CHAPTER 6

Restoring full employment:
The Job Guarantee

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1. Introduction

In this chapter we outline and develop the Job Guarantee (JG) approach to full employment and inflation control based on the proposal by Mitchell (1998). We contrast the JG with the wage-cutting approach proposed by the Five Economists (FE) (for example, Dawkins, 1999, Keating, 2002). The context of the chapter is that since the mid-1970s - a period we term the "NAIRU era" - there has been persistent demand deficiency and high unemployment. The one indisputable fact regarding this period is that the Australian economy (like most) has failed to generate enough employment or enough hours of work to match the preferences of the labour force.[2]

Shifts in unemployment are still dominated by shifts in aggregate demand (Mitchell, 2001a). The active labour market programs and welfare retrenchments that have been pursued for many years have not altered this fact. Mitchell (2001b) has also shown that a major contributory factor for the persistence of unemployment over the last twenty five years has been the failure of the public sector to maintain their share of employment. A compounding factor has been the misuse of monetary policy, which has led investment ratios to fall (Ball, 1999; Modigliani, 2000; Mitchell, 2001a).

Modigliani, a co-founder of the NAIRU terminology, recently showed that unemployment is an outcome of demand-deficiency driven by inappropriate monetary policy from central banks obsessed with achieving low inflation (Modigliani, 2000). Unemployment remains high, there is increased underemployment (Mitchell and Carlson, 2001), and GDP gaps persist (Mitchell, 2001a). The 1990s show that

persistently high unemployment will eventually control inflation and expunge inflationary expectations (Mitchell, 2001c). But how does the economy then support higher levels of demand again without reigniting inflationary pressures? The standard monetarist literature is silent. The modern neo-liberal approach is more sophisticated, using unemployment to expunge current wage pressures and labour market deregulation to make their reemergence more difficult. Labour market deregulation also aims to reduce union power and make it more difficult for workers to eke out an existence on welfare payments. Industry deregulation has also aimed at increasing competition. The problem is that none of these policies generate sufficient demand to return the economy to full employment. We thus reject the NAIRU approach to stabilising the price level because it is very costly in terms of unemployment and foregone output.[3]

The two approaches compared in this chapter capture in many ways the main divide amongst Australian economists concerning appropriate interventionist policy. They both recognise that the market alone will not deliver full employment. However, the FE approach sees the problem as being largely on the supply-side and assumes the demand-side will accommodate. We argue that it is a modern version of the classical wage cutting approach with Say's Law being invoked to ensure that the demand issues can be assumed away. In the FE view, unemployment is a labour market problem. The JG approach starts with the notion that unemployment arises from deficient aggregate demand in the product market (Mitchell, 1998, 2001a). However, it eschews traditional Keynesian remedies because there are major concerns about inflationary biases and environmental problems. Under the JG the public sector resumes the role it played in the post-World War II period of full employment as an *employer of the last resort*; ready to absorb the flux and uncertainty of the private capitalist system. We summarise the JG and FE approaches in Table 1.

Section 2 outlines the basic features of the JG policy and provides more detailed analysis of the inflation control mechanisms and the interaction between the JG and individual incentives to work. The JG is shown not to reduce the incentives to work. Given that there is considerable doubt among academics, financial economists and the policy makers who take their advice, about the viability of budget deficits, Section 3 focusses on this issue.

Table 1 Comparison of the Job Guarantee and the Five Economists' proposal

Characteristic	Job Guarantee	Five Economists
Job Creation	Every worker unable to find a job in the private sector is automatically guaranteed a public sector job.	Jobs growth depends on the private sector responding to relative wage reductions. No jobs growth is in-built.
Inflation impacts	Explicit inflation control to ensure full employment is sustainable. Changes in employment composition maintain the price control.	No explicit inflation control mechanisms. The wage-price pressures in the economy with higher demand are not addressed.
External Sector impacts	Exchange rate adjustment with Marshall-Lerner elasticities assumed.	No explicit statements about the effects of higher employment levels.
Interest rate impacts	Downward pressure on interest rates and debt issues required to hold target cash rate.	No explicit statements about the effects of higher employment levels.
Wage conditions	Minimum wage growing with average labour productivity and indexed	Real wage cuts for some of the lowest paid workers over several years.
Wage inequality	Decreased	Increased
Tax/benefit system	Simplified with the removal of unemployment traps. Increased incentive to work.	Unemployment traps removed. More incentive to work via tax credits, but possibly deleterious to secondary income earners. Downward pressure on social welfare benefits.
Environmental aspects	Inherent to proposal by diverting employment and output into green activities.	None specified.
Equity aspects	Guaranteed job for all. Strong social wage supports in place.	Unequal treatment of low-wage workers, particularly award-dependent workers in high income families.
Efficiency aspects	Static and dynamic via higher activity and growth of investment and productivity.	Employers of low wage workers subsidised. Growth of low wage jobs. Less training and job instability of low paid.

Section 4 analyses the argument of the Five Economists in relation to our central theme that unemployment arises due to demand deficiency. We argue that the proposal of the FE would not generate full employment with price stability. Concluding remarks follow.

2. The Job Guarantee policy

2.1 Basic outline of the Job Guarantee

(a) A buffer stock of jobs: The public sector operates a buffer stock of jobs that expands (declines) when private sector activity declines (expands). The JG thus fulfills an absorption function to minimise the costs associated with the flux of the private sector.

(b) JG Wage: To avoid disturbing the private sector wage structure and to ensure the JG is consistent with stable inflation, the JG wage rate would be the minimum wage. The JG wage may be set higher as part of an industry policy.

(c) Social Wage: A wide range of social wage expenditures, including adequate levels of public education, health, child care, and access to legal aid, supplements JG earnings. The JG policy does not replace the conventional use of fiscal policy to achieve social and economic outcomes.

(d) Family Income Supplements: The JG is not based on family-units. The JG wage (available to anyone over working age) would be supplemented with benefits reflecting family structure. In contrast with workfare there would no pressure on single parents to seek employment.

(e) Inflation control: The JG wage provides an in-built inflation control mechanism (Mitchell, 1998, 2001c). The ratio of JG employment to total employment is called the Buffer Employment Ratio (BER). The BER conditions the overall rate of wage demands. When the BER is high, real wage demands will be correspondingly lower. If inflation exceeds the government's announced target, tighter fiscal policy would be triggered to increase the BER, which entails workers transferring from the inflating sector to the fixed price JG sector. Ultimately this attenuates the inflation spiral. Thus instead of unemployment being used to discipline the distributional struggle,

the JG policy achieves it via compositional shifts in employment. Full employment is maintained. The BER that results in stable inflation is called the Non-Accelerating-Inflation-Buffer Employment Ratio (NAIBER). It is a full employment steady-state JG level, which is dependent on a range of factors including the path of the economy. Its microeconomic foundations bear no resemblance to those underpinning the neoclassical NAIRU. Incomes policy may also be used to reduce the steady state JG employment level consistent with stable inflation.

(f) 'Loose' Full Employment: The JG policy introduces 'loose full employment' because: (i) the demand pressures would be less than if the unemployed were fully employed at market wages in the private sector, and (ii) there is no disruption to the relative wage structure of the private sector.

(g) Would the NAIBER be higher than the NAIRU? In a NAIRU-economy a particular level of demand curbs the inflation. Introducing a JG means that the initial level of JG employment will deliver a higher demand level than inherited from the NAIRU economy. Doesn't this disturb the NAIRU demand balance? We repeat that the JG creates loose full employment. The JG workers comprise a credible threat to the current private sector employees because they represent a fixed-price stock of skilled labour from which employers can recruit. Business is more likely to resist inflationary wage demands from its existing workforce as a result. In this sense, the inflation restraint exerted via the NAIBER is likely to be more effective than using a NAIRU strategy.

(h) The JG is not a more elaborate form of workfare: Workfare does not provide secure employment with conditions consistent with community norms with respect to non-wage benefits and the like. Workfare does not ensure stable living incomes are provided to workers. Under workfare, the state extracts a contribution from the unemployed in exchange for their welfare payments. The state, however, takes no responsibility for the failure of the economy to generate enough jobs. In the JG, the state assumes this responsibility and pays employees award conditions.

(i) Unemployment benefits: We would scrap the unemployment benefits scheme (see below) and free the associated administrative

infrastructure for JG operations. Mutual obligation would be redefined because the receipt of income by the unemployed worker would be conditional on taking a JG job.

(j) Administration: For reasons explained below, the JG would be financed federally with the operational focus being Local Government. We would abandon the Jobs Network and restore the Commonwealth Employment Service (CES), which would coordinate JG employment creation with local managers. Local administration and coordination would ensure that the JG program led to the creation of meaningful, value-adding employment.

(k) Type of Jobs: The JG workers would participate in many community-based, socially useful activities, including urban renewal projects, personal assistance to pensioners, and environmental schemes, such as reforestation, sand dune stabilisation, and river valley and erosion control. The buffer stock of labour would however fluctuate with private sector activity and the design of JG jobs and functions would have to reflect this. Projects or functions requiring critical mass could face labour shortages as the private sector expanded. Thus the stock of standard public sector jobs, which is identified with conventional Keynesian fiscal policy, would be likely to expand, reflecting the political decision that these were essential activities.

(l) Open Economy Impacts: Mitchell (1998, 2001c) analyses the consequence for the open economy of the introduction of a JG policy. The JG requires a flexible exchange rate to be effective. A once-off, modest increase in import spending is likely to occur because JG workers would have higher disposable incomes. Any depreciation in the exchange rate is likely to improve the contribution of net exports to local employment, given the estimates of import and export elasticities (Dwyer and Kent, 1993; Bullock, Grenville and Heenan, 1993). Mitchell (2001c) formally tests and rejects various claims that rising budget deficits impact adversely on financial markets. Further, capital flows dominate the balance of payments. It is likely that a fully employed economy with price stability would be attractive for long-term investors.

(m) Environmental benefits: The JG proposal will assist in changing the composition of final output towards environmentally sustainable

activities, which are unlikely to be undertaken by traditional private sector firms. A JG job should be offered as long as it increases the Genuine Progress Indicator (Watts and Mitchell, 2000a). Future policy must consider environmental risk factors and threshold effects in the use of natural capital. A risk-averse attitude is wise (Zarsky, 1996: 172). Indiscriminate (Keynesian) expansion fails because it does not address the need for risk aversion. It is not increased demand *per se* that is necessary but increased demand in certain areas of activity.

## 2.2 Incentives and the Job Guarantee

Does the JG provide appropriate supply-side incentives in the presence of the welfare system? Using a neo-classical approach we compare the JG to an unemployment option (with and without unemployment benefit) and to private sector employment. The work-leisure choice facing an individual is shown in Figure 1. The unemployment benefit is OA. The individual is currently unemployed due to demand deficiency in the private sector and is located at point A on IC_1. The individual would be indifferent between working in the private sector at the hourly reservation wage W_p (corresponding to budget line OB) and remaining on unemployment benefit. Any slight rise (fall) in the private hourly wage will induce the individual to seek (leave) employment, if unemployment benefits were unlimited in duration.

In the JG approach, the worker is faced with a choice between zero income and a JG job (in the absence of a private sector job) paying an hourly rate W_j, (corresponding to budget line OC). The worker would prefer the JG job (at C) in this case but s/he would prefer the unemployment benefit if it were available. This worker would also prefer a private sector job to the JG at the reservation wage should one become available. Thus the JG does not provide a disincentive to work in the private sector, but unemployment will be preferred if the benefit exceeds OE. This justifies the mix of guaranteed employment without the unemployment benefit being available.

We also modelled the choice between the JG and Workfare via a simulation approach. We made the standard constrained utility maximisation tractable by using a Cobb-Douglas preference function and then examined the conditions that would be required to render the JG a

preferable choice in the face of Workfare (a full derivation of our model appears in Mitchell and Watts, 2001). We conclude that, under plausible conditions, the JG will be preferable to Workfare.

Figure 1 Comparing work choices and incentives
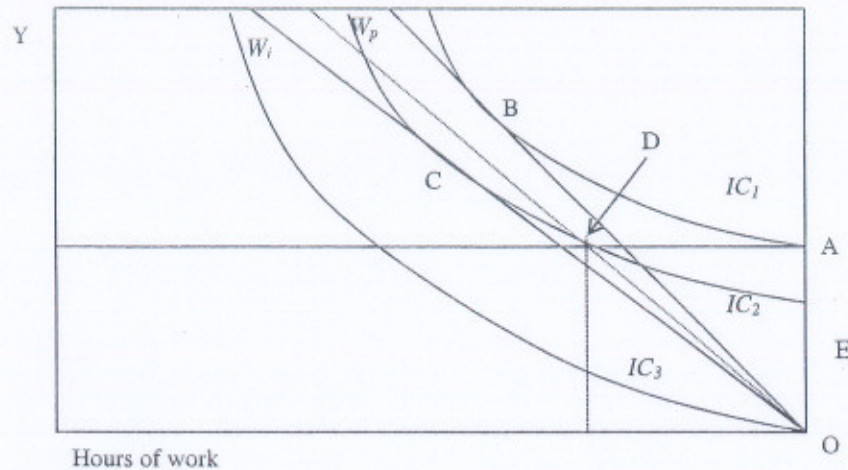
3. The cost of the JG, budget deficits and financial markets

3.1 What does it cost?

The critics of the JG approach claim it is unviable because of the alleged financial constraints that would arise from higher budget deficits. The budget deficit is clearly endogenous under the JG policy (Mitchell and Mosler, 2001, 2002). Watts and Mitchell (2000b, 2001) have provided detailed estimates of a JG program to achieve 2 percent unemployment. Their work includes estimates of direct costs, automatic stabilisation effects (increased taxes and the reduction in unemployment benefits), and the savings associated with a reduction of labour market programs. All other discretionary government expenditures on items such as health, education and the police are left unchanged. Using figures for 1999(4), they conclude that the net budgetary costs lie between $5.5 and $6.4 billion for a full year depending on assumptions made about the labour

market behaviour of Disability Support recipients. These costs fall as the private economy expands.

However, the use of budget deficits remains controversial since the NAIRU era has been marked, in part, by a vigorous pursuit of budget surpluses. Wray (1998) provides an excellent account of the destructive consequences of this policy. We now carefully deconstruct the financial arguments to show where the negative connotations of budget deficits fail to meet the test of logic and empirical scrutiny (This section is based on Mitchell and Mosler, 2002).

One of the most damaging analogies in economics is the alleged equivalence between the household budget and the government budget. A household (the user of the currency) must finance its spending, *ex ante*, whereas the government (the issuer of the currency) spends first and without a financing constraint. The government spending is desired by the private sector because this provides it with money, which it requires to fulfill its legal taxation obligations. Therefore, a simple, and often overlooked point, is that the government has to spend first before the private sector can pay its taxes, save in the unit of account, and maintain transaction balances.

Orthodox economists build on this false analogy by invoking the accounting relationship they call the government budget constraint (GBC) which describes three alleged forms of finance: (a) raising taxes; (b) selling interest-bearing government debt to the private sector (bonds); and (c) issuing non-interest bearing high powered money (money creation).

Various scenarios can then be constructed to show that either deficits are inflationary, if financed by high-powered money (debt monetisation), or squeeze private sector spending if financed by debt issue (so-called crowding out). There are two flaws in this argument: (a) the link between monetary growth and inflation is not well established, and (b) the concept of debt monetisation (money creation) is an inaccurate depiction of the issue of high powered money.

3.2 Money and inflation

The conclusion that monetary growth causes inflation is a replay of the neutrality argument embedded in the Quantity Theory of Money (QTM) (for example, Blanchard, 1997). The following circular analysis is

provided. Whenever, the government 'prints money' it can exchange it for goods and services from the private sector. The real goods and services it extracts are called *seignorage*. With a constant velocity of circulation, this increase in high powered money, reflected in higher nominal demand, would be split into price and real output changes, according to the nature of aggregate supply. The QTM assumes that the economy is already operating at full capacity, so that the aggregate supply curve is vertical. Then the truism that high powered money growth is directly reflected in the inflation rate is clear. But an economy constrained by deficient demand (defined as demand below the full employment level) can respond to a nominal impulse by expanding real output. We refute the inevitability of the association of inflation with monetary growth within relevant capacity utilisation ranges.

3.3 Reserve Accounting – why debt monetisation is problematic

Orthodox analysis also ignores the impact of the government spending on bank reserves. Deficits/surpluses between the public sector and the private sector (more/less government outflows than inflows) have major implications for what is termed 'system wide liquidity' and promote changes in the reserves in the financial system. We do not review the operations of the payments and settlement process here (see Mitchell and Mosler, 2001). The commercial banks (and some other selected financial institutions) maintain exchange settlement accounts (ES accounts) with the RBA to allow the settlement of financial transactions within the financial system. Exchanges between ES accounts in settlement sum to zero in terms of the system wide balance and so in net terms the money market cash position is unchanged. Transactions between the Commonwealth government and the private sector, however, change the system balance. Government spending and purchases of Commonwealth Government Securities (CGS) by the RBA add liquidity and taxation and sales of CGS drain liquidity. These transactions influence the cash position of the system on a daily basis and on any one day they can result in a system surplus (deficit) due to the outflow of funds from the official sector being above (below) the funds inflow to the official sector. The system cash position has crucial implications for RBA monetary policy, which targets the level of short-term interest rates. The cash rate is the rate charged on overnight loans between financial intermediaries. The RBA indicates to the market that it will trade CGS (sell in a system-

surplus, buy in a system-deficit) to maintain this rate. This provides the banks with an ability to get 'same-day funds' and avoid end-of-the-day dealings with the RBA or other banks, which would be on less than desirable terms. So the system balance is an important determinant of the use of OMO by the RBA. How does this help us to understand the relationship between budget deficits and the sale of CGS?

On any day, the transactions between the Commonwealth government and the private sector will not usually net to zero. If the system is in deficit (net value flowing to the official sector), the overall level of the ES accounts will fall. The system requires cash for balance (the ES accounts must be in credit) and this places upward pressure on short-term rates. Several options exist. The RBA may defend its target rate and buy CGS from the banks or the deficit banks may seek cash elsewhere to get same-day funds to fulfill their ES account obligations to the RBA. There are only four sources of same-day funds available to a bank: (a) own-ES accounts surpluses, (b) other bank-ES account surpluses, (c) RBA payments for OMO purchases, and (d) repos. Banks may prefer to purchase same-day funds in the Interbank market rather than incur the penalties associated with repos. In the case of surplus ES outcomes, the RBA pays surplus commercial banks a default return equal to 25 basis points less than the overnight cash rate. This acts as a disincentive to keeping surplus account balances.

When the government runs a fiscal deficit a system-wide surplus results, after the spending and portfolio adjustments have occurred. The commercial banks will be faced with earning the lower default return on the surplus ES funds. This will put downwards pressure on the cash rate. If the RBA desires to maintain the current stated cash rate then it must drain this surplus liquidity from the system. It must sell government debt. So the role of government debt is not to finance spending but to maintain reserve balances such that a particular cash rate can be defended by the central bank.

Accordingly, the concept of "debt monetisation" is a *non sequitur*. Once the cash rate target is set, the RBA should only trade CGS if the liquidity changes are required to support this target. Given the RBA cannot really control the reserves then debt monetisation is strictly impossible. Imagine that the RBA traded CGS with the Treasury, which then increased government spending. The excess reserves would force

the RBA to sell the same amount of CGS to the private market or allow the cash rate to fall to the support level. This is not "monetisation".

3.4 Implications

There are several implications of this analysis. First, if the RBA ran a zero cash rate target, deficit government spending would not require any debt to be issued. Second, the idea of financial crowding out in this environment is meaningless. Deficits in actual fact place downward pressure on interest rates and add to the net disposable income of households in the economy. This income provides markets for private production. Endogenous credit creation then provides the deposits necessary to make payments, which facilitate production. Third, if the central bank was truly autonomous and constrained the government by refusing to create high powered money (honour the Treasury cheques) then the government would be constrained. In general, we argue that the electorate should periodically sanction policy at the ballot box. The idea of an independent central bank, which could impose harsh monetary policy, without political scrutiny would be an anathema to this objective.

4. Alternative policies

4.1 Introduction

In this section we focus on the wage-tax tradeoff advocated by the FE, which is the most articulate of the current alternative policies in Australia (see Dawkins *et al*, 1998, Dawkins, 1999). While there are differences amongst the Five Economists, the common ground is summarised as:

a) Living Wage adjustments replaced by tax credits for low wage earners in low-income families, so that effective marginal tax rates are reduced for these families;

b) a long term reduction in effective marginal tax rates through a negative income tax;

c) a systematic approach to labour market programs; and

d) upgrading educational and training systems over the long term.

We will focus on (a) and (b).

4.2 Freeze on Living Wage increases

Following the introduction of the Workplace Relations Act (1996), the main source of award adjustment has been Safety Net Cases administered by the Australian Industrial Relations Commission. Award recipients have borne the brunt of wage restraint since 1996 (Carlson, Mitchell and Watts, 2001; Watts, 2001). Dawkins (1999) now proposes suspending the Safety Net adjustments, thereby widening the wage distribution over time. Keating (2002) prefers general wage moderation, rather than this selective incomes policy, whereas Dawkins (2000) expresses concern about the high relative minimum wage in Australia and the employment impact of increasing it. By advocating selective wage moderation, rather than general wage restraint through intervention in enterprise bargaining, the FE have embraced the OECD (1994) argument, by default, that a dispersed wage distribution is a prerequisite for high employment. There is ample evidence that there is no systematic relationship between relative rates of unemployment of the unskilled and their relative wages (Nickell and Bell, 1996; Watson, 2001; and Watts, 2000). Watts (2000) notes that there has already been a long-term increase in wage inequality in Australia and it is not evident that a further increase is warranted.

The FE employment creation impact turns on the size of the labour demand elasticity and returns us to neoclassical marginal productivity strategies that failed to work in the Great Depression and fail to address the aggregate demand constraint. Nevile (2001) argues that the wage elasticity of demand of -0.4 that the FE take from Debelle and Vickery (1998) is too high relative to international evidence. Junankar (2000) argues that even if correct, the unemployment decline will be much less than the FE estimate due to the presence of hidden unemployment. Further, low-wage unskilled workers may well be substituted for higher wage, more skilled workers. Also, the FE projections depend on a significant positive scale effect, which is not estimated by Debelle and Vickery (1998).

4.3 Tax Credits

The FE also attempt to address the disincentives they claim the unemployed face because of excessive effective marginal tax rates (EMTRs) (Dawkins, 1999; Keating and Lambert, 1998). As a first step

towards a negative income tax and the integration of the tax and welfare systems, Dawkins *et al* (1998) suggest that a tax credit scheme be implemented. Keating and Lambert (1998) advocate the consolidation of means tests for different forms of family benefit into one test to get rid of the high EMTR.

The tax credit scheme would assist low income families in the face of the wage freeze. The tax credits would be linked to family income because many individuals on low incomes are considered to be members of high-income families (Richardson and Harding, 1999). Apps (2001) criticises the tax credit approach where revenue neutrality is assumed. Using the Australian Labor Party 1998 Family Tax Credit scheme as an example, Apps (2001: 19) concludes that the program is a means of "funding an expansion of welfare support for families facing falling wages due to labour market reforms, by raising taxes on median wage families with both parents working." Ingles (2001) notes that most recipients of the Earned Income Tax Credit in the USA take it as an end of year refund, because of the fear of overpayment, with little effect on labour supply behaviour. A similar response to the introduction of tax credits by low-income workers is likely in Australia. Ingles (2001: 21) also argues that the potential for fraud is higher under a system of Tax Credits if the payments are significant.

While it is possible that a high EMTR deters labour supply, with an average unemployment to vacancy ratio of around 11 since 1975 (Mitchell, 2001a), supply constraints hardly explain the persistently high unemployment. Without job creation, any positive benefits from the tax credit scheme will be ineffective. The major concern with the FE scheme is whether it would produce sufficient additional employment to restore full employment.

We also note that there are implications for equity and efficiency associated with the adoption of the FE proposal as opposed to the JG (see Table 1).

4.4 The two main contradictions

The FE approach suggests a dual role for the Government. On the one hand, it should indirectly attempt to increase the growth of low wage employment through the wage freeze (relying on market forces to provide additional low wage jobs). On the other hand, the Government

also has to ameliorate the problem of low wages for some workers by tax credits. There are two major contradictions inherent in this specific approach.

(a) Nevile (2001) estimates that if a tax credit scheme is devised to compensate for the impact of inflation on real post-tax earnings of all low income full-time and part-time wage earners in low income families, then the annual cost of tax credits is in the order of $3 billion - $7 billion, given an inflation rate of 2.5 percent and assumptions about income and asset tests and the taper rate. Watts and Mitchell (2000b) estimate that a JG program introduced at the end of 1999 would have cost about $6.4 billion and generated a guaranteed 2 percent unemployment rate. Alternatively, if revenue neutrality is the objective then the need to impose higher marginal tax rates in the phase-out range of taxable income appears to be at odds with the desire to maintain a progressive system, but achieve lower rates, unless a significant increase in employment is achieved at wage levels that yield positive net income taxes. Secondary income earners suffer an increased tax burden (Apps, 2001). Consequently there are likely to be pressures for government to restrict expenditure on the social wage, for example, through reducing the growth of expenditure on health and education.

(b) Second, with nominal wages frozen for (over)award recipients, the continued indexation of social security benefits, such as pensions and sickness benefits, will create poverty traps. Unless tax credits are relatively generous at these low levels of nominal wages, there will be pressure to let social security benefits erode in real terms over time, by failing to index, as well as tightening the availability of social welfare (Watson, 1999: 13).

5. Conclusion

We have shown that Job Guarantee proposal generates full employment with inflation control. In a typical model of individual maximisation behaviour, the JG does not distort work incentives. The JG is a safer path to full employment, as compared to wage cutting methods, because the latter relies on questionable assumptions about elasticities and lack of interdependence between wage income and spending to generate its job growth projections. The JG policy provides certainty in two dimensions: (a) guaranteed employment, (b) guaranteed income. The wage cutting

methodology does not provide certainty in either dimension, but depends on equity insurance being provided by the state and Say's Law ensuring all the demand issues can be assumed away. It does not directly address demand deficiency. Furthermore, the FE proposal has poor equity and efficiency properties.

The introduction of the JG would be accompanied by reform of the welfare system: (a) the scrapping of unemployment benefits; (b) the expansion of the social wage and family income supplements (as a precursor to a guaranteed minimum income); and (c) the abandonment of workfare.

Finally, we have decomposed the arguments against the use of budget deficits by focussing on the impacts on financial system liquidity. We concluded that deficit spending without bond sales actually places downward pressure on interest rates. The issue of debt is only required if the central bank desires to maintain a positive target interest rate. Spending does not require that debt be issued. In this sense, there is no government budget constraint.

Endnotes

[1] We are grateful to anonymous referees for helpful comments. All errors are our own.

[2] NAIRU refers to the Non-Accelerating Inflation Rate of Unemployment.

[3] Further, as a guide to policy, the centerpiece of the supply-side strategy – the NAIRU – is now significantly discredited (see for example Chang, 1997; Fair, 2000; Akerlof et al, 2000; and Mitchell, 2001a, 2001c).

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CHAPTER 7

Restoring full employment: the Five Economists' proposals

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1. Introduction

This chapter discusses the economic justification for the proposals to restore full employment first advanced by Five Economists in an open letter to the Prime Minister in October 1998.[1] These proposals by the Five Economists are then compared with the Job Guarantee (JG) scheme proposed by some other economists.

The unacceptably high level of unemployment represents a critical failure of Australian economic management. Unemployment has been too high for more than a quarter of a century despite numerous attempts to bring it down. Given our lack of success in restoring full employment, we should be especially receptive to new ideas, but we should perhaps also be wary of any suggestion that there is a single simple solution.

An obvious starting point is to ask why unemployment initially increased. There are many views, ranging from the impact of globalisation to too many migrants, or even women, taking Australian men's jobs. What we can say with reasonable certainty is that over the last thirty years aggregate unemployment has ratcheted up on four occasions – 1972, 1975, 1982 and 1983, and 1991 and 1992 (Figure 1). Significantly, while unemployment was subsequently unwound to some extent, in each episode we never quite got back to the previous level of unemployment before it took off again.

On each occasion when unemployment rose, economic growth fell below its potential, but in 1974 and in 1982 there was also a major increase in both nominal and real wages. Average weekly earnings increased by around 31 percent over the course of 1974, and by 18 percent over the twelve months to September, 1982 (ABS, TRYM