Economist Josh Ryan-Collins: How Land Disappeared from Economic Theory

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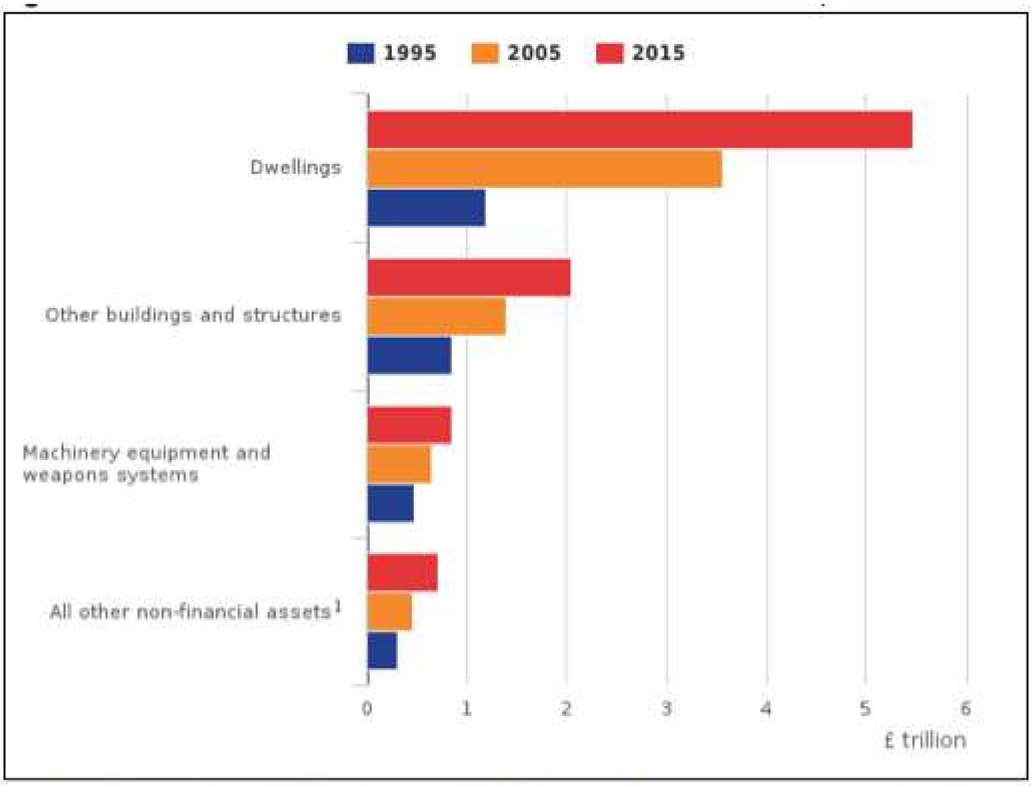
In the UK, land is not included as a distinct asset class in the National Accounts, despite being one of the largest and most important asset classes in the economy. Instead, the value of the underlying land is included in the value of dwellings and other buildings and structures, which are classed as 'produced non-financial assets' (Figure 2)

As shown in Figure 2, the value of 'dwellings' (homes and the land underneath them) has increased by four times (or 400%) between 1995 and 2015, from £1.2 trillion to £5.5 trillion, largely due to increases in house prices rather than a change in the volume of dwellings. In contrast the forms of 'capital' that we associate with increases in wealth and productivity – commercial buildings, machinery, transport, Information and communications technology has grown much more slowly.

Figure 2: Growth in the value of non-financial assets in the UK, 1995-2015



Source: Office of Natioanl Statistics: "The UK national balance sheet: 2016 estimates", https://www.ons.gov.uk/economy/nationalaccounts/uksectoraccounts/bulletins/nationalbalancesheet/2016estimates#total-net-worth

Thus, this huge growth in wealth relative to the rest of the economy originates not from the saving of income derived from people's contribution to production (activity that would have created jobs and raised incomes), but rather from windfalls resulting from exclusive control of a scarce natural resource: land.

This may help us explain – at least in part – the great 'productivity puzzle'– that is, why productivity (and related average incomes) been flat-lining, even as 'wealth' has been increasing. The puzzle is explained by the fact that the majority of the growth in wealth has come from capital gains rather than increased profits (or savings) derived from productive investment, Savings are at a fifty year low in the UK even as the wealth to income ratio hits record highs.

When the value of land under a house goes up, the total productive capacity of the economy is unchanged or diminished because nothing new has been produced: it merely constitutes an increase in the value of the asset. This may increase the wealth of the landowner and they may choose to spend more or drawn down some of that wealth via home equity withdrawal. But they equally many not. Moreover, the rise in the value of that asset has a corresponding cost: someone else in the economy will have to save more for a deposit or see their rents increase and as a result spend less (or, in the case of the firm, invest less).

In current national accounts, however, only the increase in wealth is recorded, whilst the present discounted value of the decreased flow of resources to the rest of the economy is ignored as Joe Stiglitz has pointed out. Rising land values suck purchasing power and demand out of the economy, as the benefits of growth are concentrated in property owners with a low marginal propensity to consume, which in turn reduces spending and investment. In addition, most new credit creation by the banking system now flows in to real estate rather than productive activity. This crowds out productive investment, both by the banking system itself and non-bank investors who see the potential for much higher returns on relatively tax free real estate investment.

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