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 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. We use these two factors 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 allocated to produce corn, x^c, and meat, x^m, in a closed economy, entrepreneurs will 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 required, M^r, to produce corn and meat is $M^r = M^c + M^m$, and the labor required, L^r, would be $L^r = L^c + L^m$. If, however, the money supply M were less than M^r, 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 essential 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 consumers with credit (money), output and hence employment diminishes. Similarly, it is unavailable of credit and income in rural and central city communities that cause poverty.

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 noted that in an ideal economy, we should allocate the outputs from production among employees (consumers), as well as owners of production and merchants. However, if this allocation is skewed and the owners of production receive the highest share of output, consumption, as well as consumers' levels of satisfaction and well-being, diminishes over time.

Hicks also argued that changes in the level of production and employment are a function of monetary factors. Likewise, Wicksell'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 a 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, services, and jobs. It is also essential to understand that in the absence of the banking credit channel, distressed communities can use credit unions to save and borrow for provident needs.

[1] Microeconomic Theory (1978).

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