LAND and LIBERTY

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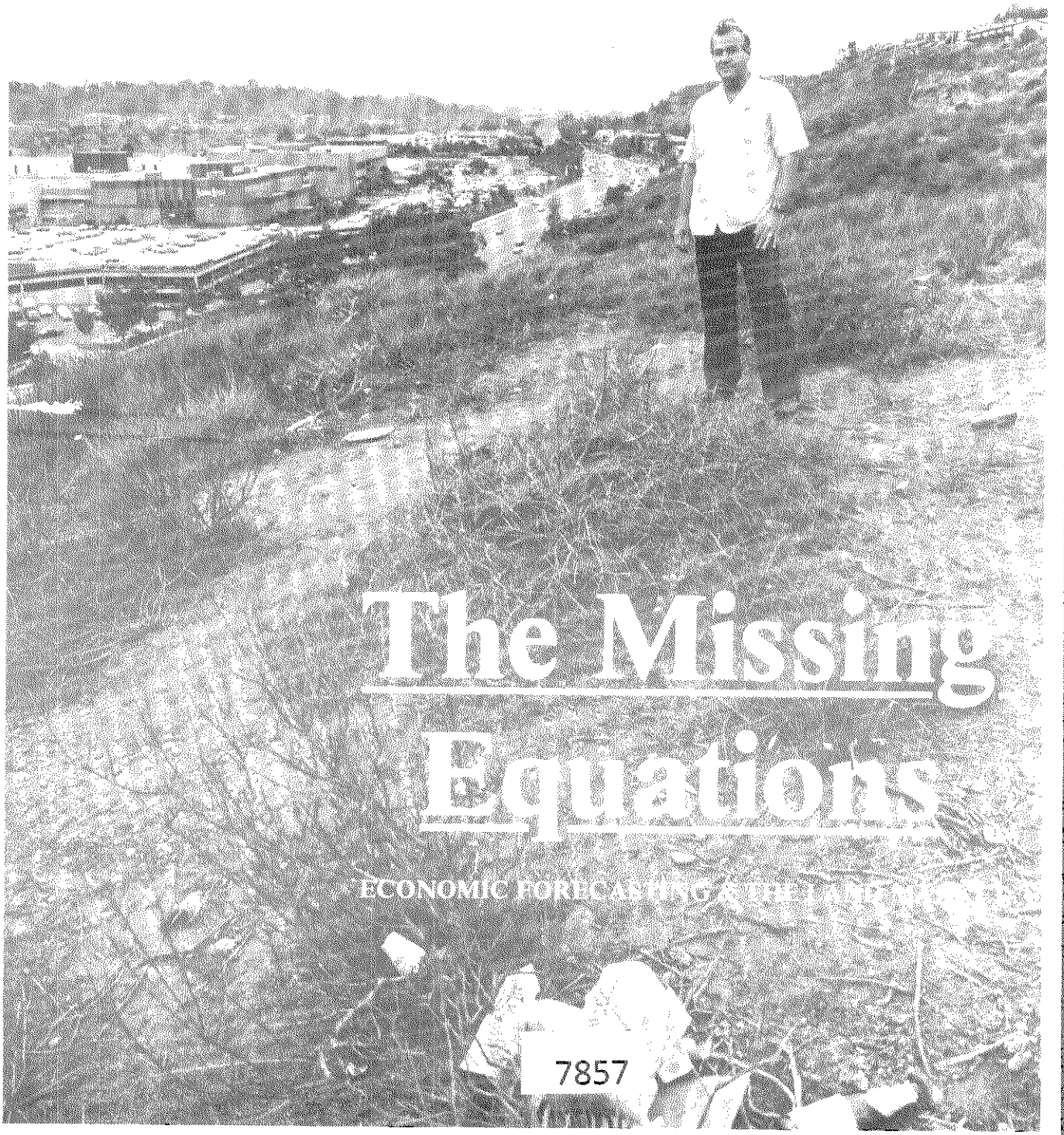
The case for a LAND PRICE INDEX



The Missing Equations

ECONOMIC FORECASTING AT THE BANK

LAND and LIBERTY

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● COVER PHOTO: Floyd Morrow surveys the hill-top land owned by one of San Diego's richest speculators. The value of the land has risen sky-high since the investment of taxpayers' money on an improved highway. Story, p.28.

Radical reform

REAL ESTATE investors were horrified when they read the U.S. Treasury Department's plan to simplify the tax system.

For the proposals, if accepted by the President and Congress, would eliminate or scale down most real estate tax deductions, credits and exemptions.

This would help the Administration in Washington to lower individual tax rates to three brackets of 15%, 25% and 35%.

On the face of it, these proposals make economic sense.

Unfortunately, however, the loss of tax benefits associated with real estate has caused a groundswell of opposition – from big speculators down to small homeowners who know that property values would decrease if these proposals were implemented. Homes, for example, would come down by an estimated 10% of current values.

What's wrong with that? Employees would at the same time pay lower income taxes. Most people, in fact, would not suffer a net loss. But there would be a dramatic and lasting impact on the property market which would ultimately benefit everyone, either directly or indirectly.

For the structure of real estate taxation is the result of decades of pork-barrel politics, and is now a major obstacle to full employment.

In a free enterprise economy, investment should be on the basis of creating maximum welfare and wealth: the market, guided by price signals, is supposed to ensure the efficient allocation of scarce resources.

But real estate investments are too often made on the basis of tax-dodging deals rather than because they add to the sum of human happiness and prosperity. So there is often a net loss of benefits to society.

The land speculator's gain is more than offset by:

● Loss through the irrational disuse of prime sites, or

● Extraordinarily-high rents which kill firms which would otherwise be competitive.

As Lawrence Chimerine, chief economist of Chase Econometrics, recently noted in relation to investment in real estate: "The tax advantages are so favourable that we see money going into projects that don't make economic sense".

So a great deal of entrepreneurial energy, and the skills of an army of lawyers and accountants, are diverted from the business of increasing wealth.

If President Reagan really means what he says about liberating the wealth creators, he needs to start with the tax system and to proceed with the proposals from his Treasury officials who have seen that – because of the tax benefits – too much money has flowed into real estate and thus deprived other sectors of investment funds.

"The Treasury contends free market forces should direct investment to its most productive uses rather than having tax benefits distort investment decisions", reported the *Herald Tribune* on January 3.

The President now has the chance to carry out a radical reform of taxation. As his starting point, he needs to discriminate between taxes on land and those that fall on buildings.

Tax relief for capital improvements and capital in all its forms is justified in terms of urban renewal, job creation and higher living standards.

And it is for these same reasons that taxes on the annual rental value of land should be RAISED: such a tax would direct land to its appropriate use.

This prospect is proved by economic theory; proved by the impact on construction in the five cities of Pennyslvania that have levied higher taxes on land than on buildings; and we believe it would be proved by the econometric work which is now being planned at San Diego State University (which is documented in the following pages).

Computers: aid or hindrance in economic forecasting?

ECONOMICS as a social science has lost its credibility in the eyes of the public.

This is the result of two developments which have occurred over the last decade:

- The pain of involuntary mass unemployment. People were led to believe that, thanks to advances in economic theory, full employment could be attained by appropriate political decisions.
- The confessions of leading practitioners that they do not really know how the "real world" economy operates. As Benjamin Friedman, professor of economics at Harvard University, recently observed: there are "lots of aspects of economic activity that we don't understand very well."

This is after 200 years of theorising.

So in response to their failures, economists are building ever-more complex models of the economy. They hope to improve their performance. Says Alan Greenspan, who was chairman of the Council of Economic Advisers under President Ford:

"Even though we've had an extraordinary increase in our tools, such as computers, we have not been able to keep pace with the growing complexity of economic relationships, both domestic and international."

EMBARRASSMENT deepens as economists vie with each other to prove that *they*, at least, earn their fat salaries.

But comparisons of their performances serve only to further expose economics to ridicule. Take, for example, attempts to forecast the growth of the economy.

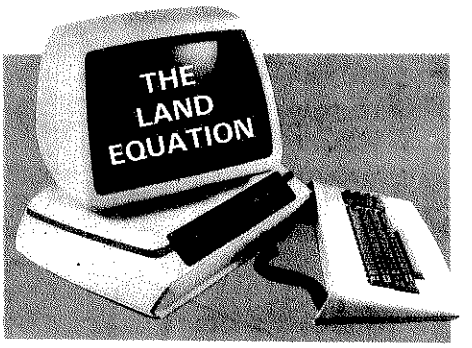
In 1983, the UK Treasury and 15 university and private sector institutions published their predictions (see table). The *likely outcome* for growth in gross domestic product is between 1½-2%.

Only five forecasters predicted this order of growth. The government's experts were not among them.

The amplitude of error is increasing: little wonder that President Reagan, after his reelection, toyed with the idea of abolishing his Council of Economic Advisers, whose forecasts in recent years have been wider off the mark than those of private business forecasters.

So the great search is on for the reasons for the poor predictive powers of economics.

It speaks volumes for the way in which this social science has strayed in past decades that its leading practitioners are searching for the world of reality.

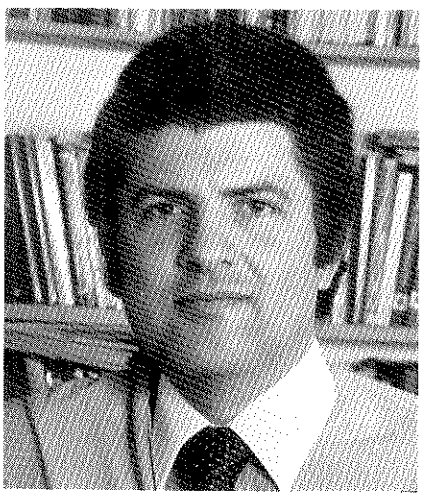


● A SUBJECT is a *science* only if its theories make it possible to predict future events. On the basis of this criterion, the collapse of confidence in economics as a social science appears to be warranted. Or is it?

Are the professionals asking the wrong questions? And looking for the wrong evidence?

Nine months ago, *Land and Liberty* correspondents from Helsinki to Tokyo began looking for answers. They found that vital equations were missing from the scores of mathematical models of the economy.

And Editor FRED HARRISON (below) flew to San Diego, Southern California, to report on what could become a remarkable breakthrough in economics.



This comes through from the words of Michael Spence, of Harvard, who last year was selected by the American Economics Association as the nation's outstanding economist under 40.

He told the *New York Times:* "Economics is at the point where we could use some breakthroughs to make substantial progress. Macroeconomics, which deals with the works of an entire economy, seems stuck at the moment because we do not have a powerful enough theoretical basis for understanding reality.

"The same is true in microeconomics, where the conceptual apparatus is not as powerful as we would like. The person who provides more powerful tools will have made a major contribution. If I stayed in economics, that is what I would spend my time trying to do".

FOR DECADES, under Keynesianism, economists have been able to delude themselves that they had the tools to manipulate the economy.

Harsh realities have now forced them to try to scramble back into the real world – and they are searching for a bridge to link ivory tower and soup kitchen.

Increasing faith is being placed in econometrics – the application of mathematics to economic theory, aided by the computer.

Increasingly complex econometric models of the economy are being built, in the search for accurate predictions of trends – the results of which just might help the politicians to construct new, more successful policies.

The stakes are high, for Western governments shape their decisions – involving the livelihoods of millions of people, and investments worth billions of dollars – on the basis of small percentage changes in the trends of key variables.

These models, however, are still built on old assumptions.

Could it be that mathematical precision is vesting them with a spurious authority?

Could it be that some basic equations are missing?

THE U.K. ECONOMY

Forecast made for 1984 at end of 1983

	Gross Domestic Product (annual % growth)
London Business School	2.2
Phillips & Drew	2.4
National Institute of Social & Economic Research	2.0
Society of Business Economists	2.3
Treasury	3.0
Liverpool	3.7
OECD	2.25
ITEM	3.0
Cambridge Econometrics	1.8
James Capel	1.9
Hoare Govett	2.6
Wood MacKenzie	2.0
Capel-Cure Myers	1.0
Simon Coates	2.0
Henley	2.4
Oxford	1.9
LIKELY OUTCOME	1½-2

FRED HARRISON
reports from
San Diego, California

The missing

NEVER before has so much brain and computer power gone into forecasting trends in western economies.

The margins of error in these forecasts, however, are increasing. This is evidence of a fundamental flaw in the theoretical perception of how the economy works.

The deficiency in the statistical data is a residual problem: the errors begin with the way in which economists are ordering the relationships of variables, and the relative importance placed on individual components of the economy.

Bigger computers are being used by economists, feeding in ever-increasing numbers of equations in their attempts to tell the world what is about to happen in such vital areas as investment and job-creation.

Bigger, however, does not mean better. In fact, even the professional forecasters now agree that they do not have an adequate understanding of what is going on in the real world.

UNTIL 1973, governments assumed that – except for brief periods – full-employment was here to stay.

Since then, more and more people have found themselves in the dole queues, and the politicians (whether wilfully or otherwise) have not been able to do much about it.

But that is why forecasting is important: either to justify existing policies, or to modify them to ensure full employment.

Economists, however, have now conceded that their mathematical models of the economy do not enable them to anticipate sharp turning points in the trends.

This is partly because the models rely on extrapolations of past trends, which cannot – by themselves – make allowances for unanticipated shifts in one or more of the component variables.

Arguably, of course, this is not the fault of the econometrician or his computer: no one can foresee *qualitative* changes which have a major impact on the cogs and wheels of the economic machine.

The fault, however, lies in the way in which economists judge the importance of what they deem to be key phenomena.

Take, for example, the use of stock exchange trends as one of the components of the "longer leading" index, which is supposed to give 12 months notice of future trends.

A boom in stocks and shares suggests business optimism, with money pouring in from investors that will be invested by companies to create new technology and more jobs.

The New York stock exchange certainly led the Washington Administration to adopt an optimistic attitude last year.

Heavy dealing on Wall Street, however, was far from evidence of confidence in U.S. corporations. We find, in fact, that a record number of companies – about 575 – repurchased their own shares. According to one estimate, $17bn was put into stock repurchases in the first six months of 1984.[1]

The principal motive: companies wanted to raise the prices of their shares above the levels placed on them by the market.

Thus, firms were depleting their cash flows (money that would have gone into new capital formation) in favour of maintaining a financial image.

The forecasters, however, were misled into thinking that all this business activity on Wall Street was evidence of future prosperity: hence the predictions – falsified in the dying months of 1984 – that there would be no downturn in the U.S. economy.

The year ended with 76 bank failures in the U.S. – more than for any 12 month period since 1937.

WE BELIEVE that the poor performance of economists can be traced to one major error.

They make exhaustive allowance for trends in the labour and capital markets – but turn an almost completely blind eye on the land market.

Dozens of equations are fed into their computer models of the economy. Missing, however, are the equations on trends in land values.

No-one can be criticised for not being able to anticipate unforeseeable events (such as the protracted miners strike in Britain): that's the work of clairvoyants.

But one-third of economic life is wilfully ignored by economists:

- Land is one of the three factors of production – yet it is effectively assigned a zero value, or neutral role, in professional assessments of economic activity.[2]
- Rental income, when properly assessed, amounts to about 30% of a nation's total income.[3]

Economic forecasters go to great lengths to measure the psychic disposition of consumers and businessmen, in their anxiety to anticipate people's intentions and actual behaviour.

Exhaustive surveys are conducted by universities and civil servants into the shifting price of potatoes and rate of change of "invisible" exports.

But when it comes to calculating the rate at which rental increases are shutting down firms – zilch.

The forecasters get full marks for *trying*. Wharton's annual model of the U.S. economy, for example, has 1,000 variables, which have to be solved simultaneously; and 800 variables in the quarterly model. As with all the other models, however, Wharton's use of housing starts in the construction industry is the nearest it gets to incorporating the impact of the land market on the economy in general.

Not surprisingly, therefore, the Wharton model – which is claimed to be different from Keynesian models, in that it does not neglect incentives and supply side considerations – fares no better than others when it comes to correctly forecasting the turning points in economic trends.

● Graham Pye

ONE ROUTE by which the land market stunts economic growth has been described by Graham Pye, the new president of Britain's House-Builders Federation.

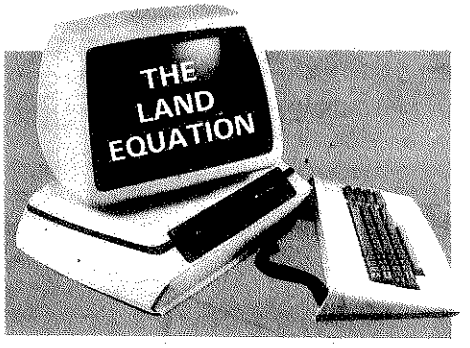
Land prices had risen by 500-1,000% in the past five years. Result: in the south-east – where the best job prospects for recession-hit Britain are to be found – land represented 30-40% of the price of a new house.

This forced the average price up to £43,500, thereby "putting up walls against mobile workers who want to get on their bikes and find a job, and then find they can't afford a house," says Mr. Pye.

This obstacle to labour mobility meant that people were forced into involuntary idleness, and the economy grew at a slower rate.

South-eastern land prices, says Mr. Pye, ought to be reduced to 20% of the cost of a house.

equations



"Errors are greater and the challenge is more severe at the turning points," observe Klein and Young in their study of the Wharton model.[4] They add, in a lament that fits other attempts at warning people about significant deviations from historical trends:

"It is not surprising to find that forecasts by any method fared relatively badly in the turbulent years since 1971. Turning points and change are more difficult to forecast than steady growth or decline.

"When the economy fell precipitously, the predicted changes were uniformly too high, and when the inflation rate climbed the most, predicted changes were uniformly too low.

"As a general rule, economists tend to underestimate change. The period of the oil embargo and the 1974 recession was a severe test for all forecasting techniques."[5]

BUT WHAT value is there in financing a forecasting industry whose rate of accuracy is only high when there is no change – when they can apparently only predict an "as you were" momentum to the economy?

Surely the resources that go into forecasting can only be justified if they correctly inform us of *changes* in the path of economic activity?

But these resources are wasted, precisely because the theory that is used to marshal them is critically defective. The 1971-4 phase of economic history is a classic example. This was a period of spectacular land speculation, a cyclical phenomenon that can be traced over the course of 200 years in Britain and the U.S.A.

Armed with a theory of the land markets, economists *could* have correctly predicted the slump of 1974, which would have occurred even without the intervention of the OPEC oil cartel.[6]

The blind spot in economic theory is inevitably matched by the vital equations that are missing from the econometric models.

That gap, however, is about to be plugged with research now being conducted by economists at San Diego State University, southern California.

Dr. George Babilot, Director of the Centre for Public Economics and a professor in SDSU's department of economics, plans to adapt a model of the San Diego County economy to incorporate new equations that deal with the land market.

The model is being fed into the university's computer by 28-year-old graduate student Cindy Woodard. In its present form, the quarterly forecasting model has 56 equations.

The model, said Miss Woodard, "is very functional. It is set up so that it can be expanded or contracted – so that we can enjoy ourselves and be creative."

Her first problem is to trace back what are called "free parameters" in the model, to see how they were developed. Prof. Denis Flag, who recast the model's language to make it compatible with the university's computer, explained:

"Sometimes you have to fudge certain relationships to get a workable result," he said. This was necessary, "since we are not able to duplicate the world as it actually is. You need to improve the result by fooling around with particular estimates, and using something different."

The free parameters are assumptions that are made to make the model produce results that apparently fit the real world experience. This manipulation is obviously necessary where the model is incomplete in some crucial way.

Andrew Britton, Director of Britain's National Institute of Economic and Social Research, is disarmingly frank in his description of "data-mining", the term he uses to describe how econometricians make their models fit reality.

Mr. Britton admits that "model-builders cannot claim to have a full understanding of fluctuations in economic activity."[7] The size of forecasting errors had increased during the 1970s, but this he appears to attribute to "a multitude of unique and random events of a kind which models don't try to explain."

● Cindy Woodard

These random events, in fact, may play a small part in the errors in forecasts. For econometric models are *bound* to yield wrong forecasts simply because a major part of economic activity – as represented by the land market – is not directly incorporated into the models.

So how do economists overcome their propensity to make errors of increasing amplitude? By respecifying the equations so that, for a short period at any rate, they yield tolerably accurate forecasts. The equations are made to fit the facts.

Theoretically, there is a problem with this. "If one goes on looking long enough one is almost bound to find something which fits the data well; but unfortunately that doesn't guarantee that one has discovered the model which explains how the data were generated."[8]

And so, inevitably, as Mr. Britton confesses:

"In their present form, however, the models don't explain many of the longer-term trends in the economy, the slower growth of output in the 1970s for example."

This is where the San Diego research may now yield seminal results.

THE MISSING land equations will be written by Fred Galloway, a 30-year-old professor in the economics department who is a whizzard at applied mathematics.

Working with some colleagues, he has already made his mark in the real estate world with a model that improves the technique of appraising the value of family homes. This model uses multiple regression analysis to calculate property values, rather than relying on the traditional approach of comparing properties with similar characteristics.

Prof. Galloway's main task is to write an equation that will enable the San Diego model to abstract land values out of general property values.

He will then have to incorporate a spatial dimension into the university's model.

"The methodology is straightforward," says Prof. Galloway. "All we need is time and money."

The new land equations, when run on the computer, will reveal simultaneous adjustments in all the other equations – and predict changes in trends for housing construction, consumption, investment, and so on, in

response to changes in the value of land in the market.

Economists will be anxious to discover if the modified San Diego model then produced more accurate predictions than the conventional econometric models.

PROF. BABILOT, who originated the San Diego project, has no doubt about the policy implications that could stem from the research. He told me:

"I and a couple of colleagues concluded that we would be able to plug a land-values formula into the model of San Diego County.

"We have the basic equation already, which will have to be modified to separate land from the value of improvements."

One task is to find new ways of raising government revenue. California is regularly assailed with political propositions to reduce the tax burden on income earners. Prof. Babilot wants to know what would happen if tax rates were raised on land and lowered on, say, consumption or incomes.

San Diego, he points out, is land-rich, but does not compare particularly well with the rest of California in terms of median incomes.

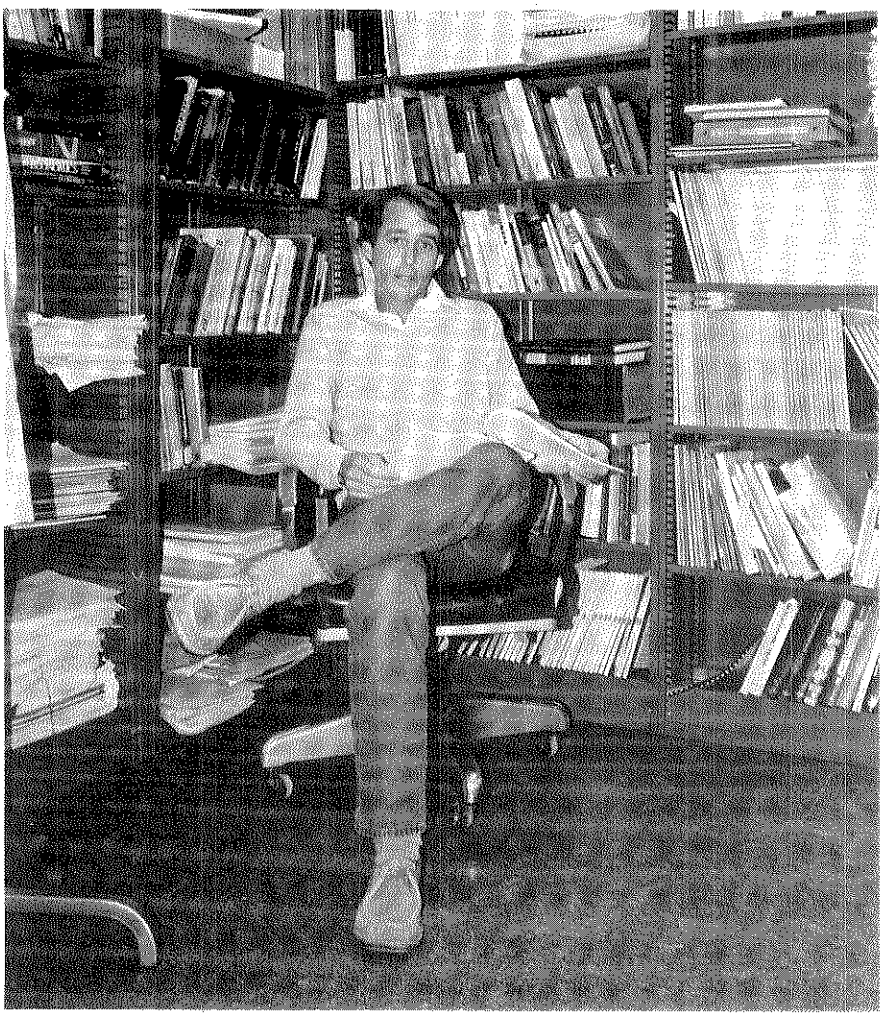
"But we have tremendous value in our land, and that seems to be our best tax base. So we want to show what would happen if we replaced, say, a sales tax with a site-value tax."

The pioneering model, he suggests, should make it possible to calculate whether land values offered the base to generate enough revenue at national level – thereby opening up land value taxation as a realistic alternative source of federal revenue.

"It strikes me that if we are serious about reducing the expenditure side of the budget, the land value tax policy is timely."

Conclusive results from San Diego would lead to theoretical turmoil among economists, who would be determined to defend their entrenched philosophical interests.

But if the San Diego computer spews out numbers that could not be challenged, a new era in the development of economics as a social science would be opened up.



● Fred Galloway – a whizzard at applied mathematics

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From tax burden to boom time

WHAT would the San Diego computer model reveal if the missing equations were fed into it?

Prof. George Babilot, who received his Ph.D from the University of Oregon, was willing to make some predictions of his own.

If the computer was asked to foretell the impact of a shift in the property tax *onto* land values and *off* the value of buildings, this – says the professor of economics – is what it would come up with:

● There would be a boom in capital formation and the construction industry.

● Money flowing into the undeveloped land market – for purely speculative purposes – would be reduced.

● Consumers would spend more – if, says Prof. Babilot, an increase in the land tax were associated with a decrease in taxes on low and middle-income earners.

● New jobs would be created, in line with the increase in private spending.

Prof. Babilot knows that there will be resistance to his fiscal proposals, but he believes that a reform of the property tax would be fair to most people.

For the current structure of taxation is regressive, he says. "It puts the burden on the low and middle-income groups.

"A shift to a higher land tax would be progressive, because it would be a move away from the regressive sales tax.

"It would do what Henry George [the 19th century social reformer]* said would happen, and everybody would benefit – benefit from it absolutely. Relative positions would change, which is why people with vested interests would oppose it. But the whole economic pie would increase".

*Prof. Babilot is one of the authors of *Critics of Henry George* (editor: Prof. R. V. Andelson), Fairleigh Dickinson U.P., 1979.

ECONOMIC FORECASTING

THIRTY-FIVE years ago, the economics profession was treated to a sceptical treatise on the value of the numbers used by forecasters.

Oskar Morgenstern, a leading member of the Econometric Research Program at Princeton University (and its Director in the 1960s), warned us even to be wary of the concepts used by economists.

Although econometrics has advanced by leaps and bounds in the past two decades, his strictures are every bit as relevant today. You think that the comparison of wage rates is relatively simple? Not so, cautioned Morgenstern. For wages include non-cash benefits, or benefits that are not directly included in the pay packet.

These "fringe" benefits are becoming increasingly important, and are counted by employees – but remain largely unquantified by the economic statisticians.

"As these factors become more important, the comparisons of mere money wage rates tend to be of increasingly doubtful value", says Morgenstern.[1]

The mathematical precision of econometrics lends a spurious authority to economic forecasting.

Take, for example, national income. According to Morgenstern, the U.S. data in the 1960s was liable to a margin of error of 10% to 20%. Yet changes in consumers' total spending power was reported and taken seriously, down to the last billion dollars or less – i.e., variations of less than 0.5%.

Arguments today over the size of the "black economy" show that we are nowhere nearer being more precise. So Morgenstern's caution seems valid:

"Statements concerning month-to-month changes in the growth rate of the nation are nothing but absurd and even year-to-year comparisons are not much better.

"The same applies to variations in price levels, costs of living and many other items. It is for the economists to reject and criticise such statements which are devoid of all scientific value, but it is even more important for them not to participate in their fabrication".[2]

This is not to say that econometric models of the economy are useless: on the contrary, they compel us to work harder at obtaining more accurate data.

This process ought to begin with a fresh examination of what is important. Rental income is a case in point.

Rent in the national accounts is "a very uncertain figure", says Morgenstern. This is because it has to be imputed to a large and growing number of home owners – "a tricky affair".

But if rental income and trends in land values were deemed to be important as forecasting variables, the government can make a decision to carry out a properly-designed survey to acquire reliable information.

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2. *Ibid.*, p.304.

A stray $50bn causes fury

THE U.S. Treasury Department used a new econometric model which projected a large surplus in state and local government coffers amounting to $55bn last year and $80bn this year.

The U.S. Conference of Mayors is furious. For they have calculated that last year's surplus was only $5bn.

"Clearly something is wrong with [your] model", the mayors have written to Robert Rafuse, deputy assistant secretary of the Treasury.

U.S. rent: $764bn

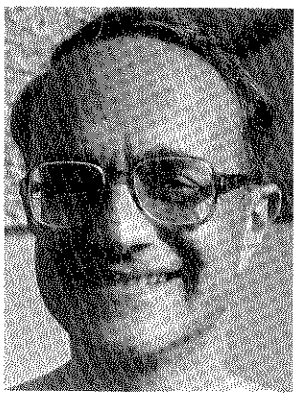
RENT as an item in the national accounts grossly understates the income received by landowners.

And it omits a great deal of realisable income that could be imputed to valuable land and natural resources.

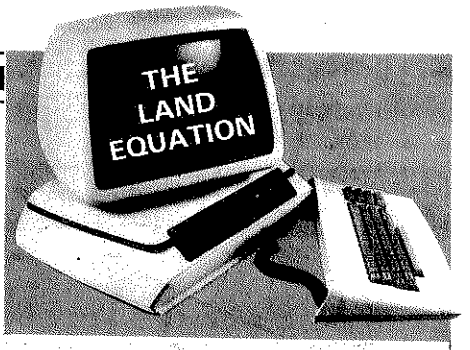
As a category, therefore, the published data is of little value to economists seeking to discover trends in the land market.

Which is why scholars have to use some guesswork when they compute rental income. This exercise was recently performed for the U.S. economy by Steven Cord, a professor of history at Indiana University in Pennsylvania.

He found that, in 1981, the annual rental income of America's land and natural resources was between $566bn and $764bn. A report on Cord's research appeared in the Jan.-Feb. issue of *Land and Liberty*.



● Prof. Steven Cord



Giant Failures

ADVANCES in economic forecasting have produced many disappointments, reports *The Economist* of London (Dec. 15, '84: p.22).

"An alliance of mathematics and computer technology has meant that models can grow and grow. The large models used by governments and, increasingly, by small and medium-sized private forecasting firms now contain many hundreds of equations.

"They are bigger; are they better? In many ways, no."

For example, comparisons have shown that "giant models are often worse at forecasting key variables like inflation and output than much smaller models".

Scientific fiction?

ECONOMETRIC models of the industrial economy produce "fragile" predictions, says Wilfred Beckerman, a fellow of Balliol College, Oxford.

Why? The first reason, he says, "is our ignorance of precisely how economies operate".

He adds: "Given the futility of attempts to predict long-term economic trends, one might ask why there is still a market for it. The main reason seems to be that the public loves to believe that we can peep into the future – witness the taste for science-fiction".

Forecaster's self-doubts

QUOTE by Wynne Godley, Director of the Department of Applied Economics, Cambridge University: "I am too old a hand to believe emphatically in any short-term forecast – even one which I have made myself!"

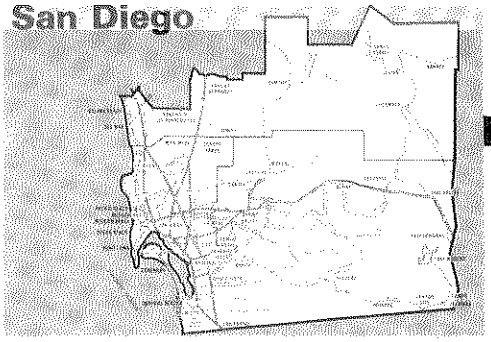
★★★

FORMULAS & SCIENTIFIC ACTION

THE LATE Lord Robbins – one of Britain's most distinguished economists of the 20th century – maintained that his discipline could not be used as a forecasting science.

For example, if an econometrician found a formula which explained the reaction of the dollar exchanges to past events, that formula would be no use as a forecasting tool.

Why? Because people would alter their financial dealings to take account of this new knowledge – and so invalidate the formula!



A city to

By Fred Harrison

SAN DIEGO County would be a perfect location for putting reforms of the property tax to the test.

Legislatures scattered throughout the U.S. are in the process of passing laws to enable local governments to reduce the tax on buildings.

This would be matched by a higher tax on land values, yielding at least as much revenue as before.

San Diego would make an exciting laboratory for fiscal reform for a variety of reasons.

- It is the eighth largest city in the U.S., and growing fast: another 250,000 are expected to be living within the city limits by the year 2,000.
- A staggering $489m will be needed during the next 20 years to finance public facilities in the inner city: it seems to make sense to reduce the tax burden on those who make it their business to renew the physical urban environment.
- Unemployment is down to 5% – below the national figure, but higher than it need be: out-of-town businesses have been deterred from locating themselves in sunny San Diego because their employees could not afford the price of houses.
- Land prices have rocketted, which according to several studies in 1984, pushed both firms and families further out from the centres of activity: a higher land tax would put a brake on speculation and bring down prices.

THE OLDEST business in San Diego, in fact, is land speculation. In its 200-year history, most fortunes have been made out of real estate.

Time and again, it has figured in local scandals.

Most of the evidence for the need for a reform of the property tax is contained in a report released by the mayor's task force last December.

The task force estimated that the cost of public facilities and services will outpace expected income by $274m over the next two decades.

A major debate has now been launched to find out what San Diegans think about the future of this south-western corner of the United States.

The big problem for the politicians will be to somehow curb the threat of huge tax increases while at the same time improving the social and economic environment.

In my view, their best starting point would be a call on a Texas-born lawyer, 51-year-old Floyd Morrow.

Morrow served on San Diego Council for 12 years. He is a former deputy mayor, and a maverick Democrat in a Republican stronghold.

AT THE heart of San Diego's problems, says Morrow, is the future shape of the city.

"The current mayor argues that there should be 'No Los Angelisation' – but the politicians have not done anything about it!

"There's a tremendous land boom in the county, which has made it impossible for homes to be constructed.

"The city is sprawling, despite all the action of the mayor and the various area governments. All their efforts to have 'controlled growth' have failed.

"Yet within the city itself there is a great deal of vacant land. One study showed that there was sufficient land within the city limits to accommodate almost one-third more of the existing population".

The solution, says Morrow, is a higher tax on the annual rental value of land.

This is the policy advocated by Basic Economic Education, a San Diego-based school of which Morrow is president.

Such a tax – if it were at a high enough rate – would:

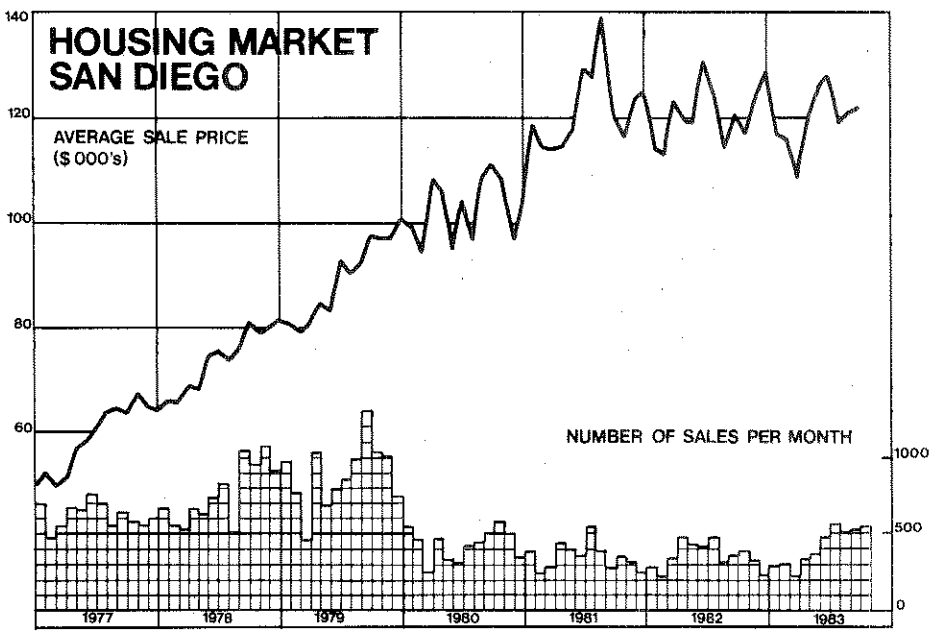
- Force owners to put their land to good use in response to the demands of the community;
- Reap a higher income for the government coffers, while not acting as a deterrent on people who wanted to invest in new buildings or technology;
- And it would also have a direct influence on the amount that had to be spent by taxpayers on new roads and other public utilities. For a more compact city would be able to scale down public services, and there would be a greater return on those facilities that were provided.

LAND VALUE taxation is a self-financing method of raising revenue.

For as a community spends money to improve its infrastructure, so the value of adjoining land rises.

Revenue from a tax that fell on those rising land values would automatically rise: in other words, tax revenue would be seen as an index of prosperity, rather than a burden on producers.

This fiscal philosophy is unique to



lead the way

the land value tax, and it is, in fact, implied in one of the recommendations of San Diego's Growth Management Review Task Force.

The task force suggests that a portion of the cost of building and maintaining streets and highways in the city should be carried by the users and property owners with access to the roads.

Ironically, it was just such a proposal that Floyd Morrow promoted as a councilman – and which the council managed to kill.

He took me to Friars Road, at a major intersection of Highway 163, to point out how the rewards of public investment in roads were reaped by land speculators.

Three-quarters of the land around the intersection is undeveloped, held by speculators who are guaranteed to make a capital killing when they finally choose to put their acres to use.

● The south side of Friars Road has been developed into a top class shopping area.

● The north side is a barren hill, with a house long since boarded up by the rich owner who feels under no pressure to release his land-with-a-view to developers.

Floyd Morrow told the story of this location (see cover photo).

"The road, a small winding road, was improved into a six-lane highway in 1969. I represented the district on the city council.

"My proposal was to take the $3.2m cost of widening the road out of the increased value of adjoining properties.

"We could do this by turning the area into an assessment district. We would have financed the road by issuing a capital improvement bond, which would have been paid for by a tax assessment on the adjoining properties.

"Instead of this, the council decided on a gas tax. The argument was that the cars using the road should pay for it.

"But the people who benefit are the landowners, who use the road for access to their properties.

"This was proved in the following year, when the improvement was immediately translated into increased land values. The land that would have been assessed increased by more than $5m, according to the assessor's records.

"So in the end, everybody paid for a benefit that was local and direct.

"To add insult to injury, we had to pay $326,000 to take small sections of land to widen the road."

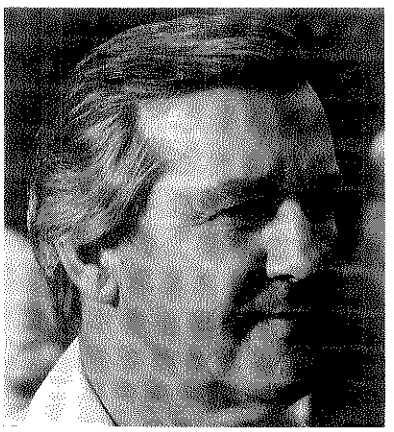
And what about the family living on the north side of Friars Road, at the foot of the hill they owned? Morrow – as he inspected the vacant hill top – explained:

WALTER MONDALE, above, Democrat candidate in the 1984 elections for the U.S. presidency, wrote in a letter to Prof. Steven Cord of Indiana University (Pennsylvania):

"There are a number of things which the federal government could do to further the taxation of land values.

"It could levy such a federal tax itself and this would be much preferable to taxes on labour and capital investment.

"It could establish a new city based solely on land value taxation in order to demonstrate the feasibility of that principle."



FLOYD MORROW, who would happily accept Mr. Mondale's challenge to prove the feasibility of land value taxation.

"One of the arguments against the special assessment was 'How can a single family pay for such a high assessment?'

"I was voted down right away. I think it was 8-1 against me.

"The owner moved out four years after the road was built, and his land is worth millions more now. He's one of the biggest speculators in the county.

"If the assessment had gone ahead, that other side of the road would also be built upon now. But the new users of the land would not have paid more for the site – they would have deducted the assessment from the buying price of the land.

"As it is, the taxpayers paid for the road improvement and left the new value to the previous owners."

The moral is clear: if sites such as these were brought into use, out-lying districts would remain in agricultural use – and local governments would not be paying for infrastructure that served only the interests of land speculators.

CALIFORNIA is one of the richest areas in the world. Even so, the state currently supports 200,000 able-bodied adults out of its welfare programmes, at an annual cost to taxpayers of between $80m to $90m.

Yet all around the state, valuable tracts of land lie vacant.

Because they are held for future speculative gain, they are *not* realistically part of the current supply of land.

As a result:

● Rents and land values are higher than they need be.

● People pay more than they need in transportation costs, as they travel to work from sprawling residential areas to the commercial districts.

● Governments are being impoverished by forking out for unnecessary highways and sewer systems.

● And workers are locked out of jobs that would take them off the dole queues.

If, therefore, the economists at San Diego State University, and the politicians of San Diego County, join together to package a new set of tax-led reforms, they will blaze a trail for the rest of California to copy.

Land: the forgotten

LAND crucially affects the house building sector.

Yet Keynesian governments in Britain, while attempting to regulate the economy in the pursuit of full-employment policies, have largely ignored the workings of the land market.

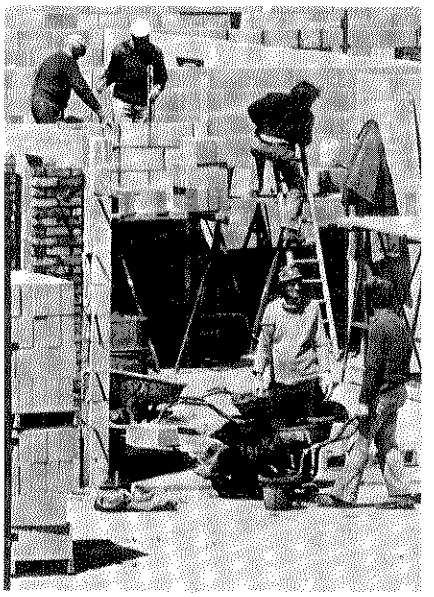
The exception has been a succession of Labour governments which have sought to control prices and the flow of land through bureaucratic mechanisms.

But their policies served to restrain the flow and accelerate the price of land!

Paradoxically, little effort is made to document the land market compared with the capital and labour markets.

Yet the determinative influence of land cannot be disputed.

- When land prices soar, the supply of houses to consumers drops within 12 months.
- When land prices drop, builders get to work to provide more new homes (see table).



"When land prices soar, the supply of houses drops within 12 months"

INSITE
on Whitehall's attitude to land

THE DEPARTMENT of the Environment publishes an index of housing land prices, but these are out-dated by the time they are published, and they are not broken down into regional indices.

Just how important the regional variations are can be judged by the fact that, although the cost of land has generally been about 15% of the sale price of a house in the past, it is 30% of house prices in the South-East.

Why does Whitehall show such little interest in the workings of the land market?

A principal explanation is that, in terms of post-war economic philosophy, land has not been viewed as important in the macro-economic regulation of the market.

But in addition, the land users – the builders – have not always aired their problems as loudly as they might have done. One explanation for this has now been offered by Hedley Smyth, a property expert at the School for Advanced Urban Studies at Bristol University.

Housebuilders, he says in a recent monograph, have a vested interest in being secretive.[1]

"This is understandable considering the amount of political mileage made from the large increases in land prices in the early 1970s, when land supply was also made a sensitive issue, on that occasion by those in favour of public, rather than private, control".

The shortage of information results in confusion in the public debates.

- Builders blame the planners for a short-fall in the supply of land.
- Planners fail to understand that builders have to realise profits if they are to stay in business. Planners, of course, zone land according to non-market criteria, which may conflict with the demands of consumers.

PARLIAMENT has singularly failed to help the public to understand the processes at work in the housing sector.

Debates tend to be sterile, with politicians stoutly defending the ideological barricades without worrying about the facts.

But the scope for reform is enormous, if consumers are to benefit from a finely-tuned system of production. Yet even the builders, who knock the planners hard, would not want the planning system dumped in favour of *laissez faire*. Why?

Says Hedley Smyth: "This is the last thing housebuilders would want, hence their genuine wish to maintain planning constraints, especially green belt policies in areas of high housing demand, albeit on a more limited basis".

He reaches this astonishing conclusion on the basis of an analysis of the motives of house-builders.

In essence, builders make large profits by buying land when it is cheap, and selling it when it is expensive. Or, as Hedley Smyth puts it: "Housebuilders need the supply of land to fluctuate over the years in order to make the most use of the inflation and land price differential in their profit realisation".

Land Prices, the Rate of Inflation, and the U.K. House Building Industry (1969 = 100)

	Housing Land Prices	*Retail Price Index*	*Differential Increase of Land Prices*	*House Building (000s) (Private sector)* *Starts*	*Completions*
1969	100	100	0	166.8	181.7
1970	109	112	–3	165.0	170.3
1971	124	116	+11	207.4	191.6
1972	209	125	+76	227.9	196.4
1973	324	135	+105	215.7	186.6
1974	322	157	–24	105.9	140.9
1975	222	196	–139	149.1	150.8
1976	222	227	–31	154.7	152.2
1977	235	265	–25	134.8	140.8
1978	287	286	+31	157.3	149.0
1979	407	295	+111	144.0	140.5
1980	535	348	+75	98.2	127.0
1981	556	389	–20	115.1	112.8
1982	627	422	+38	140.1	121.1

SOURCES: Department of the Environment; Central Statistical Office.

factor

If Hedley Smyth's hypothesis is correct, then he is accusing house-builders of putting land speculation above their productive services to consumers.

THE BUILDERS who gain from speculation are the big operators who can amass large land banks.

Small builders, however, are vulnerable to cyclical trends in the housing sector.

Much more so when they realise that trends in the land market are directly responsible for reducing the general demand in the economy, which feeds back to curtail the number of customers who can buy new homes.[2]

A smooth trend in land price increases (in line with real economic growth) would be far more acceptable to the majority of builders.

A reasonable level of average profits, earned consistently over a period of years, would yield just as much income as the present pattern in which abnormally high profits are followed by lean years.

Lean years, of course, in which many builders go bust.

But the prospects for reforms that would help to smooth out the construction cycle depend on the accumulation of *information* on the land market.

That, however, would mean exposing the secrets of the land speculators . . . which explains why the public is left largely in the dark.

REFERENCES:

1. Hedley Smyth, 'Land Supply, House-builders and Government Policies', Working Paper No. 43, SAUS, Bristol, 1984.
2. Fred Harrison, *The Power in the Land*, London: Shepheard Walwyn (New York: Universe Books), 1983.

Rising rents: 'symptom of success'

QUOTE by Dr. Bill Robinson, Senior Research Fellow and Editor of the London Business School's *Economic Outlook:*

". . . I did not include rent in my analysis for the good reason that rents, for the economy as a whole, have not grown especially rapidly over the period.

"Moreover, there are good theoretical reasons for excluding rents: high rents are in general a symptom of success, not a cause of failure."

● **MISSING from the files: Derek Shepherd with the State of Trade Inquiries which no longer ask questions about land as a constraint on builders.**

Land prices: no questions asked!

By Peter Poole

BRITAIN'S housebuilders used to monitor land prices as a constraint on their industry.

For five years, their State of Trade Inquiry – a quarterly survey of members of the House-Builders Federation (HBF) – asked questions on land.

The data did not provide answers to questions like: *By how much have land prices increased in the past three months?*

Nonetheless, a good idea could be formed from the reaction of builders to the way in which they ordered their answers to the full range of problems that confronted them.

Time and again, the lack of building land at viable prices was the major problem facing most builders.

The survey began in 1975. The questions on land were dropped in the first survey of 1980.

Why? "I don't know", says Derek Shepherd, the 26-year-old senior economist at the Building Employers' Federation, who also services the HBF.

"I guess it was dropped because the question of mortgage availability became more important from about 1979 onwards, than the supply and price of land".

THE ONLY reliable data which builders can use as a benchmark for the price they pay for land is an index prepared by the Department of the Environment.

But this information is a full year out of date by the time that it is published. It is useless, therefore, as a guide to current trends.

And it is of little use to economists who may wish to feed building land prices into an econometric model of the economy.

Yet the construction industry is a leading sector of the modern economy, determining the prosperity of hundreds of thousands of families whose breadwinners are employed in the building and ancillary trades.

Land was generally accepted as both an economic *and* political issue in the early 1970s, when speculation was rife. That was why the house-builders could not ignore it, when they launched their State of Trade Inquiry.

"It would be neglectful of an organisation not to take account of that in the State of Trade Inquiry, which is one of the few means by which we get regular information together from members on businesses prospects", says Mr. Shepherd.

But the absence of a thorough survey of builders' opinions has left a gap in knowledge. For example, when asked if he could express an opinion on the current state of the land market, Mr. Shepherd replied: "Not

in any objective way, because it's something we don't really have much data on".

So questions are asked about the availability of mortgages, and of labour – but builders are not invited to comment on the supply of land.

Questionnaires, suggests Mr. Shepherd, sometime "reflect the character of the person running them". Their contents are also shaped by comments at committee meetings, and feedback from members.

CURIOUSLY, the demand for a thorough survey of the land market is not high among builders.

Yet they are apparently dissatisfied with the official figures supplied by the DoE.

"They are critical because they tend to compare the prices they pay for particular plots of land – which may have a high value, on the outskirts of a town on the south coast, say – with the DoE average land prices.

"The DoE uses a sound statistical methodology to come up with the nearest estimate of the actual average land prices. And builders tend to get confused between simple averages and weighted averages".

Nonetheless, says Mr. Shepherd, it would be worthwhile if an up-to-date series on building land prices were available to the construction industry, published on a quarterly basis.

"It would give builders a better feel of the land market", he notes. But he doubts whether the government could be persuaded to invest money to set up an information-gathering network to chronicle the land market in the way that agricultural land prices are monitored.

Which is handy for land owners, because imperfect information is one of the principle weapons used by monopolists to squeeze abnormal profits out of land users.

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LEADING INDICATORS: Forecasting the future on the basis of an uncertain past!

Karl Oppenländer and Günter Poser (Editors), *Leading Indicators and Business Cycle Surveys,* **Aldershot (Hants): Gower, 1984, £27.50.**

IT IS by now axiomatic that what comes out of a computer depends on what you feed into it in the first place.

Economists are desperately reviewing the nature of the data fed into their econometric models, and this book is a useful summary of the current situation.

It is based on a wide variety of papers presented to a conference in Washington, D.C. in 1983, focusing mainly on surveys into the intentions of investors and consumers.

But while the methodological problems are examined in detail,

By Ian Barron

insufficient consideration is given to the accuracy and the economic relevance of much of the information that is accumulated.

No-one doubts that professional forecasters would like to improve their performance. But there is obviously a psychological problem here. What if it transpired that, because of insurmountable difficulties, economists could *not* in reality produce useful short-term forecasts?

LAND PRICE INDEX
Land and Liberty focuses on attitudes in the United States and Europe

Part 1: INTRODUCTION

THE BRITISH government, for example, places great store on the value of its index of leading indicators (see graph).

These are supposed to give up to a year's warning of trends in the economy, thereby enabling interventionist measures (if these are deemed to be desirable) to be taken in good time.

The leading indicator, however – an experience common to all Western countries – has failed adequately to foreshadow major shifts in the trends. Why?

Because the data which are used may be extremely inaccurate.

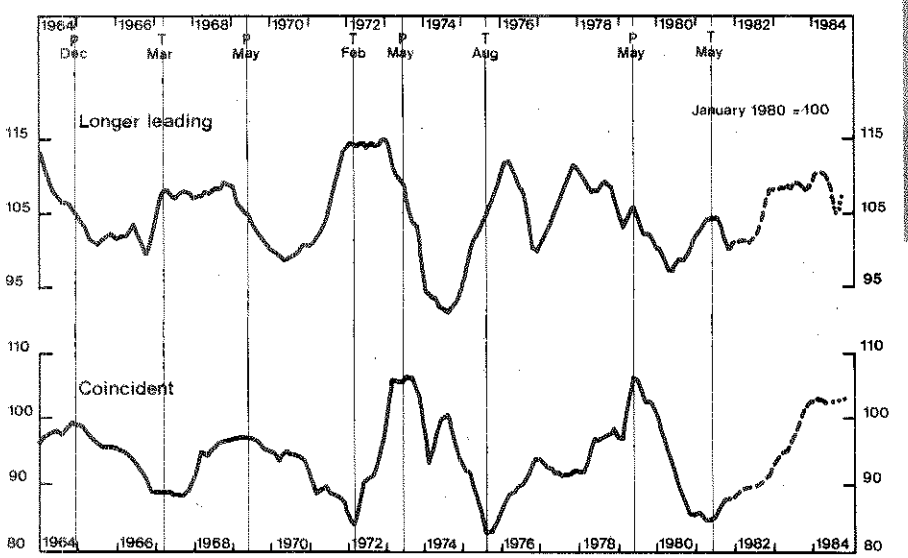
Profits, for example, are one of the five statistics that make up the UK's longer leading indicator. Profits, however, are so uncertain that they have to be repeatedly revised for years afterwards – by enormous margins.

Revisions are still being made for figures originally published in the 1970s (see Table 1).

Original estimates, then, are nearly always gross underestimates. The first

Table 1: U.K. COMPANY PROFITS (£ billion)

	Original estimate	1 year later	5 years later	Latest
1974	21.7	18.8	17.5	19.3
1975	18.6	17.8	19.8	19.6
1976	22.5	22.7	25.6	24.8
1977	25.5	26.3	30.9	30.9



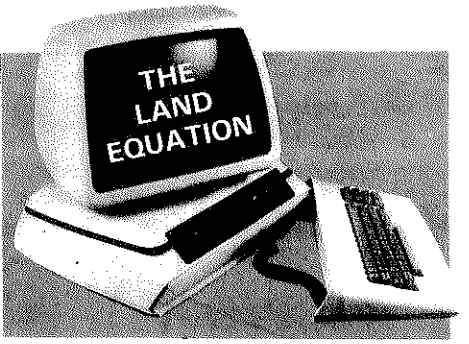


figure for 1978, for example, was £29.13bn; last year it was revised up to £35.13bn, a whopping 21% increase. So as *The Economist* observed on January 5:

"When it is first published, the indicator sometimes contains only two components. It is then frequently revised: an uncertain future is being 'forecast' on the basis of an uncertain past".

THERE is another reason why the early warning signal may be unreliable.

The selected variables may not be the best ones available, in the sense of their not being causally important.

This emerges in the paper by Baba, Nomura and Tahara, who review the way in which the indicators in use in Japan have been revised.

The timing of the new and old leading indexes, they say, had been almost the same "until the first oil crisis".

The authors, unfortunately, have been misled by the conventional wisdom that the major bodyblow to the Western economies during the 1970s was the hike in oil prices. But as we can see from Table 2, the old leading index began to go awry in 1971.

Until 1970, the old and the recently-revised leading indicators would have performed equally well, warning of peaks and troughs in the business cycle by the same number of months ahead of time.

By December 1971, however, the new index would have given a six-month warning – but the old index was no further ahead than the co-incident index of trends in the economy.

Things started going wrong for the old index a full two years before the oil price rises engineered by OPEC. It is incongruous, therefore, to attribute changes in the underlying performance of the Japanese economy to the oil sheikhs.

● Why did the old index completely fail to monitor the business cycle trough in December 1971?

We think that the answer lies in the fact that the component that was the proxy for the land market – new orders for private-sector construction work – was too insensitive to monitor the sharp upward drive of rents and land values that began in the late 1960s.

● Why would the new leading index, if it had been in operation, have given a six-month warning of the trough?

Probably because the new orders for construction work was dropped in favour of a more sensitive component – that of the number of starts in new dwelling construction.

THE PLAIN fact is that Japan's leading index would have been even more powerful as a tool for prediction if it embodied a land price index.

The Japanese Government's Economic Planning Agency is well aware (and perhaps uniquely so among all the industrial countries) of the way in which land prices distort investment and consumption decisions.

There are repeated references to the destructive impact of land speculation in the annual economic surveys.*

Yet the government's economists have made no *direct* allowance for this variable in its economic indicators, an absurd and unnecessary omission.

Economists, instead of questioning their original parameters, are seeking improvement through increasingly complex models of the economy. Yet as J. S. Armstrong notes in a paper entitled 'Recent Trends in Forecasting Methods', "it is difficult to find any evidence that sophistication or complexity has improved forecasting accuracy."

In fact, all the evidence points to the virtues of simplicity. That, in turn, places a greater burden on the analyst to choose the correct causal mechanisms with which to lay bare the workings of the industrial economy.

But economists have not yet deemed it prudent to go back to first principles, even though – in terms of classwork performance – most of them would not receive Pass grades in the school of life.

*Fred Harrison, *The Power in the Land*, New York: Universe Books, 1983, Ch. 12.

Table 2: JAPANESE ECONOMIC INDICATORS

	New Indexes		*Old Indexes*	
Reference dates	Leading	Coincident	Leading	Coincident
June 1957 P	−2	+1	−2	+1
June 1958 T	0	+1	0	+1
Dec. 1961 P	−4	+1	−4	+1
Oct. 1962 T	+1	+2	+1	+2
Oct. 1964 P	−7	+2	−7	+2
Oct. 1965 T	−2	0	−2	0
July 1970 P	−3	+1	−3	+3
Dec. 1971 T	−6	0	0	0
Nov. 1973 P	−7	+1	−4	+1
Mar. 1975 T	−1	+1	+1	+1
Jan. 1977 P	−5	0	−4	0
Oct. 1977 T	−3	−3	−1	0
Feb. 1980 P	−7	+2	+2	+1
Feb. 1983 T	−2	−2	0	0

How Reagan went wrong

LAND PRICE INDEX

Part 2: UNITED STATES

By Paul Knight in Washington

THE INITIATIVE to establish a reliable index of land prices was taken in Washington, D.C., in 1979.

Such an index is vital if gaps in econometric models of the economy are to be filled in.

Armed with a reliable series of figures on land values, it becomes possible to test, with mathematical rigour, the proposition that operators in the land market can influence what happens elsewhere in the economy.

Some information is already available:

- Every five years the Census of Governments reports on assessed values of properties, including vacant lots.
- The Department of Agriculture publishes a series on farmland values.
- The Federal Housing Administration (FHA) is a source of residential land values, gained in the course of appraising homes for insurance purposes.
- A few non-governmental bodies may be able to produce data, such as the Home Owners Warranty Corporation.

But there are deficiencies in the information supplied by these agencies, a critique of which is supplied by Grace Milgram and others in papers delivered at a Workshop on Rural Land values in 1982.[1]

THE MAN who saw the enormous political importance of a reliable land price index was Henry Reuss.

In 1979, as the then chairman of the House Committee on Banking, Finance and Urban Affairs, Mr. Reuss asked the Congressional Research Service for "exploratory work leading up to the possible creation of a national land price index".

The CRS and the Office of Management and Budget established a Task Force on Development of a Land Price Index.

The Task Force established two distinct types of needs:

First, at the national level, the index would be valuable in refining the U.S. income and wealth accounts; and to analyse the reciprocal impact of land values and policy decisions in relation to taxes, housing programmes, land management and other Federal programmes.

Second, at metropolitan level, the information would be valuable in considering government policy as it affected property taxes, zoning, the provision of municipal services and housing needs.

It quickly became clear, then, that there would be a big pay-back on the money spent in collating data on land values.

The Bureau of Labor Statistics, for example, when asked to review the possibility of developing a land price index, discovered several ways in which such an index would be useful to their programmes.

The BLS designed a pilot programme to see how best the information could be collected. At the same time, the Department of Housing and Urban Development (HUD) commissioned exploratory studies and a conference to consider the results.

Then Ronald Reagan was elected as President.

The new White House Administration decided to cut back on government spending, and the BLS and HUD research was among the first victims.

"Presumably, these budgetary constraints will be lifted at some time in the future," writes Ms. Milgram optimistically.

FOR SOME years, now, the United Nations has recommended that member countries ought to be collating information on land.

An analysis of government accounts showed that these were all but useless for assessing trends in the price of land.

"Land," as one U.S. Department of Commerce economist has noted, "has little role to play in a system of flow accounts built around the measurement of production."[2]

The U.N. emphasises the urgency of collecting this information. It proposes that land values should be net of the value of improvements on the land.

President Reagan claims to want to make the Federal Government more efficient. Here is one example where new expenditure would undoubtedly improve the value of the taxpayer's dollar.

1. Gene Wunderlich, *Land – Something of Value*, Vols 1 and 2, Cambridge (Mass.): Lincoln Institute of Land Policy, 1982.
2. Helen Stone Tice, 'Measuring land in the national economic accounts', *ibid.*

● Henry Reuss – he could see value of land price index

Challenge to economists

LAND PRICE INDEX

Part 3: UNITED KINGDOM

By Ian Barron in London

IN BRITAIN the only reliable, regular index is for farmland prices, published quarterly by the Department of Agriculture.

Data on housing land prices is published in index form by the Department of the Environment, but with a time lag of a year: this reduces its value to forecasters.

Yet there is no excuse for the paucity of data, for the Inland Revenue has a nationwide network of District Valuers who are qualified to supply up-to-the-minute information on trends in the property market.

A valuation department was set-up by the national taxing authority after the Liberal Government decided to pass a law to levy duties on land in 1909.

Nothing came of those duties, but valuers were retained in government service.

Today, they could provide an independent view of the condition of the property market that would outrival the service provided by private real estate firms.

A step in the right direction was taken in 1983, when the valuation office published its Property Market Report.

Why have an independent assessment of values? One reason was offered by *Estate Times* on Nov. 11, 1983:

"It has been curious that over the past few years, while the recession has been depressing just about everything else, property values have remained remarkably buoyant.

"A cynic would have argued that there has been a conspiracy of 'talking up the market'."

There is, indeed, a vested interest in making optimistic noises about the yields to be obtained from property. Said *Estate Times:*

"As long as there is a vested interest on the part of, particularly, the pension funds to keep property values as high as possible, there will always be someone who will express a view which will support their beliefs to the general public.

"Fortunately we now have the Inland Revenue report to provide a long stop-check on any outrageous claims."

Until then, the Inland Revenue published an "appreciation" of the property market, but this was of little value. It was published on an annual basis, as an appendix to the report of the Valuation Office; and it contained little hard information by way of prices and rents.

The Property Market Report, however, published in London by Surveyors Publications, is based on six-monthly data. The value of various categories of land are given, which in time can be built up into a useful series.

MEANWHILE, the private sector has struck back.

The four largest estate agencies in Britain have just completed a pilot study into a new property index.

Iain Reid, a research partner at the firm of Richard Ellis, told *Land and Liberty:* "We expect to publish a quarterly index. There is little point in producing an annual index. People want to see what's happening much more frequently – and fast enough after the event.

"There's no property equivalent to the Financial Times All-Share Index. The FT shows how the market is reacting on a short-term basis. You can't get down to a day-by-day thing for property, but as a start we want to go quarterly."

The new index will monitor trends in both income and capital growth. But will it lead to more investment in property? "More and more reliable information will lead to greater confidence in the market," says Mr. Reid.

One of the difficulties is that the new index will not separate land from capital improvements upon it. This does not pose a problem, in Mr. Reid's view:

"Any growth in property values attaches to the land," he said. "The buildings are only a matter of what it costs to put them there, plus the effects of lease terms on the investment.

"But basically you are talking about an enhanced land value.

"Somebody investing in a property long-term is actually investing primarily in the site. Every property is a development proposition."

The British Government will not underwrite the collection of information to construct a reliable land price index until it has been persuaded that there are serious policy implications to justify the cost.

It is therefore incumbent on professional economists – both in Whitehall and the universities – to explore the impact of the land market. A qualitative assessment would soon reveal chasms in the knowledge on which politicians have relied for administering their policies.

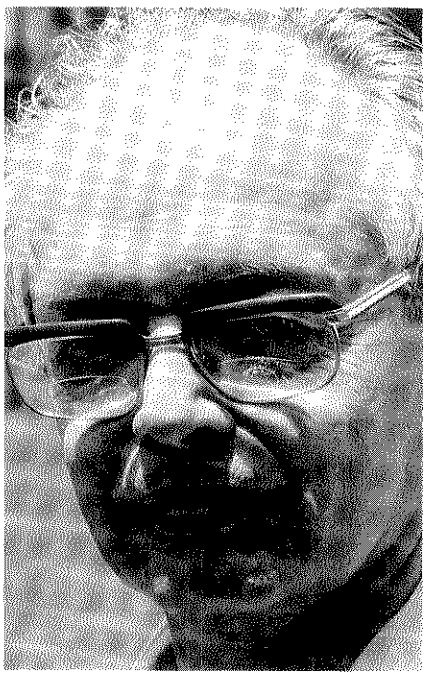
Chasms which, until now, they have only been able to bridge with the political equivalents of Indian rope tricks.

No secrets in real estate

LAND PRICE INDEX

Part 3: FINLAND

By Prof. Pekka Virtanen
Helsinki University of Technology



REAL ESTATE deals have never been secret in Finland.

Anyone can secure information on them, through research at local courts where legal confirmation of possession is granted.

Additionally, many municipalities have had their own unofficial registers on accomplished deals.

To make this information more easily accessible, the Finnish Parliament enacted a special law in 1980: Act on the Register and Statistics of Real Estate Deals (Act 552/1980, Laki kiinteistöjen kauppahintarekisteristä ja kauppahintatilastosta). This legislation came into effect on 1 July 1981.*

The general purpose of this legislation is to provide authorities and other potential buyers and sellers of real estate with correct information on the market situation, especially on prices. Previously, it often happened that agreements were based more on hearsay, and this was probably one reason for the quite steep rise in land prices.

'Real estate deals have never been secret . . . the register is computerised and up-to-date'

The register of real estate deals is kept by the National Board of Survey, with branch offices in 12 provinces (counties). All real estate deals in Finland must, by law, be done in the presence of a certain kind of notary public who submits, for each deal, a special information form to the surveying authorities (and taxation authorities, as well).

The form contains information on some facts which can influence the selling price, e.g. whether the seller and buyer are relatives; whether there are buildings upon the piece of land concerned, and (if yes) the kind of buildings; whether the land was in planning or rural areas, etc. (planning areas are those with approved detailed town plans).

The register itself is computerised and kept up-to-date with about four weeks delay. Information on individual deals, or lists of specially chosen sets of deals, can be ordered by anybody. The choice can be made very freely. For example: all deals made in 1983-84 concerning one-family houses in district X of town Y.

The cost of this service is now four to seven Finnish Marks (£0.5 – 0.9) per deal, depending on the size and kind of the order. The subscriber can choose between simple computer lists of deals, or full copies of original information forms.

ACCORDING to the act, the National Board of Survey must periodically publish essential statistics on the basis of this register.

Two annual registers have been published so far. The one for 1983 contains 43 tables and 12 figures. The tables give information by types of real estate and by types of areas.

The main types of areas are planning (urban) areas and rural areas. Both of them are examined by municipalities (461), provinces (12) and the whole state.

There are also separate tables for the number and scope (area) of deals and for actual prices.

Statistics by municipalities are given for the kind of real estate which is traded. In practice, this means unbuilt lots for one-family houses in planning areas, and built and unbuilt lots for summer houses (on the shore).

Many tables first give the number of deals and the mean of the land areas concerned. For prices, the following information is given: mean, median, minimum, maximum and standard deviation.

The user should treat these statistical facts with caution, because all factors affecting the price cannot be seen in the published material. For example, the amount of timber in forest is not recorded, even if it has the major impact on the price.

These statistics give a good general view of the real estate market, and thus provide a sound starting point for reliable valuation, and the use of econometric models will now be possible.

The published statistics tell, among other things, facts for the whole of Finland as summarised in the table below.

'According to the law, essential statistics must be published'

As the land area of Finland is about 305 000 sq.km's, the statistics show that 2% of land area changes owner yearly.

The sum of purchase prices in 1983 was 10.8bn Finnish Marks (£1.3bn). The rise in total prices over 1982 was 19%, which is partly explained by the growth of the market (number of deals grew by 3% and area by 5%) and partly by inflation (10-11%).

*"Real estate" in Finland means land and eventual buildings on it. Therefore deals concerning apartments in blocks of flats are not covered by this act. To sell a share of stocks in this kind of housing corporation is seen as a deal of movable property, and that is less controlled.

Changes of ownership	1982	1983	Change
Number	71,281	73,518	+2,237 (3%)
Area (hectares)	582,720	612,529	+29,809 (5%)

DATA: Where there's a will . . .

LAND PRICE INDEX

Part 4: GERMANY

By Henry Law

SUGGESTIONS that information about land values would be difficult to collect is firmly refuted by the wealth of data which is available in West Germany.

● All sales of building land are reported to both the statistical office of the relevant Länder authority, and to the tax department.

The information is compiled systematically, and particulars recorded include the location and size of the plot, and the zoned land use and density.

This makes it possible to analyse price trends for various categories of land.

The work is carried out at the Federal Statistical Office, which, at regular intervals, publishes tables giving building land prices covering the entire country.

● An annual survey of building land prices is conducted by the Deutsche Stadtetage, the West German association of city councils. The survey relates to a selected sample of cities, and makes use of information supplied by the local valuation boards. This is published in tabulated form.

● The Ring Deutscher Mäkler (Association of German Estate Agents) publishes land price tables from time to time, based on information supplied by its members.

The survey covers a sample of cities, and the statistics are broken down according to the type of location – city centre, city, suburban and peripheral areas being classified separately in the resulting building land price tables.

● The local valuation boards prepare land price tables on the basis of purchase price information supplied to them; these analyse long-term price trends.

Thus, in West Germany, there are three sources of information about land prices, all derived from evidence of recent transactions. This demonstrates that, given the will, information about land prices can readily be obtained and analysed.

PRICE controls on land in Germany were not finally abolished until 1960; they were a legacy of the Nazis, having been introduced in 1936.

Since then, as everywhere, the price of building land in West Germany has increased at a rate faster than all other costs.

This is attributed to the usual factors, such as urbanisation and a propensity to purchase land as a hedge against inflation. In addition, no fewer than 9m refugees had to be resettled, with predictable effects on land prices. It is a familiar story.

*The information for this article was drawn from Prof. Walter Seele's 'Land price increases in the Federal Republic of Germany', published in *Der Sachverständige*, 1984(6). An English translation can be obtained from the author at the Institut für Staedtebau, University of Bonn, Meckenheimer Allee 172, D. 5300, Bonn 1, West Germany.

Economics: straddling

THE 1984 Nobel prize for Economics was awarded to Sir Richard Stone, a retired Cambridge University professor, for his work on developing systems of national accounting – double-entry book-keeping on a grand scale.

This prompts a look at previous Nobel laureates in Economics.

The Nobel prizes were established by the estate of Alfred Bernhard Nobel (1833-1896), a Swedish inventor and engineer who developed dynamite and other explosives which he thought were so dreadful that wars would be abolished.

Annual awards were established in Literature, Chemistry, Physics, Medicine and Peace. They were started in 1901 (the Boer war was going on) and have evolved into the world's most prestigious awards.

A latecomer was Economics, a sixth category started in 1969.

'Physics has made progress: economics is floundering'

In establishing the prize, the Swedish Academy of Science wanted to stress the *scientific* aspects of the subject – indeed, they referred to it as Economic Science. They gave emphasis to techniques, methods, fact-finding, and sought to avoid ideology. Thus they aimed to put Economics on a par with the other sciences.

How has this worked out?

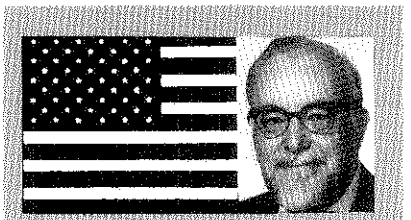
LOOKING at the list of prize winners (facing page), we see that from 1969 to 1973, they stayed close to their concept of Economic Science. The laureates worked in Econometrics, mathematical models, methodology (which, however, is not quite the equivalent of the nitty-gritty in other sciences). But then there was change.

In 1973, in the world of affairs, there was a serious global recession, the OPEC countries stunned the world with its dramatic increase in the price of oil and the conventional Keynesian wisdom suffered blows because of stagflation.

The supposed verities were shattered. and lo and behold, the Nobel prize went to *ideologues*.

In 1974 the prize was divided between Hayek, an apostle of the unregulated market, and Myrdal, a proponent of government intervention. And in 1975 the prize was divided between a Russian and an American. So if ideology could not be avoided, they at least tried to straddle the fence!

Thereafter, it is as though the billiard balls were scattered on the



ROBERT CLANCY reports from NEW YORK

table, with a great diversity of approaches: monetarism, international trade, decision-making processes, Third World economics.

But from 1980 to 1983, there was *another* interesting change. It was back to Econometrics – but with a difference.

The 1980 laureate, Lawrence Klein, served in the Carter administration and was a proponent of national policy-making. The 1981 laureate had served in the Kennedy administration, was a Keynesian and an opponent of Friedman. One reviewer asked: was the Swedish Academy of Science sending a message?

But in 1982, there was *another* change. The winds of conservatism were blowing. Ronald Reagan and Margaret Thatcher were gaining in credibility and other countries were going conservative. And the 1982 laureate was George J. Stigler, a strict marketplace economist. In 1983 the laureate was Gerard Debreu, who had undertaken studies on the equilibrium of supply and demand in a market economy, seeking to verify Adam Smith's "invisible hand." In 1984 – with no great changes in the world but with conservatism being challenged we're back to "impartial" economics with Richard Stone.

Thus we see that the Nobel decisions were affected by changing trends and the climate of thought and they could not consistently maintain the Olympian detachment they at first thought possible.

The Nobel prizes for Physics, Chemistry and Medicine indicate over the years advances in these fields. Each succeeding contribution is built on previous work and progress made.

But such is not the case with Economics as currently taught and practiced.

- For a time – a few years perhaps, or even several years – a set of ideas and policies seem firmly in place.
- Then comes an unexpected crisis and different ideas challenge the conventional wisdom.
- Perhaps one or more of these ideas become adopted and the same process is repeated.

It is as though an unseen obstacle or gap breaks down the gears of economics.

DATING from Adam Smith, economic thought has been cultivated for some 200 years. For about the same period, physics has been developing as a science.

But whereas physics has made phenomenal progress, economics is still floundering. There is not a common ground. Economists vie with one another with contradictory theories and claims. The uncontroversial contribution of the 1984 Economics laureate, Richard Stone, in developing a super book-keeping system, hardly compares with advances in other sciences. Increased understanding of how things work is what matters, and prizes don't go to people who improve ways of counting stars or blood corpuscles.

'Economic progress must be limited to the basic issues'

Real economic progress cannot be

ECONOMISTS VIE WITH ONE ANOTHER WITH CONTRADICTORY CLAIMS

the ideological fence

made without paying heed to the big basic issues.

- Can we look at the business-cycle theory of the Russian economist Kondratiev without noticing that he was exiled to Siberia for dabbling in capitalistic economics?
- Is it enough to perfect mathematical models while the world is going haywire?
- While debts and deficits are mounting everywhere, does an improved method of keeping accounts help much?
- Can developmental economies be worked out matter-of-factly while the Third World is mostly in the grip of domineering elites?
- Can an economy be described with no reference to the disinherited masses?
- Can models be constructed without regard to the effects of bureaucratic interference in the market?
- And can growth be plotted while avoiding the hottest issue all – the distribution of wealth?

If the hope is that neutrality in such matters will make economics more closely resemble other sciences, such as physics, this is not the case.

THE FACT of life most persistently ignored by today's economists is the monopoly of land and the rent of land.

Classical economics did recognise the special nature of the rent of land, and did notice that the landowner as such made no contribution to production. The phenomenon which they

'Physics would be in the same sorry state'

recognised to some extent was fully brought to light by Henry George – that the rent of land increases with the growth of society, that an artificial increase presses against other returns, and that it must be diverted from private pockets to public uses.

Economists have chosen to soft-pedal the importance of this knowledge, choosing to merge land and rent with other factors and returns.

Paul Samuelson has a good demonstration of the law of rent in his textbook, but then he does not integrate it with the rest of economics.

Milton Friedman and Herbert Simon have mildly endorsed land value taxation, but place no special importance on it.

Supply and demand economists do not notice that land is different from reproducible goods.

Computer models and forecasts take no notice of rent.

Previous winners of prizes associated with economics are:

- 1969: Roger Frisch, Norway, and Jan Tinbergen, Netherlands for their work in Econometrics and the mathematical handling of economics.
- 1970: Paul A. Samuelson, U.S., for influence as author of the most widely used textbook.
- 1971: Simon S. Kuznets, U.S., for contributions on quantitative study of the growth of nations.
- 1972: Kenneth J. Arrow, U.S., and John R. Hicks, Britain, for work in equilibrium theory – balance in the economy.
- 1973: Wassily Leontief, U.S., for input-output technique for predicting trends.
- 1974: Friedrich A. von Hayek, Britain, and Gunnar Myrdal, Sweden, for infuence on two poles of economic thought.
- 1975: Leonid V. Kantorovich, U.S.S.R. and Tjalling C. Koopmans, U.S., for work on allocation of resources for opposite systems.
- 1976: Milton Friedman, U.S., for influence as a monetarist.
- 1977: James E. Meade, Britain, and Bertil Ohlin, Sweden, for work on international trade.
- 1978: Herbert A. Simon, U.S., for analysis of organisational decision-making.
- 1979: Arthur Lewis, Britain and Theodore W. Schultz, U.S., for work on developmental (Third World) economics.
- 1980: Lawrence R. Klein, U.S., for work in Econometrics and computer models.
- 1981: James Tobin, U.S., for analysis of financial markets and macro-economics.
- 1982: George J. Stigler, U.S., for analysis of markets and effects of regulation.
- 1983: Gerard Debreu, U.S., for study of equilibrium in market economy.

With this all-important factor missing in current economics, it is no wonder that the gears keep getting stripped. It is as though in physics no importance were attached to some basic phenomenon such as light or magnetism or gravity. No doubt physics, in those circumstances, would be in the same sorry state that economics is in today.

We cannot help calling to mind Macaulay's observation that if the law of gravity offended any large pecuniary interest, there would not be wanting learned arguments against it.

Let's face it – there is much pecuniary interest in land and its rent! Could this be another "invisible hand" in economic thought?

'Economics is an even hotter topic than peace'

As for the other Nobel categories, Literature is in a class by itself, as a masterpiece can be written in no matter what year. But the other categories are supposed to show some advance. Such has been the case in Physics, Chemistry and Medicine.

It is only fair to admit that human and social affairs are much more complex than the other disciplines and that we have a long way to go to approach comparable understanding.

In this domain, besides Economics, there is the Peace prize, which was Nobel's primary interest. It has been awarded almost annually since 1901, and during that same period we have experienced the two worst world wars in history, plus a host of nasty lesser ones, plus the most monstrous of all hanging over our heads.

The awarding of the 1984 Peace prize to Bishup Tutu of South Africa shows that the Nobel people are not avoiding controversy in that field.

But by comparison, Economics is an even hotter topic than Peace (or race relations).

Economics concerns how all of us live in both wartime and peacetime, how wealth is produced and, above all, how it is distributed.

Unless this is squarely faced, there is likely to be further evasive dabbling in Economics with periodic crises.

. . . INCREASED UNDERSTANDING IS WHAT MATTERS

UNEMPLOYMENT

How pay-master Nigel Lawson made his computer dance to his tune . . .

By Peter Poole

THE PRIMACY of theory over statistics is demonstrated in a controversy that currently involves Nigel Lawson, Britain's Chancellor of the Exchequer.

Mr. Lawson, backed by Prime Minister Margaret Thatcher, wishes to persuade workers that *they* are largely to blame for mass unemployment.

To this end, the computer model of the U.K. economy has been used to show that a 1% reduction in the average level of real wages would create 200,000 jobs.

Powerful medicine for a government that has presided over a record increase in unemployment.

The computer, it seems – without political prejudice – has coughed up the "proof". Or has it? Not according to research sponsored by the Economic and Social Research Council (ESRC).

THE forecasting performance of macro-economic models of the U.K. economy is now under intense scrutiny.

The ESRC is spending over £2.8m on research into ways of improving the models that regularly produce precise numbers about trends in such things as employment, investment and international trade.

As part of this attempt to rescue the credibility of econometric research, £350,000 has been granted to establish the Macroeconomic Modelling Bureau at the University of Warwick.

The object: to improve the models, particularly in the area of forecasting and policy analysis.

And the Treasury's model (or rather, the Chancellor's *use* of that model) has become the first victims of this new research.

For the Bureau, using the public version of the Treasury's model which was made available in January 1984, fed a 1% wage cut into their computer.

Prediction: 15,000 new jobs.

This is a staggering difference from the Chancellor's claim which he made in the House of Commons on October 30 last year.

But why the difference?

LAST YEAR the Treasury's civil servants fed a new equation into their model.

This amounted to a much stronger "real wage effect", which amounts to telling the computer what result is wanted.

The result, of course, can then be used to "prove" the original proposition.

This is an exercise in rigging the results, of course, for which the computer itself cannot be blamed.

The Warwick Bureau, in its report,* criticises this particular use of "exogenisation".

This is the technique of interfering with a result that would be normally calculated by the computer from the data fed into it.

The method is treated with suspicion because, in a non-socialist economy, the government cannot directly cut average wages.

The Bureau emphasises: "Unless the mechanism whereby real wages can be influenced directly is made explicit, such exercises are of little value."

The Treasury wanted to confess to their manipulation of statistics.

In an early draft of a paper on the link between pay and jobs, distributed to their academic advisers, they noted that the criticism "which would appear to carry some weight . . . is that the simulation results depend critically on a system of adjustments which is entirely arbitrary and has no empirical basis".

This passage was omitted from the version that was published on Jan. 30. And as *The Guardian* reported the next day:

"Along with other deletions to the original paper, the change underlines the pressure which Treasury economists came under to deliver politically pasteurised results."

THIS is why theory, which explains relationships and exposes causal mechanisms, has to come before the manipulation of statistics.

But that is not to discredit the use of statistics, or the computer aided manipulation of them. For if the theory is sound, to start with, charlatans would not get away with the well-known technique of "lying by statistics".

The big tragedy for economics, as taught today, is that too many people are willing to approach this intellectual discipline within the orthodox rules.

And orthodoxy – as many economic forecasters are now willing to admit – can be horribly wrong in its theoretical foundations.

**Models of the U.K. Economy and the Real Wage-Employment Debate,* ESRC Macroeconomic Modelling Bureau Discussion Paper No. 3, University of Warwick.

● Chancellor Nigel Lawson

Economic waffle

DEFINITION of "growth recession": An oxymoron that may become the hottest waffle-word of the subtle game of economic forecasting. Succinctly put, a growth recession is a period of slow or slowing economic growth in which unemployment is likely to rise, as it does in a recession; it is a transitional period, a pause or an economic lull.

Newsweek, Dec. 2, '84: p.33.

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