

THE PROGRESS REPORT

Land Speculation: What Is It Bad For?

By Fred E. Foldvary

The cause of every major business-cycle depression is land speculation. This fact was discovered by the American economist Henry George 120 years ago.

Speculators buy land because they expect the price to go up in the future. While waiting for the price to go up, speculators do different things with land.

Some land speculators buy raw or underdeveloped land and just let it sit until they think the time is ripe for development. When many speculators are doing this in some area at the fringe of a city, often developers skip around them to areas further away from the city. That creates land-wasting urban sprawl, which then requires more roads and longer water pipers and makes it uneconomical to have public transportation. In other cases, when speculators are buying land within a city they expect to be developed soon, development instead shifts to other, less expensive, areas, and the speculators lose out. Society also loses, since that area can stay relatively undeveloped even though it is within the city.

Other land speculators buy land in order to develop, expecting the rise in land value to be a big chunk of their profits. That works out well for the first ones to do it, but at the end of the land boom, when many developers are building and hoping to cash in on the land bonanza, the land value stops rising. Those who bought near the top don't get the land gain profit, and even worse, when the real-estate market crashes, the developers end up with empty houses and office buildings, and shopping centers they where they built but folks aren't coming. They go broke, can't pay back their loans, and the banks fail, making the economy fall even more.

So the reason land speculation causes depressions is that it raises the land price too high for those wanting land for actual use. Speculation adds to the demand for land, making prices go even higher. Land becomes priced for future use, not present-day use. So those wanting sites for residences, offices, hotels, factories, and shopping centers, slow down their investing. Also, during the boom, interest rates that were low start going higher as the central bank (in the US, the Federal Reserve System) reduces the growth of the money supply, increasing interest rates. With costs rising and investment in machinery and construction down, the economy grinds to a halt. Workers get laid off, which then decreases demand, and the economy falls into a recession.

So what causes the depression is the reduction in investment in real estate and other capital goods, caused by rising interest rates and land prices. When the economy falls into the depression, real estate prices and interest rates fall, and now investment becomes profitable, and the recovery starts. For this to happen, the old bad debts have to be cleared, otherwise the financial system is clogged with bad debts, as it is now in Japan, and the new enterprises can't get the credit they need to get going. It also helps a lot if the barriers to new investment are taken down - that means eliminating restrictions and taxes on enterprise.

What makes land speculation dysfunctional - a cause of economic trouble - is not really the speculation itself, but the tax system in which it takes place. The tax systems in the world today mainly tax labor and profits. Some of the tax money goes to build public works, such as subways, freeways, streets, roads, public utilities, parks, security, fire protection, and schooling. These push up land values. So landowners get a government subsidy in the form of increased rent due to infrastructure that workers and businesses, not the landowners, are paying for. So land speculators profit from this forced transfer of wealth from workers to landowners, if they guess right on where new development will go.

There is another intervention behind the market-hampering speculation, and that is, cheap and easy credit. Land is bought with borrowed money, and when the government stimulates the economy by over-expanding the money supply, it provides the fuel for land speculation. Later, when the central bank fears this excessive money is causing price inflation, they reduce money growth, interest get hiked up, and this stops not just speculation but also investment, as noted above.

How to stop this crazy cycle? Two things are needed. First, squeeze the profit out of land speculation by having the community or the government collect the land rent. Land values won't go up if the owners don't get the future higher rents. Secondly, stop gushing money into the banking system. But this is hard to do with central banking, since there is no way to know exactly how much to increase the money supply. So let the market do it with free-market banking, where the banks issue private bank notes according to the market demand for them. (See my October 1997 editorial, "Inflation, Employment and Money" in the Progress Report Archive.)

To stop disruptive land speculation, we need free banking and the public collection of rent. Land speculation along with currency troubles due to unfree banking created the collapse of the economies of East Asia. Land speculation is now heating up in the American economy. When will society learn?