David Blanchflower of the Bank of England's Monetary Policy Committee has repeatedly argued for a cut of interest rates to fend off mass unemployment. But the underlying assumptions are wrong because they are based on defective economic theory. It is not possible to get an economy to function properly just by adjusting interest rates.

A low interest rate will cause a fall in the value of the currency in foreign exchanges, making imports expensive, and this will be reflected in prices of foods and raw materials. On the other hand, a low exchange rate is favourable for exporters and also encourages foreign ownership of land and capital, and may attract inwards investment in productive capacity. But it will also drive up property prices, in reality land values as cheap money encourages borrowing for land purchase.

A high interest rate will attract foreign deposits and have a favourable effect on the exchange rate, making imports cheap but exports relatively expensive. But it will tend to cause unemployment and will also put a check on land values.

It must therefore be obvious that there is never a "right" interest rate in the present dispensation, and to attempt to run an economy by adjusting them is doomed to failure. But what is the real cause of unemployment? "Lack of effective demand" is the usual answer, but that is a circular one because people who are not working cannot exercise demand as they have nothing to offer in the marketplace. At this point it is worth looking at what the process of production consists. There are three factors. Labour, of which there is no shortage. Capital, that is, real physical capital - machines, ships, aircraft, factory, shop and office buildings, etc, which can always be produced. But there is a third factor, one which modern economic theory hardly mentions. Land. Somewhere to conduct the productive activity. Every Big Issue seller and street busker knows the importance of picking the right pitch, but the experts ignore this vital factor.

Recession means a fall in demand. Shops and factories close. Usually, it is the marginal areas that are worst affected - places remote from the main centres of population or with poor access. Some parts of Britain will become industrial wastelands in the next couple of years, just as they did in the early 1980s, with vacant sites, derelict factories and boarded-up shops.

If the land market behaved like markets in, say, perishable foods, the price would drop to market-clearing levels and the sites would quickly be recycled to new uses, for example by redevopment or refubishment. The recession would be no more than a blip, paving the way for a fresh and vigorous new round of economic activity.

But that is not what happens. Because land is permanent and there is no holding cost other than rent foregone, its price does not fall in response to reduced demand. Owners hold it off the market, awaiting the upturn. Which of course prolongs the recession. By the time the vacant sites are brought back into use, buddleias will have grown into sturdy shrubs.

This is why land value taxation is needed - that is, an ad valorem tax on the annual rental value of the land alone. Come a recession and the tax still has to be paid, whether the buildings are in use, vacant or demolished. Owners are under financial pressure to find occupants who will pay the rent, so that they can pay the land value tax charge. If land value taxation is in place, recession is mild and short - the economy quickly bounces back.

So anyone concerned about unemployment needs to be advocating not cuts in interest rates but the prompt implementation of land value taxation.