The original documents are located in Box C42, folder "Presidential Handwriting, 6/11/1976" of the Presidential Handwriting File at the Gerald R. Ford Presidential Library.

THE WHITE HOUSE

WASHINGTON

June 11, 1976

MEMORANDUM FOR: BILL SEIDMAN

FROM: JIM CONNOR

The attached newspaper clipping was returned in the President's outbox with the following notation:

"Did you see this? Excellent."

Attachment:
From WASHINGTON POST 6/7/76
by Charles L. Schultze EMPLOYMENT & INFLATION

cc:Dick Cheney

THE WHITE HOUSE
WASHINGTON

Bill Leahman

Did you see

this?

Excellent

Charles L. Schultze

Employment and Inflation

The Full Employment and Balanced Growth Act of 1976, S.50, addresses the most important domestic problem of this decade—high and persistent unemployment. The chief obstacle to overcoming that problem, both politically and economically, is inflation. I believe that S.50 does not sufficiently recognize that fact, and hence needs to be changed in a number of important respects. Moreover, the combination of the "employer-of-last-resort" provisions in this bill and the wage standards that go with it threatens to make the inflation problem worse. These sections, particularly, need extensive reworking.

The emphasis that S.50 puts upon the goal of full employment is, in my view, quite proper. We are a society in which not only economic rewards but status, dignity, and respect depend heavily on a person's place in the work force. The single most important contribution toward solving the major social problems of this generation—deteriorating inner cities, inequality among the races and between the sexes, high and still rising crime rates, poverty, insecurity, and hardship for a minority of our citizens—would be a high level of employment and a tight labor market.

Dr. Schultze, an economist at the Brookings Institution, was director of the U.S. Budget Bureau in the Johnson administration. This article is excerpted from his testimony last month before the Senate Subcommittee on Unemployment.

However valuable some of the federal government's manpower training and other social programs may be, they cannot hold a candle to the efficacy of a tight labor market. Necessity is the mother of invention. When 4 million business firms are scrambling for labor in a highly prosperous economy, it suddenly turns out that the unemployable become employable and the untrainable trainable; discrimination against blacks or women becomes unprofitable. In World War II, to choose a dramatic example, we pushed the unemployment rate below 2 per cent. And the result of that tight labor market was revolutionary. Black-white income differentials shrank faster than in any subsequent period, the income distribution became sharply more equal; employers scoured the back-country farm areas and turned poor and untrained sharecroppers into productive industrial workers, whose sons and daughters became the high school graduates of the 1950s and whose grandchildren will shortly begin to enter college in droves.

The importance that S.50 attaches to high employment, therefore, is not misplaced. The nation cannot afford over the next decade to settle for a relatively sluggish economy and a high unemployment rate.

What stands in the way of full employment?

The basic problem with achieving and maintaining full employment is not that we lack the economic tools to generate increased employment. The traditional weapons for stimulating economic activity—easy money, tax cuts, and government spending for worthwhile purposes—are perfectly capable of generating an increased demand for public and private goods and services, thereby inducing employers to hire more workers. Moreover, we do not need to have the government hire people directly on special programs of public service employment as a long run device to reduce unemployment. The real problem is that every time we push the rate of unemployment toward acceptably low levels, by whatever means, we set off a new inflation. And, in turn, both the political and the economic consequences of inflation make it impossible to achieve full employment or, once having achieved it, to keep the economy there.

With unemployment now at 7.5 per cent, the problem is not an immediate one. A rapid recovery could continue for the next year and a half or so, pushing the unemployment rate down steadily, without setting off a new inflation. But experience in the postwar period to date strongly suggests that once the overall rate of unemployment edges below 5.5 per cent or so, and the rate of adult unemployment gets much below 4.5 per cent, inflation will begin to accelerate.

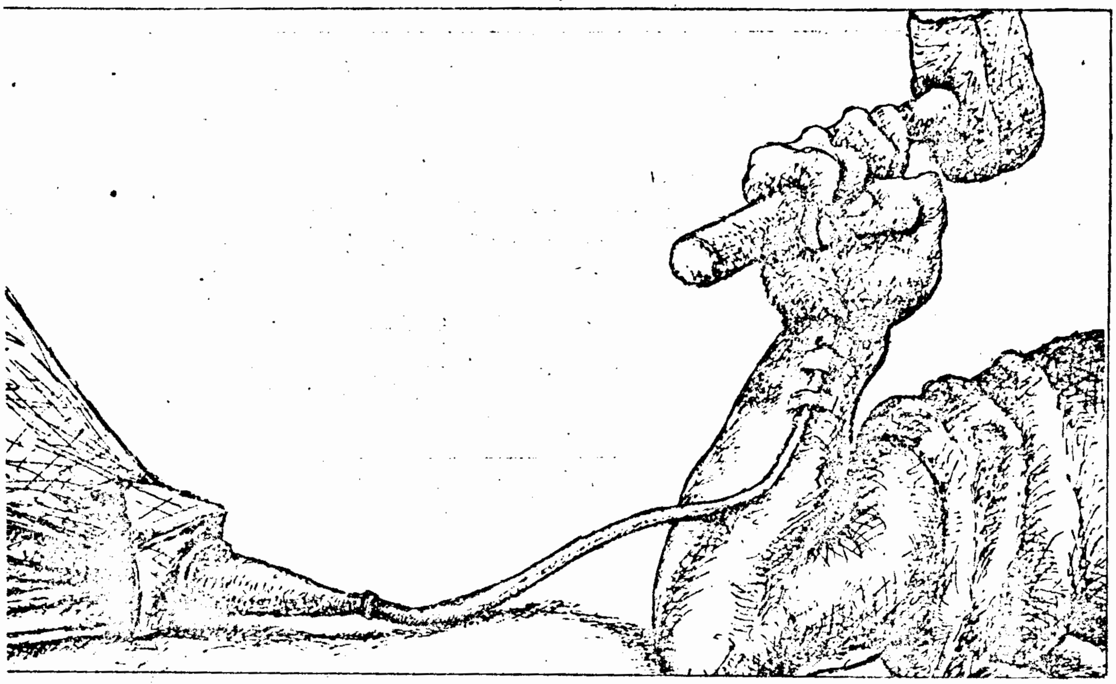
Inflation can occur for other reasons —as it did from crop shortages and oil price hikes in 1973. And inflation, once started, can persist stubbornly for a while even when unemployment has risen sharply. Despite these complications, it is still highly likely that pushing the adult unemployment rate to the 3 per cent target of S.50 would generate substantial inflation in the absence of major new tools for inflation control.

There is, among economists, a division of opinion about whether the resultant inflation would be a high but steady rate or an ever-accelerating rate. If the latter view is correct, then keeping employment to the 3 per cent target would eventually become impossible, since no economy could stand an ever increasing rate of inflation. One of the reasons we do not know the answer to this controversy is that the political consequences of inflation have been such that the nation has never persisted in holding adult unemployment to 3 per cent for many years running.

I believe, therefore, that a realistic view of both the economics and the politics of inflation and unemployment lead to one central conclusion: The stumbling block to low unemployment is inflation; the supporter of a full employment policy must of necessity become a searcher for ways to reduce the inflation that accompanies full employment.

The central problem is that when the overall unemployment rate gets down into the neighborhood of 5 per cent, the job market for experienced prime age workers becomes very tight. There are many unfilled job vacancies and not many unemployed in this age group. The large number of younger unemployed workers do not move in to fill these vacancies. As a consequence, wages are bid up sharply and prices begin to rise, even though the overall unemployment rate is still high.

One approach to this problem lies in the whole panoply of job counseling, training and placement services for youth. Federal efforts in this direction should be continued and expanded. And a carefully structured public service program for youth could also contribute. (Strangely, the "employer-of-last-resort" program in S.50 is restricted to adult workers.) But in all honesty, the record of recent years



By Geoffrey Moss for The Washington Post

does not warrant a confident hope that such programs can be the principal solution to the problem.

Sec. 206(d) of S.50 establishes a major new policy—the federal government is pledged to become the employer-of-last-resort for those who cannot find work elsewhere. Sec. 206(e)(4) provides that a person shall be eligible for an employment opportunity under this section if, among other things, he or she has not refused to accept a job that pays whichever is the *highest* of either the prevailing wage for that job or the wage paid in the government-created "employer-of-last-resort" job. In turn, Sec. 402 sets up a standard for wages in the "last-resort" jobs that is bound to be highly inflationary.

Under Sec. 402(c)(i), for example, the wage paid for a "last-resort" job in which a state or local government is the employing agent must be equal to that paid by the same government for people in the same occupation. But in states or cities with union agreements for municipal employees, and in many cases even without union agreements, the wage for a low-skill or semi-skilled municipal job is often higher than the wage paid for the same jobs in private industry. Given the provisions of Sec. 206(d), a person can turn down a private industry job and still be eligible for a "last-resort" job, so long as the latter pays more than the former, and in many cases it will. An unskilled laborer earning, say, $2.50 an hour in private industry can afford to quit, remain unemployed for four to six weeks (or whatever time might be needed to be eligible), then claim a "last resort" job paying (on municipal wage scales) $3.50 to $4.50 an hour, and come out way ahead.

This would show up in heightened form in any "last-resort" jobs created in construction work, since Sec. 402 requires Davis-Bacon wages, which in practice are set at the construction union wage scale in the nearest large city.

It is clear that in any area where municipalities or non-profit institutions pay higher scales for relatively unskilled or semi-skilled labor than does private industry, the wage scales in private industry will quickly be driven up to the higher level. Otherwise there would be a steady drain of labor away from private industry into "last-resort" jobs. A new and much higher set of minimum wages would be created!

The direct and indirect effects of this on the inflationary problem would be extremely serious, once the bill was in full operation. Labor would become very scarce over a broad range of semi-skilled and unskilled jobs in private industry. Wage rates would rise sharply and prices would follow; the size of the government's job programs would grow rapidly, as workers left lower paying private jobs for the higher wages stipulated in Sec. 402.

Once you begin to ask how to correct this problem, the dilemma of any "government-as-employer-of-last resort" provision becomes clear. When the unemployment rate is below 5 or 5.5 per cent, most unemployment is *not* long term. Among adult males, unemployment often consists of a period of four to eight weeks after a layoff before a new job is found. Among many teenagers unemployment in such times is not a steady thing, but a period between two relatively low paying jobs. What wages do you pay in the "last-resort" jobs? If you pay low enough wages so as not to attract many people from their existing jobs, you have a very unattractive program. Many private jobs are low-paying, and the only way to avoid attracting people from private industry is to set the "last-resort" wages very low indeed. But then, except in periods of high unemployment, when even very low paying jobs aren't available, who wants the program? If you set the wage somewhat higher—even if not absolutely high—it will still exceed the wages of many people with a current job in private industry. If so, it will begin to cause an exodus from private industry, and drive up wages and prices.

Special public service employment during periods of recession is a useful tool of counter-cyclical policy. Government-financed summer employment for school age youths makes sense. And, in good times, public service employment, paid at unemployment compensation rates, may be the most appropriate way to provide for that relatively small number who have exhausted their unemployment compensation. (This would, however, imply unequal pay for equal work.) But the concept of government as employer of last resort is not a workable method of pushing the overall unemployment rate down to very low levels.

I think that there would be merit in reorganizing the bill so that it jointly addressed the inflation and unemployment problems, and explicitly pointed in the direction of preventing the inflation acceleration that goes with low unemployment.