

The American Response to Financial Crisis

Lessons for Low and Middle-Income Countries

Presentation by Anthony P. Carnevale
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On Maintaining Productive Employment in Times of Crisis

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The American response

Simultaneous Two-Part Recovery Plan

- Stimulus
- Re-regulating and re-financing



The American response

Stimulus

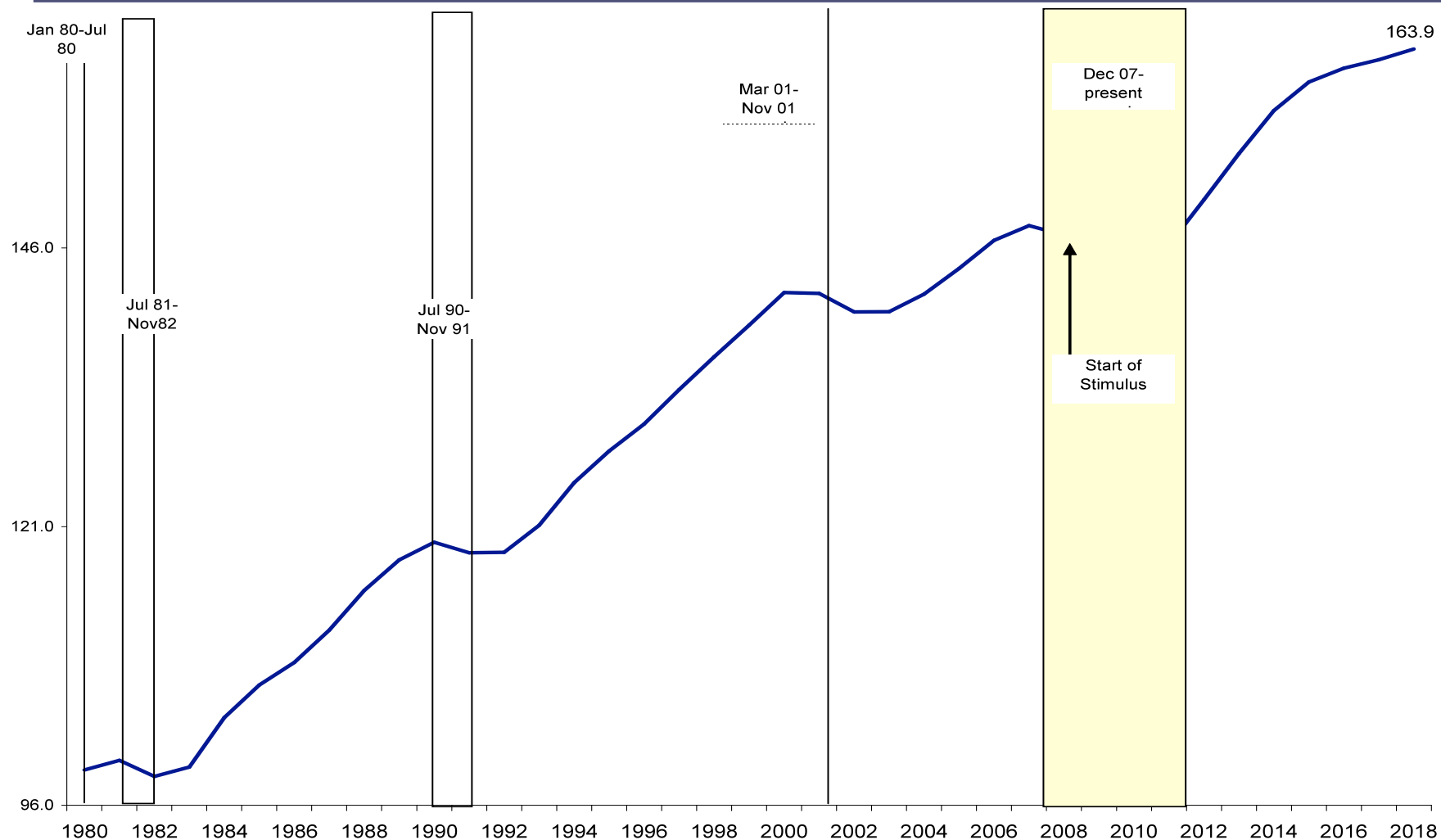
- **Classic Keynesian** consumption-led stimulus,
- **Targets spenders** with additional funding for automatic stabilizers and
- **Invests in infrastructure** for modernization in key sectors including energy efficient infrastructure, healthcare and education.

Re-regulating and re-financing

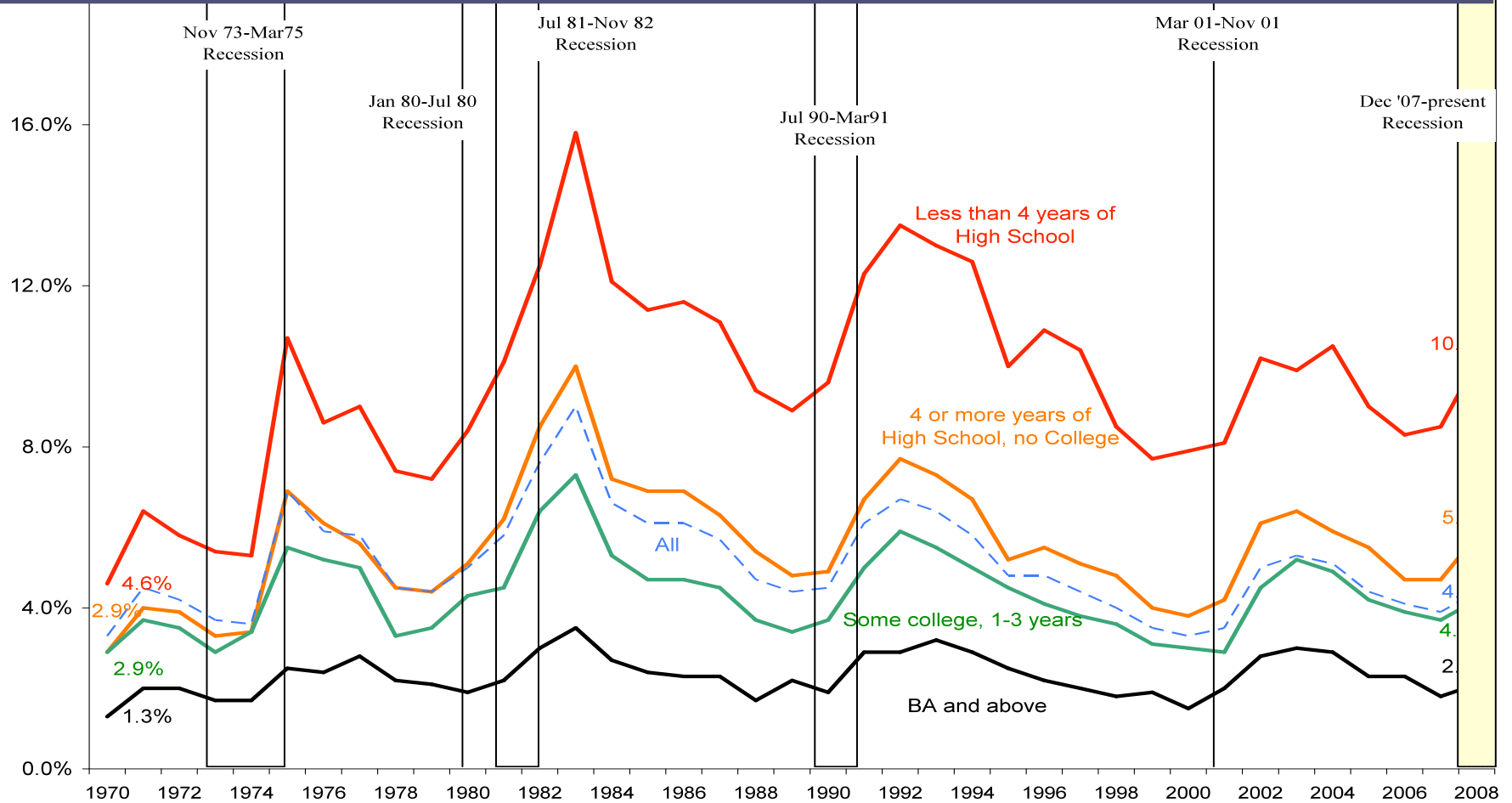
Troubled Assets Relief Program (TARP) targets financial institutions to overcome the short-term perspectives of banking and financial institutions.



With stimulus package, employment growth set to resume in 2011



Least educated are most vulnerable in economic downturns (unemployment rates by education)



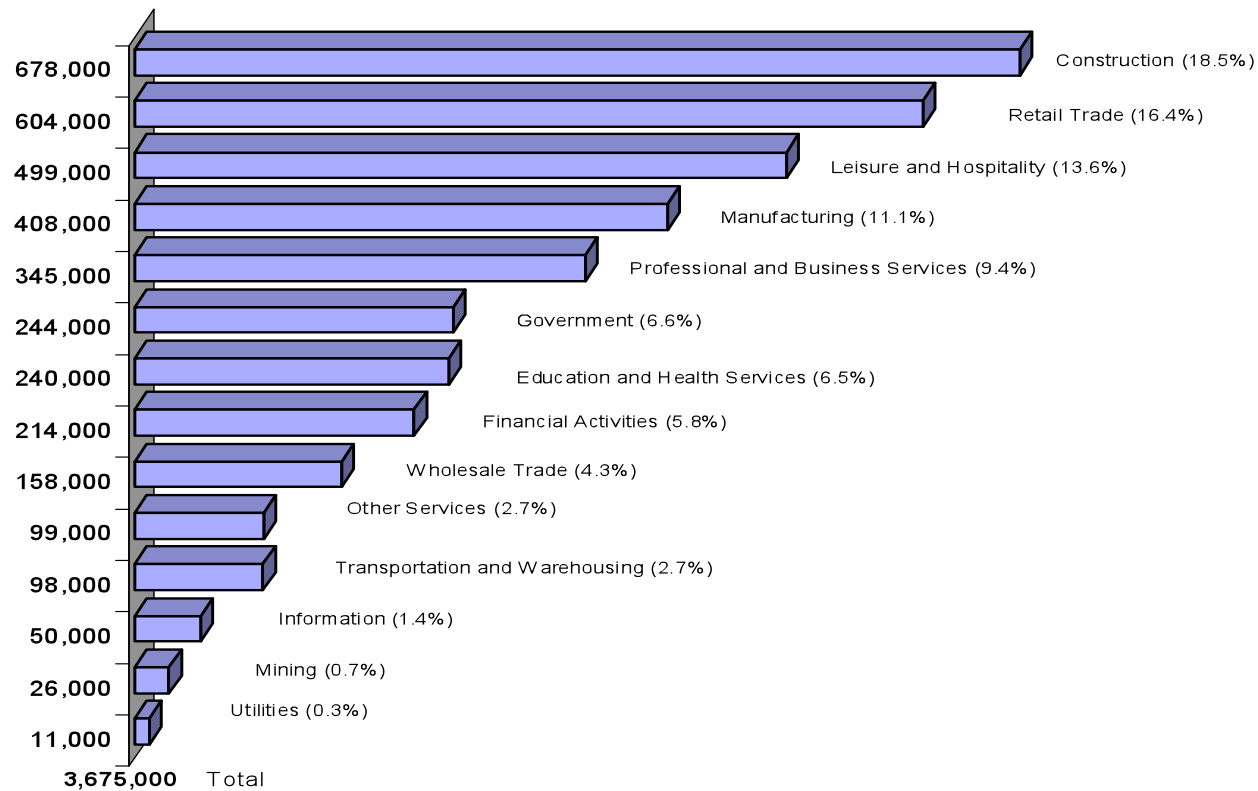
The American Recovery and Reinvestment Act (ARRA), 2009 will help the least education the most

The jobs created will require a broad spectrum of training and education levels.

The following slides show the industries and occupations where the stimulus jobs will be created as well as their education and training requirements.



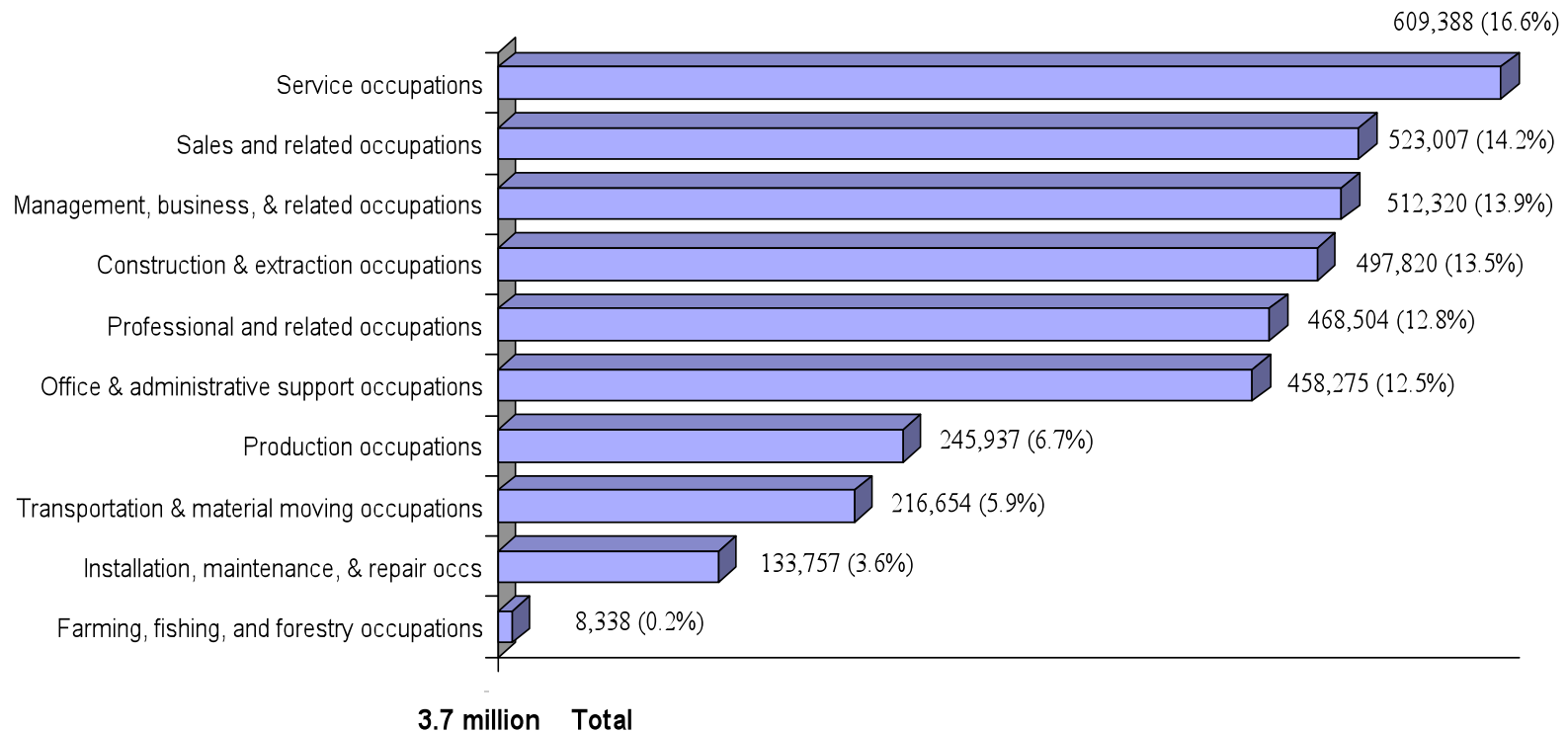
Stimulus jobs created by industry



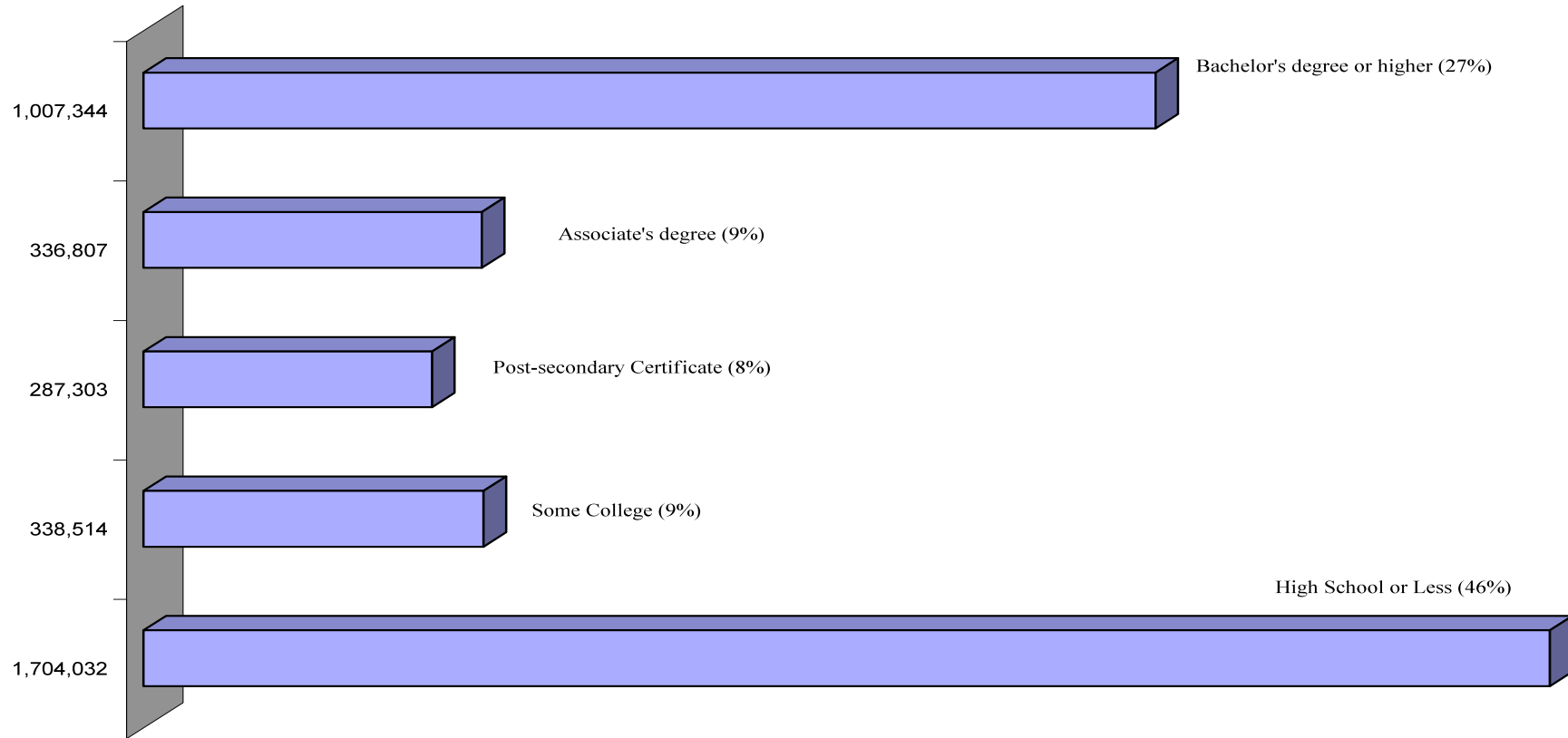
Source: Romer and Bernstein (2009) based on their estimates of the effects by Industry from Mark Zandi's "The Economic Impact of a \$600 Billion Fiscal Stimulus Package," Moody's Economy.com, November 28th, 2008



Stimulus jobs created by occupation



Stimulus jobs help least educated the most, but most require some college or better

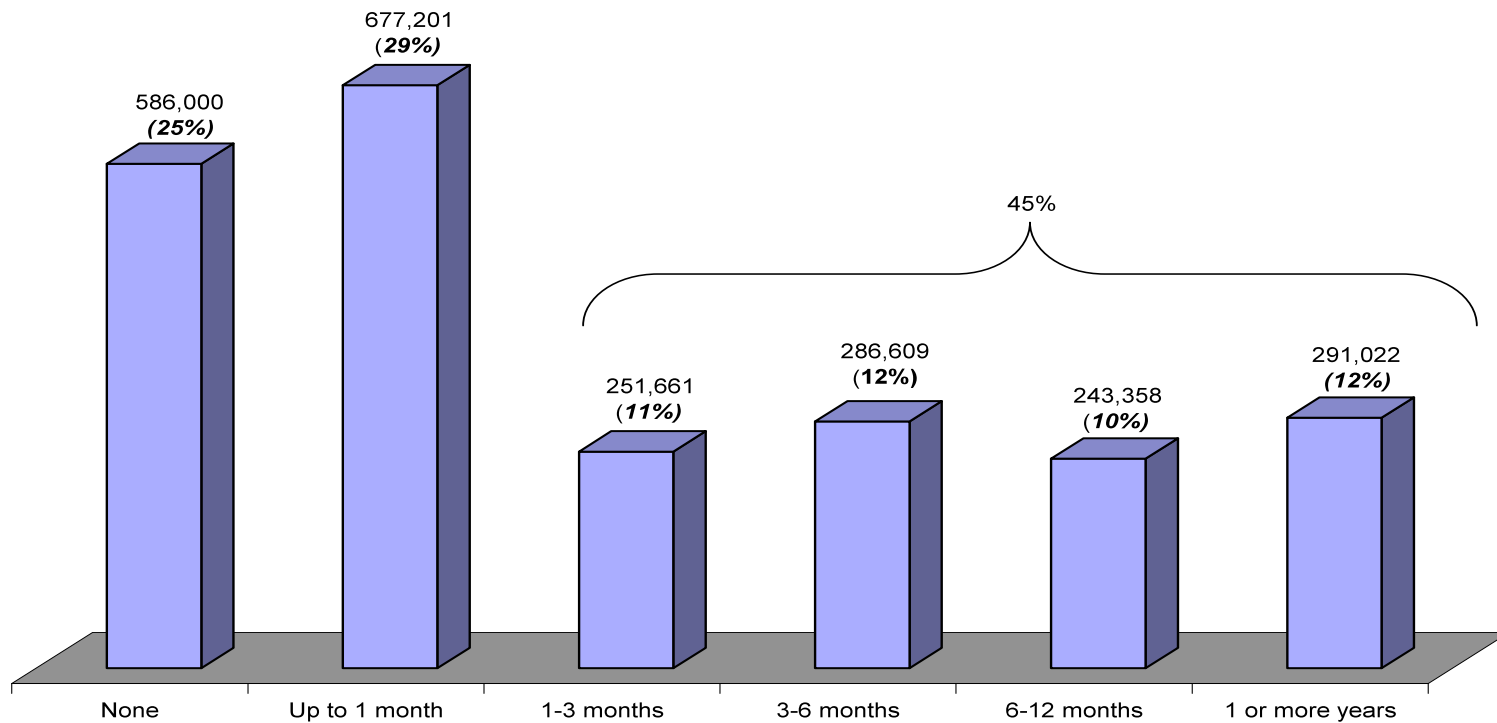


3,675,000 Total



Figure 6: 45% of non-degreed* stimulus jobs require at least 1 month of formal classroom training

Formal Classroom Training



*Non-degreed jobs include high school dropouts, high school graduates, post-secondary certificates and some college but no degree.

Source: O*NET Education and Training by Occupation



Current context makes American response unique

- **We rely on a mix of Keynesian stimulus** and automatic stabilizers. Europeans rely more on automatic stabilizers within a more robust welfare state
- In both cases there is substantial infrastructure in place for effective policies that can reach people within and outside labor markets in times of crisis
- **We are focused on growth and distribution at the margin, not development.** We are currently fighting a short-term risk/fear of deflation, and are less concerned about long term risk of inflation, in part because of our unique currency position



Possible transferable pieces of Obama stimulus package

- **Timeliness:** Otherwise there is a risk that stimulus can be pro-cyclical, increase volatility and reduce long term growth
- **Customization:** Doesn't emphasize tax cuts at a time when tax cuts would be used to reduce public and private debt and not stimulate employment
- **Balance:** Mixes short term relief with long term investment
- **Farsighted:** Focuses short term income, nutrition and healthcare assistance on part-time working mothers and children beyond the reach of conventional economic policy instruments



Context

- The financial crisis may become a fiscal crisis because stimulus increases public debt
- Long-term debt raises intergenerational equity concerns and reduces future growth
- Long term government spending and investments crowd out private investments



Special problems for stimulus in developing nations

- **Dependency on external financing** encourages more fiscal stimulus in good times and limits the ambit for stimulus in bad times
- **Limited foreign assistance** needs to balance continued economic development with humanitarian aid
- **Automatic stabilizers** are relatively weak which reduces the ability of added stimulus to smooth cycles.
- **Stimulus** requires strong currencies and reserves and the investor confidence they bring
- **Stimulus** slows to a trickle in the informal sector and has to be balanced with targeted programs for income support family planning and healthcare, especially for women and children



Limited lessons from the U.S. experience

There seems to be only two reliable rules for economic and social policy that apply equally in developed, middle income and developing economies

- Rule #1 - Adapt solutions to national conditions
- Rule #2 - Never forget rule #1



Most important lesson from the U.S. experience

Don't make our mistake. Balance innovation and regulation of financial markets as financial markets evolve.



In addition

- **Coordinate** fiscal and monetary policies
- **Beware of** policy changes in the developed nations (Mexico 1980)
- **Be timely**, depending on the projected length of the recession
- **Balance** short term safety net and income-support with long-term investment
- **Emphasize** investment in human capital
- **Customize** policies to serve local humanitarian and economic conditions
- **Target** family planning as well as women's and children's health and nutrition to avoid intergenerational damage
- **Ensure** that most spending and tax cuts are temporary so it won't affect long-term government debt

