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It Doesn't Work

Why government make-work programs can't create jobs.

Christopher Ragan
McGill University

From coast to coast, governments of all stripes like to give money to firms in the hope that they will "create" jobs. I recently glanced through the 1999 Public Accounts (available by searching the Government of Canada's web site at www.gc.ca) to see how much of the taxpayers' money gets given to firms. What I found was truly staggering. The document on transfer payments (that is, a cash gift) is 68 pages long, each one listing roughly 130 recipients. The size of the cash gifts ranged from several thousand dollars to many million dollars, with $400,000 being about average. If you're concerned about the way governments in this country spend your money, a quick read of these pages may be hazardous to your health.

The problem with such government handouts is that they rarely create jobs at all — they certainly create far fewer jobs than politicians claim. Unfortunately, the public and even some of the sensible members of the business press have bought into this myth of job creation. It's long past time to separate myth from reality. To do so, we must understand how markets allocate workers across industries and also recognize the important distinction between high-skilled and low-skilled workers. Here is an example to illustrate my main point.

Suppose the government decides to provide financial assistance to a particular industry in the hope of creating jobs. The assistance might be a subsidy, in which case the government makes a specified payment to firms for each unit of output they produce, or it may be a tax exemption, in which case the firms' corporate taxes are reduced for a specified period of time. Just to make this example especially realistic in the Canadian setting, let's suppose the recipient of the government's generosity is the aerospace industry — an industry with a long and notorious record in this country of feeding at the public trough.

The government's handout to the aerospace industry will reduce firms' costs and lead them to expand operations. Part of this expansion will involve an increase in the number of workers employed. Let's say there are 1000 more workers hired in the aerospace industry as a result of the government's program. Politicians look at those new workers and claim that their policy has created 1000 jobs. But has it?

There are certainly 1000 new workers employed in the aerospace industry, but where did these workers come from? If the politicians' claim of overall job creation is true, then all of these new workers in the aerospace industry must have been previously unemployed. Only then could the corporate welfare program lead to a *net* creation of 1000 jobs. But in an economy like Canada's current one, in which firms across the country are scrambling to find qualified employees, these 1000 highly skilled workers would not come from the pool of the unemployed. Instead, they come from other industries, where they were happily employed as computer programmers, electrical engineers, lawyers, corporate strategists, or whatever. Why did these workers switch jobs? The subsidies to the aerospace industry lead that industry to seek more workers to facilitate their expansion. But aerospace firms can attract workers away from other jobs only by offering some combination of higher wages and better working conditions. The net result is that the government's financial assistance toward the aerospace industry raises employment and wages in that industry, but it does so by bidding up the overall level of wages. These higher wages make labour too costly in those unfortunate industries not favoured by government assistance, and these high wages lead to layoffs. So the government's corporate welfare program creates 1000 jobs in the aerospace industry but it reduces the number of jobs in other industries, and so there will be far fewer than 1000 jobs created in the economy as a whole. If the economy is operating at its capacity, there will be no net jobs created at all — there will only be a redistribution across industries of an unchanged number of total jobs.

With the relatively flexible labour markets that we have in Canada, highly skilled workers tend to be employed at good jobs, and unemployed only for short periods of time as they move between good jobs. Those workers that are unemployed for anything more than a few months tend to be less skilled. So in our aerospace example, the 1000 new highly skilled workers come from other jobs in other industries — these types of workers are simply not available among the unemployed. If the government handouts had instead been given to an industry that typically hires unskilled workers, there would be a better chance that some of those 1000 new workers would come from the ranks of the unemployed, thereby making the corporate welfare program a net creator of jobs.

Herein lies an interesting irony about government intervention in markets. In this era of the “knowledge-based” and “new” economy, governments celebrate the benefits of flashy, high-tech sectors that employ highly skilled workers. In contrast, they tend to ignore those boring “old” industries that produce shoes, clothing, lumber, steel, and countless other things that employ less-skilled workers. (This bias is silly for many reasons, not least because the “new” economy is dwarfed by the “old” economy.) As a result, governments tend to think more about attracting high-tech firms and industries to their regions. But it is precisely in these industries that the corporate welfare programs will create the fewest *net* jobs.

So the next time you are listening to some politician blather on about how many jobs will be created by their latest decision to spend taxpayers’ money subsidizing a particular firm or industry, feel free to be very sceptical. Think about how many of those new workers were previously unemployed and how many simply switched from one job to another. If enough people make this distinction, and begin confronting the politicians with it, perhaps we can put an end to one of the biggest economic myths around.