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Why Is Unemployment Rising?

By Washington's Blog
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Today's unemployment numbers are bad. See this and this.

Why is unemployment rising? Because the government is doing everything wrong.

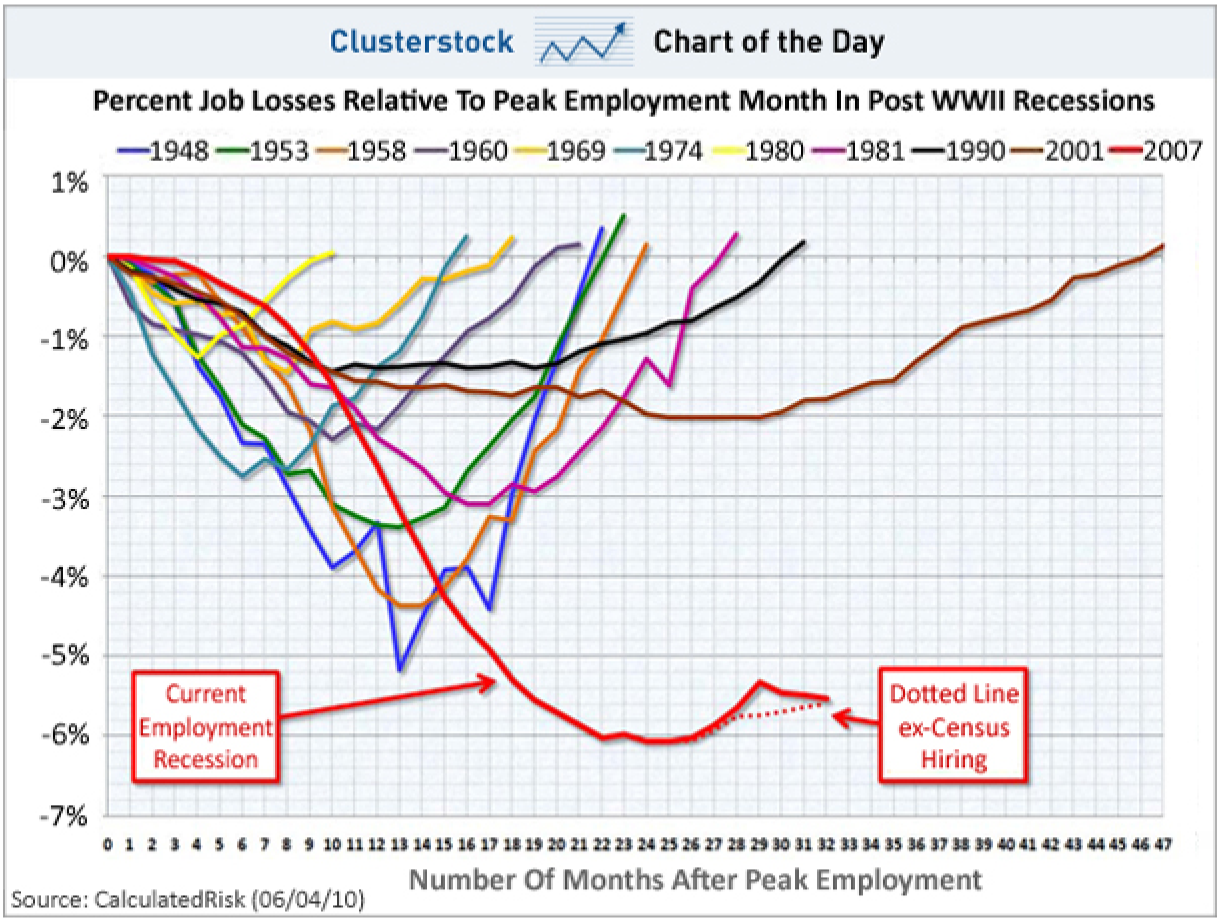
One definition of insanity is doing the same thing again and again and expecting different results. Unless the government substantially changes its approach, unemployment will keep rising.

Here are two essays I wrote – the first last month, and the second last year – explaining why unemployment is rising and what the government needs to do differently to get the unemployment crisis under control.

Government Policy Caused America's Unemployment Crisis

The unemployment rate has risen again for the the first time in 4 months. I predicted a growing, long-term unemployment problem last year.

Indeed, even after the government plays with the numbers to make them look better (using inaccurate birth-death models and other tricks-of-the-trade), this is how the current jobs downturn compares with other post-WWII recessions:



In fact, as demonstrated below, the government's actions have directly contributed to the rising tide of unemployment.

The Government Has Encouraged the Offshoring of American Jobs for More Than 50 Years

President Eisenhower re-wrote the tax laws so that they would favor investment abroad. President Kennedy railed against tax provisions that "consistently favor United States private investment abroad compared with investment in our own economy", but nothing has changed under either Democratic or Republican administrations.

For the last 50-plus years, the tax benefits to American companies making things abroad has encouraged jobs to move out of the U.S.

The Government Has Encouraged Mergers

The government has actively encouraged mergers, which destroy jobs.

For example, the Treasury Department encouraged banks to use the bailout money to buy their competitors, and pushed through an amendment to the tax laws which rewards mergers in the banking industry.

This is nothing new.

Citigroup's former chief executive says that when Citigroup was formed in 1998 out of the merger of banking and insurance giants, Alan Greenspan told him, "I have nothing against size. It doesn't bother me at all".

And the government has actively encouraged the big banks to grow into mega-banks.

The Government Has Let Unemployment Rise in an Attempt to Fight Inflation

As I noted last year:

> The Federal Reserve is mandated by law to maximize employment. The relevant statute states:
>
>> The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.
>
> ***
>
> The Fed could have stemmed the unemployment crisis by demanding that banks lend more as a condition to the various government assistance programs, but Mr. Bernanke failed to do so.
>
> Ryan Grim argues that the Fed might have broken the law by letting unemployment rise in order to keep inflation low:
>
>> The Fed is mandated by law to maximize employment, but focuses on inflation — and "expected inflation" — at the expense of job creation. At its most recent meeting, board members bluntly stated that they feared banks might increase lending, which they worried could lead to inflation.
>>
>> Board members expressed concern "that banks might seek to reduce appreciably their excess reserves as the economy improves by purchasing securities or by easing credit standards and expanding their lending substantially. Such a development, if not offset by Federal Reserve actions, could give additional impetus to spending and, potentially, to actual and expected inflation." That summary was spotted by Naked Capitalism and is included in a summary of the minutes of the most recent meeting…
>>
>> Suffering high unemployment in order to keep inflation low cuts against the Fed's legal mandate. Or, to put it more bluntly, it may be illegal.
>
> In fact, the unemployment situation is getting worse, and many leading economists say that – under Mr. Bernanke's leadership – America is suffering a permanent destruction of jobs.
>
> For example, JPMorgan Chase's Chief Economist Bruce Kasman told Bloomberg:

> [We've had a] permanent destruction of hundreds of thousands of jobs in industries from housing to finance.

The chief economists for Wells Fargo Securities, John Silvia, says:

> Companies "really have diminished their willingness to hire labor for any production level," Silvia said. "It's really a strategic change," where companies will be keeping fewer employees for any particular level of sales, in good times and bad, he said.

And former Merrill Lynch chief economist David Rosenberg writes:

> The number of people not on temporary layoff surged 220,000 in August and the level continues to reach new highs, now at 8.1 million. This accounts for 53.9% of the unemployed — again a record high — and this is a proxy for permanent job loss, in other words, these jobs are not coming back. Against that backdrop, the number of people who have been looking for a job for at least six months with no success rose a further half-percent in August, to stand at 5 million — the long-term unemployed now represent a record 33% of the total pool of joblessness.

And see this.

In fact, the Fed intentionally curbed lending by banks in an attempt to stem inflation, without addressing whether public banks could provide credit.

The Government Has Allowed Wealth to be Concentrated in Fewer and Fewer Hands

As I pointed out a year ago:

> A new report by University of California, Berkeley economics professor Emmanuel Saez concludes that income inequality in the United States is at an all-time high, surpassing even levels seen during the Great Depression.
>
> The report shows that:
>
> - Income inequality is worse than it has been since at least 1917
> - "The top 1 percent incomes captured half of the overall economic growth over the period 1993-2007"
> - "In the economic expansion of 2002-2007, the top 1 percent captured two thirds of income growth."
>
> As others have pointed out, the average wage of Americans, adjusting for inflation, is lower than it was in the 1970s. The minimum wage, adjusting for inflation, is lower than it was in the 1950s. See this. On the other hand, billionaires have never had it better.
>
> > As I wrote in September:

> The economy is like a poker game . . . it is human nature to want to get all of the chips, but – if one person does get all of the chips – the game ends.
>
> In other words, the game of capitalism only continues as long as everyone has some money to play with. If the government and corporations take everyone's money, the game ends.
>
> The fed and Treasury are not giving more chips to those who need them: the American consumer. Instead, they are giving chips to the 800-pound gorillas at the poker table, such as Wall Street investment banks. Indeed, a good chunk of the money used by surviving mammoth players to buy the failing behemoths actually comes from the Fed…
>
> This is not a question of big government versus small government, or republican versus democrat. It is not even a question of Keynes versus Friedman (two influential, competing economic thinkers).
>
> It is a question of focusing any government funding which is made to the majority of poker players – instead of the titans of finance – so that the game can continue. If the hundreds of billions or trillions spent on bailouts had instead been given to ease the burden of consumers, we would have already recovered from the financial crisis.

I noted in April:

> FDR's Fed chairman Marriner S. Eccles explained:
>
> > As in a poker game where the chips were concentrated in fewer and fewer hands, the other fellows could stay in the game only by borrowing. When their credit ran out, the game stopped.
>
> ***
>
> When most people lose their poker chips – and the game is set up so that only those with the most chips get more – free market capitalism is destroyed, as the "too big to fails" crowd out everyone else.
>
> And the economy as a whole is destroyed. Remember, consumer spending accounts for the lion's share of economic activity. If most consumers are out of chips, the economy slumps.

And unemployment soars.

As former Secretary of Labor Robert Reich wrote yesterday:

> Where have all the economic gains gone? Mostly to the top.
>
> ***

> It’s no coincidence that the last time income was this concentrated was in 1928. I do not mean to suggest that such astonishing consolidations of income at the top directly cause sharp economic declines. The connection is more subtle.
>
> The rich spend a much smaller proportion of their incomes than the rest of us. So when they get a disproportionate share of total income, the economy is robbed of the demand it needs to keep growing and creating jobs.
>
> What’s more, the rich don’t necessarily invest their earnings and savings in the American economy; they send them anywhere around the globe where they’ll summon the highest returns — sometimes that’s here, but often it’s the Cayman Islands, China or elsewhere. The rich also put their money into assets most likely to attract other big investors (commodities, stocks, dot-coms or real estate), which can become wildly inflated as a result.
>
> ***
>
> THE Great Depression and its aftermath demonstrate that there is only one way back to full recovery: through more widely shared prosperity.
>
> ***
>
> And as America’s middle class shared more of the economy’s gains, it was able to buy more of the goods and services the economy could provide. The result: rapid growth and more jobs. By contrast, little has been done since 2008 to widen the circle of prosperity.

So through it’s policies encouraging the offshoring of jobs, mergers, decreasing of economic activity to fight inflation, allowing wealth to be concentrated in fewer and fewer hands, and other policy mistakes (like pretending that there is a “jobless recovery“), the government has channeled water away from U.S. jobs, creating a worsening unemployment drought.

Note for Keynesians: As I have repeatedly explained, the government hasn’t spent money on the right kind of things to stimulate employment. See this and this.

Note for followers of Austrian economic theory: I have repeatedly railed against the government artificially propping up asset prices and leverage, so that malinvestments can’t be cleared, and we have a stagnant, zombie economy which prevents job creation.

The Rising Tide of Unemployment in America: How Bad Will It Get, And What Can We Do?

Unemployment is disastrous on both the individual and societal level.

Individuals who look for work but can’t find it are miserable.[1]

On the national level, high unemployment is both cause and effect concerning other problems with the economy. As we’ll see below, high unemployment results from a weak economy and – in turn – weakens the economy.

Until the causes of, and solutions to, high levels of unemployment are understood, we will not be able to solve the problem.

How High is Unemployment?

Before we can even start looking at causes or solutions, we have to understand what the current level of unemployment really is, and what the trends portend for the future.

Let's use America as an example. With the largest economy in the world, it has often been said that "when America sneezes, the rest of the world catches cold". And much of the rest of the world has adopted the "Washington Consensus" – America's neoliberal view of economics.[2] Moreover, the rest of the world has been infected by many types of "toxic assets" invented in America, such as credit default swap derivatives[3], as well as Wall Street style banking strategies. So I will use the United States has a case example, but will also touch on global trends.

Official figures put unemployment in the United States somewhere between 9 and 10 percent. But the official figures use a very different measure for unemployment than was used during the Great Depression and for many decades afterwards.

Specifically, the official unemployment reports of the Department of Labor's Bureau of Labor Statistics (BLS) provide conventional "U-3" figures and various alternative measures including "U-6". [4]

For example, as of December 2008, U-3 unemployment was 7.2 percent, while U-6 was 13.5 percent. [5]

U-6 is actually more accurate, because it includes those who would like full-time work, but can only find part-time work, or have given up looking for work altogether.

As can be seen by the December 2008 figures, U-6 unemployment rate can almost double the more commonly-cited U-3 figures.

But those in the know argue that the real rate is actually even higher than the U-6 figures.

For example, Paul Craig Roberts [6] – former Assistant Secretary of the Treasury and former editor of the Wall Street Journal – and economist John Williams both said in December 2008 that – if the unemployment rate was calculated as it was during the Great Depression – the December 2008 unemployment figure would actually have been 17.5%.

Williams says [7] that unemployment figures for July 2009 rose to 20.6% [8].

According to an article [9] summarizing the projections of former International Monetary Fund Chief Economist and Harvard University Economics Professor Kenneth Rogoff and University of Maryland Economics Professor Carmen Reinhart, U-6 unemployment could rise to 22% within the next 4 years or so.

As the New York Times pointed out in July[10] :

> Include [those who have given up looking for a job and those part-time workers who want to be working full time] — as the Labor Department does when calculating its broadest measure of the job market — and the rate reached 23.5 percent in Oregon this spring, according to a New York Times analysis of state-by-state data. It was 21.5 percent in both Michigan and Rhode Island and 20.3 percent in California. In Tennessee, Nevada and several other states that have relied heavily on manufacturing or housing, the rate was just under 20 percent this spring and may have since surpassed it.

Indeed, the chief of the Atlanta Federal Reserve Bank -Dennis Lockhart – said in August 2009:

> If one considers the people who would like a job but have stopped looking — so-called discouraged workers — and those who are working fewer hours than they want, the unemployment rate would move from the official 9.4 percent to 16 percent. [11]

Former Labor Secretary Robert Reich notes:

> Over the past three months annual wage growth has plummeted to just 0.7%. At the same time, furloughs — requiring workers to take unpaid vacations — are on the rise: recent surveys show 17% of companies imposing them. [12]

Temporary employment is still falling as well. [13]

And economist David Rosenberg points out:

> 65% of companies are still in the process of cutting their staff loads…
>
> The Bureau of Labor Statistics also publishes a number from the Household survey that is comparable to the nonfarm survey (dubbed the population and payroll-adjusted Household number), and on this basis, employment sank — brace yourself — by over 1 million, which is unprecedented…[14]

In addition to the failure of official BLS unemployment figures to take into account discouraged and underemployed workers, many analysts argue that BLS' "Birth-Death Model" severely understates unemployment during recessions. [15]

Many people – including economists and financial reporters – say that unemployment is much lower than it was during the Great Depression. What they mean when they say that is that current U-3 figures in America are under 10%, while unemployment hit 25% during the Great Depression.

But most people forget that the worst unemployment numbers during the Great Depression did not occur until years after the initial 1929 crash . Specifically, unemployment did not hit 25% until at least 3 years after the start of the Depression.[16]

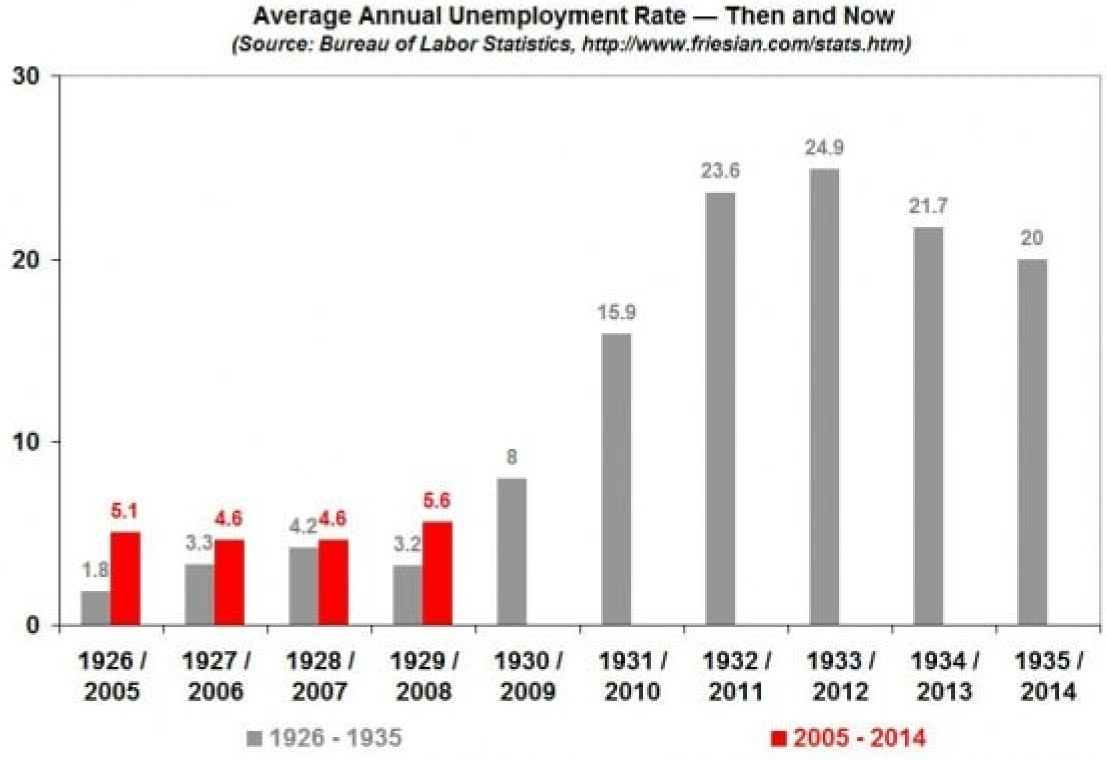
As of this writing (2009), we are only a year into the current economic crisis. Therefore, we have at least 2 more years to go until we hit the same period that unemployment peaked during the Great Depression.

Indeed, former Secretary of Labor Robert Reich wrote in April that the unemployment figures show that we are already in a depression.[17]

And Chris Tilly – director of the Institute for Research on Labor and Employment at UCLA – points out that some populations, such as African-Americans and high school dropouts, have been hit much harder than other populations, and that these groups are already experiencing depression-level unemployment.[18]

Assuming that Williams, Roberts or Lockhart's calculations of unemployment are correct (using the same methods of measuring unemployment as were used during the Great Depression), and depending on when we deem the current crisis to have commenced, then – as shown by the following charts – unemployment percentages may actually be worse than they were during a comparable period in the Great Depression:

[19 and 20]



[21]

We also know that, in terms of total numbers of unemployment people (as opposed to percentages), more people will be unemployed than during the Great Depression. [22]

What Are the Unemployment Trends?

If unemployment is anywhere near as bad as during a comparable period during the Great Depression, the obvious question is where the trends are heading.

It is well known among economists that unemployment is a "lagging" indicator. [23] In other words, there is a lag time. When the economy hits a rough patch, the economic weakness will not show up in the unemployment numbers until several months or years later.

For example, as Europe's largest bank – RBS – warns:

> Even if the economy starts to turn up the headwinds will be formidable," [the company's CEO] warned. "**The green shoots are short in duration and you need to be cautious about interpreting them**. Even if growth returns, unemployment will rise for some time afterwards …[24]

Because of the lag time between conditions in the economy and unemployment, we have to ask the following two questions in order to forecast future unemployment trends:

1) How bad were conditions in 2008 and early 2009?

and

2) What will economic conditions be like in the future?

How Bad Did It Get?

Unfortunately, many experts – including the following people – have said that the economic crisis which started in 2008 could be worse than the Great Depression:

- Federal Reserve chairman Ben Bernanke said on July 26, 2009:

  > A lot of things happened, a lot came together, [and] created probably the worst financial crisis, certainly since the Great Depression and possibly even including the Great Depression. [25]

- Economics professors Barry Eichengreen and and Kevin H. O'Rourke said that world-wide conditions are worse than during a comparable period during the Great Depression [26] (updated in June 2009 [27])
- Investment advisor, risk expert and bestselling author Nassim Nicholas Taleb said that the current crisis could be "vastly worse" than the Great Depression [28]
- Former Fed Chairman Paul Volcker believes the current crisis may be even worse than the Depression [29]
- Nobel prize winning economist Joseph Stiglitz said "this is worse than the Great Depression" [30]

- Economics scholar and former Federal Reserve Governor Frederick Mishkin said that conditions were worse than during the Depression [31]

- Well-known PhD economist PhD Economist Marc Faber believes this could be far worse than the Great Depression[32]

- Former Goldman Sachs chairman John Whitehead thinks that the current slump is worse than the Depression [33]

- Morgan Stanley's UK equity strategist Graham Secker predicts economic collapse worse than the Great Depression [34]

- Former chief credit officer at Fannie Mae Edward J. Pinto said in January 2009 that the current housing crisis was worse than the Depression, and that current efforts to rescue the mortgage industry are less successful than those used during the 1930s. [35]

- Billionaire investor George Soros said in February 2009 that the current economic turbulence is actually more severe than during the Great Depression, comparing the current situation to the demise of the Soviet Union. [36]

What Will Economic Conditions Be Like In the Future?

As of this writing, the fact that unemployment will substantially increase is quite controversial. Most people still assume that the benefits of the government's policies will soon kick in, the economy will recover, and then jobs will recover soon afterwards.

In order to accurately determine how bad general economic conditions – and thus unemployment – might be in the future, it is necessary to look at a variety of trends, including residential real estate, commercial real estate, toxic assets held by banks, loan loss rates, consumer spending, age demographics, the decline in manufacturing, and destruction of credit.

Residential Real Estate

Citigroup is projecting that unemployment in Spain will rise from its current 17.9% to 22% next year. [37]

Spain's unemployment is largely driven by the bursting of its housing bubble. [38]

Housing bubbles are now bursting in China [39], France [40], Spain [41], Ireland [42], the United Kingdom [43], Eastern Europe [44], and many other regions. [45]

(And unemployment in Japan is apparently at the highest level since the government began collecting the data in 1953, a year after the U.S. military occupation ended.)[46]

Unfortunately, while the peak in subprime mortgages is behind us, many analysts say that Alt-A mortgage defaults have not yet occurred (as of this writing), but will not peak until 2010.[47]

Indeed, the crash in real estate and rising unemployment together form a negative feedback loop. As McClatchy notes, foreclosures rise as jobs and income drop. [48]

Former chief IMF economist Simon Johnson notes that a vicious cycle also exists between unemployment and property foreclosures:

> Unemployment is always a lagging indicator, and given the record low number of average hours worked, it will turn around especially slowly this time. Until then, people will continue to lose their jobs and wages will remain flat, and any small rebound in housing prices is unlikely to help more than a few people refinance their way out of unaffordable mortgages. So unless the other part of the equation – monthly payments – changes, the number of foreclosures should just continue to rise.[49]

Indeed, the Washington Post notes:

> The country's growing unemployment is overtaking subprime mortgages as the main driver of foreclosures, according to bankers and economists, threatening to send even higher the number of borrowers who will lose their homes and making the foreclosure crisis far more complicated to unwind. [50]

Commercial Real Estate

Moreover, a **crash in commercial real estate is now picking up speed. Unlike** the subprime mortgage meltdown – which affected mainly the biggest banks – the commercial meltdown will apparently affect a huge number of small to medium-sized banks. [51]

On August 11, 2009, the Congressional Oversight Panel on the bailouts issued a report saying that small and medium sized banks are especially vulnerable, the report will say, in part they hold greater numbers of commercial real estate loans, "which pose a potential threat of high defaults." [52]

That could spell real trouble for employment by small businesses since (1) smaller institutions are disproportionately responsible for providing credit to small businesses [53], (2) credit is essential for many small businesses, (3) commercial real estate is crashing even faster than residential [54], and (4) industry experts forecast that the commercial real estate market won't bottom out for three more years.[55]

Indeed, largely because of the commercial real estate crash, the FDIC expects 500 banks to fail in the coming months. [56]

Unfortunately, the crash in commercial real estate is occurring world-wide. [57]

Toxic Assets

The Congressional Oversight Panel report also says that banks remain threatened by billions of dollars of bad loans on their balance sheets, more could fail if the economy worsens, and that – if unemployment rises sharply or the commercial real estate market collapses – the banking system could again crash:

> The financial system [still remains] vulnerable to the crisis conditions that [the

> bailout] was meant to fix…
>
> Financial stability remains at risk if the underlying problem of toxic assets remains unresolved.[58]

As Reuters notes:

> The chairman of the congressional oversight panel, Elizabeth Warren, said no one even knows the value of the toxic assets still on banks' books…
>
> "No one has a good handle how much is out there," Warren said. "Here we are 10 months into this crisis…and we can't tell you what the dollar value is."[59]

Loan Loss Rates

Loan loss rates in could also be worse than the Great Depression, at least in the United States. Specifically, during the depths of the Great Depression, the loss rate which banks suffered on their loans climbed as high as 3.4% (it is normally well under 2.0%).[60]

Last month, banking analyst Mike Mayo predicted that loan loss rates could go as high as 5.5%, which is substantially higher than during the 1930s.[61]

But the Federal Reserve's more adverse scenario for the stress tests – which everyone knows is too rosy concerning most of its assumptions – predicts a loan loss rate of 9.1%, nearly three times higher than during the 1930s.[62]

As US News and World Report wrote in May 2009:

> For most of the past 50 years, the loss rate on all bank loans has stayed well under 2 percent. The Fed estimates that over the next two years the loss rate could reach 9.1 percent. You know all those historical comparisons that end with "the worst since the Great Depression"? Well, 9.1 percent would be EVEN WORSE than during the 1930s. Still looking forward to a soft landing or a quick recovery?[63]

Consumer Spending

Consumer spending accounts for the vast majority of the economy in the United States. The figure commonly cited is that consumer spending accounts for 70% of U.S. Gross Domestic Product. [64]. (Consumer spending has been a lower percentage of GDP in most other countries. [65])

But the economic crisis is driving consumer spending downward. Economist David Rosenberg [66] says that consumers have undergone a generational shift in spending habits, and will be frugal for a long time to come.[67]

The head of Collective Brands, Matthew Rubel, states:

> Consumer spending as a percentage of GDP has moved down, will probably continue to move down through the end of year, and then normalize as we get

> into somewhere in early-to-mid next year, from our point of view.[68]

The chief economist of IHS Global Insight, Nariman Behravesh, says consumer spending will decline to 65 percent of GDP:

> With individuals more focused on saving than spending, Behravesh said retail consumer spending as a percentage of GDP is likely to fall from 70 percent to 65 percent. “It will take a while, maybe 10 years,” he said. “Correspondingly other countries are going to have to shift in the opposite direction to rely more on their own consumers rather than the U.S. consumers.”[69]

Jason DeSena Trennert, Chief Investment Strategist for Strategas Research Partners, says:

> Consumer spending as a percentage of GDP is going to go in one direction for a long time — lower.[70]

Time points out :

> Economist Stephen Roach, chairman of Morgan Stanley Asia, says that “there is good reason to believe the capitulation of the American consumer has only just begun.” U.S. consumer spending as a percentage of GDP reached 72% in 2007, well above the pre-bubble norm of 67%. Using that as a gauge, Roach says that only 20% of the potential retrenchment of spending has taken place, even after the dramatic decline at the end of 2008. “The imbalance that contributed to the crisis — overconsumption and excessive savings — cannot continue,” says Ajay Chhibber, director of the Asia bureau at the United Nations Development Program in New York City. “The model where you stimulate and [then] go back to the old days is gone.”[71]

The Wall Street Journal notes:

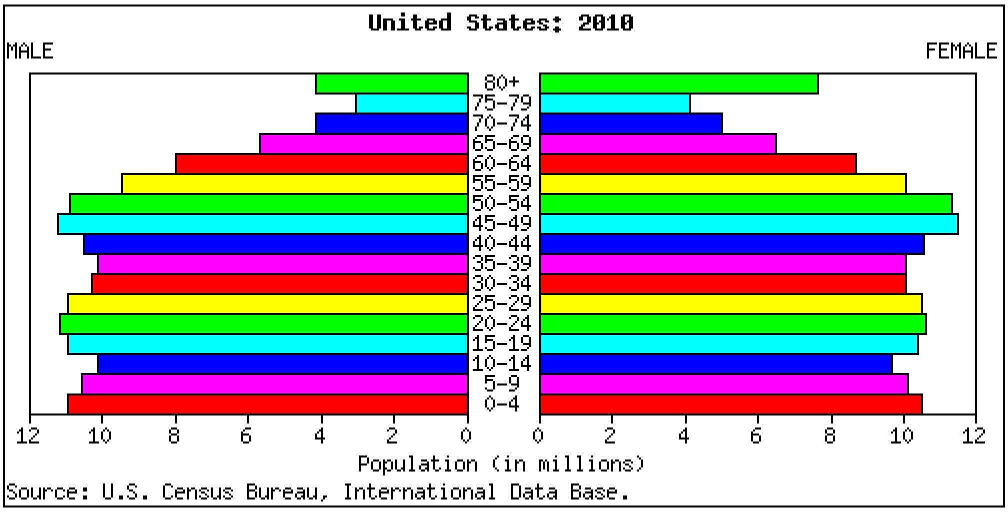
> “Economists also see an upturn in U.S. household saving as the beginning of a prolonged period of thrift…..”[72]

Demographics

Financial analysts who have studied U.S. demographics – like Harry Dent and Claus Vogt – point out that the U.S. population is aging:

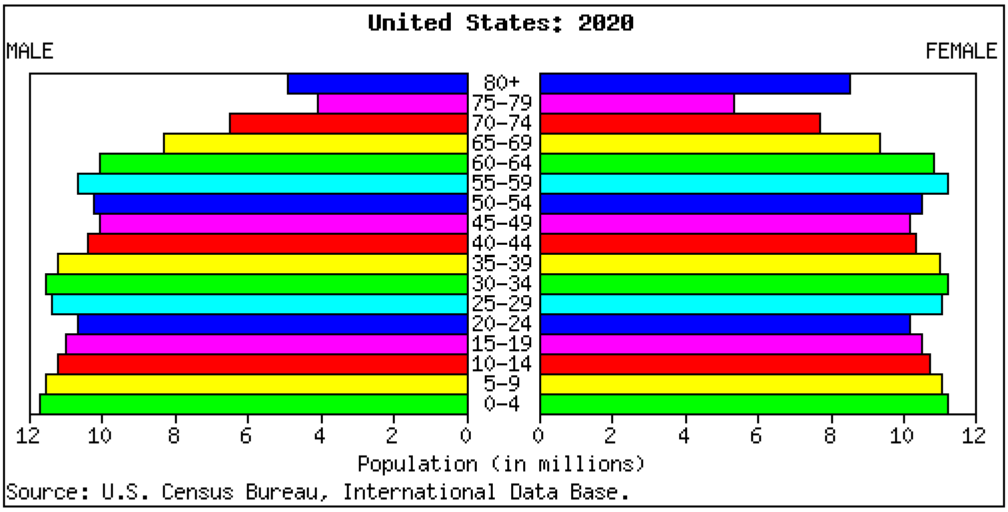
United States Population Pyramid for 2010

Predicted age and sex distribution for the year 2010:



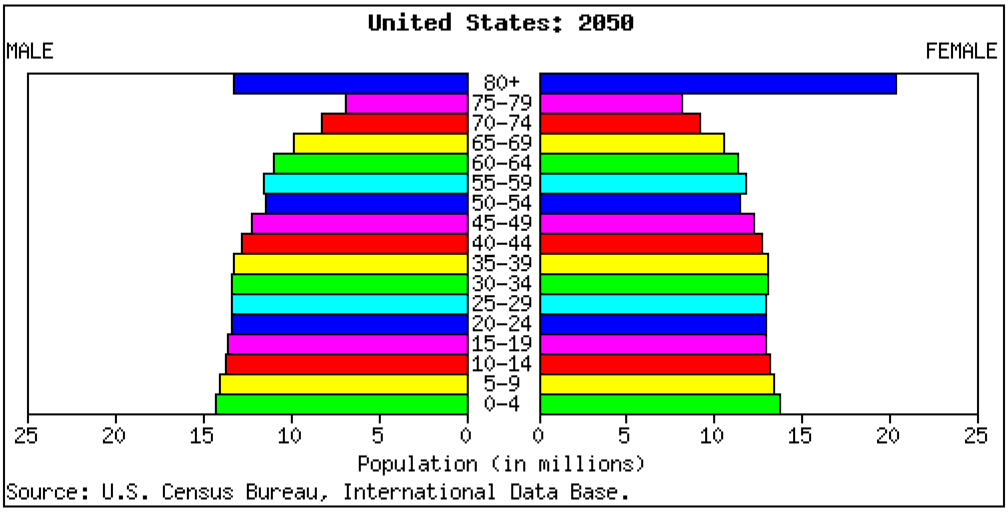
United States Population Pyramid for 2020

Predicted age and sex distribution for the year 2020:



United States Population Pyramid for 2050

Predicted age and sex distribution for the year 2050:



[73]

Vogt argues that an aging population within a given nation is correlated with a decline in that country's economy. [74]. Certainly, a population with less working-age people and more dependent elderly people will experience a drag on its economy.

Dent argues that one of the main drivers of a country's economic growth is the number of people in the country who are in their peak spending years.

For example, Dent says that in the U.S., 45-54 year olds are the biggest spenders, because that is when – on average – they are paying for their kids' college, paying mortgage on the biggest house they will own during their life, etc. Dent argues that the American economy will tend to grow when the number of 45-54 year olds grows, and to shrink when it shrinks.

As the charts above show, the number of 45-54 year olds in the U.S. will shrink considerably in the year ahead.

Decline in Manufacturing

As everyone knows, the manufacturing has shrunk in the United States and the service sector has grown. Even in a manufacturing center such as Detroit, manufacturing jobs have been declining for decades:

[75]

Indeed, according to professor of economics Dr. Mark J. Perry, manufacturing jobs have dropped to their lowest level since 1941, and are now below 9% of the workforce for the first time. [76]

Wayne State University's Center for Urban Studies argues:

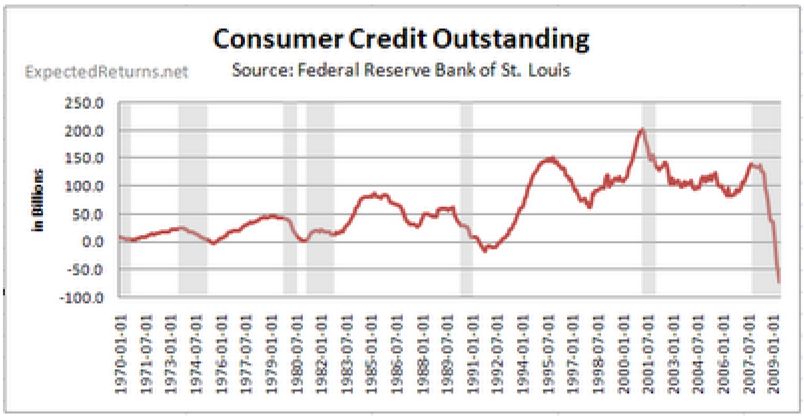
> For each job lost in the manufacturing industry, more spinoff jobs are lost than would be in other sectors. Each manufacturing job helps support a larger number of other jobs than do most other sectors. [77]

That means that the ongoing reduction in manufacturing jobs will adversely affect unemployment for the foreseeable future.

Destruction of Credit

The amount of credit outstanding has been reduced by trillions of dollars in the past year.

For example, the amount of consumer credit outstanding has plummeted:



Banks have become tight-fisted about lending, and this will probably not change any time soon. As the New York Times wrote in an article from October 2008 entitled “Banks Are Likely to Hold Tight to Bailout Money”:

> “Will lenders deploy their new-found capital quickly, as the Treasury hopes, and unlock the flow of credit through the economy? Or will they hoard the money to protect themselves?
>
> John A. Thain, the chief executive of Merrill Lynch, said on Thursday that banks were unlikely to act swiftly. Executives at other banks privately expressed a similar view.
>
> ‘We will have the opportunity to redeploy that,’ Mr. Thain said of the new capital on a telephone call with analysts. ‘But at least for the next quarter, it’s just going to be a cushion.’
>
> ***
>
> Lenders have been pulling back on credit lines for businesses, mortgages, home equity loans and credit card offers, and analysts said that trend was unlikely to be reversed by the government’s money.
>
> Roger Freeman, an analyst at Barclays Capital, which acquired parts of the now-bankrupt Lehman Brothers last month [said] ‘My expectation is it’s quarters off, not months off, before you see that capital being put to work.’ ”[78]

And another New York Times article included the following quote:

> “It doesn’t matter how much Hank Paulson gives us,” said an influential senior official at a big bank that received money from the government, “no one is going to lend a nickel until the economy turns.” The official added: “Who are we going to lend money to?” before repeating an old saw about banking: “Only people who don’t need it.”[79]

Reading between the lines, the bank officials are saying that they will not lend freely until the economic crisis is over.

As WLMLab Bank Loan Performance points out, outstanding loans in the United States have dropped $110 billion dollars quarter-over-quarter. [80]

McClatchy notes:

> Over the course of 2008, the nation’s five largest banks reduced their consumer loans by 79 percent, real estate loans by 66 percent and commercial loans by 19 percent, according to FDIC data. A wide range of credit measures, including recent FDIC data, show that lending remains depressed.[81]

The Telegraph writes:

> US credit shrinks at Great Depression rate prompting fears of double-dip recession…

> Professor Tim Congdon from International Monetary Research said US bank loans have fallen at an annual pace of almost 14pc in the three months to August (from $7,147bn to $6,886bn).
>
> "There has been nothing like this in the USA since the 1930s," he said. "The rapid destruction of money balances is madness."
>
> The M3 "broad" money supply, watched as an early warning signal for the economy a year or so later, has been falling at a 5pc annual rate.
>
> Similar concerns have been raised by David Rosenberg, chief strategist at Gluskin Sheff, who said that over the four weeks up to August 24, bank credit shrank at an "epic" 9pc annual pace, the M2 money supply shrank at 12.2pc and M1 shrank at 6.5pc…
>
> US banks are cutting lending by around 1pc a month. A similar process is occurring in the eurozone, where private sector credit has been contracting and M3 has been flat for almost a year.

[82]

Indeed, total seasonally adjusted consumer debt fell $21.55 billion, or at a 10.4% annual rate, in July 2009 alone. credit-card debt fell $6.11 billion, or 8.5%, to $905.58 billion. This is the record 11th straight monthly drop in credit card debt. Non-revolving credit, such as auto loans, personal loans and student loans fell a record $15.44 billion or 11.7% to $1.57 trillion [83]

In addition, the securitization market has largely collapsed, which in turn has destroyed a large proportion of the world's credit. As noted in an article in the Washington Times:

> "Before last fall's financial crisis, banks provided only $8 trillion of the roughly $25 trillion in loans outstanding in the United States, while traditional bond markets provided another $7 trillion, according to the Federal Reserve. The largest share of the borrowed funds – $10 trillion – came from securitized loan markets that barely existed two decades ago. . . .
>
> Mr. Regalia [chief economist at the U.S. Chamber of Commerce] said … 70 percent of the system isn't there anymore,' he said."[84]

The reason that seventy percent of the system "isn't there anymore" is because the traditional bond markets and securitized loan markets (part of the "shadow banking system") have dried up. As the Washington Times article notes:

> "Congress' demand that banks fill in for collapsed securities markets poses a dilemma for the banks, not only because most do not have the capacity to ramp up to such large-scale lending quickly. The securitized loan markets provided an essential part of the machinery that enabled banks to lend in the first place. By selling most of their portfolios of mortgages, business and consumer loans to investors, banks in the past freed up money to make new loans. . . .
>
> "The market for pooled subprime loans, known as collateralized debt obligations (CDOs), collapsed at the end of 2007 and, by most accounts, will never come back. Because of the surging defaults on subprime and other exotic mortgages, investors have shied away from buying the loans, forcing

> banks and Wall Street firms to hold them on their books and take the losses."

Senior economic adviser for UBS Investment Bank, George Magnus, confirms:

> The restoration of normal credit creation should not be expected, until the economy has adjusted to the disappearance of shadow bank credit, and until banks have created the capacity to resume lending to creditworthy borrowers. This is still about capital adequacy, where better signs of organic capital creation are welcome. More importantly now though, it is about poor asset quality, especially as defaults and loan losses rise into 2010 from already elevated levels.[85]

And McClatchy writes:

> The foundation of U.S. credit expansion for the past 20 years is in ruin. Since the 1980s, banks haven't kept loans on their balance sheets; instead, they sold them into a secondary market, where they were pooled for sale to investors as securities. The process, called securitization, fueled a rapid expansion of credit to consumers and businesses. By passing their loans on to investors, banks were freed to lend more.
>
> Today, securitization is all but dead. Investors have little appetite for risky securities. Few buyers want a security based on pools of mortgages, car loans, student loans and the like.
>
> "The basis of revival of the system along the line of what previously existed doesn't exist. The foundation that was supposed to be there for the revival (of the economy) . . . got washed away," [economist James K.] Galbraith said.
>
> Unless and until securitization rebounds, it will be hard for banks to resume robust lending because they're stuck with loans on their books.[86]

Not only has the supply of credit been destroyed, but the demand for many types of loans – such as commercial real estate loans – is also drying up.[87]

So there is simply much less credit flowing through the economic system than there was prior to 2007.

The New Normal – Lower Economic Activity

As chief economist for the International Monetary Fund, Olivier Blanchard, said:

> This recession has been so destructive that "we may not go back to the old growth path … potential output may be lower than it was before the crisis." [88]

All of the above trends force many economists to conclude that economic activity as a whole will be lower for many, many years. In other words, they say that "The New Normal" will be a much lower level for the economy.

Pimco CEO Mohamed El-Erian says elevated unemployment and record wealth destruction will keep growth at 2 percent or less for years. [89]

As Bloomberg writes:

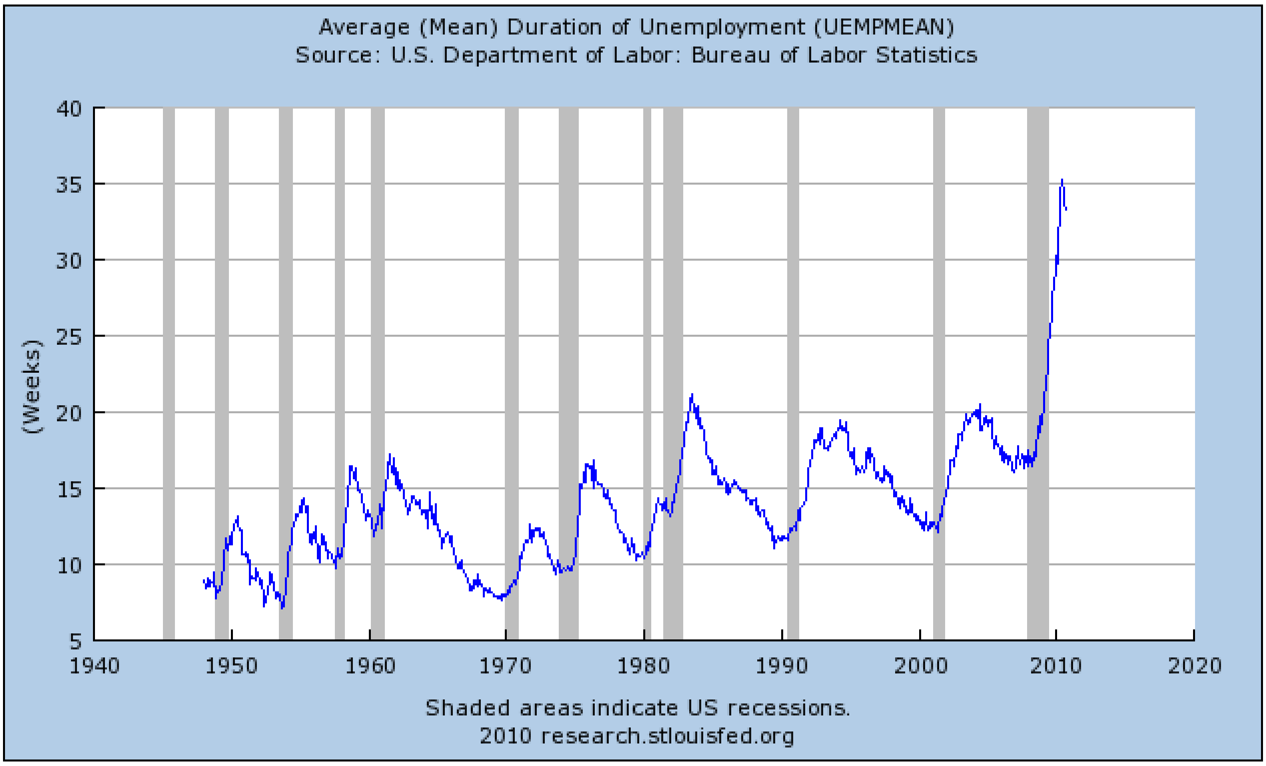
> The New Normal theory predicts that the recession will leave unemployment, forecast to reach 10 percent for the first time since 1983 early next year, higher for years. [90]

Indeed, the "overhang" of inventory [91]- that is, the inventory of unsold goods – in everything from housing [92 and 93] to cars [94] to consumer electronics [95] means that the newly reduced consumer demand is meeting up with very high levels of supply. [96 – Indeed, entire fleets of cargo ships are sitting empty because of slack demand] This is a recipe for unemployment.

Many economists also point out that the length of time people are remaining unemployed is skyrocketing. As the Washington Post notes:

> Another disturbing development was that the number of people out of work for 27 weeks or longer reached a record 5 million, accounting for a third of the unemployed. That suggests to some economists that those job losses were caused by structural changes in the economy and that many of those people won't be called back to work once the economy picks up. The longer people are out of work, the harder it becomes for them to find jobs and the more likely they are to exhaust savings or lose their homes to foreclosure. [97]

The following chart from the St. Louis Federal Reserve Bank shows that people are staying unemployed much longer than they have in any previous economic downturn since 1950:



[98]

As David Rosenberg writes:

> The number of people not on temporary layoff surged 220,000 in August and the level continues to reach new highs, now at 8.1 million. This accounts for 53.9% of the unemployed — again a record high — and this is a proxy for permanent job loss, in other words, these jobs are not coming back. Against that backdrop, the number of people who have been looking for a job for at least six months with no success rose a further half-percent in August, to stand at 5 million — the long-term unemployed now represent a record 33% of the total pool of joblessness. [99]

[100: for graphical updates on the state of the economy, see charts from the Cleveland Federal Reserve Bank posted at http://www.clevelandfed.org/research/data/updates/index.cfm?DCS.nav=Local]

Other Theories Regarding the Causes of Unemployment

The main cause of unemployment today is the economic crisis. For example, a report from the the National Industrial Conference Board pointed out in 1922 stated the obvious: depressions increase unemployment. [101]

The report also points out that seasonal variations, "immigration and tariff policies and international relationship" can affect unemployment figures. [102]

In fact, economists from different schools of thought ascribe different causes to unemployment. For example:

> Keynesian economics emphasizes unemployment resulting from insufficient effective demand for goods and services in the economy (cyclical unemployment). Others point to structural problems, inefficiencies, inherent in labour markets (structural unemployment). Classical or neoclassical economics tends to reject these explanations, and focuses more on rigidities imposed on the labor market from the outside, such as minimum wage laws, taxes, and other regulations that may discourage the hiring of workers (classical unemployment). Yet others see unemployment as largely due to voluntary choices by the unemployed (frictional unemployment). Alternatively, some blame unemployment on disruptive technologies or Globalisation.

[103 and 104]

For example, many Americans believe that globalization has increased unemployment because "American jobs" have moved abroad. Certainly, the American government has encouraged multinational corporations based in the U.S. to move jobs overseas. But quick fixes may lead to new problems. For example, a new American protectionism could stifle trade, further weakening the American economy.

Similarly, some economists believe that inflation decreases unemployment. However, that is only true where the workers drastically underestimate the extent to which higher prices are decreasing the real value of their wages. Indeed, as the Cato Institute notes:

> This reduction in unemployment cannot occur unless workers systematically underestimate the inflation rate. When workers are aware of the inflation rate and, for example, have their pay adjusted according to the cost of living, they will interpret wages properly and not be misled into thinking that a normal wage offer is a relatively high wage offer.

Rather than merely failing to decrease unemployment, inflation may actually increase the unemployment rate. Frequent concomitants of inflation, such as high interest rates and volatility and uncertainty in the financial and product markets, increase the risks inherent in business operations and thereby discourage the expansion of firms and the creation of jobs. [105]

Therefore, many “quick fixes” for unemployment may actually do more harm than good.

Isn’t the Government Helping to Reduce Unemployment?

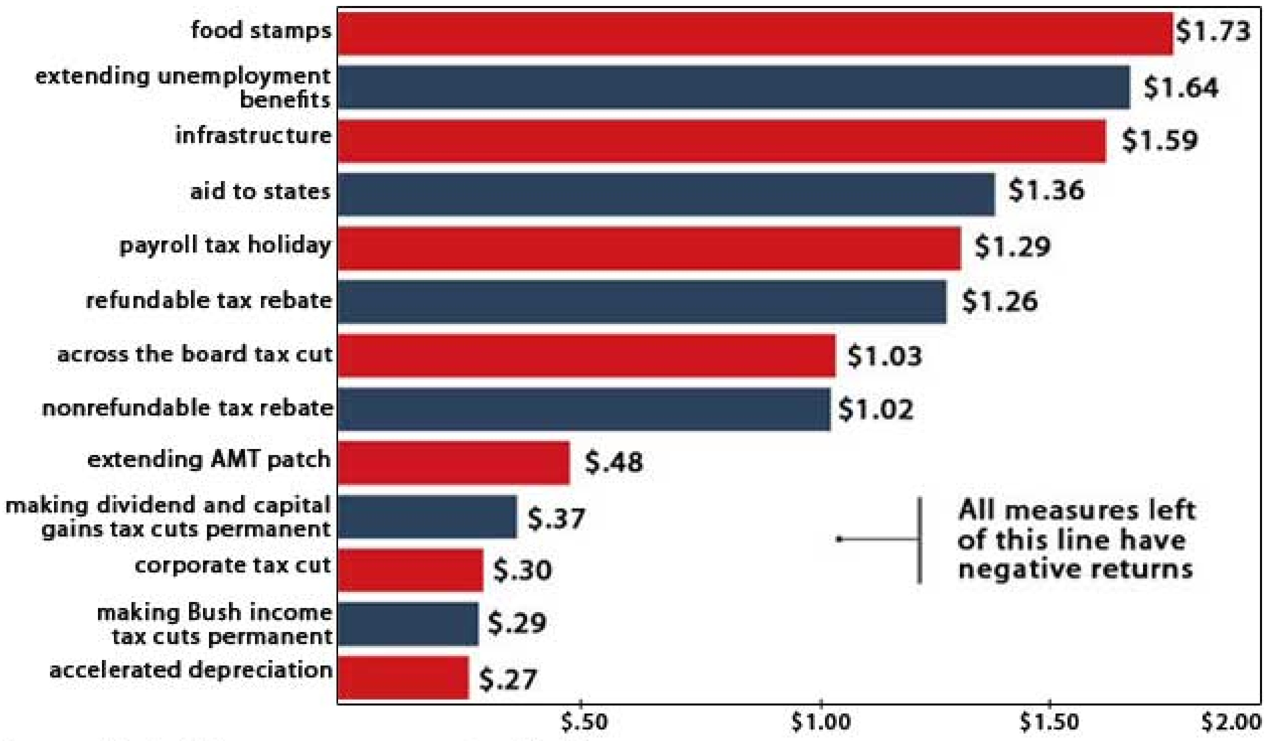
The government has committed to give trillions to the financial industry. President Obama’s stimulus bill was $787 billion, which is less than a tenth of the money pledged to the banks and the financial system. [106]

Of the $787 billion, little more than perhaps 10% has been spent as of this writing. [107]

The Government Accountability Office says that the $787 billion stimulus package is not being used for stimulus. [108] Instead, the states are in such dire financial straights that the stimulus money is instead being used to “cushion” state budgets, prevent teacher layoffs, make more Medicaid payments and head off other fiscal problems. So even the money which is actually earmarked to help the states stimulate their economies is not being used for that purpose.

Indeed, much of the $787 billion was earmarked pork [109], not for anything which could actually stimulate the economy. [110]

Mark Zandi – chief economist for Moody’s – has calculated which stimulus programs give the most bang for the buck in terms of the economy:



Source: Moody’s Economy.com; congressional testimony

[111]

But very little of the stimulus funds are actually going to high-value stimulus projects.

Indeed, as the Los Angeles Times points out:

> Critics say the [stimulus money reaching California] is being used for projects that would have been built anyway, instead of on ways to change how Californians live. Case in point: Army latrines, not high-speed rail.
>
> ***
> Critics say those aren't the types of projects with lasting effects on the economy.
>
> "Whether it's talking about building a new [military] hospital or bachelor's quarters, there isn't that return on investment that you'd find on something that increases efficiency like a road or transit project," said Ellis of Taxpayers for Common Sense.
>
> Job creation is another question. A recent survey by the Associated General Contractors of America found that slightly more than one-third of the companies awarded stimulus projects planned to hire new employees. But about one-third of the companies that weren't awarded stimulus projects also planned to hire new employees.
>
> "While the construction portion of the stimulus is having an impact, it is far from delivering its full promise and potential," said Stephen E. Sandherr, chief executive of the contractors group.
>
> It's unclear how many jobs will be created through the Defense Department projects. Most of the construction jobs are awarded through multiple award contracts, in which the department guarantees a minimum amount of business to certain contractors, and lets only those contractors bid on projects.
>
> That means many of the contractors working on stimulus projects already have been busy at work on government projects.even the stimulus money which is being spent [112]

David Rosenberg writes:

> Our advice to the Obama team would be to create and nurture a fiscal backdrop that tackles this jobs crisis with some permanent solutions rather than recurring populist short-term fiscal goodies that are only inducing households to add to their burdensome debt loads with no long-term multiplier impacts. The problem is not that we have an insufficient number of vehicles on the road or homes on the market; the problem is that we have insufficient labour demand.[113]

Donald W. Riegle Jr. – former chair of the Senate Banking Committee from 1989 to 1994 – wrote (along with the former CEO of AT&T Broadband and the international president of the United Steelworkers union):

> It's almost as if the administration is opting for a rose-colored-glasses PR strategy rather than taking a hard-nose look at actual consumer and employment figures and their trends, and modifying its economic policies accordingly.[114]

How Much Unemployment Do We Want?

On the one end of the spectrum, Article 23 of the United Nations' Universal Declaration of Human Rights declares:

> Everyone has the right to work, to free choice of employment, to just and favourable conditions of work and to protection against unemployment.[115]

In other words, the U.N. says that there should be essentially no unemployment for those who wish to work.

On the other end of the spectrum, some people – who make a lot of money during periods where the condition lead to high levels of unemployment – are comfortable with unemployment percentages reaching those in the Great Depression.

Societies should decide for themselves what level of unemployment they consider acceptable, and then demand policies which will accomplish that goal to the greatest extent possible. As discussed above, there are many factors which affect employment levels, and so solutions are complicated.

However, without an open and visible public policy debate about the issue, unemployment levels will either remain second order affects of policy choices concerning other elements of the economy, or will be decided behind closed doors by decision-makers who may or may not have the best public interest in mind.

Public Funding

As the above facts show, unemployment is a very serious problem in the United states, and world-wide. The policy responses of the U.S. and other Western governments has not been working. As discussed above, there is no simple solution.

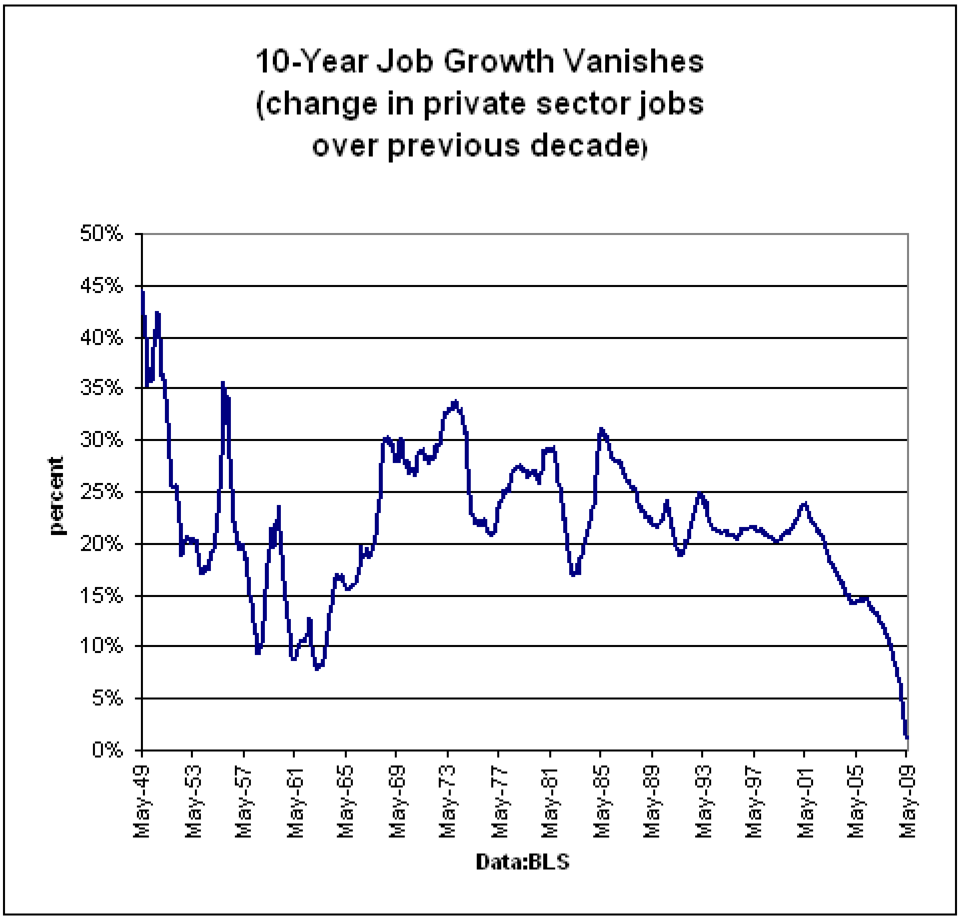
Senator Riegle recommends a 4-part prescription, including:

> Ensure that loans and credit facilities are readily available to the nation's small and medium size businesses and manufacturers.

Many of the top economists argue that we need to break up the giant banks which are insolvent in order to save the economy.[116] Fortune[117], BusinessWeek[118] and Federal Reserve governor Daniel K. Tarullo[119] have pointed out that breaking up the largest, insolvent banks would allow more competition from small to mid-size banks, and that such banks may actually make more loans to small businesses. More loans to small businesses would lead to more employment by those many small businesses.

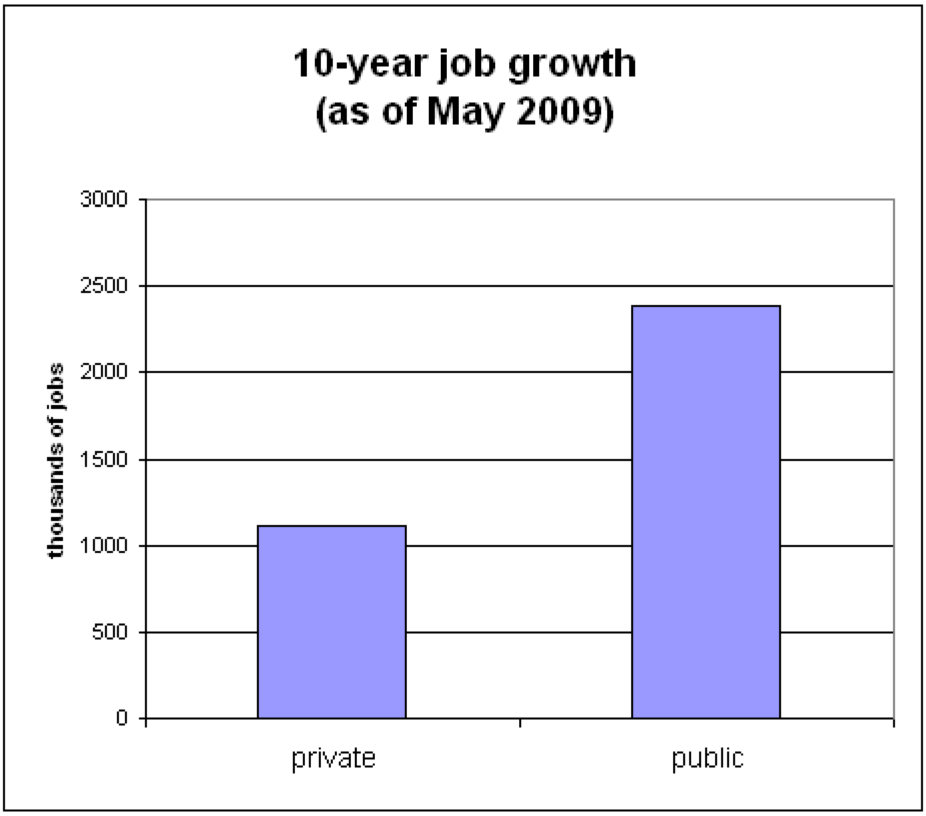
In addition, the U.S. has largely been financing job creation for ten years. Specifically, as the chief economist for BusinessWeek, Michael Mandel, points out, public spending has accounted for virtually all new job creation in the past 1o years:

> Private sector job growth was almost non-existent over the past ten years. Take a look at this horrifying chart:



Between May 1999 and May 2009, employment in the private sector sector only rose by 1.1%, by far the lowest 10-year increase in the post-depression period.

It's impossible to overstate how bad this is. Basically speaking, the private sector job machine has almost completely stalled over the past ten years. Take a look at this chart:



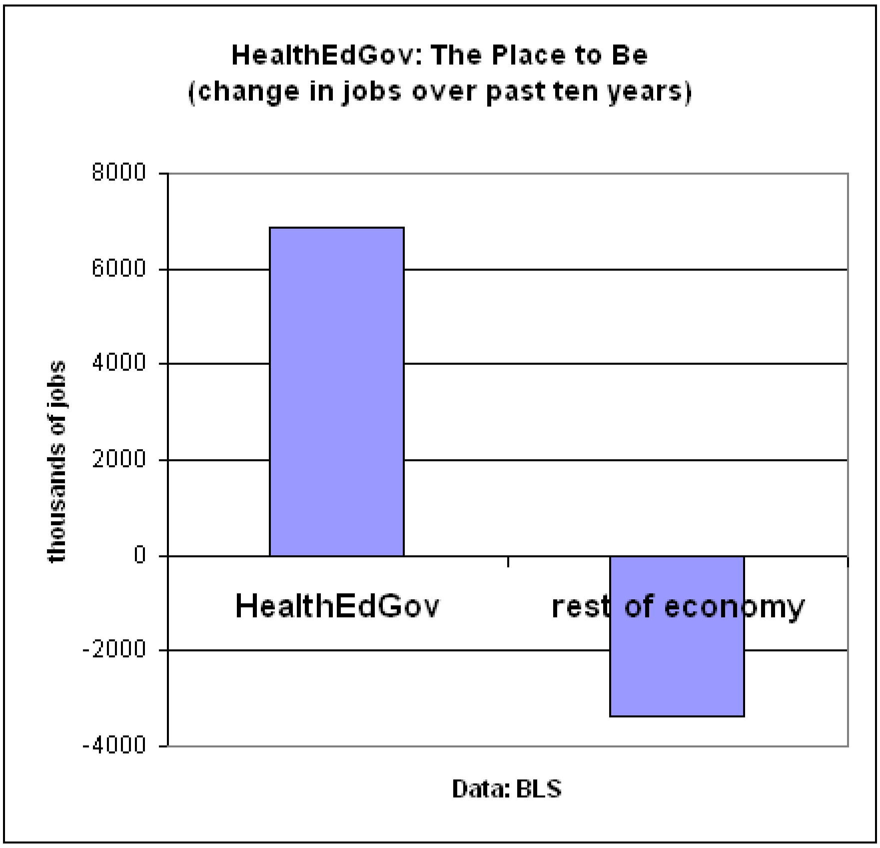
Over the past 10 years, the private sector has generated roughly 1.1 million additional jobs, or about 100K per year. The public sector created about 2.4 million jobs.

But even that gives the private sector too much credit. Remember that the private sector includes health care, social assistance, and education, all areas which receive a lot of government support.

***

Most of the industries which had positive job growth over the past ten years were in the HealthEdGov sector. In fact, financial job growth was nearly nonexistent once we take out the health insurers.

Let me finish with a final chart.



Without a decade of growing government support from rising health and education spending and soaring budget deficits, the labor market would have been flat on its back. [120]

Raw Story argues that the U.S. is building a largely military economy:

The use of the military-industrial complex as a quick, if dubious, way of jump-starting the economy is nothing new, but what is amazing is the divergence between the military economy and the civilian economy, as shown by this New York Times chart.

In the past nine years, non-industrial production in the US has declined by some 19 percent. It took about four years for manufacturing to return to levels seen before the 2001 recession — and all those gains were wiped out in the current recession.

> By contrast, military manufacturing is now 123 percent greater than it was in 2000 — it has more than doubled while the rest of the manufacturing sector has been shrinking…
>
> It's important to note the trajectory — the military economy is nearly three times as large, proportionally to the rest of the economy, as it was at the beginning of the Bush administration. And it is the only manufacturing sector showing any growth. Extrapolate that trend, and what do you get?
>
> The change in leadership in Washington does not appear to be abating that trend…[121]

So most of the job creation has been by the public sector. But because the job creation has been financed with loans from China and private banks, trillions in unnecessary interest charges have been incurred by the U.S.

Former Washington Post editor and author of one of the leading books on the Federal Reserve, William Greider, points out that governments actually have the power to create money and credit themselves, instead of borrowing it at interest from private banks:

> If Congress chooses to take charge of its constitutional duty, it could similarly use greenback currency created by the Federal Reserve as a legitimate channel for financing important public projects–like sorely needed improvements to the nation's infrastructure. Obviously, this has to be done carefully and responsibly, limited to normal expansion of the money supply and used only for projects that truly benefit the entire nation (lest it lead to inflation)…
>
> This approach speaks to the contradiction House Speaker Pelosi pointed out when she asked why the Fed has limitless money to spend however it sees fit. Instead of borrowing the money to pay for the new rail system, the government financing would draw on the public's money-creation process–just as Lincoln did and Bernanke is now doing.[122]

By creating the credit itself – instead of borrowing from private banks and foreign nations – the American government could finance the creation of new jobs without incurring huge interest charges owed to the private banks and foreign countries which lent America the money. In other words, the U.S. government would itself create the new credit, just as Lincoln did to finance the civil war.

By financing new projects with credit created by the government itself, America might be able to pick itself up by its bootstraps and put its people back to work.

The same may be true for other countries as well.

Articles by: **Washington's Blog**