The Levy Economics Institute of Bard College

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Policy Note

2009 / 5

A PROPOSAL FOR A FEDERAL EMPLOYMENT RESERVE AUTHORITY

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Introduction

There is already considerable talk about the possible need for a massive public works program in response to the deepening recession and rising unemployment. However, an ad hoc emergency approach is going to waste billions of dollars by mismatching skills and needs. The proposal outlined here is aimed directly at providing good planning consistent with maintaining market freedom and minimizing pork-barrel legislation.

In spite of the glamour of high finance, investment banking, and the stock market, efficient production and full employment are what count. A healthy economy is one that does not waste the real resources of goods and labor.

Enterprise is fostered by commonly understood and accepted rules of the game, and the rules do not appear by magic, nor do the markets produce them. They require the development and enforcement of, among other things, an accounting system, bankruptcy and default laws, a commercial code, and contract law. When the system is under stress, fail-safe measures must be adopted.

In the reality of a dynamic economy, the formulation, legislation, and enforcement of rules to set the stage for the functioning of a successful enterprise economy are critical. It is a difficult, ongoing process overseen by fallible and self-centered human beings.

Ideologues on both the right and the left imagine utopian scenarios that include either an ideal government or no government at all. Neither of these states has, or ever will, exist, except in political rhetoric aimed at fooling the unwary. Reality and "good enough" economic efficiency reside not only in building the institutions and laws that provide the rules of the game but also in answering the question, Can these rules be implemented successfully at a reasonable cost?

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One of the more successful government financial institutions in the United States is the Federal Reserve System (Fed). It has manifested an interesting blend of public and private forces, and is clearly sensitive to both local and global concerns. Unfortunately, the Fed and the Treasury are not enough. There are occasions when the financial control mechanisms of a society are not sufficient to prevent serious damage to the fundamental economy they are meant to protect. Therefore, the system requires a fail-safe mechanism that comes into play when the financial brakes do not work. Such a mechanism, in the form of a Federal Employment Reserve Authority, is discussed below.

A Financial Fail-Safe Mechanism

Our financial institutions and instruments are part of a delicate overall guidance and control system for the political economy. The structure has to match the supply of public goods and taxation to the demands of the electorate. This calls for a blend of economic, political, bureaucratic, and social forces.

The Federal Reserve System, created by act of Congress in 1913, has been evolving and adjusting for nearly a century. The system's organizational structure is laden with checks and balances, and represents diverse interests. Its Board of Governors is appointed by the president and requires confirmation by the Senate. Like the Supreme Court, the Federal Reserve Board is the product of the interplay of political, economic, and legal forces. The number of governors reflects a designer judgment call on the balancing of powers and the ability of the institution to function.

It is suggested that, in order to keep a socially acceptable index of unemployment below some specified level, a government agency similar in power and structure to the Fed would be appropriate. This agency—a Federal Employment Reserve Authority, or FERA—would be devoted to monitoring the "natural rate of unemployment," which is "natural" in the sense that it is dependent on society's existing institutions, laws, customs, and technology. FERA would require considerable hand-tailoring to provide the appropriate control details needed. But as a permanent body it would be a vast improvement over a last-minute, temporary disaster-relief program such as the Depression-era Works Progress Administration (WPA).

In the design of an institution aimed at modifying the level of unemployment it is highly probable that we would need to hand-tailor a control structure with governance numbers different from those of either the Supreme Court or the Federal Reserve in order to fit the population of the United States in the 21st century. A sketch of this proposed institution is provided below.

In addition to its governing board, the Federal Reserve System includes 12 district banks and has approximately 25,000 employees. An agency such as FERA more naturally calls for a central or controlling authority in Washington and a branch in each of the 50 states. Each state branch would have on average 100 to 200 employees—for an agencywide total of 5,000 to 10,000—and a board of governors split among business and labor representatives, as well as academics and federal and state representatives. Each branch would monitor unemployment in its state. It would also maintain a list of potential public works projects with priorities and potential revenue-generation possibilities. The priority would be self-liquidating projects where some portion of the revenues would flow back to either the state or the federal government.

The central Authority would be responsible for developing state and federal taxation and funding guidelines in concert with the Federal Reserve System and the Treasury via a Joint Assessment Financing Board (JAFB). The duties of this board would be to constantly monitor the listing, evaluation, financing, and paybacks proposed by each state branch so that the structure of the financing could be set in place as soon as the employment level in any region exceeded the trigger value. A further duty of the JAFB would be to determine the breakdown of unemployment in the state—how much is attributable to recession, and how much is attributable to the application of new technology. (Technological unemployment should not call for agency action except via an Educational Retraining Board acting in concert with the educational resources of the state and the federal Department of Education.)

It is important to stress that constant monitoring, along with the ability to act quickly and deliberately, is a necessity. This will require that legislation be passed in advance to provide flexibility in emergency financing without having to request funding from Congress during a crisis.

The central Authority would supervise oversight of the projects to be enacted. The state branches and member firms would be responsible for the generation and maintenance of micro information on local unemployment, the valuation of projects worthy of sponsorship in a high-unemployment environment, and the distinction between recession and technological unemployment in their area.

There are several basic principles that should be adhered to by the Authority:

(1) It should never own assets that it does not have the in-house capability to evaluate, and should avoid supervision of projects where it does not have in-house expertise.

(2) Its role is to coordinate and stimulate activities promoting employment, not to employ individuals directly. Only under conditions of a deep depression should a direct, WPA–style employment approach be permitted as an act of last resort.

(3) The Authority must stress transparency in the availability of its information sources, evaluation of the regional economic and employment status, as well as the projects to be implemented and the bidding and procurement procedures employed.

(4) Once unemployment goes above a fixed level of, say, 6 or 7 percent (to be adjusted as circumstances warrant), the Authority would put out bids for projects in coordination with federal and state funding authorities involved in financing.

The drafting of institutional rules is an evolutionary process, and there are many details to be worked out. Rather than a blueprint, the above comments are offered as a platform for building in a fail-safe mechanism to protect the real economy when the financial-control structure fails.

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