THE ECONOMY IN PALLIATIVE CARE

(To palliate: to relieve a disease without curing) by David Smiley

David Smiley analyses the debate started by Kevin Rudd's essay titled 'The Global Financial Crisis'. It's disappointing to see that so many in the debate lack the understanding of land based economics that David and many of us have.

While the world's experts are arguing about how to relieve the pain of recession, few are diagnosing its fundamental cause and fewer still are prescribing a fundamental cure. Let us start in Australia.

THE GLOBAL FINANCIAL CRISIS was the title of an essay by Kevin Rudd in the February issue of The Monthly. Rudd's essay was largely ignored until Robert Manne explained some of its terminology in the March issue and then opened it up to debate in a symposium of international experts in the May issue. Rudd's essay argued for the replacement, by social democracy, of the free-market and neo-liberal philosophies of some outgoing administrations in the English-speaking world. It contained a powerful critique of the outcomes of these philosophies, and an argument for market regulation to correct market failure in the financial sector. Though this central thesis was extensively set out, quite crucial aspects of method and of scope were mentioned but, regrettably, not developed. For example, the methods for correcting market failure go far beyond market regulation. And the scope of the problems now facing social democracy goes far beyond the financial sector. Regrettably, there were very few references in the essay to the housing market where the meltdown started. And, though this meltdown will have very large impacts beyond the OECD economies, there were only passing references to the threats to the Millennium Development Goals, protection, climate change, and to emerging poverty-driven conflicts.

THE SYMPOSIUM, published in the May issue, contained an introduction by Robert Manne to five world experts asked to comment on Rudd's essay. This advice was inconsistent and, in some places, badly confused over the nature of land, capital, and the institutions that use them. Since this confusion is of extraordinary importance I will summarise the five contributions and then pose questions that Kevin Rudd should try to answer.

Eric Hobsbawm starts on firm ground, reminding us that monopoly capitalism and monopoly socialism have both crashed in the past and that all economies now combine the public and the private. The rationale for this combination is already well established in the constituents of market failure theory such as monopoly, externalities, merit goods, rent seeking, and non-monetary components of utility such as the environment. However, in a single paragraph, the fourth, Hobsbawm makes four serious mistakes that compromise the remainder of his response. One: that the higher growth rate of the post-1945 "golden age" was due to the remnants of war-time central planning. No, it was due to massive infusions of Marshall-plan capital into war-torn Europe, with results predicted by the theory of marginal returns in situations where the capital base is seriously depleted. Two: that subsequent slowing growth in the OECD was due to market fundamentalism. Partly true, but during that period accelerating real estate speculation was already dragging investment away from the productive towards the unproductive. Three: that the Asian economic miracles rested on "distinctly un-Hayekian" principles. No, "In all three of Asia's biggest successes - Japan, South Korea and Taiwan - the groundwork for both fast growth and the income equality that eased the social strains of development was laid by a radical land reform." (The Economist, 29 June, 1991, p. 16). Four: that Atlantic capitalism was responsible for the economic stagnation of the bottom 40% of the US population. No, that stratum was a class that, until tempted by Fanny Mae and Freddy Mac, rented housing from a land-owning class whose wealth was rapidly increased by a raft of tax breaks, remorselessly increasing real rents paid and implicit rents received in huge un-taxed capital gains.

David Hale profoundly disagrees with Hobsbawm. He argues that the present crisis arose, not from systemic failure of false ideas but from easily avoidable factors such as the American obsession with home ownership. His criticism is that Kevin Rudd neglected to mention that "The downturn resulted from the collapse of the residential real estate market in the US" and that it was Congress that essentially promoted the sub-prime boom.

Dean Baker was the first economist to warn of the dangers of the housing bubble. His criticism is that Kevin Rudd had underestimated the role of the real estate bubble in causing the meltdown. Yet "There was overwhelming evidence that the economy was being driven by a gigantic asset bubble....creating US$ 8 trillion in housing-bubble wealth."

Charles Morris is critical of the role of neo-liberal economics in getting us into this mess but, perhaps because he is a lawyer and banker, he seems unaware, as also does Hobbbawm as a historian, of the warnings about market failure coming from mainstream economists in the last 20 years.

John Gray, like Morris, Manne and Rudd, is also critical of the neo-liberal experiment. For a political philosopher, he is surprisingly supportive of globalisation and capitalism: "Only one model of globalisation has broken down, and only one model of capitalism - the highly unstable, financially driven version promoted by the US over the past 20 years - has gone into retreat." His main concern is that, without any effective global government, the world's great powers are now competing with one another to gain natural resources and to avoid paying the costs of climate change.

PAIN ON THE ROAD TO RECOVERY is the title of Kevin Rudd's 6,100 word essay published on July 25. In this government blueprint he explains to us that his system of palliative care, the bank bailouts and stimulus packages, is much superior to that of other countries. His diagnosis is that we have been living beyond our means, and his prescription is, essentially, that we must work harder and smarter. He seems to have completely ignored Hale's and Baker's criticisms, a point not missed by the Sydney Morning Herald in next day's editorial. "There's been no serious effort to 'deleverage' households from their high debt levels, mostly associated with house prices. Instead the housing market has been primed a bit more, through the first-home buyer subsidy." I found no reference to real estate bubbles and no mention of the tax reforms that might have pricked the real estate bubble and thus reduced the risk of recession. In fact there was only a brief mention of a tax review, one due at the end of the year, the key focus of which was not to prevent future bubbles but to attract international investment and business.

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QUESTIONS KEVIN RUDD SHOULD ANSWER (From points made in his July essay)

Infrastructure developments in roads, rail, ports, energy, schools and hospitals all increase nearby land values. These values are created by society and should be returned to society. Will your government tax these windfall rents, or will they be collected and squandered privately? See tax reform below.

Coal. Do you intend to exempt the coal industry from the emissions trading scheme? If so it will cost $10 billion in revenue over ten years. As well as set back your own initiatives on climate change. See tax reform below.

Financial regulation. "When markets do stabilise and start to rise once more, it is certain that financial institutions will find ways around the G20's new rules." (The Sydney Morning Herald editorial, News Review, April 4-5, 2009, page 10). Would it not be better to go to the source of the problem, housing bubbles, and prick them with heavy land taxes?

Global competitiveness. During the Great Depression, protectionism reduced global competition and added years to the depression. Are you going to yield to selfish pressures from those unwilling to share the pain of recession?

Innovation. Taxing our uses of scarce resources encourages new inventions, substitutions, and better use of existing resources. Coal and petrol are just two of many examples. Innovations are also encouraged by shifting taxes off labour and capital. Why then is your blueprint for this vital subject confined to the setting up of a national broadband network?

Climate change. See tax reform below.

Water scarcity. See tax reform below.

Protection, in the wake of the recession, now threatens to further destabilise poor countries already suffering. Should your government be therefore yielding to pressure from unions and employers for protection? And should not your government be doing more to discourage agricultural protection? 'Farmers in poor countries struggle to compete with heavily-subsidized farmers in Europe and America - and even see their own market destroyed when food surpluses are dumped. Lost trade costs poor countries an estimated $700 billion each year, says the UN, a figure that dwarfs aid spending' (Economist July 1, 2000:50). And "Rich country farm subsidies prevent the poorest countries from selling some of the only goods, other than illegal drugs, that they are able to export, keeping millions of people miserable. Consumers in rich countries pay over the odds for food. And for what? So that a tiny number of farmers and a few large agricultural firms in rich countries can continue to benefit at the expense of the world's poor." (Economist, April 17, 2004).

Failure to meet the Millennium Development Goals. A problem only briefly mentioned in your first essay, will destabilise poor countries, with a backlash on rich countries. There is already evidence of potentially explosive social unrest as reductions in livelihood are mixed toxically with rises in poverty, energy costs, water scarcity, and environmental damage. Why is this not even mentioned in your July blueprint?

Inoculation against future recessions. If real estate bubbles precede and then trigger financial bubbles, should you not prick this bubble by ramping up taxes and cutting subsidies that would discourage speculation in rising land values?

Tax reform. This is the most effective way of correcting market failures such as monopoly, rent seeking and collusion. Also, a tax shift away from the production of goods and services and onto our uses and misuses of land and natural resources can do the following:

- Reduce the rate at which we deplete our natural resources.
- Reduce the rate at which we damage our natural environment.
- Achieve redistributive justice.
- Achieve economic efficiency.
- Reduce the amplitude of business cycles and hence prevent recessions. See articles in Progress, especially by Bryan Kavanagh.

In conclusion. The journal in which you are reading this article is dedicated to achieving social justice by fundamental tax reform. If you agree with what you read, send a copy or write to your local MP.