

New Trend in Unemployment?

The High-Pressure U.S. Labor Market of the 1990s

By Lawrence F. Katz and Alan B. Krueger

The recent performance of the U.S. economy has been nothing short of extraordinary. Both inflation and unemployment reached their lowest levels in 30 years in 1998. And the unemployment rate has been under 5 percent for two years, while inflation has been *declining*.

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Unemployment in the 1990s expansion (through 1998) is 0.8 percentage point lower than it was in 1989 at the peak of the last expansion.

How are we to account for this combination of low unemployment and low inflation? Has the labor market changed in some fundamental way to lead us to expect that this new regime will continue? Four labor-market explanations for the contemporaneous decline in unemployment and inflation are worth exploring. The first involves demographic trends over the past decade. The second is the surge in the prison population during the 1990s. The third is possible improvements in the labor market that allow better matching between workers and jobs. And the fourth is possible worker reluctance to press for wage gains in this recovery because of anxiety about job prospects.

Changing Demographics

One of the first places economists look to explain long-term movements in the unemployment rate is changes in the age composition of the labor force. Because teenagers and young adults traditionally have much higher unemployment rates than do prime-age adults, changes in the age structure of the work force can affect the unemployment rate. Seminal studies by George Perry and Robert Gordon, for example, showed that the entry of the baby boom cohorts into the labor market helped increase joblessness during the 1960s and 1970s. And recent studies by Robert Shimer and by Robert Horn and Philip Heap suggest that the maturing of the baby boom cohorts has helped lower unemployment in the 1990s.

The rise and fall of the share of young workers in the labor force over the past four decades has been dramatic. The share of those under 25 years of age increased from 16.6 percent in 1960 to 24.5 percent in 1978, and then fell to 15.8 percent in 1997. The average unemployment rates for teenagers aged 16–19 and for young adults aged 20–24 during 1960–98 were 16.8 percent and 9.6 percent, respectively, compared with 4.2 percent and 3.7 percent for those aged 35–44 and 45–54.

What would have happened to

unemployment between 1960 and 1998 if the age structure of the labor force had remained constant? Our calculations reveal that the unemployment rate rose 0.63 percentage point from 1960 to 1979 and then fell 0.69 point from 1979 to 1998 because of age structure changes. How far do these changes go toward explaining why unemployment is lower in the 1990s than in the 1980s or 1970s? They can account for essentially the entire 0.5 percentage point decline in the unemployment rate from the peak of the economic expansion in 1979 to that of 1989. But demographic changes account for only around a 0.2 percentage point decline in unemployment from the 1989 peak to 1998, or about one-quarter of the 0.8 percentage point actual change. That leaves much of the decline unexplained.

Rising Incarceration Rates

Another major demographic shift that could influence the unemployment rate involves the dramatic rise in the U.S. incarceration rate during the past several decades. Figure 1 shows the share of the U.S. adult population in prison or jail from 1947 to 1998. In 1970, 2 of every 1,000 adults were incarcerated; by 1998, the number had increased to 9 of every 1,000. The proportion of the population in prison or jail has doubled since 1985, with men accounting for about 90 percent of those behind bars. To put the magnitude of this social problem in perspective, in June 1998 the number of adult men in prison or jail equaled 2.3 percent of the number in the labor force.

Because people who are in prison or jail are not counted in either the numerator or denominator of the official unemployment rate (which covers only the civilian noninstitutional population), the recent surge in the prison population may have produced a discernible impact on the measured unemployment rate. To the extent that the decline in the official unemployment rate simply reflects the removal from the civilian noninstitutional population of a large number of incarcerated individuals with high unemployment propensities, however, it cannot be interpreted as an improvement in labor

market performance for any given group of people—nor does it take into account the possible lasting negative effects of incarceration on the future labor market prospects of these individuals.

Based on current estimates of the employment and labor force participation rates of individuals comparable to the incarcerated population, we estimate that the increase between 1985 and 1998 in the number of men incarcerated has reduced the total male unemployment rate by about 0.3 percentage point. Because the incarceration rate for women is so much lower than that for men, the rising incarceration rate has probably lowered the overall unemployment rate since the mid-1980s by only about 0.1–0.2 percentage point.

Improved Job Matching

Changes in the functioning of the labor market itself may also account for today's low unemployment rate. Two developments in particular may have improved the matching of workers to jobs over the past decade.

In 1993, Congress began requiring states to implement a Worker Profile and Reemployment Services program to improve the efficiency of the Unemployment Insurance system. The goal was to help identify jobless workers who are likely to have so much difficulty finding work that they exhaust their unemployment benefits. To assist these workers,

FIGURE 1.
Share of U.S. Population
in Prison or Jail, 1947–98

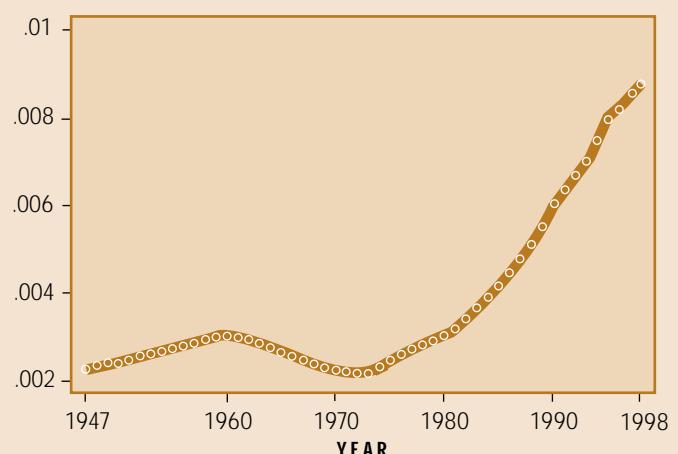


Figure shows ratio of prison and jail population to civilian, noninstitutional population. Authors' calculations based on Bureau of Justice Statistics data, BLS population data, and Richard Freeman, "The Labor Market," in *Crime*, 2nd ed., edited by James Q. Wilson and Joan Petersilia (Institute for Contemporary Studies, 1995).

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worker profiling provides reemployment services, including job search workshops, counseling, job clubs, and referrals to employers. Workers thus identified must avail themselves of these services to be eligible for benefits. States began phasing in worker profiling systems in 1994, and by 1997 essentially all unemployment insurance recipients were profiled. That year 30 percent of benefit recipients were placed in the selection pool for services, and 35 percent of those in the pool were referred to some type of service—the intensity of which varied considerably from state to state. Last year one million workers reported for at least one type of service, and three-quarters of a million completed a service. Could WPRS on such a scale significantly influence the aggregate unemployment rate?

Based on estimates of the effectiveness of job search assistance from a series of random assignment demonstration programs, we calculate that the operation of WPRS systems in 1998 reduced the total weeks of unemployment in the U.S. economy by from 0.5 million to 4 million weeks. During 1998, an average of 6.2 million workers were unemployed each week, producing a total of 322 million weeks of unemployment. Thus the total share of unemployed weeks reduced by WPRS relative to total weeks of unemployment would be

only 0.15–1.24 percent. Had worker profiling not been in effect, the unemployment rate would have increased from its actual level of 4.5 percent in 1998 up to a range from 4.51 percent to 4.56 percent—increments so small as to be nearly indistinguishable from sampling error in the unemployment rate. This is not to say that improving the reemployment system is not a worthy goal, but it does highlight the fact that even cost-effective micropolicy interventions of modest scale are unlikely to have much effect on aggregate outcomes, such as unemployment.

A more promising explanation for improvements in the efficiency of the labor market in the 1990s is the rapid growth of the temporary help services industry. Employment in the industry increased from under 0.5 percent of U.S. employment in the early 1980s to 1.1 percent in 1989 and to just over 2.2 percent in 1998. Temporary help accounted for 8.2 percent of employment growth during 1992–98, as opposed to 4.1 percent in the 1983–89 expansion. By making it easier for firms to locate qualified and screened employees, temporary help services may lower hiring costs, reduce labor market bottlenecks, facilitate better job matches, and put more competitive downward pressure on the wage-setting of incumbent workers.



LLOYD WOLF

Unlike the WPRS, temporary help agencies appear to have increased their scale of operations to the point where they can significantly affect the aggregate labor market. Approximately 3.2 percent of employed workers in the February 1997 Current Population Statistics supplement were on-call workers or employees of a temporary help agency or contract firm. Sharon Cohany reports that 60 percent of the 1.3 million self-reported employees of temporary help agencies in the February 1997 CPS were temporary workers for economic reasons. If, in the absence of the expanded temporary help industry, half of these "involuntary" temporary workers had continued searching for work while remaining unemployed, the official 1997 unemployment rate would have risen by around 0.3 percentage point.

Beyond such possible direct effects of shifting workers from job search during unemployment to job tryouts in temporary jobs, the growth of temporary help services may facilitate wage restraint by making it easier for firms to locate substitute workers. The increased ability to establish contingent work arrangements may also allow employers to raise wages for marginal workers working for temporary help agencies without creating internal equity problems that, in the past, may have necessitated increasing the wages of incumbent employees to prevent morale problems.

An indication of the possible importance of the temporary help industry in facilitating wage restraint, and thereby possibly lowering unemployment, is that states such as California and Florida, which had a well-developed temporary help industry at the start of the 1990s, experienced lower wage growth in the 1990s (controlling for cyclical conditions) than did states with only fledgling temporary help industries. Taking into account the wage effects, we estimate that the temporary help industry lowered unemployment by up to 0.39 percentage point over the past decade.

Worker Insecurity

Observers as diverse as Robert Reich and Alan Greenspan have argued that worker insecurity has slowed wage growth during the 1990s. One reason for the increased insecurity might be the decline of unions in the United States. Union membership has fallen steadily since reaching a peak in the mid-1950s. In 1973, 24.6 percent of private-sector workers belonged to a labor union. By 1998 that rate had fallen to 9.6 percent.

During their heyday, unions had great bargaining power, increasing wages not only for their own members, but also for

Implications for Low-Income Workers

In the past few years, as unemployment has continued to fall—and the minimum wage has increased—the much publicized gap between workers at the top and bottom of the wage scale has finally begun to narrow. Real wages have risen across the wage distribution, with lower-wage workers receiving proportionally the largest real wage gains. For workers with lower levels of educational attainment and those in the lower deciles of the income distribution, wage growth is especially responsive to movements in the overall unemployment rate. Lower-wage workers also benefit disproportionately from a tight overall labor market because their own unemployment declines more than aggregate unemployment. Even so, many less-skilled and disadvantaged workers continue to suffer long spells of joblessness in today's buoyant labor market. The average duration of unemployment spells remains stubbornly high.

The labor market developments that have reduced unemployment and contributed to price stability during the 1990s have helped offset the secular fall in demand for less-skilled workers and provided economic improvements for disadvantaged workers and their families. The large expansion of the earned income tax credit (EITC) since 1993 has interacted with tight labor markets to generate more widespread poverty reduction and economic benefits to the disadvantaged in the post-1993 period than in the comparable period of the expansion of the 1980s. But despite these recent improvements, low-wage workers still have not fully regained their real wage levels of two decades ago. And whether the strong labor market of the past few years has improved the labor market connections for disadvantaged workers enough to cushion them against the next economic slowdown—especially in the face of lessened cash assistance for the nonemployed—remains an important open question.

nonmembers through the threat of unionization. But with only one-third of nonunion members desiring union representation in the mid-1980s and early 1990s, employers in most industries today probably face little threat of unionization. If workers have become more timid in their wage demands in the 1980s and 1990s, the low level of private-sector unionization would seem a prime explanation: they lack the representation to press for wage gains.

Because the decline in union membership has been rather steady and persistent, it may seem unlikely that weakened unions could have a discrete effect on wage-setting practices beginning in the 1990s. But the union movement may have passed a tipping point, with its support falling so low that employers now feel virtually free to ignore union demands. In 1998 there were only 34 strikes involving 1,000 or more workers. The 0.2 percent of work time lost to strikes in 1998 was only slightly more than 1997's record low.

What is the evidence that heightened worker insecurity is influencing labor market behavior? National data show a slight decline in job tenure and increase in displacement rate in the mid-1990s. But, as Charles Schultze writes elsewhere in this issue, the rise in job instability in the 1990s is modest compared with the public attention the issue received in the mid-1990s.

And although in surveys during the mid-1990s workers tended to voice higher-than-expected job insecurity, self-reported job insecurity has now returned to past levels for business cycle peaks. In addition, 1997 and 1998 survey data from the Institute for Social Research, which tracks families' financial security as part of its consumer confidence measure, find a sharp increase in the net fraction of families who think they are now better off financially than they were a year ago. Indeed, according to the latest 1998 data, that fraction is higher than at any time since 1965. In short, the evidence for worker anxiety causing wage restraint in the late 1990s is, at best, ambiguous.

Looking Ahead

How likely is it that the labor market changes we have investigated will have a lasting effect on employment trends in the United States? Population and labor force projections through 2006 imply that demographic shifts will exert very modest downward pressure on the unemployment rate. No evidence in the labor force projections suggests that unemployment will rise early in the next millennium because of demographic shifts. Likewise, labor market shifts brought about by innovations in the temporary help industry are likely to represent lasting structural changes in the efficiency of the labor market. The future size of the incarcerated population is difficult to predict because it depends in large part on sentence lengths—and cannot at any rate, as noted, be said to be an improvement in the labor market. Future progress in lowering unemployment will likely require new approaches to reducing the incidence of long-term unemployment and improving the labor market prospects of the less skilled and the disadvantaged. ■