**Episode 473: Does the Economy Do Better Under the Democrats, and Has Obama Been Better Than Reagan?**

**Guest: Gene Epstein**

**WOODS:** I want to talk today about a column that you wrote for *Barron's*, "A Tale of Two Labor Markets," and that will spin off into a variety of other topics. But I want to begin with a discussion about this column, because you're hitting on a subject that does come up quite a bit when people are trying to defend the Obama economic record, and they'll say look, Obama inherited a real mess, and he's actually turned things around pretty well. We've had good, strong employment figures; the unemployment rate is low, and he's even done it better than Reagan did. Now, I raised that with David Stockman, and he was not persuaded.

**EPSTEIN:** Mm hmm.

**WOODS:** You also are not persuaded, but for a different reason. There's something that is fundamentally different about the labor market, not the unemployment rate and the way it's measured, but about the labor market itself in the 1980s, as opposed to the labor market from 2009 to 2015.

**EPSTEIN:** Sure, we should start there, Tom, but I do want to emphasize, however, that one of the parallels that we're talking about when we talk about the labor market of the 1980s versus the labor market today is that Reagan, in fact, there was a real mess in '81, '82, and the usual tendency is for a messy recession — '73, '74 was also a real mess, by the way. And what usually happens, for reasons that are not too hard to discern, is that the climb out of that mess is usually a bit more rapid than climbs out of minor recessions, as in the case of, for example, 2001 or '91. So therefore, we should have expected slightly faster growth since the Great Recession, just as we had very much faster growth in the 1980s.

I want to go back to that, but in response to your question in particular, the huge and obviously the difference that's just in your face about the 1980s versus today is that two things were happening demographically, and in a way, economically. The first, which was expected, is that the last wave of baby boomers, who were born in the early to mid 1960s, were screaming into the labor force in the 1980s. Now, that was expected. And of course we did have vastly higher employment, a vastly higher number of candidates seeking work in the 1980s. But what was also totally unexpected is that the labor force participation of those baby boomer women soared beyond anybody's wildest dreams.

And so the bottom line fact is that in the first six years of this expansion since the 2009 trough, the unemployment rate has fallen from 10% to 5.3%. By uncanny coincidence, after the first six years of the expansion in the 1980s, the unemployment rate had also fallen to 5.3% from a somewhat higher level of 10.8%. So in the 1980s, the trip downward was a bit faster in terms of the unemployment rate, but more especially, the trip upward in employment was absolutely colossal in the 1980s.

Employment over that six-year period in the 1980s, the first six years of the expansion, rose by 17 million people, 17 million jobs, and against a smaller base, since the population was smaller in the 1980s. That was an increase of more than 17%. So that's 17 million jobs, a 17% increase. Over the recent six years of the expansion, we've added 8.7 million jobs, just about half as many, and of course in percentage terms, because of a larger base, that's just 6.2%. And so again, the amazing thing that sort of stares you in the face is that the expansion during the 1980s accommodated so many newcomers into the labor market, and so that's the stark difference between the labor market — the "tale of two labor markets" in the recent period versus the previous period.

But there are a couple of other things to say about that, and I should go on with that. The point is that the influx of women into the labor force was totally unexpected. In 1973, for example, the Bureau of Labor Statistics, which with the help of the census routinely makes predictions about the labor force, had underestimated the number of women into the labor force by about 10 million. They predicted by 1985 42 million women would be in the labor force, and instead, it was 51 million — a miss of nearly 10 million women. Now I want to pause and ask you what you would even have said about that, that not just the prospect that everybody knew was that the baby boomers would be streaming into the labor force, and that would be difficult enough to accommodate, but on top of that, an unprecedented 10 million extra women are seeking jobs in the 1980s. That would have been staggering. What would you have said about that and how the economy could have created jobs to accommodate all these people?

**WOODS:** Well in fact, you say in your column that of course this was unanticipated, just how large the influx of women was, so because it was unanticipated, we didn't get all the hand-wringing about how terrible this would be, because we wouldn't be able to find jobs for them all and unemployment would be high.

**EPSTEIN:** Yeah.

**WOODS:** But if they had realized it, we surely would have gotten all this hand-wringing, because, as again you point out in your column and as I pointed out myself, that is what we heard as early as 1943 from Alvin Hansen, that we can't just demobilize after World War II, we can't just stop building tanks, even though we don't need them anymore, because what are all these people going to do for a living?

There's going to be a major unemployment crisis. And there was no crisis. They go to work producing things for the other people who are going to work, and the market clears.

**EPSTEIN:** Yes. And I think it's kind of a — but I even wonder, you know, if I do some soul searching — and I started doing a regular column about the economy in early '92, '93, so I wasn't there then. But I just wonder, if you and I were to ask the question, you know, let's say it's early 1970s, and somebody does foresee, somebody asks what's going to happen if women start getting divorced, baby boomers start going out on their own, if there's suddenly a work ethic that's unprecedented among women, and we get a labor force participation rate among baby boomer women that's going to soar, that's going to really increase. I wonder how intimidated you and I might have been.

We might even have thought, well, okay, that was special circumstances post-World War II. I believe they were somewhat special circumstances. These men were returning, many of them had not worked before, they were all returning, you know 11 million men returning, some of them went to college, the vast majority sought work, but they didn't have in their mental accounting what work needs to pay, so they sort of took whatever jobs they could. We might have said that that's something special.

And we might even have been intimidated. How are these women going to be accommodated? Well, I think that the lesson, and even in the market, even in the 1980s, when we might have been — there was lots of unionization, there was minimum wage — we might have been a little bit unsure of the result. But indeed, however, we should emphasize that it took six years in the 1980s for the unemployment rate to come down from 10.8% to 5.3%. It did take six years. And so we do know that while labor markets can be far more flexible in a free market economy, that there must have been a certain amount of inflexibility if it took that long for the labor market to truly clear. But we at least should recognize that even the flawed U.S. labor market has a tendency to accommodate the supply. There's not a fixed amount of jobs in any economy.

And now let's cut to the chase about what's recently happened. We have a very much lower participation by the labor force, and there is this belief that if we had more men and women coming into the labor force, that the unemployment rate would again be sky high. The myth persists, that that's what would happen to the unemployment rate.

Now, Tom, maybe I should shift gears and talk about a bone of contention among free market economists. I think even, well, we're always bringing in big Bob Murphy, because he's such a great source, about the nature of the unemployment rate as conventionally defined.

**WOODS:** Yes, let's definitely get to this, but I want to throw you a bit of curveball on this question.

**EPSTEIN:** Sure.

**WOODS:** There's been some debate within circles of historians who talk about the New Deal, over when we're measuring unemployment — I know this is not your point, but it's mine and I'm the host of the show —

**EPSTEIN:** Yes.

**WOODS:** It's about whether we should count people who are employed in make-work projects as being employed or not. Because a lot of times when we look at the statistics showing the crummy economy under FDR, that's because we're counting those people as not being employed. And these historians say if we count them as being employed — which certainly from a colloquial use of the word "employed," they are — then the figures look much better.

**EPSTEIN:** I see. Yes.

**WOODS:** Now of course we would be inclined to say maybe we shouldn't count them, because these are not jobs that we know for a fact are adding value, because they are not occurring on the free market, and they're just taking resources from taxpayers and giving them to these people. Because obviously if we counted those people, then all we would have to do to get 100% employment would be to just fund everybody, just print a lot of money from the Fed, give it to people, and then we'd have no unemployment. That would obviously not be a useful figure.

**EPSTEIN:** Yes.

**WOODS:** But on the other hand, if we are to say that those people are not employed, then am I really to say that, for instance, during Hilary Clinton's tenure as Secretary of State, she was unemployed? Is that analytically useful? What does your gut tell you about this?

**EPSTEIN:** No, it may be one of my weaknesses or one of my strengths, is that within my limited priorities, I tend to be fascinated by labor markets more than any other market, and I write about labor markets a whole lot and am happy about the fact that really it's only since the 1990s that the bond market especially has been fascinated by the employment and unemployment figures, so I get away with writing about it.

First of all, let me say that our mentor, yours and mine, is mainly Bob Higgs, Robert Higgs, the economist, who's looked so closely at these things. And of course it is true, as Higgs has pointed out and as you just pointed out, that the idea of counting people as employed who are in make-work projects of no particular value to anybody is a bad procedure, and that the people who really are employed in the private sector are the people to count as employed.

But now we get into, and indeed we said we're back into this issue of the two flavors, as labor market economist, Casey Mulligan, likes to put it, the two flavors of not being employed. And I would say, again, that those people who are in make-work projects are not legitimately employed in a market sense. Absolutely. But the idea that we then want to put those people among the unemployed, that's where I would draw the line. I would say that those people will either not be employed or not be interested in working, or if they do come into the labor force and they do seek work, they will pretty soon find some kind of job.

So they go off and do seek work, in other words, into the legitimate market-oriented labor force. And so that's the distinction. I've got three buckets, in other words — or maybe, I guess you could say four buckets. The buckets are employed legitimately in the market economy, employed illegitimately in the make-work economy — but then where do I put you if you're employed illegitimately? Well, you'd either be employed or you'd not be working or you'd be unemployed. Or put it another way, you're not working, you're either unemployed or you're not employed. And the unemployed versus the not employed are the two flavors.

And Casey Mulligan, by the way, a labor economist who's very cynical about the distinction, he's right that there's a sort of blurred line between the two. But I would say that, by and large, it's legitimate to distinguish between those people who are not working but who want a job and are seeking work versus those people who are not working who do not want a job and who are not seeking work, and that's of course the broad, vast majority of people who are not employed. And to go back to the point, I agree with you about their being employed, absolutely, but not employed legitimately.

**WOODS:** All right, so let's go back to the bone of contention that you wanted to talk about regarding the unemployment rate.

**EPSTEIN:** Yeah, okay. The point is this, and indeed, since you were citing, I think, mainly Bob Higgs' insights and again, Bob Higgs taught me that it's sort of a no-brainer to recognize that the U.S. economy clearly produced far less when World War II started, because he points out that so many people who were supposedly working were basically drafted into the war effort, either to produce armaments or to be in the Army. So therefore, his terminology is very useful of that, what produces actual goods and services in the market economy and what legitimate employment is all about.

But with respect to those people who are not working, then Bob Higgs, in a recent article that I read by him, agreed with me, agreed that the Bureau of Labor Statistics is actually, given its progressive, sort of left-oriented tradition, is essentially very, very lenient in defining the unemployed. The unemployed is, again, those who are not working, but who are seeking work. And it's based upon a very imperfect statistical force. That's why one month's numbers or two months' numbers is just a blurred snapshot; you've got to put them in line together to get a picture of what's been happening.

What they do is it's based on a census survey of 50,000 households nationwide, statistically representative, and they ask you were you employed in the last week; if you were not employed over the last week, did you look for work; do you want a job, are you available for work, and did you look for work over the past four weeks? I think those are reasonably pointed questions. In 1994, they had a redesign of the questionnaire that I think sharpened the questions pretty well.

But here's the whole point. What are their criteria for looking for work? You say you want a job? How did you look for work? And the key point, as I think we could all imagine, is that when a census government interviewer asks you do you want a job, people tend to exaggerate, if anything, their commitment to the workforce. Research by the Bureau of Labor Statistics has shown that over and over again. So we can rest assured that, if anything, they're exaggerating the story.

So they are asked, you want a job? Yes. You were available for work last week? Yes. And you looked for work over the last four weeks? Yes. And how did you look? Well, the census interviewer's given guidelines about what qualifies as an active job search. And one of the things that qualifies is that you called a relative about a job. You made one phone call over the past four weeks with a cousin about a job prospect, and that counts as active job search. Now, at one point I jokingly wrote that the Bureau of Labor Statistics' commissioner had a deadbeat relative who she's supporting, who said yeah, I looked for work; I called cousin Joe and I asked about a job. I don't even think she'd regard that as an active job search, but the cousin could point out that was an active job search in the eyes of your agency.

So again, they bend over backwards to count anybody as looking for work. You filled out one job application, and on top of that, you don't have to document that you did any of these things; you simply have to say that you did. And given that people tend to exaggerate their commitment to the workforce, I believe that the estimate of a little over 8 million people, which is the recent estimate, or 5.3% of the labor force, as unemployed is, if anything, a bit of an overestimate, not an underestimate.

**WOODS:** All right, let's say something about — I want to go back to the '80s versus now thing.

**EPSTEIN:** Sure.

**WOODS:** There's a way we can compare those two periods, first in terms of the composition of the labor force, the introduction of all these women coming into the labor force in the '80s that no one anticipated. There's another aspect of this. I'm just curious, what — I'm pretty sure I know the answer — but what was the trend in terms of these various metrics of economic freedom in the 1980s versus today, and does that bear on our understanding of what the dynamics of the numbers are?

**EPSTEIN:** I think it does. I actually have the numbers in front of me. The economic freedom index, again, as calculated by the Fraser Institute, which has an index that was developed with the help of free market economist, Milton Friedman, and it's quite transparent in the sense that all the numbers can be replicated based upon numerical sources that all can be researched. In other words, it will stand up to peer-reviewed literature, and it has been used in peer-reviewed literature.

The economic freedom index was at 7.92 in 1980, and it rose to 8.11. This is out of a possible 10; 10 is, so to speak, perfect economic freedom. This was 7.92 to 8.11 from 1980 to 1985. That's over the relevant period; they took these snapshots every five years in those years. So that's again 8.11 by 1985. Today, the 2013, the most recent figure on economic freedom is 7.73. 7.73 versus 8.11 in 1985. So it's lower and it's been flat. It was about 7.71 in 2009. So it's been basically lower and flat, making no progress from '09 to 2013, whereas it was higher and rising from 1980 to 1985.

Now, it's kind of an abstract number, but the thing that's especially valuable about it, and I wish more of my free market colleagues would use it, is that it does what it wants to do, in the sense that it was developed — five different components of it — it's got five different sub-components having to do with the rule of law, with openness of trade, with monetary policy, with a set of reasonably sound ideas about size of government, sound ideas of what unleashes entrepreneurship, flexible labor markets, and all the rest.

But the whole point is that nobody can decide what you want to do with it. It goes in trends that are based upon numbers that are beyond the control of those who calculate it, and therefore the fact that it — and here I'll give a broader story — it rose in the 1980s under Reagan, but it also rose in the 1970s under Nixon and Carter. It rose in the 1990s under George H.W. Bush and Bill Clinton. In 2000 it peaked, and since 2000 it has fallen. It's either fallen or backed up a little bit or been steady. It's practically level now with where it was in 1970. So the broad trends are 1970 to 2000, it rises fairly steadily; since 2000, it falls. So the fact that it was rising in the 1980s I think is part of the story of what happened with labor markets then.

And indeed, I do think, now to drill down to what has been happening, especially under the Obama administration and actually under the George W. Bush administration as well, is that size of government is partly implicated. There've been massive interventions into the labor markets, as documented by conservatives like Charles Murray, as documented by politically incorrect labor market economist like University of Chicago economist, Casey Mulligan, that have caused deep disincentives to work.

And the disincentives to work, which involve, for example, an unprecedented enrollment in the Social Security Disability program — that is the most dramatic. The fact that the labor force could be more disabled over the last 10, 15, 20 years is absolutely absurd, but yet, disability pay outs to prime age men, 25 to 54, have soared. And the key point about the disability program is that their declaration is don't let us catch you working — at least don't let us catch you working on the books, because if you are working on the books, you're going to lose your disability payment. So I believe that the very timid influx of prime age men into the labor force, of prime age women under the Obama administration recently has been in part due to the explosion of disability payments. There's also Obamacare, as Casey Mulligan has documented, which by the way, the Congressional Budget Office agrees with Mulligan, that it's in the process of causing disincentives to work, and that two to four million workers are going to be among the missing.

Now that's what's recently happened. It was not by and large happening in the 1980s, and that's the key reason why — the thing that's most troubling, which is that labor force participation over the last 10 years has declined, that that is due, I believe, to government intervention that was not happening in the 1980s. And that directly relates to key measures of economic freedom.

**WOODS:** Let me ask you one more thing, Gene. I don't know if you've seen this, but it's come up again in connection with some comments that Donald Trump apparently made some time ago regarding the performance of the economy under Democrats versus Republicans, and of course the implication is that the economy doesn't do well under free market principles, which is what we associate with the Republicans, rightly or wrongly. So have you looked at any of this, and what do you make of that kind of claim?

**EPSTEIN:** Well, clearly we do have a source on free markets. We do have a measure. Again, all of us sort of Austrian, free market types have ambivalent feelings about Milton Friedman, but I refer you to Walter Block's very touching obituary of Friedman when he died. There were some very good things about the guy, and he did help design this economic freedom index. And again, it's objective. Nobody can say — unfortunately, what some of us do is with the benefit of hindsight, we retrofit a story to what's been happening under Obama.

In this case, in the case of the economic freedom index, there is no retrofitting. It was devised years ago, and it does what it wants to do. Nobody can tell it to peak in 2000 and then begin to decline. So the story then of the economic freedom index is incredibly bipartisan. And I'm personally comfortable with that, as somebody who almost never votes either Democrat or Republican, never voted for either of them in the national election. In the 1970s, 1980s, and 1990s, the economic freedom index steadily rose, and all the global research shows that when the economic freedom index is rising, you can expect economic growth to either be reasonably robust or to increase. And so indeed, in the '70s, '80s, and '90s, we had reasonably good economic growth of 3 to 4%. Since then, in 2000 when the economic freedom index began to decline, that's when economic growth began to slow.

**WOODS:** Okay, so that's the more interesting question, is where's the economic freedom index during these years, not which party happens to be seated in the White House.

**EPSTEIN:** Precisely, precisely. But it does turn out that the economic freedom index is amazingly bipartisan, that it did rise in the 1990s, when mostly Bill Clinton was in charge. It did rise. And it did peak in 2000. And it did begin to fall when George W. Bush was in charge and when Obama was in charge. So it begins to sort people out in a very bipartisan way. It puts George W. and Obama together, and it even links, to some degree, Jimmy Carter. Now to Carter, some of us know, there was the big push toward deregulation began under Carter, for example. And so indeed, it turns out that that's the major story.

And why, again, do I insist that that should be the number, the index that we look at? And again, it's not just one index; it's got five sub-components having to do with the rule of law, monetary policy, openness to trade, and so on. It's objective. It's an objective index. It was devised years ago, and it does what it wants to do.

So again, Donald Trump is on such a low level of understanding that I don't know if I should point this out to him, but indeed, if you and I were talking to him, we would say this is a measure that does it objectively, and it does demonstrate that free markets matter. Indeed, as you perhaps know, the economic freedom index is devised for now more than 115 nations globally. It's been used in peer review research, and it does show something fairly simple: that levels of economic freedom for each country tend to correlate with levels of prosperity. Rates of increase and decrease in economic freedom tend to correlate with rates of increase and decrease in conventionally measured economic growth. That applies to the U.S. just as much as it applies to most other counties.

**WOODS:** Well, Gene, I'm very pleased to note that your article, "A Tale of Two Labor Markets," is available for free; it's not behind a subscription wall or anything —

**EPSTEIN:** Okay, that's good.

**WOODS:** So I'm going to link to that at TomWoods.com/473, which is the show notes page for today. And we'll wrap things up, and we've got so many other economic things to talk about, but I'm so glad we hit actually on this Democrat/Republican thing, because I've had a lot of people ask me about that and haven't had time to look at it, but I think you give the definitive reply to that. And that was just a bonus; I wasn't even expecting to cover that.

**EPSTEIN:** Well, good.

**WOODS:** So thanks a lot, Gene, I appreciate it.