Global Institute for Sustainable Prosperity

Policy Note No. 105
April 2015

Employer of Last Resort Program for Italy: *It's cheaper than you think*

Giuseppe Mastromatteo
Research Scholar, Global Institute for Sustainable Prosperity
Professor, School of Economics of the Catholic University of Milan

Lorenzo Esposito
Research Scholar, Global Institute for Sustainable Prosperity

After the 2008 crisis destroyed the confidence of public and institutional opinion in the received macroeconomic wisdom, the world is once again ready to understand how modern capitalism really works, and from central banks to academic institutions, economic thought has become receptive to a re-reading of Hyman Minsky. His contribution is already at the center of the debate on financial stability, but his work on labor market policies, particularly his proposal to give the State the role of "Employer of Last Resort" (ELR)[1] is still being ignored by the mainstream. After decades of virtually disappearing from the economic policy discourse, the concept of full employment is finally back on the agenda as central banks and governments attempt to reduce unemployment through monetary and fiscal policies. All of a sudden, a war on poverty, a fairer income distribution, full employment and financial stability are back on the agenda because this is what the world economy needed after the global financial crisis. However, in a world where, according to the International Labor Organization, the number of unemployed people exceeded 200 million, full employment can only be reached with a deliberate active policy. ELR is the answer.

In a nutshell, the ELR program is a uniform base wage offered to anyone willing to work in substitution of any other unemployment benefit. Hired people are employed in local community projects linked to social needs. In this brief policy note, we cannot address the critiques of the ELR program; we will only focus on its many positive features. In fact, the ELR program helps to immediately reduce poverty and overall demand volatility by eliminating unemployment in a way that does not trigger wage-price inflation spiral. ELR is the only program that encompasses all the different aspects of a labor market policy: unemployment and employability, human capital preservation, misery prevention, income distribution and poverty; it positively affects economic growth on many counts (above all, expanding the workforce employed and employable in the future); and finally, it lowers financial fragility because it improves wage and income distribution in the labor force. In other words, full employment and stability without inflation.

[1] Here, we only present a brief version of the idea. A first draft of the full work with bibliography can be retrieved from http://www.siecon.org/online/wp-content/uploads/2014/10/Mastromatteo-Esposito-164.pdf

Even if the scheme is theoretically sound, in an era of public budget restrictions many could consider it politically untenable. That is why an efficient, accountable, and transparent implementation of the ELR program is key to its practical feasibility. We will address here two aspects of this issue.

The first is institutional design ("who is in charge"). We think that the best arrangement is to split responsibilities as follows: the "center" (a central body like a ministry) should be in charge of the general framework in terms of resources, rules, etc.; and local authorities and communities should be in charge of the practical tasks: priorities, hiring, paying wages, etc. This is necessary to ensure popular participation in the projects without renouncing the economies of scale and coordination coming from a central body that has the oversight of the project.

The second point is accountability and transparency. First of all, transparency towards the people entering the scheme. The duration and termination of employment should be transparent, and recruitment criteria should not discriminate based on gender and ethnic or social origins. Secondly, the ELR jobs have strings attached. For instance, in the case of *Plan Jefes* in Argentina, eligibility for employment was conditional on proof that the workers' children were attending school and were receiving appropriate medical treatment such as vaccinations.

Similarly, in discussing a job guarantee scheme for the UK, the Trades Union Congress (TUC) pointed out that since what was offered involved real jobs, there was no problem with sanctions faced by people who turned them down. Thirdly, transparency is also important for taxpayers because in many cases these programs are criticized for being ridden with corruption and inefficiency. To avoid such outcome, it is vital to ensure clear and simple rules and empowerment of local communities. It is essential that the program be built step by step locally in terms of project selection, implementation and monitoring. The lack of local involvement downgrades the ELR program to a simple program of benefits distribution.

In assessing how to ensure accountability and transparency, it is useful to start from the analogy of *the last resort*. Some ELR economists prefer to use the terms Job Guarantee, Public Service Employment, Buffer Stock Employment, etc. because the "last resort" term has a negative connotation. We think that ELR is the right name because the ELR program aims at treating all citizens in the same way as banks are treated. The latter are heavily regulated during good economic times, and they are bailed out with public money by the lender of last resort (LLR) and other tools during bad economic times. While central banking aims to ensure of financial stability, the ELR program guarantees social stability.

The analogy should be explored in a far deeper way than the creators of the idea could think. The essence of the LLR is that the central bank stands ready to lend an unlimited amount of money against a collateral at a punitive rate. In this regard, ELR should work exactly in the same way. Just like the interest rate charged by the central bank is aimed at restoring financial stability, the ELR wage is used to stabilize the labor market. The amount of central bank lending depends on the condition of financial markets. The more depositors and banks regain confidence, the less LLR is vital.

Similarly, the more private firms hire, the less ELR is crucial to full employment. Like central bank lending, ELR is useful in any given economic situation as a countercyclical tool. The ELR wage stabilizes the labor market in the same way that the risk-free rate stabilizes financial markets.

The analogy should go further. Just like free banking was never really possible, a "free" labor market is tantamount to using unemployment to reach higher labor market flexibility hence wasting potential production and aggregate income. Any good feature attached to LLR can be easily transferred to ELR. Therefore, we can concentrate on two issues to complete the analogy: the equivalent of a central bank and how to create something similar to banking regulation.

We think that in order to manage the ELR program as a whole, the government should create a State agency similar to a banking supervisory authority or a central bank. This agency should have the mandate to cure unemployment just like the central bank is mandated to ensure price stability. Therefore, coordination between them is needed in the same way that banking supervision and monetary policy are done by two different institutions.

What should be the main practical tasks of the ELR agency? Basically: to define the ELR wage (just like the policy rate is set by the central bank) and to supervise the projects where ELR workers are employed. The practical toolkit of this supervision can be taken from the experience of banking supervision: on-site inspections, off-site analysis of a structured series of efficiency indicators, analysis of the quality of management, consumer protection tools and so on. In fact, the literature on the issue proposes very similar tools to those used in banking regulation. For sure it would help greatly to make the projects more efficient, but it could also fail every now and then just like it happens in banking regulation. That is why, for ELR to work, accountability granted by a State agency would not be sufficient.

As Minsky pointed out, ELR *per se* is not about Big Government but about social and local empowerment. ELR allows local needs to be met by the local unemployed population. It would be too expensive to control these projects only from the center. It would also keep local communities in a state of passivity. Therefore, besides the State agency, the ELR program should also include the active control of the local community that have the unique capacity to ensure the input to the scheme (workers) and to receive the output (i.e. the social services). Therefore, every district where ELR projects are taking place, a small local management commission should be set up, and should consist of local citizens adequately trained by the State agency, appointed experts and representative of ELR workers. This commission should be in charge of ensuring the effectiveness of the local ELR project and could be in a sense a local branch of the State agency. The active participation from below and the expertise and coordination from the center can ensure that the ELR program is effective and efficient. Local examiners could enforce a quality control mechanism based on the specific features of each situation where work can be organized and managed in unconventional ways without being 'unproductive'.

How much will ELR cost in Italy and beyond?

There are several studies using cost-benefit analysis of the ELR programs based on a variety of tools[2]. All these analyses conclude that an ELR program would lead to burdens varying between 1 and 3.5 percent of GDP at its peak, with a benefit at least double in terms of GDP, which is also consistent with Minsky's original calculations. Therefore, ELR would be more than self-financing. In addition, ELR eliminates other State expenses, some direct, such as unemployment benefits, other indirect, like the costs linked to misery and unemployment in terms of health, criminal activities and so on. More generally, in one way or another, unemployed workers are fed by the employed people; therefore, ELR wages are not an added social cost. All of these ideas are supported by a very recent case study about Greece[3]. This thorough reading on how to tackle the terrible situation of unemployment in Greece after years of austerity, points out that a full scale ELR program would cost between 1.5 and 5.4% of GDP; moreover, 60% of this cost would be recouped by the State in taxes, etc. It also estimates that at the current minimum wage, for every 10 ELR new jobs, around 4 indirect jobs are created and that the GDP increase is 2.3 times the cost of the program. Simulation results are based on the Eurostat Input-Output (I-O) tables of the country.

Comparing the I-O tables of the specific sectors used by the study as ELR jobs creators we can see that there is a strong similarity, despite all the differences between the Greek and Italian economies. In fact, these five sectors[4] have a very similar weight in the economy (12.46% and 12.59% of the total output respectively in Greece and in Italy) and their input composition is also similar (see Table 1)[5].

Table 1: Input Composition of the *Synthetic Sector*		
	Greece	Italy
Intermediate consumption	46,30%	50,13%
Compensation	35,09%	33,00%
Gross operating surplus	18,53%	15,31%

Therefore, we can confidently use the multipliers of the original research to simulate the cost of an ELR program for Italy. In particular, we base our analysis on the following assumptions:

Table 2: ELR Program Multipliers[6]	
GDP multiplier	2.3
Overhead costs add-on	40%
Indirect to direct jobs ratio	40%
State recouping	40%

[2] For related bibliography, see footnote no. 1.
[3] Observatory of Economic and Social Developments, Labour Institute, Greek General Confederation of Labour 2014. *Responding to the Unemployment Challenge: a Job Guarantee Proposal for Greece* (http://www.levyinstitute.org/pubs/rpr_apr_14.pdf).
[4] Environmental services; Constructions; Security and investigation services; Services to buildings and landscape; Office administrative and support; Education services and social work.
[5] The synthetic sector is built using the single sectors data weighted for their share of the total output.
[6] The overhead costs add-on was estimated by Minsky at 25%. State recouping is circa the fiscal pressure.

Using these coefficients we can simulate the impact of the ELR scheme. We use 2013 data in the following table[7]:

Table 3: Results		
Variable	Value	Comment
Hourly wage (a)	€8	In Italy there is no legal minimum wage. We reached this figure using France's SMIC for 2013 less 15%[8].
Hours worked per year (b)	1,500	The hours worked in 2013 have been 1,578 in the industrial sector and 1,570 in the service sector.
ELR workers (c)	1.7 million	Total labor force is 25.533 million; unemployed people are 3.113 million; leaving aside 3% of the total labor force, as suggested by Minsky, yields approximately 2.4 million workers of which around 70% covered by ELR as direct jobs.
*ELR annual wage (W=a*b)*		€12,000
*ELR total cost per worker (T=W*1.4)*		€20,000
*ELR gross cost (G=T*c)*		**€34 billion**
*Increase in GDP (Y=G*2.3)*		€78.2 billion
*State recouping from ELR (S=Y*0.4)*		€31.3 billion
ELR net cost (G-S)		**€2.7 billion**

The total cost of an ELR program in Italy is about 2% of GDP, close to the estimates quoted above. To put this number (€34 billion) in context, we should consider that, in 2012, the total cost of employment policies for the Italian government was more than €29 billion, of which €23 billion for unemployment benefits. This means that the ELR labor cost would increase the *gross* bill for the State by no more than €5 billion. As for the net cost, considering only the direct GDP growth, the situation would be by far better given that now these benefits are paid without any direct increase in GDP, while the economic growth generated by the ELR program could be in the range of €80 billion per year, which means, *inter alia*, more than €30 billion of new revenues for the State.

Looking beyond the Alpes, and if we use Italy as a rough guide for the world, an EU-wide ELR program would cost about €300 billion a year, whereas a world-wide ELR program would cost €1,3 trillion annually. These numbers may seem astronomical, but, again, they should be put in context. Public money used to contain the crisis in 2009 amounted to about \$23 trillion already.[9] To save US and EU banks alone, their governments used \$14 trillion,[10] which could have funded 20 years worth of ELR programs in these economies. At the end of the day, an ELR will always be cheaper than a lender of last resort program; and we think it is at least just as important.

---

[7] Bank of Italy *Annual Report for 2013, Statistical Appendix*.(http://www.bancaditalia.it/pubblicazioni/relann/rel13/rel13it/app_13_totale.pdf).
[8] This is roughly the difference in the average gross wage of the two countries. (http://en.wikipedia.org/wiki/List_of_European_countries_by_average_wage), For the SMIC see http://www.insee.fr/fr/themes/tableau.asp?ref_id=NATnon04145.
[9] "Il Sole 24 Ore," March 22, 2009.
[10] A. G. Haldane, 2009, *Banking on the State* (http://www.bis.org/review/r091111e.pdf).