U.S. ECONOMY– INTEREST RATES
NPR program Morning Edition, Dec. 7, 2015.

David Greene, Host, commented about the Federal Reserve having kept interest rates at zero for seven years and having done quantitative easing. He was speaking with David Wessel, director of the Hutchins Center at the Brookings Institution and a contributing correspondent to The Wall Street journal.

Response of Ed Dodson, Cherry Hill, NJ

Take just one of the statements made by David Wessel. He says: "More than 1 in 8 Americans with a mortgage has a house that's worth less than the value of their mortgage." This is not actually true. A house is a form of capital good, and all capital goods are valued by determining replacement cost, then deducting actual depreciation. In most markets, what has fallen and failed to recover is the value of the land beneath the house. To understand what drives property markets requires a thorough analysis of the underlying land markets. Throughout history, land prices are driven upward by speculation to the point where neither businesses nor potential residential property buyers can afford to pay the asking price without huge risk of defaulting on escalating mortgage debt. The collapse in 2008 had other contributing causes, but the credit-fueled and speculation-driven land markets were the core driver. Too few economists understand this to be the case.

David Green reminds listeners that the Federal Reserve has "kept interest rates at zero." In doing so, the Fed generated an unsustainable surge in asset prices at the expense of the savings of tens of millions of people. The short-run result was to stimulate a renewed upsurge in land (and property) prices. Lower mortgage interest rates means (all other things being equal) that the purchasers of property can afford to carry higher levels of debt. This expanded affordability is capitalized by land markets into higher land prices. With households incomes not increasing (or other costs of living rising), the property markets will stall. This is particularly the case because renters are simultaneously being hit with rent increases and are not able to save for a down payment or even to cover closing costs to acquire property. Rising land costs also make it almost impossible to construct affordable rental housing without huge public subsidies. Thus, owners of existing rental units are able to increase rent demands without much risk of losing tenants. Those who cannot afford the rents demanded are forced to move in with family members or, too often, become homeless.

Mr. Wessel concludes the economy is getting better. He notes: "We've recovered all the jobs we lost during the great recession, and the government reported last week we now have four-and-a-half million more jobs than we did before the recession." This is good news. However, an equally-important question is whether those who have returned to the work force are being paid the same wages with the same benefits as previously. Many are not. And, during their period of unemployment many have fallen behind on debt obligations, have lost homes to foreclosure and are among the households competing for the limited and increasingly expensive stock of rental housing.

Mr. Wessel joins with the majority of economists who have little or nothing to say about the ability of the Federal government to service the national debt without significant increases in taxation. And, here, about the only prominent economist who seems to understand the implications of various tax policies on economic growth is Joseph Stiglitz (who has found the basis for his analysis in the writings of the 19th century political economist Henry George). Stiglitz has correctly pointed to existing policies as the main reason for the growth in income and wealth inequality. The way government raises its revenue favors gains on the sale of financial assets and land over the production of goods and delivery of services. Ours has become a society of "rent-seekers" who claim much but produce nothing themselves.

When David Green asks why the government stimulus package has "not worked faster?" there are specific reasons, largely ignored by those we look to as experts. At the heart of the problem is a reliance on neoclassical economic theory to construct public policy. Neoclassical economics asserts that price clears all markets, that when prices are rising supply will increase to bring the markets back into equilibrium. This works pretty well for labor and for capital goods (and even for credit). It works not at all for the primary factor of production, "land."

Most people have no choice but to continue to offer their services even when wages are falling. Stop working and life expectancy is short. Capital goods are in a continuous state of depreciation, of losing functional utility and resale value, slowed only the constant infusion of more labor and more capital goods. The supply of land is inelastic; we cannot produce more or move land from one location to another. So, the demand for land increases the supply of land brought to the market can actually decline due to hoarding and speculation. On a supply-demand chart this shows the supply curve leaning to the left, with no intersection with the demand curve. This is a problem for neoclassical economics, addressed by simply redefining nature as a form of capital. The real world consequences of this have been devastating.

There are a handful of economists I respect who have made a real effort to bring these issues to the public attention. At the top of this list is Mason Gaffney, a long-time professor of economics at the University of California (Riverside), now retired. Right up there with him is the British economist Fred Harrison, whose first book on the role of land markets in the economy -- "The Power in the Land" -- appeared back in the early 1980s. I encountered their writings during the 1980s and the light immediately went on. It is tragic that their insights have not been recognized by the media and found their way in the public discourse. We have paid a heavy price for the ignorance of our policy makers and those they listen to. <<