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HOW TO GET OUT OF THE RECESSION

The UK economy has suffered from the worst recession since the nineteen thirties, and may or may not get out of it soon. Many experts believe that a second dip is on the way. Others think that there may be a very long recovery period, rivalling that of Japan after the collapse of land values in Tokyo in 1990. The optimists are looking for a rapid climb into growth and stability, but without seeming to worry about whether this will eventually lead to yet another collapse, like that of 2008.

Amidst these diverse opinions what policies should the Coalition Government adopt? Nowadays, economic policy falls into two main categories, namely fiscal and monetary. So-called supply side policy is a third option, but even if it is a real alternative there is no doubt that it tends to take time to come to fruition – and at present there isn't time! We are on a knife-edge, where no one knows which way things will fall out.

What then are the possibilities for fiscal and monetary policies? The former is under the huge constraint that there is a budget deficit of around £170 billion. This seems to leave only two basic options: to raise taxation substantially or to reduce expenditure by an equally large amount. Of course, in practice there will be some kind of combination of the two. In fact, the Government has already made its choice. Although there will be some tax increases, notably of VAT to 20% in the 2011, massive cuts in public expenditure in the region of 25%, spread over the next five years, are already being implemented. To some extent these may be genuine efficiency savings, but for the most part they will be cuts in employment, procurement and services of all kinds from defence to welfare. These will hit regions like the North East and South Wales disproportionately, since they have relatively high public employment. Multiplier effects, as public service incomes fall leading to less consumer expenditure, will add to the depressive effect on the whole economy.

But, says the Government, all this will be compensated by higher activity in the private sector, as private firms develop, especially in the export and investment sectors. Why this should happen is not clearly explained. Reducing public expenditure and releasing labour from the public sector does not, unfortunately, automatically raise output and employment in the private sector. Exports and investment are thought to be growth areas. Yet international markets are likely to become more competitive as other countries are similarly looking to exports for their recovery; and investment opportunities depend very much upon a revival of consumer spending. So there is a big question mark over the realism of this policy of expecting the private sector to climb out of the recession, and to rebalance the economy on a sounder private/public basis.

The alternative not chosen by the Government is to raise much more in taxation. Under the existing tax regime this could be disastrous. Income tax, national insurance, VAT and every other tax, except perhaps business rates, hit the margin of production. This takes two forms. Firstly, there are firms whose location is marginal, either because they are sited in regions of lower productivity or because they are locally marginal in the sense of being away from city centres or other areas of high rent. Secondly, the margin of production can be the final labour and capital employed by any firm, including large and well-sited ones. These factors of production are marginal because of the diminishing returns that operate on any site after the optimum level of employment is reached. They are the first to be made redundant when the firm's output falls or when any extra charges are placed on it.

Whatever type of margin of production it is, taxes that are unrelated to economic rent will hit the margin. Marginal firms will make losses and close down. Marginal workers and marginal capital will be made redundant. For this reason, any increase in existing taxes will reduce output for the whole economy. Indeed, less taxation may be collected, even at the higher rates. Such an attempt to correct the budget deficit and to pull the economy out of recession would be self-defeating.

Logically only one solution is to be found to this dilemma. If public expenditure is not to be drastically cut and existing forms of taxation not to be increased, then some other form of government revenue must be found. Fortunately the answer is to hand. The taxation of economic rent would raise large amounts of revenue without having any adverse impact on production at all. Why not? – because the economic rent is a surplus arising from the greater natural productivity of a site and not from the greater quantity or efficiency of the factors, namely labour and capital, using it. The surplus arises entirely from natural features like fertility, from the presence of a community and from the provision of public services. In short, it arises from location. Therefore it belongs in equity to the society that creates it. Were this natural fund collected as government revenue, other taxes that damage firms could be reduced. Output would rise and more economic rent would be available for collection. There is a virtuous circle involved in such a tax shift.

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What then of monetary policy? This, too, faces a dilemma. On one hand, the banking system needs to be controlled, so that it does not descend into a quagmire of bad debts caused by foolish and greedy lending to property developers and delinquent mortgagors, as happened two years ago. On the other hand, the banks need to be free to expand their lending to firms to enable the economy to grow by enterprise and investment. Should the Government limit bank lending or free it from any restraints? Another dilemma!

Yet once again the answer lies in taking a stand on natural law. What is the natural function of the main providers of credit, namely the banks? It is surely to offer loans to those firms that need money to pay for productive projects of any kind that require liquidity in advance of completing such projects. Since production takes time, this means that virtually all firms need loans of some kind, unless they have large liquid resources to hand. The construction industry, for example, obviously needs substantial bank advances in order to employ large resources of labour and capital until its projects are completed and buildings are fully paid for. Yet consumption goods industries similarly need bank money to finance their ongoing stocks, wages and overheads in advance of selling their goods and services for cash.

Government policy on banking, therefore, should be designed to encourage, or to demand, that banks lend for productive purposes and not for barren ones like the purchase of land. Whenever land is bought money changes hands, but nothing is produced. The land is already there and always has been. Buying what is on the land i.e. buildings and plant etc. is, of course, another matter. Transactions in land have to take place. Land has to be bought if firms are to operate and if houses are to be lived in. The effect of these transactions, however, can be gradually reduced in its impact on the economy. For this impact depends upon the price of land. The volume of bank lending for land purchase depends upon this price. When it rose enormously in the decade before 2008, the banks granted huge loans to finance land deals. Were its price to be reduced significantly, bank lending for this totally unproductive purpose would be far lower. Ideally the price of land would be zero, but that is not a realistic target in present circumstances. It would require that all economic rent were collected as public revenue, so that holding land for non-productive purposes would be pointless.

How then is the price of land to be reduced? Once more we need look no further than to the equity of a tax on the annual value of land. Such a tax reduces the capital value of a piece of land proportionately. If the rate of tax were gradually increased the capital value, i.e. the price, would steadily fall. We need look no further for a solution to the monetary dilemma than we did for the fiscal dilemma. Both are solved by the substitution of a land value tax for such taxes as income tax and the rest that fall on the productive areas of the economy.

It should be no surprise to any student of natural law that such a comprehensive solution is available. All the excessive complications of government policy concerning the budget and the monetary system arise from the neglect of natural law. Economic rent is the natural fund for raising public revenue. There is both a moral and an economic case for this. The natural fund belongs to the whole community by right, and it is also the proper means for financing public expenditure of every kind. All that remains is to convince the Coalition Government and its advisers that the acute problems that they face can be dealt with simply by a reversion to equity.