UNEMPLOYMENT: PROBLEMS AND POLICIES

SELECTED PAPERS

EDITED BY IRVING BERNSTEIN

Institute of Industrial Relations

University of California • Los Angeles

Los Angeles, 1976.

Published in 1976

Copies of this volume may be purchased
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Cover Design by Marna McCormick

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FOREWORD

During the year 1975, unemployment in the United States was 8.5 percent of the civilian labor force. This was the highest rate the nation had sustained since the Great Depression. Joblessness was more severe than this average among young workers, particularly teenagers, nonwhites, and women. Two related factors complicated this condition: continuing rapid inflation in the United States and the appearance of the same phenomena in other nations--rising unemployment and increasing prices. This congeries of problems caused world-wide concern, which was much in evidence in America. It also led Congress to enact legislation in the hope of developing policies to deal with these knotty issues.

The Institute of Industrial Relations concluded that it would be helpful to gather a group of noted authorities to discuss these problems and policies. The results are incorporated in this study. The Institute is grateful to these economists for their writings. It also acknowledges the contributions of two of its staff members, Irving Bernstein, for organizing the volume, and Felicitas Hinman, for editing it.

Frederic Meyers, *Director*
Institute of Industrial Relations
University of California, Los Angeles

August 1976

UNEMPLOYMENT: PROBLEMS AND POLICIES

THE DIMENSIONS OF CURRENT UNEMPLOYMENT

Charles C. Killingsworth*

In 1960, the Bureau of Labor Statistics reported that the average number of unemployed workers was 3.9 million, which was 5.5 percent of the civilian labor force. In the Presidential campaign of that year, John Kennedy made unemployment one of the major issues, and promised to "get this country moving again." After Kennedy won the election, there was a national debate about how best to reduce unemployment; but scarcely anyone questioned the basic proposition that an unemployed total of around 4 million workers was intolerable.

In the first nine months of 1975, the total number unemployed (again according to the BLS) averaged 7.9 million workers, or 8.5 percent of the labor force. Yet the public discussion of the unemployment problem was strangely muted, except for the predictable outcries from union leaders. The national Administration was reported to believe that no measures to reduce unemployment beyond those already in place were necessary or desirable. And its actions confirmed that report, although members of the Administration "projected" unemployment rates well above most postwar recession highs for most of the rest of the 1970s. With only a few notable exceptions, many nationally known political figures had little to say and less to propose about unemployment. The general public was reported to believe that the most important national economic problem was not unemployment, but inflation. True to the old American advice to make a virtue of necessity, some people argue that we need high levels of unemployment, at least for a few years, in order to end inflation.

In the euphoria of the mid-1960s, it was fashionable to say that never again could a democratic government permit high levels of unemployment for extended periods. Today, almost any proposal to reduce unemployment--even to 5-6 percent range which used to be considered intolerably high--invites the accusation that the proponent is "in favor of inflation." Many economists and most political figures shun that label like the plague. The present checkmate is largely a product of the view, which has become widely prevalent in the past decade, that there is a "trade-off" between

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unemployment and price stability: if you want less of one, you must accept more of the other. It is time to take a critical look at this proposition as it applies to the current situation in the nation. This statement approaches the task by undertaking to answer five questions, as follows:

1) How much unemployment do we have now?
2) What is the outlook for unemployment?
3) Is there a "trade-off" between unemployment and inflation?
4) What are we doing now about unemployment?
5) What additional steps should we take to deal with unemployment?

1. How much unemployment do we have now?

Table 1 shows recent changes in the official count of employment and unemployment. Employment peaked in July, 1974, at 86.4 million persons, and dropped to 83.9 million in March, 1975, a decrease of 2.5 million. Since March, total employment increased by 1.5 million; in other words, it would appear that about 60 percent of the job loss has been regained. These figures are almost universally regarded as a measure of the performance of the market economy, and the apparent 60 percent recovery of the job loss in this period of sharp recession is generally interpreted as one indicator of fairly rapid recovery. This interpretation of the figures is misleading, at least with regard to the experience of the past 15 months. What is generally ignored is that the employment figures have been affected since early in 1975 by the rapid expansion of Public Service Employment under the Comprehensive Employment and Training Act. Enrollees in that program (and its predecessor under the Emergency Employment Act of 1971) are counted as "employed" in the labor market statistics. But the jobs involved are not "market-generated" in any generally accepted sense of that term. They are filled only by workers who have had a substantial period of unemployment and have been unable to find jobs in the normal labor market.

These manpower program jobs are designed to offset, to some degree, a job shortage in the normal labor market. If the total employment figures are adjusted by excluding the manpower program jobs, a somewhat different result is obtained from the July-March-September comparison. With this adjustment, the July to March decrease in employment amounts to 2.7 million jobs, and the March to September recovery, amounts to 1.4 million jobs. In other words, the decrease in market-generated jobs was actually somewhat greater than the official figures show, and the recovery is somewhat less. Only about half of the actual loss has been offset.

The unemployment figures are also somewhat misleading, in part because of the manpower program jobs and in part because of the marked increase in the number of "discouraged workers" in the past year.

Table 1

EMPLOYMENT, UNEMPLOYMENT AND PUBLIC JOBS PROGRAMS,

1974 - 1975

(In thousands, seasonally adjusted)

Month and Year	Total Employment	Unemployment		PEP and PSE Enrollment
		Number	Rate	
1974: Jan.	85,800	4,665	5.2	73
Feb.	85,861	4,690	5.2	63
Mar.	85,779	4,602	5.1	58
Apr.	85,787	4,537	5.0	49
May	86,062	4,691	5.2	43
Jun.	86,088	4,769	5.2	36
Jul.	86,403	4,880	5.3	33
Aug.	86,274	4,925	5.4	33
Sep.	86,402	5,303	5.8	41
Oct.	86,304	5,540	6.0	49
Nov.	85,689	6,019	6.6	55
Dec.	85,202	6,601	7.2	64
1975: Jan.	84,562	7,529	8.2	77
Feb.	84,027	7,484	8.2	94
Mar.	83,849	7,980	8.7	168
Apr.	84,086	8,176	8.9	235
May	84,402	8,538	9.2	275
Jun.	84,444	7,896	8.6	305
Jul.	85,078	7,838	8.4	315
Aug.	85,352	7,794	8.4	315
Sep.	85,418	7,773	8.3	315

Sources: Cols. 1, 2, 3: Published reports, Bureau of Labor Statistics.
Col. 4: Unpublished data, Manpower Administration and estimates.

In the second quarter of 1974, the BLS reported a total of 652,000 discouraged workers (those who would be actively seeking jobs, and hence would be counted as unemployed, except for the fact that they think they could not get a job. In the second quarter of 1975, the discouraged worker total was 1,153,000. The expansion of manpower program jobs and the increase in the discouraged worker total both contributed to a substantial understatement of the number of people who wanted jobs in the regular labor market, but could not find them. If the May, 1975, official unemployment rate is adjusted for both of these factors, a recalculated rate is obtained of 10.0 percent rather than the 9.2 percent rate that was reported by the BLS for that month. The point, simply put, is that what we really want to measure is the performance of the regular market economy, and the 10 percent unemployment rate is a more accurate measure of that performance than is the official figure of 9.2 percent. The official unemployment rate for September, 1975, was 8.3 percent. When this figure is adjusted as above for the recent increases in discouraged workers and manpower program job slots, it becomes 9.2 percent. In other words, by a conservative estimating method, it is clear that there are at least 8.6 million people who want jobs and cannot find them in the regular market economy.

Much could be written about the distribution of unemployment--that is, the large differences between various subgroups of the labor force. It is probably true that the higher the officially reported rate, the greater the understatement of unemployment, because the most disadvantaged groups are disproportionately represented in manpower job programs and in the discouraged worker count. Nevertheless, the officially reported figures suggest the magnitude of differences. In September, when the national unemployment rate was reported as 8.3 percent, married men with spouse present had a reported rate of 5.3 percent, while black teenagers had a rate of 37.2 percent. Professional and technical workers had a reported rate of 3.3 percent, and nonfarm laborers had a rate of 15.2 percent. The rate for government workers was 4.2 percent, and that for construction workers was 19.2 percent. Other striking differentials could be cited, but these examples perhaps suffice to make the point that the national unemployment rate averages together very large differences in unemployment among various groups in the labor force. And the greatest difference of all is hardly ever mentioned: Whatever the national unemployment rate is said to be, the individual without a job has a personal unemployment rate of 100 percent!

One final aspect of the reported unemployment figures needs no comment. In September, 1975, the BLS reported that the number of workers unemployed for six months or longer rose to a total of 1.6 million, which was the highest total in the post-World War II period.

2. What is the outlook for unemployment?

When the BLS announced, early in October, that the official unemployment rate had dropped from 8.4 percent in August to 8.3 percent in September, official spokesman in Washington professed to be encouraged by this change. The sense of their comments was that the economic recovery is progressing well. Running the published figures through a pocket computer reveals that the August to September change was actually from 8.36 percent to 8.34 percent. The chances are approximately 100 out of 100 that this change of two-hundredths of one percent was due entirely to sampling error. That this minute jiggle of the numbers should be taken as encouraging is one indication of the slowness of the improvement in the unemployment situation in recent months.

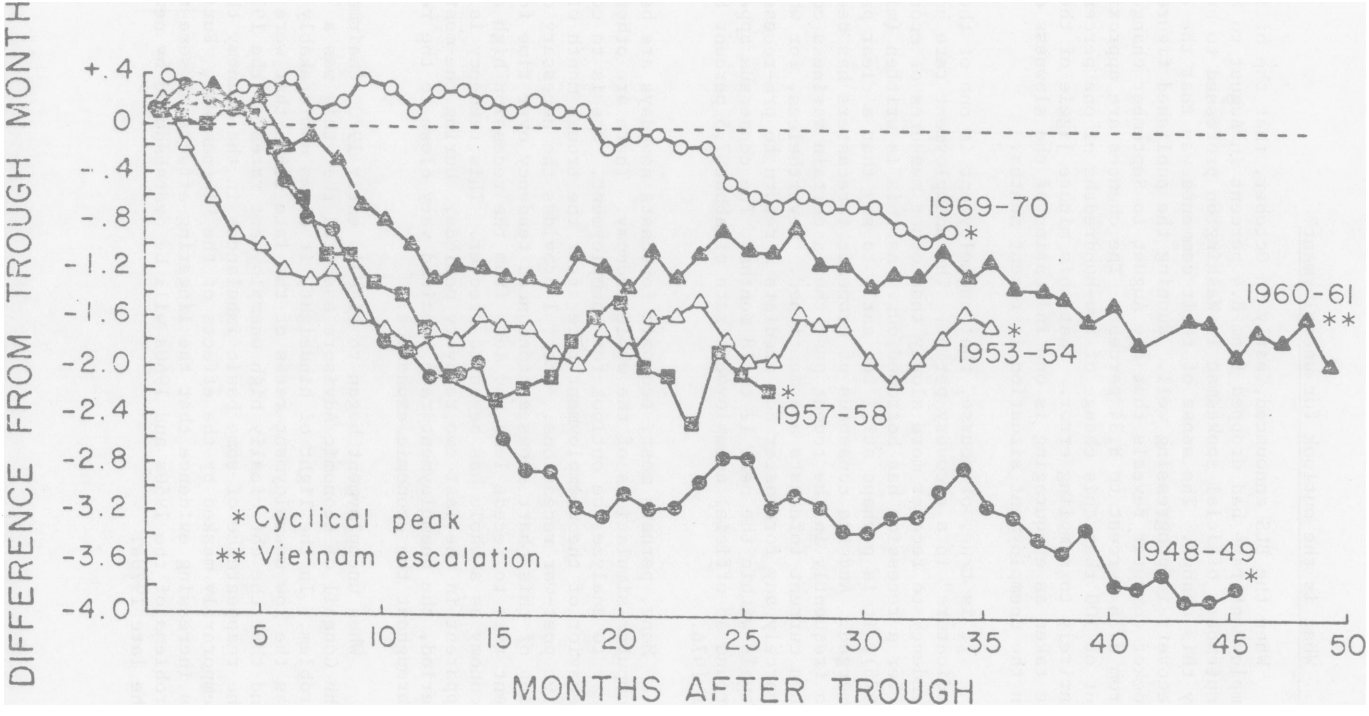
It is true, of course, that unemployment is one of the "lagging indicators" in a recovery period. The unemployment rate has a historical tendency to recover more slowly than other measures of economic activity after a recession has bottomed out. As this is written (mid-October 1975), it is perhaps still too early to say that a clear pattern has emerged. And the consensus of economic forecasters has been so wrong so frequently in the recent past that a certain wariness commends itself when current forecasts are mentioned. Nevertheless, for what it is worth, scarcely any forecaster now predicts a return to pre-recession unemployment levels within the next 12 to 18 months. The consensus appears to cluster around an official unemployment rate of about 7.5 percent by the end of 1976.

Many, perhaps most, economic forecasts nowadays are based upon computer simulations of the whole economy. There are other, less mechanical ways to analyze the outlook for unemployment. One is to consider the behavior of the unemployment rate after the trough month of each of the five post-war recessions. Chart 1 provides the necessary data. Examination of this chart shows a pronounced tendency over time for the unemployment rate to recede less and less from the recession high after the economy as a whole has begun to recover. This tendency is particularly apparent in the last two recovery periods. During the most recent recovery period, the unemployment rate remained very close to the recession high throughout the economic expansion.

When unemployment began to rise in early 1970, Chairman Stein of the Council of Economic Advisors asserted that this was a "transitional" problem. In the light of hindsight, it seems unmistakably clear that it was the low unemployment rates of the late 1960s that were "transitional," and that the chronically high unemployment rates of the 1970s reflect the reappearance of some basic imbalances in the economy that were temporarily masked by the effects of the Vietnam War. Furthermore, there is increasing evidence that the lingering effects of some employment problems of the 1950s and 1960s will be overshadowed by new problems in the late 1970s.

CHART 1

CHANGES IN THE UNEMPLOYMENT RATE FOR THE CIVILIAN LABOR FORCE IN MONTHS FOLLOWING TROUGH OF FIVE POSTWAR RECESSIONS



The disturbing fact is that some of the industries that contributed substantially to the growth of employment throughout the years since World War II now show signs of stagnation or decline.

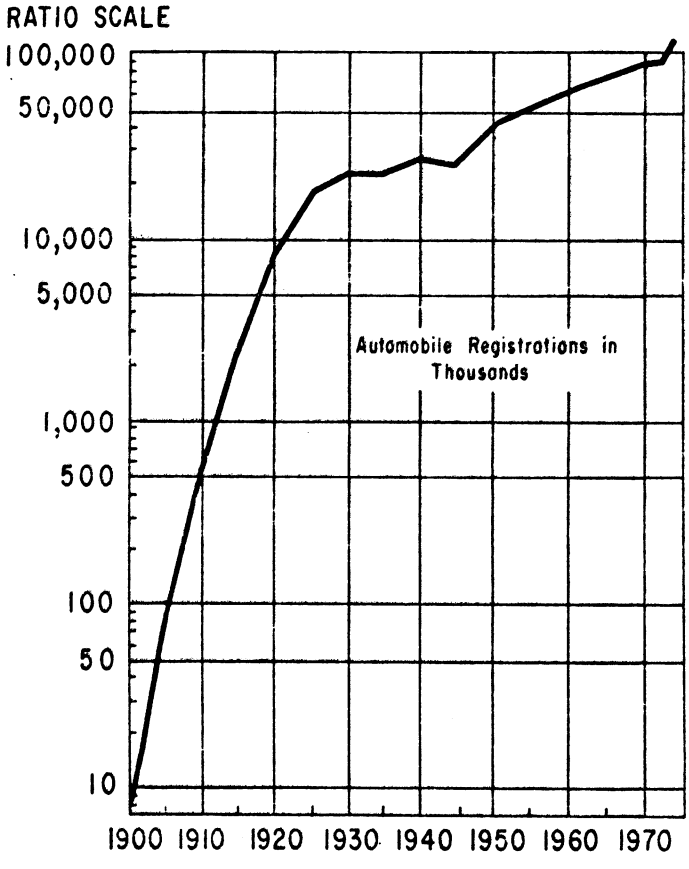
Automobiles. Chart 2 shows two striking aspects of the growth of the automobile industry of the United States in the twentieth century. The automobile using population was growing much more rapidly than the human population throughout most of the century. The chart illustrates the point that, in the most recent years, the growth of this industry has been pressing against an upper limit. The latest figures available indicate that we now have one car for every two men, women, children and infants in the United States. Recent developments have sharply accentuated the long-run trend toward slower growth in this industry. High price increases, even if largely caused by forces beyond the control of the industry, have adversely affected sales prospects. Past and anticipated increases in the price of gasoline, insurance, financing, repairs, and so on have contributed to slower sales. There has been an intangible but not unimportant shift in cultural values as well. It is no longer as fashionable as it once was in middle-class America to have a new car every year or two. There has even been a suggestion that a five-year-old car with 80,000 miles on the odometer may be the new status symbol. None of these are transitory influences.

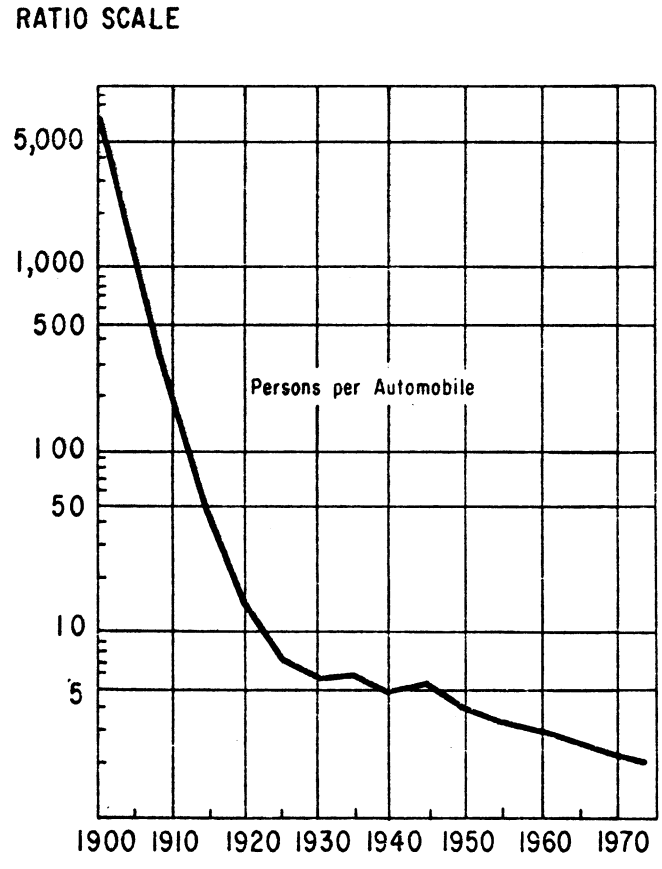
In the early 1970s, the automobile industry was getting about 4 percent of total disposable personal income for its products. In 1975, it is getting about 2.5 percent of a smaller total. In 1973, the industry employed about 950,000 workers; in 1975, the average for the year will probably be about 200,000 less than that. Professor Wassily Leontief has estimated that for each 10 workers in the automobile and parts industry, there are about 15 workers in other industries supplying raw materials--glass, rubber, steel, textiles, copper, and so on. This estimate implies a loss of another 300,000 jobs in the raw materials industries because of the slump in autos, or a total of 500,000 in 1975. Some of this job loss is temporary. But it seems highly doubtful under present circumstances that the automobile and related industries will ever again provide regular jobs for as large a proportion of the labor force as in the 1970-73 period.

Education. From 1950 to the 1970s, this nation increased its spending on education at all levels almost tenfold--from 8.8 billion dollars in 1950 to 83 billion dollars in 1972. The percentage of Gross National Product going to education increased from 3.4 percent in 1950 to 7.9 percent in 1972. Since 1972, the share of education in GNP has been going down rather than up. Enrollment in colleges and universities has also declined, but by much less than the decrease in the share of GNP. No single factor can completely explain this rather sudden reversal. However, there undoubtedly has been some public disillusionment with education as the purported best road to the good life, and education has fared rather badly in the increasingly tough competition for tax dollars.

CHART 2

AUTOMOBILE REGISTRATIONS AND PERSONS PER AUTOMOBILE IN THE UNITED STATES, 1900 - 1973





SOURCE: *Statistical Abstract of the U.S.*, and computations. Registration figures since 1930 include passenger cars and taxis; in prior years they also include busses.

The sudden sharp reduction in demand for teachers has had an adverse effect on the labor market for all college graduates. In recent years, their largest single source of employment has been education. The sudden change in this sector of the labor market has to some extent contributed to the devaluation of the college degree as a ticket for a job. And thus we have a self-reinforcing process: the decline in the prospects for this industry contributes to a further decline in its prospects. In the years ahead, it is likely that education will be taking less than its former share of a growing labor force, rather than a growing share as in the past two decades.

Health care. Another of the great growth industries since World War II has been health care. The nation spent 12 billion dollars (4.6 percent of GNP) on health care in 1950; the expenditure in 1973 was 94 billion dollars (7.7 percent of GNP). Employment in health fields increased by about 50 percent (from 2 million to 3 million) from 1960 to 1970. As the use of health care personnel and facilities has increased, costs have increased even more rapidly. This industry has contributed significantly to the general price inflation of the past ten years. And now the growth of this industry has slowed markedly; from 1972 to 1973, the percentage of GNP going to health care was unchanged, after two decades of substantial increases. Experts on the economics of the industry expect little further expansion in the years ahead. The labor market implications of this levelling-off may not be entirely obvious. The greatest expansion in employment in this industry from 1960 to 1970, both in percentage terms and in absolute numbers, was at the lower skill levels. Thus, the increase in physicians, dentists and related practitioners was only 17 percent; the increase in health service workers (assistants, aides, etc) was 67 percent. If the labor requirements of the health care industry diminish to the replacement level, this will have a significant effect on the supply of new jobs in the economy with a relatively short training period.

Construction. The construction industry had the highest unemployment rate reported for any of the standard industry classifications--19.2 percent in September, 1975. This is a cyclically sensitive industry, of course, but its present difficulties have deeper roots than the recent recession. In the consumer market, construction costs have far outstripped the growth in disposable personal income in the past decade. In the government market, the great boom in education construction has ended; the great national network of freeways is virtually completed; and proposals for the other kinds of public structures must compete with other rising claims on tax dollars. From 1950 to 1974, the percentage of the labor force employed in construction decreased somewhat, but in absolute numbers the industry provided 1.2 million more jobs in the latter year than in the earlier. With 700,000 of its present work force now unemployed, construction is not likely to offer large numbers of new jobs in the next few years.

War. Over the past 40 years, wars and preparation for wars have had larger effects on the labor market figures than most analysts recognize. Large increases in the size of the armed forces reduce the number of young men in the civilian labor force. Large orders for conventional weapons and other equipment such as wheeled vehicles, ammunition, helmets, and so on, create large numbers of assembly-line jobs for semiskilled workers. During the period of heavy production for the Vietnam War from 1965 to 1968, defense industries provided 48 percent of the new blue-collar jobs in the economy. Now, war appears to be a likely candidate for being listed among the declining industries. The number of persons now serving in the armed forces is the lowest since 1950. In the past five years, national defense expenditures as a percentage of GNP have marched steadily downward--from 9 percent in 1969 to 6 percent in 1974. Some of this reduction may be attributed to the U.S. withdrawal from Vietnam; but the GNP percentage for 1974 is the lowest since 1950.

There are perhaps, other industries that belong on the list of "endangered species," but this listing is intended to be illustrative rather than exhaustive. The basic point of this discussion is not that the country is headed for another depression like the one in the 1930's. The market will again generate a growing total of jobs, and there will be new growth industries. Most people will live lives of comfortable affluence. But we will face a massive problem of redeployment of our labor force--a problem that is likely to equal or exceed the comparable problem of the 1950s and early 1960s.

We never really solved that problem, although the effects of the Vietnam War led some people to believe for a time that we did. The Vietnam War removed about a million young men from the civilian population, most of whom would have been in the labor force except for the war; and war production provided a large number of temporary jobs for blue-collar workers. The growth of manpower programs during the late 1960s and the clssification of many of the enrollees as "employed" in labor market statistics also contributed to the appearance of full employment.

The war ended; war production was sharply cut back; hundreds of thousands of former draftees were returned to civilian life; manpower programs levelled off or were, in some instances, reduced in size; and the labor force resumed its normal rate of growth. The forces of change in the American economy left large numbers of workers stranded in the wrong occupations and the wrong cities. Monetary policy was directed toward the control of inflation, and the fiscal policy did not avert the deepest recession since the 1930s. The recession aggravated the displacement effects of structural change while leading many analysts to believe that all the unemployment was caused by the business cycle and the fight against inflation.

The question now is whether we must accept, for the rest of the decade, unemployment rates that were generally regarded as intolerable only a dozen years ago, or whether some combination of manpower and fiscal policies can avert the loss of hundreds of billions of dollars worth of production and prevent the ruin of millions of lives to which some of our national leaders appear to have resigned themselves.

3. Is there a "trade-off" between unemployment and inflation?

In 1958, Professor A. W. Phillips published an article entitled, "The Relation Between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1861-1957." His findings were not entirely free from ambiguity and, at least by contemporary standards, his methodology was not impeccable. But almost immediately the so-called "Phillips-curve" became a major factor in employment policy. Many economists, with varying degrees of success, tried to determine whether the Phillips-curve relationshop was applicable to American data. Some analysts found little need for data. The relationship was so logical and so consistent with economic theory that, if the data did not plainly show it, there must be something wrong with the data. With the passage of time, the relationship became one between the level of unemployment and rate of inflation.

The teaching was clear. In the most widely used economics textbook of modern times, the one by Paul A. Samuelson, the matter was stated as follows:

"Experience suggests that in the short run there is a trade-off between the intensity of unemployment of men and capital and the intensity of price increase.... One must not exaggerate the exactitude of the Phillips curve but nonetheless it is one of the most important concepts of our times."

Stated a bit more directly, the doctrine is that if you want less unemployment, you must accept more price increase; and if you want less price increase, you must accept more unemployment.

The data invoked to provide empirical support for this concept have turned out to be fractious. The alleged relationship cannot be demonstrated in any straightforward manner. On the simplest level, for example, the data show that the United States had quite low unemployment rates through most of the years 1951, 1952, and 1953; yet, coincident with unemployment that at times was less than 3 percent, we also had very low rates of price increase. There were wage and price controls during part of this period, but their abrupt removal early in 1953 made no difference. On the other hand, in the last three years, we have had unemployment rates

that were extremely high by postwar standards and very rapid price inflation as well. Various strategies have been followed to overcome such fractiousness of the data. Leads and lags of varying duration have been tried. Additional variables have been thrown into the equations, often with little effort to justify their use except for the fact that more satisfactory results were thereby produced. Some analysts, like Samuelson, say that the Phillips curve describes a short-run relationship; others say that it describes a long-run relationship. If all else fails, or seems inadequate, there is the useful notion of a *shifting* Phillips curve--that is, a relationship that changes from year to year.

Despite these difficulties, the Phillips curve has gained increasing influence in policy-making. When men in high office tell us that we must accept high unemployment rates for years into the future in order to bring inflation under control, they are echoing the Phillips curve doctrine. But, as so often happens, as the acceptance of the Phillips curve among economic policy-makers has spread, skeptics have arisen among the professional economists. And the skepticism is not confined to the "liberals" in the profession. Some persons whose conservative credentials are unquestionable have recently joined the skeptics--for example, William Fellner and Arthur F. Burns. The Burns formulation is especially pertinent. In effect, he says that whatever may have been the validity of the Phillips curve concept in the past, it is clear that it is inapplicable to the present unemployment-inflation situation. Others have pointed out that to a large degree, recent increases in the price level have obviously been caused by factors that are wholly unrelated to the state of the labor market--the outstanding examples being world-wide crop failures, the unilateral decisions of the Arab oil cartel, and the tightness, in the recent past, in world markets for raw materials.

Forty-five years ago, there was general agreement among the world's leading economists that the *only* way to reduce unemployment was to reduce wages. One of the great achievements of J. M. Keynes was to demonstrate the fallacy of this doctrine. Cutting wages might induce some employers to hire more workers, he said, but he pointed out that that was certainly not the *only* way or the most effective way to reduce unemployment. Like the insistence on wage-cutting, the Phillips-curve concept surely has a kernel of truth in it. *Some* approaches to the reduction of unemployment would be very likely to generate upward pressure on the price level. But there is really no convincing proof of the widely accepted belief that *any* reduction in unemployment, no matter what its level is and no matter what means are employed, will cause more inflation. It is true that few, if any, professional economists would state the doctrine quite so crudely. But many, perhaps a majority, would certainly accept the Samuelson dictum that there is some kind of "trade-off" between inflation and unemployment. The notion that there is such a trade-off has become an important barrier standing in the way of a substantial reduction in unemployment.

4. What are we doing now about unemployment?

In terms of numbers of workers involved, by far the largest program for dealing with unemployment is unemployment compensation. Table 2 shows the main programs; there are other, smaller ones not shown. As is apparent, what has developed is a kind of ad hoc jumble of programs with some variations in financing arrangements and duration of benefits. In general, the maximum duration for any recipient is 65 weeks, or approximately 15 months. By the best estimates available, it appears that we spent a total of 13 billion dollars on all of the main unemployment compensation programs in Fiscal Year 1974-75, and it is estimated that we will spend another 19 billion dollars in Fiscal Year 1975-76. During most of 1975, between six and seven million workers have received benefits. In recent weeks, the number of claimants appears to be showing a downward trend.

In terms of numbers of dollars, the biggest effort to date against unemployment is tax-cutting. The total value of tax cuts, personal and business, and rebates in 1975 is estimated at approximately 22 billion dollars. As will be discussed shortly, the tax cuts were not motivated solely by benevolence toward the unemployed. However, the reduction of unemployment was said to be one of the intended benefits of the tax cuts. It is difficult to estimate how many jobs were or will be created by the tax cuts. Former Secretary of Labor John T. Dunlop, who is an economist, was reported to have estimated that about 900,000 jobs would be created by the tax cuts and rebates by the end of 1975.

The Public Service Employment program is currently financed at a level of about three billion dollars per year, and Manpower Administration estimates place the current number of enrollments at about 315,000 (see Table 1). As presently established, this program (somewhat like the unemployment compensation program) operates under a variety of legislative authorizations, mainly under the Comprehensive Employment and Training Act (CETA). The day-to-day administration of the program is delegated to many hundreds of "prime-sponsors" around the country--primarily state and local units of government.

There are other programs that aid the unemployed, such as food stamps, general relief, and so on, but the amounts going to the unemployed cannot be determined with precision. There are also many private programs, such as Supplementary Unemployment Benefits in automobiles, rubber, steel and some other industries. In some companies, the reserve funds have been depleted and payments have been reduced or terminated.

5. What should we be doing about unemployment?

It is far easier to point out what is wrong with what we are doing now about unemployment than it is to say what would be better. But both matters must be considered.

Table 2

UNEMPLOYMENT INSURANCE PROGRAMS IN A NUTSHELL

	Program	How Financed	Number of Weeks	*Expected Expend. in Fiscal Year 1975	1976
1.	Regular Unemployment Insurance	State Unemployment Tax on Employer Payroll Financed Unemployment Tax monies used to cover state administration costs and to maintain a loan fund.	26 (max.)	$9.5 Billion (a minimum of $.5 billion for fiscal 1975 will come from the loan fund; between $3 and $5 billion in loans is expected for F.Y. 1976)	$12.7 Billion
2.	Federal - State Extended Benefits	50% from State Unemployment Taxes 50% from Federal Unemployment Tax.	13 (max.)	$1.4 Billion	$2.9 Billion
3.	Federal Supplemental Benefits (FSB)	Federal Unemployment Tax - at this time financed by repayable advances from general revenues	26 (max.)	$ .7 Billion	$1.6 Billion
4.	Supplemental Unemployment Assistance (SUA) (covers workers not covered by 1,2, and 3 above)	General Federal Revenues	39 (max.)	$1.4 Billion	$2.1 Billion
			Total	$13.0 Billion	$19.3 Billion

*These figures come from the statement of Lawrence Weatherford, Unemployment Insurance Administrator, to the Federal Advisory Council on Unemployment Insurance on March 5, 1975 in Washington, D.C.

Unemployment compensation has always been considered "the first line of defense" against unemployment. Therefore, the salient features of the system have always included limited duration of benefits, a relationship between wages previously earned and the size of the benefit amount, employer experience rating, and so on. The present use of this system to cope with very long-term unemployment threatens to change the system itself in rather fundamental ways, and it is creating future problems for the states that now have the highest levels of unemployment.

As of October, 1975, eleven states had found it necessary to borrow funds from the federal government to continue to pay unemployment benefits. By the end of 1975, the number was expected to rise to fifteen; and by the end of 1976, it is likely that thirty states will be borrowing money to pay benefits. Those states that exhaust their reserve funds and borrow will have to tax the employers in their boundaries more heavily to repay the loans than will the states that have been more fortunate. The states with the largest unemployment problem will have a competitive disadvantage as compared with the states that have been less affected.

The greatest shortcoming in such heavy reliance on unemployment compensation is that this program pays very large aggregate sums of money to millions of people for doing nothing and going nowhere. When we are dealing with relatively short-term unemployment, the unemployment compensation system functions well. It is not perfect, but it is a most useful social invention which has probably contributed significantly to the moderation of the business cycle, and has alleviated much hardship. It is much less defensible as a program to deal with a high level of long-term unemployment, particularly when structural changes in the economy are contributing to the unemployment. This approach contributes nothing to the solution of such structural problems--aside from income maintenance.

If we want to meet some part of the very long-term unemployment problem with a minimum income guarantee, we can devise a more rational and more equitably financed system than the present patchwork of add-ons to the existing unemployment compensation system. Under the present system, many people who are not in need are eligible for benefits; others who are in need are ineligible. Unemployment compensation payments do not encourage preparation for a change in occupation or place of residence, which will be required of many people if they are to adjust to the effects of structural change. Former Secretary of Labor Dunlop stated the opposition of the administration to further extensions of unemployment benefits, and this is a position that deserves support--provided that other programs are developed to meet the needs of the long-term unemployed.

Tax-cutting is perhaps irresistibly seductive for politicians. Hardly anybody ever objects to paying less taxes. Many Keynesian economists join with conservative opponents of "big government" in proclaiming the virtues of tax-cutting. Yet the effectiveness of tax-cutting as a remedy for unemployment is more a matter of faith than demonstrated fact. The main evidence on this point is often said to be what happened in the late 1969's.

We had a 14-billion-dollar tax cut in 1964, when the unemployment rate was around 5.4 percent; by 1968, the unemployment rate was down to 3.6 percent (annual average) and in 1969 it was 3.5 percent. Many economists have attributed all of this reduction in unemployment to fiscal policy (a few would give some of the credit to monetary policy as well).

This interpretation rests upon a fallacy that is easily revealed. Chart 3 makes the point. The definition of unemployment was changed twice during the relevant period (1965 and 1967), and the definition changes in combination reduced the reported unemployment rate by 0.7 percent. The Vietnam War, as already noted, reduced the size of the civilian labor force significantly; a conservative estimate of the effect on the reported unemployment rate is a reduction of 0.5 percent. There were other factors in addition to these--and equally unrelated to fiscal and monetary policy--that contributed to lower unemployment during the late 1960s. But considering only the definition changes and the Vietnam War effects, in combination they contributed about two-thirds of the reduction in the reported unemployment rate in the second half of the 1969s. To attribute the entire reduction to monetary and fiscal policy imputes to such policy about three times as large an effect as is justified by the facts. The point is not that tax-cutting has no effect on unemployment; rather the point is that the magnitude of the effect has been substantially exaggerated.

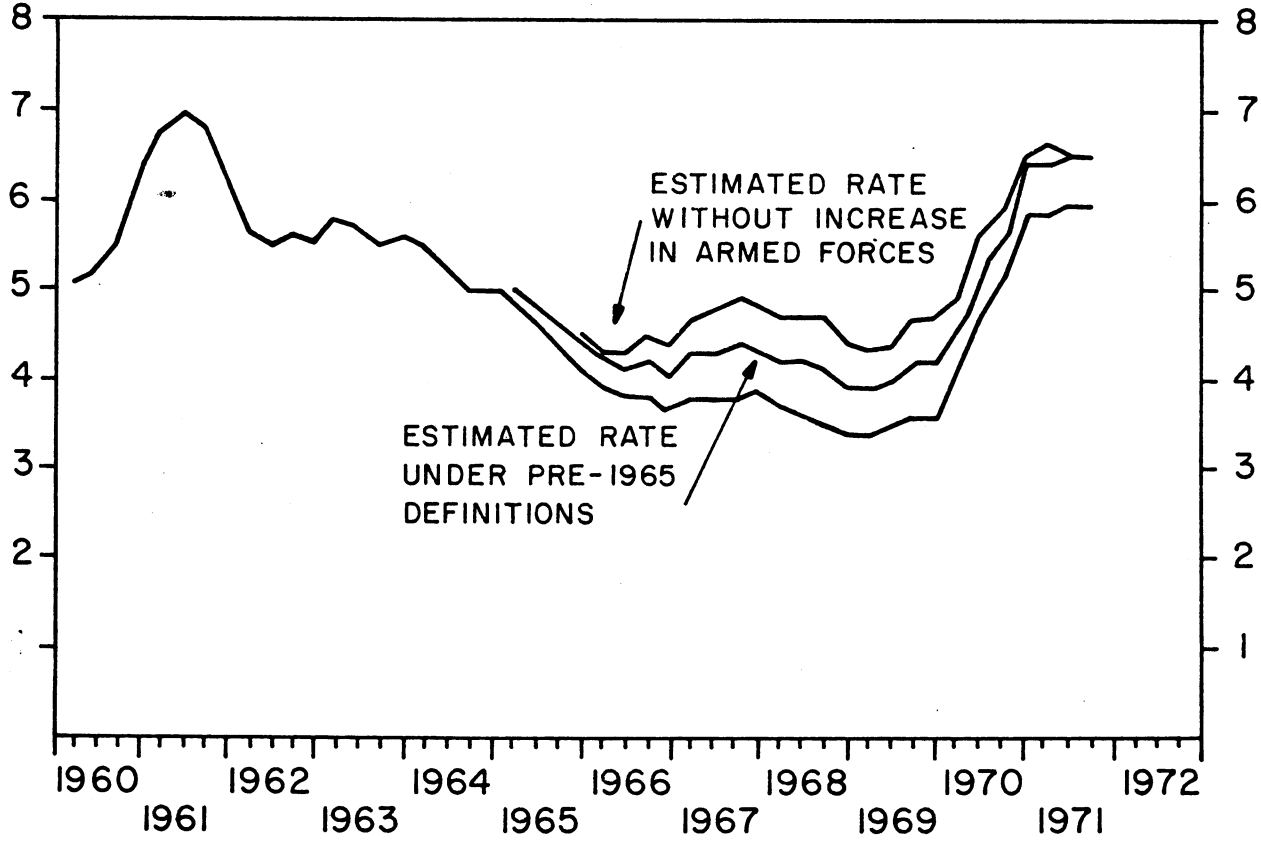
Three other disadvantages of tax-cutting should be noted. The experience of the 1960s shows that this remedy for unemployment apparently does the least for the most disadvantaged members of the labor force. Despite the tax cut, and despite manpower programs which focussed disproportionately on the disadvantaged, black teen-age unemployment, for example, did not decline at all during the great boom of the 1960s. Furthermore, tax-cutting is apparently a very expensive way of creating jobs. If Secretary Dunlop's estimate that 900,000 jobs will result from tax cuts and rebates of 1975 is accurate, the cost will be approximately $25,000 per job. Finally, there is general agreement that tax-cutting cannot contribute very much to the solution of structural problems. In the debate on employment policy in the early 1960s, there was disagreement about how much structural unemployment there was then; but there was general agreement that tax-cutting, and fiscal and monetary policy generally, are not the most effective tools for dealing with structural unemployment. Indeed, Keynes himself, in the 1930s, took the position that expansion of aggregate demand could not by itself remedy structural imbalances.

For a time, it seemed that Public Service Employment was almost everyone's favorite remedy for unemployment. More recently, there has been a reaction--or overreaction--against the earlier enthusiasm. The criticisms are numerous and varied: the PSE jobs are not going to the right people; there are "leakages" that reduce the anticipated impact of the nominal job slots by 50 to 90 percent; it doesn't make sense to have cities hiring new people with federal money while they are laying off their regular employees, and so on.

CHART 3

U.S. UNEMPLOYMENT RATE BY QUARTERS

All Workers, Age 16 and Older
1960 to Date, Seasonally Adjusted



Few informed people would argue that the existing PSE program is the best of its kind that could be devised by the mind of man. The present program was the product of legislative compromise and urgency, plus an effort to fit the program into the untried framework of state and local administration that is provided under the Comprehensive Employment and Training Act. Improvements can and should be made in the program. Tighter eligibility requirements should be enacted and enforced. The "leakage" argument rests far more on speculation than on hard evidence; and such leakage, at its worst, would not render the program less effective than tax-cutting. But if convincing evidence of a serious leakage problem does emerge, the obvious solution for it is federal administration.

The most valid criticism of the PSE program is that it is far too small to make a real dent in unemployment. Currently, the number of job slots that has been funded equals about 4 percent of the total number officially counted as unemployed. In the years of the Great Depression, we provided jobs, under roughly equivalent programs, for 30 to 35 percent of the unemployed. Today, a program of comparable size would provide 2.3 to 2.7 million job slots, or eight to nine times as many as are now funded.

Now that the PSE program is increasingly subject to criticism, including some that is not justified, it seems important to emphasize two advantages of basic importance.

(i) It is better for society in general and better for the individuals involved to pay them for working than it is to pay them for not working. Society gets the benefit of the goods and services thus produced, and the individual has a better chance of hanging on to his or her self-respect and ability to work.

(ii) A PSE program is a much more cost-effective way of providing jobs for the unemployed than is tax-cutting. If the gross pay of the average PSE job is $10,000 per year, the net cost is probably about half of that amount. Unemployment compensation payments that the worker would otherwise receive must be deducted from the gross cost; and the PSE worker will pay taxes on his earnings (he pays none on unemployment compensation). Therefore, the net cost may be roughly estimated at about $5,000 per year. In a broader kind of cost accounting, that net dollar cost must be set off against the value of the goods and services produced by the PSE worker. A careful analysis of experience under the 1971 Public Employment Program concluded that the great majority of the enrollees performed work that was as useful as that of regular employees of state and local governments.

There are indications that one consequence of the popularity of PSE programs at the local level has been a sharp cutback in expenditures for manpower training programs. Such a cutback is surely shortsighted. Obviously, it does not make sense to train people for jobs that are not available, and manpower training has had a bad press on this point.

It has also become faddish to assert that manpower training has been shown to be a "failure." This assertion is reiterated reflexively by some persons who appear never to have examined the available facts. Some programs in some locations have "failed"; it is nonsensical to generalize from such incidents to a sweeping conclusion. The fact is that the great majority of careful studies of manpower training programs show positive rates of return for the investment in training. Some critics have raised questions about the methodology of such studies--and some of the methodological criticisms are justified. But the reality is that in the social sciences, methodologically impeccable experiments are more of a Utopian vision than a practical possibility. At the present writing, the weight of the evidence decidedly supports a finding that manpower training has been successful. Hard evidence of "failure" is virtually nonexistent. Given this state of affairs, policy should ignore the mythmakers and revive manpower training, while continuing careful evaluation studies.

Finally, we need some new approaches to the old problem of depressed areas and sick industries. Perhaps it is not excessively pessimistic to say that our previous efforts in this area have accomplished little more than to show us what does not work. Of course, there are exceptions. For example, during the 1960s, there was experimentation with programs to increase worker mobility, and some of the programs reportedly were relatively successful. Yet we have no federal programs of this kind in operation today. This body of experience should be reviewed and consideration given to substantial efforts in this area.

Americans have sometimes seemed to have an excessive fondness for simple answers to complex problems. For a decade or so, many analysts believed that employment policy was virtually synonymous with fiscal and monetary policy--or, to simplify even further, that if you want to reduce unemployment you need only to reduce federal taxes. The ultimate illusion was that government had mastered the unemployment problem and all that remained was to master the technique of "fine-tuning." The development of persistent and excessive unemployment after U.S. withdrawal from Vietnam, and the catastrophic rise of unemployment in the current recession, may have corrected the complacency of the 1960s and the early 1970s. But we now have a virtual paralysis of employment policy. The source of the paralysis is a new simplism: that the country needs to have seven or eight million unemployed workers at least for the next few years in order to bring inflation under control. The point of this statement is that this "need" is but another illusion. It is certainly possible to find ways of reducing unemployment that would make the inflation problem worse. But the rate of unemployment does not uniquely determine the rate of inflation. And unemployment can be reduced far below seven or eight million without aggravating inflation. We have some weapons at hand that can be effectively utilized, and we need to invent some new ones. Certainly the one weapon that will not help is benign neglect.

THE TAX REDUCTION ACT OF 1975
IMPACTS ON UNEMPLOYMENT AND INFLATION

George H. Hildebrand*

By way of beginning, let me say that I consider my task to be an examination of the relationship between the Tax Reduction Act of 1975 and the current problems of unemployment and inflation. In consequence, I shall have very little to say about two other matters that nonetheless are highly relevant to my topic. One of these concerns the very important question of the comparative efficiencies of tax reductions, increased public spending, and monetary expansion as the principal alternative methods for reducing unemployment. The issues here are important, complex, and subtle, extending as they do far beyond the confines of cost-benefit analysis to reach into much deeper questions of social and economic philosophy.

The other matter to be largely put aside here concerns the protean nature of the problem of unemployment itself. Higher public spending, tax cuts, and easy money all represent attempts to increase total effective demand, on the now conventional premise that the central problem of unemployment derives from demand deficiency. Fill in the gap with aggregative expansionary measures, and output and employment will move up in linear correlation until full employment is achieved. And in large part, to be sure, this reasoning is correct. Unfortunately, it leaves out some now critical problems: the point at which the correlation ceases to be linear; the point at which inflation begins; and the degree to which overall unemployment--measured and unmeasured--involves problems of structural mismatching whose deeper sources can not be turned aside by techniques of aggregative expansion of total demand.[1/]

Major Features of the New Tax Law

With these two caveats, let me turn now to Public Law 94-12, the Tax Reduction Act of March 29, 1975.[2/] Several observations may be made at once. First, the law was passed some five quarters after the recessionary decline in real GNP had started, and three quarters following the decision of the Federal Reserve to go over to a restrictive monetary policy to combat double-digit inflation. Second, the central provisions of the new law are, in composite, of a "one-shot" character: absent further legislation, their multiplier effect for GNP is terminal rather than continuing. By the end of March, 1976, its stimulus will be over and other expansionary forces will have to carry the burden of reducing unemployment. Third, the new law is omnibus in nature: it is directed at disposable personal income at various levels; at private investment and at the profits of small business; at

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assistance to specific industries, such as residential construction and truck and bus manufacturing; at a special single cash payment to Social Security claimants; at a special cash payment to all low-income taxpayers; and at an increase in taxation for the petroleum production industry.

Finally, the measure should not be interpreted in any simplistic way. As both the Senate Finance Committee and the House Committee on Ways and Means took pains to emphasize, the law is intended to stimulate both consumption and investment. In short, it does not rest upon any naive notion such as that the rate of investment is uniquely determined by the rate of consumption. But more than this, it reflects purposes other than economic expansion alone.

Turning, now, to the basic details of the measure, it is necessary first to distinguish between the rebate upon individual tax liabilities for 1974 (-$8.125 billion, all falling within QII75) and reductions in individual liabilities that take effect between QII75 and QIII77. These latter embrace FY75 (-$9.639 billion), and FY76 (-$8.808 billion), and FY77 (-$0.526 billion). On a calendar year basis, individual tax liabilities are estimated by the Treasury to decline by -$10.262 billion in 1975 (plus the rebate of -$8.125 billion credited to CY74), plus $-0.605 billion in 1976, and -$0.071 billion in 1977. What we have, then, is a large cut effective in calendar 1975 (-$18.387 billion), a much smaller one for 1976, and a negligible amount for 1977.3/ Limiting ourselves only to the major categories, the largest reductions involve (1) the rebate on 1974 liabilities; (2) the increase in the maximum standard deduction for CY75 (from the existing $1,300 to $1,600 for the single persons and $1,900 for joint returns, together with a rise in the standard deduction to 16 per cent of adjusted gross income, with new maxima of $2,300 (single) and $2,600 (joint); and (3) an additional personal exemption credit of $30 each for taxes paid on 1975 income. The rebate applies only to 1974 tax liabilities, while (2) and (3) are effective only for one year (generally 1975). (4) An earned income credit is also provided for 1975, refundable at 10 per cent of earned income to a maximum of $400, where earned income is $4,000 or less for a family with one dependent child, declining to zero at adjusted gross income of $8,000. Finally, the cuts for individuals include a number of relatively small special provisions such as an increased child care deduction; and extended capital-gain exemption period on sales of old residences; a 5 per cent tax basis credit up to $2,000 for purchase of a newly constructed residence started before March 26, 1975; and an increase in the investment credit for unincorporated firms of from 7 to 10 per cent.4/

The second general category of reductions applies to corporations. For CY75, the Treasury estimates a total cut of $2.560 billion on liabilities, deriving mostly from an increase in the investment credit against tax liabilities where expenditures are made for new plant and equipment (-$2.832 billion), and a combined increase in the surtax exemption and decrease in the first-bracket rate for corporate taxable income of small firms. Against this it must be noted that the Act eliminates completely

the percentage depletion allowance for all large oil producers; reduces credits for foreign taxes paid by oil companies; and modifies the private benefits of deferrals of foreign-earned incomes of these concerns. Thus on the corporate side there are partically offsetting increases (-$1.734 billion in CY75, +$2.587 billion in CY76, and +$3.025 billion in CY77) in tax liabilities, directed against the now very unpopular oil industry.[5] Against these, the cuts are aimed at encouraging new domestic plant and equipment expenditures, and small firms and corporations generally.

Finally, the new law increases Federal outlays by an estimated $1.900 billion in CY75 and $0.700 billion in CY76. There are two sources involved: (1) a $50 payment in 1975 to beneficiaries under the Social Security and Railroad Retirement programs; and (2) a thirteen-week extension (to 65 weeks) of emergency unemployment compensation benefits to those unemployed who have exhausted fifty-two weeks of benefits.[6]

Putting all of these provisions together on a liability basis, the Department of Commerce arrives at a total direct impact for the first full 12-months of $22.9 billion. The general breakdown is as follows:

Table 1

First Full-Year Impact of Tax Reduction Act of 1975, Liability Basis (Billions)

Tax reductions	
Individual	$18.5
Corporate	4.3
Total	$22.8
Tax increases	
Corporate	-$ 1.8
Net reductions	$21.0
Increased outlays	$ 1.9
Total impact	$22.9

Source: U.S. Department of Commerce, Survey of Current Business, "Tax Reduction Act of 1975" (April, 1975), table 9. No specific calendar or fiscal year is to be associated with this "first full-year" effect.

On a national income and product accounts basis (NIPA), the Department of Commerce estimates that for CY75 tax receipts will fall $18.6 billion, as against only $2.6 billion in CY76 (with corporate taxes treated on a liability basis and personal taxes on a payments basis). Increased expenditures (NIPA) are put at $1.9 billion in CY75, and $0.7 billion in CY76.7/

In any event, both the Treasury and the Commerce calculations show that the major impact of the new law will be felt in calendar 1975, although a declining stimulus will continue to be exerted even into early 1977.

It should also be noted that all of the quantitatively important parts of the measure are purely temporary: the rebate on personal income taxes for 1974 is strictly a once-and-for-all provision, while the cuts in prospective personal tax liabilities, although they extend over more than one quarter, all will phase out automatically within two years. On the business side, the increase in the investment credit is limited to two years. By contrast, the termination of the percentage depletion allowance is eliminated immediately for major producers, while changes in the treatment of foreign earned oil income (for U.S. tax credits) takes effect generally with 1975. Finally, on the expenditure side both the Social Security payment and the increase in the UC benefit period are self-limiting to 1975.

In the large, therefore, as the measure stands it provides a net stimulus to the economy, through tax reductions and increased expenditures, for mainly CY75 and CY76. By contrast, its longer-run effect will be deflationary, because of the scheduled return to the former individual rates and business investment credit, and because of the permanent increases in taxes on the petroleum industry.

What Can Be Said about Quantitative Effects of the New Tax Law?

It is natural to ask what will be the overall cumulative impacts of these tax cuts for individuals and corporations, and of the increased spending that is also involved. This takes us into multiplier theory, although given the fragile state of current predictive econometrics, perhaps the less said the better.

As Klein points out, there exist three precedent fiscal "experiments" to guide our thinking in this difficult field.8/ With the "permanent" reductions in the Federal income tax in 1964, the overall effects were correct in sign, and "the multiplier effects worked out right."9/ In 1965 there was an excise tax cut. Again the effects were those predictable from econometric model analysis. But then came the Income Tax Surcharge and Expenditure Control Act of 1968, in which the realized cut-backs in quarterly increments to GNP, as well as other basic indicators of slowdown, all fell well short of predictions. Although we can not examine in detail Klein's reasons for the failure of econometrics to perform well on this occasion, they are worth citing because they are relevant to our present problem.

(1) The surcharge was temporary, and this implies a lower multiplier than for a permanent change of income. (2) It took so long for the measure to become law that its full effects were widely anticipated and thus offset by changes in public behavior. (3) By 1968:3 monetary policy turned strongly expansionary, in effect to work against fiscal policy.[10] (4) Public behavior may be asymmetrical as regards increases versus decreases in income. (5) Economic change is stochastic; peoples' range of choice is broader than models can allow for. This leads to sharp variations in observed series. (6) Structural changes of a permanent sort can occur, throwing off predictions based upon stable relations within a model.[11]

Except for the legislative and money supply factors, these potentially disturbing factors are also present today, making the task of prediction at least as hazardous as it was in 1968.[12] Other problems increase the level of difficulty even further. Except for the heavily increased taxes on the petroleum industry, all of the important changes enacted in the new law are temporary, although some of them stretch over several quarters, while others are strictly one-shot affairs (the rebate and the Social Security payments). Either way, they involve transitory increases in disposable personal income so far as individual income taxes are concerned. In result we should expect a lower marginal propensity to consume a smaller multiplier than if the cuts (or payments) were permanent. As for business investment, there exist profound ignorance and therefore profound disagreement over the impacts of investment credits, as regards the volume and the timing of investments, and the multiplier effects.[13] Given a two-year temporary increase in the investment credit, to what extent is there a "borrowing" from the future--a temporal redistribution of the dollar value of the stock of projects, as against an inducement of a net increase in investment over the longer period?

At any rate, these observations should at least make it clear that even the most sophisticated model carries a high risk that its predictions will be wide of the mark.

Viewing matters in an admittedly simplistic fashion, we may follow the Department of Commerce allocation, which breaks up the stimulative process into two successive calendar years, as shown in Table 2.

Table 2

Timing of Tax Cuts and Increased Transfer Payments
(billions)

	CY75	CY76
Reductions		
Personal	$16.0	$1.8
Corporate	2.6	0.8
Expenditures1/	1.9	0.7
Total	$20.5	$3.3

1/ "Dividend" on Social Security and Railroad Retirement plus extension of Unemployment Compensation entitlement from 52 to 65 weeks.

Source: U.S. Department of Commerce, Survey of Current Business (April, 1975), pp. 9-11.

If we accept, faute de mieux, the unreasonably high multiplier suggested by the Department of Commerce, namely, 2.5, we would deduce that, ceteris paribus, there would be a net stimulus of $51.25 billion in nominal GNP in CY75, and of $8.25 billion for CY75. At the other extreme, if we presume a very low multiplier of 1.3, we obtain increases of $26.65 billion in CY75, and $4.29 billion in CY76. Assuming, next, that nominal GNP for CY74 amounts approximately to $1,400 trillion, then we might expect an increase for 1975 of 3.7 per cent ($51.25 billion) on the higher multiplier, separately from all other factors, including further increases in the price level. By contrast, if the lower multiplier holds, we will have an increase of slightly less than two per cent in nominal GNP.

Thus, putting the best face on things, the tax cut and expenditure increases in CY75, standing alone, would not fully provide the 4.25 per cent annual trend rate of increase needed to absorb the normal annual natural increase in the labor force, and to prevent the associated trend rate of increase in gross labor productivity from invoking any significant displacement of presently employed workers into unemployment. Put differently, it seems likely that it will take more than this tax measure to get a significant reduction in the presently high (over 8 per cent) rate of measured unemployment. If, instead, the much lower gross multiplier of 1.3 were to hold, then the burden on monetary expansion and the "natural" forces of recovery becomes all the greater if the goal of a significant reduction in the general rate of measured unemployment is to be achieved.

Although I have nothing useful to say here about which multiplier has the greater truth value in a probabilistic sense, my intuition tells me to lean toward the lower value. First, I believe that reductions in corporate tax liabilities have a different, as well as lower, value than those that apply to personal income taxes. Second, I have enough faith in the distinction between permanent and transitory increases of personal income to believe that a one-shot combination of rebates (1974) and tax liabilities (1975) will have less annual stimulus for consumption outlay than would the same combination with the reduction in prospective tax liabilities made permanent. In other words, on the personal income side a one-shot measure involves a lower GNP multiplier than a permanent one, even for the same initial year. Finally, as I interpret the new law, I see the investment credit provision as bringing forward toward the present an increase in outlays for plant and equipment, temporarily augmenting the current investment multiplier, whatever it may be, but with depressing impacts two years later because the effect is to borrow from the future, so to speak.

Putting it all together, therefore, I conclude from admittedly simple aggregative reasoning that if our goal--and it is certainly mine--is to cut back sharply on unemployment, then the 1975 tax reductions should be made permanent, so that their multiplier effects can approach a steady state rather than be dissipated within a period of less than two years. On the same ground I favor continued monetary expansion at a rate moderately above the normal noninflationary trend of 4 - 4 1/2 per cent per year.

Relating the Impacts to the Scope of the Unemployment Problem

As of late Fall, the United States has eight million unemployed, or 8.6 per cent of the current labor force. Suppose now that we set 5 per cent as our initial target for the reduction of unemployment to a more acceptable level: what contribution may the new tax law be expected to make, and what are the basic conditions for achieving this goal?

In seeking an answer, we start from the depressing fact that the law has been in effect now for almost three whole quarters, and yet the unemployment rate stands at 8.5 per cent. More than this, the various predictive models now extant all suggest that at least 75 per cent, and probably much more, of full multiplier effects occur within the first year after a fiscal policy has been introduced.[14/] Consider also that on a calendar year basis by far the larger part of the indicated effect on GNP falls in 1975. Even granting some lag for the multiplier to reach its peak, there can hardly be any doubt that a major part of the impact must have been felt by now. Yet we remain on a plateau of 8.5 per cent unemployment. Indeed, since the rate was 8.7 per cent in March, 1975, we have to infer that the direct effect of the law was negligible, granting that in its absence things might have gotten worse.

Assume, next, that the 8.5 per cent rate still holds at the start of 1976. Okun's "law" suggests that real GNP must rise roughly by three per cent to bring down the general unemployment rate by one percentage point. Initially, then our goal of a five per cent rate calls for an increase of 10.5 per cent in real GNP merely to absorb the present excess supply of labor. However, we must also allow for the growth factor--an annual increase of at least 2.5 per cent (currently) for the civilian labor force, and an additional 2.5 per cent annually for increased output per man-hour.15/

Putting things together, it would require an increase in real GNP of five per cent merely to stand still with an unemployment rate of 8.5 per cent during 1976. To bring the rate down to five per cent by the end of next year would require at least an additional ten percentage points of increased GNP, or 15 per cent overall (in nominal terms, with the price level assumed to rise seven per cent, we reach the unbelievable figure of 22 per cent).

Obviously, the United States is not going to increase real GNP by 15 per cent in 1976. Nor is it going to cut the unemployment rate to five per cent by the end of that year. Indeed, we shall do well to achieve the latter goal by the end of three years. For this will require a sustained rate of expansion in real GNP of over five per cent yearly, or, with annual inflation continuing at five to seven per cent, over ten per cent yearly in nominal GNP.

Given that the main stimulus of the tax law is already largely over, I conclude that we shall have to rely on other factors--recovery of private capital formation and renewed tax reductions, for example, to achieve five per cent unemployment by the end of 1978.

Let me close this section with a few brief comments on the current economic situation. On the favorable side there has been a well-sustained (until August, when signs of weakness appeared) expansion of retail sales, which extends back to December, 1974, and which began gaining momentum during the summer months, perhaps stimulated by the tax measures. Other encouraging factors involve the contraction of inventories--admittedly negative in its initial impacts--the rather steady advance in industrial production, and the fall in the measured rate of general unemployment.

However, there are some adverse factors, and these are important enough to warrant condiderable skepticism about the strength and persistence of the current recovery. Foremost, there is the evident failure to bring the rate of inflation down to an acceptable long-run level; indeed, a distressing reversal appeared in July and August, centering in foods and petroleum products. At the same time, and largely for the same reasons, starting with the middle of QII75 interest rates again turned sharply upward. This reversal included short-term rates (commercial paper, CD's, Treasury bills) as well as rates on long-term bonds of all classes. By late Fall, this movement has again turned around. Thus it may be too early to conclude that "crowding out" has already started in the

capital market under the pressure of the ever-growing Federal deficit, but let those who continue to urge easy money and more public spending as the answer to practically all economic ills carry the burden of showing that a vigorous non-inflationary recovery will be the necessary outcome over the next two years.16/

Perhaps the most serious adverse factor of all is the depressed state of private capital formation in this country. It hardly needs saying that net private investment is the vital factor for job creation, for higher labor productivity, for higher real wages, and for our competitive strength as a world trader. But notwithstanding this elementary truth, the tax law of 1975 in the main has a quite different orientation. Its main intent is to promote increased consumption among the low and middle income groups, both for its own sake and perhaps for its indirect stimulus for investment. I do not really disagree with this purpose. But I have to say that the obviously muted direct stimuli to investment in the new law are centered upon cuts in taxes for small firms, together with a contemporary increase in the investment credit. The economic heartland--big corporate business--goes largely ignored, save that the oil industry gets its lumps through ending the depletion allowance and tightening the treatment of its earnings abroad.17/ Both are complex issues and I can not consider them here. But I do say that their effect surely will be to reduce the inducement to invest in this now very unpopular industry, of all times just now. And, as a general matter, I would like to see an overhaul of corporate taxation across the board, modelled upon the German and Japanese principle of promoting a high rate of private capital formation because of its overall economic benefits for everyone. We are not putting enough real resources into capital formation. In result we are not creating enough new jobs, nor are we achieving internationally respectable rates of improvement in labor productivity.

The Tax Law and Inflation

I believe that the root cause of inflation is always the mismanagement of money, specifically, the persistent toleration or encouragement of a situation in which the rate of money formation outruns the rate of production. Accordingly, I do not believe that the present American inflation which incidentally has now gone twelve years without interruption, is to be attributed to the Arabs, the Russian wheat deal, supermarket operators, big business, or labor unions. One can not account for the whole price level by appeal to particular prices. As William Wolman puts it, the great European inflation of the 16th century is to be explained by the vast influx of Spanish silver from the New World, and not by a peculiar coincidence of decisions by the managers of the various royal salt, wool and other monopolies to put up their prices at the time. Today the principal source of inflation is deficit spending by governments, financed for the most part through the central banks and an accompanying expansion of individual bank reserves and deposit credits.

Now all of this emphatically is not an argument for never running a deficit. It is only to say that the habit of running deficits is easy to acquire. It is also very difficult to break, and it has a way of capturing monetary policy to make it the reluctant servant of inflation, and of disrupting capital markets at the cost of impairing real long-run growth.

In the United Kingdom today a situation of hyper-inflation now exists, with the price and wage levels advancing at over 25 per cent a year. What is less well-known is that for the past five years the British Government has been expanding the money supply at rates of over 20 per cent a year--in an economy whose real growth rate is about 2-1/2 per cent a year. Behind the soaring money supply is a long and unbroken chain of deficits, mostly incurred to finance a whole group of "loss-making" nationalized industries plus various programs for income redistribution. Over the past eight months, sterling has depreciated 15 per cent relative to the dollar. And if the UK Government were suddenly to try to finance these now virtually uncontrollable deficits without recourse to the banking system, the consequences would be a massive liquidity crisis, followed by economic collapse and massive unemployment.

The American case diverges in major respects, but the difference seems to me to be more of degree than of kind. We, too, have been financing a long string of deficits through the banking system, and we have just gone through two years of double-digit inflation. Until recently the American deficits had their inception in the Vietnamese War and the Great Society programs. Today they have a strongly growing source in a large array of transfer programs (food stamps, Social Security) and soaring expenditures for education. We, too, face the possibility that Federal spending will become uncontrollable, and along with it the deficit as well.

It is within this context of dangers to price stability and growth that one ought to consider the Tax Reduction Act. Looked at by itself, the approximately $20 billion change in the revenue-expenditure relation is not burdensome, while certainly the case for the tax cuts is a strong one. Rather, my concern is that the overall deficit for FY76 will not turn out to be the officially predicted $60 billion, but rather a number between $85 and $100 billion. No problem, say some economists, arguing that "given" a multiplier of 2.5, plus severe unemployment and excess capacity--say a gap of $250 billion in full-employment GNP--the result simply will be matching increases in effective demand and in real output.

Perhaps so. But I see two problems here. First, how is the deficit of $60 to $100 billion to be financed? If the answer is by recourse to the capital markets without added bank credit, then there can hardly be any escape from soaring interest rates, greater distress than ever in construction and the durable goods industries, and widespread cancellations of projects for private investment. Alternatively, if the Federal Reserve is to be co-opted in the service of the deficit, then there can hardly be any dodging the monetary consequences: an acceleration in the rate of

money formation, "to keep the capital market orderly and make credit available at reasonable rates of interest." In part output can increase in response to a linear way, but not for long. The danger then is that the deficits will get out of hand, while within one to two years double-digit inflation will afflict us once more. And in the process it will prove impossible to hold down interest rates, because lenders will learn to expect accelerating inflation, while borrowers will find it initially attractive speculatively to "get in on the action."

The second danger is that if an accelerating deficit is to be covered independently of the banking system or of recourse to higher taxes, then the government becomes a major competitor for gross savings, to push aside the business sector that still accounts for 85 per cent of all output, and along with it state and local governments that also have important capital needs.

Thus I conclude that the Tax Reduction Act was a good thing on its own terms; that it will make some contribution to lower unemployment, although a very modest one; and that from a larger point of view it will complicate an already difficult deficit problem, and with it monetary policy. Only with luck and remarkable sophistication and courage will we be able to check inflation and restore adequate real growth of output and employment within the next three years.

Footnotes

1. As Blinder and Solow observe in a perceptive recent paper, the real supply function for output relative to the price level is a curve with three segments: the first one is perfectly elastic and represents the "crude Keynesian" case; the second rises to the right, indicating that output ceases to respond proportionately to changes in demand; while the third segment is zero-elastic and depicts the monetarist view of the relationship. It is the second segment that tends to be overlooked in debate, although it is the one that usually prevails, including today. See Alan S. Blinder and Robert M. Solow, "Analytical Foundations of Fiscal Policy," *in* The Brookings Institution, *The Economics of Public Finance* (Washington: Brookings Institution, 1974), 31, 73.

2. Public Law 94-12, 94th Congress, H.R. 2166, March 29, 1975.

3. U.S. Treasury, Office of the Secretary of the Treasury, Office of Tax Analysis, news release dated April 8, 1975. These figures do not include special expenditures for Social Security or for higher unemployment compensation.

4. Details here are from an undated Treasury release, "Summary of Tax Cut Bill," *passim.*

5. U.S. Treasury, release of April 8, 1975.

6. U.S. Department of Commerce, *Survey of Current Business*, "Tax Reduction Act of 1975," (April, 1975), 10. These figures are seasonally adjusted annual rates, NIPA basis.

7. *Ibid.*, table 10.

8. Lawrence R. Klein, "An Econometric Analysis of the Revenue and Expenditure Control Act of 1968-69," *in* Warren L. Smith and John M. Culbertson, eds., *Public Finance and Stabilization Policy: Essays in Honor of Richard A. Musgrave* (North Holland Publishing Co., 1974), 333-353.

9. *Ibid.*, 333.

10. Blinder and Solow also note the stimulus from monetary expansion, which they put (M_1) at an annual rate of 7.3 per cent during January 1967-January 1969--the fastest rate of increase since 1946. Blinder and Solow, *op. cit.*, 112.

11. Klein, *op. cit.*, 336-337.

12. Measured as M_1, money supply in October was only 4.6 per cent ahead of a year previous.

13. Blinder and Solow have an excellent discussion of these problems; *op. cit.*, 91-95.

Footnotes cont'd.

14. Blinder and Solow, *op. cit.*, 81. All of the multipliers considered in their study are cumulative. That is, they are based on sustained ("permanent") changes in tax rates or public spending, not temporary changes with built-in termination dates.

15. Paul W. McCracken follows a similar procedure, *in* "The Targets for Economic Policy," *Wall Street Journal* (Nov. 25, 1975).

16. In one sense, of course, there is always crowding out because, at any market-clearing rate of interest, there will always be excluded potential demands for investment money for projects and extensions of projects whose estimated RoI is below the market rate.

The more subtle aspect of the matter is, what happens when the government adds heavy and *prolonged* borrowing to a capital market in which interest rates are stable? In time these rates will rise, with both the timing and degree of rise dependent in part upon the amount of overall slack in the economy. The rise in interest rates will crowd out lower order proposed capital outlays. Efforts to reverse the rise will require central bank intervention to speed up the expansion of money, which subsequently will accelerate inflation and thus abort the effort to hold rates down. Meanwhile, deficit financing indeed does exclude lower-order uses for gross savings.

17. Politics apart, it is plainly inconsistent to try to encourage capital formation in the electrical utilities branch of the energy industry while simultaneously dealing a staggering blow to the earnings, and therefore capital formation, of the petroleum branch of the energy industry. Yet that is what the new law does.

THE TAX REDUCTION ACT OF 1975--A DISCUSSION

Daniel J. B. Mitchell*

Three points in the Hildebrand paper strike me as needing further discussion. These are tax policies with respect to oil, the "crowding out" effect of bond-financed federal deficits, and the "root" cause of inflation. I will deal with these in sequence and then touch on what I see as a bright spot for 1976.

I. Oil

The oil issue has become entangled in the debate over current economic policy. Obviously, it does have some short-run policy implications. Taxes imposed on the industry must be considered along with other taxes in calculations regarding fiscal policy and its effect on aggregate demand and employment. Tax policy also has inflationary implications, especially if consumption taxes are included. Consumption taxes would obviously have an impact on retail prices and could contribute to inflation and inflationary expectations. Thus, it is clear that oil policy cannot be divorced from other more general economic policies.

I would not agree, however, with the implication that any taxes imposed (or tax loopholes removed) on the oil industry are inappropriate. My personal bias is for a policy which places greater emphasis on consumption limitation than on production stimulation. This approach would involve heavy consumption taxes with the revenue collected returned to the public via some sort of income tax rebate. The result would be a lesser dependence on foreign sources, and a reduction of the adverse environmental effects which flow both from consumption and production. It seems clear that if we want people to drive automobiles which exhibit miles per gallon comparable to European cars, then we have to charge European-style gasoline prices. The windfall profits that such prices imply can be avoided only if they are imposed publicly--through taxes--rather than privately.

II. Crowding Out Effects

The view that budget deficits automatically push up interest rates needs to be qualified. Much depends on whether fiscal policy "works," i.e., whether it in fact can stimulate output. If it can raise output and income,

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then it must also increase saving. The added saving can absorb some--even all--of the extra federal borrowing, thus at least partially relieving pressure on interest rates.1/

It is obviously true that at full employment, increased deficits must have a crowding out effect. By definition, at full employment output and income cannot be raised. Therefore, saving will not increase and the added federal borrowing must have an upward impact on interest rates. But we are currently far from full employment, and it would be inappropriate to apply a full-employment model to the current situation.

III. The Cause of Inflation

Is it enough to say that "the root cause of inflation is always mismanagement of money"? From my viewpoint, there is a further question. Why is money mismanaged? The answer usually given is that monetary policy tends to be too liberal because the public places strong emphasis on high levels of employment. But even this answer is inadequate. Why is it so difficult with present day institutional arrangements to achieve those levels of high employment?

It has been pointed out recently that the current recession is somewhat comparable to the short-lived slump in 1921 in terms of its intensity. Yet in that earlier recession, prices fell drastically.2/ In the current recession the upward climb of prices and wages abated only mildly from the record rates of 1974. Our institutions now have a tendency to build in inflation. That is why money seems to be persistently mismanaged. Once an initial bit of mismanagement has occurred, the consequences are difficult

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[1]Consider the following overly simple Keynesian model:

i) $Y = C + I + G$
ii) $C = a + b\ (Y - T)$

Where Y = national income = national output, C = consumption, I = investment, G = government spending, and T = taxes. If saving (S) is defined as Y-C, then it is easy to show that $dS/dT = -b$. This suggests that if taxes are cut by one dollar, saving will increase, but by something less than one dollar since b can be taken to be positive but less than one. Thus, the increased budget deficit (or decreased surplus) engendered by a tax cut is partially offset by increased saving. Some upward pressure on interest rates will result, but there is not a one-for-one crowding effect. If the economy is stimulated by an increase in G, it can be easily shown that $dS/dG = 1$. In this case, the increased budget deficit (or decreased surplus) is entirely offset by increasing saving, and there is no crowding out effect.

[2]The Handbook of Labor Statistics, 1974 indicates a drop of almost 15% in consumer prices between 1920 and 1922 (p. 301).

to reverse. Tight money can squeeze real output, but its impact on inflation is mild. Put another way, if inflation were more reactive to monetary policy, there would be far less monetary mismanagement.

The monetarist model, like all aggregate models, really assumes a single-sector economy producing one good with price P. It is very hard to introduce the effects of relative price changes into such a model. Hence, there is a tendency to downplay the effects of oil cartels or world prices for wheat. But I am not ready to assume that if one price goes up, some others will automatically come down, thus leaving P at its pre-ordained level. It is instructive to look at what the monetarists of the St. Louis Federal Reserve Bank were forecasting in late 1972. They expected an inflation rate of about 3.5-4.0 percent for 1973, if wage price controls continued to be effective and 4.5-5.0 percent if they did not.[3] Neither rate comes near the actual 8.8 percent jump in the Consumer Price Index that year, simply because the forecasters had no way of predicting the largely exogenous world commodity inflation, exacerbated by dollar devaluation.[4] Their only consolation was that the Keynesian forecasters had an equally dismal record. (The Keynesian UCLA Business Forecast for inflation in 1973 was somewhat over 3 percent.)

IV. The Near-Term Outlook

There has been much debate over the impact of escalator clauses in labor contracts on inflation. Some believe that such clauses are themselves inflationary, since they speed up the wage/price spiral. A recent study undertaken for the Council on Wage and Price Stability, however, is skeptical of this view.[5]

Whatever the effect of escalators may be in the long-run, their impact in 1976 is likely to be anti-inflationary. Most of the big contracts which will be renegotiated in 1976 are three-year agreements which contain escalator clauses. Hence, the workers under these contracts

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[3]Keith M. Carlson, "The 1973 National Economic Plan: Slowing the Boom," Federal Reserve Bank of St. Louis Review, Vol. 55 (March 1973), p. 9. Inflation was projected to decline in 1974.

[4]Joel Popkin estimated that about 45% of the increase in consumer prices in 1973 was attributable to world commodity inflation. See his "Commodity Prices and the U.S. Price Level," Brookings Papers on Economic Activity, number 1 (1974), pp. 249-259.

[5]The study by H.M Douty is reprinted in Daily Labor Report, August 20, 1975, pp. E1-E22.

were substantially protected from the inflation of 1973-75. We won't be facing a "catch-up" situation in collective bargaining for the key sectors, a factor which may encourage moderation in wage settlements.

Productivity is also a plus factor. Output per manhour typically rises faster than its long-term trend during economic recoveries. This takes pressure off unit labor costs, and therefore off prices. Since 1976 should be a year of continued economic recovery, the helpful gains in productivity can be expected.

These two moderating factors provide grounds for optimism. The less that fiscal stimulus is dissipated in inflation, the more it can do for real output and employment. As Professor Hildebrand points out, the impact of the 1974 tax cut is likely to be greater if it were made permanent. It would appear prudent to take this step as soon as possible.

PUBLIC SERVICE EMPLOYMENT AND INFLATION

Michael Wiseman*

The current recession is unique. In magnitude it is the worst reversal of economic expansion since the 1930s. The turnaround and recovery--if that is what we are experiencing--is proving remarkably sluggish. But its most unique feature from the standpoint of policy making is the remarkable persistence of inflationary pressures in the face of extraordinarily high unemployment rates and considerable excess capacity. This last aspect has stimulated a search for policy instruments capable of reducing the uneveness of the burden of the recession on households while not exacerbating inflation and thereby hindering economic recovery.

Government sponsored public employment programs for the jobless are frequently cited as the appropriate tool for achieving this end. The most recent support for public employment as fiscal policy appropriate for this recession has come from the Congressional Budget Office. In a survey of possible stimulatory fiscal policies, written at the request of the Senate Budget Committee and apparently enjoying wide circulation in both houses of Congress, the CBO concluded.

> The use of federal funds for the direct hiring of workers is likely, in a short run, to have a significant impact on employment and unemployment rates. Public service employment is likely to have a greater effect on employment in the short run than other fiscal measures such as tax cuts or increases in government spending. To the extent that the unemployment rate is a true indicator of social distress there is a clear value in attempting to lower that rate in the most expedious manner possible.1/

The CBO gave public service employment high marks for its believed minimal impact on prices--allegedly lower per job created than all of the alternative programs considered.2/ The commendation, however, was qualified:

> . . .a public jobs program will have a lesser inflationary impact to the extent that it is targeted at unskilled workers. The fact that many skilled individuals are currently part of the unemployment poor or that unemployment is expected to remain high throughout 1977 does not significantly alter the issue.3/

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Assuming a program cost of $8,500 per job, the CBO calculates that $1 billion in initial expenditures on public service employment would create 90,000-150,000 new jobs. In terms of job creation, the next best alternative was general revenue sharing to state and local governments. This alternative would produce from 72,000-100,000 jobs with a billion dollars of initial expenditure. For PSE, revenue sharing, and other alternatives, the total budget cost over two years would be less than $1 billion because of increased taxes and reduced transfer costs generated by the job expansion the programs bring about.

All this sounds like gospel to those of us who are long-time PSE supporters. But since being a believer does not generally call for eschewing theology, it is useful to review the case for PSE as counter recession fiscal policy and the qualifications that should be appended to the CBO's endorsement. In the next section I describe the grounds on which the argument for PSE rests. In Section 2 I shall point out a number of problems with the logic of the argument and the reality of current public employment efforts. I shall conclude the paper by qualifying the CBO's endorsement and by proposing two changes that would improve the public employment program by reducing its effect on prices and increasing its output.

The Case for PSE

Proponents of PSE contend that expenditures on emergency public employment move the economy leftward along a more favorable Phillips curve than would be traversed in the short run under alternative policies. A given reduction in unemployment generated through PSE will, in other words, be associated with less inflation than the same change when brought about by increased aerospace expenditures. Why should this be the case?

Four arguments are usually cited to support the claim that PSE can improve the short-run inflation/unemployment trade-off. The most obvious to the lay public is that money spent on PSE gets translated directly into job creation for the unemployed. It is not diverted into wage increases for existing jobholders, payments for capital services, or reduction in materials inventories. The popular metaphor for the way traditional Keynesian policy reaches the unemployed is, I believe, "Feeding the horses to feed the sparrows." With PSE, the horse is bypassed and the sparrows--the unemployed--get fed better, more quickly, and in a manner more palatable to the outside observer.

The second argument is that, unlike the stimulus provided by a tax reduction, expenditures on PSE employment can be targeted. Such targeting occurs in two ways: First, expenditures can be concentrated in areas bearing the brunt of the unemployment generated by the general business downturn. Second, the moneys can be concentrated on those workers within such areas in greatest need and whose employment will

have the least effect on output from nonsubsidized employment. The sizable expenditure leakage out of labor market areas as workers spend wages on goods produced elsewhere vitiates the local multiplier impact of federal PSE expenditures, but, leakages or not, all first-round reduction in unemployment generated by a public service employment program will occur in the targeted areas.

The Congressional Budget Office emphasizes the importance of targeting public employment funds on labor market areas on the basis of *incremental* unemployment generated by a recession. Substantial structural differences exist from area to area in normal unemployment rates. Hall and others have argued that such conditions seem to be more or less permanent and to reflect industrial-structure and other local peculiarities, which may or may not require special manpower policies but which are, in any case, not the target of counter-recession PSE programs.4/

The choice of targeting procedures for selecting jobholders under PSE will affect national output in two ways, one obvious and one not so obvious. The obvious one is that, to the extent that such workers do anything of value to taxpayers, they add to perceived national product. By national income accounting standards, of course, PSE workers create value in current dollars in an amount equal to their pay. In converting to real, constant, dollar terms, our national accountants tell us that every dollar of PSE wages paid goes for output that is equivalent in real terms to that associated with 65¢ paid in the private sector. The disparity is created by the national accounting convention that productivity of government employees does not increase. Whether or not this is reasonable is not at issue here: regardless of price adjustment made, employment of additional workers will increase GNP originating in the government.

The less obvious effect of PSE is on output in the private sector. For maximum effect on output and the least effect on prices, workers selected for PSE should be those in excess supply at the time of employment and throughout tenure in PSE. The conceptual test for identifying a worker in "excess supply" is to ask the following question: Will employment of this worker over whatever time period the program covers reduce the number of jobs or increase the number of job vacancies in the private sector? A reduction in the number of jobs in the private sector can occur when PSE lures workers away from private employment and employers respond by not replacing them.5/ An increase in the number of vacancies can occur for the same reason (just assume that the private employer keeps the slot vacated by the new PSE worker open but takes his time about filling it), or because government agencies filling PSE jobs select those workers most likely to return to private employment in the near future. The absence of such workers from the unemployment pool will mean that some employers will take longer to fill vacancies, and may do so ultimately with less productive people than would have been the case otherwise. The first effect will increase unemployment; both effects will lower gross national product.

Since almost all PSE programs proposed fund total job creation in amounts far less than the number of unemployed, some allocation procedure must be employed. The CBO suggests that it is less-skilled workers who are most likely to meet our criteria for identifying labor in excess supply. Others suggest an unemployment criterion. Either is feasible. The important idea is that, given the shortage of jobs, some sort of statistical discrimination must be employed to maximize the effect of the program on employment and minimize its effect on prices. One of the great advantages of PSE is that theoretically plausible procedures for allocation are not so arcane as to be administratively preposterous.

The third virtue of PSE is its flexibility. Unlike public works, it is alleged that public service employment programs can be started up quickly and "turned off" when such stimulus is no longer needed. In the immediate context, quick start-up and a short implementation lag is possible because any new public employment programs can be administered through the existing system of manpower program funding created by the Comprehensive Employment and Training Act of 1973 (CETA).6/ Other fiscal policies--in particular, tax cuts--can also be rapidly implemented and altered when conditions improve, but the "outside lag" between implementation and the point at which effect on employment and output is felt is likely to be much slower. To get the same short-run effect (six to twelve months) on employment as PSE would require far greater outlays and would consequently pose a much greater threat to price stability.

The fourth virtue of PSE is that the aggregate stimulus associated with unemployment reduction using such expenditures need not be so great nor so inflationary as for other fiscal policies with the same employment consequences. This favorable effect occurs because of the efficiency with which such expenditures are converted into employment. The fact that first-round expenditures are translated immediately into job expansion means that the economy moves along a more favorable short-run Phillips curve than would be the case for other fiscal policies--this is just virtue one restated. But in terms of immediate impact on the budget deficit, the influence of PSE expenditures is also minimized by the fact that many of the jobless hired would have, in the absence of PSE wages, drawn on one or more government transfers--food stamps, unemployment insurance benefits, or welfare. The Congressional Budget Office points out that average UI benefits are $3,250 per year; this, plus other transfers reduced and taxes increased due to PSE, serves to reduce the net budgetary impact of PSE expenditures and, as a result, the multiplier effect of such outlays. These considerations cause the CBO to argue that all the alternatives have a greater net budget cost than public service employment, given a billion dollars in initial outlays. The difference in some cases is substantial. The net budget cost over twenty-four months of a tax reduction of $1 billion was estimated, for example, to be between $637 and $663 million; for PSE the corresponding figure was between $312 and $392 million.7/

In summary, the occasionally maligned but always stalwart proponents of Public Service Employment expenditures have gained a new ally in the Congressional Budget Office. The CBO's case contains elements of all of the four major arguments for PSE. Such expenditures, it is claimed, produce a greater reduction in unemployment per dollar of initial outlay, can be targeted on areas and individuals bearing the brunt of the recession, can be turned on and off relatively quickly, and have less impact on the federal deficit than other fiscal policies involving expenditures or tax reductions of equal amount. The CBO's endorsement is strengthened by the inclusion of unfavorable cost and impact estimates of other programs; its importance is enhanced by its audience. In the next section I shall review these arguments again in light of actual operation of Public Service Employment and other considerations.

Some Extenuating Considerations

There are a number of well-known objections to the case we have sketched above. In this section I will review them and add where appropriate new information based on my own research or that of others. My objective is to evaluate the reliability of the CBO's estimation of the effects of additional outlays on public service employment. I shall follow the order in which the arguments for public service employment were presented in the preceding section.

The employment effect

The most important advantage of PSE over other fiscal policies is the fact that PSE funds go directly for employment. To the extent such expenditures are substituted for wages that would have been paid by local governments in any event, the employment effect of PSE is diminished, and the program takes on attributes of a targeted tax cut. These substitution of "displacement" effects have received a great deal of attention. Common estimates suggest that as many as 50 per cent of jobs created under PSE substitute for employment that would have been created anyway. These estimates are discussed below. While I believe displacement is an important problem, I think these estimates should be discounted both because they are based on unreliable inferences from local response to other federal programs and because of the nature of the current public employment program.

It is virtually impossible to gauge the extent of displacement of regular workers by those paid for through PSE. The ideal displacement estimate would be based on a projection of what local governments would have employed in the absence of public service employment. No such estimates are available and the extraordinary characteristics of the current financial situation faced by many cities make simple extrapolation of past trends to predict employment without PSE useless. Among the most frequently cited estimates of the displacement effect are those of Alan Fechter of the Urban Institute.[8] Fechter's approach

was to treat PSE grants as equivalent to either lump-sum grants in aid to local areas or wage subsidies and to employ the Gramlich-Galper estimates of the displacement effects on local expenditures.[9] Since Gramlich and Galper estimate that every dollar of federal aid in a program of lump-sum grants to local government is translated into (at best) about a fifty-cent increase in expenditures, Fechter concludes that every dollar in PSE money means in the long run only fifty cents in new PSE wages. This estimate is translated to imply that PSE outlays produce only one-half as many jobs as simple division of average wage into total outlays would suggest.[10] A similar conclusion is reached by Levitan and Taggart based on on-site evaluations of public employment under the Emergency Employment Act of 1971.[11]

I think Fechter's estimates are grossly exaggerated, but Levitan and Taggart are probably right. Other than the one we observe in operation now, we have only one "observation" on public service employment programs in the postwar period. As I have described elsewhere,[12] the Public Employment Program funded by EEA was a very loosely administered general employment subsidy program. Administrative guidelines to prevent displacement were not enforced. Restrictions on characteristics of persons hired, in particular the unemployment restriction, were applied only casually if at all in many areas. Public employee unions were not prepared to monitor PSE hiring to prevent substitution and neither was the Department of Labor. It is not surprising that under these conditions substitution would and did take place, and it was this displacement that Levitan and Taggart reported. On the other hand, EEA did not represent the last word on program design. The public service employment programs sponsored under the Comprehensive Employment and Training Act are better.

There are a number of reasons for believing displacement experience with CETA will be more favorable to the national objectives of the program than was the case with EEA. Displacement, when it occurs, is done subtly. Workers leaving public jobs through retirement or for other employment are replaced by PSE workers; programs are redesigned to utilize greater numbers of subsidized workers at the expense of those who would have been hired for regular positions. These things take time. The increase in PSE over the past twelve months, especially under Title VI, has been quick and large.[13] New public service employees were added in many cases to already established city budgets and under the vigilant eye of public employee unions. The opportunities for the more blatent forms of substitution have been correspondingly reduced. The new public employment funds made available in January came in addition to funds already provided by CETA, and I suspect that in many cities the obvious opportunities for displacement had already been exploited. This, coupled with the jawboning done by the Manpower administration helped assure maximum impact on employment.

The point here is that Fechter's generalizations have little merit as a guide to the potential of public service employment as a policy for coping with the kind of recession we are now experiencing. There exist a number of feasible program design procedures for PSE which will minimize displacement over the twelve to twenty-four-month policy horizon of interest. I am not yet ready to adopt the view that the Manpower Administration bureaucracy is so inefficient that the agency cannot monitor a program to a sufficient extent to assure that displacement effects will be less than those associated by Gramlich and Galper with general federal grants in aid.[14]

The problem of targeting

Public employment funds were triggered on the basis of absolute unemployment rates rather than increments to some "normal" standard of unemployment as the Congressional Budget Office suggests is most appropriate. It is not clear, however, that the results under the procedures currently employed for allocation by the Manpower Administration would differ dramatically from allocations under a rule keyed to increments in the numbers of unemployed. In Table 1, I report figures for unemployment and public service employment under Title VI of CETA for labor market areas in this region. The first column provides figures for changes in unemployment between December 1974 and December 1975 in each area. For comparison with allocation of PSE jobs the second column shows the "share" of incremental employment over all of the areas listing accruing to the labor market identified. The third column identifies the number of filled Title VI jobs reported by all CETA prime sponsors in the designated areas as of June 1975. The job numbers are restated as proportions of all jobs filled in these eleven areas in the last column. Note that the increase in unemployment is closely correlated with the increase in PSE jobs. The mildly disproportionate share of PSE occurring in the San Francisco-Oakland office is probably attributable to the exceptional performance of San Francisco's public employment program in getting jobs filled under Title II, performance that meant a generous allocation of the supplemental funds. Assuming that interregional allocation of funds is similarly correlated with unemployment and intraregional allocation is similar for other manpower administrative regions, these figures suggest that the allocation procedures currently employed for PSE funds are not worth worrying about unless extraordinary increases in funding are contemplated.

Allocating PSE jobs among workers has proved to be a much more complex problem. Important tradeoffs are immediately encountered in selecting procedures for deciding who will get the jobs. In particular it is difficult to reconcile the need for rapid expansion of employment in PSE with attempts to restrict jobs to persons likely to meet the "excess supply" restriction cited earlier. Both organizational and

TABLE 1

CHANGE IN UNEMPLOYMENT AND ALLOCATION OF TITLE VI PSE, MAJOR LABOR MARKET AREAS IN MANPOWER ADMINISTRATION REGION 9

Labor Market Area	Δu 1973:4-1974:4	Share*	CETA** Title VI Jobs	Share of Title VI PSE
Phoenix	20,300	.086	771	.067
Anaheim-Santa Ana-Garden Grove	22,700	.096	703	.061
Fresno	4,000	.017	300	.026
L.A.-Long Beach	76,500	.322	3,926	.340
Riverside-San Bernardino-Ontario	16,500	.079	884	.077
Sacramento	7,300	.031	347	.030
San Diego	35,500	.150	1,462	.127
S.F.-Oakland	37,800	.159	2,211	.192
San Jose	12,300	.052	476	.041
Stockton	1,900	.008	171	.015
Honolulu	2,700	.011	296	.026
Total	237,500	1.00	11,547	1.00

SOURCE: Unpublished data, Manpower Administration

*Of total additional unemployment in areas listed

**Filled as of July 1, 1975.

political factors are involved. Cities claim that it is difficult to find people meeting guidelines that call for, for example, more than a month of unemployment before PSE acceptance who can meet requirements for PSE jobs, especially those jobs involving administrative work. The case was made sufficiently strongly before Congress to bring about a *reduction* in the amount of unemployment that would qualify a potential jobholder for employment in a Title VI job from four weeks (as under Title II) to two, despite the fact that the erosion of business conditions was steadily increasing the number of long-term unemployed persons in both high-and low-skill categories.

This trade-off is undoubtedly exaggerated by local governments. The providers of public service jobs under the manpower revenue sharing format created by CETA have mixed motives. Local governments have an obligation to taxpayers both to spend such money when it is available and to get as much out of it in terms of tangible public services as they can. The more qualified the jobholder in general the greater the return to local government from creating the PSE job. Unfortunately, it is also true that the people local governments would most like to hire are those most likely to find jobs in the private sector or unsubsidized government and least likely to meet out definition of "excess supply."

Aside from the tendency of local government to pick the best people possible, there are psychological and political factors that make it difficult to target jobs on workers likely to meet the excess supply criterion. It is not easy to tell people they cannot have jobs because they have been unemployed three weeks instead of four or because on average persons like themselves are likely to find jobs in the near future without assistance. Such regulations constitute an act of statistical discrimination that is impossible to explain to job applicants. Compared to the standard civil service procedure of allocating the jobs on the basis of test scores, these procedures seem capricious at best. As a result virtually every cities will revert to examinations, random allocation, for filling of jobs on a first-come, first-served basis to meet PSE goals. All of these procedures weaken the effectiveness of PSE, but reduce the political costs of its administration at the local level.

Application of simple standards like restriction of jobs to persons unemployed six weeks or more is further complicated by the fact that people soon learn what they are. To my knowledge no one has ever attempted to verify statements about income or employment on the application forms of PSE applicants for any prime sponsor in this region. Cities have no access to withholding or other records received from employers; checking by other means takes a great deal of time when prime sponsors are under obligation to deliver jobs.

One way out of this problem is to assign to an independent agency responsibility for certifying persons as eligible for PSE jobs. My candidate would be the state employment services--the Employment Development Department in California. The EDD has access to UIB claims information plus, because of worker registration while seeking work, much better information on worker history and current employment status. A state agency is likely to receive more accurate information from persons seeking jobs. A switch to this system would encounter prime sponsor resistance, but it will cut their costs considerably by eliminating the arduous process of sifting through PSE applicants and the political liabilities associated with denying some applicants employment.

The implementation lag

We should be cautious in extrapolating recent experience with public service employment to provide predictions about the rapidity and efficiency that additional PSE could provide. Recent experience also indicates that the tradeoffs encountered in speeding up creation of PSE may mean the concentration of jobs on the severely distressed is lost. With reduction in the precision of the targeting of such jobs the effect on local labor costs is increased and the potential for PSE to reduce private sector output is enhanced. Also, the public employment program has now reached a level about twice as large as was achieved in 1971. The program pays for little but wage costs of PSE jobholders. Under current financial conditions, most local governments do not have the funds to provide the necessary complementary inputs to expand employment under PSE much further. This means that if the federal government wants substantially more PSE jobs it must seek other agencies in the private or public sector to provide the jobs or provide more liberal funding of capital and materials costs. Any move in this direction will necessarily increase the effect of PSE on prices and reduce its comparative advantage relative to other policies in reducing unemployment.

The other side of the implementation argument is the claim that PSE can be terminated more rapidly than other targetable fiscal policies. The speed of closure is enhanced if workers are paid at rates less than those paid in nonsubsidized positions under conditions of full employment. However, wages paid under CETA tend to be at a level at or above comparable low-skill employment in the private sector--averaging around $8,000 to $10,000 per year in this area. If such jobs are actually given to low-skilled workers with a history of employment difficulties, they may be the best alternative available regardless of business conditions. Furthermore in many cases they constitute an inside track to regular civil service employment. In this case it will be difficult to bring the program to a halt. While on paper it would appear to be a simple matter to stop a PSE program, politically it may be very difficult. Further expansion will compound the problem.[15/]

Effect on the budget

The estimates of the net budgetary impact of PSE expansion included in the CBO's evaluation are probably biased downward by substantial overstatement of the proportion of recipients who, in the absence of the program, would be drawing unemployment insurance benefits. The CBO assumes that 80 percent of all public employment program participants will not be new labor force entrants (persons with no work history on which to base a UIB claim), and that of workers with previous work experience given public service employment 80 percent would be UIB eligible. Thus for 64 percent of $3,250 per year is imputed to account for reduced transfers.

The problems with this estimate are probably obvious. Congress has already specified that priority for PSE jobs under CETA should be granted workers who have exhausted their unemployment insurance benefits. Again, although no hard figures exist for evaluating this factor, one's impression is that substantially less than 80 percent of PSE hired are eligible for or receiving unemployment insurance at the time they are hired. Official information on this fact is of questionable validity since most applicants sense that destitution makes employment most likely and probably tend to underreport transfers other than AFDC. Furthermore, it is unreasonable to assume, as the CBO does, that all PSE hired collecting UIB at time of entry would continue to do so for a year. Some will be nearing the point of benefit exhaustion; others would have found employment before a year's benefits were drawn. Taking such people out of the labor market may, of course, leave jobs open for other workers whose employment will cut governmental transfer costs, but by the CBO's own reckoning such jobs will be filled only 64 percent of the time by UIB eligibles.

Conclusions

At first and even second blush, Public Service Employment seems the ideal fiscal policy of compromise. For fiscal activists it offers a governmental policy of aggressive intervention in local labor markets designed to seek out workers suffering most from the recession. For the "steady as she goes" school PSE seems remarkably prudent, offering considerably more employment per dollar of deficit created and in consequence presumably relieving political pressures for more aggressive policies with possibly greater inflationary consequences.

Despite the intrinsic merits of PSE, however, the case for further increase in PSE funding is weakened by the unsatisfactory procedures currently employed for allocating such jobs and the limited capacity of local governments to expand employment further under existing cost sharing procedures. Before more is attempted two things must occur.

First, a careful inventory of alternative sources of PSE jobs must be made. One potential source is special-purpose governments such as sewer districts, park and housing authorities, and the like. Redevelopment agencies, still alive in most cities but now relatively moribund due to funding cutbacks, might be tapped for minor public beautification projects. Subsidized employees might also be made available to non-profit organizations eligible for subsidy; a start could be made using the list of participants in the United Way drive. To my knowledge no one has inventoried the jobs such agencies might create.

Second, authority for certification of PSE candidates should be shifted to an independent agency, presumably the state employment service. Local CETA prime sponsors remain the best candidates for allocation of PSE money. The difference between the current system and the one I envision would be that whereas now prime sponsors allocate money and allow recipient agencies to hire their own employees, such hiring under the new proposal would be constrained to the group of individuals certified PSE eligible by the employment service.

With these modifications it should be possible to expand PSE further while enhancing its favorable characteristics as macroeconomic policy. Such expenditures should provide a useful and politically popular complement to other elements of a package of antirecession fiscal policies.

Footnotes

1. Congressional Budget Office, *Temporary Measures to Stimulate Employment: An Evaluation of Some Alternatives* (Washington: U.S. Government Printing Office, 1975), p. 40.

2. The CBO also considered additional revenue sharing to state and local governments, a program of accelerated public works, a tax cut, and expansion of purchases of goods and services by the federal government. Employment impacts were estimated using large-scale macroeconomic forecasting models.

3. Congressional Budget Office, *Temporary Measures to Stimulate Employment*, p. 37.

4. See R. Hall, "Why is the Unemployment Rate So High at Full Employment?" *Brookings papers on Economic Activity* 3 (1970): 369-402. In some cases, the appropriate manpower policy for dealing with such problems might include public employment programs designed to provide training and to create portals into civil service employment for disadvantaged workers. Structural policies of this type are not discussed here, but I have commented on them elsewhere. See Frank Levy and Michael Wiseman, "An Expanded Public-Service Employment Program: Some demand and Supply Considerations," *Public Policy* 23 (Winter 1975): 105-134; and Michael Wiseman, "On Giving a Job: The Implementation and Allocation of Public Service Employment," in U.S. Congress Joint Economic Committee, *Achieving the Goals of the Employment Act of 1946* (Washington: U.S. Government Printing Office, 1975).

5. What I have in mind here is a situation in which a recession renders some workers in private firms unprofitable. They are retained (hoarded) either out of benevolence or because employers expect conditions to improve and wish to avoid the retraining costs and ill will generated by layoffs. A marginal worker under these conditions, if lured away by subsidized employment in the government sector, might not be replaced until general business conditions improve.

6. The CBO cites rapid start-up time of incremental public service employment, given the existence of a ready administrative apparatus, as one of the program's important advantages (see Congressional Budget Office, *Temporary Measures to Stimulate Employment*, p. viii).

7. Congressional Budget Office, *Temporary Measures to Stimulate Employment*, p. 69.

8. Alan E. Fechter, "Public Employment Programs: An Evaluative Study," in U.S. Congress Joint Economic Committee, Subcommittee on Public Welfare Studies in Public Welfare No. 19, *Public Employment and Wage Subsidies* (Washington: U.S. Government Printing Office, 1974): 93-123.

Footnotes cont'd.

9. Edward M. Gramlich and Harvey Galper, "State and Local Fiscal Behavior and Federal Grant Policy," *Brookings Papers on Economic Activity I* (1973): 15-58.

10. The actual estimates depend on whether cross-section or times series data are employed for estimation of the substitution effects and the actual characterization of PSE. See Fechter, pp. 102-106.

11. See A. Levitan and Robert Taggert, eds., *Emergency Employment: The PEP Generation* (Salt Lake City: Olympic Publishing Co., 1974): 16-17.

12. See Wiseman, "On Giving a Job."

13. The original allocation for public service employment under CETA came under Title II of the act. Title II funded about 170,000 jobs. For a variety of reasons described in my earlier paper ("On Giving a Job") many of these jobs were not filled until late last year. Last December Congress added funds for an additional 110,000 jobs under Title VI of the law. Title II PSE was aimed at structural problems and not recession (recall the act was passed in December of 1973). Title VI is a better example of an antirecession program.

14. For some suggestions on improving the design of such programs to minimize substitution effects see Wiseman, "On giving a Job."

15. The best procedure is probably to establish from the beginning that tenure on PSE jobs will be limited to, say, twelve to eighteen months and to assure at least limited UI benefits to workers evicted from public service employment. Prime sponsors under the current program tend to believe and to lead employees to think that funds will be extended beyond the nominal duration of the program. While in view of EEA experience this is a reasonable expectation (some public service employees from the EEA program were transferred in 1974 directly to CETA jobs) it hinders preparation of PSE workers for reentry into unsubsidized employment and allows prime sponsors to avoid worrying about arrangements for smooth program closure.

PUBLIC SERVICE EMPLOYMENT AND INFLATION--A DISCUSSION

Walter Fogel*

As a supporter of public service employment in dealing with unemployment, I am in essential agreement with Professor Wiseman's position. My comments will concern relatively small points in his paper and some slightly different notions about future public employment measures.

In addition to those given in the paper, there is another reason for not being greatly concerned over the substitution of federal money provided for public service employment for state and local government financing. To the extent that this substitution does take place, expansion of state and local government employment is less than would occur without such substitution. This means, also, that with substitution state and local tax revenues are less than they are without substitution. The tax revenues not collected remain with businesses as well as with citizens who, presumably, spend most of that money; their expenditures have some employment effects, although perhaps less than would occur through state and local government expenditures of the same amounts. The point is that the employment (job creation) effects of new federal funding for public service jobs are not vitiated because state and local governments use some of the funds to reduce their own expenditures. State and local governments, unlike the federal government, operate with balanced budgets. When they reduce expenditures, taxpayer spending increases.

Professor Wiseman recommends that state employment services--the Employment Development Department, in California--be assigned responsibility for certifying persons eligible for public service employment. This is a logical move worth trying (isn't it already being done in some places?), but I am not confident that it would be fully successful. State employment services are not known for efficacious service to the disadvantaged, and I believe it very important that the disadvantaged be served well in public employment programs. Chicanos, for example, tend to have little contact with state employment services for various reasons, and would probably participate less in a program where certification occurs through state employment services than they would in present programs.

The possible structural benefits of PSE programs were mentioned by Wiseman. I should like to emphasize these possible benefits. When "unqualified" workers--those who cannot get jobs in the private sector in periods of strong business activity--are employed in public employment programs, and have their productivity qualifications raised through

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this experience so that they then can get jobs when business is strong, structural improvement in the work force has occured. The full employment-unemployment rate has been lowered, welfare payments have been lowered, and the incomes and self-respect of some people have been improved. Of course, it is much easier to talk about a structural effect than to accomplish it. In particular, it is very difficult to get state and local governments to hire the hard-to-employ. But an anti-cyclical public employment program provides an opportunity to improve the qualification structure of the work force at no expense to its major objective, the alleviation of unemployment. I believe that at least half of the jobs in a PSE program should go to hard-to-employ people.

The major shortcoming of PSE is that the programs are so very small in relation to the need. Wiseman presents data showing that Title VI (CETA) PSE funds, appropriated in response to the severe recession of 1974, employed less than five percent of the increases in unemployment which occured in Region 9 during 1974. A program which helps 1 in 20 people who need it cannot be considered a significant effort at all; it is tokenism,provided to create the illusion that something is happening; it is hardly worth serious study.

Why doesn't the United States, in the face of unemployment of more than eight percent, establish a bigger PSE program? According to Wiseman's figures, almost four million PSE jobs could be created for a gross cost of $30 billion, but a net budget cost of less than $12 billion. Even granting that this net cost is probably underestimated and that materials and capital costs necessary to employ 4 million people would have to be added, the price still seems low for cutting our current massive unemployment almost in half. (I assume here that the PSE hiring would concentrate on people who are in substantial excess supply so that upward wage pressure in the private sector would not develop.)

I do not really know why United States policy does not go for a much bigger PSE program. I suspect that many citizens still regard such programs as boondoggles which wast taxpayers money on unworthy workers. The now, deep-rooted cynicism against government programs of all kinds certainly doesn't help.

It seems to me that, in general, public employment programs have not been creatively managed, and this has hurt their image and possibilities for expansion. Little creativity has gone into the development of jobs, either in government or in nonprofit organizations. There are all kinds of work which can be done to make this society a better place in which to live. Some creativity in the development of labor-intensive jobs to meet these needs is required. One great aid toward releasing the required creativity would be to provide some funds for complementary materials and capital. Current and past restrictions of PSE programs against

purchases of materials and capital assume either Stone Age work methods or ample local government revenues. Neither is likely. Another aid to creative job development would be the removal of current requirements for absorption of PSE participants into nonsubsidized government employment.

These requirements make government jurisdictions cautious about job development. They do not have the revenues or the employee turnover to absorb many participants. The requirements also encourage "creaming" of job applicants, since absorption must take place through Civil Service selection procedures. PSE programs (at least the ones I have in mind) are anti-cyclical, aimed at absorbing some of the cyclical unemployment produced by the private sector. It should be expected that as the economy picks up, PSE participants will go back to work in the private sector (to ensure that, PSE participants should be paid less than private sector wages rather than more, as is often done in regular government employment). Some, on the basis of successful job performance, can be transferred to regular government employment as jobs open up, but there should be no expectation of this.

PSE programs have not been creatively managed in terms of their "press," either. The EEA of 1971 provided 150,000 or so contributive jobs--useful work was performed in them, but I saw little in the press about this accomplishment. I saw many items, however, about specific failures of the EEA, where the program was corrupted by politics or was badly damaged.

These matters need to be examined at greater length. Suffice it to say, here, that PSE programs should be greatly expanded to deal with unemployment, but before that can be done there must be some evidence that the government officials involved can think creatively about the design and operation of such programs.

THE ROLE OF UNEMPLOYMENT INSURANCE:

The 1974-75 Recession

William Haber*

The American unemployment insurance system was born in 1935 as a part of the Social Security Act of that year. By the time the system became fully operative in 1937 and 1938, a relatively small proportion of the insured work force was eligible for benefits. Consequently, the unemployment insurance system was not really tested during the great Depression of the 1930s, nor was it subjected to any severe strain during the 1940s. The war in Europe and our own involvement beginning in December 1941 created manpower shortages. When World War II was over reconversion proceeded at a spectacular pace, and it was not until the end of the decade that the unemployment insurance system was operating during a recession.

All of the recessions, however, in the past 25 years--1949, 1954, 1958, 1961 and 1971--were relatively short-lived and provided only a mild test for the capacity of the system to provide benefits and remain financially viable.

The current recession provides the first real test of the unemployment insurance system--40 years after its birth. This is the most serious economic decline since the Great Depression. The numbers involved, the duration and persistence of joblessness have combined to create an unprecedented drain on the unemployment insurance reserves of many states. Moreover, in the absence of alternative income maintenance programs for jobless men and women, we have relied upon the unemployment insurance plan to perform functions it was simply not designed to accomplish. In addition, looking at the economy in the early months of 1976, it does not appear that the pressure upon the unemployment insurance program is likely to be relaxed before the end of the decade. We may well be into the 1980s before an annual employment rate of 4 or 5 percent is achieved.

In the absence of alternative programs to provide for the unemployed, we are repeating the British experience of 1920-34. When the unemployment insurance plan in England had to face the problem providing benefits to demobilized soldiers, the government created out-of-work benefits for ex-service men. The plan was, of course, assumed to be temporary. When those who were properly "covered" and drew benefits to which they were "contractually" entitled exhausted these benefits, the British created what they called "uncovenanted benefits." This was followed by "extended benefits" or

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"emergency benefits," with one extension after another. In the public mind the British unemployment insurance system soon became known as the British dole. And this it was referred to until a supplementary program was established in 1934 to provide for those whose entitlement to insurance benefits had ceased.

The American unemployment insurance system, also because of the absence of a clearly defined alternative in providing for the unemployed, has been undergoing changes in the benefit duration provisions. The original state unemployment insurance laws provided duration of 12 to 16 weeks, on the advice of actuaries who concluded that a 3 percent tax on total covered wages could not support longer durations. As experience revealed that longer durations were needed and that they could be supported at fairly low tax levels, states increased their duration maximums. At present, all but one state program have maximum regular benefit durations of at least 26 weeks. After some state experimentation starting in the late 1950s and two temporary federal enactments in 1958 and 1961, the 1970 Employment Security Amendments inaugurated a Federal-State Extended Benefit Program providing as many as 13 additional weeks of benefits during periods of high unemployment. In 1971, a temporary federal program added another potential 13 weeks. In 1974, the Federal Supplemental Benefit Program added yet another 13 weeks; it was augmented in 1975. Regular, extended and federal supplemental benefits now provide a potential benefit duration of 65 weeks.

The estimated annual cost of these combined programs in 1975 and 1976 is about $18 billion, a little less than 3 percent of total covered wages. This tax rate hardly differs from that originally assumed in the 1930s to be necessary for support of an unemployment insurance program. Of course, annual unemployment insurance costs are a great deal more than they were. But since 1942, the average state employer tax rate has been less than 2 percent of total wages. Since 1946 it has been less than 1.5 percent, and from 1967 to 1973 it was less than 1 percent. It should be remembered, however, that the percentages referred to are related to total wages and not to the wage base upon which the tax--or so-called "contribution rate"--is imposed. It clearly suggests that an increase in the wage base upon which the tax is imposed cannot be avoided.

Significant changes have also taken place in the weekly benefit amount. Ten years ago, in two-thirds of the states the maximum weekly benefit was less than half the state average weekly wage. In 1975, only ten states have maximum weekly benefits that are low. In 1965 only one state, Hawaii, had a maximum weekly benefit that was two-thirds of the state's average weekly wage. By now, a dozen states have legislated such a maximum rate.

A federally mandated maximum weekly benefit of at least 66 2/3 percent of the state average weekly wage has long been a controversial proposal that employer groups have vigorously opposed. Nonetheless, in 1973 such a standard was proposed by President Nixon, and in 1975 the president of the Interstate Conference of Employment Security Agencies testified before a congressional committee that most state administrators support such a federal standard.

It is clear that the system was not designed to finance benefits for 39 weeks or 52 weeks, and certainly not for 65 weeks. On December 31, 1974, state unemployment fund reserves totaled about $10.5 billion. It is estimated that state tax collections for 1975 and 1976, plus interest on reserves, will add another $13.1 billion, making a total available for the payment of benefits of about $23.6 billion. However, the estimated outgo of regular benefits and the state share of federal-state extended benefits amount to $13.2 billion for 1975 and to over $13 billion for 1976, creating a total for the 2 years of considerably over $26 billion--a shortfall of between $2.5 to $3 billion.

These figures are aggregates. Individual state funds will, of course, be affected differently. Already, however, more than ten states have borrowed over $800 million from the federal loan fund, and as many as twenty more states may have to borrow from the loan fund before 1976 is over. The total anticipated borrowings may approach $5 billion. Obviously, Congress will have to provide the loan fund with advances from general revenues for the fiscal year 1976.

What changes are necessary?

There is genuine need for a high-level commission representing labor, industry, the government, and those who have made the study of unemployment insurance their specialty to explore the changes which must be made in the present system of unemployment insurance. It was created during a great depression. It provided for nominal benefits for relatively short duration of some 13 weeks for a portion of the work force. Most of the civilian jobs are covered now and those which are excluded should be added to the system. There is no justification for excluding some 12 million jobs which are not now covered. State and local government employees, as we know from our recent experience with one municipal finance crisis or another, do not have the job security the public has associated with government jobs. With universal coverage and present benefit levels a serious examination is called for as to how the system is to be financed.

Historically, the system has relied on employer payroll taxes, federal and state, for its revenues. Originally, total wages were taxable. Since 1939, however, the federal taxable wage base has been a fixed dollar figure. Until 1972, this was increased to $4,200.

With few exceptions, the state tax bases have been the same as the federal. State unemployment funds have paid for regular benefits and half the cost of federal-state extended benefits. Since the taxable wage base is fixed and wages continue to rise, each year the unemployment insurance system taxes a smaller percentage of covered wages. In 1972, when the $4,200 taxable wage bas became effective, it reached 52 percent of total wages. In 1976, it is expected to be less than 47 percent.

It is clear that either the rate on $4,200 is increased or the base is enlarged. There is a strong case to change the wage base from the $4,200 that is presently prevailing to one which more nearly approximates average weekly wages in the state. This must be a federal requirement in order to dilute the impact of interstate differences.

Repayment of Loans

Something will have to be done about the loans which have been extended to many states in order to provide the benefits which may run as long as 65 weeks. A heavier burden will fall upon employers whose payroll will be taxed in order to underwrite the repayments due to the federal loan fund. One suggestion has been that the period of repayment should be extended perhaps over 5 years or even for as long as a decade. Another possibility is to have the federal government absorb these loans as an additional cost of the recession.

Limitation of Benefits

No unemployment insurance system can provide one extension of benefits after another. A supplementary plan is absolutely essential. A national public assistance program for unemployed persons with federal standards of benefits--not necessarily equal to unemployment insurance benefits--and financed entirely from general revenues of the federal government must be provided. Unemployment insurance must be limited so that the word "insurance" does not totally lose its meaning. If our experience suggest that 26 weeks of benefits is substantially adequate for the overwhelming proportion of the jobless worker, then it is incumbent that we recognize the 26-week limit. In my view this is too short and 65 weeks is far too long. Perhaps the duration of unemployment insurance benefits should not exceed 52 weeks. After such a period, benefits related to previous earnings records should be replaced by assistance grants related to current needs.

State-Federal Financing

While I have always believed that it was a mistake to have State systems of unemployment insurance rather than a single national system, state systems exist and need to be buttressed by the federal government. A compromise would be for the state system to be responsible financially for benefits up to 26 weeks and for the state and federal government to

share equally in financing benefits after 26 weeks up to the limit of 52 weeks. If benefits are authorized beyond 52 weeks, they should be financed entirely by federal funds. If a state cannot meet its share of benefits, it may borrow from the federal government, but should repay such loans within a stated period and adjust its contribution rates, if necessary.

After individuals exhaust 52 weeks of insurance benefits, their cases should be trasferred to a general federal assistance program. Their past earnings record and insurance benefit record should be made available to the local public assistance office to help in possible decisions such as assignment to public employment, etc.

Federal assistance grants should be related to the level of earnings in the local labor market as determined by averaging the OASDI earnings records reported for employed workers in that area for a moving bracket of previous quarters, as they become available. The technical problems involved in this approach are not overwhelming.

Is Unemployment Insurance a Disincentive for Reemployment?

The high-level commission referred to above should also examine to what extent the charges alleging that the unemployment insurance system increases both the amount of unemployment and its duration have any validity. Much has been made of the allegation that since the unemployment insurance benefits are not taxable, they actually replace much more than the 40 or 50 percent of the wage loss which is contemplated; as a result it has been charged that workers take more time searching for new jobs and that such extended search is socially wasteful. It is even assumed that the percentage of unemployment is somewhat increased due to this market behavior of wage earners by as much as 1.25 percent. In brief, it is charged that the unemployment insurance system provides a disincentive for reemployment. This author believes the charges are highly exaggerated. However, in view of their widespread currency, especially when SUB (Supplementary Unemployment Benefits) are included, a careful analysis of this problem is called for.

Reexamining and Revising Unemployment Insurance

Finally, the unemployment insurance system must be examined in the light of the vast changes which are taking place in the American economy. This writer is not prepared to join those who say that "the era of growth" has come to an end and that we are now living in an economy of scarcity. It is clear, however, that the problems of ecology and energy and the shift in international competition have produced or are producing dramatic changes in our manpower requirements. There are millions of "dead end jobs." The "bright future" jobs are not on the production line. "Structural unemployment" provides a real hazard to millions of wage earners unprepared for tomorrow. The unemployment insurance system must be revised to deal not only with relatively short

term displacement which we had in mind when the law was enacted, nor primarily with cyclical fluctuations which worried us most during the 1930s. The problems are more complex than either time lost between jobs or long-term recessions. The program designed for the 1930s--virtually unchanged since--needs to be reexamined.

Why Not a Work Program?

Payment of cash benefits for millions of workers looking for work simply makes no sense. For the short term it is, of course, the most economical and desirable method. For 65 weeks or more, whether paid for through unemployment insurance funds or through a National Public Assistance Program, it represents a waste of human resources. The WPA of the 1930s and the NYA and CCC, among other programs of that era, have, unfortunately, created a negative image. It makes much more sense to provide jobs on approved public projects requiring only nominal investment for materials and capital to clean up our streets and alleys, to fix our potholes, to improve the river fronts, to add to our public facilities of schools, playgrounds, hospitals, parks, and community centers. Much of that was done during the 1930s and it is unfortunate that all that we remember are the cartoons of workers leaning on shovels and the bored boondoggles. We forget the hundreds of thousands of linear feet of sidewalks and curbing and streets, the reforestation and park improvements, the river beautifications. For long-term unemployment, this makes more sense than unemployment insurance. We need to do that without considering the larger and more controversial proposal of the government acting as an "employer of last resort."

THE ROLE OF UNEMPLOYMENT INSURANCE -- A DISCUSSION

George S. Roche*

I concur with Professor Haber in his judgment that unemployment insurance in America was not designed to replace wage loss throughout a period of high and long enduring unemployment. I also agree that the financial arrangements supporting the program are not adequate to provide one extension of benefits entitlement after another for an indefinite period. And, I also agree that some other solution must be devised if it is necessary to continue income maintenance for a long period of high, structural unemployment.

I should note that any differences between us reflect the fact that my approach to unemployment insurance problems is colored by my long experience with the program in California, just as his seems to be affected by the Michigan experience. I would expect to find comparable differences in the outlook of someone with long and intimate experience with the program in, for example, New York, or in Illinois, or in Georgia. California has seen the liquidation of major industrial complexes several times without seriously endangering the solvency of its unemployment insurance reserves; Michigan has not always been so provident--and I use the term advisedly.

I do believe, however, that it is high time we take a good look again at just what we expect unemployment insurance to do for us. For a good many years we have taken the program for granted as a going institution, basically sound, and with all of the accumulated accommodations between special interests in the several states. We see it as replacing wage losses in a reasonably satisfactory way in a gradually expanding economy with only moderate inflation and price increases. Now we find that the economic prospects are no longer those of 1946-70; they seem to differ from the recent situation just as radically as those prospects differed from the economic scene of 1935.

In short, our complacency has let us be caught up with the hard facts of life in a changed world situation.

To assess the present dilemma, let us consider two or three of the interrelationships which we have, in practice, ignored when making the kind of piecemeal modifications in the program that have characterized legislative action over the past thirty years. These modifications have

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been worked out in a tug of war--sometimes an unequal tug of war--between those who want to keep costs "in line" and those who demand benefits, between employees who benefit from certain existing arrangements and employers who do not, between workers who need larger benefits for longer duration and those who want at least some benefits, between states which want to gain or keep tax differentials they hope will bring new industry and states which believe their economic health depends on reasonable benefits for their unemployed.

Weekly benefit amounts, the duration of compensation, entitlement to benefits (both qualifying work experience and disqualifications from benefits), and benefit financing (both tax rates and, even more importantly perhaps, the taxable wage base) have all been involved in the hauling and pulling. They are now out of kilter in the overall, and all must be straightened out together.

In almost every instance, changes in these interrelated factors have been made within a conceptual framework that assumed, tacitly if you will, that things would go on as they had been in the past so that all that was required was a patch here or a change there. The continued availability of about the same job opportunities, the continued existence of the ongoing labor-management relationships, the continued availability and dependence on existing fringe-benefit systems were all tacitly assumed.

Today, the prospects of an energy crunch and radically changed relationships between the western economies and those of the Third World raise doubts about the outlook for the status quo so easily relied on over recent years. Whether or not the outlook is as serious as some say, we must look again at what we expect from unemployment insurance, if only to be prudent in the face of impending change.

To take one set of relationships, technical if you will, the quality of the program is determined by decisions about requirements as to prior work experience entitling to any benefits, the proportion of wage loss of the well-paid worker that will be compensated, and the duration of such compensation. Past decisions about these three matters created vested interests which impinge on current decisions, whether between workers with varying wage and work experience or between workers and employers over the cost of benefits.

In California, to take a specific example, about eight weeks of work at the statutory minimum wage will qualify a claimant for some benefits. This reflects a decision about who is to be granted benefits and is a cost factor as well. Related to this, California limits the basic award of benefits to one half of base period wages, which curtails the duration of benefits for some workers, to as short a time as twelve weeks for a few. At the same time, maximum weekly benefits do not compensate a

high-wage worker for an acceptable proportion of his wage loss when out of work. This is a money saving factor which always comes into the legislative debates in terms of..."if fewer were entitled to trivial benefits, then we could afford to compensate the high-wage, long-term worker for more of his wage loss." Vested interests on all sides tend to perpetuate the status quo, leaving the impression that, somehow, Peter is being robbed to pay Paul. Somehow, there is always a difference of opinion about who is cast in the role of Peter, but no one raises the question about what the program is supposed to be doing for whom.

To continue with this set of relationships, extended duration of benefit provisions get added as though all workers who become unemployed are full-time workers who have lost a long-term job. To revert to the claimant who qualified for benefits with eight weeks of work, his twelve weeks of minimum benefits go along with the others and become 31 or 32 weeks at minimum benefit amounts. He can, then, be a very costly impediment to more adequate benefits for those who do have a past history of substantial employment.

The last relationship to be brought into this picture is the disqualification from benefits in the case of a voluntary quit without good cause. In California, a claimant is disqualified from benefits for the duration of the current unemployment and until requalifying wages have subsequently been earned. This was put into California law in a "package deal" that left the low qualifying wage requirement untouched and cut benefit costs enough by the disqualification to offset the cost of an increase in the weekly maximum benefit. Now the voluntary quit provision does cut costs substantially, and it has certain satisfying moral overtones--but it can be overcome with relative ease by members of unions which control a lot of short-term jobs having high turnover. On the other hand, it can be a disaster for a worker who has been with an employer for a long time so that he does not know the labor market and the technicalities of the unemployment insurance law. If he should take a fill-in job to try to better himself and find this job to be unsuitable, he can disqualify himself from long term compensation to which he has established his entitlement, and do this by a technically voluntary quit--even though the job he quit may last over a few days longer than he held it.

The real meaning of these California provisions, taken together as they must be, is an unemployment insurance program weighted by past decisions against the worker thrown out of steady work by the kind of change that has recently hit the auto industry. Benefits for the steady worker are smaller than he needs, and he faces a real risk of losing these when trying out some alternative to his persistent unemployment. If I use California as my example here, let me assure you that most other states offer much poorer programs in almost every respect.

To turn to another set of relationships, every increase in the maximum weekly benefit amount requires a corresponding increase in the fund reserves against a level of unemployment that throws high-wage workers on the street and requires an increase in the tax base that alone will assure that the fund reserve can rebuild to safe levels. To take a simple example of the matter, 1,000 new claimants at a maximum benefit of $75 a week--and all high-wage earners get the maximum amount today--will add $75,000 a week to the disbursements of the fund; if, instead, the maximum weekly benefit is $100, the same 1,000 claimants will virtually all be entitled to this amount and the additional weekly cost of benefits will now be $100,000 a week. A state unemployment insurance fund which looks adequate or even large, judging by past expenditures with a $75 maximum benefit--here we are again on the tacit assumption that things won't change--could prove disastrously small for heavy, long-term unemployment with high-wage workers all getting the maximum of $100 a week.

So far, the problem is self-evident. The catch lies in the fact that benefit amounts are determined by the total wages a worker has earned, but only some of these wages are taxable. The disparity between total and taxable wages is magnified by rapid increases in wage rates, so the potential liability of a fund in the face of high unemployment increases much faster than the tax base, and the solvency of the fund becomes increasingly at peril, especially since the revenues can change only slowly because experience rating provisions modify tax rates on the basis of several years of past cost experience.

The insolvency of some of the state funds seems to be the outcome of hauling and pulling on benefits without regard for the implications these have for the long-term financial underpinning of the programs. Again, California has been somewhat unusual in its refusal to ignore its obligation to provide financial arrangements which could withstand the impact on fund balances and recovery rates of changes in maximum benefits that exacerbate the stresses on solvency in times of high unemployment among the well-paid workers.

I would like to comment, in passing, that citing tax rates without reference to the proportion of total wages subject to the tax is a misleading way to assess the costs of the program; too much variety in the base used by the several states gets glossed over when this is done.

In closing, I wish to say that we face two related problems. The first is to get the program's house in order for the kind of short-term unemployment we have seen it coping with in the past. The second is the problem of income maintenance currently demanded for workers who may well be caught in a profound shift in the structure of the American economy caused by the energy and foreign trade situation that seems to

be developing. We should not go down the road Britain took in a comparable situation in the 1920's, overburdening the fragile tax base traditional in American unemployment insurance (Britain also used public funds in part, even for regular unemployment benefits). Neither should we turn our backs on the unemployed in the industrial complexes hit by recent changes. If we truly face a period when serious and widespread dislocations will occur in employment opportunities, however, it would be a small kindness to those affected to tease them into staying where they are, as the British did with their depressed areas in the 1920's, instead of helping them to make some accommodation that resolves the basic problem they face. Whether the situation is permanently serious I must leave to others to decide, and how to cope with this kind of problem I must also leave to others, since it appears to me to be outside the capabilities of unemployment insurance as we know and finance it today.

UNEMPLOYMENT IN THE 1970s

Robert A. Gordon*

In his Budget Message in January, 1975, President Ford presented an alarming set of unemployment projections for the remainder of the 1970s. What was particularly striking was not so much the high unemployment expected during 1975--here he was not pessimistic enough--but the dismally high unemployment rates anticipated for the remainder of the decade, despite recovery from the current recession and a resumption of economic growth. The figures he presented implied an average unemployment rate of 7.3 percent during 1975-79, with the rate on an annual basis remaining at about 7 percent or above through 1978.

This was a dismal prospect indeed and brought forth vehement protests both in and out of Congress. The Administration has emphasized that these were not official forecasts, and there have been subsequent statements that the future need not be as bleak as these unemployment projections implied.

Private economic forecasts through 1977 are also pessimistic as to how rapidly unemployment will decline as the economy recovers from the present recession. No forecast that I have seen suggests that the unemployment rate will be as low as 6 percent by the end of 1976, and it almost certainly will not fall as low as 5 percent in the remainder of the decade. And if we look back to the first half of the 1970s, we find that the unemployment rate averaged 5.4 percent during 1970-74, with unemployment as low as 4.9 percent only in 1970 (as it rose rapidly from the abnormally low figure reached at the peak of the Vietnam war boom in 1969) and in the cyclical-peak year 1973, which ushered in the 1974-75 recession.

It would now appear that, in the absence of a strong stimulus that does not seem to be in the cards, the national unemployment rate will average well over 6 percent in the decade of the 1970s--far and away the worst record of any 10-year period since World War II.

How much unemployment must we tolerate--both in the very short run and also through the rest of the 1970s--and how do we most effectively relieve the distress resulting from present and prospective levels of unemployment? It is to one or another aspect of these questions that the papers in this volume address themselves.

Major Causes of Unemployment in the 1970s

Why is unemployment presently so high, why did it average well over 5 percent in the first half of the 1970s, and why do prospects seem so bleak for the remainder of the decade?

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We are now painfully beginning to recover from the worst business recession of the postwar period, during which unemployment rose to the highest level in nearly 35 years. Further, it is the first truly international recession since World War II, with virtually all of the industrial nations experiencing not merely a slowing in their rates of growth but actual absolute declines in total output and significant increases in the level of unemployment. How did it happen?

There seems to be fairly general agreement that the recession resulted primarily from two major deflationary shocks. The first was the oil embargo and the subsequent massive increase in oil prices. This in turn led to a sharp drop in automobile production and in the output of dependent industries, widespread curtailment in energy consumption, and a massive transfer of purchasing power from oil importing countries--including the United States--to the OPEC countries.

The second principal cause of the recession was restrictive government policy, particularly monetary policy, aimed at curbing an accelerating rate of inflation. Short-and long-term interest rates rose to unprecedented levels; business borrowing was curbed; and residential building collapsed. Not until the recession was well under way did the Federal Reserve authorities begin to ease up on the reins; and a fiscal stimulus, through tax rebates and tax reductions, did not begin to stimulate the economy until about the time the trough of the recession was reached. Professor Hildebrand provides in his paper a useful analysis of the Tax Reduction Act of 1975 and an appraisal of its possible effects in stimulating the economy.

It is now generally agreed that the recession began about November, 1973, but it was not clear at first that anything more was involved than the shock of the oil crisis from which the economy would quickly recover. Indeed, real GNP, industrial production, and other important business indicators held up fairly well through the third quarter of 1974; and the seasonally adjusted unemployment rate did not rise to 6 percent until October. But then the roof caved in under a massive wave of inventory liquidation. Between the fourth quarter of 1974 and the second quarter of 1975, nonfarm inventory investment declined by about 28 billion dollars (annual rate) in 1958 prices; in current prices, the decline amounted to about 48 billions. And the unemployment rate shot up to 9.2 percent by April, 1975. Relative to GNP, this was the most severe inventory liquidation of the postwar period.

We now seem to be coming out of the recession, and unemployment has begun to decline showly although the rise in October was disconcerting. Nearly all forecasts suggest that the recovery will continue through 1976 and into 1977, but, as already noted, with the unemployment rate remaining at an uncomfortably high level through the remainder of the 1970s. And some forecasters are already beginning to predict another recession in 1977.

Why do we have to accept such high unemployment rates for so long? What has happened to the presumed commitment to full employment, to the pledge in the Employment Act of 1946 that "it is the continuing policy and responsibility of the Federal Government...to promote maximum employment, production, and purchasing power"? We once thought of a 4 percent unemployment rate as corresponding approximately to the goal of "full employment." When unemployment stubbornly remained at an uncomfortably high level after the 1970 recession, then Secretary of the Treasury John Connally referred to the full-employment goal of 4 percent as a "myth." Since then, in and out of Washington, it has come to be increasingly accepted that we cannot hope to push unemployment down below 5-5 1/2 percent if we are to bring inflation under control. And for the next two or three years even fairly liberal economists agree that we are not likely to be able to get the unemployment rate below 6 percent.

The Trade-off between Unemployment and Inflation

Let us now look more closely at the reasons for this unhappy situation. I have already referred to the causes of the 1973-75 downswing. It was the recession that pushed the unemployment rate up above 8 percent. But what are the longer-run causes that will keep it high during the rest of the 1970s? Basically, two sets of factors are involved.

The first is simply the effort to curb inflation. Despite Professor Killingsworth' skepticism, there is a short-run relationship between unemployment and the rate of increase in wages. It is true that the curve has shifted upward, in part because of anticipations of further inflation. But this is the important point, particularly in the view of the present Administration. It is essential that these inflationary expectations be damped down, and continuing high unemployment will help to do this. Or, to put it negatively, unemployment must not be permitted to fall fast and far enough to engender inflationary expectations as strong as those that existed in 1974 and the preceding several years.

The Administration, including the Board of Governors of the Federal Reserve System, clearly hope that, by avoiding what they consider overly expansionist monetary and fiscal policies, it will be possible to bring about a gradual downward shift in the short-run Phillips curve. If a suffient downward shifting occurs during the remainder of the 1970s as continued high unemployment curbs expectations of further inflation, then, hopefully, in the 1980s we might be able to enjoy both lower unemployment and less inflation than we have had in the recent past. This, at least, seems to be the hope. Among the assumptions underlying the hope is that the OPEC countries will behave themselves and that we will not again have the kind of upsurge in world food and raw material prices that we had in 1973-74.

The second set of factors at work which has worsened the trade-off between unemployment and inflation results from important changes in the composition of the labor force. Over the last 15 years, there has been a significant increase in the fraction of the labor force composed of teenagers, a product of the postwar baby boom; and with this increase in supply has gone a rise in the teenage unemployment rate relative to the national average. For an even longer time, the labor-force participation rate for women has been steadily increasing, and in this case also one result has been some rise in the female unemployment rate relative to the national rate.

A favorite exercise in recent years, which has been taken up by the President's Council of Economic Advisers, is to compute how much this change in the age-sex composition of the labor force has increased the national unemployment rate. One way of doing this is to take the relative importance of the different age-sex groups in 1956 (when the national unemployment rate was approximately 4 percent) and apply these weights to the actual unemployment rates of the different age-sex groups in, say, 1974. This approach reduces the national unemployment rate in 1974 from 5.6 to 4.7 percent. In short, the change in the age-sex composition of the labor force by itself worsens the unemployment rate by nearly one percentage point. This suggests that, apart from inflationary expectations, the change in the sex-age composition of the labor force has made an unemployment rate of 5 percent about as difficult to achieve today as a rate of about 4 percent 20 years ago.

I should like to consider further some of the implications of the changes that have occurred in the age-sex composition of the labor force and relate them to the wide and changing differentials in unemployment rates when the labor force is classified by race as well as by age and sex.[1]

Table 1 presents some of the relevant figures for particular groups when the labor force is classified by age, sex, and color. In addition to the officially reported rates presented, the table also shows "adjusted" unemployment rates for the nonwhite groups. Labor-force participation rates for these groups--all males and young females--are significantly lower than for whites of the same age and sex. These lower participation rates presumably reflect primarily the "discouraged worker" effect. Were decent jobs available for these nonwhites, participation rates for these groups would presumably be about as high as for whites.[2] Thus the "adjusted" unemployment rates shown in Table 1 are calculated by adding to those reported as in the labor force and as unemployed the additional number needed to bring the labor-force participation rates for these nonwhite groups up to those of the corresponding white groups.

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1. The remainder of this section, including Table 1, is taken from my statement presented to the Joint Economic Committee on July 25, 1975.

2. I realize that lack of jobs is not the only reason why nonwhites withdraw from the labor force. The health of nonwhites tends to be less good than that of whites, and the availability of only low-paying and otherwise demeaning jobs also discourages work incentives. But these are merely aspects of the general discrimination against nonwhites that is built into the social and economic environment.

Table 1

Unemployment Rates for Particular Age, Sex, and Color Groups, Actual and Adjusted, 1956, 1973, and 1974

(Percent)

	Actual Rates			Adjusted Rates *	
	1956	1973	1974	1973	1974
White					
Male					
16-19	10.5	12.3	13.6		
20-24	6.1	6.5	7.8		
...	...	...	...		
45-54	2.8	2.0	2.2		
...	...	...	...		
Total	3.4	3.7	4.3		
Female					
16-19	9.8	12.9	14.5		
20-24	5.1	7.0	8.2		
...	...	...	...		
45-54	3.3	3.1	3.6		
...	...	...	...		
Total	4.2	5.3	6.1		
Nonwhite					
Male					
16-19	15.3	26.9	31.6	45.4	48.7
20-24	12.0	12.6	15.4	16.7	19.7
...	...	...	...	...	...
45-54	5.4	3.2	4.0	8.9	12.6
...	...	...	...	...	...
Total	7.9	7.6	9.1	14.2	16.1
Female					
16-19	22.8	34.5	34.5	55.1	66.8
20-24	14.8	17.6	18.0	23.1	25.2
...	...	...	...	...	...
Total	8.9	10.6	10.7	0.4	3.0

Source: Manpower Report of the President, May, 1975.

* Adjusted unemployment rates were calculated as follows. The difference between white and nonwhite participation rates was determined for each age-sex group, and this difference was multiplied by the nonwhite population to determine the change in the nonwhite labor force necessary to make nonwhite participation rates equal to those of whites in all age-sex groups. This increment in the labor force was then added to both unemployment and the actual labor force to derive an adjusted unemployment rate.

Even without this adjustment, the figures for white teenagers and for nonwhites are bad enough. Much publicity has been given to white teenage unemployment rates of 12 to 15 percent and to rates for black teenagers of 30 to 40 percent. But note also the rate for nonwhite males in the 20-24 age group in the relatively good year 1973, a rate nearly twice as high as for white males in the same age group. And before I am criticized by the fairer sex, let me hasten to add that unemployment rates for women are significantly higher than for men--overall and in most age groups.

Now I come to the "adjusted" unemployment rates for nonwhite teenagers and nonwhite adult males. For all nonwhite males, the official unemployment rate is nearly doubled if we include the presumably discouraged workers. It is trebled for nonwhite males in the 45-54 age group. This is merely one of many pieces of evidence pointing up the severity of the problem of structural unemployment in the United States--and the need for pinpointing our employment targets on the most disadvantaged groups.3/

It is of interest that our "adjusted" unemployment rate for all nonwhite females is much lower than the actual rate. This is because the labor-force participation rates for all nonwhite females age 25 and over, particularly age 25-44, are higher than for whites. It is a reflection both of the need for an additional worker in intact nonwhite families and of the greater prevalence of female-headed families among nonwhites.

There are a number of other points that can be made about the figures in Table 1. Let me mention just a few, comparing the figures for 1956 and 1973. Relative to the unemployment rates for all whites of each sex, the unemployment rates for white teenagers, male and female, have risen a bit but not much. And white male teenagers were relatively worse off, compared to all white males, than were white female teenagers relative to all white females. The dramatic deterioration in the relative position of teenagers has been among nonwhites, and especially males. The male nonwhite teenage rate was about twice the overall nonwhite male rate in 1956; it was 3.5 times the nonwhite male rate in 1973. For nonwhite female teenagers, the corresponding ratio also rose, but not as much--from 2.6 to 3.3.

If we turn to trends in unemployment differentials by color and sex, we find some modest improvement in the differentials by color for each of the sexes, but deterioration in the relative position of women, a bit more for nonwhites than for whites.

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3. I shall not try to deal with the other elements that enter into the calculation of what is called a "subemployment index," particularly low wages and involuntary part-time unemployment.

Commentary on Papers Presented

Against this background, I now offer a few brief comments on the preceding papers.

Let us begin with George Hildebrand's evaluation of the Tax Reduction Act of 1975. While his analysis of the probable multiplier effects of the 1975 fiscal stimulus is too simple, I agree with his conclusion that the tax reductions should be made permanent. But I should favor a more expansionary monetary policy than he seems prepared to accept. As for his concern about business investment, I do not think that this important component of aggregate demand would be significantly stimulated in 1976 by the sort of overhaul of corporate taxes that he suggests. Professor Hildebrand is justified in expressing concern about the role of increasing government deficits in leading to acceleration in the growth of the money supply and this to accelerating inflation. He might, however, have placed more emphasis than he does on the range of pressures that lead to the increased government spending and deficits. More important, he ignores the pressures from trade unions and large firms that generate increases in unit labor costs and prices which the monetary authorities then feel compelled to ratify by increases in the money supply in order to avoid a politically unacceptable level of unemployment.

Professor Killingsworth is concerned entirely with unemployment, so much so that he comes close to denying that there is any necessary relationship between inflation and unemployment. He has long emphasized "structural" changes that are making it more difficult for the American economy to generate a satisfactory number of jobs, given the size and specific characteristics of the labor force. In his present paper, he emphasizes the retardation in growth of particular industrial sectors, and states that these and other changes "left large numbers of workers stranded in the wrong occupations and the wrong cities."

I have long made a study of the dispersion of unemployment rates along various dimensions of the labor force. The chief widening in the dispersion of unemployment rates--which is one measure of the sort of structural maladjustments that Professor Killingsworth is emphasizing--has occurred along the age-sex dimension of the labor force. Relative to the national unemployment rate, unemployment rates for youths and for women have risen; those for prime-age males have fallen. Dispersion of unemployment rates by industry declined significantly in the 1960s, although there does seem to have been some increase in the early 1970s. But the historical record does tend to suggest that the American economy has been able to adjust reasonably well to changes in the industrial and occupational composition of the demand for labor. The structural problem in the last twenty years has arisen much more out of the difficulty in adjusting to the changing composition of the supply of labor.

I shall pass over Professor Killingsworth's discussion of the Phillips curve. Apparently he is not familiar with some of the recent relevant literature and has nothing to say about the fairly successful efforts that have been made to incorporate inflationary expectations and changes in the age-sex composition of the labor force into Phillips-curve regressions.

Professor Killingsworth's last section is entitled: "What should we be doing about unemployment?" While it includes a number of details with which I should quarrel, I certainly agree with the main thrust of his argument: We need to find ways to put the unemployed back to work; we need to do so faster than the federal government is now planning; and enlarged and improved manpower programs should play a major role in this effort. I agree also with his support of an enlarged public-service-employment program and new and improved efforts in the area of manpower training. And, as he suggests, we need to develop new types of programs --which unfortunately will take a good deal of time to put into effect.

Let us turn now to Michael Wiseman's paper. I can be brief, because I find little in the paper to criticize. I was one of the first strong supporters of public service employment (PSE), and I favor a larger program than we now have. I should accept, in such a larger program, the sensible suggestions that he makes for modifying procedures. I found particularly useful his evaluation of the "leakage" problem; and it was encouraging to have his demonstration that the displacement problem is not as serious as has been widely supposed.

Professor Wiseman considers PSE essentially in terms of its role in absorbing the cyclically unemployed--a program that would, wholly or in large part, be discontinued when unemployment fell to some specified level, nationally or in local areas. I should argue for what I have termed a "two-tier" program. Under such a program, there would be a permanent tier of public service jobs always available for the structurally handicapped. Manpower training could be an integral part of such a program. Superimposed on this permanent, lower tier would be a triggered PSE program that would go on and off with cyclical changes in (national and local) unemployment rates.

I shall conclude with a few comments on Professor Haber's suggestions for improving our system of unemployment insurance. I can be brief, because this is not an area in which I can claim any special competence.

I should go further than Professor Haber is apparently prepared to go toward nationalizing our present federal-state system. Certainly we must move toward federal standards. I have long thought that we have gone too far with our system of experience-rating for individual employers within each state. I should like to see a greater pooling of risks among the states as well as among individual employers within each state.

As to the duration period for benefits, I certainly agree that the basic period of 26 weeks is too short. I am prepared to accept his suggestion of a basic 52-week period, with some stiffening of eligibility requirements, but with the understanding that a temporary lengthening of the basic benefit period to 65 weeks or longer may (hopefully not very often) become necessary.

What else might be done to spur those on unemployment compensation to accept lower-paying and less attractive jobs until employment conditions improve? I still resist the proposal to tax unemployment benefits, but something can probably be done to stiffen the rules requiring that beneficiaries accept the more unattractive jobs that might still be available in periods of high unemployment.