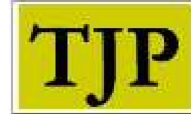
Full employment, why not?



By Byron A. Ellis - January 27, 2014

Full employment occurs when all or nearly all persons willing and able to work at prevailing wages and working conditions can find jobs. Full employment, however, shifts bargaining advantages from employers to workers.

In developed countries, after the 70s, full employment policies were no longer pursued. Mainly because economists, such as Milton Friedman and Robert Lucas, Jr., attacked Keynesian ideas and substituted the full employment goal with the concept of natural rate of unemployment.

Friedman and Lucas argued that Keynesian policies were useless against inflation; since, Keynesian prescriptions would lead to low rates of involuntary unemployment. Thus, for Friedman and Lucas, low rates of involuntary unemployment, below the “natural rate of unemployment,” cause inflation. The natural rate of employment, however, is a Friedman invention and there is nothing natural about it.

Many mainstream economists, as well as politicians, on both sides of the aisle, continue to argue that involuntary unemployment is due to structural problems and not lack of effective demand. As their predecessors, they claim that insufficient employability is due to lack of technical qualifications; and, argue for retraining programs.

However, it does take a lot of understanding to know that even trained PhDs, engineers, accountants and lawyers remain involuntarily unemployed or underemployed in economies that do not generate full employment.

Involuntary unemployment occurs when the amount of goods and services produced are less than the amount required to employ all those willing and able to work. Thus, effective demand is insufficient to increase production to the level of, or near, full employment.

Therefore, it is effective demand that leads to full employment. Thus, it is false to argue that businesses create employment and that with more training the involuntarily unemployed will find jobs. Employees cannot find jobs when jobs are not available and employers will hire and train if there is high demand for their products and services.

It is the expectation of high levels of consumption that leads entrepreneurs and businesses to expand production and hence jobs. Nonetheless, consumers can only increase consumption when their incomes are rising.

Consumers’ income rise when in-country currency in circulation is increasing. However, many economics studies, such as Porter and Judson, indicate that a high percentage of US currency is held abroad.

If a large percentage of US currency is circulating abroad, it is unlikely that in-country currency in circulation is appropriate to create effective demand that leads to full employment.

Ironically, the Federal Reserve claims not know with certainty the share of US currency circulating abroad. But, despite not knowing, Fed officials restrict monetary aggregates, which causes the economy to reach an equilibrium level below full employment.

As a result, full employment cannot be decoupled from the appropriate flow of money in circulation. Thus, when politicians and government officials talk about job creation and exclude credit (currency in circulation) expansion, they are not credible. Economies cannot expand if currency in circulation is stagnant or diminishing.

It is bank credit (putting money in circulation) that expands the income and consumers' demand deposits.

Mainstream economists claim that there is a tradeoff between unemployment and inflation, based on the Phillips Curve (PC). And, it is this false belief that prevents many economists and politicians from embracing the concept of full employment.

The PC is a relationship between inflation and unemployment that does not account for globalization, the expansion of the supply chain. Therefore, in a global, or expanding, economy the PC is meaningless.

Moreover, it is not low unemployment that causes inflation. Rather, it is supply restriction that causes consumers to bid up prices. Unemployment result from adverse monetary changes, particularly when the government (the Fed) remove money from circulation by raising the federal funds rates. Raising the federal funds rate is a euphemism for taken money out of domestic circulation.

Like Say's Law, it is time to bury the PC. Even Milton Friedman recognized that PC had no validity and introduced as a substitute the natural rate of unemployment, which is the PC with a twist. The PC, as well as the non-accelerated inflation rate of unemployment (NAIRU) are only applicable under supply constraints.

However, if money in circulation (credit) and production are increasing at the appropriate rate, there would be little or no inflation and the economy would move towards a full employment equilibrium.

Unfortunately, it appears that government officials prefer an economy with an equilibrium far below the full employment level and this is evident by deliberate and sustained periodic hikes to the federal funds rate, as well as the introduction interest payments on banks' reserves.

In every instance where government officials, the Fed, raised the federal funds rate for sustained periods, recessions have occurred, and when the government pays interest

on reserves (fiat money given to the banks by the Fed), they create a disincentive for banks for lending to the public and expanding domestic money in circulation.