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Aggregate or Structural Approaches to Full Employment

THE EMPLOYMENT ACT which we celebrate today has had its share of the vicissitudes of fortune that go with life. The bill originally proposed by Senator Murray ran into massive opposition in the House, and many anxious months elapsed before the Congress hammered out an acceptable compromise. The machinery established by the Act has not always functioned smoothly or as its designers may have hoped. At times, the findings by the Council of Economic Advisers have lacked the detachment or the lustre of science. At times, the pronouncements of the Joint Economic Committee have suggested excessive partisanship or haste. In one year the Congress refused to vote a full year's appropriation for the Council's activities, and its ability to survive became doubtful. Despite such occasional setbacks, the moral authority of the Employment Act has grown with the passage of time. Indeed, in the span of a mere twenty years, the Act has acquired the force of an economic constitution. The President, his Council of Economic Advisers, the Congress, in some degree the entire

Address on twentieth anniversary of Employment Act, Washington, D.C. Reprinted from *Twentieth Anniversary of the Employment Act of 1946: An Economic Symposium,* Joint Economic Committee, Eighty-Ninth Congress, Second Session, February 23, 1966, pp. 27–33.

executive and administrative establishment, including the Federal Reserve Board, now function under this "constitution" when major economic policies are developed.

As befits a constitution, the Employment Act lays down general principles and procedures, but gives little guidance on how the Federal government is to discharge its new responsibility of promoting "maximum employment, production, and purchasing power." To be sure, the Act stresses the importance of proceeding "in a manner calculated to foster . . . free competitive enterprise." This constraint reaffirms our nation's commitment to the principle of freedom, but it does no more than that. The Act also specifies that the means employed in furthering its objectives must be consistent with the "needs and obligations" of the Federal government, with "other essential considerations of national policy," and with "the general welfare." In view of this broad language, our successive presidents have been able to deal under the umbrella of the Employment Act with such objectives of policy as stability of the general price level, faster improvement of productivity, equality of opportunity, and equilibrium in the balance of payments. However, the Act itself is entirely reticent on these matters, and therefore gives no clue to the way in which any of these objectives is to be sought, or how the pursuit of one or another of them may aid or limit the achievement of "maximum employment, production, and purchasing power." In short, the Act practically leaves the means for dealing with recession, unemployment, or inflation to judgment concerning the individual case.

The flexibility inherent in the Employment Act has proved very helpful to government officials charged with its administration. Indeed, economic life is so full of surprises that it is doubtful if the Act could have survived if the Congress had prescribed some formula, whether the one suggested by the

Murray bill or any other, for achieving maximum employment —to say nothing of maximum production or purchasing power. At the same time, the sweeping but imprecise mandate of the Act has imposed an extremely difficult task on the Council of Economic Advisers and the Joint Economic Committee, and beyond them on professional economists as a class.

Taking the past twenty years as a whole, the administrators of the Employment Act have concentrated on the maximization of employment, but they have not neglected other major objectives of national policy. By and large, our economy has performed well during this period. We have preserved the essentials of freedom in a revolutionary age, when many other nations have lost or destroyed their freedom. Our economy has continued to grow in size and efficiency. We have made great strides in moderating the business cycle, and the fruits of industry have been widely distributed among our people. The Employment Act has contributed to these achievements by introducing elements of order into economic policymaking and by providing assurance to both businessmen and consumers that economic storms would not be left to themselves. We must not, however, gloss over the lapses from full employment during the postwar period, or the series of recessions, the deterioration in the value of the dollar, the chronic deficit in the balance of payments, and the persistence of pockets of poverty in our land of plenty. If the efforts of the administrators of the Employment Act have not always been successful, the reason in large part is that they have worked with tools that are much too crude.

We need, in particular, better ways of determining whether, when, or to what degree unemployment can best be attacked by over-all monetary and fiscal policies. Our nation has relied preponderantly on such policies during the past few years on the ground that aggregate demand was deficient. This approach has certainly not been wanting in plausibility. In view of the fact that we experienced a recession in 1957–58, that the recovery which followed was incomplete, that another recession occurred in 1960–61, and that a good part of 1962 was marked by sluggishness, there can be little doubt that a deficiency of demand was a major cause of unemployment during much of the period since 1957. However, the Council's calculations of the gap between actual and potential output, quite apart from being fragile, cannot be treated as measures of demand shortage. If aggregate output falls short of its potential, the gap may have nothing to do with any weakness of demand. It may instead reflect obstacles on the side of supply or a failure of the constituent parts of demand and supply to adjust sufficiently to one another. Since the structure of our economy keeps changing, these changes as well as difficulties on the demand side must be reckoned with in a scientific diagnosis.

Let me note briefly a few of the structural factors. First, welfare programs have grown very rapidly in recent years. A great merit of these social measures is that they maintain a flow of income during periods of unemployment, so that even poor men may practice some of the discrimination in job choosing that comes as a matter of course to the well-to-do. Our statistical measures, however, do not recognize this voluntary aspect of unemployment, nor the fact that our social legislation together with increasing prosperity have been tending to increase it. Second, women and teenagers have become a much larger factor in the labor force since the late fifties. But women are less inclined or less able than men to end their unemployment by taking a job in another city. Indeed, they are less prone than men to move to another occupation or another firm within the city of their residence. Moreover, married women commonly seek only part-time or intermittent work. And since a large proportion of the teenagers in the labor force are students, they also frequently seek part-time or intermittent work. But a new entrant into the labor force rarely finds or takes a job immediately; in other words, he is unemployed for a time. Since these unavoidable intervals of unemployment are repeated for intermittent workers, the volume of unemployment has tended to rise as the intermittent work force has grown. Third, the obstacles to rapid adjustment in the labor market have lately become larger. The pace of technological change has quickened. The supply of part-time workers has increased with sudden rapidity, while the evolution of demand has been gradual. Also, the legally prescribed minimum wage has risen much faster than the average wage at the very time when the ranks of unskilled and inexperienced workers were swelling. Hence, shortages of some types of labor and in some communities have coexisted with surpluses in others to a larger extent than before.

It is developments such as these that the structuralist school has emphasized rather than any deficiency of aggregate demand. And just as the expansionist school has sought to fortify its claims by an impressive array of evidence, stressing in particular the depressed state of business investment in fixed capital between 1957 and 1963, so the structuralist school has marshalled considerable evidence on the high and rising level of overtime work, on the concentration of unemployment among less educated workers, on the jump in the ratio of the unemployment rate of Negroes to that of whites since the mid-fifties, on the exceptionally high ratio of the unemployment rate of teenagers to that of adult males during the past three years, and so on. Most structuralists have been entirely ready to grant that easy money, lower tax rates, and larger Federal expenditures—that is, the remedies favored by the expansionists—would reduce unemployment. They have insisted, however, that more lasting effects would be achieved by attending to the structural causes of unemployment, and that the risk of inflation would also be reduced in the process. Although their views were heeded to some degree, as the Manpower Development and Training Act of 1962 and related legislation testify, the expansionist theory proved more congenial to the mood of our times. Had it done so to a lesser degree, I believe that unemployment would now be no higher while the danger of inflation would be smaller than it has become.

My purpose on this occasion, however, is not to press the relative merits of this or that school of economic thought. My basic point is rather that existing information has prevented economic investigators from reaching the precise diagnosis of the unemployment problem that the Employment Act so plainly requires. The Act declares that the Federal government has the responsibility of promoting "conditions under which there will be afforded useful employment opportunities . . . for those able, willing, and seeking to work." To discharge this responsibility, statistics are needed to determine to what degree, if any, the aggregate demand for labor falls short of the number of "those able, willing, and seeking to work"—that is, of the supply of labor. But the aggregate demand for labor includes the unfilled jobs as well as those that are being manned, just as the aggregate supply of labor includes the unemployed workers as well as those who have jobs. Hence, to determine the relation between aggregate demand and supply, information is needed on three magnitudes—employment, unemployment, and job vacancies. Unhappily, while we have comprehensive statistics on the first and the second, the data on job vacancies are fragmentary, and it has therefore been impossible to bring either the expansionist or the structuralist theory to a decisive test.

If I read the Employment Act correctly, its implementation requires continuous, carefully compiled, and comprehensive statistics on job vacancies. It may be interesting to know whether the existing unemployment rate is above or below 4 per cent, but neither this conventional figure nor any other can be relied upon to identify maximum employment—or its equivalent in common usage, full employment. What really matters for the purposes of the Employment Act is not what figure on unemployment appears to correspond best to the concept of full employment, but how the amount of unemployment that actually exists compares with the number of job openings. When unemployment exceeds job vacancies at prevailing wages, the demand for labor is clearly insufficient to provide employment for everyone who is able, willing, and seeking to work. At such a time, a deficiency of aggregate demand exists, and a governmental policy that relies on monetary, fiscal, or other devices to expand demand is, in principle, suited to the nation's needs. On the other hand, when the number of vacant jobs is equal to or larger than the number of the unemployed, there is no deficiency of demand. A government that is seriously concerned about inflation will not seek to expand demand at such a time, but will instead concentrate its efforts on securing better matching of the men and women who seek work with the jobs that need to be filled. By equipping ourselves in the future with more of the information needed to determine the true state of demand, we should be able to pursue the objective of full employment with less danger of causing serious inflation.

This objective will be promoted by other improvements in economic information. Our statistical system is the best in the world, but it is not keeping pace with the needs of our times. We learn, for example, that unemployment amounted to 3.3 million this January. What precisely does this figure tell us? A short answer is that it reports the number of jobless persons who are able, willing, and seeking to work. This answer, however, is incomplete and in some respects misleading. In the first place, the figure includes an unknown number of individuals who, while they are willing to work and are seeking work, are so handicapped physically or psychologically that they would be unable to hold down a job even in a very tight labor market. Second, the unemployment figure includes several hundred thousand persons who actually have jobs; specifically, those who are waiting—whether of their own choice or the employer's—to start work within thirty days, those who are searching for a new job while they are absent from work, and those who have been temporarily laid off but have definite instructions to return within thirty days. Third, the unemployment figure includes an undetermined number who are not looking for work diligently. A man who applied for a job as much as sixty days ago, but made no other effort to find a job while waiting for a reply to his application, may still be counted as unemployed. Fourth, the unemployment figure includes a certain number of persons, again of unknown magnitude, who are not looking for work in any sense, either because they are temporarily ill, or because they are waiting to be recalled from an indefinite layoff, or because they believe that no work is available in their community or trade. On the other hand, the unemployment figure omits some, perhaps many, persons who have stopped looking for work because they have established that acceptable jobs are unavailable within their geographic reach. Clearly, the unemployment figures which serve as a basis for much of our policy-making are highly technical and somewhat dubious aggregates. Not only is it desirable to refine the concept of unemployment; we also need to learn how to assemble and use statistics of unemployment so that the parts which cannot be readily influenced by broad fiscal or monetary policies may be approached by more direct measures.

Other branches of our statistical system also show signs of age and need to be revitalized—notably, the records of prices and wages. The quotations that enter into price indexes of industrial commodities at wholesale are largely based on list prices rather than actual market transactions. But in the course of an economic upsurge, such as we have been experiencing, discounts tend to become smaller, concessions fewer, and premiums more frequent or larger. By neglecting these changes, our price indexes have understated the advance of the wholesale price level since mid-1964. If more accurate price indexes had been available, we might have realized sooner that the remarkable period of general price stability which began in the late fifties had come to an end, at least temporarily.

Despite their element of bias, the wholesale price indexes have the merit of comprehensiveness—an advantage that our measures of wage changes lack. The fullest set of figures published by the Bureau of Labor Statistics pertains to hourly earnings of production workers in manufacturing. These figures represent hours paid for, not hours worked, and hence do not allow for the increasing number of hours paid for but not worked. They do not include fringe benefits—a factor that has become of major importance to employers and employees alike. A sizable and increasing fraction of employees are classified as "nonproduction" workers, and they are not covered at all in the wage statistics. Finally, it is well to note that employees in the goods producing industries are now outnumbered by those in the service industries, and that the statistical coverage of wage rates and earnings in the service industries is meager.

But the records that are used most widely and on which businessmen as well as government officials have come to rely most heavily are the estimates of gross national product—that is, the nation's total output of goods and services. These figures not only inform us on past and current economic conditions, but also serve as a basis for much of the forecasting in which economists and others necessarily engage. As is true of so many parts of our statistical system, the gross national product estimates are more dependable than comparable data for most other nations. They are not, however, as good as they should be. The July 1965 issue of *Economic Indicators,* for example, reported that the gross national product in 1964 was 623 billion dollars. The next month's issue reported the appreciably higher figure of 629 billion for the same year. In fact, had it not been for certain changes of definition that accompanied the statistical revisions, the latter figure would have been 640 billion. Or to cite a more nearly current example, the increase between the first and second quarters of 1965 was reported in successive issues of *Economic Indicators* as 9.2, 9.5, and 11.2 billion dollars, while the increase between the second and third quarters was reported as 11.0, 11.6, and 12.7 billion. While I admire the constant striving of statisticians for promptness, precision, and conceptual relevance, I also suspect that the initial underestimates of the growth in our nation's output last year may have contributed to the somewhat tardy realization by policy makers that slack in the economy was vanishing. I have wondered over the years, and still do, how much might have to be added to the cost of gathering our statistics so as to reduce, if not eliminate, the need for sizable revisions in the future, and whether the resulting benefits would not greatly outweigh the cost. I hope that the Joint Economic Committee, which has often taken the initiative to improve our statistical system, will seek answers to these questions.

Let me say, finally, that the implementation of the Employment Act requires, besides better information, more realistic models of the workings of our economy than are now current. Contrary to widespread notions, neither the labor force nor the output per man-hour grows steadily and smoothly, year after year. Nor is the gap between actual and potential output like a bathtub that merely needs turning on of the fiscal faucet to be filled. Experience teaches that productivity increments tend to decline as full employment is approached. If this tendency is overlooked by the makers of policy, the bathtub may overflow. Experience also teaches that confidence is a basic factor in economic life, and that it therefore makes a difference, even if we cannot express it in a mathematical equation, how we seek to fill gaps. Arithmetically, one dollar in the Federal budget is like any other, but from an economic viewpoint the individual dollars differ. The great success that attended the recent reduction of income tax rates cannot be attributed solely to the arithmetical magnitude of the fiscal stimulus. It was also due to the fact that the government took numerous steps to improve confidence after the unhappy steel price episode of April 1962, that the fiscal stimulus adopted in early 1964 took the form of a tax reduction instead of an increase in expenditures, and that the tax reduction became effective over the entire range of personal and corporate incomes instead of being limited, as some well-meaning citizens had urged, to individuals at the lower end of the income scale. But just as confidence may be strengthened by creating a better environment for enterprise and investment, so also can it be damaged by imprudent management of governmental finances or by arbitrary interference with the workings of labor and commodity markets.

I wish to congratulate the present Council of Economic Advisers and the Joint Economic Committee on their efforts to bring our evolving economic knowledge to bear on the nation's economic condition. They need not be reminded of William James' pragmatic maxim that "we have to live today by what truth we can get today, and be ready tomorrow to call it falsehood."