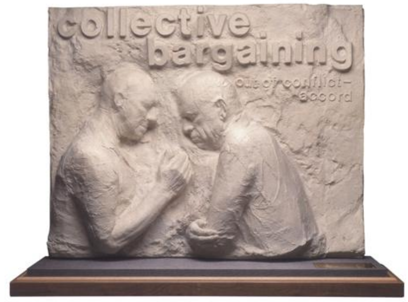

Mitchell's Musings 11-19-12: Cliffs and Ceilings

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With the 2012 presidential just election past, news media attention is being focused on upcoming presidential/congressional negotiations over the "fiscal cliff," the end of the Bush tax cuts and big federal spending cuts, and on raising the debt ceiling. At least some of the discussion, particularly around the fiscal cliff, revolves around the specifics of the taxes and the spending cuts. Another strand of the discussion involves the economic impact of the cliff. The Congressional Budget Office (CBO) projects a recession in 2013 if the cliff taxes and spending cuts go into effect and nothing further is done.[1] Other forecasters generally agree with that assessment. There has been less attention so far to the debt ceiling issue. But the last time the ceiling was in play, the focus was more on financial markets and how they might react if the U.S. defaulted on its debt payments.

False Dichotomy

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

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

Limits of Models

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

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

Unlike the cliff and just its Keynesian consequences, it is not even clear how one should model the consequences of hitting the debt ceiling and defaulting. What exactly would happen and how financial markets would react is unknown. Although there have been national government defaults, those examples involve minor players. We have no past history that would tell us about a U.S. default. So both events – cliff and ceiling - could have real economy consequences and both could have financial consequences. And, as the 2008 financial crisis taught us (or should have), we aren't all that good at predicting the magnitude of the fallout of such events.

Collective Bargaining Lessons

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

Deadlines

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

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

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

In retrospect, this legal requirement seems naïve. Could it really be that the parties stumbled into a strike because they both forgot that their contract – which they had negotiated – was slated to expire? That interpretation seems quite implausible. What seems more likely is that the last-minute settlement phenomenon is a function of having a specific deadline. Well prior to the deadline, there is time for bluffing, for feeling out the other side, and for adjusting strategy based on what is learned. Once the deadline nears, however, it is the pressure to avoid a work stoppage – which imposes costs on both sides – that pushes both parties to put their true positions forward and determine if there is room for a deal.

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

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

Public Relations

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

Defining Negotiations

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

Reframing

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

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

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

Repeat Game

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

In particular, past behavior in negotiations over the expiration of the Bush tax cuts are now "data" for the parties as they negotiate this time. So, too, were their actions in the prior negotiation over the debt ceiling. The parties may now either regret their past behaviors or, in any event, may want to convince their counterparts that they will be behaving differently in this round. Escaping from the past, however, will likely require much more than just saying that this time it's different. Some concrete changes in behavior well before a crisis is reached would be necessary. If one or both parties really plan to change, they will need to demonstrate the change early and establish credibility or they will risk stumbling into a crisis inadvertently.

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

Internal Bargaining

In collective bargaining, the union side often has factions (perhaps skilled vs. unskilled workers, older workers interested in pensions vs. younger interested in health care, etc.). Moreover, a union is ultimately a political institution with periodic elections of officials. Tentative deals with management are often subject to a membership ratification vote so union leaders have to bring along disparate interests. That kind of factionalism is less prevalent on the management side. Nonetheless, factionalism on one side can make deal-making more complicated. Union negotiators have to negotiate with their internal interest groups as well as management. Good management negotiators need at least to understand the internal problems that their union counterparts are facing.[2]

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

The Great Unknown

A final point. Over the years, there have been attempts to model collective bargaining and depict it as a mechanical process of iterative adjustment to a settlement. But there has always been a conceptual problem with such modeling. If the eventual settlement could be foreseen, there would be every reason to settle today on the deal that would eventually occur anyway. Why resist doing what is inevitable? The problem is that there is more uncertainty in the process than such models allow. And

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

the parties may disagree on what the eventual deal might be. So be wary of confident predictions about the outcomes of the cliff and ceiling deals. For example, it seems to be assumed by some commentators that since Obama won re-election, the prospects for quick settlements on cliff and ceiling have increased because the President's side has been strengthened. Of course, a quick deal could happen. But I know of no bargaining model that can confidently make that prediction.