

# **Submission to the Senate Select Committee on Housing Affordability in Australia March 2008 – June 2008**

by  
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## **Introduction**

On 14 February 2008 the Senate established a Select Committee on Housing Affordability to inquire into and report on the barriers to home ownership in Australia, including:

- the taxes and levies imposed by state and territory governments;
- the rate of release of new land by state and territory governments;
- proposed assistance for first home owners by state, territory and the Commonwealth governments and their effectiveness in the absence of increased supply;
- the role of all levels of government in facilitating affordable home ownership;
- the effect on the market of government intervention in the housing sector including planning and industrial relations laws;
- the role of financial institutions in home lending; and
- the contribution of home ownership to retirement incomes.

In early 2007 I wrote a two-part article "Sydney's housing disaster" in which I explained the most significant aspects of the current housing affordability crisis in Sydney.

The article was published on the popular FinancialSense website at:

<http://www.financialsense.com/fsu/editorials/2007/0420.html>

<http://www.financialsense.com/fsu/editorials/2007/0426.html>

My submission to this Senate Committee will be a targeted summary, followed by the full text of my housing disaster article.

## **The Housing Affordability Crisis**

Sydney is suffering a housing crisis. Housing has become so expensive to buy or rent that many families cannot afford independent housing. In Sydney and most other places in Australia an average family can no longer afford to buy an average house. There is an abundance of evidence that Australia has a housing crisis.

Affordable housing is housing that is of adequate size, of sound construction, and a reasonable commute from work that pays a wage that can buy or rent the house with enough money left over for a reasonable life. A modern advanced country such as Australia, with plenty of land should be capable of providing affordable housing for all its people. What has gone wrong?

Housing is so egregiously overpriced in Sydney and Australia that it is obvious that something is badly wrong. It should be easy to find the cause or at least some of the causes of this problem.

## 10 Steps to a Housing Disaster

Starting with only 21 million people and a giant island with 100 acres of land per person, how could we engineer some of the least affordable housing on the planet?

Here is a recipe to make housing unaffordable:

### Step 1 - CHOKER NEW CITIES

Divide the island into 7 states and create one giant city per state. Force almost all the people into the giant cities with policies such as:

- All business zoned in the centre of the city
- All government departments must be in the capital city
- Non-giant cities given terrible infrastructure

With decent transport this gives 7 areas with 40km radius, approximately 1700 square metres per person. Still too much land to create a crisis!

### Step 2 - CHOKER TRANSPORT

Neglect the transportation system so that it is not practical to live more than 20km from the city centre. This cuts us back to 400 square metres per person. Still plenty of space on average, but the largest cities will need some high-rise housing to get by.

### Step 3 - CHOKER HIGH-RISE

Refuse permission for high-rise in many cases. Old suburbs must be preserved for the old people who still live there. No extra housing to be built for young families.

### Step 4 - CHOKER LOW-RISE

Much land within range of the city to be kept off the market in the form of national parks, government department land and farms without permission to subdivide. If you have 5 acre or 25 acre farms within reach of CBD then declare the area semi-rural and don't allow extra housing there. With policies like this even low-population cities like Darwin and Hobart can have a housing crisis!

*The first four points will choke-off all avenues of extra housing supply, so now let's increase the need for extra houses – one house per family – by increasing the number of families.*

### Step 5 - HAVE LOTS OF BABIES

In 20-30 years they will leave home to start extra families.

### Step 6 - INVITE IN MANY IMMIGRANTS

Why not increase the immigrant intake to record numbers?

### Step 7 - DIVORCE IN RECORD NUMBERS AND LIVE LONGER

This will result in a declining number of people per household. We need more dwellings for a given number of people.

*Now with the supply of extra houses choked and the need for extra houses increased, price will race upward, as the poorer families are priced-out of housing. Now let's goose the price even more with idiotic economic "demand side" techniques*

### Step 8 – LOWER INTEREST RATES AND LOWER LENDING STANDARDS

Instead of paying off a \$100,000 house at 13% interest, why not service a debt of \$500,000 at 7%. Why not use 80% of two incomes and eat poverty food for the rest of your life?

### Step 9 – FIRST HOME BUYER'S GRANT

It won't create a single extra house, but it might drive existing house prices up.

### Step 10 - TAX ADVANTAGE TO SPECULATORS

With prices racing up, beyond the reach of first home buyers, give more money to those people most capable of driving prices even higher. Use government tax money to encourage rich people to borrow money and buy existing housing to rent-out to poor people. We can pretend that this creates extra cheap housing and is good for the poor people.

Step 11 – A WORLD-WIDE CREDIT BOOM AND ASSET BOOM  
Improper to include in the list of 10, but it doesn't hurt to mention it.

### **The Four Bases of Housing Affordability**

In baseball you need to get past 4 bases in order to score a run. Similarly for every Australian to have affordable housing there are four bases that must be covered:

- 1 – Quantity – there must be enough houses zoned. We need one dwelling per family.
- 2 – Location - Enough must be well-located. Working people need to be within reach of jobs
- 3 – Price – affordable by some reasonable measure –eg 4 times salary or 30% of income, etc
- 4 – Buyers – must be sufficiently responsible and thrifty.

These four bases are very useful in analysing the problem. Most people will point to one of these bases as being “the” problem causing the crisis.

Listen to some comfortable old people and they put all the blame on base 4 (the buyers). They say there are plenty of well-located houses and the price is not too high. They blame young people for wasting their money on Plasma TV and iPods and flashy cars.

Listen to some financial theorists and they say it is a world-wide phenomenon focused on base 3 (price). They too believe that we have enough well-located houses and great transportation, but due to financial matters the price is temporarily wrong.

My belief is that the problem is bases 1 and 2, there is a shortage of houses and transport infrastructure:  
**1 – Quantity – not enough houses zoned** anywhere near where govt zones jobs and forces people to live  
**2 – Location – not enough of these houses are well-located in terms of reasonable commute to work**  
3 – Price – price is too high – mainly a symptom of 1 and 2, but also due to other factors  
4 – Buyers – are victims

Government has choked the supply of well-located housing by choking the transportation system and by choking the zoning of additional dwellings on the fringe and choking high-rise and choking new cities.

### **Starter Home Crisis**

It is very important to distinguish between expensive luxuries bought by the rich, and basic essentials bought by ordinary people. For example, if you heard that the price of the rare Ferrari F40 had just risen so only billionaires can afford one, this is clearly a different problem to Toyotas and Fords becoming unaffordable to the average worker.

Many commentators make the mistake of lumping-in luxury mansions and starter homes in the same analysis. They focus on price, see that mansion prices rose the most, find the reason for that, and wrongly apply it to the starter home situation. Big mistake.

The crisis in Australia is a starter home crisis. Newly created young families cannot get their hands on enough newly created dwellings. For decades newly created homes were cheap and abundant. Now they are incredibly expensive. What happened to the supply and demand for starter homes to cause this?

Extra housing can come from one of 3 directions:

- 1 – afar – new cities
- 2 – outward – on the fringe of existing cities
- 3 – upward – high-rise living

The vital thing to understand about these extra dwellings is that the supply is practically unlimited. There is plenty of scope for new cities. On the fringe one farm can become 100 houses. In the inner suburbs one house can become 10 units or 20 stories can become 40 stories. Supply of extra dwellings on the margin is naturally unlimited. Only government is big enough and dumb enough to turn an unlimited supply into a shortage.

My article “Sydney’s Housing Disaster” explains in detail how all these three avenues of supply were choked by government in Sydney.

## Cheap Land – Shortage of Permission to Build

Numerous studies show an enormous rise in the cost of “land”. A starter housing block in Sydney would once cost 1x salary and now the same block costs 7x salary. The cost to build the actual house has remained constant at around 3x-5x salary. Clearly the cost of land is at the heart of the problem.

More specifically, the cost of land with permission to build has risen, because the permission to build extra dwellings has become scarce. Check the price of adjacent fringe land, one with permission to subdivide and build, the other with no permission. There is a huge difference in price.

Check the price of suburban land with permission for only one house. Now compare it with the block nearby that has government permission to build units. There is a huge difference in price. That’s pointing to the problem.

In a recent presentation titled “Some Observations on the Cost of Housing in Australia” Reserve Banker Anthony Richards pinpoints the problem of starter homes. The full article is well-worth reading

[http://rba.gov.au/Speeches/2008/sp\\_so\\_270308.html](http://rba.gov.au/Speeches/2008/sp_so_270308.html)

He says:

*So if we are looking for explanations why housing is not as affordable as we might like, it may be necessary to look at factors on the supply side as well. One obvious place to start is the cost of land for building new houses near the edges of our cities. To shed some light on this, in late 2007 Reserve Bank staff looked at newspaper advertisements and websites for new housing developments in each of the five major capitals, focusing on the least expensive land available in major developments. These were typically lots around 400 square metres in size, ... around 40 kilometres (Sydney) from the CBD. Entry-level lots were around \$200,000 in Sydney... These were representative prices for low cost land, with the average cost of building sites noticeably higher.*

He goes on to ponder whether the high cost of such small blocks far from the city would explain much higher prices for decent-size blocks a decent commute to the city. It sure does!

Anthony Richards has to tread carefully to avoid upsetting his political masters, but I don’t. \$200,000 is an outrageous price to be charging a young family for a tiny block of land that is 40km through Sydney’s transport disaster to a job in the CBD. This is a disgrace and government is to blame via all the supply-side restrictions listed in Richards’ article and more.

## Poking Demand and Choking Supply

Government has done something very bad to the supply and demand of starter homes which has led to outrageous prices of starter homes, and supported much higher prices of better homes. In short, government has poked the demand and choked the supply of starter/marginal/extra homes.

Poking Demand:

- Government brings in many immigrants

Choking Supply:

- Government **refuses** permission to build extra housing on the fringe or extra units in the city, and new cities
- Government add **taxes**, charges and levies to extra housing
- Government requires onerous **compliance** with regulations
- Government creates **delays** in approving dwellings.
- Government **neglects** transport and other infrastructure which reduces the area in which well-located and well-serviced homes can be built

There is much debate on which of the five chokers (refusal, taxes, compliance, delays, neglect) is the biggest and baddest. Interestingly, if refusal is the big one, then lowering taxes will give a windfall to developers, whereas if refusal is a small one, then reducing taxes will cause a drop in prices. This debate is fascinating from an academic point of view, but rather pointless if the aim is to solve the housing crisis.

It is like watching a man being attacked by five dogs and debating which dog has the bigger bite. Far better to chase off ALL the dogs and save the man.

### **“It’s not our fault” says the State Government**

Occasionally State government issues a statement saying it is not to blame for the land shortage, it has released many acres of land and developers are hoarding it for higher prices, so-called “landbanking”. One developer alone has enough land for 2000 homes, or such. Big whoopee, we have 150,000 immigrants per year, so 2000 homes is a drop in the ocean.

Besides, if landbanking is occurring then this is the fault of government. During a housing crisis it is incredibly stupid to hand-over large chunks of land to rich hoarders instead of to families who need housing. This is not releasing land for housing at all. Government should install roads and pipes itself and then auction the land in small parcels and/or a tax could be placed upon unused land to prevent hoarding.

### **A Wayward Balloon**

Once a shortage has been engineered by poking demand and/or choking supply, a whole new confusing range of factors come into it. In a government-caused shortage, price breaks free from its tether, the cost of production, and it comes under the influence of myriad factors. Under these conditions, if you focus on price and study the myriad factors then you will lose track of the root of the problem (the government-caused shortage).

In my following article “Sydney’s Housing Disaster” I go to great length to describe how a shortage causes price to disconnect from “Cost of Production” and become driven by “Buying Power of the Strongest Loser”. Failure to understand this concept is why most of what is written about the housing crisis in Australia is wrong.

*Consider this: If a little girl is holding a balloon by a string then the position of the balloon is dictated by the girl’s hand. A very simple situation. If her naughty brother cuts the string then the balloon is cut free from the girl’s hand and its position comes under the influence of all sorts of things such as the helium inside it, updrafts and downdrafts and cross-winds, and even passing birds with sharp beaks.*

Similarly the price of starter homes was once tethered to the cost of production, of marginal housing, which was always 3-5 times salary. I have lost count of the number of times I have read wrong analysis that describes things like interest rates, credit, tax treatment, and dual-income as controlling the price of starter homes. Sure, these things all affect prices of desirable houses that are naturally scarce for any reason, but should not control the price of starter homes, which are naturally unlimited.

Wherever government does not choke building permission, the record shows that there is an abundance of supply of starter homes at the cost of production. If this was the case in Australia, you would see an abundance of ordinary houses on each city fringe for sale for \$200,000 each, and you would find home units springing-up in average suburbs for the same price or a bit less. This happens in all countries and all times where government is not overly restrictive.

It might be that interest rates and easy credit would allow a young family to borrow \$600,000 but there is no way on earth they would pay this for a starter home if other starter homes down the road were for sale for \$200k. It is simple competition of an abundant resource.

Similarly if the wife gets a job it might allow them to pay twice as much for a house. They indeed might choose to bid-up the price of a rare established house, but this is irrelevant to the price of starter homes which are tethered to the cost of production at \$200k. Abundance, competition, cost-of-production, simple.

How scary that an old investor with negative gearing and a lot of equity will be able to outbid you and offer \$400k for a starter home. Just ignore him, and go down the road and buy another one for \$200k. Abundance, competition, cost-of-production, simple. What? You can’t go down the road and buy one for \$200k because government has choked the supply, this means you have to compete with the investor. Well then blame the government for choking the supply, please don’t blame the investor or his negative gearing.

Harbourside land is naturally scarce and its price is driven by the buying power of the richest few that can fit there. So the price of the most desirable 1000 houses is connected to the buying power of the 1000 richest people. Pity that you and I can’t afford one, but nothing to do with the housing crisis.

Scarce items are priced by the buying power of their purchasers, the buying power of the strongest loser. Whereas abundant items are priced at the cost of production. I have explained why starter homes could be abundant, but government choking and poking has made them unnecessarily scarce. This is why the price has disconnected from the cost of production and now depends on myriad buying-power factors. Don't study price and go off on a tangent. Study the choking and poking and see the root of the problem.

### **Negative Gearing**

Negative gearing is a red-herring and is not the cause of the housing crisis. Sure, negative gearing is unjust during a housing shortage and adds to the crisis during a housing shortage, but negative gearing is not the cause of the housing shortage. By solving the supply and demand issues I have mentioned, the housing crisis can be solved without touching negative gearing.

Negative gearing is not the thing that caused starter house prices to detach from the cost of production. That was due to government poking and choking. Going back to our balloon analogy, it was government that cut the string and negative gearing was one of the updrafts that took the balloon (house prices) out of reach. Sure, if we take it for granted that the string is cut, then the updraft is the cause of the problem. But go one step deeper and the naughty boy was the cause. So too naughty government is the cause of high starter house prices, because it cut the tether, not the negatively geared investments that actually took the price upward once the tether was cut.

There are many opponents of negative gearing who do not understand what I have written. They blame negative gearing alone for the housing prices. It is very sad to see them wasting their effort and confusing the issue.

Although negative gearing is not the main problem, I do support the proposal to grandfather negative gearing and subsequently limit it to new construction only. This would help dampen the speculation mania that the housing shortage has caused. Admittedly it is treating a symptom and not the cause, but this crisis is so bad that it might help in the interim before extra supply can come on stream.

### **Stamp Duty**

Stamp duty is a rotten tax. Stamp duty should be first on the list of taxes to abolish. It fines people who move to be closer to work. It fines an old person who moves a short distance to a smaller home. Stamp duty in NSW is out of control. Please abolish it. Stamp duty is not the cause of the housing crisis, but it does make it worse.

My plan to remove stamp duty would work over a 10 year period. Each year more and more of the stamp duty from each state would be shared amongst all the states. In year 1, 10% of the stamp duty is shared and 90% goes to the state in which it was collected. In year 2, 20% of the stamp duty is shared and 80% goes to the state in which it was collected. This way each state would have an increasing incentive to lower its reliance on stamp duty.

### **Infrastructure Charges**

In principle it is not such a bad idea for a user-pays charge. More people into an area cause more costs to council so fair enough that they pay.

Unfortunately the infrastructure charges are a bit wayward. Better to use the older rates system to cover the costs. The silly pegging of rates has caused some councils to become rapacious in their infrastructure charges and other councils to become rapacious in the parking fine enforcement. This is unjust and inequitable. Some developers argue that flat-rate infrastructure charges skew the market toward larger and more expensive houses. Could be true. Unpeg the rates and lower the infrastructure charges please.

### **Immigration**

It is very nice to invite extra people to Australia. However we must ensure there are enough extra well-located homes to take them and well as all the locally-raised Australians or else someone must miss-out. Missing-out on housing is not very nice.

When there is a shortage of housing, the price is bid-up, and the winning bidder pays more whilst the losing bidder misses-out. Both bidders lose-out this way. The real winner is the seller, the investor and/or the govt that collects the money from the buyer.

When there is abundant housing, immigration can solve certain problems, but during a housing shortage, more immigration makes problems worse. During abundant housing, immigrants pose no threat to the ability of young Australians to obtain traditional decent housing, but during a housing shortage, immigrants do pose a threat and cause resentment. The threat to young Aussies comes from both rich immigrants who can simply outbid the young, and comes from poor immigrants who can pool their resources and share a house whilst the young Aussies miss-out on the standard of housing enjoyed by previous generations.

Of course the real problem is not the immigrants, but is the housing shortage that government has created. However in the short-term I recommend a massive cut to the number of immigrants. A simple method would be to find out how many extra dwellings were zoned and built in 2008. Subtract the number of extra locally-raised families that were created in 2008, and allow this many extra immigrant families in during 2009. This way immigrant demand cannot swamp housing supply.

### **Home Buyer Assistance Schemes without more Supply**

Any scheme that attempts to help first home buyers that does not increase the supply of extra houses will fail and be counterproductive. The first home buyers grant, shared equity schemes, savings schemes, etc, are all worthless in solving the housing crisis. My article explains why.

### **Rent price controls**

Rent price controls always fail in the long-term and lead to shortages and neglected housing and a seized market which eventually hurts tenants. However if government was to tackle the underlying supply and demand problems, then I would support rent price controls that lasted a few years until the housing crisis was fixed. This short-term rent price control would actually help existing tenants, unlike most other schemes that have been proposed.

### **Public Housing and Co-operative housing schemes**

This housing crisis has resulted in publicity for many groups that provide housing for people in desperate situations. If asked, it is not surprising that executives from these groups will suggest that they can help solve the housing crisis. No doubt some of them will make submissions to this Senate Committee. The hammer sees every problem as a nail.

Such groups are genuine and provide a valuable service to our poorest people, but they are completely unnecessary to provide housing for ordinary Australian families.

The old joke goes "Q: What is the best way to save a lawyer from drowning? A: Take your foot off his head" Similarly the best way that government can save the housing market from choking is to take its hands off the market's neck. Fancy organisations and schemes are not necessary to solve this crisis.

Ordinary Australian families don't need charity to get a decent house, all they need is a fair go from their own government. If government takes its foot off their heads, the average young family will no longer be drowning and struggling to afford housing.

*This ends the summary of my submission to the Senate Select Committee on Housing Affordability in Australia. What follows is my article from 2007 which describes in detail the Housing Affordability crisis in Sydney.*

## **Sydney's Housing Disaster**

Sydney is suffering a housing crisis. Housing has become so expensive to buy or rent that many families cannot afford independent housing. In Sydney and most other places in Australia an average family can no longer afford to buy an average house.

In response to the crisis, many young adults have delayed moving out of their parents' homes, some younger buyers are pooling resources (eg two couples buy one house) and outright homelessness has increased with charities reporting record numbers of homeless people in Australia.

In crisis there is opportunity and landlords have responded by raising Sydney rents to a high percentage of average earnings, and by creating an unprecedented number of illegal half-houses to rent to people desperate for even half a house to live in.

Since Australia's population now exceeds 20 million, and we now have less than 100 acres of land per person, some people believe that this acute shortage of land is what has driven housing to unattainable prices for an average young family.

I think the housing crisis is not caused by a shortage of land, but by a shortage of government permission to build houses. Government has simply given permission to build fewer houses than are needed to house all the families here. It's that simple. It is a monumental failure of government.

*This article is about more than just a planning problem in one city. It is about ignorance of markets and price, and the absurd things people believe about economics. I recommend the article to all readers with an interest in these things, particularly part 1.*

The housing crisis in Sydney is duplicated throughout the world where similar views and policies are found. Every Australian capital city is affected, as are parts of New Zealand, the United Kingdom and parts of the USA. I recommend this entire article to all readers who are concerned for poorer families struggling to pay for housing in these places.

The article has been divided into two parts:

Part 1 delivers the "Parable of the Frozen Oranges" and covers the meaning of price and the real meaning of Sydney house prices.

Part 2 gives more details about the planning failures, the role of investors, moronic proposed solutions, and the underlying reasons for the planning and housing disaster in Sydney. Some solutions to these problems are also given.

### **The Parable of the Frozen Oranges**

Once upon a time there was a school attended by 10 boys. The school was in a place called "Orange Land" where the great orange dream of all mothers was for their children to eat one orange per day. With this in mind, the boys' mums set up a school canteen, arranged an orange supply from a nearby farm, and sent their children to school with money to buy one orange and other food from the canteen daily.

As happens so often in life, the children were given unequal amounts of canteen money each day. The 1st boy was given \$1, boy2 was given \$2 and so on, with the richest boy10 getting \$10 per day.

For a long time everything worked fine. Every day 10 oranges were delivered to the canteen and sold for \$0.20 each. Each boy obediently bought one orange and spent the rest of his money on other things.

### **The Natural Orange Squeeze**

Then one day there was a problem at the orange farm and only 9 oranges arrived from the farm. Fred and Frank ran the canteen, so to handle the shortage they adjusted the orange price to "market price" (via a Dutch auction process) and found that at a price of \$2 the demand for oranges was exactly 9. (The boy with \$1 missed out).

A few days later only 8 oranges were delivered, so the market price became \$3, \$24 dollars of oranges were sold, and 2 boys missed out. Later when only 7 oranges were supplied, the market price became \$4, \$28 dollars of oranges were sold, and 3 boys missed out.

During this orange shortage, some children complained that they could not afford to buy an orange anymore. But Fred's defence was "Supply and demand. The market sets the price, not me".



The school headmaster overheard the grumbling about oranges and asked the canteen if everything was all right.

"Yes sir" said Fred "our orange supply has increased from \$2 per day up to \$28 per day."

"Wow that's a strong orange market" said the headmaster "talk about healthy growth."

That night the headmaster spoke to his neighbour, an economist, and bragged about the orange growth.

"Wow" said the economist "An income of \$10 per day can conservatively be capitalised at \$40,000. The orange division of your canteen alone is worth at least \$100,000."

### **Contrived Orange Squeeze**

One day things at the farm got back to normal and the supply reverted to the normal 10 oranges. But Fred did not want to see a bad orange market with the price returning to \$0.20, so he held back several oranges in the freezer. In fact he found that he could maximise profit if he sold exactly 6 oranges each day at a price of \$5 to receive \$30 (with 4 boys missing out daily).

Now with Fred contriving to choke the supply of oranges the market price was set by a combination of Fred's restriction and the amount of money each boy could possibly afford to pay. Yet Fred's defence still was to parrot that "prices are set by the market" and the boys ignorantly nodded in agreement and did not blame Fred for their predicament. For the boys did not understand markets.

### **Ignorant Meddling**

Still the boys complained and complained and eventually the headmaster decided to do something about the problem.

The headmaster prided himself with his grasp of economics and knew well enough that a market was something to be worshipped, and never interfered with. He felt that he needed to solve this problem without being seen as to meddle with "the market". His greatest fear was that this canteen might be a "free market". He didn't know exactly what this was, but he knew all too well that the free market was an object of awe, and it was the greatest sin to even suggest a problem could arise from the use of this type of market.

The headmaster took a deep breath and pressed on. He felt sure could solve this problem without spoiling the purity of this canteen market. The problem was obvious to him, and it wasn't a bad market. With 10 boys and 6 oranges, quite clearly there was a shortage of dollars.

The 4 poorest boys simply did not have enough dollars to buy oranges. The market price of an orange was \$5. Therefore any mother who sent her child to school with less than \$5 was depriving her child of an orange. How could she expect her son to obtain \$5 worth of orange for the lesser amount she supplied? The effrontery of some mothers!

*"Too few dollars. Mothers to blame. If I can devise a program to raise more dollars, all the boys will get oranges and I will get the credit."* thought the headmaster to himself.

The headmaster got out his calculator and punched in the figures. Since only 4 boys missed out at \$5 per orange, no more than \$20 per day would be needed to ensure every boy could buy an orange. To achieve this, he ran a fundraising day and collected many dollars. The next day he tried out his scheme and before lunch gave an extra \$5 each to boy1, boy2, boy3 and boy4 taking their totals up to \$6, \$7, \$8 and \$9 respectively.

The scheme worked as far as ensuring that boy3 and boy4 got an orange. But the headmaster was shocked and dismayed to see that the market price moved up to \$7 causing boy5 and boy6 to now miss out for the first time. Not only had the scheme failed to get extra oranges into the hands of the boys, but it had interfered with the precious market by changing its price.

Fred and Frank were delighted by the scheme and loved the resultant higher capitalised value of the canteen. They wanted the failed scheme to be given more funding, but the headmaster scrapped the scheme and gave up. Bad though it was for children to miss-out on food, interfering with a market was an even worse thing. This problem was obviously one he could not solve.

*"This problem needs someone even more expert in economics than I"* said the headmaster to himself.

### **A Deeper Freeze and Bigger Squeeze**

The canteen continued to hold back oranges and maximise profit for a long time until Frank noticed there were 2000 oranges in the freezer. "Hey Fred" he said "we've got an asset worth \$10,000 here" (2000 of \$5 each). "Let me run the canteen and see if I can boost our equity."

To this end the next Monday Frank froze 5 oranges (instead of the usual 4) and sold the remaining 5 at market price of \$6 each. The freezer now held 2005 \$6 oranges for a value of \$12030. On Tuesday Frank froze 6 oranges and sold the remaining 4 at market price of \$7 each. The freezer now held 2011 \$7 oranges for a value of \$14077. On Wednesday Frank froze 7 oranges and sold the remaining 3. The freezer now held 2018 \$8 oranges for a value of \$16144. On Thursday the freezer held 2026 \$9 oranges worth \$18234, and on Friday the 2035 oranges were worth \$20350 as the market price of a single orange hit \$10.

*Frank noticed that his freezer value had increased by more than 10% per day for 5 days. At this historical rate of increase it would not be long before the freezer was worth a billion dollars! Who said there was no investment that always went up?*

### **Reality Bites Oranges**

Sadly, whilst the unrealised capital gain on the frozen oranges soared, the scarcity of oranges to eat was having a bad effect on the boys. Some children simply could not afford an orange. The other richer and more lucky children could afford to buy, but were left with much less money to buy other things which they reasonably wanted and in normal times could have "afforded". It was clearly unfair to all the boys.

There was some debate amongst the boys over what was to blame for the high prices. Being boys they came up with all kinds of idiotic explanations ranging from illegal aliens taking oranges to taxes raising the price. One lone boy suggested that maybe they just needed more oranges. He was laughed off as an idiot. This dolt could not appreciate the complexities of economics. Clearly the orange problem was one of price, not quantity (thought the boys).

The whole situation was very divisive to the boys. It created orange "haves" and orange "have-nots". Disagreements over the cause and solution added to the strife. The boys who could afford oranges felt themselves superior to those who could not and gave themselves credit. They blamed the poorer boys for not having enough money. They pointed out all the other food the poorer boys bought with their money. "If you did not buy all those things then you all could afford oranges" The richer boys chided.

One boy suggested that they should be given a special "orange buyers grant" so they could all afford oranges. Some boys thought that taxes should be added to oranges to make them cheaper, other boys thought taking away taxes would do the trick! Other boys suggested that low interest rate loans were the solution to the problem, or that they should get more money from their parents as a kind of advance on their inheritance.

Fred and Frank overheard the boys arguing and were delighted. As long as the cause was in dispute, the canteen could continue to deny fault and rake in large profits.

Sadly, the boys' solutions were never going to work. All of their solutions focused on dollars, and how many more dollars were needed, or how to transfer dollars from one person to another. All these solutions were garbage, because the problem was actually a numerical shortage of oranges available for sale. It was a food shortage, not a funding shortage, that was the underlying cause. Any solution that did not increase the number of oranges was nonsense and could not possibly work.

At this point word of the boys' predicament got through to the mothers. The mothers had heard talk of the capital value of the orange division of the canteen. They had heard stories of the huge value of its frozen orange stocks. These simple mothers who thought a canteen was a simple device to provide food to their children, were now told that it could make the entire school rich. Yet despite this excited talk, each day all they could see was their boys returning home with their money spent and no orange in their tummy. At its worst point, nearly all of the boys were being literally frozen out of orange ownership by the policies of the canteen. This was a situation that needed to be fixed.

### **Mums Storm the Canteen**

The wise mums, who had created the canteen and ultimately controlled it, came to a realisation and stormed the canteen, demanding a change of policy.

The headmaster replied that there was an orange boom in progress that was making the school very wealthy and we must not interfere with the market. "The canteen is now making many more dollars each day, the canteen is now worth so many more dollars, and think about how many dollars the freezer of the canteen is worth." said the headmaster.

"We don't need no bloody more dollars" said the mothers "our children need more @#\$\$ oranges". All the talk of dollars had obscured the simple physical reality that there was inadequate supply of oranges to the children.

"If this canteen is not supplying the necessary number of oranges to our children then it must be replaced with one that will, regardless of who loses dollars or who doesn't get the dollars they were hoping for" stated the wise mothers.

The mothers rectified the problem because they understood what the true purpose of the canteen should be. The purpose was to **give** a sufficient number of oranges to their children, not to **take** the maximum number of dollars from their children. This was the purpose, and achieving this purpose was the true value of the canteen to the school.

The dumb men made the mistake of confusing the price signal which is "exchange value" of a market with the "use value" of the canteen. This is an extremely common mistake because the English language badly overloads the term "value". Many people who don't understand markets have come to believe that anything that gets more money from a market must be a good thing. This belief has merit in a competitive market situation, but is dangerously wrong when it involves a license to sell a naturally scarce resource.

The real meaning of all the dollar values in this story can be easily seen:

\* If the farm sends 7 oranges instead of 10, then this action has done 3 oranges of damage to the children (compared to the normal situation). This physical damage is unavoidable, being caused by a physical shortage of oranges

\* If the canteen invokes market-based rationing and makes \$28 in profit, then this is \$28 of damage to the children, in addition to the 3 orange shortfall damage. In total, the 10 boys combined have now been hit by a shortage of 3 oranges (which they cannot eat) and the loss of \$28 (which they must pay to the canteen). The \$28 damage was not strictly necessary and was purely the result of applying market-rationing to a shortage situation.

\* If the canteen has a capitalised value of \$100,000 then this represents \$100,000 of similar damage to children over the lifetime of the canteen. The \$100,000 figure is obtained by calculating a discounted present value.

\* The \$20350 value of the frozen oranges and the projected billion dollar value were simply ridiculous. The \$20350 value would require all 2035 oranges to be sold at \$10 each. But the \$10 per orange price only exists when a single orange is sold per day. Therefore the \$20350 "value" is a computation based upon a theory of selling few (1) and many (2035) simultaneously. It is nonsense. The billion dollar projected value of the freezer is even more absurd. It is based upon a continuation of factors that cannot possibly continue.

The fundamental problem with the canteen was that it had "lost the plot" and changed its focus off what oranges it could give to the boys onto what dollars it could take from them. If you assume that every market is good and pure and beyond reproach, and if you assume that anything that gets more dollars from a market is good, then you will draw some moronic conclusions, like the canteen men did.

Once all the talk was about more dollars instead of more oranges, the plot was clearly lost. This is in fact a useful clue. If you ever find a problem where all the talk is about dollars and not about the underlying physical resources, then you can assume that people have lost the plot there too and don't know what they are talking about.

## **Housing Crisis Similarities**

*There are many similarities between the orange shortage in the parable and the housing shortage in Sydney:*

- there is a simple shortage of an essential item

- having shelter is called "The Great Australian Dream" instead of being treated as the essential that it actually is
- the shortage has created "haves" and "have-nots"
- the shortage has also caused high prices
- the shortage and the higher prices hurts both those who cannot pay the higher prices and those who do pay them.
- there is a basic misunderstanding of the meaning of the higher prices and a celebration of the higher prices
- housing is no longer considered as a way of giving shelter to people but a way of getting dollars from them.
- moronic worship of the market mechanism - "this is a free market and must therefore be perfect"
- shortage of houses is misdiagnosed as a shortage of money
- moronic solutions are proposed that shuffle dollars but do not create a single extra house.

To further see the similarities between the orange shortage and Sydney's housing shortage, I will rewrite the "reality bites oranges" section and change a few words (in italics). Does this describe the housing situation in Sydney, Australia, New Zealand and England? I think so.

### Reality Bites Housing

Sadly, whilst the unrealised capital gain on *every homeowner's house* soared, the scarcity of *houses to live in* was having a bad effect on the *young families*. Some children simply could not afford *a house*. The other richer and more lucky children could afford to buy, but were left with much less money to buy other things which they reasonably wanted and in normal times could have "afforded" (*like having babies*). It was clearly unfair to all the *young families wanting to buy a home*.

There was some debate over what was to blame for the high prices. Being *human* they came up with all kinds of idiotic explanations ranging from illegal aliens taking *houses* to taxes raising the price. One lone boy suggested that maybe they just needed more *houses*. He was laughed off as an idiot. This dolt could not appreciate the complexities of economics. Clearly the *housing* problem was one of price, not quantity (thought *everyone*).

The whole situation was very divisive to *society*. It created *housing* "haves" and "have-nots". Disagreements over the cause and solution added to the strife. *Those* who could afford *houses* felt themselves superior to those who could not and gave themselves credit. They blamed the poorer *people* for not having enough money. They pointed out all the other *things like DVD's and IPODs and overseas trips* the poorer *people* bought with their money. "If you did not buy all those things then you all could afford *houses*" The richer *people* chided.

One boy suggested that they should be given a special "*first home buyers grant*" so they could all afford *houses*. Some boys thought that *capital gains* taxes should be added to *houses* to make them cheaper, other boys thought taking away *stamp duty* taxes would do the trick! Other boys suggested that low interest rate loans were the solution to the problem, or that they should get more money from their parents as a kind of advance on their inheritance.

*Politicians and their crony developers* overheard the boys arguing and were delighted. As long as the cause was in dispute, *they* could continue to deny fault and rake in large profits.

Sadly, the solutions were never going to work. All of their solutions focused on dollars, and how many more dollars were needed, or how to transfer dollars from one person to another. All these solutions were garbage, because the problem was actually a numerical shortage of *houses* available for sale. It was a *housing* shortage, not a funding shortage, that was the underlying cause. Any solution that did not increase the number of *houses* was nonsense and could not possibly work.

At *some point* word of the *next generation's* predicament got through to *some old voters who cared*. The *old voters* had heard talk of the capital value of *Sydney's housing stock*. They had heard stories of the huge value of *their own houses*. These simple *old folk* who thought *housing* was a simple device to provide *shelter* to their children, were now told that it could make the entire *society* rich. Yet despite this excited talk, each day all they could see was their *own children* returning home from *work with not enough money to buy housing and raise a family of their own*.

## The Meaning of Unrealised Capital Gains

Many people misunderstand unrealised capital gain. An unrealised capital gain on a house is the amount of dollars you guess it would sell for today, less the dollars you actually paid for it. We call the capital gain **unrealised**, because you haven't got it yet. The main problem is that many people are treating the gain as if they do already have it. These people think they are already rich, when they are not yet rich. That's the main mistake.

In the parable, when Frank looked at unsold oranges in the freezer he saw big dollars. Now many Sydney homeowners see their unsold house as money in the bank. Frank had 2035 oranges that "could" sell for \$10 each, and now many Sydney homes "could" sell for half a million dollars. Can they really? These unrealised capital gains appear to represent great wealth. Is it an illusion? What's the difference between unrealised gains and true wealth?

The key is to know the "three missing links". An unrealised capital gain offers great promise, but three things must yet happen to make the homeowner actually rich:

- 1) They must lose the need to live in the house, and hence gain the ability to sell it
- 2) market prices must remain high in the interim
- 3) a buyer must come along and actually pay the market price

These are three missing links. If any of these three does not happen then a homeowner will never convert an unrealised gain into real riches that give real benefit.

### ***Hidden Liability***

The first issue is a matter of a hidden liability.

Imagine if I was to tell an Australian that the price of a transplant heart on the black market of Vulgaria has just gone up to \$1 million. Very few Australians would feel richer as a result of this price change. Quite simply, people are smart enough to know that they cannot sell their own heart because they need to keep it inside their body in order to live. In accounting terms the need to keep a heart is a liability that cancels out the value of their own heart which is an asset. You possess an asset, but your **need to keep it** is a liability.

Strangely, when it comes to houses, many people are not smart enough to make the very same connection. Many homeowners feel they are richer because their house could sell for a higher price, even though they need their house and therefore cannot sell it.

If a Sydney house owner-occupier is not able to sell the house because he needs to work in Sydney or he wishes to live in Sydney, then this person has gained nothing from higher house prices while his position remains unchanged. Although the house is an asset which now has a higher price, the person's need to live in Sydney is a liability that has risen just as much, leaving him no better off.

*Not all homeowners are richer already, only if the homeowner can dispense with the need to live in the house, and hence gain the ability to sell the house, can he actually be richer.*

### ***Price Sustainability***

The second issue is the validity of previous market price when applied to future sales. If one is to sell at yesterday's price in future, then this pricing must be maintained in the interim. A quick rule of sustainability is: For a price level to be maintained, the number of people trying to cash out must not overwhelm the number of buyers able to pay in, over the period in question.

Skeptics of a price rise will often say something like "they can't all sell at these prices, if all the houses went on the market at once, who would buy them? prices would collapse" This statement is just a cheap trick. It is merely plugging in two most extreme and most unlikely factors into the rule of sustainability. Of course if everyone tries to cash out immediately this will overwhelm the buyers. There's no real danger of that happening. The real danger would be if there is a predictable surge of sellers, or a predictable dearth of buyers, such as would occur if prices get too high.

Let's review a normal house market. Typically around 5% of all houses will change ownership each year, some of these going to first home buyers. Often the seller of a 1st home will take the proceeds and buy a 2nd home, the seller of which will use the proceeds to buy a 3rd home. So it is fair to say that perhaps 2% of houses are first homes for young families. These 2% of sales underpin the entire 5% of houses traded,

which underpin the unrealised capital value of the entire 100%. 2% equates to the entire housing stock going from old to young buyers over a 50 year period. So that seems realistic.

The fact that a small number of sales underpin the "value" of the entire housing stock is not by itself a cause for alarm. If prices are normal then there is no reason to ever think that sellers will overwhelm the buyers. If the prices are fair and stable then the situation can continue indefinitely. There is only cause for alarm if prices are too high or going too high. If so then all derived values and expectations are suspect.

Consider price sustainability in our orange example. As the orange squeeze progressed, prices rose to \$10, at which point only 1 in 10 boys could afford one. This dearth of buying power could be easily overwhelmed by an attempt to sell the oranges, so it is unlikely that all 2035 oranges could be sold at this price in a reasonable space of time. Even worse was to take the rising price trend and extrapolate future prices. Frank thought his freezer would be worth a billion dollars and many Sydney homeowners expect their houses to "double" every decade. Frank did not understand that no child could afford to pay \$20 for an orange, and likewise the average Sydney family will not be able to pay 100 times salary for a house.

In the case of the oranges the situation was unsustainable because there were fewer and fewer boys able to buy oranges, a trend that could not continue. In the Sydney housing market each year the average age of first home buyers rises and the percentage of income used in debt service rises. This cannot continue. I can't tell you what the future holds or exactly what future buyers will be able to pay. But today's average price of 10 times average salary has been paid by only a small group at a terrible cost (like one \$10 orange). It seems unlikely to me that all houses can trade at these prices. And with some sellers expecting houses to be 20 times salary next decade, and 40 times salary a decade after that, it seems simply impossible.

*Not all homeowners are richer already, only if the current high prices can last until the homeowners are ready to sell will they be richer*

### **Wealth Source**

The third issue is where does the actual wealth come from, and when?

When one house in a suburb sells for a bit extra, then every homeowner in the suburb feels richer. It is as if these owners feel that they all have obtained an increase in wealth from this one same transaction. This is nonsense. An increase in wealth has not already occurred. If an increase in wealth does occur, it will be in future and the wealth will come from multiple buyers from multiple future transactions. i.e. each owner gets richer when he sells his house to someone, not when his neighbour sells a house.

If you buy bread at a bakery and watch the baker place 1, 2 or 3 loaves of bread in your bag, then clearly you already have this bread. There is no reason to think you cannot get the bread out of the bag later when you want it. People often talk about high house prices as if it is money "in the bag" like this bag of bread. They talk about their house that "went up" from \$100k to \$800k as if something actually happened to their house, it went up, and now contains a lot more dollars. They talk as if the wealth transfer has already happened, and getting the dollars out of the house, when they want it, is a sure thing. These people are wrong. The wealth increase is potential, not actual, and if it happens the wealth will come from future buyers, not from something that has already occurred to "the market".

Understanding the wealth source is fundamental to deciding if higher prices are good or bad. How do you feel about this burden on future buyers? In the orange parable, the orange shortage was soon causing profits of more than \$20 per day. This was clearly a transfer of money from the boys to the canteen that had already happened each day. The mistake came when the headmaster and economist figured this made the canteen worth \$100,000 and was a very good thing. The dumb men figured a wealth gain of \$100,000 had already occurred. The truth as recognised by the mothers was that this \$100,000 of unrealised capital gain represented a projected future burden on boys buying oranges from the canteen. The mothers correctly thought this was a very bad thing, and so they fixed the problem.

The situation with the Sydney housing shortage is very similar to the orange parable. When a small number of current buyers are forced to pay too much for housing, then a small transfer of wealth from buyer to seller has already happened. There is a huge disparity in the attitudes of Sydney people toward the situation. Many homeowners mistakenly think a huge increase in housing wealth has just been given to the entire city and think this is very good. But in reality the unrealised capital gain represents a huge burden on future buyers, a

very bad thing for them. Should a majority of voters ever decide to fix this problem, then unrealised capital gains will disappear along with the burden on future buyers.

Even if Sydney's high prices are never reduced, the truth of the burden will affect today's smug older homeowners. The next generation of overburdened house buyers will simply not have enough resources leftover to pay high taxes to support today's huge govt and tomorrow's huge retiree population, nor solve other expensive problems facing society such as peak oil, and environmental degradation.

*Remember: Not all homeowners are richer already, only when a future buyer can be found to pay the high price, will the homeowner be richer.*

To summarise the three missing links of wealth, keep in mind what has already happened vs what might happen later. If one house on a street sells for more, then what has already happened is that one buyer paid more to one seller. If 100 people on the street now feel richer, they are not already richer, but this might happen in future if:

- 1) All 100 must lose the need to live in their houses and put them all up for sale.
- 2) Market prices must hold at the higher level in the interim.
- 3) 100 new buyers must come along and actually pay the money to the sellers.

### **Taking Equity Out of the House**

Some people would argue that higher house prices do make a person richer even if they cannot sell, because they can borrow against the higher value of the house which they term "taking equity out" of the house.

Taking equity out of a house is a misnomer, and does not make a person rich because they must repay the money or lose the house. In reality you are not taking anything out of the house, you are risking ownership of the house in order to borrow money from another party. If a desperate gambler borrows money from a loan shark, knowing he will have his leg broken if he fails to repay, we do not say this gambler has "taken equity out of his leg". We know that this foolish gambler has risked his leg in order to borrow money from the shark.

Borrowing money against a house is not always foolish or reckless, and having this option might be considered a good thing. However the ability to borrow money is not the same as being truly richer, so it should not be confused with real wealth.

### **Political Pressure**

When unrealised capital gain is wrongly considered to be wealth, there is a powerful political constituency supporting price rises, and it becomes extremely difficult, politically, to stop the rises.

Imagine an example where something bad has caused a house price rise and one buyer pays more to one seller. Now 100 homeowners on the street feel richer. The one recent buyer also feels he has bought good value and will be richer because prices are "going up". So 101 people are happy as a result of a bad thing that caused a price rise, all because of a misunderstanding of the meaning of unrealised capital gain.

Under this situation of wealth illusion any person trying to tell the truth, that 100 are not richer and 1 is poorer, will find himself unpopular. Any politician trying to correct the injustice, remove the bad thing, and drop prices, will also be most unpopular.

In the orange parable I showed the canteen men, headmaster and economics liked the higher prices. In Sydney housing we find that a majority of people like high house prices, even though the rise is caused by a reversible bad thing and represents an unjust burden on the future generation, not a real increase in wealth.

It is important to understand how perception and politics is the real driving force behind the Sydney housing disaster. Ask Australian voters "are you prepared to sacrifice your unrealised capital gain on housing, in order to give a fair go to the next generation?" The answer is a resounding "No".

### **The Meaning of Price**

Very few people properly understand price. So when the price of something rises, most people are mistaken as to what this means.

Price only exists where society chooses to ration a resource via a market. With societies and markets you must decide which is the horse and which is the cart. Many PDUMs (People who Don't Understand Markets) make the mistake of thinking the market is the horse and society the cart. These PDUMs worship the market and think the book of life starts with a supply and demand chart, and they want all other people to live according to "the market" (which they rarely define). This type of PDUM can't imagine a given resource being rationed via any means other than his preferred design of market. I think that's nonsense. There are many other ways of rationing resources, such as "equal bites", "women and children first", or "whatever you say boss".

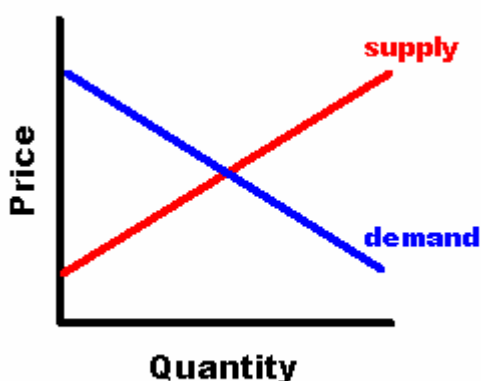
The headmaster made a classic PDUM mistake. He feared to question the market. If the market said an orange was worth \$5, then that must be correct and no child with less than \$5 should have one. This was foolish because there were other ways of rationing oranges that the headmaster did not consider.

With Sydney housing, many market-worshipping PDUMs make a similar mistake to the headmaster. These PDUMs think that if a family cannot pay the market price for a house, that it is therefore right and proper for that family to be houseless. The minds of these people can never consider that there might be a problem with a market. It is against their religion. "The market is always right" say these callous PDUMs. Other PDUMs admit there is currently a problem, but are sure it is temporary because a market is in operation. "The market will solve the problem" these nonchalant PDUMs say (from the comfort of their own homes).

We do not have space here for a treatise on markets. So we will skip over the basic questions of **when and why a market should be used** and jump straight to the advanced question of the meaning of price **when a market is being used**.

### Supply and Demand

Here is a typical supply and demand chart that you might find in an economics book.



As usual the vertical axis has price and the horizontal axis has quantity. Where the demand curve hits the supply curve gives the market price and the quantity traded. This S&D chart is typical of a reasonably competitive market for something where supply and demand are highly elastic. The blue demand line leans leftward to the extent that demand is elastic, and people want less at a higher price. The red supply line leans rightward to the extent that supply is elastic and can be increased if price moves high enough to justify it.

Although most items that we buy are sold in reasonably competitive markets like the above graph, many readers would also be familiar with a market where both supply and demand are relatively inelastic. The market for oil (and hence the price of petrol/gasoline) is such a case. Oil demand is **inelastic**, because despite higher prices, most people must drive the same car the same distance to work each day. Supply is **inelastic** because our oil rigs take a long time to get going and are already pumping at full capacity. Therefore supply can not be increased much for a higher price. The result is that over recent years, oil has increased in price by more than 200% whilst quantity increased by less than 10%. (There is more to this story, but my point about elasticity is valid)

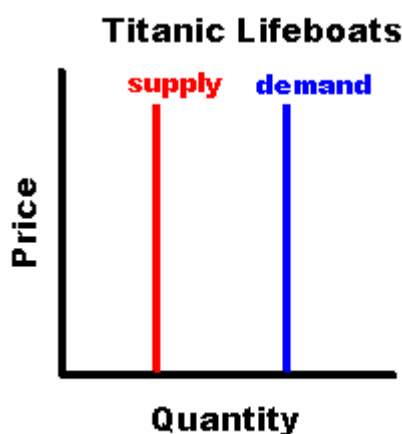


The word elastic refers to the ability of quantity to change with price. Quantity is elastic if it can be stretched and shrunk by the force of price. High prices will squash and shrink the quantity demanded, and high prices will stretch the quantity supplied, and vice versa for low prices.

### Rigid Supply

The extreme case of inelasticity occurs when supply and demand are rigid/fixed and cannot be changed by price. A rigid demand is where people need the same amount of something regardless of price. A rigid supply is where regardless of how much people offer to pay, there is only that fixed amount available. The orange parable had rigid demand because every mother insisted her boy eat one orange per day. The orange parable had rigid supply because a fixed number of oranges came from the farm or were sold by the canteen.

The infamous sinking of the Titanic is a real-life example of rigid supply and demand. There were roughly 2500 people and 1000 lifeboat seats when the Titanic sunk. To survive each person needed exactly one lifeboat seat, and sadly there weren't enough seats.



In a case such as the Titanic, it would be hard to justify using a market to ration the scarce essential resource. Had the gun-toting Titanic crew sold the lifeboat seats in a market, the survivors might have included less women and children, and more rich people and bullies able to get the most cash at the time. The market would also have transferred money from buyer to seller, but that's beside the point here.

With a fixed number of lifeboat seats and a fixed number of people we can calculate the number of people who must miss-out (and perish). We don't know who, but we do know the number. Although markets and money could be used to ration the resource and change **who** gets a seat, money could in no way increase the quantity of the resource and change the **number** of people getting seats. Therefore money-focused schemes such as offering low interest rate loans, or giving lifeboat seat buyers grants would not have increased the total number of people who were able to buy a lifeboat seat. These bizarre financial schemes on board the Titanic would have been completely useless; just like re-arranging deckchairs on that very same boat.

### Competitive Supply Joy

The most joyful situation is not rigid supply and scarcity, but abundance from eager best suppliers. We want that supply curve to be an almost flat horizontal line, the opposite of the vertical line from the Titanic disaster.

Often the best way to get abundance is for govt to create a competitive market so that the best suppliers compete with each other to maximise supply and minimise price. Every market comes into existence when the most powerful entity (the govt) licenses scarce resources to create a definition of private property. This private property concept (enforced by govt) creates a market with associated "market forces" aka price. The market rations scarce resources and has wealth effects on the citizenry.

In taking scarce resources and licensing them to citizens, govt confers benefits. These benefits are conferred somewhere along the elitist/equality spectrum. In the worst extreme govt can give great privilege to elites via monopoly. With the best extreme govt gives equal benefits to every citizen via competition. This best case is the competitive market. Prices in a competitive market have a special meaning:

In an ideal competitive market, price is a signal of best use and best supplier. The price signal directs best activity by telling consumers which item is best to use and which item should be conserved. Price tells competing suppliers what best to produce and the price paid by a consumer provides perfect compensation to the supplier. Ideally the price paid covers and only covers all the true and fair costs associated with the production of the resource.

In a competitive market what you buy is effectively created for you by your payment. What I mean is that the supplier will make it for you on the spot (like a hamburger) or will sell you one out of inventory and then replace it soon after. Essentially they make it for you. Essentially your buying does not deny the resource to anyone else in the long term. Your payment pays for it, so no one is hurt by the entire process.

Since the supply curve is near horizontal, price increases are near zero as buying is increased. Since supply is effectively unlimited, there is an equivalence between money and supply. We can talk as if money is equivalent to the item. A person lacking the item lacks money. Getting more money is equally good to getting more of the item.

Competitive markets are a special case, a kind of ideal where the use of a market is most justified. Every item that sells in a competitive market is amongst the most competitive and price is set by the marginal, or least best, item. Since, in ideally competitive situations no supplier has an advantage, all supply is marginal. Therefore:

*In competitive supply joy, price is the cost of production.*

### **Rigid Supply Horror - The Strongest Loser**

In a rigid supply situation the situation is completely different and price means a completely different thing. It is vital to know this, and most market-worshipping PDUMs don't.

If rigid supply exceeds demand then the price will be zero. Air is priced at zero. If the Titanic carried 5000 lifeboat seats, they could have been sold for zero also. A price of zero means there is excess supply. It does not mean the item has no use value. For example air and lifeboats seats can clearly save lives despite being free.

If demand exceeds the rigid supply then price is not zero and has a different meaning. A shortage, combined with the govt decision to ration the resource with a market, will cause "rigid supply horror" prices.

In shortage, prices no longer reflect the cost to produce an additional item but jump to reflect the cost to outbid other people on the same item. Price is not what it takes to make the thing, but what it takes to beat other people out of it. That is a profound difference.

In shortage prices jump above production cost to just above the buying power of those who must miss-out. In shortage the exchange value of govt licences (aka private property) jump to reflect the potential wealth transfer from buyer to seller, which is unearned wealth. These are two artifacts of the decision to ration that particular resource with that particular private property licensing scheme.

In rigid supply horror there is no equivalence between money and the item. The supply curve is vertical which means no amount of money can obtain more supply. If a person is short of the item, we cannot say he is short of money, because more money cannot solve a shortage caused by rigid supply.

In a rigid supply market, price is the buying power of the marginal loser. The losers (who miss-out on buying) are those with the weakest buying power. The marginal loser is the strongest of these losers. Therefore:

*In rigid supply horror, price is the buying power of the strongest loser.*

### **Two Meanings of Price**

By looking at two extreme cases in the use of markets we can see there are two disparate meanings of price. When markets are used under ideal circumstances, price is a guiding light toward best activities, perfection, justice, fair compensation and joy. But when markets are used under the worst circumstances then price is a measure of shortage, horror, injustice and profiteering.

It is hardly surprising that a tool can work well or poorly in different cases (the market being merely a resource-rationing tool). What is surprising is that some people are so foolish as to take the meaning from the successful cases and infer it upon the cases of failure. When a market is used correctly then supply and demand and price will get a good result, and this good result justifies the use of that market in that particular case only, not in all other cases. PDUMs (People who Don't Understand Markets) assume that every market must be like the ideal one in their textbook, and therefore the result of every market must be perfect. That's what they are really saying when they appeal to "capitalism", "supply and demand", "the market" or similar. It is a dangerous dogma to infer market character from one case onto all markets. Market zealots making this mistake are like a boy who is sure the tiger at the zoo would be nice to pat, because the boy knows how friendly his pet pussycat is.

The disparate meanings of price and the implications can be shown by a simple example:

Imagine a McDonalds store selling hamburgers. In a competitive market like hamburgers, the suppliers can provide a practically unlimited quantity at the current market price. If a McDonalds burger costs \$1 and I am stopped at the door by 5 tramps who tell me that they are hungry, then I can give each one \$1 and I have effectively given them a burger. The same applies no matter how many begging tramps there are. Because hamburgers have an abundant supply curve that is horizontal, we know that giving money is equivalent to giving hamburgers.

Contrast this with a rigid supply situation where the Mona Lisa painting is being auctioned at Sotheby's. Imagine if the painting is expected to sell for one billion dollars and 5 art collectors stop Bill Gates at the door. Even if Bill gives \$1 billion to each of them, it is impossible for all 5 of them to buy the Mona Lisa from that auction. Because the supply curve is vertical, that situation is rigid supply horror and more money is not equivalent to more of the item.

### **Sydney Housing Horror**

Now that we understand the meaning of price, we must decide if Sydney housing is competitive market joy or a rigid supply horror show.

It is clear to me that the Sydney housing situation is much closer to rigid supply horror than it is to competitive market joy. Whilst the price of many goods falls to reflect lower production costs, the price of Sydney houses rises to reflect the higher buying power of the families who miss-out on housing. Richer and richer young families are missing-out as price rises. That's the strongest loser effect!

For Sydney housing the demand is ever so slightly elastic. Although you might think every Sydney family needs exactly one Sydney house, this is not quite true. Some Sydney families can share a house with friends or relatives. And some Sydney families become so desperate that they uproot themselves and leave Sydney. Therefore the Sydney situation is not quite as bad as on the Titanic where to miss-out meant certain death.

Sydney housing supply however is very much like the supply of lifeboats on the Titanic in that it is completely rigid and unresponsive to price. Govt planning and zoning defines a precise number of houses that are allowed to be built. The price of housing depends on what it takes to outbid weaker families on the fixed (too few) number of houses permitted by gov't. The price does not reflect the cost to produce additional dwellings.

If gov't has zoned fewer houses than families exist then some families must miss-out on independent housing. This simple fact escapes most commentators on the Sydney housing crisis, who seem to think the problem is dollars. Don't they understand that if population grows until there are 4 million Sydney families, but gov't has only permitted 3 million Sydney houses, then 1 million families must miss-out on exclusive use of a Sydney house? That is primary school mathematics.

No matter how much money people offer to pay, gov't does not increase the supply of housing permission. That's inelastic. That is rigid supply horror. Supply of house-building permission is not market-based, but is

politically-based. If you take money to a council and offer to pay for a permit to build an additional house, then you will be arrested for offering a bribe. Sydney housing permission is not a competitive market.

*To see why Sydney housing is not a competitive market, compare it with the qualities that I earlier said a competitive market would have:*

- Housing permission is not available at the cost of production.
- Housing permission price does not tell competing suppliers what best to produce (ie where to permit the houses) nor tell buyers where it is best to live. There is no competition to supply housing permission. Govt has a monopoly on housing permission supply.
- Housing permission is not effectively created by the buyer's payment. It is not essentially made for the buyer. Each buyer of housing permission effectively denies permission to a weaker buyer who must miss out.
- Price of housing reflects what it takes to outbid other buyers not the cost of production.

### **Bastard Market**

*"Houses cost what someone is willing to pay for them. It's not anyone's fault it's called supply and demand."*

Posted by: Dave at January 23, 2007 1:29 PM

[http://blogs.smh.com.au/newsblog/archives/your\\_say/009426.html](http://blogs.smh.com.au/newsblog/archives/your_say/009426.html)

It is ludicrous to claim that Sydney house prices are justified or legitimised by the working of supply and demand. Such statements show profound ignorance of markets, and a failure to examine what is behind supply and demand in Sydney to see what is really going on.

*All markets lie somewhere on the govt/individual spectrum where the result is determined partially by govt and partially by individual choice. Some "free market" touters claim that the free market is the point at which individual control is 100% and govt control is 0%. Let us examine the Sydney housing market to see where it lies on the spectrum of govt vs individual control. Let us look further into supply and demand factors to see to what extent the situation reflects choices made by private citizens and to what extent it reflects govt decisions. Does the Sydney housing market have 0% govt influence? Might we be dealing with the hallowed "free market" here?*

With Sydney housing you have supply fixed by govt via the zoning laws. A house cannot be built without permission from govt. Therefore:

**Supply is fixed by govt.**

Sydney housing demand comes from families. The largest number of new families comes from local population growth. These families are the children born 20-30 years ago. Since their number exceeds the number of families who die out, extra houses are needed. This demand is essentially fixed, since it is too late to stop these children from being born and growing up. Most demand is fixed. The 2nd largest component of housing demand comes from immigration. Govt fixes the level of immigration as it likes. So we can say:

**Demand is fixed by govt.**

It gets worse. We know that in a shortage the price will reflect the buying power of the strongest loser. Most home buyers in Sydney will use a home loan to pay for their house. Therefore their buying power depends on their borrowing capacity. Who sets the interest rate that determines the repayments and hence the borrowing capacity? It is the govt's central bank that fixes the interest rate on loans.

- \* Govt determines the level of supply of new housing in Sydney via zoning.
- \* Govt is behind the largest variable component of demand via immigration.
- \* Govt is pivotal to the funding of housing via interest rates.

*"I don't accept that the government is the major problem. It is a free market controlled by supply and demand."*

posted on 28 mar 07 - 8:24 pm by devils\_advocate to g\_t

<http://cracker.com.au/viewthread.aspx?threadid=174590&categoryid=11121>

Please don't be swayed by some clown referring to housing as a "free market". Anyone who uses free market theories to justify the state of Australian housing is a charlatan. If there is such a thing as the free market, Sydney housing aint it. This is an abomination of a market, a bastard child of govt.

The Sydney housing crisis, the prices of housing, the location of housing, the size and style of housing and the infrastructure that supports it in no way reflects the ideals of regulation via price in a market, these being expression of free choice by citizens and selection of best activity via price signals. Sydney housing demonstrates nothing close to the ideals that support the use of markets in society. I don't see private property used for efficiency or fairness. Licensing doesn't give benefits to consumers by creating competing suppliers. Licensing is done to confer privilege on favoured developers and landowners, and to transfer wealth from the young generation to the old.

My belief is that the Sydney housing crisis is not a deliberate conspiracy, but is the result of gross govt incompetence. I see it as an egregious failure of central planning, shamelessly excused as being the fault of "the free market". We do indeed have a market here, but it is a bastard of a market.

### **The Meaning of Sydney House Prices**

Now is the time to apply our knowledge of markets and price and determine the meaning of Sydney's house prices.

We understand the difference between competitive market joy and fixed supply horror. We know that Sydney is rigid supply where price reflects the buying power of the strongest loser.

Firstly we need to recognise that every house is unique, so we must group them in order to make sensible comments about each group.

If a starter house now costs more than it did 10 years ago, this means that the people now missing-out on starter houses have more buying power than the people who missed-out on starter houses did 10 years ago.

If a median house price has risen from 4 times salary to 10 times salary in the last 20 years, this means that all families with buying power of less than 10 times salary will now miss-out on a median house, whereas before only families with less than 4 times salary buying power would miss-out.

If the very same house that sold for 5 times salary in 1970 now sells for 20 times salary unrenovated, this means that a family with 19 years salary buying power is now getting a worse house than a family in 1970 with 5 times salary buying power could get.

A fool might look at prices and say that the Sydney housing situation is wonderful:

- The Australian housing market has performed strongly over the last 30 years, making many Australians rich.
- Australians are now much richer because housing wealth has increased by \$2 trillion dollars or such.
- The average Australian household is richer because their assets including housing have increased by more dollars than their debts.
- Not only traditional houses have boomed, but also units and townhouses have increased in value.

However, since we are smarter than fools and know the real meaning of prices we can see that Sydney's housing performance has been very poor:

- Luxury houses remain rare and owned by the very rich.
- Quality houses with good transport are now available to a smaller portion of families.
- What was once an average house is now available to fewer families than before.
- The average house of 1970 is more desirable than the average house of today. We know this because those same houses unrenovated today are very expensive.
- Many families today live in sub-standard housing, whereas in 1970 they would have lived in ordinary, decent, or quality housing.
- Many more families are houseless, either sharing with friends, or living with parents or in charity housing.

## Sydney's Housing Disaster Part 2

This is the second of two parts in an article about Sydney's housing crisis.

Part 1 delivered the "Parable of the Frozen Oranges" and covers the meaning of price and the real meaning of Sydney house prices.

Part 2 gives more details about the planning failures, the role of investors, moronic proposed solutions, and the underlying reasons for the planning and housing disaster in Sydney. Some solutions to these problems are also given.

### House Components

In this article till now I have not discussed the components that make up a house. Initially it was best to discuss a whole house, like a whole orange. If you can understand how a shortage of oranges would cause some boys to miss-out, you can also grasp why a shortage of houses would cause some families to miss-out.

*I mentioned how govt controlled the supply of housing by price-inelastic politically-based supply of dwelling permission and I said this was the cause of Sydney's housing horror. Now is the time to study the components of housing and find evidence to back-up my claims.*

Most people think of a house as being comprised of house and land. In fact there are 4 distinct components:

- 1) house materials.
- 2) house construction labour.
- 3) raw land - a licence from govt for exclusive limited use of land.
- 4) dwelling permit - permission from govt to build a house upon the specified raw land.

Every baker knows that if he runs short of flour, yeast or water, he cannot bake any more bread. So too every builder knows that if he doesn't have the material, labour, land or permission for a house, then he can't build another house. Since Sydney's population is growing and the number of families is increasing, it is necessary to increase the number of houses to avoid families missing-out on independent housing. That's not rocket science so far.

But for a while now Sydney has been unable to build enough extra houses and many families are missing-out on independent housing. It must be a shortage in one or more of the components of a house that is causing this shortage. Once we can identify the problem component, we can work on a solution. Which component is in shortage?

I believe that the cause of the shortage is quite easy to identify. **There is a shortage of govt permission.** Govt, via council zoning, is simply not giving permission to build the number of houses we need for the number of families we have.

Here are my beliefs:

- \* In Australia we have enough labour to build housing for every young family.
- \* In Australia we have enough materials to build housing for every young family.
- \* In Australia we have enough land to build housing for every young family.
- \* But in Australia we **do not** have enough permission from govt to build housing for every young family. That is why not all families have a house. It is not a problem of dollars, there is no shortage of dollars, there is a shortage of permission from govt.

Let us examine the components, their markets and their prices, to see if I am right.

In 1970 in Sydney a typical young family might pay 4 times average salary for an average house. Land with dwelling permit cost 1 times salary, the house materials and labour cost 3 times salary. Now a similar house would cost 10 times average salary. Land with dwelling permit costs 7 times salary and house materials and labour cost the same 3 times salary. I used the AV Jennings website (<http://www.avjennings.com.au/>) to verify this. Many of their houses cost 4-5 times average salary, but they are much bigger and better than average houses from 1970.

Building materials are supplied in highly competitive markets. Not only do materials compete against each other (eg steel vs tiles) but each material has several competing suppliers, and materials can be imported if the local market becomes uncompetitive. In Sydney there has not been a sustained shortage of building

materials for decades. Building labour is also supplied in a competitive market. Although govt does license all tradesmen and charges fees, levies and income taxes on them, the market is still reasonably competitive. It is not that hard to become a tradesman, and tradesmen earn a good but fair wage for their labour.

Despite an enormous rise in burdensome taxes and regulations from govt, our building industry has managed to keep house construction costs at the same multiple of salary as in 1970. This is a wonderful achievement, the result of innovation, improvements and a testimony to the success of markets. There is no shortage in materials or labour. There is no price rise in materials or labour. I declare that materials and labour are not the cause of Sydney's housing crisis.

It is the cost of the land with dwelling permit that has changed since 1970. The problem must be a shortage of land, a shortage of building permits or both. Let us examine the cost of each to see where the problem lies.

Dwelling permits are not sold alone. They are granted by govt to specific blocks of land. These blocks of land are then sold. There are two ways of figuring out the cost or value of the permits. You could ask a developer to estimate how much extra a block of land would be worth if it came with permission for more dwellings. Any developer worth his salt can make these estimates. The other way is to find similar land with different dwelling permission, and to compare prices. For example, let me ask you: Why does 5 acres of "farmland" in Castle hill with permission for only 1 house cost \$2 million whereas next door 5 acres of residential housing land with permission for 30 dwellings sells for \$10 million? Do your sums and you can figure the approximate value of building permission in Castle Hill. And when you consider that part of the "farm" value is speculative premium that it will be rezoned, you can get an even more accurate figure.

By doing this we find that land has increased in price slightly but dwelling permission has increased enormously. I encourage every Australian reader to do these calculations and see that it is true in their area. Under a market regime where dwelling permission is freely available it would be that the cost of land would be the amount of money needed to persuade an existing land owner to do without a portion of their land. As population rises and wealth rises, you would expect the cost of raw land would also rise. Particularly in areas of high demand (waterfront) the cost of land would be very high. We can't do much about that.

However if govt makes dwelling permits readily available then there will always be affordable housing available for young families somewhere. There has never been a shortage of land proposed for subdivision. Australia still has 100 acres of land per person. Many landowners will be always willing to subdivide if they can make a profit and will propose all kinds of subdivision schemes if there is a buck in it (which there definitely is).

When you study the matter, the housing shortage is definitely caused by a shortage of permission from govt. Quite simply Australian govt has permitted fewer dwellings in our entire country than families live here. The problem is worst in Sydney. In Australia there is not one house for every family because govt does not permit sufficient number of houses. It's moronic, but true.

## Regulation Choke Point

At some point of time between 1970 and present, govt regulations choked the housing supply and caused the housing shortage and high prices. In the parable of the frozen oranges the exact time and cause of the shortage could be pinpointed. But the situation with housing subdivisions and regulations is more complicated so we cannot similarly pinpoint the exact moment when govt caused the shortage of housing.

Zoning regulations have existed for many decades before this crisis. It has always been normal (and arguably healthy) for a percentage of subdivision applications to be rejected. Some rejections are not the problem. The problem is when the regulations are too strict to allow the need for extra houses to be met. What this means is that the faster your population growth, the looser your zoning rules must be. Before 1970 there were always sufficient subdivision permissions granted to meet the needs of population growth, whereas since then there have been insufficient approvals. The difference between **sufficient** permission and **insufficient** permission is the key to the whole housing crisis.

Once the zoning choke point is reached there will be some clear signs that it has occurred. There will be a housing shortage and certain class of people such as low income families will no longer be able to afford housing. There will be a great rise in the price of the permission component of a house. Although we cannot

pinpoint the start of the housing crisis, we know it occurred after 1970, since that is when the signs of shortage first started to show.

## **The Role of Investors**

Investors who buy housing influence prices but have no effect on the housing shortage.

Since the shortage is caused by the number of dwelling permits being less than the number of families, the only realistic solution is to create more dwelling permits. Basically, investors cannot do this. Only if an investor is able to persuade govt to issue more dwelling permits can this investor help solve the housing shortage. Conversely, only by keeping a house empty without tenants could the investor worsen the housing shortage.

It is vital to understand that most investors have no influence on the govt permitting process. Most investors buy existing housing (buy to let) and have no effect on the housing shortage since these investors do not create or destroy any housing and do not create or destroy any families. When a buy-to-let investor buys a house, they make one less house available for other families **to buy**. However they also make one more house available for other families **to rent**.

Some unthinking fools blame investors who buy existing housing for causing Australia's housing shortage. These fools seem to think that investors destroy the accommodation they buy and don't rent it out. Other fools think that the housing shortage can be solved by encouraging more investors to buy existing houses and make them available for rent. These fools seem to think that buying an existing house creates more accommodation. Of course it doesn't. Every house bought by investors is one less house that can be bought by a young family to live in.

A buy-to-let investor is effectively buying the entire lifespan of a house's use and then carving it up and selling it off a month at a time to tenants. The act of cutting a pizza does not create or destroy any food. Likewise, slicing an existing house into rental portions does not create or destroy accommodation.

## **Investors and Prices**

Whilst investors do not destroy or create accommodation, recent times have seen a huge rise in the popularity of housing investment and many more houses in Sydney are owned by investors than ever before. What is the effect of this on prices?

If a large number of buy-to-let investors buy housing this forces a large number of families to rent instead of buy. It will be the market forces of prices that cause these families to rent instead of buy. So we can say a large number of investors will cause renting vs buying to become more attractive to a large number of families. It could be that purchase prices go higher and rents go lower than they otherwise would have been (if not in actual dollar terms). However this is not certain.

If say 1000 young couples, living with mum and dad wanted to buy their own first house, but were outbid by 1000 buy-to-let investors, then clearly purchase prices would be driven up (in order to do the outbidding). Now if we assume that 200 of these youngsters are so upset by missing-out and detest the idea of renting so much that they continue to stay with mum and dad, then we have 800 extra renters and 1000 extra houses to rent. This will drive rental prices down. However if all 1000 of the young families decide to rent regardless, then the number of extra renters matches the number of extra houses and the effects on rental prices will be uncertain. If I had to take a guess I'd say that the buy-to-let craze in Sydney drove sale prices up a lot and rents down slightly, compared to what they would have been without the craze.

*Sadly, a large number of Australians cannot think for themselves and will believe whatever powerful elites tell them via the media. In the late 1980's the govt removed the negative gearing tax deduction on housing investment. A powerful group of liars wanted this tax change reversed and campaigned that the tax change was causing rents to rise enormously and forcing young people out of housing. The media campaign got the change reversed and created a myth about tax incentives and rental prices that persists to this day.*

A smart person can easily see how this myth is nonsense. Firstly statistics on rents do not show a large spike in rents in that period. Rental prices have been rising because of the housing shortage, and will rise in fits and starts. The rises prove nothing about tax deductions, especially since rent prices did not fall when the tax change was reversed. Secondly think about this, if the tax change had encouraged investors to abandon their investment and sell the housing, some other families must have bought that housing to live in. These



families would no longer need to rent, and hence the fall in housing available for rent would be matched by a fall in families wanting to rent. No change.

### **Is Housing Investment Benign?**

I have shown that housing investors did not create the housing crisis and probably do not affect rental prices much. However let me be clear that all this housing investment is not benign. It does have seriously bad effects on society.

Investors bid up the purchase price of housing. Young families wanting to buy face two problems. Firstly since there are not enough houses in Australia some families must miss-out and others must pay higher prices to outbid the strongest losers. The second problem is that investors are buying some of the scarce houses.

*The investors' buying will cause more young families to miss-out on buying via higher prices, higher prices which must be paid by the winning young families. That is bad for them. The young families that miss-out on buying must then rent, and this has emotional ramifications.*

Consider that many boomers bought their house when they were young. Now they buy investment property. Without the boomer, you would have a young family buy their own house and live in it. But now the boomer buys it as an investment and deprives the young family of following in his path. The boomer uses his higher income, home equity and tax advantages to outbid the young family. The boomer then allows the young family to rent the house from him. The govt gives a tax break to the boomer and makes it up by higher taxes on other taxpayers, which includes the young family.

Each homeowners boomer of course controls the house he lives in, as far as colour of the walls, placement of hooks, and all manner of appliance and maintenance and renovation issues. Many investing boomers also control these same matters in the houses occupied by the next generation. How this situation can be efficient or fair escapes me. It is bound to cause waste and resentment.

The older generation has long held a majority of votes, and in a democracy it has quite properly held power and got to decide via its politicians and their policies, how to treat the younger generation. We can see the choices they have made. In time the younger generation will become larger and take ascendancy. At that point the younger generation will decide how the old are treated as far as taxes and benefits are concerned. While there is plenty of potential for tit-for-tat retribution, and many boomers may get what they deserve, it gives me no pleasure to see society run along these lines. A little consideration for others would be nice.

### **Ignorant Meddling, Moronic Schemes and the Blame Game**

Throughout this article the most important point I want to get across is that not every Australian family can buy an Australian house because there are not enough houses.

If there are 10 houses for every 11 families then the only number we can know and should care about is that 1 family will miss-out. We cannot predict the exact house price, nor does it matter. Price will be the buying power of the "richest family that misses-out", but price is not the problem. Once we know that a shortage of houses is causing families to miss-out on a house, we must identify what is causing the shortage and how to solve it. The problem causing the shortage is that govt is not zoning enough extra dwellings. The solution must involve more dwelling permission from govt. Any proposal that does not involve this is moronic.

In the parable I showed moronic ideas that shuffled money but did not get a single extra orange, and I said one of the similarities in Sydney housing was:

\* moronic solutions are proposed that shuffle dollars but do not create a single extra house.

I cannot stress enough how these moronic schemes and ideas are causing the problem to continue because they take attention away from the real problem. 95% of newspaper articles about the housing crisis do not mention the need to get more housing. The vast majority of proposed solutions do nothing except shuffle money and would not create a single extra house. I cannot overstate how stupid that is.

On the Titanic you cannot save any more people without more lifeboat seats, and in Sydney you cannot house any more families independently without creating more houses. If govt does not give permission for more houses then there will not be more houses. It's that simple.

Let us run down some of the ignorant meddling, moronic ideas and ridiculous blame gaming that has occurred.

*Claim: The problem is that high house prices are caused by low interest rates.*

Since in a shortage our house prices will reflect the buying power of the strongest loser rather than production cost, this is partly true. Low interest rates have increased the borrowing ability and hence buying power of the group who miss-out on housing. These desperate losers have used their borrowing power to bid up the price of housing, causing the winners to pay more to outbid them.

The claim is false because if govt permitted enough dwellings, prices would fall to production cost. Buyers might use borrowed funds to buy more expensive (to produce) houses, but need not do that.

*Claim: Negative gearing by investors is to blame*

False. Negative gearing is not the cause of the housing shortage. Negative gearing is a money-shuffling scheme that does not create or destroy accommodation, except in extremely rare cases (see below). We don't have space for a full discussion of negative gearing. But basically the case against negative gearing should be based on whether it:

- \* unfairly enriches one group at the expense of another
- \* encourages investors to outbid young families and force them into an emotionally inferior rental arrangement.
- \* causes an excessive number of rental housing units where rental arrangement is poorly suited. eg purchase makes more sense for society.
- \* helped lead ignorant people into a speculative frenzy

Negative gearing is not the cause of the housing shortage and is not the main problem facing young home buyers. Negative gearing is a red herring.

*Claim: Negative gearing deduction should be grandfathered and subsequently only available on new dwellings, not existing dwellings*

That's not the solution either, because the limiting factor on new housing is the permission from govt, not a shortage of payment offers to the developer. Once a developer gets permission for more dwellings, he will build and he can sell without difficulty. The act of creating new housing can be attributed to the govt permission, not to the builder or the buyer (investor or not). It is true that tax incentives could bring about new dwellings where the permission is already available, but building is extremely expensive. eg you need to knock down a good house to build two, or you are allowed build on a cliff. In this case tax incentives could make the difference. But these cases are rare, the resulting dwellings would be expensive, and the process is arguably a case of malinvestment.

*Claim: The problem really took off when the govt halved the capital gains tax rate*

Basically false. Tax changes have no effect on the dwelling shortage because it is caused by a shortage of govt permission. Tax changes may have increased speculation and increased house buying prices, but did not affect the price of housing to rent. Tax changes may have sparked a fire, but the fuel for that fire is the dwelling shortage steadily building since 1970 and the fault of govt zoning.

*Claim: House price rises are caused by immigration*

Partially true. Govt is failing to permit the extra dwellings needed by both local population growth and immigration. The real fault is that our dwelling permit scheme is rigid and does not respond to demand or price. It is debatable whether our permit scheme could cope with just local population growth. Immigration certainly makes the problem far worse, prices far higher and results in resentment when rich immigrants take houses that would otherwise go to poor Australian families. Immigration should be curtailed until the housing crisis is solved, but immigration is not the problem.

*Claim: The problem could not have been present before 1989 because that is when house prices first exceeded the historical average of about 4 times average salary*

Wrong. The problem started before 1980. During the 1980's interest rates were very high which reduced buying power and masked the transition of price from "cost of production" to "buying power of strongest loser". Had interest rates stayed at normal levels we could have expected prices to have risen before 1989.

*Claim: There was no problem in early 1990's because Australian household debt was at 50% of income, low by international standards of 100%*

This is rubbish. Firstly who is to say that 100% is the correct level? Secondly, average household debt was only low because it included debt for many houses bought before the enormous price rises. Since then, the

high house prices and high debt load has caused the average to rise. Now Australian household debt is toward the top of the International scale at 150%.

*Claim: A large first home buyers grant will solve the problem and allow every young family to afford a house*

Rubbish. When there is not enough of something and that something is rationed by a market, then some people will miss-out and think "they cannot afford that something". The problem is not affordability but quantity. There is not enough of it for everyone. If you get nothing else out of my article please learn this. When dumb people see that others cannot "afford" something, these dummies think that more dollars is the solution. That does not work when the supply curve is vertical in rigid supply horror. When the foolish headmaster figured he could get every boy an orange if he gave money to the poorest boys he was making this blunder. What actually happened is that market price rose and forced another boy to miss-out.

This exact same blunder was made by the Australian Federal govt when it created a first home buyers grant that gave \$7000-\$14000 to so-called first home buyers. The effect on prices was almost instantaneous. All houses became about \$10,000 more expensive overnight. If any first home buyers did get a house as a result of the scheme it was only at the expense of other buyers who were priced-out by the \$10,000 rise. Since the scheme did not create a single extra dwelling permission there was never going to be any other outcome. The result was as predictable as it was sad. Taxpayers giving thousands of extra dollars to house sellers and not a single extra family getting housed.

*Claim: It is the fault of young people these days who buy DVD's, plasma TV and overseas holidays. In my day we went without these things.*

Rubbish. DVD's and overseas holidays are now inexpensive and it makes sense to buy them. Young people cannot afford housing because it is relatively more expensive than it was in your day, because your govt has zoned too few extra dwellings. In your day govt zoned enough dwellings, and in your day you bought refrigerators and colour televisions (equivalent to today's luxuries) and could still afford housing.

*Claim: When I got married I lived in a caravan or shed till I saved enough for a house. Young people these days want it all now.*

Rubbish. Some old people nostalgically remember living in a caravan or shed, but they likely only did this for a few months when aged around 20. Now we have people aged 30 who have had to live with their parents for an extra decade. There is no comparison. Besides, today's govt does not allow people to live in caravans or sheds. It is now illegal.

*Claim: We need more investment in housing to solve the problem*

False. (see the section on the effect of investors) We need more permission for housing, not more investment in existing houses. Even if Bill Gates came to Australia with his billions he could not create a single extra house without permission from govt. We don't need Gates and his billions. We just need the permission from govt.

*Claim: There is a shortage of land*

Rubbish. There is 100 acres of land in Australia per person. Even on the fringe of the most crowded city there is plenty of land with owners eager to subdivide it for more housing. (They of course subdivide it for dollars, the buyers want it for housing). The "[5 acres now](#)" group is begging for permission to subdivide their 25 acre Sydney blocks into 5 acre blocks. No doubt some of these owners would be prepared (at a price) to subdivide into 100 house blocks thereby creating 99 extra dwellings.

The reason people think there is a shortage of land is that a standard "house block" of land is now so expensive. People are not smart enough to realise it is the permission component that is so expensive, not the land itself (see the section House Components). Once you can think of permission as being a component of a house, it is easy to see that permission is where the shortage lies, not in the land.

*Claim: John Howard says the states are to blame for not releasing sufficient land*

John Howard is essentially correct. By releasing land the states provide additional blocks of land with dwelling permission, so this is one solution. However a better solution is to free-up zoning regulations so that private landowners can also subdivide and hence "release" land that way.

*Claim: Parents should help their children buy houses via gifts and loans of money*

Nonsense. Whilst these schemes may help one child buy a house they will not create a single extra house. Such schemes increase the buying power of the strongest loser and hence cause price rises which price-out other losers.

*Claim: It is the fault of taxes placed on developers. Every block sold by developers is taxed by \$100,000 therefore this amount is added to the sale price by developers*

Wrong. Essentially any taxes are paid out of the windfall profit to developers and not added to the sale price. When govt creates a shortage of dwelling permits it forces house prices up to the buying power of the strongest loser. This creates a windfall profit for any developer that is granted extra dwelling permits. If govt then taxes the developer, the govt is grabbing a share of this windfall for itself.

The taxes are rapacious, and are a clear warning sign. Any govt that would charge these high taxes would surely do other bad things. It is these other bad things that have caused the housing crisis. Assume a typical house block costs \$400k with \$110k what it takes to persuade the owner to sell and \$290k being the dwelling permission windfall. Assume govt dwelling taxes are \$120k, this means the developer gets a \$170k windfall. If govt was to fix the real problem and give sufficient dwelling permission, then land prices could easily fall by \$170k as the developer's windfall is eroded. For land prices to fall by the final \$120k, govt would also have to reduce its dwelling taxes.

So in typical areas where govt dwelling permission is very scarce, the govt taxes do not add to housing costs and are not the problem. But in areas where govt dwelling permission is not so scarce, eg if they zoned a huge number of units in a cheap area, it is possible that govt taxes could be the limiting factor and hence be "the" problem.

*Claim: There is a world-wide housing bubble caused by an epic credit expansion and concomitant low interest rates. When the boom ends as it must, then prices will fall and young people can afford homes as before.*

*It is true that there has been an epic worldwide credit bubble and I expect Aussie house prices to fall when it ends. But this price fall will put net zero extra families into houses. A credit contraction does not create a single extra house, nor a single extra permission for a house, where the bottleneck lies. Prices will fall when a credit contraction lowers the buying power of the strongest losers. The price changes will allow some young buyers to afford housing but at the expense of other people who can no longer afford it. eg due to high interest rates. Since credit is purely financial and does not affect the number of houses permitted by govt, any credit change cannot affect the number of families who miss-out on housing. For example, if a credit contraction causes a bust that makes 100,000 houses affordable to first time buyers, then what happens to the people currently living in those very same 100,000 houses?*

## **Sydney's Planning Disaster**

Australia's housing crisis is caused by govt permitting an insufficient number of new houses since around 1970. But the deeper problem reaches further back than 1970. Govt regulation has been growing for a long time. It was only since the 1970's that regulation grew big enough to choke off the new house supply and cause clear distress.

To really solve the housing crisis we must recognise the wider problem of govt regulation and not just cut it back a little to alleviate the symptom. If we just tinker with the zoning rules we might remove the symptoms for a while, but like cutting the top off a weed, new symptoms will soon show up.

Back before 1970 govt permission for housing was sufficient, but even further back govt permission for land use was abundant. Under that long-gone regime the mechanism for locating new housing was essentially individual choice based, or market-based. Exactly where the people lived was more-or-less decided by the wishes of individuals. Now where people live is decided by govt because politically-based town planning now decides where all extra housing is built. Why did those people settle in that new town in 1850? Because that is what they wanted, they had their own reasons. Now, why did 10,000 people move into yardless McMansions in that new suburb with no train service? Because that is where govt wanted people to live, and that is the block size that govt zoned. When govt zones insufficient housing, some people must move wherever govt does zone it.

Does a govt planning elite know and care better than individuals when it comes to choosing a place to live? Our society seems to think so.

In fact not only housing, but all land use used to be dictated by what people found was best. Fishing towns formed near fish. Mining occurred near minerals and mining towns formed near prolific mines. Farms formed where soils were fertile, and farming towns formed to service nearby farms. Heavy manufacturing cities formed near deep water ports, etc. Living arrangements sprung up or wound down to suit conditions, not to

suit govt. But over the last century a transition slowly occurred. Now all changes to land use are dictated not by what individual people want, it is now what the govt wants, or more precisely what planning elites want.

Whilst there is nothing fundamentally wrong with having a govt, and some decisions are best made by govt, it is also clear that govt is not the best judge of certain aspects of our lives. I think house location is one of them. Some things are best decided by the people who know and care about their own circumstances and possess important local knowledge and motivation. For example before 1970 a young family who needed a house block only needed to make an offer to an existing land owner. You can be sure that if there was a piece of land that was well suited to take an extra house, some young person would spot it and make an offer on it. But now however, govt planners must be convinced of the merits of extra dwellings. They are much harder to persuade, because they don't need the dwelling for themselves, don't benefit from the sale proceeds, and their entire job revolves around red-tape and refusing applications. They have all kinds of paperwork and rules to follow, and they don't know the needs of the young family and may not care if young families have housing at all. In fact the record shows that they do not care about young families. Since 1970 these out-of-touch planning elites have zoned too few houses to meet the demand from young families.

### **The Four Blunders of Govt Planners**

The fundamental planning flaw made by our society is, in my opinion, to embrace big govt and a "govt knows best" communist-style approach to town planning. In my opinion citizens should be given more choice and govt should take less control over housing. That's the root of the problem.

*Once the bad decision was taken to use all-powerful town planners, we became victims to any blunders these planners would make. The govt planners in our society have made four main blunders:*

- 1st blunder of govt planners is to zone insufficient extra housing
- 2nd blunder of govt planners is to zone extra housing in the wrong place
- 3rd blunder of govt planners is to provide inadequate services everywhere (particularly trains and roads)
- 4th blunder of govt planners is to zone workplaces too far away from housing

Keep these blunders in mind as we discuss how govt planners have gone about their task and the mess they have created in Sydney.

### **The Three Directions of Growth**

Australia does not have a population control scheme. Since our population is increasing our govt planners must zone extra housing. Govt planners can chose from three basic directions of where to house the extra people. The directions for growth are:

- 1 - afar - by building new cities and towns
- 2 - outward - by going out and building around the fringe of existing cities and towns
- 3 - upward - by going up, infill building to raise the density of existing cities and towns

Keep in mind that these three directions of growth all used to be handled by the market. Pre-1900 the direction of growth was market based and the market did a bit of each. Since 1900 or so growth has been directed by politically-based decisions made town planners. How did the planners perform? Did they steer growth in better directions than the market-based approach?

### **Read my lips - No New Towns**

Over the last century since govt took over town planning it has not allowed any new cities or towns to form. I can't think of a single new town or city that govt has created in Australia since Canberra. This is an extremely important fact that few people seem to appreciate.

Imagine that you knew a young gardener who had just taken control of an established garden. You visit his new garden and then you visit him in 20 years time and find that his garden layout has not changed one bit. He has created no extra garden beds. He has planted no extra trees, and hasn't even replaced the rusted water pipes. He has done basically nothing except jamming more plants into the old garden structure. You would think there was something wrong with that gardener. Even if the garden was perfect 20 years ago, surely the needs would have changed in some way as to require at least some significant change. That is one dull gardener!

Our govt is like that gardener. It took over the town planning and inherited a town layout that was essentially market-based. Every town and city had a reason to exist and reflected citizens' choices. But since govt took

over the planning it has failed to make adequate changes. Govt has created no new cities for decades! I think we should have some. What do you think? Let me see. If we have 300 towns for a population of 10 million, how many towns would you expect for a population of 20 million? 600? 500? surely not the very same 300. But that is what our moribund govt planners give us. Such imagination, such planning prowess! They just jam more people into the old layout that best suited people in the year 1900. Nothing has changed since then I suppose. Duh.

Some things can become too big and nature has a way of limiting the size of things. The world's tallest man was too tall to be healthy and he died an early death. When a beehive gets too big, the bees split it in two and go off in a swarm. But when govt planners control our housing the cities just keep getting bigger and never split. What's wrong with this picture?

I think some of our Australian cities have grown too big and have become like outsized beehives. Things that are too big are inefficient and not healthy, like the world's tallest man. That's part of the problem with our country. Big govt lacks the imagination to do what should be done, like create new cities. Govt should either get the imagination to create new cities, or install a market-based system that will allow citizens and/or companies to create the cities as required.

The reason that govt has not created any new cities or towns is easy to guess at. Govt employees are salaried bureaucrats not paid to take risks or solve problems. These guys can get away with being lazy or unimaginative or hamstrung by red-tape, but they might be fired if they actually do something that draws attention. Planning a new town would be hard work and risky, therefore govt planners will not choose to do this.

Govt planners will not create new towns, therefore they only have two options left on where to place the extra houses: either outward or upward.

### **Let's go out**

For several decades up till 1990 govt planners, being lazy and unimaginative, simply zoned all the extra housing on the fringes of existing cities, and grew our towns and cities outward. By releasing govt-owned land for sale and by allowing farms to be rezoned into housing estates, govt forced all new housing onto the edges of our cities. In a typical case such as Sydney, new housing moved out in a radius from the city centre, 30km, then 40km, then 50km from the centre. Our cities were becoming massive. When would it stop?

This zoning system had several problems. Since the 4th blunder (to zone workplaces too far away from housing) placed many jobs in the city centre, this scheme required workers to travel longer and longer distances to work every day. Blunder 3 (to provide inadequate services, particularly trains and roads) meant that efficient transport was not provided. New fringe suburbs ruined the amenity of existing suburbs as all the new people jammed up the inadequate roads and trains on their way to work and play. Since Sydney planners basically stopped building railway track in around 1930, new fringe suburbs did not have nearby rail stations. Desperate rail commuters were forced to drive long distances to rail stations, overflow the tiny 1930's sized railway car parks, and wait for overcrowded trains.

Arterial roads designed in 1950 (by the last half-decent govt planners) for a small city jammed up and these arteries started to flow slower than residential streets. Desperate long haul commuters took to residential streets to escape the traffic jams. The residential streets were not suited to this and the traffic upset local residents who called for a solution. The results of blunders 3 and 4 were clear to see as main roads were now slower than residential streets. How would the Sydney planners respond?

When faced with such an obvious sign of planning failure would our planners rise to meet the challenge, find the underlying cause of this problem, fix the problem, and get our main roads once again flowing faster than the minor streets as they should be? Yes and No! Their "solution" ended with the main roads faster than the minor streets, but these blundering cretins did it by blocking, zagging, humping and bumping the residential streets to make them even slower than the jammed-up arteries. If that response doesn't demonstrate the calibre of our govt planners, then I don't know what will.

By around 1990 this "outward" growth scheme had reached its limits (particularly in Sydney) and something had to give. By 1990 even the most stupid and blind govt planner could see that the outward growth scheme had been a failure and could not continue. The newer fringe suburbs had lousy transport to the city, and the older suburbs' transport systems had become jammed up too.

The blundering planners finally had to admit that something was wrong, but they were loath to admit they were in any way to blame. Politicians repeatedly told us it was the fault of people who wanted to drive cars instead of taking public transport. Maybe politicians should provide some public transport, and perhaps try using it themselves, before saying pathetic garbage like this. (Who voted for those clowns?) When you expand a city you must expand services such as trains and roads and you must zone work locations close to the new houses. Yet blunders 3 and 4 ensured this was not done. Our blundering planners could not admit fault and hence concluded that the policy of outward growth was no good and they must try another option. There was only one direction left to go.

Boxed into a corner by the failure of their previous blundering, the elite planners took the only option their narrow-minds could conceive. While previous plans deserved to be called "dumb" and "dumber", the planners felt that their next desperate plan deserved to be called "smart". The idea of "Smart Growth", of building our cities upward, was born.

### **Let's Jam**

With the option of planning new towns deemed to be too hard and risky, and the option of city fringe expansion deemed a failure, the only option our blundering planners could see was to jam more people into the existing city limits and call this smart. They decided to grow the cities upward via a process known as infill building, or "Urban Consolidation". Once the decision was taken, the "Smart Growth" bandwagon commenced. I try to avoid using the words "smart" and "government" in the same breath, but our blundering govt planners amazingly were able to get many people to passionately embrace the govt "Smart Growth" plan.

Most Australians are simple folk who don't think for themselves about public issues and merely trust and vote for the major political parties. Such simple folk were easily convinced by the smart growth campaign. The campaign convinced folk that the same govt that had presided over past problems now held the future solution. They convinced folk that the govt now saw the evil causes and would now do the complete opposite as the solution.

The campaign was simple:

*Growing a city outward is evil. The complete opposite of outward growth is upward growth. Clearly more high-rise apartments are essential. Traveling 30km to work each day in a private car is evil. The complete opposite is traveling 30km to work each day in a public train. Clearly the new high-rise should be concentrated around existing outer-suburban train stations.*

*Sadly, most people cannot think straight, identify a simple opposite, and see all the options. The simple opposite of growing a city outward is to NOT grow the city outward, from which not growing the population is one clear option, and growing new cities is another. Properly managing the outward growth is another option. The simple opposite of traveling long distances to work in a car each day is to NOT travel long distances to work in a car each day, from which springs solutions such as traveling shorter distances to work, people working from home, or more people working fewer days, and many other alternatives.*

All of a sudden we were told that Sydney needed higher density living. Sydney could transform itself into a 400 square kilometre version of romantic inner-city Paris. All kinds of rationales were concocted. We were told that providing services to the city fringe was too expensive for govt. (Funny how 1960's govt could manage it on much lower taxes.) It would be much cheaper and better for people to make fuller use of existing facilities in the established areas of the cities.

Suddenly our traditional houses and backyards were "urban sprawl" and bad for the environment. Environmentally-conscious citizens should live in high density apartments and leave most of Australia's 8000 BILLION square metres of area for other purposes (to be decided by elite govt planners). Our children would have lower environmental impact if they never saw and climbed a tree, but instead were taught an affinity for trees in a govt-approved high-rise childcare centre.

Suddenly the problems with our overcrowded train system were blamed on TOO FEW PEOPLE !!! If only we had more people in our city then we could run an efficient, cheap, fast and clean train system like Singapore they told us. Phooey.



Of course the same blundering fools who failed at low density planning were destined to also fail at high density planning. This was certain. Central to the failure was blunder 3, failure to provide services. The boomer generation seems obsessed with selling-off govt assets as opposed to building any new ones. You cannot grow a city without extra services, either outward or upward or afar. This obvious fact seemed to escape the planning elites.

This blunder 3 brought almost immediate failure to the "Smart Growth" plan. Due to blunder 3 established suburbs did not have adequate services to start with. Since there was no surplus capacity to take advantage of, as soon as our planners jammed more people into the existing areas, obvious shortages occurred. Affected people got angry, and made the connection of growth with shortages. Street parking disappeared in many places. Residents who needed or wanted this for themselves forced their council to steal this public property and license it as private property via residential parking permits. Other council scoundrels installed pay parking meters, profiteering from the rigid supply horror of parking, and did nothing to increase supply. Electricity blackouts became more frequent. Roads jammed-up worse than before, and train services continued to decline. Some Sydney railway platforms started to resemble those of Tokyo, only without the prompt, fast and efficient train service to match.

Besides the basic need to increase services, higher density development has many other problems. Upgrading services in an established area is extremely expensive and disruptive. Just imagine digging up a busy road to install a larger water pipe. It is much cheaper to provide water, sewerage and roads and rail to fringe greenfield development. If you've got to build extra housing for more people it is cheaper to build on a vacant block than on top of existing housing. The reason is simple. When you demolish existing housing for higher density, you must then pay the cost of the new housing for the new people and also pay the cost of replacing the housing for the existing people (whose housing you demolished). This not only applies to housing but also to much other infrastructure. It is quite simply stupid and expensive to force high density on established areas when there is the option of low density building elsewhere on greenfield sites. The Smart Growth phase in Sydney saw a shocking amount of serviceable housing, roads, pipes, and other infrastructure simply ripped-up and destroyed to make way for its higher-density replacement. That's dumb growth in my book.

Not only is high density development more expensive in the conventional sense, but it carries a higher environmental impact. The "Ecological Footprint" is the best measure of the impact each person has on nature's carrying capacity, not how much land their immediate dwelling takes up. It has been found that high-rise apartments have worse environmental impact than well-designed standalone housing because of all the common area electricity use, the energy to dry clothes, and the inability to collect solar energy or water, grow vegetables, and use natural ventilation and optimal orientation.

The Smart Growth scheme also met strong political opposition. High density development was opposed by local councils and local residents. Since there had been a multi-decade period in which almost all new housing went on the city fringe, a whole generation of councils and residents had grown used to the idea that their suburb need never allow extra housing. If you go hiking with Arnold Schwarzenegger you get used to not carrying your share of the load, and this is like what happened to local councils and residents. They got so used to other areas carrying the load of extra housing, they thought they need never allow any extra housing in their area. These councils and residents were livid when other people wanted to move in on their turf.

### **Sydney Transport**

*Sydney transport is a disaster area that merits a special mention. The blundering govt planners do not seem to know that car transport has peculiar scalability. It first scales very well, then it scales very badly. What this means is that you can double the traffic a couple of times and suffer no ill-effects. If a handful of cars on a road flow smoothly, then twice as many will also flow smoothly and so will four times. But after cost-free and easy expansion the system starts to hit hard limits until it imposes enormous costs in time and money to get any more cars on the roads. Some readers may recognise this effect in their city.*

When you increase the size of a city, there comes a point when you must switch from cars, to mass-transit, or some alternative. Sydney planners did the opposite, they ceased building rail and tried to get by with scant road improvements. If you take a small city in 1970, then double the population, double the radius and double the density of drivers by sending all the women to work, then you have 8 times the distance traveled by car. Put your numbers in for Sydney, consider the scalability of car transportation, and figure the rest out.



In 1960 it is fair to say that many, if not most, Sydney residents could walk to, or drive and park at, a railway station, get a seat, and a quick ride to the city. Now in 2007 after massive expansion of the city, jamming up of the roads and trains, and underbuilding railways, only a tiny portion of Sydney residents can do this. Many Sydney workers travel more than 2 hours each day in their cars. Planning blunders have created a car-dependant city that is addicted to fast-vanishing oil, where trains and public transport are a sick, overtaxed, dirty, dangerous, unreliable, expensive joke, and all the cheap-and-nasty traffic fixes have already been done.

### **All grown up with no place to live - BANANA, CAVE, NIMBY and NOPE**

*BANANA - Build Absolutely Nothing Anywhere Near Anything*

*CAVE people - Citizens Against Virtually Everything*

*NIMBY - Not In My BackYard*

*NOPE - Not On Planet Earth*

Many factors have come together in Sydney to create a situation that seems hopeless, and which has no one simple and easy solution.

The disastrous rise in the size and power of govt saw greater govt control of planning, an area big govt was poorly suited to. Big govt made so many planning blunders for so long that most citizens, quite understandably, do not want any more govt planning done near them. Moribund govt planners have not built a new town in decades. Outward growth on the city fringes was a disaster and city residents now rightly object to more of it. Upward "Smart Growth" in the city was also a disaster. Govt has apparently exhausted all its options for growing our country and has come up blank. And yet our population continues to grow naturally, and govt rabidly brings in immigrants. Young families and immigrants clearly need more housing, but the way to get it now appears most unclear.

Over the last century the size and power of govt has risen, driven by a rising love of govt. Govt programs have given all kinds of things to all kinds of people, and many more people want govt to give much more to them. People now feel sure that govt can give them whatever they desire. As well as this, and quite possibly connected to it, over the last century the average citizen has become dumb, unthinking and detached from reality. This happened despite information being far more widely available from sources such as the Internet. An extreme example would be people who think milk and eggs come from supermarkets, rather than cows' udders and hens' vents.

In everyday life this type of ignorance is mostly harmless but in the voting booth these morons become a clear danger to themselves and others. Morons with this level of ignorance will vote for policies that are certain to prevent themselves getting what they really want. For example these morons might vote for politicians to ban hens and cows, yet the moron really wants to keep eating milk and eggs. Or they might elect politicians to ban nuclear and phase-out coal, when the moron really wants electricity in his home. Or like in Sydney, morons elect politicians who bring in immigrants, pay a \$3000 baby bonus, and choke house building, when the morons really want their children to be able to grow up, move out, and own their own home.

A rise in selfishness and stupidity of the population has meant that many people think that blocking anything unpleasant near to them is a socially acceptable and viable planning policy. These people either don't know or don't care that some unpleasant things have to go somewhere. Power plants, refineries, dumps, even other people's houses must be placed somewhere. The NIMBYs want that somewhere to be somewhere else, and think this is a policy every area should follow.

Communities should know that if they want to have a certain lifestyle they must accept their share of the bad stuff that goes with it. Recently in California an Australian company was hoping to build a liquid natural gas terminal to allow delivery of desperately needed gas for California's burgeoning population and energy needs. One protesting NIMBY was interviewed about the plans of this Australian company and scornfully said "why don't they build it in Australia instead?". Because California generates its electricity from gas-fired plants. Its existing gas supply is facing decline whilst population and electricity demand increases. An LNG terminal at California is a possible solution. I don't influence Californian planning decisions yet I know these facts. The protesting NIMBY tries to influence the decision without knowing these facts.

In Sydney NIMBYs, BANANAs, CAVEs and NOPEs can see the results of badly-planned growth and they now want it stopped, particularly near them. It may be desirable to stop Australian population growth. But the

way to do this is by slowing immigration and/or reducing local birth rates. If you slow immigration now, then you need less housing from this point onward. If you slow birth rates now, then you need less housing in 20-30 years time. This might be good policy, but you don't wait until the next generation grows up and then strangle the supply of housing. That's moronic and cruel.

The idea that a society can raise children and then deny them housing is preposterous, yet many older Sydney residents feel that this must be done to maintain the character of their suburbs. Some justify this by claiming they are doing it "to stop profiteering by greedy developers". Greedy developers aren't the problem, the problem is stupidity causing a housing shortage. Developers are just providing essential housing to the grown-up children and immigrants brought in by the older generation. What makes it profiteering is that govt made building permission scarce, expensive and highly profitable, instead of abundant and cheap like it used to be and should still be. Today's developers have been given approval for some truly awful dwellings. I wouldn't want these near me either. The real problem is that govt has not approved enough better alternative dwellings elsewhere. It is not the developers' fault.

Maintaining the character of an area is a nicety, but the idea that suburbs should remain static is moronic, like a garden that never changes. The policy of denying housing to new families shows an appalling disregard for the young generation. And think about the practicalities of it all. Young adults in their 20's and 30's are now forced to live with their parents because extra housing can not be built. How does this maintain character? Now we hear scathing comments about "Adultescents" or "Kidults". These words didn't exist before the housing crisis forced young adults into an extended childhood. Is that maintaining the character of the area in which we live?

Think about other practicalities such as where they are going to park their cars. If you have got 4 adults with 4 cars living in a 1970's house with a single garage, where do you park all the cars and still maintain the character of the area? Two in the front, two in the back, I suppose. Sorry I forgot. They should sell the cars and all catch public transport.

### **The Infrastructure Drought**

One of the most perplexing questions about our society in the last 30 years is how come the size and cost of govt has risen so much and yet the level of basic services has fallen so low? I'd guess that in the last 30 years taxes have doubled and basic service levels have halved. I reckon it is that bad. How could this have happened?

Here are a few possibilities:

\* Our cities have become too big and inefficient. For example if we need twice as many ambulances because they are all stuck in traffic then this costs more and gives less service.

\* Big govt is plain inefficient. Many govt programs involve govt wastefully doing what citizens could and should do for themselves efficiently.

*\* People have become so dumb that they don't understand the proper role of govt and the role of private enterprise. Govt now employs near to half the population, yet in University they don't teach govt, they only teach business. So, many people running govt are trained in running a private business and so try to run govt like a private business. The goal of every private business is to cut costs and raise prices and take profits wherever possible, constrained only by competition. Govt has no competition so it can raise taxes and drop services without limit. This has happened. Govt elites are now making fortunes for themselves and their cronies, instead of serving the public.*

\* Too many Chiefs and not enough Indians. Govt has too many bosses and too many people writing rules and regulations. Govt has employed many more people than before, but too few do anything useful. Most govt employees work in areas such as writing new laws that did not exist, inventing and issuing new forms that did not exist and checking compliance to restrictions that did not used to exist. Others work on producing spin-lie statistics and reports that show how life under big govt is so good, and why we should vote that same mob in next time. Not only is big govt itself top-heavy with Chiefs and short of Indians, but it has made the whole of society top-heavy with parasitic occupations when you count govt employees and also private employees doing govt-mandated stuff. We now have so many more bosses, rule writers, inspectors, paper-pushes, fine-issuers, licensing boards, compliance departments, gobbledygook lawyers and other leeches such as advertising liars, and too few actual producers of stuff that makes life better.

\* People have become dumbed-down morons who can no longer do simple things for themselves. With govt taking over all aspects of our lives we are losing the ability to think. This is very expensive and inefficient. If a moron is walking on a wet govt footpath and the govt warning sign has faded, then this moron may not realise that the path might be slippery and they fall and are injured. So not only do we need govt employees to make the footpath, determine where signs should be, make warning signs, and inspect and replace warning signs, but we also need govt hospitals to mend the morons, and thousands of lawyers to sue afterward. Morons have more accidents, morons make more mistakes, morons waste. With so many of these morons working in govt, with no clear idea of what govt is supposed to do, no wonder the system gives such poor service at such high cost.

Those few possibilities might explain why govt is taking so much more from us and giving so much less to us, but is there another explanation? If the role of govt is to collect taxes from us in order to provide services to us, how could this tragedy occur? Do the above points explain it well enough? Perhaps not.

Perhaps there is another explanation. What if the role of govt is not "to collect taxes from us in order to provide services to us" but this is just a lie they tell us. What if our govt has become like a farmer who keeps us like animals for his own benefit. If the farmer can collect twice the eggs and give half the feed he would do so, wouldn't he? That would explain a doubling of taxes and a halving of services. Perhaps somewhere along the line we voted in a govt that sees us as animals to a farmer, as slaves to a master, or serfs to a Lord. Just something to think about. It might be a good idea to vote out govts that view citizens in that way.

## **The Solution**

The solution to Sydney's and Australia's housing crisis is for govt to be less restrictive and ensure that it approves sufficient new dwellings to meet the demand for extra housing from young families and immigrants. This is the solution. Evidence of success would be the price of housing falling to traditional levels, and children being able to grow up, move out and buy a house, at the traditional age.

However, I explained all the details and the history of planning blunders and some of the underlying sentiments to show how hard it will be for the solution to occur.

Society must decide if the purpose of its housing, of its housing "market", is to provide shelter to people, or to take money from people. A market is the best way to do this in either case. A fair market could efficiently provide best housing for people. An elitist market, such as today's Sydney housing market is effective at taking money from one group of people and giving it to another group.

The main thing is to re-establish a market-based mechanism for deciding where people live. This means that individuals would decide where they want to live, they would buy land there, and govt would then follow the people, permit dwellings, and provide services there. A market-based solution does not imply a free-for-all where govt has 0% involvement, but govt must have less involvement in planning because govt has proven to be incompetent at planning.

*I can't predict where growth would occur under a market-based solution, because a good market reflects a bit of everybody's wishes, not just my wishes or that of elites. There would probably be a bit of each type of growth, some afar, some outward and some upward. I guess that most growth would be afar, and that Sydney's size would shrink as it faced competition from new cities that were better and cheaper to live in. But I could be wrong. Since Australia has a massive backlog of service building to do, we cannot expect a rapid improvement in services. In fact new housing could be expected to make some shortages get worse before they get better.*

## **Market Solutions**

All of my solutions to Sydney's housing crisis are market-based solutions.

I like to see markets with:

- 1) more citizen control and less govt control
- 2) more equality and less elitism
- 3) more simplicity and less complexity

*Sadly, society currently is full of market factions, market myths and market dogma that work to prevent us from using the best markets. By thinking for ourselves about markets, instead of parroting dogma, we can select and adjust our markets to create the best markets for our situation.*

In the final sections I have tried to give several market-based ideas. These suggestions are supposed to be practical steps in the right direction and are not claimed to be an ideal market solution. The current Sydney housing situation is a market with much govt control, much elitism and much complexity. My suggestions are simple steps away from this, not an ideal.

Forget the dogma and keep in mind that bad markets or "politically-based" schemes will only reflect the wishes of elites, whereas good markets will reflect the wishes of all people.

### **Infrastructure and Services and Smaller Govt**

Govt must get back to basics and become more efficient and spend a higher portion of taxes on actual services and a lower portion on waste. Services, particularly rail and roads, but also water, sewer, schools, hospitals, parks and even shopping centres, must be improved dramatically in all areas to catch up with the increase in population.

*The bloated size of govt is the main problem facing modern western society. It is like a huge parasite that is choking the life out of society. Govt has become very large in the last 30 years and it is still increasing in size. We can rapidly solve the problem of Sydney's unaffordable house prices by changing our zoning regulations. But we cannot create great housing and social outcomes without solving this problem of big govt. I don't know if we can reverse the trend gradually, or if a complete crisis of confidence in govt is needed to do it. Either way I don't see this problem being fixed quickly.*

The solution is to remove many areas of govt and to privatise other areas. But when I say privatise I mean using a competitive market mechanism to return control to citizens. Nowadays the word "privatisation" has been hijacked by elites. Govt elites take a bloated wasteful govt monopoly and hand it over to crony elites who turn it into a slimmed-down cruel profiteering private monopoly. That's not the kind of privatisation we want.

In the long run, govt should not have so many employees. But since firing them all at once would be traumatic, instead we should slowly move many govt employees from wasteful paper-pushing, into useful front-line work. For example a meddling hospital administrator paid \$140,000 could be retrained as a nurse and his pay gradually reduced to that of a nurse. A railway marketing liar who writes glowing reports about the trains, could be retrained as a useful train cleaner. Those blundering railway managers who have spent years failing to install Singapore-style ticketing could be retrained to sell old-fashioned tickets on the platforms.

### **Subdivision and Building Approval Mechanism**

I am disgusted by all govt planners and the disaster they have created. Firing them all immediately is an option, but a kinder solution is possible.

It must be made clear to the govt planners that they are a failure and are to blame for the shortage of decent housing, transport, working, shopping and other arrangements in Australian society. I would give all govt planners an immediate symbolic cut in pay. Govt planners can be given one last chance but must be put on notice that if they don't lift their game dramatically they will lose their jobs.

As a first step I would demand that all planners move to a standardised process. All local planning departments currently do their own thing and approve or reject as they like. All planners should instead assess every application and give a score out of 100, where 100 equates to the level where approval would have been given under the old system. Local planners should be forced to be consistent, and should be taken to court if they give different points for similar applications. Council planners should only give points to applications, and not approve the application. A central authority should decide how many points are needed for approval.

For example, if not enough extra dwellings get approved in a 3-month period, then the authority can drop the approval threshold to 98 points. This would mean that every previously rejected proposal with 98 points or more would be automatically approved. The central authority would be given the task of ensuring that the number of approved dwellings matches the number of families.

## **New Towns**

Declare a housing state of emergency and immediately start a system that will create new towns. For starters get govt planners to build 2 new small cities somewhere. Also put out tenders for 2 or 3 private consortia to create new cities. In doing so, we want some mechanism to capture and share the gain in land value from this.

I don't have faith in govt to build new towns, but in this crisis situation I would support them trying it. If it goes wrong it will be a further reminder to the public about the incompetence of govt. If it goes right, then I will get a pleasant surprise and many people will get pleasant cheap housing.

The housing crisis is so severe that we have little to lose. Govt planners have turned Sydney into a giant badly-planned city. Even if they go on to create a new small badly-planned city, it will probably be better than Sydney, so there is little to lose.

## **NIMBY Solution**

We need to invent some fresh schemes to combat NIMBYism. When NIMBYs are successful in banning something unpleasant near them, they in effect impose something unpleasant on other people. We need some schemes that impose a cost on the NIMBYs to reflect the cost they impose on others. This is the "chooser-pays" principle, as used in the best type of market.

NIMBYs remind me of the story of the Little Red Hen, where all her lazy friends found reasons not to help make the bread, but were very willing to help eat it. The Little Red Hen taught her friends a lesson by denying bread to those who didn't help her make it. A typical NIMBY doesn't want a powerplant or a dump anywhere near him, but still wants his lights to come on, and his garbage to be taken away. NIMBYs must be taught the lesson that they cannot expect to enjoy a lifestyle if they won't participate in the unpleasanties that enable that lifestyle.

NIMBYs also remind me of a naughty child who refuses to eat the parts of his meal that are good for him. Such a child either doesn't know or doesn't care about healthy eating. He wants to have only the pleasant stuff and nothing unpleasant to eat. NIMBYs either don't understand that unpleasant stuff is necessary, or do know and want to force it on others. Either way NIMBYism is socially unacceptable and unworkable. Perhaps we can deal with NIMBYs in the same way we deal with naughty children or lazy friends. A naughty child might not be given any icecream until he has finished eating his vegetables. Likewise a NIMBY could be deprived of electricity until he has approved the construction of some generating capacity.

One type of scheme that could be used is shown by this example. Consider a power station. All residents are surveyed and asked would they want a power station near them on the promise of first priority for electricity. All answers are tallied and the power station is placed near the fewest objections. If too many object then the power station is not built. When power runs short and load shedding is needed, the answers to the survey are used to determine where the power is cut. Those areas where residents most objected to the power plant are the first to lose electricity.

Rather than devise and employ complex surveys, we should look for simpler market-based schemes that will combat NIMBYism. The fairest market-based system for land would involve land users not buying land outright, but paying a charge that varies, both up and down, when other people do things that affect the value of the land.

Under such a scheme NIMBYs who force a bad thing to go somewhere else would then suffer a higher charge, whereas the people coping the bad thing would be compensated with a lower charge. The scheme is fair and can be win-win. For example, rich people are prepared to pay for luxury land free of bad things, and poorer people are happy to live near some nasties, if they get the land cheaply. Under the ideal of such a scheme, the concept of a NIMBY practically ceases to exist, as govt becomes market-driven and strives to place all infrastructure in such a way as to maximise total land value.

The point of mentioning NIMBY's is that we have a problem. If selfish and/or stupid people buy land they will then exert political pressure to site value-reducing infrastructure elsewhere, and value-enhancing infrastructure nearby. NIMBYs are a significant factor in land use and so a solution is required. This could be an education scheme to reduce stupidity and selfishness, a wide-ranging land value charge, a complex survey system, or something else. But something needs to be done about NIMBYs.

## **Cemeteries**

Cemeteries are an appalling waste of land in my opinion. It is a disgrace that our society can allocate land for dead bodies to lie in, yet can't allocate land for young families to live on.

Personally I am dead against cemeteries, but I do not want my personal preference, or the preference of elites, forced on other citizens. The case of cemeteries is a good example to show how a market-based solution can be best and can equally reflect the preference of all people.

In a politically-based solution, elites would decide if we have graves or not. If the controlling elite liked graves then every dead body would have one and much land would be taken up, but if the elite disliked graves, no dead body would have one. This system does not reflect the preferences of all the living people in society. This system reflects the wishes of elites.

By contrast, a good market will demonstrably reflect the wishes of all people. In the cases of graves, a fair market would see graves used wherever people are prepared to pay the ongoing cost of tying up the land, and would see graves dispensed with where this is not the case. Under this true "chooser-pays" system some graves would exist, but society would not subsidise those who like graves at the expense of those who need land for other purposes.

A fair price to pay for grave land would be the equivalent rent for the land's best other use. For example, figure out what else the land should otherwise be used for, figure out its capital value and the rent is say 5% of this per year. If the relatives are happy to pay this amount per year then the grave stays, if not the grave goes. Pay up, or dig up.

The concept of buying a burial plot for eternity is absurd. If govt A 200 years ago took amount of money B from person C to allow body D to be kept on land E, then why should people today respect this arrangement and not reclaim the grave land E and put it to its best use now? A, C and D are long dead, and the money B paid by C to A is long spent and any benefits to society are no doubt long gone. I see no reason not to reclaim grave land if no one is prepared to pay for it on an ongoing basis.

If you think that people today should not be stuck honouring bad decisions made by govt planners long ago, then you will support the removal of cemeteries under this market-based scheme.

## **Undertaxed Offices, Overtaxed Trains**

Our cities have grown in such a fashion that large numbers of people must travel from the suburb where they live to the city office where they work. This would be well and good if it was the result of "chooser-pays" and fair market principles in action. Unfortunately it is not. The result is waste of resources such as workers' time, fuel, infrastructure, space and environmental resources.

The main problem is that govt will only zone office blocks in the city centre and not in suburbs. Developers have no trouble getting approval to jam more offices in the city, but councils don't allow high-rise offices in suburbs because they are out of character with a residential area. This is stupid. Electricity, water and phone can easily be connected anywhere, but workers are hard to transport in to the city. Offices should be near where the workers live, not congregated elsewhere. The idea that every residential area should be far from work areas is clearly an elitist scheme that reflects the wishes of elites, not the wishes of all people equally. Since at least some people want to work near their home, any half-decent market scheme would result in some workplaces near some homes.

*Another problem is that office site selection is not a chooser-pays system, but reflects the wishes of elites. Most corporate office sites are chosen by corporate elites, not by the many workers who must travel to work. The elites naturally want a prestigious city office near their prestigious city mansion. These elites don't care that most of their workers must travel long distances to somewhere they can afford to live. Our tax laws don't help either. The cost of the city office is tax-deductible to businesses, whereas the cost of travel to work is not tax deductible to workers. Our govt declares that the cost of travel from home to work is a private expense and is the fault of the worker for choosing to live so far away. This is nonsense. It is govt that zones the housing and offices. Govt forces the worker to travel from wherever he can afford to live, to wherever he can find a job.*

A solution to the tax problem is to transfer the cost of travel off the workers and onto the business elites who site the offices, or at least onto the shareholders who select these elites. The solution is to give workers tax deductions for travel in typical cases, and to pool the cost and transfer it to employers based on a special formula. The formula would not depend on the actual homeplace of an employer's workers, but would be based on a reasonable average distance needed to be traveled by an average worker on that pay rate. For example a business would be heavily taxed if it had many low-paid workers and its office was far from cheap housing. Conversely a high-paying company could site its office anywhere, and a business near cheap housing would not be taxed even if some workers came from afar. This system would be a better market that better reflects the wishes of all people.

I stress that this tax scheme would not be part of the best market-based society, and should only be used in a crisis situation such as Sydney. In time a market-based land use scheme would see successful businesses starting in new towns and cities. But in the interim, tax schemes such as this could encourage some existing businesses to make the move before they otherwise would.

### **Transition Dwelling Permits**

Currently govt has restricted house building permission so much that the value of building permission has risen enormously. Because of this, whenever govt grants permission for an extra dwelling it is equivalent to a \$300,000 windfall to the developer (just to put a figure on it) of which the govt claws back perhaps \$150,000 in taxes. Now the real solution is to increase the number of dwellings approved and hence bring this windfall right down. In the interim however there is another way of operating. We could issue every 20 year-old who has grown up in Sydney with a "Half Sydney Dwelling Permit". This HSDP could be combined with a 2nd HSDP and used to get automatic dwelling permission on any land in Sydney. It would work like this.

Under the old system a farmer might ask govt for subdivision permission and if he gets it, he gets the \$300,000 windfall per extra dwelling. If the subdivision is rejected then the farmer gets nothing. Under the interim system, a young couple with two HSDP's could approach a farmer and offer him say \$150,000 for a chunk of land without dwelling permission. The couple then provides the permission via the HSDP's. What this means is that the landowner gets less money and the young families pay less money, and govt gets less control over subdivision. The windfall is effectively split between buyer and seller, instead of seller and govt. Young Australians could be given this HSDP's whereas immigrants would not be. This would help correct the situation where rich immigrants are coming in and pricing young Australians out of housing. Of course young Australians could sell their permits to rich immigrants and leave Sydney. But then at least that would be their choice and they would get something for being forced out of their home city.

Of course there are many issues to be resolved with this scheme and it should only be used as an emergency interim measure until the massive increase in dwelling permits can occur and bring down the price of housing in Australia.

### **Rezoning Based on Distance to CBD**

One way to rapidly get more dwellings permitted would be an automatic system that sets a minimum house block size depending on distance from the city centre. This would give approval for large blocks near the city to be divided into small blocks, and acreage more distant from the city to be divided into several large blocks.

To avoid a flood of extra dwellings we would attach a large fee onto any subdivision occurring under this scheme. This way landowners in a hurry to subdivide would provide some extra dwellings and big payments to govt, and more greedy or patient landowners could wait to get approval under the other scheme.

### **Final Notes**

This has not been the shortest article I have ever written, and I thank any readers who have made it all the way through.

During this article I chose to make harsh criticisms of various people and take on a slightly moralistic tone. I crossed the line between coldly explaining how things work, and telling you how I feel about it. I made this choice to help get my point across. However there is another less judgmental way of looking at things which I want the reader to be aware of.

I have said that politicians are bad, town planners are bad and incompetent, and many people are morons. In a sense this is wrong. Firstly people will think the way they think and in a sense "have a right" to think this

way. If a person thinks and votes one way and is happy with the result then who am I to say it is wrong and they are a moron?

On the subject of politicians it is definitely true that politicians will do, and must do, whatever is necessary to get votes. After an election we are left with only the politicians who did this. Therefore it is a bit unfair for me to criticise a politician who is simply doing and saying what voters require him to do and say. It is not the job of politicians to run the place to my satisfaction or to plan the city well, or provide any service such as trains, water or electricity. It is the job of politicians to do whatever the majority of voters want. If the majority of voters is determined to vote for a big-talking liar who will promise all, bankrupt the country and start a war, then this is precisely his job once he is elected. It is perhaps improper for me to criticise him for doing it.

It is a bit unfair for me to criticise town planners. I said that govt planner have "failed", but this is not correct. They have failed to do **what I want**. But they have succeeded in doing what pleases them, they have done whatever they wanted to do. That's success. Town planners do not have the job of planning the town to please me. Their job is to do whatever pleases their bosses, the politicians and the underlying voters. Sydney's town planners have been very successful in pleasing their bosses and being paid a lot for it. Sydney politicians have been very successful in getting votes and a lot of money for themselves. I congratulate them all.

*It is a bit unfair for me to criticise the majority of voters. The majority of voters has been very successful in getting the govt they vote for. We do have a democracy, which suits the majority. I am in the minority and I don't approve of your choices but I congratulate you on your success majority. Enjoy your democracy and your chosen government.*