Mitchell’s Musings: July-September 2015

(Some changes in format have been made from originals.)
Mitchell’s Musings 7-6-15: Lessons for the Greek Crisis from What Didn’t Happen in California

Daniel J.B. Mitchell

From time to time in these musings, I have referred to a paper I wrote back in 1998 – before the Eurozone was fully in place – entitled “Eur-Only as Sovereign as Your Money: California’s Lessons for the European Union.”¹ The paper appeared in the June 1998 edition of the UCLA Anderson Business Forecast publication as an excerpt from a longer presentation I made subsequently at a meeting of an international group that took place in Bologna. The theme of the paper – as the title suggests – was that countries joining the Euro-zone were giving up an important element of their macroeconomic policy.

Specifically, countries joining the Euro-zone were surrendering their conventional monetary policy (control of interest rates) and the ability to change their exchange rate, i.e., to vary their competitive costs of production, relative to those of their major trading partners. In recompense for that loss of control, those countries that joined would get lower cross-border transactions costs and an end to exchange rate risk with other countries within the Euro-zone. So was the upcoming sacrifice worth the benefit? That was the key question and it seemed to me at the time that there was insufficient recognition of the trade-off prospective Eurozone members were facing.

The paper noted that the State of California was effectively a member of the “dollar-zone” within the U.S. Thus, while benefiting from lower transactions costs and an absence of exchange rate risk with the rest of the U.S., California had no independent state monetary policy. Put another way, California’s monetary policy was effectively in the hands of an external Federal Reserve, the U.S. central bank. And when California experienced a negative shock – the end of the Cold War around 1990 and the resultant decline of its then-large aerospace/military industry – it could not change its exchange rate to facilitate the adjustment relative to the other areas of the U.S.

There were two results of this lack of economic sovereignty in California. A mild recession in the U.S. in the early 1990s could not be escaped by California since it was part of the overall dollar-zone. And the structural negative shock (end of the Cold War) played out as an ongoing state budget crisis, a decline in employment, an out-migration of those workers displaced by the shock, etc. Californians who were around at that time will recall those developments and adjustments as painful.

Californians might also recall something else that happened in the aftermath of the downturn of the early 1990s. Just as the state government was adversely affected by the economic shock

¹http://www.anderson.ucla.edu/documents/areas/fac/hrob/Mitchell_Eur-Only.pdf
(reduced tax revenue), so, too, were local governments within California. One of those local governments, Orange County – located just south of Los Angeles – went into bankruptcy in late 1994.²

There is an old joke that you can find out who is swimming naked only when the water recedes. It turned out that Orange County had been engaged in financial speculations which, for a time, provided high returns on investment that helped sustain local services by supplementing tax revenues. But with high returns inevitably comes risk. And one day the economic tides receded and there were big losses rather than high returns for Orange County. The County’s financial misbehavior was exposed and it could not pay all its bills. Some creditors would not be paid on schedule.

As are the other counties in California, Orange County is run by an elected Board of Supervisors.³ In 1995, the Board put a proposition on the County ballot asking voters whether they wanted to raise the local sales tax to maintain services and avert bankruptcy-related cuts. The tax was rejected by the electorate. And after some missed debt payments, arrangements were worked out with creditors and eventually the County recovered. There is more to the story, but now you have the general outline.⁴

The article I referred to at the outset of this musing drew lessons for the impending Euro-zone from what happened at the state level in California in the 1990s. But there are also lessons from what didn’t happen at the local level in California for the current Greek crisis. But let’s start with what did happen. The private sector in Orange County continued its recovery from the larger California recession that developed earlier in the decade as can be seen on the chart below.

Having an unstable local government that was in financial difficulties was certainly not a plus for the County’s business climate. But those difficulties didn’t create a local recession, either. In particular, there were no financial panics. There were no runs on banks in Orange County. County residents had full access to their bank accounts. They didn’t empty grocery store shelves and hoard food. They didn’t hoard currency. ATMs operated normally. Residents’ credit cards continued to be accepted. Stock markets in the U.S. and around the world did not tremble because Orange County’s government couldn’t pay all its bills.

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²Orange County at the time had a population of about two and a half million people. Its population today is over three million and it has a gross product of over $200 billion. See [http://www.fullerton.edu/cdr/ocff.pdf](http://www.fullerton.edu/cdr/ocff.pdf). In dollar terms, that gross product is roughly comparable with Greece’s.

³Counties in California’s complicated hierarchy of governments provide health and welfare services, run local jails, and provide services such as police and fire in unincorporated areas (areas that are not part of cities) and in cities that contract with the county of such services.

⁴See [http://www.ppic.org/content/pubs/op/op_398op.pdf](http://www.ppic.org/content/pubs/op/op_398op.pdf)
Now imagine a very different scenario. Suppose the Federal Reserve had declared in 1994 that if Orange County’s government couldn’t or wouldn’t pay all its debts, the Fed would stop providing the ongoing backup to banks in Orange County that central banks typically provide. Suppose that the Fed had announced that if Orange County’s government could not pay its debts, the County could no longer even be in the dollar-zone and therefore the County would have to introduce its own currency or somehow cope on its own. Clearly, there would have been a more drastic fallout from the Orange County bankruptcy than actually occurred if any such announcement had been made. Surely, there would have been runs on Orange County banks. Since those banks are connected to financial institutions outside Orange County, the panic could easily have spread nationally and even internationally.

But none of these things happened. In fact, it is unthinkable that the Fed or other central government institutions in the U.S. would take such a position. They simply wouldn’t say that because a local government within the dollar-zone was not meeting its obligations to creditors, all central obligations to maintain financial and general economic stability within that jurisdiction’s private sector would cease. They wouldn’t say that the local jurisdiction would have to create its own currency thereafter. Instead, they would view the residents,
banks, and businesses of areas within the dollar-zone as remaining in it, regardless of what their local government authorities might do.

Indeed, anyone reading this musing would say that my hypothetical story above is ridiculous – because it is ridiculous. I have no idea how the Greek electorate will vote on the planned referendum on the Eurozone’s terms. I have no idea what the Greek government may do. And it really doesn’t matter for the purpose of this musing. If the story above seems ridiculous as a policy for U.S. central authorities to have followed in Orange County’s government debacle, why isn’t it a ridiculous policy for Euro-zone central authorities to be following in the Greek debacle?

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5Although this musing is dated the day after the planned referendum, it was written before. Mitchell’s Musings are typically dated the Monday of the week in which they appear.
Mitchell’s Musings 7-13-15: Worker-Skill Mismatch or Something Else?

Daniel J.B. Mitchell

Has the labor market changed since its last business cycle peak in 2007? Between then and now, we had the Great Recession which presumably could have made structural alterations to the way the labor market functions. The most widely used measure of labor market conditions is the official unemployment rate. Unemployment by that index is falling towards levels similar to the last peak as can be seen on the chart below. So, although we are not necessarily at the next peak, are we coming back to “normal”?

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Unemployment Rate, Seasonally adjusted

[Graph showing unemployment rate]

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There are other measures of the labor market which suggest that things now are “different” relative to what they were at the 2007 peak. Among them is the job openings rate (or vacancy rate) which is currently above the previous-peak levels even though unemployment is still higher than at prior-peak levels. The chart below illustrates that shift between the prior peak and now. It shows, as just noted, that the job openings rate is higher now than then.
Moreover, the job openings rate shift seems to have occurred at around the time the Great Recession bottomed out in 2009. That is, it is not just recently that job openings could be viewed as higher than you might have expected given the condition of the labor market. The U.S. Bureau of Labor Statistics (BLS) provides a chart of the so-called “Beveridge curve,” the (inverse) relation between the job openings (vacancy) rate and the unemployment rate. A standard interpretation is that if the Beveridge curve shifts up and to the right on the chart, there is some kind of new inefficiency that has been introduced into the labor market. You can view the curve shift as indicating that it takes more vacancies than “normal” (with “normal” meaning what the relation was before the 2007 peak) to bring the unemployment rate down to any given level.

But what is the nature of that inefficiency? Whose fault is it? BLS provides a standard interpretation of the curve shift along with its chart:6

6http://www.bls.gov/web/jolts/jlt_labstatgraphs.pdf
The position of the curve is determined by the efficiency of the labor market. For example, a greater mismatch between available jobs and the unemployed in terms of skills or location would cause the curve to shift outward (up and toward the right).

Although the BLS doesn’t specify the nature of the inefficiency, a standard story is that worker skills don’t match employer needs; worker skills have somehow eroded or become outmoded.

There is a puzzle to the worker skill mismatch story. While it’s possible for worker skills to become outmoded over time if they are not employed, as with capital depreciation, the effect should take a while to set in. The fancy word for this explanation of depreciating skills is “hysteresis” in the labor market. Whatever you call it, the skill erosion story seems to put the onus for the problem on the supply side (worker side) of the labor market. Workers, the story
implies, should update their skills to meet employer needs. When they do, they will get jobs more easily. If you are more liberal in your political orientation, you might alternatively say that we need public programs to subsidize retraining. Workers need retraining, in that view, but government should help them obtain it.

However, labor markets have two sides. What about the demand side (employer side)? When a sharp recession occurs, there is a period thereafter during which recruitment is easy for employers. Applicants are plentiful. Employers need not do much more than let it be known that jobs are available to have a queue of applicants. That phenomenon – long queues - is a sudden effect that emerges with a sharp recession.

Unlike unemployed worker skill erosion which occurs over time, no gradual change is involved on the employer side. So it could be that the skill that has eroded is not a worker skill but an employer skill. The lost skill – if that is the right word - is employer aggressiveness in recruitment. Employers, in this alternative story, have forgotten that it is sometimes necessary to reshape jobs to worker needs and skills, and to outbid other employers in terms of pay and conditions.

If that demand-side explanation doesn’t suit you, here is another story, also on the demand side. Hiring can be loosely considered indefinite or temporary. Temp hiring can be done through an employment agency or directly by an employer. In either form, it puts the new hires on notice that their jobs are of short duration or are explicitly temporary.

Our labor market data only measure hiring through temp agencies. The data don’t reflect any distinction between temporary or indefinite hires. So if workers are hired directly by employers but with a temporary understanding, we have no measure that distinguishes such hires from “regular” employment. We do know, as the chart below shows, that the proportion of hires through temp agencies is now higher than it was at the previous peak. Temp agency hiring can be taken as a proxy for more temporary hiring in both forms (direct and through agencies).

If employers have shifted their hiring toward short-duration labor market contracting, perhaps after having experienced the trauma of having to do mass layoffs of regular employees during
the Great Recession, one would expect more vacancies now. Short duration hiring means frequently having vacancies as the temp hires are let go and replaced. Put another way, there will be more churning in the labor market which is likely to be associated with more vacancies at any point in time.

The point of this musing is not to produce a definitive story of why the Beveridge curve, as charted by BLS, has shifted up and to the right. Rather its point is that assuming the explanation is entirely on the supply (worker) side of the labor market is unwarranted. The supply-oriented explanation of outmoded job applicants has implications. It suggests that there is a skill mismatch problem and that the onus is on the worker (perhaps with government assistance) to fix it. One way or another, workers should get themselves retrained. For example, the recent interest in policies to promote tuition-free community college seems linked to such a diagnosis.
But if what we are observing is a change in employer behavior, an exclusive focus on community college tuition or similar measures is aimed at the wrong target. We know from past experience with high-demand labor markets that employers eventually come up with ways to adapt to the worker supply that is available. In past periods of high demand, employers have boosted their own training efforts. They have bused in workers from more distant areas. They have redesigned jobs. We might start, therefore, by promulgating reminders of such past efforts and by highlighting examples of whatever current efforts in that direction are now occurring.
Mitchell’s Musings 7-20-15: A Practical University Alternative in Sexual Harassment and Assault Cases

Daniel J.B. Mitchell

There has been a succession of stories concerning universities attempting to deal with complaints about sexual harassment and assault. Growing pressure on universities to do something about the issue has led to creation of internal adjudication processes that sometimes take on Orwellian aspects and sometimes simply lack appropriate and basic due process. Legal scholars have been pointing out the problem for some time. But two recent cases have highlighted the issue.

The first involved a professor – Laura Kipnis at Northwestern University - who was accused of writing an op ed about Title IX7 – a federal requirement related to discrimination on the basis of sex - that made some students uncomfortable (they said). While anyone can file anything, at some point in the investigation, the university authorities began to take the charge seriously and seemed to forget about academic freedom. Prof. Kipnis was writing about a public policy matter. When Prof. Kipnis exposed the proceedings, there was an Internet storm and the charges were dropped.8

The second case involved a court decision that went against the University of California, San Diego. In that matter, one student accused another of non-consensual sex. Note that an accused student is likely to have fewer resources than a tenured professor for challenging university procedures (as in the Kipnis matter). Nonetheless, after the accused student was suspended and took his case to court, the judge in the case found that basic due process had been lacking. There was also evidence that a university official had added to the penalty imposed on the accused student in retaliation for his eventual recourse to the judicial system.9 Whether the university will appeal the verdict is not known at this writing. However, the court decision led to an editorial in the Los Angeles Times questioning the ability of universities to provide fair proceedings. The editorial concluded:

If schools are going to remain in the business of handling allegations of sexual assault, they must be sure victims are treated with respect, that complaints are taken seriously and pursued vigorously, and that the basic rights of the accused are not abridged.10

What seems clear is that universities are not well equipped to handle such cases. If they hire officials whose job it is to prosecute as well as investigate, there is a built-in conflict of interest, as the San Diego case makes clear. As it happens, the University of California’s Board of Regents is at present trying to come up with rules and procedures to deal with sexual harassment and assault adjudication. There have been vague assurances from the university’s central administration that the eventual machinery to be proposed will be fair to the accused. However, as long as the adjudication process is entirely in-house and run by university officials (sometimes with student panels), the issue of lack of due process will remain.

But there is a potential solution: outsourcing the final step in the process to professional arbitrators. Note that this solution is one which universities that have unionized employees regularly use in the

7http://www2.ed.gov/about/offices/list/ocr/docs/tix_dis.html
8http://dailynorthwestern.com/2015/06/06/campus/investigators-find-prof-laura-kipnis-not-violate-title-ix/
labor relations context. If it can work there, why should it not be utilized in the area of sexual harassment and assault?

I am going to put aside the issue of whether university adjudication processes should be used for complaints of conduct that, if it occurred as charged, is criminal. There is an argument to be made that at least some complaints should be referred to local police or – if the university has its own police department – to that agency. Nevertheless, let’s assume, for purposes of this musing, that universities – perhaps because of Title IX or for other reasons – will feel that they need to have an internal mechanism for all complaints.

Because the union sector has declined drastically over the past few decades, its procedures for grievance adjudication may not be well known by top university officials. Even in universities that have collective bargaining for some employees, labor relations may be compartmentalized so that those decision-makers not directly involved in union-management issues may not be fully aware of the workings of systems of grievance and arbitration. So let’s review what a typical system entails.

If an employee has a grievance, there is generally some informal review which may resolve the matter. Absent an informal resolution, there follows a more formal step procedure in which the grievance is taken up by the union on behalf of the employee with management. If a settlement is not reached after the step process is completed, an outside professional arbitrator is selected. The arbitrator then hears the case in a procedure that is less formal than might occur in an outside court, but does involve witnesses, evidence, cross examination, briefs, etc. Both sides are able to present evidence and rebuttal. In the case of an employee who has been subject to discipline, the grievance is framed in the context of “just cause.” Was the discipline imposed for just cause? That question starts with whether the alleged infraction occurred and then whether – given all the circumstances – the discipline imposed was appropriate.

Over many years, the concept of just cause has been developed in arbitration as a kind of common law. Nonetheless, it suggests due process. Relevant would be the thoroughness of the investigation by management, the consideration of available evidence, consistency with past discipline in similar cases, etc. Arbitrators will consider what the union-management contract has to say in terms of procedures that must be followed and about the meaning of just cause. The decision of the arbitrator, which could be a voiding or lessening of the discipline imposed or upholding the discipline, is then binding on the parties. Note that managers who have the authority to impose discipline know that it is always possible that their judgments might be tested in the grievance process and could ultimately be reviewed by an outside neutral arbitrator.

Of course, it is possible to try and reverse labor-management arbitration decisions in the external courts. But courts tend to “defer” to arbitration decisions. There is a practical component to such deferrals. Court caseloads are crowded. If there is an alternative process that incorporates due process, second guessing professional arbitrators is not something that courts would want to do on a regular basis.

There is a difference, of course, between a labor relations grievance and a complaint of sexual harassment or assault. There is no direct analogy to a labor-management contract in the latter situation. Neither the person making a complaint nor the accused has the equivalent of a union to be a representative in the process. But the key point is the potential – known to all involved – that if the
matter is not settled informally or through the step process, there will be an outside neutral reviewer and arbitrator who will make a final decision.

The fact that there are differences between an employment-related grievance in the union-management context and a complaint of sexual harassment or assault is not a barrier to using an outside arbitrator. In place of the contract and general rules of the workplace are university policies regarding sexual harassment and assault. The process can include permitting both the person making the complaint and the accused to have a representative present as an advisor at every point in the procedure. (Indeed, the university could offer to provide such a representative.) In short, there is nothing that prevents an outside neutral professional from being used as the final decision-maker. Indeed, not using a neutral outsider invites external review of the type universities don’t like – either an Internet fury as in the Kipnis affair or an adverse court decision as in the San Diego case.

Daniel J.B. Mitchell

It has long been noted that women receive lower pay on average than men. Once that basic observation is made, it leads to a research literature as to why. Is it due to discrimination? Or is it due to other factors such as occupational choice or education or experience? The approach at that point is to standardize statistically for whatever you might think leads to pay differentials in the labor market and then see if there remains an unexplained differential after controlling for those independent influences. If there is an unexplained component, that remaining gap is attributed to discrimination or at least to unknown influences. (A similar literature exists for race or ethnic pay differentials.)

As interesting as that literature may be, there is another approach equally of interest. We can look at the trend in the ratio of earnings between females and males over time. The U.S. Bureau of Labor Statistics has tracked worker-reported “usual weekly earnings” of full-time employees on a quarterly basis since 1979. The chart below shows annual data from that series through 2014. There are several notable aspects of the female-to-male pay ratio. The first is that it generally has risen over time, although not without interruption. The periods of especially rapid rise seem to occur during recessionary periods such as the early 1980s, the early 1990s, the early 1990s, and the early 2000s. These are periods when the male-oriented manufacturing and construction sectors were especially hard hit.

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![Chart: Female/Male Ratio of Median Usual Weekly Earnings (%)]

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The fact that the female/male pay ratio has tended to rise over the past three and a half decades suggests a bifurcated labor market. In relative terms, although not in absolute pay terms, women’s labor market prospects were improving relative to men’s. That relative gain doesn’t mean that the gain in some absolute sense was remarkable. When you look at the chart below, which presents pay in inflation-adjusted terms by sex, male pay is going nowhere (it actually trends slightly down, falling about a quarter of a percent per annum end-to-end) while female pay is showing modest gains (rising about half a percent per annum).

The limited pay gains in real terms of American workers is a much discussed phenomenon and another subject. But what about the bifurcation seen in the two charts so far? Was that a continuation of an earlier pre-1979 trend?

Since the BLS data used for the two charts shown so far begin in 1979, they can’t answer that question. However, the U.S. Bureau of the Census has related data that go back further in time. So we can look at the trend in Census data before and after 1979. The Census data record annual earnings of full time and full year employees by sex. They go back to 1960 on a reliable basis.\textsuperscript{11} The chart below shows the trend from 1960 through 2013. As can be seen, in general terms, the post-1979 period is similar to

\textsuperscript{11}Census has data back to 1955 but cautions that the pre-1960 figures are unreliable.
what we found using BLS data. That is, the trend is upward and there seems to be a boost in the trend during recessionary periods.

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**Female/Male Median Income Ratio of Year-Round Full-Time Employees (%)**

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It appears, however, from Census data that there was a breakpoint around 1979. Before that time, although the female/male pay ratio bounced around, it showed no upward trend. Then it began an ascent.

If the ratio showed no trend in that earlier period, that fact had to mean that males and females were experiencing about the same real and nominal pay changes. From 1960 to 1979, real female pay rose about 1.8% per annum end-to-end and real male pay rose about 1.7%. Thus, in a relative sense – not an absolute sense – there was a unisex labor market before the 1980s and a bifurcation thereafter.

Although the absolute pay gap between males and females and its causes remains an interesting research topic, getting a sense of what moved the labor market in a relative sense from unisex to bifurcation is equally important and, perhaps, less well researched. There are some obvious potential causes: the political shift to the right in the 1980s, the sharp decline in unionization, irreversible drops in employment in some key male-oriented sectors of manufacturing, e.g., steel, during the rise of the U.S. dollar in international exchange markets. Perhaps there was a burst of technological change that

Source: [http://www.census.gov/content/dam/Census/library/publications/2014/demo/p60-249.pdf](http://www.census.gov/content/dam/Census/library/publications/2014/demo/p60-249.pdf)

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had a more adverse effect on males than females in the labor market. But whatever the cause(s), the shift in the labor market from the 1970s to the 1980s seems to be an understudied topic.
Let’s start by conceding the obvious (to anyone who knows even a little about labor market statistics). Educational attainment is positively correlated with good job outcomes. More educated workers are generally paid more and have lower unemployment rates, as the chart below from the U.S. Bureau of Labor Statistics (BLS) shows. Correlation isn’t causation, of course. Some observers would argue that much of what we see as correlation is due to what was once called “creeping credentialism.” In that view, more education is increasingly being required for jobs that don’t objectively need it. Various stories can be told that could, in theory at least, produce such a creep. But for purposes of this musing, and given the strength of the correlation and its persistence, let’s go further and concede some degree of causation between more education and good results in the labor market.

Earnings and unemployment rates by educational attainment

<table>
<thead>
<tr>
<th>Education attained</th>
<th>Unemployment rate in 2014 (Percent)</th>
<th>Median weekly earnings in 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Doctoral degree</td>
<td>2.1</td>
<td>$1,591</td>
</tr>
<tr>
<td>Professional degree</td>
<td>1.9</td>
<td>1,639</td>
</tr>
<tr>
<td>Master’s degree</td>
<td>2.8</td>
<td>1,325</td>
</tr>
<tr>
<td>Bachelor’s degree</td>
<td>3.5</td>
<td>1,101</td>
</tr>
<tr>
<td>Associate’s degree</td>
<td>4.5</td>
<td>792</td>
</tr>
<tr>
<td>Some college, no degree</td>
<td>6.0</td>
<td>741</td>
</tr>
<tr>
<td>High school diploma</td>
<td>6.0</td>
<td>668</td>
</tr>
<tr>
<td>Less than a high school diploma</td>
<td>9.0</td>
<td>488</td>
</tr>
<tr>
<td>All workers</td>
<td>5.0</td>
<td>839</td>
</tr>
</tbody>
</table>


The link between education and good labor market outcomes seems to have been driving federal policy of late, particularly when it comes to higher education. There has been a push for various goals linked to obtaining a four-year college degree. There was much talk of having “debt-free” college graduates, of free tuition at community colleges (which typically can take students half way to a four-year bachelor’s degree). There was also a push at the federal level to rate colleges with some kind of uniform scoring, an attempt that now seems to have been semi-abandoned in favor of more generalized “accountability.”12 Such issues seem to be likely topics for the upcoming 2016 presidential race. But the emphasis on higher ed seems misplaced.

It’s easy to move from the observation that on average (an important qualification that can hide much variance around the average) someone will benefit in future employment from completing college to an implicit policy that everyone should go to (and should complete) college. But viewed only from a labor market perspective, college completion is just an instrument for improved employment outcomes, not a goal in itself. (And many academics, particularly those in programs that don’t lead to professional degrees, would object to viewing education as a purely job-related pursuit.)

BLS projections don’t indicate that the occupations with the most employment expansion are those that require college degrees. Below is an excerpt from a BLS table showing employment projections through the year 2022. The occupations with the most absolute employment growth (a characteristics more relevant than percentage growth when it comes to job opportunities) clearly are not those which BLS rates as requiring a four-year bachelor’s degree.

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Source: [http://www.bls.gov/news.release/ecopro.t05.htm](http://www.bls.gov/news.release/ecopro.t05.htm)

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In short, having everyone go to college on the assumption that all would end up in better jobs – even if universal college completion were a realistic goal – would likely produce a labor force of overqualified – and possibly frustrated – workers. Someone would have to do the jobs listed on the table above. Note also that, by definition, there would be no college premium in terms of pay or any other measure if everyone completed college. Nor would the pay level currently seen as an average for college grads likely be what prevailed if everyone were a four-year graduate. Labor market policy would better be focused on improving standards for those folks in jobs which don’t require a college degree and who don’t have such degrees.
Mitchell’s Musings 8-10-15: What Can We Reasonably Ask?

Daniel J.B. Mitchell

Robert Lawrence of the Peterson Institute posted a video which purports to resolve the issue of why real wages have lagged productivity since the 1970s. He starts with a chart showing a gap opening up between average hourly wages of production and nonsupervisory workers deflated by the Consumer Price Index (CPI) and output per hour (productivity) as measured by the U.S. Bureau of Labor Statistics (BLS). In steps he adjusts the real wage series by adding in employees other than nonsupervisory workers, taking account of benefits received by workers (which are not included in the average hourly earnings series) and noting that the price index used to deflate the output numerator in “output per hour” differs from the CPI and that the former rises slower than the latter starting in the 1970s. So if you use wages and benefits for all workers and if you deflate those wages by the deflator for output rather than by the CPI, the puzzle disappears except for the period after the Great Recession.

It’s worth noting that there is no law of the universe that says that real wages (however measured) must rise with productivity (however measured). The idea that the two series should be linked derives from the observation that they appeared to be moving together after World War II as an empirical matter. Furthermore, there seemed to be two notions that there should be a linkage beyond the mere empirical observation. To explore the proposition, let’s represent the idea in the abstract:

Let W = a measure of nominal wages, P = a general price index, Y = a broad measure of national output in nominal terms, and L = labor hours. Saying real wages rise with productivity is equivalent to saying:

\[ \frac{W}{P} = \frac{s(Y/P)}{L} \]

Note that you can rearrange these terms to become \( s = \frac{WL}{Y} \), i.e., \( s \) turns out to be labor’s relative share of national output. So the assumption that real wages rise with productivity is another way of saying that labor’s relative share of national output is constant. Note, for later reference, that this rearrangement is entirely in nominal dollar terms; there is no price index involved.

Some observers see (or saw) a moral element in having real wages rise with productivity; some see (or saw) a moral element in labor’s relative share being a constant. In the former case, there seems to a Puritan Ethic-type morality behind the idea that the way workers get ahead is through producing more. Work harder and you will advance! In the latter case, perhaps it is just seen as fair that labor and capital each share proportionally as the economy grows. I am not saying that these are good ways to look at the relationship; only that there is a certain appeal to the concept from various moral angles.

There is also an historic link to the history of wage-price controls and guidelines and the real wage-productivity relationship. We can also rearrange our starting equation as:

\[ P = \frac{(1/s)[WL/(Y/P)]}{\text{average wage cost of a unit of real output or what is called “unit labor costs.” If } s \text{ is a constant, so is } 1/s, \text{ and the revised equation says that prices are proportionate to unit labor costs. An interpretation is that firms use some kind of markup pricing when aggregated so that if you can set (or limit) the rise of unit labor costs, you can set (or limit) the}} \]

rate of inflation. Control wages, the nominal element in unit labor costs, and you can control prices. Crudely, your guideline for nominal wage increases should be your target rate of inflation plus the expected long-term rise in productivity. Such rules were used in the Kennedy-Johnson wage-price guideposts program and the Nixon-era wage-price controls.

Note that there is nothing about wage equality or inequality involved in these notions. And it is more or less assumed that W is an aggregate measure (an average wage of everyone) and that if some element of pay comes in the form of benefits, it is included in W. Similarly, it is more or less assumed that P is a general measure of prices and that it is used both to deflate output and to deflate wages. Since P is an average, nothing precludes some prices from rising faster than others. Since W is an average, nothing precludes particular wages, say for certain occupations or groups, from rising faster than others.

The idea that real wages either should, or do, rise with productivity in the abstract doesn’t deal with inequality of wage growth within the workforce and certainly includes payment for labor in the form of benefits. So let’s take a look in the chart below at the BLS data set that most closely adheres to the broad concept. Such a data set can be found in the various series connected to output-per-hour (productivity). The price index used to deflate wages (which include benefits and pay for all workers) is the Consumer Price Index. The broadest sector available is the “business” sector which is essentially all private business plus government enterprises that are quasi-commercial such as the Postal Service, transit operators, etc.

It is well known that productivity, as measured by BLS, has a cyclical component so the chart above uses business cycle peaks (except for the latest available year, 2014) to adjust for such effects. The real wage and the productivity measures do seem to diverge starting in the 1970s, although pinning

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14 We start the chart in 1953 to avoid effects of World War II wage-price controls and Korean War controls. There was a double-dip recession after 1979 so we skip the middle “peak” of that episode on the chart. Otherwise, peaks are based on NBER business-cycle dating.
down the precise year in which the divergence occurred would be difficult since the two data series
never moved precisely in lock step.

It’s also true, as Lawrence noted, that much of the divergence seems to be based on the faster growth
of the CPI relative to the deflator used for determining real output, as can be seen on the chart above.
However, Lawrence seems to take the two indexes to be “true” for their different purposes. That is, the
CPI is supposed to be truly a valid measure of worker consumption over the decades while the deflator
used to turn nominal output into real output is truly valid for that purpose.

But there are problems in assuming, particularly over long periods, that abstract concepts of worker
welfare or estimates of aggregations of the diverse outputs of a complicated economy in real terms are
somehow uniquely defined. Consider the CPI. It has undergone various methodological changes over
the period shown on the charts. Yet, because it is used for indexing in legally-enforceable contracts, BLS
never revises it retroactively since that would upset its consistent history. Instead, one methodological
version is spliced onto the previous version going forward.\(^\text{15}\)

For example, during the 1970s, the BLS measure of housing costs was determined by a methodology
that gave heavy weight to (mortgage) interest rates. Before the 1970s, such rates did not fluctuate
much but then, in part because of a pickup in inflation, the rates began to move. Eventually, a different
methodology base on rental equivalents of owner-occupied housing was installed, but not

\(^{15}\text{The version of the CPI used in the real wage series is actually an amalgam of two versions of the CPI. The index up to 1978 is based on the Consumer Price Index for all urban consumers (CPI-U) and so is not retroactively revised. The trend from 1978-2014 is based on the Consumer Price Index research series (CPI-U-RS) and so uses a different methodology. (See BLS media release USDL 15-1056, June 4, 2015.)}\)
retroactively. And there have been other such changes, especially with regard to substitution effects and quality adjustments.

The deflator used for output by BLS is really part of the national income accounts. There, too, methodology has changed over time, but unlike the CPI, such changes are often incorporated retroactively back to arbitrary dates. And the methodological changes introduced, while they are aimed at actual theoretical problems, are typically chosen from a set of reasonable approaches. Put another way, there are alternatives which might have been chosen that would have produced different results.

In short, it is hard to say when you look at the divergence between the official measure of real wages and the official measure of productivity, what the question(s) should be. Saying the divergence is largely due to workers’ typical consumption baskets somehow systematically differing from the output basket starting in the 1970s assumes that we have the “right” price indexes for both of the baskets. But maybe productivity isn’t growing as fast as the official measure suggests. If the “true” price index is more like the CPI and less like the official deflator, measured productivity would rise more slowly. It all depends on how much faith you have that we have the right price indexes.

We can, however, take the abstract concept that real wages should, or do, or used to, rise with productivity and get rid of the uncertain price index element entirely. As we noted above, that concept is equivalent to saying that labor’s relative share of output – at least adjusted for the business cycle – is more or less constant. Labor’s share and output can be measured in nominal terms; no price index is required. We don’t have to worry about price index methodology. So let’s look at the share over time.

As the chart above shows, the share seems to have started slipping in the 1960s. It flattened in the 1980s and staged a partial comeback in the 1990s. (Did high tech and finance sector pay hikes during the dot-com boom cause the partial reversal?) Then labor’s relative share declined, notably starting BEFORE the Great Recession took effect, and continued to decline thereafter.
In short, if I had to choose a research project based on these observations, I wouldn’t focus on why worker consumption basket prices differed from output basket prices – because there are too many iffy methodological adjustments in our price indexes. I would instead focus on an issue that doesn’t depend on price indexes at all. What explains the movement, adjusted for the business cycle, of labor’s relative share? Why did it start to decline in the 1960s? What gave it a temporary partial boost in the 1990s? And what happened to the share after the end of the dot-com boom?
From time to time, these musings have talked money, specifically currency exchange rates. There has been much news media discussion in the past week about the recent China devaluation of the Yuan. So let’s start with terminology. A freely floating currency – one that is not “manipulated” – sometimes rises in value relative to other currencies and sometimes falls. It sometimes appreciates and sometimes depreciates. That’s the terminology we use for those movements when they occur due to market forces. No government or central bank or any other official agency is responsible. Appreciation or depreciation just happens due to market conditions.

In contrast, the word “devaluation” implies that a policy decision was made to change (lower) a currency’s value relative to another. The word devaluation, put another way, implies “manipulation.” (The opposite is “revaluation.”) You can’t talk about a “devaluation” and then ruminate over whether manipulation has occurred. It has occurred by definition.

Now there is a longstanding history in international monetary affairs about the pluses and minuses about systems of fixed exchange rates, freely floating exchange rates, and arrangements that fall somewhere in between. The old gold standard was a system of fixed exchange rates. The Bretton Woods system set up towards the end of World War II was a fixed exchange rate system. When Bretton Woods fell apart in the early 1970s, a mix of arrangements developed. The U.S., however, largely left its dollar to float. Some countries attempted to maintain fixed arrangements relative to one another but float against others. Some tried to keep their currencies within a band of some other currency. The Eurozone eventually formed and some countries abandoned their internal currencies for a common, international currency. There were experiments with “currency board” systems in which a country pegged its currency to another through a kind of central bank operating by formula.

To the extent that a country chooses to have some say in its currency’s value, and not leave the exchange rate entirely to market forces, there has to be some regime of regulation and/or intervention in currency markets, i.e., “manipulation.” You can debate whether the result of such manipulation is a Good Thing or a Bad Thing, but (again) that there is manipulation taking place is not a matter for debate.
When you look at China’s trade with the U.S. as shown on the chart, there is an anomaly. You have a rich country – the U.S. – borrowing from a developing country, essentially to finance current consumption. As the chart above indicates, that odd situation has persisted for a long time. The U.S. trade deficit with China now is close to 2% of U.S. GDP. That figure may not sound like much. But, to put it in perspective, the peak-to-trough drop in U.S. real GDP during the Great Recession was around 4%. So the impact of 2% is hardly negligible.

China, from time to time, says that it wants to move (gradually) to a floating exchange rate. But the chart surely suggests that what it has been doing is maintaining an undervalued currency. The recent devaluation was said to be part of a move to a market exchange rate. Numerous journalists repeated that interpretation. But any such move would have to be a revaluation (increase in the Yuan’s value), not a devaluation.

Moreover, as noted earlier, the very word “devaluation” implies an official policy, not some blind market force. So it’s hard to get away from the fact that China views the exchange rate as a macroeconomic tool, not something to be left to the forces of currency markets. It “manipulates” its currency value. Actions speak louder than words, although apparently not to those journalists who repeated the self-contradictory move-towards-the-market story. The Chinese economy was slowing down and to stimulate demand, the Yuan was devalued by the powers-that-be in China. It isn’t complicated. No elaborate interpretation is needed. And it’s a move away from the market, not towards it.

What is the impact on the U.S.? Again, the story is not complicated. If boosting Chinese exports to the U.S. and discouraging Chinese imports from the U.S. is a stimulus to China’s economy, it has to be a negative, other things equal, for the U.S. Commentators quickly chimed in to say that, yes, there is a negative effect, but it will be small. After all, the trade deficit with China is only 2% of the U.S. GDP and the devaluation will only have an incremental effect on that pre-existing deficit.

The problem, however, is that for a country such as the U.S., marginal shifts in trade patterns are always in some sense small in their overall impact. But they can be large in individual industries or sectors. As we have pointed out in past musings, manufacturing – which is now only about an eighth of U.S. GDP - is especially affected by trade shifts since much of trade involves manufactured goods. So what happens in trade and exchange rates matters to manufacturing and to jobs in manufacturing.

Rather than discuss what the Chinese devaluation means – when it’s obvious what it means – isn’t it time to revisit U.S. exchange rate policy, a policy discussion that really hasn’t occurred since the early 1970s when fixed exchange rates were abandoned? At that point, the U.S. essentially said it would not intervene in exchange markets in order to affect the value of the dollar, but that other countries could do what they liked. The problem with that approach is that an exchange rate inherently involves two currencies; it is the price of one currency relative to another. So the decision to float the dollar and let others do what they liked was essentially a de facto decision to let other countries “manipulate” the value of the dollar, if they so wanted. It might have been the best policy choice back then. But over four decades later, it’s time for a review.
Of late, political pundits are trying to understand the appeal of Donald Trump on the Republican side of the presidential race and, to a lesser degree, Bernie Sanders’ appeal on the Democratic side. Both are typically viewed as “populists” who have a limited appeal to a base audience in their respective parties. One approach is to depict the two candidates as mirror images, one on the left and the other on the right, who are somehow similar.

For those pundits who focus on Trump, there is a notion that his appeal is to older white males who became economically outmoded due to some inevitable force – Technology? Inexorable trade competition in a global economy? – and therefore have fading and anachronistic concerns about disappearing jobs. It’s harder to put Sanders in that category, however, because he hasn’t made anti-immigrant comments whereas Trump has.

I am neither a pollster nor a political scientist so I won’t pursue the question of whether the two candidates are appealing to similar groups or not. What I will say is that if your image of a disenchanted voter is an aging white male manufacturing worker, or perhaps a white male displaced from that sector, you might want to take a look at manufacturing demographics.

Let’s start with the male/female breakdown. For the entire employed workforce in 2014, almost 47% were women. In the manufacturing sector, a little over 29% were women. So, if you had the impression that there were more men than women in manufacturing relative to the overall workforce, you were correct. But note that almost 3 out of 10 workers in manufacturing were women. Would you really want to take the position that those female workers aren’t concerned about their jobs and/or potential displacement from those jobs?
What about age? Again, if your preconception is that a typical manufacturing worker is older than the typical worker in the overall workforce, you are correct. However, as the chart above shows, the difference is not striking. The median age of a worker in manufacturing is a couple of years older than that found in the overall workforce, but the share of older workers in manufacturing really isn’t all that different. Presumably, the younger workers in manufacturing care about job loss or the threat therefrom.

![Percent of Employment in 2014 by Race/Ethnicity: All Sectors vs. Manufacturing](chart)

As for the race/ethnic cut, yes, there is a slightly lower percentage of blacks and Latinos in manufacturing compared to the overall workforce, but – again – the difference, shown on the chart above, isn’t sharp. There are actually somewhat more Asians proportionately in manufacturing than in the workforce as a whole. Of course, manufacturing is a broad term and at a detailed level, the various minority percentages vary. For example, blacks are more heavily represented in motor vehicles and Latinos are more heavily represented in furniture manufacturing, Women form a slim majority of textile and apparel manufacturing workers.

What we can say about manufacturing workers is not that they are totally different in their response to political appeals that connect to their jobs because of their demographics, but rather that they are responsive because neither political party has been sensitive to their plight. Would a young Latina

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16The bars on the chart for white-Anglo workers are estimated as residuals after subtracting blacks, Asians, and Latinos. That approach slightly underestimates the white-Anglo group because a relatively small percentage of Latinos also identify as black. But the chart is reasonably accurate for purposes of this musing. All charts and data are from the U.S. Bureau of Labor Statistics.
worker in manufacturing not be concerned about possible layoffs or displacement simply because she isn’t an older white-Anglo male? As long as there is an impression among the political elite that there is nothing to be done about jobs in manufacturing because blind forces of technology and trade are at work, there will be political space for “populist” appeals to such workers, regardless of age, sex, race, or ethnicity. As long as there is an elite stereotype that manufacturing is composed of just aging white males who are a declining share of the electorate, and that therefore concerns of the workforce in that sector don’t matter, there will be such political space. And, no, just telling everyone to go to college, and even offering plans to subsidize going to college, isn’t a political solution – or even an economic solution – to the problem.
Mitchell’s Musings 8-31-15: Stock Market Gyrations: What’s the Right Lesson?

Daniel J.B. Mitchell

Last week’s “volatility” in the stock market produced predictable results. There was an attempt in the news media to find the “cause.” The cause de jour was said to be investors’ concern over the economic slowdown in China and the devaluation of the Chinese currency. But wait! As we have noted in prior musings, the devaluation was intended to stimulate Chinese net exports and thus stimulate the Chinese economy. So shouldn’t investors have taken the devaluation to be a Good Thing, if they were worried about the growth rate of the Chinese economy? More importantly, if the stock market had gone up rather than down, wouldn’t the news reports have attributed the rise in the market to the devaluation’s effect on improving the Chinese economy? We could go on with this theme. To this author, these stories are what might be called elevator tales.

What’s an elevator tale? In the building on the UCLA campus in which I have my office, the elevators have never worked well. One of the four elevators in the building is often out of service, although which one it is varies. And when the elevators are working, they do mysterious things such as reverse direction before getting to your desired floor or arriving at a floor without opening the door. Faced with the inexplicable over the years, I have heard fellow passengers express theories about elevator behavior. Examples: You have to press twice or more to ensure getting to your floor. Jumping up and down in the car will ensure that the door will open. (I always offer the explanation, if asked, that the underlying problem is that the donkey in the basement who pulls the rope didn’t get enough carrots.)

In short, whether it’s elevators or financial markets, having stories to explain the inexplicable gives folks a sense of security and control.

There is a chronic description problem when the stock market’s gyrations are discussed. The market went down because everyone was selling. If that were the case, one might ask who they were selling to. Isn’t every stock sold also a stock bought? So couldn’t we just as well say that everyone was buying? In the end, this type of analysis is saying nothing more than that the market went down today because the net consensus among traders was that the price should be lower today than it was yesterday. Some traders thought the new price was a good deal and bought at the new, lower level. Some thought it was a bad deal and sold. Everyone didn’t do anything. Some folks bought; others sold. (And some of these “folks” were programmed computers.)
Despite the fact that stock markets are an amalgam of many traders (and trading computers), the ups and downs are routinely interpreted as if the market was a single struggling individual with bouts of optimism and pessimism. After stumbling, the market was trying to recover. The market was taking a corrective action. Such modern anthropomorphism is no more helpful to understanding gyrations in the market than were old explanations of natural phenomena as the whims of human-like rain gods and the like.\(^{17}\)

Finally, there was advice in the news media from “experts” to actual ordinary folks (not computers) with their life savings in 401k and similar plans and in defined-contribution pensions. Typical advice was not to sell because the market goes down since a saver’s horizon – retirement – is off in the future. But wait! Telling folks not to sell in a market downturn because the downs will be followed by ups is inconsistent advice. If you as an expert financial advisor know for sure that the down will be followed by an up, shouldn’t you be advising folks to buy, not just hold? If there is certain to be an up, you will surely gain by buying, no? And, by the way, if the down is sure to be followed by an up, why was there a down in the first place? Was the market god angry?

When there is “volatility” in the stock market, the issue of pensions and pension finance inevitably comes up. Even apart from last week’s turmoil, over the past year, broad stock market indexes such as the S&P 500 have essentially gone nowhere. So defined-benefit pension funds – which generally are built upon assumptions of long-run annual earnings of ±7.5% - have been reporting returns over their past fiscal year of much less than that. In some cases, such plans have cut their assumed future long-term rates of return to 7.25% or less.

Which brings me to what should have been learned about pensions from last week’s stock market events, but wasn’t. Yes, defined-benefit pensions have to deal with volatility, changes in the long-term outlook for likely returns, uncertain projections about life expectancy and inflation, etc. They can

\(^{17}\)Los Angeles Times columnist Michael Hiltzik put it nicely: “Stocks staging a stunning comeback,” declared anchor (CNBC) Amanda Drury around 1:45 p.m. Eastern. A few hours later, one of her colleagues, sounding like a play-by-play announcer at the World Cup, announced that the Dow Jones industrial average were "trying to recover from an early 1,000-point plunge." The truth, obviously, is that as the reflection of millions of individual investment decisions along with algorithm-based trading, the markets don't "stage" anything. See http://www.latimes.com/business/hiltzik/la-fi-mh-market-turmoil-and-the-problem-of-cnbc-20150824-column.html.
become underfunded if errors in such forecasts are made. But they have one attribute that defined-contribution plans, 401ks, etc., don’t have; they are collective. They pool risks because many people are covered. The many people are not only those enrolled at a point in time but also over time. Old folks retire; new folks come into the plan.

The fact is that all of the factors that affect defined-benefit plan funding are also present in defined-contribution plans. If your individual rate of return turns out to be less than you assumed, you won’t have enough money for retirement. If you live longer than you expected, you may run out of funds. The difference is that without risk pooling, the problems caused by incorrect assumptions are more severe to the individual than when there is risk pooling. If you run out of funds, you can’t go back in time and redo your behavior. In contrast, a large plan with many individuals can make adjustments and corrections iteratively over a long period.

There is much research indicating that people are not very good at long-term planning and investment strategies. There are ways to mitigate some of these issues such as default opting into job-based saving plans and the offering of “life-cycle” investment options in such plans. And there are problems with having defined-benefit pension funding depend on the long-term good economic health of a particular employer. But the loss of risk pooling as the private sector has moved away from defined benefit and towards defined contribution pensions is a problem. The push to have the same thing happen in the public sector is intensifying the problem. And moves to privatize Social Security – individual accounts that move away from risk pooling – would be a disaster. In the end, Social Security is the ultimate collective, risk-pooling pension plan.

Too bad that when “everyone” was selling last week, they didn’t have time to consider the virtues of risk-pooling. Too bad that when the market was “trying” to recover, it didn’t think about the lessons for collective vs. individual pension systems. Maybe next week, the market god will be in a more contemplative mood.
The standard Labor Day article either talks about whether organized labor will make a comeback after a long period of decline, or it picks up on some other aspect of labor market trends and problems such as stagnant wages, pay inequality, job insecurity, etc. This musing is being written shortly before the Labor Day articles for 2015 actually appear. So what the actual balance will be among these two types is unknown.

My own guess is that because of the decades-long trend in falling unionization rates, there will be more of the latter (labor market issues) – probably many more – than of the former (union comeback). You have only to ask what “CIO” stood for in 1955 (when the CIO disappeared into the AFL-CIO and unionization was at its peak) and what happens nowadays if you Google “CIO.” You are more likely nowadays to run into “Chief Information Officer” as the meaning of CIO or – even more tellingly – “Chief Investment Officer,” than you are to encounter the 1955 meaning. (If you don’t know the 1955 meaning, you’re just making my point.)

So assuming articles on problems of the contemporary labor force are mainly what you will encounter, my further guess is that what you will also find is the idea that the jobs of the future will require college degrees. Higher ed, in other words, is the solution to today’s labor market problems, at least in that telling. Let’s put aside the inconvenient fact that according to the U.S. Bureau of Labor Statistics, the top projected job openings are in retail, food service, and other low-educaon and low-paid occupations. What we are talking about here is public perceptions, not necessarily reality.

Universities and colleges have long been referred to as “ivory towers.” Presumably what is meant by that phrase is insulation from the “real world.” Given that longstanding view, combined with the more recent perception that the solution for labor market problems is getting a college degree, and you have a circumstance that did not exist in the past. If, in the past, universities and colleges were insulated ivory towers, but you didn’t need to go there, their ivory tower aspects were a mere curiosity. If, on the other hand, you (or your kids) do have to go there, what might have been a curiosity back in the day becomes a potential conﬂict if you see future barriers to entrance.

The problem becomes especially acute in public higher education. Public institutions – because they are supposed to offer lower-cost attendance options than private - thanks to government subsidy – become viewed as the utilitarian route to labor-market advancement. And if the folks in charge of those institutions seem engaged in odd activities unrelated to efﬁcient and inexpensive student processing, public concerns are raised. What are those folks doing with taxpayer money? Why should I as a taxpayer be subsidizing such activities at a time of rising tuition?

The most obvious elements of friction relate to admissions (access) and, as noted, rising tuition. During the Great Recession, state governments tended to reduce appropriations for public higher ed as tax revenue declined. As a result, tuitions rose and, in some cases, enrollments were cut. With a piece of their budgets cut away, such adjustments by public higher ed institutions was inevitable. In some cases the response of public higher ed institutions was also semi-privatization, usually admission of out-of-state and foreign applicants at higher-than-local sticker prices for tuition. Typically, however, the

actual decisions to raise tuition and/or cut enrollments (or to semi-privatize) were made – not by the legislators and governors who cut the budget – but by the immediate authorities who run public higher ed institutions. So, conveniently for legislators and governors, blame was deflected to those authorities. They made the choice.

While the Great Recession is over, its after-effects linger. Public higher ed authorities – having been cast as the villains in the tuition/enrollment/semi-privatization episode – must now appeal to already offended voters for funding restoration and support. Higher ed authorities may feel that it is unfair to have to shoulder the blame, but that is the reality. They can only go so far in trying to point fingers at legislators and governors since neither are anxious to assume blame, even retroactively. And both are needed, along with voters, for support.

I am most familiar with the case of California, which has the image of a diverse “blue” state that takes generally liberal positions. So let’s look at voters there. You might expect a greater degree of public sympathy for higher ed in California than elsewhere because of its blue reputation. However, it ain’t necessarily so. Like a lot of things, it depends on perceptions.

The last gubernatorial election in California was held in November 2014, but the outcome was known well in advance. Incumbent Jerry Brown was expected to win reelection by a large margin. Under those circumstances, with no real contest at the top of the ticket, voter turnout was expected to be low (and it was). So voters who did turn out were presumably biased toward those in the electorate most interested in public affairs.

In order to predict the results of elections, the California Field Poll attempts to focus on those in the public who actually will vote. A few weeks before the November 2014 election, it polled what it considered to be a sample of “likely voters.” What was the demographic and political makeup of that sample? The table below provides a summary that may surprise.

<table>
<thead>
<tr>
<th>Party</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Democrats</td>
<td>43%</td>
</tr>
<tr>
<td>Republicans</td>
<td>34%</td>
</tr>
<tr>
<td>No party/other</td>
<td>23%</td>
</tr>
<tr>
<td>Strongly conservative</td>
<td>20%</td>
</tr>
<tr>
<td>Moderately conservative</td>
<td>11%</td>
</tr>
<tr>
<td>Middle-of-the-road</td>
<td>41%</td>
</tr>
<tr>
<td>Moderately liberal</td>
<td>11%</td>
</tr>
<tr>
<td>Strongly liberal</td>
<td>17%</td>
</tr>
<tr>
<td>Age 18-29</td>
<td>11%</td>
</tr>
<tr>
<td>Age 30-39</td>
<td>14%</td>
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<tr>
<td>Age 40-49</td>
<td>16%</td>
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<tr>
<td>Age 50-64</td>
<td>32%</td>
</tr>
<tr>
<td>Age 65+</td>
<td>27%</td>
</tr>
</tbody>
</table>

White, non-Hispanic 70%
Latino 16%
African-American 6%
Asian/other 8%

Male 50%
Female 50%

Union household 18%
Nonunion household 82%

If you want to characterize the median California voter – whose support presumably public higher ed institutions want – that voter is white, nonunion, age 50+, middle-of-the-road politically, independent, and equally likely to be male or female. So the key to political success in California is definitely not denigrating or offending older white males. Other poll data suggest that the median likely voter has just a bachelor’s degree, i.e., 50% of likely voters have educations below that level, 50% have educations at that level or above.

The notion that California is inherently “progressive” on social issues isn’t suggested or supported by the history of state ballot propositions over the past quarter century despite its blue state reputation. Consider the following election results:

Prop 187 – Ban on public services for undocumented immigrants (passed 1994)
Prop 209 – Ban on affirmative action in public higher ed admissions and state contracting (passed 1996)
Prop 227 – Sharp limits on bilingual education (passed 1998)
Prop 22 – Ban on gay marriage (passed 2000)
Prop 8 – Ban on gay marriage (passed 2008)

Clearly, if some of these propositions were on the California ballot today, they would not pass.

Attitudes do change over time. But to the extent that California – despite its blue state image – is on the leading edge of emerging causes, that leadership is more likely to be true in the environmental area rather than when it comes to social attitudes.

Much of the latest social agitation in higher ed, including in the public institutions of California, has involved such matters as microaggressions, statements – perhaps inadvertent – that might offend. A good deal of this agitation has developed within universities. It isn’t coming from median voters who

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Note that there is a big difference between the general population and the likely voter population. Children don’t vote. Non-citizens don’t vote. Those eligible to vote have to register and then turn out.


Not all the propositions would necessarily be reversed today. A move in the state legislature to put a proposition on the ballot repealing Prop 209 (affirmative action) not long ago was quickly killed when the Asian community – that felt its kids would be disadvantaged by repeal – vocally objected.
aren’t preoccupied with microaggression, but who do have concerns about tuition and access – based on all those labor market predictions that you must have a college degree in the future.

Those voters are not committed to public higher ed institutions as centers for promoting social change as California’s ballot history suggests. Particularly given the coarse discourse readily found in everyday political debate, the internet, popular entertainment, etc., what is characterized as a microaggression in university circles seems mild to anyone with a TV or laptop. Ten or twenty years from now, perhaps voters of that future period may have changed their views. But for now, issues such as tuition, access, and student debt are the big issues for higher ed. In contrast, a focus on other matters by those folks running public higher ed institutions is likely at best to appear off-topic and unresponsive to the concerns of the median voter.

Put another way, being off-topic and unresponsive may be viewed by median voters as a microaggression against them, what they think, and how they talk. And there are consequences if that is what voters come to perceive about public higher ed and believe is going on there. Within academia, there seems to be a body of psychological research on microaggression in the context of interpersonal interactions. It goes along with longstanding research on framing and hidden prejudices. Continued research of that type should be encouraged. But the research so far seems to lack an outward component when it comes to application to higher education.

More precisely, what is odd is not the research in the abstract, but its policy consequences within higher ed institutions. There is much effort at documenting the impact of the microaggression controversy on everyone except those median voters on whose goodwill the fate of public higher ed institutions depends. Put another way, there seems to be great concern about the impact of what might be said within the institution. But there is no concern – or even perception – as to what the impact might be when bureaucratic university policies on microaggression leak outside the institution.

Thus, when a University of California guide that indicated that asking people where they are from is equivalent to telling them they aren’t “true American(s)” is discovered, and is (predictably) circulated on the internet, the guide – and the official “seminars” at which it was used - become a target of ridicule and offense. Did the University really believe that someone saying America was the “land of opportunity” was a micro-aggressor? And, no, it’s not just right-wing news media that pick up such stories. That episode found itself quickly aired in the mainstream. It creates the image of academic administrators gone amuck with political correctness at a time when they should be focused on access and affordability.

Ultimately, the idea that through official policy speech should be constrained so it never offends anyone within the institution, while at the same time its impact on outside political constituents should not only be ignored, but not even recognized, seems bizarre. It is even more bizarre in a world in which

23 http://www.ucop.edu/academic-personnel-programs/_files/seminars.Tool_Recognizing_Microaggressions.pdf. The official university position seems to be that speech was not being forbidden but that attendees at the seminar were being sensitized.

24 http://www.scpr.org/programs/airtalk/2015/06/24/43412/microaggressions-should-they-be-censored-on-colleg/
those median voters on the outside are being told that the key to labor market success is a college
degree and that their political support is thus needed to fund public higher ed. In an era of economic
insecurity, where is the research on the impact of university-generated microaggression against the
median voter? Where are the seminars on the external impact?
Imagine you are driving a car. If you depress the accelerator, the car tends to go faster as more gasoline flows into the engine. If you ease up on the accelerator, the reverse occurs. Over time, if anyone cared to do so, you could measure the average angle of the accelerator pedal relative to the floorboard for all the years you had been driving. I suppose you could say that this average angle was “normal” in some sense. But would anyone argue that at any point in time it was wrong to deviate from the “normal” angle? If you were driving up a hill, you would push the accelerator down to maintain speed so the angle would be below normal (average). If you were driving down a hill, you might take your foot off the pedal entirely. In neither of these situations would you say you were doing the wrong thing. You were simply adapting to driving conditions.

When it comes to Federal Reserve policy on interest rates, however, the notion that deviations from the norm are wrong and should be corrected ASAP, regardless of economic conditions, seem to be in the air. Interest rates are being kept low presently, which is seen as “abnormal” because on average they have been higher. Because the current level is abnormal, the Fed – it is argued - should raise rates. If the Fed doesn’t raise rates, Bad Things will happen because, well, it’s not normal for rates to be so low. The economy is sure to overheat and break out in inflation.

When you dig into it, there are folks who believe terrible things will happen if we don’t revert to “normal” because there was much previous monetary creation by the Fed to combat the Great Recession and then to stimulate the recovery, as the chart below shows.
The problem is that there still is no sign of this inflation. Moreover, there is no sign that financial markets are currently expecting inflation. The 10-year “breakeven” inflation rate – the difference between 10-year inflation adjusted Treasury security yields and conventional 10-year Treasury yields shown below - has bounced around since the Great Recession (when something like the Great Depression was feared and zero inflation or less was projected). But the breakeven rate is currently in the 1.5-2.0%/annum range. So in what sense is the economy overheating or are financial markets expecting such overheating? The problem seems to be that for some folks, facts don’t get in the way of theory.

![10-Year Breakeven Inflation Rate](image)

There is another strand of the argument that the Fed should be raising interest rates now, even though inflation isn’t high. In this view, there is a “natural” rate of unemployment. Below that level, labor shortages will arise, employers will start bidding up wages (faster and faster the theory goes). The rising labor costs will show up in prices through markups and therefore will pass into price inflation.

It is true that as the unemployment rate has declined in recent years, the U.S Bureau of Labor Statistics’ (BLS) job openings (vacancy) rate has increased. In fact, the job openings rate (shown below) has exceeded its pre-Great Recession peak. But before panicking, there is a question as to whether we have the right story. Where is the ever-accelerating wage inflation? As measured by the latest release of the BLS Private-Sector Employment Cost Index, for example, accelerating wage inflation has yet to emerge, suggesting that past relationships are not holding.25

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25Readers of these musings will know that in a prior post, I expressed the view that it looked like there was some acceleration in wage inflation. See [http://employmentpolicy.org/page](http://employmentpolicy.org/page).
Maybe the (new) natural rate of unemployment has yet to be reached. Maybe it has changed from whatever level it stood at prior to the Great Recession. Maybe the past is not prologue. There seem to be a lot of maybes here – too many – to make a major monetary policy decision based on old assumptions.

Private Sector Job Openings (Vacancy) Rate, Seasonally Adjusted

![Job Openings Graph](https://1775968/3328512#sthash.1ymQLhfw.dpboz)

But we have to let the latest data talk and right now that is not the tale they are telling.
We know there have been other changes in the labor market apart from the old wage inflation/vacancy/unemployment link. For example, the employment-to-population ratio is well below its pre-Great Recession peak. So there may be more slack present in the labor market than is suggested by measured unemployment or vacancies. No one knows for sure.

**Employment-to-Population Ratio, Seasonally Adjusted (Percent)**

Apart from whether the wage/vacancy/unemployment rate relation is the same as it was, say, ten years ago before the Great Recession, there is still another question to be posed. The theory or story of the natural rate of unemployment is basically a labor market tale. It involves demand for labor pulling up wages and the resulting wage inflation being passed along into price inflation. The problem is that broad macro measures such as the unemployment rate are correlated with other broad measures such as estimates of the gap between actual GDP and “capacity.” It’s hard to say empirically which index we should be looking at or what the true story is.

At one time when unions were strong, stories of worker bargaining and labor costs passed into prices may have made sense. But today, the determinants of price inflation (which in the end is what the Fed cares about) may be largely a product market story, not a labor market story. We may be looking in the wrong place when it comes to predicting the point when price inflation will become a problem. All of which brings us back to our car analogy. The current position of the accelerator seems consistent with our current driving conditions. Current interest rate policy is not causing inflation. Why make a change?

Daniel J.B. Mitchell

Last week’s musing involved the then-upcoming decision by the Federal Reserve on whether to raise interest rates. The musing noted that there was pressure on the Fed to raise short-term rates from near zero, not because there was some evident change in economic circumstances that would warrant a hike, but because near-zero rates were abnormal. I argued that the factors that should be the determinants – the general state of the economy in real terms (including the labor market) and inflation – were not indicating a need for a shift in policy. If anything, there were some weaknesses still present on the real side and inflation (whether we are talking wages or prices) was low and not accelerating.

Ultimately, the Fed’s decision – taken with only one dissent - was not to raise interest rates.26 And the factors cited were pretty much along the lines above: the condition of the real economy and the lack of inflation:

“On balance, labor market indicators show that underutilization of labor resources has diminished since early this year. Inflation has continued to run below the Committee’s longer-run objective, partly reflecting declines in energy prices and in prices of non-energy imports. Market-based measures of inflation compensation moved lower; survey-based measures of longer-term inflation expectations have remained stable…”

In the run-up to the decision, there were editorials and op eds and general articles. The upcoming decision was hyped, in some cases well beyond what was warranted. In view of some observers, there were suggestions that the current low rates were an aid to Wall Street. One article suggested that financial markets were addicted – as in morphine - to low rates.27 But another op ed after the decision complained that it was Wall Street, or at least the holders of capital, that wanted a rate hike.28 In fact, immediately after the decision the S&P 500 index

27http://www.latimes.com/business/la-fi-fed-market-influence-20150912-story.html (See the quote at the tail end of the article.)
rose and then fell. For the week ending September 18 as a whole, the index ended up almost exactly where it started.

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S&P 500
S&P Indices: .INX - Sep 18 5:10 PM ET
1,958.03

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Basically, monetary policy is a blunt instrument when it comes to such concerns as income distribution (Main Street versus Wall Street; the 1% versus the 99%). Issues of income distribution are best addressed through fiscal policy. Unfortunately, at present fiscal policy is as gridlocked as ever. Indeed, at this writing, there is looming yet another threat of a federal government shutdown. So, as has been the case for much of recent history, monetary policy is the only macro instrument we have going. We should be grateful it’s in sensible hands.

Luckily for the U.S., the Fed has been chaired in the Great Recession and its aftermath by two non-ideological pragmatists who let the data talk and avoid basing decisions on outmoded theories: Ben Bernanke and Janet Yellen. Here is Yellen’s policy statement after the recent interest rate decision:

...Our actual policy actions over time will depend on how economic conditions evolve, which is quite uncertain. If the expansion proves to be more vigorous than currently anticipated and inflation moves higher than expected, then the appropriate path would likely follow a steeper and higher trajectory; conversely,
if conditions were to prove weaker, then the appropriate trajectory would be lower and less steep.\textsuperscript{29}

What more do you want?

\textsuperscript{29}http://www.federalreserve.gov/mediacenter/files/FOMCpresconf20150917.pdf
Mitchell’s Musings 9-28-15: Look for Earlier Problems

Daniel J.B. Mitchell

When I taught labor markets and got into incentives, there was always the issue of incentives which led to perverse behaviors that eventually harm the organization. A simple example is a piece rate system that emphasizes quantity over quality and leads to defective, hasty production. Usually, there is some awareness of the potential pitfalls of incentive programs and additional arrangements may be put in place to prevent perverseness. In the piece rate example, you can hire inspectors who watch for defects. But such supplementary efforts cost money and attaining 100% perfection may not be the optimal decision. Some level of defects may be acceptable. And no incentive system perfectly aligns worker interests with employer interests, despite claims and hypes.

The idea of incentives should not be limited to explicit formulas that link pay to output (such as piece rates, sales commissions, etc.). In organizations, there are inevitably ways employees discover to get ahead. Certain behaviors are rewarded, perhaps by promotions, plum assignments, and the like. The notion that organizations have “cultures” – for better or for worse - is closely related to the idea of built-in incentives. Employees figure out what gets them rewards. The actual culture may have little resemblance to grand platitudes in organization mission statements. It’s the substance of numerous “Dilbert” cartoon strips.

What I used to say in class is that if you observe a perverse outcome, it could just be a one-time fluke or a mistake. But if the perversity repeats, there is probably something in the organization that incents such behavior.

The recent Volkswagen scandal suggests a corollary to me. In the Volkswagen case, certain diesel engine cars had computer programming built in to allow detection of government emission tests. The engines operated differently during such testing than they did when run in actual driving conditions. In some cases, car buyers may have received government rebates based on the supposedly low emissions. As revelations of the fraud became public, the CEO of Volkswagen resigned hastily saying he was “not aware” of having done anything wrong. He said he was “stunned that misconduct on such a scale was possible in the Volkswagen Group.”

If you think about this episode, you can see that the risks of the fraud becoming known over time had to be large. The programming was in the cars waiting to be detected by authorities that became

suspicious. There is always some disgruntled employee or some righteous whistleblower somewhere in
the system to leak out the information. And the gain to Volkswagen of having somewhat lower
emissions really wasn’t all that great, especially when compared with the cost of the eventual
revelation.

So, is it possible that the emissions fraud was a one-off event, due to the action of some “bad apple” in
the corporate barrel? Should the CEO really have been “stunned”? Maybe. But it seems very unlikely
that – even if this incident was a one-off event – that only one bad apple could have pulled it off. There
had to be a lot of folks at some level in the firm aware of what was being done, even if the CEO did not
know of - or did not officially authorize - the plan.

My corollary suggests that a really big fraud of the VW type is unlikely to be a one-off event. The
corollary is instead that if there is a really big perverse event, look for earlier – perhaps less risky –
frauds that have not yet been uncovered. If there were such frauds, and if those employees who
perpetrated them were met with rewards, you can see how a perverse-incentive culture could form
that eventually led to the emissions scandal. My suggestion to the authorities who will be probing the
VW emissions fraud is to find out what preceded it.