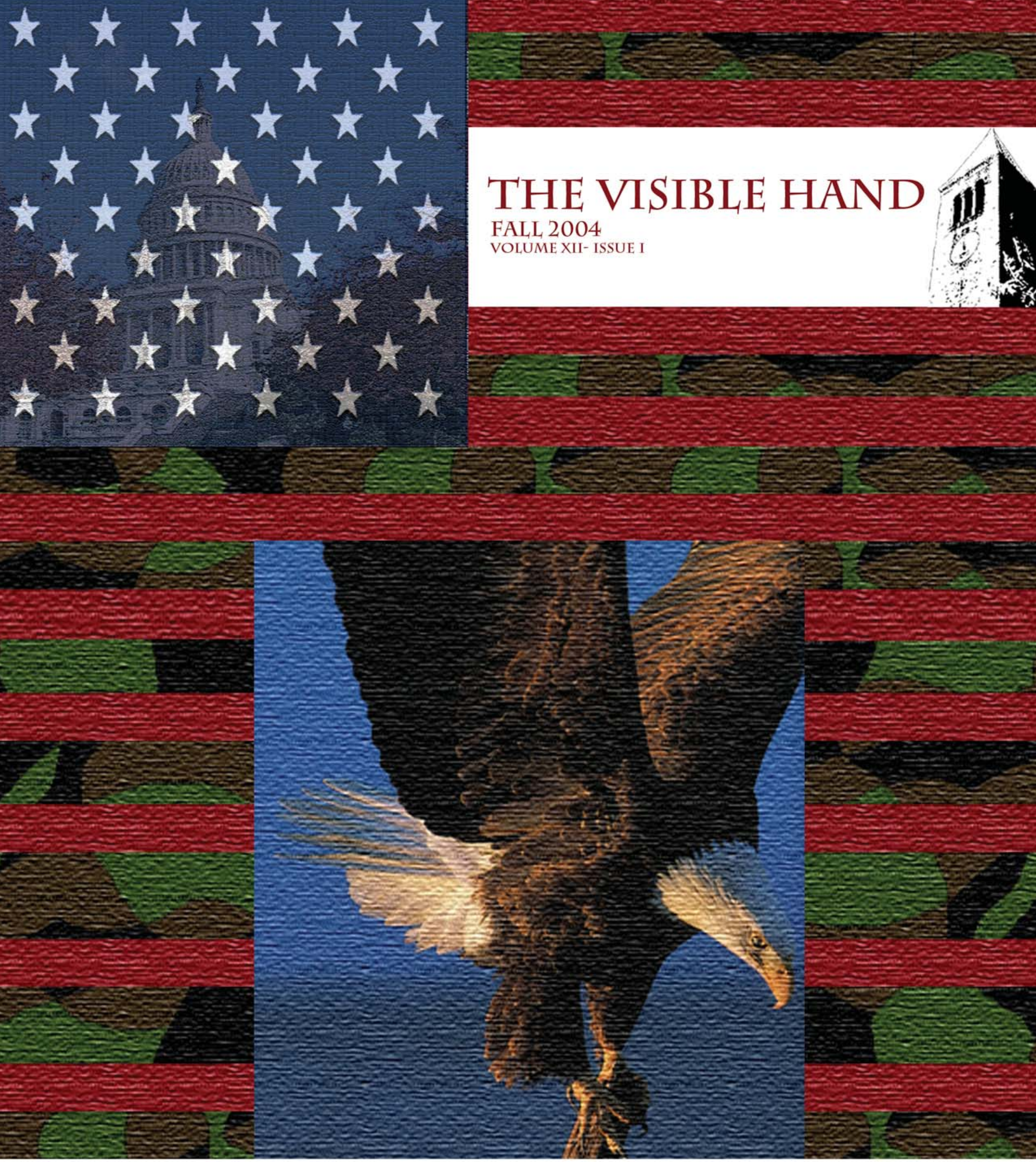

THE VISIBLE HAND

FALL 2004
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-INDIVIDUAL RESPONSIBILITY, INCENTIVES AND THE CORPORATE CLIMATE
-THE ECONOMIC EFFECTS OF THE EU EXPANSION
-BEHIND THE SEAMS OF CAFTA: A LOOK AT TRADE AND INTERESTS GROUPS IN THE US
-TAX REFORM: POTENT POLICY OR PATHETIC POLITICS?

THE VISIBLE HAND

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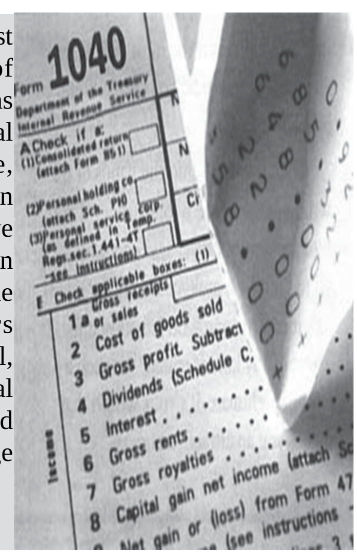
Investigating the issues

Taxes

Jobs

FREE TRADE The Central America Free Trade Agreement (CAFTA) is a proposed preferential bi-lateral and regional trade and investment agreement between the United States and five Central American countries. Will American consumer and producers benefit from this open sectoralism and regional liberalization, or will outsourcing and asymmetrical trade ensue? Page 18

TAX POLICY Over the past twenty years the issue of fundamental tax reform has sporadically become central to Washington discourse, most recently in the 1990s in 1996 and 2000 when Steve Forbes made a flat tax, an income tax having a single rate for all taxpayers regardless of income level, the center of his presidential bids. But should the United States adopt a flat tax? Page 5



THE VISIBLE HAND

FALL 2004

Investigating the issues

Globalization

Ethics

EUROPEAN UNITY In May, 2004 the European Union expanded eastward to include 10 new countries, increasing its total membership from 15 to 25 countries. Considering the fact that several of the new members are former Communist countries, what might be the economic effects of this expansion? Page 28

HALLIBURTON

CORPORATE RESPONSIBILITY Should individual employees be morally (and legally) responsible for corporate actions? Given the fictional entity of a corporation, this raises some interesting questions. Page 38

From the Editor:

"If anything can go wrong, it will"

source: Capt. Edward A. Murphy

We could all use the optimism of Mr. Murphy. For example, it's an unwritten law that the chance of your computer printer breaking is directly proportional to the importance of the document being printed. The latest email forward imploring you to send it to ten people in the next 3.14 seconds or risk eternal damnation? Comes out without a hitch. Term paper about the economic effects of reforming the medical malpractice insurance industry through tort reform? Not a chance.

I'm sure you're asking yourself, "What does this have to do with *The Visible Hand*?" if you haven't already skipped ahead to the article about CAFTA out of frustration. Well, it turns out that we experienced more than our fair share of Murphy's Law inspired snafus.

Originally, I had planned to dedicate this entire issue of the journal to the US Election with an ambitious target for release one day before the polls opened. Yet, it turns out that three weeks notice added with a Cornell workload left us wanting for enough articles to produce something longer than the sports section of the *Cornell Daily Sun*. Either that, or the *Sun's* many columnists saturated the market for Cornell originated punditry.

Thus, some of our writers operated under the assumption that their work would be published before the election. I mention this fact in case you happen to come across an article that appears to be out of date. Yes, it's old news by now that Bill O'Reiley was correct in classifying the viewers of *The Daily Show with Jon Stewart* (and by extension the youth of America) as "stoned slackers". The much ballyhooed surge in youth voter turnout critical to a Democratic win was thwarted after the munchies sent us to Taco Bell instead of the polls. Nevertheless, it's important to remember that the problems which framed this election remain problems to be resolved. Healthy discourse is a vital part of this process.

On a more personal note, thank you to all the writers, editors, and sponsors who made this issue possible! I would also like to encourage anyone interested in writing about economics or working with an enthusiastic editorial team to join us next semester as we begin work on the Spring 2005 issue - subscribe to our listserv by sending an email to [visiblehand-subscribe@yahoogroups.com]. With that, I would like to welcome you to the Fall 2004 issue of *The Visible Hand*!

Best,

Michael Tang

Our Mission

1. To raise economic, political, and social awareness amongst Cornellians of our roles as citizens of the global community.

2. To address and analyze current news-worthy events while promoting further inquiry into how they fit within a historical context, as a link between our past and the possible realities of our future.

The Visible Hand

Volume XII: Number I

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The Visible Hand welcomes your economic-related submissions and comments. Please contact the editor-in-chief or send mail to: Cornell Economics Society, Uris Hall, 4th Floor, Cornell University, Ithaca, NY 14853.

Tax Reform: Potent Policy or Pathetic Politics?

By: Carlo S. Caretto

"The federal income tax system is a disgrace to the human race." - Jimmy Carter, 38th President of the United States

Most of us know that the United States is joined only by Liberia and Myanmar in not officially adopting the metric system as its predominant system of measurement. The story is much the same with taxation: the United States is unique among industrailized countries in employing a system of taxation that is income based, as opposed to consumption based. However, that may be about to change…

U.S. Taxes vs. Rest of World

Taxation in the United States differs from taxation in other industrialized countries in three main ways. First, the overall level of taxation in the United States is significantly lower than it is in other industrialized nations. In 2000, total taxes were 29.6% of GDP in the United States and of the thirty developed countries that constitute the Organization for Economic Cooperation and Development (OECD), only Mexico, Japan, and Korea had lower levels of taxation. The European Union average was 41.6%.

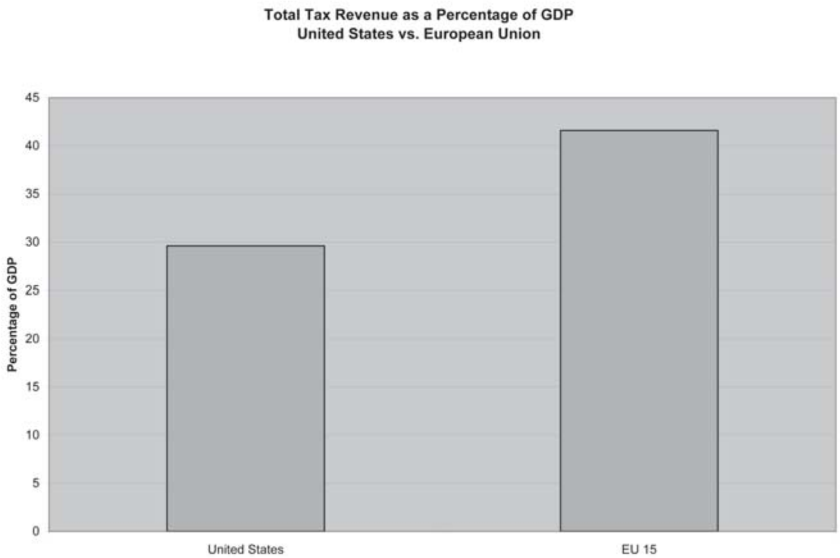
Second, the United States differs in the type of taxation it imposes. Consumption taxes are the primary revenue collecting instruments

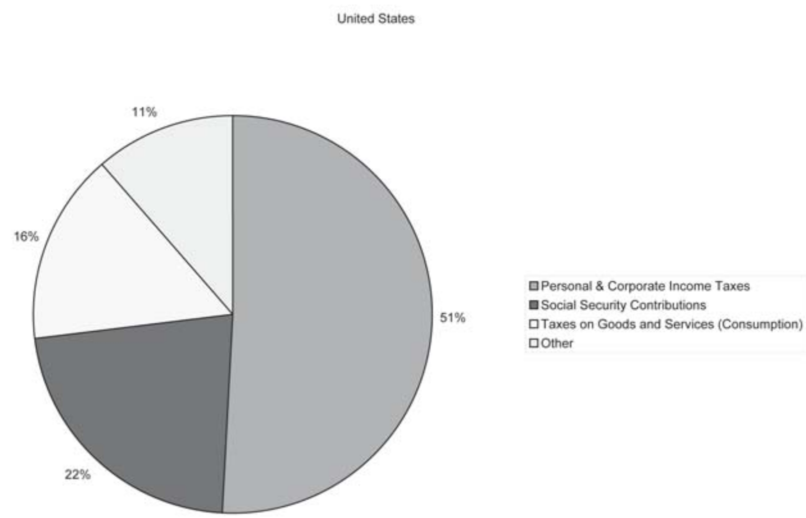
Total Tax Revenue as Percenatge of GDP

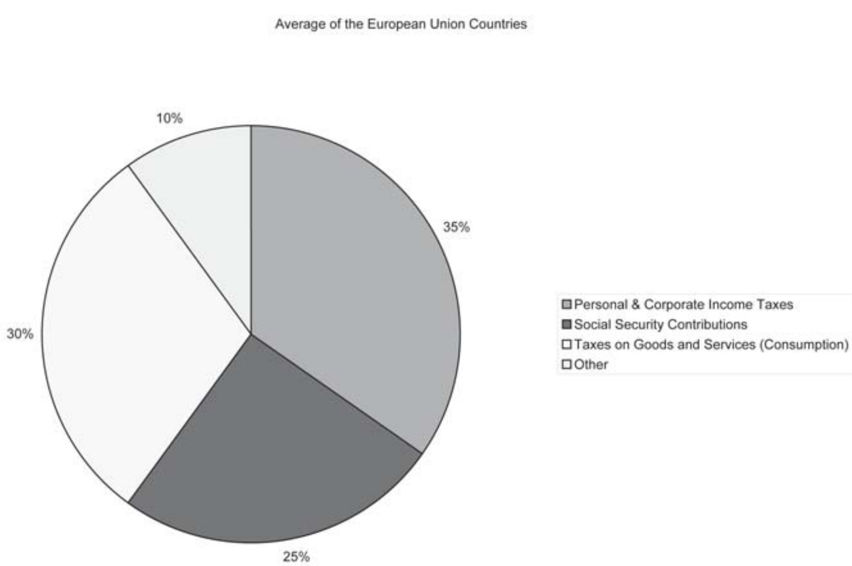
Country	2000	Country	2000
Mexico	18.5	United Kingdom	37.4
Korea	26.1	Greece	37.8
Japan	27.1	Germany	37.9
United States	29.6	Hungary	39.1
Ireland	31.1	Czech Republic	39.4
Australia	31.5	Norway	40.3
Turkey	33.4	Netherlands	41.4
Poland	34.1	Luxembourg	41.7
Portugal	34.5	Italy	42
New Zealand	35.1	Austria	43.7
Spain	35.2	France	45.3
Switzerland	35.7	Belgium	45.6
Canada	35.8	Finland	46.9
Slovak Republic	35.8	Denmark	48.8
Iceland	37.3	Sweden	54.2

Unweighted averages	
OECD Total	37.4
OECD Europe	39.9
EU 15	41.6

Carlo S. Caretto '08 is an Economics and Government major in the College of Arts and Science.







throughout the world and for the OECD, the long-term trend is increasing revenue yield from consumption taxes. In fact, 29 of the 30 member countries now have a VAT/GST. In 2000 personal income taxes constituted 42.4% of U.S. government revenue while sales and consumption taxes provided only 15.7%. In OECD countries consumption taxes were, on average, 31.6% of tax revenue, almost twice that of the United States.

The final difference in tax systems is that the U.S. has a "classical system" of income taxation in which income earned through corporations (dividends) faces double taxation, taxed once when earned by the corporation and once when earned by the shareholder. In 2003, Mr. Bush proposed a dividend tax plan under which corporate dividends would not be taxed thus ending this double taxation of profits but due to strong lobbying Congress simply cut the tax on all dividends. That may change in a second term, however. Most Conservative Republicans take pride in pointing out that the current system discourages saving by taxing it twice. Dennis Hastert, Speaker of the House of Representatives, says that income taxes should be scrapped in favor of a national sales tax.

The Case for Consumption Tax

Over the past twenty years the issue of fundamental tax reform has sporadically become central to Washington discourse, most recently in the 1990s after Republicans captured the House of Representatives and also in 1996 and 2000 when Steve Forbes made a flat tax, an income tax having a single rate for all taxpayers regardless of income level, the center of his presidential bids.

But should the United States adopt a flat tax? This seems to depend on how the reform is introduced. Alan J. Auerbach concludes from his simulations that an immediate move to the flat tax may increase economic efficiency and raise GDP by 8 percent in the long run. However, adoption of a consumption tax that provides transition relief and

Tax Structures as Percentage of Total Tax Receipts, 2000

Country	Personal income tax	Corporate income tax	Social security contributions: Employees	Social security contributions: Employers	Taxes on goods and services	Other taxes
United Kingdom	29.2	9.8	6.7	9.4	32.3	12.6
United States	42.4	8.5	10.2	11.9	15.7	11.3
EU average	25.6	9.2	9.5	15.6	30.0	10.1
OECD average	26.0	9.7	7.9	14.7	31.6	10.1

preserves the progressivity of the current tax system would probably result in a small output gain and no increase in economic efficiency: Joel Slemrod and Auerbach reach this conclusion about the primary economic benefits of the Tax Reform Act of 1986, an act passed by the Congress with the intention of simplifying the income tax code, broadening the tax base, and eliminating tax shelters. The top tax rate was lowered from 50% to 28% while the bottom rate was raised from 11% to 15% making this the only time in the history of the U.S. that the top rate was reduced and the bottom rate increased concomitantly. Despite the bill being passed under the Rgean admnistration, the official sponsors of the bill were Richard Gephardt (Missouri – D), and Bill Bradley (New Jersey – D).

Dale W. Jorgenson and Peter J. Wilcoxen (of Harvard University and the University of Texas respectively) analyze the impact of fundamental tax reform on the dynamics of U.S. economic growth over a quarter century in their 1997 analysis that came in response to the aforementioned Washington discourse on tax reform that occurred in the mid-1990s. Jorgenson and Wilcoxen consider two alternative approaches to tax reform: the flat-rate consumption tax (introduced by Majority Leader Dick Armey) and the income-base value-added tax with a flat rate. Their simulations of U.S. economic growth under alternative tax policies are based on an intertemporal equilibrium model of the U.S. economy. Their model of U.S. economic growth is disaggregated to the 35 industries and the model distinguishes among 1,344 types of households, disaggregated by family size, age and gender of household head, region of residence, race, and urban versus rural location. The model is built around submodels of investment and saving based on rational expectations.

...the tax code stands at more than 50,000 pages and its immense complexity imposes a massive cost on the economy.

In order to analyze the economic impact of changes in tax policy, they simulate the growth of the U.S. economy with and without policy changes. They conclude that under the flat consumption tax GDP would increase by almost 3.3 percent (as opposed to the growth of GDP under the old tax system) in the first year, rising gradually to a peak of 3.7 percent in 1999 and then declining to a long-run level almost identical to the initial value of 3.3 percent over the next quarter century.

They also conclude that taxation of consumption would induce a shift in the composition of economic activity from consumption toward investment as shown in Figure B. Real investment would initially rise by 4.9 percent and then gradually fall to zero within the next decade. Consumption would initially rise by 2.9 percent, and then decline in proportion to GDP. However, consumption would eventually rise to a slightly higher proportion of GDP than under the existing tax system.

One case for tax reform is rarely mentioned: the tax code stands at more than 50,000 pages and its immense complexity imposes a massive cost on the economy. Most estimate that cost to be over $115 billion per year. Abundant loopholes encourage people to waste time and money on tax-avoidance schemes. In a 2002 memo prepared by Assistant Treasury Secretary Pam Olson (one of the country's leading tax experts) for Treasury Secretary Paul O'Neill, Olsen gives clear evidence of this needless complexity: the memo states that over half of all individual tax filers use a paid preparer, that in 2001 the IRS received over 74 million phone calls and 9 million "walk-in" visits, and that the IRS website (containing information about tax provisions) received over 2 billion "hits" in 2001. There are those, such as Mitchell L. Engler of the Cardozo Law School who dispute the importance of this: "contrary to the long-standing belief that the income tax imposes an excess tax burden on all investment return, recent scholarship establishes that, relative to a pure income tax, the consumption tax relinquishes the tax burden on only the risk-free investment return. Accordingly, the consumption tax addresses the loopholes while relinquishing relatively little."

Engler goes on to note that despite threshold appeal the consumption tax has not yet replaced the income tax and he explains this failure through an analysis of the cash flow tax. Engler makes the case that the lack of any current tax on saved wages raises tax avoidance, transition, and revenue concerns and that saving decisions could be impacted undesirably under a cash flow tax with progressive rates, weakening the case for the consumption tax.

The argument that proponents of the consumption tax would make for its superiority is therefore three-fold: fairness, economic efficiency, and simplicity. The issue of fairness is questionable: as Kenneth J. Kies, Chief of Staff, Joint Committee on Taxation, was quoted as saying in 1995, "A person who has paid income taxes all his working life, and who retires [becoming a consumer] just as the consumption tax is introduced, isn't going to get the joke." The argument for economic efficiency, in terms of size of deadweight loss, is also undermined, most notably by Gary S.

Becker, winner of the 1992 Nobel Prize in Economics, who in a recent NBER Working Paper with Casey Mulligan makes the case that more efficient tax systems lead to bigger government and so the argument becomes a preference of the citizen between time-savings vs. bigger government. In Deadweight Costs and the Size of Government, they conclude that flatter taxes tend to encourage bigger government because taxpayers offer less resistance to increases in flat tax rates than in rates of less efficient forms of taxation and that any decline in the resistance of taxpayers leads to larger government budgets. For example, flat tax rates such as the VAT and Social Security taxes on earnings usually start at very low levels but consistently increase over time. They cite the VAT as now being 20 percent and higher in some countries and payroll taxes beginning at a modest 2 percent in the 1930s in the United States but having increased 21 times to the present 15 percent combined rate on employees and employers. They conclude that as a result of such increases, countries that receive a larger fraction of their tax revenue from flat taxes tend to have significantly larger governments.

Implementation of a Consumption Tax

There are primarily two ways of implementing a consumption tax. The first is the method advocated by Dennis Hastert, Speaker of the House of Representatives, who feels that income taxes should be replaced by a national sales tax. This transactional tax on retail sales would tax annual consumption at a flat rate much in the same as value-added taxes (VATs) do in the rest of the world. The drawback to this method is that the tax is not in any way related to one's financial situation and therefore the burden of taxation would probably fall more heavily on poorer Americans, since most capital, whose returns would not be taxed, is held by the rich. The question is whether the benefits of encouraging more investment outweigh the costs of the moral dilemma of shifting the burden onto the poor. The second method largely overcomes this problem. Personal consumption could simply be taxed by starting with income and then subtracting all savings. In this way it could still be a graduated or progressive tax.

Either way, there are two routes to a single-rate tax. The first and most simple would be for the President or a Congressional leader to draft a flat income or sales tax and present the entire package to the country for approval, but this route is unlikely due to huge political hurdles. The second route is what tax reformer Ernie Christian refers to as "The five easy pieces:" if, 1) the estate tax is eliminated, 2) capital gains are no longer taxed, 3) the Alternative Minimum Tax is ended, 4) all savings are made tax free, and 5) businesses are allowed to write off investments in a single year, and then everyone is charged the same rate, we will have a flat tax, Christian says. Obviously, the first has failed politically in the past, while the second is far more likely to succeed. As Grover Norquist puts it, "the five-step program has the advantage that each of its elements has its own built-in constituency, while support for an official flat tax is far more diffuse." And this seems to be the route favored by President Bush. As Daniel Altman notes, this is revolution by stealth : The estate tax is being phased out; taxes on dividends have been halved; and proposals for new savings accounts will exempt investment income from tax entirely for nearly all Americans. So President Bush is trying to fulfill his promise that "in a new term, I will lead a bipartisan effort to reform and simplify the federal tax code."

The first route is being taken in Iraq, however, where one "need not worry about all the political and transition problems that have made adoption of fundamental tax reform here so difficult," wrote Bruce Bartlett, an economist in the Reagan and first Bush administrations. Much to the delight of proponents of the flat tax, Paul Bremer, the U.S. administrator in Baghdad, signed legislation in September of 2003 declaring that "the highest individual and corporate income tax rates for 2004 and subsequent years shall not exceed 15 percent." It is too soon to evaluate the effects of the flat tax in Iraq and the success or failure of such a tax in Iraq may not necessarily equate with failure or success in the United States.

Outlook

For his second term, George W. Bush

One of the reasons tax reform did not take place in the 1990s was that the Republicans couldn't agree on which was best, a national sales tax or a Dick Armey-style flat tax.

promised his own tax reform, saying that he would reform the present income tax system, and that it is "going to take a lot of legwork to get something ready for a legislative package." Without dwelling on specifics he has said that ideas such as a national sales tax deserve study.

"I've earned capital in this election and I'm going to spend it for what I told the people I'd spend it on, which is - you've heard the agenda: Social Security and tax reform…" the president said. President Bush said tax simplification efforts in his second term would be "revenue-neutral" and that he would also seek to ensure that any reform effort rewards risk and doesn't have unnecessary penalties: "The simplification would be the goal. Secondly, that obviously that it rewards risk and doesn't have unnecessary penalty penalties in it (sic)."

Chris Edwards, Director of Tax Policy for the Washington-based Cato Institute, believes that a new Bush administration would address Social Security reform before tackling tax simplification. One of the reasons tax reform did not take place in the 1990s was that the Republicans couldn't agree on which was best, a national sales tax or a Dick Armey-style flat tax. As a result, tax simplification proponents will have to either pick a system or reach a compromise this time around.

Tom Giovanetti, President of the Lewisville, Texas-based Institute for Policy Innovation thinks a flat tax is more likely than a national sales tax because it would be easier to implement since, as previously discussed, a flat tax can be introduced in pieces, incrementally over a period of years, while a national sales tax would require a complete revolution.

In any case the prospects are exciting and the developments that occur over the next four years will be interesting.

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Bush-Kerry Tax Policy: Who Benefits and When?

By: Ray Wang

President Bush has taken strong positions in keeping current tax cuts permanent and replacing the income tax with a national retail sales tax (NRST). Senator Kerry's tax proposals involved repealing many of Bush's taxes, but he also intends to make some tax cuts permanent. What are each policy's pros and cons with respect to the economy, household, and social benefits?

(Editor's note: Due to publishing constraints the outcome of the election was not known at the time this article was written)

Tax reform took center stage in the political arena of the 2004 Presidential Election. Everyday on the campaign trail, President George W. Bush and Senator John Kerry debated the economic pros and cons that stem from current tax cuts. Indeed, tax policy is one of the few matters, besides the war in Iraq, that divided the two candidates. This is not surprising, given that the most powerful fiscal tool at the disposal of the President and government is tax policy.

Taxes are one of the few pieces of legislation that directly affects all Americans and American businesses, thus indirectly influencing the economic well being of the world as well. However, it is important to recognize that there is no right or wrong when it comes to analyzing the tax policies of Bush and Kerry. A better question to ask when deciding which candidate to vote for would be, "Who benefits and when?"

In examining President Bush's tax policy over the past four years, there is no doubt that the highlight was the substantial tax cuts he made: the 2001 Economic Growth and Tax Reduction Reconciliation Act (EGTRRA) and the 2003 Jobs and Growth Tax Reduction and Reconciliation Act (JGTRRA). These tax cuts were justified in reversing the tide of a slumping U.S. economy, following the burst of the high-tech bubble, September 11th, and a wave of corporate scandals. President Bush has since attributed a large part of the country's current recovery and high rates of employment to his tax cuts. On the other hand, Senator John Kerry has taken the opposite stand by aggressively condemning tax cuts. He denounces Bush's tax policy for being overly generous to high-income taxpayers, depleting revenues from the federal government at a time of war and on the eve of the baby boom retirement, and depleting a budget surplus into a record high federal deficit.

A better question to ask when deciding which candidate to vote for would be "Who benefits and when?"

Bush now claims that (if re-elected) his tax proposal would result in greater benefits for the individual taxpayer than Kerry's tax plan. He proposes to make many of the individual income tax components of the EGTRRA permanent, including: doubled child tax credit ($1000 per child), expanded dependent care credit ($3000 per dependent, up to $6000), marriage penalty relief, 10% tax bracket (the lowest of tax brackets), and the reduction of marginal tax rates from 39.6% to 35%, 36% to 33%, 31% to 38%, and 28% to 25%. The reduction in marginal tax rates in four different brackets would result in savings for over 7.8 million American families. In addition, Bush wants to make many economically beneficial elements of the JGTRRA permanent. Taxation on dividends and capital gains would decline to 0 percent for filers below the 25% tax bracket. Taxpayers in higher brackets would pay relatively lower taxes on dividends and capital gains, from 20% to 15%.

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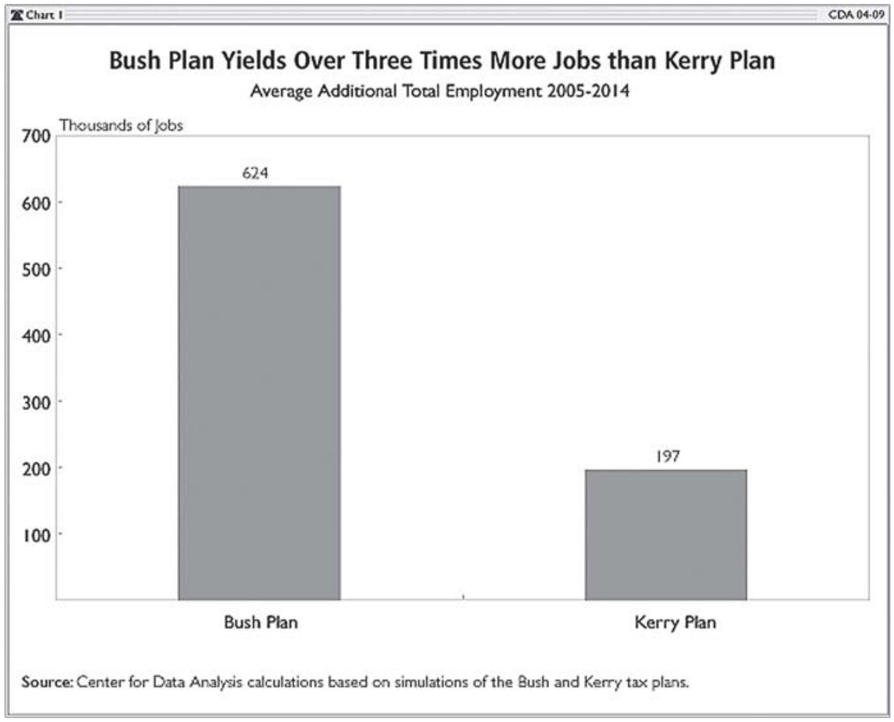
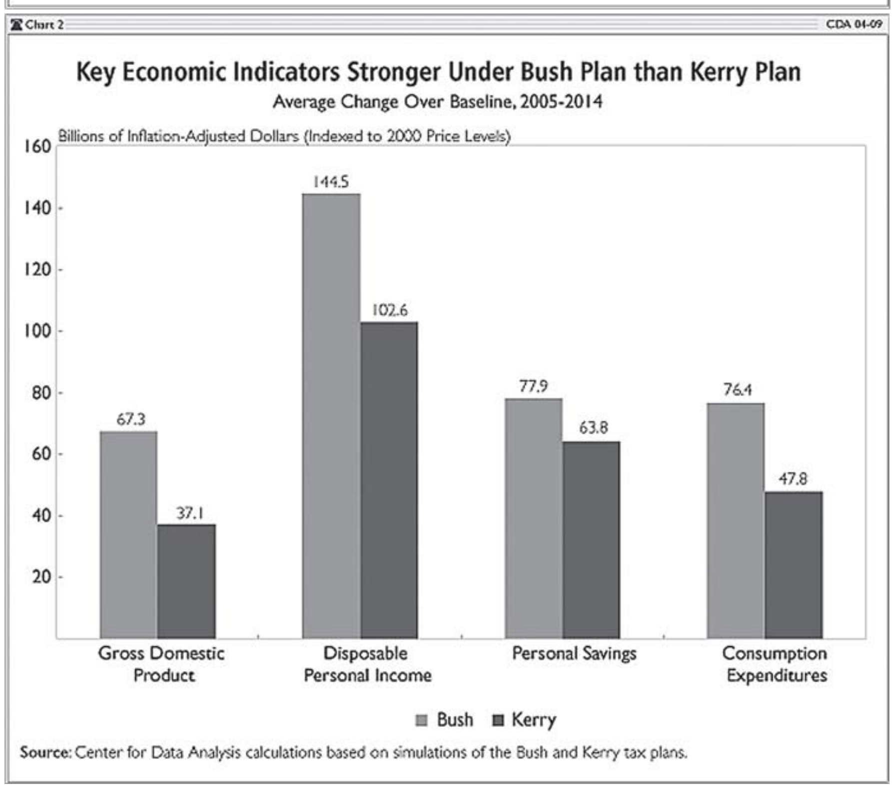
Thus, we can see that an important element and contrast between the Bush plan and Kerry plan is the treatment of high-income taxpayers. Unlike Senator Kerry, the President does not exclude high-income Americans from tax cuts. Bush's tax proposal does not use income and earnings as an eligibility test for tax cuts; taxpayers in the top two income tax brackets are treated the same as those in the lower brackets. President Bush also differs from Senator Kerry on "death taxes." The Bush party calls for the permanent repeal of the estate and generation-skipping tax. President Bush has also considered replacing the income tax with a national retail sales tax (NRST). The NRST would be revenue-neutral (unbiased towards income level), requiring a 21% tax rate to replace income taxes and a 38% tax rate to replace all federal taxes.

However, it is inaccurate for the average voter to assume that Bush equates to tax cuts and Kerry equals paying through the nose. In fact, Senator Kerry's tax plan for individual income taxes will retain several provisions of the 2001 and 2003 tax bills under Bush. Many of his proposed changes include identical elements to the Bush plan, including marriage penalty relief, double child tax credit, 10% tax bracket, and a reduction on taxes of regular income, dividends, and capital gains. The key difference between them is that Kerry proposes a reduction in all income tax brackets except the top two; and tax cuts on dividends and capital gains only apply for taxpayers with incomes below $200,000. Kerry campaign materials indicate that the tax rates in the top two brackets would increase to their pre-EGTRRA levels, and tax rates on capital gains and dividends would also increase. The effect of Kerry's tax policy will be to exclude high-income taxpayers from these benefits.

The candidate who provides the most suitable and appealing policy for steady economic growth will win this election. The foundation for sustaining economic growth lies in corporate taxes. Kerry's plan for business tax would reduce the corporate income tax by 5% and drop the marginal rate from 35% to 33.25%. Senator Kerry also plans a one-time tax break for American companies outside the U.S. Instead of paying the full tax on taxable income, companies would pay a special 10% tax. A partial repeal of tax deferral on overseas income would also be made since these companies have already been subject to tax by foreign governments. In contrast, President Bush's tax plan will not be focusing on new corporate tax cuts, but will be primarily concerned with capital tax cuts and making the 2001 and 2003 tax cuts permanent, rather than have it expire between 2005 and 2011.





income. Similar to Bush's tax policy, Kerry's plan will also produce a tremendous reduction in revenue, estimated to be $686 billion over 10 years. In contrast, over 75% of this amount will be attributed to demand-side tax reductions, personal income. Dynamic analysis displayed by the following graphs suggests that Bush's tax plan will facilitate economic growth and employment rate superior to that of Kerry's plan.

Gross domestic product is estimated to average $38 billion higher during the first six years through 2010 and an average of $111.3 billion per year higher thereafter under the Bush plan. The stimulus to GDP comes from accelerating total consumption by lowering personal income tax throughout all brackets and demand-side provisions such as the $1000 child credit. The Bush plan also places heavy emphasis on expanding the supply of labor and capital, thus raising the level of employment by an average of 624,000 jobs per year during 2005 – 2014. However, the average unemployment rate is estimated to reduce by only 0.2 percent due to lower tax rates causing labor force participation to rise almost as fast as employment. The increase in disposable income for a family of four would average $1,848 per year higher under the Bush plan. The most integral aspect of Bush's plan is the reduction of tax burdens on capital, which will enhance overall investment and cause a sustained rise in GDP. The most recent fiscal quarters following the JGTRRA show that investment is expanding by over twice the historical average due to the 2003 dividend and capital gain tax reduction.

On the other hand, Senator Kerry's plan is centered on steadying economic development, keeping the federal deficit in check, and then facilitating sustained growth. Kerry's tax policies are designed to and will slow the U.S. economy through 2010, especially in the areas of employment and capital growth. Kerry is focused on sustaining steady, long-term economic growth, rather than to apply rapid fiscal stimulus. Kerry's tax plan will do nothing to improve GDP within the next few years; estimated increase of less than $7 billion per year. Capital investment, inflation, and interest rates will also be relatively unchanged through 2011. Kerry's proposal of extending Bush's 2001 and 2003 tax cuts for taxpayers with income under $200,000 will not take effect until 2010. The impact of Kerry's plan after 2010 is similar if not identical to the immediate effects of Bush's tax policy. Both consumption and personal savings will rise by an average of $111.6 billion and $150.3 billion from 2011 to 2014, and real disposable income per family of four will be $3,030 higher per year. In contrast to the effects of Bush's plan, total employment will drop below the average by 126,000 jobs from 2005 – 2010. Once the permanent tax cuts are in place in 2011, employment levels will rise by an annual average of 682,000 jobs.

Thus, the key question for voters to decide on is a choice between gaining now versus reaping benefits later on. The path that President Bush has chosen is "now". Americans want accelerated growth, high rate of employment, increased disposable income, a prosperous economy and lower taxes. Bush's tax plan would deliver all this and more, and it would take effect now and in the near future. Under Bush's plan, the federal deficit will amount to record highs and jeopardize the long-term

It is ultimately up to voters to decide the issue of who benefits and when.

growth of the American economy. Accelerated growth today and through the next 4 to 5 years could hamper the economy for the next 15 to 20 years afterwards. The Kerry plan, like Bush's, stimulates economic expansion and activity as well but only from 2011 onward. Kerry implements a more cautious and steady approach in stimulating the economy. The proverb, "one step backwards now in order to take two steps forwards later" is an apt description for his tax proposal. Instead of aggressively forcing the economy to expand and grow without a solid foundation for such growth, Kerry wants to use the next 6 years to stabilize the economy and federal deficit. Only his corporate and capital tax proposals will take place before 2011 in hope of aiding the business and investment portion of the economy first. Then, in 2011, components of the EGTRRA and JGTRRA will be made permanent with several modifications. In addition to considering the choice between now or later, the question of "who?" must also be taken into account. The two candidates have distinctly different approaches to tax policy when considering supply-side and demand-side. President Bush devotes the largest part of his tax reduction to changing the incentive to work and invest. In contrast, Senator Kerry devotes a much larger portion of his tax cut to supporting the demand or consumption side of the economy. This is evident by the number of taxes that were designed to reallocate tax cuts toward either common households or high-income taxpayers / corporations (who own the majority of resources for investment). Hence, the main distinction between Bush's and Kerry's tax plane is the emphasis on supply-side for the former and demand-side for the latter. It is ultimately up to voters to decide the issue of who benefits and when. However, human nature tends to indicate that when people want something they want it as soon as possible, not promises for the future; advantage Bush.

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Fiscal and Monetary Policy in a Political World

By Andrew Holmberg

"It's the economy, Stupid!" –Bill Clinton

During the 2004 race for the presidency, America has heard rhetoric from Democrats and Republicans about the state of the US economy. The debate has centered around two issues: tax policy and the government deficit. The Democrats argue that the economy is weak, citing that George W. Bush is the first president to preside over a net job loss since Herbert Hoover. Dispelling this criticism, Republicans have declared that the Bush tax cuts helped bring America out of a recession and towards the path of consistent economic growth. Democrats counter that the Bush tax cuts have fallen primarily to the rich at the expense of the those more in need, and in the process, have created massive fiscal deficits. As these political foes paint starkly contradicting images of the American economy, what can be said about the actual state of the economy today?

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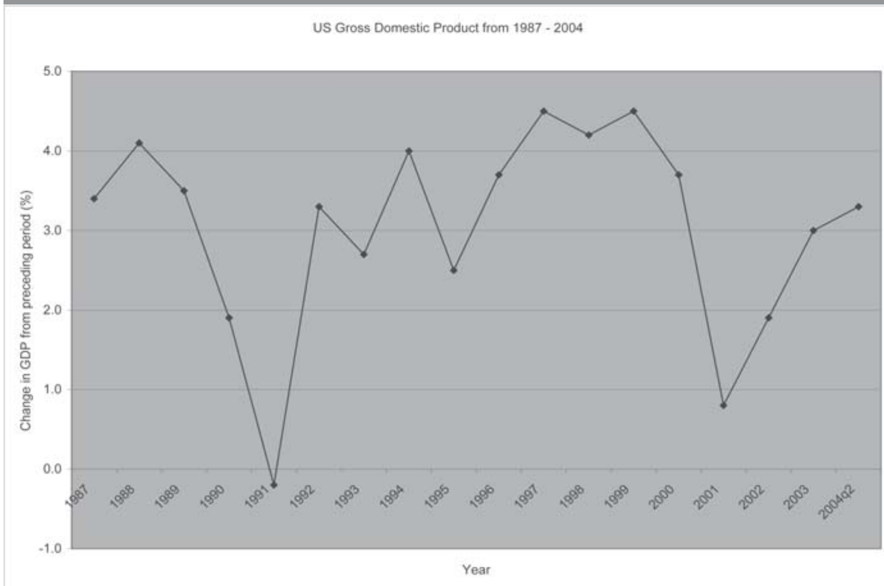
In 2001, the economy saw a sharp drop in Gross Domestic Product. After the 9/11 attacks, the burst of the technology bubble and the corporate scandals, the economy was moving in the wrong direction. In the first quarter of 2001, the percent change in annual investment was –2.4%, consumption was 1.08%, net exports were -.04% and government spending was .92%. Even prior to 9/11, the economy was contracting. The graph below shows that the contraction was mainly due to a decline in Gross Private Investment, which fell to –3.94% at the end of 2001. But, by 2002, the economy began to regain its footing, and has been growing at an annual rate of approximately 3% over the past few years. The growth of GDP was –1.4% in the third quarter of 2001 and rose to 3.4% in the second quarter of 2002. Gross Private Investment rose from -3.95% in the fourth quarter of 2001 to 2.34% in the first quarter of 2002. In conclusion, since the contraction in 2001, the economic indicators tell us that the economy is stronger than it was in 2001. [4].

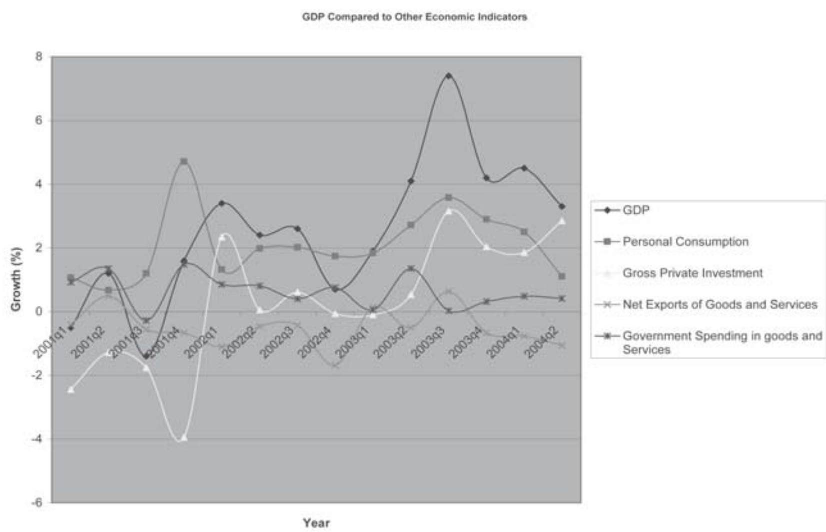
In June of 2001, President Bush lowered federal income taxes, increased the child tax credit, reduced the marriage penalty, lowered the dividends and capital gains tax rates and over time, will repeal the estate tax. These tax cut amounts to $1.35 trillion over 10 years. This government's taxing and spending is called fiscal policy [6]. Greenspan also acted to thwart off a recession in 2000 by continually reducing the fedfund rate, which in tern increased the money supply in the economy. This control of the money supply by the Federal Reserve's is called monetary policy [2].

Stimulating the Economy:

A reduction in taxes will increase consumer's consumption. When taxes are reduced, people can either save their extra income or spend it. Most people choose to spend some and save the rest. The fraction that one saves when one receives extra income is the marginal propensity to save, and the fraction one consumes is the marginal propensity to consume. The increase in consumption leads to increased demand for goods and services. Firms will increase output to meet the higher demand. To meet the higher demand they will need to higher more workers [1]. So, as a result employment will go up and more people will have jobs.

Government spending is also a





stimulant to the economy, because an increase in government spending will increase the demand for goods. And since short run prices are fixed, firms increase production to meet the higher demand at the set prices. Because firms increase production to meet the higher demand, employment goes up and output goes up. There's also a multiplier effect associated with government spending, which says that if government spending goes up by $1, than output will go up by more than $1 [1]. Thus, through tax policy and spending, the federal government can influence the economy.

The Federal Reserve also has a role in keeping the economy steady. The Fed can control the money supply by reducing the fedfund rate, which allows banks to lend more freely, which increases the money supply. When there is more money in the economy, and because prices are fixed in the short run, demand for goods increases. Firms meet the new demand by increasing productivity and hiring more workers. This leads to an increase in output. Lower fedfund rates also means a lower cost of capital. In a fractional reserve banking system, each dollar saved can generate several dollars of loans through the money multiplier effect. al, which allows firms to invest in new infrastructure at a lower cost [1].

The long run effect of both an increase in government spending and a decrease in taxes is the same. The firms will eventually raise their prices because of the rise in demand. The rise in prices leads to lower production and higher interest rates. The long run affect is higher interest rates without a change in output. The only difference between government spending and lower taxes is that lower taxes raise the full employment output for consumption, whereas government spending raises full employment output for government purchases [1].

For the before mentioned philosophies to work, two propositions must hold. The first is that prices must be fixed in the short run. Essentially this means that it takes time for firms to recognize a change in demand and adjust their prices accordingly. Second, we are assuming that the Ricardian Equivalence doesn't hold. If consumers receive a tax cut, and the government doesn't change its spending habits, than informed consumers will realize that in the future their taxes will be higher. Because they think their taxes will be higher in the future, they choose to save their tax cut to pay for the future increase in taxes instead of using a portion of the tax cut for consumption. Keynesians will argue that the Ricardian Equivalence does not hold and that consumers will choose to spend some of the tax cut [1].

The business cycle consists of contractions and expansions and our fiscal and monetary policy is a reaction to these troughs. When the economy expands, rates go up and the budget becomes balances. This is to keep the economy from overheating and creating a bubble. When the economy does contract, rates go down, taxes decrease and spending goes up to keep the economy from going into a recession. Contractions and expansions, however, are inevitable regardless of policy. Thus, *In a fractional reserve banking system, each dollar saved can generate several dollars of loans through the money multiplier effect.*

the goal is to keep the economy growing steadily while minimizing the periods of contractions.

Bush v. Kerry

President Bush and Senator Kerry offer different ideas for fiscal policy. Kerry has been hammering Bush on the deficits and the tax cut. He claims the tax cut is for the rich only. President Bush claims that Senator Kerry will raise your taxes.

President Bush wants to make his tax cuts permanent. This is based partially on economics and partially on ideology. The economic idea is that lower tax rates will give people an incentive to work more and produce more, which will lead to long-term growth. Lower taxes will also boost consumption because people will have more disposable income. There is some evidence against this. George H. W. Bush and Bill Clinton both raised income taxes and what followed was a strong period of sustained economic growth. Certainly, we don't want to go back to the days when the top bracket is 70%, because when taxes are high, we do see a disincentive to work. We see evidence of this in Europe where the amount of labor supply is less than the Unites States. But, if the economy is growing, the tax cut did its job and the time has come to balance the budget. Bush's agenda for his second term plans to increase spending by $82 billion and increase new tax cuts by $157 billion in 2005 alone. Due to the current tax cuts and his future agenda, the Bush agenda will cost $1.326 trillion and add to the deficit. (Pear) The plan that Bush has proposed will only balance the budget if another technology boom occurs and revenues start pouring in. If the revenues from growth are high enough to balance the budget without changing taxes, than the new tax rates can stay. Or, if we are able to curb spending enough to balance the budget, than the tax cut can stay. Bush has showed no signs of decreasing spending other than his cuts in entitlement programs. Having government spending and tax cuts now that the economy is growing is irresponsible fiscal policy. The debt that we accumulate will have to be repaid and future generations will suffer because of this. If President Bush is to have a second term, he will need to be more fiscally prudent than in his first term due to the changing economic situations.

Senator Kerry has proposed $498 billion in tax relief. He will give middle class tax cuts, health care credits, college opportunity tax credits, job tax credits and energy credits. He also proposes to repeal the upper-income tax cuts and to revise the estate tax. He has proposed new spending of $771 billion. The new spending involves health care, education and more troops. The total cost of Kerry's plan is $1.269 trillion. (Pear) Like Bush's agenda, Kerry's plan will not balance the budget unless there is another technology boom and revenues go way up. John Kerry's campaign has claimed that he is serious about lowering the deficit. If he is to accomplish this goal, he will have to re-evaluate his spending proposals. The economics behind Senator Kerry's plan is that increasing government spending will raise GDP. But, if the government overspends, there will be a crowding out of private capital and private investment will decrease.

The tax cut of 2001 should not be looked at as a political issue. The tax cut was needed to revitalize the economy. Now that it appears that we are seeing consistent growth, it is time for the government to act promptly to bring the budget into balance in order to avoid rising interest rates. The choice between the two candidates is clear when it comes to economics: higher taxes and higher government spending for Kerry, or lower taxes and modest spending for Bush. But, neither candidate has laid out a future agenda that makes much economic sense. The economics calls us to return to a balanced budget and avoid rising interest rates. When the economy begins to slide into recession, economic stimulus will be needed once again. But, we must have a balanced budget so that when the time for stimulus comes, the federal government has the funds to provide the stimulus. The candidates need to forget about politics and ideology and begin to focus on what is best for the economy in the long run.

...if the government overspends, there will be a crowding out of private capital and private investment will decrease.

Author's Note:

I wrote this article before the presidential election had been decided and today I learned that President Bush has won the election. The Republicans have also taken control of the Congress. What does this mean for our economic future? That is a question that would take much research to answer. I believe we can expect the tax cuts of 2001 to become permanent and for the Republicans to continue running a deficit. The deficit will mean rising prices and rising interest rates. But, with luck, we will see an increase in investment because of the increased capital stock along with a rise in consumption due to lower taxes. This would lead to consistent growth, which means more revenues for the federal government. This will not be enough to lower our huge debt. President Bush will need to learn to get out his veto pen and stop some of the pork barrel spending that is currently plaguing Washington. America future citizens deserve better than to inherent the irresponsible debt of the leaders of today.

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Behind the Seams of CAFTA: A Look at Trade and Interests Groups in the US

By: Sukhneel (Neelu) Toor

The Central America Free Trade Agreement (CAFTA) is a proposed preferential bi-lateral and regional trade and investment agreement between the United States and five Central American countries. One of the most involved industries is textiles, and caught between opposing textile lobbying groups—such as the American Apparel and Footwear Association and American Textile Manufacturers Institute--the USFG has yet to ratify the treaty. Will American consumer and producers benefit from this open sectoralism and regional liberalization, or will outsourcing and asymmetrical trade ensue?

Kill CAFTA! That is the new rallying cry of the American Textile Manufacturers Institute (ATMI). The Washington-based trade association announced that it would make defeating the Central America Free Trade Agreement (CAFTA) its top priority. ATMI leaders said the agreement is full of loopholes that will favor foreign textile workers at the expense of those in the United States. Meanwhile, the American Apparel and Footwear Association (AAFA) has submitted various letters to the United States Trade Office urging the immediate progression and eventual ratification of CAFTA. The Central American Free Trade Agreement is a proposed free trade agreement between the United States and five Central American countries: Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. The textile and apparel industry is a common thread that weaves together the United States and other world economies. Therefore, this agreement will have widespread ramifications on trade within the industry. A comparison of the arguments by both ATMI and AAFA, as well as other factors about free trade agreements, reveal that CAFTA would allow the United Sates to gain an increased competitive advantage in the industry, enable the Central American textile industry to continue after the end of textile quotas, and set a positive trend in the industry for openness, competition, and efficiency. Yet many argue that the ratification of CAFTA would bring hardships to the American worker and hurt the US textile and apparel industry as well as cause further environmental degradation and labor abuse in Central America.

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Passage of "fast track" legislation this past summer has led to a strong push by the Bush Administration to negotiate new trade agreements around the world with a major focus on a free trade agreement with Central America. National assemblies in the Central American countries and the U.S. Congress must first approve of CAFTA before it becomes law, and the proposal could come up for a vote in Congress as early as December 2004. CAFTA would only involve 0.8% of overall United States' trade, yet it would affect a textile workforce of 450,000. The huge debate in the textile and apparel industry between pro and anti-CAFTA factions has pitted the members of the community against each other over the future of the industry. ATMI argues that more jobs will be lost as they are exported to Central America with lower job wages and more lax environmental, health, and human rights standards. AAFA, on the other hand, stipulates that an agreement is the best option to buffer the United States textile industry against a surge of foreign imports and the greater loss of American textile worker's jobs after the elimination of textile and apparel quotas in 2005.

The textile and apparel industry has been one of the major staples in the American economy and comprises a longstanding part of United States' manufacturing. However, over the years its role in the international market has changed due to increasing globalization and its effects on trade. In the textile and apparel industry trade and production are derived from three types of economies: highly industrialized nations, such as the United States, with generally high-value-added applications; newly industrialized countries, like Korea, with medium and low-end applications; and emerging nations, exemplified by China, with low-end applications (Elinsky et al 2004). As a nation with high-value-added applications, the United States is a dominant global leader in many areas; however, the country has consistently run an overall textile trade deficit, as imports increasingly exceed exports (Elinsky et al 2004). As a result of escalating production costs and decreasing selling prices, the textile and apparel industry is suffering. Consequently, the United States ships raw materials to other countries in which the products are made. The cost of labor is cheaper and gives retail companies the ability to buy and sell at lower costs.

ATMI is concerned that CAFTA will be the harbinger of more job losses.

The textile import surge has led to substantial downsizing and consolidation within the industry. The increase in competitiveness from foreign producers and manufacturers has also led to several textile companies having to shut down operations. This trend can be seen in profit margins as both payroll expense and capital investment in manufacturing establishments are above the all-industry average, while shipments are below average; the result is lower profit margins than the average U.S. manufacturing establishment. The industry's high usage of capital equipment provides some barriers to entry, which typically protects domestic markets. However, due to current declines in profitability, domestic markets are hindered by this capital expenditure as non-capital-intensive competition from foreign producers threatens U.S. dominance in the domestic market.

ATMI is concerned that CAFTA will be the harbinger of more job losses. The fear, in general, is that jobs in low-wage industries, such as textile manufacturing, will be outsourced to countries with lower-labor-cost competitive advantaged economies. The results of the ratification of CAFTA would also harm Central American countries in other ways. First of all, they would lose the benefits of their natural resources and infrastructure to multinationals that would move their production there from the United States. The governments of the five participating countries would be coaxed into taking loans from the IMF, the World Bank, and the Inter-American Development Bank to subsidize processes and infrastructure that would be needed to facilitate the new market system. The multinationals would benefit with cut-price concessions and preferential investment deals while Central Americans would be left with higher utility bills, public service cutbacks and escalating debt repayment. In the long run Central America would lose, in terms of public health care, environmental degradation, agriculture, labor, and textile and apparel trade – it is the worst of possible actions according to ATMI.

There are also loopholes to the agreement that ATMI says would adversely affect the United Sates textile and apparel industry. The US government agreed on the yarn-forward rule of origin it had originally proposed for CAFTA, which will benefit Mexican, Canadian and Asian textile workers at the expense of workers in the United States (Engler 2004). This allows them to export raw materials and then import duty-free, semi-finished products to be completed in those countries, which means retailers can sell their finished products at a comparatively lower price. During the negotiations, the industry proposed an innovative and flexible 'short supply' process that could have easily brought half a billion square meters of new business to Central America from the Middle East without sacrificing a single U.S. job (Engler 2004).

The short supply list, developed in consultation with textile and apparel industries in Central American and the United States, states that apparel containing certain basics and materials in 'short supply' in the U.S. and Central American may also qualify for duty-free treatment (The IBERC Group 2003). Even within this policy, however, there are still existing loopholes. ATMI's initial analysis shows that, if this agreement goes into effect, U.S. textile mills will be forced to initially close at least 10-15 textile mills and throw thousands of U.S. workers of out their jobs. Final job losses and mill closures could be significantly larger (ATMI 2004).

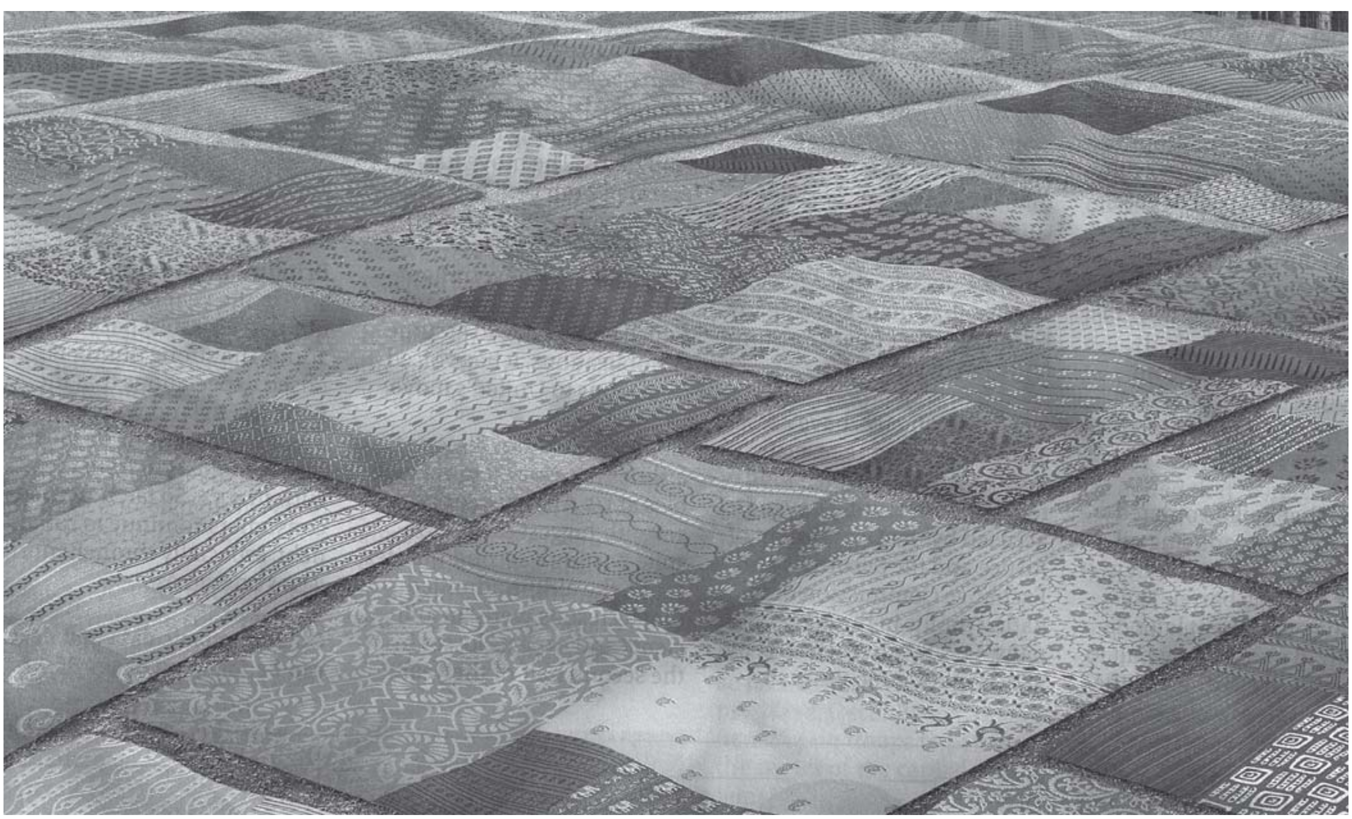
In opposition, AAFA claims the textile and apparel industry in the five Central American countries will not survive in a quota-free world unless CAFTA is negotiated and implemented. The battle over allowing the use of 'third-country' fabrics, known as tariff preference levels and also as cumulation, is one of the main contentions between the two groups. ATMI and the united textile and fiber coalition fighting to protect the remaining U.S. jobs have vigorously opposed the use of foreign fabrics in the region. Conversely, AAFA argues that the textile and apparel industry in Central America is not well suited to compete in the market after 2004 even with the benefits provided in the preference program, the Caribbean Basin Trade Partnership Act (CBTPA) (The IBERC Group 2003).

As imports for Asian supplies have grown, the market share of Central American suppliers has declined or remained stagnant. Thus, the prices are an indication of higher-end products. In addition, when quotas were removed from certain products during trade integration in 2002, prices from Asian supplies declined by amounts far greater than the quota premiums that were in place (The IBERC Group 2003). This is not an indication of sudden price gouging or dumping; instead it is proof that Asia's trade became free to shift 'down-market' into lower valued items. Since Asian countries held the highest priced segments of each of these markets, any achievable growth in trade was in lower-valued goods. Without a trade agreement in place Central America will continue to suffer from these new emerging countries with low-end applications. The Central American textile industry employs a combined 394,000 people, and without CAFTA, Central America will likely lose significant U.S. market share in big-volume categories produced in the region, such as cotton knit shirts, cotton and man-made fiber woven shirts, cotton trousers and shorts, when quotas are removed at the end of 2004 by a World Trade Organization mandate.

CAFTA requires that textiles and apparel will be duty-free and quota-free immediately if they meet the Agreement's rule of region, promoting new opportunities for Central American and U.S. fiber, yarn, fabric, and apparel manufacturing. An unprecedented provision will give duty-free benefits to some apparel made in Central America that contain certain fabrics from North American Free Trade Agreement (NAFTA) partners, Mexico and Canada. This new provision encourages integration of the North and Central American textile industries and is a step to prepare for an increasingly competitive global market (AAFA 2004). It will consolidate the western hemisphere into a powerful trading bloc, which will be momentous. It is crucial that these nations reach an agreement before the end of the WTO quotas in 2005 to counter against other trading blocs such as the European Union, Mercosur, and East Asia.

Elements of a free trade agreement (FTA) would also be most beneficial to the long-term sustainability of the Central American textile and apparel industry. It would include liberal and user-friendly short supply provision and cumulation, whereby inputs from other trade preference partners are allowed, and tariff preference levels whereby limited but meaningful quantities of apparel are provided preferential treatment regardless of the origin of the inputs. Without these additional and updated trade preferences, the textile and apparel industries of Central America could experience job losses measured in the hundreds of thousands. The difference between job loss in Central America and the United States is that in America, there is the opportunity for former textile and apparel employees move to other markets in highly profitable and productive sectors in which the United States has a comparative advantage. The level of highly-skilled workers and the availability of jobs other than in manufacturing means that people who would have formerly worked in textiles and apparel can move to better, higher-paying jobs that could not be filled by Central American countries (Luke 2004). The U.S. has the capacity for high-value-added applications whereas El Salvador, for example, is a low-level application nation. Therefore, those textile and apparel manufacturing jobs should be reserved in Central America while newer, better, more competitive and efficient positions are developed in the United States.

CAFTA also includes a plethora of benefits for the United States. First time duty free access for U.S. exports including all textile, apparel and footwear products to Central America, permanent market access and the elimination of the Sept. 30, 2008 expiration date that governs the current trade partnership with



Central America and the Caribbean and the retention of duty drawback deferral mechanism are only the first few returns and additions among many benefits. Others include simplified customs procedures to ensure that excessive documentation does not act as a disincentive to the use of U.S. inputs; the maintenance of the Berry Amendment which requires the U.S. Defense Department to purchase only U.S. made apparel and footwear products; a 'yarn-forward essential character' rule that ensures that most of the textile and apparel items covered by the FTA utilize a substantial amount of US or regional inputs. As a result of these benefits, there is still a substantial amount of safeguards for the United States' textile industry despite the loss of jobs that will inevitably come from the free trade agreement.

Free trade agreements and expanded markets usually create rather than divert trade, which will benefit Central America as well as the United States. This allows for economies of larger-scale production. It also attracts foreign investment and encourages specialization, increasing research and development. One of the biggest arguments against CAFTA and other FTAs is that they promote a 'race-to-the-bottom'; it is the trepidation that U.S. multinational companies will locate production facilities in developing countries, exploit local resources, and re-export back to the United States(Balke 2004). However, there is evidence that suggests that these allegations of the race-to-the-bottom just aren't happening. Corporations continue to invest in the developed world, where their investment is far more secure rather than relocating to the developing. This sort of activity actually only accounts for less than 4% of total U.S. investment abroad (Balke 2004).

Besides attaining greater gains from free trade through obtaining larger economies of scale and stimulating investment, greater competition is also generated. Competition among producers in broader markets promotes more efficient means of production, cheaper prices and a greater variety of products. With the inflow of investment from FTAs, capital is also directed towards research and development that again increases efficiency, quality, and the price of products and services. However, in order to protect textiles and apparel in America from the job loss that will come with CAFTA, ATMI wants the government to raise the tariff rate on foreign products so that the domestic industry faces less competition and generates more sales. Enacting such policies would be a big mistake. When the government imposes a tariff or quota on a product, it effectively raises the price of the product and is equivalent to placing a tax on consumers. Not only does such a policy harm American consumers, but it also discourages U.S. textile and apparel manufacturers from seeking out more efficient means of production. "Producers that enjoy high levels protection of are usually uncompetitive and dependent on the tariffs for their survival" (Aggarwal and Ravenhill 2001). It may alleviate some of the hardships faced by those in the industry, but it harms the vast majority of Americans consumers.

Currently, the strategic trade approach promoted by ATMI also implies that imperfect competition is dominant, meaning that highest possible economic efficiency can never be attained. Moreover, in applying strategic trade theory and providing a rationale for nations to use protectionist measures, it gives unfair precedence to the textile and apparel industry despite the fact that favoring one sector would out of necessity divert scarce resources, and it harms other sectors that might be even more valuable to the economy over the long run. In addition to producer complacency, a major consequence of trade barriers is misallocation of resources and the "redistribution of national income from consumers to protected producers interests" (Gilpin 2001).

The textile and apparel industry, with groups such as ATMI, are impairing U.S. national interests as well as the Bush free trade doctrine. Therefore, the United State need to look at what is best for successful diplomatic "realism and imagination, continuity and flexibility, vigor and moderation" (Turbowitz 1998). The U.S needs to address these six issues by doing the following: fact the fact that eventually full free trade will inevitably render U.S. textile and apparel firms unable to compete comparatively; creatively pursue research and development to gain a competitive edge; continue the ultimate goal of full free trade; become flexible with quota and tariff levels; and reinvigorate other sectors by emphasizing those in which in the U.S. has competitive advantage and moderate its protectionist policies.

Despite the job loss that will come with CAFTA, the United States textile and apparel industry needs to respond to the changes in the global marketplace. Specialization and other internal adjustments can accommodate the American textile and apparel industry to the rest of the global market. Instead of simply pursuing a strategy of long-term production, the U.S. textile and apparel producers should invest in technological innovation along with research and development. Furthermore, American firms should attempt to move away from mass production towards a niche-based strategy. By following German and Italian models, U.S. firms should also compete on the basis of quality, style, originality, or prestige, instead of solely on the basis of cost (Dertouzos et al 2001). Currently, the market for technologically superior textiles (advanced fibers), dominated by North America, is increasing faster than the total world market. Further, consumers in many markets are continually demanding more technologically sophisticated textile products. This is a niche where U.S. manufacturers have a degree of competitive advantage. This demand is especially pronounced in developing countries whose economies are only now becoming industrialized. The gradual phase-out of the quota structure will facilitate access to such economies for

U.S. textile producers.

The American Textile Manufactures Institute and the American Apparel and Footwear Association, representatives of the same industry, have both been vying for different actions from the United States' government. For one group CAFTA is ruinous, for the other it is the chance for both Central America and the United States to pull ahead in international textile and apparel markets. In the United States, jobs will be outsourced but research and development will increase and those previously occupied jobs will move to high-application level sectors. In Central America, jobs will be maintained and increased and eventually living standards will hopefully increase with the rise in prosperity that increased trade will bring to those nations. By adopting flexible production methods, pursuing innovative investments, and seeking niche markets for higher quality goods, firms, such as the ones that ATMI is protecting, the United States can be competitively successful even without extra trade barriers, quotas and safeguards. Furthermore, the provisions of CAFTA that include yarn-forward essential character, short supply lists, and the maintenance of the Berry Amendment will still encourage and facilitate continued growth and production in the sector of the textile and apparel industry that the United States has a competitive advantage in.

With CAFTA, in addition to the assumed benefits of free trade, the textile and apparel industries in both Central America and the United States will become more competitive. CAFTA provides a unique opportunity to modernize the arrangements for preferential access to the U.S. and Central American markets for textile and apparel goods. Additionally, it possibly represents the last opportunity to ensure that regional textile and apparel production will be able to compete and therefore survive in a quota-free world after 2004. It is therefore vitally important that the United States and Central American countries quickly finalize, enact, and implement a free trade agreement. It seems as though ATMI should not want to kill CAFTA, but instead, like AAFA, should give it a chance to breathe.

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Job-Starved America Asks: What Have You Done for Me Lately?

By: Rick Gold

Why the Bush economic plan has lead to a consistantly sluggish job market.

As the summer came to a close, employment prospects in the United States economy continued to look glum. President Bush had spent the earlier part of the summer spreading his positive outlook that a strong economic recovery was on the way. With job analysts predicting the addition of 112,00 in June and 243,000 jobs in July, the situation seemed to be getting better. When the actual numbers were tabulated, however, the economy only gained 78,000 jobs in June and 32,000 in July. At the beginning of July, The New Standard - an unaffiliated, noncommercial, hard news source - estimated that the economy would need to grow by 360,000 jobs a month from August until November to prevent the Bush presidency from being the first since Hoover to end with a net job loss. According to the Bureau of Labor statistics, private sector jobs decreased from 1.8 million to 1.6 million jobs between January 2001 and September 2004. In total, there were 913,000 jobs lost in the public and private sector over the same period. With the election approaching, many wondered what part the government has played in creating the current decline of jobs available in the economy. Consequently, many wonder what sort of role the job loss played in deciding the election.

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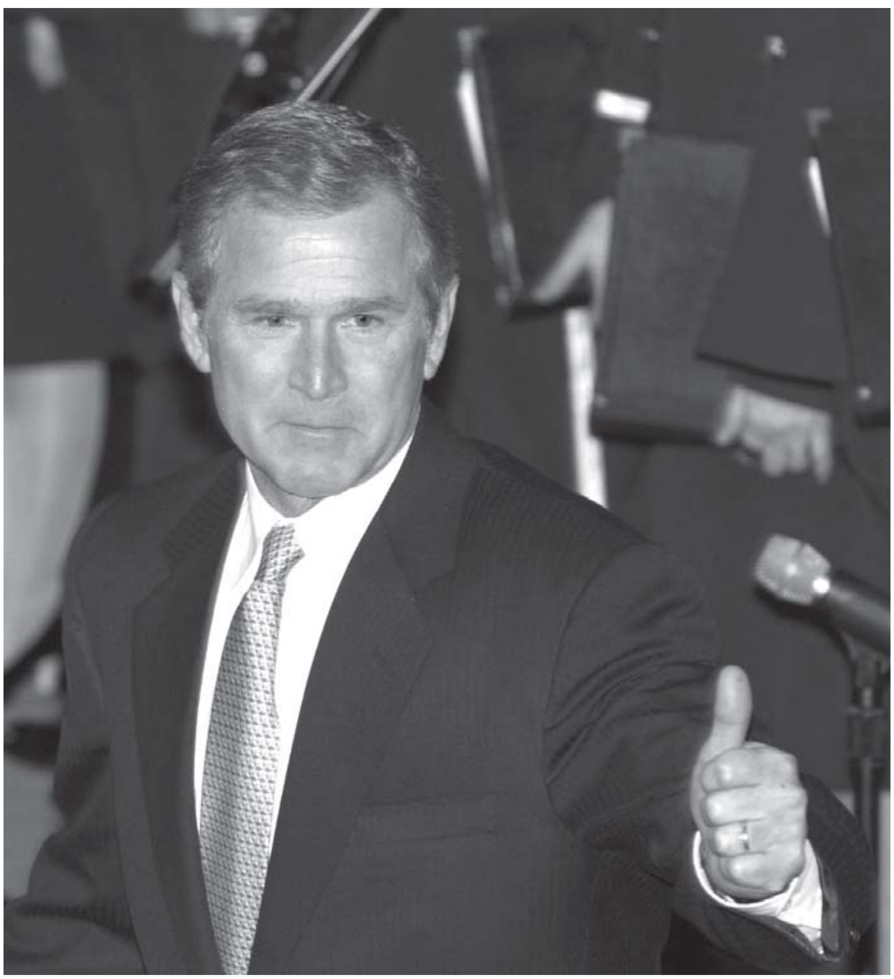
Many hastily blame George W. Bush's embrace of neoconservative economics for the poor economic recovery and substantial job loss. Neoconservative economics follows the doctrine that the poor will be better off with lower flat tax rates than with the welfare and education programs that would be financed by higher taxes. Neoconservative economics is rooted in supply-side theory, which posits that cutting taxes on wealthy individuals helps to create jobs. High taxes on America's wealthiest individuals reduces the economy's growth potential. However, in the wake of major scandals surrounding such corporations as Enron and WorldCom, the American people have a much more difficult time placing their confidence in the unregulated market system. This, in turn, has led to decreased investment spending, dropping prices on the Dow, and lower Consumer Confidence numbers. President Bush tried to combat the negative economic climate of the United States at the beginning of his presidency through the implementation of a tax cut worth trillions of dollars.

The tax cuts themselves were not successful in bringing the country out of the recession. . .

Bush's large tax cut, which generally aided the wealthiest 1% of Americans the most, did eventually lead to increased consumer spending. However, some may argue that having a tax cut with a broader focus, for example, including more middle class families, would have led to even more consumer spending. The combination of deficit spending--$422 billion at the end of fiscal 2004--and tax cuts has led to growth, but not to the degree that the general public wants to see. The tax cuts themselves were not successful in bringing the country out of the recession; many other factors stymied the positive effects of the tax cuts, particularly the industry-specific job loss due to terrorism concerns and the outsourcing of domestic jobs abroad.

Another often cited argument is that outsourcing, allowed by President Bush, is partly responsible for the lack of employment growth. In fact, John Kerry even made sure to stress the President's allowance of outsourcing in the first Presidential Debate According to a study conducted by Charles Schultze, of the Brookings Institution, however, outsourcing is much less of an issue than most believe. According to the Schultze study, only 155,000 to 210,000 service jobs have been moved overseas in the last 4 years. Additionally, Schultze says that only 4% of the mass layoffs in the last two years have been due to competition from imports and relocation to overseas producers. These statistics imply that the effects of outsourcing are still being exaggerated in order to place more blame for the employment situation on President Bush's shoulders.

Charles Schultze has spent a significant amount of time studying the issue of the current job loss and determined one of the main culprits to be higher worker productivity. Unfortunately, higher productivity means fewer workers hired. Schultze insists that the trend is a positive one due to the fact that higher productivity eventually leads to a higher standard of living. Between 2001 and 2003, the output per worker per hour increased annually by 4.1%. Employers have realized that due to low consumer confidence, they must use what they have at their disposal and, thus, they only feel the need to hire more workers when profits are reasonably assured. In addition, new technology is probably playing a large part in the increased productivity. Schultze concluded if the immense trend towards higher efficiency had not occurred, then 2 million more jobs would actually have been created by election time.



Another major factor that could be responsible for such high job loss could be the war in Iraq. In November 2002, Yale economist William Nordhaus examined the possible results of two types of war in Iraq. The first was a "quick victory" and the second was a "prolonged conflict." Nordhaus estimated that between 150,000 and 350,000 troops would be deployed to Iraq and the surrounding areas in the event of a conflict. As of September 21, 2004, the official estimate of troops deployed in the "Central Command Area of Responsibility" was between 200,000 and 250,000. The "quick victory" scenario proposed by Nordhaus did not transpire. The Nordhaus "quick victory" model proposed a thirty to sixty day air and ground war followed by a two and a half month presence after victory. Instead, the war began in March 2003 and is still carrying on, with intense fighting between United States forces and guerilla fighters.

As history has proven, war usually results in economic expansion. The military buildup following the attack on Pearl Harbor and entry into World War II lifted the U.S. economy out of the Great Depression. Similar, yet smaller, buildups in military spending and output accompanied both the Korean War and the Vietnam conflict. However, the large booms traditionally associated with wartime did not materialize during the first war in the Persian Gulf; the public sector buildup was minimal. Instead, the economy was affected by psychological factors based on the public's feared response to the war. Anxiety over the first Persian Gulf conflict led to declines in stock prices, the U.S. dollar exchange rate, and consumer sentiment. The fear led further to decreased investment by consumers. In addition, the possibility of an oil shock due to a prolonged conflict with one of the world's largest oil producers led Nordhaus to assume that any long conflict with Iraq would result in a recession.

Two years since Nordhaus's publishing, it has grown increasingly apparent that the "prolonged conflict" model aptly describes the present situation in Iraq. Since the war is not yet over, for all intents and purposes, it is difficult to compare the Nordhaus post-war predictions with the current situation. Even so, his predictions are telling. According to Nordhaus, during the nine years following the war, the United States economy would experience a $665 billion loss in GDP. This loss would be a result of rising oil prices due to the lack of Iraqi oil production in the world market. In addition to the losses due to an oil spike, Nordhaus predicted cyclical losses of $391 billion due to the effects of the recession that would not even be close to offset by the short-run stimulus of a war. Several simple formulas exist to derive the predicted job loss due to a decrease in GDP. Using the DRI-WEFA econometric forecasting model, Nordhaus predicted a 2.4 point reduction in GDP which translated into 1.6 million jobs lost in 2003 and 2004 combined. Nordhaus also predicted 300,000 more jobs lost per year between 2005 and 2011. According to a recent study by the Economic Policy Institute, the United States economy has lost approximately 1.2 million jobs since the end of the recent recession in November 2001. The most recent Persian Gulf War and its lack of a conclusion could be largely responsible for America's inability to climb out of its recession.

On November 2, 2004, the citizens of the United States went to the polls and cast their votes for the next president of the United States. George W. Bush won a resounding victory in both the popular vote and the Electoral College. Many expected the events of the past four years to symbolize a call for change. While fifty-five million Americans voted for Senator Kerry, fifty-nine million voters went cast their ballot for President Bush. As TV coverage of the election dragged on through the night, many political commentators noted that Bush supporters were voting *against* the candidate who would help their economic situation the most. The state of Ohio, the deciding state in the 2004 electoral college race– home to thousands of lost industrial jobs – was won by President Bush. Two questions arise from these startling results. First, is the economy is as important of an election issue as strategists assume? Undoubtedly, the state of the economy is an important variable in election politics. One's financial situation and prospects always have some impact on a voter's political choices. But are there other issues which are more important to American voters than the almighty dollar? The 2004 election seems to confirm that the economy can be merely a secondary election issue. Safety and ideology must be more important to the fifty-nine million voters who went to the polls on November 2 than money. Many Bush supporters feel that the war in Iraq is necessary to stamp out terror and protect their interests at home. Those supporters were willing to ignore the economic consequences of the war in Iraq, the underachieving effects of the Bush tax cut, and the suffering caused by outsourcing in order to ensure that their commander-in-chief was one who agreed with their beliefs. Maybe the dollar is not so mighty after all.

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The Role of Outsourcing in The 2004 US Presidential Election

By: Kirk Lucadamo

Throughout the nation, politicians and pundits alike hyped this election as more important than usual, which has proven to be a self-fulfilling contention. We now know that President Bush will preside over our nation for four more years, and he will be faced with the awesome responsibility of appointing new Supreme Court justices within his second term. Moreover, recent rumors about the potential of a military draft were undoubtedly in the minds of millions of Americans and were considered heavily as these critical ballots were cast. Furthermore, with winter approaching, the key issue of the flu shot shortage was critical to millions of voters, and was expected to be of particular importance to the elderly and others who are prone to the epidemic. In addition to all these issues, which were unquestionably pivotal in this year's Presidential election, a major source of debate has garnered less attention in recent weeks: outsourcing. While many political commentators expected this to be a chief concern as the election neared, it has not received the consideration of some recent developments. Nonetheless, outsourcing remains a topic of great importance, not to be ignored or underestimated.

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Nonetheless, outsourcing remains a topic of great importance, not to be ignored or underestimated

According to a study done by Kate Bronfenbrenner, a labor expert at Cornell's School of Industrial and Labor Relations, and researchers from the University of Massachusetts-Amherst, 48,417 American jobs were lost due to outsourcing between January and March of 2004, and this figure is used to estimate that approximately 406,000 American jobs will be lost due to offshore outsourcing over the course of this year [1]. Around eighty-three percent of these jobs were lost in the manufacturing sector, and Bronfenbrenner predicts that the outsourcing phenomenon will continue to grow, perhaps even at an accelerated rate [2]. Outsourcing is a far more serious problem than the majority of Americans realize, and because this election debates an unusually large amounts of pressing issues, the outsourcing problem has not been adequately addressed by either candidate.

In keeping with the main principles of the Republican party, President Bush has not opposed outsourcing because, as he spoke about on February 9, 2004, with respect to his 412-page "Economic Report of the President," Bush feels that "when a good or service is produced more cheaply abroad, it makes more sense to import it than to provide it domestically" [3]. While this comes as no surprise considering Bush's thoughtful economic plans (read: no millionaire left behind) it still contradicts the basic economic principles of promoting domestic growth and working to maximize the (export – import) figure that weighs so heavily in calculating a nation's growth rates and data for GDP. In short, the Bush regime has sought to improve the economy by "opening foreign markets for American manufactured goods, farm products, services, and intellectual property" because "President Bush rejects economic isolationism because he understands that free and fair trade and global economic growth means more jobs, higher wages, and greater prosperity for Americans" [4]. However, this plan does not adequately take into account the flaws of a free trade policy: lower standards of living in other nations across the world mean that residents of numerous foreign nations are willing to work at lower wages, thus taking jobs from Americans. In other words, there is a possibility that Bush's plan will increase overall economic growth by increasing large-corporation profits, but it comes at a significant cost: the loss of hundreds of thousands of "blue-collar" American jobs, as reported earlier by the Bronfenbrenner study, and thus an increase in the unemployment rate. Additionally, this means a decrease in U.S. per capita income and overall GNP.

Senator Kerry has outline a clear and realistic plan to limit the outsourcing of American jobs. First off, he has pointed out major flaws in the President's policies regarding jobs and the economy, noting that 1.6 million private-sector jobs have been lost under the Bush administration and the trade deficit in 2003 was a record 490 billion dollars, amounting to five percent of U.S. GDP [5]. In response to this, Senator Kerry has proposed stronger "Buy American" guidelines for defense and homeland security to strengthen the American manufacturing industry. Additionally, if he were elected Kerry would have raised the minimum wage in America from $5.15 to $7.00 by 2007, meaning more than 7 million Americans would see a raise and the earnings of a full-time worker would increase by an average of $3,800 per year [6]. Kerry has also gone so far as to condemn the American firms that outsource thousands of jobs each year by calling them traitors, as Kerry was quoted by the Contra Costa Times on the West Coast as denouncing the Bush Administration for "rewarding Benedict Arnold CEOs who move profits and jobs overseas" [7]. Kerry realizes that outsourcing may take away profits from the elite leaders of corporate America, but it will decrease unemployment and boost the income of tens of thousands of American workers.

Now that the election is over and we are faced with four more years of President Bush, one may argue that an attack on his economic policy is unnecessary, and the ultraconservative may even call it unpatriotic. Still, millions of Americans share my anti-Bush sentiment, and a victory in this year's Presidential election does not mean an end to such criticism. On November 2, 2004 our nation decided that "moral values" like the banning of gay marriage and stem cell research were more important than the country's economic status. Thus, our highest office was given back to Bush, in no small part due to the fact that among the 22% of voters who listed these "moral values" as the most important issue, 80% supported the incumbent [8]. Based on the figures in the Bronfenbrenner study, this means that more than a million jobs are expected to be outsourced in Bush's next term, but we have no one but ourselves to thank [9]. I would be lying if I claimed that outsourcing, and conservative economic policy in general, is not beneficial to anyone. Many economists expect outsourcing to generate large amounts of revenue for the corporate leaders of America while leaving tens of thousands of "average" Americans unemployed. But for some reason, our country seemed to think that helping the upper class was more important than assisting the massive middle class.

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The Economic Effects of the EU Expansion

by Linda Pedersen

In May, 2004 the European Union expanded eastward to include 10 new countries, increasing its total membership from 15 to 25 countries. Considering the fact that several of the new members are former Communist countries, what might be the economic effects of this expansion?

The recent expansion of the European Union will bring many changes to Europe. Having increased in size from 15 to 25 member countries, the EU has not only nearly doubled in size, but has also shifted its scope eastward toward the former Communist countries of Eastern Europe. As a result, the role and function of the EU is changing, as its member countries have not only become more numerous, but also much more diverse in terms of their current and past economies.

It is too early to determine exactly what the economic impacts of the EU expansion will be, and both optimistic and pessimistic predictions abound. However, one thing is for sure, and that is that there are several economic issues that need to be addressed in order to ensure a successful transition to greater European unity.

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Economic Differences

The European Union had experienced expansions earlier. For instance, the EU increased by a much larger proportion in 1973 when Great Britain, Denmark, and Ireland joined. Their addition to the EU increased the member population by 33.4% and the GDP of the member countries by 31.9%. In comparison, the recent expansion, which occurred this May when Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia were added to the EU, was of a smaller proportion. Yet while this expansion only increased the member population by 19.6% and the member GDP by 9.1%, it is exceptional for another reason [3].

For the first time, the EU is accepting former communist countries, three of whom were a part of the Soviet Union. This step is certainly positive in the respect that it is reaching across the Iron Curtain which once divided Europe, and bringing western and eastern Europe closer together, but it is also problematic. The newly admitted countries are significantly poorer than the old members, as the average per capita GDP for the new members is only 46.5% of the old members' average per capita GDP [3]. The fact that the economic differences between the old and the new members are so significant is creating much concern among the older member countries.

...a crucial aim for a successful EU expansion is a high degree of convergence in the new and old member countries' per capita GDPs.

The Importance of Convergence

In his opening address at the European Central Bank convention, "The new EU Member States: convergence and stability" on October 21, 2004, Lucas Papademos, Vice President of the European Central Bank, claimed that a crucial aim for a successful EU expansion is a high degree of convergence in the new and old member countries' per capita GDPs [2]. As things stand at the moment, it would take Poland 59 years to catch up to the EU average per capita GDP [5]. Papademos claimed that, "Even though progress has been achieved in the areas of privatisation and product market deregulation (with the exception of utility prices) and today the relative size of different sectors (agriculture, industry and services) and the distribution of employment have converged towards EU levels, we cannot deny that there are still large differences [2]." Despite the economic differences between the new and the old EU members, economic progress is already being achieved in several areas.

> *...the fear of labour mobility shows that the heat of competition in the labour market is felt. The prospect of larger movements of workers can thus act as a catalyst for much needed labour market reforms.*

Papademos believes that the quest for a convergence in per capita GDP lies in further "trade and financial integration, intra-industrial specialization, and fiscal consolidation." When improvements are achieved in these areas, the new member countries should be well on their way toward joining the EU members who have already adopted the euro as a common currency. As the old member countries are experiencing slow growth, the fact that the new members are growing faster than the old members provides further hope that they will be able to catch up economically and that they will contribute to a more dynamic business environment driven by increased competition [2].

New Dangers

Many skeptics of the recent EU expansion base their criticisms on other potential problems in addition to those mentioned above. Their worries are essentially rooted in two potential problems. The first one is that existing EU countries might have to pay more money to the EU now that it is in the process of expansion. Among Europeans who have experienced meager economic growth and high unemployment, the EU is for the moment not very popular. In a recent poll it was revealed that less than 50% of the population in the EU member countries support EU membership, a considerable decline from the more than 70% support in the early 1990s [3].

In addition to worrying about higher expenses to the EU, existing members are also concerned about the potential for mass migration from the much poorer new member countries. After joining the EU, the borders between the countries are virtually eliminated as a person can travel passport-free from one EU country to the next, and a common fear is that Eastern Europeans might arrive in large numbers to pursue opportunities in the richer Western European countries [3]. In response to this threat, the EU has now imposed a law postponing the free movement of workers from the new member countries for seven years. Since the old member countries have already taken steps to prevent a mass influx of eastern European labor and many experts say that some migration of labor might not be completely detrimental, the future of the EU does not appear as bleak as some skeptics might portray it.

Free Movement of Labor

In his speech at the European Central Bank conference on October 21, 2004, Tommaso Padoa-Schioppa, Member of the Executive Board of the European Central Bank, emphasized the positive aspects of the potential for labor migration. Padoa-Schioppa claimed that, "...the fear of labour mobility shows that the heat of competition in the labour market is felt. The prospect of larger movements of workers can thus act as a catalyst for much needed labour market reforms." In a Europe that has been plagued by meager economic growth lately, the potential competition from cheap Eastern European labor may actually be a blessing. As Padoa-Schioppa

summarizes it, "the pressure of competition from the ten is a potential bless for structural reforms in the old part of the EU, a part of Europe that for so long has recognised the need for them, but has not fully implemented them [1]."

What Lies Ahead?

As the European Union assimilates to the reality of having 25 rather than 15 members, several challenges lie ahead. The most pressing issues in the near future will be the ratification of the EU constitution, the potential for Turkey's admission into the union, and the continued progress of the new EU members toward eventually fulfilling the Maastricht Treaty requirements and adopting the euro as a common currency [3]. Jean-Claude Trichet, President of the European Central Bank, concluded the ECB conference by observing that the adoption of the euro is the eventual goal for the newly admitted members, but as the new member countries are in no way identical, there is no predefined path for their adoption of the common currency [4].

While it is too early to evaluate the success of the recent EU expansion, Padoa-Schioppa made an important observation about the successful expansion of the EU. He correctly observed that, "The blow-bless alternative should not be seen from the angle of predicting, but rather from that of acting. The future is open and this is why policy, responsibility, freedom, exist. It depends on us whether the opportunity will be seized [1]." The future of the EU is not necessarily completely positive or completely negative. It depends on how the member countries respond to and embrace the ongoing changes within the Union and the opportunities that these changes provide.

the adoption of the euro is the eventual goal for the newly admitted members, but as the new member countries are in no way identical, there is no predefined path for their adoption of the common currency [4].

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Addressing US Trade Imbalance: Tasks Ahead for Policy Makers

By: Madhurima Bhattacharyay

The current account (CA) balance depicts a country's current transaction with the rest of the globe, which includes trade (export and import), income from international investment, and government and private transfers. The sharp rise in recent United States' (US) CA deficit has set off alarm bells among politicians and economists and has become a hot topic for debate in the Presidential election. The CA deficit has reached a record high of 5% of GDP representing around 6 % of global savings despite more than 10% dollar depreciation in real effective term from its peak in early 2002 (IMF, 2004).

The US CA deficit is driven by a widening trade deficit that reached a record $166.2 billion in the second quarter of 2004, up from a revised $147.2 billion in the first quarter. This is a result of many interrelated factors in the US and the rest of the world. The main reason for the ballooning CA deficits include relatively strong performance of the US economy in comparison with its trading partners. This leads to stronger demand for imported goods in comparison to exports and, consequently, to the continuous widening of the trade deficit. In addition, large foreign capital inflows contribute to the growing US deficit by increasing demand for dollar assets, which in turn triggers an appreciation of the US dollar. This is exacerbated by the rising fiscal deficit and very low household savings rate in the US.

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On the other hand, major trading partners of the US have significant CA surpluses, thus creating a global imbalance.

Trends in US Current Account Deficits

When a nation's economy grows faster than that of its trading partners, the demand of households and firms for imports increases. In addition, domestically produced goods and services also increase, which in turn generates greater demand for imported raw materials and intermediate goods, thereby reducing the current account balance. On the other hand, faster growth abroad generates demand for the country's exports and improves the current account balance.

With other factors remaining constant, current account balances among various countries of the world depend on market decisions about the global allocation of capital. The expected rate of risk-adjusted returns of investment in the US is considered to be better than other major industrial countries and developing countries with CA surpluses due to its higher productivity growth.

The US CA deficit has continually deteriorated since 1900 except in 2001 when it moderately declined to 3.8 percent of GDP. At the end of 2003, it reached $ 531 billion or 4.8 percent of GDP, a fourfold increase over the 1.2 percent of 1990. This is mainly due to the fact that imports (8.4 percent) grew at almost double that the rate of exports (4.6 percent). Although the real effective exchange rate of the US dollar depreciated about 10 percent from its peak in early 2002, it was almost entirely against developed industrial countries and therefore produced no significant change in its competitive position against major developing trading partners (IMF, 2004).

According to Federal Reserve Board, the deficit may remain at 5 percent of GDP or higher for some time, due to the relatively robust growth potential of the US, the almost record price increase of oil, and rising interest rates (IMF, 2004).

Implications of US Current Account Deficit

Assuming the US growth continues to be robust and current exchange rates are maintained, the US trade deficit will further increase if growth is weak in the rest of the world. A large trade deficit implies that international demand for goods and services produced domestically is lower, which may discourage the domestic capital spending necessary to create jobs for the 8 million unemployed Americans. This, together with large indebtedness and low savings, may in turn affect the longer term economic growth . The size of the CA deficit is currently not a major problem, but it could become unsustainable and thus be a potential risk to the US economy and the world economy in the near future. Further increases in oil prices, which have already breached a record $50 per barrel, and in the US budget deficit will compound the aforementioned risk.

According to the IMF (2004), the US deficit will be primarily financed by savings from the rest of world, in light of the country's large fiscal deficit and very moderate national savings. This may hamper global recovery by dampening investment in other countries that, in turn, may further widen US deficit and result in financial market imbalance.

In the medium-term, the US financial market could be at a risk in the event that foreign investors become concerned about its capacity to repay its debts. Economists have mixed opinions regarding the potential risk of this global imbalance.

Bergsten (Economist, 2004) said, "A further oil shock, a dollar collapse and a soaring U.S budget deficit would all generate much higher inflation and interest rate. A sharp dollar depreciation would increase the likelihood of further oil price rises. Larger budget deficits will produce larger US trade deficits, and thus more protectionism and dollar vulnerability".

According to some economists, this large deficit will decrease some much-needed investment in sectors that generate high-skilled employment in the US, such as knowledge-based industries and skills, and consequently negatively affect economic growth. In an interview with Reuters, Peter Morici, a Professor at the University Maryland said, "The trade deficit is reducing US investments in knowledge-based sectors and slashing more than one percentage point off economic growth each year."

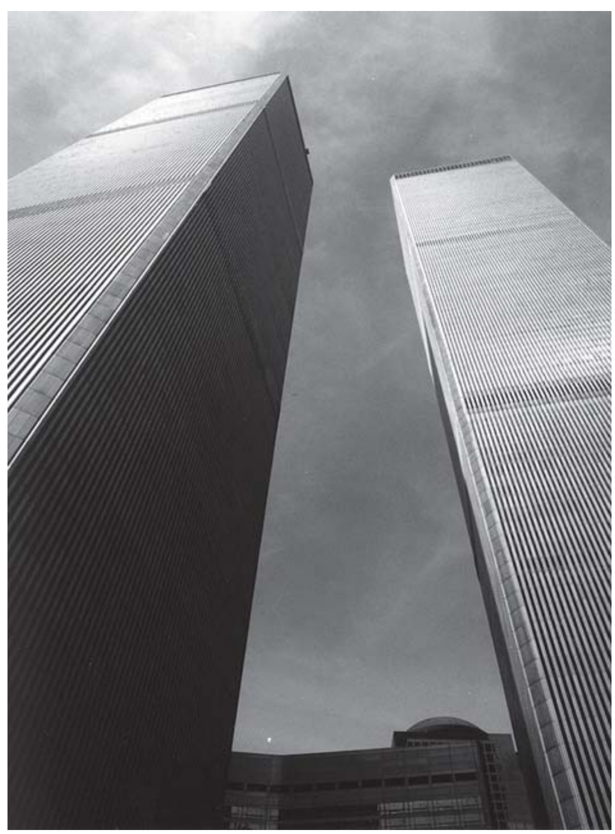
Others believe that the defecit reflects foreign investor's general confidence in the US economy. Some economists believe that the US current deficit is sustainable. Dooley et. el. (2004) argued that "A chronic US current account deficit is an integral and sustainable feature of a successful international monetary system. Successful economic development is powered by net savings flow from poor to rich countries. The US current account deficit is an integral and sustainable result of its role as the center country or the reserve currency in the revived Bretton Woods system".

According to Greenspan (2004a), "Spreading globalization has fostered a degree of flexibility that raised the probability of a benign resolution to the US current account imbalance.'' Globalization reduces the cost and increases the reach of international finance, which facilitates the acquisition of US debt and equity by foreigners. The size of the US CA deficit may be constrained only by the willingness of foreigners to hold US assets and liabilities. At the moment, there are no signs that the CA deficit has a negative impact on the US economy. Moreover, the US economy has shown an admirable resilience to external shocks in the past 25 years and will likely overcome a decline in demand for dollar-backed instruments.

Policy Implications

After this year's election, American policy makers need to take a bipartisan view with regard to the trade imbalance in order to make the appropriate policy initiatives to address this potential risk.

At present, the US is tightening its monetary policy, although most of its major trading partners still follow a more relaxed monetary policy. This may strengthen the US dollar and lead to weaker US exports and a larger current account deficit. On the other hand, tight monetary policy may slow down US



growth and reduce import demand, which will reduce current account deficit at the expense of higher unemployment. Therefore, monetary policy may not be effective at addressing the current account deficit because of the trade-offs involved.

All countries should work together to expand multilateral trade liberalization. There is a need to ensure the success of the Doha Round in order to improve access to markets as trade barriers are lowered. The US trade deficit, acquired mostly against developing country trade partners, has fueled protectionist sentiments and is currently directed towards outsourcing activities. Trade protectionism may work for short-term but it may cause larger trade conflicts. According to Greenspan (2004b), "The cost of any new such protectionist initiatives, in the content of wide current account imbalances, could significantly erode the flexibility of the global economy. Consequently, it is imperative that creeping protectionism be thwarted and reversed."

Since the current account balance is equal to the difference between domestic savings and domestic investment, it can be improved by increasing national saving. The US could generate higher net domestic savings through fiscal consolidation and structural policy reforms to increase the household savings rate and build capacity of workers to cope up with emerging challenges of an increasingly globalized labor market.

At the same time, surplus countries need to adopt fiscal policy expansion to enhance domestic demand. However, fiscal policy alone cannot ensure current account adjustment. Attempts should be made to persuade major trading partners of US, particularly those with a surplus trade balance with the US to implement flexible foreign exchange policies. A significant depreciation of US currency against its major trading partners is a very important aspect of reducing the trade imbalance. East Asian countries are among major exporters to US: the total current account surplus of East Asian countries surpassed $100 billion in 2003 and their total foreign reserve is currently around $1.2 trillion, much of it in US treasury bonds and other instruments. Despite upward pressure on East Asian currencies this year, intervention of their monetary authorities in the foreign exchange market did not allow any significant appreciation of their exchange rates.

Among the major trading partners of the US, China has the highest trade surplus. The Chinese Yuan is currently pegged to the dollar and there is a need to introduce more "flexibility" in the Yuan exchange-rate arrangements. Mr. John Snow, America's treasury secretary, is strongly lobbying for a revaluation of the Yuan.

Conclusions

There is an urgent need to address US trade imbalance through appropriate policy and structural adjustment, not only in the US but also in the rest of the world. Although some economists argue that the present US current account imbalance is an integral and sustainable feature of a well-developed international financial system, this imbalance is not sustainable in the medium-term. The cost of not resolving this imbalance could be staggering and could bring serious disruption in the world economy. After this year's election, American policy makers need to take a bipartisan stance in order to undertake appropriate policy initiatives to address this potential risk.

This global imbalance can be resolved through a gradual adjustment of the US economy and the economies of its trading partners. Major trading partners of the US, particularly those with a surplus trade balance with the US, should implement appropriate foreign exchange policies and all countries should work together for further worldwide trade liberalization. More importantly, the US should start to undertake structural policy reforms now to increase household savings rate and curb fiscal profligacy.

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Organ Shortages and the Market Solution

By: Ali John Ghassabeh

An economic analysis of the societal benefits to be gained by legalizing the organ trade to create a market for vital organs..

The first successful organ transplant occurred on December 23, 1954, when an identical twin donated a kidney to his brother, who lived for eight more years. In the 1960s, the organs of cadavers began to be transplanted into living human beings. Over the past three decades, organ transplants have become a relatively common medical procedure. The improved success rates resulting from medical advances have increased the demand for organ transplantation, especially with kidneys. Kidney transplants succeed 90 percent of the time, with an even higher rate when a living person donates.

Organ transplantation in the United States centers on an idea that an organ is an inalienable right or good. This means that organ transplants must be altruistic, with the only possibility of exchange through donation. The National Organ Transplantation Act (NOTA) of 1984 banned the interstate buying and/or selling of human organs in the U.S for the purpose of transplants. Ironically, organs can still be bought and sold for medical research. NOTA basically allows compensation solely for medical expenses and lost time at work. The ban on financial compensation for providing organs derives from a moral argument against the right to sell organs. Many lawmakers simply feel that transplanting a body part to another person must be an inherently altruistic gift. Another major reason for NOTA's ban on selling organs was the fear that poor people could be exploited and coerced into selling their organs, yet not be able to buy them if they needed organs themselves.

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Current Problems with Organ Transplants

Shortages

The biggest problem with the current system of procuring and transplanting organs is the shortage of organ supply. The increase in organ transplant success has made transplanting organs a more viable option to many more patients. Unfortunately, the supply has simply not been able to satisfy demand. Of the 20,000 people that die each year by causes, such as car accidents, only 2,500 are used as organ donors [1]. The numbers are staggering. In the past decade, an average of over 4,000 people have died per year while waiting for an organ transplant. In 1999, 66,175 people were on waiting lists for organ transplants, but there were only 10,073 organ donors in 1998. The situation has only been worsening over time as waiting lists have risen by 313%, while the number of donors has increased only 42% since 1988 [2].

These numbers only tell part of the story. In addition to the tens of thousands in need of transplants, thousands more could use a transplant, but are not even eligible for waiting lists. The shortage of kidneys currently "forces surgeons to be quite conservative in determining criteria for eligibility for kidney transplantation" [3]. These people, along with the tens of thousands on waiting lists, use dialysis machines. Dialysis is a painful and long process where the patients are hooked up to machines for hours a day, several days a week, to remove waste from their blood. Dialysis is also much more economically costly than the cost of a kidney transplant, after considering the ongoing length of dialysis and its hindrance to the person's ability to work. After a kidney transplant, the recipient can usually return to a relatively normal life within several months. An economic study found that "there is a cost saving for each kidney transplant of over one million dollars over a 20 year period," when compared to dialysis and the resulting deaths of not performing a transplant [4].

Another major problem is that the organs of those who had expressed a desire to donate upon their death are not actually donated. Up to 40% of potential donations are not transplanted for a variety of reasons [5]. Organ donors have the opportunity to express their desire to donate throughout their lives, usually when renewing driver's licenses. Because this wish is rarely conveyed to family members, the relatives often do not give the consent necessary for doctors to remove the organs of the deceased. One relative's rejection often prevents the donation, even if everyone else allows organ retrieval. Doctors often fail to even notify families of the desire to donate organs, preventing more potential transplants. Even when cadaveric organs are finally obtained, they are not necessarily matched with a recipient in a timely manner for the transplant to occur.

Transplant Costs, Prices, and Quality

The current government system states that organs should not be bought or sold. Although the altruistic policy is designed to avoid marginalizing and exploiting the impoverished, poor people do not benefit under the current system. Potential transplant recipients are only wait listed if they can afford to pay for the transplant, either out of pocket, through insurance, Medicare, or Medicaid. Poor people are the least likely to be able to pay. The government fails to understand or admit that the value of the organ is actually transferred to the costs of the transplant. The organ is in essence still sold because its value is absorbed as an input cost of the transplant procedure. NOTA simply prevents the donor from being compensated for the organ, and the financial gains are received only partially by the recipient paying for the transplant. A greater extent of the value of the unsold organ is gained in the higher price surgeons, hospitals, and transplant agencies charge.

The excessive entry of transplant centers into the transplantation industry is a direct result of prohibiting organ sales. A 1988 study showed "over 40 percent of all heart transplant centers performed fewer than six transplants" [6]. As already mentioned, the organ does not become less valuable by not allowing its sale. In fact, with a smaller supply of organs, the marginal value of each organ is higher than it would be in a market [7]. Hospitals receive organs from donors. The hospitals are supposed to give these organs to transplant centers, but are inclined to establish their own transplant center so they can receive compensation for the organ through a transplant [8]. More transplant centers then enter the industry and are inefficient because the high value of organs they freely received, allows them to charge higher prices for transplants. In most industries, the supply of the product would go up, price goes down, and average costs remain the same. However, the supply of transplants cannot go up because the supply of organs to be transplanted has not increased.

Organ transplantation favors larger transplant centers, but the excess entry into the organ transplantation industry causes two major problems. Each transplant center exhibits economies of scale with a more cohesive and experienced medical team. Each center also has a fairly high amount of fixed costs. With too many centers, the average cost of each transplant goes up because the team is not as experienced with post-transplant care. In addition to this, organs become more rare and valuable for each center. The center then passes the cost of fewer surgeries and more valuable organs to the patients [9].

The other problem with excessive entry is that the quality of surgeries decline. The number of potential recipients per center decreases. When a center gets an organ, an optimum match is less likely to occur when there are fewer potential recipients to compare the organ with. The organ may have to be sent to another center or paired up with someone with a less than optimal match [10]. The quality of each accepted organ declines as each center requires more organs. For example, the size and age matches may be poorer. In both cases, the quality of the organs is worse and the success rates of transplants decrease.

Cadaveric Organ Market

A large supply increase of organs for transplantation would match more donors and recipients, reducing and likely eliminating the ongoing organ crisis. An increase in supply of organs also would correlate to an increase in the quality and success of organ transplants. A stricter screening process and better matches between donated organs and recipients can be made, ensuring an improvement in the quality. If the government were to allow the buying and selling of organs, simple economic reasoning would lead us to believe that there would be an increase in the supply of organs. Many potential sellers would agree to sell their organs upon death so that their loved ones can get financial benefits at the time of organ retrieval. Organs currently have a price ceiling of 0. With the ceiling removed, the supply would increase. Supply would match demand at economic equilibrium, and more organs will be provided to society.

One argument against open markets is that the cost of organs would cause the cost of transplants to increase. This would make people not covered under health insurance or government programs to be unable to afford the already expensive transplant and post-surgery care. However, transplant centers and surgeons already charge higher monopoly prices by including the inherent cost and value of the organ in their transplant services. The shortage of organs, the essential input of transplants, restricts the quantity of transplants below the competitive level, which increases the profits within the industry [11]. An open market would eliminate the pricing advantages and monopoly profits, thus lowering the price of organ transplants.

Living Donors & Sellers

A market that allows the buying and selling of organs from living donors would further increase the supply and quality of kidney transplants. Currently, living kidney donors are very rare because they usually donate only to family or friends. By opening a market, many people will be motivated to sell their kidneys for financial benefit. If only 1% of citizens participate in this market, the shortage of kidneys would be eliminated [12]. The market will be able to discriminate for healthier kidneys, resulting better matches for patients. The quality of transplants would surely improve because there is a higher success rate associated with living donor transplants.

There are also major social and economic gains from an open market for trading organs. The recipients, who would otherwise die or remain emotionally and physically pained on dialysis, clearly benefit from successful organ transplants. Sellers that choose to sell kidneys are better off because the monetary gains from the transplant are higher than the value of one kidney. The only losers are the companies, businesses, and individuals that were obtaining organs for free, and using their value in setting the price of transplant procedures. As a result, society as a whole would benefit with an organ market, achieving Pareto efficiency.

The most common concern is that the poor will be exploited or coerced to sell their kidneys. At the same time, these same individuals would be unable to afford the organ transplants if they would ever need it. The idea that these people will be lining up, desperate for money, to sell their organs is quite exaggerated. One reason is that poor people are the most likely to have unqualified kidneys due to higher rates of alcohol and drug abuse [13]. In addition, more rigorous tests would be

implemented to discriminate against unqualified kidneys because of the increase in the number available for transplants. More importantly, prohibiting kidney sales from this reasoning is "paternalistic, and as such, dehumanizing," treating the impoverished as children who are incapable of making rational decisions for their own interest [14]. It deprives them of a valuable opportunity to make money without even understanding their situations. In addition, the risk of dying while donation a kidney was only 1 in 20,000 in 1993, and has only decreased over the past decade [15]. The current laws are failing to protect citizens, considering that a person is more likely to die waiting for a kidney transplant rather than donating one and living with the other.

Another argument against markets is that poor people would not be able to afford the organ transplants. Yet these same people are unable to afford organ transplants under the current system. The current national health care system that covers only a fraction of the people who need it causes this problem, not an open market. The government could act as a "payer of last resort" for people unable to pay for transplants in a similar way it does now, through Medicare and Medicaid [16]. The market can actually make poor people better off because organ transplants could become cheaper with an increase in organ supply and removal of monopolistic prices from transplant centers. A tax could also be levied on organs sold in order to transfer money into a government program or charity that will help provide poor people with money to buy a transplant if they need it.

Conclusion

The United States has been facing an organ shortage crisis for the past decade. The current organ procurement and transplant system has not addressed the thousands of deaths per year and the tens of thousands more patients that continue to suffer in need of organ transplants. Clearly, changes need to be made, but the government has done little to correct this problem. A market with organs from both living people and cadavers would increase the supply of organs. It would eliminate the economic shortage that currently results from the price ceiling of $0 for an organ. It may not completely wipe out the medical shortage, but if the government can improve health care coverage, then every covered American should be able to receive an organ transplant if they ever need one. An increase in supply of organs will add organs that are in better condition for transplant, making the quality of transplants better as well.

Despite the probable benefits of a market, the American public and government has remained skeptical. Holding on to moral and ethical complaints, defendants of the current system maintain a need to keep organ donation altruistic. These people fail to admit that markets are designed to make everyone better off. People choose to sell or buy something because they think that they will be better off by making the trade. It does not matter whether the market is for food, clothing, or organs. If the government simply allowed financial compensation for transplantable organs, both the transplant patient and the seller are better off. In the worst-case scenario, a market would still be able to slightly increase the number of organ transplants, giving a huge benefit to the lives saved. In the best-case scenario, the shortage in organs would be eliminated, saving the lives of thousands of people and improving the lives of countless others.

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Individual Responsibility, Incentives, and the Corporate Climate

By: Thomas Wei

Should individual employees be morally (and legally) responsible for corporate actions? Given the fictional entity of a corporation, this raises some interesting questions.

Imagine the following scenario: one day at the Random X Corporation, Joe Potatoes, a loyal employee for 15 years, is sternly asked by his boss, Carly Corn, to begin expediently destroying several bins of documents that appear slightly suspicious in nature. Being a genuinely honest individual, Joe contemplates objecting, but then remembers the company's implicit, but strict, "no tolerance for subordination" policy. He also realizes that he needs 20 years of service to the company in order to secure a pension and other retirement benefits. With a wife and three children approaching college age to support, Joe does not think much further— he obediently destroys the documents. Two years later, a federal investigation begins, alleging that the corporation intentionally kept a dangerous product on the market, which led to the untimely death of thousands of hapless consumers. It turns out that those documents Joe had destroyed earlier were internal research studies that verified the imminent danger of the corporation's product. The question is: should Joe be personally liable for the corporation's act to keep the dangerous product on the market? And even more broadly, should each and every employee of the corporation be held responsible as well?

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This paper briefly explores some of the issues arising in the case above. First, we verify the applicability of the hypothetical scenario to the real world. Then, we explore the underpinnings of the dilemma, including both the theoretical and legal aspects, from an economic perspective. Finally, we use the theoretical framework to reach a normative conclusion on how the issue ought to be addressed both publicly and privately.

A Hypothetical Scenario or Realistically Applicable?

The case presented above, though admittedly embellished, is far from implausible. In fact, there are many comparable real-world examples, a few of which are described below. These examples attest not only to the pervasiveness, but to the relevance as well, of such ethical dilemmas in today's workplace. Although in each case some of the actions of the corporation and/or its employees are violations of criminal law, and some others of civil law, we will not focus so much on making the legal distinction.

In 1993, a civil class-action lawsuit on behalf of 77 plaintiffs was filed against the energy giant Pacific Gas & Electric (PG&E). A few years later, the total number of plaintiffs grew to over 600, and PG&E was ordered to pay $333 million in damages, making this the largest direct action lawsuit in US history [1]. This case arose from the fact that an unusually large number of residents in the small town of Hinkley was getting sick for unknown reasons. The cause was contaminated drinking water because PG&E was releasing large quantities of carcinogenic hexavalent chromium into the local water wells. Causation and even harm suffered from consuming the contaminated drinking water was relatively easy to prove; however, whether there was a breach of duty on the part of PG&E was more challenging to demonstrate. Indeed, one of the fundamental questions was whether PG&E corporate headquarters was even aware of the actions of its local plant in Hinkley. Evidence turned up showing that workers in Hinkley had discovered signs of contamination in 1965 and had reported it to company officials. Furthermore, a former worker eventually testified to having been ordered to shred documents, which would have proven PG&E headquarters' awareness of the contamination. As a result, the corporation was found to be responsible for inflicting harm on the residents of Hinkley. The more difficult question is whether the individual workers who were aware of the contamination did all that was morally right. They reported the contamination to their superiors and secretly disobeyed the order to shred documents, but this failed to reduce injuries suffered. Should the workers have done more to see that the contamination ceased? Finally, should the workers at PG&E who were not aware of the contamination be held morally or legally responsible as well?

In 1994, documents from inside the tobacco industry revealed damaging evidence about the industry's long-running history of consumer deception. A memorandum appeared quoting Brown and Williamson Tobacco Company's (B&WT) General Counsel as saying "we are in the business of selling nicotine, an addictive drug" [2]. This is in direct contradiction to B&WT executive Thomas Sandefur's testimony to the US Congress that he did not believe nicotine to be addictive. In addition, during this time, a whistleblower, Dr. Jeffrey Wigand, came out to testify against his former employer about research projects designed to increase the addictive effects of nicotine by using ammonia. Dr. Wigand, realizing that the ammonia made cigarettes become more toxic, was discharged when he refused to proceed with the research. These revelations accelerated an already on-going criminal investigation of the tobacco industry's marketing techniques at the time. Dr. Wigand took significant action as if it were his moral and legal responsibility to prevent the potential fallout of the corporation's decisions from coming to fruition. However, what about the other employees of B&WT? Regardless of whether they possessed knowledge of Dr. Wigand's research project, should they be responsible for the corporation's products, how it is marketed, and how it may potentially affect consumers?

In 1982, eight families in Woburn, Massachusetts sued two major corporations, Beatrice Foods and W.R. Grace, on the grounds that seven children and one adult had contracted leukemia as a result of exposure to water wells contaminated with the chemical trichloroethylene [3]. The resulting investigation, trial, and settlement were somewhat inconclusive since the jury's findings were confusing enough that the judge dismissed the verdict. Eventually the case was settled out of court, and a cleanup effort of the water wells was spearheaded by one of the co-defendants, W.R. Grace. Assuming that the two corporations were the cause of the contamination and sickness, was it a moral responsibility of each and every employee to have realized the problem and taken all necessary action to prevent harm and subsequently costly litigation?

A Framework for the Dilemma: Principal-Agency Theory

The three major cases presented above provide a brief survey of the many situations that inevitably arise in the workplace regarding ethical behavior and moral obligation. The novel spin comes into play when addressing the issue of individual employees' responsibility for the final outcomes of the corporation. We now begin tackling this issue by developing the underpinnings of corporations and describing how their special status creates certain complexities in determining right action and morality.

A corporation is not an individual, but rather an entity. The difference, in this context, is that an individual is a single, tangible person with a unique identity. A corporation also has a unique identity, but this identity is formed by the conglomeration of many diffuse individuals. The result is a mélange of interests and backgrounds, which generally makes resolving the consequences of a corporation's actions more challenging. For example, the Ford Motor Company designed and released the Pinto model in 1968 that eventually led to several accidental fatalities when the sub-compact vehicle exploded during rear-end collisions. The explosion occurred because of the Ford design, which placed the fuel tank in the very rear of the vehicle [4]. Now suppose that the courts determined that Ford was not only negligent, but criminally liable as well, for its actions. If in addition to monetary sanctions, prison time were necessary for the corporation, how would a judge determine who would serve the time? Technically, a corporation consists of the shareholders (owners), managers, Board of Directors, and employees. Sometimes these individuals amount to thousands of people, all a part of the corporate entity. So then, is each and every one of them liable? This is clearly difficult to determine, as described in the cases from the previous section above.

Several ideas have emerged to describe the individual-corporation or analogous part-whole relationship from above. Perhaps the most important of these is the Principal-Agency Theory, which has been championed as a model that predicts the behavior of corporations. The main premise of the theory holds that since a large group of individual shareholders collectively owns a corporation, the transaction costs would be infinitely high if they were to make all decisions as a group. Consequently, the need for an "agent" to make decisions on behalf of the "principal" (in this case, the shareholders) arises. It is mistaken to think of the agent as both the Board of

Directors, which shareholders elect, and the CEO, whom the Board chooses; in reality, all employees are agents because together they make the corporation function.

Berle and Means, two leading scholars in the corporate law realm, argued that this setup makes it impossible for all shareholders to induce corporate managers to act in the owners' best interests [5]. As a result, managers, and presumably other employees, can utilize the corporation's resources as they see fit. The consequence is that owners' legal rights to the organization do not reflect their actual control over it.

This appears to be a decidedly pessimistic view of how corporations function. In fact, if the above assertion were the case, shareholders would probably divest their ownership rights, and corporations would not be a successful form of business. In the 1970s, a group of researchers working independently expanded on this negative view to formulate the modern day Principal-Agency Theory [6,7,8,9]. These researchers recognized that there exists a problem of information-asymmetry: that is, shareholders cannot monitor managers directly, so they need to design a way to induce the managers to act in shareholders' interest without being monitored. The researchers found that despite the information-asymmetry, an optimal solution still arose whereby the agent acted in accordance with the principal without direct monitoring. The optimal solution was attributable to the formation of incentive contracts. Examples of incentives include protecting the reputation of the agent and making compensation and bonuses contingent upon the agent's satisfactory performance [10]. Another corollary to the Principal-Agency Theory contends that with the proper incentive system in place, decision-making will not be affected by organizational structure or decentralization [11]. In other words, regardless of whether subordinates or bosses across many separate departments make the decisions, these agents will all still act in the best interests of the principals, or shareholders in this case.

Inferences for Right Action

Even though Principal-Agency Theory is not an ethical theory, it does make sizable claims that lead to interesting inferences regarding the question of individual responsibility in the corporate setting. First of all, if a proper incentive structure is set in place, all agents will act in the best interests of the principal (owners). That is, agents will engage in behaviors that will maximize the profitability and ensure the longevity of corporations. The presumption then is that agent behavior will be "right," both in a legal and moral sense. We combine the legal and moral senses together here because many ethical issues that may arise in the workplace, such as conflicts of interest and fraud, are inherently considered morally wrong— but they are also legally wrong. In other words, many acts that would be considered unethical are also illegal. Therefore if an employee acts illegally or immorally, which presumably negatively reflects upon the corporation (and so the employee is not acting in the best interests of the corporation), it is the true fault of the incentive structure, rather than the employee. One could take this a step further and say that since shareholders (principals) and legislators actually formulate the incentive structure, it is ultimately their responsibility if the resulting actions of the agents prove egregious. That is, if the incentive structure is right, the agents will act right. Hence, the Principal-Agency Theory leads us to the normative conclusion that the shareholders are responsible for the corporation's actions.

Take the example of the Enron corporate scandal in December 2001. Kenneth Lay, then the CEO, was accused of hiding massive debt and inflating the profits of a corporation in serious financial trouble. This artificial inflation seems to have been in the best interests of the shareholders at the time since stock prices went up; however, in the end it proved not only wholly illegal (and immoral), but was also in the worst interests of the company, as the energy giant proceeded to bankruptcy, and stockholders lost every penny of their investments. The Principal-Agency Theory stops short of outright insinuating that Kenneth Lay or any other employee has no culpability in the company's downfall. However, the theory might point to the fact that corporate executives generally receive stock options, the idea being to align the interests of management with shareholders [12]. The problem is that option grants are often based on short-term accounting performance, with no requirement for executives to hold shares for the long term. The result is an incentive to inflate short-term stock performance, but failure to create long-term value, as is essentially what occurred with Enron [13]. From this, the theory then suggests that the optimal solution would not simply be to punish Kenneth Lay, but rather to change the incentive structure of the company. Another implication this theory makes is to note that some employee on the inside could have come out earlier and blown the whistle before the point of no return was reached. This did not happen however, and Principal-Agency Theory implies that this was because there were and are insufficient incentives for employees to come forward and report illegal business practices. This is precisely why there are currently many pieces of legislation around the nation proposing to protect whistleblowers more comprehensively [14].

Concluding Remarks

In the end, Principal-Agency Theory fundamentally assumes that individuals cannot really control themselves; instead, they simply react to incentives seemingly without regard to morality or actual consequences. This appears to be a philistine viewpoint because it rejects any notion of human conscience. In the opening case of this paper, it is perfectly plausible that Joe Potatoes would blow the whistle on the corporation, even though the only incentive to do this would be Joe's good feeling for doing the "right" thing. In fact, in the B&WT case, Dr. Wigand seemed to give up much more than his job by coming out to testify. Principal-Agency Theory would predict no action in these cases, which is clearly not always correct. Nevertheless, since incentives tend to be the tool used in making laws to prescribe behavior, the theory provides an interesting method to uncover the legal and ethical aspects of corporate versus individual responsibility.

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