



Harnessing the Profit Motive of Local Government: Enlisting It in the Wider National Interest

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THE AIM OF THE CENTRAL GOVERNMENT IS TO MOTIVATE LOCAL GOVERNMENT
TO ACT IN THE GENERAL INTEREST

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HARNESSING THE PROFIT MOTIVE TO MAKE CONFEDERATION WORK BETTER

by

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(Preliminary draft of a paper to be presented to the Victoria
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This draft is for discussion purposes only and will be presented in the form of an annotated outline. The overall outline consists of five basic headings, as follows:

- I. The profit motive of local government and its basic harmony with the organic general interest
- II. Conflicts of particularistic local interests with general interests
- III. Traditional means to overcome or submerge local-central conflicts
- IV. Desirable federal policies
- V. What to do until the doctor comes -- interim provincial policies.

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- I. The profit motive of local government and its basic harmony with the organic general interest

To organize a nation, the art of central government is to motivate provincial governments to act in the wider public interest -- to serve the nation by serving themselves. Provincial and local governments have objectives and operate under constraints and incentives just like persons and firms. Economists have analyzed persons and firms, since

Adam Smith at least, and examined how public policy can work with the market to harness private motives to public ends, but they have neglected the analogous question about provincial and local governments.

Provincial governments relate to national governments much as their own local governments relate to them, and I will use "local" to refer to the smaller component government vis a vis the larger one in both cases.

The local viewpoint differs from the central in that the local turf is more completely open to the movement of labour and capital. The local government is defined as an area of land. Men and capital may come and go, and the level of their economic rewards is determined in national and world markets. Land is fixed and from the viewpoint of local government is the residual legatee. That is, the benefits of local spending lodge mainly in higher local land values and the cost of local taxes lodge in lower land values. Land is the equity interest in the local corporation; land income is the bottom line of its income statement. Local motives therefore may be well understood as efforts to maximize land income and values. Maximizing land income can be quite harmonious with the central interest. A private owner maximizes net income from given land by using it so as to maximize its net service flow. His greed, harnessed by the market, makes him allocate his land in a socially oriented way. Increasingly one hears "highest and best use" belittled as though it were a morbidity, but basically it means the use serving the most human needs. That rule is subject to minor qualifications, but the qualifications are not the rule.

The same rule holds for local government which is in effect a group of landowners in league to improve their property and administer it jointly. Local government is a half-way house between the individual landowner and the central state. Landowner control is modified by democracy, but the fact that labour and capital must constantly compete with potential immigrants minimizes their motivation to maximize their factor shares by political means, other than those that exclude outside labour and capital.

There is an important element of truth, then, in viewing local government something like a business firm. The proper role of central government then is to create a framework of institutions within which

the firm maximizes the general welfare as an incident to maximizing its own.

The great nation-builders of history have recognized this truth. They must give the local satraps something to control and to maximize legitimately. This is a constructive governmental use of the invisible-hand principle.

They have also recognized that something more is required which I will call "citizenship". That is, there must be a direct relationship between each individual and the central state, a relationship in which each individual stands on common ground with each other. "Empires" may be distinguished from "nations" by the former's use of zamindars or caciques and mercenaries whose relationship with the state is more contractual than organic. Zamindars and caciques are local landowners in outlying colonies under the general military umbrella of the Mother Country. They perform local policing functions and enjoy the privilege of considerable immunity from taxes levied on citizens of the metropolitan country, but they lack any organic relationship with the metropolitan central state and historically tend to fade away, as Mr. Kipling predicted they might.

II. Conflicts of particularistic local interest with general interests

- A. Hanseatic Mercantilism
- B. Fiscal Mercantilism
- C. Protecting the Commons
- D. Covert Imperialism

A. Hanseatic Mercantilism

This is the kind of behaviour described by Gustav Schmoller in his classic work on mercantilism, that is the exercise of monopoly power by a state or locality which has some, and they all do. An outstanding modern example of course is OPEC, which could have learned everything it knows and perhaps did by observing the Texas Railway Commission and the Alberta system of pro-rationing production to market demand. The growing use of marketing boards lends itself to this kind of monopolistic price and output behaviour. The Anti-Combines Act in Canada, like the Anti-Trust legislation in the

United States, tends to exempt provincial, local and state governments from its purview.

A perfectly analogous exercise of provincial power which is much less likely to be recognized for what it is, is the deliberate withholding of real estate from the market in order to pull prices up. The purchase of real estate by immigrants is analogous to the export of products from the province. The passive withholding from sale of lands by the Crown provincial may, in some circumstances, be a form of Hanseatic mercantilism, under this description; so may a policy of agricultural land reservation by a province which reserves land from its highest and best use. The extent to which it actually fits the description depends however, not simply on the existence of the power, but the manner in which it is exercised, and this is not intended to assert that such powers are necessarily always exercised in this manner. A sometime aspect of Hanseatic mercantilism is the "employer gild variation". In this variation the objective is to hold down the demand for labour and therefore hold down wage rates. This is done by discouraging the allocation of land to labour-intensive industries. One way of exerting the monopoly power inherent in a local jurisdiction is to tax exports where it is believed the tax may be shifted to outsiders. In the case of real estate this includes newcomers and members of powerless out-groups and ethnic and national minorities and so on. A problem with this kind of device is that it does not discriminate between the intended victims and the children of the old settlers who are generally in the same role as immigrants and other out-group members.

B. Fiscal Mercantilism

This might also be called "fiscal environmentalism" or "fighting tax pollution". These names are suggested because this kind of behaviour so often is wrapped, rather hypocritically, in the flag of environmentalism. Fiscal mercantilism has four thrusts:

- 1) To acquire and enrich the tax base. Generally there is a compensatory principle at work in respect to local taxation. To wit, "local governments seek to attract whatever they are allowed to tax".

(This is an important factor to consider in evaluating the likely efficacy of user charges in controlling local pollution, congestion, and so on.)

2. To repel and reject public charges.
3. To minimize export of tax payments to senior governments.
4. To maximize the import of grants from senior governments.

Until fairly recent times, local governments acted as though they thought they could achieve these ends by competing to attract population. The traditional "Chamber of Commerce" was a boomer booster organization, but in the last twenty years these attitudes have changed drastically and the anti-growth rage is now in the ascendant, creating a whole new collection of problems. People as such have become unattractive, capital only moderately attractive, and open space highly attractive.

This change in attitudes is the combined result of several factors, many of which are fiscal. It is beyond the scope of this paper to look into the history of fiscal changes; it is limited to suggesting fiscal reforms to offset these changes in attitude towards immigration.

One change that is identifiable is a loss of belief in economies to scale of population. People are much less conscious now than they used to be of the advantages of a large market, the cultural advantages and variety of a large city, the advantages and economies of increasing load factors and sharing risk in a large population, the advantages of a regional population large enough to support local industry, and so on.

The changed attitude is partly a matter of increased democracy of folk ways and mores. A land-owning oligarchy is anxious to keep cheap, docile labour on hand, as long as it does not demand expensive education, equal rights in public places, and so on, but when the proletarians become assertive of their individual rights in these matter, the oligarchy is anxious to see them leave.

It is partly a matter of mechanization. Each person now sheds more external pollutants than formerly because he is armed with formidable engines of nuisance which have been made cheap. Thus each

person needs more room. Presumably this problem can be minimized when institutional and social controls shall have caught up with ATV's, portable radios, lawn mowers, imported sports cars and motorcycles, and similar artifacts which, in the hands of a small number of inconsiderate and irresponsible people can vastly increase the elbowroom required per capita.

It is partly a matter of the decline of public morals with concomitant increase in petty thievery, assault and so on.

The characteristic landowner defense against this kind of thing is typified by exclusionary zoning. However, as a fiscal device, exclusionary zoning is ultimately self-defeating because in order to fight one kind of social cost it inflates many others. For this and other reasons it must give way to more efficient devices.

C. Protecting the Commons

Every local jurisdiction contains some natural commons, like beaches and parks, and some artificial commons, like public schools and highways, whose attractiveness to old settlers may be reduced as population increases. Increasing population pressure which used to be a minor nuisance has now become a major threat, at least in the minds of many people, owing to the factors outlined above under B. The response has been the establishment of exclusionary local controls and at the provincial level, exclusionary provincial controls, such as the agricultural land reserve of British Columbia. These controls of course tend to keep land from what an economist would call its highest and best use. In a crude and ill-calculated sort of way these controls are designed to maximize the welfare of old settlers in a jurisdiction by protecting them from the competition of immigrants. In the process, of course, they redistribute wealth among the old settlers. Those who would like to sell their land for a higher and better use are considered "greedy" because of the conflict of their interest and that of the other old settlers. In terms of the national polity however, the greed of the owners wishing to sell is an expression of the interest of immigrants wishing to buy and have access to the resources of the province in question.

D. Covert Imperialism

The imperialism of local and provincial government under the umbrella of a national government must of course be covert. However, there is room for maneuvering in the establishment of sovereignty over unclaimed resources, such as radio spectrum, off-shore minerals, anadromous fish, and so on. The arenas in which this competitive imperialism occurs are also the questions of who shall levy taxes, who shall collect rents, who shall regulate, and in the ultimate absurdity, who shall have the right to waste public capital in premature and sub-economic development schemes. The last of course represents a miscalculation on the part of local government as to where its true interests lie and may reflect some conflict of interest between ownership and management, just as with a large corporation.

III. Traditional means to overcome or submerge conflicts

A. The tendency of exclusionary provincial and local policies if pursued by all is to drive landless, routeless proletarians from pillar to post until they become sufficiently desperate to offer their services for so little that they somehow become attractive to the dominant landholding oligarchy. Their problem is accentuated because as they become more attractive to said oligarchy they become ipso facto less attractive and more of a threat to other old settlers who have some influence, that is, organized labour. This problem is eased somewhat when they are easily differentiable as by speaking a foreign language or being of a notably different race or religion. With the decline in ethnic differentiation, however, this solution is becoming less feasible and in addition is less acceptable to modern concepts of justice and equity and definition of first-class citizenship.

B. A second traditional solution has been for an economy and an empire to expand so fast and acquire and move into new land so rapidly that land develops little or no value so that class structures based on property ownership remain weak or local or transitory. This was an essential part of the 19th century solution in Canada and the United States, and it had a notable revival in the 1930's following the burst of urban expansion of the 1920's when this and other factors conspired

to bring land values down so low that a great deal of land was abandoned for taxes.

In the 1960's a more overtly imperialistic expansion occurred which worked, but not quite as well. People tended to stay at home, at least within the continental limits and cheap labour was not welcomed in person but by proxy in the form of cheap, imported products of high-labour content. This cheap labour was differentiable by virtue of being located overseas.

In recent times there is little sign that this solution will indeed keep land cheap. For perhaps the first time in our history we are undergoing an extended period when land values remain high relative to wage and salary incomes over an extended period, resulting in exacerbated class distinctions between haves and have-nots.

C. Socialization of rent.

1. At the local level this is a traditional role for the property tax. It works, however crudely, so long as people accept the advantages of the economies of scale that attend growth, which is encouraged by property taxation, especially that part which falls on land values. It works better where the provinces prevent the development of tax havens by constantly balancing school district tax bases to equalize revenue sources. The provincial government, which is the seat of sovereignty, lends to local school districts its reserved right to tax real estate, a sovereign right which it never relinquished since the real estate was transferred to private owners, subject to taxation, which is an assertion of the grounds reserved equity in real estate. In return for lending this power to the local school districts, the Crown provincial requires them to provide free public education and other services, from this base. A kind of birthright principle is implicit, where every unborn child and every immigrant's child is granted a kind of equity in the lands of the province. The local powers cannot deny to the meanest immigrant's child the same common education they provide for their own. This has been quite an effective device over the last several decades in overcoming local particularism. We are all familiar with the strenuous and continuing local efforts to work out from under this servitude. In recent years exclusionary land-use policies administered

at the local level have proven to be an increasingly effective -- and exceedingly costly -- barrier to the effectiveness of this device, which is therefore in need of review and modification.

2. At the provincial level socialization of rent is most notable in the Crown land provinces. The dynamically growing application of the principle has been a major change, just in the last two or three years, owing to a combination of the increasing level of such rents and the increasing assertiveness of provincial governments in asserting their ownership. At the same time there has been little or no socialization of rent from fee-simple lands, either in the Crown land provinces or elsewhere.

The federal government has taken strong exception to this trend, as everyone knows. It is playing a kind of dog-in-the-manger role by obstructing provincial collection of rents from Crown land without, however, effecting much federal collection of these same rents. That is, its propensity to grant favourite income tax treatment to resource companies is unabated in all respects but one, and that one, the non-deductibility of provincially-levied royalties, is clearly calculated to weaken the provinces.

The federal interest correctly perceives, I believe, that the level at which pooling of rents occurs is the level of loyalty, the centre of the organic element in polity. Thus, provincial rent collection is a threat of sorts to the national unity. I am skeptical of the alternative interpretation which is that the provinces are threatening the national revenues, inasmuch as the federal disposition is clearly not to collect much net revenue from resource corporations. However, I retain an open mind on this subject and would welcome comments from my learned co-confererees on this topic.

And yet the socialization of rent at the local school district level has not threatened the unity of provinces, but rather re-inforced it, and it seems to me that provincial socialization of rent could be a factor strengthening national unity rather than the reverse, always provided that the federal authority insist, in the strongest and strictest terms, that there be no direct or indirect barriers to free inter-provincial migration (including exclusionary zoning).

3. At the federal level, socialization of rent is currently minimal and partial and essentially negative in spirit. It is partial because it is focused almost entirely on the Crown land provinces and one particular kind of rent, that arising from "natural resources", very narrowly construed. There is no parallel effort to socialize the rents of fee-simple lands and the effect as among provinces is highly discriminatory.

The two primary means of this partial socialization, that is the two-price system for petroleum and the non-deductibility of provincial royalties, are the crudest, most uneconomical devices that can be imagined from the viewpoint of efficiency and conservation.

The economical way to collect rent is through a straight-forward tax system which identifies rent at the source, on the ground, in rem, distinguishing clearly between low-grade and high-grade deposits, between good locations and bad locations. The power to do this rests in the federal income tax which at the same time treats on an equal basis the income from fee-simple lands.

The route to this end was charted by the Carter Commission several years ago. It is not too late to dust off these recommendations and try again. Public sympathy for greater taxation of resource rents has increased in the last few years.

D. Appropriate distribution of spending. Socialization of rent is not so effective if we turn right around and return the money whence it came or should have come. If the distribution formula be keyed to real estate then in effect there is a de-socialization of rent. This is inherent in grants to municipalities as such, for example, and very likely in the federal equalization grants system.

Socialization only occurs when the grants have the character of a social dividend. That is, they are based essentially on a per capita formula. Provincial school equalization formulas and per capita grants to municipalities have some of this character. However, these devices at present appear to be too weak to overcome galloping exclusionary zoning and other exclusionary municipal policies.

IV. Desirable federal policies

There has been a growing tendency for central governments to subsidize local governments and at the same time to allow these governments to adopt exclusionary policies by which they limit the enjoyment of the subsidy to a smaller number of old settlers. I suggest that this combination of policies is the height of inequity and folly from the standpoint of national unity.

There has been a tendency to subsidize capital spending by local governments, as by capital grants and tax exemption of their bonds. This is a good way to make work for capital which is in short supply, but a bad way for labour, which is in long supply.

There has been a tendency to create an incentive structure which caused local powers to perceive their interest to be exclusionary and then to turn around and preach at them and scold them for their anti-social attitude. This suggests the legend of King Canute and the waves. Effective central policy will make use of the invisible end principle. People cannot be expected to act for long against their perceived interests.

There is a strong tendency for the federal government to extract tax money from persons through the federal payroll tax (that is income tax with preferential treatment of property income), and then return money, not to people as such but to governments as such, which is just a step or two away from returning it to property as such, since governments are defined as collections of real estate. Thus, central government relates to individuals as an exploiter and to local governments perhaps as a benefactor. Referring back to II B. in the outline on fiscal mercantilism, this combination of central policies strongly affects the attitude of local government towards the desirability of attracting persons. To the extent that the federal government extracts money from persons, they are less able to pay local taxes, and to the extent the federal government gives subventions to local governments, the less they need resident citizens to pay local taxes. People as such come to be regarded as a pollutant; first a fiscal pollutant and then just a general nuisance, threat, liability and public charge.

My recommendation obviously then is that this relationship should be reversed and that the federal government should relate to persons more as a net benefactor. Localities would then compete to attract people instead of as now to repel them.

One need not fear that localities would then be swamped with people since this is a zerosome gain (except for international immigration to be considered separately). The difference would rather be a shift in the terms of trade in favour of labour and a higher degree of national unity and loyalty. Who, after all, would not value more highly his citizenship in a country whose federal government took less from him and gave him more?

To implement this general scheme here are some more specific suggestions:

A. The federal government should review local and provincial zoning, building code, utility extension and related exclusionary policies as barriers to the free movement of persons in the nation. I invite your attention to the recent Petaluma, California, case in the United States where a city was successfully sued in a federal court on the grounds that its exclusionary zoning interfered with the interstate movement of persons.

B. The federal income tax should be modified so as to tax payrolls less and property more. The Carter Commission has already shown the way.

As a counterpart to this and integrated with it, a vastly increased individual exemption in respect to earned income at least is in order. This would be a way of effecting the social dividend or per capita grant. There is no need for the cash to make a round-trip to Ottawa and back; we only need to increase the exemption. To be sure there would be a publicity value about an explicit "social dividend" which some political leaders might favour, however, I don't think myself that the average citizen who is capable of filling out a complicated income tax form is really that stupid.

C. Grants of all kinds should be on a per capita basis, and preferably sent directly to individuals rather than to provincial or local governments. That having been done, then each provincial and local

government should be self-supporting, an independent profit centre. Those that are not self-supporting under these circumstances are a net drain on the national welfare and should be allowed to liquidate themselves on terms which they find most advantageous. It should not be assumed, however, that this is a draconian hardship policy which would particularly penalize outposts which now appear to be submarginal. On the contrary, the distribution of rents to persons would considerably reduce the relative attractiveness of those locations which generate more rents and enhance those of locations that generate less. This policy would remove a pronounced locational bias which we have lived with for so long that we are almost unaware of its existence.

D. It is probably appropriate for the federal government to lend considerable aid and comfort to localities in protecting their commons by the imposition of user and effluent charges. This is because of the law of selective fiscal gravity: local governments seek to attract whatever they can tax. This tends to limit the effectiveness of their use of user and effluent charges to protect their commons.

It also seems proper for the federal government to provide some leadership in a drive for more responsible and considerate public behaviour. Just how this might be done is a field outside my expertise, but it clearly would be a most productive use of public funds.

E. Some federal leadership could be exerted in promoting the use of mass transit and other mass systems in preference to individual transit and other individual systems (like septic tanks and private wells). Within mass systems we need more use of "inverted rate structures" granting lower rates to smaller users and promoting higher density.

F. All grants should be either to persons or on a per capita basis. There should be no capital grants or grants to governments as such. This includes "tax subsidies".

G. Social dividends should not in any way be described or thought of as "redistribution" of income, but rather as the original distribution. "Redistribution" is an offensive term in that it presupposes a distribution of property antecedent to taxes and social dividends which these are alleged to disturb and rearrange. The more proper con-

cept, I believe, is that taxes on the rent of the land over which the nation is sovereign are simply an expression of each citizen's equity in these lands and not a taking or redistribution from other presumed owners or occupants of these lands. The social dividend is a birth-right or a citizenship right, rather than a grant of charity or no-blesse oblige. Servitude to taxation and the possibility of increased taxation is an organic incident of every land title under the common law used by the English-speaking peoples and has its counterparts in other systems of law and land tenure as well.

H. There is a federal interest in better assessment of property which might be expressed through a national board of equalization or other device for auditing and improving provincial and local assessment. One purpose would be to protect the federal revenues by preventing any false depreciation of land for federal income tax purposes. Another is to prevent the use of inaccurate assessment as a device to interfere with inter-provincial migration. Any local exclusionary device is a barrier to migration of citizens and the under-assessment of undeveloped land relative to land in active use is clearly such a device, both in effect and intent.

It would be appropriate for the federal government to review provincial preferential assessment and tax rate laws which, for example, base the assessment of farm land on "use" instead of market or actual value. Once again I hasten to point out that each locality views these as devices to keep itself from being flooded with unwanted developers and so on, but from a national viewpoint we need to look at the total system and avoid falling into a fallacy of composition. The people who flood one area will desiccate another. Those who live here will not live there. And again we must remember that the system of per capita grants and social dividends described earlier will minimize the tendency now frequently deplored for people to congregate around the pot of honey. That is, around the local jurisdiction with the strongest tax base.

I. It would be desirable for the federal authorities to construe more broadly the concept of indirect taxes which are forbidden to the

provinces. An economist would say that the more direct a tax is, that is the less shiftable it is, the less excess burden it has. Excess burden in turn is some measure of the degree to which a tax penalizes immigration and economic activity generally.

Such a move would tend to limit the provinces to taxes of a more promotional type.

J. The problem of absentee ownership, about which so much concern is expressed, is largely solved when the federal and local governments take a higher percentage of their revenues from property, since it is property which is the object of concern here. This at once discourages absentee ownership and speculation and at the same time makes it less objectionable since the absentee owner is contributing to the support of the state. It obviates the alternative which is a variety of discriminatory measures against absentees which would be administratively difficult, invidious (like the California Alien Land Act of ill fame), and eventually probably unworkable, as well as inviting retaliation from other countries.

K. International immigration would now have to be controlled, since the value of citizenship in Canada would rise considerably above world levels. To an economist the best solution here would be to put a substantial price on Canadian citizenship. This may sound awful to the moralist and the poet because of conventional connotations and misunderstandings of language, but may actually be the most efficient and equitable way of handling this tortured problem. It would satisfy Canadian labour by keeping out cheap labour and it would satisfy Canadian bookkeepers by maintaining the value of Canadian citizenship, which our set of institutions creates and sustains. As world citizens we would doubtless set the price somewhat below its market value, and as humanitarians we would doubtless allow specific exemptions from time to time. This is material for whole books.

Having expressed the basic discrimination in a lump-sum cash payment, all further kinds of discrimination could be dispensed with, thus doing away with all kinds of unpleasant institutions we now labour under, and effecting great social efficiencies.

L. Finally, a policy of international free trade would be quite possible and feasible and would not threaten the unity of the nation. The national polity would be bound by sharing of resource revenues. This would free us from the alternative wasteful policies now used in lieu of this kind of genuine binding. We need not fear that the ties of trade alone would overcome citizenship ties made as strong as I suggest. This, it seems to me, is the only way to unite the Canadian nation durably, because on any other basis Canada as a nation is in conflict with powerful economic forces related to the high cost of east-west transportation.

V. What to do until the doctor comes: interim provincial policy

A. The province should tax rent at the source rather than at any commodity level and thus be more sure on legal grounds of the deductibility of the provincial charge. That is, the closer the provincial charge is to the ground from which the resource comes, the greater it has the character of a "direct tax" and the less vulnerable it is to federal raids. In this case good law also makes good economics since this is the only effective way to collect economic rent anyway. I believe that the province of British Columbia made both a legal and an economic error in collecting rents through a marketing agency which is vulnerable to federal arrogation.

The Crown land provinces would be advised well, I believe, to increase their taking of economic rent from fee-simple land as well. Then they will be armed with the weapon of consistency when they criticize the federal government for its inroads into the rents of Crown land alone.

This would also make it feasible to alienate more Crown land since the public equity would then be asserted through the imposition of property taxes. The deductibility of property taxes on fee-simple land is not likely to be challenged by the federal department of national revenue.

To be concluded.