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Youth Unemployment

Unemployment is not a problem for the vast majority of teenage boys, but is concentrated among a small group that suffers a *serious* problem. This and other findings emerge from two background studies prepared for NBER's project on youth employment: **Teenage Unemployment: What is the Problem?,** *Working Paper No. 393,* by Bureau President **Martin Feldstein** and NBER Research Analyst **David Ellwood,** and **Why is There a Youth Labor Market Problem?,** *Working Paper No. 365,* by **Richard Freeman,** director of NBER's Program in Labor Studies.

Feldstein and Ellwood, using data collected in the Current Population Surveys for October and March 1976, focus on 1,451 out-of-school males to determine the extent of the youth unemployment problem. Freeman looks at unemployment and other records from 1950–77 and attempts to identify the causes of the problem.

Freeman begins by reviewing the high unemployment rates of youth: in 1977 among white high school graduates, the unemployment rate (as a percent of the labor force) for those over 25 years of age was 3.9 percent; it was 8.9 percent for those under 25. Among black high school graduates, the figures were 7.8 percent and 22 percent, respectively. Moreover, the fraction of young males obtaining white-collar jobs upon high school graduation actually declined from 20.2 percent in 1967 to 13.2 percent in 1977. Finally, the earnings of the young have fallen relative to the earnings of those over 25 so that by 1977, 24-year-old white youths earned, on average, only 75 percent, and nonwhites 63 percent, of what older workers earned.

However, both studies suggest that the reported numbers may be misleading. Freeman points out that different surveys show very different employment rates. For example, in 1966 the National Longitudinal Survey reported 46 percent of males 16 to 17 years old were employed—much higher than the Current Population Survey's figure of 36 percent. The discrepancy may be due to differences between sample groups, but it may also be due to the fact that some surveys are answered by youths and others by parents; the two groups do not necessarily give the same answers.

In 1976, 850,000 male teenagers, or roughly 18 percent of the teenage labor force, were unemployed. But as Feldstein and Ellwood point out, more than one half of these teens are enrolled in school. Ninety percent of all teenagers are working, in school, or both. In fact, only 5 percent of all teenagers are both unemployed and not in school.

Other facts brought out in the study by Feldstein and Ellwood raise questions as to the seriousness of the youth unemployment problem. For example, the authors find that virtually all unemployed teens live at home: more than 87 percent of the out-of-school group live with parents or relatives, and only 7.5 percent live alone or with a family of their own. Moreover, spells of unemployment among this group are generally short: over one half of the spells end within one month. In October 1976, 45.5 percent of unemployed youths were out of work for four weeks or less, and only 10.7 percent had been out of work for as long as twenty-six weeks.

These facts notwithstanding, Feldstein and Ellwood stress that unemployment is a serious and persistent problem for a small group of boys with relatively little schooling, especially high school dropouts. The unemployment rate for teenaged high school dropouts is 28.2 percent; the rate improves as they move into their 20s, but remains relatively high. Dropouts constitute 57.5 percent of the young unemployed, a figure that has been growing steadily over the last ten years or so, according to Freeman.

Differences in the employment experiences of whites and nonwhites constitute another serious concern for the authors. Both papers report that nonwhites have considerably higher unemployment rates than whites: in October 1976, 57 percent of nonwhite

out-of-school teens were unemployed as compared with 26 percent of white out-of-school teens. Freeman believes youth joblessness is concentrated among minorities and a small segment of whites.

Between 1969 and 1977, he reports white teenage employment rates rose, but nonwhite employment rates fell by 3.1 percent. However, part of the decline in the ratio of employment to population for blacks was due to increasing school enrollments. Among 20–24 year olds, 26.1 percent were in school in 1977, up from 8.3 percent in 1964. Freeman's analysis further shows that youths from disadvantaged areas, youths with less schooling, and youths who live in areas with a high concentration of young people all have lower probabilities of employment than others their age.

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However, the vast majority of the teenage unemployed are white: 77 percent nationally (in October 1976), 64 percent in the central cities. Even among families with incomes under $10,000, whites constitute 70 percent of the unemployed in the nation and 50 percent in the central cities. Lowering the unemployment rate of nonwhites to the level for whites would lower the total unemployment rate for out-of-school males only from 19 to 16 percent. Feldstein and Ellwood therefore point out that "the stereotyped image of an unemployed teenager as a black central city resident corresponds to less than 15 percent of the unemployed."

Feldstein and Ellwood find that at least one half of the racial differences observed can be accounted for by other demographic factors. They examine the unemployment rates within races by schooling, age, and family income and find that 12.7 percent of a 24.3 percent difference is due to demographic composition. For example, among low income families, there is relatively little difference between unemployment rates for whites and nonwhites.

Freeman goes on to explore the causes of high youth unemployment rates. He cites evidence that turnover and mobility are two of the most important factors. Since young persons tend to shop around before deciding on an appropriate job, and since institutions are likely to lay off their newest workers first, much youth unemployment is "normal." Freeman cites studies showing that one fourth of men aged 18–24 changed jobs in a year, compared to less than one tenth of 35–54 year olds. He further points out that the difference between the rates of unemployment of younger and older persons can be attributed to the percentage of persons who experience unemployment over the year rather than to a larger number of spells per person or the greater length of spells.

Freeman also stresses the importance of a lack of jobs, partially reflecting aggregate economic conditions. Youths have higher employment rates when economic growth is rapid and when adult unemployment is low. Youth employment is also higher in areas where industries are willing to hire the young and in industries where the work force is highly mobile.

Youth employment is also somewhat sensitive to wage rates. In occupations with high initial wages but slow wage growth, youth unemployment is high. Moreover, when the legislated minimum wage is increased, youth employment declines.

Feldstein and Ellwood find the effect of the numbers of young workers on unemployment to be exaggerated. They use the example of summer employment to justify their view. For example, in March 1976, 3.8 million 16–19 year olds were in the full-time labor force. This rose to 7 million in June and to 8.3 million in July. Of the 4.5 million extra entrants to the labor force between March and July, 4 million (89 percent) were working in July. The teenage unemployment rate fell from 22.6 percent in March to 16.3 percent in July. In light of the economy's ability to accommodate a large increase in young job seekers each summer, Feldstein and Ellwood question whether the gradual increase in young workers in the economy is a major cause of unemployment.

Freeman does not see the "baby boom" influx of young workers as an important factor in youth unemployment, either. However, he finds that the growing number of young workers has been reflected in the declining earnings of younger workers relative to older workers in recent years.

Disability Insurance and Work

At least half of the recent puzzling decline in labor force participation among men aged 45–54 can be explained by the growth of the Social Security Disability (SSD) program, according to a study by **Jonathan Leonard,** a research analyst at NBER. In **The Social Security Disability Program and Labor Force Participation,** *Working Paper No. 392,* Leonard attempts to explain why, in the last twenty years, the labor force participation rate of middle-aged men has dropped 10.6 percentage points for nonwhites and 4.4 percentage points for whites.

There have been two important liberalizations in the SSD program, enacted in 1956 to provide income to the totally disabled. In 1960, the eligibility age for men

was lowered to 50, and in 1965, the definition of disability was expanded to include any impairments expected to last for at least one year. At the same time, benefits were increasing both because of increases in nominal earnings and through Congressional action. By 1975, over 6 percent of prime age nonwhites, and over 3 percent of prime age whites, were SSD beneficiaries, and the system was paying $8.4 billion to 1.75 million people. By 1977, among nonwhite men aged 45–54, almost one in five was out of the labor force in a typical week, and about one third of these were receiving SSD benefits.

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Further observation reveals that SSD is the largest source of income for 45–54 year old men who are out of the labor force. Moreover, the termination rate among SSD beneficiaries is only about 10 percent, so that most SSD beneficiaries receive benefits for more than three years.

Leonard's statistical analysis shows that, controlling for health characteristics and potential earnings, a $180 increase in real yearly benefits will increase the proportion of SSD beneficiaries in the population by 1 percentage point. However, the higher one's wage was in the past, the less likely one is to be a beneficiary. In part, this may be because white-collar workers can continue to work when they are disabled more readily than blue-collar workers whose jobs are more physically demanding.

Over time, increased percentages of SSD beneficiaries have matched, at least point for point, the decreases in labor force participation. These results imply about a 2 percentage point drop in labor force participation since 1957 due to the more than 50 percent increase in average real SSD benefits (relative to a 16 percent increase in real wages). This is a substantial labor supply response among those who are usually considered incapable of working.

Before accepting the explanation that SSD causes declining labor force participation, Leonard examines three alternative explanations: the dissolution of the American family, increased participation of females in the labor force, and past economic dislocations.

It has been shown that single men have lower labor force participation rates than other men. Therefore, the breakdown of the family could explain declining participation rates. However, Leonard finds that among the 45–54 year old men in question, the proportion married (with spouse present) has actually increased from .78 to .84 since 1940.

Some speculate that the increase in working women may be the cause of declining labor force participation among males. However, regressions based on 1966 data from the National Longitudinal Study show that wives' incomes do not have a significant effect on husbands' labor force participation rates. Moreover, the labor force participation rate among nonwhite women in the 45–54 age group has actually fallen.

Third, Leonard finds no changes in occupational and industrial distribution, or other dislocations, serious enough to affect the labor force participation rate for males. He therefore returns to the link between the liberalizations in SSD and the growth of SSD beneficiaries. He concludes, "declining job opportunities seem to be a plausible explanation for the program's accelerating growth during the 1970s, but not for the 1960s." Moreover, "given the increases in real incomes and real per capita health expenditures, it seems implausible to attribute the increasing proportion of beneficiaries in a given age group to deteriorating health." Therefore, "the SSD program has acted as an escape hatch out of the labor force for disabled men. The more generous the benefits and the poorer the labor market conditions are, the more attractive the escape hatch becomes."

Effects of Tax Integration

Integrating the U.S. corporate and personal income taxes has been proposed as a means of eliminating the distortions that result from the double taxation of dividends. A new NBER study, *Working Paper No. 337R,* **Tax Integration in the United States: A General Equilibrium Approach,** quantifies the gains that would result from four approaches to integrating the corporate and personal income taxes.

In the study, **John Shoven,** NBER and Stanford University, and coauthors **Don Fullerton** of Princeton, **A. Thomas King** of the Federal Home Loan Bank, and **John Whalley** of the University of Western Ontario analyze four integration plans: (1) total integration, which involves the effective elimination of the corporate income tax and the taxation of all corporate income at personal tax rates; (2) the deduction of dividends from the corporate income tax base; (3) the exclusion of dividends from the personal income tax base; and (4) a partial dividend gross-up plan.

The authors use a medium-size, numerical general equilibrium model to assess the economic improvement that would be associated with the reallocation of capital and the altered saving behavior under the four plans. The model uses a 1973 data set and includes nineteen industries, sixteen consumption goods, and twelve consumer classes. It includes a complete set of taxes (including property; excise and sales; corporate

franchise; and federal, state, and local income taxes) and a model of government spending behavior. Labor supply, foreign trade, investment, and other variables are also incorporated.

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In order to maintain government revenue in the face of the four tax modification plans they examine, the authors adjust personal income tax rates by the required amount. This procedure not only gives the changes in the economy that each alteration in tax policy would imply but also computes the compensating adjustments in the tax rate that would be necessary to hold government revenue constant.

The estimates computed by the authors indicate that each of the four plans improves economic efficiency. Because resources are reallocated and saving decisions are less distorted by taxes, economic welfare is enhanced. The magnitude of these gains is nontrivial. The authors estimate that complete tax integration (that is, effective elimination of the corporate income tax) would result in an improvement in efficiency worth $6 billion per year (in 1973 dollars), or present value gains (the discounted total gain for all future years) of roughly $200 billion. The limited distributional analysis presented in the paper indicates that this gain would be spread throughout consumer classes in such a way that every class would be better off in the long run.

The precise estimates of the effects of any of the tax modification policies depend upon the exact manner in which the tax code is altered to maintain government revenue. The two dividend deduction plans result in long-run efficiency gains to the economy that are roughly 60 percent as large as complete tax integration. However, the two dividend deduction plans differ in several economic respects, particularly in their distributional impacts. The dividend gross-up plan examined by the authors, which involves giving stockholders a credit of only 15 percent of the corporate income tax paid by firms, results in the smallest improvement in economic welfare, roughly half the size of the improvement estimated for complete tax integration.

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