

# The Coming 'Housing' Crash

## The Dreamers & The Deceived

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THE WORDS promised a revolution. Tony Blair's vision for the future of Britain presented a portrait of a civilised society of the kind that is not accessible to people under the present economic rules. Unfortunately, the economic policies of the New Labour government that came to power in a landslide victory in 1997 were anchored in the ideology of the past.

Mr. Blair did not intend to deceive the electorate. Nor was his next door neighbour in Downing Street, Gordon Brown, motivated by duplicity when he promised that the era of stop-go economics was consigned to the history books.

When the record of the post-Thatcher era comes to be written, no-one will be able to question the sincerity of Tony Blair and his team of politicians who genuinely wished to give the people of Britain a new start; one that would serve as an example for other countries which were similarly afflicted with protracted unemployment, crime, bankrupt welfare programmes and archaic political structures. Some of these blemishes to society will have been modified by New Labour, but the one promise that people will remember was the undertaking to eliminate the stop-go business cycle. And they will find that the government failed.

As the new Chancellor of the Exchequer, Mr. Brown made the following statement in his speech to financiers in the City of London on June 13, 1997:

We must break out of the stop-go cycle under which, every time we expand, capacity constraints and under-investment trigger

inflationary pressures. We need to lock into our economic policy a commitment to consistently low inflation over the long term. Real stability is achieved not when we meet a target one or two months in a row, but when we can confidently expect inflation to be consistently low for a long period of time.

This prospectus was offered in good faith, but it was baseless. It was rooted in a monetary theory that was divorced from reality. Even the government's key statistic was rigged to exclude the one number which might have made it a crude signal of what was happening in the economy - the government's preferred measure of inflation excluded the cost of mortgages on peoples' homes. For the past 200 years Britain, as the first industrial economy, had been subjected to booms and slumps. Economists to this day cannot provide a coherent theoretical explanation for what drives the business cycles which have inflicted untold suffering. The New Labour Party had no deeper understanding of what caused the instability; and no wand to wave which might inject a sustainable stability into the system for the first time.

As the crises emerged it would not be possible to blame the Thatcherite past. The Organisation for Economic Co-operation and Development in its *Economic Outlook* (June 1997) pronounced the British economy healthy when New Labour came to power. It perceived "few of the internal or external imbalances which have provoked past recessions".

Nor could political opportunism be blamed for failures of monetary policy, for Mr. Brown's first act was to transfer power over interest rates to the Bank of England.

Mr. Blair laid out his priorities for a stable economy when he told the European Socialist's Congress in Sweden on June 6:

There is a role for government: market forces are not a new God. But the role of government has changed: today it is to give people the education, skills, technical know-how they need to let their own enterprise and talent flourish in the new market place.

This was idealism at its noblest, a world where people were free to exercise control over their lives. That control has been absent for the 200 years of industrial history, it remains absent today,

and unless there is a "paradigm shift" in thinking, Mr. Blair will not be able to arm his government with the tools to empower people in the future. The fundamental reason why millions of people lack the ability to earn a decent living without interference is not a mystery; but they will continue to be vulnerable because the political and economic system is rigged to filter out of our individual and collective consciousness the one fundamental factor which turns many of us into architects of chaos in the community.

THE BEST of all economic measures to be taken for the prosperity of a community is the appreciation of a value which, for most practical purposes, is not allowed to intrude in the minds of the class that governs us.

As that value expands, the community is enriched beyond what it takes just to keep us reproducing (our families) and producing (the primary material wealth that we consume to maintain our basic living standards).

As that value expands, the capacity of our culture to flourish and our economy to increase its productive efficiency is enhanced.

As that value expands, the scope for personal generosity and social welfare increases in a way that would otherwise be very difficult.

What, then, is that value? It is the rent of land and natural resources.

The technical definition is "economic rent", net income - the residue, or surplus, that is left after meeting the costs of production (interest on capital investment) and reproduction (the wages of our labour).

The rent of land and natural resources. To engage in a discussion on this topic with those economists who are concerned with the stuff of macro-economics (unemployment, inflation and related social policy), recalls the mutual incomprehension that prevailed when Capt. Cook met his first South Sea islanders.

Land is one of the three factors of production, but it has been subsumed into the catch-all category of "capital". It is of almost no interest to economists other than those engaged in the sub-disciplines of agriculture and urban economics. Rent is not

allowed to distract discussions on Globalisation or the future of the Welfare State or the Business Cycle.

That is why the vision that I have presented above, of rental income as the primary measure of social prosperity, is excluded from practical politics. It *would* be included, as the foundation of public welfare, in a rational world built on justice. The economic texts (if you look hard enough) do concede that the formula for the sustainable, self-financing system is to be found, first and foremost, in the correct treatment accorded to the rent of land and natural resources. But that is not our world. We have resigned ourselves to living with the bad times that overshadow the brief periods of good times, a world in which we are obliged to work frenetically (those who retain their jobs) rather than being able to relax and participate in a mutually enriching social *milieu*. A world that collapses from one crisis to the next, in which politics has become the tedious art of crisis management rather than offering creative leadership. Why? Despite the volumes of words written on the subject, the economist is inhibited from explaining why our lives are pitted with regular periods of collective traumas.

There is not much point in asking politicians, either, for a convincing explanation. For when they find that events have slipped from their grip, then - since they think they have done all that is humanly possible - the explanation is deemed to be one that is beyond human control. Governments always seek election with the promise that they will deliver a stable economy; but the four or five years of the life of a parliament is generally sufficient to prove them incapable of producing such a desirable outcome. Thus, two of Britain's former Chancellors, Nigel Lawson and Norman Lamont, were mortified by the boom of 1988 which led to the bust of 1992. They pronounced that the business cycle was the product of natural law. Mr. Lawson put it thus: "There always has been, and always will be, an economic cycle".<sup>1</sup> His successor at the Treasury, Norman Lamont, fleshed out this explanation:

And the fact is you do have recessions, you do have trade cycles, and no amount of sophisticated twiddling knobs can avoid that; and it may be very tempting to try to blame a building [the Treasury] and a number of people in it for the fact that the sun rises or the sun sets, but it's inherent in the world in which we live.<sup>2</sup>

Lord Lawson (now elevated to the peerage for his services to the nation) was to confirm the naturalness of the business cycle when he pronounced that "abolition of the economic cycle is not within the power of any government to deliver".<sup>3</sup> Mere mortals, of course, cannot be held responsible for the workings of natural laws.

Defeated by events and anxious to clear their names in the court of public opinion, politicians resort to a primitive explanation based on the alleged workings of the universe. Thus are reputations rescued by sophism.

CHAOS: we are concerned here with two kinds. First, there are the natural cases which are underpinned by pre-determined boundary or quantum conditions. In addition, there are the unnatural forms of chaos which are to be found in society. These are induced by those man-made laws and institutions which obstruct the freedom of the individual; which are not consistent with the principles of rationality and justice, or the laws of nature. They are, then, dysfunctional. Not surprisingly, therefore, the impact of such arrangements manifests itself in the form of disorder. If such disorders keep repeating themselves in a cyclical form we can call them chaotic but hold out the hope of uncovering the reasons by investigating the logic of their patterns, if such patterns exist. Such patterns will not emerge, however, if we wilfully exclude the data that would identify them; that, unfortunately, is precisely what we do.

As the economy begins to grow buoyantly the rent of land and of the resources of nature becomes a larger proportion of national income. This ought to be welcome: a larger surplus means more to be spent on the good things in life. And yet, it is just at this point that the crisis breaks out and the economy launches itself into a tailspin.

Just as the production of goods and services increases at an accelerating rate, as the manufacturers and the providers of commercial services get into their stride, as the index of growth in the gross domestic product assumes an exciting tempo - the system collapses. Boom/bust: the fateful economic duality which is the bane of governments.

The statistical correlation between the two phenomena - rent, rising and collapsing as a proportion of a growing national income - does not necessarily imply a causal connection between boom-time and economic slump. But how do we know, if we do not study the dynamics behind the trends in rental income? That is a question that does not preoccupy economists for (we have to re-emphasise) the rent of land is a subject that for them barely exists. If that sounds enigmatic, the reader is invited to browse through a standard university textbook on economics. In some 900 pages, the rental income of land and natural resources may receive a grudging mention in two pages. One-third of the national income has been all but tipped into a black hole, ostracised as a subject of research by academic economists.<sup>4</sup> Where policy-makers do occasionally take the trouble to consider land their ruminations are almost exclusively focused on the countryside and almost never do they treat this natural asset as a flow of income: they fix their minds on land as a physical entity.

The outcome of this neglect is the repeated convergence of a pattern of behaviour which is the primary cause of social chaos: the unleashing of negative forces that appear to come from nowhere and which ride roughshod over the industrial economy and over our lives.

We could have expected better from the professionals who deal with property as a tradable asset, which includes bare sites. The quality of the service that they provide to their clients depends heavily on the accuracy of, and access to, information about their market. An efficient market depends on maximum exposure to the pricing signals that determine peoples' decisions about the allocation of resources. We find, however, that with some exceptions, the property professionals contribute to the general confusion by assiduously insisting on not talking about land as a distinct category; instead, they employ general terms like "property" or "housing". Thus are the unique characteristics of land concealed, especially their capacity to influence our lives through the natural environment and through our communities. The land market is left free to operate unbridled in a malevolent manner on society and its ecological environment, in a way that we do not tolerate in the labour market.

The curious treatment of land - our most precious resource - is illustrated by the study that sought to compute property values in Britain in 1995. This drew on data from the Office of National Statistics.

Table 1

**Total Value of Property Stock: UK, 1995 (£, billions)**

Industrial Buildings	32.1
Commercial Buildings	265.2
Other Buildings	134.5
Residential Buildings	1,217.7
Agricultural Land, Building & Forestry	40.8

Source: Office of National Statistics, *United Kingdom National Accounts*, London: HMSO, 1996, Table 12. 1; cited in Mark Callander & Tony Key, "What is the Value of UK Property?" *Chartered Surveyor Monthly*, April 1997, p. 31.

Land is acknowledged once, as an asset in the agricultural sector. Residential property, which is computed to represent 41% of the total net wealth in the UK economy, is characterised as all bricks-and-mortar. The buildings, presumably, are levitating? Factories appear to be airborne, as are offices and shops.

And yet farmland is relatively insignificant compared to the value of land in its other uses. A comprehensive study of UK land values (for 1985 - the year before the land boom of the late 1980s) revealed that farm and forest land constituted 4% of the total value. Compare this to residential land, which was estimated at 34% of the total rental income (including mineral rents).<sup>5</sup>

The United States is no better served. Once upon a time, the Federal Reserve Board did list land as a separate category. For 1994, it estimated land values at \$4.4 trillion and building values at \$9 trillion. This total of \$13.4 trillion of real estate value represented two-thirds of the total value of all real assets (\$20 trillion). However, as with official data available in all European economies (apart from Denmark), the value of land as an income-yielding asset (and one that generates "capital gains") is either grotesquely distorted or ignored. In the United States the rent of land is artificially concealed by a variety of devices such as tax loopholes. While enriching the real estate sector, these loopholes deprive policy-makers of the transparency that is required if the

productive economy is to be freed of real estate bubbles and their ensuing insolvencies. Is this farce orchestrated, or accidental? The reader must judge on the basis of the facts. The rules of the game in the United States are revealing.

Deductions for fictitious depreciation (achieved by overly rapid depreciation, and the redepreciation of depreciated buildings) help to deny US taxpayers a fair system of taxation. Apart from the relatively few urban sites damaged through industrial pollution, the US Government cannot justify the repeated depreciation of an asset that does not physically waste away and whose value is generally upwards only.<sup>6</sup> Urban sites derive their value from their location, the growth of savings recycled into the real estate market (mainly to reap land-value gains), the growth of population, and investment in public infrastructure. These phenomena ensure that the price trend is inexorably upwards over time, despite intermittent catastrophic collapses.

The official data on US land values were not what traders in the market would recognise as real, but at least some numbers were being produced. Land had a formal status in the nation's accounts. Then, in 1995, the Federal Reserve discontinued publishing the estimates. Why? Because those estimates were meaningless! The Balance Sheet estimates for real estate in the aggregate were supposed to represent *current* market value. Because of the methods employed, however, the value of land was treated as a residual value. From the current market value was subtracted buildings at their *replacement value*. The Commerce Department's construction price index was used to estimate the rising reproduction costs of buildings. Thus, the longer a building was left standing - no matter how much it had deteriorated - the larger the amount that was deducted from the property's overall appraised value to derive "land value" as a residual. This produced unrealistically low estimates for "land value". Those estimates were so low that by 1994, in many commercial areas owned by corporations, a statistical illusion was produced that assigned land a *negative* value. The national income economist Dr. Michael Hudson has estimated that corporate real estate alone was undervalued by a trillion dollars in 1994.<sup>7</sup> This is because the reproduction cost of industrial and commercial buildings far

exceeded their actual market value. In reality many sites would be of more value *without* those buildings on them. The Federal Reserve methodology - treating the income of land as a residual - reversed reality: it operated under the assumption that properties would be more valuable with their buildings, but *without* their land! Thus is land implicitly characterised as an awkward intrusion; with life much simpler if only it would go away!

Rather than publish preposterous estimates, the Federal Reserve statisticians decided to publish no estimates at all. They still estimate buildings in terms of their reproduction costs, but the line hitherto labelled "land" is now left blank. "Anyone can do the same calculation we did before, and subtract buildings from real estate to get, well, whatever they want to call it," a Federal Reserve statistician explained to Dr. Hudson.<sup>8</sup>

The US government was producing (and continues to produce) two sets of balance sheets, two sets of books. One is for the tax collector, and the other purports to reveal what really is happening in the economy. Confronted with these two balance sheets - and lacking a coherent theory to interpret the data - it is not surprising that people find it difficult to follow what is happening in the land market and to anticipate correctly the turning points in the growth of the economy. It is equally not surprising, therefore, that the US Government is unable to constrain the rise of asset prices to limits consistent with a competitive and efficient market: officially it does not even know what is going on, for it deprives itself of the requisite information.

By these means are the understanding of the source of all life - and of the greatest financial fortunes - brusquely set aside. Does it matter? Professor Jones claims that it does. In his unique compilation of data on land values from a sample of the leading market economies he demonstrates a pattern that is startling in its regularity. That regularity gives the impression of orderliness. We can see that there is a predictable pattern to the trends in the price of land, but we know from previous studies that the land market is the most unstable of all markets, when viewed over 20-year periods. It exercises a powerful influence - both direct and indirect - on all the major variables in the working mechanism of the market economy. Its power is most forcefully expressed in its

ability to stop those mechanisms from working: to inject an artificial chaos into people's everyday lives.

INSUFFICIENT attention has been paid to the ways in which the chaos makers in the land market shape our destinies.

Despite the assertion by politicians that they are dedicated to stabilising production and minimising the disruption of economic activity, periodic bouts of unemployment continue to afflict our lives; and the role of the land market continues to be excluded from the spotlight. A revealing example - one that is not exceptional and has been selected at random - illustrates the point.

Voters who were courted by politicians in the British general election campaign in April 1997 were told that, if they elected New Labour to government, the business cycle would be smoothed out of existence. At the height of that election the Royal Institution of Chartered Surveyors reported that house prices in some parts of the country had risen by at least 5% over the previous three months. The surveyors were relieved to disclose a buoyant residential market which was the best in 20 years apart from the soaring values of 1988. Thanks to that market, Mr. Blair himself was about to reap a fortune (*box, page 11*). What was the electorate to read into this news? The alarm bells were certainly not triggered. Why? Because the analysts were mulling over a general category - house prices - rather than looking at its component parts. Over the previous year, the price of residential land had risen by up to 16% in some areas, according to one of the country's leading real estate agencies.<sup>9</sup> Such increases in land prices were beginning to exclude families who were planning to build their own homes, but the economists continued their blissful contemplation of the more moderate data which was in line with the government's target inflation figures. A 5% increase in house prices was not a matter for consternation; a forecasted increase in land prices of 30% to 40% in some areas of Britain during 1997 would spell havoc, but concern was not being expressed because the spotlight was not on such statistics. In the event, land prices rose by 33% (East Anglia and South East), 35% (South West) and 30% (Wales), in the year to March 1997, and were forecast to

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## The something-for-nothing ethic

TONY BLAIR'S "tough love" message to unemployed teenagers on a South London council estate expressed the philosophy of his government:

The basis of this modern civic society is an ethic of mutual responsibility or duty. *It is something for something.* A society where we play by the rules. *You only take out if you put in.* That's the bargain.

Five years before he preached that lesson, Mr. Blair purchased a house in north London for £375,000. As he was delivering his strictures on the need to "take out if you put in", he was contemplating the asking price for the house which he wanted to sell: he no longer needed it, for he was moving his family into Downing Street. That price was £615,000.

A sale at close to that price would yield the Blair household an unearned fortune of over £200,000.

In a location outside London that five-bedroomed terraced property would fetch £120,000. So over £500,000 of the price was attributable to the site, the value of which had more to do with the efforts of Roman legionnaires than anything that Mr. Blair had done while residing in Islington.

The Blairs had "traded up" through the London housing market in a fashion that was prudent, according to the rules of the game. Having stepped on to the lowest rung and traded up, Mr. Blair was consolidating a windfall fortune from the rise in land values since he was first elected to Parliament. He was claiming his share of something for nothing.

Extracting something that was not put in (by the efforts of any one individual) was the one underlying ethic that escaped the attention of New Labour's policy gurus.

*It is the bargain that locks unemployed teenagers into the "sink" housing estates in Britain's inner cities.*

SOURCES: *The Guardian*, June 3, 10 & 11, and *The Daily Telegraph*, June 11, 1997.

areas of Britain. "Over the next couple of years this is good news for landowners but land price volatility means that the land market moves further than house prices - in both directions."<sup>10</sup>

What are the policy consequences of this political indifference? A joint study by a Professor of Finance at Imperial College, London University, and the City brokers Merrill Lynch was published a few weeks before the election date was announced. This purported to offer a model of the UK housing market. A variety of variables were analysed, including mortgage interest rates, real incomes and retail prices, to offer a prediction about future trends. The study concluded that house prices were under-valued by 25% below their equilibrium level, and that real house price growth would peak at an annual rate of 12.7% in 1998. The authors claimed that "one of the major advantages with the techniques we employ is that they can be used to forecast how the inter-related variables may evolve over any time horizon we choose".<sup>11</sup> The mathematical equations enabled the authors to conclude that real house price growth would fall back towards zero by the year 2003 and that at the end of the forecast period (2007), house prices would be rising at a year-on-year rate of 11% if the inflation rate was at the predicted rate of 7%.

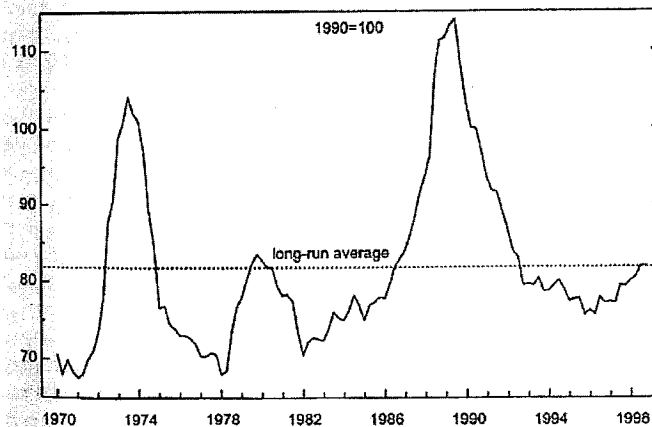
Nowhere in their study do the financial experts from the prestigious institutions of Imperial College and Merrill Lynch make one reference to the trend in the rents or selling prices of land. It was once again as if the housing sector existed in an airborne state. One possible explanation may be that the authors believed that the behaviour and influences of dealers in the land market and the direction of the price of land correspond with the behaviour and price trends in the market for bricks and mortar. This is not the case.

- Land is in fixed supply in those places where people need to live, close to the opportunities for employment. There could be no doubt about the pressure on that stock of land: in Britain it is supposed to cater for an extra 4.4 million new houses over the 20 years to 2016. The supply of land in locations where it is needed shrinks and therefore *its price is inexorably upwards over time*.
- The supply of bricks and mortar *increases* with demand, how-

ever, and *prices therefore tend to decrease over time*. There is no problem about meeting demand in those places where people want to live and work.

The outcome of this primary economic reality is a dangerous tendency towards instability and thwarted expectations, which is most dramatically illustrated by the ratio of people's earnings to house prices (Graph 1). This instability, given the conventional rules of our society, manifests itself in the myriad forms of conflict that torture the industrial economy (such as in labour relations). Most of these social tensions, if we are to believe the economic literature, have nothing whatsoever to do with the land market. But the historical evidence, when it is correctly read, demonstrates that speculation in land pushes its price beyond affordable limits, the fall-out from which works its corrosive influence into every corner of our lives.

GRAPH 1  
UK house price-earnings ratio



Source: *Equipping Britain for our long-term future*, Financial Statement and Budget Report, July 1997, London: The Stationery Office, p.61.

If these types of trends were analysed to reveal the vice-like grip that land monopoly exercises over the wealth-creating process, the policy-makers would not be caught by surprise. They would not need to invoke brutal instruments (such as the general increase in interest rates) to "tame" the runaway economy. But because the influence of the land market is shrouded, politicians are *always* caught on the hop. The most recent case was the *débauche* of 1988/9 throughout the world. Among the victims was Britain's Nigel Lawson, whose political fate was sealed by the failure to adjust economic policy to the economic realities out in the streets. The boom/bust was not his fault, as far as he was concerned. But:

What made it all seem worse than it was, was the failure of the forecasters to predict the severity of the recession.<sup>12</sup>

Now, if a recession can be predicted, there is likely to be something that can be done about it; unless, of course, we subscribe to the hurricane theory of recessions implied by statements such as those offered by Lord Lawson. But Lawson was incorrect: the timing and severity was forecasted in good time for corrective measures to be taken against the forces that would wreck many households. In a book published in 1983 I analysed economic trends in terms of the 18-year cycles in prices that can be traced in the land market. I noted that, with the previous trough in 1974, 18 years of growth would be terminated in "yet another deep-seated depression of even greater magnitude than the structural recession which began in 1974".<sup>13</sup> That dated the next trough to 1992. In Britain, the bottom of the depression is acknowledged to be in the first quarter of 1992. There was no magic about the prediction: it merely required an unprejudiced analysis of those factors that destabilise the industrial economy. After publication of the book I submitted a briefing paper to alert the Treasury to the date and severity of the next recession, but its officials evidently failed to brief Mr. Lawson when he moved into No. 11 Downing street. Had they done so, he would not have complained in his memoirs that forecasters had failed to signal the severity of the next recession.

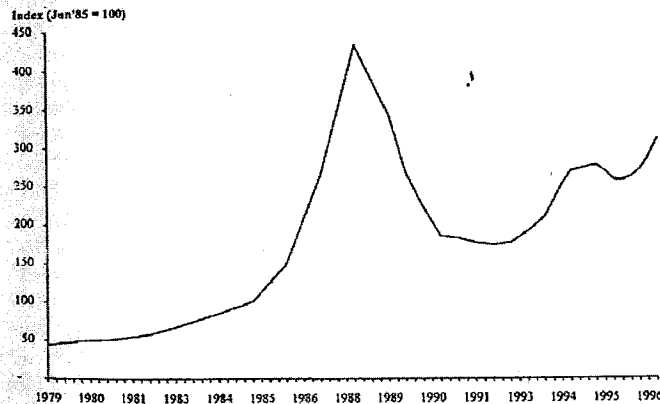
Might the Treasury have independently anticipated events?

### According to Lawson

The first indicator of the recession that lay ahead was house prices. These had been rising at a staggering annual rate of over 30% at the end of 1988.<sup>14</sup>

Again the casual treatment of economic factors! If Lawson thought that 30% was a staggering statistic, what would he have said if he had looked at the numbers in the land market, where prices were leaping by 100% and even 150% in the residential land sector (Graph 2)?

**Graph 2**  
Performance of UK residential land values

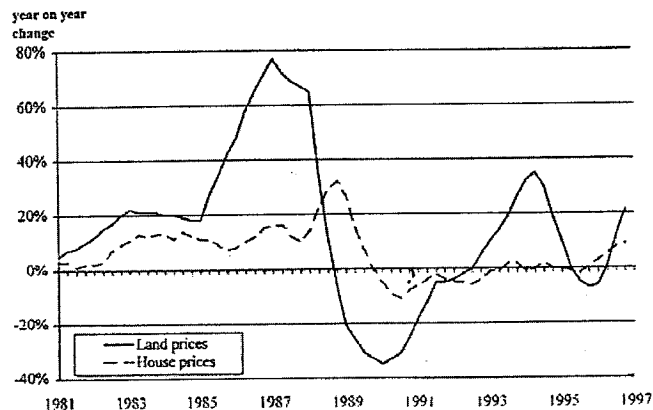


Source: Savills Research, London

But why assign causal significance to land prices? Lawson shared the consensus view which dominated the Thatcher years (and to be fair, this was the conventional wisdom of the previous years under Labour governments); namely, that "rigidities of the British pay culture" (i.e., trade unions) were heavily responsible for increasing "cyclical fluctuations in unemployment".<sup>15</sup> But could it be that greater responsibility lay with land prices? Graph

3 compares the year-on-year changes in land and house prices. We see that land prices rise higher and collapse before the trends in "house" prices. I have offered an account of the macro- and micro-economic impact of this relationship elsewhere.<sup>16</sup>

**Graph 3**  
Land prices and house prices



Source: Savills Research, London

THE COLLECTIVE failure of the economics profession (and, therefore, of the governing class) is not so much with the tools employed by the analyst as with the singular refusal to treat land (or, to be more accurate, the rent of land) as a relevant category. Economists employ mathematical and algebraic tools to try and model the economy in a way that would enable them to identify the points of friction. They persistently fail, which by now ought to indicate that they are not looking for the right clues: an army of Watsons without a General Sherlock Holmes. If this is correct it means that, no matter how sophisticated their tools, they are bound to draw erroneous conclusions. And that, indeed, is the sad record of economics, a discipline which even some of its leading practitioners have characterised as being in a state of terminal decline.<sup>17</sup>

Economists favour econometrics to analyse the economy and offer predictions. This technique merges economic theory, mathematics and statistics to enable the economist to test data scientifically. Econometrics is a comparatively recent addition to the economist's methods (dating from the 1930s), but Professor Jones bases his analysis on the even more recently developed theory of catastrophes. This is an innovative tool which has proved to be fruitful in a variety of disciplines, illuminating knowledge in areas which might not have otherwise been accessible.<sup>18</sup>

Catastrophe theory accepts both the reality of instability and the possibility of long-run stability in a working system where small errors are magnified into large problems if they are not anticipated and corrected. Professor Jones concludes that chaos need not reign in the economy. He reviews the policy options that are available to governments to smooth the growth of output, and endorses a conclusion that has, in fact, stood the test of time and theoretical examination.<sup>19</sup>

Despite the rampant instability in the economy, we ought not to be surprised at the proposition that stability *is* achievable. A guiding law of evolution as it has shaped the destiny of our species has been the propensity to develop a cosmology that imposes order on what would otherwise appear to be a chaotic world. The search for "the laws of complexity" is now a new and controversial pursuit in academia,<sup>20</sup> but it is an activity as old as the power of intuition in mankind. The early philosophies and religions were systems for integrating seemingly random and mysterious facts into unified and meaningful wholes. Survival depended on the ability to understand the workings of the universe and to be able to "make sense" of them: that was the creative genius of *Homo sapiens* who, in the pre-scientific era, could convincingly "explain" phenomena that would otherwise be intolerable intrusions into daily lives.

Today, we have new views on the world. Scientists claim that there is a unity in the forces of nature which they can lay bare. Psychoanalysts suggest that the quest for order in our relationship with the outer world stems from a sense of chaos within ourselves.

If we accept the idea that being less than perfectly adapted to the external world is part of man's biological endowment which stimulates his imagination, it is not surprising that so many of the people who develop the most fertile imaginations are driven by inner tensions.<sup>21</sup>

The history of the natural sciences is a remarkable record of our capacity to project an order on the world by deepening our understanding of the laws that regulate nature. By a cumulative process, one generation of scientists is able to build on the knowledge of its predecessors to generate increasingly richer theories that open up for us the former mysteries of the dynamics of the cycle of birth, growth and death in all aspects of life. Laws replace myths; laws that can be falsified by the accumulation of new evidence and replaced by seemingly more accurate portrayals of the observable facts. Progress is made through the honest testing of information to expose and discard false notions, a mind-clearing technique that enables us to move on to new hypotheses about what makes the world go round. Scientists accept a number of rules that are rigidly enforced: one of these is that concepts must be accurately defined and consistently applied. By this means they are able to communicate with each other in a meaningful way. It is not a question of whether the results of tests from one laboratory are ideologically congenial to the researchers in another laboratory: the results are objectively measurable and the tests repeatable, or they are not, in which case they are discarded.

And then there are the social sciences. People find it perplexing that we cannot match our views on the unity of nature with equivalent understandings about the unity of society, at least in its post-tribal forms. Society is riddled with the damage inflicted by disorderly processes; one outcome is that sociology, which ought to be one of the most exciting and valuable of the social sciences, is routinely ridiculed by commentators.

Globally, for example, it is hard to understand why there are 50 million children who are mentally or physically impaired because of inadequate nutrition<sup>22</sup> when the world is sufficiently richly endowed with natural resources to enable all parents to provide

for the needs of their offspring. Those parents have the natural instinct to want to feed their children so that they might grow up healthy in mind and body. And yet, something evidently prevents them from achieving this primary ambition.

In the natural sciences, refinements in our sense of order are achieved when formerly incomprehensible theories - often condemned as mad and dangerous - turn out not to be the delusions of lunatics. All that is required is the accumulation of sufficient data to be able to demonstrate (for now, at least) that a hypothesis has been "proved". This "proof" is no more than that the theory "explains" events to the satisfaction of observers based on an honest appraisal of all the relevant data. And yet, in the social sciences, we find an abiding resistance to a certain category of facts; especially so in one area of political economy. The result is a social pathology stemming from an anti-scientific, irrational streak in our collective consciousness. Those facts are the ones that relate to the creation and distribution of land's value (which contrasts starkly with the law as it relates to the articulation of property rights in land, which is precise to the last detail)<sup>23</sup>. The explanation is to be found in ideology. Land is said to be unimportant; not worthy of the talents of John Maynard Keynes, for example; he, the most influential of economists in the 20th century, who dismissed land in his most important book, treating it as a historical curiosity, relevant to earlier farm-based societies only.<sup>24</sup>

INSISTENCE on the clear definition and consistent use of concepts is an invariable rule of natural scientists which is routinely abused by economists. Words are loosely employed which then colour debate in the mass media to the point where misunderstandings are a regular hazard of discourse. A key word like "inflation", for example, is used to signify any price rise, no matter what the cause; thereby enabling commentators to get excited about a trivial statistic, the better to confront government with an apparent crisis worthy of a headline.

One result is that statistics *per se* are ridiculed, when the fault actually lies with the way in which they are mistreated by prejudices that are portrayed as theories. The mistreatment of the

unemployment statistics during the Thatcher years is a case in point.

Wrestling with statistics and theories is the means towards an end: formulating policies that enable us to construct solutions to problems. How the problem is *perceived* helps to determine whether a correct solution is generated or not. If economists and governments adopt an indifferent attitude towards land we would not expect researchers to ask appropriate questions; which may explain why economists are still not able to solve the problem of the business cycle. But worse than that: by formulating the problem incorrectly, "solutions" may be adopted which may and do further exacerbate the underlying problem. An example, chosen at random and with no intention of placing a special burden of responsibility on the scholar concerned, is a research project at the University of Warwick in England which sought to explain high unemployment in the industrial nations.

Andrew Oswald, in a study which he warned was conjecture with a high content of speculation, sought to relate unemployment to the rate of home ownership. With about 30 million people officially unemployed in the OECD countries (over 10% of the workforce) the subject was of unquestionable importance. Noting that the secular rise in unemployment had proved difficult to explain, Oswald hypothesised that the cause might be found in the housing markets: did the rise in home ownership constrain the reallocation of people to new jobs by making owner-occupiers relatively immobile? If so, western governments that had encouraged home ownership were evidently misguided; moreover, the workers themselves would in part be responsible for their fate by succumbing to the attractions of owning rather than renting their homes.

The statistics charted by Oswald were tantalising. Countries with the largest rises in home ownership during the 1970s and 1980s had the largest rates of unemployment. As a general rule, an increase of 10 percentage points of owner-occupation was associated with an increase of 2.2 points to joblessness. In the case of the UK, Oswald claimed that the 30% increase in home ownership in the past few decades was responsible for almost 6% of extra unemployment. In 1996, Spain, Ireland and Finland had the highest unemployment rates in the western world; they also

had the highest proportions of home ownership. Switzerland, with the lowest unemployment rate in Europe, had the smallest amount of home ownership.

In the 1960s, North America had the greatest proportion of people unemployed; it also had the highest concentration of owner-occupation of housing. Events began to change from then, however, for the US and Switzerland were unusual in that they had little increase in home ownership. They also experienced almost no rise in unemployment.<sup>25</sup>

What are we to make of this? Why should the ownership and sale of a readily reproducible asset like bricks and mortar be any more of a constraint on the jobs market than the ownership and sales of cars or washing machines? Mobility is important to a dynamic labour market, but in the 1980s *the shortage of skills in locations where they were required appeared only during the period of land speculation*. This can be very well documented, for example, in the construction industry where the trade associations take the trouble to track events in the land market as well as in the labour and capital markets.<sup>26</sup> The mobility problem stemmed not from tenurial rights, *per se*, but with the prices that freehold owners were demanding, which did obstruct the ability of people to move from one region to jobs in another region.

Precisely why does friction develop in the residential market? What are the motives that underpin that apparent friction? There is no mystery about the expectations of home owners who resist "doing a deal" at realistic prices to enable people to move in and out of locations. The name of the game is capital gains. But from where does the home owner expect to make those gains? He is obviously not expecting to do so from bricks and mortar: they depreciate with age in the same way as cars and washing machines. *The rise in "house" prices, with few exceptions, is entirely attributable to land!*<sup>27</sup>

We now have a possible explanation for high unemployment rates in certain countries which has little to do with the division between owner-occupiers and those who rent their houses and apartments. We would expect the higher rates of immobility to show up in those countries where people were most extensively engaged in land speculation in the residential sector. Unlike bricks

and mortar, as we noted above, land is in fixed supply. Therefore, by protracting one's occupation of the asset one can reasonably expect to reap a significant capital gain on the original purchase price. The result is to drive prices above their affordable levels and reduce output, which dislocates the economy.

How does this competing thesis, which focuses on the land component of the residential market, square with the exceptional case of the United States? That country has seen profound bouts of land speculation since the 1960s.<sup>28</sup> The land speculation thesis is not damaged by the US evidence. The uniquely high levels of migration into North America serve both to drive up the price of urban land and drive down the level of wages even without an increase in owner-occupation.

The policy implications are now thrown into stark relief. If we were to accept the categories and analysis offered by Andrew Oswald we would conclude that governments ought to limit the right of people to own their homes. This offends our notions of freedom and intuitively does not make sense in terms of the operations of a market economy: we want people to build and own houses to meet their needs, and that activity (if rationally based) ought to be to everyone's benefit; or, at the very least, at no-one else's expense.

But if the problem of unemployment is viewed in terms of the exercise of monopoly power in the land market, an entirely different strategy suggests itself. Some individuals make unearned gains from a natural resource. In the process they inflict damage on the welfare of other people. In all conscience, this cannot be regarded as a morally legitimate form of entrepreneurial activity, and it is certainly not consistent with the principles of efficiency within the framework of the market economy.<sup>29</sup>

Thus, we see how the remedy is suggested by the way we frame the problem; and the degree to which the remedy is appropriate depends on whether we have been correct in the original description and analysis of that problem. The fact that economists and governments of the western democracies underplay the significance of land may explain why they have yet to banish the business cycle and mass unemployment.

The correct remedy is the one that treats rent of land as public

revenue. This fiscal strategy lacks novelty apart from one characteristic: that of being correct. It entails the reform of the structure of public finance in terms that were originally expounded by the French Physiocrats; they wrote at least a quarter of a century before the Industrial Revolution, and their principal finding that the rent of land is the ideal source of public finance has been repeatedly affirmed as correct right up to the present time.<sup>30</sup>

The treatment of rent as public revenue would eliminate the acquisitive force behind the booms and busts. In addition, it would become possible to untax people's earnings from work and saving, which would liberate people to exercise rational choices. That boom/busts do disrupt the pattern of investment and production can be gauged by the impact of recessions on the growth of people's disposable incomes. In the United States, for example, in 1995 the median income had dropped back to the 1989 level: five years of work, and (in real terms) people were no better off. The fiscal reform proposed here would ensure that the short-term private interests of the individual would converge with the long-term interests of the community. This would enable people to plan the accumulation of savings over their earning life-cycle to the point where the price of capital would drop to very low levels: it would be at this point that poverty and unemployment would be permanently eliminated within a system of sustainable development.

AFTER HIS defeat in the British general election in 1997, John Major made his resignation speech on May 2, outside No. 10 Downing Street. His political epitaph consisted of a catalogue of statistics. This was supposed to summarise the legacy which the Conservatives were bequeathing to the New Labour government.

The economy is booming, interest rates are low and inflation is low and unemployment is falling. The growth pattern is well set, the health service is expanding, the education service is improving and the crime statistics are falling... the incoming government will inherit the most benevolent set of economic statistics of any incoming government since before the First World War.

One statistic was missing. Over the previous 12 months the

price of housing land had risen by between 25%<sup>31</sup> and 35%.

The incoming Premier, Tony Blair, and Chancellor designate Gordon Brown, perpetuated the notion that it was possible to maintain a stable economy if monetary policy was administered responsibly. This view echoed the monetarist views of the Thatcher era, during which Chancellor Lawson had emphatically stated: "In a free economy, the only way you can keep the economy on track is by use of interest rates".<sup>32</sup> The New Labour leaders felt confident about promising the British electorate that there would be no business cycle dislocations on their watch. They would be even more vigilant than the Tories!

That was a promise reiterated on July 2, 1997, when the long-term fate of Blair's New Labour government was sealed by the fatal weakness in his Chancellor's first budget. With these words to the House of Commons, Gordon Brown entered the famous-last-words anthologies:

I am determined that as a country we never return to the instability, speculation, and negative equity that characterised the housing market in the 1980s and 1990s. Volatility is damaging both to the housing market and to the economy as a whole. So stability will be central to our policy to help homeowners. And we must be prepared to take the action necessary to secure it. I will not allow house prices to get out of control and put at risk the sustainability of the recovery.

Two initiatives were supposed to deter the next housing boom:

- Tax relief on the interest paid on mortgages was reduced by 5%, from 15% to 10%, from April 1998.

The land price cycle, which has a virile history of 200-years, will shrug this off with no difficulty. The previous Conservative administration reduced the tax relief by 25%, from 40% in 1991 to 15% in 1995, a comparatively savage reduction which did not deter the explosive lift-off in housing land prices which at one stage achieved an annual growth rate of 40% (see Graphs 2 and 3, pp.15-16)

- Stamp duty payable on the sale of houses was raised from 1% to 1.5% on properties above £250,000 and to 2% for properties sold at more than £500,000.

With these measures Gordon Brown intended to combat a housing boom in favour of stable long-term growth, but he was placing an unfair burden on his weapons. At a typical mortgage interest rate of 7.75% a borrower with a qualifying loan of £30,000 would pay £9.70 a month extra in 1998-99, or an annual loss in income of about £120. This is equivalent to an interest rate rise of under a third of 1%. Set against this, however, the shrewd home owner imbued with the "trading up" psychology takes into account house price rises of anything between 5% to 10% a year as the land-price cycle gears up. With the average price of a house at £60,000 in 1997, according to the Halifax Building Society, a 1% increase in prices returns a capital gain of £600. That comfortably offsets the loss of tax relief. A 5% increase yields a gain of £3,000. A 10% increase nets an unearned capital gain of £6,000. Against such realistic expectations the cut in tax relief (which is an unwarranted subsidy that ought to be eliminated on grounds of fairness) is puny, with no macro-economic significance whatsoever.

Fairness was the principle against which Gordon Brown wanted his budget to be judged. Compare, therefore, his tender treatment of the property market with his intentions towards unemployed youngsters. Public money invested in the education and retraining of unemployed youths and to help them secure jobs, declared the Chancellor, had to be matched with new responsibilities. There was no option "to stay at home on full benefit. So when they sign on for benefit they will be signing up for work. Benefits will be cut if young people refuse to take up the opportunities". There was nothing wrong with the sentiment, but why reserve it for idle youths when land owners wilfully retain out of use (or in a state of severe under-use) vast quantities of extremely valuable land? This land is needed by people to provide themselves with homes and jobs. For two centuries, idle and under-used land has placed an artificial ceiling on Britain's growth potential. Yet Gordon Brown offered no formula for calling culpable land owners to account; owners who are enriched out of the value created by the community (public value is a correct characterisation of the net income, or economic rent, of land).

Gordon Brown was correct to state that the fabric of society is

heavily determined by the structure of taxation. He said:

The tax system sends critical signals about the economic activities a society wishes to promote and deter.

In the era of New Labour, the signal to unemployed youngsters is that they will have to earn what money they receive from the public purse; while land speculators may continue to hoard land - literally: keep it unemployed, even while its price rises - until it suits them to make a "killing" out of capital gains.

The property boom in 2,000 will come as a shock to Gordon Brown; who, if he is still presiding in Britain's Treasury in the first decade of the millennium, will (like Lawson) be politically traumatised by the astronomical unearned gains from land that will be pocketed by shrewd operators who know how to manipulate the tax system.

A SIMILARLY distorted structure of public finance blights economic policy in the United States, where Joseph Stiglitz, who was chairman of President Clinton's Council of Economic Advisors, moved to the World Bank as chief economist in 1997. He assured:

[T]here is no higher likelihood that we will enter a recession in the near future than there is at any other time. In fact, quite the contrary. I would say that a very large proportion of economic downturns have been caused by monetary policy stepping on the brakes too hard in the face of inflationary pressures. We don't have any inflationary pressures right now, so I don't see any potential for a downturn.<sup>33</sup>

This was the conventional analysis of an economist who read the signs in terms of the supply of money and levels of interest rates, but who did, in fact, also understand the way in which investment in land could disrupt the economy. Referring back to the Reagan era, he noted that

a disproportionate amount of that [investment] went into building commercial real estate, which was left vacant and helped lead to the *débatcle* of the late 1980s. As a result, what you had is an investment expansion that was based not on fundamentals but on misguided tax distortions.<sup>34</sup>

It had been land speculation, pure and simple, and the "misguided tax distortions" were not misguided at all; tax policy was deliberately guided in the direction of penalising work and saving and rewarding those who speculated in future capital gains from land. And that fiscal philosophy had not been corrected sufficiently to warrant the clean bill of health issued by Dr. Stiglitz.

Dr. Stiglitz, along with the finance ministers in governments in all the market economies, were guiding the ships of state with blinkers on their eyes. The macro-economic significance of real estate "tax distortions" needed to be analysed carefully, not treated as a residual problem. Such an analysis would reveal distortions that were subsidies to landowners and disincentives on the people who work and save. The outcome is inflated land prices and the depressed output of goods and services; the cyclical frenzy of land speculation and the crushing of communal and individual welfare. Attention to such a process would be drawn by the publication of a Land Price Barometer. Alas, the missing statistic meant that the ministers with their hands on the wrong levers could not, in fact, hope to eliminate the recurring boom/busts.

The consequence is predictable. By 2007 Britain and most of the other industrially advanced economies will be in the throes of frenzied activity in the land market to equal what happened in 1988/9. Land prices will be near their 18-year peak, driven by an exponential growth rate, on the verge of the collapse that will presage the global depression of 2010. The two events will not be coincidental: the peak in land prices not merely signalling the looming recession but being the primary cause of it.

Why can't we prepare for this tragedy? The track record of its practitioners belies the claim that economics is a social science, for a science is supposed to offer predictions; and the one phenomenon that economists do not predict with confidence is the turning point in the business cycle. They are obliged to resort to hindsight, as historian Eric Hobsbawm acknowledged in his review of the 20th century. Summarising the postwar years, he asked:

Why should the world economy have become less stable? As

economists observed, the elements stabilising the economy were now actually stronger than before, even though free market governments, like those of Presidents Reagan and Bush in the USA, Mrs. Thatcher and her successor in Britain, tried to weaken some of them..... As this era was still continuing at the end of the Short Twentieth Century, we may have to wait for some years before the economists are able to use the historians' ultimate weapon, hindsight, to find a persuasive explanation.<sup>35</sup>

It ought not to have been necessary to have to resort to hindsight to explain the aggravated instability of the second half of the 20th century. Social scientists ought to be able to quantify the elements that are at the source of the problems, which they would have been able to do if they had been willing to employ a theory that was capable of zeroing in on the source of instability. The reason why the economy had become less stable was that more people were participating in the get-rich-quick activity of land speculation in its various guises. This took either direct forms, such as "trading up" in the residential market, or buying and selling sites in the commercial sector; or indirectly, as with buying into pension funds and insurance companies which invest heavily in land-rich corporations, and the trade in securitized debt on real estate.

There was no need for the market economies to be caught unawares in 1974, 1982 or 1992, or by the next mid-cycle crash in 2000 which will be followed by the major economic collapse in 2010. Both these looming catastrophes will be driven primarily by activity in the land market.

This prediction could be translated into appropriate corrective action if the politicians and their policy-advisers face the facts. We should not be optimistic. The capacity for collective amnesia where the bad economic news is concerned is a psychological state acknowledged by the Bank for International Settlements, the Swiss-based central bank for the world's central banks. In its 1997 report, BIS said: "This potential for 'memory failure', with costs that may span decades, argues strongly in favour of central banks being given a clear mandate to ensure price stability".<sup>36</sup>

This proclivity for memory failure is nurtured by what passes for capitalist ideology. The outcome is a sledgehammer approach to

economic policy, which is now principally framed around the word *inflation*. The rapid rise in money values is a disturbing phenomenon, and one that needs to be avoided. That is why governments want "sound money". But what is the consequence of treating the rate of inflation - the general increase in prices - as the single most important barometer of the state of health of the economy? When prices are smoothed to a single number, the policy-makers are deluded. Thus, when the Blair government came to power the rate of inflation was a fraction over 2%; this was deemed to be a sound achievement of the Major government. But as we have seen, land prices were escalating in some regions where people wished to live and work by an annual rate of up to 40%. And no-one was planning to do anything about it.

When the rate of inflation is said to be rising, governments resort to a crude policy instrument: interest rates are raised. This punishes people who are innocent. A *general* rise in interest rates to "cool" the economy injures the businessman who needs to borrow money to oil his productive enterprise: his costs rise for no good economic reason and he loses business to his foreign competitors. Meanwhile, the actual problem - the overheating land market - is barely affected: the cost of the rise in the mortgage interest rate is more than covered by the capital gains that the borrower anticipates.<sup>37</sup>

Sooner or later politicians will agree to neutralise the negative influences of the land market. That will necessitate the development of a Land Price Barometer that relates price trends to the general prosperity of the community. How this barometer would function is implicit in Professor Jones' statistics and made explicit in his analysis. If governments are to improve their performance on behalf of their citizens, they need to retreat from their state of virtual reality into the realms of the world in which most people earn their living.

But having the correct facts is one thing; knowing what to do with them - the correct policy response - is another. The Japanese, for example, are advanced with their methodical tracking of the evidence, which they justify in these terms:

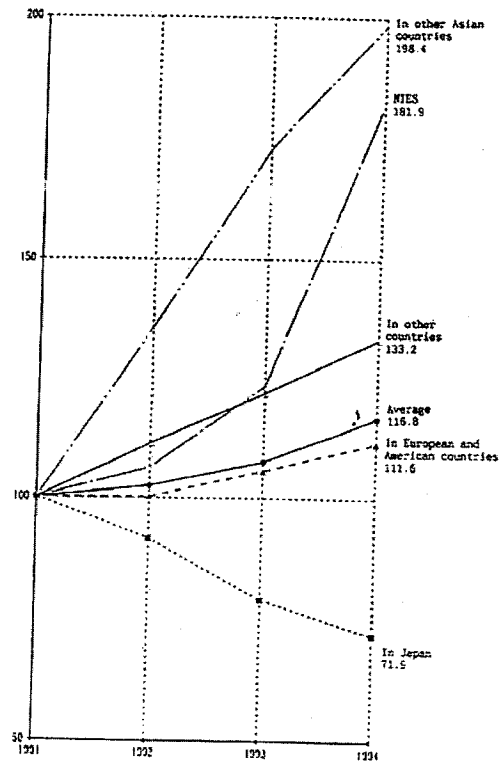
[S]ince people, property, money and information move in a borderless

realm in our modern age, where these elements mutually affect each other, it has become increasingly important to survey and compare data and information relative to real estate both at home and abroad with particular reference to how it affects our daily lives and our economy.<sup>39</sup>

Japanese workers paid a heavy price for the record growth in land prices during the 1980s, one consequence of which was "our losing industries which are moving abroad and also proving to be a barrier to foreign industries locating in Japan".<sup>39</sup> Graphs 4 and 5 (on page 31 and 32) compare residential and commercial land prices. Japan was in a seriously weakened state at the beginning of the 1990s. Land prices crashed in Japan compared with other countries. By the mid-1990s, most of the OECD economies were just managing to pull themselves out of the depression. The major exception was Japan, where (by January 1997) land prices across the nation had dropped for the sixth consecutive year. They had fallen by 62% in big cities since the all-time peaks in 1991, according to the National Land Agency. But although Japan is unique among the OECD countries in that the land component of the economy is now treated as a category that warrants serious analysis, successive governments in Tokyo have failed to adopt fiscal policies that would neutralise the forces that periodically induce chaos in that country's domestic markets.

The global nature of the economy commends a uniform approach to correcting the obstacle to prosperity; an obstacle that is common to every market economy, and from which few people benefit. Professor Jones identifies the fiscal policy which he argues would correct the chaotic conditions, a policy that is fully elaborated from historical and legal perspectives by Kenneth Jupp and in economic terms by Mason Gaffney.<sup>40</sup> The solution lies in the treatment of land and natural resources as the public's primary revenue-generating asset. The technical economic and legal specifications of the stabilisation programme are not the problem: the obstacle lies in the minds of men. Economic historian Joseph Schumpeter acknowledged this problem when he publicly warned economists that "there exist in our minds preconceptions about the economic process that are much more dangerous to the

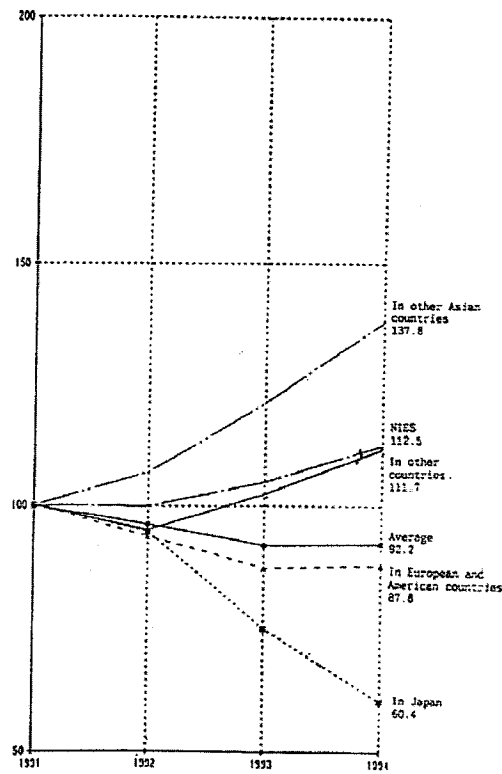
**Table 4**  
**Japanese residential land prices for family homes**



Source: The World Land Survey 1995, Values of Land, Homes and Rentals, Land Bureau, National Land Agency, Japanese Association of Real Estate Appraisal, p.8.

cumulative growth of our knowledge and the scientific character of our analytic endeavours because they seem beyond our control in a sense in which value judgements and special pleadings are

Table 5  
Japanese commercial land prices



Source: The World Land Survey 1995, Values of Land, Homes and Rentals, Land Bureau, National Land Agency, Japanese Association of Real Estate Appraisal, p.8.

not...We shall call them Ideologies".<sup>41</sup>

The political quest continues for the stable - sustainable - economy.

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