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From Séance to Science

THE ONUS is on the apologist for capitalism to defend that form of economic organisation.

Capitalism is justified in terms of its efficiency. According to the authorised version, no other kind of social system can deliver the goods which people want at the prices they can afford. The competing social system exposes this claim as false.

De-constructing the capitalist system is not a conceptual challenge for anyone. All we need to understand is that it is composed of two entirely distinct social formations. On the one hand, there is the culture of the Predators: the people who live off the labours of others. Those others are the Producers: the people who add value to the wealth of the nation. For five centuries, Britain has lived with that system, and successfully implanted it on the five continents of the world.

It is impossible for a system that is embedded in foundations of monopoly power to be efficient. From this, it follows that by erasing monopoly power, we are left with a system whose efficiency has increased by a quantum leap. Some measures of this increase are offered in Chapter 12. But first, we need to return to an assessment of extent and process by which capitalism is rendered systemically inefficient.

We start with those who manage banks. They throw away billions of dollars of money that belongs to others. You are likely to be one of their victims.

Britain's biggest bank, HSBC, managed to lose \$17bn (£8.5bn) on bad loans in 2007. It locked itself into America's subprime disaster by paying \$15bn to acquire Household, the US consumer finance group in 2003. But that did not stop it paying one director £9.9m (\$20m) in 2007.

Bankers claim that their mind-boggling

fees and bonuses are the market rate for their jobs. It appears that the world's leading banks are so bereft of talent that they are not able to head-hunt managers with the skills to avoid some of the biggest losses in corporate history. So they hire men (and they are all men) whose faith in free markets turned out to be misplaced.

If I had been the CEO of a bank with a global reach, I would have made sure that my shareholders did not suffer astronomical losses. In 2005, I would have instructed the dealers to get rid of assets that contained toxic mortgages. That was the year in which I published the warning that CDOs had been "pumped up to between $300bn and $400bn on the global scale".[1] The risks were shifted on to working people "through a reduction in the quality of the investments held by their pension funds".

Money-men were pocketing huge bonuses because the laws which govern their activities are rigged to favour those who can devise ways to extract wealth without adding to the sum total of the pie that can be shared between us.

1 Harrison (2005: 181).

Land speculation was the sole reason why Japan suffered its Lost Decade in the 1990s. The waste will continue for decades into the 21st century, following the housing crises from which no country in the world was immune.

China, ironically, the country whose constitution is rooted in the ideology of Karl Marx, is leading this century's charge into the nightmare waste of human labour and natural resources. Policy errors are adding to the trauma. China's companies are "strapped for cash, unable to build on the land they have accumulated. Beijing is breathing down their necks, having pledged earlier this year to tax and seize hoarded land."[2]

Bank of China invested $10bn in American sub-prime property, and paid the price as its assets lost their value. The Politburo realised that home-grown land speculation linked to American land speculation would compromise its attempt to straddle the ideological divide between communism and capitalism.

Over in Japan, the country that had not

2 Cheng (2008).

fully recovered from the land speculation of the 1980s suffered again when its property market began to slump in spring 2008. People found it "difficult to pay for the higher cost of land that developers are passing onto them through the sales price".[3]

As capitalism buckled, dark thoughts entered the minds of the Captains of Industry. Joseph Ackermann, the head of Deutsche Bank, Germany's biggest bank, declared: "I no longer believe in the market's self-healing power."[4] Deutsche Bank's chief economist, Norbert Walter, predicted that "The turbulence won't be over before the end of 2009 ... We need a new order and a new way of thinking in regulating the finance markets." The losses came thick and fast ... UBS, Switzerland's largest bank, wrote off $18bn in 2007, and another $18bn (£9bn) in early 2008 ... the total, worldwide, was now predicted to notch up to losses of $600bn.

3 Whipp (2008).
4 Skapinker (2008).

The Reality Check

MY WORST FEARS were being realised. I was branded a Prophet of Doom by the media. Aghast at my prediction about the property market, one columnist asked: "Is it by chance that this crystal ball gazing – so far – seems to have been uncannily accurate, or does Harrison really know something we don't?"[5]

If I have a crystal ball, then it's one that you, too, are now able to use. If you have stayed the course with me, you will know that it does not require the brainpower of an Einstein to fathom the cycles of earthly economics.

I knew that forecasting a global depression was not going to win me friends. Reputations had to be defended. Lord George, as Governor of the Bank of England during the early years of the build-up to the property boom, knew that his stewardship would come under examination, for he was the central banker who presided over the start of the housing cycle in the 1990s. I was not surprised when he

5 Clark (2008).

declared: "I don't believe in the blame game."[6]

But I also knew that events would eventually force economists to admit that "the prospect is for a complete seizure of the commercial paper market, which would set in motion forces like the debt deflation of the 1930s" (as one of them at the London School of Economics put it).[7] And that economic editors would get round to noting that, "The last time big finance messed things up as spectacularly as this was the late 1920s and early 1930s."[8]

A new brand of leadership is needed. Leaders need to distinguish between appearances (the social veneer) and reality. Outward appearances change through time, but the internal mechanism that drives property speculation into booms and busts remains the same in all business cycles, everywhere, at all times.

- In the 18th century, the canal-building revolution drove the property boom/busts.

6 Inman (2008).
7 Wade and Auerback (2008).
8 Elliott (2008c).

- In the 19th century, the railways drove the land boom/busts.
- In the 20th century, cars drove the suburban house building sprawl that shaped the classic boom/bust.
- In the 21st century, property boom/busts will be driven by the new opportunities created by the eastward shift in the economic epicentre.

The only remedy for economic instability is the counter-cyclical reform which has been known to economists for 300 years. But politicians will provide leadership only if the terms of public debate shift away from the language of the séance to the methods of science. To achieve that, we need to challenge the smears that are levelled against the one policy that can muster the economic muscle to forestall the next land-led boom/bust. Unwittingly, the Governor of the Bank of England makes my case for me.

Mervyn King has "dreamt" of discovering taxes "which eliminate the excess burden" that damages the economy, "but it is not easy to find taxes which have no disincentive effects". Given his pessimism, we are not surprised when he says that we have to live with "the inescapable losses which the need for revenue imposes on the taxpayer".[9] In Britain alone, in 2006, losses inflicted by the government's revenue-raising policies totalled about £160bn, according to Ronald Banks, Chairman of the Land Research Trust. He used the Treasury's own yardstick to calculate the deadweight burden of taxes that deter people maximising their private and social welfare.

But isn't there one "tax" that enables us to escape these losses? Why yes, wrote the man who would be Governor of the Bank of England (he was a professor of economics at the time). The windfall gains from land and property development could be taxed without such malevolent effects on people's incomes. We know this, because (he wrote) "the theory of economic rent suggests that they could be taxed very heavily without inhibiting development".

So why doesn't Mervyn King coil into his chauffeur driven limo and glide down Whitehall to the Treasury, to commend this

9 Kay and King (1990: 18, 19).

time-honoured way of raising revenue to the Chancellor of the Exchequer?

He won't do so, because according to King, there is a problem with this policy. He and his co-author claim: "At the end of the 19th century, a movement led by Henry George argued, vigorously, that for these reasons [*the public collection of rent does not damage the economy*] land should be the principal tax base." But while "the underlying intellectual argument for seeking to tax economic rent retains its force", it appears that there are practical problems.[10] And what were those problems? Successive Labour governments had taxed land since 1947, and they had all ended in failure!

Those postwar forays into land taxation did deserve to end up on the scrap heap of discredited legislation.[11] But *those taxes were nothing like the fiscal policy prescribed by Henry George*, the American social reformer who campaigned for economic justice. Nevertheless, King smeared Henry George (1839-1897), using the technique favoured by the Spanish Inquisition: guilt-by-association.

10 Kay and King (1990: 179).
11 Blundell (1994).

In his *Progress and Poverty* (1879), George recommended public charges on market-determined rents. The charge would fall on current values. This meant that land users – working through the marketplace – determined how much they paid into the public coffers. The charge was not tied to an event (such as the development of land), so it could not be avoided. The policy would work, as it does today (on an anaemic scale) for state and municipal governments in Australia, New Zealand and Denmark.

Mervyn King's readers, however, are not left with the vision of a benign form of public finance. Instead, their minds are coloured with stories culled from the record of botched-up experiments by governments which made no claim to be employing the revenue system that would deliver efficient results.

Re-educating Economists

THE DEPRESSION of 2010 unites all nations into a single economic fate, but one with multiple possible outcomes. Some will be heavy losers, like Europe and North

America. Cultures on other continents will flourish, but only if they are not crushed over the next business cycle. To avoid being steam-rollered into a flat vision of virtual reality, a new way of perceiving the world is required.

If the practitioners of economics wish to participate in that future, they will need to re-educate themselves. Today, they are mediums in touch with another world while exploiting us in this world. Economics must be transformed from séance into science. The challenges faced by economists are indicated by Alan Greenspan, whose words indicate the long journey that must be taken by economic bean-counters.

Critics place responsibility for the financial crisis on Greenspan's shoulders.[12] He has certainly set himself up as the target for the fairground coconut shies. In a 2005 speech, he declared – just as American house prices hit their 14-year peak – that,

> Innovation had brought about a multitude of new products, such as sub-prime loans ... with these advances

12 Fleckenstein (2008) and Bonner and Wiggin (2008) are two examples of the instant wisdom that fails to offer an informed account of the historical context of the boom/bust cycles.

in technology, lenders have taken advantage of credit-scoring models and other techniques for efficiently extending credit to a broader spectrum of consumers.[13]

Twelve months later, those "efficient" products contributed to the seizure of America's banks. And what did the ex-chairman of the Fed think about this turn of events? Looking back, the best he could offer was the wisdom of the medium divining the future through the séance.

If we could adequately model each phase of the cycle separately and divine the signals that tell us when the shift in regimes is about to occur, risk management systems would be improved significantly.[14]

Gods – but not Greenspan – *divine* the future.

If economists wish to switch from divination to the methods of science, they need to abandon Greenspan's mind-colouring language. He analyses problems in terms of economic equations that cannot measure "animal spirits". It is these "spirits" – which apparently cause fear and euphoria – that lead to booms and busts, according to Greenspan.

13 Greenspan (2005).
14 Greenspan (2008).

Box 10:I

Salvation, Nordic-style?

Bear Stearns, a US investment bank, received mouth-to-mouth financial resuscitation when it fell victim to land speculation. That shock sent the US central bank in search of solutions. It promised the greatest shake-up since the 1929 stock market crash. Bankers feared greater regulation. Attention turned to Scandinavia's rescue of its banks in the 1990s.

The Nordic banks were victims of land speculation in the 1980s. They were brusquely nationalised. Norway's government insisted that the banks' shareholders should bear the losses. That lesson did not sit well with Wall Street: it wanted to protect shareholders from having to pay the price for the damage they inflicted on others.

But American financiers also preferred to ignore a second lesson. The 1990s rescue did not immunise

Box 10:1 (contd)

Norway's banks from the impact of land speculation. Its banks, and local governments, participated in land speculation in America through investments in the debts cooked up in Wall Street. They lost billions in American sub-prime property.

The general lesson: banks will continue to act as conduits for risky lending to property speculators, whatever the regulatory regime. The channels through which credit is made available to speculators changes in appearance to suit circumstances. There was the "secondary banks" crisis in the UK in the 1970s, the savings and loans crisis in America in the 1980s, the off-balance sheet charities located in exotic tax havens in the 2000s…but these all boil down to the same process. When capital gains from land speculation reach astronomical heights, the temptations are too great to resist; and regulations can be sidestepped by imaginative accountants and lawyers.

Black magic mumbo jumbo may suit economists searching for the powers of the gods, but that way of thinking has little to do with the world of people who work to pay their mortgages. If the Fed wishes to moderate the anguish inflicted on America, it needs to overcome the amnesia that enables it to ignore the lessons of history (see box on page 213).

Abstract thinking, or a knack with numbers, does not qualify anyone to pronounce on what happens in everyday life. But these tools do have an important role to play in redesigning the future; by, for example, reconstructing the past, to calculate the trends that really matter. This was done for South America's four largest economies, using a technique called "backcasting". It proved possible to trace the cyclical trends in the GDP of Argentina, Brazil, Chile and Mexico, going back to 1870. But the IMF economists who undertook the work failed to *explain* why those growth trends were punctuated by recessions which recurred, on average, every 18 years.[15]

15 Catão (2007).

Economists need intellectual therapy to relieve their minds of the fake models that caricature human behaviour and society. Because they have been co-opted into an agenda that locks our minds into a bankrupt model of the economy.

Gatekeepers of Our Minds

CHANGE WILL BE resisted by the Gatekeepers of our Minds. They persist with the claim that there is "no silver bullet" that can resolve the mess to which global markets were reduced at the beginning of the 21st century.[16] Public opinion is being moulded into accepting that financial crises and unemployment are the result of "market failure".[17]

But the market is no more than you and me agreeing to buy and sell our wares in the shops, at prices that are acceptable to us. Do we cause the failures that repeatedly crush the economy?

You will know, by now, that the problem

16 Guha (2008c).
17 Seumas Milne (2007), writing in *The Guardian*, pointed to the collapse of Northern Rock as "a classic case of market failure".

lies with the rules which determine what we may do within the market. Through the democratic process, the wisdom of the crowd could oblige governments to amend those rules in favour of our best individual and shared interests. But the Gatekeepers of our Minds include economists who persist in misrepresenting the economy, causing confusion and therefore hindering the reform process.

Thus are our lives subordinated by the pressures from the money markets. But the theories also influence the decisions of politicians. Mervyn King confirms this with the claim in his textbook that

> Banking is often suggested as a possible victim for special taxation ... Some of this simply reflects a primitive distrust of finance. Certainly it is difficult to see how any economic rents accrue in banking.[18]

Apart from land developers and the owners of valuable estates, the one group that pockets a significant slice of society's land rents is to be found in the banking sector. The rents are vacuumed up through the mortgage market. But according to Britain's top banker, anyone who thinks

18 Kay and King (1990: 186).

that banks should be targeted for special taxation has a "primitive" turn of mind!

The old doctrines have failed. There is no rescue package worthy of the name in the intellectual toolkits of free market libertarians, mixed-economy Keynesians or utopian socialists. And it is futile to retreat to ever more complex regulation by government agencies whose persistent failures confirm that they cannot be relied upon to protect our vital interests.

You now know that the fate of the property market is predictable, pre-determined by the rules of governance. *This is what politicians want to keep a dark secret. That is why they do not want you to discuss the economics and ethics of the land market.*

Is ignorance bliss?

The depression of 2010 need not be as deep or as extended as the 1930s. Nor need there be a repeat of this tragedy in 2028. Rules can be modified, democratically, if you insist on your right to control your life.

ECONOMISTS HAVE exposed the pathetic state of their art by appealing to the Queen. They think a monthly audience with Her Majesty would improve the performance of Whitehall forecasters. *Some hope!* When the Queen asked an economist at the London School of Economics why no-one had predicted the 2008 credit crunch, he could not offer a coherent explanation. So the British Academy tried to elucidate what had gone wrong, concluding that there had been "a failure of the collective imagination of many bright people".[19]

It's nothing to do with imagination. Economics is perverted by politicians like the man once known as the Prince of Darkness. Peter Mandelson, appointed by Gordon Brown as Lord President of the Council, First Secretary of State and Secretary of State for Business, Innovation and Skills, flew to Berlin to launch his plan for a greater role for the state in the markets. This is the man who, in 1997, was told, by me, how to help Tony Blair avoid the property boom/bust. When he was able to influence the markets – *when it mattered* – he failed in his duty. Why should an audience with the Queen improve his performance?

19 Allen (2010).