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Economic Newsletter for the New Millennium

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WHAT IS HAPPENING IN THE CRADLE OF DEMOCRACY?

Plato, Pericles, Demosthenes, and Aristotle…

Where are you now that we really need you?

Is there a contagion spreading across democratic nations?

'Rights without responsibilities' is the new cry

'Trillions for redistribution; not a penny for job growth'

Alexis de Tocqueville could see it coming way back in the early 1800s.

> *"The American Republic will endure until the day Congress discovers it can bribe the public with the public's money."*
>
> Alexis De Tocqueville, Democracy in America, 1835.

Several years ago, I asked a 'man of the cloth' of strong socialist bent (he was, in fact, a self-professed 'Christian Marxist'; clearly an oxymoron if there ever was one), to discuss with me, the distinction between abject real poverty and relative poverty. Without hesitation and with a tone of finality, he said he would not do so.

…Too bad…

Relative Poverty
http://en.wikipedia.org/wiki/Poverty_threshold#Relative_poverty

Abject (absolute) Poverty
http://en.wikipedia.org/wiki/Poverty_threshold#Absolute_poverty

Extreme Poverty http://en.wikipedia.org/wiki/Extreme_poverty

Several years before this incident, a student from Africa, Nigeria as I recall, stormed into my office and menacingly demanded to know where the poor were in this country, the U.S. of A. The anger in his voice having scared the day lights out of me, I was making my peace with God fully expecting I would be in the headlines the following day as a professor terminated by an angry student, whom by the way I had never seen before…or since. He calmed down as he explained he had looked all over parts of this country and especially the Detroit metropolitan area, and saw no poverty. His standard of comparison was his native country in Africa, where real abject poverty abounds.

Over the last year, several fellow alumni and I from the University of Detroit, have written and offered for presentation at two conferences, papers arguing that capitalism, to the extent it is competitive, results in the accomplishment of justice in all its aspects; commutative, distributive, and social.

Summa Theologica, II-II, q. 58
http://www.newadvent.org/summa/3058.htm

> *Justice – is the perpetual and constant will to render to each one his right.*

Catechism of the Catholic Church, 2411
http://www.catholic-catechism.com/ccc_2411.htm

> ***Commutative Justice*** *regulates exchanges between persons and between institutions in accordance with a strict respect for their rights. "Without commutative justice no other form of justice is possible."*
>
> ***Distributive Justice*** *regulates what the community owes its citizens in proportion to their contributions and needs.*

Catechism of the Catholic Church, 2426
http://www.catholic-catechism.com/ccc_2426.htm

> ***Social Justice*** *is ensured when society provides the conditions that allow associations or individuals to obtain what is their due, according to their nature and their vocation. (CCC, 1928)*

RERUM NOVARUM - ENCYCLICAL OF POPE LEO XIII
ON CAPITAL AND LABOR
(Given at St. Peter's in Rome, the fifteenth day of May, 1891, the fourteenth year of Our pontificate)

http://www.vatican.va/holy_father/leo_xiii/encyclicals/documents/hf_l-xiii_enc_15051891_rerum-novarum_en.html

Rerum Novarum
http://en.wikipedia.org/wiki/Rerum_Novarum

For any economy to function efficiently, the income distribution must reflect some degree of inequality. Not everyone has the same quantity nor quality of productive resources to offer in the production of goods and services. But when markets are dominated with political power and/or monopoly power reflected in the ability of one or a few firms to control supply and therefore price, as in for example the oil markets, the additional income inequality resulting is NO LONGER JUSTified.

This excessive inequality, resulting from the lack of competition, typically results in government fiscal policies that attempt to redistribute income and wealth reducing the excessive inequality. Much of history is replete with government failure to achieve this goal and at times increasing the inequality through a flawed political discernment process.

Rarely is the question asked or is there a requirement that the beneficiary of the redistributive efforts has provided the service of his or her own productive resources such as labor and debt or equity capital. When for a while, and not too long ago, 'Workfare' was being attempted, many of the more liberal persuasion yelled and hollered at how cruel it was. Easy to forget isn't it?

Workfare – http://en.wikipedia.org/wiki/Workfare

Little distinction is made between income earned by supplying productive resources to the economy's production process and income earned by the use of market power, usually in the form of restricting supply, to expropriate from buyers more expenditures than a more competitive economic environment would require.

This control of supply is not restricted to the supply of goods and services in the product market, but also occurs in the market for productive resources, including labor through the cartel effects of unionization.

Technically, in the presence of market power, suppliers such as the large oil firms expropriate and the labor of such firm organized by strong unions also expropriate the consumer surplus and convert much of it into producer surplus (for many years referred to as economic rent) along with a loss of consumer surplus that producers do not receive, a deadweight loss as it is called in economic theory.

This producer surplus or economic rent, as it is also called, is the excess income (profits) earned above what the firm could earn if the market were highly competitive. For productive resources such as labor, excess compensation above what the resource such as labor could earn in a competitive, non-unionized labor market (its opportunity cost), is also contrary to commutative justice.

Consumer Surplus

The consumer surplus is an estimate of how much more consumers would be willing to pay for the market quantity purchased if they had to, but do not have to if only one price is charged to all buyers. While a laptop computer might be worth several thousand dollars to a potential buyer, competitive forces have pushed the prices down to less than a thousand; thus, moving toward maximizing the consumer surplus.

Opportunity Cost

This is the compensation that a productive resource such as labor, could earn in its next best COMPETITIVE alternative employment. Remember that the productive resources include not only labor, but debt and equity capital, entrepreneurship and land (which encompasses natural resources). Included in opportunity cost is what is referred to as 'normal' profits. Using labor as an example, if you are receiving less than your opportunity cost from your employer, in a competitive environment, you would simply find another job that covers your opportunity cost. Conversely, if you are receiving in excess of your opportunity cost as an employee, this violates the principle of equity and, if left unchanged in competitive product markets, will eventually have ramifications in terms of long-term viability for the firm, e.g., General Motors and Chrysler.

Producer Surplus/Economic Rent

Normal profits or opportunity cost level profits are a cost in economics just as is the cost of labor compensation. Equity capitalists are self-employed. Technically and simply, the firm they own employs them. The self-employed include stockholders. Income or compensation to productive resources in excess of this opportunity cost level is called a producer surplus (economic rent is the more traditional term), and is above what is needed to bring and keep the resource in the firm's employment.

Connection between Consumer Surplus and Producer Surplus

Any producer surplus flowing to the productive resources such as labor or the owners (equity capitalists) came at the cost of a reduced consumer surplus and some degree of deadweight loss. This causes the *consumer/buyer to pay more than they might otherwise have to pay in a more competitive environment. As competition increases, downward pressure of product prices will eventually reduce the producer surplus and increase the consumer surplus along with a restoration of the deadweight loss to the consumer surplus.*

Excess management compensation, a form of producer surplus or economic rent, is a major cause of unjustified excessive inequality in the income distribution. These excessive compensations are often followed, sooner or later, by Chapter 11 and/or Chapter 7 bankruptcy hearings as seen recently at Chrysler and General Motors.

Unreal non-wage benefits to labor are one of the causes of excessive and *unjustified* inequality in the income distribution. The private sector firms agreeing to defined benefit pensions, usually due to strike threats by unions, are often impossible to adequately fund, and are just as guilty of contributing to excessive inequality in the income distribution as are various levels of government that are badgered by powerful labor unions (e.g. AFSCME http://www.afscme.org/ - American Federation of State, County and Municipal Employees) into agreeing to not only current compensation packages that are now proving impossible to pay for through taxes but huge retirement benefits including health care for the retirees that are equally impossible to fund adequately through taxes.

Government employees on the average receive total compensation packages about 44% greater than the average of private sector employees.

EMPLOYER COSTS FOR EMPLOYEE COMPENSATION – MARCH 2011

http://bls.gov/news.release/pdf/eci.pdf

Total employer compensation costs for State and local government workers averaged $40.54 per hour worked in March 2011 (versus $28.10 per hour for private industry), the U.S. Bureau of Labor Statistics reported. Wages and salaries amounting to $26.55 per hour accounted for 65.5 percent of compensation costs while benefits averaged $13.99 per hour worked and accounted for the remaining 34.5 percent.

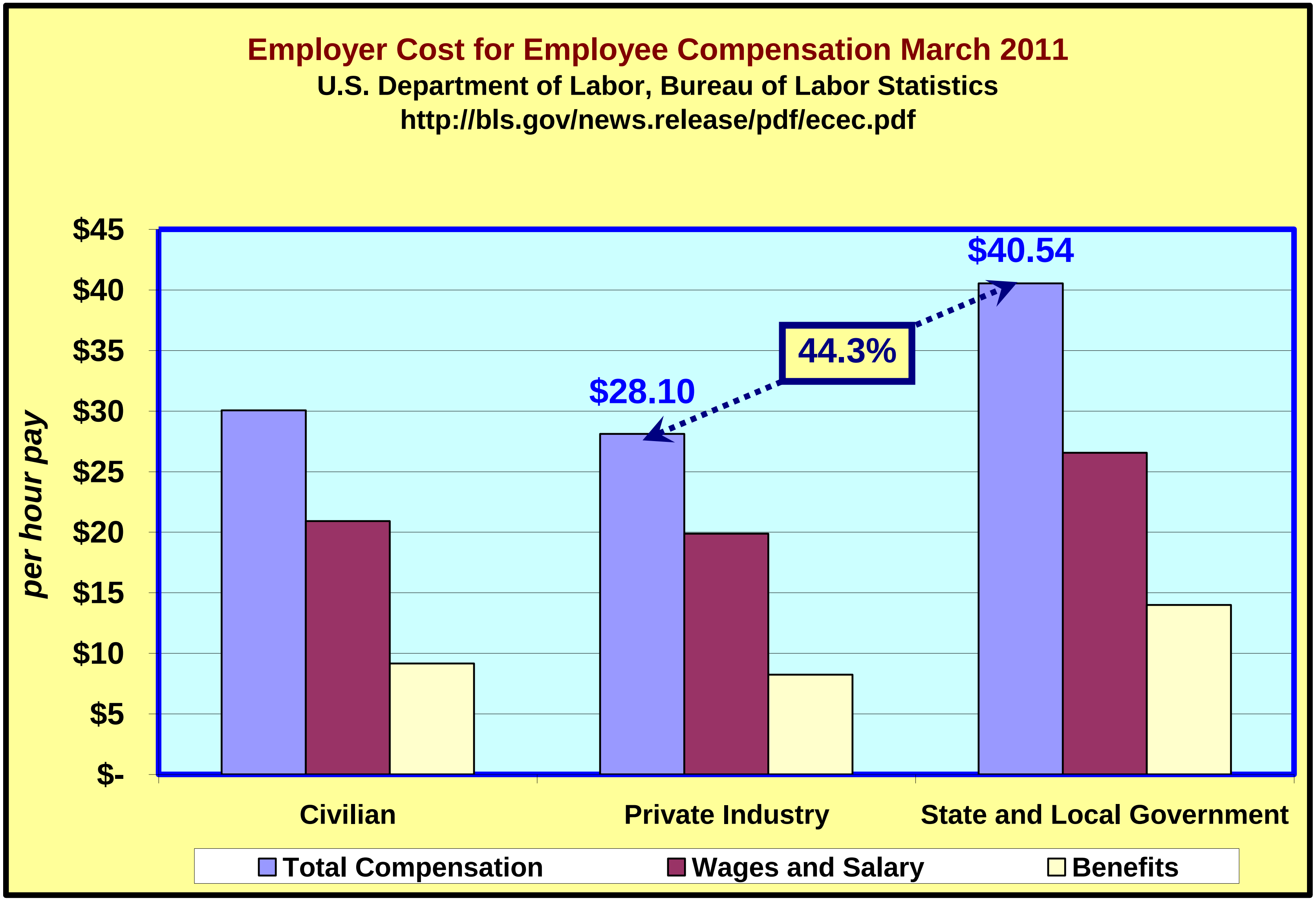

Employer Cost for Employee Compensation March 2011
U.S. Department of Labor, Bureau of Labor Statistics
http://bls.gov/news.release/pdf/ecec.pdf
$45
$40
$35
$30
$25
$20
$15
$10
$5
$-
per hour pay
$40.54
44.3%
$28.10
Civilian
Private Industry
State and Local Government
Total Compensation
Wages and Salary
Benefits

Table A. Relative importance of employer costs for employee compensation, March 2011

Compensation component	Civilian workers	Private industry	State and local government
Wages and salaries	69.6%	70.7%	65.5%
Benefits	30.4	29.3	34.5
Paid leave	7.0	6.8	7.5
Supplemental pay	2.3	2.7	0.8
Insurance	8.9	8.0	12.0
Health	8.4	7.5	11.7
Retirement and savings	4.5	3.5	8.2
Defined benefit	2.7	1.5	7.4
Defined contribution	1.8	2.1	0.8
Legally required	7.8	8.2	6.0

The U. S. Economy in 2011: A Real Bummer
http://www.econnewsletter.com/73901/48901.html

Profits of oil companies in the U.S. resulting in a return on equity (ROE) of just under 30% percent are a result of lack of competition condoned by the regulatory authorities. These are UNJUSTified as well. They are exploitative and result from a lack of competition.

Exxon's Profits: Measuring a Record Windfall
By Marianne Lavelle
Posted: February 1, 2008

http://money.usnews.com/money/business-economy/articles/2008/02/01/exxons-profits-measuring-a-record-windfall

"The U.S. Energy Information Administration's most recent analysis of the oil industry's performance, released just last month, showed oil industry return on equity of 27 percent—about 10 points higher than that of other manufacturers."

…must be nice!

EXXON MOBIL CORP

http://finapps.forbes.com/finapps/jsp/finance/compinfo/Ratios.jsp?tkr=xom

5-Year Average (2006-2010): Return on Equity = 28.9%

Entitlement programs such as the inadequately funded Social Security and Medicare programs and the unfunded Medicaid program are far beyond the ability of the current level of taxes collected to fund them and raising taxes to fund them will result in the destruction of job growth.

The U.S. Economy: It's beginning to look a lot like Europe
May 2, 2010

http://blogs.udmercy.edu/newparadigm/tag/social-security-deficit/

SOCIAL SECURITY
March 31, 2010 (CBO Director's Blog)

http://cboblog.cbo.gov/?p=595

CBO projects that revenues from payroll taxes credited to the trust funds will be $12 billion lower in 2010 than in 2009, while benefit payments will be $37 billion higher. This year, for the first time since the Social Security reforms of the early 1980s, benefit payments from the trust funds will exceed the trust funds' receipts from the public (which consist mostly of revenues from payroll taxes and exclude interest on Treasury securities held by the trust funds).

http://www.ssa.gov/OACT/TRSUM/index.html

MEDICARE
As was true in 2008, Medicare's Hospital Insurance (HI) Trust Fund is expected to pay out more in hospital benefits and other expenditures this year than it receives in taxes and other dedicated revenues. The difference will be made up by redeeming trust fund assets. Growing annual deficits are projected to exhaust HI reserves in 2017…

Promise anything that will elect you and hope that you can retire from elected office before the proverbial "crap hits the fan." Après moi, le deluge best describes local, state, and federal legislative assemblies in this nation.

The only difference between Greece and the U.S. of A. is the persistence and size of the riots. Wisconsin, Indiana, etc. are beginning to look a lot like Athens, Greece.

The rise of default risk at local and state governments in the U.S. is reaching scary heights. At the federal level it is called sovereign risk and such risk is now heard daily on newscasts.

Après Moi, le Deluge

http://www.econnewsletter.com/68201/index.html

Why can't we raise taxes as the President and many U.S. Senators are arguing? Franklin Delano Roosevelt, FDR, tried it and it failed. He finally accepted deficits and then borrowed to finance the excess of spending. The Federal Debt at the time was relatively small and there was no threat of default and hence sovereign risk was not an issue then as it definitely is now.

…but the Great Depression continued and took a dreadful further collapse again in 1937.

Read what Henry Morgenthau, Jr. told House Ways and Means Committee on May 9, 1939:

http://blog.heritage.org/2009/01/14/were-spending-more-than-ever-and-it-doesnt-work/
William Beach
January 14, 2009

> ***"We have tried spending money. We are spending more than we have ever spent before and it does not work."***
>
> ***"I say after eight years of this Administration we have just as much unemployment as when we started. … And an enormous debt to boot!""***

FDR's policies were failures, and Morgenthau was a close confidant who served as Treasury Secretary from 1934 to 1945. This is a far cry from the gigantic myths concerning the alleged successes of FDR.

More recent studies have concluded what Henry Morgenthau had concluded more than 70 years ago.

Thomas Cooley and Lee Ohanian, UCLA Anderson School
August 27, 2010
http://online.wsj.com/article/SB10001424052748703461504575443402028756986.html

Where are the Jobs? The Parallels between Today and the Great Depression
http://www.youtube.com/watch?v=qm5ZbjkGV3Y

The States and Municipalities have been and will continue to be in trouble
http://www.pewcenteronthestates.org/uploadedFiles/Grading-the-States-2008.pdf

Illinois Teachers' Retirement System (TRS)
http://trs.illinois.gov/

TRS TO BOOST PRIVATE EQUITY INVESTMENTS DURING 2012
http://trs.illinois.gov/subsections/press/2011/June_24_2011.pdf

The 10 Biggest Failed Pension Plans
By Emily Brandon

Posted: August 23, 2010
http://money.usnews.com/money/blogs/planning-to-retire/2010/08/23/the-10-biggest-failed-pension-plans

Firm and Year Terminated	Total Claims	Vested Participants	Average Claim Per Person
1. United Airlines (2005)	$7.4 billion	123,957	$60,033
2. Delphi (2009)	$6.1 billion	69,042	$88,475

3. Bethlehem Steel (2003)	$3.7 billion	91,312	$40,021
4. US Airways (2003)	$2.8 billion	55,770	$49,337
5. LTV Steel (2002, 2003, 2004)	$2.1 billion	83,094	$25,694
6. Delta Air Lines (2006)	$1.6 billion	13,291	$123,473
7. National Steel (2003)	$1.3 billion	33,737	$37,811
8. Pan American Air (1991, 1992)	$0.8 billion	31,999	$26,285
9. Trans World Airlines (2001)	$0.7 billion	32,263	$20,717
10. Weirton Steel (2004)	$0.6 billion	9,410	$68,064
Top 10 Total	$27 billion	543,875	$49,933

Source: Pension Benefit Guaranty Corp.

In an article on this website just a short while ago, it was pointed out that much of the excessive inequality in the distribution of income and wealth, comes from suppliers in markets that lack significant competition from other suppliers. Contrary to some of our friends on the far right, free market capitalism does not mean it is all right to eliminate competition by collusion, mergers, and acquisitions and then stick it to the consumers with higher prices. Social acceptance of free market capitalism is a result of its ability to deliver equity and efficiency which are increasingly the outcome as **COMPETITION BECOMES MORE SIGNIFICANT**.

INFLATION BY DECONTENTING

February 12, 2011

http://www.econnewsletter.com/71501/46701.html

"The lack of significant competition causes the violation of equity and efficiency thus reducing the per capita material standard of living and results in an increasingly unequal income distribution far more unequal than needed for the achievement of equity. This latter violation has increased the fuel for those seeking massive redistribution of income. Rarely, however, do those agitating for such redistribution differentiate between the opportunity cost level of a productive resource's income and the surplus reward currently called a producer surplus."

Adam Smith's Invisible Hand of competition is the catalyst that assures efficient production and an equitable distribution of income. The high prices of crude oil and its refined products speak chapters on free market capitalism when markets are no longer competitive.

GM and Chrysler went under because of excessively bloated and overcompensated executives and excessively bloated and over compensated labor represented by powerful unions. Compared to them, the transplants are lean and mean and increasingly successful.

MARKET FAILURE AND THE ROLE OF GOVERNMENT – GOVERNMENT FAILURE VS MARKET FAILURE

When the economic reality of increasing returns and economies of scale are dominant factors, natural monopolies and natural oligopolies result. Regulation of such natural monopolies as electric power, are NOT anti-capitalistic, but rather a surrogate for competition (granted that often such regulation is a less than perfect surrogate). Anti-trust agencies and the legislation that established them are not anti-capitalistic or socialist. They could certainly do a much better job than they have been doing. But absent the Invisible Hand of competition, they are needed.

Our friends on the far right that are more pragmatic than ideological can point to many such failures in the past and currently. Government failure is very real and significant. The following are some cases in point: the failure The SEC and self regulatory bodies to prevent the fiasco that started our ongoing financial and economic crisis, the failure of the anti-trust agencies (FTC and Anti-Trust division of the Justice Department) to prevent the re-cartelization of the U.S. segment of the oil industry, war on poverty, etc.

http://byrned.faculty.udmercy.edu/2008%20Volume,%20Issue%202/2008%20Volume%20Issue%202.htm

Note the following well…

Income redistribution of unjustified inequality *after the fact* is always less efficient than maximizing competition to the extent possible to prevent the occurrence of the excessive inequality before the fact. That is the role of anti-trust policies and public utility regulatory bodies. They failed us in the 1990s when these inept anti-trust agencies allowed a re-cartelization of the U.S. segment of the oil industry. The current administration selection of appointees to staff the anti-trust agencies has also been a failure despite their claims of not appointing lobbyists favoring cartelization of markets.

Case in point------- is an American lawyer lobbyist, and internet policy expert who served as personnel counsel for the Obama-Biden Transition Project. She now serves as Assistant Attorney General for Antitrust at the United States Department of Justice."

http://en.wikipedia.org/wiki/Christine_A._Varney

> *"**Christine A. Varney** is an American lawyer lobbyist, and internet policy expert who served as personnel counsel for the Obama-Biden Transition Project. She now serves as Assistant Attorney General for Antitrust at the United States Department of Justice."*

Antitrust Chief to Step Down
Departure Comes Amid Several High-Profile Merger Reviews

Wall Street Journal story July 7, 2011

http://online.wsj.com/article/SB10001424052702303544604576430171298566868.html

> *"Christine Varney, the assistant attorney general who spearheaded the Obama administration's drive to reinvigorate antitrust enforcement, plans to step down next month to join the law firm Cravath, Swaine & Moore LLP."*

"As a Cravath partner, Ms. Varney will work on antitrust issues related to mergers and acquisitions."

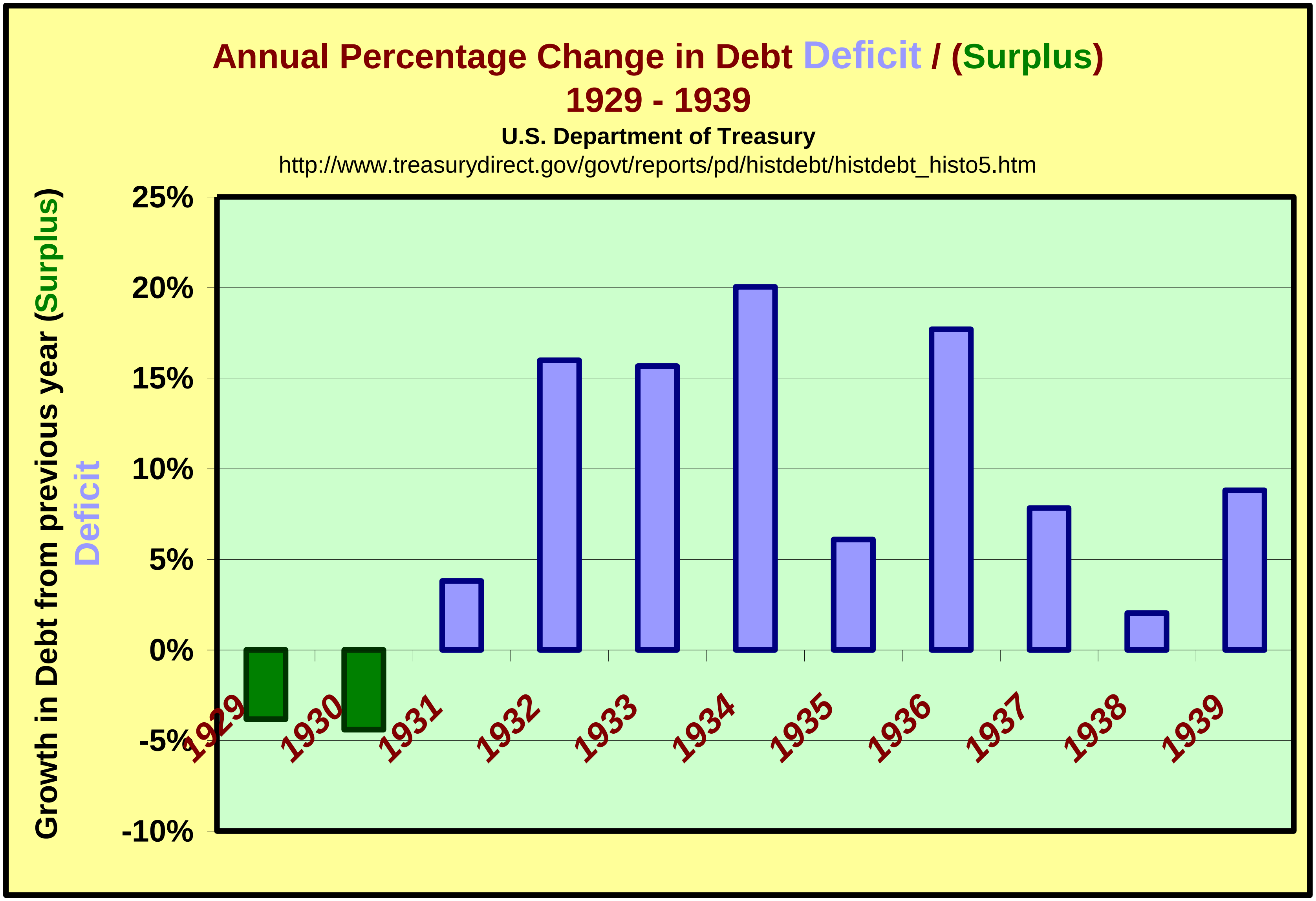
Once again, a look at the Great Depression...and then on to policy over the last 20 years or so

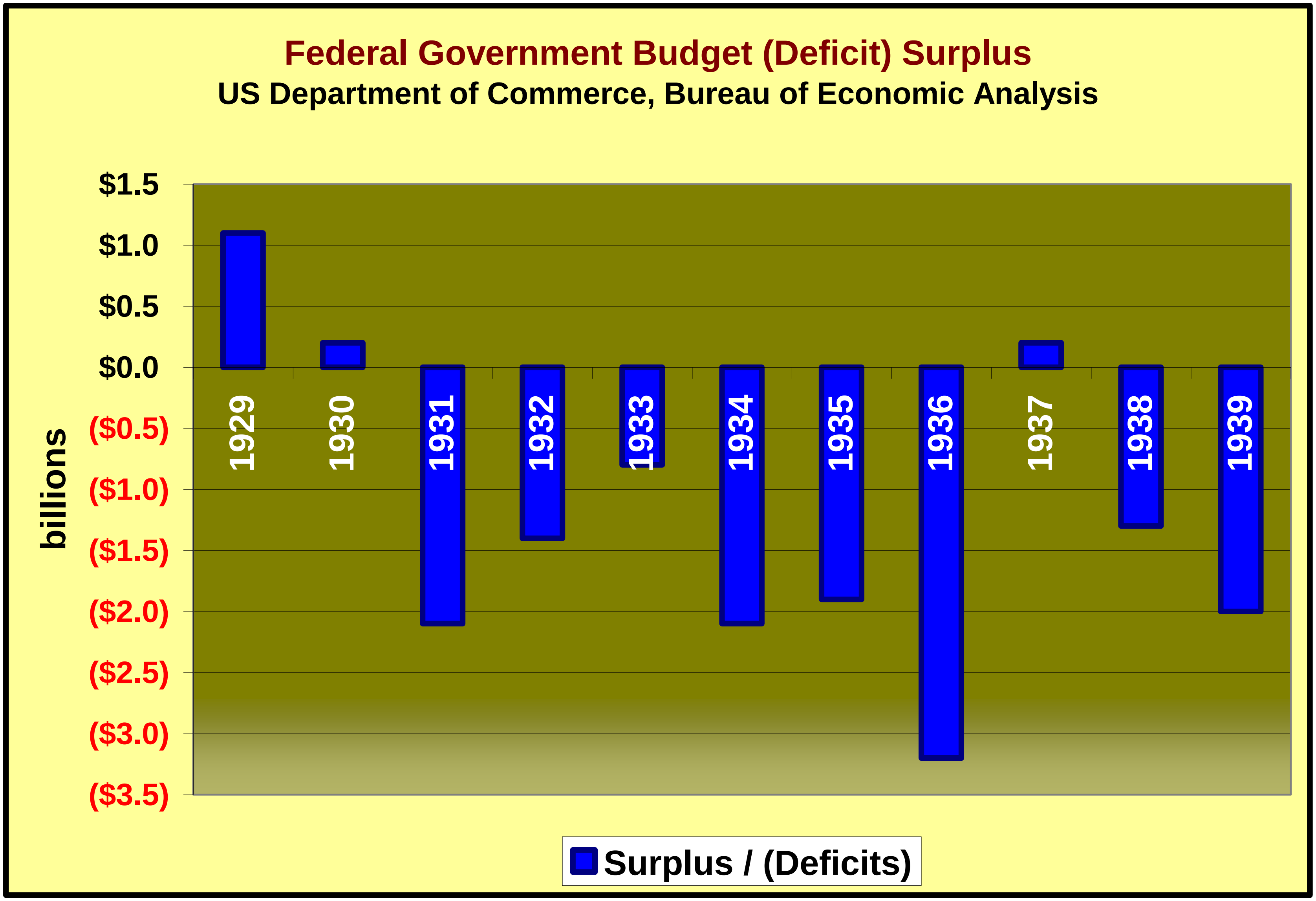
***Répétez s'il vous plaît*?**

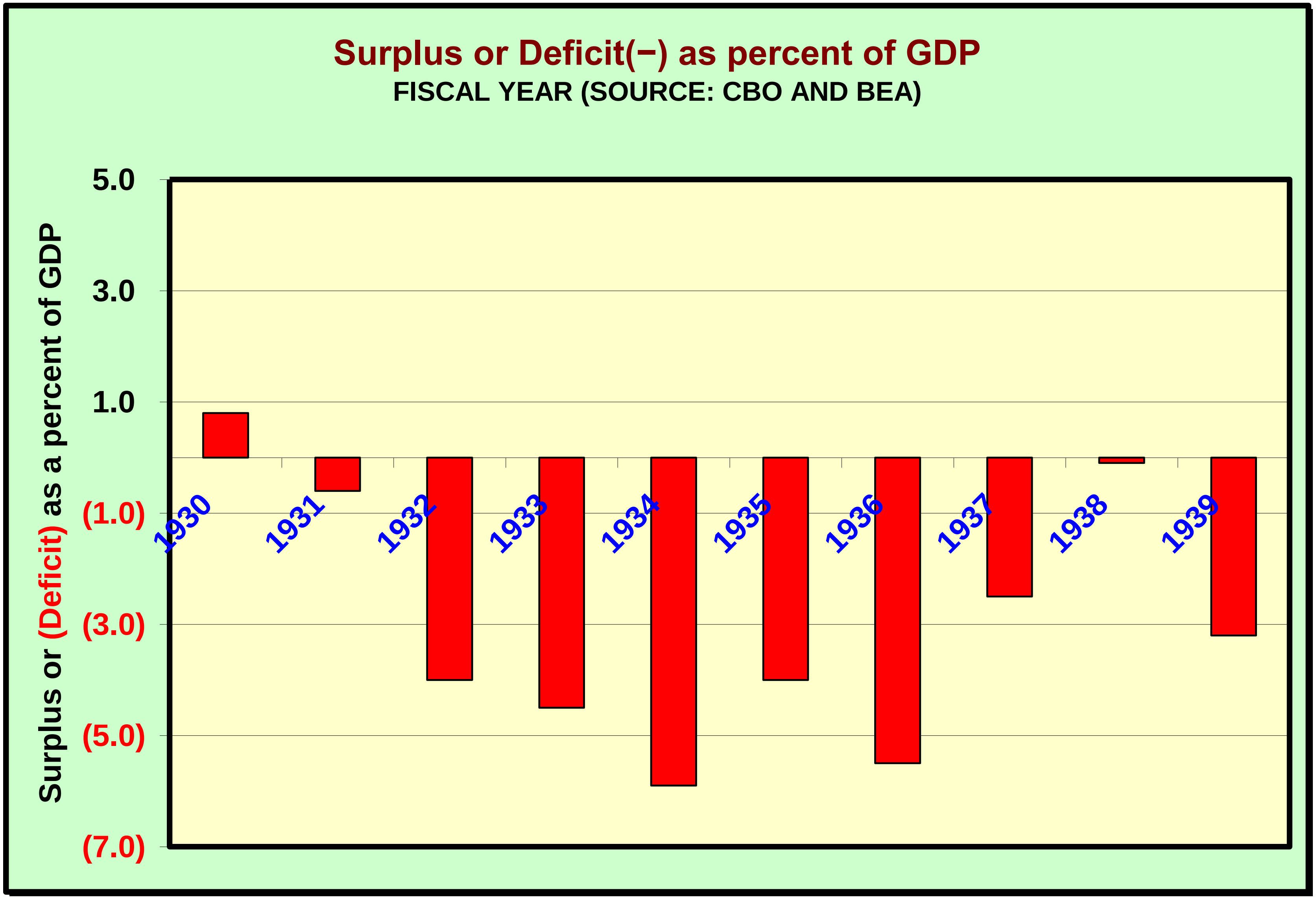
No thanks!

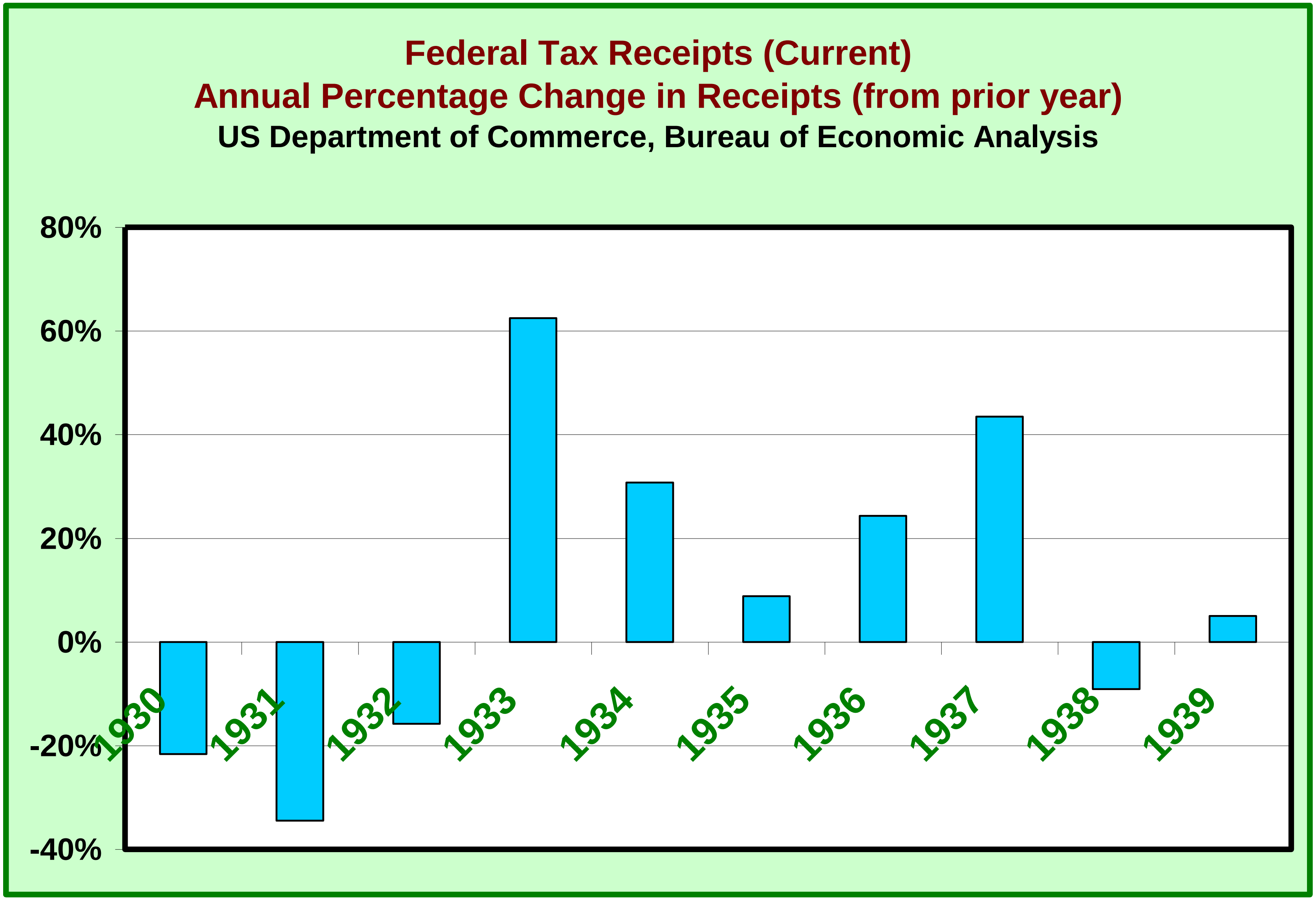
Been there and done that.

...it's just *Déjà vu* all over again...


Annual Percentage Change in Debt Deficit / (Surplus)
1929 - 1939
U.S. Department of Treasury
http://www.treasurydirect.gov/govt/reports/pd/histdebt/histdebt_histo5.htm
Growth in Debt from previous year (Surplus)
Deficit
25%
20%
15%
10%
5%
0%
-5%
-10%
1929
1930
1931
1932
1933
1934
1935
1936
1937
1938
1939


Federal Government Budget (Deficit) Surplus
US Department of Commerce, Bureau of Economic Analysis
$1.5
$1.0
$0.5
$0.0
($0.5)
($1.0)
($1.5)
($2.0)
($2.5)
($3.0)
($3.5)
billions
1929
1930
1931
1932
1933
1934
1935
1936
1937
1938
1939
Surplus / (Deficits)


Surplus or Deficit(−) as percent of GDP
FISCAL YEAR (SOURCE: CBO AND BEA)
Surplus or (Deficit) as a percent of GDP
5.0
3.0
1.0
(1.0)
(3.0)
(5.0)
(7.0)
1930
1931
1932
1933
1934
1935
1936
1937
1938
1939


Federal Tax Receipts (Current)
Annual Percentage Change in Receipts (from prior year)
US Department of Commerce, Bureau of Economic Analysis
80%
60%
40%
20%
0%
-20%
-40%
1930
1931
1932
1933
1934
1935
1936
1937
1938
1939

President Franklin Roosevelt's (FDR) early attempts at reducing the growing deficits due to the collapse of the tax base in the Great Depression are but one example of the failure of fiscal policies to prevent the occurrence of federal deficits and a rising national debt.

When Clinton became President in 1993, he inherited an annual federal deficit of $290 billion (1992) and a U-3 unemployment rate of 7.5% (1992). In 1995, he appointed Robert Rubin as Secretary of the Treasury (http://en.wikipedia.org/wiki/Rubinomics). He and President Clinton lobbied Congress to dedicate the higher taxes legislated in 1993 toward reduce the federal deficit and they agreed with him.

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http://www.heritage.org/research/reports/2008/03/tax-cuts-not-the-clinton-tax-hike-produced-the-1990s-boom

The Clinton Tax Hike

In 1993, President Clinton ushered through Congress a large package of tax increases, which included the following:

- An increase in the individual income tax rate to 36 percent and a 10 percent surcharge for the highest earners, thereby effectively creating a top rate of 39.6 percent.

- Repeal of the income cap on Medicare taxes. This provision made the 2.9 percent Medicare payroll tax apply to all wage income. Like the Social Security payroll tax base today, the Medicare tax base was capped at a certain level of wage income prior to 1993.

- A 4.3 cent per gallon increase in transportation fuel taxes.

- An increase in the taxable portion of Social Security benefits.

- A permanent extension of the phase-out of personal exemptions and the phase-down of the deduction for itemized expenses.

- Raising the corporate income tax rate to 35 percent.

According to the original Treasury Department estimates, the Clinton tax hike was to raise federal revenues by 0.36 percent of gross domestic product (GDP) in its first year and by 0.83 percent of GDP in its fourth year, when all provisions were in effect and timing differences associated with near-term taxpayer behaviors had sorted themselves out. In 1997, the fourth-year effect would be roughly equivalent to an increase in the federal tax burden of about $114 billion.

For a while it seemed to worked but in 2000 the economy collapsed as the mounting federal budgetary deficits helped to collapse aggregate demand and with its collapse, GDP came crashing down and the federal budget surplus quickly became a deficit.

From our very first newsletter…August 2003

http://byrned.faculty.udmercy.edu/Newsletter%20Vol%202003%20Issue%201.htm

What Recession? Welcome to the World of the New Economic Paradigm

> *"This last recession* [in 2000]*, short and shallow though it was, should have never occurred. There are two smoking guns, so to speak, that caused it.*
>
> *The first was the steady rise in the effective tax rate from 1993 through 2000 as can be seen in the chart (Figure 3)."*

[The second smoking gun]

> *"As the tax burden continued to rise, The FED (FOMC) began a policy of severe monetary constraint in 1999 continued it through 2000. Given this two pronged constraint of fiscal and monetary policy, the economy began a collapse in mid-2000 and then turned negative in the first quarter of 2001 and stayed negative through the third quarter."*

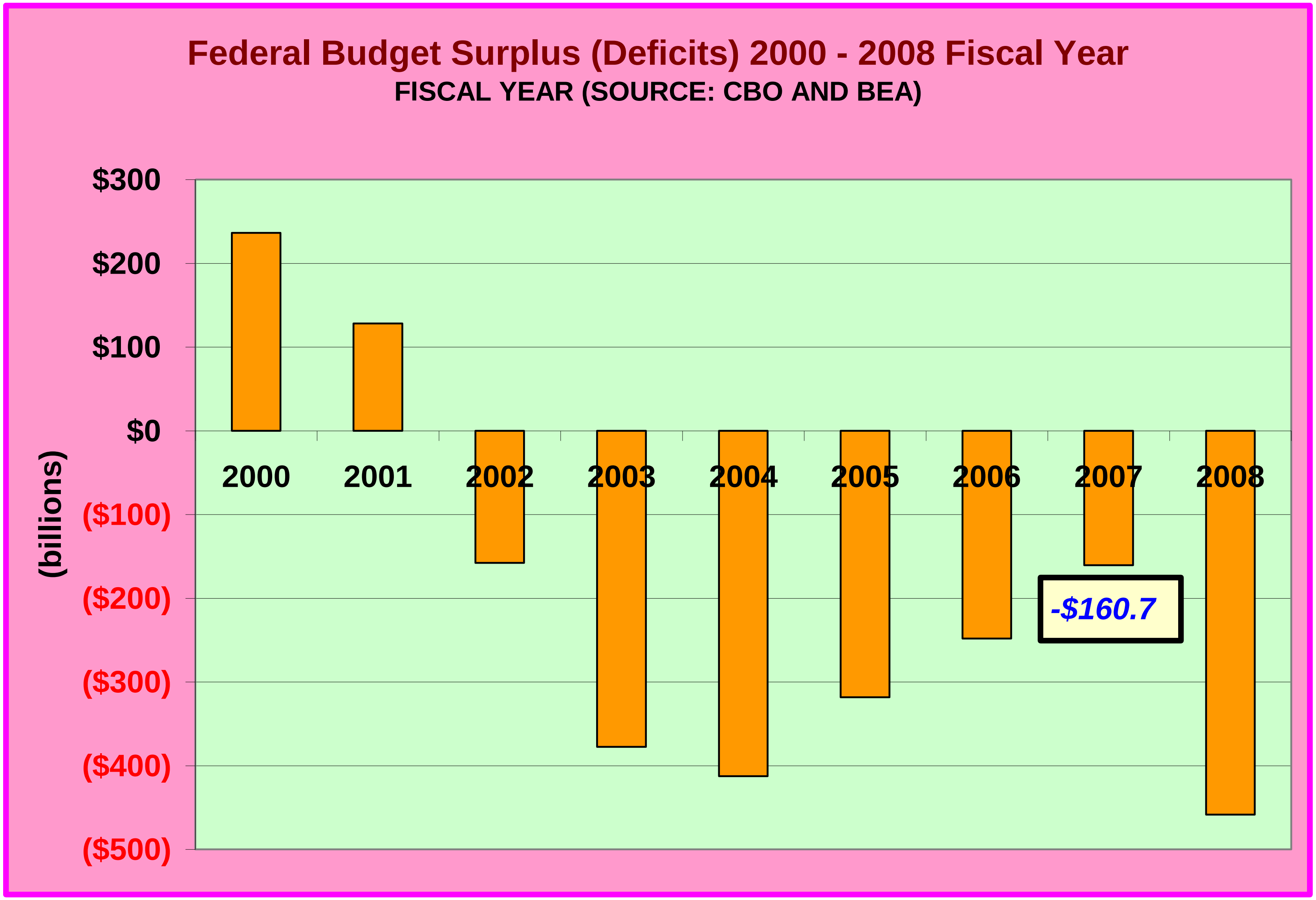
As George W Bush became president in 2001 he was faced with a collapsed economy and a national security environment totally unprepared and begging for a 9/11 disaster. And so it occurred.

Shortly after Bush became president, given the collapsed economy due in part to the high tax rate environment, he sought tax rate relief in order to stimulate the economy. Congress gave him the desired tax rate relief but tacked a sunset provision on the legislation now causing great uncertainty in business planning aggravated by the recent passage of a very costly heath care system.

It should be pointed out that in Bush's second term, the federal budget deficit was decreasing through the end of the 2007 Fiscal Year (October 2006- September 2007) where is it was whittled down to $160.7 billion.

FYI – the federal [budget] fiscal year used to run from July 1 – June 30 of the following year. This was the case until 1976, when Congress failed to pass a budget in a timely manner and the federal fiscal year moved from October 1 – September 30 of the following year.

U.S. Fiscal Year
http://en.wikipedia.org/wiki/Fiscal_year


Federal Budget Surplus (Deficits) 2000 - 2008 Fiscal Year
FISCAL YEAR (SOURCE: CBO AND BEA)
$300
$200
$100
$0
($100)
($200)
($300)
($400)
($500)
(billions)
2000
2001
2002
2003
2004
2005
2006
2007
2008
-$160.7