The Global Crisis According to Stiglitz

A Critique of

The Stiglitz Report:
Reforming the International Monetary and Financial Systems in the Wake of the Global Crisis[1]

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An assessment commissioned by the Robert Schalkenbach Foundation

SUMMARY *The seizure of the financial sector in 2008 inaugurated the most disturbing economic crisis since the Great Depression. In the US, house prices (June 2011) have declined further than they did in the 1930s, and nearly one in six people depend on government food stamps to ensure they have enough to eat. The United Nations appointed a panel of experts to investigate the reasons and offer recommendations for reforms. The experts chaired by Joseph Stiglitz, a Nobel Prize winning economist who has earned his credentials as an independent-minded public servant, attributed ultimate responsibility to financiers. These were the people who had reaped huge rewards and then shifted the costs on to taxpayers. If reforms are confined to those elaborated in* The Stiglitz Report, *however, the next boom/bust cycle is unavoidable. This will terminate with a peak in land and house prices in 2026. Extrapolating current trends and the anticipated shifts in economic and political power over the new 18-year business cycle, we predict a global crisis centred on 2028 that will be even more socially damaging than those currently being experienced. The stakes are high: failure of economic policy today will drive the world past the tipping points on climate change, global poverty and resource wars.*

In his Foreword, Joseph Stiglitz stresses that his panel was comprised of experts who could offer an independent assessment of the economic crisis. He emphasises that personal and political interests colour the views of many social scientists that help to shape economic policy. We may, therefore, judge the validity of his claim in terms of whether *The Stiglitz Report* reaches beyond the conventional policies currently recommended (or being considered) by governments, agents of the state and their consultants, who claim to be working towards stable economic growth.

Stiglitz maintains that it is possible to achieve standards of objectivity in which economic theories and insights may be offered that have not been compromised

[1] *UN Commission of Financial Experts* (The Stiglitz Report), New York: The New York Press, 2010. Hereafter: Report

by (say) the lure of bonuses that are said to influence financiers, or the prejudices of "free market fundamentalists". Stiglitz draws attention to the policy preferences known as the Washington Consensus which he characterises as the "dominant orthodoxy". If the economic crisis was facilitated by that ideology, is *The Stiglitz Report* free of the bias and material interests that subvert those ideas that *could* generate the desired outcomes from economic practices?

The standards against which we must judge the report are set by Stiglitz.[2] His targets and aspirations for a new globalisation are fourfold.

1. Better, more democratic governance
2. Greater stability
3. Faster growth
4. Output more equitably shared

We conclude that the recommendations in this report cannot deliver on most of these goals. *The Stiglitz Report* confines itself to the conventional wisdoms that are reported in the daily press. Although Stiglitz himself claims that they were commissioned with the freedom to develop "new ideas",[3] the burden of their recommendations is directed at the re-regulation of the financial sector. Fiscal reform is limited to issues relating to the environment, and is largely presented in obtuse language. There is no treatment of tax reform in terms that would amount to a counter cyclical strategy for stabilising the capitalist economy. This means that the primary source of instability in the capitalist economy (the pursuit of unearned income via the land market) will continue to destabilise the global economy over the next business cycle.

The Role of Real Estate

The clues that could have led to a substantive analysis of the 2008 crisis were noted by Stiglitz himself. He recognised how "the real losses in output would come after America's real estate bubble broke".[4] The report alludes to the collateral damage inflicted by activities in the property markets in the developed countries which

[2] Report, p.xxiv.
[3] Report, p.xiii.
[4] Report, p. xvi.

endured real estate bubbles that “precipitated problems in financial markets”.[5] The increase in the value of collateral offered for loans contributed to the expansion of credit.[6] Interestingly, the report does note that if lending to real estate was constrained, there would be an increase in capital investment in other sectors.[7] And yet, despite these insights, *The Stiglitz Report* fails to offer a formula for synthesising all these strands in a problem-solving blueprint.

Instead of forensically examining the way factor incomes are affected by property bubbles, and tracing the linkages to bankers and the wider economy, the experts sidelined the sub-prime mortgage market. It was no more than one example of “predator lending”.[8] As a consequence, important issues that might have affected their conclusions were not explored.

Speculative activity in the housing market does receive a glancing reference on page 20. Responsibility for the consequences, however, is diverted away from land speculators. Culpability is assigned to financiers rather than to the flaws in governance which actively encourage property speculation. Thus, we are not told about the implications of the policy failures that encouraged banks to “exploit those who were financially unsophisticated and incentives to maximise transaction costs”.[9] And so, rather than offering the new ideas promised by Stiglitz, the experts direct their wrath at financial markets.

Fiscal Reform

Given the report’s references to the property market, we might have expected a discussion on fiscal reforms that would neutralise the propensity to speculate in property. Instead, that discussion is confined to issues relating to climate change. The dynamics of urban real estate are absent from consideration.

But even to the extent that the report does discuss fiscal policy, untutored readers would not understand that *The Stiglitz Report* was referring to the need to tax a particular flow of income (rents), offset by a reduction in taxes on labour remuneration and the profits of man-made capital. These issues are glossed over with

[5] Report, p.27.
[6] Report, p.84.
[7] Report, 94.
[8] Report, p.93.
[9] Report, p.78.

the repetition of the street slogan: tax “bads” (like pollution) rather than good things (like work and savings).[10]

How would taxes on carbon emissions reshape the economy? They would “simultaneously correct a negative externality”.[11] A trained economist would know what that meant (maybe); but what about the people whose political support is needed, if there is to be a radical restructuring of the incentives that affect the fabric of society? What does that word “externality” mean, exactly? We shall explore that concept below. Here, we need to note that even the carbon tax recommendation is presented in contradictory terms. The authors appear to endorse the cap-and-trade arrangement for diminishing CO_2 emissions. That means *The Stiglitz Report* implicitly accepts the privatisation of at least part of the rents that measure nature’s capacity to absorb waste. *As such,* The Stiglitz Report *actually reinforces the doctrines that endorse a form of income distribution that is at the heart of the global crises*. We need to unpack the report’s failure to use language that people can understand in a way that leads to the democratic mandate that is the political pre-condition for the adoption of the appropriate corrective policies (see Box 1).

Box 1
Choking on Agglomerations

The Stiglitz Report refers to proposals for what is known as the Tobin tax (a charge on financial transactions). There are difficulties with the implementation of that proposal, they note, such as the risk of banks losing some of their trading business to smaller exchanges. But The Stiglitz Report suggests that a small tax on financial transactions could work. Why? Because of the “positive agglomeration externalities” associated with banking (Report, p.189).

What does this mean? In layman’s language, the experts are saying that the rents of the locations occupied by banks are raised because of the close physical proximity of financial institutions. Bankers and brokers want to rub shoulders with each other, and are willing to pay a premium to occupy buildings close to one another’s offices. A charge on those rents could be carried without distorting economic incentives. But *The Stiglitz Report* fails to spell out the economics of this virtuous way of raising revenue in terms intelligible to people not familiar with the jargon of economics. To be fair to laymen, however, we need to acknowledge that even the most celebrated of economists, including those with Nobel prizes, lack the understanding needed to explain why a public charge on the value of locations cannot be transferred to others (which would distort activity).

On taxation, criticism in *The Stiglitz Report* is directed at tax havens. But the report does object to the way fiscal jurisdictions in the global South have been turned

[10] Report, p.188.
[11] Report, p.187-188.

into scapegoats while US states like Nevada offer corporations the opportunity to register themselves in ways that are not transparent to fiscal authorities.

Fatally, from an analytical point of view, *The Stiglitz Report* fails to develop the implications of its references to money laundering. Drug lords and kleptocratic dictators are fingered, without an additional discussion of how the largest part of the value extracted out of the economy is by owners of land who (*qua* owners) contribute no inputs of matching value. The notion of free riding is employed in relation to countries that are tempted to employ protectionist policies,[12] while ignoring the people who free ride on society by living off the rents generated by others.

Culpability, when it is assigned, is directed at Stiglitz's *bête noir,* the IMF, for pushing developing countries towards policies that caused the crisis.[13] This institutional critique camouflaged the failure to provide the assessment of the theory of post-classical economics which is required, if the needed forensic examination is to be equipped with the appropriate tools to interrogate the facts.

Box 2
Risks & Rewards, Rip-offs & Responsibilities

Following conventional wisdom, *The Stiglitz Report* claims that "financial markets did not manages the risks well before the crisis" (p.xxii). On the contrary, bankers rode the risk curve very well to maximise their incomes *over the property cycle.*

The financial sector is not a state-sponsored service. It is a profit-seeking, privately owned business. Taking into account all the factors that are permitted under the law, including moral hazard and the gullibility of low-income families, financiers structured their business deals to generate returns which, over the years 1997-2007, yielded handsome rewards (stocks, bonuses) which far eclipse the losses subsequently incurred (2008 to date).

If this outcome is viewed as a risky approach *from society's point of view*, we need a deeper debate on precisely what claims society has to the forms of income which render the economy unstable. If the responsibility is not with the financial sector and its agents (they do not create the laws of the land or frame the nation's tax policies), could the failure be in the realms of governance? If so, a debate is needed that reaches beyond the alleged failures of those civil agencies deputed to regulate the banking sector.

Thus, the analysis of risk is emotive rather than analytical. Stiglitz himself repeats the general complaint that bonus schemes in the banking sector encouraged "short-sighted behaviour and excessive risk-taking".[14] Financial incentive schemes were, in fact, long-sighted as far as the financiers were concerned. Apart from the

[12] Report, p.29.
[13] Report, p.xii.
[14] Report, p.xx.

individuals who were held to account for operating Ponzi schemes, bankers continue to enjoy their millionaire lifestyles funded by the bonuses received over the past decade, and they are receiving their bonuses in the post-crisis period. If incentives are really distorted by bonus schemes, a comprehensive analysis is needed which takes into account the corresponding failures of governance (see Box 2).

Equally shallow is the report's review of the benefits allegedly derived from the regulation of the financial sector. Faith placed in the gains from re-regulating banks relies on the belief that the regulations spawned by the 1930s Depression delivered a period of stability.[15] This historical perspective, which helps to legitimise the notion that the financial sector can be managed by regulators, can be challenged (see Box 3).

Box 3
Regulating the Boom/Bust Business Cycle

The Stiglitz Report breaks 20th century financial history into three phases:

- Pre-1929, leading to the Wall Street crisis
- Post-1930s up to the 1970s: absence of crises. The world had learnt the lessons of the Great Depression
- 1980-2010: de-regulation ("liberalisation") of the late 1980s was followed by more than 100 financial crises

An alternative scenario can be constructed that locates the post-1980s events in an historical process that spans 200 years of financial instability. The early postwar decades were relatively stable because of the massive levels of capital formation necessitated by the destructive world war. But, even so, the banking sector was *not* immune from crises despite tight regulation following the Glass-Steagall Act. The UK suffered the "secondary banking crisis" (1973-75), and in 1976 James Callaghan's Labour administration suffered the humiliation of a financial crisis that led to an appeal to the IMF for financial support.

Research is needed into the hypothesis that the financial crisis of 2008/10 would have occurred even if the Thatcher and Reagan liberalisation policies had not been implemented. That research would need to take into account the continued presence of incentives that shaped the boom/bust cycle of the past 200 years.

The Managerial Hypothesis

It is disappointing to find that Stiglitz himself narrows the analytical framework by endorsing the view that developing countries were innocent victims of "America's mismanagement of its economy".[16]

[15] Report, p.59.
[16] Report, p.x.

The authors appear to be confused about the origins of the crisis. On page 191, we are told that the crisis spread from the "country of its origin" – America. But we are also told that "Other countries had real estate bubbles which also collapsed, with similar consequences. These difficulties in the real estate sector *precipitated* problems in the financial markets".[17] Here was an insight that required a deep analysis of real estate economics and this sector's the macro-economic influence. That analysis, if it was undertaken by the experts, is not disclosed in their report.

Instead, we are offered the impression that the problem was of a managerial character. But if there was mismanagement, it is difficult to see how we can exonerate other countries which employ a similar financial model to the one favoured by the USA. It may be that the US took the lead (through its advocacy of the Washington Consensus) in advocating "liberalisation" on developing countries. But at what point do sovereign nations in the global South begin to take responsibility for their actions? If they acquiesce in the doctrinal preferences of the US, should they not share the blame for consequential failures?

The *mismanagement* approach to diagnosing the crisis distracts attention from the structural flaws that may actually be the source of cyclical financial crises. The managerial hypothesis presupposes that the economy is such that people in authority can exercise power to maintain stability of the system (presumably if they remained alert at their posts?).

The Metrics of Externalities

The Stiglitz Report refers repeatedly to externalities without adequately elaborating on the metrics of the costs and benefits of decisions that influence outcomes. The use of that word "externality" may reveal much about why contemporary economic analysis continues to fail to deliver coherent strategies for establishing stable growth that benefits everyone.

We get the idea that a bad externality imposes negative consequences, as with the pollution from a power plant that damages people's health. And then there are the good externalities. These, notes the report, may arise from the "positive agglomeration" associated with the concentration of stock market activities in particular locations. But *The Stiglitz Report* fails to lead us to the one policy that

[17] Report, p.27, emphasis added.

would painlessly transform bad externalities into good ones. Repetitive use of the world *externality* compromises analysis by suggesting that, in some material way, consequences in the economic sphere are ejected into some non-economic space. In reality, the consequence of every action is measured by the pricing mechanism (see Box 4).

Box 4
Can we Externalise our Actions?

Post-classical economists suggest that the pricing mechanism in private markets is so constructed as to make it possible for some people to avoid the consequences of their actions. Thus, the costs of pollution are "externalised". This is an example of "market failure", and it leads to policy prescriptions such as the need for regulatory intervention. Thus, polluters escape the consequences of their anti-social action: they dispose of their waste in a way that imposes disadvantages on others. Take a closer look at what actually happens.

- The cost of disposing of waste by-products is not borne by the polluter. *Ergo*, this is reflected in higher profits. The cost is not "externalised": it is transferred to others. Insofar as property rights permit this, we are dealing with a process that is *internal* to the economic system.
- When others are forced to absorb the cost, this reduces the economic value of the locations they occupy: the rents are lower because of the health hazards.

This cost-transferring process is *internal* to the social system. It was intended by those who, in the past, framed the tax-and-tenure rules. It is misleading, therefore, to characterise the process as a failure. In fact, it is eminently successful in its intent. We do not improve analysis by talking about the need to *internalise* the costs within the pricing system, because they are already internalised, through the land market.

We need to appreciate the awesome financial implications that are camouflaged by that clunky concept "externality". Investment in education, or laws that permit labour migration, draw attention to outcomes that may be good, or disruptive of people's lives, depending on the character of the financial system.

Education delivers returns that exceed the rewards received by employees and the entrepreneurs who invest in the capital of enterprises. By one route or another, that additional value (surplus to the labour and capital markets) is transformed into rents that are charged for the use of land and natural resources. A similar outcome arises with the freedom of people to move to places where there are economic opportunities. The free flow of labour results in additional value being created in excess of what is paid to Labour and Capital. Remittances by workers from developing countries, for example, totalled $325bn in 2010, according to the World Bank.[18] Much of that

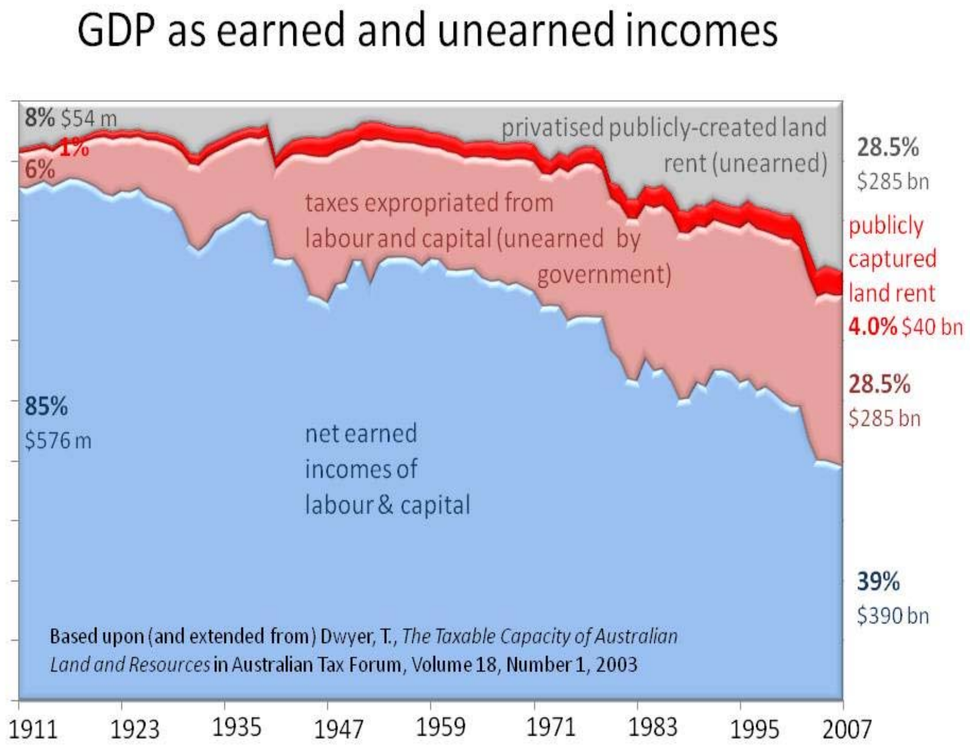
[18] "Drain of Gain?", *The Economist*, May 28, 2011, p.80.

money is invested in real estate (such as building homes in recipient countries where many of the extended families could not otherwise afford to pay for the construction of modern dwellings). This, in turn, raises the prices paid for the use of land.

Australia offers an overview of the outcome of the confluence of such externalities. Figure 1 traces the distribution of income over the 20th century. As a proportion of GDP, the net earned income of Labour and Capital declined. But the real living standards of a workforce that grew through migration rose by an enormous factor. The share of rents rose from about 14% of GDP in 1911, to a combined tax and rent total of 61% a century later. If government had not used income, corporation and consumer taxes to raise its revenue, the taxed income would have surfaced as land rents.[19] Australia benefited from investment in public services funded out of rents. A huge sum was delivered as a result of migration and investment in the families who relocated themselves on this continent from Europe and Asia. This case illuminates the vision of how good externalities secure the welfare of the nation.

[19] This is the ATCOR thesis, originally articulated by John Locke and currently elaborated by Mason Gaffney.

Figure 1



But we need to pause to reflect further on this case. Might Australia have been materially richer and environmentally healthier if she had continued with her 19th century policy of funding infrastructure *directly* out of the rents of land?[20] Did the almost complete abandonment of the rents-as-public-revenue policy, in favour of conventional fiscal policies like the income and corporation taxes, inflict deadly losses on the economy? These questions relate to the way in which the pricing mechanisms – of both the public and private sectors – either worked in harmony with each other, or were in conflict. If they were in conflict – as when prices do not distribute incomes according to the contributions of those who participated in the economy – this process was responsible for imposing artificial limitations on the productive abilities of the population.

The Stiglitz Report would have performed a valuable service if it had drawn attention to this reality. It could have done so by employing the insights of the Henry

[20] R.V. Andelson, *Land Value Taxation Around the World*, 3rd edn., Oxford: Blackwell.

George Theorem elaborated by Joseph Stiglitz in 1977.[21] Instead, the report, while drawing attention to bad externalities, does not do so in terms that would animate public support for the radical changes which Stiglitz himself considers are necessary.

The Soft Shoe Shuffle

The Stiglitz Report wants to go in for "the kill," but ultimately fails to do so. Its analytical apparatus does not empower the experts to follow their instincts to their logical conclusion. We see this with their use of metaphors, and the inadequate deployment of terms like *subsidies*.

Negative subsidies create losers. Should we measure these losses to determine whether the financial system should be re-calibrated to eliminate subsidies? The report refers to "free riders" without adequately exploring how the capitalist economy operates to discriminate in favour of privileged people who enjoy lifestyles on the backs of other people's labours.

In relation to the banking system, the discussion on externalities offered by *The Stiglitz Report* is superficial. If an individual bank exposes itself to risks that may render it bankrupt, it may also undermine other banks to which it is linked through debts and the trades in financial instruments that were backed by sub-prime mortgages. *The Stiglitz Report* contrasts this vulnerability with the macro-economic consequences of a shoe shop failure.[22] This facile comparison does not illuminate the junction boxes in the structure of the economy that are liable to trigger shock waves if one of them should fail under stresses caused by overloading the system (see Box 5).

Box 5
Shoeing in the Wrong Metaphors

Investigation into the causes of the financial crisis needs to reach beyond the use of metaphors. If the report had substituted a construction company for the shoe shop, it could have derived insights that were significant as advanced warning of an impending financial crisis.

We know from historical evidence that speculative activity in the land market raises prices for assets that are in fixed supply above the levels that many users can afford. The negative effects may be traced in the increasingly onerous terms imposed on people taking out mortgages, and the effects on the balance sheets of shoe shops on Main Street through the reduction in disposable incomes. If a construction company should fail, that would tell us a great deal about the distribution of income, the strains on household budgets and the approximate point reached by the property cycle within the overall 18-year business cycle. *

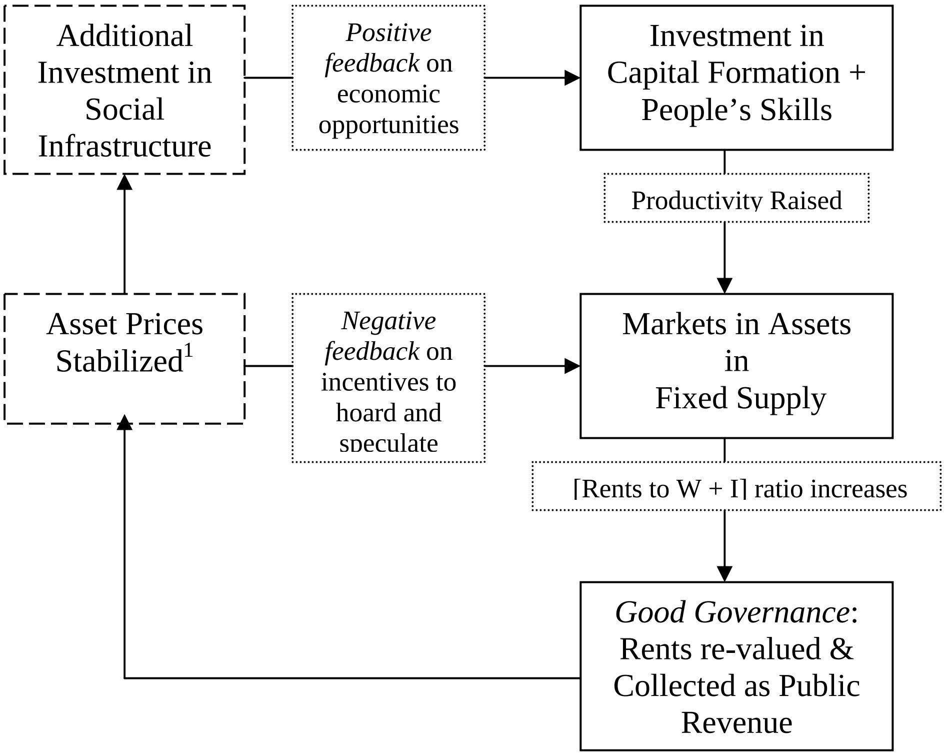
* Fred Harrison, *Boom Bust*, London: Shepheard-Walwyn, 2010.

Laying Bare the Linkages

Figure 2 traces the chain of events triggered by investment in education and occupational skills, which raise productivity in the economy. One consequence is an increase in rents people are willing to pay for the use of land. This, in turn, encourages banks to increase the credit advanced to all the participants in the property market. Thus, as value-adding people raise the levels of productivity in the economy, many of the benefits tend to be captured in prices that rise faster for assets that are fixed in supply. Urban land is an obvious example of such assets. In the composition of the nation's income (as we saw in the case of Australia), this is reflected in the shift in the ratio of economic rents relative to wages (W) and profits (I).

Given the tax-and-tenure rules as currently constructed, it would be *irrational* for profit maximising bankers *not* to focus their attention on the rewards to be derived from all the activities associated with trades in assets that include land. This is what happened in the run-up to the peak in property prices (2006 in the US, 2007 in Europe). The fiscal system reinforced the incentives to concentrate on such deals because, at present, it rewards land speculation while penalising the value-adding activities that take place through the labour and capital markets. Might it be otherwise? *The Stiglitz Report* is silent. If we are looking for an Economic Stabilisation Theorem, we need to look elsewhere. A starting point would be to take a close look at the points of tension in the market economy. Some of these are schematically illustrate in Figure 2.

Figure 2
Systemic Stresses in the Capitalist Economy



Asset prices rise as productivity raises returns in the land market, causing banks to expand the supply of credit. This further raises land prices, which (under the current fiscal policy regime) drives prices to heights that are beyond affordability for many people and firms. What would happen if, instead, the good externalities that surface as rents were treated as public revenue? The threat of internal shocks is neutralised. The incentive to speculate in land is removed (negative feed-back). Instead, the extra revenue is channelled into social infrastructure, which gives a further upward twist to productivity. The economy is on a virtuous growth cycle.

Bereft of an awareness of this process, it was not possible for *The Stiglitz Report* to deliver anything but recommendations that happen to suit those who continue to live off the rents produced by the value-adding population. The Producer economy will continue to suffer violent swings (positive feed-backs) if rent-seekers are free appropriate the increments of new income added to the economy.

The productive economy needs a mechanism for re-balancing itself, at higher planes of income to secure evolutionary progress. Negative feedbacks are positive inducements to qualitative advances in lifestyles. People may opt to work less, at current levels of material income, rather than accumulate more tangible wealth. This is the trade-off in the pursuit of leisure and aesthetic wealth, which is the mark of a civilisation *when everyone is free to engage in this process*. How might the Stiglitz experts have led themselves to more profound conclusions? One route would have been through a deeper examination of cases of recent boom/busts. One such example is the Asian crisis of 1997, to which they had drawn attention.

The Asian Crisis

The low interest rate policy promoted by Alan Greenspan (then Chairman of the US Federal Reserve), in part to combat the Asian crisis, created the flow of "hot money" into the property markets of countries like Thailand, Indonesia and the Philippines. Real estate prices rose to levels that became unsupportable. They had one direction only in which to move – downwards. Focusing on this case, the Stiglitz experts could have asked two questions:

1. Would the incentives that attracted the hot money speculators have been diminished if the Asian banking system was more tightly regulated (complying, say, with the notions now being touted for controls over banks in Wall Street and the City of London)?

To answer that question it would have been necessary to evaluated the rates of return from the continuation of property speculation after allowing for the cost effects of greater oversight in that region's financial sector. As land prices can rise at annual rates achieving 30% and more, there is a high probability that tighter regulation of lending would not have deterred the practices that are adopted by banks that fuel property booms.

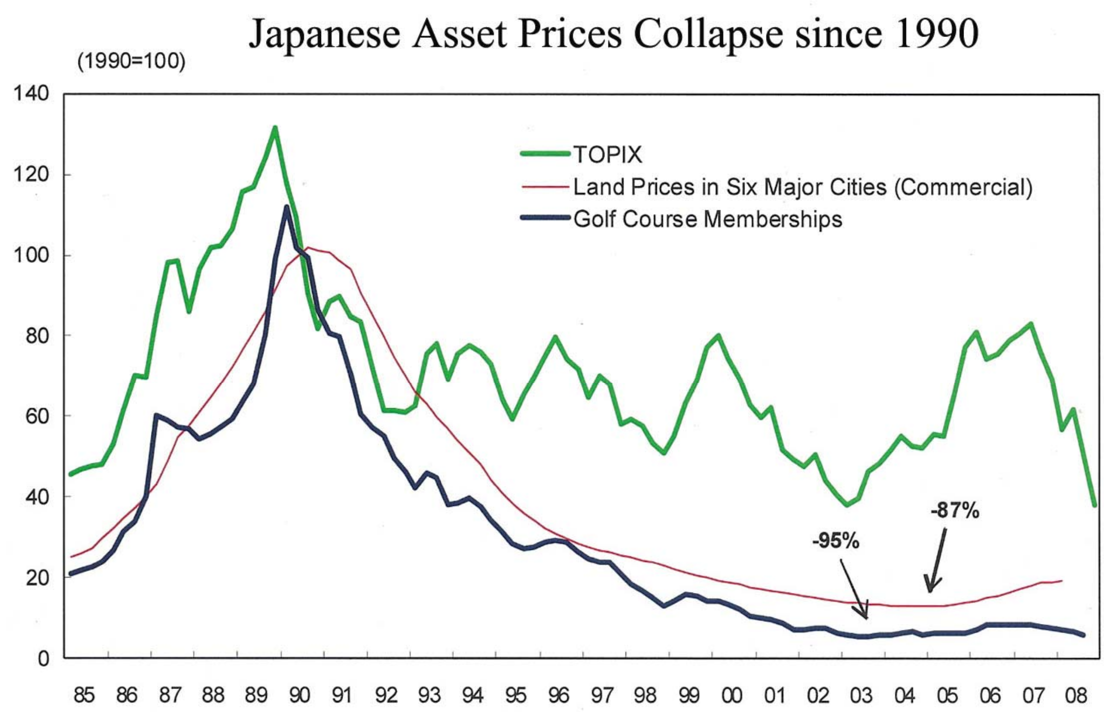
2. If Asia's governments had applied the Henry George Theorem, so that a rise in land and resource rents would have benefited the public sector, would that have moderated the direction of capital flows?

We suggest that the people of Asia would now be richer for having bypassed the boom that led some of their countries into busts and the arms of the IMF. If Western investors could not extract high returns from Asian property, would they have invested their money in productive enterprises within their home economies? The answer, again, depends on the nature of the fiscal incentives within the trans-Atlantic countries.

Japan's Lost Decade

In my view, on the basis of current policies recommended for the financial sector, the economies of Europe and North America will endure the fate suffered by Japan in the years following its last land-led asset bubble.

Figure 3

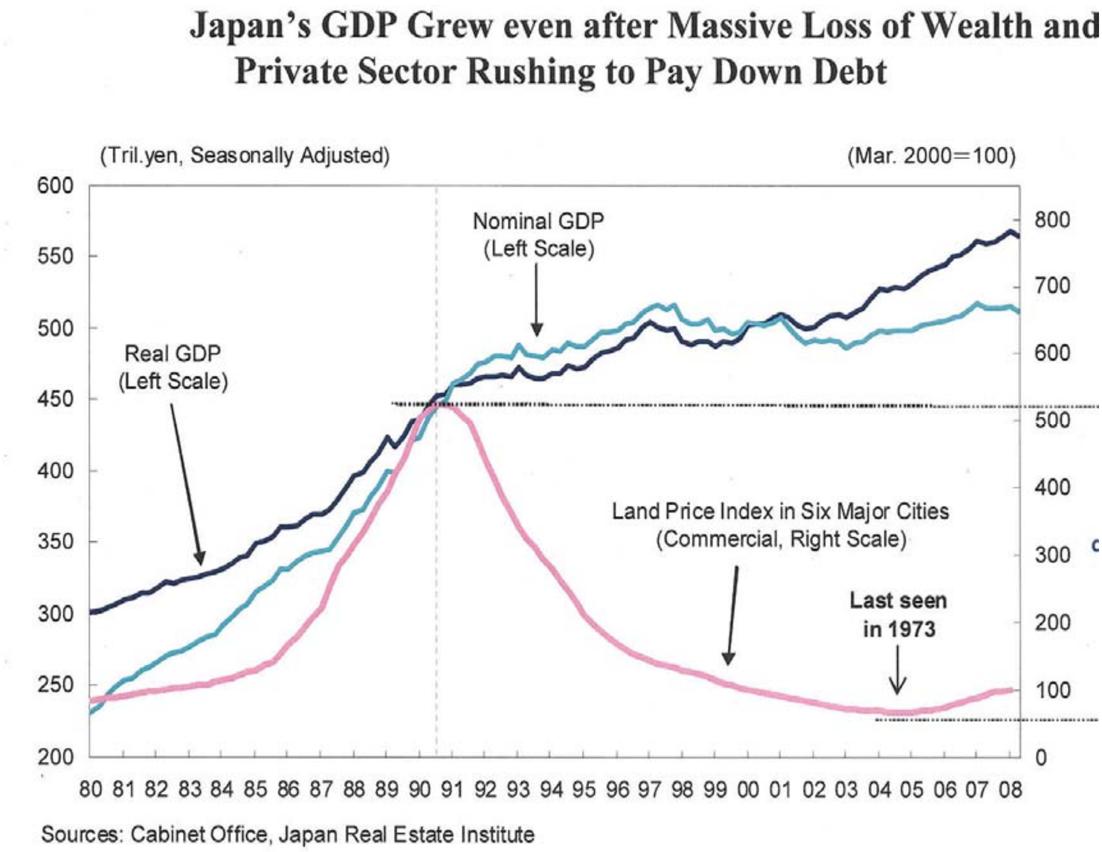


Sources: Tokyo Stock Exchange, Japan Real Estate Institute, *Nikkei Sangyo Shimbun*

Figure 3 tracks land prices in the run-up to the bubble's peak, and the social trauma that followed. To try and escape that economic depletion, successive governments resorted to a monetary policy of low interest rates and the protection of banks (by refusing to write-off the bad loans to the property market[23]). The result was protracted economic losses with substantial negative effects on the quality of people's lives. This included the dismantling of the lifetime employment arrangement that had hitherto been practised by many successful corporations.

Japan's policy-makers were deceived by indicators that convey false information. GDP, for example, continued to grow even as the quality of people's lives contracted (Figure 4).

Figure 4

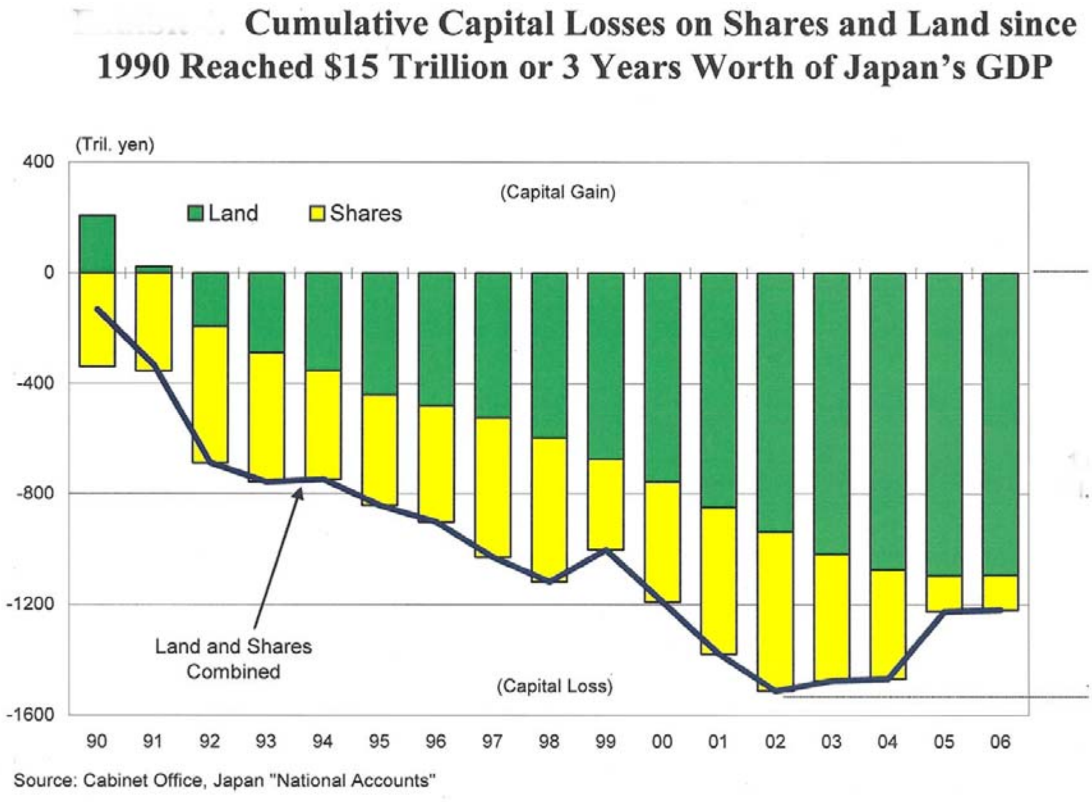


A Land Price Index, as the measure of the economy's net income, provides the best indication of the health of the economy. But although Japan's statistics on prices in the land market are second to none, her policy-makers lack the theoretical apparatus that turns their Land Price Index into the primary diagnostic tool. If they

[23] A similar attempt to maintain the viability of banks, by not writing off their loans to the property sector, is being made today. In Britain, banks are using soft terms to for borrowers so that they do not default – leaving the banks with bad debts. This tactic has been criticised by the Financial Services Authority (Philip Aldrick, "Banks 'use soft terms to conceal bad debt', *The Daily Telegraph*, June 1, 2011). The IMF warned of the systemic dangers implied by this strategy in its report published on June 7, 2011. Building companies are similarly evading reality by subsidising their customers to the tune of £1bn. Shared equity schemes convey the impression of buoyancy in the housing market that could mislead government into thinking that their "growth strategies" are working; when, in fact, the financial integrity of the building companies is being further damaged.

had correctly interpreted their Land Price Index, they might have drawn different conclusions about how best to cope with the crisis. The losses were staggering (Figure 5).

Figure 5



The people of Japan were not the only ones to suffer from this failure of governance, however. By keeping the cost of money at zero, the rest of the world endured the *carry trade*. Money was borrowed in Japan and reinvested by speculators in real estate in Europe and North America. This added to the "over-heating" of prices in land markets that peaked in 2006/7. Because of the low cost of borrowing money out of Japan, western banks could afford to carry the higher risk of lending to sub-prime borrowers in Baltimore and Detroit (USA) and Birmingham and Droitwich (UK).

The Threat from China

Joseph Stiglitz has personally made a notable contribution to economic theory, not least with his formulation of the Henry George Theorem. This renders it all the more puzzling that he fails to place the Georgist paradigm at the heart of his macro-economic analyses.

High finance (in both the private and public sectors) do more than just circulate within some surreal financial world: it is the facilitator that links all the component parts of the economy, including public policy and the property markets. Thus, failure to understanding the way in which the financial arteries operate leads to fatal consequences. An example is the way in which monetary theorists emphasise the quantity of money as central to the stability of the economy. They are misled by their inability to recognise the direction of causation. Credit expands *in response to rises in the price of land*.

By failing to highlight the structural weaknesses in the foundations of the capitalist economy, *The Stiglitz Report* lost a golden opportunity to guide policy-makers towards the sustainable forms of production and income distribution. This lost opportunity will be seen to have been responsible for fatal errors in the coming decades. The crisis in economic philosophy is most ominously highlighted by the way in which western economies are sleep-walking into a trap being laid by communist China.

China’s policy changes in the realms of property rights and taxation will protract the restoration of full employment in the West while guaranteeing that the next property cycle will disrupt the global economy.

There is no mystery about the communal and macro-economic stresses that can be tracked back to the tax-and-tenure model that is at the core of capitalism’s problems. The relevant information is in the public domain, and was therefore available to the Stiglitz experts. A recent example is the publication of articles in the *Financial Times* which leave no doubt as to the way the disruptive forces operate within the market economy.

- June 1, 2011: Jamil Anderlini contributed an article headlined “Fate of real estate is global concern”. Stability within the Chinese economy was predicated on the health of its property market. Prosperity within China, in turn, affected the flow of world trade and therefore the health of household economies in Europe and North America.

- June 2, 2011: the headline for the article by Henny Sender and Jamil Anderlini was “Land price fall threatens local finances”. Municipal governments became heavily dependent on the sale of land to speculators for revenue needed to invest in infrastructure. The prospects of windfall gains from land speculation had driven prices beyond the affordability of most people. Beijing imposed restrictions on the property market, which staunched the flow of revenue to local governments, causing a fiscal crisis.
- June 3, 2011: “Rise in evictions sparks deadly violence”, reported Jamil Anderlini. An estimated 3m farmers faced the prospect of losing their land every year in “a massive new wave of land grabs”. This provoked protests as communities were broken up in a transformation of neighbourhoods that were perceived to be driven by a malevolent political agenda that enriched a few property developers and which corrupted civil servants.

Thus, a few pithy articles explain why the global economy will not achieve the desired stability over the next business cycle. To rub home the lesson, Anderlini returned with another article on June 6, 2011, headlined: “Beijing must avoid at all cost a giant pop as it reins in house prices”. It was, of course, the land price (not the price of reproducible bricks-and-mortar) that counted.

China over the next business cycle, in the run-up to the peak in global house prices in 2026, may be treated as a laboratory-like test of the thesis in Henry George’s *Progress and Poverty* (1879). To date, all the evidence affirms the contention that land speculation is the single most destabilising form of activity in the market economy. The antidote prescribed by George: socialise the rents and eliminate the injurious taxes, to convert bad externalities into good ones through accelerated investment in public goods and the expansion of demand for employees.

None of this empirical evidence informs *The Stiglitz Report*. Consequently, the fiscal remedy fails to surface in the recommendations on how to deliver a financial industry that works with the value-adding sectors. As a result, the discourse on policy reforms is left open to vacuous proposals such as the need for a Happiness Index to track the state of health of the economy (see Box 6).

Box 6
Are You Happy?

In May, 2011, the OECD launched its on-line Better Life Index. Individuals may calculate standards of living in the 34-member countries. David Cameron's Coalition government in Britain is elaborating a similar Happiness Index against which to judge the efficacy of its policies.

The happiness concept was effectively deployed by America's Founding Fathers. They substituted happiness for the word "estate" (the old English legal term for landed property) when they formulated the future of the United States. They aimed to deliver "Life, Liberty and the pursuit of Happiness" in place of John Locke's "Life, Liberty and Estate".

The political convenience of the happiness goal is that one cannot begrudge and question some people who may be happier than others. Nor can an unhappy person demand her constitutional right by suing government for more happiness. It is, of course, possible to sue government if people had a constitutional right of equal access to land or the benefits funded by the rents channelled through the land market.

Towards a Better World?

Stiglitz claims that "the world after the crisis will be different than the world before the crisis".[24] Confidence in this forecast is grounded, in part, in the capacity of people like the UN's experts to identify a uniform one-size-fits-all approach to solving the problems of the global economy. The imperative for such a uniform approach is illustrated by the report's claim that it was "hard" to achieve global recovery if one part of the world remained in recession (isn't this tautology?).[25]

Box 7
The Sovereign Wealth Strategy

If the global economy is operating at sub-optimal levels, is it possible for a country or region to break away from consensus policies to elevate their operational efficiency and achieve full employment of resources?

There is no reason, in principle, why a nation could not generalise the Henry George Theorem (which Stiglitz developed in terms of the economics of an individual city). An individual country could restructure the way it raised revenue without transgressing international agreements under treaties such as those enforced by the World Trade Organisation. This financial reform would reduce costs of production and raise the economy's competitiveness in global markets without the need for the austerity policies that are now reducing people's living standards within the trans-Atlantic regions. Some countries *would* complain that this gave the reformed economy an "unfair" competitive advantage (lower prices flowing from political decisions). But there would be nothing to stop such complainants from adopting the same reforms.

[24] Report, p.xxiv.
[25] Report, p.x.

Policy-makers seek comfort in the view that all countries should pull together according to some agreed set of policies. But why rely on a single strategy to re-float every country simultaneously? Does that not pose the risk that a failed package of policies may constrain *all* countries below their optimum operational levels? After all, we have it on the authority of *The Stiglitz Report* that “It is not clear that there is yet an adequate understanding of the dimensions of the required action”.[26] And if that *is* the case, why should we have confidence in the ability of an International Panel of Experts to deliver advice any more reliable than that which was on offer from the IMF?[27] The pursuit of uniformity (conformity?) distracts from the possibility that lessons may be derived from the success of an individual country that chose to “go it alone” (see Box 7).

In the terms of my assessment, there is little in the report’s recommendations to suggest that the Stiglitz experts would lead us to a better world. They do not suggest ways of altering the incentives that are ultimately responsible for triggering cyclical breakdowns. If the world is going to be different, after the crisis, the changes will not be for the better for most people in the trans-Atlantic countries.

I now offer my overall assessment of the value of *The Stiglitz Report* under the four criteria stipulated by Joseph Stiglitz.

“*Better, more democratic governance*”

Institutional reforms are proposed that would lead to greater transparency and democratic participation. Pensioners, for example, should be represented on regulatory institutions,[28] because they are particularly vulnerable to the losses induced by financial crises. Such interventions, however, would prove to be cosmetic. Ultimately, the power resides with those who control the nation’s net income (rents). *The Stiglitz Report* fails to articulate the one fiscal reform which, if implemented, would democratise the public’s revenue. Systematically shifting taxes from “goods” to “bads” – to use their terminology – would deliver a revenue system based on moral imperatives as well as delivering efficient economic outcomes. But Stiglitz confines this strategy to those cases that would affect polluters. And even in this area, the discussion is nebulous. One result is unfolding even now (2011): governments are

[26] Report, p.194.
[27] Report, p.127.
[28] Report, p.106.

diluting their plans to intervene with polluter-pays policies under the stress of the economic downturn.

Having failed to exploit the benefits of a radical reform of fiscal policy, it is not surprising that the report retreats to proposals that would further exacerbate the very problems that it censures. One of these is moral hazard in relation to the protection offered to the "too big to fail" bankers. The report seeks to expand the risks associated with moral hazard with its proposal to protect home-owners from their own actions (see Box 8).

Box 8
The Land Speculating Home Owner

The Stiglitz Report seeks to exonerate the millions of home-owners who found themselves in financial trouble when prices began to decline in 2007, in the USA, and thereafter in Europe. Provision, apparently, ought to be made to made for "keeping people in their homes" (pp. 101-102).

Many families were undoubtedly innocent victims of the property bubble – but that does not mean they did not feel good about the rise in the equity in their homes. But many millions of home-owners bought properties as investments, not just as somewhere to live and raise a family. Many transactions were of the "moving up the property ladder" type, in which people made decisions solely on the basis that they were shrewdly accumulating wealth by borrowing more and buying dwellings in higher-value locations. This was classic land speculation activity. If that activity has negative macro-economic consequences, home-owners contributed to the financial crisis in 2008. To protect them from the consequences of their actions, therefore, is precisely the kind of moral hazard action to which *The Stiglitz Report* objected in relation to banks. But the report steered clear of any evaluation of the moral culpability of home-owners. In this, it was being as politically correct as the politicians whom the report seeks to censure.

The recommendations in *The Stiglitz Report* do not favour improvements in the quality of governance. By relying on bureaucratic and regulatory mechanisms, the power of the state's agencies would be enhanced. This would not reduce the democratic deficit that causes the apathy displayed by large numbers of people who stay at home rather than vote in elections.

"*Greater stability*"

Modifications to lending practices in property markets (such as ceilings on how much might be advanced as mortgages to borrowers[29]) would not stabilise the trans-Atlantic economies. During the 19th century, in the UK, highly disciplined building societies

[29] Report, p.106.

were ultra responsible in their lending practices. And yet, the boom/bust cycles wreaked havoc with the most powerful industrial nation in the world. Periods of "stability" were merely the recovery phases between the previous recession and the next one. As soon as the economy started to grow, again, the propensities of the predator culture re-asserted themselves. Given the laws of tax-and-tenure, it could not have been otherwise; and will not be otherwise, no matter how many of the Stiglitz recommendations are adopted, because none of the proposed measures neutralises the distortions that arise from the licence to speculate in land.

The report proposes the creation of a Global Economic Co-ordination Council. We may assume that the experts had confidence in the leadership of Joseph Stiglitz, such that this new body would perform more effectively than the existing international institutions that sought to guide the global economy along a stable path. Stiglitz is undoubtedly an authority on problems like those associated with asymmetric information. But his willingness to put his name to this report does not inspire confidence. An example is the criticism of credit rating agencies, which failed to publish risk assessments that alerted investors to the build up of a dangerous situation in the financial sector.[30] This was a defect in the quality of information available in the public domain. But was it a problem intrinsic to the market economy, or due to bad governance? It would be trite to expect a *perfect* information system (no more probable than perfect competition in the real world), but might economic instability be due to constraints on information that are artificial in their nature (see Box 9)?

[30] Report, pp.97-98.

Box 9
Can Joseph Stiglitz Fill the Missing Gaps?

Joseph Stiglitz was honoured with a Nobel Prize for his work in the realms of asymmetric information. But his thesis that the discontinuities in economic activity are the result of gaps in the flow of information – which affect decisions in negative ways, including raising risks – bears closer scrutiny.

Stiglitz presumes that "market failures", such as those in the financial sector (Report, p.58), would continue to disrupt growth, because information asymmetries were inevitable. An example from the financial-property sectors is offered by the UK financial institutions' use of offshore vehicles (registered in tax havens like the Channel Islands) to hold mortgages. These were "off balance sheet" assets. The scale of the sector's involvement in property was consequently disguised. But this information deficit was intentional: it was the outcome of "tax efficient" practises. This was not a case of market failure, but an eminently successful way to maximise the profits of shareholders

Thus, the pricing mechanism, as the prime route to discovering information in the marketplace, may be distorted by government policy. If the *private* pricing mechanism is inefficient because of an aberrant *public* pricing mechanism (taxation), why treat asymmetric information *as intrinsic to the market economy?* Could the public pricing mechanism be reformed so that the private one could work more efficiently in the financial and property sectors? *The Stiglitz Report* is silent on this possibility. This is disappointing, given the report's assertion (p.31) that the burden of remedial action now had to fall on fiscal policy.

"*Faster growth*"

The market economy has under-performed by a significant margin throughout the history of industrial society. The rate of growth was compromised by the determination to divert rents away from investment in infrastructure, which inevitably meant that some of the potential gains from higher productivity were not achieve. Under the Stiglitz recommendations, those constraints on productivity remain in place.

In the 21st century, the increased complexity of the globalised economy means that property speculators will have little difficulty in evolving stratagems to circumvent new regulations. The 2010-2028 business cycle will display all the dramas which, to a more or less degree, were present in the cycles of the last two centuries. It is improbable that recommendations in *The Stiglitz Report* could lead to faster rates of growth in Europe or North America. The pace will be set by the Asian countries. It is in their interest to use west countries as markets for their consumer goods, so they will do nothing to benefit their competitors in the sphere of production.

Thus, western nations will discover that the "recovery" of their economies will be of the jobless kind. Shrinking productivity in the labour markets will not be countered by investment in infrastructure. The outcome will be protracted stagnation.

Insofar as governments continue to use the money printing presses to bolster their economies, there will be inflation. That inflation will not encourage capital formation on a sufficient scale to compensate for the loss of capital and entrepreneurial opportunities that exit towards Asia. Nothing in the Stiglitz recommendations can neutralise these trends.

"*Output more equitably shared*"

The current trend in income distribution was established in the 1970s: an increasing gap between rich and poor, with a measurable squeeze on middle class incomes. Stiglitz relies on "progressive" income taxes to transform this trend. The hope is forlorn. As I explained in *Ricardo's Law*,[31] the "progressivity" doctrine that underpins income taxes provides philosophical cover for the redistribution of wealth from low-income people who rent their homes, to high net worth individuals who occupy prime residential locations.

Given the current outlook for employment – deterioration in prospects for low-skilled workers whose jobs will continue to gravitate towards Asia – this process of income redistribution will continue. As the productivity of western nations shrinks, so the taxable capacity of their economies will diminish. The scope for redistributing income to those in need will be reduced. This process has already begun, under the guise of the "austerity" measures that governments in Europe say are necessary to pay down sovereign debts. Politicians are leaving their electorates to assume that, once the debt overhang has been brought under control, the generous safety net that existed in the early decades of the Welfare State will be restored. In time, it will dawn on people that this route to equity has been closed for good. Stiglitz fails to point to an alternative door, through which we might find the formula for fairness.

In conclusion Given that Joseph Stiglitz understands the economics of the land market, including the fiscal implications of rent-as-public-revenue, and that he personally *does* advocate the collection of rents at the rate of 100% for the benefit of the common good, how do we account for the absence of this policy in the report that bears his name? I searched in vain for the ideas "which might have been more helpful

[31] Fred Harrison, *Ricardo's Law*: *House Prices and the Great Tax Clawback Scam,* London: Shepheard-Walwyn, 2006.

in avoiding the crisis and mitigating its extent".[32] My assumption is that Stiglitz was obliged to confine himself to those ideas with which his experts were comfortable. Their ideas did not encompass those that would have permitted a radical re-appraisal of the tax-and-tenure paradigm favoured by post-classical economists. As a result, there is little in *The Stiglitz Report* that would upset the vital, long-term interests of land speculators, their support services (which includes the banking sector), and the wider circle of people who pocket the rents of the nation.

[32] Report, p.192.