



During and After the Crisis: Why Is an Employer of Last Resort Policy Needed?

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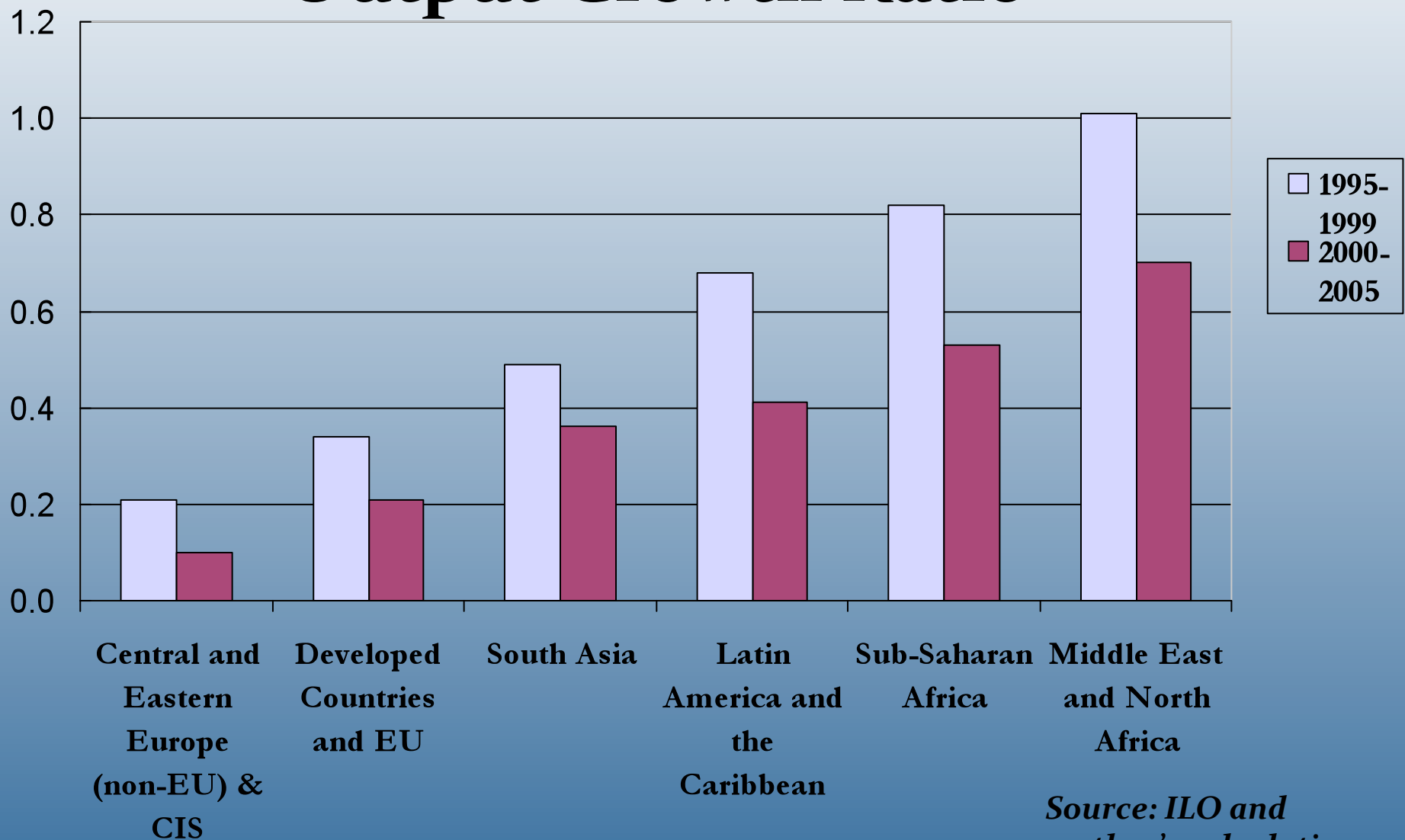
**EMPLOYMENT GUARANTEE POLICIES:
RESPONDING TO THE CURRENT ECONOMIC CRISIS AND CONTRIBUTING TO LONG TERM
DEVELOPMENT**

22-23 June 2009

A collaborative project of the United Nations Development Programme (UNDP)
Regional Bureau For Latin America and the Caribbean (RBLAC) and the Bureau for Development Policy (BDP)
In partnership with the Levy Economics Institute,
Annandale-on-Hudson, New York

“There is plenty of evidence that unemployment has many far-reaching effects other than loss of income, including psychological harm, loss of work motivation, skill and self-confidence, increase in ailments and morbidity (and even mortality rates), disruption of family relations and social life, hardening of social exclusion and accentuation of racial tensions and gender asymmetries.” *Amartya Sen*

Trends in Employment to Output Growth Ratio



UNEMPLOYMENT RATES (Latest Available)



Argentina	8.4%	Mexico	5.3%
Australia	5.7%	India	6.8% (2008)
Brazil	8.9%	Indonesia	8.4% (2008)
Chile	9.8%	Peru	9.3%
China	9.0% (2008)	Poland	11.0%
Colombia	12.0%	South Africa	23.5%
Euro Area	9.2%	Spain	18.1%
Greece		Switzerland	3.5%
9.2%		Turkey	16.1%
OECD (average)	7.8%	United States	9.4%
Global	(forecast)	Venezuela	8.1%
6.1-7.1%			

U.S. UNEMPLOYMENT PICTURE (May 2009)



“Full” Unemployment Rate	16.4%
Official Unemployment Rate	9.4%
Youth	22.7%
African Americans	14.9%
Hispanics	12.7%
Labor Participation Rate	65.9%
Unemployed Persons	14.5 million
Part-time for Economic Reasons	9.1 million
Marginally Attached & Discouraged	2.2 million

Source: BLS

The Role of Markets



- Economic and social outcomes not optimal in the relevant time
- Real markets – Insufficient demand
- Labor markets – Large numbers of unemployed labor, able and willing to work
- Financial markets – *Stability is destabilizing* (H.P. Minsky)



The Role of Government

- **Laissez-faire and small government yield uneven and often times disappointing outcomes**
- **Production markets: It can increase economic well-being (food and shelter security)**
- **Labor markets: It can implement active labor policy**
- **Financial markets: It can ameliorate instability**

The Role of Government

**During sharp downturns and financial crises
(Great Depression; Great Recession 2007-?)**

- **Big Government to maintain income and profit flows**
- **Big Bank – Lender of last resort to inject liquidity into the financial system**



THE GREAT DEPRESSION (1929-1933)

- Cumulative GDP decline of more than **26%** over the four years (1930-1933)
- Unemployment rate $> 30\%$ (non-farm workforce) and reached 50% in Harlem, NY
- Wage income fell **-42.5%** over 1929-1933
- Insolvency of the banking system

ANSWER: Big Government – New Deal Programs and financial markets regulation



THE GREAT RECESSION (2007-?)

- Cumulative GDP decline of more than 6%
- Job losses more than 7 million
- Loss of \$14 trillion of net worth

ANSWER (So Far): Big Government and Big Bank have injected \$10 trillion and about to overhaul financial markets regulations

JOBLESSNESS



- **Concentrated among segments of the population that suffer other disadvantages**
- **Racial and ethnic minorities**
- **Immigrants and distressed migration**
- **Women (especially female heads of households with children)**

JOBLESSNESS



- Younger and older individuals
- People with disabilities
- People with lower educational attainment
- Lack of employment is highly correlated with poverty and high degree of social exclusion



EMPLOYMENT POLICY

APPROACHES:

a) Behavioralist

b) Structuralist

c) Keynesian

EMPLOYMENT POLICY CRITERIA



- (i) Is not inflationary**
- (ii) Does not interfere with micro-decisions of individual firms**
- (iii) Does not rely on the “fine-tuning” of the aggregate demand approach**
- (iv) Is consistent with the premise that, to the extent possible, socially-productive work is preferable to income maintenance**
- (v) Does not replace existing jobs**

EMPLOYMENT POLICY OPTIONS



- **Reduction of work week – work sharing scheme**
- **Employment Subsidies**
- **Direct Job Creation by Government – (Employer of Last Resort or Employment Guarantee Schemes)**

REDUCTION OF THE WORK WEEK: COUNTRY EXPERIENCES



The experiments of this policy have failed:

Europe: Germany (1950s, 1960s)

Netherlands (1970s, 1980s)

Belgium (1980s)

France (1990s)

Australia (1980s)

Japan (1990s)

During the current recession



- Governments are experimenting with work-sharing programs
 - So far 17 states in the US have established such programs to avert lay-offs
 - Germany, France, Netherlands, Finland and Greece are implementing versions of “short work” programs

EMPLOYMENT SUBSIDIES



- **Employment subsidy schemes entail partial offset of the cost to firms of hiring additional workers**
- **Wage subsidies have been proposed in the U.K. by Pigou (1933), Kaldor (1936), Jackman and Layard (1986), Snower (1993) and in the U.S. by Hammermesh (1978), Haveman and Palmer (1982) and more recently by Phelps (1994, 1997) and Snowden (2007)**
- **Interferes with employer decisions and thereby distorts the market mechanism**

EMPLOYMENT SUBSIDIES



- **Difficulties with implementing this employment option**
- **Likely not to achieve higher levels of employment because it is possible that employers will seek to substitute subsidized workers for those currently employed**
- **Limited application in some developing nations where the private sector is not sufficiently developed**

DIRECT JOB CREATION: Government as Employer of Last Resort (ELR)



- **First proposed by Hyman Minsky (1965). Revived in late 1990s by scholars at the Levy Economics Institute, U of Missouri-Kansas City and U of Newcastle in Australia.**
- **Achieving full employment should not be based on subsidizing demand**
- **A strategy for full employment that does not lead to instability and inflation**
- **If private sector demand is insufficient to provide full employment**



- **Only government can divorce profitability from hiring of workers and can create an infinitely elastic demand for labor**
- **Government takes responsibility to provide employment to all those willing and able to work at uniform hourly wage**
- **Increases flexibility in the labor market by creating a ready supply of labor to meet demand**

DIRECT JOB CREATION: ELR



FEATURES OF THIS POLICY

- **Government establishes the wage and benefits that will be offered to anyone who is legally able and willing to work and would employ all who want to work in the public sector**
- **Government becomes “a market maker for labor”. In effect it “buys” all unemployed labor at a fixed wage or “sells” (provides it to the private sector) at a higher wage**
- **The commodity (labor) has a stable price. Thus, this employment policy ensures full employment with stable prices**



- The ELR program, unlike a Keynesian demand management policy, would not lead to tight labor markets or inflation
- The ELR program would act as an automatic stabilizer – employment increasing in recessions and shrinking during economic expansions
- Some social support programs would be necessarily maintained

DOMESTIC POLICY SPACE REQUIRES FISCAL SOVEREIGNTY



- **Government spending creates private sector assets in the banking system**
- **Taxation creates private sector debts to the government that must be financed with those assets**
- **If taxes exceed government spending the private sector is in net deficit, i.e. insolvent**
- **If the private sector holds assets for other convenience purposes financial stability requires a government deficit over time equal to the private sector's demand for money balances**

DOMESTIC POLICY SPACE REQUIRES MONETARY SOVEREIGNTY



- Government spending increases unborrowed bank reserves
- Excess reserves drive interbank rates to zero
- To keep interest rates positive the government must borrow
- As borrower of last resort it can fix the interest rate
- Interest rates are thus not constrained by private sector willingness to buy government debt or the size of the deficit
- The government does not have to borrow or issue debt in order to deficit spend
- It follows that the government can always set the short term interest rate independently of the size of the deficit - - viz. Japan

EXPERIMENTS OF ELR or EGS POLICY

Temporary and small-scale programs



1. **UNITED STATES:** New Deal public work programmes (WPA, PWA, CWA) 1933-1936
2. **SWEDEN:** “Right to work” rather than “right to income” programme, 1938-1970. Programme focused on the “socialization of investment” and offered an alternative to welfarism by emphasizing the “right to work” rather than the “right to income.” Unemployment rates were below 3% until the late 1980s and with the dismantling of the programme in 1990 (conservative government) unemployment reached 9.6% in 1993 and has since fluctuated between 4 and 7%
3. **AUSTRALIA:** Keynesian Commonwealth Employment Service, 1940s-1970s, delivering an average of 2% unemployment in contrast to unemployment hovering near 9% in the 1990s and over 4% presently
4. **FRANCE:** “Professional Transaction Contracts” first proposed by Jacques Attali in 1984. Pilot programmes began in six districts (2005) and are currently being evaluated before being officially adopted nationwide

LATIN AMERICA



BOLIVIA

- Emergency Social Fund (Public Works Infrastructure Programme, 1986)

CHILE

- Public Works Programmes (1975-1987) to combat 30% unemployment, employing 13% of the workforce

EL SALVADOR

- Fund for Social Investment launched in late 1990. Programmes work closely with NGOs and community-based groups

MEXICO

- Programa de Empleo Temporal (1995) – community development through intensive use of unskilled labour for social and productive infrastructure. By 2000 programme had increased to one million beneficiaries

PERU

- Public Works Programme (1991) modeled on Chile's ESF programme but focusing primarily on Women in Lima (At one time employed 500,000)

AFRICA



BOTSWANA

- Labour-Based Relief Programme and Labour-Intensive Rural Public Works Programme (1980s)

MOROCCO

- Promotion Nationale (since 1961): 45 years of successful experience of Public Works programmes. Focuses on the development of rural communities, the Saharan and South Provinces. (Consistent annual increases in working days)

SOUTH AFRICA

Expanded Public Works Programme (2004)

- Increasing labour-intensity of government-funded infrastructure projects
- Creating work opportunities in public environmental programmes
- Creating work opportunities in public social programmes
- Developing small businesses and cooperatives

ASIA



BANGLADESH

- Public Works Programmes (i.e. Food for Works 1980s; Rural Maintenance Programme 1990s)
- Labour-Based Programmes (i.e. Rural Development Programme)

KOREA

- Emergency public works programmes for low-skill workers following the East-Asian crisis (1997-8)

INDONESIA

- Poverty alleviation programmes (1979) and Emergency job creation measures in response to Asian crisis, *Padat Karya* programmes involving small-scale infrastructure projects

LARGE-SCALE PROGRAMS

INDIA

- Maharashtra Employment Guarantee Scheme
- National Rural Employment Guarantee Act

ARGENTINA

- Heads of Households Plan (*Jefes de Hogar*)

SOUTH AFRICA

- Expanded Public Works Programme (EPWP)

SPECIAL CHALLENGES FACED BY DEVELOPING COUNTRIES



- **Production of a small range of commodities**
- **Export limited**
- **Imports substantial**
- **Informal sector significant with large wage disparity from the formal sector**
- **Administrative capacity of national government limited**
- **Domestic infrastructure inadequate to facilitate expansion of productive capacity**
- **Exchange rate is likely pegged**

SPECIAL CHALLENGES IN IMPLEMENTATION:



- **Program's monetary wage close to the average wage in informal sector**
- **Design projects that increase the availability of necessities, i.e. locally-produced food, increase productivity in agriculture, and basic services in line with meeting human development goal.**
- **Design ELR projects aiming at enhancing the nation's ability to increase production for export**



- **Develop infrastructure to reduce business costs and attract private investment**
- **Phased implementation of the program**
- **Decentralization of project development, administration and supervision**
- **For some countries, financing can be obtained through international aid (provided the program directly increases exports)**
- **ELR projects should not compete with private sector**



FINANCING MODALITIES FOR AN ELR PROGRAM

HIGH-INCOME COUNTRIES:

FUNCTIONAL FINANCE

- Sovereign Currency with Floating Exchange Rates (U.S., Japan, S. Korea, Canada, U.K., Australia, certain lower-income nations, i.e. Mexico)

“SOUND” FINANCE

-Non-sovereign Currency with Floating Exchange Rates (Eurozone members)

FINANCING MODALITIES FOR AN ELR PROGRAM



“SOUND” FINANCE AND/OR ODA

- MIDDLE-INCOME COUNTRIES (Mexico)
- LOW-INCOME COUNTRIES (Post Conflict)

RESOURCE WEALTH NATIONS

- OIL PRODUCERS: OPEC (*Iran, *Iraq), Russia
- DIAMOND AND GOLD: (S. Africa)
- METALS: (Chile)
- FINANCIAL RESERVES: (Brazil, China)

A HYPOTHETICAL ELR PROGRAMME IN THE U.S. - COSTS AND BENEFITS



Number of ELR workers	7 million
Wage rate with benefits	\$15 per hour
Annual Wage Bill	\$191 billion
GDP	\$14,500 billion
Annual cost as % of GDP	less than 1.32%
Multiplier	1.3
Multiplier Effect	191 x 1.3 = \$248 billion annual addition to GDP or 1.72% of GDP

Thank you

