PRACTICAL POLITICS

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Where has **PRUDENCE** gone? What happened to the **GOLDEN RULE**? Wasn't it a shame to sell half the nation's **GOLD RESERVES** at the bottom of the market at an average price of $285 a troy ounce whereas now it is standing comfortably at well over $1,000? Above all, what happened to the boast to have ended the cycle of **BOOM AND BUST**? Let there be no doubt about it, the Government could have sheltered this country from all but the outer ripples of the current disaster, had it heeded our advice in Issue No. 71 (June 1997). The U.K. could by this time already be collecting a significant proportion of land-rent, with concomitant replacement of taxes on production, trade, earnings, savings, and spending. This would, *inter alia*, have removed the speculative "hope" value in land pricing which falsely gave people and businesses the impression that they had surplus funds to play with and could offer land (with or without developments on it) to lenders as collateral for what is now seen as wretched over-borrowing. Banks and other lenders likewise accepted land (albeit labelling it as real estate, property, assets, or equity) at rising but utterly illusory valuations, as security for ruinous over-lending. Even if the regulatory authorities (Bank of England, H.M. Treasury, FSA) had been asleep, would all the banks, in a LVT working environment, have become caught dealing in overseas "toxic" securities?

We foresaw this slump, writing in Issue No. 116 (July 2002) that it would occur "probably around seven years hence". The key indicator is when the buying/selling price of land noticeably exceeds the capitalisation of its annual rental value [≠]. Land is not reproducible or transportable, and all that can happen when demand rises is for the price to rise too. Speculation and "hope value" merely push the price up further, until it is well out of line with the optimum current use value. That is the danger signal. Land <u>is</u> key.

[≠] It is insufficient for just one class of land (domestic,say) to be the subject of speculative activity, but trouble is certainly beckoning when all or most others are involved too (industry, warehousing, retailing, entertainment and leisure, offices, agriculture).

Footnote:– With so much "quantitative easing" going on now, and with straightforward currency debasement by resort to the printing presses more or less certain in the future, the world looks likely to be smothered in fresh new money that will buy less and less. In circumstances like this, **gold** comes into its own. It is difficult to increase the supply of gold in a hurry (new mines are out of the question in the short or even medium term), so gold is seen as a storer of value and a great hedge against the ravages of inflation. Whilst it is true that a gold bar earns no interest, it is also true that, with interest rates generally low at present, there is a lot less to lose than when interest rates are higher and there are currencies that are strong and fairly reliable. Bullion has much going for it these days.

DEPRESSION – DEVELOPMENTS AND REPERCUSSIONS

United Kingdom

In the first half of the financial year, Government borrowing reached £77.3 billion (£77,300,000,000, seventy-seven thousand three hundred million pounds) for a nation of around 60 million people – an unwanted record. With tax receipts dropping and welfare payments rising, this is a truly awful position to be starting a recovery programme from. Borrowing for the financial year is likely to top £175 billion. It will get worse before it gets better.

Government policies are full of contradictions. Interest rates are low, to stimulate business recovery and, coincidentally, to make it cheaper for HMG (by far the biggest of all borrowers at present) to raise the cash it has to have; but higher rates will be needed to attract foreign investors to buy the inevitable outpouring of government gilts and to stave off a lowering of the grading of U.K. debt by the credit agencies. Quantitative easing (which could go to as much as £225bn.) was supposedly introduced to stimulate the economy, but in practice it will eventually result in a debased currency and add to the general woe. Meanwhile, banks have been exhorted to increase their lending, but have also been told they must raise their capital-to-lending ratios. The truth is that there is no logical, easy, painless way out of a slump. The only solution is not to have one in the first place. This is achievable only through a correct understanding of the rôle played by land in the economy, leading to implementation of a proper national land-rent charge (a.k.a. LVT).

Faltering **banks** have been failing, and put on life support or been amalgamated with others. However, before they can continue to receive state assistance, two recent aggregations, Royal Bank of Scotland and Lloyds Banking Group, are each expected to hive off a package of some of their constituent parts, which are to be put up for sale to, in effect, new entrants. Furthermore, the nationalised Northern Rock is to split in two – a so-called good bank to be replete with taxpayers' money and let loose again on the market, and a bad bank, filled with toxic and suspect assets, to hang on, minimise losses, and generally make the best of a bad job.

New hybrid capital instruments are appearing – "constituent capital", or "Co-Cos" for short. These are interest-bearing bonds that can convert into equity if the market value of the bank's core equity falls too low, at which point interest is earned only if the bank manages to operate profitably. CoCos can thus, like shares but unlike ordinary bonds, absorb losses.

Also in trouble, and busily amalgamating, are some of the **building societies**. These are mutuals, depending on their members' capital. Their structure does not enable them to raise equity on the financial markets or by calls on their existing shareholders. CoCos are thus not for them. They are, therefore, pondering adapting their PIBs (permanent interest-bearing shares) into profit-participating deferred shares, or PPDS for short. The PPDS could, if necessary, act in an emergency as a bond in receipt of an equity dividend and, as such, could absorb losses.

Europe

Superficially the euro is standing up well, but in fact the eurozone is under stress. Greece and the Republic of Ireland are major worries. Spain is widely suspected of concealing the extent of its indebtedness. Portugal and perhaps Italy are not far from trouble. Elsewhere in the EU, the whole of the former Iron Curtain bloc is wobbly, Latvia especially so. Blithely ignoring these immediate problems, the EU is planning “a systemic risk board along with three further European supervisory bodies: a European banking authority; a European insurance and occupational pensions authority; and a European securities and markets authority” [a]. This package threatens to impinge on member states’ fiscal responsibilities with a vengeance!

The wider world

Dubai is so obviously enmeshed in problems stemming from land issues, that there is little more to stress. **Japan** continues to struggle, after two decades of misery, wallowing in the after-effects of the mad1980s land boom that reached truly absurd proportions. “In the **US** they have near zero rates, external deficits, and public debt skyrocketing to 100pc of GDP, and on top of that they are printing money” [b]. There is also unemployment. “The Federal Reserve and other central banks will be forced to engage in outright monetisation of government debt by next year, whatever they say now” [c]. Meanwhile, **China** keeps the renminbi pegged to the dollar to support its lagging exports, but “asset bubbles are starting to form. Residential property prices in Shanghai and Shenzhen have increased almost 50pc in a year” [d].

The lesson

If you want to control bankers’ activities, introduce LVT and advance rapidly towards full collection of the annual rental value of land. Remember that land value is often not only a major element in property prices but also in share values because corporations own (or have significant beneficial interests in) land. Without the illusory froth of land speculation, banks would have no rôle but to lend in support of real wealth creation.

[a] Hella Ebrahimi, “Daily Telegraph”, 16th. November [b] HSBC currency chief, cited by Ambrose Evans-Pritchard, “Daily Telegraph”, 7th. October [c] Professor Tim Congdon, International Monetary Research, cited by Ambrose Evans-Pritchard, 15th. September [d] John Foley, “Daily Telegraph”, 23rd. October

SOME DIFFERING WAYS IN WHICH LAND VALUES ARISE (OR NOT)

(i) “House prices are soaring in areas whose schools enjoy a good reputation”. Property research has shown that “Access to a good school is the single most important consideration when parents with school-age children decide where to live, but homes with access to high-quality schools come at a significantly higher price” [e]. Location! Location! Location!

(ii) “More than £40million of funding is helping to clean up a heavily contaminated former industrial site in Norfolk, revitalising a long-neglected part of the district...beside the historic town centre of King’s Lynn” [f]. Good! But who is pocketing the increased land values? And for doing what?

(iii) Why is housing and housing land costing more in part of Perthshire? “Perhaps Pitlochry’s biggest advantage in the 21st century is good transport. It is an hour’s drive from Edinburgh airport and it sits alongside the A9 road from Perth to Inverness. There is a modern train service for those going “down south” to England – the 09.23 from Pitlochry takes you into London’s King’s Cross terminus in time for afternoon tea or for a quick walk to nearby St Pancras International for the Eurostar train to mainland Europe” [g]. The scenery is not so bad, either. Naturally a new breed of commuter is attracted.

(iv) Jean Colbert, avionics engineer and physicist, and his wife chose to move homes within San Bernardino, California, from Riverside to “a more human neighbourhood, so we got [a house] near the Mexican neighbourhood, which was separated from us by a railroad track. We had a swimming pool built, thinking it would add value to the house. When we returned to France and sold the house, we were told the property hadn’t increased in value because we were close to the Mexican neighbourhood.” In this case, location stubbornly reflected prevailing social preferences. Clearly the land (site) value had sunk during the passage of time and had negated the improvement value.

[e] Sarah O’Grady, “Daily Express”, 4th. November [f] “Media Planet”, 21st. July [g] Graham Norwood, “Financial Times”, 21st. November [h] Jean Colbert, interviewed by Carolyn Reynier, “Financial Times”, 5th. September

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