Thesis #6

The world is on the cusp of the greatest redistribution of income in history. Infrastructure, which originated as a life-force, sent its value flowing through the ages to endow people with richer lives. When that social value was diverted into private pockets, people were cheated and their civilisations imploded. That catastrophe is once again unfolding in our midst.

The Art of Political Rip-offs

Fred Harrison

Contents

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MORE than two thousand years ago, Li Bing was appointed as the governor of China's Shu Province. His legacy is a canal: Li diverted water cascading down the Minjing River from Tibet. His canal waters the plains of Chengdu to this day. He initiated a piece of infrastructure that delivered a permanent increase in welfare for the peasants working the fields, by providing a steady stream of water for their crops. The original investment has repaid itself in terms that cannot be calculated. Who can doubt that the canal covered its costs? Since 276 BC it helped to generate additional food out of the soil, creating a "Land of Abundance". Dykes and dams ensured homes and fields were never again subjected to floods and droughts.

But such monumental investments can be a mixed blessing. To maximise the social value delivered by investments like that canal required more than the engineering genius of Li Bing. If the gains were not shared on an equitable basis, the canal could be turned into a tool for exploiting the peasants who farmed the 25,000 square kilometres that were irrigated.

The water needed to flow alongside wise financial policy. Otherwise, the net gains – what Marxists call the "surplus" – would attract warlords. Those social renegades were always ready to unsheathe their swords and go a'hunting for the rents that emperors failed to collect and recycle back into the community to fund the common good. If we cannot compute the rents generated by the canal, we can examine more recent examples to gain a sense of the role played by infrastructure in enhancing a society's productivity.

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Take the case of London's Blackwall tunnel. It was dug beneath the Thames in 1897. Before it was opened, the productivity of nearby locations was measured by the selling price of land: £3 an acre. After it opened, the price jumped to £200 an acre (Tyler 2013: 158). But that increase in productivity was not shared by all the taxpayers who funded the excavation beneath the river. Over the past century, commuters who travelled into North London via the tunnel pocketed the enhanced productivity that they did not fund. Result: the burden on taxpayers was higher than it need have been.

The tunnel illustrates the way in which "public goods" like schools and highways are converted into instruments for redistributing a nation's income. A democratic mandate does not exist for the policy of transferring wealth from those who create value to those who exercise the power to extract a nation's rents. That is why the process is covert. Politicians fabricate myths about the need to raise taxes to pay for such projects without disclosing the ulterior motive: the quest to enrich those who own land, or who can manipulate the credit-creating system to share in the spoils.

One justification for increasing investment in infrastructure is the need to create jobs. But instead of improving people's welfare, the boom in investment that is now in the making will inflict enormous costs. *The world is on the cusp of one of the greatest redistributions of income in history.*

Economists at McKinsey Global Institute estimate that, just to keep up with projected global growth of GDP, $57 trillion needs to be spent on infrastructure by 2030 (Dobbs *et. al*. 2013). Governments are planning investments that will turn into a rip-off on a scale unparalleled in the annals of capitalism. *Natural habitats will be wrecked, and cultures impoverished, in pursuit of the capital gains from tax-funded investments*. Here, we focus on the impact on culture.

Culture is a composite of two elements.

- The *software* consists of the customs and practices into which each new generation is schooled. Children are inducted into their community's language, belief system, moral code and "manners".

- The *hardware* consists of physical amenities like the highways, water and energy utilities, monumental structures (administrative and spiritual centres). These are public in nature, distinct from the assets owned for the private use of individuals.

Friction arises when the boundary that divides private from public assets is not respected. That boundary was eviscerated after Europe's States were privatised some five centuries ago. A perverse model of statecraft was incubated that was then embedded (through colonialism) across the rest of the world.

Two hundred years ago, the infrastructure that supported Britain's Industrial Revolution accelerated the debasement of culture's software. Decisions were made to accommodate the appetites of those who dedicated themselves to the art of living off their community's rents. Those people used infrastructure (like mass transit systems) to short-change fellow citizens by engaging in a psycho-drama. *The trick was to persuade others to fund the infrastructure that would increase the rents going into their pockets*.

The lead role in facilitating that trick was played by those who manipulated the statecraft of greed (Thesis #1). The drama, in the form of multiple rip-offs, illuminates how the public's finances served as a malevolent force, one that now disrupts communities across planet Earth.

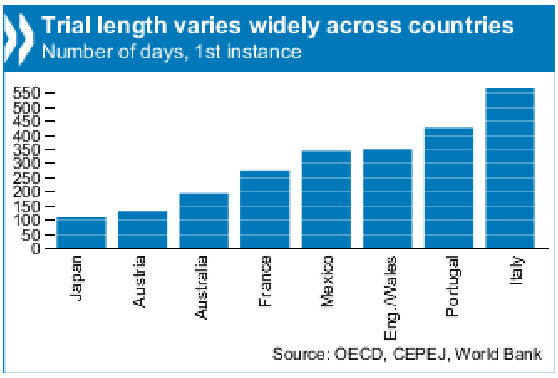
Rip-off 1 The Corruption of Morals

In December 2013 the OECD's Working Group on Bribery reported that Ireland had broadened the forms of bribes covered by the foreign bribery offence in the Prevention of Corruption (Amendment) Act 2010. Ireland now has jurisdiction over foreign bribery committed abroad by Irish companies and nationals. Sanctions for false accounting offences have increased. But the OECD's *Phase 3 Report on Implementing the OECD Anti-Bribery Convention in Ireland* is silent on the public finance system that fuelled bribery in Ireland over the past 20 years.

A series of public investigations have revealed a catalogue of abuses by land developers, public officials and politicians who bribed their way to small fortunes in the process of extracting rents out of the public domain during the property boom. The financial incentives for corrupting morality remain in place today, awaiting the temptations that will re-emerge in the next real estate bubble. And, ironically, enhancing the system of justice itself is not sufficient to diminish the risks of corruption.

Tax-funded investment that improves civil justice would boost productivity, innovation and people's living standards, according to another report from the Paris-based think-tank (OECD 2013). Again, missing from the analysis is any appreciation of the role of fiscal policy in the process of corruption.

Protection of property rights and enforcement of contracts encourages savings and investment and enhances competition, innovation, the development of financial markets and growth, notes the OECD. Reducing litigation rates increases the efficiency of civil justice. The scope for improvements to performance in OECD countries is enormous (see chart). But bringing the least efficient countries up to best practise would come at a price. *The net gains from improved systems of justice would translate into higher location rents, thereby encouraging rent-seekers to reap some of that value by political manipulation and illegal means*.



Rip-off 2 Rewards for Speculators

The politicians who decided to order the construction of a harbour bridge in Sydney knew that land would rise in value. So to fund the bridge, they introduced a "betterment tax" on land. This raised £114,768 in 1923, peaked at £194,651 in 1930, and then fell under the influence of the Great Depression. That was when the land speculators got to work. The outcome was recorded by civil engineer Lewis East:

Property owners, particularly those who were speculating in land subdivisions and were unable to dispose of their holdings, complained that they were unable to receive the benefits they expected, and were successful in having the [tax] rate reduced in 1933 and again in 1936. In 1938 it was discontinued altogether (East 1944).

The bridge cost £9.8m to build. Taxpayers recovered £2.4m. Since then, the continuous increase in productivity has gone into the pockets of land owners.

Rip-off 3 Waste of Capital

Infrastructure built primarily to serve rent-seekers generates urban sprawl, environmental damage (loss of green fields), additional pollution (from extended commuter journeys) and it wastes capital. Opportunities for land speculation are increased, and resources available to value-adding enterprises are decreased.

The economics of this process has been documented by Mason Gaffney, emeritus professor of economics at the University of California (Gaffney 2009). Capital-intensive infrastructure (like roads to under-populated areas) turns over very slowly: meaning, a slow payback period of 30 years or more. This is at the expense of high-turnover private enterprises which generate profits quickly, and are labour-intensive.

The "bridges-to-nowhere" syndrome illustrates how rent-seekers influence the State. A notorious example is that of Japan during the boom years of the 1980s. Governments were discredited by scandals revealing the way in which politicians favoured their constituencies with capital-draining projects (Harrison

1983). The scandals around Prime Minister Kakuei Tanaka brought shame on the nation, but failed to stop what Americans call "nose-in-the-trough" politics. A recent example is the "roads to nowhere" in Portugal (Wise 2013).

Rip-off 4 Higher Taxes

Socially useful infrastructure is self-financing. There is no need to tax earned incomes to provide the transit systems, utilities and other forms of infrastructure needed to service modern societies. But because the net increase in income created by those public goods is privatised, governments have to resort to one of two financial mechanisms to fund the delivery of the infrastructure.

1. Increase the taxes on the incomes people earn from work.
2. Borrow from bankers, who willingly create "credit": the rents generated by infrastructure are paid to them as interest (Hudson 2012).

Outcome: the economy is permanently locked into a path of growth that is below its potential. The distortions caused by taxes yield gains to rent-seekers and permanent losses to the working population. Those losses are cumulative. If valued on a compound basis, the total sacrifice endured since Li Bing constructed his first dike is of an order that would challenge the mightiest of modern computers to add up.

Rip-off 5 Destruction of Jobs

The rent-seeking culture survived by capturing the science of political economy. Economists misinform policy-makers in ways that undermine the prospects of present and future generations. Spurious theories are promoted to camouflage the forces that destroy people's livelihoods. One is the argument that "inheritance is the major determinant of wealth inequality" (Harbury and Hitchens 1979: 136). We are told that parents endow their children with the wealth they accumulated from a lifetime's work, providing their offspring with an advantage over children who do not inherit wealth. That is obvious. But is this the *major determinant* of inequality?

Public policies that sponsor the mal-distribution of income are the *major determinant*. Taxes that favour rental income and penalise labour's income undermine the efforts of each generation to deploy talents and energy to yield the lifestyles of their choice. An example is the way in which Ireland is responding to the land-led boom/bust that destroyed its economy in 2008.

Ireland's politicians deluded themselves by fabricating the myth of the "Celtic Tiger". They were actually fuelling an obscene bout of land speculation. Public investment in infrastructure, such as improvements to railways and new motorways (part funded by the European Union's taxpayers) was under-written by high-octane debt. Governments refused to introduce even a modest property tax on real estate. The property market collapse was spectacular.

Record numbers of people lost their jobs. The government mailed letters to workless youths to encourage them to seek jobs abroad. One recipient was informed of a bus driver vacancy in Malta. The pay was €250 (£209) a week, with the bonus of a "Mediterranean climate" (Smyth 2013). Politicians killed off the jobs, and left the next generation to pay the price.

Rip-off 6 Discrediting Democracy

At the commemoration service held for the late Nelson Mandela in December 2013, the public booed their President, Jacob

Zuma. The belief in the streets of South Africa was that the political elites had benefited disproportionately from post-apartheid reforms. After 20 years of democracy, South Africans are growing increasingly angry that income inequality is as bad, if not worse than it was during the apartheid era. One in three workers does not have a job or has stopped looking. Violent crime and corruption are pervasive. As part of its "modernisation" programme, the ANC government "reformed" the social infrastructure. This included abolishing the direct (albeit modest) tax on land. Meanwhile, a favoured few ANC insiders grew rich; not least because they were able to access the rents of a resource-rich nation.

Globally, scandals associated with political corruption are in the main associated with extracting rents out of the public purse. The alarming rate at which US banks are leveraging depositors' money to purchase public assets like ports, airports, toll roads, power, and natural commodities is analysed by one attorney as a direct threat to American democracy (Brown 2013).

Rip-off 7 Killing the Future

The more a community invests in schools, the wider the choice of life-styles for children when they enter adulthood. But access to tax-funded schools is not based on equality of opportunity, but on the size of the mortgages that families can afford.

- ❖ In the US, the premium for homes in the catchment areas of top-ranked elementary schools was an average $50 per sq. foot in 2012. In Chicago, the median price of such a home was over 58% higher than the median price for a home near an average-ranked school (Podmolik 2013).
- ❖ In Britain, the average premium for a home near a good state primary school is 40% higher than comparable properties in the same area. In some locations, house prices near good schools are 170% higher than comparable addresses (Malnick 2013).

The higher location values register the additional benefits gained by accessing the best schools. If the rents were collected, they could be reinvested in raising the quality of poorer-quality schools. Instead, the benefits go into the pockets of land owners.

The consequences are transmitted inter-generationally. The values of privileged residential properties increase faster than dwellings in other areas. Owners accumulate those higher returns as capital gains, which are then used to fund additional unearned benefits. These may range from paying for children to enter top-class universities to enjoying "conspicuous consumption" lifestyles. Meanwhile, taxpayers in poorly endowed areas help to fund the high-quality schools that trigger this process of dividing the generations into Haves and Have-nots.

Rip-off 8 Carving-up Countries

The singular cause of these ruptures to people's lives, and to their relationships with their natural and social habitats, is the failure of governments to apply a justice-based pricing system. If the value created by infrastructure is not collected to fund their capital costs, it does not go begging. It is collected through the land market, which is the mechanism for measuring the value of a bundle of such services in each location.

The inter-personal injustices emerge on a nation-wide – and even a continent-wide –

scale. Resources are extracted from peripheral regions and employed in higher productivity locations. This process is Ricardo's Law at work, leading to concentrations known as "agglomeration" (Harrison 2006a). Because tax policy favours high value locations, society is carved up in ways that prejudice the essence of what it means to be human.

An example is the fiasco associated with the proposal for a high speed railway (HS2) in Britain. The Cameron Coalition government argues that cutting the travel time to the north of England for businessmen would yield massive gains. But the net benefits would be captured by commercial enterprises in the South-East. Reducing the costs of doing business with other regions works to the advantage of businesses in London. That outcome does not feature in the cost/benefit analyses published by the government, which is not even sure how much the investment would cost taxpayers (one estimate puts the cost at £80bn: Watts 2013).

Reclusive localism is not the answer. Few people wish to live isolated lives. Life is enriched when communities are linked by roads and railways. The pricing mechanism that required people to pay for the services they used would yield the correct balance between spatially distributed resources and communities.

Full, marginal-cost Pricing

HS2 illustrates the imperative need for a partnership between the public and private sectors. Large infrastructure generally requires extensive tracts of land, which can only be assembled with the support of legal sanctions. In addition, regulatory systems are required to maintain the quality of services provided by what are often monopoly suppliers.

The appropriate balance between the public and private sectors is achieved by employing full-cost pricing. This consists of

1. Direct payment for specific services, where these are personally accessed by individuals from the agencies that provide them (as when travelling on a train).

User charges would be very low. They would reflect the "marginal" cost of (say) providing an extra seat on a train. *Capital costs should not be included in ticket prices.* Under the present garbled arrangement, in which private and social costs are jumbled together, travellers are called upon to defray part of the capital costs of infrastructure. This means that user charges are higher than they ought to be, with consequent distortions to people's preferences (such as opting to travel by car).

2. Capital costs would be funded out of the rents that the infrastructure generates. These rents are measured within the catchment areas serviced by the infrastructure, as illustrated by the case of schools.

In the case of the extension of the London Jubilee line, the capital cost of £3.5bn was rewarded with a net gain of £14bn, as measured by the increase in land values around the stations stretching from Waterloo to Canary Wharf (Harrison 2006b).

People know how to assess the quality of services they want, and they can relate this to what they can afford. This exercise is performed every time a family chooses where to live. The price of every location includes a range of amenities on which home buyers place a value, when they decide on the location of their choice.

Ordinarily, prices are negotiated through real estate agents. The vendor does not call the agreed price a tax, for the obvious reason: the payment is not an arbitrary levy exacted from someone's income. The price is symmetrically related to the services which the prospective purchaser judges will fulfil his needs.

But there is an anomaly in this charge. The price of a house is paid to someone who does not provide the services whose value is included in the negotiated price. Public agencies provide the schools, parks, transit systems, and so on, which affect the value of each parcel of land. The money that is paid to private individuals is a monetary measure of the failure of governance. This failure caused Europe's governments to hand the provision of public goods to banks in the 1990s, creating the financial conditions for the property boom that bust in 2007 (Box 1).

Democratising the Public's Finances

Full-cost pricing is *not* a neutral fiscal policy, a pure revenue raising tool. It is biased. It favours expanded employment prospects, and it diminishes the stresses generated by the pathological defects in the economic system. These benefits are achieved by untaxing earned incomes, and deterring land speculation which necessarily ends in busts.

By phasing in the democratic form of public finance, incremental changes would occur in the character of the Tax State. The scope for "nose in the trough" deal making in the corridors of power would be eliminated (because transparency and accountability are intricate features of full-cost pricing). Adjustments would automatically emerge in the structure of the social system, and in people's behaviour. These include enhancement of the psychological health of the population.

Box 1
How to Fuel a Boom/Bust

Exiting the recession of 1992 (a recession caused by a classic land-led housing boom), cash-strapped governments offered banks the chance to provide amenities such as bridges, roads and power plants. *Wall Street Journal* reporter Charles Fleming noted that this opened up a "rich market in infrastructure". He added: "This shift from public money to private has led to an unprecedented boom in the global project-finance market…lenders are increasingly seeking project debt because it offers higher margins and longer maturities than traditional corporate loans" (Fleming 2013). Britain was notorious for leading the way in Public Finance Initiatives that saddled the nation with huge debts and poorer public services.

When the political system is sensitive to people's wishes, power is diverted away from corporate lobbyists. The sole price for these gains is agreement to pay for services based on (a) what you want, (b) where you want it, (c) when you want it, and (d) in the proportions that you want.

Recycling rents back into the public's infrastructure is the financial system's automatic stabiliser at work, operating as a feed-back mechanism. The growing, dynamic macro-economy is kept on an even keel, enabling people to create the living patterns that fit their needs at the local, regional and global levels. That feedback mechanism does not currently exist, which is why the capitalist economy is cyclically torn apart by booms and busts.

Learn, or Lament?

The economics of full-cost pricing are well attested in the economic literature. But economists choose to present the theory in narratives that favour the *status quo.* Alan Greenspan, for example, continues to shape perceptions about the future. His qualification for pontificating is his malevolent contribution to the US economy, which collapsed at the end of his tenure as Chair of the US Federal Reserve. On TV, and in Press articles, he claims that there is great uncertainty about how to recover from the depression which he helped to create. He notes that firms are clinging to their cash instead of investing it. This, at a time when there is a desperate need to ramp up investment in America's infrastructure (see Box 2).

Box 2
Degrading America's Infrastructure

Investment in US infrastructure up to 2020 will fall short by $1.6tn, according to the American Society of Civil Engineers. The quality of aviation, bridges, dams, drinking water, energy, hazardous waste, inland waterways, levees, ports, public parks and recreation, rail, roads, schools, solid waste, transit, and wastewater will suffer for want of resources.

These services generate benefits that exceed their costs. So why are US governments only proposing to spend about $2tn when the nation needs to invest $3.6tn?

Greenspan vindicates his failure to anticipate the financial crisis by claiming that "herd behaviour" did not feature in forecasting models. He now claims that it *is* possible to make financial sense of "animal spirits" and anticipate future asset booms. Nowhere in his latest analysis (Greenspan 2013) is there any indication that he has learnt the real-world lessons of his mismanagement of America's financial system.

Some fiscal experts, like Vito Tanzi, say that the economic role of the State is changing. Tanzi, who directed fiscal policy at the International Monetary Fund, sub-titled his latest book *The Changing Economic Role of the State* (2011). On the issues that are relevant to a sustainable economic future, no such change is occurring. Post-classical economic doctrines prevail.

The great fear, now, is that "secular stagnation" will afflict the trans-Atlantic economies. *The Economist* is typical in urging more investment in infrastructure *without explaining that, under the current pricing system, the primary effect would be to redistribute income* (*The Economist*, 2013: 15). Increases in production and consumption would play a supporting role: necessary, to generate the rents that are the focus of public policy.

Banks and sovereign wealth funds based on oil-rents are lining up to offer cash to western governments that promise them super-profits over the next 30 years. Taxpayers will get the raw end of the deal. Not only will they fund the infrastructure through taxes, but they will also pay an additional cost in the form of "austerity" policies. People below the super-rich category will endure a reduction in real incomes over the next few decades as their governments slash budget spending to cope with increases in their debts.

This outcome is aided by international agencies that advocate policies which misalign costs and benefits. That is happening in Tunisia, for example, where the OECD and the African Development Bank is helping to shape a new law on public-private partnerships (PPPs). The outcome will not be a partnership of equals. Private capital will ensnare future governments in deals that will yield huge rents for banks and higher taxes for the people of Tunisia.

As things now stand, infrastructure will be deployed in the 21st century as a weapon of mass destruction, to protect the predatory rites of the culture of rent-seeking.

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