Comments and Discussion: The Hall and Holt Papers

R. A. Gordon: The papers by Hall and by Holt and his colleagues at the Urban Institute are at the opposite ends of the spectrum in their analyses of what manpower policy can contribute to improving the tradeoff between inflation and unemployment. Holt and his associates hold out high hope with a much expanded and improved set of programs. Hall writes off 80 percent or more of the effect on unemployment that Holt and his colleagues estimate would result from their recommendations. Indeed, Hall can see little if any effect of existing manpower programs in shifting the Phillips curve, and apparently believes that whatever their merits on other grounds, existing programs are largely worthless as a means of improving the unemployment-inflation tradeoff.

My own position lies between these two extremes. I think that Holt and his colleagues are too optimistic, both in their assessment of the magnitude of the effect of their program in reducing unemployment and in their implication that a program of the size and kind they envision is politically feasible.

On the other hand, I believe that Hall goes much too far in the other direction. His Table 1, for example, seriously underestimates the number of workers who might be helped by the Employment Service. While there is an interesting discussion, at the beginning of Hall's paper, of the alternate views that have been expounded regarding defects in the labor market that yield an unfavorable Phillips curve today for the United States, the views he summarizes are incompletely described, and he does not consider the various ways in which they may overlap each other.

The next section of Hall's paper offers a critical evaluation of a manpower recommendation put forth by Holt and his colleagues at the Urban Institute. Even if Congress should appropriate the funds and we should have more of an internal revolution in governmental bureaucracy than is likely to occur, I doubt that the measures proposed are likely to bring down the national unemployment rate by more than 2 percentage points without increasing the rate of inflation.

Hall estimates the maximum effect of the measures proposed as a 0.4 percentage point reduction in the unemployment rate. I think he is too pessimistic. Neither Hall nor the Holt group pays any attention to seasonal unemployment, which apparently amounts to something like 20 percent of the total when the unemployment rate is about 4 percent. I have estimated that government and employer policies in this area alone might shave 0.2 percentage point off the overall unemployment rate. With respect to the possible effects of improvement and enlargement of the Employment Service, I think Hall is much too negative. I am not prepared, however, to defend the precise reduction in the unemployment rate from this program that Holt and his colleagues estimated. I find completely unacceptable Hall's argument that, if a public employment service could succeed in doing a significantly better job than it is now doing, private placement services would have been more active since the gains accrue to the workers or the employers and therefore could be paid for. In a footnote, Hall admits that there may be some externalities involved in a public employment service. But so far as I can see, he ignores barriers to an effectively functioning labor market that a large and efficient Employment Service could hope to overcome, such as the lack of information among the unemployed, and their inability or unwillingness to pay for the services of private agencies. The profit-making private placement services have little interest in some of the groups currently experiencing the highest unemployment rates, for example, the unskilled—black or white—and teenagers. Hall seems to ignore the modest success the Employment Service has had in the last few years in getting private employers to list vacancies with them.

I should like to suggest that Hall consider modifying his characterization of the internal labor market as both "a rational and efficient response to the technology of production." The submission by employers to union-imposed security rules, job classifications inherited from the past, the habits governing what vacancies are listed with whom, employer capitula-

tion to workers' prejudices regarding color and sex—all these may indeed seem rational to the employer in his particular environment, but they are not necessarily efficient. They are rational only in the particular environment, changes in which should be one of the aims of manpower policy. Granted that many employers have more qualified applicants than vacancies at the wages they offer, they can still be induced to fill some of them from those referred to them by the public agencies and the coordinated manpower program.

I agree with Hall that there is little chance of eliminating the dispersion of unemployment rates among the various sectors of the national labor market. However, I think he pays too much attention to the occupational dimension, as do Holt and his colleagues. I believe other dimensions of the labor force, particularly age and sex, are more significant in this connection.

I, too, am skeptical regarding the effects of training programs. But when Hall asks what part of the individual benefits may be due not to the manpower programs themselves but to the selection process that screens out the least motivated and the least intelligent, I must remind him that the programs have helped to bring forward the more motivated and more intelligent and to provide them with an opportunity that they have not previously had.

I do not agree that restrictive institutions and discrimination are the only fundamental causes of duality in the labor market. I personally think that not one, but several, secondary labor markets exist. Different factors cause high unemployment rates and turnover rates among black adults on the one hand and white women or teenagers on the other.

It is not clear whether Hall has fully tested the existence of a dual labor market. My view is that he has not organized the data in a way to test the hypothesis effectively.

Charles Holt: Although the conclusions reached by our group at the Urban Institute and those reached by Robert Hall seem quite diverse, the close similarity of the theoretical structure of the analyses deserves emphasis. Most of the differences hinge on the character of the barriers between the various labor market segments and the estimates of quantitative magnitudes.

The tremendous disparities in unemployment rates among demographic groups, and probably among occupational groups, are attributable primarily to the differences in turnover rates, while in contrast, the variations

in the aggregate unemployment rate over the business cycle are due primarily to changes in search time. The vacancy-unemployment ratio, which changes cyclically, influences the length of the job search process.

One of the real differences between Hall's frame of reference and ours is that the two concern quite different worlds in terms of unemployment levels. We perceive the American scene as characterized by unacceptably slack labor markets for most of the last twenty years, and we seek policies that can lower unemployment substantially. To the extent that Hall implicitly accepts the continuation of slack labor markets with many unemployed workers at plant gates, his pessimism about training, moving, and placing the unemployed is justified: There are simply too few jobs and manpower programs cannot be very effective. However, getting the additional jobs would be no problem for macro policy if inflation did not accompany them.

To achieve a much lower level of unemployment—for example, cutting unemployment in half—without inflation would require cutting the number of unfilled job vacancies in half as well. With both unemployment and vacancy stocks substantially reduced, the search processes would have to be much more efficient than they are now in order to accommodate the placement flow. That basically is the reason that we conclude that the search and matching process requires substantially larger institutional resources.

Hall stresses the internal labor market as an alternative to the external labor market, and hence, the virtual irrelevance of the public Employment Service for most workers. I would be more influenced by that argument if turnover rates were not so high. When the flow through the labor market in a year is something like half of total employment, the external labor market is obviously very important. When a company decides to upgrade internally, it may have to train and upgrade a whole chain of people as contrasted with hiring a single qualified person from outside.

Hall has a great deal of confidence that the personnel offices in large corporations know what their vacancies are and make optimal allocations of staff. But research on the collection of vacancy data indicates that personnel offices often have seriously deficient knowledge of their needs for workers. I do not share Hall's view of the personnel office as a tightly knit, highly efficient, centralized information-transmitting organization within a corporation.

Although it may appear paradoxical, one of the reasons that I am

optimistic about what the Employment Service can do is that there is so much room for improvement. In Hall's example, IBM achieved in its program for disadvantaged people a turnover rate less than half the comparable national average. If one company program can reduce turnover 50 percent, perhaps it is not unreasonable to expect the Employment Service to achieve a 5 percent improvement across the board. We propose tripling the resources of the public Employment Service and subsidizing its functional integration with the private employment agencies.

Hall is quite right in emphasizing, as we did, the conflict involved in simultaneous goals of reducing turnover and speeding placements, but the conflict presents no paradox. It means only that achieving one goal makes achieving the other more difficult. This needs to be taken into account in program design and administration.

Hall asks why, if placements were going to contribute so much social gain, private business isn't more active. The fact is that private business *is* beginning to expand in this field. The revenues of private employment agencies have roughly tripled in the last ten years. We know that many of the private employment agencies are composed of one man at a desk with a telephone. Such operations might increase the segmentation of the market. And there may be important returns to scale that are missed. I hope that Hall is overly pessimistic about what the Employment Service could do, given the challenge and the resources.

We propose a million work-study slots aimed at getting young people started in good jobs, but Hall questions the impact on youth unemployment. Roughly 600,000 teenage students have been unemployed. We assume that these young people participate in the labor force in the same way that other groups do. Typically, half of an increase in vacancies leads to a decrease in unemployment and half to increased participation. If, of the million new job slots, half were filled with unemployed students and the other half with students who decided that they wanted to work, youth unemployment would still decline by roughly 500,000.

A serious ambiguity runs through both the analysis of the "Lyrics" paper and Hall's critique of it, and this accounts for some of the discrepancies in the estimates of program impacts. The paper argues that the labor market is partitioned into many interacting segments, but because the theory for dealing with such complexity is lacking, estimates were made by *assuming* that the market was composed of partially isolated compartments, an assumption that was known not to be fully correct. Hall displays

similar ambivalence. On one hand he argues for the validity of the dual labor market hypothesis, in which people are viewed as accepting bad jobs because they are barred by institutional barriers from obtaining good ones. But on the other hand he suggests that subsidized jobs for high school students have the same inflationary impact as an increase in aggregate demand, a conclusion that rests on the absence of barriers to youth. And his critique of dispersion reduction as an anti-inflationary measure rests crucially on the implicit assumption that the *same* inflation rate prevails in all compartments, an assumption that is not justified in a compartmentalized market, and not always in a segmented one.

Hall is concerned that the employment weights that are used in aggregating compartmental Phillips relations will be changed by programs that affect the distribution of the labor force between compartments in order to reduce unemployment dispersion, and that the changed weights will affect the intercept of the aggregate Phillips curve. As was pointed out in our "Lyrics" paper, these weights could be kept exactly constant by a compensating policy in the compartmental distribution of demand, but a much milder policy probably could maintain the constancy of the intercept of the aggregate relation.

Although our policy analysis concentrated on the supply response of the labor market, Hall's point raises the obvious possibility of manipulating the distribution of demand as an additional means of reducing inflationary pressure. The policy implication then is that the demand for labor should be redistributed away from compartments with high turnover and, hence, high compartmental intercepts toward compartments with low intercepts.

However, Hall's question about the reduction of unemployment dispersion also raises the deeper issue of the adequacy of the theory of a compartmentalized labor market. Here a distinction should be drawn between the use of the theory for *estimating* program magnitudes and benefits, and its use to obtain decision criteria for actually *operating* such programs. We have used the compartmentalized theory for the former but would not recommend it for the latter. Two different approaches were used in making estimates of skill training requirements, and they checked reasonably well.

When programs are designed for a field in which the basic functioning of the system is not well understood, eclecticism and common sense are needed, not blind adherence to a single, admittedly oversimplified, model. The criteria for identifying skill shortages should certainly include vacancy-unemployment ratios and the ratios of their duration, and not rely mechanically on the equalization of unemployment rates.

Until further theoretical and empirical work is done on a market of interacting segments, substantial uncertainty will remain. Perhaps Aaron Gordon is correct in suggesting that these papers establish upper and lower bounds on program impacts and the correct estimates lie somewhere in between.

On the issue of institutional barriers, Hall argues that the Urban Institute group makes no *concrete* proposals. The group sees the problem as basically one of political and economic power. A presidential commission is proposed to study this area with a view to establishing an *active* government policy to remove these barriers instead of actually reinforcing them as is true in many cases (see Hall's comments on government employment).

Although we may have doubts about what a presidential commission can do, the proposal is to escalate attention to this area of problems to the national policy level, and identify it as one source of the national inflation and unemployment dilemma. Economists probably don't have a great deal to contribute to such problems as power, discrimination, and the like. Indeed, the stress on friction and structure in the labor market can be interpreted as indicating that economists have gone about as far as they can go in reducing unemployment with macro policies and that it is time for the vocational counselors and educators, industrial engineers and psychologists, and personnel men to take over to improve labor market operations on the micro level.

Although Hall is pessimistic about the proposed programs, he implicitly estimates an increase in GNP by about $6 billion from the 0.4 percentage point reduction in the unemployment rate that he predicts would result from the proposed $9 billion government expenditure.

One of the difficulties in formulating manpower policy is the weaknesses of the program evaluations. Some people have concluded that they are an inadequate basis for drawing any conclusions at all. Control groups, and the measurement of indirect impacts and market conditions, typically have been absent. Recently, however, some new and better studies have been appearing. The Olympus Research study of four cities has concluded that, as the result of a wide range of manpower programs, increases of the order of 20 percent were achieved in wages, together with a 20 percent decrease in unemployment.[1] Although there was no control group, 1,700

1. "Total Impact Evaluation of Manpower Programs in Four Cities," Study Conducted by the Olympus Research Corporation for the U.S. Department of Labor, Report MEL-71-05 (Springfield, Va.: National Technical Information Service, 1971; processed).

people were interviewed one year later about their intervening employment experience. Other studies now under way seem to be obtaining encouraging results. No solid evidence has demonstrated that manpower programs are effective, but neither has the opposite been established.

The appeals to altruism in aiding the disadvantaged that Hall discusses will have some impact. However, employers with vacancies of long duration are already under some pressure to fill them by hiring workers whom otherwise they would not consider. By concentrating the services and subsidies that the Urban Institute group proposes to help fill these jobs, inflation should be reduced and manpower programs made more effective as spurs to upgrading and to extending job tenure. Then, with inflation reduced, it should be possible to increase aggregate demand. The "bad" jobs in the secondary labor market will either be upgraded or remain empty as their former occupants opt for the jobs vacated by upgrading or for the new jobs created by the expansion of production. Governmental pressure for racial, age, and sexual balance in employment may also help to dissolve barriers that segment the labor market.

Hall's proposed wage subsidy for hiring and retraining the disadvantaged would be a good complement to present manpower programs that are oriented toward the poverty population in a usually slack economy; but, as he points out, it may do little to improve the Phillips curve. Only if we can find a way to lick inflation are we likely to be able to unleash the aggregate demand that is required to put the disadvantaged—and everybody else—to work.

Robert Hall: My argument on private placement is not affected by the size, or even the rate of growth, of the private placement industry. I simply would find paradoxical a situation in which an opportunity for large profit existed and industry was not taking advantage of it. But the crucial argument for expansion of the Employment Service has to do with externalities and not with the proposition that large unrealized profits are available. I have not seen very persuasive evidence that those externalities exist.

Why is the turnover rate so high? Does it cast doubt on the hypothesis about the internal labor market, which implies that it is very much in the interest of the employer and the employee to remain together? But statements about the average rate of turnover say nothing about its distribution. The distribution of turnover, or alternatively the distribution of

tenure on jobs, is sharply skewed. The interesting element in the distribution of tenure, especially among older men, is the very large fraction of the labor force that has tenure of ten to twelve years. All the turnover comes from a very small fraction of the labor force, comprising people who change jobs two or three times in the same year. Even when half of the labor force does not change jobs at all over a period of several years, it is still possible to have a turnover rate that is 50 percent a year.

General Discussion

Walter Heller said that both the Hall and the Holt papers emphasized the supply side, and left some issues on the demand side unexplored. He wondered how much of the unemployment problem stems from the inefficient training and educating for jobs that don't exist, and felt that we were doing a relatively poor job of forecasting the pattern of labor demand. He suggested that more resources be invested in forecasting job patterns and manpower demands, not just this year and next, but five or ten years hence.

John Kareken noted that the Department of Labor has made forecasts of occupational needs. When they forecast a big demand for engineers, engineering school enrollments shot up. The only problem, however, was that the forecast appears to be dead wrong. Hall reported that the Department of Labor still stands by that forecast, arguing that the failure of demand today is temporary and that the demand for engineers will be very strong in a few years.

Holt agreed with Heller that the methods of forecasting labor demand were extremely crude and that little research and few resources had been devoted to the task. But he pointed out how difficult it is to do such forecasting. To forecast the aggregate dimensions of the economy is difficult enough, let alone forecasting how many engineers will be needed and then how many of them should be metallurgical or electrical engineers. He felt that it was wrong to make a heavy investment in long training programs for jobs with a high degree of specificity. Instead, we should have generalized education for the young and provide training and retraining programs aimed at adults to respond to needs as they arise throughout people's lifetimes.

James Blackman agreed with Heller's criticisms. He noted, however, that recently there has been increased recognition of the need for medium- and long-term forecasting models that elucidate labor demand by type. While earlier studies at the National Science Foundation and elsewhere tended to be overly mechanical, efforts are now in progress to build economic models that incorporate cobweb relationships appropriate for estimating manpower supply and demand.

David Fand asked whether, if by some miracle you could get rid of restrictive institutions, there would be a substantial increase in the number of good jobs or, instead, a drop in remuneration on the good jobs. Hall replied that both would occur, with his Figure 1 analysis showing very little effect on wages and Figure 2 showing quite a lot. He leaned toward Figure 2 as the more realistic model, but felt the evidence was not very strong.

Paul Samuelson noted that the basic question is why the United States has a "worse" Phillips curve in 1971 than in 1925 or 1905, and why the United Kingdom has a "worse" Phillips curve now than in A. W. Phillips' sample years such as 1875 or 1937. Furthermore, why does Germany, and possibly Japan, have a "better" Phillips curve than the United States does (as when a slowdown in the mid-1960s caused union *and* nonunion wages to decline in Germany)? He felt that the swollen ranks of young people offer some explanation, but that most of the discussion in the Holt and Hall papers did not help to answer the question. In simplified form, wage changes are geared to some measure involving the number of job vacancies (a) and jobseekers (b), say,

$$\text{wage change} = k\,(a - b).$$

The remedies discussed in the papers would alter the measure inside the parentheses. But Samuelson conjectured that the principal change is in the meshing of that measure with the wage changes that result from it, the k in the simple equation. The reason lies, first, in the accelerated move toward "administered wages" coupled with the concern for workers' morale and productivity were wages to be held down; and, then, in the failure of the unemployed to exert a limiting pressure on wage increases to the same extent as in the past because of changed attitudes about what jobs they will take. American workers today are better informed about job opportunities than they were in the past. They are better educated, and probably more flexibly trained than before. If a magic wand caused youths,

blacks, and the unskilled—or, more generally, the lower-income strata of our increasingly affluent society—to be satisfied with available but poor jobs, and if that wand caused the antitrust laws to get corporate prices that clear markets and to lessen labor market imperfections so that wage rates move more nearly as they would in auction markets, we could get a really better old-fashioned Phillips curve.

In response to Samuelson's question about worsening of the tradeoff, Hall felt a good part is explained by the change in the demographic composition of the labor force, as indicated by George Perry's paper last year. After this change is taken into account, the deterioration is not quite so puzzling. He questioned Samuelson's conjecture that there was an income effect on the Phillips curve such that as income goes up it is less burdensome to be unemployed and hence unemployed individuals will not accept jobs as quickly. Cross-section regressions presented last year by Hall showed the income effect on unemployment to be slightly negative, whereas any voluntary theory of unemployment would surely suggest it to be strongly positive. Therefore, very little empirical evidence supports what seems to be a sensible idea—that as a society becomes more affluent it demonstrates a greater tendency to unemployment.

William Poole said that in an important sense the Holt and Hall papers did not quite meet head on. He interpreted the Holt paper as dealing with frictional unemployment, whereas Hall focused more on problems of the type of job, type of individual and training, and discrimination. Frictional unemployment is not the most important part of the problem. As society becomes wealthier, people quite naturally spend more time between jobs. They can afford to do so, and there is every reason for them to do so to insure that the new job suits them better than the last. High turnover also demonstrates that labor markets are quite fluid. People are able to leave jobs secure in the knowledge that in a not unreasonable length of time they will find a new one.

R. A. Gordon said that he was increasingly impressed by the decline in the share of the labor force made up of prime-age adult males and the accompanying unemployment disparities. In projections up to 1980, he foresaw the situation getting steadily worse. To the extent that a very tight supply for this particular labor force group leads to rapid wage increases with a spillover effect to wages of other groups, there is little hope for holding down the rate of wage increase in the 1970s.

Holt said that the analysis presented in his paper put a lot of stress on

the frictions in the employment process. Where an increase in aggregate demand does not push down unemployment, it has to push up wages and prices. The ideal situation might be a lot of friction in the wage-price process to minimize the inflation problem and a minimum of friction in the unemployment process. Unfortunately, very little work has been done on the frictional processes involved in wage and price change. Much stress has been laid on a vertical Phillips curve, which assumes frictionless change in wages and prices without any pressure at all from aggregate demand.