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A Bankrupt Paradigm

FROM THE DAY he replaced Tony Blair as Prime Minister, Gordon Brown knew he had enemies on his own backbenches in Parliament. His brooding quest for ultimate power had been thwarted for 10 years, but he finally made it into No. 10. But the knives were being sharpened, and his greatest self-proclaimed achievement – *No More Housing Boom Busts* – was discredited. He needed a narrative. Like Superman, he needed to *save the world*. Such an achievement would silence his critics, and secure his legacy as the prudent architect of a rejuvenated British economy.

Brown exploited every twist and turn in the financial crisis, to distance himself from the home-grown economic disaster and shift the blame onto others. His flight to New York in April 2008 was one such occasion for political theatre. In the muscular vocabulary which he had mastered, he warned the heads of the largest American banks that they should "come clean". He wanted them to disclose all the losses they had endured as a result of the sub-prime mortgage crisis.

For 10 years, Brown had failed to come clean on the tax-driven losses which he inflicted on the people of Britain while he presided at the Treasury. Who was he to lecture others on the need for transparency?

But Brown was not alone in seeking to camouflage the failures of governance. Presidents and prime ministers around the world directed blame for the economic freefall on "greedy" bankers. And to create the security of a consensus, they issued a communiqué in September 2009, following the meeting of the leaders of the G20, who represented the biggest economies in the world. They met in Pittsburgh to define a blueprint to prevent the world from ever again relapsing into financial crisis. They pronounced on the need to balance the trading relationships between the East and West. In essence, America's consumers should save more money, and China's savers should spend more money. But there was nothing about the epicentre of the economic tsunami that swept over the global economy in 2008. The property market was off the agenda. They performed a semantic waltz around root causes.

The bankers, of course, received what had become a ritual whipping for being greedy. But no proposal emerged to recalibrate the tax regime in ways that would favour reforms to investment and consumption habits to deliver long-term growth. And so, in January 2010, President Barack Obama dug deep into his linguistic larder and led the charge against the financial sector. The big banks would have to be broken up. Banks that looked after the deposited savings of the nation would have to be separated from the speculative investment functions of hedge funds. Never again would the banks be "too big to fail". Obama lashed the financiers, offering them the fight for which they were spoiling in defence of their bonuses. This was catharsis for two years of stress in which no part of the workforce, from workbench metal bashers to top scientists, was exempt from redundancy. Someone had to pay, and the anger was directed at the Big Bonus earners of Wall Street and the City of London.

So the scene is set. As from 2010, the global economy is back on course for the next cycle of property booms. The real estate cycle will peak in 2025/2026, followed by an even deeper crash to the bottom in 2028.

Re-regulating the banks will make no difference to the incentives and opportunities for pursuing capital gains in the land market, which is where the crisis in capitalism begins and ends. Banks have been exposed to cyclical crises for at least 200 years, as an examination of the graph on page 156 of the monumental study by Reinhart and Rogoff reveals.[1] The incidence of banking crises has been rising steadily since 1800. There was a pause between 1940 and the early 1970s, but this

1 Reinhart and Rogoff (2009).

was *not* because of the Glass-Steagall regulations introduced in the US during the Depression of the 1930s. World War II intervened to squash the cycle. Business-as-usual did not resume until 1956 (it took 10 years to reconstruct the capital base of most western nations). From that point, it was only a matter of time – 18 years, to be precise – before the cycle of banking crises resumed.

Financial crises have occurred under all forms of regulatory regimes. There was no regulation in America in the 19th century, there was some regulation early in the 20th century, and there was tight regulation up to the late 1980s … yet the financial crises recurred without failure. So why are we supposed to believe that a new regulatory regime can thwart the underlying processes that drive the boom/bust cycle? The consensus among politicians and economists stems solely from the fact that they are locked into a bankrupt political philosophy, one that *excludes from sight one of the foundations of the economy*. The power-brokers have lost the sense of an alternative to capitalism.

Quest for a New Economic Order

EVERY YEAR, the cream of the world's intellectual, financial and political classes fly into Davos, in Switzerland, for a talk-in about their primary interests. In 2010, the task of the host organisation, the World Economic Forum, was to assist in the definition of a new agenda of reform. Its initiative was nothing less ambitious than to "rethink, redesign, rebuild" the world.

That most shrewd of economic commentators, Martin Wolf of the *Financial Times*, optimistically assessed that the forum could make a useful contribution to global reform "provided the world does not expect too much".[2] The forum established 70 global agenda councils packed with experts charged with exploring every issue under the sun. Every issue, that is, except the one that might actually enable the people of the world to reconstruct a social organisation beyond capitalism.

Their deliberations *had* to fail, because the economic paradigm with which they were working *excluded* the part played by

2 Wolf (2010).

property rights, and their enabling tax policies, in shaping people's knowledge, investments and expectations.

It took a film maker with no economic training to point out the realities. Michael Moore's *Capitalism: A Love Story*, received its premiere in Los Angeles as the Davos set boarded their private jets to fly to Switzerland for their networking sessions. The film does not offer a solution, as its maker frankly admitted. There were shocking episodes of maltreatment of employees by the corporations, and trenchant attacks on the corruption of politics in Washington, DC, by corporate lobbyists. But no indication of how to re-base the economic system in a way that would fulfil people's aspirations. Moore was honest about this shortcoming. He told an interviewer that he wanted to replace capitalism with democracy – but he could not describe the kind of economic organisation that corresponded to the politics of popular participation in the nation's decision-making.

What I'm asking for is a new economic order. I don't know how to construct that. I'm not an economist. All I ask is that it have two organising principles.

Number one, that the economy is run democratically. In other words, the people have a say in how its run, not just the 1%. And number two, that it has an ethical and moral core to it. That nothing is done without considering the ethical nature, no business decision is made without first asking the question, is this for the common good?[3]

Here was a film maker in search of an answer. That answer has been in the economic and political literature for centuries. And yet, it is not on the political agenda. It is an economic paradigm in search of democratic support. I thought I knew the man who not only understood what was wrong with capitalism, but also understood the nature of the reforms that would take us beyond the ramshackle system that tyrannises people's lives. He was a Nobel laureate who could command the attention of the world's media. Did he have the courage to spell out the truth? That was the question that preoccupied me, one hot summer's day in 2009, as I drove to Manchester to interview Joseph Stiglitz. We met in his study, where he had agreed to be interviewed for a documentary film that I was making about casino capitalism.

3 McGreal (2010).

Of Myths and Missed Opportunities

STIGLITZ is a firebrand with an intellectual pedigree second to none. He has occupied the highest positions in Washington, as economic adviser to the Clinton Administration, and then as Chief Economist at the World Bank. As an academic, he earned a Nobel Prize in 2001. But he also has street cred: he speaks his mind, in language that people can understand. Unlike so many professors who enjoy sinecures in the leading universities around the world, Joseph Stiglitz is no hostage to vested interests.

And so, as I questioned him in front of a camera, he did not pull his punches. About the lobbyists who bent legislation to free the Wall Street bankers so that they could rip-off low-income Americans with expensive sub-prime mortgages. About the lobbyists who scuttled the legislation that was needed to curb the greenhouse gases emitted by gas guzzling automobiles and coal-fired power stations. About the distortions in the economic statistics that create the illusion of material prosperity.

Here was a man who knew the truth.

And Stiglitz *does* know the truth. In his scholarly articles, he has written about the economics of real estate – as they relate to public finance – under a new term: the Henry George theorem. Given certain circumstances, the funding for public services could be defrayed out of the rent of land. Stiglitz understood that the land market was something special. Surely he could integrate this knowledge with the behaviour of the financial sector during the decade up to the housing bust of 2007? I was to be disappointed. In his analysis, he volunteered nothing about the economics of land speculation.

As I took my leave, I handed the professor a copy of *Boom Bust*. In this, I described the dangers of wrapping people's mortgages into complex financial instruments that would one day smash savings and impoverish pensioners.

Joseph Stiglitz is no apologist for capitalism. That is clear from *Freefall*, the book that he published in 2010. Here was his chance to define the economic agenda that would carry us beyond capitalism. Instead, we are provided with a myth-riddled account of how, why and where the crisis struck the global economy. Every one of the myths would reinforce the economics that foredooms us to the chaos of another housing boom/bust.

MYTH *The crisis began in America*

It did not. It began in the UK. It began in Spain. In Ireland. In China, all the way down to the tiny Baltic countries like Latvia. Every one of these countries was responsible for cultivating its home-grown crisis, located in the domestic land market. It was the pursuit of the windfall gains from land that infected all walks of life – including the banking sector – that predetermined the fate of their economies.

MYTH *Markets do not work well on their own*

They can. Provided the ground rules are correctly framed, markets can operate without government intervention on the scale that seems to be envisaged by Stiglitz. He is a fan of John Maynard Keynes, who advocated the need for government intervention to maintain full employment. But the Keynesian model is deeply flawed, because it assumes "the land problem" had been solved.[4] Keynes's view on land reinforced the doctrinal reworking of classical economics over the previous three decades, which blinkered politicians like President Franklin D. Roosevelt, who sought to reform capitalism with the New Deal.

MYTH *The crisis exposed flaws in the capitalism that emerged in the late 20th century*

The flaws which cripple the enterprise economy were already in place *before* the Industrial Revolution. Blaming everything on Margaret Thatcher and Chicago's economic fundamentalists distracts people from the cause of the repetitive syndrome which molests people's lives.

MYTH *It has been hard to see the flaws in capitalism*

The flaws are inscribed in the history books, and on the graphs that gather up the statistics on the performance of real estate markets in countries as large as the United

4 Harrison (1983).

States, and as small as the Netherlands. There is no difficulty in *seeing* where the tensions arise in the capitalist economy, if you know what you are looking for.

MYTH *Rugged individualism and market fundamentalism have eroded any sense of community*

In Britain, the bonds of community were eroded by the land grabs of the 16th and 17th centuries, and the enclosures of common land in the 18th century. The aristocracy used Parliament to legitimise their privatisation of the commons, displacing the villagers and destroying the customs that bound people in social solidarity. Blaming the modern variant of the economic fundamentalism that camouflages the pathological fall-out of those early land grabs does nothing to enlighten people about the remedial policies that are needed in the 21st century.

MYTH *There is no going back to the world before the crisis*

Not true. On the strength of the regulatory reforms announced by Obama, the world that existed before the crisis – a world of property boom/busts, a world of chaos and underemployment and unaffordable housing – remains solidly in place. For the first signs of that repetitive syndrome, witness the housing bubble that provoked China's central bank to tighten monetary policy in 2010.

Analytic Philosophy

POLITICIANS USE language to camouflage their actions. In the US, it was impossible to admit that the \$700bn (£380bn) bail-out of the banks *socialised* the bad debts which were created by land speculation. To bamboozle the public, the Bush administration had to bend people's minds.

When the two biggest mortgage companies (Freddy Mac and Fannie Mae) were nationalised, the White House refused to face the reality. So they invented a new word. The banks were being taken into "conservatorship". Not *nationalised*, because that offended the authorised doctrine of property rights. Liberalisation of the banking sector in the 1980s had been justified by right-wing ideologues on the strength of the claim that "markets know best". And yet, here before our very eyes, the market had collapsed and needed a bail-out. To the rescue: *taxpayers' money galore!*

But this was *not* socialism. It was just the latest exercise in old-fashioned taxpayer-funded protection of land speculation. This was *capitalism* red in tooth and claw, ensuring that the damage to the people who monopolised the nation's rents was minimised, at someone else's expense. And today, we can count on the fingers of one hand the professional economists who understand this, and can sensibly articulate it for their students. What, then, constitutes the paradigm that can take us beyond capitalism? We can quote from a long panel of distinguished philosophers who have described the key changes that are needed. I shall summarise the wisdom of the 3rd Earl Russell because, uniquely, his tool-in-trade was language.

Bertrand Russell (1872-1970) was a British philosopher, logician, mathematician and historian. He was awarded the Nobel Prize in Literature in 1950. His *History of Western Philosophy* became a best-seller. He is considered as one of the founders of analytic philosophy. As one of the 20th century's leading logicians, no wordsmith could pull the wool over his eyes. And so, by reading his works, we get to the crux of what it would take to reshape the capitalist order into something that would satisfy people like Michael Moore.

"Private property in land has no justification except historically through power of the sword," he wrote in 1916, in *Principles of Social Reconstruction*.[5] But to achieve justice, and economic efficiency, it was not necessary to become a communist (following Marx, by supporting the nationalisation of the means of production). All that was necessary was to eliminate the monopoly in land, and the power of money. But how could this be achieved, without turning into a communist? The answer was to undermine the monopoly power that was placed in the hands of land owners. Forensically, Russell dissected that power in these terms:

> If I own land in London or New York, I can, owing to the law of trespass, invoke the whole of the forces of the State to prevent others from making use of my land without my consent. Those who wish to live or

5 Russell (1961: 491).

work on my land must therefore pay me rent, and if my land is very advantageous they must pay me much rent. *I do not have to do anything at all in return for the rent*. The capitalist has to organize a business, the professional man has to exercise his skill, but the landowner can levy toll on their industry without doing anything at all. Similarly if I own coal or iron or any other mineral, I can make my own terms with those who wish to mine it, so long as I leave them an average rate of profit.

Russell understood the unique nature of rent: capitalise it, and trade it in the markets, and you have a monopolistic system that distorts competition, maldistributes income and wrecks the value-adding activities of entrepreneurs and their employees.

But it was not just the productivity of individuals which is capitalised into the value of land. The collective improvements to which we allude when we talk of progress raises the productivity of the economy, and the net gains are captured by those who claim the legal right to land and nature's resources.

Every improvement in industry, every increase in the population of cities, automatically augments what the landowner can exact in the form of rent. While others work, he remains idle; but their work enables him to grow richer and richer.

But what of the power of money? Russell's logical mind was not to be deceived. He understood that bankers depended on that original derivative in the financial markets – the law that permits the credit creators to extract a share of the rents.

> The men who have most economic power in the modern world derive it from land, minerals, and credit, in combination. Great bankers control iron ore, coalfields, and railways; smaller capitalists are at their mercy, almost as completely as proletarians. The conquest of economic power demands as its first step the ousting of the monopolists.[6]

That is the legacy of the past, and that malignant power shackles society today. If there is nothing we can do about it, politicians should be honest and tell their constituents that their hands are bound. They should confess that they cannot ameliorate the collateral damage inflicted by that "mother of all monopolies" (Winston Churchill). They should not promise to abolish poverty and inequality, and should not pose as the champions of human rights. If there is nothing they can do about this outrageous inheritance, at least admit it.

6 Russell (1961: 518).

But there is something we can do about it. Bertrand Russell was unremitting in his logic:

> The mere abolition of rent would not remove injustice, since it would confer a capricious advantage upon the occupiers of the best sites and the most fertile land. It is necessary that there should be rent, but it should be paid to the State or to some body which performs public services; or, if the total rental were more than is required for such purposes, it might be paid into a common fund and divided equally among the population. Such a method would be just, and would not only help to relieve poverty, but would prevent wasteful employment of land and the tyranny of local magnates. Much that appears as the power of capital is really the power of the landowner – for example, the power of railway companies and mine-owners. The evil and injustice of the present system are glaring, but men's patience of preventable evils to which they are accustomed is so great that it is impossible to guess when they will put an end to this strange absurdity.[7]

Capitalism is a bankrupt paradigm. It cannot be reformed. By invoking the principles of justice and economic efficiency, we can begin to visualise a new kind of society.

7 Russell (1961: 492).

TABLOID EDITORS are ecstatic when house prices rise. They rose in the UK in 2009. Good or bad? These increases signal a pathological problem. But silence from the commentariat is convenient for politicians, who don't have to explain to voters that free fortunes from their homes are not compatible with sustainable growth. Now, countries which suffered lightly from the sub-prime scandal are driving the next housing boom/bust cycle. Canada's house prices jumped 19% in 2009, achieving records in Toronto and Vancouver. At five times the average after-tax income, this was a crisis in the making. More serious: the property boom in China. The Politburo pointlessly passed a law in 2009 keeping land in public ownership whilst allowing speculators to pocket the rents from land (see Epilogue, page 263). The flame-throwing dragon will burn a lot of us by 2028, the end of the new business cycle that begins in 2010.