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What Type Of Full Employment? A Critical Evaluation of "Government as the Employer of Last Resort" Policy Proposal

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INTRODUCTION

After more than three decades during which the concept of full employment has virtually disappeared from the vocabulary of mainstream economists and policy makers and been replaced by either the old Friedmanite "natural rate of unemployment" or the NAIRU, in recent years this discourse has changed dramatically. A group of economists of Post-Keynesian persuasion have quite boldly reaffirmed their commitment to full employment and

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have argued that full employment is not only socially desirable as a policy goal but also technically achievable via public spending without the accompanying runaway inflation that mainstream economists normally assume is associated with this state. Following Minsky (1986), this view has come to be described as "government as the employer of last resort" policy proposal and, as the name suggests, it commits the state to hiring anyone able and willing to work at a given money wage, thereby effectively eradicating involuntary unemployment.

The purpose of the article is to evaluate this contemporary proposal not only on its own merits but also in relation to alternative proposals to be found historically. For this reason, the article begins with a brief analysis of Keynes's original perspective that linked full employment to a particular composition of public spending and to a resulting functional distribution of income. This is followed by an analysis of the neoclassical response that rejects this Keynesian vision of full employment and replaces it with a less interventionist "pro-market" policy of guaranteed income. After pointing to the deflationary consequences of such Friedmanite policy of guaranteed income in a world in which full employment is not the norm, the article then focuses on the current Post-Keynesian policy proposal of government as employer of last resort (ELR).

Using a framework of analysis that is familiar especially to Kaleckian economists, the article shows how, under an ELR system, more than one state of full employment is conceivable: a "high wage" full employment or a "low wage" one, with the latter being compatible with a situation characterized by substantial disguised unemployment. It ensues that the choice of the ELR wage would be of significance in bringing the economy closer to potential output since any variation in the ELR wage could trigger changes in the labour force participation rate. At the same time, it is argued that the choice of this particular base wage could also have significant consequences on the economy's wage structure and on the pattern of wage inflation and, therefore, on the ability of policy makers actually to keep a lid on wage and price changes over time under ELR. For this reason, while an ELR policy system would be a clear substantial

improvement to the current system in which governments seek to maintain a permanently high level of long-term unemployment in order to keep downward pressures on inflation, an ELR program would not be completely free of some possible negative side-effects that such a full-employment policy could also engender.

SOME NOTES ON KEYNES'S ORIGINAL POLICY VIEWS TO ACHIEVE FULL EMPLOYMENT

In commenting on the socio-economic realities of mass unemployment of the 1930s, John Maynard Keynes (1936, p. 373) wrote: "The outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and income." To both Keynes and numerous Post-Keynesian writers of the post-war period, full employment was the necessary prerequisite to the achievement of a more equitable distribution of income (and wealth). Indeed, as is also forcefully stated by Arestis and Sawyer (1998, p. 181), the two goals could (and should) not be seriously dissociated. This is because, to achieve full employment, policies should be put in place whose impact would be inevitably to lead to income and wealth redistribution.

As it has been discussed in much greater detail elsewhere (Seccareccia, 1993, 1994, 1995; and Seccareccia and Lavoie, 1989) as well as, to some extent, in Kregel (1985), Smithin (1987) and Pressman (1987), in the *General Theory*, Keynes had proposed a short *ensemble* of specific policies to achieve full employment which, in contrast with the traditional textbook caricature of Keynesian short-term policies of "pump-priming", were of a long-term nature and whose impact would be on the long-term evolution of the functional distribution of income. These policies pertain to what Keynes had described as the "socialization of investment" and the "euthanasia of the rentier", that he believed would impact upon the size of the economic surplus as well as on how that surplus would be divided among social classes in a capitalist economy. For example, Keynes's notion of socializing investment is best understood in his support of the setting up of a National

Investment Board (NIB) throughout most of the 1930s and early 1940s. The alleged purpose of such a Board was to achieve full employment by strategically regulating the aggregate flow of investment expenditures through the appropriate control of long-term financing. When such a NIB policy of directly intervening in the financial capital markets by redirecting investment were to be coupled with a monetary policy of pegging nominal interest rates at a very low level, the result would be that the economy would be hovering about the full employment level and, at the same time, massively redistributing income away from the *rentier* sector, thereby leading to the so-called "euthanasia of the rentier".

While being sympathetic to short-run stabilization policies, to our understanding, Keynes was not particularly interested in achieving this long-term goal of full employment and income redistribution by means of a policy of functional finance of the type first put forth by Abba Lerner during the 1940s. Evidence presented by Colander (1984) suggests that Keynes was somewhat ambivalent to functional finance. While initially rejecting it and, indeed, never publicly endorsing it (see Metzler, 1988), in private correspondence with Lerner he had come around to seeing its merit as a basis for policy.

A possible reason for this ambivalence is because, as pointed out by Kregel (1985), Keynes regarded operating deficits in the "normal" or "ordinary" budget of the state as a visible sign of the government's lack of a strong public investment policy to achieve full employment by means of an activist NIB. For this reason, he was careful to distinguish between the current and the capital accounts of the state. Keynes's position was that, in an expenditure-led high growth economy propelled forward by the activity of the NIB, governments should aim at running surpluses in their "ordinary" (or recurring) budgets and that these surpluses should be "transferred to the capital Budget, thus gradually replacing dead-weight debt by productive or semi-productive debt." (Keynes, 1980, p. 277). Hence, just as a private investment ultimately bears fruit for business enterprise, such a comprehensive public investment policy would pay for itself over time by engendering surpluses in the government's operating budget. Unlike

private firms, however, governments would utilize this surplus not to extinguish their debts but to expand their capital expenditures strategically.

The effect of this continuing transfer of operating surpluses to capital budgets would be gradually to socialize a growing proportion of total investment expenditures. Indeed, he argued that these public capital expenditures should be significant enough to achieve full employment by stabilizing aggregate investment spending over the business cycle and, in the long run, they should be "maintained at a level which will allow the growth of capital to the point where it ceases to be scarce." (Keynes, 1936, p. 376.) To this end, he eventually envisaged as much as two-thirds or three-quarters of total investment as being under the influence of the public authorities. The implication of all of this is that Keynes's original position (with regard to policies to achieve full employment) was concerned not only with the level of public spending but also with its *composition* over the long term. Moreover, by means of what may be dubbed a "reflationary" growth process, his public expenditure policy had clear long-term objectives in terms of income distribution: the gradual elimination of *rentier* income.

THE NEOCLASSICAL RESPONSE: INCOME SUPPLEMENTATION PROGRAMS WITHOUT FULL EMPLOYMENT

Keynes's radical policy system would neither find favour from the economic establishment of his times nor of ours. As Hayek (1966, p. 243) put it so succinctly, Keynes was supposedly reviving the most naive "inflationist fallacies" that no scarcity exists in the labour market (except at full employment). Despite the strong neoclassical opposition, governments both during WWII and the early post-war period did come to subscribe to some aspects of Keynes's thinking, largely because of factors pertaining to the balance of political forces at the time that gave rise to what some have described as a Fordist social structure of accumulation (*cf.* Paquette, 1999, pp. 967-971). As a by-product of the early postwar political commitments to full employment in Western Europe and North America, the

international policy drift in favour of high employment by means of public investment and low interest rate policy did follow a general policy pattern quite compatible with Keynes's vision. However, already in the late 1950s, growing fears of a "creeping inflation" associated with high employment brought many policy makers (as noted by Lerner, 1963, p. 229) to "retreat from Keynesianism". These fears, especially as it came to be crystallized in the Phillips curve trade-off menu and subsequently in the Friedmanite natural rate hypothesis, ultimately came to spell the end of activist state policy to achieve full employment. As has been witnessed over the last three decades, policy moved full circle back to the neoclassical supply-side doctrines of the 1930s. Once again, the only appropriate role of government has become that of ensuring its long-run monetary and budgetary neutrality and actively to remove all institutional obstacles in the labour market that prevent wages from falling in order to reduce the equilibrium level of unemployment.

As understood within neoclassical theory, unemployment is the result of structural rigidities that do not allow the labour market to perform its functions in terms of allocation and clearance. Consequently, any macroeconomic policy that does not take heed of these underlying functions would generate inflationary pressures. Instead of seeking to boost progressively aggregate demand whose ultimate repercussion would supposedly be accelerating inflation, it is by dismantling various institutional obstacles in the labour market that would bring equilibrium unemployment closer and closer to its natural or full employment level (*cf.* Seccareccia, 1991a, 1991b, and Bougrine and Seccareccia, 1998, 1999).

If problems of income distribution and poverty were to arise from the normal functioning of an unhindered, competitive and flexible labour market, the solution would be to set up a redistributive system that is presupposed to be least distorting in the sense of permitting wages to serve as the primary allocative and market-clearing device while, at the same time, not having the inherent inflationary features that were assumed to accompany Keynesian full employment policies. It is in this context

that the various programs of income supplementation such as Friedman's negative income tax and other notions of guaranteed income (GI) came to be seen as *substitutes* for an activist Keynesian policy of achieving full employment. As Friedman (1962, p. 191) pointed it out, unlike minimum wages and other similar income support systems such as unemployment compensation, a GI system would not much "distort the market or impede its functioning." This is because a GI policy would create incentives for individuals to offer their labour services in the private sector labour market while, at the same time, provide a basic income that would not hinder wage flexibility.

The idea of a GI system is quite simple. In an unfettered competitive labour market tending towards full employment, all individuals ought still to be guaranteed a minimum basic income (MBI). However, instead of most current transfer systems which allow individuals to receive either welfare payments or work (but not both), thereby creating work disincentives, a GI system would supplement a low-wage job by taxing back only a fraction of the GI transfer. The idea is appealing since it is concerned with some income security objectives not presently met by numerous current welfare systems, especially with regards to the working poor. However, as it has been argued elsewhere (see Iacobacci and Seccareccia, 1989, and Seccareccia, 1991a), such as system would only be desirable in an ideal neoclassical world in which full employment has already been reached. On the assumption that the minimum basic income would be set close to what are present welfare transfers to the poor and in the absence of a comprehensive minimum wage legislation and Keynesian fiscal and monetary policies to achieve full employment, the effect would be significant wage deflation with the accompanying proliferation of low wage jobs. This is because the GI policy would significantly increase the number of employable welfare recipients seeking work in labour markets already characterized by chronically high unemployment. Due to the increased propensity to accept lower-paying jobs that would be generated by what in Iacobacci and Seccareccia (1989) was described as the "compensation effect" of the income support provided by the GI program,

such a policy would only intensify the downward pressures on wages and would activate forces pushing towards a low-wage/part-time economy.

Of critical importance to us, at the macroeconomic level, the adoption of such GI programs would have an important effect on the responsiveness of wages to the business cycle. As cyclical unemployment rises, the number of workers willing to accept lower-paying jobs or a cut in wages (if already employed) would also rise, due to the compensation effect. In the process, the neoclassical flexible wage system would be rehabilitated; but, as Keynes (1936) had argued, flexible labour costs do not move the economy closer to full employment. Because of the negative feedback effects on aggregate demand, just the reverse would be true, especially if the gap between wages and profits might be widening in the long run owing to the proliferation of low wage jobs.

These wage deflating tendencies, which would result from the above-mentioned compensation effect, could exist regardless of the guaranteed the MBI that would be set by the government. However, the higher the MBI, the lower would be the participation rate on the part of households, and thus the lower ought to be the underlying labour market pressures to bring down wage costs. This is shown in figure 1, where the MBI is measured on the vertical axis and the (percentage) employment rate (*e*) and participation rate (*l*) are measured on the horizontal axis. Even if the employment rate (defined as the ratio of employed workers to the working age population) remains insensitive to a small change in the MBI (because of the usual explicit assumption of "fiscal neutrality" of the GI program [for a discussion, see Iacobacci and Seccareccia 1989, pp. 162-163]), if the participation rate falls as the MBI rises, this would ultimately bring down the unemployment rate, reflected in the narrowing gap between *e* and *l*. In reality, however, labour demand (*e*) would probably not be inelastic to changes in the MBI. As the MBI moves upward, it would likely have a destabilizing effect on the wage structure over time as firms offering wages below the MBI would be under growing pressure to increase them, especially if labour becomes progressively scarce as the labour force participation rate (*l*) falls. To the extent that this positive effect on overall

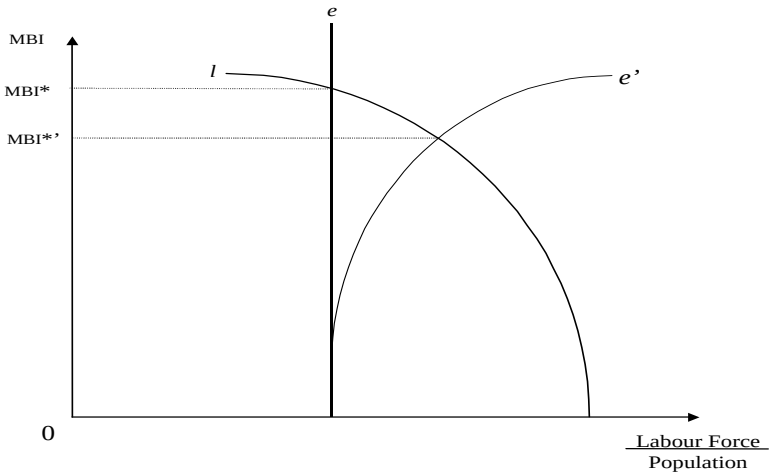
wages becomes significant (as the MBI rises), we could trace an upward-sloping adjusted *e'* curve reflecting the higher macroeconomic demand for labour arising from the increased consumption demand that ought to accompany the higher real wages.

Consequently, the choice of the minimum basic income is a critical factor in determining how significant would be the wage deflation bias in the operation of a GI program. As the value of the MBI approaches MBI* (or MBI*') in figure 1, it is likely that the wage deflating influence of the GI program (due to the compensating effect) would be progressively outweighed by upward labour market pressures on wages as firms compete for qualified workers. However, as much as one may theorize about these latter effects, the dangers of inflation would be incredibly remote under current GI proposals. This is because GI programs are generally packaged so that the MBI is sufficiently low, usually below the poverty line and, indeed, even below existing social assistance levels (Iacobacci and Seccareccia, 1989, pp. 147-148). For this reason, not only do all proposed GI programs meet the criterion of zero inflationary pressures that is of concern to neoclassical theorists but, as it has been argued, the adoption of such programs would have a clear deflationary bias in the labour market.

GOVERNMENT AS EMPLOYER OF LAST RESORT: AN ALTERNATIVE TO THE DEFLATIONARY BIAS OF NEOCLASSICAL POLICIES?

Over the last few years, a powerful alternative Minskian policy view (in which government is envisaged as an employer of last resort [ELR]) has emerged which completely stands on its head the neoclassical policy dilemma. Instead of the presumed incompatibility between inflation and unemployment that is at the core of the neoclassical policy perspective, advocates of ELR, such as Mosler (1997-1998), Wray (1997, 1998a, 1998b), Forstater (1997), Mitchell (1998), and Nell (2000) agree with Keynes (as well as with Lerner and Minsky, among others) in pointing out that true full employment is not only desirable but also achievable

FIGURE **1**
Relation between MBI and Employment/Participation Rates



without the inflationary effects that are assumed to accompany it. Much like Keynes, full employment must be attained by means of demand-side policies and not through tinkering with the supply-side of the labour market. Furthermore, the whole notion of monetary/fiscal neutrality, so critical to the neoclassical policy system, is completely rejected since permanent deficits financed through money creation would be entirely compatible with price stability within the ELR framework (*cf*. Parguez, 1998).

According to Wray (1998a, pp. 125-126), an embryo of the ELR proposal can be found in Minsky (1986, p. 308), though one can probably trace ELR roots back to some early New Deal authors of the 1930s. Not unlike the GI programs, the basic structure of an ELR policy is also quite simple. As stated by Wray (1998a, p. 124), it ought to rest on two key features: *i)* there would exist a perfectly elastic demand for labour by government at a given ELR wage, thereby establishing a "buffer stock" of labour; and *ii)* the basic ELR wage would be a discretionary variable set exogenously by

the state, which through its hiring becomes the effective "wage setter". Given the vagaries of private sector employment, the ELR state would be prepared to hire all unemployed workers shed by the private sector at the basic ELR wage, thereby guaranteeing effective full employment.

Analytical Framework

To analyze the implications of ELR, it would be useful to address our concerns within a particular Post-Keynesian or Kaleckian framework of analysis to be found in Eichner (1987), Nell (1988, 2000), and, among others, Seccareccia (1991b) and Bougrine and Seccareccia (1998, 1999). In a non-ELR world, let us assume that total real income, *Y*, depends on aggregate expenditures, which can be conveniently divided up into the discretionary (*A*) and the non-discretionary expenditures (*C*):

$$Y = C + A \qquad [1]$$

where $A = I + D + X^n$, and where I = private sector investment expenditures, D = government (non-ELR) budget deficit, and X^n = net exports. At the same time, let us suppose that total income, *Y*, can be classified as employment income, wL, and property income, π, so that:

$$Y = wL + \pi \qquad [2]$$

were w is the average real wage rate of the combined private and public sectors, L is total employment and π is the flow of profit, interest and rent. Adopting a simple classical savings function whereby the propensity to consume out of wage income (σ_w) is greater than the propensity to consume out of property income (σ_π), or in the extreme case that will be considered here $\sigma_\pi = 0$, we obtain that $C = \sigma_w(wL)$. Hence, introducing this assumption into equation [1] above, we have:

$$Y = \sigma_w(wL) + A \qquad [1']$$

Finally, specifying a simple Leontief linear aggregate production function such that $Y = aL$, where a is average labour productivity, we arrive at the following fundamental equation:

$$aL = \sigma_w(wL) + A \qquad [3]$$

which, when re-organized, gives the aggregate labour demand curve for (non-ELR) labour at the macroeconomic level:

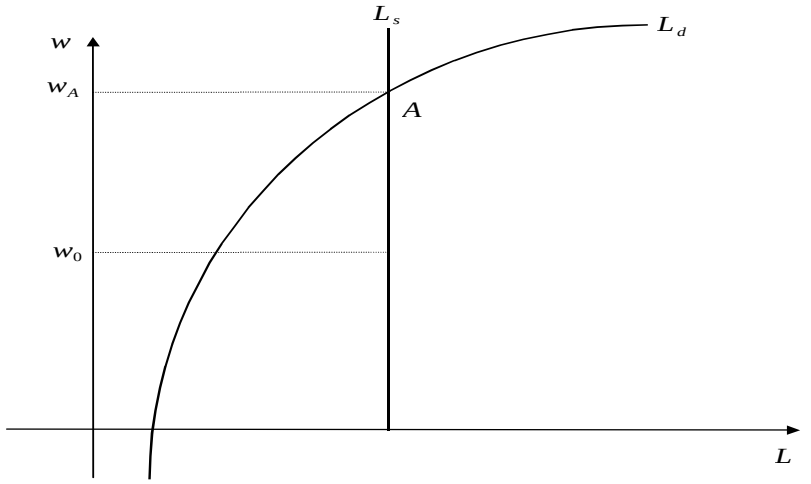
$$L^d = \left(\frac{\frac{1}{a}}{1-(\sigma_w)\frac{w}{a}} \right) A \qquad [4]$$

with the usual Keynes/Kalecki property that $\partial L^d/\partial W>0$ and $\partial^2 L^d/\partial W^2>0$; that is to say, that in contrast with neoclassical theory the real wage-employment relation is necessarily positive and, in this case, also non-linear.

As can be found inter alia in Nell (1988), we can illustrate graphically this aggregate labour demand curve as in figure 2. Any increase in A or σ_w, or any fall in a, would have the effect of shifting the L^d curve outward to the right and/or modifying its slope. Introducing an inelastic labour supply curve (L^s), we can thus derive the usual Post-Keynesian results. At a given average real wage, w_0, associated with an excess supply of labour, there exist no self-correcting mechanisms to bring the economy to its full employment level at the intersection point A. Indeed, if wages were flexible downward in the sense favoured by neoclassical theory, the effect of a fall in real wages would be merely to make matters worse on the unemployment front. Hence, unemployment is not the result of real wages being too high. Rather it is because of a lack of aggregate effective demand due to the fact that, for a given flow of autonomous expenditures, wages are too low. Consequently, only by an increase in discretionary

spending, *A*, and/or an accompanying rise in real wages, *w*, can an economy reach full employment.

FIGURE **2**
Macroeconomic Labour-Market Relation



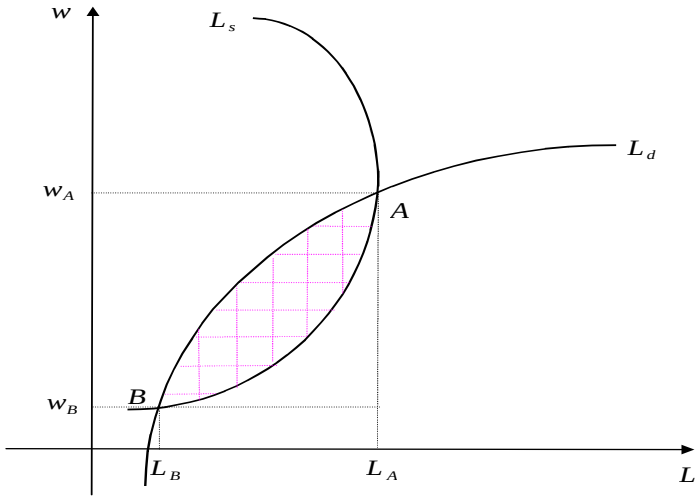
Before analyzing ELR policy within this framework, let us discuss more carefully the nature of the aggregate labour supply curve. It is well known on the part of neoclassical economists that labour supply (*i.e.*, labour force participation) is not completely inelastic to movements in the real wage (see Killingsworth, 1983). If one were either to conceive of it historically or compare economies internationally, it is well known that in developing economies labour force participation rates would be relatively low (that is to say, there would exist vast labour reserves), and the desire to attain the high consumption levels of developed countries would be very high.

In such economies, characterized by low real wages and high levels of disguised unemployment, labour supply would be sensitive to real wage movement and positively sloped, in conformity with traditional analysis (*cf.* Wisman 1989, and Prasch 2000). For instance, over the last two

decades, the unemployment rate of a country such as Mexico has hovered around the 3 per cent value with projected rates of about 2.5 per cent for 2003 and 2004 (See *OECD Economic Outlook*, no. 73, June 2003, p. 208). Undoubtedly, such a low official unemployment rate masks a high degree of disguised unemployment revealing vast potential reserves of underutilized labour that would quickly decline as real wages rise. However, as the real wage rises, households would be attaining progressively their targeted consumption norms (*à la* Duesenberry) and, concomitantly, those substantial labour reserves would become depleted. At sufficiently high real income levels, the labour supply curve would become more inelastic and could eventually become backward bending. Indeed, this latter phenomenon is actually confirmed by household behaviour in North America. Real wages have generally fallen during long historical periods since the 1970s but labour force participation rates have risen consistently throughout this period.

In figure 3, we have traced a labour supply curve that depicts these specific features discussed above: the curve would first be positively sloped and ultimately would become backward bending at high real income levels. Since the labour supply curve intersects the labour demand curve at two separate points in figure 3, one may thus conclude that an economy can achieve full employment at two distinct levels: at a low wage level, w_B, and employment level, L_B, and at a high real wage, w_A, and employment level L_A. The intersection point *B* in the diagram represents a "Third World" type of solution to achieve full employment representing economies studied historically by development economists such as W.A. Lewis (1979), in which massive disguised unemployment ($L_A - L_B$) is the norm (*cf.* Cornwall, 1977). On the other hand, the point of intersection *A* represents a hypothetical state of veritable full employment for an advanced capitalist economy in which those potential labour reserves have essentially dissipated. As studied by Keynes during the 1930s, an advanced capitalist economy that must face a chronic shortage of effective demand would normally find itself within the shaded area of figure 3 between the intersection points *A* and *B*, that is to say, in a state in which substantial involuntary unemployment is the norm.

FIGURE **3**
Low-Wage/High Wage Full Employment and Involuntary Unemployment

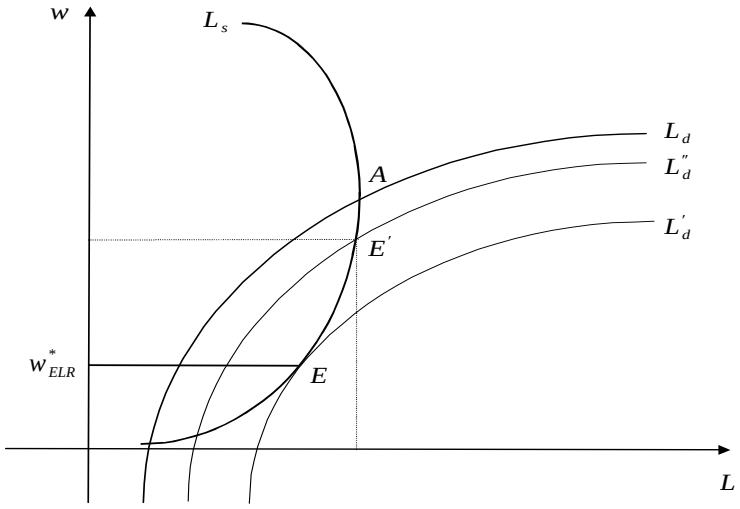


Implementing an ELR Program

What would be the implication of an ELR program in such an economy? Figure 4 shows how at w^*_{ELR} the program implementation would now set a floor so that the effective labour supply curve would resemble an inverse L-shaped relation. However, before pursuing the analysis further, the reader should take note that for the sake of analysis, in the diagram, w^*_{ELR} represents the ELR-weighted average wage for the economy, inclusive, therefore, of the exogenously set ELR wage. Also, for analytical purposes, we are supposing that, in the short run, prices would be relatively insensitive to changes in the ELR wage, so that fluctuations in the nominal base wage would also mirror similar movements in the real w^*_{ELR}.

We believe that this latter assumption is appropriate for at least two important reasons. Firstly, a rise in the base ELR wage would not normally

FIGURE **4**
ELR Full Employment



trigger a concomitant increase in *all* other public or private sector wages. Hence, following an ELR wage increase, one would not expect across-the-board wage spillover effects in all sectors that would be accompanied by a proportional increase in prices, at least not in the short run. Indeed, to the extent that the change in wages is initially limited to ELR workers, it is unlikely that government-administered public service prices would be much affected by fluctuations in the ELR wage, unless governments would be, at the same time, committed to a neoclassical policy of sound finance! As it will be discussed below further, however, this assumed lack of sensitivity of other wages would depend crucially on the initial choice of the ELR wage, so that the higher is the chosen w_{ELR}, the greater would be possible spread effects on other wages and on prices over time. Hence, in the case of an existing low w_{ELR}, changes that would affect wages only at the very bottom of the wage structure would not probably generate significant spillover effects.

Secondly, even if the change in the ELR wage were to generate significant feedback effects across the complete spectrum of wages in the economy, the pass-through effect on prices would depend, among other things, on the significance of such factors as foreign trade. With the obvious exception of such large trading blocs as the United States and the European Union, most other countries in the world today would be highly exposed to foreign trade, for instance, with the case of Canada not being atypical, with exports constituting over 40 percent of gross domestic product (GDP). Faced with stiff international competition, firms would probably much better accept lower mark-ups in the short run than risk losing international market shares, and would seek to re-establish profitability over the long term primarily by reducing unit labour costs via increased productivity. For analytical purposes, therefore, it would be quite legitimate to suppose that a change in the money ELR wage would not give rise, in the short run, to a proportional change in prices (a possibility that even Kalecki [1971, pp. 161-162] had envisaged because of such outside forces impacting on firms' degree of monopoly).

Let us assume that the exogenously chosen level of the ELR real wage, w_{ELR}, would bring forth a specific weighted value of w^*_{ELR} in figure 4. For diagrammatical illustration, we have selected purposely this starting point for our analysis in figure 4 because it reflects the largest gap between aggregate labour demand and supply and it coincides with the maximum stock of involuntary unemployed labour that would have to be absorbed by the ELR program. Once that w^*_{ELR} is set and the ELR program is implemented, the economy would thus find itself at the tangency point E in the diagram. At any other level of ELR-weighted wage between w_A and w_B (such as $w^{*\prime}_{ELR}$), the ELR-adjusted labour demand schedule would cross the labour supply curve, thereby requiring less spending to absorb the lower volume of involuntary unemployed associated with it, say, at E'. There thus emerges an apparent trade-off that can be easily inferred from our diagram. Any ELR-weighted wage greater or less than w^*_{ELR} (associated with point E in figure 4) would entail proportionally *less* expenditures on the part of the state to eliminate the involuntary unemployment. However, while the

financial costs might be proportionally lower, the social costs would be very different as to whether one would choose the top or bottom side of the threshold level, w^*_{ELR}.

The lower is the selected w_{ELR} that would move the economy closer to the low-wage full employment point at w_B, the higher would be the level of disguised unemployment (or the rate of underutilization of productive resources) in an economy. This is because, barring forced labour (which is out rightly excluded [see Wray 1998a, p. 124]), the state presumably would not be able to constrain people to work for what some workers would deem to be an unacceptable wage. Naturally, on the top side of the threshold level w^*_{ELR}, the higher is the ELR wage and, once again, the lower is the volume of involuntary unemployed to be absorbed by the ELR program. In contrast with the low-level ELR, however, the *lower* would be the number of disguised unemployed connected with this high average ELR-weighted real wage level. Finally, as the real wage continues to rise, the economy would reach the upper turning point of the labour supply curve in our diagram at the intersection point *A*. At this high end of our aggregate real wage scale, full employment is reached without the need for ELR jobs and there exists no significant labour reserves.

From this analysis alone, the choice of w_{ELR} becomes highly critical. One could imagine two types of effective full-employment systems under ELR: a low-wage ELR program (presumably enacted by a right-wing government) with w_{ELR} gravitating around the bottom end of our relevant average real wage spectrum, and a high-wage ELR policy (possibly decreed by a social democratic regime) with less wastage of human resources due to the lower levels of both "involuntary" ELR workers *and* disguised unemployment. Given the critical role of the ELR wage, it is rather surprising that advocates of ELR have shown little concern with this thorny issue of what actual type of full employment is socially most desirable. Should it be a low-wage ELR system tending towards w_B that would be accompanied by a large wastage of human resources or should it be a high-wage full employment system with w^*_{ELR} moving closer to w_A?

Inflation/Deflation and ELR

In going through this simple exercise, an obvious question ought now perhaps to strike the reader: why go through this process of setting up an ELR program in the first place? Surely, a Keynesian policy of high public investment, low interest rates, and high real wages (as described in section 2 above) would also take the economy close enough to the intersection point *A*? Much like conventional wisdom, the answer that is provided by some defenders of ELR is that a Keynesian full employment policy would necessarily be inflationary as in a Phillips curve world (*cf*. Mitchell, 1998). To his credit, Wray (1998a, p. 153, *fn*. 29; and 1998b) himself is quite careful at times in stating that he does *not* necessarily endorse such an explanation of the inflationary process. However, while distancing themselves from the neoclassical explanation of inflation, it is quite clear that advocates of ELR are catering to those numerous mainstream economists who believe in a NAIRU, whereby inflation is seen as the ineluctable consequence of Keynesian "tight" labour market policy (even though this mainstream view is highly disputed and, to a large extent, has been discredited [Galbraith, 1997]).

If one believes in some Phillips curve process, then what is needed is a policy system that would recreate "loose" labour market conditions even at full employment. Does an ELR system provide such a "loose" labour market environment? It all depends, once again, on the choice of w_{ELR}. If one chooses the low-wage ELR regime, there would be some pressure to bear on wages to move downwards toward the low ELR anchor. For instance, in a period of fiscal austerity in the public sector, what would prevent a local government concerned with the size and cost of its own employed labour force from shedding some of its workers with relatively higher wages and trade union protection and replacing them with low wage ELR workers? "Workfare" policies may, to a certain extent, be envisaged in this light, *i.e.* as an attempt by certain governments in North America to cut public expenditures while trying to maintain some low-end public services. In other words, as Kriesler and Halevi (2001) correctly remind

us, the state would not be neutral on these matters. Wray (1997) does seem to recognize this danger; yet there appears to be nothing that is built in the ELR system to prevent such a deflationary wage effect to occur in the public sector.

In much the same way, a low-wage ELR regime could destabilize downwards private sector wages if w_{ELR} is set below pre-existing statutory minimum wages. Admittedly, the political prospects of this happening would be slight, but not impossible. Hence, while many of the advocates of ELR, such as Forstater and Wray, are committed to the principle of a "living wage" along the lines put forth by Pollin and Luce (1998), there is nothing that would prevent government authorities to set the ELR level below a "living wage". Indeed, if w_{ELR} is set low enough, it is not only the weight of the "buffer stock" of ELR workers that may pull other wages (situated further up the wage scale) downwards but, as many ELR analysts seem to forget, it is also the weight of the army of disguised unemployed as the chosen w_{ELR} is set closer to w_B in figure 3. Because the ELR wage sets a floor to wages, the deflationary effect would never be as strong as with the neoclassical GI systems (*cum* involuntary unemployment), but such an effect cannot be excluded.

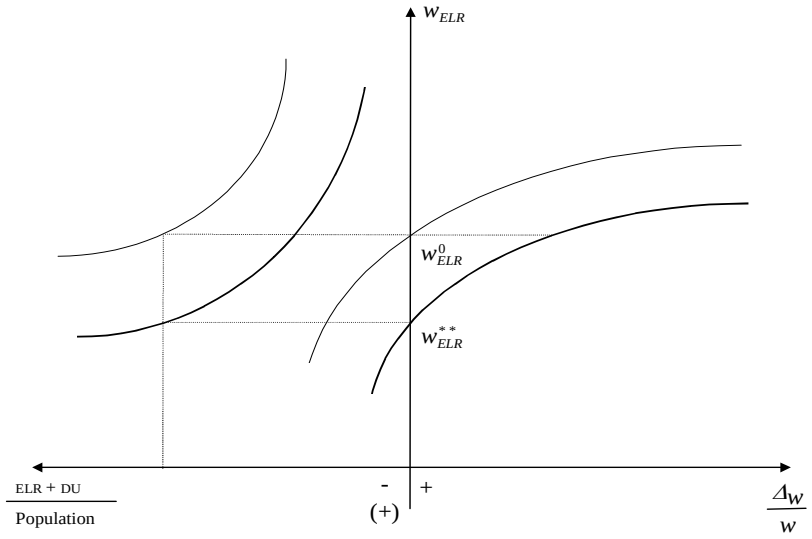
Would there be an inflationary bias under an ELR system, as some analysts have suggested (see Aspromourgos, 2000, and López-Gallardo, 2000)? Once again, as was stated above, this would depend to a large extent on the choice of w_{ELR}. The higher becomes the ELR wage (in figure 4), and the more destabilizing would be the implementation of such a program on the wage structure over time. As Keynes had understood it long ago, workers are perhaps more concerned with their relative wages than with the level of prices in the economy. Owing to these powerful normative forces in the labour market that make for a constancy of relative earnings (*cf.* Seccareccia, 1991a, pp. 48-49), if w_{ELR} is set relatively high, the effect would be not unlike what would happen if a statutory minimum wage is raised significantly in a fully employed economy. Its impact would probably be to provoke over time what some would describe as a "wage-wage" spiral via the "leap-frogging" effect that it can generate. Hence, independently

of the size of the ELR pool of workers associated with a given w_{ELR}, an inflation of the type, which, for instance, Kaldor (1976, p. 708) had identified as best representing the "creeping inflation" of the 1950s and 1960s, would be the probable outcome over time of introducing an ELR system with a w_{ELR} that is "too high".

Wray (1997, 1998a, 1998b) has insisted, however, that such a process ought *not* be dubbed inflation. It would produce merely a once-and-for-all jump in wages; it would not generate a "continuous pressure" on wages and prices. Regardless of one's terminology, to the extent that the setting of w_{ELR} generates instability in the wage structure that may take a long time to wind down, economists have traditionally described this as an *inflationary* process. As shown in figure 5, on the right-hand quadrant, we have depicted the possible relation between the exogenous setting of w_{ELR} and wage inflation, $\Delta w/w$. *The* higher is w_{ELR}, the greater would be the long-term instabilities in the wage structure and the "wage-wage" inflation, $\Delta w/w$ (measured on the horizontal axis), that would be engendered over a certain time period by the initial increase in the ELR wage. On the other hand, if the policy authorities choose a sufficiently low w_{ELR}, one could even imagine that the wage structure may be sufficiently destabilized in the downward direction as to generate a wage-wage deflation. Even though such effect would be much more mitigated than in the upward direction, thereby leading to a more asymmetrical relation (as depicted in our diagram), wage deflation cannot be excluded. The point of intersection on the w_{ELR} axis represents the ELR wage, w^{**}_{ELR}, that would preserve relative stability in the wage structure, and therefore in "wage-wage" inflation. Somewhat analogous to Galbraith's (1998) "ethical rate of unemployment" that stabilizes earnings relativities, we could conceive w^{**}_{ELR} as the "ethical" w_{ELR} that would least disturb relative wages.

On the left-hand quadrant of figure 5, on the other hand, we have depicted a simple negative relation between the exogenous setting of w_{ELR} and the sum of ELR workers and disguised unemployed (DU) as a proportion of the working age population which could be inferred from figure 4 above. It is derived on the assumption that, for a given working age

FIGURE **5**
ELR ***Anti-Inflation Policy***



population, as one projects down a line perpendicular to the horizontal axis from the high wage full-employment point *A* in figures 3 or 4, this would constitute the maximum number of workers that would be employed by the non-ELR sector at that high wage level. At any other point below point *A*, this maximum value would now be divided up into those who would have dropped out of the labour force (the number of DU, because of the lower participation rate), and those who would constitute the number of involuntary unemployed who would be absorbed by the ELR program on account of the lower non-ELR aggregate labour demand. Hence, as w_{ELR} falls, the sum of ELR workers and DU increases, thereby establishing a negative relation that is now depicted in the left-hand quadrant of figure 5.

For the sake of the analysis, let us now assume that ELR policy makers (who chose a given w^{0}_{ELR} in figure 5) are *not* satisfied with the presumed outcome in terms of generating some given level of wage inflation. The

solution that would be available under ELR to deal with this undesirable inflation would be a very traditional one. In essence, either government can raise taxes and/or cut non-ELR expenditures or raise interest rates to slow down private spending so as to increase the "buffer stock" of ELR workers. Just to quote Mitchell (1998, p. 552):

> In the face of wage-price pressures, the BSE/ELR approach maintains inflation control in much the same way as monetarism —by chocking aggregate demand and introducing slack in the non-buffer stock sector.

In terms of figure 4, the idea would be that it would shift the non-ELR aggregate labour demand curve to the left; or, in terms of figure 5, the lower overall non-ELR labour demand would be reflected in an upward shift in the negative relation on the left-hand quadrant between w_{ELR} and rate of ELR employment *plus* the number of DU (as a proportion of the working-age population). Simultaneously, this would also entail an upward shift in the w_{ELR} and $\Delta w/w$ relation on the right-hand quadrant, that is, up to the point where w^0_{ELR} is now compatible with zero wage inflation.

Under ELR, the government would thus have two tools at its disposal to combat wage inflation: *i)* to choose a sufficiently low w_{ELR} so that "wage-wage" inflation would not be a significant factor in a fully employed economy; or *ii)* if it does not wish to tinker with the w_{ELR}, it could wring inflation out of the system by controlling aggregate demand facing the non-ELR sector. The first instrument is nothing more than a specific type of incomes policy that focuses on regulating income at the lowest end of the wage scale; while the second is, of course, merely a variant of the Phillips curve or NAIRU in disguise, with the "buffer stock" of ELR workers now replacing the involuntary unemployed as the preferred mechanism of controlling wage and price movements.

In the final analysis, it may therefore be argued that the mechanisms in place are *not* that fundamentally different when comparing the current system of controlling inflation to the proposed ELR system. Within the present institutional arrangements, the state achieves its inflation targets merely by varying the reserve army of involuntary unemployed. In the ELR

case, it would be through variations in the buffer stock of ELR workers caught in a situation of "loose" full employment. While the latter ELR system can be termed a "Pareto improvement" when compared, say, either to the present wasteland of human resources or even to the deflationary GI alternatives that are sometimes offered by neoclassical economists, one could still legitimately ask the question once again: is this the type of full employment that one would find socially most desirable?

CONCLUDING REMARKS

After over a quarter century of being offered nothing but larger and larger doses of austerity in order to fight an anticipated inflation that does not exist, it is truly refreshing that there are economists out there who have had the courage to bring to the forefront once again the full-employment objective. What is at issue among those of us who are strongly committed to full employment is not the goal itself, which neoclassical economists adamantly reject in favour of some elusive NAIRU, but rather what *type* of full employment do we feel is most desirable for a free and caring society that would like to see involuntary unemployment eradicated. For those of us who believe in a socially responsible economics, this question needs to be seriously addressed.

As it was described in the introduction, in Keynes's original paradigm the full employment goal was not to be dissociated from the income distribution objective. By pegging interest rates at very low levels (consistent with his view on the "euthanasia of the rentier") and with a vigorous public investment policy (his so-called "socialization of investment") that would bring both employment and real wages up to point *A* in our figure 3, Keynes was encapsulating these seemingly disparate goals into one key overall objective. Indeed, not only was he connecting full employment to his income distribution objective but, perhaps, even more fascinating, interest rate policy and even a preference for a specific composition of investment (and output) were all conceptually intertwined in Keynes's analytical framework. The ELR policy, on the other hand,

would be able to achieve admirably the strict target of full employment but only by creating a "buffer stock" of ELR workers that would be needed to keep an effective lid on wage inflation. Instead of a system tending towards Keynes's full-employment point *A*, we have a system that can be anchored anywhere within the range of points *A* and *B* in figure 3, consistent with a wide range of income distribution. As a result, this openness leaves room for competing views of ELR and perhaps, more importantly, it leaves entirely open the question of what type of income distribution. Furthermore, unlike Keynes's strong preference for public investment, the issue of the actual *composition* of ELR spending (and output) is also left completely open within the ELR analytics.

Some may see virtue in a policy that allows so much open-endedness. However, without providing clearer objectives, especially on the income distribution side (such as offering strong safeguards against the low-wage ELR variant), one might simply be recreating an ELR system that mirrors the present system. That is to say, we would merely have changed the status of the involuntary unemployed to that of an ELR worker, but the individual's role would be substantially the same —that of preventing wage inflation and the labour market from inching upwards closer toward point *A* in figure 3.

Finally, it is also for reasons pertaining to income distribution that an ELR system should not be brandished in the same way as GI systems are frequently presented, that is, as an all-purpose replacement of other existing social programs. It is quite evident why statutory minimum wages might be redundant under ELR, even though, as Papadimitriou (2000, p. 28) notes, one can conceive of certain market wages actually being situated even below the ELR wage; however, it is not clear why other social programs, such as unemployment compensation, would also disappear under ELR. With the political dangers that a low-wage ELR system be adopted, it would be important in this case that laid-off workers have a clear *choice* between ELR work and a multitude of existing institutional forms of social assistance in order to prevent any possible deflationary pressures from taking hold. Defenders of ELR have been more careful not to sell ELR in the

same way that GI systems have been marketed historically; but, this was not always so in some earlier presentations of what ELR is intended to replace (*cf.* Wray, 1997).

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