The Reason So Many People Are Unemployed

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Around the time of the Great Depression, a man named John Maynard Keynes made an incredible discovery. The reason so many people were out of work was not really because of irresponsible banks or high taxes or reckless government policy. It was really much simpler than all that: there wasn't enough money.

Now, as individuals, we'd all like a little more money for ourselves. But pause for a moment and think about what it means if there isn't enough money in the economy as a *whole*. A good way to wrap your head around this is to think about a much smaller case: instead of the whole economy, let's think about a now-famous babysitting co-op on Capitol Hill. Instead of dollars, the co-op used its own scrip that was worth an hour of babysitting time. When you wanted to go out, you'd pay a couple hours to someone else to watch your kids; then when they wanted to go out, they'd pay you or someone else to do the same for them.

It all worked great for a while, until one day they found they had too few pieces of scrip. Every couple had only a couple hours left and, having so little, they didn't want to waste it. So they all decided to save it for a very special occasion. This was kind of an incredible situation — even though there were people who wanted someone to babysit their kids, and people who were willing to do just that, the deal didn't happen, simply because the co-op hadn't printed enough colored pieces of paper. Eventually the co-op learned their mistake, printed some more scrip and handed it out, and everybody went back to babysitting like before and were much happier for it.

The same thing happens in the real economy. When there aren't enough green-colored pieces of paper around, everybody gets worried and holds on to the little they have. Even if you'd like someone to build an extension on your house, and there's someone else out there who'd like to build an extension on your house, the deal doesn't happen, just because you don't have enough green pieces of paper (or, more realistically, dollars in your bank account). This is a total waste. You don't get the extension and the other guy doesn't get a job, all because we haven't run the printing presses enough (or added enough zeroes to the bank's computers).

Before the Great Depression, most countries wouldn't simply print more colored pieces of paper. They were on the "gold standard" and they would only print more currency when more gold was discovered. This led to the most bizarre series of booms and busts as more gold was discovered in strange places and then "used up" by population growth or other things. After Keynes, countries eventually stopped this silliness and just started printing their money directly.

As soon as they abandoned the gold standard, they begun recovering from the Great Depression.

But the power to print more money is obviously a very special power and you wouldn't want it to fall into the wrong hands. So, in the United States, we've taken it away from elected politicians and given it (mostly) to the big banks. The banks select people to run their local Federal Reserve and then some of those people (along with some additional folks nominated by the President) are selected to be members of a group called the Federal Open Market Committee (FOMC). The FOMC, essentially, decides how much money there should be in circulation, which in turn decides how many people have jobs.

You might think this sounds crazy — a bunch of unelected bankers get to decide how many people have jobs? — and, in fact, it is crazy. But I'm not making it up. Ask a macroeconomist, like Paul Krugman, and this is exactly what he'll tell you. And if you look in the Federal Reserve Act or on the Fed's website, you'll find their mission is to "promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." These multiple goals are relatively recent; before 1978, the goal was simply "maximum employment, production, and purchasing power."

Now some people will claim that the Federal Reserve has done all it can to create more jobs but the recession is so deep this time that there's nothing else it can do. But that's just not true — even the chairman of the Federal Reserve, Ben Bernanke, says it's not true. He was asked about this in a Senate hearing. As the *Economist* summarized his response: "Mr Bernanke does not want to risk a de-anchoring of inflation expectations. He is willing to accept 10% or greater unemployment and the resulting economic and political fall-out in order to avoid that risk."

Which brings us to the subject of inflation. Obviously if you print a lot of new money, it makes existing money worth a little less. This is annoying, but is it worse than having people out of work? Well, it depends who you are. If you have a lot of money, you're more worried about it becoming worth less. But if you work for a living, you're more worried about people being out of work. As you might expect, Mr. Bernanke has a lot of money, as do the other bankers on the committee and the people who selected them. So they've decided to let millions and millions of people be unemployed and the rest of us experience the resulting recession rather than risk the chance that some of their money might be worth a little less.

The biggest reason this is possible is because nobody realizes it. If it was conventional wisdom that a bunch of unelected bankers looking out for rich people were the reason everyone was out of work, politicians would be forced to explain to angry voters why we had this crazy system and might actually consider doing something about it. But, incredibly, it just seems like nobody has any idea. Voters don't realize it, politicians don't understand it, journalists don't cover it. And, in fact, they're so far from having any idea that it's really difficult to explain it to them. When you say a bunch of unelected bankers are the reason there are no jobs, they just look at you like you're crazy. I've just spent a page or two explaining it and you still probably think I'm crazy. But it's true! This isn't some Ron Paul-type crackpot idea; this is mainstream economics, from Paul Krugman to the head of George W. Bush's Council of Economic Advisors.

I feel a bit like the guy in one of those movies, going around and telling everyone that the murderer is standing right over there — right there, look! — but nobody believes him and people continue to die. It's incredibly frustrating, and I have no idea what to do about it.

One final point: How did we get into this mess in the first place? Why did we suddenly find ourselves without enough money? Well, there was a housing bubble: for many years, house prices kept going up and up for no other reason than everyone was betting that they were just going to keep going up. When house prices were unsustainably high, that was part of the money in circulation. But when the music stopped and the bubble popped, house prices cratered and nearly $8 trillion disappeared overnight. The government has printed a bunch of money since then, but nowhere near the $8 trillion we lost. Obviously a lot of other bad stuff happened during the financial crisis, but this is the reason everybody is out of work.