

Mitchell's Musings

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Note: Format and numbering may vary from originals.

Mitchell's Musings 10-1-12: Looking Backward at the Supposed BLS Labor Data Conspiracy

Daniel J.B. Mitchell

Labor market data - such as the unemployment rate - are widely watched as indicators of the direction of the national economy. In the world of politics, they are also often seen as indicators of how the electorate is responding to economic trends. Although there are models that link voting behavior to unemployment rates, the models don't tell you whether manipulating the official data would change voter response. That is, are voters responding to actual economic conditions or are they responding to the official reports of those conditions?

One of the more shameful outcomes of the Watergate affair and the revelation of the existence of the White House tapes was the discovery that President Nixon – encouraged by his aide Charles “Chuck” Colson – that there was a conspiracy at the U.S. Bureau of Labor Statistics (BLS) to fudge the unemployment data to his (Nixon's) disadvantage. Transcripts from the tapes reveal that the President was convinced that Jews and Democrats at the BLS were behind the conspiracy and that he ordered aides to compile a list of Jews and Democrats in the BLS – which the aides did. It appears that some of those persons listed experienced adverse job consequences subsequently.⁽¹⁾

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⁽¹⁾ Timothy Noah, “Malek Talks! Fred Malek makes his most detailed public statement about counting Jews for Richard Nixon, but he omits the most shameful part,” *Slate*, April 1, 2011. The documents providing a count of the alleged conspirators refer to them as “ethnics.” See http://www.nixonlibrary.gov/themuseum/exhibits/2010/watergateexhibitbackground/wg_resources/malek06a.pdf and http://www.nixonlibrary.gov/themuseum/exhibits/2010/watergateexhibitbackground/wg_resources/malek06b.pdf

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Although the demand for the listing came over a year before the 1972 election in which Nixon won a second term handily, even after the victory talk of the conspiracy continued. In a 35-minute conversation between the President and Colson of December 9, 1972, focused mainly on political matters and on the aftermath of the 1972 election, there is discussion of the new Secretary of Labor named by Nixon, Peter Brennan. Brennan came out of the construction unions of New York City and was a Democrat. But the Democrats had been split by the Vietnam War with the anti-war faction succeeding in nominating George McGovern as the party's presidential candidate. Brennan represented the “hard hat”/support-the-war faction.

At one point in their December 9th conversation, the President and Colson discuss what they see as a purge of McGovernites following the loss to Nixon. The AFL-CIO and its president George Meany had not endorsed either candidate in 1972. Some individual unions did support McGovern; the Teamsters – who were outside the AFL-CIO at the time – supported Nixon. Nixon and Colson in their conversation see the Brennan appointment as bringing the “working man” to Nixon, if not to the Republicans more generally.

In a second excerpt from that conversation, the alleged conspiracy at the BLS comes up and Nixon and Colson indicate they believe that Brennan will clean out the conspirators. In this conversation, the alleged conspirators are referred to as “bureaucrats.” Colson and Nixon seem to believe that the conspiracy involved fudging the seasonal adjustment factors used for the unemployment rate data. No such conspiracy existed but the two are sure that one did.

There is reference to the Commissioner of Labor Statistics, Geoffrey Moore. In a break from the past - in which the Commissioner was seen as a technical-professional position, not a political appointment - Moore had been requested, along with political appointees, to submit his resignation at the end of Nixon’s first term. Surprisingly, the resignation was accepted so that Moore was effectively terminated. In the conversation, Nixon says he didn’t want Moore kicked upstairs to some other government position; he wanted him out. Apparently, the President blamed Moore for not removing or controlling the alleged BLS conspirators.

The individual later named to succeed Moore – Julius Shishkin – presumably with Brennan’s endorsement, ironically was Jewish while Moore was not. Shishkin continued as Commissioner under President Ford after Nixon resigned due to the Watergate affair and refused to submit his resignation when Ford’s term ended.⁽²⁾ Of course, there never was any conspiracy at the BLS against Nixon, before or after the termination of Moore. Indeed, although BLS statistical methodology has sometimes been criticized on various technical grounds, there has never been evidence of a data conspiracy involving labor market information for or against any president. The Moore termination did inject politics into a technical function. Shishkin’s stance undid some of the damage and no president, as far as we know, has since believed in a data conspiracy at BLS.

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⁽²⁾Shishkin’s refusal to submit a resignation is mentioned in the official BLS history, http://www.bls.gov/opub/blsfirsthundredyears/chapter_8.pdf, p. 218. His papers are in the Gerald Ford presidential library:

<http://www.fordlibrarymuseum.gov/library/guides/findingaid%5CShishkin,%20Julius%20-%20Papers.htm>

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You can hear the two excerpts from the December 9, 1972 Nixon-Colson conversation at:

<http://www.youtube.com/watch?v=pQjiSQKlpS8>



Mitchell's Musings 10-8-12: Controlling Meany

Daniel J.B. Mitchell

In the early 1970s, union contracts covered about a fourth of the workers on U.S. payrolls. Today, the fraction is about half that. Moreover, while there is still a public image of a union worker as a blue collar type working in the private sector, say, in construction or manufacturing, about half of union coverage is now in the public sector. Of course, the stereotypical image is a throwback to an earlier era. To some extent, that image was personified by George Meany, president of the AFL-CIO from 1955 until he stepped down in 1979. Meany, with his trademark cigar, had come up from the New York City building trades and looked the part.

Even in the early 1970s, private sector unionization had been slipping as a proportion of the workforce for almost two decades. But the trend was partially masked by the rise of public sector unionization. Through executive order and later legislation at the federal level and through state and local legislation, public sector collective bargaining was growing. Moreover, in absolute terms, union membership grew even if it failed to keep up with workforce expansion. Still, in the mid-1950s when the AFL-CIO was born out of the merger of two rival union federations, the relative slippage had begun just as Meany took over as the most visible face of organized labor.

Despite the decline in private unionization, union wage bargaining was viewed by the Kennedy and Johnson administrations as a significant component of the inflation process. A system of voluntary anti-inflation wage-price guideposts was installed by the Kennedy administration, an American version of "incomes policies" found in Western Europe and elsewhere abroad. These guideposts fell apart under Lyndon Johnson's administration as the labor market heated up during the Vietnam War demand expansion. But the guidepost attempt reflected an important train of macroeconomic thought in that era.

With the election of Richard Nixon in 1968, such programs fell into disfavor only to be revived by the new President to an extent far more reaching than under Kennedy-Johnson. Nixon imposed *mandatory* wage-price controls in mid-August 1971. The Nixon program went through various phases with the initial Phase I being a 90-day freeze. Phase II was announced in early October 1971, but did not go into formal effect until mid-November when the freeze expired. Under Phase II, the wage side of the program was to be administered by a tripartite Pay Board with five members each from management, from labor (which meant private sector union leaders at the time), and from the public. Readers of earlier Mitchell's musings will know some of this history.

Readers will also know from prior musings that the Nixon White House tapes – revealed during the Watergate affair - are increasingly being put online. But the ability to find the relevant information about the relation between the White House and organized labor as wage-price controls were imposed on the tapes is limited. The search aids available are geared to such "big" episodes as Watergate and the Vietnam War. In order to find relevant information on the controls or other areas of economic policy, researchers have to look for personalities identified as being in the conversations who might

have had something to do with economic policy or for dates during which such policy might have been discussed. Audio quality varies substantially; some tapes are essentially inaudible. However, there are usable taped conversations – or excerpts within such conversations – that do deal with controls policy.

Even though unionization was slipping, it was clear at the time that the Nixon Phase II wage-price controls were essentially linked to labor costs. Price controls were basically allowable markups over cost and, at the macro level, *net* costs are heavily labor costs. The Phase II wage guidelines (really wage *increase* guidelines) were based on a complicated mix of compromises wrapped around a basic concept that wages should rise at the same rate as national productivity plus a target rate of (low) inflation. Although even in 1971, nonunion labor costs were dominant in the American economy, there was a belief that unions were in key sectors which set wage patterns in other industries, both union and nonunion. There were thus a few key unions in a few key industries and thus a handful of key labor leaders seen as important to any anti-inflation policy.

Of course, the AFL-CIO as an organization, and in the person of George Meany, had to be on the Pay Board. But two big unions in the early 1970s were not part of the AFL-CIO. The United Auto Workers (UAW) had dropped out of the labor federation in 1968 over tensions related to the Vietnam War. In the early 1970s, the UAW was headed by Leonard Woodcock. And the Teamsters had been expelled from the AFL-CIO in the late 1950s over corruption issues. Teamsters president Jimmy Hoffa was in fact in prison but he remained the titular head of the union. The actual head – although he could not take the title of president as long as Hoffa retained it – was Frank Fitzsimmons.

Given these institutional realities, the Pay Board's labor members initially included Meany, Woodcock, and Fitzsimmons. Two other AFL-CIO unions were also represented: the Steelworkers under I.W. Abel, and the Machinists under Floyd Smith. To the extent there was an individual in the Nixon administration in 1971 who was a liaison to organized labor, it was George Shultz. Shultz at that time was director of the Office of Management and Budget (OMB) but he had been Nixon's first Secretary of Labor.

Shultz was able to maintain a personally friendly relationship with Meany. Fitzsimmons was also friendly with Shultz. It is noteworthy that the Teamsters' head had a special reason to be friendly. If Nixon pardoned Hoffa on condition that he step down as president of the Teamsters and avoid further union activity, Fitzsimmons could have the union's presidential title and not worry about Hoffa interference.

At the time the Pay Board was being formed, the presidential election of 1972 was only a year away. Typically, the AFL-CIO would back the Democratic candidate. As it turned out, the Democrat ended up being the anti-Vietnam War George McGovern. So, in the end, the AFL-CIO and Meany were neutral in the election and Fitzsimmons and the Teamsters - after Hoffa received his conditional pardon - endorsed Nixon. But none of these developments were evident a year before the election.

Four Nixon taped conversations give insight into this period. First, Nixon bought into the idea of wage-push inflation and the need for controls – particularly on key labor union settlements - although not all of his advisors did. Second, Nixon relied heavily on Shultz for advice on what to do about organized

labor, particularly as labor leaders protested the freeze and the emerging design of Phase II. As Phase II planning and implementation developed, there was a clash, which became public, between the President and Meany. I have put up two YouTube videos which contain four conversations in all that are revealing about the internal thinking and planning in the Nixon administration that went on in the fall of 1971.

The first conversation between Nixon and Shultz on September 23, 1971 (before the outline for Phase II had been announced and probably even before the plan had been made final) shows Nixon fretting over what Woodcock and Meany might do in response to whatever is put forward. Nixon wanted to appear tough on labor and believed that the union leaders were out of step with their membership, but he also wanted their cooperation with Phase II. He asks Shultz if Woodcock and Meany had to be treated with “kid gloves.” Shultz doesn’t think so but wants the focus to be on what Woodcock and Meany were saying rather than on them as personalities. He cautions Nixon that saying that union leaders were out of touch with their membership would especially annoy them.

A second conversation between Nixon and Shultz occurred on November 2, 1971. By this time, the design of Phase II had been announced although Phase II itself would not formally begin until mid-November. Nixon says he would like to “take on Meany” but as before he is fretting that labor could walk out of the Pay Board or not cooperate and thus kill the Phase II program. In fact, Nixon says he really has very limited sanctions that he could impose as a practical matter if labor doesn’t cooperate. He is willing to make concessions and make a deal, almost any deal that is necessary. The only real sanction he sees to obtain labor cooperation is public relations. Nixon believes that the general public favors his wage-price program and, if labor is uncooperative, the union leaders would be blamed.

You can hear these two conversations at <http://www.youtube.com/watch?v=afJhbXMeL5o>.

The next two conversations occur when Phase II is in early operation but there remains great tension at the Pay Board between labor and management and the public members. As of November 20, 1971, Nixon is still worried about what would happen if labor walked out. Shultz doesn’t think that such a walkout is imminent but agrees with Nixon that Meany is unstable and unpredictable. Shultz says that there is no question that there is a “war” between the Nixon administration and Meany and the only question is how to fight the war.

Toward the end of the conversation, the issue of the Hoffa pardon arises. Shultz has been told second-hand that Meany would not object to a pardon (even though it was the AFL-CIO under Meany that ejected Hoffa and the Teamsters from the federation on corruption charges). But Shultz and Nixon are unsure of what Meany might actually do if a pardon were granted. The conversation is evidence of the early thinking on the pardon and its implicit relationship to Teamsters’ cooperation with the wage-price program.

Amidst the tensions over Phase II, Nixon went to the AFL-CIO convention in Miami to speak. At the convention, he received a frosty reception, especially from Meany. In a conversation of November 22, 1971 with FBI director J. Edgar Hoover, Nixon and Hoover discuss the immediate aftermath of that

episode. Hoover thinks Nixon came out ahead because of the disrespectful treatment by Meany and that other labor leaders were embarrassed by Meany's behavior.

You can hear these two conversations at <http://www.youtube.com/watch?v=NtMaDbqmsuY>.

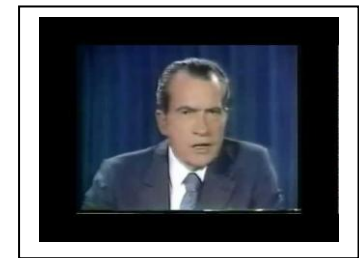
So what do we learn from the taped conversations? Of course, they are interesting from an historical viewpoint, particularly with regard to implementation of the Nixon wage-price controls program. In addition, the focus of the President on labor union personalities illustrates the thinking of that era on how the wage-price mechanism worked. The notion was that influencing the behavior of a few key individuals could noticeably affect inflation.

There is also a lesson on contrasts; then vs. now. Unions in 2012 may still play an important role in politics, but few would think of them as significant players nowadays in the overall inflation process. Note that there was a greater consensus across party lines in the 1960s and early 1970s on economic policy than there is today. Nixon's wage-price controls and the Kennedy-Johnson wage-price guideposts developed out of the same thinking, even though the Nixon controls went further by being mandatory. If there is any consensus today that remains from the earlier period, it is mainly that economic trends have something to do with election results.

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George Shultz and President Nixon



Mitchell's Musings 10-15-12: Back Then the Question Was "What Now?"

Daniel J.B. Mitchell

In past musings, I have taken advantage of the growing availability of "White House tapes" from the Nixon era.¹ Not surprisingly, given the history of the disclosure of the tapes during the Watergate affair, the focus of many tapes being made available involves that scandal. The search options provided are limited. It can be difficult to locate conversations dealing with subjects beyond Watergate or other "big" stories of the day such as the Vietnam War. Conversations dealing with economic policy can certainly be found but researchers must use proxies such as the names of participants who might have been involved in policy discussions or the dates when such discussions are likely to have occurred. Then it is necessary to look at online written outlines of the conversations – which often covered a variety of topics – to see if economic policy was actually discussed.

A major policy turning point occurred on August 15, 1971 when President Nixon announced in a TV address that he was unilaterally ending the Bretton Woods international monetary system of fixed exchange rates that had been established in 1944 at the tail end of World War II.² Bretton Woods was a fixed exchange rate mechanism under which all major currencies were linked to the U.S. dollar at set prices and the dollar was in turn linked to gold at \$35/ounce. There are interesting historical reasons why the system was created in that format but the key point as of 1971 was that the dollar was overvalued at official exchange rates relative to other major currencies. That overvaluation required international authorities – central banks and treasuries – to intervene in the currency markets to buy up the excess dollars. As foreign authorities acquired a growing hoard of dollars, they were tempted to buy gold from the U.S. Treasury with those dollars, essentially speculating that the U.S. dollar would eventually be devalued and the price of gold would be raised. Thus, the American gold supply was dwindling.

Foreign authorities had agreed during the late 1960s to refrain from such speculative behavior but by 1971 their promises were being breached. Part of the August 15 announcement was that the "gold window" of the U.S. Treasury would be closed, so gold purchases could no longer be made there. Thus, the drawdown of the U.S. gold stock was halted. The dollar was allowed to float (presumably to depreciate) relative to other currencies. It was unclear what new agreement, if any, would be made with other countries on exchange rates. However, there was a general assumption that there would be negotiations through the International Monetary Fund (IMF) over a possible new system.

The other major element of the August 15 announcement was a change in domestic policy. In a dramatic change in direction, anti-inflation wage-price controls were imposed in the form of a 90-day freeze on wages and prices (Phase I). During the freeze, a new system of more flexible wage-price controls was to be created. There were precedents for such a system from World War II and the Korean

¹ Not all of the tapes were recorded in the White House. Some were recorded in other presidential locations or are telephone calls.

² See <http://www.youtube.com/watch?v=Wv4gpyfLF3s> and <http://www.youtube.com/watch?v=iRzr1QU6K1o>.

War and from foreign “incomes policies.” In addition, the Kennedy-Johnson administrations had applied “voluntary” wage-price guidelines. However, it was assumed that the supposedly conservative President Nixon would eschew such interventionist policies. Indeed, on that assumption, the Democratic congress had given Nixon a legislative blank check to control inflation on the assumption he would not use that power. The notion was that in the upcoming 1972 presidential election, his failure to halt inflation despite the blank check would be an issue.

Given these two dramatic announcements in international and domestic macroeconomic policy, it might have been expected that five weeks after the change in course, there would be advanced planning underway a) to outline what a new exchange rate policy might be and b) to develop the details of the Phase II wage-price controls. In fact, however, a phone conversation of September 22, 1971 between then-OMB Director George Shultz and the President suggests that whatever planning had been going on was at an embryonic stage. I have posted the relevant excerpt from that conversation at <http://www.youtube.com/watch?v=eQARcxRX0Kg>

We learn five interesting things from the conversation. First, as noted, is the fact that five weeks into the 90-day period after which Phase II is supposed to come into existence, there was no Phase II. Shultz gently points out to Nixon that it will take time – once the conceptual details of Phase II are established – to create the necessary administrative machinery to operate the new program. Second, although there is no 90-day limit on creating a new world monetary order, the IMF was in fact meeting the next week. Presumably, the member nations of the IMF were expecting some kind of information from the U.S. on what would come next. But the President seems to view the IMF meeting as an interruption which would tie up key officials who might otherwise be doing more important things. So he suggests that everything (Phase II and planning on the international front) will have to wait until September 30 (six weeks into the freeze) after the IMF meeting is over.

Third, it is apparent that the President relies heavily on Shultz for counsel in economic matters although he has other economic advisors, notably Herb Stein, chair of the Council of Economic Advisors. At the end of the conversation, he indicates that Shultz might have Stein tag along on a plane trip in which some Phase II planning might be discussed. Stein is clearly to be involved in the planning but he seems to be less of an influence than Shultz.

Fourth, there are several references to Arthur Burns, chair of the Federal Reserve. Because of Federal Reserve independence, the Fed chair is not usually considered a part of the presidential administration even if he is appointed by the President. But Burns does seem to be expected to be involved in the ongoing economic planning. Indeed, Nixon indicates that Burns was a major driver behind imposition of wage-price controls and that whatever Phase II turns out to be will need to be sold to Burns.

A fifth component of the conversation involves gold. Prior to the Great Depression, private American citizens could hold gold. Gold coins were in circulation. However, during the early New Deal, President Roosevelt raised the official price of gold. To avoid giving windfalls to those holding gold, private gold was required to be sold to the Treasury at the old price and citizens could not hold gold (other than in

jewelry, tooth fillings, etc.). During the conversation, the idea of ending the ban on private gold holdings is mentioned but the timing is said not to be right. This reference in the conversation suggests that although a new world monetary order had not been developed, the thinking in the Nixon administration was that in whatever might emerge, gold would no longer play a significant role. Whatever rationale there had been for the gold ban was now gone.

The world of expansive presidential economic power of 1971 seems quite different from the contemporary scene of much more constrained presidential authority. We noted in a prior post that the role of organized labor was viewed as important back then in the inflation process although – given the drop in unionization subsequently – no such view prevails today. If there is any similarity in that regard between then and now, it is in a reference to a dock strike on the West Coast which was underway at the time Nixon and Shultz spoke.

There are really only two industries nowadays in which a labor dispute could have a notable effect on the economy: longshore and railroads. Both sectors can disrupt commerce more generally by halting freight movement. Shultz and Nixon discussed the dock strike and the possibility of using a Taft-Hartley injunction to halt the strike.³ (Shultz seemed disposed to let the strike continue without intervention because employers felt such federal involvement might weaken their hand in bargaining.) Some readers may recall that President George W. Bush imposed a Taft-Hartley injunction during a West Coast longshore work stoppage (a lockout) in 2002. But there is a difference, even in this seeming parallel, between the Bush and Nixon eras. In the Nixon era, the concern was partly over the more general disruption to commerce but also that a big pay settlement to end the dock strike could upset whatever wage controls might emerge in Phase II. Under Bush, there were no controls about which to worry and no thought that a big union settlement could cause inflation.

While it may be inevitable that the release of the Nixon-era White House tapes has focused on Watergate, it certainly would be helpful for those seeking to understand economic policy in that period if a more comprehensive search capacity was included. One view, of course, is that the past is the past and there are no lessons to be learned for contemporary economic policy. However, economic policy is often path-dependent and knowing where we came from can help us to understand where we are.

³ The Taft-Hartley Act of 1947, enacted after a wave of strikes that followed the end of World War II, gives the President the authority – through a court procedure – to impose an 80-day “cooling off” period in the case of “national emergency disputes.” Railroads collective bargaining is regulated by the Railway Labor Act which provides for a related procedure.

Mitchell's Musings 10-22-12: Playing With Numbers

Daniel J.B. Mitchell

An earlier Mitchell's Musings dealt with President Nixon's suspicions that technicians at the Bureau of Labor Statistics (BLS) were somehow diddling the labor market numbers to make him look bad – suspicions reinforced in paranoid taped conversations with Charles Colson of later Watergate ill-fame.⁴ These suspicions by the President – reinforced by anti-Semitic notions that it was Jews in the BLS that were conspiring against him – ultimately led to adverse personnel actions for some BLS staff. In any event, my musing turned out to be well timed since it coincided with suggestions by former General Electric CEO Jack Welch that the most recent release of the unemployment rate was rigged. Welch hinted on Twitter that the technicians were diddling the number to help Obama in the upcoming presidential election by making the unemployment rate fall below 8%.⁵

There was also some email back-and-forth about the Welch episode on the LERA-Dialog server when I posted an item about it. Prof. Sean Flaherty of Franklin and Marshall College sent me an email as a result noting that there is some evidence from behavioral economics that people who cheat are more likely than others to assume that others are also cheating. As one commentator pointed out, financial data released by General Electric under the Welch regime have been questioned as manipulated.⁶ In addition, a quick Google search found an academic study suggesting that those in positions of high authority are themselves more likely than others to cheat.⁷ They apparently feel entitled by position to do so.

⁴ Mitchell's Musings 10-1-12: "Looking Backward at the Supposed BLS Labor Data Conspiracy," <http://www.employmentpolicy.org/sites/www.employmentpolicy.org/files/field-content-file/pdf/Daniel%20J.B.%20Mitchell/MitchellMusings%2010-1-12.pdf>.

⁵ In the second presidential debate of October 16, 2012, Mitt Romney did not challenge the validity of the 7.8% unemployment figure and in fact cited it (as still too high).

⁶ Clyde Prestowitz, "Jack Welch owes us an apology," *Foreign Policy*, October 8, 2012. Available at http://prestowitz.foreignpolicy.com/posts/2012/10/08/jack_welch_owes_us_an_apology. "Maybe Jack's suspicions arise from his own experience with reporting good and bad numbers. His main claim to fame, after all, is that he produced a string of 80 quarters of uninterrupted increases in earnings for GE. This no doubt reflected his genius as a corporate manager, but it also reflected use of off balance sheet vehicles such as those used by Enron before its bankruptcy and other creative accounting techniques linked to GE Capital, the company's finance arm. So, maybe from this experience Jack thinks that happy coincidences just don't occur."

⁷ Joris Lammers, Diederik A. Stapel, Adam D. Galinsky, "Power Increases Hypocrisy: Moralizing in Reasoning, Immorality in Behavior," undated, available at <http://www.kellogg.northwestern.edu/faculty/galinsky/Power%20Hypocrisy%20Psych%20Science%20in%20press.pdf>

Which leads to an interesting question: Did President Nixon ever try *himself* to manipulate official government economic statistics? As noted in prior musings, the tapes of “White House” conversations that were uncovered as part of the Watergate affair are gradually being made available online.⁸ However, search options for finding topics on the tapes are limited. Nonetheless, I did find a relevant conversation between then-Office of Management and Budget director George Shultz and President Nixon of May, 12, 1971. You can find it at: <http://www.youtube.com/watch?v=1qV84JmgwVE> Before saying more about that conversation, some economic background is in order.

President Nixon came into office in January 1969 in a period in which the Vietnam War expansion had overheated the economy. Unemployment at the time was down around 3.5%. The inflation rate, measured by the Consumer Price Index (CPI), was up above 6% and seen as likely to rise if nothing were done. Large wage settlements were creating concerns about a “wage-price spiral.” The hope was that a restrictive macro policy, particularly on the part of the Federal Reserve, could engineer a “soft landing,” i.e., a slowdown of the economy just sufficient to cool inflation without causing a full-fledged recession.

As it turned out, however, there was a recession which the National Bureau of Economic Research (NBER) now dates as beginning in December 1969 and ending in November 1970. As a result of the recession, inflation slowed and unemployment – which tends to respond with a lag – rose. The table below shows the basic outcome.

	CPI Inflation Dec. to Dec.	Annual Rate	Unemployment
1967	3.0%		3.8%
1968	4.7		3.6
1969	6.1		3.5
1970	5.6		4.9
1971	3.3		5.9

As with all recessions and their aftermaths, in real time, it was hard in the spring of 1971 to judge exactly what was happening to the economy. It is difficult after any recession to identify initially clear signs of a recovery or how robust that recovery is likely to be, even if recovery is detected unambiguously. A sluggish economy in 1971, especially if it were continued into 1972, would not be good presidential politics for the 1972 re-election campaign.

⁸ Not all conversations that were taped occurred in the White House. Some occurred in other venues or were phone calls.

We now know, thanks to NBER, that there was a recovery underway at the time of the May 12, 1971 conversation. But opinions appearing in news items of that period were mixed. The available real GNP figures for the fourth quarter of 1970 didn't look all that good. But they were affected by a strike at General Motors, clouding the interpretation.⁹

In short, there was a mix of economic indicators, some pointing to sluggishness; others pointing to a more optimistic interpretation. In the May 12, 1971 conversation, it is apparent that President Nixon has earlier been told of a new number that might be interpreted optimistically and that might be fed to the news media as proof that a solid recovery was occurring. It is not apparent from the conversation, however, to which of the many economic figures released by government agencies the President is referring. So some detective work was needed.

What we do learn is that the magic number to which Nixon refers is \$30.8 billion. We know from the conversation's date that the President's talk with Shultz occurred on a Friday. We know that the number given to the President was not yet ready for official release and we learn that the release date would normally be on a Friday – so the normal release date would have to be the following Friday, May 19. With some detective work, I was able to find that the February seasonally-adjusted figure for new orders for durable goods that was released on May 19, 1971 was \$30.8 billion. So apparently, that number was the topic of the Nixon-Shultz conversation.

Now the figure on monthly new orders for durable goods is not a high-profile piece of economic information comparable to, say, the unemployment rate or the CPI inflation rate. So why the President was so taken by the figure is not clear. But apparently he was previously told it was a good number and that it would refute naysayers who were writing pessimistic stories about economic trends.

Despite what he might have been told, Nixon had an exaggerated notion of what the impact of the figure, once released, would be. In fact, when it was released, there was no heralding of the information as a sure sign of a strong recovery. Indeed, as the excerpt in the box below from the Los Angeles Times shows, the figure was reported as something of a negative because it was *lower* than the January figure although higher than the year earlier number. And the number appeared on page D9 of the paper; it was hardly front-page news. No one cared all that much about the number.

⁹ General Motors and the auto industry was a much more important component of the economy in 1970 than it is today. See <http://www.youtube.com/watch?v=DUtgF-XkDXA> , <http://www.youtube.com/watch?v=G83QduYKfgs>, and <http://www.youtube.com/watch?v=9PgG-nmWfo0>.

Whatever the actual impact of the number, on May 12, when he talked with Shultz, the President thought the figure would be a plus and was anxious to make the information public. The problem was that that normally-scheduled timing would mean that it would not be made public for a week. Releasing the number early because the President thought that it would be advantageous politically to do so would have been improper.

Nixon in the taped conversation looks for a rationale for an early release, one way or another. He says that he is concerned that the figure might leak out before the release date and then would not be interpreted “properly.” He says the official policy of his administration is “never to put out anything in advance” and to treat statistical releases “honestly.” But the President says that if the numbers are available earlier than the normal release date, they shouldn’t be held up “in my opinion.” If the numbers are ready on Tuesday, he says, they shouldn’t wait for release until Friday.



Shultz counters that the scheduled date is the following Friday but says it is “our policy that we don’t sit on numbers.” Shultz reports that he spoke to statistician Julius Shishkin and told him that the numbers should be produced as fast as possible.¹⁰ Maybe – if the numbers are ready - they could be released Thursday instead of Friday, Shultz tells Nixon. So now the possible irregular speed-up drops from Tuesday to Friday in the conversation. But Shultz then tells Nixon about all the details that have to be worked on apart from just the bottom-line number. He seems to be hinting that even a release one day earlier than normal might not be possible.

All of the underlying figures have to be prepared that add to the bottom-line total, Shultz points out. The press release has to be written. Shultz then goes into a tangent about inventory figures which he says are bullish and that leads to further discussion of profits and the effects of the General Motors strike. So the conversation begins to be steered away from early release idea of Nixon’s to

¹⁰ Shishkin is discussed in the earlier musing cited in footnote 1.

general interpretation of recently-available data by Shultz. My interpretation is that Shultz was trying at that point to divert Nixon from the idea of an early release without flatly saying “no.”

However, Nixon was not sufficiently diverted. He then raises the idea of discussing the possibility of an early “inspired leak” with White House speechwriter William Safire. Nixon wants Shultz to do the chatting with Safire. But Shultz shouldn’t directly tell Safire to leak anything, Nixon says. And the decision on leaking should be between Shultz and Safire; Nixon says he doesn’t want to know about it.

Shultz finally says he thinks the data should be released in “the normal way.” It may be that Shultz realized that apart from the virtues of not leaking, the figure was not all that important. “We shouldn’t hail” the figure when it comes out, Shultz says; he suggests a low-key approach. Nixon is persuaded by Shultz and now frames his suggested interaction with Safire differently. He just wants the story to get a “good play” when it comes out. Shultz agrees and says maybe the figure might be higher than \$30.8 billion when the release is finally ready.

Nixon wonders whether “honest economists” will pick up on the significance of the figure. He wants someone to help press secretary Ron Ziegler make the right interpretation. Shultz agrees that such assistance would be a good idea. And from what we know, there was no leak and the figure came out on the normal schedule.

Of course, releasing data on a pre-announced official schedule is one important way of avoiding charges that government statistics are being used for political purposes. Nixon’s proposal to advance the release of what he thought was a positive number would have undermined that approach. Shultz in various ways resists the idea of a leak or an early release and appears to have killed it, both in the conversation and in actual practice. That interpretation of the May 12 conversation is consistent with Shultz’s behavior in another instance in which he – in his later position as Treasury Secretary – was asked to launch improper IRS investigations of supposed Nixon enemies and refused to do so.¹¹

Since President Nixon was willing to play with the timing of what he thought would be a positive official economic statistic, perhaps it is not surprising that he would assume that his assumed enemies in the federal statistical bureaucracy might want to adjust other numbers to be negative. In an interview in 2008, the above-mentioned William Safire refers to Nixon as a

¹¹ See the brief excerpt on YouTube in which Shultz describes the later IRS incident at http://www.youtube.com/watch?v=FG_TjWN-Mk4. An aide to Shultz reports that White House counsel John Dean has come to him with a list of names to be targeted. Shultz tells his aide to refuse and to tell Dean that if he (Dean) has a problem with the refusal, he has a problem with Shultz, not the aide. Shultz reports in the YouTube interview that he never heard anything from Dean but that when the White House tapes became available, he learned that Nixon was angered by the refusal.

multi-layered cake with different personality aspects, one layer being what Safire termed “mild paranoia.”¹² Nixon didn’t want to think of himself as doing anything wrong early in the May 12 conversation but he then shifts and rationalizes the inconsistencies. The shifting from doing no wrong to strategies for doing wrong all occurs within a conversation lasting four and a half minutes.

Of course, the same personality inconsistencies and contradictions may account for why the administration of the supposedly-conservative Richard Nixon originated modern affirmative action in the workplace. The inconsistencies and contradictions may explain why Nixon signed off on worker safety legislation, on environmental legislation, and why he implemented wage-price controls.¹³ They might account for why he advocated (unsuccessfully) for a national health insurance system based on an employer mandate.¹⁴ And there was Nixon the anti-communist who became “Nixon in China.”

Nixon went to China literally. But figuratively - with his inconsistencies and contradictions - he went to China more than once. We can thank George Shultz for halting one trip on May 12, 1971.

¹² See <http://www.youtube.com/watch?v=yHLsE5nYuGk>.

¹³ See <http://www.youtube.com/watch?v=Wv4gpyLF3s>.

¹⁴ See <http://www.youtube.com/watch?v=iGKkPEvD2OM>.

Mitchell's Musings 10-29-12: Labor Shortage?

Daniel J.B. Mitchell

We hear from time to time that jobs are going begging because workers don't have the right skills. Somehow, by coincidence, this skill gap just happened to occur at the time we had the Great Recession and financial crisis.

Manufacturing, we are told, is especially being held back by a lack of properly-skilled workers available to do the jobs required.⁽¹⁾ It's a great "things-are-not-what-they-seem" story in a period of high unemployment. But it's a dubious proposition.

There are some official data that track such developments, albeit imperfectly, for nonfarm payroll workers. So let's start with some basics. The U.S. Bureau of Labor Statistics (BLS) has surveyed employer-reported vacancies (termed "job openings") on a consistent basis since late 2000. Is the vacancy rate in manufacturing particularly high compared to other sectors? Let's look at the most recent monthly survey.⁽²⁾

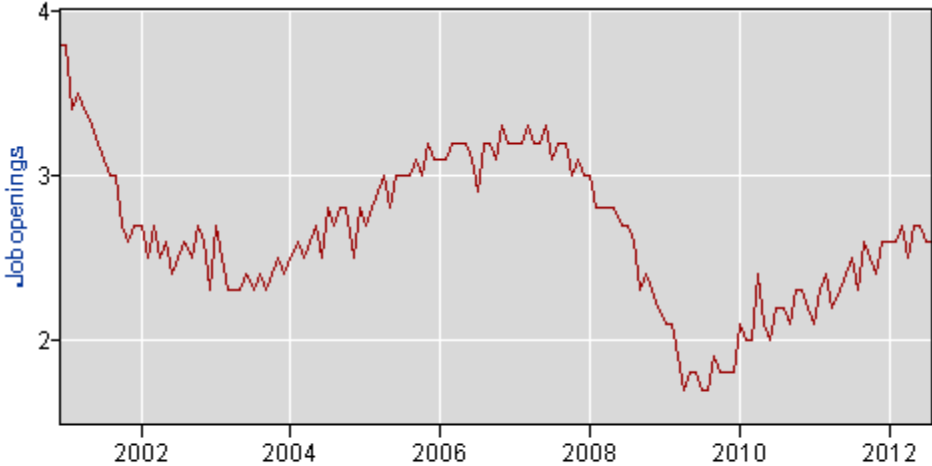
August 2012 Seasonally Adjusted	Job Openings Rate (%) ⁽³⁾	Number of Openings (000s)
Total	2.6%	3,561
Total private	2.8	3,192
Construction	1.5	82
Manufacturing	2.1	255
Trade, transportation, utilities	2.3	605
Retail trade	2.3	353
Professional & business services	3.8	708
Education & health services	3.1	657
Health care & social assistance	3.4	596
Leisure & Hospitality	2.9	414
Arts, entertainment, Recreation	2.8	56
Accommodation & food services	3.0	358
Government	1.7	369
State and local govt.	1.6	307

As the table on the prior page indicates, the vacancy rate in manufacturing is *lower* than those of most other sectors. The exceptions are construction, hard hit by the housing/mortgage meltdown, and government, especially state and local, which is declining in employment as a result of budget crises that followed the Great Recession.⁽⁴⁾ Is it really likely that the higher vacancy rates in sectors such as retail trade or accommodations and food service indicate that those sectors had a harder time finding workers with the right skills than manufacturing? Lesson: Anecdotes about spot worker shortages in manufacturing (or elsewhere) do not a macro-story make.

The manufacturing vacancy rate has floated around in the 2.0–2.5% range of late. Thus, even if magically every one of those vacancies could have been filled, manufacturing employment and output would have been only about 2.0-2.5% higher. As the chart below shows, the vacancy rate in manufacturing has not returned to its prior cyclical peak. So it can't be said that, but for some supposed unprecedented labor shortage, manufacturing would be back to its pre-Great Recession level. Manufacturing employment at the time of the August 2012 jobs report was about 16% below where it was when the economy last peaked in 2006-2007.

Furthermore, the chart below also shows that even at the cyclical trough, there were some vacancies in manufacturing; the vacancy rate never fell below 1.3%. So before the Great Recession, there was a “core” of unfillable vacancies of something over 1%. In other words, if we could today magically fill all *feasible* manufacturing vacancies, employment and output in that sector might be 1.0-1.5% higher, not even the 2.0-2.5% of the prior paragraph.

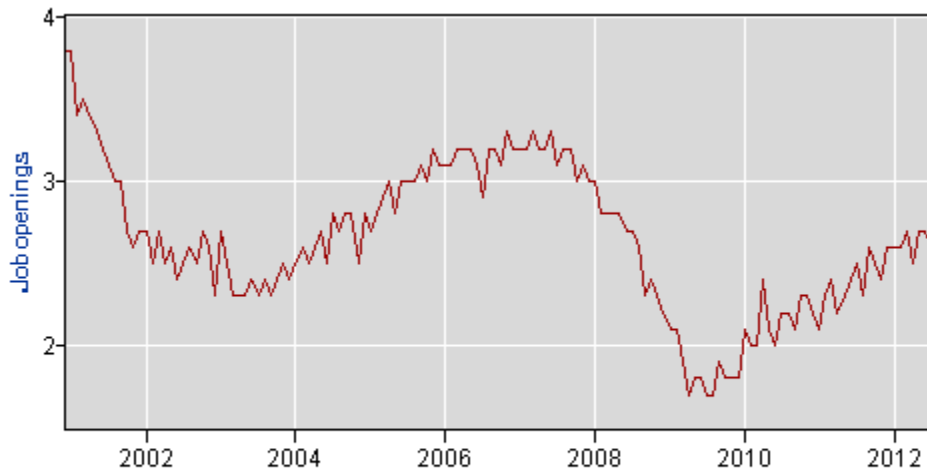
Job Openings Rate: Manufacturing



What about the economy as a whole, not just manufacturing? Is there evidence of some sharp jump in structural labor shortages caused by workers suddenly not having the right skills just when the Great

Recession struck? In fact, the overall picture – which can be seen on the chart on the next page - looks much like the manufacturing story. The total vacancy rate now is about half a percentage point above manufacturing. But its irreducible trough level was also above the manufacturing rate by about the same amount. So if we could have magically matched each feasibly-fillable vacancy with a worker, total employment and output would have been 1.0-1.5% higher economy-wide, i.e., about the same percentage magnitude as we estimated just for manufacturing.

Job Openings Rate: Nonfarm



Economists have another way of looking for signs of a rise in structural mismatch. The so-called Beveridge curve plots the vacancy rate against the unemployment rate. We then look to see if, at a given unemployment rate, when moving from period A to period B, the vacancy rate became higher. In the abstract, that increase would be a sign that greater mismatch between workers and job openings had occurred in the interim.

The problem with that simple interpretation, however, is that the unemployment rate is rarely stagnant. It may be falling or rising, depending on economic conditions at the time. We might well expect that at a given unemployment rate there would be *more* vacancies if the unemployment rate were *falling* than if it were *rising*. In a rising unemployment situation, employers - taken in aggregate - are less likely to be looking to recruit new workers than in a situation of falling unemployment. That is, the outlook employers see for needing more workers depends on the direction of the economy. In recessions, employers are more likely to be thinking about shedding workers than about recruiting. The reverse is true in expansions.

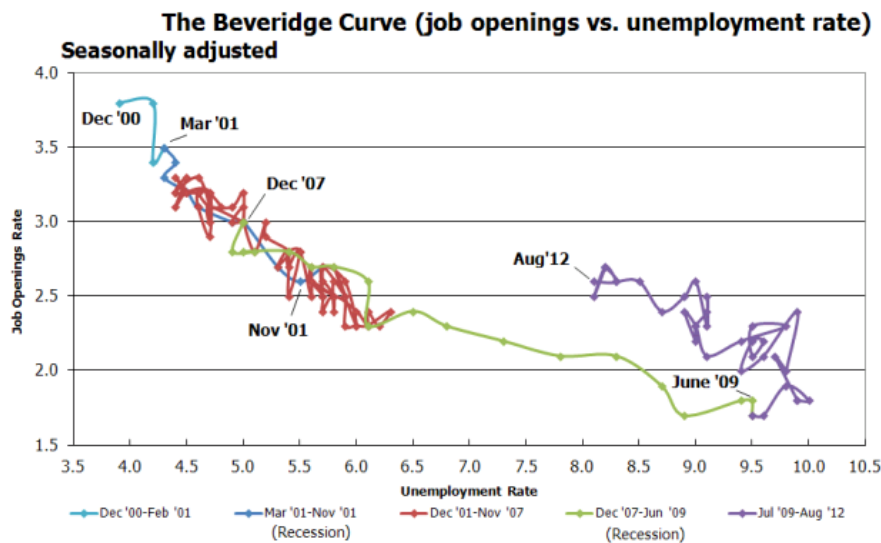
BLS conveniently has plotted out a Beveridge curve which is reproduced on the next page.⁽⁵⁾ The unemployment rate for August 2012 was a little over 8%. As the chart shows, at the last time the unemployment rate was at that level, vacancy rates were lower by about 0.4 percentage points. But, as

noted above, the last time we hit 8%, the unemployment rate was on the way *up* (recession). In August 2012, it was on the way *down* (expansion). So we might well expect more vacancies in the recent period relative to what was occurring as the Great Recession unfolded.

Despite that important proviso, let's take a conservative position and assume that the *entire* 0.4 percentage point gap at around 8% unemployment was due to a rising structural worker/job mismatch. Under that assumption – if we could magically have undone that hypothetical rise in mismatch – the unemployment rate in August would *at most* have been something like 7.7%.⁽⁶⁾ Employment and output economy-wide would have been higher by something like that margin.

Now an unemployment rate a bit below 8% is clearly better than one a bit above 8%. And it would be nice to have 0.4% more jobs and output than we actually do. But none of these imaginary gains would have put us near full employment. At the prior cyclical peak, by way of comparison, unemployment was about 5%, not a bit below 8%. The obvious point by now (I hope) is that our current problem is lack of demand, not a sudden jump in structural mismatch in the labor market.

None of this analysis means that improved job training and retraining opportunities through vocational programs at community colleges and other institutions would be futile. Community colleges in particular have been hurt by the Great Recession and its impact on state and local budgets. If you were a governor or mayor, you might well understand that the overall lack of demand was largely a macro challenge which, for better or worse, needed attention at the national level. So what is left for state and local policy is precisely tasks such as providing vocational education opportunities. The problem with circulation of the *can't-find-any-qualified-workers* stories arises at the national level. At that level, mismatch anecdotes and loose figures on supposedly widespread labor shortages are too-often used to blunt efforts to deal with deficient demand.



Endnotes

- (1) For example, http://www.washingtonpost.com/business/economy/us-manufacturing-sees-shortage-of-skilled-factory-workers/2012/02/17/gIQAo0MLOR_story.html. Some stories are more cautious and say the shortage is going to happen but isn't quite here yet, e.g., <http://www.businessweek.com/articles/2012-10-14/there-will-be-a-factory-skills-shortage-dot-just-not-yet>.
- (2) The data on the table are preliminary estimates by BLS.
- (3) The job openings rate is computed by dividing the number of job openings by the sum of employment and job openings and multiplying that quotient by 100.
- (4) Source of the table: <http://www.bls.gov/news.release/pdf/jolts.pdf>. August data are preliminary.
- (5) Source: http://www.bls.gov/web/jolts/jlt_labstatgraphs.pdf.
- (6) The August 2012 unemployment rate was 8.1%. Labor market experts reading this musing will know that if you raise employment, the increase in jobs does not come one-for-one from the ranks of the unemployed. Some new workers will be drawn in from outside the labor force. So the drop in the unemployment rate would be less than what is stated in the text. The drop in the unemployment rate would be less than 0.4 percentage points.



Mitchell's Musings 11-5-12: Political Economy, 1971

Daniel J.B. Mitchell

Note: With both presidential candidates' campaigns getting ready to pounce on the November 2 media release by the Bureau of Labor Statistics on the employment situation (unemployment rate, etc.), I thought I would put out this edition of the Mitchell musings early (Oct. 31), even though it is technically dated Nov. 5. In a sense, it is timely because it deals with presidential re-election concerns about the state of the economy. But the musing is also "untimely" in that it refers to events of 1971. Still, as a Halloween offering, the musing does point to the fact that nothing is scarier than not knowing for sure what is about to happen.

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This musing comes just as the nation is about to vote in a presidential election. One factor that has been much discussed in that context is the role of economic trends – often the trend in the unemployment rate - in shaping the election outcome. Those researchers who model the impact of economic trends on presidential elections seem to focus on *direction* (expansion or contraction) rather than on the *absolute condition* of the economy or labor market. Republican nominee Mitt Romney has tended in the 2012 campaign to point to the absolute level of the economy, the sluggishness of the recovery, and the fact that administration economists, early on, had been too optimistic in their projections. Incumbent President Barack Obama points to the fact that recovery is underway and promises that recovery will continue under a second term.

Earlier musings have been based on now-available Nixon "White House tapes" and their revelations about policy making.¹⁵ It's quite clear from the tapes that President Nixon was very much interested in economic trends, particularly as he looked towards his 1972 re-election campaign. In this musing, I focus on a June 1, 1971 taped telephone conversation on the economic outlook and on economic policy, both monetary and fiscal. The participants are the President and George Shultz. It can be heard at <http://www.youtube.com/watch?v=M6DtzjVJM-w>.

The economy the President inherited in 1969 had been heating up during the late 1960s under pressures of the Vietnam War. Concerns about inflation led the Federal Reserve to take actions to slow the expansion, hopefully producing a "soft landing," i.e., a growth pause that would not technically be a recession. As it turned out, however, a recession did occur which the National Bureau of Economic Research dates as starting in December 1969 and ending in November 1970. By June 1971, it appeared clear that the economy was expanding again. But the question was how solid and rapid the expansion would be and what would economic conditions be in the coming election year.

At the time, the economics profession was split between monetarists, led by Milton Friedman of the University of Chicago, and Keynesians, led by (among others) Paul Samuelson of MIT. Friedman's

¹⁵ As has been noted in earlier musings, not all of the tapes were of conversations in the White House. Some conversations took place in other locations or on the telephone.

position was that the Fed should simply keep the “money supply” growing at around 2% per annum and not attempt to fine tune the economy. I put “money supply” in quotes because there are various definitions of what one might mean by “money” and Friedman focused on a particular narrow definition that he favored. When deregulation of the financial sector began to occur (later in the 1970s), and different financial assets became more interchangeable with narrowly-defined money, the definition issue became more important. But in 1971, there was less concern about the definition than subsequently arose.

The Keynesian perspective put more emphasis on fiscal policy than the monetarist view. Keynesians were more inclined to approach monetary policy as the setting of interest rates by the Fed – which had been the traditional approach. As many observers have pointed out, at any moment the Fed can target the growth of money (somehow defined) *or* interest rates. But it cannot do both. In any event, Keynesians tended to be activists and did not go along with the idea that the Fed should passively increase the money supply at 2% (or any other pace) without regard to economic conditions. Rather they thought that the Fed should cut interest rates when the economy slowed and raise them when it overheated. Although it was not so evident in 1971, the Fed during the later 1970s and into the 1980s became monetarist - in the sense of focusing on the money supply – but remained activist in the sense of varying its monetary targets with the condition of the economy.¹⁶

George Shultz, who had been Nixon’s Secretary of Labor initially, was - by June 1971 - his Director of the Office of Management and Budget. It is evident from various Nixon-Shultz phone conversations, including the one of June 1, 1971, that the President regarded Shultz as a key economic advisor and probably *the* key economic advisor. There was an economic policy group, referred to at the time as the “triad,” consisting of Shultz, John Connally (Secretary of the Treasury), and Paul McCracken (Chair of the Council of Economic Advisors). During the phone conversation with Shultz, there is reference to the “quadriad” - which was White House-speak for the triad plus Arthur Burns, chair of the (independent) Federal Reserve. It might be noted that including the Fed chair in such a group as if he were a member of the administration was unusual. Burns seemed closer to the administration than other Fed chairs have been.¹⁷

In the phone conversation, President Nixon is concerned that Milton Friedman has been consulted by the Fed and Burns. He knows that Friedman favors the constant 2% policy which Nixon fears would not aid the pace of the post-1970 recession expansion. Shultz tells Nixon that in fact Friedman, given the sluggish economy, supports temporary 4% money supply growth. On the other hand, Paul Samuelson is pushing the Fed for a more expansive policy which Shultz terms “let ‘er rip.” Shultz reports that Connally and McCracken are on the side of more expansion. Shultz, however, defines himself as a

¹⁶ As the Fed later became more monetarist, it faced a problem with defining the money supply that came along with financial deregulation. It tried to set targets with various definitions simultaneously, but that approach proved difficult since the relationship between the different versions of money kept changing. By the 1990s, the Fed had returned to the interest rate approach.

¹⁷ Members of the Fed’s Board of Governors, including the chair, are appointed by the President for fixed terms. But the Fed is viewed as an independent agency and is supposed to be insulated from politics.

moderate. He is concerned that too much expansion in 1971 could lead to an overheated economy in 1972.

The President says that the problem with Friedman is that he doesn't have a sense of politics. Congress will act if the administration doesn't take an expansive stance by adding to federal spending (fiscal stimulus). It is noted, however, that some of the pressure for more spending comes from the Nixon administration's policy of shifting to a volunteer military and away from the draft. If the military has to depend on labor-market recruitment rather than compulsion, a large pay raise is needed. Toward the end of the conversation, there is mention of a proposal by Commerce Secretary Maurice Stans to have a mid-decade census. Shultz thinks whatever such a census could accomplish could be done with some cheaper sample surveys. And Nixon doesn't want to spend money on a mid-decade census, apparently because it would signal laxness in constraining the federal budget.¹⁸

With hindsight, we know that in two-and-a-half months an international dollar/gold crisis will cause the President to declare a dramatic change in economic policy. The remnants of the gold standard will be ended, the dollar will be allowed to float temporarily while a new international monetary system is planned, and wage-price controls will be imposed. But international downward pressure on the dollar in currency markets is not mentioned explicitly in the conversation. Shultz tells the President that Burns wants to talk with him (Nixon) about the international situation. Burns probably wanted to alert the President to what was already occurring in currency markets. But Nixon is not anxious to have a meeting alone with Burns on that subject. He indicates that whatever Burns has to say should be aired in the quadriad. Was this decision a missed opportunity to look into the economic future? We will never know.

So what do we learn from this conversation? First, the more things change, the more they remain the same. Presidents worry about the economic conditions that will surround their re-election campaigns. Although the more recent studies that indicate that the *direction* of change is very important hadn't been done yet, there seemed to be a political sense back in 1971 that the pace of expansion would be important. Second, the economic circumstance that would turn out to be the most important with regard to actual policy in election year 1972 – the downward pressure in world currency markets on the U.S. dollar - was not understood (or at least not appreciated) by the President or his key advisor. Third, the gap between political economy and academic views of economic policy was apparent, particularly in President Nixon's complaint about Milton Friedman's advice. It also shows up in the position of the academically-oriented Council of Economic Advisors (CEA) and its chair, Paul McCracken. It's pretty clear that McCracken as the official advisor is nevertheless not the key advisor.¹⁹

Apart from the general concern about the economy in an election year, are there other parallels with 2012? There is no contemporary direct parallel with the unforeseen dollar crisis of 1971 that would

¹⁸ I have truncated the conversation at that point to meet YouTube length requirements. The omitted material, however, does not add to the content of the conversation.

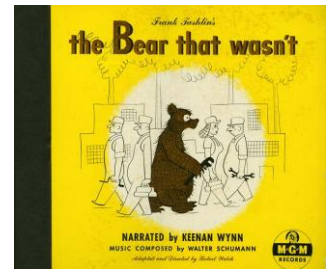
¹⁹ Both Shultz and McCracken came from academia. But President Nixon seems to have regarded Shultz as having a political sense, perhaps because of his earlier role as Secretary of Labor.

soon upend economic policy in 1971-72. But the Obama administration faced a different kind of unknown when it came into office. Economic forecasting relies heavily on past experience, nowadays in the form of econometric models based on historical empirical data. When the economy is functioning outside the normal range in which most of those data arose, forecasting models are unlikely to be highly accurate.

To the extent there is an analogy with 1971, it is that what would happen to the U.S. economy and labor market - even in the few months after the Obama administration came into office - was not foreseen. As is well known in hindsight, unemployment quickly exceeded forecasts and expectations. In political terms, however, Nixon was able to react to the unforeseen events once they occurred. But it was much harder for the Obama administration to chart a new course, particularly once the House of Representatives changed hands in 2010, an event itself that was conditioned by economic conditions and the lagging labor market. There is the apocryphal quote of movie mogul Sam Goldwyn, "Never forecast, especially about the future." But it's a luxury presidents don't have. Even when they can't get the forecast right, they have to forecast and then live with the political consequences.

Mitchell's Musings 11-12-12: Bear With Me

Daniel J.B. Mitchell



I know the temptation after a major election is to write something about what it all means. But immediately after an election is probably not the best time to gain perspective. I am writing this musing – despite the official date above – on Election Day well before results are known. So all I know is that much is being made of the votes of white, male blue-collar factory workers, particularly in swing states. Explanations and interpretations are being offered by pundits as to why they vote the way they do. In short, nowadays such workers are viewed as exotics whose motivations need interpretation. But what about in the past? How have such workers been seen over time?

At the end of World War II, such workers would have accounted for one out of four employees in the nonfarm sector. Agriculture was a larger share of the workforce then than it is now so the proportion for all workers would have been closer to one out of six. Now, given the shrinkage of manufacturing as a proportion of the workforce and other demographic changes, the ratio is probably around one out of twenty.)

Although they were never a majority of overall employment, people paid more attention to such workers after World War II because manufacturing was considered a key sector around which much of the rest of the workforce revolved. Manufacturing was a sector in which high-profile labor disputes occurred, particularly in the aftermath of the War as wage-price controls were relaxed. Big union settlements in manufacturing were seen as pattern setters for other (lesser?) industries.

In an earlier musing, I noted that you can learn about public perceptions of the workforce at different points of time from children's stories.²⁰ Specifically, in that musing, I noted that government workers seemed to be held in much higher esteem in the period after World War II than they are now. So what about those factory workers? How were they perceived? In fact, such factories were seen as standard workplaces. Those workplaces could be parodied and critiqued, but they were not exotic.

When I taught a course in labor market policy, we would get into corporate structure and supervision and the evolution of thinking and practice in those areas. And I would use a video (actually an audio with pictures) with an excerpt from a children's story that became popular just after World War II, "*The Bear That Wasn't*." The story appeared immediately after the War (1946) as a phonograph recording and as an illustrated book. You can find the video excerpt I used at <http://www.youtube.com/watch?v=opPrTrpHydU>. Some of the images from the book can be seen in that video.

The story itself involves a bear who finds a cave in which to hibernate at the beginning of winter. During the winter, a factory is built over the cave so that when he emerges in the spring, he is in a mid-1940s workplace. The idea of a factory in the story is blended with that of a corporation run by a hierarchy of

²⁰ http://www.employmentpolicy.org/sites/www.employmentpolicy.org/files/field-content-file/pdf/Daniel%20J.B.%20Mitchell/MitchellMusings%202-20-12_0.pdf.

managers with the lowest level being a factory foreman. In other words, the idea of a big corporation is identified with manufacturing. There are mainly men in the factory as production workers and they are white in all of the illustrations in the book. The original record album cover – progressive for its time – depicted one woman and three male production workers. However, women do work in the factory, but primarily as secretaries to the hierarchy of management.

The Foreman stopped laughing. He was very mad.
"Don't try to fool me," he said. "You're not a Bear. You're a silly man who needs a shave and wears a fur coat. I'm going to take you to the General Manager."
The Bear said, "No, you're mistaken. I am a Bear."



The General Manager was very mad, too.
He said, "You're not a Bear. You're a silly man who needs a shave and wears a fur coat. I'm going to take you to the Third Vice President."
The Bear said, "I'm sorry to hear you say that... You see, I am a Bear."



When the bear finds himself in the factory, he is confronted by the foreman who tells him to get to work. The bear protests that he isn't a factory worker; he is a bear. But he is gradually convinced by the hierarchy of management which he confronts that he is "a silly man with a fur coat who needs a shave." Thus convinced, he ends up working in the factory pushing buttons, turning wheels, and cranking cranks. In effect, he loses his identity and becomes a Tayloristic production worker. Note that the story assumes that any child of the 1940s would recognize an extended corporate hierarchy. (Or it at least assumes that their parents would recognize one and would explain the concept to the child.)

As the story continues, the factory suddenly shuts down - as many did after World War II production halted – and, of course, as they did during the Great Depression, a period which would have been fresh in a parent's memory. The other workers go away, leaving the question of whether the bear can regain his true identity before it's time to hibernate again. For those readers curious about the *denouement*, I have provided the entire recording – not just the YouTube video excerpt – in two parts at:

<http://www.facebook.com/photo.php?v=10151318648476522> (Part 1) and

<http://www.facebook.com/video/video.php?v=10151318663171522> (Part 2).

Had the story been written today, undoubtedly the bear would have emerged in an office park, not a factory, and the humor in the tale would probably have been closer to a *Dilbert* comic strip (which often

includes talking animals in its fictional white-collar workplace). In these days of so-called management “delaying,” the satire would probably not have involved a tall corporate hierarchy. Rather it would have revolved around management-speak aimed at persuading the bear that he is in fact a silly “associate.” The supposed fur coat could be accommodated at work as long as the bear appeared on “dress-casual” day. In any event, the workforce would have been depicted as more diverse than the original. And when the company went out of business, the bear would have been left with his health insurance expiring and wondering why no one warned him about the danger of keeping too much company stock in his 401k.

But what about the workers represented in the original story - those white, mainly male factory workers? They were depicted in 1946 as subject to an identity-suppressing Tayloristic hierarchy. But they would not have been seen at the time the story was written as exotics whose electoral motivations needed deep explanations by pundits.

Mitchell's Musings 11-19-12: Cliffs and Ceilings

Daniel J.B. Mitchell



With the 2012 presidential just election past, news media attention is being focused on upcoming presidential/congressional negotiations over the “fiscal cliff,” the end of the Bush tax cuts and big federal spending cuts, and on raising the debt ceiling. At least some of the discussion, particularly around the fiscal cliff, revolves around the specifics of the taxes and the spending cuts. Another strand of the discussion involves the economic impact of the cliff. The Congressional Budget Office (CBO) projects a recession in 2013 if the cliff taxes and spending cuts go into effect and nothing further is done.²¹ Other forecasters generally agree with that assessment. There has been less attention so far to the debt ceiling issue. But the last time the ceiling was in play, the focus was more on financial markets and how they might react if the U.S. defaulted on its debt payments.

False Dichotomy

So let's begin with an observation. It's not clear to me that the two negotiations – the cliff and the ceiling – are really so separate in what they might affect. That is, the idea that the cliff involves the real economy (taxes and spending cuts and whether they will cause a recession) while the ceiling involves a separate financial world is problematic. The Great Recession occurred, or at least reached the depths that it did, because of a financial crisis. That is, the real and the financial were not neatly divisible.

One unknown and unsustainable element in the current U.S. position in the world is the continuing American trade deficit and the large resulting pile up of dollars abroad. A run on the dollar in foreign exchange markets could produce another financial crisis. That is, what could occur might be more than just a fall in the value of the dollar relative to the value of other currencies. A sudden fall of the dollar *could* cause large financial institutions that were assuming the dollar wouldn't drop essentially to go into bankruptcy, depending on what they had assumed and the assets they had on hand as a cushion. A crisis related either to the cliff or to the ceiling *could* be the trigger for such a run. I say “could” because there is no certainty. But it's a risk it would be nice not to take.

Limits of Models

Given that risk, the CBO estimate of what going over the cliff might mean for the real economy could be misleading and an underestimate of the damage. CBO plugged the cliff tax increases and spending cuts into a forecasting model which produced the usual “Keynesian” results; both would have a negative effect on economic activity. But a financial panic is not something such forecasting models can handle or predict.

Unlike the cliff and just its Keynesian consequences, it is not even clear how one should model the consequences of hitting the debt ceiling and defaulting. What exactly would happen and how financial

²¹ The CBO report is available at <http://www.cbo.gov/sites/default/files/cbofiles/attachments/11-08-12-FiscalTightening.pdf>.

markets would react is unknown. Although there have been national government defaults, those examples involve minor players. We have no past history that would tell us about a U.S. default. So both events – cliff and ceiling - could have real economy consequences and both could have financial consequences. And, as the 2008 financial crisis taught us (or should have), we aren't all that good at predicting the magnitude of the fallout of such events.

Collective Bargaining Lessons

Despite the long preamble, my primary focus in this musing is not on forecasting such consequences but on the negotiations that have to take place on cliff and ceiling. More specifically, it is on what collective bargaining – a process of negotiations in the labor-management context – might tell us about these two political negotiations. In its much-diminished current state, collective bargaining nevertheless involves thousands of contracts which are regularly negotiated and re-negotiated. And even if you date modern collective bargaining only back to the 1930s – such bargaining actually has a much longer history – we should be able to learn something about negotiating from all of that experience.

Deadlines

Let's start with deadlines. The fiscal cliff has a clear deadline date, January 1, 2013, because that is what Congress enacted. The debt ceiling deadline is murkier. When the ceiling is hit depends on the flows of income into and out of the federal government and the pace at which debt rises as a result. Moreover, there are temporary ways in which the federal government can juggle accounts once the ostensible ceiling is hit that can delay the ceiling's impact.

Collective bargaining contracts have specific deadlines, namely the contract expiration dates. Of course, the parties can continue to negotiate after the deadline. But unless they formally extend the contract, there are real legal consequences of going beyond the expiration date. Typically, labor agreements have restrictions or outright bans on strike actions (and lockouts) while they are in effect. Those restrictions and bans disappear when the contract expires. Absent a contract that is in effect, management can bargain to an impasse and then unilaterally impose new terms and conditions. In essence, once the contract expiration date passes, both sides are free to take aggressive actions that they couldn't take before. So the expiration date has a reality to it; it is more than a date on a page.

One well-known phenomenon is that contract deals in collective bargaining are often reached at or around the expiration date. Midnight bargaining is often reported. There was a wave of strikes right after World War II (as wartime restrictions were relaxed), and Congress apparently viewed such strikes as the result of the parties not having enough time to reach settlements. The 1947 Taft-Hartley Act includes a provision that keeps contracts in force unless one or the other parties notifies its counterpart sixty days in advance that it wants the contract actually to expire at the deadline.

In retrospect, this legal requirement seems naïve. Could it really be that the parties stumbled into a strike because they both forgot that their contract – which they had negotiated – was slated to expire? That interpretation seems quite implausible. What seems more likely is that the last-minute settlement

phenomenon is a function of having a specific deadline. Well prior to the deadline, there is time for bluffing, for feeling out the other side, and for adjusting strategy based on what is learned. Once the deadline nears, however, it is the pressure to avoid a work stoppage – which imposes costs on both sides – that pushes both parties to put their true positions forward and determine if there is room for a deal.



In loose terms, the parties have to get serious close to the deadline. Before that time, what is occurring is an exchange of information clouded by an incentive to provide false information on how much of a hardliner you will be and about what issues you will be a hardliner. You don't want to give the other side the impression that you are Mister Softee when it comes to key issues. The other side is looking for signs that in fact you are Mister Softee.

Since the fiscal cliff has a precise deadline when something actually happens, that characteristic suggests we should not be surprised if there is a midnight deal in that negotiation. Because the debt ceiling doesn't have as clearly defined a deadline as the fiscal cliff, the lack of pressure from a well-defined deadline could make reaching a ceiling deal more difficult. That is, without a clear target date near to which you have to get serious, the line between the time to get serious and the time for information exchange is not evident.

Public Relations

Another feature of collective bargaining, particularly when it involves large groups of workers and presents the possibility of inconvenience to the public, is that negotiations occur in the context of public opinion. Obviously, both the fiscal cliff and debt ceiling negotiations have a public element. Neither side wants to be blamed by voters for untoward consequences. Neither wants to appear irresponsible. So part of the process is explaining the virtues of your side to the public. Public opinion plays a part in the negotiation because the parties may see or public opposition or support as putting pressure on the other side.

Defining Negotiations

While we tend to think of negotiations as occurring in direct bargaining between the parties, in fact statements to the news media and other public actions are a form of communication and testing of the other side. That is, negotiations are more than the parties meeting in a room and talking. However, the news media tends to see negotiations as the face-to-face formal meeting and depicts periods when no such meeting is taking place as a sign there is no communications. But that interpretation simply is not correct. Even apart from private conversations outside the meeting room, not talking, walking out of a meeting, etc., are all forms of communication. Both parties are constantly trying to read each other based on what they say in meetings but also all their other actions or inactions.

Reframing

Sometimes mediators are called into labor disputes to assist the parties. Indeed, the above-mentioned Taft-Hartley Act requires a notification to the Federal Mediation and Conciliation Service (FMCS) when there is a pending contract expiration. The parties don't have to accept mediation from FMCS but it is potentially on offer to them. Mediation is not as formalized in the kind of political negotiations that the fiscal cliff and debt ceiling represent. But one thing mediators in labor disputes do is suggest ways of reframing issues so that solutions become more acceptable to both sides. Even if there are no mediators in the cliff and ceiling cases, the idea of reframing is potentially important.

Note, for example, that you could frame the cliff negotiations as being over a tax cut or a tax increase. Taxes go up if the cliff is reached. A deal to suspend only some of the increases could also be considered a tax increase, since someone will still pay more in taxes after January 1, 2013. But a partial suspension of the taxes that would go into effect for some subset of taxpayers could be called a tax cut (relative to what otherwise would have occurred). There could be useful ambiguity about whether a deal is a cut or an increase. Such creativity in reframing would be harder in the case of the debt ceiling. But there will be strong incentives to be creative there, too.

Reframing, it is important to point out, is not quite the same as "win-win." Sometimes there *are* deals in which both parties to a negotiation benefit – that is what "win-win" is usually taken to mean. Reframing, however, can be more a matter of face saving so that both sides can claim to have won, even if that is not quite what happened.

Repeat Game

Collective bargaining is what is called by economists a repeat game. Unlike, for example, two people who meet to haggle over a sale/purchase of a used car and its price, the parties to a collective agreement have likely bargained before and expect to do it again in the future. In the used car case, the game is played only once and either a deal is reached or not. The two sides may not know anything about their respective pasts and may never see one another in the future. That is not the case in collective bargaining.

In particular, past behavior in negotiations over the expiration of the Bush tax cuts are now "data" for the parties as they negotiate this time. So, too, were their actions in the prior negotiation over the debt

ceiling. The parties may now either regret their past behaviors or, in any event, may want to convince their counterparts that they will be behaving differently in this round. Escaping from the past, however, will likely require much more than just saying that this time it's different. Some concrete changes in behavior well before a crisis is reached would be necessary. If one or both parties really plan to change, they will need to demonstrate the change early and establish credibility or they will risk stumbling into a crisis inadvertently.

As noted, you don't want to be seen as Mister Softee in a negotiation, particularly if you don't intend to be. But if you have been Mister Softee in the past, you will have to demonstrate clearly to the other side that that was then and this is now. It would be better to make the demonstration early – before stumbling into a crisis.

Internal Bargaining

In collective bargaining, the union side often has factions (perhaps skilled vs. unskilled workers, older workers interested in pensions vs. younger interested in health care, etc.). Moreover, a union is ultimately a political institution with periodic elections of officials. Tentative deals with management are often subject to a membership ratification vote so union leaders have to bring along disparate interests. That kind of factionalism is less prevalent on the management side. Nonetheless, factionalism on one side can make deal-making more complicated. Union negotiators have to negotiate with their internal interest groups as well as management. Good management negotiators need at least to understand the internal problems that their union counterparts are facing.²²

Both the cliff and ceiling negotiations involve two sides that are really more like unions than like management. Although ultimately, any deals must involve the President and the Congress, the negotiations are really between the President and Democratic leaders in both houses of Congress and the Republican leaders in both houses of Congress. Put another way, the cliff and ceiling deals are more complicated than a typical union-management negotiation because the potential for factionalism is at least double; it exists on both sides. And, of course, the stakes are higher.

The Great Unknown

A final point. Over the years, there have been attempts to model collective bargaining and depict it as a mechanical process of iterative adjustment to a settlement. But there has always been a conceptual problem with such modeling. If the eventual settlement could be foreseen, there would be every reason to settle today on the deal that would eventually occur anyway. Why resist doing what is inevitable? The problem is that there is more uncertainty in the process than such models allow. And the parties may disagree on what the eventual deal might be. So be wary of confident predictions about the outcomes of the cliff and ceiling deals. For example, it seems to be assumed by some commentators that since Obama won re-election, the prospects for quick settlements on cliff and ceiling have

²² The contrast between the management and union sides is nicely made in the interview of a former union and a former management negotiator at <http://www.youtube.com/watch?v=wC8kSydOdd4>.

increased because the President's side has been strengthened. Of course, a quick deal could happen. But I know of no bargaining model that can confidently make that prediction.



Mitchell's Musings 11-26-12: LBJ and the Man of Steel

Daniel J.B. Mitchell

In earlier Mitchell's Musings, I have taken advantage of the growing availability of Nixon-era White House tapes to illustrate the economic policies and labor market features of that period. One byproduct of the disclosure of the Nixon White House tapes as part of the Watergate affair was the revelation that there were also tapes made during the Kennedy and Johnson administrations. These earlier recordings are also becoming available.

As a Democrat, Lyndon Johnson had an easier relationship with organized labor than did Nixon. But both presidents operated in a period in which unions represented a much larger fraction of the private-sector workforce than today. Both administrations occurred in an era in which concerns about wage-price spirals and wage-push inflation were prevalent. And both had interventionist policies to address those concerns; Nixon had formal wage-price controls while Johnson inherited a "voluntary" wage-price guideposts program from the Kennedy administration.

In both periods, there were notions of "key" industries whose union-management wage settlements were thought to set patterns for other industries. Steel was such a key industry. President Kennedy had gotten into a fight with the steel industry over a price increase in 1962 after the White House had intervened to promote what it viewed as a modest anti-inflationary wage settlement. (See <http://www.youtube.com/watch?v=aAVAJ6mwBVE>) The steel industry withdrew its price increase at the time but the issue of steel prices continued to be of concern to the Kennedy administration's economic advisors during the following year. (See <http://www.youtube.com/watch?v=XN-6RmagJtg>, <http://www.youtube.com/watch?v=ukA84gynl8w>, and <http://www.youtube.com/watch?v=fEMUodE3HEg>.)

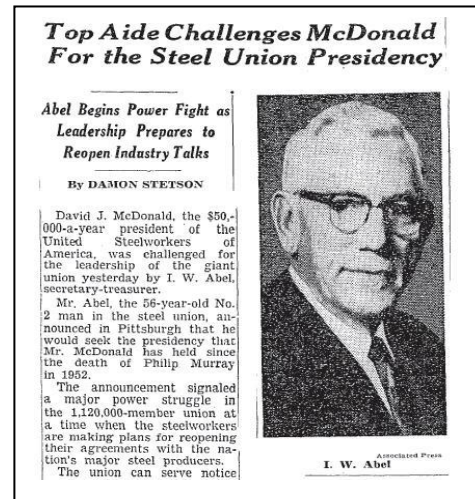
The dollar under the 1945 Bretton Woods fixed exchange rate system began to come under downward pressure relative to other currencies under Kennedy and the problem continued during the Johnson years. Steel, because of its direct and indirect price implications, was seen as important in the foreign context. Price increases and strike disruptions were viewed as potentially undermining American competitiveness in world markets and therefore making support of the dollar more difficult.

Eventually, the pressures of economic expansion during the Vietnam War undermined the guideposts. And eventually, Nixon ended the Bretton Woods system. But the year 1965 was transitional as the economy began to up (and the War expanded). Johnson followed steel labor developments and ultimately intervened in the 1965 steel collective bargaining settlement. His interest in steel and in its economic implications can be heard in four telephone conversations I have placed on YouTube.

In the first conversation in early 1965 with Walter Reuther, president of the United Auto Workers, Johnson is concerned about the election contest going on within the Steelworkers, a union with a claimed membership of 1.2 million. David McDonald, president of the Steelworkers since 1952 was

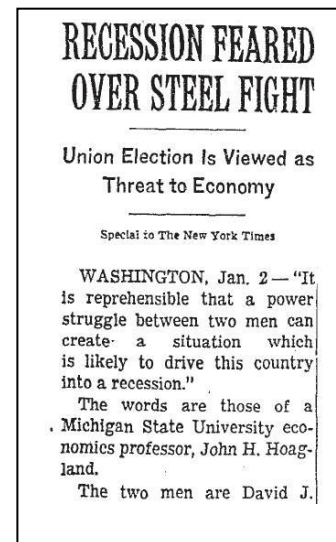
being challenged for that office by the union's Secretary Treasurer, I.W. Abel.²³ McDonald had been president during the very lengthy 1959-60 strike in steel so it would be a mistake to characterize the contest as between a militant Abel vs. a soft McDonald. Abel's issue was in essence that McDonald was too distant from the rank and file. During the very bitter election, Abel pushed for dealing with a variety of local issues and for a greater worker voice in setting bargaining goals. Abel was also critical of the labor-management "Human Relations Committee" that had been set up in steel in 1960 to avoid future strikes such as the one that took place in 1959-60.

The negotiations for a 1965 contract with the basic steel companies were supposed to be going on during the election period. But bargaining was postponed as the contest developed. In their phone conversation, Johnson asks Reuther who will win the election. Reuther says that it will be very close – he doesn't make a prediction – but advises Johnson to stay out of it. As far as steel prices are concerned, Reuther suggests that Johnson have people from the Department of Commerce and the Council of Economic Advisors meet with "technicians" from the steel companies to discuss the companies' justifications for any price increases. But he is sympathetic to Johnson's wish not to have a Kennedy-style confrontation with the industry.



Abel was the victor in a close election and by the time the election results were clear, negotiations with steel (and aluminum) had resumed. In a second conversation, Johnson talks with Abel during August 1965 as bargaining continued with the major steel companies. However, the president avoids any detailed discussion of the talks and instead calls to invite Abel ("Abe") to an informal dinner at the White House and ostensibly to discuss as the Vietnam situation. The call is clearly one of relationship-building more than substance. Johnson asks Abel for his views on the Watts Riot. Both agree that "Negro boys" need to be more responsible now that civil rights legislation has been adopted. But Abel compares the Riot with violent labor disputes in the 1930s and believes things will eventually work out. You can hear the first two phone conversations at

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



²³ There had been earlier challenges to McDonald over such matters as the level of union dues, but they had not succeeded in toppling him. McDonald, as Secretary-Treasurer, had been the heir-apparent to Phil Murray who was essentially the founder of the union and died in 1952. Abel just used his initials in preference to Iorwith Wilbur (for obvious reasons). After being ousted by Abel, McDonald was invited to attend the 1966 Steelworkers' convention by those still loyal to him but he played no role in organized labor or the Steelworkers thereafter. Perhaps in bitterness over his treatment, he went against his union and most other unions and endorsed Nixon in 1968.

The third conversation takes place in September after the steel negotiations have been completed – with White House intervention – and a strike has been averted. There is the same cordiality between Johnson and Abel that was heard in August. Abel thanks Johnson for federal assistance in settling a bitter local dispute in the aluminum industry in the Los Angeles area.²⁴

In a fourth call with Senator Russell Long (Dem. – Louisiana) in November, Johnson reflects on his relationship with the labor movement including with the Steelworkers. He insists he has been strict with labor and that union settlements have been within the wage guideposts. But he also details, in X-rated language, a spat he had with the aluminum industry over releasing government stockpiles of aluminum to hold down prices in the face of Vietnam-related demand. You can hear the third and fourth calls at <https://www.youtube.com/watch?v=MUK7VKMtVRk>.

These four phone conversations paint a picture of very different economic and political times from what we have today. Clearly, unions are much weaker than they were in the mid-1960s. No one would imagine negotiations in the steel industry (now much shrunken and fragmented) as preoccupying a president today. Surely, it is hard to conceive of President Obama – although a Democrat – spending much time fretting over who would become the next president of the Steelworkers if there were an election contest in that union.

Notions of key industries, wage-price spirals, and such are not part of the contemporary debate on economic policy. And to the extent that unions are in the news, it is more likely to be in the public sector than the private. But that was then and this is now.



STEEL DEADLINE EXTENDED 8 DAYS AS JOHNSON ACTS

President Calls Leaders of Both Sides to White House and Demands an Accord

CITES INTERESTS OF U.S.

Talks on New Contract to Continue in Washington—Strike Tonight Averted

By DAVID B. JOHNSON

WASHINGTON, Aug. 28.—President Johnson announced tonight an 8-day extension of tomorrow night's steel strike deadline, making a cordially averted confrontation with the Steel Union of U. S. M. and managers for 10 days and 10 hours and the United States of America the spring in the distance. (Continued on the first page)

JOHNSON REPORTS ACCORD ON NEW STEEL CONTRACT AFTER SUGGESTING TERMS



Associated Press Wirephoto

REPORTS ON STEEL TALKS: President Johnson with E. W. Abel, left, union head, and R. Conrad Cooper, right, management representative, at the White House last night.

STRIKE IS AVERTED

Cost of the Agreement

²⁴ The Harvey Aluminum Company in Torrance, California had been nonunion and a longtime target for organizing. The Steelworkers won representation but were unable to negotiate a contract and went on strike. Violence occurred and talks were resumed under the auspices of the Labor Department and the Federal Mediation and Conciliation Service. The dispute had a political aspect as the daughter of the firm's owner was married to a major California Democratic figure.

Mitchell's Musings 12-1-12: Way Too Much information

Daniel J.B. Mitchell

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"Whoa—way too much information."

New Yorker, 4-15-02

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In other musings, I have questioned whether we get too much information from public data releases. For example, the “advance” estimate of real GDP growth in the third quarter of 2012 was released on October 26. On a seasonally-adjusted, annualized basis, real GDP was reported to be rising by 2.0%. The second estimate released one month later was 2.7%. There will be a third release in the future and then a complete revision beyond that. The difference between real GDP rising at 2.0% vs. 2.7% is actually considerable; it’s big enough potentially to affect, say, Federal Reserve monetary policy. So could we not have waited for a more complete figure? There are lots of other examples. The assumption often seems to be that more data released more frequently is inherently a Good Thing. But there is no testing of that assumption. Can we say that economic policy was improved? Can we say that whatever gyrations in financial markets the very preliminary data engendered produced a social benefit?

The belief that more data and more information is better is obviously at least questionable. Since the human beings that have to analyze the data have a limited capacity to do so, flooding them with information may lead to a reduced quality of decision making. I happen to live in a city – Santa Monica, California – whose city council evidently believes that a large flow of information will improve public decisions. Santa Monica has a population of about 90,000. It operates, as do many smaller cities in California, under a city manager system. The idea of a

city manager system is that a professional executive is hired to run the city administration on a day-to-day basis with general policy to be made by the council.

That's the theory. But here are some items that went before the council at its meeting of November 27, 2012:²⁵

Coin-Operated Telescopes and Binoculars on the Santa Monica Pier and Palisades Park – recommendation to authorize the City Manager to negotiate and execute a License Agreement with Fare Share Enterprises for the installation and maintenance of new coin-operated telescopes and binoculars on the Santa Monica Pier and Palisades Park.

256 Santa Monica Pier Leasehold (Rusty's) – recommendation to authorize the City Manager to negotiate and execute an Amended and Restated Lease Agreement with Hospitality Industry Management Group, LLC d.b.a. Rusty's Surf Ranch for 256 Santa Monica Pier.

Bid Award for the Purchase of Asphalt Materials for Street Maintenance – recommendation award Bid No. 3098 to Vulcan Materials Company, in the amount of \$155,000 for FY 2012-13 for the purchase and delivery of asphalt materials, with one additional one-year renewal option in the amount of \$250,000, for a total amount not to exceed \$405,000 over a two-year period.

Bid Award for Purchase of Three Bin Trucks – recommendation to award Bid No. F4028 to Wondries Fleet Group in the amount of \$127,183, for the purchase and delivery of three bin trucks to the Resource Recovery and Recycling Division.

Banking Services Agreement with Wells Fargo Bank – recommendation to authorize the City Manager to negotiate and execute a contract with Wells Fargo Bank, in an amount not to exceed \$375,000 for banking services over a five year term.

None of the items above can be said to be basic city policy; they are all administrative and implementation decisions. For example, is the decision on what kind of garbage trucks to purchase basic policy? Do the elected members of the city council have any expertise regarding garbage trucks? Members of the city council all have "day jobs," i.e., some other claims on their time. The more time they spend on garbage trucks, asphalt, and coin operated telescopes at the beach, the *less* time they have for basic policy. Even if they ultimately don't discuss these matters and approve them as "consent items," they are choosing to decide to do so. A flood of information can be a distraction and a diversion from what is important. Note also that if something subsequently goes wrong with, say, the asphalt contract, those who negotiated the deal can pass the blame onto the city council members who approved it.

²⁵ Source: <http://www.smgov.net/departments/council/agendas/2012/20121127/a20121127.htm>.

I have seen the same process at work in my university. If you look at the UCLA's organization chart, at the top we have a chancellor and an executive vice chancellor who correspond loosely in business terms to a CEO and a COO. There are far too many reports²⁶ feeding into them and as CEO and COO they have limited capacity to analyze the data flow as a result. The result is a process that comes down to "call me if you have a problem," which means in practice that you don't get called until the problem gets out of hand. (Who wants to tell their boss – until things have reach a crisis stage – that you have a problem?)

In good times, a system of information overload can work tolerably well, mainly because there is money around to fix the resulting problems. Santa Monica by municipal standards is a well run city. But it is also an affluent city that has benefited by a rush of high-tech firms that want to locate within it. That rush, in turn, leads to commercial development and spillovers such higher property taxes and a customer base for upscale restaurants, retail, and hotels. The city thus has a tax base sufficient to deal with problems.

Similarly, when my university operated during generally prosperous times – which in California means roughly World War II to the end of the Cold War – things also ran reasonably well on the campus. But the system came under strain once there wasn't a steady flow of fix-it money to handle problems inherent in a system with an information overload at the top.

So why doesn't the system correct itself once the strains have become apparent? Is it because the people at the top are control freaks who resist delegation? In any particular organization, that explanation might be valid. I always advised students in my labor economics and other classes that if a problem occurs once or twice, it could just be a mistake. But if the problem continues beyond once or twice, there are likely to be incentives involved that make keeping the defective system in place attractive to key players, but not necessarily those at the very top.

Somewhere in the 1990s, management "delayering" as a concept came into vogue. It was said that firms had become too bureaucratic and that you could just get rid of redundant layers of senior and middle managers, thus making firms more nimble and saving on overhead.²⁷ Of course, if you flatten a hierarchy, the people at the top get more reports as do those in the remaining layers. And the possibility, and probably the reality, of an information overload can develop.

Naturally, those displaced folks who had once been employed in the eliminated layers were not happy about their fates. Some readers of this musing may recall the profiles of displaced

²⁶ I am using the term "reports" in the management sense, i.e., people who are subordinates rather than paper reports.

²⁷ <http://www.economist.com/node/12677027>.

(downsized) managers – sad tales – that appeared in the *New York Times* in the mid 1990s.²⁸ But those displaced managers are - by definition - not in the system anymore. Usually the survivors - with their added responsibilities - are depicted as overworked victims of the “new normal.” But that view may obscure the incentives and advantages for them of a system in which too much information flows to their superiors.

I can make a confession since what I will now report occurred in the distant past. From 1979 to 1990, I headed the Institute of Industrial Relations at UCLA as its director. As a department head at the time, I ostensibly reported directly to the chancellor’s office, i.e., to the CEO-COO pair described earlier. In principle, all of our financial accounts were monitored. And we produced, as required, lengthy annual reports with all kinds of detailed charts and tables; lots of information. But I saw to it that we maintained as complicated a set of accounts as possible. And our annual reports were compendiums of information overload. Everything was done by the book. But the book was hard to read.

Because we had a semi-commercial side, charging for conferences, training programs, and publications, there was a mix of business and academic accounts. Some money was ultimately from the state; some was “private.” But there was also a degree of fungibility between the accounts. What the university wanted to know from time to time, particularly when there were budget squeezes, was whether we had any unspent or excess funds in reserve that could be reclaimed by the powers-that-be. By shuffling money around, however, and by burying our “rainy day” reserves in several hard-to-find places, we saw to it that there never seemed to be anything that was unspent or could be reclaimed. And the reserves were divided up in various accounts and never appeared amidst the flood of other data in our annual reports. In effect, providing a flood of data to the top created *de facto* autonomy and a wall of protection.

I surely was not the only university manager who understood that fact back then. There are university managers today that still understand it. In fact, there are managers everywhere, not just in universities or city governments that understand it.

I can see the objection forming that I am giving public sector and nonprofit examples and that such things could not occur in the more efficient private, for-profit sector. But delayering as a management fad was developed and centered in the private, for-profit sector. And it has persisted as a concept there. The idea that shallow hierarchies necessarily produce nimble, flexible organizations continues to the present. The idea also persists that those managers who have been given a broader span of control are sad victims of cruel overwork relative to managers employed in the steeper hierarchical organizations of the past.

²⁸ <http://www.nytimes.com/specials/downsize/glance.html>.

An alternative view, however, is that delayering – although unpopular with those unfortunate downsized occupants of the displaced layers – can be quite popular with the managers who remain. They get *de facto* autonomy and – because the general rule is that the more responsibility and reports you have, the more you should be paid – they get a financial reward to boot. So the notion that the system will self-correct (if delayering goes too far) may not be valid. Those who operate the system have an incentive to perpetuate it. They are likely to resist creation (or re-creation) of new layers above them.

Bottom line: Wherever you see excess information – whether it's official government data or insufficiently steep management hierarchies – ask yourself what are the incentives that perpetuate the system. Someone wants the system to continue or it wouldn't. Someone benefits from it. Someone keeps it going.

Mitchell's Musings 12-24-12: Paychecks and Balances

Daniel J.B. Mitchell



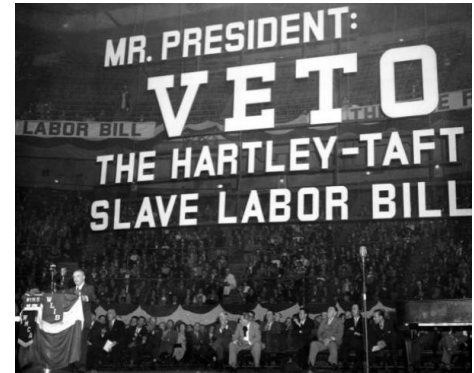
Much has been written about the legislature in Michigan, traditionally a highly-unionized state, enacting a “right-to-work” law. The phrase, “right to work,” sounds as if the law was some sort of full employment act, guaranteeing employment to everyone who wants a job. But that is not the meaning. Under such state laws, workers who are represented by unions cannot be required to be members or to pay union dues or even “agency” fees.²⁹ The union, however, is obligated by law to represent such workers in bargaining, grievances, etc., under the “duty of fair representation.” There is a long history of debate about such laws and the arguments surrounding them are well known.

In the past, however, the debate has largely been partly framed as a civil liberties issue – can or should the government force someone to be a member of, or even pay agency fees to, a private organization, even if that person benefits from that organization? (The debate is generally posed as freedom of association vs. free riders.) Or the controversy has been framed as an economic issue: Do such laws weaken unions so that a) employers are attracted to right-to-work states (job creation) or – related – b) do they lower labor costs? (Unions refer to such laws as “right-to-work-for-less.”) Note that much of the debate occurred after the passage of the 1947 Taft-Hartley Act, a time when much of the south was under one-party rule by segregationist, conservative Democrats – the so-called “solid south.” Taft-Hartley made such state laws – which might otherwise have been precluded by federal pre-emption in the regulation of collective bargaining – legal under its section 14b.

The Taft-Hartley Act was passed over the veto of President Truman and represented a major modification of federal labor law – the 1935 Wagner Act in particular - regarding unions and collective bargaining. Originally, the entire law was the target of a union campaign for repeal. When it became clear that total repeal was unlikely to happen, section 14b and right-to-work laws became the favored union target. But beyond issues such as freedom of association vs. free riders and issues (a) and (b) above, there was not much more to the debate. And 14b was never repealed.

²⁹ For the record, it should be noted that even if there is no right-to-work law and even if the union contract says all workers represented must become members, a worker cannot be forced to be a union member under court decisions. That is, the clause can legally say that membership is required but it cannot be enforced. Workers in such situations can be required to pay fees, typically something less than full membership dues, that are linked to the cost of representation but do not include union political action. Where there is no right-to-work law, unions can bargain for a union shop - but with no guarantee that the employer will agree – (which ostensibly requires new hires to become members), an agency shop (which ostensibly requires nonmembers to pay full dues), or a maintenance of membership clause (which ostensibly requires union members to remain members during the life of the contract). Taft-Hartley forbids “closed shops” in all states (whether or not they have right-to-work laws). Closed shops required that new hires already be union members. Some closed shops in industries such as construction continued *de facto* despite the Taft-Hartley ban. Nowadays, since we no longer have labor reporters who know much about unions and bargaining, I heard one radio reporter report on the Michigan right-to-work law as a ban on closed shops.

After the Taft-Hartley/14b flurry of interest, the right-to-work issue largely disappeared. But it was resurrected in the 1990s in a more political context in the form of proposed state “paycheck protection” laws. Such laws ban union dues – typically deducted from paychecks – from use in political campaigns. California has had three variants of such laws placed on the state ballot by initiative, all of which have been rejected by voters, most recently in November 2012. Basically, such laws are not about job creation or labor costs or freedom of association. They are about defunding Democrats. Of course, in the past when the south was all-Democratic, defunding Democrats was not the goal.



From the conservative viewpoint, labor unions tend to support liberal candidates and give most of their political contributions to Democrats. With the rise of public sector unionism, roughly in the 1960s and 1970s, and the longstanding downward trend in private unionization, unions have become identified with government. If you don’t like government, you also don’t like unions and the candidates they support. You don’t like their influence in state legislatures, city councils, school districts, or – for that matter – at the federal level.³⁰ So anything that impedes their ability to act politically is something you favor.

An interesting question in the face of current low unionization rates (so that most voters are not unionized or don’t belong to households of union workers) is why voters in states such as California decline to enact such laws. Is it because they are “pro-union” despite having no union connection? Is it because they favor everything that unions do? Such motivations seem unlikely. I suspect that the median (and therefore nonunion) voter views unions as a “special interest,” just as the business community is composed of “special interests.” Thus, voters in Michigan, before the legislature acted, declined to support a union-backed ballot measure that would have put collective bargaining as a right into the state constitution and likely have precluded enactment of a right-to-work law. The union-backed measure was seen as the product of a special interest group. But voters probably would have rejected a right-work-law ballot measure if it had been offered to them directly, particularly had union-backed measure not been offered.

My guess is that anti-union laws that seem aimed at defunding Democrats were rejected in California because, although unions are seen by voters as a special interest, they are also seen as a *different* special interest from those in the business community.³¹ There is a long American tradition of constitutional “checks and balances” with the three branches of government checking each other. The

³⁰ At the federal level, in the 2007-8 election cycle, Political Action Committees (PACs) aligned with unions gave 93% of their contributions to Democratic candidates for the House and Senate. Source: U.S. Department of Commerce, *Statistical Abstract of the United States 2012* (Washington: GPO, 2011), p. 264.

³¹ The latest paycheck protection initiative on the California ballot, Proposition 32 of November 2012, received 43% of the vote.

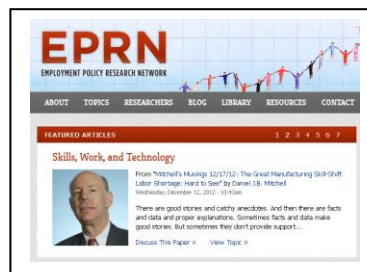
concept was translated into economic terms in the 1950s by John Kenneth Galbraith who viewed “big business,” “big labor,” and “big government” as countervailing forces. Big labor is not so big anymore, but it still can mobilize dollars and in-kind services on behalf of political figures and causes.

In California, at least, the median voter is a Galbraithian, even if he or she has never heard of Galbraith. The California voter may feel that unions are too powerful or have their own special interests at heart. But nonetheless, the California voter worries about what would remain of the political scene if unions were withdrawn from the fray, leaving the field only to business-oriented special interests?³²

³² I have posted TV ads for various propositions that were on the November 2012 ballot in California on YouTube in three parts. The second part at <http://www.youtube.com/watch?v=QhNcGqZPTHs> includes the paycheck protection (Prop 32) ads, pro and con. After the election, one union ran a radio thank-you ad to voters who rejected Prop 32. It can be heard at <http://www.youtube.com/watch?v=7RREP1WdBes>.

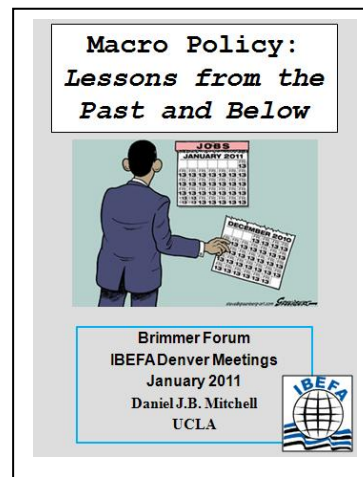
Musing on Advice for the New Administration: Five Suggestions

Daniel J.B. Mitchell*



For a little over two years, I have been writing a weekly blog/column for the Employment Policy Research Network (EPRN), the network site affiliated with LERA and supported by various foundations. Many of these weekly postings have in fact been advice – to someone about something on policy related to jobs and employment. There was a concentration on macro issues, including international trade, which have an impact on jobs and unemployment. In addition, taking advantage of audio tapes now available from the Nixon era and the Kennedy/Johnson period, I have looked at how earlier presidents responded to the economic issues of their days in office. Some of the musings dealt with government at the state and local level, particularly California, whose budget problems I have tracked for many years in annual chapters and other outlets (including LERA’s latest research volume). In some instances, the postings can be described as micro comments on HR practice. All are available at www.employmentpolicy.org [click on my name] and I am drawing on a subset of them to put together advice for the new administration – advice I suspect is not generally being offered.

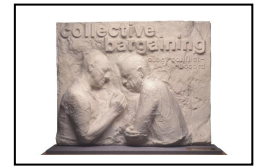
Apart from the EPRN musings blog/column, at the ASSA meetings just two years ago, I appeared on a “Brimmer Forum” panel that was related to today’s topic. The panel was sponsored by the International Banking and Finance Association with which Andrew Brimmer – who passed away recently - was long connected. I gave advice there – advice I have given several times in the musings – which I cribbed from famed financier Warren Buffett, who gave the advice in 1987. It was ignored then. It has been ignored since. It will be ignored now. But I feel compelled to put it forth again since absent trade policy, there really is no potential job creation option. And since I will give some advice that I know will be ignored, I will also give some advice that might be followed, advice not contingent on some Grand Bargain or some congressional compromise. Let me start with things that can be done internally, i.e., that don’t require legislative approval. And then I will do my Buffett thing.



Bargaining Strategy

In a recent musing, I looked at lessons that could be drawn from the (much-diminished) world of collective bargaining for negotiations more generally. It is clear that the new administration faces a period of divided government in which there will need to be negotiations with Congress, especially the

* Professor-Emeritus, UCLA Anderson School of Management and UCLA Luskin School of Public Affairs. Musing for week of 12-31-2012 and paper prepared for presentation at Labor and Employment Relations Association (LERA) meetings, San Diego, January 4, 2013. This paper was posted on 12-26-12 before any resolution of fiscal cliff or debt ceiling negotiations and reflects no developments after that date.



House. At this writing, the outcome of the “fiscal cliff” is unknown. But I pointed to several lessons that could be learned from collective bargaining in that earlier musing.

One lesson is that labor negotiations are often concluded at the midnight deadline, not because bargainers aren’t giving themselves enough time (which our legal framework assumes) but because of the logic of a meaningful deadline. In the collective bargaining world, the deadline is often the expiration of the existing contract.

There are real consequences of going past such a deadline, basically in the tools both sides acquire at that point. Until we are close to the deadline, there is opportunity and incentive for testing the other side, bluffing, and posturing. But since real potential costs accrue at the deadline, there are incentives at that point to make a true offer and see what possible common ground exists. Obviously, the deadline can be missed and impasses and full-scale disputes can occur. But often, settlements are reached. So I predicted that the fiscal cliff would indeed be a cliff hanger.



More to the point for advice is the observation that collective bargaining is usually a repeat game in which the parties’ behaviors in one negotiation condition their understanding and expectation of what to expect in the next one. Changing one’s behavior requires future consistency and proof – possibly in the form of an impasse.



In previous negotiations on the Bush tax cuts and the debt ceiling, the President was seen by the opposition as someone who could be rolled. Note that the signature “Obamacare” plan ultimately wasn’t produced by bipartisan compromise but was enacted by one political party through a parliamentary maneuver engineered by Nancy Pelosi. ***So my advice for current and future political negotiations is that for the President to be seen henceforth as a tough bargainer, a consistent hard bottom line will be necessary. Over the course of four years, even if hanging tough creates impasses initially, a tough consistency may in fact reduce the frequency of such events as the game repeats. Bargaining credibility can be regained, but only over time and with proof.***

Interpreting Polling Data as a Guide to Policy

We have all heard of “push polling” in which the goal of the pollster is to cause the respondent to adopt a particular opinion rather than neutrally uncover what the general opinion is. As I have followed California policy issues, however, it has become clear to me that even the “best” polls are inevitably pushing opinions. My favorite example, about which several musings were written, dealt with the public pension issue. Offered a variety of pension “reforms,” poll respondents often agreed with drastic approaches such as converting everyone to 401k (defined-contribution) plans. But the reforms they



agreed with were inconsistent with their responses to an initial question as to whether public pensions were too generous. Even in the face of considerable negative agitation on the pension issue, California respondents were more likely to say public pensions were at *appropriate levels or not generous enough* rather than too generous.

So why would they endorse drastic reforms if they thought there was no problem or the problem was miserly pensions? Presumably, it had to be because the pollster kept offering a menu of reforms that were in the policy space. If the pollster is offering reforms, respondents apparently came to reason that there must be a too-generous pension problem after all that needed fixing.

Let's look at polling from the viewpoint of the *incentives facing polling organizations* in the face of a public that is not focused on the various issues about which policy wonks or politicians are concerned. Pollsters have to come up with public opinions on various topics – even if the public doesn't really have opinions on them - or who will read their polls? There is an inevitable framing of questions in ways to elicit opinions about issues on which poll respondents may really have no opinion or only vague or no knowledge. If you stopped ten people in the street and asked them what the fiscal cliff was, how many could give a cogent answer?

My advice is not to worry about polls on detailed policy issues. Polls can tell you in broad terms what folks are worried about. (If you didn't know, they worry about jobs and the economy.) When it comes to detailed policy issues which most people don't follow, it is more important to frame public opinion than to cater to what even the best pollsters tell you public opinion is.

It is also important to avoid the popular metaphors that float around major issues in the news media. The U.S. turning into "Greece" is one example. In fact, Greece became contemporary Greece by giving up its currency and promising payments in a currency (the euro) not its own. The U.S. hasn't done that. Social Security described as a "Ponzi scheme" is another example. Long before there were social insurance schemes and pensions, there were intra-generational transfers within extended families to support the elderly. So unless you think your family is a Ponzi scheme, Social Security isn't one.



Government Data as a Guide to Policy

Government data on economic trends is clearly indispensable for making economic policy. There was a flurry of attacks on the accuracy of data that didn't accord with someone's view of what was happening. (Former GE CEO Jack Welch didn't like the drop in measured unemployment prior to the 2012 election and charged fraud.) In a couple of musings, I noted related episodes in which data fraud was charged that had occurred in the past. However, the fact that our data system is actually not being manipulated by dark forces doesn't mean that public data collection and distribution cannot be improved.

Some of my musings have suggested that in a sense, we get too much data in an effort to be Johnny-on-the-spot current. I was reminded of this observation by the latest release of the GDP figures for the third quarter of 2012. The advance estimate was that real GDP in that quarter rose by 2.0% at an annual rate. Then the estimate was raised to 2.7% and most recently to 3.1%. Of course, there is seemingly a

big difference between 2.0 and 3.1. But should policy be made based on these sorts of estimates and re-estimates? Would policy be harmed if we waited for enough data and dropped premature estimates?

In some cases, data are routinely released monthly (unemployment rates, the Consumer Price Index) while others come out quarterly or annually. In general, less frequent release might allow resources to be diverted to collecting more detailed information. As far as I can tell, the current frequency of data production seems to be based on tradition rather than a look at alternatives.

Finally, for key series, the government has a monopoly on much data collection and methodology. In the last couple of decades, user interests and the virtues of easy interpretation seem to have been sacrificed for theoretical reasons. It used to be said, for example, that the CPI tracked the cost of a “basket” of typical consumption items. That was a simple idea which Grandma (whose Social Security is indexed to the CPI) could understand. But you really can’t say that anymore about the CPI.

For that matter, is it really helpful to have the components of real GDP not sum to total real GDP because someone liked the idea of a chained Fisher Ideal index? Did the benefits of introducing the NAICS industry breakdown into major series such as payroll employment outweigh the costs of abandoning the longstanding SIC series (thus making time-series analysis difficult)? Does anyone even ask these questions? I think there is a problem here. One symptom of a lack of user orientation is the apparent discontinuance of the popular *Statistical Abstract of the United States*, even as an online publication. And, of course, there is the important issue of the totally non-transparent “quality” adjustments that affect real GDP, productivity, and major prices indexes such as the CPI.

I suggest a task force be set up on federal economic data series, especially the time series that are widely used for macro policy purposes. Of course, there should be some experts on the task force of the type who love chained Fisher Ideal indexes. But I would also include business journalists, forecasters, and non-academic economists who would be asked to scrutinize key series for understandability and usability. My sense is that nowadays we breathlessly await the advance estimate of real GDP change without a clear understanding of what real GDP is. Perhaps more importantly, if Grandma’s Social Security is indexed to the CPI, you should be able to explain the CPI to Grandma.

Avoid Monetarist Predictions and Policy Prescriptions

If there is any hero to emerge from the economic wreckage of 2008 and its aftermath, it is Ben Bernanke, chair of the Federal Reserve. He may not have gotten everything right – who does? - but at least he moved about as far as possible given legal constraints to a) prevent calamity and b) provide whatever stimulus close-to-zero short-term interest rates can provide. He also joined Chief Justice Roberts in taking himself out of the 2012 presidential campaign. Roberts did so by finding grounds to approve Obamacare. Bernanke did so by saying he did not want to be reappointed to another term at the Fed.

Of course, there are the Ron Paul types who think we shouldn't have a central bank. But there is another group who keep forecasting some kind of vast acceleration of inflation because the Fed has bought a vast hoard of securities to keep short-term interest rates down. Back in ancient times when I was a graduate student, there used to be monetarists and Keynesians. Monetarists tended to be free-market types; the Keynesians were more interventionist. The current crop of inflationists seems to be monetarist descendents.

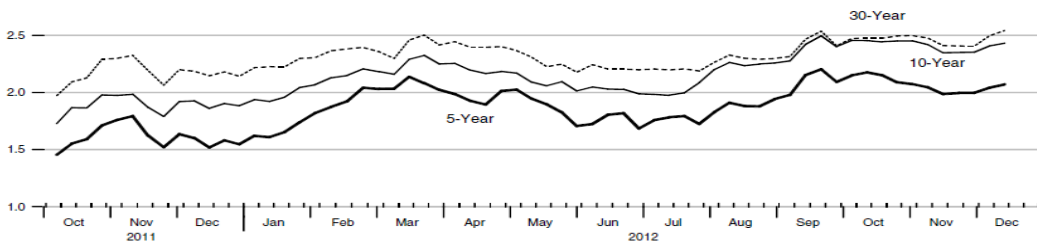
But there is a problem. Back in those ancient times, we did not have a direct measure of inflation expectations. Nowadays, thanks to the federal government's issuance of (CPI) inflation-indexed bonds, we do have such a measure. We can look at the yield spread between conventional Treasury bonds and the inflation-indexed bonds as the financial market's expectation of where the CPI is going, even over very long periods. And financial markets say that inflation will average something like 2-3%/annum, and sometimes less, over the long term which doesn't seem like hyperinflation to me.

Inflation-Indexed Treasury Yield Spreads

Averages of Daily Figures

Percent

3.0



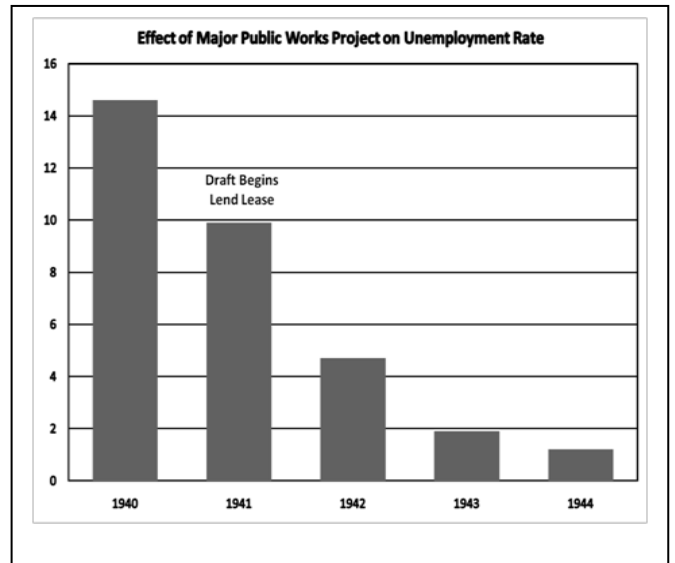
Of course, given what happened in 2008, one might be skeptical of the wisdom of financial markets or other markets. The gyrations in the assumed inflation rate implicit in the yield spreads – even over decades when the only information is about current events – might make one cautious. But if you are a true monetarist, a true offspring of Milton Friedman, you are not allowed to doubt the wisdom of the crowds in the marketplace.

Of course, nothing is impossible. Maybe we will have hyperinflation. ***But my recommendation is that when it is time to replace Bernanke, the administration should find and nominate his long-lost identical twin. If it turns out he actually doesn't have a twin, just don't nominate a monetarist who somehow doesn't believe what financial markets predict as the likely course of inflation and instead fears hyperinflation. Otherwise, you will get premature austerity.***



Avoid Confusing What Happened and What Could Have Happened: Background to Buffett

One of the bits of folk wisdom that has floated around since the events of 2008 is that it always takes a long time to recover from major financial crises. I don't dispute that observation as an empirical fact. And it is a convenient fact since it rationalizes and justifies what has happened so far this time. The recovery has been slow, according to this rationale, because it inevitably had to be slow.



If you are doing economic forecasting – which essentially means projecting past experience into the future – making a prediction of a long recovery period once the economy bottomed out would have been a reasonable decision. The empirical/historical evidence is supportive. But the problem is that such empirical observations include both the financial triggering event *and* then the reaction of policy makers operating within institutional and ideological constraints. For example, in some future financial crisis, one observation will be that of the EU opting for austerity rather than stimulus. The move to austerity in the EU was a human policy decision, however, not an inherent force of nature.

In contrast, imagine yourself to be a benign dictator back in 2008-2009 who wanted a rapid recovery. As dictator, you control the Treasury. You can tax (or reduce taxes) at will. You can spend at will on anything including spending for direct job creation. You can bail out anyone and anything. You control the Federal Reserve. You can buy or sell anything using the Fed. I suspect a rapid recovery would have occurred under such conditions. Of course, in fact policy makers were much more constrained legally and politically compared to my hypothetical benign dictator.

The closest U.S. approximation to the dictator example occurred at the eve of World War II. Unemployment was high in 1940, the first year incidentally that the Current Population Survey actually measured unemployment. World War II amounted to a massive public works program (with spending on military products) and a massive public employment program (the draft). At its peak, the military portion of government was consuming over 40% of GDP. Indeed, there was so much demand pressure that consumer goods were rationed. The auto industry was directed, for example, to cease domestic car production and produce only military vehicles.

Despite the controversy over the bailouts and stimulus in 2008-2009, the addition to demand from fiscal policy came nowhere close to World War II's impact. The bailouts and stimulus were enough to stop the economic freefall but not much more. You can point to all sorts of political reasons why more wasn't done. ***But it really is wrong to say that the recovery is slow because crises of the type that occurred in 2007-2008 must entail long recoveries by some natural law. They are slow only because policy makers***

are not free generally to respond otherwise or – absent a war on the scale of World War II – they won't do otherwise.

That observation leads me finally to my Buffett plan proposal which – as I said at the outset – past evidence suggests you will ignore and policy makers will ignore. It could be followed, but won't be.

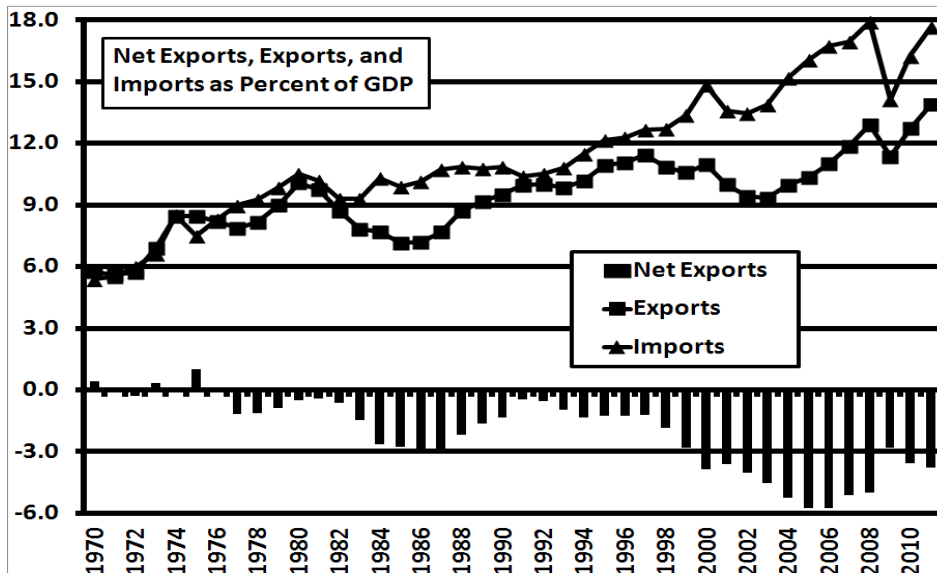
The Wrong Deficit

I noted at the outset that some of my musings have dealt with earlier presidents and their policy decisions. One of the preoccupations of presidents in the 1960s and into the early 1970s was the dollar exchange rate. At the time, the exchange rate was supposed to be fixed relative to other currencies under the 1944 Bretton Woods system. Nowadays, other than in the election context of China-bashing, you rarely hear about exchange rates.



In the 1980s, there was more discussion of exchange rate trends than now. But the villain *de jour* was Japan, not China. And it was in that environment that Warren Buffett wrote an op ed entitled “How to Solve Our Trade Mess Without Ruining Our Economy” in the *Washington Post* of May 3, 1987.

Before I go further with what Buffett (and I) propose, let me indicate why the proposal – which seems to be about international trade – is in fact a jobs program. First, let's note the obvious. Under current political alignments, there will not be any explicit additional jobs stimulus program. Second, the U.S. has run a net export (goods and services) deficit since the mid-1970s. A country which runs a net export deficit (buys more from the world than it sells) must finance the gap by either running down a past store of assets and/or by running up debt. In fact, the U.S. has become the world's largest debtor. It has so far been able to do so because official entities - such as foreign central banks - and private investors have been willing to hold an ever-expanding volume of dollar assets.



Some countries, such as China, are willing to control their exchange rates to keep their exports flowing to the U.S. Whether or not this policy is rational for China as a society, that is what China does. It at least benefits the elites who run the country. It creates jobs in China, which holds down unrest. But it's not just Chinese policy makers. Private investors worldwide have viewed the dollar as an international currency – which it has been since the end of World War II. So they have absorbed the outflow of dollars.

However, the ongoing pile up of foreign holdings of dollars (which are mainly held privately) poses a financial risk. What if there were a run on the dollar? Would it just take the benign form of a smooth dollar depreciation? What if some too-big-to-fail financial entity turns out to have assumed that the dollar wouldn't fall and suddenly needs a bailout? The current political climate would likely preclude such action. In short, at this point, bringing down the net export deficit would be both a demand/jobs stimulus and at least a step towards averting an uncertain eventual reaction to ongoing net export deficits. ***Thus, despite all the concern about the federal budget deficit, the deficit to focus on and correct is the net export deficit. We are worrying about the wrong deficit.***

If the U.S. were currently at full employment, an exogenous shock moving the negative net export balance to zero would create excess demand and inflation. But the U.S. is decidedly not at full employment. And other than Bernanke's low interest rate policy, there is nothing fiscal policy is doing to add to demand.

When the nation was last at something like full employment in 2006, the net export deficit amounted to almost 6% of GDP. The Great Recession cut import demand more than foreign demand for U.S. exports and thus dropped the deficit to around 3% of GDP. But as the recovery developed, by 2011, the deficit had risen towards 4%. These are large magnitudes, particularly when one considers that no other additional stimulus will be forthcoming.

In what sector would the added jobs be located if the U.S. net export balance went to zero? Much of international commerce, even when services are included, involves trade in "things." Some of those things are agricultural or mineral products (e.g., wheat, oil). But when you look at exports and imports of the U.S., roughly half involves manufactures. Now manufacturing accounts for only about a tenth of employment in the larger domestic economy. So let's assume that we closed the net export deficit and increased the number of jobs through more exports and through import substitution by 3%. If half of those jobs were in manufacturing, they would amount to a 15% increase in employment in that sector.

As a side note, ***please avoid the twin fallacies of 1) manufacturing is not coming back and 2) there is a vast manufacturing skill shortage preventing it from coming back.*** I have explored both in my Mitchell's Musings blog. The first is incorrect because the only way the U.S. can ultimately repay its international debt is by net exporting which – as just noted – is heavily manufacturing-oriented. The second is based on anecdotes from a sector which has gone from a long period of labor shedding (going back well before the Great Recession) to a bit of expansion. Manufacturers have to relearn how to recruit; the problem is on the employer side, not the worker side.

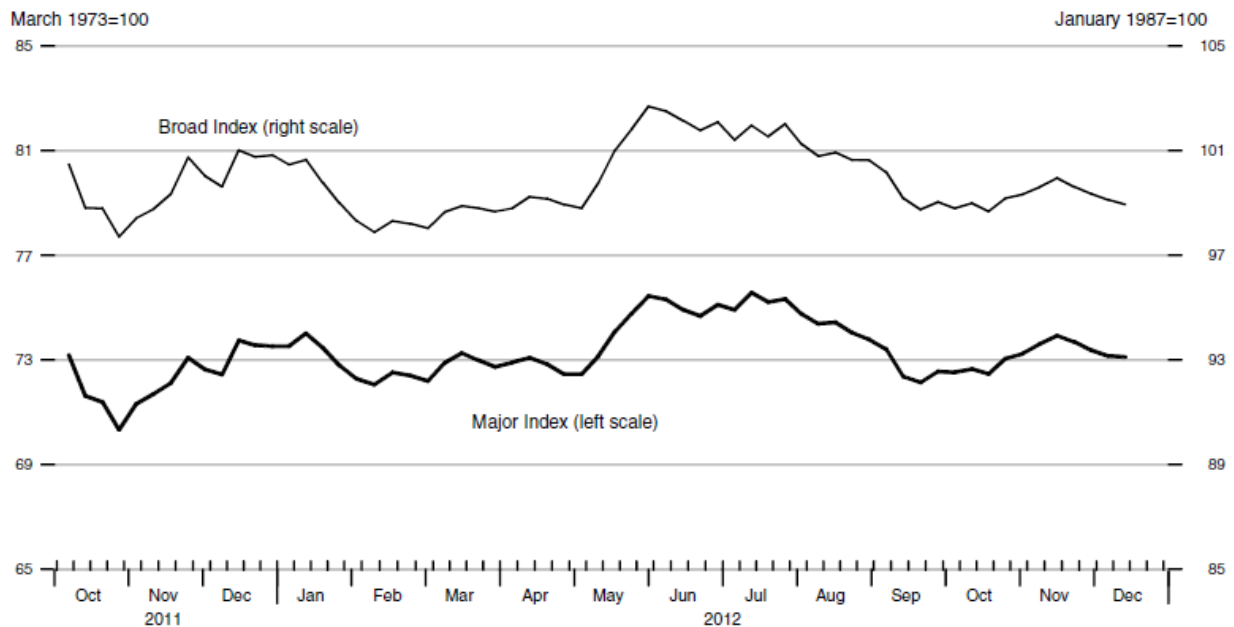
Short of some elaborate controls program, the U.S. has only a limited influence on the dollar exchange rate. Estimates can be made of what exchange would be consistent with a zero net export balance. But no one can know for sure. However, as Warren Buffett pointed out back in 1987, there is a market solution. In effect, he proposed a variant on cap and trade.

The essence of the Buffett plan was simple. Anyone exporting a dollar's worth of goods or services from the U.S. would get a voucher permitting the import of a dollar's worth of goods and services. The value of imports is therefore capped at the value of exports. The recipient of the voucher could exercise it directly or sell it to an importer. Essentially, the prevailing exchange rate plus the value of the Buffett voucher produces a *de facto* exchange rate faced by exporters and importers equal to the exchange rate that is consistent with a zero net export balance. *Note that no single country is singled out for bashing.* Anyone can buy or sell anything from anywhere but at the end of the day exports = imports. (The plan could be phased in over time since the voucher value could initially be set at greater than \$1.)

Are there administrative complications with the Buffett plan? You would have to have a mechanism for verifying true values of exports and imports. Note that we already do such an evaluation on imports via customs inspections for tariff assessments. There are issues related to service exports and imports such as royalties on intellectual property (movies, TV shows, music, books, etc.) and tourism. But since this proposal will be ignored, we don't have to dwell on those complications.

Trade-Weighted Exchange Rate Indexes

Averages of Daily Figures



Probably, you will initially want to ignore the proposal because it is “protectionist.” But if you do the math, you will see that it is simply a *de facto* downward move in the dollar exchange rate. The dollar goes up and down relative to other currencies all the time. Is every decline “protectionist”? Another objection is that it involves “unilateral” action by the President when we should obtain agreement by all

other countries. As I have noted in my EPRN musings, Nixon unilaterally ended the entire Bretton Woods exchange rate system in 1971. (You can see him do it on TV on my YouTube channel: www.youtube.com/danieljbmitchell. [Search under "Nixon."]) Presidents can act boldly if they want to.

By the way, the likely outcome of a U.S. policy announcement that the Buffett plan would be implemented would in fact be a call for an international conference to deal with exchange rate manipulation and unsustainable trade imbalances. I don't know what the outcome of such a conference would be. But it is at least possible that if the U.S. took the unilateral step of announcing the Buffett plan, some kind of new multilateral deal would follow and the Buffett plan would not actually have to be implemented.



Of course, if you don't like the Buffett plan but have no alternative to suggest, you can fall back on the idea that steps are already underway to correct the trade problem. The Chinese are raising the value of the Yuan, albeit at a snail's pace. The unemployment rate is coming down. In fact, the U.S. runs a net export deficit with just about every significant trading partner; it isn't just the Chinese. And the gradual U.S. economic recovery will add to the net export deficit. The problem is not solving itself, contrary to what some observers would like to believe.

My advice is that we implement the Buffett voucher plan. You can pick whatever reason you like to ignore my advice. (But do tell me your better idea for job creation when you ignore mine.)

Summary

I have provided five pieces of advice to the new (re-elected) Obama administration, one of which is sure to be ignored – based on past evidence - and any of the others could be ignored. If the advice isn't followed, at least I have done my citizen's duty by offering it.

- *In current and future political negotiations, for the President to be seen henceforth as a tough bargainer, a consistent hard bottom line will be necessary. Over the course of four years, even if hanging tough creates impasses initially, the consistency may in fact reduce the frequency of such events as the game repeats. Bargaining credibility can be regained, but only over time.*
- *Don't worry about polls on detailed policy issues. Polls can tell you in broad terms what folks are worried about. (If you didn't know, they worry about jobs and the economy.) When it comes to detailed policy issues which most people don't follow, it is more important to frame public opinion than to cater to what even the best pollsters tell you public opinion is. Remember that pollsters have a strong incentive to tell you about public opinion even if the public really has no deep felt or knowledgeable opinion.*

- *A task force should be set up on federal economic data series, especially the time series that are widely used for macro policy purposes. Of course, there should be some experts on the task force of the type who love chained Fisher Ideal indexes. But I would also include business journalists, forecasters, and non-academic economists who would be asked to scrutinize key series for understandability and usability. If Grandma's Social Security is indexed to the CPI, the CPI should be explainable to Grandma.*
- *When it is time to replace Ben Bernanke as head of the Federal Reserve, the administration should find and nominate his long-lost identical twin. If it turns out he actually doesn't have a twin, just don't nominate a monetarist who sees a future of hyperinflation. Otherwise, you will get premature austerity.*
- *Despite all the concern about the federal budget deficit, the deficit to focus on and to correct is the net export deficit. We are worrying about the wrong deficit. My advice is that we implement the Warren Buffett voucher plan which would quickly bring the net export deficit to zero. It would create jobs particularly in manufacturing. And it would help avert a future international dollar financial crisis. You can pick whatever reason you like to ignore this proposal; it has been ignored since 1987 when it was initially put forward. But – please - first come up with a better idea for creating jobs.*