Funding the Future

A tale of what's wrong in our economy

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I was speaking at #OccupyNorwich yesterday. One person who joined the audience, with his wife, graphically explained what is wrong with the economy.

A youngish man, in his late 20's I'd guess, he was angry. He'd done everything society had asked of him. He'd got good GCSE and A levels, done a practical degree (pharmacy) and was now working as a chemist - the sort of skill society undoubtedly needs. his wide was working too. But despite that they cannot buy a house and so feel unable to start a family because of the uncertainty rented accommodation provides. And he had no idea when he might do that: the level of deposit demanded was so high that after paying rent the obstacle to purchase seemed insurmountable.

Why was it that this was so? he demanded of me.

And I had to agree he was right to make the demand, although it was not in my gift to put things right. And yet we can put things right.

There is no doubt at all that current house prices are massively over-inflated. That is because banks lent too much on the security of land. And yet to restrict lending now does not of course help this man and his wife.

It's also because we did not tax housing enough, either through land value taxation, stamp duty, capital gains taxation and most especially inheritance tax, which is absurdly low. All have contributed to the over-pricing of land.

Giving tax relief for those buying property to let when it is denied t those borrowing g to ht has also over-inflated prices at the low end of the market, enormously. Buy to let interest releif has to go.

Being too lax with overseas landlords, and landlords holding property through offshore companies has also mean a major error of judgment. HMRC has failed in its duties here.

And as I have argued, giving tax relief to let 500,000 properties (at least) sit vacant is crazy: empty properties should be taxed at up to five times normal rates (having allowed for absence for sickness) to raise revenue and force property into the market.

But most of all, the simple fact is that wages are too low and property prices are too high. We can't deflate without failed banks and recession. So we have to reflate, and that means we positively need wage inflation in this country whilst we do at the same time ensure house prices don't rise by building significantly more homes to meet demand, so holding donw prices by meeting demand.

Inflation frightens people, I know, and someone always raises the spectre of Zimbabwe when it is mentioned, but that's ludicrous. The economic environment created by a despot intenmt on destroying his economy is hardly a basis for rational comparison. And the fact is that right now the debt that banks and governments have created cannot be repaid: it's pointless pretending that might be possible. In that case there are, as I've suggested five ways of tackling this issue. They are:

1) Inflate our way out of this situation, with the debt being devalued into a manageable sum (historically this is how most debt has ever been repaid)

2) Default - which has unknown consequences;

3) Forgiveness - which is planned default;

4) Enforced saving (which is not the same as austerity) but which directs much saving into government debt to ensure funding remains possible;

5) Closing the tax gap - i.e. collecting the money due to government to help manage debt;

6) Social breakdown - which many now see as a very high risk indeed.

I'm going to comment separately today on why collecting tax is a Keynesian solution - because it is. But right now I'll concentrate on the first three.

Default or forgiveness is likely in some cases - such as Greece and Italy. Ireland and Portugal will eventually follow suit. But for the UK that is unlikely. Here inflation is the answer. So long as wages are allowed to rise with prices and land supply is increased by public building and enforced purchase of land banks from property companies refusing to use them if need be so that house prices are kept down then inflation firstly writes off debt and secondly restores order to markets corrupted by excessive money creation. This is a powerful social advnatage.

But yes, it's true that some people's savings will suffer in the process. I agree that's true. And it is a price well worth paying to avoid social mayhem or war. We can survive iinlfation, quite easily. We cannot survive war.

So let's be realistic about the choices we make now. Savings savers may not be possible is we save society - and yes, decent state pensions may be required as a result. But that we can afford.