Statement of Alice M. Rivlin
Director
Congressional Budget Office

before the
Subcommittee on Domestic Monetary Policy
Committee on Banking, Finance and Urban Affairs

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There should be no release of this statement until its delivery, scheduled for 10:00 a.m. (E.D.T.), Thursday, August 12, 1982.

Mr. Chairman, as requested by the Subcommittee, my testimony today will briefly summarize the current unemployment situation and the outlook for the near term, and then discuss the effects of unemployment on the federal budget.

THE UNEMPLOYMENT SITUATION

Unemployment has been rising for some time. In the last 12 months alone, the overall unemployment rate has increased from 7.2 percent to 9.8 percent. Almost 10.8 million persons are searching for jobs and more than one million others report that they have given up looking for work and are therefore no longer counted as unemployed.

The recent upsurge in unemployment occurs within the context of longer-term increases in both employment and average joblessness. Employment has grown rapidly in recent decades, increasing from 66 million workers in 1960 to nearly 100 million today. The share of the population in the labor force has also increased somewhat during that time--as a result of increased participation by women that has been partially offset by decreases in participation by men. The unemployment rate has also increased over this period, from an average of 4.6 percent in the 1950s and 1960s to 6.2 percent in the 1970s. Thus far in the 1980s--a period dominated by recession--unemployment has averaged 7.8 percent.

Unemployment has hit some groups especially hard. Blacks had a jobless rate of 18.5 percent in July and Hispanics a rate of 13.9 percent, while teenage unemployment was 24.1 percent. Among black teenagers in the labor market, half are without jobs. The current recession has also caused high unemployment in the construction and machinery-producing industries. The combination of recession and longer-term structural problems has produced severe economic distress for workers in some industries, such as steel and automobiles, and in some areas of the country, especially the industrial Midwest. The overall unemployment rate in July for blue collar workers was 14.4 percent. Geographically, Michigan had the highest unemployment rate in May of this year at 14.3 percent, with Illinois, Indiana, and Ohio averaging over 11 percent; a number of other states in the far West and South also had jobless rates in excess of 11 percent.

The Congressional Budget Office (CBO) expects recovery in the second half of this year, and moderate growth through 1983. Unemployment is projected to decline slowly, but to remain above 8.5 percent in the final quarter of 1983. On the other hand, the unusual combination of tight monetary policy--designed to reduce inflation--and expansionary fiscal policy means that there is considerable uncertainty about the sustainability of the recovery. Without a strong and sustained economic recovery, significant reductions in unemployment will not occur.

THE EFFECTS OF UNEMPLOYMENT ON THE FEDERAL BUDGET

Changes in economic conditions, including the level of unemployment, have substantial effects on the federal budget, and small changes in the economic outlook can affect the deficit dramatically. Increases in unemployment are usually a symptom, or result, of reductions in real economic growth, and it is this lower growth that is primarily responsible for the budgetary changes associated with increased unemployment. Other economic factors affecting the deficit include inflation and interest rates. Inflation affects the federal budget by increasing tax revenues, although this sensitivity was significantly reduced by the indexing and tax-rate changes made in the Economic Recovery Tax Act of 1981. Inflation also increases outlays for indexed benefit programs. Higher interest rates primarily increase the cost of financing the federal debt. The following discussion concentrates on the budgetary impacts of reductions in real growth and associated increases in unemployment.

Effects on Revenues

The primary effect of reduced real growth and higher unemployment on the federal budget is to reduce federal revenues. Federal tax receipts decline in part because unemployed workers suffer reductions in earnings and therefore pay less in taxes, but primarily because of other changes. For example, the number of hours worked by those who remain employed tends to fall in periods of high unemployment, and wage increases generally are moderated. These factors reduce personal incomes and, thus, federal tax revenues. Business earnings also fall during periods of reduced growth, further lowering tax receipts. A reduction in growth sufficient to cause a one-percentage-point increase in the unemployment rate is generally associated with about a $20 billion to $30 billion annual reduction in federal revenues.

Effects on Expenditures

Reduced real economic growth and higher unemployment affect federal expenditures by increasing outlays both for unemployment compensation and for other federal programs.

Unemployment Compensation. Unemployment compensation acts as an automatic economic stabilizer by providing additional income to some persons affected by cyclical downturns. This program provides benefits for up to 26 weeks to covered workers who lose their jobs, plus an additional 13 weeks of extended benefits for some persons during periods of high unemployment.

The Omnibus Reconciliation Act of 1981 limited the conditions under which extended benefits are paid, however, thus reducing the stabilizing effect of unemployment compensation. The 1981 act eliminated a provision that called for extended benefits to be paid to eligible workers nationwide whenever insured unemployment exceeded a certain level.[1] As a result, extended benefits are now available only on a state-by-state basis, whenever the insured unemployment rate in the state exceeds a certain threshold. An increase of one percentage point in the overall unemployment rate now increases total unemployment insurance outlays by roughly $3 billion to $4 billion per year.

The 1981 Reconciliation Act also limited the conditions under which extended benefits are paid on a state-by-state basis, further limiting the program's stabilizing effects. Effective at the end of this September, the statewide insured unemployment rate

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1. The insured unemployment rate is the percent of workers covered under state unemployment compensation programs who are collecting unemployment compensation benefits.

necessary to initiate extended benefits is to be raised. When this occurs, some of the 500,000 long-term unemployed workers in the 26 states currently paying extended benefits are likely to lose them. The number of persons actually affected will depend on economic developments during the next few weeks, however, since unemployment rates in several states are close to the present threshold level. Another provision of the 1981 Reconciliation Act--which requires that extended-benefit recipients not be counted in the calculation of the insured unemployment rate--has already caused some states to cease paying extended benefits sooner than they would have otherwise.

A final factor that has reduced the automatic stabilizing effect of unemployment compensation is the growing difference between the overall unemployment rate (as reported in household surveys) and the insured rate--resulting in a smaller share of all unemployed persons receiving benefits. During much of the last decade there was about a three-percentage-point difference between these two rates, but in the last two years this difference has increased to about five percentage points. This growing difference may be due in part to the changing composition of the labor force--including more women and youth, for example--which has resulted in a smaller share of workers having the long-term attachment to the work force necessary to qualify for unemployment benefits. Also, recent back-to-back recessions may not have allowed some workers to acquire the earnings history needed to receive unemployment benefits. Nonetheless, this development remains largely unexplained.

Other Expenditures. Other federal assistance programs also respond to changes in real growth and unemployment, but with more of a lag. The number of low-income persons eligible for Medicaid, food stamps, and cash assistance payments grows as unemployment rises. Social Security outlays increase somewhat with the unemployment rate, since persons who are eligible for benefits on the basis of age or medical condition are drawn onto the benefit rolls in increasing numbers. Together, yearly outlays for these programs increase by about $1 billion for each one-percentage-point increase in the unemployment rate. In addition, federal interest costs increase by roughly $2 billion to $5 billion in the first year because of higher deficits resulting from increases in spending and reductions in revenues.

Net Effects on the Budget

The overall sensitivity of the budget to changes in economic conditions can be seen by considering CBO's preliminary reestimate of the fiscal year 1983 deficit expected to result from the policies of the First Concurrent Budget Resolution. While the preliminary CBO forecast does not differ sharply from the economic assumptions used for the First Resolution, these differences result in surprisingly large budget reestimates (see Table 1). The CBO expects unemployment and interest rates to be somewhat higher in 1982 and 1983 than assumed in the First Resolution, and inflation and real growth to be lower. On the basis of these differences, the CBO now projects that the 1983 deficit under the First Concurrent Resolution will be approximately $25 billion to $35 billion higher than under the Resolution's economic assumptions.

Of the $25-35 billion estimated increase in the deficit, about $14-20 billion is attributable to reduced real growth and the associated increases in unemployment. About $13-17 billion of this represents reduced federal revenues and $1-3 billion represents increased outlays--primarily for unemployment compensation.

The preexisting unemployment level may affect the budgetary impact of any increase in joblessness. For example, a given change in the unemployment rate will result in a greater change in

TABLE 1. COMPARISON OF THE PRELIMINARY CBO FORECAST AND THE ECONOMIC ASSUMPTIONS OF THE FIRST CONCURRENT RESOLUTION FOR FISCAL YEAR 1983

Economic Variables	Resolution	CBO Preliminary
Nominal GNP (percent change)	11.6	10.1
Real GNP (percent change)	4.4	3.6
GNP Implicit Price Deflator (percent change)	6.9	6.3
Unemployment Rate (percent, calendar year average)	8.4	8.8
Three-Month Treasury Bill Rate (percent, calendar year average)	10.7	11.1
Estimated Increase in Deficit (billions of dollars)[a]	25 - 35	

a. Also includes effects of changed economic conditions in 1982.

outlays if the level of unemployment is near the state trigger rates for extended unemployment benefits than if the unemployment level is far above or far below the trigger rates. The preexisting level of unemployment may also affect the mix of persons newly unemployed--between more established workers who are likely to qualify for unemployment benefits and less experienced ones with fewer assets who may qualify for means-tested support programs.

Current Proposals

The Congress is currently considering several unemployment compensation proposals that would mitigate the short-term effects of high unemployment. The House has passed, and the Senate has indicated its support for, federally-financed supplemental benefits for long-term jobless workers in states with high unemployment. Other proposals would continue extended benefits in states that have recently--or will soon--trigger off the extended benefits program because of the 1981 changes in the law. Still other proposals would provide relief to states that are having difficulty repaying funds borrowed from the federal Treasury to provide state benefits. Depending on the combination of proposals, their total cost could range from $1 billion to $5 billion in fiscal year 1983.

Other proposals before the Congress could offset some or all of these added costs as well as address the longer-term financing problems in the unemployment compensation system. The Senate has passed a proposal to increase the federal unemployment tax on employers, and the House has voted to reduce the income thresholds above which unemployment benefits are taxed as income. Increased revenues from these changes could at least partially offset the costs of proposed benefit extensions in fiscal year 1983, and could significantly exceed those costs in future years.

CONCLUSION

In summary, unemployment is high and is expected to remain so in the near future--adversely affecting many individuals and the federal budget. Although overall economic expansion is the most effective way to achieve significant long-term reductions in joblessness, the short-term effects of high unemployment could be mitigated somewhat by changes in certain federal programs--such as unemployment compensation--that assist unemployed persons.