

What is going on now in the economy is like the progressive collapse of a dam. First, a crack, then a small leak, and over the past twelve months it has turned into a breach with the collapse of a financial giants nearly every day. The US government is now trying to put together a monster rescue of all the bad debt but it is looking as if they cannot afford to do it. What really happened? What should governments do? Where will it end? And then what?

Many are the explanations. Greed. Collapse of confidence. Collapse of trust. But to blame it on greed explains nothing. It is axiomatic that in the world of economics, everyone, all of us, that is, seeks to achieve their objectives with the least effort. Acts of charity and altruism fall outside the economic realm. If perverse incentives exist within the economic system, then people will engage in perverse activities. As has been demonstrated elsewhere on this web site, because of the way the tax system works, the incentives exist for people to lend more money than is wise to people who cannot afford to pay it back, on the security of land whose value has been pumped up by the very same lending practices. These incentives do not need to be put there deliberately. In fact, they are mostly unintentional, but the effect is just the same. Other incentives unintentionally built into the tax system encourage idleness, joblessness, crime, drug dealing and all sorts of anti-social activities.

What should governments do and where will it end? Some argue that if governments stand aside, the collapse of the financial system will have ruinous effects on the economy and lead to widespread public unrest as unemployment takes hold. It will. But bailing-out is either at the expense of the taxpayer or of savers, as the value of the currency dwindles away through inflation. This too will not be without wider social and political consequences. Which is the least-bad course?

What has happened cannot be undone. As mentioned above, at the root of this crisis lies the fact that people have bought land from other people for more than it is now worth, borrowing more money than they could afford to pay back, from banks who used the over-valued land as collateral for the loans. The only cost-free way to put that right would be to write off the debt and *at the same time, recover money from previous landowners* - everything in excess of present values.

Recovering the money overpaid to the previous landowners is of course impossible, though the prompt introduction of land value taxation at a realistic rate would have much the same effect as clawing back the overpayments. But it will not happen. So the cost of the bail-out will fall on taxpayers and savers, whilst former landowners are allowed to hold onto what they should never have received. There will be a surge of inflation in a couple of years' time. That is the price of moral hazard. It is not Keynesianism, which, whatever its faults, at least left behind a legacy of infrastructure of lasting value. This bail-out will just leave behind a wastland, because in the meantime, recession will bite.

What are the causes of that? The root cause is land and buildings being held out of use, causing a bottleneck in the economic process. As every street busker and Big Issue seller knows, nothing can be done without a suitable plot of land on which to conduct the activity. But there is another ingredient to the mix. The economy depends on trust, and confidence in the existence of a market. Only then can people invest actual physical capital by purchasing raw

materials, putting up and refurbishing buildings, and buying machinery and plant. It requires credit. Credit is a "commodity" that has long been in short supply. The word credit comes from the Latin "Credo", which means "I believe", with connotations of faith in something or someone. In the context of business, it means having trust in the person or organisation to whom a loan has been advanced. The original purpose of such credit was to finance, for example, a farmer, from the time the seeds were purchased and sown, to the time when the crop was harvested and sold, at which point the loan was paid off. In such a credit system, there is no need for interest or collateral. The banker of course needs to be paid for the service provided, and there needs to be some system of insurance against default, for example due to crop failure, but there are many ways of ensuring this - futures markets and insurance schemes, for instance, can spread the risk.

Modern finance is the very opposite of credit. It is governed alternately by emotion, with phases of optimism and fear. In the optimism phase, money can be made by moving it hither and thither. The fear phase has arrived. This guarantees that the recession will continue for longer than it need have done. Would it have helped to have had LVT in position? Undoubtedly, because, first, the land price bubble would never have occurred; second, because without the availability of land to be used as collateral, the banking system would have had to go back to the notion of credit as properly understood, making advances on a single criterion: faith in the borrower's ability to pay it back? And third, there would be no withholding of land from the market due to the need to pay the LVT charge regularly. The lack of LVT will further prolong the recession, which looks as if it will be the worst since the 1930s, and what did that lead to? There is no reason to believe that governments will be any better at dealing with this one. Expect turbulent times.