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ABSTRACT

The proceedings of a House of Representatives joint task force on the relationship of Federal budget policy to unemployment are presented. The hearings include statements from a representative of the United States Catholic Conference, economists of the Urban Institute, the vice president of the Committee for Economic Development, and a congressman. Additional information for the record is included. Some of the issues which received attention in the hearing are how Federal programs and improvements in the economy might affect unemployment, the effects of the trade deficit on the labor market, and educational policy. (KH)

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RELATIONSHIP OF BUDGET POLICY TO UNEMPLOYMENT

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HEARING

BEFORE THE

TASK FORCE ON ECONOMIC POLICY

AND THE

TASK FORCE ON HUMAN RESOURCES

OF THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

FIRST SESSION

NOVEMBER 20, 1985

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RELATIONSHIP OF BUDGET POLICY TO UNEMPLOYMENT

WEDNESDAY, NOVEMBER 20, 1985

HOUSE OF REPRESENTATIVES,
TASK FORCE ON ECONOMIC POLICY AND
TASK FORCE ON HUMAN RESOURCES,
COMMITTEE ON THE BUDGET,
Washington, DC.

The task forces met, pursuant to notice, at 1:40 o'clock, in room 210, Cannon House Office Building, Hon. Mike Lowry (chairman of the Task Force on Economic Policy) and Hon. Pat Williams (chairman of the Task Force on Human Resources) jointly presiding.

Mr. LOWRY. This is a joint task force hearing on the question of unemployment in our country and specifically on the question of the effect of economic policy on unemployment in our country and what effect our budget policy can have on unemployment.

I would like to ask unanimous consent that my opening statement be entered into the record.

[The opening statement of Mr. Lowry follows:]

OPENING STATEMENT OF HON. MIKE LOWRY

Today the Task Force on Economic Policy joins with the Task Force on Human Resources to begin to explore the relationship of budget policy to unemployment. I hope that this and future hearings will better prepare us to make more informed choices during the next budget cycle.

The present economic recovery has entered its 36th month. During this time there has been good news, including the creation of 8 million new jobs and relatively low levels of inflation. Some policymakers would rejoice at the duration of the recovery. Some economists would lead us to believe that this is the best we can do.

Yet the recovery has been uneven and incomplete. Budget deficits did initially stimulate the economy, but this stimulus appears to have run its course. The economy is sluggish and unemployment remains stuck around 7 percent. Over 8 million Americans are left jobless. Employment in the manufacturing sector remains below the level of 6 years ago. The trade deficit has exploded to unprecedented heights. There has been a massive diversion of resources out of the civilian economy into the military sector. The farm sector remains weak and vulnerable. Both the domestic and international financial system remains unstable and debt continues to pile up.

Our present economic experience appears to be consistent with the trend over the last several decades: each economic downturn has been followed by higher levels of unemployment. Unemployment averaged 4.5 percent in the 1950's, 4.8 percent in the 1960's, 6.2 percent in the 1970's, and 8 percent in the 1980's. A much larger portion of the unemployment burden continues to be borne by youth, minorities, and women. Present economic policy has not altered this trend and, in many ways, worsened our chances for reducing unemployment.

The whole structure of our economy has been distorted by high deficits, high interest rates, and high trade deficits. The real economic danger is that the damage may not be easily repaired if these structural imbalances persist much longer. Markets lost—at home or abroad—may not be regained. Our competitors will not wait patiently for us to recapture the ground lost in recent years. Money borrowed to finance today's deficit must be repaid in the future at the cost of tomorrow's investment and our children's standard of living.

I am convinced that there must be a way to boost the well-being of jobless and poor Americans. In fact, I would go further and say that our social and economic system cannot sustain a high level of prosperity if we continue to exclude tens of millions of Americans from the mainstream of economic life.

We are faced with choices. I believe that these choices must be informed by both good economics and social justice. That, in fact, fairness and efficiency are not mutually exclusive, but can be made mutually reinforcing. We must abide by our Nation's traditional belief in each individual's worth. We must remain rooted in the belief that Government and our community as a whole must offer a helping hand to those less fortunate so that they have the chance to help themselves.

Mr. LOWRY. I would like to call on the cochairman of this hearing, the chairman of the other task force, Pat Williams, to see if he has a statement.

Mr. WILLIAMS. Thank you, Mr. Chairman.

I join you in welcoming the witnesses today in what I expect to be the first of several hearings, at least, of the two task forces on the impact of the economic policies of the last 4 years on unemployment. We hope that we will gather information which will help this committee with the information necessary as we begin to make the coming year's important budget decisions starting in just a few months.

November 19, there was an article in the Wall Street Journal entitled "The Frost Belt's Revenge." It might have defined one of the dilemmas that brings us here today. Let me quote quickly from the article. "New England's economic miracle has come about largely because of the quality of its human capital. By this standard, the Sun Belt's near future is not promising."

For generations, New Englanders—they haven't been alone in this country—but New Englanders have invested very heavily in public education, in human capital, with the result that their work force and the work force in some other selected places in America is literate, educable, and for the unemployed, very importantly, reeducable. And those areas which have a long tradition of that type of investment are the ones that have best recovered and most quickly bounced back from the economic recession.

Now, one other point, Mr. Chairman. It seems to me we know one thing for sure about this Congress, particularly the House of Representatives—and Chairman Rodino can speak to this; over the years he knows much better than I—the thing we know for certain is that when the House hurries on issues of major importance, the House makes mistakes.

The House is hurrying to make dramatic long-term changes in our budgetary process. It goes, of course, by the name of Gramm-Rudman. If this House continues to hurry and tries to meet self-imposed artificial deadlines, this House is going to make a mistake, and the mistake will be made most likely on the human capital side of the public's investment.

So part of what brings us here today is to decide or to try to get some help in deciding just how important the investments on that side of the ledger really are and whether those kinds of investments can be jettisoned all for the purpose of a process about which we are hurrying to decide.

Thank you.

[The opening statement of Mr. Williams follows:]

Opening Statement of Hon. Pat Williams

I would like to join my friend, Representative Mike Lowry, in welcoming the witnesses today for what we expect to be the first of several hearings that our task forces will be holding on the impact of the economic policies of the last 4 years on unemployment. By examining these economic policies and their impact on individuals as well as how effective our Nation's investment is in upgrading the education and employability skills of certain individuals, we hope to provide the Budget Committee with the necessary information to make decisions on funding for these efforts next spring.

One only needs to look at an article in the Wall Street Journal of November 19, 1985, entitled "The Frost Belt's Revenge," to define our dilemma. The theme of this article is, "New England's economic miracle has come about largely because of the quality of its human capital. By this standard, the Sun Belt's near future isn't promising." Why has this occurred? For generations, New Englanders have invested heavily in public education with the result that the regional work force is literate, trainable, and retrainable. Currently 10 Sun Belt States show unemployment rates over the national average while only one State in the northeast exceeds the norm.

I raise this example with the fervent hope that we as a nation don't fall into the same trap and fail to continue our investment in human capital. We know one thing about the Congress of the United States and particularly this House of Representatives. That is, when it comes to major issues which effect the lives and wallets of the American people, when this House hurries, this House makes mistakes. We only have to look back to 1980 when Mr. Gramm and others had a magic prescription to balance the budget. They were going to balance the budget in 5 years. How well did their proposal work? We have the largest deficit in history!

Now they have a new proposal. Here is what it does. The higher the unemployment goes in this country the less money we have to spend on unemployment benefits and the Job Corps. When we have giant needs in education, for example, the shortage of math and science teachers, the less money we have to spend. The greater the defense needs, the less we are going to have to spend on defense and our manpower needs.

Does the American public support this policy? The answer is a clear no. Does the American public support deficit reduction? Of course. They do support the resetting of our Nation's compass.

But the same people who promised a balanced budget resulting from actions in 1980 are now promising to do it again with Gramm-Rudman. Frankly, the American people cannot afford any more of their mistakes.

We welcome your testimony today for we have a lot of work ahead of us.

Mr. Lowry. Thank you, Mr. Williams.

To introduce our first witness today we have the honor of having one of the most highly respected Members of this Congress—and, I think, probably in the history of this Congress—chairman of the Committee on the Judiciary, Peter Rodino, to introduce our first witness.

STATEMENT OF HON. PETER RODINO, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. Rodino. Thank you very much, Mr. Chairman and members of the panel, Pat, Mike. I consider it a privilege to be here before this distinguished panel.

I know how concerned you have been in trying to wrestle with the problems that affect all of us. I know that when there are matters to be discussed, matters to be considered that are matters that deal with the human factors, the human element, I know that Mike Lowry and Pat Williams are foremost among those. Without considering the human element—the human equation, as I like to call it—in whatever we do, we're not going to be able to succeed in achieving the great principles that are part of this Nation to which we have been dedicated and committed, historically.

Let me say that my task today is a very pleasant one. I have had the privilege of knowing the man who is going to present his views to you on behalf of the United States Catholic Conference. He is the Most Reverend Joseph A. Francis, the auxiliary bishop of Newark.

As you well know, Newark forms an integral part of my constituency. I am aware, as the bishop will tell you in his very eloquent statement before this committee, of the problems that affect us, especially high unemployment as it does exist especially among the poor, the minorities, the blacks, and Hispanics. I have been dealing with this for a long period of time.

I am not going to say anything more other than to say, I endorse the great statement that is going to be presented to you. I know that Bishop Francis is going to tell you that he is not particularly expert in the science or the art of economics. He may not be, but he certainly is a scholar. He has researched. Beyond that, he is a man who, being a man of the cloth, has committed himself and all of his life to knowing what effects these matters have on the individuals in our society.

And he, knowing the archdiocese, knowing the people who are part of that archdiocese and having been able to minister to their needs, knows too what it means in social costs when we have tremendously high unemployment and how it does, as he is going to say, and very eloquently, demean the dignity of the human being and have a very lasting and telling effect.

I think it tells on our society when we multiply one human being times 8.5 million unemployed and that is only the surface of it.

So, without saying anything other than it is my privilege and my honor to present a man whom I respect, admire, and have deep affection for, the auxiliary bishop of the Archdiocese of Newark, Joseph A. Francis, my friend.

Mr. LOWRY. Thank you, Mr. Chairman. Thank you for honoring us with your presence to come and introduce Bishop Francis.

Bishop Francis if you would care to, proceed with your testimony.

STATEMENT OF BISHOP JOSEPH A. FRANCIS, AUXILIARY BISHOP, NEWARK, NJ, ON BEHALF OF THE UNITED STATES CATHOLIC CONFERENCE

Bishop FRANCIS. Thank you very much, Congressman. I would just like to say this is my Congressman and we feel that he is a legend in his own time and we are very happy to have him as our Congressman.

Thank you very much for that introduction, Congressman.

As Congressman Rodino mentioned, I am Bishop Joseph A. Francis, auxiliary bishop of the Catholic Archdiocese of Newark. I speak today on behalf of the United States Catholic Conference, the national action agency of the American bishops.

I appreciate this opportunity to present testimony on the social and human costs of unemployment. I come before this task force not with any particular economic expertise but rather for the purpose of calling attention to some of the moral and human dimensions of unemployment. My remarks, therefore, will focus on the social and moral aspects of joblessness.

I might add as an aside, I was in Watts in 1965 during the civil disturbances there, and of course unemployment was one of the major issues in that disorder.

In the church's social teaching, employment has been seen as a central issue in the economy precisely because it is so important for human dignity. A belief in the special dignity that is inherent in every human person is the starting point for all of the church's reflections on economic issues. But this is particularly true in the case of unemployment. The basic test of economic policy is how it affects human persons and how it promotes or denies human dignity and the common good.

Employment issues are at the very heart of the economic analysis from the church's point of view because work is seen to have a special dignity. It is linked to the very meaning of life. Through work, human beings express themselves, actualize themselves, have their dreams fulfilled. They become more human, more capable of taking responsibility for their lives. Through working men and women actually participate in creation. They share in God's work.

Human labor, therefore, is enobling because it contributes to the dignity of the human person and to the fulfillment of God's plan for all of creation.

From this perspective, therefore, unemployment as we now see it in our country is a particularly serious evil. It ranks at the top of the church's economic issues to be addressed.

To the degree that we appreciate the special dignity that is attached to work, to that degree should we understand the tremendous social and human loss that results when millions of Americans cannot find work. Young people are, in effect, told, "Society has no productive role for you. There is no contribution which you can make." As a result, alienation and loss of confidence intensifies, leading to increased anxiety and despair.

As a religious leader and a pastor, I can tell you of the relationship between high levels of unemployment and alcoholism, family breakdown, and violent crime, and in not too few instances, suicide itself. Each day I see hundreds of educable, but cynical and frustrated young people, out of the classrooms and on the streets because they feel that having an education certainly does not lead them to where they would like to go because they would not be able to make use of the skills that they have attained.

Of special concern to us is the negative impact of the loss of income and employment on personal and family relationships. Unemployment very often results in the loss of the homes of people who have worked so hard to attain them. It places intense strains on families and is often the main cause of the disintegration of families and entire communities.

There is also a spiritual aspect to this issue. What happens to a nation that begins to accept the notion that it cannot use the talents and labor of all its people? What happens to us as a people as we watch families which have made the slow and painful climb up the economic ladder be pushed down once again into poverty and dependence by the loss of a job?

As a society, as a country, can we accept the notion that some will have jobs and income while others will be told to wait a few years and to subsist on welfare in the interim? What does it mean when our leaders say there is no way in the foreseeable future to harness the idleness of so many for work on vital social needs such as housing, transportation, health care, the renovation of our highways, our bridges, our recreational areas? Are we saying that large numbers are dispensable? Are we saying that society does not need them?

Such questions pose profound issues of national purpose and identity. These social, human, and spiritual dimensions of unemployment deserve prominent consideration in any and all deliberations on future economic policy. It is our position that the current levels of unemployment are unacceptable and these human, social, and spiritual costs are intolerable.

Fundamentally, our Nation must provide jobs for those who can work and should work, and decent income for those who cannot. An effective national commitment to full employment is needed to protect the basic human right to useful employment for all Americans.

We feel that it is essential to know that unemployment strikes disproportionately at those who are weakest in economic terms and those who are subject to all kinds of discrimination: minorities, young people, women, the poor, and the unskilled. For blacks, for example, the economy has been in recession on a permanent basis. During the last 25 years the unemployment rate for blacks has been roughly double the rate for whites.

While my primary purpose here is not to describe a detailed employment policy, I do want to suggest some broad elements that will be necessary if we are to be effective in combating unemployment. We must begin with the firm conviction that full employment is the foundation of a just economy. Therefore, the most urgent priority for domestic economic policy should be the creation of new jobs with adequate pay and decent working conditions for everyone. And this has to be done in partnership with Government, the private sector, and the labor unions.

The complex web of social forces has produced the human tragedy of which I speak, and the solution will clearly not be a simple one. However, we must not be deterred. Apathy and cynicism in the face of this tragedy would be the worst kind of moral failure this country could face.

There are those who will say our society cannot afford full employment, that Government programs to stimulate and create jobs would simply cost too much. In contrast to such arguments, let me ask this question, or these questions: What cost is too high for reducing the despair and alienation of hundreds of thousands of able-bodied Americans? What cost is too high for reducing the crime, drug abuse, alienation, and self-destruction caused by the currently massive youth unemployment? What cost is too high for restoring the vision and hope of those who will build the future? What cost is too high for human dignity?

On a related matter, I want to call attention to the fact that our Nation's Unemployment Insurance Program has been steadily eroded in recent years. Today the system provides benefits to only about 40 percent of the 8.3 million people who are jobless. Since 1981 major cutbacks in the system have been implemented, the joint Federal-State program of extended unemployment benefits has been virtually eliminated.

And in March Congress failed to extend the Federal Supplemental Compensation Program. As a result, many States now provide only the minimum of 26 weeks of unemployment coverage. For many long-term unemployed workers, benefits have been exhausted, and no unemployment assistance whatsoever is available to them.

Finally, I urge you to consider the fact that many of the long-term unemployed and those who have used up their unemployment benefits are now among the ranks of the very poor. Joblessness has pushed them into poverty.

As I am sure you know, the so-called safety net for the poor has become more symbolic than real in recent years. Federal funding for programs that provide basic necessities for low-income people have been cut by about $30 billion. Yet, poverty in our Nation continues to be a widespread and urgent problem. One of every seven Americans is poor in the richest land in the world. More than one of every five American children is poor. Nearly one of every two black children in this Nation is poor.

With alarming statistics like these, is it not obvious that we have an urgent task before us? We simply must summon the political will and the moral rectitude to implement an aggressive campaign to reduce unemployment and poverty. For the current trends in these areas are not only unacceptable, they are a serious threat to our society's future, a scar on the face of our Nation, and a violation of the most basic norms of human dignity.

I fully understand that this task force is not able to solve these massive problems single handedly, yet I sincerely urge you to do your part by working to provide adequate funding for employment and human needs programs.

In closing, let me try to convey a sense of urgency in this matter by reciting for you the words of a 52-year-old man, unemployed and the father of nine children.

He says:

> Let me tell you what it's like for one guy to be 52 years old and jobless in America. I like to feel that I don't scare any easier than the next guy But to be 52 years old and jobless is to be frightened, frightened to the marrow of your bones Your day starts with it and ends with it. It's all pervasive. It's numbing It's mind-boggling. Things you've always taken for granted fall apart. To feel the disintegration of your confidence as a man and your ability to protect your family from economic disaster is to envy just about everybody who has a job, any job. It's to realize the simply stunning fact that you are without meaningful representation in this society It's to realize that for many Americans the problem you are facing for the first time has become a way of life. The carnage is strewn about America for anyone with eyes to see in our mental hospitals in our drug abuse centers, in the alcoholic wards of our hospitals, in our juvenile shelters in our prisons and on the streets of our cities. And finally, it's to lie sleepless in bed waiting for the dawn of a new day and realize that something is terribly wrong.

I thank you very much.

[Testimony resumes on p. 15.]

[The prepared statement of Bishop Francis follows:]

PREPARED STATEMENT OF BISHOP JOSEPH A. FRANCIS

I am Bishop Joseph Francis, Auxiliary Bishop of the Catholic Archdiocese of Newark. I speak today on behalf of the United States Catholic Conference, the national action agency of the American Catholic bishops. I appreciate this opportunity to present testimony on the social and human costs of unemployment. I come before this task force, not with any particular economic expertise, but rather for the purpose of calling attention to some of the moral and human dimensions of unemployment. Others who will speak this afternoon will address this issue from a more strictly economic view. My remarks, therefore, will focus on the social and moral aspects of joblessness.

Allow me to begin by quoting briefly from a statement on unemployment issued by the Bishops of the United States in 1930. The bishops said:

> This unemployment returning again to plague us after so many repetitions during the century past is a sign of deep failure in our country. Unemployment is the great peacetime physical tragedy of the nineteenth and twentieth centuries, and both in its cause and in the imprint it leaves upon those who inflict it, those who permit it, and those who are its victims, it is one of the great moral tragedies of our time. (The Bishops of the United States, Unemployment, 1930)

In the Church's social teaching, employment has been seen as a central issue in the economy precisely because it is so important for human dignity. A belief in the special dignity that is inherent in every human person is the starting point for all of the Church's reflections on economic issues, but this is particularly true in the case of unemployment.

In our view, the formation of economic policy is far too important to be left solely to technicians, interest groups, and market forces. For the workings of the economy have implications far beyond the marketplace, the board room, and the stock exchange.

Behind the jumble of statistics and the rise and fall of economic indicators, lie human lives and individual tragedies. It is precisely for these reasons that economic issues are also moral issues. The basic test of economic policy is how it affects human persons, and how it promotes or denies human dignity and the common good.

Employment issues are at the heart of economic analysis from the Church's point of view, because work is seen to have a special dignity. It is linked to the very meaning of life. Work is, in the words of Pope John Paul II, "a key, probably the essential key, to the whole social question . . . "[1] Through work, human beings express themselves, actualize themselves. They become more human, more capable of taking responsibility for their lives. Through working, men and women actually participate in creation. They share in God's work. Human labor, therefore, is ennobling because it contributes to the dignity of the human person and to the fulfillment of God's plan for creation.

Employment, therefore, involves more than mere economic productivity. It has to do with the very identity of the human person — how individuals see themselves. It has to do with their dreams and their visions for the future, with their ability to respect and love their fellow human beings. In short, employment involves more than dollars and cents, sweat and muscle. It involves the heart and the soul.

From this perspective, therefore, unemployment is a particularly serious evil. It ranks at the top of the Church's list of economic issues to be addressed. To the degree that we appreciate this special dignity that is attached to work, to that degree should we understand the tremendous social and human loss that results when millions of Americans cannot find work. Young people are in effect told: "Society has no productive role for you, there is no contribution which you can make." As a result, alienation and loss of confidence intensifies, leading to increased anxiety and despair. As a religious leader and pastor I can tell you of the relationship between high levels of unemployment and alcoholism, family breakdown, and violent crime. Each day I see hundreds of educable but cynical and frustrated young people out of the classrooms and on the streets near high schools.

But this is more than a personal conclusion drawn from my own experience. It is also the conclusion of formal research in the academic arena. As I am sure you know, Dr. Harvey Brenner of Johns Hopkins University, and others, have thoroughly documented the direct and startling relationship between economic distress and increased mental illness, cardio-vascular disease, and pre-natal deaths. High unemployment also frequently leads to greater alcoholism, drug abuse, child abuse, and crime. Moreover, it contributes to rising social and racial tensions. Threatened by loss of a livelihood, workers too often look for scapegoats and may blame minorities, aliens, women or young people with serious consequences for intergroup relationships.

Of special concern to us is the negative impact of the loss of income and employment on personal and family relationships. Unemployment very often results in the loss of the home itself. It places intense strains on families and is often the main cause of the disintegration of families and communities.

There is also a spiritual aspect to this issue. What happens to a nation that begins to accept the notion that it cannot use the talents and labor of all its people? What happens to us as a people as we watch families which have made the slow and painful climb up the economic ladder, be pushed down once again into poverty and dependence by the loss of a job? As a society, can we accept the notion that some will have jobs and income while others will be told to wait a few years and to subsist on welfare in the interim? What does it mean when our leaders say there is no way in the foreseeable future to harness the idleness of so many for work on vital social needs such as housing, transportation, and health care. Are we saying that large numbers are indispensable? That society does not need them? Such questions pose profound issues of national purpose and identity. These social, human, and spiritual dimensions of unemployment deserve prominent consideration in deliberation on future economic policy.

We believe that the current levels of unemployment are unacceptable and that these human, social, and spiritual costs are intolerable. Fundamentally, our nation must provide jobs for those who can and should work and a decent income for those who cannot. An effective national commitment to full employment is needed to protect the basic human right to useful employment for all Americans.

Our nation simply cannot afford to have more than eight million workers unemployed. America cannot afford the destructive impact that joblessness has on its families and communities. We cannot afford the economic costs, the social upheaval, and the enormous human tragedy caused by unemployment. In the end, however, what we can least afford is the assault on human dignity that occurs every time another person is left without adequate employment.

We must resist the temptation to underestimate the dimensions of this problem. The official unemployment figures, as bad as they are, do not reveal the full magnitude of the human tragedy that is involved. In addition to the 8.3 million who are officially unemployed, many others are underemployed or have given up looking for work.

We feel that it is essential to note that unemployment strikes disproportionately at those who are weakest in economic terms and those who are subject to discrimination: minorities, young people, women, the poor, and the unskilled. For blacks the economy has been in recession on an almost permanent basis. During the last twenty-five years the unemployment rate for blacks has been roughly double the rate for whites.

Youth are also especially hard hit by unemployment. And for minority youth the magnitude of the problem almost defies description. Since 1958 more than one in four black youths in the labor force has been unemployed. The current rate is more than 30%. If an overall unemployment rate of 10% is called a recession, by what name do we describe the plight of black teenagers? Should not we be fearful of the possibility that a permanent underclass has developed, and that virtually an entire second generation of ghetto youth will never enter into the labor force?

Although my primary purpose here is not to describe a detailed employment policy, I do want to suggest some broad elements that will be necessary if we are to effectively combat unemployment. We must begin with a firm conviction that full employment is the foundation of a just economy. Therefore the most urgent priority for domestic economic policy should be the creation of new jobs with adequate pay and decent working conditions. At present, there is minimal endorsement of this goal of full employment, but no real commitment to bringing it about. Clearly this must change if we are to end the human and social devastation that joblessness brings to our nation.

While the private sector must play a major role in the task of job creation; because about 80 percent of the jobs in the United States are found there, it must also be recognized that government has a prominent and indispensable role to play in addressing the problem of unemployment. The market alone will not automatically produce full employment. Therefore, the government must act to ensure that this goal is achieved by coordinating macro-economic policies, by job creation programs, training programs, and other appropriate measures.

A complex web of social forces have produced this human tragedy, and the solution will clearly not be a simple one. However, we must not be deterred. Apathy and cynicism in the face of this tragedy would be the worst kind of moral failure. There are those who will say our society cannot afford full employment, that government programs to stimulate and create jobs would simply cost too much, that we cannot risk higher inflation by lowering the unemployment rate too much. In contrast to such arguments, I ask: What cost is too high for reducing the despair and alienation of hundreds of thousands of able-bodied Americans? What cost is too high for reducing the crime, drug abuse, alienation and self-destruction caused by the currently massive youth unemployment? What cost is too high for restoring the vision and hope of those who will build the future? What cost is too high for human dignity?

Unemployment is not only a short range, cyclical problem requiring temporary measures to alleviate suffering. Rather, a careful analysis reveals that since World War II unemployment has been substantial, persistent and drifting upward. As I am sure you are aware, next year is the 40th anniversary of the Employment Act of 1946. The promise of that Act has not been fulfilled. In fact, it has fallen increasingly short of its broad social and economic purposes.

We believe that the improvement in the unemployment figures during the last several years should not divert us from the critical task of devising long-term policies and comprehensive programs that will ensure genuine full employment. Most forecasts still project that large-scale unemployment will extend into the next decade unless major new policies are adopted.

As members of the House Budget Committee, you have a significant role to play in this matter. As you know, the funding for unemployment and training programs has fallen since FY 1980 from over $9 billion to approximately $5 billion in FY 1986. In the context of continued high unemployment, these budget cuts have only exacerbated the problem. Clearly, this trend must be reversed. I strongly urge you to do all in your power to provide more adequate funding for employment and training programs in your deliberations next year.

On a related matter, I want to call attention to the fact that our nation's unemployment insurance program has been steadily eroded in recent years. Today the system provides benefits to only about 40% of the 8.3 million people who are jobless. Since 1981 major cutbacks in the system have been implemented. The joint federal-state program of extended unemployment benefits has been virtually eliminated, and in March Congress failed to extend the Federal Supplemental Compensation Program. As a result,

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many states now provide only the minimum amount of 26 weeks of unemployment coverage. For many long-term unemployed workers, benefits have been exhausted and no unemployment assistance whatsoever is available to them.

Despite the current "recovery," hundreds of thousands of long-term unemployed have been left behind. Their needs must not be neglected. In your budget deliberations, I urge you to provide adequate funding for the remaining portions of the unemployment insurance system.

Finally, I urge you to consider the fact that many of the long-term unemployed and those who have used up their unemployment benefits are now among the ranks of the poor. Joblessness has pushed them into poverty. The so-called safety net for the poor has been more symbolic than real in recent years. As I am sure you know, federal funding for programs that provide basic necessities for low-income people have been cut by about $30 billion since 1980.

Yet poverty in our nation continues to be a widespread and urgent problem. The current poverty rate is the highest for any non-recession year since 1966. One of every seven Americans is poor. More than one of every five American children are poor. Nearly one of every two black children in this nation are poor. With alarming statistics like these, is it not obvious that we have an urgent task before us. We simply must summon the political will and the moral rectitude to implement an aggressive campaign to reduce unemployment and poverty. For the current trends in these areas are not only unacceptable; they are a serious threat to our society's future, a scar on the face of our nation, and a violation of the most basic norms of human dignity.

I fully understand that this task force is not able to singlehandedly solve these massive problems. Yet I sincerely urge you to do your part by working to provide adequate funding for employment and human needs programs.

In closing, let me try to convey a sense of urgency in this matter by reciting for you the words of a 52-year-old man — unemployed and the father of nine children.

> Let me tell you what it's like for one guy to be 52 years old and jobless in America. Your days start with it, and end with it. It's all pervasive. It's numbing. It's mind-boggling. Things you've always taken for granted fall apart. To feel the disintegration of your confidence as a man, and your ability to protect your family from economic disaster. It's to envy just about everybody who has a job, any job.
>
> It's to realize the simply stunning fact that you are without meaningful representation in this society. It's to realize that for many Americans the problem you are facing for the first time has become a way of life. The carnage is strewn about America for anyone with eyes to see. In our mental hospitals, in our drug-abuse centers, in the alcoholic wards of our hospitals, in our juvenile shelters, in our prisons, and on the streets of our cities.
>
> And finally, it's to lie sleepless in bed waiting for the dawn of a new day and realize that something is terribly wrong.

Thank you.

Mr. LOWRY. Thank you very much, Bishop Francis, for an excellent statement.

This joint task force is really interested in looking at the budget questions we know are going to be coming up next year and for many years following that. Around Congress, Let's say that we think the general economy is going to get better, that inflation is going to stay low at the good rate it is now, that real interest rates will decline, and that we think that the general economic conditions will improve. If that is so, will that improvement in the general economy address the problems of the structurally unemployed, those same areas of the statistics that you were addressing in part of your statement, of people who have been unemployed for such a long period of time in those sectors of our economy? Are there particular Federal programs that ought to be addressing those problems regardless of how well the economy is going? If so, what programs are the most important to do that?

Bishop FRANCIS. I wouldn't be able to tell you what programs are the most important to do that. I think that we know from the past that this country has done a phenomenal job in meeting the needs of the poor and unemployed in years past. We also know that we have had some very terrible programs, and many of them were absolute failures, and we cannot afford to make the same mistakes. I think, as was just mentioned by—was it Mr. Brown or Mr. Williams—that sometimes Congress has the character of moving too quickly perhaps without enough thought to the outcome of many of these things.

But what I am most concerned about, whether the economy improves to the point where we would be able to make the unemployment picture less, that we would be able to have people living at a much higher level of income and comfort and convenience. Attitudinally, we have to be able to know and to accept and to recognize the point that I tried to make in the very beginning of the statement, that we are talking here about a concern for the dignity of every single human being.

Money alone, of course, will not solve this. It will depend on how we approach that aspect and whether or not we may not be on the verge of bankruptcy in terms of the job situation. But we may now have a moral bankruptcy here which does not really take into consideration that aspect of our brothers and sisters, their dignity and the right that they have of housing, for food, for employment, and for the basic human services that contribute to the dignity and self-respect that people have.

Mr. LOWRY. Mr. Williams.

Mr. WILLIAMS. Bishop, give us a sense of the frame of mind of those people that you serve; that is, those who have suffered difficult financial times and come through this last recession and find themselves or their families still unemployed. What is their emotion? Is it one of frustration or hopelessness? Give us, if you can, a general notion about those people.

Bishop FRANCIS. Well, let me relate what we did last year in Newark. As you know, the bishops, the U.S. Catholic bishops, are working on a pastoral on the economics in this country and the capitalist social principles. So we held hearings somewhat similar to congressional hearings in various parts of the archdiocese. We held hearings with people in the corporate sector, with people in Government.

When we had these hearings, almost invariably when we spoke to the people who were at the bottom of the economic ladder, the unemployed, there was a sense of frustration, there was a sense of hopelessness, there was a sense of anger. And to compound this, they began to realize that instead of Government and the private sector being willing to come to their aid, it seems that both groups were moving farther and farther away from them. And the feeling is, Am I really a part of the society in which I live? Am I really a part of society which has been written off? Am I a part of society that has anything to contribute?

I think one of the things that we learned, and I have learned, over the years is that people do not want handouts. People want to be able to enjoy the fruits of their labor. They want to be able to have the satisfaction of knowing that the food that is placed on the table, the clothing that they wear on their backs, the homes in which they live are the results of good, hard work, with a sense that they have earned it, that they have not been given it and that they are not dependent totally on handouts. So that's the feeling. And in a word, there is a lot of frustration, there is a lot of anger out there.

As I mentioned at the beginning of my testimony, I was in Watts. I spent 12 years in Watts, CA. I was there on Friday, August 13, 1965, when the place exploded. I was the principal of a high school in the middle of Watts. One big factor was the tremendous void between the people who lived on Central Avenue and in the Watts area and the people who lived across Western Avenue—

Baldwin Hills, Beverly Hills, the gap there, the poverty, the unemployment on the one hand and the opulence on the other hand. That was one of the things that really started the Molotov cocktails flying.

So if you are asking me what I see in the future, I am very much afraid of what I see in the future.

Mr. WILLIAMS. Thank you.

Mr. LOWRY. Our valued member from Colorado, Congressman Brown.

Mr. BROWN. Thank you, Mr. Chairman.

Bishop, I would add my voice of thanks for your coming today. I might note that I share your view of your Congressman. I have the pleasure of serving with him on the Judiciary Committee, and I must tell you it has been a delight even for a minority member to serve with him. He is a person of great integrity.

I also share your very sincerely held concern about those less fortunate in our society and the very difficult circumstances they face.

Having said that, let me bring up a couple of things that I was puzzled by in your statement. You referred on page 7 of your statement, to a cut of almost $30 billion since 1980 in programs that provide basic necessities for low-income people.

I have looked through our budget documents here. They indicate a 60-percent increase in spending for Social Security and railroad retirement since 1980 and 80 percent increase in Government spending for medical care. Actually, it's over 80 percent in medical care since 1980. This is to the 1985 comparison. Obviously, there will be a bigger increase in that in 1986. And the category of public assistance and related programs, an increase of over 25 percent.

I know overall spending is up over 65 percent comparing 1985 since 1980. Two-thirds of our increase in spending has been in nonmilitary areas. So at least the figures I am looking at show dramatic increases in spending for programs that relate to the poor. Perhaps you could advise me where our disagreement is.

Bishop FRANCIS. Let me put it this way. I think that one has to look at the fact that while the spending has increased because of the joblessness, because of unemployment, there are a lot more people who now have to be involved. High rates of unemployment as we have in the past always demand a considerable amount of spending. And I think we're talking about proportions here. While the overall cost and the overall amount of money has been increased, the number of people who are dependent on what is available certainly has. And that's where we figure that decrease is taking place, not so much in terms of what you are actually spending now, but the number of people who are being helped and aided by that spending.

In other words, if I am spending $25 a day to get a meal for one person and I am spending $35 tomorrow for a meal for two people, the spending, of course, has increased, the amount of money has increased, but the number of people who are being helped certainly has not been increased. I think that is the figures that we are talking about here.

Mr. BROWN. I noticed SSI, which is aimed at the poor, has increased from $6.468 billion to $9.9 billion in 1985. Again, the point is we have seen a dramatic increase in Government spending in these areas.

The second question that I hope you might share your thoughts with us on, the report of the bishops appears to be not the most glowing endorsement of market forces that I have ever heard. And yet, Western Europe, for example, that has had far more government control or government involvement in this area than the United States, has done far worse than this country has in the last few years.

My question is, If additional Government control and involvement is the key toward relieving unemployment, why is it Western Europe in the last decade has remained static in the number of employed, and we have had an enormous increase? I think we are somewhere in the neighborhood of a 15-million increase in the number of people working in this country, while Western Europe, that has adopted apparently the kind of program the bishops would like, has not had an increase.

Bishop FRANCIS. Let me put it this way. I don't believe the bishops—first of all, the statement at the present moment is a draft statement. It is not a complete statement. I would like to make that quite clear. It is not a completed, fully accepted statement. We will vote on that in November.

Second, I think in the statement itself, in the document itself, we speak of a coalition not only of Government—we are not asking Government alone, we are asking the private sector, which employs about 80 percent of the people who are employed in this country, we are asking—there has to be a coalition of Government, the private sector, and the labor unions to bring about what we are asking.

And while you mention it, we don't speak of the market in such glowing terms, I don't think we have singled out the marketplace, we have singled out the whole country, and we call not only upon Government, private sector and labor unions in the document. If you have had a chance to read the draft, in the final section the church calls upon itself. The church is an employer. The church is a steward of moneys. The church is in the business of building and so forth and so on. We call upon ourselves also to do what we call upon others to do within the context of our involvement.

So I don't think the comparison between what is taking place in Western Europe and here would be too fair a comparison to make in placing it in our statement. We are—in other words, we're calling everybody to put his and her shoulder to the wheel in every possible way. And it goes back again to the statement we make in the beginning. It's not so much what we do for people, it's what we do to people that we are very much concerned about.

Mr. BROWN. Thank you.

Mr. LOWRY. Mr. Williams.

Mr. WILLIAMS. Bishop Francis, I just want to make a point for the record. Your sense that while dollar spending may be increased, the number of people that we are serving relative to the number that need serving is decreasing is accurate. And when this Budget Committee prepares the budget, we define increases in the budget due to inflation as real growth. When we say "real growth" we include programmatic growth, which means that anyone turning 65 this year will receive their Social Security benefits. We assume we're going to keep our word with people and allow all of those eligible to come onto a program to come on. The young child who is poor and handicapped, that child is eligible for assistance under our various handicapped acts. That's programmatic growth.

Now, let me just share with you for the record some interesting facts about our spending patterns. Since 1980 we have increased real growth—the growth that counts. We have increased defense spending by $77 billion—with a "b"—above real growth. We have cut education, training, and social services for Americans by $11.45 billion below real growth. At the same time we have increased defense spending by $77 billion above real growth, we have cut job training programs $300 million below real growth, and student aid $400 million below real growth.

So your sense that we are not only keeping up with the increased demands, in fact, in the very important areas of domestic spending, we are not even keeping up with the level growth—inflation and programmatic.

Mr. LOWRY. Yes; I think equal time.

Mr. BROWN. I certainly don't want to get into a debate with the gentleman from Montana. If I were going to get in a debate, I would pick someone not near as able as he. [Laughter.]

But I am looking at our budget documents. The figures are overwhelming in the enormous growth in the social programs. I am afraid his observation on the enormous growth of military spending is quite accurate. I would say there are some of us Republicans who voted against that increase while the majority of Democrats voted for it. But perhaps we should leave that for another day.

With regard to numbers, SSI, aimed at the poorest of the poor, has increased. The revised figure for 1985 as it came out is $9.7 billion in 1985. What you find is a 50-percent growth in SSI payments since 1980.

There was a point raised about the number of people served under SSI, and that going up and that being a reason for the 50 percent increase. The figures that our budget documents have in them indicate 4.2 million people receiving SSI in 1980, only 4 million is projected for 1986. So what apparently has happened is you had a 50-percent increase in SSI, with a drop in the numbers, not an increase.

I thought perhaps since we were on that subject you might want those figures.

Mr. LOWRY. It shows what we are all grappling with and what we will be again grappling with in the budget in 1986 as we fight with these programs.

Bishop Francis, thank you very much for meaningful testimony and taking your time to come and join us. We appreciate it very much. Thank you.

And I thank Chairman Rodino.

Mr. RODINO. Thank you.

Bishop FRANCIS. Thank you.

Mr. LOWRY. Our next panel will be Dr. Isabel Sawhill and Dr. Charles Stone of the Urban Institute, Washington, DC.

Dr. Sawhill and Dr. Stone, thank you very much for joining us. I think we would just like to proceed with your testimony and maybe between the two of you, you have chosen who would go first. Dr. Sawhill.

STATEMENT OF ISABEL V. SAWHILL, PH.D., ECONOMIST, THE URBAN INSTITUTE, WASHINGTON, DC

Ms. SAWHILL. Thank you very much, Mr. Chairman.

What I will do is simply summarize the major conclusions of our testimony and then turn it over to Dr. Stone, who has been doing much of the research on the impacts of deficits and trade on domestic employment and who did much of the hard work of putting the written testimony together. I should also mention that much of our testimony is based on research done for the National Commission for Employment Policy, although they are not responsible for our conclusions.

There are five points that we make in the testimony. First is that the current policy mix—that is, a loose fiscal policy with a tight monetary policy and the large budget deficits that have accompanied that mix—have had a major impact on the trade deficit. In other words, the two deficits are closely related.

We did some simulations with the DRI model. And those simulations show that current policies have produced trade deficits that are more than twice as large as the trade deficits we would have had with a more balanced monetary/fiscal mix.

The second point is that this paticular mix of policies has probably not had a major impact on the level of unemployment for the economy as a whole, but it has discouraged output and employment in manufacturing, agriculture, and other sectors where trade is important, while encouraging output and employment in services and other sectors that are relatively unaffectd by trade.

The third point is that although the appreciation of the dollar has reduced inflation in the short run—that is, over the past few years—the dislocation of large numbers of workers in key industrial sectors is now creating a structural unemployment problem that cannot be eliminated by macroeconomic stimulus alone without generating unacceptable inflation in the future.

The fourth point: Without action to reduce the budget deficit, any actions taken to lower the value of the dollar or reduce the trade deficit are likely to be either ineffective or counterproductive.

And the fifth point is that the right solution to our current problems is to reduce the Federal budget deficit and ease monetary policy in a compensating fashion.

However, since it will take time to bring budget deficits under control and time for lower budget deficits to impact favorably on trade deficits, some interim assistance for dislocated workers is called for.

That is the summary, and I will turn this over now to Dr. Stone.

STATEMENT OF CHARLES F. STONE, PH.D., ECONOMIST, THE URBAN INSTITUTE, WASHINGTON, DC

Mr. STONE. Our emphasis in this testimony is on the impact of the budget deficit in combination with monetary policy on the trade deficit because that, we feel, is the area in which the current mix of policies has had the most impact and the area in which there is some trouble. The general state of the economy is not too bad. The recovery from the 1981 to 1982 recession has been accompanied by a drop in the unemployment rate, although it still remains rather high; substantial progress against inflation, although there is still some concern about whether inflation will be rekindled; and a strong rebound in investment, although only to a level that is not substantially higher as a share of GNP than we enjoyed in 1979.

The area of the economy where there is the biggest trouble is, therefore, the area of trade, and the emphasis in our testimony is on that.

In order to look at the impact on trade, what we tried to do was estimate on an industry by industry basis the number of jobs in an industry that have been created as a result of meeting export demand, and also the number of jobs, the number of additional jobs, that would be created if we were to replace all imports with domestic production.

The difference between the number of jobs created by exports and the number of jobs that in a sense have been replaced by imports is what we call the net impact of trade on employment. Our testimony uses this concept througout.

What is interesting about the net impact of trade on employment is that things have changed very dramatically between the 1970's and the 1980's. There is a perception among many people that the United States was experiencing trade problems in the 1970's. In fact, the United States ran trade surpluses through most of the 1970's.

And according to our calculations, the net impact of trade on employment was positive in the 1970's and the number of additional jobs generated by trade increased during the decade, whereas in the 1980's—specifically after the change in the policy mix toward a tighter monetary policy in the interest of controlling inflation and easing of fiscal policy associated with large budget deficits—as a consequence of that, we have had a substantial turnaround in the trade deficits and along with that a substantial swing in the net contribution of trade to employment.

We estimated in 1979 trade was making a net positive contribution of a million jobs, and in 1984 trade was making a net negative contribution of a million jobs.

These numbers should be understood in the context of expanding job growth in the economy. Between 1979 and 1984 the U.S. economy generated an additional 6 million jobs. Our estimates suggest that if all other things had been equal but trade had been in balance, there would have been a further 2 million jobs created in that period.

Now, we have to be very careful in interpreting those figures because they are heavily dependent on the kind of macro policy that we pursued during this period. On the basis of domestic demand growth over this period, there would have been 8 million more jobs created, but trade took away 2 million jobs.

The question is whether the Federal Reserve would, in fact, have been willing to provide sufficient domestic demand stimulus to actually generate those additional jobs if it had not been for the help of the strong dollar and the trade deficit in keeping inflation down.

We think it is more reasonable to suppose that the Fed would have pursued a monetary policy that would have given us about the same path of output and employment that we actually got, so the number of new jobs created in the economy would have been about the same as the number that were actually generated.

Therefore, we think that the major difference would have been in where the new jobs were and what sectors experienced expanding employment and what sectors experienced contracting employment, for we think that there is probably not an important impact of trade on aggregate employment and that the important impact is on a sector by sector basis.

We have provided a table in our testimony which suggests what the affected industries were, and for comparison purposes we looked at the same kind of question for the 1972 to 1979 period as we do for the 1979 to 1984 period. In the earlier period we find only two broad industry categories in which there was a decline in employment in which trade played an important role in explaining that decline, that is, textiles and apparel, and leather goods, primarily footwear.

Mr. LOWRY. This is page 12 of your testimony?

Mr. STONE. That's page 12.

Whereas applying the same calculations of the net impact of trade to employment growth in the 1979 to 1984 period we find a much longer list of industries that experienced a decline in employment in which trade effects, negative trade effects, contributed to that decline in employment, including some of our most important sectors: transportation equipment; automobiles; textiles and apparel once again; chemicals; leather; the agriculture sector, which was always a strong export sector; paper and allied products; rubber and miscellaneous plastics; primary metals; the steel industry; machinery in which case a lot of the losses due to the loss in export markets, although there is also substantial import penetration; fabricated metal products; food products; and then another list of miscellaneous manufacturing industries.

We argue that if it had not been for the large trade deficit brought on by the strong dollar which we think was brought on, in large measure, by the budget deficit and the mix in policies that we are pursuing, that if it had not been for that, these industries would have experienced smaller adverse trade effects and smaller adverse employment effects.

These are the results that we present in our written testimony. What are the implications of this for policy? We think that it's very important to bring the budget deficit under control because that is the major cause of the problem. Attempts to deal with the symptoms, such as import restraints or other limitations on trade, are unlikely to be effective in solving this overall problem.

For example, if we impose import restraints, they are likely to put further upward pressure on the dollar, which will hurt the export sector even more and is unlikely to have a positive impact in reducing the imbalance between what sectors are expanding and what sectors are contracting.

Therefore, we think that what should be done is to take action to reduce the budget deficit because if the budget deficit is reduced and monetary policy is allowed to bring interest rates down, then it is possible for the dollar to come down, which will have a favorable impact by both expanding exports and contracting imports. This will promote a more balanced economic recovery and will allow more sectors to participate in that recovery.

Thank you.

[Testimony resumes on p. 38.]

[The prepared statement of Ms. Sawhill and Mr. Stone follows:]

PREPARED STATEMENT OF CHARLES F. STONE AND ISABEL V. SAWHILL [1]

LABOR MARKET IMPLICATIONS OF THE MONETARY/FISCAL POLICY MIX

We appreciate this opportunity to present our views on the impact of the current monetary/fiscal policy mix on labor market conditions. Our conclusions are as follows:

1. The current mix of large federal budget deficits and an antiinflationary monetary policy has produced high real interest rates, an overvalued dollar, and an exploding trade deficit.

2. This particular mix of policies has probably not had a major impact on the level of unemployment for the economy as a whole; its major effect has been to discourage output and employment in manufacturing, agriculture, and other sectors where trade is important, while encouraging output and employment in services and other sectors that are relatively unaffected by trade.

3. Although the strong dollar and rising import penetration may keep inflation down in the short run, the dislocation of large numbers of workers in key industrial sectors may result in a long-term deterioration in the inflation/unemployment trade-off if dislocated workers cannot move readily into new jobs in tho sectors with expanding employment opportunities.

4. Without action to reduce the budget deficit, any actions taken to lower the value of the dollar or reduce the trade deficit are likely to be either ineffective or counterproductive. If they succeed in reducing imports, exports are likely to fall as well. If they succeed in reducing the trade deficit,

[1] The authors are economists with The Urban Institute. This testimony represents their personal views and not those of the Institute or its sponsors.

foreign borrowing will be reduced and interest rates will have to rise here. This will hurt investment and the economy's prospects for sustained, noninflationary growth.

reducing the federal budget deficit and easing monetary policy to allow interest rates to come down, we can achieve more balanced long term growth and allow more sectors to participate in that growth.

Introduction

The large federal budget deficits that have emerged since 1981 and the antiinflationary monetary policies pursued by the Federal Reserve since 1979 have combined to produce high interest rates relative to inflation, a sharp rise in the foreign exchange value of the dollar, and an exploding trade deficit. Nevertheless, by many conventional measures of economic performance, the economy seems to be functioning reasonably well despite large budget deficits. We are, after all, now in the third year of an economic recovery marked by strong investment growth and dormant inflation.

Yet unemployment remains above 7 percent, few are confident that inflation has been tamed permanently, investment as a share of GNP is barely above where it was in 1979, and a substantial fraction of that investment is being financed by foreign borrowing rather than domestic saving. More important still, the foreign trade balance, which was in surplus as recently as 1982, is now in deficit by well over $100 billion and this trade deficit is severely distorting the pattern of output and employment in the economy in ways that are harmful to long-term growth.

The Budget Deficit, Trade, and Employment

Many people believe that the United States first began to show signs of a serious deterioration in international competitiveness in the 1970s. In fact, the United States ran trade surpluses during most of the 1970s, and our preliminary estimates of the impact of trade on employment suggest that more jobs were created by exports than were lost to imports in those years. Moreover, there were few industries in which trade was an important cause of declining employment during the 1970s.

Things changed dramatically in the 1980s. As net exports turned negative after 1982, so did the net contribution of trade to employment. Based on preliminary data, we estimate that the number of jobs created by exports fell short of the number of jobs required to replace imports with domestic production by about a million jobs in 1984 and that changes in the pattern of imports and exports contributed to employment losses across a much wider range of industries than in the 1970s.

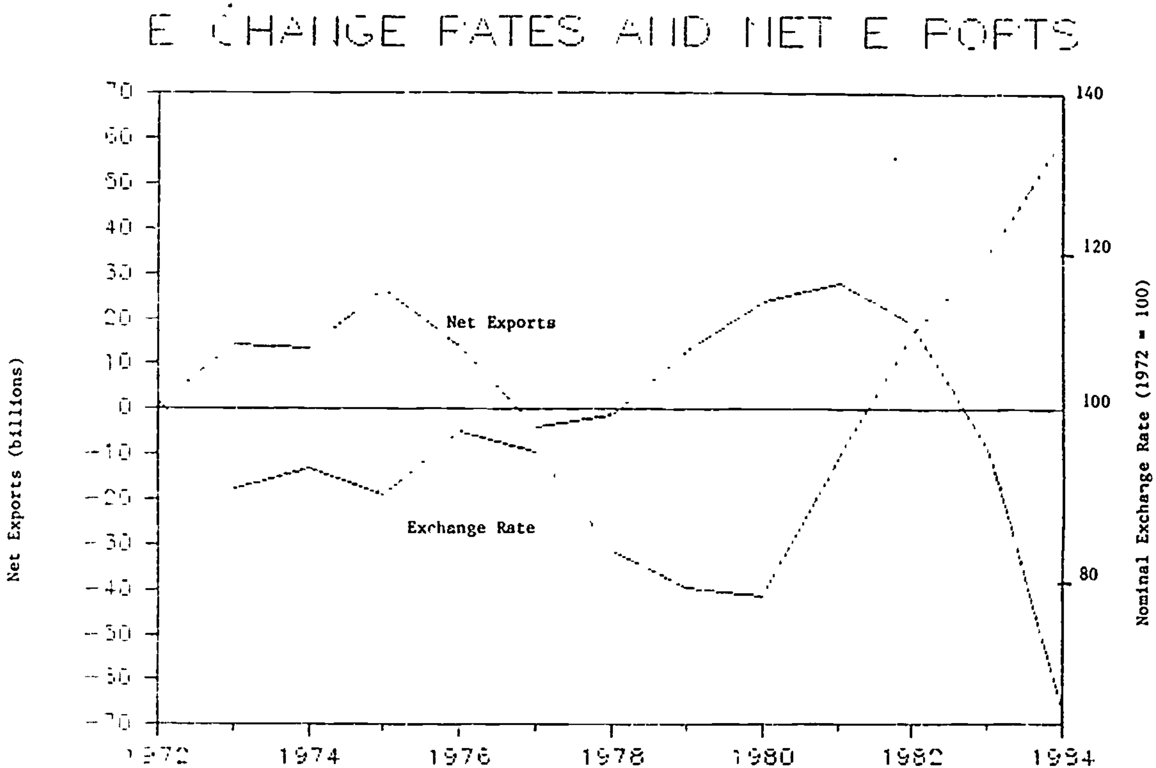
What caused this reversal? There is nothing in the experience of the 1970s to suggest that the United States was losing international competitiveness in those years. Our preliminary findings are that the net contribution of trade to employment was larger in 1979 than in 1972 and this is consistent with the findings of others, including Robert Lawrence of the Brookings Institution that, far from deindustrializing America, trade was contributing to the growth in employment in manufacturing during the 1970s.

We believe that the most important factor contributing to the emergence of a large trade deficit in the 1980s was the rise in the value of the dollar after 1980 and that the most important factor contributing to the rise in the value of the dollar was the emergence of a large federal budget deficit. Exhibit 1 shows that the behavior of the exchange rate and the behavior of net exports are almost mirror images of one another between 1972 and 1984. This correlation is borne out in more careful statistical studies of the causes of the trade deficit (see, for example, CBO's The Economic and Budget Outlook, August 1985, pp. 46-51). Most of the deficit is explained by the strength of the dollar. Unfair trade practices among our trading partners, the loss of markets in less developed countries due to their debt crisis, and slower growth among our trading partners are of lesser significance quantitatively and have been offset for the most part by declining oil imports.

The strong dollar is in turn explained by the high interest rates associated with the current policy mix. As long as fiscal policy is highly stimulative due to the budget deficit, the Fed must keep interest rates high in order to restrain aggregate demand in the interest of controlling inflation. High interest rates and low inflation in the United States make the dollar an attractive international asset and strong demand for the dollar increases its foreign exchange value. This in turn stimulates imports and discourages exports.

Put another way, in order for foreigners to acquire the dollars they need to buy our assets, they must sell more to us than they buy from us, requiring us to run a trade deficit equal in magnitude to our foreign borrowing. Urban Institute simulations, using the DRI model, of an alternative policy mix combining tighter fiscal policy with an easier monetary policy over the 1981-1984 period suggest that the trade deficit would have been less than half as large in 1984 had such policies been followed.

Exhibit 1

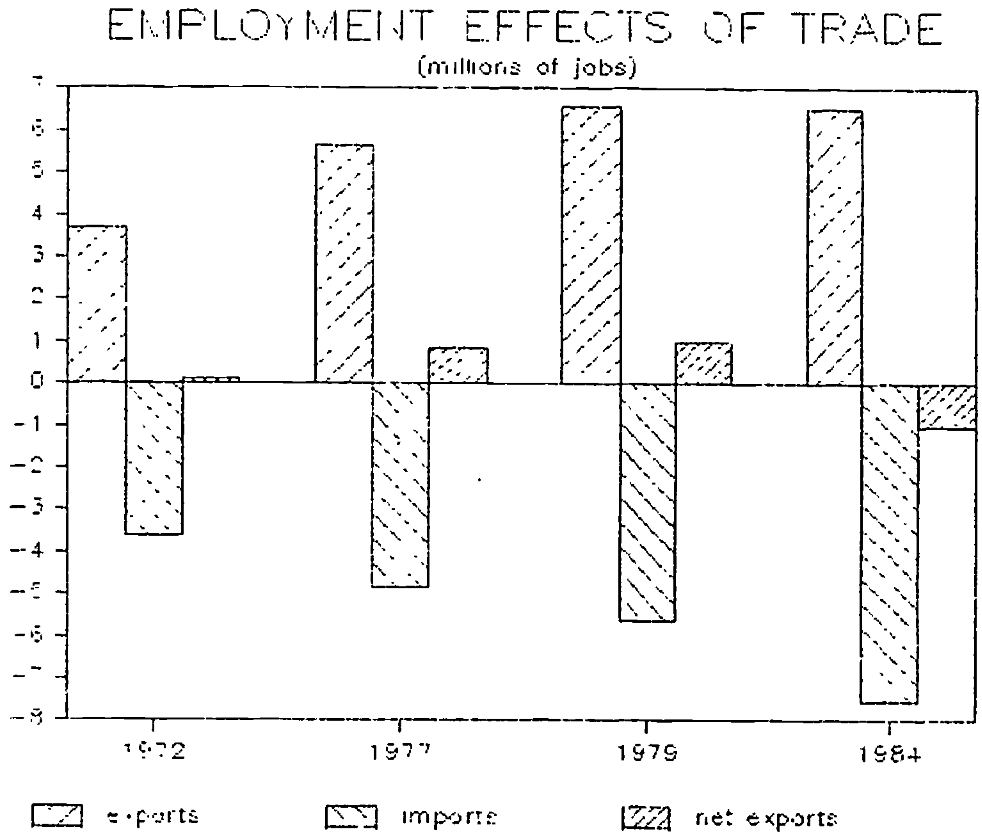

EXCHANGE RATES AND NET EXPORTS
Net Exports (billions)
Nominal Exchange Rate (1972 = 100)
Net Exports
Exchange Rate
70
60
50
40
30
20
10
0
-10
-20
-30
-40
-50
-60
-70
140
120
100
80
1972
1974
1976
1978
1980
1982
1984

28

Turning to the employment effects of the trade deficit, Exhibit 2 shows our preliminary estimates of how many jobs were created by exports and how many additional jobs would have been generated if imports had been replaced by domestic production in 1972, 1977, 1979, and 1984. (We will use the less cumbersome, but slightly misleading, phrase, "replaced by imports," to describe jobs that would be created if domestic production were substituted for imports.) Between 1972 and 1979, both the number of jobs created by exports and the number of jobs replaced by imports grew with the volume of trade, but the former grew more rapidly and the net contribution of trade to employment rose from under 100,000 jobs in 1972 to nearly a million jobs by 1979. With the rise in the value of the dollar and the emergence of a large trade deficit, the contribution of exports actually fell slightly between 1979 and 1984, while the number of jobs replaced by imports increased substantially. As a result, the net contribution of trade to employment changed from a surplus of nearly a million jobs in 1979 to a deficit of just over a million jobs in 1984.

Exhibit 3 places these results in the context of employment growth over several subperiods between 1972 and 1984. For each period, the lefthand bar shows the actual gain in employment, the middle bar shows the increase in employment that would have been required to satisfy domestic demand with domestic production, and the righthand bar shows the net contribution of trade to employment growth. It is interesting to note that the employment growth that would have been required to meet domestic demand between 1972 and 1977 was quite similar to what would have been required between 1979 and 1984 but that actual employment growth was much larger in the earlier period. This is because the net impact of trade in the earlier period was to add to employment growth while the net impact in the latter period was to hold back employment

Exhibit 2

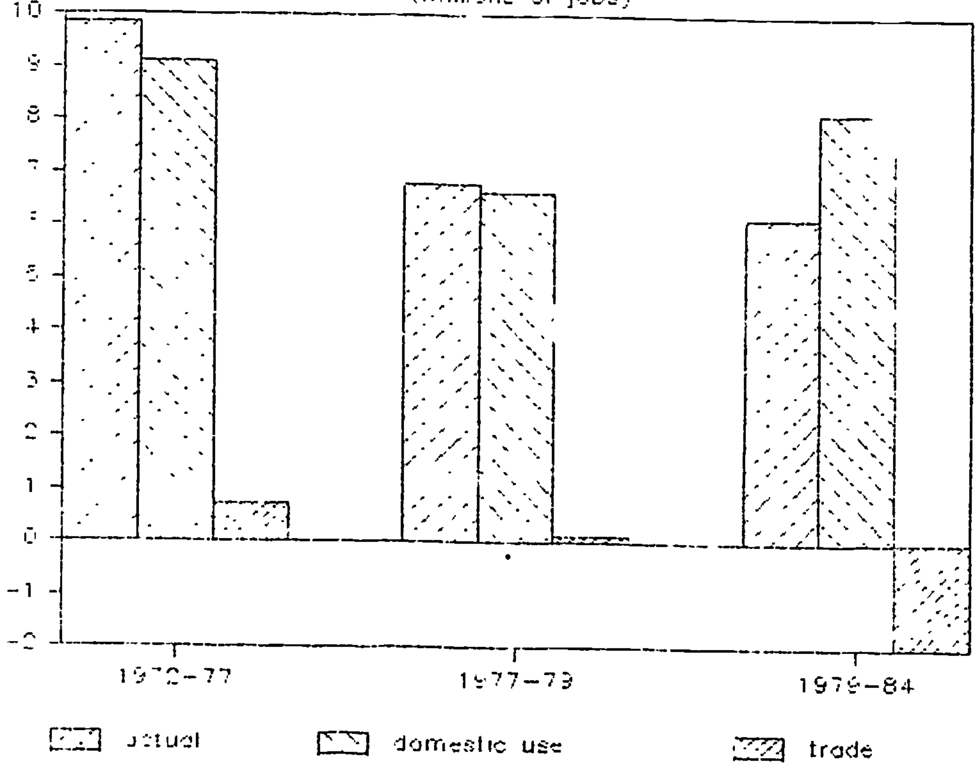

EMPLOYMENT EFFECTS OF TRADE
(millions of jobs)
7
6
5
4
3
2
1
0
-1
-2
-3
-4
-5
-6
-7
-8
1972
1977
1979
1984
exports
imports
net exports

30

Exhibit 3

CHANGES IN EMPLOYMENT, 1972–84

(millions of jobs)



growth.

In interpreting these results, it is important to recognize that the level of imports and domestic demand are critically sensitive to the macroeconomic policies that are being pursued. It is moot, for example, whether the Fed would have allowed domestic demand to grow as much as it did between 1979 and 1984 if it had not been for the effect of the strong dollar and import competition in restraining inflation. But if the Fed had been more accomodative, and if the employment effects of trade had remained the same as they were in 1979, an additional 2 million jobs would have been created and the unemployment rate would have come down to 5.6 percent by 1984. This is well below the 7.5 percent unemployment rate actually experienced in 1984, but it is not so very far below the 5.8 pereent unemployment rate experienced in 1979 and it is equal to the rate experienced in 1972.

It may be more reasonable to suppose, however, that the Fed would have exercised sufficient restraint to achieve about the same output and employment path as we actually experienced even if the budget and trade deficits were much smaller. This is especially likely given the higher inflation likely to have resulted under more accomodative policies. With a different policy mix but the same overall stimulus, the aggregate unemployment rate would have been much the same. What would have been different is the mix of employment gains and losses across industries.

Our preliminary results are suggestive of how changes in the value of the dollar and the trsde deficit hsve distorted production and employment (Exhibit 4). Between 1972 and 1979, only two of the broad industry sectors in our study, representing less than [illegible] percent of totsl employment, experienced

Exhibit 4

The Impact of Trade on Employment Growth

	Share of Total Employment	
	1972-79	1979-84
Industries with an Overall Employment Gain		
Supplemented by Trade	55.3	21.9
Diminished by Trade	33.2	49.1
	88.5	71.0
Industries with an Overall Employment Loss		
Aggravated by Trade	2.8	25.2
Diminished by Trade	8.8	3.8
	11.6	29.0

falling employment in which trade was a contributing factor. The more common experience was for trade effects to augment domestic demand growth in contributing to employment growth. This occurred in industries representing well over half of all employment. Between 1979 and 1984, in contrast, trade contributed to employment losses in industries representing more than a quarter of all employment, and trade made a positive contribution in industries representing less than a quarter of all employment.

Who were the industries affected? Exhibit 5 lists apparel and other textile products and leather (primarily shoes) as industries in which losses due to trade contributed to overall employment losses between 1972 and 1979. Our preliminary estimates are that total losses in these sectors were less than 200,000 jobs. For the 1979-84 period, the list of industries in which losses due to trade contributed to overall losses was much longer. We estimate the losses in these sectors to be more than 2 million jobs, with at least half of those losses due to trade. Affected industries include automobiles, steel, machinery, textiles and apparel, agriculture, and food products. Making up for these losses were strong gains in wholesale and retail trade and other services.

Surely industry-specific factors are important in explaining some of these changes between the 1972-1979 period and the 1979-1984 period, but it is hard to reject the view that without the large federal budget deficit and the strong dollar we would have had more balanced employment growth in recent years. Although aggregate employment may have been no higher, there would have been more jobs in manufacturing and agriculture and fewer jobs in services.

Exhibit 5

Industries in which Trade Contributed to Employment Losses

1972-79	1979-84
Apparel and Other Textile Products	Transportation Equipment
Leather (primarily footwear)	Apparel and Textiles
	Chemicals
	Leather
	Agriculture
	Paper and Allied Products
	Rubber and Miscellaneous Plastics
	Primary Metals
	Machinery
	Fabricated Metal Products
	Food Products
	Miscellaneous Manufacturing

Policy Implications

If workers moved quickly and easily between jobs, there would be little reason for concern about policies that stimulated demand in some sectors while reducing it in others as long as aggregate demand was sufficient to achieve a satisfactory level of employment. However, a steel worker does not move quickly and easily into computer services. Thus, the current policy mix aggravates the problem of dislocated workers who find it difficult to find employment after losing their job.

A recent study by the Bureau of Labor Statistics found that about 1 million workers a year lost their jobs due to a plant closedown or move, slack work, or abolishment of their position between January 1979 and January 1984. Almost half did not find another job within 6 months. While many of these workers were laid off for reasons that are unrelated to the deterioration in our trade balance, many are from the same industries that have been most severely affected by that deterioration. Moreover, the incidence of trade-related dislocation has probably continued to rise since January 1984 (although the incidence of non-trade-related layoffs almost surely has fallen). A new BLS survey could shed additional light on this issue and we hope that the Congress will encourage the collection of more data in this area. Finally, it is worth mentioning that Title III of the Job Training Partnership Act (JTPA) is currently serving about 100,000 workers per year or about one-fifth of the long-term experienced unemployed who reported a job loss to the BLS.

Because an increasing number of workers are "structurally" unemployed, as a result of the current policy mix, attempts to lower the unemployment rate through macroeconomic policies are more likely to rekindle inflation. The strong dollar brought on by the current policy mix has helped lower inflation in the short run, but it may end up contributing to an increase in the dispersion of unemployment rates across labor markets in different areas of the country that actually will worsen the inflation/unemployment trade-off in the long run. Furthermore, industries too long disadvantaged by an overvalued dollar may lose markets and fall behind their foreign competitors in ways that make it difficult to catch up once the dollar falls. Thus, there are potential adverse long-term consequences to the current policy mix that may not be readily apparent at present.

What should be done? Let us first discuss what should not be done, and that is to impose trade restraints. Without action to reduce the budget deficit, the imposition of trade restraints will be either ineffective or counterproductive. As discussed above, as long as we continue to have foreign borrowing needs associated with the large federal budget deficit, we must run a trade deficit equal in magnitude to our foreign borrowing needs. If we impose import restraints, that will reduce the supply of dollars available to foreigners. They can either reduce their lending to us or they can bid up the value of the dollar still further in an effort to acquire the needed funds. In the former case, interest rates will have to rise here, reducing investment. In the latter case, a further rise in the value of the dollar will hurt exports still more and probably offset any positive impact of lower imports on the trade deficit. And this does not even take into account the possibility of foreign retaliation against our exports.

What should be done is to reduce the federal budget deficit and expand monetary policy in order to keep demand growing but with lower interest rates. With lower interest rates and reduced foreign borrowing needs, the value of the

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dollar can come down. This will expand exports at the same time imports are being reduced. The trade deficit will be lowered and there will be greater output and employment in agriculture, manufacturing, and other trade-sensitive sectors. Without action to reduce the budget deficit, we will continue to borrow against the future and distort the pattern of output and employment in the economy in ways that are harmful to long term growth.

Since it will take time to bring the budget deficit under control and time for this to effect the trade deficit, safety nets (such as unemployment insurance and Title III of JTPA) for affected workers should be maintained and strengthened.

Mr. LOWRY. Thank you for excellent testimony.

Federal Reserve Board Chairman Paul Volcker sat right where one or two of you or both of you are.

Ms. SAWHILL. He is big enough to fill both spots.

Mr. LOWRY. He answered my question to him last year just like he answered probably everybody else sitting up here on the panel and all other kinds of people.

I said, "Chairman Volcker, if we cut the budget $50 billion," because that was the figure that kind of magically has come out of the air from someplace, as you are all aware, but we were all in this $50 billion figure, "if we cut it $50 billion, will there be some sort of an offsetting monetary policy?" I guess that means easing the monetary policy. And he wouldn't answer that.

He wouldn't answer that for me, and to my knowledge he has never answered that for anybody.

This is what I keep hearing. Will reducing the deficit—will the action taken by this Congress, which is not easy action, to reduce the deficit cause easing of the monetary policy? Would that be the right description?

Ms. SAWHILL. If I were he, I am not sure I would give any answer in advance either, because what the Federal Reserve wants to do is watch what happens to various indicators of economic performance. But I am sure that he would be willing to say that if various indicators moved in the right direction, that there would be a corresponding shift in monetary policy.

So if you accept the story that we and many others have laid out about the linkages between deficits, interest rates, and the value of the dollar, then I think one can be reasonably assured that something would be done there. But I think your concern is understandable.

Mr. LOWRY. In your list of the 1979 to 1984 scenario of the loss of jobs, trade contributed to loss of jobs, are you saying that because of the products involved within those industries, that the job loss is because of the disadvantage of the dollar?

Mr. STONE. There are certainly some industry-specific factors that have played a role in many of these cases. But I think down the line the strong dollar has hurt each of these industries to differing degrees. But I think there is probably no industry on the list that has not had some adverse impact due to the strong dollar alone, but in addition there are surely industry-specific factors that won't go away if the dollar should come down.

Mr. LOWRY. Let's say the relative value of the dollar decreases because these actions in some way happen. What about the 16-percent adult black unemployment rate or 18 percent or whatever that constant figure continues to be in these areas of where we seem just to have a constantly nagging unemployment problem? Will that affect it?

Mr. STONE. It would affect it if it were accompanied by somewhat more of an expansionary policy in the aggregate, although once again probably not very much. The people that you're talking about are people who are disadvantaged for reasons that don't have too much to do with the level of demand in the economy. They are disadvantaged for other reasons.

So this policy would affect people who have traditionally been in the labor market, have traditionally had good jobs and now find themselves out of those jobs. People who have traditionally been out of the labor market or traditionally had bad jobs might not see so much of an impact.

Mr. LOWRY. Then one of the things we are very interested in looking at as co-task forces is are there Government policies that could possibly affect the employment status of the people who traditionally have been out of work regardless of the trade deficit or these factors that you are addressing here?

Ms. SAWHILL. Well, that is a very big question, obviously. The way I tend to think of it, there are three groups that we worry about. One group is youth, particularly minority youth, as you suggested. The second group is adults who traditionally have been dependent on welfare or public assistance of some kind. And the third group are more experienced, somewhat higher paid workers who have been dislocated by various kinds of structural change, including trade.

For the first group, the disadvantaged youth, you might want to take a look at the recent report of the National Academy of Sciences, which has just finished reviewing all past programs for this group and trying to sort out what we have learned from that effort.

We have tried some things in the past that did not work, but we also have a record of achievements and several programs that have been found to be very successful. I am thinking particularly of the Job Corps, and I see no reason why a program like that that has a good track record should not be expanded if we are concerned about this group.

As far as the mothers on welfare are concerned, I happen to think that some of the experiments that are going on now with various forms of Workfare deserve very careful scrutiny. Some of the demonstration programs around the country suggest that mothers on welfare think it's quite fair to require them to work in return for their benefits, and that when they are given some job search assistance, which can be reasonably inexpensive, they are quite successful in making the transition into the labor market.

As for the third group of dislocated workers, I think they are probably the greatest challenge of all, and I think your next panel is going to have something to say about them.

I am struck by the fact that their major problem is a loss in earnings. Even when they become reemployed, they are typically reemployed at lower paying jobs. The Government's own data show that even those who have been through title III of JTPA programs are earning only about $6 an hour when they get through.

So I think we need to consider not only training and job search options for such workers but also possibly some mechanism to compensate them for some of that earnings loss, perhaps by using a portion of unemployment insurance to make up the difference or part of the difference in the gap between their old wage and their new wage.

That was a long answer, but it was a very broad question.

Mr. LOWRY. Congressman Frost.

Mr. FROST. I am going to ask you a question about this proposal that is pending in Congress right now, the Gramm-Rudman proposal. I think you have read about it in the newspaper and probably are somewhat familiar with it.

Under this proposal we would have targets for bringing the deficit down in each of the succeeding fiscal years. And if Congress is not capable of reaching the target, then there would be an automatic cut that would be somewhat across the board, with certain things exempt.

Now, does it make any difference how we cut the deficit, or is the only thing cutting the deficit? Now, let me be specific. If we were to go into these automatic cuts with Social Security exempt and with interest exempt and perhaps some other things exempt, then you would have these automatic cuts, take things out, trade adjustment assistance, the Export-Import Bank, educational programs designed to improve adult literacy, and perhaps some of the other programs that you have talked about.

Do you care how we reach the deficit target? Does that make any difference, or are we just to reach that deficit number regardless of the consequences along the way?

Mr. STONE. In terms of the questions that we have specifically been addressing about the impact of trade, the impact of the aggregate deficit on the trade deficit and on unemployment in different sectors, it's not so important how the deficit is reduced, but that's not to say that the question of how you go about reducing the deficit is not an important question that should be considered. And so there is a question of should the deficit come down? Yes. Are there good and bad ways to do it? So pick a good way.

Mr. FROST. Well, my question is, is the automatic cut across some of the board a good way?

Ms. SAWHILL. If I could just elaborate on what Dr. Stone is saying in terms of macroeconomic impacts, that is impacts on the performance of the economy, the way the deficit is reduced makes some difference for a lot of technical reasons we don't have to go into now.

But I think a more important point is that people can have very different opinions about which kinds of spending are most desirable or valuable. That's more a political judgment than a judgment that we can make as economists. We may have personal preferences and we may have views about the benefits of some Government programs relative to their cost based on research. I just mentioned the Job Corps, to take an example, as a program in which the investment of taxpayer dollars seem to more than pay for itself. So we can make those kinds of judgments.

Mr. FROST. To follow up on that, if we were to adopt the Gramm-Rudman procedure and it would actually happen, then we won't be making political decisions. There will be no political decisions made by elected officials. We will have a windup toy, and the windup toy then will be responsible for making the cuts.

Now, my question to you is, is that a desirable way or does it make any difference in terms of what you all are looking at in terms of jobs and the trade deficit?

Mr. STONE. It's not desirable to have automatic cuts independent of the state of the economy, independent of whether more stimulus or less stimulus is called for. So in that sense, it's not a good idea to have, as you described it, a windup toy, because there is some judgment involved about what the level of spending should be at the aggregate level, the macroeconomic level that we are concerned about.

Mr. LOWRY. Congressman Williams.

Mr. WILLIAMS. Congressman Frost puts his finger on the dilemma of the Gramm-Rudman proposals; that is, they don't consider that some spending might be economically sound while other Federal spending might not be economically sound, so expenditures from the Federal Government increase the paucity of the dollar. And some don't seem to have any return to the treasury while other efforts on behalf of the Federal Government, on behalf of the public through the Federal Government, do seem to have significant return to the treasury. You mentioned Job Corps as one of those.

Let's take this scenario. Foreign governments tighten their trade restrictions. Our Government passes not only the textile bill with the copper and shoe component on it but other similar trade legislation. Our Government begins to go into another recession. The Congress passes Gramm-Rudman. Given that scenario, which is not terribly unlikely, it seems to me, what could we look for in the way of economic growth, unemployment 24 to 36 months from now, in your best estimation?

Ms. SAWHILL. I don't think that we can do a very good job of forecasting unemployment 2 or 3 years from now. I think that we know that there is a danger of protectionism now and that it would not be good for the economy if we go in that direction. And I think we can worry about Gramm-Rudman being too much of a windup toy. It's my understanding that particularly in the House bill there are some provisions that provide for an exception when the economy is performing poorly.

But I think any such set of provisions tends to be less satisfactory than having greater discretion as we have now.

Mr. STONE. I think if Gramm-Rudman puts fiscal policy on automatic pilot, then the burden falls on monetary policy to determine what the level of employment and inflation will be. And we have already talked about how it's difficult to figure out what the inscrutable Mr. Volcker will do.

Mr. WILLIAMS. Let me go at it this way. Was the budget deficit of the past 36 months stimulative to the economy during the time of recession?

Ms. SAWHILL. Yes.

Mr. WILLIAMS. If we have another recession, should we be reducing or increasing the budget deficit? If this budget deficit helped during the last recession, if we have another recession, should we at the same time be reducing the Federal budget deficit?

Ms. SAWHILL. I think that one doesn't want to make any sudden or abrupt or large changes in the deficit under such circumstances. But I think that over the next 5 years, it is still imperative that we be on a gradual path toward either budget balance or something close to it, perhaps a deficit of 2 percent of GNP.

The reason that one doesn't have to count on fiscal policy alone as the solution to another recession is because, as Dr. Stone has said, we do have another instrument here, and that is monetary policy. Now, to the extent that monetary policy is constrained by the international situation, I think it is much more judicious if we have the freedom to use fiscal policy as well as monetary policy to combat another recession. It's always better to have two tools than one.

Mr. WILLIAMS. Is the deficit directing our monetary policy to any great extent?

Mr. STONE. To the extent that we have a fairly large and stimulative budget deficit, monetary policy has to be more contractionary than it otherwise would be in order to keep from overstimulating the economy. Now, some might argue that monetary policy could afford to be a little easier even than it is now in order to bring the unemployment rate down faster. But presumably, some balance is being arrived at between the risks of further inflation and the gains from lowering unemployment still further. The two interact.

Ms. SAWHILL. If I could just interject one other comment. I think the thing you have to worry about is that because Mr. Volcker may think that there is going to be a sudden plunge in the dollar which could be somewhat destabilizing to our financial institutions, he may feel constrained to keep interest rates at a certain level to maintain a certain amount of foreign capital in this country. And if that is the case, then monetary policy is also not completely free to respond to a new recession. So that is something we should probably worry about.

Mr. WILLIAMS. The trade deficit was about $35 billion when President Reagan assumed office; that is, in his first term. This year it is probably going to reach $135 billion or so. It seems to many economists that that creates a potentially unstable situation where we would have a run here on our assets which, in turn, would force up the yen, the franc, and others to an inflationary point, causing significant unemployment abroad. Do you share those concerns as they relate to the size of our trade deficit?

Mr. STONE. To the extent that our trade deficit represents a surplus for the rest of the world, that is providing some stimulus to them. But they have a whole mix of policies themselves that they are following that is determining their overall level of unemployment. So if the dollar were to fall suddenly and our purchases from abroad were to go down, then certainly that would have—if nothing else were changed, that would have an adverse impact.

Mr. WILLIAMS. Is that an unlikely situation, to have a run on our dollar?

Mr. STONE. It's not unlikely that the dollar is going to fall. Whether it falls rapidly or slowly is anybody's guess. And even to say that it's not unlikely that it is going to fall, economists have been losing probably lots of money over the past 4 years betting on the decline of the dollar and it hasn't happened yet.

Mr. WILLIAMS. Finally, a question for you, Dr. Sawhill. I know you are interested in—and I have seen your testimony here on title III—the dislocated worker program. The 1986 Labor-HHS appropriation bill has reduced money for that program from $223 million to $100 million. And the rationale behind that is that there is $187 million in carryover money that is available in the pipeline. Now, that level differs from State to State. Money is there nationally. Of course, it's not there uniformly in each State.

In your judgment, given your interest in this program, has the House been wise in that cut?

Ms. SAWHILL. I think it would have been better to maintain spending for that program at least at its original level. I think the lack of spend-down is largely due to the fact that this is a new program that is being administered by the States for the first time. They are still figuring out how to allocate the money out to local projects, and all of that takes a great deal of time, and the local projects themselves have to get started. For those reasons, it seems terribly unwise to me not to have given this program a chance to get up and running.

Mr. LOWRY. On point 2 of your opening statement, this particular mix of policies, fiscal and monetary policies, probably has not had a major impact on the level of unemployment in the economy as a whole, but the distribution of the unemployment or the employment. And then I thought you said that if a policy mix was better, monetary and fiscal policy mix was better, 2 million jobs would be created. I am not saying those are inconsistent. I am just trying to make sure I follow what we're saying here.

Mr. STONE. Those two statements are inconsistent. You can't have no effect on total employment and have 2 million more jobs. What we are saying is that, in our judgment about what the Fed actually would have done, they would not have provided enough stimulus to generate those extra jobs, that they would have pursued an aggregate policy that would have generated about the same level of aggregate unemployment. But if they had chosen to be more accommodative and if we had not had the large budget deficit causing the large trade deficit, then we could have had the 2 million more jobs.

Mr. LOWRY. All right. I think that certainly answered the question. Now, would that then have been inflationary to a dangerous degree?

Mr. STONE. Until you added the last clause, the answer is, yes. It almost surely would have added somewhat to the inflation rate. The estimation the simulation of the DRI model that Dr. Sawhill mentioned earlier showed an inflation rate about 1½ points higher. Now, a 6 percent, 6.5-percent inflation rate seems high compared to what we have actually experienced. It might have looked very good compared to the 10- or 11-percent inflation rate that we were starting out from had we pursued these different policies. Whether that's a dangerous level or not is a matter of judgment.

Ms. SAWHILL. You have to remember, along with that higher inflation we would have had an unemployment rate more like 6 percent instead of what we do have. So you've got gains on that front offsetting the higher inflation.

Mr. LOWRY. But that DRI model was about 6 to 6.5 percent inflation, or was it lower than that?

Ms. SAWHILL. No; I think it was about 6, 6.5 percent.

Mr. LOWRY. And that would have been approximately what period of time?

Ms. SAWHILL. That's where we would have been in 1984.

Mr. LOWRY. 1984.

Mr. STONE. With about 6 percent inflation, 6 percent unemployment, rather than 4 percent inflation and 7.5 percent unemployment.

Mr. LOWRY. Right now, in 1986, what would you say the 1986 inflation rate is? And then juxtapose that same question onto the effects in 1986–87.

Ms. SAWHILL. It tends to remain about the same, you know, assuming no new events disturb the economy further. So I think you could assume that we would still have higher inflation by a point or two. However, I think you have to take these simulations with a grain of salt. They only give you a rough estimate of what the difference might be, maybe 1 percentage point or 2 percentage points higher inflation now and a lower unemployment rate by 1 percentage point or 2 as well.

Mr. LOWRY. As a result of an easier monetary policy going with a less-budget-deficit fiscal policy?

Ms. SAWHILL. Right; we had balance in the structural budget in our analysis and a much easier monetary policy.

Mr. LOWRY. Well, thank you very much for very helpful testimony. It was very good, and I thank you very much.

Our last witness today is Nathaniel Semple, Committee for Economic Development.

Mr. Semple, thank you very much for joining us today.

As you may have heard, we have been asking some questions, among the many things we are looking at, of course, being Government policies effect on employment and can it have a positive effect on employment. And also, we are trying to get as good information as possible going into the next budget cycle as we face those questions of program cuts and eliminations and what is the cost-effectiveness of those Government programs. We are trying to get as good a background as we can on those, among other things.

So thank you very much, Mr. Semple, for joining us today. Just proceed as you would.

STATEMENT OF NATHANIEL M. SEMPLE, VICE PRESIDENT, COMMITTEE FOR ECONOMIC DEVELOPMENT, WASHINGTON, DC

Mr. SEMPLE. Thank you. I suspected you might want to deal with that, and as a result, all I can see in my testimony are crossed-out pages and black lines and a variety of other things. So the good news is you won't have to listen to too much, and the bad news is that I might get a little bit off the beaten track if I have inserted the wrong page in the wrong place.

I am delighted to have the chance to testify. The CED, as you know, consists of 200 leading business executives and a considerable number from academe. We have long worked in the area of human resource and capital issues, and we have just recently put out two statements, one that is just now being put out, that has to do with dislocated workers, specifically one that has to do with the future of the labor market.

Now, I will talk about the micro aspects of this and not the general issues that Isabel Sawhill talked about. We do agree with her observations about the impact of the deficits and trade policy on employment.

One message I would like to deliver today is that we feel in terms of human impact, the most severe effects will not be from change that moves too fast, but change that moves too slowly. It is our view that the economy is going to change, continue to change in response to competition. And no one can disagree with Bishop Francis' characterization about what work means to individuals. Our concern is that if you don't allow the change to occur, the work will not be there.

There are two groups that are in danger, we feel, despite everything and are in danger of being left behind. One is the dislocated worker. The policy paper which we are about to release, entitled "Work and Change: Labor Market Adjustment Policies for a Competitive U.S. Economy," details some specifics as to how best deal with that.

The loss of employment in manufacturing doesn't necessarily mean we are deindustrializing. That is a point I would like to make. As a percentage of gross national product over several years, manufacturing continues to remain relatively stable. It is pretty much the same today as it was in 1950, 1960, 1970, and 1980. What is happening is that the manufacturing is restructuring out of older-line industries, those industries that have commonly been held to be representative of American strength. And I had a note in here that the fact that we call Superman a man of steel is an indication of how deeply ingrained this view is in our society.

Unfortunately, the dislocation problem is deeply centered in this area. Despite the nature of the problem, it is not, in terms of the overall economy, as bad as it first appears. Dislocated workers, however you define them and how broadly, constitute only one-half of 1 percent of the U.S. labor force, although they do represent about 7 or 8 percent of the total unemployed.

The fact that a good deal of the loss in manufacturing of about 1.8 million has been offset by increases in new service jobs. We do not believe that these service jobs necessarily mean that people are worse off. The average loss in pay, for example, between the two of only $9 to $7.50, a good deal of which can be accounted for by the fact that the jobs lost in manufacturing are relatively higher paying and the new ones being created are entry level and therefore lower paying.

We don't view the fact of having 6 or 7 million new jobs as bad news. In addition, we also feel it offers a lot of opportunities for people who would not otherwise have an opportunity to get into the labor market.

Nevertheless, the problem of dislocation is severe, and as my previous friends testified, it is severe in certain industries, particularly steel, electronics, rubber and tire and all the other ones we hear about everyday. The problem is how do you deal with this? Neither public nor private policies today are well suited to dealing with it. Private policies suffer from a failure to deal ahead of time with the problem of employee adjustment. Public policies are too rigid, bureaucratic, and poorly managed.

In my view, and one which is shared by most of our trustees, the most important test of any public or private policy should be whether or not it eases or impedes the transition of workers to new opportunities, to new work. We believe that management plays a preeminent role in doing this. This is one thing we want to make perfectly clear. The difference in what management does today and what they have done in the past will spell the difference as to whether this adjustment will continue or whether there will be resistance to allowing adjustment to occur.

We have illuminated a number of specifics in that area. I will talk about, however, the area that you are concerned about; that is, the public side.

There are four critical elements of public policy. First—if it turns out there are five, I will apologize—the establishment of incentives——

Mr. LOWRY. It's close enough.

Mr. SEMPLE. It's close enough. Right.

First of all, there has to be establishment of incentives for reemployment, and we think you have to start with programs like UI and other such efforts that focus and encourage reemployment from higher paid jobs into lower paying jobs. I will get into this in more detail in a minute.

We think there has to be a much better coordination of public and private sector resources at the State and local level. We at CEO believe private sector involvement in the design and implementation of job training programs can be effective, and has been. We also believe, in terms of the long run, that education reform that emphasizes skills and attitudes for future workers, today's students, is critical.

To be a bit more specific. First, the difference between TAA—trade adjustment assistance—and title III. We are not great supporters of TAA, and there are a couple of proposals up now to use TAA as an adjustment device. And from what we have seen in the past and what we have seen in the operation of TAA, these are not going to work.

First of all, as happens in some Government programs, TAA is voluminous in terms of paperwork and bureaucracy. Second, import competition is not the only reason we have had dislocation;

there are a lot of other reasons, including consumer preference changes, domestic competition, and a variety of other things that occur that cause people to lose their jobs. To discriminate against all those people because they have not somehow met the import competition test we think is unwise.

Third, any one of us who has had experience with the U.S. Employment Service are not too impressed with their track record. And we are certainly not impressed with their ability to encourage adjustment.

I would only suggest that anyone who wants to see this operation visit the local employment service office to see how encouraging they are about adjustment policy. Some are doing better. I won't criticize the entire operation, but I am just not convinced that alone they can do the job.

There is also no direct involvement of management or labor in the transition process, leaving it entirely up to the worker and the Government to do the job. We think this is a mistake.

Finally, the program and the ones that have just recently been suggested only offer training. Now, we think training is fine. But what is training when there are no jobs for it, or, what is training that is inappropriate for the jobs that do exist? We feel the best kind of training is on the job, and the first thing you have to do is get workers into those jobs.

Let me get to the third point, and that is, the best way to do this is through some redesign of the unemployment insurance system. We have numerous suggestions in our work about how to improve UI. It is a serious problem financially and otherwise.

Nevertheless, we believe that there are some things that can be done creatively to improve the delivery of UI as an adjustment device. I will give you just one example. We have found some collective bargaining plans, for example, have successfully enabled workers to move by paying for a period of time the difference between their old wage and the new wage.

This would apply particularly in high wage industries like steel, which has enjoyed, for example, an average of 40 percent of wage premium over the average manufacturing. When a steel plant closes in a community, there are no jobs around that pay as well, or very few. These people, who are older, are generally tied to the community for reasons of culture, church, and everything else, have an extremely difficult time moving. They don't want to move. There is not much option for them, and as a result, they have become increasingly part of the long-term unemployed. They are a very difficult group to deal with.

The biggest problem they confront is they don't like taking a lower salary and I think that is very understandable. Most people don't.

So what we propose is that if workers lose their jobs, that you cash out a portion of their unemployment insurance, particularly if it's extended, and use it as the difference between the old wage and the new wage for a period of 6 months or a year or however long the extended program works.

What we have found in private plans is that by the end of 6 months or a year, the worker is up to the level they had worked before. What it does, it encourages getting over that initial hump.

If there is any resistance because of wage, at least it's one option available that encourages them to move. It's not the only one; there are lots of others, including job search and retraining and a variety of other options.

A point I want to make is that in delivering these programs, flexibility is critical. Every worker has a different situation. There are no two alike, even in a plant closing. They all have different family resources, they all have different available needs. If you only limit it to one thing like training, as they do in some of these proposals on TAA, it's not a good idea.

Now, the program we think actually that has more promise is title III of JTPA. It has had serious startup problems, there's no question about it. But Governors have not had a great deal of experience in working adjustment programs. Furthermore, the Governors, as happens in Washington, are confronted with turf struggles among the various agencies who are grabbing for their share of the dislocated worker pot. Some States have overcome this. California and others have created teams to overcome their problems.

Nevertheless, the advantage of title III over, say, TAA is that it allows programs to be developed closer to the communities, for example, where plants close. In private sector plans and in private sector plant closings, title III has been a very real and successful add-on to efforts, for example, to set up plant assistance centers for workers who are going to lose their jobs. We find that title III is more flexible and more adaptable, can provide different kinds of resources, and you don't have to go through quite as much.

This again does not belie the fact that there have been a lot of problems and the Governors have been short in responding to requests. Nevertheless, we think it would be wrong in any State just to start cutting back on title III or to replace it with TAA. I will just end on that point there.

We feel there are a lot of other things that can be done in the public sector in disclocated worker programs. I won't get into them in great detail now. However, I would be delighted to provide you with some of our other suggestions. They are rather voluminous, and I know you don't want to listen to all of them.

There is one other group that is going to be in danger of being left behind, and that is, in our view, today's students. You have heard a lot about the problem of quality education and the quality of schools. We take this extremely seriously.

As Congressman Williams knows, Brad Butler testified before this committee about 1½ or 2 years ago as we were in the middle of a study which was directed to this concern. This study has been released, and it has a nice cover and everything. What we want you to do is to go through it at some point because it suggests a number of specific policies we think are important in terms of your need to invest in education as a human resource.

Ironically, this study came out of a discussion of productivity, and we felt that as human capital and human resources to productivity was critical. We formed a panel that included 20 current and former CEO's, Al Shanker, the head of one of the largest urban school districts in the country, and a variety of others.

We took a hard look at this and we looked at it in terms of return on investment. There were four areas we looked at. We looked at what skills kids will need when they get out of school to get a job now and in the future. Second, if you were to solve this problem, where would you put your money? And third, how do you deal with the teacher problem? And fourth, what business could do to leverage itself.

I will talk now about where we think one should spend the money. We felt that the best investment would be to provide preschool education for every disadvantaged student in the country left of the Ypsilanti program. We realize this is an expensive recommendation. But we were convinced after studying the evidence the returns to students were significant, far beyond any measure of anything we had seen before elsewhere, and were definitely worth looking at.

We don't necessarily suggest the Federal Government pick up this role. We feel if there is a first option choice, it should be State and local with the business community helping leverage the necessary tax dollars and bond issues to do it.

Nevertheless, we felt preschool education was a No. 1 element in dealing with particularly disadvantaged individuals who were not going to be able to obtain long term employment if they didn't get it.

The second area we found that had a good return was Job Corps. Now, this much maligned program has been the subject of a lot of discussions and debate. We realize it is limited in terms of scope and application. Nevertheless, in terms of kids who drop out of school—and this year there will be 700,000 such kids—that it provides a better alternative than anything else we've seen in terms of getting these kids back in the schools.

A third area we felt, of course, was to improve the compensation level of teachers. And a fourth level was to provide for increased Federal research. It doesn't seem like a big recommendation; nevertheless, we think information is critical to improving quality education in the future. We don't think we get enough good information.

Mr. Chairman, that is kind of it, in brief. I feel somewhat remiss because the recommendations are so many, and in a case like this you feel like you've only touched on them. But I suppose it would be better if you asked questions and then I could raise them in whatever detail you want.

[Testimony resumes on p. 65.]

[The prepared statement of Mr. Semple follows:]

PREPARED STATEMENT OF NATHANIEL M. SEMPLE[1]

Mr. Chairman, my name is Nathaniel Semple and I am Vice President and Secretary of the Committee for Economic Development which, as you know, directly involves over 200 of the nation's top leaders in business and academe.

I am delighted to have been asked to testify to this special joint session of the Budget Committee Task Forces on Economic Policy and Human Resources. All too often the impact of macroeconomic policy on the labor market is set aside in economic poli discussions, and has been almost totally absent in the recent debates on trade, tax and budget issues. You are to be commended for having this hearing.

The U.S. economy is at a crossroads. Faced with the harsh and very new reality of intense international competition and the end to U.S. economic insulation, we must define a course that will enable the American people to meet this competition confidently, without fear for their economic futures.

Nowhere is this more important than employment policy. Americans have come to see this new era of international competition not for the opportunities it offers -- and as I will testify it does offer new opportunities -- but for its threats. This is most visibly and dramatically evidenced by the increasing number of jobs that are being lost in those industries that have long been symbolic of American strength and achievement. The fact that "Superman" is known "as the man of steel" is no small reminder of how deep seated this view is in American culture.

[1] The views expressed herein are solely those of the author and in no way represent CED, individual CED trustees, their organizations or any other business association.

Unfortunately, what is less well understood is that as the U.S. economy necessarily restructures to meet the competition, "old" work is being eliminated and "new work" created. And over the past five years, a good deal more "new work" has been created than "old work" lost. In other words, this change has brought more opporunity than loss.

If there is one message I would like to deliver today it is that in term of the human impact, the more severe effects are not from change that moves too fast, but from change that is made to move too slowly. Unless we adopt both successful public and private policies to encourage adaption of the labor market, we will be guaranteeing fewer employment opportunities and a reduced standard of living not only for today's worker but tomorrow's as well. These policies need to address those groups in the labor market who today are unable to adapt but will need to adapt if they are not to be permanently left behind.

The first such group is the so-called "dislocated worker." This past week over forty of CED's top management participants approved the release of a paper entitled, "Work and Change: Labor Market Adjustment Policies for a Competitive U.S. Economy", that thoroughly details what needs to be done in both the public and private arenas to ease the plight of those who have been laid off from our capital intensive industries. The Subcommittee, chaired by Frank Doyle of General Electric, included representatives from Ford, G.M., AT&T, Pacific Telesis, Northern Telecom, U.S. Steel, Procter & Gamble, Aluminum Company of America, and others. Although the paper they have formulated will not be released until early next year, my comments will draw heavilv from the preliminary version.

The common perception of the dislocated worker problem is shaped by what most Americans see on TV and read in the newspapers. What they do see are large numbers of people who have had strong attachment both to their jobs and their communities losing those jobs. They see people who, having benefited from the relatively high wages that much of the American Industry has enjoyed over the past two decades, have neither the skills needed nor the opportunities available to replace the job they are losing. This bleak picture translates into a more general feeling that we as a nation are losing our industrial base and our status as an economic power; that we have a serious unemployment problem that will only get worse; that the plants that are closing are moving somewhere else in the U.S., or, worse, overseas; and that whatever new jobs are created usually involve passing out hamburgers at glorified hot dog stands at substantia less pay.

The first perception -- that the people who have permanently lost their jobs in manufacturing are having a tough go of it -- is for the most part true. The second, that this reflects a denouement of the American economy is dangerously innaccurate.

The loss of employment in our manufacturing sector does not necessarily mean that, on the whole, we are deindustrializing or losing our manufacturing base. Despite dramatic declines in a number of specific industrial areas such as steel, apparel, textiles, machine, shoes, electronics and a number of others, the <u>contribution of manufacturing to</u>

GNP has remained remarkedly stable over the last three decades. Manufacturing continued to contribute at the end of 1984 (24.2%), as much as it did in 1980 (23.7%); 1970 (23.3%); 1960 (23.7%); and 1950 (24.2%). Much of the loss in capital intensive industries has been offset by a move to new types of manufacturing, such as communications equipment, hospital supply, furniture and fixtures, fabricated metal products, electrical and electronic (outside of radio and TV receiving equipment) and transportation.

Second, the number of those dislocated represents a relatively small fraction of total U.S. unemployment and the labor force. Under the broadest definition, those "dislocated" due to plant closings in manufacturing constitute less than 1/2 of 1 percent of the U.S. labor force and about 7 or 8 percent of the total unemployed. Furthermore, the recent decline in manufacturing employment has been offset by a growth of nearly 10 million net new jobs in the past 6 years -- a figure that compares to a net loss among the Common Market economies of over 2 million. Even in regions where there have been the largest number of jobs lost in manufacturing, these have been more than offset by total job growth and continued increases in the disposable income.

In the East North-central states, employment grew between 1979 and 1983 from 29.5 million to 38.1 million. This was accompanied by a growth in the region's real dispoable income from the 1965 level of $3,772 per capita, to $5,583 per capita in 1980. Although other areas experienced a faster rate of growth in disposable income during this period, total per capita income in the East North-central states continued in 1980 to be the highest in the nation outside of the Pacific Coast.

Third, where gains in manufacturing employment have occurred it has not be caused by "fugitive plants" fleeing from one area to another. Such growth has resulted primarily from the initiation of a new business or the expansion of an existing one. A study of Fortune 500 transportation equipment firms reveals that these companies redeploy capital primarily by acquiring or opening new facilities, or expanding existing plants. Of the 331 plants operated by these companies during 1970s, 77 were expanded, onl 28 were closed or sold. Of the 143 new plants opened, 126 were either acquired or opened anew; only 17 were relocated from another region.

Finally, the belief that these manufacturing jobs are somehow being "replaced" by less well-paying and poorer value added service jobs is dangerously mistaken. Those who adopt this argument run the risk of slowing down the kind of change that is currently accounting for new job opportunities at good wages for millions and millions of Americans. Essentially this view runs as follows. Manufacturing has lost approximately 1.8 million manufacturing jobs as of October 1985 from the peak manufacturing year of 1979. Most of these have been high value added jobs in industries such as steel, automobiles, industrial equipment, textiles and apparel, paying on the average slightly over $9.00 an hour. Because the service jobs that are "replacing" those lost in manufacturing pay less -- about $7.50 and hour -- many see these as less valuable, both to the individuals who are employed in these jobs and to the economy at large. Also, the inference is that because many of the new jobs are being filled by women, that they are less value-added or, indeed, "less esteemed". Finally, it is argued that those displaced from industry are unable to obtain the better paying service jobs since they lack the required skills.

Unfortunately, these misconceptions underlie much of effort directed to stopping the loss of manufacturing jobs by preventing the movement of capital and labor to new areas. As I have already noted, the loss of 1.8 million manufacturing jobs since 1979 has been offset by an increase in <u>ten million</u> new jobs in the economy, a total far in excess of that of any industrialized country in the world. This job growth, 94 percent of which has come in new service positions, has provided millions of Americans with opportunities for work who have never worked before and who otherwise would not have such an opportunity, and has resulted in historically high labor force participation rates for both women and men. This is a trend we find <u>encouraging</u>, not discouraging. Because many of the new jobs that are being created are in entry level positions, it is logical that because the manufacturing job losses involve longer tenured, higher paying positions, that some wage differential has occurred. In fact, it is surprising that the differential is not greater, since so many of the losses of "real jobs" have occurred in industries which even when compared to manufacturing at large have enjoyed as high as a 40 percent pay premium. We, at the CED, have long argued that the premiums historically paid in these industries are a major source of these industries' current competitive problem.

Finally, much of the job growth in services, such as finance, communications and information processing, business services, electronics, wholesale and business trade, is in response to improved, not declining U.S. lifestyles and consumer preference. This growth is not a result of a decline in manufacturing but, we would contend, is a result of an increasing ability of manufacturing to move away from older, less profitable lines of manufacturing to new markets where the application of new technology and product design provides better return.

None of this obviates what is occurring in a number of our traditional manufacturing sectors which have experienced a substantial loss of output and employment. Most seriously affected has been, of course, the steel industry, which today is shipping about half of the tonnage being shipped just over a decade ago. This reduction has been accompanied by a rapid decline in employment, from a level of 509,000 in hourly unionized jobs in 1973 to somewhat under 300,000 today. Similar declines have occured in apparel and related manufacturing -- which have been totally unequipped to deal with the immense labor cost advantage enjoyed by their Pacific Rim competitiors -- and in machine tools, fabricated metals, certain consumer electronics, rubber and tires, ball bearings, semi-conductors and watch production.

I should point out that not all of this is "blue collar" hourly employment. Competition has also led to a considerable thinning of mid-management.

These losses have contributed to a net loss in manufacturing jobs of about 1.8 million since the peak year of 1979 -- out of a total manufacturing labor force of about 20 million, 13 million of whom are production. During this period, about 2.5 million manufacturing workers became displaced, though only a fraction have remained permanently unemployed. More than 60 percent have found a new job -- more often than not outside their original industry -- and the bulk of those who remain out of work were the last ones to lose their jobs and have had the shortest time relatively to find and obtain reemployment.

However, workers in some industries, particularly metal products, have had extreme difficulty. While only 1 in 10 of those dislocated in manufacturing were employed in primary metals, 40 percent today are still looking for work and another 16 percent have dropped out of the labor force altogether. No other industrial sector comes close to this record of difficulty. These workers share common characteristcs. They are usually older, with long attachments to their employment than the average, have enjoyed good wages, often amounting to 40 percent than their counterparts in other manufacturing areas, and for reasons of family ties and community are most reluctant to move.

Neither public nor private policies are well suited to dealing with the problems these workers face, or the problem any dislocated worker faces. Private policies suffer from a failure to deal ahead of time with the problem of employee adjustment; public policies are too rigid, beaurucratic, and poorly managed. It is my view, and one which is shared by CED's trustees, the most important test of any public or private adjustment policy should be whether it eases or impedes the transition to new opportunity; whether it establishes or denies supportive mechanisms for workers undergoing the often painful and costly move to a new job.

The CED believes that management remains, as always, ultimately responsible for ensuring the profitability of an enterprise. The difference now is that many of the measures that need to be taken to ensure profitability in an intensely competitive world are more likely to involve changes in the type of work done and the number of people employed. We are convinced that labor adjustment policies, therefore, have to be factored into any decision taken by management to improve competitive position.

There are five critical elements of adjustment around which we believe policies in the private sector should be structured:

- Communication between management and labor regarding the competitive realities of the business and steps needed to stay profitable;

- Employee involvement in the design and implementation of productivity improvements;

- Adoption of flexible total compensation as a means of keeping wage and benefits costs in line with the business' competitive position;

- Voluntary company notification of decisions affecting jobs, particularly in cases of plant closings, work transfers, or automation;

- Establishment of <u>support programs</u> that allow people to shift to new opprotunities either within the firm when new work is being created, or outside when old work is being eliminate.

Since your concern is quite properly the government role, I want to stress that the CED has concluded that government at all levels remains ultimately responsible for creating and sustaining the conditions for economic growth. Without these conditions, there would be little prospect of new employment opportunities, and government's ability to balance fairly the demands of competing interest groups would be diminished. Rapid change, therefore, poses as serious a challenge for government, particularly our form of democratic, pluralistic government, as it does for industry.

Labor adjustment policies in the <u>public sector</u> should seek to maximize values, such as mobility, that give the U.S. a distinct competitive advantage over other countries. The critical elements around which such policies should be structured are:

- Establishment of incentives for <u>reemployment</u>, beginning with existing programs such as UI and focusing on encouraging reemployment in an initially lower paying but growing industry;

- <u>Coordination</u> of public and private sector resources at the state and local level to enable quick and effective response to plant closing situations;

- Private sector involvement in the design and implementation of job training programs, in order to tie training more closely to the needs of industry and increase a trainee's chances of getting a job;

- Encouragement of entrepreneurial initiative on the part of small and large enterprises;

- Education reform emphasizing the skills and attitudes needed to prepare students for a changing marketplace of high valued-added, technology-based jobs.

A second group that will clearly be left behind are those who lack the basic skills required in today's labor market to obtain and retain productive employment. This includes adults of all ages, and youth, both those graduate now from high school and unless things change, a large proportion of future high school graduates.

A good deal has been said about the current "disadvantaged" population. As you know, they are the focus of the only major federal job training program, JTPA, and have been the focus of nearly two decades of federal employm.nt and remedial training programs. Prior to my current employment, I spend nearly ten years as a counsel on the House Labor Committee wrestling with ways to improve the chances of those who for reasons of income or lack of skills were not able to find work. All I can say is that, despite a good deal of progress and the promise of JTPA, this group represents about an intractable problem. Since I suspect that this is a concern of this Committees, I would be happy to respond to any questions you may have in this area.

However, for the remainder of this testimony I would like to address the future. As you may know, the CED, under the guidance of Owen Butler, Chairman of the Procter and Gamble Company, issued what has come to be a singular, if not landmark report on the business perspective of what is happening in our nation's schools and what needs to be done if they are to provide young people with the needed skills to obtain productive employment in the future.

Entitled Investing in our Children: Business and the Public Schools, this study evolved directly out of a concern expressed by a number of our members several years ago that a critical element of improving the nation's rate of productivity, which for twenty years had chronically fallen behind that of our major international competitiors -- was improving the skill level of our nation's workforce, and particularly, the skills of new entrants graduating from the nation's secondary schools. A special Subcommittee was established to look at the problem, which included twenty current and former chairmen of major U.S. businesses, the presidents of seven major Universities, the deans of three of the nation's leading colleges of teacher education, the superintendent of one of the nation's largest urban school districts, Al Shanker of the AFT, a number of former teachers and a host of other top level educators and business advisors. As for parental representation, almost all where current or former parents and with children in the public schools, and almost all had attended public school. Not surprisingly, the interest level in this report was high.

The report looked at four aspects of the decline in quality in the nation's schools on which the Subcommittee felt that business has a particularly useful perspective: first, what skills students graduating from school would need to assure themselves of a good opportunity for productive employment: second, where we should invest our resources to improve substantially those skills: third, how best to upgrade and strengthen the teaching rpofession to improve the quality of instruction and fourth, how best the business community could leverage its influence to generate the needed support to undertake the needed steps.

I will address myself to the first two aspects of this report, which I would happy to provide to you. The CED Subcommittee was deeply disturbed by the increasing number of reports that indicated that students entering the labor force were increasing unprepeared. One study, for example, estimated that by the year 1990, unless things change, between 1 and 1.5 million of the nation's 2 million graduates would not have the skills needed to obtain a job. A second revealed that more than 700,000 young people were dropping out of high school each year, thus guaranteeing these youth a lifetime of labor market problems. A third revealed that there is a direct correlation between the total number of young people between the ages 16 and 24 who have dropped out of school over the past several years -- about 2.8 million -- and the total number of youth in this age category who are listed as unemployed, which last month was 3.3 million.

The Subcommittee felt that a message had to be delivered to the schools, parents, and students themselves in loud and clear terms on just what was needed if they expected to obtain decent employment. We did not by any means view this as the only role for the schools but felt it one that has lost significant quality over the past decade. We undertook a survey of several thousand businesses, and were careful to distinguish between those skills needed to obtain a job and those needed to advance out of that job. Surprisingly, the same skills were listed for both, with some minor variations. The Subcommittee found that besides needing substantially better basic skills, students were coming to the work place with the wrong attitudes. We concluded that occupation specific training, of the sort delivered by vocational education, should be delivered only after the essential grounding had been made in these other two areas.

The Subcommitttee went on to look at how best to do this. They felt that additional resources would be needed in four areas: pre-school education for 3 and 4 year olds; teacher compensation; middle schools and federal research. They determined that funding should not be decreased for Job Corps, and that efforts should be made to expar job corps type programs at the state and local levels. The Subcommittee concluded that funding should not be increased for vocational education until the system underwent radical change and improvement.

In all of these areas the Subcommittee drew its conclusions after exhaustive research detailing the returns, to students and society, of these proposals. By far and away the Subcommittee felt that pre-school education, as structured after the Ypsilanti model, gave the clearest and greatest return, and recommended that every disadvantaged child in the country have this type of advanced preparation made available.

Mr. Chairman, the details of the CED report are many and varied, and much too lengthy to detail here. I would be happy to go into any aspect of this report in any detail you may wish. I hope I have indicated to you how deeply concerned the CED's members are that our future ability to compete depends on preparing today's youth in ways that allow them to learn and adapt.

In conclusion, Mr. Chairman, the CED has looked carefully at two groups, one currently in the labor market, and one that will soon be, and identified where there will need to be significant changes in both public and private approaches. We believe that it will take both government and business to do the job.

Thank you.

Mr. LOWRY. Thank you, Mr. Semple. We appreciate the variety and the number of recommendations and specific recommendations.

Would you just expand a little on the Ypsilanti program? I am not familiar with that. Mr. Williams probably is, and probably should ask this question.

Mr. SEMPLE. Do you mind if I pull out a little summary of this?

Mr. LOWRY. This was preschool?

Mr. SEMPLE. Preschool.

Mr. LOWRY. And that is different in some ways from Headstart?

Mr. SEMPLE. It's a more specific, detailed program than Headstart. It's got a lot of elements to it. For example, it's a very controlled model. There are only seven or eight students in the class. It directly involves parents. For example, teachers regularly visit parents. We found that in developing programs, that parental involvement made a distinct difference in whether the kids were able to take what they learned in school back home again. We found in many Headstart programs this element was missing.

We found in Perry—in Ypsilanti, it was the Perry School in Ypsilanti—we found that program contained in addition to that plus better teacher-child ratio and a variety of other things than most programs.

The results were rather significant. We found that it reduced crime among those students compared to a control group by half, increased their real earnings by about 60 or 70 percent, increased their employment rates by that figure as well. These are huge returns or what we thought were relatively modest investments, and the total reduction in terms of all the social costs that come from underschooled and undereducation of dropouts were almost eliminated.

So being business people, we felt, well, here is an investment, and here is a darned good return. Let's put our dollars there, and that's the way we looked at it.

Mr. LOWRY. In your study, was there any sort of an estimate of what applying that sort of a model across the country, what the costs would be and would it require commitment toward financing that, which in one way or the other would involve a Federal commitment? I am assuming that, for instance, there has to be a way by which the States and local governments would have to have a way to pay for that. Correct?

Mr. SEMPLE. Absolutely. That's a reasonable question. We could recommend all the expensive programs we want. How are you going to go about funding it? I may be a little off on this estimate, but we estimated that the cost to duplicate was somewhere between $3,000 and $4,000 a child. Then if you involved all children, it would run about $2.5 billion nationwide. The total expenditures on U.S. public elementary and secondary schooling today is about $130 billion. So as a percentage of the total expenditure, to us it's a modest percentage.

Of course, you can always argue maybe you can readjust what you've got now into more Headstarts, and we had a lot of suggestions on this. We think there is a great deal of administrative bureaucracy in the schools that could be reduced, and those funds could be leveraged to the classroom. Needless to say, we had a lot of discussions with the education community about those proposals. But nevertheless, we think there is a lot of readjustment that could provide some of the revenues. Nevertheless, we understand you are not going to get it all from there.

Our argument is that if the business community gets committed to this kind of a concept, they've got to get behind it at the State and local level and not resist State and local bond issues to increase funding for schools. They may require that these issues be directed toward this or whatever. But if the funding is to come from anywhere, it should come from that level.

Now, it may be that in terms of Federal policy, you may want to redesign it, reallocate, or rethink some of the Headstart programs to make them a little more along this model. We don't have any specific recommendations on how to do that. But I think by looking at the Ypsilanti model and translating it back, it would be a worthwhile thing to do.

Mr. LOWRY. Did you have a chance at the time you were going through this study and recommendation to look at the effect of the deductibility of State and local taxes upon the ability to do this?

Mr. SEMPLE. I am sorry you asked that question, because I really don't have—our problem, of course, is that in any situation we are in the midst of tax reform and deficit reduction and everything else, and frankly, our troops were divided. And as a result of being divided, we didn't come out with a recommendation.

There were those who felt very strongly that State deductibility would undermine the ability of financing at the State and local level. On the other hand, there were those who were so concerned about the whole issue of tax reform and its implications for competitiveness in the U.S. economy that they did not want to limit the options ahead of time. So quite frankly, we didn't come up with a recommendation on that.

I think the only thing I can say is that we strongly feel that whatever the outcome of tax reform, and if it makes it harder for localities to fund, it makes our job that much more difficult to get the funding. If we are committed to what we are saying in this, then I can assure you, from what I have seen, what Brad Butler has been doing around the country and our other trustees, they will have to go in and fight that much harder.

Mr. LOWRY. I apologize to my partner for taking his questions. But let me ask just one other question that is not within what we had asked you to address. Actually, it comes almost more, I think, from the panel before you—deficit, trade deficit, jobs. What is the position of the CED as far as a revenue increase as part of a deficit reduction package?

Mr. SEMPLE. Tax increase?

Mr. LOWRY. Yes.

Mr. SEMPLE. We have gone on record supporting a revenue increase, if necessary. We did so several years ago in a series of recommendations included in a document we called "Fighting Federal Deficits." It laid out a 5-year plan which is remarkably close to what has been laid out in the current debate. But it included, as a last resort, tax increases. And it also included such controversial items as a minimum tax, although, of course, there is a huge debate over what you mean by that. And perhaps at the time, it was extremely controversial. I can still remember the reaction even among the business community—a surtax. But these were temporary.

We also had a series of recommendations on tying, for example, the inflation index to some reduced increase in the entitlement programs, the CPI minus two. The ironic effect is that it all came up pretty much close to where we are now.

The difficulty politically, obviously, is to link all those things together, but nevertheless we have come out for some kind of revenue increase, but it's conditioned on all these other things occurring as well.

Mr. LOWRY. Thank you. Mr. Williams.

Mr. WILLIAMS. Thank you. I want to commend the Committee for Economic Development, the chairman, and Vice Chairman Brad Butler, who I have come to know, like, and respect. I want to particularly commend you for this volume. This one happens to belong to the staff of the Budget Committee, and it's well earmarked. It's written in the margin.

Mr. SEMPLE. We sometimes wonder if they don't just let it gather dust on the shelf.

Mr. WILLIAMS. The two books in my office, one with my subcommittee, the other in my office, are equally well-marked and used. We appreciate the specificity, particularly, of the recommendations that your committee has made.

I was pleased with your response to Mike Lowry's question about recommendations that your group has made on revenue increases, if necessary in certain circumstances. Has your group had an opportunity to take a close look at and make a judgment about the Gramm-Rudman or similar budget process?

Mr. SEMPLE. We have no policy recommendation on it. I will tell you how the debate has gone on it at CED. To say that we have looked at it, yes, we certainly have. Our reactions are probably similar to some of those up here on the Hill. They feel that something has to be done. They are not at all sure that this is the right way. There is a sense of frustration about the inability to deal with the deficits. There is an overriding concern that it has to be dealt with, yet there is a concern about the arbitrariness and some of the potential consequences of enacting something with such rigid guidelines.

I think what is going to happen is going to happen before we have a chance to figure out what we should do about it, which is kind of probably reflective of the way it's being done.

Mr. WILLIAMS. That's what we're worried about here, too, that something is going to happen before we decide what it is we want to do.

Mr. SEMPLE. So what we think we are going to do is take a look at if something should happen and recommend ways to get it back into sync if it's way out of kilter. But right now, we're just watching this train go by, in some bewilderment, I might add.

Mr. WILLIAMS. Your committee knows illiteracy, functional illiteracy, is at a magnitude where it threatens America's continued economic growth among certain populations. It is at a magnitude where it is costing the private sector in America millions of dollars a year, costing the public sector many, many times that. It is not a new problem before the Congress, nor is it a problem that has been left unattended in the past two decades.

The Congress, this Congress, continues to try to find better ways to reduce the problem of illiteracy among the population. Some of us have been coming together now for several months in an effort to develop legislation or, more likely, a series of pieces of legislation. And we hope to have those ready for introduction before long.

I will be sending your committee our suggestions, and I would appreciate it if you could take some time to analyze those and make some recommendations, even if they are informal.

Mr. SEMPLE. We would be delighted to do that.

Mr. WILLIAMS. You have been very helpful to us. You are geared up to do it now?

Mr. SEMPLE. We are geared up.

Mr. WILLIAMS. I want to recommend to you that you do that as a way of continuing to assist the public sector. Again, my commendation for the work of your committee.

Mr. SEMPLE. Thank you.

Mr. LOWRY. Thank you very much, Mr. Semple. We appreciate your time, and I hope we will be talking again. I am sure we will.

Mr. SEMPLE. Thank you very much.

Mr. LOWRY. We now have a slight problem. I think we are just going to have to go ahead and adjourn. We have one additional witness whose plane got goofed up coming from Harvard, who is catching a second plane, and we frankly don't know where Dr. Summers is at this time. We don't even know when that second plane was going to get here.

So having now gone past—I am sure I am correct in assuming Dr. Summers is not here? Having gone an hour past that time, I believe we are going to have to adjourn, unfortunately, at this time and apologize to Dr. Summers, and at our next hearing request his indulgence to maybe join us at that time.

We do have a copy of Dr. Summers' prepared statement, which, without objection, we will make at part of the record at this point.

[The prepared statement of Mr. Summers follows:]

PREPARED STATEMENT OF LAWRENCE H. SUMMERS, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

My name is Lawrence Summers. I am a professor of Economics at Harvard University specializing in macroeconomic and labor market issues. I am pleased to have this opportunity to address the budget deficit problem in general and the associated labor market dislocations in particular. The budget deficit and level of employment are intertwined. Large chronic budget deficits threaten the productivity growth which is necessary if the dual goals of full employment and a rising standard of living for American workers are to be met. These comments consider first the dimensions of the budget problem and then take up its shorter and longer term implications for the labor market.

I. The Dimensions of the Deficit Problem

In thinking about our deficit problem it is crucial to recall that analysis of historical experiences, the traditional tool used by economists to reach judgments about the effects of public policies, is not possible. The current US deficit situation is outside the range of historic experience. We are in uncharted and probably dangerous territory. The current US deficit experience is unique in several respects:

- Deficits are far greater than ever before in peacetime even after adjusting for the increased size of the economy. Since the Second World War, the largest budget deficit attained in the United States was 4 1/2 percent of GNP in 1975 at the trough of a steep recession. The budget deficit in 1985 is projected to be around $210 billion or 5 1/2 percent of GNP.

- Annual deficits in the range of $200 billion amount to roughly $850 of annual borrowing for each US resident or over $3,000 for a typical family of four. Over just five years this addes up to $15,000 of additional family debt with further debt accumulating rapidly thereafter.

- Large deficits have never before been incurred on such a sustained basis. Recession-induced deficits typically shrink as the economy recovers and expands. For example, the large 1975 deficit occurred after a year in which the deficit was less than one percent of GNP. Thereafter the deficit shrank steadily and in 1978, after three years of recovery, the deficit was just 1 1/2 percent of GNP. In contrast, over the last several years of strong economic growth, the deficit as a percent of GNP has not once fallen below 4 1/2 percent and will remain at record levels for a number of years unless major budget action is taken.

- Interest rates exceed projected growth rates of GNP. According to the recent six-year forecast of the Congressional Budget Office, long-term interest rates will average 10.5 percent between now and 1990, nearly three percentage points above the 7.7 percent average growth in GNP over this period. This is unprecedented. In the thirty years from 1950 to 1980, the annual growth in GNP averaged 7.7 percent, two full percentage points above the long-term corporate interest rate. This means that we can no longer grow our way out of our debt burden. The increased borrowing just to pay interest on the outstanding debt is now greater than the increase in the economy's capacity to pay it back. Under these circumstances, the only solution is significant reductions in the budget deficit.

Budget Outcomes

The cumulative effect of sustained large budget deficits and the associated high real interest rates is the "Reagan parabola" in the debt-to-GNP ratio depicted in Figure 1. The figure shows the ratio of the national debt to GNP over the period 1950-2000 under alternative budget projections. Except for some temporary bulges during the 1975 recession period, the ratio declined fairly steadily from 1950 until 1980. Since then the ratio has been on a steeply climbing path. While recession weakness was responsible for some of the ratio's increase between 1980 and 1982, budget policy is responsible for its recent increases.

After 1984, the figure shows two paths for the debt-to-GNP ratio based on two budget scenarios drawn from recent CBO estimates:

- The pessimistic scenario is based on the CBO's "Baseline Projections." It assumes that there are no changes in current policies affecting taxes and spending. The starting point for this projection is the Congressional Budget Resolution adopted by Congress in September of 1984.

- The optimistic scenario is based on the CBO's estimates of spending and receipts under the revised Congressional Budget Resolution passed last spring. The budget numbers that lie behind this extremely ambitious path assume that the Congress and the President agree on cuts in outlays of $35 billion for fiscal 1986, $60 billion for fiscal 1987, $90 billion for fiscal 1988, and correspondingly greater amounts in the future.

The two paths define dramatically different budget policies. Under the pessimistic scenario the debt-to-GNP ratio continues to climb. Given the large increase in the dollar scale of the economy due to inflation and real growth over the 15 year period, the rapid increase in the debt-to-GNP ratio will lead to dollar amounts of total debt of over $9 trillion by the year 2000, an amount that appears staggering in today's terms.

Under the optimistic scenario, due to very significant spending cuts, the debt-to-GNP ratio levels out and then begins to fall slightly. Even so, under these very optimistic budget assumptions, the debt-to-GNP ratio remains quite high by recent standards even through the beginning of the next century.

It is important to recognize that the choice we face is not between tax increases or spending reform and the accumulation of debt, but between tax increases or spending reform today, or debt accumulation and more tax increases or spending reform in the future. As I shall detail the accumulation of Federal debt has potentially serious consequences. These are not alternative costs which must be weighed against the costs of tax increases or spending cuts. The accumulation of debt only postpones and increases hard choices between tax increases and spending cuts. Just as installment borrowing only postpones households' reductions in consumption or increases in income generation, so too Federal borrowing cannot eliminate the painful choice between spending cuts and tax increases.

II. Budget Deficits and Medium Term Dislocations

Many of the labor market problems in the American economy today are directly traceable to the effects of budget deficits on the short run competitiveness of American producers of tradeable goods. Before exploring these linkages it is crucial to emphasize how successful the American labor market has been in the last 15 years in dealing with structural change and a large influx of workers to the labor force. Since 1970, the American economy has created more than 30 million new jobs. In contrast, the nations of Europe have created no new jobs at all, and in some countries employment has actually declined Canadian unemployment has been increasing quite steadily for close to a decade now. This does not mean that we cannot do still better. But it does suggest that our labor market which has been relatively free from public interference has worked reasonably well. It suggests to me that we should look for macroeconomic rather than microeconomic solutions to current labor market problems.

Between 1979 and 1985 the American economy created eight million jobs as total non-agricultural employment increased from 90 to 98 million. Over the same interval employment in manufacturing declined by two million jobs or nine percent. In part, the relative decline of manufacturing represented a continuation of long term trends. But for the most part, it was the result of the burgeoning US trade deficit which has risen from low levels to its current level of close to $150 billion. The decline in manufacturing employment has meant the loss of a large number of relatively high paying jobs. And it has had an adverse impact on the industrial regions of the country.

To the extent that fundamental conditions have led to declines in manufacturing there is little that policy can do beyond trying to cushion the process of adjustment. Indeed efforts to do more are likely to be counterproductive as the European example suggests. But to the extent that the decline in manufacturing is the transitory consequence of macroeconomic policies there is a clear case for reversing those policies. To do otherwise is to squander large amounts of both physical and human capital, and to limit the potential of American industry to respond when international conditions are again more propitious.

The mechanisms linking the budget deficit and the decline in manufacturing employment are easily seen in terms of a fundamental identity - national savings less national investment equals total exports less total imports. The balance of payments must balance. The difference between national savings and national investment, the capital account must just offset the difference between imports and exports, the current account deficit. This identity represents an important truth. Only policies which increase national savings or decrease national investment can conceivably impact on our trade deficit.

To digress briefly, this suggests the futility of attempts to improve our trade performance with protectionist policies. Tariffs, quotas, and the like do not directly affect national savings or investment and are therefore unlikely to have much impact on the overall trade balance. They are likely only to change its composition. Trade policies which block imports of particular goods for example reduce American demand for foreign currencies and thereby increase the exchange value of the dollar. This in turn reduces the competitiveness of other American producers. Protectionist policies are not only beggar thy neighbor because they hurt other nations but also because they further worsen the problems facing other unprotected US producers.

We can only improve our trade deficit by increasing national savings or decreasing national investment. Of these choices, increasing national savings seems far preferable. Maintaining a high rate of investment is critical if we are to achieve rapid economic growth in the future. Capital investment permits increases in amount of capital that workers have at their disposal. More importantly, it permits the embodiment of technical change and provides the incentive for a high rate of innovation. The costs of increasing national savings seem small by comparison. The US has one of the world's lowest savings rates. And many see the need for us as a nation to provide more adequately for the future quite apart from considerations of international competitiveness.

The major tool that the government has at its control for increasing national savings is government saving through budget surpluses or dissaving through government budget deficits. Unfortunately, the government has been dissaving on a massive scale by running budget deficits over the last few years and appears likely to do so in the future. Traditionally private savings in the US economy has run at about between six and seven percent of GNP. Government dissaving has been running recently at about five percent of GNP. This dissaving is the primary cause of the current imbalance between US saving and investment and the resulting large trade deficit. The only way to restore savings-investment balance in a durable and to revivify the traded goods sector of the American economy is to sharply reduce the budget deficit.

Where does monetary policy fit into this equation? In the short run easier monetary policies can push down interest rates and cause the economy to expand. As the economy expands national savings increase more rapidly than national investment. Consumers save some of their extra income, corporations retain more earnings and extra tax revenues from an expanding economy reduce government borrowings. With this increase in national savings comes a decline in the trade deficit. But history teaches us that monetary policy can only be effective in increasing output in the short run. In the longer run, which may only be a couple of years, increased money growth will be translated into inflation and will do little to improve the trade balance.

Sometimes it is suggested that direct intervention into the foreign exchange markets can improve our competitiveness by reducing the exchange value of the dollar. Many economists doubt the efficacy of such sterilized interventions. How could they possibly work given the identity holding that savings less investment equals exports less imports? The argument has to be that the sale by US officials of dollar assets reduces their price implying that they must carry a higher yield. Higher interest rates then reduce investment and increase savings working towards the restoration of trade balance. But these connections are tenuous. Dollar and foreign currency denominated assets are very close substitutes for many investors and so it is unlikely that intervention on a reasonable scale would in fact have much impact on interest rates, the savings investment balance or our trade problems.

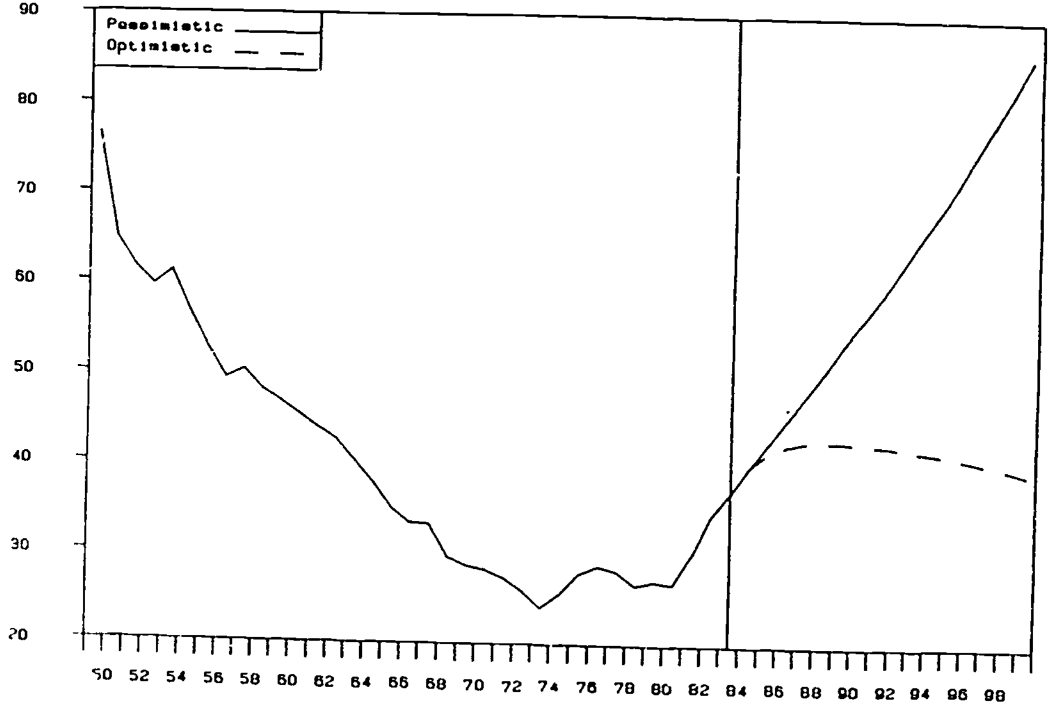
The Federal budget deficit is the primary cause of our trade problems and the resulting employment dislocations. It should be addressed urgently. Alternative microeconomic policy measures which would be appropriate if secular structural change were the source of employment problems are not appropriate in dealing with deficit caused employment dislocations. We do not want to move workers out of industries that are only non-competitive because of the budget deficit. Nor do we want to encourage firms to start phasing out operations in the parts of the economy which would be competitive if budget deficits were reduced. New budgetary policies are the only right answer to deficit caused employment problems.

III. Longer Term Implications of Budget Deficits

Budget deficits draw funds into the United States to finance investments that would otherwise be financed with US savings. But in the case of a large country like the United States they do not attract enough funds to finance all the investment that would take place in their absence. It is because the total supply of investable funds declines relative to the demand that budget deficits are associated with increases in real interest rates. Increased real rates restore balance by crowding out some investment projects that would otherwise be undertaken. In a study completed some time ago, I estimated that each dollar of budget deficit crowded out about 25 cents of plant and equipment investment.

Reduced investment means reduced productivity growth. This confronts the labor market with an unpleasant dilemma. It can accept a reduction in the growth of living standards and thereby maintain American competitiveness on world markets. Or it can insist on continuing increases in living standards and risking pricing American firms out of world markets. Neither alternative is palatable. Structural policies directed at getting workers to make the first rather than the second choice are a poor alternative to measures which can eliminate the dilemma. Increased national savings and investment can go a long way in this direction. And reductions in budget deficits are the obvious first step.

Figure 1.
Federal Debt: 1950-2000
Pessimistic vs Optimistic
(percent of GNP)



Mr. LOWRY. I want to thank the witnesses very much. I thank the official reporter.

We stand adjourned. Thank you.

[Whereupon, at 3:30 p.m., the task force adjourned.]

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