

Notes and Communications

In Defense of Employer of Last Resort: A Response to Malcolm Sawyer

While we welcome a chance to discuss the merits of employer of last resort (ELR) proposals, it is difficult to respond to Malcolm Sawyer's (2003) assessment.¹ First, many of his critiques are superficial because he attempts to cover just about every issue even tangentially related to ELR. Second, he has relied to an alarming degree on *critics* of ELR (Aspromourgos 2000; Kadmos and O'Hara 2000; King 2001; Kriesler and Halevi 2001; and Mehrling 2000) for statements of the principles of ELR and, thus, misrepresents the program we endorse. In our response, we focus only on what we believe is the main thrust of his critique, that

1. ELR could increase employment without setting off greater inflationary pressures than those that are already present in other policies designed to reach full employment, but it cannot enhance (improve) price stability—it faces a “NAIRU” constraint.
2. ELR increases employment by stimulating aggregate demand and, hence, operates no differently from any “Keynesian” fiscal policy or monetary policy.
3. ELR is a “make work” program or, more negatively, another name for unemployment and, at best, replaces unemployment with underemployment.
4. ELR proposals have ignored the substantial logistical problems generated by cyclical fluctuation of participation in the program.

We will deal with the first two claims in the next two sections and with the other claims in the following section. In the final section, we briefly discuss interest rate and financing issues that are muddled in Sawyer's exposition.

Aggregate Demand and Employment

In this section, we contest Sawyer's (repeated) claims that ELR increases employment by raising aggregate demand and that any benefits achieved by ELR could just as

well be achieved by raising general government spending, lowering taxes, or “dropping money from helicopters” (Sawyer 2003, 887).

The ELR approach is not equivalent to pump priming. An ELR program offers a basic wage (and benefits package) to anyone ready and willing to work and, in this sense, guarantees “full employment.” It “hires off the bottom,” operating as a buffer stock program. When private firms downsize in recession, dismissed workers can find employment in ELR. In an expansion, private firms hire workers out of the buffer stock “pool.” The size of the buffer stock is thus related to the performance of the private sector plus non-ELR government employment. Indeed, government “demand management” can manipulate the size of the ELR pool through countercyclical pump priming (Wray 1998, 139–140). However, with the ELR program in place, “loose full employment” is maintained no matter what the level of aggregate demand happens to be. (The implications of “loose full employment” are discussed later.) We thus reject Sawyer’s claim (2003, 884) that the “ELR scheme seeks to remove demand-deficient unemployment through the provision of required aggregate demand” as overly simplistic and misleading. Importantly, one could envision a deflationary government policy (increased taxes and/or reduced overall spending) accompanying the introduction of ELR to reach and sustain full employment. We do not recommend such a policy (unless there were excessive overall demand), but it shows that Sawyer has mistakenly conflated ELR with Keynesian pump priming.

Sawyer rightly argued that ELR workers will need some capital and office/management support. Hence, total ELR spending will be higher than the sum of wages and benefits spent on ELR workers. However, implementation of ELR also allows some savings to be made (outlays which support *unemployment* programs would be shifted to the *employment* program). In any case, ELR represents the minimum stimulus required to achieve full employment and does not rely on market spending and multipliers—and “works” regardless of the level of demand.

ELR and Inflation

Following the previous argument, we could dismiss Sawyer’s fear that a demand stimulus necessarily generates inflationary pressures as being irrelevant to the ELR proposal because ELR achieves full employment without regard to the level of aggregate demand. However, the inflation debate reveals fundamental differences in the assumptions which underpin our ELR proposal and appear to account for Sawyer’s erroneous reasoning about ELR and inflation.

Sawyer claimed that ELR faces a NAIRU constraint (2003, 898) and said “the stock of unemployed under present policies [NAIRU policies] . . . and the stock of ELR employees are viewed as analogous,” with inflation accelerating should unemployment fall below some “natural level.” Sawyer then claimed that the “NAIRU” under ELR (following Mitchell 1998, he called this NAIBER for “non-accelerating inflation buffer

employment ratio”) could be higher than the current NAIRU (see Mitchell 1987 for discussion about the nonnatural rate microfoundations of the NAIBER and its fragile, multiple, and cyclically sensitive nature as a macroequilibrium), wrongly attributing this to higher aggregate demand levels that he believes inevitably accompany an ELR—a mistake we dealt with earlier. Further, Sawyer presumed that the inflationary impacts are the same no matter what method is used to move the economy to full employment. By ignoring the distinctive ELR dynamics, Sawyer was left to rely on a Friedman “natural rate argument” against full employment achieved through general demand stimulus to mount his criticism, a critique that cannot be applied to a buffer stock employment program.

Is the NAIBER higher than the NAIRU? We juxtapose two buffer stock approaches to inflation control: (a) a NAIRU-buffer stock of unemployment to inhibit real growth and (b) an ELR involving an open ended (elastic quantity), fixed wage buffer stock of employed workers (see Mitchell and Mosler 2002). The ELR wage sets a floor price and cannot directly pressure wages that are above the floor. Once-off changes would follow if the ELR wage were set above (or below) the lowest prevailing wage.

While ELR *can be* implemented without raising aggregate demand, let us assume here that ELR is added to the current system so that demand does rise. We argue that for microeconomic reasons, a system with ELR in place can tolerate higher aggregate demand without inflation (see Mitchell 1998). A neoliberal (and Sawyer) immediately wants to know why replacing unemployment with (higher-paying) employment *ceteris paribus* is not inflationary given it ostensibly disturbs the balance set by the NAIRU—in Sawyer’s words (2003, 898), “the level of unemployment achieved could be below a supply-side-determined inflation barrier . . . the NAIRU.” Apart from the demand effects, Sawyer (influenced by Michal Kalecki’s now rather dated 1943 prognosis) worries that the ELR compensation package would be more appealing than the benefits now received by the jobless. Hence, workers under an ELR would become more aggressive in wage demands in non-ELR jobs because the fear of unemployment is gone.

First, we do not know whether workers are indifferent between working and being idle while collecting hand-outs of similar value (Mitchell and Watts 2002 analyzes the possibilities). Even if ELR compensation is set substantially higher than the level where workers are indifferent between working for ELR wages and being idle (collecting hand-outs), it causes a one-off adjustment of non-ELR labor compensation to restore indifference. That is not inflation as normally defined.

Second, Sawyer believes that ELR workers pose a lower threat to the wage aspirations of non-ELR workers than do the unemployed. Negation of this proposition relies on an understanding of how the ELR buffer stock works to create “loose” full employment. We argue that ELR workers do comprise a credible threat to current private sector employees because they represent a fixed-price stock of working labor from which employers can recruit. In an inflationary episode, business is more likely to resist wage demands from its existing workforce if it has the option of hiring ELR workers. Sawyer

does not explain why the unemployed and those out-of-the-labor-force are equivalent in the eyes of employers to ELR workers, who are already demonstrating their availability to work and offering a work history to potential employers.

To understand the dynamics of an ELR economy, suppose inflationary pressures accompany strong private investment growth. If government *chooses* to deflate demand to ward off inflation (this is *not* our policy recommendation but a likely response), it will increase the size of the ELR buffer stock, inflation-fighting, pool. Since ELR workers are a better inflation-fighting force than are the jobless, the necessary adjustment to demand will almost certainly be smaller with ELR in place. If government decides *not* to deflate demand, the ELR pool still allows the economy to operate with higher aggregate demand and lower inflation pressures, although inflation can still result. Hence the NAIBER is actually below the NAIRU in the sense that (non-ELR) employment can be higher before the inflation barrier is reached. A poorly designed ELR (say, where ELR wages were indexed to inflation, while unemployment compensation was not) could result in a NAIBER above the NAIRU. But this would not reflect our proposal.

In summary, ELR does not operate like any other “Keynesian” fiscal policy nor like a Monetarist “money drop.” Unlike a “money drop,” it requires that participants work for their compensation. Unlike “pump priming,” it achieves “loose” full employment because it “hires off the bottom.” It does not seek to employ any specific number of workers nor does it seek specific skills. Most importantly, it does not chase wages upward and thus never competes with higher and rising private sector wage offers. As a consequence, ELR can achieve and sustain noninflationary full employment at any level of aggregate demand.

Microeconomic and Labor “Market” Considerations

Cyclical Flexibility and Types of Jobs

A common criticism of ELR relates to whether there would be enough jobs of sufficient merit to fully occupy the extant unemployed. Sawyer argued that suitable ELR jobs would “not require much skill” or “use skills which are widely available in the population,” providing output which is not “necessary in that the output is only forthcoming when aggregate demand is low and the ELR jobs are required” (2003, 891). Thus, ELR only increases output when demand is low—but it must be output that is not desired so that it can be immediately “switched off” as the economy expands. Elsewhere, Sawyer argued that output is maximized at full employment (886). So, logically, once an ELR is implemented, output cannot be increased. The analysis in the first section shows this reasoning to be incorrect. ELR can achieve full employment at any level of aggregate demand and at any rate of economic growth. The question is whether logistical problems could be overwhelming.

Significantly, Sawyer ignores the fact that private sectors everywhere create and destroy large numbers of low-wage, low-skill jobs in any given month with very little criticism or scrutiny. It appears he is disturbed only when the public sector creates such jobs, because of problems of switching on jobs which have capital requirements, problems in “undercutting of wages for mainline public sector jobs” by being “substitutes for mainline public sector employment,” problems in yielding output “in competition with output which is or could be produced by the private sector,” problems relating to the spatial and temporal distribution of unemployment and the like (2003, 892–893). We do not believe that the private sector has a monopoly on being able to mobilize a diverse range of resources and successfully complete thousands of tasks within a tight and complex schedule. The ELR buffer stock of jobs is designed to be a countercyclical fluctuating workforce, and the jobs would have to be productive yet amenable to being created and destroyed in line with the movements of the private business cycle. While challenging, this is not an impossible requirement for public policy to meet. The cyclical nature of the jobs suggests that the buffer stock should be split into two components:

1. A stable core component that represents the “average” buffer stock over the typical business cycle determined by structural issues and macroeconomic policy settings.
2. A transitory component that fluctuates around the core as private demand ebbs and flows.

Sawyer argued that ELR is more difficult to organize where a lot of labor market churning occurs (i.e., large fluctuations of short-term unemployed). Actually, the opposite conclusion is more plausible: many of those losing jobs will prefer to undertake full-time search rather than accepting temporary ELR work (Wray 1998, 127). The relatively low pay will act as a disincentive for many job losers; in addition, as we have argued, ELR could provide, say, up to six weeks of pay for full-time job search.

Further, the business cycle fluctuations of employment are not nearly as large as Sawyer suggests. Using the most recent U.S. downturn as an example, fewer than 3 million private sector jobs were lost and just under 1 million government jobs gained. L. Randall Wray and Marc-André Pigeon (2000) calculated that near the Clinton business cycle peak there were perhaps 12 million jobless but “employable” Americans (aged 25–65). Sawyer argued as if the ELR pool will fluctuate from some number of millions in recession to zero employees in a boom. This vastly overstates the likely fluctuation of perhaps 2 million of an ELR pool of 8 million.

We adopt the structuralist view that a dynamic capitalist economy always leaves behind a significant number whose skills are not appropriate (Wray and Pigeon 2000). Admittedly, we cannot know how many will opt for ELR employment, but the program could be phased in to reduce logistical problems. After the phase-in, administrators would prioritize work allocations from a broad array of community-enhancing activities. In the short term, the buffer stock would fluctuate with private sector activity as workers

move between the two sectors with demand changes. But the stable core buffer stock component would make it unlikely that any important function or service would be terminated abruptly when private labor demand rises. Longer-term changes in the size of the stable core buffer stock would reflect discrete (planned) changes in government policy. More ephemeral ELR activities could then be designed to “switch on” when private demand declined below trend. These activities would not be used to deliver outputs that might be required on an ongoing basis but would still advance community welfare. For example, ELR jobs in a particular region might be used to provide regular shopping or gardening services for the frail aged, to support the desire of many older persons to remain in their own homes. It would not be sensible to make these services transitory. (They could be reassigned to “mainline public sector” work if political sentiment changed.) Other “off-the-shelf” projects would be undertaken or completed only when the ELR pool expanded sufficiently (see Forstater 1999).

We do not believe that private markets are always best and that public programs are necessarily unmanageable. Nor are ELR jobs simply “make-work”; rather, these are “paid work” jobs, and program administrators need to ensure that social benefits are realized from the program. So long as marginal benefits are above zero, it is socially beneficial to put unused resources to work. However, that sets a very low standard that can be exceeded quite easily with a modicum of professional responsibility.

Underemployment and Part-Time Work

Sawyer considered that ELR work is akin to underemployment and effectively “constitutes unemployment by another name” (2003, 894–897). The International Labour Organization (ILO) defines two types of underemployment: (a) “time-related” underemployment, or insufficient hours of work and (b) underemployment reflecting situations that include “inadequate use of occupational skills; excessive hours of work; inadequate tools, equipment or training for the assigned tasks; travel to work difficulties; inconvenient work schedules; and recurring work stoppages because of delivery failures of raw material or energy” (ILO 1998). While he did provide in an endnote one quote from Wray (1998) indicating that there is no reason why ELR cannot offer part-time jobs on demand, Sawyer criticized ELR advocates for focusing on full-time employment (2003, 897; also see his endnote 13). But ELR can provide flexible work schedules according to worker preference, so there is no time-related underemployment in the ELR.

It is the second notion of underemployment that must underpin Sawyer’s attack on ELR. Sawyer (surprisingly) employed human capital analysis to compare the implied productivity of the ELR job (q) to the “true” productivity of the worker in an alternative job (Q) (2003, 894). Where $q < Q$, the general case according to Sawyer (2003, 894) because “ELR jobs are low-skill, low-productivity jobs,” “underemployment replaces unemployment.” But ELR jobs must be designed to be accessible to the most disadvantaged workers in the labor market, who typically bear the brunt of unemployment. In

that sense if productivity resides in the individual (as in human capital theory) as opposed (more realistically) to being the outcome of a complex mix of individual characteristics, team-based collaboration, on-the-job training, and job design and management, then it is highly likely that q will approximate Q , for most individuals who will rely on ELR employment for anything other than short transitional unemployment. This is not underemployment in Sawyer's sense. Clearly, professional (high-skilled) workers may rely on ELR for income support when they cannot find a job befitting their skills. In these cases, there will be some underemployment in the Sawyer sense. However, in professional occupational markets, it is more likely that some frictional unemployment will remain, as skilled workers who are laid off are likely to receive cash payouts that forestall their need to get immediate ELR work.

Moreover, a further point should be made. At present, the private sector in some capitalist economies (notably, the English-speaking ones) has substituted unemployment for time-related underemployment (with implied inadequacy of employment situations). The introduction of an ELR would probably place pressure on private employers, particularly in the low-skill service sectors, to restructure their workplaces to overcome the discontent that their underemployed workers feel. An underemployed worker in the private service industries would probably be attracted to a full-time ELR position at similar hourly wage rates. Consequently, an ELR would probably reduce underemployment in the private sector.

Value of Output

Sawyer also argued that it is likely that ELR workers will be “paid more than they produce” (2003, 895) and if w (the ELR wage) $> q$ then “the ELR workers are making net claims on the rest of the economy [that] are greater than those currently made by the unemployed.” However, Sawyer's argument that if the output “is not valued by others, it is as though the ELR worker is producing nothing” (895) implies that the private market is the only meaningful output validation mechanism. Even neoclassical theory recognizes the difference between private and social values. There are countless activities that have near zero value in the private market place but could have positive social value. Some of these activities are labor intensive and are ideal for ELR job creation. Further, activities with marginally sufficient output as valued by markets can have little or even negative social value—with burger flipping an obvious candidate. It is difficult to believe that ELR will produce less social value than fast food production.

Financing, Interest Rates, and Other Muddled Issues

Sawyer appears to be confused on the “financing” involved in sustaining an ELR program. Given space limitations we address only a few of the major issues here.

First, in claiming that ELR would be deficit financed, Sawyer misunderstands why many explications of ELR have discussed the functional finance approach to deficits—not because ELR spending will be deficit financed but in order to dispense with the typical argument that government cannot financially “afford” such a program. In reality, the government’s budget outcome is largely “endogenously” determined by the spending propensities in the nongovernment sector. The government’s budget moves countercyclically as a result. It is true that as the economy slows and the ELR pool grows, the government budget will move toward deficits. However, it is perfectly conceivable that in expansion the budget would be in surplus, even with a sizeable ELR pool remaining (would Sawyer then claim that the budget surplus “financed” ELR?). Clearly, the budget balance will fluctuate over the cycle but ELR in no sense requires budget deficit finance.

Sawyer, following G. Kadmos and Philip O’Hara (2000)—critics of ELR—wrongly characterized the ELR argument by saying “it is asserted that government expenditure can be (and is) financed by ‘printing money’ (the creation of HPM). The difference between the HPM issued by the government to pay for its expenditure is less than that which is taken back by government” (2003, 885). He placed himself firmly in the “government budget constraint” framework by assuming that “printing money” and “bond issuance” are required to “finance” government deficits. Actually, government always spends by crediting bank accounts and taxes by debiting them. If spending exceeds taxes, then HPM remains as bank reserves, but it is misleading to say that deficits are financed by printing money. Sawyer does not recognize that ELR will be “financed” in the same manner as any other government spending.

Second, when Sawyer worries that HPM “printed” to “finance” the deficits created by ELR might generate inflation (akin to the Monetarist “excess money supply” story), he only displays a profound misunderstanding of treasury and central bank operations. If the government credits to bank balance sheets resulting from payment of ELR wages (and other associated spending) lead to excess banking system reserves, these are immediately drained by automatic central bank intervention—either by winding down loans at the discount window or through open market sales of bonds. Unless the overnight rate target is zero, there won’t be any “excess money” left sloshing around the system to cause inflation. Bond issuance is a process whereby the government offers interest-bearing asset alternatives to non-interest-bearing reserve accounts at the central bank—not to “finance” government spending but rather to provide a means whereby the central bank can maintain some target short-term interest rate and generally support a desired term structure of interest rates. It is thus part of monetary policy that has nothing to do with finance (Wray 1998; Mitchell 1998).

Finally, Sawyer misunderstands interest rate-setting procedure. He argued that central banks cannot simply set the interest rate anywhere they like and doubts that deficit-spending governments can maintain bonds rates as low as half a percent. Actually, overnight interest rates are set by the central bank. This does not mean that rates are set

arbitrarily without regard to economic considerations. The central bank may believe it needs to raise rates in response to deficits, to fight inflation, or to protect the currency, or to achieve any number of other goals—but targets are exogenously set. Since bills/bonds paying a positive interest rate are preferred over nonearning, undesired, excess reserves, the rates on sovereign debt can, indeed, be kept at half a percent, or lower, if desired, irrespective of the size of deficits (Japan keeps rates at zero in spite of the largest budget deficits in the developed world!).

Conclusion

In conclusion, it is useful to quote Hyman Minsky:

Work should be made available for all able and willing to work at the national minimum wage. This is a wage support law, analogous to the price supports for agricultural products. . . . To qualify for employment at these terms, all that would be required would be to register at the local U.S.E.S. (US Employment Service). Part time and seasonal work should be available at these terms. . . . National government agencies, as well as local and state agencies would be eligible to obtain this labor. They would bid for labor by submitting their projects, and a local “evaluation” board would determine priorities among projects. . . . The basic approach is straight forward—accept the poor as they are and tailor make jobs to fit their capabilities. After this is done, programs to improve the capabilities of low income workers are in order. (1965, 299–300)

Certainly, many of the details surrounding implementation and operation of an ELR program remain to be solidified. And one can conceive of a poorly formulated program. But why would progressive economists want to propose a “make-work” program that prevents workers from using any skills or education, that fluctuates wildly from zero to millions of employees, and that prohibits part-time work or job search while employed? Why not create a “paid work” program instead, with flexible work schedules and positive social benefits?

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Note

1. The term *employer of last resort* (ELR) (used in the work of L. Randall Wray) is interchangeable with the term *buffer stock employment* (BSE) and *job guarantee* (JG) (used by Mitchell). We use

ELR here as unifying terminology because it is the main term used by Malcolm Sawyer. Wray now prefers “public service employment” (PSE). While ELR is accurate in one sense, it also provides a negative connotation that neither PSE nor JG implies.

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