Robert Barbera, Tuesday, April 12, Lunch Remarks

Amid worldwide morose punditry I begin with a poem:

Syrian exit, growing risk of Brexit,
China elites exiting stage right,
Putin, Trump, Le Pen, itching for a fight.
Pundits quote Yeats as they watch the world unfold,
Gyrations are increasing and the center cannot hold.

We find ourselves today asking elemental questions:

Is there anything left to the neo-liberal* synthesis?

Can we rescue anything from the Washington Consensus?

More generally, is there an evolutionary way out of today's dire circumstances? In the U.S., amid widespread disagreement about much, a majority agree on one thing. They agree that's it's not a fair deal or a new deal, it's a raw deal. OK? Bernie's calling for revolution. Donald is threating devolution. What animates many supporters of both is a belief that the regular Joe or Jane is not a part of anything that's good or that has any upside. So, to me it begs a central question. Are there conventional steps that, if taken, would address many of the concerns of the frustrated majority? Or is this a moment where it just gets worse unless we are revolutionary or devolutionary? Truth in advertising, I am biased. The first shaping of the neo-liberal synthesis was done by Paul Tsongas, the late Senator from Massachusetts. President Clinton operated under the framework, but Tsongas hammered it out. And I was on the Tsongas staff when he did so. I was 27 and wet behind the ears and had nothing to do with its first construct. I did, however, spend a lot of time thereafter running down a lot of rabbit holes and coming to appreciate what he was talking about. So when I say that this framework has the right stuff to deal with today's woes, know that I am definitely not an impartial observer. * Not neo-liberal as it is used in the UK or Continental Europe..

What does the Tsongas brand of neo-liberalism have to offer? Tsongas emphasized hands on pragmatism in lieu of steadfast wedding to ideology. Pragmatic approaches to problems delivered progress. Ideological dictats sent you down hopeless rabbit holes. Let me give you a real world example, circa 1979.We were bailing out Chrysler—this is the first bail out, not the most recent one—and the firm's financials made it clear that, embracing business as usual practices and the company was doomed. The strategy of the Banking Committee was to take all the stakeholders, force them to cough up something significant, and make the Federal government loan guarantees the icing for Chrysler, not the cake. And big concessions were absolutely necessary. The firm had to weather recession level sales rates and endure the onslaught of Japanese cars that were cheaper, more fuel efficient, and a lot better. Concessions from the workforce, Tsongas asserted should amount to a three year freeze on hourly wage rates.

*Neo-liberal in the sense that was used in the U.S. in the 1980s

In the Senate hearing room, in the media, and later that day in his office amid 25 BIG UAW workers all hell broke loose. I remember being in the Tsongas Senate office fearing for my life. The UAW was dumbfounded that any democrat could demand something of the rank and file. It was heresy. The fact that the company, in its current construct was doomed, didn't seem to matter. How militant were unions in the 1970s? How many of you remember the Woody Allen movie, *Sleeper*? The protagonist is admitted to a hospital to get his ulcer fixed. He wakes up and it's 250 years later. He confronts a dystopian society, the tattered remains left after a nuclear war. Our 1970s protagonist muses aloud, "So was it the U.S. or the Soviets that started Armageddon?" His guide to the new world explains, "Neither. A man named Albert Shanker got a hold of a nuclear device." Anyone remember Albert Shanker? He was the President of the New York State Teacher's Union. Obviously he was a visible, volatile, militant union leader. If we remade *Sleeper* today, who possibly could we substitute in that movie line for Albert Shanker? Nobody! There's no union leader anywhere near that virulent, visible, and crazy. But if we wanted virulent, visible, and crazy, we have a lot of people to put in place, right? We've got Rush Limbaugh. We've got Glenn Beck. We've got Anne Coulter. The Tsongas pragmatic perspective in the late 1970s compelled him to combat ardent lefties. Tsongas pragmatism in 2016 to my way of thinking, demands similar combat. But clearly the ideologically driven notions that directly conflict with the reality of the situation, now largely emanate from the other side of the aisle.

How can I claim neo-liberalism, a pragmatic market friendly, but social equity concerned approach has something to offer today? Simple, we failed to use pragmatism for nearly a decade. Instead, Congress, controlled by Republicans, has been in the ideological thrall of Marx. Consider Mitch McConnell. McConnell declared in 2008 that his number one job was to make sure that Obama was a one-term president. He saw his job not as to maximize the social welfare of the citizens of the US. His job was not to maximize the social welfare of the citizens of his state. His job was to make sure that Obama failed. To do so, he declared war on any White House initiative. And paralysis ensued. This is a Marx, pure and simple. Many, I suspect, are not prone to believe me. So I went to the archives and identified the key rhetorical phrases. I present them verbatim:

> "Your proposition may be good,
> but let's have one thing understood,
> —whatever it is, I'm against it.
> And even when you change it or condense it,
> I'm against it."

Now that's pure Marx—Groucho, not Karl. Groucho, in his aptly named film *Horse Feathers* offered up this tactic, sung with a harmonica. It is a perfect melodic aria describing the U.S. political state of affairs since roughly 2012. And precisely because stalemate has been the rule for so long, I suspect a pragmatic approach could do wonders. Hence my willingness to assert that evolutionary notions, informed by a neo-liberal pragmatism, need to be given a chance, before we contemplate the nuclear option—remember, in *Sleeper* it sure dint work for Albert Shanker.

Larry Summers put it eloquently a few months back in the F.T. Economists overemphasize the *no free* lunch notion. In current circumstances U.S. policy makers are staring at a lot of low-hanging fruit. What are gains from trade? I am not talking about international trade; I am talking about gains from political trade. Say we sit down to bargain and contemplate a swap. Imagine my team is ten times better off, post trade, and your team's circumstances marginally improve. If my dictat says, 'anything that is good for you I can't do" then I don't make the trade. Well for nearly eight years anything that improved Obama's lot was verboten, no matter the general upside. We are almost certainly, therefore, well inside our production possibility space. Low hanging fruit abounds.

Monetary policy, of course, is the one policy arm not caught up in stalemate. It receives enormous scrutiny, relative say, to budget debates. Why? We all know the budget is stuck on dysfunctional autopilot. Monetary policy, in stark contrast, is very much in play. It's been the only game in town in the U.S. and abroad. Monetary policy does, however, have its ideologues, to be sure. A rational approach right now, I would argue, must allow for how complex inflation dynamics are relative to our simple, indeed simple minded models suggest they are.

Do we need radical changes to monetary policy? I think not. We do, however, need to be clearer in our thinking. There are some simple notions that upon closer inspection don't hold up. Start with a Taylor rule. We can assert that $U^*=5\%$, that $\pi^*=2\%$. Embrace r^* of 2% and fed funds today should be 4%, not 0.4%. OMG we are off by an order of magnitude. The Taylor rule says rates are too low. And the pace of jobs growth, using a simple model appears much too strong. If we assume no rebound for labor force participation we can support about 100,000 new jobs per month. The trend of the past several years is more than twice that pace. Our simple model tells us bad things will surely happen if this keeps up. What are those bad things? If employment grows too quickly, unemployment falls too far, wages accelerate too rapidly, we get a big inflation problem and it ensures we must endure a recession, to rid us of this inflationary excess. Simple, neat, and likely to be wrong.

To make the *too hot* case a litany of assumptions have to be made about participation levels, slack wage dynamics, labor productivity and inflation expectations formation. All of these concerns are highly problematic. Jon Faust, a colleague of mine at JHU, co-authored a paper delivered at Jackson Hole in August of 2015. The paper notes that *disparate confounding dynamics*, essentially items like the ones I listed above, habitually thwart the predicted changes in inflation that simple labor market conditions predicts. Once we allow for these other issues, it is not clear at all that strong jobs growth for the next few years, would turn out to be anything but good news.

Let us explore some of these disconnects: What if participation rates rebound? Unemployment may fall but wages may not accelerate. Unemployment may fall, wages may accelerate, but labor productivity may accelerate so there are no unit labor cost pressures. Unemployment may fall, real wages may accelerate faster than labor productivity, but wages may recover some lost share of national income, instead of generating accelerating inflation. Unemployment may fall, wages may accelerate, real wage rates may accelerate faster than labor productivity and inflation may accelerate, but after four years of being under forecast and under target and two years meaningfully under target, a couple years above target would be fine. *"The Myth of Normal," by John Faust and Eric Leeper.

How might participation rise amid an aging workforce? Allow for a partial recovery for prime age participation and the overall participation rate can rise for two years. Indeed this could accommodate two years of 200,000 per month jobs growth with the jobless rate slipping to 4.5%

Let's say you don't have that much of a rebound and the unemployment rate goes to 4 percent. In a wildly deflationary world that we've been confronting, it's not ipso facto, categorical that we get a big acceleration for wages. So it may turn out that the participation rate rises some, that the unemployment rate falls more than you thought it would, but you still don't have an acceleration for wages.

What about if wages accelerate and what about if wages accelerate adjusted for inflation faster than labor productivity? Now this is the Holy Grail. This is where you run headlong into monetary policy doctrine. If real wages rise faster than labor productivity, we suffer upward pressure on unit labor costs and inexorably this leads to accelerating inflation. Even left leaning economists acquiesce to this linkage. How many times have you heard the following;

> "Well, you know we want productivity to accelerate so we can get real wages to accelerate, but we understand that we can't let real wages run faster than productivity, because of the clear inflationary implications."

OK, but I went to a seminar on a different topic a few weeks back. At this seminar we lamented the fall in wages as a share of national income. You all need to appreciate this delicious irony. The only way wages can go up as a share of national income is if real wages accelerate faster than labor productivity. It's an accounting identity. It's de rigueur now to point out that real wages have been falling or didn't keep up with productivity since 1980. From 2000 to 2013 you go from 57.5% all the way down to 53%, as labor's share really gets nailed. It at 54.4% now; we've had a one-year rally.

Let's posit that over the next two years we allow wages as a share of nominal GDP to go from 54.4% to 55.4%. What would that mean for average hourly earnings? It means that if inflation is around 2% wages will climb 4% with productivity at 1%. In this construct wage earners' share of national incomeclimbs modestly with 4% wage increases, and nothing of any substance happens to inflation.

Now, alternatively, we could begin to see some pressure on inflation. What's inflation done recently? Well, it's been below 2 for four years. The core rate's been below 2 for four years. We use the PCE deflator core and we're talking about 1.3–1.4 over the last two years. Well, you know, you want to me symmetric, how about 2.7–2.6 over the next two years, and I have a calculator that does this for me, it sounds like it averages to 2. So if we're not apoplectic about 1.3–1.4, we don't have to be apoplectic about, you know, 2.6–2.7 for a couple of years. If that unfolding allows for some of this to go on with participation, with wage earners share, we could find ourselves in a situation where a consequence of leverage—and I am not talking about Minsky's leverage, I am talking about leverage in the labor market—a consequence of leverage in the labor market, wage earners could get a rising share over the next several years. And I see that as vanilla ice cream monetary policy rather than a radical set of steps that would need to be taken and if that unfolded at the margin it might be positive, in fact, reasonably positive.

My point? One need not leap to radical solutions. Pragmatic approaches can steer us to a better place. We simply need to be *for them*, not *against them*.