

A Theory of Corruption

The Corruption of Rent as Public Value

TO UNDERSTAND the making of poverty, both in the poor neo-colonised countries and in the rich West, we need a theory of corruption.

We have seen how social scientists now focus on the damage that is caused by the misuse of rent. As it happens, that economic concept is the most analytically fruitful tool for understanding the processes at work.

To trace the way in which a community may be corrupted, we need to explain how institutions are prevented from discharging their function as the buttresses of society. If the institutional foundations are rotten, they cannot support people in their relationships with each other. The consequence may be that some individuals can amass the resources with which to exploit others. The rent of land is the key. Cultural degradation stems, in the main, from the failure to treat rent as social revenue.

The function of each of the categories of income is a

natural one. With wages, people reproduce themselves. That is to say, they labour for the means to support their families. With interest (or 'profits'), capital is reproduced. That is to say, the prospect of a reward encourages people to save part of their incomes, which can be turned into the means of production (factories, computers, screw-drivers, and so on). Rent is a community's economic surplus. As such, it is the basis of the artistic, scientific and spiritual creativity of people in association. Thus, the manner in which rent is deployed – and the manner in which the total income of society is distributed – determines the character of a society. Rent is the one source of revenue whose existence is dependent on the cooperation of all of us. And that, ironically, is the reason why it is also the most vulnerable to abuse.

Economists classify rent as a pure surplus, because it has no cost of production. This may be puzzling to those who – in the everyday but technically-loose use of the term – rent their home, or who pay commercial 'rent' for the use of offices or industrial premises. But the special significance attaching to the rents of land and natural resources is recognised in the academic literature, in which rent is classed as 'unearned'.

The exceptional nature of rent is acknowledged by those economists who identify it as the appropriate source of revenue for government. Adam Smith, for example, described rent as the "peculiarly suitable" source of revenue to defray the costs of the state.¹ That was in the 18th century. A century later, John Stuart Mill described how rents fructify even while the owner of the land is asleep, and that this growing revenue should be captured by government.² In the United States, what would prove to be the first global best-seller on economics at the turn into the 20th century was penned by

Henry George, a San Francisco journalist who observed the formation of rent at the margins of Western settlement.³ In *Progress and Poverty* his devastating critique explained why the market economy subjected people to mass unemployment in the case speculation in land was permitted.

Between them, these and other economic philosophers⁴ demonstrated that there was, indeed, something unique and complex about rent. Wages, self-evidently, are the direct reward for my labour; therefore, no-one had a moral claim on that income. But who had the right to claim rent? It was, after all, a 'public value'. This was the description by Alfred Marshall, the professor of economics at the University of Cambridge whose work, a century ago, revolutionised the analytical tools employed by economists. In successive editions of *Principles of Economics* he worked his way towards an analysis of the role of rent in industrialised economies.

Marshall observed the way in which Britain's Parliament was locked in mortal combat as the democratically elected government fought land owners over the future of the nation's rents. Peers in the House of Lords obstructed the government's Finance Act (1909), which became known as the People's Budget. The ensuing constitutional crisis and public debate helped to clarify the social role of rent in Marshall's mind. He was originally hostile to Henry George during a lecture by the American at the University of Oxford.⁵ But by the time he had polished his treatise after the First World War, Marshall settled on the view that the rent of land was, indeed, a revenue "governed by causes which are mostly beyond the control of him who determines what buildings shall be put on it".⁶ He intervened to support the Liberal Government in its constitutional clash with the House of Lords in 1909.

In a letter to *The Times* he made it emphatically clear that

The proposal made in the present Budget to isolate future accretions of 'public value' and to tax them...I regard...as in many ways a great improvement...in so far as the Budget proposes to check the appropriation of what is really public property by private persons and in so far as it proposes to bring under taxation some real income, which has escaped taxation merely because it does not appear above the surface in a money form, I regard it as sound finance. In so far as its proceeds are to be applied to social problems where a little money may do much towards raising the level of life of the people and increasing their happiness, it seems to me a Social Welfare Budget.⁷

Rent is exceptional because it originates when people engage in cooperative economic activity. Marshall and his predecessors understood that *everyone* participates in the formation of rent through the million-and-one contributions that we collectively make to the production of wealth, and to the myriad social activities that attract us to our communities.

This is not a socialist theory. A sophisticated market is required to identify, value and collect rent, with a pricing mechanism that operates within a competitive *milieu*. The land market performs the social function, enabling all of us to participate in the processes by which rent is creamed off the top of the economic pie. It is by this joint co-operation and competition, as individuals and as members participating in larger groups (such as private enterprises or public agencies), that we contribute towards the crystallisation of some of our output as rent. How does this knowledge, that rent is public value, help us to understanding how poverty is manufactured and culture is corrupted? We may again refer to India as an illustration.

Colonialism had to be more than a land grab. To succeed,

it had to engineer a profound re-ordering of social organisation in the appropriated territories.

For the British, the primary purpose was to capture the rents generated locally for export back to London. From our theoretical exposition of rent as the source of vitality for a people's culture, we can deduce that the population suffered grievously as its public value haemorrhaged away. The scale of the losses is recorded in reports to the House of Commons based on the commercial activities of the East India Company in the second half of the 18th century.

Trade was a cover for the real intent. The British were in India to extract rent.

Rents derived from lands constituted in those days 'the principle source of revenue.' All the lands in Bengal and Bihar were considered as belonging to the Crown or sovereign of the country, who claimed a right to collect rents or revenues from all of them.⁸

The scale of the unequal exchange is indicated by the balance of trade for the three years up to 1769. Goods and bullion worth 56.1m rupees were exported from India, offset by the import of bullion of 5.5m rupees. One of the British officials in India at the time, Richard Becher, alerted his government to the decline of the condition of the people, one consequence of which was the great famine of 1770.

The British knew that, to squeeze the rents out of such foreign territories, they had to manipulate land tenure to suit their revenue needs. This led to grievous errors of administration which inflicted terrible damage to the lives of local people.

Estates were knocked down to speculators at a revenue which... the estates were unable to bear. Ignorant of the real capabilities of

the country and incited by the hopes of profit, speculators readily agreed for sums which were far beyond the capacity of farmers. The result was that the districts had fallen hopelessly into arrears; and chaos invaded the entire land revenue system.⁹

In experimenting with new ways to secure a steady flow of rents back to Britain, the tillers of the soil were subjected to abusive changes to land tenure. Traditional sources of authority, and related social practices, were manipulated by people who lacked understanding of a population that had supported a once-great civilisation. In the early decades, the tribal chiefs (*zamindaris*) were made to suffer as harshly as the peasants. If they failed to pay rents arbitrarily set at too high a level, managers were imposed on them “who plundered the tillers of the soil and caused misery and depopulation”.¹⁰ Where the tribal chiefs were converted into landlords, during subsequent phases of administrative experiments, the chiefs “changed their attitude towards the tribal peasantry”, following the shift from custom to contract.¹¹

With the British government ordering new assessments on land values (the ‘Permanent Settlement’), “the landlords now got unlimited powers of increasing the rents of the cultivators; rack-renting ruined many families”, leading to outbreaks of violence, social chaos and confusion.¹² Concurrent with the alien legal system introduced by the British was the conversion of tribal chiefs to the Hindu faith.

Thus in the first half of the 19th century the traditional tribal society was being undermined: custom was being undermined by contract, a barter economy by a money economy they had not yet learnt to handle, and divisions of the land determined by tribal custom were replaced by a landlord-tenant relationship.¹³

From this summary, we may perceive that the moulding of the colonial economy had little to do with the economics of the free market (which is how critics typically characterised the system, to smear 'capitalism'). It was more akin to organised brigandage. The purpose of the colonial project was the predatory acquisition of the public value through the use of force, which necessarily entailed the refashioning of people's lives – social, psychological and spiritual – in the pursuit of the appropriation and privatisation of their rents.

The Age of Colonialism

NATURE EXACTS a charge for the use of her resources. People have to work for the benefits that they receive from her. This, generally, puts us all on a more or less equal footing. And yet, nature is blamed for cursing those communities in which people kill for her riches and corrode the institutions of civil society.

We need to explain why anti-poverty economists like Jeffrey Sachs focus so much significance on rent as an obstacle rather than a remedy. The explanation must specify why the community's surplus income – which might enrich us all – is associated with poverty on a mass scale. Marshall provides an illuminating starting point.

These considerations lead us to repeat that, whether in an old or a new country, a far-seeing statesman will feel a greater responsibility to future generations when legislating as to land than as to other forms of wealth; and that, from the economic and from the ethical point of view, land must everywhere and always be classed as a thing by itself.¹⁴

Marshall affirms Adam Smith's observation that rents were the most appropriate sources of revenue to defray the costs of public goods. In feudal Europe, the king represented the state and society as the sole land owner. "Private persons were but *holders* subject to the obligation to work for the public wellbeing."¹⁵ The problems began when *holders* decided that they would become *owners*. To achieve this, however, they had to erase the traditional social obligations that were attached to rent. Rent was privatised, a legal accomplishment that entailed a *de facto* coup against the state.

Thus, in the first phase of the Age of Colonialism, the West's own people of the commons were displaced from the acres on which they earned their living. Poverty became a defining characteristic of modernity. Many died of starvation or disease contracted in the overcrowded and unsanitary conditions in the towns and cities. Over time, millions of displaced souls were forced to sail to foreign lands, where they visited their trauma on the indigenous peoples – phase II of the colonial project.

Why did it happen? Why was rent not accorded the same proprietary safeguards as those which people applied to their wages and to the profits of their enterprises? Why was the arrogance of the land-grabbers allowed to prevail? Most of us would find agreeable a life of leisure, with the strain of having to labour for the food on our table removed by the daily flow of manna from heaven. But we recognise that this is a fantasy. It is impossible, *except for those who can channel the community's rents into their pockets*. That arrangement is impossible without controlling the levers of power.

Because of its public character, rent requires a framework of rules. For rent's social character can be realised only if the

laws of the land protect it. There are two ways to secure its distribution, whether properly or improperly. In both cases, the state must be involved, either directly or by default.

The first way to allocate rent is through the public purse or other representative institutions through which people agree to cooperate with each other. This entails the measurement and collection of rent, and its use to fund the services that people share.

The second approach to the distribution of rent occurs by default. This happens when the state abandons its social obligations to represent everyone, and fails to allocate public value in a way that is perceived as fair to all. The consequence – in a thousand unperceived ways – is the incremental breakdown of order in civil society. The impact ranges from the acts of poverty-driven antisocial behaviour of the individual through to full-scale genocide. These are all linked by the failure of the state to exercise lawful authority on the basis of natural justice. The result is a free-for-all scramble to grab a share of the nation's rents.

- The historic roots of de-socialised rents in Europe are forgotten. But the violence that lurks in the shadows of the richest nations can, ultimately, be traced back to the breakdown of civil society as a result of the rent grab by the feudal barons.
- Warlords carve up diamond and oil resources in Africa because the state fails to secure equal opportunity for everyone. Into the void move the malevolent forces that employ destructive power to appropriate the riches of nature and create poverty.

Thus, we can see that the way in which rent is treated is the primary indicator of the character of a society. Economic historian Joseph Schumpeter alluded to this when he wrote that “nothing shows so clearly the character of a society and of a civilisation as does the fiscal policy that its political sector adopts”.¹⁶ We learn most of what we need to know about a community by examining the fiscal junction boxes. These expose the nature of power and of the rights that citizens may exercise.

Is it too late to heed Marshall’s advice, that “whether in an old or a new country, a far-seeing statesman will feel a greater responsibility to future generations when legislating as to land than as to other forms of wealth”? Some social scientists, when confronted with the virtues of rent as public value, acknowledge that it should be treated as the revenue to fund the services that we share in common – but they retreat behind the claim that it is too late to make the change for ‘old countries’ like the United States.¹⁷

This excuse is no longer persuasive, because humanity has now entered a new world. In 2008, for the first time, more than half of the world’s population – 3.3 billion people – live in urban areas. This number will climb to 5bn over the next generation.¹⁸ This changes the balance of our relationship with nature. UN-Habitat makes it clear that this transformation will require a “revolution in thinking”. Can the displacement of most humans from their roots in the countryside become the trigger for reforms that finally abolish poverty? Or are we facing a new wave of impoverishment, this time relocated from the countryside to the town?

The evidence for this trend from China, for example, is compelling, and it illustrates how policy-makers have not yet

learnt how to relate complex rights on property to optimum policies of public finance. The outcome, in China, is grievous. Despite the communist doctrine which reserves the nation's assets for the common good, large-scale corruption is being fuelled by the privatisation of resource rents.

The costs have been cautiously quantified as equal to 3% of China's economic output, or \$86bn in 2003.¹⁹ According to research by Minxin Pei, bureaucrats are stealing – on conservative assumptions – 10% of land revenues, investment and government spending, and posing a “lethal threat” to China.

A 2006 study of 3,067 corruption cases found that about half of the officials or individuals engaged in corruption related to infrastructural projects and land transactions....Typically, local officials use illegal (and sometimes violent) means to acquire farmland at low prices and later sell the user rights of the land to developers in exchange for bribes. A survey of 16 cities conducted by the Ministry of Land Resources in 2005 found that half of the land used for development was acquired illegally. According to the head of the Regulatory Enforcement Bureau at the Ministry of Land Resources, the government uncovered more than one million cases of illegal acquisition of land between 1999 and 2005.²⁰

The pillaged money could fund the health and education of a population that has suffered decades of deprivation. Instead, culture is retarded while billionaires are created in the land that still pays lip service to Marx and Mao. The richest person in China today is a 26-year-old woman, Yang Huiyan. She is reported to be worth £8.8bn, following the decision of her father to list his property development company on the Hong Kong stock exchange.²¹

Legitimate money is to be made by constructing buildings

that add value to China's capital stock. But much of the income gushing into the construction sector is rent that the politburo is failing to capture to fund the redevelopment of Chinese society.

De Soto: the Myth of 'Capital'

IF WE define corruption as the privatisation of public value, China is not far removed from the capitalist model. By its acts and omissions, it adheres to the theory that is favoured by Western financial institutions. According to their doctrine, poverty would be diminished if the neo-colonised countries privatised urban land rents: by attaching individual owners to land, and applying the rule of law, people are motivated to work and invest.

Hernando de Soto has popularised this theory in his widely acclaimed *The Mystery of Capital*. People who live in slums should be given secure title to their dwellings and the plots they occupy. With property deeds in their pockets, they could borrow from banks to fund new enterprises.

The shelters constructed by slum dwellers do have a value, largely because of the locations they occupy close to city centres. In Lima, Peru, for example, a house-by-house valuation (based on replacement costs in 1984) found that the average value of a slum dwelling was \$22,038.²²

If de Soto's programme was adopted, people would acquire land – most of it currently in public ownership. No doubt many of them would benefit. But what happens to the next generation of migrants from the countryside who then squat in neighbouring *barrios* and *favelas*, their dwellings

constructed from scavenged materials? The crisis of poverty would be perpetuated. The de Soto formula, which was commended by politicians such as Margaret Thatcher, is based on a primitive view of property. It disregards the sophisticated layers of meaning embedded in rights that were wisely devised by pre-modern communities.

There are at least two major problems with de Soto's doctrine, in relation to his own plan to motivate people into the self-employment that would raise living standards.

First, it does not fit with reality. Fieldwork in Peru and Argentina reveals that owning the title encourages the poor to improve their homes, but they are not more likely to obtain loans from banks to start businesses. The reasons given include the belief that property is too valuable to commit as collateral, and that life's risks make people reluctant to take on debt.²³

Secondly, the de Soto doctrine ignores how value is generated and distributed. Consequently, it ignores those public policies that can synthesise the two levels at which people live in the real world.

- Property rights need to be *disaggregated* into public and private categories while *simultaneously* harmonising them through complementary pricing mechanisms.
- The community needs to *distinguish* the private and public sectors, while *uniting* the two in an integrated community that provides everyone with the opportunity to live balanced lives.

Privatising the slums on the basis of the vulgar formula promoted by de Soto would not create the syntheses that

can deliver functionally efficient communities while also safeguarding the natural environment. During the heyday of colonialism, the disasters inflicted on people and their cultures laid the foundations for the catastrophes that now loom in the 21st century. Whereas before, the predatory abuse of people's rents was a localised calamity, now they will determine the fate of humanity.

By 2050, cities are expected to support 75% of the global population. Humans are embarking on a new voyage. Our cultural future is not prescribed. On its present trajectory, that future will turn out to be the nightmare that ends all nightmares. The majority of people who will migrate from the countryside will be poor, living in squatter settlements on the edge of mega-cities. How we integrate them will determine whether we foster the conditions that nourish prosperity, or acts of terrorism and the further abuse of nature.

Generally speaking, the planners who visualise eco-friendly urban spaces have not yet understood the errors that shaped modern cities. Because of their notion of property rights and public finance, economists and sociologists continue to promote models of living that are sterile. With present thinking, the prospects remain bleak. That new strategies are not on the current agenda is affirmed by the World Bank's president, Robert Zoellick, who has promised to step up the flow of billions of dollars in extra aid. Without that foreign aid, he says, the UN's Millennium Development Goals will not be achieved.²⁴ In our view – recalling the failures of foreign aid over the past decades – more of the same by the World Bank will not achieve the breakthrough that is needed.

Our critique has emphasised the negative role of the West. But the neo-colonised world also needs to play its

part in remedying the blight of its impoverished masses. Part 2 provides deeper scrutiny of the underlying causes of institutionalised poverty in these neo-colonial regions. Part 3 elaborates the template for solutions on the ground.