
Reducing Unemployment: Current Issues and Policy Options—A Summary of the Bank’s 1994 Symposium

By Bryon Higgins

Reducing unemployment has become a top priority for economic policy in most industrialized nations. While unemployment will ebb somewhat as countries recover from the recent global recession, millions are likely to remain jobless for a variety of structural reasons. Moreover, there is a disturbing trend in many industrialized countries toward long-term unemployment, especially among low-skilled workers. This trend has had less effect on measured unemployment in the United States than in Europe in part because U.S. workers have greater incentives to accept low-wage jobs. Nonetheless, virtually all industrial countries face a jobs problem that impairs living standards and threatens a breakdown in social cohesion.

To enhance understanding of what has caused this problem and to analyze policies to address it, the Federal Reserve Bank of Kansas City sponsored a symposium entitled “Reducing Unemployment: Current Issues and Policy Options.” The symposium was held August 25-27, 1994, at Jackson Hole, Wyoming.

This article highlights the issues raised at the symposium and summarizes the papers and com-

mentary. The first section of the article identifies areas of agreement and disagreement among program participants. The remaining sections summarize the views of symposium participants and their policy recommendations.

SYMPOSIUM HIGHLIGHTS

Symposium participants agreed high structural unemployment in industrial countries has resulted from the interaction between market forces and government policies. The principal change in underlying labor market forces in the past 20 years has been a decline in the demand for low-skilled workers, caused mainly by changing technology. In countries such as the United States, with limited government policies affecting labor markets, these forces have led to marginally higher unemployment but also to large increases in income inequality and poverty. In most European countries, with more extensive government policies toward labor markets, the result has been high structural unemployment, especially for low-skilled workers. Much of the increased unemployment is not merely temporary. Long-term unemployment has become a structural feature of economies in many European countries, in part because of generous government payments to the

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jobless and high payroll taxes to finance those payments. Policymakers in the industrial countries have been faced with a tradeoff between growing long-term unemployment or growing income disparities, a tradeoff Chairman Greenspan characterized in his opening comments for the symposium as both stark and dissatisfying.

Most participants felt the tradeoff could be improved—but probably only modestly—by adopting different labor market policies. The least costly improvement in Europe would be to reduce “employment protection,” that is, the laws that make it costly and time-consuming for employers to dismiss workers. Although providing job security, employment protection legislation has also made employers less willing to hire workers in the first place, especially so given the heavy payroll tax burden employers bear in Europe. Lowering payroll taxes, especially for low-wage workers, would further reduce the disincentive to job creation. To complement these policy changes, limiting the duration of unemployment benefits would provide greater incentive for the long-term unemployed to seek employment. Most participants also agreed that replacing “passive” income support payments to the unemployed with “active labor market policies” which increase employment opportunities could also reduce structural unemployment somewhat. Even with these and other changes to improve the functioning of labor markets, however, most participants concluded that substantially reducing European unemployment would necessarily entail increased income inequality and poverty so long as market forces continued to favor high-skilled over low-skilled workers.

In contrast to these broad areas of consensus, participants disagreed on several specific aspects of the unemployment problem. Some participants thought more accommodative monetary policies in Europe could contribute substantially to reducing unemployment, while others felt central banks could best contribute to job growth in the long run by continuing to focus on price stability. Nor was there complete agreement on the effectiveness of

several labor market reforms in reducing structural unemployment. Many participants, especially those from the United States, emphasized the need for paring the European “welfare state” as a prerequisite to reducing long-term unemployment. But several of the European participants questioned the effectiveness and political feasibility of doing so, especially if it resulted in growing income disparity and poverty as in the United States.

The differing degrees of emphasis on alternative policy responses reflected in part differing evaluations of the principal causes of rising unemployment. Those who believed the chief culprit has been the growth of the welfare state naturally placed more emphasis on reversing that trend, while those who believed other causes had also been important were less inclined to recommend drastic changes in the welfare state as a solution. Participants also differed on how much unemployment could be reduced in the United States and elsewhere by increased government spending on training programs, wage subsidies, and other active labor market policies. Some felt such policies could substantially improve the job prospects for low-skilled workers, but others thought they would prove too costly or ineffective.

EXTENT AND CAUSES OF UNEMPLOYMENT

The first two sessions of the symposium documented the upward trend in unemployment and analyzed its causes. Topics examined included the differing degrees to which rising unemployment has affected various geographic areas and groups of workers, whether economic theories adequately explain these differences, and what factors have caused rising unemployment.

Upward trend in unemployment

John Martin presented evidence on how much unemployment had increased in countries belonging

Table 1

Unemployment Rates in OECD Countries
(Standardized to conform with ILO guidelines)

	1960s	1970s	1980s	1990	1992	1994*
OECD	2.8	4.3	7.0	6.0	7.3	8.5
Canada	4.7	6.6	9.3	8.1	11.2	10.8
France	1.7	3.8	9.0	8.9	10.4	12.3
Germany	.6	1.9	5.7	4.9	4.6	10.0
Italy	3.8	4.7	7.5	8.2	8.3	11.7
Japan	1.3	1.7	2.5	2.1	2.2	2.9
United Kingdom	2.0	4.4	10.1	6.9	10.0	9.6
United States	4.7	6.1	7.2	5.4	7.3	6.3

*Projections from *OECD Economic Outlook*, June 1, 1994.
Source: OECD.

to the Organization for Economic Cooperation and Development (OECD). As shown in Table 1, unemployment rates have risen over the past three decades in the OECD as a whole and in each of the large industrial countries. The increase has been much more pronounced in most European countries than in the United States, Canada, or Japan. As a result of the pervasive upward trend, about 35 million persons in OECD countries were unemployed in 1994, and an additional 15 million are estimated to have given up on seeking a job or were forced to settle for a part-time job.

Martin also demonstrated that high unemployment has affected some demographic and social groups much more than others. Young people experience unemployment rates more than twice as high as do adults in most industrialized economies other than Germany, which has a strong apprenticeship system for training young workers. In half of the remaining countries in the European Community (EC), youth unemployment rates had surpassed 20

percent by 1993. The other major groups to suffer exceptionally high risk of unemployment are those with low educational qualifications. Workers who have no college experience are especially susceptible to joblessness; their relative plight worsened substantially in the 1980s in terms of both the chance of finding a job and of the wages paid when successful. In Martin's view, this latter trend provides support to the common belief that the relative demand for low-skilled workers has declined in most industrial economies—a belief shared by most symposium participants.

Another disturbing trend, in Martin's view, is rising long-term unemployment, especially in Europe. In the EC, more than 40 percent of the unemployed had been out of work for more than a year, compared to only 12 percent in North America. This difference reflects very different labor market dynamics in the two regions. U.S. workers are much more likely to lose existing jobs, but are also much more likely to find new jobs fairly

quickly, than are their European counterparts. Martin also cited evidence suggesting the long-term unemployed are “outsiders” insofar as wage-setting is concerned because increased long-term unemployment does little to restrain wage increases for the “insiders” who have jobs. In his view, this evidence bolstered the argument for targeting labor market policies to the long-term unemployed as the most effective, as well as the most equitable, way to reduce unemployment without setting off a wage-price spiral.

In his discussion of Martin’s paper, Dennis Snower reviewed theories of unemployment to determine which best explained the pattern of unemployment in OECD countries. He indicated most theories fail to explain why unemployment has risen more in Europe than in the United States. The most promising, in his view, is the insider-outsider theory discussed in Martin’s paper. Because European firms find it costly to reduce their work force due in part to employment protection laws, European workers’ jobs were secure in the face of the mild recessions typical in the 1950s and 1960s. As a result, unemployment rates remained low in Europe during this period. As the severity of recessions increased thereafter, though, firms were forced to reduce the size of their work forces. Having once incurred the high cost of doing so, firms were reluctant to hire workers back, preferring instead to invest in labor-saving capital equipment. The impediments to labor mobility in Europe help explain why high European unemployment rates persist after major recessions and why labor turnover is so much lower in Europe than in the United States. Moreover, the reluctance of European firms to rehire workers helps explain why so many long-term unemployed are outsiders without any appreciable effect on the wage demands of the insiders. Although economists are far from developing theories that explain all aspects of labor market behavior, Snower found the insider-outsider theory the best available foundation for policy recommendations to reform labor markets.

Causes of high unemployment

In his paper, Paul Krugman presented a somewhat different perspective on the causes of high unemployment. He emphasized the distortions caused by the European welfare state as the principal culprit. High payroll taxes, in addition to such stringent labor market regulations as the employment protection guarantees stressed by Martin and Snower, reduce the wages firms are willing to offer to attract employees. At the same time, generous welfare benefits for the unemployed reduce their incentive to accept jobs at these low wages. The resulting wedge between what employers are willing to offer and what workers are willing to accept explains why European unemployment is so much higher than in the United States, where taxes and benefits are considerably lower.

The interaction between the welfare state and a changed economic environment, Krugman argued, can also explain why unemployment has increased so much in Europe. The change he emphasized was declining demand for low-skilled workers in industrial nations. Such a change would tend to increase income inequality by depressing the wages of low-skilled workers. But large disparities in incomes are what the European welfare state was designed to prevent. The collision of market forces pushing toward greater income inequality with government policies that prevented such inequality has resulted in growing unemployment in Europe, especially among low-skilled workers. In analyzing the reasons for declining demand for these workers, Krugman expressed skepticism about the importance of increased competition from newly industrializing nations. Although intuitively plausible, this explanation has been found to have little empirical support according to Krugman. Instead, he attributed the declining demand for low-skilled workers to technological change that devalues the market value of manual labor.

The same forces raising unemployment in Europe, Krugman claimed, have caused rising poverty and income inequality in the United States.

With less generous social service benefits, low-skilled workers in the United States have seen their real incomes decline. Krugman did not see any painless way out of the tradeoff between more poverty and more joblessness. Transforming low-skilled workers into high-skilled workers through improved education and training might seem the obvious solution. But raising education levels can be done only gradually, and government training programs are not particularly effective. Some modest improvement in Europe might result from restructuring the welfare state to reduce distortions. Only a major “pruning” of the welfare state, however, is likely to reduce European unemployment substantially, and then at the expense of increased poverty. Krugman concluded policymakers in both Europe and the United States confront the harsh choice of accepting either high unemployment or widespread poverty.

Edmond Phelps explained why he thought the causes of unemployment are more diverse than implied by Krugman’s paper. His research indicated OPEC oil shocks, increased taxes on labor, and higher real interest rates have contributed importantly over the past several years to the rise in the natural rate of unemployment—that is, the unemployment rate consistent with stable inflation. He agreed with Krugman that growth of the welfare state and a decline in demand for low-skilled workers have contributed to high unemployment in most industrial countries. He was skeptical regarding Krugman’s claim that increased competition from newly industrializing economies had not contributed importantly to the declining demand for low-skilled workers. Accordingly, he advocated redistributing the overall gains from free trade through subsidies to employers who hire such workers. The first step in this direction should be a tax credit to offset the payroll taxes paid for low-wage workers, financed in part by reducing the most distortionary elements of the welfare state. If tax credits prove insufficient, governments should consider cash subsidies to firms that employ low-skilled workers.

Like Phelps, Christopher Pissarides felt Krugman put too much of the blame for unemployment on welfare state policies. He did, however, advocate less restrictive employment protection laws in Europe. In his view, laws making it costly for firms to fire workers merely stifle necessary labor market adjustments, thus benefiting neither employers nor workers. Other improvements would be to limit the duration of unemployment compensation and to spend more on active labor market policies to help the unemployed find jobs. While such pruning of welfare benefits can and should be used to reduce European unemployment, Pissarides was emphatic that income support for low-skilled workers should remain. In his view, minimal government support for the disadvantaged, as in the United States, is a “cruel route” not to be followed in Europe.

MONETARY POLICY AND UNEMPLOYMENT

The focus of the symposium next shifted to the relation between monetary policies and unemployment. Topics addressed included whether expansionary monetary policies in Europe should be used to complement needed labor market reforms, the differences between Japanese and European labor markets, the unique legislative mandate guiding New Zealand’s monetary policy, and the pressures on central banks to pursue more stimulative monetary policies when unemployment is high.

The role of monetary policy

In his paper, Charles Bean explained what role monetary policy could play in reducing European unemployment. He argued the main reason unemployment has risen so much more in Europe than in the United States is that European labor markets create long-term persistence of unemployment. His empirical estimates show that shocks with only temporary effects on unemployment in the United

States have permanently raised unemployment in Europe. Due to various persistence mechanisms, any increase in European unemployment is quickly translated into a higher equilibrium (or natural) unemployment rate. Lasting reduction of unemployment in Europe can only be achieved with structural reforms to improve the functioning of labor markets.

Bean maintained expansionary monetary policies should nonetheless be used to complement labor market reforms. Such reforms could prove so politically unpopular they would soon be reversed unless their benefits are realized quickly. Macroeconomic policies should thus be used to ensure aggregate demand grows rapidly enough to take full advantage of the expanding aggregate supply resulting from labor market reforms. Expansionary fiscal policy is effectively precluded by the large structural budget deficits in most European countries. The responsibility for demand stimulus, therefore, falls to monetary policies. In Bean's view, European central banks should be willing to tolerate slightly higher inflation for the next few years if necessary to achieve the goal of reducing the European unemployment rate five percentage points by the end of the decade. In countries where employment growth is stifled by insiders' aggressive wage demands, a temporary incomes policy might prove a useful adjunct to labor market reforms and stimulative monetary policies.

Bean cautioned against coordinating national monetary policies to achieve exchange rate stability. If labor market reform proceeds at different rates, exchange rates may need to adjust to ensure that each country can realize the full benefit of its reforms. Exchange rate fluctuations within the current wide bands of the European Monetary System should provide adequate scope to pursue independent monetary policies. But an attempt to narrow exchange rate bands or to move rapidly to monetary union would prevent an efficient transition to lower levels of unemployment.

Stanley Fischer disagreed that tolerating higher inflation was necessary to realize the benefits of

European labor market reforms. Although real wages in Europe may need to decline modestly to reduce unemployment, this decline could occur without higher inflation. Labor market reforms will themselves increase wage flexibility enough to accomplish slower growth in wages without higher inflation. Fischer nonetheless endorsed Bean's plea that central banks in Europe accommodate the higher economic growth potential accompanying labor market reforms.

Takatoshi Ito explained how Japan has managed to avoid the high and rising unemployment observed in Europe. One important factor has been a steadfast Japanese commitment to low inflation. Ito was skeptical of Bean's contention that tolerating higher inflation could reduce European unemployment. The major reason unemployment has remained low in Japan, however, is Japanese labor market institutions have allowed shocks to be absorbed without laying off workers. Whether this will remain so in the face of a severe recession and strong yen is uncertain. Major Japanese companies have increasingly shifted production abroad, raising the prospect unemployment will trend upward in Japan in the years ahead, as it did in Europe during the 1980s.

In Allan Meltzer's view, the upward trend in European unemployment has been due almost entirely to the corrosive effects of the European welfare state. Imposing high taxes on the income of those who work, and using the proceeds to subsidize those who do not, reduces incentives to seek employment, thereby raising the measured unemployment rate. Meltzer presented evidence the European countries which had increased welfare spending most had also experienced the largest increase in unemployment. He found this a compelling reason for eschewing the monetary stimulus recommended by Bean, concentrating instead on supply-side remedies to "welfare state unemployment."

In summarizing the discussions of the first day of the symposium, Nigel Lawson also emphasized the importance of supply-side remedies for reducing unemployment. He emphasized such remedies

would be difficult politically because they would cause painful adjustment. Lawson nonetheless urged economists to be forthright in recommending the uncomfortable policy changes necessary to reduce unemployment, “because I don’t know where politicians and policymakers are going to get their guidance from if these things aren’t spelled out clearly.”

The importance of price stability

In his luncheon address, Donald Brash explained what he thought monetary policy could—and could not—contribute to reducing unemployment. In his view, monetary policy can best contribute to minimizing unemployment by maintaining price stability. He cited New Zealand’s experience as support for this view. In the 1970s and early 1980s, monetary policy was used to stimulate the economy. The resulting burst of inflation caused consumer prices to increase fivefold from 1970 to 1984. This high inflation was accompanied by an upward trend in the unemployment rate. The ultimate result of stimulative monetary policy, therefore, was higher rather than lower unemployment.

This period of stagflation in New Zealand led monetary policy to be reoriented toward price stability. The new orientation was codified in 1989 with passage of a new Reserve Bank Act. The Act instructs the Reserve Bank of New Zealand to focus exclusively on achieving and maintaining stability in the general level of prices. The Government and the Reserve Bank have agreed that maintaining consumer price inflation in a range of 0 to 2 percent fulfilled that mandate. Steadfast pursuit of price stability has kept New Zealand’s inflation rate in that range since 1991. Although experiencing a prolonged recession during the period of disinflation, the New Zealand economy has subsequently rebounded. The unemployment rate has already come down substantially from its recession peak and is expected to decline further. Based in part on New Zealand’s experience, Brash argued that

focusing on price stability is not antithetical to reducing unemployment but is a prerequisite for doing so in a lasting way.

This unique legislative mandate for price stability has not, Brash said, entirely shielded the Reserve Bank from political pressures to pursue a more stimulative monetary policy. Critics have attacked the Reserve Bank Act for its alleged callous disregard for the unemployed. Brash views one of his most important functions to be convincing these critics that “attempting to trade-off just a little more inflation for a little less unemployment, however tempting, just isn’t a workable proposition.”

STRUCTURAL POLICIES TO REDUCE UNEMPLOYMENT

In the next two sessions of the symposium, participants evaluated the effectiveness of alternative policy reforms in reducing structural unemployment. Among the reforms discussed were reducing unemployment insurance benefits, imposing a tax on firms that lay off workers, offering subsidies to firms that hire workers, investing more in education and training, and increasing job search assistance to dislocated workers.

Evaluating alternative policy reforms

In his paper, Dale Mortensen evaluated alternative labor market policies using a theoretical model of job creation and job destruction. According to the model, unemployment could be reduced by cutting back on the generosity of government payments to the jobless or by reducing payroll taxes. The effects of other prospective policy changes are less clear. Imposing a tax on firms that lay off workers, for example, would reduce the incidence of layoffs but could also make firms less willing to hire new workers. Similarly, a tax credit for firms that hire workers would increase job creation but might also increase job destruction if firms lay off

some workers in order to get the tax credit when replacement workers are hired. The net effect of both tax credits for hiring and tax penalties for firing on the overall level of unemployment are therefore ambiguous in the theoretical model. Only by using an empirical version of the model can such ambiguities be resolved.

Mortensen thus presented numerical estimates using an empirical version of the theoretical model to evaluate prospective U.S. policy changes. Using values he considered realistic for the parameters of the model, Mortensen estimated that a firing tax would raise rather than lower unemployment. Such a tax would so impede workers' mobility that aggregate output would also suffer. In contrast, reducing unemployment benefits would be effective in substantially reducing U.S. unemployment, but only at the expense of forcing many of those who could not find jobs into poverty. Similarly, cutting such payroll taxes as the social security tax would not have a large enough beneficial effect on unemployment to justify the accompanying adverse effect of lowering pension and health care for the elderly. A more promising labor market reform in the United States, Mortensen concluded, is a hiring subsidy to employers. According to his estimates, such subsidies would substantially reduce U.S. unemployment without imposing hardships on the poor or the elderly. This and similar active labor market policies might best be financed with a payroll tax since, according to the model, such taxes have minimal disincentive effects on hiring.

Martin Feldstein was less sanguine than Mortensen about the prospective benefits of hiring subsidies. In Feldstein's view, Mortensen's model does not provide a reliable basis for estimating the likely effects of actual policy changes. Other studies have found that hiring subsidies are a waste of taxpayers' dollars. Feldstein recommended instead the U.S. unemployment insurance system be reformed to reduce structural unemployment. Such reforms, if carefully designed, could substantially increase incentives for finding a job without imposing hardships on the truly disadvantaged.

Subjecting unemployment insurance benefits to the income tax, which the United States now does, reduces disincentives for job seeking but does not reduce benefits for those too poor to pay taxes. A more radical reform would be to set a maximum weekly benefit of about \$200, thereby reducing the benefit levels for those who previously had a high-paying job but retaining current benefit levels for others. This type of reform would be much more effective in reducing unemployment, Feldstein argued, than would hiring subsidies.

Assar Lindbeck also expressed skepticism about the advisability of hiring subsidies. He pointed out both workers and firms would have powerful incentives to find ways to exploit the subsidies. Firms that previously transferred workers from one plant to another, for example, could benefit by splitting into two companies in order to reap the benefits of hiring subsidies to the plant that was increasing employment. Lindbeck also argued that Mortensen's policy prescription of more government involvement in labor markets through hiring subsidies and higher payroll taxes should be compared with less government involvement in labor markets before concluding how best to reduce unemployment.

Active labor market policies

In his paper, Lawrence Katz evaluated the effectiveness of active labor market policies in solving the jobs problem, which he defined as "too few decent employment opportunities to go around." The problem has led to higher unemployment in Europe and to increased poverty among working families in the United States. Government programs to enhance the skills and adaptability of the work force could, in Katz's view, help solve the jobs problem on both sides of the Atlantic. He identified three key elements to such a strategy.

The first element is to create "a system of life-long learning." Katz cited several studies showing investment in human capital has large

payoffs both for the aggregate economy and for individuals. Because the jobs problem has disproportionately affected the employment prospects for less-skilled workers, government programs to improve education and training must be an integral part of any long-run solution to the problem. Keeping more young people in school, enabling less-educated adults to return to school, and encouraging employers to invest in their workers are all essential for enhancing the skill level of the work forces in America and most other industrial countries.

A second major element in solving the jobs problem, according to Katz, is to help displaced workers get new jobs. Most studies suggest job search assistance for such workers is an inexpensive way to reduce the amount of time between jobs. Helping workers start their own businesses has also been shown worthwhile for the minority of displaced workers who have both the willingness and ability to do so. Other forms of government retraining programs have been less successful in part because the programs were not well designed. Overall, Katz strongly advocated a comprehensive "reemployment system" intended to assist displaced workers in getting jobs rather than the current system of merely providing income support during the job search process.

The final element for solving the jobs problem, Katz argued, includes policies to ensure low-skilled individuals can earn more by working than by not working. One such policy is a minimum wage set high enough to increase earnings of low-skilled workers but not so high that they are priced out of the market. Direct government subsidies for the working poor, such as the earned income tax credit in the United States, can also "make work pay" for those whose earning power is minimal.

In his comments, James Heckman emphasized the importance of identifying the most effective programs for improving the lot of less-skilled workers. His reading of the evidence suggests that the returns to government training programs are generally very low. Rather than using scarce budget resources for training displaced workers, in Heckman's view,

government programs should focus on early childhood intervention to increase the chances that youth from disadvantaged backgrounds stay in school. A "super-Headstart" program for preschool children has proven effective in raising their educational attainment and reducing their criminal activity in subsequent years. Such programs would yield benefits, however, only in the long run. The short-run problems of less-skilled, adult workers might be more effectively addressed through government subsidies to their employers rather than through government training programs in part because such workers are less malleable than youth.

In his comments, John Morley emphasized the importance of striking a balance between employment growth and equitable distribution of income. The 1993 White Paper issued by the European Commission recommended supply-side obstacles to job creation be removed in a way that avoids increased wage inequality. The historical evidence is clear, Morley contended, that unfettered operation of labor markets produces wide disparities in income which are socially unacceptable in developed countries. As a result, governments in most European countries have faced serious political and social constraints on how much to deregulate labor markets. The sharp rise of wage inequality in the UK which accompanied deregulation has discouraged similar policies elsewhere in Europe. In Morley's view, how much employment growth in Europe can be achieved without unacceptable income inequality remains an open question.

OVERVIEW PANEL

The final session provided speakers the opportunity to give their perspective on the broad range of policy issues discussed at the symposium.

In his overview comments, Frans Andriessen outlined a plan for reducing European unemployment by reforming the European welfare state. Reforming the welfare state is necessary, in his view, if it is to survive. Yet the widespread poverty resulting

from allowing living standards to be determined mainly by unfettered labor market forces, as in the United States, is not politically or socially feasible in Europe. Andriessen concluded the welfare state must be reformed in a way that does not impose unacceptable burdens on low-skilled individuals.

Reforming tax systems, Andriessen argued, must also be an integral part of reducing European unemployment. To support the generous benefits available under the European welfare state, taxes on earned income are very high. These taxes have raised the cost of labor so much that many low-skilled individuals have been priced out of the market. Lowering the labor cost for low-skilled jobs should, in Andriessen's view, be the first priority in reducing European unemployment. This could be done, for example, by lowering taxes on low-income workers, including the payroll taxes paid by their employees. The resulting revenue loss might be offset by additional energy taxes, which would have the ancillary benefit of encouraging conservation. Especially if supplemented by active labor market policies and perhaps additional public sector jobs, this type of tax reform could substantially reduce European unemployment.

In his overview remarks, Alan Blinder discussed the role of macroeconomic policy, especially monetary policy, in reducing unemployment. While agreeing monetary policy had little if any role in reducing structural unemployment, he also pointed out monetary policy could affect short-run cyclical fluctuations in unemployment. Moreover, he argued that central banks should attempt to guide the unemployment rate to the natural rate. He thus viewed the legislative mandate calling upon the Federal Reserve to pursue both maximum employment and stable prices as being an appropriate charge for central banks. Because he considered U.S. unemployment to be near the natural rate at the time, Blinder saw little the Federal Reserve could do to reduce unemployment further.

Blinder did see a role for monetary policies in reducing European unemployment. Blinder interpreted the consensus among symposium participants

to be that macroeconomic policies might be able to pare the unemployment rate in the European Union—which was close to 11 percent at the time—by two or three percentage points in the short run without igniting inflation. In addition, the natural rate of unemployment in Europe might be further reduced two or three percentage points in the long run by structural labor market reforms. He agreed with other symposium participants that the success of structural labor market reforms could well depend on the macroeconomic environment. If so, macroeconomic policies and labor market policies should be viewed as complementary rather than unrelated approaches to reducing unemployment.

Michel Hansenne urged in his comments that the unemployment problem be viewed in a global context. He presented estimates by the International Labour Office (ILO) that 120 million persons worldwide were unemployed, of which about 85 million were in developing economies or economies in transition. Moreover, a significant reason for rising unemployment and income inequality in the industrialized economies is difficulty in adjusting to changes in the global pattern of trade and production. Despite this difficulty, Hansenne warned against resorting to protectionist trade policies in a vain attempt to resist shifts in the international division of labor.

He also warned against overzealous pursuit of employment growth at the expense of economic equity. Labor markets should not be evaluated exclusively in terms of allocative efficiency, Hansenne argued. They are also social institutions that help decent societies achieve the goals of equity and fairness. In describing the qualitative dimension of the jobs problem, Hansenne stated:

[E]mployment is not just a matter of numbers....[T]he conditions under which work is performed, the livelihood it provides, and the solidarity shown by those with work and income towards those without: these are also measures of a decent society.

In his comments, Hans Tietmeyer explained his views on how the Deutsche Bundesbank could best

contribute to lowering German unemployment. He argued that high German unemployment is predominantly a structural phenomenon. One structural problem is that generous benefits available to the unemployed reduce their incentive to work, especially for low-skilled individuals. Moreover, the high cost of dismissing workers due to employee protection laws discourages firms from recruiting new employees. In addition, the cost of labor in Germany is too high, especially for low-skilled workers. Although some progress has been made in reducing these and other structural labor market problems, Tietmeyer stressed the reforms will only gradually reduce German unemployment.

The Bundesbank's role, in Tietmeyer's view, is to create "the underlying monetary conditions that foster greater monetary stability." He rejected the contention that a considerable portion of German unemployment was cyclical and could thus be reduced by lower short-term interest rates. Pointing to uncertainty about how much of German unemployment was cyclical, Tietmeyer asserted that attempting to use monetary policy to reduce unemployment could lead to higher inflation. This would be particularly risky, he maintained, because of the German people's aversion to inflation. For these and other reasons, Tietmeyer argued the Bundes-

bank could best contribute to lowering German unemployment by reducing inflation.

At the conclusion of the symposium, George Schultz observed the discussion had focused on those who are unemployed but remain within the traditional system. He pointed out a large and growing group of unemployed persons are in a very different system: "They are in a system of crime and drugs, of no family attachments, and of gang attachments." This alternative system, Schultz said, posed a serious threat to American society. He concurred with James Heckman's assessment that early intervention might well prevent the very young from repeating the cycle which leads ultimately into the alternative system.

Despite these differences of opinion on details, a recurring theme throughout the symposium was that reducing structural unemployment would require difficult policy choices and tradeoffs. As Chairman Greenspan put it in his introductory remarks, "The job of analysts and policymakers, such as the group represented here, is to try to make the issues and tradeoffs clear to our elected representatives. For, at the end of the day, it is they who must make these very difficult choices. We, however, can play a major role by arraying the real alternatives."

**REDUCING UNEMPLOYMENT: CURRENT
ISSUES AND POLICY OPTIONS**

A symposium sponsored by the Federal Reserve Bank of Kansas City

August 25-27, 1994

Session I

Chairman

NIGEL LAWSON, Former UK Chancellor of the Exchequer

Introductory Comments

ALAN GREENSPAN, Chairman, Board of Governors of the Federal Reserve System

The Extent of High Unemployment in OECD Countries

JOHN MARTIN, Deputy Director, Education, Employment, Labour and Social
Affairs Directorate, OECD

Commentary

DENNIS SNOWER, Professor, Birkbeck College, London

Past and Prospective Causes of High Unemployment

PAUL KRUGMAN, Professor, Stanford University

Commentary

EDMUND PHELPS, Professor, Columbia University

CHRISTOPHER PISSARIDES, Professor, London School of Economics

The Role of Demand Management Policies in Reducing Unemployment

CHARLES BEAN, Professor, London School of Economics

Commentary

STANLEY FISCHER, Professor, Massachusetts Institute of Technology

TAKATOSHI ITO, Senior Advisor, Research Department, International Monetary Fund

ALLAN MELTZER, Professor, Carnegie-Mellon University

Luncheon Address:

The Role of Monetary Policy: Where Does Unemployment Fit In?

DONALD BRASH, Governor, Reserve Bank of New Zealand

Session II

Chairman

GEORGE SHULTZ, Former U.S. Secretary of State

Reducing Supply-Side Disincentives to Job Creation

DALE MORTENSEN, Professor, Northwestern University

Commentary

MARTIN FELDSTEIN, President, National Bureau of Economic Research

ASSAR LINDBECK, Professor, Institute for International Economic Studies, Stockholm University

Active Labor Market Policies to Expand Employment and Opportunity

LAWRENCE KATZ, Professor, Harvard University

Commentary

JAMES HECKMAN, Professor, University of Chicago

JOHN MORLEY, Head of Employment and Labour Market Policy Unit, Commission of the European Communities

Overview Panel

FRANS ANDRIESEN, Former Vice President, Commission of the European Communities

ALAN BLINDER, Vice Chairman, Board of Governors of the Federal Reserve System

MICHEL HANSENNE, Director-General, International Labour Office

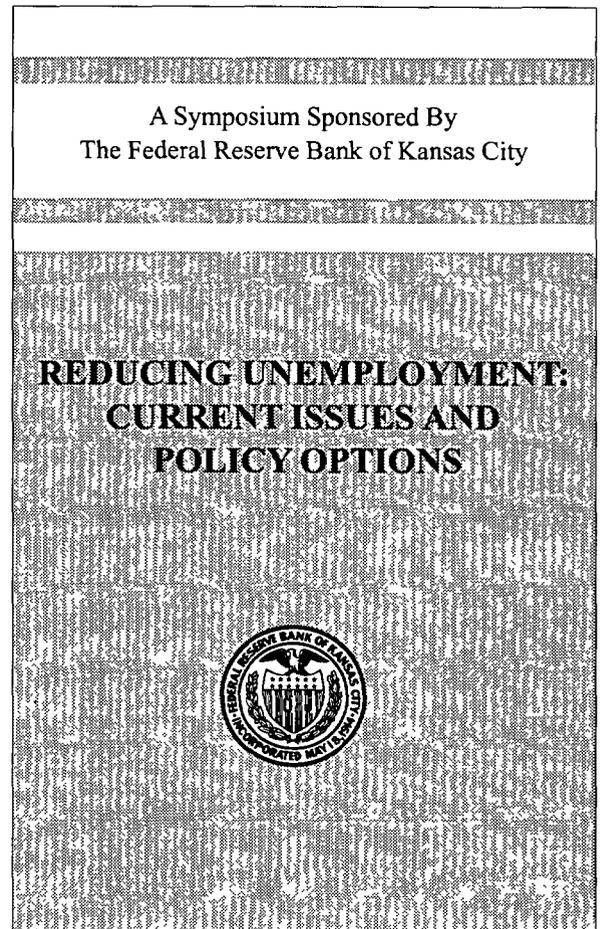
HANS TIETMEYER, President, Deutsche Bundesbank

***REDUCING UNEMPLOYMENT:
CURRENT ISSUES AND POLICY
OPTIONS***

Reducing unemployment has become a top priority for economic policy in most industrialized nations. While unemployment will ebb somewhat as countries recover from the recent global recession, millions are likely to remain jobless for a variety of structural reasons. Virtually all industrial countries face a jobs problem that impairs living standards and threatens a breakdown in social cohesion. To enhance understanding of what has caused this problem and to analyze policies to address it, the Federal Reserve Bank of Kansas City hosted a symposium on "Reducing Unemployment: Current Issues and Policy Options" at Jackson Hole, Wyoming, on August 25-27, 1994. The symposium proceedings will be available soon.

For a copy of the current or past symposium proceedings, please write:

Public Affairs Department
Federal Reserve Bank of Kansas City
925 Grand Boulevard
Kansas City, Missouri 64198-0001



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