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HIGHLIGHT

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Full Employment Has Not Been Achieved

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In March and May 1999 the unemployment rate was only 4.2 percent, but unemployment rates as conventionally measured cannot tell the entire story. The job landscape does not seem so rosy when one considers that in addition to the millions of officially unemployed there are at least 4.5 million who are no longer counted as part of the labor force but would be willing to work if a job were available and there are close to 4 million people who are counted as employed but are involuntarily working part-time. Many welfare recipients who are forced off the rolls are unable to find work. To make matters worse, unemployment is underestimated if one applies the concept of "disguised" unemployment, that is, growing employment in services, whose productivity is low compared with productivity in manufacturing.

Policymakers have come to accept the notion that there is a "natural rate of unemployment" below which unemployment cannot fall without creating inflation. According to this notion, price stability and the labor market flexibility that enables the private sector to respond to changes in demand depend on the existence of a "reserve pool of labor," millions of individuals who are ready, willing, and able to work but must remain idle. Claims that the nation has reached "full" employment take for granted the need for this reserve, but is this the best we can do during the longest peacetime expansion in our history and what will happen when the inevitable downturn comes? Can we achieve truly full employment in the sense that all individuals who want to contribute to the American economy and society can find productive work commensurate with their abilities?

Policymakers must craft employment policies that uphold every individual's basic right to a job and that, at the same time, are not inflationary, do not interfere with decisions of individual firms, do not rely on the failed approach

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of fine-tuning aggregate demand, and are consistent with the fundamental premise that, to the extent possible, socially productive work is preferable to income maintenance. This brief examines three measures that have been proposed to achieve higher employment—reduction of the workweek, employment subsidies, and public service employment—to determine which best meets these requirements.

Reduction of the Workweek

The principal arguments made in favor of reduction of the workweek and other work-sharing arrangements (such as job sharing and phased retirement) are that they "redistribute work over people so as to reduce the extent of involuntary unemployment" (Drèze 1986, 1), provide flexibility, and promote power sharing in the workplace. Reduction of the workweek has been introduced as a mechanism to counter high unemployment at various times by governments and trade unions in Germany, France, The Netherlands, Belgium, Australia, and other countries. It not only has failed to enlarge the pool of employed workers but also has had such negative side effects as loss of output, inflation, and imbalance of trade (Owen 1989, 141).

The design of the public service employment program ensures that federal spending will rise only to the point at which all involuntary unemployment is eliminated. Once there are no workers willing to accept a job, spending will not increase. . . .

Reduction of the workweek is a strategy that is not likely to be tried in the United States, where work hours have been increasing through overtime as a means for employers to cut costs (they do not pay benefits on overtime work) and for employees to boost income. The increase in hours between 1982 and 1995 is approximately equivalent to adding 3.7 million new workers to the labor force (Bluestone and Rose 1998, 35).

All individuals who want to work cannot be employed by spreading the work of those who are already employed. Moreover, working time reductions instituted during periods of persistently high unemployment can become permanent, thereby increasing the already significant number of individuals who are chronically under- or unemployed. To deal adequately with structural unemployment requires not rationing work, but making more work.

Employment Subsidies

Subsidies for rewarding work already exist in the form of the earned income tax credit (EITC), and a negative income tax has often been proposed as a means to promote employment. Evidence for the effectiveness of the EITC is mixed, and it has been criticized for many reasons: it is vulnerable to abuse since it does not take into account non-wage income; it is directed mainly to heads of households and neglects many poor, single workers; it intervenes in labor markets by depressing wages; it provides the least incentive to work to those whose job commitment is the weakest, since the potential benefits for them are low (Phelps 1997). The negative income tax works more to alleviate inequitable distribution of income than to induce workers to find and hold a job.

Edmund Phelps has presented a more extensive plan for subsidizing the employment of low-wage, lower-skilled workers (1994a, 1994b, 1997). He contends that employment subsidies can act as an impetus to employ more people who are currently unemployed or not in the labor force. Subsidies offset the cost to employers of hiring additional workers, and the higher wages that result from subsidies are an incentive for disadvantaged workers to enter the labor force. These individuals may otherwise be susceptible to engaging in illegal activities or relying on public assistance (Phelps 1994b, 57). Phelps estimates that the initial cost of his proposed employment subsidy would have been about $125 billion in 1997. He is not concerned about the cost of his proposal, since he calculates that a small increase in the payroll tax (2.5 percent) can finance it.

Even though Phelps refers to his scheme as a "market-based approach," the plan entails significant interference with employer decisions, thereby distorting the market mechanism. There is a question as to whether a firm's behavior will become directed toward obtaining the subsidy, rather than toward the market to obtain profits. Phelps argues this criticism away by distinguishing "private" from "social" productivity, which gives rise to distinguishing private from social costs; he asserts that economists have long recognized that even in competitive markets a "free-market" price may diverge from the "right" price.

It is by no means certain that Phelps's plan will actually achieve higher levels of employment. For one thing, employers may try to substitute subsidized workers for those currently employed. If the plan does increase private sector employment, it may have two serious side effects. First, it is likely to tighten the labor market, adding a rigidity to the economic system that hinders expansion. Second, even though firms will pay only a portion of the wages of the expanded workforce, more money will enter the economy through the subsidies, putting upward pressure on prices. In the end, what can be said is that subsidized low-wage labor schemes come with a high price tag and may not guarantee full employment.

Public Service Employment

Hyman P. Minsky (1986) proposed an employment strategy in which government acts as the "employer of last resort." He felt this strategy could promote full employment without the inflationary pressures and structural rigidities usually associated with it. A group of researchers at the Levy Institute (Wray 1997; Forstater 1997; Papadimitriou 1998) have developed Minsky's proposals in considerable detail.

The proposal—here called the public service employment program—has two basic components: a job program that offers workers an opportunity for employment and an exogenously set program wage that protects against inflationary pressures. The government would announce the wage at which it will offer employment to all who want to work and then would employ them at that wage in the public sector. Regular public service employment would remain unaffected. If the government sets the wage at $6.00 per hour, a worker could make $12,500 by working full-time, full-year (2,080 hours). The government would become, in a sense, "a market maker for labor"; it would stand ready to "buy" all unemployed labor at a fixed price (wage) or to "sell" it, that is, allow the program labor force to be reduced when the private sector needs labor and offers workers a higher price (wage). Even as the program ensures full employment in times of both expansion and contraction, it also ensures a flexible labor market, able to respond to changes in private sector demand for labor.

The program would eliminate all involuntary unemployment. There will always be many individuals who choose to remain unemployed for a variety of reasons; some may be unwilling to work for the government, others may be unwilling to work for the government's predetermined wage, and still others would prefer to search for a better or different kind of job. Some individuals will remain unemployed because they cannot meet the minimum standards for public employment. However, this program would mean that anyone who wanted to work and was able to would have the opportunity to do so.

A program of such scope means that social spending for the unemployed can be substantially reduced. Of course, the program cannot replace all social support because many individuals currently receiving such assistance are not and probably could not be in the labor force. Taking the current number of unemployed, the savings from various programs that would be eliminated or reduced, and the projected cost of the public service employment program, Wray (1997) has estimated the net cost to the government at about $50 billion. Since this sum is quite small relative to the size of the federal budget, the budgetary effects of the program would be relatively small. Moreover, this estimate does not take into account any indirect benefits likely to redound from the policy from decreases in the social and economic costs of unemployment (such as crime, physical and mental ill health, deterioration of skills) and from the promotion of beneficial public sector projects (such as environmental cleanup, urban reconstruction, educational services).

Can aggregate demand increase sufficiently with the additional federal spending and still not generate inflation? The existence of 6 million unemployed and almost 4 million underemployed workers is evidence that aggregate demand is currently below the level required for full employment. However, Keynesian demand management policies designed to increase private demand for labor often cause labor markets to become tight enough to generate inflation before full employment is reached. The design of the public service employment program ensures that federal spending will rise only to the point at which all involuntary employment is eliminated. Once there are no workers willing to accept a job, spending will not increase and therefore spending will not cause aggregate demand to increase beyond the full employment level, alleviating concerns about demand-pull inflation. Increases in demand will shrink the supply of program labor, and decreases will replenish it.

What about cost-push inflation resulting from pressure on wages and in turn on costs and prices? The wage paid by the public service employment program is exogenously set and, being fixed, will have a stabilizing influence on prices. Although most low-wage jobs in the private and regular public sectors will experience a one-time wage increase, a one-time increase is not inflation. Against any tendency for wages to ratchet upward must be measured the fact that program employment will maintain and possibly enhance the skills and work habits of workers temporarily unneeded in the private sector. The somewhat higher cost to the private sector of hiring workers away from the program relative to the cost of hiring unemployed workers in the absence of the program is partially offset by the higher productivity of workers who have been continuously employed, thereby reducing pressure on prices. Costs will be reduced further by the elimination of the need for experience-rated unemployment insurance taxes. By and large, even the one-time upward adjustment of wages and prices is likely to be quite small.

A public service employment program preserves worker skills and productivity and provides valuable public services. It will be relatively inexpensive and may even pay for itself.

What Is to Be Done?

It is difficult to see how full employment under a public service job opportunity program could be more inflationary than our current system of maintaining a reserve pool of labor and public assistance—a system that pays people for not working, allows their human capital to depreciate, and results in the high economic and social costs associated with unemployment. The costs of unemployment include the loss of output that unemployed workers could have produced and the burden of paying for the income support and services the jobless receive. Negative effects that afflict the jobless include the loss of freedom and social exclusion, poor health, discouragement and loss of motivation for future work, weakening of family structure, cynicism and ultimate loss of social values and self-reliance, and psychological suffering even to the point of suicide (Sen 1997). Unemployment breeds racial and gender intolerance. It engenders resistance to organizational flexibility and promotes technical conservatism among current workers because of their fear of downsizing and joblessness.

A public service employment solution can provide full employment with price stability and labor market flexibility. It preserves worker skills and productivity and provides valuable public services. It will be relatively inexpensive and may even pay for itself.

The nation's commitment to full employment, as expressed in Franklin Roosevelt's assertion of every person's "right to employment" and the initial push to "guarantee full employment," has been reduced over time to the "promotion of maximum employment" and further still to the present-day acceptance of a rather large "natural rate of unemployment." In William Vickrey's presidential address to the American Economic Association in 1993, he said, "There is no reason inherent in the real resources available to us why we cannot move rapidly within the next two or three years to a state of genuinely full employment and then continue indefinitely at that level." The task for economists now is to renew the commitment to full employment—to develop policies that make truly full employment possible and to encourage policymakers to marshal the resources to implement those policies.

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