Thatcher is currently claiming that workers and their employers hold their fate in their own hands: the government has yet to learn the lesson that the fate of the labour market was sealed in 1985, when speculators started to buy and sell land at rates of profit that had nothing to do with the productivity of the economy.

This is the logic of a trend measured by Muellbauer: "Between 1981 and the second quarter of 1988, the price of an average building plot, relative to personal disposable income per head in the UK, rose from 1.6 to 4.1 in England and Wales, and from 2.3 to 7.2 in the rest of the south-east."

The expansion of borrowing on the back of the increase in asset values also drove up interest rates, at the expense of investors who wanted to create jobs and wealth

Completing the vicious downward circle into depression, Muellbauer notes the effect on the housing market. "With house and land price to income ratios at current levels, there is little scope for landlords to make good economic returns from renting property at affordable rents. Thus, there is little hope of expansion in a private rented sector offering affordable rents and so little hope of achieving improved labour mobility."

Throwing more money at the problem - Thatcher's solution, which Muellbauer rejects -only aggravates the crisis.

The distortions need to be eliminated - yet, surprisingly, these have been ignored by Margaret Thatcher. Surprising, because the central tenet of her economic philosophy is the need to free up the markets in favour of efficiency.

Instead of doing so, however, the government's abolition of the residential property tax merely consolidates the inefficiencies in this sector. What needs to be done? Muellbauer declares: bring back the tax on residential property - ideally, tax exclusively the value of land.

"First, it would be a tax on

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CONFUSING WEAKNESSES

IN SEARCHING for the flaws in conventional economic theory, Britain - as ever - provides an illuminating starting point. For two reasons: the UK is the neatest of the major economies to monitor, statistically, and the most volatile in behaviour, *writes Ian Barron.*

Take inflation. Margaret Thatcher came to power as a "monetarist". Since 1979, however, Milton Friedman - arch exponent of monetarism - has disavowed key elements of the Conservative Government's actions. Not surprisingly, because much has happened that is inconsistent with the Chicago School's theoretical expectations.

Right wing economists in Britain - especially the ones associated with the Institute of Economic Affairs, who have taken a pride in advising a compliant Thatcher government over the last 10 years - are now faced with the extreme embarrassment of explaining why the economy is sliding into recession.

Events are rapidly depreciating professional reputations, but theories are also back in the melting pot; especially monetarism, which - as practiced - has been found to be wanting in the real world.

Christopher Huhne - an advocate of a tax on land values, who has been acclaimed joint winner of this year's Harold Wincott prize for excellence in financial journalism — (the premier award in Britain of its kind) notes:

"Some analysts became worried by the growth of credit and 'broad' money - bank accounts - in 1987. But why was the growth then any more worrying than the similar pace of growth in the preceding years, when there had been no ill effects? Why worry when M4 - the main broad money measure - had grown even more rapidly in 1981 and inflation had fallen?"

"The broad money measures were roundly discredited as an indicator of spending and hence of potential inflationary pressure. But other indicators hardly fared better. The main 'narrow' money measure, MO - notes, coin and bankers' cash at the Bank of England - failed to capture the inflationary problem of 1973-4. During the recent episode, it only began to accelerate above a growth rate of 5% at the beginning of 1988 when most of the problem was in the pipeline."[1]

One reason for the confusion is the failure to define "inflation" properly. Another is the failure to isolate the unique dynamics of the land market. These weaknesses are evident in a study by Geoffrey Wood, professor of economics at the City University Business School.[2] As a consequence, he emphasises a monetary strategy for future reforms:

"Control of the money supply implies a tight constraint on the rate of growth of the balance sheet of the banking sector as a whole. Even more basic is control of the rate of growth of the central bank's own balance sheet. Discipline should start at the top. The Bank of England should limit the growth of its balance sheet."

The USA has a well-disciplined, independent central bank which the British are now proposing as a model for the Bank of England. And Japan is not noted for financial laxity. Yet both have suffered from a boom in land prices, which is at the heart of current economic traumas.

No matter how stringent monetary policy, speculation will take place when the balance of advantage shifts in favour of the land market. That's where the trouble begins and ends: and monetary policy, lax or tight, does not play the prime role in starting or stopping it.

Monetarists need to get out into the real world.

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2. *Money, Credit and Inflation*, London: IEA, 1990.