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EPB MEETING
Wednesday, September 1, 1976
8:30 a.m.

Chris -
What is
Commis up at
EPB today?



August 27, 1976

ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE

Proposed Agenda

Monday, August 30, 1976

No EPB Executive Committee Meeting

Tuesday, August 31, 1976

- Lesch*
1. Report of EPB/NSC Commodities Policy Coordinating Committee State-Treasury
 2. Assessment of U.S. Performance in Implementing Multilateral Aid Commitments State

Wednesday, September 1, 1976

- Jane*
1. Policies to Deal With Structural and Induced Unemployment Malkiel
 2. Treasury Regulations Concerning Bonds Issued on Behalf of a State or Political Subdivision Treasury

Thursday, September 2, 1976

No EPB Executive Committee Meeting

Friday, September 3, 1976

No EPB Executive Committee Meeting

COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

ALAN GREENSPAN, CHAIRMAN
PAUL W. MACAVOY
BURTON G. MALKIEL

August 31, 1976

MEMORANDUM FOR THE EXECUTIVE COMMITTEE OF
THE ECONOMIC POLICY BOARD

Subject: Policies to Deal with Structural and Induced
Unemployment

At last week's EPB meeting the discussion focused on the issues of targeting CETA funds under Titles II and VI to the long-term unemployed, that is, to workers who had exhausted their unemployment insurance benefits and youth who have been unemployed for a long duration. At the September 1st meeting of the EPB we will focus on the remaining three issues covered in our memorandum of August 20, 1976.

Issue 2 -- Youth Unemployment

This issue is concerned with alternative means of expanding employment opportunities for youths through a reduction in the barriers to employment created by other government policies.

Policy Recommendations

1. Propose a youth differential in the minimum wage or exempting the earnings of youths paid near the minimum wage from payroll taxes.
2. Establish an inter-agency group to work with the Department of Labor for expanding experimentation with exemptions to the minimum wage within the current FLSA framework.
2. Request that the Commission on Paperwork undertake a study of the impact of the paperwork burdens on the summer employment of youths, and consider ameliorative policies.



Issue 3 -- Unemployment Compensation System

This issue is concerned with the increase in the unemployment rate induced by the current regular state unemployment compensation system.

Policy Recommendations

1. Require states to increase the extent of experience rating of firms in the unemployment compensation tax.
2. Treat unemployment compensation benefits as if they were labor market earnings in the Federal income tax and for the determination of social security benefits for retirees receiving both benefits.

Issue 4 -- Reducing Barriers to Occupational and Geographic Mobility

This issue is concerned with expanding productive job opportunities by reducing barriers to mobility that result in a less efficient utilization of labor resources. Reducing these barriers would lower frictional and structural unemployment.

Policy Recommendation

1. Establish a task force to examine:
 - (a) The extent to which Federal and state occupational licensing laws and other regulations can be modified to provide a more efficient utilization of labor resources.
 - (b) The effect on employment of Federal efforts to reduce discrimination in the public and private sectors of the economy.
 - (c) Federal programs that are intended to facilitate geographic and job mobility.

BRC

Barry Chiswick

BGM

Burton G. Malkiel

EPE

THE WHITE HOUSE

WASHINGTON

August 21, 1976

MEMORANDUM FOR THE ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE

FROM: ROGER B. PORTER *RBP*

SUBJECT: Policies to Cope with Structural and Induced
Unemployment

Last May, at the request of the EPB Executive Committee, the Council of Economic Advisers prepared a paper on a "Profile of the Unemployed." Since the discussion of that paper last spring, several Executive Committee members have expressed an interest in exploring policy alternatives to address structural and induced unemployment.

Burt Malkiel and Barry Chiswick of the CEA have prepared an options paper on "Policies to Cope with Structural and Induced Unemployment" which is attached. This paper is scheduled for discussion at the Tuesday, August 24, EPB Executive Committee meeting.

"PRINCIPALS ONLY"

Jim Cannon

I've given copies to Leach & Lissy & asked for their comments. Since it is "principals only" I assumed you would be attending.

Attachment

Art

MEMORANDUM TO EPB EXECUTIVE COMMITTEE

FROM: Barry R. Chiswick and Burton G. Malkiel

SUBJECT: Policies to Cope with Structural and Induced Unemployment

The Nature of Unemployment

There is a popular misconception, all too often reinforced by misguided public policy, that if 7-1/2 million Americans are unemployed on average in a year, it is the same 7-1/2 million persons who are unemployed throughout the year. In fact, most unemployment is of relatively short duration. The situation is more like having 25 million Americans unemployed for some part of the year with the typical duration of unemployment being something like 7 to 8 weeks. This is why the Administration generally has not favored public service employment or public works programs. Such programs are not a solution for the problem of short duration unemployment. Indeed, by taking workers out of the job search process, they may actually inhibit the finding and acceptance of productive private sector employment.

We must not, however, be misled by averages. There is, to be sure, considerable long duration unemployment at the present time. For example, while only 32 percent of the unemployed in July 1976 were out of work for 15 weeks or longer, 17 percent were unemployed for 27 weeks or longer. It is this group that suffers the most serious hardship from unemployment and to which public policy must be especially concerned. And some demographic groups have relatively high rates of unemployment. Although the unemployment rate in July was 7.8 percent, it was 16.3 percent for white teenagers and 34.1 percent for black teenagers.

Some of the unemployment in our economy is "frictional," that is, arising from normal economic change -- the growth or decline of firms, changing productive techniques, labor force entry and the search for better wages and working conditions. Some unemployment is "cyclical," a result of the recent recession. Another part might be considered "induced." The availability of unemployment benefits, including long duration benefits, and the difficulty of effectively enforcing a work test may have induced some to be unemployed who otherwise might have been employed or dropped out of the labor force. Finally, some unemployment is "structural," that is, resulting from a lack of training, the obsolescence of a skill, old age, geographic mismatches of jobs and workers, or artificial barriers to wage rate adjustments.

The available data do not allow us to distinguish among the different types of unemployment. We do, however, have a breakdown of the demographic characteristics of the unemployed. Older workers are more likely to be unemployed for a long duration than workers age 25 to 54. While it is true the very high youth unemployment rates are largely the result of a very high incidence of short duration unemployment, the considerable amount of long duration unemployment among youths, especially black youths, is clearly an important policy concern.

This paper sets out several issues concerning structural and induced unemployment. Issue (1) is related to the more immediate Presidential decision regarding the extension of public service jobs under CETA Title VI. It discusses limiting CETA PSE jobs to unemployment insurance exhaustees.

Issues (2) to (4) are concerned with more long-term policy decisions to increase employment opportunities and reduce the unemployment rate. Alternative means of reducing the minimum wage barrier to youth employment are discussed in issue (2). Unemployment induced by the present unemployment insurance system and ameliorative policies are considered in issue (3), while issue (4) is concerned with identifying means of reducing barriers to occupational and geographic mobility.

Presidential Decisions

In early June, the EPB presented to the President a discussion of several employment related bills. At that time, he decided to hold to the policy of phasing out the CETA Title VI (emergency employment) public service jobs, as there was continuing improvement in the economy. However, from May to July, although employment increased by 210,000, unemployment increased by 560,000, and the unemployment rate increased by 0.5 percentage point. This has heightened concern for the pace of improvement in job opportunities and in the unemployment situation.

The most immediate issue coming before the President is likely to be his position on the bill (H.R. 12987) to reauthorize Title VI of CETA, emergency public service jobs. House-Senate Conference is scheduled for August 24-25. The Senate version is a doubling of the program size to 520,000 slots. It would convert current slots as they become vacant, plus all new slots, to time-limited projects reserved for persons unemployed 15 weeks or longer or who have exhausted UI entitlement and who have family income below \$6,700.^{1/} The House version is a "such sums" reauthorization of the present design with technical amendments, one of which (allowing 15 percent vs. the present 10 percent of the grant to be used for non-wage costs) could reduce the total number of jobs funded. Current informal indications are that the Conference will come out close

^{1/} When the President proposed the emergency CETA PSE expansion in October 1974, he requested that the slots be reserved for unemployment insurance exhaustees. At that time, there was little Congressional sympathy for this requirement. With the change in economic circumstances, the Senate action indicates that such a proposal may have more support at this time.

to the House version and that there is a possibility that the total slot size which the report will suggest might not exceed the current 260,000. Within the next two weeks therefore there could be a Conference bill before the President, and if that becomes law, a 1977 supplemental appropriation bill of somewhere between \$700 million and \$2.8 billion shortly thereafter.

Issue (1) discusses the CETA PSE program and a means of targeting it to the long-term unemployed.

Issue 1 -- Long Duration Unemployment

Policy Recommendation

1. Reserve PSE job slots (CETA Titles II, VI) for persons with work experience who have exhausted their unemployment insurance entitlement.
2. Reserve CETA PSE job slots not filled for youths with long-term unemployment.
3. Target more of the CETA Title I training funds to UI exhaustees.

Discussion

Although most unemployment is characterized by high turnover and short spells of unemployment, some individuals are unemployed for a long period of time. During the very high level of unemployment of 1975 about 1.2 million persons (1.3 percent of the labor force) were unemployed 26 weeks or longer, 687,000 persons (0.7 percent) reported unemployment lasting at least 39 weeks, 157,000 (0.2 percent) reported 65 weeks or more and 79,000 (0.1 percent of the labor force) reported 99 weeks or more.

With the economic recovery there has been a sharp decline in long duration unemployment. After reaching a peak of 3.3 percent in December 1975, the long duration unemployment rate (those unemployed 15 weeks or longer as a percent of the labor force) has declined to 2.4 percent in July. In the coming months there will be a continued economic recovery and a continued gradual termination of very long duration unemployment benefits under the Federal Supplemental Benefits program as state insured unemployment rates decline. Both factors can be expected to lower the extent of long duration unemployment as reported in the Current Population Survey.

The nature and magnitude of any persisting long duration unemployment problem as the economy continues to recover from the recent recession are

unclear. It is not likely to be skill specific, but it may be somewhat regional if the automobile industry lags behind the rest of the economy. Far more likely, however, it will not be concentrated on the basis of occupation, industry or region, but may be experienced throughout the country by individual older workers with few skills or obsolete skills, and little incentive for retraining.

It is sometimes believed that public service employment is a useful remedy for this long duration unemployment. However, based on the characteristics of persons placed in CETA funded PSE job slots, it would appear that the current program is not addressing the problem of the long-term or hardcore unemployed.^{1/} Rather, it appears that state and local governments tend to select persons with favorable employment characteristics -- they tend to be prime age, male, and at least high school graduates (Table 1). In addition, they are not particularly handicapped in finding employment because of a physical disability, criminal record or limited knowledge of English.^{2/} Only 13 percent were receiving unemployment insurance benefits prior to starting PSE employment. This suggests that if they had in fact been unemployed it was either voluntary or of a very short duration. Thus, it appears that most of the persons currently in CETA PSE job slots would not have substantial difficulty finding private sector employment during the current economic expansion.

One policy to aid unemployment compensation exhaustees would be to limit PSE job slots to persons who had exhausted their entire entitlement,

^{1/} Persons whose public employment was created because of the PSE funding need not be the same persons the prime sponsors report as being in PSE job slots.

^{2/} Of the CETA Titles II and VI participants from July 1975 to December 1975, 3 percent were physically handicapped, 3 percent were offenders and 4 percent had a limited English speaking ability.

Table 1. Characteristics of Participants in CETA Titles II and VI and the Unemployed, Fiscal Year 1975 (percent)

<u>Characteristics</u>	<u>CETA</u>		<u>U.S. unemployed</u>
	<u>Title II</u>	<u>Title VI</u>	
Total	100.0	100.0	100.0
Sex:			
Men	65.8	70.2	54.9
Women	34.2	29.8	45.1
Age:			
Under 22 years	23.7	21.4	34.8
22 to 44 years	62.9	64.8	46.0
45 years and over	13.4	13.8	19.1
Education:			
8 years and under	9.4	8.4	15.1
9 to 11 years	18.3	18.2	28.9
12 years and over	72.3	73.3	56.0
Race:			
White	65.1	71.1	81.1
Black	21.8	22.9	18.9
American Indian	1.0	1.1	
Other	12.1	4.9	
Spanish speaking	16.1	12.9	6.5
Limited English-speaking ability	8.0	4.6	--
Veterans:			
Special Vietnam era	11.3	12.5	7.5
Other	12.6	14.6	9.4

Source: Employment and Training Report of the President, 1976.

including Federal Supplemental Benefits.^{1/} Since this would be a temporary measure, not a permanent haven for the "unemployables," these jobs should have a finite duration (e.g., one year or 18 months). The expectation is that at the end of this period labor markets would be sufficiently tight for all but the very hardcore unemployed to find a regular job. Even if the replacement effect (i.e., using CETA funds for jobs that would exist in any case) would be as large under a PSE program limited to exhaustees as it is currently, limiting it to exhaustees would have a stronger net job creating impact for the economy as the program would be biased in favor of those with the greatest difficulty in finding regular employment. It would also demonstrate Administration concern for the long-term unemployed.

Limiting the PSE job slots to unemployment compensation exhaustees would, in effect, be a return to the President's original proposal in October 1974 which was rejected by Congress. At that time, however, unemployment was rising sharply, the depth of the recession was uncertain, and state and local government budgets were showing large deficits. Given the continued expansion of job opportunities, and the improved situation for state and local government budgets, more attention will focus on those with the greatest difficulty finding work. As a result, these recommendations may

^{1/} To discourage persons with little work experience, and hence a very short UI entitlement, from becoming unemployed so as to join the PSE program, there should be a minimum entitlement requirement. The program could, for example, be limited to persons with at least ten weeks of entitlement under the regular 26 week unemployment insurance program.

The maximum entitlement in FY 1977 will vary among the states from 39 to 65 weeks depending on whether FSB is operative in the state. If Special Unemployment Assistance is still in effect, the maximum duration under this program will remain 39 weeks. These different durations may raise equity issues in a program limited to exhaustees.

receive a more sympathetic hearing, as is suggested by the Senate attempt to limit the program extension to persons with at least 15 weeks of unemployment.

There are presently 50,000 PSE slots under CETA Title II and 260,000 under Title VI.^{1/} Although the President has proposed a gradual reduction in the size of the Title VI program, it appears that Congress will soon pass an extension that will retain the 260,000 level.

One response to this Congressional action would be to propose limiting eligibility in Titles II and VI to UI exhaustees, and adding funds only up to the level of the present Title VI. This would add \$0.7 billion to the budget outlays in 1977 and \$2.1 billion in 1978. If phased in as the present Titles II and VI slots were vacated, and if the turnover were complete by the end of 1977, 310,000 slots would become available for this purpose. If it were limited to Title VI, 260,000 slots would be available.^{2/}

It is important that this program not encourage workers to remain on UI until they exhaust their benefits and that the program not discourage participants from searching for a regular job. For these reasons, the jobs should have a finite life (e.g., a maximum of one year or 18 months) and offer low wages.^{3/} There are several different procedures for setting a maximum wage, including a tie to the minimum wage, a fixed dollar amount, or a proportion of prevailing wages in the CETA area. While the first two procedures

^{1/} Title II was intended to be a permanent program for areas with unemployment rates over 6.5 percent, providing transitional public service employment as a manpower development device. Title VI was the emergency program enacted in place of the President's 1974 proposal, and was intended to be countercyclical job creation. Locally, the programs are generally indistinguishable in terms of who they employ and for what reasons.

^{2/} It should be noted, however, that with more restrictive eligibility requirements, it will take longer to fill the job slots.

^{3/} In the President's October 1974 proposal, the wage limit was \$7,000. Congress has shown little sympathy for limiting wage rates on PSE jobs below \$10,000, and the current average is about \$7,800.



imply a uniform maximum wage across the country, the last implies a maximum wage that is higher in higher wage areas. The implications of alternative formulas warrant study.

It is difficult to estimate the number of persons who would be eligible for and wish to accept these public service jobs. The Department of Labor estimates that about 1.8 million persons will exhaust their entitlements (FSB, SUA and EB in states in which FSB has triggered off) in 1977. If the program excludes persons age 65 and over and excludes those whose regular UI entitlement was very short (say less than ten weeks), the number of participants may be reduced by 25 to 30 percent.^{1/} Some of the exhaustees would take a private sector job as these job opportunities continue to expand, while others would drop out of the labor force because of family responsibilities and school.^{2/} Among those still unemployed or discouraged workers, some proportion would prefer to remain unemployed rather than accept a low wage PSE job. Our limited knowledge of the behavior of exhaustees does not provide guidance as to the size of this proportion. If 70 percent would accept the low wage PSE job, the number of UI exhaustees in 1977 eligible for and interested in the program would be about 380,000.^{3/} However, if only 50 percent would accept these jobs, the number would be about 270,000. At this stage in our knowledge, these estimates are not firm.

1/ The 1975 paper "Special Report to the Secretary of Labor on the Characteristics of Exhaustees," indicates that about 75 to 80 percent of FSB exhaustees were age 22 to 64. Some adults, particularly married women, have short entitlements because of limited work experience.

2/ We lack adequate data on the experiences of recent exhaustees. One study of exhaustees in 1971-72 suggests that two months after exhausting benefits about 40 percent were still unemployed or were discouraged workers.

3/ This is obtained from the following assumptions: 1.8 million exhaustees, of whom 75 percent are eligible, of whom 40 percent are still unemployed or discouraged workers, of whom 70 percent would take the job.



PSE job slots that are not filled by UI exhaustees may be set aside for out-of-school youths who, although eligible for at most only a short duration of benefits because of an insufficient work history, have experienced a long period of unemployment. There is, however, the concern that a dependency relationship would develop. To reduce the dependency relationship these jobs should be for a relatively short fixed term (e.g., up to six months), used only once by a youth and pay no more than the Federal minimum wage. This would be a small supplement to CETA Title I which provides job training, including some work experience, for about 1 million youths, exclusive of the summer youth program.

Another policy would be to target more of the CETA Title I training funds, including some part of those used for work experience, to the exhaustees of the unemployment compensation system. However, the greater the number of constraints placed by the Federal Government on state and local government prime sponsors, the further we have moved away from the original intent of the CETA program to allow prime sponsors to administer the program so as to satisfy what they perceive to be local manpower requirements. Since we now have had some experience with the CETA program, this may be an appropriate opportunity to reevaluate this policy. Even if it is decided to stay with the original intent of the CETA program, it would still be possible to provide financial incentives to local prime sponsors to use more of their CETA resources for UI exhaustees.



The FY 1977 budget includes \$1.3 billion for Title I block grants, and about \$50 to \$150 million could be available in combined Title I and III discretionary funds. Within the current budget estimates the targeting could be done in the following ways:

(a) Reverse current policy on the block grant approach for CETA and seek legislation to:

--establish in the statute a mandatory first preference for exhaustees, or the use of mandatory percentage of the Title I block grants for exhaustees; or

--establish in the statute the right of the Secretary to set preferences for who gets served and with how much.

(b) Reserve the Secretary's discretionary funds in whole or part for providing training for UI exhaustees.

(c) Develop a procedure for using the discretionary funds to provide incentives to Title I sponsors to use greater percentages of their block grant funds to serve exhaustees.



Issue 2 -- Youth Unemployment

Policy Recommendations

1. Propose a youth differential in the minimum wage or exempting the earnings of youths paid near the minimum wage from payroll taxes.
2. Establish an inter-agency group to work with the Department of Labor for expanding experimentation with exemptions to the minimum wage within the current FLSA framework.
3. Request that the Commission on Paperwork undertake a study of the impact of the paperwork burdens on the summer employment of youths, and consider ameliorative policies.

Discussion

The Administration's policy response to the high youth unemployment rate, beyond the general efforts to restore full employment has been manpower programs, including the Job Corps (CETA Title IV), and summer employment programs.

Our manpower training programs have typically addressed the problem of poor training either on the job or in school that may ultimately lead to low earnings. Particularly for youths, they also seek to temporarily reduce unemployment during the period of training or work experience. Such programs, however, are not necessarily designed to reduce unemployment permanently. The training programs may increase unemployment in the future if the training is for a high unemployment occupation (e.g., construction) or if it encourages a new round of job exploration after the training is completed.

Youths who appear to have the most severe learning disabilities or problems of adaptation to the school or work environment tend to have the most severe unemployment problem. The very characteristics that result in failure in school and in the labor market are likely to result in failure in specific government training programs. Thus far,

however, we lack adequate evaluations of the economic impact of the youth training programs.

The Summer Youth Employment Program provides work experience (averaging 20 hours per week) for disadvantaged youths who cannot find private sector employment. It is expected that about \$560 million will be spent this summer for almost 900,000 job slots at about the minimum wage for disadvantaged youths age 14 to 21. Although the summer youth programs are well liked by local governments, their net effect on teenage employment is not as large as the number of program participants since an unknown proportion of the youths would have found a private sector job if the program did not exist. It is expected that as the economy improves, the number of slots in the Summer Youth Employment Program will decrease.

There would be less need for Federal training and summer employment programs for teenagers if it were not for the job limiting impact of the Federal minimum wage. In the last decade, the Federal minimum wage for jobs covered prior to 1966 has increased at about the same rate as the adjusted average hourly earnings index. By itself, however, this would tend to contract relative job opportunities for youths since with a growing proportion of the labor force consisting of youths, one would expect a slower rise in youth wages than in average wages.^{1/} More important, perhaps, has been the dramatic expansion of coverage of the Federal minimum wage from 62 percent of private nonsupervisory workers in 1961 to about 85 percent in 1976, with the

^{1/} This will tend to have a reverse effect in the 1980's as youths become a smaller proportion of the labor force.

expansion primarily concentrated in the youth-intensive service and farm worker sectors.^{1/}

On the basis of research studies, the CEA estimates that a youth differential in the minimum wage of 10 percent (currently 23 cents) is likely to increase teenage employment by about 2 percent, or by about 150,000 jobs. With the youth differential it would be easier for teenagers to find jobs offering one-the-job training that would increase future earnings, thereby decreasing the need for federally subsidized training programs. The effect on adults of the increase in teenage employment is unclear.^{2/}

It may not be feasible to introduce a youth differential in the minimum wage. The minimum wage is not only an economic issue, but also a highly emotional and political issue. Many adult workers are concerned with competition from youths who do not have family responsibilities. Others believe that each job should provide earnings sufficient to support a family. These concerns need to be addressed when considering a teenage differential, or an alternative policy instrument with the same objective.

One means of achieving a favorable employment impact by lowering the effective minimum cost of employing a worker without lowering the minimum wage would be a reduction of employer paid social security taxes. This could be accomplished by permitting an exemption of employer contributions for teenagers earning near the minimum wage or through funding the employer contribution out of general revenues. The latter would explicitly introduce the far broader issue of general revenue financing of social security.

^{1/} In recent years, there has been an increase in job specific minimum wage exemptions authorized by the Department of Labor. The growth in exemptions is small compared to the expansion in coverage. Most of the exemptions are for students working in educational institutions.

^{2/} Although studies have found a significant adverse effect of the minimum wage on teenage employment, no net effects have been found for adults. However, these studies have not examined the impact of a teenage differential.

The waiver of the employer contribution would be the equivalent of a reduction in the minimum wage, and the CEA estimates that this would expand teenage employment by about 90,000 jobs.^{1/} If the waiver were limited to youths in the neighborhood of the minimum wage, based on the hourly earnings of teenagers as reported in the May 1976 CPS, the loss in payroll tax revenue would be about \$250 million per year.^{2/} The revenue loss per job created would then be about \$2,800 per year.

Social security taxes are only one of several non-wage costs of employment that are imposed by governments at various levels. Frequently, the paperwork burden and administrative cost of adding someone to the payroll are substantial in relation to earnings, particularly for low wage and part-time workers. In addition to social security taxes, adding someone to the payroll involves determination and paperwork with respect to Federal and state income tax withholding, unemployment insurance, workmen's compensation, Federal and state child labor laws, work permits, safety regulations, etc. No clear estimates appear to have been made of such costs in relation to part-time and summer employment of youths. They appear to be significant particularly for small firms that cannot afford automated data systems or personnel departments. It would be useful to have a task force to identify these costs, estimate their impact and analyze the feasibility of streamlining or eliminating some of these burdens. In particular, it would be useful for the Commission on Paperwork to undertake a specific

^{1/} This is based on the 5.85 percent social security tax rate paid by the employer and an estimated elasticity of 0.2.

^{2/} This is based on the following assumptions: For the 2.5 million teenagers reported as earning between \$2.00 and \$2.50 per hour, the average wage is \$2.30 per hour, they work 1,000 hours per year, the tax rate is 5.85 percent and 75 percent are in covered employment.



study of the paperwork burdens attendant to employing youths part-time or during the summer.

Another approach may be to expand Department of Labor exemptions from the minimum wage (i.e.; reductions in the applicable minimum wages) for part-time or full-time workers with low levels of productivity, such as youths and the disabled. This would circumvent the adverse effects of the minimum wage without an explicit violation of the minimum wage principle and without linking this issue to others, such as social security policy. Under current legislation the Department of Labor issued 802,000 exemptions in FY 1976 of which 614,000 were for students employed part-time in their educational institutions.

Although the Fair Labor Standards Act would permit an expansion of exemptions through changes in regulations, the economic and political impacts of such changes need to be examined. It may be useful to establish an inter-agency group to work with the Department of Labor for an expansion of experimentation with exemptions within the existing FLSA framework.

Although black teenagers have a higher incidence and a longer duration of unemployment than white teenagers, the racial difference narrows dramatically as the youths age a few years. Black youths tend to have fewer skills and earn lower wages than white youths. Job Corps-type training programs, summer employment programs, and a reduction in the effective minimum cost of employing youths may be particularly important instruments in providing black teenagers with job and training opportunities currently, and in providing the foundation for greater wages and employment security in the future.^{1/}

^{1/} In the absence of economic impact evaluations of the youth oriented training programs, it is not clear if program redesigns could result in more permanent benefits.

Issue 3 -- Unemployment Compensation System

Policy Recommendations

1. Require states to increase the extent of experience rating of firms in the unemployment compensation tax.
2. Treat unemployment compensation benefits as if they were labor market earnings in the Federal income tax and for the determination of social security benefits for retirees receiving both benefits.

Discussion

One major source of unemployment is the temporary layoff. About one-half of unemployed job losers (or about one-quarter of all of the unemployed) are on a temporary layoff. Persons on a temporary layoff are automatically counted as unemployed in the Current Population Survey (CPS) regardless of whether they search for work. Most do not search for other employment because they expect to return to their previous job, and they receive unemployment compensation in the interim. The incidence of temporary layoffs is greater, and the duration of the layoff when it occurs is longer, because of the incentives built into the unemployment compensation system.

The benefits under the regular state program are financed by taxes on the base wages of workers (currently, generally the first \$4,200 of earnings). However, the system has very weak experience rating and in some instances, no experience rating at all.^{1/} That is, for most

^{1/} Some states have no experience rating, that is, all employers pay the same tax rate (e.g., Washington, Hawaii, District of Columbia). For states with experience rating, the bands are typically quite narrow, from 1.5 to 3.3 percent of taxable wages. Some states, however, have wider bands. For example, the bands in Michigan are from 0.8 to 6.6 percent.

There is apparently more experience rating in the workmen's compensation system in which large firms, whether self-insured or not, are fully experience rated. The greater experience rating may arise because in most states private firms provide the insurance, and the states generally allow large firms to self-insure. Self-insurance is not a feasible alternative in the unemployment compensation system since a worker may be entitled to benefits on the basis of work experience with several employers.

firms an increase in layoffs (and hence unemployment insurance benefits for its workers) will have no effect or a very small effect on the firm's unemployment insurance taxes, largely because tax rates are set within very narrow bands. In addition, unemployment benefits are exempt from both Federal income and payroll taxes and are not treated as earnings in the social security test for persons who are "retired" and are receiving both benefits.^{1/}

These factors provide an incentive for firms to have more frequent layoffs, each of a longer duration, rather than keeping workers on the firm's payroll during slack periods. These provisions also benefit the firm's workers as they can receive higher wages when they are employed and tax-free unemployment benefits when they are on a layoff. This, in effect, subsidizes firms with high layoff experiences due to seasonal, cyclical or random events at the expense of firms with stable employment. It thereby increases the magnitude of measured unemployment consistent with noninflationary full employment by artificially reducing the cost of unemployment to workers and employers.

If firms were required to pay higher UI taxes if they used temporary layoffs more frequently, there would be a greater incentive to retain workers on the payroll during periods of slack work. If workers had to pay taxes on their unemployment compensation benefits, the net monetary gain from being unemployed compared to working would be reduced, and workers would have an incentive to discourage the use of temporary layoffs. It would also reduce the incentive of retirees and others to become and remain unemployed.

^{1/} The Treasury Department estimated that in FY 1974 the revenue loss from not treating any unemployment compensation benefits as taxable income in the Federal income tax was \$1.05 billion, under an implicit marginal tax rate on unemployment benefits of 18 percent. About 40 percent of the loss in revenues was from families earning \$15,000 or more (AGI) in 1974. The estimated tax loss is \$3.0 billion for FY 1976 and \$2.4 billion for FY 1977.



By itself, full experience rating would not mean an increase in taxes on average. It would, however, mean an increase in taxes for firms whose workers are subject to relatively high levels of unemployment, and lower taxes for firms with better unemployment records. To the extent that the movement to full experience rating lowers unemployment insurance claims, payroll taxes could be reduced.

The unemployment insurance system was developed during the depression when payroll taxes were small, and the income of nearly all payroll workers was below the exemption level of the Federal income tax. In that environment the Treasury Department regulation (1938) exempting unemployment compensation benefits from taxation was a reasonable administrative convenience. Currently, however, the tax exemption creates inefficiencies in the incentive for greater unemployment. It also creates inequities since for two persons with the same weekly wage the benefits replace a greater proportion of lost wages for the person from the higher income (higher marginal tax bracket) family.^{1/}

If benefits were taxed as earnings, and benefit levels were unchanged, after-tax benefits would decline for recipients in families with a non-zero marginal Federal income tax rate. The decline would be larger the higher the recipient's family income. Under present legislation, there is no Federal standard for unemployment compensation benefits. However, one

^{1/} This situation often arises when a secondary wage earner in a multi-worker family goes on unemployment insurance.

would expect that at least some state governments would raise the benefit levels to "offset" the tax effect. Several different formulas could be used. For example, benefits could be increased by the extent of the marginal Federal income tax rate applicable to the average recipient from a low-income family,^{1/} or alternatively, the rate applicable to the average recipient. The latter would, of course, imply a larger increase in pre-tax benefits and a larger increase in the tax rate. To the extent that average after-tax benefits decline, the perverse incentive effects in the unemployment insurance system are reduced.

The Administration should encourage the forthcoming National Commission on Unemployment Compensation to study intensively the issues of experience rating and the taxation of benefits.

^{1/} This rate may be zero, depending on the definition of "low income."

Issue 4 -- Reducing Barriers to Occupational and Geographic Mobility

Policy Recommendation

1. Establish a task force to examine:

- (a) The extent to which Federal and state occupational licensing laws and other regulations can be modified to provide a more efficient utilization of labor resources.
- (b) The effect on employment of Federal efforts to reduce discrimination in the public and private sectors of the economy.
- (c) Federal programs that are intended to facilitate geographic and job mobility.

Discussion

One means of expanding productive job opportunities is to reduce barriers to job mobility that result in a less efficient utilization of labor resources. This would tend to lower frictional and structural unemployment. Some barriers to job mobility are warranted. For example, there clearly need to be some restrictions on who can be a physician. Other barriers to job mobility are clearly inefficient and are either anachronisms or are intended to maintain artificially high wages for persons in the "protected" sector.

Although occupational licensing had been largely a state function, the increased Federal intervention in the workplace (OSHA), training subsidies (CETA, health practitioners), and subsidies to industries (maritime, railroads,



health care reimbursement) have increased the Federal interest and role in this area. And, the government clearly has an important role to play in reducing discrimination in training and employment, that is, on the use of criteria not related to productivity. The purpose of the task force would be to identify areas where Federal or state legislation and regulations can be modified to generate a more efficient allocation of labor resources.

The task force would also examine the effectiveness of current Federal programs, both regular and experimental, that are intended to facilitate geographic mobility or job mobility within a geographic area. These include the Employment Service, the computer job matching program, trade adjustment assistance and migration assistance.

MEMORANDUM TO EPB EXECUTIVE COMMITTEE

FROM: Barry R. Chiswick and Burton G. Malkiel

SUBJECT: Policies to Cope with Structural and Induced Unemployment

The Nature of Unemployment

There is a popular misconception, all too often reinforced by misguided public policy, that if 7-1/2 million Americans are unemployed on average in a year, it is the same 7-1/2 million persons who are unemployed throughout the year. In fact, most unemployment is of relatively short duration. The situation is more like having 25 million Americans unemployed for some part of the year with the typical duration of unemployment being something like 7 to 8 weeks. This is why the Administration generally has not favored public service employment or public works programs. Such programs are not a solution for the problem of short duration unemployment. Indeed, by taking workers out of the job search process, they may actually inhibit the finding and acceptance of productive private sector employment.

We must not, however, be misled by averages. There is, to be sure, considerable long duration unemployment at the present time. For example, while only 32 percent of the unemployed in July 1976 were out of work for 15 weeks or longer, 17 percent were unemployed for 27 weeks or longer. It is this group that suffers the most serious hardship from unemployment and to which public policy must be especially concerned. And some demographic groups have relatively high rates of unemployment. Although the unemployment rate in July was 7.8 percent, it was 16.3 percent for white teenagers and 34.1 percent for black teenagers.

Some of the unemployment in our economy is "frictional," that is, arising from normal economic change -- the growth or decline of firms, changing productive techniques, labor force entry and the search for better wages and working conditions. Some unemployment is "cyclical," a result of the recent recession. Another part might be considered "induced." The availability of unemployment benefits, including long duration benefits, and the difficulty of effectively enforcing a work test may have induced some to be unemployed who otherwise might have been employed or dropped out of the labor force. Finally, some unemployment is "structural," that is, resulting from a lack of training, the obsolescence of a skill, old age, geographic mismatches of jobs and workers, or artificial barriers to wage rate adjustments.

The available data do not allow us to distinguish among the different types of unemployment. We do, however, have a breakdown of the demographic characteristics of the unemployed. Older workers are more likely to be unemployed for a long duration than workers age 25 to 54. While it is true the very high youth unemployment rates are largely the result of a very high incidence of short duration unemployment, the considerable amount of long duration unemployment among youths, especially black youths, is clearly an important policy concern.

This paper sets out several issues concerning structural and induced unemployment. Issue (1) is related to the more immediate Presidential decision regarding the extension of public service jobs under CETA Title VI. It discusses limiting CETA PSE jobs to unemployment insurance exhaustees.

Issues (2) to (4) are concerned with more long-term policy decisions to increase employment opportunities and reduce the unemployment rate. Alternative means of reducing the minimum wage barrier to youth employment are discussed in issue (2). Unemployment induced by the present unemployment insurance system and ameliorative policies are considered in issue (3), while issue (4) is concerned with identifying means of reducing barriers to occupational and geographic mobility.

Presidential Decisions

In early June, the EPB presented to the President a discussion of several employment related bills. At that time, he decided to hold to the policy of phasing out the CETA Title VI (emergency employment) public service jobs, as there was continuing improvement in the economy. However, from May to July, although employment increased by 210,000, unemployment increased by 560,000, and the unemployment rate increased by 0.5 percentage point. This has heightened concern for the pace of improvement in job opportunities and in the unemployment situation.

The most immediate issue coming before the President is likely to be his position on the bill (H.R. 12987) to reauthorize Title VI of CETA, emergency public service jobs. House-Senate Conference is scheduled for August 24-25. The Senate version is a doubling of the program size to 520,000 slots. It would convert current slots as they become vacant, plus all new slots, to time-limited projects reserved for persons unemployed 15 weeks or longer or who have exhausted UI entitlement and who have family income below \$6,700.^{1/} The House version is a "such sums" reauthorization of the present design with technical amendments, one of which (allowing 15 percent vs. the present 10 percent of the grant to be used for non-wage costs) could reduce the total number of jobs funded. Current informal indications are that the Conference will come out close

^{1/} When the President proposed the emergency CETA PSE expansion in October 1974, he requested that the slots be reserved for unemployment insurance exhaustees. At that time, there was little Congressional sympathy for this requirement. With the change in economic circumstances, the Senate action indicates that such a proposal may have more support at this time.

to the House version and that there is a possibility that the total slot size which the report will suggest might not exceed the current 260,000. Within the next two weeks therefore there could be a Conference bill before the President, and if that becomes law, a 1977 supplemental appropriation bill of somewhere between \$700 million and \$2.8 billion shortly thereafter.

Issue (1) discusses the CETA PSE program and a means of targeting it to the long-term unemployed.

Issue 1 -- Long Duration Unemployment

Policy Recommendation

1. Reserve PSE job slots (CETA Titles II, VI) for persons with work experience who have exhausted their unemployment insurance entitlement.
2. Reserve CETA PSE job slots not filled for youths with long-term unemployment.
3. Target more of the CETA Title I training funds to UI exhaustees.

Discussion

Although most unemployment is characterized by high turnover and short spells of unemployment, some individuals are unemployed for a long period of time. During the very high level of unemployment of 1975 about 1.2 million persons (1.3 percent of the labor force) were unemployed 26 weeks or longer, 687,000 persons (0.7 percent) reported unemployment lasting at least 39 weeks, 157,000 (0.2 percent) reported 65 weeks or more and 79,000 (0.1 percent of the labor force) reported 99 weeks or more.

With the economic recovery there has been a sharp decline in long duration unemployment. After reaching a peak of 3.3 percent in December 1975, the long duration unemployment rate (those unemployed 15 weeks or longer as a percent of the labor force) has declined to 2.4 percent in July. In the coming months there will be a continued economic recovery and a continued gradual termination of very long duration unemployment benefits under the Federal Supplemental Benefits program as state insured unemployment rates decline. Both factors can be expected to lower the extent of long duration unemployment as reported in the Current Population Survey.

The nature and magnitude of any persisting long duration unemployment problem as the economy continues to recover from the recent recession are

unclear. It is not likely to be skill specific, but it may be somewhat regional if the automobile industry lags behind the rest of the economy. Far more likely, however, it will not be concentrated on the basis of occupation, industry or region, but may be experienced throughout the country by individual older workers with few skills or obsolete skills, and little incentive for retraining.

It is sometimes believed that public service employment is a useful remedy for this long duration unemployment. However, based on the characteristics of persons placed in CETA funded PSE job slots, it would appear that the current program is not addressing the problem of the long-term or hardcore unemployed.^{1/} Rather, it appears that state and local governments tend to select persons with favorable employment characteristics -- they tend to be prime age, male, and at least high school graduates (Table 1). In addition, they are not particularly handicapped in finding employment because of a physical disability, criminal record or limited knowledge of English.^{2/} Only 13 percent were receiving unemployment insurance benefits prior to starting PSE employment. This suggests that if they had in fact been unemployed it was either voluntary or of a very short duration. Thus, it appears that most of the persons currently in CETA PSE job slots would not have substantial difficulty finding private sector employment during the current economic expansion.

One policy to aid unemployment compensation exhaustees would be to limit PSE job slots to persons who had exhausted their entire entitlement,

^{1/} Persons whose public employment was created because of the PSE funding need not be the same persons the prime sponsors report as being in PSE job slots.

^{2/} Of the CETA Titles II and VI participants from July 1975 to December 1975, 3 percent were physically handicapped, 3 percent were offenders and 4 percent had a limited English speaking ability.

Table 1. Characteristics of Participants in CETA Titles II and VI and the Unemployed, Fiscal Year 1975 (percent)

<u>Characteristics</u>	<u>CETA</u>		<u>U.S. unemployed</u>
	<u>Title II</u>	<u>Title VI</u>	
Total	100.0	100.0	100.0
Sex:			
Men	65.8	70.2	54.9
Women	34.2	29.8	45.1
Age:			
Under 22 years	23.7	21.4	34.8
22 to 44 years	62.9	64.8	46.0
45 years and over	13.4	13.8	19.1
Education:			
8 years and under	9.4	8.4	15.1
9 to 11 years	18.3	18.2	28.9
12 years and over	72.3	73.3	56.0
Race:			
White	65.1	71.1	81.1
Black	21.8	22.9	
American Indian	1.0	1.1	
Other	12.1	4.9	
Spanish speaking	16.1	12.9	6.5
Limited English-speaking ability	8.0	4.6	--
Veterans:			
Special Vietnam era	11.3	12.5	7.5
Other	12.6	14.6	9.4

Source: Employment and Training Report of the President, 1976.

including Federal Supplemental Benefits.^{1/} Since this would be a temporary measure, not a permanent haven for the "unemployables," these jobs should have a finite duration (e.g., one year or 18 months). The expectation is that at the end of this period labor markets would be sufficiently tight for all but the very hardcore unemployed to find a regular job. Even if the replacement effect (i.e., using CETA funds for jobs that would exist in any case) would be as large under a PSE program limited to exhaustees as it is currently, limiting it to exhaustees would have a stronger net job creating impact for the economy as the program would be biased in favor of those with the greatest difficulty in finding regular employment. It would also demonstrate Administration concern for the long-term unemployed.

Limiting the PSE job slots to unemployment compensation exhaustees would, in effect, be a return to the President's original proposal in October 1974 which was rejected by Congress. At that time, however, unemployment was rising sharply, the depth of the recession was uncertain, and state and local government budgets were showing large deficits. Given the continued expansion of job opportunities, and the improved situation for state and local government budgets, more attention will focus on those with the greatest difficulty finding work. As a result, these recommendations may

^{1/} To discourage persons with little work experience, and hence a very short UI entitlement, from becoming unemployed so as to join the PSE program, there should be a minimum entitlement requirement. The program could, for example, be limited to persons with at least ten weeks of entitlement under the regular 26 week unemployment insurance program.

The maximum entitlement in FY 1977 will vary among the states from 39 to 65 weeks depending on whether FSB is operative in the state. If Special Unemployment Assistance is still in effect, the maximum duration under this program will remain 39 weeks. These different durations may raise equity issues in a program limited to exhaustees.

receive a more sympathetic hearing, as is suggested by the Senate attempt to limit the program extension to persons with at least 15 weeks of unemployment.

There are presently 50,000 PSE slots under CETA Title II and 260,000 under Title VI.^{1/} Although the President has proposed a gradual reduction in the size of the Title VI program, it appears that Congress will soon pass an extension that will retain the 260,000 level.

One response to this Congressional action would be to propose limiting eligibility in Titles II and VI to UI exhaustees, and adding funds only up to the level of the present Title VI. This would add \$0.7 billion to the budget outlays in 1977 and \$2.1 billion in 1978. If phased in as the present Titles II and VI slots were vacated, and if the turnover were complete by the end of 1977, 310,000 slots would become available for this purpose. If it were limited to Title VI, 260,000 slots would be available.^{2/}

It is important that this program not encourage workers to remain on UI until they exhaust their benefits and that the program not discourage participants from searching for a regular job. For these reasons, the jobs should have a finite life (e.g., a maximum of one year or 18 months) and offer low wages.^{3/} There are several different procedures for setting a maximum wage, including a tie to the minimum wage, a fixed dollar amount, or a proportion of prevailing wages in the CETA area. While the first two procedures

^{1/} Title II was intended to be a permanent program for areas with unemployment rates over 6.5 percent, providing transitional public service employment as a manpower development device. Title VI was the emergency program enacted in place of the President's 1974 proposal, and was intended to be countercyclical job creation. Locally, the programs are generally indistinguishable in terms of who they employ and for what reasons.

^{2/} It should be noted, however, that with more restrictive eligibility requirements, it will take longer to fill the job slots.

^{3/} In the President's October 1974 proposal, the wage limit was \$7,000. Congress has shown little sympathy for limiting wage rates on PSE jobs below \$10,000, and the current average is about \$7,800.

imply a uniform maximum wage across the country, the last implies a maximum wage that is higher in higher wage areas. The implications of alternative formulas warrant study.

It is difficult to estimate the number of persons who would be eligible for and wish to accept these public service jobs. The Department of Labor estimates that about 1.8 million persons will exhaust their entitlements (FSB, SUA and EB in states in which FSB has triggered off) in 1977. If the program excludes persons age 65 and over and excludes those whose regular UI entitlement was very short (say less than ten weeks), the number of participants may be reduced by 25 to 30 percent.^{1/} Some of the exhaustees would take a private sector job as these job opportunities continue to expand, while others would drop out of the labor force because of family responsibilities and school.^{2/} Among those still unemployed or discouraged workers, some proportion would prefer to remain unemployed rather than accept a low wage PSE job. Our limited knowledge of the behavior of exhaustees does not provide guidance as to the size of this proportion. If 70 percent would accept the low wage PSE job, the number of UI exhaustees in 1977 eligible for and interested in the program would be about 380,000.^{3/} However, if only 50 percent would accept these jobs, the number would be about 270,000. At this stage in our knowledge, these estimates are not firm.

^{1/} The 1975 paper "Special Report to the Secretary of Labor on the Characteristics of Exhaustees," indicates that about 75 to 80 percent of FSB exhaustees were age 22 to 64. Some adults, particularly married women, have short entitlements because of limited work experience.

^{2/} We lack adequate data on the experiences of recent exhaustees. One study of exhaustees in 1971-72 suggests that two months after exhausting benefits about 40 percent were still unemployed or were discouraged workers.

^{3/} This is obtained from the following assumptions: 1.8 million exhaustees, of whom 75 percent are eligible, of whom 40 percent are still unemployed or discouraged workers, of whom 70 percent would take the job.

PSE job slots that are not filled by UI exhaustees may be set aside for out-of-school youths who, although eligible for at most only a short duration of benefits because of an insufficient work history, have experienced a long period of unemployment. There is, however, the concern that a dependency relationship would develop. To reduce the dependency relationship these jobs should be for a relatively short fixed term (e.g., up to six months), used only once by a youth and pay no more than the Federal minimum wage. This would be a small supplement to CETA Title I which provides job training, including some work experience, for about 1 million youths, exclusive of the summer youth program.

Another policy would be to target more of the CETA Title I training funds, including some part of those used for work experience, to the exhaustees of the unemployment compensation system. However, the greater the number of constraints placed by the Federal Government on state and local government prime sponsors, the further we have moved away from the original intent of the CETA program to allow prime sponsors to administer the program so as to satisfy what they perceive to be local manpower requirements. Since we now have had some experience with the CETA program, this may be an appropriate opportunity to reevaluate this policy. Even if it is decided to stay with the original intent of the CETA program, it would still be possible to provide financial incentives to local prime sponsors to use more of their CETA resources for UI exhaustees.

The FY 1977 budget includes \$1.3 billion for Title I block grants, and about \$50 to \$150 million could be available in combined Title I and III discretionary funds. Within the current budget estimates the targeting could be done in the following ways:

(a) Reverse current policy on the block grant approach for CETA and seek legislation to:

- establish in the statute a mandatory first preference for exhaustees, or the use of mandatory percentage of the Title I block grants for exhaustees; or
- establish in the statute the right of the Secretary to set preferences for who gets served and with how much.

(b) Reserve the Secretary's discretionary funds in whole or part for providing training for UI exhaustees.

(c) Develop a procedure for using the discretionary funds to provide incentives to Title I sponsors to use greater percentages of their block grant funds to serve exhaustees.

Issue 2 -- Youth Unemployment

Policy Recommendations

1. Propose a youth differential in the minimum wage or exempting the earnings of youths paid near the minimum wage from payroll taxes.
2. Establish an inter-agency group to work with the Department of Labor for expanding experimentation with exemptions to the minimum wage within the current FLSA framework.
3. Request that the Commission on Paperwork undertake a study of the impact of the paperwork burdens on the summer employment of youths, and consider ameliorative policies.

Discussion

The Administration's policy response to the high youth unemployment rate, beyond the general efforts to restore full employment has been manpower programs, including the Job Corps (CETA Title IV), and summer employment programs

Our manpower training programs have typically addressed the problem of poor training either on the job or in school that may ultimately lead to low earnings. Particularly for youths, they also seek to temporarily reduce unemployment during the period of training or work experience. Such programs, however, are not necessarily designed to reduce unemployment permanently. The training programs may increase unemployment in the future if the training is for a high unemployment occupation (e.g., construction) or if it encourages a new round of job exploration after the training is completed.

Youths who appear to have the most severe learning disabilities or problems of adaptation to the school or work environment tend to have the most severe unemployment problem. The very characteristics that result in failure in school and in the labor market are likely to result in failure in specific government training programs. Thus far,

however, we lack adequate evaluations of the economic impact of the youth training programs.

The Summer Youth Employment Program provides work experience (averaging 20 hours per week) for disadvantaged youths who cannot find private sector employment. It is expected that about \$560 million will be spent this summer for almost 900,000 job slots at about the minimum wage for disadvantaged youths age 14 to 21. Although the summer youth programs are well liked by local governments, their net effect on teenage employment is not as large as the number of program participants since an unknown proportion of the youths would have found a private sector job if the program did not exist. It is expected that as the economy improves, the number of slots in the Summer Youth Employment Program will decrease.

There would be less need for Federal training and summer employment programs for teenagers if it were not for the job limiting impact of the Federal minimum wage. In the last decade, the Federal minimum wage for jobs covered prior to 1966 has increased at about the same rate as the adjusted average hourly earnings index. By itself, however, this would tend to contract relative job opportunities for youths since with a growing proportion of the labor force consisting of youths, one would expect a slower rise in youth wages than in average wages.^{1/} More important, perhaps, has been the dramatic expansion of coverage of the Federal minimum wage from 62 percent of private nonsupervisory workers in 1961 to about 85 percent in 1976, with the

^{1/} This will tend to have a reverse effect in the 1980's as youths become a smaller proportion of the labor force.

expansion primarily concentrated in the youth-intensive service and farm worker sectors.^{1/}

On the basis of research studies, the CEA estimates that a youth differential in the minimum wage of 10 percent (currently 23 cents) is likely to increase teenage employment by about 2 percent, or by about 150,000 jobs. With the youth differential it would be easier for teenagers to find jobs offering one-the-job training that would increase future earnings, thereby decreasing the need for federally subsidized training programs. The effect on adults of the increase in teenage employment is unclear.^{2/}

It may not be feasible to introduce a youth differential in the minimum wage. The minimum wage is not only an economic issue, but also a highly emotional and political issue. Many adult workers are concerned with competition from youths who do not have family responsibilities. Others believe that each job should provide earnings sufficient to support a family. These concerns need to be addressed when considering a teenage differential, or an alternative policy instrument with the same objective.

One means of achieving a favorable employment impact by lowering the effective minimum cost of employing a worker without lowering the minimum wage would be a reduction of employer paid social security taxes. This could be accomplished by permitting an exemption of employer contributions for teenagers earning near the minimum wage or through funding the employer contribution out of general revenues. The latter would explicitly introduce the far broader issue of general revenue financing of social security.

^{1/} In recent years, there has been an increase in job specific minimum wage exemptions authorized by the Department of Labor. The growth in exemptions is small compared to the expansion in coverage. Most of the exemptions are for students working in educational institutions.

^{2/} Although studies have found a significant adverse effect of the minimum wage on teenage employment, no net effects have been found for adults. However, these studies have not examined the impact of a teenage differential.

The waiver of the employer contribution would be the equivalent of a reduction in the minimum wage, and the CEA estimates that this would expand teenage employment by about 90,000 jobs.^{1/} If the waiver were limited to youths in the neighborhood of the minimum wage, based on the hourly earnings of teenagers as reported in the May 1976 CPS, the loss in payroll tax revenue would be about \$250 million per year.^{2/} The revenue loss per job created would then be about \$2,800 per year.

Social security taxes are only one of several non-wage costs of employment that are imposed by governments at various levels. Frequently, the paperwork burden and administrative cost of adding someone to the payroll are substantial in relation to earnings, particularly for low wage and part-time workers. In addition to social security taxes, adding someone to the payroll involves determination and paperwork with respect to Federal and state income tax withholding, unemployment insurance, workmen's compensation, Federal and state child labor laws, work permits, safety regulations, etc. No clear estimates appear to have been made of such costs in relation to part-time and summer employment of youths. They appear to be significant particularly for small firms that cannot afford automated data systems or personnel departments. It would be useful to have a task force to identify these costs, estimate their impact and analyze the feasibility of streamlining or eliminating some of these burdens. In particular, it would be useful for the Commission on Paperwork to undertake a specific

^{1/} This is based on the 5.85 percent social security tax rate paid by the employer and an estimated elasticity of 0.2.

^{2/} This is based on the following assumptions: For the 2.5 million teenagers reported as earning between \$2.00 and \$2.50 per hour, the average wage is \$2.30 per hour, they work 1,000 hours per year, the tax rate is 5.85 percent and 75 percent are in covered employment.

study of the paperwork burdens attendant to employing youths part-time or during the summer.

Another approach may be to expand Department of Labor exemptions from the minimum wage (i.e., reductions in the applicable minimum wages) for part-time or full-time workers with low levels of productivity, such as youths and the disabled. This would circumvent the adverse effects of the minimum wage without an explicit violation of the minimum wage principle and without linking this issue to others, such as social security policy. Under current legislation the Department of Labor issued 802,000 exemptions in FY 1976 of which 614,000 were for students employed part-time in their educational institutions.

Although the Fair Labor Standards Act would permit an expansion of exemptions through changes in regulations, the economic and political impacts of such changes need to be examined. It may be useful to establish an inter-agency group to work with the Department of Labor for an expansion of experimentation with exemptions within the existing FLSA framework.

Although black teenagers have a higher incidence and a longer duration of unemployment than white teenagers, the racial difference narrows dramatically as the youths age a few years. Black youths tend to have fewer skills and earn lower wages than white youths. Job Corps-type training programs, summer employment programs, and a reduction in the effective minimum cost of employing youths may be particularly important instruments in providing black teenagers with job and training opportunities currently, and in providing the foundation for greater wages and employment security in the future.^{1/}

^{1/} In the absence of economic impact evaluations of the youth oriented training programs, it is not clear if program redesigns could result in more permanent benefits.

Issue 3 -- Unemployment Compensation System

Policy Recommendations

1. Require states to increase the extent of experience rating of firms in the unemployment compensation tax.
2. Treat unemployment compensation benefits as if they were labor market earnings in the Federal income tax and for the determination of social security benefits for retirees receiving both benefits.

Discussion

One major source of unemployment is the temporary layoff. About one-half of unemployed job losers (or about one-quarter of all of the unemployed) are on a temporary layoff. Persons on a temporary layoff are automatically counted as unemployed in the Current Population Survey (CPS) regardless of whether they search for work. Most do not search for other employment because they expect to return to their previous job, and they receive unemployment compensation in the interim. The incidence of temporary layoffs is greater, and the duration of the layoff when it occurs is longer, because of the incentives built into the unemployment compensation system.

The benefits under the regular state program are financed by taxes on the base wages of workers (currently, generally the first \$4,200 of earnings). However, the system has very weak experience rating and in some instances, no experience rating at all.^{1/} That is, for most

^{1/} Some states have no experience rating, that is, all employers pay the same tax rate (e.g., Washington, Hawaii, District of Columbia). For states with experience rating, the bands are typically quite narrow, from 1.5 to 3.3 percent of taxable wages. Some states, however, have wider bands. For example, the bands in Michigan are from 0.8 to 6.6 percent.

There is apparently more experience rating in the workmen's compensation system in which large firms, whether self-insured or not, are fully experience rated. The greater experience rating may arise because in most states private firms provide the insurance, and the states generally allow large firms to self-insure. Self-insurance is not a feasible alternative in the unemployment compensation system since a worker may be entitled to benefits on the basis of work experience with several employers.

firms an increase in layoffs (and hence unemployment insurance benefits for its workers) will have no effect or a very small effect on the firm's unemployment insurance taxes, largely because tax rates are set within very narrow bands. In addition, unemployment benefits are exempt from both Federal income and payroll taxes and are not treated as earnings in the social security test for persons who are "retired" and are receiving both benefits.^{1/}

These factors provide an incentive for firms to have more frequent layoffs, each of a longer duration, rather than keeping workers on the firm's payroll during slack periods. These provisions also benefit the firm's workers as they can receive higher wages when they are employed and tax-free unemployment benefits when they are on a layoff. This, in effect, subsidizes firms with high layoff experiences due to seasonal, cyclical or random events at the expense of firms with stable employment. It thereby increases the magnitude of measured unemployment consistent with noninflationary full employment by artificially reducing the cost of unemployment to workers and employers.

If firms were required to pay higher UI taxes if they used temporary layoffs more frequently, there would be a greater incentive to retain workers on the payroll during periods of slack work. If workers had to pay taxes on their unemployment compensation benefits, the net monetary gain from being unemployed compared to working would be reduced, and workers would have an incentive to discourage the use of temporary layoffs. It would also reduce the incentive of retirees and others to become and remain unemployed.

^{1/} The Treasury Department estimated that in FY 1974 the revenue loss from not treating any unemployment compensation benefits as taxable income in the Federal income tax was \$1.05 billion, under an implicit marginal tax rate on unemployment benefits of 18 percent. About 40 percent of the loss in revenues was from families earning \$15,000 or more (AGI) in 1974. The estimated tax loss is \$3.0 billion for FY 1976 and \$2.4 billion for FY 1977.

By itself, full experience rating would not mean an increase in taxes on average. It would, however, mean an increase in taxes for firms whose workers are subject to relatively high levels of unemployment, and lower taxes for firms with better unemployment records. To the extent that the movement to full experience rating lowers unemployment insurance claims, payroll taxes could be reduced.

The unemployment insurance system was developed during the depression when payroll taxes were small, and the income of nearly all payroll workers was below the exemption level of the Federal income tax. In that environment the Treasury Department regulation (1938) exempting unemployment compensation benefits from taxation was a reasonable administrative convenience. Currently, however, the tax exemption creates inefficiencies in the incentive for greater unemployment. It also creates inequities since for two persons with the same weekly wage the benefits replace a greater proportion of lost wages for the person from the higher income (higher marginal tax bracket) family.^{1/}

If benefits were taxed as earnings, and benefit levels were unchanged, after-tax benefits would decline for recipients in families with a non-zero marginal Federal income tax rate. The decline would be larger the higher the recipient's family income. Under present legislation, there is no Federal standard for unemployment compensation benefits. However, one

^{1/} This situation often arises when a secondary wage earner in a multi-worker family goes on unemployment insurance.

would expect that at least some state governments would raise the benefit levels to "offset" the tax effect. Several different formulas could be used. For example, benefits could be increased by the extent of the marginal Federal income tax rate applicable to the average recipient from a low-income family,^{1/} or alternatively, the rate applicable to the average recipient. The latter would, of course, imply a larger increase in pre-tax benefits and a larger increase in the tax rate. To the extent that average after-tax benefits decline, the perverse incentive effects in the unemployment insurance system are reduced.

The Administration should encourage the forthcoming National Commission on Unemployment Compensation to study intensively the issues of experience rating and the taxation of benefits.

^{1/} This rate may be zero, depending on the definition of "low income."

Issue 4 -- Reducing Barriers to Occupational and Geographic Mobility

Policy Recommendation

1. Establish a task force to examine:
 - (a) The extent to which Federal and state occupational licensing laws and other regulations can be modified to provide a more efficient utilization of labor resources.
 - (b) The effect on employment of Federal efforts to reduce discrimination in the public and private sectors of the economy.
 - (c) Federal programs that are intended to facilitate geographic and job mobility.

Discussion

One means of expanding productive job opportunities is to reduce barriers to job mobility that result in a less efficient utilization of labor resources. This would tend to lower frictional and structural unemployment. Some barriers to job mobility are warranted. For example, there clearly need to be some restrictions on who can be a physician. Other barriers to job mobility are clearly inefficient and are either anachronisms or are intended to maintain artificially high wages for persons in the "protected" sector.

Although occupational licensing had been largely a state function, the increased Federal intervention in the workplace (OSHA), training subsidies (CETA, health practitioners), and subsidies to industries (maritime, railroads,

health care reimbursement) have increased the Federal interest and role in this area. And, the government clearly has an important role to play in reducing discrimination in training and employment, that is, on the use of criteria not related to productivity. The purpose of the task force would be to identify areas where Federal or state legislation and regulations can be modified to generate a more efficient allocation of labor resources.

The task force would also examine the effectiveness of current Federal programs, both regular and experimental, that are intended to facilitate geographic mobility or job mobility within a geographic area. These include the Employment Service, the computer job matching program, trade adjustment assistance and migration assistance.

MINUTES OF THE
ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE MEETING

August 31, 1976

Attendees: Messrs. Seidman, Lynn, Richardson, Rogers, MacAvoy, Malkiel, Gorog, Parsky, Darman, Katz, Penner, Porter, Hormats, Perritt, McDowell, Leach, Rosenblatt, Kamens, Butler, Spaulding

1. Report of Commodities Policy Coordinating Committee

The Executive Committee reviewed the report of the Commodities Policy Coordinating Committee on the International Resources Bank and the Common Fund.

The discussion of the Common Fund focused on the economic impact of the Fund on developing countries and on the United States; the current U.S. position on the Fund; the schedule of dates when the Fund will be considered, including the request for written comments on the Fund to UNCTAD by September 30, 1976, a preliminary meeting in late November 1976, and negotiations on the Fund in March 1977; the three basic options developed by the CPCC; and technical considerations with respect to the timing of U.S. statements on the Fund

The discussion of the International Resources Bank focused on the narrative description of the International Resources Bank and a set of questions and answers for policy guidance on the IRB to Administration officials.

Decisions

Executive Committee members were requested to provide Mr. Seidman's office with their comments and recommendations on the Common Fund options paper no later than September 7, 1976. The comments and recommendations should include both the departmental or agency position with respect to the alternatives outlined in the options paper as well as the departmental or agency view with respect to the issue of timing.

The Executive Committee approved the CPCC recommendation that the United States not submit written comments to UNCTAD on the Common Fund proposal by the September 30 deadline.

The Executive Committee approved the description of the International Resources Bank and the set of Q&As to be used as policy guidance for Administration spokesmen. The Executive Committee also agreed that the description of the International Resources Bank would not include: (1) giving the IRB authority to act as a residual guarantor against commercial risk for any obligations in a trilateral contract which is part of an IRB sponsored project; (2) giving the IRB authority to raise funds for specific projects by issuing bonds in its own name; and (3) giving the IRB authority to provide supplemental buffer stock financing.

2. U.S. Performance on Multilateral Aid

The Executive Committee reviewed a memorandum, prepared by the Department of State, on "U.S. Multilateral Aid Giving Performance." The discussion focused on the U.S. performance with respect to fulfilling announced commitments to specific multilateral aid institutions, the overall performance of the U.S. vis-a-vis other developed countries in providing official development assistance, and the relationship of the U.S. aid performance and our position on the Common Fund and other objectives of the LDC

Decision

The Executive Committee requested Treasury to prepare a paper outlining the substantive decisions and schedule for decisions relating to U.S. commitments to multilateral aid institutions in order to develop an Administration position prior to the annual World Bank/IMF meetings the first week in October.

EYES ONLY
RBP