This version distributed to JJ mailing list.

Jobs Creation and Government Policy

address by

Jerry L. Jordan
President and Chief Executive Officer
Federal Reserve Bank of Cleveland

Instituto Mexicano de Ejecutivos de Finanzas AC
Merida, Mexico
Saturday, November 30, 1996

I. Jobs as an Objective of Government Policy

The dominant view of economic policymakers for much of the 20th century has been that a competitive marketplace will not generate enough employment opportunities. This view underlies the advocacy of government programs to "create jobs." At least since the Great Depression of the 1930s, we have seen aspiring politicians declare that their number-one economic objective would be to increase employment.

The intellectual justification for attempting to use government budgetary and monetary policies to fine-tune macroeconomic activity was provided by John Maynard Keynes' "The General Theory of *Employment* Interest and Money" [italics added for emphasis]. This landmark book, born in the great global Depression of the 1930s, was the cornerstone of the economic doctrine that dominated western macroeconomic policies for several decades following World War II.

Before Keynes, the notion of jobs creation as an objective of government would have seemed absurd. I am reminded of a story that a western businessman told me a few years ago. He had recently been touring China, where he came upon a team of nearly a hundred workers building an earthen dam with shovels. The businessman lamented that with an earth-moving machine, a single worker could create the dam in an afternoon. The curious response from the local official was, "Yes, but think of all the *unemployment* that would create." "Oh," said the businessman, "I thought you were building a dam. If it's *jobs* you want to create, then take away their shovels and give them spoons!"

In the final decade of this century, the role of government has been moving away from the Depression-era way of thinking. In the 21st century, creating *work* for people will not be viewed as a desirable goal of government policy; fostering an environment for *wealth creation* will.

Work is the necessary means of achieving wealth: in order to be consumers, we must also be producers. Despite whatever good intentions are presumed, when government shifts the focus away from creating wealth and toward creating jobs, it inevitably engenders a lower aggregate standard of living. A successful government policy--one that helps create wealth for its citizenry--must simultaneously reduce the work burdens of the labor force. That does not mean people will need to "share jobs," take low-paying jobs, or go unemployed. Wealth creation occurs as the muscle component of employment diminishes and the brainware component increases.

Consider the work record of industrialized countries in the past century. In the United States, for example, the average workweek has fallen by roughly half since 1900, a pattern followed by every industrialized nation in the world. Among the benefits of wealth accumulation is the increase in leisure that it affords. I do not question that very poor nations are typically characterized by people who work most of their waking hours. To do otherwise would be disastrous. And I suspect that where you find impoverished nations with high rates of joblessness, you will also find political/economic systems that have large disincentives to create and accumulate wealth.

The distinction between creating wealth and creating "work" can be illustrated by an economy that has experienced a catastrophic natural disaster. A well-known feature of market economies is that in the wake of a disaster, such as a hurricane or earthquake, employment and production tend to rise. One conclusion from this observation might be that market economies routinely maintain armies of unemployed workers who are gratefully called into service by the new demands of rebuilding houses, roads, and all of the other investments that were damaged or destroyed. But clearly, these people are not better off because they are working long, hard hours. A more reasoned conclusion, I think, is that these natural disasters are *destroyers* of wealth--and creators of work in the sense that households and firms must now toil harder to help minimize and recover from their losses. I doubt that this is the sort of "jobs creation" program the electorate has in mind when they cast their ballots, although I suspect that many government "jobs" programs operate much like a post-disaster cleanup program.

II. Government and Jobs Preservation

Many people support a government role in maximizing employment in the belief that markets will not optimally provide opportunities for everyone who is willing and able to work. But what sorts of opportunities should the government provide under this philosophy?

Given the importance policymakers generally assign to the task of creating employment for the citizenry, it is surprising how little they know about the nature of jobs creation in market economies. Indeed, in examining the U.S. record, we find no identifiable, systematic factors related to industry, region, wages, employer size and age, capital and energy intensity, or foreign competition that would account for a significant share of the types or number of jobs created or destroyed in the economy. Because policymakers have no clear foresight of where entrepreneurial energies will be directed in the future, it's impossible for them to predict where jobs creation "should" occur. It is not surprising, then, that government policies which seek to direct the flow of entrepreneurial talents in a effort to promote "good" jobs, and presumably to discourage "bad" jobs, will have uncertain and potentially negative effects on economic prosperity.

Government-targeted employment policies breed special interest groups that inevitably reduce the efficiency of markets. These policies tend to persist beyond the point of any economic desirability and inhibit an important--indeed, necessary--antecedent to jobs creation: jobs *destruction*. In the United States, for example, sectors and industries that claim the highest rates of net new jobs created are generally the same sectors and industries that have the greatest rates of jobs destroyed. Similarly, nations with high rates of jobs creation also tend to have high rates of jobs destruction.[1]

In other words, much of what government touts as a jobs policy is actually a jobs *preservation* policy, the net result of which is that resources are held hostage in less-than-efficient, or their second-best, use. Can we conceive of a single job creation for which there was not a destruction of a less-efficient, and therefore less-prosperous, job? Indeed, can we conceive of any advance that does not make obsolete some less-efficient order of business?

I am of the generation that can still operate a slide rule--for what purpose I can only scarcely remember. But this technology must necessarily have been supplanted by

---

[1] The correlation between jobs creation and destruction rates by industry in the United States over the 1973 to 1988 period is 0.77 percent, as calculated from data found in Steven J. Davis, John C. Haltiwanger, and Scott Schuh, *Job Creation and Destruction*, Cambridge, MA: MIT Press (1996), table 3.1.

the invention of electronic calculators, and already miniature personal computers are making calculators obsolete. This is the nature of progress--to make obsolete old technology. In the words of Joseph Schumpeter, it means to "creatively destroy" the pre-existing order.

So, too, with human technology and the jobs that technology defines. As the stagecoach driver yields to the railway engineer, who yields to the truck driver, who yields to the airline pilot, the jobs of the old technology give way to the more prosperous jobs of the new. Yet, because of their imperfect vision, government jobs programs are almost everywhere jobs protection policies, which by extension tend to inhibit the creation of new, wealth-enhancing technology. The stagnant labor markets in Europe are a direct result of labor laws and regulations designed to protect *existing* jobs, even at the social cost of discouraging new capital formation.

III. Borders, Prosperity, and Capital Freedom

The natural experiments provided by political borders illustrate what government can and cannot accomplish. Why economic prosperity varies greatly along a seemingly arbitrary boundary poses perhaps *the* critical question for those of us called economic policymakers. What is the economic importance of these borders that separate prosperity on one side and poverty on the other?

In the simplest terms, there can be only two reasons for divergent levels of per capita income: 1) different levels of resources or 2) differences in the allocation of resources (which may be either *how* the resources are employed or *how many* of the resources are employed). Moreover, these two sources of economic prosperity are interdependent: how a nation decides to allocate its resources will ultimately determine how many resources it has to allocate.

Borders separate different political/economic systems with varying commitments to the unobstructed use of private resources. That is, borders often mark varying degrees of capital fertility--the incentives that promote the propagation of new capital that has allowed rich regions to achieve and maintain higher standards of living. The resources of the industrialized world were not endowed; they were created by entrepreneurial effort within the political/economic system. Entrepreneurial effort is not manufactured by social engineers, but nurtured by the tilling of the economic soil in which such efforts must ultimately take root.

It is a great conceit of governments on both sides of any border, I think, to behave as if market forces can be forestalled by more vigilant attention to guarding such borders. And it is a great myopia of governments to misconceive how these flows are the by-products of their antimarket policies. On both sides of the border, a government's first inclination will likely be to build a fence--to try to circumvent the imbalance that the market is attempting to correct.

IV. The Role of Government in the Economy

The role of governments in the economy was laid out in a wonderful essay by the late economist Karl Brunner, "The Poverty of Nations."[2] A person in an economy can use resources in only one of four basic endeavors: he can produce, trade, influence the political process in an effort to redirect greater resources to his advantage, or protect

---

[2] Karl Brunner, "The Poverty of Nations," *Business Economics*, January 1985 (pp. 5-11).

himself against the wealth-redistributing efforts of others. In the first two uses--production and trade--the total welfare generated by the economy increases. In the language of economists, these activities represent a positive-sum gain. However, the latter two efforts--redirecting the flow of resources or protecting against the wealth-redistributing efforts of others--are zero-sum, or even negative-sum, games. They add no value and therefore generate a lower standard of living for the citizenry as resources are directed away from production and trade. Government institutions--laws, rules, regulations, and the judicial system--influence each of the resource allocation decisions.

The influence of government as a wealth-redistributing body is well known in both eastern and western economies. As we have had ample opportunity to observe, government wealth redistribution via explicit or implicit taxation necessarily lowers the incentive to create and accumulate wealth, thereby lowering the potential productive power of the economic system. But governments also promote production and trade, because they are assignors and protectors of property rights, and provide for the enforcement of private contracts. These are wealth-enhancing activities that help the productive capacity of an economy blossom. Thus, governments have two necessarily contradictory and coexisting modes, "the protective mode" and "the redistributive mode."

These modes of government suggest why arbitrary borders along a political boundary generally signify regions of varying prosperity. They are the frontiers of a government's authority and, as such, they mark the varying degrees of both the protective and redistributive modes. Either of these two government roles can contribute to a barren economic landscape. Too *little* protective power, or too *much* redistributive effort, inhibits the creation and retention of wealth within a particular government's borders, and retards equilibrating forces that attempt to provide for a more comparable standard of living.

Now that the concrete and barbed-wire walls that separated the eastern and western European economies no longer exist, we can expect to see a narrowing in the wealth differentials between the two regions. However, until a legislative and judicial infrastructure has been built that allows the protective state to exist in a meaningful sense, the large gap in economic well-being cannot be closed.

A necessary precondition for the accumulation of capital is the protection of property rights. Those countries that make the most rapid progress in adopting western legal, financial, and accounting practices will usher in a new era of prosperity for their economies.[3] Similarly, until the redistributive modes of many Western European economies are substantially curtailed, the stagnation in their standards of living is certain to persist.

The ability of governments to influence the creation of wealth, documented in a recent study produced by a consortium of research institutes--including the Fraser Institute in Canada, CISLE in Mexico, and the CATO Institute in the United States--has generated a great amount of interest. That work attempted to gauge, in a methodical way,

[3] In a recent study, Clague, Keefer, Knack, and Olson note that "in general, democracies provide greater security of property and contractual rights than autocracies. But these benefits of democracy did not appear quickly: the property and contract rights were often poor in democracies that had lasted only a short time. Among the relatively small group of countries within our sample that moved from one regime type to another, the security of property and contract rights was greater while they were autocracies than while they were democracies. We found, by contrast, that long-lasting democracies offer better protection for property and contract rights than any other regime type of any duration." (p. 271)

the economic freedom of a broad cross-section of nations.[4] The conclusion from examining more than 100 countries over a 20-year period was that governments with a strong commitment to economic freedoms--free personal choice, the freedom of exchange, and the protection of private property--tended to be faster-growing, wealthier countries. No nation with a persistently high economic freedom rating during the 20-year period failed to achieve a high level of income. Furthermore, the 17 countries with the most improved freedom ratings all had positive and generally strong growth rates, while the 15 countries where economic freedoms declined recorded real per capita GDP deficits.

V. A Wealth-Creation Role for Monetary Policy

There is a presumption that monetary policy in industrial democracies has two objectives--to promote price stability (low inflation) and to promote employment growth. Although many contend that these objectives are in conflict, I disagree. It's false to conclude that a trade-off exists between price stability and jobs creation. Such a perception puts proponents of stable monetary systems in the position of appearing to be anti-jobs. On the contrary, by protecting the purchasing power of a nation's money--and thereby protecting the property rights of the private enterprises that use the publicly provided money--the central bank promotes the creation and accumulation of wealth.

The alternative of allowing the purchasing power of a nation's monetary standard to erode over time--to allow inflation to occur--redirects a nation's resources from

[4] See James Gwartney, Robert Lawson, and Walter Block, *Economic Freedom of the World: 1975-1995,* Vancouver: The Fraser Institute (1996). A useful summary of the book is found in "Of liberty, and prosperity," *The Economist*, January 13, 1996, pp. 21-23.

activities that create *new* wealth toward efforts to protect existing wealth from the ravages of inflation and currency devaluations. If the wealth-redistributive effects become great enough--that is, if the inflation rate becomes extreme--the monetary standard will be abandoned by the citizenry, and a monetary standard that is outside the political boundaries will emerge.

Historically, nonpolitical payments systems have come in the form of commodity monies--such as a gold standard--although competing national currencies have been used in recent times. More than two-thirds of the U.S. currency, for example, is held outside the country, a trend that has accelerated in recent years. In the 1980s, the bulk of new U.S. currency was shipped to Latin America, and in particular Argentina, where the dollar is commonly used to settle ordinary auto and real estate transactions. Since the tumbling of the Berlin Wall at the end of 1989, currency shipments to Eastern Europe and the former Soviet republics have grown enormously as the dollar has become a readily accepted medium of exchange in these emerging market economies. In fact, in 1994, U.S. currency shipments to Russia accounted for more than half of all net foreign currency shipments, and in 1995, gross shipments of U.S. currency to Russia are reported to have been as high as $100 million per business day.[5]

The reason for the competing monetary system is clear. Because of the seigniorage incentive of the Russian government, the Russian central bank continues to debase the ruble. The implicit inflation tax on ruble transactions has provided the

---

[5] See Richard D. Porter and Ruth A. Judson, "The Location of U.S. Currency: How Much Is Abroad?" Board of Governors of the Federal Reserve System, manuscript, June 1995.

incentive for Russian transactions to occur via a more efficient currency, in this case, the U.S. dollar.

When we think of money as a public good that facilitates the operation of markets, we begin to see that stable monetary standards need not be anti-jobs creation, but are pro-wealth creation. This is the realization in a wide variety of market economies around the world. Since 1991, seven nations have adopted an inflation objective as the sole objective of their central banks.[6] In large part, these governments had become disenchanted with the role of the monetary authority as a fine-tuner of the economy. In virtually each instance, the unintended consequences of misguided short-run "counter-cyclical stabilization policies" were that the purchasing power of their moneys became unstable, fluctuations in business activity grew worse, and wealth was eroded.

The evidence on wealth creation and inflation is incomplete, but there can be little doubt that this view is gaining broad appeal. A recent study for the Bank of England reported that if country characteristics are held constant, a 10-percentage-point increase in average inflation reduces the growth rate of real per capita income by about 1/4 percentage point and lowers the ratio of investment to GDP by about 1/5 percentage point. These results imply that the long-run effects of inflation on a nation's standard of living can be large when accumulated over a number of years.[7] This work is consistent with findings by economists at the Federal Reserve: "...evidence consistently points to a

[6] This list includes Australia, Canada, Finland, New Zealand , Spain, Sweden, and the United Kingdom.
[7] See Robert J. Barro, "Inflation and Economic Growth," Harvard University and the Bank of England, *Bank of England Quarterly Bulletin*.

negative correlation between inflation and the growth of productivity over the post-Korean-War period in the United States."[8]

Economists will debate the details on how best to implement a stable price objective for central banks. Indeed, such debates have been occurring in the United States for many years now, as they have around the world. But there is one essential element of this objective: governments must abandon the notion that unstable payments systems--inflationary payments systems--are useful jobs creation strategies. The record on this point is clear. To allow for the highest standard of living for its citizenry, the central bank must provide the highest possible incentives for the creation and accumulation of wealth, and that, above all else, means they must provide a stable monetary system.

---

[8] See Glenn D. Rudebusch and David W. Wilcox, "*Productivity and Inflation,*" Federal Reserve Board manuscript, May 1994.