Fiscal 'jungle' threat to global recovery

by Fred Harrison

WESTERN leaders failed to agree on a satisfactory package of fiscal and monetary policies when they met at the Versailles economic summit last month.

So we are still in that "jungle" of controversy over the future of fiscal and economic policy which Senator Howard Baker, leader of the Republican majority in the U.S. Senate, referred to after the breakdown of talks with President Reagan in April.

The result is the perpetual postponement of recovery into sustained growth. Policies being pursued in the capitals of the industrial economies are contradictory and self-defeating, almost wilfully designed to thwart the ambitions of employees and entrepreneurs who want the freedom to get on with the task of creating new wealth.

Muddled thinking is undermining efforts to increase investment and employment. This critical situation will continue so long as there is no agreement on an effective strategy for reforming a system that is patently malfunctioning.

THE SUPPLY SIDE economics of President Reagan and Mrs. Thatcher continue to dominate policy. We saw in a previous issue[1] why this strategy would fail. Simply stated, the proposition is that sustained recovery will not occur while the imperfections of the land market enable a small group of monopolists to capitalise the value of tax cuts into higher land values.

● HENRY REUSS

This analysis is based on the economics of Henry George, whose classic work was devoted to the study of industrial recessions.[2] We can now begin to test George's proposition that recovery will occur only when one – or a combination – of three things happens:

- the share of national income received by wage-earners drops significantly;
- the share going to rent-receivers drops significantly; or
- a significant increase in productivity provides entrepreneurs with the internally-generated cash to reinvest in new capital equipment, thereby stimulating output.

On the basis of a superficial analysis, the signs in **Britain** at the moment suggest optimism.

Employees suffered a big drop in real income in the first half of this year, thanks to a moderation in wage increases – the lowest rates for four years.

And market analysts are now issuing guarded warnings against investment in property: they point to the unfavourable trend in the property index compared with company shares. The growth in rental income has been slowing down for the best part of three years. Rents for prime property have tended to underperform inflation over the last two years, and are now flat in money terms.

On top of this, there has been a measurable increase in productivity (bought at the expense of a 3m "shake-out" of workers from jobs).

DOES THIS all add up to the ingredients for a sustained recovery? Alas, no. There are two reasons.

The first concerns government policy. Mrs. Thatcher, like President Reagan, attained power with the promise to cut taxes; this was supposed to stimulate investment which would increase the supply of goods onto the market.

In fact, thanks to Conservative tax policies, the government now takes 57p out of every extra pound that is earned – compared with 55p in 1978, according to calculations made by Andrew Dilnot of the Institute of Fiscal Studies. The marginal tax rate is now $2\frac{1}{2}$ per cent higher that it was in the year before Mrs. Thatcher was sent to Downing Street in 1979.

This does nothing to increase investment or expand household consumption. But there is another consideration which is ignored by the economic analysts.

Land monopolists, although confronted by mounting vacancies in office blocks and on industrial estates, are still poised to nip any sign of growth in the bud.

As Sir Kirby Laing, chairman of Laing Properties, reassured shareholders in his annual report:

TABLE I: Income arising in the UK – Appropriation Account (£m)

	Companies & Financial Institutions		Industrial & Commercial companies	
	Gross Trading* Profits	Rent & Non-trading income	Gross Trading* Profits	Rent & Non-trading income
1979	27,285	11,283	30,057	2,438
1980	25,135	15,083	29,614	2,915
1981	24,211	16,644	31,149	3,413

* Before providing for depreciation and stock appreciation

"... periods of recession usually offer the best chance for generating attractive opportunities for the future."

Rents have not slumped in a way that would have been predictable on the basis of historical experience, when the worst recessions were associated with a total collapse in the land market.

Since 1974, the land market throughout the Western world has been supported by a variety of government and banking devices.

Until last year in Britain, despite the collapse of the manufacturing sector, rents have been a buoyant source of income compared with the return to capital (Table I). The real rate of return on capital employed by industrial and commercial companies (excluding North Sea activities) in the UK in 1981, was 2½ per cent.[3]

Not surprisingly, therefore, people with money to invest have been putting it into land rather than capital equipment (Table II), thereby prolonging the recession.

Industrial rents have weakened this year – but *not by as much as we would have expected on the basis of the slump in output*. Why?

According to Hillier Parker, one of Britain's leading real estate agencies:

> **"... the manufacturer can take comfort from the recent improvement in productivity ... which has resulted in only modest increases in unit costs. Without this improvement, rents would have fallen further behind inflation."**

In other words, land monopolists have been able to capture the gains in productivity – gains which, in a rational economy, ought to have gone to entrepreneurs in the form of higher profits and used for fresh fixed capital formation. As can be seen from the Investors Chronicle-Hillier Parker Index, industrial rents recovered markedly in the six months to last May – coinciding with the increase in productivity.

THE ONLY way to neutralise the rent effect which is consistent with other goals – optimising the use of resources, encouraging hard work, rewarding entrepreneurial risk-taking, preserving a free market – is to impose a heavy *ad valorem* tax on the annual value of land, i.e. the economic rent of land in its unimproved state.

TABLE II: BRITAIN – Gross Domestic Fixed Capital Formation

(1975 prices: £m)

	Private Sector	Manufacturing	Dwellings	Transfer costs of land & buildings
1979	14,198	3,969	3,623	695
1980	14,289	3,577	3,129	674
1981	13,878	2,947	2,363	719

* Including purchases *less* sales of land and existing buildings

The importance of defining a workable land tax policy is exemplified by the alarm that emerged from Dublin when the newly-elected Government of **Ireland** announced a capital gains tax at the rate of 60 per cent on gains made within a year.

Critics claimed that this would deter investment and close down the Dublin Stock Exchange within a few years.

But it then transpired that the target was not share deals but speculation in development land around Dublin, which had made millionaires out of rural landowners.

Rates of return at current replacement cost (net)*

Industrial and commercial companies and manufacturing companies based on national accounts data

Per cent

	All industrial and commercial companies	Industrial and commercial companies excluding North Sea	Manufacturing companies
1977	7.4	7.0	6
1978	7.7	7.2	6½
1979	6.6	5.3	4
1980	5.5	3.6	2½
1981	5.0	2.5	n.a.

*Pre-tax rates of return on production or trading activities in the UK.

The value of prime sites near the capital have increased from I£40,000 an acre to I£200,000 "overnight".[5]

The over-stretched land market has already claimed its first major victim – the Gallagher Group, the Republic's largest property developer, went into Receivership in May. The cost of two prime Dublin sites acquired within the last year is believed to have led to the Group's undoing.

THE WAY to take the heat out of any land market is to tax the prospective gains on an annual basis, and the first step is to make sure that the fiscal marksman can hit his target. This means that the politicians have to call a land tax precisely that – a land tax – and not a capital gains tax.

By increasing exchequer revenue from land, investors are persuaded to look elsewhere for profitable opportunities.

Such a course was proposed by **West Germany's** ruling Social Democrat Party at its Munich Congress in April.

Unfortunately, because of the fragile nature of Chancellor Helmut Schmidt's coalition Government, observers were not willing to bet that the party's policies would move from resolution to legislation.

A firm political lead from one of the leading western nations is crucial if reforms – rather than some horrific alternative such as the militaristic solution – are to generate a new dynamism in the economy.

The failure of the established political parties to initiate change suggests that reformers may have to look for action from the grass roots: people who are the victims of recession may be able to persuade the politicians that constructive change is long overdue.

Investors Chronicle-Hillier Parker Rent Index — **Change (%) per annum on previous reading**

	1969	1972	1973	1974	1975	1976	1977 May	1977 Nov	1978 May	1978 Nov	1979 May	1979 Nov	1980 May	1980 Nov	1981 May	1981 Nov	1982 May
ICHP Rent Index	+9.3	+12.2	+39.8	+16.0	+2.8	+1.2	+4.8	+8.5	+14.1	+16.5	+23.4	+17.0	+15.9	+8.6	+9.2	+7.1	+5.4
Shops	+7.8	+14.0	+26.3	+15.1	+5.9	+6.7	+6.3	+12.3	+21.7	+24.3	+26.6	+19.6	+11.8	+5.5	+8.2	+8.4	+7.1
Offices	+11.4	+12.9	+55.1	+12.1	−2.8	−4.9	+1.6	+5.6	+12.5	+12.2	+18.6	+14.7	+16.6	+12.9	+12.9	+9.7	+3.7
Industrial	+7.0	+8.1	+24.0	+28.9	+13.2	+7.9	+8.9	+9.2	+7.8	+14.3	+27.9	+17.5	+20.4	+5.6	+4.3	+0.6	+6.2

Might that upward pressure occur in the **United States**? Congress is trying to exercise budgetary influence over the President, but political commentators are sceptical of the possibility of substantial success. One of them noted:

"... it is against tradition for Congress to take the lead in shaping the budget. The big congressional battles have not been fought over budgets but over sedition acts, slavery, tariffs, the fate of Senator Joseph McCarthy, equal rights, the crimes of President Nixon."[6]

This is too fatalistic a view. Despite the cumbersome written constitution, Washington's political processes are capable of change.

For example, Henry Reuss, chairman of the influential Joint Economic Committee, recently proved to the constitutional experts that Congress has the legal capacity to instruct the Federal Reserve Board to change its monetary policies.

Mr. Reuss is the senior Congressional politician in favour of land value taxation, but the influence that he exercises is not now likely to bear fruit. For he is not seeking a return to the House of Representatives in the mid-term elections in November.

Even so, with U.S. unemployment forging ahead from its present level of nine per cent, many people are looking for a standard bearer.

Fresh opportunities for shaping fiscal policy must continue to present themselves. For tax policy is at the heart of the U.S. economic debate. President Reagan is staking his credibility – and re-election for a second term, if he seeks it – on the belief that sustained growth will follow a restructured fiscal system.

The controversy, of course, arises when questions are asked about *who* should benefit from a change in taxation. It is now evident that the policy-makers have not yet demonstrated an awareness of the critical need to bring land value taxation into their reckoning. The land monopolists will therefore continue to enjoy the benefits of their unearned income with the knowledge that, whatever else may happen, they will continue to sit on an asset that appreciates in value even while the jobless tramp the streets in search of employment.

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4. *A Forecast of Industrial Rents*, No. 1 (April 1982): Press Notice dated 26.5.82.
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6. Henry Brandon, 'Persuading men to enjoy cactus', *Sunday Times*, 9.5.82.

ST. LOUIS STUDY PROVES IT:

Voters would back land value taxation!

BY THE EDITOR

***LAND & LIBERTY* analyses developments in land tax policies throughout the world in a special nine-page report in this issue.**

Land value taxation is still neglected by the world's statesmen; but activist groups and professionals are showing an increasing awareness of the importance of this fiscal policy.

Starting with a report on the Dublin budget plans (p. 69), our correspondents report from as far afield as the Dominican Republic, in the Caribbean, to Denmark, to Western Australia "down under".

THE ETHICS of sharing the value of nature's resources, while preserving the liberties of the individual, are beyond dispute.

Opponents of those reforms that emphasise the need to displace the tax burden away from income earned by labour and capital, and onto socially-created land values, rarely dare to challenge the land tax on equity grounds.

Instead, appeals are made to vested interested groups, the largest of which is made up of home-owners. They are scared into thinking that land value taxation would undermine the secure possession of their domestic domain.

Economic efficiency, then, has to be the basis of a reply to such opposition.

We know from all the evidence – empirical studies (such as the pilot survey of Whitstable, in south-east England), and the practical results from places where buildings are untaxed – that the theoretical claims are verified.

Nonetheless, while waiting for statesmen to be gripped by the conviction that their constituents would be best served by this fiscal reform, we must continue to advance the case through fresh research.

The results add to the overwhelming conclusion that economic efficiency cannot be optimised, and justice cannot be seen to be done, until the value of nature's resources are captured for the public benefit.

EVIDENCE from one such study has just been published by the Public Revenue Education Council of St. Louis, Missouri.

The Council asked itself: What would happen if taxes on buildings were wiped out? Would people end up by paying *more* if the property tax fell exclusively on the value of land?

A random sample of properties in St. Louis was examined. The researchers worked on the assumption that the same amount of finance would have to be raised via the property tax. This is what they found:

- 73 per cent of properties owned by individuals would pay less. The average tax decrease was **$66** (23 per cent). 27 per cent of the properties averaged a **$45** (51 per cent) tax increase.
- Vacant, under-developed and deteriorated properties would have to pay higher taxes. These, in the main, are owned by corporations, banks and trusts. Even so, big organisations also stand to gain by a change to site value taxation. 50 per cent of the banks and trusts, and 25 per cent of the corporations, stand to pay lower property taxes in St. Louis.

RESULTS such as these go a long way towards persuading people that, on the grounds of self-interest alone, they should back the proposal to change the nature of the property tax.

But the local, individual benefits do not constitute the whole case for land value taxation; indeed, comparatively speaking, these are minor benefits. Greater attention ought to be paid to the macro-economic benefits, a major point emphasised in our report on Jamaica (pages 70 to 74).

Analyses at the level of the economy, unfortunately, are bedevilled by a shortage of relevant data – and most important of all, reliable indices of long-term trends in land values and rents.

Even so, these shortcomings must not be used as excuses for parochialism or even inactivity. Never before in the history of industrial society has the need for land value taxation been either more obvious or more urgent.

Land & Liberty will remain alert to global developments, and we ask our readers to monitor events in their countries on our behalf. We need all the material – from Press reports to official documents – that we can get.

Our goal is a reform of a tax system which, today, actively inhibits people from achieving the social and economic lifestyle to which they are entitled in a civilised community.

POLITICS & THE LAND TAX

10 pages of reports start on P.69