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Blueprint for Growth

CHINA'S GLOBAL hegemony draws closer with every passing day. Her advances in the economic and political spheres cannot be stopped. But they can be fatally *accelerated* by policy failures by Western governments.

If Europe and North America fail to develop a blueprint for reconstruction that works from the ground up, the outcome will not be confined to the loss of incomes. The threat is to the viability of the western social order itself.

Every policy miscalculation by the West has an upside for China. That is because scope for internal growth insulates China against any reprisals that could be levelled against her. And so, 2010 is the turning point into a new business cycle, but also the beginning in the shift in the balance of power.

Commercially, the trade war that looms on the horizon would accelerate China's internal development. The economic hinterland is enormous, hungry for investment in infrastructure and bringing 400m rural consumers into the domestic market. For the West, protectionism would be as much of a disaster as it was in the 1930s.

Economically, China's domestic consumer market could rise from the 2009 level of $1.72 trillion (£1 trillion) to a staggering $15.9 trillion by 2020, according to one estimate by Credit Suisse.[1]

Militarily, China felt strong enough to threaten economic sanctions against US corporations (particularly damaging for Boeing), to register her hostility when the

1 Lewis (2010).

US government announced a $6bn arms sale to Taiwan.

Financially, Western countries and corporations are forced to queue at Beijing's cash points. The financial consequences will not be fully apparent until after Asia's sovereign wealth funds have completed their "once in a lifetime" purchases of western assets. A political price will be exacted by China, whose nationalistic focus on economic development is even threatening neighbours like Thailand.

Ecologically, as the West struggles to develop a low-carbon economy, China helped to block a deal at the Copenhagen conference and is forging ahead with dirty technologies that power her factories. If the oceans *do* rise in response to global warming, the highest-cost damage will be inflicted on northern Europe and North America.

Scientifically, China has leapt ahead of her "emerging countries" competitors (Brazil, Russia and India) with research that will give her the competitive edge in the coming decades.[2] Particularly dangerous is

2 Cookson (2010).

the degeneration in Russia's scientific record. If Russia is forced to rely on energy resource rents for revenue, the Kremlin will resort to aggressive tactics to exact ever higher rents from Europe for oil and gas.

But these trends are as nothing, compared to the trump card which China has yet to play. That card is even more lethal than her undervalued currency, which adds to her competitive advantage in the global markets.

For now, Beijing has agreed to employ a tax regime that is a carbon copy of the West's. That ties one of her hands behind her back. By taxing wages and corporate profits, the full potential of the Chinese workforce cannot be exploited. So the astonishing double-digit growth rates of the past 20 years, when extrapolated into the future, *understate the capacity of the Chinese economy by a large margin*. Her growth rates could be even higher. How?

Ask yourself: how did Hong Kong become the super-star in the economic galaxy – eclipsing even the performance of the United States? Hong Kong's economy is applauded as the best in the world, in terms of GDP, versatility, and the freedom to produce wealth and attract capital.

Then ask yourself: how did Taiwan, after the communists had driven the republicans onto what was then called Formosa, turn itself into the first Asian Tiger?

Both those economies applied the rules of public finance that unleashed creative energy. Their governments drew their revenue from the rent of land, and left workers and entrepreneurs free to do what they do best – add value to products that sell to the world's consumers.

If Beijing scraps its taxes in favour of the Hong Kong/Taiwan model, whole regions of the West would turn into economic wastelands. By shifting the structure of her public revenue, China would cut labour costs (and therefore the prices of exported goods) even further; and accelerate capital formation (in doing so, raising productive efficiency) even faster. That explosive growth would be sustainable, because it would not be hampered by land speculation. Net result: the death of all hope of an export-led recovery for the West.

Who Do You Work For?

WESTERN GOVERNMENTS have boxed themselves into a corner. One policy exists which comprehensively re-tools society to face the problems that lie ahead. But that is the one policy that governments refuse to even discuss. The sole exception was the decision by the Republic of Ireland to explore the prospects of fiscal reform. Finance Minister Brian Lenihan announced on December 9, 2009:

> In the Renewed Programme for Government we have accepted the recommendations of the Commission on Taxation on the need for a property tax. Considerable ground work will need to be done before a Site Valuation Tax can be introduced. Work will shortly begin on the registration of ownership and the valuation of land.

We all know the saying: *There is nothing more certain than death and taxes*.

There is nothing we can do to avoid our eventual end, but there is a great deal we can do about taxes. The starting point is mind-cleansing therapy, because our knowledge has been prejudiced by interests opposed to a justice-based society. Our emotions are manipulated, because those interests need to confine debate to inanities. We need to clear away some of the nonsense that is talked about taxation.

The challenge is illustrated by the crass language of the author of a best-selling book on how to get rich. Robert Kiyosaki wrote *Rich Dad Poor Dad: What the Rich Teach Their Kids* to persuade his readers to work for themselves rather than as someone else's employee. He feeds prejudice by asserting that "Average Americans today work five to six months for the government before they make enough to cover their taxes".[3] That is music to the ears of hard-pressed workers, but it is a dumb way of expressing the flaws in the public's finances. The aim is not to enlighten, but to arouse animosity against government. The poor and middle class, he says, for example, "sit there and let the government's needles enter their arm and allow the blood donation to begin".

Similar shock tactics are employed by the Adam Smith Institute, a perversely named London think-tank. Every year, it announces the UK's Tax Freedom Day. In

3 Kiyosaki (2002: 116).

2008, Tax Freedom fell on June 2. Briton's taxpayers were invited to believe that the average person spent more than five months of the year *working for the government*. The estimate is based on government spending of £600 billion. That's £10,000 per person in the UK, double the rate in 1997.[4]

I ask: Do you work for the government? Is it "the government" that wants tax-funded highways, or do you use the roads to travel to work? Are schools for "the government" – or do you send your children to be educated at a state school? What about the fire and police services: are these for the benefit of government, or do you dial for the emergency services when your house is ablaze or a burglar threatens you in your home?

You, in fact, work for yourself. The government is in your pay, and required to provide the services that you cannot provide directly by and for yourself. But propagandists like Kiyosaki arouse passions by using language that inflames people's frustrations. This vanquishes the

4 http://www.adamsmith.org/tax-freedom-day/.

thinking space we need, in which to reflect coolly about the source of our problems.

The P&P Paradigm

DISCUSSION ON TAXATION should be located in a framework that takes into account the relationship between property rights and public finance. This is what I call the P&P Paradigm. It accentuates the nexus between property rights and the pricing mechanism.

- **Property rights.** Are we free to keep and enjoy what is ours? Or do we live off what belongs to others?

It is impossible to address the issues about taxation *without* agreement on what belongs to *me*, and what belongs to *you*; and – crucially – what belongs to *us*.

- **Public finance.** Are we taxing the things that ought to be taxed? Or are taxes damaging people's efforts to earn their living?

Although these two issues are intimately related, governments impose policies without addressing the fundamental principles of property rights. That, in turn, damages the way we are governed. Discussion is prejudiced, leading to bad results. Most taxes, for example, are biased against earned incomes: that's why they damage our health (fatally, in many cases). They subvert our wealth (the losses can be quantified – and they are stupendous).

Other streams of income, however, ought to be treated as the public's revenue and shared through the services provided by public agencies. But because they are favourably treated for tax purposes, they corrupt the common wealth (which is why the streets have become mean places).

Now let's examine how taxes affect us.

- Conventional wisdom asserts that "*Paying taxes to government is a penalty*". Taxes are a measure of our loss of liberty.

Government acts on your behalf. You channel some of your earnings through it, as your agent, to pay for the services that you want to share with your neighbours. We need government to provide law and order, political leadership, public health, transport systems and so on. When you pay your taxes, you pay for these services, *so you are working for yourself*.

The current administration of taxation *is* seriously flawed, but criticism should avoid rousing people's passions in ways which corrupt the democratic process. We do need greater efficiency in the way government spends our money. We do need to insist on compliance with the principles of justice. But such outcomes will not be encouraged by angry denunciations that have no factual basis.

- *Governments waste taxpayers' money*. The public sector, through the state bureaucracy, *is* guilty of throwing money away. But this loss is trivial compared to the damage caused by the *way* revenue is raised.

Economists use a term to concede that taxes on labour and capital distort incentives in ways which reduce incomes. The jargon is "excess burden". A more enlightening term is "deadweight losses". Losses arise when people duck and dive to avoid paying taxes. Their productive efficiency is reduced.

In capital markets, investors are advised to channel money into "tax efficient investments". Decisions are made *not* because they yield the highest profits or welfare, but because they minimise taxes.

In labour markets, people may decline to earn higher wages (for example, by refusing to work overtime) because the tax-take reaches the point where it is not worth sacrificing leisure time for the extra buck in the back pocket.

Governments are aware that they inflict these deadweight losses. That is why they manipulate taxes to create smoke-and-mirror effects. But people are not stupid. Even so, they feel they cannot influence policy. This results in political apathy. Thus are the losses continuously inflicted on the economy, even as politicians urge people to work harder or better. And yet, all the time, *they are responsible* for restraining people from achieving the full output potential based on available skills and capital. When did you last hear a finance minister confess that he was an obstacle to your prosperity?

The Riches in Store for All of Us

THE KEY IS NOT *how much* you pay to the government, but *how* government collects its revenue from you, to supply the services you want.

Economists can calculate the losses that you suffer. The haemorrhage of wealth and welfare is on a scale that is difficult to wrap our minds around.

I calculated the losses that Britain endured during the 10 years of Tony Blair's premiership. Using the Treasury's own measure of deadweight losses, Britain lost £120bn in wealth and welfare as a result of the taxes that were used to raise £399bn in 2003/04 alone. The loss rose to about £138bn in 2004/06. Such losses exceeded the funds needed to provide all the *additional* services the nation required. In total, between 1997 and 2007, Britain lost wealth and welfare equivalent to one year's worth of output. It was as if Britain shut down its economy for 12 months during Blair's Downing Street years. That is one measure of how we could have been richer, if government had used revenue-raising methods that did not damage economic incentives.[5]

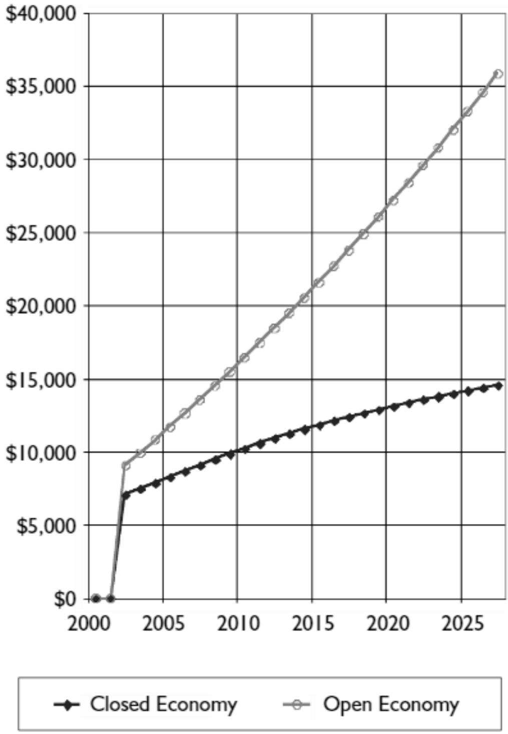
Nicolaus Tideman, professor of economics at a Virginia university, calculates that drawing US revenue from the rents of land and natural resources would generate a remarkable increase in the nation's income (see Graph 12.I).[6] His calculation can be divided into two parts. First, there are the losses to productivity caused by taxes that distort people's incentives with respect to how much to work and how much to save. Second, benefits arise from eliminating the damage caused by land speculation.

- The annual benefit from removing disincentives to work and to save would initially be $730 billion ($4,700 per worker).
- A further annual benefit of $590 billion ($3,800 per worker) would accrue as a result of eliminating the impacts of land speculation.

5 Harrison (2006b: 43-44, 155).
6 Dr Tideman received his PhD from the University of Chicago. After teaching at Harvard University, he served as Senior Staff Economist at the President's Council of Economic Advisers before moving to Virginia Polytechnic Institute and State University.

Graph 12:I

Net Annual Gain per Worker in 2004 Dollars from Shifting as Much Tax as Possible to Land



Source: Nicolaus Tideman

- The value of this combination of benefits would rise each year by about $90bn ($480 per worker).[7]

These calculations show that there would be an annual *increase* of income per worker of over $8,500; climbing each year by an average of nearly $500, as the efficiencies of the new approach to raising revenue kicked in. Those sums indicate the extent of the damage inflicted by the current tax doctrine.

America desperately needs the tax-shift. Large swathes of her inner cities are No-Go areas which are imploding under the stresses which nourish a culture of guns and narcotics. The countryside needs to be re-populated. Charging rent – rather than taxes – to pay for public services, automatically delivers such complex outcomes without the need for direct government intervention. Adjustments arise as people re-claim their share of the public domain. But this is *not* achieved by taking land

7 These numbers represent up-dates to the economy of 2008 that Dr. Tideman calculated, at my request, to a model that is described in Tideman *et. al.* (2002: 416-441) and Tideman and Plassmann (2003: 56-60).

Box 12:1

When is a Tax Not a Tax

We voluntarily identify the combination of public services that we want by choosing the locations where we live and work. And we declare the value of those amenities by the price we agree to pay for exclusive occupation of those locations.

So rents are *not* taxes. Taxes are crude exactions on income, levied without linking the payer to the services. You would think that economists would respect these distinctions. They don't.

Mervyn King and John Kay's textbook on taxation reviews the theory of economic rent. They acknowledge that some activities generate rent which could be targeted for special taxation. But they then wonder "why it might be thought that discriminatorily high taxes could be imposed without inflicting economic damage".[1] That phrase "discriminatorily high taxes" colours people's minds. Do shop-keepers discriminate against (or tax) customers when they charge the full price for their goods?

Fair dealing is not what this fiscal policy receives from economists. Example: Kay and King say that it is "apparent" that economic rents are insufficient "for this to be a practical means of obtaining the resources needed to finance a modern State". They produce no evidence to support this claim. For the sources of rent that would fund the services we need, read the list compiled by Mason Gaffney.[2]

1 Kay and King (1990: 180). 2 Gaffney (2008).

from anyone. The benefits arise from reforms to the public's finances. A new phase in the settlement of America would be launched. This time, however, there would be no free riders.

Professor Tideman did not try to hide this policy from America's old foes. He is an economist with a conscience. That is why he invited some distinguished economists to sign an Open Letter to Mikhail Gorbachev when the Soviet Union was considering its *perestroika* reforms. Tideman drafted a submission to Gorbachev that explained the benefits of raising revenue directly from the rents of land and Russia's vast natural resources. The riches were sufficient to fund the nation's public services without burdening workers with taxes (this is not a case of semantics: see the box). The Nobel laureates who co-signed that recommendation were James Tobin, Franco Modigliani, Robert Solow and Bill Vickrey. Tragically, for Russia, Boris Yeltsin declined to follow this advice. The result was the incubation of a new parasite in the Russian body politic: the oligarch.

The Riches of Oz

ESTIMATING THE impact of a revenue shift is aided in Australia by that country's land value-based revenue system. My numbers are based on calculations by Bryan Kavanagh of the Melbourne-based Land Values Research Group.

In 2004, less than AU$30bn (12%) of the publicly created $245bn in resource rents was collected for the public purse. This left $215bn in resource rents to circulate in the private sector – a powerful incentive to speculate in land and commodities.

- In the 30 years to 2006, the four economic downturns triggered by real estate booms caused a *loss* of GDP of about AU$768bn. This is the additional income that would have been distributed if the economy had not gone into the land-led recessions of 1976-8; 1983; 1991-2 and 1999-2003.

This loss, however, underestimates how much richer Australia would be, had she not been the victim of land speculation. If investment had not been impeded by the recession years, GDP in 2004 (AU$810bn) would have been appreciably higher. Factoring in further adjustments, such as the higher rate of growth of productivity, Kavanagh concludes that national income today would be AU$2,200bn from just capturing half of Australia's rents, *with offsetting reductions in taxes on earned incomes*.

Kavanagh reports that, according to their latest estimates for 2006, a rent-based approach to raising public revenue could generate sufficient additional national income to make every man, woman and child richer by about AU$35,000 every year. This estimate was based on conservative assumptions, and a more realistic estimate put the gains at $1 trillion, or AU$49,000 per person.

Economists will argue about the finer detail of the estimates, but one fact is beyond dispute. Every citizen in Australia would be richer by a significant margin if government raised revenue in ways which worked with the grain of human creativity, rather than with taxes that are barriers to productivity.

Blueprint for Growth

PAST CIVILISATIONS collapsed because, ultimately, their elites failed to adapt to the threats that could overwhelm them. The West faces such threats today. The CIA calls them mega-trends. Global poverty, economic crises, environmental stresses, organised violence – they all interact with each other, driving them beyond the control of government. The failure of UN talks on climate warming in Copenhagen in December 2009 is an example of a crisis out of control. Thus –

Poverty and a shrinking global economy → Migration to Europe/USA → Stresses on social order and welfare budgets → Fascist-like reactions → Containment laws that erode liberty.

This trend is intersected by –

Ecological havoc (such as deforestation) → Population displacement to neighbouring regions/countries → Defensive reactions → Military intervention.

Overlaying the economic and environmental issues are the resort to organised violence.[8] Thus –

Organised crime exploits weakened State → Businesses pay protection money → Increased taxes to fund law and order → Diminished economic activity.

A global whirlpool of crises is like a tsunami heading for the mainland. Unstoppable. Except that these tsunamis are man-made. And they are getting worse, because Western governments are weakened on all fronts. They have adopted austerity as the key to recovery instead of the blueprint for growth which I have outlined. Cuts in public spending – to offset the reduction in tax revenues – is a strategy based on a false doctrine. Retrenchment drives the final nail in the economic coffin for Europe.

America will have to rely on her military strength to secure a measure of protection and growth, because she is broke. The federal government's spending will exceed income by $1.6 trillion in 2010. Over the next 10 years, the predicted gap is $8.5

8 Harrison (2010).

trillion. This leaves China to test her strength against the super-power.

- Barack Obama's cancellation of NASA's lunar programme leaves China free to take the lead in the race to return to the moon and exploit the economic and political opportunities of outer space.

For Europe, the one hope is tax-led growth. But viewed from that perspective, the European Union's policy is a disaster. Its Commission wants member governments to bring finances under control by cutting the wages of public employees. Wage-slashing began in the private sector in 2008. But why should employees pay for the crisis generated by people who reaped the capital gains from land? That question is ignored, as governments continue to preside over the widening wealth gap.

- In Britain, the richest 10% (household wealth: £853,000) is now 100 times better off than the poorest (maximum household wealth: £8,800), according to a government-sponsored research report by the National Equality Panel.

For those on the lowest incomes, forecasts by the National Institute of Economic and Social Research (NIESR) makes depressing reading. Disposable income will fall through to 2012, with unemployment rising to a peak at close to 3m at the end of 2011. In the housing sector, a further decline in Britain's building industry's labour force was forecast by the Construction Skills Network. Meanwhile, house prices in London and the South East were expected to return to double-digit growth in 2010, widening the wealth gap with the rest of the nation.

- British property companies owned by five of the nation's richest aristocratic landowners went on the prowl for cheap sites, preparing to capture the fortunes to be made out of the next property cycle.[9]

It was a return to business-as-usual for the Predators, while employees were forced to bear the brunt of the downturn.

If Europe wants to survive, it will need to promote the controlled transformation

9 Warren (2010).

of the revenue systems to deliver the balanced growth that creates jobs, raises living standards and conserves the environment. Instead – in the name of controlling the emission of greenhouse gases – Europe's policies are being designed in a way that will fuel a stock market bubble in 2019. The IMF is initiating a $100bn (€62.5bn) global spending spree to bolster investment in low carbon enterprises. In the UK, government's subsidies will add to the attractions of the shares of the renewable energy industry. The cumulative effect: a rise in the price of land that falls into the catchment area of this policy.

The mid-cycle bubble in the shares of clean energy companies will burst just as the global economy takes off from the launch pad for the final phase of the land-led boom, which will end in the depression of 2028.

Governments will not now act to prevent what is going to happen. But based on this inquest into the failures of governance, readers of this book are now equipped to identify defensive strategies to minimise the risks that will threaten prosperity over the next business cycle.

THE PARLIAMENT that ended in 2010 in disgrace is called the Rotten Parliament because of the scandal over MPs' expenses. The biggest profits were from their second homes. Taxpayers paid for those properties, but MPs pocketed the capital gains. Why complain? MPs milked taxpayers, but that's what the rest of us do as the price of our homes rises (the economics of this crooked process is described in my book *Ricardo's Law*). Expecting law-makers to reform a tax regime that enriches many of their constituents tests their moral character. But it's also a test of our consciences.

The principles of good governance are not a secret. Samuel Brittan,[10] the *Financial Times* columnist, explains: "Land taxation has the advantage over other forms in that it is in principle based on pure space and *need not be a disincentive to either capital or labour*" (emphasis added). Economists admit that "The receipt and allocation of economic rent is a central determinant of the distribution of income in modern economies".[11] So

10 Brittan (2005: 103).
11 Kay (2004: 282).

why don't they enact this reform? Because a Rotten Parliament reflects a rotten system, which means that it's up to all of us to work for change.