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December 7, 2017

# The Liscio Report

On the Economy

For John Liscio 1949-2000

## For our homeland

> ***• respectable withholding haul***
>
> ***• QCEW: wages vs. AHE, payroll report accurate, big employers generating job growth***
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> ***• startups increase, optimism booms, mixed news on productivity***
>
> ***• aspects of cynicism and the tax bill***
>
> ***• opioids and labor force withdrawl***

In November, 73% of the states in our survey met or exceeded their forecasted withheld tax collections, a nice bounce from 36% in October (and 65% in September), and those reporting growth over the year rose to 83% from 75%. The average over-the-year growth rate was steady at 4.7%, off slightly from October's 4.9%, and the margin above forecast was 0.6%, up slightly from October's 0.4%.

Calendar issues put some downward pressure on October receipts while lifting September's, but were not the whole story, and it's encouraging that November was above both months. Some states are pretty sanguine about withholding trends these days, and rightly so. One of the largest states has missed forecast only twice this year, the best performance, and some Midwestern states that were struggling in the spring are on better footing these days: one noted November was the first time in months they hit target.

Nonetheless, some of the notes from our contacts were a bit downbeat. Our contact in another Midwestern state noted they were 7.4% above November 2016, "which is good, but only up 2.4% year to date, which is not so good." She thinks they will struggle to make forecast. Our contact in a large Northeastern state was surprised by weakness there, while a contact in the Midatlantic, that had been doing well, is getting used to it. Many states report a slower trend, as they expected and so not a worry right now.

There's also the possibility that November is regaining its place as an important month for bonuses, especially since former issues with tax strategies have played out. That is of course good for consumption but can be misleading on employment growth.

### QCEW alert

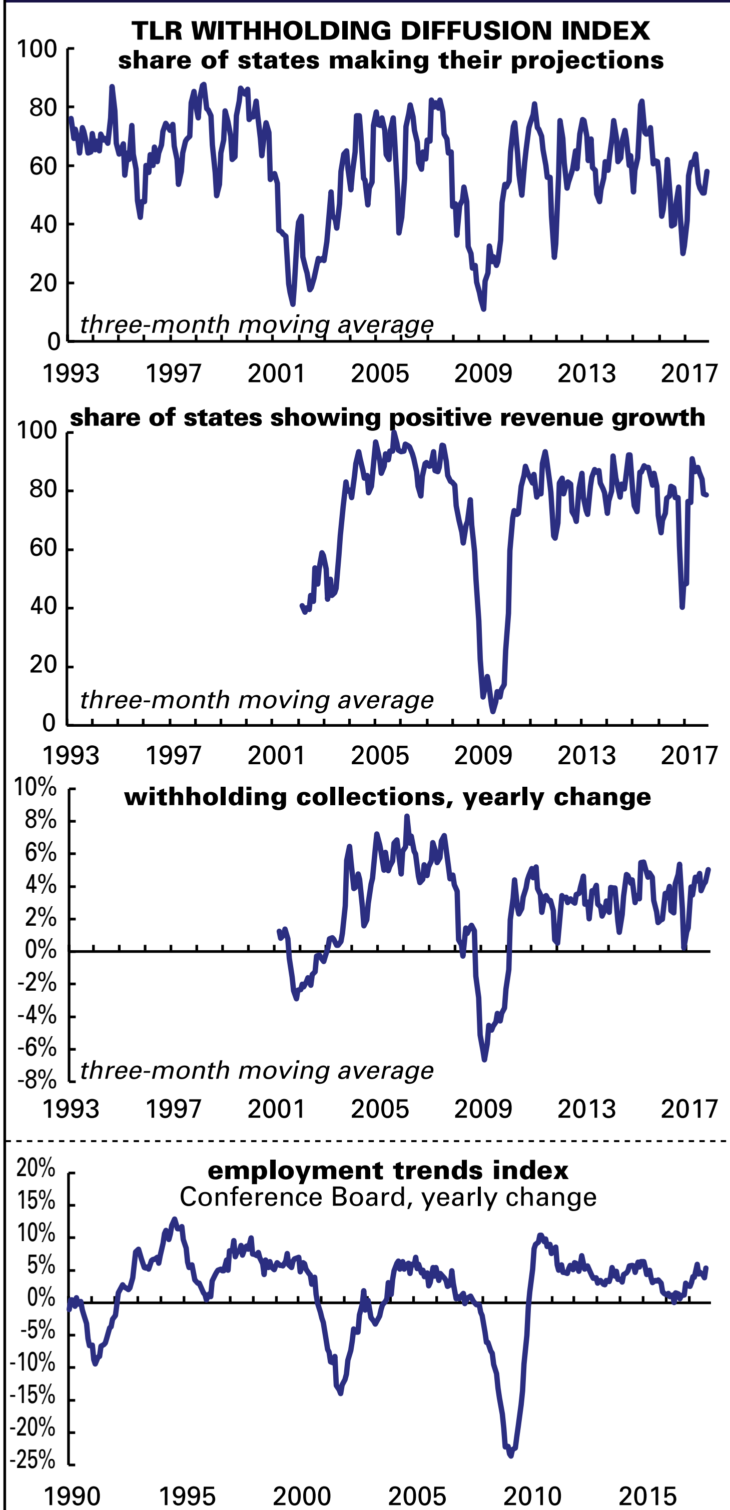
In Tuesday's Quarterly Census of Employment and Wages (QCEW) report for the second quarter, wages were shown to be up 3% over the year, well above the average hourly earnings (AHE) measure. It's not surprising they are different. The QCEW series includes bonuses and stock options, while the AHE series includes only those bonuses paid with every paycheck, which are a smallish number. That's why the payroll number is benchmarked to the QCEW employment level, but the earnings series is not benchmarked to the QCEW wage level.

A helpful QCEW contact noted that his staff receives wages, options and bonus data bundled, but that when something catches their eyes on the wage front, they can follow up with businesses, and the one-off stream almost always is responsible. He also noted that average hourly earnings once told us what we needed to know about incomes and consumption, but things are more complicated these days.

That's as far as the BLS staff is allowed to speculate. So we'll add that with the advent of more complicated executive packages, average hourly earnings have lost ground in suggesting the direction of consumption, but comparing the trends in QCEW wages and average earnings gives us additional information on disparities between the incomes of those who are eligible for stock options, and those who are not.

Oh, and the growth rate in employment reported by the QCEW, based on the near-complete coverage provided by the

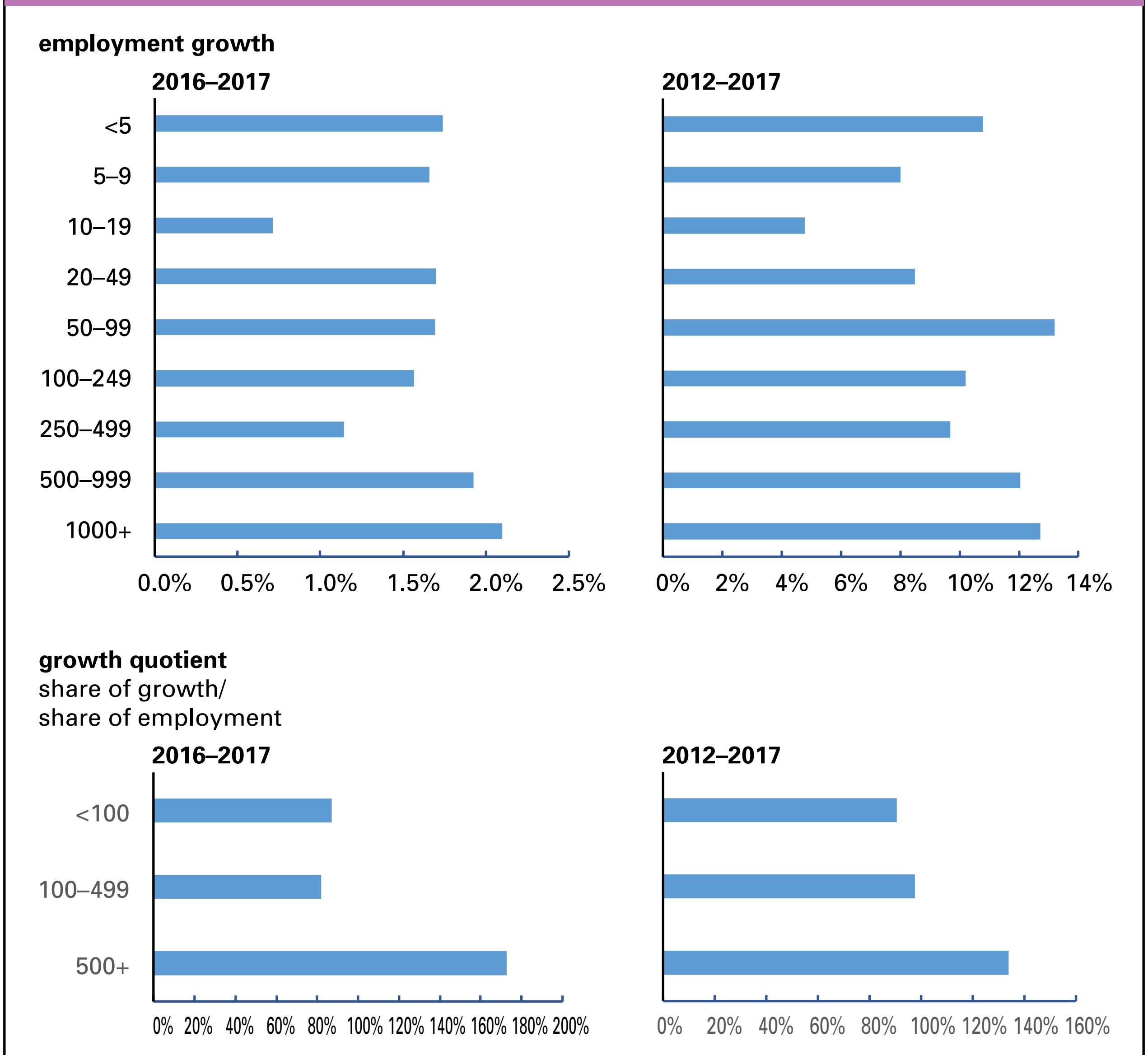
**four employment indicators**




The Conference Board's ETI leads payroll growth by about three months. It appears here with permission.

unemployment insurance system, was 1.7% for the year ending in June, compared with 1.5% for the payroll survey. For the private sector, the QCEW came in at 1.9%, vs. 1.7% for the payroll measure. The brith/death model is maligned across the political spectrum, so it's encouraging to see it revert from both sides of zero by smaller than historical percentages.

**employment growth by establishment size**
Quarterly Census of Employment and Wages

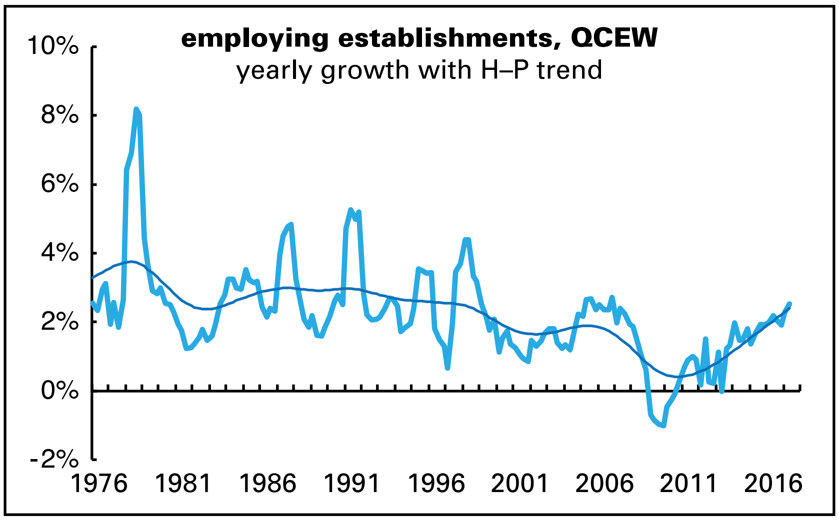



## size concerns

Speaking of the QCEW, here's yet another application of this rich survey. We often hear that small business is the engine of job growth. We've taken issue with that piece of received wisdom in the past: it's not small businesses that contribute mightily to employment, it's young ones.

Here's a fresh perspective on this exercise in fact-checking: the QCEW's data on employment by establishment size.

On p. 3 we've graphed the growth in employment by the number of employees per establishment. (The data is only available for the first quarter of each year, and starts in 2012.) Note that the smallest size classes are not in the lead—in fact, the largest, establishments with 1,000 or more employees—led the pack between 2016 and 2017, and were the second-fastest over the 2012–2017 period.




The biggest establishments are not the biggest employers: the 1,000+ category accounts for just under 11% of employment, compared with 52% for establishments with fewer than 100 workers. But the big employers are more than pulling their weight, and small ones aren't quite pulling theirs. That point is illustrated by the second set of graphs on p. 3. We've aggregated establishments into small (fewer than 100 employees), medium (100–499), and large (500+) and computed their contribution to employment growth over the two intervals shown relative to their share of total employment. So the smallest group of employers accounted for 57.3% of employment in 2017Q1 but contributed 50.4% of the year's growth in employment, for a growth quotient of 87.1% (50.4/57.3). Big employers contributed 28.6% of growth even though they account for 16.6% of employment, for a growth quotient of 172.7%, almost twice as big. Results were similar over the five-year period, 2012–2017, as well.

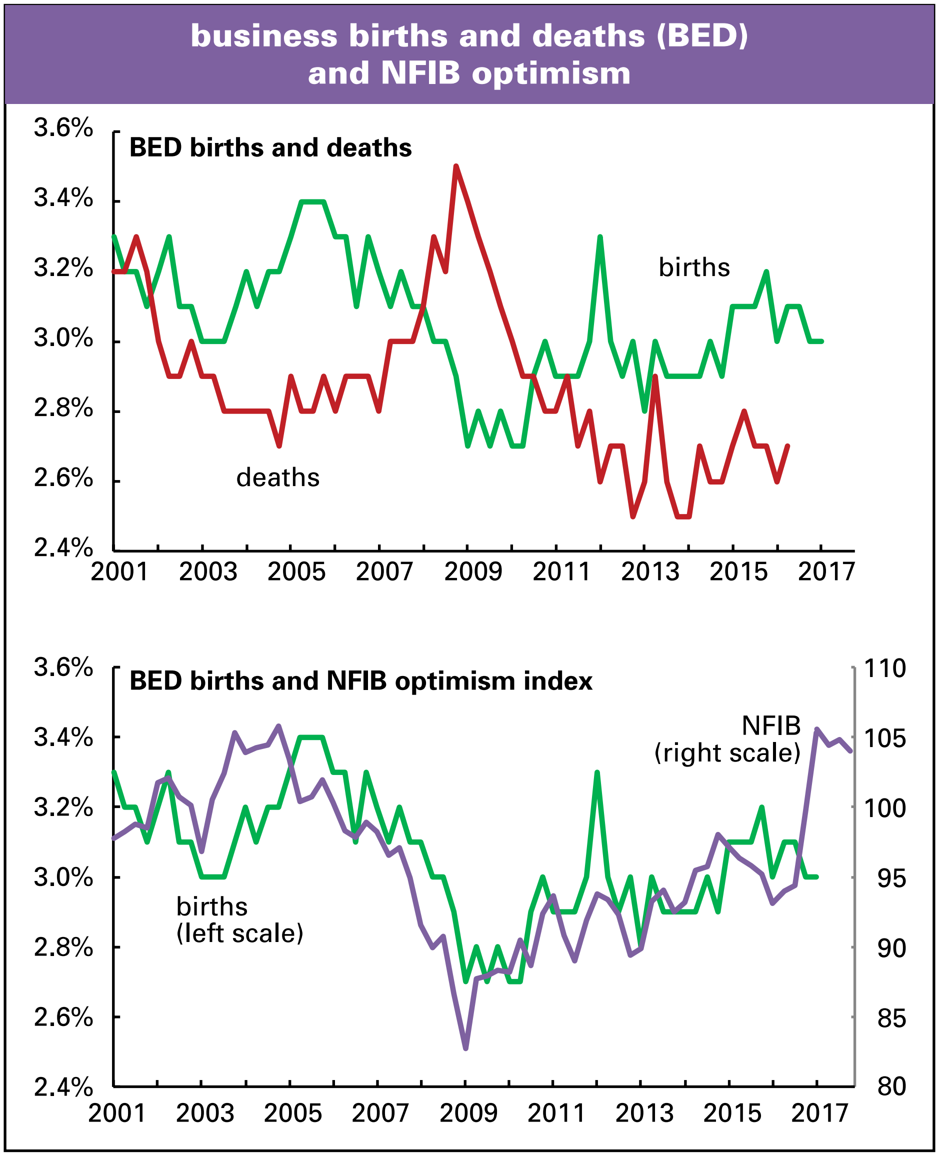
Another thing about the big boys/girls: they pay better. (No graph here, sorry.) The 1,000+ set paid a weekly wage that was 161% of the average in 2017Q1; the smaller groups, those with fewer than 50 workers, paid between 15% and 25% below the average (rounding slightly). The cult of small business is driven more by faith than fact. That makes the likely redirection of money from small business and labor to big capital likely under the new tax bill, see below, even more disheartening.

### startups and sentiment

Speaking of young firms and job growth, Tuesday's release of the QCEW data for 2017Q2 also showed the second consecutive acceleration in the yearly growth in employing establishments. (See graph, p. 4.) The gain for the year ending in June was 2.5%, the highest since the 2.7% rate in 2006Q4, and the trend rate, 2.4%, is the highest since mid-1998. This upturn began in early 2010, so it's hardly a neonate. It's a good portent for future job growth.

Will it continue? The National Federation of Independent Business's optimism index shot up after the November 2016 election and has fallen back only slightly since. That suggests a rise in startups might be in the offing. The index does have some leading properties, but as the bottom graph on p. 5 shows, the rate of business births (available only through 2017Q1) has yet to join the party. Maybe it's too soon; we'll have to watch this in the coming months.

The graph just above the NFIB/births graph sheds light on where the upturn in establishment formation is coming from: the birth rate is relatively high, though below earlier peaks. (This data comes from the Business Employment Dynamics survey.) But the death rate (which is only available through 2016Q2—the statisticians have to wait a few quarters before they can be sure an enterprise is dead) is low by historical standards



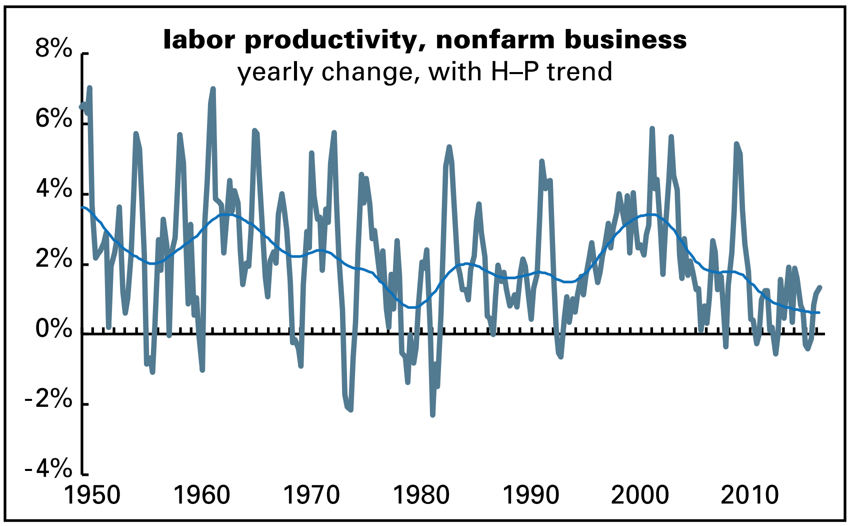

In part the low level attests to the durability of the firms that survived the recession, which runs in line with the low layoffs rate making a big contribution to payroll growth. In any case, it's nice to see the number of establishments rising.

## productivity

There was some good news about productivity in the second take on the third quarter, released on Tuesday. Output per hour in the nonfarm business sector rose at an annual rate of 3.0%. For the year, it was up a less impressive 1.3%.

Beyond the headline, though, some of the numbers were less impressive. For nonfinancial corporations, productivity was unchanged for the quarter, and for manufacturing it was down 4.4% (annualized). If nonfinancial corporations and manufacturing were so unimpressive, the unincorporated service sector must be booming!

As the graph on p. 6 shows, the trendline has yet to turn up, and the absolute level of the quarter's number doesn't look all that grand either. The story is similar for nonfinancial corporations—and for manufacturing, trend productivity growth is 0.3%.




The quarter's strong productivity gain, at least in the nonfarm business sector, sure isn't going into wages: real compensation was up at an 0.7% annual rate in the quarter for the broad nonfarm sector, and 0.5% for the corporate sector. But unit profits didn't do so well either, up just 0.1% in real terms.

**in thought...**

Ethical philosopher Julian Baggini stresses the importance of the difference between thinking cynically and acting cynically in his essay available here.

Noting that there is nothing good about those who "cynically deceive to further their own goals," many, including whistleblowers, are cynical about what they see and idealistic about what they decide to do about it. Baggini calls intelligent cynicism a searchlight for the truly positive, and argues that cynicism is a greater force for improvement than optimism because the cynic correctly assesses the obstructions special interests will erect in the way of true progress. "Progress is more of a challenge for the cynic but also more important and urgent, since for the optimist things aren't that bad and are bound to get better anyway."

**...and in deed**

It is not possible that the legislators who manufactured the new tax bill do not know the difference between the official corporate tax rate and the effective tax rate. If you lower the rate, you have to close the loopholes.

If you claim that repatriating funds is a big deal, you need to look at things like, oh, the recent Bank of America/Merrill Lynch survey in which CEOs and CFOs ranked capital expenditures fourth of four possibilities for how they would use that cash, behind debt reduction, share buybacks (AKA asset inflation), and mergers & acquisitions, which are known to consolidate jobs.

Or history. It's risky to have a debate on whether or not the 2004 tax amnesty "worked," without defining the term If you read below the headlines you'll see that amnesty program didn't work for some because they believed it would create jobs, but it worked for others because a big chunk of change did come into the country, even if it went mostly into investors' pockets, not into capital spending and job creation. So the debate is really about what "worked" means, not if that amnesty did or did not create jobs. Anyone with a rudimentary understanding of productivity might ask, Why bother?

**why not call it what it is?**

The flinty hearted voters whose prevailing issue is their own tax rates are no doubt lifting a glass these days, which makes it all the more gratifying to see those who understand this stuff come out swinging, and especially those who hold cautious and conservative views on the deficit.

David Rosenberg, of Gluskin Sheff, joked, "Whoever would have thought that a 476-page bill would be associated with simplifying the tax code?" Josh Rosner, managing partner at Graham Fischer, notes that the bill will become "cement shoes," for the Republican party, but "more consequentially it may seal the fate of the great experiment begun by our Founding Fathers…. It will permanently increase the wealth gap and reduce social mobility," because money will travel to big capital at the expense of small business and labor.

David Kotok of Cumberland Advisors shone his flashlight on a carve-out written by Pat Toomey, a Republican senator from Pennsylvania, that would exempt "all" colleges that don't accept federal student aid from the endowment tax. But, oops, apparently it would only have benefitted Hillsdale College in Michigan, a college with close family ties to current Education Secretary Betsy DeVos, and whose president was considered for the position last year. Four Republicans joined Democrats to kill it.

Kotok clarified his intent: "My point here is not just about this attempt to use a legal provision to favor Hillsdale. I've never been to that college and have no plans to visit. My point is that the political forces of our nation continue to use these special interest maneuvers…. Only the intense scrutiny of a free press saves our citizens from many politically motivated giveaways like this…. The best a citizen can do is to protect the freedom of our press and to encourage the press to report without inhibition, to remain observant and vociferous, and to not give up."

A renewable energy coalition notes that although the Senate bill keeps tax credits in place, the Base-Erosion Anti-Abuse Tax provision would undermine their ability to put the credits to use, which could put $60 billion in clean-energy investments at risk. Last spring, over at Fox News, Liz Claman reported that proposed changes to renewable energy credits were already cutting into deals and could lead to heavy layoffs in the field, which would be especially hard on rural America, a wide swath of which has benefitted greatly from construction of solar and wind farms.

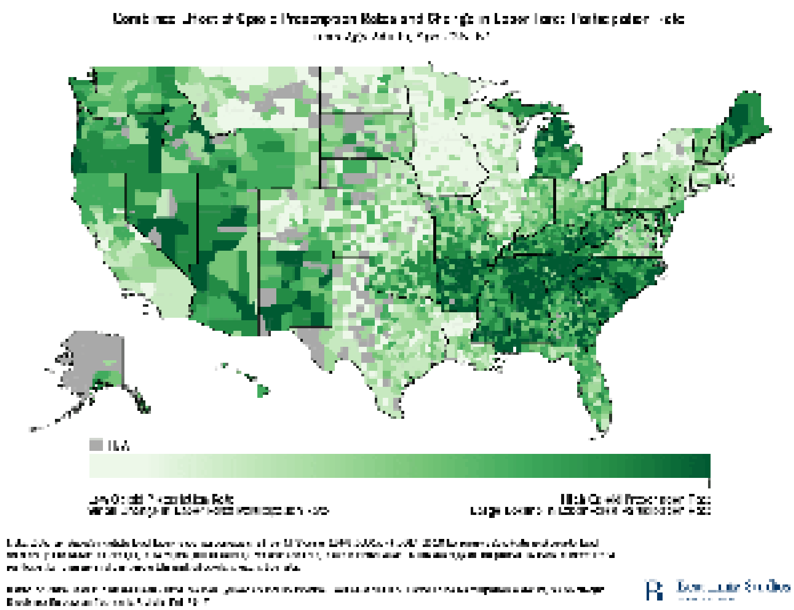
Considering effects on the stock market, the guru himself Art Cashin wrote in his laconic style, "Conventional wisdom says that given the very narrow vote in the Senate…the final version should be little changed from what originally passed the Senate. If so, that could be a problem." (Since the bills were very hastily written, especially the Senate's, the conference committee's work of reconciling the two versions will be unusually complex.)

Cashin notes that the alternative minimum tax, which would raise taxes for some companies, along with restrictions on deductions, would be major problems for the market, and he recalls that the first time there was a mention of holding the corporate cuts until 2019, as in the Senate bill, the stock market "sold off sharply."

This is included not as a critique of the bill, not our wheelhouse, but to ask just who its authors are aiming to please. We know it's not the working class, but it's not the investment class either. Rosner may be right about the choice of footwear.

**bad timing**

Rising opioid addiction and death rates create an opportunity to round up many of the problems we face as a nation. We have argued that the fear of failing a drug test probably is not what is suppressing job switching, as some have argued, but we are not going to argue with Princeton economist Alan B. Krueger's recent studies on the link between pain medication and labor force withdrawal. His findings that have made the headlines: nearly half the prime-age male workers not in the labor force take pain medications every day. Eleven percent takes prescription medicine, 16% takes over-the-counter remedies, and 20% takes both, which works out to 2 million NILF men taking prescription pain medicine every day.



When departing Chair Yellen spoke about this last summer, she said it isn't clear that "it's causal or if it's a symptom of long-running economic maladies that have…particularly affected workers who have seen their job opportunities decline." Also at Princeton, Anne Case and Angus Deaton, that's Sir to us, have detailed the despair factors in rising death rates for poorly educated non-Hispanic whites in the United States. The two report that the death rates move in line with "measurable deterioration in economic and social wellbeing," which include declines in marriage rates and labor force participation, with increases in pain, and physical and mental illness.

Yellen has a point, and Krueger notes that whatever the direction of causality, opioid use and labor-force participation are intertwined in many regions of the country, and should be a national priority.

What hasn't been in the headlines so much are the regional disparities Krueger documents. He linked declines in labor force participation with increases in opioid prescription rates to produce the map on p. 8. Much of the difference in the deepness of the green, in this case "bad," comes from medical practices. Even if you adjust the rates for the overall health of the communities, differences in practices remain "significant."

It's hard to imagine the state of a mind that would take a look at all of this and decide it's a good time to cut access to education and addiction programs.

### an enforcement problem

But not that kind. It was actually hard to believe a series of reports in the *Washington Post* in 2015–2016 detailing efforts of some members of the pharmaceutical industry to weaken DEA enforcement tools, but the reports were well documented on the record. According to those reports, in 1996 the DEA began an aggressive campaign to slow the rise of the opioid epidemic. To do so they filed civil cases that ordered suspicious distributors to immediately suspend drug shipments and pay heavy fines. No surprise this was met with a lobbying effort, but it is a surprise that by 2012 the DEA itself began denying and blocking enforcement actions. This caused such actions to fall from 131 in 2011 to 40 in 2014, before rising to 64 in 2016. As we all know, over this period the addiction and death rates were rising.

Gretchen Morgenson of the *New York Times* has argued this collusion might be attacked as a shareholder issue. The CEO of McKesson, a firm that recently paid a $150 million settlement for repeated failures to report suspicious drug orders, after having paid $13 million, and promising to ramp up compliance, in 2008, received $692 million in realized compensation since 2008. Such fines are excluded from performance measures used to determine compensation, although they risk reputations and invite Congressional inquiries, not in shareholders' best interests need we add? When Morgenson wrote her piece the shareholders were yet to meet. When they did, they voted, albeit it in a nonbinding vote, against the pay packages.

In defending the company's actions, their spokesperson cited their corporate motto, "I CARE." (Integrity, customer first, accountability and respect.) Surely many employees do care, but the overall track record suggests otherwise for the entity.

Definitely time for enlightened investors to put their shoulders to the wheel and make the markets work to their benefit.

### Friday's numbers

We don't think the payroll report could change thinking about the fully priced in December rate increase, so the risks are neither symmetrical nor asymmetrical. We expect private payrolls were up 185,000 with a 10,000 assist from government, bringing the headline to 195,000.

Seasonal factors expect layoffs in construction, but the balmy weather, rebuilding in Texas and Florida, and the state of the housing market suggest that might be misguided this year, leading to an upside surprise there. It's hard to read the hurricane effects. As we suspected in our writeup of state payrolls last month, it's a bit hard to believe that Texas employment was only down a revised 5,000 in the wake of the hurricane. Only to rebound by 71,500 in October, so we're not sure how that will play out, but we have penciled in some residual upward pressure from the rebuilding efforts.

Wages were up 0.5% in September and flat in October. We think that flatness is a reaction to September's possibly hurricane-driven outsized gain, so November should be back to trend, 0.2%, aided a friendly calendar technicality.

The Household Survey was a real mess over the last two months. Since August the population grew by 409,000, the labor force fell by 190,000, the number of employed rose by 422,000, and the number of unemployed fell by 612,000. Within that all sectors save the population lived up to their noisy reputations. The unemployment rate, of course, depends on what happens with the labor force, and since October's decline more than reversed September's also hurricane related, we believe, gain, that's a risk. But the other factors we look at suggest the rate held at 4.1%.

The stodgy work week has held at 34.4 hours for several months, and we don't know why that would change.

—Philippa Dunne & Doug Henwood