

'DISGUISED INCREMENTS: The Externalities Factor in Land Economics'?

Why is it so difficult to recruit people to the idea of Land Value Taxation?

Are they all doing so well under the present system that they don't want to know?

They must see the inequalities that it turns up

Is it just that they hope to get in for their own piece of the action? *Hey*, it could be their turn next! – As if society could be run like a Tattsлото draw, with a Jackpot for the lucky few!

Is the whole subject so difficult that it is beyond the understanding of most people?

Perhaps it is any one, or perhaps all, of these things. But I don't think so: I think people simply do not realise how much wealth is out there, how it comes to be, and that they should have a share of it – by right; in fact, by birthright!

They do not understand about the Common Wealth. They accept the dominant paradigm of a lucky few controlling land and natural resources, while the rest of us struggle to make ends meet. It is seen as the natural order of things. That's why Twiggy Forrest and Gina Reinhart were able to stand on the back of a truck, getting sympathy from Australians who they have deprived of their rightful bounty. “We need more”, they lamented, and they got it. In the past year their combined wealth has risen by \$16 billion - not a bad return for their media campaign!

But even that is small chips. The real money is in urban land. But that is spread across many more people, so any attempt to recoup some of the rent for public purposes – and lets not fudge here; no matter what the purist debate says, we're talking about a tax! - will raise the hackles of many more people. *Just*, it might be. *Fair* and *equitable*, it most certainly is. But just try to tell that to the ordinary guy with a mortgage, or even an investment property. For him, its just another attack on what he sees as his hard work. He's not interested!

But if there were a way to show just how much rent is out there, currently going into just a few pockets, then it may be possible to initiate a mass movement for ordinary people to claim their just rewards. To start that movement, it will be necessary to identify those 'hollow logs', establish just how much sits in them, and publicise what could be done with those extra billions. Because in those 'hollow logs' are the “*Disguised Increments*” of land.

Last month, a great Australian passed away in Brisbane. While Joh Bjelke-Peterson rode roughshod over all good governance practice in Queensland, Philip Day was a constant thorn in his side – perhaps that alone qualifies him as a great Australian, but Phil Day was much, much more:- a lawyer, town planner and academic, he was a

progressive, public-spirited man and a values-based administrator. In his book, Hijacked Inheritance, (2005) he examines our National Anthem, “Advance Australia Fair”.

Fair? Ummm, is Australia *fair*? When the song became popular, in the early part of the twentieth century, Australia was striving to be the most egalitarian society on earth. It wasn't, of course, but there was a national commitment to the “Fair Go”, and that drove policy making for 40, perhaps 50, years. By the time “Advance Australia Fair” became the National Anthem in 1984, that egalitarian zeal had already subsided, and the age of the individual had begun. Philip Day laments the “inequality, insecurity and alienation” of our society, and the social ills they spawn. Not to mention the increased household debt, and the privatisation of community institutions. That is the Australia of today. So, where did Australia Fair start to go wrong?

Here are a few starter thoughts:

We live in a **free market** society, but what is truly a free market?

Look at the restrictions we face in any market - the regulations, the constraints, the bureaucratic requirements. Is it any wonder that our economy stalls?

Earned Income - We go to work; we rest; we play;

When we work productively, we are entitled to the fruits of our labour. From the factory labourer to the managing director, a pay-scale rewards us for the benefit we provide to the company. Artists, sportspersons and inventors are rewarded for their talent and initiative, while entrepreneurs are rewarded for their ability to market a useful product. They all earn their income through their labour.

But there is another group of people who do nothing to earn their income. They own land, or have rights to some natural resource. In many cases, titles are handed down from one generation to the next. They do not have to work. They can simply charge the rest of us a rent to access that land or natural resource, so we can go about our business of making a living. **This is unearned income!** The landowners are supported by the law, having a title or licence that is backed by the Courts. But that is a man-made law, developed by the very landowners (or their forebears) that benefit from its provisions. The rest of us pay them for the privilege that they bestowed upon themselves.

Equality under the law implies the equal ownership of natural resources. There is nothing wrong with land being owned on individual titles. That is necessary so we can call it ours, and build a home or business there; but the rental value of the land, which reflects the economic benefits bestowed by the whole community, belongs to all of the community in equal shares. That would make the system fair.

These days, **rent-seeking** is associated with political lobbying - seeking some subsidy, tax-exemption or regulation that primarily benefits the lobbying group. It is

inefficient because it does not create any benefit for society; it merely redistributes resources from taxpayers to the special-interest groups.

But there are other rent-seekers. People who hoard land, and release it for housing or commercial use only when their extortionate price has been paid, are rent-seekers too. It is legal, but that is the only distinction from the usual protection racket, where a gang takes a cut from a shopkeeper's profits.

At the heart of our problem, I suggest, is the notion of the public good.

- Governments no longer know what is public and what is private. They sell off public assets and businesses, but then enter markets that should be left solely to the private sector. Expediency trumps philosophy.
- We should be confident in our entitlement to the fruits of our labour and entrepreneurial efforts; it is ours. Yet, it is necessary to make some contribution to the conduct of the state? On what basis should that contribution be calculated?

Another speaker today has spoken of the benefits of a Land Tax. I agree completely. But the land under our feet is only part of the Common Wealth. When we think of land, we need to think more broadly – and include all of our natural resources, as well as other community created wealth generators – the things we do as a society that help build our communities. Here is a list of just some of the things that are not colloquially called land, but are part of our Common Wealth:

- ambient air (the right to breathe it and the license to pollute),
- water and the beds under it,
- wild fish, game, and vegetation,
- the environment,
- natural scenery,
- the ecology,
- weather,
- falling water,
- the radio spectrum,
- the natural gene pool,

And these are some of the human additions to the Common Wealth, which should be treated in exactly the same way as land:

- docks,
- aquifers,
- rights of way,
 - eg a right-of-way is a very valuable asset, as railways show
- take-off/landing time slots for aircraft,
- "air rights" to strata in the third dimension of cities,
- Any franchise, license or privilege giving territorial

rights:.

A 'Disguised Increment' is the Cream that rises from the milk of these privileges!

Today, I will examine just a sample. We will look at:

- Environment – externalities; mineral extraction
- Land use – zoning, betterment, housing
- Public infrastructure – public transport, community services
- Climate Change

Environment

We will start with the environment because there, externalities are easier to understand. The price we pay for some things is sometimes much less than their actual cost. There are numerous examples of such "external costs" or "externalities." Pollution of a river by a paper-making company, for example. Or, nutrient runoff from agricultural practices that ruins fishing grounds eg Gulf of Mexico - long before BP filled it with oil. Closer to home, the Barrier Reef is under threat from nutrient runoff. The classic example is acid rain, where the damage might not even be in the same country. These **costs are not borne by the company** that creates the problem, but are imposed on society. We all pay.

Mining operations can have external costs too. The external cost of mining could include the destruction of the fish habitat in local rivers or adjacent seas, while the use of cyanide in the mining operation can create a cocktail of trouble for local people. The external costs are borne by the public at large, not by the mining company. The additional profits obtained from these morally bankrupt scenarios are the "Disguised Increments" of our economic system.

Because the ecological relationships are complex, calculating the costs of externalities is not easy. But that is no excuse for not attempting to put a price on them. As far as possible, the producer should bear all the costs of production, and a truly free market can then decide if the price is too high. On balance, production may not be much affected, because the community should receive monetary compensation to the extent of the costs imposed on them.

Lets look at Land Use

Re-zoning land from rural to residential or commercial will always increase the value of that land. Literally overnight, or at the stroke of a Ministerial pen, windfall profits are conferred on landowners. The decision to rezone the land, whether taken by the Minister, a Planning Authority, or a local Council, is made on behalf of the community. But all of the windfall gains are bestowed upon a few private landholders. This encourages speculation in land, with Planning Schemes being seen

as “speculator's guides”.

But it is not a new phenomenon. Leonie Sandercock wrote “*Cities for Sale*” in 1975; she lamented that urban planners continue to devise land-use plans which perpetuate the transfer of income from the poor to the rich. Three decades on, her prophecies have become 'de rigueur'.

Overcoming that particular problem is not even difficult. The collection of 'betterment' would collect that windfall gain for the community. 'Betterment' is simply that – the collection of the unearned capital gains resulting from land use rezoning. It has been recommended for generations, but it is testament to the strength of the land-owning lobby that they have been able to defy those recommendations and influence legislators to their private benefit. It helps that many of those legislators understand the issue all too well, often being substantial landholders themselves!

But zoning changes are no longer the only means of privatising the value of land. We have now made an art-form of speculating in housing; 'property' as it is generally called. To encourage home ownership, tax advantages are provided to the homeowner. This extends to the land that the house sits on. No distinction is made between the land – a natural resource – and the building – a man-made construction. The land on which our principal residence sits is exempt from any Land Tax. While that seems to be popular, the taxes levied in lieu of it are discriminatory, inefficient and distortionary in our economy. The gains of home owners are paid for by those needing a roof over their heads. As the British economist Martin Weale argues, the accumulation of property wealth is in effect *an act of theft* perpetrated on the younger generation, who must pay the exorbitant prices demanded by baby-boomers, or rent.

But one house is no longer enough. To reduce the inefficient taxes levied on individual's labour and productive effort, property has become society's bulwark against the taxman. Concessions are given for interest payments, maintenance, and even holidays – er, business trips – to view the property interstate. That the claims for maintenance far exceed the value of all houses it is supposedly spent on does not faze our decision-makers; property is king, and if negative gearing forces house prices up so new entrants to the housing market are left behind, we can always give them a grant to get them onto the bloated mortgage treadmill. This is absurd public policy; driven by a madness where everyone knows the scheme will stall and self-destruct at some point.

But we can't blame the participants for their part in this lunacy. It is the natural result of the decline of our egalitarian society. When government policies reward speculation and rent-seeking above honest toil, it is inevitable that people will choose that path. When the tax system encourages dishonesty and deceit, it is little wonder that our society is less inclined towards the common good.

The disguised increments in the housing market are thinly disguised indeed; they are

there in full view for anyone with the will to look. Yet we are blind to it.

We'll move on to Infrastructure - Public transport is another area in which anyone with a little wit, and a matching will, can see the problem of unearned increments. The solution is just as simple.

Politicians assume that public services cannot be self-financing, and insist that subsidies are necessary. Well patronised public transport systems can pay for themselves, if only the system is established properly. Ticket sales can cover the running costs of the service. It is paying for the capital costs that drags the operators into deficit. But it need not be so.

If the transport operator was able to collect the value that their services create, there would be no deficit. That value includes the part that leaks out into the private sector and is capitalised into the value of land. Sites within 400 metres of new railway stations are uplifted progressively, dependent only on the proximity of the rail station.

How do I know this? I've read the inside story of the Jubilee Line extension in London, which is the subject of *Taken for a Ride* by Don Riley. He is a property owner south of the Thames, who became very wealthy because the Jubilee Line provided easy access to his properties. He calculated that the rail extension, which cost \$3.5 billion, returned \$13.5 billion to lucky landowners along the line. A later study by UK's Treasury confirmed his findings, even if their figure of \$12 billion was slightly lower.

But London is not the only example. A barren rock on the south coast of China has become one of the commercial hubs of the world. Hong Kong was developed as a free market model for the world. Its success is astounding; but perhaps the most remarkable aspect is that its wealth has been created on a land value capture model. Its public transport system is integrated into the city's commercial and residential needs. The State-controlled land agency MTR allows private developers to build high value commercial hubs at and above railway stations, but always to the MTR's high standards. Profits are shared with MTR, which is able to expand the network to cater for the rapidly expanding population. Since profits are substantial (\$5 billion pa), the citizens of Hong Kong gain worthwhile benefits. They get all the benefits of a modern, integrated system, while the fares have been frozen since 1997.

Capturing the value of land to pay for public services makes sense. Not to do so allows the uplift in land value to accrue to private landholders, who have done nothing to earn the windfall.

In slightly different ways, Singapore and Japan also collect increased land values for the public good. Fred Harrison shows how in his book, *Wheels of Fortune*. All of this information is freely available to our politicians. They prefer to continue to disguise these increments (billions of dollars annually), and allow them to accrue to a

few landowners.

By comparison, let's briefly look at New York. Its Metro is wholly financed by the fares paid by its users. It struggled for funds over the years, and fell into disrepair; many users moved to car use instead. Meanwhile, in the vicinity of the stations, speculators made a killing, which retarded the city's economy. If the system had been funded as it should have been, through land value capture, it could have provided a low-cost (perhaps free), high quality service, while avoiding the need for the wasteful highway network.

We have looked at externalities in the environment, land use and infrastructure; and we have found that 'Disguised Increments' exist in all of them. So, as a society, what have we learned? We need to look at a modern problem to see whether we are likely to do better than we have in the past. And what bigger issue is there in our time than climate change?

I have no intention of entering the debate whether global warming is real, is caused by carbon dioxide, or is the result of other man-made emissions. For the sake of this presentation, I will accept all of those propositions, and concentrate on the remedies so far proposed. The favoured remedy is the 'cap and trade' system, which seems to have won the day from a carbon tax. That is, a market-based solution is preferred over a bureaucratic one.

But will it work? And who will be the big winners?

It seems that there is a lot of faith embedded in the claims being made. While economic logic tells us that a higher price on oil and coal will lead to lower consumption, a lesson learned in the 70's was that the oil price spike did not cure our addiction to oil at all. People still needed to move; industry still needed to manufacture. So, unless alternative energy systems are found, the level of pollution is not likely to reduce much, despite the higher price.

A worrying sign is the enthusiasm for 'cap and trade' shown by major banks, such as Goldman Sachs, and the big consulting firms. They weren't too interested in a carbon tax, where governments collect the cash, but are very keen on being part of a market in carbon. The recent behaviour of these corporate financial giants should make us wary of their public interest claims. What schemes will be conjured this time? The potential for fraud is huge, but we are told to just accept it – and pay the price!

'Cap and Trade' does not reduce emissions by the major players. It allows the big polluters to continue to pollute as before, as long as they can buy carbon credits to offset their pollution. So the system says it's OK to foul the atmosphere – for a fee! Or to continue polluting in the US, Europe or Australia, by upgrading a factory in China or India. For a bit of fun, you might like to check out CheatNeutral.com. It provides a forum where we can offset our marital infidelities by purchasing some

chastity from more monogamous souls!

What we are trying to achieve is lower carbon emissions. That is the 'cap' part. If we set the cap at where we think it ought to be (around 350 parts per million is the most common figure), and enforce it, the emission problem is solved. The 'trade' part would be unnecessary. 'Trade' is the carrot being offered to the polluting industries to compensate them for their sins of the past. It is similar to the claims of the slave owners who demanded compensation for their loss of property rights. President Lincoln said 'no' and stood firm. Should we?

Europe has had an emissions trading scheme for some time now. Citigroup's analysis of it is not inspiring. Prices up; emissions up; profits up – mainly in the banking industry. But, of course, we are told our scheme will be better. Who knows? While we have no effective way of valuing the climate or the atmosphere, we will continue to be in the hands of the financial sector. And they will capture the 'Disguised Increments'. Surely this is the real Tragedy of the Commons - the loss of our appreciation of its value.

Summary

This paper has barely touched the surface of externalities in the land market. While we have looked at some environmental and land-use issues, and shown how public transport infrastructure could be self-funding, there is no time to examine some of the other rent-seekers:—

- the banks, for example, with their creation of credit, and promotion of high property prices;
- the technology revolution, using public spectrum at discounted rates; and,
- public utilities (now private, in many cases) where profits are no longer returned to the people, but are either privatised or confiscated as hidden taxes.

There are many more examples. These are the Disguised Increments of our times.

So, why don't we, as a society, revolt against these travesties? Why do we accept them?

The world is ready for change! An international survey of 29000 people, conducted by the BBC, found that two out of three wanted a transformation of our economic systems. People are dissatisfied with the status quo. But, as yet, there is no popular movement to inspire the masses to make society a better place for the majority of people. Barack Obama had the word – **Change** - but, so far, no sign of any substance.

But, the climate change issue shows how much the world has already changed. Global issues affect us all. There seems little point in Australia acting alone. Wilkinson and Pickett, in *The Spirit Level*, say, “We depend on world cooperation like never before. Policies to reduce carbon emissions depend on a sense of social responsibility, of cooperation and public-spiritedness.” And the whole theme of their book is that, to achieve those things, we need more equal societies throughout the world. Their evidence shows that more equal societies do better on public

spiritedness.

So that brings us back to our National Anthem. How fair is Australia?

Australia could be fairer, as we have seen, if we shifted from rent-seeking towards a more inclusive Australian society, where everyone shares in the Common wealth of the nation. Two practical steps could become giant leaps forward:

1. eradicate the unearned increment; and,
2. capture the community-generated value of land for the whole community.

These are political matters. They are morally just; they are economically sound. That is not in question. The only reason they are not already in place is because our politicians do not have the courage to challenge the rent-seekers. Yet, the people are screaming out for a values-based approach to policy; the prize is there to be had. Surely a tax package that reduces the burden on labour, on capital, on sales and on entrepreneurship, *and* which continues to provide all existing government services, could be 'sold' to the electorate. The time is right. In the words of modern Goliath, 'Just do it'.

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