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CONTROLS vs INCENTIVES
SOME CONTENTIOUS ECONOMIC VIEWS

by
Tim Fielding

As what is now apparently a severe economic recession wracks the country, the editor and president have spent quite a few hours in the office trying to analyse the "popular-or-unpopular" dilemma facing the Canadian public concerning the control-obsessed economic policies of all levels of Government in an attempt to come up with some less heavy-handed alternative suggestions, based more on flexible incentives and rational/liberal schemes for improving the economic welfare of the people.

Although our ideas came quickly, public acceptance (albeit with a resigned shrug of the shoulders) of more and more controls has come faster. They even seem resigned to the fact that public works cost increases in lieu of "subsidies" from Government must come from their own pockets directly, although they seem oddly less inclined to accept "cut backs" in public services to save money. Obviously the situation cries out for some "new" economic thinking to find alternatives to this "controlled costs" approach to public finance and general economic malaise.

Our thoughts have thus strayed away from specific urban economics to more general liberal economic theories, although significantly all levels of Government at the highest levels have shown interest in our "test-study area" proposals for urban property tax reform as local tax levies are exceeding inflationary rises and services are static or declining. We still have hopes of becoming at least part of a platform in upcoming Provincial (and possibly Federal) elections which have to be fought on our economic crisis issues.

A television program aired recently on CTV , "Troubles in Britain", should serve as a grim warning and should prod economic theorists to think more of liberal incentives rather than controls. In this program, the entire British economic mess was blamed on post-World War Two socio-economic policies and welfare-state mis-management. Post 1945 Governments of both factions eagerly moved to increase Government spending and to close (via taxation) the so-called "loopholes" of the clever rich industrialists. The result was that the immense potential capital resources for industrial investment that many Britons retained throughout the war were either (a) channelled into Government schemes (which perhaps was partially justified by public works war losses) or worse, (b) channelled into resources that the Government couldn't directly touch - land and "objects d'art". The result was that stock markets and investments stagnated - and new industrial programs couldn't find the capital to get off the ground. To compound the problem, the Government initiated a disastrously heavy-handed capital gains tax and a well-meaning (but backfiring) death duty/estate tax on inherited land. The result - people lost all desire to improve privately owned land and bought stock only as a retirement savings plan (if at all), thus tying up the two basics to a dynamic economy - land and capital. Actually, people found a loophole in the real estate tax and eventually bought land, regardless of possible death duties as a hedge against inflation - the old-time "secure capital" approach to land that all Georgists find so annoyingly prevalent, past and present.

Thus, art objects and land escalated in price/value while industrial capital, other than the imported variety and international loans, was not available to develop a modern dynamic industrial economy akin to Japan's. The government, committed to huge social welfare schemes, costly to administer, couldn't generate enough capital itself to fill the gap. Meanwhile, British homes become stocked with antiques, etc., with an enormous face value, while the stock market languished as much as the private land bought and kept as a "tax free" (until death!) hedge. The work force received no incentive to invest, mistrusting the stock market, and labor incentive schemes ran into trouble with unions on one side and Government welfare state controls on the other. Private superannuation schemes, stock options, profit sharing schemes, divident reinvestment allowances, etc. remained in the eyes of British work force, about as well understood and interesting as Ming dynasty pottery antiques. While those interested in the latter (and knowledgeable originally about the former) sighed into their vintage port and worried about handicaps in "the 2-30 at Newbury".

The resultant disaster should serve as a warning to countries such as Canada which also face socio-economic crises, smugness, and over-zealous Government "control" of the land's destiny. How can they avoid it? In any case, there are still lots of ways communities and industries in the U.K. could (and sometimes do) "hustle" in a private incentive way for development capital. Unfortunately, rewards for this approach are not very satisfying and the public appreciates it little and cares less!

A start could be made by government to get people interested in private and/or community socio-economic investment and competitive schemes. Fears of a repeat of 1930's depressions should be allayed by a Government that monitors and steers, rather than controls. The U.S. is showing that this can work by its actions today and its abandonment of strict economic controls, even if it still retains a Keynesian approach to fiscal policies. Government does have a place in economic "control" - but it should be far more subtle. It should also invest in educating the people, using public educational systems, towards responsible economic behaviour. The U.K. is now realizing the folly of its well-meaning but mismanaged "welfare state" ways and is tentatively attempting this. There must be a compromise between control and incentive and the public must know the basic details of the workings of such a compromise. The public must become economically educated and more responsible for their own actions via the actions of democratic Government. Even the mighty and successful U.S.A. should take heed! No one wants a return to the free for all wheeling/dealing economic framework of pre-depression U.S.A., but likewise no one should feel that necessarily "Uncle Sam" knows best always and will take care of things without community and private enterprises prodding him forwards.

Some classic cases of Government "insensitivity" have recently come to light - and the U.S.A. is hardly immune from Government economic bungling. Canada, however, seems to be more vulnerable to such antics, possibly because of our fragile population and land resources and our monolithic resource-centred economy. Canadian chauvanists should make note of our present situation and guard their zealous tongues.

For example, a recent issue of "Playboy" paints a frightening picture of social security cost-benefit practices in the U.S.A. and portends a bleak future for those who rely on this Government investment scheme. For copyright reasons, (and we wouldn't want to tangle with "Hef" and the bunnies!), we cannot quote from this here but the article, by Scott Burns, appears in November 1975 issue on page 138. Apparently the obvious solution - to give greater incentives to private savings by reducing taxes on dividends and capital gains (and instead tax land values??) or deferring taxes on reinvested dividends - has been proposed. The author concludes, "the probability of seeing anything enacted is about as high as the chance of Patty Hearst being the Republican nominee for President. Economic reality, and political survival, alas, are mutually exclusive!" (Old cynicism indeed from a Playboy "advisor"!)

Equally disillusioned is Jim Lotz, a sociologist/geographer reporting on the National Social Science conference held in Ottawa November 20-22, 1975. Some other views from this conference in relation to economic matters appear elsewhere. All underscore some of the frustrations that we have felt in gaining Government interest in our ideals.

We would also like to examine the recent staggering 25% increase in subway/transit fares in Toronto. On this point, the Provincial Government opted out of massive subsidies - basically a wise move - leaving the operators (the Toronto municipal government) with a need to raise the money themselves. So far so good - but all the TTC could do was to raise fares, having had no other tax levy (or otherwise) options left open to them by the Provincial Government that controls such matters. Why couldn't this level of Government at least put some flexibility and fiscal power back in the han ds of the local Government that they had so calmly left holding the financial baby? Although nibblings at, and murmurings, about property tax reform and municipal fund raising have been rife recently, no one seems to have any dynamic incentive plans for moves in that direction other than to semi-seriously suggest something that is seriously in operation in many countries and cities (and with imminent application in the U.K.), namely, municipal capital project lotteries!! How about a TTC lottery? First prize - 10 lifetime TTC free passes - which could then be auctioned off to the highest bidder by the winner who could then donate his "take" to a charity and deduct it from his income tax, etc., etc.!! Don't we know a simpler, more logical way? (See Incentive Taxation, January-February, 1976)

With all these financial crises facing an ingenuous Toronto used to wealth and expansion, the major topic of housing costs has taken a back seat and mortgage/development capital ideas and schemes have been gathering dust. However, we herewith present in this issue our President's scheme which you will note again stresses private funds over Government subsidies and controls as a means of satisfying community housing and development needs, although it does not put down government involvement - merely redirects it to a more suitable flexible approach.

Stock ownership plans for employees have also been advocated by us and we are interested to note that at least some other thinkers are on the same track. One example is the Kelso approach as outlined in 'The National Dilemma' by Winnett Boyd and Ken MacDonald - illustrated in striking cartoon form by Orville Ganes, another "educational" approach we are considering for our own ideals. Like many others, we feel that if industries and other non-industrial but socially established organizations that rely on private enterprise (e.g. religious groups and educational organizations) realized that a monolithic state-controlled society and economy could threaten their self-interest, there would be more acceptance of our philosophy by people who have influence (albeit rapidly dwindling) in the Nation's affairs.

MORTGAGE MONEY FOR THE HOUSE BUILDING BOOM

A great number of Canadians with varying amounts of savings are in a quandry as to investments. Many would like to help prospective home owners finance their homes but uncertainty and the risk of loss inhibits them.

Insurance companies and others in the mortgage loan business usually are quite willing to loan money on first mortgages up to approximately 75% of the market price. The rate of interest charged is influenced by the current prime lending rate established by the Bank of Canada, plus about 2%.

For instance, if the prime lending rate is 9%, then most mortgage companies will charge 11% with an amortization schedule based on 20 to 25 years.

If the purchaser has been able to save 10% of the price at which the property will sell, with a first mortgage of 75%, then he is faced with the need to raise a second mortgage for the 15% balance of the price. Sometimes the vendor will take back this second mortgage and the interest rates can vary greatly. Some will take the mortgage at the 1st mortgage rate, but most charge much higher rates. Sometimes the asking price for the property is intentionally high so that the vendor can sell the second mortgage at a discount. This latter practice has the effect of inflating selling prices.

People have been conditioned to the idea that second mortgages are an insecure investment. However, with present market conditions and the steady shrinking of our dollar value, second mortgages have for many years been one of the best investments. The reason for this is that in practically every case in urban Canada, land increases in value and usually the building either increases or maintains its value relative to the original purchase price. The second mortgage becomes more secure with each payment and should the mortgagor default in payment, the second mortgagee merely has to maintain the first mortgage payments and assume the title to the property.

Example: Property sold for $60,000.00

			Interest Month
Down payment		$ 6,000.00	
1st mortgage	12%	45,000.00	$450.00
2nd mortgage	15%	9,000.00	112.50
		$60,000.00	$562.50

In the above example, the purchaser would have to pay about $600.00 per month to cover interest, principal and taxes. If the second mortgage could be obtained for 12%, the interest payments would be reduced to $90.00 per month, a saving of $22.50 per month.

If the 2nd mortgagee has to foreclose, he has the option of keeping the house for his own use, renting it at a rental that will pay the 1st mortgage, taxes and interest on his $9,000.00 or selling the property. If he decided to rent the property, he would have to obtain a rental of between $625.00 and $650.00 per month.

However, if the 2nd mortgagee/owner sold it under the same terms as the initial sale, the result would be:

New selling price			$60,000.00
	Real estate commission @ 5%	$3,000.00	
	Legal costs approximately	1,000.00	
	Total costs of Resale	$4,000.00	

New down payment	$ 6,000.00
Balance of 1st mortgage (after a few payments)	44,800.00
New 2nd mortgage	9,200.00
Total - (New selling price)	$60,000.00

The 2nd mortgagee/owner would receive the new down payment	- $ 6,000.00
After deducting selling costs in the amount of	- 4,000.00
Would gain	$ 2,000.00

His original investment of $9,000.00 in the 2nd mortgage would then have been reduced to $7,000.00.

The new 2nd mortgage (as shown above) is	- $ 9,200.00
Total investment by 2nd mortgagee	- $ 7,000.00
Showing a net gain to 2nd mortgagee of	- $ 2,200.00

The interest on this new 2nd mortgage of - $ 9,200 @ 12% would be $1,104.00 per year. However, his investment is only - $ 7,000 , resulting in an interest rate being received by the 2nd mortgagee of 15.77%.

If the 2nd mortgage rate of interest is 15%, then the interest received on the $7,000.00 investment would actually be 19.7%.

Many times, the interest rate charged by 2nd mortgagees is so high that it makes it impossible for the purchaser to complete the sale. If the fear of financial loss was removed, then a great deal of the funds held by the private sector would flow to this investment need. 2nd mortgages would be placed at about the same interest rate as first mortgages.

The advantages for mortgagees of regular monthly mortgage payments are many:-

1. Interest is received monthly
2. The principal portion of the payment can be saved and added to in order that funds can be accumulated for another mortgage.
3. Satisfaction of being a factor in another person making progress is gratifying.
4. The return on investment is far higher than most investment plans.
5. The use of private sector funds can reduce the need for many government subsidies with the result that taxes need not be raised to pay for these subsidies.

We propose, therefore, that the Ontario Government guarantee 2nd mortgages, provided that they are at the same rate as the 1st mortgage, and the down payment be sufficiently high to ensure that the purchaser will want to protect his/her equity.

From the point of view of the Government, this will stimulate home ownership and renovation at a reasonable interest rate and as well, be instrumental in involving the private sector's funds directly in the encouragement of housing. The history of payment of good second mortgages is very sound and as a result, no Government funds will be necessary.

After this program has been operating for some time, it is quite possible that pension funds that are invested in low interest return investments, will be shifted to second mortgages at a much higher interest rate.

As confidence in mortgages develops, private funds will become more readily available and with large sums chasing mortgages, the interest rate will tend to fall. With reduced interest rates in housing, more houses will be built.

* * * * * * *

OBITUARY

ERNEST J. FARMER - 1883-1975

by Ernest C.J. Bowser

On September 25th, 1975, Ernest Farmer slipped away from us and very few Square Deal readers were aware of his death. It is ironical but it is typical of Ernest. He was the Father of the School, started the School of Economic Science as a name for Toronto in 1938, rather than the Henry George School.

Ernest started teaching by visiting and teaching classes in homes. He took street cars, and mostly walked, regardless of weather. He was President of the School of Economic Science and the Henry George Foundation for many years.

Somewhere in those early years he started the "Square Deal"; he wrote the copy, edited it himself, made it ready for mailing, then walked to the Post Office.

About 20 years ago, new graduates were anxious to help. Ernest would listen to all the new ideas and sometimes excessive enthusiasm. At the end of a meeting, Ernest was as enthusiastic as the new graduates.

However, he was still the "Father" of the School, and everybody kept in touch personally, over and above the regular meetings, for advice and guidance. Of course, Ernest never missed a meeting. One night we had the worst snow storm of the winter and Ernest walked through snow over his knees to the home of the Pott's for our Executive meeting. At that time he was pushing 80 years of age, lugging copies of the Square Deal to distribute amongst the Executive and therefore save postage.

Ernest was born in Woodstock in 1883, was reading and writing at the young age of 3. His brother Arthur used to tell me he felt he was the dumb one in the family because he couldn't read and write until he was four.

At a young age of 20 years, Ernest graduated from McMaster University with a B.A. in Modern Languages. The University gave him an Honourary Doctor's (ATCM) in Music at the same time as receiving his B.A.

From there he went to Leipzig in Europe, studying more music for another three years. In 1906 he returned to Toronto and joined the Hamburg Conservatory of Music. Some time later he transferred to the Toronto Conservatory of Music which is now called the Royal Conservatory of Music of Toronto.

Besides being President of the School of Economic Science, and teaching, of which he never received any remuneration, Ernest travelled all over Canada examining music students. These trips were in major cities, but also way off the beaten track. He could have written a book on drafty railroad stations, buses, and old cold hotels. I actually remember when he was 84 years old he went all the way to Yellowknife.

What I will always remember most was his sense of humour. After a meeting, then coffee and cookies, Ernest would stand in the centre of the room, straight as a ram rod and start hi very dry jokes and poems. They were all funny, and the odd part was we had never heard them before, or since. When we had meetings in his own home we would make him play the piano, which was a Grand, and took up over a third of his living room. The music was beautiful, and he was always worried about his eyes as to the day would eventually arrive when he could not attend the Symphony concerts.

Ernest J. Farmer was an intellect, a genius, a musician, a humanitarian, dedicated, and generous to the School, both in time and donations. But, he was quiet and always on the sidelines.

It was typical - - he just slipped away.

* * * * *

THE POETS HAVE SAID IT ALL BEFORE

by J. Lotz.

In *The General*, C.S. Forester compares the behaviour of the British generals in the First World War to that of an isolated tribe that has learned how to use nails. One day, the tribe finds a screw. They treat it like a nail, and wonder why it is so difficult to hammer it into wood.

Forester's analogy haunted me as I attended sessions at the conference. Quite obviously, in Canada, we have accumulated a lot of answers to the problems of social change. But have we been asking the right questions? My role was to comment on Industrial Relations problems from the citizen's or general public's perspective. The members of the "General Assessment panel" read their papers, so things got off to a dull start. The academics were academic, and the civil servants civil. The case study was on "The Task Force Report on Labour Relations", the Woods Report of 1968. Given the troubled conditions in the Canadian labour force — and the crippling strike of the Post Office that was in progress during the conference — this document was about as relevant as a Babylonian clay tablet. Indeed, a senior government official at the final plenary session identified the government's relations with its own employees as a major area of concern.

From the citizen perspective, industrial relations in Canada resembles a private poker game, played by experts. In the sessions, everyone seemed to know everyone else; participants were old friends and/or enemies. They spoke a language, used terms, and dropped names that meant nothing to me. Academics attacked government officials, who felt they had to defend themselves. Labour union officials poured scorn over both houses, pointing out that labour union members were the last ones to hear about research on their problems. Much of this, of course, was pure theatre, and theatre of the absurd at that.

In the final session, an apostate labour relations expert claimed that he would never again work for government. Another authority saw the need to spend $50 - 100 millions on demonstration projects in industrial relations. He rather spoiled his case by pointing out that similar projects in Norway had collapsed when the social scientists left. A former Deputy Minister of Labour pondered the science and public policy have been two balls juggled by politicians and civil servants to keep the ordinary citizens bemused — and amused — in a time of rapid change. A labour mediator (in conversation) told me how he settled one tense situation. He asked both sides to examine the implications of their actions for the rest of the community. Using "common sense", the two sides settled the dispute quickly.

If social scientists are to play any sort of a role in the development of Canada, they are going to have to work in the middle ground, between the people and the government. And they are going to have to report their findings in a language that the ordinary citizen can understand. Those at the conference were against government secrecy, but they ignored the problems of professional obscurity.

The swing from positivism to pessimism in social science in Canada has mirrored a change in the mood of the nation. On several occasions, I heard the phrase 'The Emperor's Clothes'. A speaker at the final plenary session quoted Yeats's words; "Things fall apart; the centre cannot hold;/ Mere anarchy is loosed upon the world".

A fairy tale teller and a poet, in a few words, summed up the state of society much better than the multitude of Canadian social scientists who attended the conference.

School of Economic Science

The School of Economic Science is a private, non-profit, educational organization. It was incorporated in the Province of Ontario in 1939. Affiliated schools are active in most of the large cities of North America and in a number of other countries.

The school focuses its attention on the economics of the property tax, and is undertaking research into land taxation, building taxation, land use, municipal finance and related maters and produces educational material to promote better use of land.

The school advocates Site Value Assessment for taxation as the appropriate method of property taxation as it provides incentive to build and improve while at the same time it encourages putting land to good use.

A subscription to the "Square Deal" is $3.00 per year. You are invited to recommend it to new subscribers who will appreciate the efforts.

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