8 ACCOUNTING FOR DEMOCRATIC GOVERNANCE

The First Law of Social Dynamics

If we accept the Treasury's measure of the damage it causes to the economy (30p/£), Britain lost £120 billion in wealth and welfare as a result of the taxes it levied in 2003/04 (£399 billion) (HM Treasury, 2005: table C8), rising to a loss of about £138 billion in 2005/06. This value exceeds the funds required to provide all the *additional* services the nation needs. These sums are underestimates of the real sacrifice made by the nation. Nonetheless, they represent a loss of about £1 trillion during the lifetime of the Blair government's search for value for money from public services.

The cumulative deficit in the wealth of the nation over the two centuries since 1799, when Parliament first adopted income tax, is the measure of the persistent failure of public finance policies. Our quest is to specify strategies that are sustainable in the context of the way we achieve mobility in a fast-moving world.

Our self-funding 'sustainable' mobility hypothesis may be contrasted with the idea of perpetual motion, which was first conceived by Indian mystics in the twelfth century. During the Enlightenment, artists and philosophers searched for the secret of the costless way to drive vehicles. Leonardo da Vinci sketched a self-moving car. It was a futile project. Perpetual motion would subvert the laws of nature. The dreamers were seeking to violate the First Law of Thermodynamics, which states that energy cannot be created or destroyed. Costless mobility was a fantasy. Even so, we can move closer to the notion of perpetual motion than the current approaches to mobility, which are wantonly profligate with energy, space and the demands on our lives.

The closest we can come to perpetual motion is the financial formula that I call the First Law of Social Dynamics. The law concedes that motion will consume energy, but the benefits are maximised for the least possible input of time, energy and space. *The mechanism that drives this law of social behaviour and organisation is the requirement that those who wish to enjoy mobility should defray the costs by paying for the benefits.* They should provide the resources to keep the wheels turning. Free riders are not welcome. This disciplines consumption, and the operating mechanisms become self-sufficient in the sense that their costs are not transferred to people who do not benefit from them.

The law operates within the framework of free markets. The mechanics of the process are well established. They start with the capacity of markets to value accurately the net benefits of mobility. The self-funding principle requires an open, interdependent system. A railway or highway remains viable only for so long as it is wanted by the users who are willing to pay for the mobility it generates: that is, only for so long as it adds value to the individual's and the community's wealth and welfare. To be viable it has to be integrated into the needs of the public it serves.

But the valuation of land, which is crucial to the self-funding system, is alleged by critics to be a problem. This is spurious. London would not have achieved world-class status in the twentieth century if its transport providers had believed that.

The builders of London's commuter trains had no difficulty in measuring the value of land or, on occasion, capturing it. Notable was the testimony of Frank Pick (1878–1941), a solicitor who joined the North Eastern Railway in 1902. He was hired by the Underground Group in 1907, and he played a crucial role in the evolution of the capital's transport network over the next 30 years. As vice-chairman of the London Passenger Transport Board he highlighted the significance of land values in evidence to the Barlow Commission:[1]

> The moment an underground extension is projected the value of the land is at least doubled. When the railway is built and the stations are opened the land adjacent to the stations is at least quadrupled in value ... In view of the difficulty of maintaining a public utility like the London Passenger Transport Board in a satisfactory condition from the receipts of fares there is every reason, in the interests of the public, why the Board should receive its appropriate share of the land values it helps to create ... The earnings of a Tube railway, even under favourable circumstances, are not sufficient to provide the interest and the sinking fund upon the capital invested. (Quoted in Halliday, 2001: 104)

The Metropolitan Railway financed investment by buying green fields to the north of London, at agricultural prices, and capitalising on the rise in the value that was fostered by the arrival of their trains. Pick believed that this model should be adopted for further investment in London's Underground. He was to be disappointed: 'This potentially valuable source of railway finance was once again not taken up. Profits from property development

1 The Royal Commission on the Geographical Distribution of the Industrial Population (1939), known as the Barlow Commission after its chairman, Sir Montague Barlow.

would go only to property developers. The benefit to railway companies would be confined to the extra journeys of those who travelled to and from the properties' (quoted in ibid.: 104). Handing the value created by the Underground trains to others subverted the financial viability of transport services. It dissipated the value that was needed to ensure the continuous upgrading of infrastructure.

While there are methodological challenges with respect to dividing rent into its component parts (what part may be attributed to the good local school compared with access to the subway station?), there is no merit in the claim that it is difficult to separate the value of land per se from buildings.

In Japan, the Ministry of Land, Infrastructure and Transport notes that their 'land is regarded as a separate asset from buildings' (Ministry of Land, Infrastructure and Transport, 2002: para. 1). The compilation of statistics on land values throughout the nation is comprehensive.

Denmark has levied a charge on land values for the past 80 years, with no practical difficulties in valuing land for fiscal purposes (Lefmann and Larsen, 2000).[2] Similar conclusions apply to the administration of land taxation in New Zealand and Australia.[3]

If governments are serious about privatising transport services and removing capital costs from their books, they will need to cooperate with entrepreneurs and civic communities in the quest

2 The British Treasury appears to be impressed by the evidence on the Danish land tax (see HM Treasury, 2003: box 2.12, p. 122). The practical, neighbourhood-level reappraisal of land values in Denmark was cheap to administer and it attracted few appeals (see Müller and Mørch-Lassen, 1989).

3 Australia's valuation expertise may be assessed by reviewing the website of the Valuer General of New South Wales. See www.lands.nsw.gov.au.

for solutions. This entails the search for practical policies in place of political rhetoric.[4] Fashionable concepts like sustainability need to be translated into functional mechanisms. By harnessing the power of the First Law of Social Dynamics, problems may quickly be resolved. Two examples illuminate the point.

In Europe, disputed ownership rights over the time and space above airports will continue to disfigure the airline industry. Lower-fare airlines are seeking greater access to major airports like Paris Orly. They are resisted by squatters, the flag carriers that inherited their slots from the state without obligation to pay the full market rent. One outcome was estimated by the London-based consultancy National Economic Research Associates. The EU's 20 most crowded airports could accommodate 52 million more passengers a year by 2007 if the landing slots were placed on a commercial footing (Walsh, 2004). The consultants suggested that the slots should be publicly traded so that they were reallocated to those who could fly full plane loads. Absent from this proposal, however, was consideration of ownership rights. If these were retained in the public domain, the efficient market policy would be annual rental charges that soaked up the full potential, determined by auctions (as in Hong Kong), matched by commensurate reductions in taxes.

Back on earth, carnage on the roads is the human price that is paid for the failure to employ optimum pricing policies. According to the World Health Organisation and the World Bank, road traffic accidents are likely to become the world's third-biggest cause of death and disability by 2020. Road crashes kill 1.2 million people every year and injure 50 million more. Deaths from traffic

4 This point was forcefully put by *Financial Times* columnist John Plender (2004).

accidents will increase by 80 per cent in the developing countries by 2020 (Williams, 2004). Investment in safer, more efficient forms of mobility is required, but the funds for these are said to be in short supply. But the World Bank fails to commend the self-funding strategies; or it does so in a tepid way, as in the case of privatisation policies in the Philippines.

While urging the need to reduce dependence on government finance in favour of private investment, the World Bank merely alludes to optimal funding policies. It acknowledges that property developers would invest in improved transport amenities 'to maximise the value of their land and property holdings and to secure air rights to the space over and around stations and terminals for commercial and retail development' (World Bank, 2000: 67). But from where would the funding come to defray the capital costs? The World Bank waits until its last sentence to meekly suggest that consideration be given to the possibility that 'landowners speculating on real estate appreciation [might] contribute to right-of-way costs' (p. 68). Such timidity in analysis gives comfort to politicians who prefer not to appear intellectually adventurous.[5]

Has the time come for a principled approach that fits with the commercial model? Should people pay for the benefits they receive? With the leaders of the G8 countries urging developing nations to improve governance in return for debt relief, we may judge Western governments by similar criteria.

5 How to transform the virtues of democracy (transparency and accountability) into a political problem is illustrated by the treatment of public charges on land values by Klaus Deininger (2003). The high visibility of the charges, he claims, 'makes their introduction more difficult' (p. 168); not least because of the 'political clout of landlords' (p. 169). World Bank pessimism is infectious, especially among politicians in need of campaign funds.

Paying for benefits received

Few of the members of the British Chambers of Commerce (10 per cent of them) accept that transport fully meets their needs. Indeed, the ability to expand their enterprises was hindered by transport infrastructure (39 per cent). So what did they think about the funding issue? They were informed that 'Significant increases in property prices are often associated with new local transport initiatives, for example the Jubilee Line London tube extension'. Would they support the proposal that some of that increase should be reinvested in transport? Compared with 19 per cent who favoured that policy, 54 per cent opposed it (British Chambers of Commerce, 2004).

Most property owners wanted to pocket the windfalls. That meant others would have to pay for the capital investment which they wanted to use. But what if reform included reductions in those taxes that damaged the interests of themselves and their tenants? That would expand their markets and the communities in which they lived would be renewed. That richer prospectus, I suggest, would attract the support of most of them.

A pact between people and property is needed, built around a trade-off: lower taxes for a commitment to earmark rents to fund shared services. This was the message of London property developer Don Riley, whose book *Taken for a Ride* (2001) contributed significantly to the public debate in Britain on how to harness location rents to fund infrastructure. London property owners, including the City of London, should take the lead in showing government that measuring and valuing land and recycling incremental values into community services is a practical proposition. Riley explains how, with the aid of a slide rule and some basic information on the footprint of a property, owners or their agents can easily measure the land area of each of their properties. So instead of floor-by-floor assessments, owners, aided by people with local knowledge, would place their individual properties into a banded scale of site values. Colour-coded banding on land maps would quickly reveal sites that were over- or under-valued. In Riley's case, 'If we were to levy my location at £2 a square foot, on a current land value of £250 a square foot, the location levy would be the equivalent of £124,000 a year. A 10-year levy for transport revitalisation would ensure that my location values were enhanced to perhaps £350 per square foot.'

The traditional landed class might resist this proposal. But we may appeal to their self-interest, to recognise that their London estates would gain from the restructuring of taxation. They do not travel by public transport but thanks to the tax system we may say that they top the list of free riders. They must appreciate that they have a stake in funding London's transport system out of rents. Through the Crown Estate, for example, the Queen is now spending £500 million on reconstructing parts of Regent Street. The Crown Estate will need shoppers to throng into the West End, but people with discretionary cash to spend are likely to boycott the antiquated Underground facilities that most commuters have to use. But by upgrading the ambience of travel on the Tube, making travel into Piccadilly Circus and Oxford Street a pleasure, the rents of the Crown Estate would be boosted.

But there would be a price: the commitment by government to abolish taxes that damage the economy. Capital gains and inheritance taxes, for example, may be abolished and income tax rates reduced to make way for public charges on the rents of land.

The transition to the new arrangements would be politically attractive because, in the early stages, spending on shared services would not be reduced. Equivalent sums would be raised through the levy on land values (Riley, 2003). This would ensure the continuity of the services people need while affording them time to taste the benefits of the reform.

Elements of the new strategy are already emerging.

The 3G electromagnetic spectrum auction generated £22.4 billion for the Treasury in 2000. The telecom operators were willing to bid that much for the privilege of holding 20-year licences, which was the market's valuation of the rents of the radio spectrum (Harrison, 2003).

Renting the use of valuable space is accepted as the solution to congestion. London's congestion charge is crude yet effective in reducing congestion and pollution.[6] More than a dozen cities are interested in following the capital's example, and the government is proposing electronic 'tagging' in cars which will register from 2p per mile on quiet roads to £1.30 per mile on busy roads at peak times.

Transport for London and transport agencies elsewhere are proposing that they should have the right to borrow money from

6 Rana Roy (1998) points out that congestion charging is equivalent to premium rents on residential and commercial space in central urban areas and that 'this practice is accepted as a natural solution by all parties – by economists, politicians, residential and commercial tenants, and the public at large' (p. 56). If congestion charging were applied uniformly throughout Britain the result would be a financial surplus of around £10 billion – five times the level of public subsidies to rail at the time he was writing. The striking difference between the rents of roads and urban residential and commercial space, however, was obvious. The latter is 'owned by a small minority of property owners. The premium prices ... accrue to this minority. (Nor are they recycled back to the tenants or to society at large.) In contrast, we, the public, own the roads. Hence, any premium prices paid by passengers and freight users in an efficient pricing regime would, in the first place, accrue to all of us'.

the capital markets (offering the future stream of fare revenue as security), but more importantly that they be granted the use of financial instruments to tap land values that were enhanced by transport investment. Some entrepreneurs from the transport and property sectors endorse Bob Kiley's stress on the need for new infrastructure because 'Business cannot make important investment decisions while there is uncertainty about future transport plans' (Sheppard et al., 2003). They propose that part of the property tax that they pay on their commercial premises should be ring-fenced for transport.

There are many sources of economic rents to be tapped to enhance the performance of both private commerce and public services.[7] Using these to pay for shared services, however, is not an extension of conventional tax philosophy: it is based on the principle that people pay directly for the benefits that they choose to receive by virtue of the locations they choose to occupy. Can we afford not to deepen fundamental reform? The scale of the gains is made apparent by a comprehensive audit of the costs of funding transport out of taxes.

Accounting for leakages and losses

Treasury accounting conventions conceal information that ought to be in the public domain. The issue of transparency may be considered in relation to the revival of plans to construct Crossrail, the rival to the Jubilee Line in the 1980s.

Funding, as ever, was the obstacle to a vital addition to the capital's rail network. Mayor Livingstone's consultants argued

7 For an extensive list of these non-distorting sources of revenue, see Gaffney (1998).

that the £7 billion cost could be more than justified. The total of £19 billion benefits came from additions to output associated with increased accessibility to central London, including £8 billion from savings in journey times. This gain, suggested the mayor, could be achieved by funding Crossrail by the following means:

- 'Roughly half' could come from taxes – say, £3.5 billion (Livingstone, 2004);
- £2 billion from 'predicted rises in land values along the route' (Blitz, 2004).
- £1.5 billion from an increase in Tube and bus passengers' fares.

A return of £19 billion over a 30-year period against the investment of £7 billion appears to be a good deal, but the bottom line is not so generous when we factor in the losses and leakages.

The cost of the Treasury's £3.5 billion must be adjusted to take account of the deadweight loss. The Treasury favours a cautious 30p/£ ratio, but other economists have suggested estimates ranging from 50p to £1.50 for every £1 raised by bad taxes. If we split the difference and assume that the loss is £1, the cost of public investment in Crossrail doubles to £7 billion. But if we want to appreciate the true scale of the impact of taxes on Britain, we need to adjust that cost even further.

According to the most recent research, by Professor Nicolaus Tideman, tax-induced losses are potentially as high as £2 for every £1 raised with the aid of 'bad' taxes (see Box 7). If this is correct, the cost of Crossrail to taxpayers rises from £3.5 billion to more than £10 billion. If we add to this the costs of the inequities arising

Box 7 The historic reality

Treasury economists treat the deadweight loss of taxes by taking the economic system as it exists. This means that their measure of the social opportunity cost of taxpayers' money ignores the additional value that would be generated if taxation were as efficient as it would be if government employed Adam Smith's fiscal recommendations.

In particular, the losses arising from inefficiencies in the land market (through land hoarding and under-use) are ignored. These losses must be attributed to the tax system, because they would not be incurred if people had to pay rent for the benefits delivered to their land. Owners would not keep their sites idle or under-used, as many of them do at present. Taking this into account, the estimate of losses arising from the present tax regime would rise by a significant factor.

Viewing the losses as potential gains under the optimum fiscal/pricing system is reasonable. The losses are the result of economic attrition that has been going on for two centuries. Reversing that history would take time, of course; so the immense gains would also take time to percolate through, as the economy adjusts to higher levels of productive efficiency.

from the leakages of value into the land market, the benefits of Crossrail are wiped out.[8]

The accounting deficiencies may be further illuminated on a national scale by the Blair government's ten-year transport plan.

8 We have not begun to trace the consequences of the leakages that drive people out of employment, forcing them into dependency on the public purse and thereby imposing further costs on taxpayers.

When it was announced by Deputy Prime Minister John Prescott, taxpayers were merely offered an account of the expenditures (£180 billion). Absent was a measure of the leakages and losses. A revised form of accounting is suggested in Table 5.

The estimate of leakages – the 'externalised' values that are siphoned through the land market – appears in column 4. This registers an unrealistically low minimum figure of £185 billion, which we base on the writings of a Nobel prize-winning economist, William Vickrey, who devoted his academic life to teaching at Columbia University, New York.

Vickrey was a lifelong student of the economics of transport systems in London and New York. He emphasised that landowners could share the costs of public services by paying for the capital infrastructure, because the externalised values they captured were at least as great as the capital sum that needed to be invested to upgrade mass transit systems. In fact, it was in their financial interests to do so:

> Equity and efficiency are both served by having landlords contribute to the network costs of the services so as to enable their prices to be brought closer to marginal cost. In the long run the increased efficiency of the local economy would tend to redound to the benefit of the landlords by raising their market rents by more than the amount of the subsidy. (Vickrey, 1999: 23)[9]

But by how much more would rents rise as a result of the application of the optimising policy? Vickrey (ibid.: 25) did not suggest numbers for the upper limits of the gains in rent:

9 Vickrey actively canvassed the need to rebase public charges on economic rent, to deter (and therefore eliminate the losses from) the sub-optimal use of land.

Table 5 **The 10-Year Transport Plan**

*Investment and expenditure, 2002–011 (£bn outturn prices)**				*The impact of fiscal policy*	
	Taxpayer-funded expenditures	Private investment	Total	Land value leakage	Dead-weight loss†
	(1)	*(2)*	*(3)*	*(4)*	*(5)*
Road, railways & other transport	£124bn	£56bn	£180bn	Between £185bn and £540bn	Between £37bn and £248bn

* Derived from Department of Transport, 2000: 3

† Estimates draw on modelling by Tideman and Plassmann (1998) and Tideman et al. (2002)

> If landlords in a community could be made aware of their long-run interests, they would voluntarily agree to tax themselves on a site-value basis to subsidise utility rates so as to permit them to be set at close to the efficient level, and find that the rental value of their land had risen by *more than the amount of the tax subsidy*. (Emphasis added)

So even on this cautious assessment the amount that government spent on infrastructure would be covered by increases in rents. But the leakages of land value may be as high as £540 billion, if we take as our guide the uplift in values arising from new transport systems such as London's Jubilee Line Extension, which delivered a benefit-to-cost ratio of 3:1.

In addition to the leakages, we also have to factor in the deadweight losses from taxation. The range of the loss is shown in column 5 in Table 5. At a minimum, the UK would be deprived of wealth and welfare worth about £37 billion, if we use the Treasury's measure of the SOCEF. The loss rises to something like £248 billion if we use the comprehensive measure of deadweight losses proposed by economists such as Professors Tideman and Plassmann.

Thus, under the tax-based transport plan, the ten-year redistribution of income to prosperous property owners is on a horrendous scale. Not only are the poorest taxpayers likely to be non-owners of property and cars, but they also contribute disproportionately to the enhancement of the value of land owned by rich car owners.

The data in column 4 shows that sufficient *additional* value will be generated to at least cover the investment cost. *The capital investment in transport infrastructure pays for itself.* Under the optimal funding policy, *the transport projects would not need income to be redistributed from taxpayers.*

Retiring the bad taxes

It is exciting to contemplate the size of the transport windfalls in terms of the opportunity to abolish taxes that damage the nation's wealth and welfare.

If we adopt the benefit ratios identified in the seminal study by the European Conference of Ministers of Transport (ECMT), the ten-year spending plans could raise land values by a ratio of more than 3:1.[10] So if the plan were fully executed, the windfall for landowners could exceed £540 billion if the benefits were fully translated into increases in land values. By tapping just a part of

10 Members include the UK and 42 other European countries. There are seven associate members (Australia, Canada, Japan, Korea, Mexico, New Zealand and the USA).

such gains, the scope for reducing the taxes on labour and capital would be considerable. Adopting this financial strategy would transform transport into one of the leading sectors for structural reform. Individuals and firms, fully informed of the costs of their use of transportation, would make rational decisions about the levels of their demand for mobility (ECMT, 2003: 3). This begins to deliver the self-funding, integrated ideal. For the highways, for example, 'When congestion is present and charged for, the capital costs of roads will normally be recovered' (p. 9). The dividends, when measured on an economy-wide scale, are enormous. This is implied by the ECMT study *Reforming Transport Taxes*. The efficient way to raise revenue was defined in these terms: 'Charges on external costs. This requires users to pay for the benefits which they receive, as when they deposit waste in the environment. Efficiency and welfare neutral charges on economic rents and on the production of natural resources' (ibid.: 20). These contrasted with 'efficiency and welfare reducing taxes – most other forms of taxation'.

Europe's transport ministers wanted to know the scale of gains that would be achieved if governments set prices close to the point where users and other beneficiaries covered the costs. A model was needed to calculate the deadweight losses. Under current policies, the bias is towards the over-pricing and under-use of rail, and the under-pricing and over-use of urban roads. To reverse this situation it is necessary to deploy charges that do not exact an 'excess burden'. The ECMT proposed that distortionary taxes should be replaced by the efficient forms of charges, and deploying the gains 'to reduce the level of the distorting taxes' (ibid.: 22). It was argued:

Table 6 **Revenue and welfare changes from optimal pricing (€ billions per annum)**

Revenues	*Britain*	*France*	*Germany*	*Total*
Reference scenario revenues*	59.84	49.10	56.97	165.91
Optimal revenues	98.79	77.01	99.13	274.93
Absolute change in revenues	38.95	27.91	42.16	109.02
Percentage change	65	57	74	66
Welfare				
Absolute change in welfare	17.42	10.16	8.76	36.34

*The reference scenario is based on existing costs including estimated external costs, taxes, prices and traffic. These corresponded closely with official and published estimates of tax receipts for all the transport modes covered in each country.
Source: ECMT, 2003: table 1, p. 34

> For the benefits of optimising transport pricing by means of taxes on externalities do not accrue only within the transport sector in the form of a reduction in the levels of congestion, pollution and accidents. They also accrue to the larger society. The new revenues from externality taxes can be put to use *to reduce the level of welfare-reducing taxation for any given level of public expenditure.* (p. 31, emphasis added)

The ECMT researchers studied five countries, including the Netherlands and Finland, using data for 2000. The results for Britain, France and Germany are shown in Table 6.

The largest gains in both revenues and welfare were achieved in Britain. For the three countries, there was additional revenue of €109 billion per annum, and a €36 billion per annum net welfare gain. The welfare improvement is a *net* gain: what remains after deducting the reductions in some benefits enjoyed by motorists who are currently under-charged, and taking into account reductions in travel time for motorists and freight traffic in the newly decongested roads, reductions in pollution and accidents, and so on.

Table 7 **Cost recovery from optimal pricing (€ billions per annum)**

	Britain	*France*	*Germany*
Infrastructure costs with capital costs discounted at 6 per cent (C)*	22.50	36.04	27.10
Optimal revenues from all inland transport modes less VAT (R)	82.75	58.06	82.89
Cost recovery (R/C, %)	368	161	306

* Excluding air transport
Source: ECMT, 2003: table 6, p. 43

A second major finding concerns the capacity of transport systems to finance the costs of infrastructure. For three European countries the results are shown in Table 7: optimal revenues are sufficient to defray the fixed costs. In the case of Britain the cost recovery is 368 per cent, or a ratio of 3.7:1. Germany is not far behind with a ratio of 3:1.

The findings for Britain may be interpreted with reference to land values, which ultimately reflect most of the externalised costs and benefits. London's Jubilee Line Extension increased adjoining land values, according to Don Riley (2001: 23–5), by something close to £14 billion.[11] The JLE cost £3.4 billion to build.

At the very least, we can conclude that the application of optimal pricing and public finance policies would yield enormous material, social and environmental gains.

Optimal pricing enables governments to restructure national budgets. Such a strategy would be consistent with emerging thinking in Europe. The tax shift commended by the ECMT study endorses the marginal social costs pricing policy proposed by the European Commission (1998).

11 Subsequent studies commissioned by Transport for London found that the uplift in land values around just two of the JLE stations was of the order of £2.8 billion.

From these findings, we can draw two vital conclusions:

- The claim that a shortage of funds constrains investment in transport is spurious. The perception that there *is* a shortage springs from a philosophy of taxation that is at variance with economic reality.
- Subsidies from taxpayers are not needed. If people paid for the services they received at the locations they occupied, capital-intensive projects could be self-funding.

To secure a democratic consensus behind fiscal reform, however, people need to accept that the boundaries between rights and responsibilities must be renegotiated. This is not a novel proposal. Amendments to laws have occurred in the past in response to the changing needs of an evolving economy, as Adam Smith (1766 [1982]: 470) noted.[12]

Reforms would need to include safeguards for those who are at risk during the transitional period, but the personal incentives to change are overwhelming. The logic of the reform would be self-evident to people who demand value for their money. When people spend their earnings, £1 buys them £1's worth of goods or satisfaction. When government spends people's money, the real value of its £1 drops to 70p (if you accept the Treasury yardstick), or that value is completely negated, if we accept the estimates of independent economists.

12 Adam Smith draws attention to what happened when, with the development of markets, it was necessary to construct highways through private estates. Originally, rights of way were of a personal character, but these could not serve a complex commercial society. It was necessary for the law to be amended so that servitudes were transformed into real rights which could be enforced against the proprietors of land.

This loss is plugged if Adam Smith's optimum policy for public revenue is adopted.

One test of efficient governance, then, is the financial one: £1 spent by government must be as valuable as £1 spent by the person who earned it. This is the imperative to which government needs to aspire. When it is achieved, society would be presented with a new range of remarkable options. One would be the choice of reducing state provision of services. Responsibility for personal health and education was transferred to the welfare state because the leakages and losses made it impossible for millions of people to pay for these themselves. But the 60-year experiment in welfare statism has failed to deliver on its promise to close the gap between the rich and the poor.

To remain competitive, Britain must embark on meaningful fiscal reform. Ultimately, what matters is not *how much* is raised by taxation so much as *how* it is raised. A new paradigm is needed for the post-industrial society. We can now visualise the contours of that alternative. At its cutting edge would be the freedom of people to invest in their country's infrastructure. Hong Kong, which was a British initiative, provides one model for this prospectus.

The wheels of fortune are currently moving in China's direction, in the process further eroding Europe's manufacturing base. There is evidence that dynamic regions in China, such as Shenchen, are already using the optimum pricing/funding model for city infrastructure to support their booming property development. Privately funded highways are being added to the nation's transport infrastructure, and private capital from the West is now being sought to upgrade the state railways (Dickie, 2005; Dickie and Guerrera, 2005; Gapper, 2005). If China were to adopt such policies throughout her territory, economic survival for countries like Britain would depend on the willingness to match that one reform.

China is developing a model that combines lower labour and land costs with a lower tax burden. That combination is lethal. In response, the West should resist the easy temptations of protectionism. The solution is to retire its obsolete tax-driven strategies. Otherwise, our cities could be reduced to hollowed-out satellites of the dynamic Asian economies, struggling outposts of the Chinese manufacturing machine. For example, we can visualise the prospect of Asian-owned mega retail parks being built on exhausted gravel pits in Kent, selling imported clothes and consumer durables direct to consumers and cutting out British middlemen. Those consumers could be shuttled in every fifteen minutes on the privately owned Paradise Express from Canary Wharf II, a terminus that channels people away from the West End and London suburban shopping centres.

The expertise to exploit the synergy that flows from an integrated transport/retail nexus already exists in the Far East (see Chapter 4 above). It is even now being offered to Britain and Germany by Hong Kong's MTR Corporation (Wright 2005). By harnessing such experience, a new golden age could dawn for Britain, but this will not be achieved through government exhortation. Rather, we should trust the natural talents of our entrepreneurs and their employees. Once liberated from the burden of taxation, they would have all the incentives in the world to secure Britain's share of the looming global prosperity.