November 28, 1977

AN ANALYSIS OF THE

CARTER-HUMPHREY-HAWKINS PROPOSAL

INTRODUCTION

During the Presidential campaign of 1976, candidate Jimmy Carter endorsed the Humphrey-Hawkins Bill, but later hedged his position. This was done on the advice of campaign aides who informed him of the massive centralized planning of the economy called for in this legislation.

Since taking office President Carter has been hesitant to endorse the Humphrey-Hawkins measure. Faced with a skeptical business community, Carter has attempted to refrain from endorsing any legislation that would produce chills up and down Wall Street and send the economy into a tailspin. However, this has placed him politically "between a rock and a hard place." If he endorses legislation that gives the business community the "jitters," this may abort the moderately bullish economy we are experiencing and precipitate a recession.

On the other hand President Carter has political promises to keep. In 1976 he was the first Democratic Presidential candidate since Franklin Roosevelt in 1944 to carry the Solid South (except for Virginia). Carter's share of the black vote was the same as McGovern's in 1972 (well over 90%), plus he was supported by labor and liberal intellectuals. This is the old "Roosevelt Coalition," and except for the South, it is liberal. In return for their campaign support, they have demanded a quid pro quo, and that is the Humphrey-Hawkins bill. This the President has done, yet the version he has endorsed is vastly different from the 1976 legislation (H.R. 50).

PROVISIONS

FULL EMPLOYMENT AND BALANCED GROWTH ACT OF 1976 (H.R. 50)	FULL EMPLOYMENT AND BALANCED GROWTH ACT OF 1977
1. Would require the federal government to use various social and economic programs to reduce unemployment from the 1976 figure of 7.5 percent to 3 percent in 4 years.	1. Extends till 1983 the goal of "reducing unemployment among Americans aged 20 and over in the civilian labor force to not more than 3 percent and to reduce unemployment among the entire civilian force aged 16 and over to not more than 4 percent...."
2. Mandate that the federal government be the employer of last resort by setting up "reservoirs of federally operated public employment projects."	2. The bill would not authorize new Federal job programs or other spending, but would leave to Congress this authority. Programs already in force would be required to adhere to the bill's goals, and conceivably these programs could have additional funding.
3. Set up an "alternative source of capital funds for local and state governments to finance public facilities."	3. The President's annual January economic report would be required to include short-term numerical goals for employment, production, real income, unemployment, and productivity for the current year and the next, plus medium-term goals for the following three years.
4. Make full use of presidential powers that would make the creation of full employment as the nation's first priority. These powers would include, but not be limited to the use of the federal budget, monetary policies, tax policies, the power to dictate policy to the Federal Reserve Board, and the power to raise or lower interest rates.	4. The President would have to list those programs and policies necessary to achieve these goals plus propose Federal budgets compatible with them.

5. Require that the President submit an annual report to Congress that would set annual quotas in areas such as employment, production, and purchasing power in order to reach full employment. He would "reorder national priorities" and certain areas of the budget would be exempt from future cuts if they fell within the national job plan.

6. Furthermore, he would create an "Advisory Committee on Full Employment and Balanced Growth," the "Full Employment Office," and the "Division of Full Employment and Balanced Growth" to implement the policies of the bill.

7. The cost of the bill would be an estimated minimum of $45 billion.

5. Each year the Federal Reserve Board would be required to tell Congress its plans for monetary policy and describe how these plans fit in with the President's goals.

6. There has been no cost estimate made of this bill. It is open-ended. "Sec. 403. There is authorized to be appropriated such sums as may be needed to carry out the provisions of this Act."

INFLATION

Many newspaper accounts have reported that President Carter's reluctance to endorse this legislation earlier was tied to his concern that the bill would further heat up inflation. Only when he was assured that it would not did he indicate his approval of the bill. However, the Humphrey-Hawkins legislation requires that there be coordination between programs already in progress and the goals of this bill. Some critics see a discrepancy between Presidential actions and Presidential rhetoric.

Even though the President says that the bill contains "a strong anti-inflation commitment in addition to the anti-unemployment commitment," other economists see it differently. Surprisingly, one of them is John Kenneth Galbraith. "At a four percent unemployment rate, there is no question, the American economy can be disastrously inflationary...I must specifically and deliberately warn my liberal friends not to engage in the wishful economics that causes them to hope that there is still undiscovered fiscal or monetary magic which will combine low unemployment with a low-level of inflation." (Testimony before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, on S. 50, the Fair Employment and Balanced Growth Act, May 21, 1976.)

Furthermore, many economists see a serious flaw in this bill's approach to inflation. Sec. 109. Overcoming Inflation, Sec. 9(a) states that "The Congress hereby determines that the objective of achieving price stability as soon as feasible...." The rest of this section treats high prices as inflation. The classical and generally accepted definition of inflation is an increase in the money supply. More specifically, it is an increase in the money supply over and above that of a parallel increase in the production of goods and services. Free market economists agree that more and more money chasing fewer goods produces higher demand and therefore higher prices. An example: During the five fiscal years, 1971-76, about 23 percent of the Federal deficits were financed simply by having the Federal Reserve provide more credit on the basis of which the banking system then created some $250 billion of additional money and credit. Largely as a result of the monetization of the 1971-76 Federal deficits, the money supply (M_2) rose by 55 percent at a time when the output of goods and services grew by only 15 percent. The result was an increase in consumer prices of almost 40 percent.

Senator William Proxmire (D-Wisc.), Vice Chairman of the House-Senate Joint Economic Committee, has this to say about inflation, "...the major cause--certainly in the long run--has been the ponderous and burdensome government which has produced first the creeping, then the running, and finally the galloping inflation. ...Government spending has to be financed by the private sector, either through taxes, which add to the cost of production and thus to the costs of living, or through inflation." (Senator William Proxmire's paper "Inflation and Government Spending," was delivered at the Menace of Inflation Symposium of the Committee for Monetary Research and Education, Inc. at the Center for Strategic and International Studies of Georgetown University, Washington, D.C., November, 1974).

Certainly the variance of these two views on inflation will have to be debated if the Humphrey-Hawkins bill is to be considered by the Congress.

FEDERAL RESERVE POLICIES

According to this current proposal, the Board of Governors of the Federal Reserve would be required to furnish to the Congress "an independent statement setting forth its intended policies for the year ahead, and their relationship to the short-term goals set forth in the Economic Report...the Congress shall then take such action as it finds necessary to assure closer conformity to the Full Employment and Balanced Growth Act of 1977." A number of observers are concerned that this would make the Federal Reserve Board more open to partisan control. The Washington Star in its editorial of May 7, 1976, had this to say about the previous Humphrey-Hawkins bill:

> The bill would necessitate an undetermined but considerable amount of political manipulation of the monetary and interest rate policies of the Federal Reserve Board. Some fellow in the White House basement ...might be making monetary policy. If that happens we might be well advised to swap our wallets for wheelbarrows.

UNEMPLOYMENT

Essentially the Humphrey-Hawins bill is an effort to fight unemployment. However, two questions have to be asked when we talk about unemployment. The first is, whether there are government programs that contribute to unemployment among certain segments of our society. The second question that economists are asking is whether our methodology of determining who is unemployed needs some attention.

In October the general unemployment for all workers was 7 percent; while among teenagers it was 17 percent and well over 40 percent with black teenagers. Under this legislation unemployment would be reduced by a combination of job training programs and macroeconomic monetary and fiscal policy. One economist who disagrees with this approach is Dr. Walter Williams. In 1977 Dr. Williams, Associate Professor of Economics at Temple University, Philadelphia, Pennsylvania, prepared a 59-page study for the Joint

Economic Committee of the U.S. Congress on the minimum wage. His findings were that the minimum wage law held back the employment of teenagers, racial minorities, and the physically handicapped. Williams suggested that the best way to reduce unemployment among these marginal workers was to abolish the federal and state minimum wage laws and reduce monopolistic union practices.

THE MYSTIQUE OF THE 4% UNEMPLOYMENT RATE

The Humphrey-Hawkins bill calls for a reduction of "unemployment among the entire civilian labor force aged 16 and over to not more than 4 percent...." The 4 percent unemployment rate has been traditionally called the zero-unemployment or full-employment rate. Below this figure inflationary pressures begin to accelerate. Also this 4 percent figure has been interpreted to include people who are changing jobs, students just entering the market place, and housewives also looking for employment. The history of how this figure has become a benchmark for full employment is quite interesting.

In 1948 the general unemployment rate was between 3½ and 4 percent, and during the Korean War it slipped to 2½ percent. From that time onward it has gone up. Excepting the 1960-61 recession, the rate during the early 1960's was between 5 and 6 percent. At that time the Kennedy Administration chose the 4 percent rate. (Council of Economic Advisors, Annual Report, 1962, p. 46). This was considered to be quite a conservative level since a 3½ percent rate had been attained in the early 50's. In December 1965 the 4 percent rate was achieved along with some slight inflation although by the second half of 1968 a 3½ percent was met, but not without raging inflation. From that time forward the 4 percent rule was considered optimum yet since January 1970 it has not been attained --with or without inflation.

Even though the 4 percent rule has remained inflexible, there have been massive changes in the composition of the labor market. An example of this has been the role of women in the job market. Their representation in the labor force has increased from 31 percent in 1956 to 40 percent in 1976. This has been an increase in their participation rate from 37 to 48 percent, while at the same time there has been a decline in this rate for older men. With ~~this~~ change in women's employment, there has also been a shift among young workers aged 16 to 24. Their participation rate has increased from 17 percent in 1956 to 24 percent in 1976. It should be noted that women and young workers have more frequent periods of unemployment because they enter, leave, and reenter the labor force and shift between jobs in search of better opportunities. "In the high-employment year of 1973, men between the ages of twenty-five and fifty-four had an unemployment rate of 2.5 percent, whereas women had a 6.0 percent rate and young workers had a 10.5

percent rate." (Phillip Cagan, "The Reduction of Inflation and the Magnitude of Unemployment," Contemporary Economic Problems, 1977, William Fellner, ed., Washington, D.C.: American Enterprise Institute, 1977, p. 29.)

Many economic observers are surprised that with these significant changes in the makeup of the nation's work force that it has taken over two decades for the federal government to update their definition of a full employment rate. Finally, this year the Council of Economic Advisors estimated that an unemployment rate of 4.9 percent in 1977 was equivalent to a 4.0 percent rate in 1955, "perhaps, closer to 5.5 percent." (Economic Report of the President, 1977, pp. 48-51.) Even this 5.5. percent may be unnecessarily low. Phillip Cagan estimates that the noninflationary unemployment rate is now between 5.8 and 6.2 percent. In a November 13, 1977 editorial the Washington Post also noted that a 4 percent full employment rate seemed to be unrealistic. "The main point of the bill, in its present form, is to set a 4 percent unemployment rate as a goal to be achieved over five years. How? The bill doesn't say. Why 4 percent? Because, until recently, that was the conventional definiton of full employment. It was the level below which the rate could not be pushed without a surge of wage inflation, as employers bid against each other for scare manpower. Unfortunately, that threshold has shifted upward in recent years. In terms of inflationary risk, an unemployment rate of 5 or even 5.5 percent currently is the equivalent of 4 percent in the 1950's."

Another government program that may inflate unemployment statistics is the work registration requirements for certain welfare recipients. In March 1977 a study was published by the Law and Economics Center of the University of Miami School of Law. The authors were Drs. Kenneth W. Clarkson and Roger E. Meiners, economists at the University of Miami, and the study was entitled "Inflated Unemployment Statistics: Effects of Welfare Work-Registration Requirements." This study was also presented as a paper at the 1977 Public Choice Society meeting in New Orleans. Their findings show that the inclusion of individuals who would not have been previously considered unemployed has had the effect of padding the unemployment rate over the past few years by approximately 2½ percentage points. For example, in 1976 when unemployment was officially at 7.7 percent, it was actually 5.3 percent under traditional standards. In 1976 the food stamp program alone inflated the unemployment statistics by more than one million persons.

The following table shows the effects these work registration requirements have on the unemployment rate. It is taken from p. 18 of their study.

Table 8

ESTIMATES OF THE EFFECTS OF FOOD STAMP AND AFDC WORK REGISTRATION REQUIREMENTS ON THE UNEMPLOYMENT RATE

1974-1976

ITEM	1974	YEAR 1975	1976
Average Civilian Labor Force (thousands)	91,011	92,613	94,773
Average Official Unemployment (thousands)	5,076	7,830	7,288
Average Official Unemployment Rate (percentage)	5.6%	8.5%	7.7%
Average Food Stamp Work Registration Active Employment Service Applicants (thousands)	784[a]	1,209[b]	1,227[c]
Average AFDC (WIN) Mandatory Registrants (thousands)	917[b]	1,099[b]	1,160[c]
Corrected Average Unemployment (thousands)	3,375	5,522	4,901
Corrected Civilian Labor Force (thousands)	89,310	90,305	92,386
Corrected Unemployment Rate (percentage)	3.8%	6.1%	5.3%

Sources: Bureau of Labor Statistics, EMPLOYMENT AND EARNINGS, Table A-1; Department of Labor, Employment Series Automated Reporting System, (unpublished statistics); National Center for Social Statistics, THE WORK INCENTIVE PROGRAM, Report E-5.

a) Based on monthly average for June through December.

b) Based on monthly average for January through December.

c) Based on monthly average for January through September.

The conclusion of their study is: "Since the unemployment rate is often used as a basis for policy decisions, it is import- to distinguish between the effects due to the new institutional requirements and those attributable to the more traditional reasons for identifying individuals as unemployed." p. 19.

SUMMARY

With these figures showing that perhaps the unemployment rate is overstated, President Carter may be basing his full employment program on some fallacious assumptions. The possibility of increased inflation is real and should be fully debated if and when the Congress begins consideration of this legislation.

By David A. Williams
Policy Analyst
Economics/Taxation