

Thursday, February 8, 2007

That comfy cozy Nanny State

A couple of recent developments have got me thinking about the nature of the socialist, nanny state, what it does to people's self-reliance and the insidiousness of entitlement programs in general.

South of the border, a minimum wage raise has been passed while up here the airwaves are full of cheery ads from the CDIC that the amount of bank deposits covered by the CDIC has been raised to \$100,000.

The Canadian implementation of deposit insurance is supposed to be funded by the premiums of its member institutions. Thus the CDIC is a Crown Corporation funded by its member banks and it pays out settlements from its own reserves, or if depleted it is allowed to borrow up to \$6 billion to cover banking collapse. So on the surface it appears as if bank failures covered by CDIC don't come out of the taxpayers pockets.

This looks nice on paper. In reality the CDIC has cash reserves on-hand of 1.4 billion to cover payouts on a failed bank. It can, in a pinch, borrow that further 6 billion which brings it up to 7+ billion. Which basically means it has the resources to cover about 1.6% of the 437 billion worth of deposits insured, most of it with borrowed money. In the event of some sort of systemic or cascading banking failure, the rest would have to come from the Federal Government, better known as, the taxpayers.

We've seen exactly this happen in the US during the S&L scandal of the late 80's. The sister body to the FDIC, the FSLIC (which covered S&L's specifically) went insolvent and the entire debacle is said to have cost the American taxpayer \$150 billion.

In a very under appreciated and obscure book called *The Monetary Elite vs. Gold's Honest Discipline* by Vincent LoCascio, the flawed logic of government underwritten deposit insurance is revealed time and again.

"[P]eople fail to consider that federal guarantees make bank failures more likely by artificially encouraging people to choose the highest interest rates available, which in turn causes bankers to seek riskier, higher-yielding loans and investments".

Because in our cozy nanny state, the bankers enjoy an exalted safety net the rest of us capitalist pigs can't, in fact, mustn't depend on:

"Failing banks do not face the same fate as other failing businesses. Other failing businesses must contract, face more restrictive credit conditions, tighten their belts, and turn adverse results around as quickly as possible to become more viable. Failing banks, however, can ignore the reality of their situation...They can use federally guaranteed deposits to try to speculate themselves out of trouble

What if businesses could operate impervious to the whims and pitfalls of the real world? Imagine if you will a scenario in which all businesses operating in Canada were automatically covered by the CBEOLIC, the Canadian Business Errors & Omissions Liability Corporation. Over time, you watch the effectiveness of the entire business sector erode away to incompetence of tragic proportions. Why try harder to mitigate risks? If anything goes wrong the government will mail you a cheque. What a country!

Somewhere along the line the desire to collectively pool resources (taxation) to protect the unfortunate during hard times mutated into a perversion where a coddled citizenry expect "the government" to absolve them from taking responsibility for their own lives.

It permeates into all walks of life whether people care to admit it to themselves or not. Why bother saving any money? If you lose your job you get Unemployment Insurance. Why put anything away for the future? When you get old you will get payments from the Canada Pension Plan. People don't cop to this on a conscious level, it just manifests as the aggregate household savings rate slides down over the years. Seldom do people carry out simple back-of-the-napkin calculations that would help them understand that UI is no substitute for lost wages and if you actually tried to live off your projected CPP benefits then plan your retirement around living in a cardboard box and eating out of dumpsters.

Students and leftists carry this to extremes, demanding all manner of fantasy world perks like a "guaranteed living wage", not understanding that if their dreams were to come true, the nature of inflation and money supply would kick in and after a nasty and unbargained for displacement, they would be back to, or worse than where they started. All a guaranteed minimum living wage would succeed in doing is moving the effective poverty line to the new minimum wage.

A very good dissection of minimum wage laws I've seen is James Ostrowski's *How To Help Low-Wage Workers (Without Raising the Minimum Wage)* where he gives us five reasons our nanny state overseer politicians love to pass minimum wage laws:

"Why do politicians love to propose increases in the minimum wage?

1. It costs them nothing other than the ink and paper the bill is printed on.
2. The vast majority of the law's supporters simply do not understand the technical economic reasons why the law fails to help the working poor.
3. Many people do not understand what the law actually means.
4. Powerful special interests favor the minimum wage for reasons unrelated to the welfare of low-wage workers.
5. The minimum wage promises to give us something for nothing."

and proceeds to outline exactly why raising the minimum wages exacerbates unemployment. So politicians can get people to vote for them by dangling this carrot, but in the end more of the working poor will lose their job for their troubles.

To put it simply, minimum wage laws don't force employers to keep workers at the new minimum wage. If the economic output of a worker is below the new minimum wage, he won't get paid more, he'll be fired. The politician won't care, he's already been elected.

"Tragically, those priced out of the labor markets by the minimum wage are often young, unskilled, high school drop-outs, or minorities. Those who most need that first unskilled, low-wage job are most likely to be economically and legally unemployable after the wage rate is raised.

Thus, the first obvious effect of the minimum wage is to cause unemployment among the least skilled and most disadvantaged workers!"

Beyond the seemingly counter-intuitive outcome of increasing unemployment, Ostrowski identifies the following 5 after effects of increasing minimum wages:

1. causes unemployment among the least productive workers;
2. reduces wealth, causing prices to rise (same amount of money chasing fewer goods and services causes prices to rise)
3. causes premature replacement of workers with technology, which again, reduces wealth and causes prices to rise.
4. raises the cost of living for all
5. increases the ranks of criminals and black market workers such as drug dealers with all the attendant social costs.

and punctuates it with the thought experiment:

"If the minimum wage law does not cause unemployment and can raise living standards at zero cost, why keep it so low? Why not have a minimum wage of \$50 an hour? That way, we can all be upper middle class. The answer is that it would cause mass unemployment because most people aren't worth \$50 an hour. "

He concludes his analysis with what really would work to improve the lot of the low-income working poor:

1. reduce their taxes
2. reduce their cost of living
3. increase capital investment

Which also seems to work for the not-so-poor, the middle-class, the rich and for businesses. Go figure.

I've looked at both ends of the spectrum of self-sufficiency eroding Big Government initiatives that purport to provide "safety nets" and guarantees for that which can never be guaranteed.

There is only one person in the world who can guarantee that if a bank folds, I won't be wiped out. There is only one person to guarantee that I earn a living wage that can provide for my needs and those of my family.

That person is me. And that person is you.

Posted by Mark Jeftovic in Armchair Analysis at 15:29

Amen. Individual responsibility. What a novel idea!
Anonymous on Feb 8 2007, 15:49

You can guarantee seeing a Libertarian candidate in your riding by being a candidate yourself
It does not have to be a big time commitment, and for once in your life, you can vote for somebody with whom you in complete agreement with...
Anonymous on Feb 8 2007, 16:15

If I am not mistaken, the CDIC does not 'rate' deposit takers based on their risk, as would a true insurance company. This just adds to the moral hazard.

It annoys me to hear complaints about how a single mother of two can't live on the minimum wage. Of course not! Why on earth did she have two children if she knew she couldn't support them? As a senior citizen, I remember when a young, unwed mother would ensure her child had a decent future by putting it up for adoption, or the father would take on his obligation and marry the girl.
Anonymous on Feb 8 2007, 17:28

Mr. Jeftovic's long march to conservatism begins with the assumption (by you and me and him) of personal responsibility. I quite agree.
Anonymous on Feb 8 2007, 18:55

Although I'm a pretty hardcore Libertarian, I support our state's "minimum wage"; \$7.50/hr here in California.

But I oppose the concept of a "living wage" (taken locally to mean about \$24 per hour).

Are these different words for the same concept, differing only in the amount?

No.

I agree with most of Mark's reasoning--if applied to the higher wage--and would therefore be on the same side of an argument about the "living wage". But different phenomena prevail below say \$10/hr.

A free market only works as libertarians describe when all participants are informed, competent, and uncoerced.

The problem is that people whose lack of skills makes them minimum wage earners tend also to be poorly informed, less competent (if only as negotiators), and more easily intimidated.

Mark's post implies that those who are currently employed at \$7.50/hr must be worth that much, or they'd be replaced by another business method (e.g. automation).

Let's accept that hypothesis. Now, what if the state minimum wage were lowered, or failed to increase with inflation? Would those employees' wages grow apace with inflation (because they are worth that much, as posited), or slide closer to the national minimum wage (\$5.15/hr).

I believe they would slide (or at best stagnate at \$7.50). If you disagree, there's no point in arguing further. If you agree, I hope you'd consider the minimum wage a reasonable protection; and probably the simplest form such a protection could take.

Ironically, I reached this conclusion after observing how easily well paid "exempt" engineers can be abused by their employers;

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browbeaten into working 5 or 10 extra hours each week for no extra pay. If they couldn't stand up to their bosses I realized that most minimum wage employees probably wouldn't be able to either, absent minimum wage and hourly pay laws.

Based on my observation of engineers, I support overtime laws for all employees. I say "Let the market freely determine the value of 40 hours of an employee's time, then the law needs to protect that wage or it will tend to be eroded wherever there is a combination of unethical managers and nonconfrontational employees."

Anonymous on Feb 12 2007, 05:07

Christopher says "A free market only works as libertarians describe when all participants are informed, competent, and uncoerced." First, "uncoerced" is a big part of the definition of free market.

I disagree that ALL participants need to be informed and competent for the free market to 'work.' Clearly the more informed I am, the better I will do as a buyer in a free market. And the more competent I am, the better I will do as a seller. So the free market provides incentives for people to be informed and competent. But even the uninformed will benefit as a result of the more informed.

Surely a person unhappy working for minimum wage has an incentive to look for a better paying job and only stays where he is because there isn't a better job available. And if he loses his job because of an increase in the minimum wage, is he better off?

And if there should be a minimum wage, then you would agree there should be a minimum price for all products and services in the market, since the producers won't be able to pay wages unless they get some minimum price. What good is a minimum wage to people who are unemployed? Don't we need a law requiring everyone to have a job? How would that work?

If there were fewer unskilled workers than positions available, the free market would raise the 'minimum' wage. So the question might be why do we have more unskilled workers than we need? Might it have something to do with the fact they were educated in government-run schools? Or might the drag of government on our economy be causing fewer jobs to be available? And what effect does inflating the money supply have on those working for a minimum wage?

And why should some bureaucrat be concerned about the wages of some 'browbeaten' engineers? If there is competition for engineers, they will leave the demanding (unethical?) employer for one that offers better working conditions. If not, engineers will likely be happy to work extra hours to keep their jobs, and help to keep their company in business, or some will make a career change.

Anonymous on Feb 12 2007, 20:00