Revisiting the unfashionable
job creation

Rosa Dias and Geoff Harris revisit budget deficits and direct job creation programmes as ways to create jobs.

This article re-examines two unfashionable ways of creating jobs. The first part suggests that contrary to conventional economic thinking, increasing budget deficits may stimulate investment and job creation. In the second part, direct job creation programmes are evaluated using 'social profitability' as the main criterion, rather than budgetary impact.

Carefully designed and managed job creation programmes will create jobs and can also meet important social needs. Their social benefits can outweigh their social costs.

The Gear strategy of 1996 expressed a strong commitment to 'fiscal discipline' by reducing the budget deficit to below 3% of GDP. This would, it was hoped, build confidence among local and foreign investors and raise investment levels. We look at whether reducing the budget deficit to an arbitrarily determined level is correct, given the large-scale unemployment and under-use of capacity in the South African economy.

The unemployment rate currently ranges between 25 and 38%, depending on how it is defined and calculated, and capital stock is being used to about 70% of maximum capacity. As Joseph Stiglitz points out, there is no simple optimum level of budget deficit. 'The optimum deficit depends on circumstances, including the cyclical state of the economy, prospects for future growth, the uses of government spending, the depth of financial markets and the current level of national savings and investment.'

We argue that the mainstream theory promoted by the International Monetary Fund and World Bank does not explain high and increasing unemployment rates in countries like South Africa. Policymakers have expressed frustration that they are 'getting things right' in terms of fiscal responsibility but without the expected reward in terms of greater foreign investment. If doing the 'right things' has not brought foreign investment, perhaps one should concede that they are not the right things to do. Fiscal responsibility costs South Africans a great deal in expenditure on health, education and the like.

Why budget deficits are 'bad'

The objection to budget deficits is that the more government spends in excess of revenue, the more it must borrow. The three methods of financing a deficit may create macroeconomic problems: external financial flows may prove unstable, money creation causes inflation, and internal finance raises domestic interest rates.

Internal financing has particularly concerned South African policymakers. In a simple macroeconomic framework, the savings of households and firms form a pool of funds in the commercial banking sector. These are available to local investors, who borrow to finance the purchase of capital stock, and to government, which borrows to finance budget deficits. The conventional argument is that the higher the budget deficit is and the more government borrows, the less funds are available for private investment. In addition, higher government borrowing means higher interest rates, which increase the cost of capital to private investors.

South African policymakers have repeatedly identified the lack of savings as a constraint on investment, and have argued for the reduction of the deficit to release scarce savings for private sector use. This assumes that investment is determined by interest rates.

The possible virtue

We argue that domestic and foreign investment in South Africa may not be particularly responsive to interest rates. If this is the case, the marginal loss of investment as a result of deficit-induced increases in interest rates is likely to be outweighed by substantial increases in investment as a result of the deficit-financed stimulation of the economy.

Higher government spending creates a greater demand for firms' products, and this creates positive perceptions of sales and cash flow and raises companies' investment spending. Thus the emphasis on small deficits and lower interest rates may mean less investment than would result from larger deficits and higher interest rates.

Several studies have found that 'output or sales is clearly the dominant determinant of investment spending, with the cost of capital having a modest effect'. Fazzari's study of United States manufacturing firms during the 1970s and 1980s, for example, showed that private investment responded to firms' sales growth and cash flow rather than to interest rates.

Gibson and Van Seventer support this finding for South Africa. Published before the release of Gear, their model of the South African economy predicted that cutting the budget deficit would lead to lower production, employment and income levels and reduce firms' sales growth and cash flow, making them hesitant to invest in capital stock. A decline in government spending would cause the South African economy to stagnate further, signalling falling profits to investors and heightening uncertainty regarding future investment. High unemployment means a lack of income for households and, therefore, a lack of demand for output. Future profitability is of utmost concern to potential investors, and stagnant markets are not likely to attract investment. In addition, there is no conclusive evidence that an increase in the budget deficit drives up interest rates.

Deficits generate income. If increased public spending creates employment and income, some of the income will be saved. What is consumed creates further spending, more income and even more savings. When the economy has unused resources, expansionary fiscal policy creates domestic savings. If savings increase with deficits and fall with deficit reduction, the link between deficits and interest rates is no longer obvious.

This means that people's welfare is being sacrificed by policymakers in their worship of an ideology that is not producing the goods. Government is choosing not to create jobs in order to comply with free market ideology. There are plenty of signs that the strongly free market approach will be very unfashionable by 2010. The rest of the article evaluates the social costs and benefits that could arise from government increasing its spending on direct job creation.

Direct job creation programmes

One perception of government job creation programmes is that they employ people to dig holes and then fill them. However, many programmes enhance society's physical and human capital. Examples include employment of teams to build community security, to clear alien vegetation from catchment areas and to educate people about communicable diseases. Many people are unemployed and many socially valuable tasks are not being done. Direct job creation brings these elements together for the good of society.

We focus on the social profitability of direct job creation programmes. We argued earlier that there are reasons for being less concerned than is fashionable with the size of budget deficits. Even if we remain obsessed with the size of the deficit, budgetary spending on direct job creation would be immediately reduced by at least 25% in tax revenue increases, before other savings are counted.

We now evaluate the case for direct job creation, using a cost-benefit analysis (CBA) framework. The four basic steps in any CBA are:

- the identification of all benefits and costs, including intangibles;
- the valuation of each of these, where possible;
- discounting the stream of net benefits which flow from the project; and
- the calculation of measures which summarise the outcomes of the project.

Of these, identification and valuation are the key. Our basic contention, that such projects may be socially profitable in that their resource benefits exceed resource costs, can be demonstrated without going into the other steps.

There are three categories of impact to search for in the identification phase:

- resource benefits (the increased output as a result of a project, or the resource costs saved); resource costs (measured by the opportunity costs of the resources used); and
- transfers (involving monetary flows from one sector of society to another, without increasing output or incurring an opportunity cost).

Transfers cancel to zero and are not included in CBA calculations. Table 1 summarises the resource benefits and costs expected in a direct job-creation project.

We will assume a project or series of

Table 1: Resource benefits and costs of a job creation project

Resource costs

- Opportunity costs of the financial resources used to pay wages and materials.
- Opportunity costs of the administrative resources used to set up and implement the project.
- Opportunity costs of the activities foregone by those now employed.

Resource benefits

- Increased output of goods and services.
- Saved resource costs in such areas as health and crime prevention.
- Intangibles, for example, higher self esteem.

Government employs people to clear alien vegetation.

projects employing 10 000 people who are paid an annual wage of R25 000 each.The major resource costs are the wages (R250-million) and equipment and materials (say, R50-million) involved in the project. The administrative inputs should not be under-estimated.We allow three alternative proportions of the basic cost: 10, 15 and 20%, resulting in administrative costs of R30-million, R45-million and R60-million respectively. It might be argued that the third resource cost – the value of the activities given up by those who are now employed – should be valued at zero, but we use alternative values of 10 and 20% of the wage cost, that is, R25- and R50-million for this.Total resource costs, then, are between R330-million and R410-million.

The major resource benefit is the value of the output.These may be one-off benefits, but are more likely to involve a stream of net returns over time. Placing a value on outputs as diverse as community security, water yields and reduced disease is a challenge but it can be done.We assume that the (present) value of the output is equivalent to 75, 100 and 125% of the wages and material costs, that is, R225-million, R300-million and R375-million respectively.These assumptions are crucial and need explaining.

An extreme view would be that the output of government job creation projects would always be less valuable than their wage cost – otherwise the private sector would do the work. But projects like those suggested above will not yield a profit to the private sector.The entire community will benefit but it is not feasible to collect payments from people when, for example, they benefit individually (but often unknowingly) from greater security or greater HIV/AIDS awareness.The community as a whole must pay through the tax system.

Simple arithmetic suggests that the present value of outputs from such programmes is likely to far outweigh their wage and other costs.An HIV/AIDS awareness educator is surely likely, over the course of a year, to save hundreds of lives.A small number of community security personnel are likely to have a significant impact on the private and social costs of crime.The increase in water yields from clearing alien vegetation in water catchments may mean that new dams do not need to be built.

The saved resource costs in terms of better health and less crime are difficult to estimate.We are measuring the marginal social costs of crime and ill health. Obviously, a considerable proportion of health, police and justice expenditure is fixed irrespective

Table 2: The net social impact of employing 10 000 people (millions of rand)

	Pessimistic	Middle	Optimistic
Resource costs			
Wages, materials	300	300	300
Administrative costs	60	45	30
Resource benefits			
Increased output	225	300	375
Health, crime savings required to break even	135	45	(45)

of how the services are used Some costs, however, are closely related to demand.The information required to estimate such saved resource costs is not available.Therefore, our approach is to calculate the level of savings in terms of crime and health required for a break-even result, and to consider whether these savings could be reasonably expected.

The figures discussed above are summarised in Table 2, which shows that saved resource costs in respect of health and crime would need to be R45-million and R135-million under normal and pessimistic assumptions respectively, but that under optimistic assumptions, there is a social profit even without such savings. If our figures are reasonable, it is clear that carefully chosen, well-planned and well-managed direct job creation projects can yield a net social benefit.The fundamental assumption concerns the value of output.

Another virtue of direct job creation programmes is that they can target particular groups or areas.They provide an opportunity for government to raise the income of disadvantaged groups, and in disadvantaged areas, in a way economic growth or general government expenditure cannot.While the multiplier effects of government expenditure are not normally counted in CBAs (because all projects have multiplier effects), that there will be such an effect among disadvantaged people is another benefit.

It may be argued that direct government job creation does not create 'real' jobs because they are not in the service of private profit. On this reasoning, no government job would be real. It is based on an extremely narrow definition of profit and ignores market failure. Left to itself, the free market will not produce a socially optimal outcome – governments must intervene to ensure such outcomes. Certainly, government failure can also occur.What is needed is a balance between private enterprise and government involvement.

Conclusion

The first part of this paper provided evidence that budget deficits may have a positive net effect on investment and job creation.The second showed that direct job creation programmes are more likely to deliver jobs, and deliver them where they are most needed, than indirect methods.They can enhance society's physical and human capital and yield a social profit. However, they do require careful planning and management.

Some will dismiss budget deficits and direct job creation for ideological reasons. We believe we have shown they deserve to be considered seriously as ways of increasing employment in South Africa. ★

Rosa Dias and Geoff Harris lecture in the School of Economics & Management at the University of Natal, Durban.This is a shortened version of a paper prepared for the Work 2001 Conference held in April 2001.A copy of the full paper is available on request (harrisg1@nu.ac.za or (031) 260-1186).