# it's the *land* economy, stupid!

# part 2: sustainable land markets in the public interest

**In the second instalment of a two-part article on land and housing markets, Stephen Hill examines the structural problems caused by excessive real estate debt and proposes policy and fiscal reform to rebuild sustainable property and land markets that provide the foundation for a fairer society**

The first part of this article, published in the December 2012 issue of *Town & Country Planning*,[1] examined pioneering research by Professor Peter Ambrose and the RICS on the potentially destabilising social and economic effects of land and house price speculation in the UK and other developed economies, and considered the shortcomings of neo-classical economic theory and valuation theory and practice in shaping solutions to dysfunctional land and property markets. This second part analyses the structural problems for national economies associated with excessive debt attached to real estate, and outlines a comprehensive programme of reforms needed to unlock investment in infrastructure and bring housing and land markets back into equilibrium and serve a positive function in the social and economic life of the country.

**'When will we ever learn?'**

Writing and speaking as a Liberal MP in the run-up to the 1906 general election campaign and the 1909 People's Budget, Winston Churchill argued that the strength of the economy and the welfare of all citizens depended on stable and fair land markets, and that inequitable wealth creation though inflation and speculation in land prices undermined basic freedoms: 'The best way to make private property secure and respected is to bring the processes by which it is gained into harmony with the general interests of the public.'[2]

The Liberal Government's answer was to tax the 'scarcity rent', or unearned income from inflationary and speculative land value increase, as proposed by the 19th century thinker Henry George – i.e. an annual tax on the value of the assumed optimal use of land ('optimal use' as also, as noted in Part 1 of this article, in the RICS Charter – 'securing the optimal use of land and its associated resources to meet social and economic needs').

However, George's analysis was defective. He was as much an abstract and universalist theorist as the neo-classical school he was critiquing. He did not see that the uniqueness of land and natural resources in the context of the political economy of each country and its institutions – particularly financial institutions – might bring about very different effects in different places.

By contrast, the Norwegian economist Thorstein Veblen, working in the USA in the late 19th and early 20th centuries, made the link between real estate and what he called 'financial predation'. By using the development of the growing country town as his example, he characterised real estate as 'the great American game… an enterprise in 'futures'.[3] The economic rent, or excess profit, to be derived from speculative land sales became accepted as the normative price for land, and was thus capitalised unquestioningly into corporate financing and individual mortgage debt by the banks. Their willingness to supply credit then fed the inflationary pressures on the very commodity it was secured against; and so ultimately undermined the financial sustainability of property assets, which nevertheless remained the banking system's essential medium for transactions, and thus undermined the banks themselves. Sound familiar?

George would not extend his proposed reforms to the banking sector, considering that the correct pricing of agricultural land through taxation would be sufficient. Both he and Veblen were successfully marginalised by the neo-classical schools then gaining ascendancy in the American universities, supported by landowners, bankers and others who have relied on these schools ever since for their sources of advice and intellectual respectability. They were rendered ineffective as much by being ignored as by being refuted, simply taking rent-seeking out of the spotlight.

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Veblen, however, always retained a popular readership for his ideas, and is enjoying new prominence internationally. Michael Hudson, an academic economist and Wall Street adviser himself, has been at the forefront of reviving interest in Veblen. He emphasises Veblen's importance for his analysis, derived from the German historical schools and the American institutionalists, which retained rent theory and its corollary idea of unearned income as an unnecessary overhead on productive national wealth creation.

Veblen also understood what the neo-classicists did not – that debt is important as a form of capital which 'determines who gets what, and how income is distributed or siphoned off'. He maintained a focus on financial institutions being able to exploit rent-seeking opportunities, which even Marx's critique of capitalism had not foreseen. 'More than any other institutionalist, Veblen emphasized the dynamics of banks financing real estate speculation and Wall Street manoeuvring to organise monopolies and trusts.'[4]

Since Veblen's and George's time, however, vested land-owning interests and their advisers have, mostly successfully, resisted the idea of annual land value taxation or other forms of rent recovery, despite their successful application in rescuing failing markets and tackling social and economic dysfunction in particular places across the globe. The promoters of the Garden Cities understood that they also had to create a settlement-wide land and development model which replicated these principles if they were to achieve their intrinsically long-term objectives. The Garden Cities remain a ground-breaking, innovative and uniquely popular 'growth' model, and are one of the few examples of successfully applying principles aimed at moderating the impact of short-term land speculation in the public interest that have also been sufficiently resilient to adapt and stand the test of time.

Yet the widespread application of Veblen's and George's ideas remains elusive, regarded by some as 'so simple, so fundamental and so easy to carry into effect that I have no doubt that it will be about the last land reform the world will ever get'.[5] Nevertheless, Veblen predicted exactly what we have recently witnessed in a significant number of national economies. The conjunction of land markets and financial institutions was constructed just as he had described them; although magnified, this time, by the software and banking culture of systematised betting unimagined in Veblen's time.

**Low-carbon rather than real estate 'futures'?**

However, Veblen's and George's principles should now be understood more broadly as central to the debate about the value not just of land, but of all those resources of nature that were traditionally viewed by neo-classical economists as 'not scarce', but which now clearly are. As EU Environment Commissioner Janez Potocnik and *Financial Times* Chief Economist Martin Wolf have acknowledged (see Part 1 of this article),[6] nationally located land and natural resources have to be understood as essential parts of the production processes that underpin the performance of a nation's GDP, as well as playing a part in determining global wealth creation and distribution. The management of land and natural resources also lies at the heart of any realistic attempt by UK plc to meet the 80% reduction in carbon dioxide emissions needed by 2050. But land and natural resources are still considered off-limits for political action and intervention.

In a speech to the World Bank in 2002, Herman Daly,[7] Professor of Economics at the University of Maryland, proposed taxing 'the resources and services of nature and to use these funds for fighting poverty and for financing public goods… In fact, failing to tax away the scarcity rents to nature and letting them accrue as unearned income to favoured individuals has long been a primary source of resentment and social conflict.' He was imagining a situation that feels uncomfortably like now; a time of greatly increased resentment at the social, economic and environmental disparities and spatial injustices that have grown up over a generation, and which have been exposed by the current economic crisis and are now embedded in global austerity policies.

As noted in Part 1 of this article, Conservative Party Chairman Grant Shapps was therefore absolutely right, when Housing Minister, to seek to open a debate on what would an intelligent housing market look like.[8] He also rightly acknowledged that 'market conditions don't exactly match this picture at the moment. The economic legacy... has made things very, very difficult... and will do for some time'.[8] Let us hope that he and his Ministerial colleagues understand the true cause of this legacy, and which economic legacy it is that needs to be addressed.

Former Prime Minister Harold Macmillan put his finger on it in a private letter to Margaret Thatcher in 1980: 'Any attempt to force money onto unbound borrowers will lead to disaster.'[9] The Lady was not impressed. The absence of any of her customary marginal notes, even of disagreement with her predecessor, suggests her utter contempt for such prudence.

**Above**

In Karlsruhe, in Germany, an urban brownfield site has been redeveloped through arm's-length municipal project management for 'building groups'

However, the true legacy of the financial deregulation that began in the 1980s is that we are now a nation awash in debt, too much of it property related, as Veblen would have foreseen. Public debt of £1 trillion is a concern, of course, but, as the Chancellor has had to acknowledge in the Autumn Statement, it can be lived with. At historically modest levels over two centuries, it is dwarfed by private debt of £6.4 trillion at 477% of GDP, nearly half of which is housing and commercial property debt – and not to mention £5.5 trillion of derivatives still to be unwound, allegedly matched by asset values.

In late 2010, John Hawksworth, Chief Economist at PwC, argued that 'Sooner or later, this will have to be addressed… deleveraging goes well beyond the immediate challenge of getting the public finances under control.'[10] Yet, in summer 2012, even the Bank of International Settlements, the central banks' central bank, reported that 'during the crisis, rescued banks did not reduce the riskiness of their new syndicated lending compared to their non-rescued peers. In fact, our results suggest that the relative riskiness of their lending increased.'[11] Martin Wolf described the effect of global capital inflows from Far and Middle Eastern GDP surplus economies into the GDP deficit countries of Western Europe and their property markets as 'the biggest misallocation of resources imaginable';[12] a misallocation that is now more pronounced as these funds continue to flood into housing markets in London and the South East,[13] supplemented by capital flight from failing euro-economies. London property, much of it now unoccupied, is effectively the 'new gold'.

So despite Mr Shapps' entreaties, we continue to pretend that house prices are affordable and sustainable, when they are costing up to 20 times average incomes in many parts of the country, while incomes are now in continuous real decline. Only rising house (and land) prices – i.e. 'getting back to normal' – are commonly regarded as a 'good thing'. Yet in 2007, Martin Weale, then Director of the National Institute of Economic and Social Research, and now on the Bank of England's Monetary Policy Committee, estimated that annual house price increases were equivalent to a government current account deficit of 4.4% of GDP, or £65 billion a year.[14] It is unlikely that even Veblen could have imagined any government permitting, and to some extent encouraging by its policies or lack of policies, such a significant drag on economic performance, and a huge opportunity cost on national social and economic wellbeing.

**Global financial realities**

How much more decarbonising of the economy, sustainable infrastructure and job creation could have been afforded with that £65 billion a year? The answer to that question is not one that can be considered just in terms of national policy. The last 30 years of financial deregulation has also coincided with a global pattern of under-investment in infrastructure; a deficit that is now being rectified at speed in the newly emerging economies. But older economies, like the UK and USA, need major infrastructure investment too, especially if they are to remain competitive. As EU Environment Commissioner, Jane Potocnik has noted, Europe now looks very weak against China, with its ability to buy up and colonise the world's land and natural resources.

The World Economic Forum[15] and the McKinsey Global Institute[16] have estimated global infrastructure needs at $3-4 trillion annually. On a range of low to high global growth scenarios to 2030, they also estimate global deficits of savings against investment requirements of $0.8-2.4 trillion annually. With many governments constrained in what they can spend, the search for private long-term investors is on, matched by those investors also looking for secure inflation-proofed investment opportunities.

Competition for the sources of investment that are available will be fierce. The prize will go to those countries able to offer the greatest certainty and predictability of timely planning and delivery, and thus the flow of revenues back to investors. UK life assurance and pension funds are certainly in the market, but their preconditions for investment will be hard to meet; the premium for illiquidity for anything up to 50 years, and the demonstrable lack of a robust and clear strategic spatial planning investment framework in the UK, for a generation past, will be high. In both the USA and UK, investment managers have little experience in these asset classes, and thus a lesser interest in them as investment opportunities.[17]

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McKinsey's 'rule of 2.5' suggests that to raise GDP by 1%, spending on infrastructure and other capital needs to increase by 2.5%. If the UK is to return to a situation where it remains globally competitive, with annual growth in the order of 2.5-3%, then it needs to be investing up to £95-110 billion year-on-year in meeting the country's everyday infrastructure needs. That order of magnitude in investment will not be achieved by exhortation to pension funds and life assurance companies, or by random acts of planning deregulation taken from a short-term political perspective.

As the Chairman of the Long Term Investors' Club[18] said on the homepage of its website: 'The economic and financial crisis has clearly shown the limits of what is essentially a 'short-term' market approach. Difficulties encountered in durably reviving the economy stem partly from the lack of structural mechanisms to sustain a long-term recovery.'

**The case for radical reform**

Long-term investors will not be impressed by such recent political statements of intent as 'We can either spend money on council tax benefit or take a little cut on that and a little cut elsewhere, then put it all together in order to spend money on developing our infrastructure.'[19] The already rich rent-seekers will win again at the expense of the poorest. Only a considered series of major policy and fiscal reforms will be sufficient to create an entirely new kind of climate for long-term investment. There are five overarching and interlocking areas for this reform:

- ***Local government finance – reforms to unlock the investment potential of public property assets, public capital and revenue investment, combined with more strategic use of spatial planning, sustainable economic development and wellbeing powers:*** Local authorities remain disempowered in their current relationship with central government, with insufficient freedoms to create the conditions in which private and other public investors will invest long term in 'their place' with certainty and confidence.

  Recent reviews of local government finance and the failure to address the need for revaluation of the local tax base in England, under this Government and the last, continue to undermine the financial autonomy of local government, and put local authorities at a huge disadvantage compared with their mainland European counterparts and competitors for attracting new investment and jobs. The revaluation exercise is commonly branded as 'too difficult'. Devolved administrations in Wales and Northern Ireland have accomplished their revaluations without either political meltdown or IT embarrassment.

- ***Spatial planning and climate change – reforms (of culture not legislation) which ensure that spatial planning becomes what it was originally intended to be; namely, a strategic enabling framework for public and private investment that has the capacity to create investor confidence:*** This is an unfashionable political idea; but without good strategic planning, private money will not come.

  Contrary to received opinion, the last thing that long-term investors want is a deregulated and unstrategic planning system. Adventitious relaxations of the Green Belt (an outdated policy that certainly does need reform) or misplaced ideas about 'freeing up' the planning system simply open up planning to the unstructured and damaging rent-seeking activities of land speculators. This will not impress or attract investors whose investment needs to be assured through predictable, consistent and inflation-proofed returns up to 50 years ahead. They will only invest in situations that are sustainable, in every sense of that word – i.e. properly risk-managed. This requires strategic spatial focus, sustained political leadership and commitment to growing particular places, and technical expertise to respond to the climate change and fossil fuel shortage imperatives that will undoubtedly be encountered during the lifespan of the investment.

**'Contrary to received opinion, the last thing that long-term investors want is a deregulated and unstrategic planning system'**

- ***Infrastructure investment and delivery – reforms that create new national and local infrastructure investment banks, of the kind commonly seen in mainland Europe, Australia and Canada:*** The Green Investment Bank and recently announced bond guarantees are valuable, but essentially too small and limited in scope. Infrastructure UK is an important initial move towards the effective integration of private investment with focused public investment in areas that are committed to the levels and type of sustainable growth that is right for their locality.

  What are self-evidently missing from current plans are the providers of shorter-term development finance for infrastructure. For instance, without lending institutions to smooth the cashflow for CIL-funded local infrastructure, the much praised experience of the Milton Keynes Tariff cannot be replicated. It was wholly dependent on an £80 million Treasury facility which turned English Partnerships into a local development bank to ensure that enabling infrastructure was completed in a timely way, so that development could follow infrastructure. Maybe a reinvigorated Public Works Loan Board and the resources of our publicly owned banks could be turned to these productive and wealth-creating purposes?[20]

  Public 'spending' should also aim to secure an economic as well as a social return on its investment. Ironically, the period 1950-76 was the only period since 1875 in which the UK was not the lowest spender on infrastructure among the developed nations in Europe and North America.[21] This was, of course, the period of post-Second World War reconstruction up to the IMF crisis, during which New Towns were the centrepiece of government spending. Ironically, the New Towns were one of the UK Treasury's most profitable investments ever, generating returns to the public purse in land receipts right up to the present day. The Treasury took and benefited from a 50-year view. The current inefficient mechanisms and short-term view of infrastructure needs are not fit for purpose for today's global land and investment markets.

- ***Property-related taxes – reforms that abandon the current emphasis on taxing production and earned incomes, and move progressively away from inefficient and perverse transaction taxes in favour of a fairer and more efficient system focused on consumption, unearned wealth and the use of property and land:*** Only the state can ensure a fair and progressive allocation of those scarce resources which have a uniquely important role to play in the life and finances of a modern political economy. Land price unconstrained by public interest considerations is one of the main reasons why it is so hard to move to a fairer society and a low-carbon economy. Land price still externalises all the environmental costs that other aspects of public policy are trying to tackle through regulation, at the most contested and policy-inefficient moment in the investment and development cycle.

  Negative incentives should include central and local taxes to discourage both non-development and delaying or carrying out less than optimal development on allocated or consented land beyond the delivery targets of a plan period, thus frustrating the objectives and soundness of the spatial plan through untimely delivery. Facilitated by the other reforms proposed, housing producers must be put into a position where they have to compete genuinely on cost, quality, variety, quality of aftercare, and speed of delivery, free from the current pressures and temptations of speculating further in land futures.

  Such taxes should not just be focused on owners of development land. Most homeowners are now rent-seekers. Over a generation, many will have gained more in untaxed unearned house price increases than they pay in income tax, leaving disadvantaged private and social renters and the unhoused to carry the whole burden of their own welfare. The Deputy Prime Minister has already articulated a more thoughtful approach to tax reform than the crude and populist 'mansion tax' annual charge proposals:

  *'Old progressives are obsessed with one single marginal tax rate… rather than looking at the overall system… and allow symbolism to trump real reform. By contrast, new progressives want to reform the tax base fundamentally, towards taxation of unearned wealth and pollution, rather than people.'*[22]

**'There are options for selective restrictions of enfranchisement rights, alongside public action in land assembly, to maximise the potential for value created to go into infrastructure and thus contribute to long-term affordability'**

- ***Land policy reform – reforms in land assembly to bring forward the quantity of land actually required:*** The Housing Forum's *Land for Homes* report in 2009 examined the ability of housing producers to create their own land supply. Over the post-war period, a good average might be in the order of 140,000 plots (as opposed to total starts and completions) per annum. Any ambition for 240,000 or more homes a year therefore begs the question: 'Who generates the rest?' There are few realistic alternatives to state action in land assembly.[23]

  Positive incentives should encourage landowners to participate in consortia with public enabling bodies committed to bringing forward plan-led development. Landowners would obtain a guaranteed minimum price for their land and a share of value created after investment and development, subject to their participation in a Voluntary Partnership Agreement (VPA) for land development with public and private land developers. Additional tax credits should incentivise landowners to defer any land receipt and profit-taking until the development is completed. VPAs would become an attractive, quicker and cheaper alternative to Compulsory Purchase Orders as the principal means of public agencies acquiring a sufficient interest in land to make development happen.

  There is also a case for rethinking leasehold enfranchisement rights. The leasehold and freehold options in English land law traditionally provided very efficient means for allocating capital, risk and reward, and helped to ensure that development land remained a long-term investment, rather than a short-term speculative commodity. By permitting enfranchisement since 1967, the process of commodifying land and the houses that go upon it has been reinforced. Similarly, the Right to Buy, by using significant public resources in capital receipts and cost recovery forgone, has merely stimulated the post-deregulation rent-seeking culture, without contributing to overall supply. Trying to revive the Right to Buy now will have the same effect: the very opposite outcome to Mr Shapps' intelligent housing market ambitions.


**Above**

Ordinary citizens are beginning to take action to remedy market failures and lack of political will– community organisers London Citizens outside St Clement's Hospital in East London, campaigning for a Community Land Trust to build genuinely affordable homes, related to local incomes

There are options for selective restrictions of enfranchisement rights, alongside public action in land assembly, to maximise the potential for value created to go into infrastructure and thus contribute to long-term affordability. The Community Land Trust (CLT) phenomenon shows that some new homeowners are also willing to opt out of their enfranchisement rights voluntarily. Residents in the St Minver CLT in North Cornwall are living the principles of George and Veblen, forgoing any increase in the land value of their homes, and giving up the rent-seeking potential of speculating in land.

CLT residents have made the choice that politicians dare not offer. They are acting out the principles of David Ricardo's Law of Economic Rent, recognising that it is 'the rent of land [that] continues to shape the destiny of communities, as the glue that holds together the parts that constitute civilised society'.[24] Ricardo and all modern economists would, however, have assumed that it was governments that would be the prime-movers of such economic policies and actions. But it is, in fact, ordinary citizens that are taking action to remedy the failures of markets and the lack of political will, even if the scale at which CLTs can operate is necessarily small. It is simply more important to CLT residents to live in that particular place, where they can work and be near their family connections, and to be able to afford a reasonable quality of life, unfettered by excess debt. Mr Shapps should approve: that's what a 'boring housing market' really looks like.

**Conclusion – the example of Churchill**

All five of these reforms are essential for UK plc to compete more effectively for international capital, and to rebuild more sustainable property and land markets that provide the foundation for a genuinely fairer society and a low-carbon economy. Even small steps to put them into effect will require extreme political courage in relation to land policy and rent-seeking: something that no politician has seriously attempted to do since 1909, with the People's Budget and Churchill's election campaign. However, we should remember that his party was elected on that platform.

**'Letting land and housing markets revert to the way they were will, this time, only reinforce the structural economic and social problems we already have'**

Churchill railed against land speculation then, and would now despair at the structural inequalities and poverty that we have created by not addressing these issues. He would have given short shrift to today's Conservative Party fundraisers, who were only recently reassuring party donors that the Coalition's mansion tax proposals were dead, with the ringing endorsement of the politically attractive but economically illiterate idea that a 'tax on property is a tax on ambition and aspiration'.[25]

The debate that Mr Shapps, in his role as Conservative Party Chairman, should now lead, with politicians of all parties and the public, is about the very nature of investment in land and property, and the balance to be struck between debt and equity, between long- and short-term returns, between stewardship and speculation, between genuine risk and reward, between public and private interests, between earned and unearned wealth, and between local and national interests.

Letting land and housing markets revert to the way they were will, this time, only reinforce the structural economic and social problems we already have. Cloaking housing growth and renewal in the folksy garb of the early 20th century Garden Cities will not protect them against the activities of Veblen's 'financial predators'. We also need a new professional understanding of value that reflects the necessary balance between all these things, and both social and economic need.

## 'If politicians and the professions can decouple housing markets from financial capitalism, we might truly look forward to a land economy of more intelligent and sustainable markets operating for the benefit of all'

If politicians and the professions can decouple housing markets from financial capitalism, we might truly look forward to a land economy of more intelligent and sustainable markets operating for the benefit of all. They might just be able to lay the foundations of a fairer, more generous and more equitable society than is currently imaginable, and a social and economic legacy of the kind that visionaries like Veblen and Ambrose so vigorously advocated.

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**Notes**

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4 M. Hudson: *Veblen's Institutionalist Elaboration of Rent Theory* (see note 3)
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