CHAPTER 2

The Dual Problems of Structural and Cyclical Unemployment

UNEMPLOYMENT IS THE MOST SERIOUS ECONOMIC PROBLEM now facing the United States. By December 1982 the number of unemployed had risen by more than 4 million since the beginning of the recession in July 1981. The unemployment rate was higher in December 1982 than at any point since the Depression, with over 12 million persons counted as unemployed. Even after the economy recovers from the recent recession, it is likely that the unemployment rate will reach a plateau between 6 and 7 percent.

This chapter analyzes the two major types of unemployment: cyclical and structural. The high level of cyclical unemployment now prevailing in the United States is a major problem, but it should prove transitory. Only a healthy and sustained recovery from the recent recession can effectively diminish cyclical unemployment. Even after full recovery, however, a serious structural unemployment problem will remain unless measures are taken to improve the functioning of labor markets. Reducing structural unemployment will require attacking the special problems of young people and the long-term adult unemployed.

This chapter begins by describing the dimensions of the cyclical and structural unemployment problems. It then examines the potential of public employment programs and macroeconomic policies to lower cyclical unemployment. Finally, policies for reducing structural unemployment are considered.

THE RECENT RECESSION

The unemployment rate in December 1982 stood at 10.8 percent of the civilian labor force. Since the recent period of economic slack that began in January 1980, the unemployment rate has risen by 4.5 percentage points. During the recent recession, which began in July 1981, the unemployment rate rose by 3.6 percentage points. Historical experience suggests that the unemployment rate tends to increase for several months after the level of production bottoms out

and it is possible that the unemployment rate will reach 11 percent at some point during 1983.

Beyond those officially counted as unemployed, the recent recession has prevented many Americans from working as much as they would like. In December 1982 there were over two million persons involuntarily working part time. The Bureau of Labor Statistics also reported that there were over 1.8 million discouraged workers in December. These are individuals who have given up looking for work because they believe they cannot find jobs.

Unemployment is often linked to economic hardship. While many of the unemployed receive unemployment insurance and live in families that have other members who work, many unemployed individuals and their families suffer economic distress. Table 2–1 presents information on the incomes of families in which the husband, wife, or head of household experienced unemployment during 1981. (Data for 1982 are not yet available.) Three types of families are distinguished: (1) families in which both husband and wife worked, (2) families in which only the husband or male head worked, and (3) families in which only the wife or female head worked. For all of the family types, unemployment experienced by husband, wife, or head of household significantly lowered median family income. For example, single-earner families in which the husband (or male head) was never unemployed had a median income in 1981 of $25,000. In contrast, the median income of similar families in which the male head experienced 1 to 26 weeks of unemployment was $16,500. Families in which the male head was unemployed for more than 26 weeks had a median family income of $10,200.

TABLE 2–1.—*Median family income by unemployment and family status, 1981 (current dollars)*

Family status	Unemployment status of husband, wife, or head of household		
	Person never unemployed	Person unemployed less than 26 weeks	Person unemployed more than 26 weeks
Husband and wife both work	$31,600	$23,000	$17,900
Only husband or male head works	25,000	16,500	10,200
Only wife or female head works	18,900	15,200	11,200

Source: Department of Labor, Bureau of Labor Statistics.

The financial losses of the unemployed are not the only costs of a prolonged economic decline. Considerable anxiety and emotional distress is experienced by those who have lost their jobs or who fear that they might lose their jobs in an economy with a declining number of employment opportunities. Protracted unemployment is

frequently associated with poor health, psychological problems, and gradual erosion of job-related skills.

THE COMPOSITION OF CYCLICAL AND STRUCTURAL UNEMPLOYMENT

The unemployment problem can be divided into two components, cyclical and structural unemployment. The term *cyclical unemployment* is used to refer to the unemployment associated with cyclical downturns in aggregate economic activity. The incremental unemployment associated with the recent recession would fall into this category. The term *structural unemployment* is used to refer to the unemployment that remains even after cyclical recoveries in aggregate economic activity.

In large part, structural unemployment is a natural concomitant of a dynamic economy with constantly changing patterns of demand. Labor markets are in constant flux, with people entering and leaving the labor force, losing or quitting old jobs, and looking for and acquiring new jobs. Some amount of structural unemployment is an inevitable aspect of a large modern industrial economy such as ours. It is important to realize that although expansionary macroeconomic policies cannot reduce structural unemployment permanently, certain microeconomic policy interventions can affect the ease and speed of the process that matches workers with jobs.

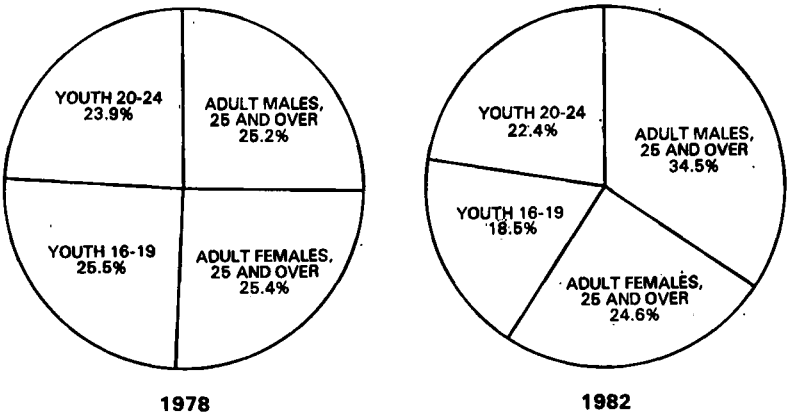
Some insight into the differences between cyclical and structural unemployment can be obtained by comparing the characteristics of the unemployed in 1982 and in a period of low cyclical unemployment. Since the unemployment rate in 1978 was 6.1 percent, close to most observers' estimates of full employment, data from that year will be used to illustrate the characteristics of structural unemployment. The next two sections examine the composition of the unemployed population in 1978 and 1982 in terms of demographic composition and reasons for unemployment. A third section analyzes the dynamics of unemployment.

DEMOGRAPHIC COMPOSITION

Chart 2–1 provides information on the demographic composition of the unemployed population in 1978 and in 1982. The chart shows that young people under age 24 account for a substantial fraction of unemployment both when the economy is weak and when it is strong. Persons under 24 accounted for 49 percent of total unemployment during 1978 and 41 percent of unemployment in 1982. The decline in the share of youth unemployment reflected the large increase in unemployment among adult males in cyclically sensitive sectors of the economy, such as manufacturing.

Chart 2–1

Distribution of Unemployment by Age and Sex



NOTE.—DATA RELATE TO PERSONS 16 YEARS AND OVER.
SOURCE: DEPARTMENT OF LABOR.

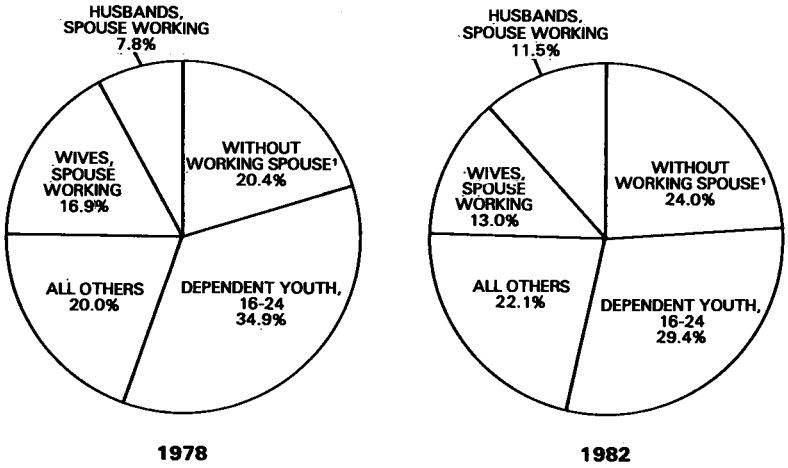
A pattern that appears in Chart 2–2 is the cyclical sensitivity of unemployment among those who provide the primary financial support for a family. The share of unemployment among husbands, wives, and family heads in families without a working spouse rose from 20 percent in 1978 to 24 percent in 1982. Because unemployment undoubtedly imposes its greatest hardship when it hits a worker upon whom others depend for their sole support, this increase is particularly distressing.

A continuing tragedy in both good and bad times is the very high rates of unemployment of blacks and other minorities. This group accounts for a share of unemployment that is greatly disproportionate to its share of the labor force. While blacks and other minorities comprised 13 percent of the labor force in 1982, they comprised approximately 23 percent of the unemployed. Chart 2–3, shows that the recent recession raised the unemployment rate of blacks and other minorities proportionally less than that of the rest of the population.

However, black and other minority unemployment rates increased sharply during the recession and continue to greatly exceed those of the entire population. The unemployment rate for black and other minority adult males was 16.2 percent in 1982, compared to 7.8 percent for white males. For black and other minority teenagers the unemployment rate was 43.9 percent, compared to 20.4 percent for white teenagers.

Chart 2–2

Distribution of Unemployment by Family Status



¹HUSBANDS AND WIVES WHOSE SPOUSE DOES NOT WORK AND PERSONS WHO MAINTAIN FAMILIES.

NOTE.—DATA RELATE TO PERSONS 16 YEARS AND OVER.

SOURCE: DEPARTMENT OF LABOR.

REASONS FOR UNEMPLOYMENT

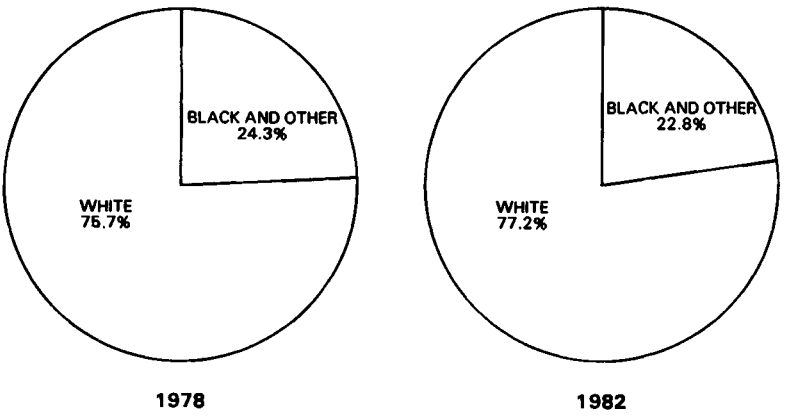
Analyzing the problem of unemployment requires understanding the process by which people become unemployed. The unemployed are often described in stereotyped terms as the victims of permanent layoffs by firms that are either partially or fully shutting down. Even during the recent recession, however, this characterization applied to less than half of the unemployed.

As part of the monthly Current Population Survey, the unemployed are asked a number of questions designed to elicit the reasons for their unemployment. The answers to these questions permit a breakdown of the unemployed into five groups: (1) persons laid off who can expect to return to the same job; (2) persons who have lost jobs to which they cannot expect to return; (3) persons who have quit their jobs; (4) reentrants who are returning to the labor force after a spell of neither working nor looking for work; and (5) new entrants who have never worked at a full-time job before but are now seeking employment.

Chart 2–4 shows that the distribution of the unemployed among these categories is very sensitive to cyclical conditions. The share of persons who have lost their jobs, either temporarily or permanently,

Chart 2–3

Distribution of Unemployment by Race



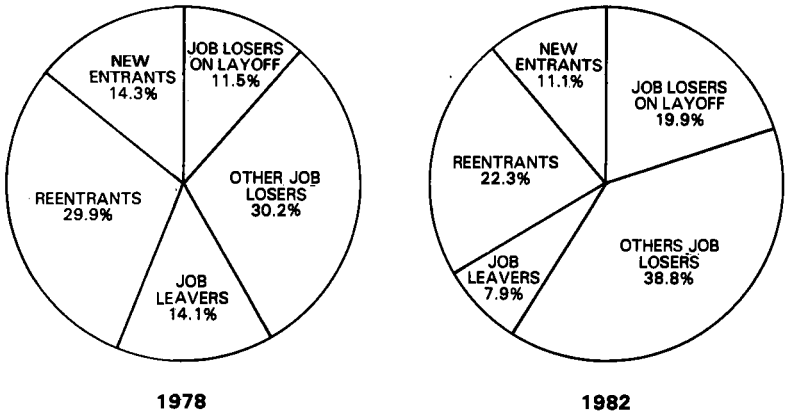
NOTE.—DATA RELATE TO PERSONS 16 YEARS AND OVER.
SOURCE: DEPARTMENT OF LABOR.

is particularly sensitive, rising from 42 percent in 1978 to 59 percent in 1982. Over this period the number of job losers on temporary layoff tripled and the number of permanent job losers more than doubled. The decline in alternative employment opportunities resulted in a decline in the share of unemployment traceable to workers leaving their jobs voluntarily during the recession—from 14 percent in 1978 to 8 percent in 1982. Finally, because the number of labor force entrants and reentrants is relatively constant, their share in total unemployment declined somewhat during the recession.

The data on reasons for unemployment indicate a major difference between cyclical and structural unemployment. Almost 90 percent of the increase in unemployment during cyclical downturns involves increases in job losses and layoffs, as firms respond to declines in demand for their products. On the other hand, almost 60 percent of structural unemployment is comprised of voluntary job leavers, labor force entrants, and reentrants. The remainder are job losers. As described below, the very different causes of cyclical and structural unemployment suggest that different policy responses are appropriate.

Chart 2–4

Distribution of Unemployment By Reason



NOTE.—DATA RELATE TO PERSONS 16 YEARS AND OVER.
SOURCE: DEPARTMENT OF LABOR.

THE DYNAMICS OF UNEMPLOYMENT

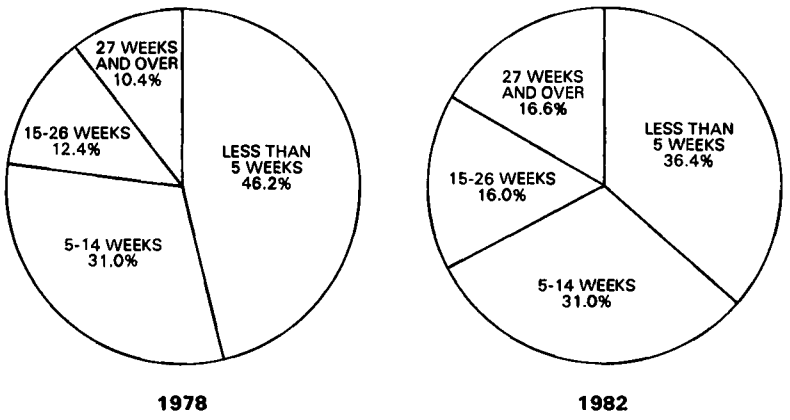
An essential feature of the unemployment problem is its dynamic character. The appropriate design of policies to reduce unemployment depends on whether most of the unemployed are out of work for a long time and must wait for an economic upturn to find jobs or whether they are a group whose membership changes rapidly, even during recessions.

The principal source of information on the duration of unemployment is the monthly Current Population Survey, which asks persons who report themselves as unemployed to report how long they have been unemployed. Chart 2-5 presents information on the duration of unemployment in 1978 and 1982. The clearest difference between cyclical and structural unemployment emerges in the incidence of long-term unemployment. In 1982 the number of unemployed individuals who reported that they had been out of work for 6 or more months was almost three times the corresponding number in 1978, when the economy was operating without significant cyclical unemployment.

While the incidence of long-term unemployment increases sharply during recessions, it is important to recognize that many of the un-

Chart 2–5

Distribution of Unemployment by Duration



NOTE.—DATA RELATE TO PERSONS 16 YEARS AND OVER.
SOURCE: DEPARTMENT OF LABOR.

employed find jobs or withdraw from the labor force relatively quickly. Of all the persons who became unemployed in September 1982, over 45 percent were no longer unemployed by October, and over 65 percent were no longer unemployed by November. However, evidence on the duration of unemployment is not purely indicative of the ease or difficulty with which persons find jobs since almost half the unemployed leave the labor force without finding jobs.

While most persons who become unemployed look for work only briefly, this group does not comprise a large part of the unemployment problem. It is long-term unemployment that is of special concern. A recent study found that in 1978, more than 40 percent of total unemployment was due to the 15 percent of the unemployed population who were out of work a total of 6 months or longer during the year. This concentration of long-term unemployment among a relatively small group of the unemployed is particularly pronounced during cyclical downturns. Data on this subject are not yet available for 1982. During 1975, however, when the unemployment rate was 8.5 percent, an estimated 52 percent of unemployment was due to the 22 percent of the unemployed population who were out of work more than 6 months.

These findings suggest several conclusions. First, even during recessions, most persons who become unemployed either find jobs or leave the labor force relatively quickly. Second, the unemployment problem is most serious for those who are unemployed for prolonged stretches. Third, the incidence of long-term unemployment is very sensitive to cyclical conditions, which suggests that it will diminish as the economy recovers. Even after a recovery is well underway, however, a sizable fraction of total unemployment will involve protracted joblessness. The needs of the long-term unemployed deserve special recognition in the designing of policies to attack structural unemployment.

COMBATING CYCLICAL UNEMPLOYMENT

High rates of cyclical unemployment, which the American economy is now experiencing, are largely a consequence of fluctuations in aggregate demand caused by macroeconomic policies and shocks to the economy. As described in Chapter 1, the historical experience of the United States and other countries suggests that disinflation is generally associated with lost output and increased unemployment. During periods of disinflation and recession, the measures available to reduce the pain of the transition from accelerating inflation to price stability are limited. Greater fiscal or monetary stimulus might increase employment, but only at the risk of igniting inflation. Chapter 1 describes the principles that the Administration feels govern sound macroeconomic policies.

THE LIMITS OF MACROECONOMIC POLICY

The only way to reduce current high levels of cyclical unemployment is for the United States to achieve a sound recovery from the recent recession. Avoiding future recurrences of high cyclical unemployment requires avoiding an expansion so rapid as to lead to rapidly increasing inflation. Historical experience suggests that the change in the rate of inflation depends both on the rate at which economic activity is expanding and on the level of economic slack. If the slack in the economy declines too rapidly, or capacity utilization is held at too high a level, inflation will tend to increase. The lower limit on unemployment below which inflation will tend to increase is referred to as the *inflation threshold* unemployment rate.

While it is not easy to pinpoint the inflation threshold unemployment rate precisely, it probably lies between 6 and 7 percent. Econometric studies of historical data suggest that when unemployment is close to 6 percent, the rate of inflation tends to accelerate. For example, during 1978 when the unemployment rate was 6.1 percent, infla-

tion as measured by percentage changes in the gross national product (GNP) deflator rose to 7.4 percent from 5.8 percent in 1977. An even larger increase occurred in 1979 when the unemployment rate averaged 5.8 percent.

The Effect of Demographic Factors

There are a number of reasons to believe that the inflation threshold unemployment rate increased during the 1960s and 1970s. Many economists believe that demographic factors may have contributed to the increase. Persons with little labor market experience tend to have high rates of unemployment as they move from job to job in an effort to obtain a desirable career position. In the last 15 years, the children of the baby boom have reached maturity thus raising substantially the share of inexperienced workers in the labor force. In addition, women with little recent labor market experience have entered the labor force at an unprecedented rate during the last 15 years. It has been estimated that if the labor force had the same demographic composition today as it had in 1958, the unemployment rate would have been about three-quarters of a percentage point lower in 1982. The share of young people in the labor force will decline sharply over the next decade due to a dramatic reduction in the birth rate throughout the late 1960s and the 1970s. This provides grounds for cautious optimism that the inflation threshold unemployment rate will decline.

Social Insurance Programs

Other factors which have increased the inflation threshold unemployment rate in recent years are less likely to be reversed in the next decade. These include the effects of social programs. While providing important financial support to their recipients, these programs also have both behavioral and reporting effects on the measured unemployment rate.

Behavioral effects of social insurance programs such as unemployment insurance include the encouragement of firms to lay off workers and the inducement of persons to prolong their spells of unemployment. These effects are discussed in more detail below. Reporting effects occur when programs induce persons to change reporting of their labor force status, without changing their behavior. For example, some experts believe that the Federal Supplemental Benefits program instituted during the 1975 recession caused persons who otherwise would have withdrawn from the labor force to report that they were unemployed because of job search requirements. There is some evidence to suggest that the work registration requirements in the food stamp and AFDC programs have had a similar effect.

Wage Rigidity

A number of studies show that wages and prices are much more rigid now than prior to World War II, and that rigidity has increased within the post-War period. Increased wage rigidity is likely to raise the economy's inflation threshold level of unemployment, since less flexible wages increase the inevitable unemployment associated with the sectoral shocks which buffet the economy.

The reasons for this change are not well understood. A side effect of the provision of a "safety net" program is that employees may become more resistant to wage reductions, leading to increases in wage and price rigidity. To the extent that the two-earner family is a form of private "safety net" against the financial losses of unemployment, the recent growth in the number of two-earner families may also have contributed to increasing wage rigidity in the United States over time.

Increasing Structural Change

A final factor that may have contributed to a rising inflation threshold unemployment rate is the increasing rapidity of structural change in the economy. This acceleration, which is in part caused by the economy's increasing sensitivity to events in the world economy, is evidenced by increasing dispersion across industries and localities in rates of unemployment. Because transfers of human and physical resources are costly and take time, increased unemployment is a concomitant of structural change.

While the separate impacts of these factors—changing demographic composition, larger social insurance programs, increased wage rigidity, and increased structural change—are difficult to quantify, it is reasonable to conclude that together they may have significantly increased the inflation threshold unemployment rate. Expansionary macroeconomic policies are unlikely to reverse the effects of these changes.

PUBLIC WORKS EMPLOYMENT PROGRAMS

Direct provision of public works jobs by the government is a politically popular response to cyclical unemployment during recessions. Available evidence suggests, however, that public works programs adopted in past recessions proved counterproductive, and that the inherent capability of public works programs to combat cyclical unemployment is limited.

The Timing of Public Works Expenditures

Public employment programs that produce useful goods or services generally take time to plan and implement. Therefore, such programs often have their greatest effects on public employment long

after an economic recovery has begun. For this reason, public employment programs have sometimes exacerbated rather than mitigated cyclical fluctuations in aggregate demand. A study of the Accelerated Public Works program enacted in September 1962 by the Congress to combat the high unemployment rate of the early 1960s found that the number of jobs created by the program peaked in June 1964, 37 months after the bottom of the recession. More recent experience also confirms that lags in implementation are long. A recent study by the Office of Management and Budget found that 90 percent of the outlays for local public works projects designed to stimulate recovery from the 1974–75 recession occurred more than 2½ years after the trough of the recession. The lags in implementing public works programs result in their having destabilizing effects, since a large share of the resulting spending occurs during periods of economic expansion.

The Effect of Federal Funding of Public Works on State Expenditures

Even when spending for these programs begins immediately after they are enacted, many public works projects do not yield a net increase in employment. Because of the long planning and implementation lags, most of the projects available for immediate funding are those that were planned before the recession began. Thus, Federal expenditures on these projects often substitute for outlays that would have taken place anyway.

A major effect of Federal public works expenditures may be to alter the timing of public works projects. The expectation of new public works programs may induce State and local governments to delay making outlays during the early stages of economic downturns in the hope that they will receive Federal funds for projects they have "on the shelf." The importance of this possibility is suggested by experiences with the Local Public Works Capital Development and Investment Act of 1976 and the Public Works Employment Act of 1977, programs intended to spur recovery from the 1975 recession. Three characteristics of these programs may have created incentives for local governments to delay their own discretionary spending until they could see whether the Federal Government would pay their entire bill: (1) projects were financed fully by the Federal Government; (2) grants were limited to quick-starting projects; and (3) there was considerable uncertainty and lengthy delays in the process of awarding money to State and local governments. One study found that State and local public works expenditures fell substantially in mid-1976 and decreased further between 1976 and 1977. It suggested that this may have occurred because States and local governments delayed projects in anticipation of funds becoming available under the 1976 and 1977 public works programs. The study also suggested

that these measures may have caused the postponement of as much as $22 billion in total government spending.

Crowding Out of Private Sector Employment

Another reason for discounting the efficacy of public works measures is their adverse side effects on private employment. If public works outlays are financed by additional taxes, the income and spending of consumers are reduced, decreasing the number of jobs in the private economy. Alternatively, insofar as public works outlays are financed by borrowing from the public, interest rates are raised, crowding out some forms of private spending and reducing private employment. The higher interest rates resulting from increased Federal borrowing also discourage capital investments that help create future employment.

Benefits to Workers

An additional reason to discount the efficacy of accelerated public works projects is their limited value to participants. Most jobs in countercyclical public works projects are of extremely short duration and are unlikely to provide participants with lasting job skills. Under the Public Works Impact Program, initiated in fiscal year 1972, the average duration of employment amounted to only 4.1 weeks. Almost 60 percent of all employees worked 2 weeks or less. Data for the local public works programs initiated in 1976 and 1977 and described above, indicate that the average job lasted only 3.5 weeks.

Although public works programs are motivated by a desire to provide jobs for the unemployed, very few jobs are actually filled by unemployed workers. Under the Public Works Impact Program, only 27 percent of all jobs were filled by the previously unemployed. Under the more recent public works programs of 1976 and 1977, it has been estimated that only 12 percent of all jobs were filled by previously unemployed workers.

COMBATING STRUCTURAL UNEMPLOYMENT

The preceding analysis suggests that it would be imprudent to use macroeconomic policies to reduce the unemployment rate below its inflation threshold level of 6 to 7 percent. Such an effort would increase inflation, and ultimately prove counterproductive as increased inflation was followed by recession. This does not mean that unemployment rates in the 6 to 7 percent range are either inevitable or desirable. The inflation threshold level of unemployment can be reduced by policies that consider the special problems of two groups of workers: (1) young people, and (2) adults experiencing long-term unemployment. It can also be reduced by reforms of the unemployment

insurance system, which, while providing valuable insurance, may increase the incidence of unemployment.

THE PROBLEM OF YOUTH UNEMPLOYMENT

At times of low cyclical unemployment, about half the unemployed are young people between the ages of 16 and 24. Close to one-fourth of all the unemployed are teenagers aged 16 to 19. While unemployment clearly imposes hardships on youths, it has very different economic impacts than it does for adults. Many unemployed youths are in school and looking for part-time work. Most of this group, and many other young people who have left school, are not economically independent, but rather live at home and rely on their parents for financial support. Many other young people experience only brief periods of unemployment as they move from one job to the next.

Table 2-2 provides information on the labor market activities of young men and women aged 16 to 19 in October 1981, when the teenage unemployment rate was 24.1 percent. Data for 1982 are not yet available. As the table reveals, only 5 percent of all teenagers were out of school and measured as unemployed (because they were looking for work). A striking feature of the youth labor market is the large fraction of young people who are out of school but are neither working nor looking for work. Over 30 percent of female and 14 percent of male out-of-school teenagers were not in the labor force. The factors underlying this labor force withdrawal by young people are not well understood. In some cases, young people may withdraw from the labor force because they are discouraged about their prospects for finding suitable employment. In other cases, labor force withdrawal may reflect a desire for leisure.

The observations about the dynamic character of unemployment made elsewhere in this chapter are especially true of young people.

TABLE 2-2.—*Educational and labor market activities of youth aged 16 to 19, by sex, October 1981*

Item	Number (thousands)	Percent of subgroup	Percent of population	Number (thousands)	Percent of subgroup	Percent of population
	Males			Females		
Total population	8,036		100.0	8,059		100.0
Enrolled in school	5,683	100.0	70.7	5,526	100.0	68.6
Employed	2,024	35.6	25.2	1,829	33.1	22.7
Unemployed	424	7.5	5.3	429	7.8	5.3
Not in labor force	3,235	56.9	40.3	3,268	59.1	40.6
Unemployment rate (percent)	17.3			19.0		
Not enrolled in school	2,353	100.0	29.3	2,533	100.0	31.4
Employed	1,585	67.4	19.7	1,340	52.9	16.6
Unemployed	434	18.4	5.4	417	16.5	5.2
Not in labor force	334	14.2	4.2	776	30.6	9.6
Unemployment rate (percent)	21.5			23.7		

Source: Department of Labor, Bureau of Labor Statistics.

Most young people find jobs or leave the labor force fairly quickly. It was recently estimated that of those male teenagers who become unemployed in a given month only 42 percent remain unemployed in the next month.

Youth unemployment is nevertheless a critical economic problem. A large part of the youth unemployment problem is traceable to the small group of teenagers who experience extensive unemployment. More than 52 percent of all unemployment experienced by teenage males aged 16 to 19 in 1981 was due to the 4.4 percent of the male teenage population of this group who were out of work for more than 6 months during that year.

Evidence also suggests that certain teenagers who suffer extensive unemployment earn lower wages later in life. The direction of causation is very difficult to establish since persons with low skills may simply fare poorly both early and late in life. However, the best evidence available suggests that poor labor market experiences early in life cause reduced wages during adulthood. This suggests the importance of developing policies to improve employment opportunities for the long-term unemployed and to reduce job turnover.

Training, Unemployment, and the Minimum Wage

A major problem in the youth labor market is the dearth of "career-oriented" employment opportunities. While people who participate in post-secondary schooling are generally subsidized by the public sector, public support of equivalent magnitude has not been available for the post-high school training of youth who choose to enter the labor force after high school.

Employers may find it very difficult to offer such training because of the constraints imposed by minimum wage legislation. These laws discourage employers from hiring unskilled workers at very low wages and compensating them further by providing training. This may help explain very high job turnover among youths as they move rapidly in and out of "dead-end" jobs. Another consequence of minimum wage laws is that they prevent some young people from acquiring the training that would permit them to find steady, well-paying employment as adults. Statistical studies provide evidence that minimum wages significantly depress the accumulation of valuable skills and resulting growth in earnings among youths who are paid the minimum wage. There is also evidence that the negative effects of the minimum wage on employment and training are concentrated

disproportionately among youths with the fewest labor market skills. Thus, although the stated purpose of the minimum wage is to reduce poverty, experience suggests that it may actually decrease the lifetime earnings of some of the poor and thereby increase income inequality.

POLICIES TO REDUCE YOUTH UNEMPLOYMENT

Almost all observers agree that mitigating the problems of instability and high unemployment in the youth labor market requires increasing the availability of career-oriented employment and training. This can be accomplished through public support of training, minimum wage reforms, and employment tax credits.

The Job Training Partnership Act

The Job Training Partnership Act (JTPA) of 1982 represents a major Federal initiative to reduce structural unemployment among youth and adults. The JTPA departs from previous Federal employment training programs by establishing a formal partnership between private industry, the public sector, and vocational training institutions for the purposes of planning, designing, and providing federally financed training. Federal resources are targeted to individuals identified as most in need: economically disadvantaged youth, low-skilled and chronically unemployed adults, and skilled workers who have lost jobs in declining industries and regions. The problems faced by the latter group are discussed more fully later in this chapter.

The JTPA is intended to fill an important niche in the national employment and training system by serving individuals who are unable to make use of job training provided by more traditional institutions: high schools, vocational-technical schools, community colleges, universities, and employers. Federally funded training programs such as JTPA provide a second chance to youth and adults experiencing trouble in the labor market. The JTPA is administered at the State and local level. This allows training programs to be tailored to the particular needs of workers and employers in local labor markets.

Minimum Wage Reforms

The Administration will propose a summertime differential minimum wage for young people under the age of 22. Between May 1 and September 30 of each year the minimum wage for this group would be reduced to $2.50 from $3.35. This measure would encourage firms to hire young people, just out of school, and give them the experience needed to compete effectively in the labor market. It will also encourage employers to provide youth who remain in school with valuable work experience during the summer months.

The Targeted Jobs Tax Credit

An alternative policy avenue for encouraging employment and training of young people is to provide tax credits or wage subsidies

to employers who hire youths. Tax credits are currently provided to firms that employ economically disadvantaged youths, aged 18 to 24, under the Targeted Jobs Tax Credit program. The credits are also targeted to welfare recipients, and economically disadvantaged Vietnam veterans, cooperative education students, handicapped persons, and ex-convicts.

The tax credit lasts for up to 2 full years. In the first year it is equal to 50 percent of an individual's earnings, up to a maximum credit of $3,000. In the second year it is equal to 25 percent of earnings, up to a maximum credit of $1,500. Participation in the program has been limited since its inception in 1979. This is an apparent consequence of administrative problems encountered by the agencies responsible for determining program eligibility (especially the Job Service), reluctance on the part of eligible recipients to use the tax credit as a self-marketing tool, and employers' reluctance to let government programs influence hiring decisions.

Recent legislation added a second component to the tax credit program by providing a tax credit for summer employment targeted at economically disadvantaged youths aged 16 and 17. The tax credit for this group is quite large, equaling 85 percent of wages, up to a total summer income of $3,000. The summer Targeted Jobs Tax Credit program, in effect, allows employers to hire eligible youths, who are paid the minimum wage for a net cost to the firms of 50 cents an hour. The program will be in place for the first time during the summer of 1983.

A virtue of measures which subsidize employment and on-the-job training for youth is that they counteract the large bias toward formal schooling over on-the-job training inherent in current policies. In part because of large public subsidies to higher education during the last two decades, the percentage of young people, aged 18 to 24, enrolled in higher education rose very sharply from 26 percent in 1963 to 41 percent in 1975. This shift toward increased formal schooling was accompanied by a decline in the relative wages of college graduates and high school graduates. The ratio of the average annual incomes of college graduates to that of high school graduates, aged 25 and over, fell from 1.53 in 1968 to 1.38 in 1978.

LONG-TERM UNEMPLOYMENT AND STRUCTURAL CHANGE

An especially visible and serious component of the unemployment problem is composed of adults suffering protracted unemployment. At present, most long-term unemployment is a consequence of the recession and the resulting reduction in the demand for labor. But as discussed earlier in the chapter, long-term unemployment will remain a significant problem even after the economy recovers.

Structural Change and Economic Adjustment

A large part of long-term unemployment among adults can be traced to structural changes in the economy. An increasingly important source of structural change is the growing interdependence of the U.S. economy with that of the rest of the world. The share of export and import-competing industries in GNP has increased over the last several decades, and many industries have consequently felt the cold winds of economic change. By December 1982 the unemployment rate had reached 23.2 percent in the motor vehicle industry and 29.2 percent in the primary metals industry. Other industries, including mining, construction, and lumber, have also contracted rapidly, leaving behind a significant number of long-term unemployed. These figures reflect both changes resulting from foreign competition and the sharp declines in the demand for manufactured goods caused by the recent recession. The gradual decline of the dollar in foreign exchange markets to historically prevailing levels, a drop in real interest rates, and general economic recovery would contribute to easing the problems of troubled industries, as explained in Chapter 3. However, most observers believe that foreign competition will present persistent problems in some domestic industries even in the long run.

In a number of these industries, significant adjustments will need to take place. If foreign firms can continue to produce goods at lower costs than U.S. firms, either domestic production will contract, forcing workers to leave the affected industries, or workers will have to accept constant or even declining real wages. The former option is particularly painful in industries like automobiles and steel, where workers have become accustomed to high standards of living. Because wages in these industries are substantially greater than wages in other manufacturing industries, workers find it difficult to locate suitable alternative jobs.

Programs which inhibit the transition of workers from declining industries to growing industries would raise the level of structural unemployment in the economy. Included in this group are programs which would provide financial assistance to industries without providing incentives for employee relocation or wage and price flexibility. In a dynamic economy subject to the pressures of domestic and foreign competition, our economic health depends critically on the ability of workers and firms to respond quickly to changing economic conditions.

Policies to Alleviate Long-term Unemployment

The centerpiece of Federal policy to alleviate long-term unemployment is Title III of the new Job Training Partnership Act discussed earlier in the chapter. Title III established State-administered programs of employment and training assistance for dislocated workers,

defined broadly to include individuals who have become unemployed as a result of plant closures, laid-off workers who are unlikely to return to their previous industry or occupation, and individuals experiencing long-term unemployment in occupations with limited employment opportunities. Matching grants are provided to States on the basis of their unemployment conditions. Title III authorizes States to establish a wide variety of employment and training activities, including job search assistance, job training, relocation assistance, and employment counseling. Individuals receiving Title III assistance may also receive unemployment compensation, if they are eligible.

The Administration in its 1984 budget has introduced two new approaches to the problem of reducing long-term unemployment. First, it has proposed that Federal unemployment laws be amended to permit States to use a portion of the unemployment insurance taxes they collect to support retraining and job search assistance for their unemployed workers. Second, the Administration has proposed that the Federal Supplemental Compensation program be replaced when it expires with a new temporary program that provides incentives for work as well as compensation for long-term unemployment. As an alternative to added weeks of unemployment compensation, this program would give recipients the option of receiving assistance in securing work through a system of tax credits to employers. This will give employers a significant incentive to hire the long-term unemployed.

THE EFFECTS OF UNEMPLOYMENT COMPENSATION

For more than 40 years, unemployment compensation has given valuable support to millions of unemployed workers and has provided an important source of security to millions more who are employed. Along with these beneficial consequences, however, the present structure of the unemployment insurance system has altered the incentives faced by employers in hiring and firing decisions and the incentives of unemployed workers to accept new employment opportunities. As a result, unemployment compensation seems to have increased the incidence and duration of unemployment.

The current system of unemployment compensation produces two distinct but related adverse incentive effects. First, for those who are unemployed it reduces the cost of unemployment, providing an incentive for longer durations of unemployment. Second, current methods of financing unemployment insurance increase the incidence of unemployment by increasing the size of seasonal and cyclical fluctuations in unemployment and by making temporary jobs more common.

Incentives to Prolong Unemployment

Payments to the unemployed clearly raise the level of household expenditures that can be maintained when one or more family members are not working. Such payments reduce the economic pressure to find work immediately, encouraging a longer period of job search during which the unemployed worker hopes to find a more attractive job than might otherwise be found. For some workers unemployment insurance replaces more than 70 percent of after-tax wages during periods of unemployment. Economic research indicates that there is a positive relationship between duration of job search and the level of unemployment benefits.

Workers who take longer to find jobs because of unemployment compensation are in no sense "loafing" or "cheating." An unemployed person who does not expect to be recalled by his previous employer can expect, on average, to find a better job the longer and more carefully he looks. Unemployment insurance, by reducing the cost of additional weeks without work, encourages unemployed workers to continue searching for better employment opportunities.

Incentives for More Unstable Employment

A second avenue through which the unemployment insurance system, as currently financed, tends to increase the economy's rate of structural unemployment is by increasing seasonal and cyclical fluctuations in the demand for labor and the relative number of short-lived, casual jobs.

The effect of unemployment compensation is to offset the market forces that would otherwise decrease, at least somewhat, the amount of unstable employment in the economy. Insofar as unemployment compensation provides a subsidy to unstable employment practices, it reduces the wage differential required to attract workers to seasonal, cyclical, and temporary jobs. And because employers pay a relatively small premium for unstable employment practices under current methods of financing unemployment insurance, they have little incentive to reduce this instability.

The current subsidy to unstable employment patterns would be reduced if unemployment insurance were financed through a more completely experience-rated employer tax that more accurately reflected the expected level of unemployment benefits to a firm's laid-off workers in the future. The theory of experience rating is clear: if an employer pays the full cost of the unemployment benefits that his former employees receive, he will not have an incentive to make excessive use of unstable employment practices. Recent statistical research demonstrates that there is, in fact, a strong positive relation-

ship between incomplete experience rating and employment instability.

Most States use experience rating to some extent, in that some employers contribute to the State unemployment compensation fund partially on the basis of the unemployment experience of their own employees. The degree of experience rating is highly imperfect, however, for two reasons.

First, a significant share of benefits paid are not directly charged to firms, but rather, are spread across all the firms in a State. These include benefits paid to job leavers, benefits to employees of firms no longer doing business in a State, and allowances for dependents. Extended benefits, which are available in high unemployment States to workers who have exhausted their regular unemployment insurance, are also not directly charged to employers.

Second, employer contributions are limited by minimum and maximum tax rates. Firms stuck at the maximum or minimum tax rates will find that their tax rates do not change even if the unemployment experience of their workers is altered. As a consequence they face reduced economic incentives to smooth employment fluctuations.

One measure of the extent of experience rating is the proportion of benefits received that are not effectively charged to the former employer. A value of 100 percent represents perfect experience rating. A recent study of nine States over the period 1971–1978 found that on average, less than 60 percent of total benefits were experience rated, by this definition. The degee of experience rating fell to 47.5 percent during the 1975 recession and reached a high of 62.6 percent in 1978, a year with relatively low unemployment.

The problem of imperfect experience rating has been partially remedied by a provision of the Tax Equity and Fiscal Responsibility Act of 1982 which raised the federally proscribed lower bound on State maximum unemployment insurance tax rates from 2.7 percent to 5.4 percent of employers' taxable payroll. Because of this change, fewer firms are likely to face the maximum tax rate.

CONCLUSIONS

The dual problems of cyclical and structural unemployment are both extremely serious. Increased unemployment during cyclical downturns, and the high levels of unemployment that prevail even after the economy recovers, impose large costs on the unemployed and the economy as a whole. Fortunately, both can be ameliorated by prudent public policy. Sound macroeconomic policies will avoid recurrences of the rising inflation of the 1970s and subsequent in-

creases in cyclical unemployment. Policies directed at young people and the long-term unemployed, and reform of the unemployment insurance system, can significantly reduce the level of structural unemployment.