2011

Blog for
Employment Policy
Research Network

Daniel J.B. Mitchell

MITCHELL'S MUSINGS:
DECEMBER 9, 2010 TO DECEMBER 12, 2011 (FIRST YEAR)

Note: Format may be different from original. Some typo correction included. Originals at employmentpolicy.org

Mitchell's Musings [12-9-10]

Various items cross my electronic desk on a regular basis. (Fortunately, my electronic desk is more orderly than my actual desk.) Here are a few recent items:

Workplace Data on Employment Relations:

Stephen Wood of the University of Leicester has provided an overview of an ongoing British survey on employment relations. A summary is reproduced below. In the U.S., we regularly collect data on employment through the Current Population Survey and related surveys. We capture the basics of employment status, pay, and other variables. However, we do not regularly survey the climate or institutions of employment relations, other than to identify union membership and union coverage. It is left to individual researchers to gather information on employment relations on a one-off, and therefore costly, basis. Perhaps the U.S. needs a version of the British approach.

The Sixth Workplace Employee Survey

Fieldwork for the Sixth Workplace Employee Survey (WERS) begins at the end of January. This flagship study of employment relations in Britain will continue to collect data from employers, employee representatives and employees in a representative sample of workplaces. Its core design is well-established and the majority of questions in the survey of 2004 will remain.

The main objectives of WERS are:

1. To map workplace employment relations in Britain and changes over time.

2. To inform policy development and stimulate and inform debate and practice.

3. To provide a comprehensive and statistically reliable dataset on British workplace employment relations, which is made publicly available and easily accessible.

The structure of the 2011 survey is:

- *A face-to-face structured survey interviews are conducted with the most senior manager at the workplace who is responsible for employment relations and personnel issues will be conducted in a sample of 2,700 workplaces. The sample will combine 1,800 workplaces that are new to the study and repeat interviews at 900 workplaces which were first surveyed in 2004.*

- *In each of the 2,700 workplace a self-completion questionnaire is distributed before the interview to collate information on the basic characteristics of the workforce, and a second questionnaire is left at the end of the interview to assess the financial performance of the workplace.*

- *Survey interviews are undertaken in the same workplaces, with one trade union employee representative and one non-trade union representative where present (approximately 1,000 interviews are anticipated).*

- *A self-completion survey with a representative group of up to 25 employees, randomly selected from each workplace participating in the survey (approximately 25,000 completed surveys are expected).*

These elements provide a three-way linked dataset and a two-wave panel.

Changes from the 2004 WERS include:

- *A reduction in the size of the management questionnaire to increase response rates and reduce costs.*

- *The introduction of the two-wave panel which contains the same questions as the main study through administering the cross sectional instruments in a sample of workplaces first interviewed in 2004.*

- *A major revision of the interview schedule for the worker representative survey.*

Low-Wage Workers

One of the major anti-poverty programs in the U.S. is the Earned Income Tax Credit (EITC). Some states have their own versions of the federal program. My home state of California does not. But, of course, California employees are eligible for the federal program. Essentially, low-wage workers under EITC can receive tax "refunds" that can be larger than what they owe. EITC is a kind of negative income tax, but it is conditional on being employed, unlike other versions of the negative income tax. A recent study for California finds a positive impact on the state's economy from payments to those who claim EITC payments. But it also finds that a considerable number of eligible workers do not claim their payments.

See "The Economic Impact of the Earned Income Tax Credit (EITC) in California"

Antonio Avalos, California State University, Fresno

Sean Alley, California State University, Fresno

The California Journal of Politics & Policy

http://www.bepress.com/cjpp/vol2/iss1/17/

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Not everything that crosses my electronic desk is brand new. I recently received a working paper on self-employment of low-skilled workers by Magnus Lofstrom of the Public Policy Institute of California. It finds that low-skilled males seem to benefit from self-employment. But the opposite is the case for women who seem better off in conventional wage jobs. Yet low-skilled women do enter self-employment, despite the disadvantage, an outcome that the author suggests may be due to lack of affordable child care.

See "Does Self-Employment Increase the Economic Well-Being of Low-Skilled Workers?"

IZA Discussion Paper 4539, October 2009

http://ftp.iza.org/dp4539.pdf

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Income Support for the Elderly

Social Security is the major income support for roughly the bottom third of the income distribution of recipients. With defined benefit plans rapidly disappearing in the private sector, and with public defined benefit pensions under attack, Social Security is becoming the main stable source of elderly income, i.e., a source not dependent on the stock market, interest rates on savings, etc. Social Security benefits are indexed for inflation as measured by the Consumer Price Index. Particularly during the 1990s, there were complaints that the CPI overstated inflation and therefore was artificially raising Social Security costs.

Various changes were made in the CPI as a result to deal with quality improvements and substitution effects. Reducing the rate of CPI inflation – regardless of the merit of those complaints – clearly cuts into Social Security benefits over a retirement lifetime. The longer the life, the bigger the cut. An interesting question is whether the CPI's market basket adequately reflects consumption of the elderly, as opposed to the average worker. A recent NBER working paper suggests that the significance of medical care expenses of the elderly causes the CPI to understate what a elderly-customized CPI would measure as relevant inflation. Thus, elderly purchasing power is reduced as elderly recipients age.

See "How Well Are Social Security Recipients Protected from Inflation?"

By Gopi Shah Goda, John B. Shoven, Sita Nataraj Slavov

NBER Working Paper No. 16212

http://www.nber.org/papers/w16212

And finally, a note without comment from the San Francisco Chronicle, Dec. 9, 2010

Number of the day $1

That's how much less Wal-Mart will be paying in hourly wages to new employees working on Sunday, under a policy change announced this week. Until now, Wal-Mart has offered a Sunday premium of a buck an hour to reward workers for coming in that day. But being open on Sundays is no longer a novelty, and offering extra pay is a declining practice, says Craig Rowley, who works for the retail consulting firm Hay Group. "Today, working retail requires that you work weekends - it's part of the job," he says. A silver lining for current workers: The change will only apply to employees hired after Jan. 1.

Source: http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2010/12/08/BUQT1GNQL9.DTL#ixzz17cwe0nY2

Mitchell's Musings 12-15-10

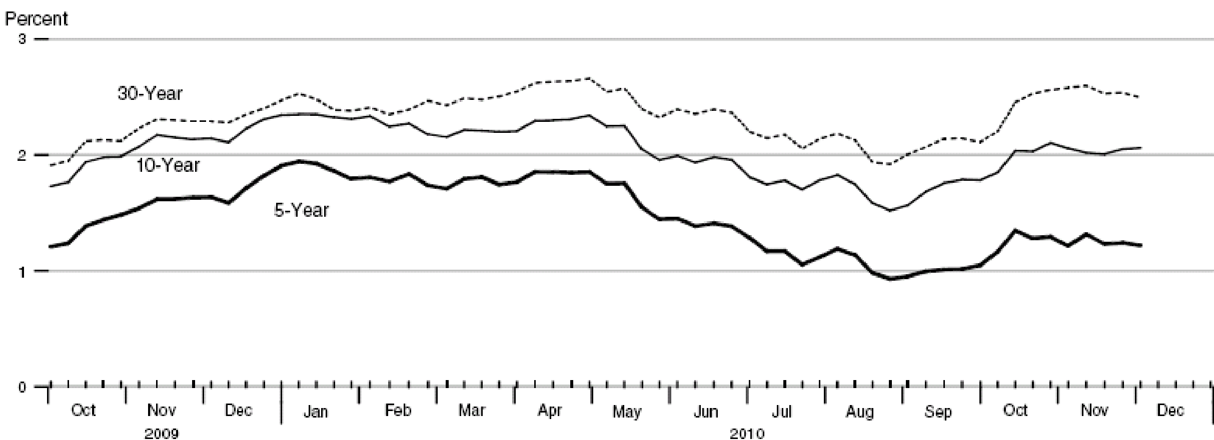
Today's release of the Consumer Price Index reports inflation over the past year (Nov. 2009 – Nov. 2010) to be 1.1%. (http://www.bls.gov/news.release/pdf/cpi.pdf) The "core" inflation rate (omitting the volatile food and energy sectors) for that period was 0.8%. While much could be said about the pluses and minuses of CPI methodology, these are very modest numbers. No one is seriously maintaining that we currently have some kind of hidden inflation problem.

An Inflationary Future?

Rather, there is debate about what current and possible near-term monetary policy (of the Federal Reserve) and fiscal policy (the domain of Congress and the President) might be doing to future inflation rates. There certainly have been complaints that current stimulatory macro policy (including its effect on the federal budget deficit) inevitably is heading us toward some kind of eventual inflationary explosion. Proponents of that view tend to be believers in free markets. So what are those markets telling us about long-term expectations of inflation?

Fortunately, there is a readily-available means of determining what transactors in financial markets believe. The U.S. Treasury issues conventional securities of various durations. These pay a fixed dividend and repay the principal on maturity. It also issues inflation-adjusted securities – known as TIPs - that adjust the principal according to the CPI. The spread between conventional Treasuries and TIPs is essentially the market expectation of inflation over the maturity period.

The Federal Reserve Bank of St. Louis makes available a weekly chart of the spread:



As can be seen on the chart, financial markets currently predict that over the next thirty years, the CPI will rise an average of about 2.5% per annum. Over the next decade, the expected inflation rate is a bit over 2% per annum. And over the next five years, the expected rate is under 1.5%. These are not exactly Zimbabwe-style inflation expectations.

It is true that the expected inflation rates – as measured by these yield spreads - tend to rise and fall with current economic developments. Expectations rose in the past couple of months but they are at the same modest levels seen last spring. At the very least, those who counsel against attempts to stimulate the economy should explain why their expectations of looming inflation are correct and why the financial markets have got it wrong. You can't both say that markets know best and that you know better.

The More General Economic Question

Particularly after the financial meltdown of 2008, there has been a fair amount of soul-searching in economics – especially macroeconomics – about the degree to which the economy can be forecast or about what we really understand about how a complex economy functions. A recent example is an NBER working paper by Harald Uhlig, "Economics and Reality," Sept. 2010. (http://www.nber.papers/w16416) The same issue was raised at the December quarterly economic forecast of the UCLA Anderson School which I attended.

Basically, it was suggested at the forecast conference that those who take strong positions of the op ed variety typically have a pre-determined model in their head or on their computer. The model contains their view of how the economy functions, and – thus – their predictions and advice are based on predilections. That is certainly true, but what is the implication?

Calls for modesty in economic predictions and advice are warranted. But ultimately policy makers do have to make choices. It is always possible to create a scenario in the abstract in which there are inadvertent or perverse consequences of those choices. Nonetheless, choices have to be made.

If I am driving my car and a child darts into the street, my response will surely be to swerve away and hit the brakes. Is there a scenario in which that decision turns out to be a bad choice? Clearly, there is. I might lose control of the car and end up harming more people than if I had done nothing. Whether something worse happens will also depend on how other nearby cars and pedestrians react to the sudden emergency. It is doubtful, however, that most people – confronted by a situation in which a child darts in front of them – would choose the conservative, do-nothing option. Yet in the economic sphere nowadays, there is no shortage of macro advice these days equivalent to saying that it's best to hit the child because doing anything else *might* – under some scenario – turn out to be worse.

The model in my head suggests that the best time to do nothing is when things are fine and no apparent problems are on the horizon. That isn't the case today.

Mitchell's Musings 12-20-10

I have been thinking about <u>take-aways</u> of late. We are all aware of the decline in such components of the employment contract as employer-provided health care. The chart below - which focuses on my home state of California - is one of many of its type that readers are likely to have seen. While there is an evident cyclical effect on the chart of the Great Recession (and of the prior housing boom), the secular erosion is also apparent.

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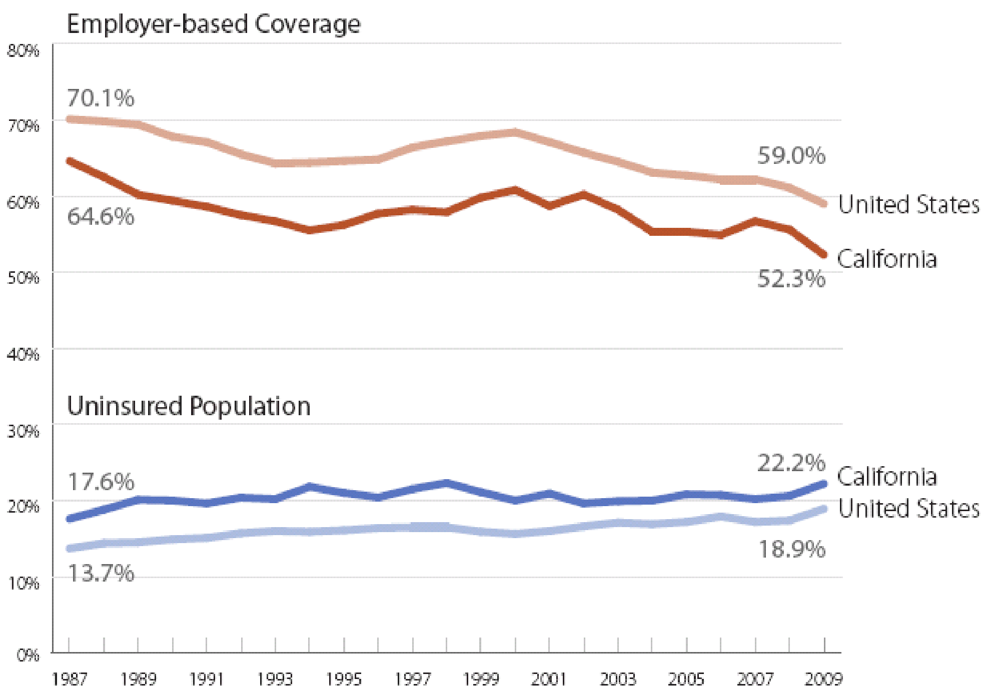
Job-Based Health Insurance Coverage for the Non-Elderly: U.S. and California



*All numbers reflect the non-elderly population, under age 65.

Note: Details may not add to totals because individuals may receive coverage from more than one source.

Source: Employee Benefit Research Institute estimates of the March Current Population Survey, 1988–2010 Supplements.

Source: http://www.chcf.org/~/media/Files/PDF/C/PDF%20CaliforniaUninsured2010.pdf

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But while take-aways from the employment contract such as health insurance and defined-benefit pensions are the targets of various periodic surveys, there are other workplace "perks" that are often unmeasured. Two items from the *Los Angeles Times* and one from the *Sacramento Bee* caught my eye last week.

First, there was the case of the incredible shrinking cubicle:

Office walls are closing in on corporate workers (excerpts)

Businesses used to provide 500 to 700 square feet of work space per employee, but the average is down to 200 square feet — and shrinking. The recession and an emphasis on teamwork accelerated the trend, and younger staffers prefer less.

Roger Vincent, Dec. 15, 2010

The walls are closing in on white-collar workers — their office environments are shrinking, propelled by new technology, a changing corporate culture and the age-old imperative to save a buck. Although personal workstations won't disappear, the sprawling warrens of cubicles and private offices that have defined the workplace for the last few decades are heading the way of Rolodexes and typewriters. The shift is of tectonic proportions, experts on the workplace say. In the 1970s, American corporations typically thought they needed 500 to 700 square feet per employee to build an effective office. Today's average is a little more than 200 square feet per person, and the space allocation could hit a mere 50 square feet by 2015, said Peter Miscovich, who studies workplace trends as a managing director at brokerage Jones Lang LaSalle…

Companies have been gradually dialing back on office size and grandness for years, but the recession accelerated the trend as sobered owners let go of their old floor plans and tried new ways to speed productivity, attract talent and cut costs. There are other factors at play in the push to make work spaces smaller and more communal. Many companies are emphasizing teamwork, and younger employees accustomed to working anywhere but at a desk are turning up their noses at the hierarchical formality of traditional offices.

…Office tenants who renew their leases these days often cut their space total 10% to 30%, according to Jones Lang LaSalle. The term "restacking" has emerged to describe the common process of making offices more efficient by changing the floor layout, reducing paper file storage space and introducing smaller, uniform workstations.

You can find the full article is at www.latimes.com/business/la-fi-office-space-20101215,0,965694.story

> Note that article is at pains to attribute at least some of the take-away of office space to the alleged desires of young workers and the need for teamwork. But I was reminded of a line from Edgar Allen Poe's "The Pit and the Pendulum": *I shrank back -- but the closing walls pressed me resistlessly onward. At length for my seared and writhing body there was no longer an inch of foothold on the firm*

floor of the prison. Maybe that analogy came to me because I am old and tend to work alone. You must admit, however, that even if the Poe reference is too severe, there is at least material for a Dilbert cartoon in the above article.

On the same page, there appeared a second article of note, although it was dated a day earlier:

Office holiday parties are fewer and less elaborate (excerpts)

Shan Li, December 14, 2010

Southern California developer Robert F. Maguire remembers fondly the holiday bashes that once rocked corporate Los Angeles. "We had some wonderful parties that were very exuberant." There was live music and drinks aplenty, in addition to memorable presentations of hors d'oeuvres, entrees and pastries rarely seen at holiday parties today, recalled the man who built the U.S. Bank tower in downtown Los Angeles, the tallest office building in the West.

…It's not that Los Angeles has forgotten how to party. Corporate events for employees, clients, and favored customers are in full swing across the Southland. But in recent years, changing social values and a difficult economy have toned down many corporate holiday celebrations in Southern California and across the nation. Instead, there are more office potlucks, client lunches, charity projects, and holiday snacks with less alcohol flowing.

…Nationwide, 79% of companies will throw some kind of holiday event this year, a 2% drop from last year and down 16% from 2004, executive search firm Amrop Battalia Winston said. It is the lowest percentage in the 22 years the company has conducted the survey. "People have gone through a survival mode, and we still have one of the largest unemployment figures in our lifetimes," said Dale Winston, the company's chief executive. "Companies are starting to do better, but many who aren't holding parties just don't think it's appropriate or don't want to spend the money." …

But the article ends on a high note:

John Challenger, chief executive of outplacement firm Challenger, Gray & Christmas Inc., said it's just a matter of time before corporate holiday soirees make a comeback. "The corporate holiday party scene is going to vary greatly across the country and in different industries," he said. "But, overall, we are probably still a year or more away from a widespread return to the types of festivities held prior to the recession."

Full article: www.latimes.com/business/la-fi-holiday-office-parties-20101215,0,1034840.story

One wonders whether Mr. Challenger's optimism is warranted. Can we also expect cubicles to expand in the recovery? If so, why is there all that talk about a "new normal" that has become so fashionable? As in the case of the shrinking cubicle, the article attributes the decline of the party to "changing social values." Employees, I suppose that phrase means, no longer like elaborate parties. But if that is so, why would we expect a comeback? My hunch is that as in the case of health insurance, there is both a cyclical decline and a secular decline at work and that both are more a matter of cost than anything else.

The third and final news item that caught my eye last week comes from the *Sacramento Bee*. The background to that item was a shopping mall in the Sacramento, California area that burned down after a fire was set by a disturbed individual who barricaded himself inside. Folks wondered why the sprinkler system did not activate and an investigation followed. I'll provide an excerpt of the article below and then pose a simple question.

Galleria worker shut off water, report says

Ed Fletcher and Sam Stanton, Dec. 17, 2010

Fifteen minutes after the blaze inside the Westfield Galleria broke out in October, a mall maintenance worker turned off the sprinkler system for more than an hour, apparently because he believed police wanted the system shut down, a new report by Roseville officials concludes. The report on the Oct. 21 blaze states that the sprinklers were turned off for 71 minutes in the area of the fire, and that the worker later told investigators he did it because a UPS driver told him police wanted the system turned off. Roseville police and fire officials said Thursday that no such order came from them, leaving the possibility that the devastating blaze blew out of control simply because of a misunderstanding by well-intentioned bystanders.

…The incident began shortly after 10 a.m., when authorities say (the arsonist) barricaded himself inside the GameStop and set off an incendiary device. By 10:23 a.m., at least one sprinkler head in the area had activated, and by 10:29 the first emergency units arrived…

At 10:38 a.m., a "Westfield employee shuts sprinkler valve off, he says at direction of law enforcement," the timeline states. "Neither police nor fire are aware of shut-off."

In follow-up interviews, authorities said, the employee indicated a UPS driver had told him police wanted the sprinklers shut off. Investigators interviewed both workers and said "neither the UPS worker nor the maintenance worker could recall or identify who initiated the request."

The report does not identify either worker. Roseville Police Capt. Stefan Moore, tactical commander that day, said the two workers were among the first people on the scene

before the SWAT team arrived and were trying to be helpful. “They were trying to be good Samaritans," Moore said. "They were trying to do what they thought was right in a very chaotic situation."

Seventy-one minutes elapsed before fire officials realized the entire system in the east side of the mall had been turned off – something they discovered, according to the report, when they overheard the maintenance worker talking about what he had done…

Full article at http://www.sacbee.com/2010/12/17/3264489/galleria-worker-shut-off-water.html

The focus of the article and the investigation in reports is whether the police and fire authorities had acted properly. It did not focus on *why* the mall employee – who the article surprisingly characterizes as a “bystander” - had no idea about what to do in case of a fire or other emergency. Presumably, even rudimentary worker training would suggest that turning off the sprinklers in the face of a fire was not a Good Thing to do. Presumably, only an employee without a clue as to what should be done would decide to follow the advice of a passing UPS driver.

So what do we learn from this third item? It is one thing to take away office parties and cubicle space for employees. There are larger social issues surrounding such take-aways about declining workplace conditions. But such erosions are not immediately life threatening. However, emergency training does not fall into the category of a nice workplace perk that can be taken away to save expenses. Nothing in the article suggests that the question occurred to anyone as to why an employee of a mall would not have had adequate emergency training.

Since no one thought to ask that question, I will pose it here.

Holiday greetings, readers.

Mitchell's Musing 12-27-10

Who Is Going to Pay for Higher Education?

It has become a truism that education is a key element in labor-market success. Although some critics have complained about creeping credentialism and over-education, there is generally agreement that increased education raises lifetime earnings and reduces the risk of unemployment. Beyond that benefit, however, is the question of who pays for education, particularly higher education, and especially *public* higher education.

The Great Recession has stressed the fiscal situation of state and local governments. Public universities and community colleges depend on state and local finance for varying proportions of their expenditures. With public fiscal resources diminished, higher educational institutions have been raising tuition as an alternative source of funding. There has been talk over the years about privatizing such institutions. While complete privatization would raise complicated legal issues, it can be argued that a shift toward tuition and away from public subsidy is a kind of *de facto* privatization.

Often held out as a compromise approach is the so-called "Michigan Model," involving the University of Michigan and the State of Michigan. An accord with the Michigan powers-that-be and the University gives the University authority to charge more-or-less market levels (that is, private levels) of tuition with cross subsidies to Michigan residents, especially those of lower income. Out-of-state students pay full freight and thus help provide the cross subsidy. The University of Virginia is often depicted as having a similar arrangement with its state powers-that-be. High-tuition/high aid is another descriptor of this model.

In some cases, university administrators seem to be too timid to talk openly about options such as the Michigan Model. At the University of California, tuition has been rising as the state deals with its ongoing budget crisis. But the issue has been handled in a reactive way. As the state cuts back support, the Regents of the University raise tuition – often accompanied by predictable student protests. But there are also protests from some of the same legislators who voted for the state budgets that have squeezed University funding. That is, absent any official accord with the state, the University and/or its Regents become the villains. And legislators are free to have it both ways; they can cut support and complain about the consequences.

California is not alone; there have been similar developments elsewhere. Tuition increases at Virginia Commonwealth University (not the University of Virginia) have been met with retaliatory cutbacks in state aid. See:
http://www2.timesdispatch.com/news/2010/dec/18/tdmain01-mcdonnell-punishes-vcu-for-tuition-increa-ar-723886/

At McGill, an increase in MBA tuition has produced a retaliatory reaction from the Quebec provincial government.

See: http://www.theglobeandmail.com/news/national/quebec/mcgill-mba-students-left-out-to-dry-by-tuition-fight/article1845280/

Of course, there can be controversy *within* academic institutions – and resistance to changes in the funding model – absent some kind of overall policy. The UCLA Anderson School of Management developed a plan for financial "self sufficiency" with support of a significant majority of its faculty and seeming support from campus administrators. But, at the moment, the campus Academic Senate is opposing the move, fearing (apparently) that the idea would spread to other departments.

See: http://www.senate.ucla.edu/documents/AGSMFSS_AcademicSenateResponse.pdf

Most economic forecasts suggest that the U.S. economy will be experiencing a prolonged period of sluggish growth with high unemployment remaining an issue. In that environment, state and local governments cannot expect robust tax revenues. Many state and local governments managed to delay the full impact of the Great Recession, in part by using federal stimulus funding that is now disappearing. The outlook, therefore, is for continued funding difficulties for public higher education, despite the commonly-heard rhetoric about the need to prepare the workforce of the future.

It seems unlikely that Washington will be in a political position to come to the rescue of public higher education. But there could be an initiative from Washington at least to foster some kind of public forums on who will pay for higher education. Is anyone in DC listening?

Mitchell's Musings 1-3-11

Happy New Years to all. As 2010 closed, the NBER working paper abstracted below crossed my desk. First, take a look at the abstract. Then I will muse about it and related phenomena and what might be implied.

How Does the Business Cycle Affect Eating Habits?
Dhaval M. Dave, Inas Rashad Kelly - working paper #16638 (HE)

Abstract: As economic expansions raise employment and wages, associated shifts in income and time constraints would be expected to also impact individuals' health. This study utilizes information from the Behavioral Risk Factor Surveillance System (1990-2007) to explore the relationship between the risk of unemployment and the consumption of various healthy and unhealthy foods. Estimates, based on fixed effects methodologies, indicate that a higher risk of unemployment is associated with reduced consumption of fruits and vegetables and increased consumption of "unhealthy" foods such as snacks and fast food. In addition to estimation of the average population effect, heterogeneous responses are also identified through detailed sample stratifications and by isolating the effect for those predicted to be at highest risk of unemployment based on their socio-economic characteristics. Among individuals predicted to be at highest risk of being unemployed, a one percentage point increase in the resident state's unemployment rate is associated with a 2-8% reduction in the consumption of fruits and vegetables. The impact is somewhat higher among married individuals and older adults. Supplementary analyses also explore specific mediating pathways, and point to reduced family income and adverse mental health as significant channels underlying the procyclical nature of healthy food consumption.
http://papers.nber.org/papers/W16638

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We all expect that unemployment – as a Bad Thing in itself – will have adverse consequences. But whether we could say *a priori* that we knew it would lead to poor nutrition in the sense of excess fast food, is another matter. If the opposite result were found, we could easily rationalize it as fast food being a luxury item that could be dropped from consumption. Or we might just expect reduced caloric consumption of all types of food as consumption generally fell.

One of the enduring puzzles in the social sciences is that the relation of unemployment to crime is elusive. We might expect, *a priori*, that crime would go up as the unemployment rate rose. And we could tell stories – if it were so - about desperate people doing things they would otherwise not do.

In a cross-sectional sense, it is likely that in any urban area, poor neighborhoods (which typically exhibit higher unemployment rates than others), will have higher crime rates, particularly the violent types of crime that make the TV news. But in a time-series sense, there is no clear cut relation between crime rates and the business cycle.

The *Los Angeles Times* recently ran a story about the (puzzling) falling crime rate in LA (where the unemployment rate is above the national average). But the phenomenon of falling crime is national. Not only in that article, but in other stories on crime, experts were asked for explanations. And, of course, they had stories to tell. Sometimes, however, they cited city-specific explanations, e.g., some kind of local policing innovation, which did not explain why the same trend would be seen in other cities.

These tales of falling crime brought to mind a former colleague of mine – Eric Monkkonen of the UCLA History and Public Policy Departments – who died in 2005. Monkkonen was an historian who studied murder. He developed time series of murder rates in diverse cities. In a talk he gave at UCLA, however, while he documented waves of rises and falls in murder rates, he suggested that social scientists really don't have consistent explanations across time.

You can find *ad hoc* stories in the labor relations literature about why unionization rates - and labor unrest more generally - rose during the Great Depression. Generally, scholars point to worker anger about the collapsed economy and related job conditions or to legal developments such as the Wagner Act (which actually was passed after the rise began). If the same folks are asked why we don't see a similar trend during the Great Recession, undoubtedly there are stories to be told about a less friendly legal environment or about the cushioning effect of the remains and progeny of the New Deal's "safety net." But perhaps it is wise to acknowledge that the really don't know exactly why the Great Depression produced rising unionization. It certainly was not predicted by observers at the time.

Similarly, in the late 1960s, there was a wave of strikes among unionized workers. Was it due to rising Vietnam-era inflation? Was it due to the very low unemployment of that period (the opposite of the Great Depression!)? Or was it the blue-collar version of the student rebellion on college campuses of that period – baby boomers angry at "the establishment"?

Overconfidence in what we know about social phenomena can lead us into trouble when it comes to policy. The Obama economists were sure that unemployment would not rise to the 10% level - but it did. However, they had to forecast using models based on data that did not include the kind of financial collapse that had occurred in 2008. Overconfidence in the models led to both economic and political consequences that the forecasters surely would now regret.

So for a New Years' resolution, perhaps a bit more humility would be in order. Here at EPRN, we strive to provide the best research we can about labor-market topics. But even with the best research on hand, we can never be truly sure. From a policy perspective in an uncertain world, it is always advisable to have a Plan B available – just in case we are wrong.

Mitchell's Musings 1-10-11

I was pleased to see the positive response at the Denver-LERA meetings last week to the official unveiling of EPRN. Because of a teaching conflict, I could not attend the Thursday panel related to EPRN but the Friday session definitely provoked audience enthusiasm. The key idea behind EPRN is to provide a convenient site for both scholarly communication and for media representatives and policy makers to engage with researchers on critical issues surrounding the labor market.

Policy maker is in fact a vague concept. We often see it personalized as a particular official, perhaps a president, governor, mayor, or a congressional or legislative leader. In fact, policy is commonly made in a diffused fashion with a mix of ideas, ideologies, and agenda capture that involves both officials, researchers, media dialog and reports, etc. It is through gaining a voice in that diffused process that EPRN can make its influence felt.

One item that caught my attention recently is a paper by Steven D. Levitt and John A. List in which they find that the famed Hawthorne Effects were much overstated. ("Was There Really a Hawthorne Effect at the Hawthorne Plant? An Analysis of the Original Illumination Experiments") You can find the paper – if you are a member of the American Economic Association – at
http://www.aeaweb.org/articles.php?doi=10.1257/app.3.1.224
If you are not a member, you will have to get hold of the January 2011 issue of the *American Economic Journal*. However, the paper in fact has been available in draft form for some time.

The longstanding view of the Hawthorne Effect – based on experiments in industrial lighting in the 1920s – is that the productivity gains reported were due to workers being appreciative of the attention they received – not the variations in the lighting. Others, before Levitt and List, have been skeptical. But for advocates of that viewpoint, this interpretation fit very well into the narrative of the human relations side of management. Findings of the Hawthorne Effect were seen to prove that treating workers well and having them participate in decisions was an alternative to the more Taylorist approach then in vogue. From the human relations perspective, workers were more than cogs in an industrial machine to be manipulated by industrial engineers and clever piece rate systems.

What the Levitt-List paper suggests is that researchers must be careful to consider whether their own predilections are in some way coloring their interpretations of empirical investigations. That's not an especially original or profound thought. Who could disagree? But it is a good reminder.

Mitchell's Musings 1-17-11

Walls and Futures

Let's start with walls. The *New York Times* in its 1-15-11 edition carries the story of the Great Wall of the US that has already cost a billion dollars and won't be built on the US-Mexico border. It was supposed to be a high-tech virtual fence that would spot illegal border crossers electronically. Apparently, the technology isn't what it was supposed to be. See
http://www.nytimes.com/2011/01/15/us/politics/15fence.html

Now I know that immigration advocates sometimes argue that "walls don't work" and that people will come "anyway." That is not quite true. It depends on the wall, the probability of being caught, and the penalty. If you have ever been to the Checkpoint Charlie museum in Berlin – which commemorates the Berlin Wall – you should have learned this simple point. Although the museum is dedicated to the courage of those who made it over the wall, the fact is that only a handful ever did. The Berlin Wall was effective because the East Germans and Soviets were willing to spend handsomely on fortifications and to shoot anyone who tried to cross. The US would not be likely to build anything as effective and harsh as the Berlin Wall, but it could – given enough money – make the border more difficult to cross than it is now. That doesn't mean that it should do so.

The issue is whether wall technology is the best way to limit border crossings. Back in 2006, Michael Dukakis and I noted in an op ed in the *New York Times* that an alternative approach to walls was to raise the minimum wage and enforce labor standards. If you are a conservative who believes that a) raising the minimum wage cuts jobs and b) illegal immigration should be discouraged, the two objectives go together. People cross the border for jobs, primarily low-wage jobs. If there are fewer of those jobs available, fewer people will come, regardless of the wall and its technology. What's not to like?

You can find the op ed at
http://www.anderson.ucla.edu/Documents/areas/fac/hrob/mitchell_dukakis_wages.pdf

Of course, enforcing labor standards has some costs. But such enforcement is likely to be less costly than high-tech walls that turn out not to be feasible.

The Future

A journalist called me the other day about the future, specifically what jobs will look like 25 years from now. The US Bureau of Labor Statistics is a bit more cautious. It forecasts ten years at a time. Its latest forecast runs from 2008-2018. You can find the BLS forecast – it prefers the word "projection" – at
http://www.bls.gov/news.release/pdf/ecopro.pdf

The problem with making really long projections is that the temptation is to extrapolate some immediate trend that won't persist or, alternatively, to make up a future that reflects what we want – not what is likely to be. In the film *2001*, made in the late 1960s, computers by the turn of the century had become sentient beings capable of evil. These computers, however, were clearly mainframes and

they had very poor graphics. People flew routinely to the moon on Pan Am (defunct before 2001) and made video calls from space on the Bell system (also defunct) in large phone booths. No cell phones were apparent.

In the film *Bladerunner*, made in the early 1980s and depicting Los Angeles in 2019, the dominant ethnic influence on the city seems to be Japanese (not Latino). The air is polluted but apparently not by cars, since people fly through the air in some kind of vehicle. Biotech is so far advanced that "replicant" humans are on the loose along with other biologically engineered creatures. Both *2001* and *Bladerunner* represent projections of events at the time they were made (moon voyages, Japanese manufacturing success) that did not turn out to progress linearly.

On the other hand, as noted above, there is wish fulfillment. In *Looking Backwards*, the utopian novel of the late 19th century, by 2000, no one works for wages. Everyone receives what he/she needs including universal health care. And folks retire to a pleasant life in their forties. That did not quite happen.

It is not just entertainments that feature false forecasts. When Social Security was being created in the mid-1930s, demographic projections were made for funding purposes. However, the demographers were unaware that the post-war baby boomers would begin arriving in a decade. Indeed, they did not know there would be a war. Keep that in mind when you read about 75-year projections that are regularly released nowadays about Social Security.

The current version of projecting seems more likely to make the error of projecting immediate trends linearly than wish fulfillment. The big event of recent times is the Great Recession and its high unemployment rate. It is increasingly fashionable to argue that the current 9+ percent unemployment rate is the result of a structural imbalance between job skills of job seekers and what employers want. The problem with structural arguments is that the labor force is like molasses. Structural imbalances can occur, but they accrue slowly over time.

But the Great Recession happened very fast. Unemployment does not suddenly shoot up for structural reasons. But such structural labor market interpretations can be self-fulfilling. If we make the mistake of assuming that the unemployment rate is caused by some structural characteristic – and therefore that little can be done about it – the European evidence does suggest skills can erode during prolonged unemployment. Doing nothing can turn a demand problem into something intractable. And at present we are not doing much.

Mitchell's Musings 1-24-11

In the *Los Angeles Times* of January 18, the columnist who covers consumer affairs opened an article with the following introduction:

The reaction of Claremont resident Randy Scott was typical of the many e-mails I received last week after reporting that Southern California Edison wants to jack up people's electricity rates in part to cover its pension losses in the stock market. "Unbelievable!" he said. "How can the PUC even approve this request?"

Source: http://www.latimes.com/business/la-fi-lazarus-20110118,0,1032274.column

There are several things to be said about this article but one is that the complaints about public pensions have now spread to private pensions, albeit here a pension of a private regulated utility. So let's talk about pensions and pension funding and about state and local finance. But let's do it in reverse. And then let's talk about public opinion and its molders.

State and Local Finance

A longstanding principle of state and local finance is that while borrowing for long-term capital projects is OK, it is bad policy to borrow for ongoing routine governmental expenditures. Put another way, you shouldn't be paying for the current expenses of the fire department by borrowing. There are various rationales for this position. Perhaps the prime reason for not borrowing to pay current expenses is that if you do so on a regular basis, your debt will rise to the point where you can no longer borrow. In short, paying for current expenses by borrowing is unsustainable, although it might be done for a short time. Another notion is that long-term capital projects will benefit both current and future users and that therefore, stretching out the payments so those in the future pay "their" share is appropriate.

(Let's not get into *federal* government financing here which has other elements including macroeconomics and the power to create money. We are talking in this musing about state and local governments that do not have such responsibilities and powers.)

Pensions and Pension Funding

Underfunding a defined-benefit pension plan is essentially borrowing to pay current expenses, in that case the current remuneration of employees. The pension payments to employees are promises to pay annuities in the future. If adequate funding is not put away when those employees' services occur, essentially, the result will be that future taxpayers will have to pay for services they may not have been around to receive. In addition, the growing value of pension promises can eventually become unsustainable unless adequate funds are put aside when the benefits are earned.

Pension *aficionados* have a concept called the "normal cost" of a pension. The normal cost is essentially the value of the incremental liability incurred by the plan each year as active employees accrue service credit. Put another way, the normal cost is the value of each year's future promises. To keep a plan

roughly fully funded (so that the employing entity is not paying for current services by *de facto* borrowing), the normal cost – however it is split between employer and employee contributions – needs to be flowing into the fund.

As readers of this musing will likely know, defined-benefit pensions determine monthly benefits by age, service, and earnings history of the employee through a formula. As such, the employer takes on the risk of having adequate funding when the benefits must be paid. Employees do not invest the funds nor are they subject to risks in financial markets directly. The promise to them is the pension formula. How the employer acquires the resources to meet those promises is not of concern to the employees.

Defined-benefit pensions can be thought of as a pension plan that comes with pension insurance. In contrast, particularly in the private sector, defined-contribution plans simply give the employee a tax-favored savings account in which the employer places a set contribution. The formula is the basis of the contribution, not the benefit. The employee invests the monies contributed in various alternatives (a stock fund, a bond fund, etc.) and come retirement time, he/she has an amount of cash that reflects his/her skill (luck?) in investing. What is in the plan on retirement will depend on the condition of financial markets at that moment and what is in the employee's portfolio. What kind of annuity the money in the plan on retirement might buy will depend on the portfolio value and on such variables as the then-prevailing interest rate. There is no pension insurance in a defined-contribution plan. But, of course, there cannot be underfunding since no future promises were made.

Most striking about the article cited above is that it tells the reader nothing about the history of the funding of the Southern California Edison plan. Was there a policy of deliberate underfunding? Or is the employer acting responsibly in its current funding decision? There is nothing in the article that suggests there is anything underhanded going on.

What seems to upset the journalist who wrote the piece is that many Edison customers don't have defined-benefit pensions with their characteristic of pension insurance. I am sure that Edison employees have a health insurance plan that also protects them against another form of risk, i.e., sickness and injury. But the area served by Edison will have many electricity customers who lack job-based health insurance. (Southern California residents have a lower-than-national-average rate of coverage by such insurance.) So is it also an outrage that Edison customers, through their electric bills, are paying for health-risk coverage of Edison workers?

When you push the argument to the extreme, the ultimate conclusion must be that no Southern California Edison customer should pay for the costs of any Edison employee who earns more than he/she does or who has any condition of work better than the customer. I doubt the journalist who wrote the article – on reflection – would endorse that view. After all, one could easily ask whether any customer of the *LA Times* should "pay for" the costs of the compensating the author if the customer earns less than the author does.

Opinion Molders

There was a time in California, as in other states, that key newspapers and their owners were major opinion molders of public opinion and were major political players as a result. You may have seen the PBS program on the Chandler family a few years ago, the family that for many years owned the LA Times and were big movers and shakers in state and local affairs.

As in the case of other newspapers, the Internet and the changing reading habits of the general public have led to major cutbacks, layoffs, and bankruptcy, at the *LA Times*. Whatever security journalists there and elsewhere may have had is long since gone. Recent years have seen loss of circulation, downsizing, and the diminishment of the *LA Times* as a national newspaper. Its travails are parodied regularly by a website: www.notthelatimes.com that whose homepage looks similar to the actual www.latimes.com, but ridicules the paper. (And even the parody website now seems to have fallen into Hard Times; its current version months out of date.)

Figure 1 below shows the sorry condition of newspaper employment in the U.S., now down to levels of the late 1940s. But despite their diminished state, newspapers still have an impact on public opinion. Most have moved on to the web and are therefore contributing to public perceptions through that medium. In addition, former newspaper journalists have experimented with blogs or have attached themselves to other internet forums. But job security and good benefits are not likely to part of a typical journalist's labor market experience.

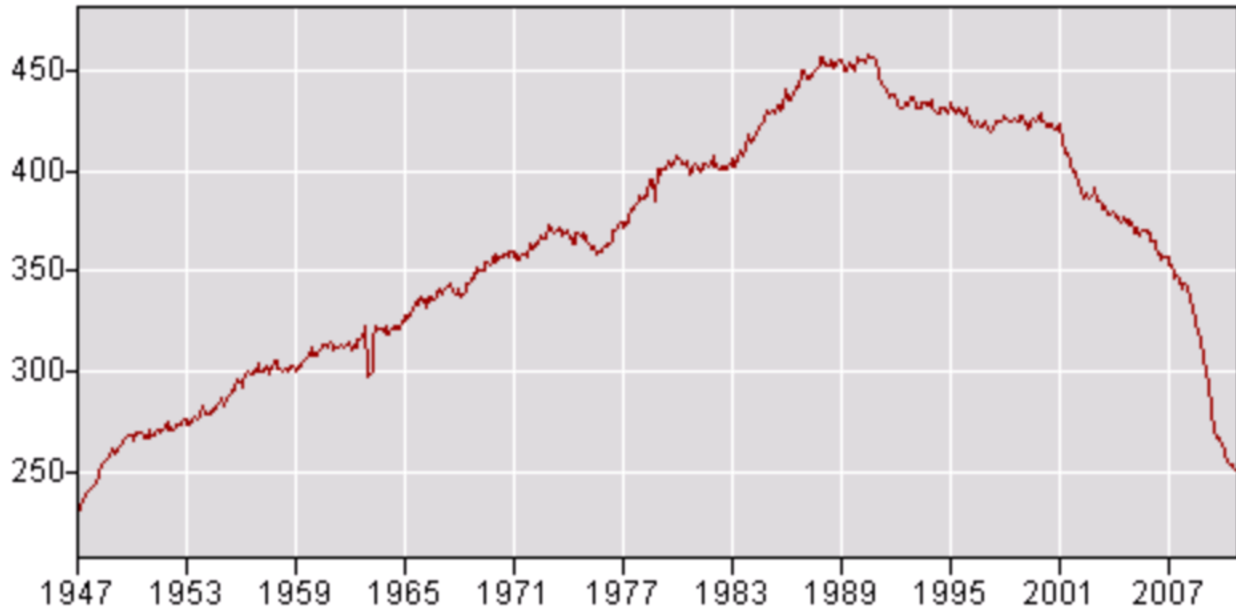
The figure indicates that job growth in the newspaper industry peaked in the late 1980s and early 1990s. But the real slide begins around 2000. Many journalists may have entered the profession, therefore, with expectations that were subsequently shattered. So it is understandable that there should be journalistic complaints about others in the labor force, here utility workers but more often public sector workers, who have been relatively insulated from the Great Recession.

While the reaction is understandable, it is not helpful in determining public policy. Southern California Edison is a regulated utility whose rates must be approved by a state agency. The article that triggered this musing does not tell you whether Edison misbehaved in its pension funding or whether it is acting responsibly. Misbehavior should not be rewarded by regulators. But the costs of responsible behavior should be reflected in utility bills.

I have sympathies for journalists whose career expectations were thwarted. But I also have sympathies for utility workers whose compensation packages include benefits. If their pension fund is not made whole, is that really of benefit to the larger society?

Bottom line: A famous early 20th century cartoon (see below) suggested that if things are bad we resent anyone who has it even a little better. Probably not the best approach.

Figure 1: Newspaper Employment in Thousands, 1947-2010



Source: U.S. Bureau of Labor Statistics

The Masses

"'I Gorry, I'm tired!"

"There you go! You're tired! Here I be a-standin' over a hot stove all day, an' you workin' in a nice cool sewer!"

Mitchell's Musings 1-31-11: What's Missing. What Could Be Missing.

I had less time than usual to muse this week owing to a course I do on California Policy Issues which dumped a pile of student papers on me. Nonetheless, I did catch the President's State of the Union address. And, of course, the text of the speech is on the White House website, readily downloadable for some word counts.

Presidents have to decide what to talk about in such speeches. They can be future oriented. Or they can dwell on current issues. This speech was clearly future oriented. "Invest" (or investment) came up 13 times. But there are some current problems linked to the labor market and the economy that might have received more attention.

"Jobs" came up in the speech 25 times. "Unemployment" came up zero times. "Deficit" came up eleven times with regard to the federal budget. But it came up zero times with regard to the fiscal condition of state and local governments. And it came up zero times with regard to international trade, i.e., the trade deficit. Exports came up 4 times. But imports came up zero times.

I understand the political logic of putting one's best foot forward and offering a grand future vision. But I am concerned about current conditions and what can happen in the near term. As is well known, the original economic forecast of the Administration underestimated the degree to which the unemployment rate would shoot up as a result of the Great Recession. Just a year ago, the *Economic Report of the President* (released in February 2010), somewhat overcorrected for past over-optimism by assuming the 2010 unemployment rate would average 10%. It appears, however, that the average was about 9.6%. However, thereafter, last February's official forecast was for notable – but not dramatic – drops in the unemployment rate to an average of 8.2% in 2012 and a continuing decline to below 6% by 2015. Real GDP would be growing over 4% per annum in 2011-13. The table on the next page summarizes the official February 2010 forecast.

I also show on that table the UCLA Anderson Forecast which was published in December 2010. Not surprisingly, UCLA was closer to the mark on unemployment and real GDP growth (since it could make use of actual data for most of the year). UCLA does not forecast all the way to 2015. But its outlook for 2011 and 2012 is decidedly less optimistic than where the Administration was last February.

We will soon see what the official Administration forecast is when the budget proposal and new *Economic Report* are released. Even the old February 2010 forecast was not very cheerful when the labor market perspective is considered. If the official forecast is now revised in the direction of UCLA's, that would make the labor market prognosis look even worse.

If the official focus in Washington is on the deficit, there will not be much action on jobs. And there seems little prospect in any event for action directed toward unemployment. The state and local sector could well be a source of more layoffs in 2011-12. State and local governments have ways of delaying their responses to an economic downturn and its resulting loss of tax revenue. But it appears that most

of these responses have been played out and now – absent aid from Washington – the adjustment will occur.

The trade deficit continues to be adding to U.S. debt to the world. But more importantly, it is a drain on jobs – particularly in manufacturing – in the short term. The trade deficit is a balance of exports against imports. Thus, talking about exports is talking about only half the story.

As I have previously written, cajoling other countries about their exchange rates has little or no effect. If direct stimulus from Washington is now not feasible, dealing with the trade imbalance is all that is left. But we are not dealing with it.

	Economic Report of the President, February 2010		**UCLA Anderson Forecast, December 2010**	
	Unemployment Rate [%]	**Real GDP Growth [%]**	**Unemployment Rate [%}**	**Real GDP Growth**
2010	10.0 [9.6]	3.0 [2.9]	9.7 [9.6]	2.8 [2.9]
2011	9.2	4.3	9.6	2.1
2012	8.2	4.3	9.1	2.8
2013	7.3	4.2	n.a.	n.a.
2014	6.5	3.9	n.a.	n.a.
2015	5.9	3.4	n.a.	n.a.

Note: [ ] = latest estimate of actual value.

Data Concerns

Discussion of the international sector should remind us of the need for having data relating to economic conditions (pay, unemployment, etc.) abroad. It appeared last year that the U.S. Department of Labor was going to cut off funding for just such data collection. But a fuss was made and, for a time, the international data program appeared to have been saved. Now, again, the threat of a cutoff seems to have arisen. I reproduce below a recent email from Bob Bednarzik for whatever action you may deem appropriate.

Dear supporters of BLS International Labor Comparisons,

Here is an update on the budget situation for the BLS Division of International Labor Comparisons (ILC)

which was slated for termination in the President's 2011 budget.

We had some fleeting good news during the lame duck session of the Congress when the Senate drafted a budget that included funding for ILC. I am sure that your support was a major factor in this outcome. However, the lame duck omnibus appropriations bill did not come up for a vote; instead the Congress passed a Continuing Resolution (CR) that expires March 4 to keep the Federal Government funded. Thus, ILC lives on, but is still in danger in the current budget-cutting atmosphere.

Just yesterday, it came to my attention that Paul Krugman (Princeton Professor, Nobel Prize winning Economist, and New York Times columnist and blogger) posted a blog in praise of the St. Louis Fed's new international data base named FRED that draws most of its data from ILC. Professor Krugman was apparently unaware of the ILC budget situation, so I posted a comment (see comment # 25) about ILC's proposed termination and I referenced the petition you signed. Currently, the link I included to the petition does not work, but another friend of the program has just submitted a comment to include the correct link. You may wish to add a comment of your own. Shorter postings are preferred. You can read Krugman's blog at: http://krugman.blogs.nytimes.com/2011/01/28/fred-goes-global/

To post your comment you must first register: first click on "post a comment" at the end of Krugman's blog. And from there go to the end of the comments and click on "register," set up your password, and you're up and running in a few minutes.

FYI: Here is the link to the petition which currently has 265 signers: http://www.ipetitions.com/petition/saveilc

Anything you can do to get more petition signers and/or add to the Krugman blog will be important to the survival of ILC.

Thanks again for your support,

Bob Bednarzik, Ph. D.
Georgetown University
Public Policy Institute

Mitchell's Musings 2-7-11

Trade and Stimulus

I hate to keep harping on such esoteric matters as exchange rates and the U.S. foreign trade imbalance. But I was reminded of the topic in an item from the National Bureau of Economic Research's emailed *Digest* for this month. The *Digest* summarizes recent NBER research. Below is an excerpt from one item:

Cash for Clunkers Had Modest and Short-Lived Effects

Under the $2.85 billion "Cash for Clunkers" program, the federal government paid automobile dealers between $3,500 and $4,500 each time a customer traded in an older, less fuel-efficient vehicle and purchased a newer, more fuel-efficient vehicle. The rebates were passed on to customers as a purchase incentive. The program was designed to boost automobile sales and to stimulate the economy. In The Effects of Fiscal Stimulus: Evidence from the 2009 "Cash for Clunkers" Program (NBER Working Paper No. 16351), co-authors Atif Mian and Amir Sufi find that in 957 U.S. cities, the surge in automobile sales was short-lived while the program was in place. About 360,000 automobile purchases were induced in July and August 2009. Most of these purchases simply were brought forward by a few months: a sharp decline in sales after the program ended suggests that it had a muted total effect on auto purchases, the authors conclude…

The actual paper to which the summary refers is available at
http://papers.nber.org/papers/w16351

Is there more to be added to this analysis? About a third of car sales in the U.S. in 2009 were imports. Yours truly traded in an old Ford for a Toyota Prius. Toyota had planned to open a U.S. plant to manufacture that model, but dropped the idea when the Great Recession came along.

Of course, some of the stimulus from my particular clunker trade-in, even if it was short lived, did stay in the U.S. The dealer markup was about 20%. Local sales taxes and other motor vehicle fees plus transport from the port to the dealer have to be considered. So probably about a third of the stimulus stayed home and two thirds went to Japan in that particular scale. Still, when you combine the fact of only a modest time shift of sales found in the NBER study with the large leakage of the clunker stimulus abroad, there isn't much left for the domestic economy.

The U.S. foreign trade imbalance/exchange rate issue goes beyond particular stimulus efforts (of which there are not likely to be more anytime soon). As the U.S. continues a sluggish recovery, part of the internal demand expansion will leak out abroad, i.e., the trade imbalance reinforces the sluggishness. But there seems to be more willingness at present to acknowledge the trade issue than to deal with it. From the NY Times:

China's Currency Avoids 'Manipulated' Ruling Again

Sewell Chan, Feb. 4, 2011

WASHINGTON — The Obama administration said on Friday that China's currency remained "substantially undervalued" compared with the dollar but declined once again to cite Beijing for currency manipulation…

http://www.nytimes.com/2011/02/05/business/global/05yuan.html?_r=1&scp=1&sq=china%20exchange%20rate&st=cse

Enough said.

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Stepping Up in Direct Democracy: Donations Cheerfully Accepted

Here is a quote without comment from the State Worker blog, an ongoing feature of the website of the Sacramento Bee, the major newspaper in California's capital city.

…Ebenstein figures it will take at least $1 million to collect enough signatures to qualify a measure for the ballot. When asked whether he can raise that much money, plus more for campaign ads, Ebenstein said ***he believes that moneyed interests in Santa Barbara and elsewhere will step up****.*

If you are wondering to just what will the moneyed interests be stepping up, here is more detail from the lead-in to the post:

A Santa Barbara-based organization that wants to end union representation of California government employees has revved up its campaign contribution collection machinery for a run at putting the idea to a statewide vote. Although Secretary of State records indicate that Californians for Public Union Reform hasn't reported that it has taken in any money yet -- it just filed with the state last week -- it is positioning itself to accept contributions with an aim toward putting an initiative on the ballot next year.

Lanny Ebenstein, UC Santa Barbara economist, head of the California Center for Public Policy and president of the Santa Barbara County Taxpayers Association is named in the state filing as the reform group's treasurer. If his name seems familiar, it's probably because Ebenstein authored "Reforming Public Employee Compensation and Pensions." a report that purported to show that California public employees' pay and benefits are "unjust." …

The full posting is at http://blogs.sacbee.com/the_state_worker/2011/02/group-aims-to-end-public-emplo.html#ixzz1CodG7way

Although posting describes Mr. Ebenstein as a UC (University of California) Santa Barbara economist, a search on the University's website/directory finds no one by that name.

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What to Do When You are Not Being Educated

A final note is the item below from the San Francisco Chronicle of February 5, 2011:

Jonathan Zhang gingerly lifted the lab mouse by its tail and placed it on a spinning machine designed to test the movement of mice with Parkinson's disease. Out of eight San Francisco high school students, each clad in moss green lab coats, latex gloves, disposable head caps and shoe covers, the senior from George Washington High was one of the first to handle the mouse, which ran frantically in place as the laboratory machine whirred. The demonstration at the UCSF Mission Bay campus Friday afternoon was part of a citywide effort to give youths a chance to experience professional workplaces in their areas of interest. Organized by the Mayor's Youth Employment and Education Program, the annual effort ***occurred on a day that students had off from school due to teacher furloughs****.* …

Did anyone note that cutting the school year via teacher furloughs is not a good way to prepare the students for the high-tech jobs they were taken to observe? Just asking.

The full article is at http://sfgate.com/cgi-bin/article.cgi?f=/c/a/2011/02/05/BAJ91HJ2F3.DTL

Mitchell's Musings 2-14-11: Technology and What We Know

There are known knowns. These are things we know that we know. There are known unknowns. That is to say, there are things that we know we don't know. But there are also unknown unknowns. There are things we don't know we don't know.

Donald Rumsfeld

It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so.

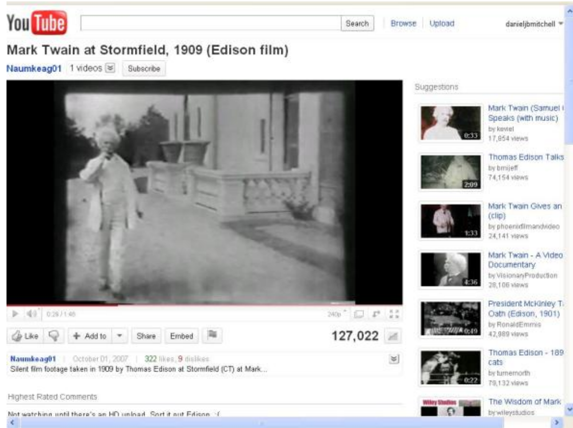
Mark Twain

I have been musing about "technology." We tend to believe that we are living in an unprecedented age of technological advance. The new techology will change the labor market. People will be able to work from anywhere. Collaborations and team efforts will be enabled. Jobs of the future will be wholly different from today. And just to make the point, nowadays, if you want to see Rumsfeld make his famous remark, you can just click on YouTube at

http://www.youtube.com/watch?v=GiPe1OiKQuk and there it is.

In contrast, the best we can do for Twain – because he lived in an earlier era - is offer you an old silent movie

http://www.youtube.com/watch?v=leYj--P4CgQ



But before we let the notion of unprecedented technological advance get the best of us, a bit of humility is in order. After the LERA meetings in early January, my wife and I had some time before our plane back to Los Angeles and we went to the Denver Art Museum. On exhibit was the painting below by George Ottinger completed in 1873.

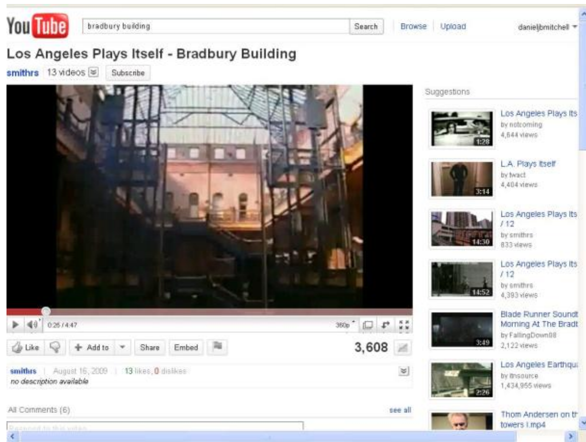
A nineteenth century observer would have had no trouble interpreting the image. A pony express rider is contemplating his future displacement as he observes telegraph polls being erected. New technology! The telegraph, by the Civil War era, had enabled instant communication across the country and – once the Transatlantic cable was laid – across the world. It facilitated commerce, united markets, and made

possible long-distance railroads. Folks in that period would have thought they lived in an age of unprecedented progress.

A visitor to downtown Los Angeles would do well to visit the Bradbury Building, completed in 1893. (Yes, Virginia, there is a downtown Los Angeles.) Indeed, you have probably seen the building already because it appears in numerous Hollywood films, notably *Blade Runner* (1982), and more recently *500 Days of Summer* (2009). The building is said to have been inspired by Edward Bellamy's book, *Looking Backwards* (1888). *Looking Backwards* is a Rip Van Winkle story in which the main character somehow wakes up in the year 2000 and finds a utopia in which wages no longer exist, folks retire at a young age to enjoy a pleasant leisure, and various technological miracles are in evidence. But what the Bradbury Building actually looks like is the latest thing in the early 1890s, i.e., a linear projection of what seemed ultra-modern then.

YouTube is again our enabler; you can see the Bradbury Building in various movies at

http://www.youtube.com/watch?v=CwmsZrvfOv8



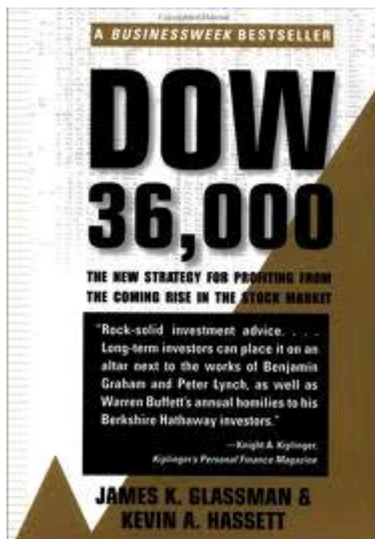
It isn't just late 19th century architects and authors who got the future wrong. As noted, the Bradbury Building was a prime location in the movie *Blade Runner*. As seen from 1982, by the year 2019 when the movie takes place, Los Angeles would be dominated by Japan – not a word of Spanish is heard in the film. Runaway bio-tech engineered "replicants" from other planets that we apparently would be visiting were on the loose in the city. Could anyone have known in 1982 that as we approach 2019, the American space program would be in a shambles and American astronauts would be dependent on the Russians (once the last space shuttle is mothballed) to get them into space? Could anyone have known that Japanese real estate investors in Los Angeles would lose their shirts in the commercial property bust of the early 1990s?

Is there evidence that technology is now racing ahead in an unprecedented fashion? The main indicator we have is the multifactor productivity index produced by the U.S. Bureau of Labor Statistics which purports to take account of the growth of labor and capital in explaining the change in real output. To the extent that output grows faster than can be explained, the index is viewed as an indicator of

technological progress. Of course, this type of "residual" methodology for estimating the advance of technology can be criticized. But unless you have a better measure, consider that from 1948 to 1990, the index grew at about 1.5% per annum. Let's take that 42-year period as a base.

We tend to view the period from 1990 on as corresponding to the Internet boom. However, the multifactor productivity index from 1990 to 2009 rose at a modest 1.1% annual rate, i.e., more *slowly* than in the post-World War II period up to the Internet era. (If you want to factor out the depressing impact of the Great Recession, you can look just at the period 1990 to 2006 when the rate was 1.2% per annum.) Where is the great acceleration in technological progress? It is not apparent that there was one.

The lesson from the past is clear. Be very cautious about brave predictions of the future. They tend to be linear projections of immediate tendencies. And they inevitably assume that the current period is one of unprecedented technological progress that will change everything. If you need further convincing, you can contemplate the image below.



Mitchell's Musings 2-21-11: Is Retirement Based on 401k OK?

The chart below comes from an article in the *Wall Street Journal* of 2-19-11 with the title "Retiring Boomers Find 401(k) Plans Fall Short." The article is at http://online.wsj.com/article/SB10001424052748703959604576152792748707356.html?mod=WSJ_hp_LEFTTopStories

However, the title and chart pretty much tell the tale.

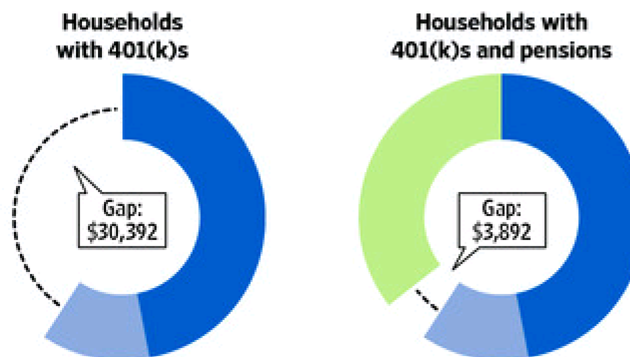
401(k) Plans Come Up Short

Most households nearing retirement with 401(k) plans as their main retirement savings fall short of what they need. Even most households with both 401(k)s and pensions fall short.

Annual retirement income needed: $74,545

Social Security:	$35,080
401(k):	$9,073
Pension:	$26,500

Based on a 2009 median income of $87,700 for households whose heads are 60-62 years old, and a median 2010 401(k) of $149,400 for that group. Assumes households need 85% of pre-retirement income in retirement.



Sources: Center for Retirement Research at Boston College; Federal Reserve; New York Life Insurance Company

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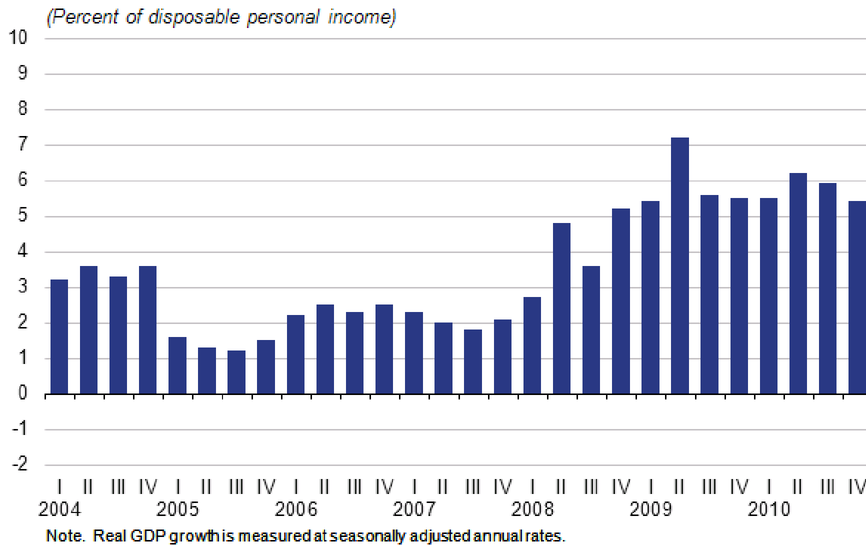
The tax code provides a strong incentive to save through 401ks, IRAs, and similar plans. In addition, private employers often provide matches to the employee contribution. Nonetheless, Americans don't do a great job of saving. As the chart on the next page shows, prior to the Great Recession, the personal saving rate in the U.S. (which *includes* saving through pension arrangements) was floating around in the 1-4% range, down from 9-10% in the late 1970s. The Great Recession pushed up the rate somewhat – since saving is the mirror image of consumption – but the resulting 5-6% saving rate range is hardly a mark of personal thriftiness. And it is likely to fall as the economy (slowly) recovers.



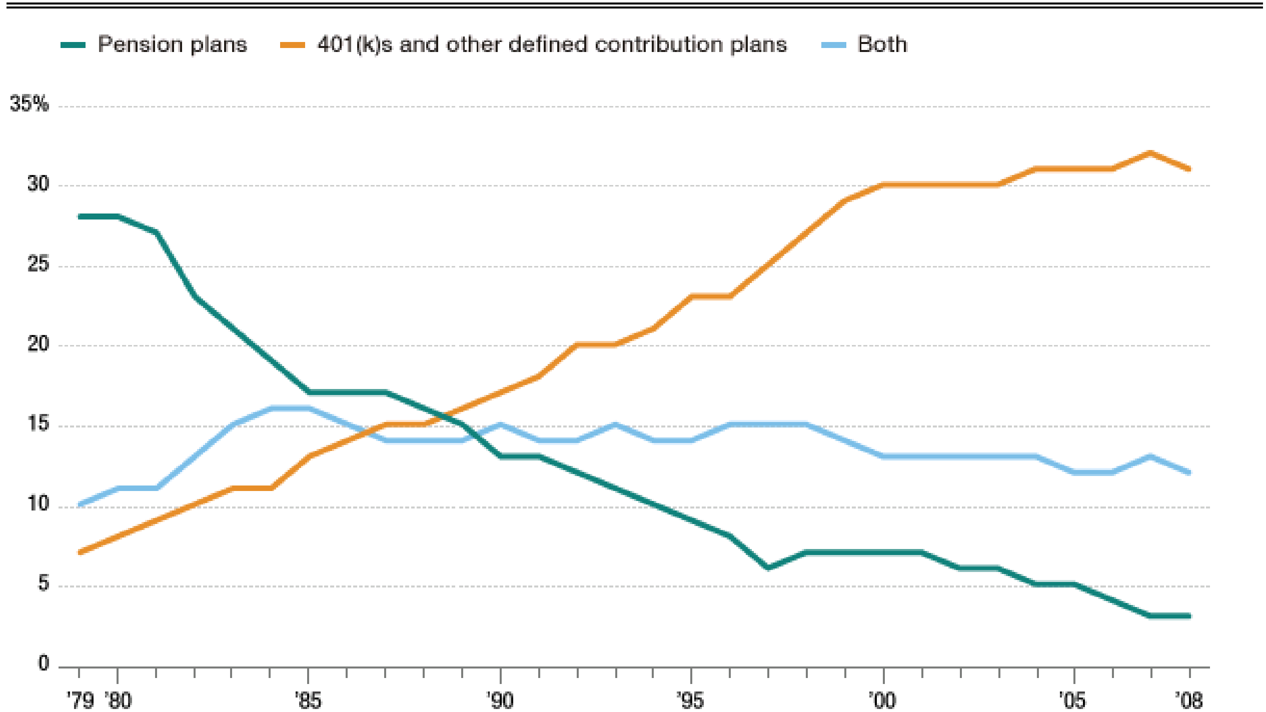
Recent efforts – following the insights of "nudge" economics – involve making enrollment in 401k-type plans the default option for new hires. That is, it has been found that if workers have to check a box indicating they want to join their employer's 401k plan, they are less likely to do so than if they have to check a box saying they don't want to join. While the nudge approach may be a triumph for behavioral economics, what it really shows is that folks are not very good at planning for the future. If workers were rational in the traditional economic sense, the default setting should not affect their choice. Checking a box, one way or the other, is essentially costless.

Behavioral economists have also discovered that even when folks do elect to save, they are not especially good at investing. If employers offer three options, say, company stock, a mutual fund, and a bond fund, workers are likely simply to divide their contributions into one third segments for each. There are partial remedies for this tendency, such as life-cycle funds that automatically move away from stocks and towards fixed investments as workers age. But for any given worker, it is difficult to diversify away from the risk that – by the luck of the draw – even a life-cycle fund in his/her particular age cohort won't perform particularly well.

Plans in which employers make a contribution or a match – but leave it to employees to invest – are known as defined contribution plans. In contrast, those plans which promise an eventual retirement benefit based on a formula (typically relating to age, tenure, and earnings history) are known as defined benefit. The employer is supposed to contribute adequately to a trust fund – and invest the monies in the trust appropriately – so as to finance the promised benefit. Defined benefit plans, in principle, solve the saving problem and the investment problem for the employee. In principle, those who are trustees of such plans are supposed to ensure that adequate funding goes into the trust fund. In principle, those

who handle investment decisions for such plans are more expert than ordinary employees. They also, in principle, solve the cohort problem, since workers of all different cohorts are mixed together.

However, as the chart below indicates, in the private sector, coverage by defined benefit plans has been declining and defined contribution plans have been in the ascent. Typically, those workers in the private sector still covered by defined benefit plans are unionized. And the union sector in private employment has been in decline since the mid-1950s.



Source: Employee Benefit Research Institute. EBRI's estimates for 1998-2008 were done using Department of Labor and Current Population Survey data. Credit: Alyson Hurt / NPR

Source: http://www.npr.org/templates/story/story.php?storyId=124131819

Defined benefit plans remain prominent in the public sector, which also has a notably higher unionization rate than the private sector. However, such plans typically pre-date the era of public sector unionization. Nonetheless, the current controversy over the use and underfunding of public defined-benefit pensions has become intertwined with a more general attempt – notably in Wisconsin – to ban collective bargaining in government.

Defined benefit plans do need to be adequately funded and administered. In the end, although there are legal constraints on the ability of governmental employers to reduce promised pension benefits, the promise is based on a trust fund and inflow of revenue – typically from both employer and employee –

to maintain the fund. Pension experts have a concept known as the "normal cost" of the pension. Essentially, the normal cost is an estimate of what needs to be put away in a given year to fund that year's incremental promises of future benefits. If good practices are followed, there is no reason why a defined benefit plan cannot be operated successfully.

Sadly, good practices were not followed in notable cases. When this happened in the private sector, the liabilities fell on the federal government, because private defined benefit pensions are federally insured. There are problems related to the perverse incentives in the private sector to "put" (in financial jargon) the liability on the feds. These perverse incentives need addressing. And there clearly need to be reforms in the way state and local defined benefit plans – which are not federally insured - are operated.

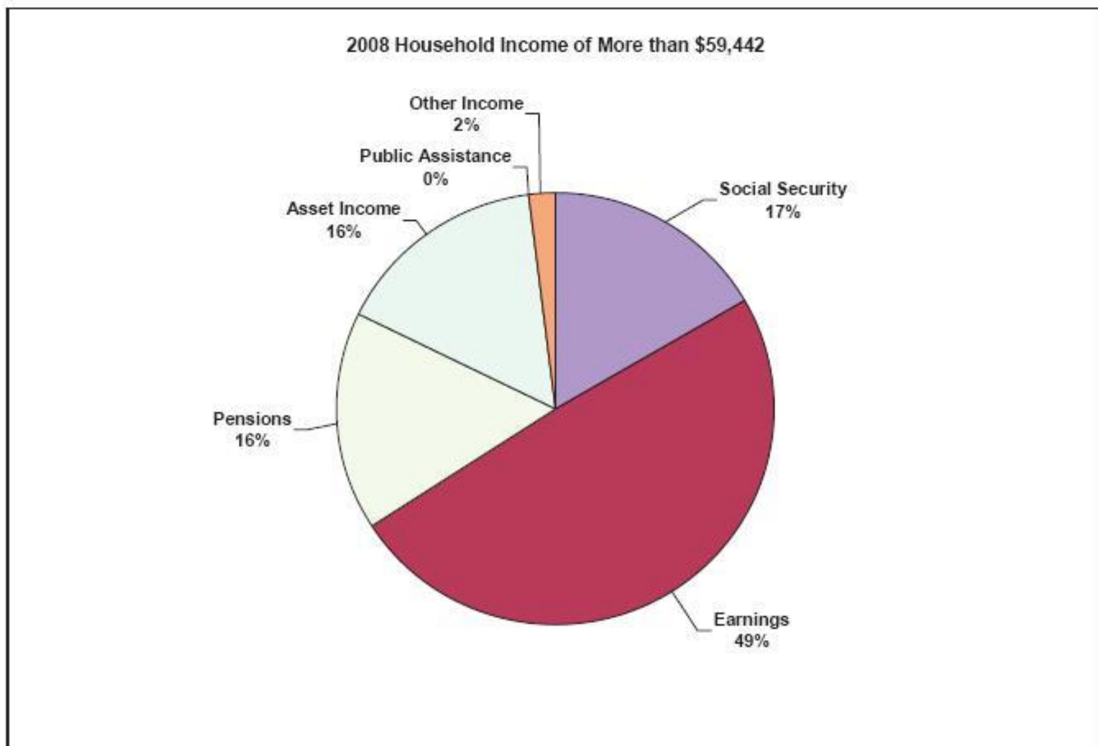
With all that said, the move away from defined benefit is precisely the wrong direction for the American retirement system to be headed. The 401k approach to encouraging saving has not succeeded in raising the long-term personal saving rate. Indeed, the era of the 401k has seen a general decline in such saving. The traditional notion of retirement planning was at one time said to be a three-legged stool. There would be Social Security (which is defined benefit) as the first leg – a kind of minimum safety net. There would be employer-provided defined benefit plans as the second leg. And there would be individual saving (which is really what a 401k is) as the third leg.

Those critics who don't like defined benefit pensions as a concept – in part because they associate such pensions with unions - typically don't like Social Security as a concept either. Unfortunately, a one-legged stool is at best precariously balanced. There is an illusion that if Social Security and defined benefit pensions would just go away, the liabilities they represent would also vanish. Demographics and the lessons of history say otherwise. But I will muse about that proposition in a future edition of this blog.

Mitchell's Musings 2-28-11: Grandma's Unfunded Liability

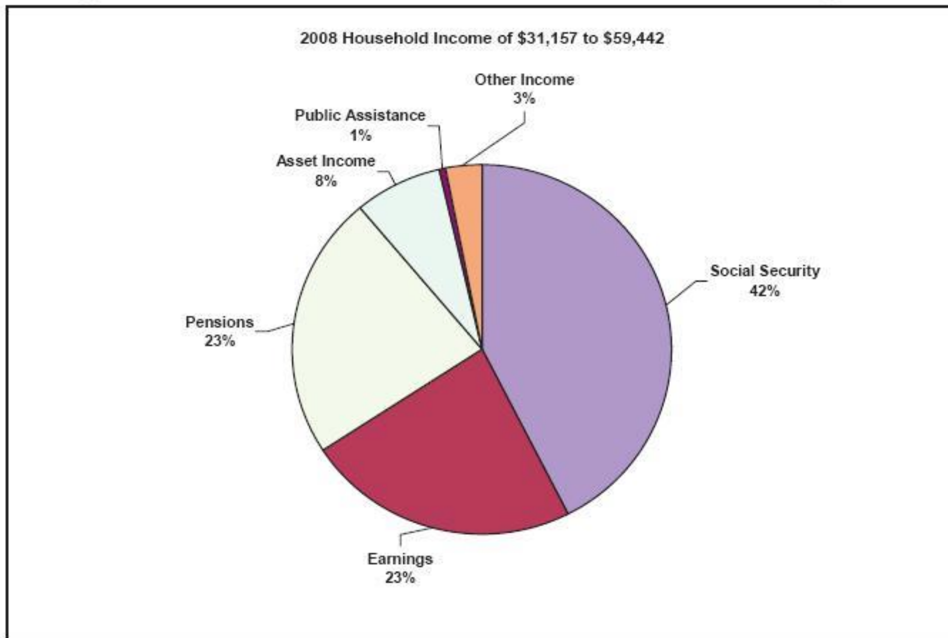
Currently, about 38 million individuals age 65 and over receive payments from the Social Security program. About 59 million individuals of all ages in total receive payments, including those retired early, disabled, or under other related components of Social Security. There will be about 80 million people in the U.S. over age 65 in 2050, according to Census projections. The proportion of the population in that age bracket will be a little over one fifth of the total as the baby boom bulge peaks in 2040-2050. At present, the figure is about 13%.

Social Security income is an important resource for households with a head or spouse of head age 65 or older. Below are four charts (numbered 5-8) from a Congressional Research Service report breaking down the share of Social Security income by household income quartile from top to bottom. (The source is http://assets.opencrs.com/rpts/RL32697_20091002.pdf) In the top quartile, Social Security accounts for about one sixth of income, a small but not negligible share, and the about half of income comes from employment.



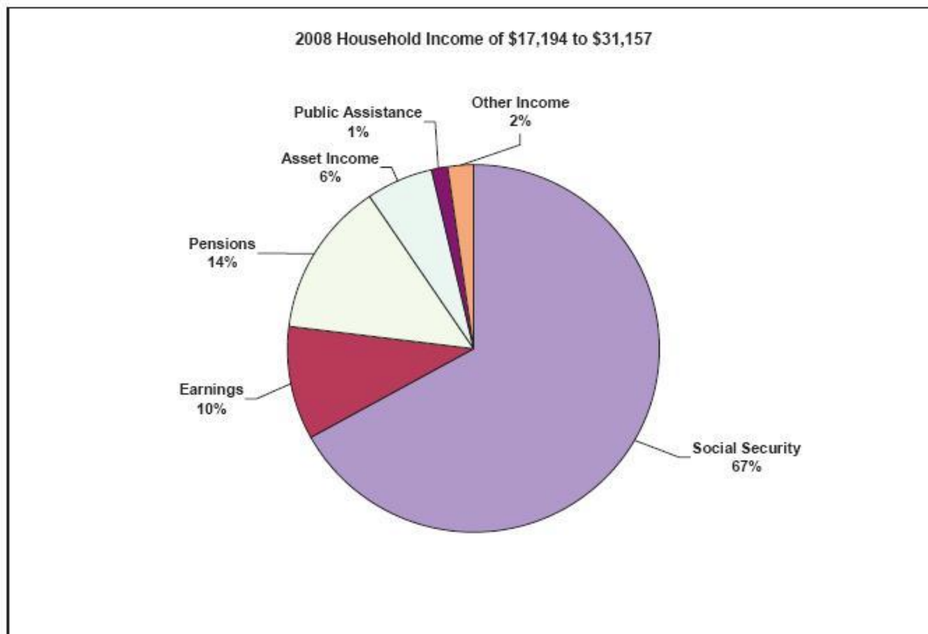
In the next lowest quartile – shown on the next page - the share of Social Security rises to 42% while the employment share drops below one fourth.

Figure 6. Sources of Household Income in 2008, Second Quartile, Age 65+



In the third quartile from the top, Social Security accounts for two-thirds of income and employment drops to a tenth.

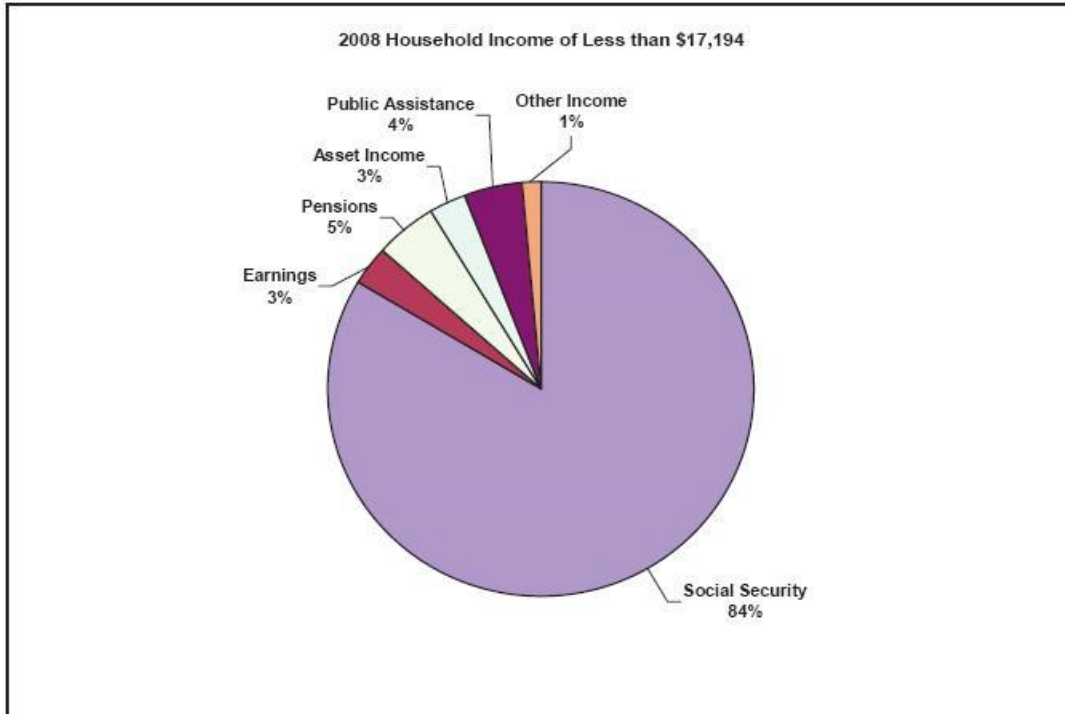
Figure 7. Sources of Household Income in 2008, Third Quartile, Age 65+



Finally, in the bottom quartile (next page), 84% of household income comes from Social Security and the employment share is negligible. Note that in none of these pie charts do private pensions of any type (defined benefit, defined contribution, IRAs, etc.) make up a substantial share of retirement income.

Particularly for the bottom half of the household income distribution, pension income is drawfed by Social Security.

Figure 8. Sources of Household Income in 2008, Bottom Quartile, Age 65+



The lesson from the information above is that Social Security is THE retirement program for the U.S. Sometimes, in political discussions, Social Security has been described as a “third rail” for any elected officials who propose to trim it. Actually, what the data show is that careless fiddling with the program in any substantial way could expose those covered by Social Security (most of the U.S. population) to a third rail.

As is well known, the Social Security system has an unfunded liability. Normally, the projections made for Social Security go out 75 years. That is a long time. In my undergraduate class this quarter, someone asked about the length of the projections. I pointed out that unless an elixir of youth is discovered, most of the folks in the class – obviously including yours truly – would be dead by the end of that period. A sobering thought! Undaunted by that thought, however, the trustees of the system actually make a projection of the unfunded liability for forever. Forever is a very long period; indeed, everyone who is alive today *or will ever be alive* will be dead by the time forever ends. Nonetheless, on a forever basis, the unfunded liability was put at about $16 trillion. (You can find this figure at http://www.ssa.gov/OACT/TR/2010/IV_LRest.html#267528 on Table IV.B7.)

How shall we think of that number? We might compare it with other unfunded liabilities. Although Social Security has a dedicated revenue stream of payroll taxes, the Defense Department does not. It is funded out of the general budget. Since the president is constitutionally required to provide for the

national defense, if we take his latest defense request of $670.9 billion (http://comptroller.defense.gov/defbudget/fy2012/FY2012_Budget_Request_Overview_Book.pdf) and assume we will continue at that level in real (inflation-adjusted) terms forever, the unfunded liability of the Pentagon would be about $27 trillion. (I used a real interest rate of 2.5% in that calculation as the discount factor.)

More seriously, we can simply ask to what extent the liability for Social Security would go away if we somehow obliterated the system. There would still be aging baby boomers. For that matter, the generations beyond the boomers would also still be aging. At some point in their old age, they would be claiming a share of GDP. In the period before Social Security was created, elderly support was provided in various ways. A few people saved enough to retire comfortably. Others worked until they dropped. Extended families took care of elderly relatives. Or there were poor houses and similar charitable arrangements. To the extent that the elderly could not support themselves through work or savings, there was an implicit societal unfunded liability that could have been calculated. Of course, no one made such calculations back in the day, because there was no official system created to take over much of these responsibilities.

The bottom line from these musings is that much of the unfunded liability which we now explicitly calculate for Social Security would be there without the system. Unless each generation truly saves enough to provide for its own retirement – and we are far from that situation – there will always be an intergenerational unfunded liability that no clever scheme can erase. The immediate political task before us is to determine how much of the GDP of, say, 2040 can reasonably go to the aged boomers. In reciprocal terms, that question comes down to how much income sharing the active workers of 2040 will be willing to provide. We can have that conversation in terms of modifications to Social Security so long as we understand the underlying demographic basis of the issue, essentially the boomer bulge in the population. The demographics tell us that, in the main, we can shuffle the liability around, but we cannot make it go away. Grandma will be here, no matter what we do.

Mitchell's Musings: 3-7-11 What "Everyone" Knows

Some old timers, especially if they came from the New York City area, will know the name Jean Shepherd. Shepherd was on the radio in New York's WOR from the early 1950s until the mid-1970s, typically late in the evening or at night. And he just talked. He told stories about his family, growing up in the 1930s, being in the Army in World War II, and about odd items in the news. If you have ever seen the movie "A Christmas Story," something of a classic of the season, you have seen a film based on these radio stories.[1]

Some of the radio stories Shepherd told were true, others were embellished or fictional. WOR was a "clear channel" AM radio station which means that no other stations were on the same frequency in the U.S. At night, AM signals carry over a wide area, even a thousand miles, so his program could be heard up and down the East Coast and into the Midwest and Canada.

Early in his career, Shepherd was on the air after midnight. In consultation with his night listeners, who could phone in, he concocted a hoax. Most hoaxes are developed in secret. The interesting thing about this hoax is that it was not done in secret; anyone with a radio could listen in as the hoax was first concocted and then implemented over an extended period. Essentially, what Shepherd wanted to demonstrate was that simply by insisting that something was true, you could eventually get the talking heads and chattering classes of the world to believe it.

Shepherd's hoax involved having his listeners walk into bookstores and ask for a non-existent book by a non-existent author. Shepherd and his listeners came up with the titillating book title "I, Libertine." He was interviewed about the I, Libertine hoax on a radio program in the 1960s about a decade after the event. You can hear the interview in two parts here:

Part 1: http://www.youtube.com/watch?v=2tCfVhsTj-E

Part 2: http://www.youtube.com/watch?v=2yly5qrbn3I

One of the listeners who was aware of the hoax was a *Wall Street Journal* reporter who eventually arranged with Shepherd to tell the story.

I tell you this tale because of two stories that appeared recently in the *Wall Street Journal.*

Everyone knows that the public is furious with public employees and supports taking away their collective bargaining rights. Right? How does everyone know? Because it has been reported that way, over and over again.

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[1]A sample scene is at http://www.youtube.com/watch?v=zdA__2tKoIU .

But a *Wall Street Journal* poll in fact says everyone who knows that to be a fact is wrong.

March 2, 2011

WSJ/NBC Poll: Strong Support for Bargaining Rights

Americans strongly oppose efforts to strip unionized government workers of their rights to collectively bargain, even as they want public employees to contribute more money to their retirement and health-care benefits, the latest Wall Street Journal/NBC News poll shows.

Eliminating collective bargaining rights for public-sector workers over health care, pensions or other benefits would be either "mostly unacceptable" or "totally unacceptable," 62% of those surveyed said. Only 33% support such limits…

The full article is at http://blogs.wsj.com/washwire/2011/03/02/wsjnbc-poll-strong-support-for-bargaining-rights/tab/print/

Everyone also knows that the public is itching to cut the federal budget deficit and that for the first time "entitlements" are on the cutting block. Right? One problem, though. A *Wall Street Journal* poll says the opposite:

March 3, 2011

Poll Shows Budget-Cuts Dilemma: Many Deem Big Cuts to Entitlements 'Unacceptable,' but Retirement and Means Testing Draw Support

By Neil King Jr. and Scott Greenberg

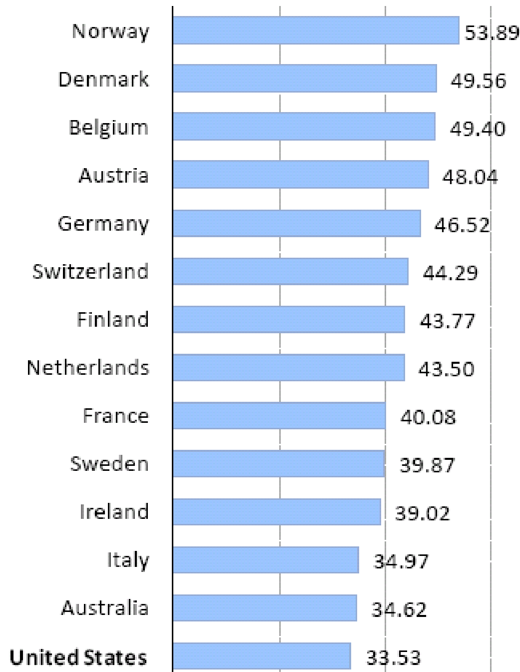
WASHINGTON— Less than a quarter of Americans support making significant cuts to Social Security or Medicare to tackle the country's mounting deficit, according to a new Wall Street Journal/NBC News poll, illustrating the challenge facing lawmakers who want voter buy-in to alter entitlement programs. In the poll, Americans across all age groups and ideologies said by large margins that it was "unacceptable" to make significant cuts in entitlement programs in order to reduce the federal deficit. Even tea party supporters, by a nearly 2-to-1 margin, declared significant cuts to Social Security "unacceptable." …

Full story at http://online.wsj.com/article/SB10001424052748704728004576176741120691736.html

The moral? If all you know is what you read in the papers (or nowadays on the Internet), be careful about what stories you read.

Mitchell's Musings 3-14-11: Trade Again

From time to time, I muse about international trade and particularly the U.S. trade deficit. Two events brought this issue back to my attention. The first was a release by the U.S. Bureau of Labor Statistics (BLS) of its series on hourly compensation costs in manufacturing (wages, benefits, and payroll taxes) in various countries as compared with the equivalent American compensation cost. The latest data are for 2009. For reasons I will explain below, the chart below covers only countries whose pay level was *higher* than the U.S. level.



As can be seen above, the U.S. manufacturing pay level was $33.53 per hour in 2009. In contrast, Norway – at the top of the chart – had a pay level of $53.89. These figures are in U.S. dollars at exchange rates of 2009, unadjusted for living costs in the various countries. (For purposes of cost competition in international markets, local living costs are irrelevant.)

Now you might assume that these countries, with their higher levels of pay, would be at a disadvantage in cost competitiveness relative to the U.S. and that the U.S. would therefore run a trade surplus with them. They are all developed countries with access to the same technology as the U.S. In fact, in aggregate, the American trade balance with these countries was negative to the tune of -$50 billion.[2] The U.S. trade deficit in total in 2009 was a little over -$500 billion so countries with pay higher than the U.S. nonetheless accounted for about 10% of the deficit.

[2] The U.S. ran surpluses with Belgium, Switzerland, the Netherlands, and Australia in 2009. Trade balance data are available from the U.S. Bureau of the Census at http://www.census.gov/foreign-trade/balance/index.html. The BLS release is at http://www.bls.gov/news.release/pdf/ichcc.pdf .

China, in 2009, accounted for about 45% of the deficit. So, yes, there is something going on with regard to trade with China. The big candidate there is the artificial exchange rate. But what about the other countries?

As international economists will point out, trade imbalances reflect differences in national saving and investment rates. The U.S. has been a deficient saver for many years and has borrowed from the world to finance its trade deficit. The indirect labor market impact has been to shift jobs out of manufacturing and into retail. That shift has distorted the labor market and tended to erode good jobs.

That brings me to the second event of last week that brought this topic to mind. The UCLA Anderson Forecast presented its quarterly outlook for the U.S. and California. However, its conferences always have an additional theme and in this case it was bringing back manufacturing. To paraphrase the observation of Prof. Edward Leamer - who heads the forecasting project - what the U.S. needs to do now is turn its shopping malls into factories.

Of course, that shift is easier said than done. It is fine to point out that the trade deficit is ultimately unsustainable, that "eventually" the world will grow weary of financing the trade deficit, and that something will then happen. In the words of President Nixon's chief economist Herb Stein, "That which cannot go on forever must come to an end." However, the world has grown used to the U.S. playing Keynes in recessions and generally providing jobs for everyone else. Both the U.S. and the world need weaning from their bad habits.

In prior posts, I have suggested that the U.S. needs to be proactive in this regard. I have noted the long-neglected Warren Buffett plan for forcing resolution the trade issue.[3] In the short term, it would help with the aftermath of the Great Recession. In the longer term, it could avert finding out just how that which cannot go on forever will come to an end. That end could be through another very unpleasant financial crisis, this one situated in currency markets rather than housing/mortgage markets, but with potentially the same effect. Making the shift now to balanced trade will avert the pain later.

[3] See http://employmentpolicy.org/topic/10/op-ed/how-solve-our-trade-mess-without-confrontation-china

Mitchell's Musings 3-21-11: What the U.S. Shouldn't Do to Help Japan is What We are Doing

In these musings, I have been harping for some time on U.S. trade and exchange rate policy as it relates to helping the U.S. climb out of the aftermath of the Great Recession. Improving our trade balance could play an important role in job creation, particularly in manufacturing. Now we have something new in international affairs: the Japan earthquake/tsunami/nuclear disaster. In that context, I read an article in the New York Times of 3/18/11 which I will break into three excerpted segments with some commentary on each. You can read the full article at http://www.nytimes.com/2011/03/18/business/global/18group.html

Segment #1

"Investors might have been expected to sell yen as Japan struggles to deal with the impact of an earthquake, a tsunami and a nuclear crisis. Instead they had flocked to the currency, briefly driving its value relative to the dollar to the highest level on record Thursday, before it receded to close at about 79 yen to the dollar."

The argument in this first segment seems to be that it is somehow unnatural for the yen to rise, given the disaster in Japan. Bad things happening in Japan – the segment suggests – should cheapen the yen. So let's consider that argument. Over many years, Japan has followed economic policies designed to ensure a trade surplus with the rest of the world (including especially the U.S.) and a positive current account balance. If a country chronically spends less abroad than it earns from abroad, its hoard of reserves will grow and grow. The result of those policies was thus the steady accumulation of foreign exchange reserves by Japan. Those reserves currently stand at roughly $1 trillion according to the IMF.

Now, thanks to the ongoing disaster, Japan will need to spend some of those foreign exchange reserves. There will need to be a massive rebuilding program which will divert Japanese capacity from exports to domestic use. And there will need to be imports. It's not just structures that will have to be replaced. All of those ruined cars you see in the news photos and everything that was in those structures will also have to be replaced. Again, all of that replacement activity will mean diversion of Japanese resources to domestic use and more imports from abroad. The diversion will come at a time when Japan's domestic production capacity is limited due to reduced electricity supplies and due to the displacement of many people who would otherwise be working.

One might expect, therefore, that spending those foreign exchange reserves by Japan would drive down the value of the currencies being held (especially the U.S. dollar) relative to the yen. The appreciation of the yen is not the product of some irrational investor behavior. It could be, in fact, investor anticipation of a likely course of events. Appreciation of the yen is, after all, part of the mechanism that will bring world resources into Japan to deal with the consequences of the disaster.

I didn't make all of this analysis up as you can see from Segment #2 of the New York Times piece:

"Some analysts said the buying was driven by speculation that Japanese insurance companies and other investors would sell foreign assets to cover the cost of rebuilding after the earthquake. Japanese officials sought to dispel that theory, noting that past disasters such as a 1995 earthquake did not create such an effect."

The only thing missing from the quotation is that it will not just be insurance companies that will be spending on rebuilding and replacement. The Japanese government will itself have to undertake a massive program. Consumers in Japan will have to spend on replacement as well.

What we really learn from Segment #2 is that as reasonable as the rationale for a rising yen might seem, the authorities in Japan don't want to believe it. (Clearly, the current disaster is far worse than the 1995 earthquake they cite.) In short, the powers-that-be in Japan want to go on with an undervalued yen to promote exports as if nothing had happened. Clinging to old ways is their privilege, I suppose, but surely – you might think - the U.S. and other major countries would not encourage them in that approach. Think again, however. Japan has in fact been actively trying to prevent the yen from appreciating and here is Segment #3 which is the lead-in to the story:

"The United States and other major industrial nations will join Japan in a highly unusual effort to stabilize the value of the yen by intervening in currency markets, the Group of 7 nations announced Thursday night. Markets responded immediately by driving down the value of the yen against the dollar, reversing almost a week of sharp increases."

"Stabilize" above is code for preventing yen appreciation as the second sentence in the segment makes apparent. In short, the U.S. is cooperating with an effort that is not what Japan should be doing and that is bad for job creation – particularly in manufacturing – in our own labor market. What Japan needs at this time is technical aid to deal with its dysfunctional nuclear power plants. What it does not need an export promotion campaign. It is the U.S. that needs an export promotion campaign. If we help maintain an undervalued yen (an overvalued dollar), we are not promoting U.S. exports or jobs.

Mitchell's Musings 3/28/11: Pensions Suitable for Framing

Various organizations do polling in California on issues of the day. Two widely respected organizations are the California Field Poll and the poll taken monthly by the Public Policy Institute of California (PPIC). Both organizations recently issued poll results concerning public pensions, although the PPIC poll also included a broad range of other topics. The Field Poll to which I will refer below is at http://field.com/fieldpollonline/subscribers/Rls2369.pdf (released 3/17/11) and the PPIC Poll is at http://www.ppic.org/content/pubs/survey/S_311MBS.pdf (released 3/23/11).

The Field Poll press release carried the headline "MORE CALIFORNIA VOTERS NOW VIEW PUBLIC PENSION BENEFITS AS TOO GENEROUS. NARROWLY OPPOSE TAKING AWAY COLLECTIVE BARGAINING RIGHTS OF PUBLIC SECTOR EMPLOYEES. MAJORITY SUPPORT FOR A NUMBER OF PENSION REFORM PROPOSALS." [The headline was in caps.] The PPIC report, as noted covered a broad range of issues. When it came to the section on pensions, the headline was "MOST SUPPORT PUBLIC EMPLOYEE PENSION REFORMS." [Headline also was in caps.]

Let's start with the Field Poll results. Below is a table reprinted from the Field release:

California registered voter views about the pension benefits received by most state and local government workers

	Too generous	About right	Not generous enough	No opinion
Total registered voters				
March 2011	**42%**	**34**	**14**	**10**
October 2009	32%	40	16	12
Party registration (*March 2011*)				
Democrats	32%	39	18	11
Republicans	59%	26	6	9
Non-partisans/others	40%	36	15	9
Union affiliation (*March 2011*)				
Union member in household	30%	45	20	5
Non-union household	47%	31	12	10

What you see on the table above are two alternative messages. On the one hand, the percent of California voters who think public pensions are *too generous* rose from 32% - when the question was previously asked - to 42%. But also note that 48% of voters think that public pensions are *about right* or *not generous enough*.

Given the agitation around public pensions in California (and elsewhere) over the past year or so, the rise in the "too generous" response is not surprising. Apart from well-publicized issues of underfunding, there have been scandals related to investments in the largest state pension plan, CalPERS. And, in the small (and low-income) City of Bell in Los Angeles County, there has been a highly-publicized scandal about key officials paying themselves exorbitant salaries which would produce proportionately large CalPERS pensions. (Some of these officials are now on trial.)

In the face of all the pension agitation and scandals that have occurred, however, it could certainly be argued that the surprising fact that 48% of voters viewed public pensions as "about right" or "not generous enough" could have been the headline. More voters thought that pensions were about right or not generous enough than thought they were too generous. What wasn't surprising was that news media accounts followed the Field headline "MORE CALIFORNIA VOTERS NOW VIEW PUBLIC PENSION BENEFITS AS TOO GENEROUS."

Note that the "more" in this headline refers only to *growth* in the too generous view. Someone quickly reading the headline could easily think that "more" meant that more respondents thought pensions were too generous as opposed to the percentage that were OK with public pension benefits or even thought they were too small. The headline in the *Sacramento Bee*, for example, was "Field Poll: Californians OK with unions but support public pension rollback." (See http://www.sacbee.com/2011/03/17/3481700/field-poll-californians-ok-with.html) The headline in the *San Francisco Chronicle* was totally misleading: "Poll: CA public-worker benefits 'too generous.'" (See http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2011/03/17/BAMJ1ID7A3.DTL)

The Field Poll went beyond simple measures of pension generosity. Various options for pension modification were given to respondents. A majority approved *all* of the suggestions, as can be below and on the next page, save for one involving imposing higher taxes to pay for pensions.

California registered voter reaction to various proposals aimed at dealing with the long-term financial obligations of public employee pension and health benefits

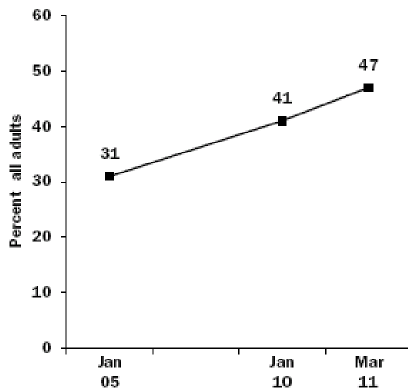
	Total registered voters	Democrats	Republicans	Non-partisans/ others
Establish an upper limit or salary cap when calculating pension benefits of public employees				
Approve	73%	68	81	71%
Disapprove	20	24	11	24
Require state and local government workers to pay more each month for their pension and health care benefits				
Approve	69%	67%	77%	65%
Disapprove	26	31	15	31
Increase the minimum age at which public employees can receive pension benefits				
Approve	60%	54%	66%	65%
Disapprove	32	37	24	31
Reduce retirement benefits for new employees and for the future un-worked years of current employees				
Approve	58%	53%	70%	52%
Disapprove	37	44	24	40

California registered voter reaction to various proposals aimed at dealing with the long-term financial obligations of public employee pension and health benefits	Total registered voters	Democrats	Republicans	Non-partisans/ others
Replace the current pension system for public employees with a new system that would combine 401k-style benefits with reduced guaranteed payments				
Approve	56%	50%	67%	52%
Disapprove	35	41	22	42
Give state and local governments the legal authority to modify existing pension agreements with their current workers				
Approve	52%	46%	63%	47%
Disapprove	41	45	31	46
Pass a temporary tax increase dedicated to building up the necessary funds for paying the pension and other retirement benefits owed to public employees				
Approve	26%	35%	14%	23%
Disapprove	67	58	77	72

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

In effect, there seems to be a contradiction here; 48% of voters are OK with public pensions or even think they are too small. Yet every suggestion for trimming these same pensions is supported.

What about the PPIC poll? The release from PPIC leads with the chart below which emphasizes growing anti-pension sentiment among the general population. (PPIC results refer to the general population but sometimes break out voters.



PPIC began polling on the pension issue in early 2005. At that time, then-Governor Arnold Schwarzenegger was in the process of putting on the ballot a series of initiatives in an effort he characterized as "the Year of Reform." There was to be a pension initiative but because of a drafting error it was not put on the ballot (and all the other initiatives failed to pass). However, the January 2005 date is useful because although political aficionados in California were aware of the governor's pension initiative, it likely was not widely known among the general public. The 31% figure, therefore, might be regarded as a baseline. That is, if asked about public pensions by a pollster, something like 30% of general respondents will always say they are a problem.

PPIC asked respondents about cutting back pensions as a solution to the ongoing (and severe) California state budget crisis. Note that the wording on the PPIC table below refers to the budget "this year." That phrase is ambiguous. Does it mean the current fiscal year (2010-11) or does it mean the next fiscal year, about which budget deliberations are currently taking place?

"As the state government looks for ways to balance the budget this year, do you think the state government should decrease the pension plans of government employees, or not?"

	All Adults	Party			Public Employees
		Dem	Rep	Ind	
Yes, state should	53%	48%	69%	55%	28%
No, state should not	39	42	23	32	62
Don't know	8	11	7	12	10

Whichever it means, the fact is that none of the widely-discussed pension changes would have much effect on the immediate budget. The main issue is past unfunded liability. Even the most aggressive proponents of cutting back public pensions in California recognize that pensions of retirees cannot be legally cut. They also recognize that already-accrued pension benefits cannot be cut, although there is dispute about the degree to which new accruals for existing workers can be modified. What the respondents on the table above may simply be saying is that things should be cut to balance the budget, although they have no accurate knowledge of the relevant savings that would result.

Like the Field respondents, PPIC respondents react to suggested ways of cutting pensions by supporting them, as the table below illustrates.

"Would you favor or oppose changing the pension systems for new public employees from defined benefits to a defined contribution system similar to a 401(k) plan?"

	All Adults	Party			Public Employees
		Dem	Rep	Ind	
Favor	71	70	80	72	56
Oppose	16	16	12	17	31
Don't know	13	14	8	11	13

Note that the question above involves defined contribution vs. defined benefit plans. But the only definition provided is that defined contribution plans are like 401k plans. No one was apparently asked if he/she knew what

defined benefit, defined contribution, or 401k actually meant. Even those who have 401k type savings plans at work may not know that number, actually an arcane number in tax regulations, by heart.

Beyond definitions, what were the respondents to these polls really concerned about? When the state budget is suggested to respondents as something to worry about, over two thirds say it is a "big problem" in the PPIC poll, as shown below. If public pensions are then put in the context of the big budget problem, it is not surprising that cuts in those pensions are supported.

"Do you think the state budget situation in California—that is, the balance between government spending and revenues—is a big problem, somewhat of a problem, or not a problem for the people of California today?"

	All Adults	Party			Likely Voters
		Dem	Rep	Ind	
Big problem	68%	73%	88%	75%	83%
Somewhat of a problem	24	20	10	21	14
Not a problem	4	3	1	1	2
Don't know	3	4	1	2	1

However, none of this analysis gets to the depth of what is really bugging Californians. Are the respondents to these polls losing sleep about the state budget and public pensions? There is a pretty good hint in the PPIC poll that they are not. California has the second highest unemployment rate of any state in the U.S., over 12%. It had a disproportionate share of the housing boom/bust and the related mortgage/financial fiasco.

PPIC asks about the most important issue facing California. Fifty-three percent say "it's the economy, stupid." Only 14% of the respondents say it is the state budget. Even among presumably more politically aware "likely voters," the figure is only 21%. So what is really happening here?

"Thinking about the state as a whole, what do you think is the most important issue facing people in California today?"

Top four issues mentioned	All Adults	Party			Likely Voters
		Dem	Rep	Ind	
Jobs, economy	53	53	50	54	51
State budget, deficit, taxes	14	13	26	14	21
Education, schools	10	11	4	11	8
Gas prices	4	5	3	2	3

Undoubtedly, most Californians have some awareness of the state's budgetary problems. But they really aren't paying a great deal of attention to the details. What they are worried about is the state's economy, not its budget. Still, if a pollster comes a-calling and asks about the state budget, respondents will say that the state budget is a big problem. But there may not be much depth of feeling or knowledge behind that answer. If the pollster goes on and suggests approaches (including pension cuts) that might be solutions to the big budget problem, respondents will tend to go along.

It has long been known that responses to poll questions are sensitive to framing. Neither PPIC nor Field is what is derogatively known as a “push-poll.” Both organizations are earnestly trying to sense public opinion, not make public opinion. But in doing so, they inevitably raise concerns among respondents about issues which those respondents have only limited or no day-to-day worries. If you were a respondent, how many “don’t know” answers would you want to give, particularly since the very act of polling suggests that the questions are about matters which you should be worried about and have knowledge about?

The bottom line here: Be cautious about poll results dealing with technical issues that are not day-to-day concerns of most folks. That caution should be applied, whether the polls are taken in California or elsewhere.

Mitchell's Musings 4-4-11: Where Are We Going?

Those readers who are members of the American Economic Association may have seen the article "Top Incomes in the Long Run of History," by Anthony B. Atkinson, Thomas Piketty, and Emmanuel Saez, in the March 2011 *Journal of Economic Literature*. Below are some charts on income inequality from that article.

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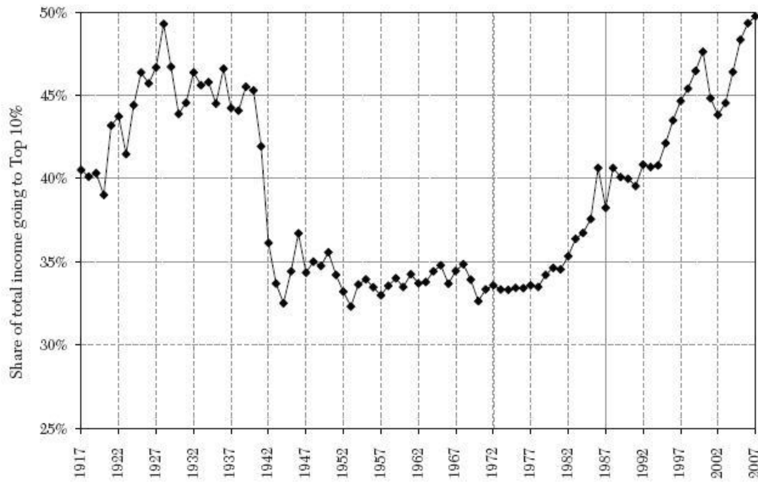


Figure 1. The Top Decile Income Share in the United States, 1917–2007.

Notes: Income is defined as market income including realized capital gains (excludes government transfers). In 2007, top decile includes all families with annual income above $109,600.

Source: Piketty and Saez (2003), series updated to 2007.

Atkinson, Piketty, and Saez: Top Incomes in the Long Run of History 7

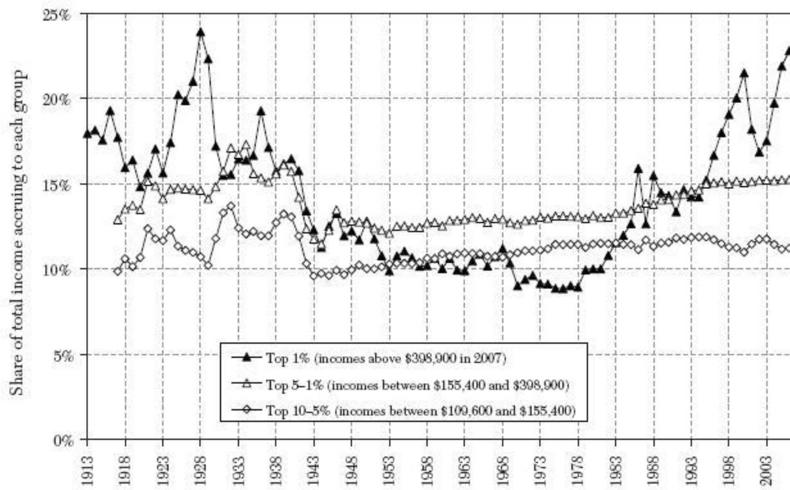


Figure 2. Decomposing the Top Decile US Income Share into three Groups, 1913–2007

Notes: Income is defined as market income including capital gains (excludes all government transfers).
Top 1 percent denotes the top percentile (families with annual income above $398,900 in 2007).
Top 5–1 percent denotes the next 4 percent (families with annual income between $155,400 and $398,900 in 2007).
Top 10–5 percent denotes the next 5 percent (bottom half of the top decile, families with annual income between $109,600 and $155,400 in 2007).

Atkinson, Piketty, and Saez: Top Incomes in the Long Run of History 9

TABLE 1
TOP PERCENTILE SHARE AND AVERAGE INCOME GROWTH IN THE UNITED STATES

	Average income real annual growth (1)	Top 1% incomes real annual growth (2)	Bottom 99% incomes real annual growth (3)	Fraction of total growth captured by top 1% (4)
Period				
1976–2007	1.2%	4.4%	0.6%	58%
Clinton expansion				
1993–2000	4.0%	10.3%	2.7%	45%
Bush expansion				
2002–2007	3.0%	10.1%	1.3%	65%

Notes: Computations based on family market income including realized capital gains (before individual taxes). Incomes are deflated using the Consumer Price Index (and using the CPI-U-RS before 1992). Column (4) reports the fraction of total real family income growth captured by the top 1 percent. For example, from 2002 to 2007, average real family incomes grew by 3.0 percent annually but 65 percent of that growth accrued to the top 1 percent while only 35 percent of that growth accrued to the bottom 99 percent of U.S. families.

Source: Piketty and Saez (2003), series updated to 2007 in August 2009 using final IRS tax statistics.

Perhaps the extreme concentration at the top shown on these charts no longer surprises anyone. It is interesting that even among the top 10%, the big gains are just in the top 1%. I do imagine, however, that even aficionados of these kinds of data are surprised that public anger of late is targeted at government sector employees and their pensions. Whatever the excesses in that sector, no one there

falls in the top 1% (unless someone in the top bracket chooses to run for office in a self-financed campaign).

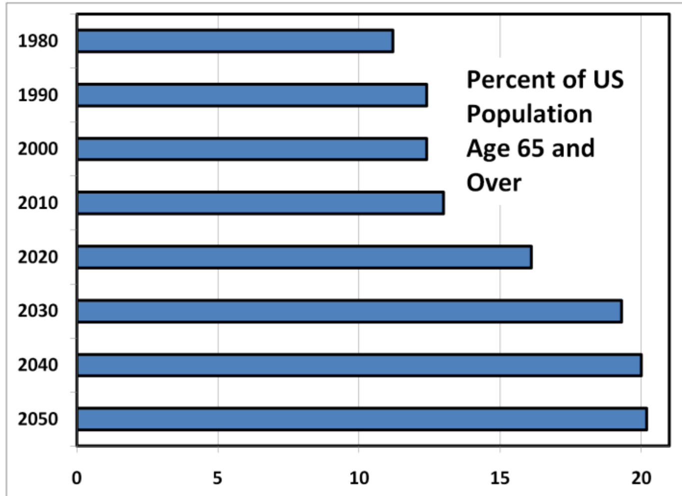
What may have surprised some observers about current political turmoil is the historical background of the Great Depression. The Great Depression – which as the charts above indicate followed an earlier run-up in inequality - led to a shift to the left in national politics. Note, however, that it is dangerous to rely on an N of 1 in a sample. (And let's be grateful that there is only one Great Depression!) Moreover, while the net effect of the Depression was indeed a shift to the left, there were many social movements put into play back then that either were on the right or were hard to characterize.

That thought was brought to mind by an invitation for me to speak next week (April 13) at Middlebury College on a book (and related articles) I wrote circa 2000. The talk is entitled "Ham and Eggs in the 21st Century?" which was the title I wanted to give the book. But the publisher insisted folks would think it was a cookbook with such a title. So the title became the dry "Pensions, Politics, and the Elderly: Historic Social Movements and Their Lessons for Our Aging Society" (M.E. Sharpe, 2000). My assignment at Middlebury is to update what I said over a decade ago.

The book deals primarily with various "pensionite" movements that arose in California – especially during the Great Depression – some of which spread nationally. Most notable was the Townsend Plan (federal pensions of $200 a month for every citizen over 60 who promised to spend all the money each month and also promised not to work). The Ham and Eggs movement was a state (California) version - $30 Every Thursday to be paid by the state to all citizens over 50 and to be financed out a kind of state currency. Ham and Eggs appeared twice on the state ballot in 1938 and 1939 and might well have passed the first time but for the shenanigans of its promoters.

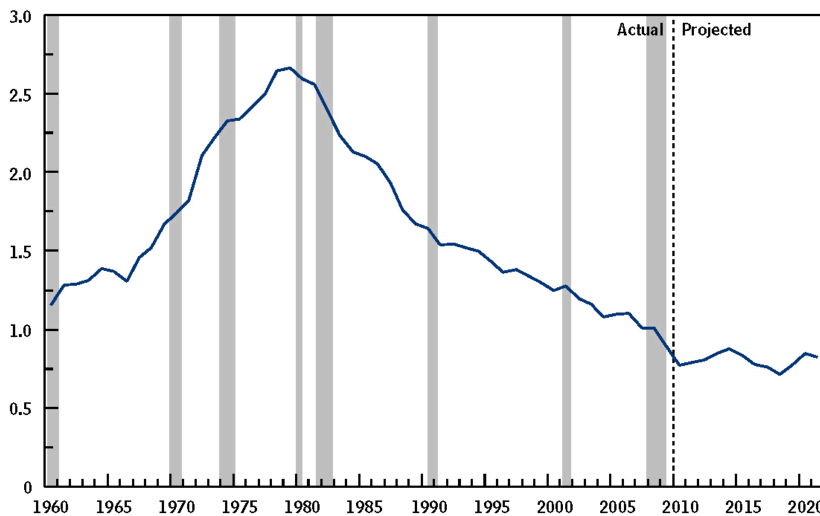
The book notes that there were other movements around in that era not necessarily connected to pensions such as Social Credit (which took over the Province of Alberta in Canada), Senator Huey Long's Share the Wealth movement, or radio priest Father Charles Coughlin's Social Justice movement. California's age-heavy demography drove its movements towards pensions but in other areas of the country, there were other concerns. The various movements synthesized social concerns and currents of thought of the day and often had elements of conspiracy theories as part of their appeal.

In short, it is not evident that inequality and an economic downturn has a predictable directional effect on politics. All we can say is that the combination seems to have roiled politics in the 1930s and seems to be having the same general effect now. Moreover, there are some aggravating circumstances now that are reminiscent of age-heavy California back then. The baby boomers are starting to retire and the proportion of the elderly in the population will be increasing, as the chart below – based on Census projections – indicates.

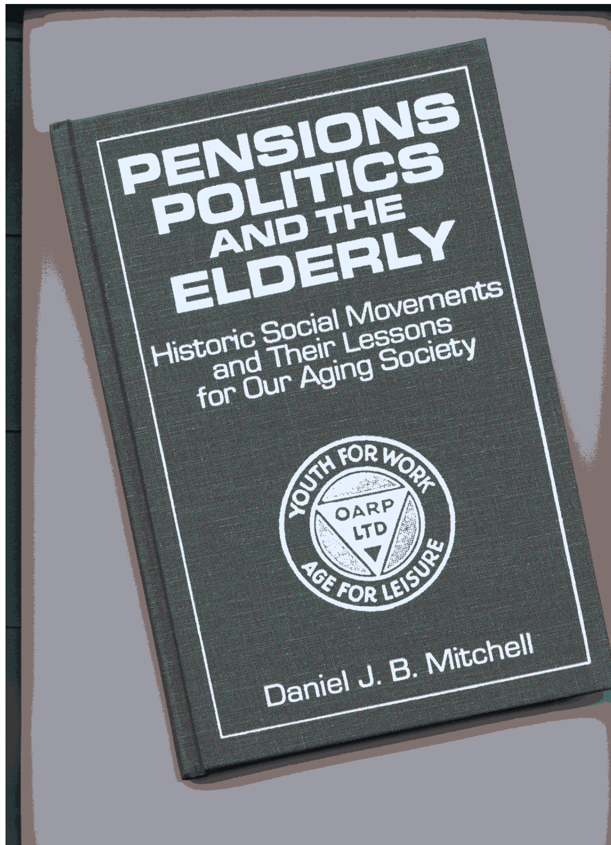


So more people in the population, even now, are more worried about their retirement years than might have been the case even a decade ago. Viewed that way, it is not surprising that public pensions are now controversial. The average citizen may have some vague knowledge about income inequality. But he/she is unlikely to move in the same circles as anyone in the top 1% of the income distribution. He/she is more likely to know the teacher down the street or the clerk in the county hospital on the next block.

The retirement of the boomers not only means more elderly to be supported in some fashion (and requiring medical care), it also means a smaller fraction of the adult population working. Congressional Budget Office projections (from http://cboblog.cbo.gov/?p=1976) reflect this impact, as the chart on the next page illustrates. There was a marked run-up in labor force particpation beginning in the 1960s, particularly among women. By the late 1990s, that effect had leveled off and we are now in a period of participation decline, aggravated by the Great Recession. What is occurring is not just the usual policy wonk statistical analysis of the ratio of active workers per retiree. In more personal terms, working Americans will be seeing more non-workers, down the street and on the next block.



In short, the historical record doesn't allow us to say much about the left/right political impact of these shifts in income, the business cycle, and demography. The record just suggests instability and conflict are in our future.



Mitchell Musings 4-11-11: Rationalizations, Explanations, Incentives

Last week, I happened to hear a radio newscaster attribute a downturn in the American stock market to an aftershock earthquake in Japan. Now I suppose there must be a model that indicates that bad news for Japan is automatically bad news for the U.S. economy or the U.S. stock market. But I can make a plausible model that would say that the bad news in Japan would be good for the U.S. economy or stock market (less competition globally; more demand for U.S. exports). Most plausible of all is that there was absolutely no connection between the two events and that whoever wrote the script for the newscast just needed an explanation for a financial development.

The stock market seems particularly prone to attract such non-explanation explanations since it fluctuates from day to day. When it goes up, you often hear that the explanation is that everyone was buying. When it goes down, the explanation given is that everyone was selling. That is an odd idea when you take a moment to reflect. Every stock that is bought is one that is sold. Repeat: every stock that is bought is thereby sold. Buyers need sellers. (Sometimes, however, when I point this out to folks, I get surprised looks.) The everyone-was-buying or everyone-was-selling story is really saying nothing more than that the market consensus was that prices should be higher or lower than they were before. But the story sounds plausible and seems to provide an explanation. Human beings want explanations; they want stories and rationalizations. We really don't like the idea of randomness and luck or just not knowing.

There is a tendency, because we want stories of causation, to over-attribute good or bad outcomes to leaders. In politics when the economy is performing well, the president, governor, or mayor is apparently given credit. Political leaders understand this tendency and often take credit for the jobs "they" created. Of course, in downturns, political challengers to incumbents blame the incumbents for the jobs that "they" lost. Various studies do suggest that election outcomes are influenced by the direction of the economy. I am not saying political leadership has nothing to do with economic trends. But I am saying there is a tendency to give more credit or blame for what happens to leaders than they deserve.

Similarly, successes of enterprises - or organizations within enterprises – tend to be over-attributed to top managers. As any reader of Dilbert will undoubtedly attest – and anyone who has ever taught or studied in a management school should know – the field is prone to fads and gurus who sell fads. And there is a tendency – because we want to attribute causation to something – for fads and gurus to arise. Let's consider a possible mechanism.

Suppose that there are two outcomes for a firm or division within a firm: success or failure. Suppose a guru/fad is in vogue and top management has a choice: follow the guru/fad or don't

follow. Suppose following the guru/fad does not in fact contribute to success. The chart below illustrates the four possible combinations, designated as A, B, C, and D.

	Don't Follow Guru/Fad	**Follow Guru/Fad**
Success	**A**	**B**
Failure	**C**	**D**

If you did nothing new as a top manager, i.e., you didn't follow the guru/fad, and your organization experienced success (A), you have offered evaluators no explanation in your own behavior for the success. Evaluators are likely to attribute the success to something else, whatever handy explanation they can find. On the other hand, if your organization experienced success and you followed the latest guru/fad (B), you can be seen an up-to-date manager who adopted the wise course of action and therefore succeeded. You should certainly be rewarded with pay, promotion, or even a better position in some other organization. (B is better than A in the face of success.)

Failure (C and D) can never be good. But if you followed the latest guru/fad and yet the organization experienced failure (D), it is possible you might escape blame. Perhaps something else can be found to be the needed explanation for the failure since you were doing the right thing. If the organization experienced failure and you are perceived as having done nothing (not followed the guru/fad; position C), surely you will be blamed and penalties will likely ensue. (D is better than C in the face of failure just as B is better than A in the face of success.) In short, everything points to following the guru/fad as the low-risk strategy since you will end up in the preferred B or D.

There is much more to be said about this conclusion – which, after all, is based on a "story."   It does not explain why some guru/fads catch on and others don't. And you might be a brave leader who did something unique that was plausibly related to success other than following the guru/fad approach. In that case, you might well be credited with being exceptionally perceptive and innovative as a manager if the organization experiences success. But the risk is that you might end up in position C, in which case the risk increases that you will be blamed for the failure. (You took an oddball approach rather than follow the guru/fad and look what happened.)

The key point here is that we tend to commit to stories and explanations and then interpret events as consistent to that commitment. Our institutions – as in the management case – can reinforce such beliefs and commitments. Challenges to prior commitment are likely to provoke annoyance at best.

The commitment problem comes up in other contexts. An example appeared in my hometown newspaper, the *Los Angeles Times*, last summer. There is general concern about the quality of education in the Los Angeles Unified School District. The *Times* discovered that the District had been compiling "value-added" data on teachers but was not using these data in personnel evaluations. There is a whole literature, I gather, in the field of education on the use of value-added scores and how valid they are. The idea seems to be to look at student <u>improvement</u> via standardized tests for students under a particular teacher. Since what is being measured is the <u>change</u> in the test score rather than the absolute value of the score, the value-added methodology is seen as adjusting for pre-existing student advantages or deficiencies.

The *Times* got access to the value-added scores and published them on its website <u>by teacher name</u>. As might be expected, teachers who had low scores were unhappy, although the *Times* gave teachers the option of commenting on their scores on its website.

I don't want to get into the validity of such scores, since I don't know the education literature. I can, however, see at least some questions about a) interpreting the scores (since, for example, students are not randomly assigned to teachers) and b) about the wisdom or ethics – given that uncertainty – about publishing the scores by teacher name. It would seem (to me) that if there were doubts about validity, publishing the scores by name was not appropriate. The *Times* could have run averages or distributions for particular schools, for example, without names.

The more the publication of the scores by name was challenged, however, the more the *Times* insisted that it had done a service to the community. Parents could see if their children had good teachers, for example. Yet if the *Times* had looked at some of the comments that teachers put on its website, those comments might have at least raised some doubts.

In some cases, it appeared there may have been errors in the data set, e.g., the teacher was not teaching the subject in which he/she appeared to be rated. One comment stood out to me as suggesting a problem with the methodology. The particular teacher who commented was rated as "average" in effectiveness overall, including specifically average in effectiveness in English instruction, but he/she still had complaints. I reproduce his/her comments below in italics. I have inserted *, **, etc., at points in the comment to serve as footnotes indicating problems in grammar.

"My value-data score change after other teacher complaints that the data was** incorrect based upon pool for teacher* with 60 or less*** students**** it just goes to show you how other teacher's***** data can effect****** mine. Not only are scores based upon what my students are doing, but how other teacher's***** students are doing. Just goes to show you how there are lies, damn lies, and then statistics."*

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*Possible typos; should be "change<u>s</u>" in the first case and "teacher<u>s</u>" in the second. **Purists would say "were" but "was" is now acceptable. ***Should be "fewer." ****Sentence should end with a period at this point and a new sentence should start with "It." *****Should be "teacher<u>s'</u>" in both instances. ******Should be "<u>a</u>ffect."

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There are various interpretations that might be drawn from this teacher's comment. It could be that all teachers who are rated "average" in effectiveness in English are actually sadly ineffective and surprisingly inarticulate. But it could also be that the value-added approach is subject to wide error in its ratings. This teacher, perhaps, should have received a poor rating – particularly in English - but was incorrectly rated as average. Since the possibility of error cannot be ruled out, the *Times'* continued assertion that all was well – its commitment to that view - seems inappropriate (to me, but not to it).

What is the lesson from this musing? At some level, we know that we tend to seek and see explanations for random events. We know that political leaders cannot be responsible for everything that happens when they are in office. We know that management is particularly prone to faddism and gurus. And we know that once we commit to a particular interpretation or course of action, it is very difficult to change course and admit error, or even possible error. It's fine to argue forcefully for a position we believe in the social sciences. I often do. But there should always be room for doubt.

Mitchell's Musings: 4/18/11 International Data: Here Today; Gone Tomorrow?

At one point about a year ago, there appeared to be a plan to end international data collection through the U.S. Bureau of Labor Statistics (BLS), connected to budgetary concerns. The threat was publicized on the web and protests were registered. Given the current budgetary issues in Congress, I am concerned that international data could again be threatened – if not this year, then some time in the future.

Chart 1:

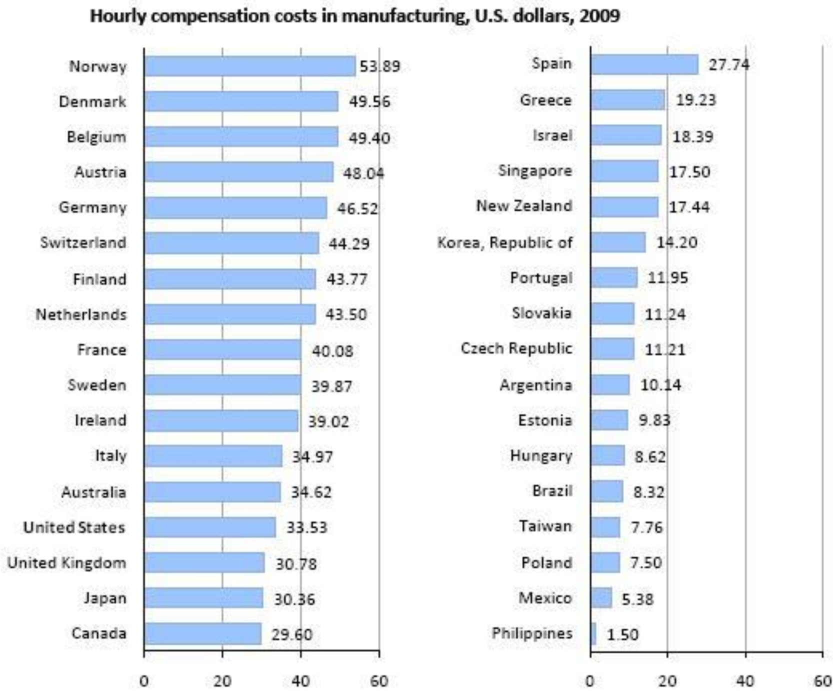
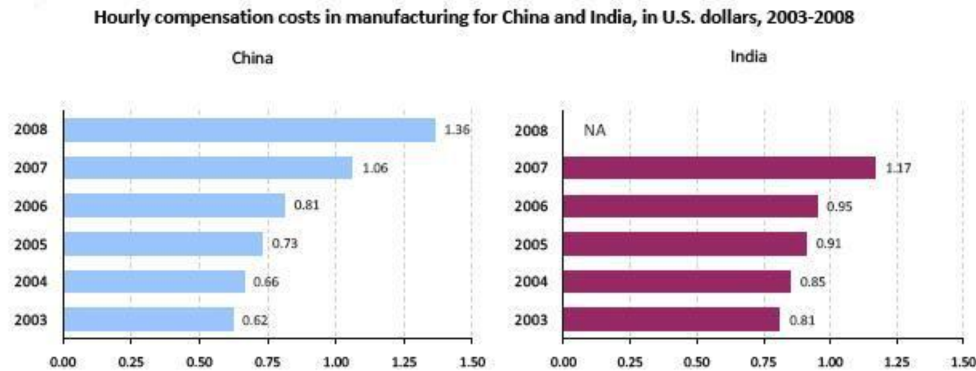


Chart 1 above is illustrative of one kind of international information found currently on the BLS website and in various BLS publications. If you wanted to know how U.S. hourly labor costs (wages, benefits, payroll taxes), at prevailing exchange rates, rank relative to those of other countries, you can find the information readily. Of course, by itself, such information does not provide everything you might want to know about trade "competitiveness." But it does, for example, indicate that the U.S. is not an especially high-wage country within the developed world. And it does show that in the developing world, the wage gap relative to the U.S. is particularly large. Distance matters importantly in international trade and migration so the fact that the U.S. shares a border with Mexico – where pay is only 16% of the American level – is obviously significant with regard to both issues.

One of the major world economic developments since the 1980s is the emergence of China (20% of the world's population), and now India (17%), into the international marketplace. Unfortunately, data collection in both countries is limited. But the BLS website does provide some information, suggesting pay in both is approaching the level of the Philippines, as Chart 2 (next page) illustrates.

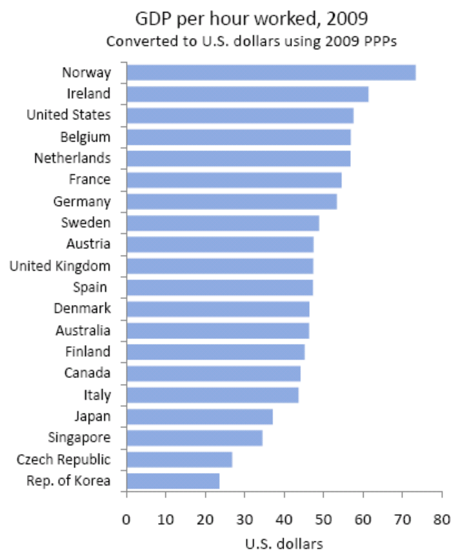
Chart 2



The March 2011 BLS *Monthly Labor Review* has a detailed article on China and the complexity of data gathering and interpreting there. [http://www.bls.gov/opub/mlr/2011/03/art4full.pdf] An earlier study in May 2010 provided a similar analysis of India: http://www.bls.gov/opub/mlr/2010/05/art1full.pdf.

What about productivity? BLS provides information on trends in output per hour in manufacturing and unit labor costs over time. Those data, however, are in the form of index numbers which don't permit comparisons at a moment in time. But you can find data on GDP per work hour measured in purchasing power parity (PPP) terms which give a crude indication of international productivity differences, as illustrated on Chart 3 (below).

Chart 3



It might surprise you to learn from the chart above (and the underlying data that can be found at http://www.bls.gov/fls/intl_gdp_capita_gdp_hour.pdf) that by this measure, Japanese productivity is about two-thirds of the U.S. level.

I could go on giving illustrations of the use of international data collection. Many readers will know, for example, that the BLS adjusts foreign labor force data – such as unemployment rates – to American concepts. Such information provides a means to compare, for example, the impact and severity of the Great Recession across countries.

It seems odd that these kinds of international comparative data were ever on the cutting block. Truisms such as "we live in a global economy" still abound in popular discourse. If you look back over time, you would find that at one time the BLS produced far more information on the union sector than it does today. There were "wage chronologies" that followed particular union-management settlements viewed as pattern setters. Union settlements by contract were reported regularly in *Current Wage Developments*. Calendars of contract expirations appeared in the *Monthly Labor Review.* Data on work stoppages covered small strikes and lockouts, not just those involving 1,000 or more workers, as is the case today. The dropping of these various programs – a process that essentially began in the 1980s – was rationalized on the grounds that the union sector was declining. Whatever the merits of that argument, there is surely no analogous decline in the importance of global developments to the U.S.

Mitchell's Musings 4-25-11: Default, Dear Brutus, Is Something S&P Can't Evaluate

Daniel J.B. Mitchell

There were big headlines last week when the Standard & Poor's rating service issued a warning about a possible future downgrading of US Treasury securities. Not surprising, some of the reaction was grumbling about rating agencies that totally missed the mortgage fiasco. But others saw the warning as reasonable and a Good Thing. The *New York Times*, for example, ran an editorial entitled "Good Advice from S&P." In fact, the text of the editorial was more qualified than the title suggests. The thrust was that default was not imminent but it would be a good idea for the U.S. eventually to deal with its large deficits. So S&P should be thanked for bringing the issue to our attention. (See http://www.nytimes.com/2011/04/20/opinion/20wed2.html)

Actually, the advice was not so good. S&P normally looks at securities issues by private entities and sub-national governments in terms of whether those entities and governments can repay what they have borrowed. Private entities and sub-national governments cannot create money. They borrow in currency created by someone else. So it is possible for them to run into trouble and not have enough of that currency to repay – or repay on schedule. The same is true for national governments that have surrendered their currencies, e.g., those in the Euro zone. In that respect Greece, which has had recent financial problems, is not different from, say, a city in the U.S. It is also possible for national governments that have their own currencies, but that borrow in other countries' currencies, to find themselves unable to repay. Think Mexico – which borrowed in dollars - and its various peso crises.

The U.S., however, can create dollars and it borrows in dollars. A Treasury bond is a promise to pay back interest and principle in dollars. Even the inflation-adjusted Treasuries are ultimately promises to pay back in dollars. So the U.S. can't default on the grounds that it doesn't have enough dollars. It always can have enough dollars to pay what it owes *unless* it makes a political decision not to do so. Such a political decision could be, for example, not raising the debt ceiling, an issue that is about to come up. However, S&P is not in a position to evaluate such a political decision using the usual financial indexes it analyzes when it evaluates more typical securities.[4]

Now some will argue that if the U.S. continues in its large federal deficits – and if it then monetizes the resulting debt – that process will be inflationary and inflation was really S&P's concern. S&P, in that interpretation, feared that while the U.S. would repay, the repaid dollars would be worth a lot less than today. But if that were the basis of its concern, S&P should be downgrading every security – public and private – that is currently denominated in dollars. (Presumably, however, it should not downgrade

[4] I am not alone in pointing out the problem of applying usual S&P analysis to Treasuries. Only two days before the *New York Times* ran its editorial, a more enlightening view appeared on its own website. See http://www.nytimes.com/roomfordebate/2011/04/18/is-anyone-listening-to-the-standard-poors/ignore-the-raters?

inflation-adjusted Treasuries.) But S&P did not threaten all dollar-denominated securities with downgrades.

Others might argue that what S&P was worried about was a chain of events running from the federal deficit to dollar devaluation relative to other currencies. But, again, if that were the case, S&P should be downgrading all securities denominated in dollars. (Presumably, if dollar devaluation were the actual worry, even inflation-adjusted Treasuries might be downgraded.)

I know that it is very unsettling for folks to think of money as something created and not “real.” After all, people strive for money; they even murder for money. But in the end, in modern monetary systems, money is a social convention. People accept dollars in payment because they know others will accept them. I know that if you pay me in dollars, I can take those dollars to the grocery and buy my daily bread. There is a long chain of historical explanations about why in the U.S. people nowadays “think in” dollars while in Japan people “think in” yen and about how those two currencies – and all others – arose. For those interested in such matters, you can easily investigate online what “dollar” means, e.g., http://hotword.dictionary.com/dollar-joachimsthaler-origin/. But the bottom line is that it was unhelpful to have S&P confuse the issue of Treasury risk. Such confusion can lead to political responses that in turn can produce pressures for inappropriate monetary and fiscal policy.

None of the above should be taken to mean that it is a Good Thing over the long run for the U.S. to run large federal deficits. Such deficits are a form of dissaving in the public sector. That dissaving, combined with low rates of household saving, is part of the story of why the U.S. runs large trade deficits. And it is trade deficits about which S&P – if indeed it were worried about dollar devaluation – should be highlighting. It is the trade deficit that produces large holdings of dollars abroad. As previous posts on this blog have emphasized, it is the trade deficit that undermines U.S. manufacturing and the potential for good jobs in that sector. And it is those large holdings of dollars abroad - and their potential to create a run on the dollar and the next financial crisis -that could threaten jobs throughout the economy.

Mitchell's Musings 5-2-11: Rationalizing Unemployment: How Long Can You Go?

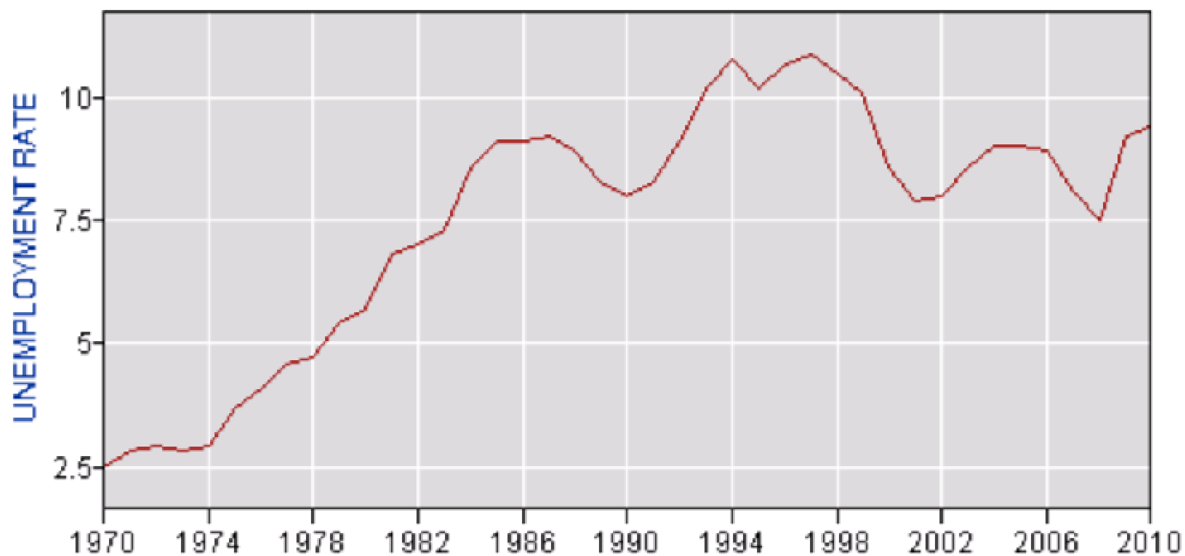
An earlier post on Mitchell's Musings noted the potential threat to federal funding for collection of international labor-market data. Happily, that threat has now receded for the time being. That development is a cheerful note for the data source. But the data found there do not necessarily lead to cheerful conclusions about political economy.

Last week, there was much fanfare when Ben Bernanke, the Federal Reserve chair, held a news conference that was viewed as a bold exercise in transparency. On the other hand, there was also criticism of the Fed and of Bernanke for being too concerned with the threat of inflation and insufficiently concerned with ongoing unemployment. But the controversy itself raises the question of how the political system reacts to extended periods of unemployment.

Most forecasters – including those at the Fed – expect a prolonged period of unemployment. Typically in such forecasts, the unemployment rate gradually declines. But, of course, once forecasting goes out over periods of years, it cannot pick up whatever surprises may be in store – negative or positive – along the way. So the tendency of forecasting models is always to return gradually to "normal" after a shock. The predicted unemployment rate oozes toward a level somewhere in the 5-6 percent range.

International data on unemployment in developed countries indicate that it is quite possible for unemployment to remain high for many years, with ups and downs along the way. The chart below, for example, shows the French unemployment rate from the early 1970s (when it was quite low) to 2010.

France: Unemployment Rate (US Basis)

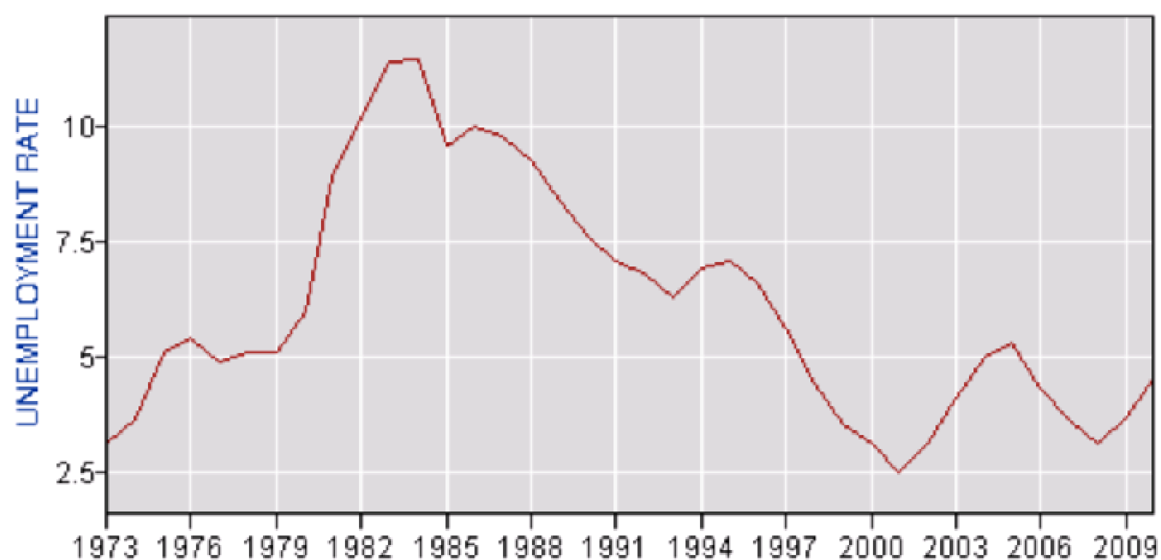


It is worth noting that the earlier years depicted on the chart long pre-date the replacement of the franc by the euro which, as prior posts on this blog have noted, now constrains French economic policy. Governments have come and gone in France since the unemployment rate became stuck at relatively

high levels in the 1980s. But those high unemployment levels seem to have become a French norm, something to fret about perhaps, but not something that leads policy makers to make drastic changes or to question basic assumptions.

What is also of interest is that the comparative data do not show uniformity in unemployment rates across EU countries. For example, the chart below shows the Dutch unemployment rate through 2009 (the latest year available currently from the U.S. Bureau of Labor Statistics database). Thus, French policy makers would not have to look very far to find a country whose unemployment rate fell notably after its rise in the early 1980s and that has generally fluctuated at lower levels than found in France.

Netherlands: Unemployment Rate (US Basis)



In short, there is reason to think that political inertia can arise in countries where unemployment remains high for an extended period. The jobless problem comes to be seen as inevitable or structural or is rationalized as due to some cause that cannot be much affected by policy.

"Technology" was a common villain in the U.S. of the 1930s. It was revived again during the "automation scare" of the 1950s and early 1960s. [See the accompanying video posted at http://www.employmentpolicy.org/automation-scare-1950s.] In both cases, wartime expenditures (World War II after the 1930s; Vietnam after the early 1960s) dropped the unemployment rate dramatically.

The technology/structural stories in the U.S. faded away both times after the unemployment rate dropped. But memories in policy circles are short. History suggests old tales can return. Indeed, they already have.

Mitchell's Musings 5-9-11: Data Driven

The U.S. Bureau of Labor Statistics (BLS) issued its monthly release on "The Employment Situation" for April on May 6. Some seeming anomalies were contained in the release. The unemployment rate rose from 8.8% in March to 9.0% although the nonfarm payroll survey showed a gain of 244,000 jobs, March to April. So jobs were up but so was unemployment. The unemployment figure comes from a survey of households while the nonfarm jobs figure comes from a different survey of employing establishments. If you looked at the employment figure from the household survey, it indicated jobs had declined by 190,000.

Each month, BLS puts out a similar release and such anomalies appear. So BLS includes in each release a lengthy explanation. The household survey and the establishment survey are different, it explains. For example, they cover different parts of the workforce, e.g., the household survey includes self-employed workers while the establishment survey doesn't (unless they appear on a payroll). The establishment survey double-counts people who hold more than one payroll job while the household survey doesn't. Seasonal adjustment (all the data cited above are seasonally-adjusted) actually only corrects for normal seasonality so that particularly harsh weather, for example, will still affect the numbers. The release goes on to explain the noise factor inherent in sample surveys. Etc., Etc.

After BLS is done, private analysts further offer explanations of the anomalies. It is true, for example, that household survey employment declined by 190,000. But if you look only at nonagricultural wage and salary workers in the household survey, thereby coming closer to the coverage of the establishment survey, there was actually an increase in employment of 40,000.

So here is an interesting question. Much of the explanatory information is meant to illuminate why seeming trends over a one-month interval can just be noise. So why do we release the data on a monthly basis?

All data release and collection intervals are somewhat arbitrary. Annual data, however, at least are linked to the solar cycle. We evolved out of an agrarian society in which knowing when to plant and when to harvest was important. The solar cycle determines the seasons. So calendars evolved around the solar cycle. Ancient monuments such as Stonehenge and Machu Picchu seem to be designed to track that cycle. Months, on the other hand, have something to do with the lunar cycle but don't correspond to that cycle very well (because the lunar cycle and the solar cycle are not matched).

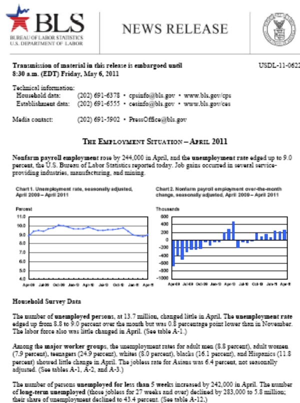
Some data are released in short intervals linked to administrative issues. For example, since we allocate unemployment benefits by weeks, data on new claims for unemployment benefits come out weekly. The short interval makes them quite noisy but they appear as a byproduct of the cycle within an ongoing program that wasn't intended as a data collection exercise. Of course, some of the most volatile data that appear come from financial markets on a continuous basis. Financial data are often produced privately and are commonly the byproducts of needed internal tracking of transactions.

At the other extreme, we have the decennial *Census of Population* that is at the intersection of the solar cycle and the number of human fingers. Its origins were not for economic policy but rather to allocate political representation. Apart from the administrative cost and difficulty of collecting the *Census* – think about what was entailed in 1790! – the instability that would result in frequent reallocation of legislative power is obvious.

We have been tracking the labor market on a monthly basis for decades. The household survey, for example, began in 1940. So everyone assumes that monthly data on, say, the unemployment rate is part of the natural order of things and is somehow critical to economic policy. Financial markets assume that the labor-market data in the monthly release will affect policy, such as Federal Reserve policy on interest rates, and so great care is taken by BLS to ensure secrecy until the official release date and time. But no one asks if it is a Good Thing that economic policy is being made on noisy data.

So I will ask. Might we benefit from having a less frequent collection of labor-market data with the cost savings that result put into, say, a larger sample? A larger sample would allow more detailed and accurate geographic or demographic divisions of the data.

We manage to get along with GDP figures that are released quarterly rather than monthly. (And those data have to be revised several times because the seeming need to have quick quarterly information means that not all components of the GDP are completely available early on.) Why is the unemployment rate fundamentally so different from the GDP that it cannot be released quarterly? Would economic policy in fact be harmed by less frequent information, particularly if the survey output was more detailed? Is policy being driven by minor perturbations and anomalies that result from semi-lunar data collection?



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U.S. DEPARTMENT OF LABOR

NEWS RELEASE

Transmission of material in this release is embargoed until 8:30 a.m. (EDT) Friday, May 6, 2011 USDL-11-0622

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THE EMPLOYMENT SITUATION – APRIL 2011

Nonfarm payroll employment rose by 244,000 in April, and the **unemployment rate edged** up to 9.0 percent, the U.S. Bureau of Labor Statistics reported today. Job gains occurred in several service-providing industries, manufacturing, and mining.

Household Survey Data

The number of **unemployed persons**, at 13.7 million, changed little in April. The **unemployment rate** edged up from 8.8 to 9.0 percent over the month but was 0.8 percentage point lower than in November. The labor force also was little changed in April. (See table A-1.)

Among the **major worker groups**, the unemployment rates for adult men (8.8 percent), adult women (7.9 percent), teenagers (24.9 percent), whites (8.0 percent), blacks (16.1 percent), and Hispanics (11.8 percent) showed little change in April. The jobless rate for Asians was 6.4 percent, not seasonally adjusted. (See tables A-1, A-2, and A-3.)

The number of persons **unemployed for less than 5 weeks** increased by 242,000 in April. The number of **long-term unemployed** (those jobless for 27 weeks and over) declined by 283,000 to 5.8 million; their share of unemployment declined to 43.4 percent. (See table A-12.)

Mitchell's Musings 5-16-11: What's the Program? What Should It Be?

The Joint Committee on Taxation issued a report last December on federal "tax expenditures." Given the complexity of the tax code, the document runs over 60 pages. And it comes with the usual caveat. When some activity is given encouragement by the tax code, it presumably changes behavior, that is, it encourages the activity (which is precisely the point of the favorable treatment). Thus, the calculation – which assumes the activity is independent of the tax code – will tend to exaggerate the revenue that would be obtained if the favorable tax treatment were eliminated.[5] (On the other hand, because state and local income taxes tend to mirror the federal tax code, the total public encouragement of tax-favored activities is understated.)

As is well known, Congress has historically loved the idea of home ownership. Thus, in federal fiscal year 2011, the tax expenditure on the combination of the mortgage interest deduction, deductibility of local property taxes, and exclusion of capital gains on sale of residences, came to over $133 billion in tax expenditure terms. And, there are many other smaller tax-based encouragements to home ownership buried in the tax code, e.g., favored treatment for rehab of older structures. Given the level of tax expenditure, we would surely have to consider home ownership as a major federal program.

Home ownership is ultimately something individuals decide to do or not do. There is little employer involvement. But Congress has long believed that there are things you should do in connection with employment. If your employer provides you with a dollar in wages, it is taxable. But if your employer provides you with a dollar's worth of health insurance, it is not. So there is a strong incentive to obtain health insurance via your employment (or as a dependent of someone in your family with a job). The federal tax expenditure on employer-provided health care is listed in the Joint Committee's report at over $117 billion in fiscal 2011.

What about saving for retirement? On-the-job defined benefit pensions have a tax expenditure of $51.9 billion; defined contribution plans have $38.2 billion. That's a total of over $90 billion. So we have tax expenditures of over $200 billion just for the health and retirement income forms of encouraging employees to receive or undertake activity through the employment relationship. (Some other benefits through the employment relationship also receive tax-favored treatment, e.g., life insurance.) Even if your employer does not offer a retirement plan, you can have your own IRA-type plan – but the contributions place in it must generally be work-related.

Of course, to do things through your employer, or through working, you need to have a job, or at least be self-employed. To some extent, providing benefits through the employment relationship does encourage work. There is a market for private purchase of health insurance, for example. But individual policies are expensive and you might not be able to buy it at all because of pre-existing conditions (although that is changing as the new federal health law takes effect). Apart from these indirect incentives, the tax code also provides direct encouragement of working – at least for lower-wage

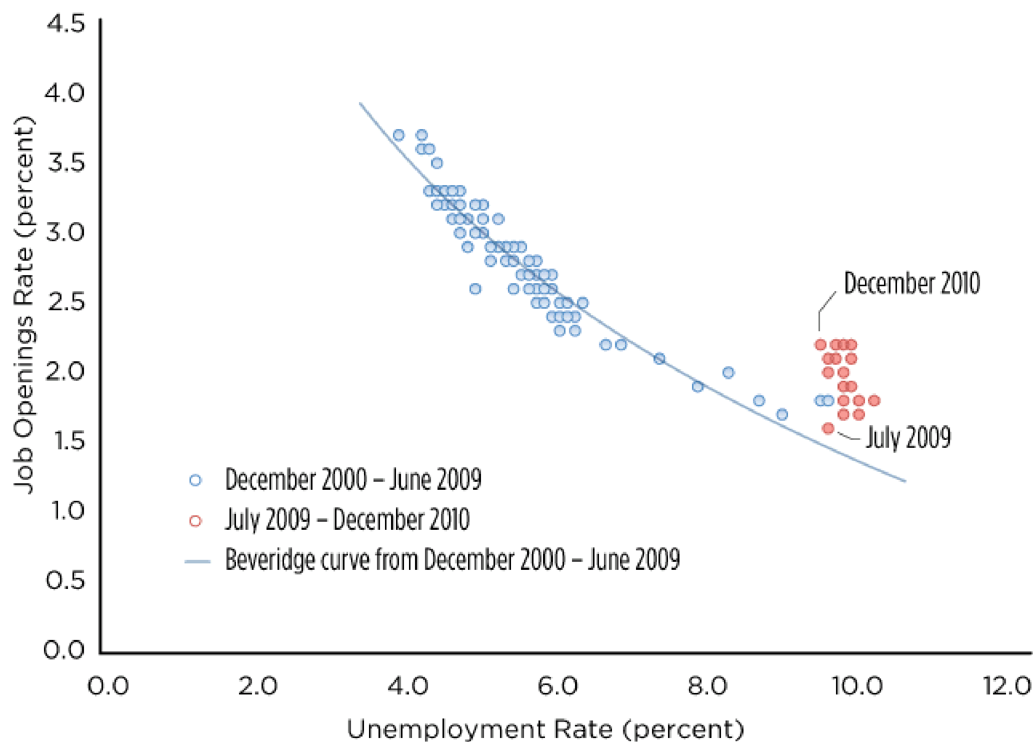
[5] The document can be downloaded at http://issuu.com/danieljbmitchell/docs/taxexpenditures.

individuals – through the Earned Income Tax Credit (EITC) which had a tax expenditure of over $52 billion attached to it in fiscal 2011.

Which brings us to the aftermath of the Great Recession and to the legacy it left of joblessness. It appears that further economic stimulus is not going to come from federal fiscal policy. State and local government are much more limited in their ability to stimulate. Indeed, many of them are in layoff and retrenchment mode. So that leaves monetary policy as our sole anti-unemployment program. Or does it?

There are voices in the Federal Reserve anxious to promote the idea that a) there is little the Fed can do because the unemployment problem has become structural, and b) the goal of monetary policy should be exclusively on holding down inflation and that single-minded approach will (eventually) allow unemployment to fall. An example of this approach can be found in the 2010 Annual Report of the St. Louis Federal Reserve Bank, available at
http://www.stlouisfed.org/publications/ar/2010/pages/ar10_2a.cfm

The structural argument appears in that Report in the context of a "Beveridge" curve from the report reproduced below:



SOURCE: Job Opening and Labor Turnover Survey, Bureau of Labor Statistics/Haver Analytics.

The curve traces an empirical relation between the vacancy rate (job openings) and the employment rate from the end of 2000 until the end of the Great Recession (officially in July 2009). Thereafter, through December 2010, the vacancy rate rises but unemployment does not fall as expected from the estimated curve. The conclusion drawn is that the new unemployed don't match what employers are seeking and therefore there is little the Fed can do about the mismatch. Readers familiar with U.S. economic history will recognize that similar sentiments were common in the early 1960s when the incoming Keynesians of the Kennedy administration were confronted with structuralist objections.

The Beveridge curve is not really a theoretically-derived relationship. It simply embodies the common sense idea that if vacancies are high, there should be less unemployment. We don't have a long history of vacancy data to know what the relationship "should" be after a major shock such as the Great Recession.[6] The earlier recession in 2001 which the data on the chart encompass was very mild.

To be considered a vacancy, the employer offering the position must engage in "active recruiting" for individuals to fill it. According to the Bureau of Labor Statistics, "Active recruiting means the establishment is taking steps to fill a position. It may include advertising in newspapers, on television, or on radio; posting Internet notices; posting 'help wanted' signs; networking with colleagues or making 'word of mouth' announcements; accepting applications; interviewing candidates; contacting employment agencies; or soliciting employees at job fairs, state or local employment offices, or similar sources."[7] There is considerable variation in the intensity of such recruitment methods. Whether employers have altered their intensity of candidate search as a result of the economic shock of the Great Recession is unknown. Similarly, how the unemployed may have recently adapted to the so-called "new normal" (sustained high unemployment rates) is also unknown.

In short, it is rather early to make definitive judgments as to whether a mismatch in vacancies and job candidates has mysteriously opened up in the past two years. Official projections from the Fed suggest that the long-run normal rate of unemployment is thought to be in the 5-6% range, which does not seem to indicate that a structural shift toward a job mismatch is believed to have occurred.[8] If it is not expected to be present in the long run, it is not clear why it should be assumed to exist now. And, of course, there is a considerable gap between current unemployment of around 9% and a norm of 5-6%. So there is room for improvement, even if you believe some kind of structural shift has developed.

Is there a danger of inflation? At some level, there is a danger of virtually anything. However, data on the spread between inflation-adjusted Treasury securities and conventional (non-inflation-adjusted) Treasuries suggest that no big acceleration in inflation is expected by financial markets. Financial

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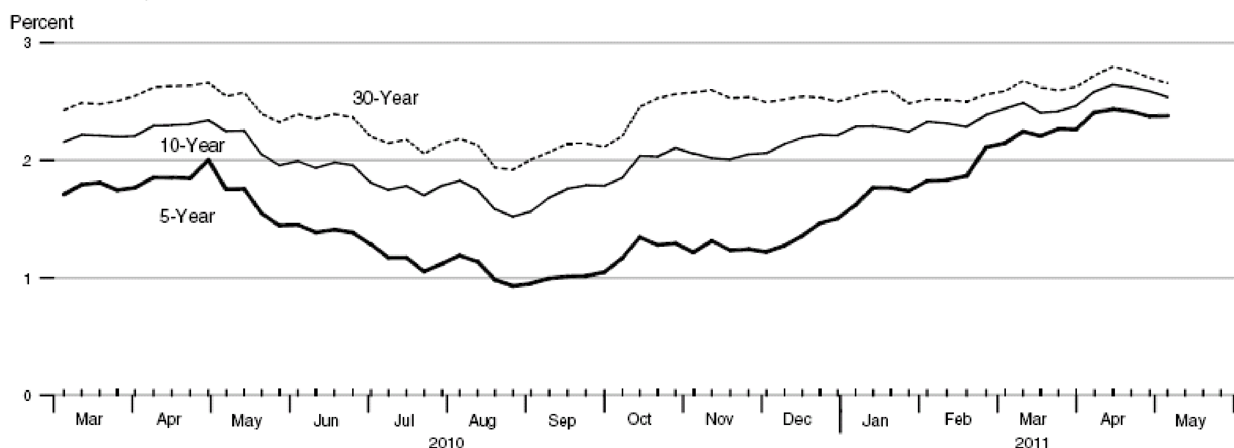
[6] The U.S. Bureau of Labor Statistics, in a data correction, lowered the vacancy rate data slightly for 2010. See http://www.bls.gov/jlt/2010revisionjo.txt. It appears that those corrections were not included in the chart although the effect would be minor.

[7] http://www.bls.gov/jlt/jltdef.htm#2

[8] See http://www.federalreserve.gov/monetarypolicy/mpr_20110301_part4.htm

markets seem to vary their inflation expectations for periods of as long as 30 years in response to short term developments. So perhaps we should not put strong weight on such expectations. Nonetheless, the chart on the below (from the St. Louis Fed!) does not indicate any great fear of imminent inflation. Indeed, the inflation spread (expected inflation rate) over the short term is below the spread of over the longer term.[9]



What about labor costs? Are wages rising to a point that inflation is threatened? If there are rising vacancy rates but job candidates for those vacancies are unsuitable, we should be seeing a notable wage acceleration. Employers should be bidding for the scarce capable candidates. The table on the next page shows the trend in the hourly Employment Cost Index over the past two years. Benefit costs have been the most notable element in compensation increase over that period and it is likely that the culprit in benefits is health care. Overall compensation (wages + benefits) is in the range of 2% per annum, hardly an indication of some incipient wage-push, to use an old phrase.

In summary, federal tax policy remains tilted toward encouraging people to obtain retirement and health care benefits through the work relationship. But unemployment remains high. The conclusion that nothing can be done about this contradiction because unemployment has become structural is at best premature. Harping on a risk of some imminent inflation explosion is also counterproductive. To the extent that there is pressure on labor compensation, it likely is arising from rising health care costs, not from a shortage of capable workers. Getting the unemployment rate down remains – or should remain – the principle goal.

[9] One could ask how financial markets know that the inflation rate from 2016-2021 will be higher than the inflation rate from 2011-2016 (which is implicit in the chart). One could ask how they know that the inflation rate from 2021 to 2041 will be higher than that from 2011-2021. But perhaps such questions would be impolite. The chart is from http://research.stlouisfed.org/publications/usfd/20110512/usfd.pdf .

Percent Change in the Employment Cost Index

	Twelve Months Ending:	
	March 2010	March 2011
State & Local Workers		
Total Compensation	2.0%	1.8%
Wages & Salaries	1.6	1.2
Benefits	2.5	3.3
Private – Union Sector		
Total Compensation	3.4	2.5
Wages & Salaries	2.5	1.9
Benefits	4.8	3.7
Private – Nonunion Sector		
Total Compensation	1.4	1.9
Wages & Salaries	1.3	1.6
Benefits	1.5	2.8

Source: http://www.bls.gov/news.release/pdf/eci.pdf

Mitchell's Musings 5-23-11: IMF Doesn't/Can't Deal With a Major US Issue

Recent unfortunate events – unrelated to world monetary affairs – have put a spotlight on the International Monetary Fund (IMF). So let's bypass the current scandal and instead ask what the IMF is supposed to be doing and why it isn't doing it.

Some history is required. The IMF was set up in the waning days of World War II as an international agency to administer a new world monetary order known as the Bretton Woods system, so-named after the New Hampshire town in which its arrangements were negotiated and ratified. An old newsreel gives some background:

http://www.employmentpolicy.org/1944-bretton-woods-conference-first-video-associated-mitchells-musings-5-23-11

Although the newsreel suggests broad international agreement on what emerged, in fact the Bretton Woods system was primarily the product of a negotiation between Britain - in the person of John Maynard Keynes – and a US Treasury official – Harry Dexter White. Although you have undoubtedly heard of Keynes and probably not heard of White, given the balance of power, the White-US view of what the IMF should be prevailed.[10] Essentially, the Keynes-British view was that the IMF should be a kind of international central bank with the authority to created money. The White-American view was that the IMF should be a relatively weak financial intermediary – a kind of international savings and loan – with only a limited power to borrow and lend to governments and national central banks. Given the balance of power in 1944 between Britain and the US, the American approach prevailed.[11]

The Bretton Woods system involved fixing two kinds of prices, currency exchange rates and the price of gold in dollars. The US dollar was to be the world international currency with all currencies maintaining a fixed exchange rate to the dollar. Neither Keynes nor White thought that gold need play a role in the Bretton Woods system in theory. However, since the world was used to gold as part of the monetary order, the US would maintain the official price of gold at $35/ounce, an arbitrary price that had been set by the Roosevelt administration during the Great Depression. If every world currency was pegged to the dollar and the dollar was pegged to gold, then indirectly every currency had an implicit gold value.

Bretton Woods was a fixed exchange rate system. Exchange rates can be fixed providing someone is willing to buy and sell currencies at the fixed rate in unlimited quantities. If the official price of the

[10] White was supposed to head the IMF at its inception but was accused of being a Soviet agent. There is an interesting tale there, but you can investigate it on Google.

[11] The US had a long history of domestic politics revolving around suspicion of banks and British finance reflected, for example, in the free silver movement of the late 19th century. There was no way Congressional approval for a world central bank could be obtained. Symbolically, the IMF's headquarters – unlike the UN's – was put in Washington, DC, i.e., where the US government could keep an eye on it and not near the financial center of New York City.

British pound is, say, $2.80 (as it was at one point), someone must be willing to stand ready to buy and sell dollars for pounds and pounds for dollars at that rate. Essentially, it was left to countries to see to it that their currencies stayed at the fixed value.

Note that there is an asymmetry built into any fixed rate system. If, say, the pound was in excess demand (tending to appreciate above the fixed price), the British central bank could sell pounds and buy dollars, preventing the rise. Since the British central bank can create pounds, it essentially has an unlimited supply of pounds with which to buy dollars. But when the reverse is true, i.e., when the pound is in excess supply (tending to depreciate), Britain needs dollars – which it can't create – to buy up the excess pounds. The IMF was supposed to be able to lend those dollars to Britain. However, as a weak institution, the IMF did not necessarily have sufficient dollars. It was, therefore, easy for countries to deal with excess demand for their currencies (since no aid was needed) but tough to deal with excess supply.

When a country found its currency in excess supply, the usual remedy was to raise interest rates (to attract an inflow of foreign funds and thus increase demand for its currency). High interest rates and other austerity measures would also slow the domestic economy. Recessions are a great way to cut back on imports (and therefore decrease the supply of your currency to the world), if you are willing to tolerate the other nasty consequences of the resulting economic slump. To the extent that the IMF lent funds to countries with such crises, it tended to demand austerity as a condition of the loan.

However, there was one country over which the IMF had little influence: the US. In the 1960s, the dollar tended to be in excess supply against other currencies. But the US was not particularly interested in austerity. Indeed, the incoming Kennedy administration had been elected on a platform of stimulating economic growth. Growth was seen as important, not just for the obvious domestic reasons, but because the US was seen as slipping in growth relative to the Soviet Union at the time. Pro-growth policy was part of the Cold War.

Under Bretton Woods, Kennedy administration was regularly confronted with dollar and gold crises which threatened its growth efforts. Perhaps the best illustration was provided by accident during an international demonstration of the first television communications satellite, Telstar. A special international broadcast was arranged in which people in North America and Europe would see such touristic sites as the Statue of Liberty and the Eiffel Tower via satellite.

Since Telstar was not geo-fixed, there were periodic intervals of 18 minutes when the satellite was over the Atlantic and transmission was possible. In the midst of the first demonstration broadcast, a Kennedy administration news conference was shown. During that random 18 minutes on essentially a random day, there was an international gold/dollar currency crisis brewing. Actually, it was not a surprise since such crises were regular events. President Kennedy dealt with the crisis on the broadcast:

http://www.employmentpolicy.org/telstar-us-golddollar-crises-1960s-second-video-associated-mitchells-musings-5-23-11

Such gold/dollar crises continued during the Johnson and Nixon administrations until President Nixon unilaterally ended the Bretton Woods system in August 1971:

http://www.employmentpolicy.org/nixon-ends-bretton-woods-system-third-video-associated-mitchells-musings-5-23-11

Basically, the kind of austerity policy that the IMF would have prescribed for other countries with overvalued currencies was not in accord with the Nixon administration's policy goals. Neither Kennedy nor Johnson nor Nixon had much tolerance for allowing Bretton Woods commitments to interfere with domestic objectives.

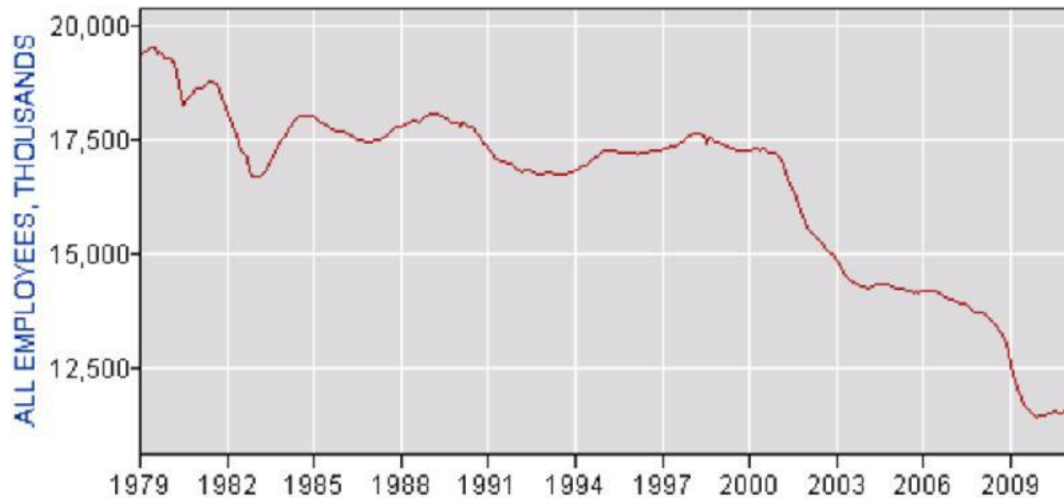
In late 1971, there was an attempt to recreate elements of Bretton Woods as part of the Smithsonian accord. But that Bretton-Woods-lite system lasted only 13 months and again failed when there was renewed pressure on the dollar which the US was not in a mood to resist. The world moved to flexible exchange rates in early 1973, seemingly leaving the IMF with no purpose to exist. It had been created to administer the Bretton Woods system which no longer existed.

Of course, the IMF did not go out of business. Even with flexible exchange rates, governments can get into trouble if they borrow or otherwise acquire obligations denominated in other countries' currencies. The IMF moved toward arranging loans to such countries, typically with austerity conditions. Its operations in that field have been subject to considerable criticism, but are not the subject of today's musings. What is the subject is a) the observation going back to the creation of the IMF and Bretton Woods that the IMF seems to have authority over every country except the US and b) the observation that surplus countries don't need IMF aid and thus are not subject to its influence.

Those two observations take us to the current situation in which the US has become the world's largest debtor and runs chronic large trade deficits. As earlier musings have noted, the impact on the US labor market falls heavily on manufacturing jobs, which have been in long run decline as Chart 1 on the next page illustrates. But this situation is precisely the kind of circumstance in which the IMF has little influence. It cannot tell the surplus countries – notably China – what to do since they don't need anything from the IMF. The old asymmetry continues. China can continue with an undervalued currency so long as it is willing to accumulate dollars.

The US is not as much the influence it was at the IMF at the end of World War II. But it still dominates and is free to ignore IMF policies it does not like. In short, the world's biggest international monetary problem seems to be beyond the reach of the IMF – the agencies ostensibly charged to deal with such matters - given current economic and political arrangements.

Chart 1: US Manufacturing Nonfarm Payroll Employment



There has been a tendency to downplay the job decline in US manufacturing with the comeback that what is occurring is actually a remarkable growth in productivity in that sector. Under this argument, employment is declining because fewer workers are needed, thanks – presumably – to rapid technological advances not found in other sectors. That argument has been called into question by a recent paper pointing to biases in the price estimates for imported inputs into manufacturing which overstate production and productivity advance.[12] But even apart from such data problems, a move toward balanced trade would have a substantial job-creating impact on US manufacturing. A trade surplus – the only way the US can begin to pay off its vast debt to the rest of the world – would have an even bigger impact.

What is clear from history going back to World War II is that the IMF cannot solve the international monetary problems of the US. Solutions in the past have come from unilateral US action when a crisis arises. Most likely, so will solutions in the future; there seems at present to be no taste among US policy makers to work seriously on the trade deficit problem in advance of a crisis.

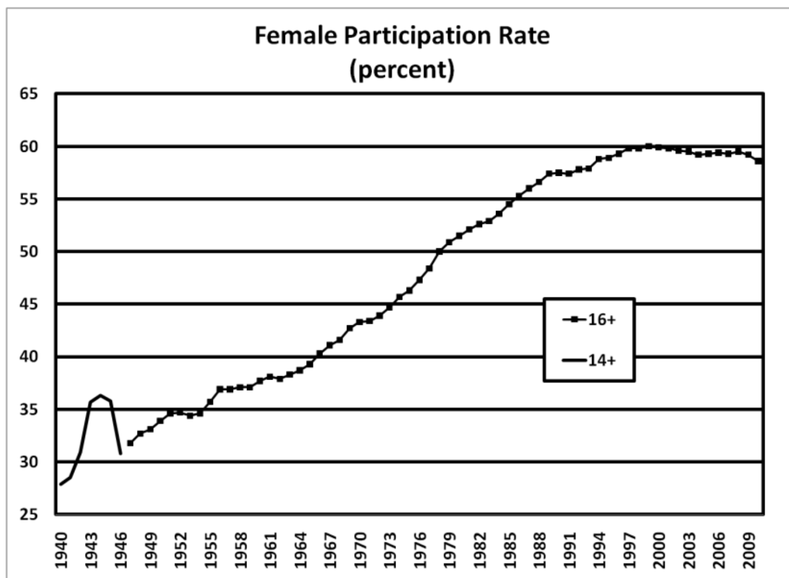
[12] Susan Houseman, Christopher Kurz, Paul Lengermann, and Benjamin Mandel, "Offshoring Bias in U.S. Manufacturing," *Journal of Economic Perspectives* (Spring 2011), vol. 22, no. 2, pp. 111-132.

Mitchell's Musings 5-30-11: Women Workers After World War II

Women were encouraged during World War II to replace men who had been drafted and to move into traditionally male factory and other jobs. And they were encouraged to stay there for the duration as the video link below suggests:

http://www.employmentpolicy.org/dont-be-absentee-ww2-film-keep-women-job-connected-mitchells-musings-5-30-11

It might have been thought that the jump in female participation in the workforce and the taking up of occupations in traditionally male jobs would have had an impact after the War. As the chart below shows, however, there was a blip up in female labor force participation during the War but it seems to be a one-off event.[13] Thereafter, a long-term, gradual upward trend resumed.



Claudia Goldin's well-known study documents the fact that women who entered the workforce temporarily during World War II seemed to withdraw thereafter.[14] There is certainly anecdotal evidence

[13] The modern Current Population Survey which tracks labor force developments starts in 1940. Data through 1946 are for women 14 years old and older. Thereafter, the data are for 16 years and older.

[14] Claudia D. Goldin, "The Role of World War II in the Rise of Women's Employment," *American Economic Review,* Sept. 1991, pp. 741-756. Available at http://www.economics.harvard.edu/faculty/goldin/files/worldwarII.pdf

that women returned to traditional roles after the War, partly to produce the postwar baby boom. Modern feminism seems more linked to the 1960s than the 1940s.

While big events such as World War II can have lagged echo effects, it seems puzzling that the immediate impact of the sudden shift of women into the workforce during the War was at best muted. One of the reasons for the limited impact may simply have been that the move of women into the workforce during the War was explicitly labeled as temporary as can be seen here.

http://www.employmentpolicy.org/displacement-women-workers-after-world-war-ii-linked-mitchells-musings-5-30-11

There is much in the modern literature on behavioral economics and psychology that suggests the importance of framing. The reiteration in wartime propaganda that women should view their move into employment as temporary and even abnormal undoubtedly had some effect in framing their thinking concerning labor market behavior. Moreover, older cultural norms persisted in the 1950s, particularly regarding work in nontraditional occupations, not only factory work, but also managerial jobs:

http://www.employmentpolicy.org/attitudes-toward-working-women-1950s-linked-mitchells-musings-5-30-11

A range of developments *after* the 1950s seemed to change social norms. These included eased divorce laws and "the pill," as well as legal developments such as the Equal Pay Act and the inclusion of women in Civil Rights legislation in the 1960s and thereafter. Indeed, if we are looking for a second break in the series on the female participation chart that needs analysis, it is the leveling off of the upward trend in the late 1990s. Nothing as dramatic as World War II occurred at that time.

What can be said is that the US seems to be toward the higher end of developed country female labor force participation at present. According to the Bureau of Labor Statistics, the cross-country 2010 participation rates for women, standardized to US definitions are:

Canada 62.4% - Sweden 60.4% - Australia 59.8% - Netherlands 58.8% - US 58.6% - UK 56.8% -

France 51.7% – Germany 51.6% - Japan 48.1% - Italy 38.3%

Is there a ceiling somewhere around 60% as these figures suggest? In any event, history suggests that if the upward trend resumes, the new break will probably not be associated with a great event.

Mitchell's Musings 6-6-11: Public Priorities

A short musing for June 6 for two reasons. First, LERA's National Policy Forum is meeting June 6-7 in Washington and I am on the program. Second, the table below makes my message clear enough. Sometimes a table, like a picture, is worth a thousand words.

"Thinking about the state as a whole, what do you think is the most important issue facing people in California today?"

Top four issues mentioned	All Adults	Party			Likely Voters
		Dem	Rep	Ind	
Jobs, economy	57%	57%	51%	49%	52%
State budget, deficit, taxes	11	11	17	16	16
Education, schools	9	13	8	10	11
Immigration, illegal immigration	4	4	5	4	4

The table is from the May 2011 Public Policy Institute of California (PPIC) public opinion poll. As usual, the poll asks questions about all kinds of issues, e.g., the state budget. But the fact is that issues other than "jobs/economy" are only distant concerns. If pollsters insist on asking questions about other public issues, of course they will receive responses and these responses will be analyzed and re-analyzed. But it is glaringly obvious that the California public is not losing sleep over the issues that animate politicos or policy wonks.

To me, the table suggests something else. Only when "jobs/economy" problems are resolved will the secondary issues be addressed in a sensible way.

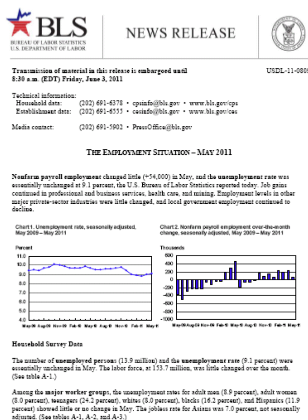
Of course, the PPIC poll is only for California. But despite stereotyped views about Californians elsewhere in the nation, I doubt that the results would be different elsewhere, at least not in states with high unemployment rates.

The full PPIC poll – with details on methodology - is at http://www.ppic.org/content/pubs/survey/S_511MBS.pdf

Mitchell's Musings 6-13-11: Interpretation

As many readers will know, our Employment Policy Research Network (EPRN) – which hosts this blog – had the lead slot at the annual LERA-National Policy Forum in Washington, DC last week. Apart from the specifics of the various sessions and presentations, several thoughts came to my mind because of the event and the location.

The DC types who attended kept referring to "Friday," not as a day, but as a political/economic event. In one session, someone (an out of towner) asked exactly what was "Friday." It turned out to be a reference to the monthly media release of the U.S. Bureau of Labor Statistics (BLS) on the employment situation of Friday, June 4. The release indicated that payroll employment growth – while positive – was disappointingly small. The unemployment rate was above 9% (9.1% to be precise), up 0.1 percent, an increase which BLS characterized as "essentially unchanged." The implication was that economic growth, or at least job growth, had stalled - with all the political freight that a poor job market could imply for election year 2012.


BLS
BUREAU OF LABOR STATISTICS
U.S. DEPARTMENT OF LABOR

NEWS RELEASE

Transmission of material in this release is embargoed until 8:30 a.m. (EDT) Friday, June 3, 2011 USDL-11-0809

Technical information:
Household data: (202) 691-6378 • cpsinfo@bls.gov • www.bls.gov/cps
Establishment data: (202) 691-6555 • cesinfo@bls.gov • www.bls.gov/ces

Media contact: (202) 691-5902 • PressOffice@bls.gov

THE EMPLOYMENT SITUATION – MAY 2011

Nonfarm payroll employment changed little (+54,000) in May, and the **unemployment rate** was essentially unchanged at 9.1 percent, the U.S. Bureau of Labor Statistics reported today. Job gains continued in professional and business services, health care, and mining. Employment levels in other major private-sector industries were little changed, and local government employment continued to decline.

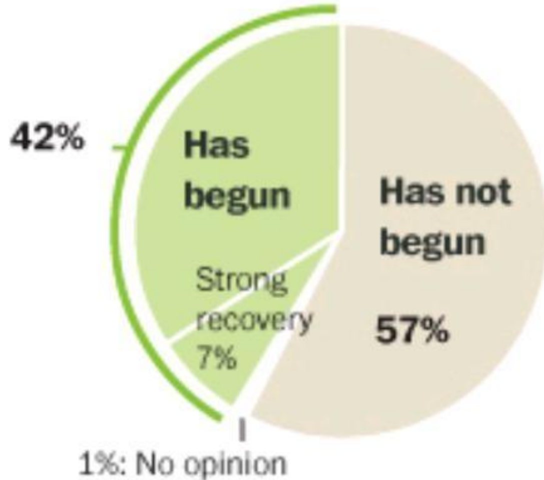
Household Survey Data

The number of **unemployed persons** (13.9 million) and the **unemployment rate** (9.1 percent) were essentially unchanged in May. The labor force, at 153.7 million, was little changed over the month. (See table A-1.)

Among the **major worker groups**, the unemployment rates for adult men (8.9 percent), adult women (8.0 percent), teenagers (24.2 percent), whites (8.0 percent), blacks (16.2 percent), and Hispanics (11.9 percent) showed little or no change in May. The jobless rate for Asians was 7.0 percent, not seasonally adjusted. (See tables A-1, A-2, and A-3.)

In an earlier blog entry, I mused about the frequency with which official economic data are released and whether we might learn more from less frequent – but larger sample/more detailed – information. And I could repeat that question here. Note that we are talking about preliminary data, seasonally adjusted, that will later be revised. However, beyond the frequency issue, I had a sense that there was confusion within the DC bubble between the BLS media release and the public perception of the employment situation.

As it happened, the *Washington Post* released its opinion poll (Washington Post-ABC) about the president and (to me) more importantly about public views on the job situation. The key thing to note about the poll was that, although it came out on the second day of the conference, i.e., after "Friday," it was taken *before* the BLS release appeared. So public perceptions could not have been influence by the release (which only policy wonks read) or the media reporting of the release (which could conceivably influence public perceptions).



What is most apparent from the poll (see the pie chart above) is that more than half of respondents thought the recovery had not begun. To economists the issue is not whether there is a recovery but whether it is too slow or might stall. But to a good chunk of the general public, there isn't a perceived recovery at all despite the fact that there has been both (some) job growth since the bottom of the Great Recession and (some) lowering of the unemployment rate since that bottom. Month-to-month vagaries in BLS media release data are not driving this public perception. Real world experience is.

On the other hand, media releases and newspaper headlines can drive policy – or at least policy discussions – within the DC bubble. By coincidence, I gave a PowerPoint presentation at the Policy Forum on June 6 on public pensions. One of the points I made was that big numbers on the unfunded liability of public pensions can drive policy discussions although media reports typically do not get into the mechanics of how such estimates are calculated or what they mean.

To illustrate this point, I calculated the unfunded liability of the Pentagon, not retirement expenses but simply of ongoing military operations, using Social Security-type methodology. I produced a figure of $24 trillion!! The Defense Department has no dedicated revenue stream – only spending – but the federal government is constitutionally obligated to provide for the national defense indefinitely out of general revenue. Currently, the cost is in the range of $700 billion per annum. (Since forever is a long time, I stuck to the 75-year horizon used for Social Security in making my calculation.) The problem is that while $24 trillion is a scary number, it doesn't tell you much about whether, for example, we should have become involved in Libya. Indeed, by itself, $24 trillion is useless information.

(Mitchell's Slide of 6-6-11)

Just as the *Washington Post* cooperated in making my point on the labor market, *USA Today* conveniently helped make my point on calculating liabilities.

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U.S. owes $62 trillion

JUNE 1: New York Rep. Anthony Weiner

"I was a victim of a prank."

MONDAY

"This was me doing a dumb thing . . . and lying about it."

Unfunded obligations amount to $534,000 per household

By Dennis Cauchon
USA TODAY

The federal government's financial condition deteriorated rapidly last year, far beyond the $1.5 trillion in new debt taken on to finance the budget deficit, a USA TODAY analysis shows.

The government added $5.3 trillion in new financial obligations in 2010, largely for retirement programs such as Medicare and Social Security. That brings to a record $61.6 trillion the total of financial promises not paid for.

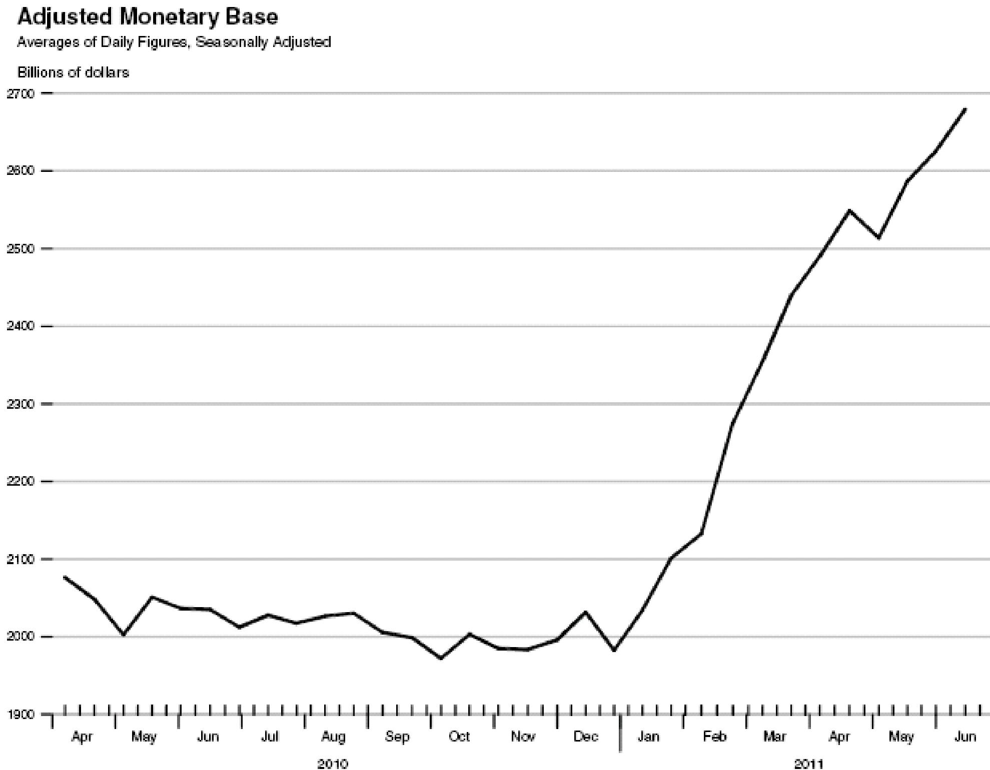
Financial liabilities

Of course, *USA Today's* headline of 6-7-11 referred to Social Security, Medicare, etc. It did not include my estimate of the Pentagon's unfunded liability. And, beyond that omission, how enlightening is the headline? Within the DC bubble, will it contribute to rational discussion of "entitlements"? Will anyone note that defense is an "entitlement"? Perhaps more importantly, will such headlines divert attention from the finding of the *Washington Post* poll that found that over half of respondents think the recovery has yet to begin – and would presumably like something done about that state of affairs? Sadly, these questions tend to answer themselves.

Mitchell's Musings 6-20-11: A Lesson Learned from Mr. 880

UCLA's Anderson Forecast for the U.S. and California was released last week and it was not a happy picture. Recovery is underway, but seems to have slowed – even stalled. Unemployment is coming down but the forecast for the U.S. in 2013 is still around 8%. The rate doesn't get down to levels seen prior to the Great Recession for five or more years.

The St. Louis Federal Reserve puts out a weekly chart book of monetary and financial indicators. Below is a chart from the latest edition which reminds us that the Federal Reserve is the most active element in macro policy today in trying to deal with the aftermath of the Great Recession. Whatever criticisms can be leveled at the Fed for its pre-crisis policy, Fed Chair Ben Bernanke has been doing what he could since the crisis unfolded to avert what might have been a total disaster. In essence, what our EPRN hopes to foster, i.e., learning from academic research, has been reflected in Fed policy. In the case of the Fed, it is the research literature on the Great Depression which suggests that Fed policy back then tended to be passive or perverse. So taking that lesson, Fed policy has been active.



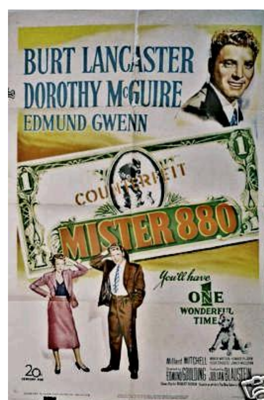
Nonetheless, despite pushing the envelope on Fed policy, the central bank is constrained in what it has the authority to do. You may recall that in the early days of the financial crisis in 2008, the Fed could not on its own produce the so-called TARP (troubled asset relief program) due to legal restrictions. It had to go to Congress along with the Treasury for action to be taken.

In the abstract, a central bank would seem to be able to buy toxic ("troubled" was a euphemism) assets from distressed financial institutions simply by writing a check. But apparently that option was not permitted under the law. Indeed, in the abstract, a central bank could purchase anything, not just financial assets, by writing a check. In theory, a central bank could have done the bailouts or even run its own New Deal-type jobs program by writing checks. But, of course, there are legal and institutional constraints.

The usual explanation for such constraints is that central banks might excessively "print" money and cause inflation. However, I think there is something deeper than that fear, particularly in the American case, which feeds a need to constrain the Fed and to regard it with suspicion. It is hard for the average person to wrap his or her mind about the concept of creating money – which is what central banks do. Money is supposed to be "real." Folks and businesses compete for money. They cheat and steal and even murder for money. So how can it be just created?

In a class I used to teach on international economics, when we got to international monetary systems and their relation to domestic monetary systems, we would take up central banking. I told a story – a true story – that occurred in the late 1930s and into the 1940s. I first read about this tale when I was in high school, although I don't recall the original source. A more recent search for references led me to a book that told it in comic book form, one frame of which is reproduced below.[15]

Here is the story: Mr. Emerich Juettner lived in New York City with his dog, eking out a very modest living. As hard times pressed in, he got the idea of counterfeiting one-dollar bills. His reproductions were so bad that the name of George Washington was misspelled. But he got away with it for years because no one looks at one-dollar bills. Despite all the impressive seals and numbers and signatures on the One, people take them and pass them on because they know that other people will take them and pass them on.

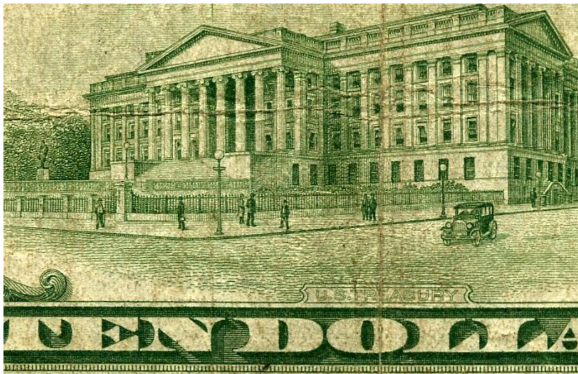


[15] George Hagenauer and Carol Sifakis, *The Big Book of Little Criminals* (New York: Paradox Press, 1996), pp. 86-88.

In effect, in modern monetary systems, money is a social convention.[16] You accept dollars because everyone else does. Everyone else does it for the same reason. What exactly is a "dollar," after all, but an abstract unit of account?[17]

Mr. Juettner continued for years just passing a few of his bills to have enough to eat. He might never have been caught except that his dwelling caught fire and some kids found his printing press plates in the ruins which were turned over to the police. The story had a happy enough ending. Juettner was given a few months in jail and Hollywood turned his tale into a movie, *Mister 880*, so named because the file kept by the Secret Service on the phony bills was numbered 880.[18] You can see the trailer for the film at http://www.youtube.com/watch?v=3Xk2oPkKuAI.

Sometimes the tale of Mr. 880 did not sufficiently convince students. Money *must* be something. They would argue that no one looked at Mr. 880's one-dollar bills because of their low value. Back in the day before the Treasury introduced its new series of bills with the enlarged presidential pictures off center and other changes that are supposed to make counterfeiting more difficult, I had another demonstration. When the old series was still in circulation, I would show the students the front of each bill ($1, $2, $5, $10, $20, $50, $100) and ask which one had a picture of an automobile on the reverse side. The students would be asked to vote by a show of hands – not call out – as I displayed each one. Most students abstained – they didn't know. Of those voting, the most common answers were the Two and the Hundred. (Because you don't see those denominations that often, the students assumed they must be the right answer.) Actually, the answer was the very common Ten:[19]



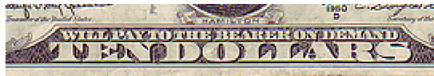
[16] If you have stumbled on this website and now feel an overwhelming urge to send me a tract on why we should return to the gold standard, or on monetary conspiracies, or why you don't have to pay income taxes because the money isn't real, please save yourself a stamp and refrain. You are just proving the point.

[17] If you Google the word "dollar," you will find it derives from the German for "valley," a specific valley in what is now the Czech Republic. (Try searching on" Joachimsthaler" if you have trouble finding the reference.)

[18] The Secret Service is in charge of dealing with counterfeiting. Sadly, the film is not available on DVD in the U.S. although apparently it is sold in Europe.

[19] Rather than update the car, the new ten-dollar bills eliminated it from the picture.

My final tale came from my undergraduate days at Columbia College. Prof. Peter Kenen taught the introductory economics course and included on the syllabus was a book of readings. One of these readings, which also involved a Ten, was a reproduction of a correspondence with the Secretary of the Treasury. Ten dollar bills back then (the 1960s) bore the statement that "The United States of America will pay to the bearer on demand Ten Dollars." Someone enclosed a Ten in an envelope and wrote his demand to the Secretary of the Treasury for ten dollars. He got back a polite letter with two Fives.[20]



Bottom line: I have seen criticism of the Fed of late, coming from left and right. The Fed is charged with not doing enough, or with doing too much, or not doing what it was doing the right way. There are complaints that the Fed isn't sufficiently "transparent," although I am never sure what that means exactly or how more transparency would improve policy. My sense is that at the base of the complaints – and at the base of the constraints on the Fed – is the simple fact that most people just cannot deal with the concept of an institution that creates money or the idea that money is only a (very useful) social convention.

[20] The new series of bills just say "ten dollars" but they don't promise ten dollars to the bearer on demand (presumably because the bearer already has ten dollars).

Mitchell's Musings 6-27-11: Working on the Railroad

In *Historical Statistics of the United States*, I came across this tabulation of average annual earnings per full-time employee in 1900 (private sector):[21]

Finance-insurance-real estate	$1040	
Nonprofit	$652*	
Construction	$593	
Railroad	**$536**	**[$548]****
Bituminous coal mining	$516	
Local transportation	$510	
Wholesale-retail trade	$508	
Gas and electric utilities	$506	
Manufacturing	$487	[$435]**
Educational services	$469	
Telephone and telegraph	$433	
Anthracite mining	$340	
Personal services	$330	
Medical & other health services	$256	
Agriculture-forestry-fishing	$178	

*It's not clear exactly what is in this sector since medical and educational services are listed elsewhere. Presumably, whatever it contains involves white-collar and professional occupations.

**Figures in brackets [ ] are for "wage earners" only.

Some elements of the ordering are surprising. The medical sector is down toward the bottom, perhaps a reflection of the notion that in 1900, going to a hospital was a risky business, perhaps

[21] U.S. Bureau of the Census, *Historical Statistics of the United States: Colonial Times to 1970* (Washington: GPO, 1975), vol. 1, pp. 166-168.

as likely to harm you as help you. That finance comes in at the top is probably no surprise to 21st century observers.

What interested me was the position of railroad workers. The data, with all their limitations, suggest that rail workers were relatively highly paid, given the standards of that time, although the data above were collected only a few years after the "Pullman strike" of 1894 was broken.

In 1900, the automobile was a rich man's toy and traveling any distance, or transporting cargo, most likely involved rail. Railroads were seen as a key industry. The folkways of that era suggested that the public saw rail workers as entrusted with considerable responsibility. Consider the 19th century poem, *The Night Operator*, which hails the work of a night-time railroad telegraph operator, whose efforts keep passengers safe:

http://www.employmentpolicy.org/night-operator-linked-mitchells-musings-6-27-11

Or consider the poem, *Asleep at the Switch,* about a 19th century railroad switchman whose failure to perform leads to disaster:

http://www.employmentpolicy.org/asleep-switch-19th-century-poem-linked-mitchells-musings-6-27-11

(In one version of the poem, the result of being asleep at the switch is an actual disaster. In another version, the switchman awakes in his bed after having a bad dream of the disaster – a happier ending. He was asleep, but not at the switch.) We still use the expression, "asleep at the switch," to connote a failure to perform, even though public fascination with railroads is largely a thing of the past.

Perhaps, then, it is not surprising that rail workers were relatively well paid in 1900. They were entrusted with public safety and with expensive capital equipment. But unlike workers in many other industries, direct supervision while on the job was not technically possible. You had to rely on them to do the job responsibly. Time and motion studies, Taylorism, and similar workplace practices that were coming into vogue at the time did not easily apply to railroads. There may well have been what economists would call an "efficiency wage" element in the pay of rail workers, i.e., a pay premium to encourage good performance.

Is there relevance for today? For a time, the contemporary complaints about public sector workers and their compensation tended to omit police and fire, the so-called "first responders" who were celebrated after the terrorist attacks of 9-11. Now, however, even first responders seem to be included in such complaints.

In a sense, in the aftermath of the Great Recession with its elevated unemployment, it is possible to cut pay, benefits, and conditions without immediate consequence. You can always say to those who resist such cuts that they should be grateful to have a job.[22] But in the future, as the broader labor market slowly heals, there may be untoward consequences of that approach. Someone may be asleep at the switch just when you need assistance.

[22] The above-mentioned 1894 Pullman strike was a response to wage cuts during the recession of that era.

Mitchell's Musings 7-4-11: Old Thinking

July 4th is supposed to celebrate "independence," a word which among other things connotes New Thinking. But on several critical issues, there seems to be lots of Old Thinking. Let's start with the macro and proceed to the micro.

Inflation or Unemployment?

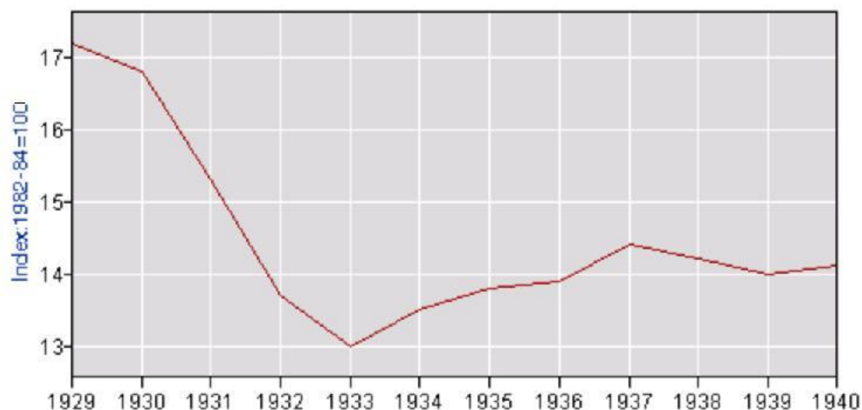
What should we be worrying about at the moment, inflation or unemployment? One of the paradoxes of the Great Depression was the concern back then about inflation. When measured by the Cost-of-Living Index (predecessor to the modern CPI) of that era, prices were in fact 18% lower in 1940 than they were in 1929, as can be seen on the chart below. And, to be fair, there were those academics - such as Yale economist Irving Fisher - who were concerned about "debt-deflation." It is true that prices could – and sometimes did - rise in the face of considerable economic slack. But inflation never reached as high as 4% per annum and the price trend returned to deflation in the late 1930s. Clearly, however, unemployment – which was largely unmeasured until 1940 when the Current Population Survey began – was THE problem of the day.

Inflation anxiety was Old Thinking. It wasn't just the Federal Reserve that worried about inflation in the 1930s, as this humorous recollection of that era suggests:

http://www.employmentpolicy.org/high-school-inflation-worries-during-great-depression-linked-mitchells-musings-7-4-11

All this history could be a quaint memory except that in the aftermath of the Great Recession of 2008, and with the latest release on GDP suggesting a stalling recovery, we seem to be repeating the Old Thinking. The Fed seems under attack from those who worry that its various policies, including the recent quantitative easing policy, will produce inflation. As has been noted in earlier musings, financial markets continue to forecast CPI inflation in the 2-3% range over the long run.

BLS Cost-of-Living Index



The initial hope was that policies adopted in late 2008 and early 2009, especially those involving "shovel ready" infrastructure projects, would take care of the unemployment problem – or at least reduce it substantially. While such policies helped stave off a decline into something truly resembling the Great Depression, the recovery path has been insufficient to lower unemployment at anything like the pace originally projected. Infrastructure is never really shovel ready, except for projects that were about to occur anyway.[23] Major infrastructure projects inherently involve complicated processes of planning and tend to trickle out as their various review and design phases are completed. As President Obama recently said, *"Shovel-ready was not as shovel-ready as we expected."*[24] So what can be done now? That question leads to the next area of Old Thinking.

Federal or Trade Deficit?

The New Deal administration of the Great Depression is often characterized as having followed "Keynesian" policies. The phrase "Keynesian" in such accounts is taken to be a synonym for deficit spending to stimulate the economy. In fact, the writings of John Maynard Keynes were barely coming on the scene when the New Deal began and the Roosevelt administration was quite concerned about running deficits – traditional Old Thinking. It looked for taxes to raise, such as the federal gasoline tax. The Social Security payroll tax was imposed in 1937, even though no pension benefits were to be paid out until the 1940s. In retrospect, these deficit concerns are seen as offsetting other efforts at job creation.

We again seem preoccupied with the federal deficit, now encapsulated in the conflict over raising the debt ceiling. Let's put aside the obvious point that producing a default on the federal debt by not raising the debt ceiling would be a Bad Idea. The question to be asked is which deficit we should be worrying about – particularly given the slack labor market – the federal budget deficit or the U.S. trade deficit?

Last week, the latest Bureau of Economic Analysis release put the U.S. net international investment position at minus $2.4 trillion at the end of 2010.[25] That net debt of the U.S. to the world is the result of continuous net export deficits, especially since the 1980s. "Net" means that the U.S. had gross liabilities of $20.9 trillion and gross assets of $18.5 trillion. Some of the gross liabilities are illiquid, e.g., physical assets such as real estate, factories, etc., and not easily sold off quickly. But much of it is liquid including $4.4 trillion in federal obligations to foreign central banks and official institutions. Holders can abandon (sell) these assets. (Again, threatening to default by not raising the debt ceiling is a Bad Idea, precisely because a run on the dollar could produce another financial crisis.)

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[23] As noted in earlier musings, local authorities may actually halt such projects temporarily in the hopes of obtaining federal financing for them, a perverse effect.

[24] Peter Nicholas, Obama Seeks Ways Around Congress to Boost Economy," *Los Angeles Times*, June 14, 2011.

[25] Release BEA 11-34, June 28, 2011:
http://www.bea.gov/newsreleases/international/intinv/2011/pdf/intinv10.pdf

The U.S. net export balance in 2010 was a negative $516.4 billion or about 3.5% of GDP. Simply bringing that balance to zero (to stop increasing the net debt) would be far more stimulative and job creating than any policy now in the works or likely to be in the works.

Unfortunately, pep talks about high-tech manufacturing, green jobs, and being more competitive won't do much to lower unemployment, certainly not in the immediate situation. If the U.S. wants to be competitive, it needs to deal aggressively with the dollar exchange rate problem. In earlier musings, I have pointed to the (Warren) Buffett plan that would swiftly bring trade into balance.[26] I have yet to hear of any other approach that addresses the exchange rate/jobs problems, especially in manufacturing. But Old Thinking prevails.

Top Down or Bottom Up?

Let's switch now from the macro to the micro. In a slack labor market where jobs are scarce, management can always say to workers that they should be lucky to have a job. *"If you don't like it here, try finding a job somewhere else."* In contrast, a buoyant labor market can be an equalizer. Workers can find a job somewhere else when there is a labor shortage. Their concerns, in the face of a labor shortage, have to be the concerns of management. Moreover, what they have to say about how things are run can be valuable to management. But there is little incentive to pay attention to what workers say in a period of high unemployment. Labor shortages are more conducive to listening to the help than the current labor surpluses.

I was reminded of that fact after several recent airline flights on a particular carrier. I won't name it here, but you can find the full story – which was featured in the *Los Angeles Times* – plus a document from airline management that was given to me by a flight attendant. The references can be found at another blog I do:

http://uclafacultyassociation.blogspot.com/2011/06/diversion-from-obvious-doing-what-they.html

To recap: the airline introduced a new system of boarding passengers. It appears, however, that the new system causes delays, a fact that flight attendants have pointed out – and to which this passenger can personally attest. But it also appears that no one at the top is listening since the system continues in effect. Perhaps that is because – in the current state of the labor market – no one at the top has to listen.

Management always knows best is Old Thinking. But at both the macro and micro levels, Old Thinking is in the ascendancy.

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[26] The Buffett plan would provide those who sold a dollar of exports with a voucher entitling the holder to import a dollar's worth of imports. Vouchers could be exercised directly by recipients or sold to importers. In effect, the prevailing exchange rate plus the cost of the voucher would be the exchange rate associated with a zero net export balance.

Mitchell's Musings 7-11-11: Nothing New?

Many readers know that LERA – the parent organization that hosts EPRN - maintains the LERA-Dialog emailing service on which various articles and opinions are posted and discussed.[27] A recent discussion involved the meaning of words. An old debate was resurrected on the use of phrases such as "human resources" and "human capital" to describe employees. I say old because a similar debate went on when the predecessor of LERA, the Industrial Relations Research Association, changed its name to the current Labor and Employment Relations Association. At the time, it might be noted, those folks attached to "industrial relations" failed to remark on the lack of descriptiveness of that term. Do industries have relations?

In any event, in the course of the email back-and-forth on LERA-Dialog about these issues, someone noted that nowadays employees are often referred to as "associates," with whatever positive connotation that word is supposed to have. Partners in the enterprise? When I used to teach in whatever you want to call the field, students tended to think that calling workers associates was a recent innovation, maybe a practice created by Starbucks – a company that does just that. In fact, most employment practices that we identify as modern or recent have long histories. It isn't quite true that there is nothing new under the Sun. But it is true that ideas have a way of percolating and then becoming popular, perhaps with a new label or some repackaging.

Consider a firm which calls its workers "associates," has company executives and workers eating in the same cafeteria, provides a massage parlor and physical therapy for employees (and, of course, insurance), and features management-by-walking-around. The firm's top executive talks about how the company can be competitive in global markets. You can see a two-part video about the firm at the links below:

Part 1 at http://www.employmentpolicy.org/innovative-personnel-practices-during-ww2-part-one-linked-mitchells-musings-7-11-11

Part 2 at http://www.employmentpolicy.org/innovative-personnel-practices-during-ww2-part-two-linked-mitchells-musings-7-11-11

The only thing that might be surprising is that the video was made in 1943, i.e., during World War II.

I would like to put a happy ending on this week's musing and tell you that these advanced human resource or industrial relations or employment (you pick the description) practices ensured a postwar success for the firm in the video. Sadly, however, it went out of business a few years after the War.

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[27] Information on how to put yourself on the LERA-Dialog emailing list is available at http://www.leraweb.org/participate/email-listservs

There is undoubtedly a lesson from that outcome, too. But we can save that lesson for some future musing.

Mitchell's Musings 7-18-11: Incas, Space Shuttles, and the Absence of Nellie

Back in the day, way back in the day, the Inca Empire was invaded by Pizarro and a small band of conquistadors. The Spaniards were placed in a kind of Inca fort where they were visited by the Inca king and his soldiers. As the accompanying video clip to this musing dramatizes, however, the confrontation ended with Pizarro capturing the king, a military turnaround:

http://www.employmentpolicy.org/spanish-confrontation-incas-linked-mitchells-musings-7-18-11

When you view the video, it appears that the key ingredient giving the outnumbered Spaniards the advantage was their possession of firearms, a technology the Incas did not possess. But another interpretation is that the true underlying factor behind the victory was literacy, as symbolized by the Bible shown to the king at the beginning of the clip. In that interpretation, literacy allowed military technology in Spain - and in Europe more generally - to develop; advances could be passed from generation to generation through writing and records. Not only did the ability to pass down information permit the development of firearms but it also fostered communication of military tactics. Of course, the history of the event shown in the video is the Spanish version precisely because they could write history and the Incas couldn't.

There is much to be said for that viewpoint; the development of writing was a critical advance where it occurred. A few years ago, ILERA – the International Labor and Employment Relations Association – held its world congress in Lima, Peru. While in Lima for the meetings, I saw an exhibit in a museum there tracing the various civilizations that had come and gone in Peru. The Incas were in control at the time the Spaniards arrived but many other groups had preceded them. What was striking was the up and down of technology – some groups were advanced in pottery and textiles, for example, but others were not. Absent writing, technology could be lost in the turmoil as one group took over from its predecessor.

On the other hand, we have examples of civilizations that developed writing but that nonetheless had long periods in which technology did not advance. China is often offered as an example, since – although it had writing and scholarship – it did not seek to import western technology (including military) or develop equivalent technology. Ultimately, the result was foreign domination, just as the Incas experienced. Japan – another society that had writing - after first following the Chinese example, reversed course in the late 19th century and imported western technology. Nowadays, China is advancing by doing what Japan did earlier.

What history suggests is that to pass down technology and advance technology, societies need both writing *and* doing. That is, learning by doing is important; it isn't enough to have technology tucked away in a book. Imitation of technology is one way of advancing. Europeans learned to make porcelain from China and then spread that technology. But artisans in that field, and virtually all field, learn on the job. Internships, residencies, apprenticeships, etc., are part of the transmission of technology. Experience is a teacher. Mentors are teachers.

Now let's look at a recent development: the launch of the last American space shuttle. It seems to be the assumption that the U.S. can put space technology in a book for a time – but not actually do it – and then open the book and resume where it left off. Much the same assumption appeared to be behind the abandonment of manned travel to the moon. I doubt that either assumption is valid. As generations of folks who actually did it disappear, it will be difficult to pick up where the old program left off.

It is remarkable (to me) that the U.S. space program is being dismantled (sorry, NASA, but that is what is happening) without a public outcry. Some people regard the space program as just symbolic and a product of the Cold War, which is now over. But even if you think of it purely in military terms – the way it was viewed during the Cold War – it seems strange that abandonment is occurring. There is substantial vital technology in space in the form of communication satellites, for example, that could be targeted in a military conflict.

And there is a purely domestic aspect to the questionable notion that technology can be kept in a book and then quickly restored. Let's take American manufacturing. As stressed in prior musings, the U.S. trade deficit – a deficit that is unsustainable and must reverse – is in large part reflected in a manufacturing deficit. Industries that once existed here were outsourced abroad. The jobs and the know-how that was embedded in those jobs were abandoned. It may well be that – absent an ongoing skilled workforce – the costs of re-starting abandoned industries will be higher than if the abandonment had not occurred.

The British had an expression for learning a job by a new employee through just observing what incumbent workers were doing: "Sitting by Nellie." But now we have a problem to address: Nellie ain't here anymore. It's fine for political leaders to talk about new jobs and the need for education and training. But a piece of the training-and-education program needed is missing. Nellie is gone or going. Is anyone concerned about the challenge that absence poses?

Mitchell's Musings 8/1/11: Good News and Bad News from (Real) Deadlines in Negotiations and the Negotiating Process

As this musing is being written (7-30-11), there is no resolution to the debt ceiling negotiations that are going on in Washington. Is there anything to be learned from labor negotiations about this political process?

Union-management negotiations have been much studied, in part because information about them is more available than on other types of negotiations. There have been many empirical studies trying to understand the failures of union-management negotiations to reach "peaceful" resolutions, i.e., to understand why and when work stoppages occur. The negotiating process in collective bargaining itself has also been the subject of public policy; various policies have sought to encourage resolution of labor disputes. For example, the Federal Mediation and Conciliation Service was created to offer the services of professional mediators to union and management negotiators.

Clearly, there are many differences between the political negotiations process underway in Washington at this writing and a typical labor negotiation. But one similarity is the presence of a deadline. August 2 has been declared to be the date on which the debt ceiling will be hit and, therefore, the date at which – unable to borrow – the federal government will be short of cash to pay all its bills. This date is widely referred to in the news media as "default" although actual nonpayment of federal debt service – interest, etc., on Treasury securities - seems unlikely.

Interesting questions have been raised about whether August 2 is truly the date on which cash runs out and about whether there are ways for the Treasury to get around the ceiling limit, even if August 2 is the actual date. Nonetheless, so far the parties to the negotiation have been treating the August 2 date as a deadline. So what do we know about deadlines and negotiations?

It appears that deadlines must at least threaten unpleasant or potentially unpleasant consequences to facilitate agreements. When deadlines are totally arbitrary - one thinks about Israeli-Palestinian negotiations in which dates on which something is supposed to be agreed come and go without any real impact – they have no effect. But in the case of union-management negotiations, real things do happen at one critical date: the contract expiration. The contract expiration is more than an arbitrary date on the calendar.

Most union contracts have some version of a no-strike/no-lockout clause. So when the contract expires, so do those clauses. The parties are then free to impose economic harm on each other. Although we don't keep data on such things, it is often the case that settlements are reached just as the expiration date is reached, sometimes with midnight settlements.

I used to do a 2-hour simulation in a class dealing with labor negotiations – Yes, Virginia, there used to be classes on labor relations! – in which negotiating teams were given points for various contract gains (from their perspectives). After one hour, however, it was specified that the existing contract expired and a strike would immediately occur producing point losses. There

was a one-shot point loss at that moment and then a loss for each minute of non-settlement. I won't go into more details – the game was elaborate with the union team, for example, split between skilled and unskilled workers with different point gains and losses – but suffice it to say that most settlements occurred just at the deadline. On the other hand, not all teams avoided strikes. In simulations as in real labor negotiations, an incentive to settle is not a guarantee of settlement.

At the time of the 1947 Taft-Hartley Act, there had been a wave of post-World War II strikes. Congress seemed to think that the strike problem reflected a need to make available more time for negotiations. If the parties just had more time, they would be more likely to settle peacefully rather than blunder into a work stoppage. Public policy should insist that they have enough time to work things out. So the Act includes a 60-day pre-notification period.

Under the Act, even though contracts have internal expiration dates, the contract could not end until one party notified the other at least 60 days in advance. The problem with this approach is that the parties obviously know when their contract expires – they negotiated it after all. So the phenomenon of the midnight settlement has nothing to do with notification and everything to do with having a deadline that has real consequences. With the deadline approaching, there is pressure on both sides to stop bluffing and to reveal their true negotiating positions. The imminent deadline thus facilitates a settlement, albeit often at the last minute. That's the Good News.

But there is Bad News, too. Obviously, there are cases in which settlements are not reached at or before the deadline and in which work stoppages occur. In some cases, these stoppages can turn out to be prolonged and destructive to both parties. So the fact that deadlines, even real deadlines, don't always bring about settlements is a part of the Bad News.

But there is another Bad-News feature of intense negotiations (which become more intense as the deadline/expiration date approaches). When a settlement is reached, the parties can suffer from an illusion about how the outcome should be evaluated. There is a distinction between *reaching* a deal – a narrow definition of success – and the *quality* of that deal.

It is easy for parties to negotiations who have had a really tough time reaching an accord to feel that they have been successful simply because they did reach a settlement and it was so difficult to get there.[28] In the late 1970s, I examined the union sector in a Brookings book and noted that there seemed to be a bubble-like phenomenon occurring at that time in the union-nonunion pay differential.[29] A continuous rise of that differential had to be ultimately unsustainable and yet, in each individual contract negotiation, the parties undoubtedly felt that they had reached the best deal possible. After all, the economic background of the 1970s was difficult. In the end, however, the process of the widening pay differential reversed with a wave of concession bargaining in the 1980s and substantial job loss and market-share loss in the union sector.

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[28] An interesting radio interview suggests that the process can become the dominating influence: http://www.youtube.com/watch?v=wC8kSydOdd4

[29] Daniel J.B. Mitchell, *Unions, Wages, and Inflation* (Washington: Brookings Institution, 1980).

More recently, I have followed California budgetary policy and the negotiations in the state legislature and with the governor that produced eventual budget deals. The state constitution specifies that the legislature is supposed to enact a budget by June 15, i.e., two weeks before the start of the new fiscal year on July 1. Presumably, this advance date exists to give the governor time to decide whether to veto the budget, sign it as passed, or sign it with line-item vetoes. However, until recently, there was no consequence if a budget was not passed by June 15 since there were no penalties for the legislature if that deadline passed without a budget. State fiscal affairs between June 15 and June 30 continued normally under the terms of the yet-to-expire fiscal year; nothing was disrupted.

However, at one time the expiration of the California fiscal year on June 30 was similar to a contract expiration in the union sector. If there was no new budget enacted by July 1, state bills could not be legally paid until a deal was reached. So although under the state constitution the governor proposes a new budget in early January, the heavy negotiations in the legislature did not typically start until the June 30 deadline approached, almost six months later.

But sometimes – as in labor negotiations – a deal was not reached in time and there was no budget on July 1. When such episodes occurred, courts began stepping in, requiring that the state pay certain bills despite absence of a budget. The consequences of missing the June 30 deadline were thus progressively reduced since the government continued functioning in most respects. The June 30 deadline, in short, had less and less meaning as court interventions accumulated. Having a deadline on paper became less and less effective in incentivizing an on-time deal. Budgets were chronically enacted late.

Last November, however, California voters approved various budget-related ballot initiatives. Among them was a provision that members of the legislature would forfeit their pay for each day beyond the constitutional June 15 deadline that a deal with a "balanced" budget was not reached. It was not clear how this proviso would work in practice. But there was a clear rush in the legislature just before June 15 to pass something. The resulting budget was ruled to be unbalanced and legislators' pay began to be forfeited. A new deal was quickly reached. So the effect of the deadline was evident – the Good News. However, the quality of the deal (how the enacted 2011-12 California budget will work out as the current fiscal year unfolds) is not so evident – the Bad News. The budget was "balanced" in significant part on paper by making optimistic economic assumptions that might not be realized.

The difference between political negotiations – whether at the state or federal levels - and labor negotiations is that in the latter case, processes have evolved involving third parties – mediators, arbitrators – who can help the parties resolve their problem. In the case of political negotiations, such as those surrounding the federal debt ceiling, there seem to be no external facilitators available. Indeed, there are many centrifugal forces that have come into play.

So, as this musing is being written, what lessons do we draw? The August 2 deadline for the debt ceiling negotiations does seem to matter. The various parties seem to be taking it seriously and assuming that bad things could happen thereafter.

However, if the deadline turns out to matter enough to bring about a House-Senate-President accord, the contents of that deal need to be evaluated separately from the negotiations process. The fact that it was tough to get there does not mean that the outcome is inherently desirable. As in the case of labor negotiations in the 1970s, the consequences of tough bargaining were not immediately apparent to the negotiators. They undoubtedly felt that just reaching a deal was an accomplishment. But in the longer term the consequences were unfortunate.

Mitchell's Musings 8/8/11: Missing the Big Picture?

Two developments last week – one local; the other national - got me musing on the capacity to miss the Big Picture in various settings. First, below in italics is an extract from an article that appeared in the Los Angeles Times on August 2.[30] The article deals with the California food stamp program which allows recipients to use the stamps in restaurants if they have "don't have the means or ability to prepare their own meals." Those running the program want to educate such recipients not to consume unhealthy junk food. News articles nowadays often provide human-interest examples and this one is no exception. Here is the article's introductory text:

Anna Harrald likes to eat at Taco Bell because the hard-shell tacos are "nice and cheap and good." From KFC and El Pollo Loco, the chicken she stores in a friend's refrigerator will feed her for days. The 46-year-old homeless woman, who sleeps by a canal along the 710 Freeway in Long Beach, is one of at least 141,000 people in Los Angeles County eligible to use their food stamps at local restaurants under a state program aimed at helping the elderly, homeless and handicapped get a meal…

Now it is understandable that someone in charge of the food stamp program should be concerned about Anna Harrald's eating habits at Taco Bell. But isn't Ms. Harrald's real problem that she "*sleeps by a canal along the 710 Freeway"* as compared to her "*hard-shell tacos"*? The Big Picture here seems to have gotten lost.

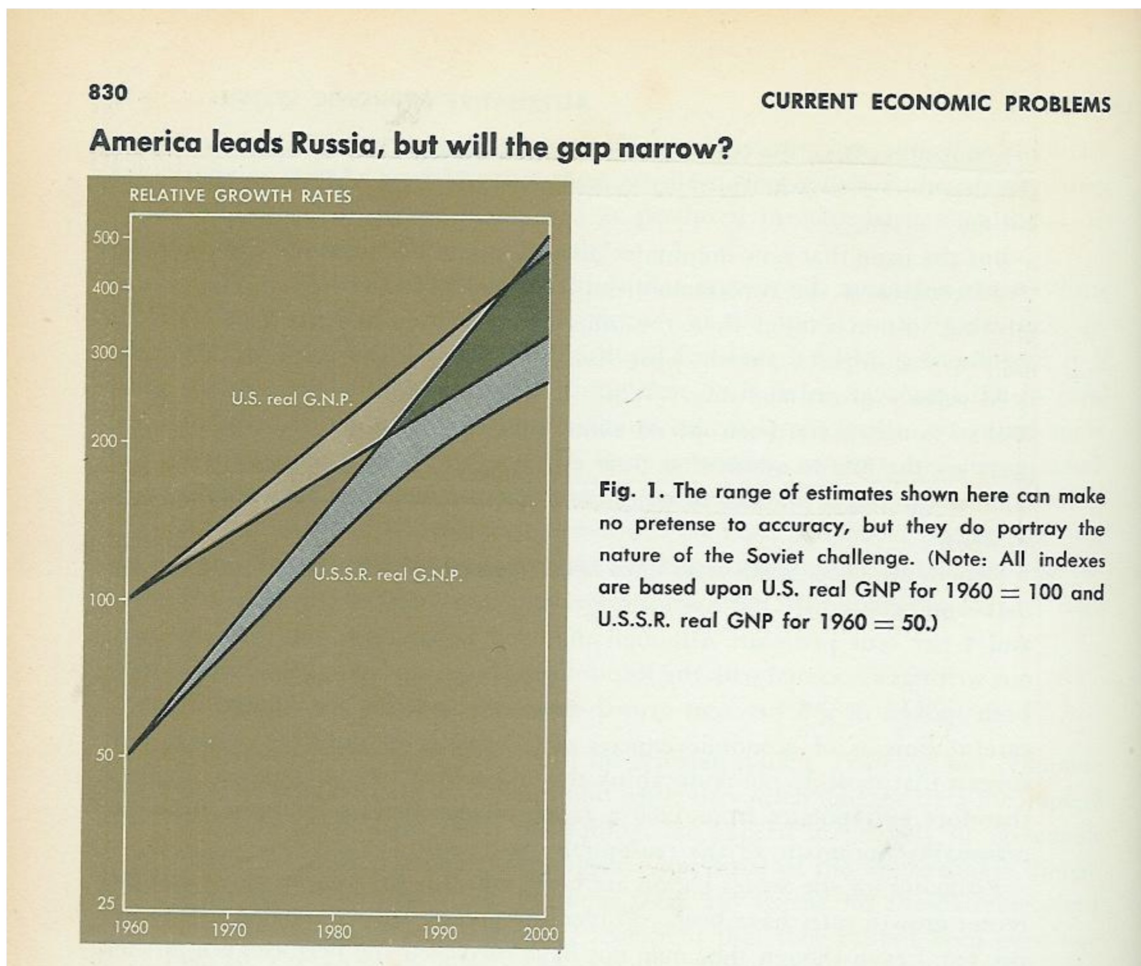
As noted, the LA Times article happened to appear on August 2. That was the date the federal House-Senate-President debt-ceiling deal was reached - the second development that got me musing. Much of the subsequent news analysis focused on the drama of the negotiations process – a topic that I dealt with in last week's musing. After the drama story came analysis of the details of the deal and what federal programs might be cut. Finally, there was discussion of the general economic impact and the effect on state and local governments. Experts were quoted. These components of the story are all worthy items for analysis, of course. But is there an underlying Big Picture missing?

Note that the debt-ceiling deal came shortly after another development that I referenced in an earlier musing – the end of the U.S. space shuttle program. If you think back to the 1950s and 1960s – this author is old enough to do that – it was evident then that the first man on the moon would either be an American or a Soviet astronaut/cosmonaut. No one would have thought that even if the first to get there were Americans, the Soviets – who had launched Sputnik before the U.S. had an orbiting satellite – wouldn't eventually put a man on the moon. But they never did. Totally inconceivable was the idea that *no one* would be on the moon in the early 2000s – remember the late 1960s film "2001"? It was inconceivable that the Soviet Union would not exist at all by 2001 – or that, to the extent that Americans might go into space after 2011 - it would have to be on a Russian rocket, a remnant of the Soviet space program.

[30] The full article is at http://www.latimes.com/news/local/la-me-food-stamps-20110802,0,7994181.story

Even as the Soviet Union was in the process of collapsing in the 1980s, none of the many U.S. Sovietologists-analysts predicted there would be no Soviet Union for them to study within a few years. I remember as an undergraduate in the early 1960s taking a course on the Soviet Union. Soviet experts back then would analyze whether some speech by a Soviet functionary was said in the official transcript to be followed by "applause, "prolonged applause," or "prolonged applause – all rise" as an indication of who was moving up or down in the governing hierarchy. The experts were almost as enmeshed in the details of the Soviet system as the functionaries themselves.

There was debate when I was an undergraduate as to whether, by 1990, the Soviet GNP (back then – there was an N rather than a D between the G and the P) would exceed the American GNP. The chart below, from the 1961 edition of Paul Samuelson's standard and influential textbook on economics was typical of the discussion at the time.[31]


830 CURRENT ECONOMIC PROBLEMS

America leads Russia, but will the gap narrow?

Fig. 1. The range of estimates shown here can make no pretense to accuracy, but they do portray the nature of the Soviet challenge. (Note: All indexes are based upon U.S. real GNP for 1960 = 100 and U.S.S.R. real GNP for 1960 = 50.)

Despite all the detailed expertise of Sovietologists, the Big Picture – the fact that the Soviet system could collapse entirely by 1990 - was missed. And it continued to be missed until the actual event. The

[31] Paul A. Samuelson, Economics: An Introductory Analysis, fifth edition (New York: McGraw-Hill, 1961).

Sovietologists were not alone. The functionaries running the Soviet system also did not anticipate the collapse, even when it was soon to occur.

In the 1980s, but well before the Soviet collapse, an economist who was a Soviet expert told me that he had spent considerable time in the Soviet Union in the 1970s and had talked with elite economic experts there. As part of the elite, they had access to western journals and western thinking and had an interest in reforming the Soviet system to function more efficiently with markets, etc. But they could not see how to do it. They had the goal but not the means.

The transition seemed to these elite insiders to be an impermeable barrier. What would happen in the transition if the army didn't get its potatoes? That was a question one of them had asked to illustrate the transition problem. So what you had was an elite ruling group that viewed the system they were running as flawed in major ways but that couldn't see any way to change it. They could see the system's dysfunction but assumed that it would nonetheless continue as is indefinitely.

So what does this history suggest? I am sure that in the aftermath of the federal debt-ceiling deal, researchers will be doing analyses – as they should - of the deal's economic impact and focusing in particular on its employment aspects. But there are enough symptoms in recent developments to suggest that just focusing on those effects could put us in the same category of those experts who tracked whether some Soviet official merited "applause, "prolonged applause," or "prolonged applause – all rise."

Perhaps we need some folks with expertise in the history of the rise and fall of empires. Or maybe we need some organizational experts who can tell us how folks within a system, or close to it, can miss the tell-tale signs of major developments that will soon fundamentally change it. We may be missing the Big Picture, developments which could have a more profound effect on jobs - and on economic prospects more generally - than the usual estimates of employment multipliers would indicate.

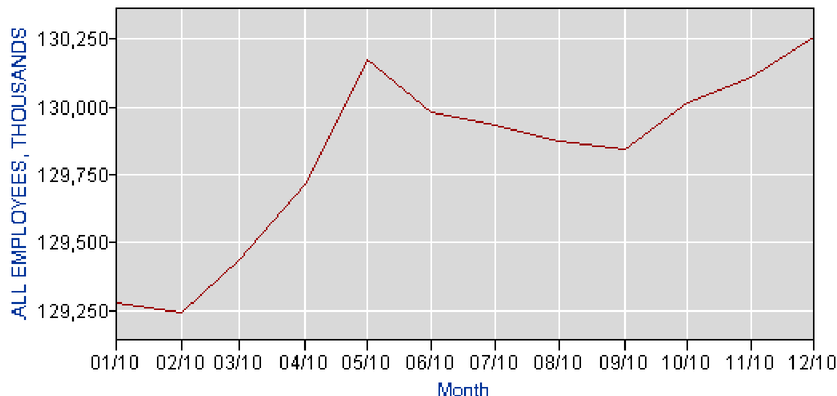
Mitchell's Musings 8/15/11: Census & Jobs

I am currently traveling outside the U.S. so there will be a short musing for this week. Much has been said about public job creation and the effect of state and local public sector job loss in the aftermath of the Great Recession. In particular, some critics say that – through some logic – creating jobs during an economic slump in the public sector would be offset by job loss elsewhere. Again, following that logic, federal aid to state and local governments whose revenues were reduced by the Great Recession has essentially been off the table when the remainder of the stimulus program ended.

As it happened, however, we had an inadvertent social science, macro-level, experiment in 2010 in the effects of public job creation. As per the constitutional mandate, the decennial Census of Population was taken in the spring of that year. About 800,000 workers were hired to conduct the Census. Some of these workers were on such short-duration contracts that they were missed when the establishment survey was taken. But the Census Bureau estimated in advance of the actual event that something over 600,000 Census-collection jobs would be picked up in official data series.

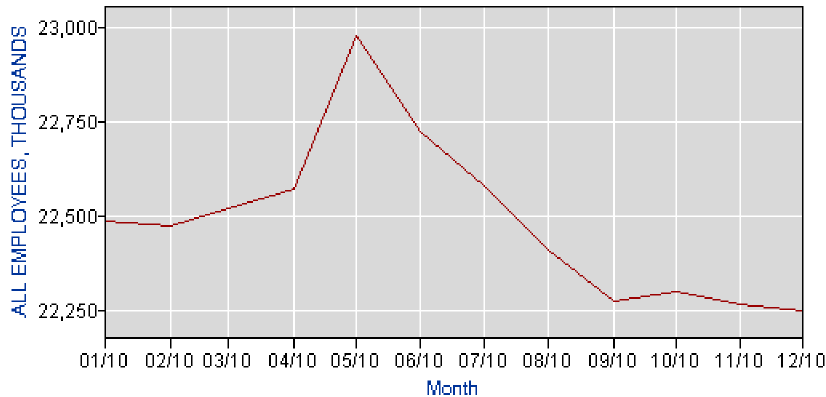
So, did it happen? Did we see a jump, after the fact, in the data?

Below is a chart, based on U.S. Bureau of Labor Statistics data, of nonfarm payroll employment in 2010, seasonally adjusted.



At the time, employment – apart from the Census hiring – was on the rise. Use your imagination to draw a crude trend line on the graph above, but ignore the Census hiring that peaks in May. The deviation uptick from trend (actual vs. trend) is in the ballpark of the predicted 600,000+ jobs created in the public sector by that hiring.

On the next page is a similar graph, just of government-sector employment. Again, use your imagination to draw a crude trend line in this sector which, apart from the Census peak, was declining. You again see the expected creation of 600,000+ jobs.



At the time the Census hiring occurred, economists carefully noted that the Census hiring should be ignored, i.e., adjusted out of the data, in order to get a sense of where the job market was heading. Since Census hiring was clearly a temporary and unusual event, making such exclusion was justified for the purpose of longer-term economic forecasting and analysis. But for purposes of answering the simple question of whether hiring through a public sector employment program would create jobs net or not, you don't want to ignore the Census. The Census was an inadvertent experiment well designed to answer the question.

QED; net jobs were created. The job creation due to the Census was not offset elsewhere. Why? Because there was then (in 2010) a substantial idle labor resource from which to draw, thanks to the Great Recession and its aftermath of high unemployment and worker displacement. It is now more than a year after the 2010 Census hiring peak and there still remains a substantial idle pool of labor on which some other program of job creation could draw. State and local government job reductions are contributing to that pool.

Do we have to wait until the 2020 Census for a new job-creation program to come along?

Mitchell's Musings 8/22/11: More on Jobs and the Census

Last week's musing took on the issue of creating jobs through direct government hiring. I noted that we had an inadvertent social science experiment in 2010 when the federal government hired a large number of workers to conduct the constitutionally-mandated Census of Population. There are those critics who think that if the government hires workers directly, the effect on total employment will necessarily be offset by a diminution of jobs elsewhere. But as shown last week, the Census hiring in 2010 did add to employment on net, i.e., public plus private jobs. The added Census jobs were not subtracted from private jobs.

As a result of that musing, it was suggested to me that it would be useful to look also at the conduct of the 2000 Census.[32] The usual story of why public job creation will be offset elsewhere is through some version of "crowding out." Presumably, under that story, the folks hired for public jobs would otherwise have been privately employed. But this misinterpretation of the labor market's operation is a classic case of why there is a difference between macroeconomics and microeconomics. If microeconomics is assumed to be analysis of a labor market that always "clears," i.e., one in which there is some version of full employment, then, indeed, creating jobs in one sector pulls otherwise-employed workers out of some other sector.

So let's tell a simple story. Suppose there are 100 workers available and all of them are employed (100 jobs are filled). Suppose we now create 10 new Census jobs. Despite the Census job creation there will still be only 100 workers available. So the Census will have to bid those workers away from elsewhere in the economy and there will be no net job creation. But if there are only 90 jobs and 100 workers available (so 10 workers are idle), we can raise employment to the full 100 by creating 10 more jobs. There is more to be said about how the real world labor market operates but this little tale is a good starting point.

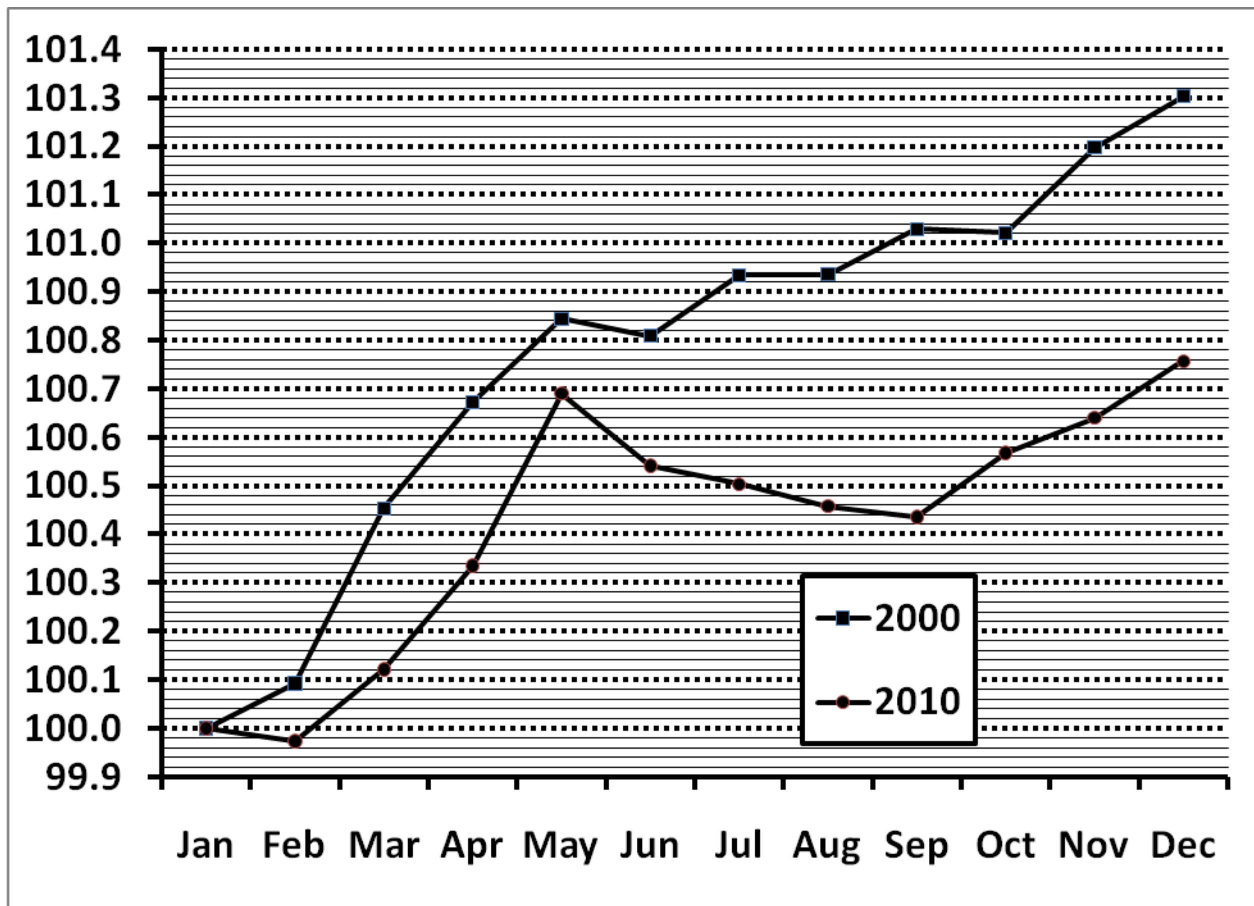
The year 2000 was one of full employment with the unemployment rate averaging a very low 4.0%. It was the peak of the dot-com/stock market boom. There was little idle labor compared to 2010 when the unemployment rate averaged a very high 9.6%. So we would expect that Census hiring in 2000 would have a lesser effect on net employment (public plus private) than it did in 2010. That is, there would be crowding out in 2000 compared to 2010. Put another way, the year 2000 was similar to my 100-100 example; the year 2010 was similar to my 90-100 example.

Now let's take a look empirically. The chart on the next page compares the course of employment – month by month – in 2000 and 2010 with seasonally-adjusted nonfarm payroll employment. January of each year is set equal to 100. As expected, the impact of Census hiring in 2000 shows up as a minor blip – only a small deviation from trend – when compared with 2010. In the later year, net employment jumps – peaking in May – and then declines as the temporary Census hiring ends and reverses. In 2000, the Census Bureau had to bid away workers from elsewhere. In 2010, it had idle workers available.

[32] In the spirit of giving credit where credit is due, my son Joshua W. Mitchell was the source of this suggestion.

In both years, of course, there had to be some crowding out and some net job creation. There is always a mix of the two effects in reality but the mix changes with the state of the labor market. The (very) tight labor market of 2000 – and rapid underlying job growth in that year - meant that much of the effect of Census hiring was crowded out. And the (very) loose labor market of 2010 – with its slow underlying job growth - featured little crowding out and mainly job creation.

I suspect that few readers of this blog will be surprised at the contrast – shown on the chart below - between the two Census years. But it is worth documenting the contrasting effect, given the current opposition to any efforts at job creation. As noted last week, the next Census won't be around to provide work until 2020. But right now in 2011, there are signs of a stalled or at least very sluggish economic recovery.



The essence of macroeconomics is that sluggish economic performance reinforces itself. Employers won't hire when demand is weak. The resulting unemployment from the lack of hiring produces weak consumer demand. In the face of weak demand, there is little incentive to invest in new productive capacity. While macro-economies do have aspects of resilience, there is always the danger of low-level traps.

Nowadays, when you hear talk by employers of a "new normal," what they are telling you by that phrase is that they believe we are in a low-level trap and they are making their hiring plans accordingly. The same "new normal" belief characterizes those making investment decisions and consumers making purchasing decisions. All three sets of actors – employers, investors, consumers – are making perfectly rational micro decisions as they observe the behavior of the other actors. But the rational micro actions collectively add up to a suboptimal macro level of activity.

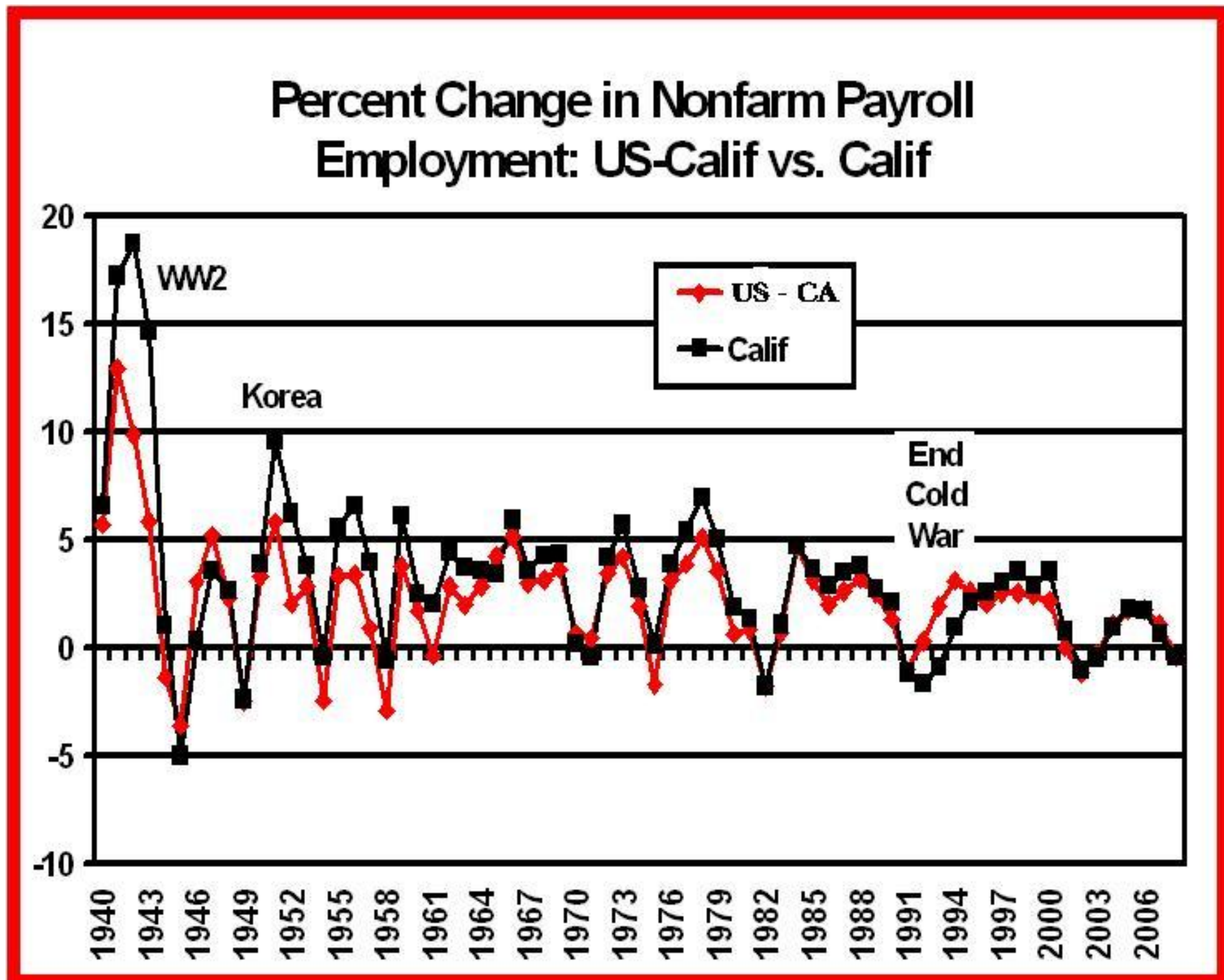
Years ago in a lecture at one of UCLA's quarterly economic forecast conferences, macroeconomist Axel Leijonhufvud gave a talk in which he pointed to the analogy of a ship in rough waters. Most ships are built to withstand the impact of a mild-to-moderate wave. A ship may rock back and forth for a time after the shock of being hit by a mild-to-moderate wave. But it ultimately returns to center thanks to its built-in stabilizers. A really big wave, however, can capsize the ship and it cannot right itself. Outside intervention is then needed to right the ship.

The obvious conclusion is that some direct action on job creation is now needed to get us out of the "new normal" low-level trap. Direct action doesn't necessarily mean a public jobs program, i.e., hiring by the government. But it does at least mean government purchasing goods and services – and encouraging the purchases of goods and services in the private sector - to make up for the missing demand that the economy cannot generate on its own.

Mitchell's Musings 8-29-11: Affairs of the States

Recently, California Governor Jerry Brown appointed a job czar. Also, recently, the City of Los Angeles appointed a job czar. Those actions in my home state got me to thinking. I suspect job czars are popping up in some form around the country. Implicit in such appointments – and related state and local actions – is the idea that at the sub-federal level, there is room for action to combat unemployment and create jobs. If I were a job czar, or were advising one, what would I do/say?

Below is a chart I showed to a class almost a year ago. It plots the annual change in nonfarm payroll employment in the U.S. *excluding* California against California employment. The chart suggests a limited scope for action at the state level in California to offset the ups and downs of the national business cycle. Basically, the employment history of California is largely the history of the rest of the U.S. with an adjustment for military spending. California grew remarkably faster than the rest of the U.S. during World War II. There was also a California advantage during the Korean and Vietnam Wars. When the Cold War ended, however, the U.S. outpaced California in the early 1990s.



It is certainly right to look to Washington for action in rejuvenating the recovery from the Great Recession as the chart above suggests. But the reality is that the Federal Reserve has indicated it has gone as far as it wants to go. And – as the recent debt ceiling "debate" indicated – there is not going to be any action that depends on Congress.

It may be unfair of the electorate to hold state and local officials responsible for fixing their economies when the central authorities ought to be doing it - but voters nonetheless do hold local political leaders accountable. Hence, we have appointments of job czars and the like. What can we say to such czars about the pattern of recovery so far and the scope for state and local action?

In the Appendix to this musing, I list the fifty states and the change in nonfarm payroll employment in each from December 2007 (generally taken as the national peak of the business cycle) through June 2011, using seasonally-adjusted data. There was variation in the degree to which the individual states experienced the Great Recession and the subsequent sluggish recovery. Can we give any advice to job czars about actions they might take, based on that state-level variation?

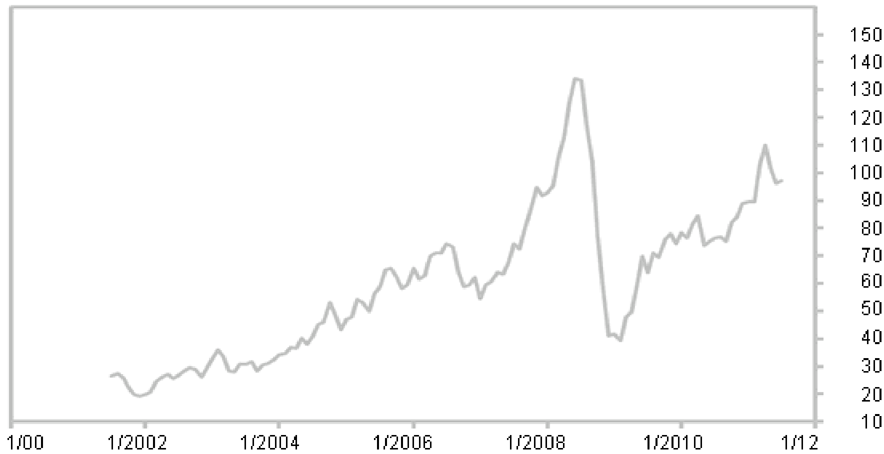
Over the entire period of the Appendix table, some states actually showed employment growth, even though across the entire U.S. (omitting Washington, DC), there was a net decline in jobs. Some states experienced only modest declines. Arbitrarily, let's take a look at the top-10 states in terms of job change and the bottom-10.

	Employment Change	Foreclosure Rank*		Employment Change	Foreclosure Rank*
Top Ten			*Bottom Ten*		
North Dakota	8.8	50	Delaware	-6.7	26
Texas	3.7	24	North Carolina	-7.2	37
Alaska	3.4	39	Alabama	-7.2	31
South Dakota	0.0	43	California	-7.4	3
Nebraska	-0.7	45	Michigan	-7.7	4
Oklahoma	-1.1	30	Georgia	-8.0	8
West Virginia	-1.1	49	Idaho	-8.2	6
Louisiana	-1.3	28	Florida	-8.9	7
Massachusetts	-1.7	40	Arizona	-10.5	2
New York	-1.8	46	Nevada	-13.7	1

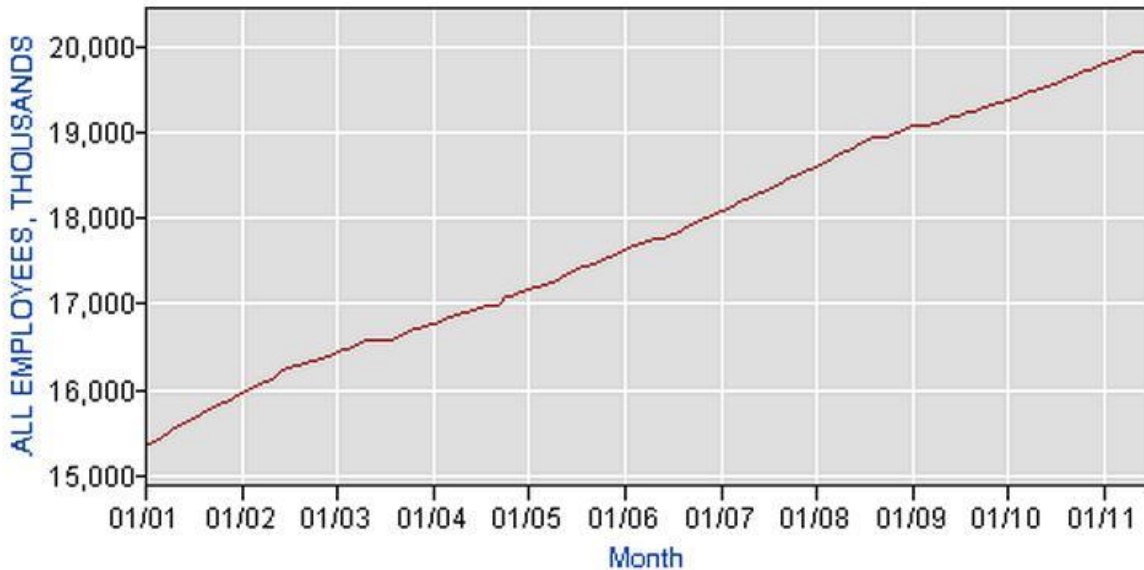
*Foreclosure rank as of July 2011 measured by foreclosures per household from
http://www.statehealthfacts.org/comparetable.jsp?cat=1&ind=649

When you look at the top ten – the states that did best – energy seems a good story for much of that group - oil, natural gas, coal, ethanol/corn. (North Dakota, if you didn't know, is having something of a local natural gas boom.) Oil prices generally rose during the first decade of the 21st century. As shown on the chart on the next page, oil prices started at around $30 per barrel and peaked at over $130 in summer 2008 just before the financial crisis hit in the fall of 2008. The price then plummeted in the

crisis, but has since floated back up to around $100. New York and Massachusetts – as the second chart on the next page shows – don't have significant energy but both have notable sectors in education and health care, a form of employment that has been expanding and seems virtually recession-proof.



Source: http://forecastchart.com/chart-crude-oil.html



Source: U.S. Bureau of Labor Statistics

What about the bottom-10 states? California actually has substantial oil production in absolute terms, but as the nation's largest state, oil production is only a small part of its economy. What stands out about the gap between the bottom-10 and the top-10 is the foreclosure index. States which did well in the Great Recession and its aftermath tended to avoid the housing/mortgage bust. (And adding a pre-existing energy and/or a recession-proof component to their economies was a big help.) Those states that did poorly tended to have high foreclosure rates, i.e., they were centers of the housing/mortgage bust. What does not seem to be associated with the gap between the top-10 and the bottom-10 are the usual "business climate" indicators. Some are "red" states; some are "blue." Whatever validity such indicators have has little to do with short-term business cycle effects.

So what should a state or local job czar be doing in the short run? He/she can't control the national monetary and fiscal policies. What the top-10/bottom-10 gap suggests is that the focus should be on cleaning up the mortgage foreclosure mess. That approach may involve help from federal regulatory authorities. So if such help is needed, it should be sought.

The current state of affairs, in which individual banks and financial institutions operate independently, opens the door to a classic coordination failure. A foreclosed empty house on a block can lead to neighborhood decay. It discourages remaining homeowners from preserving their investment and may promote more home abandonment and foreclosure. Foreclosures lead to falling government revenues from property and other taxes and to state and local layoffs – which exacerbates the foreclosure problem and causes further economic distress.

Bottom line: If I were a job czar, I would start by working on foreclosures. Over the longer haul, there may be institutional issues and remedies – education, infrastructure, sensible zoning and regulatory frameworks – that can encourage job creation. But do first things first.

Appendix: Nonfarm Payroll Employment Change, Seasonally-Adjusted: December 2007 – June 2011

State	Change
Alabama	-7.2
Alaska	3.4
Arizona	-10.5
Arkansas	-2.7
California	-7.4
Colorado	-4.8
Connecticut	-4.8
Delaware	-6.7
Florida	-8.9
Georgia	-8.0
Hawaii	-6.3
Idaho	-8.2
Illinois	-5.2
Indiana	-6.6
Iowa	-3.0
Kansas	-5.1
Kentucky	-4.1
Louisiana	-1.3
Maine	-4.1
Maryland	-3.8
Massachusetts	-1.7
Michigan	-7.7
Minnesota	-3.8
Mississippi	-5.6
Missouri	-5.1
Montana	-2.9
Nebraska	-0.7
Nevada	-13.7
New Hampshire	-2.8
New Jersey	-5.3
New Mexico	-5.3
New York	-1.8
North Carolina	-7.2
North Dakota	8.8
Ohio	-5.8

Nonfarm Payroll Employment Change,
Seasonally-Adjusted: December 2007 – June 2011 – continued

Oklahoma	-1.1
Oregon	-6.6
Pennsylvania	-2.2
Rhode Island	-4.8
South Carolina	-6.3
South Dakota	0.0
Tennessee	-6.7
Texas	3.7
Utah	-4.8
Vermont	-2.3
Virginia	-3.2
Washington	-5.2
West Virginia	-1.1
Wisconsin	-3.9
Wyoming	-1.8
All but DC	-4.6

Source: U.S. Bureau of Labor Statistics

Mitchell's Musings 9-5-11: No Match for the Job at Hand

One outgrowth of the Los Angeles Watts Riot of the 1960s was creation of a public transit bus route to take (then) black cleaning women to such locales as Beverly Hills, Bel Air, Westwood, and Pacific Palisades. The bus left the black neighborhoods early in the morning and went to the upscale neighborhoods. In the evening, it ran in the opposite direction. That is, the bus line was not a continuous back-and-forth service that ran all day but was geared specifically to the labor market, going just one way in the morning and the other way in the late afternoon.

As the demographics of the LA region changed over the years, the passengers were more likely to be Latina than black. However, the post-Watts bus service continued until 2004, when other routes were established. Two profiles of the old route that appeared in the *LA Times* referred to bus line 576 as the "Nanny Express."[33]

Why was this unusual service created? In the aftermath of the Watts Riot, there was much attention to black unemployment as a cause of the Riot. Out of that concern came the observation that available jobs - and available workers to fill those jobs - could be geographically mismatched; workers were in one location and jobs in another. Hence, the remedy in this case was to create a transit route to make the match.

Job mismatch is sometimes viewed as locational, as in the example above, but more commonly it is discussed in terms of skills. Employer skill needs are said to be different from those that the unemployed have on offer. Typical remedies proposed for this mismatch are job training and education.

Job mismatch is often linked to so-called "structural" unemployment. Discussion of structural unemployment seems to arise whenever the labor market is at extremes. In periods when the unemployment rate is relatively low, economists start worrying about inflation. The story told is that due to job mismatch, the labor market is tighter than the unemployment rate might suggest. Those who are unemployed don't have the right skills or are not in the right place and so therefore employers will bid up wages as they compete for the few who do match their location and skill needs. Rising wages will push up prices, etc.

When the unemployment rate is relatively high, structural stories also come into vogue. Macro remedies – stimulatory monetary and fiscal policies – won't work, according to these stories – because the unemployed aren't what employers want. There is no point is using macro policy because it will just cause inflation. Such structural stories have an appeal to those

[33] You can find the story at http://articles.latimes.com/2000/jul/04/news/mn-47637 and http://articles.latimes.com/2004/dec/11/local/me-nanny11

commentators who, for ideological or other reasons, don't want to adopt macro policy to reduce unemployment. And the structural tale appeals to policy makers who, for political or other reasons, haven't and/or can't adopt such macro remedies.

Clearly, at any point in time, there *are* structural mismatches in the labor market. However, at present, there seems to be confusion about the existence of *some level* of structural unemployment (always true) and the *change in that level* (which may or may not be occurring). Has there been some sudden shift in worker location and skills vs. employer location and skill demands that just happened to correlate with the financial collapse of 2008 and its aftermath?

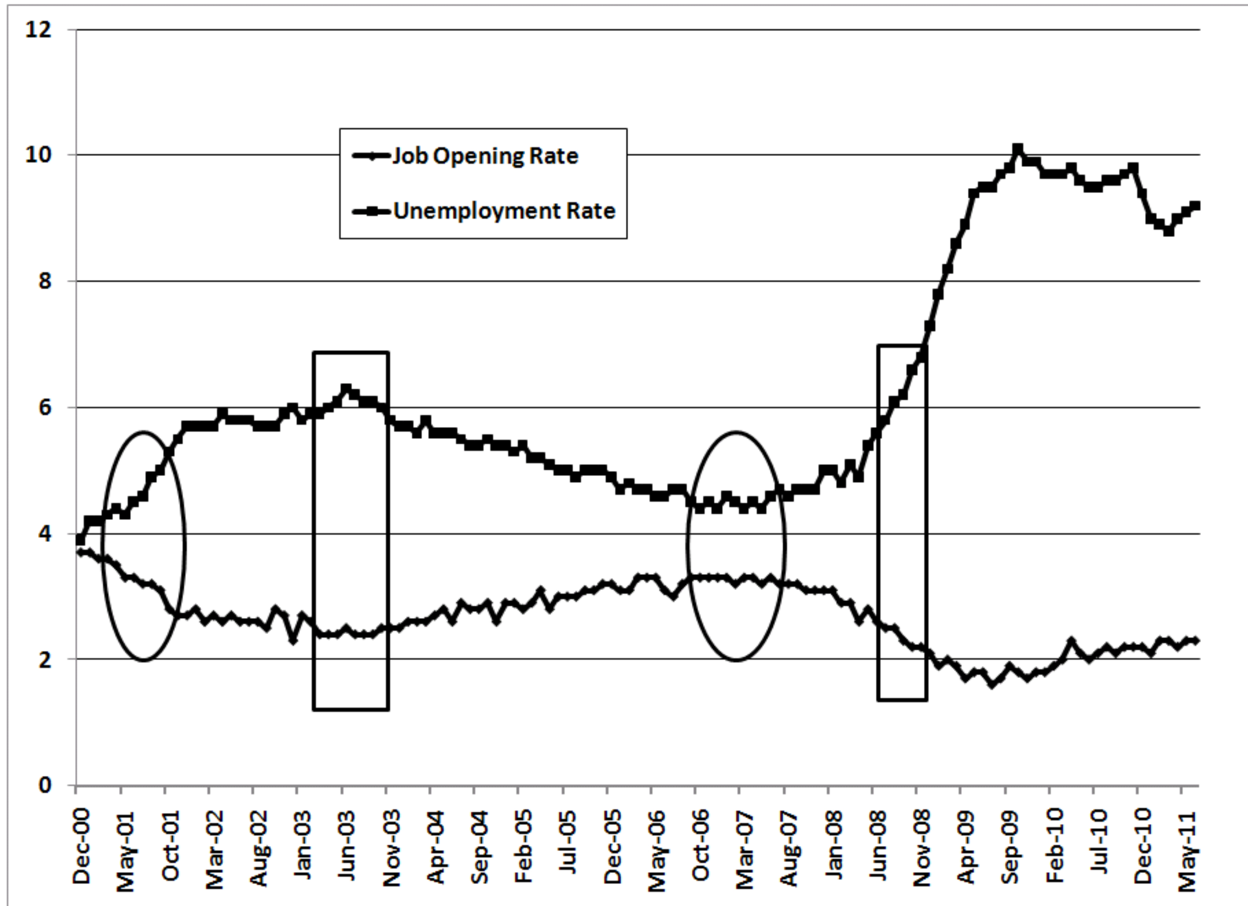
In principle, one indicator of a change in the level of structural unemployment could be the relationship between the vacancy rate (job openings available from employers) and the unemployment rate. If, over time - for a given unemployment rate - the vacancy rate rose, that increase would suggest that there was a rise in available jobs that the unemployed were not capable of filling.[34] "In principle," however, is the operative term because although we have kept unemployment rate data since 1940, there has been no long-term official collection of vacancy data.

The U.S. Bureau of Labor Statistics (BLS) did do some experimental vacancy work for the manufacturing sector in the late 1960s and early 1970s, but the series was discontinued. Economists have since used proxies such as the Conference Board index of help-wanted newspaper advertising as a substitute for vacancies. But the validity of that series was upended by the rise of the Internet for job advertising. Most recently, however, the BLS resumed collecting vacancy (and turnover) data with its Job Openings and Labor Turnover Survey (JOLTS).

JOLTS data begin at the end of 2000, around the peak of the dot-com boom, and continue on a monthly basis to the present. That isn't a long period in which to detect the development of underlying structural shifts in the labor market. But if you are a proponent of the "macro-won't-work-now-because-it's-structural-mismatch-problem approach," you evidently think that such shifts happen within short periods. So let's do some quick-and-dirty work with JOLTS and the unemployment rate and see what we can. Do the data suggest that the level of structural unemployment has shifted up in some dramatic fashion?

[34] Economists will recognize that I am referring to the "Beveridge curve" literature here.

A chart of the job openings (vacancy) rate vs. the unemployment rate appears on the next page.[35] Note that even when unemployment peaked in early 2009, the jobs opening rate was about 2%. What that suggests is that there are going to be some vacancies reported no matter how deep the slump. Economists have long noted the existence of "frictional" unemployment, i.e., that there will always be some minimal time needed to find jobs, even in booms, and so the unemployment rate has never been/can never be zero.[36] Vacancies seem to exhibit the mirror image of such frictions. No matter how dismal the economy, there are always some vacancies.



The housing/mortgage bubble did not produce quite the boom that the dot-coms did. But the former episode got the unemployment rate down to around 4.5% in late 2006 and early 2007. As the economy cooled off after the peak of the dot-com boom, the unemployment rate began

[35] The data on the chart are seasonally adjusted. Definition of JOLTS data can be found at http://www.bls.gov/jlt/jltdef.htm

[36] During the peak of World War II, unemployment was in the 1-2% range. It was in the 2-3% range during the Korean War and 3-4% during the Vietnam War.

to rise, getting to around 4.5% in late spring/early summer of 2001. These two periods are marked on the chart with ovals. Note that the jobs opening rate in *both* periods was about the same, around 3.3%. So, looking at two low unemployment rate periods over 2001-07 does not indicate a rise in structural unemployment over that six-year period. That is, the unemployment-vacancy relationship was about the same in both.

What about high unemployment rate periods? The dot-com bust ultimately drove unemployment a bit over 6% in mid-2003. By late summer 2008, unemployment was back at that level (and rising). In those two periods, marked by rectangles on the chart, the job openings rate was about 2.5%. So, again, no sign of a shift in the unemployment-vacancy relationship is apparent. In short, to take a structuralist view of our current situation, you would have to believe that the level of structural unemployment abruptly shifted up *after* 2008, even though for the five or six proceeding years, it showed no signs of movement.

Does that observation mean that no policies aimed at structural unemployment are worth considering at present? Not at all. But it suggests that they were equally worth considering in 2006-07, before the current slump. And there are limits to what could be accomplished by such policies, back then and now.

If you could magically overcome *all* barriers through some set of micro-level policies – structural and frictional – so that each reported vacancy now was immediately filled by someone now unemployed, the unemployment rate would currently be a bit over 7% instead of a bit over 9%. And the jobs opening rate would be – by definition – zero! However, as noted above, it is likely that a good portion of current jobs opening rate are the analog of frictional unemployment, i.e., always going to be with us.

Do you think you could devise structural policies that could cut the current vacancy rate in half by transforming those currently unemployed into something more like what employers desire? If you think so, then you could cut the unemployment rate from its current 9+ percent to 8+ percent. But in the history of the series, the jobs opening rate has never been as low as half its current level.[37]

A realistic assessment would likely be still less optimistic than cutting current vacancies in half. Using feasible micro-level structural policies (retraining, relocation allowances, etc.) might knock a few tenths off the current unemployment rate, absent macro stimulus. Taking structural action is worth considering but it doesn't get to the heart of the problem.

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[37] The latest figure available at this writing is for June 2011. The jobs opening rate as of that date was 2.3%. The lowest it has been since collection of the data began is 1.6%.

Mitchell's Musings 9-12-11: Where's Waldenville?

I am in transit this week and so this musing will be brief. I suspect readers had their fill of the usual Labor Day "where-are-unions-going?" news articles last week. A typical newspaper article of that genre, which you may well have read, will have noted that private-sector unions have been declining. It will go on to say that now public-sector unions are the new – but troubled - face of unionism.

The articles which took that approach were generally not positive reviews. One example appeared on Labor Day in the Sacramento Bee which focused on California unions in particular:

…The decline of manufacturing in the 1960s and 1970s hit unions hard, but they found a savior in Jerry Brown, who was elected governor in 1974. He signed long-sought collective bargaining legislation for farmworkers as well as teachers and other government workers... On this Labor Day, it would be accurate to say that without more than a million public employee members, the California union movement would be virtually dead.

…Rather than celebrating political hegemony this Labor Day, therefore, unions are losing ground due to economic circumstances, hoping voters will impose new taxes, and fearing they'll pass a ballot measure that would curb unions' power to collect political money from members. It's a holiday that drips with irony.

Full article at: http://www.sacbee.com/2011/09/05/3885175/dan-walters-a-labor-day-that-drips.html

However, in the wake of the various ten-year memorial services and retrospective articles on the terrorist attacks of September 11, 2001, it may be time to recall that there was at that time – only a decade ago - a different view of public workers and, therefore, public sector bargaining. Public workers were not viewed with hostility immediately after September 11. They were instead heralded as brave "first responders," particularly in regards to the New York City attack and the activities of police and fire fighters at the World Trade Center.

One of the effects of the decline of unionism is that courses on traditional labor relations, i.e., union-management relations, have all but vanished. Indeed, courses that deal with ordinary employees – nonunion or union - have largely disappeared from (American) business schools. When unions were strong in the private sector, they were seen as a challenge to management and therefore worth studying. If unions were worth studying, so were the employees they represented or sought to represent.

But nowadays, human resource courses, to the extent they exist, tend to deal with relations among managers (management teams, leadership, etc.). It is not clear there are any ordinary employees in the archetypal business school model firm, just managers.

For those readers who may still teach traditional labor relations - perhaps in policy schools - there are some multimedia resources available that deal with negotiations and dispute settling with a public-sector focus. But they are old sources. In the late 1970s, the U.S. Department of Labor sponsored the Waldenville series, dealing with negotiations, mediation, and grievance arbitration. I will provide links below but, again, the main problem with the videos available – Waldenville and others - is that they are outdated. The hairstyles of the actors look funny. Moreover, the economic climate was different.

The Waldenville series was made during a period of high inflation and large nominal wage increases. To contemporary students, the wage increases under negotiation will seem hugely outsized. However, it would not be terribly costly to redo these videos, updated to current reality and issues (and hairstyles). They could deal with furloughs to deal with budget problems and/or underfunding of pension plans. With modern technology, distribution of videos via the Internet is essentially costless.[38] And the basic lessons of the Waldenville stories that were told still need telling.

In the Waldenville negotiations film, for example, the fact that there are factions within unions that, in effect, require an internal negotiation is brought out clearly. The use of informal discussion between the key labor and management reps outside the official bargaining room is illustrated. In the mediation episode, it becomes clear that the mediator who is brought in is not just a passive go-between but instead uses leverage to push the parties towards agreement.

The bottom line for today's Mitchell's Musing is an editorial comment/proposal. Much of the video teaching material related to labor relations is out of date. It needs updating. There is unlikely to be a commercial supply of such material forthcoming. If up-to-date material were available, there would be greater public understanding of the bargaining process. But if the job is going to be done, any updating will need to be sponsored by the U.S. Department of Labor – as it did in the 1970s - or by some nonprofit organization.

It's a job worth doing. Any takers out there?

[38] The Waldenville series were distributed on VHS tape cassettes. Some university libraries may still have copies. However, such tapes are prone to deterioration.

Links to Waldenville negotiations video:

Part 1: http://www.youtube.com/watch?v=Px86OwXcVAI

Part 2: http://www.youtube.com/watch?v=FDFkMHuupuE

Part 3: http://www.youtube.com/watch?v=jm0RRrZBWd0

Part 4: http://www.youtube.com/watch?v=W9htze_cJHs

Part 5: http://www.youtube.com/watch?v=SLTjPVd380s

Links to Waldenville mediation video:

Part 1: http://www.youtube.com/watch?v=XZh3FVP6mSs

Part 2: http://www.youtube.com/watch?v=EXDQyPwODiY

Part 3: http://www.youtube.com/watch?v=PpcZ5W27JxU

Part 4: http://www.youtube.com/watch?v=xKg14EvTb4k

Links to Waldenville grievance arbitration video:

Part 1: http://www.youtube.com/watch?v=b30qUsvBP8A

Part 2: http://www.youtube.com/watch?v=LFUDD4kfQ24

Part 3: http://www.youtube.com/watch?v=UP4hdPxQm38

Part 4: http://www.youtube.com/watch?v=ExlwSCRft7k

Part 5: http://www.youtube.com/watch?v=bcmBtKWFINU

Mitchell's Musings 9-19-11: Is Your Family a Ponzi Scheme?

There has been much talk recently of Social Security as a "Ponzi scheme," so-named after con-man Charles Ponzi pictured above. Conventionally, Ponzi schemes are defined as arrangements in which investors are promised enticing returns (greater than market) and in which these returns are in fact paid out of new contributions by new recruits.[39] I say "conventionally" because that is not the definition I would use. I will argue below that the conventional definition is incomplete and not especially useful in its application to Social Security. But note that there is a glaring oddity *if* the conventional definition is used.

Those critics who characterize Social Security as a Ponzi scheme are also prone to say that it is a *bad* investment, i.e., that it gives retirees a *lower* return than they could earn in the market. Opponents argue that participants would do better if only they could take their payroll tax contributions and place them in the market. It is hard to reconcile low return with a scheme that depends on offering a high return.

A recent poll asked respondents if they thought Social Security was a Ponzi scheme. Seventy percent disagreed with that characterization, 20% agreed, and the rest didn't know. I would not put much stake in these results – there was no evidence that the pollster asked respondents if they knew what a Ponzi scheme was or – if not - what they thought it was. But the word "scheme" does not sound particularly nice – it connotes fraud. And recipients may have had a sense that a phase that combined "Ponzi" and "scheme" was even more negative in its implications than just "scheme."

Perhaps most telling was that 82% said they would not support eliminating Social Security.[40] What we mainly learn from the poll is that if people like Social Security – and they apparently do - then they don't

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[39] The Wikipedia definition is "a fraudulent investment operation that pays returns to its investors from their own money or the money paid by subsequent investors, rather than from any actual profit earned by the individual or organization running the operation. The Ponzi scheme usually entices new investors by offering returns other investments cannot guarantee, in the form of short-term returns that are either abnormally high or unusually consistent. The perpetuation of the returns that a Ponzi scheme advertises and pays requires an ever-increasing flow of money from investors to keep the scheme going."

[40] The poll, by Public Policy Polling, can be found at http://www.publicpolicypolling.com/pdf/2011/PPP_Release_US_0913925.pdf

like giving it negative-sounding descriptions. (Note that some respondents must have opposed eliminating Social Security *even if they thought it were a Ponzi scheme*!)

The classic Ponzi scheme is of the chain-letter variety. Under a chain letter, recipients of a letter are told to mail some amount, say a dollar, to a name listed on the letter and then to send the letter to, say, ten friends with a similar request. If every letter recipient follows the rules (and there is no guarantee that they will) – eventually your name shows up on many letters as the place to send a dollar. You receive some large number of dollars in exchange for your meager investment. Chain letters typically involve such high rates of return and rates of participant expansion that they literally run out of people who could be participants after a few iterations. That is, they are bound to fail after a short time.

Other Ponzi-type schemes are less obvious and may involve selling some product. Participants may ostensibly be sales people for, say, some vitamin concoction which they sell and also recruit new sales people who buy the concoction to sell to still others. However, the return is not really the profit on the concoction but the recruitment revenue that is generated; people keep buying more tonic to sell to others. These schemes are harder to detect and prosecute – their promoters will claim they are just in the health tonic business - but they also eventually run out of people to recruit as sales agents. They fail for later participants.

Most prominent in recent years – at least in terms of magnitude - was the Madoff scheme. The gimmick here was that the investment returns promised were not extraordinary, just better than typical; no one was promised that his/her money would double in six months. But the return was high enough, and seemingly-steady enough, to attract enough new investors in sufficient numbers to keep the scheme going for many years. The plan would fail if too many folks started cashing out – as tends to happen during financial panics such as occurred in 2008.

The essence of Ponzi schemes is that they must ultimately fail, with the date of “ultimately” a function of the details of the plan (not promising too high a return keeps it going longer) and that the returns are paid by new participants.

So, is Social Security a Ponzi scheme? It does involve, at least in part, an intergenerational transfer, i.e., younger workers and their employers pay into the system and support older workers who are retired. But that is not a complete definition. The critical part is whether it must fail and exactly what is being promised.

There was a time when there was no Social Security. The first payments under Social Security didn’t begin until the 1940s. So who paid for elderly support before then? It might be nice to think that each elderly person, pre-1940, saved enough as a youngster to pay for himself/herself in old age. But in fact – although there certainly was saving – elderly people were often supported by younger relatives in extended families, by charities, or by local governments through such institutions as poorhouses.

Family payments, charitable payments, and local government poorhouses are all examples of intergenerational transfers. Younger family members, donors to charities, and local taxpayers were in

effect transferring resources to the elderly. You can look at the process involved as new "participants" paying a "return" to earlier participants (who themselves were once young family members, donors to charities, or local taxpayers). So if new participants paying for earlier participants is your definition of a Ponzi scheme, you would have to label families and – indeed – whole societies and nations as Ponzi schemes.

Indeed, nations are Ponzi schemes under that definition even if the elderly seem to save for retirement on their own. At any moment in time, new workers are entering the labor market and – combined with the workers already there – are generating the national GDP. Older workers are exiting the labor market and drawing on that GDP which younger workers are producing. There is, therefore, an intergenerational transfer going on. (If younger active workers all went on strike and refused to generate GDP, the elderly non-workers could not consume, regardless of what they had been saved.) Put another way, saving gives you consumption entitlement tickets – the means to buy. But if you are an elderly non-worker, you depend on younger active workers (the new participants in the national "scheme") to provide something to buy with those tickets.

The critical point of a Ponzi scheme is not that there is some version of an intergenerational transfer (the economic system *always* depends on new participants) *but that the scheme must fail*.

So let's go back to the extended family example, which was the human race's *de facto* retirement plan long before there were actuaries, trust funds, or – for that matter – individual accounts. In less developed parts of the world, the extended family is still the default retirement plan. Parents have children. If the parents live beyond an age when they can work, the children or other economically-active relatives support them. The plan can fail only if there are no children or younger relatives. However, there is a question about *how much* support each of the children or younger relatives will provide to elderly parents and relatives and about how much per capita support each elderly non-worker relative will receive. Those amounts are not fixed.

In fact, the amount of the transfer in an extended family plan is likely to vary with the economic fortunes or misfortunes of the workers in the family and with the ratio of elderly non-workers to younger workers. In a steady-state situation, there might well be a reasonably constant intergenerational transfer flow. But there will inevitably be shifts over the years in family fortunes and in the elderly-to-young ratio.

Let's suppose that the usual plagues and illnesses happened to be at a lower-than-normal point when a particular generation was born so that more of that generation survived to working age than would typically be the case. There would first be a bulge in the youth part of the family; the elderly-to-young ratio would fall. Probably, the elderly in the family would especially benefit from the bulge in younger workers and each younger worker would have less of a support burden imposed for transfers to the elderly. But as that fortunate younger generation aged, the ratio would eventually rise.

However, there need be no failure of the extended family retirement plan because of this deviation from the steady state. What there needs to be is an adjustment; some internal family agreement must

be reached concerning the magnitude of the transfer. What we might expect, when the elderly-to-young ratio rose, is that the younger generation would end up paying somewhat more per capita than in the past. And we might expect that the elderly non-workers would receive somewhat less per capita than what they might have expected had the demographic bulge not occurred. There is not a failure but there is an adjustment. Readers will not have a problem seeing the analogy to the baby-boom/baby bust demographic story that has characterized the U.S. after World War II.

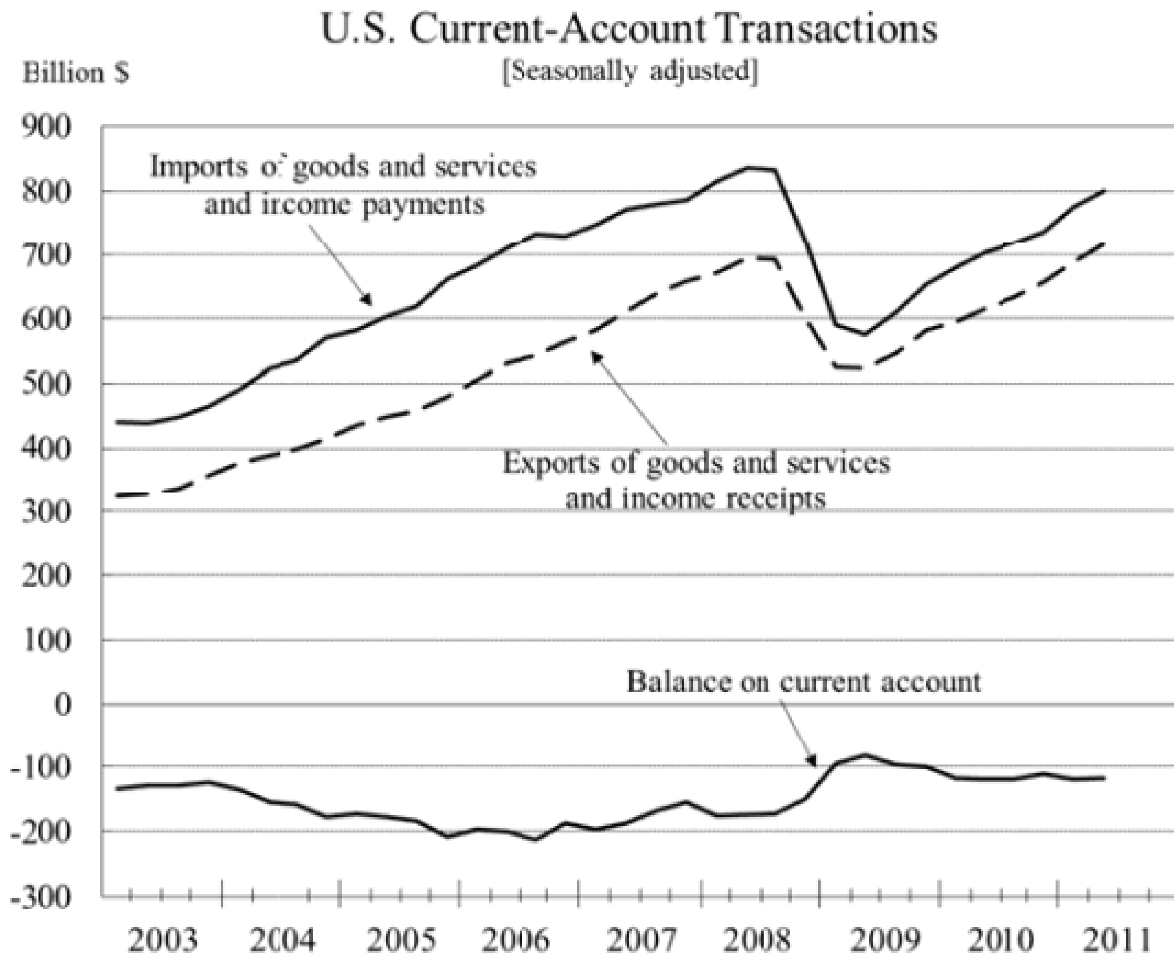
The debate over whether Social Security is a Ponzi scheme is not helpful in understand these dynamics. If you define a Ponzi scheme as anything with a new-participant-to-old-participant transfer, than almost any system is a Ponzi scheme including Social Security. But under that definition, families are Ponzi schemes and nations are Ponzi schemes. True Ponzi schemes combine the transfer with absolute guarantees that ultimately cannot be met because the promises cannot be changed, either to recipients or those paying in. (Madoff could not make good on his absolute promise to cash out all participants if they so-requested.)

Social Security, while it has formulas on both the tax and benefit sides, is not frozen and immutable. Both sides – taxes and benefits - can be changed. Over time, for example, payroll taxes have been increased. And cuts were made in promised benefits in the 1980s by the so-called Greenspan Commission through raising the retirement age and other devices.

At present, there is a failure related to – but not in - Social Security. *The failure is in the political system that is supposed to be the plans adjustment mechanism – rather than in the plan itself*. The debate over whether Social Security is a Ponzi scheme is a symptom of that political failure.

Mitchell's Musings 9-26-11: Odd Selectivity in Choosing from Buffett's Policy Buffet

This week's musing deals with what gets on the national policy agenda – or, more pointedly – what doesn't. To motivate the discussion, let's look at two charts below and on the next page and then proceed. Both charts are from press releases of the U.S. Bureau of Economic Analysis and both deal with the international element of the U.S. economy. The first chart deals with flows, the flows of goods and services exported and imported from the U.S.[41] The U.S. runs a large deficit on current account (or just on trade in goods and services). It remains large in recent years, but "improves" as a result of Great Recession (mainly because the downturn discouraged consumption of consumer goods, including foreign-made consumer goods).

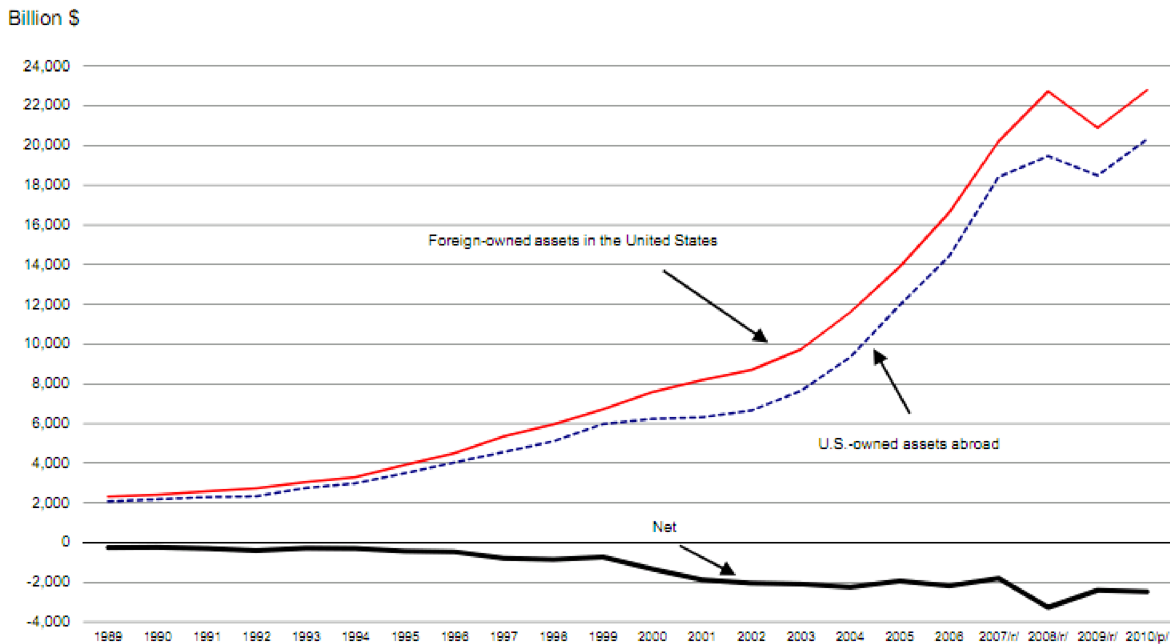


From: http://www.bea.gov/newsreleases/international/transactions/2011/pdf/trans211.pdf

[41] As noted on the chart, the data graphed include income payments and receipts. If we confined the chart just to exports and imports, it would look much the same.

The second chart deals with a stock rather than a flow. It shows what can be thought of as U.S. net debt to the world. If a country (or a household) continues to buy more from the outside than it sells – as the U.S. has been doing for a very long time – it must inevitably run down any net reserve of previously-accumulated assets and eventually go further and further into net debt.[42]

Net International Investment Position of the United States at Yearend, 1989 - 2010



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From: http://www.bea.gov/newsreleases/international/intinv/2011/pdf/intinv10.pdf

Now that these points of arithmetic and economic history have been made, let's go back to a consideration of what gets on the national policy agenda. Actually, trying to figure out how things get on the agenda is a longstanding concern of political scientists. And it's of obvious interest of lobbyists and others who want particular topics to be part of the agenda. A great deal of money is spent by interest groups on trying to push particular issues to the forefront.

One way that issues become talked about in policy circles is if famous people talk about them. And one such person is famed financier Warren Buffett, chairman of Berkshire Hathaway. Most recently, Buffett's proposal that, in a properly-functioning tax policy, his average tax rate as a billionaire should

[42] The lines of the chart also vary with fluctuations in exchange rates which cause the dollar equivalents of assets denominated in foreign currencies to vary.

not be less than his secretary's – received major attention. The proposal grew out of Buffett's op ed in the *New York Times* entitled "Stop Coddling the Super Rich," http://www.nytimes.com/2011/08/15/opinion/stop-coddling-the-super-rich.html, and took on the name "the Buffett Rule." Much debate has ensued, and continues to ensue, about the Rule. But clearly, the fact that Buffett said it – and did so in a major national newspaper - put the idea on the national agenda. It was widely discussed. Whether or not the Buffett Rule will ultimately influence the tax code is another matter.

Buffett's national comment on taxes was not the first time he had ventured into fiscal policy. Another notable episode occurred at the state level, in my home state California. In 2003, as a consequence of a state budget crisis, a recall campaign against incumbent governor Gray Davis was begun. It eventually led to the entrance as a candidate - and election - of Arnold Schwarzenegger to replace Davis. During the campaign, Schwarzenegger created a team of economic advisors including Warren Buffett. Buffett, however, touched the third rail of California politics – Proposition 13 – a very popular 1978 ballot initiative which drastically cut and capped local property taxes.

One feature of Prop 13 is that taxes on properties are based on the *original* sales price, not the current market value. Buffett pointed out in an interview that a property in California he had purchased long before 2003 had a very low Prop 13 assessment (and tax) while a much-less-valuable – but more recently purchased – property had a substantially higher Prop 13 assessment and tax. He also compared the tax he paid on both with what he paid on a still-less-valuable property in Omaha.[43] (Buffett paid more on his Omaha property than on either of his California properties.)

Schwarzenegger quickly distanced himself from Buffett's comments. California politicians shy away from any comments that suggest they are unhappy with Prop 13. Nonetheless, the fact that Buffett said what he said was widely reported in the news media, even outside of California. Indeed, the statement arose in an interview in the *Wall Street Journal*. So Buffett's view was placed on the agenda, much to the distress of the candidate he was supporting. If a less prominent person had said the same thing, few would have noticed.

In short, Buffett - over the years - has provided a buffet of policy opinions that can be – and often are – chosen for the agenda. But is there any topic that – even when Buffett discusses it in a major national newspaper – gets no notice? And, if there is such a topic, why is it considered either unworthy or taboo by policy makers, politicians, and the talking heads of Washington? As you might guess, there is such a topic and it is precisely the one suggested by the two charts presented at the outset of this musing: U.S. international trade.

The chronic tendency of the U.S. trade imbalance was already evident in the late 1980s. On May 3, 1987, Buffett published an op ed in the *Washington Post* entitled "How to Solve Our Trade Mess

[43] Buffett noted after the campaign that his interview – with the *Wall Street Journal* - was not completely reported. See http://wealthandwant.com/docs/Buffett_Prop13.html

Without Ruining Our Economy."[44] I have discussed this proposal and op ed in previous musings and even at academic meetings. But I am not Buffett, so no one notices.

At the time Buffett wrote his piece, there was concern about Japan (China had not yet registered as a major trading country with the U.S.) and the large surplus in trade Japan was running with the U.S. Here is a quote from the Buffett op ed:

If we were less well-off, commercial realities would constrain our trade deficit. Because we are rich, however, we can continue to trade earning properties for consumable trinkets. We are much like a wealthy farm family that annually sells acreage so that it can sustain a life style unwarranted by its current output. Until the plantation is gone, it's all pleasure and no pain. In the end, however, the family will have traded the life of an owner for the life of a tenant farmer.

The time to halt this assets-for-consumables trading is now, and it can be done. The plan I have in mind may at first sound gimmicky. In truth, it retains most free-market virtues. It neither protects specific industries nor punishes specific countries, and it should not engender trade wars. It would increase our exports and might lead to increased overall world trade. And it would balance our books without further devaluations of the dollar.

Sounds good, no? An idea from a prominent person in a major national newspaper that addresses an issue of the day! What was the plan?

We would achieve this balance by issuing what I will call Import Certificates (ICs) to all U.S. exporters in an amount equal to the dollar value of their exports. Our exporters would, in turn, sell the ICs to parties wanting to import goods into the United States. To import $1 billion of goods, for example, an importer would need ICs that were the by-product of $1 billion of exports. The inevitable result: trade balance.

In short, Buffett's plan was a voucher arrangement. Exporters would get vouchers entitling them to import an equivalent value to what they exported. They could exercise the vouchers directly or sell them in the market to others who wanted to import. But, at the end of the day, since you could not import a dollar of goods or services without a voucher with a face value of a dollar – and since the total face value of all vouchers was equal to the value of U.S. exports - the value of imports would have to be equal to the value of exports.

Like all proposals, there are complications. There would be administrative costs involved in the Buffett plan, for example. Some agency would have to verify the claimed values of exports and imports.[45] But,

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[44] https://docs.google.com/Doc?docid=0ATVLYPK7QI_4ZGNkcWtteHJfNThjNTdmY3NndA&hl=en_US

[45] Note that we already have a customs bureaucracy that examines the value of imports. And exports are policed to a degree to prevent sales of certain military-related products. But, clearly, the plan would entail more inspectors.

if you do the math, what Buffett proposed was a way of attaining the specific exchange rate (the net of the actual exchange rate and the market price of the voucher) that equates exports and imports.

You might think that this proposal would have had some traction in Washington, both because Buffett said it and because it appeared in the *Washington Post*. But it never got on the agenda. The op ed came and went. DC took no notice or averted its eyes.

Was its failure to gain traction due to a fear by the DC cognoscenti of being called “protectionists”? I don’t know the answer. One possibility is that, by 1987, the dollar exchange rate – which had appreciated steadily during the first half of the 1980s and had raised concerns in doing so– had reversed direction and was depreciating by 1987. Perhaps the DC opinion guardians of that era thought that the trade/dollar problem was going to resolve itself. A related possibility is that the economy had been recovering since the deep double-dip recession of the early 1980s and so the jobs-trade connection was perhaps seen as an issue of the past. But the fact is that although the exchange rate has fluctuated since 1987, the U.S. has continued to run large net export deficits. And there have been three recessions - including the Great Recession - since 1987.

From time to time, the jobs-trade issue is raised. Most recently, EPI, for example, has issued a report on estimates of job losses due to trade with China.[46] And when such reports are released, they receive some newspaper attention.[47] But no one has come up with a solution. Instead, particular industries seek protection, perhaps by filing charges of dumping. Or there is litigation at the WTO about trade in particular products. Or there are rhetorical episodes of China-bashing by politicians (as there was Japan-bashing when Buffet wrote his op ed). Such bashings create foreign policy frictions but have little impact on the underlying problem. Recall, in contrast, that Buffett argued that his plan “*neither protects specific industries nor punishes specific countries…”*

Ultimately, for the U.S. to begin repaying its net foreign debt, it will need to run a net export surplus. Just having balanced net exports would only stop the debt from increasing. In 2010, the net export deficit was about -$500 billion. So just moving to zero would be a domestic jobs/economy stimulus of $500 billion. To put that number in perspective, the President’s recently-released jobs proposal – which faces strong opposition in Congress – was widely labeled in the news media as a $450 billion economic stimulus package.

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[46] See http://www.epi.org/publication/growing-trade-deficit-china-cost-2-8-million/. There are many issues surrounding the making of such estimates. I am not focused on the validity of a particular methodological approach in this musing; the EPI report is simply an illustration that the trade issue is discussed – but not the Buffett plan to address it.

[47] See, for example, http://latimesblogs.latimes.com/money_co/2011/09/trade-deficit-with-china-cost-nearly-28-million-us-jobs-since-2001.html

So why was Buffett's proposal quickly forgotten in 1987 when it was made? Why isn't it on the agenda now - given the sorry state of the contemporary jobs market? As the King sang in the musical *The King and I*:

"Is a puzzlement!"

Mitchell's Musings 10-3-11: No Multiple Choices in Political Economy?

Consider the following situation: You are driving up a hill when your car runs out of gas. You should have been paying attention to the fact that the gas gauge was nearing the "empty" mark, but you were so entranced with how nicely the car had been running up to that point that you failed to look at what the gauge was indicating. The engine stalls and the car slows to a stop and begins to roll backwards. So you step on the brake, halting the dangerous backward roll. But, of course, just stopping the car from rolling backwards – although it prevents disaster - does not solve your problem; you aren't getting to your destination. Luckily, there is a gas station where you have stopped so you can refill your tank. You then restart the engine, step on the accelerator, and resume driving up the hill. Given the degree to which you have depressed the accelerator, however, it turns out that the car is moving up the hill more slowly than you would like.

Given this scenario, you should:

a) Reason that since stepping on the accelerator as far as you did didn't produce sufficient speed, stepping on the accelerator has no effect at all and you should take your foot off the pedal.

b) Reason that – although you are going too slowly now - you should not depress the accelerator further because- if you do - you might end up going too fast after you get to the summit of the hill and you begin to descend.

c) Reason that putting gas in the tank and stepping on the accelerator deprived the car of its natural ability to travel at the desired speed. You should stop the car, drain the tank, and wait confidently for the car to get you to your destination on its own.

d) Reason that there has been a structural shift in the law of gravity since your car resumed travel and that, therefore, there is nothing to be done other than to continue to drive more slowly than you would otherwise like. Eventually, you will get to your destination.

e) Depress the accelerator further now. When you get to the top of the hill, ease up on the accelerator. If the car nonetheless goes too fast on the down side of the hill, take your foot off the accelerator and apply the brake to maintain the desired speed.

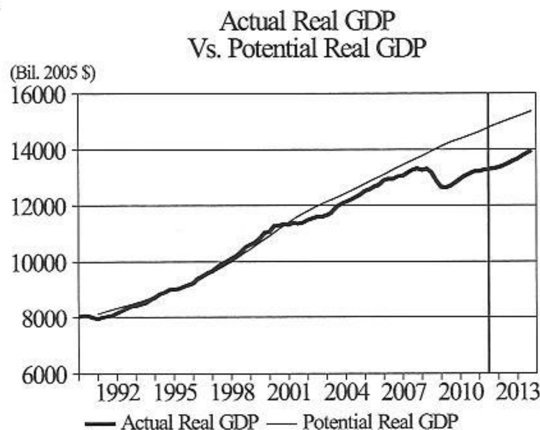
I hope you will see some analogy in the story above to the economic crisis of 2008 and beyond and to the debate about what was done in response to the crisis and about what to do now. I also hope you would select option "e."

Obviously, I have framed the story to fit my view of the way the macro-economy functions and how it responds to policy. Critics would find fault with various aspects of my car-economy analogy. But note that even if you agree 100% with my framing and analysis, there is one subtle assumption in my little tale. I assume that there is an Option "e."

Option “e” states that you can take a corrective action after first making a forecasting error. That is, you depressed the accelerator to a given degree, assuming that (i.e., forecasting that) the car would travel at the desired speed – and your forecast turned out to be incorrect. You underestimated what was needed. But because option “e” is assumed to be available, your initial forecasting error is not critical. You can always make an iterative correction. Indeed, drivers typically do not know how many inches of accelerator depression are needed to maintain the speed of a car on a given grade of a hill. The freedom to adjust the accelerator continually makes that precise knowledge unnecessary. Drivers simply adjust the accelerator until the car travels at the desired speed.

Political economy is not as kind to policy makers as cars are to drivers. As a policy maker, you may have a one-shot, discrete opportunity to implement a remedy and – if the forecast on which you base that remedy is incorrect – a later iterative correction may not be readily available. So, first, there is an issue of the degree to which economic forecasts can be accurate. Second, the ability you have to make an iterative adjustment depends in a democracy on how the public feels about what has happened and how those perceptions are determined.

I thought about these matters while attending – and speaking at – the latest UCLA Anderson Forecast program two weeks ago. Below is a chart from that program that summarizes the Forecast. The Great Recession takes the form of a large gap opening up between potential and actual GDP. Note, however, that there is no forecast on the chart of a second decline, i.e., there is no formal double-dip recession: What is depicted is a stalled, sluggish economy that will not get to full employment – or anywhere near that point – anytime soon. (Indeed, unemployment begins to rise in the near term under the UCLA Forecast as job creation does not keep up with labor force growth.)



The UCLA Forecast, like others, is based on a combination of modeling and judgment. Most past recessions have resulted from downturns in particularly cyclically-sensitive industries such as construction and manufacturing. The no-double-dip prediction in the UCLA Forecast was based on the

(sad) fact that these industries are already so depressed that it would be hard for them to contribute more to a double dip.

Such judgmental reasoning, and more formalized econometric modeling, is based on past experience. But the problem today is that the current situation is extraordinary; what normally happens is not necessarily a good guide. There isn't much past experience to go on. The chance of a forecast error is therefore greater than in normal circumstances. In the question-and-answer period at the UCLA Forecast program, the forecasters acknowledged that an unforeseen event – perhaps a crisis in the Middle East that substantially jacked up oil prices – could tip the economy into a double-dip recession.

If you were a macro-policy maker – and if you were basing your actions on the UCLA Forecast – an important question is whether you have the equivalent of an Option "e." That is, you would assume – as the Forecast suggests – that there will be no double-dip recession. But if you turned out to be wrong, would you be able to make a midcourse correction to address that event?

A major constraint on your options is public perception and agenda framing. Below is a chart from a monthly opinion poll in California taken by the Public Policy Institute of California (PPIC). The poll makes it clear that what is of greatest concern to the general public, and to voters, is the economy and jobs. Issues that political types may think are important to people – education, immigration, etc. – hardly register.

"Thinking about the state as a whole, what do you think is the most important issue facing people in California today?"

Top four issues mentioned	All Adults	Party			Likely Voters
		Dem	Rep	Ind	
Jobs, economy	67%	73%	64%	66%	67%
Education, schools	6	7	7	4	6
State budget, deficit, taxes	6	6	10	11	10
Immigration, illegal immigration	4	2	4	4	3

Source: http://www.ppic.org/content/pubs/survey/S_911MBS.pdf

When people are asked to judge the success or failure of economic policy, they judge on the basis of what actually happened, not what might have happened or what was averted.

"Since taking office, have Barack Obama's economic policies made economic conditions better, worse, or not had an effect so far?"

	All Adults	Party			Likely Voters
		Dem	Rep	Ind	
Better	26%	42%	8%	23%	27%
Worse	29	10	68	30	37
No effect so far	40	41	19	42	31
Too soon to tell *(volunteered)*	2	3	1	–	2
Don't know	3	3	4	4	3

Over two thirds of respondents to the PPIC poll view recent policy has either having had no effect or having made things worse. Note that by some measures, things *can* be said to be worse than in January 2009. The unemployment rate, for example, back then was 7.8% (albeit on the rise) as opposed to the latest 9.1% (in August 2011).

PPIC pollsters then went on to ask about remedies, but in a specific way. <u>Federal spending</u> is posed as one solution (so note that the pollster is implicitly telling respondents that spending is a plausible economic policy to undertake) versus <u>budget deficit reduction</u> (so the pollster is implicitly telling respondents that deficit reduction is a plausible economic policy to undertake). The choice is put as "spending *to help the economy recover*" versus budget deficit reduction – without the added phrase about helping the economy recover. Did respondents assume, given that there was a choice of two, that both would "help the economy recover"? You can't tell for sure but it is certainly possible that posing the issue in this way – and this is the way pundits have been posing it – suggests that perhaps either one would help the economy recover.

"If you were setting priorities for the federal government these days, would you place a higher priority on spending to help the economy recover or a higher priority on reducing the budget deficit?

	All Adults	Party			Likely Voters
		Dem	Rep	Ind	
Spending to help the economy recover	56%	64%	25%	55%	48%
Reducing the budget deficit	39	31	70	43	48
Don't know	5	5	5	3	4

Note also that since over two-thirds think that Obama administration policy – which has focused on spending – had no effect or has made things worse, at least some respondents who favored spending in the question above must also have believed that spending had no effect or made things worse – or were unaware of what Obama administration policies were.

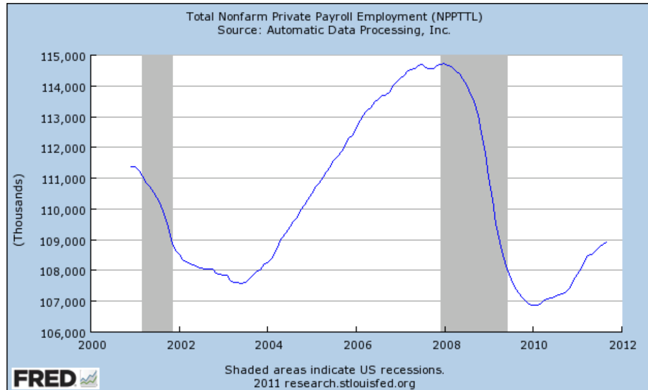
As is well known, initial forecasts of the Obama administration economists overestimated the impact of the stimulus program and other related efforts. But the ability to make an iterative adjustment (an Option "e") was quickly limited by the political system. Voters know only what has happened, not what might have happened. They don't have a defined economic model; at most they have predilections about what is good or bad policy. If clear progress is not perceived, incumbents are blamed and the tilt is toward the opposition in the next election (two years later). In the U.S. political economy, there is a *de facto* intolerance for forecast errors – even though such errors are inevitable, particularly in an unprecedented situation.

If there is any lesson from the Great Recession, it is that attention must be paid to expanding the macro-policy "option space." There can't be just a one-shot fix; there needs to be room for iterative adjustment and midcourse corrections. The trick seems to be less in trying to sell the public a model of how the economy operates and how it responds to policy - and more in trying to convey that economic recovery is a work in progress.

Mitchell's Musings 10-10-11: Does Size Matter?

Daniel J.B. Mitchell

The graph below will be familiar to anyone who has followed recent labor-market developments. It shows the big drop in private-sector jobs during the Great Recession. And it shows only a partial recovery which lags the official end of the downturn and which suggests – if its current pace continues – that it will be years before employment climbs back to its previous peak, let alone catches up with natural labor force growth.

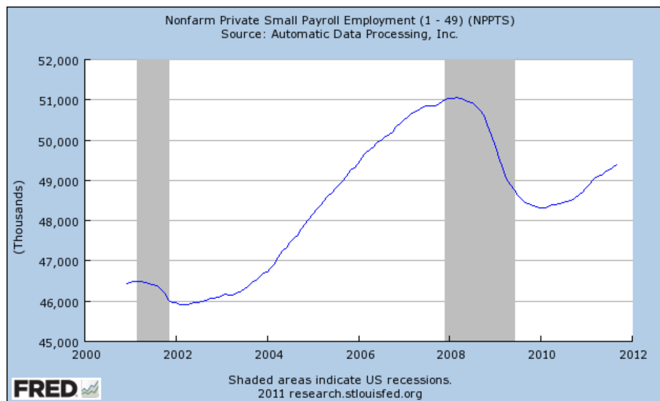


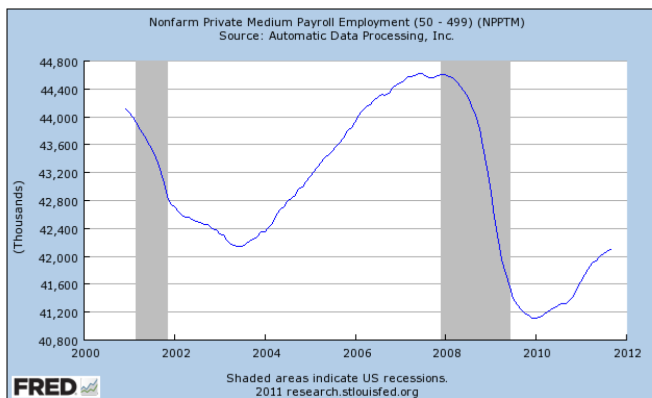
Note, however, that the chart above – while familiar looking – does not come from the usual U.S. Bureau of Labor Statistics (BLS) establishment survey but rather from a private firm – Automatic Data Processing - that handles payroll data for employers. The firm reweights the data from its client to approximate national employment patterns. Its adjusted estimates generally track the ups and downs of BLS data.[48]

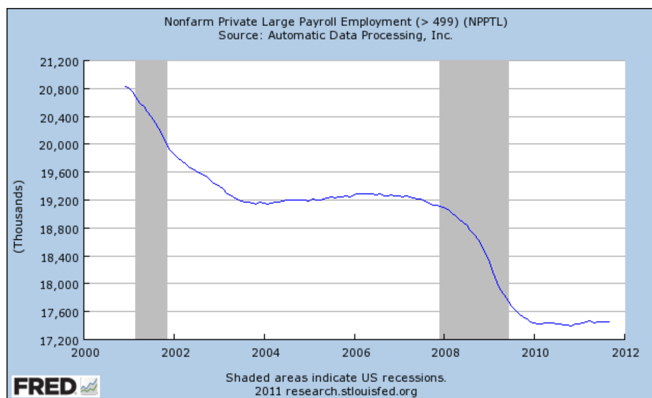
One element of the alternative data source is its ability to break out small payrolls (1-49 employees) – as shown on the chart below – from medium sized payrolls (50-499 employees) and from large payrolls (500+ employees).[49] Charts featuring those breakouts by employment size are shown on the next page.

[48] I obtained the chart above and others below from FRED, a database maintained by the Federal Reserve Bank of St. Louis <http://research.stlouisfed.org/fred2/>. Information about the reports from Automatic Data Processing is at http://www.adpemploymentreport.com/ The two series differ at the peak of the employment cycle by about one million jobs (BLS is lower).

[49] A payroll size and a firm size may not be the same thing. A payroll's employment coverage can't be larger than the size of the firm. But it could be smaller if, say, just a subsidiary of a larger firm had its payroll processed by Automatic Data Processing. In the text, we use payroll size as a proxy for "enterprise" size and avoid the word "firm" in the text.

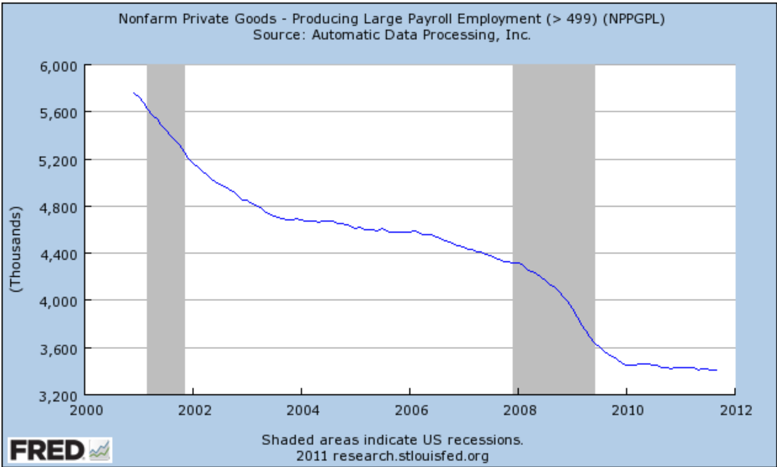




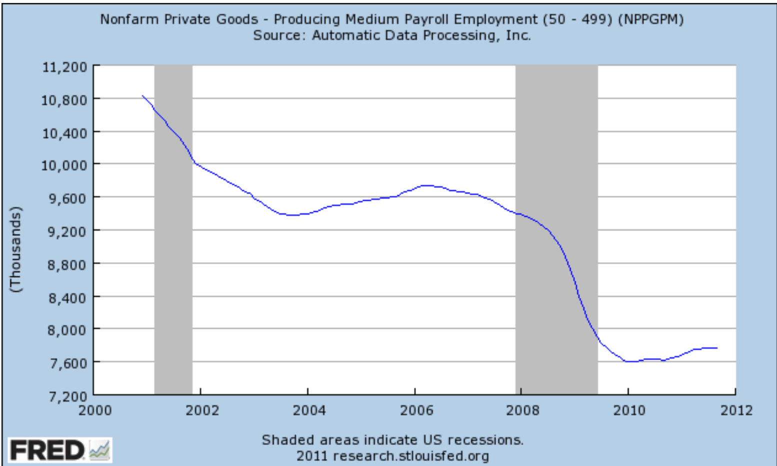


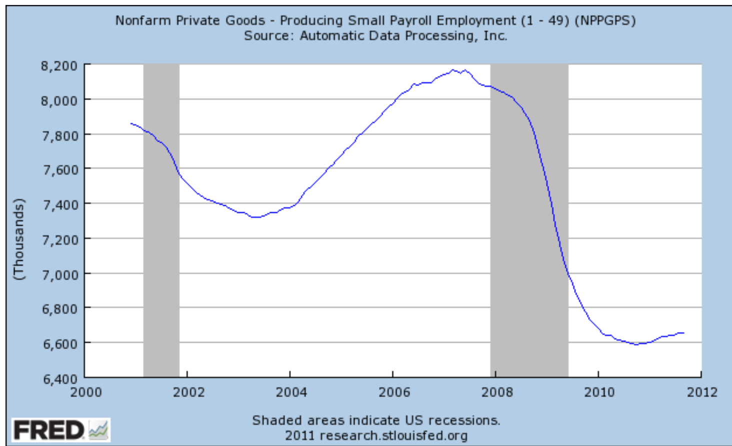
Note that there is employment growth in the post-Great Recession period *except* among the largest enterprises. From that observation comes two questions. One is whether the large enterprise deviation is simply an industry-mix result. That is, we tend to view manufacturing as dominated by large enterprises. So if manufacturing is having particular problems in the recovery from the Great Recession, perhaps that explains the seeming large-medium-small deviation. A second question is whether there are consequences of the deviation of large enterprises, *regardless* of whether that deviation can be explained by industry mix. It is really the latter question I want to pose. But let's look at the former first.

The chart below indicates that in the “goods” sector (the sector that includes manufacturing), it is certainly true that big enterprises are in trouble and don’t show signs of recovery. Indeed, their troubles began well before the Great Recession, although they were certainly exacerbated by it.

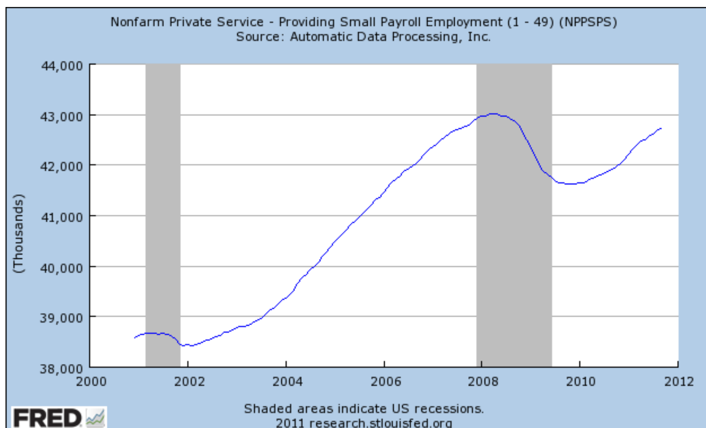


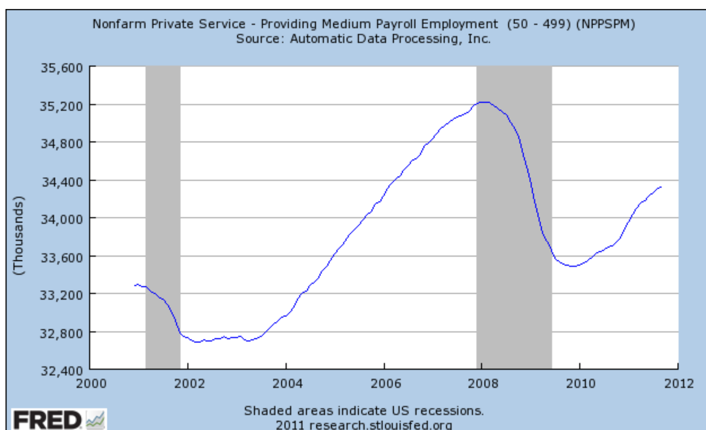
In fact, the goods sector – including manufacturing – contains a mix of large, medium, and small enterprises. How have the medium and small enterprises done within that sector? As the charts below and on the next page, indicate, the non-large enterprises did better than the large ones in the pre-Great Recession period, but have stagnated since. So there is something to the idea that sectoral mix explains some of the large-medium-small differences at the all-industry level in the post-Great Recession era. Large enterprises in the goods sector tend to drag down the all-sector results for large enterprises.

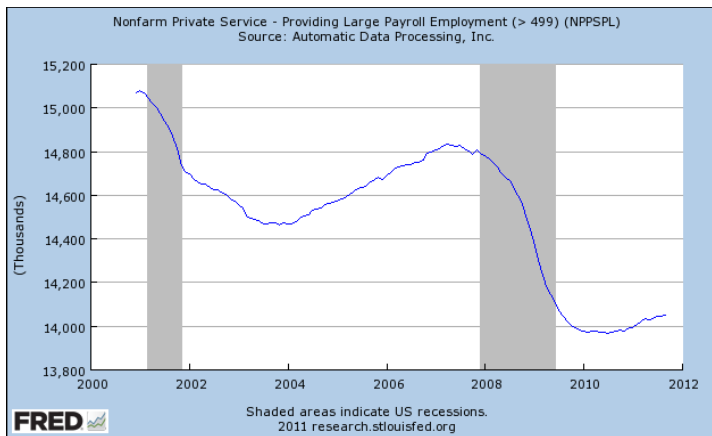




Outside the goods sector, however, we see the earlier pattern of smaller enterprises doing better in the recovery than larger, as the three charts below and on the next page illustrate. The smallest service enterprises, in fact, are actually nearing their pre-Great Recession peak. Medium-sized service enterprises are about half way back to their peak. But the largest enterprises show little recovery. In short, size matters. And size seems to have a role in the degree of job recovery, *apart* from any sectoral-mix effects.







That observation brings us to the second question of whether there are consequences – sectoral mix or not – of the differential pace of job recovery by enterprise size. That question can't be answered by the data we have presented. But it is well known that larger enterprises on average tend to pay more than smaller ones and to offer more generous employee benefit packages. Larger enterprises tend also to have more formalized human resource practices (evaluation, reward, training, etc.) and to have internal organizations that look after those practices. So it is possible that while small is beautiful (or at least less ugly) in terms of post-Great Recession job growth, smaller enterprises may also be producing a lower quality of jobs than existed before. In short, there is a research project for academics suggested by the charts we have presented.

There is also an interesting institutional question for the news media. Because larger enterprises are more formalized, they are more likely to have executives in the human resource field who belong to professional organizations and are therefore more dominant in the conversation and perception of what is going on in that field. What happens in big enterprises is more likely to receive media attention; such enterprises are easier to identify and query than smaller ones. So for those in the news media, the question is: Are you missing something?

Mitchell's Musings 10-17-11: The Legacy of Movements

Daniel J.B. Mitchell

The advent, first of the Tea Party and then of the Occupy Wall Street movements, has produced a rash of media comment on political movements – in particular those that are associated with Hard Times and high unemployment. There is discussion of whether the Occupy Wall Street (and now other locations around the country) is a kind of Herbal Tea Party, i.e., whether the two are aligned in some way although found on opposite ends of the political spectrum.

It is natural in the aftermath of the Great Recession to look back at the Great Depression of the 1930s when various political movements attracted public attention and in some cases had long-term consequences. At the most general level, what seems to happen in periods of economic distress - when an impression grows that those in charge have mishandled things or are not adequately addressing the problem - is a tendency to bring fringe ideas forward. Such ideas and proposals may have been around for a long time but, absent other solutions, people are more receptive to anyone or any movement that claims to have the answer.

The first thing to say is that the movement that had the most dramatic and long-lasting effect was the labor movement – something the contemporary media seem totally to have missed. Yes, nowadays private-sector unions are back on the periphery of the labor market – as they were before the Great Depression. And, yes, public-sector unions are on the defensive now (in part because they lack the base they once had in the private sector). But these current circumstances do not alter the fact that unions played a major role in the economy for decades after the Great Depression.

Unions were considered to be of macroeconomic significance – particularly in the 1960s and 1970s – with the most tangible public policy consequence being various wage and price guidelines and controls programs. And they succeeded – at least for many years - in their twin objectives of recognition by major employers and improvements in pay and benefits. Even today, they remain a political base of support for one of the two major political parties. All of that aspect of history seems to have gotten lost in the media commentary on the Tea Party and the Occupy Wall Street movement. And it has been lost in the search by pundits for Great Depression parallels.

Other movements of the Depression era had consequences, but those consequences were not necessarily what the movements had sought. The appendix to this musing has video links to some of the more prominent movements of the 1930s, including the labor movement. In some cases, the movements of the Great Depression were tied to a single personality. Senator Huey Long – former governor of Louisiana - led a "Share the Wealth" movement with vague redistributional demands. But his movement largely ended with Long's assassination in 1935. However, his son, Russell Long, later became an influential U.S. senator later and, in an echo of his father's interests, promoted Employee Stock Ownership Plans (ESOPs) – which can be seen (and were seen by Russell Long) as a kind of wealth redistribution.

Catholic priest Father Charles Coughlin developed a large radio following for his programs featuring a mix of monetary theories including suspicion of the Federal Reserve, various monetary theories, demands for social justice, and - increasingly - anti-Semitism. Although he initially supported the New Deal, he turned vociferously against it. Ultimately, Coughlin, the remnants of the Long group, and Francis Townsend (see below) mounted a third-party campaign for president in 1936 – featuring an obscure candidate - which in the end had little impact. Coughlin's movement largely withered when he was taken off the radio by the Church. But his strain of monetarism and money conspiracy theories continued and remains on the periphery today. It might be argued, however, that one indirect influence he had on a former parishioner led to a kind of activism many years later of which Coughlin would surely not have approved.[50]

A movement of World War I (then known as the Great War) veterans developed in response to the treatment of veterans by Congress and an earlier history regarding (northern) vets of the Civil War. Congress created a disability pension plan for Civil War vets that gradually morphed into a general pension for veterans (whether disabled or not) and their surviving spouses. As it expanded, the plan grew more and more expensive and became politically contentious. The result was that when World War I veterans – who were heralded for having saved the world for democracy – came back, they receive no pension plan and were mainly promised a bonus to be paid in the 1940s.

In 1932, the "Bonus Army" marched on Washington to demand immediate payment of the bonus – given the Depression and the need for cash – and camped out on the mall. Ultimately, the bonus marchers were dispatched by the Army. The spectacle of veterans attacked by the Army – seen throughout the country in movie newsreels – was shocking to the electorate and widely seen as the end of President Hoover's hope for re-election. Although the Bonus Army's demand was not met, an indirect effect was enactment of the GI bill for returning World War II vets. Washington did not have any appetite for a repeat of the Bonus Army and provided for generous treatment of World War II veterans.

Francis Townsend, an elderly doctor from Long Beach, California, had both a following and a cause that was more focused than either Long's or Coughlin's. Starting in the Depression, but in the era before Social Security was enacted, he came up with a proposal that everyone over age 60 should receive $200 a month – a large sum at the time ($400 for an elderly couple!) – from the federal government. To receive the payment, the elderly recipient would have to promise not to work (leaving more jobs for the young) and to spend all of money within the month (stimulating the economy).

The Townsendites succeeded in electing friendly congressional representatives and even senators. They were strongly *opposed* to the Roosevelt administration's Social Security plan because it seemed very

[50] Activist Tom Hayden, former California legislator and Chicago 7 defendant, was a parishioner in Father Coughlin's church growing up in Detroit. Whether his activism stemmed from that earlier version of social justice is an interesting question. Catholic social teaching can be quite opposed to free-market capitalism and has spawned activism on both the political right and left.

stingy compared to Townsend's and was not slated to make its first payments until the 1940s. But, nonetheless, they indirectly and unwittingly helped enact Roosevelt's Social Security by turning the President's plan - which was for the time a radical proposal - into the moderate alternative to Townsend. They also spawned state-level versions of the Townsend plan, notably California's "Ham and Eggs" proposal that appeared twice on the state ballot and came close to passing the first time in 1938. At the state level, the pensionites did not attain the particular plans they wanted but they did succeed in boosting state old age payments.[51]

Novelist muckraker Upton Sinclair in California attracted a large following in his 1934 EPIC campaign for governor. (EPIC = *E*nd *P*overty *i*n *C*alifornia). He changed his party registration from Socialist to Democratic and captured the gubernatorial nomination. The EPIC plan was an amalgam of various ideas floating around at that time: cooperatives, monetary schemes, and economic planning. In a sense, EPIC was a caricature of the New Deal. A massive campaign defeated Sinclair but an indirect consequence was a shift in registration advantage from Republican to Democratic. Various EPIC Democrats were elected to the legislature even in the wake of Sinclair's defeat. Over time, they gradually became more conventional liberals.

Of course, any movement that attracts large numbers of people has the potential to have some kind of effect on public policy. But it does appear that movements that are highly dependent on a particular leader and/or are more focused on being against current arrangements than on specific agendas to change it tend to fizzle. In that respect, movements that arise in response to Hard Times may not be all that different from those arising in other periods and with other objectives.

The Civil Rights movement of the 1950s and 1960s which had both charismatic leadership and a focused object – ending segregation – had a long-term impact. In contrast, Ross Perot's campaign for the presidency was heavily focused on a personality and was mainly about being against the insiders in the two major political parties. Perot got 19% of the vote in 1992, substantially less in 1996, and essentially disappeared. Perhaps the key lesson from the movements of the Great Depression and other periods is that leadership and a doable agenda are most important in producing a long-term impact.

[51] I have written about pensionite and other social movements in Daniel J.B. Mitchell. (2000). *Pensions, Politics, and the Elderly: Historic Social Movements and Their Lessons for Our Aging Society*. M.E. Sharpe.

Appendix on Multimedia Sources:

Veterans

*World War I patriotic song promises a great future awaits returning war veterans:

http://www.youtube.com/watch?v=FOWRMEAc8q0

*Abuse of veterans in the Great Depression reflected in popular culture:

Movies:

http://www.youtube.com/watch?v=Gocdp6Nis5g

http://www.youtube.com/watch?v=2zn9taX9DWo

and especially:

http://www.youtube.com/watch?v=37-ocetYDdU (…you put a rifle in his hands…)

Music:

http://www.youtube.com/watch?v=llhRGUYMcfU (…or guns to bare…)

Bonus March on Washington in 1932 (newsreel footage):

http://www.youtube.com/watch?v=xkmo4ygPTjc

Personalities:

*Father Coughlin (newsreel):

http://www.youtube.com/watch?v=llhRGUYMcfU

*Father Coughlin (audio of sample radio programs):

http://ia700304.us.archive.org/11/items/Father_Coughlin/FatherCoughlin_1937-04-11__ReliefThatFailsToRelieve.mp3

http://ia700304.us.archive.org/11/items/Father_Coughlin/FatherCoughlin_1938-12-11__JewsSupportCommunism.mp3 (You might Google Harry Bennett who is cited.)

*Francis Townsend (newsreel):

http://www.youtube.com/watch?v=B10O4qUR7tY

*Huey Long (newsreel):

http://www.youtube.com/watch?v=mdzAbxsjPRA

*Upton Sinclair: (Parts 1 and 2)

http://www.youtube.com/watch?v=AS77eZVIsXc

http://www.youtube.com/watch?v=16xdCQIae4w

The Ham and Eggs Movement in California: (audio of lecture)

http://www.archive.org/details/HamEggsInThe21stCenturyDkSmithLectureByDanielJ.b.mitchellAt

The Labor Movement

Enactment of the Wagner Act: (newsreel)

http://www.youtube.com/watch?v=WSCExIoib5g

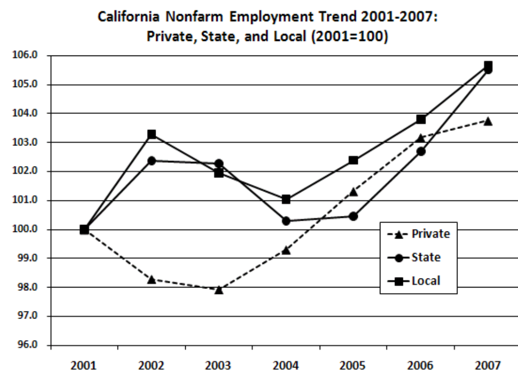
Unionization at Ford:

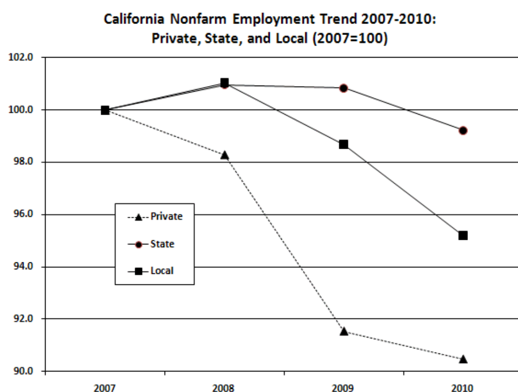
http://www.youtube.com/watch?v=vrw_WRhUfog

Mitchell's Musings 10-24-11: What You Call It Counts

California was disproportionately hit by both the dot-com bust/recession of the early 2000s and the Great Recession that started in late 2007. The state had a disproportionate share of dot-com firms and a larger housing/mortgage bubble than the typical state. In both cases, the impact on California's public sector brought national attention. In the wake of the dot-com bust and the resulting state budget crisis, California's governor was recalled in 2003. And in the wake of the Great Recession, California end up issuing IOUs instead of paying all its bills during the summer of 2009.

As the two charts below show, in both episodes private sector employment and public sector employment in California reacted to the downturn on different time tables. Private sector employment dropped quickly. Public sector employment *rose* for a time and then dropped with a lag. The drop has been particularly severe in the later downturn.





If we are seeking an explanation for this lagged response, an obvious place to look is in the system of state and local finance. However, rather than get into the specifics of the California state and local fiscal system (or the state's political system of "direct democracy" that allowed the gubernatorial recall), I want instead to consider budgetary accounting terminology. That focus may seem an odd choice, even arcane. Or it may seem to be at best a matter of concern

just for one state. But however much California may differ from other states in its fiscal and political institutions, as far as I can tell, it is similar to the rest in its budgetary terminology. And it appears that the terminology used at the state and local level may get in the way of policy makers – particularly elected officials – in making decisions as to how to react to the ups and downs of the business cycle and its fiscal reflections. What I will describe, in summary, is not exclusively a California problem, although I will be using California examples.

If you have ever taken a course in accounting, you will be familiar with the difference between an *income statement* of a firm and its *balance sheet*. The former represents flows over a time period (a year). Essentially, you learn from the income statement how much revenue has flowed into the firm. Subtracting the expenses (the outflow) tells you whether that firm has made a profit (revenues > expenses) or a loss (the reverse). In contrast, a balance sheet is a snapshot at a moment in time (the end of the year). It compares assets and liabilities as of that moment – it is a "stock," not a flow - measurement. A firm whose liabilities are greater than its assets is in trouble.

When we talk about the federal government running a deficit (or a surplus – there have been some as recently as the Clinton administration), we are describing flows. A federal deficit means that less came into the Treasury than went out in the course of a fiscal year. A federal surplus is the result. Now, one might think the same would be true at the state and local level but, unfortunately, that is not the case.

State and local governments typically have a "general fund" that handles regular operating expenses, e.g., paying police and teachers. They also have special funds that are earmarked for particular purposes. Transportation funds may receive gasoline tax revenues, for example, and then use them for road construction and maintenance. The general fund and the special funds look something like household checking accounts. Money flows into them and out of them and there is, at any time, a balance. And that is where things begin to get messy. The funds have three aspects: inflows, outflow, and the balance. The first two are flows. The last is a stock. Hence, there is a possibility of confusing flows and stocks.

Note that the balance in these accounts – which we will refer to henceforth as the "reserve" – is, in essence, the sum of past *net* inflows. If, over some time period, more flows into a fund than goes out, the reserve will rise; if more flows out than flows in, it will fall. So if stocks and flows are mixed up into a single measure, the time dimension can become ambiguous since the reserve implicitly embeds past time periods.

Generally, when a state or local "budget" is discussed, the discussion is focused on the general fund. Because of the stock-flow confusion, the words "surplus" and "deficit" do not necessarily

have the federal meaning when they are used at the state and local level. Sometimes, a budget will be described as in surplus or perhaps "balanced" because there is a positive reserve left in the fund. Thus, revenue may be falling short of expenditure and, therefore, the reserve is eroding – but the last penny of the reserve has not yet been drawn down. Describing such a budget as being in surplus or balanced makes it sound healthy. But a falling reserve – headed toward zero – should be flashing danger.

Let me give a concrete example of the problem. California experienced a high-profile electricity crisis in 2001 – the result of a poorly designed deregulation scheme. The big California utilities teetered on bankruptcy and became unable to buy power. As an emergency response, the state stepped in to buy electricity on behalf of the major utilities. Assurances were given to the public that the state would buy the power from its budget "surplus." The only difficulty was that in the federal sense of that word, the state was in deficit. Moreover, it was evident by that point in time that the economy was turning down, thanks to the dot-com bust.

With a colleague of mine at UCLA – the late Werner Z. Hirsch - I wrote an op ed in the Los Angeles Times entitled "Surplus? California is Running a Deficit." It began with the following words:

As California's electricity crisis unfolded, there was much talk about using the state's "surplus" to fend off high energy costs. Indeed, in recent years the surplus has been regarded as the answer to just about any social need in California. There is just one problem, evident in the governor's budget documents but ignored by the public and the Legislature. In the current fiscal year ending June 30, California is running a deficit. And the budget proposals for the next fiscal year similarly project a deficit…

The op ed went on to describe the situation as it then appeared in official documents in more detail. It concluded:

…It is important to stop sugar-coating the state's fiscal situation with talk of a phantom surplus. The governor's budget needs to be revised to take realistic account of the energy crisis, even before May when such corrections traditionally are made. That way, administrators of programs that receive state funds will have a chance to plan for possible cutbacks. The general fund shouldn't be running a deficit now when the money may well be needed later.[52]

[52] The full op ed is available at https://docs.google.com/viewer?a=v&pid=explorer&chrome=true&srcid=0BzVLYPK7QI_4MDQwNzMyYWEtMjhhNC00MWUxLWI5YzgtOWUxN2IzMGRhYThj&hl=en_US

The op ed elicited an angry letter to the editor from the state's budget director a few days after it appeared insisting there was a surplus. What he meant was that there was still some reserve left. Yet it was obvious that a state running a deficit at the peak of the cycle when revenue was at a maximum would be in trouble as the downturn progressed. And the inevitable did happen – California had a major budget crisis. As the crisis unfolded, it was soon determined that the budget director needed to spend more time with his family (and someone else was appointed). Eventually, thanks to the 2003 recall, the governor also found himself with more family time.

Would better fiscal policy have been made if common-sense terminology had been used? There is no guarantee, of course, that better policy would have been the outcome. But what can be said is that use of terminology that obscured fiscal reality made it more likely that bad outcomes would follow. As it has been said, if you don't know where you are going, it may be hard to get there.

What about the response to a budget crisis, once it has occurred? Again, fuzzy accounting terminology gets in the way of understanding what the options are. Typically in a crisis, the reserve in the general fund becomes negative, a situation analogous to overdrawing a checking account. It is possible to run with a negative reserve through borrowing. Borrowing can be internal – the general fund borrows from the other special funds – or external (borrowing from financial markets). Because of the fuzzy terminology, the goals of getting back to a positive reserve, i.e., making up for past fiscal sins, and of dealing with the current situation become confounded. In effect, the one-year time dimension is lost. Budget proposals made during midyear crisis course corrections are described as "deficits" if they don't make up for past sins *and* finish with a positive reserve by the end of the coming fiscal year. In effect, three years – or more – become the implicit time period of the problem.

At one point in California's budget crisis, the speaker of the assembly and the governor described the state as having remedied a $60 billion deficit in a $100 billion budget. When I posed the idea of fixing a $60 billion deficit *in the common-sense meaning of that term* in a $100 billion budget to an audience of fiscal experts, they laughed. In the common-sense (federal) meaning of the term, there would be no practical way of making such a fix. The problem with the statement was that the $100 billion was a one-year flow and the $60 billion was a correction for the past sins, the current year, and the forthcoming year. And, not surprisingly, the supposed $60 billion fix did not resolve the entire problem.

Suppose California's fiscal dilemma had been reframed as follows.

1) We have a negative reserve in the general fund. How do we finance the negative reserve until we can work our way out of the problem?

2) We need to make a midyear correction in the current year's budget because our assumptions when that budget was enacted were over-optimistic. What can we do in the short run in the current year, given that it is partly over?

3) If we make no changes, the budget next year will be in deficit? Do we try to run a sufficient surplus to bring the reserve back into positive territory? Or will we need a multiyear workout, given the depth of the crisis?

By breaking the $60 billion "deficit" into its true components, we at least have made the options clear – although, again, there is no guarantee of good decision making.

Even at the current time, the stock-flow mix in terminology is California driving policy. Any proposed budget that does not ostensibly produce a positive reserve by June 30, 2012 (the end of the current fiscal year in California) is described as a deficit, even if they are budgets in which revenue > expenditure. That terminology drives the option of a multiyear workout off the agenda. And/or it gives rise to budget "solutions" that appear to meet the June 30 goal but may not do so.

There are still other terminology problems in state and local government accounting. I have used California examples because I am familiar with that state's fiscal history. But the same problem is common in all states and localities. Right now, layoffs in state and local government have been offsetting private job growth. Current terminology tends to delay recognition by state and local governments of downturns; politicians are told that budgets are "balanced" or even in surplus until reserves are exhausted - at which point there is a full-blown crisis. In essence, there is no crisis until there is a severe one. Then politicians are told there are deficits unless there is a complete fix in a short period of time – a large surplus to rebuild the reserve by the end of the fiscal year.

The likely outcome of current terminology is a more erratic pattern of state and local government employment than there needs to be with sharp layoffs just when the labor market needs the reverse.

Mitchell's Musings 10-31-11: A Cautionary Tale – Research Incentives

Daniel J.B. Mitchell

I was first introduced to the attraction of showing that things are not what they seem as an undergraduate taking an introductory economics course in the early 1960s at Columbia. We used Paul Samuelson's classic textbook, Economics – the fifth edition published in 1961. I still have the book. On page 331, there is a section on "The Creation of Bank Deposits." Its introduction includes the observation that bankers *"…sometimes argue that the banking system cannot (and does not) create money. 'After all,' they say, 'we can only invest what is left with us. We don't create anything. We only put the community's savings to work.' Bankers who argue in this way are quite wrong. They have become enmeshed in our old friend, the fallacy of composition: what is true for each is not thereby true for all."*

Undoubtedly, generations of instructors who used that book wowed their undergraduates by showing that the dumb bankers in fact don't understand their own system. Your wise instructor, in sharp contrast, would let you in on the hidden knowledge by which you could be smarter than the bankers. And your instructor did so – as in the Samuelson text – using various numerical examples demonstrating how money in excess of reserves is indeed created by the banking system as a whole, but not by each individual bank.

Therein is found a dilemma for academics. There are strong incentives to show that common knowledge is wrong or that things are not what they seem. Your audience, be they undergraduates or academic journal referees, will be impressed. I was reminded of that fact by a recent development at the Rand Corporation, a well-respected think-tank in Santa Monica, California.

On October 24, Rand "retracted" a technical report that it had earlier released and then removed from its website. The report – which attracted considerable attention when it was initially released – dealt with the closure of "medical" marijuana dispensaries which have proliferated in California despite federal law. Voters approved a ballot initiative allowing medical marijuana but most of the dispensaries in fact were selling recreational pot behind a thin veneer of medicine. Various cities began cracking down on them and ordered closures. The study dealt with the impact on crime of the closures.

The now-discredited Rand report purported to show that, contrary to what you might think, crime *rose* in the neighborhood of the pot stores after they were closed. However, it appears, based on news accounts and Rand's own statement on the retraction, that there were major problems with the report. These lapses included failure to verify that the stores that were ordered to close actually did so and lack of needed crime data.[53]

For purposes of this musing, the report and its particular deficiencies are not the focus. What is the focus are research incentives. I suspect that apart from the specifics of the Rand incident, those incentives played some role in that occurrence. The common expectation was that pot stores attracted a criminal element and that, therefore, closing them would reduce local crime. When it was announced that the reverse was the case, the report became especially newsworthy.

As noted before, there is a natural tendency – whether as an undergraduate instructor or an author of research papers - to want to show that things are not what they seem – or what common sense or common knowledge would lead you to expect. I can forecast with 100% accuracy that tomorrow the Sun will rise in the east and set in the west. But no one will be especially impressed. A journal submission that carefully documented the equivalent of the directional rising and setting of the Sun would be unlikely to be accepted for publication. There surely would be no TV interviews or news accounts.

So an interesting question arises? Even apart from any political motivation, in the aftermath of the Great Recession, where are the academic incentives when it comes to current macroeconomic policy? They probably lie in demonstrating that policies that would seem to the average person to stimulate the economy really don't have that effect. The normal expectation is that government spending would stimulate the economy since it involves direct and indirect hiring, spending by those who are hired, etc. Similarly, the normal expectation is that tax cuts would help, too. Keynesianism has a common sense element and has become a kind of folk wisdom. So coming up with stories, models, or empirical evidence suggesting that the normal expectations are in fact true is not especially exciting. At best, there is some greater interest in estimating the magnitude of the expected effect.

But coming up with stories and models in which the normal expectation is *incorrect* is more newsworthy – and potentially more academic journal-worthy. Of course, there is a spectrum. You might get some points for showing that while the normal expectations are correct in direction, the actual magnitudes are very small. And that way, you don't risk having to defend some totally new model of macroeconomic functioning. All you are saying is that things are what they seem, but not very much.

[53] A news story on the retraction can be found at http://www.latimes.com/news/local/la-me-rand-pot-study-20111025,0,2844501.story. The official Rand statement is at http://www.rand.org/news/press/2011/10/24.html. An initial news report – when the report was first released – can be found at http://www.latimes.com/news/local/la-me-0928-marijuana-dispensaries-20110921%2C0%2C7776989.story

It is an axiom in economics that people respond to incentives. But there is therefore a syllogism entailed in that axiom. Economists are people. Therefore, economists respond to incentives. It's a good idea to keep that syllogism in mind when reading the contemporary professional literature, particularly when it comes to contemporary macro policy, and more particularly when someone is saying there is no effect, very little effect, or perverse effect.

Mitchell's Musings 11-7-11: Current Events and Currency Burdens

Daniel J.B. Mitchell

From the New York Times comes this story about Japanese policy to weaken the yen against the dollar:

*...The strong yen is a **burden** for Japan as it seeks a path to recovery after natural and nuclear disasters this year. While companies have been quick to rebuild factories and restore supply chains, the yen has undermined revival for the nation's exporters, which drive much of its economic growth, by making their products less competitive overseas...*

Full article at http://www.nytimes.com/2011/11/01/business/global/japanese-officials-intervene-to-weaken-yen.html

And the headline on the article reads "Japan Acts Alone to Weaken Its Currency" (underline added).

Now the yen/dollar ratio is the reciprocal of the dollar/yen ratio. So it must follow that a strong dollar is a burden for the U.S. as it seeks a path to recovery. That simple arithmetic, however, seems to have been lost when it comes to the U.S. and its policy on trade and exchange rates. Why is it legitimate for Japan to act unilaterally ("alone") in setting its exchange rate but not the U.S.?

You might think that Japan was running down its international reserves as a result of the tsunami-nuclear disaster. But you would be wrong; Japan has over a trillion dollars in international reserve assets – nothing much has changed on that front since before the disaster. A trillion dollars might seem like a lot but it is roughly a third of the accumulation amassed by China – a country which also acts unilaterally regarding its exchange rate.

As prior musings have noted, the U.S. could stimulate its economy to the tune of 3-4% of GDP simply by closing its net export deficit. And, in fact, to work off its debt to the rest of the world, the U.S. needs to run an export surplus.

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And while we are on the subject of currencies and such, here is another excerpt from a news item – this one from the Santa Monica Mirror, a newspaper given out for free in my home town:

The three major national credit rating agencies, Fitch Rating, Moody's Investor Service, and Standard & Poor all affirmed the City of Santa Monica's triple-A credit ratings this week. A credit rating of triple-A is the highest credit rating the agencies assign. Santa Monica's strong fiscal management, low debt levels and diverse economy, is behind the rating, according to the City…

Full story at http://www.smmirror.com/#mode=single&view=33324

Readers will recall last summer's flap when one of the credit rating agencies downgraded U.S. Treasury securities below triple-A. Now Santa Monica, a city of around 90,000 people, is definitely affluent and has a solid tax base. Despite its reputation in the past as a leftist "Peoples Republic of Santa Monica," the local authorities have always taken pride in its triple-A rating. But seriously, Santa Monica bonds more secure than U.S. Treasuries? The federal government can create dollars and its securities are promises to pay in what it can create. Santa Monica has to earn its dollars to repay its debts; it can't create them. To the extent that China and Japan are holding dollar reserves, you can rest assured that none of their holdings are in Santa Monica bonds.

The slogan on the City seal translates as *happy people in a happy city*. We are indeed happy about our town having a triple-A rating. But we are not silly about it. The failure of institutions of finance – which include ratings agencies – to think rationally about monetary matters is also a burden on the recovery of the U.S. economy.

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And then there is Greece. After negotiating a "rescue" plan to avoid default, Greece announced it would hold a referendum on whether to implement the rescue – which Greek voters might well reject because of the austerity entailed. Later, there seemed to be uncertainty about the referendum idea on the part of the Greek government and then the idea seemed to fade. Let's put aside the question of whether the rescue plan was well designed or whether the euro-zone

countries are helping or hurting their own recovery with their various policies. Here is a quote from an article about the issue, again from the New York Times, on the proposed referendum when it seemed to be a live prospect:

"If Greek citizens decide to vote against it, it would be very difficult for the Greeks to stay in the euro zone," Ms. Möller said. "Maybe this is the most elegant way of leaving the euro zone, not members kicking out a country but the Greeks choosing, through democracy and with legitimacy to leave."...

Full story at http://www.nytimes.com/2011/11/02/world/europe/markets-tumble-as-greece-plans-referendum-on-latest-europe-aid-deal.html

You have probably seen any number of such stories, which involve Greece defaulting in some way – referendum or not - and exiting the euro. What none of these off-hand comments explain is exactly how Greece could exit the euro. Greece gave up its drachma currency to be part of the euro-zone. Would it just print up some new drachmas and toss them in the street? Would it demand that its population turn it the euros it has been holding for new drachmas at some arbitrary exchange rate? I hate to think of the popular response. Would it attempt to pay off its creditors in new drachmas? It's relatively easy to give up a currency, but not so easy to create (or re-create) one. Even Santa Monica - with its triple-A rating - might have a problem if it decided to issue "monicas" in place of dollars. The possibility of a renewed financial crisis based on the European Greek/euro dilemma remains.

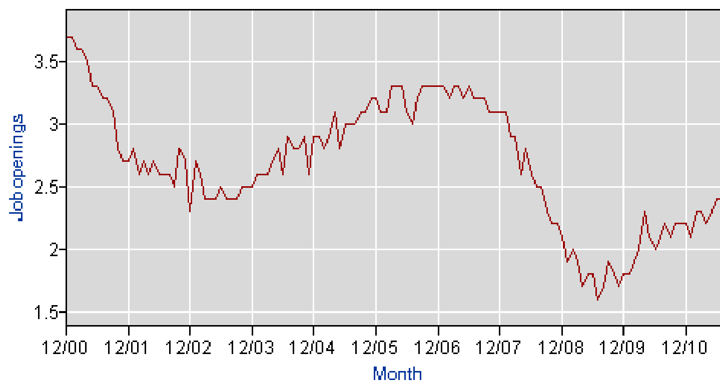
In short, the only thing for sure about the Greek/euro currency crisis is that it threatens to be a burden on the U.S. recovery. As such, it is in good company with the aloofness of U.S. trade and currency policy and with silly bond ratings.

Mitchell's Musings 11-14-11: Back in the Day Employers Couldn't Be Picky

Daniel J.B. Mitchell

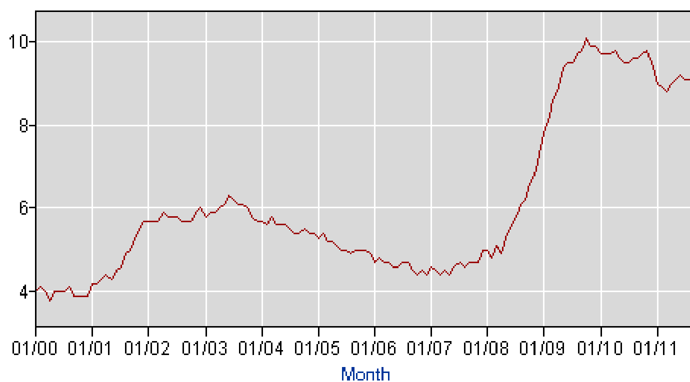
The U.S. Bureau of Labor Statistics Job Openings Rate (vacancy rate) fell substantially in the Great Recession, as the chart below – which begins at the first available data point, December 2000 - shows. Even at the peak of the housing/mortgage bubble in 2006, the rate was not as high as it had been in late 2000.

Job Openings Rate: Nonfarm (seasonally adjusted)



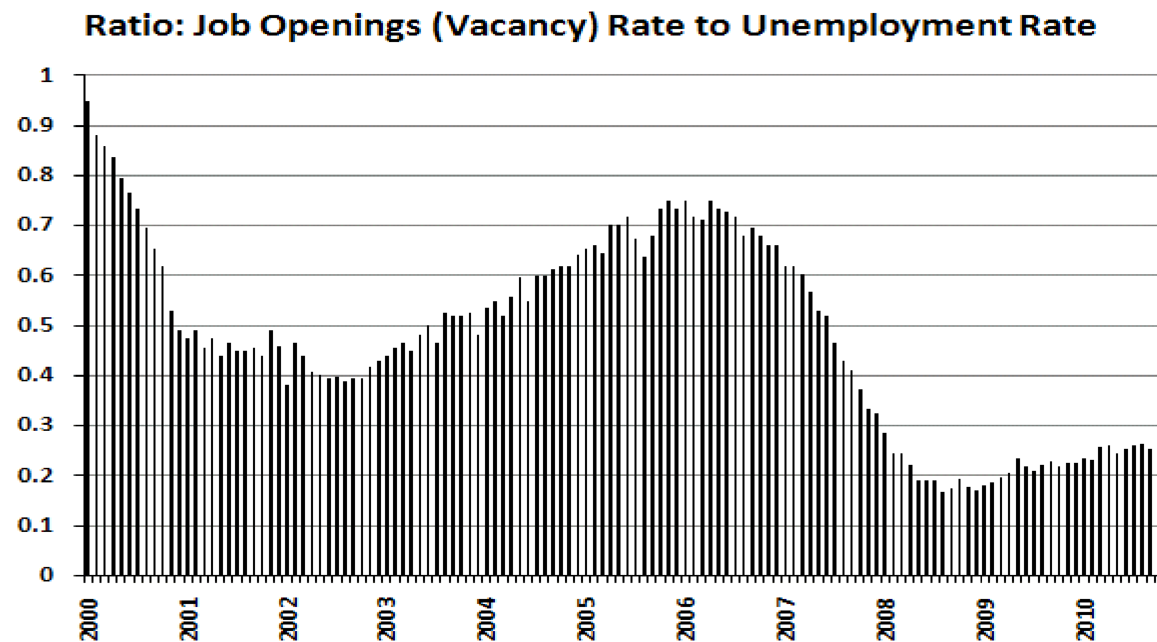
Similarly, the unemployment rate at the peak of the housing/mortgage boom never dropped as low as it did during the dot-com boom era. In many respects, therefore, the latter boom was only a partial recovery from the former.

Unemployment Rate: US Total (seasonally adjusted)



The job openings data unfortunately began at the peak of the dot-com boom and do not go back further in time for historical research. However, the old Beveridge definition of full employment was a situation

in which vacancies were equal to unemployment, i.e., there was a job for each job seeker, although for some reason the two – vacancies and people - were not being linked. By that definition, there was full employment at the peak of the dot-com boom, as the chart below – which runs through October 2011 - shows. The ratio of vacancies to unemployment was roughly 1 at the end of 2000. In contrast, at the peak of the housing/mortgage boom, around 2006, there was only about three-fourths of a job for each job seeker.



So, was there ever a time before in which the kind of full employment we saw during the dot-com boom arose? Of course, there were periods of wartime when full employment – indeed, overfull employment – existed: World War II, the Korean War, and the Vietnam War. That fact might lead you to conclude that reaching full employment in peacetime hardly ever happens. But we don't have to go all the way back to those wars to find such labor-market conditions. In fact, the late 1980s had similar characteristics, although, sadly, the job openings data were not available to give us a complete measurement.

In the late 1980s, there was much interest in then-existing labor shortages. I did a piece at that time for the *Brookings Papers on Economic Activity* looking at the issue and others attempted to construct Beveridge-type measures from what data were available.[54] One of the interesting features of that

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[54] Daniel J.B. Mitchell. (1989). Wage Pressures and Labor Shortages: The 1960s and 1980s. *Brookings Papers on Economic Activity*, pp. 191-231. Available at http://www.anderson.ucla.edu/documents/areas/fac/hrob/mitchell_wage_pressure.pdf

period, particularly in some areas of the country, was that employers actively sought workers – whatever workers they could find. They sent vans to get them. They made whatever accommodations were necessary to obtain the labor they needed to fill jobs. And the folks who were recruited into those jobs were not just in the high-tech occupations. Retail, manufacturing, blue collar, white collar, all were in limited supply. All were scarce.

Check out the video on the "Massachusetts Miracle" of 1987 to get a sense of the labor market back then at http://www.youtube.com/watch?v=zO2ppa5iUEI. There was no talk back then of a jobs-employer mismatch as there is today. Rather, employers adjusted to prevailing conditions. Years before, the late Arthur Okun had coined a phrase for the phenomenon: a "high-pressure" labor market.[55]

It may seem counterintuitive but complaints about job mismatch – stories about how the jobs are really there but workers are not competent to fill them – tend to arise when unemployment is high. Why is that? Take a look at the job vacancy to unemployment ratio on the chart of the previous page. At the bottom of the most recent cycle, there were fewer than two jobs for every ten job seekers. If you were the rare employer doing a lot of hiring, and there always are some employers hiring, you could be very picky. And the typical employer who was doing hiring, the index suggests, effectively rejected eight out of ten applicants. Even now, the soft recovery has only brought the ratio up to around a fourth. So employers who are hiring nowadays can be thought of as rejecting three out of four job applicants.

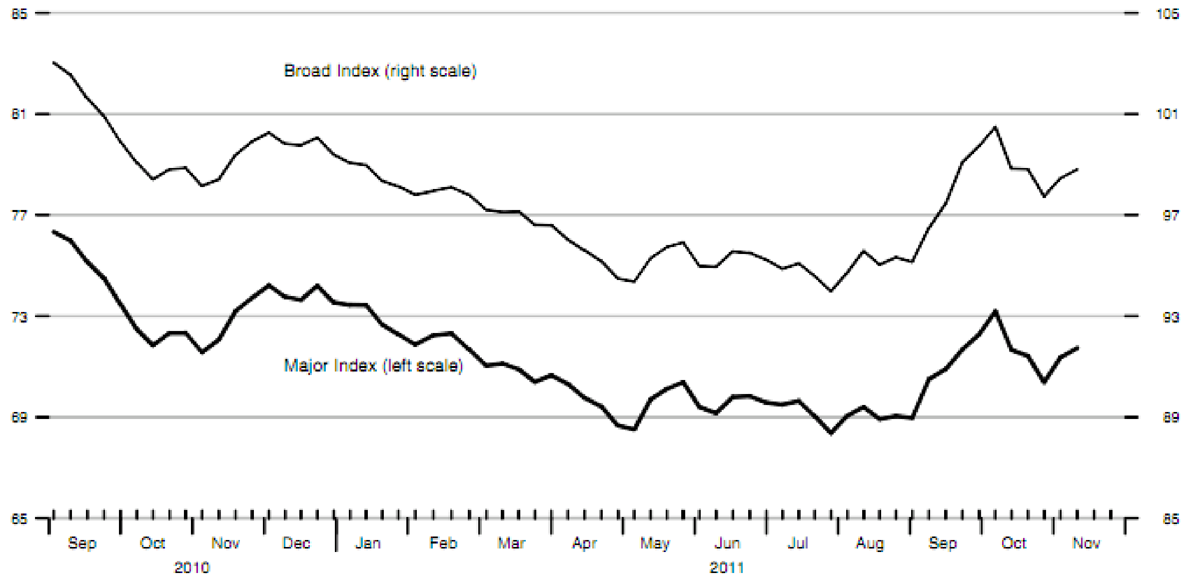
Given those high rejection rates, there has to be some rationale at the micro level by whoever is making the hiring decision. Lots of applicants have to be refused. That is, as a hiring employer, you have to find lots of faults with lots of people. You have to find faults that in more prosperous periods you would have overlooked. Is it any surprise, therefore, that anecdotes about inadequate job seekers abound in the current period?

Such anecdotes should be seen as symptoms of a soft labor market with high unemployment, not causes of it. The only guide to policy they provide is that the economy needs a more robust recovery.

[55] Arthur M. Okun, "Upward Mobility in a High-Pressure Labor Market," *Brookings Papers on Economic Activity*, 1:1973, pp. 207-252.

Mitchell's Musings 11-21-11: Lessons from the Grid

Daniel J.B. Mitchell



As the chart above reminds us, international financial markets – even in the absence of an immediate crisis – can be erratic. Within the timeframe shown on the chart, the dollar first dropped about 10% relative to other currencies, then suddenly rose about 8% starting last summer, and has moved up and down since. Concerns about how the EU was handling its euro/sovereign debt problem seemed to play a major role in the recent gyrations.

The euro problem, however, threatens an even more dramatic adjustment than just a volatile exchange rate. Failure of major European financial institutions - if the euro/sovereign debt issue is not resolved - could have important and adverse consequences for the sluggish U.S. recovery. Indeed, such a development could bring about an otherwise unlikely double-dip recession in the U.S.

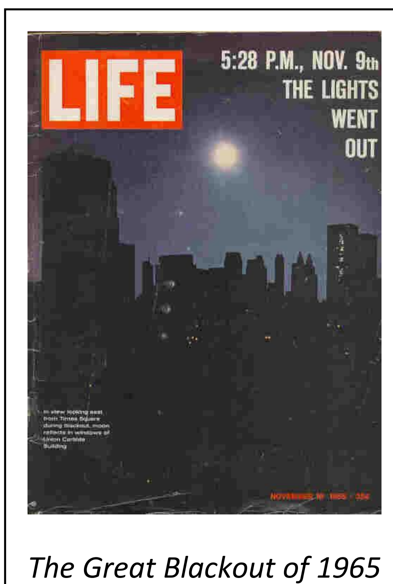
One response to such a prospect is the oft-heard phrase, "we live in a global economy." That phrase typically is invoked to indicate that the impact of external developments on the American economy are like the weather, i.e., they are unavoidable. But is that viewpoint really valid?

I was a graduate student at MIT on November 9, 1965, about to leave the campus in the late afternoon, when suddenly the lights went out. In fact, they went out all over the Northeast and

parts of Canada. It took a long time to get the lights back on. You need electricity to start a generator so it is hard to restart an entire system. For those unfamiliar with the event, go to http://www.youtube.com/watch?v=cdF-CsxqDko for a TV news report, in part illuminated by candlelight, on the great blackout.

The 1965 power failure was the first really large-scale regional electricity blackout. At one time, individual cities and areas had self-contained electrical systems. Each was isolated from the other so that each had to have substantial back-up capacity to deal with peak loads and possible failures of individual pieces of equipment. Linking the various systems together provided potential savings and efficiencies. In the event one area had a power deficit, surplus power from elsewhere could take up the slack. In addition, a large grid allowed trade in electricity. So, for example, areas of Canada with significant hydroelectric resources could export electricity to the U.S. The grid opened up exports and imports of power.

As it turned out, however, there was an unforeseen downside to the grid, well illustrated by the major failure of 1965. A disturbance anywhere in the system could cascade, affecting a vast area and millions of people. In the case of the 1965 blackout, the initiating problem arose in Canada. The grid turned what could have been a local malfunction into a regional failure.[56]



The Great Blackout of 1965

How does this tale of a huge power failure relate to the euro/sovereign debt problem and – more generally – U.S. international economic policy in the aftermath of the Great Recession? In an international economics course I used to teach, I would point to the 1965 power grid

[56] Various explanations of the triggering event in Canada and how it cascaded throughout the region are available on the web. See, for example, http://www.semp.us/publications/biot_reader.php?BiotID=387.

experience while examining the pros and cons of fixed exchange rates vs. flexible. Fixed exchange rates facilitate trade and investment by making prices more certain over extended periods of time and by reducing exchange rate risk and cost. They help tie national economies together. But they also efficiently transmit disturbances – such as inflation or recession – from one country to another. Flexible exchange rates tend to isolate such disturbances precisely because countries are not so efficiently linked together.

Slide from International Econ Course

The lesson of the 1965 great blackout for operators of power systems was that efficiencies of interregional power transmission had to be balanced against preserving electricity supply locally. If there is a disturbance externally, local areas needed to be able to unlink from the grid. They needed to be able to isolate themselves from the source of the disturbance.

As noted at the outset, right now the U.S. is threatened with a disturbance from abroad, i.e., from the euro area. Even apart from the issue of Greek debt and contagion to the debt of other European countries, the powers-that-be in Europe seem to have opted for austerity, worsening the demand for U.S. exports. We have a flexible exchange rate with the euro zone which might have softened the impact of that perverse European policy. But the Greek debt problem has caused the dollar to appreciate as speculators worry about European inaction. In addition, China continues its dysfunctional undervalued exchange rate against the dollar, also draining demand from the U.S., particularly in the manufacturing sector. Effectively, China maintains a quasi-fixed exchange rate against the dollar.

When there is a disturbance on the electrical grid, we now have systems in place that unlink and isolate the disturbances to the locale causing them. In 1994, for example, the large earthquake in Los Angeles early in the morning of January 17 caused lights to blink in Seattle as local LA-area power sources failed. But the system quickly cut LA loose from the grid, isolating the problem before it could spread. In contrast, when it comes to the international economic network, policy makers in the U.S. seem to insist on an economic version of a pre-1965 grid. The mantra, "we live in a global economy," is taken to mean that unlinking is impossible, even when the link poses a threat to – or at least a drain on – recovery from the Great Recession.

It would be nice if all countries would cooperate in promoting recovery. But, as noted, Europe seems intent on a policy of austerity whose growth-retarding effect is felt elsewhere, including in the U.S. with its high unemployment rate. China, for internal reasons, regards its exchange rate against the dollar as its own domestic affair – as if two currencies and countries were not involved. Japan has had a long history of China-type policies.

In periods of prosperity, perhaps such external behaviors could be overlooked. But not now. In the international econ course mentioned earlier, I would start on the first day by asking students to raise their hands if they believed in free trade. All hands would go up. Then I would ask how one could "believe" in something on the first day of a course in which no analysis of the topic had yet been provided. Faith-based economics – including international economics - makes for poor policy.

Mitchell's Musings 11-28-11: The Recovery Has Left Many People Jobless – But is it Really a "Jobless Recovery"?

Daniel J.B. Mitchell

The New York Times carried an op ed dated November 24 which dealt with high unemployment.[57] Obviously, high unemployment remains a major problem and needs discussion. But the op ed seems to take it for granted that the future – thanks what used to be called "automation" back in the 1950s – will forever be one of "superfluous" workers.[58] And it uses the phrase "jobless recovery" to describe the current situation.

"…When the jobless recovery ends and the economy is restored to good health, today's surplus will be reduced. New technology and the products and services that accompany it will create new jobs. But unless the economy itself changes, eventually many of these innovations may be turned over to machines or the jobs may be sent to lower-wage economies. In fact, if modern capitalism continues to eliminate as many jobs as it creates — or more jobs than it creates — future recoveries will not only add to the amount of surplus labor but will turn a growing proportion of workers into superfluous ones…"

I see two big problems with both the interpretation and the terminology. The automation scare of the 1950s was followed by an economic boom in the 1960s which brought about low unemployment. The 1960s were followed by stagflation in the 1970s, in which unemployment fluctuated – sometimes high; sometimes low – but with ongoing inflation problems. There was some revival of the automation scare in the 1970s. But in fact folks back then became more concerned about a seeming slowdown in productivity growth – which meant the previous trend toward less and less labor per unit of real GDP was fading away. A national Productivity Commission was even established to determine what to do about lagging productivity growth; the concern was that maybe the U.S. wasn't automating enough – a kind of lack-of-automation scare! Then there was a boom following the double-deep recessions of the 1980s and, as unemployment fell, whatever remained of the automation worry – and the lack-of-automation worry - seemed to vanish.

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[57] Herbert J. Gans, "The Age of the Superfluous Worker," *New York Times*, November 24, 2011. http://www.nytimes.com/2011/11/25/opinion/the-age-of-the-superfluous-worker.html?ref=opinion

[58] News reports and popular culture in the 1950s reflected that concern. For a serious news report from that era, see http://www.youtube.com/watch?v=8odWZgFBqxQ. For popular culture, see http://www.youtube.com/watch?v=gd5CoMeip9o.

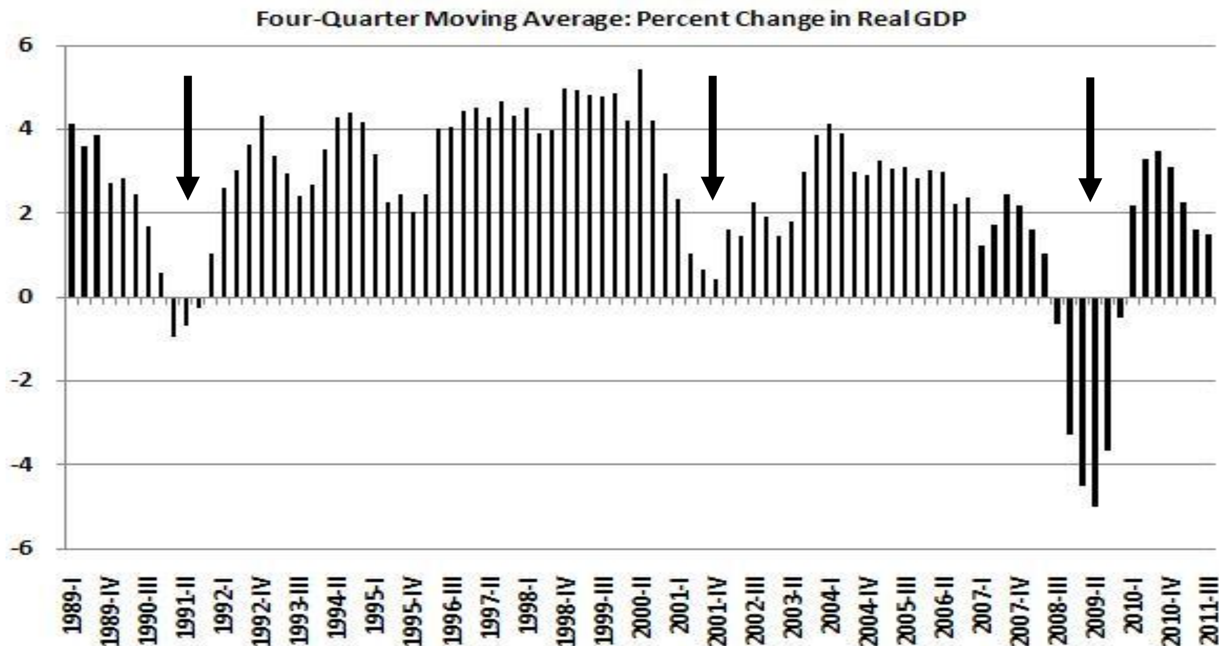
The lessons of history concerning "modern capitalism" and of versions of the automation scare seem to be that such scares come and go with the rate of unemployment and casual perceptions of technology. Of course, history doesn't determine the future. Maybe - to use the phrase more typically applied to rationalizing bubbles before they burst - "this time it is different." But I get nervous when history is ignored. And I get particularly nervous when talk of high unemployment and of automation (nowadays dubbed "technology") become intertwined, since the implication is often taken to be that nothing can be done.

What about terminology? The phrase "jobless recovery" came into vogue in the aftermath of the recession of the early 1990s. Except in my home state of California – which had to deal with the end of the Cold War and the consequent decline in aerospace – that recession was quite mild. But at least in the early stages of recovery, employers seemed reluctant to hire. Of course, by the end of the 1990s, unemployment was quite low and there was plenty of hiring going on. But then there was another mild recession and folks again started talking about a possible jobless recovery.

The key point about the recessions of the early 1990s and early 2000s was that they were *mild* but unemployment went up and took awhile to come down. It may be that employers in those two episodes were especially cautious about making hiring commitments. In the early 1980s, there had been a double-dip recession with the second one being quite severe. So less than a decade later, employers may have decided to wait and see whether another dip was coming after the mild recession of 1991. The recession in the early 2000s was accompanied by unusual events: the dot-com stock bust and then the September 11 terrorist attacks. So, again, employers may have been nervous about what might follow and thus were cautious in hiring.

The chart on the next page shows the annualized quarterly changes in real GDP from 1990 to 2011, smoothed using four-quarter averaging and with three recessions marked with arrow. It is clear from the chart that the aftermath of the Great Recession was unlike that of the mild recession of the early 1990s – when the "jobless recovery" phraseology came along – and unlike that of the mild recession of the early 2000s. The key feature of the Great Recession was that it was anything but mild.

If you have a deep, deep recession, you are going to have substantial unemployment as a result. Nor has the recovery since the latest recession officially ended been particularly robust. Indeed, while real GDP continues to grow, its pace of growth has tapered off.



The recovery after the latest recession can be characterized as jobless – in the sense that unemployment shot up and has remained high. But it has not been a "jobless recovery" in the sense in which that terminology has been previously used. We are not viewing a puzzle in the current period in which employers seem to be overly cautious about hiring despite having experienced only a very mild recession. Employers in recent years have experienced a very deep recession. And they have been beset with fears that there could be yet another downturn stemming from such events as the current euro crisis. So they are reluctant to hire.

There is nothing really surprising going on today that points to some break in trend or some grand structural shift. As Calvin Coolidge (supposedly) said, "When a great many people are unable to find work, unemployment results." In short, there is much joblessness today, but is it really a puzzle why that is so? Let's put off great speculations about possible future trends and focus on the obvious.

Mitchell's Musings 12-5-11: What's a Double Dip?

Below is an excerpt from an article – dated Nov. 23, 2011 - that appeared in the Orange County Register and relates to the retirement system of the California State University (CSU) system.[59]

Pay for retired CSU professors seen as 'double dip'

Retirement has been good for Cal State Fullerton Professor Jesa Kreiner. As a full-time professor of mechanical engineering during 2008-09, Kreiner made $106,000 for teaching eight courses. Last year, after retiring, he made $146,600 – for teaching four classes at the same school.

Kreiner benefits from an obscure California State University program that allows professors and librarians to retire and continue to work part time, collecting both a pension and a paycheck. Kreiner disputes the numbers contained in the CSU pay data, but said he could not find the exact figures for his retirement benefit and part-time pay. Nevertheless, he defended the system that allows him to collect two checks. "I think it's fair," Kreiner said. "If you work for a place for 40 years and contribute to its growth, you have earned it."…

"It's a ***double dip****," said Jon Coupal, president of the Howard Jarvis Taxpayers Association…*

The full article is at http://www.ocregister.com/news/csu-328504-ferp-faculty.html

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Let's explore some alternative scenarios on the assumptions that a) the article above describes a "double dip" and that b) even though Professor Kreiner disputed the numbers, the figures presented are correct. And let's note that the phrase "double dip" has a pejorative connotation.

Scenario 1: Professor Kreiner, on retiring, took his pension as a lump-sum rather than as a monthly annuity. He then returned to work part time, deriving other income for living costs from whatever investments he made with the lump sum and whatever periodic draw down he made from his lump sum. His income from part time work is apparently - based on the news article - $40,600 (total payments pension + part time salary of $146,600 minus his full time former salary of $106,000). He would then not be receiving a monthly annuity at all; just the part time salary plus investment return and draw down.[60]

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[59] California has three public higher education systems. The University of California system, the California State University system (known at one time as the state college system), and the community college (junior college) system. All provide defined benefit pensions to their regular employees.

[60] I am assuming that since he worked 40 years, Professor Kreiner's pension annuity is 100% of his former salary. For purposes of the various scenarios, however, the precise dollar amounts are not important. The essence of the article is that by drawing a pension based on a career at Cal State Fullerton and then returning to work there part time upon retiring, Professor Kreiner was double dipping.

Scenario 2: Professor Kreiner, on retiring, took his pension as an annuity but went to work part time for another employer, say a private college, which paid him $40,600 for part time teaching. His teaching + pension total would then be the same $146,600 as in the article.

Scenario 3: Professor Kreiner on retiring took his pension as a lump sum and went to work for the private college as in Scenario 2.

Scenario 4: Professor Kreiner spent his career, not at Cal State Fullerton, but at a university with a defined contribution plan such as TIAA-CREF. Upon retiring, Professor Kreiner took the accumulated sum in his pension account and bought an annuity that paid him $106,000 per year. He then went back to work part time for his university, earning $40,600.

Scenario 5: Same as Scenario 4 except that Professor Kreiner did not take the money he had accumulated in his defined contribution account out of the account and convert it to an annuity. Instead, he earned his part time salary and derived other income from the investments he made in the account plus whatever he chose to draw down from the account.

Given these five scenarios, which – if any – is a double dip? Or, maybe the question should be, which – if any – *isn't* a double dip? All of the scenarios are functionally equivalent to the scenario in the Orange County Register article. A portion of Professor Kreiner's compensation was in the form of a pension, whether defined benefit or defined contribution, in all five scenarios. At a point in his later life, apparently after 40 years in his case, Professor Kreiner reduced his workload to part time and drew on those pensions.

While pondering which of these scenarios is (or is not) a double dip, you might also ponder whether it matters whether the pensions outlined were partly employee paid? Suppose Professor Kreiner's employee contribution was one half of the total with the employer paying the other half. If you consider him to be double dipping in a particular scenario (including the one in the article), but now factor in his one-half contribution, would you instead say that he was only 1.5 dipping? If he contributed one fourth, would he be 1.75 dipping?

If you think it is double dipping no matter how much Professor Kreiner contributed, then what would you say about an employee who had worked for an employer with *no* pension plan at all, but who had saved on his/her own – say through an IRA. Would such an employee be double dipping by working and drawing on the IRA? Would you say that someone receiving Social Security and also doing some work for pay is double dipping? You are talking about lots of folks if Social Security (a defined benefit pension) and part time work (including self employment) constitutes what you mean by double dipping.

What precisely is the Orange County Register upset about? The language in the article – an "obscure" program that permits retirees to come back part time - makes it clear that someone is upset. The obscure program in question is basically the federal tax code. Is what is causing the upset the fact that Professor Kreiner earned more when he worked full time than the average employee in Orange County? Is it that he is better off in retirement than the average employee? Or is it that the pension plan

covering Professor Kreiner is underfunded?[61] Would his return to part time work have been OK if the pension plan had been 100% funded? Is it that Professor Kreiner is a public employee?

You might say that even though the scenarios presented above are basically equivalent, some of them (which ones?) don't pass a "sniff test" and it is the sniffing that tells you whether what is going on is a double dip. Sniff tests, even if inconsistent and subjective, are sometimes part of the criteria for public policy. But at some point, as you explore the various scenarios, you have to ask whether we are talking about a double dip or about a double standard.

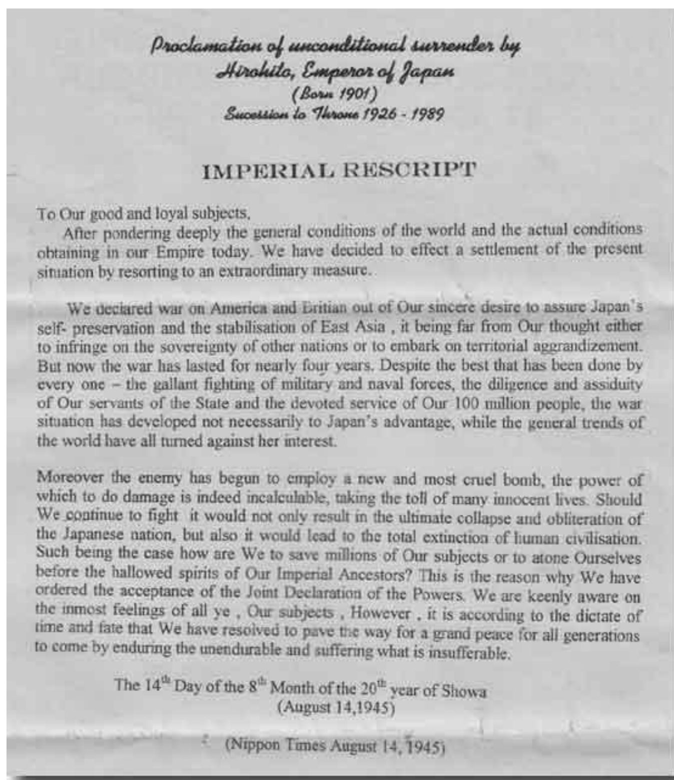
[61] Employees of the CSU system are covered by a large state pension fund known as CalPERS which is underfunded.

Mitchell's Musings 12-12-11: When is the War Over?

Daniel J.B. Mitchell

Just about a year ago, this Mitchell's Musings series was begun on EPRN. Also, by coincidence, last week contained December 7, 2011, the 70th anniversary of Pearl Harbor Day. Both of these occurrences of the past led me to think – in an admittedly odd way – that we are likely to be facing our current economic dilemma (and its very closely aligned political stalemate) for quite some time. That's not a happy thought but many of the items posted by researchers at our EPRN point to that conclusion.

I had an uncle – now deceased 30 years - who served in the Army during World War II in the Pacific Theater. He once told of being stationed on one of the U.S.-occupied islands in the Pacific awaiting the military invasion of mainland Japan, a task widely expected to be a very bloody affair. In the meantime, he had a job taking messages that were received and decoded at a radio office on the island to the local commander. A message came in saying an atomic bomb had been dropped on Japan. To my uncle, this message sounded like science fiction. Atomic energy had been talked about as some possible distant prospect up to that time; not something on the immediate horizon. In any event, suddenly Japan surrendered and my uncle was taken by ship to Yokohama, the port near Tokyo, and told with another soldier to take a local commuter train to Tokyo and report to a particular address. He and his companion boarded the train filled with Japanese, with some trepidation. They were the only Americans on board. The other passengers could have torn them apart. But in fact they were treated deferentially by the other passengers. Why? Because Emperor Hirohito had said the war was over.



Proclamation of unconditional surrender by
Hirohito, Emperor of Japan
(Born 1901)
Sucession to Throne 1926 - 1989

IMPERIAL RESCRIPT

To Our good and loyal subjects,

After pondering deeply the general conditions of the world and the actual conditions obtaining in our Empire today. We have decided to effect a settlement of the present situation by resorting to an extraordinary measure.

We declared war on America and Britian out of Our sincere desire to assure Japan's self- preservation and the stabilisation of East Asia , it being far from Our thought either to infringe on the sovereignty of other nations or to embark on territorial aggrandizement. But now the war has lasted for nearly four years. Despite the best that has been done by every one – the gallant fighting of military and naval forces, the diligence and assiduity of Our servants of the State and the devoted service of Our 100 million people, the war situation has developed not necessarily to Japan's advantage, while the general trends of the world have all turned against her interest.

Moreover the enemy has begun to employ a new and most cruel bomb, the power of which to do damage is indeed incalculable, taking the toll of many innocent lives. Should We continue to fight it would not only result in the ultimate collapse and obliteration of the Japanese nation, but also it would lead to the total extinction of human civilisation. Such being the case how are We to save millions of Our subjects or to atone Ourselves before the hallowed spirits of Our Imperial Ancestors? This is the reason why We have ordered the acceptance of the Joint Declaration of the Powers. We are keenly aware on the inmost feelings of all ye , Our subjects , However , it is according to the dictate of time and fate that We have resolved to pave the way for a grand peace for all generations to come by enduring the unendurable and suffering what is insufferable.

The 14th Day of the 8th Month of the 20th year of Showa
(August 14,1945)

(Nippon Times August 14, 1945)

Recently, I came across a similar account by another American soldier who described a similar sequence of events - including the train ride in which nothing happened because the emperor had said the war was over. It's worth listening to that soldier's description at http://www.youtube.com/watch?v=uCugmebnCNA. Apparently, such stories were common. Despite the fierce fighting before the War suddenly ended, once the emperor said it was over, it was (largely) over.[62] Indeed, the emperor's announcement – which was recorded on a phonograph record for subsequent broadcast – was expected to be the final word, so much so that rogue Japanese military officers sought to prevent the broadcast knowing what its consequence would be.[63] But their coup failed.

There is precedent for someone saying that the war is over and, as a result, suddenly fierce fighting ends. The American Civil War – the bloodiest war in terms of American casualties that the U.S. has ever fought – ended because General Lee said it was over. And once he said it, suddenly it was over and soldiers on both sides stopped their operations.

There are also cases in which the end did not come so smoothly. The defeat of Germany in World War II required a full military invasion by the Allies. There was no one to say the War was over for Germany until it was over *de facto*.

What seems to be needed for nations to change directions sharply is a calamity (as experienced by Germany, Japan, and the American South) *and* a leader to make an announcement saying it was necessary. In some cases, however, even without a calamity on the scale experienced by Germany and Japan and the American South, a leader can create dramatic change. Think of Gorbachev's impact – both in the Soviet Union itself and in Eastern Europe more generally. (And note that in Gorbachev's case, just as in the case of the emperor, there was a near coup to stop him.)

For the U.S. after the Civil War, the next major calamity was the Great Depression of the 1930s. And big changes in national policy resulted from that event, voiced by a leader. Roosevelt was not able to end

[62] There were some cases of straggler Japanese soldiers who fought on for years. And there was a group of Japanese soldiers trapped in China that continued to fight after the War officially ended.

[63] You can hear the recording at http://cgi2.nhk.or.jp/shogenarchives/sp/movie.cgi?das_id=D0001410387_00000

the Depression, as his critics like to point out, but he did at least bottom it out. And it proved to be sufficient simply to persuade the electorate that he was doing his best to deal with it, among a cacophony of conflicting opinions on what should be done. Absent his leadership, the Depression could have evolved into something far worse, both economically and politically.

Compared to the circumstances above – major wars and the Great Depression - the Great Recession of 2008 and its aftermath may not seem to be a full-scale calamity. But for many displaced from jobs and incomes, it is. And an ongoing political war - which the Great Recession seems to have intensified - has paralyzed national economic decision making. Unfortunately, there is no one to say the war is over.