Chapter Two
The Nature of Unemployment, Inflation and Taxation

Most people will do just about anything to avoid a serious discussion of conventional economics. The conversation normally gets so complex and confusing that plain old "common sense" becomes useless. That this is the case may not be accidental. Complexity conceals corruption.

This chapter will attempt to blow away the smoke so that you can see the fire and understand, for yourself, why our economy is burning out.

Why Are So Many People Unemployed?

The three main causes of our persistent and high rate of unemployment are: labour-saving technologies, globalization and an over-reliance on borrowed money.

Unemployment associated with labour-saving technologies is not new. Ever since the industrial revolution began we have been struggling with the same problem. Before machines became powerful and complex, human energy was the main ingredient, and cost, in the production process. Using hand-

tools and simple mechanical devices, workers would apply their knowledge, skill and energy and slowly transform raw materials into finished products. Capital and equipment costs were low and energy and labour costs were nearly synonymous. What a person earned was a major portion of the price of the goods that he produced. What a person was paid for his labour was very nearly what he needed to spend in order to sustain himself and his family. His role as a worker, or his cost as a factor of production, was in balance with his role as a consumer.

During the industrial revolution, however, things began to change dramatically. The use of non-human power sources, coupled with the rapid advancement of machine technology increased society's productive capacity enormously. Suddenly, human labour was no longer the basic energy unit of production. Capital and equipment costs soared, while the need for human-labour inputs declined. As machines displaced more and more workers, unemployment levels grew and the competition for fewer jobs held the cost of labour down. Before long, the balance between what workers were paid for their labour and the cost of the goods and services which they produced, and were expected to buy as consumers, was lost. Credit was used to bridge the gap and more and more we relied on promise-to-

pay money to keep the economy growing.

Finally, in 1929, the Great Depression exposed our folly. Prices could not be pushed any higher to support further economic expansion. Too many were either out of work or at their credit limit and the heavily-leveraged financial "house of cards" crumbled. In December of 1932, Fortune Magazine published a remarkably candid article entitled "Obsolete Men" which documented the devastating impact that modern machine technology had made in the labour market.

The same sequence of events is happening again today as sophisticated computer-based technologies displace workers. The effects this time, however, are far more wide-reaching as computers revolutionize not only production techniques but also distribution, retail and even service operations. Human labour, once again, is being devalued as unemployment and economic insecurity make people more submissive.

Globalization is also making labour income prospects much worse. Corporate ownership and market dominance is becoming increasingly concentrated. A few hundred extremely powerful transnational corporations with interlocking owners and managing directors have effectively reduced the entire globe into one vast nation/market. In

doing so, they have been successful in playing one region of the globe off against the other. Threatening both workers and governments that they will simply pull out of a country if they don't get their own way, they have been able to force down labour and taxation rates (as well as environmental and health and safety regulations) all over the world. To compete on such insane terms, a country like Canada simply must lower its labour rates <u>and</u> have high unemployment levels.

Even if Canada had the lowest labour rates in the world, we would still have some unemployment, as our citizens would be too poor to sustain any significant domestic demand. Most low-wage, third world countries have a persistently high level of unemployment. In fact, it is now openly admitted that it is *essential* to have an inventory of desperate, unemployed people in order to keep a lid on wage expectations. Economists refer to this level of unemployment as the Non-Accelerating Inflationary Rate of Unemployment, or the NAIRU. Whatever the price of labour, there are simply not enough workers needed nowadays to employ everyone who is willing to work.

The third major factor which is contributing to our current high level of unemployment is the rising cost of interest in the economy. Since 1974,

Canadians have been relying heavily on credit to maintain their standard of living. In 1974, total public and private debt in Canada was $234 billion, total Gross Domestic Product, or G.D.P., (a measure of the total value of all goods and services produced in the domestic economy) was $152 billion. and the ratio of debt-to-GDP was 154:100. In 1994, total public and private debt in Canada was $1,833 billion, total Gross Domestic Product was $750 billion and the ratio of debt-to-GDP was 244:100. *During the twenty year period, total debt grew by a factor of 8 (784%) while GDP only grew by a factor of 5 (493%).*

All of the interest on society's debts is ultimately paid by the consumer/taxpayer. When businesses borrow, their interest costs are passed on to consumers, embedded in the price of their goods and services. If businesses didn't recoup their interest costs they wouldn't be in business very long. Governments pass along their interest costs to us through taxes. When interest payments rise faster than wages, consumers must either borrow more money in order to sustain their purchasing power or else cut back on their consumption, which leads to a recession. When interest payments rise faster than revenues, governments and corporations must "downsize" in order to avoid deficits and operat-

ing losses.

Between 1974 and 1994, total interest payments in Canada increased by a factor of 7 (685%), from $26.9 billion in 1974, to $184.3 billion in 1994. *During the same period, wages and salaries only grew by a factor of 5 (495%)*, from $82.9 billion in 1974, to $410.3 billion in 1994. *In 1994, the total burden of interest in the economy was equivalent to almost half (45%) of the total that was paid out in wages and salaries that year.* It is no wonder that consumer demand is stagnant. Consumers are drowning in the ocean of society's debt.

Once our collective interest costs exceed about 50% of consumers' wages, a recession is virtually inevitable. From 1980 to 1991, there was only one year (1988) in which intecrest costs were less than 50% of wages and salaries. Prior to 1966, however, society's collective interest costs were less than 20% of wages. What happened? In 1967, the Liberals abolished the legal maximum on interest rates which up until then had been set at 6%. The only remaining restriction on interest rates is contained in the Criminal Code and is set at 60%.

There is far too little legal tender money in circulation today. In 1945, legal tender money accounted for about 27% of the total money supply, in 1974, it accounted for about 11%, in 1994, it

accounted for less than 5%. In 1966, the M1 (see page 19) represented 36.5% of the total money supply. In 1994, however, the M1 accounted for only 13.6% of the total money supply. When the M1 per capita is expressed as a percentage of the total GDP, it becomes clear that relative to the growth in the population, the M1 has dropped steadily from 5.6% of GDP per ten million Canadians in 1966, to just 2.6% of GDP in 1994. There is simply not enough new, interest-free money being added each year to the total money supply in Canada to keep pace with our spending requirements.

As we saw in chapter one, the federal government could create additional interest-free, legal tender money by financing more of its operations directly through its own bank, the Bank of Canada. If it had continued to create the same portion of the money supply that historically it had up until 1977 (about 20%), the federal government would have avoided the excessive interest costs which created our deficits and led to the mountain of national debt that we now face. Our social programs, national institutions and crown corporations would still be intact and our taxes might even be much lower. The only reason given by the government to explain why they so abruptly abandoned such a sensible monetary policy was "to fight inflation".

What is Inflation?

Inflation is generally thought to be any increase in the price of the goods and services that we consume. Improvements in the quality of the merchandise being sold or the methods by which it was produced, however, are all too often ignored. For example, a five-passenger, two-door automobile with a four-cylinder engine and standard transmission which sells today is a completely different product from a similarly configured automobile made in the 1950s. In most of today's cars, plush interior styling, air-conditioning, high-quality audio systems and an array of computerized enhancements are part of the "standard equipment" which is included in the base price of the vehicle.

To compare the price of today's luxurious cars with their plain-jane equivalents from the 1950s and to claim that inflation has pushed up car prices by a factor of ten, (or whatever the appropriate factor may be), is very misleading. Consumers who purchase a car today are getting a whole lot more than they were back then, and comparing the price of even two similarly-configured vehicles is like comparing apples with oranges. In addition, consumers today are paying for tremendous improvements in fuel efficiency and emission control systems. Today, when they hand the dealer a cheque,

they are not just buying a car, they are also buying a cleaner environment, the cost of which is embedded in the price of their new vehicle.

Inflation is a natural, healthy and essential part of a truly free and open market. Like a grease, inflation lubricates the friction between the interests of capital and the demands of labour. In a free market, both capital and labour continually strive for a bigger share of the proceeds from production. If labour wins a wage increase, management tries to raise prices in order to maintain or improve their previous level of profitability. If prices rise, labour attempts to negotiate a wage increase in order to maintain or improve their previous purchasing power. Neither side ever wins absolutely and the contest is never over.

The freedom to struggle, however, is essential if the market is to remain free and open. A market is really only free and open if there is an equal opportunity for all parties to negotiate for a bigger piece of the economic pie. As long as the market remains free and open, neither side can get too far ahead of the other before the other side begins to catch up. Inflation, or rising prices, is the natural consequence of each small victory for either side. In an open market, employed consumers from either side of production (ie. both capital and labour)

rarely suffer much or for long from inflation, at least in terms of current earnings or purchasing power, *so long as their right to negotiate for a "fairer-share" of the economic pie is not obstructed.*

Inflation could be a problem for people who are trying to store the purchasing power of their *previous earnings* in their savings. Having no way other than interest to negotiate an increase in their savings, over time part of their purchasing power could be lost to rising prices if interest rates should fall below the rate of inflation. This rarely occurs, however, as interest rates are normally maintained well above the current inflation rate. Inflation is really only a problem for people on fixed incomes, or for people whose incomes can't keep up with prices because they have no power to negotiate a raise.

It is curious then that the Bank of Canada and the financial press have put such a great effort into vilifying inflation. It is often portrayed as a menace, a monster, a robber in the night that steals away the purchasing power of our money. The Bank of Canada now treats inflation as if it were public enemy number one. Controlling it is more important than our unemployment crisis or the crippling effect that high interest rates have on our economy.

The most likely reason behind the campaign

to exaggerate the public's fear of inflation is so that it can be used to justify restricting the rights of workers to organize, negotiate or strike for a bigger slice of the economic pie. In other words, it could be an attempt to dismantle the free and open market by turning the public against the grease which is needed to operate it. It is curious that those who demonize inflation never suggest that profits might need to be constrained in order to moderate price increases. Another reason could be that the fear of inflation allows the Bank of Canada and the financial community to rationalize and profit from the excessively high interest rates which they claim are necessary in order to battle the beast. The fact that the high cost of money is often one of the main causes of inflation doesn't seem to bother them.

Now that you know more about inflation, let's return to the question of why the government does not borrow more of the money that it needs, *free of interest costs*, from its own bank, the Bank of Canada. The usual explanation given by the experts goes something like this: borrowing from the private banks reduces the supply of short-term loan money that is available by soaking up private capital which is floating in the money markets; this raises the cost of money (interest rates) which in turn reduces the demand for borrowed money by

consumers; when less money is borrowed, less is spent, which means the demand for goods and services decreases; weak consumer demand holds prices down and voila! ...inflation is licked. The problem with this explanation is that the federal government could reduce the money supply by exactly the same amount, *without incurring any interest costs*, simply by requiring the private banks to hold a greater percentage of their deposits as reserves. As shown in Chapter One, this would reduce the money supply by restricting the amount of promise-to-pay money that the private banks could create as new loans.

If the Bank of Canada was truly concerned about the devastating effects of inflation it could suggest to the government that all wages, salaries and prices across the land be divided by a common factor on a predetermined date. In an instant, all of the effects of inflation would disappear and judging by the newly reduced prices, it would seem as if society had simply gone back in time. For example, if the common factor chosen was ten and the day before the predetermined date you earned $50,000 a year, an average house cost $250,000 and a medium-priced car cost $20,000, then on the day after the change you would earn just $5,000 a year, but houses would cost only $25,000 and cars

only $2,000. It sounds like the sixties to me! It would be interesting to compare the differences between the relative purchasing power of workers and management immediately after the reduction with the relative purchasing power that actually existed in the sixties. It is unlikely that you would find that workers now had a bigger slice of the production pie than they did thirty-five years ago.

What is Taxation?

Although everyone pays taxes, few people think much about what the purpose of taxation really is. Governments use the tax system to finance their own operations, to provide goods and services to the population, to redistribute incomes, to influence the amount of money that is available in the economy for private consumption and to encourage or discourage certain types of social and economic activities. In 1994, total government spending on goods and services plus capital stock represented nearly a quarter of Canada's total Gross Domestic Product (22.3%). Total government expenditures (all types of spending by all levels of government) were equivalent to almost one-half of Canada's total GDP (48.5%). Clearly, the government is a major player in our economy.

In the Constitution, two broad classifications

of taxes were set out: direct taxes and indirect taxes. According to John Stuart Mills, a respected nineteenth-century economist, "A direct tax is one which is demanded from the very person who it is intended or desired should pay it. Indirect taxes are those which are demanded from one person in the expectation and intention that he shall reimburse himself at the expense of another" [1]. In other words, an indirect tax is one that is paid for by one person who then passes along its cost to someone else. Property taxes and personal and corporate income taxes are direct taxes, while customs and excise taxes are indirect taxes. The Constitution placed no restrictions on the federal government's power to levy taxes, but it prohibited the provinces from imposing any indirect taxes.

Personal income taxes were first enacted by the federal government in 1917 to help pay for the cost of fighting in World War I (corporate income taxes had been introduced the year before). At the time, there was considerable public unrest over "the failure of some well-to-do people to contribute as generously as they should have to the patriotic and other war funds"[2] and there was a popular outcry for the "conscription of wealth" [2]. Although the Minister of Finance of the day, Sir Thomas White, placed no specific time limit upon the duration of the in-

come tax in his April 1917 budget, he did suggest that the necessity to continue on with the measure should be reviewed a year or two after the war was over. When the war ended, the government ignored his encouragement to abandon the tax for it had become dependent upon the revenues that it generated. Prior to the war, the government had relied primarily on land sales, customs duties and excise taxes for its revenues.

All taxes are a burden on the productive energies that drive the economy. The tax system is an inefficient and complex way to generate government revenue. To legislate, interpret and enforce the system is extremely costly, as is the entire remittance procedure. While the tax system does redistribute income in ways which benefit the poorest segment of the population, it places a tremendous burden on low and middle income earners. The system taxes labour income at a much higher rate than interest and investment income and favours high income earners by providing many exemptions and credits which are only practical for the rich. Nearly everyone must be willing to support the tax system in order for it to work, but the recent growth of the "underground economy" suggests that this may soon no longer be the case.

Mention a world without taxation today and

most people will think you are crazy. But such a world is possible (as you will see later on in this book) if only the government would re-assume the responsibility which was given to it, and to it alone, in the British North America Act, to create and control the money supply of our nation. Why the government refuses to do so is the topic of the next chapter.