

Economic illusion

THE U.S. economy is passing through one of its dangerous phases of illusory activity.

The stock market boom has encouraged most people to believe that growth is "real" in the sense of a sustainable increase in output and employment prospects.

In fact, America is engaged in a speculation spree that has not been seen since 1929.

- Money is flooding into corporate pockets. People have been lured by increasing profits, but these are the result of President Reagan's tax cuts rather than improved performance in the markets.

- Gamblers on the stock exchange are now younger, from the lower income groups (small investors willing to stake under \$5,000) and women now outnumber men.

- Ten million new investors have entered the stock market since 1981. Stocks can now be bought over the retail counter at the Sears, Roebuck chain stores.

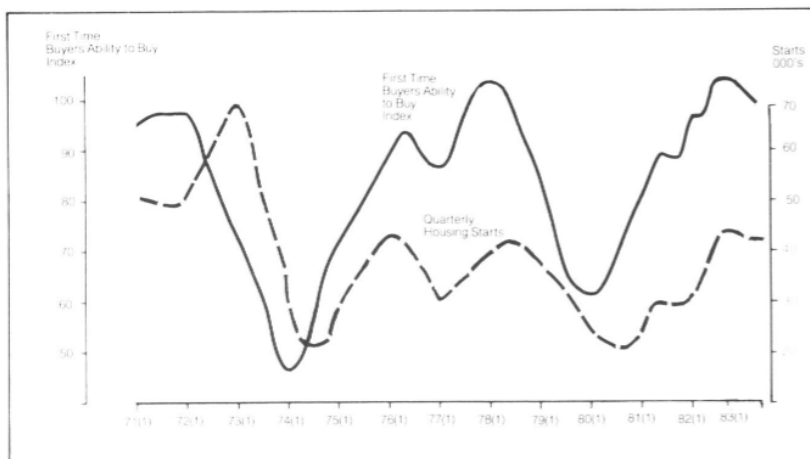
But where is the money going? Not into fresh capital formation!

It's being mopped up by the corporations to ease their cash flow problems.

THE SPECULATORS have created the bull market because they think that stock prices are going to continue upwards – not because they have faith in the companies that are issuing the stocks.

Sooner – rather than later – will come the reckoning, because the U.S. economy is growing on credit, rather than through the creation of wealth.

Consumer borrowing leapt last



● **Diag. 1: First-time buyers' ability to buy, compared with housing starts in U.K. (seasonally adjusted).**

June, and one expert has estimated that in 1983 the net increase in credit was \$565 billion, an 18 per cent increase over 1982.

Ronald Reagan, meanwhile, is hoping that his Keynesian pump-priming deficit – now nearing the \$200 billion mark – will continue to deceive the electorate at least until the presidential elections in November.

But the danger signals are already there to be seen. Output in the housing sector has slowed down, and investment in new housing is one of the best indicators of what is happening to the "real" economy.

Commerce Secretary Malcolm Baldrige, reacting to the trends in the housing market, says that gains in construction have slowed more quickly in this "recovery" than in most previous upturns.

GNP in the final quarter of 1983 dropped to an annual rate of 4.5 per cent, which the Administration glossed

over as evidence of the economy's ability to sustain the recovery. The macro-economic lessons of the housing market, however, cannot be ignored; these can be illustrated with the case of Britain, where the same alarm bells began to ring during the winter months.

WHILE professional forecasters have been arguing over the relative merits of their economic models, consumers have been expressing themselves forcibly.

- The consumer boom was financed through disinvestment. The Bank of England has shown that £7 billion was "leaking" out of mortgage finance into other forms of spending.

Output from the manufacturing sector has remained static, while production of investment goods declined throughout 1983.

Despite this grim message, research among consumers has produced a picture of "a new, hedonistic streak" in attitudes and behaviour.

- People's ability to buy new homes has been declining. According to Patrick Jenkin, the Secretary of State for the Environment, speaking on November 28:

"The construction industry is vital to our national economy. It employs well over a million people and accounts for 10 per cent of Gross Domestic Product."

Since the great crash of 1972/3, however, the construction industry's

Table 1: MANUFACTURING INDUSTRY: Profitability, 1955-1981

	Pre-tax rate of return to fixed capital: * %			
	U.K.	U.S.	Canada	West Germany
1955-58	17	27	23	39
1959-62	16	26	19	31
1963-67	14	34	18	22
1968-71	11	24	15	23
1972-75	8	20	17	17
1976-80	6	18	14	16
1980	4	12	15	14
1981	2	12	14	na

*Net of stock appreciation and capital consumption

net output as a percentage of GDP has consistently declined – and is now just over five per cent.¹

Although the government continues to emphasise the importance of the supply of land to the housing industry, builders continue to complain that land prices are thwarting their ambition to supply a new house to everyone who wants to buy one.

The crucial *determinative* influence of the housing market on the economy is illustrated by Diagram 1. Trends in people's ability to buy houses foreshadow trends in the house building sector.

And these, in turn, foreshadow economy-wide trends.

So, the slump in construction in 1973 and 1976/7 came before the general slumps of 1974 and 1979.

We can see that, throughout 1983, people's ability to buy new homes has been declining: from this, we can predict that 1984 will see another major downturn in economic activity in general.

THIS PREDICTION rests on the assumption that the land market is the major influence on construction, and on economic activity in general.

The impact of the land market can be seen from the point of view of income distribution. Since 1955, the rate of return on investment in capital has been *decreasing*. (See Table 1.)

Meanwhile, the rate of return on land has been inexorably *increasing*.

The U.K. and U.S. housing sectors are examined in depth in this survey, but it is vital to remember that these serve to alert us to crucial macro-economic trends that determine levels of employment.²

Unfortunately, business cycle theory is in a mess. This explains why the world's leading economists are now regaling us with their confessions of failure: see page 34.

Not until they come to grips with the operations of the land market – the activities of speculators, the maldistribution of national income, the squeeze on entrepreneurs' profits and workers' wage packets – will they devise rational policies to rescue the industrial economy.

While the "experts" deliberated, the small-time gamblers continued their spending spree on the New York stock exchange.

The Wall Street bubble burst at the end of February: whom will the speculators blame?

REFERENCES

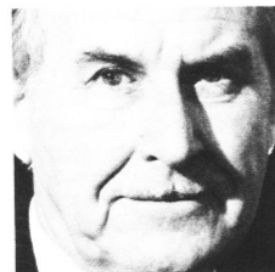
1. "The U.K. construction industry – valued but victimised?" *Midland Bank Rev.*, Winter 1983.
2. Fred Harrison, *The Power in the Land*, Universe Books (New York) and Shephard-Walwyn (London), 1983.

Land prices at record levels

U.K. HOUSING



● Patrick Jenkin



● Peter Woodrow



● Terry Roydon

THE BRITISH government has returned the burden of responsibility for providing new homes from the public to the private sector.

Environment Minister Patrick Jenkin told housebuilders: "The government regards this shift in balance... as highly desirable."

The builders, however, have warned that they are prevented from meeting this challenge – by the cost of land.

Land prices soared by as much as 80 per cent during 1983.¹ This has sharply dragged up house prices.

The government has consistently claimed that there is sufficient land available to meet needs, but a State of Trade survey among builders last October made two facts clear:

- Mortgage money was in plentiful supply, and was not holding up the sale of houses;
- Land prices were so high that they were affecting the ability of builders to meet the demand at competitive prices.

The then President of the House-Builders Federation, Peter Woodrow, declared: "These comments bear out recent reports from house-builders of record prices being paid for housing land in many parts of the country."

And his successor, 36-year-old Terry Roydon, warned that unless urgent steps were taken to ensure an adequate supply of land, prices would escalate more rapidly.

THE MOUNTING evidence finally forced Mr. Jenkin to admit in December: "... the housebuilders are telling me that shortages are increasing over the medium term, that land prices are rising sharply, particularly in the South-East, and that the provision made in structure plans is not always well related to market demand."

● Turn to p. 28

Table II: HOUSING COSTS, Britain (1980 = 100)

	Construction materials	Price per plot	Price of houses	House Price/Earnings ratio
1980	100	100	100	3.31
1981	108	104	106	3.03
1982	117	117	108	3.02
1983 (Q2)	125	127	117	3.17

SOURCES: Department of the Environment and Nationwide Building Society.

A shattered dream

CONSTRUCTION of new houses in the United States started to tail off during the winter after a promising upturn last summer.

Economists attributed the slow-up to rising interest rates on mortgages: the problem of land prices was ignored by the economic forecasters.

Yet the price of land has been at the heart of the industry's problems.

- Between 1977 and 1980, the cost of labour and materials increased by 47 per cent. The price of land increased by 94 per cent, according to the National Association of House Builders in Washington, DC.

- The inevitable happened: the rate of construction of new houses slowed down. Land prices now account for a quarter of the price of a new house (Table III).

- But in 1982, land prices weakened: builders were able to get back to work.

- By the end of 1983, however, land prices had begun to recover: this meant a slow-down in new construction, as prices were pushed beyond the reach of many families.

Now, families are finding it increasingly difficult to buy a home. Increasingly, they are having to rely on a second income to price themselves into the housing market: (Table IV).

THE ESCALATING price of land is the main reason why, in 1982, the proportion of owner-occupied households dropped for the second consecutive year, to 64.8 per cent.

Land prices are also responsible for a reversal in another trend: during the 1970s, homes were getting bigger. They are now getting smaller, as builders try to economise on land and so claw more people into the market.

The "American dream" – priority for home-ownership – has now been wistfully renamed as "the Australian dream". For over 70 per cent of Australian people own their homes, and the figure is rising, much to the envy of American commentators.¹

U.S. HOUSING

The land boom of '83 was foreseen by real estate analysts early in the year, who presented it as "opening the door to astute, small-scale investors, including those with little cash and modest incomes".²

But while the speculators may begin to clean-up, the families who need homes are undoubtedly suffering.

The Reagan Administration has slashed the money for assisted housing from \$26 billion (1980) to \$10 billion this year.

The lack of subsidies, however, is not the problem. The U.S. Congress committed \$363 billion to Federal housing subsidies during the last 50 years. Despite this staggering sum, the *New York Times* pointed out on December 5:

"An estimated 27 million people live in rental housing that is either substandard or too expensive."

Now the Reagan Administration is talking about a new system of housing vouchers, in a bid to help the poor. There is no discussion, in Washington circles, about the possibility of curbing the growth of land prices in a bid to bring house prices into line with people's wages.

REFERENCES

1. Don DeBat, 'Housing Goals Criticised by Analysts', *The Washington Post*, Nov. 19, 1983.
2. Kenneth R. Harney, 'Land Mini-Boom Foreseen', *The Washington Post*, March 19, 1983.

- Interest rates weakened as the housing sector's output began to drop, last autumn. Yet economists single out interest rates as the prime problem for the housing market. In fact, adjusted for taxes and inflation, the true mortgage rate is 2½ per cent, the same as it was 20 years ago when the housing sector was far more vigorous – and land prices, relative to wages, were much lower.

NEW YORK CITY, which operates 18 emergency shelters for the homeless, has begun to solve the problem of its large stock of empty buildings.

It is spending \$300,000 to cover windows with vinyl decals depicting a lived-in look of curtains, shades, shutters and flower-pots.

City officials say the spruce-up is designed to raise the morale of residents, discourage vandals and create a better impression for motorists who drive through run-down areas.

The City plans to provide 2,000 more beds in shelters over the next two years.

PERMITS to build sewers are valuable assets in Houston, Texas. Builders cannot develop land without purchasing the permits from landowners who have not used up their quota.

Sewer rights are being sold for up to \$5,000 a time, but owners are now holding on to their permits . . . speculating on higher prices.

Table III

Costs of new \$70,000 home, U.S.A., 1982: %	
Labour	15
Materials	30
Finance	15
Land	24
Rest (including profits)	16

● U.K. HOUSING – from p. 27

So the government has reluctantly agreed to re-examine the provision for land made by planning authorities.

Economic reality, however, had overtaken political action. The recovery of house-building in the first quarter of 1983 turned into a downward slide, as the price of land outpaced other construction costs.

Despite the expenditure of nearly £40m of taxpayers money in reclaiming derelict land at 80 urban sites in the past two years, builders were locked into a process which they called "planning for recession".

Twenty years ago, land accounted for about ten per cent of the cost of a new house. Today, in many areas it has risen to over 30 per cent.

The ratio of house prices to people's earnings moved sharply upwards, thereby shrinking the market and preventing the industry from re-employing the hundreds of thousands of skilled construction workers who were on the dole.

And the government decided that it would be prudent to issue a second draft of its circular on Land for Housing.

REFERENCE

1. 'Warning: Land shortage', *Estates Times*, Dec. 16, 1983.

Table IV: COST OF NEW HOMES, U.S.A.

	1977	1982	% change
Median house price: \$	45,050	74,790	66
Combined incomes of families able to afford a new home: \$	22,500	37,131	65
Percentage of purchasing families with two or more incomes	47	54	—
Median age of buyers	33	34	—

SOURCE: National Association of House Builders.