PRACTICAL POLITICS

April 2008 Issue No. 164

DENIAL, BELITTLEMENT, BEWILDERMENT, PAIN

In our Issue No. 159, in July 2002, we forecast the next slump would arrive in around seven years' time. When the early signs were noted last year, they were widely overlooked or seen as little local difficulties. Next came awareness that matters were indeed going awry, but it was all confined comfortably to sub-prime housing mortgages and a few banks, mostly in the U.S.A. Then it became obvious that it was spreading – geographically, more deeply into housing markets, and indeed into the wider reaches of world economic activity. There are still those in denial, believing, in public at least, that it is really a little blip that will be over by the autumn. For most, though, the pain has yet to come; but come it will, next year.

In our own country, RBS and HBOS have announced steps to repair ("strengthen" is the polite term) damaged balance sheets by means of rights issues. The Bank of England has devised a neat scheme to provide succour to banks that have liquidity problems but still have quality assets they can pledge. Will this £50 thousand million arrangement be big enough, though? What happens when supplicants run out of AAA assets? When does a haircut become a scalping?

How does it come about?

The depression the U.K. is on the verge of entering, may be part of a general trend amongst nations with developed economies, but it is not something imported from foreigners. In essence, it is home grown. Ripples from overseas trading partners who had brought about their own collapses would inevitably have had some repercussions here; but that is no justification for us to have engineered a disaster of our own. Erroneous economic analysis translated into poor politics, lies behind our ills.

The cardinal mistake is to fail to distinguish land from wealth. In political economy, land is not wealth. Land is defined as the whole of the material universe apart from man and his products. Land is not man-made. Wealth, by contrast, is made by man, working on land and fashioning the Earth's natural resources to produce goods, both consumer goods and capital goods. It is of course true that land can be bought and sold, like a man-made commodity, but that does not make it wealth in the sense given to the term in economics.

Land is fixed in both quantity and location. Each location, each parcel, site, or piece of land, is unique – a natural monopoly, in fact. When there is a shortage of a man-made commodity, more can be rushed in from elsewhere or manufactured locally. Land, however, is not reproducible, nor can it be moved from where it has little value to where it is in great demand. The market simply does not work with land in the way it does with manufactured goods. When land in a particular location is rising rapidly in value, all it can do is go on rising, because that is the only response of which it is capable.

The land value of a site reflects the natural and social advantages which it enjoys in relation to all other sites. This is expressed in an income stream, called its annual rental value or, simply, rent. Rent is the value of the land in current conditions. When land is bought, the buyer is paying a price which is greater than the mere capitalisation of that rent, however. He is being asked to anticipate future increases in rental value, paying to-day for the right to to-morrow's rent. More than that, he is speculating, buying "hope" value – increased land value resulting from population growth and movement, from economic progress and development, and, often supremely, from acts of public policy, infrastructure developments, and possible reallocation of land to higher planning use. Thus the capital (buying/selling) value of land is way out of line with the much more stable rental value, and is self-evidently prone to violent swings. Yet it is the unreliable, swollen capital value of land which banks and similar institutional lenders are accepting as collateral for loans (including mortgages, of course) and it is those same bloated capital values that borrowers are relying on for retirement savings and a free-and-easy current life style.

Land is the key factor behind it all. It is consistently ignored by academics, commentators, business economists, and politicians, who insist on covering it up by writing and talking of housing when they must know they mean housing land, or by use of generalised terms such as property, assets, and equity. Land is not man-made, but the free gift of Nature or the Creator. It does not behave in the same way as man-made goods do. Its capitalised value (price) is a trap, a moving illusion at the core of the boom/bust cycle [please see Uncoloured Supplement No. 2, distributed with Issue No. 161].

Some recent developments

"As a share of their total loan book, [U.K.] banks' lending secured on commercial property is at record levels" [a]. "Office lettings in central London fell by almost a third over the past six months as companies scaled down staffing needs and froze office searches because of economic uncertainty" [b]. "The retail sector has been hit hard, and this year will offer mixed fortunes for investors in the nation's shops…The pain has been sharp, deep and felt on every high street” [c]. “The services sector…is also facing a major slowdown …The outlook for the construction sector is the worst in over a decade” [d]. “Housebuilders Taylor Wimpey and Barratt admitted halting much of their land-buying operations” [e].

“Swiss bank UBS is planning a £8bn rights issue…America’s Lehman Brothers has also announced a rights issue. Other lenders have had capital injections from sovereign wealth funds” [f]. “International banks are scrambling to sell their holdings of Spanish mortgage debt at deep discount, fearing that the country may be sliding into the worst economic downturn in its modern history…Developers owe €290bn to the banks and lenders, known as cajas” [g]. “Many small and medium-sized builders and real estate groups are going bust…Some of Spain’s biggest real estate groups…have been locked in negotiations with creditors to stave off bankruptcy” [h]. “Confidence at major Japanese manufacturers fell to its lowest in more than four years…Many companies are looking to scale down spending on new equipment and factories” [i].

[a] Roger Bootle, “Daily Telegraph”, 25th. February [b] Lucy Killgren, “Financial Times”, 12th. April [c] Chris Bourke, “Estates Gazette”, 1st. March [d] Edmund Conway, “Daily Telegraph”, 1st. April [e] Lucy Barnard, “Estates Gazette”, 5th. April [f] Katherine Griffiths and others, “Daily Telegraph”, 18th. April [g] Ambrose Evans-Pritchard, “Daily Telegraph”, 4th. April [h] Leslie Crawford, “Financial Times”, 29th. March [i] “Daily Telegraph”, 2nd. April

LAND LICENSED IN THE RADIO SPECTRUM

In our Issues Nos. 70, 97, 100, and 123, we have reported and discussed developments in the U.K. and in Germany in respect of the use of the radio spectrum. In particular, we have stressed that the air is, in political economy, classed as land, being part of the material universe distinct from man and his products. Now we learn that, “In the US, the coveted 700MHz spectrum will become available in mid 2009 when TV broadcasters switch from analogue to digital transmissions. The auction of the spectrum raised $19.6bn for the US treasury” (Paul Taylor, “Financial Times”, 5th. April). “AT&T and Verizon Wireless won the bulk of the new licences, spending a combined $16bn. Other winners included Qualcomm, the mobile chip maker, which paid $554.6m for five licences”. Both companies intend to use the band to build new 4G networks “based on…the favoured next generation technology…The new US networks will start to be built in 2010 – about the same time that operators in Europe and Asia…plan similar initiatives.”

This is a further interesting development of the way in which the benefits of the air above can be devoted to the common good. The Crown Estate owns the rights to the seabed. Why not bring the concept to *terra firma* as well and treat it too as common property? Can LVT be far behind?

TAXING TIME FOR TAXES

The Government is not having a good time with taxes and budgets at present. The “non doms” are starting to walk away. The rate of corporation tax has already induced some companies to base themselves in the Republic of Ireland. The row over the 10% income tax band showed unpreparedness and lack of dexterity in reacting. The changes to capital gains tax had not been thought through, either, and the law of unintended consequences rose up again: indeed, for the forgotten ordinary investor, the abolition of indexing and tapering, coupled with the inflationary outlook, will soon more than negate the lower percentage levy and make this measure, in effect, one of retrospective taxation. Meanwhile the Treasury profits from its massive *ad valorem* tax takes from petroleum production and petroleum products – a fact of which, at last, the public is beginning to take notice. A great nation can assuredly do better than this: the sooner LVT is adopted, the better.

TOUGHER TIMES FOR MORTGAGE FRAUDSTERS

The bursting land bubble is putting one set of undesirables out of business. The Financial Services Authority has “hundreds of cases…in its sights” (Daniel Thomas, “Financial Times”, 23rd. February). Criminals used false, high valuations to obtain mortgages, paid the true price to obtain the properties, and disappeared with the profits, typically “£45,000 per property”. With full LVT there is no bubble, and only the man-made house to buy.

HISTORY IN A NUTSHELL

“Millions of immigrants fled from Europe, where land was expensive and wages were low, to America, where land was cheap and wages were high. As land prices rose and wages fell in the East, settlers underwent great hardship to find affordable land in the West...Now that the frontier is long gone and land has become more and more expensive, how will ordinary people find the American dream?” (Council of Georgist Organizations, Evanston, Illinois, April 2008).

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