PRACTICAL POLITICS

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"It may well be that the boom the next time round will be less extravagant than that of the late 1980s, so perhaps the next slump will be less serious than 1992… and the timing – well, probably around seven years hence" ("Practical Politics", Issue No. 159, July 2002).

DEPRESSION OR NO DEPRESSION? THAT IS THE QUESTION

Well, there has been a pronounced boom in housing land, coming to a disruptive end in the U.S.A. in particular but also visible in Spain, the Baltic states, France, and the Republic of Ireland, with signs beginning to show in the U.K. too. Banks have advanced funds against the increasingly illusive security of speculative land value. Investors in domestic property are finding that yields on swollen purchase prices are falling short of realisable rentals. Those with mortgages are feeling the pinch from rising interest rates.

"Lending has soared, particularly against overpriced houses [*i.e.* over-priced housing land – ed.] and particularly in the United States" [a]. "US consumers have been using their homes as cash machines in recent years to support their normal expenditure" [b]. In Japan "the economy may be tipping back into deflation after the housing collapse during the summer" [c]. "Best estimates of the scale of the banking system's total losses from US sub-prime mortgages are in the $150bn–$200bn range" [d]. Citigroup, Merrill Lynch, Morgan Stanley, and HSBC have all taken big knocks, while in the U.K. the distress of the admittedly much smaller Northern Rock is all too evident. "The UK economy bears many similarities with the US economy, with consumer spending in recent years being considerably financed by mortgage equity withdrawal and not by growing consumer incomes. Consumer debt is high and savings are low" [b]. "In the real world outside the banks, the process of adjustment is only just getting going" [d].

[a] Editorial, "The Shareholder", October 2007 [b] Kleinwort Benson Private Bank Quarterly Review, September 2007 [c] Ambrose Evans-Pritchard, "Daily Telegraph", 16th. October [d] Roger Bootle, "Daily Telegraph", 12th. November

After the euphoria, the fear

Will the collapse spread beyond domestic property, and will the banking sector as a whole be able to cope? If the answer to the first part of the question is "no", then that to the second part will probably be "yes", and there will be no general economic depression. Agricultural land looks ahead to greater demand for conventional food production (crops and livestock) to satisfy expectations of rising living standards in the third-world, plus the new demand for cultivation of crops for biofuel. The big attraction of farm land nevertheless remains the prospect of its conversion to a more lucrative higher use. In the hinterland of Dublin, for instance, “Fortunes have been made in the re-zoning of agricultural land for housing” [e].

Whilst there have been no general sustained indicators of untoward boom in industrial, retail, office, or other commercial land, there have been signs of faltering demand, and these can only be exacerbated by events in the domestic and banking sectors. Banks have belatedly become selective in how much they advance to home buyers, and now take more care over the credit worthiness of their mortgagers. Stagnation in the housing market will reduce construction activity and affect manufacturers and retailers of household goods and furnishings. ‘Feeling the pinch’ will dampen consumer demand for goods and services. With loans at low interest rates no longer available, commercial undertakings with large capital-intensive projects will be deferring their plans and adding to the tendency for unemployment to rise.

“Foreign creditors are no longer willing to underwrite Spain’s property market…The regional *cajas*, or savings banks, are vulnerable. Many of the *cajas* have leveraged their risk by launching their own property ventures, much to the horror of the Bank of Spain” [f]. The credit agency, Moody’s, “has warned that the City office market is at its most vulnerable state for years” and that “commentators have forecast an oversupply for 2009/10” [g]. “Commercial property funds have been one of the hottest-selling retail investment vehicles over the past 18 months…but most of the UK’s leading funds have seen their value slide as commercial property prices fall amid fears that the market has become over-inflated and is set for a cyclical downturn” [h]. “In early summer, HSBC sold its Canary Wharf headquarters for a staggering £1.1bn. Six months on, the commercial property market has collapsed and the pessimists are predicting a bleak future. Deals have dried up and those agreed have been revised or dropped altogether” [i].

[e] Letter, “Financial Times”, 10th. November [f] Ambrose Evans-Pritchard, “Daily Telegraph”, 3rd. October
[g] “Estates Gazette”, 3rd. November [h] Daniel Thomas and Jim Pickard, “Financial Times”, 6th. October
[i] Sophie Brodie, “Daily Telegraph”, 13th. November

Puny defences

Governments are preparing to fight this war against economic depression with the same derisorily inadequate defences that were deployed in the crash of 1992. They have two weapons – the printing press and interest rates! The U.S.A. (and, it now seems, France, within its euro corset where one size has to fit all), believe “the necessary course…is to make money cheaper and to keep doing so if necessary until the final mines in the financial waters have been identified and neutralised…The gold price has suddenly shot through the roof [note by ed. – it closed at $804.10 an ounce on the London bullion market on 12th. November]. This is a sign that the market fears that easier money will usher in inflation” [j].

Governments are not wholeheartedly opposed to inflation – at least, certainly not at first. Currency debasement favours the over-borrowed by allowing them to cheat lenders by repaying in devalued ‘funny money’, whilst at the same time relieving banks of the necessity to foreclose and to have to sell re-possessed property at distress prices in a sinking market (or, *in extremis*, go cap in hand to the Treasury and beg to be rescued).

Central banks, like the Bank of England, however, often have prevention and control of inflation as a prime duty. They do not have the opportunity to do this by raising taxation, and are left with just the one means, namely the setting of base interest rates. Raising the lending rate is intended to counter monetary inflation. Borrowing becomes more expensive, which deters spenders who do not have ready cash available; and it attracts foreign lenders who see an opportunity to get a higher return on deposits than is obtainable at home (or elsewhere that is tolerably trustworthy).

National economic policy is thus pious, orthodox, unprincipled muddle.

[j] John Authers, “Financial Times”, 22nd. September

Land – the neglected factor

For many years there was a widely held pretence that land was without economic importance, had rather gone out of fashion, scarcely existed really. It may have been the crash of '92 which began the process of re-evaluation. Officialdom remains in formal denial of course, but everything points to an awareness that land is, after all, the key factor, and that to neglect it is to ensure failure. During his watch as Chancellor of the Exchequer, Gordon Brown bragged that the cycle of boom and bust had been consigned to history. That is certainly untrue. Indeed, it is looking increasingly likely that the present ructions may not be a mere market correction with only the mildest transient effect on the real economy, but, rather, the advance signal that a full economic downturn lies ahead. As we wrote in our Issue No. 22 (November 1991), “Government needs to stop looking exclusively at the labour and capital markets and turn attention to the underlying significance of land in the economy. All booms are characterised by land speculation and all recessions are preceded by the bursting of the bubble. Fully applied, LVT would knock out all possibility of land speculation.”

ROUND AND ABOUT

(i) “**UK Coal** has recorded a 143% increase in interim pretax profits, which it said was largely owing to its drive to unlock the value of its 50,000-acre land bank…The valuation of UK Coal’s land has risen 36% to £398m. It has upgraded the estimated land value in 2012 by £100m to £900m” (“Estates Gazette”, 8th. September). What’s on your balance sheet?

(ii) “Sell off **Sainsbury’s** substantial freehold property and my back-of-the-envelope jottings suggest the retailer would barely make a profit next year if it had to pay rent – compared to the £500m analysts expect this year” (Richard Fletcher, “Daily Telegraph”, 13th. November). Planners might note that the land value component of the properties is boosted by their reluctance to grant planning consents to supermarkets, which limits competition and favours near-monopoly.

(iii) “**Leicester** council said it would sell off tranches of land to raise money to improve city infrastructure…Land sales will generate a steady flow of income, which could be used for city-centre schemes, energy projects or other council proposals” (“Estates Gazette”, 8th. September). The council might have kept the land and raised money by issuing bonds against the security of the rental income stream which the land would yield. Again, if LVT were in operation, that land rental value would remain in public hands, and the site values from the city-centre would likewise be captured, both before and after implementation of those infrastructure improvements.

WE ARE – ALL OF US – BEING WARNED!

On 13th. November, for the thirteenth year running, the European Court of Auditors refused to approve the EU’s accounts. On the same day, as reported by Bruno Waterfield in the “Daily Telegraph” of 14th. November, President Sarkozy of France, in an address to the European Parliament in Brussels, told the assembled MEPs “he is planning to use his turn at the EU’s rotating presidency, in the second half of next year, to call for new European powers in highly sensitive areas. The president said: 'Now we have got to resolve the political issues and to broach them without fear. We have got to debate them without taboos. **Budgetary policy**, **trade policy**, **monetary policy**, **industrial policy**, **taxation**, all policies, any policies'.” [The bold lettering is ours – ed.]. Do we feel lucky?

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