LVT could spare Thatcher U-turn!

• The team: Fred Harrison, left, John Loveless, Dr Alex Hardie, Ron Banks, David Richards, Harry Orenstein (who dropped out) and Dr Duncan Pickard. They contributed to *Costing the Earth*, published on June 14.

INSITE reports on the first major study of the value of a nation's land and natural resources in modern times. The results reveal why the British economy is under siege. Can Margaret Thatcher meet the challenge?

THIS BAND of scholars, who first met in 1987 to study the British land market, intuitively feared that achievements in the labour and capital markets – the results of reforms instituted by the Thatcher government during the early 1980s – would ultimately be destroyed by land speculators.

This was the lesson of the history books, but in the past the process has always been blurred by the presence of other factors which appealed as explanations for slumps in business.

Testing the hypothesis that the land market seriously undermines the wealth-creating process has been impaired by the paucity of data. Twentieth century economists have made sure of that: they have all but ignored the land market.

This was not the intention of the leader of the neo-classical revolution, Alfred Marshall (1898: Bk VI: Ch IX), who emphasized the need to disaggregate rent from the profits of man-made capital. Unfortunately, the economists who followed him chose to conflate land into capital and treat rent as part of interest received by the owners of capital. This created the theoretical confusions which have been at the heart of the failures of public policy.

The authors of *Costing the Earth* suspected that the incentive to create wealth was distorted by the greater rewards of land speculation. But to test this hypothesis they needed to fill in the huge gaps in the national accounts.

The general view among economists is that rent represents a small fraction (2-5%) of national income. The UK team, led by property developer and foreign exchange broker Ronald Banks, concluded that in 1985 the rental value of Britain's land and other natural resources was £58bn. This was over 22% of income as measured in the national accounts.

In the last half of the 1980s there was an explosion of speculative activity in the land market. Did this lead to a shift of income in favour of the landowners? The consequences of such a trend were well summarised by Margaret Thatcher in 1980 when – in recalling the property boom of the early seventies – she told a radio interviewer:

We got an artificial boom, and do you know where the money went? It did not go into investment or expansion, it went into the biggest property boom we've ever seen and I don't wish to see the like of it ever again. It did the Conservative Party immense harm, it not only went into these enormous prices of

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property, the boom eventually collapsed, and in the meantime inflation rose and rose and the moment inflation goes up you are much less competitive and eventually unemployment rose again .... Spending more money than you've got when you are already over-spending is not the answer. What that does is to have another artificial boom, have prices going into property going up and up, and that would finish up with increased unemployment.

Because the land market operates in 18-year cycles (Harrison 1983), it was reasonable to anticipate that – with the previous peak in 1973/4 – the next real-estate led crash would occur in 1991/2.

The study found that rent as a percentage of national income increased dramatically, from 22% in 1985 to 28% (1989), moving on to a peak estimated at 30% next year. This trend suggests that, if land speculation **can** destabilise the industrial economy, Britain was heading for trouble.

THE British government's dramatic reform of the economy between 1979 and 1985 focused exclusively on the labour and capital markets. Trade union legislation banned wildcat strikes and other labour malpractices, and the movement of capital was liberalised to make it easier for entrepreneurs to create new businesses and jobs.

These institutional and legal transformations produced the supply-side revolution which the UK desperately needed. Productivity soared ahead of Japanese levels. Why, then, did the balance of payments crisis strike in mid-1988, followed by the sterling crisis in mid-1989? These mysteries dissolve once the trends in rental income are uncovered and properly analysed.

A housing boom originated in the South-East in 1985 which enriched existing homeowners – in the first phase of a land boom that went on to benefit those who owned land suitable for industrial and commercial use. Result: the *wealth effect*. As the asset value of people's homes soared they increased their borrowing and consumption.

A full 80% of the credit base since 1985 has been built on the increase in the value of residential land – which this summer has been fetching up to £2m an acre in some parts of the South-East.

The economic consequence was inevitable: consumer **demand** grew faster than the **supply** side of the economy. The imbalance in foreign trade was the result, for – in the time available – British manufacturers could not hope to satisfy the property-boom based expansion in consumer demand. The table shows what happened: people went on buying sprees, and personal debt – including mortgages – is now estimated to be equal to income.

PERSONAL DEBT IN THE U.K. ECONOMY

	Outstanding debt as % of income
1985	72.8
1986	80.1
1987	89.1
1988	95.0
1989	100.0[1]

• Henley Centre data, reported by Sue Thomas, 'Shoppers losing their taste for plastic debt', *Sunday Times*, May 30, 1989. The 1989 figure is for the first quarter only.

• Last but not least, the seventh member of the *Costing the Earth* think tank, Dr. Francis M. Smith. He took the picture on the previous page!

THATCHER did "tame" the labour market, but the *demand-pull* on the economy has generated a *cost-push* which must find its expression in wage settlements that will now outpace gains in productivity. This is the inevitable outcome of the need to preserve existing living standards.

Employers will agree to larger wage deals to retain the services of their employees – particularly in the South, where the residential land market has been identified as the major obstacle to the fluid operation of the labour market (Bover *et al* 1988).

The rate of increase in the rental value of urban land has far outstripped the rise in other forms of income, especially wages. In relation to housing, employees will **now** have to secure substantial pay settlements to restore a tolerable ratio between their wages/salaries and mortgages.

The Thatcher government adopted a policy of high interest rates to combat inflation and the growing balance of payments deficit. This monetary strategy seriously damages the supply-side of the economy. High interest rates raise the costs of production (making UK goods less competitive in foreign markets) and undermines the ability of entrepreneurs to create new businesses and jobs.

This might have been tolerable for the sake of relative price stability, if it was the only tool available. It isn't. The solution has to be found in fiscal policy.

TAX-CUTTING has been one of the government's most popular policies, but the 1988 budget is blamed by Opposition politicians for the current crisis. In fact, it is impossible to attribute the growth in consumer demand to the increase in disposable incomes which fed into the economy late in 1988: by then, Britain was already robbed of the longterm benefits of Thatcher's attempt at a supply-side revolution.

The error in fiscal policy was to ignore the land market. The classical economists, from Adam Smith and David Ricardo onwards, spelt out that if you improved productivity the net economic benefits would show up as higher land rents.

This economic law has been effectively disguised both by the prejudices of post neo-classical economists and by the trend in tax policy over the past 200 years. The shift towards a tax structure biased against the incomes that people *earn* concealed the way in which land values rose as entrepreneurs improved the capacity of the economy.

Costing the Earth begins the process of proving that a tax on the annual rental value of land is the only policy that could prevent a recurrence of the traumas now being inflicted on the British economy.

POLL TAX THREAT TO LAND MARKET

NEXT YEAR the weakening of the economy ought to be reflected in a weakening of rents.

In the course of the traditional rent cycle the peak in the rate of increase in land values signals a depression by 18 to 24 months – hence the prediction of a crash in '92 by the London-based Centre for Incentive Taxation.

This time, however, the process is further complicated in Britain by the introduction of the Poll Tax. The abolition of the residential property tax will deepen the impact of the land market as landowners respond to the logic of the market.

This is reportedly already happening: the Poll Tax comes into existence this year in Scotland, where private landlords have been accused by Shelter, a housing charity, of demanding a windfall profit estimated at over £40m a year – because the residential property tax is no longer payable.

The sum will be measured in hundreds of millions of pounds throughout the UK, when the basis of local taxation is changed for England and Wales next April.*

The change will buoy up the rental value of residential land and protract the economic problems at the turn of the decade. What would happen if a tax on annual rental values was quickly introduced?

Empirical studies in the United States and Australia verify that this would have several immediate beneficial effects of a counter-cyclical nature.

The house construction industry would be given a new lease of life by the spontaneous release of vacant sites that are being held idle for speculative purposes, and by the fact that the value of capital improvements would not be liable for tax.

As the land value tax rate was incrementally raised the government could reduce the damaging forms of taxation that inhibit personal incentives and deter people from investing their savings for the future.

* Nick Cohen, 'Landlords "profiting from the poll tax"', *The Independent*, May 99, 1989.

Margaret Thatcher is not in the pocket of the landowning elite that traditionally manipulates the Conservative Party – but does she have the courage to confront the most powerful forces in Britain and radically transform the tax system in favour of people who earn their incomes?

Without this reform it will be impossible for a radical free market government to institute changes of a permanent nature. The cyclical property booms will continue to periodically disrupt the supply-side, distort individual incentives and encourage governments (no matter how reluctant they may be) to intervene and "manage" the economy.

Margaret Thatcher has to either adopt the land value tax, or perform one of the most embarrassing U-turns of modern politics and return to the Stop-Go policies of yesteryear.

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