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BEFORE THE

TASK FORCE ON DISTRIBUTIVE IMPACTS OF
BUDGET AND ECONOMIC POLICIES

COMMITTEE ON THE BUDGET
U.S. HOUSE OF REPRESENTATIVES

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Mr. Chairman:

Since the depths of the recession in 1975, the unemployment situation has improved markedly. The overall unemployment rate, which was 8.3 percent in the last quarter of 1975, dropped to 6.6 percent in the last quarter of 1977. Over the same period, the number of people unemployed declined by 15.2 percent, and employment rose by 7.9 percent.

The fall in unemployment associated with the recovery has not, however, been experienced equally by all members of the labor force. Two groups--nonwhites and teenagers--continue to be plagued by very high unemployment rates. As Table 1 shows, while the unemployment rate for whites declined from 7.6 to 5.8 percent, the rate for nonwhites declined only slightly--from 13.8 to 13.3 percent. In fact, the unemployment rate for nonwhite adult women increased from 11.3 to 11.8 percent. Although adult nonwhite male unemployment rates have fallen, they dropped no faster than those of white males, and they began at a much higher level. Further, these differences in white and nonwhite unemployment rates have continued despite the fact that nonwhite adult employment has increased faster than white employment.

Teenage unemployment has remained high. Nonwhite teenage unemployment increased from 35.9 to 38.3 percent, and employment for this group has risen less than half as rapidly as white employment. This is a major reason that teenage black unemployment is so difficult a problem. While teenage unemployment has always been higher than adult unemployment, it is higher now than it has been in the past, and the very high black teenage rate is of great social concern.

Today, I would like to review with the task force the reasons for these unemployment rate differences, the prospects for these inequalities being reduced as the economy moves towards full employment, and the impact some illustrative policies might have on those differences.

TABLE 1. TRENDS IN UNEMPLOYMENT RATES AND EMPLOYMENT LEVELS DURING THE 1975-1977 ECONOMIC RECOVERY a/

	Unemployment Rate in		Change in the Gap	Increases in
	1975 IV	1977 IV	between Nonwhite and White Rates	Employment 1975 IV-1977 IV
			(percentage points)	(percent)
Overall	8.3	6.6	--	7.9
Whites				
Aggregate	7.6	5.8	--	7.8
Adult males	6.1	4.2	--	5.9
Adult females	7.3	6.0	--	10.0
Teenagers (16-19)	17.6	14.1	--	11.3
Nonwhites <u>b/</u>				
Aggregate	13.8	13.3	+ 1.2	9.1
Adult males	12.0	10.1	n.c.	7.6
Adult females	11.3	11.8	+ 1.8	11.6
Teenagers	35.9	38.3	+ 5.8	4.8

a/ The rates are seasonally adjusted, based on unpublished data from Bureau of Labor Statistics.

b/ Nonwhites include blacks and other nonwhites.

The Reasons for Unemployment Differences

White/nonwhite and adult/teenage unemployment differences can be attributed to general slack in the labor market, structural factors, and the unintended consequences of government policies.

Slack in the Labor Market. A principal cause of the nonwhite/white and teenage/adult unemployment rate differentials is the overall looseness of the labor market. Although the unemployment rate has dropped substantially, the decline started from a very high level and, until recently, it has been proceeding relatively slowly. In January 1978, 6.3 percent of the labor force (6.2 million workers) remained unemployed, and there were few signs of labor shortages. At this level of unemployment, less-educated, less-skilled, and less-experienced workers are relatively unsuccessful in competing for jobs.

During most recoveries, disparities in unemployment rates, especially between whites and nonwhites and between teenagers and adults, have declined. The teenage unemployment rate has tended to change by about 1.5 percentage points for every percentage point change in the aggregate unemployment rate. The nonwhite rate has tended to fall by 1.8 percentage points for every percent fall in the overall rate. But this has not been the case for nonwhite groups during the current recovery.

Changes in labor-force participation during this recovery have contributed to the continued looseness of the labor market and dampened the reduction in the unemployment rate differences. During the current recovery, labor-force participation by nonwhite teenagers increased, swelling the ranks of the potentially unemployed. The growth in labor-force participation by adult women probably diminished the recovery's impact on the unemployment rates of all groups--especially those of teenagers and nonwhite women. The participation rates of adult women increased

from 46.2 to 48.6 percent between the end of 1975 and the end of 1977. If the rate had remained at its earlier level, 1.8 million fewer women would have competed in the labor force in the fourth quarter of 1977. Because of changes in demographic patterns and in labor-force participation rates during the recovery, women, teenagers, and nonwhites have accounted for an increasing share of the labor force.

Economic Structure. Longer-term economic and demographic changes and the structure of the recovery have also contributed to unemployment differences and help explain why those disparities have not been significantly reduced during the current recovery. Some of these changes are geographical. As employment growth shifts from the Northeast and Midwest toward the South and Southwest, and from older central cities toward suburbs and newer cities, job opportunities move away from groups that already experience high levels of unemployment. Inequalities thus increase.

Different levels of schooling, skill development, and work experience, as well as discrimination in hiring practices, are other determinants of unemployment rate disparities. The unemployment rates of more highly educated workers are lower than those of less educated workers, and the disparity between the rates for whites and nonwhites is lower among the more educated. In the long run, as more jobs demand workers with more skills, employment opportunities for disadvantaged workers will decline. This in turn will tend to increase inequalities. Discrimination against black workers and against teenagers also causes higher unemployment rates for both groups; less discrimination could diminish unemployment inequalities in the future.

One reason why the current recovery has had such a limited impact on unemployment disparities is because of its uneven impact on different sectors of the economy. In spite of a dramatic expansion of federal countercyclical assistance to state and local governments through public service employment programs and antirecession revenue sharing, state and local employment has grown more slowly during the recovery than during the recession or the expansion that preceded it. This sector of the economy hires disproportionate numbers of nonwhites, and its sluggish growth has slowed the reduction in nonwhite unemployment. Construction activity, on the other hand, has grown rapidly during this recovery; but that sector employs relatively few nonwhites.

Federal Policies. Unemployment inequalities may also be the unintended consequences of some federal policies. Increases in the minimum wage and payroll tax rates can diminish employment opportunities for less skilled workers, particularly teenagers. Increased demands that military recruits have high school diplomas will decrease unemployment among high school graduates, but probably will increase unemployment among high school dropouts. The geographic shift of employment opportunities from central cities to suburbs has also been encouraged by some federal policies, ranging from highway building to tax incentives.

The Outlook Under Current Policy

There is little reason to be sanguine that current policies or trends will significantly reduce unemployment rate disparities. The recovery is continuing, but if current fiscal and monetary policies were to remain in force over the next two years, economic growth would slow late in 1978 and throughout 1979. The unemployment rate would decline to the 6- to 6.5-percent range by the end of 1978, and would very likely remain there in 1979. Such a slowdown would probably mean that unemployment inequalities would remain essentially as they were in January 1978, when the overall unemployment rate was 6.3 percent--or they might even grow slightly.

Over the longer run, demographic and other trends may tend to magnify unemployment inequalities. The continued growth in the proportion of teenagers who are nonwhite may increase teenage unemployment. Increasing labor-force participation by women may increase unemployment among less skilled and less experienced workers. Despite improved fiscal conditions in the state and local sector as a whole, pressure from taxpayers and declining school enrollments may slow state and local employment growth still further. Higher minimum wages and payroll taxes will continue to discourage employers from hiring younger and less educated workers. Employment shifts from cities to suburbs, and from the Northeast and Midwest to the South and Southwest, are likely to continue.

Policy Alternatives

While a complex mixture of aggregate economic and structural factors are responsible for the persistence of unemployment rate differences, it is generally agreed that a healthy economy is an important first step towards a reduction in those disparities and a precondition for the success of structural programs. Skill training and education will have little impact on unemployment if there are too few jobs for the newly trained and educated.

In response to the forecast that continuing current fiscal policies would result in an economic slowdown, a number of proposals for changes in fiscal policy have been made. The President has proposed a reduction in personal and corporate taxes, totaling \$25 billion in fiscal year 1979. Others have proposed increasing federal expenditures or combining expenditure increases and tax reductions.

Different fiscal instruments are likely to have different effects on employment, and on unemployment inequalities. Dollar-for-dollar, tax reductions tend to have less effect, because some share of the reduced taxes is saved by consumers. Further, neither consumers nor corporations are likely to respond to a tax cut by increasing their spending disproportionately for goods and services produced by nonwhite or younger workers; hence, the employment growth stimulated by tax reductions will not greatly ameliorate unemployment inequalities. Specific tax cuts can, however, have different effects on inequalities. Expansions of the investment tax credit may help nonwhites by increasing employment in general, but

they may hurt those workers if they encourage further shifts of jobs away from urban areas, or if capital goods are substituted for labor. On the other hand, employment tax credits that focus on workers with particular attributes (such as poverty status or long-term unemployment) have been proposed, but these credits are untried and their effectiveness is very uncertain.

Increased across-the-board government purchases of goods and services ranging from buying more military hardware to hiring more civil servants will tend to reduce unemployment more than will tax cuts. They may also be designed to reduce unemployment inequalities. Government purchases can be directed toward firms (through minority enterprise contracting programs) or toward geographic areas in ways that increase their effectiveness in reducing unemployment inequalities.

Public service employment programs can, if implemented successfully, have even more impact on reducing unemployment and unemployment inequalities. Such programs tend to create more jobs per dollar, because a larger share of their resources is spent on wages and salaries, and because the wage levels of the jobs they support are on average lower. The more these programs are targeted toward disadvantaged workers, the greater their impact on unemployment inequalities. Recent public service employment programs have been reasonably well targeted; at the end of fiscal year 1977, 19 percent of the public service employment program participants were under 22 years old; 34 percent were nonwhite. Certain public service employment programs, such as the summer youth program, are aimed exclusively at younger workers.

Successful implementation and targeting of public service employment programs is by no means a certainty, however. If recipient governments substitute federal support for funds they would have spent anyway, public service employment may be no more effective than a tax cut in stimulating employment growth. Effective targeting could, however, increase nonwhite or teenage employment, even if aggregate employment were changed little.

The effects of each of these three policy instruments--tax cuts, increased government purchases, and public service employment--are very uncertain. A billion-dollar increase in public service employment program funding is estimated to increase employment by some 80,000 jobs approximately a year after implementation; a similar size tax cut would increase employment by about 22,000 jobs. The effects of those instruments on unemployment inequalities would also be substantially different. If the proportion of indirectly stimulated jobs held by nonwhites were 13 percent (roughly the share during the recovery to date), and nonwhites continued to hold 34 percent of the newly-created public service jobs, about 29 percent of all the jobs resulting from a public service employment program would be held by nonwhites. For all of the programs, however, it should be stressed that success in reducing unemployment and other inequalities depends crucially on consistent and effective targeting on those most in need. Failure to target effectively might even increase inequality.

Impact of Alternative Fiscal Policy Packages

The various instruments may be packaged together in a number of ways. If a quick, substantial increase in economic expansion is desired, tax reductions must represent a significant share of a package, because neither increased government purchases nor large-scale expansions of public service employment can take place rapidly. If, on the other hand, reduction in unemployment inequalities were the overriding objective, targeted employment programs would be called for, even though they may take effect more slowly.

As illustrative examples, I would now like to discuss the employment effects of two possible options to the current policy budget: the Administration's budget request, and a fiscal package in which tax cuts are smaller and public service employment funds are greater, but the total cost is the same. As I noted in my testimony before the House Budget Committee two weeks ago, fiscal policy options also affect inflation, growth in the Gross National Product, and other economic outcomes, but this morning I will concentrate my discussion on their employment effects. (Table 2 summarizes the effects of the two options.)

Package I--The Administration's Proposed Tax Reduction and Expenditure Increase

The Administration's fiscal policy package relies primarily on tax reductions of \$25 billion below current policy levels in fiscal year 1979. Not taking into account energy rebates, the net tax cuts for individuals would be \$18.3 billion and \$5.1 billion for corporations in 1979. The

Administration has also proposed an expenditure increase of \$6 billion above current policy. If adopted, the Administration's tax cuts are estimated to reduce the unemployment rate by about 0.3 percentage points and to increase employment by about half a million jobs at the end of 1979. The Administration's proposal would probably have little effect on unemployment inequalities. The teenage unemployment rate would probably decline slightly more than the adult rate, but increasing payroll taxes and minimum wage levels, and continuing increases in labor-force participation, would slow reduction in the differential between teenage and adult unemployment rates. Similarly, the nonwhite unemployment rate would decline only slightly, relative to the white unemployment rate. If the pattern of the current recovery continues, about 13 percent of the new jobs the plan would create would be held by nonwhite workers.

Package II--A \$23 Billion Tax Cut, a \$2 Billion Increase
in Public Service Employment, and a \$6 Billion
Increase in Government Expenditures

This fiscal package would have the same direct budgetary cost as the package proposed by the Administration and would continue to rely heavily on tax reductions. The tax cut for businesses would remain at the level proposed by the Administration, while the personal tax cut would be reduced by \$2.2 billion. Under this option, public service employment levels would grow by 475,000 (from 725,000 to 1,200,000) over the course of fiscal year 1979, requiring \$2.2 billion in increased outlays.

CBO estimates that, at the end of 1979, this option would reduce the unemployment rate by about 0.5 percentage points below what it would be if current policy were to be continued. This would be an additional 0.2 percentage point reduction below what would result from the Administration's proposal. Put another way, this option would lead to 730,000 more jobs than those that would result from current policy, or 240,000 more jobs than would result from the Administration's proposal.

If the proportion of public service job holders who are nonwhite remains as it is now, approximately 20 percent of these new jobs would be filled by nonwhites. Because this package would increase both the number of added jobs and the fraction of them filled by nonwhites, approximately 82,000 more nonwhites might be employed than with the Administration's proposal.

TABLE 2. EMPLOYMENT IMPACTS OF ILLUSTRATIVE FISCAL POLICY PACKAGES

	Current Policy	Alternative Package I The Administration's Proposed \$25 Billion Tax Reduction and \$6 Billion Expenditure Increase	Alternative Package II \$23 Billion Tax Cut, \$6 Billion Expenditure Increase, plus \$2 Billion Public Service Employment Expansion
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Unemployment Rate			
1979 IV	6.1 to 6.6	5.8 to 6.3	5.6 to 6.1
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Employment Growth Over Current Policy (jobs in thousands)			
1979 IV	N/A	490	730
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Percentage of 1979 IV Increased Employment Going to Nonwhites			
	N/A	13	20

N/A Not Applicable.

Long-Term Strategies to Reduce Unemployment Inequalities

Continued economic growth, together with targeted employment programs, can reduce inequalities in the short run, and a prosperous economy is necessary for the success of longer-run programs. Nevertheless, it is to such long-run structural programs--plus an end to discrimination--that we must look for a major shift away from systematic inequalities in the job market.

Skill-oriented and on-the-job training programs, for example, appear to improve the employment successes of their enrollees, especially their more disadvantaged, minority trainees. The President's fiscal year 1979 budget proposal includes budget authority of about \$4.85 billion for employment and assistance training, including \$2 billion for CETA Title I, and \$296 million for the Job Corps. During fiscal year 1977, more than 40 percent of the participants in these programs came from minority groups. Fifty-one percent of Title I enrollees and all Job Corps participants were under 22 years of age. In addition, the Youth Employment and Demonstration Projects Act will add more than half a billion dollars, targeted directly on youth, this fiscal year.

A budgetary increase of \$500 million for CETA Title I would allow about 300,000 more participants to be served during fiscal year 1979. Implementation problems, however, could dissipate the efficacy of this expansion in ways similar to those at work in public service employment programs: Targeting could weaken as these programs expand; fiscal substitution could also occur. In fiscal year 1977, only 52 percent of

the CETA Title I outlays were spent on training activities; the remainder supported public service employment, work experience, and other activities.

The President's budget requests \$4.6 billion for postsecondary education programs. More than 85 percent of that sum is for funding student assistance programs that have, to date, been oriented primarily toward low- and moderate-income students. Although nonwhites account for only about 12 percent of all college students, about one-third of the recipients of those programs are nonwhite. Numerous proposals are being made to expand these programs to support middle-income students and to subsidize middle-income families with students through tax credits for educational expenses. The President has recently proposed an expansion of Basic Educational Opportunity Grants and other student-aid programs to include these students. An additional \$1.2 billion has been requested to fund this effort. Alternatively, if higher equality of educational opportunity and lower white/nonwhite unemployment differentials were desired, increased support could continue to be directed toward lower-income students.

Because discrimination is an important cause of unemployment inequalities, federal civil rights activities should be another focus of budgetary attention. Federal efforts in this area include enforcement of nondiscrimination in private and public employment, and of affirmative action among federal contractors. Efforts to ensure equality of educational opportunity and fair housing opportunities could also lead to improved employment equality. The President's budget estimates increased

federal outlays for each of these antidiscrimination activities in fiscal year 1979.

Mr. Chairman, let me close by emphasizing that the measures I have discussed this morning must complement one another because the problems--particularly the cyclical and structural problems--reinforce one another. The budgetary process is well-suited to plan against such problems, and extension of budgetary horizons toward five years could make it even more useful.

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