Mitchell's Musings

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Format may differ from originals

Note: There were no musings for the period January-March 2016

Mitchell's Musings 4-4-16: What is the Point?

Daniel J.B. Mitchell

The Mitchell's Musings column resumes now that the UCLA winter quarter has ended along with the course I co-teach each winter with Michael Dukakis on *California Policy Issues*. UCLA's winter quarter consists of ten weeks of instruction (plus a week for exams). Each week of the course is devoted to a different area of public policy, although there is often a significant overlap between the various subjects.

In particular, the topic of week 8 is California economic policy. Each year, I give a presentation in that week involving PowerPoint slides and videos on state economic policy. Although the presentations each year have been similar, they are updated and evolve as events change. You can find the latest version at the link below:

https://archive.org/details/210bEconPt2Video (About an hour and a half in five parts.)

There is a key point in the presentation: If you think of economic policy in the short-term macroeconomic sense (trying to flatten out the business cycle), there isn't a great deal California can do. The California business cycle is pretty much a reflection of the U.S. business cycle and the policy instruments needed to deal with that issue are largely in the hands of the federal – not the state - government. Much of the impotence at the state level lies with the fact that states do not have independent monetary policies since they don't have their own currencies. The states of the United States are part of the larger U.S. dollar zone. What countries in the euro-zone have discovered, perhaps to their dismay, is that giving up their national monetary systems meant that they have become as limited in macro affairs as are states with the U.S.

However, despite the greatly constrained capacity of states such as California to deal with macroeconomic affairs, that fact has not limited the ability of the electorate to hold governors responsible for local economic conditions. It's best not to be a governor during a downturn. Being a governor in the expansion phase is far more pleasant. As California governor Jerry Brown recently commented while reflecting upon the current state expansion:

"It's quite remarkable what California's been able to do. That won't always be, and when that turns around, I think the job [of governor] will be far more challenging than it is today."[1]

During Hard Times, despite the seeming unfairness of holding a governor responsible for something that ultimately has to be dealt with at a higher level, there is often some justice in it. When they stand for election, governors and other state and local officials often take credit for good economic conditions when those circumstances are present. If they are candidates for office (but not actually *in* office) during election campaigns, they may well blame incumbents for Hard Times and promise to do something about conditions. So voters can't be faulted from attributing to governors more economic authority and control than they actually have.

There is an interesting question, one which is not raised in the class presentation since the course is confined to the state level. Numerous studies indicate that presidential elections are influenced by the

[1]http://www.latimes.com/politics/la-pol-ca-jerry-brown-approval-rating-latimes-poll-20160329-story.html. Brown was governor in the 1975-83. In 2005, he was back in California state politics and joked and philosophized about the limits of the role of governor at a conference at UCLA: https://archive.org/details/BollensRies542005Excerpt.

state of the national macro-economy. And my presentation does note that the macro-economy is largely the province of the federal government which does have a monetary system and, thus, a monetary policy. State and local governments can't create money; the federal government can. But in the American system, what exactly is the federal government?

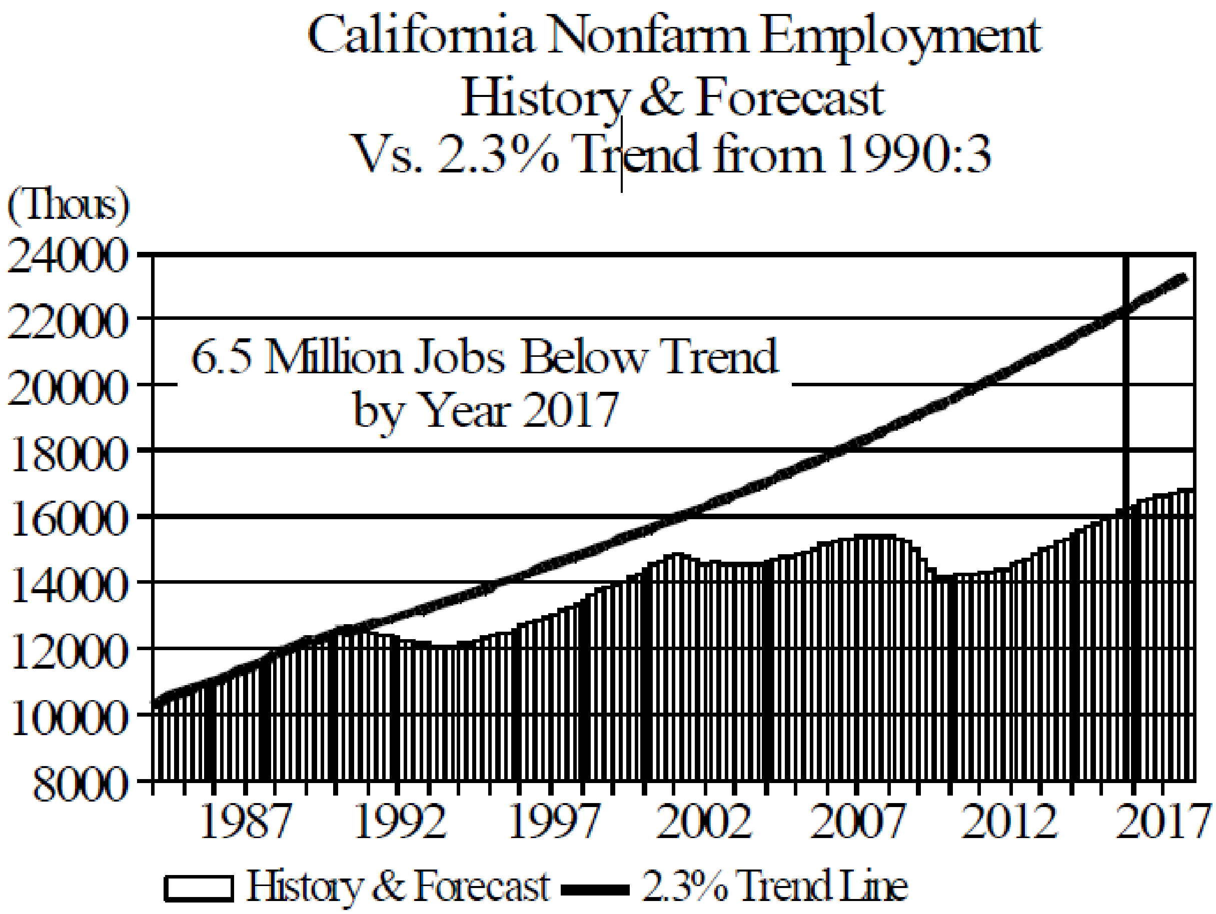
It isn't just the President (any more than a state within the U.S. is just the governor). There are three distinct branches of government and fiscal policy, even if the President can propose a particular fiscal approach, is largely a matter for the Congress (with the judiciary chiming in on whether what Congress did is constitutional). Apart from the three branches, the Federal Reserve is quasi-autonomous by design. The President cannot order up a particular monetary policy. But as at the gubernatorial level, that fact doesn't prevent presidents from taking credit for good economic conditions. And it doesn't prevent presidential candidates from claiming that they will unilaterally produce improved conditions.

In the class presentation, I note that there is a difference between macroeconomics in the short-term, business-cycle sense of the word - as we have been using it above - and long-term trends. Averaging out the business cycle, what is the underlying growth trend of a state? It could be faster, slower, or the same as the national trend of which it is a component. Obviously, there are external factors beyond state control that can affect the long-term trend. In the California case, from World War II until the end of the Cold War, the state growth rate was boosted by military-related expenditures from the federal government as can be seen in Appendix A. So world events were an important economic driver for California.

However, even though there was an outside boost to state growth, California took advantage of the tax revenues that the boost generated to build up its physical and educational infrastructure. Those investments were expenditures that helped reinforce the effect of the external stimulus. Indeed, one could argue that much of the challenge facing California after the end of the Cold War involved (and still involves) maintaining and expanding that Cold War-era infrastructure in a period when the pie is not expanding as fast as the old trend.

In short the lesson I hope the students in *California Policy Issues* take away is to be skeptical of candidates at the state and local level who promise quick economic miracles, particularly during periods of national economic difficulty. And while the federal/presidential story is more complex than the state and local version, at least I hope they will remember that under the U.S. system of governance, presidents cannot decree monetary and fiscal policies. They are not dictators, beneficent or not.

Appendix A: California's Post-Cold War Deviation from Cold War Employment Trend



Source: UCLA Anderson Forecast, December 2016.

Mitchell's Musings 4-11-16: What is the Point? – Part 2

Daniel J.B. Mitchell

Last week's musings dealt with a lecture I gave in my course *California Policy Issues* on state economic policy. Basically, after watching that lecture, it seemed (to me at least) that there were a few key points in the presentation and that those points were in fact made clear. Earlier in the same course, however, I gave a lecture on fiscal policy which has some obvious overlaps with the later one. See https://archive.org/details/10bfiscal2016pt1. After watching that fiscal presentation, I am less confident that all the key points that should have been made actually were made or were made clearly enough.

In that earlier lecture the topic is really budgeting. There was a time, back when I was an undergraduate in the 1960s, in which courses were offered which dealt with that topic in economics departments under the heading of "Public Finance." Since that time, Public Finance has become "Public Economics" and the name change signified that the topic is now a whole lot more theoretical than in olden times. So the nuts and bolts of state and local fiscal affairs are not likely to receive much attention.

Undergraduate students can still take courses in accounting, as I did. But such courses tend to be focused on corporate, i.e., private sector, accounting and not the kind of accounts routinely found at the state and local level. That's a definite gap in the curriculum, particularly for students who might be considering careers in the public sector. Nonetheless, there is one benefit that a student with an accounting background would have and that benefit is a recognition of a key point in the lecture: the distinction between stocks and flows and the related notion that flows have to be defined over a unit of time (such as a fiscal year).

The lecture does make it clear (I think) that notions of surplus and deficit should be defined as flows (and thus linked to a specified time period). In corporate accounting, for example, flows are reflected in income statements. And the profits and losses shown on those statements are roughly analogous to surpluses and deficits in government budgets.

Similarly, the balance sheet in corporate accounting is a stock measure since it shows assets vs. liabilities at a point in time, e.g., the end of the fiscal year. But the analogy somewhat breaks down since balance sheets for governments typically value only cash as assets and omit physical assets that governments own (office buildings, roads, bridges, schools, equipment, etc.). Balance sheets for government do show debt although there are issues about what debts are to be reflected. (Should unfunded retirement-related liabilities be listed along with bond-type debt, for example?)

What I think is not clear is that, although the lecture notes that the budget is the most complete piece of legislation establishing priorities, the budget doesn't directly tell you much about judgment or good administration. Fiscal prudence, i.e., managing the budget so that bills can be paid both in good times and bad, doesn't mean that budgetary priorities are the "right" ones. Right and wrong in that case are individual political preferences, not matters of accounting. And even if your priorities match those of the legislature and the budget, fiscal prudence doesn't tell you whether the priorities are being accomplished efficiently or effectively.

Although the budget lecture focuses on California and provides some of that state's recent budgetary history (including the fiscal crisis surrounding the Great Recession), it omits an important observation. It doesn't note that popular opinion judges whether fiscal affairs in Sacramento are being managed correctly by the absence of crisis. That is, if there are no dark headlines, things must be OK.

For many years, until voters changed the rules through a ballot proposition in 2010, a budget could not be passed without a two-thirds vote of the legislature (in both houses). That requirement rarely caused significant delay in good times. In bad times, however, budgets were late – sometimes by months – creating a crisis. Bills couldn't be paid without budgetary authorization, even if cash was on hand to do so. Thus, delay and crisis in Sacramento was a signal to the voters that something was wrong and that fiscal affairs were being mishandled. Typically, pollsters would detect a sharp drop in favorability ratings of the governor and legislature when budget delays occurred.

Crisis via delay was a crude public signal, but it was a highly visible signal. Delays in budget enactment at least gave an indication of a problem before fiscal affairs reached a point – as occurred in 2009 – that cash couldn't be found to pay all bills and IOUs had to be issued instead. Now that the delay signal is gone (thanks to the end of the supermajority requirement), the need for consistent budget definitions of concepts such as deficits is heightened.

Yes, Governor Jerry Brown got voters to approve a "rainy day" fund that is supposed to (help) avert future fiscal crises. But the rainy day fund itself tends to obscure the issue of whether there is a deficit so long as a crisp definition of that concept is not mandated. The flows into and out of the General Fund now have to be added to the flows into and out of the rainy day fund to calculate deficits and surpluses properly.

You can find the elements of such a conclusion in the lecture. But after a replay, I have to conclude that the implication may not be apparent. Next year, I will have to clarify. In the meantime, all that can be said is that such policy reforms as removing the two-thirds budget rule or creating a rainy day fund have unintended consequences. Perhaps that is another point that also needs to be made next year.

Mitchell's Musings 4-18-16: Insidious Incentive? Not So Much

Daniel J.B. Mitchell

Below in italics is a quote from a recent Urban Institute policy brief:

> *"Though the Supreme Court's four-to-four deadlock in Friedrichs v. California Teachers Association on Tuesday upheld the requirement that nonunion members pay union fees, it raised new doubts about the fairness of a practice conservative activists have fought for decades.* ***But a more insidious—and lesser known—injustice faces teachers in California and around the nation: they must contribute a substantial share of their salaries to pension plans that deny them a fair return… A 25-year-old teacher hired today would receive a future annual pension of only $12,000 if she teaches for 20 years or $3,500 if she teaches for 10 years. That teacher would have to remain employed for at least 28 years to collect benefits worth more than the required plan contributions. Teachers who stop teaching earlier lose money in the mandatory plan. They would receive more retirement income if they could opt out of the plan and invest their contributions elsewhere. Teachers with shorter tenures end up subsidizing the large pensions received by the longest-tenured teachers.*** *Only 35 percent of new hires and 47 percent of teachers who work at least five years will receive pensions more valuable than their required plan contributions…"*[2]

What is odd about the quote above is that the author's seemingly-astounding discovery of an "insidious" element in teacher compensation is simply a description of any run-of-the-mill defined-benefit pension plan. All such traditional plans favor long-service employees and can be viewed as "subsidizing" the pensions that are received by those long-career workers by those with short careers. The more generous the plans are to long-service career workers, the greater is the cross-subsidy they provide from short-timers.

But is such a compensation structure "insidious"? Let's note that a retirement plan that is offered as one part of an employment package differs importantly from, say, a stand-alone investment opportunity offered by a financial institution. Whether you should invest in a stand-alone opportunity is your own decision and is independent of your occupational choice. Absent false promises by the offering financial institution, you should not - and presumably won't - invest in something that offers you an expected below-market, substandard return.

Employment packages are different from stand-alone investments in that they contain elements that may be more or less advantageous depending on your job-related behavior. Thus, a sales commission could be said to be a bad deal for sales personnel who turn out not to sell much. A piece rate would be a bad deal for a factory worker who turns out to be not especially productive. Contingent and competitive promotion arrangements (tenure for

[2] http://www.urban.org/urban-wire/teachers-required-pension-contributions-are-less-fair-union-fees

professors; making partner for lawyers) – sometimes referred to as "tournaments" by economists - can be bad deals for those who don't "win" the tournament prize. (That is, those faculty who don't make tenure and those lawyers who don't make partner are losers in such arrangements.) Etc. Etc.

A defined-benefit pension is meant as a reward for those employees who don't leave the job early (voluntarily or not) and who stay for a long time. They also provide a significant incentive toward the end of a career to retire (and thus for labor force renewal). If you don't stay for a long career – or if you persist beyond some "normal" retirement - such pensions are not going to reward you and you will in effect subsidize those who do follow the incentives. So, yes, it's true that a 401k plan or cash balance plan would be better deal for short-career teachers.[3] But if that's not the kind of employee school districts want, is it insidious for those districts to offer a particular compensation arrangement that isn't a good deal for them?

If we drop the inflammatory language of the policy brief (which I have to say is a bit surprising for the Urban Institute) and if we look at the critique apart from that language, is there something more useful to be said? Note that Congress, in its wisdom, has chosen the employment relationship as a locus for a kind of privatized social insurance. Through tax incentives, it has incentivized employers to offer health insurance (an offering now reinforced by "Obamacare" rules) and retirement plans.

Congress *does* directly provide health care for older individuals (Medicare) and a defined-benefit pension (via Social Security). However, to the extent social insurance is promoted through the employment relationship, the social welfare motivation doesn't necessarily mesh with a general policy preference to let employers design workplace compensation and incentive packages as they think best. In effect, there are two objectives of public policy at issue here – adequate retirement income and letting employers design their own personnel motivational systems. Tinbergen's rule in economics – usually stated as a general need to have the number of policy instruments match the number of policy goals – points to the tension created when social welfare/social insurance objectives are imposed on workplace arrangements. One instrument – a tax incentives for retirement plans – may not accomplish both goals.

If the concern is for adequate retirement incomes for oldsters, perhaps beefing up Social Security – a program which Congress directly controls – would be a better approach than discouraging defined-benefit pensions.[4] Social Security could be a Tinbergen-style second

[3]We are ignoring substantial behavioral research that suggests that employees are not great at either setting appropriate saving levels for themselves or at selecting investments for their retirement funds. So 401k plans in practice may turn out to be inferior to defined-benefit pensions. Surely, the security value of defined-benefit pensions has to be considered in comparing them to other tax-favored saving plans; 401k-type plans create risks assumed by employers under defined-benefit pensions. The cash-balance approach deals partly with such risks, but typically offers a low rate of return. None of these complications are addressed in the Urban Institute brief.
[4]Note that public school teachers under defined-benefit pension are often excluded from Social Security.

instrument. It’s too bad the Urban Institute’s policy brief didn’t consider that approach, although I wouldn’t characterize that omission as insidious.

Mitchell's Musings 4-25-16: Just Plain Bills

Daniel J.B. Mitchell

There is a great deal of excitement over the recent announcement that Andrew Jackson will be taken off the twenty dollar bill and replaced with Harriet Tubman. Although various images of the Tubman bill have appeared in the news media, the actual redesigned bill has yet to be, well, redesigned. There was also excitement over the decision *not* to take Hamilton off the ten dollar bill – apparently due in part to the influence of the current hit Broadway musical about him.

But here's the thing. When the new Tubman bill does appear – news reports say the new bill will be unveiled in 2020 – it will be worth precisely two Hamiltons. That sum is the same value that Jackson has today. That is, despite the political and historical significance of exchanging Jackson for Tubman, there will be no monetary significance of the switch. Zilch. So with 20-20 vision, I can predict that two tens will be equal to one twenty when the new bill comes out. Why is that? Why is that true, now and then?

Is it because the twenty dollar bill says it is "legal tender for all debts public and private." Actually, the ten dollar bill has the same wording. So that phrase can't be the difference. Is the paper in the twenty worth double the value of the paper in the ten? No, it's the same material. And unlike some foreign currencies where the size of bills vary from denomination to denomination, the size of the ten and twenty will likely be the same, as is the case now.

Is it because the twenty is "backed" with twice as much something (gold? silver? bananas?) as is the ten? No. The twenty isn't backed by anything except two tens, or four fives, or ten twos (remember them?) or twenty ones.

Well, what about the coins you could get for a twenty? They are made out of metal(s) and metal(s) is (are) something. You could get 2000 metallic pennies for a twenty, for example. Indeed, in recent years, it costs the U.S. Mint more to make pennies (and nickels) than their face value.[5] So you might even say a penny is worth more than a penny.[6] In which case you might say a twenty (exchangeable into pennies) is thus worth more than a twenty, albeit by the same percentage that a ten is worth more than a ten.

OK, you get the point. Money in modern times is a social convention, although a very useful one. Money is used for exchange because everyone does it. Everyone in 2020 will know that with beginning-to-wilt Jacksons and newly-printed Tubmans both in circulation at that time, both will be worth the same amount and both will be worth two Hamiltons. The only real difference between a Tubman and a Hamilton will be that the former will be stamped "20" and the latter "10."

It may seem odd that people compete for – and even steal and murder for – the obtaining of pieces of paper (or electronic representations thereof) which have value due to a social convention. But people do. And it is the same social convention that allows macro policy control of interest rates and exchange rates and thus the general pace of the economy.

[5]The U.S. mint at present has negative "seigniorage" on pennies and nickels (the "profit" it makes on selling coins to the Federal Reserve) but makes it up on other coins. See https://www.treasury.gov/about/budget-performance/CJ14/20.%20Mint%202014%2004%20April%20FINAL%20ok.pdf. Note that economists sometimes use the word seigniorage to refer to more complicated concepts such as implicit interest-free loans to the central bank.

[6]At present, the excess cost of pennies and nickels is not so high that it pays to melt them down.

Mitchell's Musings 5-2-16: The Gig is Up (or is it?)

Daniel J.B. Mitchell

Have you been hearing or seeing excited reports about the "gig economy"? Punching the phrase into Google produced 485,000 references. Here is one of them that provides a definition:

> *A gig economy is an environment in which temporary positions are common and organizations contract with independent workers for short-term engagements. The trend toward a gig economy has begun. <u>A study by Intuit predicted that by 2020, 40 percent of American workers would be independent contractors</u>. There are a number of forces behind the rise in short-term jobs. For one thing, in this digital age, the workforce is increasingly mobile and work can increasingly be done from anywhere, so that job and location are decoupled. That means that freelancers can select among temporary jobs and projects around the world, while employers can select the best individuals for specific projects from a larger pool than that available in any given area…*[7] [underline added]

The use of the phrase "gig economy" seems to have developed with the visibility of transportation services such as Uber and Lyft which depend on independent contractors to drive their cars. I particularly call your attention to the prediction above that by 2020, forty percent of workers will be independent contractors. How plausible is that prediction, given that changes in work arrangements tend to evolve slowly and that we are already in 2016?

The forty percent prediction must have seemed plausible to the person that wrote the item cited. But did he/she check to see what the current proportion is that is projected to go to forty percent in a space of four years? Specifically, did he/she check the numbers that are available from the U.S. Bureau of Labor Statistics (BLS)? If you go to the BLS website, you won't find a data series called "gig workers." But you will find data on self-employed workers which is what independent contractors are. Of course, some self-employed workers do such things as run small retail stores or are proprietors of other businesses.

[7] http://whatis.techtarget.com/definition/gig-economy

So gig workers are a subset of the self employed.[8] Still looking at the ratio of self-employed workers to wage-and-salary workers should give us a sense of any trend and the magnitude of the gig phenomenon.

As the chart shows, the ratio of self-employed workers to wage and salary workers depicts a long-term downward trend and certainly no rise in recent years.[9] Note that the ratio measure slightly overstates the proportion of total employment represented by self-employed workers. But we are talking about a proportion of around 6%.[10] So the idea that the proportion is going to be 40% in a mere four years is implausible. More than 50 million workers would have to be converted from "regular" status as wage-and-salary employees to self-employed, even if you assume that all self-employed workers are

[8]We are ignoring the litigation challenging that independent contractor status of some gig workers.
[9]I used March data (seasonally adjusted) since March is the latest month available at this writing.
[10]There is a small number of "unpaid family workers" that is omitted from the chart and the calculation. Early in the period on the chart, such workers were more numerous but they are a minor fraction of the workforce today.

independent contractors.[11] Perhaps a more interesting employment-related question than the trend in gig workers is the presence of incentives for journalists to exaggerate workforce developments.

[11]One might argue that perhaps the new gig workers will be moonlighters with regular jobs and a gig job. But the proportion of moonlighters, like that of the self employed, has shown a long-term decline. The proportion is about 5%. See http://www.bls.gov/opub/mlr/2015/article/multiple-jobholding-over-the-past-two-decades.htm.

Mitchell's Musings 5-9-16: Making the Grade

Daniel J.B. Mitchell

There is an old (but ongoing) debate about the economic value of general education, particularly at the level of higher education. We know that more education is correlated positively with what students eventually earn on the job. So there seems to be a reward by employers for added education. But is the association the result of some tangible job skill acquired with education? Or is there some kind of creeping credentialism under which workers compete for jobs by trying to be more educated than the average?

The debate is really focused on fields such as humanities and social sciences in which – apart from the academic labor market itself – the knowledge acquired in college courses is not specifically sought by most employers. For most jobs, as an example, your knowledge of English literature may not be called upon very often. Yet employers say that they want employees who have skills that they associate with general college education. In certain fields, e.g., engineering, particular skills that have a more direct vocational link to jobs can be cited. But in the humanities and social sciences, the skills involved seem to be more amorphous, e.g., ability to learn, to organize, to evaluate.

Once on the job, employees of all types are subject to some form of periodic evaluation. Most often, an important element of subjectivity is involved in these evaluations. In larger firms, some kind of evaluative rating is produced for various attributes and added monetary compensation may flow as a result of good ratings. Opportunities to advance on the job (promotion) may also be linked to the results of performance appraisals. Of course, some jobs entail easily countable outputs – widgets produced, value of sales made, etc. However, even in jobs we associate with readily countable outputs such as production operatives in manufacturing, the use of mainly objective compensation systems (piece rates) seems to be in a long-term decline.[12]

In white collar and professional fields, a typical reward system – particularly where "countability" of output is low - is for employees to be evaluated by their supervisors for various traits and behaviors they exhibit. And such evaluation schemes are inherently subjective, even where formal personnel appraisal forms with rating scales and the like are in use. Being evaluated by your boss may be arbitrary or even unfair – particularly as perceived by someone who receives a low rating. But what is the alternative? As

[12]http://www.nber.org/papers/w16540.pdf.

economists put it, there is an "agency problem" inherent in employment. The "agent" (employee) may not do what is required by the "principal" (employer) unless there is some process of monitoring and evaluation, generally tied in some way to reward.

So, getting back to higher education, what process found there is analogous to the real world of work? Grading is an obvious answer. The student (like an employee) is evaluated based on his/her performance in such assignments as term reports and exams and behaviors such as class participation. The evaluator is ultimately the instructor (like a boss/supervisor) even in large classes where there is delegation to teaching assistants (TAs). Although there is no direct pay linked to grades in college, opportunities for graduate school or scholarships or research assistant jobs are associated with good grades.

As it happens, I co-teach a course on California Policy Issues. I won't go into details, but the course has been taught at UCLA since 1994.[13] It now enrolls 60 students and is routinely over-subscribed (wait listed). For various reasons, the sponsoring department would like to upgrade the course so that it would give students additional credit. To make the change, an application must be completed and submitted. The instructions for filling out the requisite application indicate that a syllabus should be part of the application and say that the syllabus should include a "description of grading policy, *specifically*, the percentage that each component carries in determining a student's career grade." (Italics taken from instructions)

Here is what the current syllabus in fact says:

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> *GRADING POLICY: Unlike other classes you will have taken at UCLA, we do not use a mechanical formula for course grading, i.e., X% for this; Y% for that.* We do look at such matters as your record in terms of absences, lateness to class, leaving class early, and failure to hand in assignments on time. The two instructors make a joint judgment about the quality of your individual and team reports as well as other aspects of your record. In making that evaluation, we look to see if suggestions we made on the outlines and drafts were followed in the final product. In short, we evaluate student performance in PP 10b in the way real-world future employers are likely to evaluate you. Your real-world future

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[13]I have posted about the course previously: http://employmentpolicy.org/page-1775968/3930230 and http://employmentpolicy.org/page-1775968/3937639.

> employers are very unlikely to evaluate you on the basis of some simple formula of X% for this and Y% for that…[14]

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Exactly how this particular issue will be resolved has yet to be determined. However, there won't be a change in the grading policy from its current subjective format. We will see whether the university powers-that-be will be flexible enough to accept a course that actually has workplace-like attributes when it comes to student evaluation.

So research alert for labor economists and educational specialists! We are about to have a direct test of the idea that what students learn in college is of general application to their later employment.

[14] https://issuu.com/danieljbmitchell/docs/10brd16.

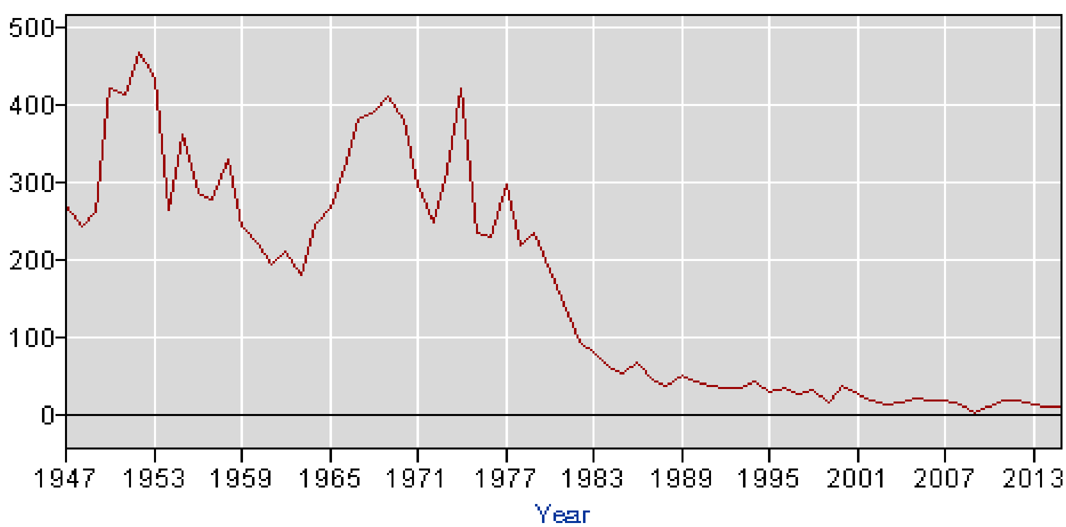
Mitchell's Musings 5-16-16: Worker Unrest

Daniel J.B. Mitchell

When people think about unrest in the 1960s and 1970s, they think about civil rights demonstrations, urban riots, and anti-Vietnam War protests. Of course, all of those things occurred. But often neglected was the worker unrest of that period. In that era, unions were much more prominent – especially in the private sector – than today. So strikes were one way in which worker discontent was expressed.

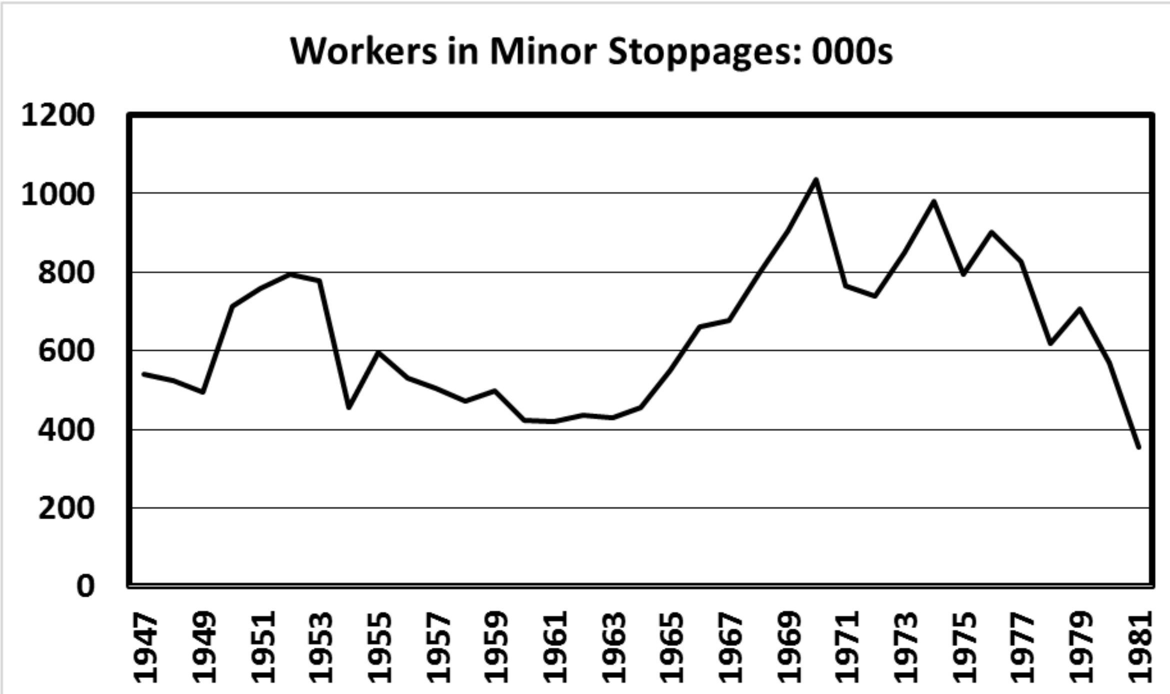
The U.S. Bureau of Labor Statistics (BLS) still tracks strikes (actually, "work stoppages" since some stoppages can be lockouts rather than worker- or union-initiated strikes). But it now tracks only "major" work stoppages, i.e., those involving 1,000 or more workers. As the chart below shows, major strikes have dwindled down to very small numbers. Whereas in the post-World War II period it was common for 300 or 400 such strikes to occur, in 2015 there were only 12 involving 47,000 workers.

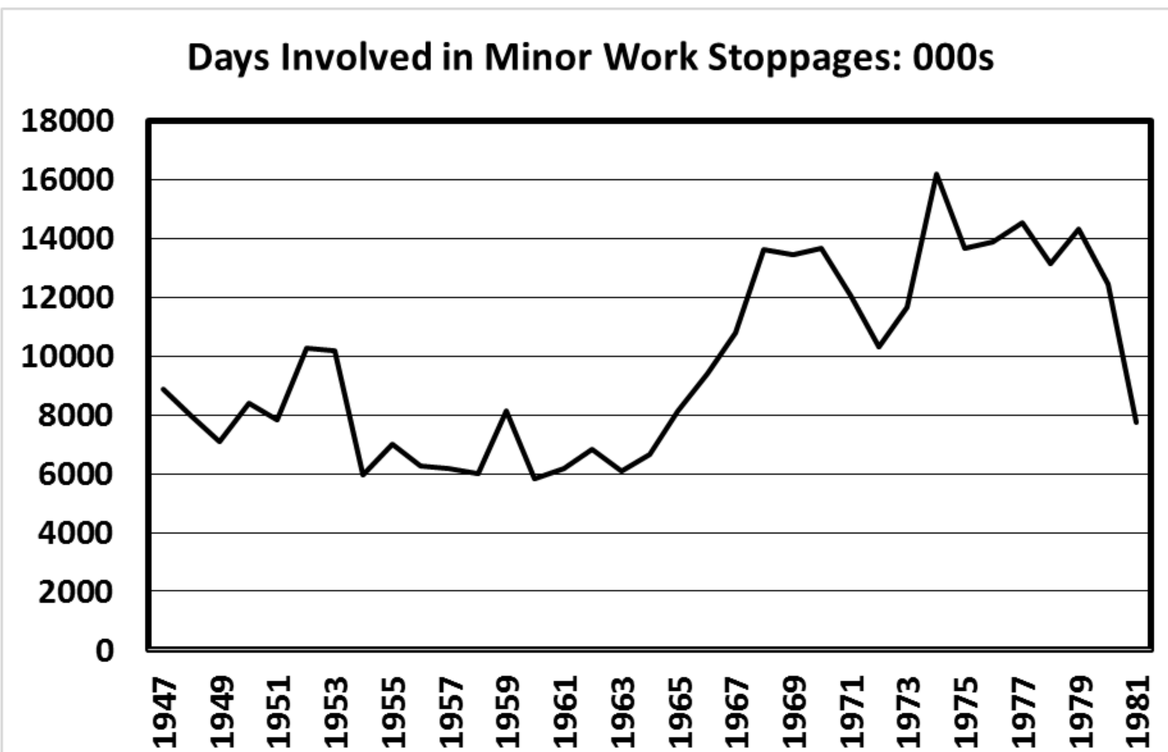
Number of Major Work Stoppages



At one time, BLS tracked strikes below the 1,000 worker level. If memory serves me, the cutoff was something like 50. But as unions went into decline, BLS paid less attention to them as a priority for statistical programs. "Minor" strikes (those involving fewer than 1,000 workers) were dropped from the series after 1981. So up through 1981, it is possible to see what was going on in smaller units.

Big strikes tended to be concentrated among "key" contracts that set "patterns" for smaller units. And they tended to involve basic contract renegotiation disputes over wages and benefits. Major contracts, sometimes involving tens or hundreds of thousands of workers, would expire and sometimes strikes occurred. Smaller unit strikes were often over local issues, sometimes "wildcat" (unauthorized) strikes that could involve grievances, local workplace rules or issues, or even intra-union conflicts. Sometimes after the national bargaining was done, local branches of the national union would deal with local concerns.[15] Arguably, there is information about general worker unrest in "minor" disputes that is unrelated to accidents of big contract renegotiation timing.





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[1]A handful of nonunion stoppages were included in the data. But these were (are) rare for obvious reasons.

The charts above on minor strikes suggest that the second half of the 1960s and the 1970s was a period of notable worker unrest.[16] There was a bit of a lull in the early 1970s that seems to be associated with the wage-price controls of that era. With the exception of the Korean War period – in which wage controls seemed to provoke disputes – the period before the mid-1960s was relatively quiescent compared with what followed.

Dramatic union decline begins in the early 1980s with two back-to-back recessions and we know that major strike activity declined, based on BLS data. We don't know for sure what happened in minor contracts but anecdotally at least, there was also a decline in strike activity there. Fewer workers were unionized so strikes became progressively less useful as a proxy for general worker discontent.

There were political developments that accompanied the rise in strike activity starting in the mid-1970s that have some resonance with the Trump phenomenon we see today. It appears that discontented white male blue collar workers, who back in the day were a major component of union activity, now form a part of the Trump coalition. The late 1960s saw a rise in inflation that eroded real wages – at least temporarily. That development was part of the discontent. But there were other developments in the larger society that also caused anxiety.

The one-time solid Democratic south – under federal orders to desegregate – began its switch to becoming the solid Republican south as part of the "southern strategy." But there were continuing racial tensions in the north and west, too. Reagan was elected governor in California in part in response to the Watts Riot, a fair housing law (that was repealed by voters), and college student demonstrations at Berkeley and elsewhere. As the 1960s progressed, the Vietnam War became another contentious issue.

Franklin Roosevelt's New Deal coalition of Dixiecrats (southern segregationists), northern liberals, minority voters, and unions began to fray in response. Well before there were "Reagan Democrats," there were Nixon Democrats, part of the "silent majority" who were concerned about societal trends.[17] The Nixon administration made a conscious effort to appeal to "hard hat" union workers angered at Vietnam protestors. At the same time, the administration put pressure on those same hard hats to open their unions to blacks; it was the Nixon administration that unveiled modern affirmative action, first aimed at urban construction trades under the Philadelphia Plan.[18]

By the mid-1970s, there were the first glimmers of deindustrialization (in part due to a major recession) and early signs of pressures on middle class incomes. Concerns about such matters became more and more prominent. But by the end of the decade, the country moved not to the left but rightwards. Senator Ted Kennedy played a role somewhat analogous to Bernie Sanders in the primaries, tending to undermine the Democratic establishment candidate, incumbent President Jimmy Carter.

In short, the worker discontent that seems reflected in pre-1980s strike data must be seen as part of a larger phenomenon that was also expressed politically in the 1980 election. Nowadays, with the decline in unionization, the strike option is not available to most workers as an outlet for demonstrating unhappiness. We don't have data on minor strikes and major strikes are no longer a proxy for

[16] I subtracted major stoppages from total stoppages to obtain the minor residuals.
[17] https://www.youtube.com/watch?v=v7XJH8uI9YI
[18] A review of Philadelphia construction trades practices began under the Johnson administration. The incoming Nixon administration under then-Labor Secretary George Shultz formulated an affirmative action plan featuring the kinds of goals and timetables that came to apply to such efforts.

generalized discontent. But the political option for expression remains and shows itself in voter support for unconventional candidates such as Trump and Sanders. And while it might not be surprising that some of the union workers who remain might be attracted to the latter candidate, Trump also has an appeal to them.[19]

Sanders' "path to the nomination" seems to be rapidly disappearing, as did Ted Kennedy's in 1980. So that leaves Hillary Clinton versus Donald Trump in November. Election campaigns in the U.S. are assemblages of various interests and groups behind a candidate. Discontented workers are one such group which is up for grabs and could be critical in determining the outcome.

[19] http://www.politico.com/story/2016/01/trump-seiu-mary-kay-henry-217445

Mitchell's Musings 5-23-16: An Op Ed That's Not So Great

Daniel J.B. Mitchell

Below is an excerpt from an op ed that appeared in the New York Times of May 16, 2016:

> ***Make America Great Again for the People It Was Great for Already***
>
> *By Bryce Covert*
>
> *DONALD J. TRUMP has promised to Make America Great Again, and people have listened. He is the presumptive Republican nominee. He got there with that one consistent campaign imperative splashed across his website, on loud red baseball caps, on stickers, yard signs and other slogan-ready paraphernalia… Which America is he promising to us? If you ask his supporters, they say life has gotten worse for people like them over the last 50 years. It seems safe to assume that, in the eyes of Mr. Trump's overwhelmingly white male fans, America was greater a half-century ago. Indeed, it was pretty great — for them. It's not just that factory jobs were more plentiful or that women and minorities were largely kept from positions of power. Large national programs that radically changed the country kept America great specifically for white men. New Deal-era systems like Social Security and unemployment insurance; rules that demarcated minimum wages and maximum work hours and protected unionization; and the G.I. Bill at the end of World War II substantially transformed the country and created a booming middle class. But they all purposefully left out most women and minorities…*[20]

Wait a minute! New Deal (1930s)? GI Bill at the end of World War II (1940s)? The number of white men who now even remember the New Deal or the GI Bill at the end of World War II is rapidly diminishing. The op ed also talks about a "half century ago" (1960s). So given the ambiguity of what time period we are supposed to be thinking about, let's consider someone – a male given the slant of the piece - who was, say, age 20 in 1966 (a half century ago). He's an early baby boomer, born in 1946.

At that age in 1966, particularly if he wasn't enrolled in college, he was about to be drafted into a war that was ultimately lost. He was on the cusp of an economic era – when he got out of the military – shortly to be characterized by "stagflation." By the time he was 30, not only was the Vietnam War lost but the Watergate scandal and the Nixon disclosures and resignation had undermined faith in government. The first signs of de-industrialization and the growth in income inequality were being felt. And the country had just started to emerge from a severe recession.

As numerous polls have indicated, the Trump strength is among voters with less than a full college education, particularly males. Among adults in the U.S., roughly a third of folks have a BA or more, so a large majority don't. Does Ms. Covert think that for folks like those in that majority, things were "pretty great" in her time-ambiguous past? Does she think that women and minorities would be better off today without "New Deal-era systems like Social Security and unemployment insurance" or that they would have been better off back then without them? She never quite says, but then, what is the article all about?

[20] http://www.nytimes.com/2016/05/16/opinion/campaign-stops/make-america-great-again-for-the-people-it-was-great-for-already.html

Does Ms. Covert know that before the New Deal, blacks (the main minority group of that era) looked to the Republicans (the Party of Lincoln) as their representative and that it was those New Deal programs that turned them into reliable Democrats? Yes, that switch in party identification occurred *despite* the segregation-supporting Democrats of the South, despite other discriminatory programs and practices, despite the continued segregation of the military, etc. It continues today in the strong support of blacks for the Party's "establishment" candidate in the current Democratic contest, Hillary Clinton, over outsider/independent candidate Bernie Sanders.

Perhaps Ms. Covert thinks women and minorities weren't hurt by the loss of those "factory jobs" which she casually mentions. She might be interested in looking at the composition of the workforce in the factory jobs that remain. She might be surprised by the number of women and minorities who work in that sector and who could be working there if those jobs were "more plentiful."[21]

I used to teach a course in labor relations and used a video made by the U.S. Department of Labor called "Waldenville." In that video, in which a public sector negotiation is depicted, a more experienced union negotiator tells a local union official that it is important to listen to member proposals, even if they seem weird. There is a message, even if hidden, in those opinions. "Listen to what they feel" rather than what they say is how the suggestion is put.[22] The message in that context is that you get nowhere by ignoring or condemning members (who are also voters in the union situation).

In politics, you also get nowhere by condemning voters. If you don't like a candidate, condemn that candidate, not the people who lean towards that candidate. Voters in any group are up for grabs to varying degrees – *but only if you appeal to them on the basis of their underlying concerns*. In this case, it's evident that Ms. Covert doesn't like Donald Trump. But Trump's voters seem to be responding to two broad issues: economy/jobs and homeland security. So rather than issuing condescending op eds, which seem to blame today's potential Trump voters for the sins of the 1930s and 1940s, why not focus on those issues?

You don't have to win over all of any group in an election contest.[23] And you don't have to make racist or sexist appeals.[24] Elections are won by coalitions. In some cases, even if some demographically-defined group tends to vote a particular way, you can peel off enough of that group to make a difference in the total vote. But you won't peel off anyone by condemning them and alienating them.

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[21]In 2015, of the over 15 million workers in manufacturing, 29% were women, 10% were black, 7% were Asian, and 16% were Latino. The minority proportions are roughly in line with the proportion of the three groups in total employment. Women are underrepresented, but there are still over four and a half million women workers in manufacturing. Source: http://www.bls.gov/cps/cpsaat18.htm. An earlier musing in this series dealt with the need to check the demographics: http://employmentpolicy.org/page-1775968/3714884#sthash.KTWWX2zL.dpbs.

[22]https://www.youtube.com/watch?v=Px86OwXcVAI (Part 1: The conversation is at 5:04-6:22). For those interested in the rest of the video: Part 2 is at https://www.youtube.com/watch?v=FDFkMHuupuE; Part 3 is at https://www.youtube.com/watch?v=jm0RRrZBWd0; Part 4 is at https://www.youtube.com/watch?v=W9htze_cJHs. The video was divided into four parts because at the time YouTube had a 10-minute limit.

[23]As of March 2016, 70% of women had an unfavorable view of Trump. But 23% had a favorable view. The percentages for men were 58% and 36%. http://www.gallup.com/poll/190403/seven-women-unfavorable-opinion-trump.aspx.

[24]I'll leave it to readers to decide whether condemning white males falls into that category.

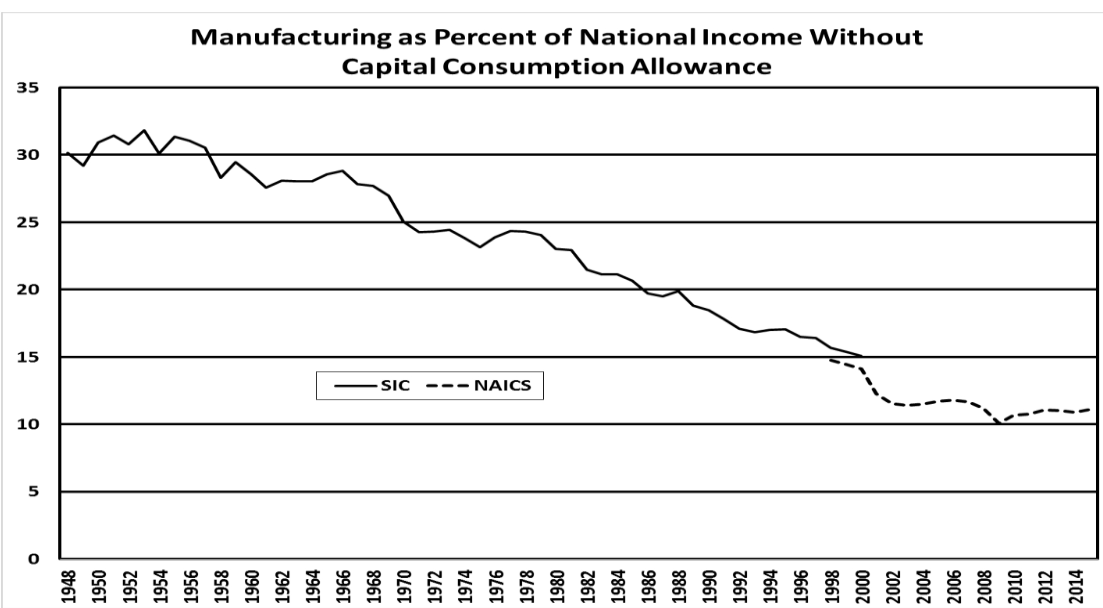
Mitchell's Musings 5-30-16: What Was Missing

Daniel J.B. Mitchell

I recently attended the LERA (Labor and Employment Relations Association) meetings in Minneapolis. LERA is the organization that sponsors the EPRN website on which this column appears. Confession: I was on the program committee that helped develop the meeting's agenda. But as I attended sessions and heard speakers, there was a missing element. Maybe that is my fault.

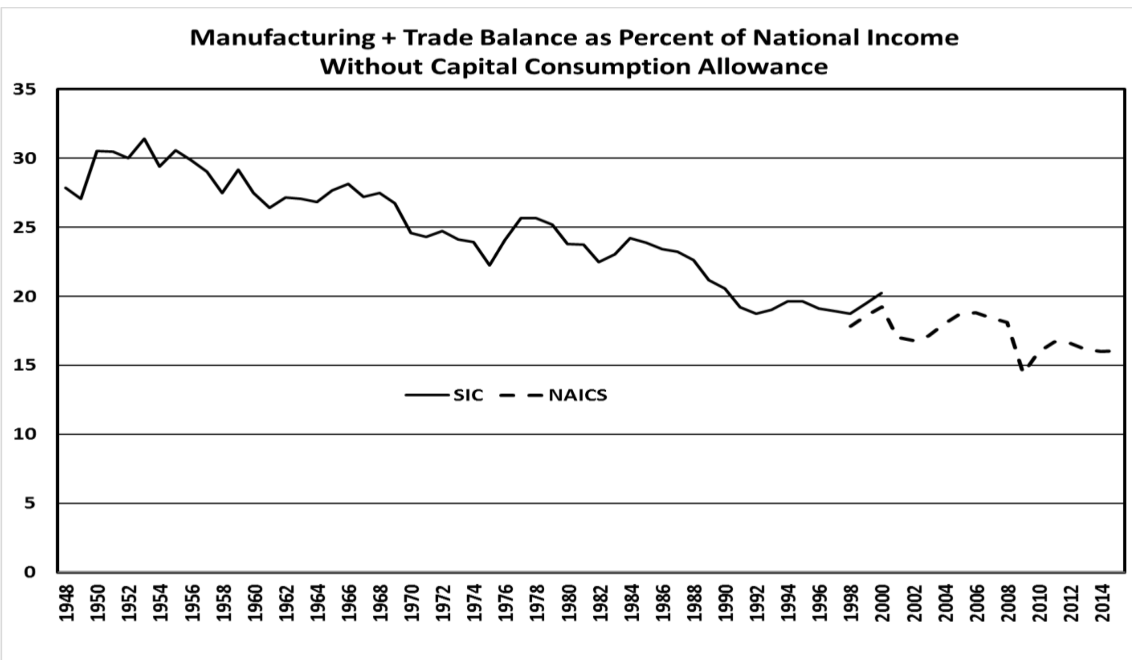
There was some mention of the current presidential campaign. However, back when the program was being planned, no one – except maybe Donald Trump and Bernie Sanders (neither of which was on the program committee – could have foreseen how the campaign would evolve. And one way in which it did in fact evolve was candidate discussion of the loss of "good" American manufacturing jobs due to globalization.

I attended one session on the auto industry – domestic and transplant/foreign - and its shift of facilities to Mexico. However, that session was mainly descriptive (but very interesting). Another interesting panel discussed the incorporation of labor standards into trade agreements such as the currently-pending TPP. Some of the sessions were run simultaneously so I can't say what happened in all of them pertaining to trade and jobs. And I wasn't at the last two days of the conference so maybe the omission I am alluding to - exchange rates – was somewhere on the later program after all.



Let's have some background. The chart above provides a summary, from the perspective of national income accounting, of the long-term slide of manufacturing relative to overall U.S. economic activity. Back in the 1950s, manufacturing accounted for 30+ percent of American total activity, as depicted on the chart. Nowadays, the share is 10+ percent. That's a big slide. What caused it?[25]

The two main causes of choice for the slide in the literature have been technology (rising productivity so fewer workers are needed) and globalization (jobs being outsourced abroad via imports plus competition with U.S. exports). As a quick experiment, I rewrote history on the chart below by assuming that the goods trade balance had been zero (rather than negative over much of the period) and further assumed that *all* the extra activity generated came from U.S. manufacturing. (Not all goods by any means are manufactured so the latter assumption in particular is extreme.) Making those assumptions reduced the relative decline of manufacturing. Instead of going from 30+ percent to 10+ percent, it went from 30+ to 15+. That's not nothing in terms of a reduction, but it does suggest that a lot of the reduction was due to some combination of technology and change in demand toward non-manufacturing (including services).



On the other hand, the shift in the current endpoint from 10+ to 15+ isn't negligible. That's roughly a one third increase in manufacturing activity (and presumably jobs) from what we have today. Of course,

[25]As the chart shows, the switch from the SIC definition of manufacturing to the NAICS definition knocks about a percentage point from the total.

I made extreme assumptions to get to that third. Nonetheless, it does suggest that different trade arrangements could have a significant impact on the number of manufacturing jobs and the size of that sector.

It's hard, however, to see how a revision of labor standards clauses in trade agreements would have much effect. The LERA panel on standards previously mentioned concluded as much. And as long as there are no effective limits on exchange rate manipulation, it's hard to see that trade agreements that ostensibly reduce foreign trade barriers to American exports will have much effect. Such arrangements are more likely to increase both exports and imports and leave the balance between the two largely unchanged.

Exchange rates are tough to negotiate about because the definition of "manipulation" is bound to be unclear in practice. Were the U.S. to take unilateral action on exchange rates (as the Nixon administration did in 1971 and 1973 when then-existing fixed rates were abandoned), such defensive responses might be ruled by some tribunal to be manipulation. Put another way, if the U.S. were to take such actions, having treaties with provisions ostensibly dealing with the topic might be a hindrance.

Addressing the exchange rate issue, if it were done by the U.S., won't change the advance of technology and the shift in demand toward non-manufacturing activities. We are not going back to the 1950s with 30+ percent of activity in manufacturing. But it could have a significant effect in creating more manufacturing jobs. And it would surely have more effect than the indirect remedies that are often suggested such as providing better training and education. Such provision may be important in its own right. But it is a palliative when it comes to jobs-trade-exchange rates.

Mitchell's Musings 6-6-16: In the Long Run…

Daniel J.B. Mitchell

John Maynard Keynes is often quoted as saying that in the long run, we're all dead. His famous statement was meant as a critique of economic reasoning concerning processes that would eventually lead to a desirable stable outcome, while neglecting the difficult transition on the way to that outcome. But the issue of getting to the long run arises in other contexts as well. Consider the following news item:

> *Demand for long-term care is expected to increase as the nation ages, but the majority of Americans 40 and older lack confidence in their ability to pay for it. The annual cost of long-term care expenses range from $17,680 for adult day care to more than $92,000 for a private room in a nursing home, according to Genworth Financial. Yet an Associated Press-NORC Center for Public Affairs Research survey finds that a third of Americans 40 and older have done no planning for their own long term care needs, such as setting aside money to pay for a home aide or to help with daily activities or a room in a nursing home…*[26]

The article excerpted above is not unique. Think of the number of articles you have read in recent years about people – especially aging baby boomers - not saving enough. Usually, the thrust of such articles is to urge readers to plan ahead "better" than they otherwise might. But there is another message implicit in such pieces. It is that folks don't generally do a very good job about planning for the future and the private market doesn't do a great job in helping them. If such planning was well handled privately, you wouldn't be seeing such news items.

In the long run, the baby boomers will pass on as will everyone reading this musing. However, the transition will be difficult in the absence of some provision dealing with the possibility of needing expensive long term care or just outliving one's savings. And, as noted, there are problems in private provision of protection against such risks.

[26] https://insurancenewsnet.com/oarticle/poll-people-unsure-about-ability-to-pay-for-long-term-care

First, folks are not good at planning for unpleasant long term outcomes. Second, commercial remedies such as long term care insurance and annuities are not all that effective in solving the problem. Let's take long term care insurance. Presumably, like any insurance, it can only be offered in such a way as to minimize adverse selection. So commercial providers can't offer it in a form that let's purchasers wait until they know they need long term care. It has to be offered well in advance of potential need to get a large and representative risk pool.

But if it is offered well in advance, purchasers are trusting that some insurance company in the distant future (when it may have been merged, acquired, or possibly gone out of business) will treat them fairly at a time when they are likely to be unable to fend for themselves. That's a lot to expect. And even setting aside that issue, what will the premiums be over time? Will they remain "affordable"? CalPERS – the giant state pension and health care system for California public employees – offered long term care insurance to participants, but later jacked up the premiums. Participants had to choose among the options of paying the much higher rates, accepting a cut-down policy going forward, or simply dropping the coverage for which they had been paying. So even a state-level public entity had difficulty providing subscribers with the coverage they originally thought they were buying.

As for simple saving, there is always the issue of outliving the amount put away. And what is put away will vary in future real value with unknown rates of return and with the rate of inflation in the future. Annuities can be bought in commercial markets but they are often expressed in nominal terms, i.e., not adjusted for inflation or only partly adjusted. And they tend to be expensive. There is an adverse selection issue inherent in annuities in that folks who have expectations of being Methuselahs are the likely buyers. Some of the tendency to believe you will be a Methuselah may be unrealistic expectations. But individuals do have relevant knowledge – based on family background and their own prior health history – as to how long they are likely to live.

Defined benefit pension plans are effectively savings plans with default annuities attached. But as is well known, such have been disappearing from the private sector and have been under attack in the public sector for underfunding. Defined contribution plans, 401k-type plans, and

IRAs are not particularly good substitutes. So what remains is Social Security and Medicare, i.e., federal compulsory social insurance arrangements that spread risk. It's fine to encourage folks to save more. Urging them to take out long term care insurance – given the problems of commercial provision – may not be so fine. Ultimately, what is needed at this juncture is a strengthening of social insurance, particularly to deal with health-related concerns such as long term care.

There is an unrealistic libertarian assumption that if we just leave such matters to the private market – and let folks suffer the consequences if they do the wrong thing – the role of government in elderly support can be limited. The ants will retire in style and the grasshoppers… Well, too bad for them. In fact, the political process and past history suggests that if there are lots of elderly folks (who are also voters) that find themselves in distress - or if there are lots of younger folks (who are also voters) finding themselves in distress due to a need to support their parents - there will be pressure for government to do "something." Such pressures are what led to the creation of Social Security and Medicare in the first place.

Mitchell's Musings 6-13-16: It's not true that nostalgia ain't what it used to be

Daniel J.B. Mitchell

Nostalgia is pretty much what it used to be. There has been much criticism of the Donald Trump campaign slogan – "*Make America Great Again*" – essentially on the grounds that it neglects those things in the past that weren't so good. But the tendency to romanticize the past, and to ignore its nasty bits, is near-universal and has long existed. Think of the continued popularity of *Gone with the Wind* and its romantic view of the anti-bellum Old South and slavery.

The latest example I have come across in the past-was-great school of thought was an op ed in the *Los Angeles Times* entitled "You're reading the Bible wrong."[27] The theme of the piece is that the Bible is really "humanity's diary." Let's put aside the fact that much of humanity has other religious traditions. The scholarly authors of the op ed argue that the Bible really is an attempt to codify behavior as humanity switched from being hunter gatherers to participants in complex agrarian societies. Evolution didn't make us good citizens of such complex societies, according to the op ed's authors. We are really hunter gatherers by nature.

> *…If many of us today feel a sense of longing for paradise, it is because we live in a world for which we were not really made. Our innate psychology prepares us to live in small groups of mobile hunter-gatherers, virtually without property, where brothers are each other's best allies, where the need to share everything cuts down on competition and conflict as we struggle to survive against nature, where men and women are nearly equals, and where we do not have to rely on abstract laws to sort out conflicts. The Bible therefore reflects enduring human concerns hailing back to our days as hunter-gatherers: We hate injustice, despotism and excessive wealth and yearn for belonging, for community and for a peaceful life...*

It is perhaps unkind to note that the view of the authors' of the op ed of hunter-gatherer societies is an updated Biblical Garden of Eden in which none of today's problems – money grubbing, conflict, sexual and wealth inequality – exist. Never mind that in such societies you died at an early age of various diseases, or maybe were eaten by some wild animal, or maybe were killed by some other tribe in the forest primeval.[28] The

[27]http://www.latimes.com/opinion/op-ed/la-oe-van-schaik-michel-how-to-read-the-bible-20160610-snap-story.html

[28]UCLA Prof. Jared Diamond: *"Traditional nomadic tribes often end up abandoning their elderly during their unrelenting travels. The choice for the healthy and young is to do this or carry the old and infirm on* their *backs — along with children, weapons and necessities — through perilous territory. Also prone to sacrificing their elderly are societies that suffer periodic famines. Citing a dramatic example, Diamond said Paraguay's Aché Indians assign certain young men the task of killing old people with an ax or spear, or burying them alive. 'We react with horror at*

op ed's utopian view of human nature back in the day as inherently peaceful is a twenty-first century fantasy version of the old Noble Savage. Britannica.com defines that ideal for those not familiar with it:

> *Noble savage: In literature, an idealized concept of uncivilized man, who symbolizes the innate goodness of one not exposed to the corrupting influences of civilization.*[29]

You can also find the Noble Savage idea in the Marxist view that the human race in the distant past lived under "primitive communism." In the long run, according to that view – and with a little push from those cognoscenti who understand the "scientific" laws of history – we will get back to a utopian modern version of our original state of nature. In the meantime, of course, there may have to be some pain and sacrifices. Millions were killed in the name of that idea. Many others died for it.

In short, it isn't just old white males without college educations who are, or who will be, attracted to slogans such as "Make America Great Again." Academics and scholars are prone to it, too, if the idea is put in the right terms. There is a broad appeal to a return to a wonderful past across the political spectrum. The more realistic idea of voting for candidates who will - more likely than not and despite their faults - incrementally push things in the direction of improvement is just not so catchy.

So don't expect Hillary Clinton to have a cakewalk into the White House. And for *Gone with the Wind* fans longing for the past, here's some background on cakewalks:

> *The cakewalk was a pre-Civil War dance originally performed by slaves on plantation grounds. The uniquely American dance was first known as the "prize walk"; the prize was an elaborately decorated cake… Plantation owners served as judges for these contests…*[30]

Ah, those Good Old Days.

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these stories, but upon reflection, what else could they do?" Diamond asked. "The people in these societies are faced with a cruel choice.'" Source: http://newsroom.ucla.edu/stories/jared-diamond-on-aging-150571 [Underline added.]

[29] http://www.britannica.com/art/noble-savage

[30] http://www.npr.org/sections/codeswitch/2013/12/23/256566647/the-extraordinary-story-of-why-a-cakewalk-wasnt-always-easy

Mitchell's Musings 6-20-16: If it ain't broke, don't Brexit (but it's not a big deal for the U.S.)

Daniel J.B. Mitchell

Obviously, the possibility of Britain leaving the European Union ("Brexit") is a Big Deal – over there. But let's put things in perspective from the vantage point of someone on the U.S. side of the Atlantic. It is perfectly possible for a country to be in close geographic proximity with the EU (as is the UK), to have substantial trading and investment relations with it, and yet not to be a member state. Switzerland does it. Norway does it. Both are prosperous countries and would be prosperous countries, whether in or out of the EU. Switzerland in fact considered becoming an EU member but recently withdrew its application to join. Both countries, it might be noted, have independent currencies.

This logic has not limited the hyperbole in the campaign leading up to the Brexit vote. Here's an example from a recent British headline:

> ***Britain will become an isolated trading post "with the significance of GUERNSEY" if we vote for Brexit says French minister***[31]

Britain has long been an EU member.[32] But, like Switzerland and Norway, it has an independent currency and long ago dropped plans to abandon its pound for the euro.[33] So it's important to distinguish EU membership from being in a monetary union. The latter is a far more significant policy decision – as Greece found out in the last few years. Membership (or not) in a trade group with an umbrella of social and other regulatory arrangements – which is what the EU is – is a lesser decision, particularly since nonmembers can negotiate trade deals with the EU (as Switzerland and Norway have).

Giving up your currency, in contrast, means giving up setting your own monetary policy. It's a substantial loss of economic sovereignty that also compromises domestic fiscal policy. But, as noted, staying in the EU for the UK doesn't mean a full-blown monetary union. Indeed, as we pointed out in the case of Greece in prior musings, once you give up your currency, there is no simple way to get it back. Despite the endless talk during the Greek debt crisis that Greece would somehow leave the euro and go back to

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[31] http://www.dailymail.co.uk/news/article-3648044/Britain-isolated-trading-post-significance-GUERNSEY-vote-Brexit-says-French-minister.html.

[32] British membership in the predecessor European Economic Community was initially blocked by French President Charles de Gaulle. The headline above suggests French attitudes have changed.

[33] In 1992, Britain dropped out of a prior European monetary arrangement that was a predecessor to the creation of the euro. Essentially, when it became difficult to maintain the value of the pound relative to the value of a basket of other key EU currencies, Britain abandoned the effort.

the drachma ("Grexit"), no one ever specified exactly how that could be done.[34] Indeed, if Britain had joined the euro and given up the pound, there would be no realistic way for it now to consider a Brexit. A dropping of membership in the EU would imply dropping the euro for any euro-zone countries that might consider such a move.[35]

Now it's true that there is a difference between being in the EU and then pulling out and never having joined it in the first place - as is the case for Norway and Switzerland. Exactly what kind of new relationship might be negotiated with the EU by Britain is unclear. There might be some turmoil in financial markets due to uncertainty. The transitional costs might be appreciable – hence the title of this musing. But what about the implications for the U.S.?

For the U.S., there has been a tendency to attribute domestic monetary policy decisions to a possible Brexit that really have no logical connection to it. Indeed, just about any event can be linked to a possible Brexit if you don't worry about causality or if you want to invent a story. Drops in the American stock market have been attributed to a possible Brexit in the business news media on the grounds that uncertainty makes investors nervous. But with only a little cleverness, you could easily come up with a hypothetical scenario in which Brexit could *boost* financial asset prices in the U.S. Example: Turmoil in financial markets abroad leads to a rush by international investors to dollar assets as a "safe haven." The rush of international liquidity into the U.S. lowers bond yields and boosts the stock market.

The Fed recently decided not to raise interest rates and the Brexit possibility was mentioned in the news media as one factor in the decision. But in fact, the Fed itself did not mention Brexit in its official explanation and referred only vaguely to "financial and international developments."[36] Fed Chair Janet Yellen, *when asked*, did say Brexit was a factor in the decision.[37] But as a practical matter, U.S. interest rates are still pretty close to zero as they have been since the Great Recession. What practical difference would it have made – even assuming some financial turmoil due to a Brexit – if the Fed had slightly

[34]Would you print up a bunch of new drachmas and throw them in the street, hoping everyone would pick them up and throw away their euros? If that sounds ridiculous, then what alternative would be the process? During the Greek crisis, did you ever hear anyone propose an actual, workable mechanism for Greece to exit the euro?
[35]Technically, several mini-states such as Monaco use the euro without being official members of the EU. If a major euro-zone country dropped out of the EU but wanted to continue with the euro, some arrangement such as a currency board would be required. A country with a sophisticated financial sector (as the UK possesses), would essentially need an agreement with the EU. But, of course, the UK is not part of the euro-zone.
[36]https://www.federalreserve.gov/newsevents/press/monetary/20160615a.htm.
[37]http://www.cnbc.com/2016/06/15/federal-reserve-june-meeting-latest-news-on-the-decision-and-news-conference.html.

raised interest rates at its last meeting? It could simply have reversed the increase if that were subsequently deemed appropriate.

Fact is, there was no particular domestic reason to raise interest rates at the last meeting. Inflation is still not apparent. True believers in the quantity theory of money have long ago gone into hiding after years of incorrect inflation-is-just-around-the-corner predictions. The Brexit possibility was more of an excuse than a cause for leaving U.S. monetary policy unchanged. A recent UCLA forecast suggests that the labor market still has some room to expand before full employment constraints become an issue.

In short, we wish our British friends good luck with their upcoming Brexit election on June 23.[38] The case for getting out of the EU is not especially strong since Britain will retain its independent currency, in or out. In the short term, a Brexit might have some negative effects in the UK as folks try to figure out what's next. There would likely be political fallout since the British prime minister favors continued membership in the EU and has campaigned for it.

In the longer run, a Brexit vote might simply mean some new trading arrangements with the EU. Perhaps a new arrangement might be negotiated for the UK to remain within the EU and a new vote could be held. Or perhaps Britain might stay outside and have a Swiss/Norwegian-type relationship with the EU. Either way, the effect on the U.S. economy - once the dust settles - should be slight and not a driver of macro policy.

[38]British opinion polls at this writing are indicating a close vote. The murder of a Labour Party MP who favored membership may have some effect.

Mitchell's Musings 6-27-16: Lessons from Labor Negotiations for Brexit

Daniel J.B. Mitchell

Last week's musing, written before the "Brexit" vote, noted that while Brexit was a Big Deal for Britain (and not a particularly wise choice), it was not likely to be a big deal for U.S. economic performance. I noted that the really big choice for countries entering the EU or within the EU was being part of the euro-zone (or not), because of the euro's compromising effect on national economic sovereignty. But Britain never joined the euro-zone. So why have a Brexit?

Undoubtedly, now that the pro-Brexit vote has occurred, you'll find economic forecasters who will predict – down to the tenth of a percentage point – what the effect of Brexit-related "uncertainty" will be on the American GDP growth rate. (If the problem created by Brexit is uncertainty, how can you be certain?) But let's put aside the U.S. effect and look in this musing at the negotiations that must now ensue between Britain and the EU. And let's note at the outset that the vote in favor of Brexit was 52% to 48%, hardly an overwhelming endorsement. Basically, the British electorate was split down the middle. Some random event or perhaps a better campaign by the anti-Brexit group could have reversed the totals.

I saw a headline on the *Boston Globe* website the day after the vote – "Britain exits the EU, and the world shudders" – which was totally misleading.[39] Britain hasn't already left the EU and couldn't do so under the most accelerated possible timetable for a couple of years. Rather, there has been a referendum to start negotiations on the terms of a divorce. So let's focus on the word "negotiations." Is there anything that can be said about these Brexit negotiations from the study of labor relations? I think there is.

Defined Goals

In labor negotiations, while the parties can't be sure of the outcome, they usually start with some defined goals of what they would like to achieve. In the Brexit case, the current prime minister of Britain – who opposed Brexit but promised to have a vote on it – is stepping down for obvious reasons. Who his successor will be in the Conservative Party is as yet unknown. The Party remains split between pro- and anti-Brexit forces. So the immediate leadership of the country is unknown. The opposition Labour Party

[39] http://www.bostonglobe.com/news/world/2016/06/24/brexit-aftershocks-more-rifts-europe-and-britain-too/qMwFN0TAAidpzb4jyTkliL/story.html.

largely opposed Brexit and there is pressure on its current leader to step down. Given its state of political flux, Britain doesn't have defined goals for the eventual negotiations with the EU. And it can't have defined goals until its political process determines who will lead the country.

What about the other side? Does the EU have defined goals? Hasty and ill-considered statements from various EU officials made immediately after the vote indicated that they want the process to be over with quickly. But it takes two to tango and the British aren't ready to dance. The outgoing prime minister would be foolish to rush into talks and start making deals which his successor might void. And why would the EU want to start with a lame duck prime minister and then be confronted with someone else who might insist on starting over?

Anyway, the day before the election, the EU's goal was that there should be no Brexit. Suddenly, after the vote, the goal became to divorce "fast." But "fast" is not a goal; terms and conditions are goals. If you view the negotiations as being about divorce, there are complicated areas to be considered such as the status of EU and British nationals now residing in the two areas, trade relations such as tariffs, etc. But what if the EU goal were to remain not having a divorce, i.e., no Brexit despite the vote? We'll come back to that possibility later.

Defined Chief Negotiators

In traditional labor negotiations, someone on each side ultimately has to call the shots. Even though there are negotiating teams, someone must ultimately be in charge who can make and accept offers. Usually, in the private sector, the management side is inherently the more disciplined party since the union is a representation organization. But in public sector labor relations – with elected officials and designated professional negotiators on the management side – unity on that side is not always present.

As noted, Britain's political process will eventually produce a new leader. But that process has just started to operate. And the initial response of the EU was statements being made by various officials without any clear lines of authority. In short, there are no defined chief negotiators in place on either side of the negotiations. The parties aren't ready.

Never Say Never (and Never Say Must) *Unless* You're Sure

Labor negotiations are what economists call repeat games. Contracts are agreed upon, signed, ratified, and then expire on a specified date and have to be re-negotiated. If, in today's negotiation, you say you will never accept something and then accept it, you lose credibility in future negotiations. If you say there is something you absolutely must have, and then accept a deal without it, again you lose future credibility. When you say never or must in the future, why should the other side believe you?

Presumably, in the Brexit case, there will be only one EU negotiation with Britain. But the EU is said to be concerned that other countries might want whatever deal Britain gets at some point in the future. So saying never to something Britain wants (or saying the EU must have some provision from Britain) and then conceding could undermine EU credibility with another country in the future.

Does the EU really know at this point what its "nevers" and "musts" are, especially since there doesn't seem to be a defined negotiating leader? It doesn't seem to have its nevers and musts, and – if that's the case – the EU isn't yet ready for negotiations. And neither is Britain.

Silence is Golden

There is a false idea that the solution to all ills - whenever official institutions are involved - is "transparency." But transparency is not consistent with meaningful negotiations. That's why negotiations are held in private in the labor relations realm. If they are not kept private, the negotiators are forced to play to various outside constituents and cannot be frank with each other.

Sometimes, external news media statements are used to put pressure on the other side. But such use of outside pressure involves having a *strategy*. Right now, the EU – due to its lack of a defined leader – features officials mouthing off without any strategy. In short, the EU is not ready to negotiate until it has a strategy, has a designated leader, and can maintain discipline (no mouthing off) within its officialdom.

Deadlines Can Be Helpful But Only If They Are Real

In a labor negotiation, there typically is a date at which a contract expires that serves as a real deadline, real in the sense that there are consequences of not reaching a settlement by that time. Generally, contracts have no-strike clauses. So once the expiration date is past, the union is free to strike (although it doesn't have to do so). After contract expiration, management is free to change terms and conditions once it has bargained to an "impasse" (although it doesn't have to do so). For these reasons, labor agreements are often reached shortly before the *de facto* deadline of the expiration date.

Of course, parties to any negotiation can always set some arbitrary deadline for themselves. But if nothing real happens when that deadline passes, there will be no pressure to reach a deal at that point. There is talk of a two-year deadline for a Brexit divorce. But would anything happen if the deadline passes and a deal hasn't been reached? There has never been a divorce of an EU country before. So in practice, it's unlikely anything would happen if the deadline came and went without a deal. That fact is yet another reason for not rushing into negotiations. Starting early doesn't prevent finishing late.

Third Parties Can Help

Although we have pointed out that "nevers" and "musts" can be dangerous, parties to negotiation sometimes stumble into taking positions that are hard to change. As labor negotiations illustrate, points of inflexibility are when mediation can be helpful. A mediator can help the parties reformat their positions so that they seem to be – or can be said to be - within the parameters set by their previous nevers and musts. Mediators, in short, can often induce flexibility when positions have hardened.

One way to settle disputes if the parties become stuck and mediation fails is arbitration. In the labor relations case, there are well known individuals who can play the role of neutral third parties. Surely, in the international field, there are prominent former diplomats and officials who could play such a role for the EU and Britain. (Barack Obama will be around after January 2017 – but the EU might regard him as too Anglophile.)

Negotiations Might End in No Brexit

We hinted at the possibility that the EU's former goal, no Brexit, could be revived. Why shouldn't no Brexit still be the EU's goal? In fact, there is already a petition drive in Britain for holding another referendum. However, just repeating the previous referendum seems unlikely and might alienate voters. But it certainly sometimes occurs in labor negotiations that a deal is reach, is rejected by workers in a close vote, and then is cosmetically redesigned and re-voted (and accepted). As noted, 52% vs. 48% was not an overwhelming margin of victory for Brexit. As problems for Britain begin to arise – calls for Scottish independence, Northern Ireland issues, volatile stock markets, etc. – there could be a change in public opinion. A small shift could turn the decision around.

As noted, an identical repeat referendum with the same choice as before might be a hard sell. But what if there were to be a second referendum *after a divorce deal was tentatively concluded*, whenever that turns out to be? There could be a referendum on the terms of divorce. It wouldn't technically be a repeat of the Brexit vote. It would instead be a vote to accept the yet-to-be-negotiated divorce terms, yes or no? And if voters rejected the terms of the negotiated divorce, they would automatically be voting for no divorce, i.e., no Brexit. That's the kind of reformatting that occurs in creative labor relations and which could be applied in the Britain-EU case.

Bottom line: Everyone should take a deep breath and stay calm. Learn from labor negotiations. Goals need to be set. Leadership needs to be arranged. Mouthing off by unauthorized officials needs to be discouraged. The parties should avoid inflexible nevers and musts. Use of neutral third parties should be considered. And the possibility of no Brexit should remain on the table. There will be negotiations, but what's the rush?