Economic Policy Institute

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BOOK REVEALS THE CRITICAL IMPORTANCE OF LOW UNEMPLOYMENT FOR WORKING FAMILIES

Higher Wages and Lower Poverty Produced by Full Employment Far Outweigh Any Inflation Dangers

For decades, the conventional economic wisdom has been that allowing unemployment to fall below 6% would destabilize the economy by triggering inflation. A new book published today by the Economic Policy Institute shows how the jobs boom of the second half of the 1990s discredited that theory. Unemployment fell to 4% during that period, raising wages and reducing poverty along the way, without triggering a corresponding rise in inflation.

The Benefits of Full Employment: When Markets Work for People, by economists Jared Bernstein and Dean Baker, presents a comprehensive picture of the '90s jobs boom and its impact. The authors make a compelling argument that it's time for policy makers to rethink the relationship between unemployment and inflation and to renew their commitment to policies for achieving full employment.

Baker and Bernstein propose a new view that de-links full employment from inflation and defines it, quite simply, as a period when virtually everyone who can work has a job. They point out that in the fully employment labor market of the latter 1990s, fast productivity growth and low unemployment combined to lift the living standards of all working families, not just those at the top of the income scale.

The distinction is far more than just a technical one, since the level of unemployment we set as a target is embedded in the policy decisions we make about jobs and unemployment. A target that is too high carries enormous consequences not only for workers who are either already unemployed or in danger of becoming so, but also for low-wage workers whose wages are held down by the higher unemployment rate.

"The experience of the latter 1990s taught us that if we want the fruits of economic growth to be broadly shared, we need a full employment economy, with unemployment near 4%. Yet, to this day, key policy makers think we cannot sustain unemployment rates below 5%," said Bernstein, EPI senior economist. "If this misguided belief causes the Federal Reserve Board to slow economic growth or leads the government to fail to provide appropriate fiscal stimulus, the bottom half of working families will needlessly suffer."

Full Employment explores the link between the fall of unemployment to 30-year lows and corresponding improvements in wages, job quality, crime rates and other measures of economic and social well-being. The book also uncovers how low unemployment, along with faster productivity growth, produced salary gains and job opportunities for low-wage workers in the jobs boom. The authors examine wage trends, poverty rates, recessions, recoveries and other aspects of the economy and its cycles, broken down by gender, race and income level to prove how important high employment is to a healthy economy.

The economic boom of the 1990s proves that some orthodox views on the economy and unemployment are misleading, said Baker, who is co-director of the Center for Economic and Policy Research in Washington, D.C. During those prosperous times, Baker points out, the unemployment rate fell two full percentage points below the level that many economists had considered "safe," yet there was no increase in inflation whatsoever.

Their book demonstrates the urgency for policy makers to pursue economic initiatives that aim to reduce unemployment rates, particularly as states and cities struggle with unprecedented fiscal crises. The difference between 4 percent and 6 percent unemployment can determine whether tens of millions of workers can improve their salaries and truly keep up with the cost of living, Baker adds.

"There is no other single policy that helps the poor as much as full employment," Baker said. "The workers who find jobs when the unemployment rate falls are disproportionately less advantaged and minorities. For these people, full employment makes a huge difference."

Among the book's findings are:

- From 1995-2000, the economy boomed, unemployment fell, while the rate of inflation actually fell, growing 0.7% slower than it did from 1989-1995. This directly challenges the idea that very low unemployment triggers ever-increasing price inflation.
- Full employment improves wages and living standards, especially for low-income families. During the 1990s recovery – when unemployment was falling to 30-year lows – the real wages of low-wage workers grew more quickly than they had in a generation.
- The income of low-income families grew almost 20% over the 1990s recovery, adding just under $4,000 by 2000 (in real 2000 dollars). By contrast, growth from 1982-89, when unemployment never got below 5%, added half that amount.
- From 1995 to 2000, the poverty rate of African-American children fell by 15 percentage points, more than three times the gain of the 1980s recovery. Full employment led to marked improvements in job quality. The share of involuntary part-timers fell to a twenty-year low, and the shares of low-wage workers receiving health-care and pension coverage through the job rose to 14- and 20- year highs, respectively.

Full Employment also provides historical context by reviewing employment and inflation rates from the past four decades to reveal the fault lines in this high unemployment-low inflation theory, referred to as NAIRU (non-accelerating inflation rate of unemployment). For example, the authors show how a 5.9% inflation rate during the 1960s didn't come from low unemployment. Tax hikes, a rise in health care costs from Medicare and Medicaid, and errors in measuring the consumer price index contributed to high inflation.

The Economic Policy Institute is a nonprofit, nonpartisan economic think tank founded in 1986. The Institute can found on the web at http://www.epinet.org.