PRACTICAL POLITICS

June 2010 Issue No. 182

Since our previous Issue appeared, there has been a General Election and a change of government. With a budget imminent and with further announcements awaited on the direction the new government is to take, we defer comment until our next Issue. For the moment, we again focus primarily on the dark clouds hanging over the economy.

DEPRESSION – THE ORIGINS

Over the years, we have been forecasting this crash [a], as, indeed, we had seen the crash of 1992 coming. The boom/slump cycle arises from the failure to appreciate the significance of the first lesson in the study of economics. The prime factors in the creation of wealth are land (the material universe apart from man and his products) and labour (all forms of human productive effort). To these are added capital, which is that part of production not directly consumed but diverted back into the processes of production and distribution of wealth (the like of buildings, tools, machinery, storage depots, delivery vehicles,). Thus, to use the language of the classical economists, we have land, labour, and capital, which receive, respectively, rent, wages, and interest. The big mistake is to fail to preserve the distinction between land and capital. Land is finite and not transportable. It was not man-made, but came free with our planet – it had and has no cost of production. Capital, on the other hand, is man-made, reproducible, and, mostly, transportable.

Increased demand for a product leads to increased production and trade, through the medium of the price mechanism. Land, however, not being man-made, can respond to increased demand only by rising in price itself. This leads to land speculation. Land, given the advantage to its owner of fixed supply, looks like a jolly good thing to have: without effort on the owner's part, it will be worth more to-morrow than to-day, and can safely be under-used or unused in the meantime, or it can be turned over in a series of quick sales for quick profit. There is noticeable divergence between land sales prices and land on long leases on the one hand, and short-term land rents (tenancies) on the other. As speculative activity intensifies, land price far outstrips the land's value in use to-day. Eventually the bubble bursts in dramatic fashion. With the crash come pain and ruin.

In the boom, individuals and corporate bodies were going to the banks and proffering their artificially swollen land values as collateral for loans. Banks were competing to make seemingly profitable loans to clients, based on the security of those same swollen land values. Both are caught in the crash. At this point it becomes clear that the banks have been playing new games with all that new money and have made matters much worse for themselves and ultimately for their nation's taxpayers. Thus politicians and the public come to learn about loans made to sub-prime borrowers, sliced and diced and slipped in with mortgage-backed bonds. These bonds are in turn packaged to make a collateralised debt obligation (CDO). A credit default swap is an optional extra for "long" and "short" investors to play the CDO game without either party's actually owning the CDO. [No, nor can we fathom why anyone would play about with instruments like this which they did not properly understand! – ed.].

What is clear, though, is that this crash is not at root a banking issue. It all began with land speculation – the same frenzied activity that set off the 1992 slump [b]. A final cautionary note is needed here: many who ought to know better, use terms such as property, assets, and equity to cover their failure or unwillingness to distinguish land from capital, even though the two are different and demonstrably behave differently in response to economic stimuli. It is our claim that, fully and properly applied, land-rent capture (known here historically as land value taxation) knocks out all possibility of land speculation. The time to start preparing for its implementation is now.

DEPRESSION – THE ONGOING STORY

"Banks face a new asset value crunch as tens of billions of pounds of property loans come up for refinancing as soon as this year, raising the prospect of a further wave of write-downs…Banks could be forced into another round of fire sales and write-downs that could damage their balance sheets" but they are "cautious about selling off their real estate-backed debt holdings as they are unwilling to take the large upfront costs", preferring to store up problems for themselves later [c].

"German banks have around €43bn of Greek sovereign debt on their books, and French banks have even more. Britain has relatively high exposure to Portuguese and Spanish debt, whereas, incredibly, France owns Italian debt worth around a fifth of its entire annual economic output." All this is "as much a case of reckless lending as profligate borrowing…As banks have shrunk their balance sheets, governments have expanded theirs so as to stop demand from collapsing. The underlying problem of too much debt has remained the same" [d]. Indeed it has. "Foreign holders of Greek and Portuguese debt have seized on emergency intervention by the European Central Bank to exit their positions, leaving eurozone taxpayers exposed to the credit risk" [e]. In Spain, the government intervened to rescue Cajasur, one of the country's largest regional banks, which are in danger of "succumbing to local property busts. Cajasur is heavily exposed to second homes on the Costa del Sol, where prices are in free fall…Spain's property companies have debts of €445bn…mostly owed to savings banks known as cajas" [e]. The time to camouflage such debts has now gone. The Bank of Spain has set down new rules to "force lenders to write down bad debts within a year" and "set aside reserves on €60bn of foreclosed property still sitting on their books at face value". Investors were no longer believing balance sheets "distorted by overvalued holdings of real estate" [e]. "Spain's unemployment was already 20.5pc even before this latest dose of shock therapy. There are 4.6m people without work" [e].

Let us conclude this depressing survey with two nuggets from outside Europe. "The financial crisis which brought about the collapse of Lehmans began with the boom and subsequent bust of US property prices and the catastrophic loss of value of some of the fancy derivative instruments which were based on them"[f]. "Asia is leading the recovery but China is the key driver and the rampant growth of its property sector worries many" [g].

DEPRESSION – WHAT NEXT?

"A slump is but the tragic and erratic correction of the fevered disorder that is a boom. Booms are based on illusory expectations, mis-interpretations of the signals coming from the behaviour of land. If land values were to be taxed, such speculative activity would be damped down. If the economic rent of land were collected in full – as we think it should be – then land speculation would disappear entirely. If the mere holding of land produced no income stream to the possessor, land as such would have no selling price. The capitalisation of zero is zero. If site rents were paid to the national exchequer, not only could existing taxes be removed or at least abated, but private profit could be made only from the activities of labour and capital. Undistracted by the siren call of huge speculative takings from land dealing, the economy could and would grow in an orderly manner, consolidating productivity gains and ensuring the rewards of enterprise and effort went appropriately to those responsible for producing them" [h].

Government should announce at once that the nation will move to fund the public revenue from a National Land-Rent Charge (LVT), and should steer through the Commons a short and simple Act to provide funds for the necessary preparatory work, including, of course, the land valuation. This show of determination will of itself bring early benefits. Policies to get out of the slump can then perhaps be slanted towards reduction or removal of the first taxes to be replaced by LVT and to promoting activities that will, when completed, result, *inter alia,* in improved public services and amenities.

[a] "Practical Politics", Issue No. 116 (July 2002), said of the next slump, "the seeds are being sown now, the mechanism will be the behaviour of land, and the timing – well, probably around seven years hence."
[b] "Practical Politics", Issue No. 29 (July 1992), and Uncoloured Supplement No. 2 distributed with Issue No. 161 (January 2008) [c] Harry Wilson and Helia Ebrahimi, "Daily Telegraph", 10th. June [d] Jeremy Warner, "Daily Telegraph", 27th. May [e] Ambrose Evans-Pritchard, "Daily Telegraph", 18th. May, 24th. May, 28th. May, 31st. May [f] Roger Bootle, "Daily Telegraph", 3rd. May [g] Neil Hume, "Financial Times", 22nd. May [h] This piece originally appeared in Issue No. 29 of "Practical Politics" (July 1992).

INDIA

We have described how the Conservative government, shortly before the prorogation of Parliament in 1997, was contemplating collecting land value for public revenue purposes in this country [j]. We later described how the subsequent Labour government organised and carried out that policy [k]. The scheme was to auction part of the air waves. The radio spectrum is classed as land in economic analysis, the air being part of the natural order outside of man and his products. In the end, after 150 rounds of bidding, spread over 8 weeks, 5 companies each won a 20-year licence to use part of that radio spectrum. The proceeds totalled £22,500,000,000 (£1,125,000,000 per annum on simple linear division). The winners were able to offer what were called third generation mobile phone services. The auction receipts were a legitimate rent, capitalised over 20 years, for the right to enjoy exclusive use, over that period, of a natural resource – a small part of the radio spectrum. It was not without hitch (easily avoidable another time), but it has worked and is bringing in money still. If a thin slice of air spectrum was worth £1,125,000,000 per annum, how vast must be the yield from the nation's land area! Germany was sufficiently impressed to follow suit. India has now done so too, auctioning third generation (3G) spectrum licences for nine Indian regions to Vodafone and other operators for "almost $15bn (£10.4bn), more than the amount analysts expected" [m]. India ought now to go beyond that, and apply the LVT principle to the nation's land surface.

AFGHANISTAN

"The Afghan government claims its untapped mineral wealth could be worth £2,040 billion and is preparing a drive to drum up interest from international mining firms…India and China are expected to be particularly interested in exploiting the deposits of copper, iron, lithium, gold, niobium, mercury, cobalt, and other minerals…Mining experts cautioned that the figures were speculative and the country lacked the infrastructure or legal framework to attract investors" [n]. Clearly this is a country with a potentially bright future. Before we rush to suggest secondment of qualified land valuers we wonder what thoughts have been passing through the minds of the world's political leaders, diplomats, and military chiefs.

[j] "Practical Politics", Issue No. 70 (April 1997) [k] "Practical Politics", Issue No. 97 (May 2000) [m] "Daily Telegraph", 20th. May [n] Ben Farmer, "Daily Telegraph", 18th. June

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