Research Department
Federal Reserve
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San Francisco

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Business & Financial Letter

Jobless and Benefits

What is the lowest rate of unemployment attainable without accelerated inflation, under the institutional structure existing today? This full-employment unemployment rate (FEU) was estimated at about 4.0 percent by the Council of Economic Advisers in the early 1960's, but another Council came up with a 4.9-percent estimate early this year. That shift reflects demographic and other changes that have occurred over the past decade and a half. However, other factors not included in the Council's calculations suggest an even higher full-employment unemployment rate—such as the tendency of the jobless rate to rise as improvements are made in the unemployment-insurance (UI) program.

Some analysts still tend to think of the 4.0-percent rate as consistent with full employment and price stability, but they tend to ignore the many recent changes that have affected the sex-age composition of the labor force and the movements of workers in and out of jobs, and in and out of the labor force. Women and teenagers have come to account for a larger proportion of the workforce, and these groups historically have had higher-than-average frictional unemployment. Their increased importance in the labor force thus tends to raise the overall jobless rate associated with a given degree of labor-market tightness and full employment. The current 6.9-percent unemployment rate therefore in part reflects the inadequate current business recovery, and in part the larger unemployment that today appears consistent with a given degree of labor-market tightness.

Teenagers and women

Teenagers historically have experienced a substantial amount of joblessness. Young untrained individuals generally spend more time than older workers learning about job opportunities and searching for suitable employment. They generally experience high turnover rates as they experiment with different occupations and employers. Moreover, minimum-wage legislation may adversely affect employment, because firms will tend to reduce their hiring of untrained workers whose productivity lags behind the wages they must be paid. In addition, the teenage FEU rate appears to be higher now than it was a decade or two ago, because school-enrollment rates have risen, and students are more likely than other youths to move in and out of the job market.

The higher incidence of unemployment among women also reflects a high proportion looking for initial jobs and re-entering the job market after varying periods of non-market activity. Frequent movement in and out of the labor force, among women as a group, is in part related to family obligations and decisions.

These factors would suggest a full-employment jobless rate of about

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4.9 percent, but in the Council's view, still other factors would suggest an even higher rate. For example, an expanded unemployment-insurance program tends to increase the duration of unemployment and to increase the supply of labor generally. The expansion of other welfare programs for the low-income unemployed, as well as the growing proportion of families with two major earners, also may have lessened the financial burden of unemployment for many families. These factors, the Council contends, "have tended to weaken the tie between current consumption and current earnings, and they may have increased the extent of unemployment that is consistent with a full-employment economy."

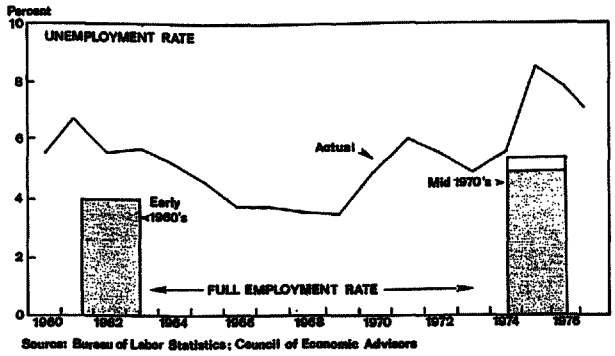
Unemployment-insurance benefit payments, while providing income maintenance for the unemployed, also tend to increase the supply of labor over time. The expanded UI benefits tend to increase the number of people who want to enter or remain in the labor force. Consequently, for any given level of aggregate demand, the system generates a larger labor force and a higher unemployment rate than would otherwise exist. Some analysts argue the reverse, pointing to the UI program's ability to boost incomes and spending, and thereby reduce unemployment, as an instrument of automatic stabilization. However, a particular level of aggregate demand may be approached through any number of alternative routes. Direct Federal spending programs, for example, could add to final demand and employment without inducing as much of an increase in labor supply as would occur under the UI program.

UI and labor supply

The availability of unemployment-insurance benefit payments can affect the supply of labor because individuals in general tend to respond to changes in their expected wage incomes. At least three elements may enter into the calculation of expected income from employment: potential wages, potential jobless benefits, and job-finding costs. Ordinarily, an individual will incur both psychic and pecuniary costs in searching for a job, and these costs may reduce the expected net benefits from market activity and thereby tend to reduce the quantity of labor supplied. On the other hand, the availability of UI benefits may offset some of the direct costs of job search, and in this way, increase the net benefits expected from job holding and thus strengthen labor-force participation.

Labor-force participation also may rise because of the actions of some individuals who report that they are looking for work even when they are interested only in receiving jobless benefits. The same result might occur because of the actions of those who search for seasonal or temporary jobs, not because of the direct pay involved, but rather because their job search makes them eligible for UI benefits at frequent intervals.

The unemployment-insurance tax structure also may tend to raise the



Source: Bureau of Labor Statistics; Council of Economic Advisors

labor-force and unemployment figures. Most state laws create a rather loose relationship between the benefits received by an unemployed worker and the tax payments made by his employer—which, incidentally, helps explain why the program is not self-financing. Employer contributions to state unemployment-compensation funds increase in line with the amount of benefits paid out to former employees. Because of the ceiling on employer contributions, however, a firm that is paying the maximum rate incurs no cost for additional unemployment and incurs no gain from a small reduction in unemployment. The tax structure, although designed to stimulate employer efforts to reduce unemployment—the "experience rating" system—thus contains a flaw which limits its effectiveness.

What FEU rate?

Demand management, through fiscal and/or monetary policies, attempts to achieve a level of aggregate demand consistent with the full-employment jobless rate. Underestimates of this rate thus could lead to unnecessary expansionary policies which aggravate inflationary pressures. Of course, some increase in the FEU rate could be consistent with the operations of an efficient economy. For instance, public policy would probably be ill-advised to try to reduce the higher unemployment rate associated with higher school enrollment, because the benefits of increased education should far more than offset the costs associated with students' high labor-turnover rates.

Our labor-supply model suggests that since 1973—the last year of relatively full employment—expanded unemployment-insurance benefits have increased the full-employment unemployment rate by 0.3 percentage points, from 4.9 to 5.2 percent. (By the calculations of the Council of Economic Advisers, other factors may have raised the rate even further, to about 5.5 percent.) Further liberalization of UI benefits would push the FEU rate up even more, since our estimates are based upon an unchanged (1976) level of benefits.

We should not assume, however, that the level of joblessness associated with full employment will continue to increase over time. A reversal of recent trends in labor-force composition could bring about a different movement in the full-employment unemployment rate. In particular, the rate could actually decline in future years as the population ages and as the young come to represent a smaller proportion of the labor force.

Nevertheless, the full-employment unemployment rate is also related to the existing economic structure and laws. The primary purpose of the unemployment-insurance system remains income maintenance for the unemployed. As a byproduct, the program appears to have induced a greater supply of labor from the population over time, and to have increased the rate of unemployment consistent with a given degree of price stability.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 8/3/77	Change from 7/27/77	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	99,243	+ 501	+ 10,639	+ 12.01
Loans (gross, adjusted)—total	76,541	+ 397	+ 9,729	+ 14.56
Security loans	1,868	+ 78	+ 455	+ 32.20
Commercial and industrial	23,672	+ 14	+ 2,095	+ 9.71
Real estate	24,729	+ 103	+ 4,273	+ 20.89
Consumer instalment	13,290	+ 82	+ 1,905	+ 16.73
U.S. Treasury securities	8,865	+ 118	– 724	– 7.55
Other securities	13,837	– 14	+ 1,634	+ 13.39
Deposits (less cash items)—total*	97,783	+ 485	+ 8,869	+ 9.97
Demand deposits (adjusted)	27,677	– 104	+ 2,646	+ 10.57
U.S. Government deposits	484	+ 134	– 154	– 24.14
Time deposits—total*	67,629	+ 250	+ 5,983	+ 9.71
States and political subdivisions	5,415	– 217	– 487	– 8.25
Savings deposits	31,926	– 66	+ 5,271	+ 19.77
Other time deposits‡	28,310	+ 531	+ 1,575	+ 5.89
Large negotiable CD's	10,735	+ 398	– 463	– 4.13

Weekly Averages of Daily Figures	Week ended 8/3/77	Week ended 7/27/77	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (–)	+ 99	– 10	+ 47
Borrowings	15	8	4
Net free(+)/Net borrowed (–)	+ 84	– 18	+ 43
Federal Funds—Seven Large Banks			
Interbank Federal fund transactions			
Net purchases (+)/Net sales (–)	– 195	+ 153	– 88
Transactions with U.S. security dealers			
Net loans (+)/Net borrowings (–)	+ 196	+ 152	+ 151

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

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