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Speculation: a US Hypothesis

Pre-industrial modes of production were coherent. They functioned as stable systems over very long periods of time without generating problems. The crises which disturbed them from some normal level of activity can be ascribed, in the main, to external influences over which there was no control. Hunter-gatherers may have gone hungry at times because the herds failed to return to the traditional grazing grounds. In agrarian systems, famines occurred because of inclement weather. This is not to deny that problems did not originate from within the system. Over-zealous hunting can deplete the available stock of animals in a tribe's territory; over-intensive cultivation can turn soil into a dust bowl. But these were aberrations, cases of unwise, irregular, self-destructive, management of affairs by individuals, and were not entailed by the mode of production itself.

Because these systems were stable, over very long periods of time, scholars classified them as 'stagnant' societies. But the peoples themselves were content. They were culturally equipped to deal with deviant cases within their ranks, and they developed elaborate rituals to explain, if not to control, the 'acts of god'.

Industrial society, by contrast, has in its short life been riddled with regular economic crises which appear to be caused directly by malfunctioning elements of the system itself. If the record is to be believed, capitalism suffers from internal contradictions which preclude stable production of goods and services over a long period of time.

The view that the industrial mode of production based on the private ownership of capital was inherently defective was promoted at a very early stage by left-wing critics. One was Robert Owen, who attributed unemployment to 'under-consumption'. His solution was to create small, self-contained communities. Members would share a communal ethic and earn their living by agriculture and industry in which machinery would be carefully controlled. Owen's scheme was promoted in the House of Commons during the first major industrial recession, in the late 1810s. It was advocated in 1817 by De Crespigny, who placed great store by the claim that people were rendered unemployed by the advance of technology.[1] The theoretical critique from the left was advanced by Frederick Engels in *The Condition of the Working Class*, who argued that capitalism operated through cyclical fluctuations and that therefore the system had to create and maintain a permanent reserve of workers. Karl Marx elaborated on the inevitability of these characteristics. Anarchy reigned because of the multiplicity of individual decisions: entrepreneurs could not have perfect knowledge of the state of the developed market. Furthermore, the maldistribution of income as a result of private ownership of capital meant that labour could not buy back all that it produced. From this, it followed that at certain times there would be 'over-production'. The excess of goods in relation to demand would set in motion a recession, because entrepreneurs were forced to cut back on output and new investment. Only planning from the centre — where the decision-makers had an overview of the total system — would eliminate the risk of wrong decisions. This would create a rational programme of economic activity. Only social ownership of the means of production would ensure that the rate of consumption was tailored to output. In a word — socialism.[2]

The over-production thesis did not mean that recessions were always caused by the inability of labour to buy up the goods which it produced. Marx said that rising wages also caused crises, for among capitalists 'the stimulus of gain is blunted'.[3] Attempts to make up for a decline in the rate of profit, by increasing aggregate profit, merely reinforces the over-production of commodities on sale in the market. Marxists, therefore, have got it both ways. Either there are recessions because the wages of labour are too low, or because wages are too high! And in both cases capital is said to be unable to adjust itself smoothly, and this results in dis-equilibrium.

There have been many theoretical attempts from the time of Marx to Keynes to explain why the modern industrial economy staggers from one recession to another with the predictability of the seasons. All the variables — trends in national income, consumption of durable goods, fresh formation of fixed capital, phases in the innovation of consumer goods and processes of production — have been scrutinized in the search for the cause of trade cycles. Most of these attempts are of a descriptive rather than explanatory character.

With the fall from popularity of the Keynesian doctrine — the tools of which failed to assist the politicians to prevent or even to ameliorate the recession which struck the capitalist West in the 1970s — there has been a hiatus in public policy formation. In desperation, there has been a fall-back to simplistic 'solutions' like the monetarism which found popularity in Britain in the early 1980s. These, however, have been attempts at sitting tight in the hope of happier days to come, relying on the principles of sound budgeting for individual households rather than for nations.

With one major exception, no-one has offered land speculation as the possible explanation for cyclical recessions. This hypothesis was advanced by Henry George. Land speculation, he said, was not the only cause of depressions; but it was 'the great initiatory cause'.[4]

George was not satisfied with conventional 'explanations'. How could it be, he wondered, that there was 'under-consumption' when people were hungry, poorly clothed, badly housed? They were willing to consume more — what stopped them? And how could it be that there was 'over-production' by capitalists who were supposed to be in search of profits? Supply might be larger than demand for a particular product at a given moment in time; but what stopped the entrepreneur from cutting his price, selling off his goods and smoothly moving into a more profitable field of activity?

George concluded that land monopoly was to blame. It operated at two different levels of intensity. Speculation caused depressions by enabling people to demand prices which were extraordinarily high: effectively, the monopolists demanded a part of *tomorrow's* output *today*. The effect of this is to milk the returns to capital and/or labour. But this can only be tolerated up to a point, beyond which it becomes uneconomic to employ either capital or labour; unemployment ensues. Secondly, land monopoly enables speculators to hold land idle in the expectation of future capital gains. This is the wait-and-see strategy. As a result, scarce land is withheld from production — in itself preventing new employment — and as a consequence of the contraction in supply, this pushes up the level of rents of land in use. This has the effect of bankrupting some firms which would otherwise be profitable and competitive.

> Production [wrote Henry George] therefore, begins to stop. Not that there is necessarily or even probably, an absolute diminution in production; but that there is what in a progressive community would be equivalent to an absolute diminution of production in a stationary community — a failure in production to increase proportionately, owing to the failure of new increments of labour and capital to find employment at the accustomed rates.[5]

This produces 'a partial disjointing of production and exchange', which manifests itself in apparent over-production and under-consumption. A decline in output continues until one or a combination of three things happens:

(1) the speculative advance in rents terminates;

(2) an increase in the efficiency of capital and/or labour results in an increase of income and a readjustment of the distribution in relative shares going to the factors of production; or

(3) labour and capital reconcile themselves to lower returns in wages and interest.

Henry George provided an account of how recessions cause the collapse of banks, the bankruptcy of firms and the panic of speculators who find that they have to finance loans at high interest rates for land which is suddenly seen to be over-valued. He used largely impressionistic evidence to support his theory. For this he cannot be criticised, for it is only in recent years that statisticians have produced data in anything like sufficient quantity and quality to enable us to elaborate the theory in a scientific manner.

Our first problem concerns periodicity. The waves in the trade cycle move in regular sequences. The shortest, terminating every four or five years, is the one which concerns democratic politicians most. They feel obliged to keep wary eyes on the economic indices in case these predict unfavourable events coinciding with election time. The most important cycle is of 20-year duration. The cyclical trends in the movement of phenomena like population, migration, immigration and house building were first fully elaborated by Simon Kuznets for the USA.[6] The importance of these long cycles is that they terminate in slumps, the amplitudes of which are greater than those experienced during the course of the upswing of the cycle. This is because inventory investment and other volatile forms of investment coincide with a downturn in the building programme, thereby creating a severe recession.[7] But Kuznets has admitted that, while there is no difficulty in identifying the long swings, there is a problem in explaining them.[8] He had to content himself largely with describing the phenomena.

Does the land speculation hypothesis fit into the 20-year cycle? In the 1930s Homer Hoyt, then a post-graduate student at the University of Chicago, investigated the trends in land values in Chicago over the remarkably long period of 100 years. He discovered a regular cycle of 18-year duration.[9] His data is considered to represent the general trend in real estate values in the USA over the period up to the 1930s.[10] Hoyt has since up-dated his material, and his results are listed in Table 5:I. They fit neatly into the sequence of business cycles. A peak in land values is missing. Its absence may be explained by the threat and advent of the world war, which disturbed the benign psychological outlook which is necessary for speculation. Consequently, the peak of this cycle was eliminated.[11]

But what if the trends in land values were simply a response to other variables in the economy? We expect to see a rise in land values, for as national income increases, so does the surplus, or economic rents. Rising land values, then, are a derived phenomenon. So how can we justifiably ascribe the primary power to cause recessions to the land market, the income for which is itself dependent upon the functioning of the labour and capital markets? Is it not possible that a downturn in national income then results in a drop in land

TABLE 5:I
USA 1818-1929

Peaks in land values[1]	Building cycle peaks[2]	Economic recessions
1818	—	1819
1836	1836	1837
1854	1856	1857
1872	1871	1873
1890	1892	1893
—	1916	1918
1925	1927	1929

Sources: 1 Homer Hoyt, 'The Urban Real Estate Cycle — Performances and Prospects', in *Urban Land Institute Technical Bulletin* No. 38, 1950, p. 7.
2 G. Shirk, 'The 18⅓-Year Cycle in Total Construction', *Cycles*, August 1981, p. 149, Figure 1, and C. A. Dauten and L. M. Valentine, *Business Cycles and Forecasting*, Ohio: South-Western Publishing Co., 1974, p. 277. For the booms of the 1830s and 1850s, see also G. F. Warren and F. A. Pearson, *World Prices and the Building Industry*, 1937, p. 99.

values? This is the popular view: the causal forces are held to be in the opposite direction to the one postulated by Henry George. To prove a causal connection working from land speculation to the wider economy, we need to trace more than 'a fairly close correspondence'[12] between movements in the real estate market and phenomena like the building cycle.

The timings favour Henry George's hypothesis. Table 5:I shows that the peak in land values is reached 12 to 24 months before the economic recession; i.e., the downturn in land values precedes the decline in general economic prosperity. But this chronological sequence is insufficient to prove cause and effect. Landowners may just be blessed with better predictive foresight than the rest of us (though, in that case, why do so many of them continue to buy land just as the speculative bubble is about to burst?).

We need to demonstrate a transmission mechanism, one by which antecedent behaviour in the land market diffuses itself into the factory, office and corner retail store. One such mechanism may be the activity in the construction industry. If land, because of speculation, costs too much, does this curtail construction and thereby dampen activity over a wider sphere of the economy? The American evidence is tantalising. The peaks in the building cycle *follow* the peaks in land values and *precede* general economic recessions!

This relationship will be investigated in detail in Chapters 8 to 10. First, however, we need a more detailed account of speculative behaviour.

Land speculation is a two-dimensional activity. It is *spatial*. It entails the acquisition of control over a clearly-defined piece of territory, such as land on the fringe of an urban area, or large tracts on the frontiers of a colonising society. It is also *temporal*. Purchases today are calculated to provide a financial gain through resale in the future. Thus, the dealer has to be willing and able to hold onto land for a period of time, and sell when he calculates that prices have reached their most attractive heights.

A useful definition of land speculation has been provided by Prof. Botha. It is, he says, 'an investment over a relatively short period of time in an asset yielding an unrealistically high rate of return accompanied by a relatively low degree of risk'.[13] This contrasts land speculation with speculation in other areas, in which the risk of loss is much greater — for example, in the currency markets. We need to know more about the time scales, however, to see how they relate to the 18-year cycles that have been observed in the US economy.

Botha distinguishes three broad categories of time: secular, long and short-term. In the first case, a second or third-generation land monopolist who sells at a hundred times the original purchase price cannot be said to have speculated; the land was not bought with an intention to capitalise on increasing land values within the lifetime of the buyer. An example of this is the Spanish olive grower who owned five acres near Madrid. He and his family fled from General Franco's army in 1940. The family split itself between London and New York. The parents died, and after the death of Franco the children decided to investigate their ancestral past. They discovered that the five acres that they had inherited were worth £5m. in 1980, just 40 years after the last olive had been picked.[14] During that time, the land had remained idle, but the suburbs of Madrid grew outwards and around the site. So far as the land users of the Spanish capital were concerned, the owner of the five acres was doing a Rip Van Winkle act: he had gone to sleep. Still, the value of the land soared with the prosperity of the community. The children, however, while benefiting from their unearned millions, were not *speculative* owners in the sense which we wish to emphasise for the purposes of this study.[15]

At the other end of the time-scale, people who buy and quickly re-sell land for a profit usually do so for less spectacular gains. This sharp wheeling-dealing characterises the tail-end of a cycle in land values, when speculative 'fever' has gripped a wider circle of people who, perceiving the huge gains made by those who bought for rock-bottom prices, decide to gate-crash the market.

The more interesting time-period, for Botha, is the intermediate phase, his 'relatively short period' which, in terms of his three categories, is the long period. He cites the example of someone holding land for 10 years, having bought it at agricultural use values and allowing it to lie fallow in the knowledge that urban expansion will force up the price in the fullness of time.

This intermediate time-scale is characterised by a conscious decision to methodically identify and acquire tracts which will eventually be required for development; and the willingness to wait while values rise to obtain a profit well over what can be obtained in the course of normal trading in a competitive market. Botha's example of 10 years was intended to be illustrative. It does not fit well into an 18-year pattern. Intuitively, we would expect speculators who were tutored in the art of dealing in land to buy when prices were at their lowest — at the beginning of a cycle — and sell just before prices reached their peaks: they would sell to the 'mugs' in time to get out of the market before the inevitable crash.

The risky phase of the speculative boom is the last 12 to 18 months. During this period, dealers tend to be the innocents who have entered the market at a very late stage. Most of the profits have been taken by the shrewd dealers, who have held the land for most of the cycle and then withdrawn while the going was good. The latest entrants are those who buy at the speculatively-high prices which bear no relation to the performance of the economy; and they have a rapidly-decreasing margin of time in which to raise their prices, find new buyers and complete the transactions before the alarm bells begin to ring. Thus, we would postulate that a 15 to 16-year period would be the optimum period. This would ensure maximum profits and guarantee a safe withdrawal from the market before the slump. If this time-scale is popularly employed by land speculators, we will have recognised an important element of the dynamics of the 18-year cycle in land values.

The empirical evidence verifies our hypothesis. In the most exhaustive study ever conducted into motives behind the ownership of land on the urban fringe — nearly 700 owners of undeveloped land at the edge of six metropolitan areas in North America were interviewed between 1977 and 1979[16] — it was discovered that the transition in ownership from traditional rural owners to investors and developers 'begins more than 15 years before the land is actually developed for urban use'.[17] Similar time-scales were revealed in a study of 56 vacant sites in South Wales; 64% of the sites were held idle for 15 years or over, and the most popular duration of vacancy was the 15-19 years period (27%).[18] The evidence supports the view that speculators are willing to hold land vacant for a considerable period of time in the expectation of making substantial unearned profits from the needs of society. Providing the purchases are made at the right time, and in the right place, speculation in land conforms to what *Fortune*, the American business magazine, deemed 'a law that seems to make certain you will win'.[19] Thus, there appears to be a significant synchronisation between the time horizons of speculators, and the 18-year cycle.

Other features of speculation and land monopoly can be highlighted by contrasting land with capital as factors of production. In the past, the differences have been disguised. G. D. H. Cole, a leading left-wing historian of working-class institutions, exemplifies the perverse insistence on anaesthetising people from an appreciation of the internal dynamics of the Western economic system:

> ... in highly industrialized countries in particular the distinction between land and capital has lost most of its economic importance, at any rate where a class of great landowners, clearly distinct from other capitalists, has ceased to exist.[20]

Rental income, likewise, is conflated into the catch-all category of property income.[21] By blurring the differences, the deleterious influence of the land speculator is ascribed to the owner of capital. Yet land and capital are different species of phenomena.

For a start, the power acquired by those who buy land depends crucially on the unique characteristics of land. The time-horizons are different in the land and capital markets. Land can be held idle for long periods because it is not perishable. The pressure on landowners in a contest of economic strength is far weaker than that which confronts labour and capital. Agricultural land will renew itself, and therefore retain its value; owners need not, therefore, capitalise their assets for long periods. Land which derives its value from locational advantages presents no problems whatever. But capital in the form of machines and buildings perishes and must therefore pay for itself within a limited period, during which the capitalist cannot avoid the costs of maintenance. There is no escape from this by transforming capital into cash, for unless it is employed — by being lent to others — it either depreciates in value as a result of inflation, or does not earn an income (in which case it might as well be used for consumption).

Furthermore, there is a distinct difference in the ability to finance loans originally taken out to buy land or accumulate stocks. Except during deep recessions, banks will continue to lend money when the asset is land, even (or rather, especially) during uncertain times. This makes it possible to refinance loans used to buy land: thus, the speculator can hold out for better prices which must eventually come his way. Credit to help to finance inventories, however, is much more difficult to obtain. Credit shortages occur far more regularly as a deterrent to stock accumulation. Indeed, the acute credit shortage associated with the downturn of the shorter, five-year cycles is a direct limitation on accumulation.[22]

The next major class of differences between land and capital relates to the impact on the workings of the economy. Land hoarding results in a contraction in the supply of what is a fixed factor: there is no way of making more land, and reclamation is of no significance. So the price of land is forced up. Firms which are restricted in their choice of locations — because of the need for access to special services, or raw materials, or markets, for example — have two options. They must either increase their product prices, which is not usually possible in a competitive market, or they must absorb the higher cost of rent out of profits. As a result, consumer satisfaction and the output of goods are reduced. Hoarding manufactured goods, however, does not destabilise aggregate demand,[23] and if abnormal profits are made out of a rise in prices, other manufacturers will be attracted into the market. This forces down prices and removes the incentive to hoard goods in warehouses. Manufacturers, then, have every incentive to meet demand at the lowest competitive prices, which raises consumer satisfaction and ensures the full employment of resources.

Finally, consider the money and stock markets. At certain times, principally near the top end of the land value cycle, when people are gripped by speculation mania, the bidding for money to buy land pushes up the rate of interest. This makes it difficult to borrow to finance the formation of new machines on which people rely for new jobs and wealth. Institutions seeking to attract depositors' funds to invest in land force others to raise their interest rates in order to remain competitive. Building societies are an example of this, and as a result low-income earners experience greater difficulty in obtaining mortgages. Speculation in share prices on the stock exchange in the hope of capital gains, on the other hand, reduces the cost of finance to firms, so directly encouraging investment.[24]

Thus, we begin to see that land speculation is a unique economic phenomenon, deriving its power from the ability to play a passive, wait-and-see game, capable of yielding enormous fortunes for shrewd dealers who, as land monopolists, do not contribute anything to the wealth of nations; a power which gives it the ability to inflict severe wounds on the active agents of the wealth-creating process, the workers and their accumulated savings (capital).

Notes

1 The Owen plan was opposed by, among others, Henry Brougham, on the grounds that the real problem was over-population — the poor, it seemed, bred too fast for production to keep up with fertility! See B. Gordon, *Political Economy in Parliament 1819-1823*, London: Macmillan, 1976, p. 65.

2 Socialist planning does not admit of industrial crises. While Menshikov is happy to describe postwar economic recessions in the capitalist West as 'crises', his colleague Khachaturov will only admit of 'minimum efficiency years' in the USSR — and even then the national income is held to be 'less than normal owing to poor harvests'. Who can plan the weather? See S. Menshikov, *The Economic Cycle: Postwar Developments*, Moscow: Progress Publishers, 1975, and T. Khachaturov, *The Economy of the Soviet Union Today*, Moscow: Progress Publishers, 1977, p. 337.

3 *Capital*, Vol. I, *op. cit.*, p. 580.

4 *Progress and Poverty, op. cit.*, p. 264.

5 *Ibid.*

6 S. Kuznets, *Capital in the American Economy*, Princeton University Press, 1961.

7 G. F. Warren and F. A. Pearson, *World Prices and the Building Industry*, New York: John Wiley & Sons, 1937, p. 97; R. C. O. Matthews, *The Trade Cycle*, Cambridge University Press, 1959, p. 214, n. 1; and A. Shonfield, *Modern Capitalism*, London: Oxford University Press, 1969, pp. 21, n. 1 and 28.

8 *Op. cit.*, p. 424.

9 H. Hoyt, *One Hundred Years of Land Values in Chicago*, University of Chicago Press, 1933.

10 H. Hoyt, 'The Urban Real Estate Cycle — Performances and Prospects', in Urban Land Institute *Technical Bulletin* No. 38, June 1950, pp. 7-8, and Warren and Pearson, *op. cit.*, p. 151, Table 4.

11 For a discussion on the distorting influence of the World Wars, see Shonfield, *op. cit.*, p. 27.

12 Thompson, 'The Land Market', *op. cit.*, p. 47.

13 D. J. J. Botha, *Urban Taxation and Land Use*, Report of a one-man Commission appointed by the City Council of Port Elizabeth, South Africa, 1970, p. 23.

14 B. Jordan, '"Abandoned" Madrid plot worth £5m', *Financial Weekly*, 13.6.80.

15 Whatever the motives of the owners, of course, the disruptive effects on the economy are still the same. Madrid, for example, was obliged to urbanise around the vacant site, which meant that rural land was developed needlessly and people were forced to commute to the city that bit further than was necessary.

16 H. J. Brown, R. S. Phillips and N. A. Roberts, 'Land Into Cities', Cambridge, Mass.: Lincoln Institute of Land Policy, 1980, mimeo.

17 Brown *et al.*, 'Land Ownership and Market Dynamics at the Urban Periphery: Implications for Land Policy Design and Implementation', *World Congress on Land Policy 1980*, editors: M. Cullen and S. Woolery, Lexington, Mass.: Lexington Books, 1982, p. 131.

18 M. M. Bruton and A. Gore, 'Vacant Urban Land in South Wales', Cardiff: Dept. of Town Planning, University of Wales Institute of Science and Technology, Vol. 1, p. 74.

19 'The Strange Leveling Off in Land', *Fortune*, Oct. 1963, p. 124, which notes (p. 128): 'True, most US real estate is bought with borrowed money, and the speculative land buyer must pay stiff interest rates, but these will hardly prompt

a cut-price sale so long as the land increases in value without a lift of the owner's finger'.

20 G. D. H. Cole, 'Capitalism', *A Dictionary of the Social Sciences*, editors: J. Gould and W. L. Kolb, London: Tavistock Publications, 1964.

21 'We conclude that it is meaningful to distinguish two income shares, which we have termed employment (labour) and property income; that this distinction bears considerable similarity to the Marxian and neo-Keynesian classification of income by class shares, but much less resemblance to neo-classical concepts of "factor shares".' J. King and P. Regan, *Relative Income Shares*, London: Macmillan, 1976, p. 14.

22 Matthews, *op. cit.*, p. 93.

23 *Ibid.*, p. 273.

24 *Ibid.*, p. 61.