Chapter 1

THE TRADE-OFF BETWEEN UNEMPLOYMENT AND INFLATION

Early in 1962, the Council of Economic Advisers proposed an unemployment target for the American economy. "In the existing economic circumstances," it declared, "an unemployment rate of about 4 percent is a reasonable and prudent full-employment target for stabilization policy." [1]

As the reference to "existing economic circumstances" suggests, this was not conceived as a permanent target. The Council observed that "If we move firmly to reduce the impact of structural unemployment, we will be able to move the unemployment target steadily from 4 percent to successively lower rates." Four years later, indeed, it felt that a reduction had become appropriate: "The unemployment rate has now virtually reached the interim target and is projected to fall below 4 percent in 1966. There is strong evidence that the conditions originally set for lowering the target are in fact being met, and that the economy can operate efficiently at lower unemployment rates." [2]

This conviction was short-lived, however. After a year's experience with lower rates (the average for 1966 was 3.7 percent), the Council reaffirmed the original figure. After citing advocates of 5- and 3-percent targets, it concluded that "The experience of the past year provides a partial answer, suggesting that the 4-percent judgment was nearest to the mark." [3] This figure was again reaffirmed 2 years later:

> "In light of the considerations discussed above, a 4-percent unemployment rate was established as an 'interim' target for national policy early in the Kennedy administration. In each of its last seven annual reports, the Council of Economic Advisers has based its estimates of potential output on a 4-percent rate of unemployment. This report continues to make use of this definition." [4]

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[1] *Economic Report*, 1962, p. 46. It is interesting to note that as early as 1947 the Committee for Economic Development defined "high employment" as an unemployment rate of 4 percent, and geared its "stablizing budget" proposal to that figure. See *The New Economics*, MAPI 1968, p. 6.
[2] *Ibid.*, 1966, p. 75.
[3] *Ibid.*, 1967, p. 42.
[4] *Ibid.*, 1969, p. 64.