

2 THE DIS-INTEGRATED ECONOMY

The planning and policy nexus

Planning was supposed to bring order to the economy, efficiency in the use of resources and equity for those who had been excluded from the riches of the nation. What happened? In terms of Britain's transport sector, we may turn for some answers to a committee of parliamentarians.

The Future of the Railway (House of Commons Transport Select Committee, 2004) was dated 1 April. Its contents were unbelievable. Was this the ultimate April Fool's Day stunt? The report by the members of parliament was an excoriating censure of public agencies. Were these really so incompetent? If not, how do we explain the comedy of errors documented for the House of Commons? Taxpayers were being increasingly committed to subsidising what was supposed to be a private railway, and decision-making agencies such as the Strategic Rail Authority (SRA) were tying themselves up in knots through confusion over lines of authority.

Seasoned politicians, entrepreneurs and railway professionals administered the network over the ten years following privatisation. They are not fools. And yet, the all-party committee of MPs exposed the hapless activities of an industry that had seen the privatised Railtrack go into administration when government

pulled the plug on further subsidies. This was ammunition for those who opposed the sale of state assets. Why did the railway collapse into shameful chaos?

To comprehend what drove the twists and turns of policy, our starting point is the Blair government's £32 million multi-modal studies. The 22 studies were intended to guide integration in the use of cars, buses and railways. In July 2000, the government published *Transport 2010: The 10-Year Plan*, which was promoted with vigour by Deputy Prime Minister John Prescott. The Commons Transport Select Committee investigated the studies and the way in which the decision-makers planned to use the products of the lucrative consultancy projects. Their catalogue of criticisms and revelations does not inspire confidence in the tools of transport planners. 1

Congestion

Research was concentrated in areas that were deemed to be congested. Alistair Darling, as secretary of state responsible for transport, admitted that the measure employed by his experts was not 'the best way of measuring congestion' (p. 11). So the studies were about a problem in which the science was contested. The experts applied techniques that were not synchronised with the real world. The Department for Transport conceded that 'it would be better to develop ways of measuring congestion which relate more closely to travellers' experience of delays' (p. 69).

The economic impact

The Commons investigators discovered that the experts had little

realistic understanding of the economic impact of transportation. While the CBI had estimated that imperfections in the transport system were costing the economy £20 billion a year, the government's independent adviser, Professor David Begg, acknowledged that their understanding of the true cost of congestion was poor. The Commons committee declared: 'It seems bizarre to plan a strategy around the principle of congestion reduction without having a good understanding of its true costs or long-term impacts' (p. 11).

The financial context

Wishful thinking coloured the government's approach. The consultants disclosed that they were told to search for solutions to the congestion of highways as if there were no financial constraints on the schemes they might propose. They assembled a wish-list of proposals that the transport minister conceded were not affordable. Enter the SRA, which made it clear that it did not regard the studies as the best way to plan a rail network! (p. 53).

Pricing prevarication

The government was open to the idea of charging motorists for access to highways. The transport minister acknowledged that road charging 'is something we need to consider, we need to debate'. The committee was not beguiled: 'But that is more or less the same words that many Secretaries of State have said since the 1960s' (p. 62).

Cost–benefit analysis

Value for money was a litmus test for government. But in examining transport policies, the committee concluded that ‘There is no evidence of a cost–benefit analysis of many of the schemes in its Plan’ (p. 66). Whitehall’s curious approach to forward planning was matched by the operations of the SRA. Priority, in the SRA’s view, should be given to its preferred schemes. But the committee revealed that ‘There is no evidence of a cost–benefit analysis of many of the schemes in its Plan that would enable it to make this decision’ (p. 53). Curtly, it added that the position of the government and the SRA on rail schemes ‘does not make sense’.

The planning framework

Even if schemes were shown to be value for money, ‘we are extremely concerned that rather than promoting the findings of the studies, recent service cuts may actually undermine the strategies’. In fact, concluded the MPs, far from moving towards an integrated system, the ‘planning process is now facing a “disintegrated” implementation process whereby road solutions will dominate because they have committed funding and an effective champion and implementation agency’ (p. 67).

Political decision-making

Plans were leading to what the MPs called an ‘inevitable outcome’ – the further dispersion of people, which would add to severe congestion in the long term (p. 67). Having commissioned the studies on the basis that funding was not a constraint, the Depart-

ment for Transport found that it could not afford to finance the recommendations (p. 65). The MPs stated the blindingly obvious: 'It is not possible to have a multi-modal programme of improvements if there is no money for rail investment' (p. 66).

Land use

The MPs perceived tensions between land use and transport policies, and they recommended closer liaison between the Department for Transport and the Office of the Deputy Prime Minister, which carried responsibility for land planning (p. 64). The problem was to identify the mechanism for achieving a balance between transport and land use. Was the car, per se, the cause of urban sprawl? That was the opinion of land-use experts, who were commissioned by the Department for Transport to recommend a solution. What they called 'the only effective means of doing so' would be to curtail the use of the car (p. 39, citing Town and Country Planning Association, 1999). But was this putting the cart before the horse? Could the popularity of the car be the consequence of failed policies (cause), rather than urban sprawl (symptom)? If so, might restraints on car ownership be erroneous or premature?

The committee censured the expenditure of large sums of money on consultancy services, and wondered whether this money ought to be spent on infrastructure. Even the secretary of state admitted that the escalating costs of his multi-modal studies were 'frankly unacceptable' (p. 23). The quality of advice did not always appear to justify the cost, in the opinion of the MPs.

Would it be too harsh to accuse government of not knowing whether it was coming or going? The select committee could

be forgiven for levelling such an accusation. Five months after informing the committee that it was too early to assess whether the government was going to meet its targets in terms of a *reduction* in congestion, a progress report was published which admitted that congestion would actually *increase* over the ten-year period even if the plan were implemented (p. 13).

How do we account for this depressing assessment of the capabilities of highly paid, dedicated politicians, civil servants and their academic and professional consultants? It appears that no matter how diligent they may be, there was no prospect of delivering an integrated transport plan that was worth the paper on which it was written. One problem was that forecasts were unreliable. Predictions – such as the rate of increase in the purchase of cars or the growth of rail passengers – are derived from assumptions about the rate of growth in GDP and how income affects people's need to travel. Such extrapolations are based on a theory of the business cycle which is not capable of robust forecasts over a period of twelve to eighteen months, let alone a decade.¹

The outcome is that people are going in circles. Literally. Dr Denvil Coombe, who co-authored the Department for Transport's guidance on the multi-modal studies, and who led the south-west Yorkshire study, said as much. The locations of people's homes and jobs were not sensibly linked to the transport systems. He found that the use of land 'has created a dispersed orbital trip making pattern, which uses unsuitable road network. By its nature, it is also challenging to cater for by public transport'

¹ Business cycle forecasts are tolerably accurate when the economy is motoring along 'on the flat'; but the empirical evidence shows that people in the economic driving seat tend to be blinkered when they arrive at the bends (see Harrison, 2005).

(House of Commons Transport Select Committee, 2004). One consequence was that people spent more time commuting than their European counterparts: the average British worker devotes 46 minutes each day to travelling to and from work (Commission for Integrated Transport, 2001).

Surrogate signals

If the market economy as it evolved in the nineteenth century failed to deliver the best possible results, it appears that the methodologies of planners are no more successful. We build roads and lay tracks to add value to the wealth of the nation. That wealth includes the benefits from preserving the natural environment and enriching culture, which make communities attractive as living organisms. The investments yield net gains. How do planners assess these net benefits? They count bodies. How many people will use the new facility, how much time will be saved in transit, and what is that additional benefit worth to users?

The technical problem with this body-counting procedure is that the planner cannot sum the value of all the individual preferences of travellers with accuracy. Arbitrary values are employed as substitutes for the real thing – the actions of the users themselves, which speak louder than words. The historical outcome was inconsistent with the market ethos. In the USA, for example, the militarisation of resource allocation has had more influence over transport planning than the economic imperatives of free enterprise. A British transport planner who held senior positions in the Whitehall hierarchy, A. J. Harrison, neatly summarised the association in *The Economics of Transport Appraisal*. He explained

how the methodological impulses came together in the planning strategies of the US Department of Defence:

While these developments were going on in the US Department of Defence, engineers in the field of urban transport were beginning to develop models of transport systems (paralleling the military systems analysis) which have made it possible to consider evaluating all the components of very large investment programmes at one and the same time and to relate them to the wider urban and land use planning context. (Harrison, 1974: 8)

The market approach would have been to log the impact of transport through the prism of land prices. As every estate agent knows (his knowledge is displayed in his advertisements), the land market delivers a robust account of the net effects of (say) a new railway that comes to town, or a bypass highway that steers traffic away from the city high street. As the rents of land rise or fall, so we know whether there is a net gain or loss to a particular location or the neighbourhood, city or nation.

The data collected by armies of statisticians that are deployed to track the movements of the travelling public, whose values they cannot hope to measure with accuracy, are a substitute for the hard facts provided by the travellers. But the way in which the net benefits are crystallised is not some mysterious act of alchemy. A. J. Harrison succinctly described the process. One example was the electrification of a commuting service, which can lead to 'an increase in rental or property values, while values elsewhere fall, reflecting the changes in relative accessibility which have taken place'. This analysis offers insights into the way in which the wheels of fortune turn to deliver an unequal distribution of the benefits:

Existing users of the service will experience a direct gain in the course of the trips they make, but if they decide to move, they will be able to charge incomers a higher price for their houses than previously, up to the limit of the gain in accessibility, and hence, even though they move from the area, they may be able to take with them, in a capital sum, the benefits in terms of reduced travel times which the rail improvement created. Commuters renting property will not be able to do so: the gain in this instance will be experienced by landlords as long as they are able to adjust the rents they charge accordingly. (Ibid.: 58)

This 'direct gain' is the value that the home owner *would have been willing to pay* when those services were originally provided, but which he was not required to pay.² This untapped benefit is called 'consumer surplus' (see Box 3). By default, that value is capitalised into the price of land and retained by existing property owners who do not (of course) choose to transfer it to newcomers to the property market.

Why was the value attributable to land not used to evaluate the financial viability of transport projects? There were two reasons. Rents measure the net benefits generated by infrastructure that are distributed in a form that may be cashed at the bank. Rents are part of the market's pricing mechanism. Planners, imbued by the doctrine of 'market failure', preferred their surrogate measures of benefits. The second problem was that the value of land beneath buildings was not separately recorded: there was no reliable database that could be used to assess the impact of

2 The purchasers of homes in the future would be charged for the service; but that charge is bolted on to the price of properties when they are sold. The value of the service is paid to vendors, not the providers of the improved transport facility.

Box 3 Rent and the consumer's surplus

The concept of consumer surplus describes how some people are willing to pay more for a product or service than its market price.*

Competition levels prices down to marginal costs. This usually means that an enterprise can make a profit from revenue after defraying all its costs. If a prospective customer is willing to pay £2 when the price of the product is £1, he enjoys a 'surplus' of £1. *Good luck to the consumer!* would be most people's response. When that effect is multiplied by a million, the economic implications are dramatic. We may trace the impact all the way down the pricing chain to the point where the 'surplus' is transformed into the rent of land. This may be viewed as the outcome of either of two routes: (1) downward pressure on prices implies an increase in productivity, yielding gains that people can afford to invest in land; (2) monopoly power associated with land means that owners can extract increases in disposable incomes that result from efficiencies in the economy.

There are exceptions. One relates to the collective bargaining power of trade unions. Another relates to non-unionised workers whose scarce skills enable them to command extraordinary remuneration (such as software programmers in the early years of the computer age). Sooner or later, however, these obstacles are eroded, and landowners are ready to claim the net benefits generated by the cost-cutting progress in the economy.

* Although the concept is treated in the standard economic textbooks; of especial relevance is the study by Rana Roy conducted in collaboration with an independent economic expert group under the chairmanship of Professor Chris Nash of ITS, Leeds: *Infrastructure Cost Recovery under Allocatively Efficient Pricing*, UIC/CER Economic Expert Study: Final Report, London, March 1998 (UIC, Paris, September 1998; available at www.landresearchtrust.org).

new investments. For some, the redistributive effect was best left shrouded in mystery.³

This was bound to cause problems. Planners resigned themselves to the use of subsidies derived from taxes. This led to analytical contortions, as displayed by the authors of *Regulatory Reform*. They claimed that 'there is no way of generating these funds other than by causing distortions elsewhere in the economy' (Armstrong et al., 1994: 15–16). This was factually incorrect, but the psychological dissonance could be addressed by a logical explanation for ignoring the value of land. In cost–benefit analysis, it is analytically incorrect to add together both the increase in land values *and* the imputed cash benefits of such things as shorter travel times or the elimination of congestion.

[P]ossible double counting of benefits!... arises from the fact that user benefits, as experienced on the transport network, can be transferred to non-users. One of the most important examples of this derives from the close relationship between changes in land values and changes in transport costs... The important point is that while the benefits might in principle be measured by measuring travel benefits or by measuring changes in property values... the two approaches must not be combined. If they are, benefits will be counted twice. (Harrison, 1974: 57–8)

3 The European Commission's 1996 Green Paper on transport pricing reviewed the externalised costs (which taxpayers are often called upon to correct with subsidies) but ignored the external benefits (which are privately appropriated): European Commission, *Towards fair and efficient pricing in transport: policy options for internalising the external costs of transport in the European Union*, Luxembourg: Office for Official Publications of the European Communities, 1996. The European Commission subsequently made amends by commissioning research through the European Conference of Ministers of Transport, some results of which are discussed in Chapter 8.

Planners had a choice: they could collect the information from the marketplace, or they could develop a parallel set of data based on questionnaires, stopwatches and their assumptions about human behaviour. In the ideological climate of the 1960s, the market's pricing signals were dismissed in favour of surrogate signals of human behaviour and preferences. So for 40 years investment in infrastructure was at the mercy of political horse-trading (notably in the USA and Japan) or the calculations of planners (notably in the UK).

The calculations of planners rely on leaps of faith disguised by a spurious statistical precision. For example, planning methodology relies heavily on estimates of the time saved in trips. That time is multiplied by a notional cash value to provide a guide to the presumed benefits of new investment. But whose values are really portrayed in the cost-benefit analysis – the planner's or the passenger's? The links between subjective and objective time are not well understood (Bates et al., 2001; Noland and Polak, 2002; O'Neil et al., 1998; Yarmey, 2000; Yen et al., 2001). At the very least, these estimates would benefit from being cross-checked with data that revealed what people *did* (the additional rents they were willing to pay for a faster train or a decongested road).

Whose money is it anyway?

Are we unduly harsh in our assessment of conventional cost-benefit analysis? Despite the difficulties, is it not a useful tool for comparing projects that are competing for finance when all other conditions are equal? Unfortunately, the *ceteris paribus* get-out clause cannot be invoked in cases that involve the expenditure of taxpayers' money. For the *redistributive* impact of govern-

ment policies involves significant uncertainties. Apart from the uncertainties that relate to the losses flowing from the way government raises revenue, there are major uncertainties associated with the leakages that flow from the way government invests people's money.

Taxes on wages and savings are regressive tools for transferring money from people at the bottom end of the income scales (who tend not to own land) to people in the middle and higher income brackets (who tend to own land). This is the process of transforming earned income into windfall wealth via investment in infrastructure. Pound for taxpayer's pound, the discriminatory redistribution of income from the poor to the rich applies equally to all projects.

The problem of uncertainty arises over the allocation of windfall wealth between the owners of land. Two projects may appear similar (say, one-mile-long bypass highways that transfer traffic away from town centres); but the conventional approach to cost-benefit analysis offers no guide as to the distribution of the windfalls. Project A may deliver nearly all the net gains to one or a few people; Project B may distribute the windfall gains in smaller sums to many landowners. Or Project A may hand all the additional value to someone who is already asset rich, Project B to people who are asset poor.

The only way to remove the uncertainty and arbitrariness is to assess the net effect in terms of the prospective increases and decreases in the rental streams of land in the area affected by the investment. But enriching the methodology of transport planning in this way creates a political problem. First, it entails the admission that government tax-and-spend policies are arbitrary and unfair: they diminish the disposable incomes and living standards

of low-income taxpayers in favour of enhancing the value of the assets of higher-income landowners. Second, there is the embarrassment of the unequal distribution of windfall gains between landowners. This is a politically explosive cocktail for politicians.

And yet, to enhance the quality of governance and avoid expensive errors, people should insist on this information being made available. By secreting data on land values, government may invest in projects that are both socially and privately unviable. It may do so by 'cooking the books' – by adjusting the values that it assigns to non-financial benefits to arrive at the ratio of benefits to costs that suits it.

But private investors also need the information on the origins, magnitude and distribution of land values. In the past, the absence of this information led people to make investment decisions that wiped out their savings. The absence of this information permits ambiguities (in the definition of rights and obligations) that distorted private markets and public policy.

The investment errors were not confined to the past, however, as investors in the denationalised British Rail would affirm. More than 200,000 of them bought shares in Railtrack. They thought there was clarity over the finances associated with the company. In fact, the information void allowed ambiguities and errors to flourish. These sealed the fate of Railtrack and led 45,000 shareholders to sue the Secretary of State for Transport. Although the case was not presented in our terms, at the heart of the High Court drama was the unresolved problem of the rights to, and responsibilities of, the value that was created by the railway.⁴

⁴ Comprehensive reports on the High Court proceedings appeared in the *Daily Telegraph*, beginning with the issue of 28 June 2005.

- Investors purchased Railtrack shares at £3.80 in the belief that taxpayers would continue to subsidise the network. At their peak (in 1998) shares reached £17.68.
- In 1999 and 2000, two train crashes claimed 35 lives. Attention was drawn to past under-investment. Someone had to pay to upgrade the tracks and signalling systems. Share prices tumbled.
- Government grew anxious about the political fall-out. Travellers and trade unions criticised as anomalous the payment of dividends while taxpayers subsidised the infrastructure.

Shareholders believed that they were entitled to dividends from the money they entrusted to Railtrack, but the company also needed taxpayers' cash to fund capital improvements. This economic reality was a public relations disaster for a Labour government that tried to live with a privatised rail system. The government was confronted with what was perceived as a funding quandary. The Treasury and the Department for Transport decided to tip Railtrack into administration on the grounds that it was bankrupt. Was it? Wasn't Railtrack creating enough value to cover all its costs, including the tracks and stations? The shareholders who sued the former Secretary of State for Transport implicitly thought so. They *expected* government to fund the infrastructure out of taxpayers' money, because that was customary. Would the contradictions and ambiguities in people's perceptions have arisen if there was clarity over the origins, rights and responsibilities of the value that leaked out of the railways and into the pockets of landowners?

A resolution of the financial and fiscal issues that underpin disputes of the Railtrack kind is needed as the prelude to

rebuilding institutions and the laws that determine rights and responsibilities. But an informed debate cannot occur in an informational vacuum. Reforms are resisted until people can judge how their private and social interests would be affected. Above all, in our view, they need data on the magnitude and distribution of rent. Rent, as determined by people through their everyday transactions, is a barometer of efficiency and fairness. As such, it enhances the democratic principles of transparency and accountability, by exposing impacts that governments strive to conceal. Rent is an independent audit of the quality of governance, as well as the productivity of the economy.

The rent barometer

Viewed historically, the nationalisation of Britain's private enterprises and the resort to centralised planning was the result, ultimately, of the failure to employ rent as the principal economic guide to public policy. We shall test this proposition in Chapters 6 and 7 by scrutinising the twists and turns of events in the evolution of transport systems. Modern transportation may be dated from the decision of the 3rd Duke of Bridgewater to construct a canal (1761–65). The canal transformed the coal seams beneath his agricultural acres into streams of liquid gold, by boosting the rent rolls of his estate in the north of England. Canals made it possible to slash the cost of coal in the markets. Thus, they became vehicles for securitising, and transferring ownership over, future streams of rent.

The fragile nature of the financial system that supported this revolution surfaced in the 'mania' that exploded between 1791 and 1794. Speculation in the shares of new projects lured investors into

ruin. The fortunes that nourished the psychology of speculation were reaped by landowners, not shareholders.

The days of the canal were numbered when they succumbed to the temptations of monopoly power.

Canals prospered and became finally characterised by all the abuses inseparable from prosperous monopolies. Prosperity brought stereotyped rigidity and petrification. The owning companies were finally more concerned to maintain and increase their own profits than to meet the growing requirements of commerce, and from that period (the early part of the 19th century) dates their downfall. (Kirkaldy and Evans, 1931: 25)

Similar problems awaited the railways, which meant that they were ill equipped to deal with the challenge presented by Henry Ford's mass production of automobiles. And similar crises exist today, this time with taxpayers as the 'shareholders' who will continue to lose fortunes if there is no revision to the fiscal and financial architecture that frames the economy. But fundamental reform entails a challenge to cherished beliefs.

New approaches to public finance may be the pre-condition for improvements to the services delivered by transportation. Such issues, however, cannot be viewed in isolation from the general problem of the quality of governance. That there is widespread disaffection with government is not contested. At the heart of the dissatisfaction is discontent with the way government raises revenue and the efficiency with which it delivers its services. The quality and impact of tax policy, then, ought to be at the heart of the debate about the choices made by government on behalf of the people. But as A. J. Harrison (1974: 150) acknowledged, in relation to transport policy: 'The standard

treatment of taxation in economic appraisal is to ignore it.’

If government is to be held accountable we cannot ignore the impact of fiscal policy. New yardsticks are needed to test the efficiency with which taxpayers’ money is disbursed. Adam Smith identified the rent of land – as a source of public revenue – as setting the standard for the performance of tax policy: ‘Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the treasury of the state’ (Smith, 1776 [1981]: 826).

By this test, taxes ought not to inflict losses on people who work, save and invest. That this principle of good governance is routinely abused is beyond dispute. But it is not just taxes which cause losses. Because the state now penetrates all levels of the economy, it has acquired enormous powers of regulation. In Britain, the regulations that are deemed to be ‘bad’ are estimated to cost firms a sum that exceeds the £118 billion raised by income tax (2003/04). This is a dead loss for enterprises that survive by holding down their costs of production.⁵

Economists agree that there is one source of revenue only which meets Smith’s test of good governance. This is how one of the world’s best-selling university teaching manuals puts it:

[A] tax on rent will lead to no distortions or economic inefficiencies. Why not? Because a tax on pure economic rent does not change anyone’s economic behaviour ... hence, the economy operates after the tax exactly as it did before the tax – with no distortions or inefficiencies arising as a result of the tax. (Samuelson and Nordhaus, 1985: 605; emphasis in original)

5 The estimate is by Sir David Arculus, chairman of the Blair government’s Better Regulation Task Force, cited in Moules (2005).

Is it possible to view rents as the basis of a new approach to providing transport systems on the back of free enterprise rather than the pockets of taxpayers? Paul Reichmann, a Canadian entrepreneur, thought he could initiate such a reform. He did not reckon with the artfulness of the modern bureaucracy.