Australia's Rent-Seeking: Anatomy of a Depression?

THE AGE TUESDAY 1 DEC 1992 P12

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<u>ECONOMIC FORECASTS:</u> Although accurate forecasting is the test of any valid scientific explanation, it is not a characteristic one relates to the study of economics. Treasury's latest econometric model "TRYM" conjures up its m^{th} try to find out what is happening to the Australian economy. If TRYM does not integrate the productive and speculative aspects of the economy, it is also doomed to failure.

There is absolutely no evidence that federal Treasury, the Reserve Bank, nor business analysts bothered to quantify the funds that flowed into real estate throughout the 1980's. They majored on figures and indices on the productive side of the economy, but had no interest in the destructive figures on the speculative or rent-seeking side.

The late doyen of the Australian property valuation profession, Dr John Murray, saw this blind spot in economics, saying:

"Valuation is the most important subject in the social sciences, but it has always been outside the scope of economics as taught in the universities .... a re-integration of the theory of valuation with the main body of economic theory would lead to an advancement of learning and to a soundly-based national economy." [1]

One body which did take in the whole picture was able to forecast major economic recession from 1991 - in a submission to the Economic Planning Advisory Council (EPAC) dated as early as 1 May 1984. [2] Whilst EPAC still tries to fathom what has happened to the economy, the lonely and unsophisticated submission presumably moulders within its own archives.

The following details, collated by the Land Values Research Group, reinforce Dr Murray's opinion and show that escalating land prices act, even more than taxes, to divert capital and thereby curb effective demand and productive investment - with corresponding implications for economic activity and employment.

THE FIGURES:

Aggregate Sales and Values of Australian Real Estate

FIN. YEAR	SALES (1)	No. SALES	TOTAL VALUES (2)
1984	$36,338,617,503	556,145	$464,792,311,695
1985	$38,445,314,898	536,136	$520,573,620,600
1986	$42,308,078,259	513,473	$553,869,594,512
1987	$50,020,185,622	514,932	$639,548,486,280
1988	$77,003,258,965	654,106	$785,884,232,799
1989	$87,709,069,753	661,503	$1,021,427,550,000
1990	$65,454,422,569	486,412	$866,665,800,000
1991	$61,992,604,105	490,267	$824,670,000,000
1992 (est.)	$57,000,000,000	-	$715,000,000,000

Mean Break-up of Sales by Value :-

NSW	40%	SA	6%
Vic	25%	Tas	1.5%
Qld	16%	NT	0.5%
WA	10%	ACT	1.0%

TABLE A

The most outstanding thing in connection with the total volume of real estate sales (Table A) is that it doubled between 1986 and the peak in 1989 at $87.7 billion. Total values did not quite double, but they rose 1.84 times in the same period: and they rose to a significant figure. We are not used to the word "trillion" in Australia, but we reached $1.021 trillion in total real estate values in 1989. That is, one million million dollars, or $\$10^{12}$. Average turnover was just in excess of 8% of the total value of real estate each year during this period.

Following the collapse, a figure equivalent to one year of the national income has been written off the value of Australian properties.

Furthermore, due to massive levels of private debt accompanying the boom, it seems that the market will continue to decline for a number of years yet.

On average, New South Wales accounts for 40% of Australian real estate sales by value - a surprisingly high rate considering its population relative to Victoria. Prima facie, this apppears to indicate higher private debt levels in New South Wales.

Chart 1 is a more interesting representation of the figures, together with Australian sharemarket sales (ASX) for comparison. Viewed together, this has become known as the '80's "asset boom". Both markets were irrational and ultimately unsustainable. They were encouraged by a tax system which scarcely interferes with rampant speculation, yet levies a myriad of fines upon productive activity.

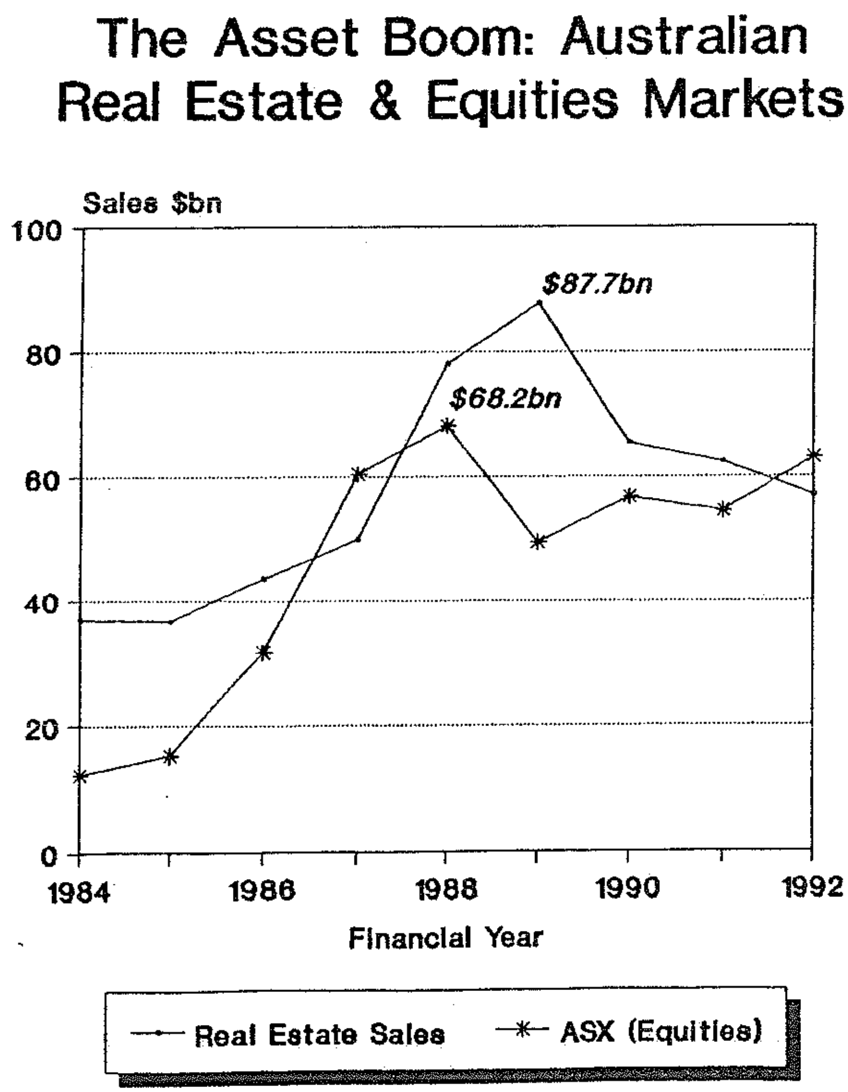

CHART 1

The speculative binge is comparable to those of the 1880's and 1920's, and the sales "bubbles" which burst are clearly evident. Between 1986 and 1989 we sank $469.2 billion into both markets. This was equivalent to 51% of our national income for the same period.

Unlike the 1920's, the sharemarket "went" first. There was a 550% increase in the volume of sharemarket sales in the 3 years to the peak at $68.2bn in 1988, and a lesser increase of 240% in real estate for the 4 years to its peak at $87.7 billion.

The shape of the two graphs is remarkably similar, because there is a closer relationship between the two markets than is generally admitted - much of the value of shares being underpinned by real estate. One market tends to feed off the fortunes of the other until a "correction" is made. For example, the ASX actually outdid the property market in the financial year before the October '87 "bust", which then reinforced the property market. Shares have surpassed real estate sales again in 1992, capitalising to about one third of the real estate market - when they are more traditionally no more than one quarter. This is suggestive of the future direction of the stockmarket when it factors the property collapse back into the value of shares.

Both the share and property markets perform valuable roles, but neither are well served by such periods of mindless speculation.

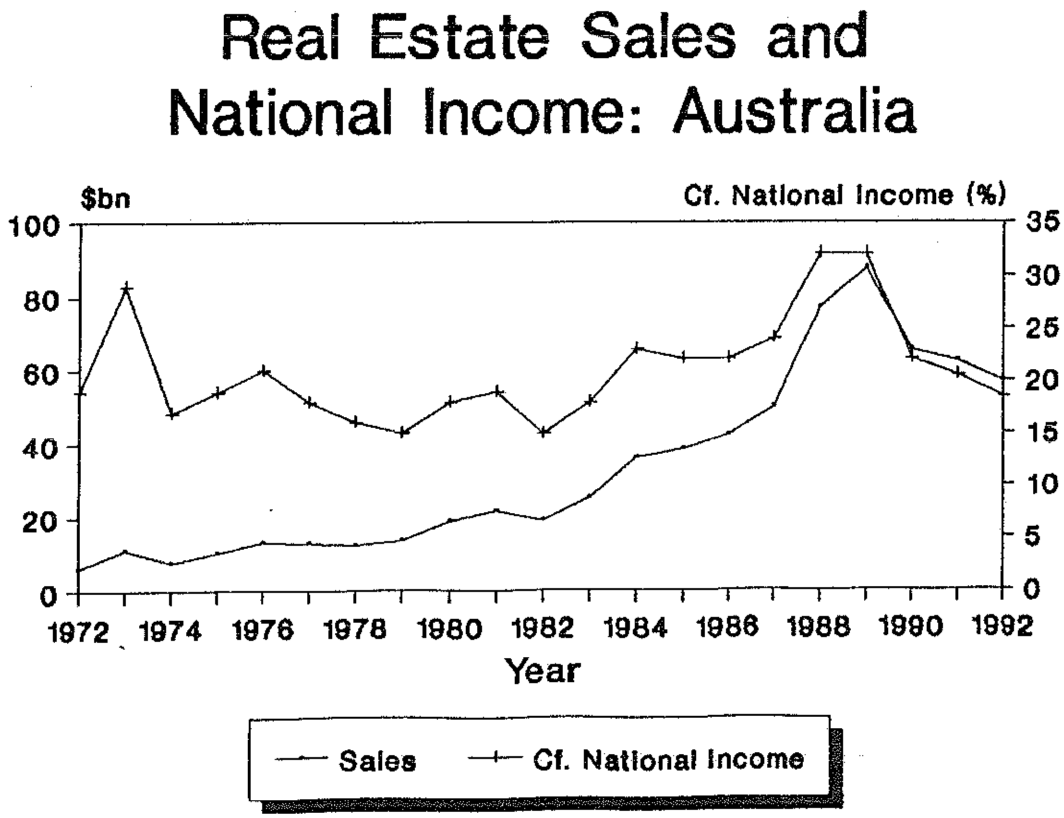

CHART 2

As Victoria's real estate transactions are comprehensively recorded by the Valuer-General's office since 1972, it is possible to extrapolate sales for Australia back to that year, using the fairly consistent nexus of 25% that exists between Victoria and the whole of Australia. They are shown in real terms at Chart 2 against national income, for comparison.

Real estate sales moving up from less than 20% as against national income to 30% at the peaks of land booms tend to confirm that speculative periods are at the expense of national productivity. So, contrary to popular mythology, it seems healthier for the prospects of the general economy when real estate prices are flat, or down - as they are now.

Empirically, it seems a good indicator that we are on course for difficult economic times when real estate sales go beyond 25% as against national income, as they did in 1973 (29%) and also in 1988 and 1989 (32%) .... or, where the number of sales gets beyond 500,000, as in 1973, and from 1984 to 1989:

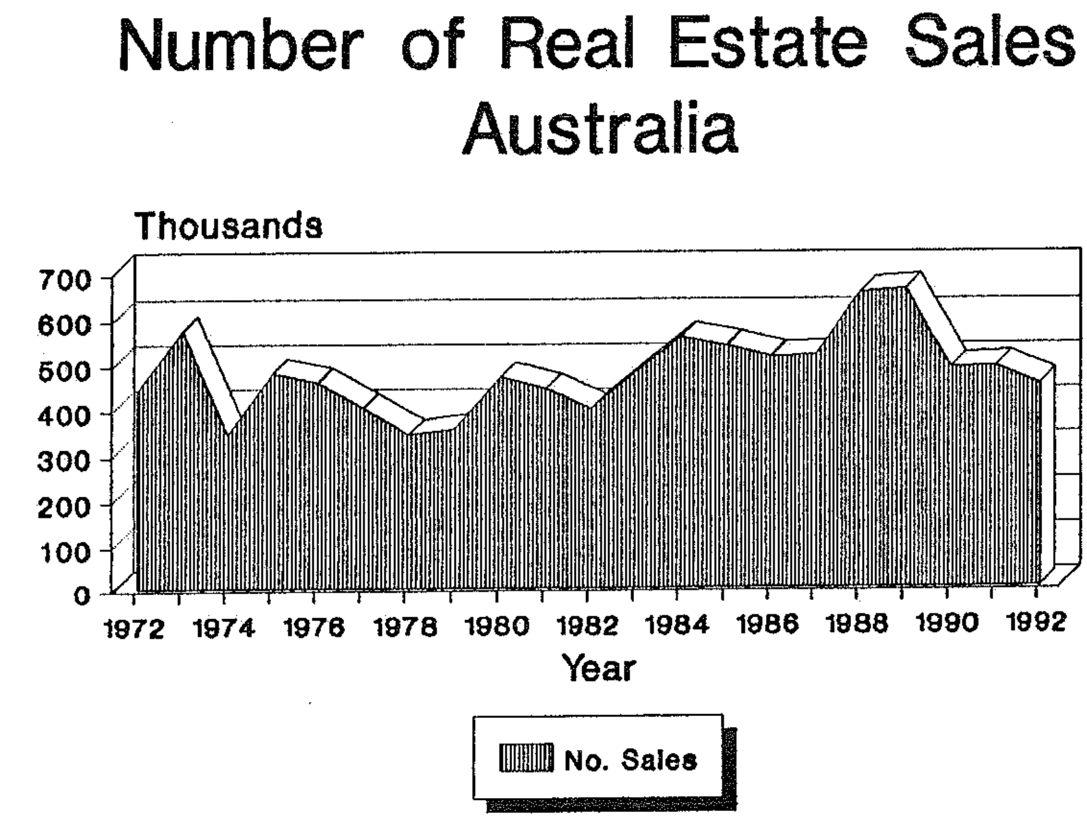

CHART 3

The similarity of shape of the *value* of sales as a percentage against national income (Chart 2) and of the graph for *number* of sales (Chart 3) shows the value of sales to be extremely numbers-sensitive. This would appear to be worthy of further investigation, in order to see if a formulaic relationship can be established between number and price.

As ever, the dynamic in the property market was the land component. Chart 4 shows that land prices grew even more quickly against national income than they did as a proportion of total real estate sales:

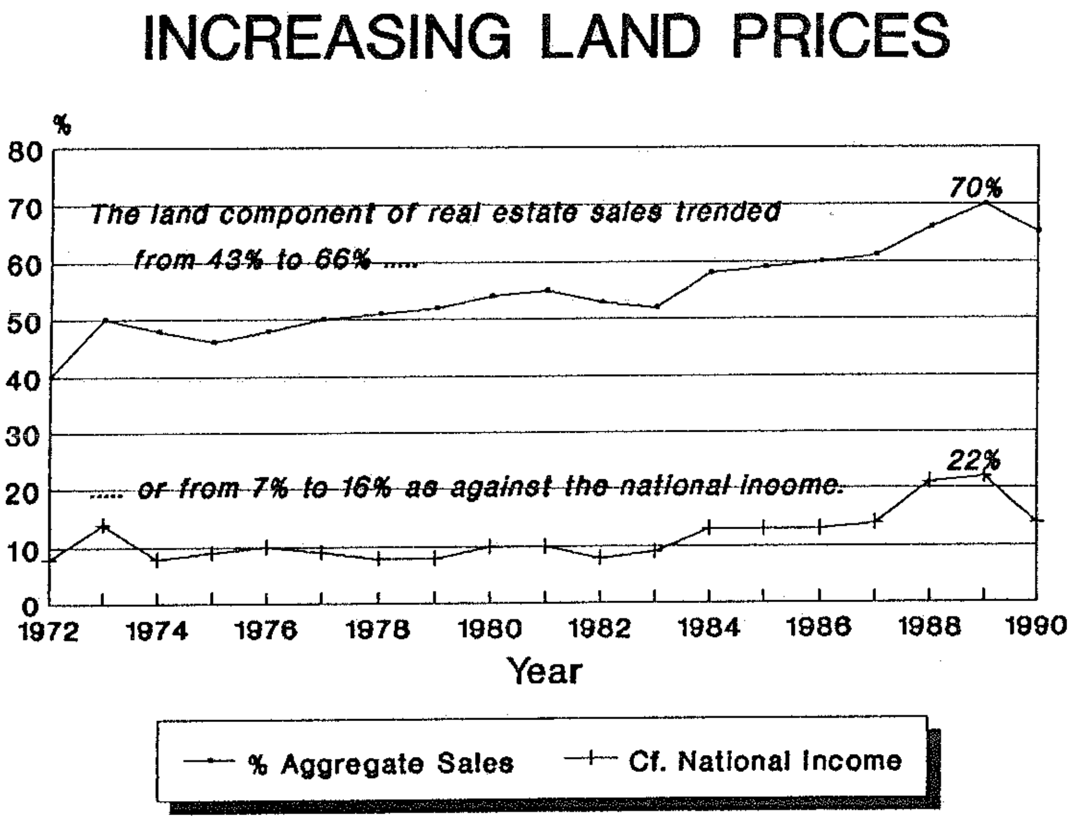

CHART 4

<u>CONCLUSIONS</u>: Chart 5 gives the whole picture, back-indexed for inflation in terms of the 1972 dollar - so that we have consistent comparison; it is arguably the ultimate economic indicator. We can see immediately that the '90's will be no simple recessionary period:

Australian Real Estate Sales As an Economic Indicator

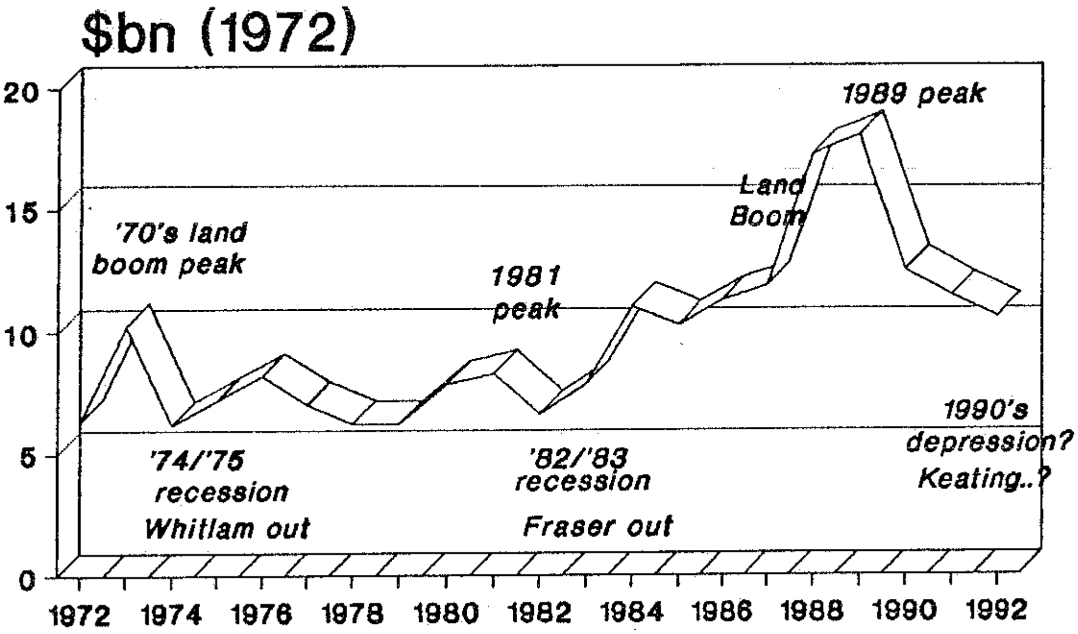

Chart 5

What are the implications of these figures for public policy, then?

Would Mr Keating have re-introduced "negative gearing" in August 1987, thereby adding fuel to the inferno, if Treasury had this data?

Could he have said, as he did as late as June 1989, that the flow of funds through the late '80's was largely the gearing up of our capital stock?

Where has the Reserve Bank been without the critical information that these statistics contain?

The figures show the process by which capital has been highjacked for the purposes of speculative rent-seeking in real estate. The sheer extent to which capital investment has suffered as a result, appears to lay bare the anatomy of a depression.

The two hundred years since the industrial revolution has shown consistently that every economic recession and depression is preceded by a land boom.....but to date we have chosen to ignore this rather obvious fact.

U.S. ECONOMIC & POLITICAL CYCLES

Land Boom Peak	Building Cycle Peak	Economic Recession	Political Upheaval
-	-	-	1788
1818	-	1819	1824
1836	1836	1837	-
1854	1856	1857	1860
1872	1871	1873	-
1890	1892	1893	1896
WW I	1916	1918	-
1925	1927	1929	1932
WW II interupts cycles			
1955	-	-	-
1972	1973	1974	-
1989	1990	1992	1996*

* *Economic Intelligence* prediction [3]

TABLE B

Although Table B provides US dates, they are very similar to those of Australia. [3] We could perhaps note that the mid to late '50's property boom in Australia was brought to a halt by the '61 "credit squeeze". Similarly, the events of 11 November 1975 attest to political upheaval in Australia in the wake of the '74 recession.

By continuing to blame a passing parade of politicians and entrepreneurs for the cycles of recession and depression, we grab at the sensational and miss underlying causes.

Unless valuers and economists combine to study the "invisible" half of the economy, in order to establish what is happening to the rent of our natural resources, our chance of regulating the Australian economy seems to be on a par with King Canute in controlling the tides. At the threshhold of the 21st century, we remain in the dark ages in economic terms.

There is no better time to cut taxation and take a greater part of the economic rent of our natural resources, in order to reduce speculative proclivities and return people to work. However, political inertia and a lack of awareness at the grass roots of the process described, still provide major stumbling blocks.

British property developer and foreign exchange dealer, Ronald Banks encapsulated the current world economic situation most succinctly: "The time has now come to retrieve the theory of rent from its obscurity, and to re-affirm the role of nature in the destiny of mankind". [4]

If we wish to break the socially devastating cycle of speculation and economic depression, he is decidedly correct.

References

1 *Murray, JFN, Valuation And The National Economy, Connecticut, USA, John C Lincoln Institute, 1967, p.2.*

2 *Association for Land Value Taxation, submission in connection with 1985 National Tax Summit, 1 May 1984*

3 *Economic Intelligence # 31, Centre For Incentive Taxation Newsletter, London, March 1992.*

4 *Banks, R, (ed) Costing The Earth, London, Shepheard-Walwyn, 1989, foreword p.x.*

Other Sources

(1) Property sales data:

Office of State Revenue, New South Wales
Office of the Valuer-General, Victoria
Department of Lands, Queensland
Office of Titles, Western Australia
Land Titles Office, South Australia
Commissioner of Stamp Duties, Tasmania
Valuer-General, Northern Territory
Land Information Office, ACT

(2) Land values data:

Commonwealth Grants Commission reports

Other:

Australian Stock Exchange Limited Annual Report 1991-92

National Accounts - Australia

ABS: CPI All Groups Time Series Report

(1) AGGREGATE OF ALL AUSTRALIAN REAL ESTATE SALES

STATE OR TERRITORY	1984 Sales	No. Sales	1985 Sales	No. Sales	1986 Sales	No. Sales	1987 Sales	No. Sales	1988 Sales	No. Sales
New South Wales	$15, 300, 000, 000	180000	$16, 000, 000, 000	170000	$18, 000, 000, 000	171000	$20, 000, 000, 000	165000	$28, 000, 000, 000	160000
Victoria	$9, 202, 013, 385	145822	$9, 129, 984, 958	127322	$10, 894, 619, 454	128134	$14, 063, 733, 064	130703	$21, 793, 298, 279	184214
Queensland	$5, 680, 787, 984	104107	$6, 149, 911, 467	101486	$5, 539, 493, 376	82706	$6, 645, 573, 669	84846	$12, 856, 918, 856	142093
West Australia	$2, 880, 951, 735	60216	$3, 558, 875, 261	70458	$3, 672, 593, 498	62770	$4, 502, 618, 587	65578	$7, 056, 264, 263	88194
South Australia	$2, 000, 000, 000	40000	$2, 132, 000, 000	41000	$2, 520, 000, 000	42000	$3, 008, 261, 848	43154	$4, 941, 174, 401	49710
Tasmania	$648, 000, 000	18000	$702, 000, 000	18000	$825, 359, 812	18863	$905, 853, 333	18017	$1, 163, 564, 639	20341
Northern T'ry	$236, 864, 399	2000	$305, 043, 212	2400	$324, 012, 119	2400	$252, 405, 121	1800	$297, 558, 527	2100
Aust Cap T'ry	$390, 000, 000	6000	$467, 500, 000	5500	$532, 000, 000	5600	$641, 740, 000	5834	$894, 480, 000	7454
TOTAL R/E SALES	$36, 338, 617, 503	556145	$38, 445, 314, 898	536166	$42, 308, 078, 259	513473	$50, 020, 185, 622	514932	$77, 003, 258, 965	654106
EST. LAND COMPONENT	$21, 076, 398, 152	58%	$22, 682, 735, 790	59%	$25, 384, 846, 955	60%	$30, 512, 313, 229	61%	$50, 822, 150, 917	66%

STATE/TERRITORY	Mean	% Sales	Mean	% Sales	Mean	% Sales	Mean	% Sales	Mean	% Sales
New South Wales	$85, 000	42.10%	$94, 118	41.62%	$105, 263	42.55%	$121, 212	39.98%	$175, 000	36.36%
Victoria	$63, 104	25.32%	$71, 708	23.75%	$85, 025	25.75%	$107, 601	28.12%	$118, 304	28.30%
Queensland	$54, 567	15.63%	$60, 599	16.00%	$66, 978	13.09%	$78, 325	13.29%	$90, 482	16.70%
West Australia	$47, 844	7.93%	$50, 511	9.26%	$58, 509	8.68%	$68, 661	9.00%	$80, 008	9.16%
South Australia	$50, 000	5.50%	$52, 000	5.55%	$60, 000	5.96%	$69, 710	6.01%	$99, 400	6.42%
Tasmania	$36, 000	1.78%	$39, 000	1.83%	$43, 755	1.95%	$50, 278	1.81%	$57, 203	1.51%
Northern T'ry	$118, 432	0.65%	$127, 101	0.79%	$135, 005	0.77%	$140, 225	0.50%	$141, 695	0.39%
Aust Cap T'ry	$65, 000	1.07%	$85, 000	1.22%	$95, 000	1.26%	$110, 000	1.28%	$120, 000	1.16%

(2) AGGREGATE OF ALL AUSTRALIAN REAL ESTATE VALUES

STATE/TERRITORY	Total Land Values		Total Land Values		Total Land Values		Total Land Values		Total Land Values	
New South Wales	$109, 000, 000, 000	44.48%	$119, 078, 600, 000	42.65%	$127, 450, 700, 000	42.19%	$156, 280, 600, 000	44.06%	$224, 486, 700, 000	47.61%
Victoria	$60, 123, 000, 000	24.53%	$73, 834, 000, 000	26.44%	$82, 609, 200, 000	27.34%	$98, 444, 800, 000	27.75%	$123, 571, 900, 000	26.21%
Queensland	$31, 373, 000, 000	12.80%	$33, 723, 300, 000	12.08%	$35, 551, 900, 000	11.77%	$38, 472, 700, 000	10.85%	$48, 909, 000, 000	10.37%
West Australia	$17, 456, 100, 000	7.12%	$20, 974, 800, 000	7.51%	$22, 593, 400, 000	7.48%	$25, 213, 900, 000	7.11%	$34, 915, 800, 000	7.40%
South Australia	$19, 386, 000, 000	7.91%	$22, 818, 000, 000	8.17%	$24, 222, 800, 000	8.02%	$25, 634, 900, 000	7.23%	$27, 672, 400, 000	5.87%
Tasmania	$3, 365, 100, 000	1.37%	$3, 750, 100, 000	1.34%	$4, 022, 100, 000	1.33%	$4, 328, 400, 000	1.22%	$5, 114, 800, 000	1.08%
Northern T'ry	$1, 369, 100, 000	0.56%	$1, 577, 000, 000	0.56%	$1, 661, 300, 000	0.55%	$1, 804, 500, 000	0.51%	$1, 753, 400, 000	0.37%
Aust Cap T'ry	$3, 000, 000, 000	1.22%	$3, 447, 000, 000	1.23%	$3, 999, 300, 000	1.32%	$4, 553, 400, 000	1.28%	$5, 106, 700, 000	1.08%
TOTAL LAND VALUES	$245, 072, 300, 000		$279, 202, 800, 000		$302, 110, 700, 000		$354, 733, 200, 000		$471, 530, 700, 000	
add 10% non-ratable land	$269, 579, 530, 000		$307, 123, 080, 000		$332, 321, 770, 000		$390, 206, 520, 000		$518, 683, 770, 000	
STATE/TERRITORY	Est. Total Improved Values		Est. Total Improved Values		Est. Total Improved Values		Est. Total Improved Values		Est. Total Improved Values	
New South Wales	$206, 724, 146, 200		$222, 022, 049, 700		$233, 659, 607, 320		$281, 758, 293, 740		$374, 144, 372, 791	
Victoria	$114, 026, 383, 871		$137, 663, 493, 000		$151, 450, 193, 942		$177, 486, 129, 920		$205, 953, 098, 643	
Queensland	$59, 500, 519, 621		$62, 877, 092, 850		$65, 178, 480, 726		$69, 362, 430, 630		$81, 514, 972, 285	
West Australia	$33, 106, 397, 876		$39, 107, 514, 600		$41, 421, 231, 676		$45, 458, 140, 310		$58, 192, 980, 214	
South Australia	$36, 766, 553, 195		$42, 544, 161, 000		$44, 408, 464, 890		$46, 217, 161, 210		$46, 120, 650, 986	
Tasmania	$6, 382, 086, 462		$6, 992, 061, 450		$7, 373, 849, 705		$7, 803, 672, 360		$8, 524, 663, 768	
Northern T'ry	$2, 596, 569, 069		$2, 940, 316, 500		$3, 045, 716, 545		$3, 253, 333, 050		$2, 922, 332, 340	
Aust Cap T'ry	$5, 689, 655, 400		$6, 426, 931, 500		$7, 332, 049, 707		$8, 209, 324, 860		$8, 511, 163, 773	
EST. TOTAL IMPD VALUES	$464, 792, 311, 695		$520, 573, 620, 600		$553, 869, 594, 512		$639, 548, 486, 280		$785, 884, 232, 799	
% SALES to VALUES	7.8%		7.4%		7.6%		7.8%		9.8%	

Shaded areas designate estimated figures