THE McKEEVER INSTITUTE OF ECONOMIC POLICY ANALYSIS

JOBS GROWTH THEORY

INTRODUCTION

As seen below, it is MIEPA's conclusion that market forces are required to create jobs - the 20th Century Soviet experiment in central planning has disproved the concept of a centrally planned economy creating jobs for all the population without the use of market interactions.

As a background and introduction, this section will discuss the jobs theory of growth and then compare it to traditional theories of economic growth.

Economic growth has become an interesting problem because of the exponential population growth of the last two hundred years. The world supported less than a billion people for many thousands of years until about 1800. Since then the population has grown to about 6 billion as of 2000. The problem of how to clothe and feed the extra five billion people is one of the major problems of our time. At the least, the world's economies must create millions of new jobs quickly.

THE JOBS THEORY OF GROWTH

In the economic circular flow of money and goods, businesses sell goods to consumers and hire workers to produce and sell those goods. The workers take their wages and buy products and services from businesses.

The classical economist's way of looking at the flow was to say that 'Supply creates Demand'. In other words, business must hire workers to create products and those workers in turn use their incomes to create demand for businesses by spending their wages. Classical economics then looks at businesses as the foundation of economic activity for their efforts to create products by hiring workers. While creating a product or service the business pays workers wages which then creates an income for consumers. Classical economics focuses on business product creation and assumes the demand will follow.

The jobs theory turns that around to make this statement: 'Demand Creates Supply'. In other words, if consumers have an income, businesses will be formed to supply products to consumers. Then, the focus is on the consumer's income - if consumers have an income, business will cater to that income by creating products for consumers to buy.

Economic growth then becomes the creation of new businesses and jobs; and, it is measured by the number of jobs created. One cannot just measure the number of businesses created since one new business may create hundreds of jobs while another new business creates only one job.

When more jobs are created, then the economy grows. It is measurable - just count the number of new jobs created and subtract the number of jobs lost. If the number is positive, then there is economic growth. If the number is negative, then the economy has shrunk.

For example, the number of people working in the USA grew from 64,630,000 in 1959 to 145,926,000 in December of 2006, according to the 2007 Economic Report of the President [http://www.gpoaccess.gov/eop/tables07.html]. This is a growth of two and one quarter times over a 47 year period.

During that same period, the population grew from 177,830,000 in 1959 to 299,801,000 in 2006. This was a growth of about 68%.

Not only did the absolute number of jobs grow by 125% during that period, the number of jobs grew almost twice as fast as the population.

The number of jobs per capita is derived by dividing the number of jobs by the population. It grew from 0.36 in 1959 to 0.49 in 2006. In other words, one working person supported nearly two non-working people in 1959, but one working person supported only one non-working person in 2006. Economic growth is measured by an increase in per capita jobs.

BUSINESS CREATES JOBS

In most economies, most jobs are created by small entrepreneurial businesses. There are four conditions required for any businesses to be formed. When present, these pre-conditions allow for job creation; when absent, job creation is almost impossible.

Middle Class

Business owners largely come from a middle class, when that class is defined as a class of people who have the extra time and income to conceive of a business opportunity and save, borrow or collect investors in order to start a business and hire employees.

PROPERTY

A business is a venture in which property is bought and sold. If property cannot be protected or defined a business cannot survive. The system which creates and protects property is a legal system installed and maintained by a government. Job creation requires a complex legal system which describes, defends and resolves disputes about personal, real and intellectual property.

Personal Property

Personal property is merchandise which is not permanently attached to the ground. The items for sale in a retail store are personal property. The legal system which creates and transfers ownership of personal property is governed by the Uniform Commercial Code [UCC] in the United States. This is a set of definitions of such things as a contract, invoice, bill of lading, receipt and so on which are accepted by all states, counties and cities in the USA. The UCC is readily available on the Internet and is managed by Cornell University Law School; it is available at http://www.law.cornell.edu/ucc/ucc.table.html.

Businesses require predictable rules about the acquisition, possession and transfer of personal property since most businesses buy and sell personal property such as those incorporated in the UCC. Businesses also require an effective police force to protect their property against theft. If the business owner cannot predict whether or not a robber will steal his property, he will take his investment to a safer country. Then, there will be no business created and no jobs offered.

A society which wishes to see job creation will incorporate standard rules of creating, owning and transferring personal property.

Real Property

Real property, or real estate, includes land, buildings and any items permanently attached to the land or building. For example, the electrical wires enclosed in the walls of a house are real property since they cannot be removed without damaging the house. But, a mirror hung on the wall with nails is personal property because it is easily movable without damaging the wall.

Much of the value in real property derives from the ability to measure and exactly describe where is the vacant land or land which underlies buildings. This ability to locate land precisely enables banks in distant cities to loan money against the value of the land and buildings. It also makes possible the establishment of the proper owner of that land so that a person's claims of ownership can be defended in court.

Land is described by surveys documented in public records and claims of ownership are recorded in public records identified by each individual parcel. Creating the value in real property requires a complex set of public records, laws, court systems to settle disputes and a police force to secure ownership from criminals.

Intellectual Property

Intellectual property is the unique product of an individual who designs a new device, writes a new article or book or writes a new song, musical composition or computer program. The value in intellectual property derives from two things; first, a system of registering claims of uniqueness maintained by a government entity and, second, a system of laws which allows the creator of the new item to sue people for damages who copy his unique works without permission.

In countries where intellectual property is not protected by the government, pirates routinely copy intellectual property without permission and pocket the proceeds.

Of course, in less developed societies some of the legal systems described above may be non-existent or very simple while still allowing entrepreneurs the incentives to hire employees. Complex laws may be replaced by societal customs and traditional practices. But, as the economy grows, the legal system will grow with it and expand the job creating opportunities.

Monetary Exchange

Job creation requires that businesses grow so they can hire more people. In turn, the energy the business owner invests into growing his business requires that he be free from simple, repetitive tasks - that's the only way he can explore new ideas and create new projects.

One of the most frustrating tasks for a business owner in an economy where there is no monetary exchange is the constant search for barter possibilities or currency exchange so the businessman can convert the goods he receives in exchange for his goods into products he needs. For example, say a business person makes plows from steel and sells them to farmers. With no monetary exchange, he will trade his plows for corn and then try to find someone with steel who will take his corn. Or, say a vendor sells supplies in a market where many currencies are circulated but buys products where only US dollars are accepted; he must spend a lot of time changing money.

Markets

A market is a place where buyers and sellers meet and exchange goods and money. It can be a physical place like a swap meet or open market, a series of locations like stores in a shopping center or a series of online web sites.

Markets can exist where property is either privately owned or publicly owned. Markets can be more or less regulated depending on the political philosophy of the country. As mentioned above, the Soviet experiment in central planning and non-market exchange in the 20th Century appears to prove that markets are required for economic growth.

The policies discussed in this site are designed to create the most possible jobs in any country. Since businesses create most jobs, improving the listed policies toward a higher score will promote and support business activity.

However, the profit goals of business can conflict with the overall goals of society in some circumstances. Additionally, evidence shows that poorly regulated markets tend to create large income and wealth disparities; such disparities can interfere with job creation and social justice when taken to the extreme. Great inequalities can create powerful pressure groups which can manipulate public policy toward private interests and which are more interested in personal profits than the welfare of society. Consequently, well managed countries ameliorate income and wealth disparities and closely monitor business activity and regulate that activity when profit seeking behavior conflicts with society's goals.

PAST ECONOMIC GROWTH THEORIES

In the past, economists have examined growth in an attempt to create a better life for more people. While MIEPA believes the job theory of growth the most applicable to the population growth problem identified above, it is worthwhile to examine historical growth theories.

Economists define economic growth as an increase in real GDP per capita. In other words, they take the entire money value of goods and services produced in a country in a year, reduce the value to account for inflation and then divide by the number of people in the country that year. That gives a measure of the amount of actual goods and services per person for that year. If the same measure next year shows a higher number, then there has been economic growth.

Using this measuring technique, the United States has shown more than one hundred years of positive economic growth - between 1895 and 1998 the real GDP per person in the USA grew by 2% per year. Although there are many explanations of this phenomenon, a few reasons include: educated population, business friendly government policies, consistent legal structure in a large market, and, a large middle class of people with enough income to think about investments.

Historically, there are several economic theories of how to create growth as measured by an increase in real GDP per capita.

1. CLASSICAL GROWTH THEORY

Writing in the 1700's, Adam Smith proposed the first theory of economic growth. His idea was that economic changes allowed for an increase in population growth, and the increase in population growth was economic growth. He reasoned this way: market forces create equilibrium of wages so that any extra children born to a family will die from starvation or disease before entering the labor market. This die-off keeps wages at a level which just supports the number of workers demanded by businesses. If the demand for workers increases so that businesses want to hire more workers at every wage, then workers will bid up their wages beyond subsistence level and more children will be able to live long enough to enter the labor force.

Once the new workers enter the labor force, the competition for jobs will drive wages down to the level needed by businesses at a subsistence wage. But, economic growth will take place since the number of workers supported by business will be larger.

2. NEO-CLASSICAL GROWTH THEORY

Writing in the 1950's Robert Solow proposed that economic growth is caused by a change in the relation of capital, or money, to labor hours worked. Basically, a new technology is invented which enables a worker to produce more output per hour worked. Business naturally invests in this new technology thereby raising the amount of capital used per hour of work. Economic growth is created because the additional capital has increased the worker's output per hour. This extra output becomes an increase in real GDP per person, or economic growth.

By following this theory, economic policies which encourage the accumulation of capital and the investment of capital into business will create economic growth.

3. NEW GROWTH THEORY

In the late 1980's a different theory of growth was introduced. This theory said that intellectual innovations, like personal computers and effective software programs, raise the productivity of all workers and raise the return on all capital invested in businesses. This higher return rate calls forth additional investment in businesses since now business investment is seen as more attractive than before.

Then this additional investment will create another intellectual innovation which will raise the productivity of all workers even further. Then additional capital will be invested and the cycle begins all over.

Whether these cycles would continue indefinitely was answered in the dot bomb recession of the late 1990's when businesses based on this growth theory mostly died.