LABOR STATISTICS AND ECONOMIC POLICY

Remarks by

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I. INTRODUCTION

I was delighted to get, and accept, the invitation from Julius Shiskin to speak before this assembly on the connection between labor statistics and monetary policy, for it is always a pleasure to have the opportunity to talk to a well-informed audience on a matter of great interest and significance.

Usually an after-dinner speech should be light and short. And that was my original intention, and perhaps your hope. However, the more I thought about the impressive credentials of this group, the more it seemed to make sense to take the risk of working you a little harder than usual, because I need your help to resolve some very disturbing questions in my mind. Specifically, since Congress (in PL 94-444) has provided for the establishment of a National Commission on Employment and Unemployment Statistics to give us the first thorough review of labor statistics since the Gordon Committee in 1962. I want to take this unique opportunity to discuss some of the issues I hope the new commission -- and all of you who are involved in its work -- will consider as it goes about its task.
II. RELATIONSHIP BETWEEN POLICY, DATA AND THEORIES

LET ME BEGIN BY INDICATING THAT THROUGH MY EXPERIENCE IN MANAGEMENT, I'VE DEVELOPED A PHILOSOPHY ABOUT HOW YOU BEST GET THINGS DONE, AND IT GOES LIKE THIS:

FIRST, REQUIRE THE MANAGER, OR POLICYMAKER, TO DETERMINE WHAT OBJECTIVES ARE TO BE ACHIEVED.

THEN, GIVEN THE OBJECTIVES, HAVE THE TECHNICAL SPECIALIST DETERMINE WHAT YOU NEED TO KNOW AND DO TO ACCOMPLISH THOSE OBJECTIVES. THIS VIEW DOES NOT IN ANY WAY DOWN-GRADE THE QUALIFICATIONS OR THE ROLE OF TECHNICAL SPECIALISTS (WHETHER THEY BE COMPUTER EXPERTS, STATISTICIANS, ECONOMISTS, OR OTHERS). IT SIMPLY MEANS THAT THE ONLY LOGICAL WAY TO PROCEED IS TO FIRST SPECIFY THE OBJECTIVES OR END-RESULTS THAT ARE TO BE ACCOMPLISHED, AND THAT IS THE RESPONSIBILITY OF POLICYMAKERS OR MANAGERS, NOT THE STAFF SPECIALISTS.

TO APPLY THIS LINE OF REASONING TO THE ISSUE AT HAND MEANS THAT BEFORE THE NATIONAL COMMISSION CAN REALLY DO ITS WORK, IT MUST FIRST FIND OUT FROM POLICYMAKERS WHAT OBJECTIVES THEY DESIRE TO ACHIEVE. BUT THERE IS THE RUB, FOR MANY POLICYMAKERS WOULD, I'M SURE, PROVIDE MANY DIFFERENT VIEWS. FOR EXAMPLE, EVERYONE WOULD PROBABLY AGREE THAT THE PURPOSE OF ECONOMIC POLICY IS TO ATTAIN THE HIGHEST LEVEL OF WELL-BEING FOR SOCIETY AS A WHOLE -- OR AS ECONOMISTS MIGHT PUT IT, TO MAXIMIZE SOCIAL WELFARE. THIS, HOWEVER, IS NOT A VERY USEFUL STATEMENT, BECAUSE, TO BE
OPERATIONAL OBJECTIVES MUST BE STATED IN QUANTIFIABLE TERMS. WE NEED NUMERICAL INDICATORS OF WELFARE IN ORDER TO DETERMINE HOW SUCCESSFUL DIFFERENT GOVERNMENT POLICIES ARE IN ATTAINING OUR OBJECTIVES. AND THE SELECTION OF THESE INDICATORS IS A VERY DIFFICULT PROBLEM, BECAUSE WHAT WE DECIDE TO USE AS INDICATORS OF WELFARE DEPENDS ON OUR VIEWS OF THE ECONOMIC WORLD. IF, FOR EXAMPLE, WE BELIEVE THAT ANY UNEMPLOYMENT WHICH OCCURS IS A RESULT OF MARKET FAILURE AND THAT IT CAN BE ELIMINATED BY APPROPRIATE AGGREGATE DEMAND POLICIES, A MEASURE OF UNEMPLOYMENT IS A VERY USEFUL INDICATOR OF WELFARE. ON THE OTHER HAND, IF WE BELIEVE ALL UNEMPLOYMENT IS IN SOME SENSE VOLUNTARY AND CANNOT BE AFFECTED BY AGGREGATE DEMAND POLICIES, WE THEN HAVE LITTLE USE FOR UNEMPLOYMENT MEASURES.

MY POINT IS THAT THE PRIMARY USE OF DATA WE COLLECT SHOULD BE TO AID IN MAKING PUBLIC POLICY, AND THE KINDS OF DATA WE COLLECT SHOULD THEN BE PREDICATED ON OUR VIEWS OF WHAT MAKES THE ECONOMY TICK. AND IF THERE ARE CONFLICTING VIEWS, AS THERE ARE, THEN IT IS ESSENTIAL TO HAVE DATA THAT HELP US TO DETERMINE WHICH VIEW OF THE WORLD IS CORRECT.

III. VIEWS HAVE CHANGED SINCE 1962

IF YOU BUY WHAT I HAVE SAID SO FAR, THEN I CAN EASILY STATE MY MAIN POINT. SOME SHARPLY DIVERGENT VIEWS ON THE ECONOMY AND ON THE LABOR MARKET, IN PARTICULAR, HAVE EMERGED SINCE LABOR STATISTICS WERE LAST REVIEWED IN 1962. CONSEQUENTLY, THE KINDS OF STATISTICS WE COLLECT MUST BE CHANGED TO HELP US EVALUATE THE
NEW VERSUS THE OLD VIEW. AT THE RISK OF WORKING YOU A LITTLE BIT, LET ME EXPLAIN WHAT I MEAN.

BACK IN 1962 WHEN THE GORDON COMMITTEE WAS AT WORK, THERE WAS ESSENTIALLY ONLY ONE VIEW OF UNEMPLOYMENT. WE MIGHT CALL THIS VIEW THE STATIC KEYNESIAN VIEW, AND ITS STORY GOES SOMETHING LIKE THIS: EMPLOYEES ENTER WITH THEIR EMPLOYERS INTO CONTRACTS WHICH PROMISE IN RETURN FOR WORK PERFORMED SOME SCHEDULE OF WAGES STATED IN DOLLAR TERMS AND COVERING A NUMBER OF PERIODS.

IF SOME UNFORESEEN EVENT OCCURS WHICH RESULTS IN A FALL IN AGGREGATE DEMAND -- FOR EXAMPLE, A SURPRISE DECLINE IN BUSINESS INVESTMENT -- FIRMS ARE NOT ABLE TO SELL ENOUGH GOODS AT THE PRICE THEY REQUIRE TO KEEP THEIR EMPLOYEES FULLY EMPLOYED. EMPLOYEES ARE LAID OFF, AND THEY AND NEW JOB SEEKERS ARE NOT ABLE TO FIND WORK AT THE CURRENT MARKET WAGE. THE GOVERNMENT, HOWEVER, CAN STEP IN AND OFFSET THIS UNFORESEEN FALL IN AGGREGATE DEMAND, AND THE SUBSEQUENT RISE IN UNEMPLOYMENT, WITH STIMULATIVE POLICIES.

I CANNOT CLAIM TO BE CERTAIN THAT OUR UNEMPLOYMENT STATISTICS ARE PREDICATED ON THAT VIEW OF THE LABOR MARKET, BUT I THINK I CAN BUILD A STRONG CASE THAT THEY ARE.

FOR EXAMPLE, SINCE 1940 NATIONAL UNEMPLOYMENT STATISTICS HAVE BEEN COLLECTED ON AN ONGOING BASIS. AND, FROM THE OUTSET, THE ATTEMPT WAS MADE TO COUNT UP ALL THOSE "ABLE, WILLING, AND SEEKING TO WORK." THE QUESTIONS ASKED IN ORDER TO DETERMINE WHO

THE JEC WENT ON TO OBSERVE THAT, "INCREASES IN GOVERNMENT AND PRIVATE OUTLAYS BOTH TEND TO INCREASE EMPLOYMENT. WHEN UNEMPLOYMENT IS HIGH, THESE OUTLAYS HAVE LITTLE IF ANY INFLATIONARY TENDENCIES."

THIS KEYNESIAN VIEW OF THE WORLD MAY EXPLAIN WHY THE GORDON COMMITTEE CONSIDERED THE IDEA OF GATHERING DATA ON WAGE RATES THAT WOULD BE "ACCEPTABLE" TO THE UNEMPLOYED, BUT THEN DISMISSED IT.

THIS STATIC KEYNESIAN VIEW OF THE LABOR MARKET, WHICH SEEMS TO UNDERLIE OUR LABOR STATISTICS, HAS SOME DEFINITE IMPLICATIONS FOR PUBLIC POLICY. TWO OF THE MOST IMPORTANT ARE:

-- LESS UNEMPLOYMENT IS ALWAYS PREFERRED TO MORE.
-- GOVERNMENT POLICIES WHICH INCREASE AGGREGATE DEMAND SHOULD LOWER UNEMPLOYMENT.
AS WE ARE ALL PAINFULLY AWARE, THE KEYNESIAN POLICY PRESCRIPTION HAS NOT SEEMED TO LIVE UP TO ITS PROMISE. POLICIES DESIGNED TO STIMULATE AGGREGATE DEMAND SEEM TO HAVE A MUCH LARGER EFFECT ON PRICES THAN ON UNEMPLOYMENT.

MOREOVER, THE EMPLOYMENT PROCESS IS DYNAMIC AND UNFOLDS IN A VERY UNCERTAIN ENVIRONMENT. WHERE THERE IS UNCERTAINTY AS THERE IS IN LABOR MARKETS, QUEUES AND INVENTORIES PLAY AN IMPORTANT ROLE IN THE EFFICIENT ALLOCATION OF RESOURCES. SO UNEMPLOYMENT NEED NOT BE INTERPRETED AS MARKET FAILURE, BECAUSE LABOR MARKETS COULD BE OPERATING EFFICIENTLY AND STILL PRODUCE UNEMPLOYMENT.

DUE TO DISSATISFACTION WITH THE STATIC KEYNESIAN THEORY OF THE LABOR MARKET AND TO ITS APPARENTLY INVALID IMPLICATIONS FOR POLICY, NEW THEORIES OF THE LABOR MARKET WERE DEVELOPED AND APPEARED IN THE LATE 1960's. TWO IMPORTANT FEATURES OF THESE NEW THEORIES ARE THAT THEY ARE DYNAMIC AND THAT THEY ASSUME DECISIONS ARE MADE IN AN UNCERTAIN SETTING. THE STORY THESE NEW THEORIES TELL GOES SOMETHING LIKE THIS:

EACH EMPLOYER WHO HAS A VACANCY MUST DETERMINE A WAGE TO OFFER PROSPECTIVE EMPLOYEES. IF THAT WAGE IS TOO LOW, HE WILL HAVE TROUBLE ATTRACTING THE QUALITY OF EMPLOYEE HE DESIRES. IF IT IS TOO HIGH, HE WILL FIND PLENTY OF QUALITY PEOPLE AT HIS DOOR, BUT HE WILL BE OVERPAYING THEM. ONCE THE EMPLOYER SETS THE WAGE, HE MUST THEN ENGAGE IN A COSTLY SEARCH OF APPLICANTS TO DECIDE -- BASED ON LIMITED DATA -- WHETHER ANY GIVEN INDIVIDUAL HAS THE NECESSARY QUALIFICATIONS. THESE THEORIES TELL US
EMPLOYERS WILL BASE THEIR OFFERING WAGE ON THEIR PERCEPTION OF MARKET WAGES, AND GIVEN THIS OFFERING WAGE THEY WILL SEARCH UNTIL THEY CAN HIRE SOMEONE QUALIFIED AT THAT WAGE OR UNTIL THEY DETERMINE THEY MUST CHANGE THE OFFERING WAGE.

PEOPLE LOOKING FOR WORK ARE SIMILARLY ASSUMED TO ENGAGE IN A PROCESS OF SEARCH. BASED ON THE COSTS OF SEARCH (I.E., ON THE LEISURE AND INCOME HE MUST GIVE UP), HIS LEVEL OF TRANSFER PAYMENTS, AND ON BELIEFS ABOUT THE DISTRIBUTION OF WAGES EMPLOYERS ARE OFFERING, EACH INDIVIDUAL LOOKING FOR WORK DEVELOPS AN OPTIMAL STOPPING RULE. HE SETS, WHAT ECONOMISTS CALL, A RESERVATION WAGE -- THE WAGE FOR WHICH HE FEELS IT PAYS HIM TO WORK -- AND SEARCHES UNTIL HE GETS AN OFFER AT OR ABOVE HIS RESERVATION WAGE.

SOME ARGUE THAT THESE NEW THEORIES OF SEARCH CAN AT MOST GIVE US A HANDLE ON VOLUNTARY UNEMPLOYMENT. THEY BELIEVE THAT THE EXISTENCE OF INVOLUNTARY UNEMPLOYMENT, LAYOFFS, AND OTHER SEEMINGLY NONCOMPETITIVE ASPECTS OF LABOR MARKETS ARE AT ODDS WITH THE NEW THEORIES.

THE ADVOCATES OF THE NEW THEORIES, HOWEVER, DO NOT BELIEVE SO. CERTAIN FEATURES OF EMPLOYMENT CONTRACTS, THEY ARGUE, CAN BE INTERPRETED AS DESIRABLE ARRANGEMENTS FOR THE SHARING OF RISK AMONG EMPLOYEES AND EMPLOYERS. RISK-SHARING ARRANGEMENTS ALMOST ALWAYS CALL FOR SOME INVOLUNTARY ACTION -- AFTER THE FACT. NO ONE, FOR EXAMPLE, REALLY WANTS TO PAY UP AFTER LOSING A BET. INVOLUNTARY UNEMPLOYMENT MIGHT THEN BE A NATURAL OUTCOME OF THE WAY PEOPLE
BARGAIN FOR JOBS IN A MARKET ECONOMY OPERATING IN AN UNCERTAIN ENVIRONMENT, AND THE CONCEPT OF INVOLUNTARY UNEMPLOYMENT THEN DISAPPEARS.

THE NEW THEORIES ARE STILL IN AN EARLY STAGE OF DEVELOPMENT, BUT THEY ALREADY HAVE SOME IMPORTANT POLICY IMPLICATIONS WHICH ARE JUST THE OPPOSITE OF THOSE FOR THE KEYNESIAN VIEW:

-- LESS UNEMPLOYMENT NEED NOT BE PREFERRED TO MORE. THE NEW THEORIES SUGGEST, FOR EXAMPLE, THAT A POLICY CHANGE WHICH INCREASES THE COST OF SEARCHING FOR A JOB WILL LOWER UNEMPLOYMENT BUT WILL MAKE PEOPLE WORSE OFF. SINCE THE POLICY CHANGE MAKES IT MORE COSTLY TO SEARCH, PEOPLE ACCEPT JOBS FASTER THAN THEY OTHERWISE WOULD. BUT THEY ARE WORSE OFF BECAUSE THEY ACCEPT THE JOBS AT A LOWER WAGE THAN THEY OTHERWISE WOULD.

-- GOVERNMENT POLICIES WHICH RAISE AGGREGATE DEMAND MAY NOT LOWER UNEMPLOYMENT.

IV. AN UNRESOLVED ISSUE

TO UNDERSTAND THIS LAST IMPLICATION, SUPPOSE THAT THE WAGES OF BOTH WORKERS AND EMPLOYERS ARE SET IN NOMINAL DOLLAR TERMS. SINCE IN FACT BOTH EMPLOYERS AND JOB SEEKERS CARE ABOUT REAL WAGES (THAT IS, DOLLAR WAGES DEFLATED BY PRICES), THEY MUST PREDICT WHAT WILL HAPPEN TO PRICES IN THE PERIOD OF THE WAGE CONTRACT. THE ISSUE THEN IS WHETHER EMPLOYERS AND EMPLOYEES BASE
THEIR PREDICTIONS OF PRICE IN PART ON WHAT THEY EXPECT GOVERNMENT POLICY TO BE.

TO ILLUSTRATE, SUPPOSE THAT WE AT THE FEDERAL RESERVE WERE TO INCREASE THE AMOUNT OF MONEY IN EVERYBODY'S POCKETS. PEOPLE WOULD SPEND AT LEAST PART OF THE INCREASE. FIRMS WOULD NOTICE AN INCREASED DEMAND FOR THEIR PRODUCTS, WOULD RAISE THEIR PRICES, AND WOULD OFFER HIGHER WAGES TO ATTRACT NEW EMPLOYEES. BASED ON A VIEW THAT JOB SEEKERS FORECAST PRICES BASED ONLY ON WHAT HAS HAPPENED IN THE PAST, WORKERS' REQUIRED WAGES INITIALLY WOULD REMAIN UNCHANGED. CONSEQUENTLY, THE INCREASED DEMAND FOR LABOR WITH AN UNCHANGED SUPPLY WOULD LEAD TO A FALL IN UNEMPLOYMENT.

BUT AS I INDICATED, THERE IS ANOTHER VIEW OF HOW PEOPLE FORECAST, AND IT IS CALLED RATIONAL EXPECTATIONS. MUCH OF THIS THEORY WAS DEVELOPED AT THE FEDERAL RESERVE BANK OF MINNEAPOLIS. BASICALLY, IT SAYS THAT PEOPLE USE THE INFORMATION THEY HAVE ON HAND TO PREDICT IN THE BEST WAY POSSIBLE. AND TO PREDICT PRICES, PEOPLE WOULD CERTAINLY WANT TO TAKE INTO ACCOUNT WHAT POLICY -- ESPECIALLY MONETARY POLICY -- IS GOING TO BE.

IF JOB SEEKERS IN OUR EXAMPLE ANTICIPATE THAT THE FEDERAL RESERVE IS GOING TO INCREASE THE MONEY SUPPLY, THEY IMMEDIATELY WILL RAISE THEIR PRICE PREDICTIONS AND THEN RAISE THEIR WAGE EXPECTATIONS ACCORDINGLY. THUS, ACCORDING TO THE RATIONAL EXPECTATIONS VIEW, AN ANTICIPATED INCREASE IN MONEY WILL RAISE PRICES AND WAGES, BUT KEEP UNEMPLOYMENT UNCHANGED.
THE CRUCIAL DIFFERENCE IN THESE VIEWS IS THEIR IMPLICATION OF HOW THE WAGES REQUIRED BY JOB SEEKERS WILL CHANGE WHEN THERE IS AN ANTICIPATED SHIFT IN POLICY. THE FIRST VIEW PREDICTS THERE WILL BE NO CHANGE, WHILE THE RATIONAL EXPECTATIONS VIEW PREDICTS A CHANGE IN THE SAME DIRECTION AS THE POLICY SHIFT.

AS A DIGRESSION FOR THOSE WHO ARE INTERESTED, BOTH VIEWS IMPLY THAT RESERVATION WAGES WILL NOT CHANGE WHEN THERE IS AN UNANTICIPATED SHIFT IN POLICY. UNDER EITHER VIEW, AN UNEXPECTED SURGE IN THE MONEY SUPPLY, FOR EXAMPLE, WILL LEAD TO A RISE IN OFFER WAGES, WHICH WITH UNCHANGED RESERVATION WAGES, LEADS TO A DECLINE IN UNEMPLOYMENT.

IN FACT, THE RATIONAL EXPECTATIONS VIEW ATTRIBUTES THE STATISTICAL RELATIONSHIPS WE OBSERVE BETWEEN UNEMPLOYMENT AND GOVERNMENT POLICIES TO THE UNPREDICTABILITY OF OUR POLICIES OVER THE PAST.

COMING BACK TO THE MAIN POINT, ONE OF THE BIGGEST CHALLENGES MONETARY POLICY FACES TODAY IS TO ANSWER THE QUESTION POSED BY THE NEW RATIONAL EXPECTATIONS VIEW -- NAMELY, CAN MONETARY POLICY DO ANYTHING AT ALL TO SYSTEMATICALLY REDUCE UNEMPLOYMENT. IF THE ANSWER IS YES, THEN WE SHOULD KEEP ON TRYING, AS WE DO, TO ACCOMPLISH WHATEVER REDUCTIONS WE CAN. ON THE OTHER HAND, IF MONETARY POLICY REALLY CAN'T SYSTEMATICALLY REDUCE THE CYCLICAL INCREASES IN UNEMPLOYMENT, THEN WE SHOULD FOCUS SOLELY ON REDUCING INFLATION AND OTHER OBJECTIVES.
THAT'S WHY I PERSONALLY PLACE HIGH ON THE POLICYMAKERS' AGENDA THE CHALLENGE TO DISCRIMINATE BETWEEN THE TWO COMPETING VIEWS OF THE WORLD I'VE DESCRIBED IN ORDER TO SELECT WHICH BETTER REPRESENTS REALITY FOR THE POLICYMAKER. THE VERY ESSENCE OF WHAT WE DO IS AT STAKE.

THAT WILL BE A DIFFICULT TASK. YET, THE RIGHT SORT OF EMPLOYMENT AND UNEMPLOYMENT STATISTICS COULD CONTRIBUTE SOMETHING TOWARD HELPING US MAKE THAT DECISION.

THE NEW COMMISSION HAS BEEN GIVEN A CONGRESSIONAL MANDATE TO CONSIDER: "THE METHODOLOGY OF ANALYSIS OF SUCH DATA, INCLUDING ITS RELEVANCE AND APPLICATION," AND "THE EXTENT TO WHICH EMPLOYMENT AND EARNINGS DATA ASSIST IN DETERMINING THE IMPACT OF PUBLIC PROGRAMS AND POLICIES UPON PERSONS WHO ARE ECONOMICALLY DISADVANTAGED, UNEMPLOYED, OR UNDEREMPLOYED."

CRUCIAL TESTS BETWEEN THE TWO COMPETING VIEWS -- THE KEYNESIAN VIEW AND THE "RATIONAL EXPECTATIONS" VIEW -- MAY WELL HINGE ON EMPLOYMENT-UNEMPLOYMENT DATA. WE NEED TO LEARN A LOT MORE ABOUT HOW JOB SEEKERS DECIDE WHAT WAGE THEY WILL ACCEPT, AND HOW THAT DECISION CHANGES OVER TIME. AND AN UNDERSTANDING OF THAT IS CRUCIAL TO UNDERSTANDING WHAT, IF ANYTHING, MONETARY POLICY CAN DO TO REDUCE UNEMPLOYMENT.

CONSEQUENTLY, AMONG OTHER THINGS, THE COMMISSION MIGHT WANT TO RECONSIDER THE IDEA (REJECTED BY THE GORDON COMMITTEE) OF COLLECTING DATA THAT WOULD INDICATE THE WAGE RATES AT WHICH THE
UNEMPLOYED ARE WILLING TO WORK. THIS MEASURE OF A LABOR SUPPLY SCHEDULE COULD PROVE EXTREMELY USEFUL IN THE DEVELOPMENT AND TESTING OF NEW THEORIES OF LABOR MARKET BEHAVIOR. OF COURSE, WAGE RATE INFORMATION OF THIS KIND COULD ALSO PROVE USEFUL IN THE ANALYSIS OF VARIOUS POLICY ISSUES, SUCH AS THE IMPACT OF THE MINIMUM WAGE AND UNEMPLOYMENT COMPENSATION BENEFITS ON THE LEVEL OF UNEMPLOYMENT, ISSUES WHICH ARE CRITICAL BUT BEYOND THE SCOPE OF MY TALK TONIGHT.

IN SUM, A REDESIGNED SET OF LABOR STATISTICS IS URGENTLY NEEDED TO HELP US RESOLVE SOME VERY BASIC POLICY ISSUES. I WISH THE COMMISSION WELL AS IT SETS OUT ON SUCH A CRUCIAL TASK.