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Housing Interest Rates

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Seventeen per cent is a high housing mortgage rate, but some commentators are predicting that it will go even higher. They say that interest rates are the only shot left in the Federal Government's locker---the only way to prevent the A$ free falling. That is true only if abandoning "The Accord" and slashing government expenditure are ruled out of contention.

Certainly, an unwise, and I believe improper, deal with the trade unions and sclerotic over-regulated industry together leave the Hawke Government with few options. Worse, the option it has chosen, monetary policy, is at least partly self-defeating.

Attempts by various Ministers to blame the bank's and other financial intermediary's profits for current high housing rates are dishonest. Banks' returns on shareholder's funds are in fact well below the average for the decade---no doubt reflecting the healthier competition which has followed deregulation. Their profits are not big enough for any likely pruning of them much to reduce the cost of money. And, if the price of money were to come down, Mr Keating would, in line with government policy, screw it back up again. So, in the interest of serious discussion of a serious problem, let us have an end to the hypocrisy.

The problem is simple; the solution is not. Our economy is not very productive because we are not investing enough capital and human effort in producing the goods and services needed to support the lifestyles we enjoy. More specifically, over-reliance on direct taxation, government monopolies, exceptionally high trade barriers, labour market regulation, agricultural produce market regulation, transport market regulation and so on, prevent the free exchange of goods and services. These measures prevent meaningful rewards for providing what is wanted and punishments for providing less. It is not our genes but our culture that is at fault. Or put another way, our rules are the wrong rules for a highly productive society.

The thesis may be tested by watching the progress of our East Asian migrants. They come here with attitudes to work and investment which prevent the current account being even worse.

In time, however, they too become corrupted by perverse incentives---they become as hedonistic as the rest of us.

Even if it were to try as hard as it should, the government probably can not now raise productivity quickly enough to cope with the problem of mounting foreign debt. Therefore, the government is trying to reduce consumption. It is, however, pushing water uphill so long as consumption is encouraged by the wages and tax deal and indexed social service payments.

By using high interest rates the government hopes to dampen down the economy---that is to say, it hopes to induce a mild recession. Such tactics require nice judgement and there is some doubt whether the recession, when it comes, will be mild.

A recession will weed out the least profitable enterprises but, because of government regulation, these are not necessarily the least efficient. There is another reason why, in the long run, monetary policy alone may not reduce the foreign debt or even give us breathing space. High interest rates or something else do seem to have increased domestic savings a little, but even more they have attracted foreign savings which have, in turn, kept the A$ high. A high dollar has reduced the competitiveness and profitability of the very industries which must produce the traded goods needed to service the foreign debt--Catch 22!

High interest rates reduce consumption only to the extent that savings increase. For every borrower there is a lender and lenders, instead of investing more, may well spend their extra dollars on consumables. Lenders tend to be poorer and older than borrowers, but have fewer family obligations. High interest rates tend to transfer spending power from home buyers to superannuants.

Don't home buyers, then, deserve a break? It is not a question of deserts but imperatives: the break must go to producers of tradeable goods. Even though home buyers pay 17%, the businesses which earn foreign exchange pay even more. Compared with the rates paid on investments in mines, farms and factories, the interest rates paid by home buyers are, almost certainly, too low. This differential, to the extent that it is artificially maintained, diverts investment from extra lathes to extra bathrooms.

The housing sector is the most politicised substantial part of the Australian economy. It is always said to be in crisis; always participating in political gimmicks, such as the recent Housing Summit; and always deciding elections. Yet, as Bill Cole points out in the recent AIPP paper, "Housing Policy", the real value of housing construction grew by 3.7% annually from 1959-60 to 1987-88. If the manufacturing, rural and mining sectors had grown as fast, it is safe to say that, if we were suffering a balance of payments crisis, we would be suffering it from a much higher living standard.

The abnormally high growth in the Australian housing stock, which has been much more than the growth in population, has not provided houses for the once unhoused poor. There were no more unhoused poor in 1969 than now---probably fewer. Instead that growth represents games rooms and sun decks for the already well-housed rich and it reflects government policy.

Cole tells us that government policies have favoured tenants in public housing over poorer private tenants; and first-home buyers over those who cannot seriously aspire to home ownership. Those who contracted a housing loan borrowed before April 1986 are being subsidised by those who borrowed more recently. Investment in something as useful in the present circumstances as a mine is subject to capital gains tax, whereas investment in most homes is not. Enjoyment taken in the form of wages or investment income is taxed, but the rental value of one's own lived-in home is not. With these incentives it is no wonder that investment in housing has grown faster than in almost everything else.

If you can find a politician who says he is about to do something to reverse the subsidy which mines, farms and factories pay to houses, vote for him---you just might have found Diogenes' honest man and he will need your vote.

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