

The Credit Crunch: Cause and Cure

by R. D. Keall

The cause is not the banking system. It is the unearned gains from land values privately monetised through the banking system. This has become a sacrosanct industry promoted by Government with tax breaks.

The cure is to socialise the same unearned, community-created gains, in lieu of taxes. A charge for what we hold or take, not what we do or make, to distinguish public from private property. The cure is a national land value rate levied by, and shared with, regional government. Initially, there should be interim gradations of income/land value as an accommodation to home owners, as against investors.

The Banking System is essentially a clearinghouse for settling trade exchanges in monetary terms, and for matching capital needs with supply. A single national institution could (some say should) fulfill the function, avoid the need for a Reserve Bank and thus isolate the remaining inflationary factor which is outside the banking system. The banking system, including the Reserve Bank, can only deal with cards given to it by Government, including the wild card of unearned gains. No bank can sift out the unearned gains element from countless transactions each day — nor is it their responsibility.

Savings with a bank, used to finance loans to other parties for working capital, overdrafts, credit cards, etc., is a legitimate use of the medium of exchange. Monetising a tradable unearned gain abuses the medium. Financing the purchase of *another* tradable unearned gain misuses it. Currently, the several functions confuse it. Defining the basis for the currency is the Government's role. The value of an artificial privilege convertible into cash is not a legitimate component of the currency base, but it is not the role of the banking system to make that distinction.

Bank loans as such, like credit cards or Bills of Exchange, have to be repaid, normally from earnings. They are not in themselves a permanent, artificial, unproductive expansion of the currency.

Money is essentially a measure of the relative labour content of goods and services permitting the exchange of goods, now, progressively or later. It assesses the relative value of the labour content, whether of brain or brawn, applied by the seller or

avoided by the purchaser, for exchange purposes. Even gold has a dollar price, for these reasons. According to the Reserve Bank of New Zealand,

Money is a medium of exchange, a standard of value, a store of wealth Not just notes and coins, but anything used to effect transactions denominated in terms of money. There is no unique practical definition of money.

When the capitalized value of a gratuitous licence which has no labour content, but does have an effective purchasing power and exchange value for the labour of others, is introduced to the labour exchange process, then the measure is thereby expanded but with no corresponding increase in the goods and services. That's inflation. Too much money chasing too few goods; future money but only present production. Over time the goods and services diminish in value whereas the rights appreciate, compounding the effect.

The valuable licences or tradable rights become part of the indiscriminate exchange of goods, services and equities, all freely interchangeable, quantified in dollar terms, and convertible into cash. Electronic transfers now replace cheques, paper notes and coins. Whilst it may be interesting to quantify M1, 2, 3 and the velocity of circulation, it cannot influence the external rogue factor that drives them. The essential equation is

$$\begin{array}{l} \text{EARNINGS \$} \\ \text{Goods \& Services} \\ \text{Cash \& Cheques} \end{array} + \begin{array}{l} \text{NONEARNINGS \$} \\ \text{Tradeable Rights} \\ \text{Certificates} \end{array} = \text{TOTAL MONEY \$}$$

Inflation often is patently due to using Budget Deficits and Reserve Bank credit to finance social welfare, wars and other political purposes. That initial genesis is of course compounded by the unearned factor above. But with balanced or even surplus budgets, we have still had rampant inflation. The inflation that persists is then disguised under a CPI (Consumer Price Index) that accommodates land price increases at the expense of wages/prices. We work harder for less to accommodate higher land prices under a tolerable net CPI. (Recent property prices have blown that one.)

Commodities, goods and services, derive their exchange value from labour. Their supply varies according to demand. Land is not man-made, has no labour content and an inelastic supply. Its value is derived from artificial right or privilege. Likewise, tradable ownership rights to other natural resources or natural monopolies give purchasing power but produce nothing.

Underlying currency inflation is caused by rising land values. We now have a land values based currency. This is acknowledged in Reserve Bank references to the “underlying inflation of the non-producing sector” — a term covering land and other factors beyond the Reserve Bank’s control.

The Government and the Reserve Bank recognise the “correlation between house prices and inflation.” The correlation is causal, and if anything Monetary Policy promotes it!

They recognise that “Monetary Policy” cannot control currency inflation. They rely on some global calamity to justify their past persistence with an inappropriate, ineffective, counter-productive manipulation of interest rates.

The focus on wages/prices is misleading and disingenuous. Wages and prices both reflect currency inflation; they do not cause it. That they rise more slowly than land values means only that people work harder for less.

Likewise reference to “house” prices and “property” is misleading and a culpable deception.

Conflating land and improvements as “property” or “house” price confuses the two distinct elements. The improvements are the product of private labour and capital, and they depreciate from day one. The land has no cost of production. It is a differential value enhanced by public expenditure on infrastructure and must be recovered accordingly. The inflationary factor is the land value, not the improvements!

Land price only arises because the community fails to collect the annual rent properly due to it. It then becomes capitalised as selling price. Thus an annual charge, such as Rates or a Land Value Tax, reduces the price by the amount of charge capitalised at the current rate of interest. On this basis the boom/bust “business cycle” can be eliminated and we can all share progressively in “Economic Growth.”

When access to natural resources is limited by a full market rental, lease, licence or fee in favour of the community, trading in natural resources is eliminated. Society gains its true source of revenue. Labour finds employment, and the inflationary factor disappears.

“Imported” inflation is absorbed over time in the exchange rate which is just another part of the price mechanism (upset by currency inflation). Likewise, price inflation, which is the inevitable consequence of currency inflation, must be distinguished from

a price rise which is only the price mechanism regulating supply and demand. The CPI doesn't do this.

Land price *deflation* can be caused by trade or currency crises, quite independent of budgets, interest rates or banking practice, e.g., switching OPEC oil settlements from US dollars to Euros will weaken the US dollar and have a deflationary effect despite a return to deficit spending. Currency expansion or contraction is heavily influenced by land price rise or fall — the rogue factor.

All progress of the last 50 years, and anticipated of the next 50, has been captured in speculative land price, privatized and lost. Borrowing to buy in again is not an option. Demand for funds locally and internationally for both public and private sectors will exceed the wasted supply, institutional or personal. The only way forward will be a rental from current production for what we hold or take. This will generate employment and wages — and progressive state funding free of interest.

Robert Keall is the Director of Resource Rentals for Revenue Association, in Takapuna, New Zealand.