WHAT TO DO ABOUT UNEMPLOYMENT?

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The pause is over and the outlook for the economy is improving. Yet even the more optimistic forecasts have a very high level of unemployment persisting through 1977. Mr. Carter has given a reduction of unemployment top priority and we can expect much action on this front in coming months. So this is an ideal time to consider what to do about unemployment.

A few years ago I hit on what, for me at least, is a useful approach to a number of our current problems. It occurred to me that there are two kinds of people in this world. One is Economic Man, the type of person economists have counted on for over a century--a rational calculator concerned above all with efficiency. The other is Social Man, concerned mostly with how people live together and how to promote social justice. Most of us are both Economic and Social Man, which is all to the good when the two complement each other. But we're occasionally torn about how to solve current problems because Economic Man and Social Man are warring with each other. I have found this device helpful in analyzing economic growth and the environment and I suggest it is also a productive way to look at unemployment.

For Social Man unemployment is an unalloyed evil. In a society that places high value on the work ethic, unemployment destroys a person's feeling of worth. It concentrates its impact on the poor, minorities and youth. It often is a product of discrimination. And although many other forces are at work in causing economic hardship, unemployment is basic to it.

For Economic Man, unemployment has some good points along with the bad. Some people are voluntarily out of work for short periods of time. They feel they can do better elsewhere so they quit and spend some time searching for a new job. Economic Man thinks this kind of unemployment is good because it

> Economic and Social Man also may argue about statistics. On the one hand, the official figures include students looking for but unable to find part-time work, workers on layoff who are soon to be recalled and people who are far from poor. Economic Man argues that the statistics exaggerate the problem. But there is a good argument on the other side. The official figures don't include those who can find only part-time work or are discouraged from looking. There are many things wrong with the data and it is dangerous to take the overall number at face value. But progress is being made by the officials in improving their calculations and much work is going forward by others in taking the aggregate figure apart to see what's really going on.

makes for a more productive labor force over the long haul and is part of a society that values free choice of occupation. (Social Man counters that much of this churning in the job market is because disadvantaged people find themselves in disagreeable, dead-end situations. It is, rather, a sign of unhealthy instability.) This "new" unemployment is unlike the stereotype hangover of the 1930s so Economic Man does not worry much about it. But not all unemployment is voluntary. Where people are involuntarily out of work, Economic Man agrees with Social Man that unemployment is a waste of valuable talent and governmental action is needed. But since no one knows exactly how much of the unemployment we see is voluntary and how much is involuntary, Economic Man and Social Man may disagree about how strong that governmental action should be.

Obviously, I have overdrawn this picture. The important point is that action must be taken to reduce unemployment from current levels, but it must be careful action that will preserve the dynamism of the economy. This is the tough trade-off: how to heed the urgings from the heart of Social Man and at the same time the advice from the head of Economic Man.

This trade-off must be borne in mind in considering three main ways of dealing with unemployment: monetary and fiscal policy, measures to deal with structural unemployment, and action to sustain incomes of the unemployed.

Solution #1: Monetary and Fiscal Policy

This is what economists call demand management, influencing the total demand for the products of our economy by changes in money growth and interest rates and by government spending and taxing. Social Man would go all out. The basic solution, he feels, is to be sure the economy is operating at full draft. Economic experience and common sense lend some support to this position. The period of lowest unemployment in recent history was World War II when the economy was straining for additional output.

Economic Man also strongly favors this tool. He sees big advantages in it over some others because it can be used to stimulate the private economy rather than enlarging the role of government. But he sees some limits. Monetary and fiscal policy, he thinks, should be used only to smooth ups and downs of the economy, not to push unemployment down to zero. His "best" rate of unemployment isn't zero but the rate where all unemployment is voluntary. To try to keep unemployment below this point is not only inefficient but produces inflation.

Now economists have spent a great deal of time and effort in recent years analyzing why this is so. They have debated about the Phillips curve--the trade-off between unemployment and inflation--whether the curve really exists, whether it shifts, and what its long-run future may be. And they have speculated about whether there is a "natural rate" of unemployment.

This business not only gets very complicated technically, but involves hard value judgments as to whether inflation or unemployment does more harm to society. In general, I would say, Social Man is inclined to accept some inflation to get lower unemployment; Economic Man would accept some unemployment to hold down inflation. I'm not saying one is soft-headed or the other

hard-hearted. The point is that in a world where we are very unsure of the relation between unemployment and inflation, what we decide to do may well depend on how much it costs us if we make a mistake. Social Man would rather err on the side of accepting more inflation because he sees unemployment as the greater evil; Economic Man leans to policies which reduce the chances of inflation because he sees this as the greater evil. This is a question each of us must answer for himself in deciding how to deal with unemployment.

On this issue I happen to feel more comfortable with the view of Economic Man. There <u>are</u> limits to how far we can push the economy without setting off skyrocketing inflation. I, for one, do not see that the answer to this dilemma is simply to put on price and wage controls (as some would) to keep prices and wages from going up as we force unemployment down. The wage-price control solution is, I think, a good example of Social Man among us trying to achieve perfectly laudable goals without first clearing with his colleague Economic Man. It is not only that controls infringe on freedom, but in the long run they don't work.

One sexual sidelight. Women have been unjustly blamed for the current high level of unemployment. It is true that more and more women have been seeking jobs, but this has been going on for many years. Analysis shows that the sharp increase in unemployment during the recession and the slowness of unemployment to decline again since is because of a weak economy, not women.

No one knows what unemployment rate is consistent with stable prices. It is clear that it has risen. Where once we talked about 3 or 4 percent, we now talk of 5 or 6 percent. I believe we have some room for additional stimulation but would be very alert to prices. Given the recent trauma of double-digit inflation, I, for one, want to proceed very carefully about forcing unemployment down through monetary and fiscal policy. If inflation were to take off again, the outlook for unemployment would not be good.

I would feel less comfortable with this view if there were no other ways to deal with unemployment, but there are.

Solution #2: Structural Measures

The reason Solution #1 can't do the whole job is that creeping into the unemployment problem over recent years has been what economists regard as a structural element. The people side of this is that there are substantial numbers, largely minorities and youth, who are not well equipped to compete in the job market. The economics side of this is that there are some ways in which the market does not work as well as we might wish.

This is a matter on which Economic Man has strong views. He has certain theories about how markets are supposed to operate and when markets don't cooperate with him, he is vigorous in urging reform. He pushes, for example, for good information. He looks for more efficient ways to bring job offerer and job seeker together. He presses for reforms that will eliminate barriers to competition, rigidity of wages, or restrictions on movements of people.

Social Man agrees only in part. He is for anything that will develop the capacity of individuals to compete, but he is sometimes afraid that the market might not produce the human results he would like to see. He would be more inclined to intervene directly to accomplish what he wants.

You can see these tendencies in the following structural measures: Training and education. Economic and Social Man both favor the development of human capital, and this is, of course, the fundamental solution. Unfortunately, past history is not particularly encouraging. Most of our experience with organized job training programs has been government oriented. From 1963 through 1974 over 11½ million people have enrolled in Federal Manpower projects such as the Manpower Training and Development Act, the Neighborhood Youth Corps, JOBS,

the Work Incentive Program, and the Job Corps, to name a few. The total Federal cost of all these programs exceeds $14 billion. The proliferation of these programs, which were often administered by competing sponsors, produced a series of frequently overlapping and uncoordinated projects. This led in 1973 to the passage of the Comprehensive Employment and Training Act (CETA) which combined job training and public employment programs into a single package. CETA places the responsibility for planning and implementing manpower programs at the state and local government level, though the sponsors are subject to Federal agency oversight.

Despite the lengthy experience with these programs, there has been very little evaluation of their impact. Title V of CETA established a National Commission for Manpower Policy which has broad responsibilities for assessing training and development programs. Several studies have already been completed, but we're still a long way from understanding the relation between manpower training and employment experience. What limited evidence exists generally shows that government training programs have positive but rather small economic effects. There is a desperate need for more research in this area to try to identify which, if any, elements of training programs have been successful.

I think there is some danger that unsuccessful employment programs can have costs beyond the dollars spent. I have in mind the possible social impacts of raising and then disappointing expectations. After an individual devotes time and energy to a training program, there had better be a job waiting if we are to avoid the kinds of frustrations we saw in the 60s.

Even more frustrating to those who look for quick results is that it will take a long time--perhaps generations--to make much progress by this route. This is not to discourage it, but only to emphasize how much other measures are needed in the shorter run.

Minimum wage. This is anathema to Economic Man. In general, it imposes an artificial price on labor and hinders free flow of supply and demand in the marketplace. In particular, it makes it impossible for employers to hire many teenagers and unskilled adults whose output is not worth the $2.30 an hour minimum. Economic Man would abolish the minimum wage.

Unfortunately, the solution is not that simple. Social Man believes that every worker deserves a decent wage. To allow firms to pay less than $2.30 an hour is to encourage poverty. But there may be a way to reduce the cost of hiring unskilled workers while still maintaining the guarantee of a living wage. How? By a wage subsidy. One proposal is for the government to issue vouchers to young people looking for employment. Firms could then redeem these vouchers for perhaps 30 to 40 percent of the minimum wage, but would be obliged to spend part of this sum on job training. This kind of program reduces the minimum wage to firms, but doesn't require young people to bear all the burden. And the training presumably leads to a higher-paying job and better job attachment. The wage-voucher training system could be combined with expanded counseling to advise young people where they can find the work they want.

I am attracted to this and similar schemes, but I suspect they have only an uphill chance of being adopted. Unions strongly resist removal of the minimum wage as well as most wage-subsidy schemes mainly because they fear that employers will hire unskilled workers at low wages to displace higher paid experienced employees. The minimum wage is too deeply entrenched politically.

Public service jobs. This solution makes sense to Social Man. Since the economic ills which produce unemployment are largely the responsibility of government, he feels it is only right for government to act as employer of last resort.

Moreover, there are so many things needed to be done--cleaning up our cities, providing better housing, you name it--that the unemployed can be put to productive social use.

Economic Man, however, has several problems with this solution. It enlarges the role of government. It is expensive in relation to results. It could be hard to terminate when conditions improve. If the wage for public service is set too high, it might simply pull workers out of the private sector. And there is a real question whether the public service employee can produce as much as he is paid; if not, the economy might not be any better off than if he were unemployed. Finally, Economic Man wonders why it is necessary to go to all the trouble and expense to pinpoint the creation of jobs. Arthur Okun calls this the "penicillin-in-the-throat fallacy." He argues that "many political decision-makers who trust their doctors' judgment that a penicillin shot administered in the rear will indeed cure laryngitis, do not trust the equally well-supported judgment of economists that fiscal and monetary injections into the spending stream will cure unemployment. Hence they prefer programs that directly and visibly create jobs without relying on the circulation of any medicines through the economic system."

One variation that has been proposed is for anyone who loses his job to be offered (after a short period under unemployment compensation) a public service job at a wage considerably below the prevailing minimum wage. If he refused, he would no longer be counted as "unemployed," and would be on his own. This solution preserves the efficiencies and incentives of the market yet provides a last resort job for those willing to accept it. Economic Man might approve of it; Social Man would abhor it. In any case, its chances politically are slim.

On the whole, I have a lot of sympathy for Economic Man's view of the public service solution. As one brought up in the Keynesian tradition, I have no hang-up about "leaf raking"; there are possibilities of temporarily putting people to productive public use. But as a solution for chronic unemployment for long periods I see difficulties. Massive public works are a second best to a vigorous private sector and they are hard to start and hard to turn off. So I see public service employment in limited amounts as one of several answers, best used as a transition device to move workers into private-sector jobs. In any case, I am not persuaded that it has as much appeal as Social Man may think. I suspect the days when unemployed youth could be recruited into the equivalent of the Civilian Conservation Corps may be well behind us.

Solution #3: Sustain Incomes

What most sets today's unemployment apart from that of the 1930s is the fact that we now have several ways of sustaining peoples' incomes in adversity. Unemployment compensation is one of these. For many years it was regarded as a good thing, one of the automatic stabilizers that helped keep the economy on an even keel. Social Man sees it as a life saver and has been successful in persuading legislators to make it progressively more liberal.

Economic Man, however, has problems with it. As presently administered he sees it as a device that reduces the efficiency of the economic system. As legislators have increasingly liberalized the benefits, he says, they have reduced the incentive for the unemployed to look for a job. Some time for search is good for efficiency and fair to the person out of a job, but too much time is inefficient. Some preservation of income is only fair, but too high a benefit makes it too attractive to stay unemployed. The "tax" on people

going back to work is too great if they can get almost as much by staying idle.

Various proposals have been made to remedy this situation. They include shortening the period of benefits, requiring the individual to take a job offered to him, and requiring him to undergo training. A proposal more likely to be adopted is to make unemployment benefits taxable. As things now stand, a person who is out of a job pays no tax, while a person with a job and with the same income and family situation pays a tax. This is not only inefficient but unfair.

Another proposition is to change the way in which employers contribute to unemployment benefits. The present system subsidizes employers in highly cyclical industries and thus increases the number of short-lived jobs. The subsidy to cyclical industries stems from the way the compensation is presently financed. Firms generally pay taxes on each employee at a rate determined by a so-called "experience rating." This means that a firm's taxes for jobless benefits depend to a certain extent on its employment record. However, the government sets a ceiling on the tax rate, so that no company ever pays more than the 5 percent limit no matter how many employees it lays off. In fact, once a firm reaches the ceiling it can increase its subsidy from other firms by accelerating layoffs. Thus, the current system is neither efficient nor equitable. The proposal is to go to a true experience rating with no floors or ceilings so that every employer would be taxed just enough to cover the benefits paid to his former employees.

My gut feeling is that Economic Man has a point. Unemployment insurance probably does reduce incentives. Economists have tried to measure how much, but they get differing results. So I would lean toward some adjustments such as taxing benefits and perhaps changing experience ratings. But I would steer

clear of drastic solutions (even assuming they had some chances politically) and take some risk of impairing the efficiency of the system. I side with Robert Solow who concludes that even if benefits increase unemployment somewhat, it doesn't necessarily follow that drastic changes should be made, "any more than you would want to suppress a quick and painless cure for the broken leg on the grounds that it would encourage some people to ski carelessly."

Conclusions

A pessimistic view of how all this adds up is that each solution has severe disadvantages. Monetary and fiscal policies can do only part of the job of reducing unemployment because they run into the inflation problem. Training and education take a long time. Operating on the minimum wage arouses severe political opposition. Public service jobs are expensive and of limited feasibility. Liberalization of unemployment benefits would further impair efficiency; if anything, minor changes should be in the other direction.

I prefer the optimistic view that action on all of these fronts will produce some results. I'm not so optimistic that I see a quick solution, but I don't believe we have yet marshalled all our forces effectively. Inevitably, we will need to trade off equity against efficiency and so neither Social Man nor Economic Man will be completely satisfied. But solving unemployment will require their combined effort. Unemployment is too wasteful of human lives, too prodigal of lost opportunities to call for anything less than our complete attention.