PART 4

Other Economic Issues

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

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The Real Bipartisan Compromise: Cut Spending on the Rich

This article was originally published at E21 on May 11, 2011.

Of the pieces in this collection, this one provoked some of the most favorable responses from people outside the political class. While the Left argues for increased income redistribution and the Right argues for smaller government, there is an obvious way to meet both sides' objectives: reduce government spending on upper-income beneficiaries. Such policy changes run into enormous opposition from entrenched political interests, but they sound eminently sensible to nonpolitical people. This piece details how the task could be approached.

BIPARTISAN EFFORTS AT FEDERAL DEFICIT REDUCTION WILL FACE stronger headwinds as the 2012 election approaches. Public statements even of those pledging an immediate focus on fiscal repairs are already exhibiting the increasing influence of political considerations. President Obama's April 2011 budget address, for example, incongruously referenced opposition "presidential candidates" and was more specific in its criticisms of Congressman Paul Ryan's budget framework than it was revealing of the administration's own policy ideas. Even members of the bipartisan Senate "Gang of Six" are dropping hints that their proposed implementation of the Simpson-Bowles commission recommendations may largely omit Social Security reform—an especially stark concession to political concerns, considering that Social Security cost growth over the next decade will exceed that of any other federal program.

The essential problem is that the two major parties are now seeking to distinguish themselves on politically sensitive tax and entitlement policies at precisely the time that bipartisan cooperation on such issues is becoming most necessary. And yet there is a clear path available for the two parties to cooperate to improve the fiscal outlook while still preserving the cores of their respective political messages: namely, by cutting the growth of federal spending on "the rich."

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The central budget messages of the two parties are distinct but not necessarily in irreconcilable conflict:

- Democrats are largely stressing distributional issues. They charge Republicans with pursuing "tax cuts for the rich" and with plotting to cut vital spending on the poor. Democrats, at the same time, deny Republican charges that they (Democrats) are indifferent to the exploding growth of federal spending.
- Republicans are generally focusing on the size of government. They charge Democrats with supporting runaway spending. They in turn deny Democratic charges that they are insensitive to the vulnerabilities of the poor.

These two messages run along different axes: one being from bigger government to smaller government, the other from rich to poor. This ideological geometry allows for substantive common ground. Specifically, if the two parties agree to cut federal spending (meaning actual outlay spending, as opposed to simply closing tax loopholes) on higher-income Americans, they can simultaneously advance Republican objectives of containing the growth of government while also advancing the Democratic message of targeting federal resources at those of greatest need—and all while reducing federal deficits.

Both parties could actually benefit with their core constituencies from such a deal, by showing they can reduce the structural deficit without betraying their core principles. Each party would also acquire a new defense against one of the other side's primary political attacks: Democrats would have shown a willingness to address runaway spending growth while Republicans would have demonstrated their willingness to go after "the rich."

Substantively, what could such a deal contain? As it happens, the two largest and fastest-growing areas of federal spending, Social Security and Medicare, are both ones for which the wealthiest Americans are fully eligible for rising benefits. Both programs are, to be sure, of extreme political sensitivity. But the financial imbalances in these two programs require correction by elected officials in any event. To the extent that spending on the wealthy is constrained within these programs, it will reduce the financial pressure for even more politically sensitive changes to them.

The essence of what is required is for the two parties to agree on how many high-income individuals to affect and on how much. Social Security provides a ready case study in how this could be done. Many Democrats, for example, have expressed sympathy with the concept of raising the current $106,800 limit on the amount of wages subject to the Social Security tax. Such a measure would affect roughly 20% of workers (the number who have wages above the current limit at some point in their careers). Legislators could therefore choose instead to slow the growth of benefits—perhaps for that same number of workers, or the top 20% of the wage spectrum. (It is best to set the target in terms of the wage percentile rather than a dollar amount of wages because Social Security benefits are calculated based on an average-wage figure called the AIME, which typically includes several zero-earnings years that bring down one's career average, and which does not count any earnings above the wage cap. Accordingly, AIME dollar figures are much smaller than most people tend to associate with real-world earnings patterns. To avoid bipartisan discussions being hung up on such confusion, the parties would do well to first determine the percentile that they wish to affect, and then have the Social Security actuaries produce the implementing dollar figures after such conceptual bipartisan agreement has been reached.)

How much should the growth of such benefits be slowed? It is not financially necessary to reduce Social Security benefits from current levels. Current Social Security proposals, for example, that employ "progressive indexing" would only impose price-indexation on less than 1% of workers, with everyone else receiving faster benefit growth. Limiting the highest-income 20% to inflation-adjusted benefits and allowing gradually faster growth for workers below that level could by itself eliminate well more than half of the entire Social Security shortfall.

As for Medicare, Democrats and Republicans fiercely disagree on whether cost containment is best achieved via a premium support model or by the federal government's imposing price controls within the program's current design. But they do agree on the need for cost containment itself. Already certain features of federal healthcare law, such as the exemption from the "Cadillac plan tax" and the vouchers provided under the new health entitlement, will grow only with CPI, despite the fact that historically health cost inflation has exceeded economy-wide CPI.[1] If it is politically acceptable to restrict these forms of federal healthcare support to CPI growth,

1. Douglas W. Elmendorf, Director of the Congressional Budget Office, to Nancy Pelosi, Speaker of the House, March 18, 2010; Compilation of Patient Protection and Affordable Care Act (as amended through May 1, 2010) (June 9, 2010).

surely Medicare direct spending on the highest-income beneficiaries could similarly be limited. (This cost containment could be achieved most neatly by changing the rate of growth for income-related Part B premiums so as to hold the growth rate for total Medicare per capita expenditures to CPI for the highest-income beneficiaries.)

Though these are the largest federal spending programs, and though most other direct spending is not targeted at the rich by any definition, savings from direct payments to higher-income individuals need not end there. Agriculture support payments, for example, are currently made to farmers with adjusted gross farm incomes as high as $750,000 (and allowing for an additional $500,000 in non-farm income).[2] At a time when so many continue to struggle amid a weak economy, when federal finances are in desperate condition, and when many talk of the necessity of raising taxes on millionaires, it is difficult for taxpayers to understand why direct payments to millionaires continue. It is encouraging that reports on nascent bipartisan deficit talks indicate that such excessive farm subsidies are potentially on the chopping block.

A bipartisan effort to restrain entitlement spending on the rich will not draw unanimous praise. Some on the far left will see such reforms as part of an insidious plot to weaken popular support for cherished programs. But even objection from these quarters is potentially useful and informative. As a nation, we must decide whether our loyalties attach to the programs in the abstract or to the individuals affected by them, both as beneficiaries and as taxpayers. We need an informed debate over whether the costs of government should rise to unprecedented levels simply because of the political importance some might attach to buying the support of those who least need assistance.

A lasting bipartisan deal to constrain the growth of federal spending on the rich may be a bridge too far before the 2012 elections. But it is an answer that will resonate with the typical, politically independent American, who is concerned about deficits, sympathetic to Republican concerns about runaway spending, and yet responsive to Democratic warnings about potential effects on the poor. If the parties could simply agree to cut spending on the rich, they could do themselves and the nation a world of good.

2. US Department of Agriculture Economic Research Service, "2008 Farm Bill Side-by-Side," last updated December 11, 2008.

Does the Government Really Need More Help Than the Private Sector?

This article was originally published at E21 on June 14, 2012.

This piece was published in response to a fairly fleeting political argument, so one might have expected it to have less staying power than others in this collection. Yet it reads especially well after the fact, and I am pleased to have the opportunity to reproduce it here as one of the better pieces.

The piece concerns a specific comment made by President Obama, echoing arguments by some policy advocates, that the private sector was faring better than the public sector in the aftermath of the Great Recession. The dispute over the truth of that statement was moderately interesting, but more intriguing to me was how one's perception of things can be enormously affected simply by how one chooses to view the data. We all must constantly bear in mind the temptation to examine data in ways prejudicial to our policy views, and be prepared to make compensating analytical adjustments to correct for our own biases. In this particular case, how the data are presented proved to be an especially important factor as well.

MUCH HAS ALREADY BEEN SAID AND WRITTEN ABOUT PRESIDENT Obama's statements of June 8, 2012, that "the private sector is doing fine. Where we're seeing weaknesses in our economy have to do with state and local government."[1] I am disinclined to critique the president's choice of words, which are routinely scrutinized to a degree that very few of us could withstand. I am nevertheless reminded of Michael Kinsley's definition of a *gaffe* as being when a politician accidentally tells the truth—or, in this instance, what he believes to be true.

President Obama's comment did not come out of thin air. For several months many policy advocates have argued that government cutbacks are hampering economic recovery and that the federal government should provide more aid to states and localities. The president's statement signals that he has internalized this view. This policy view is important—more important

1. "Obama: The Private Sector is Doing Fine," *RealClearPolitics*, June 8, 2012.

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than an inartful choice of words—because it pertains to a fundamental disagreement about the appropriate roles of the private and public sectors in our economy.

In recent months several left-of-center economics blogs have presented graphs somewhat similar to figure 1, reproduced from St. Louis Federal Reserve data by Joe Weisenthal at *Business Insider.*[2] At first glance this graph appears to substantiate President Obama's remarks—that the private sector is doing much better than the public sector. Underneath the graph Weisenthal states, "Note we're not making any conclusions. Just showing the data."

But how one presents the data can have a strong impact on how it is received. Three elements of figure 1 could well distort the reader's reaction to it. First, this is a two-axis graph, in which the scale of the private sector is compressed to seem comparable to the public sector, despite the reality that the private sector is five times as large. Second, although the graph appears at first to compare relative public and private employment to the situation in early 2009, it really doesn't. The January 2009 starting point for private-sector employment on this graph is placed visually higher than the starting point for public-sector employment. A more accurate graph would look like figure 2.

Third and most importantly, figure 1 begins in January 2009. This is critical because the decline in private-sector employment started after January 2008, and was most rapid in that year. While President Obama faces greater political accountability for events since he took office, from an economic standpoint there is no intrinsic reason to start with 2009. Quite the opposite, because looking only from 2009 onward produces a misleading picture by leaving out the critical pre-2009 decline in private employment.

To illustrate this, consider the same data when viewed from two other starting dates. I'll also add a third line for total US employment. Figure 3 shows how employment has changed since January 2008, and figure 4 shows how it has changed since January 2006.

2. Matthew Yglesias, "Public and Private Employment," *Think Progress*, July 8, 2011; David Leonhardt, "Private Hiring and Government Layoffs," *New York Times*, February 22, 2011; Joe Weisenthal, "The Chart: Public Sector vs. Private Sector Employment," *Business Insider*, June 8, 2012.

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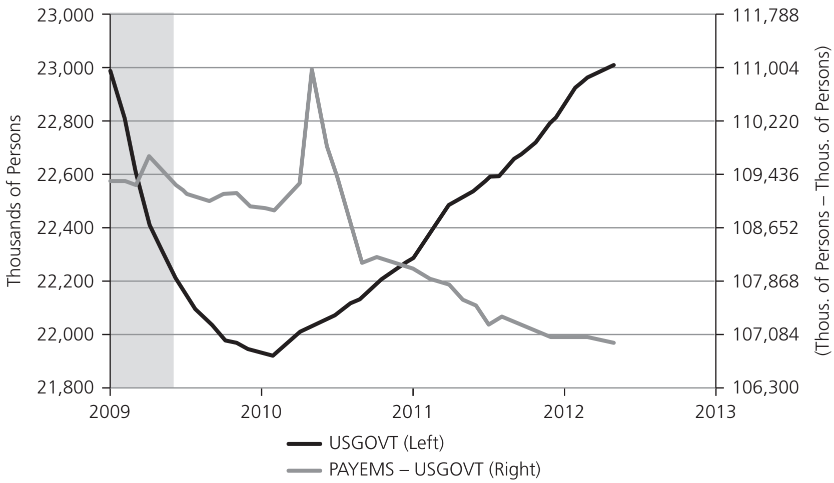
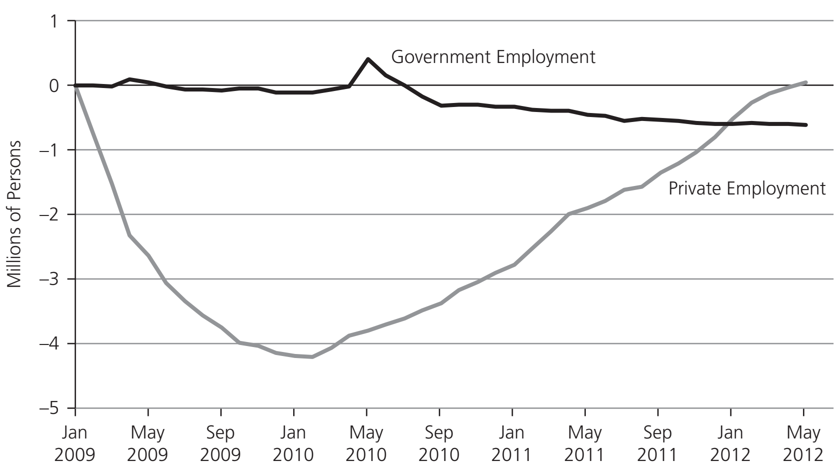
Figure 1. Public Sector and Private Sector Employment



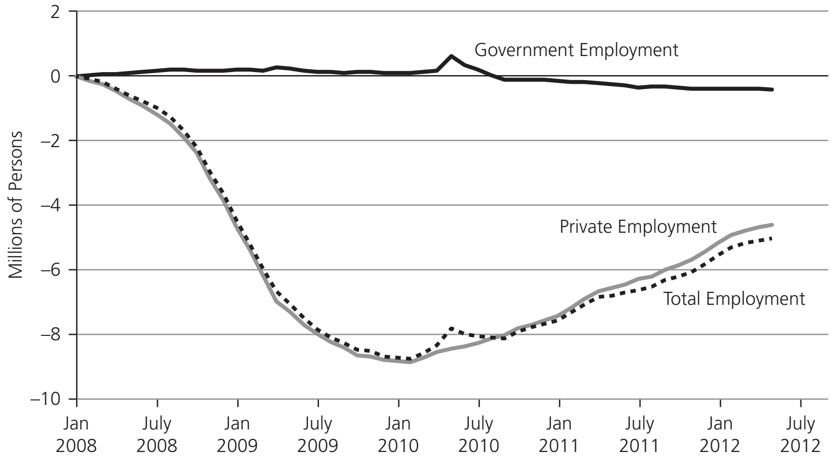
Note: Shaded area indicates a US recession.

Figure 2. Changes in Employment since January 2009



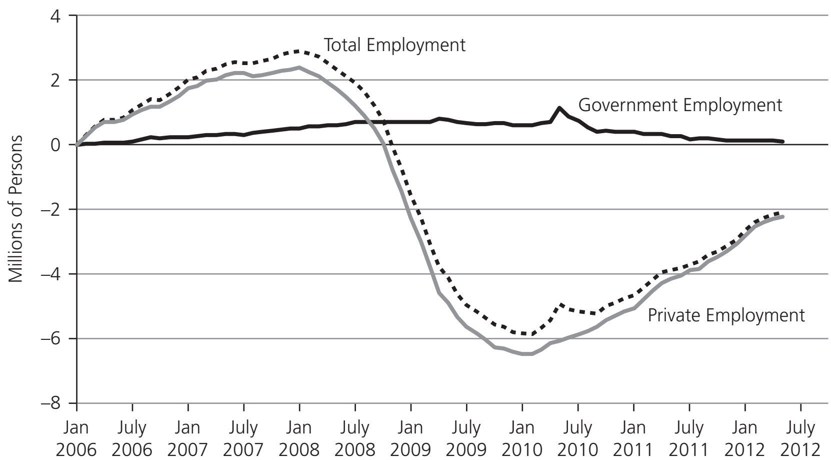
Source: US Bureau of Labor Statistics.

Figure 3. Changes in Employment since January 2008



Source: US Bureau of Labor Statistics.

Figure 4. Changes in Employment since January 2006



Source: US Bureau of Labor Statistics.

The additional context provided by these pictures suggests that the public-sector workforce has actually been, relative to the private sector, largely shielded from the recession. It is almost inevitable that the post-2010 jobs recovery would occur in the private sector because, after all, that's where all the pain was.

One can quite easily argue that the past few months represent not only a natural but a desirable correction—a belated movement from public-sector employment into private-sector employment, restoring some equilibrium that had been disrupted by the recent recession. If on the other hand one sees a given level of government-supported employment as intrinsically desirable, one is more likely to look at recent trends with alarm.

The current debate reveals that policymakers are divided on the roles they would assign to the private and public sectors. It is natural, for example, for public employee representatives to see the recent decline in government-supported employment as a problem in and of itself; some other left-of-center advocates appear to be sympathetic to this view.

That vantage point is reflected in statements like those of Vice President Biden, arguing for increased federal support to state governments by referencing sympathetic constituencies like teachers, police, and firefighters.[3] The position is further reflected in the administration's continued push for federal bailout funds for state governments.[4] Left-of-center thinkers also often express a broader view that taxpayers will in the future need to contribute more tax revenue to ensure that government can function as desired. In short, this viewpoint generally holds that the private sector needs to do more to support the public sector.

An opposing viewpoint is expressed by some right-of-center proponents, including governors Scott Walker and Chris Christie. They argue that the public sector should be trying to alleviate the burdens of the private sector rather than the other way around.

These advocates argue for restraining the growth of government so that the private sector is not ultimately required to make disproportionate further sacrifices in the form of higher taxes. They argue, echoing Ronald Reagan, that the problem isn't that the private sector has lived too well; it's

3. Seung Min Kim, "Biden Plugs Jobs Bill at Hill Rally," *Politico*, October 19, 2011.
4. David Rogers, "W.H.'s Late Push for $26B State Aid Bill," *Politico*, August 1, 2010.

that government has been living better than ordinary Americans have been. These governors have come under rhetorical fire from some public employee advocates and from some elected officials who have come to speak for those government employees' interests.

Left-of-center advocates will sometimes argue that the interests of the private and the public sector are complementary—that greater spending by states and localities will fuel economic recovery in the private sector as well. Their frequent comparisons of private-sector and public-sector workforce sizes, however, appear to reflect a zero-sum mindset about the relative importance of the public and private sectors. From a right-of-center viewpoint, there is no inherent problem if the private sector begins to grow faster than the public sector. But some left-of-center thinkers react with concern to any such trend, even when it simply reflects the private sector belatedly recovering from a painful ordeal.

There is little disagreement on the facts. There is no question that the public sector is now experiencing fiscal constraints from which it was earlier protected, both during the recession and during the subsequent government spending surge. There is also no question that the private sector was hit far harder by the recession itself, and that it has still not fully recovered.

The basic argument is this: should the public sector be given more relief—for which taxpayers must ultimately pay—or should we be trying instead to relieve the private sector of part of the accumulating bill for record public-sector spending? Specifically with respect to jobs, should our aim be to enable government to maintain recent levels of employment, or should we instead focus on enabling the private sector to recover and return to prior levels of employment? In short, should elected officials treat the government sector or the private sector as their principal client interest?

These are fundamental economic policy questions that are likely to grow more salient in the months to come.

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Minimum Wage Laws Are Barriers to Employment

This article was originally published at E21 on April 25, 2016.

The behavioral economist Daniel Kahneman writes of the phenomenon of "associative coherence"—our tendency to see information more readily when it reinforces our prior conclusions than when it contradicts them. This is a dangerous characteristic when it comes to shaping public policy, because every policy choice has downsides. Rational policy making requires us to carefully weigh a policy's upsides against its downsides, which is very difficult to do if we are comparatively blind to the downsides of policies we have already decided we favor.

The minimum wage debate is a prototypical example of a policy issue afflicted by our tendency toward associative coherence. People have various valid reasons for wanting government to mandate a higher minimum wage, but the policy has important tradeoffs, especially affecting low-skill laborers who are prevented by such laws from holding certain jobs. Rather than acknowledging, measuring, quantifying, and weighing these tradeoffs, it's too tempting to simply argue that they don't exist—that the government can raise the minimum wage without any costs to employment.

This article summarized the state of understanding of the issue as of spring 2016. Since it was published, there has been a more recent, sensational flap surrounding Seattle's aggressive increase in its local minimum wage. A study commissioned by the city found that the minimum wage increase was, on balance, harmful to low-wage workers by pricing them out of full employment. In response, many advocates denounced the study—and the city simply commissioned another one.

MINIMUM WAGE LAWS ARE MUCH IN THE NEWS THESE DAYS. NEW YORK, California, and various US cities have recently enacted legislation to raise minimum wage requirements to $15 an hour.[1] In this context it is especially worthwhile to revisit the purpose and effect of minimum wage laws.

1. Jennifer Peltz and David Klepper, "Backers of $15 Minimum Wage Eye More States," *USA Today*, April 3, 2016.

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(Arlington, VA: Mercatus Center at George Mason University, 2020).

Two policy questions are closely connected to the minimum wage debate:

- Whether government should ensure that workers receive no less than a certain amount of compensation for their labor, and
- Whether government should establish a price barrier to employment, and if so how high it should be.

The minimum wage debate is often reported as though it is about the first of these two policy issues. It is actually about the second.

If society's pertinent policy objective were to ensure that workers receive a minimum level of support for their labor, we would almost certainly pursue this objective very differently than through minimum wage laws. Federal or state governments could provide direct income support to workers, which could be designed to be a function of their employment earnings or even of total work hours.[2] Society could make a transparent value judgment about how to balance the income needs of workers with the level of support others are willing to finance. The costs of this support could be broadly distributed among all taxpayers rather than concentrated on certain business activity. Importantly, such a policy would not create direct barriers between low-income workers and jobs.

Thus we don't enact minimum wage laws primarily to ensure income adequacy for workers, which could be done in less problematic ways. The more accurate way to think of minimum wage law is as a government decision to prohibit low-wage employment. Such a law expressly prevents an employer from hiring a worker for a job earning less than the legislated minimum wage, even if that worker would otherwise consider it in his or her interest to accept the job.

Government does not and cannot compel employers to hire workers and pay them a given wage. What government does instead through minimum wage laws is to prohibit employment at lower wages. There is no guarantee that every job made illegal by this prohibition will be replaced by another higher-paying one. Indeed, it is a virtual certainty that at least some jobs will not be.

Thus, minimum wage laws reduce employment.[3] Even without an advanced mastery of economics, it is easy to understand how. If the price of

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2. Richard V. Burkhauser, "The Minimum Wage versus the Earned Income Tax Credit for Reducing Poverty," *IZA World of Labor*, May 2015.

3. Congressional Budget Office, "The Effects of a Minimum-Wage Increase on Employment and Family Income," February 18, 2014.

something (in this case labor) is raised, a purchaser (in this case a potential employer) is not only less willing but also less able to buy it. To construct a deliberately extreme example: if you could hire a plumber for $1 to unplug your drain, you would probably be delighted to do so. If instead the government required that you pay a plumber $10,000 to unplug it, you would almost certainly find a way to just do it yourself. The job would simply be eliminated. It is difficult to say for certain where this line is crossed for every job—but every job has such a line. Minimum wage laws push the lowest-skill workers from the employable to the unemployable side of that line.[4]

There is a debate among economists as to how large a minimum wage increase must be before it creates an unambiguous, measurable adverse impact upon jobs. Advocates of minimum wage increases often cite academic research by Alan Krueger and David Card suggesting that specific past minimum wage increases did not lead to increased unemployment.[5] But most academic research reaches the expected conclusion that minimum wage laws do reduce jobs, including research by Jeffrey Clemens, David Neumark, and Jonathan Meer.[6] Even Krueger recently editorialized that raising the minimum wage to $15 an hour would "risk undesirable and unintended consequences."[7] Thus economists widely agree that raising the minimum wage lowers employment; the only serious arguments are about when the effect is large enough to be discoverable.

None of this is to denigrate the motives of those who advocate raising such barriers to employment. To some eyes it is a form of exploitation if work is performed for pay below a certain level. Returning to our example of the plumber, some might regard it as unacceptably unfair to pay him

4. Jeffrey Clemens, "The Minimum Wage and the Great Recession: Evidence from the Current Population Survey" (NBER Working Paper No. 21830, National Bureau of Economic Research, Cambridge, MA, December 2015); Congressional Budget Office, "Effects of a Minimum-Wage Increase."

5. David Card and Alan B. Krueger, "Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania," *American Economic Review* 84, no. 4 (1994); David Card and Alan B. Krueger, "Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania: Reply," *American Economic Review* 90, no. 5 (December 2000).

6. Jeffrey Clemens and Michael Wither, "The Minimum Wage and the Great Recession: Evidence of Effects on the Employment and Income Trajectories of Low-Skilled Workers" (NBER Working Paper No. 20724, National Bureau of Economic Research, Cambridge, MA, December 2014); David Neumark, "Employment Effects of Minimum Wages," *IZA World of Labor*, May 2014; Jonathan Meer and Jeremy West, "Effects of the Minimum Wage on Employment Dynamics," *Journal of Human Resources*, August 2015.

7. Alan B. Krueger, "The Minimum Wage: How Much Is Too Much?," *New York Times*, October 9, 2015.

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only $1 to unplug your drain—holding this viewpoint so strongly that they would forbid the two of you from mutually agreeing to the transaction. That the job might simply be eliminated strikes some as an acceptable price to prevent this perceived exploitation. The same logic holds that it would be preferable for a person to remain unemployed than to perform a low-wage job at, for example, Walmart or McDonald's.

This means, however, that minimum wage laws inevitably price some workers out of the job market.[8] Workers most vulnerable to displacement include those with the weakest job skills, perhaps because they lack sufficient education or training or because they are young and just entering the job market. Specific sectors such as the restaurant sector often operate with thin profit margins that leave them little room to adjust to sudden changes in their labor costs other than by eliminating jobs.[9]

An underrated problem with pricing low-skill workers out of the job market is that their earnings losses are not limited to their period of unemployment. It is usually while holding a job that an individual acquires the skills necessary to achieve higher future earnings. It is therefore usually better for that individual to be employed for a low wage than not to be employed at all. This too is widely recognized. A working paper from the Boston Fed recently found that "the earnings of displaced workers do not catch up to those of their nondisplaced counterparts for nearly 20 years."[10] As the paper further states, "the longer a worker is unemployed, the more his or her skills . . . depreciate, making the worker less valuable to a new employer."[11]

This effect is of particular concern right now when young adults—those most often harmed by minimum wage increases—are falling out of the workforce in rising numbers.[12] No one knows for sure why this is happening, but the effect on these workers will be lower earnings for many years to come. This trend, as seen in figure 1 (reproduced from the St. Louis Fed), should give lawmakers pause before they erect further barriers to employment.

8. David Neumark, "Employment Effects of Minimum Wages," *IZA World of Labor*, May 2014.

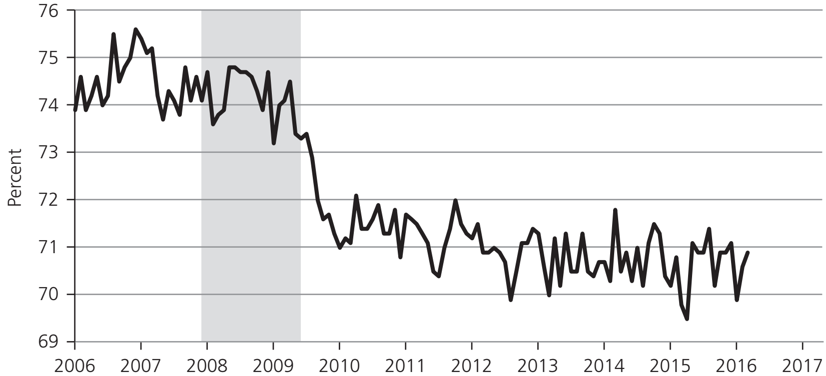
9. Kate Gibson, "How Much Will Minimum Wage Hikes Hurt Restaurants?," *CBS News Money Watch*, June 12, 2015.

10. Daniel Cooper, "The Effect of Unemployment Duration on Future Earnings and Other Outcomes" (Working Paper No. 13-8, Federal Reserve Bank of Boston, January 13, 2014).

11. Cooper, "Effect of Unemployment Duration."

12. Clemens, "Minimum Wage and the Great Recession."

Figure 1. Civilian Labor Force Participation Rate, Ages 20–24



Note: Shaded area indicates a US recession.

Source: US Bureau of Labor Statistics, "Civilian Labor Force Participation Rate: 20 to 24 Years [LNS11300036]," retrieved from FRED, Federal Reserve Bank of St. Louis, https://fred.stlouisfed.org/series/LNS11300036.

It is appropriate for lawmakers to consider policies to raise worker living standards, including the compensation workers receive for their labor. The amount of income support low-wage workers should receive beyond the amount they can freely earn is an important societal value judgment. However, it is a separate value judgment from whether and where to set a minimum wage, which is instead effectively a decision about how stringently to prohibit individuals from working.

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Keeping People Working: The Leading Economic Policy Challenge of Our Time

This article was originally published at E21 on August 24, 2016.

While income inequality has been regarded as a pressing concern in much media coverage, workforce participation is an even more fundamental economic policy challenge, bearing important implications not only for income inequality but also for societal health, wealth, and happiness.

A long-anticipated suppression of US workforce growth arising from population aging has been exacerbated by other declines in labor force participation rates, for example among young working-age males. Research by experts from across the ideological spectrum has revealed that these trends are dangerously weakening to society—worsening income inequality, dampening economic potential, and fostering social dysfunction.

Federal policy has yet to catch up to this overriding policy challenge. For the most part, policymakers have focused on ameliorating the problems of the poor—inadequate income, limited access to healthcare, and so forth—without due regard for whether our stopgap solutions are worsening the underlying problems by driving people out of the workforce, preventing them from developing critical job skills. This piece attempted to explain the stakes.

IT IS BECOMING INCREASINGLY CLEAR THAT REFORMING FEDERAL policies to keep people in the workforce is the primary economic policy challenge of our time. Americans' future quality of life will depend on our getting this right.

Americans' standards of living, and indeed our economic power as a nation, are reflections of our productive output. Only that which we produce can be transmuted into desirable things ranging from the goods that we buy and consume privately to the public goods that we share to the strength of our defenses in a dangerous world. While a great deal of our public policy debate focuses on how national wealth is distributed, we cannot distribute

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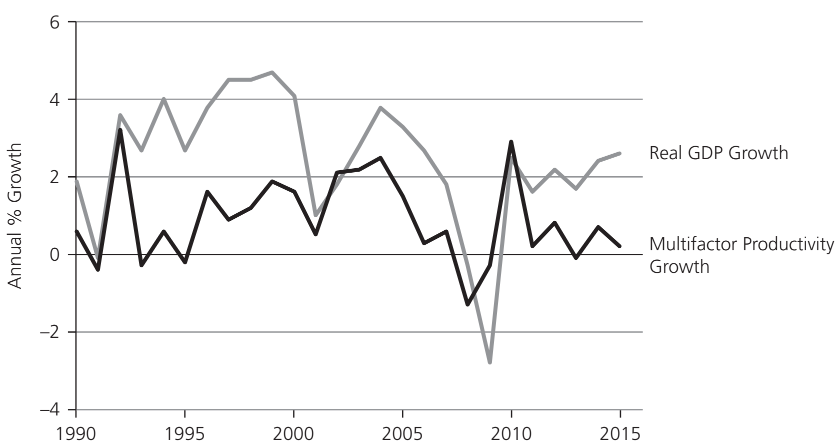
what we don't have. More fundamentally, it is our economic output that determines the quality of life Americans can enjoy.

Our economic growth is basically a function of two primary factors: how many Americans are working, and how productive we are during the hours we work. It is straightforward to understand that the more productive we are, the more wealth we will have together. Indeed, figure 1 charts recent annual growth in GDP and shows that it is generally higher when our productivity grows faster. Thus a good deal of our prosperity comes from Americans learning to work faster, better, smarter, and more efficiently. (Note: multifactor productivity incorporates not only labor productivity but also output on capital services; the GDP decline of 2008–2009 arose primarily from decline in the latter.)

As striking as the correlation is between productivity growth and total economic growth, employment growth is perhaps even more important. To be productive, Americans must work. Assuming given levels of productivity, the more Americans who are working, the more wealth our society generates. Figure 2 compares recent annual GDP growth with annual changes in total employment and renders this relationship inescapable. Our economic output generally rises (and falls) with the numbers of Americans in jobs.

This relationship is why discussions of the economy often focus on the unemployment rate, long defined as the percentage of Americans seeking

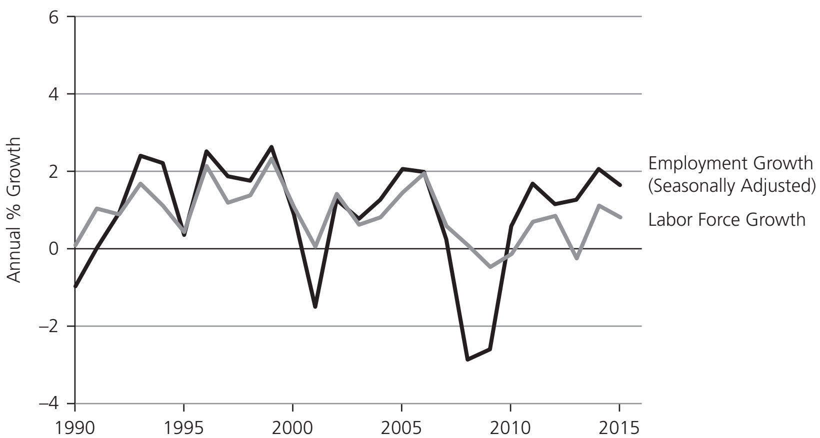
Figure 1. GDP Growth and Productivity Growth



work who are unable to secure it. In recent years it has become increasingly apparent that the health of the labor market isn't measured solely by the unemployment rate, but must account for the total numbers of Americans making themselves available for work. A quick glance shows that the growth of this available labor force is a strong determinant of the numbers of those employed: see figure 3.

Figure 2. GDP Growth and Employment Growth

Figure 3. Labor Force Growth and Employment Growth



Indeed, total labor force growth and employment growth tend to move quite closely together. The rare exceptions are years like 2008 and 2009, when unemployment rates suddenly changed.

A quick look at figure 3 shows that even though the unemployment rate has recovered from the recent recession, we have reason for continuing concern. Our total labor force—i.e., those available for employment—is no longer growing as fast as it formerly did. If we want to continue to experience improvements in our living standards, as previous Americans did, this is something we must fix.

What is behind our sluggish workforce growth? A number of things:

- Americans are spending a higher percentage of our lives out of the workforce collecting benefits from various retirement programs. This is largely because of our inadequate response to demographic change; even as longevity has increased, the age of first eligibility for such benefits as Social Security (62) and Medicare (65) has not. As a result, labor participation among seniors is lower today than it was a half-century ago, even though we generally lead longer, healthier lives.
- Various federal benefit programs are proving to be poorly designed in the sense of applying high marginal tax rates to employment earnings. Basically, this means individuals receive substantial benefits if they lack paying work, but lose them as they receive job income. This results in people making the rational decision to have less work and earnings than they otherwise would. A prominent example is the Affordable Care Act, which has been shown by the Congressional Budget Office and academic economists like Casey Mulligan to be driving many people out of the workforce.
- Other factors are not fully understood. To take but one example, it is widely documented that workforce participation has long been declining among young adult males. We do not have a single, agreed-upon explanation for this persistent participation decline.

Policy corrections to these various causes of labor participation decline will need to be implemented if the United States is to resume the economic growth rates that made us the leading economic power in the world. We simply can no longer afford to have our largest federal retirement, healthcare, and income security programs shifting people out of the workforce who, based on their health, age, skills, and general inclination, would otherwise be working. Lawmakers will have no choice but to confront these realities at some point, and would do well to do so sooner rather than later.

It is important to understand that corrections would generally tend to benefit individual program participants. This is because, while the current designs of programs from the ACA to Social Security often induce workforce withdrawal, the temporary inducement often comes at the cost of an individual's long-term interest. For example, retiring on Social Security at age 62 reduces one's annual benefits and increases the risk of outliving one's savings and experiencing poverty in old age. Similarly, those who bypass employment to receive substantial subsidies like those available through the ACA often do so at the cost of skill development that would otherwise result in higher wages later.

Only if we surmount our labor force participation challenge will we be able to successfully address other economic policy desires such as higher living standards, lower poverty, and sound federal government finances. For these and other reasons, reorienting federal policies to keep people in the workforce is likely to remain the preeminent economic policy challenge of our time.

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

Averting the Multiemployer Pension Solvency Crisis

This article was originally published at E21 on October 26, 2018.

This article was one of several I published in the fall of 2018 concerning a solvency crisis in private-sector multiemployer (union) pensions, which was threatening to collapse the US pension insurance system and was the focus of a special joint select congressional committee. Among those pieces, this article was selected for inclusion in this volume because it draws most heavily on research I had recently conducted and published with the Mercatus Center, and because it focused both on analyzing the problem and on presenting a framework for legislated reforms.

The long and short of the issue is that the impending insolvency of some large multiemployer pension plans was projected to be too much for the nation's pension insurance system (operated by the federally chartered Pension Benefit Guaranty Corporation) to cover. This situation threatened workers not only with the loss of pension benefits that were uninsured (because they exceeded insurance coverage guarantees) but also with the loss of those that were nominally insured (because an insolvent Pension Benefit Guaranty Corporation would be unable to cover even insured benefits).

Representatives of both employer and union interests pressed lawmakers aggressively for a bailout of insolvent pensions, a proposition that would be expensive in its own right but would also almost certainly lead to more expensive future bailouts, possibly spreading to state and local public pension systems. This piece showed that the root of the problem was that multiemployer pension sponsors had failed to fund their benefit promises—in large part because the promises themselves were a function of actuarial assumptions long known to violate well-established economic principles. Until these practices are reformed, as they were in single-employer plans through the 2006 Pension Protection Act, the multiemployer pension funding crisis will continue to grow worse.

EARLIER IN 2018, FEDERAL LAWMAKERS ESTABLISHED THE JOINT Select Committee on Solvency of Multiemployer Pension Plans to address an intensifying crisis in multiemployer pensions.[1] A primary focus of the com-

1. Joint Select Committee on Solvency of Multiemployer Pension Plans home page, US Senate and House of Representatives, accessed October 2018, https://www.pensions.senate.gov/.

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

mittee, which is cochaired by Senators Orrin Hatch (R-UT) and Sherrod Brown (D-OH), is the projected insolvency of our national multiemployer pension insurance system operated by the federally chartered Pension Benefit Guaranty Corporation (PBGC).[2]

PBGC's multiemployer insurance program faces a $65 billion shortfall, and insolvency by 2025, threatening the vital pension benefits of workers. Worse yet, the projected insolvency of PBGC insurance is but one symptom of systemic underfunding in multiemployer pensions themselves, which has left $638 billion in worker pension benefits—over $60,000 per worker—without financing.[3] The committee is required to vote on recommendations by the end of November 2018.[4] Last week, the Mercatus Center published my study of the crisis, which lays out the causes of the shortfall and offers a suggested framework for reform.[5] This piece summarizes the principal findings of the study.

First, some background. Multiemployer plans are private-sector defined-benefit pensions sponsored jointly by a union and multiple employers. About 10 million American workers are covered by these plans, many of these workers having held jobs in construction, mining, trucking, transportation, and other service, trade, and manufacturing industries. A distinguishing feature of multiemployer plans is that workers can continue to accrue benefits after they switch jobs to another employer participating in the same plan. A typical multiemployer plan is governed by a board of trustees, on which labor and management are equally represented. Employers usually contribute funding to plans at rates negotiated in collective bargaining agreements, though federal law may require additional contributions if a plan becomes underfunded. A central responsibility of the plan trustees is to establish a benefit structure that the employers' contributions can successfully fund.

Another distinguishing feature of multiemployer pensions is what happens when an employer withdraws from participation in a plan. In the single-employer pension world, such a withdrawal typically means that the plan is

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2. Pension Benefit Guaranty Corporation home page, US Government, accessed October 2018, https://www.pbgc.gov/.

3. Charles Blahous, "Averting the Multiemployer Pension Solvency Crisis" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, October 2018).

4. Joint Select Committee on Solvency of Multiemployer Pension Plans, "Joint Select Committee on Solvency of Multiemployer Pension Plans Seeks Input from Stakeholders," press release, April 18, 2018.

5. Blahous, "Averting the Multiemployer Pension Solvency Crisis."

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

terminated and the PBGC assumes responsibility for paying benefits, up to limits set by law. By contrast, with multiemployer plans, what is supposed to happen is that a withdrawing sponsor makes a withdrawal payment equal to its share of the plan's unfunded vested benefits, after which its workers' benefits are paid by the continuing sponsors. In practice there are multiple loopholes in the withdrawal liability rules, with the result that multiemployer plans typically inherit increased unfunded liabilities whenever a sponsor withdraws.

PBGC's multiemployer pension insurance is essentially a last line of defense for worker benefits. The forward lines are provided by employers who continue to sponsor the plan after others withdraw, the idea being that this risk-pooling largely protects workers from the consequences of any single employer going under. Accordingly, PBGC's own insurance coverage is very limited: it covers only $12,870 in benefits for a worker who has been employed for 30 years. PBGC's financial assistance to insolvent plans takes the form of so-called loans which are, in effect, ongoing subsidies because such loans are almost never repaid.

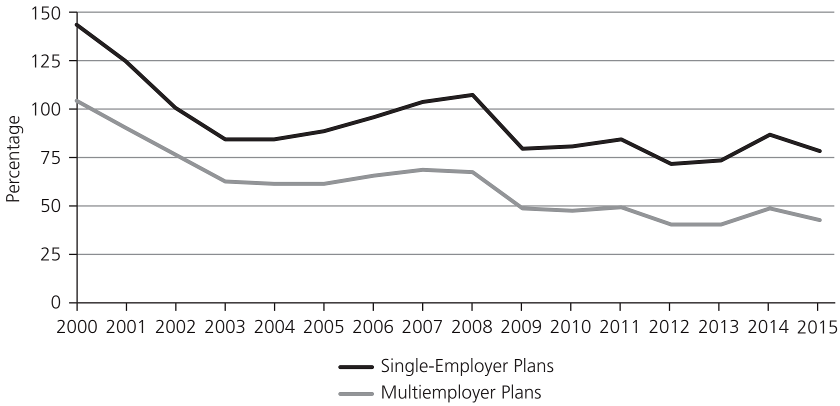
Gaps in statutory funding rules often allow multiemployer plan funding shortfalls to grow until a plan can no longer make benefit payments on its own, at which point PBGC enters the picture to provide support. PBGC currently faces projected claims exceeding $67 billion, as compared with a little over $2 billion in insurance program assets. If, as projected, PBGC is driven into insolvency by these claims, workers will not receive even their ostensibly insured pension benefits. Some estimates are that affected workers could lose up to 90% of their benefits if PBGC becomes insolvent.[6]

A good first step to finding our way out of this mess is understanding how we got here. Some assume that financial market disruptions, like the bursting of the dot-com bubble in 2000 and the Great Recession of 2007–2009, precipitated the pension funding problem. They didn't, as figure 1 makes clear.

It's true that multiemployer plans were in better shape before the stock market bubble burst in 2000, and that they took a further tumble during the 2007–2009 recession. But prudent management means anticipating inevitable market declines, and in any case the market has long since recovered from those shocks. As figure 1 shows, multiemployer plans simply started out less well funded than single-employer plans, and later failed to rebuild

6. Blahous.

Figure 1. Comparison of Single-Employer and Multiemployer Plan Funding Ratios



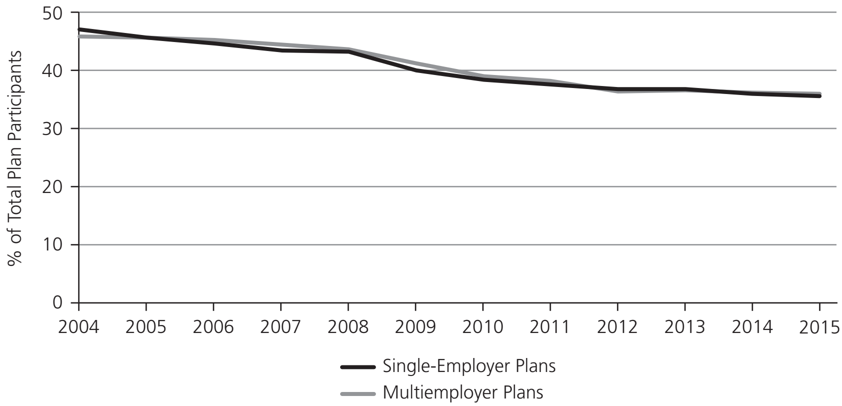
their funding levels during market recovery periods. Despite the strong stock market of recent years, the share of multiemployer plans' liabilities that are funded hasn't exceeded 70% since 2002, and declined all the way down to 43% by 2015.

It's also often noted that multiemployer plans suffer from a declining ratio of active workers to retirees, which depresses their funding contribution base. That's certainly true, but it doesn't distinguish multiemployer plans from their single-employer counterparts, which face the same problem. Single-employer plans are much better funded than multiemployer plans despite their similar demographics. (See figure 2.)

If the aforementioned factors didn't cause the multiemployer funding crisis, what did? The foremost causes are inaccurate valuations and lax funding rules. Unlike single-employer plans, multiemployer plans are permitted by law to value their assets at levels deviating by as much as 20% from current market values. But even more problematically, multiemployer plans are allowed to dramatically understate their liabilities by using inflated discount rates to translate them into present-value terms. The vast majority of multiemployer plans use discount rates of 7% or higher in their actuarial calculations,[7] roughly twice the rates used to properly calculate their current

7. Blahous.

Figure 2. Percentage of Active Workers in Multiemployer and Single-Employer Plans



liabilities. This is the biggest reason why multiemployer plans report funding percentages that are nearly 80% on average, when their true funded status averages less than 50%.

Some sources tactfully say that there are diverse views on how to correctly discount pension plan liabilities. A more accurate way to put it is that there is a firm consensus among economists on how to do it, and that most plans' actuarial practices (as well as federal funding rules) simply disregard this consensus.[8]

Multiemployer pension plans are governed by federal funding rules that are far more lax than those governing single-employer plans. Multiemployer plans are given much longer time frames to address their underfunding, and critically underfunded plans are exempted from otherwise applicable statutory penalties for inadequate contributions. Average insurance premiums paid by multiemployer plans are less than one-sixth of what they are for single-employer plans, despite an insurance program deficit nearly six times as large. Underfunded multiemployer plans are also not subject to variable rate premiums, as underfunded single-employer plans are. Finally, multiemployer plans face fewer restrictions on the growth of their benefit

8. Blahous.

promises, which allows them to dig their financial holes still deeper before (and even after) landing on PBGC's doorstep.

In addition to inaccurate valuation and lax funding rules, another factor contributing to multiemployer plan underfunding is the "orphan liability" problem—i.e., the sponsors' obligations to pay benefits to workers whose employers have left the plan. This problem is fueled by inadequate withdrawal liability assessments, meaning that it is often much less expensive for a sponsor to withdraw from a plan than to continue contributing to it. The most underfunded plans have a substantially greater share of "orphan workers" than better-funded plans, on average.[9]

The 2006 Pension Protection Act (PPA) averted a crisis in single-employer pension insurance by reforming single-employer plans' valuation requirements and funding rules. Unfortunately, the PPA did not do the same for multiemployer plans. Multiemployer plans were instead relieved of certain funding requirements and allowed to dig their underfunding holes still deeper, with the hope that the plans might invest their way out of the problem. It didn't work. With the crisis now metastasizing, it is essential that lawmakers avoid repeating this mistake on a still larger scale, and that they resist calls to bail out these troubled pensions with taxpayer-financed "loans" that are virtually certain to lead to larger future shortfalls. (See figure 3.)

My study outlines various reform principles that should underlie any committee recommendations: accuracy in asset and liability measurements, safeguards against further deterioration of underfunded plans, improved incentives for plan trustees, stronger funding requirements, and premium assessments that reflect risks to the pension insurance system.

Above all, lawmakers should signal that no taxpayer dollars will be used to bail out insolvent multiemployer pension plans. This is imperative for several reasons. First, it is fundamentally unfair—to taxpayers, and to other employers who have responsibly funded their pensions—if unions and corporations provide benefits to their workers without paying for them, and thereafter demand that taxpayers (most of whom are ineligible for such benefits) provide the funding. Second, bailing out any multiemployer pension plans will cause future pension funding to plunge, as other sponsors will then expect similar bailouts instead of financing their own benefit promises.

9. Blahous.

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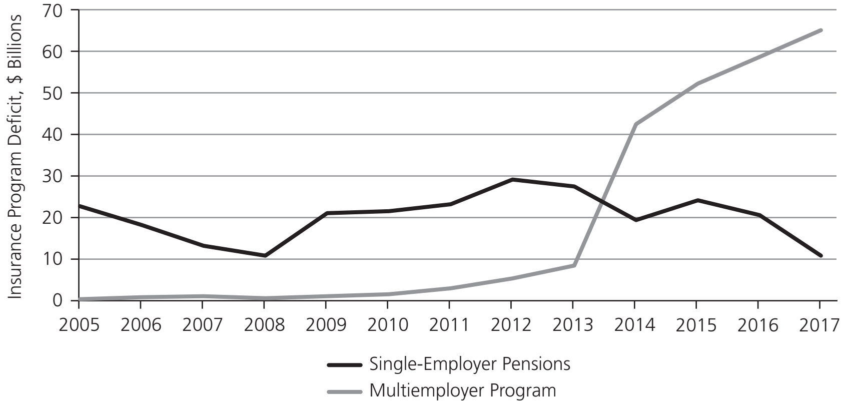
Figure 3. Comparison of Single-Employer and Multiemployer Insurance Deficits



Source: Annual Pension Benefit Guaranty Corporation reports.

Given multiemployer pensions' more than $600 billion in underfunding, this is an unaffordable risk.

The specific structures of multiemployer pension plans clinch the case against a federal bailout in a very particular way. Multiemployer pension plans are often built around an employer contribution rate negotiated between labor and management as part of a collective bargaining agreement. The plan trustees then translate those contribution rates into a benefit structure. When the trustees employ inflated liability discount rates in violation of established economics principles, this decision leads directly to inflated benefit promises to workers. It would be grossly inequitable to then transfer responsibility for paying these inflated benefit promises from the trustees who made them, to federal taxpayers.

Consideration should be given to deploying PBGC resources to relieve troubled pension plans of their orphan liabilities. This would recognize the role orphan liabilities have played in worsening the pension funding crisis, as well as the role of lax withdrawal rules in fostering those unfunded liabilities. This should only be done for true orphan workers—that is, those not subsequently employed by another continuing sponsor in the plan. It should also only be done to the extent that sponsors make offsetting changes to their plans, to reduce projected claims on the PBGC net of its assumption of any orphan liabilities. This could be facilitated by partitioning troubled plans into two parts: PBGC could assume responsibility for the section encompassing true orphan liabilities, while the employer sponsors would be responsible for fully funding other workers' benefits, under strengthened valuation and funding rules.

In sum, the multiemployer pension system faces a crisis threatening millions of workers' benefits, a crisis brought about by inaccurate valuation methods and lax funding practices. A solution to the pension problem will only last if it is built upon principles of measurement accuracy, transparency, damage control, and fairness. This means, first and foremost, requiring that employers and labor representatives only promise benefits that they are prepared to fully fund.

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