population change over time and predict the long-run distribution of behavior types. Wolchik's work extends previous results of Ruebeck's that have also been explored by Prashant Poddar '04. These extensions add to the potential list of behaviors and introduce random "mutations" in addition to the desire to imitate success.

Denica Karadzova '07, economics and business major, is working with Howard Bodenhorn on a project that investigates the

conditions of employment for manufacturing workers in early 20<sup>th</sup>-century Connecticut. The state Bureau of Labor collected information on wages, hours, capital intensity, and the number of days employees lost due to the factory shutting down. This information should shed light on two hypotheses. The first is whether workers are compensated with higher wages if they expect to be laid off for some part of the year. The second is whether more capital-intensive factories operated with less-skilled workers. ■

## Ahene Designs Land Policies in Malawi

**W**ith a professional specialization in and unique knowledge of the connection between land and the growth of markets, **Rexford Ahene**, professor of economics and business and cochair of Africana studies, has been invited by several international development organizations, including the World Bank, United Nations, and USAID to serve as a policy adviser to such countries as Botswana, Tanzania, Uganda, South Africa, Ghana, and Malawi. His scholarship in this area has led to a deeper understanding of the complex and changing relationship between local land institutions and the state.

During a 1993-94 leave, Ahene was policy adviser to the government of Tanzania. He designed and implemented a \$1.6 million land reform project, funded by the World Bank. Following its success, the World Bank invited him in 1995 to join an assessment team to evaluate Malawi's economic programs.

Malawi, a former British colony, gained independence in 1964 and was ruled by the dictator Dr. Kamuzu Banda until 1992. It adopted multiparty parliamentary democracy in 1994, and though the political situation has remained stable, economic performance is poor. A small, landlocked country of 9.8 million people, it is one of the world's poorest. Major export products are tobacco, tea, and sugar, but with declining world demand for tobacco and declining prices of tea, the economy experienced declining real growth. Frequent crop failures regularly threaten maize, the country's staple food. Poor macroeconomic policy decisions have resulted in debt to international lenders; current inflation rate is 12 percent. About 15 percent of the population is infected with HIV, malnutrition is widespread, literacy is low, and infant mortality rates are among the highest in the world.

Ahene's role in Malawi was to rationalize land policies to promote economic growth. His first task was to review existing land laws and conduct a series of land utilization studies in the traditional and commercial agricultural sectors, as well as official land management policies on government-owned lands. He returned to Malawi in 2000 to synthesize the results and develop a new comprehensive land policy, which was approved in January 2001. The World Bank committed \$26 million to implement the recommended reforms.

In a country with so many problems, why does land reform take center stage? Ahene explains that as African countries move toward market-oriented democracies they often fail to recognize existing informal and traditional property rights. These rights are



socially powerful institutions, and the basis of informal ownership is clearly defined by long-standing customs, rules, and regulations that people within the community accept and respect. Land reform must recognize these customs, but also allow for official sanction and protection.

One of the most fundamental principles of market capitalism is that enhanced protection of property rights increases incentives to invest in and improve the productivity of property. Because property rights increase the certainty of ownership, owners are more willing to make investments in buildings, equipment, infrastructure, and land conservation measures. Even more important, clearly defined rights of ownership encourage the operation of land markets and the allocation mechanism. If the market is allowed to operate, innovative and energetic farmers will be able to acquire more land. Less productive farmers will have less land. The result is a higher aggregate output.

In most African countries, property rights to land tend to be held informally so that the land cannot enter the formal marketplace and move from less to more productive owners. Although the benefits of clearly

defined property rights are established in the West, they have not been attained in Africa. In some instances, poorly designed land reform projects, such as in Zimbabwe, were counterproductive and resulted in economic meltdown.

Ahene still works indirectly with the government of Malawi and the international donor community to develop and implement a number of projects. He believes his relationship will continue for the foreseeable future. More than \$67 million in development assistance has been committed for surveying and title registration over the next 10 years. Other land development and poverty alleviation projects are being designed to encourage the effective use of land. Ahene is confident that the implementation of these policies will bring some relief. "I share the conviction," he says, "that land offers endless opportunities for economic development and discovery. It is the ultimate source of wealth and the missing catalyst in Africa's transition." ■

## Seifried Consults with

**T**he principal professional activity of **Ed Seifried**, professor of economics and business, is as an adviser and consultant to the financial services sector. He frequently serves as a facilitator for management and board strategic planning sessions with community banks. "The area where I am most active," Seifried says, "is with institutions with an asset size between \$500 million and \$2 billion. This is a large market niche despite the wave of consolidation during the last 25 years." He says that institutions of this size face intense competition from the largest commercial banks and other financial institutions, such as credit unions. Most small bank directorships are not full-time positions, so most people in those positions

# Scholarship to Work

## What's in a Name?

It is not often that industry calls on economic historians for their expertise. After all, they are more interested in explaining what happened than in predicting what may happen. But there are times when historical knowledge is valuable. Howard Bodenhorn, professor of economics and business, was recently asked for his expertise on a legal case.

The explosion in online commerce has prompted a rapid increase in the number of Internet banks, all of which need a name that conveys a sense of reliability and permanence. It is no coincidence, says Bodenhorn, that every two-horse town in America once had a First National Bank. The second bank in town rarely called itself the Second National Bank. It became, instead, the Merchants & Farmers Bank, or something similar. With so many similar names, it was only a matter of time before naming practices became an issue.

A law firm representing an Internet banking company, which was accused of wrongly taking on the name of a well-known "brick and mortar" bank, asked Bodenhorn to do some historical research on common naming practices in the industry. After some investigation, he found that it was common practice for banks in small markets to take

on a name similar to well-known banks in nearby cities. Thus, the well-known Schuylkill Bank of Philadelphia, N.A. might have a number of imitators like the Schuylkill Bank of Pottstown and the Schuylkill Bank of Adamstown. Because these little banks did not claim an official affiliation with the city bank, because they included the "of Adamstown" in their official name, and because the U.S. Comptroller of the Currency recognized the small-town bank's name, the Philadelphia bank has little or no legal recourse. This was the sort of precedent the defendant was looking for.

But, Bodenhorn notes, one can make a case for changing the rules. When banking was local and branching limited, few customers were likely to confuse the Adamstown bank for its namesake in Philadelphia. With the expansion of branch banking and, especially, with the growth of Internet banking, it may not be optimal to allow unknown banks to adopt well-known names. Customers, for example, will be not well-served if it becomes difficult for them to distinguish between the real Citibank and the Citi-bank of Boise. Precedent, in this case, may not provide the best guidance, which is *not* what the client wanted to hear. ■

## Financial Services Industry

hold full-time positions outside the bank. This means that strategic planning sessions are held on weekends.

Seifried also serves as an outside chief economist for the BNK Advisory Group, a community bank advising and brokerage firm based in the Lehigh Valley, which has about 250 community bank clients. BNK specializes in security trading for its clients, with an emphasis on bank-qualified tax-exempt municipal bonds. Seifried provides "economic commentary and advice regarding monetary trends and interest rate movements." He also tracks macro-economic conditions that might adversely affect the loan portfolios of BNK's clients.

Seifried draws two connections between his role as teacher and consultant. First, he

daily sees the connection between what he teaches in class and its practical application. Second, as the director of internships, he has been able to secure a number of interesting internships for students.

Seifried's summers are devoted to training commercial bankers as a faculty member at several schools, including the American Banker Association's Stonier Graduate School of Banking, a 10-day session every June at Georgetown University, Washington, D.C. He enjoys these sessions because "teaching applied economics to commercial bankers is a little different than teaching undergraduates." It is also a special treat, he notes, when a Lafayette alumnus shows up in one of his summer classes. ■

## Stifel Assists Policymakers in Madagascar and Kenya

Over the summer, David Stifel, assistant professor of economics and business, worked on two consulting projects for the World Bank. The first involved providing technical support to the national statistical office in Madagascar to design a nationally representative multipurpose household survey. He traveled to the capital, Antananarivo, in early June to work with colleagues for several weeks on questionnaire design and field testing, sampling issues, and overall survey organization.

Aside from measuring standards of living, the three-month survey of 5,000 households is intended to help economists and policymakers better understand how risk affects poor households. Stifel designed and tested a risk module for the survey in response to Malagasy policymakers desire for information to design policies to help poor communities and households mitigate the effects of such shocks as cyclones before they occur (e.g. strengthening roads before a storm) rather than rely on more expensive post-risk coping mechanisms (e.g. rebuilding washed-out roads).

The second project is an on-going analysis of poverty in Kenya. In the absence of survey data on household incomes since 1997, policymakers have been developing national poverty reduction strategy with outdated information.

Stifel was asked to employ techniques developed in his dissertation as well as new poverty mapping techniques to impute current poverty levels and characteristics using recent health survey data. He will present his findings to the Kenyan government in Nairobi during spring break. ■

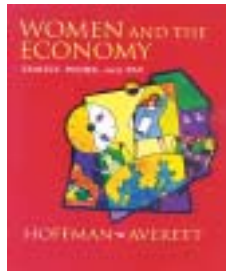


## Averett Publishes *Women and the Economy*

Using economic tools, Susan Averett, professor of economics and business, examines women's work and pay, education, divorce, fertility, and family policy, among other issues in a major new textbook, *Women and the Economy: Family, Work, and Pay* (Pearson Addison Wesley). She collaborated with Saul Hoffman of the University of Delaware.

The book emphasizes the important ways in which women's lives have changed in the past 40 years. The most obvious change is in the labor market. Women, especially those who are married, are much more likely to be employed outside the household now than in 1960 and more likely to be employed as professionals and managers. Earnings gaps have narrowed, but have not been eliminated.

*Women and the Economy* devotes considerable space to the earnings gap. Chapter 10, for example, asks whether women deserve to earn less than men. On average, the answer is still "yes." The median earnings of women is about 75 percent of median male earnings. But the



average woman still has less education and a less regular work history than an average man, which reduces female wages. The book discusses two ways to reduce the gap. The first is for men and women working in the same job to be paid the same. For young women the "earnings gap" has narrowed substantially, but has not been eliminated. The second is for men and women to work in the same jobs. The authors note that men and women work in different kinds of jobs even when they have similar skills.

While the earnings gap remains one of the most-discussed women's issues, the book highlights other issues facing women in the modern economy. Traditional marriage and child-rearing patterns are changing. Fertility rates have fallen. Women are now more likely to attend a college or university than men. The book addresses these changes and the many public policy issues that surround them, including family leave, marriage tax, welfare reform, and problems of children raised in single-parent households. ■

## Research Update

Averett Receives Grant to Study Adolescent Behavior  
**Susan Averett**, professor of economics and business, in collaboration with Daniel I. Rees and Laura M. Argys, University of Colorado-Denver, received a \$50,000 grant from the National Institute of Child Health and Human Development to study the economic effects of older peers on adolescent behavior. One or more students will be hired to assist with the research.

Average Weights for Commodities  
**Don Chambers**, KPMG Professor of Economics and Business, in collaboration with John Zdanowicz, Florida International University, is engaging in a large research project using a massive international trade dataset to determine the average weights for various commodities. After the weight characteristics of every U.S. import transaction was studied, they developed a computer analysis that allows for the determination of the normal weight characteristics for all products brought to the U.S.

Chambers says the research is valuable in two ways. First, he has uncovered some real anomalies that may reflect either errors or fraud. Either way, use of the uncorrected data will lead to unreliable statistical analysis. Second, the average weight data can be used to "flag" suspicious shipments that may be of interest to the country's anti-terrorist enforcement agencies.

Awarded Honorable Mention  
**Stacy Alboher '04**, whose research into the sale of certified forest products was highlighted in the last issue of this newsletter,



was awarded an honorable mention by Ohio State Department of Agricultural, Environmental, and Development Economics, which encourages meaningful

undergraduate research in environmental economics. Alboher's thesis was one of only four senior theses singled out for recognition. ■

## Publications and Presentations

**Edward Gamber** with **Juann Hung**, "Does International Asynchronization Matter for the U.S. Business Cycle?" *Economic Inquiry*, Oct. 2004, 647-66.

**Jerome Heavey**, "Superannuation and Social Security in Australia and the United States," *Journal of Australian Political Economy*, June 2004, 53, 191-206.

**Howard Bodenhorn** presented "Bank Chartering and Political Corruption in Antebellum New York" at NBER, NYU, and Yale; and "The Economic Consequences of Colorism and Complexion Homogamy in the Black Community" at SUNY-Binghamton.

**Thomas Bruggink** and **Daniel Williams '03** presented "Discrimination against Europeans in the National Hockey League: Are Europeans Getting Their Fair Pay?" at the Western Economic Association, Vancouver, B.C., July 2004. ■

## Students Join Phi Beta Kappa

Of the 27 students invited to join Phi Beta Kappa last spring as juniors, the following students, listed with their major and scholar designation, were from economics and business.

**William H. Bishop '05**, economics and business, Marquis Scholar

**Amanda H. Bochner '05**, international economics & commerce and Spanish

**Michael J. Bruno '05**, economics & business, Marquis Scholar

**Hart N. Feuer '05**, economics & business and German

**Emily L. Fogelberg '05**, economics & business and history

**Veronica E. Hart '05**, economics & business and Spanish, Trustee Scholarship recipient

**Katharine C. Wolchik '05**, B.S. mathematics and A.B. economics & business, Trustee Scholarship recipient

# The New Comparative Economics

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## Institutions and Legal Origins

Each capitalist economy has its own formal and informal rules or institutions that include constitutions, laws, and regulatory procedures, as well as basic social mores and religious values. These institutions intersect to determine how political leaders come into and stay in power, how property rights are defined and protected, how corporations are governed, how credit is allocated, and so on. Comparative economics recognizes that institutions differ across countries, and that they have consequences for economic performance.

Traditionally, institutions have been grouped into four categories based on their political and legal traditions—the British common law, as well as the civil law systems of France, Germany, and the Scandinavian countries. Common-law systems establish broad constitutional rules, leaving specific interpretations to legislatures and courts. Civil-law countries write comprehensive legal codes that leave little room for legislative and judicial interpretation. England built up a constitutional, jury-based system that respected general principles. France constructed a rigid, codified system that followed bright-line rules. As the principal European countries built empires between the 16th and 19th centuries, they exported their basic legal systems, and the new comparative economics investigates how the exportation of European legal

systems have influenced the economies of former colonies.

## Institutions and Consequences

While the new comparative economics is young, there is a belief that common-law countries outperform civil-law countries. When civil law is transplanted into a country with a strong dictator whose preferences differ from those of the public, he can exercise his control over the legal systems to punish opponents rather than to dispense justice. The transplantation of a constitution-based common-law system is less susceptible to these kinds of abuses because the legislature and judiciary are relatively independent of executives. Thus, when civil law is transplanted into a country with bad government, property rights become less secure, regulation grows heavier and more oppressive, corruption is more common, and there is less political freedom.

## Institutions and Economic Outcomes

The pertinent economic question, of course, is how these systems influence economic behavior and economic outcomes. Some of the best evidence to date of the differences between common- and civil-law systems comes from financial markets. In order to elicit investment, borrowers must be able to credibly assure investors that investors will receive the returns from those investments, that the borrowers cannot freely expropriate

the investors' money. The underlying legal system influences investment. If the law affords investors few protections from expropriation from management or government, investment will be lower than in a country where the legal system offers investors significant protections.

In a series of articles, Rafael La Porta, University of Chicago economist, reports that equity investors and creditors are afforded the greatest protections by English common-law countries, the least by French civil-law countries. Interestingly, Scandinavian civil-law countries are the most effective enforcers of laws protecting investors and creditors, and French civil-law countries the least effective. Scandinavian countries also have the most transparent and effective accounting standards, French civil-law countries the least. Because they offer the fewest protections to outside investors, French civil-law countries are less likely to have well-functioning banking systems or equity markets. Other studies have shown that countries with better financial markets experience faster rates of economic growth and development.

Thus, the empirical link between the legal system and economic growth is indirect, but it is consistent with economic theory. It seems, for now, that institutions rule and that a country's colonial inheritance matters in ways that previous incarnations of comparative economics did not contemplate. ■

## Students Visit Wall Street

About 70 students traveled to New York City in October to network with more than 20 alumni in the financial services field. Finance Day was co-sponsored by Career Services, the Investment Club, and the department.



Andrey Chelebiev '05 (right) talks with Michael McDonough '79, vice president for global trade financial services at the Bank of New York.



Scott Littlejohn '84 (right), managing director of financial institutions for Citigroup, chats with (from left): Jeromie Ballreich '06, Erin Koen '05, Katie Brown '06, Sandra Goldman '05 and Clint Losch '06.



## Crain Selected for William E. Simon Chair

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voters, candidates, legislators, bureaucrats, judges, and so on. Research by public choice scholars also focuses on other nonmarket institutions such as religion, the family, clubs, and culture.

The public choice research program has worked to standardize the playing field in social science research; that is, it insists on a common, consistent set of behavioral postulates.

A third critical contribution has been to elevate the importance of electoral incentives in the determination of economic policy. To put this plainly, economic policy is set by politicians—motivated, for example, by election concerns and pressure-group politics—and not by economists in the pursuit of efficiency or equity criteria. This insight seems obvious in hindsight, yet economists roundly ignored it for decades in the analysis of fiscal and monetary policy. Making this distinction an integral part of the analysis makes a big difference in the choice of policy instruments and in the design of institutions.

### *3. You now hold the Simon Chair in Political Economy. How is your research consistent with Simon's values and attitudes toward government and the economy?*

I share Simon's desire to promote societies with free, responsible, and prosperous citizens. Through his experience in business and public life, Simon saw the power of the teachings of the classical liberals as the best way to organize political and economic systems to ensure individual liberty. The essence of the classical liberal vision is a society with constitutional democracy and operative market arrangements, relatively free of hands-on political direction.

### *4. Last spring you presented a paper on terrorism. Is this part of a new research agenda, or something spurred by recent events?*

In the terrorism project (with Nicole Crain) we are assembling an extensive global database that includes over 15,000 international terrorist incidents that occurred in the last 35 years. We have two general objectives: to estimate the costs of terrorism (and thus the benefits of reducing and deterring terrorism) and to identify patterns and determinants of terrorist activities. The importance of research of this nature is obvious.

Another project is looking at the governance structure of public pension funds and how this affects fund performance. Policy makers all over the world confront an aging population and look to pension funds to help meet the growing retirement needs. A key element in meeting these needs in the United States and abroad lies in the improvement of public pension plan investment and funding performance. This project is investigating why some public pension plans outperform others and what structural design features are associated with good pension management outcomes.

### *5. What classes will you teach at Lafayette? How do you incorporate your research into your teaching?*

My political economy course was newly established this year to enhance my ability to accomplish the mission of the Simon Professorship. The course requires weekly reports that analyze issues in political economy using economic theory and statistics. I champion a learning-by-doing teaching style, so the assignments are usually ideas that I am pursuing in my research agenda.

The public finance course is similarly organized around a series of weekly assignments that require original empirical analysis. Some assignments this semester are based on extensions of my 2003 book, *Volatile States*, and they rely on datasets of fiscal, economic, political, and demographic characteristics of the American states. As an illustration of how my research gets incorporated into my teaching, one of the assignments is to use these datasets to estimate the impact of state regulations on state economic activity. The students and I are doing the research at the same time, and we learn from each other.

## THE LAFAYETTE Experience

The Lafayette Experience consists of four key elements:

- Student-focused teaching and mentoring by an exceptionally qualified faculty, committed to each student's success.
- A challenging, broad-based academic curriculum that offers strong programs in the liberal arts, sciences, and engineering.
- A small college environment with large college resources.
- A friendly residential community offering an exciting social life with a broad spectrum of extracurricular activities.