PRACTICAL POLITICS

September 2012 Issue No. 199

Since our Issue No. 198, the ***depression*** *has dragged on unabated. Speeches have been made, meetings have been held and conferences attended, sometimes against a background of marches and rioting in the streets, but still there is no solution in sight. The old solutions work no better now than they did when tried before…*

It was inevitable that sooner or later Protection would rear its head. Why, though, should any government, anywhere, want to make goods expensive for its people, especially in times of hardship like these? Again, many imports are of raw materials or are components required by home manufacturers. As a nation, we are all of us consumers, and as such we all gain from the widest choice of goods from which to select the combination of quality and price that suits our needs. As producers, though, we are divided. We gain if our own products are expensive and everyone else's are cheap. We see there is more profit to be made from a successful day's lobbying of politicians and civil servants than from weeks of work in the research laboratory or in the factory or on the farm. Fortunately there is evidence that the more enlightened commentators are ready to rally round the Free Trade flag. Some have even noticed that the EU is a protectionist trading bloc.

"Bizarrely, the EU remains by far our most important trading partner, as it has for 40 years, and we are bound into its antiquated and destructive customs union. This must change if Britain is to start exporting itself back to prosperity: we need to re-embrace the world and reduce our involvement with the EU, economically and politically…It is no longer plausible, at a time of the eurozone in crisis, to argue Britain's future is European rather than global" [a]

Countries that import to expand or sustain their standard of living but do not pay their way can, for a while, live beyond their means by running big current account deficits, borrowing from abroad "to square the circle. In effect, the surplus country lends the deficit country the money to buy its goods. During the boom, German banks were happy to do this. Come the bust, they understandably stopped. Since then, the deficits have been sustained via the backdoor of the ECB printing press and bail-outs from the eurozone and IMF". In the ordinary way, the imbalances would have been corrected "through the natural mechanism of free-floating exchange rates" [b] whereby deficit nations would devalue their currencies, both raising the cost of imports and making their own goods cheaper for others. In a monetary union, however, this cannot happen. "I don't suppose that *Götterdämmerung* is imminent…but the end is approaching inexorably" [c]. Poor € – a born flop.

Much of the recent interest has been focused on **Spain**. There have been questions on the quality of bank loans made to real estate developers and in areas such as home mortgages. "Sceptics report that Spanish banks have often failed to mark property values to market prices, and point to the common practice of restructuring loans, extending them over longer periods with lower interest rates without recognising that forbearance in the accounts. That has made mortgage books look better than they really are, and kept alive 'zombie' property developers to spare banks the financial hit of a default" [d]. Spain's authorities are in denial, and underestimate the problem. To make matters worse, "Spanish banks borrowed €315bn from the ECB under the long-term refinancing operation ("LTRO") and parked a large chunk in Spanish two-year to five-year sovereign bonds…The two-year bond has shed 9pc in face value…leaving the banks heavily under water" [e]. Later, the five-year bond fell too. Spain's regional governments, meanwhile, line up for internal rescues, with Valencia, Murcia, and Catalonia in the van.

The latest eurozone country to hit trouble is **Cyprus** (not North Cyprus, which is supported by Turkey). Cyprus requires help because of "its large exposure in the Greek economy" [f]. "International lenders…found the economy in a worse state than expected" [g]. "Locked out of the debt markets and…under pressure to find money to help to recapitalise its banks" [h], Cyprus is reported to have approached Russia for a further loan of €5bn (having already received one of €2.5bn from that source last year), and to have sought a loan from China too. Now, why would either be interested?

"**Germany** is in an extremely difficult position. Bundesbank support for fellow central banks in southern Europe and Ireland through the ECB's internal Target2 payments system has rocketed to €699bn, mostly to cover capital flight and emergency liquidity support for lenders" [e].

By contrast, two nations not only outside the eurozone but outside the EU itself, have news of a different kind to report. "**Switzerland**'s two-year bond yields are at -0.36 per cent…meaning in effect that investors are willing to pay…to be guaranteed the return of their money in two years", and coughing up what amounts to a safe custody charge for the privilege. Danish and German two-year bonds are also negative, but, at -0.25 and -0.07 respectively, are not at the Swiss level. **Norway**'s oil fund, Norges Bank Investment Management, which has a market value of more than $600bn (see our Issue No. 198), was wondering "how safe banks were if customers were balking at parking cash with them…The oil fund continued its shift away from European investments, revealing that it had sold down government bonds from a variety of countries including the UK and France as well as the peripheral European countries" [j]. Middle East sheiks, Russian oligarchs, Chinese on the make, and of course the slick in the eurozone, will likewise be pulling their money out as fast as EU and IMF 'rescue' funds are pumped in.

LITTLE BITS

(i) "The **Isle of Man**, condemned in 2008 by Alistair Darling [the then Chancellor of the Exchequer] as a 'tax haven sitting in the Irish Sea', makes a positive contribution to the British economy and particularly the City of London" [k], according to a report for the Manx government by Ernst & Young. "Because of its low-tax status" it has become "a popular place for emerging market companies…Some 15 are from India, China and Brazil...Without the Isle of Man's involvement…as a conduit sending overseas investment and cash into the City" such investment "might have been diverted elsewhere", to the detriment of the U.K. Of course, **with the annual rental value of land fully and properly collected by Her Majesty's Government in place of current taxes on work, production, trading, spending, and saving, the U.K. would be irresistibly attractive to overseas investors as well as to its own citizens. As things are, we pay once to acquire the use of a piece of land, and then pay all over again to fund government expenditure.** Nuts!

(ii) Agreement has been reached in principle for a 'highly complex' restructuring of **UK Coal**. "The company owes its customers and banks £138.3m but has a market capitalisation of less than £25m. The deal would split UK Coal in two, with one arm running its mines…and the other its property division". The pension fund "is about £430m in deficit". Four power customers "agreed to offer funding support". Harworth Estates, UK Coal's property arm, "has 30,000 acres of land and other property valued at about £272m" [k]. We did note the deal was 'highly complex', and indeed we have recorded only part of it here, but enough, we think, to show how much more valuable it is proving for this company to be holding land rather than doing something useful like digging up coal.

(iii) "English **farmland** has soared in value…by more than 10,000 per cent in the past 60 years" [m]. Land values really took off in the 1970s, "rising by 390 per cent between 1972 and 1982". "A key factor was the **UK** joining the European Community in 1973, allowing farmers to benefit from the common agricultural policy and farm subsidies". This is not true. The beneficiaries were and are the owners of farm land, as leaseholders have found out and as those with short-term tenancies have always known. So-called investors started to buy into the farmland market, attracted by tax advantages, "rising soft commodity prices and the drive to find sustainable alternative fuel sources". All a landowner has to do is sit, watch, and count unearned gains. It is even better if he can sell for higher development, like housing.

(iv) "Confidence in the sustained growth of the **real estate** industry is high in the **Philippines**. From residential to tourism to office, all areas are witnessing surging demand. The Philippines has one of the highest urban growth rates in the developing world" [n]. Pride? Fall? Ouch!

FALKLAND ISLANDS, ARGENTINA, VENEZUELA, SPAIN, ITALY, FRANCE, U.S.A. – ALL MUCH STIRRED AND MIXED IN OIL POLITICS

On and off over the years, oil companies, big and small, have studied the waters around the Falkland Islands and wondered whether there is a bonanza of recoverable oil there somewhere, or do those challenging depths merely hide a few uneconomic deposits? Until recently, attempts to find a big oil or gas field have been unrewarded [p].

Argentina had a massive $100bn sovereign default in 2001, the legacy of which still hangs over the country. YPF, the Argentine oil company, has been renationalised, to the chagrin of Spain whose energy flagship, Repsol, had a controlling 57% stake in YPF. Argentina sits on reserves of shale gas that will need many times YPF's annual dividend of $1.2bn to develop, and major investors are not exactly rushing to sign up. The overall effect is of bad blood between Spain and Argentina and to have made Spain something of an ally of the U.K. on the Falklands issue. Repsol said YPF had accounted for a third of its investments and a quarter of its operating profits.

The U.K. company, Falkland Oil and Gas Ltd. (FOGL), drilling in the waters around the islands, announced that Edison, an Italian energy group now taken over by France's EDF, had become its partner in a farm-out agreement. There is seemingly the prospect of a European market for the liquefied natural gas (LNG) which the partnership is hoping to produce. The plot thickens as Venezuela announced its state oil giant, PDVSA, would team up with Argentina to search for oil in waters neighbouring the Falklands; and Texas-based Noble Energy became the first U.S. company to sign an exploration deal in the region, with FOGL (as noted above, EDF had already bought into FOGL's licences earlier this year).

Oil and gas under the ground or seabed are natural resources, denominated as land in political economy. On *terra firma* there need be no valuation problem for LVT purposes. Offshore, exploration and production licences in a rough way recognise the principle. Carefully refined, justice to the public and to producers who find the oil and gas, bring them to the surface, and prepare them for distribution, is achievable. LVT could be built into an international settlement – but in this case!?

[a] Allister Heath (Editor, "City A.M."), "Daily Telegraph", 8th. August [b] Jeremy Warner, "Daily Telegraph", 13th. April [c] Roger Bootle, "Daily Telegraph", 25th. June [d] Victor Mallet and Patrick Jenkins, "Financial Times", 23rd. June [e] Ambrose Evans-Pritchard, "Daily Telegraph", 24th. July, 13th. June [f] Louise Armitstead, "Daily Telegraph", 26th. June [g] "Daily Telegraph", 7th. August [h] Emma Rowley, "Daily Telegraph", 13th. June [j] Richard Milne, "Financial Times", 11th. August [k] Andrew Bounds, "Financial Times", 2nd. June, 11th. August [m] Lucy Warwick-Ching, "Financial Times", 2nd. June [n] PM Communications (produced by PMC Ltd., London, W.1), 5th. June [p] This piece drew on information from articles by the following:- Jude Webber and John Paul Rathbone, "Financial Times", 21st. April; Ambrose Evans-Pritchard, "Daily Telegraph", 13th. April; Jude Webber and Miles Johnson, "Financial Times", 14th. April; Louise Armitstead, "Daily Telegraph", 18th. April; Rebecca Bream, "Financial Times", 30th. June; and Emily Gosden, "Daily Telegraph", 7th. August

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Published by the Land Value Taxation Campaign,
54, Woodway, Hutton, Brentwood, Essex, CM13 2JR,
and distributed free to selected members of both Houses of Parliament, of the European Parliament, of the Scottish Parliament, the National Assembly for Wales, and the Northern Ireland Assembly.

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