Working Paper No. 560

The Social and Economic Importance of Full Employment

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April 2009

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ABSTRACT

Unemployment was singled out by John Maynard Keynes as one of the principle faults of capitalism; the other is excessive inequality. Obviously, there is some link between these two faults: because: since most people living in capitalist economies must work for wages as a major source of their incomes, inability to obtain a job means lower income. If jobs can be provided to the unemployed, inequality and poverty will be reduced—although such policy will not directly address the problem of excessive income at the top of the distribution. Most importantly, Keynes wanted to put unemployed labor to work—not digging holes, but in socially productive ways. This would help to ensure that the additional effective demand created by government spending would not be exhausted in higher prices as it ran up against bottlenecks or other supply constraints. Further, it would help maintain public support for the government's programs by providing useful output. And it would generate respect for, and feelings of self-worth in, the workers employed in these projects (no worker would want to spend her days digging holes that serve no useful purpose). President Roosevelt's New Deal jobs programs (such as the Works Progress Administration and the Civilian Conservation Corps) are good examples of such targeted job-creating programs. These provided income and employment for workers, actually helped increase the nation's productivity, and left us with public buildings, dams, trails, and even music that we still enjoy today. As our nation (and the world) collapses into deep recession, or even depression, it is worthwhile to examine Hyman P. Minsky's comprehensive approach to resolving the unemployment problem.

Keywords: Unemployment; Employer of Last Resort; Job Guarantee; Keynesian Policy; New Deal

JEL Classifications: J01, J21, J38, J48, J68

1. KEYNESIAN THEORY AND FULL EMPLOYMENT POLICY

Since the publication of John Maynard Keynes's *General Theory*, it has been recognized that unemployment is not only a persistent feature of the capitalist economy, but worse, there are no endogenous market processes that would eliminate unemployment. To be sure, the classical economists had always recognized the importance of the "reserve army of the unemployed" to discipline labor, and they had avoided promulgating any theory of labor market clearing. Further, David Ricardo had famously worried that labor-saving capital might cause ubiquitous labor redundancy, Thomas Malthus had developed a (somewhat illegitimate) theory of a tendency for markets to face insufficient demand, and Karl Marx's two departments approach offered a variety of reasons to suspect that capitalism would not generate full employment. Still, it was Keynes who provided the clearest explanation of the problem: firms produce only the quantity of output they expect to sell and it would be highly unlikely that this would happen to coincide with full employment.

According to Keynes, even if unemployed labor bids down wages, this will not induce firms to hire more labor than they need to meet expected demand for their output. It is even worse than that, however, because the existence of a preference for highly liquid assets (like money) tends to force the economy to achieve equilibrium (defined as the level of employment at which expected sales revenue is just sufficient to induce that level of production) before reaching full employment. The exact reason for that is complex and beyond the scope of this paper. What is most important is to understand Keynes's main point, which is that unemployment is not caused by faulty operation of the labor market (such as sticky wages, lazy workers, generous welfare benefits, or low levels of training and education). In other words, he (like the classical economists Ricardo and Marx) did not see unemployment as a simple "market failure." Instead, unemployment results from insufficient effective demand and can only be resolved by creating more jobs—which in turn requires higher demand for the output that would be generated by the additional workers. In other words, unemployment is "normal," resulting from the operation of market forces, thus; can be resolved only through

purposive social policy well-targeted to raise aggregate demand and provide jobs for the unemployed.

Unemployment was singled out by Keynes as one of the principle faults of capitalism; the other is excessive inequality. Obviously there is some link between these two faults: because most people living in capitalist economies must work for wages as a major source of their incomes, inability to obtain a job means lower income. Keynes also worried about excessive income at the top of the income distribution—which he attributed to high unearned income (what he called rentier income) mostly accruing to owners of financial assets. This paper will not address that issue but instead will look in detail at unemployment and its consequences. If jobs can be provided to the unemployed, this will go a long way toward reducing inequality and poverty, although such policy will not directly address the problem of excessive income at the top of the distribution.

Many followers of Keynes have seen the solution to unemployment as various demand stimulating policies: more government spending, lower taxes, or lower interest rates to encourage private spending, most prominently investment. Clearly when aggregate output is far below potential—as it was in the 1930s—raising aggregate demand is called for. The global economic downturn in 2008 caused most economists to return to Keynes's theory as almost everyone supported fiscal stimulus policies in stagnating nations around the world. However, as an economy gets closer to full employment, it becomes far less clear that policy to raise aggregate demand should be adopted. The main objection is that if unemployment gets too low, inflation will result because firms will start bidding up wages to hire the more desirable workers (in short supply because most skilled workers will have already obtained jobs—although those with fewer skills and less work experience might remain unemployed). Since 1960, this fear—represented by the supposed Phillips curve trade-off (lower unemployment can only be purchased through higher inflation)—has been perhaps the major barrier to achieving full employment. It has caused economists and policy makers to resist policy that would actually achieve full employment.

Keynes was well aware of this problem. While he argued that "true inflation" occurs only when aggregate demand rises beyond the full employment level, he also argued that prices and wages could rise long before that point. Indeed, he believed that

the lower limit to unemployment that could be achieved by raising aggregate demand would probably be about 5%—trying to reduce unemployment below that level through the use of general macroeconomic policy would be likely to generate inflation. For this reason, he rejected general "pump priming" (that is, general policies to raise aggregate demand through a combination of tax cuts, government spending increases, or lower interest rates) in favor of "targeted" spending programs. Unfortunately, many of his followers neglected this warning, believing that Keynesian policy relies solely on "pump-priming."

Keynesian policy fell out of favor during the 1970s, when stagflation (a combination of high unemployment and high inflation) afflicted many developed nations, for the simple reason that it appeared that Keynesian policy was no longer useful: to fight inflation, aggregate demand should be reduced, while to fight unemployment government ought to increase aggregate demand. But actually the problem was that Keynes's followers had failed to follow his theory closely enough: he did not recommend general demand pumping as the one-size-fits-all solution to unemployment, nor did he believe that price hikes result solely from excessive demand.

During the Great Depression, Keynes famously remarked that if the government could find nothing better to do, it could hire one group of workers to dig holes to bury money, and then hire another group to excavate the money that would be used to pay their wages. This might seem to be a rather silly policy proposal, and Keynes meant it to be just that. What he was saying is that first, given the low levels of effective demand and the high levels of unemployment in the 1930s, virtually any paid work would be an improvement—it would provide jobs and incomes to the unemployed, raising aggregate demand and stimulating the economy. Thus, even something as seemingly useless as digging holes would be beneficial. Second, he was using such a ridiculous example to spur policy-makers to come up with more useful projects—surely even the dumbest politicians or economists could come up with something better than digging holes!

Finally, what is often overlooked is that Keynes's comments were predicated on the conditions that existed in the Great Depression—massive unemployment and idled factories. Those workers burying or uncovering money would be able to increase their consumption and the factories would easily increase output to meet that extra demand.

Thus, it really wasn't necessary for those newly employed workers to produce anything useful—all they needed was income to stimulate producers to use idle capacity. But such conditions do not usually exist, even in highly developed economies, and certainly not in developing economies—where unemployment can exist even with productive facilities operating with little excess capacity. In other words, outside depressions and deep recessions, it usually would not be a good policy to employ people in useless activities because their labor would be needed to help provide a portion of the extra output they would buy with their new incomes. Otherwise, simply paying them to do useless things would be likely to cause inflation as their consumption competed with the consumption by workers actually producing the goods everyone wanted.

Thus, what Keynes really advocated is targeted spending—focusing government spending on areas that are operating well below capacity and as well directing spending toward increasing capacity to meet social goals. Most importantly, he wanted to put unemployed labor to work—not digging holes, but in socially productive ways. This would help to ensure that the additional effective demand created by government spending would not be simply exhausted in higher prices as it ran up against bottlenecks or other supply constraints. Further, it would help to maintain public support for the government programs by providing useful output. And it would generate respect for, and feelings of self-worth in the workers employed in the projects (no worker would want to spend her days digging holes that serve no useful purpose). President Roosevelt's New Deal jobs programs (such as the Works Progress Administration and the Civilian Conservation Corp) are good examples of such targeted job creating programs. These provided income and employment for workers, actually helped increase the nation's productivity, and left us with public buildings, dams, trails, and even music that we still enjoy today.

2. THE EMPLOYER OF LAST RESORT JOB GUARANTEEE PROGRAM

Some economists (and others) have long called for a more comprehensive and sustained approach to dealing with the perennial problem of unemployment. The government could stand by to hire any workers not needed in the private sector or by existing government

operations. This has been called a job guarantee, or the employer of last resort (ELR) proposal. A job guarantee program is one in which government promises to make a job available to any qualifying individual who is ready and willing to work. Qualifications required of participants could include age range, gender, family status, family income, educational attainment, residency, and so on. The most general program would provide a universal job guarantee in which government promises to provide a job to anyone legally entitled to work.

Many job guarantee supporters see employment not only as an economic condition but also as a human right. Wray and Forstater (2004) justify the right to work as a fundamental prerequisite for social justice in any society in which income from work is an important determinant of access to resources. Harvey (1989) and Burgess and Mitchell (1998) argue for the right to work on the basis that it is a fundamental human (or natural) right. Such treatments find support in modern legal proclamations such as the United Nations Universal Declaration of Human Rights or the United States Employment Act of 1946 and its Full Employment Act of 1978 (other developed nations have similar laws that commit government to achieving full employment). Amartya Sen (1999) supports the right to work on the basis that the economic and social costs of unemployment are staggering with far-reaching consequences beyond the single dimension of a loss of income (see also Rawls 1971).

A key proposition cited by these advocates is that no capitalist society has ever managed to operate at anything approaching true, full, employment on a consistent basis. Further, the burden of joblessness is borne unequally, always concentrated among groups that already face other disadvantages: racial and ethnic minorities, immigrants, younger and older individuals, women, people with disabilities, and those with lower educational attainment. Since markets do not operate to achieve full employment, and because markets tend to leave behind the least advantaged members of society, government should and must play a role in providing jobs to achieve social justice. Proponents of a universal job guarantee program operated by the federal government argue that no other means exists to ensure that everyone who wants to work will be able to obtain a job.

There are different versions of the ELR method of guaranteeing jobs. Harvey (1989) would provide a public sector job to anyone unable to find work, with the pay

approximating a "market wage," whereby more highly skilled workers would receive higher pay. In Hyman Minsky's (1965) proposal, developed further at The Center for Full Employment and Price Stability, University of Missouri-Kansas City and independently at The Centre of Full Employment and Equity, University of Newcastle, Australia, the federal government provides funding for a job creation program that would offer a uniform hourly wage with a package of benefits (Wray 1998; Burgess and Mitchell 1998). The program could provide for part-time and seasonal work, as well as for other flexible working conditions as desired by the workers. The package of benefits could include health care, child care, payment of Social Security taxes, and usual vacations and sick leave. The wage would also be set by congress or parliament and a rate increase would be approved—much as the minimum wage is currently legislated in the United States.

The perceived advantage of the uniform basic wage is that it would limit competition with other employers as workers could be attracted out of the ELR program by paying a wage slightly above the minimum wage. The most highly skilled workers would be most appealing to the private sector, so would be recruited first. Since the uniform wage paid in the ELR program would be well below the market's pay for skilled workers, these would have a big incentive to get out of the ELR program as quickly as possible. For this reason, the ELR program would not be in competition with the private sector for any workers except those with the lowest skills and work experience.

Benefits include poverty reduction, amelioration of many social ills associated with chronic unemployment (health problems, spousal abuse and family break-up, drug abuse, crime), and enhanced skills due to training on the job. Forstater (1999) has emphasized how ELR can be used to increase economic flexibility and to enhance the environment. The program would improve working conditions in the private sector as employees would have the option of moving into the ELR program. Hence, private sector employers would have to offer a wage and benefit package at least as good as that offered by the ELR program. The informal sector would shrink as workers become integrated into formal employment, gaining access to protection provided by labor laws. There would be some reduction of racial or gender discrimination because unfairly treated workers would have the ELR option. However, ELR by itself cannot end discrimination.

Still, it has long been recognized that full employment is an important tool in the fight for equality (Darity 1999).

Finally, some supporters emphasize that an ELR program with a uniform basic wage also helps to promote economic and price stability. ELR will act as an automatic stabilizer as employment in the program grows in recession and shrinks in economic expansion, counteracting private sector employment fluctuations. The federal government budget will become more countercyclical because its spending on the ELR program will likewise grow in recession and fall in expansion. Furthermore, the uniform basic wage will reduce both inflationary pressure in a boom and deflationary pressure in a bust. In a boom, private employers can recruit from the ELR pool of workers, paying a mark-up over the ELR wage. The ELR pool acts like a "reserve army" of the employed, dampening wage pressures as private employment grows. In recession, workers down-sized by private employers can work at the ELR wage, which puts a floor to how low wages and income can go.

Critics argue that a job guarantee would be inflationary, using some version of a Phillips curve argument according to which lower unemployment necessarily means higher inflation (Sawyer 2003). Some argue that ELR would reduce the incentive to work, raising private sector costs because of increased shirking, since workers would no longer fear job loss. Workers would also be emboldened to ask for greater wage increases. Some argue that an ELR program would be so big that it would be impossible to manage it; some fear corruption; others argue that it would be impossible to find useful things for ELR workers to do; still others argue that it would be difficult to discipline ELR workers. It has been argued that a national job guarantee would be too expensive, causing the budget deficit to grow on an unsustainable path (Aspromourgous 2000; King 2001). However, proponents have argued that these critics do not understand the proposal (see Mitchell and Wray 2005 for responses to these critiques). First, they do not see the difference between general demand pumping (which can be inflationary even before full employment is reached) and targeted spending (hiring only the unemployed that the private sector does not want to hire). Second, they do not understand the putting in place a wage floor (the ELR wage) only prevents wages from falling, but cannot cause private sector wages to rise. Third, they do not recognize the countercyclical nature of the

government's spending on the program—automatically stabilizing the economy as ELR spending rises in recession and falls in expansion. Finally, they do not understand that a sovereign government can always financially afford to buy anything offered for sale—a topic we examine later in this paper.

There have been many job creation programs implemented around the world, some of which were narrowly targeted while others were broad-based. The American New Deal included several moderately inclusive programs including the Civilian Conservation Corp and the Works Progress Administration. The New Deal employment programs created jobs for 3.6 million workers—helping to reverse the Great Depression and stimulating some private job creation (however, even these programs were too small given the severity of the depression; full recovery did not occur until WWII spending brought the U.S. economy to—and beyond—full employment). Sweden developed broad based employment programs that virtually guaranteed access to jobs, until government began to retrench somewhat in the 1970s—still, Sweden operates its economy very close to full employment by providing a variety of job-creating programs at relatively high wages (Ginsburg 1983). In the aftermath of its economic crisis that came with the collapse of its currency board, Argentina created *Plan Jefes y Jefas* that guaranteed a job for poor heads of households (Tcherneva and Wray 2005). The program successfully created two million new jobs that not only provided employment and income for poor families, but also provided needed services and free goods to poor neighborhoods. More recently, India passed the National Rural Employment Guarantee Act (2005) that commits the government to providing employment in a public works project to any adult living in a rural area. The job must be provided within 15 days of registration and must provide employment for a minimum of 100 days per year (Hirway 2006). Supporters of ELR will be closely following India's implementation of this new job guarantee.

3. IS FULL EMPLOYMENT AFFORDABLE?

One of the most vexing issues surrounds the belief that while government job creation programs might be desirable, government cannot afford them. On one hand, this belief appears somewhat strange. Sweden has long maintained that because it is a small nation,

it cannot afford unemployment—it needs to have all of its adult population contributing to production in order to be able to maintain high living standards. Unemployment is very costly—not only in terms of lost output, but also in terms of all of the social ills that accompany unemployment, including crime, family break-up, and physical and psychological health problems. Critics of government employment programs probably would agree with these positions, but ask where the government will get the money to pay for job creation. In this section we briefly examine whether a sovereign government can pay for an ELR program. Here we define a sovereign government as one that issues its own currency (the Canadian dollar in the case of Canada; the U.S. dollar in the case of the United States) and that operates without a pegged exchange rate (its currency is not fixed to gold or to foreign currencies). While many people believe that a government's spending is constrained by its ability to collect taxes and sell bonds ("borrow"), that is actually not correct for a sovereign government.

Supporters of ELR argue that a sovereign nation operating with its own currency in a floating exchange rate regime can always financially afford an ELR program (Wray 1998). So long as there are workers who are ready and willing to work at the program's wage, the government can "afford" to hire them. It pays wages by issuing checks or by directly crediting bank accounts of the workers. At the same time, it credits the reserves of the workers' banks. A sovereign government taxes by debiting bank accounts of taxpayers (either directly when taxes are paid "on-line" or after receiving bank checks written by taxpayers) and by debiting reserves of the taxpayers' banks. If government credits more accounts than it debits through tax payments, a deficit results. Budget deficits then mean that workers and taxpayers have net credits to their deposit accounts. Similarly, there will be net credits to the banking system, held as bank reserves. If the reserve holdings are excessive, banks bid the overnight rate down. The government can then either choose to let the overnight rate fall to its support rate, or it can intervene to sell interest-paying bonds at the desired support rate; this will drain excess reserves. In no sense is the government spending on ELR constrained either by tax revenues or the demand for its bonds.

Nor will spending on the ELR program grow without limit. As discussed above, the size of the ELR pool of workers will fluctuate with the cycle, automatically shrinking

when the private sector grows. In recession, workers shed by the private sector find ELR jobs, increasing government spending and thereby stimulating the private sector so that it will begin to hire out of the ELR pool. Estimates by Harvey (1989) and Wray (1998) put net spending by the government on a universal ELR program at well under 1% of GDP for the United States; Argentina's Jefes program peaked with gross spending at 1% of GDP (this figure undoubtedly overstates net spending because in the absence of the Jefes program government would have had to provide more spending on other anti-poverty programs). One of the fundamental flaws of capitalism is that it is unable to generate enough jobs for everyone who wants to work. For this reason, it is the government's responsibility to supplement private job creation with direct employment programs. The employer of last resort proposal provides a novel approach to ensure that there is always a job available for anyone who wants to work, but is unable to find employment in the private sector.

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