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Chairman Lewis E. Lehrman *President* John D. Mueller

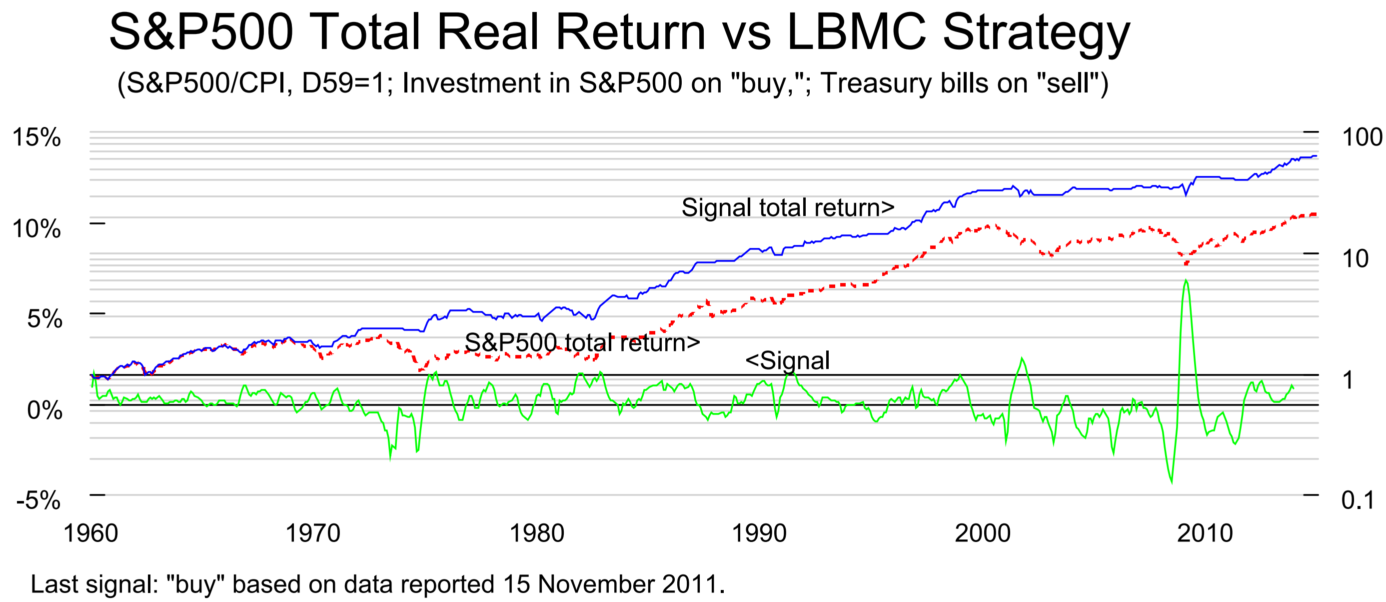
January 2015

Leave Them Laughing When You Go

By John D. Mueller

That's what I hope to do by retiring now after more than 26 years crunching LBMC's monthly economic and market forecasts. Stipulating of course that Joni Mitchell meant laughing *with,* not *at* (or cursing)—like many in these turbulent years. In this final issue of LBMC's *Economy Watch,* I've compiled the recent summary of LBMC's history and methods in *Economy Watch* and *Market Watch,* as a sort of coda.

Also as a thank-you from 'M' to those with and from whom I've been privileged to work and learn, starting with 'L' (Lewis E. Lehman), 'B' (Jeff Bell) and 'C' (Frank Cannon), our clients, and 'R'—'L's' great mentor Jacques Rueff, whose analysis of the dollar's 'reserve currency curse' (July & Oct 14 *EW*) and Rueff's Law of Unemployment (Sept & Dec 14 *EW*) we tried to implement. If I had to cite one contribution to economic forecasting, it's using the 'World Dollar Base' to predict the commodity-led price inflations (Aug14 *EW*) that triggered recessions in 1991, 2001 and 2007. It's LBMC's strategy for stock-market investing in market forecasts (Aug 14 *MW* & chart below). I plan to keep applying such principles at the nonprofit Ethics and Public Policy Center (www.eppc.org/programs/economics) to fix public policy.



Contents: page 1 of LBMC LLC's *Economy Watch* and *Market Watch*, June to December 2014.

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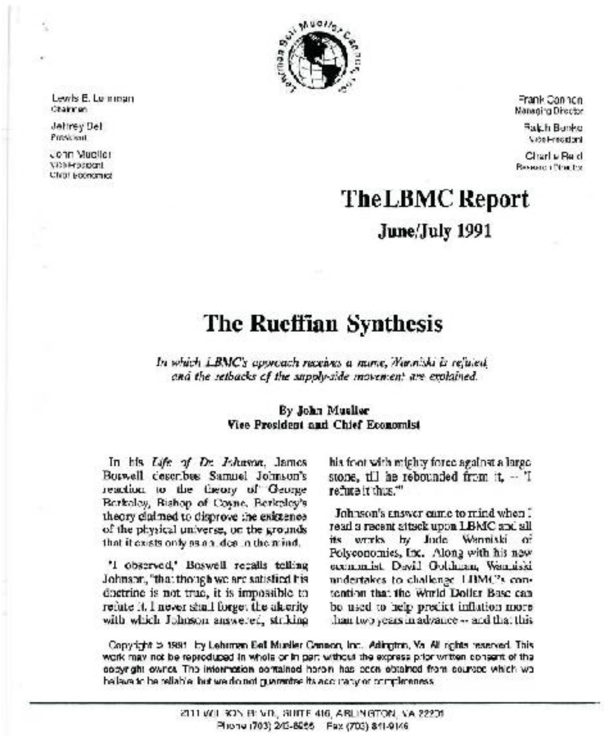
June 2014

An LBMC Retrospective: The Rueffian Synthesis



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The LBMC Report

June/July 1991

The Rueffian Synthesis

In which LBMC's approach receives a name, Wanniski is refuted, and the setbacks of the supply-side movement are explained.

By John Mueller
Vice President and Chief Economist

In his *Life of Dr. Johnson*, James Boswell describes Samuel Johnson's reaction to the theory of George Berkeley, Bishop of Coyne. Berkeley's theory claimed to disprove the existence of the physical universe, on the grounds that it exists only as an idea in the mind.

"I observed," Boswell recalls telling Johnson, "that though we are satisfied his doctrine is not true, it is impossible to refute it. I never shall forget the alacrity with which Johnson answered, striking his foot with mighty force against a large stone, till he rebounded from it, -- 'I refute it thus.'"

Johnson's answer came to mind when I read a recent attack upon LBMC and all its works by Jude Wanniski of Polyconomics, Inc. Along with his new economist David Goldman, Wanniski undertakes to challenge LBMC's contention that the World Dollar Base can be used to help predict inflation more than two years in advance -- and that this

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LBMC has been in business for 26 years, for the last 13 as LBMC LLC. LBMC originated in 1988 as Bell Mueller Cannon, Inc., becoming Lehrman Bell Mueller Cannon, Inc. in 1990 when joined by LBMC's chairman Lewis E. Lehrman. All four original principals had backgrounds in American politics including connections with then-Congressman Jack Kemp, who persuaded Ronald Reagan to adopt the basic economic principles of his two presidential administrations. Lehrman nearly became governor of New York in 1982; Bell defeated N.J. Senator Clifford Case in 1978 and is now GOP candidate for U.S. Senate. Mueller was Kemp's economist from 1979-1988; Bell and Cannon played key roles in Kemp's 1988 run for president. In part, the formation of LBMC LLC recognized and formalized the logical separation of for-profit forecasting and nonprofit public policy applications. What successes we've had are due in large part to the successful translation of the ideas of the great French economist Jacques Rueff (1896-1978: see January 2000 *LBMC Report*, available at http://eppc.org/publications/jacques-rueff-political-economist-for-the-21st-century/) In coming months we plan to summarize the principles of what Mueller described in the June/July 1991 *LBMC Report* as "The Rueffian Synthesis": http://www.thegoldstandardnow.org/the-rueffian-synthesis). These have permitted LBMC's predictions of commodity-led inflations (e.g. the 1988-90 and 2000-2008 energy spikes which triggered the 1991-2 recession and Great Recession of 2007-9) as well as our longer- and shorter-term stock and bond market forecasts.

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July 2014

An LBMC Retrospective: The Reserve Currency Curse (1986)

By John D. Mueller

As I noted in the June 2014 issue of LBMC's *Market Watch*, in coming months we plan to summarize the principles of what I once described as "The Rueffian Synthesis"—named for the great French economist Jacques Rueff (1896-1978), whose protege was LBMC's chairman Lewis E. Lehrman (http://www.thegoldstandardnow.org/the-rueffian-synthesis). LBMC's pre-history included a 1986 *Wall Street Journal* Op-Ed article, "The Reserve- Currency Curse," which (following Rueff) described the peculiarities of the U.S. dollar's role as the world's chief official reserve currency. Since the article's implications were chiefly for public policy rather than investing—I was then-Congressman Jack Kemp's staff economist when I wrote it—the article

THE WALL STREET JOURNAL THURSDAY, SEPTEMBER 4, 1986

The Reserve-Currency Curse

The world monetary system could regain a stable core if the nations with the largest market economies agreed to settle their accounts with one another in gold, not dollars.

can still be viewed on the website of the non-profit Ethics and Public Policy Center: http://eppc.org/publications/the-reserve-currency-curse/) Having failed despite many years of trying to convince U.S. economic policymakers to change the policy, we founded LBMC to predict the consequences of that failure, as they work their way through the world's markets for money (p. 3), prices (pp. 4-7) and real quantities of goods (pp. 8-10) .

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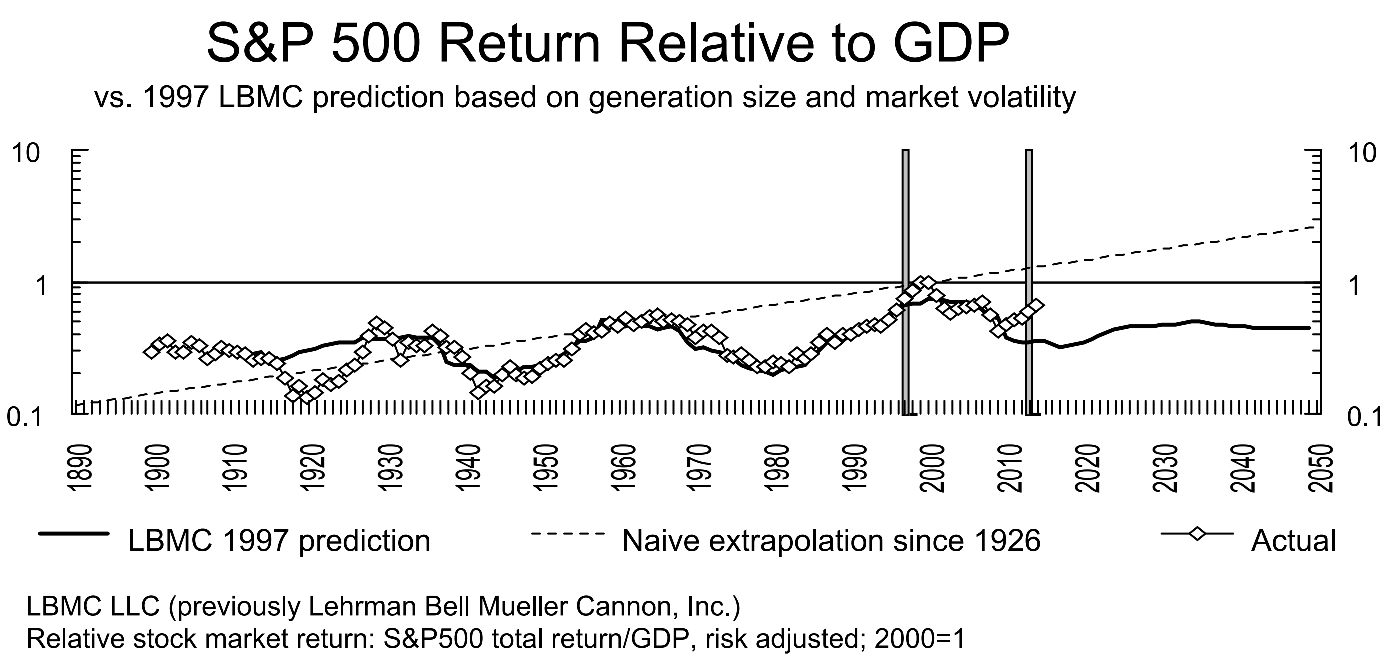
July 2014

LBMC's Stock-Market Forecasts: Long-term (1997)

In one of three 1997 papers analyzing plans to "privatize" pay-as-you-go Social Security, we showed that "the stock market, apart from random variation, is largely determined by...the rate of economic growth, the varying size of generations, and the market's volatility risk" (http://eppc.org/publications/if-economic-growth-falls-to-1-4-what-happens-to-the-stock-market/). It concluded that the Social Security "actuaries' projections imply that the same factors that drove average real stock market returns up to 10% in the past 20 years will drive returns down to 1.5% in the next 20 years — almost exactly like the periods from 1901 to 1921, from 1928 to 1948, and from 1962 to 1982." Also, "the same projections imply an average real return on the stock market of 3.2% over the next 75 years." The chart compares the model with the stock market's performance since, measured relative to real GDP. Also shown: the widely used (but wildly optimistic) extrapolation of equity returns since 1926.



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August 2014

LBMC Retrospective: 'CPI at 7%? Bet Your Reserve Dollar' (1989)

By John D. Mueller

THE WALL STREET JOURNAL.

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EASTERN EDITION FRIDAY, FEBRUARY 24, 1989 WHITE OAK, MARYLAND

CPI at 7%? Bet Your Reserve Dollar

By JOHN MUELLER

The "surprise" jump in producer and consumer price inflation is not a surprise when you understand the political and economic logic of using one nation's domestic currency—the U.S. dollar—as international money. Domestically oriented analysts have been fooled because U.S. inflation responds to the world wide supply of dollars, not just those in the U.S.

The Bush administration fervently hopes the latest figures are just an aberration. Such arguments must be used with caution. (The Carter administration used to tell us that if you took away food, energy and housing, the underlying rate of inflation was only 9%.) True, the price of crude oil jumped more than $5 a barrel from November to Japuary. But analysts knew what oil prices were, and they were still surprised. Moreover, oil prices fell sharply for most of 1988 without a fall in the inflation rate. Everything points to a broader acceleration of inflation.

While some point to rising wages or energy costs, the main cause of the current inflation is the past expansion of what my forecasting firm calls the "world dollar base"—the stock of high-powered money (currency plus bank reserves) in the U.S., plus the dollars held by foreign central banks. The world dollar base is key because the world operates on a kind of "dollar standard." Other currencies are no longer pegged to the dollar. But most currencies, including the Japanese yen and West German mark, are backed with dollars, as currencies once were backed by gold reserves. The dollar shared this role with gold under the Bretton Woods monetary system of 1944-71. But since 1971, the dollar has been the unchallenged "reserve currency," even with somewhat greater use of the yen and the mark by small countries.

This change had an important, but overlooked, consequence for the U.S. "twin deficits": budget and trade. Under the dollar standard—as under a gold standard—the rest of the world must consume and invest less than its income in order to acquire reserves (sought for reasons I shall note). In economic jargon, this is called running an overall "balance-of-payments surplus." It's analogous to the fact that to put more cash in your wallet, you must pay out less than you earn, beg or borrow.

But it's different for the reserve-currency country. If other countries increase their dollar reserves, the U.S. must pay out more than it receives—run a chronic "balance-of-payments deficit." To get a rough idea of the difference, imagine that everyone carried your personal checks around in his wallet instead of money. You wouldn't need to carry any cash—just your checkbook. And with so many of your checks floating around permanently uncashed, you would always have a fat checking-account balance at your disposal, far beyond what you had saved.

Likewise, the U.S. now has about $500 billion in its "checking account." U.S. monetary authorities hold perhaps $60 billion to $100 billion less in foreign exchange than would be necessary if the dollar were not the universal reserve currency; and foreign central banks hold an ever expandable base (now about $400 billion) in U.S. dollar assets (including "Eurodollars") as backing for their currencies.

In charge of this "checking account" is the U.S. government. Foreign dollar reserves ultimately are debts of the U.S. government, and the bulk are invested directly in Treasury securities.

Now, when central banks create half-a-trillion dollars worth of net dollar reserves, the U.S. Congress gains the potential ability to spend up to $500 billion more than it taxes from U.S. citizens or borrows from private investors.

Congress does not have to do so, and for many years it did not spend as much as it could have. In the 1970s, the expansion of dollar reserves was so vast that even after financing growing U.S. trade deficits, there was enough to flood the banking system with U.S. loans to "developing" countries. But in the course of the 1970s and 1980s, the whole $500 billion has gone to finance U.S. deficit spending and trade deficits. Obviously, other factors influence the trade deficit. But it is probably no coincidence that the official "net debtor" position of the U.S. ($368 billion at the end of 1987, and about $500 billion today) approximately equals the dollar assets of foreign central banks. This implies that, apart from the

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August 2014

LBMC's Stock-Market Forecasts: short– to medium-term (2001).

Continuing our retrospective overview of LBMC's basic methodology, we focused last month on our long-term (75-year) forecast of the U.S. equity market, which we first elaborated in a series of reports beginning in October 1997. Though remarkably prescient in anticipating the stock market's peak by 2000 and subsequent decline, any method based on annual data necessarily falls short when advising whether to be long the stock market at any given moment. Three years later, in the April 2000 *LBMC Report*, we put forward "A Rational Explanation for P/E Ratios" (later summarized in the nearby *Barron's* article —which didn't appear until June 2001). Then in the April 2001 *LBMC Report* we posed the question, "Is Equity-Market Timing Possible?" We answered with "a qualified 'yes,'" showing how to convert the relationship between producer output prices to input costs into what is now LBMC's Equity Buy/Sell Signal (pages 6-7).


BARRON'S

OTHER VOICES

VIEWS FROM BEYOND THE BARRON'S STAFF

Driving the Market

Looking for a rational theory of P/E ratios

BY JOHN MUELLER ● Everybody on Wall Street talks about price/earnings ratios, but, like the weather, nobody does anything about them. Though the P/E ratio of the whole equity market is the benchmark against which every individual stock is compared, its behavior is not well understood even by experts. Many analysts who use standard theories have concluded

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September 2014

LBMC Retrospective: Rueff's Law (1993-4)

By John D. Mueller

As noted in the June 2014 issue of LBMC's *Market Watch*, for the rest of this year we are summarizing the principles of what I once described as "The Rueffian Synthesis"—named after the great French economist Jacques Rueff (1896-1978). One of the most fruitful is "Rueff's Law"—the relation between the share of labor income in total national income, and the unemployment rate, with which Rueff explained the unprecedented appearance of chronic unemployment in the U.K. in the 1920s and 1930s. We explained and updated Rueff's Law in a series of *LBMC Reports* in 1993-94, including 'How Can Wages Fall While Unemployment Rises?' (March 1994: http://eppc.org/publications/how-can-wages-fall-while-unemployment-rises/), demonstrating the relation for the United States, and 'A Challenge to Conventional Labor Market Wisdom' (May 1994: http://eppc.org/publications/a-challenge-to-conventional-labor-market-wisdom-the-wedge-versus-social-wage-comment/), showing the same relationship in the U.K. (Samuel Brittan summarized the latter in the *Financial Times*, above). An updated U.S. chart is shown at the top of page 9, also compared with the pre-tax, pre-transfer measure used by French socialist Thomas Piketty in *Capital in the 21st Century*.

FINANCIAL TIMES

THURSDAY JULY 21 1994 — USA $1.50 Canada C$1.75 Bermuda

ECONOMIC VIEWPOINT

'Wedge' versus 'social wage'

By Samuel Brittan

Theories about the causes and cure of unemployment arrive in every post. One way to keep one's head above water is to examine together clusters of ideas with a common core, even though this does less than justice to each individual variant. A cluster, known for a long time but growing in popularity, is called the 'wedge theory'.

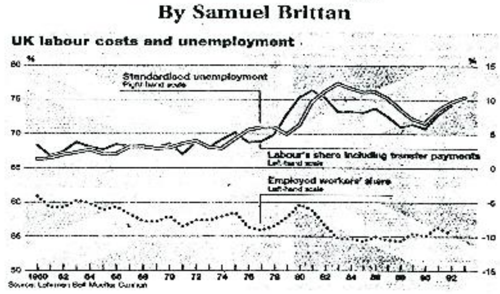
The wedge is the gap between what the employer pays in wages and what the worker takes home. In its simplest form it runs: there are so many add-ons on top of the wage bill to pay for social benefits that labour has become expensive to employ. Non-wage labour costs were estimated by a House of Lords report[1] to amount to 44 per cent of total labour costs as an EU average, but 'only' 30 per cent in the UK. In Japan they were 24 per cent and in the US 28 per cent. Businesses understandably seek to avoid these add-ons by mechanisation, labour-saving drives, macho management and so on.

As Anthony de Jasay[2] has put it: "Social protection costs more than it is worth to at least some of those that it protects. The result is that, at the margin, employment is taxed more than the subsidy is worth to workers . . . and there is a net extra burden on the economy. Enterprises have to restructure and unemployment is born of social protection."

Why are these wedge theories so familiar? It is because they have been previously promulgated in a very different political setting by leaders such as Harold Wilson, UK Labour prime minister in the 1960s and part of the 1970s.

Wilson called the wedge the 'social wage'; and he used it to sell pay restraint, arguing that real wages were much higher than take-home pay because part of workers' remuneration took the form of welfare state benefits, such as health, education, social security and so on. He used this notion in his campaign for pay restraint.

One of the most numerically sophisticated recent attempts to stand up the wedge doctrine has come from a US securities economist, John Mueller[3]. He relates unemployment to what economists used to call 'efficiency wages', that is pay adjusted for prices and productivity. He shows that, on plausible assumptions, efficiency wages can be approximated by 'labour's share of the national income'. To arrive at the latter he subtracts from gross pay taxes on labour, such as payroll levies and a share of income tax. He adds on domestic transfer payments, which are mainly for social security.



Source: Lehrman Bell Mueller Cannon

The adjusted series throws light on one paradox: why has UK unemployment risen so much over the last decade and half when the combination of labour market shakeout and Thatcherite policies has pressed down on pay relative to profits? The accompanying chart suggests that although the *employees'* share of the national income has fallen, *labour's* share, after making the fiscal adjustments just described, has actually been 5 to 10 percentage points higher than it was in the 1970s.

There are several points to clarify. It is not always realised that there is little difference, apart from presentation, between social security contributions levied on employers and those levied on employees. Both will be passed forward into the cost of labour. For instance, the main impact of UK mainstream National Insurance contributions derives from their total weight of just over 20 per cent, rather than from the fact that they are divided almost equally between employers and employees.

In some European countries with high payroll contributions, a shift from payroll taxes to income taxes or indirect taxes such as VAT has been discussed. But this would not solve the problem either. Income tax is – like payroll taxes – an almost proportional levy on wages and salaries, with some alleviation at the bottom of the scale. Indirect taxes are taxes on that proportion of income (about 90 per cent) that is spent. If workers have the market power to make employers recoup in higher pay the burden of payroll taxes, they also have the power to recoup other taxes levied directly on their incomes or expenditure.

The focus on non-wage costs is questionable. All per capita labour costs matter

The wedge theory was originally advanced not as an explanation for unemployment, but as a warning about the distortions to the supply of effort which too ambitious a welfare state could impose. This can be seen from the earlier writings[4] of Assar Lindbeck, the Swedish economist who pioneered the wedge theory when Sweden still had full employment.

The wedge may nonetheless affect employment for three reasons:

- Workers do not value the social wage as much as take-home pay, and at the margin are less inclined to take jobs or more inclined to work shorter hours. Unemployment of this kind is surely voluntary.
- Union representatives do not fully take into account the social wage and insist on higher settlements than they otherwise would, to recoup the tax wedge. As a result, workers are priced out of jobs.
- There are many factors other than the immediate state of the labour market that determine employers' pay offers. These factors cover ideas of fairness and a desire for labour goodwill. They discourage employers from trying to recoup the wedge in lower pay, but they respond by cutting payrolls instead.

Other questions arise. Why should the size of the wedge be limited to benefit expenditure? De Jasay includes all welfare expenditure – health and education as well as benefits. But why stop even there? Surely taxes on workers to pay for military expenditure, public administration or interest on the national debt are just as much part of the wedge.

What then are the policy implications of the wedge theory? Many of the academics who espouse it suggest that social security contributions should be actuarially related to benefits. In other words, contributions to finance the dole should be related to the chance of falling out of work in the particular occupation; and social security rates should be sufficient to finance state pensions on normal actuarial expectations.

In these circumstances, the argument goes, payroll levies would be for defined benefits, for which workers would be prepared to pay without recouping in wages. The view is plausible only if the actuarial contributions are also voluntary – in which case a social security system could hardly be said to exist. Moreover, the actuarial principle could not realistically cover health and education, let alone non-welfare spending.

The whole focus on *non-wage* labour costs is open to suspicion. It appeals to politicians because it looks less like union-bashing, and British ministers can also feel self-satisfied because the burden of these costs is less in the UK than in other EU countries.

But it is surely *total labour costs per head* which determine whether it is worthwhile to employ an extra person. These include pay and non-pay elements. Some of the latter escape measurement, such as restrictions on hours or on adjusting pay fully to age, experience or skill. All these things make workers expensive and it is arbitrary to pick on any one of them. 'Pricing out of work' is still the best encompassing formula.

[1] *House of Lords Select Committee on European Communities, HL paper 43, April 19 1994.*
[2] *Anthony de Jasay, A Vicious Circle of Social Kindness, Financial Times, April 29 1994.*
[3] *J Mueller A Challenge to Conventional Labour Market Wisdom. Lehrman, Bell, Mueller, Cannon 110 North Glebe Road, Suite 1060, Arlington, VA 22201.*
[4] *Assar Lindbeck, The Welfare State, Edward Elgar, 1993.*

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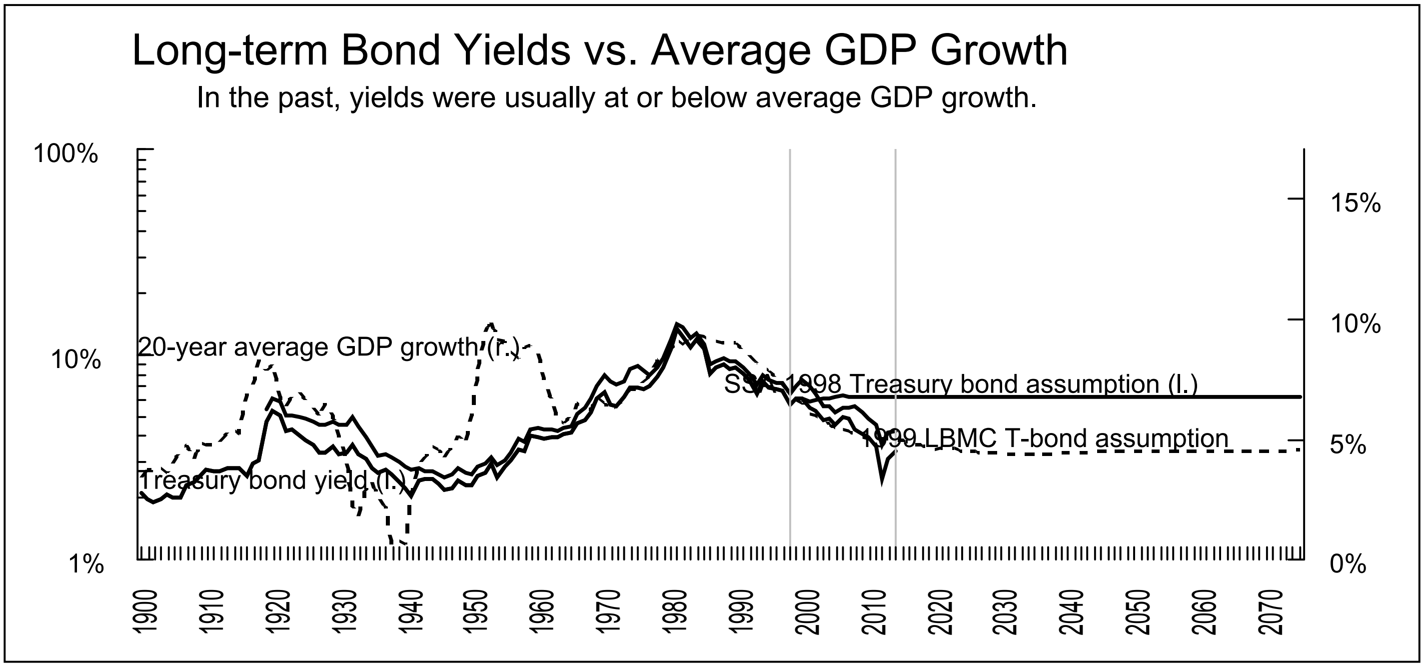

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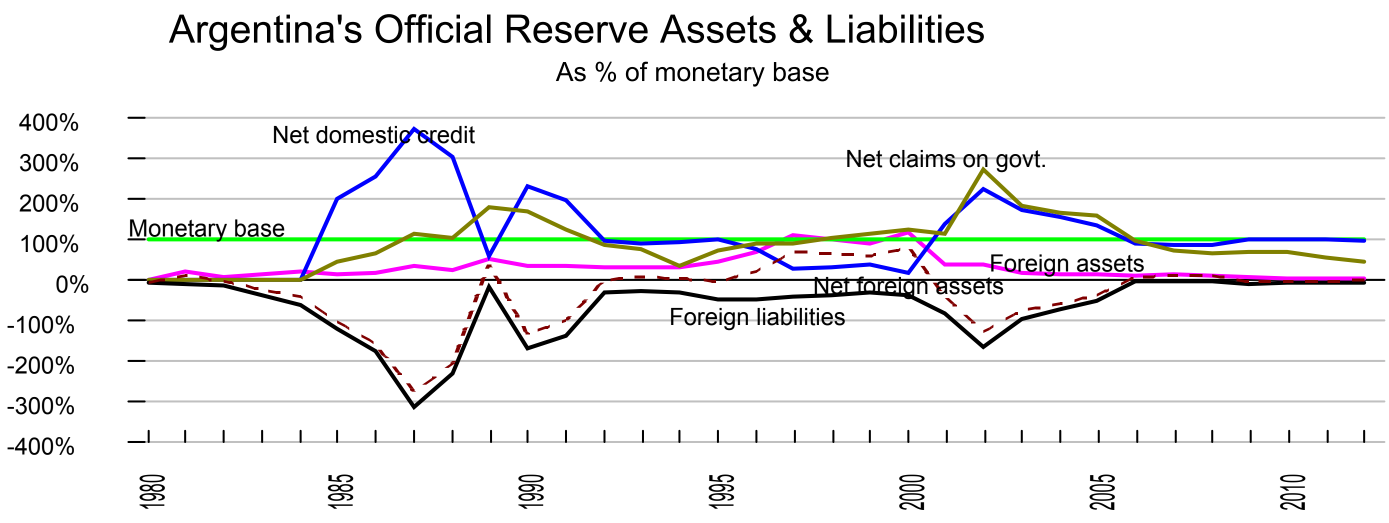
By John D. Mueller

As we noted in the June 2014 issue of LBMC's *Market Watch*, for the rest of this year we are summarizing the principles of "The Rueffian Synthesis"—named after the great French economist Jacques Rueff (1896-1978). Rueff was the first economist to describe the drawbacks of John Maynard Keynes's plan to use one nation's domestic currency, like the U.S. dollar, as an international reserve asset. Predicting episodes of commodity-price inflation using the World Dollar Base has been our bread and butter (page 5). But we've noted similar peculiarities when monetary authorities issuing currencies not typically used as official reserve currencies borrow from other central banks—for example, the European monetary system in 1992 (http://lehrmaninstitute.org/economic-policy/articles/1993%2001%2004%20-%20WSJ%20-%20The%20Curse%20of%20Being%20a%20Reserve%20Currency.pdf), Mexico in 1996 (https://archive.org/stream/mexicanpesocrisi00unit#page/292/mode/2up/search/mueller, pp. 292-312) and Israel. The same was true also of Argentina's 2001 peso crisis , which scarred a generation of Argentines, including then-Cardinal Jorge Bergoglio—now Pope Francis. As the chart below shows, Argentina erred by trying to peg its peso to the U. S. dollar, not by *acquiring* but rather *borrowing* official dollar reserves—using the proceeds to finance domestic lending, chiefly to the government.



Source: IMF

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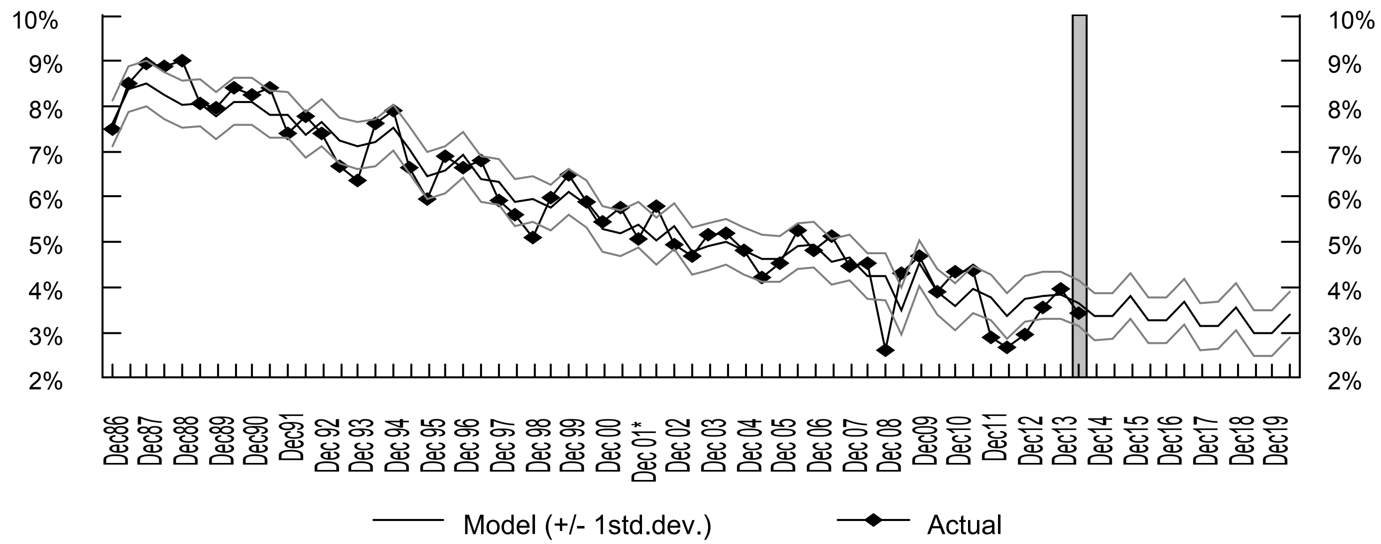
LBMC's 30-Year Treasury Bond Model



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November 2014

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By John D. Mueller

As we noted in the June 2014 issue of LBMC's *Market Watch*, for the rest of this year we've been summarizing the principles of "The Rueffian Synthesis"—named after the great French economist Jacques Rueff (1896-1978).

Though LBMC has updated and applied Rueff's ideas to forecasting the economy and markets, we have also proposed U.S. economic policy reforms we believe are in the public interest. We proposed the "LBMC Plan" for income tax and social security reform to the 1995-96 National Commission on Economic Growth and Tax Reform. And in December 2012, we summarized a comprehensive economic plan to update the four basic principles of all economically and politically successful American economic policy. We called it "The Agenda: What Is to Be Done."

As we noted in the December 2012 *Economy Watch*, "We think the agenda will update and apply these successful principles as follows:

1. "Instead of taxing income when *received* by workers and investors, all labor and property income will be taxed when first *paid* by businesses, governments or non-profit foundations, at a single flat rate, with no exclusions or credits (including capital gains and capital consumption allowances). A single credit for 'human maintenance,' based solely on family size, will rebate income *and* payroll taxes up to the poverty level.
2. "Current Social Security, Medicare and Medicaid benefits will be balanced by current payroll taxes and premiums. But if legal abortion continues—which caused the entire prospective deficits by cutting the workforce and U.S. total fertility rate (from 2.5 to 1.9 children per couple)—benefits will be proportional not only to past contributions but also to the number of children each worker has raised.
3. "Unemployment insurance—which added more than 3 percentage points to the unemployment rate when it was extended to as many as 99 weeks—will be restored to its original 26-week limit.
4. "Automatic open-ended financing of Federal deficits by the Federal Reserve and foreign central banks will be ended, by defining the dollar again as a weight of gold, while refunding existing official dollar and other foreign currency reserves, much as Alexander Hamilton refunded the massive Revolutionary War debt." The November elections offer The Agenda new promise.

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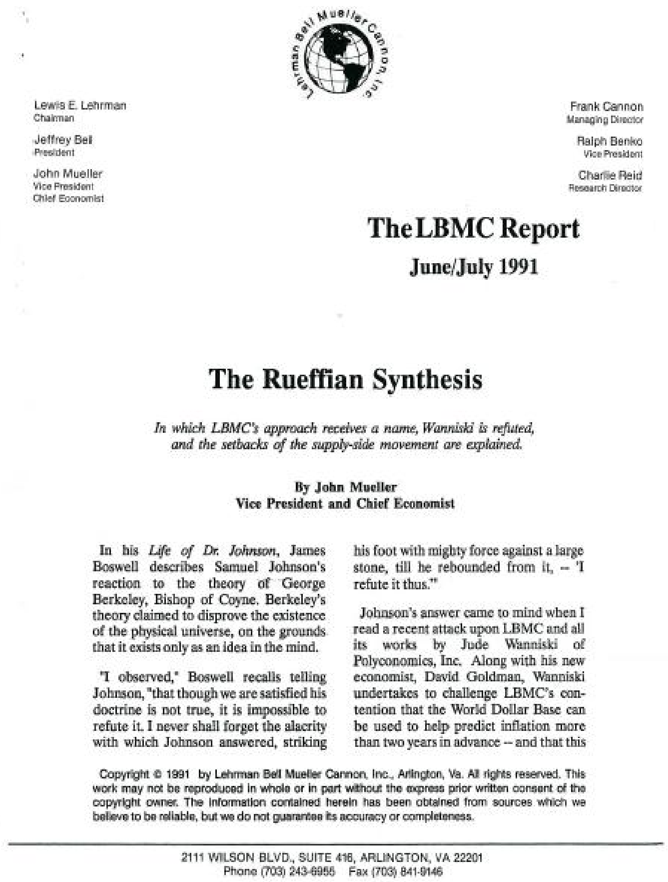
November 2014

'The Rueffian Synthesis' Again (1991)

By John D. Mueller

In the June 2014 issue of LBMC's *Market Watch* we began summarizing the principles of "The Rueffian Synthesis"—named after the great French economist Jacques Rueff (1896-1978). In founding Lehrman Bell Mueller Cannon, Inc., of which LBMC LLC is the successor, we were motivated not only by the desire to earn a living but also to settle policy disagreements among former staffers and advisers to then-Congressman Jack Kemp (1935-2009) that could not be settled by differing theories alone. Lewis Lehrman had been Rueff's protégé, The Lehrman Institute had published Rueff's complete works in French, and Lew persuaded Rueff to write his autobiography. At LBMC we updated and tested Rueff's theories with empirical evidence. LBMC's first big call was to predict, based on the 1986-1988 expansion of the World Dollar Base, the sharp rise in PPI and CPI inflation in 1989-90 (p. 2), the Fed's response of interest rate hikes, and ensuing 1991-92 recession. When Jude Wanniski at Polyconomics, Inc., disputed the prediction, I wrote a long *LBMC Report,* "The Rueffian Synthesis," which tried to explain how we at LBMC had applied Rueff's analysis, and responded to Jude's objections. I showed the basic trouble with his proposal of targeting the price of gold: the policy involves buying and selling dollar securities, initiating a roundabout arbitrage in the financial markets and real economy, while the gold standard ultimately involves buying or selling gold, tying monetary policy directly to the commodity market. The lag between World Dollar Base changes and their effect of commodity markets, including the gold price, is simply too long to make gold-price-targeting feasible, since the Fed would in effect be reacting to echoes of what it and other central banks had done one to three years earlier. Lew and I co-authored a 'Rueffian' *Wall Street Journal* op-ed article: "How the 'Reserve' Dollar Harms America," http://online.wsj.com/news/article_email/how-the-reserve-dollar-harms-america-1416527644-lMyQjAxMTI0NDI4MTcyNjE2Wj



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The LBMC Report

June/July 1991

The Rueffian Synthesis

In which LBMC's approach receives a name, Wanniski is refuted, and the setbacks of the supply-side movement are explained.

By John Mueller
Vice President and Chief Economist

In his *Life of Dr. Johnson*, James Boswell describes Samuel Johnson's reaction to the theory of George Berkeley, Bishop of Coyne. Berkeley's theory claimed to disprove the existence of the physical universe, on the grounds that it exists only as an idea in the mind.

"I observed," Boswell recalls telling Johnson, "that though we are satisfied his doctrine is not true, it is impossible to refute it. I never shall forget the alacrity with which Johnson answered, striking his foot with mighty force against a large stone, till he rebounded from it, -- 'I refute it thus.'"

Johnson's answer came to mind when I read a recent attack upon LBMC and all its works by Jude Wanniski of Polyconomics, Inc. Along with his new economist, David Goldman, Wanniski undertakes to challenge LBMC's contention that the World Dollar Base can be used to help predict inflation more than two years in advance -- and that this

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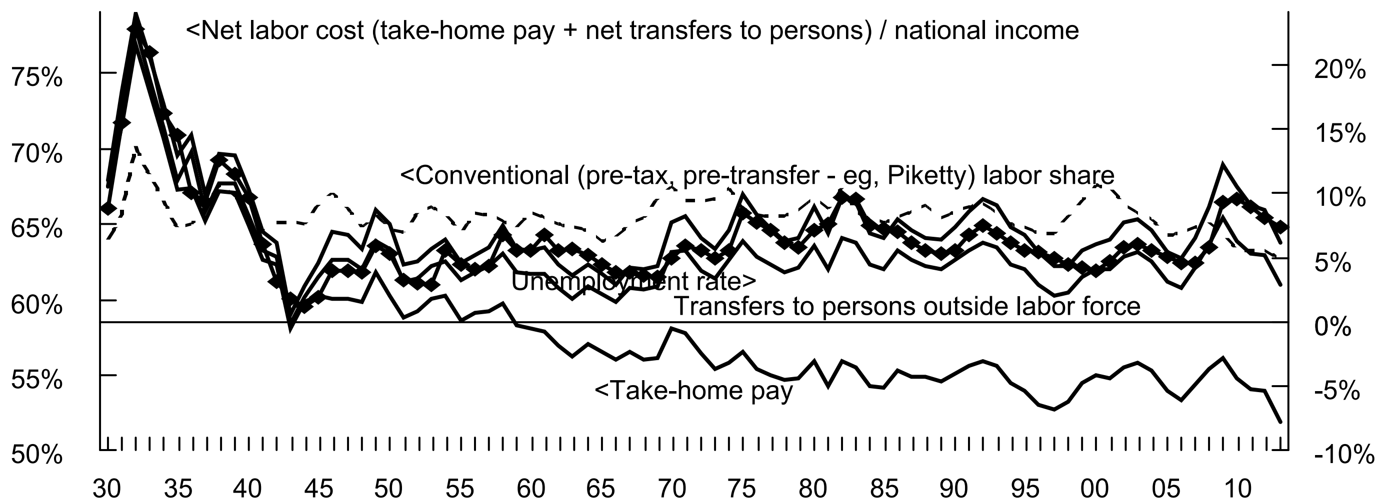
Rueff's Law in the USA
U.S. Net Labor Cost vs. Unemployment



An LBMC Retrospective: Rueff's Law & the Middle-Class Squeeze (1993-2014)
By John D. Mueller

As we proposed in the June 2014 issue of LBMC's *Market Watch*, for the rest of this year we've been summarizing the principles of "The Rueffian Synthesis"—named after the great French economist Jacques Rueff (1896-1978). In a series of *LBMC Reports* beginning in 1993 (and continuing through 2014), we focused on an issue that has increased steadily in salience (most recently by the French socialist Thomas Piketty): the "middle-class squeeze." In developing our thesis we applied 'Rueff's Law': the close relationship, first demonstrated by Rueff, between the share of labor income in total national income (measured after taxes and social benefits) and the unemployment rate. As we noted when analyzing Piketty's thesis in the April 2014 issue of LBMC's *Economy Watch* ('Monsieur Piketty, Meet Monsieur Rueff'), Piketty measures income *before* the sort of steeply redistributive policies he proposes. "Workers' take-home pay *has* been reduced," we showed, "—but by expanded shares to the unemployed and those outside the labor force—not 'capitalists.'"

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