

Mitchell's Musings: Fourth Quarter of 2013

For employmentpolicy.org EPRN

[Format may differ from original individual musings.]



Mitchell's Musings 10-7-13: Grow Up

Daniel J.B. Mitchell

This week's Mitchell's Musings was going to deal with another topic but given the current Congressional stalemate over the budget/government shutdown and the debt ceiling, it is necessary to focus on that debacle. I have in past musings talked about negotiations and negotiating strategy, particularly lessons learned from the world of collective bargaining that might be applied to political conflicts. While there are definite insights about negotiating and impasses that can illuminate the current conflict, there is a more fundamental question of why we find ourselves in the current stalemate.

It goes without saying that the Congressional conflict has the potential to damage the slow recovery from the Great Recession, should it persist for an extended period. How much damage? It is hard to say – which is precisely the point. No one can forecast what the consequence would be, other than saying the longer the government shutdown continues, the greater the likelihood of damage.

The debt ceiling – if it is hit (supposedly by the middle of this month) – and if it leads to default on U.S. Treasury security debt service – raises other kinds of risk in financial markets. The potential for financial gyrations to do harm was seen clearly in 2008. Who wants to risk that kind of event again? You might believe that the damage wouldn't be great. But do you believe it with 100% certainty. Ninety percent? Eighty? Unless you are 100% sure, you are risking potentially great harm with a 10% chance of happening or maybe a 20% chance. In the real world, people take out insurance and pay considerable premiums to offset small risks of catastrophic events.

Some readers may recall the commentary on the 1963 March on Washington by Jean Shepherd I put on YouTube (and on the EPRN website). Shepherd was a humorist who was on WOR radio in New York City from the 1950s into the 1970s, most often in the late evening but sometimes at other hours. If you Google his name, you will find websites devoted to his programming and background.¹ However, one of his broadcasts, which probably aired in the mid-to-late 1960s, is surprisingly instructive about the political and policy world of 2013. You can find it on YouTube at <http://www.youtube.com/watch?v=EOR8OKtJd0s>.

At the time of the broadcast, the first baby boomers were aging into early chronological adulthood. However, Shepherd describes them as wanting adult privileges, even as teenagers, but without adult responsibilities. He also describes somewhat older people at the time as mirroring baby boomer behavior. By adulthood, he did not mean such conventional behaviors as buying a house and taking out a mortgage. Shepherd refers instead to a much more general role. He described adulthood as taking responsibility for running the world and providing a certain stability to society.

The childish behavior of both adults of the period and teens who wanted to have what they viewed as adult rights was, in Shepherd's view based on a lack of perspective. Children tend to be self-centered

¹ Archive.org has many hours of his broadcasts that can be played or downloaded.

and view the world as either run for their benefit or believe that it should be. When they don't get their way, they throw tantrums.

Shepherd noted that when it comes to political matters, childish adults tend to view the world from what he termed a "didactic" framework, black or white. There is no understanding or tolerance for social complexity. There is only good and evil. There is little self awareness of personal complexity, as well, among childish adults. So there is no appreciation for the complexities of others.

In short, the Shepherd broadcast suggests that the seeds of the current impasse in Congress were already visible in the mid-to-late 1960s. If so, the causes – whatever they were – are more deeply embedded in the national fabric than more recent events such as the Great Recession or even the growth income inequality (which debuts about a decade later). Of course, current conditions can aggravate an underlying disease. But that fact means that if even if the symptoms recede for a time – say in the current instance through some kind of deal on the budget and debt ceiling – the disease will remain. Of course, some diseases can be cured. But the patient typically must be adult enough to take his or her medicine, even if it is bitter and unpleasant. No such maturity is evident at present.

Mitchell's Musings 10-14-13: No Law of Nature is Involved

Daniel J.B. Mitchell

Let's start with some observations.² In a modern monetary system, currency is not "backed" by some physical commodity. Back in the day, there were monetary standards based on gold or silver. Not anymore. As we have noted in prior musings, money is a social and political creation. You accept dollars in payment (for your labor or anything you sell) because you know that others will accept those dollars. If you were in Japan, you would accept yen. If you were in Britain, you would accept pounds. If you were in France, you used to accept francs. But then the "authorities" told you that from now on the currency to accept was the euro. And knowing that everyone else would do it, you then accepted the euro.

In the U.S., the authority that issues money – which you accept – is the Federal Reserve. The Federal Reserve – the U.S. central bank – is a creation of Congress. Congress, in turn, had the power to create the Federal Reserve because of constitutional provisions providing for federal regulation of the currency. **There are rules about what the Fed can do or not do. But these are not laws of nature like gravity. They are instead human creations.**



Since the federal government can create money – a power it has delegated to the Federal Reserve – it cannot really run out of money to pay its debts. In fact, it cannot run out of money to do anything. It's true that in olden times when money was gold, the King had to borrow or raise money from taxation, say, to go to war. And it is true that state and local governments *within* the U.S. (and now countries within the euro-zone) can run out of money because they lack the power to create it. But it isn't true of the federal government.

Since there is no natural law limiting the federal government's access to money under our modern monetary system, there can't be a natural law limiting its debt or, more particularly, its ability to pay its debt service. The debt and debt service are denominated in dollars. So any limits on them are artificial creations of human laws.

² There is an ongoing flow of events surrounding the topic for this week. Please note, therefore, that this musing was posted the morning of October 10, 2013.

All that said, the Treasury does have a bank account at the Federal Reserve.³ And like your checking account, Treasury receipts (from tax inflows, borrowing, etc.) are deposited in that account and payments from it are deducted from it. When the Treasury account balance runs low (because of seasonal factors affecting inflows and outflows and because the federal government is running a deficit apart from seasonality), the Treasury borrows by issuing securities and depositing the proceeds in its account. The borrowing's proceeds replenish the account balance.

So what happens if the balance were to fall below zero? If your checking account balance falls below zero, your bank can do one of two things. It can bounce your checks. Or it can loan you the money through some kind of overdraft procedure. (Many people have some kind of overdraft protection on their checking accounts.)

Yours truly is not a lawyer. But there have been discussions that the President could invoke various constitutional powers to pay debt service above the artificial debt ceiling. There have been stories about platinum coins that could be issued that would circumvent the debt ceiling. I have no expertise or judgment on such strategies from a legal perspective. But let's assume that the President - on some rationale - ordered the Treasury to keep writing checks for expenditures, including debt service, which crossed the debt ceiling and/or pulled the account balance below zero. Would the Fed bounce the checks?

Again, **there is no natural law that would prevent an overdraft**. The Fed might be concerned about creating money beyond its money supply creation targets to accommodate the federal government. But it could mop up the "extra" money created by allowing an overdraft simply by selling from its existing holdings of Treasury or other securities.

Would the Fed have a rationale for allowing such an overdraft? The Fed essentially has two long-term goals: limiting inflation and fostering economic growth. And it has a short-term goal of preventing chaos in financial markets. A default on the debt could create such chaos. Maybe you could argue that markets would somehow adjust to the default in some smooth way. But seeing what the effect would actually be is an experiment the Fed might well not want to run.

If the default triggered a run on the dollar, prices of traded goods would be pushed up measured in dollars, i.e., there could be at least temporary inflation. And financial turmoil would be bad

³ "The major items on the liability side of the Federal Reserve balance sheet are Federal Reserve notes (U.S. paper currency) and the deposits that thousands of depository institutions, **the U.S. Treasury**, and others hold in accounts at the Federal Reserve Banks." Source: http://www.federalreserve.gov/monetarypolicy/bst_frliabilities.htm.

for real economic growth – which is already anemic. Unemployment – although falling since the Great Recession – remains high. And the low employment-to-population ratio and labor force participation rate add to the indication of an overly-soft labor market. In short, the Fed would have a three-fold rationale for allowing an overdraft: preventing financial chaos, preventing inflation, and fostering economic expansion.

Of course, no one outside the Fed knows what the Fed would do if default threatened. I'm sure there has been contingency planning at the Fed. But it may be that even top officials there don't know for sure at this point what they would do. For outsiders, however, the important point is that what the Fed would do is a human decision. Like the debt ceiling itself, no law of nature is involved.

Mitchell's Musings 10-21-2013: Would They Put Their Money Where Their Mouth Is?

Daniel J.B. Mitchell

Here (below) is an excerpt from a recent *Los Angeles Times* article, one of many dealing with the current⁴ impasse in Washington over the government shutdown and the debt ceiling:

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Upset over U.S. fiscal crisis, China urges a "de-Americanized world"

By Jim Puzzanghera

October 14, 2013

WASHINGTON -- Upset that the fiscal stalemate in Washington is threatening the global economy, China called for the U.S. dollar to be replaced as the international reserve currency as well as for broader steps to create a "de-Americanized world." China also called for an end to the "pernicious impasse" in the U.S. over the raising the debt limit and ending the partial government shutdown, saying the world needed another reserve currency so nations could protect themselves "from the spillover of the intensifying domestic political turmoil in the United States."

Most countries hold their foreign exchange reserves in U.S. dollars because the currency is viewed as the world's most stable. China is the largest foreign holder of U.S. debt, with about \$1.3 trillion in Treasury bonds, and is concerned about the impact of a U.S. failure to raise the debt limit on those holdings...⁵

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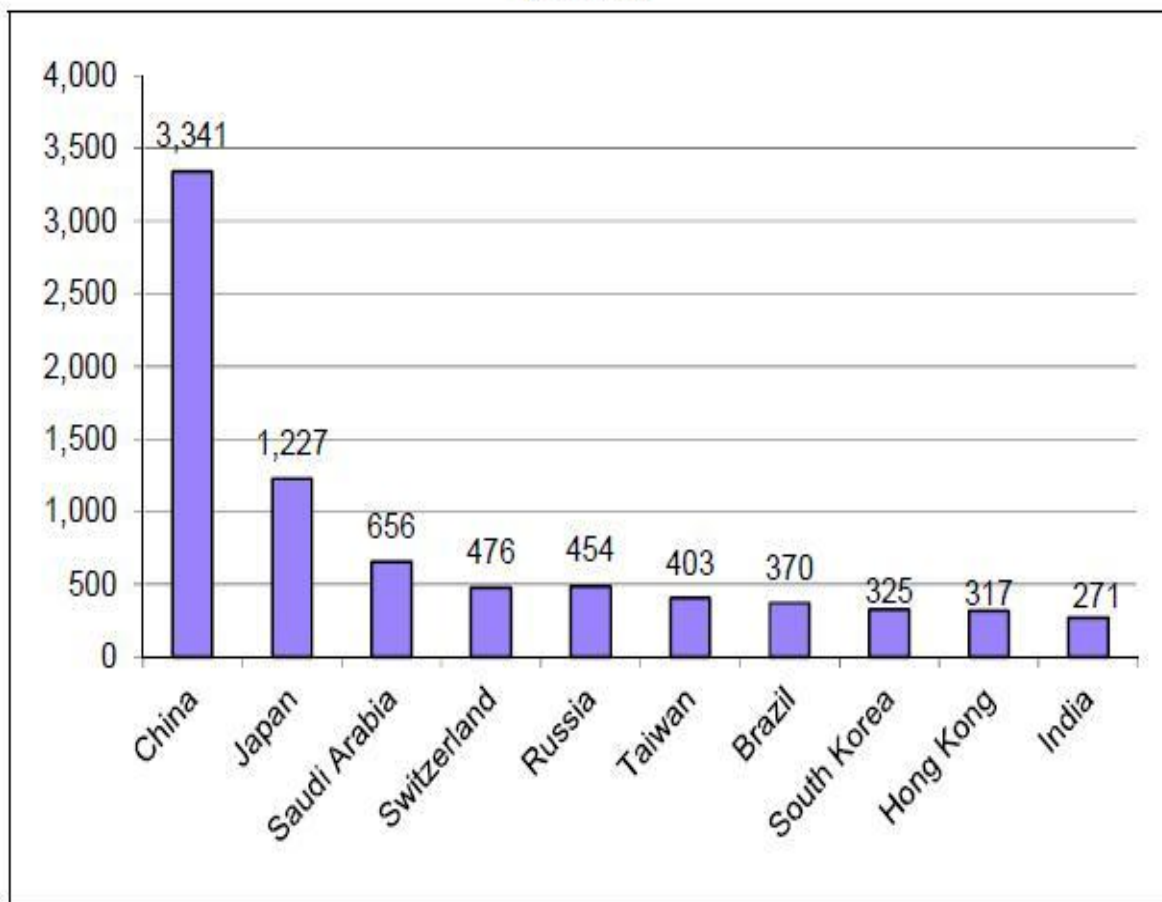
There are few bright sides to the current Congressional impasse and many more downsides. Were China to really start dumping its Treasury securities and other dollar-denominated holdings, there could be a financial panic with obvious bad results for the U.S. and world economies. But a "de-Americanized world" could be a long-term Good Thing for both the U.S. and China. If China really moved toward de-Americanization – if it put its money where its mouth is – that shift could be a good outcome of the impasse.

⁴ This musing was posted October 15, 2013.

⁵ <http://www.latimes.com/business/money/la-fi-mo-china-debt-limit-shutdown-de-americanized-economy-20131014,0,1990632.story>

One bad side of the current government shutdown is that many federal statistical websites are either not providing data or are operating only in a limited capacity. But let's look at some data sources that are available. Consider China's foreign exchange reserves. Chinese official policy, accomplished by exchange rate intervention and controls, is to run a net export ("trade") surplus, especially with the U.S. In effect, China's policy developed as an imitation of Japan's, but in absolute terms, China has outperformed its mentor in modern mercantilism. As the chart below shows, China holds huge reserves compared even with Japan's.⁶ Basically, if you chronically sell more than you buy, you end up holding more and more financial assets.

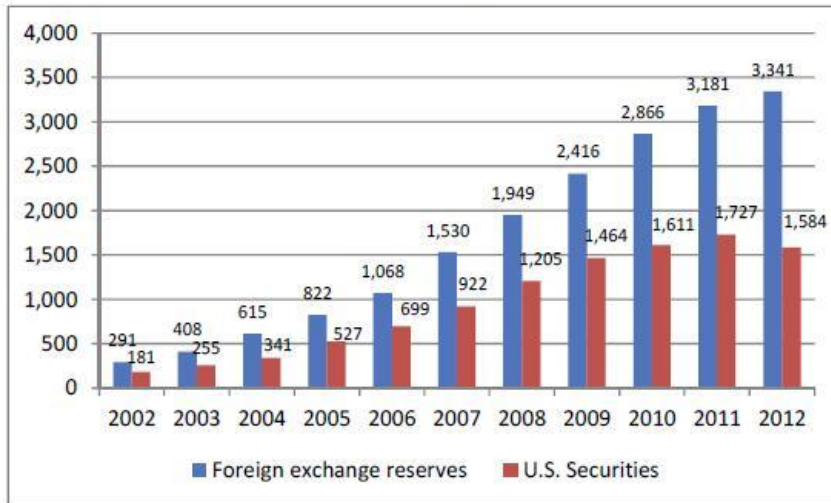
Major Holders of Foreign Exchange Reserves in 2012 Yearend
(\$ billions)



⁶ That chart and the next two charts below come from a report by the Congressional Research Service available at: <http://www.fas.org/sgp/crs/row/RL34314.pdf>

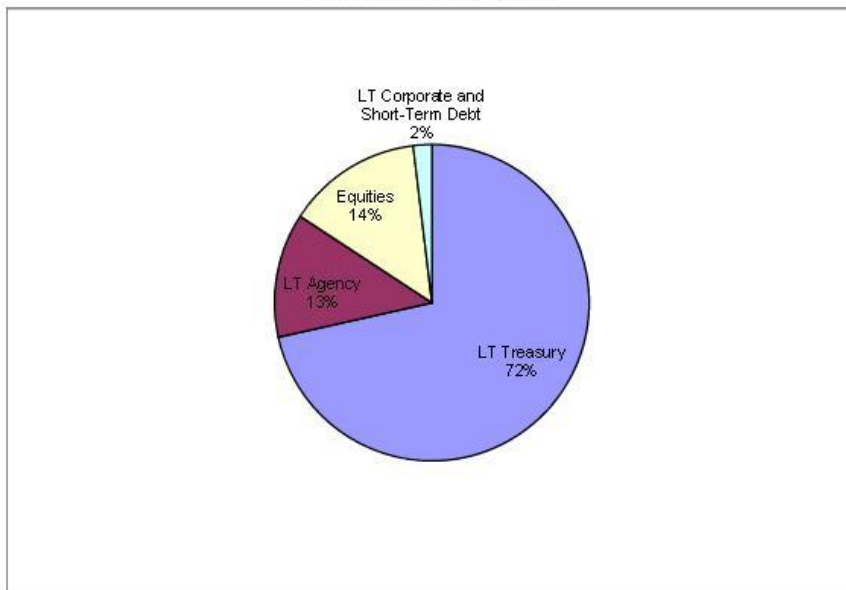
Almost half of the reserves accumulated by China are in dollar-denominated securities as the chart on the next page shows.

China's Foreign Exchange Reserves and Holdings of U.S. Public and Private Securities: 2002-2012
(\$ billions)



Seven out of ten dollars of Chinese reserves are in U.S. long-term Treasury securities and still more is held in securities issued by other federal agencies.

China's Holdings of U.S. Securities by Major Category as a Percent of Total Holdings as of June 2012



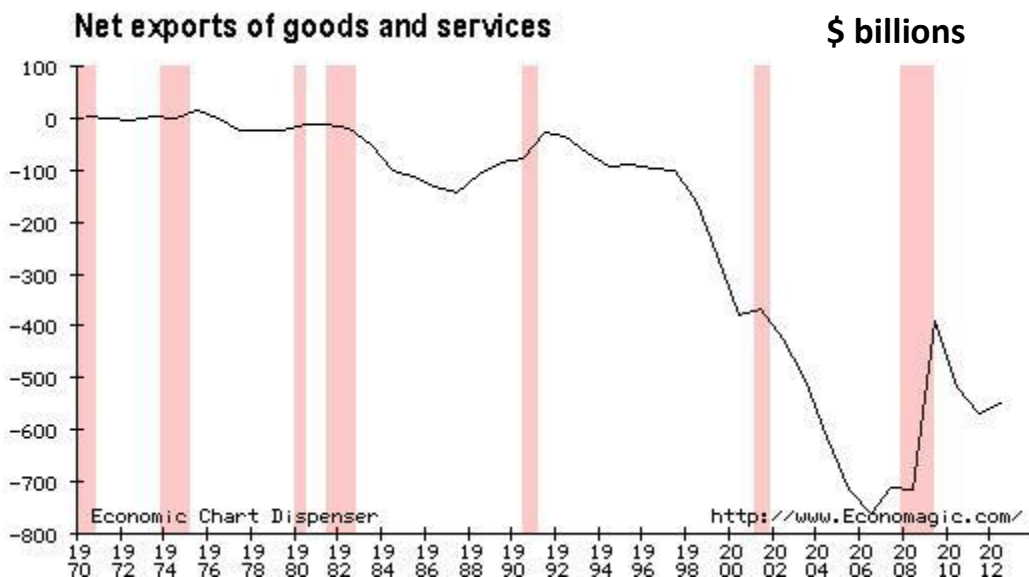
Source: U.S. Department of the Treasury, *Report on Foreign Portfolio Holdings of U.S. Securities as of June 30, 2012*, April 2013.

In short, so far, China has in fact gone along with an Americanized world economy, largely because it wants to continue running trade surpluses with the U.S.

If China were serious about de-Americanizing, it could not continue to follow such a mercantilist policy simply by switching to some other currency. The options are too limited. A jump into the euro for example would mean a big drop in the dollar's exchange rate and a rise in the value of the euro, i.e., Europe would have to play the game that the U.S. has – allowing itself to run huge trade deficits with China. Given the weak state of the European economy, such acquiescence by the Europeans seems most unlikely.

China probably would not want to anoint the yen as its reserve currency because of lingering resentments of Japan that go back to World War II. And Japan – the Chinese mentor for running trade surpluses – wouldn't be willing. So de-Americanizing in the end would mean ceasing to run trade surpluses with the U.S. and abandoning mercantilism. Although the ruling elite in China evidently thinks it benefits from a mercantilist policy, it seems likely that the bulk of the Chinese population would ultimately benefit from a system in which more of Chinese production stayed home and imports were less costly to obtain. More of the population might then enjoy the flat screen TVs and cell phones they currently produce in exchange for U.S. Treasuries.

There is no natural law that the U.S. has to run a trade deficit or that its manufacturing sector has to be outsourced abroad. As the chart below indicates, trade was roughly balanced until the 1980s. But the real downward spiral occurred as China came onto world markets in the 1990s.



The Great Recession – which cut back on U.S. imports as consumers and businesses retreated – led to a less negative U.S. net export balance. But the current deficit, about half a trillion dollars, is about four percent of GDP. So a move simply to balanced trade in the U.S. would be far more stimulatory than any other policy applied since the downturn. The job creation would dwarf anything previously implemented. And many of those jobs would be in the manufacturing sector simply because of the composition of U.S. exports and imports.

Now I know that someone out there will want to tell me stories about saving rates in the U.S. (or lack thereof) as the “true” cause of the trade deficit. But anyone who wants to do so will first have to explain how a continuous U.S. trade deficit and the piling up of net liabilities to the world (including China) could occur *and be sustained for as long as it has*. It couldn’t happen unless other countries insisted on running trade surpluses with the U.S., insisted on holding the resulting U.S. liabilities, and – in short – insisted on having an Americanized world economy. When that insistence ends, we will see the end of the seeming natural law that the U.S. must run a trade deficit forever. If China is truly retreating from that insistence, and if it makes the change in policy gradually to avoid a financial panic, both sides of the Pacific will benefit.

Mitchell's Musings 10-28-2013: Train Wrecks, French Connections, and Enrolling in Health Insurance

Daniel J.B. Mitchell

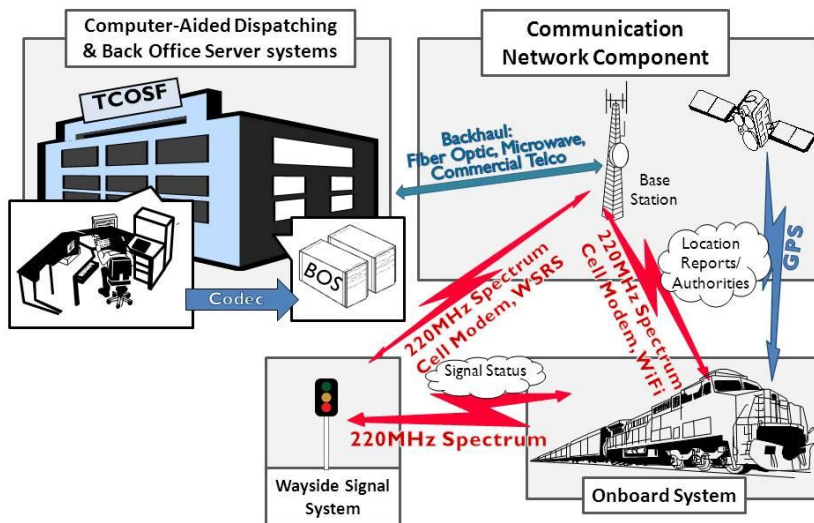
This musing is ultimately about “Obamacare” and its well-publicized website problems. But indulge me for a digression as we get there. On September 12, 2008, a Los Angeles area “Metrolink” commuter train crashed into the back of a freight train. It turned out that the engineer – who died - was texting at the time of the collision and went through a red light. You can hear the resulting 911 call and see pictures of the resulting wreck at: <http://www.youtube.com/watch?v=P39pBlwsbrE>

Not surprisingly, apart from the texting, there were discussions thereafter as why the train was able to go through a red signal. Much of what was said by officials was that eventually there would be automatic safety devices installed to prevent such mishaps. The promised technology went under the name “Positive Train Control.”

Positive train control (PTC) describes technology designed to automatically stop or slow a train before certain accidents occur. In particular, PTC is designed to prevent train-to-train collisions, derailments caused by excessive speed, unauthorized incursions by trains onto sections of track where repairs are being made and movement of a train through a track switch left in the wrong position...

Source: <https://www.aar.org/safety/Pages/Positive-Train-Control.aspx>

Of course, there was no PTC at the time of the accident. According to Metrolink, PTC was very high tech involving GPS (satellites), computers, etc., as the picture below shows. The new technology would have to be made compatible among the various railroads using the tracks and would cost over \$200 million.



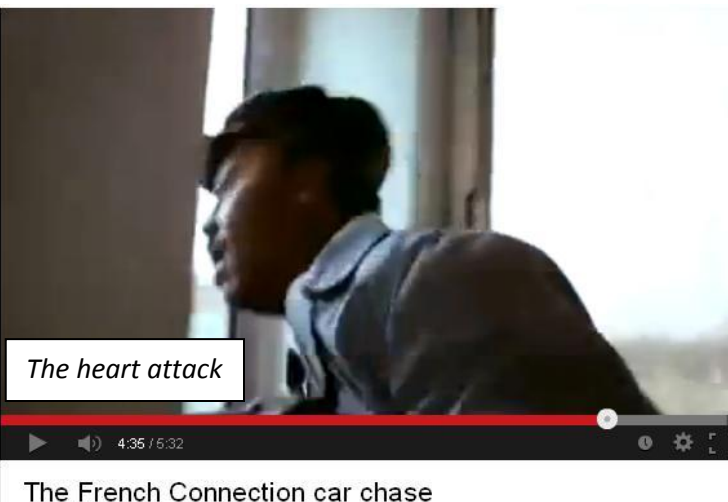
Source: <http://www.metrolinktrains.com/agency/page/title/ptc>

But that explanation was bothersome. You see, when I was in junior high and high school in New York City in the 1950s, I used to take the subway to school and was interested in its workings. One thing I learned about was a “dead man’s throttle,” a spring that would pull the throttle back and bring the train to a halt if the engineer was disabled by, say, a heart attack. Also, next to every signal on the track was a box containing a lever. When the light was red, the lever popped up and, if a train passed over it, the lever would hit a switch under the train that would in turn apply the brakes.

Have you ever seen the movie, *The French Connection*, with its famous elevated train chase scene? You can view that scene at <http://www.youtube.com/watch?v=IzEloJ5venk> . But be aware; there is a certain amount of poetic license in that chase. The Bad Guy commandeers the train:



The motorman suffers a heart attack due to the situation:



But the train doesn’t stop, despite the dead man’s throttle. That’s the first bit of poetic license. Because the train keeps rolling along at top speed (when the snapped-back throttle should have been slowing it down), it eventually begins to catch up with a train ahead and thus runs through a red signal.

At this point, the lever device should have stopped the train. In fact, if you look closely at the movie scene, the upturned lever is actually shown, as you can see below. (Apparently, someone in authority in the New York subway system must have insisted that a safety device be depicted, although the plot requires a collision.)



Despite the lever, which would have applied the brakes to the train (that should have been slowing to a halt anyway), the train crashes. Well, that's Hollywood.

At the time of the real-life Metrolink crash, I alerted various LA-area news reporters to the existence of the 1950s-era springs-and-lever devices that could have prevented the accident. But no one could get a straight answer from the Metrolink powers-that-be as to why it was necessary to await new PTC technology when a simpler, older, existing technology could have worked, at least in the interim. There seems to be an inevitable attraction to using new technology even when an old technology would suffice.

By now, you probably can see the (French?) connection to the Obamacare balky website that has reportedly prevented many people who need health insurance coverage – in part to avoid a tax penalty – from accessing the required information and from signing up. One wonders, for example, how folks originally got their Social Security cards back in the 1930s when that system was created and when there was no Internet. By 1937, payroll taxes for Social Security were being collected, a process which involved not just tax receipts but also tracking the earnings of each covered individual. Telephone? Post offices? I don't know how it was done – but it was. Apparently, it was possible to sign up millions of

people and keep track of their earnings back then. We must have at least 1930s technology available today.

It has been reported that the President wanted the signing up experience for health insurance to be as easy as ordering from Amazon. So just as we can ask why existing spring-and-lever technology couldn't have been used to prevent the Metrolink crash, we can also ask, if the goal of Obamacare was indeed to be Amazon-like, *why Amazon wasn't used?* Why set up a new (better?) system when Amazon already sells more products than there are potential health insurance plans, even in all fifty states. And Amazon provides background information on each product it sells as well as price. I'm sure there are answers to my simple question, just as there were back in 2008 when Metrolink officials were asked about why they weren't using old fashioned springs and levers. But are there any straight answers?

I suspect that in the end, at least part of the answer has to do with managerial structure. If you think of the presidency as a chief executive with (way) too many reports, you begin to understand how a problem like the faulty website could arise. The President is supposed to be on top of the many issues of foreign affairs (Syria, etc.) as well as domestic (budget, debt ceiling, etc.). Too many issues are always in play.

There is delegation of issues to the cabinet. But the cabinet consists of over twenty members, each one with a full set of issues. It's easy for a system of too many reports to become one of "call me if you have a problem." Would you like to be the one who has to make that call, particularly if the problem was one *you* were supposed to be averting? Would you like to be the one to say, Mr. President, the website won't be ready on October 1? It's a system that makes it likely that the President won't find out until October 2.

Now the Fed *is* constrained in various ways by legal requirements imposed by Congress. So there may be legal issues that arise if its assets are below liabilities. But any such constraints are purely artificial for a central bank. Just as the debt ceiling was an artificial legal constraint on the federal government, it is possible to have legal constraints on the Fed that could create a crisis where none need exist. But surely any news analysis of the supposed potential crisis at the Fed should point out such artificial constraints for what they are; legal impediments that can be altered by Congress.

The best you can say for the article is that – as has been pointed out in previous musings – under modern monetary systems, money is ultimately a social convention, something even business news reporters find it difficult to understand. People accept “dollars” because they know other people do. Paper dollars come with impressive signatures and official-sounding statements (“this note is legal tender for all debts, public and private”), and pictures of dead presidents. The dollars in your checking account are simply promises to give you dead-president pieces of paper if you ask for them.

You can say that such money isn’t “real” and needlessly fret about it. Such angst is a unique American trait, at least in some circles. You never hear about anyone in Japan fretting that the yen isn’t real. No one in Britain frets that the pound isn’t real. There are complaints about monetary policy in the euro zone, but no one frets that the euro (which was created quite recently) isn’t real.

I’m not sure what “real” means, but it is probably best to say that money is real because people believe it to be so. It may be bothersome for you to say such things about something that people strive to obtain. They work hard for it. Some even steal and murder for it. But that’s the system and there it is. The only thing that isn’t real for sure is an impending Fed crisis – unless someone wants to manufacture one.



Mitchell's Musings 11-11-13: They Laughed at [fill in the name]

Daniel J.B. Mitchell

Back in the 1950s, I recall reading an article about some kind of new flour that was to be made out of cellulose. You could bake all kinds of tasty things with it, but it would pass through your system without depositing a calorie. It would thus revolutionize eating, dieting, etc. Then I never heard any more about it. But much later came Olestra, a kind of fat you couldn't digest that was also going to revolutionize eating and end obesity. It would pass through you just like one of those cellulose cookies. Only problem, it turned out, was that Olestra gave a minority of folks the runs. How could you find out if you a member of that Olestra-intolerant minority group? The main way to find out was to eat something made with Olestra and see if you got the runs. Let's just say Olestra was not a smashing success (although for some consumers it was a dashing success).

Of course, you would not want to be remembered as someone who predicted the success of some supposed great innovation like calorie-free foods that failed. But you do have some protection in such a case. If something failed, in time people will forget it ever existed and your prediction of its success will also therefore be forgotten.

Nonetheless, it would be better to have predicted that some new innovation would succeed and then actually have that innovation do just what you said. Best of all would be to predict that something new would succeed while others predicted it would fail – and then *you* turn out to be right! People will remember such minority predictions and your career as a futurologist is assured if you can score one.

As I see it, therefore, predicting that things will succeed has asymmetrical rewards that tilt toward being an optimist about innovations. We all know the phrase, "they laughed at [fill in the innovation or innovator]" as the comeback to any skeptics. There's even a Gershwin song that features it: <http://www.youtube.com/watch?v=TdLm9qRRdh4>. Keep predicting optimistically and eventually you will hit on something that does succeed. And people will remember that forecasting success.

I thought of this asymmetry while reading a recent piece in the *New York Times* predicting how online learning was going to revolutionize universities.⁸ The title: "Innovative Imperative: Change Everything." Clearly, that's an attention-grabbing title. Not only does the title grab attention; one of the authors was a Harvard (!) professor. And, again, the piece was published in the *NEW YORK TIMES* (!). So there is hardly room for debate. But let's try.

In many cases, innovations succeed but do so over a long period of time. And the end result may simply be a modified version of what we already have. Indeed, the odd part about the *New York Times* piece is that it starts with anecdotal information on shipping. It notes that the first steam engine on a boat came along in the early 19th century and that eventually there were ships with both sails and steam engines in a hybrid format. Finally, there was just steam. But as the authors point out, the process of

⁸ www.nytimes.com/2013/11/03/education/edlife/online-education-as-an-agent-of-transformation.html

replacing sails with steam went on for decades. Is that really “changing everything”? By the way, eventually those coal-fired steam engines were replaced on ships with diesel engines. Would you call coal-to-diesel a revolution? At the end of the day, there is still shipping which has evolved from sail to coal to diesel.

Some innovations, of course, have a faster impact than steam engines for ships. Some have an impact, but not the one anticipated. There was fear that phonograph recordings would put musicians out of business. In fact, they created new markets for music. Radio broadcasting was thought at first to threaten phonograph records. But by the 1950s we had the payola scandal in which record companies *paid* disk jockeys to play their records on the air to enhance sales.

There is a tendency to think that nowadays, technology is moving faster than it did in the past. But that tendency seems to be part of the modern era, probably going back to the Industrial Revolution. Remember the film “2001” made in the 1960s? By 2001, it suggested, we would be traveling into space routinely in airplane-like conveyances complete with 1960s-style flight attendants (or should I say stewardesses?) coping with weightlessness: <http://www.youtube.com/watch?v=aBKDA11nmHw> . Video calls by travelers could be placed from a phone booth on a satellite back to Earth (using the Bell System): <http://www.youtube.com/watch?v=h2ngWkwbWqs>. Computers would by 2001 be so advanced that they could be malevolent: <http://www.youtube.com/watch?v=qDrDUmuUBTo>.

Note that all of these prognostications were based on an impression of rapid advance in the 1960s. There was the moon-landing program at the time. There were big computers. All you had to do was project these developments ahead.

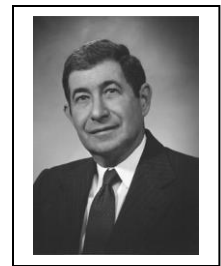
Of course, projecting ahead wouldn’t tell you that although computers have advanced in ways not foreseen in the 1960s, they have not become sentient beings. Sorry, Siri! There is no moon program nowadays, not in the U.S. at any rate. Indeed, the only way we currently can put someone in space is by renting passage from the Russians. THAT would have been hard to foretell in the Cold War 1960s. There was no more Bell System in the real 2001. But there are cell phones. We’re talking about less than four decades between the making of “2001” and its forecast year. And yet there were lots of things to get wrong.

The U.S. Bureau of Labor Statistics (BLS) over the years has calculated “multifactor” productivity indexes which supposedly take account of both labor and capital inputs into private business output. Despite the vagaries and inconsistencies involved, it doesn’t appear that recent trends in technology advance (for which such indexes are a proxy) are outpacing what was going on when “2001” was made. There did seem to be a dip in the rate of advance in the 1970s and 1980s. Various government commissions fretted over the dip in that era. But if there was a dip, it went away.⁹

⁹ Multifactor productivity 1948-73 was said by BLS to have advanced an annual rate of 1.7% in the private nonfarm business sector. [<http://www.bls.gov/opub/mlr/1988/05/art2full.pdf>] The trend bobs around from year to year and is affected heavily by the business cycle so it is best to look at cyclical peaks. From 1990 to 2000, the rate was

So getting back to higher ed, is online education about the “change everything”? It surely will change something. How fast that change will be occurring, I don’t know. Neither do the authors of the New York Times piece. What exactly will be the nature of the change and its effects on the higher ed “industry”? Again, I don’t know and neither do they. What I do know is they can’t go wrong with making an exciting prediction that online ed will change everything. If it works out, they will henceforth be geniuses. And if it doesn’t, chances are no one will remember.

0.9%. From 2000 to 2007 (the last peak before the Great Recession), the rate was 1.4%. [Calculated from <http://www.bls.gov/news.release/prod3.t03.htm>].



Mitchell's Musings 11-18-13: The Strength of Steel

Daniel J.B. Mitchell

Much is currently being written about President John F. Kennedy as the fiftieth anniversary of his assassination approaches. Although there is naturally a great deal of attention to the Cuban missile crisis, in second place as a Kennedy confrontation – but now largely neglected – was the 1962 confrontation with the steel industry – and really U.S. Steel – over a price increase. Kennedy denounced the increase in strong language as inflationary <http://www.youtube.com/watch?v=aAVAJ6mwBVE> and it was rolled back shortly thereafter. But there is more to the story.

We know now – as a byproduct of the Nixon administration's Watergate scandal – that there was recording going on in the White House not only under Nixon but previously under Johnson and Kennedy. The steel incident in 1962 did not end the matter. As a result of the steel confrontation, Kennedy was seen as in conflict with the business community, something he wanted to avoid happening again. Even if steel prices were frozen in 1962 thanks to the confrontation, what would happen in 1963? In election year 1964?

Part of the anxiety about steel prices reflected concern about the U.S. "balance of payments." In that era, exchange rates were fixed under the Bretton Woods system and the dollar was increasingly under downward pressure in exchange markets. Steel price increases were seen as harming exports of steel and other products made of steel (and encouraging imports), thus aggravating the balance of payments problem. And, of course, there was general concern about inflation. You can hear Kennedy and his advisors fret about steel in April 1963 (as the prospect of another price increase loomed) in three parts at:

<http://www.youtube.com/watch?v=XN-6RmagJtg>,

<http://www.youtube.com/watch?v=ukA84gynl8w>, and

<http://www.youtube.com/watch?v=fEMUodE3HEg>.

Despite the poor audio quality, it is clear from the recording that averting a second confrontation with the steel industry was a high priority of the participants. The hope is that some kind of acquiescence to "selective" price increases on particular steel products would avoid a repeat of what happened the year before. If selective prices were raised, that action would somehow be perceived differently than an across-the-board increase.

What brings this episode to mind was a recent release of the transcript of an oral interview with emeritus professor **Lloyd Ulman** of the University of California-Berkeley's economics department by the campus library. Ulman reviews his entire career but starting on page 107, there is extensive material on his recollections of the Kennedy Council of Economic Advisors in the early 1960s, where Ulman was on

leave as a staff economist.¹⁰ He was also involved in researching a book on the United Steelworkers union. The Council at that time featured such luminaries as members as Walter Heller (chair), James Tobin, and Kermit Gordon. Staff members apart from Ulman included Arthur Okun, Robert Solow, and Barbara Bergman.

In the oral history, Prof. Ulman adds an observation that has been missed in earlier descriptions and histories of the Kennedy wage-price guideposts program. Ulman puts that start of the demise of the guideposts as the 1962 steel confrontation. Later histories, including attempts to discern whether the program had any effect on wages and/or prices, tend to put the demise later under President Johnson, who inherited the program. Of course, the program ended up under Johnson only because of the assassination. That fact creates a “what if” question. If Kennedy had not been assassinated, had run for reelection in 1964, and had won, what would have happened to the program?

What Ulman notes is that Kennedy began to refer to the guideposts after the 1962 steel incident as the CEA’s program, not the President’s program. In short, he was not waiting for evidence as to whether the program was effective or not before beginning to disengage from it. Kennedy was certainly aware of the tension with organized labor the program had engendered. Even the president of the Steelworkers union did not support Kennedy in the 1962 confrontation. The rationale for the confrontation was that the administration had encouraged a moderate wage settlement by the union to avoid upward pressure on steel prices but the steel industry had raised prices anyway, thus comprising Kennedy. But the head of the union, according to Ulman, regarded the steel price increase simply as the basis for his next negotiated wage increase and thus saw no reason to denounce it.

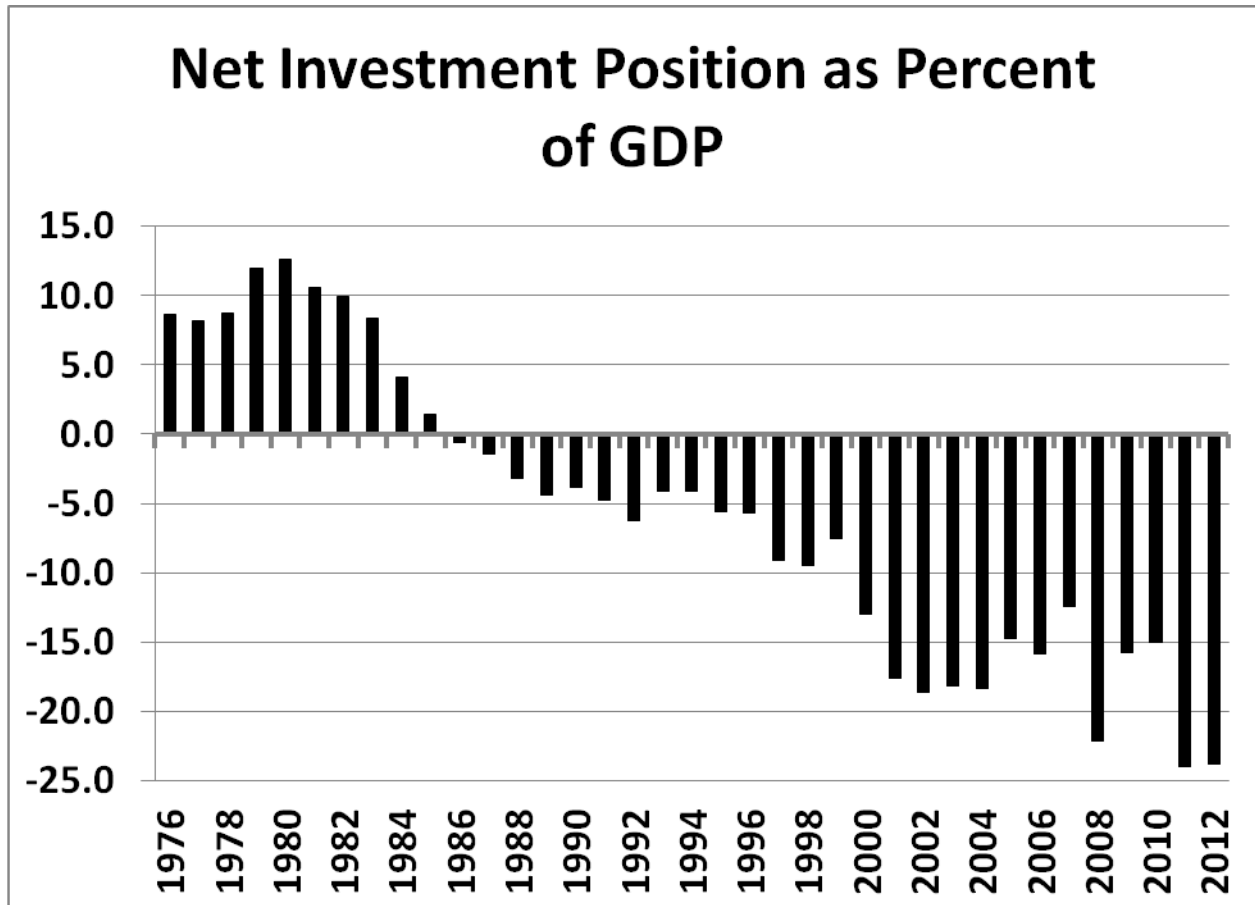
Of course, Johnson did end up inheriting the wage-price program and so it may have survived longer than it would have under Kennedy. Johnson may have believed that his persuasive powers to influence wage and price setters were more effective than Kennedy’s had been. But it seems likely, based on Ulman’s oral history recollections, that the guideposts program might well have faded away faster had Kennedy lived than turned out to be the case.

¹⁰ http://bancroft.berkeley.edu/ROHO/narrators/ulman_lloyd.html. Photo of Ulman on top of first page.

Mitchell's Musings 11-25-13: More Alike on Both Sides of the Pacific Than We Care to Admit?

Daniel J.B. Mitchell

From time to time, we muse about the American “trade deficit.” [We use that inaccurate phrase as shorthand for “net export deficit” which includes service exports and imports as well as goods.] As we have pointed out in the past, and as a recent op ed in the New York Times by Jared Bernstein and Dean Baker emphasizes, the trade deficit doesn't seem to be the deficit Washington wants to worry about. Washington types fret about the federal budget deficit instead.¹¹ Why is that?



When the U.S. buys more in value abroad than it sells (a negative trade balance), it can only do so by running down its net assets abroad and/or going into debt. In that sense, the U.S. – or any country – is like a household spending more than it earns. When Washington types fret about the federal deficit, they point to what they see as a problem of the government spending more than it takes in. Let's put aside the question of how much a problem the federal deficit actually is. And let's simply note that it is inconsistent to worry about the federal government spending more than its revenue inflow and yet be

¹¹ www.nytimes.com/2013/11/07/opinion/taking-aim-at-the-wrong-deficit.html.

unconcerned about the nation as a whole doing the same. If your thing is to worry about situations in which inflow < outflow, you should worry about both deficits.

As the chart on the previous page shows, the U.S. became a net debtor to the world in the mid-1980s and the tendency has been to increase the net debt. Each annual trade deficit adds to the debt, although due to exchange rate fluctuations (which affect the dollar valuation of U.S. assets abroad but not the valuation of foreign assets held in the U.S.), the descent into more and more net debt is erratic although unmistakable. If there were some U.S. policy in effect aimed at halting or even reversing the trend, it has yet to be apparent.

Now it might be argued that it isn't true that Washington types are unconcerned about the trade deficit. You can point to various politicians who complain about exchange rate manipulation by China, Japan, and other countries that they see as contributing to the U.S. trade deficit. But while we have sequesters and even government shutdowns ostensibly over concerns about the federal deficit, what *actual* actions can you point to on the trade deficit apart from talk? Other than rhetoric, you really can't point to a specific effective policy aimed at the trade deficit that has ever been implemented.

In the 1980s, we complained to Japan - and not much happened. More recently, we have complained to China - and not much happens. From time to time, members of Congress press the President to do something – and not much happens.¹² It's all talk.

It is sometimes said that doing the same thing over and over again and expecting a different result is insanity. But it is unlikely that those making rhetorical complaints do expect a different result. So if they don't expect a different result, it is hard to avoid the conclusion that what they want is to be on record as being against currency manipulation – or maybe just against foreign competition – without really wanting any change in outcomes.

I recently attended a lecture on the outlook for China by my UCLA colleague, Matthew Kahn. Essentially he argues that despite its lack of elections as a channel for the Chinese population to voice complaints over such issues as pollution, food safety, and other ills of China's economy, there are nonetheless incentives within the system for addressing those issues by the powers-that-be there.¹³ Economists might argue against the kind of modern mercantilism China is engaged in – exporting goods to accumulate more and more paper claims on the rest of the world, particularly the U.S. – is not a sound policy for China. But from the viewpoint of Chinese rulers, the system is working well enough. If it ain't broke, etc. Moreover, in many respects, China can be seen as emulating Japan, a country that moved

¹² <http://touch.latimes.com/#section/1780/article/p2p-77566070/>.

¹³ You can hear his lecture in two parts. Part 1: <https://www.facebook.com/photo.php?v=1436944333192023&l=2017861003521192905> and Part 2: <https://www.facebook.com/photo.php?v=1436945526525237&l=9082582019982392093>.

from feudalism in the 19th century to a prosperous modern economy while at least since the 1970s practicing mercantalism.¹⁴ Maybe the Japanese could have done it better without practicing mercantilism, but who can be sure?

So let's look at the picture from the American viewpoint. Is there a need to worry about the trade deficit and mounting debt to the world? At the present time, when unemployment is high, improving the trade balance would likely produce a jobs stimulus that exceeds anything done by fiscal policy after the Great Recession. Many of those jobs would be in the distressed manufacturing sector which is disproportionately engaged in trade, both on the export and import-competing side. In the short run, therefore, there would be a macro benefit in terms of job creation.

In the longer term, let's suppose there is a return to something like full employment. Then the effect of the trade deficit is not so much on the total *number* of jobs but on the *kind* of jobs. Good jobs in manufacturing are depressed. Other jobs in sectors such as retail trade are enhanced. There is an exacerbation of income inequality.

Finally, there is a financial risk in hoards of dollars held abroad. The best scenario would be that eventually, even mercantalists become less and less willing to trade real goods for paper claims and, as a result, the dollar gracefully declines in value, exports are stimulated, imports are discouraged, and trade becomes balanced. The worst scenario is a run on the dollar putting at risk big financial institutions that have bet on the idea that the trade deficit and mounting dollar debt can go on forever.

If it turns out that there is a sudden, unexpected fall in the dollar and some big institutions have their assets in dollars and their liabilities in something else, they are in trouble – and so are we, as we learned in 2008. Is that an experiment that you would like to run? Smart policy would be that even if it *might* be broke, it is worth fixing it.

Of course, all of these arguments assume that there are options to do something about the trade deficit and the growing net debt. Usually, to the extent there are suggestions of policies that might address the problem, they are based on some kind of bilateral threats. We threaten to impose tariffs or otherwise limit imports from China if they don't revalue their currency by X percent. Up by twenty percent? Thirty percent? But when such actions are proposed, they are seen as protectionist, China-bashing, and antithetical to other American interests such as inducing China to be helpful with regard to North Korea, or Iran, or some other foreign policy concern. So a feasible policy needs to be country-neutral, i.e., not aimed at some specific country. It needs to be simply focused on the U.S. trade balance with the rest of the world as a whole.

¹⁴ Lest it be argued that the large reserves built up by Japan are some kind of rainy day fund, note that the rainy day surely arrived with the earthquake-tsunami-nuclear disaster. Yet there was no real drawing on the reserves. Indeed, we had the spectacle of charitable Americans wanting to send monetary aid to Japan when the one thing Japan didn't lack was dollars!

As we have noted in previous musings and in other forums, such a policy *was* suggested back in the 1980s by no less an advocate than financier Warren Buffett in an op ed that appeared in the Washington Post.¹⁵ At the time, the trade deficit villain *de jour* was Japan and what Buffett proposed was a market mechanism of getting to balanced trade without engaging in Japan-bashing or even singling out Japan. You can view his proposal as a variant of what is now termed “cap and trade.”

Under the Buffett plan, anyone who exported a dollar’s worth of whatever from the U.S. would get a voucher entitling the exporter to import a dollar’s worth of whatever from abroad. The exporter could use the voucher directly or sell it in the open market to some importer. A market would develop for such vouchers.

If you do the math, the resulting combination of the market price of the voucher and the prevailing exchange rate is whatever exchange rate would be needed to produce balanced trade. But anyone is free to import whatever from wherever so long as they acquire the required vouchers. No country is singled out. There is no need to do a bilateral deal on exchange rates with anyone or try to guess what exchange rate would do the trick. There are no threats aimed at a particular country. The market does the trick.¹⁶

So why has some variant of the Buffett plan not been implemented? It’s not really complicated to explain the plan. It was published in the Washington Post, so it’s hard to argue that it is unknown to Washington types. Possibly, the elites have bought into a simple notion that because things are cheap in China, there is a natural order of things that says they should produce and we should consume (and pay on credit). This approach is a strange version of comparative advantage, i.e., the Chinese are good at producing and we are good at consuming so we naturally do what we are good at.

A more likely explanation is that in our political system, those who have been hurt by the loss of jobs and those who would benefit from balanced trade simply don’t have much voice in our system, despite the fact that we have elections (unlike the Chinese). There would be *some* costs in rolling out the Buffett approach and administering it. The costs are not great; we review incoming imports for tariff purposes and have various export controls for national security reasons. But although the costs would not be great, apparently it’s not worth dealing with those costs under current political arrangements. There is not much incentive politically for those in charge of making U.S. policy to address the trade issue.

In the end, there is a symmetry on both sides of the Pacific. In China and Japan, even if mercantilism might not be the best approach, it seems to be “working” for now. So there is little pressure internally to change course from their perspectives. In the U.S., borrowing to pay for net imports seems to be working for now and those folks adversely affected in the domestic labor market aren’t making trouble.

¹⁵ https://docs.google.com/document/d/1SFilSDsdphrQS0Q_x0mREd7kHuliVbKNSrni1MRBCwE/edit?usp=sharing.

¹⁶ Note that the impact could be phased in gradually. Initially, a voucher might allow \$1.20 of imports. Sometime later, vouchers might allow \$1.10 of imports. Then they might go to \$1.00.

Moreover, there are always stories around that the problem is taking care of itself; production is coming back to the U.S. under the rubric of “in-sourcing.” The news media lap up such stories and they are good PR for retailers, as the picture below illustrates. So let someone else in the future deal with the issue.

Maybe we are more alike on both sides of the Pacific than anyone cares to admit.

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Mitchell's Musings 12-4-13: Leadership and Accomplishment: There Must Be Both

Daniel J.B. Mitchell [Note: Date should have been 12-2-13 above]

There was much ado about President John Kennedy on the 50th anniversary of his assassination a couple of weeks ago. It is interesting that the key date involved in the celebrations was the assassination anniversary rather than either his birthday or the date of his election.¹⁷ Note that Lincoln's Birthday is what appears on calendars – or did until we combined it with Washington's Birthday and placed it into an all-purpose Presidents' Day. Lincoln was assassinated, too, but no one celebrates that date. The explanation in the Kennedy case can't be the most people still remember the assassination since the median age of the U.S. population is currently about 37. Despite the repeated phrase that everyone remembers where they were when they heard of the assassination, most people weren't anywhere.

The oddity of the assassination-celebration is not the only peculiarity I observed. Among the various op eds that appeared was one by Richard Reeves which was published in the *Los Angeles Times* and probably other newspapers.¹⁸ Reeves notes that many people - when asked - rank Kennedy up with major presidents such as Lincoln, despite Kennedy's lesser importance. But the thrust of Reeves' article was that Kennedy, despite the short duration of his presidency, was a near-great. Nonetheless, the key point of the op ed seemed to be in the three sentences below:

...But image counts, and so do words. Kennedy, like Roosevelt and Ronald Reagan, understood that words and images are the way to reach millions of people. The president's job is to lead the nation, not manage the government, which is unmanageable. Nobody remembers whether Lincoln balanced the budget...

Let's note that while nobody remembers whether Lincoln balanced the budget, everybody remembers that he won the Civil War. Lincoln didn't only lead in the sense of having an agenda; he accomplished his key goals of maintaining the union between north and south and of abolishing slavery. The idea of leadership independent of accomplishment is simply ludicrous. And, by the way, what does it mean to say that the government is unmanageable? Lincoln apparently managed it well enough to win the War. Difficult to manage is not the same as unmanageable. The op ed confuses leadership in Reeves' sense as a necessary quality with leadership as necessary *and sufficient*.

I found a far more balanced view of Kennedy and of his times recently – a view which interestingly enough appeared only a few days after the assassination when there was far less time to reflect on the Kennedy presidency. There was no benefit of hindsight. New York radio commentator and humorist Jean Shepherd deviated from his standard program format on November 25, 1963, and noted that

¹⁷ The election date is particularly of interest since it wasn't clear until well into the next day that Kennedy actually had been elected: <https://www.youtube.com/watch?v=il8T0y96LXU>.

¹⁸ www.latimes.com/opinion/commentary/la-oe-reeves-kennedy-legacy-20131121,0,5185516.story.

people often impute more control of events to the president and other political leaders than they actually have.¹⁹ So it is difficult for top officials to accomplish their goals, but not impossible.

The Reeves confusion between necessary and necessary-and-sufficient is unfortunate, whether we are talking about leadership in government – federal, state, or local – or leadership in private organizations. Clearly, micro-management from the top doesn't work in large and complex organizations. But there needs to be some mechanism put in place for the leader to monitor whether things are getting done or not. There needs to be some recognition going into the top job that ordering that something be done is not the same as getting it done. There needs to be monitoring and auditing and incentives for outcomes. There needs to be a recognition going in that underlings are not going to want to be bearers of bad tidings. Absent those basic elements of sound management, leaders who just inspire or who only shape opinion - but don't achieve - are lacking something fundamental.

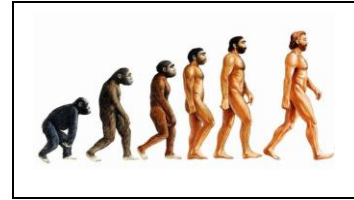
I suspect the confused vision of leadership expressed in the Reeves piece is more widespread than just with regard to Kennedy, or to presidents generally, or to top leadership in the public sector at any level. There is a mistaken view that the scut work of administering and producing is unimportant and that "anyone" can do it. Maybe some of it can be done by "anyone," but only if the incentives, monitoring, and control systems are in place and are operating. A great leader must find a way to make it happen. In the Kennedy case, for example, we know for sure it didn't happen in the case of the Bay of Pigs fiasco.

Of course, the Bay of Pigs was a form of on-the-job training for Kennedy. The Shepherd broadcast, made right after the assassination, suggests that Kennedy had learned about the strong limitations of the idea that what the president wants is what the president gets and that Kennedy had become a "realist." If so, Kennedy would likely have agreed with the view that what would have happened after November 1963 to Civil Rights legislation and other concerns of the era had he lived simply cannot be known.

¹⁹ I have posted the program in three parts at <https://www.youtube.com/watch?v=QUZVRu6fIOM>, <https://www.youtube.com/watch?v=94Z-utTByHA>, and <https://www.youtube.com/watch?v=D1otmAjAUlo>.

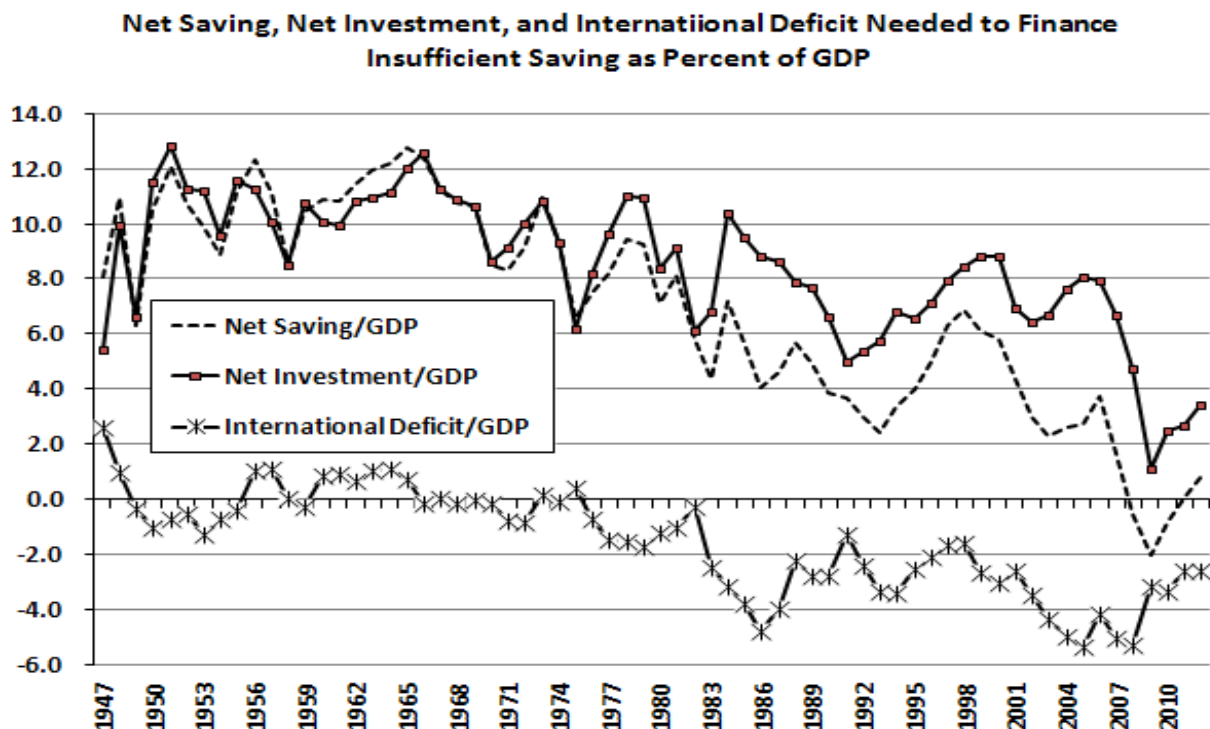
Mitchell's Musings 12-9-13: The Missing Link

Daniel J.B. Mitchell



I attended the quarterly UCLA Anderson Forecast conference last week which dealt with the economic outlook for the U.S. and California, as it always does. However, the Forecast usually contains an additional theme and this time that theme was the inadequacy of U.S. saving rates as the baby boomers retire. The discussion was familiar. Boomers did not save enough. They have created *de facto* and *de jure* liabilities for their children and grandchildren as a result. Much of the discussion revolved around Social Security, Medicare (a more dramatic issue), and state and local pension systems (against the background of the Detroit bankruptcy and possible cuts in city worker pensions there).

There was reference to stagnant real wages over the past decades which mean that the burden for younger cohorts of caring for “grandma” will be greater than it would have been had real wages advanced. (“Grandma” was the appellation used at the conference, presumably since women outlive men.) Prominently featured in the discussion was a chart - similar to the one below but showing only the top two lines. Essentially, the take-away message from the chart was that to a large degree net investment (gross investment minus depreciation) follows net saving (gross saving from all sectors – households, businesses, and government – minus depreciation). The move to more-or-less zero net saving means that the U.S. will have a smaller capital stock (via reduced investment) so that the economic base for caring for grandma will be smaller than it would have been under a high saving/high investment scenario.

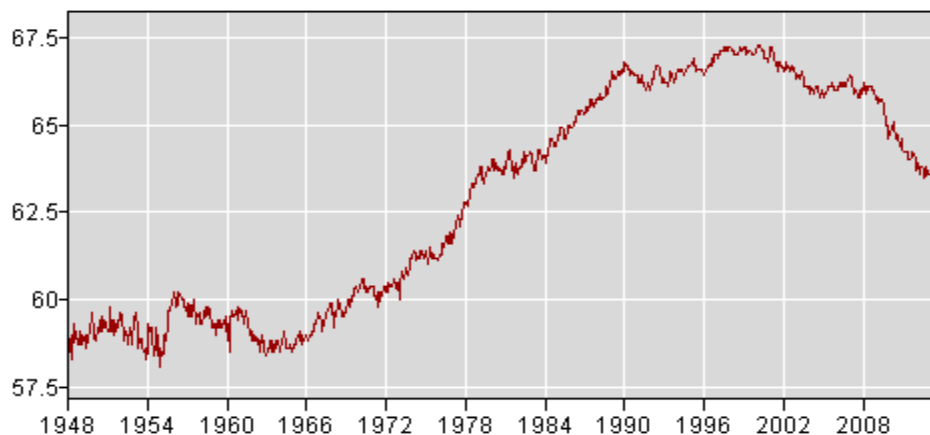


All of these concerns are legitimate but there is a missing element that links them all together. Let's start with the question as to why saving rates seem to be inadequate in a search for a missing link. And let's note that in a closed economy (no international trade possible), the saving rate and the investment rate would be the same. Saving is the putting aside of a portion of income not used for immediate consumption. Investment goods are therefore what you get when some of national income is not immediately consumed. But the U.S. is not a closed economy and so, as the chart shows, it is possible for saving and investment to diverge (even though they tend to exhibit similar trends and fluctuations) because you can also get goods from abroad, goods that are not produced domestically.

In crude and not entirely accurate terminology, you can finance more investment than your national saving would provide by buying more from abroad (importing) than you sell (exporting). Of course, to do so, you have to run down (spend) claims on the world that have previously accumulated and/or borrow from the world to finance your international deficit. And we know, as discussed in prior musings, that the U.S. has been doing just that to varying degrees since the early 1980s. The end result is that the U.S. is the world's biggest (net) debtor. The third line down on the chart shows the international deficit that the U.S. has been running to finance the gap between investment and saving as a percent of GDP.

That observation opens up two questions. First, why has the U.S. had inadequate saving? Second, why has the world permitted such borrowing? As indicated, real wage stagnation was mentioned in the conference. Note, however, that households could maintain consumption standards and even improve them by working more. In fact, labor force participation until the early 2000s had been rising during the baby boom era as indicated on the chart below. The increase was the net of female participation rising and some fall in the male rate. However, the capacity to increase overall participation lost steam in the 1990s, and the soft labor market following the Great Recession clearly reversed the trend.

Labor Force Participation Rate



In short, labor force participation increases provided a partial route to keeping up consumption which has now evaporated. The other route to keeping up consumption is borrowing which from a national perspective means borrowing from the rest of the world (and concomitantly importing more than we export). So we are back to our second question of why the world permits such ongoing borrowing.

Part of the answer, as we have noted in prior musings, is that certain other countries for varying domestic reasons keep their exchange rates low to run export surpluses with the U.S. Such policies mean that they have to accumulate claims on the U.S. (i.e., lend to the U.S.). Part of the answer is that the U.S. dollar became the principal world currency after World War II and that even with the end of the postwar Bretton Woods international monetary system in 1971, the dollar and dollar-based assets are still seen as advantageous to hold.

Note also that it is likely that the continuous U.S. trade deficit has tended especially to displace manufacturing jobs in the U.S. which at one time were the source of relatively high and rising real wages, particularly for workers with less than a college education. So real wage stagnation, international trade, and too-low saving rates are really not one-by-one developments. They are all part of a larger system which provides the missing link(s) we are seeking.

As at the Forecast conference, the popular tendency has been to blame baby-boomer “grandma” for being selfish and for not saving enough. But as the discussion above suggests, in fact grandma did what she could to offset wage stagnation and the decline in (often-male) manufacturing jobs by increasing her labor force participation. As the U.S. became a borrowing society, boomers (male and female) were facilitated in their debt accumulation by innovations such as credit cards, payday loans, and other financial devices. They were offered artificially cheap foreign goods to consume. Foreign lending to the U.S. helped hold down interest rates, also facilitating household borrowing and borrowing by other sectors. The U.S. *could* have followed policies that didn’t lead to its ongoing borrowing from the world, but it didn’t. Had it done so, perhaps real wages wouldn’t have been quite so stagnant. Perhaps the boomers would have saved more.

Grandma didn’t make those policy choices. She probably wasn’t even aware of them. So if you are looking for someone to blame, look elsewhere. And when you do, try focusing on policies that would reverse the U.S. trade deficit.



Mitchell’s Musings: 12-15-13: History Lesson

Daniel J.B. Mitchell

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Note: Last week’s musing was mistakenly dated 12-23-13, i.e., a week ahead. So I am backdating this one to the missing date of 12-15-13. There was also a misdating of the musing for 12-2-13 as 12-4-13. In keeping with the theme of the musing topic below, however, I won’t try to alter history to correct that one.

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During the communist period in Eastern Europe, I remember hearing about a joke told in one country – I can’t remember which one – that played off the communist theory or ideology that history would eventually produce some sort of utopian, cooperative society. The joke also played off the tendency to rewrite the past as particular figures - from Stalin on down - went into and out of favor. The joke went something like “the future is fixed; it’s the past that keeps changing.”

Actually, however, the tendency to change history was not/is not confined to Eastern Europe. It is a virtually universal temptation, particularly when the history involved was unpleasant. There was substantial rewriting of history in the U.S. after the Civil War. You can see it in Hollywood depictions of the south ranging from *Birth of a Nation* (1915) – which glorified the Ku Klux Klan²⁰ and helped to reestablish it – to *Gone with the Wind* (1939) - with its romantic images of slavery.²¹

Although the tendency to rewrite history is ubiquitous, at least the practice acknowledges that there is a history to rewrite. Nowadays, however, there is a tendency to pretend that either unpleasant history didn’t happen or just to be ignorant of it. Recently, *Inside Higher Ed*, an online journal of events in higher education, ran the following brief article:

Sacramento State Leaders Question Art Based on Lynching

December 17, 2013

Alexander Gonzalez, president of California State University at Sacramento, has asked for a review of policies on the public display of art, following a controversial student artwork on the theme of lynching. In the piece, two white students were suspended from a tree in a way that made it appear they had been lynched. The idea was to present lynching without black victims. In a note to the campus, Gonzalez said that he does not think that the students' intent was to incite people, but that they had upset many. "I think that as members of a very diverse university community, it is our responsibility to always be mindful and respectful of cultural sensitivity in our pursuits and activities," he said.²²

²⁰ <http://www.youtube.com/watch?v=B-znj3TTCFM>

²¹ <http://www.youtube.com/watch?v=FZ7r2OVu1ss>

²² <http://www.insidehighered.com/quicktakes/2013/12/17/sacramento-state-leaders-question-art-based-lynching>

The art project itself – apparently some kind of performance art – can be seen at <http://thecampusculture.com/2013/12/15/artist-lynching-display-on-campus-was-art-meant-to-bring-awareness-to-social-justice-and-racial-inequality/>. The creator of the project responded to President Gonzalez as follows:

I am the artist Christina Edwards, a current senior at Sacramento State University. This is my response to the President's Update letter dated December 14, 2013. On December 4th 2013 on the Sac State campus I created a performance/installation [*sic*] as part of my series entitled Restitution. Although my art was displayed on campus property my self-expression in artistic form is not representative of the beliefs and ideals held by the University as an institution. Additionally the volunteers were chosen solely for artistic purpose.

I followed every procedure that was made known to me and given verbal approval from facility services in order to create this visual installation [*sic*] safely on campus. I took all necessary safety precautions and utilized a professional person to create all props used. Additionally, the ropes and harnesses remained visible at all times to insure the safety of the volunteers and reduce the assumption that there was any real immediate danger. I choose to express my art in a way that resonates with me, but I did not intend to offend anyone in or outside of the project. The purpose of this performance was to bring to light social injustices and the issues of inequality that impact me and my community as a whole. As a young African American Woman, I feel that not enough has changed in society in terms of racial and social equality that allows for true equal opportunities.

The goal of my art was to capture the community's response while witnessing a visual display of the historical fact and tragedy of the process used to murder African American males in the United States of America, by way of lynching...²³

There are some history lessons here that perhaps President Gonzalez is either not aware of, or not acknowledging. In particular, the use of whites in place of blacks in discussion of lynching goes back to the *Gone with the Wind* era. In the film *The Ox-Bow Incident* (1943), Hollywood did make an anti-lynching statement. However, the statement was disguised. Rather than place the film in the south, the story makers made it a western.²⁴ And the victims are whites (one is Mexican) who are hanged for stealing horses, a crime of which they are in fact innocent. The only hint that the story might have anything to do with the south is that one of the ringleaders in the lynching is a southern Civil War veteran. (When he discovers the hanged men were innocent, he commits suicide.) A political backdrop of the film was southern opposition to various anti-lynching laws in Congress at the time.²⁵ You didn't have to be very clever to see through the disguise.

Apart from the ignorance of, or non-acknowledgment of, the artistic history that was revealed at Sacramento State University, there is also ignorance of events in California that occurred not all that far from Sacramento involving the lynching of two white men:

²³ <https://docs.google.com/document/d/1E2V4tZ3DxUhXpTvfq1t87mEbWg7yXzZIFNGaURwNlcw/edit#>

²⁴ <http://www.youtube.com/watch?v=UIDfzCzdjcs>

²⁵ In 2005, the U.S. Senate apologized for not passing an anti-lynching law in the earlier era.

*“(T)he people of San Jose, CA decided to take the law into their own hands. Thomas Thurmond and John Holmes were being held in connection with the kidnapping and murder of 22 year old department store heir Brooke Hart. The townsfolk, already enraged by the nature of the crime, whipped themselves into a frenzy when rumor spread that the two men were going to try an insanity defense. On the night of November 26,(1933,) they stormed the jail, broke down the door, and took the two men. The crowd brought them to a nearby park, where they (hanged) each man from a tree. No one was ever prosecuted for the lynching. In fact, **California Governor James Rolph, who had refused the Sheriff's request for National Guard troops to hold off the mob, praised the action and promised to pardon anyone charged with the lynching.**”²⁶*

Subsequently, newsreels reported on the event. See <http://www.youtube.com/watch?v=dLRMfyI5KEI>. But locally, the event was broadcast live on the radio in San Jose. Note that the local undersheriff states in the newsreel that his officers refrained from shooting at the mob because of the presence of women and children in it.²⁷ While the art project at Sacramento State may have been disturbing to some, photos of the actual San Jose lynching are far more disturbing. [Caution before you click.] <http://chewhatyoucallyourpasa.blogspot.com/2012/08/california-lynching.html>

It is often said that the only lesson from history is that we don't learn anything from history. But if we don't even know our history, we don't even have the option of not learning from it.

²⁶ <http://armedrobbery.blogspot.com/2010/11/this-day-in-crime-history-november-26.html>

²⁷ Note that in the case of a second lynching described in the newsreel which took place of a black in Missouri, the governor in that state was reported to be outraged by the event, in contrast to California's Gov. Rolph.

Mitchell's Musings 12-23-13: Attitude

Daniel J.B. Mitchell



Some of our past musings have been devoted to polls and, more specifically, to the perils of asking people about public issues, such as ballot propositions, that they know little or nothing about. In such cases, the opinions reportedly expressed rarely include more than a handful of admitted “don’t knows” when there should be lots of them. And the results are critically dependent on the framing of the question provided by the pollster, who has to explain what the issue is all about. The basic problem is that since polls in which most respondents say they don’t know or have no opinion would not be interesting and would fail to keep pollsters in business.

But polls that deal with general *attitudes*, as opposed to highly specific public policy issues, can be revealing. Sometimes they can reveal truths about another element of public policy on which we have also mused: the collection of economic statistics. Let’s take a widely-cited data series, the Consumer Price Index (CPI).

For many years, the CPI was described as tracking the cost of a typical basket of consumer goods. That description was never wholly accurate, since the basket was periodically changed to reflect shifts in consumer habits. But in recent years, mainly beginning in the 1990s when the index came under criticism as overstating the rate of inflation, methodological changes in the CPI occurred. At that point, efforts were made to account for such behavioral responses to varying prices as substitution (away from items that were becoming relatively expensive). Different weighting schemes and frequent changes in the “basket” were the result.

Let’s put aside the many questions that arise even with the simple fixed-basket approach such as the administration of the data collection process and issues related to changes in the “quality” of the goods in the basket. The more you get away from the idea of a fixed basket being priced over time and move toward trying to account for how people behave, the more you are effectively getting into the measurement of “happiness,” or at least changes in happiness related to price changes.

Note that a fixed basket has a simple interpretation. If the basket consists just of apples and I tell you that in period 1, a pound of apples cost \$2 and in period 2 it cost \$4, then all I am saying is that the purchasing power of the dollar in terms of apples declined by 50% from period 1 to period 2. I am not directly saying anything about how much people “enjoyed” consuming apples in period 1 relative to period 2. Suppose, for example, that between the two periods an official health report indicated that an apple a day keeps the doctor away. A consumer, believing that report, might – other things equal – obtain more enjoyment from an apple in period 2 than in period 1. Trying to take account of enjoyment or changes in enjoyment can become very complicated. In contrast, a simple statement that the purchasing power of the dollar in terms of apples fell by 50% between period 1 and 2 is straight forward.

How do polls come into this observation? The California Field Poll recently asked registered voters about what they thought about life in California.²⁸ More specifically, the poll asked whether California was one of the best places to live, nice – but not outstanding, about average, or a poor place to live. Let’s assume that happiness is at least correlated with believing oneself to be living in a desirable place. And let’s first look at responses over time.

Trend of how voters rate California as a place to live (among registered voters)				
	<u>One of the best places</u>	<u>Nice, but not outstanding</u>	<u>About average</u>	<u>Poor place</u>
December 2013	43%	26	21	8
2011	39%	28	20	10
2009	41%	25	22	9
2007	50%	29	16	4
2003	47%	32	14	7
2002	49%	33	12	5
2001	40%	29	20	10
2000	54%	25	17	4
1997	46%	29	18	6
1994	44%	28	18	8
1992	33%	29	22	15
1991	51%	25	17	6
1989	58%	27	11	3
1985	78%	14	6	2
1981	70%	20	9	2
1977	75%	13	9	2
1967	73%	15	10	2

Note: Surveys prior to 1992 conducted among all adults, not just registered voters. Differences between the sum of each year's percentages and 100% equal proportion with no opinion.

There is a break in the series between 1991 and 1992 (as described in the table’s footnote), but there is clearly variation over time indicated. California was particularly hard hit by the end of the Cold War, which was beginning to be felt as a decline in the aerospace industry by the late 1980s. At that point there is a notable drop occurs in the proportion of folks thinking they were living in one of the best places. Similarly, there is a drop in best-place respondents in the early 2000s (end of the dot-com boom, beginning of the dot-com bust) and again during the Great Recession. Presumably, happiness fluctuated accordingly.

²⁸The basic media release is at <http://www.field.com/fieldpollonline/subscribers/Rls2457.pdf>. More detailed tabulations are at <http://media.sacbee.com/smedia/2013/12/11/17/45/132xz3.So.4.pdf>.

House prices fell after the end of the Cold War and in the Great Recession in California. The housing sector is not easily captured by the CPI which uses a rental equivalent measure that tends to attenuate measured fluctuations. And the dot-com bust seemed to move speculative energy away from stocks and into housing and house prices. It would be hard, therefore, to attribute movements in this proxy for happiness to home price movements. Maybe they reflect labor market opportunity.

The best-place happiness proxy can be viewed in a cross section as well as over time. From that perspective, it appears that a whole range of personal characteristics affect your perception of the goodness of where you live, as the table below shows. The various demographic cuts are inter-correlated so it is hard to isolate specific effects. But the discrepancies are quite dramatic.

How voters rate California as a place to live across subgroups of the registered voter population				
	One of the best places	Nice, but not outstanding	About average	Poor place
Total registered voters	43%	26	21	8
Party registration				
Democrats	53%	26	18	3
Republicans	29%	26	25	17
No party preference/other	43%	26	21	9
Political ideology				
Conservative	32%	27	25	14
Middle-of-the-road	41%	25	23	8
Liberal	59%	26	12	2
Area				
Coastal counties	47%	27	17	7
Inland counties	34%	23	30	11
Region				
Los Angeles County	43%	25	22	9
Other Southern California	40%	31	20	7
Central Valley	33%	21	31	13
San Francisco Bay Area	54%	25	12	7
Other Northern California*	47%	15	27	10
Age				
18-39	46%	28	19	5
40-64	37%	26	24	12
65 or older	51%	21	19	7

**Small sample base.*

Note: Differences between 100% and the sum of each row's percentages equal the proportion with no opinion.

Some of the differences may reflect labor market conditions. Voters in inland areas (which tend to have higher than average unemployment) are less likely than those on the coast to think of California as one of the best places to live. But there are other elements. California has been a consistently “blue” state and in recent years state Republicans have been marginalized. There are currently no statewide Republican office holders and at the moment the Democrats have a two-thirds “supermajority” in the

legislature which means – if they vote as a bloc – they could take actions that require a two-thirds vote (such as putting propositions on the ballot). Apparently, the poll suggests, you feel less good about where you live if your politics are not in accord with those of the prevailing political outcomes. None of this attitudinal difference seems to have much to do with prices. Everyone seems to agree that the cost of living is higher in California than elsewhere, as the poll results below suggest.

	Total registered voters	Democ- rats	Repub- licans	No party pref./ Other	Coastal counties	Inland counties
<u>Cost of living</u>						
Higher	92%	89%	94%	96%	92%	92%
About the same	7	10	5	4	7	7
Lower	*	*	*	*	*	*
No opinion	1	1	1	*	1	1

* Less than 1/2 of 1%

Since perceptions of happiness or well-being or “utility” or whatever you want to call it are quite variable over time, place, political party, etc., there may be complicated differences between how different groups experience *changes* in prices as measured by the CPI. Do you have some magical method of connecting price changes with the subjective experience of those changes by the many subgroups in the population? If not, the kinds of refinement made in CPI methodology over the last couple of decades don’t capture what they purport to capture.

The more you depart from the simple and original pricing-the-fixed-basket idea, the more the making of the CPI looks political. That is not a good perception to have of economic statistics. If you want to cut back on Social Security, there is a political attraction in, say, using the chained CPI rather than regular CPI to index Social Security benefits; the chained version will rise more slowly and save money. You can always justify the decision with a veneer of economic science.²⁹ You can innocently claim just to be capturing how people’s well-being “really” is changing. But “veneer” is the operable word.

²⁹ See the earlier Mitchell’s musing on the chained CPI at <http://www.employmentpolicy.org/sites/www.employmentpolicy.org/files/field-content-file/pdf/Daniel%20J.B.%20Mitchell/MitchellMusings%204-22-13.pdf>.

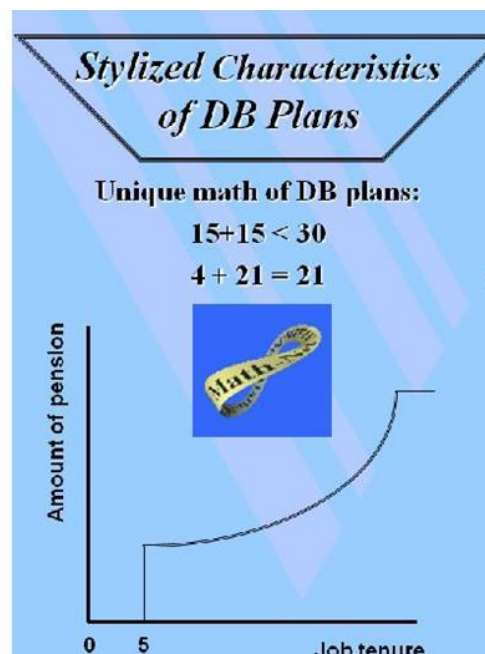
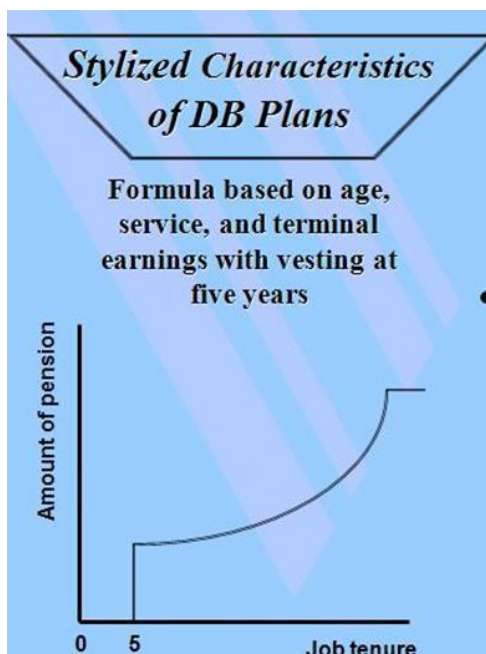
Mitchell's Musings 12-30-13: Ill-Defined Benefit Plans

Daniel J.B. Mitchell

Defined-benefit pensions in the public sector are under attack for creating large unfunded liabilities. Let's put aside the pros and cons of the debate on the scope of the problem. And let's instead discuss a particular commonly-suggested "solution" to those unfunded liabilities.

In some cases, governments have changed the pension programs for new hires but have left the plans for current workers unchanged. That approach is relatively unambiguous as to what it means (apart from whether it is a good idea). In some cases, employee contributions to pensions have been stepped up. There are issues about that approach – both legal and in terms of labor market analysis and personnel policy – but, again, what is entailed is pretty straight-forward. It is easy to understand. The most extreme approach appears to be unfolding in Detroit, where pensions of both current workers and retirees may be cut. Whether that approach stands up legally - or what will happen if it does - is unclear. So let's put the Detroit approach aside, too.

Recently, an initiative was filed in California that would give public employers the right to change (make less attractive) the pension formula for existing employees going forward, but assuring them they could keep the benefits they have earned to date. Whether the group pushing that initiative will actually have or want to spend the money needed to put it on the ballot (typically \$1 million to \$2 million), remains to be seen. However, the approach - rather than that particular initiative - is what we want to discuss since a) it is an approach commonly proposed – not just in California - and b) while it sounds straight forward, it is actually ill-defined and potentially misleading. Specifically, what does "keep-what-you-have-earned-to-date" actually entail? Let's start with two charts I used to show in a labor markets class when defined-benefit pensions were discussed.



As the chart on the left of the previous page indicates, defined-benefit pensions are based on a formula involving age, length of service with the employer, and earnings history (usually focused on final periods of service). The formula determines a monthly annuity. Typically, there is a minimum service period of five years before the employee acquires any claim on the plan (becomes “vested”). The formula is designed to “pay off” for long-service older workers. So “keep-what-you-have-earned-to-date” means zilch for anyone who hasn’t completed the vesting period of five years. Those employees haven’t earned anything in a legal sense. Those employees who have vested, but who have not reached at least whatever early retirement age is set forward in the plan, have earned something – but often not very much.

The chart on the right of the previous page illustrates the consequence of defined-benefit pension math. Imagine working sequentially for two different employers who have the identical defined-benefit pension. (Same formula at both employers.) If you worked fifteen years for one and then fifteen years for the other, you would have a combined pension less than (probably significantly less than) what you would have had if you had stayed with one employer for the full thirty years. So in defined-benefit math, $15+15 < 30$. If you worked for the first employer for four years and then the second employer for twenty-one, you would have no service credit for the first four years (since you didn’t vest at the first employer). So in defined-benefit math $4+21 = 21$.

In this example, presumably our hypothetical worker changed jobs voluntarily. But let’s change the story. Suppose the employee stuck with the first employer for the full thirty years. And suppose sometime during that career, the plan was changed so that the employee was allowed to “keep-what-he/she-earned-to-date” and then was placed under a less generous plan.

It is obvious that the result would be a lesser pension at retirement than would have occurred with the full thirty years under the old plan (since the new plan is assumed to be less generous). But how much less? That is unclear. What does “keep-what-you-earned” under the old plan actually entail? If the change to the new plan occurred in the fourth year of service, it could mean that you earned zero. Or maybe the new plan would recognize service that occurred before. But that recognition is a function of the new plan. So the meaning of “keep-what-your-earned” is ill-defined in that case.

The same ambiguity occurs in the fifteen year case. If you “kept-what-you-earned” for the first fifteen years, what you kept probably wouldn’t amount to much. Furthermore, the new plan, we know by assumption, is less generous than the old. But does it give any credit for years under the old plan? Probably, the new plan would not re-start a new vesting period for existing workers. But what the new plan might be – it might not even be a defined-benefit plan – is independent of “keep what you earned.”

Note that employee expectations and the legalities of “keep-what-you-earned” are not the same thing. An employee in his/her fourth year of service might not have clear expectations of a pension after much longer service. But he or she probably expects at least to vest, i.e., to work another year and have *some* claim on the plan. Too bad, because in a legal sense, the employee has earned zero. Similarly, a fifteen-year employee may well expect to remain employed for a considerable time, maybe long enough to

reach at least early retirement age if not longer. But in a legal sense, what he or she has earned at year fifteen is what he or she could collect after quitting in year fifteen.

These points are nuances that are unlikely to be captured in any public policy debate over public pensions or in political campaigns regarding ballot initiatives. The points may not even be well understood by judges, even judges who themselves are covered by defined-benefit pensions. What typically is reported in the news media is something simple like “employees will keep what they earned but from now on the normal retirement age is 65 instead of 60.” Such simple summaries are incomplete, misleading, and don’t capture what is being proposed. But now *you* know, even if others don’t.³⁰

³⁰ It is always hard to bring attention to complicated public policy issues or even not-so-complicated issues. Some musing readers will recall our earlier musing on “Bitcoins” and the delusions thereof. However, it turns out that simply announcing you will accept Bitcoins has become a new way of obtaining news media publicity. For example, a car dealer recently said it would take Bitcoins (just so long as they quickly convert to dollars at the agreed upon dollar price of the car). Headlines resulted. Now a local candidate for the Newport Beach, California city council said he would take campaign contributions in Bitcoins. And the announcement is seen as newsworthy, too. See www.latimes.com/local/la-me-bitcoin-20131227,0,7624885.story. ***So let it be known that the author of this musing henceforth will be happy to accept gifts of Bitcoins.*** He will also accept stocks, bonds, pork-belly futures, Picasso paintings, and even confederate money (as long as it has some numismatic value).