A COUNTDOWN TO LIFT OFF

STABLE PROPERTY PRICES are crucial to growth. That means a zero rise in land prices. The prices of buildings should not be targetted, for they are part of the economy's output and their prices are encompassed by the low inflation target for product prices. Individual products should be free to vary in price relative to other products according to supply and demand. That goes for the rent of the factor land, too. But land price, a derivative investment asset, should be strictly pinned down.

There are four sources of variation in land prices:

(1) change in rents;

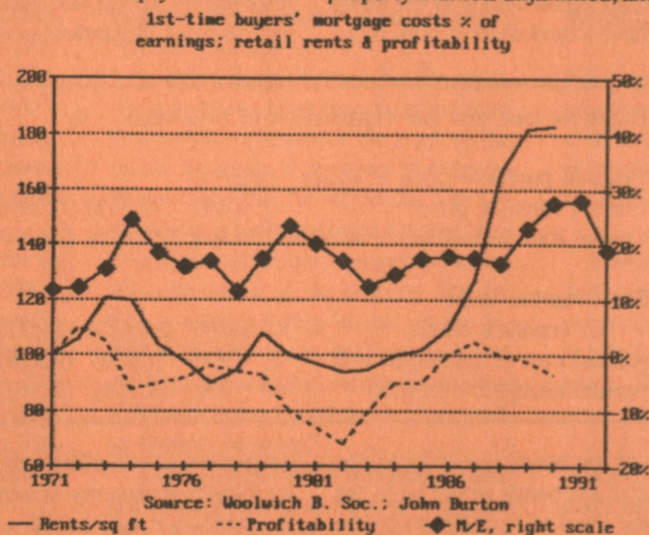
(2) change in real interest rates;

(3) change in the anticipated rate of change of land prices;

(4) change in taxation of land rents.

The first two are primary, the third can be targetted, and the fourth can be manipulated to achieve the target.

Real interest rates are variable in the short term, but rents tend to have a secular upward trend because the overall supply of land remains fixed while the uses for it multiply. Rents tend to rise at a rate even faster than economic growth, because well-located space is a "superior" good to which we devote an increasing share of our incomes as they rise. In the chart (inset), the upward trend of first-time buyers' mortgage costs as a percentage of earnings (M/E:right scale) is not primarily due to rising interest rates. Higher interest rates reduce the prices offered, rather than encourage buyers to take on higher annual repayments.



To prevent a rise in land prices, the rate of tax on land rents must increase over time. In the short term, however - as is now happening throughout the world - it may be that land rents are falling and interest rates are rising. In such circumstances, it may make sense in the short term - if we are trying to stabilise plummeting markets - to reduce land tax rates, in order to stabilise land prices. That is why 1992 is an inappropriate time to dismantle the distortions in the land market. Those distortions, historically, stemmed from the exemption of land from taxation (which was the surest way to stimulate land speculation and generate instability in the markets).

There is, of course, the political consideration. NO time is appropriate for introducing taxation unless politicians are as cunning as doves and as wise as serpents. Times of crisis offer the greatest opportunities for reform. On page 4 we examine one way to lower the price of particular sites today, and that method could have a wider application. Or it could complement other methods, by making zero land price inflation palatable to those with "negative equity".

Another route would be via real interest rates. Prime Minister John Major could give no more firm a declaration of intent to kill inflation than to commit himself to the criterion of zero land price rises and order the necessary tax machinery to be put into place. The imminent Council Tax presents him with a golden opportunity. The announcement in mid-1991 of the Council Tax as an emergency measure to replace the poll tax has no doubt prolonged the slide of land prices (just as the announcement in early 1986 that the tax on domestic property would be abolished heralded the rise of residential land prices). Mr Major could trumpet this return of the property tax as a step already taken in the correct direction, bringing housing land into line with business land.

One visible step Mr Major could immediately take would be the instruction to professional valuers to produce a comprehensive data-bank of values for all classes of land use, of the kind now available in Denmark.

By thus striking at one of the roots of the British inflation mentality, Mr Major could dispel the crisis of confidence in the currency markets which is adding a risk premium to interest rates. Sterling would bounce from the floor to the roof of its 6% band and scream for the Chancellor to slash the base rate to prevent it bumping its head. As the real interest rate fell, property markets unjammed, and land prices changed direction, the new tax machinery would begin to whir into action: the opportunities of this new fiscal regime will be examined in the next issue of EL.

Samuel Brittan was quite right. Without the exchange rate constraint the British government might never have become so desperate for a way to impress the foreign exchange markets. It could stop brazening it out and act now by grasping the surest means to hand.

☞ **Continued from next page**

however, it might be necessary to consider this scheme in conjunction with current calls for the government to relax its full-fund rule. This obliges it to fund the PSBR without resort to borrowing from banks and building societies through treasury bills, which would enable them on the strength of their additional assets to increase the money supply.

"Under-funding" the PSBR is appropriate for recessionary times, it is argued, to stimulate the money supply, reduce long rates of interest and raise equity prices. Under-funding means that the government issues fewer bonds, which would make room for more private bonds without reducing bond prices. To the extent that private bonds replaced gilts they would prevent the effects of under-funding from coming through. But that would only re-route the stimulus for the economy. The economic aim of the private bond scheme is to free the housing market of the jam caused by those who cannot move till they can sell their homes for enough to repay their mortgages.

The number of residential property sales (about 1 million a year) is now less than in the 1970s, when there were only two-thirds as many privately-owned homes. The economy is being immobilised - literally.