Economic Review

with Nicholas S. Perna, Ph.D., Webster Bank Economic Advisor

Musings & Amusings:

"The only statistics you can trust are those you falsified yourself" -Winston Churchill

"These days the politicians only tell the truth when they call each other a liar." -Alfred E. Newman

"There are two kinds of truth: There are real truths and there are made-up truths." -Marion Berry Jr.

Pinocchio meets Snopes! I get a kick out of responding to those annoying emails and Facebook postings by replying "Snopes says you are wrong." If you don't already know, Snopes is one of the websites that tells you whether a statement making the rounds on the Internet is true. There are other sites. The *Washington Post's Fact Checker* awards "Pinocchios," depending on the egregiousness of the distortion. You get one Pinocchio for "some shading of the facts," and four for telling a "whopper." A completely true statement gets a "Geppetto checkmark." I'm now thinking of starting my own truth checker. How about *AskDoctorNick.com*? Here are a few samples of what I might cover, or uncover for that matter. Many items are not really lies. Rather they are misconceptions or distortions of the truth, unintentional or otherwise. I'm reminded of that old saying: "Figures don't lie, but liars sure can figure."

The employment rate would be much higher than the official 5.9 percent if we added back all those who stopped looking. Mathematically, the assertion is true, but analytically, it is very misleading. The Labor force participation rate is the percentage of the working age population that is either working or looking for work. It has fallen very sharply during the Great Recession and Not-So-Great Recovery. If it had not fallen, the labor force would be larger by eight million persons, and the unemployment rate would have been close to 11 percent in September instead of the reported 5.9 percent.

There are several things wrong with this calculation. For starters, it assumes the entire eight million would be unemployed if they remained in the work force. This is a very untenable assumption.

Furthermore, much of the participation decline would have happened even if there had been no recession. Studies estimate that about half the drop comes from retirements of aging Baby Boomers. The rest results from inadequate demand for labor and structural changes that cause a mismatch between people and job openings.

So maybe we should add half back? Good idea, but a pillar of the unemployment rate calculation is that you have to look for work in order to be counted as unemployed. (Another misconception is that you have to be collecting unemployment insurance. Not true. In fact, half the unemployed are not).

U-6 is a more inclusive unemployment rate that is published alongside the "official" number. In addition to those officially counted as unemployed, U-6 also includes those who are working part-time but want full-time jobs as well as persons "marginally" attached to the work force. The latter are labor force dropouts who looked for work during the previous year but not in the four weeks prior to survey. In September, U-6 was 11.8 percent, which is considerably higher than the official 5.9 percent.

The Banks own the Fed. Member banks do own stock in the Fed as the price of admittance to the system. However, they don't "own" the Fed in any meaningful sense. They can't sell the stock or vote at Fed monetary policy meetings. The Chairperson and governors of the Federal Reserve Board are appointed by the President and require senate conformation. The presidents and directors of the 12 regional Federal Reserve banks are chosen by their individual boards of directors, but the Board of Governors must approve their selections. My experience in and around the Fed is that the Washington Board exerts a lot of influence on the 12 regional banks. The ownership issue is more of a distraction than anything else.

A different – and far more troublesome – question is whether financial institutions have exerted undue influence on the Fed during and after the financial crisis in the rescue and regulatory areas. The boards

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of directors of the 12 regional banks always have some bankers as members. I don't think that anyone seriously accuses the bankers of influencing monetary policy.

Rather, it is those bailouts during the crisis and the subsequent overseeing of bank activities that have people concerned. Recently, there's been some news about the possibility of undue influence by one of the financial powerhouses on decisions by the New York Fed. This will almost certainly become a big issue next year as the next presidential campaigns get going. Just wait until the Congressional hearings on the Fed start and the grandstanding begins.

By the way, I recently heard of someone describing politicians as "Pinocchios with a nose job."

The government excludes food and energy from the CPI. I can't seem to stamp this one out. Several months ago, I was on a radio talk show run by a certain ex-governor. He insisted that the Social Security annual cost-of-living adjustment did not include food and energy. I protested to the contrary and explained that the Consumer Price Index does include these. It is true that the Federal Reserve also examines the CPI, excluding food and energy, to see what is happening in the parts of the economy not subject to such large price swings, but its targets/goals are set with respect to overall inflation.

The federal deficit has been increasing. Wrong! Although politicians still refer to those "trillion dollar deficits," the shortfall for FY2014 (which ended September 30) was "only" $483 billion – down from a peak of $1.4 trillion five years earlier.

People often confuse the annual *deficit* with the outstanding *debt*. The deficit is the amount by which spending exceeds revenues and is, thus, the amount that has to be borrowed each year. The debt is the total amount of borrowing that has taken place (and not been paid off) over the years. As long as there's a deficit, the amount of debt will be rising. However, the amount of debt relative to the GDP has been falling and is now at the lowest percent since FY 2008.

We need a strong dollar. Snopes would rate this one "partially true." Strong dollar refers to the purchasing power of the dollar in overseas markets. Hence, a strong dollar will buy lots of Euros and, therefore, make your vacations, French wines, and the like, cheaper. However, it also makes U.S. goods and services more expensive for foreigners. The way I keep all this straight is by remembering that "strong dollar means weak exports."

There's yet another negative: most large U.S. companies earn a large part of their profits overseas. A rising dollar reduces the value of those profits when they are translated into dollars.

Finally, some people confuse "strong dollar" with low inflation. Inflation means that you can't buy as much as you did before with the same amount of money. As Yogi Berra said, "A nickel isn't worth a dime any more." While this may be true, it is not what is generally meant by strong dollar.

"Get ready for inflation and higher interest rates. The unprecedented expansion of the money supply could make the '70s look benign." That's a rather startling forecast by Arthur Laffer. Problem is it appeared in the *Wall Street Journal* more than five years ago. The CPI rise peaked at 13 percent in 1979, but during the past five years, it has averaged less than two percent. This has to go down as one of the worst inflation predictions in modern times.

Laffer deserves a plethora (platoon?) of "Pinocchios" for this very bad forecast and for misrepresenting what the Fed has actually done. The "unprecedented expansion of the money supply" refers to the Quantitative Easing program. The Fed purchased huge amounts of Treasury bonds and mortgage backed securities in an attempt to lower long-term interest rates.

However, the Fed *did not print money* in order to buy the bonds. Rather, it paid for them by crediting banks with reserves in their accounts at the Fed. These excess reserves have been sitting there doing nothing but earning a quarter of a point annual interest. They are not part of the money supply until they get borrowed and become deposits. What if loan demand starts to grow too rapidly? Not to worry: the Fed can nip it in the bud by raising the rate it pays on those reserves from a measly quarter of a point. Sure, interest rates will rise – but not inflation.

Laffer's views live on. Two Federal Reserve Governors, Charles Plosser and Richard Fisher, have continued to warn of future inflation if the Fed doesn't start raising interest rates soon.

And the biggest lie of them all: **Little George Washington confessed to chopping down the cherry tree because he could not tell a lie.** By now you must know that this never happened. Rather, it was likely invented around 1800 by Parson Mason Locke Weems who wrote a very popular biography of the first president. Why did Weems invent this tale? Quite possibly he did it to underscore Washington's honesty! Weems would have made a great politician.

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