STEPHEN F. AUSTIN STATE UNIVERSITY
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Our Economy: East Texas and Beyond

Director's Welcome

Greetings from all of us at the Center for Business and Economic Research! In this inaugural issue of East Texas and Beyond*, we introduce ourselves, discuss where our national, state, and local economies are currently and where we seem to be headed, and give an assessment of the recent Biden Administration plan to provide student debt relief. Future newsletters will explore other similar policy issues; if you have a suggestion for a topic you would like to see covered, please get in touch with us.*

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Student Debt Relief

by M. Kouliavtsev

The Biden administration announced in late August its plan to forgive up to $10,000 of federal loans ($20,000 for those who received Pell Grants) for all borrowers subject to some income criteria. There has been plenty of reaction and commentary – in the media and on social networks – on this development, ranging from knee-jerk reaction to more careful analysis, and we will try to disentangle the many complex details of the program.[1]

To be clear, this is not an attempt to argue either in support of or against the cancellation of student debt; after all, much of the public opinion on this matter is a function of personal preferences and values. However, there are aspects of this program that have *objectively* positive or negative effects (though the exact magnitude is often uncertain, as will be discussed below), and it is important to recognize and acknowledge them.

Skipping ahead to the punch line: as most economists appear to agree, this is, on balance, bad economic policy, if nothing else. There are perverse incentives it creates, it sets a bad precedent, it ignores and fails to address the underlying problem (in fact, possibly making it worse in the future), and it is poorly timed.

First, a brief summary of Biden administration's loan cancellation program. To be more accurate, there is more to it than just the cancellation of $10,000 or $20,000 loan balances: the program also expands eligibility of borrowers for the income-based repayment programs, where a fixed percentage of income is paid for a period of time, and the remaining balance is forgiven. Specifically, income restrictions are relaxed, the percentage of income paid is lowered from 10% to 5%, and the length of time before the remainder is canceled is shortened (at least for loans with original balances of less than $12,000) from 20 years to 10. In other words, this is a comprehensive *debt relief* program, not simply *debt forgiveness*.

Second, what is the projected impact on the federal budget of this program? In early October, the Congressional Budget Office (CBO) finally released its estimate of the cost: $400

[1] There are possible legal challenges that will need to be resolved, but we will assume here that the program "survives" those.

billion over 30 years. It is somewhat disappointing that this figure was released long after the policy decision was made and only after congressional Republicans specifically asked the CBO to assess the program.

There is a lot of uncertainty surrounding that CBO cost estimate – more than would be the case with other policies. The issue is that it isn't quite clear what the relevant baseline is against which debt cancellation should be measured.

It is unrealistic, for example, to assume that in the absence of this forgiveness program, every penny of student loans would be repaid. At the same time, the freeze on loan payments, initially put in place by the Trump administration in 2020 and extended multiple times, was scheduled to expire at the end of 2022, so borrowers who were on payment "vacation" would have to resume paying.

Could the freeze have been extended yet again if the forgiveness had not been enacted? It's unlikely because the last extension was billed as **the** final one; also, for how long would an additional extension be? As long as we are in an economic downturn of some sort? Until the 2024 presidential election, if Joe Biden plans to run again?

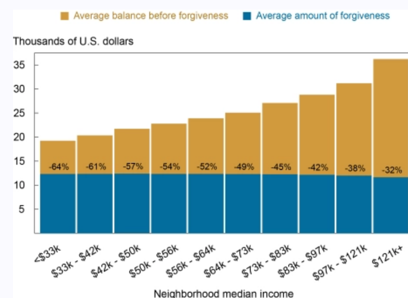
What we do know is that the current debt relief program forgives up to $20,000 for borrowers *and* restarts payments on the remaining balances – i.e., no more repayment holidays.

So, why was this done? Why forgive student loans and why now? Here are a few well-intentioned reasons often brought up as motivating this move:

- it is morally indecent to saddle people with crippling amounts of debt, which may be holding them back from leading otherwise productive and successful lives; after all, many went to college to do the right thing — acquire knowledge and skills for better-paying careers;
- this is a purely transactional step by the Biden administration: loan forgiveness was promised on the campaign trail and is now being delivered;
- to the extent that we want to increase the rates of homeownership in the US, and these large loan balances keep many borrowers from being able to buy a home, debt relief can make it easier for some to qualify for a mortgage or handle the monthly payment more comfortably.

For all of these, one can come up with a fairly convincing counterpoint: people went into debt knowingly, signing a contract to borrow funds for school; the mere promise of policy doesn't make it a good idea; and it is not clear whether homeownership can be increased substantially – or that it should even be a goal.

There is some good news in terms of targeting: according to some very thorough analysis by the New York Fed economists, borrowers in lower-income neighborhoods will benefit more than those living in higher-income areas.



Geographically, the impact of loan forgiveness is also not uniform. Areas in the South and the Northeast appear to have the largest average balances forgiven; a greater proportion of adults in the Midwest and the South will receive some forgiveness.

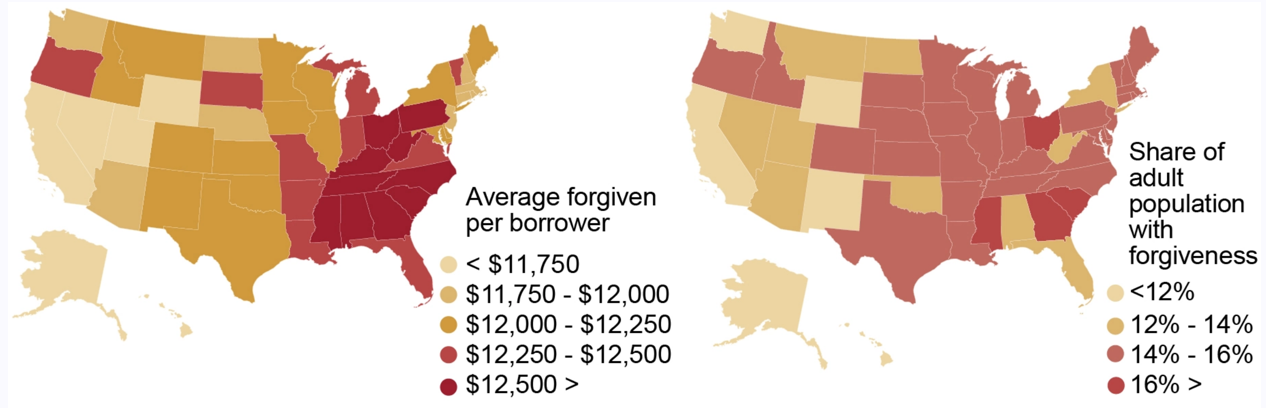
There is one very major flaw in the one-time loan forgiveness approach – it's that it is one time. It does nothing to address the underlying problem, which is the runaway escalation of the cost of higher education and the system of financing that education in the U.S. People will continue going to school and borrow funds to pay for it, and the student debt problem as we know it today will not go away. While there were some discussions by the Biden camp early on in his election campaign and shortly after the 2020 election of efforts to make community colleges free, those discussions did not lead to any federal policy. To be fair, some states have enacted their own policies addressing college affordability, especially at the level of junior and community colleges, but those are far from universal.

Now, one might come to the defense of one-time student loan cancellation on two grounds. First, student debt is different from other debt, such as mortgage loan debt, for instance, in that it is generally nearly impossible to discharge student loans through bankruptcy. It sticks with the borrower for years or decades and can really prevent them from living their best life.

Second, the current student debt holders are those who went to college in the 1990s and 2000s, at the peak of the "higher-ed bubble" – when young people were repeatedly told in high schools, at home and in the media that college is the only way to a good career. Further, they were told that borrowing is easy, normal and no big deal. To the extent that we have greater awareness of college loan debt issues now and can better prepare future youth for their borrowing decisions, this one-time forgiveness is a way to rectify us, as a society, having failed the youth of the early 2000s.

Turning now to the drawbacks of debt relief, the most glaring aspect is that this is not even the best way to direct relief to those who may need it the most. Most borrowers of college loans are college graduates or have at least some college credits (though a large portion who go to college and never finish are, arguably, in the worst position). They are, generally speaking, not the poorest or the most needy – they tend to be those with only a high school diploma (or even less). In other words, if the federal government wanted to issue $10,000 checks to help get people on their feet, people with college credits are not the right group to target.

The inflationary impact of debt cancellation is of some concern. Es-



sentially, the argument is that relieving borrowers of some debt increases their wealth but also gives them more disposable income each month — at least relative to the scenario where they have to make monthly payments on that debt. The additional spending will boost demand for goods and services, which tends to put upward pressure on prices.

Estimates of the additional inflation we might expect are quite modest: around 0.2% to 0.3% per year, although the relevant baseline discussed above is important here, too.

The effect is rather small, but it is not negligible. What may be more significant is that this additional inflation will come at a time when the economy is already experiencing a period of high inflation, and the Federal Reserve has to work hard to counteract it. This stimulative boost to the economy would have been better timed if it had been enacted in 2020 or early 2021, when we were in a deep pandemic-induced recession.

To economists, the above are not the worst aspects of this policy. The more significant costs arise from the perverse incentives that this policy creates and future behavior that, if anything, will exacerbate the current problems.

First, universities have an incentive to raise future tuition. This is less caused by the debt forgiveness itself — those with outstanding loans *could* go back to school now that they have less debt, but they are not the largest potential population of college goers. Instead, it's the lower percentage of earnings that loan repayment now equals that makes borrowing by students more attractive and, in turn, gives colleges an incentive to charge them more. After all, what difference does it make how much you borrow, if you only have to pay back 5% of whatever your future income is for 10 years and have the rest forgiven?

Some law schools have taken this a step further already. Graduates who want to go into public service are eligible for the Public Service Loan Forgiveness program, where balances are discharged after a set number of payments are made, and law programs actually make these payments on behalf of the graduates -– by first raising their tuition appropriately, of course, and having students borrow to pay it. Universities may now do this sort of thing en masse.

Second, colleges may hire more administrators, which is a problem that plagues higher education already: the so-called "administrative bloat." This is, of course, the opposite of what we would prefer – i.e., institutions finding ways to become more efficient and "lean." Rather, it drives up the already high cost of higher education without improving its quality.

Third, current and future borrowers will expect similar debt forgiveness to be implemented in the future. Despite the Biden administration insisting that this is a one-time program, it creates a precedent that, in general, the government is willing to consider canceling student debt. Worse yet, because the underlying problem of financing higher education remains unsolved, we are all but assured that the debt crisis will repeat itself. ■

Federal Reserve and Monetary Policy

by M. Kouliavtsev

On Sept. 21, the Federal Open Market Committee of the Federal Reserve announced that it will raise, again, by 0.75% its target for the federal funds rate, to 3% to 3.25%. Let's unpack and explain the previous sentence before taking a look at where our macroeconomy might be headed next.

What is commonly referred to as the "Fed" – the part of the Federal Reserve System that sets our country's monetary policy – is actually the FOMC, a group of 12 central bankers who meet once every six weeks, almost always on Tuesdays. The composition of the committee changes, as the regional bank presidents rotate to join the Board of Governors members. The goal is to give all regions of the country some input or "voice" in shaping our monetary policy.

The Fed has what is known as the *dual mandate*: the goal to keep inflation in check as well as maintain low unemployment. This is in contrast to some other countries' central banks, some of which are concerned with price stability only. Nevertheless, at the present time, inflation is clearly

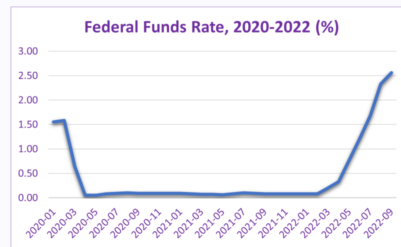
the main problem needing to be addressed, so the Fed's actions are aimed at lowering it.

Generally, the Fed has three main tools at its disposal to accomplish its goals: 1) the reserve requirement ratio, 2) the discount window rate and 3) open market operations. Practically, only the third of these is used, and it involves buying and selling Treasury bonds in the open market.

A crucial detail to recognize is that while it is common for news media to phrase the Fed's actions as "raising the interest rates," it is not strictly accurate. The Fed does not control the federal funds rate (this is the rate banks use for overnight lending to one another); instead it sets a *target* for what this rate should be, and then it buys or sells enough Treasury securities to hit that target.

Even though the Fed has a good track record of being able to hit its targets, given its decades of experience,[2] its position may be compared to steering a car by looking out the side window rather than through the windshield. You can get a pretty good idea that you're going straight by watching how far you are from the shoulder and adjust accordingly, but its imprecise at best.

Back to the first sentence of this article: the Fed announced that it believes the federal funds rate should be 0.75% higher than it currently is, specifically around 3% to 3.25%. It then immediately proceeded to sell U.S. government bonds, thereby reducing the amount of money in circulation, which leads to increasing rates. It is worth pointing out that the federal funds rate spent the better portion of mid-2020 through mid-2022 below 0.1%, when the primary goal was jump-starting the economy as it was recovering from the pandemic. In other words, we are seeing increases in the FFR target that are quite fast and dramatic.



Having explained the above, the question becomes: "What now?" How much longer and higher will the rates be pushed? The FOMC statements from each meeting mention that the Fed watches for signs of economic weakness in consumer spending, job markets, manufacturing and other sectors, but as long as there appears to be none, it will focus on inflation.

Another consideration is that the Fed is well aware of the so-called *moral suasion* aspect of its role: it is often able to influence markets, consumers and producers without taking any explicit action. It does so by shaping expectations, particularly inflationary expectations. What matters more to those engaging in any economic activity is what prices are *expected to be* rather than what they were in the past. So, while the Fed can only rely on past data it receives, its policies need to take into account how people's expectations of future inflation will be affected.

In particular, if the Fed comes out with a strongly worded announcement that it intends to vigorously fight inflation, market participants will internalize this information and *expect* lower inflation in the future. What this means is that the mere threat of action by the Fed can have the desired effect, which incidentally makes the action itself less necessary. On the other hand, in order to have credibility now and in the future, the Fed cannot simply make promises and not follow them up with actions. If the Fed kept promising to raise rates but never actually raised them, soon enough people would stop expecting lower inflation, and the Fed's announcements would no longer have any impact. But it is true that expectations matter to the extent that if the Fed needs to raise the rates, it may need to do it fewer times or in smaller increments than would otherwise be the case.

An example may be helpful to illustrate how inflationary expectations can affect actual inflation. Suppose a restaurant owner sees a news report that says inflation over the previous month was equivalent to an annual rate of 8%. For her, what matters is the predicted inflation over the *next* several months because that will affect the prices of food ingredients that she has to buy, the wages she has to pay her cooks and waiters, the utility rates and so on. Absent any other information, she may be inclined to raise her menu prices in anticipation of these higher costs: after all, the best predictor of next month's prices are current and previous months' prices.

But suppose she also hears the Fed issue a statement that it plans to focus on lowering inflation. Then, the restauranteur's expectation of future inflation may be revised downward, and she may now be planning for the cost of ingredients and labor to only be 4% to 5% higher rather than 8%. If so, she may in turn hold off on raising her restaurant's menu prices or not raise them quite as much, which of course itself contributes to lower inflation – businesses raising prices by less than they would otherwise.

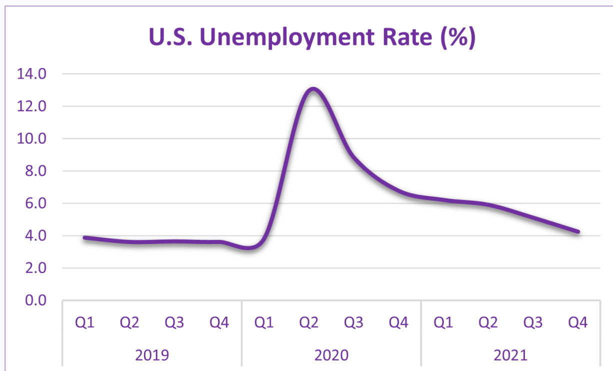
When the Fed and other analysts discuss their hopes of a "soft landing" rather than a deep recession, this is the mechanism they are counting on: inflationary expectations adjusting quickly enough to lower the actual rate of inflation without triggering a significant economic downturn. ■

[2]The Federal Reserve System was established in 1913.

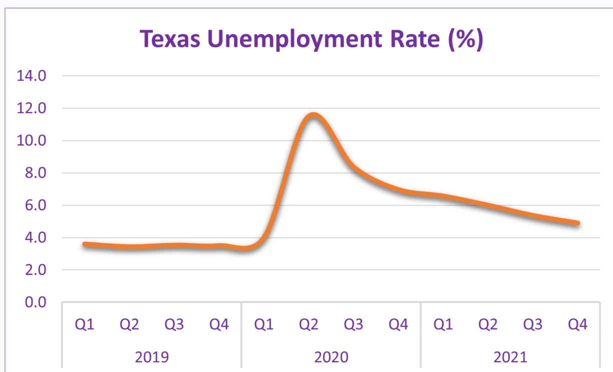
Economic Snapshot: National and Local Conditions

Labor Markets

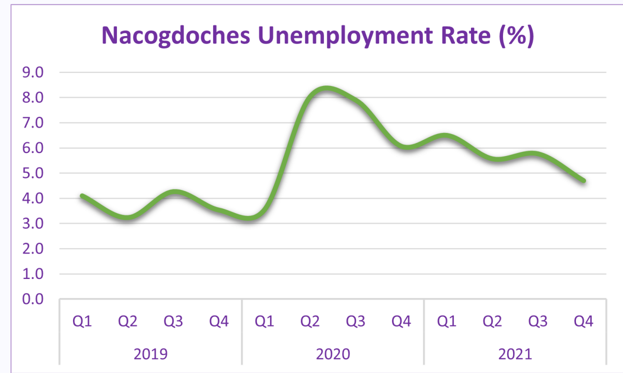
If we are in a recession, someone forgot to tell the labor market, which has been adding jobs at breakneck speed. While the latest jobs report released in October (for August data) shows a slight slowdown in the pace of job vacancy creation, there are still 1.7 openings for each unemployed person in America.



After spiking in the second quarter of 2020 -– due to the onset of the COVID-19 pandemic -– labor markets recovered gradually but steadily. This was the case nationally, in Texas, as well as locally in Deep East Texas and our immediate area.



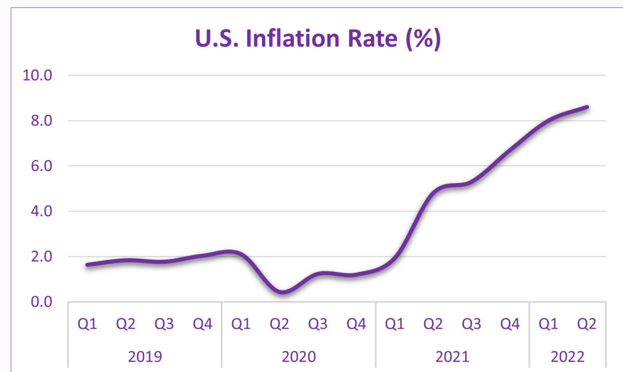
The unemployment rate in the U.S. was down to 4.2% at the end of 2021 after reaching a high of 13% in 2020. Texas saw unemployment fall to 4.9% in Q4 of 2021, while Nacogdoches County fared slightly better – 4.7%. Similarly, labor force participation recovered nearly to its pre-pandemic levels at the national level and locally in Nacogdoches, while at the state level, the size of the labor force in Q4 of 2021 actually exceeded that in Q1 of 2019.

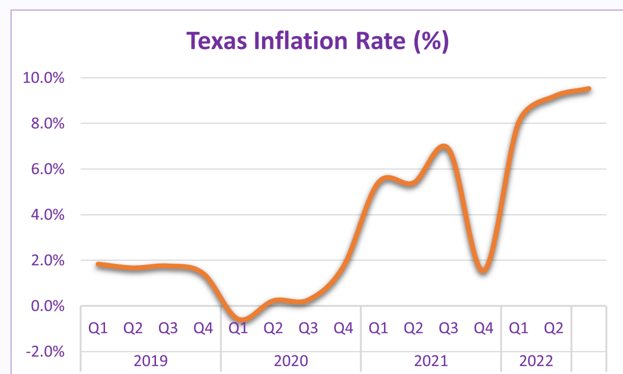


In other words, labor markets have shown a healthy rebound, and this trend has continued through the first half of 2022.

Price Levels and Cost of Living

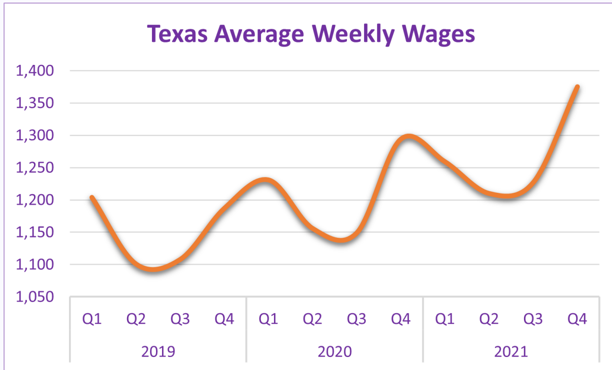
The inflation rate, measured as the change in the Consumer Price Index, has been growing steadily since the beginning of 2021 and reached an annual equivalent of nearly 9% in late summer of 2022. In Texas, a similar dynamic has unfolded, and the peak of inflation was actually higher at 9.5% in Q3 of 2022. The so-called "core inflation" – inflation for goods and services minus food and energy – which is often of greater interest to policymakers and analysts, is also high and continuing to trend upward. Food and energy prices are removed due to their volatility; in other words, core inflation can sometimes tell us if prices in general are rising even without those volatile components.

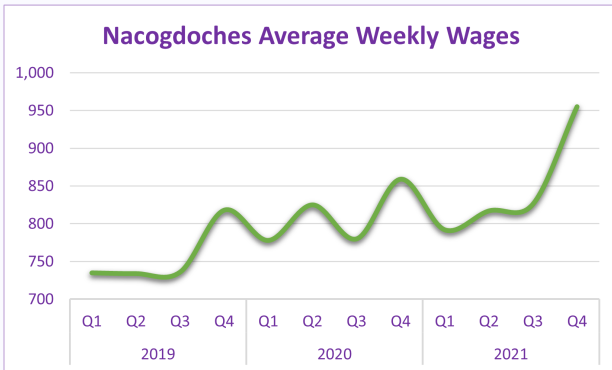




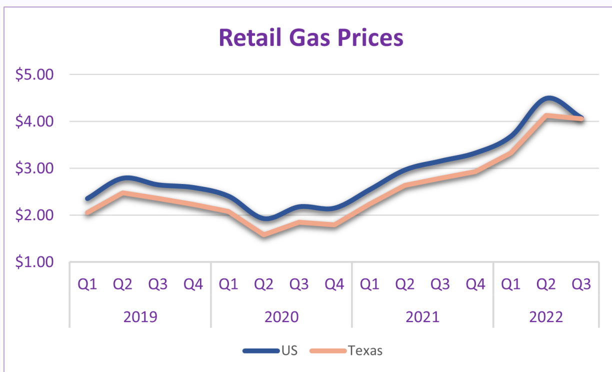
The relative strength of labor markets coupled with continuously high and rising price levels is what is motivating

the Federal Reserve to continue raising its target for the key interest rate. Average weekly wages – a standard measure of short-term changes in workers' earnings – have grown steadily over the past three years and especially since the end of 2020. This is true nationally, statewide, and locally in Nacogdoches County.



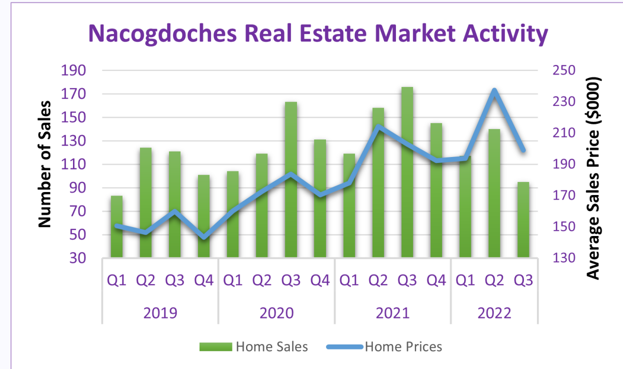


Retail gasoline prices in Texas tend to be lower than those in the U.S. overall (which are an average of all states and are skewed higher by more expensive gas on the coasts). We are seeing a clear trend downward in price per gallon, both nationally and in the state, though the levels of prices are still high: well above $3 and higher than at any point during 2019-2021.



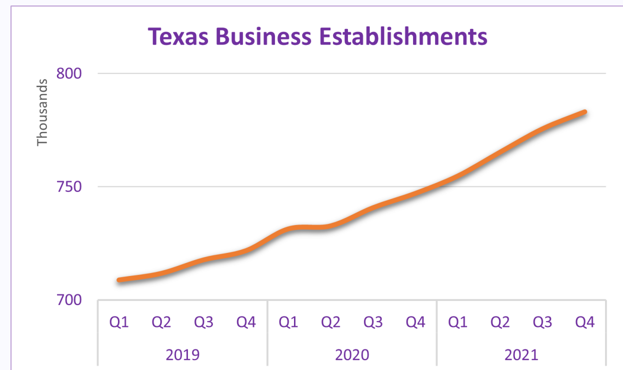
Housing Markets

Real estate market activity is showing signs of slowing down, both in terms of numbers of sales as well as average home prices. Sharply rising mortgage rates have, no doubt, contributed to this trend: for comparison, rates for a conventional 30-year loan hovered around 2.5% in the summer and early fall of 2020, but have crossed the 7% mark in September of 2022. There is also some degree of uncertainty among potential homebuyers, who may be weighing a big debt commitment against the chances of having lower incomes in the near future — i.e., the possibility of unemployment in a recession.

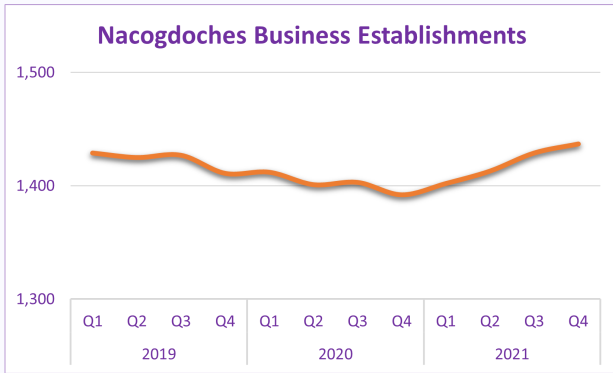


Business Establishments

On the business side of the ledger, the number of business establishments has increased steadily in Texas. Interestingly, even the pandemic year had no measurable impact on the overall trend of growth – just a small hiccup of a blip. The same pattern is visible in the 12-county Deep East Texas area; at the end of 2021, there were 8,022 establishments compared to 7,595 at the beginning of 2019.

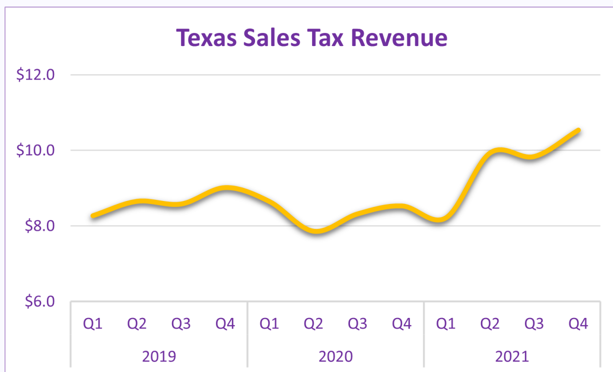


In Nacogdoches, we saw a pronounced decline in the number of establishments, followed by a strong recovery. Overall, the number at the end of Q4 of 2021 (1,437) is slightly above the number in Q1 of 2019 (1,429), so in a sense, we've rebounded back to normal.

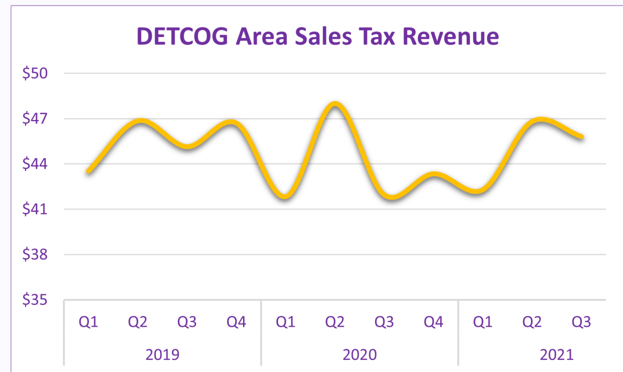


Sales Tax Revenues

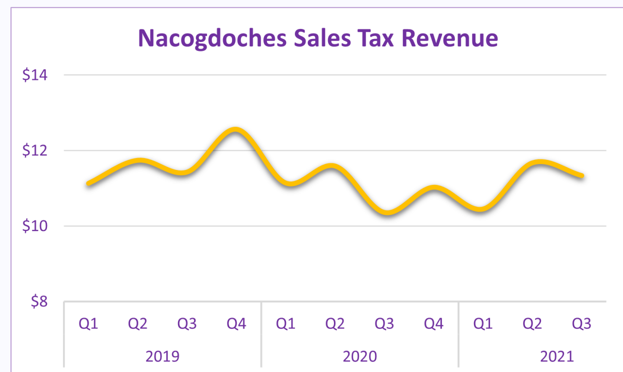
Sales tax revenue, which is not only very important for the functioning of local and state governments but also provides a good barometer of sales and consumption activity, is highly affected by economic fluctuations.



We saw a significant drop in revenue over the period of the pandemic at all levels – state, regionally and locally – and a substantial growth in the ensuing period. Texas finished 2021 on a strong growth upswing, while the pattern is more erratic in our area.



While both the Deep East Texas area and Nacogdoches County ended Q3 of 2021 ahead of Q1 of 2019, this increase is modest and followed three years of major volatility. This unpredictability in revenue receipts can make long-term planning particularly difficult, especially for smaller counties, where a 5% to 10% drop in revenue can mean that important projects are not funded.



CBER: Who We Are

Meet the team of faculty members in Stephen F. Austin State University's Department of Economics and Finance who are affiliated with the center.

Dr. Rebecca Davis
Energy and Environmental Economics
PhD, University of Tennessee

David Kaiser
Banking and Financial Services
MBA, Western Washington University

Dr. Stephen Kosovich
Labor Economics
PhD, University of Oregon

Dr. Mikhail Kouliavtsev
Industrial Organization, Antitrust Policy
PhD, Temple University

Dr. Beverly Mendoza
International Economics and Trade
PhD, Indiana University

Dr. Mark Scanlan
Tax Policy
PhD, University of Florida

CBER Staff in the Media

- ☞ Auto insurance options focused on military personnel. (M. Scanlan, *WalletHub*)
- ☞ Why do HSBC credit cards seem less popular with US consumers? (M. Kouliavtsev, *WalletHub*)
- ☞ CBER is launched and has big plans! (M. Kouliavtsev, *KTRE*)
- ☞ What is the future of coal-fired electric generation? (R. Davis, *The Conversation*)
- ☞ How do credit scores impact auto insurance rates? (B. Mendoza, *WalletHub*)
- ☞ Is a personal loan better than using a credit card? (M. Scanlan, *WalletHub*)
- ☞ How do you find the best credit card for balance transfers? (R. Davis, *WalletHub*)
- ☞ Texas' State Use Program benefits more than just those with disabilities. (R. Davis, M. Kouliavtsev, M. Scanlan, *SFA News*)
- ☞ Auto insurance policies: what are the must-haves, and are national carriers different from local companies? (B. Mendoza, *WalletHub*)

Other Research by Our Colleagues

- ✓ Kosovich, S. M. How do students use online interactive software? Evidence from a principles of microeconomics course. Glob*al Journal of Business Pedagogy*, 4.
- ✓ Kosovich, S. M. Tilting a course instead of flipping it: an experiment in partially flipping a principles of microeconomics course. *Journal of Economics and Economic Education Research*, 17.
- ✓ Giudici, E., Hu, H. Intraday Patterns in Trading Volume of the SPY ETF. *International Journal of Business and Social Science*, 10(9).
- ✓ Scanlan, M. A. Reassessing the Disability Divide: Unequal Access as the World is Pushed Online. *Universal Access in the Information Society*.
- ✓ Davis, R. J., Holladay, J. S., Sims, C. In Matthew J. Kotchen, Tatyana Deryugina, and James H. Stock (Ed.), Coal-Fired Power Plant Retirements in the U.S. (vol. 3). *Environmental and Energy Policy and the Economy.*
- ✓ Mendoza, B. Experience and Market Signals in Export Entry Decisions. *The World Economy.*