Mitchell's Musings

April – June 2018

For Employment Policy Research Network (EPRN)

Employmentpolicy.org

(There are no Mitchell's Musings for January – March 2018)

Note: This compilation will be the last quarterly collection of the regular weekly Mitchell's Musings. The website for the Employment Policy Research Network - EPRN, while still linked to the larger LERA website, is no longer being supported technically. As a result, images such as charts no longer can be uploaded to employmentpolicy.org. Although past musings are also available on other sites, it has become complicated to keep the series going, hence the discontinuation.

One source for back issues is https://archive.org/details/@danieljbmitchell (and search there for musings). Another source is https://issuu.com/danieljbmitchell.

Mitchell's Musings 4-2-2018: Identity vs. Behavior

Daniel J.B. Mitchell

As we resume these musings after the end of the winter quarter at UCLA (when I am teaching and too busy to write them), it's worth looking back at events of that period. And it's worth looking back at some confusions that arose in that period, too. One of those events was the announced imposition of steel and aluminum tariffs. Let's put aside the question of whether those tariffs were a good idea, either politically or economically. There has been much confusion in the popular news media as experts – who generally opposed the tariffs - were interviewed. From Forbes:

> *…Our deficit will not be reduced by enforcing trade rules, renegotiating existing trade pacts, or forming new ones. While these policies might shuffle the deck and alter the bilateral trade balances the U.S. has with other countries, they will not alter the overall U.S. trade balance. Indeed, policies aimed at eliminating so-called "unfair trade practices" — while attractive to many businessmen, trade unionists, most progressive activists and all who harbor mercantilist sentiments — are wrongheaded and futile.*
>
> *Why? The simple analytics of the trade deficit prove the utter futility of the Trump administration's trade policies. In economics, identities play an important role. These identities are obtained by equating two different breakdowns of a single aggregate. Identities are interesting, and usually important, by definition. In national income accounting, the following identity can be derived. It is the key to understanding the trade deficit:*
>
> *(Imports - Exports) ≡ (Private Investment - Private Savings) + (Government Spending - Taxes)*
>
> *Given this identity, which must hold, the trade deficit is equal to the excess of private sector investment over savings, plus the excess of government spending over tax revenue. So the counterpart of the trade deficit is the sum of the private sector deficit and the government deficit (federal + state and local). Therefore, the U.S. trade deficit is just the mirror image of what is happening in the U.S. domestic economy. If expenditures in the U.S. exceed the incomes produced in the U.S., which they do, the excess expenditures will be met by an excess of imports over exports (read: a trade deficit)…*[1]

The implication of this observation seems to be that if the ultimate objective of the Trump administration was to improve the U.S. trade balance (make it less negative than it is), raising tariffs is a fool's errand. If you don't change saving and investment behavior, the trade deficit will remain the same. Similar objections have been raised when the question of doing something with exchange rates is the issue.

It is true that as a matter of national income accounting, the balance of saving vs. investment is the reverse of the trade balance. One is the mirror image of the other. So it is true that if you raise tariffs *while saving and investment remain the same*, the trade balance will be unaltered. If the tariffs you raise cut down on imports, *but the trade balance is unaltered*, then it must be the case that exports will have

[1] https://www.forbes.com/sites/stevehanke/2018/03/02/trumps-tariffs-ive-seen-this-horror-show-before-reagans-terrible-trade-policies/#3d8bd21a7329.

(somehow) dropped by the same amount. Again, this observation is pure accounting. The observation is true by construction.

You can say the same thing about exchange rates. If the dollar is devalued and imports fall as a result – *and if saving and investment are unaltered* – then it must be the case that exports will fall by the same amount.

But there is a fundamental problem here. Who says that changing tariffs in a big way, or changing exchange rates in a big way, will leave saving behavior and investment behavior unchanged? Perhaps a thought experiment will be helpful. Imagine we raise tariffs on everything and keep raising them higher and higher. Imported goods and their domestic substitutes are thus becoming more and more expensive, both relative to non-traded goods, e.g., haircuts, and relative to exported goods. And imagine that saving and investment are unaltered. Surely, at some point – maybe a 500% tariff, maybe a 1000% tariff – imports become prohibitive. If we started with a negative trade balance and now imports are reduced to zero, in order to preserve the negative trade balance, exports would have to be negative! But there is no such thing as a negative export. Something is clearly wrong here. And what is wrong is the idea that tariffs (or exchange rates) don't affect saving and investment.

Here's a different scenario, one more realistic than the extreme case above, but also more realistic than the assumption that saving and investment are immutable. Suppose there is a big increase in tariffs (or a big dollar devaluation). Prices tend to rise a result. Particularly if the economy is at or near full employment (as it currently is), the Federal Reserve will raise interest rates to resist the price effect. Investment will likely fall. It's likely that saving will rise.

In past musings and elsewhere, I have noted that if the Trump administration really wants a zero-trade balance, it could achieve it with the Warren Buffett plan – a kind of cap-and-trade approach that relies on a market mechanism to bring about balanced trade.[2] If that were done – and there is no sign that my advice is being taken – since exports would be equal to imports – there would also be behavioral responses in saving behavior and investment behavior such that in the end, saving would = investment.

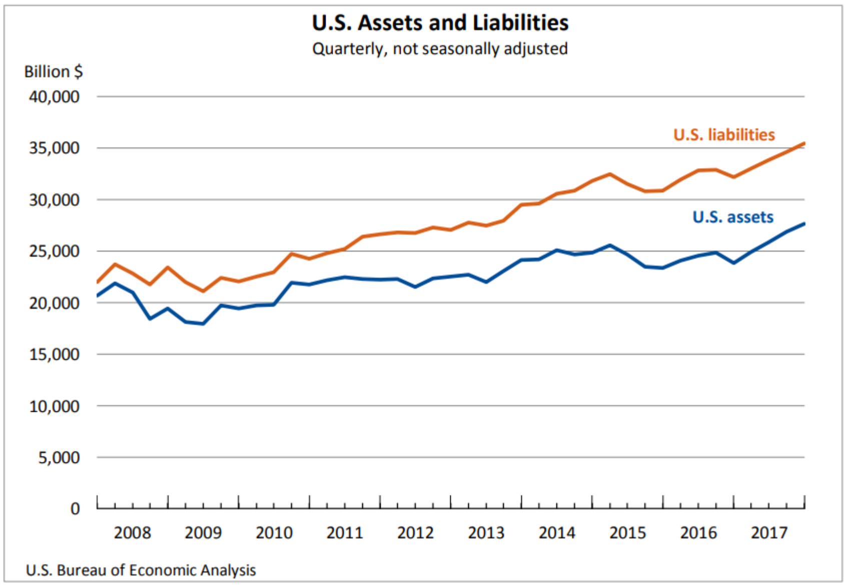
To repeat, this musing is not focused on whether Trump policies with regard to tariffs on steel and aluminum are wise. However, I will say that those tariffs appear to be based more on political symbolism than anything else. And I am not saying that pointing to national accounting identities is useless. For example, you can certainly argue, based on the identities, that the Trump tax cuts – which create governmental dissaving – will tend to worsen the trade balance. For them not to do so, they would have to raise private saving (by some magic) or reduce investment (which Trump doesn't want). But that is another story. The simple point here is that in evaluating any major policy change, you can't assume that key macro variables such as the rates of saving and investment are going to be unaffected. Nor can you ignore likely responses from policy actors such as the Fed.

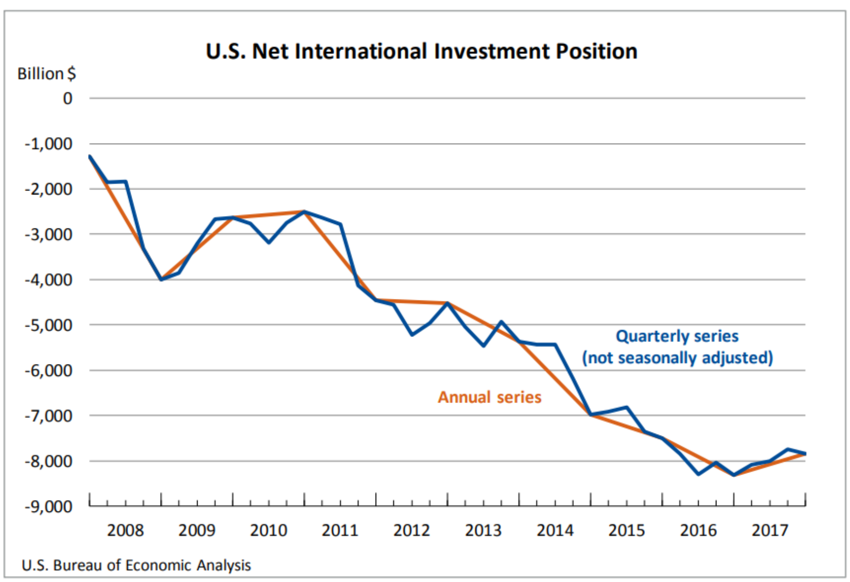
[2]http://www.zocalopublicsquare.org/2017/01/09/cap-trade-solution-trade-dispute-china/ideas/nexus/.

Mitchell's Musings 4-9-2018: Seems Reasonable, But Isn't

Daniel J.B. Mitchell

Let's start with some data points. As the charts below show, the U.S. ended the calendar year 2017 with gross liabilities to the world of $35.5 trillion.[3] But it held gross claims on the world of $27.6 trillion. The difference between U.S. liabilities to the world and U.S. assets abroad was $7.8 trillion, a *negative* net international investment position. As the charts also show, all these figures bounce around, but all have generally risen over the past decade (and before).





[3]Source: https://www.bea.gov/newsreleases/international/intinv/2018/pdf/intinv417.pdf.

Much of international investment involves portfolio investment, official reserves, and other such assets and liabilities that do not involve controlling ownership or real assets (such as real estate). Direct investment, however, does involve controlling ownership and real assets. The U.S. had such direct investments abroad to the tune of $8.9 trillion at the end of 2017. Foreign direct investment in the U.S. was also $8.9 trillion. In short, there is lots of investment, including direct investment, in both directions.

At the time of the recent tax cuts, you probably read news accounts such as this one:

> *President Donald Trump's new tax plan could cause a tidal wave of internationally held cash to flood back into the US. The repatriation tax holiday outlined in the plan, which has officially passed both chambers of Congress and is awaiting Trump's signature, is designed to incentivize US-based companies that do big business overseas to bring those profits back home. By Goldman Sachs' calculation, S&P 500 companies hold $920 billion of untaxed overseas cash, and the firm estimates that $250 billion of that would be repatriated. Looking at all US-based companies, Citigroup says there's a whopping $2.5 trillion of capital stashed internationally…*[4]

The implication was that the tax system was inducing firms to arrange their affairs so that profits would appear abroad rather than in the U.S. and thus escape U.S. taxation. Clever lawyers and accountants put these arrangements together. That part of the story was undoubtedly true. It's hardly controversial that firms seek to be "tax efficient." If you change their tax incentives, the same clever lawyers and accountants will now advise firms to alter their arrangements. The advice could well be to repatriate some of the assets that were held abroad.

But what is the implication if they do? The assumption, particularly of the president, seemed to be that these were funds that would go into real investment in the U.S. There would be a real investment boom in the U.S. that would create lots of jobs, if only all that money abroad would return to the U.S. So let's look at that idea.

When people talk about money stashed abroad, it sounds as if there was a vault stuffed with dollar bills somewhere across the sea. In fact, assets held abroad are largely investments in securities and claims of various types. For example, the assets could be claims on a financial institution (a bank) which in turn invests the assets around the world *including in the U.S.* And we know that at the end of the day in 2017, the U.S. had a net international debt of $7.8 trillion, as per the data and charts noted earlier. There is nothing in the new tax law that says that, as a first approximation, had the law been in effect in 2017, the net debt of the U.S. would have been any different (although as perhaps the gross assets and liabilities would have been different).

Would there have been more real investment in the U.S.? Let's consider Apple, since it figured prominently in the discussion of tax avoidance:

> *When Apple's efforts to reduce its taxes around the world came under fire in Congress a few years ago, CEO Tim Cook fired back. "We do not depend on tax gimmicks," Cook said. "We do not stash money on some Caribbean island." The first statement depends on the definition of a "gimmick." Apple was certainly using loopholes and openings in different countries' tax laws to minimize its own obligations. But he was telling the truth in saying the iPhone maker had no*

[4] http://www.businessinsider.com/trump-tax-reform-plan-repatriation-14-us-companies-with-most-cash-overseas-2017-9.

money stashed in the Caribbean. The company didn't need to – its funds were stashed in subsidiaries incorporated in Ireland, but that, on paper at least, had no home country for tax purposes…[5]

Let's suppose Apple really wanted to produce iPhones in, say, Detroit instead of contracting out the task to Chinese and other foreign manufacturers (as it does). Would the fact that it has made accounting arrangements so that its profits show up in Ireland – or anywhere else – have prevented it from opening a Detroit plant? A firm's investment in a new plant does not have to be financed directly from accumulated past profits. It can borrow the necessary funds locally from financial institutions. And one suspects that if Apple wanted to finance its hypothetical Detroit plant out of its own past profits in Ireland, the same clever lawyers and accountants that made those profits show up in Ireland could find a way to funnel the funds to Detroit through some sort of dummy intermediary.

The reason Apple doesn't produce the iPhones it sells in the U.S. in a Detroit plant is that it is cheaper to make them in places such as China and then import them into the U.S. Giving Apple tax incentives to make profits show up in the U.S. is unlikely to change that calculation. If it were the case that where profits show up determines production location, then iPhones would be produced in Ireland, not China. Researchers who have traced iPhone parts manufacturing and assembly have found production sites all over the world. But Ireland doesn't appear on the list.[6]

In short, it may seem reasonable to think that if past profits are repatriated to the U.S., there will be more manufacturing in the U.S. by the firms affected. It may seem reasonable to think that where accounting profits are, so goes production. But, sadly, it just happens not to be so.

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[5] http://fortune.com/2017/11/06/apple-tax-avoidance-jersey/.
[6] https://www.lifewire.com/where-is-the-iphone-made-1999503.

Mitchell's Musings 4-16-2018: Labeling What is Abnormal as the New Normal

Daniel J.B. Mitchell

In recent weeks, there have been some very large swings in the stock market. So what do we read about these developments?

> *…The era of calm markets and small price swings is over. The* ***new normal*** *on Wall Street is all about wild fluctuations, mammoth moves like the Dow Jones industrial average's 1,000-point drops earlier this year, and rapid-fire price reversals that can shift the mood of the market from optimism to pessimism in a matter of minutes — and sometime seconds…*[7]

The implication of the phrase "new normal" as used in the quote above is that the big fluctuations, which seem to be a departure from what has been the case in the past, will go on indefinitely or at least for a long time. And that proposition raises a question: Whatever happened to such notions as regression to the mean? Regression to the mean suggests that things that deviate from the way they have been in the past are just aberrations that will disappear. Why not assume that the recent "wild fluctuations" on Wall Street are destined to diminish?

I have no special insight as to whether there is or isn't a new normal on Wall Street, but my predilection would be that the current fluctuations will not go on indefinitely. Of course, there are breaks in history in which things that seem unusual based on past history in fact herald a new situation that will endure. But my sense is that the "payoffs" for predicting a break in trend that actually occurs are large compared to the payoff for calling an abnormal development a blip. There is a bigger payoff in predicting a new normal, and then hoping that your prediction turns out to be true.

It's like the reward system in economic forecasting. If you predict a recession – and one actually develops – you will be remembered as the genius who called it correctly, at least until the next recession. On the other hand, saying quarter after quarter that there won't be a recession will be correct most of the time, but not something that will enhance your reputation for prognostication. Breaks in trend are unusual (or we wouldn't call what was happening before a trend). So there are only a few opportunities to be seen as a genius. Getting it right most of the time – saying that there won't be a recession – is easy and boring and not notable. It won't get headlines and recognition.

[7] https://www.usatoday.com/story/money/2018/04/08/stock-market-2018-expect-dow-jones-volatility-trade-war-trump-talk/493234002/.

Now let's think back about the labor market discussion that characterized the aftermath of the Great Recession. We were told that high unemployment was the new normal. All kinds of explanations were offered for that conclusion. Employers wanted skills that the workforce didn't offer, so the unemployment was largely structural. Exactly why the burst in a structural problem just happened to coincide with a financial crisis was never entirely clear. The fact that the recovery was slow – so the unemployment rate remained high relative to trend – gave the new normal stories some surface validity. Here's an example from 2012 (when the unemployment rate averaged over 8%):

> *Bill Gross, manager of the world's largest mutual fund, said U.S. unemployment is now a structural, and not cyclical, problem stemming from technology advances and the lack of retraining. "Jobs are being structurally destroyed," Gross said in an interview today with Ken Prewitt and Tom Keene on Bloomberg Radio's "Bloomberg Surveillance." Employment figures released today reflect "the inability of the U.S. economy to provide jobs*..."[8]

But now the unemployment rate has somehow arrived at a low level, a little over 4%, despite the structural/new normal stories. And what do we read about employer behavior? Here's a recent anecdote from Springfield, Massachusetts:

> *Long before MGM Resorts International got the green light to build a nearly $1 billion casino and hotel downtown, it analyzed the local labor market to figure out what it would take to fill 3,000 jobs in a state new to gambling. The socioeconomic snapshot that emerged became a road map for creating a workforce from scratch.*
>
> *Census data and labor reports revealed a higher-than-average number of single parents and former offenders. So MGM Springfield added federally funded day care to the resort and lobbied to loosen a state law that restricts casinos from hiring people with criminal records. A lack of experienced blackjack and poker dealers in the area led to the creation of a gaming school.*
>
> *Managers also fanned out to senior centers, veterans clubs, vocational high schools, even churches to talk up casino jobs. They pored over layoff data from the state, including from a Springfield hospital and a nearby Sam's Club that had recently closed, to pursue workers who might be good fits.*

[8] http://www.atlantatribune.com/2012/10/02/bill-gross-u-s-economy-suffering-from-structural-unemployment/.

> *Now, months before its scheduled opening in late summer, MGM Springfield is embarking on a major hiring spree to staff its hotel, restaurants, bowling alley, movie theater, spa, retail shops, and 125,000 square feet of gambling space, all of which take up three city blocks.*
>
> *On Monday, the resort is set to announce openings for about 1,000 of its 3,000 jobs, mainly in food and beverage service. Just over 100 employees have been hired so far.*
>
> *Overall, roughly 80 percent of MGM's jobs will be full time, with the company helping to provide local training for many of them. Given MGM's good relationship with organized labor at its other resorts, a fair share will probably have union protections.*
>
> *Wynn Boston Harbor has been undertaking similar workforce development efforts, including analyzing demographics and partnering with nonprofits and community colleges, as it looks toward opening in Everett next year*…[9]

The current story is that with low unemployment, employers are being less picky about who they choose to hire than they were in 2012, and are providing training for those whose skills are lacking. Is this a surprise? It is a new normal? Not really. Brookings economist Arthur M. Okun described what happens in such circumstances back in 1972. He also noted then that when unemployment is high (as it was for several years after the Great Recession), "*society (is able to) salve its conscience by concluding that the fault of the unemployed and the underemployed lay in themselves and not in the economic system*."[10]

In short, what happened after the Great Recession wasn't the new normal. It was the old normal. When the unemployment rate is high and has been so for a few years, experts will declare it to be structural. The potential payoff was small at that time for saying that eventually the unemployment rate would fall and that when that that day arrived, employers would cease to be picky about who they hired. Making a more dramatic prediction and structural interpretation of what had happened got the headlines. Nothing new about that result, either.

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[9] https://www.bostonglobe.com/business/2018/04/01/mgm-springfield-embarks-hiring-spree/fLAXdBSOIul4ydsobAfKqK/story.html.

[10] https://www.brookings.edu/wp-content/uploads/1973/01/1973a_bpea_okun_fellner_greenspan.pdf. The quote is from p. 245.

Mitchell's Musings 4-23-2018: Grandma is the Unfunded Liability

Daniel J.B. Mitchell

A recent op ed in the LA Times points out that the Trump tax cuts are the first stage of a larger strategy:

> *…Tax cuts do not pay for themselves — not the Trump tax cuts, nor in any other case in modern U.S. practice. So we face only two possible courses of action: Either we tax ourselves more, or we dismantle the social safety net (in particular, Social Security, Medicare and Medicaid) that protects Americans from destitution or disability. Which is the right direction for our country to pursue?*
>
> *One political movement has its answer at the ready: Slash the safety net.*
>
> *Five fellows at the conservative Hoover Institution recently laid bare in a Washington Post opinion piece how the Tax Cut and Jobs Act of 2017 was just the first step in a two-step dance. The full tango goes like this: Note that our deficits are unsustainable. Blame "entitlement spending" (code for Social Security and Medicare) rather than tax cuts. Demand cuts to social spending on the pretext that some imaginary iron laws of reduced tax collections and deficit concerns require it…*[11]

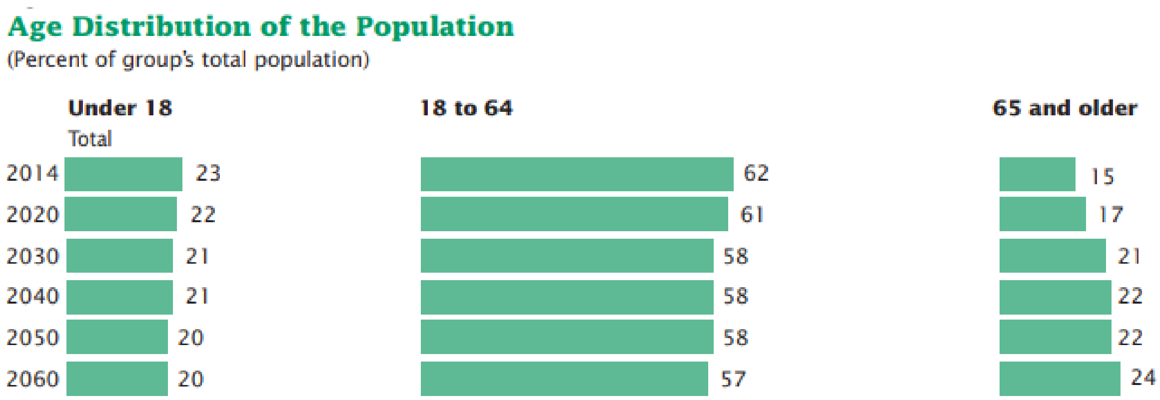
This strategy did not originate in 2017, nor is it confined to the Hoover Institution. It usually is accompanied by calculations of the "unfunded liability" of Social Security and Medicare which is viewed with alarm. And it assumes that if you cut entitlements, the unfunded liability will go away somehow. But that assumption ignores the demographics – particularly the demographics of the population bulge known as the baby boom.

Do you want to see the actual unfunded liability? You don't need to wade through government reports. Here it is below. Grandma and grandpa are the unfunded liability.

[11] http://www.latimes.com/opinion/op-ed/la-oe-kleinbard-tax-health-20180415-story.html.

The aging boomers that are the unfunded liability will eventually go away through the natural process, of course, but not because of tax cuts or budgetary calculations. So taking them out of the federal budget solves nothing. They exist and somehow society will have to fund their consumption.

Issues regarding "entitlements" involve how the GDP of 2030, 2040, 2050, 2060, etc., will be split between active workers, retirees, and other dependents (mainly children). We can have a sensible conversation about that division and come up with solutions. Or we can wait until the "strategy" described earlier creates a political crisis. As the chart below shows, the demographics are coming, tax cut or not.[12]



Years ago, I wrote a book describing political turmoil in the 1930s and 1940s in California which was then an elderly state. Many of the elderly in California in that era, absent an adequate safety net, supported hair-brained plans and backed political con artists promising pie-in-the-sky solutions.[13] If we get such results in the coming years at the national level, I suspect the folks at the Hoover Institution and other conservative think-tanks won't like the outcome of their planned crisis. One thing about the elderly; they vote in large numbers.

[12]The chart is from https://www.census.gov/content/dam/Census/library/publications/2015/demo/p25-1143.pdf.
[13]Daniel J.B. Mitchell, *Pensions, Politics, and the Elderly: Historic Social Movements and Their Lessons for Our Aging Society* (M.E. Sharpe, 2000). Now available as an eBook and through Routledge.

Mitchell's Musings 4-30-2018: Oil in Troubled Waters Can Dampen Blue Waves

Daniel J.B. Mitchell

Sometimes, a bunch of seemingly-unrelated things come together. Consider these events. There is the me-too movement linked to sexual harassment. There is California as a very blue state that is particularly sensitive to the sexual harassment issue and to ethnic minority concerns. It is also sensitive to environmental issues. There is the long-term decline of "good" blue-collar jobs. There is the decline of unions long term, especially in the private sector. There is the link between unions and the Democratic Party in California. And there is the fact that direct extraction of oil and gas in California involves something over 5,000 employees. Refining of petroleum involves another 13,000+ employees.

Some observers have forecast, based on national demographic trends, that U.S. politics will – in the long run – grow to look like California's. The proportion of the population with immigrant roots will increase, white males (stereotyped as Trump/Republican voters) will die off, liberal millennials will come to dominate, etc. The nation will turn blue and Republicans will be marginalized, as they have been in California. Demography is political destiny in this scenario. But there is a problem.

First, it is true that California demographics (minority-majority or maybe majority-minority) will eventually be followed by the rest of the U.S. However, voting patterns are not simply demographically determined. Estimates for California are that at present, about 6 out of 10 "likely voters" are white, non-Hispanics. So roughly 3 in 10 are white male, non-Hispanics in the state.[14] Let's just call it 30%. Census estimates for the proportion of folks who were white, non-Hispanic nationally and who voted in 2016 was a little over 73%. Thus, the male piece of that total was maybe 36-37%. You can't explain the difference between California – where Republicans in statewide elected office have *zero* presence – and the rest of the U.S. by that 6-7% difference among white, non-Hispanic males.

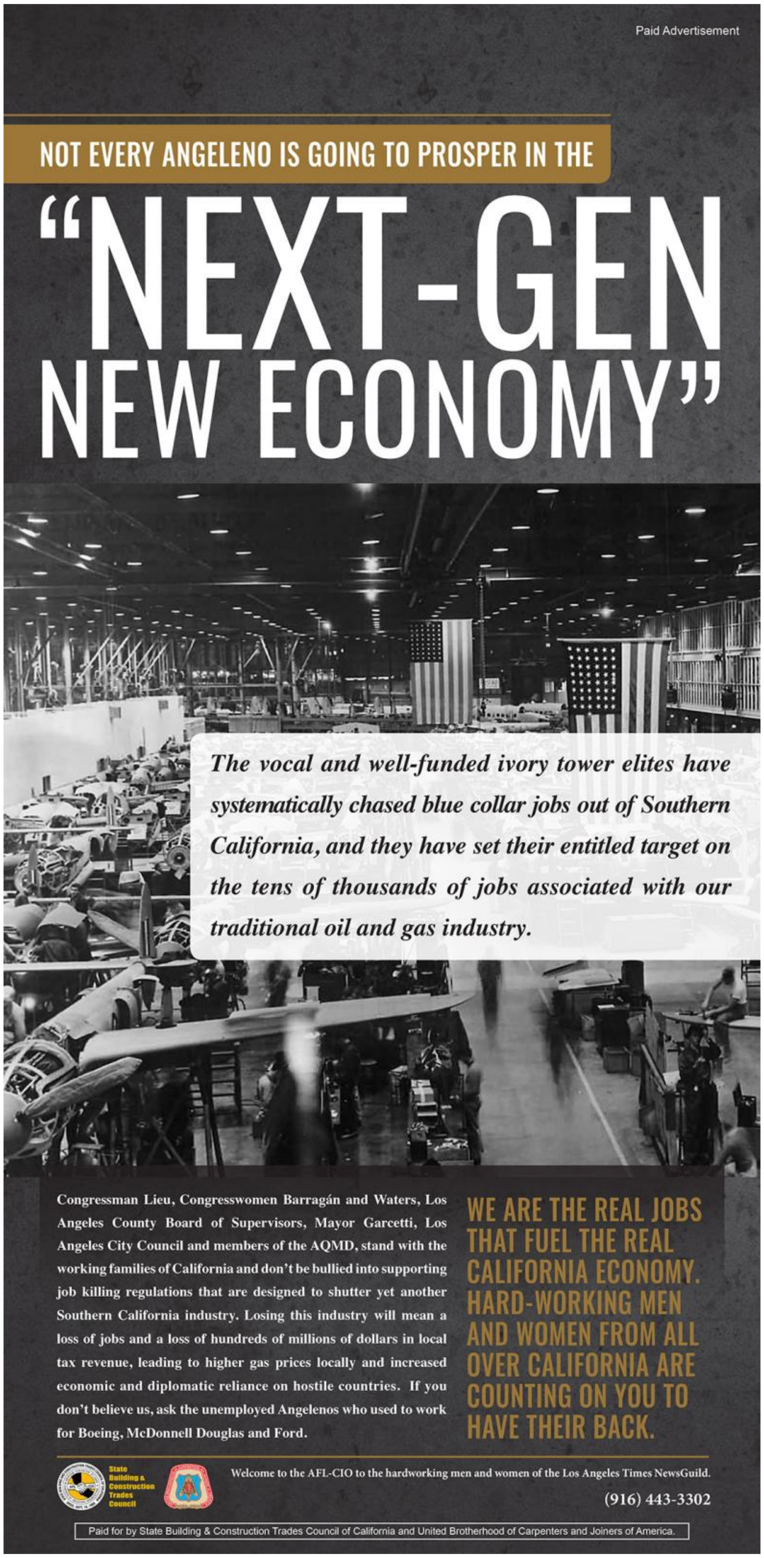
Second, the long-run demographic tale assumes that voting patterns by demographic group will remain stable over decades. But many of the white male Trump voters are the descendants of immigrants who came in the last big immigration wave in the late 19th and early 20th centuries. There is the old saying, "the last one in says shut the door; we're all here." Who is to say what Hispanic and Asian-origin populations will have as their political leanings in 2050?

Third, even if you lean towards some version of demographics-is-political-destiny, you need to show a path between now and that future. And just as there are contradictory elements in the Republican electorate, e.g., libertarians versus social conservatives, there are analogous conflicts among Democrats. So let's look at some of the seemingly-unrelated events described earlier as an illustration of the latter.

As noted, "blue" California embraces such social trends as the me-too movement. One member of the California legislature who was initially seen as a big supporter of me-too was Assemblywoman Cristina Garcia. She was also a big supporter of other "progressive" causes, notably environmental. However, accusations began to surface that *she* had engaged in sexual harassment and related behavior, ultimately forcing her to take a leave of absence from the legislature. Garcia is nonetheless currently

[14] http://www.ppic.org/publication/californias-likely-voters/. Males and females don't differ much in propensity to vote.

running for re-election. But as she campaigned, a full-page ad ran in the LA Times which we reproduce below.



You'll note that the ad does not mention Garcia. Still, at about the same time as it appeared, new accusations surfaced; this time it was said that Garcia had made homophobic slurs and anti-Asian remarks. Finally, this report appeared in the *Los Angeles Times*:

> The decision by a politically powerful labor group to openly campaign against an embattled Los Angeles-area lawmaker drew a sharp rebuke on Friday from Assembly Speaker Anthony Rendon. The Lakewood Democrat lashed out hours after the State Building and Construction Trades Council of California filed paperwork for a political action committee to defeat Assemblywoman Cristina Garcia (D-Bell Gardens). Garcia, who's seeking her fourth term, took an unpaid leave of absence in February following allegations of sexual misconduct. She has denied the reports and an Assembly investigation remains underway.
>
> Rendon didn't criticize the labor group by name, insisting instead that the decision was driven by oil and gas industry interests. "This is a thinly veiled attempt by Big Oil and polluters to intimidate me and my members. It is an affront to my speakership," Rendon said in a statement. "We are proud of the work that the Assembly has done to increase jobs and wages while defending our environment. We will vigorously defend the members of our caucus from any ill-advised political attack."
>
> A statement from the labor group, which sparred with Garcia last year on her effort to link new climate change policies with a crackdown on air pollution, said it had decided to "reverse" past support for her. "The Trades have thousands of hard working members in Garcia's district, and we look forward to lifting up another Democrat in the 58th Assembly to better represent them and their families," said the statement…[15]

Even if Assemblywoman Garcia is replaced, another Democrat will be elected in her place - so there will be no changes in the balance of the two parties in the California legislature. You can decide for yourself whether the steady surfacing of the various accusations against Garcia and the campaign by labor groups to replace her is just a coincidence. We have noted in past musings that in the current social climate, me-too accusations can be weaponized for political purposes.

In any event, the Garcia brouhaha illustrates the tension that exists between organized labor – a significant funding source for Democrats – and the wing of the party that is particularly concerned about quality-of-life type issues as opposed to "bread-and-butter" job-related issues.[16] Democrats are poised to lose support from public-sector unions due to a pending U.S. Supreme Court case. Defections of private-sector unions, such as those behind the *LA Times* ad, would be a further blow to Democrats, especially in potential swing states and districts.

Consider, too, the gerrymandering in many states by GOP-dominated legislatures, the planned inclusion in the 2020 Census of a question on citizenship that may reduce response rates in states such as California with large immigrant populations, and various voter suppression efforts. Given those considerations, the blue path running from now to the future based on purely demographic factors must be seen to be strewn with pitfalls. And, in the near term, the 2018 election appears likely to be fought

[15] http://www.latimes.com/politics/essential/la-pol-ca-essential-politics-updates-assembly-speaker-rebukes-building-trades-1524280376-htmlstory.html.
[16] https://www.nytimes.com/2018/04/19/opinion/democrats-gentrification-cities-voters.html.

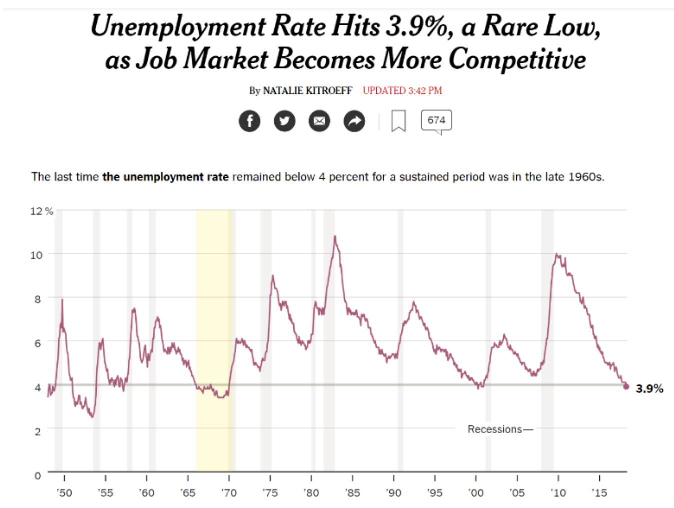
out against a background of very low unemployment. Yes, the labor-force participation rate is several percentage points below where it was at the turn of the century, but its downward trend ended several years ago. Labor-market conditions have to be seen overall as pretty good. Counting on an inevitable blue wave election in 2018, or on a gradually rising demographic blue tide, would be a risky strategy for Democrats.

Mitchell's Musings 5-7-2018: The Pay-Unemployment Connection

Daniel J.B. Mitchell

The unemployment rate has now declined below 4%. As a result, a *New York Times* website headline of May 4, 2018 has declared the labor market to be "competitive."[17] (See below.) In one sense, that characterization is correct. Employers increasingly find themselves needing to cater - more than they did not so long ago - to employee concerns and availability. An earlier *New York Times* article carried the headline "A Fast-Food Problem: Where Have All the Teenagers Gone?" It contained examples of the problems employers were having staffing and managing their fast-food operations, including this anecdote:

> *"Thirty years ago, I would not put up with the stuff I put up with today," said John Motta, a longtime Dunkin' Donuts franchisee in Nashua, N.H. When an employee recently missed a shift, one of his stores could serve only drive-through customers for about an hour. "You try not to be too harsh on them," he said, "because you're afraid tomorrow they're not going to show up."*[18]



But analysts looking at the low rate of unemployment note that despite the pressure on employers to recruit and retain workers, they haven't done much about raising wages. On a total compensation basis, private-sector pay has risen 2.8% over the year ending March 2018; a year before, the figure was 2.3%.[19] According to usual demand/supply analysis, or to the somewhat-related Phillips Curve notion, the limited wage response is surprising. But let's hold off on explanations for the moment and note a related observation. If, for whatever reason, the demand for labor rises and wages don't (or don't much), you should expect a labor shortage. And, indeed, as we have noted in prior musings - and as the anecdote above illustrates, in a shortage environment, employers overlook deficiencies in worker applicants and existing workers that wouldn't have been tolerated in less extreme circumstances.

[17] https://www.nytimes.com/2018/05/04/business/economy/jobs-report.html.

[18] https://www.nytimes.com/2018/05/03/upshot/fast-food-jobs-teenagers-shortage.html. Actually, thirty years ago (1988), the employer probably would have been equally tolerant. There was a labor shortage in that era in New England, too. See https://www.youtube.com/watch?v=zO2ppa5iUEI.

[19] Benefit costs can be noisy in the short term. On wages alone, the figures are 2.9% for the year ending March 2018 versus 2.6% for the year before. (Figures from the U.S. Bureau of Labor Statistics.)

As noted, the *Times*' headline describes current conditions as becoming “more competitive.” You might want to argue with that description, since if wages are not going up (or not going up much) it appears the competition is being confined to non-wage aspects of employment. And if employers are collectively limiting their behavior, that sounds like non-competition.

Jobless rate falls to 3.9% as pay lags

BY NATALIE KITROEFF
New York Times

The last time the unemployment rate fell below the 4 percent threshold was in 2000, during a period of frenetic activity remembered as the dot-com boom.

Nine years into a sustained, if less feverish, economic recovery, that milestone has been achieved again.

The Labor Department said Friday that the jobless rate in April fell to 3.9 percent, raising anew the question of just how tight the labor market can get, and for how long.

In the past half-century, only the late 1960s brought an extended period when the rate stayed below 4 percent.

“We've continued to add jobs routinely every month for so long, and the unemployment rate we have reached is amazing,” said Catherine Barrera, chief economist of the online job site ZipRecruiter.

President Donald Trump crowed about the landmark on Friday, tweeting, “4% is Broken!”

The steady-as-she-goes economy has produced a record 91 straight months of job growth. That may represent a healthier foundation than the dot-com era, when pride – or, as it was branded, “irrational exuberance” – went before a fall.

But the banner number announced Friday did not resolve any of the broader questions economists have about this unparalleled run.

The most prominent is a mystery that has proved impervious to easy explanation: why wage increases haven't been more robust, when the market continues to edge toward full employment.

Friday's report showed that hourly earnings went up by 2.6 percent over the past year, not much faster than inflation. The subdued wage gains eased the prospect that the Federal Reserve would accelerate its plans to raise interest rates, helping to send stocks higher. But lagging pay also reflects how the economy of 2018 is fundamentally different from earlier eras.

ROSS MANTLE NYT

A worker performs tasks at a CP Industries plant in McKeesport, Pa., last month. April marked the 91st consecutive month of job gains, the longest streak on record.

“A 3.9 percent rate today doesn't suggest as tight a labor market as 3.9 percent in 2000 or 3.9 percent in the late 1960s,” said Ellen Zentner, Morgan Stanley's chief U.S. economist.

A lot has changed since the turn of the century. The share of working-age women in the labor force began to fall in 2000, after increasing for decades. Men have been dropping out for much longer. The upshot is that a smaller share of people are participating in the labor market, and it's easier to get low levels of unemployment when fewer people are vying for jobs.

In fact, a shrinking labor force in April is part of why the unemployment rate fell to 3.9 percent from 4.1 percent even as payrolls grew by a fairly routine 164,000 jobs.

The population is also older than it used to be, on balance. The baby-boom generation has moved steadily toward retirement over the last two decades. And those still working have not helped push wages up. Generally, workers climb the economic ladder fastest when they are young, and so an older workforce may weigh on average wages, economists say.

In 2000, wages for rank-and-file workers rose at an annual rate of around 4 percent. Part of the problem now is that some 60 percent of the jobs added since 2010 have been in low-wage, service-sector jobs, according to Morgan Stanley.

Fifty years ago, there were plenty of factory jobs paying a decent wage, and unions held much greater sway. Manufacturing accounted for 1 in 4 jobs; today it's not even 1 in 10.

Back in the 1980s, economist Martin Weitzman proposed incentives for profit-sharing plans, plans which had the effect of making and keeping the marginal cost of labor, thus provoking a labor shortage with the result that the economy had an automatic tendency toward full employment.[20] We need not get into the technical details here, but with profit sharing, even though the marginal cost of labor was kept low, workers also got their profit-share payments. There were aspects of the Weitzman proposal that were similar to employer monopsony situations – which also produce *de facto* labor shortages (but which don't involve giving workers an added share).

The classic examples of monopsony, e.g., coal mining company towns with a single employer, are relatively rare. However, as Chris Erickson and I pointed out in the 2000s before the Great Recession, actual and ordinary labor markets have information barriers. Workers have to search for jobs and firms have to search for workers. These search requirements produce monopsonistic characteristics that don't require company towns and the like.[21] (But as in the company town story, workers don't get a share payment.)

There seems to be a revival of interest in labor-market monopsony of late. But you don't have to search far for an explanation of why contemporary wage response to increased labor demand is sluggish. The one universal constant when it comes to how employers set wages is that, in one form or another, they look to see what other employers in the relevant area, industry, or occupational group are doing on pay. If everyone is looking at everyone, there is a momentum of the *status quo* that is resistant to change. Add to this general observation the fact that the recovery from the Great Recession was slow so that labor markets were soft for a long time, and the fact that private-sector unions are a shadow of their former selves, and you get a kind of employer collusion on pay. I don't raise pay unless you do. You

[20]Martin L. Weitzman, *The Share Economy: Conquering Stagflation* (Harvard University Press, 1986).
[21]Christopher L. Erickson and Daniel J.B. Mitchell. (2007). “Monopsony as a metaphor for the emerging post-union labour market.” *International Labour Review*, Vol. 146, No. 3-4. Available at: http://www.anderson.ucla.edu/documents/areas/fac/hrob/mitchell_erickson_monopsony.pdf. Basically, the labor supply curve slopes upward.

don’t raise pay unless I do. The bottom line here is that the low unemployment rate and the limited movement in pay are connected. The latter helps explain the former.

Mitchell's Musings 5-14-2018: But What Are the Practical Implications?

Daniel J.B. Mitchell

Recently in the *New York Times*, a controversy arose surrounding an academic paper which suggested that Trump voters were not the stereotyped left-behind blue-collar workers. In fact, according to the study, they were motivated by something other than economics: a fear of loss of status due to increasing diversity of the U.S. population. The counter argument in subsequent *Times*' pages is that economic circumstances may tilt people toward a fear of status loss and that the culture vs. economics debate is thus ultimately futile.[22]

While this debate was playing out, opinion polls suggested that the so-called "blue wave" that some Democrats are counting on in the November 2018 midterm election is dissipating. One pollster – finding that declining trend – urged Democrats to focus more heavily on economic-type issues.[23] But, of course, if the key factor determining votes in swing districts is cultural/status rather than economic, such advice is useless. Or is it? The initial *Times* report (taking the cultural/status view) was not very clear on that point:

> *What does it matter which kind of anxiety — cultural or economic — explains Mr. Trump's appeal? If wrong, the prevailing economic theory lends <u>unfounded virtue</u> to his victory, crediting it to the disaffected masses… More important…, it would teach the wrong lesson to elected officials, who often look to voting patterns in enacting new policy*.[24] (underline added)

Let's note that the outcome of the 2016 presidential election was decided by a handful of votes in a few key states. Statistical analysis inherently occurs within a margin of error. If a handful of people who were on the margin decided to go this way or that, and that decision decided the election, it is doubtful that one can say that THE cause was economic and not cultural or was cultural and not economic. Those same people might have voted differently a week before the election or a week later, depending on who-knows-what.

The quote above seems to imply that if one concludes that THE cause was cultural – and therefore without "virtue" – focusing on economics would lead to the wrong policy choice (presumably a choice

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[22]http://www.pnas.org/content/pnas/early/2018/04/18/1718155115.full.pdf; https://www.nytimes.com/2018/05/06/opinion/trump-supporters-economy-racism.html; https://www.nytimes.com/2018/05/03/opinion/trump-industrial-revolutions.html.
[23]https://www.huffingtonpost.com/entry/democratic-momentum-poll_us_5ae789a7e4b055fd7fcedaac. See also http://www.rollcall.com/news/politics/poll-millennial-support-democrats-slips-9-points-two-years.
[24]https://www.nytimes.com/2018/04/24/us/politics/trump-economic-anxiety.html.

by Democrats seeking to win back the lost votes). As political advice, however, the virtue/culture observation is not particularly useful. It might even seem to suggest that Democrats should become more racist or nativist if they want to win. Such a strategy would likely cost Democrats more votes than it could gain. Nor is it likely that labeling the voters the Democrats need to convince as white-privileged racists would be a winning tactic.

For 2018, elections are mainly local affairs (since President Trump is not on the ballot). The old saying that all politics is local would seem to be particularly apt. Waiting for a supposed inevitable blue wave was never a good approach to the 2018 elections. Overall unemployment below 4%. There is the prospect that that President Trump might emerge from the North Korean affair with something he could brag about (whether or not it truly deals with the issue). So local economic conditions – not macroeconomics or foreign policy – are the main lever available in “swing” districts. Broad statistical studies - where you need to be 95% confident to assert an association - are of limited value in finding the issues that might induce the needed handful of voters to vote for a change in this district or that one.

Mitchell's Musings 5-21-2018: Single Payer

Daniel J.B. Mitchell

California will have its primary election in early June. In fact, because many Californians now vote by mail, that election is already in progress. California has a nonpartisan "top-2" primary system at the state level, thanks to voter-approved ballot propositions. Only presidential primaries retain the traditional partisan system.

All political parties hate top-2. The two major parties hate it because in districts where they have low representation, their candidates may be excluded from the general election. You might have two Democrats facing off, for example, in districts where Republicans have low representation, if a Republican does not at least come in second in the primary. The same is true – in reverse – in heavily Republican areas. Minor third parties don't like the top-2 system because they will almost never have a candidate in the general election. But apparently voters *do* like the system.

Although the examples above refer to "districts," when you take California as a whole, it has become in total a giant district in which Republicans are marginalized. The California Secretary of State's latest estimates indicate that the proportion of registered voters who are Republicans is now only slightly above the proportion with no party affiliation. That is, "no party" may soon become the second largest party in California.[25] No statewide offices are held by Republicans in California.

In the current gubernatorial race, there are four major Democrats, three of which currently hold statewide office and one of which is a former mayor of Los Angeles. The major Republicans are in fact minor political figures. One is a businessman (John Cox) who can self-finance a campaign but who has no political experience. The other is member of the state assembly from Orange County (Travis Allen).

Polls indicate that one Democrat, Lieutenant Governor and former mayor of San Francisco Gavin Newsom, is substantially ahead of the other candidates and will finish first in the primary. So the question is whether the candidate who comes in second will be a Republican or one of the other three Democrats (former LA Mayor Antonio Villaraigosa, State Treasurer John Chiang, and State Superintendent of Schools Delaine Eastin). If it is a Democrat, the general election race could be substantive in terms of issues debated. If it is a Republican, the Democratic frontrunner will likely just coast to victory without much of a contest.[26] That is what happened four years ago when the incumbent Democrat, Jerry Brown (now termed out) ended up running against a minor Republican.[27] If a Democrat

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[25]California has a minor American Independent Party and some voters apparently mistakenly join it thinking they are registering themselves as independents. See: http://www.latimes.com/politics/la-pol-ca-american-independent-party-california-voter-registration-card-20160419-story.html and http://static.latimes.com/american-independent-party-california-voters/. Thus, it is possible, if you add some incorrectly-registered American Independent members, that Republicans already represent a smaller group than intended no-party independents. Registration data are at http://elections.cdn.sos.ca.gov/ror/60day-stwddirprim-2018/historical-reg-stats.pdf.

[26]Newsom admits to preferring that a Republican win the number 2 slot. Republicans also hope for a number 2, not because they expect to win the governorship, but because it would encourage their members to turn out in down-ticket races, notably in some potential congressional swing districts that could affect who controls the House of Representatives. President Trump has endorsed Cox.

[27]One of the quirks of the top-2 system is that even if a candidate receives an absolute majority in the primary, the top two candidates still go to the general election. Other nonpartisan primaries – including those found in local elections in California - typically determine the final winner if one candidate receives over 50% of the vote. In 2014,

comes in second, the goal of that candidate will be to pick up Republican voters who will have to choose between two Democrats.

The polls are quite fuzzy about who will come in second in the upcoming June primary. But if it is a Democrat, it appears that the likely second-ranked candidate will be the former mayor of Los Angeles. One of the issues that would then come up is a favorite among liberal Democrats, single payer health insurance. Newsom, at this stage, says he is for it. But he waffles about the timing and the details. Villaraigosa points to the complications and basically tilts toward infeasibility any time soon. What I would expect in a Newsom-Villaraigosa contest, if it occurs, is that Newsom would play down the complications and emphasize his conceptual support. Villaraigosa would need to appeal to independent centrists and to Republicans in the general election; he would be more emphatic about infeasibility. If a Republican comes in second – and that would likely be Cox – there would be a simple division. Newsom would say he is for single payer; Cox would be against it.

Usually, when single payer is discussed, the emphasis is on funding. But there is often a focus on the budgetary cost to the government rather than the overall cost of the program, including insurance premiums. In effect, going to single payer means that insurance premiums would be relabeled as taxes that would be paid to the single government-run insurer. But the many existing government programs such as Medicaid (Medi-Cal in California) which receive federal funding would have to be folded into the single plan. That redirection of funds would require an agreement with Washington which is not likely under the present administration. And expansion of the program to universal coverage would presumably cost something. Proponents of single payer tend to assume that having one insurer would increase efficiency and decrease the cost of administration, thus providing the funds needed for the added coverage.

Let's put aside the funding aspect and look at political feasibility. And let's even put aside the lack of feasibility of getting an agreement from Washington. There remains a neglected element, path dependency. While – as proponents of single payer often point out – the rest of the developed world has single payer and seems to spend less per capita on health than the U.S., the question for the U.S. (or California) is how you get from the current longstanding (entrenched) program to single payer.

Recall back when Obama was first running for president and promised voters that they could keep their old plan under what became "Obamacare." Of course, that promise was vague on what it was that you could keep, since any major change in the overall healthcare system inevitably would lead to changes in "your" plan. But aside from that qualification, the promise could be made because Obamacare was built on the existing system with its multiplicity of plans: employer-based, individual, public, etc. It was an add-on. Obamacare was basically expansion of the individual market (via the exchanges) and Medicaid along with an employer-based mandate.

Going to single payer means scrapping almost everything we now have and starting something new. You couldn't promise voters that they could keep their old plans; the old plans would disappear. Just to get a sense of what that would mean in California, I prowled around the web and came up with a listing of all the providers operating in California as of 2016 (the latest data available). You can find that list of 106 (!)

Brown received an absolute majority in the primary, but still had to face his rival, Neel Kashkari, in the general election. (Kashkari was a former U.S. Treasury official who is now president of the Federal Reserve Bank of Minneapolis.)

providers in the Appendix. Some of these providers have only minor representation in California. But 57 of them cover at least 10,000 individuals and involve 99.7% of the total. If we go to a higher hurdle, say, at least 100,000 covered individuals, we still involve 97.2% of the total with 33 insurers. If we go to a hurdle of at least 1 million, we go to 70.7% of the total coverage with 7 plans.

There are a lot of insurers out there, but not so many when you raise the hurdle for number of people insured. Still, it is important to note that big insurers, such as Blue Shield or Kaiser, in fact offer multiple plans. There is not just one Blue Shield plan; varying options are available to individuals and employers. All the commercial insurers, except for the very smallest, are likely to resent being put out of business in California, which is what single payer would do. And the few big ones in the state could easily organize to finance a considerable opposition campaign against single payer.

Moreover, it would not be possible for proponents to make even the qualified Obama promise that you could keep your old plan. Thus, an opposition campaign could count on drumming up considerable voter fear of losing their existing coverage for something unknown. Maybe you as a voter are not totally happy with your existing plan. The notion applies here that the devil you know is likely to outweigh what you don't know.

In short, the political problem is not just one of an unfriendly regime in Washington. Perhaps there will be regime change in Washington someday. But there still would be plenty of opposition locally in California to single payer, even if – in the abstract – there appears to be voter support for the concept.[28] Polls on the subject tend to focus on cost, taxes, and budgets. A more important approach would be to ask the simple question: Would you favor single payer *if* you couldn't keep your existing plan? I suspect abstract support for single payer would drop significantly if that question were asked.

Countries around the world that have some version of single payer didn't implement it after they had created a long-entrenched alternative. It's another case of American exceptionalism.

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Appendix:

California Health Insurance Providers & Number of Covered Persons (Public and Private): 2016

Insurer	Number Covered
Access Senior HealthCare	1,887
Adventist	15,832
Aegon US Holding	3,448
Aetna	655,203
Alameda Alliance	267,040

[28]http://www.ppic.org/press-release/health-care-most-oppose-house-bill-favor-single-payer-plan-unless-it-raises-taxes/. Fifty-six percent of voters in California reportedly support abstract single payer.

American International	5,205
American National	30
American States	4
AmericasHealth Plan	436
Anthem	3,727,394
Arch	152,797
Aspire Health Plan	1,568
Assurant Inc	2
Assurity	2
AXA INS	219
BCS	639,133
Blue Shield	3,007,066
Brown and Toland	9,332
CA Society of CPAS	6,121
CalOptima	800,001
CalViva Health	359,697
Canopy Health	14,265
CareMore	56,622
CenCal	179,155
Centene (Health Net)	3,281,781
Central California Alliance for Health	352,112
Central Health Plan	33,979
Chinese Community Health Plan	23,137
Choice Physicians	14,805
CIGNA	310,883
Cincinnati	2
Citizens Choice	20,731
Combined Ins. Co. of America	2
Community Care Health Plan, Inc.	4,844

Community Health Group	291,313
Contra Costa Health Plan	194,891
DaVita	495,189
Dignity	30,136
Easy Choice	30,861
Epic	58,380
Financial Holdings	1
Geneve Holdings	299
Golden State	7,142
Guardian	24
Hartford	2,102
Health Plan of San Joaquin	343,837
Health Plan of San Mateo	126,440
Heritage	594,664
Humana	97,597
Imperial	2,574
Inland Empire	1,257,559
Inter Valley	22,642
John Hancock	10
Kaiser	8,370,850
Kemper	14
Kern Family Health Care	234,491
L.A. Care	2,056,926
Liberty Mutual	1
Massachusetts Casualty	10
Medi-Excel, SA de CV	6,873
Metropolitan	85
Molina	684,342
Monarch Health Plan	51,781

Mutual of Omaha	1,990
National Foundation	10
National Health	2,287
National Union of Pittsburgh	9,525
Nationwide	24,514
New York Life	7
Nippon	13,363
Northwestern National of Milwaukee	13
On Lok	1,443
OneAmerica Fin Partners	1
Oscar	4,101
Partnership	571,581
Physicians Mutual	9
Positive Healthcare	1,470
Premier	38,798
Primecare	201,715
Primerica	12
Prospect	8,188
Providence Health Network	14,763
Prudential	200
San Francisco	148,160
Santa Clara Family Health Plan	280,127
SCAN	170,945
Scripps	103,528
Seaside Health Plan	38,866
Sharp	130,833
SIMNSA	44,969
Stanford	1,054
State Farm	4,552

Sutter	48,284
THRIVENT FINANCIAL FOR LUTHERANS	2
TIAA FAMILY	1
Torchmark	67
Trustmark	8
United Agricultural Employees	31,058
United American	240
UnitedHealth	1,169,875
Universal Care	13,966
Valley Health Plan	167,464
Ventura County Health Plan	16,303
Washington National	3
Western Growers	65,105
Western Health Advantage	128,401
Grand Total	**32,363,570**

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Source: https://www.chcf.org/wp-content/uploads/2017/12/ZIP-CaliforniaHealthInsurersDataPublished2017.zip

Mitchell's Musings 5-28-2018: All Politics is Local – Except When It Isn't

Daniel J.B. Mitchell

Former Democratic House Speaker Tip O'Neill supposedly said that "all politics is local." What the phrase seems to mean is that issues in state and local races (essentially every race except for the presidency) are primarily determined by local conditions and issues. What it doesn't mean, however, is that the impact of local races matters only locally. A few seats in the House or Senate, for example, can determine which party controls the chamber and – potentially – the national agenda.

There is a problem when all politics is local, but the national agenda is a product of the collectivity of local races. In effect, the analogy is with externalities in economics. The incentives for candidates at the micro (state and local) level is to do what needs to be done to maximize their chances of winning. What they need to do is to focus on locally-based strategies. If there is a benefit or a cost to the national polity in following those strategies, such considerations are underweighted.

In California at the present time, local conditions have occurred which could have national repercussions – particularly on which party will control the House after the 2018 election - but which seem to be left out of the calculation by Democrats. Of course, there is another quote that is attributed to humorist Will Rogers – "I don't belong to any organized political party; I'm a Democrat." Perhaps that approach, too, is playing out in California.

I have in mind specifically the current gubernatorial race. Because Republicans have been marginalized as a party in California, there is virtually no doubt that the next governor of California will be a Democrat. Four major Democrats and two Republicans are running to succeed incumbent Democrat Jerry Brown who is termed out. All candidates must first compete in a nonpartisan "top-2" primary in early June. Whichever candidates come out first and second will then compete in the general election in November. If two Democrats come out in the top 2, there will be no Republican in the general election. But if a Republican comes in among the top 2, there will be a more traditional Democrat vs. Republican race (which the Democrat will go on to win).

According to polls, the lead Democrat is the current Lieutenant Governor, Gavin Newsom, a former mayor of San Francisco. It appears that the second Democrat is former mayor of Los Angeles, Antonio Villaraigosa. (The other two Democrats don't seem to have gotten traction.) Villaraigosa has the support of wealthy charter-school proponents who are providing significant monetary support. And he is a Latino in a state in which the Latino electorate is significant and growing. Finally, he is well-known in the more populous southern region of the state because of his two terms as mayor of LA. Nonetheless, he seems to be behind Newsom in the polls and the question is whether Villaraigosa or one of the Republicans will come in second – and thus proceed to the November general election.

Among the Republicans, there is a wealthy businessman, John Cox who has confessed to not having voted for Donald Trump in 2016. (He says he voted for the Libertarian.) His opponent is a state assemblyman, Travis Allen, who styles himself as the real conservative. Allen *was* a Trump supporter in 2016. Nonetheless, Trump has officially endorsed Cox. I will come back to that anomaly in a moment.

From the "all-politics-are-local" viewpoint, frontrunner Newsom would logically prefer that one of the Republicans win second place. If it's Newsom vs. a Republican in the November general election, Newsom is virtually guaranteed to win. In contrast, if it is Newsom vs. Villaraigosa, i.e., a race between two Democrats, the outcome is less certain.

Newsom's calculation in preferring a Republican opponent doesn't have to be surmised. He has said he prefers a Republican opponent. And since Cox seemed to be the stronger of the two Republicans, especially with the Trump endorsement, Newsom has run a TV ad which attacks Cox, alone among his Democratic and Republican primary opponents. The strategy seems to be to elevate Cox as THE true Republican opponent, thus getting Republicans united around Cox, and thus pushing Cox into second place, leaving Villaraigosa out of the running in November.

Republicans know that they are not going to elect the next governor. But if there is no Republican in the gubernatorial race, Republican turnout could be low in the general election. In the background is the U.S. Senate race in which the Republicans have no major candidates in the primary, thus ensuring that in November, the Senate race will be between two Democrats. If there is no Republican candidate for governor and no candidate for U.S. senator, the lack of candidates could depress Republican turnout.[29]

Why would that outcome matter to Republican party leaders? Because there are some key congressional races in California in potential "swing" districts. Those district elections could determine who controls the House. Republican turnout could be key in such districts. That consideration is not something that Newsom seems to be worried about – he is the all-politics-are-local example. What could guarantee his success in winning the governorship in November could also lead to continued Republican control of Congress. But the national repercussion is an underweighted externality in his calculation.

For Republicans, in contrast, local and national strategies align. Getting more turnout by having a Republican in the gubernatorial race will likely increase the odds of retaining control of the House. But there are also swing districts in the state legislature. Democrats in recent years teeter on having two-thirds majorities in the state assembly and state senate. When they have such a supermajority, Republicans can be totally ignored. When they don't, Republicans – even in their diminished condition in California – have some leverage. Thus, it's no mystery why California Republicans prevailed on President Trump to endorse Cox, despite the latter's non-support in 2016.

What has happened, in short, would be well understood by Tip O'Neill – even if he would be disappointed in the outcome. And probably Will Rogers would understand why Republicans seem to have a more coherent strategy than Democrats. Add in the economists' views on underweighting externalities and you have a pretty good explanation of what has occurred in the California primary.

[29]Republicans have put proposition on the November 2018 ballot which would repeal a gasoline tax earmarked for roads and transportation. Part of their strategy is that by putting a tax repeal on the ballot, anti-tax Republicans will turn out in November. Still having a governor candidate to vote for would be an added incentive for Republican turnout.

Mitchell's Musings: June 4, 2018 – Watch the Donut

Daniel J.B. Mitchell

When you go through life make this your goal,

Watch the donut, not the hole.

The Donut Song[30]

After much fanfare from the president about his planned "summit" meeting with the leader of North Korea, he appeared to be walking away from the negotiations before they formally began. President Trump suddenly seemed to announce that there would be no meeting. This seeming reversal led to learned analyses of why the process had failed – and was always doomed to fail. Example:

> *…(The) heady dream is over — or at least indefinitely deferred — done in by an intractable issue that proved more complex than Trump had understood and the conflicting agendas of other nations, whose leaders did not respond to the mix of threats and blandishments he deployed*.[31]

The problem with this sort of analysis should be apparent to anyone who is familiar with labor negotiations. Walking away from the table is, or can be, a form of negotiations. Negotiations consist of more than parties meeting in person in a room and exchanging demands and offers. What they do and say outside the bargaining room is a form of communication that can be as important as any face-to-face exchanges of words.

In the context of collective bargaining, there is the concept – including a legal concept - of an "impasse." Reaching an impasse does not mean that no agreement will ever be reached. Instead, it means that *in current circumstances*, no further progress can be made. When one party declares an impasse, it is saying that it cannot make further concessions. In collective bargaining law, when an impasse is reached, both sides are free to take unilateral action. The employer can put in place terms and conditions of employment. The union can reject those terms and strike in response.

There are obvious limits to applying the collective bargaining analogy to international negotiations. But ultimately in each case, what surely matters is the eventual outcome. There is a difference between the goals the parties are separately trying to achieve, the outcome at the end that is collectively achieved, and the tactics that produced the outcome.

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[30]https://www.youtube.com/watch?v=tzV-8TofHTw.
[31]http://www.latimes.com/politics/la-na-pol-trump-norkor-20180525-story.html.

I am no fan of President Trump. It may well be that his goal with regard to the Korean situation is the wrong one. For example, his goal might be *any* outcome that makes the president look good domestically, especially before the 2018 or the 2020 elections, regardless of its substance or long-term implications. It could also be – due to unknown future events - that the eventual outcome with North Korea will be bad for the U.S., even if the goal of president were a good one.[32] But walking away from the table, or - in this case - threatening not to arrive at the table, is potentially just a form of communication to the other side. And note that it was accompanied by a letter that provided a rationale for walking away. Saying the meeting is off is not in itself a failure, nor a victory, nor anything in between. It's the hole; it is not the donut.

From a domestic political point of view, criticism based on a tactic which is a commonplace in negotiations could easily prove to be counterproductive for Democrats. Within a short time after the articles analyzing the purported failure of the process were published, word came that planning for the summit meeting was still being carried out by both sides. The meeting might yet take place as originally scheduled. Or it might take place later at some date to be determined.

I have no knowledge as to whether there will be a meeting or when it might occur. I have no knowledge of what the actual goals of the two sides are. I have no way of knowing what the outcome might be, if there is a meeting. But I do know the difference between tactics, goals, and outcomes. And I know that I have yet to see those pundits who quickly analyzed the seeming failure of the process publishing anything that admits they were too hasty in their evaluations. They have yet to admit they were watching the hole and not the donut.

[32]In prior musings, I have expressed the view that issuing military threats without doing such credibility-building things as moving ships and troops, is not a good tactic. It suggests that threats are not to be taken seriously which can be dangerous if in fact they are serious. Misjudgments over what is credible and what is not could lead to the parties stumbling into a conflict by accident. In contrast, the president *can* credibly threaten not to show up at the negotiations. Troops and ships are not needed to not show up.

Mitchell's Musings 6-11-2018: Missing the True Problem

Daniel J.B. Mitchell

When President Trump tweeted in advance of the official release date about good labor market news to come, there was much resulting discussion about insider trading.[33] But that discussion misses the point. The problem with his tweeting was not insider trading.

Let's first note what insider trading means, keeping in mind that yours truly is not a lawyer. Basically, it involves acquiring and trading on information that is not available to the general public. If a drug company, for example, has discovered a new drug that is potentially valuable and if some executive of the firm buys stock in the firm before the official announcement, that purchase is insider trading. In principle, if you are caught doing insider trading, Bad Things happen to you.

One interpretation of the rationale for the ban on insider trading is that such trading is unfair to those without access to the inside knowledge. In the example above, the general public will not be aware of the news about the drug until after the official announcement. By the time most folks can trade on that knowledge, the stock will already have risen in value, particularly if insiders are already bidding up the stock.

Note, however, that - in practice - only those traders who can react almost instantly to the news will gain, even without insider leakage. So one could debate whether the result is really fairer than if "insiders" – such as the hypothetical insider-executive – get the benefit. In strict economic terms, where fairness is not considered, it doesn't really matter who gets the gain. The only thing that matters is that the stock quickly reflect the true value of the firm – including in that valuation the discovery of the new drug.[34]

In the case of the president's leak, there are two points to be made. First, unless he or someone in his circle somehow traded on the information that was leaked, he/they did not engage in insider trading. Second, his tweet was a public release that anyone with access to Twitter could have read. So the

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[33]https://www.nytimes.com/2018/06/01/us/politics/trump-jobs-twitter.html.

[34]An argument could be made that if you allowed insider trading, insiders might have incentives to leak false information and trade on it. Someone could leak information about a supposed new drug – which didn't actually exist – and then trade on the false information (buy the stock, hold it until it rises in price, and then sell it before the truth is revealed. Allowing such a practice could make the market less "efficient" because of the difficulty in distinguishing between real news and false news.

information *was* available to the general public, albeit not at the official release time. Trading on public information is not insider trading.[35]

Finally, what the president hinted at was good news in the labor market – which turned out to be a drop in unemployment to 3.8%. Unlike the drug company example, however, it is not clear what one might expect the stock market to do in response to that news. One response could be that the low unemployment rate was statistical confirmation of a strong economy - which should be good for stocks. If you thought that response was likely, you should buy stocks. But another response could be that the very low unemployment rate was a sign that the economy was overheating, that inflation could be the result, and that the Federal Reserve would likely raise interest rates as a reaction. Other things equal, a rise in interest rates might be bad news for stocks. It could mean that the economy would slow down. It could mean that investors would move money from stocks to bonds (which would have higher yields).[36] So with advance information, you should sell stocks.

Given this background, what was the problem with the president's leak? What's wrong with the leak has nothing to do with insider trading and everything to do with the integrity of government official data. There is always suspicion that government data releases are being rigged to make the incumbent regime look good. Indeed, during the second Obama campaign, there was fake news from Obama's opponents suggesting such a rigging was occurring.[37] The reason that there are official pre-announced release dates set well in advance is to minimize such suspicions. With dates fixed long in advance, there should be no suspicion that data were being released with the timing established for political purposes.

In the past, if presidents were tempted to fiddle with data announcements, there were folks in the administration that steered them away from the temptation. During the Nixon administration, for example, George Shultz (Labor Secretary, OMB Director, and then Treasury Secretary), discouraged the president from an advance announcement of good-news data.[38] Apparently, in the current administration, Gary Cohn – former director of the National Economic Council – played the Shultz role

[35]It has happened in the past that the Bureau of Labor Statistics (BLS) accidentally put an important data release on the internet before the official release time, and someone noticed it and traded in response, simultaneously informing the BLS that the information was in fact public.

[36]The movie the "25th Hour," suggests that labor market information is valuable to markets – but doesn't actually explain what the trader shown did in response to his guess about weekly unemployment insurance claims: https://www.youtube.com/watch?v=YVHY9nIPo6s.

[37]http://www.stat.columbia.edu/~gelman/research/published/ChanceEthics6.pdf.

[38]A recording of a phone conversation between Nixon and Shultz in which the latter restrains Nixon's urge to put out data early is at:
https://www.youtube.com/watch?v=1qV84JmgwVE.

with President Trump.[39] But he is gone now. And there is no one in the White House who can exercise restraint and conformance to established practice in order to protect the integrity of official data. That lack of control – not insider trading - is what the problem is.

[39]https://www.politico.com/newsletters/morning-money/2018/06/04/cohn-kept-the-jobs-numbers-for-trump-240624.

Mitchell's Musings 6-18-2018: The Donut Doesn't Look So Good

Daniel J.B. Mitchell

When you go through life make this your goal,

Watch the donut, not the hole.

The Donut Song[40]

In my June 4th musing, I started with the quote above. The theme was simple. President Trump had recently announced a cancellation of the planned "summit" with North Korea over nuclear weapons. I noted in that musing that walking out of negotiation was a *tactic*, not an ultimate *outcome*, and that critics should await the outcome – the donut. I further noted that in collective bargaining, walking out of a negotiation as a tactic was not unusual. But since the parties to a collective bargaining negotiation will likely eventually have to work out "something" (a contract, typically) – it is the resulting agreement, not the tactic which led to that outcome, that must be evaluated. Watch the donut, in other words, not the hole.

Of course, as it turned out in the North Korean affair, there was a summit in Singapore as had originally been planned. The Trump walkout was temporary and was rescinded. But the donut that emerged from the meeting was a vague agreement that, other than a return of soldiers' remains from the Korean War, didn't include what appeared to be a key objective, i.e., specific steps toward denuclearization. Moreover, President Trump after the meeting with Kim Jong-Un threw in an announcement that planned U.S. military maneuvers with South Korea would be cancelled, apparently without consulting South Korea or his own military. Not surprisingly, and with good reason, critics pointed to the ultimate donut that emerged from the summit and its aftermath as a win for North Korea.

But let's go back to the collective bargaining analogy and let's view the outcome from that perspective. Collective bargaining agreements do sometimes leave difficult issues unresolved and, in any case, don't attempt to deal with every possible situation that could emerge during the contract's duration. Perhaps the most obvious example is the fact that virtually all union-management contracts have a grievance-and-arbitration clause. If either party believes the other is violating the contract, a mechanism is in place to provide a resolution. Suffice it to say, there is no such mechanism in the deal that was signed with North Korea. That absence of a mechanism alone suggests that a rancid donut was produced.

[40] https://www.youtube.com/watch?v=tzV-8TofHTw.

But there is another lesson from collective bargaining that may be more significant. As with international negotiations, collective bargaining is a repeat game, not a one-time process. In the latter case, contracts are periodically renegotiated when they expire. In the former case, nations continue to live on the same planet and have to deal with one another indefinitely. In such situations, the deal you reach today can influence future deals and your future relative bargaining power.

For example, the date on which a union-management contract expires (which is part of any negotiation) matters in the future. Thus, if you were a union negotiator bargaining with a hotel that had a seasonal business – say, a peak season in the summer – you would push for an expiration date that would allow a strike in the summer. And, of course, from the management perspective, you would want a winter expiration.

What Kim Jong Un and the North Koreans learned from the Singapore summit – and from their and Trump's previous behavior – is what President Trump most wants is a situation in which he comes out looking good domestically. He plainly didn't like North Korean atomic bomb tests and missile launches. He didn't like bellicose North Korean threats against the U.S. All these things made him look bad. He temporarily cancelled the summit when North Korea made statements that seemed to suggest they were the winners simply by forcing him to meet. The summit was put back on track when such comments from North Korea ceased. And the whole event in Singapore was conducted with much pageantry that made Trump look good.

As a result, the North Koreans know now what makes Trump look good, and what makes him look bad, and what his objective really is. If they tested bombs or launched missiles shortly before the 2018 or 2020 elections, Trump would look bad. Even making statements around those times that they had won would make Trump look bad. In short, they have acquired leverage – bargaining power – that can be used in the future. Put another way, what's wrong with the donut is not that it doesn't immediately produce denuclearization. It is that the deal 1) has no mechanism for resolving its ambiguity and incompleteness, and that it 2) gave North Korea more leverage in future dealings with the U.S. To mix a metaphor, that's the way this donut has crumbled.

Mitchell's Musings 6-25-2018 - The World: You've Heard of It?

Daniel J.B. Mitchell

Note: This will be the last of the regular weekly Mitchell's Musings. The website for the Employment Policy Research Network - EPRN, while still linked to the larger LERA website, is no longer being supported technically. As a result, images such as charts no longer can be uploaded. Although past musings are also available on other sites, it has become complicated to keep the series going, hence the discontinuation.

One source for back issues is https://archive.org/details/@danieljbmitchell (and search there for musings). Another source is https://issuu.com/danieljbmitchell.

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From time to time, these musings have taken up the issue about balanced U.S. trade, which is said to be an objective of the Trump administration. The administration has been both imposing tariffs on various goods and threatening to do so, seemingly to pursue balanced trade. As with other pursuits of the administration, the actual goals and priorities are not clear. But balanced trade would bring about a net enlargement of jobs in the manufacturing sector (albeit not to anywhere near the proportions of the workforce back in the 1950s and 1960s).

In part because the administration's goals are fuzzy, the reaction of the news media has been to call on pundits who then say things about international trade generally, but who tend to jump from issue to issue. There are warnings by pundits about trade wars that could develop, references to the Smoot-Hawley Tariff of 1930, and discussions about the benefits from trade (often taken from fading memories of Economic 1A). To the extent that references are made to the balanced trade issue, the discussion typically notes that protecting an *ad hoc* group of industries may benefit those industries (and their workers), but that their protection may harm other industries that are users of the protected products. The thrust of such commentary is that the effect of the tariffs on the U.S. balance of trade is "complicated" because opposing forces are set in motion.

A more sophisticated version of the "it's complicated" commentary goes back to the national income identities. As you can find in any international economics textbook, at the end of the day S – I (must) = X – M, where S = Saving, I = Investment, X = exports, and M = Imports. The true reason, it is said, that American X – M is negative is because I > S. And since tariffs don't directly change I or S, placing tariffs on particular industries such as steel or aluminum will not improve the overall trade balance even if we import less steel or aluminum. Some other industries will experience more imports to offset the steel and aluminum effects.

That observation, taken by itself, is largely true. (I say "largely" because raising the domestic prices of steel and aluminum could conceivably have some effect on S and I through various indirect channels.) But there tends to be a leap after that observation to the idea that there is NO trade policy that could be enacted that would have any effect on the U.S. trade balance, X – M. And that implication is incorrect.

As I have noted in prior musings and elsewhere, a policy advocated in the 1980s by financier Warren Buffett could bring about a zero trade balance.[41] Essentially, the Buffett plan involves no tariffs or quotas or protection of particular industries. It does not involve singling out individual trading partners of the U.S. as trade villains. It does not involve pointless debates over whether currency values are being "manipulated." The Buffett Plan is essentially a variation on the "cap-and-trade" approach that is sometimes applied in the case of anti-greenhouse gas programs.

Under the plan, any entity exporting one dollar's worth of goods and services from the U.S. would earn a voucher entitling it to import one dollar's worth of imports. There would be no imports allowed without the necessary vouchers. Exporters could either use their vouchers or sell them to importers. M could thus be no larger than X. Trade would be balanced. If you do the math, you will find that the actual exchange rate plus the cost of acquiring the voucher would be equivalent to that dollar exchange rate that would be needed to bring about balanced U.S. trade.

Various objections are typically raised. One is that having balanced trade isn't necessarily a Good Thing. That is a valid point but off the mark. Perhaps the goal is wrongheaded. But that is a different issue from whether the Buffett plan could "work," i.e., whether it would produce balanced trade. So the next line of attack is the $S - I = X - M$ identity. Obviously, if $X - M = 0$, then $S - I$ must also be 0. But what mechanism is there in the plan to bring about $S = I$? There is in fact no specified mechanism for S or I in the plan, but I will assert that nevertheless market and behavioral forces would be set in motion to ensure their equality.

I will further assert that we already know of an economy which has been constrained to have $X - M = 0$ and that has somehow been forced by that constraint to end up in a situation where $S = I$. The economy I have in mind is called "the world." You've heard of it, no? So far, we have detected no life on other planets, not even microbes. As a result, we are constrained on Earth to have no trade with Mars or with any other non-terrestrial economy. Thus, for the world, the global trade balance is now, and has always been, constrained to be zero. Given that constraint, the world's S must adjust to be equal to the world's I. And the world's I must adjust to be equal to the world's S. Somehow, those adjustments happen! They have always happened! As Adam Smith might have said, an "invisible hand" brings about the equality.

While you are pondering that point, there is a secondary observation to be made. The criticism of the current policy of putting tariffs on particular products to bring about zero trade is largely correct, for reasons spelled out above. That criticism could also be applied to any trade deal that might be reached with a particular country, e.g., China, for much the same reasons. If the Trump administration really wants a zero U.S. trade balance, the Buffett tool for reaching that goal is available. So if the administration doesn't use that tool, or some equivalent, the reason can only be because having a zero balance is not the real goal. You might then conclude that *appearing* to have that goal, rather than actually achieving it, is the true objective. And you would likely be right.

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[41] http://www.zocalopublicsquare.org/2017/01/09/cap-trade-solution-trade-dispute-china/ideas/nexus/