# XIII: UNEMPLOYMENT, INFLATION AND GOVERNMENT SPENDING

Nowadays, unemployment occurs when people who would like to build homes or business premises must relinquish their plans because they cannot afford the necessary land. It occurs, also, when would-be builders are unable to pay the huge additional sums that must often be offered as interest.

Unemployment also occurs when local producers are forced out of business by overseas competitors, and when small businesses are swallowed up by larger firms who then replace men with machines.

## Unemployment and Consumption

Unemployment can also occur when prices rise and wages lag behind them to a significant extent.

For instance, a nation's citizens may receive nine million dollars, when they have produced goods and services with a market value of ten million dollars.

Under these circumstances, the local inhabitants are unable to purchase all the goods and services they produce. They must then export what cannot be sold locally.

If export markets do not absorb the difference between local production and local consumption, then markets glut with unsold goods and services.

This allows prices to fall -- eventually. In the meantime it causes some workers or their employers to receive lower incomes than usual.

If such a glut continues, then workers begin losing their jobs, and some employers close down their businesses.

Retrenched workers, and businessmen who have "gone broke", cannot purchase many goods or services. Therefore, once retrenchments set in, the gluts on the market increase. This, in turn, leads to a recession. If the recession is not overcome, a full scale depression can occur.

**Averting a Depression**

Depressions bring all wages and prices down eventually, but past depressions have not proved easy to cure. (Which might be the fault of the methods used!) Therefore, governments try to ward off unemployment and postpone depressions by:

(a) allowing wages to rise,

(b) using tariffs to increase the price of imports - so local businesses can compete, effectively, with overseas competitors,

(c) restricting competition in various ways,

(d) providing subsidies or tax-relief to struggling producers, or helping them by introducing price-support mechanisms, quotas, etcetera, and:

(e) paying social service benefits - to allow unemployed persons to continue buying goods and services.

**Imperfect Measures**

These measures all have undesirable side effects. Higher wages increase production costs and add to the difficulties of embattled producers. Unemployment benefits do the same, by increasing the need for taxation revenue. Tariffs, subsidies, quotas and price-support mechanisms help some citizens at the expense of others. Therefore, while these measures eliminate some pockets of unemployment and poverty, they may also create unemployment or reduce net earnings in some other part of the economy.

At the same time, any measure that increases wages, protects jobs or boosts incomes will boost land prices as well. This boost, in most cases, is more than can be justified by any concomitant increase in real prosperity. It therefore retards the growth of the economy and causes unemployment to worsen again.

**Treading a Tightrope**

Today's governments tread a tightrope as they:

1: battle to keep both unemployment and inflation down,

2: try to avoid measures that do more harm than good, and:

3: try to prevent hardship from falling too heavily upon any one sector of society.

These ends can rarely be achieved through mere juggling with wages, tariffs, quotas, subsidies, etc. Consequently, most non-Communist nations now seek further to improve matters by operating a welfare state economy.

**The Welfare State**

In "welfare state" economies, money is collected from the citizens and redistributed, with (hopefully) the bulk of it being collected from the rich and prosperous, and redistributed to the poor.

Welfare states come into being to help the poorest members of society, but few of them stop at that point.

Unfortunately, once a government starts collecting wealth from some citizens and redistributing it to others, then more and more people seek to be included in the redistribution, and the government is bombarded with requests for funds (or for additional funds) for this, that and the other pressure group.

**Taxes and Inflation**

Governments have few independent sources of income. Hence, if multitudinous requests are to be met, then huge amounts of money must be collected from the nation's voters and taxpayers.

Therefore, high taxation and welfare state economies go hand in hand, and the high taxes are sometimes blamed for inflation. However, taxation, in general, should not affect the Consumer Price Index. It does not add to prices overall - even though sales taxes, tariffs, excise duties, company and payroll tax and similar imposts certainly increase the price of numerous goods and services.

**Increasing One Price, Decreasing Another**

An excise tax that increases the price of petrol, tobacco or alcoholic liquors may be redistributed to reduce the price (to the consumer) of medicines or schools. Tariffs that add to the price of imported motor vehicles may reduce the amount motorists pay for roads.

Similar considerations apply to all funds collected from citizens and redistributed. Therefore, such funds do not affect the overall level of prices or the Consumer Price Index. Hence, taxation, on its own, does not really contribute to inflation.

**Unproductive Activity**

However, taxation and the redistribution of wealth keep productivity below the optimum - thereby predisposing to inflation in an indirect way.

Few of us can do two or more things at once. We cannot, therefore, be producing wealth while we are busy collecting it from some citizens and redistributing it to others. Consequently, when thousands of workers are employed in the collection and redistribution of wealth, then the nation's overall productivity must be seriously impaired.

But government employees are not the only persons engaged in unproductive activity. Nearly all citizens spend some time filling in tax returns and similarly complicated government forms. In addition, lawyers and accountants spend a lot of time helping other citizens with these tasks.

Overall, the nation spends a huge amount of working time and effort in unproductive work associated, in one way or another, with the welfare state. This clearly keeps the average standard of living below the optimum, and adds to everyone's costs. It must therefore boost prices and add to the cost of living and to the Consumer Price Index.

Wage rises granted to compensate for this are not balanced by an increase in productivity. Hence, high taxation and the redistribution of wealth contribute to inflation in that indirect way.

### Government Deficits

That is not the only way in which government expenditures contribute to inflation. Huge government expenditures can lead to government deficits. Deficits, in turn, are usually "monetized" (i.e., financed by currency debasement) eventually.

### Taxation is Unpopular, but Government Spending is Not!

Deficits arise because most people want a share of the taxpayers' funds, but very few enjoy contributing towards those funds. Hence governments, (with an eye to the next election) tend to spend more than they receive. That creates a deficit.

### Financing a Deficit

In Australia, most of the transactions used to finance the government deficit:

> "involve the issue, repurchase, redemption or acquisition of Commonwealth Government securities, but some involve or are represented by changes in other assets or liabilities of the Commonwealth Government."[23]

That means, presumably, that some of the deficit is covered by loans and repaid later, while more of it may be offset by revenue collected in a preceding or succeeding year.

### Massive and Recurring Deficits

However, while these procedures may suffice for an occasional modest deficit, they are not satisfactory when massive deficits follow one another year after year. When that happens, the government must either accept an escalating national debt (plus an ever-rising burden of interest payments) or finance its deficits by debasing the currency.

Most governments adopt the second alternative. In other words, when expenditures exceed income and the government's books cannot be balanced in any other way, then the mint and the note printing presses work overtime. Alternatively, if the government wants to spend more than it receives, it can write excessive numbers of cheques and ask the bank to cancel some of its overdraft - or something to that effect. In these ways, then, governments extricate themselves from a deficit by issuing excessive amounts of new currency - thereby diluting the money already in existence and reducing its worth.

**Pattern in Australia**

That seems to have been the pattern in Australia recently - if we can judge from Table 10[24]. This compares Australia's rate of inflation with its government deficit. It shows that high rates of inflation and massive government deficits have become common in the past few years.

**New Money from Overseas, or via the Banking System**

Table 10 shows that in 1973-74 the deficit was only $293 million, while inflation reached 12.9%, and that in 1970-71 a mere $10 million deficit accompanied an inflation rate of 4.8%.

Hence, massive infusions of new currency are not always issued and spent by the government. Inflationary additions to the money supply can also come from overseas (as loans or as capital inflows) or be passed into circulation through the banking system.

**TABLE 10: GOVERNMENT OUTLAY, GOVERNMENT DEFICIT AND INFLATION RATE, AUSTRALIA, 1967-80.**

| YEAR | GOVT. OUTLAY $ million | DEFICIT $ million | DEFICIT AS % OF OUTLAY | INFLATION RATE % |
|---|---|---|---|---|
| 1967-68 | 6,249 | 642 | 10.3 | 3.3 |
| 1968-69 | 6,633 | 385 | 5.8 | 2.6 |
| 1969-70 | 7,387 | 191 | 2.6 | 3.2 |
| 1970-71 | 8,137 | 10 | 0.1 | 4.8 |
| 1971-72 | 9,081 | 134 | 1.5 | 6.8 |
| 1972-73 | 10,230 | 709 | 6.9 | 6.0 |
| 1973-74 | 12,229 | 293 | 2.4 | 12.9 |
| 1974-75 | 17,839 | 2,567 | 14.4 | 16.7 |
| 1975-76 | 21,861 | 3,585 | 16.4 | 13.0 |
| 1976-77 | 24,123 | 2,740 | 11.4 | 13.8 |
| 1977-78 | 26,802 | 3,333 | 12.4 | 9.5 |
| 1978-79 | 29,045 | 3,478 | 12.0 | 8.2 |
| 1979-80 | 31,694 | 2,034 | 6.4 | 10.2 |

The details of these latter processes are not relevant to the present study. However, we should note that massive infusions of currency (whatever their source) create inflation that is somewhat different to the inflation discussed in the previous chapter.

## Inflation as a Cause of Rising Prices and Wages

The inflation discussed earlier accompanies or follows an increase in wages and prices, but the inflation we are discussing here actually drags prices and wages up. In other words, this latter type of inflation precedes any rise in prices and wages and is, in fact, the cause of that increase.

We can see how this works by following the course of new money put into circulation to finance a government deficit.

New money issued for this purpose is often given to pensioners, unemployed persons and other needy citizens. Alternatively, it may pass into the community as a contribution towards health, education or transport costs.

The new currency provides many people with money they did not have before. These can then purchase goods and services they could not afford previously, or pay outstanding bills. In these ways, excessive quantities of new money:

1: Increase the rate at which goods are sold and replaced in retail outlets,

2: Decrease the need for sales, discounts and other price-cutting mechanisms, and:

3: Increase competition for scarce items and allow the price of many goods and services to rise.

Higher prices and more rapid turnover in shops creates prosperity and boom conditions in factories. That leads to competition for workers and allows wages to rise.

**Complexities of Inflation**

New money passed into circulation as loans from overseas or through the banking system has much the same effect. This money is also spent by those who receive it first. It, too, is soon distributed throughout the community - where it exerts an upward pull on wages and prices and on the Consumer Price Index.

Therefore, inflation is not due simply to government deficits, wage rises, inadequate land taxes or any other single cause. Inflation is a complex matter. It will be eradicated only when its causes are all identified and removed.