Mitchell’s Musings: Fourth Quarter 2014

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Mitchell's Musings 10-6-14: Dialogue or Balance in the Ivory Tower?

Daniel J.B. Mitchell

Academia is often described pejoratively as an Ivory Tower. I say "pejoratively" because the image of the Tower is one of a world somehow isolated from external reality. There is some truth to the image, but not entirely. The real world in fact constantly intrudes into academia. There are always the usual constraints of budgets, resources, and the pressures of competition with other institutions. Sometimes conflicts from outside the Tower make their way in.

One special value that runs through academia, however, is *academic freedom,* particularly for tenure-track and tenured faculty. But when academic freedom is considered, the discussion is often inconsistent. Let's take "civility" for example. Recently, the chancellor at the University of California (UC)-Berkeley was criticized for suggesting that differences of opinion are best discussed with civility. Outside the Tower, such an assertion might be greeted with a yawn. It's motherhood and apple pie stuff! But within certain circles of academia, alarm bells went off. You see, in those circles the chancellor was arguably talking in code about something else. Spoiler alert: It was the Middle East and Israel-Palestine to be more exact.

Before we get to the details of the "something else," let's note that the dispute over civility at Berkeley spilled over to my own campus at UCLA where the student newspaper wrote an editorial saying that the Berkeley chancellor just shouldn't be talking about civility.[1] That is, in defense of academic freedom and free speech, the editorial prescribed what the Berkeley chancellor should and shouldn't say! Did anyone notice the paradox? If anyone did, I didn't notice.

On another campus – this time at UC-Santa Barbara – we had an incident in which a professor got into a physical altercation with an anti-abortion high school student/demonstrator. The professor argued in her defense that her reaction was the result of "triggering" by a placard carried by the demonstrator.[2] It was OK to be uncivil because, well, she felt like it. (That sort of defense, unfortunately, is taken more seriously in academic circles than in the court system where she was sentenced to three years of probation plus some community service and anger management classes.) The Santa Barbara incident took place among a more general discussion of whether university syllabi should have "trigger" warnings about topics that might upset a student. That is, students should be warned about possible ideas in courses that might upset them. (Fortunately, the trigger wave seems to have passed after a good deal of ridicule from outside the Tower.)

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[1] http://dailybruin.com/2014/09/15/natalie-delgadillo-civility-should-not-enter-into-the-campus-discussion-about-free-speech/

[2] http://articles.latimes.com/2014/mar/31/local/la-me-ra-the-liberal-professor-antiabortion-trap-20140331 and http://www.independent.com/news/2014/aug/18/ucsb-professor-sentenced-probation-community-servi/.

In short, there seems to be a desire among some folks in academia not to be confronted with opinions with which they disagree and, if they can't avoid such ideas or control them, to be free to be as uncivil about it as they like.[3]

So let's get back to the "something else" behind the civility issue at Berkeley. What was actually being discussed by the Berkeley chancellor, in the view of his anti-civility critics, was the Israeli-Palestinian conflict in the Middle East. Now the Middle East is a complex place with many, many conflicts and lots of forces intent on fanning those conflicts. There are some students and faculty, however, focused only on Israel-Palestine and who are pushing for university divestment of, and academic boycotts of, Israel. Rhetoric around the issue sometimes gets out of hand and there are then learned debates about whether particular anti-Israel statements are actually anti-Semitic or just critiques of a policy.

Calls for "civility" are thus generally seen more aimed at the anti-Israel group than the pro-Israel group. This interpretation was particularly likely to be drawn after the arrest and conviction in 2011 of some Moslem students who attempted to interrupt a speech by the Israeli ambassador at still another UC campus.[4]

I don't know if the local anti-civility agitation has prevented the UCLA chancellor from making a public call for civility comparable to the one at Berkeley. Maybe it has; maybe not. If you read further, you will find an official UCLA reference to "civil dialogue" as a Good Thing. There is at UCLA, however, an alternative strategy to deal with the Israel-Palestine problem by demonstrating that there is "balance."

The balancing act idea may actually have started with the UC Regents. The Regents annually select a student regent-elect who serves one year and then becomes a student-regent for the second year. There is some process – I have no idea what it is – that presents the Regents with a student candidate that they end up choosing, usually without much debate or fanfare. But two years ago, the process produced an anti-Israel Muslim woman student who supports divesting and boycotting.[5] The Regents spent time on the issue – more time than usual – before selecting her. Somehow, the next year the very same process produced a pro-Israel Jewish male student – "balance" don't you see?[6]

There is something of interest not necessarily foreseen by the Regents that came out of the dual and "balanced" choice. The terms of the student regent-elect and the student regent overlap for one year. Somehow, the two of them decided they could work together on matters

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[3]Full disclosure: I am on the executive board of the UCLA Faculty Association which voted to take a stance against what the Berkeley chancellor said. I voted AGAINST the resolution (I was the only negative vote) because a) I agree with what the chancellor said and b) there are too many other pressing issues facing faculty – tangible economic concerns – to engage in obscure side issues.

[4]https://www.insidehighered.com/news/2011/09/26/students_found_guilty_in_uc_irvine_heckling_case.

[5]https://www.youtube.com/watch?v=3LxXT8ocax4.

[6]https://www.youtube.com/watch?v=5l-e3rRDZxE.

of concern to students. As far as I know, the Middle East simply hasn't come up as one of those issues. The lesson seems to be that if you push people together with very different world views, at least sometimes they can cooperate. Balancing is not the key; fair-minded, civil dialogue is.

I recently attended a presentation by a fellow named Ali Abu Awwad, a Palestinian who lives on the West Bank. He was imprisoned on two occasions by the Israelis during demonstrations and his brother was killed in a confrontation at a checkpoint. At some point, however, he decided that dialogue was a better approach than violence and confrontation. He is currently touring the U.S. with an Orthodox Jewish Rabbi *from a West Bank settlement* with whom he made contact under sponsorship of a Christian organization. You can find out more at http://www.friendsofroots.net/.

At UCLA, when there are complaints about anti-Israel faculty and events – one research Center (the Center for Near Eastern Studies) seems to be the focus of those people and events – the official response is that UCLA has another Center which is pro-Israel. Events and programs can be trotted out to demonstrate "balance," i.e., some are pro and some are con. Consider a recent official UCLA response to the issue:

*"Academic units all across our campus are constantly working to provide programming that exposes our students and the public to a vast range of perspectives and topics. In fact, three centers at UCLA focus on Middle Eastern Affairs and regularly provide programming on Israel, among other topics: the Center for Near Eastern Studies, the Younes and Soraya Nazarian Center for Israel Studies and the Center for Middle East Development. Israeli academics, students, speakers and artists are regularly part of programming at UCLA. We recognize many subjects may engender passionate debate and difficult conversations and we encourage **civil dialogue** that appreciates the paramount importance of free expression, academic freedom and a respectful exchange of ideas."*[7] *[Bold face added.]*

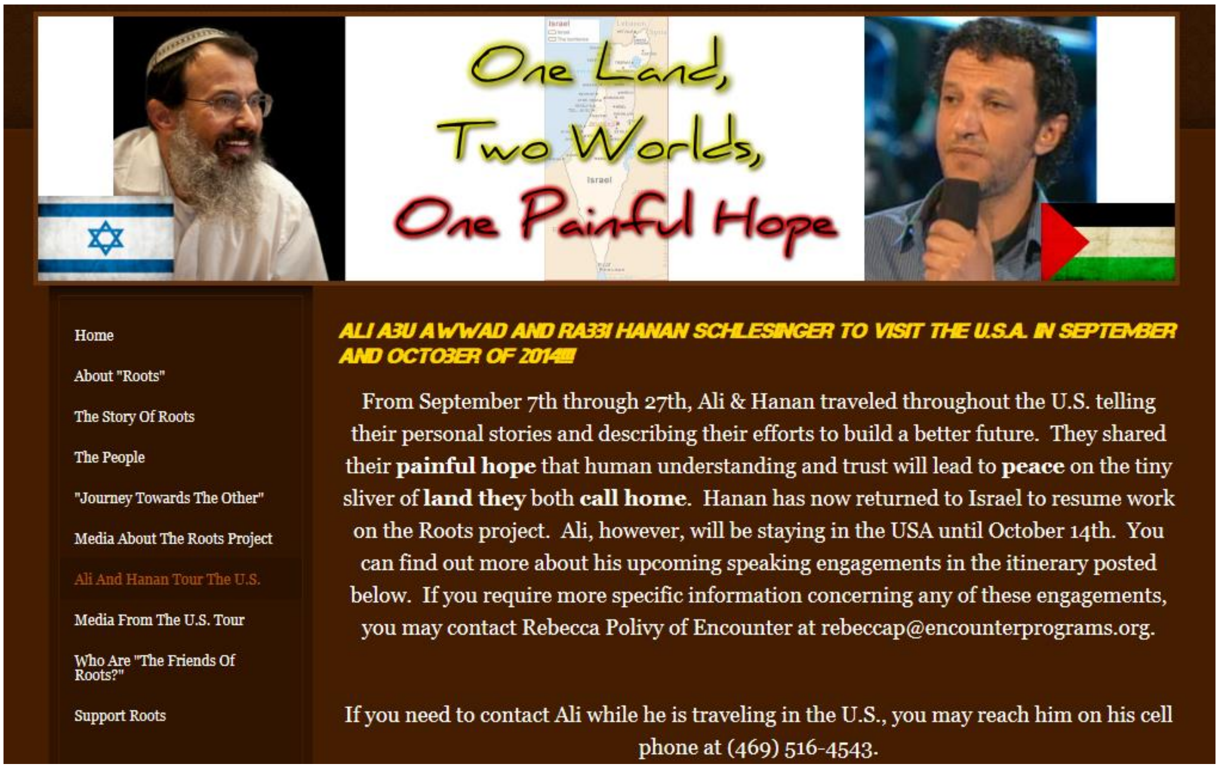
Any student of labor relations (my own interest) or any other form of conflict resolution can see the problem with this official response. There is no dialogue inherent in balancing, civil or uncivil. Balance is marginally better than imbalance, I suppose. But unlike the student-regent and the student-regent-elect, who were forced by their positions to engage each other, and unlike Ali Abu Awwad and his rabbinical associate who voluntarily chose to engage each other with civility, there is nothing in the balancing approach that brings about any engagement.

Yes, with balance, you could wander from program to program at UCLA and hear different views on the Israeli-Palestinian conflict. But the holders of those views remain separate and in isolation. Separate but equal and lack of dialogue is itself a problem – not an answer - and the larger problem isn't solved by demonstrating balance. Every program doesn't have to be

[7] https://www.insidehighered.com/quicktakes/2014/09/18/pro-israel-groups-question-federal-funds-middle-east-centers.

precisely balanced and there certainly shouldn't have to be "trigger" warnings to protect anyone from hearing something he/she doesn't like. But just having different messages and opinions in totally separate presentations and classes (hopefully, at least, expressed in civil terms) – while better than no balance at all – can't be the complete solution. Civil dialogue is needed, perhaps with encouragement from the powers-that-be if faculty cannot do it themselves.

Maybe on some future trip to the U.S., Mr. Awwad might drop by the UCLA campus. Maybe someone in authority might want to invite him. His phone number can be found below.



And if there are other universities with the same campus problems, the same advice applies.

Mitchell's Musings 10-9-14: The Menu Option [incorrectly dated; should be 10-13-14]

Daniel J.B. Mitchell

Getting a college educations is expensive. No news there. However, public universities – which rely on state subsidies for a significant portion of their "core" educational expenses – were subject to substantial budget cuts during the Great Recession. Even in the recovery, they find themselves behind in the public subsidy and so seek alternative revenue sources. One obvious source is tuition.

In my own University of California system, roughly one out of ten dollars in the budget now come from the state. That dollar is more or less matched by tuition funding. The other eight dollars result from research grants, patient revenues on campuses with hospitals, and other miscellaneous sources such as administering what used to be called the nuclear labs – a leftover from the World War II Manhattan Project.

Now there is room for argument about what "core" educational expenses are. There is much overhead involved in running a university for such things as utility service, policing, libraries, computer services, etc. So it isn't precisely true that there isn't some fungibility between, say, grants for specific research projects and core expenses (e.g., running the English department). Moreover, one can argue about what is the true marginal cost of admitting an extra student. (Presumably, it varies depending on what major the student takes, among other factors.)

While it's fun to argue about such matters, at the end of the day, there are only so many dollars entering the system and if some are cut off, either some activity is reduced or alternative funding has to be raised. It's nice to talk about eliminating waste but in the end, the story is not going to be about painless cutbacks.

Tuition is actually a complex story that goes beyond the sticker price. Different students paid different amounts depending on "need" as measured by factors such as family income. So dollars are recycled among students through a redistribution mechanism. In addition, some dollars come from outside the system such as federal aid to students. Typically, state university systems offer lower tuition to in-state residents than out-of-state. Thus, when dollars are scarce, the temptation is to admit more out-of-state and foreign students who generally pay the sticker price and receive no subsidy. (The story becomes still more complicated at the grad student level where they may be subsidies, particularly at the doctoral level).

The issue is in good measure a political one for public universities. In California, the legislature and governor ultimately determine how much subsidy the university systems (University of California, California State University, community colleges) will receive. For UC and CSU, especially, the legislature knows that cutbacks in state funding will likely lead to tuition increases. But unlike tax increases, the legislature doesn't have to do the dirty work. Indeed, it can point with horror to what the universities are doing when tuition rises. It can also complain when universities raise the proportion of out-of-state students for the added sticker price revenue.

Just as with defining core educational expense or the marginal cost of adding a student, it is possible to debate whether admitting an out-of-state student displaces a local resident. It all comes down to an argument about how many locals the university would otherwise have admitted. Since what would have happened otherwise cannot be observed, the issue remains fuzzy. Nonetheless, even if a university claims that it admitted the same number of in-state residents as before but also increases out-of-staters, if the proportion of the latter grows, it is likely that some displacement has occurred.

Standard practice – at least for the University of California – is for the Board of Regents to propose a budget for the money it seeks from the state, typically linked to enrollment. But the governor and the legislature may not go along. In fact, in the current era, they seldom due. However, other than vague warnings that tuition might have to be raised if the budget request isn't met, the university doesn't do much.

That is a mistake. What should be provided is a specific menu. If the budget is X, we will take Y in-state students and not raise tuition. If the budget is X-A, we will take Y-B students, and raise tuition by C. If the budget is X-D, we will take Y-E students, and raise tuition by F. Choose from the menu. Whether this menu is made public or delivered privately is a tactical decision. There is something to be said for a private start, simply because a change in tactics breaks a tradition and could provoke hostility.

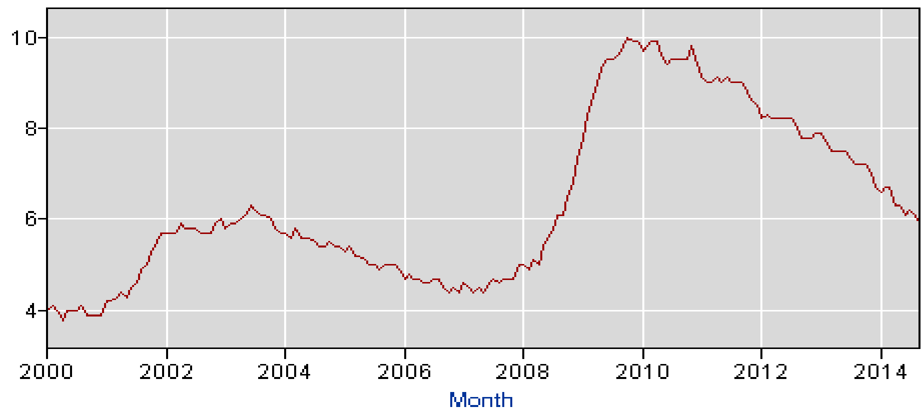
Of course, regardless of whether the menu is private or public, there would likely be pushback from the legislature and governor. They could retaliate in various ways. But the menu approach makes clear what the retaliation would entail. Fewer dollars, for example, would mean more out-of-staters and higher tuition. Basically, there are two variables in play, tuition and in-state enrollment. One or both are the adjustment factors.

Mitchell's Musings 10-20-14: Are We There Yet?

Daniel J.B. Mitchell

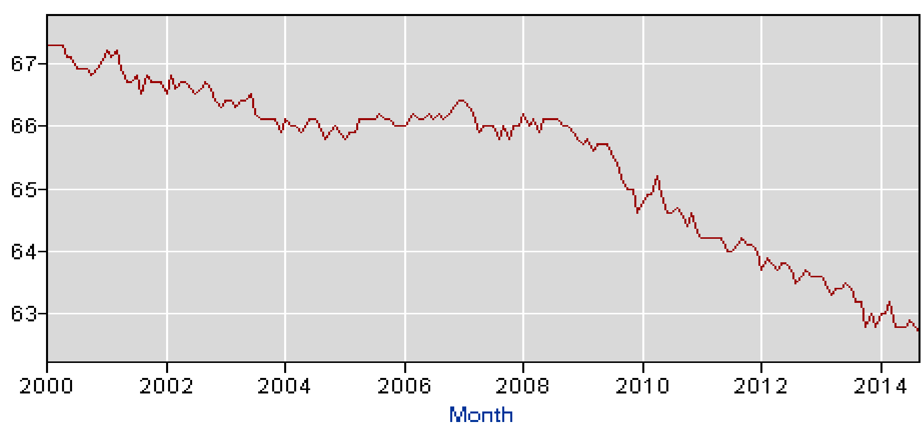
Is the labor market finally recovering? It depends on what measure you use. The most widely used index of the temperature of the labor market is the unemployment rate. By that measure, we are not back to the level achieved just before the Great Recession. But we are headed in that direction, as the chart below shows:

Unemployment Rate, seasonally adjusted (percent)



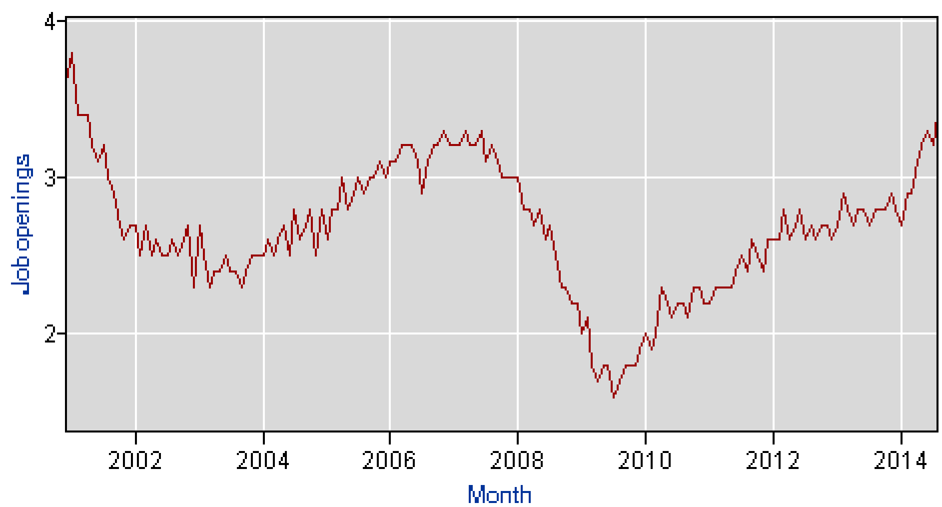
On the other hand, the civilian participation rate has been falling in what seems to be partly a secular trend but one which the Great Recession accelerated and which shows no sign of reversing.

Civilian Participation Rate, seasonally adjusted (percent)



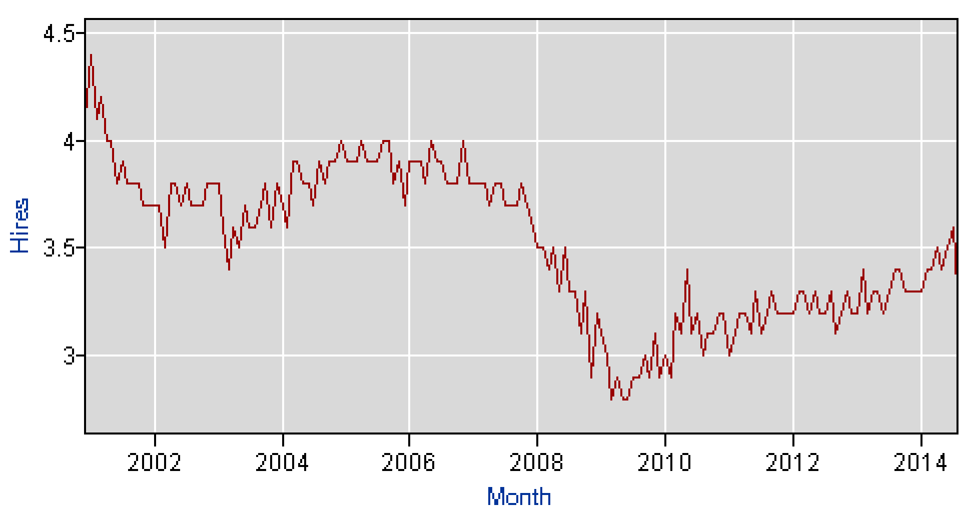
The falling participation rate – and certainly the drop triggered by the Great Recession – suggests that there is a significant amount of discouraged unemployment based on a sense that jobs are hard to obtain. So the question is whether there is anything on the horizon that would suggest change is coming, even if not yet seen. The U.S. Bureau of Labor Statistics (BLS), the source of the two charts on the previous page produces a job vacancy rate (termed the "job openings rate"), a kind of analog on the other side of the labor market to the unemployment rate.

Job Openings Rate, nonfarm sector, seasonally adjusted (percent)



As can be seen on the chart above, employers are at least claiming they have vacant jobs at a rate comparable to the peak seen before the Great Recession. Are these just claims or are employers back to hiring as they did before the Great Recession? The answer, as shown below, seems to be "not quite."

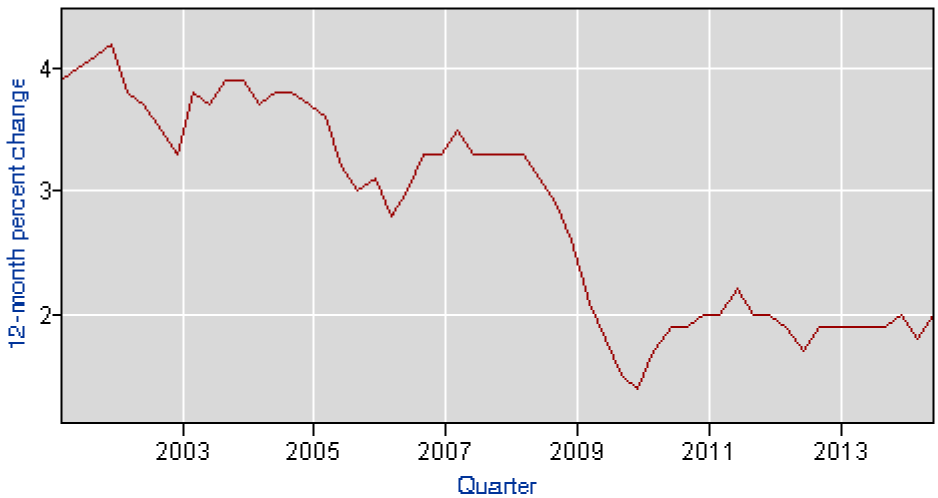
Hires Rate, nonfarm sector, seasonally adjusted (percent)



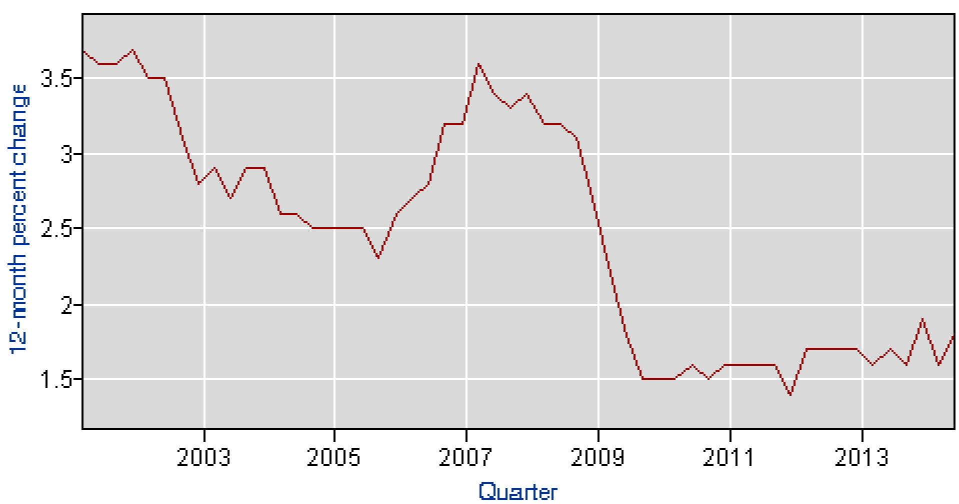
There could be a "structural" story here with employers unable to find workers with the right qualifications. In this story, vacancies are available, but somehow unfillable by the current labor supply. Potential workers, realizing they don't have the right skills, are discouraged and not participating. But there is a problem with that interpretation.

If there is truly a lack of qualified workers but plenty of jobs if only more qualified workers were available, we should see wages being bid up as employers compete for the scarce labor.

12-Month Percent Change, Employment Cost Index for Wages and Benefits, Civilian Workers



12-Month Percent Change, Employment Cost Index for Wages, Civilian Workers



It's hard to see any bidding up of pay from the two charts on the prior page. Thus, unless you believe that employers will just sit with vacancies unfilled and not take steps to try to hire the limited supply of qualified workers, the structural story has problems. What other hypothesis might square with the available data?

The labor market and its participants are not like the instantly-responding stock market. Employers tend to follow the leader – often termed "benchmarking" – when it comes to pay or other workplace practices. It is certainly the case that the recovery since the Great Recession has been slow – arguably slower than it had to be. But it is a relatively steady recovery. Unless there is an economic reversal – not impossible when one looks at trouble spots such as the Middle East – the pressure to fill unfilled vacancies will grow.

At some point, employers will be faced with two options. You can raise pay and bid for those workers you think are qualified. Or you can lower your qualification standards and – perhaps with some added training – bring in some workers who might not have been your first choice. Perhaps you might do a combination of the two. Anecdotal reports suggest that employers are beginning to move.[8] So when we say "at some point," and when we look at the charts in this Musing, we are talking about something coming relatively soon.

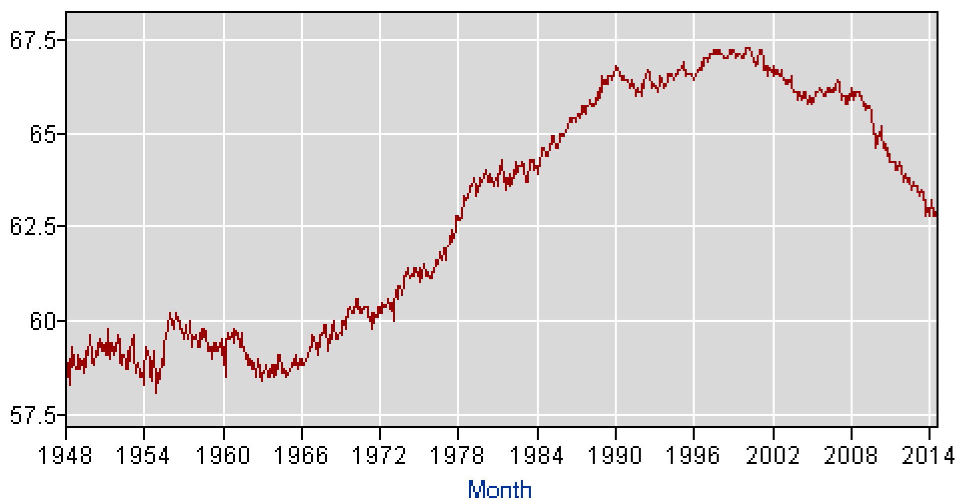
[8]See, for example, https://www.insidehighered.com/quicktakes/2014/10/14/job-prospects-are-new-graduates.

Mitchell's Musings 10-27-14: Where to Find Labor

Daniel J.B. Mitchell

In our previous musing, we looked at various measures of the labor market. Among them was the civilian participation rate, shown on the chart below. As can be seen, participation rose for decades until around 2000. Thereafter, it dropped, particularly in the wake of the Great Recession.

Civilian Participation Rate: All 16+



Nowadays, there is beginning to be discussion of labor shortages. The construction industry has been particularly vocal, although when measured by the job openings (vacancy) rate, construction does not especially stand out.[9] (The August 2014 private sector job openings rate was 3.6%; construction reported 2.9%.) Nonetheless, there could be spot shortages in construction not reflected in national average data. A Proquest search for "labor shortage" in the U.S. produced references to shortages of pilots, truckers, construction workers, teachers, health care professionals, and longshore workers.

Let's assume labor shortages are now occurring or will occur soon. The drop in labor force participation seems to reflect a contradiction. If employers can't find workers, and if – as the interpretation often is – the drop in participation reflects a kind of discouragement on the part of potential workers, there is a problem. Possibly, the paradox reflects some sort of structural mismatch; potentially available workers don't have the right skills. However, I suggested last week that employers may simply be slow to react to the change in circumstances – perhaps as a result of all the "new normal" talk of recent years which suggested that they could expect a line of applicants at their hiring doors indefinitely.

Either way, if you as an employer want workers but can't find them, you'll ultimately have to work at the problem rather than bellyache about it. That means some combination of relaxing hiring standards, training applicants if they don't have all the required skills, and – yes – raising pay and benefits to make

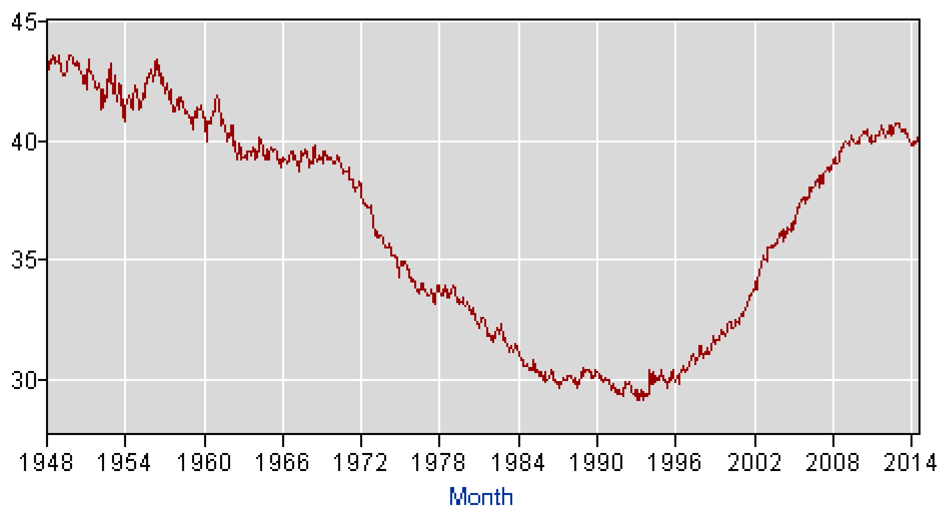
[9] http://enr.construction.com/business_management/workforce/2014/0827-contractors-turning-down-work-due-to-labor-shortages-says-agc-survey.asp.

your workplace more attractive. In effect you have to forget about the supposed new normal and get out there and recruit. Employer behavior appropriate to a soft labor market is not appropriate to a tight one.

So – if the drop in participation represents a potential pool of workers who aren't knocking on your door *but could be enticed* – who exactly is not participating? Let's look at the issue by age group.

What about older workers? The chart below (for those aged 55 and above) suggests members of the older group haven't been discouraged. Older workers exhibit labor market behavior that somewhat of a mirror image of other workers. Their participation rate *dropped* in the post-World War II era until the 1990s. Presumably, that period of drop reflected growing availability of Social Security, pensions, and other sources of support that reversed the practice of work-until-you-drop. The reversal in the 1990s and beyond may well be the discovery that those income supports, absent adequate private saving would not support an expected lifestyle. Whatever the reason, despite all the talk about folks living longer and so desiring to work longer, there seem to be limits to how far that motivation can go. If nothing else, health issues limit this source of incremental labor supply.

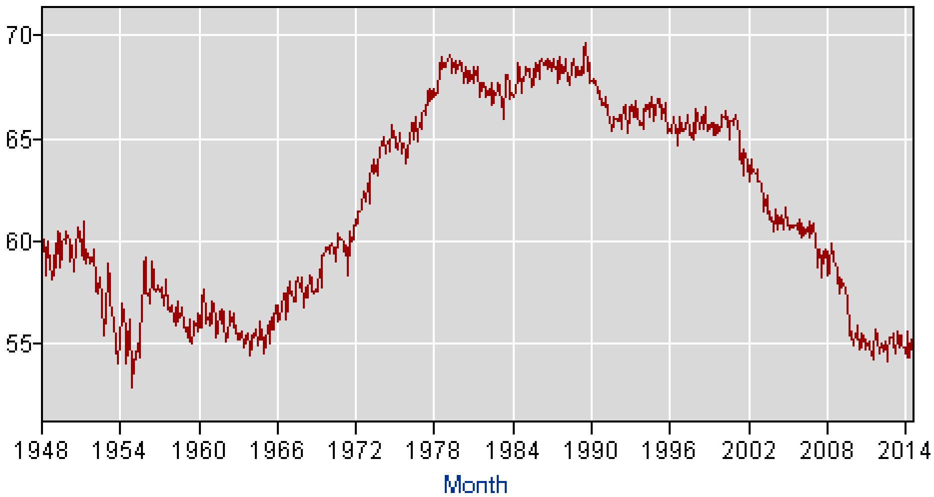
Civilian Participation Rate: All 55+



If the aging baby boomers aren't going to fill the gap – or at least not much more so than they already do – what about the other end of the age spectrum? The data suggest in fact that a good place to look for workers is in the youth range of the market. You can grumble about problems in K-12 education, poor writing ability, too much social media, etc., for young people. But – again – if there is a labor shortage and folks are not lining up at your hiring door, you have to adapt to the available labor supply. Grumbling is for the now-old new normal. But if the new normal is now disappearing, grumbling time is over.

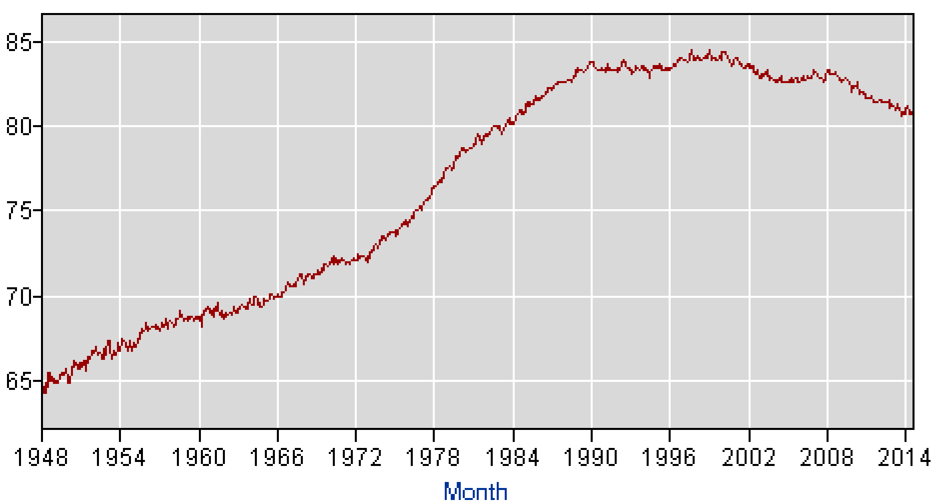
On the next page, the chart shows the participation rate for those 16-24 years old. And what you see there is a dramatic drop in participation that started in the 1990s, fell further in the 2000s, and especially declined in the post-Great Recession period. So the youth end of the labor market seems like a good place to be looking for, and recruiting, needed workers. At least for raw labor supply, that's where there is notable potential. If the supply is not exactly what you want, just reverse the old saying and instead note that you *can* teach a young horse new tricks.

Civilian Participation Rate: All 16-24



And what above the folks in the middle of the age spectrum. There are lots of them, of course. But as the chart below indicates, their participation drop is not as dramatic as that of the youth segment. And, as we have already noted, the older end of the market seems likely to be at capacity.

Civilian Participation Rate: All 25-54



The U.S. Bureau of Labor Statistics (BLS) defines a subset of those individuals not in the labor market (not participating) as “marginally attached.” The official definition is that persons who are "marginally attached to the labor force" are those who want a job, have searched for work during the prior 12 months, and were available to take a job during the reference week, but had not looked for work in the past 4 weeks.[10] Not looking in the last four weeks cuts them out of the official definition of being unemployed. Note that the precise count will be sensitive to the definitions used for marginally attached. But there were about 2.4 million such marginally attached individuals in 2013.

When broken down by age, about 31% of them were in the 16-24 year old age bracket. Yet only 16% of the civilian population 16+ was in the same age group. Those in the midyears, 25-54, constituted about half of the population and about half of the marginally attached individuals. In the 55+ group, however, despite accounting for about a third of the population, individuals in this group were only about 21% of the marginally attached.

Suppose instead of taking the BLS definition, we eyeball the charts shown earlier and note the following. Since 2008 (the Great Recession), participation of the youth group (16-24) has dropped by about 5 percentage points. Participation in the middle range (25-54) seems to have dropped by about 2 percentage points. And participation of those in the older group (55+) seems not to have dropped at all. Putting these numbers together suggests that about 44% of the Great Recession’s impact in marginalizing potential workers (pushing them out of the labor force) fell on the youth group (16-24), even though that group is only 16% of the civilian population. Fifty-six percent of the impact was on the middle age range (25-54 and there was zero impact on the older group. In short, poking around the youth group for potential workers will produce a disproportionate “yield” for employers. Poking around aging baby boomers will not; quite the opposite.[11]

Back in the early 1970s, the late Brookings Institution economist Arthur Okun described the impact of a “high pressure” labor market such as existed in the late 1960s. Employers back then looked in unconventional places and aggressively recruited to cope with labor shortages.[12] Widespread concerns about labor shortages arose again in the late 1980s.[13] Labor shortages also cropped up during the dot-com boom of the late 1990s.

We’re not yet in the high pressure labor market that occurred in these earlier episodes. And one can easily imagine external or internal events that could impede or reverse the ongoing economic recovery. However, at least for now, new normal expectations of employers that workers should be presenting themselves at the hiring gate and have an ideal set of skills are becoming obsolete.

[10] http://www.bls.gov/cps/cpsaat35.htm.
[11] http://www.bls.gov/cps/cpsaat03.htm and http://www.bls.gov/cps/cpsaat35.htm.
[12] http://www.brookings.edu/~/media/Projects/BPEA/1973%201/1973a_bpea_okun_fellner_greenspan.PDF.
[13] http://www.brookings.edu/~/media/projects/bpea/1989-2/1989b_bpea_mitchell.pdf.

Mitchell's Musings 11-3-14: The Ebola Free Ride: Look at the Incentives

Daniel J.B. Mitchell

It may be old hat to analysts of labor, management, and human resources generally, but a good rule when there is perverse behavior is to look at the incentives. However, what seems to be an obvious point seems to have escaped public policy discussions regarding Ebola. Ebola in the past was a relatively obscure disease that would occasionally break out in Africa, but generally ran its course and disappeared. In the last few months, however, it has become an epidemic in several African countries. When Ebola leaked into the U.S. via travelers from affected areas, there was an instant controversy over the appropriate policy response.

Some of the controversy involved guidelines for U.S. hospital workers and other health workers concerning how to handle Ebola patients, and – more specifically – whether the appropriate procedures were used at a Dallas hospital in which two nurses contracted Ebola from a patient. Another controversy arose over whether the guidelines in use themselves were appropriate from a technical standpoint.

However, the most visible controversy has developed over the treatment of travelers from afflicted countries, including returning American health workers who were assisting in efforts to try and contain the epidemic within Africa. Because Ebola is often fatal, various politicians proposed bans on travelers from afflicted countries or proposed quarantines of such travelers for an extended period while it was determined whether they in fact had the disease. The quarantine approach is complicated by the fact that the incubation period for Ebola can be as long as 21 days (reportedly).

The most recent controversy involved a health worker who was quarantined by the State of New Jersey on orders of Governor Chris Christie. Since Governor Christie is a likely presidential candidate in 2016 and a Republican, you might view his action as both "political" and "conservative." But my home state California, which has a Democratic Governor sure to be re-elected to a fourth term and one who is not at all likely to be a presidential candidate is also imposing quarantine procedures.[14] That fact suggests that there is an incentive for states to move in the same direction, regardless of politics.

The official response from Washington – including from President Obama – has been a combination of pointing to irrational fears about Ebola and noting that unless the epidemic is quelled in Africa, there will inevitably be some leakage to the U.S. The argument goes on to point out that quarantines might discourage health workers from going to Africa.[15] In effect, discouraging health workers from going to Africa is ultimately bad for the U.S. because of the leakage problem. So far, at least, that argument has not stopped states from moving on their

[14] http://www.latimes.com/local/california/la-me-ebola-california-20141030-story.html
[15] http://thehill.com/homenews/administration/222254-obama-we-cant-beat-ebola-by-hiding-under-the-covers

own. The health worker who was held in New Jersey went to Maine after being released and that state tried to impose new quarantine restrictions on her there.

Let's note that we don't actually know the degree to which state quarantine restrictions might discourage health workers from going to Africa. And let's concede that vastly more Americans will die of – you name it – traffic accidents, flu, etc., than will die of Ebola under any scenario, i.e., that people are not very good at weighing probabilities related to relative risks. Putting all those considerations aside, let's look at incentives for individual state action and the classic free rider problem.

Consider the California case. California has a little less than one eighth of the U.S. population. It may well have more than one eighth of relevant health workers so let's go with the assumption of a fourth of relevant health workers are in the state rather than an eighth. If California has one fourth of relevant health workers and imposes quarantine restrictions, presumably its action has no disincentive effect for the other three fourths who might go to Africa. And even the one fourth in California could escape the California quarantine by returning to another state. Or they might go to Africa despite the restriction.

Therefore, by imposing a quarantine, California – the largest state in the U.S. – has perhaps a one fourth impact on the number of U.S. health workers going to Africa. It has a relatively small effect on the health benefits to Africans (who – let us crassly note – are not residents of, or voters in, California). Some of the discouraged California health workers may be replaced by those in other states or nations. California thus has little effect on any leakage back to the U.S. of African Ebola. And if there is leakage, the leaks have something like a three fourths chance of ending up in another state.

In effect, California is a free rider or close to it. It can get whatever benefits a quarantine might have on the state (even if those benefits are non-medical reassurances felt by the local population). The costs it imposes on other states – a somewhat elevated probability of a leak from Africa – are very small and maybe almost nil. So the incentives line up in California for imposing a quarantine. And, indeed, each individual state when considering its Ebola impact, can make the same calculation. The smaller the state, the less its policy matters.

The remedy is obvious, though probably difficult to implement in practice. If each state acts alone and follows the same incentives, there will be quarantines everywhere. The impact on health worker willingness to go to Africa could be substantial as more states adopt restrictive measures. And the result could be an elevated risk of leaks of Ebola back into the U.S.

In short, there is a *collective* interest, according to the argument made by federal authorities, in not imposing arbitrary state quarantines or similar measures. But there isn't an *individual* state interest. Ergo, the federal government needs to have pre-emptive authority to act in the collective, national interest. That would be the optimum policy solution. It applies whenever collective action is needed in the collective interest but individual incentives do not align with those of the collectivity. Ebola is a textbook example.

Of course, there are cases in which free rider problems are resolved by pure exhortation to do good for the collectivity, such as federal authorities are currently trying with their plea to the states. Public radio, for example, has the free rider problem; you can receive the broadcast signal whether you support the station financially or not. Through pledge drives and other enticements, however, some listeners are induced to pay for the station even though the rational economic choice for the individual is to free ride, i.e., not to pay. It's hard to get numbers of the proportion of listeners who are induced to pay. I found one article which said one-in-ten listeners respond to appeals to pay.[16]

That proportion is apparently sufficient for supporting public radio. So possibly some state governors will pay attention to the feds and refrain from automatic quarantines. Perhaps the public will be calmed enough by presidential assurances that governors won't feel pressure to act.[17] Maybe, after Election Day, the federal exhortation approach will thus prove to be sufficient. If it isn't enough, the feds will at least have to try to produce a policy that provides more central authority than now prevails.

[16] http://www.forbes.com/2001/03/30/0330pubradio.html
[17] http://www.latimes.com/opinion/op-ed/la-oe-mcmanus-column-ebola-poltics-20141029-column.html

Mitchell's Musings 11-10-14: Lessons from the Past for the California Infrastructure of the Future

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Note: This musing was originally prepared as a background note for the UCLA Anderson Forecast December conference. A shorter version will appear on a blog of the UCLA Anderson School of Management. Despite its focus on California, readers in other areas may find it instructive.

Whenever California infrastructure investment is mentioned, there is a tendency to hark back to a Golden Age after World War II. During that period, our current governor's dad, Pat Brown, is credited with freeways, a major state water project, and the 1960 Master Plan. But there were other political figures involved and when you look more deeply, you find that these accomplishments had a longer history. Economists have a phrase, path dependency, which suggests that events of the past direct and constrain what we do in the present. And that was certainly true of the Golden Age.

One factor that ushered in the Golden Age was World War II and subsequent Cold War, both of which boosted California's economy and its growth rate with an influx of federal spending on what became the aerospace industry and other related military sectors. The result was notably faster economic and population growth in California relative to the rest of the U.S. and with a focus on technology and high paying jobs. Fast growth with good incomes meant that nasty trade-offs could be avoided. We could have expanding social programs and infrastructure investment without worrying that a dollar more for one meant a dollar less for the other.

While the era of fast growth made infrastructure investment decisions easier, even in the Golden Age there was inevitable opposition. Then-Governor Earl Warren pushed through the Collyer-Burns Act of 1947 which opened the door to the modern California freeway system, using a funding model based on gasoline taxes and a trust fund for road construction. So successful was that model in California that it was imitated at the federal level and became national policy during and after the Eisenhower years for the interstate highway system.

What we now call the three segments of higher education - the University of California, the California State University system, and the community colleges - were already expanding before the Master Plan. But turf battles between the three segments were hindering the expansion and needed to be sorted out. What the Master Plan did, therefore, was to provide a politically-acceptable division of labor for the three segments. Similarly, the idea for Pat Brown's state water project did not suddenly spring into existence in the 1960s; there had been water planning and debate for decades before. The project was built on a foundation of prior planning and it was (narrowly) approved by voters in the face of the north-south conflict that often arises when water in California is discussed.

Fast growth during and after World War II was a necessary, but not sufficient, condition for the Golden Age of California infrastructure investment. What was also needed for conditions to be sufficient was public confidence that promised projects would in fact be delivered as promised. Luckily, there was a pre-war history that suggested they could be confident. In the early 20th century, for example, the City of Los Angeles built its Owens Valley water project on time and within budget.

OK; I know. You saw the movie “Chinatown” and you think the Owens Valley project was nothing but a municipal scandal built around corruption, murder and incest. Without going into more detail, let’s just say that the movie was fictional. Not long after L.A. constructed its Owens Valley project, San Francisco built its Hetch-Hetchy water project, a project which with your modern environmental sensibilities you may also disdain. But suffice it to say, that’s not how it was perceived back then.

During the Great Depression, there were other impressive projects - some of which were motivated in part by the need for job creation and federal subsidy. With regard to water in southern California, there was the aqueduct bringing water from the Colorado River. In the Bay Area, there was the Bay Bridge and the Golden Gate Bridge. In southern California, there was the Arroyo Seco Parkway (now the Pasadena Freeway). The upshot was that in post-World War II California, voters had reason to believe that if they supported projects, those projects would be delivered. Thus, Governor Earl Warren could mobilize public pressure on the legislature to enact Collyer-Burns for freeways in the face of gridlock engendered by oil companies that disliked gasoline taxes. And Governor Pat Brown, as noted, beat back regional opposition to his water project sufficiently to obtain voter approval.

Each quarter for many years, the UCLA Anderson Forecast has updated a chart that illustrates the consequences for the state when the Cold War came to an end around 1990. You can see the chart below.

The old Cold War trend line of employment on the chart begins to separate in 1990 from actual employment and it continues to do so even in the face of the dot-com boom of the late 1990s and the housing/mortgage boom of the mid-2000s. Since 1990, California has entered a period in which its growth rate is more or less average compared with the rest of the U.S. If we had stayed on the old trend, we would have something like 6 million more jobs than we actually do. Nowadays, unlike the era of above-average growth during the Cold War's Golden Era, there are those nasty trade-offs. More money for social programs means fewer dollars for infrastructure. Alternatively, if you want to have both, someone will have to pay more in taxes. The temptation, given that unpleasant trade-off, is to charge the costs to the future via bond finance. Let somebody in the future pay for what we want.

Absent some new external accident of history, Cold War-style above-average growth rates are not going to return to California. Despite the temptation to do so, in a period of mere average growth, infrastructure – whether water projects or college campuses – should not simply be charged off to the future via bond sales, the pattern that has developed in recent years and that was, for example, reflected in the water bond on the November 2014 ballot. Absent rapid growth, we can't count on the future economy to be so much larger than it is today so that paying off past debt when the future arrives will be painless. If nothing else, there are intergenerational inequities in relying too heavily on bond finance.

At the same time, the state's record in recent infrastructure investment is blemished. The new replacement segment of the Bay Bridge, a state project, has been marked by improper state inspections, faulty components, and costs beyond budget. Closer to UCLA, the large expenditures on widening the I-405 freeway in the Sepulveda Pass - and years of inconvenience during construction - seem to have produced no marked traffic improvement. Sidewalks in the City of Los Angeles are notoriously cracked, uneven, and misaligned due to tree root damage. Public support in the future for infrastructure repairs and expansion, the funding for which should increasingly depend on user fees and less on bonds, will be limited unless there is a better record of success in past projects. Badly done projects today mean public skepticism tomorrow.

So what is to be done? Key elected officials are going to have to explain to the public what the end of the Cold War has meant for California fiscal affairs and for its infrastructure finance. It may seem odd a quarter of a century later that our politics are stuck at 1990, but that is the reality. User fees and user taxes for water, roads, and other public projects need to become a larger part of the funding mix; it can't be all bonds. And the credibility of public authorities when it comes to infrastructure implementation needs to be restored.

The old Master Plan approach, used for higher education in 1960, may be useful model today, not only for higher ed, but for transportation and water, too. We need to set up mechanisms outside the legislature for developing overall plans. Once plans are developed, key politicians need to sell the plans, first to the public and then to the legislature. Folks, the Cold War is over.

Mitchell's Musings 11-17-14: Off-Beat Poll Suggests How Little We (the Voters) Know

Daniel J.B. Mitchell

I attended a seminar at UCLA featuring several political science experts giving their reactions to the recent November general election. The panelists were mainly focused at the federal offices – House and Senate – but with some reference to state-level outcomes. Although not the focus of this musing, for those wondering, these were some of the conclusions:

- The notion that the Democrats did badly due to low turnout was debunked. Various convincing statistical charts based on historical data were unveiled showing that midterm elections with low turnout did not especially favor Republicans.
- The variable that did affect midterm election results was how favorably or unfavorably voters viewed the President. If he had low favorability ratings, his party did poorly. Again, statistics over time backed up this point.
- There is a potential longer-term effect of the most recent election. The Democrats lost seats in state legislatures and in governorships. The result is that their "minor leagues" are damaged, which means there will be fewer Democratic candidates to promote into the majors (governors, senators, congressional representatives). In the political context, what's called succession planning in business comes down to have elected officials in lower offices who can be promoted. Texas was cited as a state in which the Democrats don't have a strong minor league which hurts them in finding candidates to promote. California was cited as a state in which Republicans don't have a strong minor league which also hurts them in finding candidates to promote.
- It isn't really true that what voters want nowadays is for the two parties to cooperate and comprise to get things done. Increasingly, voters are polarized and want their party's perceived policies to prevail. My way or the highway is the prevailing mood.
- Pollsters don't have good systems for separating "likely voters" from other respondents to their surveys.

I am an amateur in such matters so I will take the top two points as proven. I would have liked to hear more about *why* President Obama had low favorability ratings, but that issue didn't come up. The third point seems reasonable and at least in California seems to be mainly true. (But let me come back to that topic below.)

On the fourth point, I would also have liked more discussion beyond the immediate consequences. There seemed to be a consensus on the panel that even if voters did want compromise and getting things done, they were unlikely to get that outcome – not just in the coming two years but over the long run. Voters are also unlikely to get an uncompromised version of what they think their party supports. The panelists didn't go into the implications, i.e., what are the long-term implications of voters being perpetually disappointed, election after election? I have a sense that continued voter frustration itself may be a Bad Thing.

What did strike me was the discussion on public opinion polling and the problems thereof, the last bullet-point item above. In fact, several Mitchell's Musings have been devoted to that issue, but at a less technical level than the panel addressed. However, shortly before Election Day, the *San Francisco Chronicle* ran a column about what seemed to be an odd poll result.

First, some background. As it happened, the November 2014 election in California was headed by the governor's "race." I put "race" in quotes because the outcome was never in question; Jerry Brown would be elected as governor. Nonetheless, Brown is the governor so what he does gets news coverage. There was a primary election in June in which he was on the ballot as a prelude for November. News media have covered the two elections, both the primary and the November general vote. Brown was running for an unprecedented fourth term, no longer allowed for any candidate in the future due to term limits (which he escaped). No other California governor has served four terms. (Earl Warren was elected three times as governor.) So that fact of the election was newsworthy because of that unusual feature.

There was also some interest in the primary because under the top-2 primary rules, the issue effectively became who would come in second behind Brown and it was clear it would be one of two Republicans. One of the two was a member of the legislature, a Tea Party type named Tim Donnelly who had a habit of making provocative and controversial remarks. And there was also an unknown former U.S. Treasury official – Neel Kashkari - who the establishment of the Party was backing because it did not want a Tea Party candidate at the head of the ticket. (You can see the Republicans' "minor league" problem in California mentioned earlier in the personalities of these two candidates.)

The result was that Kashkari, the establishment's favored candidate in the primary, had debates on AM talk radio with his opponent Donnelly. And the race between them got media attention. The Republican establishment also provided enough monetary support to make Kashkari Brown's opponent in the general election. Finally, there was a debate on TV between Brown and Kashkari, albeit one that was scheduled at an inconvenient time thanks to Brown's insistence. Still, some soundbites from the debate aired on newscasts and were picked up in the newspapers.

I am telling you all of this because of that item – published just days before the general election - in the *San Francisco Chronicle* that was referenced above: [excerpt]

Here's an eye-opener: With the election Tuesday, a whopping 4 out of 10 voters don't even know Gov. Jerry Brown is running for another term. "Isn't that astonishing?" said David Metz of the polling firm Fairbank, Maslin, Maullin, Metz and Associates. Metz included the question, "As far as you know, is Gov. Jerry Brown up for re-election this year?" on a statewide survey of 457 likely voters last week. Metz said the question was prompted by several casual conversations he'd had with people not involved in politics. "I was struck by how many of them were totally unaware that Brown was up for re-election, so I decided to test it out," he said. The findings: Forty-two percent of likely voters didn't know Brown was running — and only about 1 in 5 could name Republican Neel Kashkari as his opponent…

Full story at http://www.sfgate.com/bayarea/matier-ross/article/40-of-voters-unaware-Jerry-Brown-is-seeking-5865196.php

It might be noted that the firm that conducted the poll is linked to Jerry Brown and has no particular reason to highlight the fact that folks didn't know he was running.

Now there were special circumstances surrounding the gubernatorial election. Because Brown knew he would win, he barely campaigned. He appeared in TV ads but those ads, which were plentiful, were endorsements of two ballot propositions he was supporting. One involved a bond for water projects. The other was to establish a "rainy day" fund in the state budget. (Both passed.) The ads did not specifically ask voters to vote for Brown although he did all the talking. Kashkari did run ads in a limited way. But after the establishment of his Party put him on the ballot via the primary, they did not choose to throw a lot of money into a general election campaign that would lose anyway. So his ads were aired sparsely for lack of money.

Nonetheless, the fact is that pollsters typically give voters a choice of named candidates. Evidently, that is more information than many voters actually had. Naming the candidates when voters don't know they are going to be on the ballot is a form of framing, even if it was inadvertent.

So what did the standard voter opinion polls show? Here is a table from the California Field Poll, a long time and respected operation in the state:

Trend of likely voter preferences for Governor in the November 2014 general election

	Brown (D)	Kashkari (R)	Undecided
Late October 2014	**54%**	**33**	**13**
Late August/Early Sept. 2014	50%	34	16
June 2014	52%	32	16

(D) denotes Democrat, (R) denotes Republican.

Only 13% in late October were said to be undecided by Field between two candidates *who were named*. No one apparently said "who?" about Kashkari when he was named. No one apparently said "I didn't know he was running" when Brown was named.[18] When it came to the actual election, Brown got 59% of the vote and Kashkari got 41%.[19]

Now you could say that by confronting voters with the information that there was a gubernatorial election and who the candidates were, the Field Poll was simulating what (surprised) voters would have learned when they got into the voting booth or filled out their mail ballots. Suddenly, they would discover Brown was running. And the Field Poll did say Brown would win by a large margin (which was not a hard result to forecast). However, it's hard to get away from the fact that a major piece of information was missing – because no one thought to ask. The poll didn't ask if you knew that 2014's general election was gubernatorial and who the

[18]http://www.field.com/fieldpollonline/subscribers/Rls2489.pdf
[19]http://vote.sos.ca.gov/returns/governor/

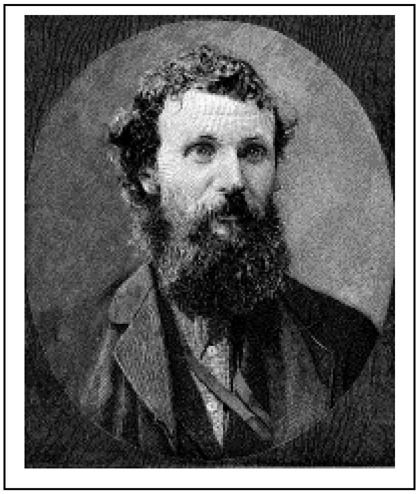
candidates were. If poll takers inadvertently stumbled on that information from *ad hoc* comments of respondents, their finding didn't make it into the published results. Or maybe respondents just didn't say.

So now let's go back to that seminar I attended on the election. Yes, questions were raised about accuracy of poll results. But they focused on technical issues such as adjusting the sample to mirror who would actually vote. The question of how to conduct a poll *without asking a question that suggested something to respondents that they didn't know* didn't come up.

Is all this a fluke? Maybe California was unique in voter in 2014 in the degree of voter ignorance. But polling often entails the asking of questions – particularly when it comes to complicated ballot propositions – that involve more than just the names of the candidates who are running. It's hard to get results from respondents if large portions of them don't know what you are talking about or what is on the ballot or what it means. So the temptation is to "explain" things to the folks you survey. And how you explain will inevitably influence the answers you obtain. Keep that in mind the next time you read a poll.

Mitchell's Musings 11-24-14: Is There Political Correctness After Death?

Daniel J.B. Mitchell



A brouhaha developed in the *Los Angeles Times* recently over John Muir (pictured at left). You probably know his name as the founder of the Sierra Club. Indeed, until recently, he had near-sainthood status for his environmentalism. The Club has a bio of Muir online which starts:

John Muir (1838-1914) was America's most famous and influential naturalist and conservationist. He is one of California's most important historical personalities. He has been called "The Father of our National Parks," "Wilderness Prophet," and "Citizen of the Universe." He once described himself more humorously, and perhaps most accurately, as, a "poetico-trampo-geologist-botanist and ornithologist-naturalist etc. etc. !!!!"

Legendary librarian and author Lawrence Clark Powell (1906-2001), (anticipating an event that was not to occur until 2006), said of him: "If I were to choose a single Californian to occupy the Hall of Fame, it would be this tenacious Scot who became a Californian during the final forty-six years of his life." More recently, famed documentary film maker Ken Burns said, "As we got to know him... he [John Muir] ascended to the pantheon of the highest individuals in our country; I'm talking about the level of Abraham Lincoln, and Martin Luther King, and Thomas Jefferson, and Elizabeth Cady Stanton, Jackie Robinson -- people who have had a transformational effect on who we are." …[20]

I said "until recently" because an article appeared in the LA Times that said in part:

…Muir's notion that immersing people in "universities of the wilderness" — such as Yosemite — sends the message that only awe-inspiring parks are worth saving, at the expense of smaller urban spaces. Critics also say Muir's vision of wilderness is rooted in economic privilege and the abundant leisure time of the upper class. Rather than accessing Muir's beloved Sierra Mountains as backpackers, skiers or rock climbers, they argue, Californians would benefit more from the creation of urban parks, additional roads and trails in wild lands…[21]

There was sufficient reader blowback from this article that one of those quoted as supporting the view above felt compelled to write a quasi-apology.

I don't come here to dispute anything about (*the LA Times'*) *story, especially the quotations attributed to me. My quotations are accurate and the story reflects a range of perspectives on Muir's legacy, including mine.*

…I…apologize to the many people I offended on Thursday and afterward as the story ricocheted around the Internet. I have heard you. I am sorry that I came across as disrespecting John Muir

[20]http://vault.sierraclub.org/john_muir_exhibit/about/default.aspx

[21]http://www.latimes.com/local/california/la-me-rethinking-muir-20141113-story.html

and his history. And I am especially sorry that I seemed to publicly denigrate your passion for understanding and caring for nature, because I share that passion. And the way that I stated my view was blunt, insensitive, and meant to provoke, like, well, a jackass…[22]

The problem here is a more general one that affects (infects?) current attitudes toward historical figures. The first difficulty is expecting that historical figures must be saints, not only with regard to what they accomplished, but in every facet of their lives. And the second difficulty is expecting that those sainthood standards must be those now prevailing rather than those prevalent in the past. There is no thought given to the likelihood that our approved behaviorial standards today may be seen by future generation as improper according to their norms – whatever those norms may be.

Thus, John Muir did not promote urban parks and wasn't appealing to just-plain-folks as we now define them. Never mind the preservation of Yosemite which those just-plain-folks can now visit. Thomas Jefferson owned slaves while writing about how all <u>men</u> are created equal. (Obviously, he should have said all <u>people</u> are created equal.) Too bad for him, therefore, and his Declaration of Independence. Never mind that most slave owners of his era did not think about all men (or people) being created equal, but Jefferson did. Abraham Lincoln said things that by contemporary standards might be considered as racist. Never mind that he issued the Emancipation Proclamation. Etc., Etc., Etc.

There is also an incentive, certainly in academia and journalism, to be able to disprove something long thought to be true or to be able to show that things are not what they seem. That's what gets attention. Just showing that things <u>are</u> what they seem and that longstanding views <u>are</u> correct wins no prizes. So the incentives are strong to undermine those historical figures generally held in high repute rather than reinforce them.

Historical figures are what they were. Sometimes they had bad judgment and human faults. Not surprisingly, someone writing in 1776 had a different view of the world than someone writing in 2014. Sometimes, in retrospect, the causes historical personalities wanted to promote had inadvertent consequences. There was an old joke during the communist era in Russia and Eastern Europe: *"The future is fixed; it's the past that keeps changing."* Under communist ideology, the world was inevitably moving towards a (fixed) communist utopia, but the past had to be rewritten continually as historical figures moved in and out of favor. That old Eastern European joke seems more applicable to <u>our</u> current attitudes than we might care to admit.

Poor John Muir. He clearly doesn't meet our self-evidently high standards. Wait! Self-evident? Wasn't that a Thomas Jefferson concept? Something about certain truths being self-evident? Maybe I should have said Muir doesn't meet our *enlightened* standards.

[22] http://www.laobserved.com/intell/2014/11/i_jackass.php

Mitchell's Musings 12-1-14: Common Sense on Online Education

Daniel J.B. Mitchell

You would have to travel to the MOON to get away from talk about how MOOCs (*massive open online courses*) are going to revolutionize higher education. There are commercial firms such as Coursera which promote such courses and have an obvious interest in keeping the talk going. In California, Governor Jerry Brown is a big fan of online higher education and is convinced, despite evidence to the contrary, that vast savings are available through MOOCs and online ed in general. The result has been a confrontation between the governor and the University of California that we will discuss in a future musing.

The problem is that MOOCs seem not to be producing the hoped-for results. You can put them on the web and get large "enrollments" but few completions. Enrollees seem to regard them as forms of entertainment – more like YouTube videos – than actual educational experiences that lead to degrees or credits. If you see MOOCs as lectures which you passively watch, there are precedents for them and, in principle, they can be cheaply produced. I found reference to an early version when radio was in its infancy offered by Tufts University in the 1920s. When TV came along, the idea was revived; you could see lectures early in the morning on *Sunrise Semester* in the 1950s and, if you bought the textbook and took the exam somewhere, you could get college credit.[23] Many more watched than ever got credit.

♬ *Sunrise, TV Set, Sunrise, TV Set, How quickly technology puts you in a daze…*[24] ♬

[23] https://www.youtube.com/watch?v=5_Q-Mw6qH9k and https://www.youtube.com/watch?v=FfsmxK0viLQ

[24] Apologies to *Fiddler on the Roof*.

MOOCs, if they are not passively watched TV-style entertainments/lectures, need to provide feedback, discussions, and exams (that can be verified as taken properly and by the person purportedly enrolled in the course) All of that interaction is costly to provide and the expenses go up as the number of enrollees increases. Just putting a camera in the back of a lecture hall, in contrast, is cheap, but the immediate interaction is lost. Telling those enrollees who want credit to report to a physical exam room somewhere on the *Sunrise Semester* model means that enrollment around the world model won't work unless there are exam rooms everywhere with proctors. These requirements are all problems that have yet to be overcome.

However, despite the problems of MOOCs, there is much use being made of the Internet in higher ed today in other ways. Much of it is improvised. Email exchanges now substitute for office hours for many students. Videos are assigned along with readings. Courses have their own websites with reading materials and other information for students.

An interesting experiment is being conducted at Harvey Mudd College in southern California to see if video lectures can be substituted for classroom lectures while the freed-up classroom is used for question and answer sections with the instructor.[25] Students are divided between those in a conventional course with classroom lectures (controls) and another section in which lessons are online and discussions are in class (the treated group). The latter gives the student the convenience of being able to watch lectures at any time and repeat those lectures at will. But the ability to ask questions *during* the lecture is lost.

So far, despite the differences between the controls and the treated group, the results seem to be that student performance is the same across the two models, conventional and lecture/videos. Whether there is cost saving from the lecture/videos approach presumably will depend on whether the lecture-online model allows larger enrollments. The larger lesson so far, however, is that a revolution in higher education – particularly with regard to vast cost savings – has yet to arrive, despite all the trendy talk about technological "disruption."

Fashionable buzzwords are fine but don't save money. Abstract ideas about the impact of technology don't necessarily translate into useful innovations. Radio was the latest technology in the 1920s, but college-by-radio didn't pan out. TV was the latest technology in the 1950s, but today *Sunrise Semester* survives only on a few grainy YouTube videos. Despite the TV option, baby boomers got their college degrees in classrooms rather than on television.

The impact on higher ed today of the Internet seems to be falling more on the library (online documents and sources) and on the registrar (student record keeping) than on the classroom. Technology will obviously affect the classroom; it already has. But, the Harvey Mudd College approach – trying out innovations against controls – seems the best way to advance. Meanwhile, don't expect miracles.

[25]http://www.latimes.com/local/education/la-me-harvey-mudd-flipped-20141117-story.html

Mitchell's Musings 12-8-14: A Walk on the Sony Side of the Street for Some Private Employees

Daniel J.B. Mitchell

You have by now heard about the hacking into Sony's computer systems, essentially shutting down those systems and stealing data including video of new and unreleased movies. Some of the stolen information has been put online.

In the wake of the Sony attack, the FBI issued a private warning to companies… to be on the lookout for a certain type of destructive malware that can make data on hard drives inaccessible, according to someone who had seen it. Retrieving any data from an affected hard drive can be quite difficult and costly, according to the FBI warning…

Employees at the Sony Corp.-owned studio behind "The Amazing Spider-Man" and hit TV show "The Blacklist," have been forced to work with cellphones and personal email accounts since images of a skull appeared on company computers last week along with the message "Hacked by #GOP." Employees were warned by Sony not to use any digital devices connected to its internal networks. The hacker group, known as "Guardians of Peace," hasn't revealed any details about its identity or provided Sony with a list of demands…

There is speculation in the article cited above that the attack came from North Korea, possibly because its leader was insulted in a Sony movie.[26] I have no idea if that suspicion is true, others have raised doubts, but the focus in the news media has been on videos that were pirated and now are being circulated on the web and on the North Korean angle. Secondarily, there has been concern about cyber security in general. And finally, there is interest in the idea of Sony employees having to revert to non-Internet technology and, presumably, the lost productivity therefrom.

At the bottom of the list of interests is the information on employees that appears to have been stolen:

Several files being traded on torrent networks seen by this author include a global Sony employee list, a Microsoft Excel file that includes the name, location, employee ID, network username, base <u>salary</u> and date of birth for more than 6,800 individuals.[27] [Underline added]

The public radio program "Marketplace" did report on the employee data aspect and a cyber-security expert who was interviewed said in passing on the broadcast, "*You know, what employee wants their salary leaked out to the world like that?*"[28] In general, however, the employee angle was not a central focus of the media coverage of the Sony hacking and the (self-evident) idea that employees might not like to have their salaries made public seems confined to the Marketplace interviewee.[29] Of course, not only would employees not want to have their salaries made public, you can bet that Sony doesn't want its salary data out there. Such data are competitive information and could lead to raiding by other firms

[26] http://online.wsj.com/articles/more-signs-north-korea-may-be-behind-hacking-of-sony-pictures-1417467267
[27] https://krebsonsecurity.com/2014/12/sony-breach-may-have-exposed-employee-healthcare-salary-data/
[28] The comment is not in the written transcript – perhaps not considered important enough - but you can hear the full broadcast at http://www.marketplace.org/topics/tech/no-north-korea-probably-not-behind-sony-hack and find the comment at around minute 2:20.
[29] As in much of the reporting on the Sony incident, it is unclear which employees had their information stolen. Some reports suggest it was managerial employees. Others don't specify.

and internal demands to remedy perceived salary inequities. Indeed, many private employers have (legally suspect) personnel policies barring employees from discussing their salaries.[30]

What's interesting about the comment said in passing on Marketplace is that no distinction was made between types of employees. In particular, the comment is equally applicable to private sector employees – such as those of Sony – and to public sector employees. Public sector employees don't want their salaries leaked out to the world any more than private. Public sector employers have the same concerns as private, although they are less likely to have personnel policies banning employees from discussing their pay among themselves.

The difference between public and private is that thanks to court decisions, public sector salaries aren't leaked out by hackers. No hackers, whether North Korean or other, are needed. Instead, government employees' salaries are deemed to be public information and not just for top officials and executives. All public employees and their salaries down to the lowest paid and those employees otherwise not key to any public policy debate are included on open Internet sources run by various sources including newspapers. No newspapers, however, put their own payrolls online even though, of course, they have the data.

As pointed out in earlier musings, making such information available by name risks ID theft for the individuals included. While there is an argument to be made for providing such data for top government executives and officials, there is little that can be learned from the data for others that couldn't be learned by simply reporting pay by job title *without the name*. If, for example, you wanted to compare public vs. private pay, you don't need the name. Yes, in theory, one could always have gone to city hall and requested to see what John Doe or Jane Doe was being paid. But it was a bother and the information by name was thus not available at the click of a keystroke.

Courts seem not to understand that the degree of availability matters and that rules about what is public were made at a time when ease of availability online didn't exist. If for some reason there was a real public interest in a specific employee's pay – say John Doe or Jane Doe had been involved in a crime – a news reporter could obtain the information. Most people were not about to make a trip to city hall to peruse salary information. They were not about to write a letter to city hall requesting the information.

Privacy advocates ought to be raising a fuss about this issue. The rules could be different; they could be updated for the reality of the Internet. Indeed, even under current rules, not everything that could be made available is made available. For example, you could argue in theory that public employees' health records should be available on the Internet. Someone might be interested in whether John Doe or Jane Doe was driving up health insurance costs for his/her government employer because of some medical condition. But no one makes that argument in practice and in fact health records are protected on privacy grounds.

There are numerous other examples in which the Internet has developed faster than the law and a review is warranted. What's not good for Sony is not good for other employers and employees, private or public.

[30]Such policies tend to violate the protections of "concerted activity" by employees found in the National Labor Relations Act, as amended. (Supervisors and managers are not protected by the Act.)

Mitchell's Musings: 12-15-14: The Governor's Calling

Daniel J.B. Mitchell

Back in 1971, I took a sabbatical leave in the spring quarter at a university in France. One of the differences I discovered between American faculty and French faculty back then was that French faculty did not have home phones. There were phones at the university. Businesses and government agencies had phones. But residential phones were hard to get. One might spend years on a waiting list before a phone could be installed.

As a result, when faculty members wanted to talk with one another, they arranged in advance to meet at school. I can recall one faculty member telling me that he was surprised to discover during a short leave at a university in Quebec that he could have a phone installed immediately in the temporary apartment he had rented. It never occurred to him that such a thing was even possible.

I am sure things have improved since that time with regard to French phone service. But an interesting question was why in 1971 residential phone service was so difficult to obtain. The answer seemed to be that phone service was handled by the Post Office. If new equipment was needed to meet demand, the money had to be allocated by the central government in the same way that a government might allocate money for, say, a new road. With budget constraints, expanding phone service was apparently not a high priority when placed in competition with other government programs. Apparently, user charges from those who had phones were insufficient to cover needed investment and expansion so phone service access was rationed. There were long queues for service. (Of course, if you had pull with someone in authority, you might be able to jump the queue.)

I was reminded of the old French phone problem by a column that appeared in the *Los Angeles Times* concerning a current dispute between the Regents of the University of California (UC) and Governor Jerry Brown over university funding. I will come back to that column below, but here is some cursory background. During the Great Recession and its aftermath, the University of California experienced notable budget cutbacks, as did many public universities around the country. Economic recovery helped add back tax revenue. But in California there had been ongoing fiscal problems even before the recession.

Governor Brown put on the ballot - and voters enacted - temporary tax increases in 2012 that added to state revenue. Although the UC Regents do not usually take official positions on ballot measures, in this case they backed the governor's initiative. After the initiative passed, the governor proposed a schedule of multi-year budget increases for UC conditioned on a tuition freeze. UC never formally agreed to the deal, but it initially froze tuition and received the increases on a year-to-year basis.

However, a few weeks ago, UC President Janet Napolitano – a former Arizona governor hired by the Regents for her presumed political skills – proposed multi-year tuition increases to supplement state funding, thus putting UC in direct opposition to the governor. Her proposal was that the state could either accept the tuition increases or buy them out with additional funding. It is unclear how this drama will play out; the governor will make a budget proposal for the 2015-16 fiscal year in early January and he hasn't said exactly what he will do with regard to UC as of this writing. Legislative leaders, who don't like tuition increases, have been proposing their own plans.

The governor is an *ex officio* member of the UC Board of Regents and - unlike most of his predecessors - he often turns up at regental meetings. His theme has been that the university needs to be more efficient – which often seems to be defined as offering more online education. Moreover, working at UC as a public university should be seen as a **"calling"** so faculty can't (shouldn't) expect to be paid competitive wages such as those at major private universities. Perhaps the calling idea was another reason I thought of the telephone example.

In the past, the Regents have been deferential to the governor's statements about priorities and callings. At their meeting when the tuition/funding proposal was made public, however, the atmosphere was less cordial. Not surprisingly, the conflict engendered considerable editorial commentary.

I alluded above to a particular newspaper column in the *Los Angeles Times* by George Skelton, an old hand who writes on state politics. That column was entitled "Many want more money; UC should get in line."[31] You can guess the message from the title, but here is the opening salvo from the column:

First of all, Californians think that raising university tuition again is a really bad idea. A non-starter. Second, although the University of California is crying for more state money, it needs to get in line. Join the crowd of folks with their hands out. K-12 schools, the impoverished aged and disabled, highway users — among others — also are clamoring for more tax dollars...

The problem with that approach is that it follows the (1971) French telephone model. Phone service back then got "in line" with every other activity of government "clamoring for more tax dollars." Raising user charges for phone service wasn't popular. So what resulted from that model was poor telephone service and rationed access. Of course, in theory the governor and legislature could decide to make UC funding a top priority. They then could buy out the proposed tuition increases. They could accede to something like the plan proposed by the Regents involving tuition increases (which because of internal cross subsidies mainly hit higher income students). Or there could be some kind of negotiated compromise which is probably Napolitano's objective.

One of the developments that eventually improved phone service in countries that followed the French model was the invention of cellphones. In some countries with highly rationed and poor quality landlines, cellphones became the alternative route to personal communication service for the masses. That kind of "disruption" example seems to be the basis for a hope by Governor Brown that "technology" will solve the problem of rising tuition and limited state funding. The problem is that despite substantial hype, online higher education hasn't proved to be a cheap quality substitute for the traditional classroom. Until some miracle of technology arrives, California can't have both UC at its current level of quality – however you might define that term – and the French phone funding model.

[31] http://www.latimes.com/local/politics/la-me-cap-tuition-20141208-column.html

Mitchell's Musings 12-22-14: A Healthy Sense of Trust

Daniel J.B. Mitchell

Retiree health care has largely disappeared in the private sector, lingering mainly in some legacy union-negotiated plans. However, it continues in the public sector. In both the public and private sectors, retiree health has tended to be treated differently from pension benefits. Pensions – and I am talking about defined benefit pensions – represent a promise of future benefits determined by a formula based on pre-retirement work and pay history. Once you know the formula and have the work and pay history of a given employee, the promised benefit can be easily determined.

In contrast, a promise of a future health benefit tends to be fuzzy. Such benefits are typically administered by an insurance carrier. The carrier offers a plan which changes over time based partly on carrier discretion and partly on (changing) legal requirements. The actual medical services are provided by doctors, labs, hospitals, etc., who have some contractual agreement with the carrier. However, which doctors, labs, hospitals, etc., have such contracts can change over time. In short, something is being promised, but what it is can vary over time. The benefits can be limited or constrained as time passes.

A major difference between the easy-to-calculate pension promise and the fuzzy health care promise is the funding mechanism. Pensions are typically prefunded through a "trust" fund. Yes, as has often been in the news of late, the plan may be underfunded, i.e., the actuarial estimate of what is in the fund, what those monies will earn, and incoming contributions, may add up to less than the estimated future liability. But something has been set aside in the trust fund and commonly there has been both an employee and an employer component to the contributions that have gone into the fund.

Now we could get into a legal conversation about whether pension promises are ironclad, particularly in the public sector where governments are making those promises. We could look at the recent Detroit example in which municipal pension benefits were cut back as part of a bankruptcy plan. I am not a lawyer and can't discuss such matters with any expertise. But what I can tell you is that creating a trust fund and have a component of contributions made by employees creates an expectation by those employees. And my non-expert observation suggests that the Detroit example is an exception and that pension promises are hard to break, once made. In the end, what does a trust fund imply other than "trust"?

Even Social Security pension promises – which detractors will be quick to point out can be legally taken away by any Congress with a mind to do so – are in practice hard to modify in ways that are adverse to retirees. Those detractors will also point out that the Social Security trust funds that are part of the funding mechanism are a mirage – it's all just federal money flowing in and out – and Social Security is underfunded despite the trusts. But as President Roosevelt (correctly) believed when Social Security was set up in the 1930s with a mix of employee and employer contributions and trust funds in imitation of the embryonic private pensions that existed at the time, future Congresses would in fact be unable to undo the system. Trust funds may be symbolic, but as political symbols they are powerful.

As noted, at the state and local level, the health care side of retiree benefits – unlike the pension side – is rarely prefunded. The benefits are essentially funded on a pay-as-you-go model. And state and local governments tend to take the position that unlike pensions, the pay-as-you-go model means that such benefits are not a legal obligation. They are nice things that are done for former workers, but if budgets run into problems, retiree health care can be cut back or even discontinued.

Those folks who have been active in pointing to underfunding of public pensions with alarm have also taken to pointing out the zero advance funding of retiree health care in the public sector. Part of their agitation has resulted in accounting requirements that public employers calculate the value of their unfunded retiree health care promises. Note, however, that there are two problems with such calculations, apart from the technical details of the calculation:

- Exactly what is being promised is unclear due to the changing nature of health care plans. A calculation has to be based on what a health care plan will cost in the future. But, as pointed out above, plans change over time in terms of benefits provided and who will be providing those benefits. How do you calculate the cost of promising benefits when you don't know what those benefits will be in the future?

- Public employers, again as noted earlier, tend to take the position that health care promises are not ironclad like pensions, but are nice things they provide for former workers which can be cut back or withdrawn in cases of budget exigencies. What does it mean to calculate a long-term cost of a benefit that might not exist in the long term?

It's not that you can't come up with a number for the liability of a retiree health plan; pay an actuarial consulting firm to come up with a number and assumptions will be made by the firm that produce a number. Those folks who pushed for such calculations probably thought that by requiring the production of a number, state and local authorities would be shocked by its magnitude and would therefore cut back on their retiree health plans. But another reaction is possible.

In my home state of California, Governor Jerry Brown is promising to come up with a prefunding plan for retiree health in his forthcoming budget message. The outgoing state controller (who has been elected the incoming state treasurer) has suggested a prefunding approach. Whatever the details, pension-style prefunding means some combination of employer and employee contributions going into a trust fund.

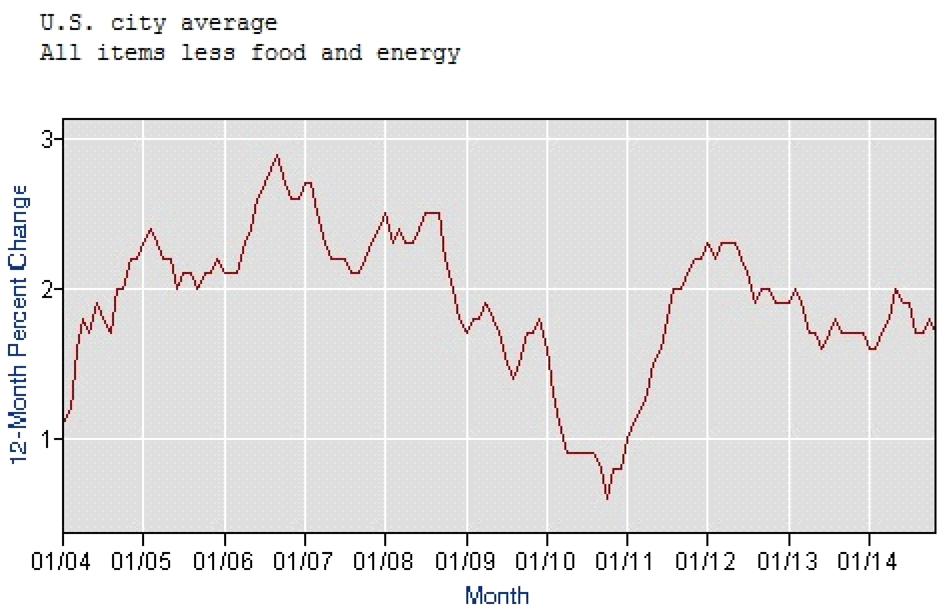
However, the more you move toward the pension model, the harder it will be to assert that health care promises are just nice things that are done for former workers but which can be undone at any time. I am not talking just about the legalities – although, even as a non-lawyer, I suspect there will be some implicit obligations inherent in the pension model when it is applied to health care. I am also talking about the Roosevelt-style political element. If you formalize the system with employer and employee contributions and prefunded trust funds, discontinuing it will be tough.

In short, those who point with alarm at public retiree health plans in the hopes they will be abolished may be disappointed. Prefunding may in fact protect such systems both financially and politically. As for the legalities, it's hard for me to believe that judges – public sector workers who are often covered by such retirement systems – won't think of "trust" in its common English meaning.

Mitchell's Musings 12-29-14: How Low Can You Go?

Daniel J.B. Mitchell

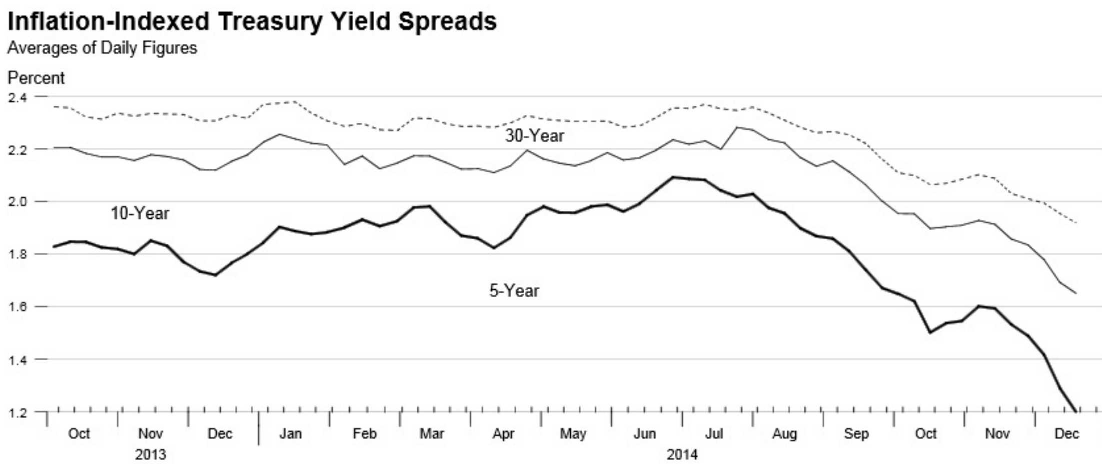
In past musings, we have noted that there is a group of monetarist-oriented economists who are convinced that the fact that the Federal Reserve greatly increased its lending in various ways during and in the aftermath of the Great Recession means a Great Inflation is on the way. So far, however, that inflation has yet to appear, as the chart below indicates. Although inflation has varied, as measured by the "core" Consumer Price Index (which excludes the volatile food and energy sectors), no Great Inflation is evident.



Source: U.S. Bureau of Labor Statistics.

Some Great Inflationists have suggested in response to the official numbers that the CPI is being rigged to hide inflation. There is some irony in that charge since to the extent there have been modifications of the CPI methodology, they came largely in response to criticisms by many of the same folks who argued in the 1990s that the CPI exaggerated the inflation rate. Apart from that historical detail, their estimate of the exaggeration was around 1 percentage point per annum, so any estimates of the effect of the modifications are upper-bounded by that limit. In short, you can't make a case for a hidden Great Inflation based on recent changes in CPI methodology.

Of course, what has happened to inflation *so far* does not necessarily indicate what *could* happen in the future. An interesting question is what financial markets expect the trend in inflation to be. One measure we have cited in prior musings is the yield spread between conventional Treasury securities and Treasury securities that are adjusted to the CPI - so-called TIPS. You can see the yield spreads below and they are not suggesting any forthcoming Great Inflation. Indeed, for the last six months, inflation expectations have been diving.[32]



Now there is no guarantee that the implicit inflation forecast by financial markets will come true. Indeed, the Great Recession was a Great Illustration of the fallibility of such markets. But what if something like the implicit forecast turns out to be accurate and the inflation rate – as measured by the CPI – turns out to be something like, say, 2% per annum over the long term?

There would be implications of such a development for macroeconomic policy which is partially aimed at keeping inflation low. *But a neglected area in the inflation outlook is the implication for defined-benefit pension plans, nowadays mainly found in the public sector*. Such plans provide a pension based on a formula linked to the earnings history of the employee. A trust fund is supposed to hold sufficient assets, derived from employer and employee contributions and past earnings on the portfolio, to pay those benefits. Particularly in the aftermath of the Great Recession and the related drop in the stock market that accompanied it, those plans tended to be underfunded.

When actuaries calculate funding ratios for pension plans, they make assumptions about inflation. Inflation is assumed to affect future wage growth of employees and thus will affect their eventual pensions, typically based on some version of end-of-career earnings. In some cases, there may also be partial or full inflation adjustments to the pensions themselves after retirement. Each plan has its own formulas so the impact of assuming more or less inflation will vary.

[32]Source: http://research.stlouisfed.org/publications/usfd/20141224/usfd.pdf

In calculating the funding ratio of a pension plan, actuaries use an assumption of the expected earnings over the long term of the trust fund portfolio. Typically, the assumption is expressed in nominal, not real, terms. A common assumption nowadays is a nominal return of around 7.5% per annum. Critics of such assumptions argue that numbers like 7.5% are too high. While portfolios might have seen such long-term earnings before the Great Recession, we are now, they say, in a "new normal" of lower returns. Therefore, the argument goes, estimates of pension underfunding are too low. Maybe the long-term rate of earnings will be only 6.5% or less and not 7.5%.

The impact of a lower actual nominal earnings rate on the funding ratio will vary from plan to plan. But to illustrate the impact, consider a promise to pay $1 per year, *adjusted for future inflation*, "forever." Suppose, in addition, you thought the inflation rate over the long term (forever) would be 3%. If you wanted to set aside enough today to meet that commitment (100% funding) and thought you could earn 7.5% per annum, you would need to set aside about $23.[33] But if you thought you could earn only 6.5%, you would need over $29, i.e., roughly a fourth more. The lower the rate you expect to earn in nominal terms, *given an assumed rate of inflation*, the greater is your liability. (If you could earn only 3% - so your real rate of earnings was zero – your liability would be infinite since it goes on forever.)

Suppose, however, your expectation of inflation dropped, say, from the 3% per annum of the previous example to 2%. Essentially, your required earning would drop by the same amount in this story. So with 2% inflation, nominal long-term earnings of 6.5% would produce about the same $23 liability that 7.5% earnings with 3% inflation gave you before.

The bottom line here is that even if defined-benefit pension trustees have been over-optimistic about assumed future nominal earnings, if inflation over the long term will be less than they expect, they in fact won't need as high a nominal earnings rate as they have anticipated. Put another way, if you argue for lowering the assumed nominal earnings rate for a pension plan because we are in a "new normal" of lower stock market gains, you have to consider whether you should also be lowering your assumption of future inflation. A "new normal" of lower inflation tends to offset a new normal of lower nominal earnings.

[33]Nominal earnings of 7.5% and inflation of 3% amount to a real rate of about 4.4%. [(1.075/1.03)-1 is about 4.4%.] Dividing $1 by .044 will give you about $23.