

What Creates Jobs?

Suppose I were to raise 10,000 fingerling fish, and release them into Lake Winnebago. Would that increase the total number of fish in the lake?

The immediate answer would be yes. Seconds after dumping them into the lake, there would be 10,000 more fish than there had been a minute earlier. But soon, some of my fingerlings would get eaten, and others would eat some of the tiny fish the lake already held. My survivors would have to compete with the other fish in the lake for food and habitat. Eventually – after perhaps a few weeks, maybe a month or so – the lake would be back to roughly the same number of fish it started with.

Any biologists could have told you this. The lake is an ecosystem, that will naturally move towards balance. The total fish population will ultimately return to its natural level, based on the amount of habitat and the total food available.

Well, that's how an economy works, too.

I hear a lot of nonsense about job creation, and job creators, like the description of CVS as a “new business that creates additional jobs”, as if jobs are something you can pull out of a hat, and suddenly create out of nothing. Well, it just doesn't work that way. Like fish, jobs need a habitat, and they need a food supply. The habitat is capital investment, and the food supply is consumer demand.

Suppose the owner of a taxi company wants to create a job for one more driver, that pays let's say \$30,000 a year. He would first need to invest in a taxi for the driver to drive – let's say a \$20,000 investment, including the meter and two way radio. He would finance the investment either from his own savings, or from a bank loan, or probably some of both. To make it worth his while, he'd need to earn some annual before-tax rate of return on his investment, let's say 15%, or \$3,000. Assuming the owner is in the 30% tax bracket, after taxes he'll net about \$2,100.

The taxi company owner's investment creates the habitat, without which the job can't exist, but it alone is not enough. The job also needs a continuous supply of sustenance, about \$33,000 worth of passengers per year, willing to pay to ride. And in a city of 60,000 people, the total demand for rides will sustain only so many taxi driver jobs.

What about lowering the owner's tax rate to create more jobs? That's the supply side advice you hear from the right these days. But even if his tax rate were cut in half, the owner would still need about a 12.4% before-tax rate of return to net his \$2,100. So the job would still need about \$32,500 worth of passengers each year to sustain it. Even a small decrease in the total demand will offset a huge (50%) supply side tax cut, in its impact on supporting a taxi job. And that ignores the jobs in the public sector – police, teachers, whatever – that will disappear because the tax cut reduced government revenue.

The reality is, it is demand, first and foremost, that creates jobs. If the demand for Tylenol and lipstick and sunglasses is relatively constant, the number of pharmacy store jobs that a city can maintain will also be pretty much constant. And that will be true, whether CVS builds a new building directly across the street from an existing Walgreen's, or not.