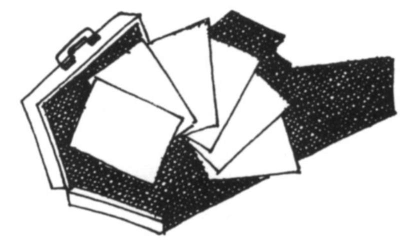

Conference Papers

The following excerpt is adapted from papers presented at the Thirty-First Annual Meeting of the Industrial Relations Research Association, Aug. 29–30, 1978, in Chicago, Ill.

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Structural unemployment without quotation marks

CHARLES C. KILLINGSWORTH

In October 1963, the chairman of the Council of Economic Advisers told a Senate committe that a huge tax cut by itself would achieve the "interim full employment target" of 4-percent unemployment and that so-called structural problems would be no obstacle at all. Therefore, the chairman said, the big tax cut was properly the "centerpiece" of the Administration's economic policy.[1]

In July 1978, the present chairman of the council told a White House press conference that more and more the data show that unemployment must be attacked by aiming policies at specific structural problems that are endemic in the economy and society.[2]

When the 1963 chairman spoke, the latest reported unemployment rate was 5.6 percent of the labor force. When the 1978 chairman spoke, the latest reported rate was 5.7 percent of the labor force. I think it is fair to say that the present chairman was facing in almost exactly the opposite direction from his predecessor of 15 years before. And his 1978 statement was no surprise.

There was a time when reputable economists would not write the word, "structural," without putting it in sanitizing quotation marks, and they would not speak the word without a snicker and a wink. Times have changed. In 1978, "structural problems" has become almost a vogue phrase in Washington. Congressional committees now write long reports about structural unemployment without a quotation mark in sight. Administration spokesmen regularly present testimony and speeches about structural unemployment without a sign of a snicker. Even some academic economists write articles explaining in detail how tough the problem of structural unemployment has become.

Change in perceptions or reality?

Has the world of reality changed so much over the past 15 years or is it only our perceptions of reality that have changed? Undoubtedly, "some of both" is the safest answer. But I believe that perceptions have changed much more than reality has. Many of the assertions, analyses, and predictions that were relied upon in the early 1960's to discredit the idea of structural unemployment as a serious obstacle to full employment have themselves been discredited. John Kenneth Galbraith remarked some years ago that, "The enemy of the conventional wisdom is not ideas but the march of events."[3]

Structural unemployment, to put the matter as briefly as possible, is joblessness—usually long-term—which results from basic changes in the economic structure: new technology, the decline of some industries and the growth of new ones, geographic relocation of industries, permanent changes in consumer tastes, changes in labor force characteristics, and so on. In the late 1950's, there was abundant evidence of such structural changes in the United States since World War II, and unemployment rates did vary greatly as between various labor force groups and various localities.

Nevertheless, President Kennedy's Council of Economic Advisers, in its first public utterances, rejected the idea that structural changes were responsible for the upward creep of prosperity unem-

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unemployment rates. The council elaborated this view in later statements, with its fullest statement in Senate hearings in the fall of 1963.[4] The essence of the council's view can be stated as follows: Structural change does create unemployment and other human problems, but there is no evidence that structural unemployment has increased at all since the end of World War II; it is certainly not the cause of higher and higher levels of prosperity unemployment. The real cause is the growth of "fiscal drag," which is the tendency of the progressive tax system to increase revenues more rapidly than government spending increases during a recovery period. This fiscal drag, the council argued, had repeatedly choked off recovery before full employment was reached. The remedy was a large tax cut. (The amount was originally set at $10 billion, but the ultimate value was $13 billion.) The tax cut would stimulate aggregate demand sufficiently to reduce unemployment to 4 percent, and everybody would benefit. But the council said again and again the benefits would not be equal—the greatest benefits would go to the labor force groups and geographic areas where unemployment was the highest. The unemployed worker would not get a tax cut, but he would get a job that would be worth a lot more than any conceivable tax refund.[5]

Structural programs discounted

The council did not oppose the so-called "structural" programs—manpower training, worker mobility assistance, area redevelopment, and the like—but it warned that these programs could not have any significant effect on the unemployment problem as long as there was an inadequacy of aggregate demand. Only after the tax cut reduced the unemployment rate to the 4-percent level would the structural programs have any chance of success. When the council was advocating a $13-billion tax cut, the appropriation for activities under the Manpower Development and Training Act was about $130 million.[6] This is a ratio of about 100 to 1. The council expressed no dissatisfaction with that ratio.

The council's insistence that structural problems had not contributed to recent increases in prosperity unemployment rates rested squarely on the view of the labor market which was most frequently stated in economic theory textbooks. Thus, in its 1963 Senate Committee presentation, the council said:[7]

> [The structural analysis fails] to make any allowance for the proven capacity of a free labor market . . . to reconcile discrepancies between particular labor supplies and particular labor demands. If relative shortages of particular skills develop, the price system and the market will moderate them, as they have always done in the past. Employers will be prompted to step up their in-service training programs and, as more jobs become available, poorly skilled and poorly educated workers will be more strongly motivated to avail themselves of training, retraining, and adult education opportunities.

Those who came to be called "structuralists" offered an abundance of statistics to support their view that the Council of Economic Advisers and others of like mind had misdiagnosed the unemployment problem. There was general agreement that there had been a substantial amount of structural change in the economy since World War II. My basic contention was that technology and other kinds of economic change had developed some new characteristics in the postwar world.[8] Such developments as the dramatic decline of agricultural employment and the equally dramatic rise of employment in such fields as education, health care, and research and development had combined to "twist" the demand for labor—pushing down the demand for low-skilled, poorly educated workers, and pushing up the demand for highly skilled, well-educated workers. The labor force had partially adapted to this great shift. The numbers of workers at the lower end of the scale had decreased, and the numbers at the upper end had increased. And the labor market had guided most of those displaced in declining industries (like agriculture) to new jobs.

But there had been a growing lag in adaptation. The growth of the lag was shown, in my opinion, by rising unemployment rates among less-educated workers at the same time that unemployment rates for better-educated workers were falling. I granted that there was some validity to the fiscal drag argument. But it seemed quite unlikely that a sharp rise in aggregate demand would create many more jobs for less-skilled workers than for high-skilled workers. It seemed much more likely that excessive reliance on stimulation of aggregate demand would create inflationary bottlenecks in labor supply before an unemployment rate as low as 4 percent was achieved.

On a more general level, I argued that the council's depiction of the labor market as a powerful and efficient homogenizer of labor was contradicted by the conclusions of a number of empirical investigators of labor markets. One of them had summed up the consensus of the empirical investigators in these words: "Labor markets are less adequate than any other type of factor or product market in the economy."[9]

The counterargument

The most ambitious effort to refute the structural thesis with numbers originated in a 1961 staff study paper for the Joint Economic Committee for which Edward Kalachek was principally responsible.[10] The study undertakes to test two main propositions: [11]

> The structural transformation hypothesis maintains that unemployment has remained at relatively high levels in the period since mid-1957 in the face of adequate overall demand forces and despite the availability of a sufficient number of job opportunities.
>
> If structural transformations have led to higher unemployment, then . . . it will be heavily concentrated . . . among workers attached to blue-collar occupations and goods-producing industries. The rate of unemployment among these workers will be higher relative to the overall unemployment rate than it was earlier.

The author then calculated an "expected" unemployment rate for particular occupations and industries—originally, for 1960, and in a later version of the study, for 1962. The principal finding was that, for a majority of what were designated as the "technologically vulnerable groups," actual unemployment rates were *lower* than the "expected rate"; and for all blue-collar occupations together and all goods-producing industries together, the rise in unemployment rates was *less* than regression analysis of the 1948–57 experience would have suggested.

This study in its committee version, and in the updated council version, had a great impact on the discussion of the structural unemployment issue. The findings were cited again and again by the council in speeches, in Congressional testimony, and in its annual report. Other economists cited them frequently in speeches and articles. The verdict was virtually unanimous: no matter how you manipulated the data, there was little or no statistical evidence to support the structural hypothesis. Rarely has an economic proposition been so thoroughly tested and so completely demolished. The "structuralists" were, quite literally, derided from public platforms and in popular publications as well as in the professional journals.

The trouble with all of this was that the "structural transformation hypothesis" was not based on anything ever written or spoken by anyone identified with the structuralist view. Nobody had claimed that there was a sudden upsurge of structural change or of structural unemployment starting in mid-1957. Nobody had claimed that "overall demand forces" were adequate during the 1957-60 period, and nobody had claimed that "a sufficient number of job opportunities" was available throughout this period. Nobody had ever defined structural unemployment in such a way that it neatly coincided with the occupational and industrial categories used in labor force statistics. I repeatedly challenged the council's formulation of the structural hypothesis, and so did several others.[12] Nevertheless, even in the 1970's, books and articles were still appearing which treated this hoax as the authoritative statement of the structuralist position.

Soon the "march of events" provided another line of argument that was highly appealing in its simplicity and apparent conclusiveness. When the great tax cut was passed early in 1964, the reported unemployment rate was 5.4 percent. By the end of 1964, the rate was still about 5 percent. Then in 1965 the rate began to fall more rapidly—in fact, faster than the council had predicted. At the end of 1965, the rate was 4.1 percent. Thereafter, the decline was slower, but a low point of 3.3 percent was finally reached early in 1969.

As early as 1966, some of the participants in the debate of a few years before were pointing to the reduction in the unemployment rate as the final and unanswerable proof that the structuralist position had been completely mistaken. As the rate continued downward, other voices joined the chorus, and the theme was heard well into the 1970's. To cite but one comment, typical of many: "The history of the 1960's demonstrated that the American economy can reach unemployment rates of close to 3 percent through the use of simple fiscal and monetary policy."[13] It should be noted that among the authors who expounded this view were four recent presidents of the American Economic Association and—no doubt—some future presidents of that organization. Economists are noted for their disagreements; but here, at last, was a verity about which there could be no rational disagreement. The official figures were there for everybody to see, and the reasoning was simple and easy to understand.

An erroneous assumption

The trouble was that this generally accepted proposition rested on a grand fallacy. The implicit assumption is that nothing but the tax cut had a substantial effect on the unemployment rate between 1964 and 1969. This is a classic example of the *post hoc ergo propter hoc* fallacy. It is not hard to demonstrate that in fact there were other factors which, in combination, had a much greater effect on the unemployment rate than the tax cut did. These other factors included the Vietnam war, two changes in the definitions of employment and unemployment, and large increases in manpower and poverty programs.

By 1969, the Vietnam war had removed a large number of young men from the civilian labor force and had induced a substantial number of others to enroll as full-time students in colleges. By conservative estimating methods, it can be shown that these effects had reduced the reported unemployment rate by 0.9 percent by 1969.[14] The two sets of changes in the definitions of unemployment took place in 1965 and in 1967. The 1965 change was to count as "employed" the enrollees in certain manpower and government-subsidized employment programs (such as College Work-Study and Neighborhood Youth Corps) although historically the enrollees in comparable programs (such as WPA in the 1930's) had been counted as "unemployed." This change, plus expansion of the relevant programs, contributed 0.5 percent to the lowering of the unemployment rate by 1969.[15] The 1967 definition changes were estimated by the Bureau of Labor Statistics to reduce the reported unemployment rate by 0.2 percent by 1969.[16] There is no "double counting" involved in these estimates. The combined effect is 1.6 percentage points.

There were other significant effects. First, between 1965 and 1968, approximately 50 percent of the *new* blue-collar jobs that were created in the U.S. economy were in defense industries. Second, the employment of less-educated men *declined* despite the war boom from 1965 to 1969.[17] The labor market twist operated almost as strongly in the period of rapid expansion as it had during the period of stagnation.[18]

The reduction in the unemployment rate from 5.4 percent in early 1964 to the lowest monthly rate reported for 1969 (3.3 percent) is 2.1 percentage points. Factors *other* than pure and simple fiscal policy, or tax cuts, accounted for about three-fourths of that decrease. Thus, one may reasonably conclude that, in the absence of these other factors, the unemployment rate would not have fallen below about 4.9 percent. The actual decline below that level was caused by factors that are antithetical to the idea of a free labor market: a military draft and governmental programs of direct job creation. There is particular irony in the fact that many of our leading economists interpreted the effects of the draft and government job creation as proof of the power and efficiency of the free labor market.

The about-face

Through the late 1960's and into the 1970's, there were a few of us who continued to argue that the Vietnam war and the changes in the definitions of unemployment had only temporarily masked the problems of structural unemployment, and that these problems would reappear. But I strongly doubt that this continuing insistence on our part was a factor of any real significance in the about-face that has now taken place in Washington and in the hinterland. Galbraith was right. It was the march of events, not ideas, that overthrew the conventional wisdom about the basic causes of exececessive unemployment in the United States.

When the Vietnam war began to taper off, unemployment started to rise. The then chairman of the Council of Economic Advisers advised the Nation that this rise—to about 4 percent—was purely a "transitional" problem.[19] But the rise continued. In 1969, the average number of persons unemployed was 2.8 million. The average number unemployed in the 1970's thus far has been 5.7 million, or more than double the 1969 average. In the past 3 years, the average has been more than 7 million unemployed. If we applied the pre–1965 definitions of unemployment, the 3–year average would exceed 8 million.

Now I am not suggesting that these totals by themselves prove the validity of the structural viewpoint. What they do prove is that we have a severe problem of chronic and excessive unemployment. And the patterns which are indicative of structural problems have reappeared, some even more clearly than in the early 1960's. So the official diagnosis has changed. And in 1978, while Congress debated a tax cut of the magnitude of $15–20 billion, the expenditures on manpower programs were running at an annual rate of about $12 billion.

What led the aggregate demand school astray? Probably the most important factor was one which the Council of Economic Advisers, early in the day, called "the nub of the issue."[20] The aggregate demand group, as *general* economists, had a quasi–religious faith in "the market" as an extremely powerful, highly efficient regulator of the economy, and a corollary belief that labor markets were like all others. This faith affected their perceptions. They quickly and uncritically embraced "evidence" which seemed to support their preconceptions, and they almost automatically rejected as "implausible" and "insufficient" any evidence which was inconsistent with these preconceptions, such as my statistical demonstrations of the labor market twist.

Second, some of them misunderstood the data on which they relied. This country generates an enormous volume of numbers relating to employment, unemployment, and the labor market. There is no substitute for a painstaking and often tedious investigation of the characteristics and meanings of the numbers that you want to use. To cite one example, the occupational classification system—especially the highly aggregated version used in monthly labor force data—is of questionable utility for any purpose, and unemployment rates by occupation are probably the most questionable of all. Again, changes in the national average unemployment rate are produced by a multitude of factors, including such artifacts as definition changes. It should be obvious that a single factor, such as a tax cut, is not likely to be an adequate or accurate explanation for a large change in reported unemployment over several years. But what one aggregate demand supporter once wryly referred to as "the enthusiasm of advocacy" can dull the caution with which sweeping generalizations might otherwise be approached. One lesson which should be emphasized is that reliance on inappropriate statistics can be as misleading as reliance on unrealistic assumptions.

Different perspectives

In a broad sense, the aggregate demand-structural controversy carried into the public arena a conflict among economists that previously had been confined mainly to the groves of academe. Some economists preferred to draw conclusions about the economy and economic policy from the assumptions of perfect competition (and all that this implies); other economists preferred to draw conclusions from direct observation of economic behavior in the real world. Most of the aggregate demand supporters came from the former group, and most of the structuralists came from the latter group. The aggregate demand school relied primarily on the theoretical model of the labor market, which makes little or no distinction between labor markets and all other types of markets. The structuralists relied primarily on the large number of empirical studies of labor markets that were available in the early 1960's.

The common theme of the empirical studies is that the gritty reality of labor markets departs widely from the simplistic assumptions of economic theory. Knowledge is imperfect, mobility is limited, wage competition among employers is unusual, workers often behave differently from the theoretical "economic man," jobs are almost never redesigned (in peacetime) to adapt them to changes in the quality of labor available, and so on. The point is certainly not that labor markets are completely ineffective, or that the forces of competition and self-interest are nonexistent. Rather, the point is that labor markets and the forces that operate within them are often inadequate to overcome the imbalances that grow out of structural changes in the economy.

Because the structuralist view of labor markets now seems to have achieved rather general acceptance, some may ask, why rake over the dead coals of an old controversy? My answer is in two parts. First, the misdiagnosis of the causes of unemployment in the 1960's probably retarded the development of adequate employment policies for about 10 years. During that time, some aspects of the unemployment problem became even more intractable. And we still do not know nearly as much as we should about how to remedy the weaknesses and imperfections of the labor market. After we are sure what works best, we will still have the task of building institutions to apply the remedies. We tried the easy, palatable answer, and it was inadequate. Now we must work on a slow, laborious answer.

Second, the past errors of analysis have not been generally recognized and corrected. Some of the current forecasting models still incorporate the simplistic view that the decline in unemployment in the late 1960's was due entirely to fiscal and monetary policy, and this misreading of the past undoubtedly contributes to the impressive record of error in efforts to predict the future. The great overstatement of the effects of the tax cut of 1964 has recently led to proposals from the radical right to cut taxes by roughly $120 billion over the next 3 years. One somewhat unexpected result of this proposal is that some of the tax cut enthusiasts of the 1960's are becoming the nay-sayers of the 1970's. The 1964 tax cut was not really as effective as today's tax cutters claim, some old tax cutters are now saying—and besides, they suggest, there were other things happening that contributed to economic expansion in the 1960's. □

FOOTNOTES

[1] The CEA presentation is published in *Nation's Manpower Revolution.* Hearings before the Subcommittee on Employment and Manpower of the Committee on Labor and Public Welfare, U.S. Senate, 88th Cong., 1st sess. (Washington, 1963), Pt. 5, pp. 1769–96. A somewhat revised version of the same presentation appears in *Economic Report* for 1963 (published January 1964), as Appendix A, pp. 166–90.

[2] *The New York Times,* July 8, 1978, p. 1.

[3] John Kenneth Galbraith, *The Affluent Society* (Boston, Houghton Mifflin, 1958), p. 13.

[4] See footnote 1 above.

[5] This point was made most specifically in response to questioning at the Senate hearing, *Nation's Manpower Revolution*, p. 1794.

[6] The MDTA appropriation figure is from Garth L. Mangum, *MDTA: Foundation of Federal Manpower Policy* (Baltimore, The Johns Hopkins University Press, 1968), pp. 32–33.

[7] *Economic Report* for 1963, p. 181.

[8] My first major presentation on this matter was made to the U.S. Senate Hearings in 1963 (see footnote 1 above; my presentation appears on pp. 1461–1511). For a fuller statement, see "Structural Unemployment in the United States," in Jack Stieber, ed., *Employment Problems of Automation and Advanced Technology* (New York, St. Martin's Press, 1966), pp. 128–56.

[9] Lloyd G. Reynolds, *Labor Economics and Labor Relations*, 4th ed., (Englewood Cliffs, N.J., Prentice-Hall, Inc., 1964), p. 375.

[10] *Higher Unemployment Rates, 1957–60: Structural Transformation or Inadequate Demand*, Subcommittee on Economic Statistics of the Joint Economic Committee, 87th Cong., 1st sess. (Washington, 1961).

[11] *Ibid.*, p. 12.

[12] For my comments, see "Structural Unemployment in the United States" pp. 148–51 (although this essay was published in 1966, it was written and informally distributed rather widely in 1964). See also, Eleanor G. Gilpatrick, *Structural Unemployment and Aggregate Demand* (Baltimore, The Johns Hopkins University Press, 1966), pp. 10–14; and R. G. Lipsey, "Structural and Deficiency-Demand Unemployment Reconsidered," in A. M. Ross, ed., *Employment Policy and the Labor Market* (Berkeley, University of California Press, 1965), pp. 219–36.

[13] Lester C. Thurow, "Redistributional Aspects of Manpower Training Programs," in Lloyd Ulman, ed., *Manpower Programs in the Policy Mix* (Baltimore, The Johns Hopkins University Press, 1973), p. 84.

[14] Charles C. Killingsworth and Christopher T. King, "Tax Cuts and Employment Policy," in Robert Taggart, ed., *Job Creation: What Works?* (Salt Lake City, Olympus Publishing Co., 1977), pp. 14–17.

[15] Charles C. Killingsworth and Mark R. Killingsworth, "The Effects of Unemployment and Training Programs on Employment and Unemployment Statistics," a paper prepared for a conference cosponsored by the University of California at Los Angeles and the U.S. Department of Labor, 1978; forthcoming.

[16] Robert L. Stein, "New Definitions for Employment and Unemployment," *Employment and Earnings and Monthly Report on the Labor Force*, February 1967, pp. 3–27.

[17] Killingsworth and King, "Tax Cuts and Employment Policy," pp. 8–14, 16–17.

[18] *Ibid.*, pp. 8–14; for an earlier analysis, see Charles C. Killingsworth, "The Continuing Labor Market Twist," *Monthly Labor Review*, September 1968, pp. 12–17.

[19] Statement by Herbert Stein, reported in *The New York Times*, Mar. 13, 1970.

[20] *Economic Report* for 1963, p. 181.

A note on communications

The *Monthly Labor Review* welcomes communications that supplement, challenge, or expand on research published in its pages. To be considered for publication, communications should be factual and analytical, not polemical in tone. Communications should be addressed to the Editor-in-Chief, *Monthly Labor Review*, Bureau of Labor Statistics, U.S. Department of Labor, Washington, D.C. 20212.