

**GOVERNMENT AS EMPLOYER OF LAST RESORT: CAN IT WORK?**  
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Randall Wray (1997, 2000a, 2000b) has recently argued that government can secure permanent non-inflationary full employment by acting as employer of last resort (ELR). According to Wray, government should always have jobs on offer to any “who are ready, willing, and able to work at a socially-established basic wage (Wray, 1999, p.1)”. The basic wage should not only include a wage component, but should also include a benefits component in the form of health insurance and contributions to social security. This proposed scheme resonates with arguments put forward by Harvey (2000) that employment is a human right, and the ELR proposal can be thought of as making this right effective.

The ELR scheme would have government establish a horizontal supply of jobs at a socially established basic wage. In doing so, proponents claim that it will take care of both the price (low wages) and quantity (unemployment) problems that have historically afflicted decentralized labor markets. The existence of perfectly elastic supply of jobs deals with the problem of insufficient jobs, while the problem of inadequate low wages is dealt with through the basic wage which sets a floor to economy-wide wages. The logic is that any private employer seeking to pay less would be unable to find workers as they would prefer ELR jobs.

The ELR proposal has its roots in a fusion of Keynesian and neo-chartalist monetary thought. The Keynesian piece reflects the belief that modern capitalist economies periodically produce unemployment owing to lack of demand, but rather than dealing with the problem by pumping up demand, ELR deals with the problem by offering public sector jobs. This supply of jobs is paid for with money financed deficits, which it is claimed would be non-inflationary because money injected in would leach back out in the form of tax payments. This latter claim is the neo-chartalist piece of the proposal.

The neo-chartalist position has close links to the legal restrictions theory of money (Wallace, 1983) which maintains that state issued fiat money has value because it is the only means of paying tax obligations. However, the neo-chartalists excavate the fiscal implications of this legal restrictions argument, and end up reversing the claim that taxes are needed to finance government spending. Instead, “taxes are required not to finance government spending, but rather to maintain demand for government fiat money (Wray, 1998, p.75).” It is this reasoning that leads proponents of ELR to believe that deficit financing of ELR jobs will be non-inflationary. The creation of ELR jobs creates income, as does spending of this income, and this in turn generates tax obligations that drain money from the system.

Lastly, this neo-chartalist deficit spending feature interacts with the Keynesian logic of demand determined private sector employment to produce a powerful automatic stabilizer mechanism. When private sector demand is low and unemployment is high, ELR employment rises. This automatically increases government deficit spending, resulting in an injection into the private sector economy that raises output and employment. The rise in private sector employment in turn draws workers off the rolls of the ELR program, resulting in an automatic reduction of government spending and a closing of the deficit.

### **Some reflections**

Questions about the proposed ELR scheme can be divided into four categories - microeconomic administrative questions, macroeconomic inflation questions, political economy financing questions, and open economy trade deficit and exchange rate questions.

*Microeconomic administrative questions.* The first major issue confronting an ELR program concerns the need to establish and efficiently administer a program that can provide productive jobs. That jobs be productive is a critical necessity: absent this, public support for the program will inevitably disappear even if the program provides overall macroeconomic benefits. Existing non-profit institutions could undoubtedly be usefully engaged in making ELR jobs productive, but scaling them up from existing levels would itself be a significant challenge.

A second microeconomic challenge, that afflicts all forms of workfare programs, is how to

provide productive public sector jobs without undermining existing public sector pay arrangements. Thus, it is not difficult to see how opponents of public sector unions could substitute ELR employment for unionized public sector jobs. In effect, an ELR program risks opening a new “public sector” front in the war against unions, and this would aggravate many of the existing problems regarding distribution of income and voice at work.

*Macroeconomic inflation questions.* The most controversial claim of the ELR proposal is that it can be deficit financed in a non-inflationary way. The claim that it is non-inflationary rests on the argument that ELR supplies jobs at a labor market floor wage rather than demanding workers and bidding up the wage.

There are two concerns here. The first is that to have meaning, the socially-established basic wage must be a real wage. In this event, there is a danger that if set at too high a level, it could draw workers out of the private sector, thereby bidding up the private sector wage and driving down private sector output supply, which in turn would drive up prices. This private sector price - wage response would ultimately draw workers back into the private sector, and is therefore self-equilibrating. However, it does illustrate a potential and ever-present inflationary pitfall connected with the issue of how to set the basic wage.

The second and more serious problem concerns the macroeconomic structure of the economy. Proponents of ELR appear to be working with a single sector Keynesian macro model with an inverse L-shaped supply curve. In this model there is no inflation as long as activity is on the bottom portion of the L. As private sector demand expands, ELR employment declines as workers are drawn into the private sector, and these new private jobs raise output and reduce price pressures. But what if the economy is really a multi-sector economy? In 2000 the U.S. national unemployment rate was 4%, but a map showing unemployment rates by county shows wide variation. Some counties had unemployment rates of 2%, but others had rates in excess of 9%. This is important because though ELR jobs will be created in high unemployment areas, the demand generated by spending of wages will spread into other areas, potentially creating inflationary pressures in those areas. Thus, spending of wages in the most depressed regions of

West Virginia involves purchases of goods made elsewhere, and the money so spent then remains in circulation in those other areas.

This leads to another concern. The neo-chartalist logic behind financing of an ELR program implicitly assumes that money spent comes back to government in the form of tax receipts. After all, taxes are required to ensure demand for fiat money. But here too there is a problem since the simplest of Keynesian income-expenditure models shows that a dollar of government spending must always increase the deficit - though the increase is less than a full dollar owing to the recouping effect of taxation.<sup>1</sup> This means that as long as government money finances the payment of ELR jobs, it will be injecting new money balances into the economy, potentially contributing to the build up of inflationary pressures. However, balancing this, it should also be noted that if there is steady productivity growth, this injection of new money might perform the useful function of supporting demand growth that absorbs the new output and prevents price deflation.

*Political economy financing questions.* Wray (2000) seeks to illustrate how an ELR program would work by reference to the experimental “buckaroo” program run by the University of Missouri - Kansas City. This program has students being obliged to do community service to earn buckaroos (university issued money) that they then pay to the university to meet their obligation regarding performance of a given number of community service hours. This program certainly illustrates the neo-chartalist dimension of money, but it also illustrates why there may be political economy financing constraints on an ELR program. In effect, the public may be unwilling to pay the taxes necessary to support an ELR program.

In the case of the buckaroo program this objection does not hold because students are

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<sup>1</sup>. This is easily seen in the following model:

$$(1) Y = c_0 + c_1[1-t]Y + G \quad c_0 > 0, 0 < c_1 < 1$$

$$(2) T = tY \quad 0 < t < 1$$

$$(3) D = T - G$$

where  $Y$  = national income,  $t$  = flat tax rate,  $G$  = government spending, and  $D$  = government deficit. In this case, the impact of a one dollar increase in  $G$  on  $D$  is  $dD/dG = t/\{1 - c[1-t]\} - 1 < 0$ .

compelled to conform to the university's requirements. But in the real world people may object to paying taxes to finance ELR jobs. People have to earn income to pay taxes, and earning income means bearing private costs. In the U.S. this political economy financing constraint appears to kick in when the tax share rises above 20% of GDP.

The existence of a financing constraint also intersects with the earlier raised microeconomic administrative concerns. If ELR jobs are viewed as not producing value, the public will turn against them and the financing constraint will bite with further force. ELR workers use their income to purchase and consume output produced in the private sector. The production of this output entails private resources and effort, so that in effect resources and effort are being transferred to ELR workers in return for money to pay taxes to finance ELR jobs. People will be much more willing to do this if they believe ELR jobs are producing output of real value - and are not just make-work arrangements to deal with the problem of unemployment.

*Open economy trade deficit and exchange rate questions.* The final set of questions concerns the exchange rate implications of ELR. Part of the income earned by ELR workers will inevitably be spent on imports, and so too will part of the induced domestic income generated by ELR workers consuming domestic output. This risks the emergence of trade deficits and exchange rate depreciation. For a small open economy, exchange rate depreciation can produce imported price inflation that can then trigger a domestic wage - price spiral. In effect, the foreign account is another open-economy channel through which a money financed ELR program could prove inflationary. Such considerations suggest that the real test of the theoretical claim that ELR can provide non-inflationary full employment is could countries like South Africa, Brazil, or Mexico implement such a program. Independent of their microeconomic administrative capacities to do so, it is likely that these countries would all find serious macroeconomic constraints at play which suggests that the claims of ELR proponents may be over-stated.

## **Conclusion**

Proponents of ELR have made a real contribution to the current policy debate by arguing that true full employment is within reach of policy makers. The strongest piece of their reasoning is

the automatic stabilizer feature of ELR programs. Unemployment is automatically dealt with by having a perfectly elastic supply of ELR jobs so that unemployed workers create employment by accepting ELR vacancies. In doing so they also set in train government spending that raises private sector demand. This expands private sector employment which serves to automatically draw workers off the ELR rolls, thereby reducing government spending. Balanced against this are the problems of ensuring that ELR work is productive in its own right, the possibility that tax payers may be unwilling to finance the cost of ELR jobs, and the macroeconomic inflation implications of deficit financing.

The traditional policy tools of a minimum wage, expansionary fiscal policy, and easy monetary policy can realize most of the goals of ELR. If set right, the minimum wage can ensure a minimally appropriate standard of living for all, and it can be bolstered by programs such as the Earned Income Tax Credit. Easy monetary policy and expansionary fiscal policy can ensure levels of aggregate demand that produce full employment. Public investment programs that conform to procedures established by the Davis - Bacon Act ensure that public capital is produced without undermining unions, and it is also produced efficiently as profit maximizing firms contract to build it. The advantage of these arrangements is that, for the most part, they leave decisions about what to purchase and how to produce it in the hands of private sector agents. For many activities this is the most efficient course. The disadvantage is that they lack the automaticity inherent in the ELR program in that they rely on decision responses by policy makers to changing economic conditions. The challenge is how to build more automaticity, akin to the ELR program, into them.

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