

Why HR 1000 Can Achieve Genuine Full Employment without Triggering an Inflationary Spiral

Feb. 8, 2015

Philip Harvey

Professor of Law and Economics, Rutgers University

pharvey@rutgers.edu

INTRODUCTION

The ability of HR 1000 to achieve genuine full employment (i.e., unemployment in the 1% to 2% range) assumes that the Fed would continue to pursue policies designed to prevent the unemployment rate (calculated as if HR 1000 job holders were unemployed rather than employed) from falling below the NAIRU level. In other words, HR 1000 is designed to mimic the labor market effects associated with the maintenance of unemployment at the NAIRU level, but with unemployed workers occupying temporary jobs (or participating in training programs) while they wait for private or regular public sector jobs to become available. .

The two premises underlying this approach to the problem of unemployment are (1) that even when GDP is at the NAIRU level the economy generates far fewer jobs than are needed to provide work for everyone who wants to work, and (2) that it is possible to design a direct job creation program capable of filling this job gap without generating harmful levels of inflation. There are four main ways in which this non-inflationary (or even anti-inflationary) job creation goal can be achieved, and all four are built into the design of HR 1000.

(1) Creating Jobs Without Adding to Aggregate Demand at the Top of the Business Cycle

The first of these design features is the ability of HR 1000 to create jobs without adding to aggregate demand at the top of the business cycle. This is possible because, unlike job creation attributable to increased business investment or increased government deficit spending, the jobs created by HR 1000 at the top of the business cycle would be fully funded on a contemporaneous basis by revenue generated by the HR 1000 financial transactions tax (“FTT”). In fact, because FTT revenues would generally exceed HR 1000 job creation expenditures at the top of the business cycle, the HR 1000 program as a whole would be fiscally deflationary at such times.¹

The opposite would be true, of course, during recessions. HR 1000 accordingly would perform the same automatic stabilizing function that the U.S. unemployment insurance program does. The only

¹ This analysis assumes that income spent purchasing securities (a transfer rather than a purchase of goods or services) either leads to or otherwise would result in consumption or (real) investment expenditures. That may not be the case, but oversaving is generally not a problem at the top of the business cycle and speculative financial investments in securities at such time is more likely to be a driver of than a substitute for real investment. That’s one reason FTT’s are advocated as a means of preventing unsustainable economic “bubbles.”

difference would be that instead of providing unemployed workers with unemployment insurance benefits, they would be provided temporary employment in jobs funded under HR 1000.

Historically, our only experience with unemployment below the NAIRU level has occurred in circumstances where the declining rate of unemployment has been attributable to growing aggregate demand. The deliberate use of fiscally neutral job growth to drive unemployment below the NAIRU level would be unprecedented, and while that very lack of experience makes it difficult to predict how much less inflationary this type of job growth would be compared to similar job growth attributable to an increase in aggregate demand, there can be little doubt that it would be less inflationary.

(2) Targeting Job Creation to Avoid Labor Shortages

The second feature of HR 1000 that would reduce its inflationary effect is the precise targeting of its job creation effect on unemployed workers. This would be in marked contrast to the tendency for market-based investment (and hence market-based job creation) to be concentrated in sectors of the economy that are “hot”—that is, those sectors of the economy which, at the top of the business cycle, are most likely to be experiencing labor shortages and supply bottlenecks.

HR 1000’s job creation effect would be distributed across regions, communities and economic sectors in exactly the opposite way. It would create jobs only where labor demand was slack rather than in the “hot” spots that attract market-driven investment. The result would be a tendency for employment rates to be leveled upward among communities, regions, and population groups—without adding to the demand for labor where it was already in short supply. In short, HR 1000 would not compete for scarce labor supplies, and this would diminish its potential inflationary impact.

Once again, it’s hard to say how much less inflationary HR 1000’s job creation effect would be due to this tendency—as compared to the inflationary tendency of the kind of job creation induced by market forces at the top of the business cycle—but we can be certain that it would be milder.

(3) Reducing Frictional and Structural Unemployment

The third characteristic of HR 1000 that would reduce its inflationary impact would be its tendency to reduce both frictional and structural unemployment in the economy. This tendency would follow from its heavy investment in job training (a third of all program expenditures), its likely effect on labor force participation rates, and its contribution to the efficiency of the economy’s job matching process. Each of these effects is discussed below.

Structural unemployment exists when jobs go begging (or are slow to fill) because job seekers lack the skills or other qualifications employers demand. During most phases of the business cycle structural unemployment is a marginal phenomenon. The larger the economy’s job gap the less likely it will be that significant numbers of jobs go begging for lack of qualified applicants. At the top of the business cycle, and especially when unemployment falls below the NAIRU level, structural

unemployment is more likely to constitute a real barrier to the achievement of genuine full employment and a contributing factor to rising rates of inflation due to shortages of qualified labor in certain occupations.

Providing unemployed workers with job training during recessions may provide long term benefits to the trainees, but it's unlikely to reduce aggregate levels of joblessness and runs the risk of embittering eager trainees who discover that there are few jobs available in the occupations for which they have trained. HR 1000 would address that problem by providing the graduates of training programs occupationally appropriate employment during recessions, until non-program jobs requiring their skills became available. At the top of the business cycle, especially when unemployment falls below the NAIRU level, training programs can satisfy a more immediate need by reducing the inflationary pressures associated with the emergence of excess demand for certain categories of labor. The fact that HR 1000 would allocate a third of its funding to job training programs accordingly qualifies as another of the bill's anti-inflationary features.

Frictional unemployment is joblessness caused by the time it takes for employers with job openings to fill and qualified job seekers with an interest in those jobs to find one another, assess one another, and conclude a hiring. While it is not one of HR 1000's stated goals to improve the efficiency of the job matching process, it would nevertheless have that effect; and a reduction in the level of frictional unemployment in the economy would tend to lower the NAIRU. Stated differently, it would have an anti-inflationary effect.

The principal source of HR 1000's beneficial effect on the efficiency of the job matching process would be a side effect of the function state employment services would perform in certifying the eligibility of job seekers for HR 1000 employment and in providing non-program employers access to the HR 1000 labor force for the purpose of recruiting new employees

To obtain access to jobs funded by HR 1000, unemployed workers would first have to register for and conduct a job search with the assistance of their state employment service; and they would be required to maintain their registration with the employment service and their availability for suitable non-program jobs for as long as they remained employed in an HR 1000 job. Performing this function would require a major investment of new resources in state employment services, of course, and this is one of the permissible uses of the job training account of the Full Employment Trust Fund HR 1000 would establish.

The information collected by state employment services via this registration process would result in the creation of a comprehensive data base of information concerning the qualifications, interests, work experience, training, and availability for work of the vast majority of job seekers in the United States, and the availability of this information would enable state employment services to quickly identify and refer qualified candidates to employment and training opportunities.

But would employers list their job openings with their state employment service? They would have to in order to gain access to the pool of job candidates working in HR 1000 jobs, enrolled in HR 1000

job training programs, or pursuing active job searches in order to qualify for employment in jobs funded by HR 1000—and that would include most potential job applicants for most job openings.

Once most job seekers and most job openings are registered with state employment services, both the job search process and the employee recruitment and vetting process would operate more smoothly and quickly. The nation's public employment service would finally be able to fulfill its potential as a clearing house for the efficient matching of job seekers and available jobs. The agony of the job search process would be eased for millions of job seekers every year, and the level of frictional unemployment would be reduced—thereby mitigating the economy's inflationary tendencies.

Finally, the enhanced efficiency and “user friendliness” of the economy's job matching process, combined with HR 1000's promise of assured employment and/or job training opportunities for all serious job seekers, would almost certainly increase in labor force participation rates. Job wanters would no longer be deterred from actively seeking work by the size of the economy's job gap and the frustrations of the job search process. They would know they could succeed in finding a job and that they wouldn't have to spend weeks pounding the pavement to do so. The result would be a higher proportion of job wanters actively seeking work, and that would mean overall employment levels could increase without a corresponding surge in the rate of inflation.

(4) The Buffer Stock Effect of HR 1000 Job Creation

The fourth way in which HR 1000 would counteract the inflationary tendencies normally associated with an unemployment rate below the NAIRU level is by insuring that persons employed in jobs funded under the Act remain available for non-program employment. Indeed, this is why HR 1000 includes language requiring persons employed in jobs funded under it to remain available for suitable non-program employment. The aim of this language is to preserve the inflation-fighting function of the economy's “surplus” labor force without requiring its members to actually suffer unemployment. And if that purpose is achieved—i.e., if the individuals employed in jobs funded by HR 1000 jobs remained just as available for non-program employment as they would have been if they remained unemployed—the program would have no inflationary effect whatsoever.

Legitimate questions can be raised, of course, as to whether persons employed in HR 1000 jobs would remain available for private sector employment without the whip of unemployment driving them to seek and accept whatever jobs are on offer. Could HR 1000's administrative requirements and the enhanced efficiency of the nation's public employment services provide an effective substitute for material want in insuring the continued availability of jobs program employees for private sector employment?

One reason for confidence on this score is that HR 1000 would enhance the employability of the reserve labor force it maintained. Unemployment may motivate workers to seek jobs, but it also has a tendency to degrade their “hard” skills, erode their “soft” skills, and make it harder for employers to judge the quality of their labor. This uncertainty is the principle reason employers discriminate in their hiring in favor of currently employed job applicants over unemployed job applicants. HR 1000

would improve the actual quality of the economy's reserve labor supply and, just as important, make it easier for employers to identify individual members of this reserve labor force who possess the qualities they are looking for.

The practical availability of individual workers for employment depends not only on the actions they take to communicate their availability to potential employers, but also on the actions employers take to identify, recruit, and evaluate potential candidates for employment. The quality of the information potential candidates for employment and employers have about one another is more important in this regard than whether it is the candidate for employment or the employer who initiates the contact. Because of the size and persistence of job shortages in market economies, employers tend to rely on job applicants to do the "heavy lifting" in making their availability for employment known. Put a sign in your window announcing that you are hiring, and job applicants appear as if by magic. This is not the only way labor markets can function. The role played by "headhunters" in the recruitment of employees possessing qualifications in short supply demonstrates that employers can adjust to the requirements of labor markets in which they must take the initiative to seek out and query the available of potential candidates for employment.

Yes, labor markets would work differently if HR 1000 succeeded in providing temporary work for virtually all members of the nation's reserve labor force. Those workers would not be out "pounding the streets" in search of work; and that means employers would have to play a more active role in identifying and reaching out to those who possessed the qualifications they were seeking. But that's how markets in genuine equilibrium should function, and HR 1000 would furnish employers with an institutional framework that would make it easy for them to step up their recruitment activities. They would no longer be able to get away with a sign in the window or a word to their existing employees that they had a job opening they wanted to fill, but they also wouldn't have to field a deluge of job applications. All they'd have to do is tell the state employment service what kind of workers they wanted to hire. The state employment service would identify appropriate candidates in the HR 1000 employee pool and provide contact information to both the employer and the HR 1000 employee along with relevant information about each of them to the other. The HR 1000 employee would know what kind of job was available, and the employer would have a list of suitably screened candidates for the job. Would this system insure the same level of "availability" on the part of HR 1000 employees as our existing reliance on the whip of unemployment? It's impossible to say for certain, but there is no reason to assume it wouldn't work as well—and it clearly would be preferable on non-economic grounds.

Another reason to doubt the adequacy of HR 1000's buffer stock effect to control inflation is the relative stability of HR 1000 wage rates. When a currently employed worker is offered a job of similar quality but which pays slightly more than their current job, the employee is likely to sound out their current employer as to whether the higher wage offer will be matched before deciding whether to accept the new job. This strategy would be unavailable to persons employed in jobs funded by HR 1000, because their wages would be fixed at a level matching the wages paid regular public sector employees who perform similar work. A desire to maintain existing relationships with co-workers, a commitment to the project on which they are working, a fear of the unknown, or simple inertia could still incline a worker to turn down the offer of alternative employment, but the force of those

considerations would be blunted to some extent by the high turnover of the HR 1000 labor force and the fact that HR 1000 would require them to show good cause for a refusal of the non-program job offer. And of course there are bound to be plenty of HR 1000 workers who don't love their job and would jump at the opportunity to "move up" to the private sector labor force.

The only employers who would face insurmountable difficulties in recruiting employees from the HR 1000 labor force would be those that paid substandard wages and/or provided their workers with substandard working conditions. There are such employers to be sure, but they tend to be concentrated in the low-wage sectors of the economy, and the fact that HR 1000 would apply pressure on them to pay their workers more and/or provide them with better working conditions would surely be viewed as an unalloyed advantage of the bill's job creation strategy—were it not for the fear that it would leave persons in the low-wage sector of the economy with no employment at all. HR 1000 would answer this concern by insuring the availability of temporary employment for these workers until the economy adjusted to a higher wage and working condition floor. Would this be inflationary? No more so than an increase in the statutory minimum wage—an intervention that has attracted a great deal of criticism because of its alleged effect on employment levels but little if any criticism as a contributor to inflation.

The One Inflationary Tendency HR 1000 Could Trigger

The preceding recital of the anti-inflationary features of HR 1000 should be reassuring. Taken together, they furnish strong grounds for believing that HR 1000 could push unemployment below the NAIRU level without causing untoward inflationary effects. There is, however, one characteristic of the HR 1000 strategy that could generate inflationary pressure. That is its effect on the bargaining power of labor. The issue is whether this would simply permit workers to claim a bigger share of national income than they now do—a trend most people would applaud—or whether it would trigger an inflationary spiral.

The possibility that HR 1000 could trigger a wage-price inflationary spiral by reducing unemployment below the NAIRU level is the reason an inflation circuit breaker has been added to the bill, the provisions of which are explained below. At the same time, however, it is important to understand how the fiscal neutrality and buffer stock effects of the HR 1000 full employment strategy would militate against the emergence of a wage-price spiral, and also why HR 1000 would not rob the Fed of its ability to stop such a spiral if it were to develop.

For wage increases to cause inflation, let alone trigger a wage price spiral, employers would have to be able to raise prices in response to the wage increase. The fact that the jobs HR 1000 created to push the unemployment rate below the NAIRU level would not be accompanied by an increase in aggregate demand would make this difficult. This means there would be no source of unsatisfied demand in the economy to drive supply-constrained prices up. A moderate increase in labor costs concentrated in low-wage industries—the likely near-term effect of HR 1000's job creation effect at the top of the business cycle, could and probably would be absorbed by low wage employers in the same way they respond to moderate increases in the minimum wage—with productivity enhancing changes in their methods of production or organizational structure and reduced profit margins until resource allocations in the economy adjusted to the new cost structure.

But why would the wage increases achieved by workers in the exceeding low unemployment environment HR 1000 would create be moderate? The answer to that question lies in the buffer stock effect of HR 1000 employment. Program wages would be administratively set at public sector wage levels; they would remain relatively stable at those wage levels; and the program's entire labor force would remain available for private sector employment at wages only marginally higher than the program wage scale. It's hard to see under those circumstances how employers could be forced to grant more than moderate wage increases.

Other than purely monetary wage-price spirals attributable to bad monetary policy, the only wage price spirals developed market economies have experienced have been kicked off by excess demand (caused, for example, by wartime spending) or by sudden shortages in key commodities (such as the oil shortage precipitated by OPEC's 1973 oil embargo). It's true, of course, that once started a wage price spiral may persist for some time—even through an economic contraction as happened in 1973-75 recession in the United States. Still, it's hard to imagine how a wage price spiral could be set off in the economic environment HR 1000 would create—an environment that included no increase in aggregate demand beyond the NAIRU level and the ready availability of a large labor reserve at relatively stable wage rates.

Finally, despite HR 1000's ability to protect workers from the ravages of unemployment, the Fed would retain the ability to stop an incipient wage-price spiral by tightening monetary policy. The only difference would be in the identity of the parties on whom the Fed's action would weigh most heavily. Under the existing policy regime, a tightening of monetary policy inflicts far more pain on workers than it does on employers. The result is that Fed intervention to stop an incipient wage-price spiral under the existing policy regime would likely stop the spiral on terms favorable to employers, as it did in the 1980s.

Under the HR 1000 policy regime this scenario would play out differently. If the fed tightened monetary policy, the resulting pain would be born mainly by employers. Instead of facing unemployment, laid off workers and new entrants to the labor force would have access to jobs funded by HR 1000, and their bargaining power would be only marginally weakened. Employers, on the other hand, would face increasing difficult raising prices in the face of either slowed growth or an absolute decline in aggregate demand. The result would be an end to the wage-price spiral on terms favorable to workers; and just as economic growth resumed in the 1980s with workers forced to accept a prolonged decline in their share of national income, so too could economic growth resume under the HR 1000 policy regime with employers facing the prospect of a declining share of national income for years to come.

Would there be a risk that the Fed's tightening of monetary policy would precipitate a downward spiral of declining GDP, increased job creation by HR 1000, continued upward pressure on wages because of the increased bargaining power of workers, more monetary tightening, a further decline in GDP, and so on? No, because wage growth would also be constrained by the slowdown (or reversal) in the rate of economic growth. Program wages would continue to be administratively set at stable levels. To obtain further wage increases, workers would have to win them from private sector employers, and their ability to do that would be constrained by the private sector's reduced demand for labor and the straitened circumstances of both public and private sector employers in a slowing economy. In other words, market forces would continue to constrain the wage setting process. Workers would enjoy more bargaining power than they previously had, but not enough power to precipitate the doomsday spiral of declining GDP described above.

The HR 1000 Inflation Circuit Breaker

If problematic inflationary tendencies emerged in the economy despite the anti-inflationary constraints described above, program hiring could be cut back and program wages could be frozen. That is what the statutory language set forth in Section 10 of HR 1000 is designed to do.

Section 10 would be activated whenever the seasonally adjusted inflation rate exceeded 3 percent and the seasonally adjusted unemployment rate fell below 4 percent. The 3 percent trigger is a percentage point above the Fed's inflation target of 2 percent and likely approximates the upper end of the range of inflation rates the Fed deems acceptable. The 4 percent trigger constitutes a reasonable approximation of the NAIRU.

Whenever both of these triggering conditions are satisfied simultaneously, Section 10 would activate a procedure that would permit quick action to curb HR 1000's possible inflationary impact followed by a public review of that action. This process would unfold as follows.

- (1) The Secretary of Labor would be required to make an initial determination as to whether there was good cause to believe that HR 1000 was playing a significant role in elevating the inflation rate above 3 percent and whether a reduction in HR 1000 hiring was needed to counter this trend.
- (2) If the Secretary makes such a determination s/he would be required to immediately issue an interim order freezing wages in jobs funded by HR 1000 and temporarily suspending new hiring to two of the four categories of persons eligible for employment under HR 1000. The two categories would be involuntary part time workers and persons receiving unemployment insurance benefits—because these two categories of job seekers have at least some alternative source of support. The two other categories of persons eligible for program employment—unemployed individuals who qualify as disadvantaged and unemployed individuals who have been looking for work unsuccessfully for 60 days—would not be subject to the hiring ban. The net effect of this partial hiring ban would be to reduce the pool of persons eligible for HR 1000 employment by about 50 percent. Persons already employed in jobs funded by HR 1000 would not be forced out of their jobs, but if their employment ended for other reasons they would be subject to the same hiring restrictions.
- (3) At the same time this interim order was announced (and 7 days before it became effective) a comment period of 30 days would be opened during which the public would be afforded the opportunity to comment in favor of or against the continuation of the Secretary's interim order.
- (4) At the end of the comment period the Secretary would be required to confirm, revoke, or modify the interim order and justify that decision in light of the arguments advanced by the public during the comment period.
- (5) To expedite the decision-making process contemplated by this procedure, Section 10 makes it clear that no review of the Secretary's order by the OMB would be required (It shouldn't in any case) and no other impact statement otherwise required by law would have to be prepared (none should in any case).

The rest of Section 10 addresses collateral issues and makes clear the permissible parameters of any order issued under the section's authority.

Section 10(f) would give the Secretary authority to shift funds from the job creation account in the Full Employment Trust Fund to the job training account if additional funds were needed to insure the availability of job training opportunities for all persons whose eligibility for employment under HR 1000 was being suspended.

Section 10(g) would give persons whose eligibility for HR 1000 jobs had been suspended the right to appeal for individual hardship exemptions from order's effect.

Section 10(h) would make it clear that neither the interim nor the final order issued by the Secretary could require the early termination of the employment of persons already occupying HR 1000 jobs.

Section 10(i) would make it clear that new hires of persons other than UI recipients and involuntary part-time workers could not be suspended.

Section 10(j) would make it clear that the Secretary's authority to freeze wage rates in the program did not extend to ordering wage reductions.

Section 10(k) would give the Secretary authority to exempt grant recipients (i.e., the providers of HR 1000 jobs) from the hiring and/or wage freeze to the extent necessary to enable the job creation project(s) they administer to continue to operate. This would be necessary, for example, if certain jobs had to be filled for the project to continue and those jobs could not be filled from the remaining pool of persons eligible for program employment.

Section 10(l) makes it clear that any hiring or wage freeze ordered pursuant to the section would automatically expire if the unemployment rate rose above 4% and/or the rate of inflation fell below 3 percent.