2. The Abandonment of Full Employment

There have been two striking developments in economics over the last thirty years. First, a major theoretical revolution occurred in macroeconomics (from Keynesianism to Monetarism and beyond). Second, unemployment rates have persisted at the highest levels known in the Post World War II period. Mitchell (2000b) documents the development of the concept of full employment since the 1940s starting with Beveridge’s (1944) emphasis on the need to create enough jobs to absorb the available labour force. Economists quickly shifted the focus and debated the magnitude of unemployment associated with full employment (Bancroft, 1950; Dunlop, 1950; Harris, 1950; Stewart, 1950). The Phillips curve era saw policy makers contriving to achieve a politically acceptable trade-off between inflation and unemployment. Fortuitous circumstances meant that unemployment remained low but the focus had changed from generating a given quantity of jobs.

Full employment as a genuine policy goal was abandoned with the introduction of the natural rate hypothesis (NRH) and its assertion that there is only one unemployment rate consistent with stable inflation (Friedman, 1968; Phelps, 1967). In the NRH, there is no discretionary role for aggregate demand management and only microeconomic changes can reduce the natural rate of unemployment. Accordingly, the policy debate became increasingly concentrated on deregulation, privatisation, and reductions in the provisions of the Welfare State with tight monetary and fiscal regimes instigated (Thurrow, 1983; Ormerod, 1994a). High unemployment persisted. The fact that quits were strongly procyclical made the natural rate hypothesis untenable. However, the idea of a cyclically-invariant steady-state unemployment rate persisted in the form of the NAIRU concept, first introduced by Modigliani and Papademos (1975). Modigliani and Papademos (1975, 142) said a NAIRU existed, “such that, as long as unemployment is above it, inflation can be expected to decline”. Various theoretical structures support this conclusion, ranging from simple excess demand models with mark-up pricing (Modigliani and Papademos, 1975), to Marxist-inspired models where inflation arises due to incompressible claims on existing real income (Rowthorn, 1980). Whatever theoretical underpinning is used, the conclusion is simple: there is only one cyclically-invariant unemployment rate associated with stable price inflation. The NAIRU concept has dominated macroeconomic policy making in most OECD countries since the late 1970s and the “fight-inflation-first” strategies have exacted a harsh toll in the form of persistently high unemployment. Full employment as initially conceived was abandoned (Hughes, 1980; Mitchell, 2000c).
The Reserve Bank of Australia (RBA) was constituted in 1959 with one of its three goals being to maintain full employment (see Section 19 of the Reserve Bank Act 1959, Subsection 2). However, since the abandonment of monetary targeting in the 1980s (the failed Monetarist experiment), the RBA has been increasingly influenced by the NAIRU concept. It is now conducting monetary policy in Australia to meet an inflation target and, arguably, has abandoned its legal obligations to maintain full employment (Mitchell, 2000b). In September 1996, the Treasurer and Reserve Bank Governor issued the Statement on the Conduct of Monetary Policy, which set out how the RBA was approaching the attainment of its three identified policy goals. It shows that inflation targeting has become its primary goal. The Statement avoided any discussion about full employment except that price stability in some way generated full employment even though the price stability required "disciplined monetary and fiscal policy". In a stagnation environment if price spirals reflect cost-push and distributional conflict factors, such an approach can surely never work. Without a JG, the RBA will always control inflation by imposing unemployment.

How does the RBA answer this apparent contradiction? Edey (1999), the RBA's Head of Economic Analysis, argues that while the Bank is sensitive to the state of capacity utilisation when it sets interest rates, the trade-off between inflation and unemployment is not a long-run concern because, following NAIRU logic, it simply doesn't exist.

Ultimately the growth performance of the economy is determined by the economy's innate productive capacity, and it cannot be permanently stimulated by an expansionary monetary policy stance. Any attempt to do so simply results in rising inflation.

Under the NAIRU approach, policy makers use unemployment as a tool to suppress price pressures and the OECD experience in the 1990s shows that this strategy has been successful (Mitchell, 1996). One explanation is that unemployment temporarily balances the conflicting demands of labour and capital by disciplining the aspirations of labour so that they are compatible with the profitability requirements of capital. Similarly, low product market demand, the analogue of high unemployment, suppresses the ability of firms to pass on prices to protect real margins. Other explanations for the effectiveness of unemployment in controlling inflation are possible. The empirical evidence is clear that low unemployment has not provided enough jobs since the mid-1970s and the conduct of monetary policy has contributed to the malaise. The RBA has forced the unemployed to engage in an involuntary fight against inflation and the fiscal authorities have further worsened the situation with complementary austerity (Mitchell, 1996, 2000b).

3. The NAIRU as a Guide to Policy

How useful is the NAIRU as a guide to policy? Figure 1 charts inflation and unemployment in Australia since the early-1960s. The experience is common for most OECD countries (Mitchell, 1996, 2000b). What is apparent from Figure 1 is the disparate behaviour of the inflation rate and the unemployment rate (see Mitchell, 2000b).

Figure 1. Inflation and the Unemployment Rate, Australia, March 1961-December 1998

![Graph showing inflation and unemployment rates](source: Australian Treasury NIFS Model Database)

It is difficult to construe an unemployment rate over the period where you would witness accelerating inflation if the actual unemployment rate were lower, or decelerating inflation if the unemployment rate was higher. Table 1 compares the frequency of accelerating inflation with decelerating inflation for given ranges of the unemployment rate. If there were a well-defined and stable NAIRU we would expect to find some unemployment rate range where all the changes in inflation were negative and below that range most of the changes in inflation positive. The results clearly do not support the existence of such a rate. We are
unlikely to get any definitive information from the unemployment data about the likely movements in the inflation rate. Mitchell (2000b) estimated a range of Phillips curve regressions, which also fail to find any evidence of a stable NAIRU specification. This is consistent with the findings of Ormerod (1994b, 45).

Table 1. Changes in the inflation rate and the unemployment rate, Australia, 1964-1998

<table>
<thead>
<tr>
<th>Unemployment Rate (%)</th>
<th>Change in current Inflation Rate</th>
<th>Change in lagged Inflation Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rise</td>
<td>Fall</td>
</tr>
<tr>
<td>&lt; 2</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>2.3-2.5</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>3-3.5</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>4-4.5</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>5-5.5</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>6-6.5</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td>7-7.5</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>8-8.5</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>9-9.5</td>
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</tr>
<tr>
<td>10-10.5</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>11-11.5</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>&gt; 11.5</td>
<td>1</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: Australian Treasury NIF Model Database.

Note that the unemployment rate ranges overlap for simplicity of presentation but the upper range in each category was 0.01 percent less than shown. The results also do not materially change when computed for quarterly data.

In the same vein, Chang (1997) concludes that:

In practice, the concept of a non-accelerating inflation rate of unemployment is not useful for policy purposes. First, the NAIRU moves around. Second, uncertainty about where the NAIRU is at any point of time is considerable. Third, even if we knew where the NAIRU were, it would be sub-optimal to predict inflation solely on the basis of the comparison of unemployment against the NAIRU. A policy of raising the fed funds rate when unemployment falls below the NAIRU may be ineffective...even if the NAIRU were constant, its location were known and all shocks to the economy were to come from the demand side. Implementing such policy would likely induce changes in the expectations and behaviour of the private sector an important additional reason to be sceptical about using the NAIRU for policy.

While there may be stability between inflation and unemployment for a period (see Figure 2), a sudden shock, especially from the supply side (as in 1974) can worsen the unemployment resulting from a deflationary strategy, which is attempting to exploit a given Phillips curve. Evidence from the OECD experience since 1975 suggests that deflationary policies are effective in bringing inflation down (Mitchell, 1996) but impose huge costs on the economy and certain demographic groups, which are rarely computed or addressed (Watts and Mitchell, 2000).

Figure 2. Instability of inflation and unemployment, Australia, 1961-1998

Source: ABS Ausstats database.

Alcalay (1999) says that Solow "admits that there are limits to growth and unemployment, but holds that we don't know what they are. In his view the harm to an economy caused by restricting growth prematurely through higher interest rates is very great, and that caused by a rise in inflation relatively modest." Solow and Taylor (1999) argue that part of the damage is to worsen the inflation constraint by sustaining high unemployment for lengthy periods of time. The unemployed adjust to a life on welfare and other means and require higher wages to induce labour supply.

The overwhelming quandary that the NAIRU approach to inflation control faces is whether the economy, once deflated by restrictive aggregate demand management, can be restarted without inflation. If the underlying causes of the inflation are not addressed a demand expansion
will merely reignite the tensions and a wage-price outbreak is likely (Cornwall, 1983; Rowthorn, 1980). As a basis for policy the NAIRU approach is thus severely restrictive and provides no firm basis for full employment and price stability.

4. The Development of the Job Guarantee Approach

The logic of using a buffer stock principle to underpin the Job Guarantee is based on the operations of agricultural price support schemes like the Wool Floor Price Scheme introduced by the Australian Government in 1970. Under the scheme, the Government established a floor price for wool after hearing submissions from relevant groups. The Government maintained the floor by purchasing stocks of wool in the auction markets when demand was low. The major controversy for economists was the “tinkering with the price mechanism” (Throsby, 1972, 162).

By applying reverse logic, one could utilise the concept without encountering the problems of price tinkering. In effect, the Wool Floor Price Scheme generated “full employment” for wool production. Clearly, there was an issue in the wool context of what constituted a reasonable level of output in a time of declining demand. The argument is not relevant when applied to available labour. The reverse logic implies that if there is a price guarantee below the “prevailing market price” and a buffer stock of working hours constructed to absorb the excess supply at the current market price, then full employment can be generated without encountering the problems of price tinkering. That idea was the seed of the JG model.

Benjamin Graham (1937) also discusses the idea of stabilising prices and standards of living by surplus storage. He describes how a government might deal with surplus production in the economy. Graham (1937, 18) says, “The State may deal with actual or threatened surplus in one of four ways; (a) by preventing it; (b) by destroying it; (c) by ‘dumping’ it; or (d) by conserving it.” In the context of an excess supply of labour, governments now choose the “dumping” strategy via the NAIRU. It makes much better sense to use the conservation approach. Graham (1937, 34) notes,

The first conclusion is that wherever surplus has been conserved primarily for future use the plan has been sensible and successful, unless marred by glaring errors of administration. The second conclusion is that when the surplus has been acquired and held primarily for future use the plan has been vulnerable to adverse developments ...

5. The Job Guarantee Model and Inflation

The distinction is important in the JG model. The Wool Scheme was an example of storage for future sale and was not motivated to help the consumer of wool but the producer. The JG policy is an example of storage for use where the “reserve is established to meet a future need which experience has taught us is likely to develop” (Graham, 1937, 35). Graham also proposed a solution to the problem of interfering with the relative price structure when the government built up the surplus. In the context of the JG policy, this means setting a JG wage below the private market wage structure. A higher JG wage might be offered if the government sought to combine the JG policy with an industry policy designed to raise productivity.

An alternative to using unemployment to suppress price rises is to transfer workers from inflating sectors to a fixed price sector. This is the essence of the JG approach. Take an economy with two labour markets: A (primary) and B (secondary) broadly corresponding to the dual labour market depictions. Prices are set according to mark-ups on unit costs in each sector. Wage setting in A is contractual and responds in an inverse and lagged fashion to relative wage growth (A/B) and to the wait unemployment level (displaced Sector A workers who think they will be re-employed soon in Sector B). A government stimulus to this economy increases output and employment in both sectors immediately. Wages are relatively flexible upwards in Sector B and respond immediately. The compression of the A/B relativities stimulates wage growth in Sector A after a time. Wait unemployment falls due to the rising employment in A but also rises due to the increased probability of getting a job in A.

The net effect is unclear. The total unemployment rate falls after participation effects are absorbed. The wage growth in both sectors may force firms to increase prices, although this will be attenuated somewhat by rising productivity as utilisation increases. A combination of wage-wage, and wage-price mechanisms in a soft product market can then drive inflation. This is a Phillips curve world. To stop inflation, the government has to repress demand. The higher unemployment brings the real income expectations of workers and firms into line with the available real income and the inflation stabilises – a typical NAIRU story.
frictional unemployment does not distort the relative wage structure so
that the wage-wage pressures that were prominent previously are now
reduced. But the rising demand softens the product market, and demand
for labour rises in Sector A. But there are no new problems faced by
employers who wish to hire labour to meet the higher sales levels. They
must pay the going rate, which is still preferable, to appropriately skilled
workers, than the JG wage level. The rising demand per se does not in-
voke inflationary pressures as firms increase capacity utilisation to meet
the higher sales volumes.

What about the behaviour of workers in Sector A? Gordon (1997, 833) said,”If there is a job guarantee program, the employees can sim-
ply quit an onerous employer with assurance that they can find alter-
native employment.” With a JG, wage bargaining is freed from the
geneneral threat of unemployment. However, it is unclear whether this will
lead to higher wage demands than otherwise. In professional occupa-
tional markets, some wait unemployment will remain. Skilled workers
who are laid off are likely to receive payouts that forestall their need
to get immediate work. They have a disincentive to immediately take a JG
job, which is a low-wage and possibly stigmatised option. Wait unem-
ployment disciplines wage demands in Sector A. However, the demand
pressures may eventually exhaust this stock, and wage-price pressures
may develop.

It might appear that the Buffer Employment Ratio (BER) – the pro-
portion of JG workers in total employment – would have to be greater
than the NAIRU for an equivalent amount of inflation control. This is
because JG workers will have higher incomes and so a switch to this
policy would see demand levels higher than under a NAIRU world. But
the JG provides better inflation proofing than a NAIRU approach be-
cause the JG workers represent a more credible threat to the current pri-
ivate sector employees. The JG employees are more attractive than when
they were unemployed, not the least because they will have basic work
skills, like punctuality, intact. This reduces the hiring costs for firms in
tight labour markets who previously would have lowered hiring stan-
dards and provided on-the-job training. They can thus pay higher wages
to attract workers or accept the lower costs that would ease the wage-
price pressures. The JG policy thus reduces the “hysteresis inertia” en-
bodied in the long-term unemployed and allows for a smoother private
sector expansion because growth bottlenecks are reduced.

A further source of cost pressure comes via the exchange rate for
small trading economies like Australia. Under a fixed exchange rate re-
geime, unless there is a coordinated fiscal policy among countries it
would be difficult for a small open economy to pursue its own full em-
ployment strategy. With higher import spending under the JG, the stimu-
lus spreads throughout the fixed exchange rate bloc and the small coun-
try would face a borrowing crisis that would negate its full employment
ambitions.

Thus, the JG requires a flexible exchange rate regime. In this context,
we can identify two external sources of inflation. First, imports would
rise because the JG workers would have higher disposable incomes than
before. This may promote exchange rate depreciation. Second, it is
likely that net exports would increase their contribution to local em-
ployment and demand. The result depends on the estimates of the export
and import price elasticities. Dwyer and Kent (1993) find that import
elasticities are small (around 0.5). So import spending will actually rise
following depreciation because while we are importing less goods and
services we are paying disproportionately more for them. The net ex-
ports improvement thus depends on the export elasticity. Indeed (1995,
125) says, “Fortunately, this seems to be the case … the supply re-
sponses to higher prices are thought to be strong in both agriculture and
mining, and the numbers for manufactures are … embarrassingly high.
… There is little objective reason to be worried by elasticity pessimism.”
(see also Bullock, Grenville and Heenan, 1993).

One traditional way to insulate the wage-price system from the de-
preciation is to introduce an incomes policy. This could involve a
framework where workers and firms agree to allow the real depreciation
to stick. So to provide jobs for everyone, current labour and profit in-
come recipients would have to reduce their real claims on national in-
come to provide space for the unemployed to increase their consump-

The JG, however, will also directly control any inflation arising from
higher import prices and/or higher export demand. The JG wage pro-
vides a floor that prevents serious deflation from occurring and defines
the private sector wage structure. However, if the private labour market
is tight, the non-JG wage will rise relative to the JG wage, and the JG
pool will drain. The smaller this pool, the less influence the JG wage has
on wage patterning. Unless the government stifles demand, the economy
will then enter an inflationary episode, depending on the behaviour of
labour and capital in the bargaining environment. In the face of wage-
price pressures, the JG ensures inflation control by choking aggregate
demand and inducing slack in the non-JG sector. The slack does not re-
veal itself as unemployment, and in that sense the JG may be referred to
as a “loose” full employment. This leads to the definition of a new con-
cept, the Non-Accelerating Inflation Buffer Employment Ratio
(NAIBER), which, in the JG economy, replaces the NAIRU as an infla-
tion control mechanism. (Mitchell, 1998)

As the BER rises, due to an increase in interest rates and/or a fiscal tightening, resources are transferred from the inflating non-JG sector into the JG sector at the fixed JG wage. This is the vehicle for inflation discipline. The disciplinary role of the NAIRU, which forces the inflation adjustment onto the unemployed, is replaced by the compositional shift in sectoral employment, with the major costs of unemployment being avoided. That is a major advantage of the JG approach. The only requirement is that the JG wage be a floor and that the rate of growth in JG wages be equal or less than the private sector wages growth.

6. The Maintenance of Full Employment

In the last section, we examined the shift from a NAIRU economy to a JG. Further issues arise when we consider the maintenance of full employment using the JG. While orthodox economists typically attack the JG policy for fiscal reasons, economists on the left are also critical. They cite Kalecki's 1943 Political Aspects of Full Employment, which laid out the blueprint for socialist opposition to Keynesian-styled employment policy. The criticisms are also relevant to the JG. Kalecki (1971, 138) said, "the assumption that a Government will maintain full employment in a capitalist economy if it knows how to do it is fallacious. In this connection the misgivings of big business about maintenance of full employment by Government spending are of paramount importance."

Kalecki (1971, 139) lists three reasons why the industrial leaders would be opposed to full employment "achieved by Government spending." The first asserts that the private sector opposes government employment per se. The second asserts that the private sector does not like public sector infrastructure development or any subsidy of consumption. The third asserts that the private sector merely dislikes "the social and political changes resulting from the maintenance of full employment" (emphasis in original).

One is tempted to respond to these assertions by referring to the long period of growth and full employment from the end of WWII up until the first oil shock. Most economies experienced strong employment growth, full employment, and price stability, and strong private sector investment over that period under the influence of interventionist government fiscal and monetary policy. This period of relative stability was only broken by a massive supply shock, which then led to ill-advised policy changes that provoked the beginning of the malaise we are still facing after 25 years. In Kalecki's defense, it might be argued that it took 30 odd years of the Welfare State to generate the inflationary biases that

were observed in the 1970s (Cornwall, 1983).

Kalecki (1971, 139-140) explains how the dislike by business leaders of government spending "grows even more acute when they come to consider the objects on which the money would be spent: public investment and subsidising mass consumption." If public spending overlaps with private spending, then "the profitability of private investment might be impaired and the positive effect of public investment upon employment offset by the negative effect of the decline in private investment." (Kalecki, 1971, 140). This criticism is applicable to the JG because the JG jobs would most likely be located in the areas that have been neglected or harmed by capitalist growth. The chance of overlap and substitution is minimal. Of course, government industry policy may deliberately target an overlap to drive inefficient private capital out.

Kalecki (1971, 140) acknowledges that the "pressure of the masses" in democratic systems may thwart the capitalists and allow the government to engage in job creation. His principal objection then seems to be that "the maintenance of full employment would cause social and political changes which would give a new impetus to the opposition of the business leaders." The issue at stake is the relationship between the threat of dismissal and the level of employment. Kalecki (1971, 140) says:

"Indeed, under a regime of permanent full employment, 'the sack' would cease to play its role as a disciplinary measure. The social position of the boss would be undermined and the self-assurance and class consciousness of the working class would grow."

Kalecki is really considering a fully employed private sector that is prone to inflation rather than a mixed private-JG economy. The JG creates loose full employment rather than tight full employment because the Job Guarantee wage is fixed (growing with national productivity). The issue comes down to whether the JG pool is a greater or lesser threat to those in employment than the unemployed when wage bargaining is underway. This is particularly relevant when we consider the significance of the long-term unemployed in total unemployment. It can be argued that the long-term unemployed exert very little downward pressure on wages growth because they are not a credible substitute. The JG workers, however, do comprise a credible threat to the current private sector employees for reasons noted above. The JG pool provides business with a fixed-price stock of skilled labour to recruit from. In an inflationary episode, business is more likely to resist wage demands from its existing workforce because it can achieve cost control. In this way, longer term planning with cost control is achievable. So in this sense, the inflation
The Job Guarantee and Inflation Control

Finally, looking to the future, those who criticise the JG from a Kaleckian viewpoint have to address the issue of binding constraints. Kalecki comes from a traditional Marxist framework where industrial capital and labour face each other in conflict. The goals of capital are antithetical to those of labour. In this environment, the relative bargaining power of the two sides determines the distribution of income and the rate of accumulation. Industrial capital protects its powerful position by balancing the high profits that come from strong growth with the need to keep labour weak through unemployment. However, the swings in bargaining power that have marked this conflict over many years have no natural limits. But the concept of natural capital, ignored by Kalecki and other Marxians, may now become the binding constraint in the functionality and longevity of the system. It doesn’t really matter what the state of distribational conflict is if the biosystem fails to support the continued levels of production. The research agenda for Marxians has to embrace this additional factor – natural capital (see Mitchell 2000b; Hawken, 1997).

7. Conclusion

We conclude that unemployment is an entirely social construct engineered by humans. There is nothing natural about it at all. The renowned ex-Dominican priest, Matthew Fox said that humans are the only species not to have full employment. Unemployment arises because government spending is insufficient relative to private savings. In this sense, the government chooses the level of unemployment. The Job Guarantee is the only logical way of providing jobs for everyone with guaranteed price stability.

Notes

1. I am grateful to the comments of anonymous referees although remaining errors are my own.

2. The NAIRU is an acronym for the Non-Accelerating Inflation Rate of Unemployment.

3. At the time, I considered that the scheme could be financed by a levy on existing incomes, which was analogous to the Wool Price finding scheme. As a result of other work, I now do not consider that there is a financing problem (Mitchell, 1958; Mosler, 1987-88; and Wray, 1998).

4. We leave aside the political rationales where presumably funding directed to sympathetic political parties and control of the media could all be effective means of opposing an incumbent government.
References


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