

BRITAIN is under pressure from the Reagan Administration to adopt Washington's tax-cutting strategy as a means of stimulating new employment and faster economic growth.

Congress is cock-a-hoop with the new arrangements, which are presented as a radical reform of the tax system leading to greater economic efficiency and social justice. Will it? Is it? Not if the property market is indicative.

Observers believe that by eliminating the tax-shelter status enjoyed by real estate, the cuts in tax rates and subsidies will encourage investments in sectors that need venture capital. For there is already a glut in office building (the direct result of the tax write-offs, and the 15-year depreciation rule of 1981). Investors no longer have the incentive to erect buildings for which there are no tenants.

Opponents who object to the loss of nearly \$1 trillion worth of tax shelters claim that we will now see higher unemployment in the construction industry, higher rents and even bank failures. *This scenario is largely intended to scare rather than be objective, but does contain many truths.*

The historical evidence supports this conclusion.

● The Finance Act (1924) gave taxpayers a 25% reduction retroactive to 1923 income, increased personal and surtax exemptions, and brought the top rate (which had stood at 73% in 1921) down to 46%.

What happened? The higher net incomes were capitalised into higher land values by land-owners. Wage-earners were happy to see their extra income sumped off into real estate — they financed the Florida land boom which peaked in 1925. Andrew Mellon, the Secretary to the Treasury, was impressed with the results of his early experiment in "supply side" tax-cutting, and the top rate was slashed to 24% in 1929...

● Then, in 1964, the Kennedy cuts saw tax-rates drop from a top

* On Jan. 1 the progressive income tax all but disappeared in the United States. And in scrapping the old law's 14 separate tax brackets, Washington's tax reformers also shook up a system that concealed unfair preferences, shelters and loopholes. What will be the impact on the economy? FRED HARRISON reports.



● George Gilder ● Martin Feldstein

Not for Britain

rate of 91% to 70% in 1965. There was an accompanying escalation in real estate values, as the land monopolists grasped the chance to claim the extra wages and salaries as theirs. The economy slipped into a recession in 1966.¹

Theoretically cautious economists might refuse to accept the argument implied by this account, namely, that there is a causal connection between a boom in the land market and slump in the economy. The Reagan Administration cannot dissociate itself from such an analysis, however, for the theory is accepted by one of its gurus.

George Gilder, in his *Wealth and Poverty*, characterised speculative real estate as a "sink of purchasing power."² A contraction of purchasing power, of course, results in the loss of jobs, as any good Keynesian will acknowledge.

PROSPECTS for a boom in real estate are enormous, for the purchasing power of individuals is being increased to the tune of \$120 bn — the estimated size of the federal tax burden being shifted from people to corporations over the next five years. This money

will be brought into play by the tenure-and-tax system to offset the negative effect on property values arising from the loss of tax subsidies which have artificially inflated the value of real estate.

That the latest tax cuts will have a significant impact on the American economy via the real estate sector has already been acknowledged by Martin Feldstein, whom President Reagan appointed as his chief economic adviser in 1982. Feldstein warns that tenants will have to pay higher rents³. Some estimates put the rise at 15% over five years.

We can now expect some wild movements in the prices of houses, with all that implies in a reduction in labour mobility. While most families might not find themselves worse off, in terms of spending power, builders will discover that the supply of affordable land has grown even tighter — thereby damaging the vital construction industry. A recession is guaranteed to follow.

The Thatcher government is already doing a remarkable job in pushing up unemployment: it does not seem necessary for the Prime Minister to adopt Washington's strategy for Britain.

REFERENCES

1. A full account of how real estate trends dislocated the economy appears in Fred Harrison, *The Power in the Land*, London: Shephard Walwyn, NY: Robert
2. Schalkenbach Foundation, 1983, pp. 125-129.
3. New York: Basic Books, 1981, pp. 42-43.

3. *Washington Post*, 31 Aug. 1986.