

Elements of a Radical Counter-movement to Neoliberalism: Employment-led Development

FADHEL KABOUB

*Department of Economics, Denison University, 100 W. College Street, Granville, OH 43023;
e-mail: kaboubf@denison.edu*

Abstract

After highlighting the failure of mainstream economic theory in dealing with the rising global inequality and economic struggles brought about by neoliberal economic policies, the paper presents the outline of an alternative policy proposal to create full employment and price stability, and to restore financial sovereignty to developing countries. Under the Employer of Last Resort (ELR) program, the government guarantees employment to all through a decentralized community-based job creation policy. Projects are selected by local community groups based on community needs and the availability of skills in the unemployment pool. Funding is provided by a central/federal fiscal authority and requires policy coordination with the central bank.

JEL codes: B5, E12, E24, F41, O23

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I. Introduction

Over the last three decades, most developing countries have been struggling with recurring financial instability, little or no economic development, and a skyrocketing debt burden, the result of which has had a devastating social and economic impact on regional as well as global economic stability. International financial institutions have been trying to spur greater economic development in order to eradicate poverty through higher economic growth. Sizeable grants and concessional loans have been provided to the developing world but results have been disappointing for the most part.

Many developing countries have very large and quickly rising external debt. Trying to pay off the debt has become a serious problem for these countries, which causes great

hardship for their people. The region of sub-Saharan Africa, for instance, pays \$10 billion every year in debt service. That is about four times as much as their spending on health-care and education. Moreover, rich countries continue to *receive* an increasing amount of net transfer of financial resources *from* developing countries, thus further increasing the debt burden and hindering the process of economic development in the South (UNCTAD 2001; Kregel 2006).

This paper will argue that the mainstream economic theory that is used to justify development policies by the International Monetary Fund (IMF) and the World Bank (WB) is flawed and has caused more damage than benefits to the developing world. The next section of the paper will present a brief overview of the failed development strategies and their socio-economic impact. The following section will then outline an alternative development strategy designed to promote employment creation, sustainable development, social justice, and enhanced national economic sovereignty. The paper will close with a summary and concluding remarks.

2. System Failure

At the end of the 1970s, many oil-exporting countries had large amounts of export revenues held in Western banks. These banks loaned a lot of those petro-dollars to Third World countries for big development projects. The theory behind these loans was that developing countries have a domestic *savings gap* and need loans to finance investment projects that promised high returns on capital. However, several factors (a rise in world interest rates, a global recession, and declining terms of trade) caused the size of these debts to start growing quickly; several countries began to fall behind on their payments. Since the early 1980s, the amount of money owed by developing countries has increased dramatically, which forced them to implement austerity policies aimed at increasing domestic savings in order to run trade balance surpluses by increasing export revenues and reducing imports. These policies led to slow economic growth and low per capita income growth in developing countries, thus aggravating their underdevelopment problems.

The initial debt burden was supposed to fuel import substitution industrialization (ISI) that could, within a couple of decades, guarantee an economic “take off.” However, a combination of unconditional protectionism, corruption, mismanagement, and misfortune led to slower than expected growth. The conventional wisdom quickly turned against protectionist policies despite the successful models developed by the Asian Tigers. The preferred model became an array of neoliberal economic policies ranging from export-led growth coupled with trade liberalization and fiscal and monetary austerity, to the privatization of state-owned enterprises and the use of foreign direct investment (FDI) as an engine of economic growth. Although some of these policies may appear to have been moderately successful, their success should be taken in context and evaluated on a case-by-case basis. FDI for instance can improve economic growth, but most of it has been going to countries like China who have made substantial investments in public infrastructure, education, and health.

The impact of these neoliberal policies has been documented and critiqued by many heterodox economists (Baiman 2006; Kregel 2004). This paper will not focus on how we got here and why, but rather on an alternative to neoliberal policies. However, it is worth mentioning the extent to which the political economy of neoliberalism has weakened the economic situation of the working class and the poor in both developed and developing countries.

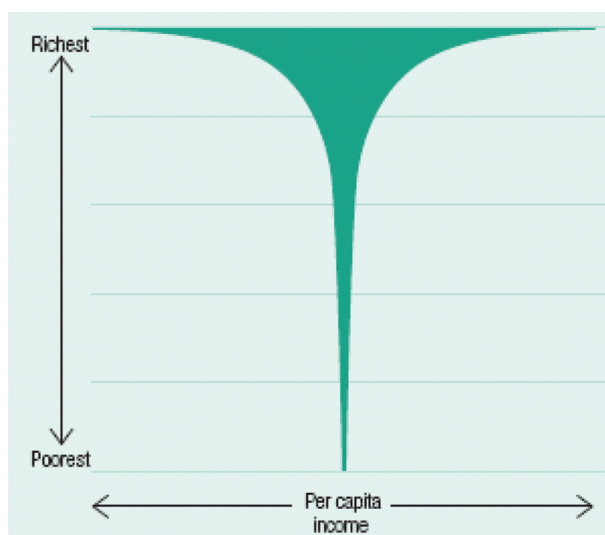


Figure 1.
World income distribution by percentile of the population in 2000.

The United Nations Development Programme (UNDP) reports that 18 countries with 460 million people have experienced a decline in their Human Development Index in the 1990s (UNDP 2005). In that same decade, UNDP also reports that 2.5 billion people still live on less than \$2 a day, and that poverty reduction slowed down in the 1990s, with about 10 million unnecessary child deaths each year. Furthermore, more than 1 billion people have no access to safe water, and 2.6 billion people lack access to sanitation (UNDP 2005). Average income levels continue to decline in sub-Saharan Africa, and several countries experienced a slowing down or a decline in life expectancy, especially countries dealing with the AIDS pandemics. Income inequality has also worsened. UNDP reports that the annual income flow of the richest 500 people exceeds that of the poorest 416 million, and that the cost of ending extreme poverty (\$300 billion) is less than 2 percent of the income of the richest 10 percent of the world's population (Figure 1).

But the most disturbing structural problem we observe is the negative net transfer of resources *from* developing *to* developed countries (Figure 2), which is probably the most important structural problem under the current global financial architecture. In 2006, for instance, developing countries as a group transferred a record 600 billion dollars to developed countries, twice the cost of ending extreme poverty. Without an immediate reversal of this trend, it is hard to imagine how the global development problem could be any different in the future than what it has been in the last three decades. The WB and the IMF have attempted to remedy this problem through a series of initiatives such as the Heavily Indebted Poor Countries initiative in 1996, and the Sovereign Debt Restructuring Mechanism proposal in 2000, in addition to a variety of debt reduction and debt restructuring schemes aimed at reducing the debt burden of developing countries.

Unfortunately, all the proposed solutions have thus far failed to solve the problem; therefore developing countries are faced with the choice of defaulting on their debt obligations and facing economic and political isolation, or continuing on the same track at the expense of the livelihood of their own population. The following section will argue that the

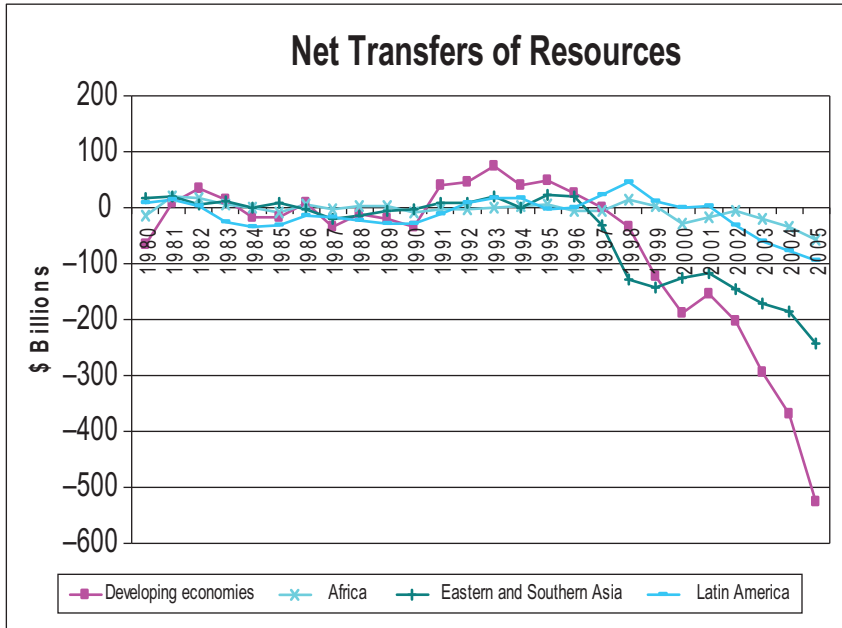


Figure 2.
Net transfer of resources (source: Kregel 2006).

heterodox economics literature does provide a more practical solution than the neoliberal status quo: a gradual development strategy aimed at utilizing the most abundant resources available—labor—as an engine for development and as a way to regain financial (and political) sovereignty in the developing world.

3. An Alternative Proposal: Employment-led Development

There has been a lot of resistance and opposition to the neoliberal agenda by heterodox economists. Kregel (2006) argues that most developing countries have abundant natural resources, but all have unemployed, underemployed, or under-qualified domestic labor. He argues that increasing employment presents the greatest potential for mobilizing domestic resources. The alternative outlined below, the Employer of Last Resort (ELR) program (Kregel 1991, 2004; Kaboub 2007c), draws from radical, post-Keynesian, and institutionalist economic theories.

The ELR program has been developed and refined by Hyman Minsky and many of his post-Keynesian followers since the 1960s as a full employment strategy in developed countries (Wray 1999), but in the last few years there has been a wave of new literature trying to adapt the ELR proposal to the context of developing countries. Kregel (2006), Wray (2007), and Kaboub (2007a) provide a survey of analytical ELR frameworks as well as a survey of full employment experiments in both developed and developing countries. Kaboub (2007b) provides an illustration of the economic impact and financial feasibility of an ELR program proposal for Tunisia.

In the ELR model, the government offers to hire anyone willing, ready, and able to work at a socially established living wage. The government would essentially create an infinitely elastic demand for labor in a new economic system with a fixed-wage/flex-quantity (of labor) policy. In other words, labor will be used as a commodity in a buffer stock system managed by the government in a countercyclical way. When the private sector is falling into a recession, the ELR program will expand as the government will purchase more labor, and when the economy booms, the private sector will hire workers away from the ELR pool (at a premium), thus allowing the ELR program to reduce the size of its intervention. A central feature of the ELR program is that it is completely decentralized in its design and implementation. Local community groups and NGOs will survey the needs of the community and will hire workers to provide such services. Naturally, the ELR workers will only produce services that are not supplied (or are undersupplied) by the private sector, thus avoiding competition with the private sector. The only centralized feature of the program is the source of its funding, which is the federal government (Wray 1998).

The ELR program requires functional finance budgeting. Functional finance is a theory developed by Abba Lerner (1943, 1947) and subsequently refined and linked up with the ELR literature by L. Randall Wray (1998) and other post-Keynesians. According to functional finance, a sovereign government as the monopoly issuer of currency has no constraint on printing money. It creates a demand for its currency by imposing a tax liability on the population. Government spending creates money, while tax collection and bond sales to the public destroy it. Taxes *do not* finance government spending, and neither do bonds, but rather bond sales withdraw excess money from the economy, thus preventing inflation and allowing short-term interest rates to remain at the desired target established by the central bank. When the central bank buys bonds, it injects currency into the economy, thus providing the necessary liquidity for economic activity. The size of the deficit does not matter as long as it fulfills the desired *functions*: full employment and price stability. A rising national debt can always be managed as long as it is denominated in the national currency over which the government has full control.

Developing countries, however, have a serious financial sovereignty problem under the existing system. Their debt is denominated in “hard” currencies that they cannot issue. Therefore, their external debt can only be alleviated through trade surplus revenues or debt cancellation. Since debt cancellation has been generally ruled out (until very recently) for moral hazard reasons, the conventional wisdom has exclusively focused on trade surplus generating policies (ISIs, export-led growth, privatization, free trade, FDI, etc.). However, as discussed above, these policies have only led to an increase in the debt burden and a worsening of the economic situation of the average person in the developing world.

The functional finance framework provides therefore a fresh new perspective on how developing countries can regain sovereignty over their own economies and establish a full employment program as the core of their development strategy. An ELR-led development policy would focus on the effective mobilization of the existing domestic labor resources—in Keynes’s terminology “socializing investment”—and “euthanize” domestic and foreign rentiers who benefit from austerity measures such as high interest rates.

A functional finance-based ELR program will reaffirm the financial sovereignty of the state, which can now fund socially productive, labor-intensive economic activity that is not supplied by the private sector. Such services would be selected and implemented by local community groups by utilizing local labor skills (to prevent a labor exodus to urban areas).

The funding will come from the national/federal government and would constitute an increase in government deficit and the national debt. The government must then issue bonds denominated in its national currency, and should attempt to gradually phase out all foreign currency-denominated debt. This can be done through export revenues, debt swaps, foreign aid, debt cancellation, or ultimately through debt default. This nationalization of the debt is arguably the most crucial component of the proposed strategy. Once the external debt is wiped out, all additional export revenues and foreign assistance should be managed exclusively for the purchase of necessities that cannot be produced domestically or acquired from neighboring countries through adequate South-South regional trade regimes.

A developing country should allow complete convertibility of its currency in international exchange markets at a flexible rate. Its central bank should give up its exchange rate defense strategy and let the value of the currency be determined in international exchange markets. In the case of a rising trade deficit, the relative value of the currency will decline (depreciation). What is the real meaning of trade deficits?

A trade deficit thus means that the country enjoys real net benefits because the benefits (imports) exceed the costs (exports). As a trade deficit increases, the per unit real cost of imports is declining in the sense that relatively fewer exports have been demanded by the ROW per unit of import. (Wray 2006: 15)

It is worthwhile to highlight the importance of imports of intermediate goods and capital goods for developing countries. Any policy that discourages those imports for “financial” reasons can only have a negative effect on economic activity. Of course, the government may wish to discourage certain imports such as luxury goods, but under a floating exchange rate regime with convertible currency, individuals who can afford such goods are free to pursue such consumption through international currency exchange markets without putting any burden on the central bank. The same would apply to private firms wishing to import intermediate goods; they can issue debt denominated in any foreign currency with no effect on the government’s ability to run a full employment policy. However, the impact of currency devaluation will require government intervention to protect vulnerable groups and to secure adequate supplies of basic necessities.

A devaluation would increase the price of imported goods relative to domestic goods. When substitutes are readily available, this could have a stimulative effect on domestically produced products. But when no domestic substitutes are available (or if domestic substitutes require imported intermediate goods), an upward pressure on prices will begin to occur. When basic food necessities are subsidized this would require additional subsidies from the government to prevent food prices from rising. Other key commodities would also require price stabilization efforts from the government, thus leading to a larger government deficit. A redistribution policy must therefore accompany the ELR program to offset any negative effects of currency depreciation on vulnerable groups. In fact, a desirable strategy for ELR is to seek to employ people in activities that help reduce dependency on imports.

In the end it all adds up to an increase in the deficit and the national debt, but given that the debt is denominated in the national currency of the country, it can always be managed in a manner that is consistent with full employment and price stability. An ELR

program should be carefully tailored to utilize the existing skills of the unemployed population and “take workers as they are,” then work on improving skills over time. ELR projects can also enhance environmental sustainability through public works projects that entail environmental cleanup, seashore cleanup, anti-deforestation, anti-desertification (dune fixation), de-salinization, flood control, storage of runoff waters, creation/expansions of public parks, recycling projects, construction and maintenance of small-scale irrigation systems, soil conservation, small-dam construction, watershed protection from erosion, management of renewable resources such as forests and groundwater supplies, conservation of common pasture lands, land terracing, land consolidation, construction of biogas plants, and installation of solar energy packages (Forstater 2003).

The decentralized feature of the ELR program enhances participatory democracy. A good model for ELR logistics would be Brazil’s experience with participatory budgeting. This prevents corruption and increases the likelihood of successful completion of the project. Needless to say, an ELR program requires careful management of fiscal and monetary policy, but its grassroots nature will ensure its transparency and credibility as the engine of democracy, prosperity, and environmental sustainability. An ELR-led development strategy does not require external financing, and does not increase external debt service. According to Kregel (2006), developing countries may face external constraints for other reasons such as in the case of a monocommodity economy, inappropriate structure of production (high-import content), or the lack of technological development.

4. Concluding Remarks

The rise of neoliberal political economy since the 1980s has put an end to state-led development, social safety nets, and welfare enhancing policies. The result has led to more inequality within and among countries regardless of their level of economic development. It has also tightened the grip of capital over labor, and has given more freedom to financial capital and fewer rights to labor. Neoliberalism as we know it may be relatively new as a global phenomenon, but its socio-economic impacts are nothing but the natural consequences of the same generic capitalist mode of production. The impact of neoliberal policies has been most devastating in developing countries. It has led to increased indebtedness to and dependence on developed economies, in addition to raising inequality and worsening the economic condition of the most vulnerable people in the world.

This paper highlighted the bulk of the traditional development policies since the 1970s and their failure to achieve any substantial improvement, but most importantly the paper outlines an alternative development strategy that focuses on the utilization of existing labor resources as an engine for economic development through an ELR program. Such a program enhances growth and sustainability, and allows developing countries to regain financial sovereignty. The proposed strategy does not require external financing, but does require a careful management of the domestic debt by the national government, flexible exchange rates, currency convertibility, capital controls, and a commitment to a well-designed redistribution policy (such as subsidies for high-import content food commodities). Securing national monetary sovereignty allows the implementation of autonomous trade and fiscal policies that are commensurate with the objectives of economic development, social justice, poverty alleviation, and provisioning of health and education.

ELR also has the potential to ensure grassroots participation at the local decision-making level, thus enhancing democratic processes. Furthermore, it allows the community to value non-market economic activities, such as elderly care, child rearing, and unpaid household work. Such a strategy could be a vehicle for encouraging communal and non-exploitative production processes that utilize technologies that do not displace labor and do not degrade ecosystems.

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Fadhel Kaboub is an assistant professor of economics at Denison University. His current research focuses on the design and implementation of full employment policies in developing countries. Before joining Denison University in 2008, Fadhel taught at UMKC, Simon's Rock College of Bard, and Drew University. He currently serves as the book review editor of the Heterodox Economic Newsletter.