



Monetary Policy as a Jobs Guarantee

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The goal of monetary policy set forth by the Federal Reserve Reform Act of 1977 is to promote stable prices and maximum employment. In the aftermath of the Great Recession, there has been considerable debate over the extent to which the Federal Reserve caused the recession, worsened the recession, and slowed the subsequent recovery. The slow recovery in particular has caused some economists and pundits to argue that monetary policy is insufficient for counteracting the business cycle and that fiscal policy might be necessary.

One recent fiscal policy proposal to address unemployment is a “job guarantee.” This proposal would essentially require that the government be willing to hire workers at a fixed real wage at all times.¹ Thus, the government would provide a safety net for workers in the form of a job should the worker be willing to work for the wage offered by the federal government. This proposal would therefore provide workers with employment opportunities when workers have difficulty finding a job, which might especially be true during recessions.

While the “job guarantee” has drawn some recent interest, little has been said about a related monetary policy proposal. In the 1980s, economists Earl Thompson and David Glasner proposed the “labor standard.”² The idea was to capture important characteristics of the gold standard. However, rather than define the dollar as a fixed quantity of gold, the labor standard would define the dollar as a fixed quantity of labor. This proposal has a variety of desirable characteristics. First, fluctuations in the price level would be driven by changes in the “real” side of the labor market. This means that in the long run, prices would decline with rising productivity. Second, by using indirect convertibility, the labor standard would outsource monetary policy to the market. Third, the labor standard implies that the central bank would behave as though it were willing to buy and sell labor at a fixed price, thereby effectively providing a “job guarantee.”

HOW THE GOLD STANDARD WORKED

To understand how a labor standard would work, one needs to first understand how the gold standard worked. Under the gold standard, the unit of account (e.g., the dollar) was defined in terms of a particular commodity. For example, the dollar might be defined as 1/20 oz. of gold. This definition implies that the official price of gold was \$20 per ounce. What this meant is that the central bank (or the banking system more generally) stood ready to buy and sell gold at a fixed nominal price. Since gold is an internationally traded commodity, the market price of gold could potentially deviate from the official price. However, if this occurred, it would create an arbitrage opportunity for either holders of bank notes or those holding gold. For example, suppose that the market price of gold was \$21. An individual holding a bank note could take \$20 in bank notes to the bank, redeem those notes for 1 oz. of gold, and sell the gold for \$21. Since anyone holding bank notes could do so, the market price could not deviate much from the official price since it created an arbitrage opportunity. The very process of arbitrage would drive the price back toward the official price. In equilibrium, the market price of gold would equal the official price.

Under ordinary circumstances, the price of gold is determined by supply and demand. This is true even when the nominal price of gold is fixed under the gold standard. To understand this point, it is important to recall that supply and demand is a partial equilibrium framework. A change in supply or demand leads to a change in the equilibrium price and quantity, holding everything else constant. So in any supply-and-demand model, the price being determined is the *real* price of the good (or the price of the good holding all other prices constant). Under the gold standard, since the central bank (or the banking system) is willing to buy and sell gold on demand at a fixed nominal price, this means that when there are fluctuations in the supply of and demand for gold, all other prices must adjust until the real price of gold clears the market.

Consider an example. Suppose that there is a gold discovery somewhere in the world. In an ordinary supply-and-demand analysis, an increase in the supply of gold would lead to an increase in the equilibrium quantity of gold and a decline in the equilibrium price. If the nominal price of gold is fixed, then the nominal price cannot decline. Nonetheless, the real price of gold can decline in order to clear the market. For this to happen, the price level must rise. A gold discovery is therefore inflationary, since all other prices, on average, would have to rise so that the real price of gold declined.

This characteristic of the gold standard is one of the most frequently cited characteristics as to why a gold standard is undesirable. Many critics have argued that because fluctuations in the price level tend to be driven by changes in the supply and demand for gold and are difficult to predict, these seemingly random fluctuations in the price level cause corresponding changes in real economic activity. Since such fluctuations could be avoided (in theory) with an inconvertible paper money standard, many economists have argued that the gold standard creates unnecessary fluctuations in the economy as a result of unexpected fluctuations in a market that makes up only a small fraction of any economy.

THE LABOR STANDARD

Under a labor standard, the unit of account would be defined as a fixed quantity of labor. Consider a world in which all labor is homogeneous. In such a world, one could define the dollar as being equal to four minutes of labor. This implies that it would take \$15 to employ labor for one hour. In other words—to draw an analogy to the gold standard—the central bank would stand ready to buy and sell labor at a fixed nominal price of \$15 per hour. This is therefore equivalent to a monetary-policy-based job guarantee in which the central bank is willing to buy and sell labor at a fixed nominal price (rather than real price). Of course, in reality, there are two practical problems with this proposal. The first problem is that labor, unlike gold or some other commodity, is not sold in spot markets. The second problem is that labor is heterogeneous. Nonetheless, the Thompson-Glasner proposal for a labor standard resolves these issues by targeting a nominal wage index through indirect convertibility.

The Thompson-Glasner proposal would work as follows: Because labor is not sold in spot markets, the central bank cannot offer to buy and sell labor on demand in some organized market. Instead, what the central bank could do is agree to buy and sell a particular asset of its own choosing on demand at the current market price, but the central bank would guarantee that the value of this asset would always be equivalent to a fixed quantity of labor. Since labor is heterogeneous, the central bank cannot pin down “the” wage because there is an entire distribution of wages. However, the central bank could commit to making sure that this asset would buy a fixed quantity of labor, *on average*, by promising to keep an index of nominal wages constant.

To understand how this would work, consider an example. Suppose that the central bank promised to buy and sell gold on demand at its current market price, but guaranteed that an ounce of gold would buy a fixed quantity of labor, on average. This is a promise to keep an index of nominal wages constant. Let’s assume that the wage index implies that the average wage is \$15 per hour, the current market price of gold is \$1,500 per ounce, and that it is January. An individual who purchases an ounce of gold from the central bank for \$1,500 expects that this ounce of gold will purchase 100 hours of labor ($\$1,500 / \$15 = 100$). In February, the average wage for January is calculated to be \$16.50. This implies that the price of labor is 10 percent higher than expected. In order to buy 100 hours of labor, this individual would have needed \$1,650 ($= \16.50×100). To compensate these individuals, the central bank would send a payment of \$150 to anyone who had purchased gold in January. However, note that since the central bank buys and sells gold, anyone who sold gold to the central bank would now owe the central bank \$150.

This type of monetary policy would ensure that the average nominal wage remained constant over time. To see why, consider that anyone who expected the average nominal wage to rise would buy gold from the central bank in anticipation of receiving a rebate from the central bank if they were correct and earn an arbitrage profit.³ If the value of purchases at the central bank exceeds sales, then this is an indication that the market expects the nominal wage to rise. Note that if this is true,

then the central bank is effectively conducting net open market sales of gold, thereby pulling dollars out of circulation. Thus, the very expectation of higher nominal wages leads to contractionary monetary policy that would, in turn, reduce nominal wages.

The situation also works in reverse. If the market expected nominal wages to decline, then the value of gold sales to the central bank would exceed the value of gold purchases from the central bank. If this is true, then the central bank would be conducting open market purchases of gold on net, thereby expanding the money supply and increasing nominal wages.⁴

The labor standard would therefore maintain a fixed nominal wage index equivalent to the fixed price of gold under the gold standard. This system has several advantages. First, recall that one criticism of the gold standard is based on the fact that fluctuations in the gold market caused by real factors, such as gold discoveries, led to fluctuations in the price level and real economic activity. The criticism was that fluctuations in a market that made up a small portion of total production had the ability to cause booms or recessions. This also resulted in fluctuations in the labor market by altering the relative price of labor in terms of gold. Under a labor standard, fluctuations in the price level would be driven by real factors associated with the labor market. An increase in productivity, for example, would increase the demand for labor. A standard supply-and-demand model would imply that real wages should rise. Since the nominal wage is fixed, this would require that the price level decline to clear the market for labor. Changes in the price level would therefore represent changes in *real* factors in the labor market, such as productivity, which some have argued is a desirable objective in and of itself for monetary policy.⁵ In addition, unlike the gold standard, the labor standard would require that the price level respond to real changes in a market that policymakers treat with primary importance.

Second, the labor standard would eliminate all nominal sources of fluctuations in the labor market. If monetary policy was seen by the market as being too tight, individuals would (on net) sell gold to the central bank in anticipation that nominal wages would decline. By doing so, the central bank would be conducting open market purchases of gold, thereby expanding the money supply. If monetary policy was seen by the market as too expansionary, individuals would (on net) purchase gold from the central bank. This open market sale would reduce the money supply and reduce nominal wages to the target level.

Third, the labor standard would outsource monetary policy to the market. Insofar as the market aggregates knowledge better than, for example, the 12 individual voters of the Federal Open Market Committee, this would more accurately align the stance of monetary policy with information about the state of the economy.

CONCLUSION

To draw an analogy to the gold standard, by fixing the nominal wage the central bank would be acting *as though* it stood ready to buy and sell labor on demand at a fixed nominal wage. In that respect, this policy is something similar to a monetary-policy-based job guarantee. In reality, a central bank cannot actually buy and sell labor on demand. However, since the Federal Reserve can buy and sell other assets on demand in a spot market, it can conduct monetary policy such that an asset's value would purchase a constant quantity of labor. This form of indirect convertibility would ensure that the dollar purchased a constant quantity of labor. The price level would have to adjust to real factors influencing the supply and demand for labor, but nominal factors would no longer have any effect on the labor market. The labor standard would therefore allow the Federal Reserve to simultaneously achieve its goals of price stability and maximum employment.

ABOUT THE AUTHOR

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NOTES

1. There is some variability in these proposals, but the general idea is the same. For details see Mark Paul, William Darity Jr., and Derrick Hamilton, "The Federal Job Guarantee—A Policy to Achieve Permanent Full Employment" (Washington, DC: Center on Budget and Policy Priorities, 2018) and the references therein.
2. Earl A. Thompson, "Free Banking under a Labor Standard -- The Perfect Monetary System" (Working Paper, University of California, Los Angeles, January 1982); David Glasner, *Free Banking and Monetary Reform* (Cambridge, UK: Cambridge University Press, 1989).
3. An individual could simultaneously buy gold from the central bank at the market price and sell gold in the market for the same price. If the wage index rises, the individual earns an arbitrage profit from the rebate collected from the central bank.
4. One caveat is in order. If cyclical unemployment tends to disproportionately affect low-wage workers, then it is mathematically possible for the wage index to rise during a cyclical downturn. Whether this is true would require both a careful empirical analysis of the distributional effects of cyclical unemployment as well as a theoretical model that would outline the conditions under which this could occur given that people expect the central bank to act in accordance with the rule described. One could also construct a nominal wage index that included workers who are involuntarily unemployed in order to avoid this problem.
5. George Selgin, "Less Than Zero: The Case for a Falling Price Level in a Growing Economy" (Hobart Paper No. 132, Institute of Economic Affairs, London, 1997).