



The Jerome Levy Economics Institute of Bard College

# Public Policy Brief

## Full Employment Has Not Been Achieved

Full Employment Policy: Theory and Practice

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LEVY INSTITUTE

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# Preface

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The U.S. economy has performed well over the last several years compared to what we have come to expect in recent decades. But, it is far from the best it can be. The unemployment rate of 4.2 percent is the lowest we have seen since the 1960s, but in the midst of the longest peacetime expansion in the nation's history it is nearly double rates common in the 1950s. In addition to the unemployed, there are millions who are underemployed and millions more who are officially out of the labor force but would work if a job were available. Of those who have full-time jobs, many earn wages below the poverty line.

In good economic times people forget about business cycles, but the expansion will eventually turn to recession. Poverty, joblessness, and underemployment will again increase. Although no one can say exactly when the next recession will begin, troubling signs have appeared around the world: equity and bond market volatility, financial crises, and obsession with budget deficit reduction. If the U.S. labor market is failing so many people at the peak of the business cycle, how will we meet the challenges of the next recession?

In this brief, I discuss three strategies that have recently been proposed to increase employment and spread economic gains to the least advantaged: reduction of the workweek, employment subsidies, and the public service employment program. The public service employment program seems preferable to the others largely because of its ability to ensure truly full employment without creating inflationary pressures. Where reduction of the workweek has been tried as an employment strategy, it failed to generate more employment and had adverse consequences for output, inflation, and balance of trade. Subsidized low-wage employment

schemes have a high cost and may not generate more employment. If they do promote employment, they may create upward pressure on prices and may lead to rigidities in the labor market that hinder expansion.

In contrast, a public service employment program would ensure full employment by offering a job at a fixed wage to anyone willing and able to work. The program would not be inflationary. Spending would rise no further than the point at which all excess labor was employed; the fixed wage would prevent accelerating pressure on costs. The program would preserve labor market flexibility. If the private sector's demand for labor increased, it could hire workers away from the program; if demand fell, workers could return to the program. Also, public service employment would prevent the erosion of human capital that comes from joblessness and would provide valuable services for the society.

I hope you find this research of interest and I look forward to hearing your comments.

Dimitri B. Papadimitriou, *President*

July 1999

# Full Employment Has Not Been Achieved

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Unemployment cannot be conquered by a democracy until it is understood. Full productive employment in a free society is possible but it is not possible without taking pains. It cannot be won by waving a financial wand; it is a goal that can be reached only by conscious continuous organization of all our productive resources under democratic control. To win full employment and keep it, we must will the end and must understand and will the means.

—William Beveridge, 1945

Writing in the 1940s, Beveridge defined full employment as a labor market in which the number of job vacancies is higher than the number of jobless (Beveridge 1945), a condition that guarantees no long-term unemployment. What Beveridge envisaged was achieved in the immediate postwar years, but it was not sustained. However, the U.S. economy now appears to have reached what many believe is “full-employment” with low and stable inflation.

In March 1999 the unemployment rate was announced at 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 the number of people who are no longer counted as part of the labor force and the number of “employed” who are involuntarily working part-time. The Bureau of Labor Statistics regularly reports large flows in and out of the official categories “unemployed,” “employed,” and “out of the labor force.” In March 1999, for example, of the unemployed, 47.2 percent were job losers, 12.9 percent were job leavers, and 40.0 percent had previously been out of the labor force. People who found jobs typically

were new entrants to the labor force or came from the out of the labor force category.

Of the 68 million people in the out of the labor force category, 4.47 million wanted a job, 1.2 million had a marginal attachment to the labor force and were not currently working, and the rest had no attachment to the labor force. In addition, Lester Thurow (1996) notes that there are a few million missing males who used to be in the workforce, are not in school, are not old enough to have retired, are neither employed nor unemployed, and are not out of the labor force. They either have dropped out of or have been dropped from the GDP machine of the United States. There are also almost 3.7 million people who are involuntarily working part-time but for statistical purposes are included in the employed category and are not differentiated from those working full-time. Although it is not possible to calculate how many more individuals would work if jobs were made available, these numbers demonstrate that there are undoubtedly millions of these potential workers.

Finally, to make matters worse, the unemployment rate is underestimated if one applies the concept of “disguised” unemployment, defined as employment in sectors with low productivity as compared with productivity in manufacturing (Robinson 1937). By and large, employment growth has been not in manufacturing but in services, whose productivity lags behind that in manufacturing (Eatwell 1995).

This state of affairs coincides with a rush to embrace deficit reduction in countries throughout the world. Part of the rush to deficit reduction in the United States is a dismantling of the social safety net that has traditionally protected the most vulnerable segments of the population from economic and other hardship. Welfare reform forces recipients off public assistance and leaves it to individual states to find jobs for them, a task the states are unable—even if they are willing—to do. Cutting off aid will not necessarily put people to work. For example, a recent survey in New York State showed that two-thirds of the individuals leaving the rolls of the Aid to Families with Dependent Children (AFDC) and Home Relief programs failed to get jobs (*The New York Times*, March 23, 1998, 1). These individuals were left without the means to provide for

themselves and their families; the reform forced them deeper into poverty rather than toward self-sufficiency.

In Europe central banks continue a policy of tight money even while many countries—within and outside the European Union (EU)—experience double-digit official unemployment rates. Belgium, France, Germany, and Italy have all had unemployment rates around 10 percent, Spain has averaged closer to 20 percent for over two years, and all are projecting similar rates through the year 2002. At the same time EU member states are preparing to give up their sovereignty to conduct coordinated fiscal and monetary policy by accepting the rules of a flawed European Monetary Union (EMU). The Maastricht Treaty sets ceilings for inflation and government deficits and debt, but not for unemployment, which, as of the end of February 1999, stood at approximately 16.8 million for the 15 member-states. When asked about remedies to ameliorate high unemployment rates, EU economics ministers respond that they are making progress identified as a “change in trend but not yet of a breakthrough” (*Financial Times*, March 12, 1998).

During the Great Depression in the United States the government addressed unemployment through direct intervention in the labor market. The government-instituted programs to create jobs were temporary, however, and they were discontinued with the economic recovery that accompanied U.S. entry into World War II. The depression-era and immediate postwar commitment to a “guarantee of employment” was replaced with efforts to “promote maximum employment.” In the 1950s and 1960s promotion of full or maximum employment meant macroeconomic policies designed to manage aggregate demand, supplemented by selective programs such as job training and limited income maintenance. With the onset of the stagflation of the 1970s, however, even the moderate approach of demand management faltered, and a consensus developed among economists and policymakers worldwide that an unemployment rate of 5 percent in the United States (and as high as 10 percent in France) would be too inflationary.

The idea of a “natural rate of unemployment,” below which unemployment cannot fall without creating inflation, continues to this day. This conventional wisdom requires that to ensure price stability, millions of



individuals who are ready, willing, and able to work must remain idle, thereby serving as a “reserve pool” or “forgotten army” of labor. Two important questions, then, may be posed regarding unemployment. First, is the current labor market situation the best we can do in times of prosperity? Second, are we prepared to meet the challenges of the next downturn? (Worrisome signs have already appeared: equity and bond market volatility in the United States and overseas, the Asian and Russian crises, unprecedented rates of household and business indebtedness in the United States, and an obsession with meeting government budget deficit reduction targets everywhere.)

The challenge for policymakers is to craft employment policies that uphold the basic human right to a job and are not inflationary, do not interfere with decisions of individual firms, do not rely on the failed approach 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. Such requirements have been recognized by a number of academics and policymakers across the theoretical and political spectrum, and many measures to achieve higher employment have been suggested. This brief examines three measures that have received considerable attention—reduction of the workweek, employment subsidies, and public service employment—to determine which best meets the requirements.

### Reduction of the Workweek

Reducing the workweek and other arrangements for sharing available work have been introduced many times by governments and trade unions alike as mechanisms to ameliorate high unemployment and to provide flexibility and power sharing in the workplace. Work sharing is not limited to reducing the normal workweek; it also includes arrangements such as job sharing, job splitting, elimination of overtime, phased entry into the labor market through extended education and training, phased retirement and in general part-time work. Part-time work was promoted by the Organization for Economic Cooperation and Development (OECD) as a measure to increase flexibility that “could enhance job creation and employment prospects” (1995, 23).

The principal argument made in favor of work-sharing arrangements is that they “redistribute work over people so as to reduce the extent of involuntary unemployment” (Drèze 1986, 1). As the Commission of the European Community put it, “The aim of work-sharing is to redistribute the total volume of work in the economy in order to increase employment opportunities for all those wishing to work. This does not mean that the volume of work remains constant. Rather it is based on the observation that this volume is at present inadequate and that we must try to redistribute it” (1978, 2). The European Union continued the endorsement of this employment strategy by incorporating it into the 1993 directive it issued on work time.

As Europe’s unemployment rates have remained at record levels, the trading of hours for jobs has remained an employment policy looked on favorably by employers and trade unions. In Germany reductions in the normal workweek were implemented in the 1950s and 1960s. In the early 1990s Germany’s economics minister, Gunter Rexrodt, suggested that saving jobs would require shorter hours and longer holidays. Volkswagen warned that it would have to make massive layoffs if a four-day workweek with a 20 percent wage cut was not accepted (Gow 1993; “Sharing the Burden” 1993). In 1982 the Netherlands experimented with a reduced workweek and forfeiture of pay increases after having experienced high unemployment and an increase in the labor force throughout the 1970s.

The French experience is perhaps the most interesting because until the 1980s there had been a widespread belief across the political spectrum in France that shortening the workweek would lead to employment creation (“France: Company Work-Sharing Agreements” 1993). In Jallade’s (1991) analysis of French working time policies, he argued that, contrary to public sentiment, no significant employment effects were discernible from the 1980s reductions in the workweek, and if there were any, they were most likely offset by the decline in French competitiveness resulting from increased wage costs. Furthermore, he suggested that the spreading of work by reducing work hours might lead not to additional jobs but to a faster pace for workers and higher productivity. Prime Minister Jospin’s attempt in 1996 to reduce the workweek to 35 hours as a macroeconomic policy for job creation met strong opposition from

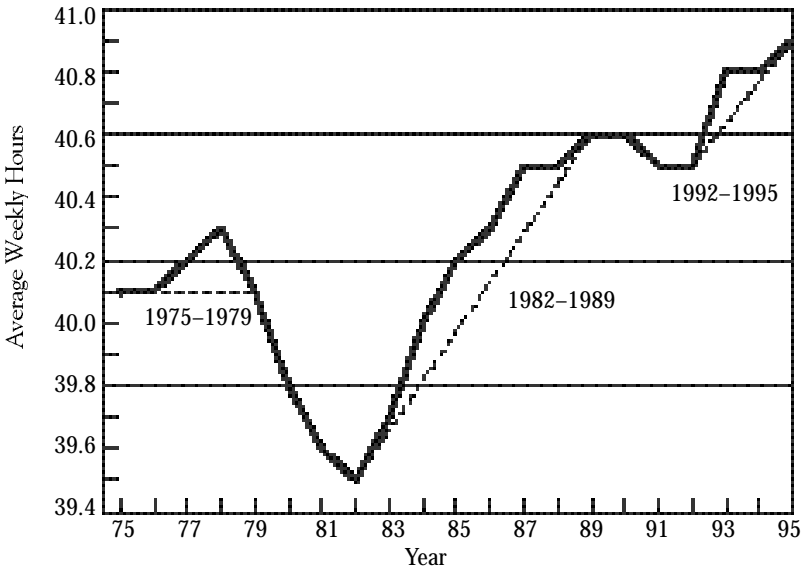
economists and trade unions alike. The government went ahead and instituted the 35-hour workweek, the objections and criticisms notwithstanding. Early reports indicate not only insignificant reductions in the unemployed but also projections of higher unit costs.

Studies to quantify the Dutch experiment's impact on employment growth showed no significant changes, indicating that reducing the workweek was "a relatively ineffective policy for reducing unemployment" (Roche, Fynes, and Morrissey 1996, 136). Although the reductions in Germany in the 1950s and 1960s did establish a new normal workweek, they had no apparent impact on employment (Hinrichs 1991). Empirical evidence on the effects of reduced working hours schemes in Belgium in the 1980s and in Australia in the 1970s and 1980s—when unemployment rose—also indicates no growth in employment (Roche, Fynes, and Morrissey 1996). To the contrary, in Australia because the standard workweek was reduced, employers had to get their employees to work overtime to make up for the reduction in hours. This extra cost reduced economic activity and resulted in a decrease in employment (Dixon 1987). This kind of employment policy resembles the "shock therapy" applied to Russia and the former Warsaw Pact economies during transition, the abysmal results of which have been well documented (Papadimitriou 1991).

In the United States reduction of working hours has not been used as a strategy to increase employment. In *The Overworked American*, Juliet Schor (1991) reported that Americans worked 1,924 hours in 1989 compared with 1,786 hours two decades earlier, an increase of 7.7 percent. She suggested that reducing the workweek would lead to less absenteeism, less turnover, less personal business on company time, lower costs, and, perhaps, increased employment. As unemployment rose in the 1970s and 1980s, some labor economists and others advocated reducing the standard workweek to "spread the work," arguing that it would put millions of individuals to work (Levitan and Belous 1977; Morand and Macoy 1984; McGaughey 1981). What happened instead was that many employers and employees (who consented because of an environment of job insecurity) have increased the workweek through overtime as a means to decrease employer costs (they do not pay benefits on overtime work) and to increase income for employees.

The magnitude of the increase in work hours has led many researchers to question the ability of official statistics on unemployment to describe real labor market conditions. Figure 1 shows the trend in average weekly hours worked for prime-age workers since 1975 (Bluestone and Rose 1998, 34). During the last two recoveries—1982 to 1989 and 1992 to 1995—average weekly hours increased significantly without a pronounced change in the number of prime-age workers, which indicates, in effect, the existence of an unmeasured labor force and provides reasons for the coexistence of low unemployment and low inflation that we have experienced in the 1980s and 1990s. In simple arithmetic terms, given that the employed labor force was about 100 million in 1982, the increase in hours is approximately equivalent to adding 3.7 million new workers to the labor force or decreasing the official unemployment rate by 3.7 percentage points (Bluestone and Rose 1998, 35). With so many employers and employees willing to increase work hours, it is unlikely that an effort to reduce the standard workweek could be successful in the United States.

Figure 1 Average Weekly Hours Worked, All Prime-Age Workers (Age 25–54)



Note: Dashed lines indicate recovery periods.

Source: From Barry Bluestone and Stephen Rose, *The Unmeasured Labor Force*, Public Policy Brief no. 39 (Annandale-on-Hudson, N.Y.: The Jerome Levy Economics Institute, 1998). Authors' analysis of Current Population Survey data.

The Japanese experience with shorter working hours has been scanty. Until recently Japan's official unemployment rates were low, thus negating any interest in full employment policy. As Deutschmann (1991) said, the employment practices of Japanese firms involve more normal work hours, more overtime, and fewer paid holidays than the practices of other industrial countries. The likely employment effects of fewer working hours were simulated with a simple model by Brunello (1989). The econometric results of the model indicated that a reduction of the work-week would be associated with an increase in overtime and a reduction in employment.

Reducing work hours to generate employment, in the European experience, not only failed to enlarge the pool of employed workers but also resulted in such negative side effects as loss of output, inflation, and imbalance of trade. Moreover, working time reductions instituted during periods of persistently high unemployment may become permanent and thus increase the already significant number of individuals who are chronically under- or unemployed (Owen 1989, 141). All individuals who are able and willing to work cannot be employed by spreading the work of those who are employed. To deal adequately with structural unemployment requires not rationing work, but making more work. What is needed is the development of policies to increase the demand for labor. To these options, we turn next.

### Employment Subsidies

Subsidies for rewarding work already exist in the form of the earned income tax credit (EITC). 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 nonwage 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 has long been proposed as an employment solution. Because it benefits every individual regardless of employment, it works more to alleviate the problem of inequitable distribution of

income than to maximize employment (Tobin 1966; Tobin et al. 1967). In addition, income maintenance programs, such as the negative income tax, increase aggregate demand without increasing aggregate supply, putting more pressure on prices than an employment program that increases both aggregate supply and aggregate demand. There is, by and large, general agreement that neither the EITC nor the negative income tax provides an inducement for employment growth among the unemployed, the nonemployed, and those on welfare or an incentive for poorly paid workers to hold onto a job to the same extent that a wage subsidy would.<sup>1</sup>

In a series of articles culminating in a highly acclaimed book, Edmund Phelps, of Columbia University, 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 for higher levels of employment from the ranks of the unemployed and those not presently in the labor force.

Employment subsidy schemes that partially offset the cost to firms of employing additional workers by public payments to the firms gained considerable currency in the 1930s as a means to counter economic contraction and high unemployment and to lift or “reward” low-wage workers.<sup>2</sup> However, as Phelps points out, in the 1950s and 1960s, when the Keynesian notion of demand management through monetary and fiscal policies dominated thought about unemployment policy, “wage subsidies fell out of fashion, if not into disrepute. Then, in the 1970s, when economists concluded that the usual monetary maladjustment works itself out—that unemployment tends toward its current ‘natural’ level through wage adjustments or the traditional behavior of the central bank—the way was clear for a return of the idea of employment subsidies” (Phelps 1997, 144).

Phelps makes the case that wage subsidies to employers can have an impact not only on the workers who directly benefit from them, but also on the wider community. Subsidies could translate into higher wages, which 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 the benefits and entitlements afforded by the safety net (Phelps 1994b, 57).

Phelps estimates that the initial cost of his proposed graduated employment subsidy (the subsidy decreases as the wage increases) would have been about \$98 billion if it had been put in place in 1990, as indicated in Table 1. The estimate goes up to \$125 billion in 1997, reflecting inflationary increases in money wages and the increase in employment over the 1990 to 1997 period (Phelps 1997, 116). Phelps is not concerned about the cost of his proposal, however, 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

Table 1. Cost of the Model Wage Subsidy Plan

Hourly Wage	Hourly Subsidy	Annual Wage	Annual Subsidy	Number of		Subsidy Outlay (\$billions)
				Employees (%)	Employees (millions)	
\$1 or less	\$0.00	—	—	1.0	0.061	—
2 to 1.01	0.00	—	—	0.2	0.122	—
3 to 2.01	0.00	—	—	0.8	0.488	—
4 to 3.01	3.00	\$7,000	\$6,000	5.9	3.599	\$21.594
5 to 4.01	2.29	9,000	4,580	10.4	6.344	29.056
6 to 5.01	1.65	11,000	3,300	9.4	5.734	18.922
7 to 6.01	1.12	13,000	2,240	9.6	5.856	13.117
8 to 7.01	0.71	15,000	1,420	9.1	5.551	7.882
9 to 8.01	0.43	17,000	860	7.0	4.270	3.672
10 to 9.01	0.24	19,000	480	8.1	4.941	2.372
11 to 10.01	0.13	21,000	260	4.2	2.562	0.666
12 to 11.01	0.06	23,000	120	5.3	3.233	0.388
13 to 12.01	0.00	25,000	0	4.6	2.806	0
14 to 13.01	0.00	27,000	0	3.4	2.074	0
15 to 14.01	0.00	29,000	0	3.7	2.257	0
20 to 15.01	0.00	35,000	0	10.4	6.344	0
25 to 20.01	0.00	45,000	0	4.3	2.623	0
More than 25	0.00	—	0	3.5	2.135	0
Total				100.0	61.000	\$97.669

Notes: Percentage distribution from the Current Population Survey, March 1990. Number of employees from the U.S. Census 1990. Table covers full-time employees in the private sector (full-time employees taken to work 2,000 hours per year).

Source: From *Rewarding Work* by Edmund S. Phelps. Copyright © 1997 by the President and Fellows of Harvard College. Reprinted by permission of Harvard University Press.

firm's behavior will become directed toward obtaining the subsidy, rather than to the market to obtain profits. Phelps argues this criticism away by distinguishing "private" from "social" productivity and thus "free-market" from "social" prices of labor, which gives rise to distinguishing private from social costs. Economists have recognized since at least the early 1900s that even in competitive markets there are many instances in which a "free-market" price diverges from the "right" price (Pigou 1933). Phelps insists his plan is based on the view that "judicious subsidies are acceptable . . . as long as the system of free enterprise is kept firmly in place" and "if low-wage workers become better rewarded, a more adventurous and less bridled capitalism might well be justified" (1997, 123).

It is by no means certain that Phelps's plan will actually achieve the higher levels of employment he assumes it will. For one thing, it is possible that employers will seek to substitute subsidized workers for those currently employed. If the plan is successful in promoting higher levels of private sector employment, it may have two serious side effects. First, it is likely to add to rigidities in the economic system that hinder expansion. As it tightens the labor market, it makes it more difficult for expanding firms to find workers. Second, it is likely to cause inflation. Even though firms will pay only a portion of the wages of the expanded workforce, more money will enter the economy through the subsidies, driving up the demand for goods and therefore 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) believed employment policies based on subsidies were liable to lead to inflation, serious financial instability, and financial crisis. He proposed an alternative 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 full employment. A group of researchers at the Levy Institute (Wray 1997; Forstater 1997; Papadimitriou 1998) have developed Minsky's proposals in considerable



detail, providing even greater theoretical support for a government job assurance strategy.

The proposal—here called the public service employment program—has two basic components: an employment program that offers workers an opportunity for employment and an exogenously set program wage that protects against inflationary pressures. The first component of the proposal is relatively simple. 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. If the government sets the wage at \$6.00 per hour, a worker can make \$12,500 working full-time, full-year (2,080 hours). Normal public sector employment would not be affected by the plan; it would remain a vital and separate component of public employment. The government would become, in a sense, “a market maker for labor” by establishing a “buffer stock of 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).

As in all buffer stock schemes, the commodity used as the buffer stock is always fully employed but also available, which means that the program ensures a “loose” labor market even as it ensures full employment. A buffer stock commodity also always has a stable price, which in this case cannot deviate much from the range established by the government’s announced wage, so the program ensures stable prices with full employment.

The public service employment program stands in stark contrast to Keynesian demand management policies. The Keynesian policies are designed to “prime the pump” with government spending to increase private demand sufficiently to lower unemployment to a level that would not be inflationary. The problem is that such policies may lead to labor markets tight enough to generate inflation long before “full” employment is reached. A public service employment strategy would operate through increases or decreases in a buffer stock of labor that was employed, rather than maintaining a reserve army of the unemployed. (If the buffer stock shrinks so much during an expansion that inflationary pressures result, government can raise taxes or reduce spending to replenish the buffer stock.)

The public service employment program can eliminate all involuntary unemployment by providing jobs for every person ready, willing, and able to work. There will still be many individuals—even among those in the labor force—who will be voluntarily unemployed for a variety of reasons; for example, 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 job. Some individuals will remain unemployed because they cannot meet the minimum standards for public employment. But any person able to work—defined broadly as anyone who can make a contribution to the economy and society, irrespective of the size and type of that contribution—will have the opportunity to do so.

A program of such scope means that much social spending for the unemployed can be reduced or eliminated altogether. For example, public service employment will render unemployment compensation unnecessary since all willing and able workers would be employed. No one who is able would be paid for not working, and pay would be equalized among those who cannot find jobs in the private sector. Other forms of social spending, such as Temporary Assistance to Needy Families (TANF), Aid to Families with Dependent Children (AFDC), and food stamps, could be substantially reduced. Because many individuals currently receiving such assistance are not and probably could not be in the labor force, a public service employment program cannot replace all social support. Precisely who would be forced out of the support programs and into public service employment cannot be easily determined. What can be seen is that for the former support recipients the program has major advantages over the current welfare-to-work schemes: It is voluntary, ensures that a job is available, and has no lifetime limit.

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, GDP, and this year's federal budget surplus (and those projected into the future), the budgetary effects of the program would be 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).

Questions are likely to be raised about the impact of a public service employment program on inflation. Will full employment increase aggregate demand to a level that results in accelerating demand-pull inflation? Alternatively, can aggregate demand increase sufficiently with the additional federal spending and still not generate inflation? The answers seem clear. Public and private sector spending now (in the absence of a public service employment policy) provides a level of employment that leaves more than 6 million workers unemployed and more than 3 million underemployed; people are not spending enough to create a sufficient number of jobs. The existence of involuntarily unemployed workers is de facto evidence that aggregate demand is below the level required for full employment. As long as additional government spending does raise employment, this indicates that aggregate demand is still below the full employment level.

The very design of the public service employment program ensures that additional federal spending will rise only to the point at which all involuntary employment is eliminated. Once there are no workers willing to accept a program job, spending will not increase. Spending will not become “excessive,” that is, it will not cause aggregate demand to increase beyond the full employment level. Fine-tuning aggregate demand, through changes in taxation and expenditure, is still possible with the adoption of this policy; increases in demand will shrink the buffer stock of labor, and decreases will replenish it. Since the program limits spending to the level that will guarantee true full employment, concerns about demand-pull inflation are alleviated.

What about cost-push inflation resulting from the pressure on wages and in turn on costs and prices? Here is where the second component of the proposal comes into play. The wage paid by the government in the public service employment program is exogenously set. Being a fixed price, it is stable and sets a benchmark price for labor. Although some private sector jobs and regular public service jobs might still pay a wage below the program wage, once the program is put in place, most of the

low-wage jobs will experience a one-time wage increase or may disappear altogether.<sup>3</sup> Wages for those who make less than \$12,500 might experience a one-time increase.<sup>4</sup> And workers of higher productivity, who already make more than \$6.00 per hour, might become more obstinate in their wage demands, so that other wages also ratchet upward. Employers will be forced to cover these higher costs through a combination of higher product prices, greater labor productivity, and lower realized profits. Thus, some product prices will experience a one-time increase, but a one-time jump is not inflation and it cannot be accelerating inflation (as these terms are normally defined by economists).

The pressure on costs would also be limited by reducing erosion of human capital. Recent literature finds that idle human capital depreciates rapidly and thus entails a high cost. Labor productivity falls quickly when labor is unemployed, and beyond some point workers may become unemployable (for example, because of loss of “work habit”). Because with a public service employment policy people who are not employed in the private sector or regular public sector continue to work, their skills do not depreciate so quickly, if at all. Indeed, the program could be geared toward enhancing the human capital of its pool of labor. This enhancement would reduce the productivity-adjusted cost of hiring workers from the pool relative to hiring unemployed workers and thereby diminish inflationary pressures.

Against any tendency for wages to ratchet upward must be measured the likelihood that the public service employment program will maintain and possibly enhance the human capital of workers who are temporarily unneeded in the private sector. When demand for private output rises sufficiently for these workers to be hired in the private sector, the somewhat higher cost of workers in the program relative to the cost of unemployed workers in the absence of the program is partially offset by higher productivity, thereby reducing any pressure on prices. Moreover, because unemployment compensation may no longer be needed, there would be no need for experience-rated unemployment insurance taxes on firms and workers. The elimination of these taxes would reduce overall labor costs for firms that typically have volatile (seasonal or cyclical) demand for labor, which, again, would tend to offset some of the higher wage costs. By and large, even the one-time upward adjustment in wages and prices might be quite small.

Other questions about a program of public service employment (reflecting a variety of political points of view) have been raised. We can respond to some of them briefly.

- *Will the program be another make-work New Deal WPA?* One way to respond to this question is to cite the many artistic and educational accomplishments and improvements to the nation's physical infrastructure that were the achievements of the WPA. More importantly, the WPA gave to millions of people the opportunity to contribute productively to the American economy and society (Minsky 1986). Another way to respond is to list the many necessary and beneficial jobs program workers could fill—teachers' aids; library and day care assistants; companions to senior citizens, the bedridden, and the mentally and physically impaired; environmental safety monitors; and many more. The program can provide valuable public services.
- *Can such a program be efficiently administered?* Given the abuses of some public programs, concerns about administering the program are legitimate. However, there have also been some model programs, such as VISTA, the Peace Corps, and Americorps.
- *Since states are already implementing welfare-to-work programs, why is this program needed?* With only a few exceptions, states have indicated that they will not offer permanent work to former welfare recipients. They will be left to fend for themselves.
- *Will a stigma be attached to participation in such a program?* Peace Corps, VISTA, and Americorps participants have been well regarded. A public service work assignment may prove to be a good entry on a resume.
- *Why worry now, when unemployment is at its lowest level in a generation?* A closer look at the official unemployment statistics shows that the country is not a "worker heaven." The large population of involuntarily unemployed and underemployed warrants concern in a country that considers socially productive work a virtue and upholds the right of its citizens to employment.

What Is to Be Done?

It is difficult to see how truly full employment under a public service job opportunity program could be more inflationary than our current system

of maintaining a reserve army of the unemployed 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. Wage subsidies and reductions in the workweek, even if they turn out to be successful at increasing employment substantially, could result in the inflation and sluggish growth associated with tight labor markets and structural rigidities. In contrast, a public service employment solution provides full employment with price stability and labor market flexibility. As Minsky put it, “only an infinitely elastic demand for labor can guarantee full employment without setting off a wage-price spiral, and only government can create an infinitely elastic demand for labor” (1986). At the same time, as long as those holding a program job are available when private sector demand increases, such a program will not result in inflationary pressures or structural rigidities. The public service employment approach also will be relatively inexpensive and likely to pay for itself. It can preserve human capital and provide valuable public services.

The costs of unemployment are significant and many of them can be quantified, especially those associated with the loss of output that unemployed workers could have produced. Furthermore, the employed (and their employers) are burdened with financing the unemployment insurance and other maintenance support the unemployed receive. Alas, the “damages” of unemployment do not stop there. Negative effects that afflict the unemployed include 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 also breeds racial and gender intolerance. It engenders resistance to organizational flexibility and promotes technical conservatism in those currently employed who fear downsizing and joblessness.

The realized costs and negative effects of unemployment are undoubtedly much higher in Europe than in the United States. Yet, the absence in the Maastricht Treaty of specific resolutions regarding unemployment, while it includes specific resolutions to reduce inflation and budget deficits, is disturbing. In the United States the government has gradually retreated from Franklin Roosevelt’s assertion of everyone’s “right to

employment” and the initial push to “guarantee full employment.” The Employment Act of 1946 reduced the commitment to the “promotion” of “maximum employment,” and since the 1970s the commitment has been reduced still further to the acceptance of a rather large “natural rate of unemployment.” But the real issue is not to discover each continent’s or country’s skeletons in the closet, but to work toward making policy-makers willing to learn from the successful (and failed) policies of the past, amend them to reflect current economic conditions, and, finally, marshal the needed resources to implement them.

In William Vickrey’s American Economic Association presidential address 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. We should then enjoy a major reduction in the ills of poverty, homelessness, sickness and crime that this would entail. We might also see less resistance to reductions of military expenditure, to liberalization of trade and migration policy, and to conservation and environmental protection programs.

Should progress toward genuinely full employment be today’s task for economists? I think so. I hope so. As Beveridge said, “To win full employment and keep it, we must will the end and understand and will the means.”

## Notes

1. These criticisms notwithstanding, many commentators have urged that the EITC be expanded to boost employment and the income of poorly paid workers (Bluestone and Ghilarducci 1996).
2. Wage subsidies have been proposed in Britain by Pigou (1933), Kaldor (1936), Jackman and Layard (1986), and Snower (1993); in the United States by Hammermesh (1978) and Haveman and Palmer (1982); and many others.
3. Workers might be willing to accept lower wages for some private sector jobs if the work is more pleasant than in public service employment jobs or if the jobs offer hope of advancement. But, for most private sector jobs, one would expect that workers would not accept them unless they paid more than public service employment jobs.
4. Based on Wray's (1997) estimate of a program wage at \$6.00 per hour for 2,080 hours per year.

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