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The Capitalist Perspective

High levels of unemployment as far as the eyes can see

Even an Obama administration that had promised economic policies to generate rapid employment growth has vaguely acknowledged that US job creation has essentially stalled.[1] Against this backdrop President Obama reiterating his Administration's commitment to foster renewed employment growth.

Logic and history tell us that the President's initiatives will fail. There's a fundamental misunderstanding inside the Obama administration and broadly in Washington about what causes investors to commit capital, and what motivates businesses to put it to work on the way to expansion and job creation.

Those perhaps incorrectly charged with boosting our economic fortunes also misunderstand the nature of unemployment itself. Though thought to be the result of a lack of aggregate demand, in truth unemployment often rears its ugly head thanks to errors of economic policy. First, policy may make it too expensive for investors and businesses to deploy capital profitably. Second, it may raise the cost for businesses to lure workers from the sidelines.

Economies are nothing more than a collection of individuals pursuing their diverse economic aims. If they are left free to do so, employment growth is the natural result. But when barriers to productive economic activity are erected, surplus resources result and are reflected in higher unemployment.

> ***When there is general confidence in the uninterrupted goings on in economic life, confidence in the legal framework under which economic life operates and in the essential integrity and fairness of governments, men with capital prefer to have their capital employed.***
>
> Benjamin Anderson, *Economics and the Public Welfare*, p. 29.

The political class lacks the basic modesty needed to back off from government solutions so that the economy can heal itself. Unless the Obama administration and Congress develop a better understanding of what is very basic, all governmental efforts to reduce the brutal pain of unemployment will fall short.

Government spending. By their nature, governments lack resources to carry out their programs. Though repeated with regularity by certain members of the economic commentariat, and with high frequency in *Wainwright* publications, this essential truth is too often forgotten. For governments to spend they must tax or extract financial capital from the private sector in order to fund what politicians deem essential.

Cast a skeptical glance at the kind of spending that has emanated from Washington historically: the Bridges to Nowhere, government buildings suspiciously built to honor living politicians, and unfunded Social Security to consume rather than build capital. We can see that political spending favors capital destruction over capital formation. The economic loss that results from profligate government waste is hard to quantify. But we can at the very least credibly ask what exciting private sector concepts might have attracted funding absent a government seemingly ungoverned by spending limits.

Government spending under the Bush administration ballooned, and it continued upward on President Obama's watch. The Obama administration sought the increases based on its belief that government funded projects would create jobs. As the numbers make clear, the opposite has occurred. Obama asked for spending increases upon ascending to the presidency with the explicit promise that if his desired policies were enacted, unemployment would not rise above 8%.[2] Sadly, as of September 2nd, the number is 9.1%. It would be even higher if the labor force participation today were the same as in 2009.

1. William McGurn, "The President's Speech Impediment," *Wall Street Journal*, September 6, 2011.
2. *Ibid*.

The situation is in extreme contrast with the recession the US felt 90 years ago in 1921. In that year the rate of unemployment rose to 11.2%, but only two years later it had fallen all the way down to 1.7%.[3]

What was the Washington response to a major recession in 1921 such that the economy recovered so quickly? Government spending plummeted. From $6.4 billion in 1920, the dollar cost of government fell to $3.3 billion in 1923.[4] The answer is pretty basic, but sadly for those hoping for another snapback now, the mere suggestion of mimicking the 1921 recession cure would be ridiculed in today's policy climate.

Irrespective of party affiliation, that level of presumed austerity from Washington isn't today remotely part of the presumed policy mix. But its success on that occasion can't be minimized.

Washington's early '20s cure was the perfect one. Particularly during downturns, it's essential to leave as much capital as possible in the private sector, where entrepreneurs and producers can access it in order to survive and grow. What's unknown is whether any member of the political class is familiar with this bit of history, and if so, whether those individuals might possess the courage to do something similar today.

Unemployment insurance. At present, one input boosting the amount of government spending is unemployment compensation. Right now unemployment benefits extend to 99 weeks, and there's talk of increasing that in the near-term. The implications for unemployment as a result of such a move will not be favorable.

Unemployment benefits reduce the pain of being unemployed, making it easier for individuals to delay their re-entry into the labor force. As Benjamin Anderson long ago observed, "any country can have heavy unemployment if it is willing and able to pay for it." Even worse, those benefits effectively raise the cost to businesses of luring workers from the sidelines. Unemployment becomes a paid economic state of existence.

Every economic good, including labor, has a market clearing price. The present problem is that jobless benefits are restraining the descent of the cost of labor to clear the market in the context of present realities. This keeps the level of joblessness higher than it otherwise would be.

Regulation. No business could grow, let alone attract the capital necessary to grow, if its goal was to fleece potential customers, or lose investor funds through reckless acts. Businesses succeed precisely because they do well by customers and investors, and as a result, generate loyalty within the marketplace.

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It's helpful to acknowledge the dark side of regulations. Without them we'd likely not suffer much at all in the way of harm from business. Regulations inhibit the path to prosperity. Instead of serving their shareholders and customers, businesses must serve political masters.

To offer but one example, Wal-Mart has for decades desired a retail banking presence. It lacks one solely as a result of rules keeping it out of the banking sector.

The Dodd-Frank finance bill, written supposedly to protect banks, is a 1,600 page document that will foist all manner of compliance costs on a banking industry already reeling from grave errors made not long ago.[5] The financial sector is increasingly weighed down with rules, compliance which will cost enormous sums. Funds that would normally drive expansion and resulting job creation are increasingly used to pay for facilitator roles within banks.

It's said that the passage of Obamacare was President Obama's signature legislative achievement. But regardless of one's opinion of the purpose of the legislation, it cannot be denied that it will serve as an increased burden on companies. A mandate requiring all Americans to be insured necessarily increases the cost of hiring. Given that it is still possible that the Supreme Court will rule Obamacare unconstitutional, it is also a source of uncertainty. Businesses have a reason to lie in wait and defer hiring until they know what their future labor costs will be.

Just recently AT&T's planned merger with T-Mobile was blocked by the Obama Department of Justice (DOJ). One factor in DOJ's decision was fear about what the elimination of redundant jobs would do to the overall jobs picture. Missed by DOJ is that thriving economies regularly shed redundant jobs. Increased profitability is a *lure* that historically blunts the effect of job loss. Unable to achieve greater efficiencies through a purchase of T-Mobile, AT&T will remain relatively stagnant thanks to government policy error. The longer-term result will be reduced profitability that constrains its growth.

Taxation. In thinking about taxation, it should be said that the word itself is unfortunate for obscuring the true definition of the word "tax." In a perfect world what we deem a tax would instead be called a price. Taxes are nothing more than a price placed on our work output, which means the higher the rate of taxation is, the *higher the cost* of productive, profitable work.

Though it should be acknowledged that rates of taxation aren't high compared with even higher rates that prevailed during parts of the 20th century, as it stands now they're set to increase in 2013 absent legislative maneuvers that would reverse this inevitability. This bit

3. Benjamin Anderson, *Economics and the Public Welfare*, 1949, Liberty Fund edition (1979), p. 477.
4. Benjamin Anderson, *op.cit.*, p. 92.
5. See Jon Huntsmann, "Reigniting the Entrepreneurial Spirit," *Wall Street Journal*, September 6, 2011.

of "regime uncertainty" can't be quantified, but it should be said that the vital few in the economy presently face the possibility that the price of their work will rise in less than two years.

Government spending has already risen quite a bit over the last ten years. It's fair to say that society's producers, witnessing the spending, know they'll eventually have to pay for it. This looming reality too perhaps weighs on productive output, and without it, there's necessarily less investment migrating to the individuals most able to innovate, and in doing so, create jobs.

Lastly, higher taxes on investment (capital gains rates are similarly set to increase in 2013) raise the cost for those with means to commit capital to exciting business concepts. Why invest if any presumed returns will be eviscerated by increased taxation on "unearned wealth"? It can't be stated enough that there are no jobs without investment. Looming tax increases on production and investment can't be aiding what remains a limping, jobless recovery.

The dollar. If it's agreed that there's no company formation and resultant job creation without investment, the dollar factor as it applies to high unemployment begs discussion. The dollar is very weak as evidenced by a gold price that continues to reach all-time highs.

Indeed, not considered enough by a political class that sees currency devaluation as an economic cure-all is the basic truth that when investors commit capital to anything, they're buying future income streams. Devaluation tautologically reduces the value of those aforementioned income streams, thus explaining why cheap currency eras are invariably poor ones for stock market performance.

There's no investment and job growth without saving first, but during periods of devaluation the very saving that authors our advancement is compromised. Thrift reveals itself as a fool's errand. Why save if delayed consumption is to be met with the devaluation of those savings?

Furthermore, just as a tax hike is an increase in the cost placed on productive work, then it's also true that inflation has the same impact. Inflation is the devaluation of our paychecks. Inflation raises the cost of working. Why get up each day to earn a wage if inflation and taxes reduce the value of the work?

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Conclusion. Thanks to a combination of government policy errors that have been piled on the US economy all at once, the level of unemployment is very high, and is expected to remain so for the foreseeable future. It's all very unfortunate, and unnecessary.

Unemployment could never prevail at the rates it does in a free economy. It sits at nosebleed levels now due to government spending and benefit errors that are extracting precious capital from the private sector only to fund programs that delay the adjustment of wage demands to market clearing levels. Superimposed on that, regulations serve as a profit deterrent on their best day, and on their worst day block the natural evolution of our economy. A stationary economy cannot attract growth capital.

Most unsung is the role of the falling dollar. We hear so much from bright minds about the need for certainty—regulatory, tax, and legal—in our economy, but not enough about how floating money values foster one of the greatest uncertainties of all. Indeed, a floating dollar make a mockery of contracts and reduces faith in government. It reduces the value of investment returns that lure those with capital into the marketplace to begin with. So it forces into hiding the investment that drives the advancement of employment opportunities.

Fixing the employment picture is basic. All it requires is modesty on the part of an untethered government drunk with confidence in its ability to fix our problems. In truth, the government can't give us what it hasn't taken from us first. To reduce unemployment is as simple as Washington doing very little, all the while fulfilling its constitutional mandate to maintain a dollar that is stable in value. Looked at from an investment perspective, high unemployment is anything but a mystery.

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