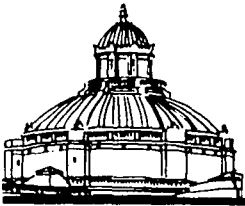


CRS REPORT FOR CONGRESS

UNEMPLOYMENT: WHY AND HOW IT IS FALLING

A rapidly expanding economy has cut the unemployment rate in about half since its peak during the back-to-back recessions of the early 1980s. This report analyzes how the current economic expansion has affected the labor market situation of workers in different demographic groups, and the short-run prospects for further improvement in the jobless rate.



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July 18, 1988  
Revised: October 28, 1988

## UNEMPLOYMENT: WHY AND HOW IT IS FALLING

### SUMMARY

Nearly 6 years after the double-digit levels of the 1981-82 recession, the jobless rate dropped to 5.5 percent in the third quarter of 1988. The rate has decreased in three distinct stages. As expected, the jobless rate fell considerably during the first couple of years after the recession's end. Then it drifted slowly downward for the next few years. Since 1987, the pace of improvement has picked up again.

How much the jobless rate falls depends upon the difference between actual and potential economic growth. Potential growth is the rate of increase in real (constant dollar) output when all factors of production (e.g. labor and capital) are being fully utilized. During the 1980s, the potential or trend growth rate per year is estimated to be between 2.5 and 2.9 percent. If the economy expands at this pace for an entire year, the unemployment rate is expected to remain fairly stable. If actual growth exceeds the trend growth, then the unemployment rate is expected to fall.

In each year since the current expansion began, actual output growth has surpassed the trend growth rate. As a consequence, the jobless rate has decreased. Assuming that economic forecasters are correct and real output growth in 1988 is greater than trend growth, the unemployment rate this year likely will be the lowest in the more than a decade. The July 1988 announcement of a more restrictive monetary policy, which is aimed at reducing the pace of economic growth due to inflation fears, may mean a smaller falloff or actual rise in the jobless rate in 1989.

As measured by their respective unemployment rates, nearly all labor force groups are better off today than they were in the worst year of the 1981-82 recession, but not all of them may be as well off as they were before the onset of the 1980 and 1981-82 recessions. After doubling between 1979 and 1982 to 8.8 percent, the adult male jobless rate dropped to 4.6 percent in third quarter 1988. It still is greater than the 4.2 percent recorded in 1979. The unemployment rate among adult women stands at 4.9 percent, lower than at any time since fourth quarter 1973. A shrinking teenage labor force and falling unemployment recently produced a 15.6 percent teenage jobless rate, the lowest since third quarter 1974. At 4.8 percent, the jobless rate of white workers dropped below its prerecession level of 5.1 percent. At 11.2 percent, the rate among black workers is below the 1979 level of 12.3 percent as well. At 7.9 percent, the unemployment rate for Hispanic workers also has fallen below the rate (8.3 percent) recorded in 1979.

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## UNEMPLOYMENT: WHY AND HOW IT IS FALLING

During the second of the 1980s recessions, the unemployment rate hit its highest point in the postwar period. The proportion of civilian workers who were without jobs during the July 1981-November 1982 recession peaked at 10.8 percent in November 1982, when nearly 12 million people were unemployed.

Since then, the jobless rate has dropped more than five percentage points to 5.4 percent in September 1988. The unemployment rate for September matches the rate for June 1974, more than 14 years ago. About five million fewer workers are unemployed today than at the bottom of the last recession.

This report will examine why the unemployment rate has fallen. It also will analyze the nature of the decline. That is, how has the economic expansion affected the unemployment situation of the various demographic groups in the labor force? The course of unemployment in the short-run will be discussed as well.

### ECONOMIC GROWTH AND UNEMPLOYMENT

According to economic theory, there is a relationship between the pace of economic growth and change in the unemployment rate.<sup>1</sup> When the factors of production (e.g, labor, capital, land) are being more fully utilized and hence output is increasing at a fairly good clip, as during an upturn in the business cycle, we expect the unemployment rate to decline. Conversely, when the factors of production are being used less intensively and hence output is decreasing or increasing slowly, as during a downturn in the business cycle, we expect the unemployment rate to rise.

This relationship is illustrated for the 1980-1987 period in chart 1. Points in the upper left quadrant represent years in which the economy expanded and unemployment fell; points in the lower right quadrant represent years in which the economy contracted and unemployment rose. For example, in 1984, real output increased by 6.8 percent and the jobless rate fell by 2.1 percentage points. Conversely, in 1982, real output decreased by 2.5 percent and the jobless rate rose by 2.1 percentage points.

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<sup>1</sup> This relationship is called Okun's law after its formulator Arthur Okun.

## Changes in Real Gross National Product and in the Unemployment Rate



Source: BLS and BEA data.

The extent to which the unemployment rate increases or decreases depends upon the gap between actual and potential rates of output growth. The potential or trend growth rate of output is defined as the increase in real Gross National Product (GNP) assuming all factors of production are fully utilized (i.e., no cyclical fluctuations).<sup>2</sup> During the 1980s, the trend growth rate is thought to be somewhere between 2.5 and 2.9 percent.<sup>3</sup> As long as the economy maintains output growth roughly in this range for an entire year, the unemployment rate should remain fairly stable.

For every one percentage point of actual output growth maintained for a year above the trend rate (assumed here to be 2.5), the unemployment rate is expected to fall by 0.4 percentage points (1/2.5). For example, if the actual growth rate exceeds the trend rate for a year by 0.5 percentage points, then the unemployment rate should fall by about 0.2 percentage points from the prior year's level.<sup>4</sup> As shown in the first two columns of table 1, the GNP-unemployment relationship holds up well on average during the 1980s. Although more closely approximating the actual unemployment rate in some years than others, the estimated jobless rates do not differ much from the actual jobless rates.

Since the economic turnaround began, the growth in real GNP has exceeded the trend growth rate each year. (See the last column of table 1.) The unemployment rate consequently has declined each year. Put another way, the jobless rate has fallen because the economy has been expanding at a rapid enough pace to fully offset any increases in the labor supply and in labor productivity that otherwise might have caused the unemployment rate to rise.

#### HOW HAS THE UNEMPLOYMENT RATE FALLEN?

Through 1986, the unemployment rate followed the general pattern of economic recoveries. Namely, it fell considerably in the first couple of years and then continued to decline but to a smaller degree. The unemployment rate dropped from 9.7 percent in 1982 to 7.5

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<sup>2</sup> There is some disagreement over the "full," "natural," or nonaccelerating inflation rate of unemployment (NAIRU) associated with trend output growth. It is an estimate of the unemployment rate when the rate of inflation is fairly stable. Estimates of the full employment rate of unemployment range from about 4.5 percent to 6 percent. The rate is thought to vary over time due to changes in labor force composition (e.g., proportion of women and youth) and in labor productivity.

<sup>3</sup> Dornbusch, Rudiger and Stanley Fischer. *Macroeconomics*. New York, McGraw-Hill. 4th edition, 1987. p. 574.

<sup>4</sup> The 0.2 percentage point decline in the jobless rate is the result of multiplying 0.5, the difference between the actual and trend growth rates, by 0.4, the GNP-unemployment relationship.

TABLE 1. Unemployment Rates and Real GNP Growth Rates

Year	Unemployment Rate		Annual Average Rate of Change in GNP (in Constant 1982 Dollars)
	Actual	Estimated	
1980	7.1%	6.7%	- 0.2%
1981	7.6%	7.3%	1.9%
1982	9.7%	9.6%	- 2.5%
1983	9.6%	9.3%	3.6%
1984	7.5%	7.9%	6.8%
1985	7.2%	7.3%	3.0%
1986	7.0%	7.0%	2.9%
1987	6.2%	6.8%	2.9%

Source: Actual unemployment rate from U.S. Bureau of Labor Statistics (BLS). GNP change from U.S. Bureau of Economic Analysis (BEA). Estimated unemployment rate calculated by CRS based upon assumption of 2.5 percent trend growth rate in the 1980s.

percent in 1984, and the number of jobless workers decreased by one-fifth (more than two million persons). For the next two years, there was little further improvement. Between 1984 and 1986, the unemployment rate slowly drifted downward to 7.0 percent, and the number of jobless workers remained above eight million.

After languishing in the seven percent range for three years, the jobless rate has been declining fairly quickly since 1987. The rate dropped to 6.2 percent in 1987, and the ranks of unemployed workers shrank by one-tenth to 7.4 million. The situation has continued to improve thus far in 1988: in the third quarter, the unemployment rate averaged 5.5 percent and some 6.7 million workers were without jobs. Not since second quarter 1974 has the unemployment rate been this low.

A slowly growing labor force is making it easier for the expanding economy to produce this improvement in the jobless rate. That is, relatively smaller decreases in the number of unemployed workers are needed to produce a declining jobless rate when the supply of labor increases fairly slowly.<sup>5</sup> During the current expansion, the civilian labor force has grown 1.6 percent annually. In contrast, the average

<sup>5</sup> The definition of the unemployment rate is the number of people without jobs (i.e., the numerator) divided by the number of people in the labor force (i.e., the denominator). If the denominator remains about the same, then less of a decrease in the numerator is needed to produce a fall in the unemployment rate.

annual growth of the civilian labor force during the 1970s was 2.6 percent.<sup>6</sup>

Both the lingering effects of the two 1980s recessions and changing demographics explain the comparatively small increase in the supply of labor during the 1980s.<sup>7</sup> Most of the baby-boom generation, the result of high birth rates in the 1950s and early 1960s, reached working age during the 1970s and swelled the size of the labor force. A period of low birth rates followed through the mid-1970s. The resultant "baby-bust" generation means relatively few new workers will enter the labor force during this decade and midway through the next.

#### Adult Men

The goods-producing sector, manufacturing particularly, bore the brunt of the 1981-82 recession and the effects of the high international value of the dollar. Because men predominate in this sector, they were the demographic group hardest hit by layoffs and plant closings. The unemployment rate of adult men more than doubled between 1979 and 1982. (See chart at top of next page and Appendix.)

As the plight of manufacturing has improved, the labor market situation of adult men also should have improved. And indeed, in third quarter 1988, the adult male jobless rate fell to 4.6 percent while unemployment among them was cut more than two-fifths (over two million men).

The present situation among adult men is not as good as it was prior to the first recession of the 1980s. Their present unemployment rate remains above the 1979 rate of 4.2 percent. More adult men (over half a million more) are unemployed now than in that prerecession year. Today, about 44 percent of all jobless workers are adult men; in 1979, their share was a good deal lower, at about 38 percent.

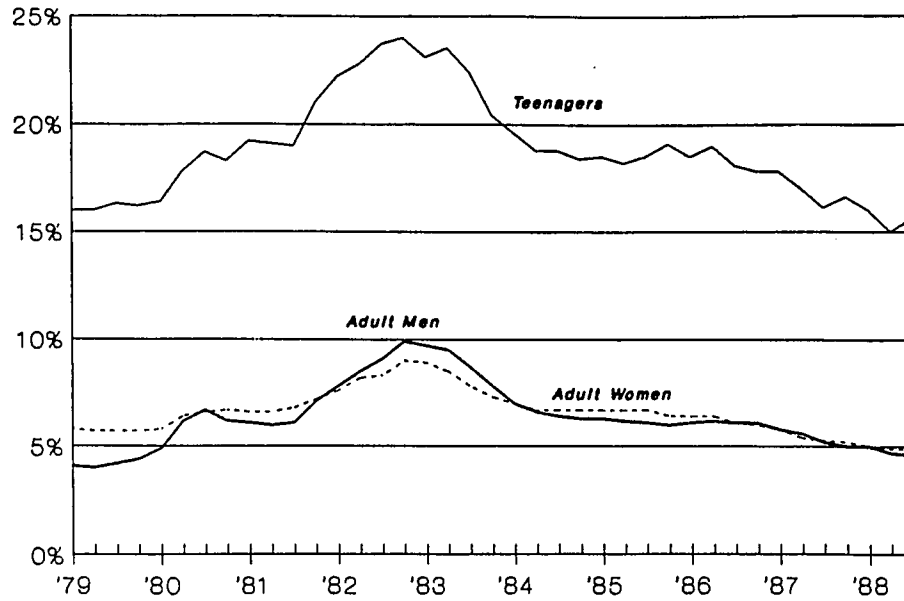
Unemployment can fall because a worker either finds a job or leaves the labor force. During a recession, the number of people who leave the labor force increases because, although they want to work, they think they cannot get a job. These people are known as discouraged workers. They are not considered part of the labor force because they are not actively looking for jobs, and therefore, their situation is not reflected in the unemployment rate.

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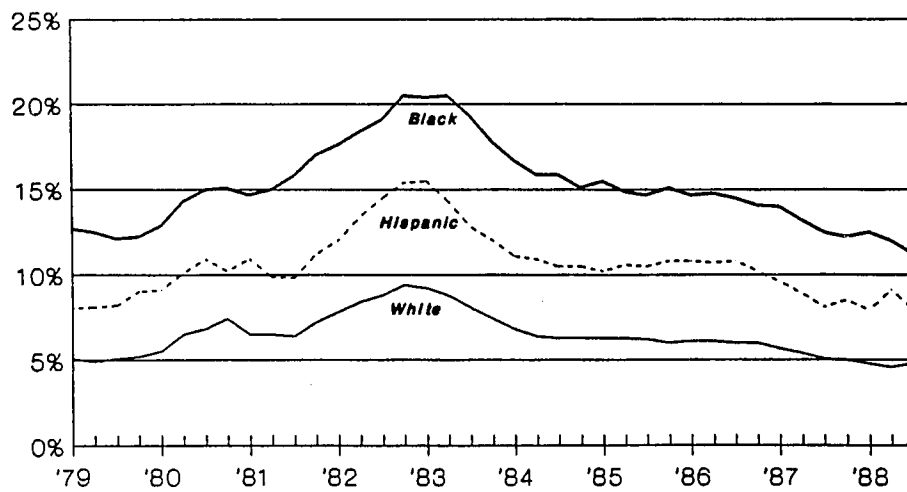
<sup>6</sup> Data Resources. Forecast Highlights. U.S. Long-Term Review, Spring 1988. p. 11.

<sup>7</sup> Shank, Susan E. and Patricia M. Getz. Employment and Unemployment: Developments in 1985. Monthly Labor Review, February 1986. p. 11.

### Civilian Unemployment Rates by Sex and Age



### Civilian Unemployment Rates by Race and Ethnic Group



Between 1979 and 1982, the number of adult men who were discouraged workers more than doubled, rising from 213,000 to 472,000.<sup>8</sup> In the third quarter of 1988, "discouraged" adult males numbered 369,000, well above the 1979 level. Adult men also are a larger share of all discouraged workers today (40 percent) than they were in either 1979 (28 percent) or 1982 (30 percent).

The greater availability of jobs during the current expansion has prompted some adult men to return to the labor force. However, workers laid off from some relatively high-paying manufacturing industries may still be discouraged about their chances of finding other jobs with comparable pay. Much of the job growth in the 1980s has been in the service-producing sector which, on average, provides lower-paying jobs than do many manufacturing industries. Without retraining, these discouraged manufacturing workers may think they lack the skills needed to get the better-paying service sector jobs. Regardless of former pay level, adult males who once held manufacturing jobs may have remained out of the labor force because they did not consider their job prospects good until fairly recently: after an increase in jobs early in the expansion, manufacturing employment dropped through 1986; only in 1987 did manufacturers resume hiring workers.<sup>9</sup>

#### Adult Women

Historically, adult women have had considerably higher jobless rates than men. The gap would narrow somewhat during recessions and widen during recoveries. In the recession year of 1982, however, the adult male jobless rate was above that of women for the first time since 1958. Although their rates have been converging over the past few years, the gap remains much narrower than during past expansions. This changed pattern is related to the concentration of women in certain service-producing industries which continue to add jobs during recessions and to the increasing number of women with a continuous commitment to the labor force.<sup>10</sup> It also is helped by the slowed rate at which women have been entering the labor force during the 1980s compared to the 1970s, so that there is not quite as much competition for jobs.

In the third quarter of 1988, the unemployment rate among adult women was 4.9 percent. (See chart at top of previous page and Appendix.) Not only is the rate below its 1979 level of 5.7 percent, but it also is at its lowest point since fourth quarter 1973. The

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<sup>8</sup> U.S. Bureau of Labor Statistics. Employment and Earnings, January 1981, p. 194 and January 1984, p. 196; 1988 third quarter data are from unpublished, not seasonally adjusted, BLS tabulations.

<sup>9</sup> U.S. Bureau of Labor Statistics. Employment and Earnings, any 1988 issue. Table B-1.

<sup>10</sup> Kean, Edward. More Men than Women Could be Pounding the Pavement Soon. Business Week, June 27, 1988. p. 24.

number of unemployed adult women, about 2.5 million, remains somewhat above its prerecession level, nearly 2.3 million.

### Teenagers

The labor market situation for 16-19 year olds has improved significantly, due to both demographic and cyclical factors. As previously mentioned, low birth rates dampened the potential supply of young workers who would be ready to enter the labor force beginning in the 1980s. Since 1979 the size of the teenage labor force has contracted by 1.5 million, or about 15 percent. The cyclical rebound since 1982 has led unemployment among teenagers to drop by over 700,000, or 36 percent. Thus, a shrinking teenage labor force and falling unemployment have worked in concert to reduce the group's jobless rate from 23.2 percent in 1982 to 15.6 percent in the third quarter of 1988. (See chart at top of page 6 and Appendix.) This is the lowest the teenage unemployment rate since third quarter 1974.

The gap between the jobless rates of teenagers and adults has been narrowing during the 1980s. Teenagers, who traditionally have had much more trouble finding work than adults, are becoming increasingly similar to the rest of the labor force in their job-getting ability. This greater similarity, along with their shrinking presence in the labor force, could put downward pressure on the overall unemployment rate.

### Race and Ethnic Groups

In third quarter 1988, the unemployment rate of white workers (4.8 percent) dropped below its prerecession level of 5.1 percent. The number of unemployed white workers has fallen by about two-fifths since 1982 to 5.0 million. (See chart at bottom of page 6 and Appendix.)

While still the majority among the unemployed today, white workers now comprise a smaller share of all jobless workers (75 percent) than they did during (77 percent in 1982) or before the 1980s recessions (76 percent in 1979). Conversely, relatively more black and Hispanic workers are worse off today than they were nearly a decade ago. In 1979 and 1982, blacks comprised 20-21 percent of all jobless workers; in third quarter 1988, their share rose modestly to 22 percent. In 1979 and 1982, Hispanics comprised 7-8 percent of all jobless workers; today, their share is 11 percent.

The jobless rates for blacks (11.2 percent) is below its 1979 level of 12.3 percent. Thus far, the black unemployment rate has shed nearly 8 percentage points from its 1982 level of 18.9 percent. It remains about two-and-a-third times higher than the jobless rate among white workers, however. Unemployment among blacks has shrunk by about 30 percent since the expansion began and today stands at 1.5 million workers.

The jobless rate among Hispanic workers has declined, and at 7.9 percent, is below the 8.3 percent recorded in 1979. Less progress has been made in cutting unemployment among Hispanics compared to the reductions made among whites and blacks. The number of jobless Hispanic workers has fallen by less than 14 percent since the economic expansion began.

It has been more difficult for the Hispanic unemployment rate to fall because of the surge in labor supply from the Hispanic working age population. Since 1982, the Hispanic labor force has grown by 50 percent. The comparable rates for whites and blacks are about 9 percent and 17 percent, respectively. This pattern is expected to continue into the 1990s. The increasing share of the labor force represented by Hispanics could exert upward pressure on the aggregate unemployment rate because Hispanics have had above average jobless rates.

#### SHORT-TERM PROSPECTS

If, as expected by economic forecasters, real GNP grows faster than about 2.5 percent for the entire year, the civilian unemployment rate in 1988 could be the lowest since 1974. Some forecasts of real output growth for the remainder of 1988 put it below the trend growth rate. It is possible then that the jobless rate might not come down as much in the second half of the year as it has in the first half.

In view of the statement of Alan Greenspan, Chairman of the Federal Reserve Board, during a Senate hearing in July 1988, a slowdown in the unemployment rate's decline is likely. He announced that actions might be taken to tighten monetary policy in order to ward off a perceived threat of accelerating inflation. Depending upon how restrictive monetary policy becomes and consequently how much the rate of economic growth slows, the unemployment rate could reverse its course during 1989 and rise rather than continue to fall.

The contribution that exports now are making to economic growth could cause workers in trade-sensitive industries to face brightening prospects. Higher exchange-rate adjusted prices of goods made abroad should help our import-sensitive industries compete in the domestic market by prompting U.S. consumers to substitute American for foreign-made goods. Lower exchange-rate adjusted prices of goods made in the United States should help export-oriented industries compete in the international market by making U.S. goods relatively more attractive to foreign consumers. Hence, increasing demand for U.S.-made goods could prompt domestic manufacturers to rehire laid-off workers and hire new workers. Given the current demographic composition of manufacturing employment, this trend will likely be the most benefit to adult male workers.

For both demographic and economic reasons, the labor market situation of teenagers could improve during the 1980s and into the early 1990s. Competition for entry-level employment among new jobseekers should lessen as employers will have fewer teenagers to choose from. The demand for jobs often filled by this group, such as

in fast food outlets and other retail stores, is expected to continue to be strong in future years. Thus, teenagers, with their traditionally high unemployment rates, might exert less upward pressure in the short-run on the overall unemployment rate.

Conversely, if current trends continue, the labor market situation of Hispanics and blacks could worsen in the future. Both groups, but especially Hispanics, are expected to be a growing share of the labor force.<sup>11</sup> Both groups also have historically had above average unemployment rates. These two forces could exert upward pressure on the overall jobless rate in future years. Moreover, Hispanics and blacks currently are concentrated in occupations that require fairly low levels of formal schooling.<sup>12</sup> In the coming years, the most rapid job growth is expected to be among occupations that require fairly high levels of educational attainment.<sup>13</sup> As a consequence, these demographic groups might experience even greater difficulty finding work as they will increasingly lack the skills being demanded by employers and will be competing for the relatively scarce low-skilled jobs.

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<sup>11</sup> Fullerton, Howard N. Jr. Labor Force Projections: 1986 to 2000. Monthly Labor Review, September 1987. p. 20.

<sup>12</sup> U.S. Library of Congress. Education and Job Growth. Congressional Research Service. Report No. 88-476 E, by Linda LeGrande. July 1, 1988. p. 6.

<sup>13</sup> Ibid. p. 3.

# APPENDIX

TABLE 1. Selected Labor Force Data by Demographic Group  
(numbers in thousands)

	1979	1982	1983	1984	1985	1986	1987	1988:III
<u>Civilian Labor Force</u>	104,962	110,204	111,550	113,544	115,461	117,834	119,865	121,880
Employed	98,824	99,526	100,834	105,005	107,150	109,597	112,440	115,189
Unemployed	6,137	10,678	10,717	8,539	8,312	8,237	7,425	6,691
Unemployment Rate	5.8%	9.7%	9.6%	7.5%	7.2%	7.0%	6.2%	5.5%
<u>Men, Age 20 or Older</u>								
Civilian Labor Force	55,615	57,980	58,744	59,701	60,277	61,320	62,095	62,858
Employed	53,308	52,891	53,487	55,769	56,562	57,569	58,726	59,937
Unemployed	2,308	5,089	5,257	3,932	3,715	3,751	3,369	2,921
Unemployment Rate	4.2%	8.8%	8.9%	6.6%	6.2%	6.1%	5.4%	4.6%
<u>Women, Age 20 or Older</u>								
Civilian Labor Force	39,708	43,699	44,636	45,900	47,283	48,589	49,783	50,874
Employed	37,434	40,086	41,004	42,793	44,154	45,556	47,074	48,372
Unemployed	2,276	3,613	3,632	3,107	3,129	3,032	2,709	2,502
Unemployment Rate	5.7%	8.3%	8.1%	6.8%	6.6%	6.2%	5.4%	4.9%
<u>Teenagers</u>								
Civilian Labor Force	9,638	8,526	8,171	7,943	7,901	7,926	7,988	8,148
Employed	8,083	6,549	6,342	6,444	6,434	6,472	6,640	6,880
Unemployed	1,555	1,977	1,829	1,499	1,468	1,454	1,347	1,268
Unemployment Rate	16.1%	23.2%	22.4%	18.9%	18.6%	18.3%	16.9%	15.6%
<u>White Workers</u>								
Civilian Labor Force	91,923	96,143	97,021	98,492	99,926	101,801	103,290	104,884
Employed	87,259	87,903	88,893	92,120	93,736	95,660	97,789	99,882
Unemployed	4,664	8,241	8,128	6,372	6,191	6,140	5,501	5,003
Unemployment Rate	5.1%	8.6%	8.4%	6.5%	6.2%	6.0%	5.3%	4.8%
<u>Black Workers</u>								
Civilian Labor Force	10,678	11,331	11,647	12,033	12,364	12,654	12,993	13,249
Employed	9,359	9,189	9,375	10,119	10,501	10,814	11,309	11,770
Unemployed	1,319	2,142	2,272	1,914	1,864	1,840	1,684	1,479
Unemployment Rate	12.3%	18.9%	19.5%	15.9%	15.1%	14.5%	13.0%	11.2%
<u>Hispanic Workers</u>								
Civilian Labor Force	5,219	5,983	6,142	7,247	7,698	8,074	8,541	8,994
Employed	4,785	5,158	5,303	6,469	6,888	7,219	7,790	8,281
Unemployed	434	825	839	778	811	857	751	713
Unemployment Rate	8.3%	13.8%	13.7%	10.7%	10.5%	10.6%	8.8%	7.9%

Source: U.S. Bureau of Labor Statistics.