THE PROBLEM OF FULL EMPLOYMENT

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It is quite difficult to give a practical definition covering all the various aspects of Full Employment. The problem of full employment varies from country to country, both according to the nature of Political social framework and according to the stage of economic development of the country concerned. Full employment however does not mean literally no unemployment,[1] that is to say it does not mean that every man and woman in the country who is fit and free to work is employed productively on everyday of his or her working life. In real world some kinds of unemployment must always exist which cannot be completely eliminated. In every country with a variable climate there will be seasons when particular forms of work are impossible or difficult to do. Moreover qualitative if not quantitative changes in demand for labour take place in every country and as a result there is always some frictional unemployment.

Leaving aside seasonal and frictional unemployment in a society which is a small proportion of the total unemployment and cannot always be completely eliminated, unemployment is due to one of the following two causes.

The problem in the under-developed countries is not that of unemployment rather it is of underemployment. This underemployment is reflected in the fact that a large part of population could be diverted from agricultural occupations without any decrease extend in agricultural output.[2] The lack of capital equipment is responsible for this unemployment which has been termed as 'Complementary unemployment'. The only remedy for this form of disguised unemployment is economic development which constitutes the major economic problem of the world.

The major cause of unemployment in industrialized countries is the insufficiency and instability of effective demand and it is with this aspect of unemployment that we would be concerned here. According to Keynes

1. Beveridge, Full Employment in a Free Society.
2. Measures of Full Employment. United Nations Publications.

employment depends upon spending which is of two kinds — for consumption and for investment. What people spend on consumption gives employment what they save gives employment only if it is invested. Investment in this sense does mean buying of stocks; it means real investment, that is buying of capital equipment. The root cause of unemployment in a free capitalist society is the fact that decisions to save and decisions to invest are made by different sets of people at different times and for different reasons. The amount which any community plans to save at a certain level of income is independent of the opportunities existing for investment. It depends mainly on the total income of the community and the distribution of this income among its members. For instance, the greater the inequality of income in a society, greater would be amount of saving done, for the simple reason that rich have a low propensity to consume as compared with the poor. In other words larger the income of an individual, greater would be the proportion of it which he saves. The amount which any community will seek to invest is governed not by the amount of saving available but by the expected rate of profit (marginal efficiency of capital).

When saving decisions exceed investment, there is a deficiency in aggregate demand for goods and services and some of the output currently produced will remain unsold or would be sold at unremunerative prices which in turn will necessarily cause a tendency towards contraction in the level of production and income. Since however saving largely depends upon the level .of income, the contraction of demand itself would tend to reduce saving and tend to establish equilibrium between saving and investment.

The achievement of full employment however requires that balance between saving and investment should be obtained at the fall employment level. The attainment and maintenance of the Full Employment implies therefore that effective demand should be adequate to provide employment for all the existing capital and labour resources of a country. The following practical definition of Full Employment in terms of effective demand has been given in a report of the United Nations. “Full employment may be considered as a situation in which employment cannot be increased by an increase in effective demand. Under normal conditions any unemployment exceeding the amount which is due to frictional and seasonal factor is a clear indication of a deficiency of demand.”

There are however possibilities that equilibrium between saving and investment may take place at an underemployment level in a free society. The explanation of the likelihood of underemployment equilibrium is to be found according to Kurihara[1] in the following plausible assumptions. The investment function is interest-inelastic. It implies that propensity to invest cannot be expected to rise to give full employment level of income when economy is in equilibrium at less than full employment level. Moreover the saving function is also interest inelastic. Even when there are no investment opportunities people may go on saving in wealthy capitalist economics. The classical economists believed that rate of interest acts as equilibrating factor, balancing saving and investment at full 'employment level'. But this assumption has been shown to be unrealistic. Finally the liquidity preference of the people is very sensitive to interest changes at very low rates. The interest rate therefore cannot be significantly lowered by increasing the money supply to stimulate investment.

Thus there is no reason to believe that the full employment level will be reached automatically or that if it is reached it will be maintained as long as variations in effective demand take place as a result of independent decisions of people to save and invest without an attempt on the part of the Government to follow a continuous and consistent policy to attain the desired objective. Achievement of Full Employment must be made the responsibility of the state as no one else has the requisite powers.

The problem of maintaining effective demand has two main aspects, how to secure an adequate level of spending and how to secure stability. Securing an adequate level of spending involves the raising of either the investment or of the consumption.

Let us first proceed to examine the role of the credit policy of a Government exercised through the central bank with its weapons of credit control like discount rate, open market operations, rationing of credit, etc.

We have already seen that investment depends upon the expected rate of profit. Rate of interest serves as a mechanism by which the efficiency of capital is discounted. As long as the interest rate is lower than the expected Rate of Profit, the investment in question would be worthwhile. The Government can therefore by following a cheap money policy as matter of public policy can stimulate investment. The low and stable interest rates have a very healthy stabilizing effect on the capital market as the risk of possible capital losses due to an increase in the rate of interest is eliminated. This in turn stimulates new real investment.

But the past experience has shown that such monetary methods of control are more effective in checking an increase in investment rather than stimulating

1. Kenneth K. Kurihara, Monetary Theory and Public Policy.

it. The simple reason is that it is easier to destroy optimism than to create it. An important factor determining the marginal efficiency of capital is the state of business confidence which is purely a psychological phenomenon. Once business confidence is shattered even very low interest rates may not tempt the businessmen in to investment. The experience of United States during the great depression in 30's amply demonstrates this fact. Even the successful application of the credit policy presupposes many conditions including the existence of an organized money market, fullest, cooperation of the commercial and financial institutions etc.

This however does not imply that monetary policy as an instrument of regulating investment is to completely dispensed with. Credit policy does influence total spending through its influence on private investment and demand for durable-consumer goods. Cheap money will also help loan financed compensatory spending by the Government the role of which we shall shortly discuss. Moreover it has been pointed out that in the industrially and financially less developed countries credit-and banking policies are much more than a mere brake on undue credit inflation.

Other methods like reduction in taxation and wages etc. have been suggested from time to time but it appears that effect of all these measures is indirect and it is now generally felt that the control and regulation of investment must be undertaken by more direct measures. A more effective method than monetary policy in modern economies is that of compensatory spending. It means that public investment should fill the inevitable cyclical and secular gans created by a deficiency of private spending.[1] On the basis of his analysis of persistent tendencies towards under employment equilibrium Keynes himself stressed the need for public investment as a balancing factor. William H. Beveridge in his book 'Full Employment in a Free Society' has suggested a new type of the budget covering the total spending in the country, public and private. He says that, "The Minister introducing .the budget after estimating how much private citizens may be expected to spend on consumption and on investment together under a condition of full employment must propose public outlays sufficient with the estimated private outlay to employ the whole manpower of the country."

In order to be effective however such a policy would require the successful estimating by the Government of investment and consumption expenditure of the private firms and individuals as well the estimation of aggregate spending necessary to sustain the full employment level. Moreover this 'compensatory spending' raises the question of financing of public

1. K. K. Kurihara, Monetary Theory and Public Policy.

investment. It is only the problem of payment of interest on public debt however which presents the problem. But as has already been pointed out by the help of cheap money policy the burden can be kept at a very low level.

The control of investment however is not the only way of influencing the aggregate level of demand. The alternative approach to the problem and one which may yield, more effective results in highly industrialized countries is the influencing of the general level of consumer demand. Keynes no doubt laid greater emphasis on increasing the investment in short run. But he agreed that, “If it is impossible materially to increase investment, obviously there is no means of securing a high level of employment except by increasing consumption.” He pointed out however that the wisest course is to advance on both fronts at once. “While aiming at a socially controlled rate of investment, in view of progressive decline in marginal efficiency of capital in highly developed economics all sorts of policies for increasing propensity to consume should be resorted to. For it is unlikely that full employment can be maintained whatever we may do about investment with the existing propensity to consume.

Highly developed countries of today particularly United States are faced with the problem of low-consumption and a high saving economy. As has been now shown that saving in itself is not a social virtue. In fact saving in money which is not offset by saving in goods (real investment) not only goes waste but creates disequilibrium in the economy by leading to a reduction of aggregate national income and thus enhances the instability.

One factor which affects the propensity to consume of the community as a whole is the manner in which national income is distributed among the members. A more equitable distribution of wealth in a community would raise the propensity to consume. The theoretical justification for greater equality in income distribution is based on the fact that has just been pointed out, that the growth of wealth which the unequal distribution of wealth facilitates increase instability.

Various methods like minimum wage-regulation, remission of taxes on poor, schemes of social dividends etc. have been suggested to achieve a greater equality in income distribution. But certain institutional factors may stand in the way of achieving greater equality in incomes by such methods. However the successful utilization of these methods would vary from country to country depending upon the political and social set up.

Schemes of social security are another very important method for stabilization of consumption expenditures. Consumption falls with falling investment because of the reduced spending of those who become unemployed. The System of social security serves to offset a cyclical decline in investment, as it prevents the consumption expenditures from falling too low during periods of falling activity. 'But the most important effect of social security programme is that it helps to sustain the level of spending in depression as it creates a sense of security conducive to such spending.[1]

It is therefore needed for achieving a high consumption economy which is the long run hope of capitalism.[2]

Another way of increasing consumption is by raising the standard of social expenditures generally, that is by spending more on education, health and by means of other supports to personal consumption.

The assumption of responsibilities by the Government for maintenance of full employment, also involves the responsibility of maintaining the stability of price level. If price inflation occurs it might become very difficult for governments to maintain full employment. Inflation may arise mainly because of the expansion of effective demand beyond the level necessary for full employment. But it may also result if in the course of expansion of employment, temporary shortages and bottlenecks are encountered. Moreover organized groups like trade unions might press for increased earnings in such a way as to give rise to a continuing upward movement of prices. Thus while inflationary pressures, which result from a general excess in effective demand a rise in prices provides no necessary evidence of general excess of demand. And therefore curbing of price increases in these cases must not be done by restriction of demand but by other suitable measures.

The problem of full employment has its international aspects also with which we have not been concerned here. But variations in demand in foreign countries have repercussions through international trade on the economy of a country, and make the achievement of full employment difficult. Therefore measures should be taken on international scale to create conditions of smooth and stable running of international trade and to prevent the international propagation of fluctuations in demand.

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1. K. K. Kurihara, Monetary Theory and Public Policy.
2. Klein, Keynesian Revolution.