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In This Issue

Not Even Bo Knows

In one of the greatest articles ever written (that's what you get when the editor is also an author), William Roberds and I delve into "How Little We Know About Deficit Policy Effects" (p. 2). Roberds and I argue that so far not much has been learned from examining the data. The data's message has been muddled because budget deficits have many causes, and the relationship between deficits and other economic variables depends on the cause. The statistical problem is to identify the portion of budget deficit changes attributable to policy changes and then relate that portion to other variables.

Roberds and I don't try to solve the identification problem, but we do try to illuminate it. We construct and estimate a simple model that illustrates how the problem arises in theory and in practice. Using this model, we then critique empirical studies in the literature and conclude that no one—not even Bo—knows whether budget deficit policies have real effects.

Why Ask Why?

Why do governments of developing countries sometimes decide to take over, or *expropriate,* firms owned and operated by foreign investors? In "Direct Investment: A Doubtful Alternative to International Debt" (p. 12), Harold L. Cole and William B. English ask this question using a simple strategic model. The model suggests that the decision to expropriate is made when the government of a country believes that the benefit of the action, which is more consumption for its people today, exceeds the cost, which is less consumption tomorrow. The decision to expropriate is shown to depend primarily on economic conditions in the developing country and on the attitudes toward risk of its residents.

Why ask why? A reason for questioning why developing country governments expropriate direct investment is to determine if something could or should be done to discourage or prevent such actions. Cole and English show that in a developing country the threat of expropriation leads to too little direct investment. They also show that the threat can be reduced with higher levels of investment. This suggests a possible role for programs that promote or channel direct investments to developing countries.

Preston J. Miller
Editor