Statement of

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Mr. Chairman and Members of the Committee:

I appreciate this opportunity to be with you today and to comment on S. 50, the "Full Employment and Balanced Growth Act of 1976."

Unemployment is a continuing human as well as economic problem. For the economy it represents a waste of resources that is reflected in a lower level of output of goods and services than could potentially be produced. For individuals it represents not only loss of income associated with joblessness, but deterioration of skills and damage to a sense of pride and self-esteem. Moreover, even at high levels of aggregate employment, unemployment problems persist for minorities, teenagers, and some other groups. Reducing unemployment is thus important not just to restore full capacity production but also to provide the opportunity to participate in the economy for all groups of workers.

While the overall unemployment rate has fallen since it reached a 35-year peak last spring, it remains far above the range that any would consider satisfactory. Even if recovery proceeds at the reasonably rapid rate that most forecasters are now projecting, unemployment is unlikely to reach even its 1960-1975 average of 5.2 percent for several years. Clearly there is good reason for proposing new programs or strategies that will speed the decline in unemployment and improve on our past unemployment record.

Reducing unemployment, however, is not the only goal of economic policy. Reasonable price stability is another major goal which the Congress must weigh along with the unemployment goal in shaping the nation's economic policies.

S. 50 calls for a new process of formulating and coordinating economic policy which, if enacted, could well lead to lower unemployment. At the same time, however, it carries a significant risk of accelerating the rate of inflation. In my testimony this morning I would like to discuss the goals of S. 50 and the possible programs to implement those goals, and then comment on the inflation problem.

Goals of S. 50

S. 50, the Full Employment and Balanced Growth Act of 1976, has several major aspects:

- Establishment of a goal of 3 percent adult unemployment to be reached as promptly as possible, but within not more than four years after the date of enactment of the Act.
- Recognition that achieving a 3 percent unemployment goal will require a mix of both aggregate demand policies and more selective targeted measures.
- Recommendation that full-employment policies be accompanied by anti-inflation measures.
- Extension of the organizational structures established in the Employment Act of 1946 and the Congressional Budget Reform Act of 1974 to establish an institutional framework whereby the President, the Federal Reserve Board, and Congress can coordinate national economic policy to achieve the goals set forth in the Act.

While the bill specifies a full-employment goal and an administrative process, it does not identify specific programs that would be enacted. Both the economic impact and the budget costs differ greatly depending on which policy tools are used to achieve the unemployment goal, which anti-inflation measures are pursued, and where the economy stands at the time the process begins. An analysis of S. 50 must necessarily be restricted to broad qualitative judgments rather than specific estimates.

The Meaning of 3 Percent Unemployment. The requirements for reaching the goal of 3 percent adult unemployment depend first of all on who is classified as an adult. A useful rule of thumb in this regard is that since the mid-1960s, the overall unemployment rate, defined as the rate for all workers aged 16 and over, has been roughly one percentage point above the unemployment rate for those 20 and over and 0.5 percentage points above those 18 and over. Table 1 contains more precise comparisions on a yearly basis.

Although demographic factors in the future could reduce this differential, projections by The Urban Institute indicate that this approximate spread will persist through the next decade. Thus, if we speak of 3 percent nonteenage unemployment, we are referring to an approximate 4 percent overall rate. Similarly, a 3 percent unemployment rate for persons 18 and over implies about a 3.5 percent overall rate.

TABLE 1--UNEMPLOYMENT RATES FOR ALL PERSONS 16 AND OVER COMPARED WITH UNEMPLOYMENT RATES FOR PERSONS 18 AND OVER AND 20 AND OVER

Year	(1) Unemployment Rate, 16+	(2) Unemployment Rate, 18+	(3) Unemployment Rate, 20+	(4) (1) - (2)	(5) (1) - (3)
1950	5.3	5.1	4.8	0.2	0.5
1951	3.3	3.1	3.0	0.2	0.3
1952	3.0	2.8	2.7	0.2	0.3
1953	2.9	2.7	2.6	0.2	0.3
1954	5.5	5.3	5.1	0.2	0.4
1955	4.4	4.2	3.9	0.2	0.5
1956	4.1	3.9	3.7	0.2	0.4
1957	4.3	4.0	3.8	0.3	0.5
1958	6.8	6.5	6.2	0.3	0.6
1959	5.5	5.2	4.8	0.3	0.7
1960	5.5	5.2	4.8	0.3	0.7
1961	6.7	6.4	5.9	0.3	0.8
1962	5.5	5.2	4.9	0.3	0.6
1963	5.7	5.2	4.8	0.5	0.9
1964	5.2	4.7	4.3	0.5	0.9
1965	4.5	4.1	3.6	0.4	0.9
1966	3.8	3.4	2.9	0.4	0.9
1967	3.8	3.5	3.0	0.3	0.8
1968	3.6	3.2	2.7	0.4	0.9
1969	3.5	3.1	2.7	0.4	0.8
1970	4.9	4.5	4.0	0.4	0.9
1971	5.9	5.4	4.9	0.5	1.0
1972	5.6	5.1	4.5	0.5	1.1
1973	4.9	4.3	3.8	0.6	1.1
1974	5.6	5.0	4.5	0.6	1.1
1975	8.5	7.9	7.3	0.6	1.2

SOURCE: Bureau of Labor Statistics.

NOTE: Column (1) is the unemployment rate for the civilian labor force for all persons 16 and over. Column (2) is the unemployment rate for the civilian labor force for all persons 18 and over. Column (3) is the unemployment rate for the civilian labor force excluding teenagers, that is, persons 16 to 19.

Programs Under S. 50

Countercyclical Programs. S. 50 outlines a number of policy measures that might be implemented to achieve the full-employment target. Standard fiscal and monetary measures might be supplemented by special job-creating policies like public service employment, accelerated public works, grants to state and local governments, and special tax incentives to business. Further, there is a provision of a limited job guarantee for persons able and willing to work and seeking work.

Special employment programs are to be enacted to the extent that fiscal and monetary policies are unable to achieve the 3 percent adult unemployment target. Presumably what this means is that supplementary measures are to be used if the inflationary pressures or budget costs associated with using standard fiscal and monetary policy to achieve the unemployment target become unacceptably high.

Special countercyclical measures such as public service employment, employment tax incentives, accelerated public works, and special assistance to state and local governments can either provide jobs directly to the cyclically unemployed (as in public employment and public works), or can provide special incentives to private industry and state and local governments to employ more people than they otherwise would

have. A recent study by CBO of temporary measures to stimulate employment,[1/] concluded that some of these measures can potentially have a higher employment impact per dollar spent than across-the-board spending or tax changes. Further, in some cases, the potential inflation impact per job is less than for standard fiscal and monetary policy, suggesting that using selective measures can improve the inflation-unemployment relationship.

Table 2 shows estimates of the employment impact and net budget cost (taking into account savings from unemployment compensation and higher tax payments from program participants) for alternative temporary employment programs.[2/] Initially, there is a fairly wide variation in cost per job, although these differences tend to narrow after a year or two of program operation. Public employment has a lower cost per job than other measures; after a year of operation, for instance, accelerated public works may cost about one and half to twice as much per job as public employment. Across-the-board tax cuts could entail a cost of from three to four times that of public employment.

1/ U.S. Congress, Congressional Budget Office, Temporary Measures to Stimulate Employment: An Evaluation of Some Alternatives, September 2, 1975.

2/ A detailed explanation of the assumptions behind these estimates can be found in Temporary Measures to Stimulate Employment cited in footnote 1 of this testimony.

Table 2--ESTIMATES OF EMPLOYMENT AND BUDGET IMPACT VARIOUS PROGRAMS COSTING $1 BILLION[1]

Type of program	Initial impact			12 months			24 months		
	Increase in jobs (thousands)	Reduction in unemployment rate	Net budget cost (millions)	Increase in jobs (thousands)	Reduction in unemployment rate	Net budget cost (millions)	Increase in jobs (thousands)	Reduction in unemployment rate	Net budget cost (millions)
Public service employment	80-125	0.07-0.11	$754-$615	90-145	0.08-0.13	$492-$425	90-150	0.08-0.13	$392-$312
Anti-recession aid to State and local governments	40-77	.04-.07	850-716	70-97	.07-.09	590-570	72-100	.07-.09	480-450
Accelerated public works	16-46	.02-.04	915-793	56-70	.06-.07	537-510	64-80	.07-.08	430-390
Tax cut [2]	8-15	.01-.02	980-960	26-35	.02-.03	740-720	30-40	.02-.03	663-637
Government purchases	20-50	.02-.04	948-870	40-70	.03-.05	600-590	60-80	.04-.05	475-425

[1] These estimates assume no monetary accommodation. If the money supply were increased to prevent interest rates from rising as a result of the expansionary fiscal measure, the job-creative effect would be higher and the net deficit cost lower. Accommodating monetary policy would increase the expansionary effect by 25 percent or more which, in turn, would reduce the budget cost by an average about $125 million.

[2] The income tax cut is assumed to be one-third corporate and two-thirds personal. If the tax cut were entirely personal, the expansionary effect would be about 50 percent greater and the net budget cost about $175 million lower.

Source: See app. B.

SOURCE: U.S. Congress, Congressional Budget Office, Temporary Measures to Stimulate Employment: An Evaluation of Some Alternatives, September 2, 1975, p. V.

Some of the more costly programs, however, have other benefits such as the high value of their output. Table 3 provides in summary form some of the considerations discussed in Temporary Measures to Stimulate Employment in making comparisons between programs. While special measures to stimulate employment may be less costly and potentially less inflationary in the short run, aggregate demand policies are sometimes viewed as a more neutral way to stimulate economic growth and create jobs in the long run.

Selective measures are also sometimes criticized when their timing does not match the need reflected in rising and falling unemployment. A program which is truly countercyclical should include safeguards to ensure that workers move rapidly into regular private sector and government jobs as the economy expands. For instance, countercyclical public works projects should be designed so that they can be started up or completed in a short time. In public employment programs, wages should be lower than private-sector alternatives (contrary to the provisions of S. 50) to ensure movement out of temporary jobs when permanent employment becomes available. Tax incentives and grants that create temporary jobs indirectly should also be designed with rapid phase-out in mind.

Programs to Reduce Structural and Frictional Unemployment. When overall unemployment is in the 4 to 5 percent range, a great deal of the remaining unemployment is due, not to any

Table 3--SUMMARY OF THE POTENTIAL IMPACTS OF ALTERNATIVE MEASURES TO STIMULATE EMPLOYMENT

	Employment impact per dollar expenditure	Startup time	Phaseout flexibility	Inflation impact	Value of output	Targetability
Income tax cut.	Relatively low, particularly in the short run.	Subject to lags in individuals' spending.	Potentially easy to terminate.	Same as any aggregate fiscal measure.	Entirely private sector.	None.
Increase in Government purchases.	Higher than tax cut; lower than special employment programs.	Potentially fast; subject to policy initiation lag.	May be hard to terminate, especially if useful output, services involved.	Same as any aggregate fiscal measure, depending on employees' skill mix.	Mostly public sector; 2d round effects on private sector.	Low.
Accelerated public works.	Potentially low if wages are high; greater job impact from low-wage projects.	Potentially long; but with wide variations depending on type of program.	Wide variation; appropriations easier to stop than some other Government programs, but large-scale projects may take long to complete.	Somewhat greater than other programs if workers highly skilled; lower if aimed at less skilled workers.	Mostly public sector; 2d round effects on private sector.	Can be directed at high-employment areas, construction trades.
Public service employment.	Relatively high if wages are low.	Potentially fast if existing programs expanded.	Relatively flexible if job tenure limited.	Low if aimed at unskilled workers and if wages are lower than private sector alternatives.	Low if emphasis is solely on job impact; if combined with training can produce useful skills.	Can be directed at most needy individuals.
Antirecession aid to State and local Governments.	Less than PSE if skill levels high; more than other Government purchases, public works.	Potentially fast; no new programs, only transfer of funds.	Potentially easy to terminate.	Moderate, depending on skill level of employees.	State and local government services.	Can be directed at Governments hit by recession.

SOURCE: U.S. Congress, Congressional Budget Office, Temporary Measures to Stimulate Employment: An Evaluation of Some Alternatives, September 2, 1975, p. VIII.

depression in the general economy, but to what are often called "structural" or "frictional" factors. Structural unemployment refers to an excess supply of labor in some sectors of the labor market with a special long-term problem--for example, a local area which is losing jobs to other regions or an industry whose output is no longer in demand. Discrimination in some occupations against racial minorities or women cause these groups to concentrate their supply in other occupations, and overcrowding of these occupations is another form of structural unemployment.

Programs to combat structural unemployment include steps to increase the demand for labor in depressed pockets of the labor market and programs to increase the mobility of individuals out of these pockets through encouragement of geographic mobility, training or retraining, and removal of discriminatory barriers, to name a few. Programs of these kinds might be more effective in reducing structural unemployment than across-the-board increases in demand that might have much of their impact on other sectors of the labor market.

Frictional unemployment refers to short spells of unemployment accompanying job turnover or initial entry into the labor force. To some extent, frictional unemployment represents a normal period of job search for new job seekers

or for persons who have left a job to seek a better one.[3/] However, some groups of people change jobs frequently, resulting in disproportionately high unemployment rates. Unskilled and disadvantaged individuals--among whom blacks and young people are disproportionately represented--experience more frequent spells of frictional unemployment than other groups. These persons tend to hold jobs at the bottom of the labor market hierarchy and they become unemployed frequently because they are fired, because they quit, and because they leave and reenter the labor force more frequently than other workers. Job attachment is weak. There is little incentive for employer or employee to maintain a long-term work relationship since there is little if any on-the-job training and hence no payoff to seniority. Job satisfaction is low, and this also weakens job ties.

Increasing job attachment by providing jobs with some training and chances for upward mobility would certainly be a desirable component of a program designed to reduce the relatively high unemployment rates of the unskilled and disadvantaged. In fact, failure to do so might result in continued high rates of unemployment for these groups, making

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3/ It is sometimes noted that frictional unemployment is higher in the United States than in other countries because of higher mobility and greater expectations of the possibility for advancement in the labor market area.

a 3 percent adult unemployment goal difficult or even impossible to achieve. Further, a case could be made that paying structural program participants a higher wage than the private economy pays them would increase job attachment and reduce the frequent spells of unemployment that characterize their job market experience.

A structural program of this kind could well be more costly on a per-job basis than countercyclical programs. Further, if the program is more attractive than private sector alternatives, workers will be drawn from the private sector, increasing the size of the public jobs program and driving up wages in the private sector. Over the longer run, however, this displacement could also result in improved working conditions in the private sector.

Since so many programs and specific program provisions are possible within the framework of S. 50, a single cost estimate for the bill would not really be meaningful. In some hypothetical average year in the 1980s, the unemployment goal in the bill might require some 2 million more jobs than the economy as it performed in 1960-1975 would be able to generate. The public cost of providing these jobs could easily vary from as little as $8,000 per job to as much as $30,000 per job. Furthermore, actual years would usually not be average years--they would instead include years of strong private demands when little or no economic

stimulus was needed and years of weak private demands when it would take economic stimulus well above the average to meet the unemployment goals of the bill.

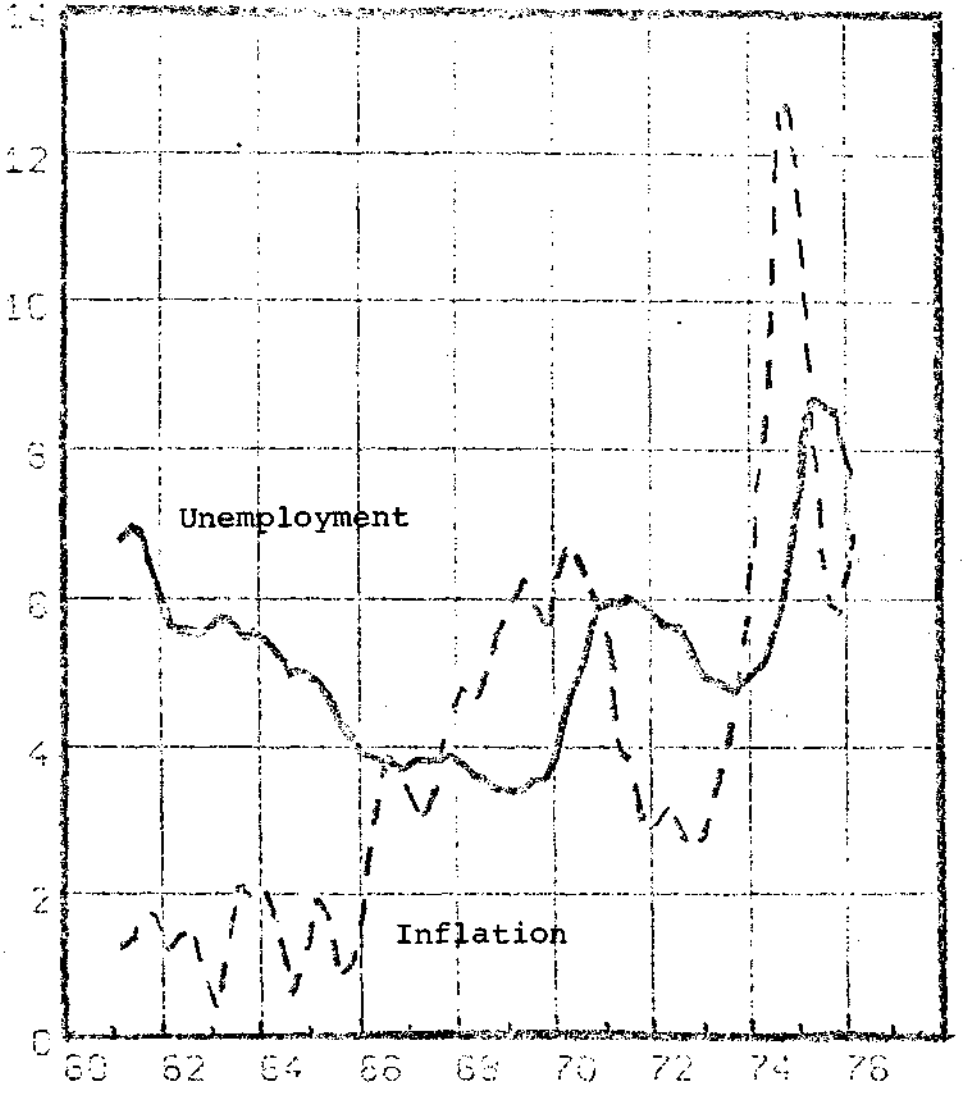
The Inflation Problem

A serious problem of pursuing a goal of 3 percent unemployment is the risk that inflation will begin to accelerate as the economy approaches the goal. Unfortunately, economists' understanding of inflation is too limited to warrant confidence in precise estimates of the inflationary risk. The historical record since 1961 is shown in very summary form in Chart 1. The measure of unemployment in the chart is the overall unemployment rate, while the measure of inflation is the rate of change in consumer prices omitting food and energy, whose prices have not been closely related to the unemployment situation.

Unemployment and inflation (omitting food and fuel prices) have generally, but not always, moved in opposite directions during this period. The 1961-1969 decline in unemployment was accompanied by worsening inflation through early 1970; and the 1970-1971 rise in unemployment, by falling inflation. In late 1971 and 1972, price controls under the Economic Stabilization Act held inflation down; but eventually, the 1971-1973 fall in unemployment was followed by greatly worsening inflation. The 1974-1975 rise in unemployment was accompanied at first by rising prices, partly due to the

Chart 1

Unemployment and Inflation, 1961-76



Notes: Unemployment is measured by the unemployment rate for all workers 16 and over, seasonally adjusted. Inflation is measured by 2-quarter changes, expressed at an annual rate, in the consumer price index less its food and energy components.

Source: U.S. Department of Labor

indirect effects of higher fuel prices and partly due to the end of price controls; but later the 1974-1975 recession saw a reduction in the inflation rate. The early 1976 improvement in unemployment has been accompanied by some acceleration in consumer prices other than food and energy, although falling food and fuel prices have kept down the overall price indexes. I believe no one studying this chart should remain complacent about the possibility of accelerating inflation as the economy nears 3 percent unemployment. Furthermore, the danger is greater the more comprehensive the definition of "adult" under the bill.

According to one set of simulations we have prepared, the added inflation associated with achieving a 3.5 percent overall unemployment rather than the long-term average of 5.0 percent is around 1.25 percentage points in the Consumer Price Index in the year the target is achieved and around 2 percentage points two years after achieving the target. In other words, if inflation were 5 percent per year in a 5 percent unemployment economy, it would be 7 percent per year two years after reaching a 3.5 percent unemployment economy. Furthermore, if unemployment were to be held at the 3.5 percent rate indefinitely, the simulations show a growing inflationary impact. As I noted, these or any other estimates are based on too many uncertain assumptions to warrant any confidence in the precise numbers. Perhaps,

though, they give some indication of the general order of magnitude of the problem.

It is possible that the careful coordination of employment programs proposed in S. 50 could reduce the inflationary risk. Well-designed programs targeted at particular groups could combat pockets of unemployment instead of spreading their effects over all sectors of the labor market. Training programs, if they were successful, could shift workers from situations of labor surplus to those of labor shortage.

On the other hand, the wage rate requirements proposed in S. 50 could worsen the inflation threat. Under S. 50, wages under "employer-of-last-resort" jobs must meet certain standards; they must, for example, be at least equal to prevailing wages paid by a local government if the local government is the employer, and they must meet Davis-Bacon Act standards in the case of construction jobs. These provisions could force private employers, many of whom do not now pay these wage rates, to raise their wages and prices in order to compete with publicly financed jobs.

The anti-inflation section of S. 50 points to some general approaches to the reduction of inflationary pressures due to tight labor markets. These include actions to ensure adequate supplies of scare commodities, particularly food and energy, recommendations to strengthen and enforce anti-trust laws, measures to increase productivity in the private

sector, and recommendations for administrative and legislative actions to promote reasonable price stability (presumably some form of price and wage controls or guidelines) if serious inflationary pressures arise. However, there is much less focus in the bill on these anti-inflation suggestions than on the unemployment goal; there is no target set for inflation as there is for unemployment.

It is, I believe, in further analysis and pursuit of anti-inflation steps that the greatest hope lies for achieving the unemployment goals of the bill. Without these steps there is a risk--not easily quantifiable, but quite possibly substantial--that the worsening price situation as the economy nears the unemployment goal will cause a retreat from the 3 percent goal. The more we learn about dealing with inflation, the greater the likelihood that we can achieve the unemployment goals which we all share.