

Job creation is a function of credit creation

By Byron A. Ellis – November 25, 2011



The standard self-serving American narrative on job creation is that politicians can create jobs. The Democrats often argue that more government spending creates jobs and the Republicans that lower taxes create jobs. However, they seldom, if ever, provide a step-by-step job creation process. And, that is because both arguments are somewhat deceptive.

Following Layard and Walters,¹ let's assume a closed economy endowed with two factors, capital and labor. These factors are used to produce products and at any given time they are available in fixed quantities.

If we represent capital as the available money supply, M , and labor, L , as the time citizens allocate to employment, to produce corn, x^c , and meat, x^m , in a closed economy entrepreneurs would allocate money and labor to produce both goods. Thus, they would need to allocate M^c and L^c to produce corn and M^m and L^m to produce meat.

The amount of money that we would need to produce corn and meat would be $M = M^c + M^m$ and the labor required would be $L = L^c + L^m$. If, however, the money supply M were less than required, they would not be able to produce all the corn and meat to satisfy consumers. Thus, if the money supply in circulation is insufficient to produce both goods, output, employment, and consumer satisfaction will diminish.

Given the available labor in a closed economy, the money supply is an important determinant in creating output, income and employment. Therefore, when the Fed drains reserves from the banking system or when the banking system refuses to provide entrepreneurs, merchants and consumer with credit (money), output and hence employment diminishes.

We can represent the production function for corn and meat as $x^c = f(M^c, L^c)$ and $x^m = f(M^m, L^m)$, respectively, where more (less) of any factor M or L leads to more (less) output, up to a point.

Layard and Walters note that in an ideal economy the outputs from production should be allocated among employees (consumers), as well as owners of production and merchants. However, if this allocation is skewed and the owners of production receive the greatest share of output, consumption, as well as consumers' level of satisfaction and well-being diminishes over time.

Hicks also argued that changes in the level of output and employment are a function of monetary factors. Likewise, Wickssell's pure credit economy describes the banking system as the grantor of loans to entrepreneurs, which they use as an input in the production process to pay for the wages of workers.

Thus, when the banking system refuses to supply credit to entrepreneurs, merchants and consumers, the economy cannot expand, even when banks receive large infusion of funds from the Federal Reserve (Fed). Banks can adversely affect economic growth, particularly when Fed and congressional policies allow them to do so.

It is therefore paramount for the American public to understand that job creation is a function of credit creation, which induces demand for goods and services, and not politicians.

¹ Microeconomic Theory (1978).