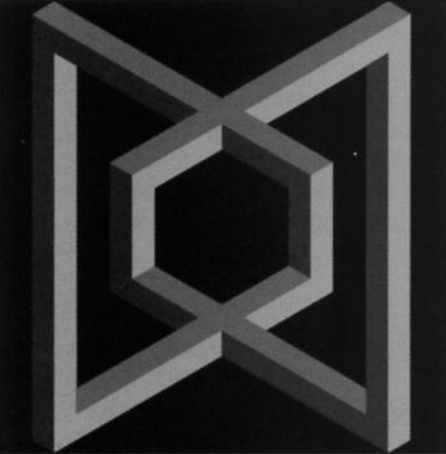


property values, because the higher selling prices of their present homes are cancelled by higher purchase prices of alternative accommodation — and they always need somewhere to live.

That argument, as far as it goes, is valid when the rise in values is due to general speculative demand [7]. But it is *not* valid when the rise is due to an infrastructure project serving the owners'



At some point the illusion becomes unsustainable and prices stop rising, taking away the alleged justification for current prices, and so on: the bubble bursts

locality, because in that case there is no matching rise in prices of alternative homes in other localities. Neither is it valid if prices in *all* localities rise due to infrastructure, because in that case the rise in prices of alternative homes is due to improved utility, and does not imply a rise in price for alternative homes of *given utility*. As ordinary home owners do not gain from general speculative demand, neither do they lose if that speculative demand is dampened by the tax system. But they still gain when the same tax system delivers improved infrastructure.

- **Bubbles and bursts:** In a *rational market*, the **capitalized** (or "lump-sum") value of a land-like asset is the **discounted present value** of the future rent stream. (That is, the capitalized value is the lump sum that would yield an interest stream equal to the rent for the same risk, or the sum of the future rental payments individually discounted for time and risk.) But speculation tends to make the market **irrational**. When people see prices rising, they want to buy into the market. In so doing, they accelerate the rise in prices, inducing more people to buy in, and so on, causing a speculative **bubble** — that is, a state in which prices are decoupled from

rents and are supported solely by the circular argument that prices will continue to rise. At some point the illusion becomes unsustainable and prices stop rising, taking away the alleged justification for current prices, and so on: the bubble **bursts**. This is obviously disastrous for investors who buy at or near the top of the bubble.

By inducing public investment in infrastructure, it would also help to lift the economy out of recessions — including the one that we're about to have, courtesy of the biggest global property bubble in history

But eventually the natural appreciation of land-like assets leads to a new bubble in the same asset class. So the market for any land-like asset class, including land itself, is **cyclic**.

The ILT would require property investors to earn income from their acquisitions in order to cover the tax, forcing them to consider the tax implications before bidding up prices, and making it less attractive to acquire land for speculation alone. These influences would impede the formation of bubbles. To avoid bubbles is to avoid bursts. Moreover, in a rising market, the ILT would produce a rising tax liability counteracting the urge to "buy in"; and in a falling market (if there were ever another falling market), the ILT would produce a falling tax liability counteracting the urge to "bail out". Thus the ILT would make property investment safer in the short term by smoothing out bubbles and bursts — but more lucrative in the long term by encouraging provision of infrastructure.

- **Recessions/depressions:** A bursting bubble in a particular asset market has two counteracting effects. On the one hand, it drives investors away from that asset class and, by default, towards some other asset class that may also be susceptible to bubbles. On the other hand, those who have invested heavily in the collapsed market must reduce their expenditure, and some (most likely those who have bought their assets with borrowed money) become insolvent. As one agent's expenditure is another's income, and as one agent's debt is another's asset, a **chain reaction** ensues, reducing the funds available for investment in other asset markets, possibly causing them to collapse, and so on. After an *isolated* bubble-burst, the former effect tends to dominate; thus the land burst of the mid 1920s led to a stock-market bubble [8], and the stock-market crash of 1987 led to a land bubble. But when that second bubble bursts, the cumulative belt-tightening and bad debt tend to cause a recession; thus the stock-market crash of 1929 led to the Great Depression, and the land burst of 1989 led to the recession of 1990–91. The exceptional size and unique importance of the land market mean that a bursting land bubble is the most reliable *single* predictor of a recession [9]; in particular, the global recessions of 1974–5, 1981–2, and 1990–91 were heralded by bursting "property" bubbles, i.e. land bubbles [10].

To the extent that the ILT would avoid property bubbles, it would avoid the ensuing bursts and recessions. By inducing public investment in infrastructure, it would also help to lift the economy out of recessions — including the one