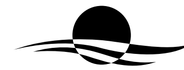
Growth
STRATEGIES



LA JOLLA INSTITUTE
Steve PonTell

Dr. Roger Selbert, Editor & Publisher
E-mail: roger@rogerselbert.com

Trend Analysis That Builds Business Decisions

3200 S. Barrington Ave. #4 • Los Angeles, CA 90066
Telephone: (310) 721-6322

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1 – THE REAL BANKING SCANDAL

Concerning the recent scandal involving manipulation of global interest rates (or Libor, the London Interbank Offered Rate), Nicole Gelinas writes in City Journal that the real scandal is government's "too-big-to-fail" banking policy:

The West's financial industry remains broken, and Western politicians continue to flail about in their halfhearted attempts to pretend that they're confronting the problem. If the West had let markets work in the years leading up to 2008 and beyond, there'd be no need to get rid of this crop of bad actors. When bubble-era banks went out of business because of their disastrous mistakes and mischief, they would have taken their failed leadership with them.

Yes, a few firms did fail, but not enough to change the institutional culture of Wall Street and the City (London's financial district). Instead, institutions that should have gone under, including the Royal Bank of Scotland, have forged ahead, dragging problems that should have been solved by now into the future and harming economic growth.

The answers to our problems are straightforward. When a bank egregiously breaks the law, it should run the risk of a criminal conviction's throwing it out of business. Let a company whose business model *isn't* law-breaking have a go at it. And when a bank, through perfectly legal mistakes, loses so much money it endangers itself, it should face the marketplace, not government rescuers. If America and Britain cannot devise a way for investors to believe that large financial firms can go bankrupt, then it's time to break up those institutions. Are we going to continue this state of economic suspension for another half-decade?

Making it clear that banks are subject to market discipline, not government bullying, will help solve other woes as well. It would be much harder for hundreds of small banks than for just a dozen or so big banks to conspire to fix Libor rates. Why don't Western governments take this route? Because the West, both in its private and public sectors, remains addicted to cheap debt to keep its consumption-dependent economies sputtering along. In recent years, central banks in America and Britain (and in Europe) have bought hundreds of billions' worth of bonds in an effort to keep global interest rates low, financial firms afloat, and middle-class borrowers placated. The West is also dependent on a too-big financial sector, which gives lots of voters, both in America and in Britain, seemingly good and stable jobs.

2 – TWO VIEWS OF THE RECENT EMPLOYMENT REPORT

The June employment report got a lot of attention. Ed Carson says it's even worse than it looks; Scott Grannis says it's not as bad as it looks. First, Carson, in Investors Business Daily:

Nonfarm payrolls rose by just 80,000 in June, slightly worse than expected and the third straight month of sub-100,000 job growth. The jobless rate held at 8.2%. The employment report was disappointing. Here are 10 reasons why the jobs market is even worse than the headline figures.

1. Unemployment has topped 8% for 41 straight months. Last time it was above 8% was December 1983.
2. The labor force participation rate was 63.8% in June, just above near modern-era lows. (It was 66.2% in January 2008 and 67.3% in April 2000). Otherwise, unemployment would be around 11%.
3. The employment-to-population ratio for those aged 25-54 dipped to 75.6% in June, down sharply from 80% in January 2008.
4. Chronic unemployment. The average length of unemployment rose to 39.9 weeks in June, close to recent peak. It was 17.4 weeks at the January 2008 peak and 23.9 weeks in June 2009, when the recession officially ended. Long-term joblessness is particularly bad because skills erode or become obsolete, leading to permanent losses in income.
5. The US added 225,000 jobs in the second quarter vs. 677,000 in Q1. That was the smallest quarterly gain since Q1 2010 – excluding the Q3 2010 post-Census decline. June's gain of 80,000 is not enough to absorb new workers to prevent the unemployment rate from rising over the long term.
6. Nonfarm payrolls are 4.935 million, or 3.6% below their January 2008 peak.
7. This is already the longest jobs recession since the Great Depression at 53 months. Payrolls aren't on track to reach the old highs until June 2015, assuming the sluggish economic expansion lasts that long.
8. Private-sector employment is down 3.9%, or 4.502 million. Government jobs overall are down 1.9%, with federal jobs (ex post office) *up 10.7%*.
9. Entrepreneurial activity is fading. The number of startup firms has crashed from pre-recession highs. Establishments less than a year old totaled 556,553 in 2010, down 26% from the peak. Meanwhile, the number of employees at startups has plunged, with a greater share of new firms with no employees – one-man shops. Very small startups are less likely to invest or to grow, a bad sign for future hiring.
10. Gross hiring. The monthly payrolls report refers to net job gains – hiring minus the number of people who were laid off or quit. Layoffs are near decade lows. Actual gross hiring fell to 4.175 million in April, the lowest since last July. Weak gross hiring reflects companies remaining cautious. It also makes it harder for the unemployed to find work, which is probably one reason why unemployment duration is so high.

Now, Scott Grannis:

The establishment survey of payrolls has been disappointing of late, finding an average monthly gain of only 105K new private sector jobs over the past four months. (I focus on private sector jobs because that's where the action is; the public sector workforce has been shrinking for the past three years due to budget cutbacks, and I view that as a good thing.) In contrast to the establishment survey, the household survey has registered a relatively strong average gain of 235K jobs over the same period. Since the jobs recovery began in early 2010, the household survey has registered about 5.1 million new private sector jobs, while the establishment survey has recorded 4.3 million. This discrepancy between the two surveys is large, and somewhat troubling. One survey says jobs growth is weak, the other says it is decent. Which one to believe?

The household survey is typically better at picking up new jobs in the early years of a recovery, since it is based on a sampling of the entire population, whereas the establishment survey only samples

known businesses. So if there are lots of new businesses being formed, especially small ones, the household survey will find those but the establishment survey won't find them until a year or so from now when it is recalibrated to match IRS data. I'm inclined to trust the household survey more than the establishment survey right now, and so I conclude that the economy is still growing at a modest/moderate pace – nothing to get excited about, but nothing to get upset about either.

Another encouraging aspect of the June jobs report is that the labor force (all those with jobs plus those who are looking for jobs) is once again growing. Over the past year, the labor force has grown 1.1%, which is roughly its long-term average. Over the past six months, however, it's up at an annualized rate of 1.7%, and it has now reached a post-recession high. The overall growth of the labor force since the recession started is of course still miserable – the worst performance in modern times – but the change on the margin is now quite positive.

3 – WHAT'S THE SOLUTION?

I enjoy the blunt musings of economist Mish Shedlock on his Global Economic Analysis web site:

The city of Stockton, California is bankrupt. It has stopped making bond payments and will become the largest city in the US to seek protection via US bankruptcy law.

The bankruptcy was inevitable.

The thing Stockton could not correct over time is ever-escalating pension promises and public union salaries. Union pensions wrecked Stockton. The only way to escape the death-grip of inane pension promises is bankruptcy.

Things like parks and marinas are one-time foolishness that can be corrected over time.

Ever-escalating public union wages and pension costs cannot be corrected over time (indeed they are 100% guaranteed to get worse). Prevailing wage laws that force cities to overpay for every city project cannot be undone over time either.

Both have to be fixed big-bang. The former by bankruptcy, the latter by brute political force, preferably at the national level.

The immediate solution is bankruptcy. Expect to see more cities file. However, longer-term structural problems must also be addressed.

1. Untenable pension contracts need to be tossed out by the courts and benefits reduced. Every taxpayer not on the public dole should cheer bankruptcy, not resist it.
2. End defined benefit pension plans for public union workers.
3. End collective bargaining for public union workers. Governor Scott Walker in Wisconsin has proven that can be done.
4. Scrap Davis-Bacon and all state prevailing wage laws.
5. Institute national right-to-work laws.
6. Merit pay for teachers.
7. More competition from accredited online schools to drive education costs way down.
8. Scrap student loan programs that only benefit administrators and educators, not the kids.

It's time to stop overpaying for all government-sponsored services including but not limited to police, fire, prison-workers, and education. The vicious, self-serving grip that unions and their political supporters have on this nation has to end. Governor Walker partially paved the way in Wisconsin. Other states must follow through. At the national level, we desperately need right-to-work laws while ending prevailing wages.

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4 – ANOTHER SOLUTION: PRIVATIZATION

As Leonard Gilroy and Harris Kenny of the Reason Foundation write in the Wall Street Journal, even Big City Democrats see the writing on the wall and are embracing privatization to improve schools, roads, parks and more:

In April, the Chicago City Council overwhelmingly approved Mr. Emanuel's $7 billion program to "rebuild Chicago" by constructing two new runways at O'Hare Airport; replacing 900 miles of water pipes and 750 miles of the sewer system; creating special routes for rapid bus transit; modernizing schools, transit stations and city buildings; and building 12 new parks and 20 playgrounds.

To pay for these projects, Mr. Emanuel is turning in part to private firms including Citibank and Citi Infrastructure Investors, Macquarie Infrastructure and Real Assets Inc., J.P. Morgan Asset Management Infrastructure Investment Group, and union-held Ullico. These firms say they are ready to provide at least $1.7 billion to help build the "new Chicago." (Though the details are not yet set, the likely arrangement would have the private firms putting up capital and then recouping their investments through user fees over a set period of years or decades.)

There are decades of major public-private partnership success stories in the United Kingdom, France, Italy, Spain and elsewhere. The Reason Foundation's Annual Privatization Report finds that partly or fully privatized airports – such as Heathrow and Stansted in London, and Leonardo da Vinci-Fiumicino Airport in Rome, which make money from airlines and especially from passengers in stores, parking lots and the like – handled 48% of European air travel passengers in 2011. That's one reason Chicago is considering privatization plans for Midway Airport (which would ultimately require approval from the Federal Aviation Administration).

Mr. Emanuel's new infrastructure plan is bolstered by the privatization success he's already experienced in Chicago. Last summer he launched a large-scale competitive bidding process in which two companies compete with each other – and head-to-head with city workers – to provide cheaper curbside recycling for Chicagoans.

The competition forced government workers to find better ways to do their jobs, and Chicago reported reducing costs by $2 million in the first six months alone.

Also privatized by Mr. Emanuel: Chicago's water-bill call center, airport and library custodial services, and the city-worker benefits-management system. Hiring private companies that could manage these services at lower costs led the city to lay off over 600 employees, so the mayor came under predictable fire from government unions. "My duty as mayor is to protect our city's taxpayers and be their voice – not to protect the city's payroll," he responded.

Mr. Emanuel is doing what sensible leaders do: focusing resources on the core functions of government and using competition to lower costs on the rest. When government agencies are forced to compete with the private sector, it saves taxpayers money and makes government more responsive to its customers. Performance-based contracts that set clear standards ensure that high-quality services are delivered by private firms that are held accountable.

Other prominent Democrats [for example, in Los Angeles, Jacksonville and Newark] are joining Mr. Emanuel in embracing privatization or nonprofit funding for the countless nonessential services that drain city coffers.

Harsh fiscal realities are making it easier for local politicians to spot the differences between vital government services and luxuries.