Can the continual boom / bust of the financial and real estate markets be considered sustainable development?

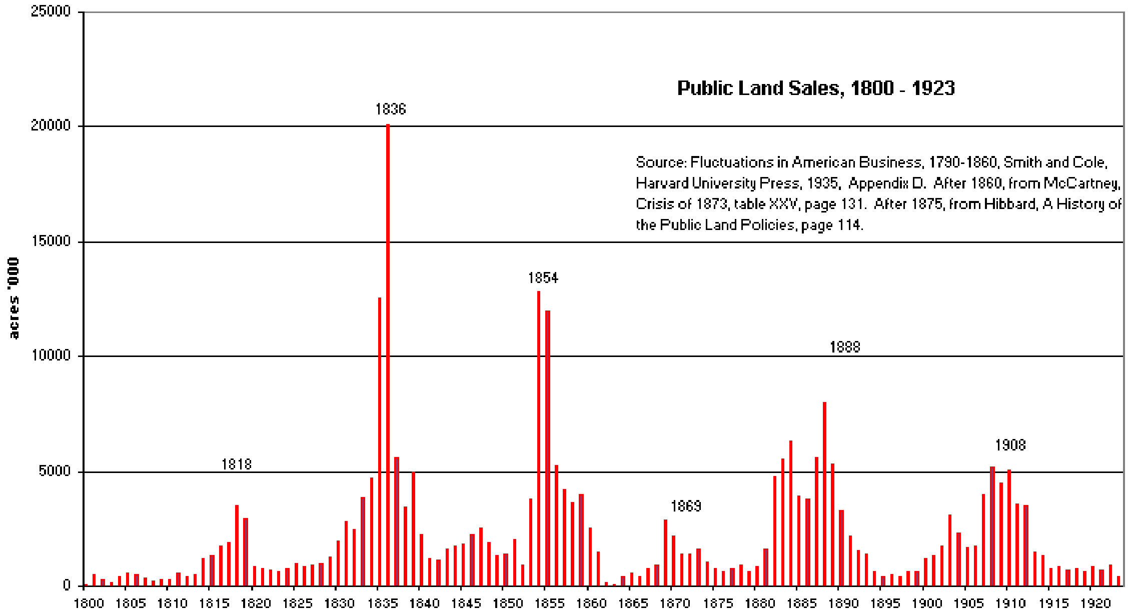
Phil Anderson, Director, Economic indicator Services Ltd.

"The US began selling off its real estate, officially, under a set legal structure, on May 10th, 1800. After that, here is what happened:

1818, a peak in land sales, followed by a downturn; in 1836, sales peaked again, ending in a depression; the next peak, in 1854, was followed by a depression; the 1869 peak was also followed by depression, likewise in 1888. The downturn following the 1908 peak was cut short by the build-up to the First World War, and real estate peaked again in 1926, followed five years later by what is today judged the world's worst ever depression. A construction-led boom (mainly government financed) peaked in 1944; the ensuing downturn was cut short by rebuilding after the destruction of the Second World War..

In other words, for the first 144 years of real estate enclosure in the US, land sales and / or real estate construction peaked almost consistently, every 18 years.

Since the Second World War and once the US economy finally shrugged off the distorting affects of all the dislocation wrought by the war, the rough 18-year cycle reasserted itself with some vigour. The final years of this first decade of the 21st century will mark the passage of another cycle, 18 years from the trough of the previous one in 1992. So far there is little evidence that anything has changed to prevent yet another housing-related downturn, then recession. Should history repeat itself, we can expect the next trough around 2010."



So wrote the presenter to his business subscribers in 2002, and something that now forms the introduction to his latest (2008) publication, *The Secret Life of Real Estate: How it Moves and Why*.

Today's economists delight in recalling the Dutch tulip mania of 1636, the South Sea bubble of the 1720's, and in more recent times the internet investment bubble of the 1990's, because it involved colourful characters in what turned out to be awesome booms that turned quickly to bust. These were, however, random events, responses to either luck (such as the alleged discovery of gold) or invention (money-making schemes of quite incredible imaginations). They could not have been predicted using the standard tools of the economist.

The financial crisis that broke in 2007, and all the previous real estate induced collapses, are different. These crises are pre-determined by the structure of the economy. Such collapses are NOT a market failure: they are actually proof that the monopoly capitalist system is working, and working well. The instability of the capitalist system is inbuilt into the DNA of the economy. The process is underpinned by the enclosure of the economic rent, a concept first formalised by English economist, David Ricardo.

Ricardo's Law of Rent states, simply, that the economic rent is not a cost of production. A house costs pretty much the same to build, wherever you build it - wages are the same, and materials costs are the same. But the selling price will depend on the location. So builders, for example, will bid more for the best locations. That money doesn't go to the workers building the house, and nor is it spent on improving the materials used. It purely benefits the owner of the land. This bid is what Ricardo was first to identify as a 'surplus': the economic rent. Property investors know it today as locational value.

Wherever a price is put on this locational value of land, a property cycle will develop as speculators and companies chase land prices higher and higher, reducing the proportion of wealth being invested in creating jobs and investing in productive businesses. This cycle is beyond the control of central banks. The enormous credit created by banks based upon this value now gives us the violence of the property boom, then bust. This cycle has so far manifest clearly in 14 years of rising prices, then four years declining.

It runs like clockwork: http://www.businesscycles.biz/business24.htm , a clock I created some years ago to help guide my own investments through the cycle. From the 1955 land price low in most Western 'rent-enclosed' economies (i.e. where land is privately owned), the 18-year cycle has been exact: 1955 to 1973/4, to 1991/2 and now to what will most assuredly be another property low in 2010.

The current banking problems at the end of yet another 18-year real estate cycle are certainly nothing new. It is amazing to witness how quickly investors forget the previous banking panics, as land prices began to deflate. In October 1973, the collapse of the US National Bank of San Diego was the biggest in 40 years. The bank collapsed because of the activities of its major shareholder, C. Arnholt Smith, chief fund-raiser for Richard Nixon and a major real estate speculator in southern California. As Californian commercial land prices plunged, the bank could not recover its lending losses.

An even bigger bank failure, that of the Franklin National Bank of New York, followed twelve months later, in October 1974, for similar reasons; declining property (land) prices. The Fed chairman at the time, Arthur Burns, when asked by a Newsday reporter what stopped the world financial system from imploding after the massive failure of Franklin bank, replied: "Luck, more than anything. We were sitting on a volcano. People were concerned in this country, but they were really scared abroad. We can't let it happen again, because we might not be so lucky the next time."

The 'next time' arrived right on cue, one cycle later with the implosion of the US banking system in 1990, led by the Savings and Loans institutions: lending against (the now declining) property prices again being the problem. Said one staff member of the Senate Banking Committee enquiry at the time, set up to make sure a banking crisis would never happen again: "'This (banking) industry is very close to the heart of the American economy. We teetered on the edge of a major, major problem here… we teetered on the edge of a major collapse … You know, all these [financial] industries could bring down the whole economy!"

Yet we never seem to learn. The continual boom and bust economics, the attendant loss of jobs, the suicides of those who went too deeply into debt and no longer thought it worth living, the societal depression when so many workers can no longer afford lodgings... can hardly be considered sustainable development.

In 1900, after the terrible depression of the 1890's – a depression that remains probably the worst the capitalist world has ever seen – Australia's politicians learned that it didn't actually have to be this way. More important, they knew exactly what was required to stop the continual boom / bust economics, with the building of Australia's new capital city to provide the ideal grounds upon which to prove it.

Upon Federation (1901) neither Sydney nor Melbourne would consent to the other becoming the capital. For a while after 1901 the two cities agreed to rotate the responsibilities and take turns seating the elected parliamentarians to govern the country until a new capital could be built somewhere in between. The elected leaders were well aware of what an announcement (or fore-knowledge of such an announcement) would have on land value in the chosen region as land speculators piled in for a quick profit from the rapidly appreciating locational value, or economic rent. To defeat them, Australia's first Prime Minister, Edmund Barton, declared that:

> So far as the law of the land allows, land within the federal area will not be sold. Its ownership will be retained in the Commonwealth. The land will be let for considerable terms but with periodical re-appraisement so that the revenues thus obtained will assist the cost of creating the Commonwealth Capital. More than that, we shall take care to put no fancy prices on land. We shall not play into the hands of the speculators …
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> *Sydney Morning Herald*, January 18, 1901

An annual rent of not less than 5 per cent of the unimproved value of the land, as assessed by an appropriate authority, was eventually prescribed for all persons who wanted to live and work in the new capital, payable quarterly in advance. The unimproved value of the land was to be reappraised at the expiration of twenty years, and thereafter at ten-year intervals. With such a simple and elegant idea, Australia went on to build the city of Canberra, truly one of the world's most spacious and amenable of capital cities.

So, if you decided to move to Canberra and the site you intended to own was appraised as worth $1,000, you paid rent to the commonwealth of $50 per year. The site was yours, to do with what you wanted: you owned it with clear title, subject to the lease; you just had to pay the economic rent for the privilege. The politicians knew what they were doing. Collecting the worth of the site yearly in advance meant that the rent of the site could not capitalise into a tradable commodity. There would be no price in which to speculate.

The price of the site, therefore, is zero.

But, although the price is zero, this does not destroy the site's use value, or worth. This has some astounding ramifications. To live in Canberra, one did not need to take out a mortgage to afford the site. (This upset the banks.) Canberra sites could never be hoarded or kept out of use in expectation of future gains: the holding cost of doing so (because you owed the land rent to the commonwealth) was too high.

No capitalised rent, no real estate cycle. No capitalised rent, no need for the vast amount of fractional reserve banking required to buy it. No boom or bust either.

Alas, Canberra's founders did not foresee the prodigious inflation to follow in the 1960's, by which time the annual rent was way above the assessed and collected values, so people quickly began to speculate in the leasehold rents, (similar to what happens in both Singapore and Hong Kong), gaining for themselves the balance of the rent and returning Canberra once more to the continual boom and bust economics everyone now thinks is a natural feature of the western way of life. This 20th century belief is no longer sustainable and it is time that it was changed.

Sadly though, we are assured of yet another real estate (in reality, land price) led boom after the current one has run its course. Present UK and US government actions to preserve the system and, most importantly, the private collection of the economic rent guarantee it. The next boom (the peak of which will occur around 2024 or so) will be truly remarkable and something to behold, as both India and China continue to develop, a process that will likely triple their respective land prices, and hence the demand for its collection by private interests, especially the banks. Will this prove sustainable economics? As the next land price boom builds, and then unwinds, you be the judge.