LABOUR LEFT
Briefing

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SOLID AS A (NORTHERN) ROCK

So, finally, Northern Rock has been brought into public ownership. Now the political fun begins. Recriminations are everywhere. I'm reminded of a 'Peanuts' cartoon in which Lucy offers consolation to a forlorn Charlie Brown at the end of another crushing defeat for his baseball team. With an arm around his shoulder, she whispers: 'Never mind Charlie. Just remember. It doesn't matter whether you win or whether you lose. It's where you place the blame.'

The Tories are dead set on blaming 'Dithering Gordon'. They see the Prime Minister's hand on the Chancellor's shoulder, and an inability to make big decisions when they were needed. There are criticisms to be made of the economic muddle behind this political mess, but none of these are grasped by the Tories.

In fact, the Tories have put themselves in a position that is uniquely hypocritical; managing to demand everything, and its opposite, at each stage of the Northern Rock crisis. Those who demanded that Northern Rock should have been left for the banking and finance systems to sort out for themselves ignore the absolute certainty of a systems collapse that would have followed. Those who blame the Government for stealing shareholders' money ignore the fact that shareholders would have had absolutely nothing had the collapse proceeded into self-destruction.

Only the Lib Dems come out of the crisis with any consistent credibility. It is understandable that they should offer the wry observation that the Government has spent £100 million on consultants' fees in order to do precisely what the Lib Dems had advised (for free) some months ago. Even so, it is hard to blame the Government for at least attempting to find a private sector solution, if private sector solutions were what you were looking for. None of this, however, goes to the core of the crisis itself.

To access this, we have to go back to the early days of the Blair administration and to Gordon Brown's tenure as Chancellor. Today's crisis emerges from out of the mistaken view that governments could get out of the cycle of boom and bust by creating an independent Bank of England, and then regulate the economy on the basis of the control of interest rates alone. In repeated the modern error of reducing economics to an analysis only of competing interests of capital and labour; forgetting what classical economists had written about the significance of land.

The basis of being really hard on Gordon Brown, as Chancellor, is also to be found in his belief that he could somehow construct a form of Keynesianism by stealth. This involved driving the economy on hidden debt. Instead of having infrastructure funded out of direct public investment, the plan was to pay for this out of private borrowing rather than public debt. It involved a dramatic loosening of the rules relating to credit creation.

During a period in which public debt was dramatically squeezed down, private credit was allowed to go through the roof. In the context of housing, it meant that prices, often literally, went through the roof too.

There are great weaknesses in a strategy that focuses solely on interest rates and inflation. It ignores the fact that footloose credit will often run in contradictory directions. Without a specific set of policies which address the impact on land prices, you are heading for unavoidable catastrophe of the sort we have created for ourselves today.

It becomes easier to make money out of land speculation than out of making goods. To some extent the Chancellor relied on this too. As house prices spiralled so his tax revenues increased with every property transaction. Land was always going to be in short supply. As the comedian Bob Hope famously said: “They ain’t making any more of it.” It allowed banks, building societies, speculators and the public to believe that housing was a never-ending upward spiral; a free money machine which guaranteed that no matter how much you put in, it would always pay back more.

The history of booms and busts over the last 400 years makes it clear that housing is a more pivotal issue than inflation. Moreover, housing ‘busts’ are invariably more dramatic and damaging than inflation/deflation ones. In the UK, one economist has consistently stood out against the crowd in urging a return to the ‘land’ issue in Government policy formulations. Fred Harrison has written numerous books on this issue, contributed dozens of papers to dozens of Government reviews and has always been singularly ignored. He does, however, have a record of being consistently right when virtually all other economists have been wrong.

Those wanting to understand the real mess behind the Northern Rock fiasco would do well to read his book ‘Boom Bust – House Prices, Banking and the Depression of 2010’. Published in 2005, it is a stark and painful analysis of the crisis we have drifted into, and will continue to find ourselves stuck in. Are there ways of avoiding this mess getting worse? Of course. But they involve a direct engagement with issues of taxation and of land.

In June 2004, Gordon Brown showered himself with accolades that he had broken a record set by Lloyd George that had given the UK its longest ever period of economic stability. He recognised that, in doing so, one serious ‘fly in the ointment’ remained. It was the fact that stability had been delivered on the basis of a dramatic collapse in the level of UK house building. Since he took over as Chancellor, housing output had declined by 20,000 properties a year. His solution was to cut capital gains tax from 40% to 10%. In his own words, the desire was “to encourage risk takers, those with ambition, to turn their ideas into reality and make the most of their talents”.

As a policy, this was a disaster. In effect, it delivered a public subsidy to land speculation and a penalty on the jobs market. International evidence required him to have done the opposite. Gordon did not have to revisit the case for national ownership of the land. He could have acted just as decisively by maintaining a very clear presumption in favour of taxing unearned incomes in land values.

As long as speculators are free to gamble on land, then land itself is guaranteed to be driven into an inflationary spiral that will ultimately devour itself. Harrison argues that such a cycle, if unregulated, is a 14 year phenomenon. It would be naïve and dishonest to pretend that Alistair Darling, as Chancellor, is responsible for this. He can, however, do something about events still in the pipeline of prospective collapse.

The answers are not to be found in Northern Rock, but in a willingness to tackle the way in which land has become a free bet for speculators. At the moment, the Chancellor faces a legal challenge from hedge funds who bought Northern Rock shares 'on the rocks' in the hope of making a killing. They are furious that their 'free lunch' has been taken from them.

It isn't enough for the Chancellor to see them off one by one in the courts. The challenge is to see off land speculators in the next Budget. For this, he needs a wisdom, a courage and a decisiveness that his predecessor sadly lacked.