

ROGER D. HODGE: STEAL THIS ELECTION

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HOW TO SAVE CAPITALISM

Fundamental Fixes for a Collapsing System

*A Forum with James K. Galbraith, Michael Hudson,
Eric Janszen, Barry C. Lynn, Bill McKibben, Joseph E. Stiglitz,
Elizabeth Warren and Amelia Warren Tyagi*

USEFUL AMATEURS

How the Smearing of Barack Obama Got Crowd-Sourced

By Ken Silverstein

Also: David Means and David Foster Wallace

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capable of keeping pace with the industry's ability to constantly create new and dauntingly exotic products.

Because risk is an intrinsic part of most financial transactions, a Financial Product Safety Commission would not—and should not—prevent every financial mistake. But the agency would allow consumers to make informed decisions about the amount of risk they want to take and would protect them from unscrupulous practices that disguise the dangers. The FPSC might evaluate loans and credit-card agreements using standards similar to ones employed by other agencies concerned with consumer safety: Is a reasonable consumer likely to get hurt by this product? Is the information provided complete and helpful, or is it designed to create a false sense of safety? Will this aspect of the product's design provide a meaningful service to consumers, or will it confuse and mislead them? Is the malfunction rate—that is, the default rate—reasonable, or is it unacceptably high? Each year millions of credit-card offers go out with tiny print detailing “double-cycle billing” and “trailing interest,” terms that have enormous financial implications but are meaningless to most people. Likewise, such products as mortgage prepayment penalties are slipped surreptitiously into agreements for the sole purpose of trapping people into loans that they otherwise would not likely take on.

Industry advocates claim that any safety reg-

ulation would constrict credit, particularly to the poor. But the FSPC would restrict only a financial company's ability to profit from deception and obfuscation—practices that lenders more frequently employ on low-income borrowers. Unlike the hard cap on total charges set by usury laws, which if too low actually does squeeze off credit to those who really need it, these regulations would merely require honest risk-based pricing, with all the costs and terms made clear up front. Consumers who can see the total cost of a financial product before purchasing it are no doubt better able to determine whether it is something they can really afford.

The ingenuity of the past thirty years has led to astonishing changes in our consumer goods. Frozen foods, televisions, and plain old toasters have been made not only more efficient, user-friendly, and varied than they were but also less expensive. And all of this was accomplished even as the products were held to increasingly higher standards of safety. But over the same period of time, innovation without sensible regulation in the financial sector has brought a subprime mortgage meltdown, credit-card contracts that have expanded from one page to more than thirty, and payday loans that charge annual percentage rates of over 900 percent. The world of physical products has become safer, while the world of financial products has become far more dangerous. That's a problem that can be fixed. ❖

TAX THE LAND

By Michael Hudson

To save industrial capitalism, we might begin by looking at changes sought by classical economists. Reformers from Adam Smith to John Stuart Mill to Thorstein Veblen hoped to streamline industry and increase economic competitiveness by doing away with the special privileges inherited from feudalism; namely, “economic rents” earned from longstanding land, monopoly, and banking rights. Income from these entitlements added to the cost of doing business but neither produced anything tangible nor spurred technological innovation. Classical economists contended that the tax burden needed to be shifted off of industry and

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labor and onto that which was taken from nature or granted by government decree—what Mill called the “unearned increment” that landlords extract “in their sleep.”

In the United States, progressive-era reforms advanced many of these ideas, and by World War I the nation was well on its way toward achieving what John Maynard Keynes would call “euthanasia of the *rentier*.” The federal government passed its first income tax in 1913, at a time when even more wealth than today was either inherited or derived from insider dealings. Steeply progressive, the tax was levied on only the wealthiest 1 percent of the population (households earning more than \$83,000 in today's dollars), with their income taxed at a marginal rate of 77 percent by 1918. Capital gains were taxed at the same level, on the reasoning that they added to net worth just as earnings and savings did. These policies



helped create a middle class in America, while similar measures did much the same in Europe.

But the class that Franklin D. Roosevelt called “economic royalists” fought back and over time (and particularly after 1980) reversed these progressive tax policies. The top marginal tax rate for personal income has been slashed, from a high of 94 percent in 1944 to roughly 35 percent today. Capital-gains taxes are now capped at 15 percent, and this tax is not even collected on the vast majority of real estate sales, since commercial owners are not taxed if they use their sales proceeds to buy new property. As a sop to homeowners, residential price gains have been made tax-free for the first \$500,000. Rental income also has been rendered free from taxation by the accounting sophistry that property is depreciating rather than rising in value, even when actual market prices are soaring. At the state and local levels, prior to 1930 some 70 percent of public revenue came from property taxes; today, only 21 percent does, with the difference made up primarily in increased taxes on income and sales.

These tax breaks on property and capital gains, along with the tax deduction for interest payments, provide a powerful incentive for buyers to go into debt; that is, to pay mortgage interest to bankers for property they hope to sell at a gain. Thus, the income that governments have relinquished through property-tax cuts ends up being paid by new buyers to banks as interest. Rather than funding new development projects, most savings have been turned into bank loans for housing that already exists,

“post-industrializing” the economy and burdening it with an overhead of non-production costs. We are far from the wealth of nations that Adam Smith imagined.

As reform-minded economists have long argued, we must tax the *rentiers*. Taxing their privilege would yield as much as the present income and sales taxes combined, without eating into the earned income of wages and profits. For example, roughly half of the estimated \$1.4 trillion rental value of all residential and commercial real estate comes from the land on which buildings sit. The idea is to tax not the buildings but this land value—sites that are provided by nature and that increase in value incidentally when a rail line or a Starbucks is built nearby. By taxing only the land, we would no longer be penalizing new construction and would discourage speculative hoarding. Indeed, in both 2006 and 2007 the market price of land went up by \$2.5 trillion. This increase in balance-sheet valuation was not earned, since landlords did not have to make an investment to create it; moreover, taxing these sites could help cover the costs of new development and would not reduce the supply of land.

A related reform would abolish the tax deduction for interest payments. In 2006, property owners paid \$742 billion in mortgage interest, accounting for 84 percent of the total interest collected by the financial sector. Assuming a 33 percent overall tax rate, this deduction alone cost the Treasury a quarter trillion dollars. (By encouraging debt financing rather than equity investment, this subsidy to mortgage lenders helped fuel the real estate bubble.)

The public also should own—or at least be able to collect rental revenue on—the nation’s infrastructure and the monopolies for which only one provider makes economic sense. The broadcasting and communications spectrum is just one example of immense private wealth that has been carved out of the public domain. (As with England’s land barons, broadcasters received their right on the condition that they fulfill specific public obligations, which, over time, they came to resist.) I estimate that the broadcasting spectrum, recently valued at \$480 billion, accounts for another \$100 billion in free economic rent. Other privatized natural resources lose perhaps \$250 billion more.

The total lost tax revenue on property, capital gains, interest, and infrastructure is likely upwards of \$1 trillion, a significant share of America’s \$12.4 trillion national income in 2007. Instituting these taxes on land would make it harder for property buyers to take on large loans for homes they cannot afford, a re-

sult that would ultimately drive down the cost of housing. Additionally, the money that was being funneled to banks in the form of inflated loan payments would now go to the government as taxes, thereby allowing income and sales taxes to be radically reduced. In all, a considerable net gain for Americans.

In our country and elsewhere, the transition

from a feudal economy to a modern one remains incomplete. Hereditary estates and monopolies still retain huge privileges; taxes on property and rents remain at historic lows. Taxing these “unproductive” incomes would help to unburden labor and enterprise, and these changes would go a long way toward fixing what ails our economic system. ❖

PLAN

By James K. Galbraith



Can Capitalism survive? No. I do not think it can.
—Joseph Schumpeter, 1942

The problem is not how to save capitalism but how to save the unique and successful mixed economy built in the United States over the eighty-five years since the New Deal. Our system is not capitalism. Our economy has a large public sector, which at its best was competently concerned with research, defense, financial stability, environmental safety, social security, and large measures of education, health care, and housing. Today, after thirty years of attack on government, all these functions are damaged and in peril.

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The rot comes from predators posing as conservatives and mouthing the rhetoric of “free markets.” They are not actually interested in free markets. Their goal is to use the government to build monopolies, to control resources, to block regulation, to crush unions, to divert as much as possible from taxpayers into private pockets. They have a reckless attitude toward war-making and they put the financial system in peril by failing to enforce standards of ethics and transparency. As a result, they imperil the country’s credit in the world. True conservatives recognize this, which is why they defected from Bush and McCain long ago.

Our postwar system was built on technological leadership, financial stability, and collective security. The world gave us credit and used our currency. Why? Because we gave it back the public goods of peace and economic progress. We were the bulwark during the Cold War. Our system wasn’t imperial: we spoke instead of community, of freedom, of common purposes and common values, and the world took us seriously because we had paid our dues.

The next successful system should be built on that model—that is, on the basis of regulated finance, collective security, and, above all, a national purpose. Since energy and climate change will dominate the global agenda for the next generation and perhaps even the following, dealing with these issues must become our generation’s purpose too. Although America is the world’s great energy wastrel, among developed countries we are the best positioned to change, to reduce our own fossil-fuel use and help the world do likewise. We have the science, the technology, the engineering, and the educational capacity to take the lead.

What we do not have is the capacity to figure out, in advance, a coherent national strategy to-