A False Premise: Politicians as Job Creators
By Byron A. Ellis - 2012

Politicians often tell constituents that they can improve the economy and create jobs. Implicitly, such an argument implies that politicians can create demand for goods and services. Demand, however, depends on income and prices. Therefore, the argument about politicians creating jobs is illusory at best, since they cannot increase money in circulation.

Thus, it is interesting to hear Mitt Romney argue that he can create jobs (demand) as president of the United States. But, how would he create demand?

Economic growth, as well as job creation, is everywhere a monetary phenomenon and the Federal Reserve (Fed), an independent government agency under the supervision of Congress, expands or contracts the money supply. However, Congress, the Fed, and some economists want the public to believe that monetary policies do not affect demand and hence economic growth and employment. Ellis labels this view a sleight of hand.

Currently, central banks, such as the Fed, manipulate interest rates to control inflation. Many central banks, including the Fed, argue that low and stable inflation increases output in the long run. However, for more than a decade Fed's manipulation of the federal funds rate has not succeeded in creating significant economic growth. Rather, it has created multiple recessions.

Reducing money in circulation led to the Great Recession of 2008, causing economic chaos and immense human suffering. Furthermore, at the height of the economic crisis, the Fed reversed its anti-inflationary policy and significantly increased the money supply to banks, a clear indication that the Fed understood that restrictive monetary policies contributed to the economic crisis.

The Fed knows that increasing the money in circulation increases economic growth and employment in the long run. The relevant question, therefore, is why would the Fed deliberately starve the economy and deny employment opportunities to Americans?

Consumers use money in circulation to purchase goods and services. Thus, when the Fed removes money from circulation, consumers have less money to purchase goods and services.

For a robust economy to exist, the value of the quantity of goods and services produced in the economy must be approximately equal to the amount of money in circulation. If the amount of money in circulation is more, inflation will occur, and if it's less deflation will occur.

If the money in circulation is more, consumers will bid up prices of goods and services produced less, consumers will not be able to purchase all the goods and services produced. Conversely, if it is.

The Fed inflation targeting policy, therefore, adversely affected the credit and monetary channels. IT policies affected the credit channel through higher interest rates that reduced money demand. Less money in circulation adversely affected the monetary channel, reducing the demand for goods and services.

Tight credit prevented the expansion of money in circulation. And, the Fed drained money from the economy by using open market operations to sell securities. When there is less money in circulation, consumers purchase fewer goods and services. As a result, inventories accumulate and the cycle of layoff begins.

So, how would Mr. Romney or any politician for that matter create jobs when the Fed mismanages the economy?

If the government engages in fiscal expansion and monetary policy is tight, fiscal spending would merely reallocate spending from the private to the public sector.

Thus, the policy framework used by the Fed in setting the daily course of monetary policy is the main problem affecting the US economy. The Fed, like many central bankers, stubborn belief in interest rates, rather than money aggregates, targets is vexing.

Milton Friedman dismissed interest rates as a policy instrument. He noted that experience demonstrated that it was not feasible for central banks to use interest rates as a target or an effective instrument.

However, central bankers believe that money is endogenous to the economic system and claim that they cannot control monetary aggregates. Nonetheless, unlike central bankers, Milton Friedman and consumers know that money (income) drives purchasing behaviors and creates demand and employment.

And, the Fed also knows that adequate money in circulation is essential for economic growth and employment. If that was not the case, the Fed would not have engaged in two rounds of quantitative easing policies when confronted with the Great Recession of 2008.

Full employment and stable economic growth are possible, under the right Fed management. Thus, appointing the right Federal Reserve chairperson that understands how to use monetary policy to attain full employment is critical for successfully moving towards full employment.