The “Practical Politics”

UNCOLOURED SUPPLEMENT

No. 3

FROM BOOM TO SLUMP

The feature, “Landing In Trouble”, which first appeared in “Practical Politics”, Issue No. 29, in July 1992, was reproduced in the “Practical Politics” Uncoloured Supplement No. 2, and was distributed last month (January 2008) with Issue No. 161 of “Practical Politics”.

In September 2002 the Land Value Taxation Campaign published a second edition of its booklet, “Crash Course” (first published in June 1993), which reproduced “Landing In Trouble” with some of the accompanying material revised. The revisions included a special new post-script, covering the decade to 2002, the text of which is set out below, exactly as published in 2002.

It is preceded by a piece from Issue No. 28 of “Practical Politics”, June 1992, which is a summary of our predictions and comments on the slump of that year, under the heading “How Deep? How Long?”.

Finally comes a selection of material from more recent Issues of “Practical Politics”.

LANDING IN TROUBLE……THEN LANDING IN TROUBLE AGAIN

HOW DEEP? HOW LONG? (from “Practical Politics”, Issue No. 28, June 1992)

With Mountleigh in receivership and Olympia & York in administration, we may say that the slump is now on – choose what euphemism you will. The triumphalism of “we told you so” is an uncomfortable charge which we wish to avoid, for in truth we derive no pleasure from this eventuality. Nevertheless, because of our stance on land and its value, we feel entitled to point out that, in Issue No. 3, in April 1989, long before any establishment forecaster could spot even a blip, we reported that “the bad times are coming”, and outlined how soaring land prices turn boom to disaster. “Speculative land values have been used to justify a credit buying spree", we said. "When their [builders'] present land banks are used up, in about two years' time, there will be massive lay-offs. With high interest rates and mounting unemployment, there will be diminished spending in the shops. Lower spending means lower production, so factories will lay off men".

In the following Issue, No. 4, we specifically wrote of "the crash of '92", saying "it could well be the worst since the War". We noted that, "Low interest rates coupled with a rosy view of economic growth led to a rise in land prices which far outstripped current viability. The Government's policies of slowing down growth coupled with its pledge to limit inflation will ensure that many businesses will fail through this overcommitment". Our prediction was right on target. This is June 1992. Our piece concluded, "We know the solution. It is to end speculation in land values. We know the only way to do that is to shift the burden of taxation from goods, services and effort onto those land values".

In Issue No. 5, we cited a newspaper article which claimed that "Even now [April 1989] the vast majority of homeowners have a property worth far more than the debt it supports…Most people can afford to borrow more, and the lenders are queuing up". It was, of course, the phenomenal rise in housing land prices which was underpinning credit expansion. We called this investment in land unproductive. If land values were collected for the public revenue, resources would become available for useful capital formation instead. "Money would be made from real wealth creation, not from the mere holding of pieces of land". We returned to this theme of saving and spending in Issue No. 14.

In Issue No. 8 (March 1990) we predicted that the bubble would burst in Japan too. We had not reported on the U.S.A., because we thought the financial crisis of the "thrifts" (building societies) was already widely known. There was more on the U.K. and Japan in Issue No. 10. Here we saw inflation (cranking out money on the printing press) as an alternative to continued high interest rates and default on debt repayments, but joining the EMS and adopting a virtually fixed exchange rate was to remove that dubious option. Issue No. 11 came out two years ago, in June 1990, when it was still rare to read of trouble ahead, but we noted, "the land boom has peaked; profits are starting to fall; the effect is creeping from the construction industry to banks who have advanced funds so uncritically; to suppliers of fixtures, fittings, and furnishings; and to advertising, car sales, and retailing". By Issue No. 13 (November 1990) we were able to record a belated awareness among the establishment that all might not be well, but, because of the continuing reluctance to admit anything more than a mild set-back, we found it necessary in May 1991, Issue No. 19, to warn, "This depression has longer to run and deeper to go". Earlier, in Issue No. 16, we castigated the Treasury forecasters for having no representation of land in their computer model of the U.K. economy.

By Issue No. 22, in November 1991, when we recorded the crisis in the Scandinavian banking sector arising from land speculation and the binge in lending to property companies, we were finally able to report that scarcely any independent forecaster saw recovery before 1993. "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". As we were further to observe in Issue No. 26, "Decisions in other areas (monetary policy, for example) certainly affect the course which booms and slumps take, but the cause of the cycle must be sought in the unique behaviour of land".

POST-SCRIPT: THE DECADE TO 2002 (from "Crash Course", September 2002)

Recovery from the slump has been patchy, protracted, or, in the sad case of Japan, scant. The U.S.A. was first out of the worst trouble. The U.K. followed, after it removed the straitjacket of the EC's ERM in September 1992. As noted in Issue No. 36, "exchange rates and interest rates are both down. Unemployment, though, remains high. With huge deficit spending, the budget is way, way out of balance." Privatisation receipts and income from North Sea oil and gas were devoted to reducing the gap on the revenue account. Thus did the crash destroy potential capital investment by HMG in public services and the infrastructure. Private businesses which in the giddy boom years of 1986-1989 had ignored the leaps and bounds of speculative land prices, were certainly having to retrench as a result of the drop in demand for their products, but were managing to ride out the recession. Others, who had gone a-borrowing on the strength of over-valued land holdings, who had developed over-ambitiously, who had taken up properties at the height of the boom, were now badly caught. As we noted in Issue No. 45 (May 1994), "Trade and turnover are down, profits meagre or non-existent. Cuts have been made…For years ahead, many businesses are committed to paying far more than their properties are currently worth, far more than they could sub-let them for."

Not only were the over-borrowed in deep trouble. Lenders were faced with a huge hangover of what had now become unsecured debt. As one instance of this, we recorded in Issue No. 63 (June 1996), the "bombed out Paris property market". Bad loans were being offloaded and the resultant losses taken by stricken lenders on their balance sheets.

By mid 1998, the U.S.A. and U.K. had largely pulled away from the bottom of the depression, and Europe was beginning to do so; but Japan was still trapped deep in its slump. "Japan had had a long-running speculative build-up to truly absurd land price levels by 1992, and thus suffered the severest of crashes when the bubble did finally burst. Worse, Japanese landowners prolong the slump, declining to lower rents and prices to realistic levels. In this they are abetted by desperate banks, who extended credit on the false security of swollen land values and now tremble as revaluation of their collateral reveals how much bad debt they are carrying, and exposes their technical insolvency. Now other Far Eastern economies have collapsed: South Korea, Thailand, and Malaysia have all had the classic symptoms of boom, land speculation, over-building to justify the rising cost of over-priced land, over-lending by banks against the illusory security of spiralling land values, and finally the burst" (Issue No. 82, November 1998).

Commentators increasingly did point to land speculation as the underlying cause of Japan’s woes, but many muddied the analysis by lumping land in with capital, to write of property, of assets, of investment, or of fixed capital investment – all of which take the bookkeeper’s view, which will not do when it comes to political economy. Meanwhile, our pages logged the fate of Japan’s crazy land boom – bad loans and bankruptcies (Issues Nos. 41 and 63) stemming from “the late 1980s, a time when the theoretical value of the land in Tokyo was more than that of the entire United States”; the perverse operation of the tax system (Nos. 50 and 90); the financial black hole so great that it was a threat to the government’s credit worthiness (Nos. 54 and 95); the way opportunities were opening to the yakuza gangster organisations (No. 61); the seeming endlessness of it all (Nos. 105 and 110) as (No. 111) banks who had “lent huge sums against wealth that never really existed” find “they cannot collect on their loans and dare not lend more, so struggling firms, starved of capital, go under, jobs are lost, spending falls, more jobs go”.

A BBC2 television programme, “Bubble Trouble”, broadcast on 9th. January 2000, was a revelation. “At last, the vital rôle of land in the boom/slump cycle was unequivocally stated and repeatedly emphasised”, we wrote (Issue No. 93). “An article by Jon Ashworth in “The Times” of 7th. January turned out to be a preview of the broadcast: “The appetite for land proved insatiable. Land, for the Japanese, was the safest of all investments; better even than gold. Land prices had never gone down and could never go down. As prices rippled out from Tokyo, farmers and smallholders, too, became millionaires. About 50 per cent of Japanese owned their own land and felt richer than ever before…but the rise in land values masked the real picture…Those on the housing ladder grew rich. For families left behind, buying a house or a flat was farther and farther out of reach or might require a 100-year mortgage…Much of Japan’s cheap loans had been advanced using land as collateral. As property prices fell, the banks swiftly realised that the loans could never be recovered…Businesses discovered that the land against which they had been encouraged to borrow so heavily was suddenly worth, perhaps, a third of its former value. By the late 1990s…in one year 17,000 small businesses went bankrupt”. Japan is the worst case, but the analysis applies world-wide.

Not only Japan has much to learn. We drew attention to a journalistic example from “The Times” in Issue No. 112, and there was another fine illustration in “The Guardian” of 21st. February 2002. Professor Patrick Minford was more robust, saying in the “Financial Times” of 8th. April 2002, “Keynesian prescriptions were duly written out by visiting Westerners. The Japanese government followed them; interest rates are now zero, public debt has soared to over 100pc of GDP, and a mass of capital has been injected into the banks. Plainly none of it has worked.” Michiyo Nakamoto reported (“Financial Times”, 8th. June 2002) that “The latest plan is to lower tax rates but collect from a wider base.” No description of this “wider base” was offered, nor was one told why it should prove effective.

What is hurtful about a slump is that bits of baby go swirling down with the bath-water. Unfortunately there is no correct or painless way out. In so far as there is governmental choice, it is a matter of the form of pain to inflict and therefore of who the prime sufferers shall be. The only answer to a slump is not to have one in the first place; and that is to be achieved by avoidance of a boom founded on illusory, speculative land values. The seeds of the next crash are already being sown (Issue No. 116, July 2002). There is still time to act. Is there the will?

FURTHER EXCERPTS FROM "PRACTICAL POLITICS"

THE HOW AND WHEN OF THE NEXT SLUMP (Issue No. 116, July 2002)

The past

"Almost every economist and forecaster reckoned a year ago that 1999 would see a recession", wrote Tim Martin in the "Daily Telegraph" of 7th. February 2000, by which time it had become clear it had been a false alarm. "Practical Politics" had been sure, however, that the forecasters were wrong: "The country is not about to enter a slump" (Issue No. 82, November 1998). In the prevailing gloom of mid 2002, we make a fuller citation from our earlier article:-

"1998 is not a re-run of 1992. It is more 1987 revisited, but with new undercurrents. The economic collapse that was signalled unmistakably in June 1992 followed a boom of several years in the late 1980s, characterised by feverish speculative activity in the land market. The course this took was analysed in "Landing In Trouble" in our Issue No. 29. By contrast, 1987 was a stock market correction, a sharp and severe fall in the price of overvalued shares, but no more than a blip in the fool progress of the real economy, which continued for a while to spiral upwards, eventually to peak and, in 1992, to crash out of control.

1998 is similarly seeing a correction of an over-valued stock market (the bears coming on at the end of the bull run), but there are important differences from 1987. 1987 occurred as the economic cycle was moving towards its peak, and Japan and the developed western world were travelling in heedless concert. By mid 1998, the U.S.A. and U.K. had already pulled away from the bottom of the depression, but Europe was only beginning to do so, with Japan still trapped deep in its slump. There is no crazed, land-driven speculative boom."

In 1998 the complications came from the East. Japan had been joined by South Korea, Thailand, and Malaysia, who had all had the classic symptoms of boom, land speculation, over-building to justify the rising cost of over-priced land, over-lending by banks against the illusory security of spiralling land values, and finally the burst. "Weakened western economies must withstand the wash" we wrote. "Provided their governments do nothing unusually foolish, though, the bear markets will bring grief but not a slump".

The present

In 2002, there is again a bear market, with correction of over-valued stock (particularly the “dot com” companies) and scares that in the aftermath there have been over-zealous attempts to “massage” corporate accounts and so conceal loss for long enough for it to mutate to catastrophe. Every cloud now has a darker lining. There is international terrorism. There is Argentina. Japan languishes in its decade-long trough. The U.S.A. is running a huge budget deficit, and so are several EU countries. There is particular and justified concern in the U.K. that parts of the housing market are, as the saying goes, “over-heating”, with prices rising unsustainably, and too much consumer spending based on the false comfort of the rising value of housing land. This indeed is potentially an indicator of a coming depression, but it is too limited in scope to provoke a general slump. In any case, agricultural, industrial, retail, office, and commercial land generally, are not in febrile, speculative grip. Neither here nor abroad is there a trade cycle reaching its peak and fit to burst. Thus, although some will face pain from over-enthusiasm for new technologies and from unwise indebtedness, the nation is not about to plunge in to general economic recession. This is not a re-run of 1992.

The future

In the U.K., government spending is rising at the very time that the consumer mini-boom is about to come unstuck. Despite pretending to have put or kept some components of public expenditure off the government’s books of account, HMG is walking into greater and greater commitments – in the social services, health, education, policing, transport, defence. Constraints on the productive economy, imposed by the EU and from Westminster, are starting to be felt. Dwindling receipts and increasing outgoings can be juggled only for a year or two. Expenditure cuts prove hard to make. Higher interest rates make people think of horses, locks, and stable doors, and in any case they squeeze and inhibit the wealth creators. Tax increases are unpopular (especially with another Election in the offing). Thus the seductive solution of currency debasement beckons. This is called, politely, increased government borrowing; but in fact it is inflation – meeting the bills by causing the requisite currency notes to be printed (at the cost in materials and labour of about 3p each).

Inflation is a dangerously mischievous device. Money can no longer be relied upon to keep its purchasing power. People then begin to look for something that will. Land, irreproducible and immovable, is the perfect “hedge”. Those who can not or will not recognise the difference between capital and land in political economy, talk of “property values” or “asset values”, but what really rises is land value. When money is pumped into circulation, banks want to lend it. Borrowers can point to rising land value as collateral for a loan. Businesses and individuals save less and spend more. Spend before money loses its value! Why save when land values keep going up and doing one’s saving for one?

Expansion breeds exuberance. The speculative frenzy and the crucial rôle played by land are explained in our article in Issue No. 29 (already referred to, above). 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. Be that as it may, the seeds are being sown now, the mechanism will be the behaviour of land, and the timing – well, probably around seven years hence.

"This boom and bust cycle remains an unsolved problem" (Andrew Crockett, general manager of the Bank for International Settlements, quoted by Ed Crooks and Peronet Despeignes, "Financial Times", 22nd. June). The problem is not unsolved. Rather do Mr. Crockett and his friends prefer to go on as if it were unsolved. For the Last Word, we cite again from "Practical Politics", Issue No. 29:-

"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."

A WORRIED WORLD (Issue No. 156, April 2007)

With the CPI now at 3.1% and the RPI up at 4.8%, the U.K. has reason to start worrying. "Many people have been buying [commercial property] assets with a lower yield than their cost of borrowing" [a]. "Investors are supposed to look forward but…most…look back – and assume that the future will be like the past" [b]. "Buyers may be paying too much for a given income stream…encouraged by past price rises" [c]. "There is probably a lot of speculation built into the housing market…on the belief that prices will go on rising smartly [d]. "With remortgaging for loan consolidation and equity withdrawal to support lifestyles…the die is cast [e]. "Britain now has the worst inflation in the G7 and…the worst 'fiscal profile' in the OECD, bar Japan" [f].

Remember the "thrifts" (U.S. equivalent of building societies) in the 1980s? Well, something similar is happening again in the home mortgage markets. "There has been a "wave of defaults in the sub-prime tier of America's property market" which "is spreading up the chain to the much-bigger prime sector" [g]. "The biggest problem in the US right now is the melt down in the housing market which hits hard at consumer wealth, which is based so precariously on debt raised against housing equity" [h]. "The slump in the housing market has caused a marked slowdown in overall economic growth…Business investment has been surprisingly weak." [i].

"Dublin may be joining the bloc of southern European states stressed by monetary union…EMU membership has distorted the economy and caused a property bubble. Personal debt per capita has reached 190pc of GDP, the highest in the developed world…Germany is at the opposite end of the cycle, starting to grow briskly after a decade of flat house prices" [j]. "French house prices have shot up by 210pc since 1995…much to the delight of 180,000 Britons with second homes across la Manche" but "according to France's OFCE research institute house prices are 25pc overvalued" [k]. "Keep an eye on the old Communist bloc…

The markets seem to assume that the Swiss National Bank will keep supplying cheap credit for ever…Switzerland raised interest rates…Hungarians, Poles, Romanians, and Balts most certainly noticed. Their mortgage payments have just gone up again for the seventh time…Latvia's central bank belatedly raised interest rates to 5.5%…still below inflation at 7.3%. Estonia and Lithuania are not much better…Throw in Turkey, Ukraine, and Kazakhstan…and one starts to discern a problem big enough to bother western banks" [l].

China faces "an oversupply of factories and office blocks…living off marginal exports" [m]. "Beijing's control over 170,000 politically-managed state bodies is more fiction than reality...Party officials have already accumulated $800bn in bad debts" [n].

[a] Jim Pickard, "Financial Times", 31st. March [b] [d] [i] Roger Bootle, "Daily Telegraph", 9th. April, 26th. December, and 16th. April [c] Michael Brett, "Estates Gazette", 27th. January [e] Howard Springett, "Daily Telegraph", 5th. March [f] [h] Damian Reece, "Daily Telegraph", 18th. April and 14th. March [g] Ambrose Evans-Pritchard and David Litterick, "Daily Telegraph", 5th. March [j] [k] [l] [m] [n] Ambrose Evans-Pritchard, "Daily Telegraph", 20th. April, 28th. March, 19th. March, 11th. December, and 20th. April

Regular readers are also reminded of the following **PIECES PUBLISHED RECENTLY IN "PRACTICAL POLITICS"** which carry more accounts of current trends and developments and our comments upon them:-

Title	Issue No.	Date	Page(s)
WOBBLY WORLD	158	July 2007	4
DEPRESSION OR NO DEPRESSION? THAT IS THE QUESTION	159	November 2007	1 to 3
DEPRESSION OR NO DEPRESSION?	160	December 2007	2 to 4

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