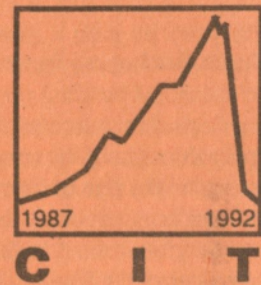


CENTRE FOR INCENTIVE TAXATION ECONOMIC INTELLIGENCE

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USA: HOUSE PRICE TAILSPIN LOOMS

SNAKE-OIL SOLUTIONS are once again in vogue in the USA, in this jittery period of presidential election campaigns and urban riots. The global economy will pay the price in protracted under-employment. The US economy has not hit the bottom; nor has the UK's. Linked to belt-tightening traumas in Japan and Germany - which will last another 12 months - a depressing picture emerges of a sustained increase in the loss of people's jobs.

The focus of EI's concern has now switched from the depth of the downturn (we have been warning about 1992 since early '88), to official illusions about the upturn. These are creating false expectations among households and corporations, the price for which, of course, will not be paid by governments. Despite data which continue to falsify the last numbers conjured up by the forecasters, the tone of official pronouncements is upbeat. Why? Because policymakers still do not have an appreciation of the cause of the current depression (that's not an allegation that can be levelled against Tokyo's mandarins). Result: the absence of appropriate policies for the 1990s exposes European and North American corporations to the Japanese scalp-hunters, who are even now tooling up for the blood-letting (see page 2).

WHY WILL THERE BE a dragged-out depression? Two reasons. First, the most fundamental of "fundamentals" (the price of land) has not yet hit bottom. Second, governments are operating in a philosophic vacuum - precisely because trends in

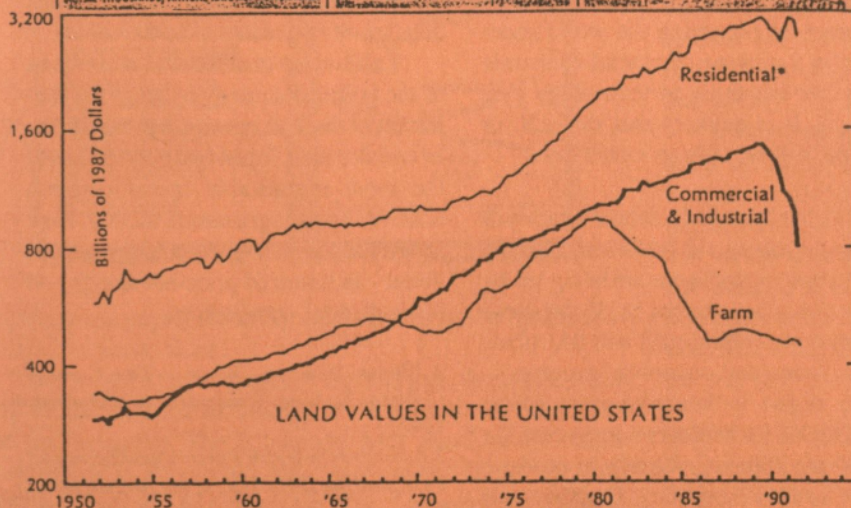
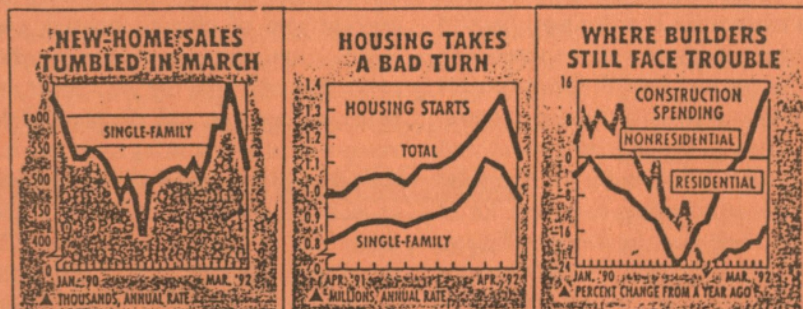
the land market are not used to illuminate problems.

Not in Japan. There, economists at Shearson Lehman Brothers Inc. suggest that falling land prices are exerting strong downward pressure on consumption. Reports *Business Week* (April 6): "Land is by far the largest component of Japanese households' net worth, accounting for more than half of their wealth...With land prices down 10% in 1991 and another 10% so far this year, Japanese consumers appear to be retrenching. And if consumption actually falls as households try to rebuild lost wealth, warns Shearson Lehman, the risks of a real recession will grow."

No parallel analysis is available for the USA, despite the availability of data which reveals a strikingly similar story. In the May issue of its *Research Reports*, the American Institute for Economic Research (AIER) analyses the land-value data compiled by the Federal Reserve Board. True, the information is poor; during the last 12 months, the estimates of total land values were adjusted upwards by as much as one-third for the years 1945-90! So the graph (left) may give a seriously misleading picture: it certainly does so for the turning points in the trend (which, of course, are the bits that matter). Even so, developments in the past two years are beyond doubt: values have crashed, as the various crises - S&Ls, banks, property companies - converged on a grand slam.

One result: small businesses - vital for employment prospects - have now suffered the worst sales decline in 18-years. They continue to fire workers, liquidate inventories and put capital spending on hold.

In construction, sales of new single-family homes dropped nearly 15% in March, the largest decline in 10 years. Non-residential construction has fallen



* Includes vacant land.

Source: Federal Reserve Board, Flow of Funds.

JAPAN: THE SECOND REVOLUTION

15% from its pace a year ago. Banks refuse to lend money for new commercial and industrial building projects, as well they might in the face of the huge oversupply throughout the continent - a fact that sealed the fate of Olympia & York, the Canadian giant which thought it could beat the global trend in land values by championing the Canary Wharf project in London's Docklands.

The AIER insists that comparisons with the 1930s are "fatuous" - but then notes: "In one respect, however, the 1990-91 recession appears to have been more severe than any since the Great Depression." Land values dropped from a peak of \$5.5 tr. at the end of 1989 to \$4.8 tr. at the end of 1991 - a loss of \$725 bn, or 13%. In constant dollar terms, the decrease was over 19%.

SANGUINE assessments about the depth of the downturn, now being broadcast by governments, rest on a willingness to underplay the significance of land in the economy (an error not committed in Tokyo - or even in Washington, where analysts nonetheless restrict their observations to trends in Japan!).

Do trends in the value of land disclose anything about the next two years? So far, major losses have been in the commercial and industrial sectors. But the AIER wonders whether "a similar 'shake-out' lies ahead for residential land values, which remain relatively close to their all-time peaks." If that "shake-out" does occur (which it will), families will see the asset value of their homes plummet. Result: disillusion, a further cut-back in consumption, and an intensified downward spiral of the economy.

EI expects this to happen, and the politicians have nothing up their sleeves to moderate the result. And this grim prospect does not factor in the financial crisis which will send Wall Street - and Washington - into a panic, as Japanese corporations and banks pull out their cash from North America (a process already begun in London) to compensate for the decline in the value of land in Japan.

* For a critical assessment of the defects in official land data in the US national accounts - and the mystery of the missing billions - see Appendix 2 in Ronald Banks (ed.), *Costing the Earth* (1989), New York: Robert Schalkenbach Foundation.

MIXED SIGNALS are creating confusion about Japan's economy. Serious, because the global economy is now heavily dependent on Japan's fate. Example: with the collapse in the value of her land, Japan's banks are now borrowing ferociously in the world money markets, helping to harden interest rates and hurt Europe and the USA.

The most pessimistic thesis - that Japan is on the verge of a social collapse - comes from Brian Reading, one of the few contemporary economists to whom it is worth listening. EI appreciates Reading's analysis, but differs markedly over his conclusions.¹

EI's research suggests a strikingly different - but equally alarming - conclusion. Japan is about to go into overdrive. She is on the verge of a social and economic revolution every bit as fatal, for the world, as the Meiji Restoration, which transformed a feudal society into a muscular industrial power.

Japan's prospects are partly obscured by the strong reservations expressed by Japanese intellectuals who now argue that they should not supplant the USA as No.1 in the world. They want to settle for No.2. But a momentum is under way that will deny them the luxury of the supporting role. As we saw over President Bush's vascillation on the Rio ecology conference, Tokyo became impatient and embarrassed Washington by forcefully declaring an intention to give a lot of money to help clean up the environment.

EI has completed a study of trends in Japan, and concludes that Japan is on the verge of becoming the world pacesetter in a number of crucial economic areas: for example, in technology (see page 3). It is unlikely that the U.S. or Europe will be able to match her.

JAPAN has launched a debate which will lead to *perestroika* in the Orient. That the intellectual explorations are being led by the bureaucracy makes it all the more certain that a radical shift will take place in the social and economic structure.

It began in January, when Prime Minister Kiichi Miyazawa instructed the Economic Planning Agency to produce a plan for the 21st century. Had the result been published in any other country, we

would have been entitled to treat it with scepticism. But the Japanese mean business. And what is more, when the verbiage is cleared out, we discover that they actually know what they are talking about.

The groups that make the consensus in Japan are tooling up for a change in social attitudes and economic behaviour which will prove lethal to her economic competitors. Why this stark conclusion?

First, the Japanese are the only people who have a clear understanding of what makes the industrial economy malfunction. That means their corrective strategy is likely to succeed, which will provide Japanese industrialists with an even sharper edge in the battle for customers over the next 18-year business cycle.

True to national character, the Japanese are not acknowledging the sweeping implications of their firm intention to solve the one issue that has provoked their current crisis - land speculation. Their planners limit the analysis to quality-of-life considerations, when they declare their intention to implement "comprehensive land policies which will accelerate increases in the supply of housing and housing sites through encouragement of planned housing construction on agricultural land in urban areas, the efficient use of vacant and under-utilized lots, and the planned development of new housing areas, provide for balanced and appropriate estimations of taxes on fixed capitals, make appropriate use of existing tax systems by strictly enforcing the land tax and ensure the appropriate utilization of land through detailed city planning and other means."²

Land-value taxation was at the heart of the political strategy to scrap the feudalism of the Tokugawa era in the 1870s. In two decades, Japan had accomplished the most remarkable transformation achieved by any agricultural society. Now she is ready to do it again, posing a serious threat - in terms of price-advantage - to her industrial competitors.

1 Brian Reading, *Japan - The Coming Collapse*, London: Weidenfeld & Nicholson, 1992.

2 *Basic Principles for Japan's New Economic Plan, and the Directions of the Investigation*, Tokyo: Economic Planning Agency, April 15, 1992.