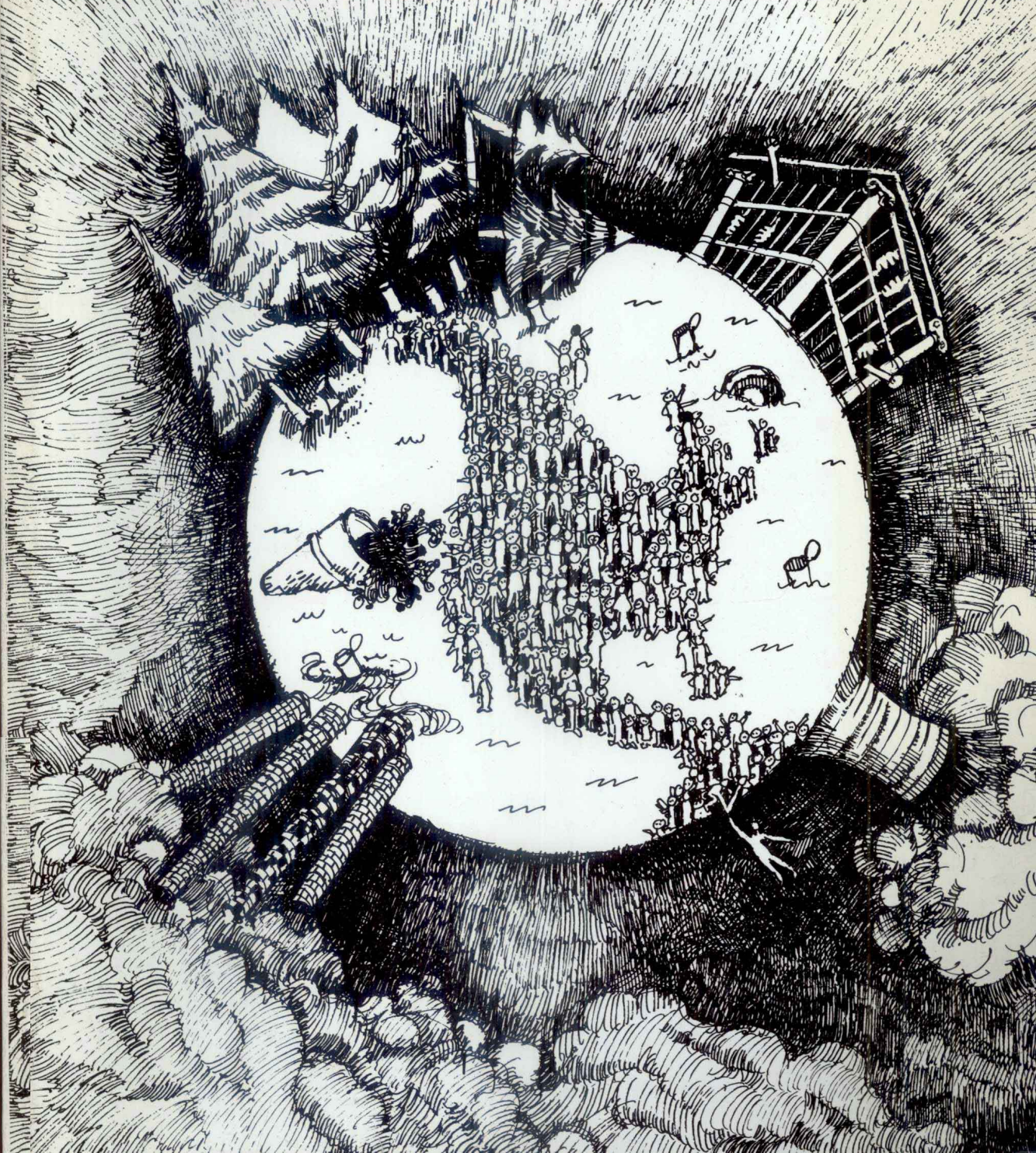


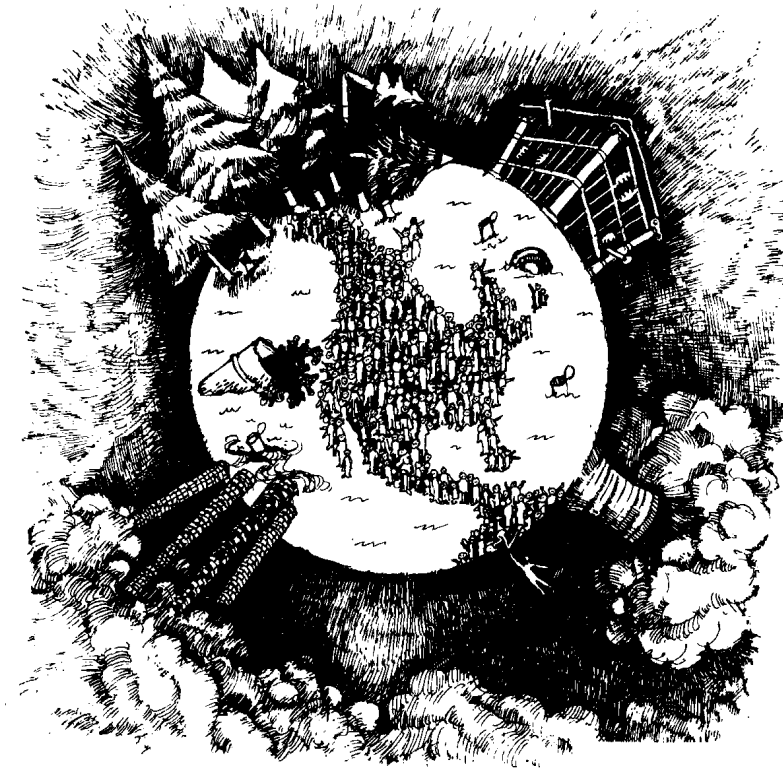
# CONTEMPORARY ECONOMIC PROBLEMS AND ISSUES

HAILSTONES & MASTRIANNA 7TH EDITION





# CONTEMPORARY ECONOMIC PROBLEMS AND ISSUES



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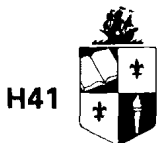
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## PREFACE

Students successfully completing a good introductory course in economics develop an understanding of the workings of the American economic system and the use of basic tools and techniques in economic thinking. But because of the comprehensive scope of a principles text, only a relatively small segment of the text can be devoted to socioeconomic problems and issues. In many texts, treatment of such issues is confined to mini-readings or concluding comments within each chapter. To the student, readings and abbreviated applications within the text often seem superficial and lacking in depth. When one considers that most students' formal education in economics begins and ends with the principles course, all too often the unfortunate result is a lack of insight into the major problems of the day.

The basic goal of this text is to fill this need by presenting fifteen major problems and issues in a manner which the student finds both interesting and enlightening. Our approach is to present the chronological development or evolution of each problem along with the current facts necessary for proper understanding of the problem. The text contains an economic analysis of the alternate solutions that have been suggested. In most cases, however, the decision as to what should be done is left to the reader. It is hoped that after the reader has marshaled the facts, analyzed the alternatives, and weighed the merits of proposed solutions, decisions can be rendered and supported on what should be done about the various problems and issues.

For those familiar with the previous edition, it should be noted that two new chapters are presented in this seventh edition. Chapter 12 focuses on the economic aspects of using and conserving our nation's natural resources. Specific emphasis in the chapter is placed on the problems associated with the demands for natural gas, water, and timberland in the western part of the United States. Chapter 14 has an international scope and concerns itself with the multifaceted problems related to the growing magnitude of the external debt of third world countries. The possible impact of defaulting on debt obligations and viable options to avoid financial calamity are examined. The other thirteen chapters have been extensively revised and updated to give the reader the most current information available as it pertains to both general and specific problems and issues.

In each chapter, the student should recognize the application of important economics concepts, such as supply and demand, opportunity cost, and cost-benefit analysis. To avoid unnecessary repetition, graphic models are used selectively with the belief that students can readily apply these tools in chapters where

such concepts are described. The main thrust of each chapter, however, is to emphasize the trade-offs individuals and society as a whole must make to achieve a desired end.

In evaluating economic policy, students should keep in mind the political realities of a democratic society such as ours. Frequently it may appear that solutions proposed by economists are both efficient and equitable and thus worthy of implementation. But public policy is largely determined by elected representatives who, in addition to seeking efficiency and equity in our economic system, are also very much concerned with the basic task of being reelected. Keeping this in mind, students can better understand why a significant number of public programs may provide substantial benefits in the present but even greater costs in the future.

Feedback from professors using previous editions indicates a variety of ways in which this book can be effectively utilized. In many cases the book is used as a supplementary text for the full-year principles course, while in others it is used for the one-term problems and issues course. In still other cases, the text serves as the basic learning tool for upper-division courses in current economic problems and issues, with greater emphasis on student research and subsequent written or verbal presentations on particular aspects of a given problem.

The authors are again indebted to the many individuals who aided in the development of the seventh edition of the book. Two members of the Economics Department of Xavier University, however, deserve special mention. We are particularly grateful to Dr. David Weinberg for accepting the responsibility for researching and writing the chapter on natural resources and to Dr. Harold Bryant for his work in providing extensive research and writing assistance for the chapter on third world debt. An expression of thanks is also due to Mrs. Marjorie Schmidt for typing various parts of the manuscript.

**Thomas J. Hailstones**

**Frank V. Mastrianna**

# UNEMPLOYMENT WHY AND FOR HOW LONG?



## THE LABOR FORCE

- The Civilian Labor Force
- Employment and Unemployment
- Labor Force Participation Rate
- Age and Sex of Labor Force

## THE MEANING OF FULL EMPLOYMENT

FULL EMPLOYMENT AND BALANCED  
GROWTH ACT OF 1978

(HUMPHREY-HAWKINS ACT)

## RECENT PROBLEMS OF UNEMPLOYMENT

## WHO ARE THE UNEMPLOYED?

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## MEASUREMENT OF UNEMPLOYMENT

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- Underemployment
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# 1

Domestic goals have been cited for our economy by Presidential commissions, Congressional committees, business organizations, private economic groups, and labor unions. The three goals that are most prominent are full employment, economic growth, and stable prices. Serious unemployment must be avoided because of its economic consequence for the total economy and the hardship it brings to individuals and families.

The double-digit levels of unemployment associated with the recession of 1982 and carrying over into mid-1983 were the worst since the Great Depression when unemployment reached 25 percent. These high levels of unemployment exacerbated the strong feeling about the problem of unemployment.

Since the end of World War II the American economy has experienced intermittent periods of full employment. But even during periods of prosperity, unemployment has stayed at undesirable levels. After a 3<sup>1</sup>/<sub>2</sub>-year period of full employment in the late 1960s, nagging unemployment recurred in 1970 and averaged between 5 and 6 percent in 1971 and 1972. It eased below 5 percent in 1973, but was aggravated by the recession of 1974-1975 and reached 9.2 percent in the spring of 1975. During the economic recovery, unemployment dropped to 7.0 percent by 1977, 6 percent in 1978, and averaged 5.8 percent in 1979. With the recession of 1980, however, unemployment rose to over 7.5 percent by mid-1980 and over 8 percent toward the end of 1981. It then peaked at 10.7 percent in December, 1982, and remained at double-digit levels until June, 1983, when it dropped to 9.8 percent. By July of 1984 it was down to 7.1 percent.

The problem, then, is that in spite of highly prosperous conditions and substantial growth in our economy, we have had hard-core unemployment in many years. Naturally, questions arise. Why have we not had full employment? What

do we mean by full employment? Who are the unemployed? How serious is the unemployment? Who are the hard-core unemployed? How do we compare with other nations in this respect? Is anything being done about it? What is the outlook for the future? Before analyzing the problem of unemployment, let us look at the definition, size, and composition of the labor force.

## THE LABOR FORCE

In May, 1984, the total population in the United States was 235.0 million. Of this total, 177.8 million were in the category known as the *noninstitutional population*; that is, all persons 16 years of age or older, including members of the resident armed services, but excluding persons in institutions and the armed forces overseas. In May, 1984, of the noninstitutional population, 115.5 million were in the total labor force. The *total labor force* includes those in the noninstitutional population who are working or looking for work. Thus, it includes the unemployed as well as the employed. Furthermore, it includes proprietors, the self-employed, and members of the armed forces. The labor force, however, excludes all persons engaged exclusively in housework in their homes or attending school. Students, for example, are not members of the labor force unless they are working in addition to attending school. If they work or look for work during the summer vacation period, however, they become members of the labor force. Likewise, when they graduate, they generally become members of the labor force.

### The Civilian Labor Force

If we subtract the number of persons in the resident armed forces from the total labor force, the remainder is known as the civilian labor force. By definition, the *civilian labor force* consists of all persons in the total labor force except members of the resident armed services. Since there were 1.7 million persons in the resident armed services as of May, 1984, the civilian labor force amounted to 113.8 million. Of the total labor force 8.5 million, or 7.4 percent, were unemployed. The *unemployed labor force* includes all persons in the labor force seeking work.

### Employment and Unemployment

The *employed labor force* is the difference between the total labor force and the unemployed. It is composed of all employed workers—including persons who did not work at all during the census week because of illness, bad weather, vacation, or labor disputes, but who had a job or business. It includes part-time

as well as full-time employment. In May, 1984, the number employed was 105.3 million. Of this total, 3.4 million were in agricultural work, while 107.0 million were in nonagricultural employment.

There were 62.3 million persons in the noninstitutional population who were not in the total labor force. Homemakers comprised 31.4 million of this group. Another 9.3 million of those not in the labor force were in school. There were 2.9 million who stated that they were unable to work. The remainder, 18.7 million, was composed of those who had retired, individuals who did not want to work, those who did not have to work, and those having other reasons for not working. A breakdown of the population and the labor force is shown in Table 1-1.

**Table 1-1**

***Population and Labor Force, May, 1984***

Category	Millions
Total population	236.0
Noninstitutional population	177.8
Total labor force	115.5
Armed forces	1.7
Total civilian labor force	113.8
Unemployed labor force	8.5
Employed labor force	107.0
Agricultural employment	3.4
Nonagricultural employment	101.9
Persons not in the labor force	62.3
Keeping house	31.4
In school	9.3
Unable to work	2.9
Other reasons	18.7

SOURCE: *Employment and Earnings* (June, 1984).

According to payrolls the bulk of the labor force is engaged in nonagricultural employment. The largest number, 21.6 million, is engaged in wholesale and retail trade. The second largest category, services, has 20.5 million workers. There are 19.6 million engaged in manufacturing, and government employment is fourth with 15.9 million workers, of whom 13.1 million work for state and local government. The sources of nonagricultural employment are shown in Table 1-2. From another point of view, 73.4 percent of today's workers are employed in service-producing industries, compared to only 26.6 percent in goods-producing industries.

Table 1-2

*Employment in Nonagricultural Payrolls by Industry Division, May, 1984*

Industry	Millions	Percentage
Goods-producing industries	24.9	26.6
Manufacturing	19.6	
Mining	1.0	
Construction	4.3	
Service-producing industries	68.8	73.4
Transportation and public utilities	5.1	
Trade (wholesale and retail)	21.6	
Finance, insurance, and real estate	5.7	
Services	20.5	
Government (federal, state, and local)	15.9	
Total nonagricultural employment <sup>a</sup>	93.7	100.0

<sup>a</sup>Total derived in Table 1-2 is not comparable with total nonagricultural labor force reported in Table 1-1. Table 1-1 includes proprietors, self-employed persons, domestic servants, and unpaid family workers; counts persons as employed when they are not at work because of industrial disputes, bad weather, etc.; and is based on a sample of the working-age population. Table 1-2 is based on reports from employing establishments.

SOURCE: *Employment and Earnings* (June, 1984).

## Labor Force Participation Rate

The labor force has been growing in size because both the population and the labor force participation rate have been increasing over the past few decades. The *labor force participation rate* is the ratio of the labor force to the population. It can be calculated as a percentage of either the total population or the noninstitutional population. Since 1950, the percentage of the noninstitutional population in the labor force has been between 59 and 64 percent. The labor force participation rate compared to the total population has risen from about 40 to 48 percent, as shown in Table 1-3. The fact that the total labor force participation rate does change over the years indicates that the labor force has some degree of elasticity. The participation rate jumped noticeably in the 1970s due to the entry of the large number of women into the labor force.

The size and participation rate of the labor force also fluctuate annually. They have seasonal peaks and troughs. Consequently, actual labor force figures are usually adjusted for seasonal changes for purpose of analysis. It is a well-established pattern, for example, that rises in the size and participation rate of the labor force can be an aftermath of the pickup in the November–December Christmas rush. It must be remembered that these changes are not always evi-



Table 1-3

*Labor Force as a Percentage of Total Population*

Year	Total Population (Millions)	Total Labor Force (Millions)	Total Labor Force Participation Rate
1950	152	64	42.1%
1955	166	68	41.0
1960	181	72	39.9
1965	195	77	39.6
1970	205	86	42.0
1975	214	97	45.3
1980	227	108.5	47.8
1984 (May)	236	115.5	48.9

SOURCE: *Employment and Earnings* (June, 1984).

dent in total labor force figures because the cyclical movements are superimposed on seasonal changes in the labor force. Seasonally adjusted data are necessary, therefore, for a proper interpretation of what is happening to the size and participation rate of the labor force as well as to the level of employment and unemployment. Seasonally adjusted figures show what is happening to the labor force exclusive of the seasonal changes that are taking place. Table 1-4 presents seasonally adjusted labor force and employment figures.

## Age and Sex of Labor Force

Before we leave the structure of the labor force, the age composition of the labor force should also be noted. Table 1-5 shows that 7.2 million people in the labor force are in the 16-19 age bracket, while at the other extreme 2.9 million are in the over-65 age bracket. The largest number, 73.3 million, are found in the 25-54 age group.

Although not shown in the table, it might be noted for future reference that of the total 48.3 million women in the labor force approximately 60 percent are married. Of the married women in the labor force, 88 percent of them have husbands who are working.

## THE MEANING OF FULL EMPLOYMENT

It is obvious that when we talk about full employment for our economy, we are not referring to a situation in which there is a job for everyone. Many people

Table 1-4

*Status of the Labor Force, 1978-1984*  
*(Thousands of persons 16 years of age and older, except as noted)*

Period	Noninsti- tutional Population <sup>a</sup>	Labor Force <sup>a</sup>	Civilian Labor Force	Civilian Employment			Civilian Unemploy- ment	Labor Force Partici- pation Rate <sup>a</sup>
				Total	Agricul- tural	Non- Agricul- tural		
1978 . . . . .	163,541	103,882	102,251	96,048	3,387	92,661	6,202	63.5%
1979 . . . . .	166,460	106,559	104,962	98,824	3,347	95,477	6,137	64.0
1980 . . . . .	169,349	108,544	106,940	99,303	3,364	95,938	7,637	64.1
1981 . . . . .	171,775	110,315	108,670	100,397	3,368	97,030	8,273	64.2
1982 . . . . .	173,939	111,872	110,204	99,526	3,401	96,125	10,678	64.3
1983 . . . . .	175,891	113,226	111,550	100,834	3,383	97,450	10,717	64.4
1984: Jan . . . .	177,219	113,901	112,215	103,190	3,271	99,918	9,026	64.3
Feb . . . . .	177,363	114,377	112,693	103,892	3,395	100,496	8,801	64.5
Mar . . . . .	177,510	114,598	112,912	104,140	3,281	100,859	8,772	64.6
Apr . . . . .	177,662	114,938	113,245	104,402	3,393	101,009	8,843	64.7
May . . . . .	177,813	115,493	113,803	105,288	3,389	101,899	8,514	65.0

<sup>a</sup>Including resident Armed Forces.

SOURCE: *Economic Indicators* (June, 1984).

Table 1-5

*Total Labor Force by Age and Sex, January, 1984 (In millions)*

Age	Total	Male	Female
16-19 years	7.2	3.7	3.5
20-24 years	15.7	8.4	7.3
25-54 years	73.3	41.7	31.6
55-64 years	11.9	7.0	4.9
65 and over	2.9	1.8	1.1
Total	111.0	62.6	48.4

SOURCE: *Employment and Earnings* (February, 1984).

are too young to work, and others are too old. Some do not want to work, and others are physically or mentally incapable of work. At the beginning of 1984 there were about 31 million persons too busy with housekeeping chores to enter the labor force, and a large number of young people are still in school. Thus, full employment is not a condition in which the entire population is employed. In fact, in our dynamic economy with its mobile labor force, it cannot be expected that everyone in the labor force would be working. There will always be some workers quitting, others being discharged, and some moving to other positions. Furthermore, many persons upon completing vocational or skilled training are unable to find a job immediately at the particular occupation they desire and will refrain from accepting another position until they can find the type of work they want. In addition, we have a number of persons who want to work but have difficulty obtaining or holding a job because of physical or mental incapacities. Consequently, we can always expect some unemployment in our labor force.

For nearly two decades it was generally accepted by reliable authorities, such as the President's Council of Economic Advisers, that full employment existed whenever 96 percent of the civilian labor force was employed. This allowed for 4 percent frictional unemployment, which was held to be consistent with full employment.

Today there are in the labor force a larger number and percentage of young people, women, and minority workers than existed in the mid-1950s when we came to accept the 4 percent unemployment figure as being consistent with full employment. These groups historically have had higher unemployment rates than the labor force as a whole. Consequently, when more statistical weight is given to these categories in establishing a full-employment unemployment rate today, it will yield a figure in excess of 4 percent, perhaps something in the range of 4.5 to 5.5 percent. A 5.1 percent figure, for example, was calculated for the 1980 *Economic Report of the President*, with a proviso that if certain nonquantifiable factors were considered the figure may be slightly higher.

It has been suggested by others that full employment should be near the point where the number of unfilled job vacancies is about the same as the number of unemployed. Unfortunately, up to the present time this is a difficult measurement, since the Department of Labor's estimate of unfilled job orders is less than precise.

Although there are some sources that think the full-employment unemployment rate should be a lower or higher number, it is reasonable to define full employment as a condition in which 5.0 percent or less of the U.S. labor force is unemployed.

## FULL EMPLOYMENT AND BALANCED GROWTH ACT OF 1978 (HUMPHREY-HAWKINS ACT)

After nearly a year of debate, revision, and compromise, Congress enacted the controversial Humphrey-Hawkins Bill under the official title of "Full Employment and Balanced Growth Act of 1978." The Act amended and embellished the Employment Act of 1946. In particular it included specific numerical targets and timetables regarding full employment and inflation rates. The Humphrey-Hawkins Act also required the President to spell out in the *Economic Report* measures designed to accomplish the objectives of the Act. This must be done by January 20 of each year.

The Act set a goal of 3 percent or less unemployment among adult workers (20 years of age or older) and 4 percent unemployment for the total labor force by the end of 1983. It required, too, that the rate of inflation be reduced to at least 3 percent by that time. In achieving these goals, the Act did give some preference to full employment insofar as it stated "the policies and programs designed to reduce the rate of inflation shall not impede the achievement of the goals for the reduction of unemployment." The long-term goal for reasonable price stability, however, is to reduce the rate of inflation to zero by 1988.

According to the Act, a balanced budget and balanced economic growth are to be sought after the goals concerning unemployment are reached. Moreover, the Act called for a narrowing of the differences in unemployment rates between various categories of the unemployed. Very little progress has been made toward this goal, however.

Two major items were included in the original Humphrey-Hawkins Bill which did not survive until the final version of the Full Employment and Balanced Growth Act of 1978. First was the concept of using the federal government as an "employer of last resort" for the unemployed if unemployment were not reduced to target levels within the five-year period. This item would have required the federal government to provide or find jobs for those who could not find employment. The second item was the establishment of a broad and specific planning system for the U.S. economy.