

CHAPTER 4

The Labor Market

THE RECENT STRENGTH OF THE ECONOMY has created a large number of new jobs, and the unemployment rate is low by historical standards. Between January 1993 and December 1996, economic growth produced 11 million new jobs. At the end of 1996 the unemployment rate was 5.3 percent. Jobholding increased dramatically even among groups whose members traditionally have difficulty finding employment.

Economic progress has greatly benefited many American workers, but it poses important challenges as well. New technologies have led to explosive growth in some industries, but to the decline of others. With deregulation and expanding international trade, firms that once enjoyed market power and could share the resulting economic rents with their workers are now forced to compete more aggressively in the marketplace. Technological change and greater competition have eliminated the jobs of some workers, but many others have found new jobs in industries that these same powerful forces are causing to expand. Yet some workers may discover a mismatch between the skills they needed for their old jobs and those required in the newly expanding sectors. These workers are at risk of significant unemployment and may have to accept lower wages when they finally do find work. The benefits that come from an economy that has been strengthened by technological progress and more intense competition should be tempered by the recognition that these same changes may have hurt some working Americans.

To what extent have structural changes in the labor market reduced the well-being of American workers? Some analysts claim that a fundamental change in the nature of employment has taken place. While acknowledging the robust growth in the number of jobs, they maintain that this growth is concentrated in low-paying jobs, that wages overall are falling, that layoffs are increasing despite a growing economy, and that the promise of long-term employment on which many American workers rely can no longer be kept.

Recent studies suggest that these claims are exaggerated. Although it is true, as some critics point out, that the number of low-paying jobs has increased, that of high-paying jobs has increased even more rapidly. It is the jobs in the middle, the ones offering

wages close to the median, that have become somewhat scarcer. Layoffs, meanwhile, are not rising: the rate of job loss has actually declined somewhat, although it does appear that certain categories of workers previously less affected by job loss are now more at risk. Real, inflation-adjusted wages have generally been stagnant over the longer term, but standard methods of adjusting wages for inflation may have masked a real rise, and total compensation, including fringe benefits, has increased. Finally, some evidence indicates that the high level of average job tenure first identified in the early 1970s has changed little since then, although other recent research disputes this claim. This chapter examines these and other labor market trends in some detail, describes how workers have responded to these changes, and discusses policy alternatives to address some of the real problems that exist.

TRADITIONAL LABOR MARKET INDICATORS

Traditional indicators of labor market performance point to substantial improvement in the last few years. Perhaps the single most important indicator, the unemployment rate, is as low today as it has been at virtually any time in the last 20 years—and lower than it was through most of the economic expansions of the late 1970s and the mid- to late 1980s (Chart 4-1). The unemployment rate for the whole of 1996, at 5.4 percent, was below the rate for any full year since 1973, except for 1989 when the rate was 5.3 percent. And not only is the overall unemployment rate low, but groups that traditionally have experienced greater difficulty in finding jobs are doing better as well. For example, the unemployment rate for blacks in both 1995 and 1996 was almost a full percentage point lower than in any of the last 20 years.

The unemployment rate measures unemployment as a percentage of the labor force, not of the entire working-age population. It would be little cause for celebration if the unemployment rate has fallen merely because some jobless workers have become discouraged and have stopped seeking work, thus removing themselves from the labor force altogether. Recent data, however, strongly reject this explanation of today's low unemployment picture. Employment gains have been strong over the last 4 years: the employment-to-population ratio indicates that almost as large a share of the population is working now as at any time since annual statistics began to be collected (Chart 4-2).

THE QUALITY OF NEW JOBS

A large number of new jobs have been created over the past 4 years, but concerns have been expressed about the quality of these

Chart 4-1 Unemployment Rate

The unemployment rate in 1996 was as low as it has been at virtually any time since the early 1970s.

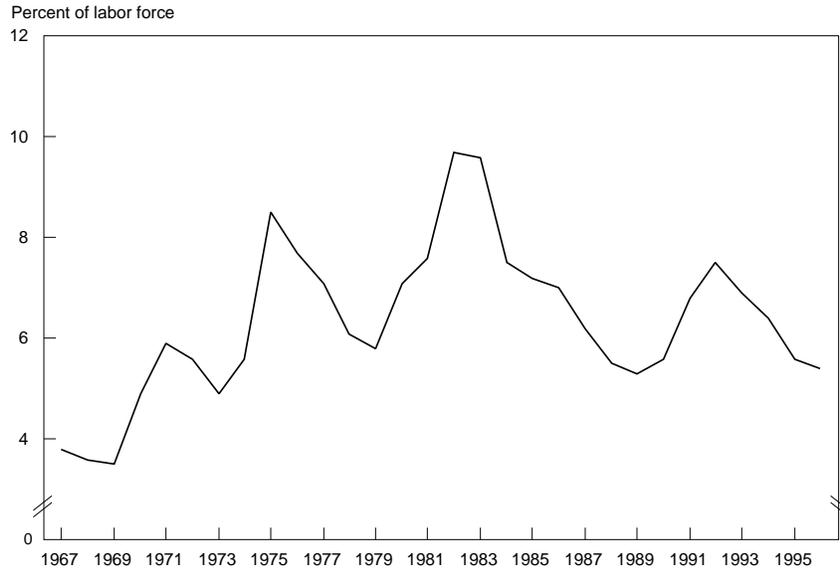
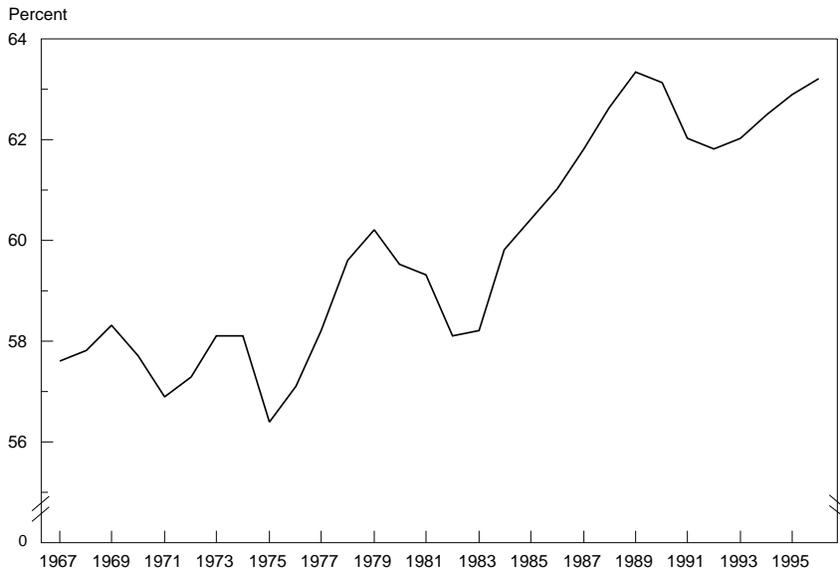


Chart 4-2 Employment-to-Population Ratio

The percentage of the population employed was near a record high in 1996.



jobs. Recent research finds that most of the new positions created in the 1990s are “good” jobs. The number of lower paying jobs also increased, however, as employment in the middle of the earnings distribution fell.

JOB GROWTH WITHIN SERVICE-PRODUCING INDUSTRIES

A disproportionate share of employment growth in the current expansion has occurred in service-producing industries. But contrary to the popular notion that service jobs are primarily low-paid positions, jobs in these industries are actually quite diverse, including many high-wage positions in such industries as financial services, health care, and computer and accounting services. For this reason it is important to determine at which end of the wage spectrum the employment growth within services has mainly occurred.

The evidence indicates that managerial and professional occupations have been the main contributors to recent job growth within service-producing industries, accounting for most of the net increase in employment in this sector occurring between February 1994 and February 1996 (1994 is chosen as the base year because the Current Population Survey, or CPS, underwent a major redesign that makes comparisons before and after 1994 difficult; see Box 4-1). Managerial and professional occupations within service-producing industries have been large contributors to employment growth in each of the past three major expansions. But gains in these occupations have been even more important in the current expansion. Employment increases in these generally higher paying occupations may not necessarily translate into high pay for workers immediately, but the greater opportunities for advancement in these jobs promise higher wages in the future.

ECONOMY-WIDE JOB GROWTH

A more detailed picture of recent job creation emerges from an examination of changes in employment within specific industry and occupational categories. A study conducted by the Council of Economic Advisers and the Department of Labor compared full-time employment in February 1994 with that in February 1996 in 45 specific occupations in each of 22 major industries, for a total of almost 1,000 industry/occupation “cells.” For each of the 287 cells in which employment was large enough to provide reasonably reliable within-cell wage levels, median weekly earnings as of February 1994 were determined, along with the median wage across all cells in that month. Employment growth between February 1994 and February 1996 in high-wage job cells, defined as those in which median earnings were above the overall median, was then compared with overall employment growth. The study found that 68

Box 4-1.—Effects of the Redesign of the Current Population Survey

The Current Population Survey (CPS), conducted monthly by the Bureau of the Census for the Bureau of Labor Statistics (BLS), is a major source of data regarding the U.S. labor market, including the monthly unemployment rate. In January 1994 the BLS revised the questionnaire to adjust for changes in work patterns and implemented computer-assisted interviewing to improve the quality of data collected.

The BLS estimates that the overall unemployment rate was not significantly affected by the redesign. This finding is contrary to early reports that the new survey produced a slight rise in measured unemployment. The new survey did change the measured composition of unemployment, however. For example, measured unemployment among 55- to 64-year-old workers and workers 65 and older increased by about 12 and 50 percent, respectively.

The breakdown of reported reasons for unemployment was also affected by the redesign. Whereas the old survey asked directly whether the unemployment spell began because of a quit or a lost job, now respondents must first report that they were working just prior to their unemployment spell before that question is asked. Evidently, asking the question directly induced some workers to report that their unemployment spell began for one of these reasons, because the number of workers classified as job losers or job leavers declined using the new survey. In addition, expanding the definition of previous work experience to include part-time work led to more workers being classified as reentrants rather than as new entrants.

The redesign also affected reported unemployment durations, because computer-assisted interviewing allows the interviewer to check whether a respondent's answers are consistent from month to month. Respondents used to overestimate short-term and underestimate long-term unemployment spells. These changes increased the proportion of spells longer than 14 weeks and decreased that of spells shorter than 5 weeks.

Other labor market indicators were also affected. Both the labor force participation rate and the employment-to-population ratio are about half a percentage point higher when measured using the new techniques.

percent of the net growth in full-time employment over this period occurred in these higher paying job categories.

The results of this research were similar to those reported in a BLS study that divided employment into 90 industry/occupation categories and then identified jobs in these categories as either high-, middle-, or low-paying. Between 1989 and 1995, employment in the high-paying and low-paying categories increased by 13 percent and 7 percent, respectively, while employment in the in-between category fell by about 3 percent.

An alternative disaggregation of jobs into extremely detailed occupational categories (also by the BLS) supports these findings. The BLS compiles responses from a full year of CPS data to examine wages and employment growth for almost 500 occupational categories. Between 1994 and 1995, some of the categories with the largest employment gains included sales supervisors and proprietors, electricians, marketing and advertising managers, and electrical and electronic engineers. Consistent with the Council's calculations, occupations in the top half of the wage distribution accounted for 70 percent of net employment growth.

FULL-TIME VERSUS PART-TIME JOBS

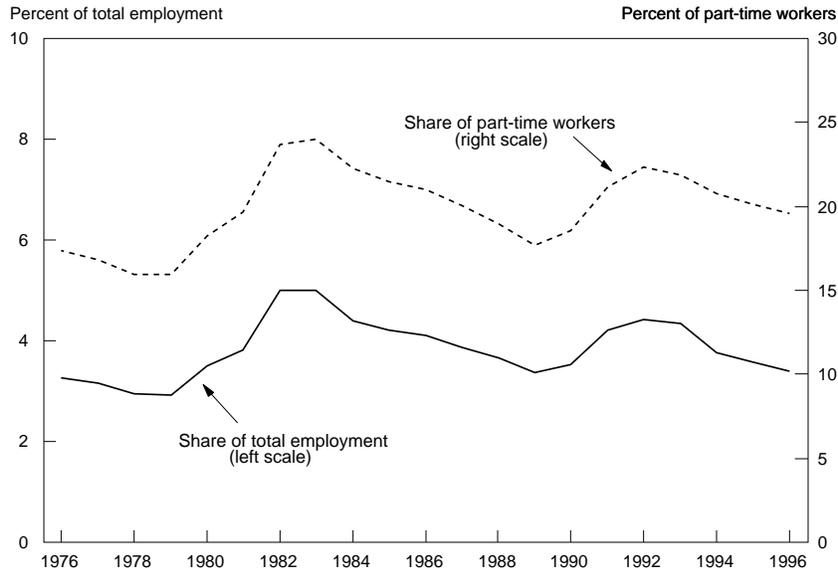
Even if today's new jobs are more likely than before to be in the higher paying sectors of the labor market, not all of these jobs provide workers with full-time employment. Data from the CPS provide an opportunity to explore trends in part-time employment. Chart 4-3 depicts the proportions of employed persons reporting that they work part-time for "economic" reasons (i.e., who would prefer a full-time job but cannot find one). Most of those who work part-time seem to do so by choice; moreover, the proportion of part-time workers who do so for "economic" reasons has been declining.

THE LEVEL OF WAGES

The economic growth of the 1980s produced only small real wage gains for workers. Moreover, real wages, when adjusted for inflation by consumer prices, have failed to keep pace with worker productivity since about 1983—a clear departure from the pattern of preceding years. (See Box 4-2 for a discussion of potential biases introduced in measuring consumer price inflation.) Although productivity growth has slowed, from around 2.8 percent per year before 1973 to 1.1 percent per year since, it has not stagnated; it therefore cannot explain these wage trends. After documenting the trends, the following discussion explores two possible explanations for them: changes in the relationship between the consumer price indexes, used for measuring real wages from the worker's perspective, and overall price indexes used for measuring real wages from

Chart 4-3 Part-Time Employment for Economic Reasons

The share of part-time workers who work part time for economic reasons and the level of such employment have declined recently.



Note: Data adjusted for the Current Population Survey redesign.
Sources: Department of Labor and Council of Economic Advisers.

the producer's perspective; and changes in the relationship between wages and total compensation, which includes fringe benefits as well as wages.

Box 4-2.—The Influence of Inflation Adjustments on Measured Real Wages and Incomes

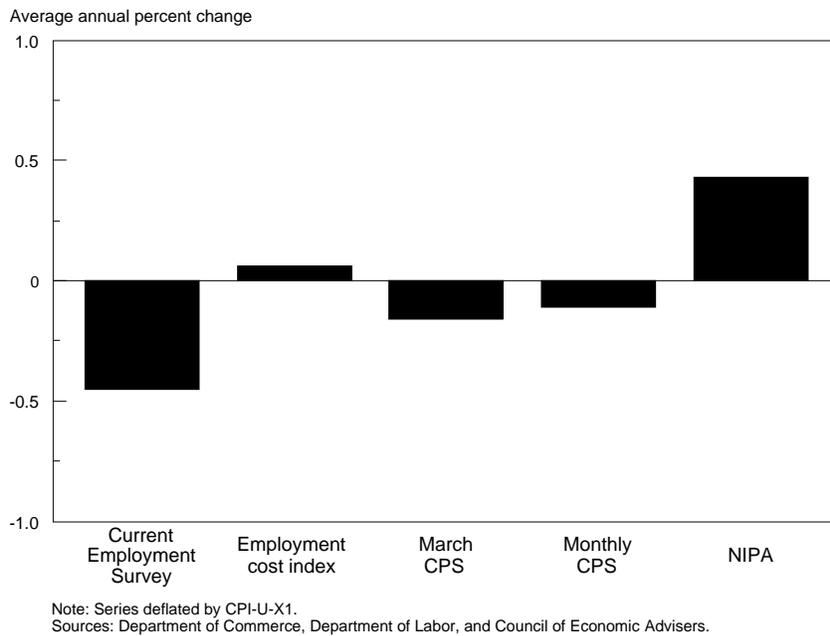
Standard analyses of wage and income trends use the CPI to adjust for inflation. But the CPI is a biased measure of the cost of living because it does not adjust for substitution between goods and may not fully account for changes in their quality—problems that are described more fully in Chapter 2. To the extent that the CPI overstates inflation, adjustments to wages and income using the CPI will understate actual growth in purchasing power.

Chart 4-5 displays trends in wages from the ECI, adjusted by the official CPI and adjusted by CPI inflation less 0.5 percentage point. If the CPI overstates inflation by 1/2 percentage point, real ECI wages have actually risen by almost 10 percent since the early 1980s. Trends in real income, described in the following chapter, show the same sensitivity to bias in inflation adjustment.

TRENDS IN WAGES

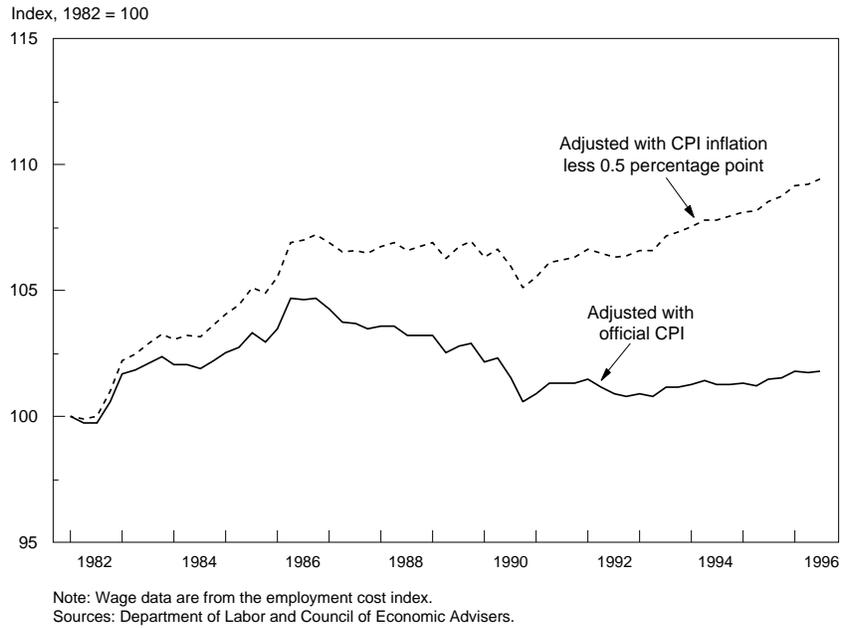
Chart 4-4 shows annualized real changes in wages and earnings over the past decade and a half using five different data sources (Box 4-3) adjusted for inflation by the consumer price index (CPI). For three of the sources, wages were virtually unchanged over the period. Changes in median real weekly and annual earnings for full-time workers, estimated from the monthly CPS and the annual March CPS, were similar to those from the employment cost index (ECI) despite several differences in methodology: the ECI data measure mean rather than median wage changes, compute hourly wages rather than weekly or annual earnings, and include part-time as well as full-time workers. Of the five series, only average hourly earnings, as measured in the BLS's Current Employment Statistics (CES) program, fell noticeably over this period. Unlike the other series, the CES covers only production and non-supervisory workers, who suffered relative wage declines in the 1980s.

Chart 4-4 **Measures of Annualized Real Wage and Earnings Growth Since 1982**
Most indicators show that real wages have remained relatively flat over the past 15 years.



An interesting feature of wage trends is that they display no apparent pattern over the business cycle. Economic theory does not offer a clear prediction of how real wages should move over the

Chart 4-5 **Alternative Inflation Adjustments to Wages**
 Real wage trends are understated if the CPI overstates inflation.



cycle. On the one hand, we might expect the greater demand for labor during an expansion to lead to real wage increases. On the other hand, as the economy expands, it puts into production its less efficient capital stock. To induce firms to do this, prices of the goods they sell must rise relative to wages, which means that real wages must fall. Empirically, the fact that aggregate measures of the real wage show little cyclical may indicate that these two effects are offsetting.

A difficulty in identifying changes in wages over the business cycle, however, is that the pool of employed workers changes. During recessions, lower skilled and less experienced workers are more likely than others to lose their jobs. When the economy recovers, these same workers become reemployed. Therefore, during an expansion the labor force is likely to include more low-paid workers; this depresses the average wage. Research shows that once the composition of the pool of employed workers is controlled for, the wages of male workers are considerably more procyclical than the aggregate wage statistics indicate.

WAGES VERSUS TOTAL COMPENSATION

The discussion so far has mainly focused on wages. However, for many purposes total compensation, which includes fringe benefits, may be a more useful measure. Although real wages have changed

Box 4-3.—Sources of Wage Data

Several data sources can be used to track trends in wages. Five commonly used sources are the following:

- The *March CPS*, conducted by the Bureau of the Census, reports median annual earnings for full-time, year-round workers for the preceding calendar year.
- The *monthly CPS*, conducted by the Census Bureau for the BLS, asks one-quarter of all respondents about their “usual” weekly earnings and hours worked on their main job, in order to estimate the median wage for all full-time workers. Earnings data from this source are reported quarterly.
- The *employment cost index*, produced by the BLS, is based on a survey of wages, salaries, and benefits in approximately 4,700 establishments in the private sector. Firms surveyed are chosen so as to maintain a constant industry and occupational mix of workers, to eliminate the effects of employment shifts between industries and occupations.
- The *Current Employment Statistics* survey, conducted by the BLS, obtains data from nearly 400,000 establishments in private nonagricultural industries regarding earnings and hours worked for all production and non-supervisory employees. The data can be used to construct a measure of average hourly earnings.
- The wage data in the *national income and product accounts*, produced by the Bureau of Economic Analysis, are based on quarterly earnings records for workers covered by State unemployment insurance. Data on the number of paid hours from the Current Employment Statistics survey are used to translate these quarterly data into mean hourly wage measures, and these data are supplemented by imputation for those workers not represented in that survey.

little in the last decade and a half, total compensation has risen modestly since the mid-1980s. Meanwhile fringe benefits, which comprise roughly 30 percent of total compensation, have risen sharply. This rise is driven primarily by rapid increases in the cost of employer-provided health benefits, which increased over 20 percent in real terms between 1982 and 1994. However, employer health costs have stabilized since 1994, reflecting some combination of slower increases in the prices of medical care services, a

shift toward managed care, increased premium cost sharing with employees, and a reduction in the share of the workforce with employer-paid health insurance (Box 4-4). In competitive labor markets, a rise in one component of compensation might be expected to lead firms to reduce another component, so as to keep total compensation in line with worker productivity. This may have happened during the 1980s and early 1990s, as wages remained relatively stagnant to compensate for sharply rising health benefit costs.

Even so, total compensation has risen more slowly than have increases in productivity, when nominal compensation is adjusted for changes in the prices of consumer goods. A possible explanation is that producer prices have fallen relative to consumer prices, largely as a result of the decline in the prices of many industrial goods, such as computers. From the perspective of firms, prices for all output, including investment goods, offer a better method of adjusting trends in compensation. Because firms hire an additional employee only if the cost of doing so is less than or equal to the value of that employee's output, a more appropriate measure to compare with productivity may be compensation adjusted for all output prices. As can be seen in Chart 4-6, changes in real compensation, when deflated by output prices, have tracked changes in total productivity more closely since the mid-1980s than when consumer prices are used for the adjustment.

JOB LOSS

The threat of losing one's job engenders justifiable anxiety, because job loss can result in a lengthy spell of unemployment and a long-lasting reduction in earnings even after a new job is found. Economic expansion creates dynamism in the labor market, with reallocation of workers across sectors, and in such periods growth in new jobs typically is sufficient not only to lower the aggregate unemployment rate and to create jobs for new entrants into the labor force, but also to accommodate those workers displaced from their old ones. Historically, the highest rates of job loss tend to occur during recessions. Some have claimed that it is high today for an expanding economy.

TRENDS IN THE RATE OF JOB LOSS

The Displaced Workers Survey, published by the BLS since 1984 as a biennial supplement to the Current Population Survey, has become an important source of data on job loss. This survey identifies workers who have lost jobs within the 3 to 5 years before the survey date, either because their plant closed or moved, because their position or shift was abolished, or because of insufficient work. The

Box 4-4.—Trends in Employer Health Care Costs

The cost to employers of providing health insurance to their employees rose more rapidly than inflation throughout the 1980s and early 1990s. Since then, however, this trend has reversed: in the past few years firms' health insurance costs have actually fallen in real terms. This turnaround is the result of a combination of factors including slower growth in medical expenditures, employers switching to lower cost managed care plans, declining health coverage of retirees, and, possibly, modest cost shifting to employees.

Slower Growth in Medical Spending. Overall private medical expenditures are increasing much more slowly than in the past. Premiums (employer and employee) at medium-size and large firms rose by about 11 percent in 1991 and 1992, but only 2.1 percent in 1995 and 0.5 percent in 1996. The move to managed care may help explain why growth in health costs has moderated so sharply. Not only are managed care plans cheaper, but their expansion may also be forcing the competing traditional plans to become more efficient.

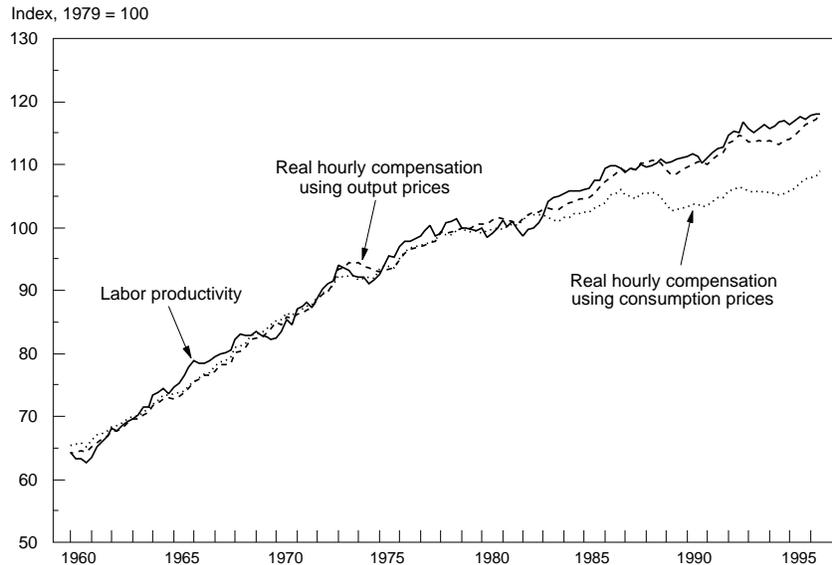
Coverage Trends. Over the past 15 years, employers have reduced the number of workers for whom they provide health insurance coverage. But most of that reduction occurred before the recent slowing in health benefit costs. However, employers have continued to decrease the share of their retirees eligible for health benefits.

Cost Shifting. Employers have tried to hold down rising health benefit costs by shifting more responsibility for premiums and other expenses onto employees. But this trend has moderated recently. Since 1992, the percentage of workers whose employers fully finance their health insurance has changed little. Nor has the average premium contribution that firms require their employees to make been modified much in recent years. Deductibles and out-of-pocket spending have increased little in the same period. One reason is that coverage has shifted dramatically into managed care plans, which typically have low copayments and deductibles.

survey, which is conducted in January or February of every even-numbered year, can be used to examine trends in displacement rates, the characteristics of dislocated workers, and the costs associated with permanent job loss. Most of the results reported in the survey, and all those reported here, reflect job displacement for so-called long-tenure workers: those who were employed in their previous job for 3 or more years. The rationale for this focus is that

Chart 4-6 Real Compensation and Labor Productivity

Real hourly compensation when deflated by output prices has risen at the same rate as productivity.



Note: Series refer to nonfarm business sector. Compensation measures are deflated by the consumption deflator for the real consumption wage and by the nonfarm business deflator for the real output wage.
Sources: Department of Commerce, Department of Labor, and Council of Economic Advisers.

individuals with lengthy job tenure are likely to have the most severe adjustment problems when displaced.

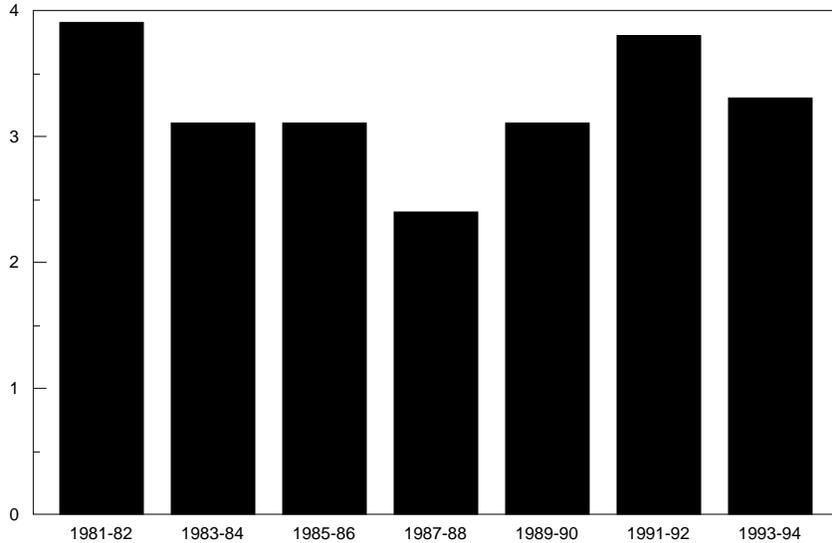
Chart 4-7 shows trends in the rate of job displacement among long-tenure workers since the early 1980s. As one might have expected from the deep recession of 1981-82, job dislocation rates were high during this period. As the economy recovered in the mid-1980s, displacement rates fell. The recession of the early 1990s again saw increasing rates of displacement: job loss in 1991-92 was as prevalent as it had been in 1981-82, even though the earlier recession was much more severe. Although displacement statistics from the 1993-94 period are calculated from unpublished data and may not be directly comparable to earlier years, displacement rates appear to have subsided to the level that prevailed for most of the late 1980s. Displacement rates were quite a bit lower, however, in 1987-88, even though the unemployment rate in those years was close to that in 1993-94. One may infer from these data that some of the problems of job loss are persisting even in the face of a healthy economic expansion.

Other measures, such as the monthly CPS, indicate that the rate of job loss has fallen significantly in recent years. The monthly CPS obtains information not only on labor market status, but also on the reasons why an unemployed worker began looking for work and the length of time spent looking. Job losers who are not on layoff

Chart 4-7 Displacement Rate Among Long-Tenure Workers

The rate of job displacement in 1993-94 was roughly comparable to that in most of the mid-1980s except for the 1987-88 period, when it was much lower.

Percent of long-tenure employment



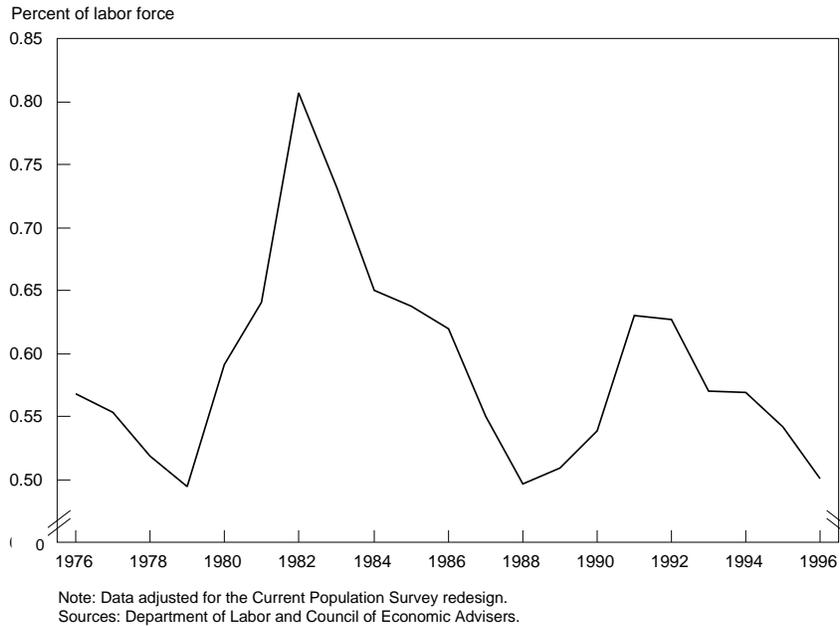
Note: Data after 1989-90 are adjusted for nonresponse and are not strictly comparable with data from earlier years.

Sources: Through 1991-92, Department of Labor. Calculations for 1993-94 are by H. Farber, Princeton University, using Department of Labor data and unpublished data.

may be thought of as “permanent” job losers, even though they may have been fired for cause or have some chance of eventually being recalled. The number of these job losers unemployed for less than 5 weeks is an indicator of the number experiencing permanent job loss. These data are valuable because the CPS is the standard survey of labor market behavior and because the data are available on a regular basis. However, displaced workers who find a new job without an intervening spell of unemployment are not captured by this measure. Chart 4-8 shows that job loss by this measure has declined over the last few years and is currently comparable to the rates observed throughout much of the late 1980s.

Initial unemployment insurance (UI) claims provide another measure of job loss. Initial UI claims have declined throughout the current expansion: weekly claims have fallen by about one-third since the 1990-91 recession. Although the share of unemployment spells that are compensated has declined over time, recent trends fairly accurately reflect changes in the number of workers who have lost jobs or been laid off. These data are obtained from the administrative records of the UI system and represent a complete count of layoff activity that leads to a UI claim, rather than a sample. The weaknesses of these data are that they include temporary as well as permanent job loss and that they do not capture job losses that do not lead to a UI claim.

Chart 4-8 Permanent Job Losers Unemployed Less Than 5 Weeks
 The percentage of unemployed workers who recently experienced a permanent job loss was low in the mid-1990s.



The distribution of job displacements has apparently changed over time. Workers in service-producing industries and white-collar occupations have become more vulnerable to job displacement, whereas blue-collar and manufacturing workers have become relatively less prone to lose their jobs. Thus, whereas service-producing industries accounted for about a third of all long-tenure displaced workers in the 1979–84 period, this sector’s share has recently climbed to over one-half. Similarly, white-collar workers represented about 40 percent of those displaced in the early 1980s but now constitute more than half of job losers. Older and more educated workers also are exposed to greater risk of displacement than in the past. The bottom line is that the risk of job loss is now spread over a wider cross section of employees.

THE COSTS OF JOB LOSS

The costs of losing one’s job include lost wages during any subsequent unemployment and any wage reduction or loss of fringe benefits that results when a new job is obtained. Displaced workers are now finding new jobs more quickly than in the past, thus reducing the first of these costs. Among workers displaced in the 1979–83 and 1981–85 periods, 60 percent and 67 percent were re-employed by 1984 and 1986, respectively. In contrast, 68 percent and 74 percent of workers displaced in the 1991–93 and 1993–95

periods were reemployed by 1994 and 1996, respectively, even though the shorter time period should have produced lower reemployment rates. The shift in the composition of displacement, from less educated to more educated workers, may explain some of the increase in reemployment probabilities, as more schooling generally helps ease workers' adjustment into alternative career paths.

Dislocated workers who find new full-time jobs often suffer a lingering decline in real earnings. Some evidence indicates that 6 or more years after displacement, the median displaced worker's earnings remain roughly 10 percent below what that worker might otherwise have expected to earn. That figure does not appear to have changed much over time. More educated workers appear to face smaller displacement costs, as their earnings losses are smaller than those of less educated workers. Furthermore, currently almost 15 percent of reemployed workers who had health insurance at their old jobs receive no such coverage from their new employers. However, this represents a considerable improvement from the early 1980s, when over one-quarter of previously insured displaced workers did not receive health insurance at their new jobs. Nevertheless, the costs of displacement are substantial for a large number of workers.

Taken as a whole, these results suggest that any sense of greater vulnerability to job loss is likely to be the result of a broadening of the risk of job displacement to groups of workers who had been relatively immune. Among those who do lose their jobs, the adjustment difficulties that follow job displacement are actually modestly less than in previous years.

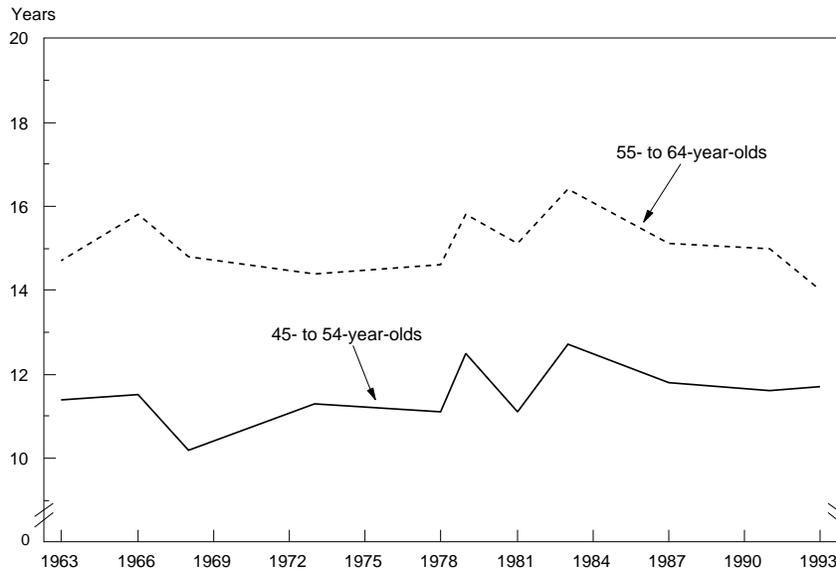
JOB STABILITY

A number of prominent U.S. firms that used to maintain policies of "lifetime employment" for their workers have recently abandoned those policies. These well-publicized reversals may have led to the widespread perception that jobs in general are less stable than they used to be. However, jobs at these firms probably never comprised more than a very small share of national employment. To arrive at a more accurate picture of job stability in the United States, one needs to examine the evidence for the labor market as a whole.

One well-known study that explored job duration in the 1970s found that many workers could reasonably look forward to "lifetime jobs." A significant proportion of workers held their jobs for 20 years or more. A more recent investigation shows that lifetime jobs are just as prevalent in the 1990s as they were during the 1970s. For instance, in 1993 the median 45- to 54-year-old male worker and the median 55- to 64-year-old male worker had been employed at their current jobs for about 12 and 14 years, respectively, and

over one-quarter of both groups had held their jobs for 20 years or more. These statistics are virtually identical to those obtained in several different surveys throughout the 1970s and 1980s (Chart 4-9), refuting the notion of a widespread reduction in employment stability.

Chart 4-9 **Median Job Duration for Males by Selected Age**
Job attachment between firms and workers has changed little over time.



Source: Unpublished calculations by H. Farber, Princeton University.

Job durations have changed for certain demographic groups, however. In particular, the trend toward greater female labor force participation is likely to have contributed to greater job tenure among currently employed women. Conversely, employment stability appears to have declined for high school dropouts.

A study conducted by the National Commission on Employment Policy, however, reported potentially contradictory evidence regarding job stability for the workforce as a whole. Using a method similar to the study just discussed, this study also found no change in employment stability. It also implemented an alternative method, using longitudinal data for each year of the 1970s and 1980s and examining respondents' answers to the question, "Did you have another main employer during the previous 12 months?" It found that the share of workers reporting having had another main employer two or more times in that period had increased between the two decades. Because these data pertain to other main jobs, they do not

necessarily provide direct evidence for job stability on the first job when workers hold multiple jobs.

WORKER ANXIETY

How have workers responded to the changes facing them in the labor market? Press reports suggest that a prevailing general sense of economic uncertainty has led workers to worry about their own prospects in the labor market. Researchers can get a reading of workers' anxiety over their economic circumstances in at least two ways. Public opinion polling directed at workers' sense of job security is one approach. Another is to examine aspects of worker behavior that are linked to feelings of security.

PUBLIC OPINION POLLS

For more than two decades, a leading nationwide opinion research organization has been asking workers, "How likely is it that you will lose your job over the next 12 months?" The proportion of respondents who believed that they were "not at all likely" to lose their jobs was lower in 1996 (51 percent) than in 1991 (about 60 percent), even though the economy was suffering through a recession in the earlier year. In fact, the low proportion of workers with this strong sense of job security in 1996 is similar to the unusually low level reached in 1983, shortly after the unemployment rate peaked at nearly 11 percent during the worst recession since World War II. However, the decline in the share of respondents who considered job loss "not at all likely" has been mirrored by an increase in the share saying that it was "not too likely." The share saying that it was "very or fairly likely" that they would lose their jobs has changed little. Accordingly, these polls suggest that more people than before are feeling a moderate, but not a high, risk of job loss.

At the same time, workers also express a perception that jobs are readily available. For many years a national business association has surveyed individuals about their views on the availability of jobs. The pattern of their responses has closely matched trends in unemployment. Another survey of consumer sentiment, conducted by the University of Michigan, also shows that consumer perceptions about the job market are consistent with economic conditions prevailing at the time. Appropriately, the current low level of unemployment is reflected in recent results from both these surveys, which indicate that workers are not overly concerned about job availability.

QUIT BEHAVIOR

Workers do appear to have changed their behavior in ways that are consistent with feelings of increased anxiety about their jobs. In particular, workers have become more reluctant to quit their jobs. Typically, during periods of prosperity, workers employed in jobs they feel are a bad match for them often quit to look for new work for which their skills would be more appropriate. Quits generally fall during recessions, when new jobs are harder to find. For any two comparable points in the business cycle, a lower overall quit rate may indicate greater worker anxiety, because it suggests that workers fear they will not be able to find or keep a new job if they quit their current one.

One measure of how many workers are quitting their jobs to look for new work is provided by the CPS, which reports the percentage of the labor force that has become unemployed within the previous 5 weeks because of having quit. Chart 4-10, which plots this measure, shows the expected strong cyclical pattern to quit behavior. The current expansion is no exception, although the rise is less sharp than that in the previous expansion, and quits fell slightly last year. Five years into the current expansion, quits are still considerably less prevalent than in the 1970s or 1980s—a finding that is consistent with lingering worker anxiety.

Chart 4-10 Job Leavers Unemployed Less Than 5 Weeks
The percentage of unemployed workers who quit their jobs in the last 5 weeks was relatively low in the mid-1990s given the length of the expansion.



Note: Data adjusted for the Current Population Survey redesign.
Sources: Department of Labor and Council of Economic Advisers.

POLICIES TO MITIGATE THE COSTS OF ECONOMIC CHANGE

The Federal Government has many policies and programs at its disposal to reduce the costs that economic growth and change impose on some workers. The main policy instrument that addresses some of the immediate needs of workers who lose their jobs is the unemployment insurance system. Other policies, such as mandatory advance notice of layoffs, may provide short-term benefits as well. Still other policies, including education and training programs, are vital for improving the longer term fortunes of those hurt by economic change. These are discussed briefly here and in more detail in Chapter 5.

UNEMPLOYMENT INSURANCE

Created in 1935 as part of the Social Security Act, the UI system has two main goals: to work as an economic stabilizer, expanding consumer spending during periods of heavy job loss, and to provide economic security for workers through income maintenance. The Federal Government maintains control over the broad design of the UI system, but States have considerable autonomy in tailoring the program's features within their jurisdictions. UI provides weekly benefits to workers who have been laid off or who have lost their jobs for reasons other than misconduct or a labor dispute. Only workers with a sufficiently long employment history (usually two calendar quarters of significant employment) are eligible. Benefits are a fraction of average weekly earnings on the job that was lost, up to a maximum dollar amount, and paid up to 26 weeks in most States. This fraction, called the replacement rate, is typically between 50 and 70 percent. Benefits are financed, in most States, by a payroll tax levied on firms.

UI benefits help workers weather periods of unemployment, since the benefits allow workers to maintain consumption patterns closer to those observed prior to the job loss. Another potential benefit of the UI system is that it may improve the match between workers and firms upon reemployment: UI may provide individuals the financial resources to prolong their job search until they receive an offer appropriate to their skills. However, little empirical evidence supports the proposition that longer search periods translate into better job matches, as measured by higher future earnings.

Although the UI system has benefited millions of workers over the years, these benefits do not come without costs. In particular, a significant body of evidence supports the contention that higher UI benefits lead to longer unemployment spells. Providing benefits to unemployed workers reduces their incentive to search intensively for a new job. Research suggests that a 10-percentage-point

increase in the replacement rate of UI benefits leads to an additional 1 to 1.5 weeks of unemployment, when an insured unemployment spell typically lasts roughly 15 weeks. Job-finding rates also increase somewhat as the exhaustion of benefits approaches.

Some States and the U.S. Department of Labor have investigated whether changes in the UI program can reduce unemployment durations and improve subsequent employment outcomes in a cost-effective manner. The research was undertaken in the form of controlled experiments. Workers were randomly assigned to treatment and control groups; those in the control groups received benefits under the rules of the existing program, while treatment-group participants were subject to an alternative, experimental set of rules. With random assignment, members of the different groups can be assumed to have similar characteristics, so that any differences in outcomes can be attributed specifically to the difference in policy.

The first set of experimental policies included job search assistance. Treatment-group members were eligible for services such as instruction in how to find a job, and for periodic meetings with employment counselors. These programs were generally found effective both in reducing unemployment durations and in increasing earnings during the first year or two following reemployment. One difficulty in interpreting the results, however, is that one cannot be sure whether the favorable effect was caused by the job search services themselves or by the more rigorous monitoring of worker search activities that accompanied them. Nevertheless, the apparent success of these experiments led the Congress to pass a law in 1993 requiring States to institute job search assistance for workers identified as likely to be hard to place.

States have also experimented with paying reemployment bonuses to workers who find jobs within a certain period after filing a UI claim; self-employment assistance programs with UI payments as support; and training programs targeted at dislocated workers. Of these, only the self-employment assistance programs yielded generally positive results. The proportion of unemployed workers starting their own businesses roughly doubled, although it remains quite low. Over an 18-month follow-up period, failure rates for these businesses were no different from those observed for businesses started by control-group members.

The reemployment bonus experiments yielded mixed results: in some but not all cases the savings in reduced UI benefits exceeded the costs of bonus payments and additional administrative expenses. It is also possible, however, that a more widespread use of bonuses would increase the share of workers filing UI claims.

Short-term training programs generally have not been as successful as other policies in improving the labor market outcomes of

dislocated workers—a result that contrasts with the findings of similar programs targeted at low-income, low-skilled workers. Programs to support longer term training—for example, those that provide funding for higher education—may yield significant benefits, but no formal, controlled experiment has so far examined such programs.

Changes in the economy have also had profound effects on the UI system. Most notably, the share of unemployed workers who received UI benefits has fallen dramatically since the early 1980s. This reduction has been attributed to demographic shifts in the workforce, a reduction in union membership, regional shifts in employment, and tightened State eligibility requirements. Payment of extended benefits during recessions (beyond the regular maximum duration) has been less likely, because the trigger that starts these payments is tied to an *insured* unemployment rate that now is a less reliable indicator of economic conditions. As a consequence, during the last two recessions the Congress authorized temporary emergency programs that did not depend on the extended benefits triggers. Such ad hoc adjustments may not be well timed to the beginnings and ends of recessions. The question of which is the correct trigger to use for this program has resulted in changes in the law, which now authorize States to adopt a *total* unemployment rate trigger for the extended benefits program if they so desire.

In addition, inflation has significantly eroded the value of the taxable wage base, upon which UI taxes are imposed. The Federal wage base, currently set at \$7,000, is not indexed for inflation and has fallen dramatically in real terms. (Although many States have a higher base, it is less than \$10,000 in most larger States.) Early in the life of the UI system, in the late 1930s, the taxable wage base was set at \$3,000 (over \$35,000 in 1996 dollars), and only relatively small, infrequent adjustments have been made since then. Such a low base makes the UI tax similar to a head tax that is disproportionately levied on firms that employ low-wage workers. The nominally rigid taxable wage base, combined with the fact that UI benefits are indexed in many States and increased regularly in others, requires periodic adjustments in State UI tax rates.

ADVANCE NOTICE

Another way to reduce the costs of job loss is to require firms to give advance notice to workers about to be displaced. Prenotification has a variety of potential benefits. It gives individuals time to search for a new position while still working, which may shorten unemployment spells or prevent them altogether. Other types of adjustment assistance (e.g., job counseling, skills retraining, or outplacement assistance) may also be more effective and easier to administer if individuals are still reporting for work.

Finally, if the notice is given sufficiently far in advance, workers may be able to switch their human capital toward skills that are likely to be useful to their future employers. Although legislation requiring advance notice has been enacted, a variety of exemptions limit the number of firms required to provide notice. It is unclear whether the legislation has increased the share of workers who are actually notified.

For those displaced workers who receive it, advance notice does appear to reduce adjustment problems. Recent studies suggest that individuals receiving at least 2 months of advance notice are out of work up to 1 week less and earn around 10 percent more in their new jobs than do those receiving no notice. Despite only modest reductions in joblessness, pay might increase through at least two mechanisms. First, employers who provide advance notice may also tend to provide other forms of readjustment assistance that might lead to wage gains upon reemployment. Second, notified workers remain jobless almost as long as other workers, but may find new jobs that better match their skills and qualifications. The available evidence lends support to both of these possibilities.

REFORMING TRAINING AND REEMPLOYMENT SERVICES

Both the Administration and the Congress have proposed consolidating many of the roughly 100 separate education and training programs now administered by the Departments of Labor and Education and reforming the overall system. Some of the proposed reforms are intended to help dislocated workers. A crucial element is the establishment of one-stop career centers where workers can find out about employment opportunities and training programs and apply for unemployment benefits. These centers are already being established in many States.

PORTABILITY OF PENSION AND HEALTH CARE BENEFITS

The costs of job transition are higher than they need to be in part because of the frictions involved in transferring pension and health care benefits. This is a significant cause of "job lock," in which workers are reluctant to leave their current jobs because they fear they will not be able to transfer their benefits. Many of these frictions can be eliminated, and recently some important strides down this path have been made. The minimum wage legislation passed in August 1996 contained a pension simplification initiative aimed at making portable pensions more available. New Internal Revenue Service regulations seek to do the same. Another recent success is the enactment of the Health Insurance Portability and Accountability Act of 1996 (the Kassebaum-Kennedy bill),

which ensures continued health care coverage for workers with pre-existing conditions who lose or change their jobs. The Administration has also proposed continuing health insurance for unemployed workers. Such a policy would further the goal of reducing the frictions associated with changing jobs.

CONCLUSIONS

Over the long run, sound economic policies that lead to low levels of unemployment and high rates of economic growth are likely to produce gains for most workers. Technological change and an increasingly competitive marketplace also help promote the conditions necessary for such growth. Most of the available evidence suggests that the U.S. labor market is quite robust, with significant job growth in the higher paying sectors, some evidence of reduced job loss, and a level of job stability that probably is no different today from what it was 20 years ago.

Nevertheless, some costs have been incurred. Government has a role in lessening the burden that economic growth causes for some workers. Some policies have been put in place, and others have been proposed, that should help reduce these costs without sacrificing growth in the economy.

One important potential cost of economic growth that this chapter has not addressed is increased inequality: the danger that those at the bottom of the earnings distribution will find themselves falling ever further behind the rest. Chapter 5 explores issues of inequality in far greater detail.