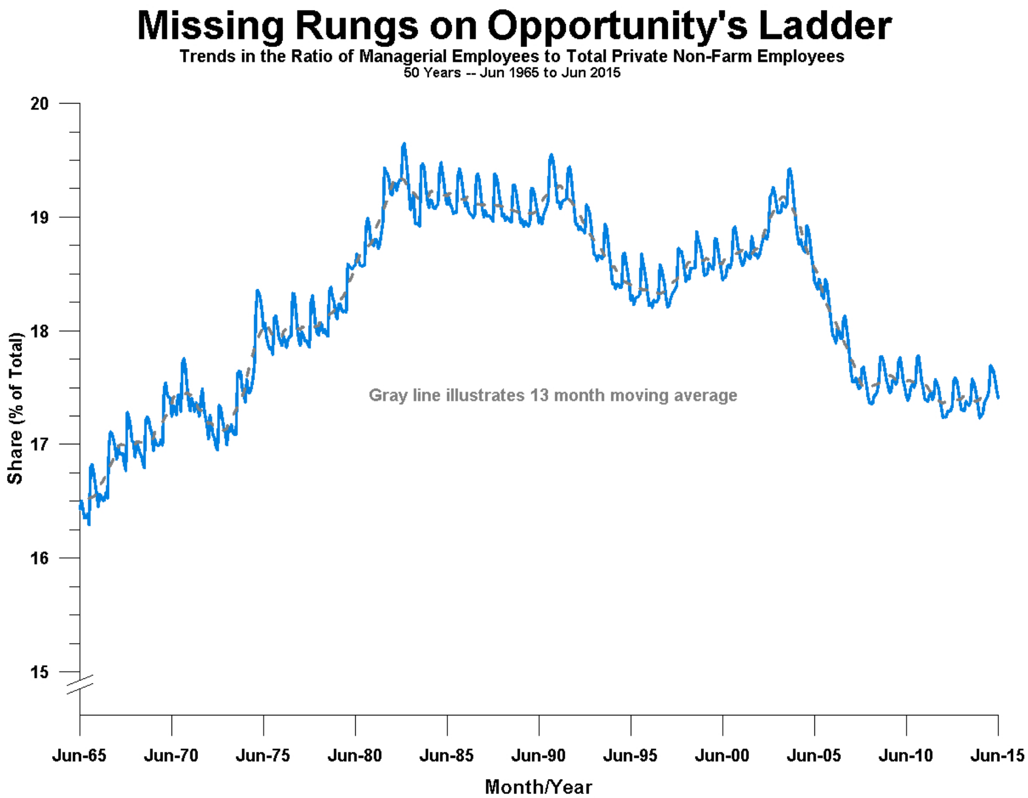
Straight from the Muse
Reflections of a Worldly Philosopher

The Woes of the Managerial Class



Notes:

The chart was created using data obtained from the Bureau of Labor Statistics' (BLS) Monthly Employment Situation report and data base.

Employee levels reflect individuals working for non-farm, private enterprises. Federal, state and local government workers are excluded from the count. Firms in the BLS payroll survey report aggregate employment numbers (less owners, partners, etc.) and non-supervisory and production worker levels. No separate count is made for managerial employees. The total for the latter is an imputed series, equal to the difference between the total payroll count and the non-supervisory and production employees payroll count. The managerial share is thus the ratio of this difference to the aggregate number of employees on the payrolls of non-farm, private businesses.

The analysis uses non-seasonally adjusted (NSA) statistics. These are the actual aggregate levels reported by survey firms, unadjusted for recurrent annual seasonal trends causing monthly spikes and declines in employment levels. The dotted gray line illustrates the 13 month moving average. This line conveys the secular trend smoothed for seasonally induced fluctuations.

(Sources: BLS; Worldly Philosopher estimates.)

For all of the media attention the Bureau of Labor Statistics' (BLS) monthly Employment Situation Report receives, actual analysis remains wanting. Even venerable and respected news organizations offer little original insight into some of the more obvious underlying trends.

This is a shame since the recent hype — over the slight acceleration in the monthly increase in non-farm payrolls — obscures real fundamental weaknesses in the U.S. labor markets. One example, which has received scant coverage, is the declining percentage of managerial positions. For generations these

"What is bureaucracy? An arrangement of individual incompetences for the purpose of general responsibility."

Anton Kuh (1890 to 1941), Austrian Journalist and Commentator

"By continuing a process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens."

John Maynard Keynes (1883 to 1943), British Economist and Political Commentator

"Corporation, n. An ingenious device for obtaining individual profit without individual responsibility."

From the *Devil's Dictionary*

Ambrose Bierce (1842 to 1913?), American Journalist and Writer

Yeah, I am on Twitter too. Follow my sporadic tweets at *mymuseclio*.

"A good politician is quite as unthinkable as an honest burglar."

H.L. Mencken (1880 to 1956), American Man of Letters

"Any man can make mistakes, but only an idiot persists in his error."

Marcus Tullius Cicero (BC 107 to 44),
Roman Senator and Political Philosopher

"I am a firm believer in the people. If given the truth, they can be depended upon to meet any national crisis. The great point is to bring them the real facts."

Abraham Lincoln (1809 to 1865), 16th President of the United States

positions have enabled many to attain middle class incomes and lifestyles. As these roles disappear, or at best, if their numbers grow at a slower pace, opportunities diminish for current and future workers.

As of the June employment report, I estimate managerial positions (as opposed to production and non-supervisory roles) accounted for 17.4 percent of total private (non-government) non-farm payrolls. Ten years ago, in comparison, the ratio was 18.4 percent. Now a one percent difference does not sound like much. But consider this: non-seasonally adjusted (NSA) private non-farm payrolls totaled 121.0 Million in June. A one percent difference thus translates into 1.2 Million fewer managerial positions. Given that there are a like number of American households, approximately 1.2 Million more might be headed by a breadwinner counted among the managerial class.

While the ladder of opportunity narrows as it is climbed, an additional 1.2 Million more white collar, managerial positions adds one or two more rungs to the ladder. Rungs that are particularly important near the bottom of the ladder. So for all of the left's lamentations on the sclerosis in economic mobility, little mention is made of this trend as a contributing factor.

Managerial employees are paid more for more hours. I compute managerial personnel enjoyed a 38.3 hour average work as of the June 2015 Employment Situation Report. In contrast, production and non-supervisory personnel averaged just 33.7 hours per week of paid work. In certain service industries — retail and leisure and hospitality, which combined account for one out of four private, non-farm jobs — non-managerial employees work considerably fewer hours per week. Assuming a 50 week year, the difference is an incremental 230 hours of pay per annum.

There are several explanations for this squeeze. The relentless (and, remorseless) pace of technological advancement has been, and remains, a key factor. A generation ago, a visitor to a typical American office would have encountered a different flora and fauna. Thanks to e-mail, voice messaging, the personal computer and the internet the typing pool, copy center, travel department and graphics department, among others, are gone, long gone.

Their virtual extinction is important because each such department would have been headed by a manager, no matter how low in the corporate hierarchy. Those positions were rungs up from the clerical class or the shop floor to management, with the incremental benefits and status such membership affords.

Technology has also enabled firms to outsource functions senior management deems to be non-core. Payroll, training, compliance, information technology are among the tasks firms have contracted with other companies to provide. As more and more functions are provided by vendors, fewer managers are needed further squeezing the ratio of managerial staff to total employees.

Widespread adoption of so-called enterprise application software packages has further winnowed managerial ranks. In the old style, hierarchical organization, multiple tiers within a function (such as accounting) existed to collect, compile, aggregate, filter and analyze data. Today software has made many such tasks redundant. Information is increasingly captured and sourced real-time and updated almost simultaneously to the firm's data warehouse. The consequence: once stored data is readily retrieved for reporting and analysis; but at the cost of a flattening of the organizational chart.

Now I am not a Luddite. I do not believe we can force technology's march backwards. But I do believe we should not encourage businesses, through misguided tax and social welfare programs, to substitute technology for labor.

It is often difficult to discern whether certain politicians are simply obtuse or patently disingenuous. On no subject is this truer than entitlement reform — and, in particular the federal Social Security and Medicare programs. To the Democratic Party the two programs are so sacrosanct that it is heresy to call either a tax on a firm's employment of labor.

That tax rate is equal to a firm's contribu-

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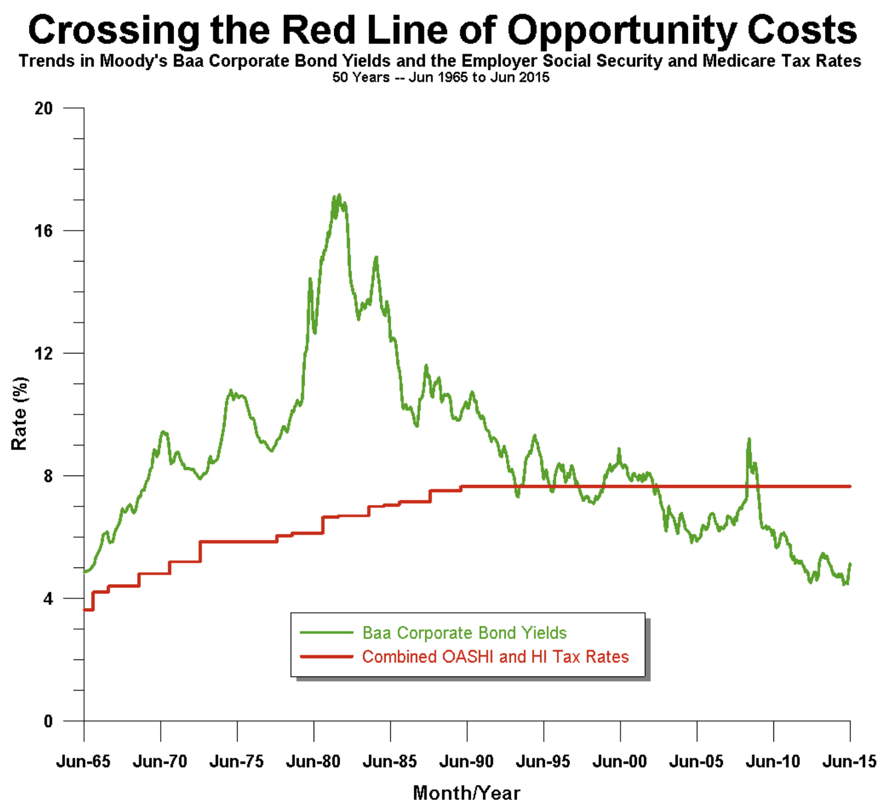
tion (now 7.65 percent) of every dollar for approximately the first $118,500 of wage and salary income; thereafter, employers pay 1.45 percent for the Health Insurance (HI) portion. Businesses thus have an added incentive to automate wherever possible. Not only are the wages paid to labor saved, but so too the taxes due to the government.

Historically marginal borrowing costs (measured by the Moody's Baa Corporate Bond Yield) exceeded the combined wage tax rate. Consequently, while businesses are constantly adjusting the mix of resources, inputs and talents they employ to improve profit margins, wage tax rates, while a consideration, were probably not a significant factor.

But in the mid-1990s the relationship reversed, with Baa yields falling below the combined wage tax rate. Over the past decade or so, borrowing costs for most large firms (the Moody's Baa Corporate Yield) have fluctuated well below the 7.65 percent wage tax rate. Since June 2009, the end date of the so-called Great Recession, the spread has aver-



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The chart above illustrates the historical trends of the Moody's Baa Corporate Bond Yields and the combined Old Age and Survivors Disability Insurance (OASDI) and Health Insurance (HI) wage tax rates.

Moody's Baa bond yields are monthly averages of daily yields for seasoned corporate bonds rated Baa by Moody's on its credit quality scale. In the Moody's debt rating scale, Baa is the lowest rating a bond can receive and still be considered to be of investment-grade quality. For a large segment of American business the yield is a good indicator of a firm's marginal borrowing cost to finance investment.

The combined OASDI and HI wage tax rate represents the aggregate prevailing rate of the two individual components during the calendar year. Since 1990, the OASDI and HI rates have been 6.20 and 1.45 percent, respectively; for a combined rate of 7.65 percent. In 2015, the OASDI rate is levied on the first $118,500 in wage and salary income. For the HI rate there is currently no ceiling on the wage and salary income subject to the tax.

(Sources: FRB H.15 Report; Social Security Administration; Worldly Philosopher estimates.)

"It will be of little avail to the people that the laws are made by men of their own choice if the laws be so voluminous that they cannot be read, or so incoherent that they cannot be understood."

James Madison (1751 to 1836), American Scholar and Statesman, 4th President of the United States

"The atmosphere of officialdom would kill anything that breathes the air of human endeavor..."

Joseph Conrad (1857 to 1924), British Author

"An unlimited power to tax involves, necessarily, the power to destroy."

Daniel Webster (1782 to 1852), American Senator, Statesman and Jurist

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"Democracy and socialism have nothing in common but one word, equality. But notice the difference: while democracy seeks equality in liberty, socialism seeks equality in restraint and servitude."

Alexis de Tocqueville (1805 to 1859),
French Political Philosopher

"It is the highest impertinence and presumption...in kings and ministers, to pretend to watch over the economy of private people, and to restrain their expense....They are themselves always, and without any exception, the greatest spendthrifts in society. Let them look after their own expense, and they may safely trust private people with theirs. If their own extravagance does not ruin the state, that of their subjects never will."

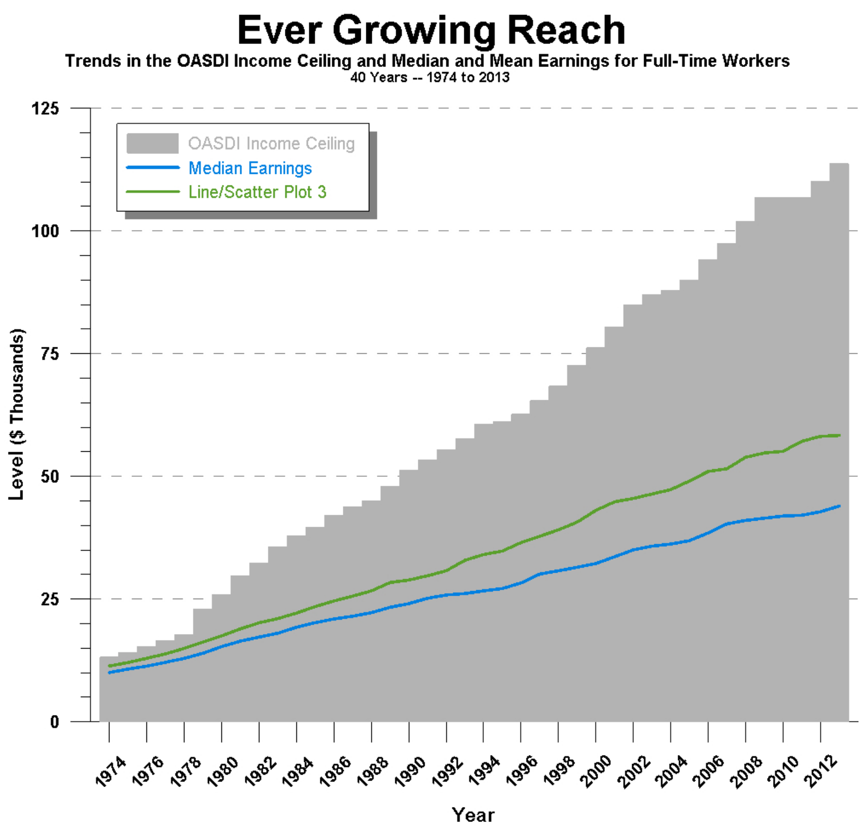
Adam Smith (1723 to 1790),
Scottish Philosopher

aged 229 basis points (bps). This is a sizeable difference; and, one I doubt many businessmen can long ignore.

The existential problem is technology has broadened the scope of jobs and functions which can be partially or fully automated. Now that the lower rungs on the white-collar ladder have already been removed the middle rungs are vulnerable.

The tax rate is only one variable in the equation; the income subject to tax is another. Since 1974, the OASDI income ceiling has increased by 5.7 percent per annum. The corresponding increase in median earnings for full-time employees (defined as those working 50 to 52 weeks per year) was just 3.9 percent. In 1974, the OASDI maximum equaled 116 percent of the average full-time salary; in 2013, the ratio stood at 195 percent. Today, fewer full-time workers enjoy a "FICA" (Federal Insurance Contributions Act) holiday towards year end. And, so too firms: most receive relief — on the employer's share — on an ever shrinking proportion of their workforce. Firms have an incentive to figure out how to do away with more and more of their comparatively highly remunerated staffs.

Low corporate bond yields have had another pernicious effect on the demand by private enterprises. Few days go by without yet another announcement of two firms merging or one agreeing to be bought by the other. In

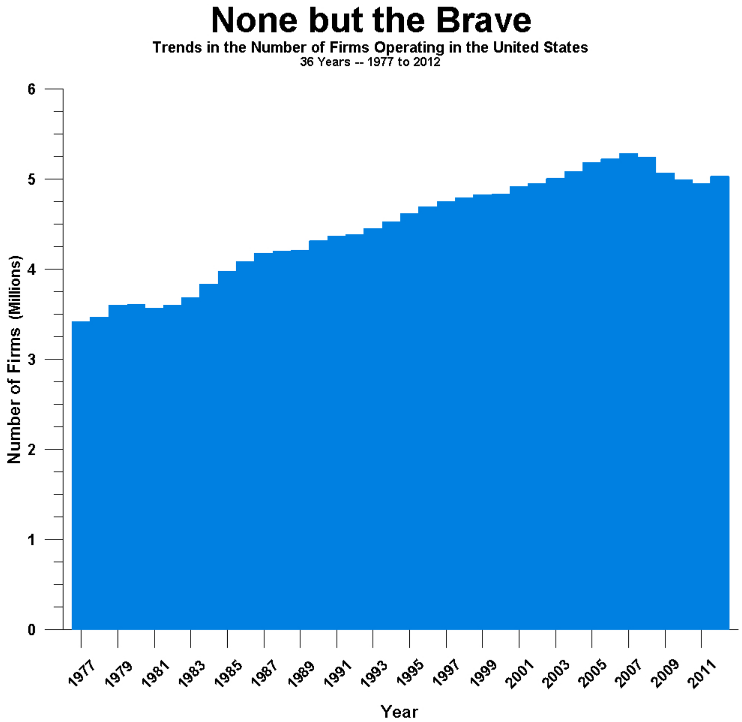


Notes:

Mean and median earnings data is for full-time employees working 50 to 52 weeks per annum compiled by the Census Bureau in its survey of demographic characteristics of the U.S. population.

The OASDI income ceiling represents the maximum wage and salary income subject to tax. As noted previously, there is currently no cap on wage and salary income subject to the HI portion. Prior to 1990, both components had the same ceiling. Then in 1991 the HI ceilings was raised to $125,000 while the OASDI ceiling was just $51,300.

(Sources: Census Bureau; Social Security Administration; Worldly Philosopher estimates.)



(Sources: Census Bureau, Survey of Business Dynamics; Worldly Philosopher estimates.)

most cases, the underlying economic rationale is labor cost savings; most often by eliminating duplicate managerial positions.

As a consequence of the ongoing merger frenzy, and the weak global economy, more U.S. firms have disappeared than have been started. Since 2007, the number of firms with 100 or more employees has shrunk by more than 5,000 (as of 2012). Over the same period, the number of firms with less 100 employees has contracted by 318,000 or 5.4 percent. Today, only a brave or foolhardy soul is intrepid enough to start a business in the prevailing economic environment. Thus, for the time being, it seems the business of America is no longer business.

The ongoing slump in business formation has received little notice or comment — at least, that I am aware of. Some may argue many of the trends highlighted here will evaporate as soon as the Federal Reserve begins to unwind its balance sheet by selling the $2.5+ Trillion of Treasury debt and mortgage-backed securities the central bank has bought with excess reserves.

My view: Do not count on it. If my interpretation is correct, the economy is much weaker and the labor markets much frailer than the media and the political class will acknowledge. For this reason, I predict the Fed will keep money free and easy for a long time coming.

Now this view does not preclude a token increase or two in the Fed Funds Rate. There are political reasons for the Federal Reserve Open Market Committee (FOMC) to give short rates a kick higher. But the timing of the contraction of the Fed's balance sheet ultimately depends on the willingness of banks to lend, drawing down excess reserves in the process. Currently there is little evidence of banks having the appetite to expand lending.

So I expect long-term interest rates to remain largely where they are. Yes, there will be the occasional nudge higher; but, unless the economic environment improves and growth rates quicken, any rise will inevitably be followed by a drift lower. Corporate borrowing costs are likely to remain well below the combined OASDI and HI wage tax rate for some time to come. This provides firms with an added incentive to economize on labor.

"Bureaucracy is a giant mechanism operated by pygmies."

Honoré de Balzac (1799 to 1880), French Novelist

"The more numerous the laws, the more corrupt the government…"

Publius Cornelius Tacitus (AD 57 to 117),
Roman Senator and Historian

"A strong conviction that something must be done is the parent of many bad measures."

Daniel Webster (1782 to 1852), American Senator, Statesman and

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"Virtue is more to be feared than vice, because its excesses are not subject to the regulation of conscience."

Adam Smith (1723 to 1790), Scottish Philosopher

"It is almost as though the universal conversion of political parties to private enterprise and the market has happened only because the state has found itself able to control our lives more effectively through regulation than through ownership."

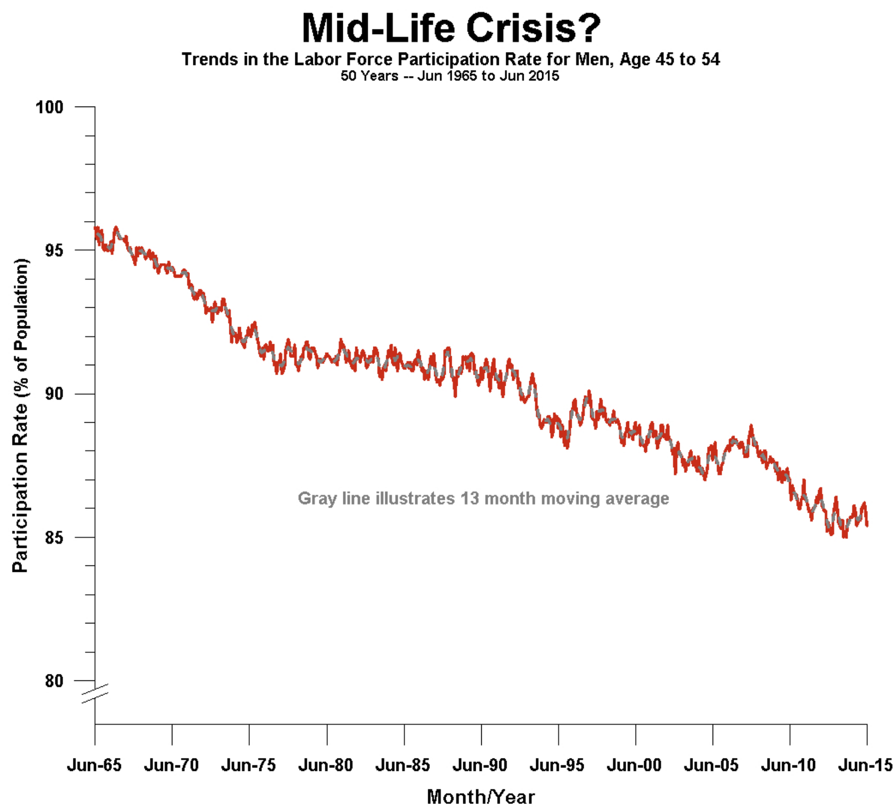
Roger Scruton (b 1944), British Philosopher and Man of Letters

If these forces remain unchecked, the labor force participation will continue to decline as laid off workers struggle to find employment. Over time they will simply give up looking, thereby exiting the labor force. These involuntary departures reduce the unemployment rate — remember, an individual must be actively seeking work to be counted among the unemployed — creating the illusion that labor market conditions are improving.

Nowhere is this more evident than population cohort comprised of men between the ages of 45 and 54. Historically, the participation rate for this segment has been among the highest of any demographic group. Men in this age bracket typically are still attaining greater seniority and higher compensation. So the continuing (and, after 2007, accelerating) secular decline since the early 1990s is troubling.

Alas, the available data does not reveal why men are leaving the workforce. Are they being coaxed out? A large inheritance, a disability or a highly remunerated spouse are all reasons why men may voluntarily opt out.

Or, have they been pushed out? Are laid off men discovering the available positions pay only a fraction of their former wages and salaries? And, for many has it been so long since they were employed that a large number have just given up? So rather than seek employment men may have moved to the margins or sought work in the gray or black market economies.



Notes:

The labor force participation rate is the ratio of those employed (or, actively seeking employment) to the total civilian population. The chart illustrates the trend for men between the ages of 45 and 54. Historically, this age and sex cohort of the population exhibited the highest rate of its members in the labor force.

(Sources: Current Population Statistics of the Census Bureau and the Bureau of Labor Statistics; Worldly Philosopher estimates.)

No one really knows. At best, given the extant data, all theories are really just educated guesses.

While the debate rages, the convergence of trends, forces and incentives for firms to pare back employment moves forward unabated.

"The American Republic will endure until the day Congress discovers it can bribe the public with the public's money."

Alexis de Tocqueville (1805 to 1859),
French Political Philosopher

"The worst evils which mankind has ever had to endure were inflicted by bad governments."

Ludwig von Mises (1881 to 1973),
Austrian Economist

"There is no art which one government sooner learns of another than that of draining money from the pockets of the people."

Adam Smith (1723 to 1790),
Scottish Philosopher