

ECO 407

**Competing Views in
Macroeconomic Theory and Policy**

Lecture 6

**Should Full Employment Be a
Policy Objective?**

The Unemployment Problem

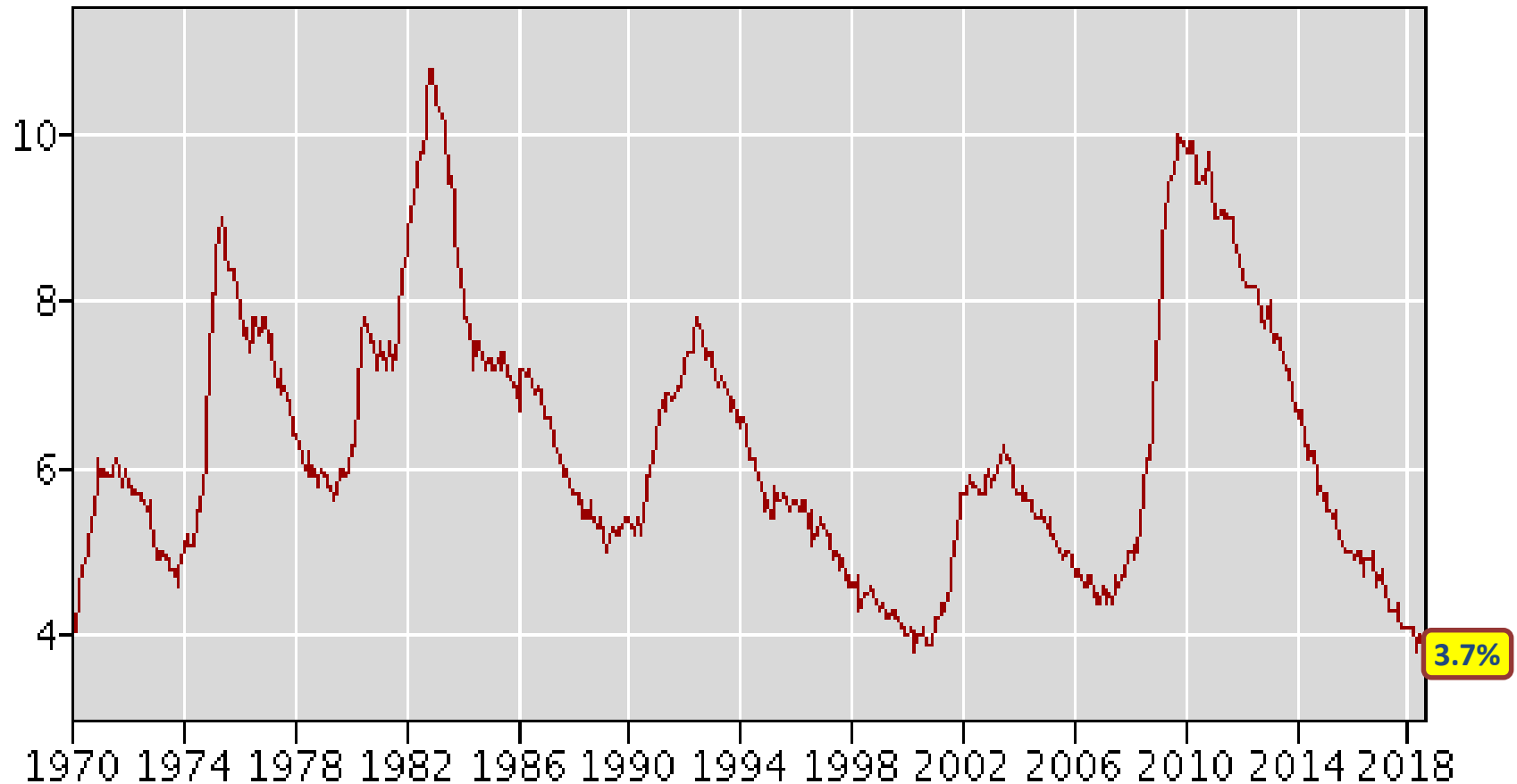
- **Unemployment** is very costly in terms of both **lost output** and **social ills**
 - In August 2019, the Canadian rate of unemployment was **5.7 percent**
 - Given a labour force of about 20 million workers, about **1.1 million** workers were jobless
 - Canada's GDP is close to \$2.0 trillion, thus **GDP** could be about **\$100 billion** greater if unemployment were eliminated
 - At the minimum wage, **labour income** would be about **\$30 billion** higher
 - At the average wage, **labour income** would be over **\$50 billion** higher
- Can we **afford** to have high unemployment?

The Employment Problem in the U.S.

- But the *employment problem* implies more than just the *open unemployment*
- In **November 2016**, there were **7.4 million** people unemployed in the U.S.
 - The *(open) unemployment rate (U-3)* was **4.6 percent**
- But there were also **5.5 million** employed part time for economic reasons and **1.9 million** people marginally attached to the labour force (the *underemployed*)
 - The *unemployment rate (U-6)* was then **9.3 percent**
- But there were also an additional **5.9 million** people outside of the labour force who reported wanting a job now
 - So a more meaningful figure for the *unemployment rate* was **12.8 percent** (the *augmented* unemployment rate)

U.S. Open Unemployment Rate

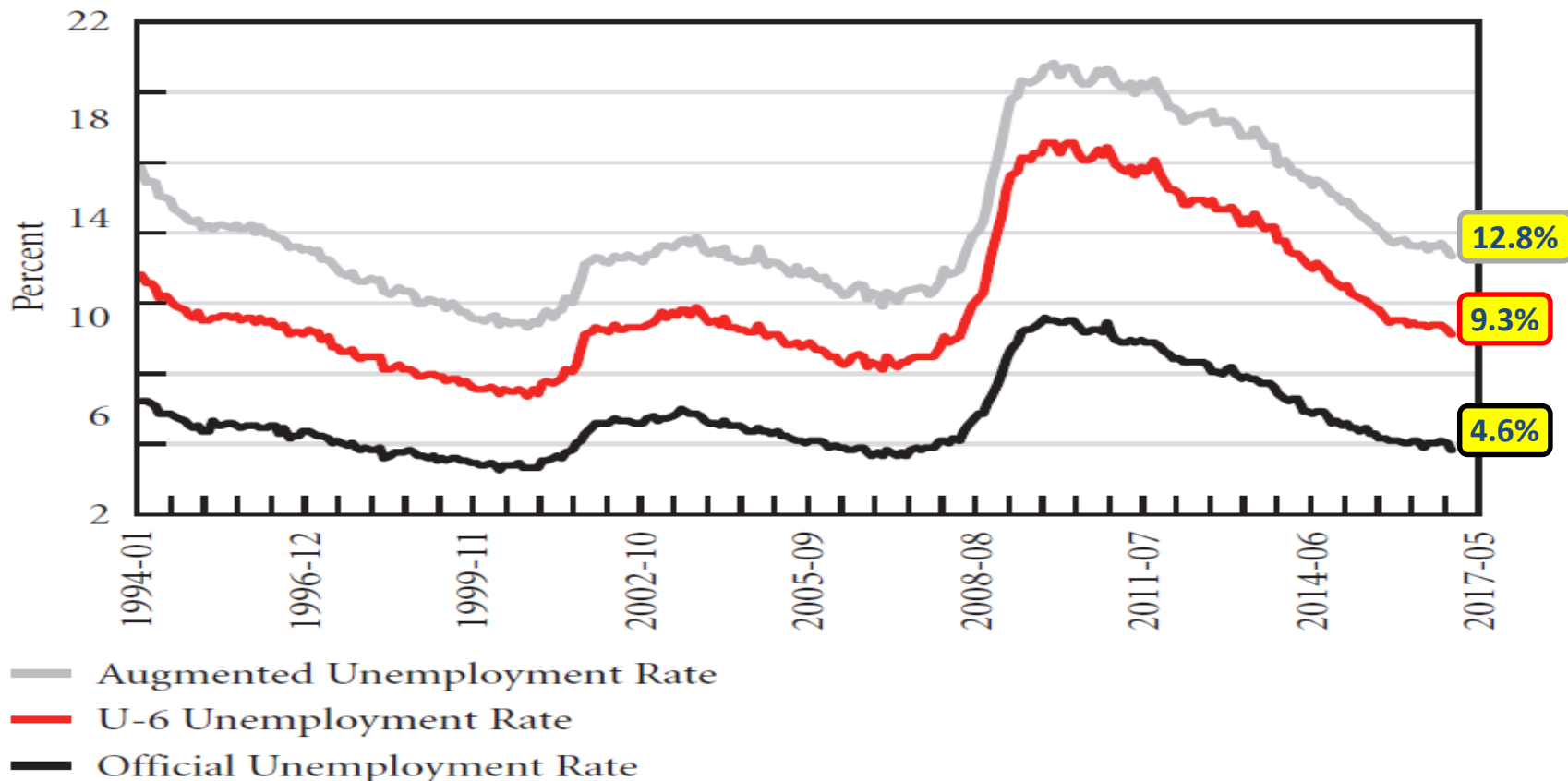
January 1970 to September 2018



Source: US Bureau of Labor Statistics.

U.S. Unemployment Rates

January 1994 to May 2017



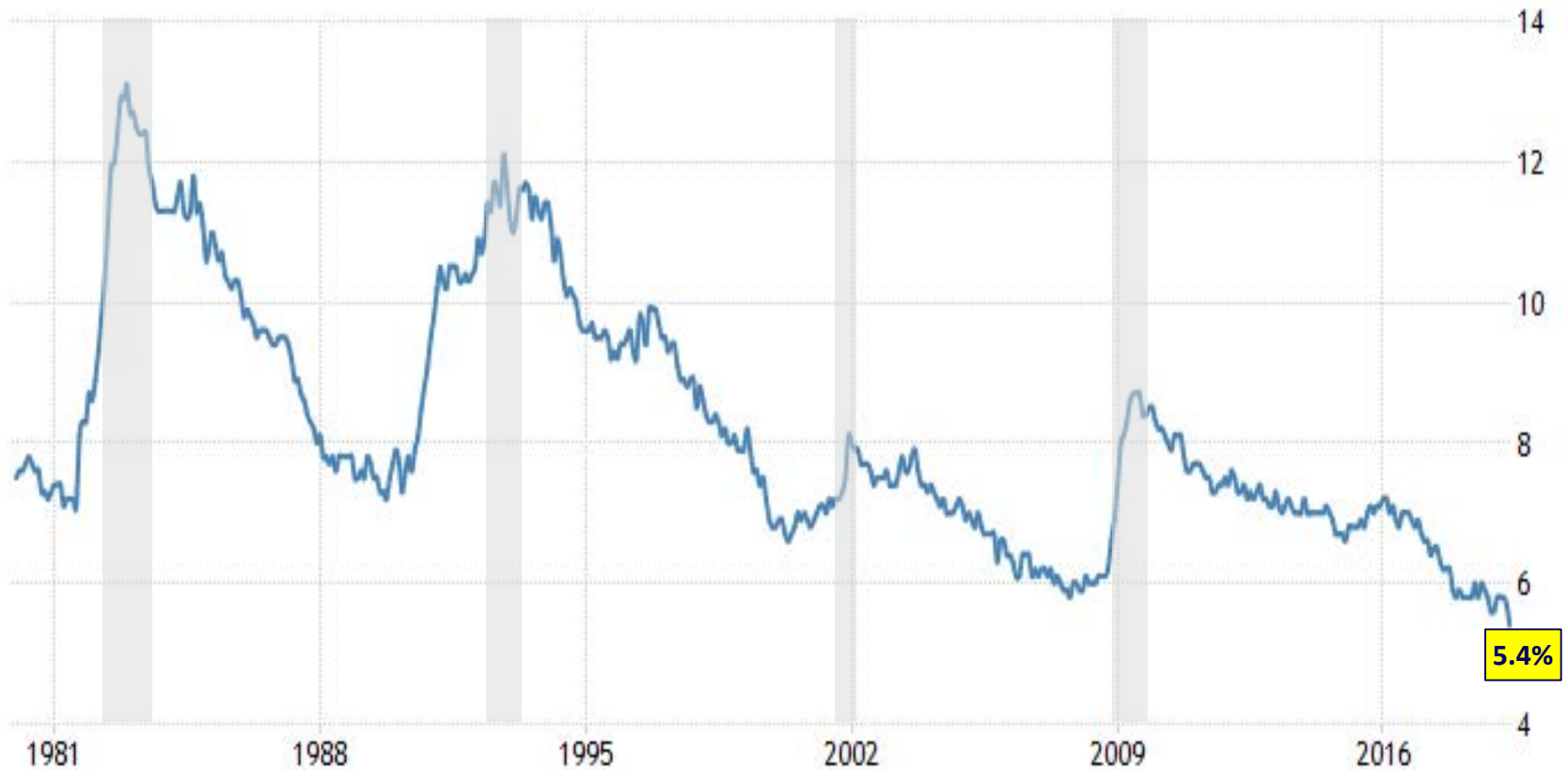
Source: F. Dantas and L.R. Wray, "Full Employment: Are We There Yet?," Levy Economics Institute, Public Policy Brief No. 142, 2017.

The Employment Problem in Canada

- In **April 2018**, there were about **1.2 million** people unemployed in Canada
 - The **(open) unemployment rate** was **5.8 percent**
 - But there were also about **2.1 million** workers underemployed or in vulnerable situation of employment (informal sector)
 - The **unemployment rate** was thus about **16.5 percent**
 - In addition, the participation rate decreased from **67.2 percent** in 2008 to **64.9 percent** in 2018
 - So about an additional **0.5 million** people were discouraged from participating in the labour force
- Therefore, the **employment problem** in Canada affected about **3.8 million** workers or **19 percent** of the labour force

Canada Open Unemployment Rate

January 1980 to May 2019



Source: Tradingeconomics.com / Statistics Canada.

Canada Labour Force Participation

January 1980 to May 2019



Source: [Tradingeconomics.com](https://tradingeconomics.com) / Statistics Canada.

Why Do We Have Unemployment?

- For Marx and the classical economists, unemployment is an ***inherent*** characteristic of the capitalist system
 - Thus unemployment is ***“normal”***
- The capitalist system will always create some unemployment
 - The ***labour reserve army***
- Unemployment is ***not*** the result of ***insufficient aggregate demand***
- Labour-saving technologies are introduced in order to increase the ***rate of profit***
 - Higher unemployment contributes to reduce upward pressure on wages
- It keeps the socially-determined ***value*** of labour low

Why Do We Have Unemployment?

- For Keynes, unemployment is the outcome of the *normal* operation of the market
 - It is *not* the result of *market failure*
 - It is due to *insufficient aggregate demand*
- Firms produce the output they *expect* to sell
 - If expectations are not fulfilled, then excess supply arises and output and employment fall
- Unemployment is not due to *inflexible wages* remaining artificially high
 - Even if wages were to fall, firms will not produce more output than they expect to sell
 - Firms will increase production when they expect their sales to rise

Keynes: Expansionary Policies to Reduce Unemployment

- If ***aggregate demand*** is insufficient, the government should implement expansionary ***fiscal*** and ***monetary*** policy
 - This makes sense particularly during deep recessions
- But what happens when the economy is close to “***full employment***” in the neoclassical sense?
 - Expansionary policy might create ***inflation***
 - Therefore, government will ***not*** implement expansionary policies to achieve ***full employment***
- According to Keynes, “***true inflation***” occurs when aggregate demand rises beyond ***full employment***
 - But ***wages*** and ***prices*** could rise before reaching ***full employment***

Keynes: Expansionary Policies Cannot Eliminate Unemployment

- Once a certain level of unemployment rate is reached, further increases in aggregate demand will cause ***rapid inflation***
- A more comprehensive approach is needed in order to achieve ***full employment*** without ***high inflation***
- Even in booming economic times, not every sector or geographical area of the economy will be producing at ***full capacity***
- Therefore, Keynes favoured ***“targeted”*** spending instead of ***“pump priming”*** spending at that point
 - Spending on areas operating below full capacity
 - Targeting job-creating programs

Employment: Is It a Market Outcome or a Human Right?

- Should employment creation be exclusively the outcome of *market forces*?
 - In a *capitalist market economy*, jobs are created according to the logic of capital
 - *Profit-maximization* will indicate what jobs will be created
 - Or should employment also be considered a *human right*?
 - It is a fundamental prerequisite for social justice
 - It is recognized as a human right by the “*U.N. Universal Declaration of Human Rights*” and by the “*U.S. Employment Act*”
- Since *markets* cannot solve the problem of unemployment, the *government* must play a role in providing jobs

Employer-of Last-Resort Programs

- Unemployment is a monetary phenomenon and profit-driven capitalist economies fail to generate full employment
- ELR is a proposal where the government employs all of the jobless who are **ready, willing,** and **able** to work in a public sector project at a **base wage**
- Benefits of ELR programs include:
 - Poverty reduction
 - Improvement of many social ills associated with chronic unemployment
 - Maintaining/enhancing skills of general pool of workers
 - It would reduce the informal sector
 - It could improve working conditions in private sector
 - It is an important build-in stabilizer

Is Full Employment Affordable?

- Unemployment is very costly in terms of lost output and social ills
 - Sweden maintains that it cannot afford to have unemployment
- Many countries have implemented different types of ELR programs over the years (the U.S. in the 1930s, Chile in 1982-83, Argentina in early 2000s, Sweden)
- Government spending is not constrained to its ability to raise taxes and borrow in financial markets (***Modern Money Theory***)
 - Spending on ELR program will not grow without limit
 - In Argentina it was 1 percent of GDP

Critique of ELR Proposals (D. Gray)

- Expansionary *fiscal* and *monetary* policy should be used to enhance employment
 - But this will not achieve full employment
- Policies that affect the *efficiency of labour markets* (i.e., wage and employment level) should not be used
- According to Gray, ELR policy would cause *undesirable effects*:
 - Universal right to a job – but what kind of a job?
 - The ELR wage might be too high – but why?
 - The geographical location could be problematic
 - Should jobs be provided according to the skills of the worker?
 - ELR could become employer-of-first-resort – why?