COMMITMENT TO FULL EMPLOYMENT

The Economics and Social Policy of William S. Vickrey

AARON W. WARNER
MATHEW FORSTATER
SUMNER M. ROSEN
Editors

M.E. Sharpe
Armonk, New York
London, England
Contents

Selected Tables, Figures, and Charts vii

Foreword The Trouble with Capitalism ix

Robert Heilbroner

Acknowledgments xiii

Introduction Commitment to Full Employment: Macroeconomics and Social Policy in Memory of William S. Vickrey xv

Aaron W. Warner

William S. Vickrey xxix

Chapter 1 Savings-Recycling Public Employment: Vickrey’s Assets-Based Approach to Full Employment and Price Stability 3

Mathew Forstater

Chapter 2 (Full) Employment Policy: Theory and Practice 17

Dimitri B. Papadimitriou

Chapter 3 Direct Job Creation 35

Philip Harvey

Chapter 4 Vickrey, Macro Policy, and Chock-Full Employment 55

David Colander

Chapter 5 The Simple Theory of Unemployment 69

Edward J. Nell

Chapter 6 Fuller Employment: William Vickrey’s Challenge to Economists 89

C. Lowell Harriss
Chapter 7  Full Employment and the Future of the Welfare State  
*Gertrude Schaffner Goldberg*  
99

Chapter 8  A Humanistic Concept of Full Employment Transcends the Welfare State  
*Helen Lachs Ginsburg*  
118

Chapter 9  Economics and the Welfare State  
*Sumner M. Rosen*  
125

Chapter 10  Rethinking Full Employment: Unemployment, Wages, and Race  
*Heather Boushey*  
129

Chapter 11  Commitment to Full Employment in a Global Economy  
*Paul Davidson*  
156

Chapter 12  Why a Global Clearing Union Based on Fixed Exchange Rates Won’t Work: A Response to Paul Davidson  
*Thomas I. Palley*  
174

Chapter 13  Employment and International Financial Markets  
*John Langmore*  
179

Chapter 14  The Keynesian Economics of Unemployment and Inequality  
*James K. Galbraith*  
182

Chapter 15  We Need a Bigger “Deficit”  
*William S. Vickrey*  
189

Chapter 16  Fifteen Fatal Fallacies of Financial Fundamentalism: A Disquisition on Demand Side Economics  
*William S. Vickrey*  
193

About the Contributors  
219

Index  
223

---

**Selected Tables, Figures, and Charts**

---

**Tables**

<table>
<thead>
<tr>
<th>Table</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1</td>
<td>Cost of the Model Wage Subsidy Plan</td>
<td>25</td>
</tr>
<tr>
<td>10.1</td>
<td>Mean Earnings per Week by Race and Gender, 1986–1996</td>
<td>143</td>
</tr>
<tr>
<td>10.2</td>
<td>Educational Attainment by Race and Gender, 1986–1996</td>
<td>143</td>
</tr>
<tr>
<td>10.3</td>
<td>Unemployment in the 50 Largest Metropolitan Areas in the United States, 1986–1996</td>
<td>144</td>
</tr>
<tr>
<td>10.4</td>
<td>Nonemployment in the 50 Largest Metropolitan Areas in the United States, 1986–1996</td>
<td>145</td>
</tr>
<tr>
<td>10.5</td>
<td>Wage Curve with Aggregate Unemployment</td>
<td>147</td>
</tr>
<tr>
<td>10.6</td>
<td>Wage Curve with Aggregate Nonemployment</td>
<td>147</td>
</tr>
<tr>
<td>10.7</td>
<td>Wage Curves with Aggregate Unemployment, by Group</td>
<td>149</td>
</tr>
<tr>
<td>10.8</td>
<td>Wage Curves with Aggregate Nonemployment, by Group</td>
<td>149</td>
</tr>
<tr>
<td>11.1</td>
<td>Real GDP (annualized growth rate)</td>
<td>159</td>
</tr>
</tbody>
</table>

**Figures**

<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1</td>
<td>Estimated Number of Jobs Needed to Achieve Full Employment, 1977–1986</td>
<td>37</td>
</tr>
<tr>
<td>3.3</td>
<td>Estimated Number of Officially Unemployed Persons Per Job Vacancy, Scattered Surveys 1964–1994</td>
<td>47</td>
</tr>
<tr>
<td>10.1</td>
<td>Labor Force Participation, Males by Race</td>
<td>130</td>
</tr>
<tr>
<td>10.2</td>
<td>Unemployment by Education and Race, September 1997 and 1998</td>
<td>131</td>
</tr>
<tr>
<td>10.3</td>
<td>Wage Curves: Aggregate Nonemployment Elasticities, by Race</td>
<td>147</td>
</tr>
</tbody>
</table>
1

MATHEW FORSTATER

Savings-Recycling Public Employment

Vickrey’s Assets-Based Approach to Full Employment and Price Stability

William Vickrey’s single-minded commitment to full employment is evident in a series of papers written in the last years of his life (Vickrey 1992a, 1992b, 1993a, 1993b, 1993c, 1994, 1996, 1997). In this work, Vickrey formulated an assets-based approach to macroeconomic analysis with definite implications for budgetary and employment policy. In Vickrey’s approach, the difference between desired and actual holdings of net financial assets—or net nominal savings—is the crucial relation in understanding macroeconomic processes, and the government budget is the key policy instrument in the necessary recycling of net nominal savings to bring the desired and actual levels into equality at the full-employment level of output and income. Vickrey believed that the major task for economists and policymakers was to devise the means whereby the necessary recycling of net nominal savings can take place without unexpected changes in the rate of either inflation or deflation. This paper explores Vickrey’s proposal for government deficit-financed guaranteed public employment as an automatic stabilizing policy instrument capable of serving as just such a means.

Vickrey’s Commitment to Full Employment

For Vickrey, 1926 was the last time there was an acceptable level of employment during peacetime in the United States (Vickrey 1994, 39). He embraced the William Beveridge definition that full employment holds when “there are at least as many unfilled job openings as there are unemployed individuals seeking work” (Vickrey 1993a, 1). Elsewhere, he describes full employment—what he called “chock-full employment” (Vickrey 1992b, 1994)—as the situation in which individuals “can find work at a living wage within 48 hours”
employment without unstable prices is a priority. But it does not follow from this necessity that inflation is a greater evil than unemployment. In Vickrey's view, while inflation is a "redistribution of the given total output . . . unemployment involves a reduction in the total product to be distributed" and therefore clearly does greater social harm (Vickrey 1992b, 341). In fact, the greatest dangers of inflation for Vickrey turn out to be the measures taken to control it, that is, enforced unemployment: "[Political maintenance] of unemployment as a prophylactic measure against a highly problematic threat of mismanaged inflation is a cure far worse than the disease" (Vickrey 1997, 505).

Vickrey scolded the economics profession and policymakers for what he saw as time wasted in arguing "over which foot is the better to shoot ourselves in" (Vickrey 1993b, 3). Extolling the benefits of full employment, he urged his colleagues, and anyone willing to listen, to immediately focus their "concentrated attention to working out the practical details and bringing the concept to realization" (Vickrey 1992b, 345). Vickrey himself led by example, racking his brains throughout his life to lay bare the fundamental causes of unemployment and devise the means of its elimination. These un- tiring efforts yielded his assets-based approach to macroeconomics, with its implications for the government deficit-financed recycling of net nominal savings, and it is to this work that I now turn.

Savings and Investment: Toward an Assets-Based Approach to Macroeconomics

Vickrey's assets-based approach to macroeconomics is rooted in the analysis of savings and investment. In orthodox neoclassical theory, savings determines investment through variations in the rate of interest. Thus, income not consumed is transformed into investment expenditure in the market for loanable funds. It is this mechanism that, under perfect competitive conditions, ensures that all output will be purchased at the full-employment level of output and income. Vickrey rejected such a view, which he identified as the heart of "Say's Law," and targeted for rebuttal the implication that economic growth is achieved by promoting an increase in savings (Vickrey 1993c, 6).

Vickrey casts doubt on the conventional view of the interest-elastic nature of both savings and investment:

On the one hand, the demand for asset accumulation and the supply of savings have become relatively insensitive to interest rates and may even have developed an inverse relationship as lowered interest rates increase the amount of assets required to provide a given level of old-age security. On the other hand, high risk, obsolescence, maintenance, and other user costs
have diminished the long-run responsiveness to interest rates of investment in
productive assets. The implicit assumption of the neoclassical paradigm that
the potential for profit-seeking capital investment would expand without limit
as real interest rates fell, so that there would always be an interest rate that
would close the gap, fails in the face of the reality of uncertainty concerning
conditions that will obtain in the remote future. (Vickrey 1997, 498)

Thus, both the positively sloped neoclassical saving function and the down-
ward-sloping interest-elastic demand curve for investment are brought into
question in Vickrey’s analysis.

Key to understanding the savings-investment relation is comprehension
of the two-sided nature of saving and spending:

[Most economic transactions have at least two aspects, and much of our
present plight is the result of looking at only one aspect and failing to
follow through on the opposite aspects and their consequences. Nowhere is
this more apparent than in the popular discussions of the levels of saving
and capital formation and their impact on the health and growth of our
economy. (Vickrey 1993c, 5)

Savings is income not spent. It is, in Vickrey’s word, “nonspending”
(Vickrey 1993b; 1993c, 5; 1994). Increased savings is therefore an increase
in nonspending, most often in the form of a reduction of consumption, and
this causes the income of others to fall. This in turn leads those experiencing
falling incomes to reduce their own savings. Vickrey liked to demonstrate this
principle with his now well-known story of abstaining from an $8 haircut:

Savings are not like a sack of potatoes which if not sold at the current price
will stay on hand and put a downward pressure on the price until sold.
Savings not immediately taken up to create capital simply vanish in re-
duced income, without even exerting a downward pressure on interest rates.
If I yield to the allures of tax concessions to IRA: As the point of not
having my hair cut, this puts $8 more in my bank account, but $8 less in the
barber’s account; there is nothing that makes it any easier for anyone to
obtain funds with which to create capital, nor anything that makes the pros-
pect more attractive. . . . If the barber reacts to curtailing his consumption,
this further reduces national income and saving. I may succeed in my at-
ttempt to save, but only by reducing the saving of others by even more.
Savings are an extremely perishable entity. Say’s law fails as soon as part
of the income generated in the process of producing the supply is shunted
off into new savings that fail to get converted into new capital goods.
(Vickrey 1993a, 6)

Not only has the increased saving not been translated into investment, but the
decline in aggregate demand that results may further impact investor expecta-
tion so that investment may actually be discouraged (Vickrey 1993b, 2).

For Vickrey, the causality runs in the opposite direction, from investment
to savings:

[If some genius invents a new product or process and obtains a credit or
borrows the funds needed to finance the capital involved in its production,
this added real wealth is, ipso facto, someone’s savings. Instead of Say’s law,
we have “Capital formation creates its own saving.” (Vickrey 1993a, 6)

Thus, investment determines savings and the mechanism that brings them
into equality is not variations in the interest rate but, rather, changes in the
level of income:

Attempted saving, with corresponding reduction in spending, does noth-
ing to enhance the willingness of banks and other lenders to finance ade-
quately promising investment projects. With unemployed resources avail-
able, saving is neither a prerequisite nor a stimulus to, but a consequence
of capital formation, as the income generated by capital formation pro-
vides a source of additional savings. (Vickrey 1996, 5)

Vickrey’s analysis of the investment-saving relation leads him to view
private-sector investment as a means whereby savings is recycled back into
the income stream. (Of course, the savings would not exist without some
initial investment.) It is a means whereby nonspending is turned into spend-
ing. If the entirety of the full-employment level of savings is not recycled
into spending by private investment, some of the full-employment level of
output fails to be justified by actual sales, and disappointed businesses cut
back production, laying off workers. Incomes of the unemployed fall, and
saving declines until it is brought into equality with the below-full-employ-
ment level of private investment. In other words, Vickrey’s analysis of the
savings-investment relation leads him to focus on the crucial issue of the
recycling of net nominal savings.

Net Nominal Savings and the Savings-Recycling
Government Budget

Another way of stating the problem is to focus on the relation between the
desired and the actual levels of holdings of net financial assets, or net nomi-
nal savings. If, at the full-employment level of output, “the total asset supply
held by individuals falls short of what they desire to hold, the curtailing of
expenditures by individuals in an attempt to bring their net worth up to a
desired level will reduce sales, production, employment, and GNP until the
corresponding demand for assets has been reduced to the available supply”
(Vickrey 1997, 497–498). Vickrey believed that there are social, institutional,
and technological reasons for a growing gap between the private demand
and private supply of assets, and that private investment cannot be relied
upon to recycle the full-employment level of savings. Unemployment is the
real, material evidence of a discrepancy between desired and actual levels of
net nominal savings, for if the desired level was lower, individuals would be
spending more, sales would be higher, and firms would be hiring more workers.

For Vickrey, there is only one solution to closing the gap between desired
and actual levels of net nominal savings: government deficits. If we consider
the problem from an assets-based approach, it is clear why this is in fact the
case: There is no other source of change in the private sector’s total holdings
of net financial assets (in dollars). One private-sector individual’s desire to
increase his holdings of net financial assets can only be realized if another
individual is willing to decrease her holdings by the corresponding amount.
The private sector is incapable of creating net nominal assets. Thus, Vickrey
concludes, there is “no adequate solution without long-term and continued
increases in government debt” (Vickrey 1997, 499); “The ‘deficit’ is not an
economic sin but an economic necessity” (Vickrey 1993b, 1).

While many have promoted the use of a capital budget by the federal
government, for Vickrey, this is beside the point, even though he considered
that there might be political or ideological reasons why capital budgeting
might make deficits more palatable:

The savings-recycling budget is possibly the most important of budgetary
concepts from the standpoint of day-to-day policy. This budget would reflect
the effect of government outlays... in recycling savings, in excess of those absorbed by private investment, into the stream of demand for output. It is the crucial element in curbing the business cycle and bringing employment of resources up to a satisfactory level. From this standpoint, it matters relatively little whether outlays are for current or for capital-account items. (Vickrey 1992a, 307)

In fact, if government investment replaced private investment, the net
effect desired might be offset, while the income-recycling function itself would
be served just as well from projects with no other justification (Vickrey 1993a,
6). Despite the crucial importance of grasping this point, Vickrey did note
that government investment that spurs further private investment, or other-
wise benefits the public, refutes the argument that the national debt is a bur-
den on future generations. He argues instead that much of the activity undertaken for the purpose of recycling savings “will form part of the real heritage left to the future” (Vickrey 1996, 4). Because savings-recycling through government deficits permits chock-full employment economic growth, “[i]t means an increased heritage of real capital plant and equipment, to say nothing of the human capital induced by fuller employment” (Vickrey 1997, 509).

Neither is the savings-recycling deficit something that can be “balanced over the cycle” (ibid. 499): “The supply of government securities will need to grow pari passu with the gross domestic product, to correspond to the gap between the demand of the population for assets and the provision of assets by the private sector” (Vickrey 1993b, 1). It must be emphasized that this is not a “closed economy” argument, the foreign sector—including foreign government, firms, and individuals—is included in the private demand for assets. As Vickrey recognized, exporting unemployment through “export surpluses... is essentially a beggar-my-neighbor policy not available as a general policy” (Vickrey 1997, 499). While Americans could indeed save net dollar assets with a trade surplus, this would only be temporary, as the resulting worldwide dollar squeeze would cause the government deficit to rise.

In promoting the need for savings-recycling government deficits and a
-growing national debt, Vickrey rejected many of the common myths and
misconceptions concerning deficits and the debt held by the economics pro-
-fession and politicians, and repeated ad nauseam by the press (Vickrey 1994;
1996). These include the assertions, unsupported by either careful analysis
or the historical record, that deficits cause inflation or high interest rates, or
crowd out private investment. Vickrey points out that not only have deficits
and the national debt not resulted in these harmful effects, but that the “exis-
tence of large government debt may be one reason we have not had a recur-
rence of a depression of the severity of the 1930s” (Vickrey 1997, 508–509):

To assure against such a disaster and start on the road to real prosperity it is
necessary to relinquish our unreasoned ideological obsession with reduc-
ing government deficits, recognize that it is the economy and not the gov-
ernment budget that needs balancing in terms of the demand for and the
supply of assets, and proceed to recycle attempted savings into the income
stream at an adequate rate, so that they will not simply vanish in reduced
income, sales, output and employment. There is too a free lunch out there,
indeed a very substantial one. But it will require getting free from the dog-
mas of the apostles of austerity, most of whom would not share in the
sacrifices they recommend for others. Failing this, we will all be skating on
very thin ice. (Vickrey 1996, 32)
Vickrey’s assets-based approach to macroeconomic analysis elucidates the fundamental relation between desired and actual net nominal savings and offers it as the key to understanding the problems of persistent unemployment. Furthermore, it leads straight to the conclusion that the savings-recycling deficit is the only way to close the gap and bring the desired and actual levels of net holding of financial assets into equality at the full-employment level of output and income. “An economy with ten percent inflation and two percent unemployment would be far healthier in human terms than one with one percent inflation and eight percent unemployment.” But fortunately, such a trade-off is not necessary, as unemployment is not needed to keep prices stable (Vickrey 1997, 505). Vickrey did feel, however, that a “new tool is needed” to complement fiscal and monetary measures if we are to accomplish the three macroeconomic goals of promoting full employment, stable prices, and economic growth (Vickrey 1993a, 7). A number of proposals have been made for government to promote full employment through direct job creation (Minsky 1986; Lowe 1988; Harvey 1989; Collins et al. 1994; Gordon 1997). Recently, several proposals have explicitly highlighted the ways in which such guaranteed public employment can serve as an effective automatic stabilizer by recycling savings through government budget deficits in just the manner proposed by Vickrey (Mosler 1997–1998; Mitchell 1998; Wray 1997; 1999).

Savings-Recycling Public Employment

We have seen that Vickrey’s chock-full employment means more vacancies than individuals seeking work, and a situation in which workers can find a decent job at a living wage within forty-eight hours. We have also seen that Vickrey considered a means to full employment without inflation a top priority for economists and policymakers. In addition, Vickrey felt that pursuing these three macroeconomic goals with only two policy instruments is like “trying to fly an airplane without ailerons . . . the third dimension of control that was the key to the success of the Wright brothers.” In his view, a new tool is needed (Vickrey 1993a, 7). We must devise a means of promoting chock-full employment without unexpected changes in the rate of inflation or deflation and must “fill the gap between the asset aspirations of individuals at this level of income and the ability of the private sector to provide assets” through savings-recycling deficits (Vickrey 1993b, 1). “There is no reason inherent in the real resources available to us why we cannot move rapidly . . . to a state of genuinely full employment and then continue indefinitely at that level” (Vickrey 1993a, 10).

Vickrey rejected the draconian “workfare” that is not combined with increases in aggregate demand:

[A]tempts to move selected unemployed individuals or groups into jobs by training, instruction in job search techniques, threats of benefit withdrawal or denial and the like, merely move the selected individuals to the head of the queue without reducing the length of the queue. Merely because any one traveler can secure a seat on a flight by getting to the airport sufficiently early does not mean that if everyone gets to the airport sufficiently early, 200 passengers can get on a flight with seats for 150. (Vickrey 1996, 27)

But when financed by deficit spending, public employment “can indeed” result in net job creation (Vickrey 1996, 28). The key, then, is to combine guaranteed public-sector employment with the savings-recycling government budget in what we here call “savings-recycling public employment,” but which has elsewhere been termed “buffer-stock employment” by Mitchell and “government as employer of last resort” (ELR) by Mosler, Wray, and others (Mitchell 1998; Mosler 1997–1998; Wray 1997; 1999).

In this approach, the government pledges to hire anyone ready and willing to work at a basic public-sector (living) wage, and the wage bill is paid for by deficit expenditure. Since unemployment is the physical evidence of desired levels greater than actual levels of net holdings of financial assets, deficit spending fills the gap by employing the unemployed. This eliminates the problem of estimating the needed level of government deficit spending, as it is reflected in the number of unemployed showing up for government guaranteed jobs. As long as the desired holdings of net financial assets is greater than the actual holdings, there will be unemployed. As the unemployed show up for public employment, the deficit will expand to pay the public employment wage bill, recycling the excess of savings over private-asset supply, and closing the gap between the desired and actual levels of net nominal savings at chock-full employment. An ELR scheme that is deficit-financed thus serves as a powerful automatic stabilizer, simultaneously guaranteeing an infinitely elastic demand for labor and the recycling of excess savings.

As Vickrey emphasized, savings-recycling public employment must not replace either private-sector or other public-sector employment. Under such a program, all the benefits of full employment outlined by Vickrey are obtained, and the social and economic costs of unemployment substantially eliminated. To the extent that savings-recycling public employment involves the enhancement of worker skills, the benefits of the program as a means of job training are actualized. While the retraining effect may prove “essential in abating structural mismatch between job requirements and individual qualifications,” net job creation means the program is not simply a cruel game of musical chairs (Vickrey 1993c, 9). Considering these factors, Vickrey also
predicted an increase in “the wages and status levels” of the lowest skilled and least well paid (ibid.).

Savings-recycling public employment will not generate deficits that will be inflationary, since the deficit will only be permitted to expand up to the point where the gap between desired and actual holdings of net financial assets is filled at zero involuntary unemployment, which corresponds to the degree to which aggregate demand falls short of the level corresponding to chock-full employment. While increasing deficits beyond that point might be inflationary, there will be at that point no more unemployed workers showing up for savings-recycling jobs, and so the scheme includes a built-in feature preventing the deficit from becoming too large. At the same time, although Vickrey recognized that, depending on the value of the initial savings-recycling public employment wage-benefits package set, “a small one-time increase in the overall price level” might be expected at the start of the program, this is in no way the same thing as “an inflationary spiral” (Vickrey 1997, 505). Other features of the program additionally guarantee against unexpected changes in the rate of inflation—which, as Vickrey emphasized again and again, is what we should have as an actual concern, as opposed to a fear of some vague notion of inflation.

First, savings-recycling public employment may be directed toward public works such as infrastructure revitalization that may promote private-sector productivity growth. Second, productivity will also be enhanced by virtue of the fact that, while unemployment is associated with the depreciation of human capital, savings-recycling public employees will experience an appreciation of skills and knowledge. Third, in addition to the decrease in the social and economic costs of unemployment, savings-recycling public employees may be engaged in activities that help reduce other social costs, such as environmental protection and cleanup. Fourth, the increase in expenditure on savings-recycling public employment will be at least partially offset by decreases in other forms of expenditure on the unemployed. Thus, expenditures on unemployment insurance and other forms of general assistance should be expected to decline. Fifth, public works tend to be less inflationary than “the dole” because the former increases both supply and demand, while the latter increases only demand. Sixth, inflationary bottlenecks and structural rigidities associated with high levels of employment can be avoided with the savings-recycling approach. Workers employed in savings-recycling public employment are still available to the private sector should the demand for labor rise, maintaining numerical flexibility without the social and economic costs of unemployment. In addition, flexibility in terms of capital goods and natural resources is maintained, as government can strategically choose to utilize methods of production and types of resources that will avoid bottlenecks and even enhance system flexibility (Forstater 1998; 1999). Seventh, firms may still be expected to maintain planned reserve capacity to meet both peak and unexpected increases in demand, so that full employment of labor will be consistent with a “normal level of capacity utilization.” Eighth, since government is willing to hire at as few or as many people who want to work at the savings-recycling public employment wage, it is free to set that wage exogenously rather than paying a market-determined wage. Being fixed, the program’s wage is perfectly stable and sets a benchmark price for labor. It is obviously unlikely that unexpected changes in the rate of inflation will be due to wage-related factors under such a system. In fact, the exogenous pricing component of the savings-recycling public employment approach may be seen as a means of defining the national currency in terms of fairly homogeneous low- or semi-skilled labor. The program wage thus serves as an anchor to which the currency is tied. Because labor is a basic commodity, employed directly and indirectly into the production of every other commodity, the savings-recycling public employment program offers a mechanism for regulating the value of the currency and thus controlling the price level. In this sense, the savings-recycling public employment approach resembles a commodity buffer-stock scheme; only here it is labor that is being used as the buffer-stock to stabilize the currency.

Savings-recycling public employment is an automatic stabilizing policy instrument that can ensure chock-full employment, generating the savings-recycling deficit necessary to equate the desired and actual levels of net holdings of financial assets as prescribed by Vickrey’s assets-based approach to macroeconomic analysis without the danger of unexpected changes in the rate of inflation. Guaranteed public employment establishes the infinitely elastic demand for labor required to meet the Vickrey-Beveridge definition of chock-full employment, and financing such employment through deficit spending guarantees the recycling of excess savings necessary to bring the desired and actual levels of holdings of net financial assets into equality at the zero-involutary-unemployment level of economic activity. A number of features of the approach establish it as not only a viable means to true full employment, but a tool for price stability as well.

Vickrey’s analysis was heavily influenced by the state of affairs existing around the time of the recession of the early 1990s. What are the implications of this work for more recent developments in the United States—and the global economy generally—as we prepare to enter the next millennium?

Vickrey’s Macroeconomics and the Current Situation

In retrospect, Vickrey’s articles from the early and mid-1990s seem incredibly prescient, as relevant to the situation in the late 1990s as they were when
they were written. We have seen that this work emphasizes the increasing inability of governments to rely on conventional monetary policy to counter recessions and depressions, due in no small part to the insensitivity of investment to lower interest rates. One need only cite the recent experience of Japan, where interest rates near zero did nothing to budgie the economy out of its deep downturn. Vickrey’s further related observation, also cited above, concerning the association of lower interest rates with higher rates of saving, also appears to be supported by the Japanese experience.

Vickrey was skeptical of the conditions of the European Monetary Union (EMU), and utilized that case to express a more general concern about the desirability of fixed versus flexible exchange rate policies:

Freely floating exchange rates are the means whereby adaptations are made to disparate price level trends in different countries and trade imbalances are brought into line with capital flows appropriate to increasing the overall productivity of capital. Fixed exchange rates or rates confined to a narrow band can be maintained only by coordinated fiscal policies among the countries involved, by imposing efficiency-impairing tariffs or other restraints on trade, or by imposing costly disciplines involving needlessly high rates of unemployment as is implied by the Maastricht agreements. (Vickrey 1996, 15)

As Vickrey recognized, a successful domestic full-employment policy requires flexible exchange rates: “Restraints on exchange rates, such as are involved in the Maastricht agreements, would make it virtually impossible for a small open economy, such as Denmark, to pursue an effective full-employment policy on its own” (ibid. 16).

Vickrey’s articles were written in the context of government budget deficits, private-sector surpluses, and trade deficits in the United States, and it has been noted that he believed institutional, historical, and social factors supported the view that private-sector surpluses were likely to continue and even grow. He thus warned against the growing calls for budget balancing, decreasing the deficit, and even running budget surpluses to pay down the national debt. In the late 1990s, the tightening fiscal stance has come to pass, coupled with a deterioration in the position on foreign trade, with the result that the private sector has actually gone into deficit.

The private sector may be divided into firms and households and, since firms have been able to maintain a surplus, it is households that have gone into deficit, with household savings exceeding incomes at record levels (Godley and Wray 1999). This has been due to credit-financed spending by households, supported by sharp rises in stock market prices. Vickrey noted the possibility of such a scenario and warned against this means of closing the gap between desired and actual levels of net holdings of financial assets: “Meeting the demand for assets by a speculative boom in stock market and other assets prices is a temporary bubble solution that is bound to burst with catastrophic consequences” (Vickrey 1997, 499). Vickrey further warns that this is particularly dangerous when combined with budget balancing, a condition that the current scene shares with the Great Depression:

There is a serious danger that the bidding up of asset prices could create a bubble of unsustainable values that is likely to collapse disastrously, as occurred in 1929 after the budget surpluses of the preceding years. Sooner or later a reduction in production and national income will set in until the reduction in income reduces the demand for assets to conform to the supply. (Vickrey 1993b, 2)

Whether precipitated by a “correction” in the stock market, a drying up of easy credit for American consumers, further instability in Asia, Latin America, or Russia, or problems related to the EMU, the United States is woefully ill-prepared for the next economic downturn. As Vickrey’s analysis makes clear, conventional fiscal and monetary policy is not sufficient to deal with a significant reduction in output and income and rising unemployment. Fortunately, Vickrey’s analysis demonstrates that a savings-recycling public employment plan could provide the automatic stabilizer that the system requires to deal with the macroeconomic challenges of modern society. We can have chock-full employment with price stability if our economic experts and political leaders can exhibit clearheaded, common-sense thinking and the courage of their convictions. They need look no further than Bill Vickrey for an outstanding example in both these regards.

References


DIMITRI B. PAPADIMITRIOU

(Full) Employment Policy

Theory and Practice

Unemployment cannot be conquered by a democracy until it is understood. Full productive employment in a free society is possible but it is not possible without taking pains. It cannot be won by waving a financial wand; it is a goal that can be reached only by conscious continuous organization of all our productive resources under democratic control. To win full employment and keep it, we must will the end and must understand and will the means

(Beveridge)

Introduction

Writing in the 1940s, William Beveridge defined full employment as a labor market in which the number of job vacancies would be higher than the number of jobless (Beveridge 1945), a condition that would guarantee no long-term unemployment. What Beveridge envisaged was achieved in the immediate postwar years, but, alas, was not sustained during the past two or even three decades. Differing from the past three decades, however, the United States economy appears currently to have reached full employment with low and stable inflation. Low unemployment rates, however, as conventionally measured, cannot tell the entire unemployment story. The Bureau of Labor Statistics regularly reports that the flows among the categories “officially unemployed,” “employed,” and “out-of-the-labor-force” are very large. In August 1999, for example, of those unemployed, 44.6 percent were joblosers, 13.9 percent were job-leavers, and 41.5 percent came from out of the labor force. Those who find jobs typically come from the out-of-the-labor-force category. Of the 68 million people in this category, 4.74 million wanted