Mitchell's Musings 8-12-13: Omitted Points

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Various reports have been appearing in the news media of late that – while describing events and information – leave out critical points. For example, in *Inside Higher Ed*, an online news magazine, there recently appeared an article about the reluctance of tenured university faculty members to retire, thanks in part to the decline in their retirement accounts due to the Great Recession.[1] But the story is actually more complicated.

Shy of Retiring

When federal law banned mandatory retirement in most occupations, an exception was made for higher education faculty thanks to then-Senator Daniel Patrick Moynihan who had come out of the university world. He argued that the combination of tenure and end of mandatory retirement would lead to faculty staying on the job too long. The law thus included a period in which mandatory retirement would continue to be allowed for faculty and then a study would be made to see if the exception should be continued. In the end, however, the exception wasn't continued and faculty, just as most other employees, cannot be subject to mandatory retirement.

Here is the missing piece from the reports on faculty who hang on beyond when they should. At many universities, faculty members have defined-contribution retirement plans, notably TIAA-CREF, which provide no particular incentive to retire, even apart from stock market losses during the recent financial crisis. Such programs are basically tax-favored savings accounts. The longer you stay on the payroll, the more you accumulate in the plan.

Some universities – including my own, in contrast – have defined benefit plans which a) shield retirees from the vagaries of the stock market and b) have retirement formulas that max out and create a strong incentive to retire. I have only anecdotal evidence from my own university but not surprisingly it appears that where you have a defined benefit plan, for the most part retirement takes care of itself. But, of course, such plans are under attack and have been largely dropped in the private sector. If you are an employer and want to have "new blood" – and want to avoid age discrimination suits – you might ask yourself why you don't have defined benefit pension. But that question is not mentioned in the reports of superannuated faculty.

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[1] http://www.insidehighered.com/news/2013/08/06/retiring-professor-says-hes-ready-leave-academe-and-others-should-too

The Choice of Chair

The news is filled with a kind of contest between two individuals who are said to be the top contenders to be the next Federal Reserve chairman (or chairwoman) when Ben Bernanke retires: Larry Summers vs. Janet Yellen. (Google those names if you haven't followed the story.) Rather than just posing a personality contest, isn't the broader question what you want in someone to head the Fed? That issue – when it is posed – often relates to what the new person will do when inflation heats up, although the promised heating up of inflation seems to be ever postponed. So here is what we do know about the Fed and the Fed job.

1) Old fashioned monetarism is dead. Indeed, the funeral occurred sometime in the 1980s, when the Fed kept trying to pick among the various definitions of the money supply for targeting and ended up with inconsistent goals. At that point monetarism really died in practice although we are still haunted by its ghost. The Fed under Alan Greenspan went back to targeting interest rates, not some illusive definition of money, and essentially just pragmatically adjusted the accelerator and the brake with the ebb and flow of the economy.

2) Changing financial institutions not only made trying to define "money" impractical, it also changed what kinds of institutions mattered in a financial crisis. Once upon a time it was just "banks." But it turned out that nonbanks such as Lehman Brothers were as capable of creating a crisis as conventional banks. Given the changing scene, what is needed in a Fed chair is someone who is committed not to let the financial system fail – we came close in 2008 – and in working to develop mechanisms to make it less prone to failure.

3) Although we like to talk about macroeconomic policy as "monetary and fiscal" policy, fiscal policy requires action in Congress and we have a gridlocked Congress. Moreover, even in the best of circumstances, fiscal policy doesn't move fast enough to deal with immediate economic downturns. The notion of "shovel-ready" projects that can be immediately implemented to stimulate the economy is a myth.

If projects are truly shovel-ready, they are likely to occur anyway. Hinting to local governments that the federal government might have stimulus funds to pay for them may well delay the projects. A rational local government administrator should stop shovel-ready projects that would otherwise be underway to see if federal money funding replace local.

In short, at the present time, macroeconomic policy is just monetary policy as conducted by the Fed. So we need a Fed chair who will be pragmatic and not be a slave to any model or school of thought. And we need one who won't dither if another emergency arises. Those are the criteria against which any candidates for the Fed chair should be evaluated. But you don't find much about these criteria in the Summers-vs.-Yellen stories.

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Pollster Alternatives

California has two major polls on state (and federal) issues. One of these is conducted by the Public Policy Institute of California (PPIC). Polling about the budget occurs on a regular basis.

Under California state budget practice, the governor presents a budget proposal in January for the coming fiscal year that begins the following July 1. In mid-May, the so-called "May revise" proposal is released by the governor. It is generally the January plan modified based on newer data on state receipts and spending and the economic outlook and on reactions to the original January version. At around the time of the most recent May revise, PPIC took a poll that related in part to the proposed budget.[2] When asked if they generally approved or disapproved of the proposal – which the pollster described – 6% of respondents volunteered that they had no knowledge of the budget and another 5% said they didn't know if they had an opinion.

All told, therefore, 11% confessed ignorance. *That proportion is implausibly small by orders of magnitude.* Yet the poll went on to gather opinions on particular aspects of the budget plan such as where priorities should be, e.g., education, social spending, or rainy day fund. So what does that fact tell you? It mainly tells you that pollsters need opinions and will get them even where none exist. Keep that lesson in mind when you read about any poll results on key issues of the day, budgetary or not. You will have to keep it in mind because you are unlikely to read it in your news source.

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The Chinese Menu

Late last month, articles appeared in the news media about a new law in China that would require adult children to visit (and presumably help support) their elderly parents.[3] Suffice it to say, such a law was seen by Americans as an oddity. But were there any lessons for the U.S.?

China doesn't have an advanced social security system. However, it has a problem somewhat analogous to the American (and European and Japanese) problem of a bulge coming in its elderly population relative to younger persons. In the U.S., the bulge results from the baby boom/baby bust phenomenon. In China, it reflects the deliberate one-child policy undertaken to limit population growth.

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[2] http://www.ppic.org/content/pubs/survey/S_513MBS.pdf (page 28).

[3] http://www.latimes.com/news/nationworld/world/la-fg-china-elderly-law-20130729,0,1879951.story

In the U.S., discussion of the elderly bulge issue tends to revolve around increases coming in the cost of Social Security and Medicare. Actuarial calculations, trust funds, and payroll taxes are the lingo through which the discussion proceeds. In other words, since we moved to a system of national rather than family mechanisms to deal with support of the elderly, we discuss the matter in terms of the paraphernalia of those national mechanisms. In China, it is still a family affair.

Note that the unfunded liability that we fret about in the U.S. regarding Social Security and Medicare is also present in China, but in a different way. In China the burden is handled more at the micro level (as it was in the U.S. before the Great Depression). There is an important lesson once you look at the issue for what it is. You cannot make the unfunded liability go away when it is demographic in origin. You can spread it around differently, macro vs. micro. But it is going to be there.

"Fixing" Social Security through privatization – a common remedy proposed by critics of Social Security in the U.S. – doesn't erase the problem. What it probably would do is ensure that the burden will be distributed less fairly as it was back in the day. Elderly individuals who don't have families or don't have families with adequate resources will receive less under such fixes. Others with wealthy families may get more. Unfortunately, "it's-the-demography-stupid" rarely appears in stories about social insurance.

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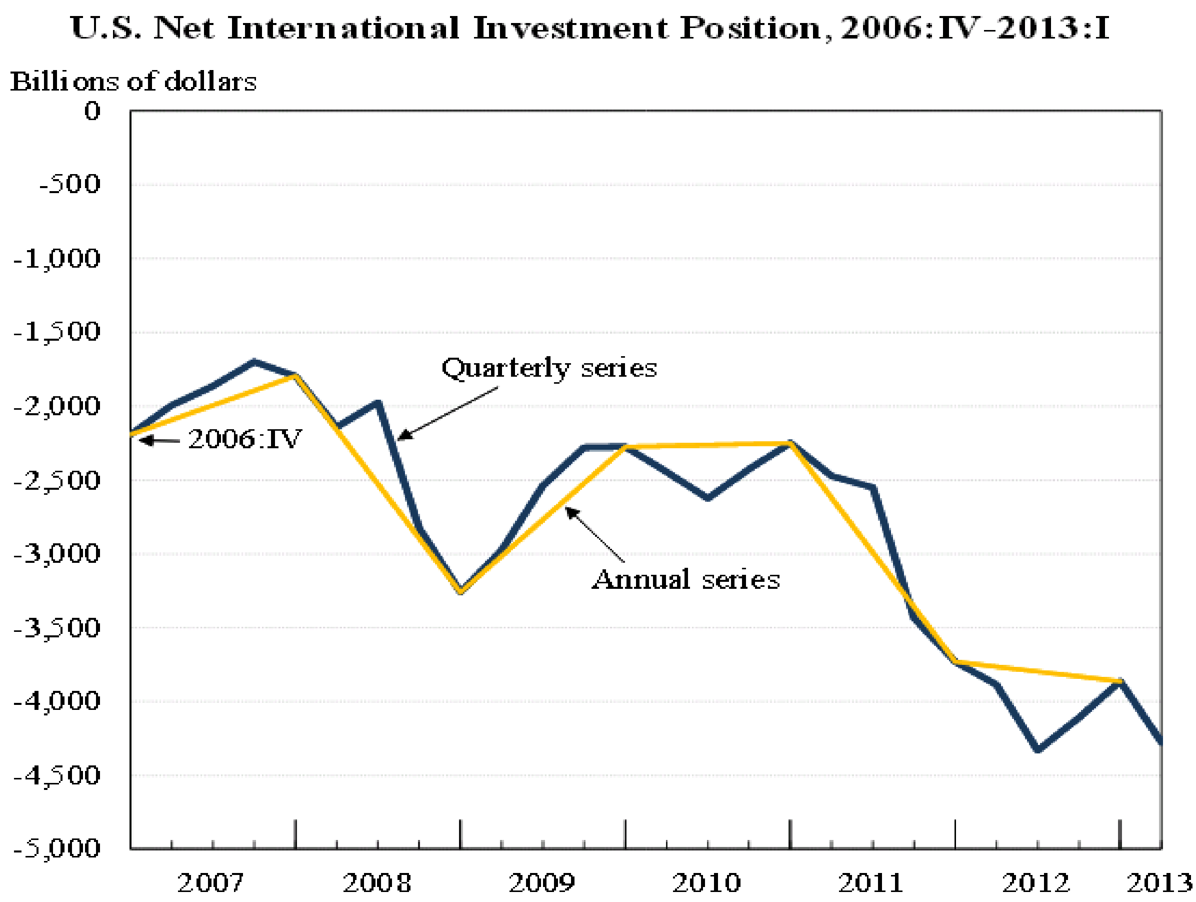
Foreign Affairs

The Bureau of Economic Affairs of the U.S. Department of Commerce periodically releases data on the U.S. International Investment Position, i.e., claims on the U.S. by the rest of the world vs. claims on the rest of the world by the U.S. The difference between the liabilities of the U.S. to the world and the assets of the world in the U.S. is the *net* debt of the U.S. to the world.

Net claims of the world on the U.S. (net liabilities of the U.S. to the world) are now well over $4 trillion. Although the amount bounces around from year to year and quarter to quarter as the chart on the next page from the latest release shows, the long-term trend of an increasing net liability is a continuing process. And it will continue so long as the U.S. goes on buying more from the world (import) than it sells to the world (export). If you spend more than you earn, you must either run down your assets and/or run up your borrowing. In that respect, a country is no different than a household.



Source: http://www.bea.gov/newsreleases/international/intinv/2013/pdf/intinv113.pdf

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Those who fret about the U.S. government budget deficit seem surprisingly unconcerned about the trade deficit and the consequent run up in American net liability. Isn't it time that someone asked what the end game is for this phenomenon? Or what the effect is on the composition of American jobs? Or about the disproportionately adverse effect the trade deficit has on manufacturing?

There are often complaints about the lack of transparency of information. Yet the international trade and investment information is released regularly for all to see. But apart from a periodic reporting of the numbers themselves, you won't find much about their implication in the news media. Indeed, that is true of all the cases reviewed in this musing. The information is available. But the implications are between the lines.