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### “Creating U.S. Jobs: A Double ‘Catch 22’”

Workers want to work, and almost every major politician has a plan to create jobs. Before convincing yourself that one plan is better than another, consider a few noteworthy facts and a couple of important realities.

Recognize that investment and consumer spending are two sectors of the economy that usually reflect accelerated growth during an expansion—say eight calendar quarters from the bottom of a recession.

According to the official marker of recessions—the National Bureau of Economic Research—the most recent downturn ended in June of 2009..

Eight calendar quarters later (June 2011), the Commerce Department reports that investment spending (9.1%) and consumer spending (4.3%) have accelerated nicely since the bottom of the recession. Growth in investment spending would have been even higher had the residential housing sector (-3.1%) not continued to slump over the period.

Clearly, housing investment is one area where we would usually see more growth at this point in the business cycle. More housing would mean more construction jobs, plus more jobs in the industries that produce goods and services that are associated with the production, maintenance, and operation of homes and households.

Why aren't more houses being built? Mainly because mortgage bankers were burned during the 2007-2009 recession and they are now very reticent to issue new mortgages.

How reticent are they to lend?

According to the June 2011 Federal Reserve Board (FRB) Flow of Funds Accounts, commercial banks now hold about \$100 billion less in mortgages than they held in 2007 before the housing bubble began to burst; about \$300 billion less than they held in mortgages at the height of the housing market in 2008.

More importantly, commercial banks are holding \$1.3 trillion in reserves at the FRB today, compared with just \$18 billion in 2007.

A similar story holds for chartered commercial banks.

New households are forming all the time with housing requirements, and every prospective home buyer has not defaulted on a mortgage. However, banks remain tightfisted when it comes to extending new mortgages.

It seems that banks want to see improved economic conditions before they begin to lend more freely. However, their reticence to lend is preventing improved economic conditions from developing. It's a "Catch 22."

What we know is that the economy is not likely to improve significantly until banks begin to release some of the cash that they are hoarding and begin to finance investment in homes and in businesses.

Therefore, any plan to create jobs that is to have a chance at success must address this fundamental issue. Whether they are offered loan guarantees, loan subsidies, or tax credits, banks must be incentivized to lend more vigorously. At the same time, banks should not be rewarded for holding vast volumes of reserves at the FRB.

However, even if all of these actions are taken, there is one additional "Catch 22" about which we should be aware. Banks, in large measure, opt not to lend during uncertain times to private sector borrowers when the government offers investment returns that are certain—albeit at low levels. A small certain return trumps a larger uncertain return.

A popular mantra is that we need the economy to grow to create jobs and to increase tax revenues in order to reduce the Federal deficit and debt. Yet the economy will not grow until banks lend to the private sector. However, banks will not lend to the private sector as long as the government continues to expand its deficit and debt by offering safe investment returns,

It appears that we are in a double "Catch 22"?

By  
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