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Full Employment

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"Blessed are the extravagant, for theirs shall be full employment."

Robert Lekachman (1966), *The Age of Keynes*, Allen Lane The Penguin Press, London, p.94

The evolution of the concept of full employment

The term 'full employment' can be traced back to William Petty's 1662 work, *A Treatise on Taxes and Contributions* who argued that non-productive labour could be supported as a consequence of the capacity of producers of consumption goods to generate a surplus over and above their own subsistence. The classical economists didn't consider full employment specifically but the general glut controversy in the 1820s laid out the issues that would become the themes of macroeconomics more than 100 years later. Say (1803) started this controversy by denying that a production economy could ever suffer a general glut. Say's Law that "supply creates demand" became the epithet of Classical and Neoclassical theory and its underlying reasoning still dominates orthodox macroeconomics today. There was not a denial that unemployment could occur but rather that it was a manifestation of a temporary disruption rather than being generalised tendency of capitalist production system. A lack of consumption would become by definition an act of investment. Moreover, they argued that there was a strict separation between output and price theory – the so-called dichotomy. So the existence of money posed no special problems. While Sismondi and Malthus demurred and argued that generalised gluts could occur even if the savings-investment identity held their analyses were flawed. It was Marx, in his critique of Malthus, who laid a modern Post Keynesian rationale for generalised gluts. Marx understood that money could be held as a stock of value and this behaviour interrupted the simultaneity of sale and purchase. He also laid the foundations of multiplier theory by arguing in Theories of Surplus Value that once the unity of sale and purchase was disturbed, the chain of contractual relationships between suppliers became threatened and overproduction, then bankruptcies and unemployment became widespread.

So by the about 1900, there were two broad views about the possibility of full employment. (a) Marxian views of crisis and the reserve army of unemployed, which saw capitalism as being incompatible with a fully employed working class; (b) the dominant (marginalist) view that unfettered market operations would ensure that all those who wanted to work at the equilibrium real wage could find it and all employers who wanted to hire at the same real wage could find labour because Say's Law held. Full employment became equivalent to the equilibrium intersection between the demand for and supply of labour, which in turn reflected the productive state of the economy driven by technology and the voluntary, optimising preferences of the population. By definition, any workers who were idle were optimally enjoying leisure and could not reasonably be considered unemployed. Mass unemployment was considered to be a transitory disturbance.

The Great Depression changed things considerably. It was hard to justify the view that the persistently high unemployment was due to changing preferences of workers (increased quits in search of leisure), excessive real wages (in the face of money wage cuts), and/or a temporary interruption to market efficiency. For the first time, notwithstanding Marx's inspiring insights, Western economists articulated a macroeconomics that could define a coherent concept of full employment and also explain mass unemployment in terms of the inherent tendency of monetary capitalism. The clue was in recognising the unique role that money could play in resolving the tensions that uncertainty creates in the decision-making calculus of decentralised agents and also realising the fallacy of composition endemic in the (micro) explanations of unemployment that dominated the times.

Whether the 1930s marked the birth of Post Keynesian notions of full employment is debatable. Post Keynesian theory has fractured origins with some practitioners seeing the labour market in Marxian, then Kaleckian terms and others tracing their ancestry to the Keynes and his *General Theory*. At any rate, the attack against the marginalist faith in self-equilibration mounted by Keynes (1936) in *The General Theory of Employment, Interest, and Money* (1936) and his monetary analysis was path-breaking. It also more clearly outlined what we now mean by the term "full employment".

Keynes linked full employment to national income levels – such that full employment occurred at the level of output when all who want to work at the going money wage rates can find a job. Full employment was an absence of involuntary unemployment. This was defined by the following thought-experiment – if a rise in nominal demand with money wages constant increases the price level (of wage-goods) but also results in both the demand for and supply of labour increasing beyond the existing volume of employment then those who gained the new jobs were involuntary unemployed. Involuntary unemployment was to be expected in a monetary economy subject to uncertainty because the act of holding money as a liquid safety net provided just the sort of interruption to the output-spending balance that Marx had clearly envisaged.

As a consequence, the maintenance of full employment required government policies to maintain levels of aggregate demand sufficient to that output remained at levels consistent with all available labour being employed. Significantly, a departure from full employment was construed as a systemic failure rather than some outcome related to the ascriptive characteristics of the unemployed themselves and/or the prevailing wage levels. Consistent with this notion was an allowance for the coexistence of unfilled vacancies and unemployed workers as part of the normal daily resolution of hiring and quits. Accordingly, full employment arose when all unemployment was frictional. Beveridge (1944) defined full employment as an excess of vacancies at living wages over unemployed persons. The emphasis was on jobs.

The slippery slope

Macroeconomic policy in the Post-War period was designed to promote full employment. Beveridge (1944: 123-135) argued that "The ultimate responsibility for seeing that outlay as a whole, taking public and private outlay together, is sufficient to set up a demand for all the labour seeking employment, must be taken by the State…" In the following years, a number of Western governments, including those in Britain, Australia and Canada, made a commitment to at least 'high and stable' employment, if not full employment. The US Government was more circumspect with its 1946 Employment Act only aiming to ensure employment opportunities were maintained. From 1945 to the mid-1970s, most governments used counter-cyclical budget deficits and appropriately designed monetary policy to maintain levels of demand sufficient to maintain full employment. Unemployment rates in Western economies were at historical lows throughout this period.

But the forebodings of what was to come were already apparent in the 1950s when the emphasis on jobs was replaced by a concern for inflation. Although only a subtle change, the redefinition of full employment in terms of an irreducible minimum unemployment rate in the early 1950s (see Mitchell, 2001) gave way soon after to the Phillips curve revolution. The Keynesian orthodoxy considered real output (income) and employment as being demand-determined in the short-run, with price inflation being explained by a negatively sloped Phillip's curve (in both the short-run and the long-run). Policy-makers believed they could manipulate demand and exploit this trade-off to achieve a socially optimal level of unemployment and inflation. The concept of full employment had been redefined to be the rate of unemployment that was politically acceptable, given the accompanying inflation rate.

Friedman's 1968 American Economic Association address and supporting work from Phelps (1967) developed the expectations-augmented Phillips curve, which spearheaded the resurgence of pre-Keynesian macroeconomic thinking in the form of Monetarism. Underpinning the Natural Rate Hypothesis (NRH) was a unique cyclically-invariant natural rate of unemployment (NRU), which was consistent with stable inflation. There was no long-run, stable trade-off between inflation and unemployment. The concept was broadened in the 1970s to incorporate a number of structural labour market impediments and the term Non-Accelerating-Inflation-Rate of Unemployment (NAIRU) become popular.

The acceptance of these new ideas was aided by the empirical instability of the Phillips curve in most OECD economies in the 1970s following the OPEC price rises. Unemployment was considered to be voluntary and the outcome of optimising choices by individuals between work (bad) and leisure (good). Full employment was assumed to prevail (with unemployment at the natural rate), given the operation of market forces, unless there are errors in interpreting price signals. The NAIRU was now viewed as synonymous with full employment. There was no discretionary role for aggregate demand management. Only microeconomic reform would cause the NRU to change. Accordingly, the policy debate became increasingly concentrated on deregulation, privatisation, and reductions in the provisions of the Welfare State while the Monetarist "fight-inflation-first" strategies ensured that unemployment persisted at high levels. The NAIRU proponents responded by claiming that steady-state unemployment rate must have risen due to worsening structural impediments although they failed to empirically substantiate this case. The fact that quits were strongly pro-cyclical undermined the NRH, but the orthodoxy evaded the damaging empirical evidence. Full employment as initially conceived by Beveridge had been abandoned.

The Post Keynesian response

With Post Keynesian economics dependent on the use of aggregate demand management as a means of attenuating the fluctuating spending patterns of the private sector (in particular, investment) the NAIRU approach to inflation control presented a fundamental quandary.

The earlier approach to improving the Phillips curve trade-off was to complement demand management policy with incomes policy, the latter being designed to batten down the supply (cost) side. Some Post Keynesians (principally the Marxian strain) had inflation models based on incompatible real income claims by workers and capital that delivered analytical findings observationally-equivalent to the NAIRU approach. They also saw a role for incomes policy although following Marx and Kalecki they didn't think that full employment (in the Keynesian sense) and capitalism were compatible.

The modern Post Keynesian approach to the NAIRU challenge is best captured by the hysteresis and persistence literature, although some of the developments in this regard are strictly Neo-Keynesian. Hysteresis or path-dependence was traced to various cyclical adjustments that occur in the labour market, which could be reversed in a growing economy. So while the steady-state unemployment rose after a long downturn, aggregate demand expansions could bring it down again. Once again full employment could be achieved at relatively low unemployment rates without ever-accelerating inflation. More recent empirical work has cast doubt on the robustness of the NAIRU story and provided strong support for a hysteretic-asymmetric interpretation of the inflation-unemployment relationship (Mitchell, 2001).

Despite these developments, Post Keynesians cannot agree on the way to pursue full employment. The predominant view assumes that the economy is still amenable to a broad Keynesian spending expansion. Some Post Keynesians eschew this approach arguing that it will be inflationary and/or environmentally damaging. This emerging minority view observes that the economies that avoided the plunge into high unemployment in the 1970s all maintained a sector that provided an employer of the last resort capacity to redress the flux and uncertainty of private sector spending. In most countries through the 1950s and 1960s, the public sector played this role, which was lost as the Monetarists began attacking the public sector on (orthodox) efficiency grounds. Accordingly, they propose a Job Guarantee (Mitchell, 2001) or an Employer of Last Resort (Wray, 1998), where the public sector maintains a constant fixed-wage job offer to anyone who cannot find employment elsewhere.

In macroeconomic terms, these models present a serious challenge to the conventional wisdom government budget constraint literature, which is accepted by many Post Keynesians. Wray and Mitchell deny that budget deficits are unsustainable and argue that the issue of government securities is designed to sustain the target interest rate, set by monetary policy, rather than being required ex ante to finance expenditure. They argue that deflationary fiscal and monetary policy which drives employees out of the private sector into lower paid Job Guarantee jobs provides an adequate counter-inflation policy if required.

Other Post Keynesians, including Arestis and Sawyer (1998) do not agree. They point to the possibility of higher inflation and an unsustainable balance of trade leading to a growing debt to GDP ratio. However, these are problems associated with the pursuit full employment *per se*, not the policies adopted to achieve it. A higher current account deficit to GDP ratio may promote a depreciation, which would reduce the overall real incomes of residents, but it may be the price to be paid for increased employment opportunities. In addition, Arestis and Sawyer (1998) remain uncertain about the relationship between interest rates and budget deficits and note the potential adverse reaction of the financial markets to fiscal expansion.

Conclusion

Over the past 30 years the NAIRU concept has obfuscated the debate over the capacity of capitalist economies to achieve and maintain full employment, as traditionally understood. Somewhat belatedly this debate is now occurring, but remains unresolved within the deeply divided Post Keynesian literature.

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