

declining. The incremental approach is also administratively more complex. ^{11/}

Fiscal Assistance for State and Local Governments. General grants (revenue sharing) might be targeted to state and local governments that have been suffering most from recession. Such funds might help to maintain needed public services in those areas and/or prevent increases in local taxes that depress local economic activity. Past experience suggests, however, that the benefits might be quite delayed, partly because budget cycles are normally determined well in advance. Moreover, many areas hardest hit by recession are also experiencing longer-run adjustment problems, which might make it difficult to end the program.

Reducing Unemployment vs Reducing Inflation

As the previous discussion suggests, policymakers are faced with a choice between reducing inflation or reducing unemployment. Both cannot be done effectively in the short run at the same time.

The Short-Run Tradeoff. Most economists believe that there is a short-run tradeoff between unemployment and inflation, but that there is no tradeoff in the longer run. During a recession, high unemployment exerts downward pressure on the rate of wage increases, while slack demand depresses commodity prices and profit margins. During prosperity, the process is reversed. Beyond a certain point, nominal wage gains are likely to increase, and inflation tends to accelerate. Thus, relatively high unemployment tends to be associated with downward pressure on inflation,

^{11/} The New Jobs Tax Credit (NJTC) was part of the Economic Stimulus Program of 1977. It was a general credit, in contrast to one targeted on specific groups such as the long-term unemployed. For studies of the NJTC, see Robert Tannenwald, "Are Wage and Training Subsidies Cost Effective?--Some Evidence from the New Jobs Tax Credit," New England Economic Review (September/October 1982), pp. 25-34; John Bishop, "Employment in Construction and Distribution Industries: The Impact of the New Jobs Tax Credit," Discussion Papers, Institute for Research on Poverty, University of Wisconsin (1980); J. Perloff and M. Wachter, "The New Jobs Tax Credit: An Evaluation of the 1977-78 Wage Subsidy Program," American Economic Review, vol. 69, no. 2 (May 1979), pp. 173-79; and M. Kaufman and T. Neubig, "A Critique of Employment Tax Credits," presented at the Eastern Economics Association meeting (April 29, 1982). In addition, the Treasury and Labor Departments are preparing a study of the NJTC mandated by law.

and very low unemployment with strong upward pressures on inflation. One reason that the tradeoff is short-run rather than long-run is that inflation expectations get adjusted upward so that very low unemployment is not sustainable.

During recessions, markets tend to adjust in ways that eventually bring about recovery. Expansive monetary and fiscal policies can be used to stimulate more rapid recovery, but they run the risk of stepping up inflation. The amount of added inflation will depend, among other things, on the size of the stimulus, the amount of slack in the economy, and the pace of the recovery.

The Costs of Unemployment and Inflation. Both unemployment and inflation have their costs. The costs of the former are easier to identify and measure than the costs of the latter. In economic terms, the cost of unemployment includes the production forgone. Since 1979, the cumulative costs of reducing inflation may have been as much as 20 percent of GNP, or roughly one-half trillion dollars (see Chapter 2). Much more difficult to quantify are the human costs such as mental and physical suffering, higher crime rates, and increased usage of drugs and alcohol. 12/

The costs of inflation are generally expressed in qualitative terms, including:

- o Distortions of the economy through the tax system if it is not indexed for inflation;
- o Distortions in relative prices and incomes that are determined in markets;
- o Distortions in regulated prices, such as those of public utilities;
- o Increases in uncertainty, especially as to future prices and interest rates;
- o Losses in the information content of price changes, when market participants have to separate relative price changes from general price changes;

12/ M. Harvey Brenner, Estimating the Social Costs of National Economic Policy: Implications for Mental and Physical Health, and Criminal Aggression, a study prepared for the use of the Joint Economic Committee, U.S. Congress, U.S. Government Printing Office (1976).

- o Increases in resources devoted to attaining speculative gains and to minimizing cash balances.

In addition to these costs, which in principle could be measured in terms of reductions in real growth, inflation causes an arbitrary redistribution of wealth and income. It is particularly hard on people with fixed incomes.

To a great extent, the costs of inflation are associated with unanticipated inflation. When people anticipate inflation, they can take steps to avoid many of the costs by planning for inflation. Policymakers can index the tax system and remove certain financial regulations. 13/

Conclusions

Unemployment is not likely to decline soon unless special measures are taken. Expansive monetary and fiscal policies could be used to hasten its decline, but stimulating the economy would mean slower progress in reducing inflation and run a risk of eventually reigniting it. In the short term, however, the inflationary risk would be held down by economic slack in this country and in other industrialized countries.

Job-creating measures targeted on individuals or areas might be used alone or as a complement to general expansionary policies. But experience with these approaches has been mixed. In the current situation of high real interest rates and massive unemployment, they could not make a substantial difference in overall unemployment.

NONCYCLICAL UNEMPLOYMENT AND POLICIES TO REDUCE IT

While the recession accounts for perhaps five percentage points of the present unemployment rate, there are other reasons for the remaining six or so percentage points. It is generally conceded that macroeconomic policies would be inappropriate tools for attempting to deal with this noncyclical component.

13/ For two recent studies of the costs of inflation, see Stanley Fischer, "Toward an Understanding of the Costs of Inflation: II," in Karl Brunner and Allan H. Meltzer, eds., The Costs and Consequences of Inflation, Carnegie-Rochester Conference Series on Public Policy, vol. 15 (Autumn 1981); and Dean W. Hughes, "The Costs of Inflation: An Analytical Overview," Economic Review, Federal Reserve Bank of Kansas City (November 1982), pp. 3-14.

Perhaps three or four percentage points of this noncyclical component represent what is called frictional unemployment--associated with entry into the labor market, seasonality, and normal job changing. Some unemployment is unavoidable in an economy with free markets, and even contributes to its efficiency. It may be possible to minimize frictional unemployment by providing better job information or modifying the unemployment insurance system. But part of the noncyclical component of unemployment represents long-term problems stemming from factors such as lack of skills, obsolete skills, and discrimination. This "structural" unemployment causes severe hardship and a waste of resources.

Noncyclical unemployment is thought to have increased over the years, from perhaps 4 to 5 percent in the mid-1950s to 5½ to 6½ percent currently, with some estimates as high as 7 percent. ^{14/} One reason is changes in the demographic composition of the labor force--specifically, relatively large increases in the numbers of women and youth in the labor force. Traditionally, these groups have had higher unemployment rates, in part because of their more frequent movement in and out of the labor market. Also, the large increase in the size of the youth and female groups is believed to have resulted in some relative increase in their unemployment rates and some relative reduction in wages, to the extent that demographic groups are not perfect substitutes in the labor market. ^{15/}

^{14/} The unemployment rate in the mid-1950s of about 4 percent was formerly taken as a benchmark for full employment. However, some recent studies have concluded that 4 percent may have been somewhat below the sustainable, noninflationary unemployment rate even for that period. For recent studies of the lowest noninflationary rate of unemployment or "NAIRU," see Robert J. Gordon, "Inflation, Flexible Exchange Rates, and the Natural Rate of Unemployment," in Martin N. Baily, ed., Workers, Jobs, and Inflation (Brookings, 1982), pp. 89-152; Phillip Cagan, "The Reduction of Inflation and the Magnitude of Unemployment," in William Fellner, ed., Contemporary Economic Problems 1977 (American Enterprise Institute, 1977), pp. 15-49; and Otto Eckstein, Tax Policy and Core Inflation, Joint Economic Committee, U.S. Congress, 96:2 (1980).

^{15/} Estimates of the impact of demographic changes on the natural rate of unemployment range from about one-half to one percentage point. Using 1956 unemployment rates, changes in the demographic composition by the mid-1970s would have added about one-half percentage point to the overall unemployment rate. However, if the prime-age male unemployment rate is taken as a benchmark, the estimated impact of demographic change is about 1 percent. See, Council of Economic Advisers, Economic Report of the President, 1978 and 1979.

Unemployment: Definition and Measurement

The Bureau of Labor Statistics estimates unemployment using a monthly sample survey of households. In general, an unemployed person is one who did not work during the survey week, made specific efforts to find a job within the previous four weeks, and was available for work during the survey week (except for temporary illness). Also counted as unemployed are persons waiting to be called back to a job from which they believe they have been temporarily laid off; and persons waiting to report to a new job within 30 days. The "duration of unemployment" is the length of time that an unemployed person has been continuously looking for work.

Traditionally, the unemployment rate has been calculated by dividing the number of unemployed workers by the size of the civilian labor force (which consists of the number of unemployed workers plus the number of employed workers). However, beginning in January 1983, the Bureau of Labor Statistics will include U.S.-resident military personnel in the denominator. The Bureau estimates that the inclusion of the military will have the effect of reducing the unemployment rate by about one- or two-tenths of a percentage point, compared with the traditional civilian unemployment rate.

Another change beginning in January 1983 concerns the racial classification of workers. Unemployment and other labor force data will be published for the "black" group instead of for the broader "black and other" group that includes American Indians, Alaskan Natives, Asians, and Pacific Islanders. At the time of the 1970 Census of Population, 89 percent of the black and other group were black. The unemployment rate for blacks is substantially higher than that for the broader group--20.4 percent as against 18.6 percent in the last quarter of 1982.

The term "discouraged workers" refers to persons who report that they want a job but have not taken specific steps to look for a job because they believe they cannot find one. Because they have not actually looked for work, they are not counted as "unemployed."

A second (and probably less important) factor accounting for some of the increase in noncyclical unemployment is the growth of other means of support for unemployed workers. Income from unemployment insurance and food stamps has grown. ^{16/} Other family members now contribute more to household income: as more women and youths have taken jobs, a higher proportion of families have more than one earner. The availability of alternative income removes some of the pressure for unemployed workers to obtain employment.

A third factor has been a declining trend in productivity growth, together with a strong momentum of real wages. Many workers, particularly unionized workers and workers in large firms, continued to demand and obtain customary real wage increases of 2 to 3 percent after the basis for such gains in increased productivity had ceased to exist. This added to inflationary pressures, and required additional slack in labor markets to offset it. ^{17/}

Other factors outside the labor market exacerbated inflation and therefore required more unemployment to counterbalance them. Examples from the last decade include energy and food price shocks, increases in payroll taxes, and the depreciation of the dollar on foreign exchange markets. Bottlenecks in plant capacity may also have played a more important role than in the past, for a variety of reasons including the sharp increases in relative energy prices and the effect of inflation on business tax liabilities.

Still another factor may be an increase in the pace of structural change in the economy. Increases in the relative cost of energy, and intensified international competition, have resulted in declining output and

^{16/} Some economists estimate that the growth of unemployment insurance may have added a few tenths of a percentage point to the underlying unemployment rate. See, for example, Phillip Cagan, "The Reduction of Inflation and the Magnitude of Unemployment," already cited, and Stephen T. Marston, "The Impact of Unemployment Insurance on Job Search," Brookings Papers on Economic Activity, 1975:1, pp. 13-48.

^{17/} Other minor factors may include the extension of the federal minimum wage to most of the economy, and the adoption of work registration requirements for the welfare system. The end of the draft in the early 1970s may have removed some of the pressure for male youths to stay in school, and thereby increased the size of the labor force and the unemployment rate for youths.

employment in particular industries and geographic areas, thus contributing to structural unemployment. 18/

Groups Suffering From Structural Unemployment

Among the groups of workers who suffer from structural unemployment are:

- o Youths, particularly those who are from economically disadvantaged families;
- o Adults with low skills who suffer chronic or recurrent unemployment; and
- o Dislocated experienced workers, particularly where there are large-scale plant closings in concentrated geographic areas.

These groups have relatively high unemployment rates, both in good times and bad. Moreover, during periods of recession or slow economic growth, their unemployment rates tend to rise more, in terms of percentage points, than the unemployment rate in general (see Table 15). Correspondingly, these groups would benefit markedly from a vigorous economic expansion. 19/

Youth Unemployment. Youth unemployment accounts for a relatively large part of total unemployment, especially during times of lower overall unemployment. In 1978-1979, for example, youths 16 to 24 comprised almost half of the total number of unemployed workers. Youth unemployment rates have increased relative to adult and unemployment rates since the 1950s and 1960s. The reasons include rapid growth in the youth population, rising labor force participation rates among youths, and more slack in labor markets. Moreover, the outlook for youth unemployment is not good in the near and intermediate term (less than five years), even though this age group will be a declining part of the total population. For one thing, unemployment

18/ David M. Lilien, "Sectoral Shifts and Cyclical Unemployment," Journal of Political Economy, vol. 90, no. 4 (August 1982), pp. 777-94.

19/ See, for example, Kim B. Clark and Lawrence H. Summers, The Demographic Composition of Cyclical Variations in Employment, Technical Analysis Paper No. 61, Office of the Assistant Secretary of Labor for Policy Evaluation and Research, U.S. Department of Labor (January 1979).

among black youths is particularly acute (see Figure 28), and their number is expected to decline much less than that of youths in general. For another, the overall job market may be quite slack for the next several years, which would disproportionately affect young entrants to the labor force. A rule of thumb is that the youth unemployment rate changes about 1.5 percentage points for every one percentage point change in the overall unemployment rate. 20/

Unemployed youths constitute a highly diverse group. Part of the difficulty in designing appropriate policies, therefore, is to determine which youths seriously need help. Recent research suggests that a relatively small proportion of unemployed youths suffer from serious, long-run problems, and that this accounts for the bulk of total youth unemployment. 21/

A recent study by the Labor Department attempted to estimate the size of the youth labor force with serious employment problems. It found that in 1977, about 2.9 million youths of ages 16-24 experienced at least 15 weeks of unemployment; 700,000 of them were from economically disadvantaged families. When the economically inactive group of youths from disadvantaged families were included--those not in the labor market or school and not caring for children--the estimate was substantially larger, approximately 2.1 million. 22/

Unemployment by itself is not a very adequate indicator of youths' situation in the labor market, since many experience it only for a short

20/ For more detailed studies of youth employment problems, see Congressional Budget Office, Youth Unemployment: The Outlook and Some Policy Strategies (April 1978); and Improving Youth Employment Prospects: Issues and Options (February 1982).

21/ For example, one recent study found that over half of the unemployment among teenage males was accounted for by just the 8.4 percent of that labor force group who were unemployed more than 26 weeks out of the year. Moreover, all groups, a mere 2.4 percent of the labor force, who were unemployed more than 26 weeks accounted for approximately 40 percent of total unemployment in 1974. Kim B. Clark and Lawrence H. Summers, "Labor Market Dynamics and Unemployment: A Reconsideration," Brookings Papers on Economic Activity, 1979:1, pp. 13-60.

22/ See U.S. Department of Labor, Office of the Assistant Secretary for Policy, Evaluation and Research, The Nature of the Youth Employment Problem: A Review Paper (March 1980), pp. 77-81.

time, or while they are still primarily in school. Moreover, youth labor force participation rates tend to rise as employment prospects improve. Thus the success or failure of youth employment programs may not be adequately shown by their impact on unemployment. A "successful program" may improve the long-run prospects of participants but have little short-run effect on youth unemployment since better opportunities may cause more youths to enter the labor market.

The Low-Skilled, Chronically Unemployed. This is the group of unemployed workers who are perhaps most difficult to identify and to help. Many workers in the low-wage labor market face long periods of unemployment or are employed only fitfully. Many withdraw from the labor market for a time. In urban areas their difficulties tend to take the form of high unemployment, while in rural areas they are more likely to be those of underemployment. Minorities have higher-than-average unemployment rates (see Figure 27). In general, the likelihood of being unemployed is inversely related to a person's level of education and economic skills.

When all this is said, however, it is still frequently difficult to identify the chronically unemployed as a group. The condition of being unemployed at any one time is not their distinguishing characteristic. This is evident from the fact that, in the low-wage labor market, the possibility of employment may bring out many people who were not previously counted as unemployed. Thus a "successful" employment program may have little effect on the official unemployment rate. This illustrates the limitations of measured unemployment as a social indicator. One useful indicator is the census category, "poverty areas of metropolitan areas." In 1978-1979, the unemployment rate in these areas was about twice the national average; and the areas had about 750,000 unemployed workers.

The persistence of chronic high unemployment in urban low-wage labor markets has many complex causes, including lack of skill, discrimination, and isolation. Frequently, the available jobs offer no future, so that there is little incentive for workers to stay. Employers, for their part, have little incentive to invest in the training of workers who frequently quit. The net result is high turnover in particular jobs, little investment in human capital, and high frictional unemployment.

Dislocated Workers. In a dynamic economy, thousands of workers lose their jobs every year because of technological change, import competition, and changes in consumer demands. Many suffer substantial loss in earning capacity, and many more experience some unemployment before they find

other work. But generally these adjustments do not result in large-scale, chronic unemployment. 23/

The number of dislocated workers may have become substantially higher since 1973, and especially since 1978-1979. Sharp increases in energy prices have affected industries and regions very differently, some gaining a relative advantage and some losing it. Foreign competition has intensified in recent years, particularly in such basic industries as steel, automobiles, rubber, and textiles. Finally, slow growth in the economy, and two back-to-back recessions, have exacerbated structural problems in many basic industries, producing massive layoffs. It is doubtful whether employment in a number of basic industries such as steel, automobiles, and textiles will ever again approach pre-1980 levels. 24/

Estimates suggest that this group now numbers in the hundreds of thousands. 25/ The problems resulting from structural changes would be difficult enough with full economic recovery. But the outlook for only a weak recovery from present low levels exacerbates these adjustment problems.

Policies to Reduce Noncyclical Unemployment

Two kinds of policies are frequently proposed for reducing the noncyclical or trend component of unemployment: anti-inflation policies (other than restrictive demand policies) and longer-run employment policies such as training and job-finding assistance. Such policies might reduce the level of unemployment consistent with sustained noninflationary growth, and in the current situation reduce inflationary pressures resulting from expansive aggregate demand policies.

Anti-inflation Policies. Policies to make the economy less inflation-prone would tend to lower the natural level of unemployment--that is, they

23/ There are notable exceptions. For example, the displacement of labor by technological change in agriculture in the South led to massive migration to urban centers and contributed to high unemployment in some cities.

24/ For a more detailed study, see Congressional Budget Office, Dislocated Workers: Issues and Options (July 1982).

25/ Recent estimates by CBO suggest that several hundred thousand workers may face prolonged unemployment as a result of long-term changes in the economy. See Dislocated Workers: Issues and Options.

would permit lower unemployment without significant inflationary pressures. Such policies might include removal of international trade barriers, minimal use of farm price supports, and a weakening of Davis-Bacon type regulations in federal contracting. Income transfer programs might be modified to reduce their adverse effects on incentives and on the efficiency of labor markets. 26/ The overall objective of such policies would be to allow markets to function more efficiently.

Various types of incomes policies--that is, policies to prevent inflationary wage and price increases--would be in line with this approach. On the positive side, tax-based incomes policies may merit further study. On the negative side, three-year wage contracts that are not synchronized in time, the almost automatic granting of real wage increases, the use of the Consumer Price Index to adjust contracts for inflation, and the use of import quotas may need to be scrutinized. 27/

Longer-run Employment Policies. Traditional efforts to reduce structural unemployment include measures to:

- o Raise the productivity of workers, such as training;
- o Increase the mobility of workers, such as relocation assistance and the provision of job market information;

26/ Some economists have argued that the present unemployment insurance program adds unnecessarily to unemployment. For example, experience-rating procedures used in some states weaken the connection between the tax that employers pay and their record in laying off workers. Tighter experience rating might reduce layoffs. Another proposal would subject all unemployment insurance benefits to the income tax, to strengthen incentives to work. See, for example, Martin S. Feldstein, "The Effect of Unemployment Insurance on Temporary Layoff Unemployment," American Economic Review, vol. 68, no. 5 (December 1978), pp. 834-46.

27/ For a discussion of factors contributing to the momentum of inflation, see Congressional Budget Office, The Prospects for Economic Recovery (February 1982), Chapter IV. Distortions in the Consumer Price Index are discussed earlier in Chapter II of the current report. Moreover, the CPI includes foreign goods and it may not be feasible to protect all groups from increases in the cost of living, particularly from foreign sources.

- o Increase the demand for selected kinds of labor, such as a targeted wage subsidy or tax credit, public service employment, and reductions in the minimum wage.

Economists emphasize two rationales for these longer-run employment policies. First, if successful, they may reduce the inflationary pressures associated with fuller utilization of resources. Second, private markets may produce less than an optimum amount of training or labor market information.

Improving Workers' Productivity. Current federal programs aimed at improving workers' productivity include the Job Training Partnership Act of 1982, vocational education, and support for students at the post-secondary level such as the Pell Grant program.

Evaluations of such programs have been mixed. In general, training for disadvantaged adults seems to have been most effective in raising the earnings of persons who have not had much exposure to the job market. It has been of substantial help to female participants, but little if any help to males. Another fairly consistent finding is that the increases in earnings resulted primarily from increases in time worked rather than from increases in wage rates. ^{28/} Possibly more intensive training may be required over a longer period to assist workers who have been in the labor force for some time but have not acquired marketable skills. Or, because of the current and prospective slack in labor markets, perhaps greater emphasis should be placed on the attainment of general rather than highly specific skills.

Mobility--Information and Placement. The Employment Service (ES) is a cooperative effort by the federal and state governments. A primary responsibility of ES is to administer the job-search provisions of the unemployment insurance system. Its placement activities are concentrated on the unskilled sector of the labor market and most of its services are localized, with very little placement activity occurring across state lines. In general, it provides little information to unemployed workers about conditions in other labor markets.

The provision of more job information might be considered, as well as migration assistance: subsidies for moving expenses, and assistance in finding housing. Some countries, notably Sweden, have traditionally made use of policies to assist workers in relocating from labor-surplus areas to

^{28/} See Congressional Budget Office, CETA Training Programs--Do They Work for Adults? (July 1982); and Laurie J. Bassi, "Estimating the Effect of Training Programs With Nonrandom Selection" (unpublished), The Urban Institute (July 1982).

relatively expanding areas. A number of experiments or demonstrations involving migration assistance have been made in the United States. 29/

Currently, the principal program for providing employment assistance to dislocated workers is the Job Training Partnership Act. Title III of that act authorizes matching funds for state programs that develop adjustment assistance programs. It authorizes job-finding assistance and migration assistance, as well as training. As yet, however, only \$25 million has been appropriated for Title III.

Other proposals for assisting dislocated workers include modifying the unemployment insurance system to assist workers in adjusting to new job situations. 30/ Currently, unemployment insurance benefits are simply income support payments, which in some circumstances may slow workers' adjustments to long-run changes in the economy. One way to encourage workers to move or undergo retraining would be to grant a final lump-sum payment after some period of unemployment, particularly after plant closings. Another might be to encourage or require persons receiving UI benefits to take training programs and, if enrolled, to complete them before looking for work. Still another approach, used by some countries of western Europe, would be to require businesses to give advance notice before closing a plant. 31/

29/ For an evaluation of some of these demonstrations, see Charles K. Fairchild, Worker Relocation: A Review of U.S. Department of Labor Mobility Demonstration Projects, Final Report to the U.S. Department of Labor, Manpower Administration, Contract No. 87-34-69-01 (1970).

30/ A recent report to the President's National Productivity Advisory Council by its Subcommittee on Human Resources proposed that states be given greater flexibility in the use of UI funds and that labor-management consultations before plant closings should be encouraged as a way of easing worker adjustments. See Daily Labor Report, No. 191 (October 1, 1982), Bureau of National Affairs, Inc.

31/ Restrictive trade policies are sometimes proposed as a way of reducing high unemployment in some sectors of the economy. This is only a short-run solution at best, because it merely redistributes employment opportunities in the short run, and reduces economic efficiency and growth in the long run. See Congressional Budget Office, "The Fair Practices in Automotive Products Act (H.R. 5133): An Economic Assessment," in Domestic Content Legislation and the U.S. Automotive Industry, Subcommittee on Trade, Committee on Ways and Means, U.S. House of Representatives, 97:2 (1982).

A variety of measures could be taken to increase the demand for certain groups of workers. These include wage subsidies or tax credits, such as the existing Targeted Jobs Tax Credit. ^{32/} Public service employment of a structural kind--in contrast to countercyclical PSE--is another approach, previously used in connection with CETA programs.

Finally, a differential minimum wage, involving a lower minimum for youths for a limited period of employment, has frequently been proposed as a means of increasing employment opportunities for youths. Minimum wage studies suggest that youth employment is relatively sensitive to changes in the minimum wage. Moreover, it might be especially sensitive to a differentially lower minimum wage. ^{33/} A disadvantage, however, is that it could lead some employers to hire youths rather than adults. Opponents charge that this displacement would be large, although little evidence is available.

Conclusion

The range of policy options for attempting to reduce noncyclical unemployment is broad. Even though inflation has temporarily abated, structural policies to reduce inflationary biases in the economic system would contribute to lower unemployment in the long run. Employment policies, such as training and job-finding assistance, and wage subsidies could also play a role.

It need hardly be said that efforts to reduce noncyclical unemployment would stand less chance of success in a time of prolonged recession or labor market slack. As mentioned earlier, the same groups who suffer high underlying rates of unemployment are also relatively more affected by prolonged slack in labor markets. Programs to train workers, to increase their mobility and upgrade their skills, flourish when labor markets are

^{32/} The Targeted Jobs Tax Credit permits a tax credit for wages paid toward the employment of workers who qualify for the credit. One recent proposal would add the long-term unemployed to the groups of eligible workers which now include disadvantaged youths, ex-offenders and AFDC recipients.

^{33/} For a recent survey of minimum wage studies, see C. Brown, C. Gilroy and A. Kohen, "The Effect of Minimum Wage on Employment and Unemployment," Journal of Economic Literature, vol. xx, no. 2 (June 1982), pp. 487-528.

tight. During recessions, such investments in human capital fall off considerably. ^{34/} The current economic outlook, unfortunately is for a slow recovery, with unemployment remaining very high for several more years. Following upon two recessions with virtually no economic growth in three years, the outlook for private investment in human capital is not encouraging.

REDUCING THE HARDSHIP OF UNEMPLOYMENT

A third strategy for dealing with unemployment would aim at reducing its hardship. This would remove some of the pressure to stimulate the economy, permitting a higher priority on reducing inflation. Some possibilities are:

- o Extending unemployment insurance (UI) benefits.
- o Sharing work--that is, paying partial unemployment insurance benefits to workers on reduced work schedules;
- o Liberalizing transfer programs for the unemployed.

Extending the Duration of UI Benefits. The federal government could lengthen the duration of UI benefits to provide additional support to the long-term unemployed. The maximum duration of the benefits under the Federal Supplemental Compensation program could be increased further; or some of the recent legislative changes affecting the availability of extended benefits could be repealed. In either case, however, the additional benefits would have to be financed through higher taxes or a higher federal deficit, since the UI system is already facing financial difficulties. ^{35/}

Work Sharing. In most states, the unemployment insurance system encourages firms to lay off some workers entirely, while keeping others employed full time because workers on a moderately reduced schedule do not qualify for benefits. In recent years, some states including California and Oregon have permitted UI benefits in certain circumstances to be paid on a prorated basis to workers on temporarily reduced work weeks. That

^{34/} See for example, Wayne Vroman, "Worker Upgrading and the Business Cycle," Brookings Papers on Economic Activity, 1977:1, pp. 229-50.

^{35/} For a more detailed discussion, see Congressional Budget Office, "Strategies for Assisting the Unemployed," pp. 42-46.

practice is also followed in several countries of Western Europe, including France. ^{36/}

Liberalizing Transfer Programs for the Unemployed. Large gaps still exist in the income safety net for the unemployed poor. Many unemployed persons do not qualify for unemployment benefits, either because they are not eligible or because they may have exhausted their eligibility. In more than half of the states, two-parent families are not eligible for Aid to Families with Dependent Children (AFDC). For workers with no children, there remain only food stamps and general assistance--the latter entirely state-financed.

The income safety net for the unemployed might be strengthened in a number of ways. In some countries, including Sweden, reduced unemployment benefits are paid to long-term unemployed workers who would not otherwise be eligible. Another possibility might be to encourage or require states to make two-parent families eligible for AFDC. Since that would not help people without children, federal assistance might also be granted to states for their general welfare assistance programs. More ambitious proposals include some form of negative income tax or guaranteed job program at low wages. These, however, would require substantial new budgetary commitments.

CONCLUSIONS

Most forecasts suggest that unemployment will remain very high for years to come, and this has prompted many proposals for policy changes to reduce it or alleviate its hardship. Policies that generate rapid growth would make by far the largest contribution to reducing unemployment. Moreover, a strong recovery would surely help, although not cure, the labor market problems of groups who suffer from structural unemployment. However, fiscal policy is already stimulative. An expansive monetary policy would likely improve growth prospects at the cost of higher inflation--not double-digit inflation, but less progress in reducing inflation, or possibly some upward drift from the rate established during the past year. If expansive policies were maintained too long with economic slack substantially less than it is currently, the inflationary risk would become greater. Thus, policymakers are faced with the choice of continuing to fight inflation

^{36/} For a discussion of experience with prorating UI benefits to encourage work sharing, see Fred Best and James Mattesich, "Short-time Compensation Systems in California and Europe," Monthly Labor Review (July 1980), pp. 13-22.

or of fighting cyclical unemployment. Available macroeconomic policies cannot do both effectively.

Because the impact of economic conditions on unemployment has been so uneven, targeted employment measures might be considered, such as public works, public service employment, and expanded employment tax credits. Under conditions of tight credit, however, such policies are less effective as a stimulus to total employment--though they would affect the distribution of employment and unemployment.

Problems of structural unemployment might be addressed with longer-run policies such as increased job training, measures to improve mobility, and expanded use of targeted jobs tax credits. Such programs are not likely to have a large impact on unemployment in the short run, particularly given the slack in the economy; but over several years or a decade they might make a significant contribution.

If policymakers choose not to pursue a rapid recovery, there are measures available to reduce the hardship of unemployment, such as extending unemployment insurance benefits or expanding the Aid for Dependent Children Program to include more two-parent families with an unemployed head. Many of these proposals, however, as well as many programs to reduce structural unemployment, would raise budget deficits unless offset by budget reductions or tax increases.

Economic growth is surely the key to reducing unemployment. Unless the economy performs well in terms of a strong sustained recovery, unemployment will remain at very high levels. Moreover, structural policies to enhance employability are not likely to be effective as long as the labor market remains very loose; moves such as fostering market competition are less likely to be undertaken in a depressed economy.



