Employer of Last Resort programs as a development strategy in a globalized world

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The Economic Theory of Full Employment: justifications for seeking full employment through ELR in the current global economic environment

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Traditional Approach to Development

- **Constraints to development:**
  - Domestic savings gap
  - Scarcity of domestic resources
  - External resource requirements
- **How to Overcome constraints:**
  - Increase domestic savings
  - Foreign savings -- external resources
    - Official development assistance
    - Private aid and investment flows
- **This is requires free movement of capital from Developed to Developing Countries**
- **Directed Aid of Free Capital Markets – Financial Globalisation**

Theoretical Support for Financial Globalisation

"The basic argument for international investment of capital is that under normal conditions it results in the movement of capital from countries in which its marginal value productivity is low to countries in which its marginal value productivity is high and that it thus tends toward an equalization of marginal value productivity of capital throughout the world and consequently toward a maximum contribution of the world's capital resources to world production and income."

Jacob Viner, "International Finance in the postwar World," *Journal of Political Economy*, 55, April, 1947, p. 98.

Implicit Assumption: return on investment is higher in developing countries

- Negative relation between capital intensity and rate of return
- You can measure capital intensity
- Foreign capital inflows increase domestic investment
- There is a high elasticity of substitution between financial assets and real assets
- Fixed Exchange Rates or insurable exchange rate risk

Assumptions cannot be verified

- No relation between capital intensity and rate of return
- There is no unambiguous measure of capital intensity
- Little empirical evidence that foreign capital inflows increase domestic investment
- However, in Latin America they do increase consumption
- There is negligible elasticity of substitution between financial assets and real assets

Neither does historical record

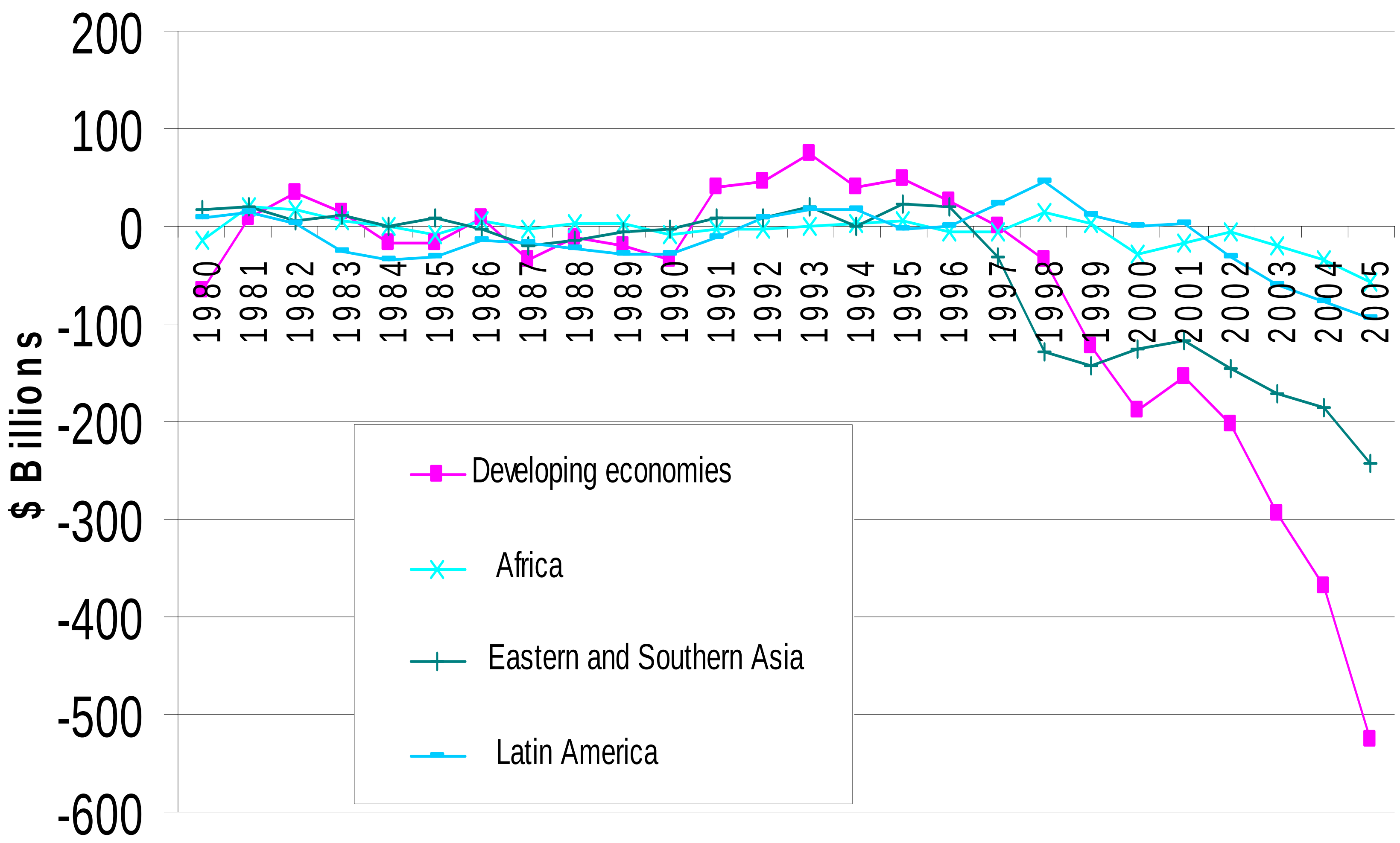
- Brazilian President Getulio Vargas, in 1951, complained that Brazil had experienced negative net financial flows from 1939 (with 1947 the exception).

- Quoted in Aristoteles Moura, *Capitais estrangeiros no Brasil*, Editura Brasiliense, Sao Paulo, 1959, pp. 26-7.

Net transfers of resources

- First UN Development Decade 0.7 % of Developed country GDP as Aid for Developing Countries
- Success measured by positive net transfers of real resources from developed to developing countries
- For Four UN Development Decades this has been the exception
  - – negative net transfers rule
    - 1960s, lost decade of the 1980s, financial crises of the 1990s
- Private Flows have become dominant
  - Resource flows no longer subject to development needs, but to private incentives

Net Transfers of Resources



Traditional Approach undermines Domestic Mobilisation

- External resource transfers fill resource gap
- Private flows and Official Aid create debt service obligations
- Earnings of foreign currency needed to meet debt service
- Earning Foreign Currency to Service debt requires an external surplus
- External surplus is a negative net transfer of resouces

Resolving the External Debt

- External surplus = negative net resource transfer
- BWI Structural Adjustment Program
  - Reduce domestic level of activity to free resources to meet debt service
  - External surplus produced via fiscal surplus
  - Reduces domestic absorption and resource utilisation
  - Creates unemployment
  - Absence of Social Safety Net creates social marginalisation

No Fifth Development Decade: Millennium Declaration

- Reduced emphasis on resource transfers
- A directed aid strategy
- Designed to meet time-bound, measurable Social Development Goals
- Goals are symptoms of underdevelopment
- Still requires external resources:
  - $100 billion per year to 2015
  - What happens after 2015?

An Alternative Approach: Global Development Partnership

- Developing countries responsible for their own development
- Primary source of development finance is Mobilising Domestic Resources
- Developed countries to provide additional resources required to support sound national development strategies

What are the available domestic resources?

- Most developing countries have abundant natural resources
- But all have unemployed, underemployed or under qualified domestic labour
- All have low participation rates and discouraged workers, especially among women
- Increasing activity levels and employment present the greatest unexploited potential for mobilising domestic resources

Recognised in2005 Summit Outcome

Employment

47. We strongly support fair globalization and resolve to make the goals of full and productive employment and decent work for all, including for women and young people, a central objective of our relevant national and international policies as well as our national development strategies, including poverty reduction strategies, as part of our efforts to achieve the Millennium Development Goals.

Employment joins MDGs

- High-level segment of the 2006 substantive session of the Economic and Social Council Ministerial Declaration reinforced the 2005 World Summit position
- Make full and productive employment and decent work for all, including for women and young people, a central objective of relevant national and international policies and national development strategies and to be part of efforts to achieve the internationally agreed development goals, including the Millennium Development Goals.

Full and Effective Employment

- New Goal of full mobilization of domestic labour resources requires
  - suitable employment opportunities for men and women
  - policies to increase participation rates
  - provision of adequate basic education for all
  - vocational and occupational training to improve skills and productivity
  - unemployment benefit scheme that avoids moral hazard and fraud
  - migration policy – use of remittances

ELR as Domestic Resource Mobilisation

- If private sector demand is insufficient to provide full employment
- Government takes responsibility to provide employment to all those willing and able to "work" at or marginally below the prevailing informal sector wage
- Increases flexibility in the labour market by creating a ready supply of labour to meet demand

Domestic Policy Space requires Fiscal Sovereignty

- Is fiscal surplus sound resource mobilsation policy?
  - 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 policy interest rate independently of the size of the deficit -- viz. Japan

What does "work" mean?

- Different according to level of development
- Primary goals:
  - Maintain and improve skill level of the labour force – basic educational skills
  - Provide social safety net – income maintenance
  - Provide social inclusion for the unemployed/unemployable – social services
  - Meet the needs of female heads of households to combine work with family responsibilities
  - Improve the well-being of society – useful public works

ELR as an MDG programme

- A suitably designed ELR programme to provide employment can also be designed to satisfy:
- MDG Goal 1: Eradicate Extreme Hunger and Poverty
- MDG Goal 2: Universal Primary Education
- MDG Goal 3: Promote Gender Equality and Empower Women
- MDG 4 and 5: Reduce Child Mortality and Improve Maternal Health