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## Zero Unemployment and Stable Prices

*L. Randall Wray*

The 1946 Employment Act committed the U.S. government to high employment and stable prices, while the 1978 Humphrey-Hawkins Act strengthened the government's commitment by setting a goal of "full employment," defined as an adult unemployment rate of 3 percent. Paradoxically, neither accepted economic theory nor practical experience indicates that high or full employment is even *possible* with stable prices. As a result, for at least the past two or three decades, monetary policy generally has been geared toward *raising* the unemployment rate as a *means* to achieving stable prices; unemployment is perceived as the inevitable *cost* of price stability.

Recently, however, the U.S. economy *seems* to have approached both full employment and low and stable inflation. While Chairman Greenspan has been hinting for months that the low unemployment rates achieved during 1997 are not sustainable and that inflation must be around some corner, he has been prevented from tightening policy because there is little evidence that inflationary pressures exist and—perhaps more importantly—because of the recent financial instability in Asia. Although some "cracks" in the "new world economy" are beginning to show, many pundits have proclaimed that we are finally reaping the benefits of Reaganomics and Volcker-Greenspan monetary policy finesse. Thus, while NAIRU still lurks somewhere in the minds of analysts, it is believed that we have achieved the best of all possible worlds: "full employment" and more-or-less stable prices.

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If this is the case, why does any sentient observer notice widespread insecurity, dissatisfaction, and even suffering in the United States? Has the population at large failed to notice the "new economy"? If things have never been better, why do fringe economists bemoan the current situation and even, heaven forbid, dare to compare our economy *unfavorably* with the early postwar economy? And why would any respectable economist suggest that we should turn to the Kennedy-Johnson years or, worse yet, to the New Deal for inspiration to guide economic reform?

Perhaps the U.S. population understands that low, measured unemployment rates cannot tell the whole story. Flows among the categories—officially unemployed, employed, and out-of-the-labor-force—are large: of those unemployed in November 1997, 45.6 percent were job losers, 11.2 percent were job leavers, and 43.2 percent came from out-of-the-labor-force [Bureau of Labor Statistics 1997]. Those who find jobs typically come from out-of-the-labor-force. Even if we agreed that the 6.2 million officially unemployed in November 1997 represented a small "cost" of price stability, there are another 67 million adults older than 16 years of age (or, 10 times the number of unemployed) who are out-of-the-labor-force. While it is impossible to calculate how many of these would work if jobs were made available, there are no doubt millions of potential workers. In addition, "welfare reform" is designed to force millions of "welfare moms" into the labor force. Current policy thus guarantees that millions, in addition to the officially unemployed, will be without work.

Here, I summarize an employment program that will guarantee true, full employment (or zero unemployment) for *all*; it is much like that advocated in the early 1980s by Hyman Minsky [1986] and more recently by Warren Mosler [1995], Philip Harvey [1989], and Wendell Gordon [1996]. I will show that true full employment is not "inflationary" and could even reduce inflationary pressures. Indeed, full employment can be sold as a means to stabilize prices, which is close to the position taken by Minsky and Mosler. Further, the full employment policy would help to reduce economic fluctuations (the "business cycle") through a powerful built-in automatic stabilizer.

### *Government as Employer of Last Resort*

The first component of the proposal is relatively simple: the government acts as the employer of last resort (ELR), announcing the wage (say, \$6.25 per hour) at which it will hire anyone who wants work. Of course, there will remain many (non-ELR) jobs in the public sector that are not a component of the ELR and that could pay higher wages; ELR is not meant to substitute for current public sector employment.

This policy will eliminate all unemployment, broadly defined as workers willing to work at the going wage but unable to find a job. Certainly there will still exist

many individuals—even those in the labor force—who will be *voluntarily* unemployed, but our only concern is to ensure that all those ready, willing, and able to work will be able to obtain a job at the ELR wage.

One implication of ELR is that much social spending currently targeted to the unemployed (such as unemployment compensation) might be reduced or eliminated. In addition, at least *some* social spending could be reduced, such as General Assistance and Aid to Families with Dependent Children.<sup>1</sup> ELR would reduce some spending on the Earned-Income-Tax-Credit (something like a negative income tax) and Food Stamps (paid, primarily, to those already working) if it raised incomes. Finally, it would reduce costs to private employers by eliminating or reducing the employer-paid portion of unemployment compensation.

ELR will eliminate the need for a statutory minimum wage, as the ELR wage will become an effective minimum wage. Indeed, it will have complete coverage, unlike the current minimum wage law, which does not cover the unemployed (whose wage is zero). Note that ELR could also provide a path to *de facto* universal health care coverage. If the ELR compensation included health care benefits, then private sector jobs would also have to provide health care (or a salary sufficient to induce workers to forego coverage).<sup>2</sup>

Elsewhere, I calculated that the net cost of ELR to the government would fall between \$25 billion and \$50 billion (total expenses in excess of \$100 billion, with savings in excess of \$50 billion) [Wray 1997]. Gordon [1996] has proposed a similar ELR-type program and estimated the net cost at \$39-\$41 billion. Harvey [1989] had calculated the cost for 1986 at \$28.6 billion. Thus, my estimate is in line with that of others. Note that we are not including a variety of possible social and private benefits. For example, it is widely recognized that long-term unemployment contributes to crime, child abuse, divorce, loss of human capital, and other social and private degradation (including insecurity even of the employed) that may be hard to value economically. Certainly unemployment is only one of the factors that contribute to such problems; however, there should be no doubt that substantial economic benefits should be generated from elimination of involuntary unemployment.

Obviously, the budgetary effects of the ELR are quite small, relative to the size of the Federal budget, to the size of the Reagan or Bush deficit, and to the size of GDP. An important question, however, concerns the impact this program would have on aggregate demand: is full employment going to increase aggregate demand sufficiently that accelerating demand-pull inflation would follow? If in the absence of ELR, public plus private sector spending provides a level of employment that leaves millions of workers involuntarily unemployed, this must be evidence that *potential* output exceeds actual output. Indeed, involuntary unemployment is *de facto* evidence that demand is too low and that the deficit should be increased. ELR, by design, ensures that the deficit will rise only to the point that all involuntary employment is eliminated; once there are no workers willing to accept ELR work, the

deficit will not be increased further. As the government implements ELR and begins employing some of the unemployed, this will stimulate demand (through the "spending multiplier"). ELR may find that only 4 million workers will eventually accept work. Still, ELR automatically operates to ensure that the deficit spending attributable to ELR is at the correct level, since every private sector job created automatically reduces ELR by approximately one job and the deficit by at least the cost of an ELR job (and probably by more as tax revenues rise and government spending falls).

This should eliminate the fear that a full employment policy must necessarily generate excessive demand-pull inflation. Of course, it can still be objected that full employment and the ELR wage will generate cost-push inflation by placing pressure on wages and thus costs and prices. We now examine the second part of the proposal: exogenous wage setting by the government.

### *ELR and Exogenous Pricing*

The size of the deficit spending necessitated by the ELR intervention will be "market determined" by the number of workers the private sector does not want. However, the "price" (ELR wage) is exogenously set. Thus, while the quantity "floats," the price is "fixed." What are the implications for prices and wages?

Clearly, with a fixed price, the ELR wage is perfectly stable and sets a benchmark price for labor. Some jobs might still pay less if they are particularly desirable. However, low-wage jobs that pay at or below the ELR wage will experience a one-time wage increase (or will disappear altogether). Employers will cover these higher costs through a combination of higher product prices, greater labor productivity, and lower realized profits. Thus, some product prices should also experience a one-time jump. If the ELR wage is set at the statutory minimum wage, the impact will be minimal—private wages need rise only sufficiently to make private sector employment preferable.<sup>3</sup> In short, at the low end of the wage scale, wages and the prices of products produced by these workers might experience a one-time increase. This one-time jump—no matter how large it is—is not inflation nor, still less, accelerating inflation.

Essentially, the ELR wage determines the wage for the lowest productivity group—the pool of unskilled and semi-skilled workers during periods of normal demand. Those workers whose productivity is substantially higher will find jobs in the private sector; those with lower productivity will work in ELR. When private demand is below normal, the government will find the average productivity of its ELR pool rising as workers are laid off in the private sector; when private demand is above normal, workers whose productivity was formerly too low to induce private hiring will leave the ELR pool. Countercyclical fluctuation of average productivity of the ELR pool helps stabilize private demand.

Given that the relation between wages and productivity is loose, some ratcheting upward of wages after the ELR policy is adopted is possible. However, just as workers have the alternative of ELR, employers have the opportunity of hiring from the ELR pool. This is the primary "price stabilization" feature of the ELR program. If the wage demands of workers in the private sector exceed by too great a margin the employer's calculations of their productivity, the alternative is to obtain ELR workers at a mark-up over the ELR wage. This will help to offset wage pressures caused by elimination of the fear of unemployment.

It must be remembered that the ELR workers are not "lost" as a reserve army of potential employees; rather, they can always be obtained at a mark-up over the ELR wage. With an ELR policy, those who are not employed in the private sector continue to work, and social policy could actually be geared toward enhancing human capital of the ELR pool. This would *reduce* the productivity-adjusted cost of hiring ELR workers relative to unemployed workers and thereby diminish inflationary pressures.

Indeed, it is hard to imagine that true full employment with an ELR program would be more inflationary than what we have currently. The current system relies on *unemployed* labor and excess capacity to try to dampen wage and price increases; however, it pays unemployed labor for not working and allows that labor to depreciate and in some cases to develop behaviors that act as employment barriers. Social spending on the unemployed prevents aggregate demand from falling excessively, but little is done to promote growth of potential output. With ELR in place, however, labor is paid for working, which can lead to production of publicly supplied goods and services, can promote efficiency of the private sector (if, for example, ELR generates productivity-enhancing public infrastructure) and reduce private sector costs (for example, by reducing crime), and can increase the education and skills of ELR workers (compared with education and skill levels of the unemployed). Thus, ELR might *increase* potential output and thereby place *downward* pressure on prices.

In a sense, ELR allows government to "make a market in labor" by establishing a "buffer stock of labor" as it stands ready to "buy" unemployed labor at a fixed price or to "sell" (provide it to non-ELR employers) at a mark-up. As is the case in all buffer stock schemes, that commodity used as a buffer stock is always fully employed. It also always has a very stable price, which cannot deviate much from the range established by the government's announced "buy" or "sell" price. This is the "trick" that allows us to obtain full employment and stable prices.

The buffer stock aspects of ELR generate "loose" labor markets even as they ensure full employment. This stands in stark contrast with "Keynesian" demand management policies that were designed to "prime the pump" with government spending that would increase private demand sufficiently to lower unemployment to the "full employment" level. The danger was that this would lead to such "tight" labor mar-

kets that inflation would be generated long before reaching full employment. ELR is not subject to this problem, for it allows loose labor markets even at full employment. If the ELR pool shrinks too much in an expansion, the government can either raise taxes or reduce non-ELR spending to replenish the buffer stock. Thus, aggregate "fine tuning" would operate through increases or decreases of the buffer stock, rather than by causing unemployment.

Note how existence of ELR will allow the government to react in a sensible manner to the threat of unemployment caused by "downsizing," labor-saving technological advancement, or labor-displacing imports. Currently when labor is displaced, there is pressure on the government to try to restrict imports or to make it more difficult for firms to lay off employees. However, once ELR is in place, displaced workers can always find jobs. Of course, it is likely that these jobs pay less. On one hand, it can be argued that the social benefits of technological advance (or cheap imports) must exceed the private costs of moving from private sector employment to ELR. On the other, this ignores the social cost of loss of aggregate demand (replacing a \$40,000 a year job with a \$12,500 a year job lowers aggregate demand), which could exert deflationary pressure on the economy. However, the government can react to this through discretionary tax cuts and non-ELR spending increases. This means that the population as a whole benefits twice: first from technological advance or cheaper imports, and second from tax cuts or spending increases. It would be hoped, of course, that the tax cut and/or spending increase would then encourage the private sector to create new jobs to replace those lost to imports. If that is the case, and if ELR employment can prepare displaced workers for those new jobs, then even the displaced workers need not be worse off.<sup>4</sup>

In conclusion, ELR is not likely to induce inflation—much less to cause accelerating inflation—even if it does cause prices to rise when implemented and each time the ELR wage is raised. However, the magnitude of the pressure on prices is attenuated by the likelihood that ELR will preserve and even increase productivity of the "reserve army" of ELR workers. Further, reduction or elimination of employment taxes related to the unemployment insurance program will also attenuate pressure on prices, as will reduction of private and social costs of unemployment (for example, reduction of crime will lower business costs). Finally, the "price anchor" of the ELR wage may impart a greater degree of stability to wages by setting a well-known wage for "standard" "buffer stock" labor that can always be used by private employers as an alternative to higher-skilled workers with "market determined" wages.

### Notes

1. Obviously, the ELR policy is not a substitute for these programs—many individuals currently receiving such assistance are not (and probably could not be) in the labor force. Ex-

actly who would be forced out of these current programs and into the ELR program is a subject of social policy but is beyond the scope of this study.

2. Note that adding health care benefits to ELR will probably not generate much additional federal spending as it will reduce spending on other federal programs such as Medicaid and Medicare.
3. If ELR includes benefits, such as health care, that low-wage private sector jobs normally do not include, then impacts will be larger as employers will have to increase private sector benefits to "compete" with the ELR.
4. Admittedly, it is impossible to guarantee that this would be the case. We must weigh the benefits received by the vast majority of the population against the losses incurred by the relatively small number of displaced workers; other policies can be targeted to these workers to minimize their loss.

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