



Urban Economic Legends: I really like the “Mythbusters” TV show, perhaps because the 13-year-old still lurking inside me loves seeing watermelons explode in the interest of science. Anyway, here are several of my favorite economic urban legends, some of which contain a grain of truth.

The Social Security annual COLA excludes food and energy. Completely false! The annual COLA (cost-of-living adjustment) increases Social Security and other benefits checks by the amount of the rise in the *All Items* Consumer Price Index (CPI) since the last COLA. The latest adjustment was 3.6 percent starting with the January 2012 checks.

The folks at Social Security compute the percentage rise in the CPI since the last COLA was paid. There were no increases in 2009 and 2010 because the CPI did not rise!

How big will the next COLA be? The monthly *Wall Street Journal* Survey of prominent forecasters (including yours truly) sees the CPI rising 2.3 percent during the second half of this year. If correct, the next COLA will be about the same amount.

If you exhaust your unemployment benefits, you are no longer counted as unemployed. This was mentioned recently in connection with the unemployment rate decline in April that occurred against a backdrop of a shrinking labor force. For this to be true, someone has to stop looking. So, it isn't automatically true.

The monthly survey of households that generates the familiar unemployment rate (8.1 percent in April) does not ask whether an individual is or was collecting unemployment compensation. As discussed in our last issue, it only inquires whether someone worked or looked for work.

However, the survey is likely affected by exhaustion of benefits. In order to keep collecting, a worker has to continue to regularly vouch that he or she is looking for work. It is a serious crime to lie. If included in the household survey sample, they would be counted as unemployed. After using up all their benefits, people may simply stop looking and not be counted as unemployed and, as a consequence, not in the work force.

However, if they continue looking, they'll be counted as unemployed until they find a job or stop looking. Problem is that we have no way of measuring how big an impact the exhaustion of benefits has on the overall jobless rate.

Stealth inflation: the shrinking sausage saga.

When the manufacturer reduces the weight of your favorite box of cookies or can of coffee, this is truly inflation. But most people think this is not captured by the Consumer Price Index (CPI). *They are wrong!*

I got really annoyed recently when stealth inflation hit close to home. While shopping, I chose what appeared to be a pound package of the store brand of Italian sausage. When I got home and started preparing my sausage and peppers grinder, I noticed that the label said it only contained 14 ounces. This really annoyed me because I felt it was outright deception. The sausage was nestled there among name brands that did indeed contain a true pound – for now, at least. And it had the same number of pieces as the pound packages except, of course, they were smaller.

However, when gathering data for the CPI, the Bureau of Labor Statistics calculates the cost-per-ounce or other appropriate unit of measurement. They use the example of the shrinking candy bar whose weight had gone from 1.5 ounces to a mere 1.0 ounce, but the price remained the same at 75 cents. Of course, our Washington watchdogs would log this in as a 50 percent price hike! So rest assured, those sneaky supermarkets and food manufacturers aren't deceiving the vigilant statistical sleuths in Washington.

Musings & Amusings

“If con is the opposite of pro, is Congress the opposite of progress?” -Unknown

“You can lead a man to Congress, but you can't make him think.” -Milton Berle

“This country has come to feel the same when Congress is in session as when the baby gets hold of a hammer.” -Will Rogers

The Federal Reserve is owned by the private banks. This is a difficult one, because private banks that are members of the Federal Reserve actually own stock in the Fed and they can influence the choice of directors and presidents for the 12 regional Federal Reserve Banks. (Before proceeding any further I should disclose that I was an economist at the Fed for several years.)

Most economists firmly believe that the member banks exert little or no influence over monetary policy, i.e., the setting of interest rates and related actions. The reason for this is that this decision-making power is highly concentrated in Washington at the Board of Governors. And the stock that the member banks hold has no voting rights. It cannot be sold or traded and by law pays a dividend of 6 percent.

Moreover, all Governors, including the Chairman, are appointed by the President subject to approval by the Senate. All Regional Fed Bank presidents must be approved by the Board of Governors, and 3 of the 9 members of the 12 regional boards of directors are appointed directly by the Board, including the chair and vice chair.

However, the question of bank regulation and oversight has been more problematic. Would bank examiners from, say, the Federal Reserve Bank of Lake Wobegon be as tough as they should be if the CEO of a private bank under scrutiny serves on the board? Hopefully, sensitivity to the concerns that arose during the 2008 financial crisis as well as new regulations will alleviate this possibility.

Is Firm Size Important for Job Formation? It is a very well known “fact”, more like an article of faith, that small firms account for the bulk of U.S. job formation. This belief has been highly instrumental in influencing economic policies towards business at all levels of government.

If my memory is accurate, it was David Birch of MIT who first called attention to the importance of small businesses as job generators some 35 years ago. Since then, there have been numerous studies using increasingly refined data and better defined concepts.

One of the most interesting contributions is the recent research paper by John Haltiwanger, Ron S. Jarmin, and Javier Miranda. They find that, indeed, small firms do a better job than large firms in creating jobs. However, once you “control for” age of firm, the advantage disappears. In plain English this means that startups and young small

firms do the bulk of the job generating. Fertility diminishes as small firms grow older.

These findings do not negate the “conventional wisdom” about the importance of small businesses. Rather, they call for a refined approach in the design of economic policies. In order to create jobs, policy should be tailored to what stage firms are at. To encourage startups and net new jobs growth at young firms, we need to, e.g., streamline the permit process, cut regulatory red tape, and provide access to early stage funding. On the other hand, we also need to keep older small firms alive and well to preserve the large number of jobs they have. Here attention may have to be more on working capital, the burden of regulation, and the like.

Small businesses are very important to our economy. And it is important to understand just how they contribute to the economy and job creation.

The Fiscal Asteroid: Some people call it “Taxmageddon” and Ben Bernanke has been referring to it as “The Fiscal Cliff.” Personally, I like the image of an asteroid hurtling towards earth and threatening to hit at precisely the same moment that the ball finishes its descent in Times Square this coming New Year. What we’re all talking about is the simultaneous expiration of the Bush tax cuts, Obama payroll tax reductions, and extended unemployment benefits on December 31. Furthermore, January 1 marks the start of \$120 billion of automatic federal spending reductions required by the failure of Congress to agree on specific deficit reduction measures last year.

I’ve seen estimates that these actions amount to 3 to 5 percent of GDP (Gross Domestic Product). If allowed to take effect, these measures are enough to cause a serious recession at a time when we’ve haven’t fully recovered from the one that ended in mid-2009.

Sure, our elected representatives in Washington are fully aware of this coming collision. But what will they do about it? Much depends on the outcome of the November elections and who has control of the Senate and the White House.

The odds are high that the asteroid won’t hit. However, even a “near miss” is apt to generate a lot of uncertainty later this year when – I almost forgot – the debt ceiling has to be increased yet again.

Correction: *The March-April edition should have said that the total number of people collecting unemployment benefits in February 2012 was 7.3 million – somewhat more than half the unemployed shown by the household survey.*

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