

# **Overheated Housing Market**

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12 January 2022

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# Overheated Housing Market

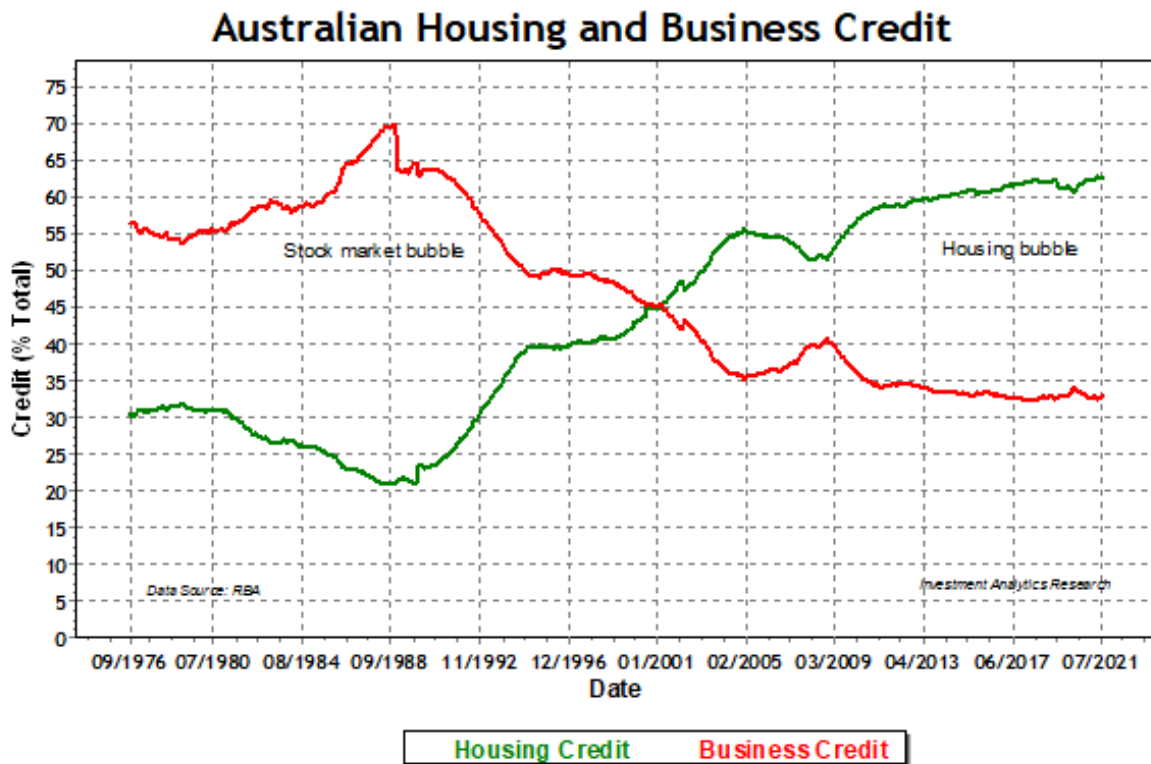
The overheated housing market reveals a fundamental defect in the structure of our economy. It is a multi-faceted problem requiring a multi-faceted solution. It is a deep-seeded problem that has existed for some time and is unlikely to be solved without fundamental changes; a problem for politicians.

Any solution will be enhanced by a well-articulated definition of the problem. The better the problem is defined the easier to find a solution. There is no silver bullet or one lever that will solve it but it is the application of properly integrated levers. To apply one lever without considering others is likely to only distort.

What is the definition of the problem and what are the component parts?

## The role of the Banks and APRA

You will see from the chart below that the mix of lending by the four trading banks as between the mortgage market and the business sector has been widening for some time. The volume of lending in to the housing market has been at the expense of lending into the business market. The difference in the mix from 1976 to 2021 (45 years) is extraordinary. It is only in the year 2001 that mortgage and business lending is in equilibrium. Many, like the former CEO of the National Australia Bank, Don Argus, states that the banks have become building societies and as a consequence the business market has suffered.



Source: Dr Wilson Sy

Whilst the banks have used technology (including digitisation) to strip costs out of home lending. In the business market, the banks have removed a huge number of relationship managers and are now much more reliant on technology, rules and box ticking. It is trite to say that business banking is way more complex than home lending and it needs the intervention of relationship managers to understand the business model, its risk and the sector, the people and the sector risks. The banks have nevertheless standardized business lending practices with a narrow product range. Products have to fit the customer not the other way round.

It is not surprising that business lending has fallen away and the banks are under attack from many new entrants, some high-tech. Remember that the four trading banks control 80% of the market. These attacks are based on particular banking customer segments and not a one-size fits all. For instance, at one end you have Judo Bank, which is strong in the use of relationship managers for SMEs. Judo Bank has recruited the best relationship managers employed by the trading banks. At the other end are high-tech, online quasi banks that are succeeding in gaining a share of specific products and customer segments that lend themselves to low-cost, online banking.

### **Why has this happened?**

#### Banks Capital Allocation Rules

One reason for the growth in home lending is APRA's capital allocation rules. APRA deems home loans be far less risky than business bank products, so the capital required to fund these loans is substantially less. The banks are able to leverage the lower capital required to significantly improve return on equity.

Is it not surprising that the banks boast about their improvement on return on equity? This has become a significant benchmark for comparing the banks, particularly when discussing the different business models. Commonwealth Bank (CBA) wins this contest handsomely. CBA has a relatively small percentage share of its total loan book in the business market.

The volume of money available for home lending has pushed the growth in the value of homes and other properties. It has inflated the values of this asset class. It is not just low interest, but also the volume of money available. But when combined it is inevitable that home asset prices will inflate and without change will continue to do so.

Another aspect is that under the Basel regulations where banks satisfy the regulatory authority, that they have appropriate risk models, they are free to calculate the capital required for residential mortgages. The oligopoly, plus I think Macquarie and Bendigo Banks, have satisfied APRA but all the other banking institutions have not. These banks are required to allocate much more capital to housing loans with the consequence that the approved banks have a massive advantage in setting interest rates on residential mortgages. This is bad for competition and simply re-enforces the power of the oligopoly and should be changed to create an even playing field.

It would be interesting to know how much house cost inflation (next subject) is in the amount of bank housing credit.

After years of speculation and uncertainty, APRA, on 30 November 2021, has announced changes in to the capital allocation rules effective January 2023, the delay giving time for the banks to realign their portfolios. APRA is placing a higher risk on fixed interest mortgages requiring more capital to be allocated and making it easier for the smaller banks to comply with the rules creating a much more even playing field. There are also concessions on the rules for small business.

### Trading/Reserve/Central Banks

This is a structural defect in the portfolio of our trading banks home lending assets. It has been shown that small changes in this ratio can make lenders incredibly vulnerable because of changes in income levels and/or interest rates. This change in the portfolio mix is extraordinarily dangerous for the Australian banking system, particularly as the four trading banks have 80% market share. The longer the term of the mortgage loan the more inflation reduces the LVR but does not necessarily change the interest-income ratio.

What this means is that the Reserve Bank is in an extraordinarily difficult position. Many would argue that the Reserve Bank's policies are fundamentally flawed and the bank must accept some responsibility for the current mess. Some argue that central banks are almost entirely responsible for the mess. It is clear that in Australia the Reserve Bank and APRA have been way too slow in acting and could have avoided much of the stress that many home buyers are now suffering. Labor wants to change the Reserve Bank Act and amend their charter. If it allows interest rates to rise too much in order to dampen inflation, it could cause severe problems for low-income borrowers and the banks. The Reserve Bank has led the market to believe that interest rates will stay low for some time. Many borrowers have relied upon this so if interest rates rise to much, borrowers will feel misled and this is important to the credibility to the Reserve Bank.

The Reserve Bank only controls the overnight cash rate, buys and sells bonds and prints money. The banks are free to set their own interest rates. The Reserve Bank has tried to influence the bond market interest rates by purchasing bonds but this has failed.

40% of Australia's borrowings are from overseas and we are very captive to international interest rates, with US rates increasing markedly because of inflation this will affect international rates and those payable by Australia as a borrower. The banks are and will continue to increase interest rates. If they do not, interest paid to interest received or the interest yield, will deteriorate. This has a dramatic effect on profits. It is similar to an ordinary business concept of gross profit. Given that the banks borrow heavily internationally, they cannot resist the trend of the increase in international rates around the world as the various countries increase rates in an attempt to deal with rising inflation.

We have seen recently CBA report a material stress in their interest yield and have made several adjustments in a short period to interest rates on mortgages to protect their profits and returns as they always do. It is irrelevant at the moment to CBA and other banks that the RBA overnight rate is very low and has not been changed for some time. What is relevant to CBA is the interest it pays.

The Reserve Bank has little leverage. Given that we could face a housing market asset bubble, it becomes an issue as to who is responsible for piercing this bubble. The Reserve Bank would not want to be seen to be increasing rates to curb inflation and growth as it could set up failure by many of our home borrowers, particularly the recent ones and damage the banking system.

We should remember that many who have fixed rate mortgages that these are often only fixed for a 2, 3, 4 or 5-year period. Therefore, in the life of a mortgage, in reality it is almost a variable interest rate.

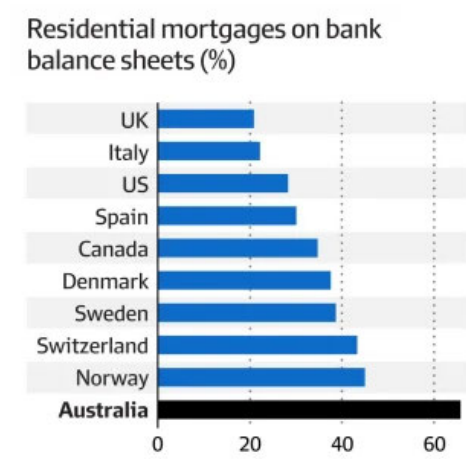
Central Banks around the world have pushed billions into the banking system and printed massive amounts of money, all of which would and will have an inflationary affect. There is simply too much money in the system.

Governments answer to this problem is to heavily subsidise deposits required by first home buyers. This also exacerbates the problem.

It should be acknowledged that the banks in December 2021 were forced by APRA to hold more capital. James Eyers, in the Australian Financial Review on 29 November 2021, reports that whilst some loans require more capital others like small business, where loans are not made against the home, the requirements have been loosened. Corporate property loans will require more capital. These arrangements are to be enforced by January 2023. The uplift will increase banks Tier 1 capital from 11.5% to 12.0%.

The APRA changes would increase the competition between the bigger and smaller banks by reducing the differences between them. Banks have responded by offering differing pricing depending upon the LVR ratios.

James Eyers discloses a very interesting table on the residential mortgages on bank balance sheets worldwide. The table below shows that Australia has the largest percentage by far.

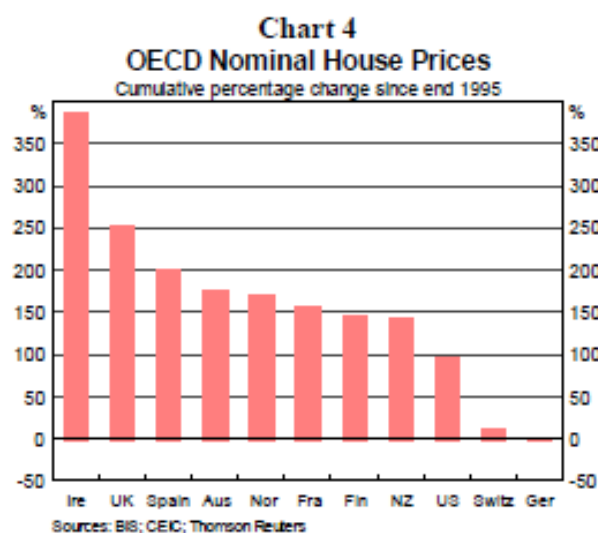


It is not surprising that housing affordability is a great black hole in Australia. APRA and the RBA deny that housing affordability is part of their mandate so denying that they are in any way responsible for the black hole. I disagree. I worry about the RBA when it makes a submission to the Parliamentary Inquiry stating there is no problem as the growth in the number of houses being built is pretty much equal to the population growth in recent decades. This is missing the point. The more housing and land packages available and that more choice available to buyers is it inevitable that prices are more likely to be stable or fall than increase. This may be the reason why many people in the market are seeking a review of the RBA mandate. Unlike other central banks, the RBA has not been reviewed for 40 years. No wonder that both Labor and the Coalition want to review the mandate. The same should apply to APRA.

Others calling for reform, such as Howard and Costello, on the release of 20-year-old cabinet papers, both criticise the RBA. The RBA has been slow to reduce interest rates when the economy needed stimulating and way behind the view of the market and then slow to increase rates to cope with inflation. Costello has an interesting position on the reasons for the first subsidy on housing. When GST included building materials the housing subsidy was a compensation mechanism, but like all subsidies and taxes, once introduced they are difficult to eliminate.

Howard and Costello also questioned whether it is wise for the RBA to predict future rates. It is not the role of the RBA to forecast, and in any event, I believe it is likely that people will rely upon those predications and make fundamental mistakes. Should a central bank be put in this position?

If you read the background notes on the Senate Housing Affordability Inquiry from 2008, you will understand some of the thinking at the RBA and the fact that things have not changed much. The RBA is comforted by the fact the most developed countries had experienced the doubling or trebling of house prices in the mid-1990s. Refer chart below.



This is no excuse for not taking out excessive costs in our house and land packages, which are unnecessary. It seems that nothing has changed in that there are clearly pockets of considerable mortgage-stress, where interest repayments are running at a high level.

The reality is that we have a structural defect in our economy with too much residential mortgages on bank balance sheets and the RBA and APRA must share some responsibility for that. It is self-evident that with historically low interest rates, it is natural for people to increase the amount of their mortgages and as a consequence put pressure on the ratio of wages income to mortgage debt.

There are specific issues in relation to APRA in that their relationship with the banks is not sufficiently independent. A more independent entity with perhaps an independent board of directors like the RBA might have come to different conclusions.

The conversation about changing these mandates will be very critical. The danger is that there will be some who will wish to impose further obligations on the banks such as climate change, when this is really a matter of government policy.

### House Cost Inflation

Coupled with the inflation in the value of homes is the cost of house and land packages. This has increased dramatically. It is an issue of imbalance between supply and demand. State and local governments make it more and more difficult to rezone land and requires an incredible range of approvals such as environment, fire protection, etc. The multiple government agencies (which I call silos, as most act independently of the others) have become very intrusive in land development. These agencies are very powerful and often do not work together and sometimes in conflict with each other. This requires developers to spend a massive amount on consultants and experts. There is a lack of proportionality and some small issues are exaggerated in their importance. Relatively small issues can involve extraordinarily amounts of expert time and cost to the developer with little value to the community. These silos have developed complex processes and demands for more and more information, some of which is of little or no significance.

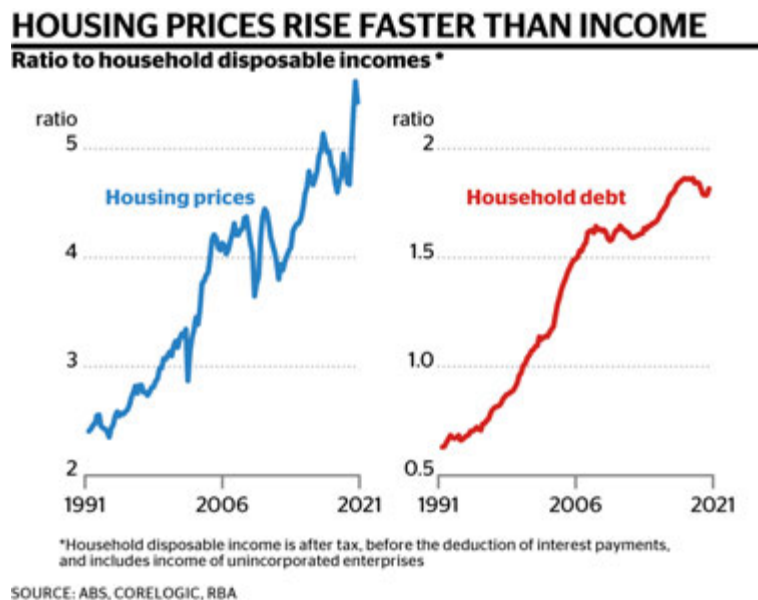
The development approval process has become an industry in its own way and the bureaucrats have become very powerful making it more complex and demanding for the developer, with a proliferation of more and more experts, including solicitors and barristers, which make it a farce. This sector, like some professions, and there is a conspiracy of silence and inaction resisting reform and cutting out costs and make planning more efficient. Why rock to boat, we are all doing very well out of it. Similarly, bureaucrats have no desire to change and at the local government level planning departments are impregnable silos. Each new development builds off the last one as it has become an art form to require additional marginal information. Developments are taking much longer to complete giving rise to a large amount of frustration to all those involved. The atmosphere seems to be that the bureaucrats etc. simply do not want development.

The consequence is not only a large increase in the cost of the land but long delays which means less land is available. Developers take advantage of this by staging their sales programme to maximise returns by delays and feeding into the market packages of land and houses which cost the home owner more. State governments and local councils are therefore mainly responsible for creating the demand supply imbalance. If more land packages were available for sale giving the prospective home owners more choice this would force developers to bring packages on to the market faster and at lower cost. It is not just inflation in value but dramatic increase in the cost of new homes. At the moment government charges amount to over 42% of a house and land



package. It is noteworthy that median house prices in Melbourne rose \$120k last year, whilst average weekly wages rose by 2% or \$1,600. This has been a major cause of the increase in the cost, quite apart from the dramatic slow-down in the process, the cost of holding stock and the large amount of time are companies spend developing land for sale. Despite this trend the Victorian government has added to this a proposed tax on the realisation value of sub-divisions.

The RBA table below says it all



When you relate it back to individual wages it is even more alarming. It means that housing prices represent 10% of the average Australian wage. With little wage growth this ratio is likely to deteriorate further. See below the table from PropTrack/ABS, published in *The Weekend Australian*, 1-2 January 2022

**AFFORDABILITY HEADACHE** 

	Median house prices*	Average earnings	Price to earnings
<b>2011</b>	\$480,000	\$55,760	861%
<b>2016</b>	\$600,000	\$62,561	959%
<b>2021</b>	\$771,000	\$69,862	1104%

\* Capital cities combined  
Source: PropTrack/ABS

Australia has one of the highest ratios in the world.

Governments have conflicting policies are being responsible for adding significant costs and also creating schemes to help prospective home owners fund their deposits. There is no evidence that governments, including local governments, are seriously trying to drive down government's percentage of the cost. It is a wonder that the banks do not complain as they are funding the inflated costs of new homes.

On the demand side, when interstate and international borders are all open again, this may stimulate some demand but it likely to be only of a short-term nature.

One of the serious social consequences of the inflated value of housing is the effect on rent for low-income earners, where the rent becomes an extraordinarily high percentage of their income. This, of course, is quite apart from the desperate shortage of social housing. The Grattan Institute published an article in the Australian Financial Review on 29 November 2021, which highlights the depth of the crises and the large shortfall in social housing unless rectified fairly soon. The country's 430,000 social housing units where low-income earners have their rent capped at 25% of household income has dropped to 4% of total stock, down from 6% in 1991. This shortfall is going to grow significantly and Grattan are suggesting a \$20b to build 3,000 homes a year.

If you look at the Budget 2021-22 (Paper No. 3, Page 50) you can see how little the federal government is doing in respect to affordable housing, compared to the demand.

### Inter-generation Value Transfer

The other structural defect is the inter-generational transfer of wealth between the younger and the older generations. The widening of the wealth gap and the inequality of income is damaging our young who are often at the front of job losses. It is much tougher for the current generation than the older generation. It is the older generation that own most of the homes with new entrants having a little impact on the mix of the various aged-segments of owned homes.

Cheap debt has unquestionably fueled house inflation. It is like too much money chasing too few goods, simply supply and demand being out of balance. It is now taking the youth of today much, much longer to fund deposits than in the past. Any further house cost inflation will do untold damage and would only exacerbate the income to debt percentage and the LVR.

This is causing a fundamental divide in the community and has, over the long term, adverse social implications. It is consistent with the view that the Australian middle class is shrinking as the upper middle class are joining the wealthy and at the other end many are dropping out to the working class. It will be interesting to see how this issue plays out at elections and how the parties devise policies to deal with this.

The other side of this inter-generational transfer is that more and more parents and grandparents are paying or contributing to the cost of their children and grandchildren's housing deposits, education and cars. The percentage contribution in this area has been increasing considerably.

### **Who will argue on behalf of the young?**

## Taxes

Another important lever is taxation. Negative gearing and the Capital Gains Tax freedom on homes is also stimulating demand causing cost inflation on houses. The housing crises is indirectly causing stress on Australia's international debt and governments expenditure. Because of these stresses there are suggestions that to deal with these issues the government should also deal with franking credits, death duties and discretionary trusts. The debt and the risks to the budget are so significant that many believe that some new taxes will have to be introduced. The writer does not necessarily agree with, but are a source of funds to cover the expenditure.

### 1. The Home

Another important lever is taxation. With the capital profit on the sale of the home being tax-free, this encourages people to regard a home as an investment rather than home. Homes have become a much higher percentage of their assets. Because of the capital gains tax exemption, people are over investing in home ownership. This is reflected in banking lending policies where the banks have allowed the ratio of annual income to the mortgage amount to deteriorate remarkably. This particularly effects new entrants such as the young.

### 2. Negative Gearing

There is the issue of negative gearing where people own several investment properties, including housing and so as competitors in the housing market pushing up prices to the disadvantage of the young. Labor got into political trouble by attempting to change this with a very crude policy. Consideration should be given to restricting the benefits of negative gearing on a progressive basis as the amounts get higher with a low base which is free of tax. A low base should remove many individuals leaving the brunt of the tax payable by those who take advantage of negative gearing in the millions.

The table below shows the methodology for reviewing this. It may well be that concessions can be made to those generating small off-set losses because at the other end of the scale there are some large negative-gearing where significant tax is being saved.

No of tax payers	Negative Gearing Loss								
	\$10m+	\$5m	\$2m	\$1m	\$0.5m	\$100k	\$50k	\$25k	\$25k or less
<b>10</b>	\$100m+	\$50m	\$20m	\$10m	5m	1m	0.5m	0.25m	<0.25m
<b>100</b>	\$1,000m+	\$500m	\$200m	\$100m	50m	10m	5m	2.5m	<2.5m
<b>500</b>	\$5,000m+	\$2,500m	\$,1000m	\$500m	250m	50m	25m	12.5m	<12.5m
<b>1,000</b>	\$10,000m+	\$5,000m	\$2,000m	\$1,000m	500m	100m	50m	25m	<25m
<b>5,000</b>	\$50,000m+	\$25,000m	\$10,000m	\$5,000m	2,500m	500m	250m	125m	<125m
<b>10,000</b>	\$100,000m+	\$50,000m	\$20,000m	\$10,000m	5,000m	1,000m	500m	250m	<250m
<b>20,000</b>	\$200,000m+	\$100,000m	\$40,000m	\$20,000m	1,0000m	2,000m	1,000m	500m	<500m

(calculations equal amount of tax)

### 3. Franking Credits

Franking credits are being abused. Some entities such as Superfunds, which are exempted tax, are receiving franking credit for which the ATO will pay the entity concerned with cash. This means the entity received a significant return on its investment. Some of these entities are making a game out of this activity.

### 4. Death Duties

The argument about death duties is that we have a capital gains tax when we realise an asset during our lifetime is it not healthy that on death there is similarly a realisation requiring duty to be paid?

The theory of death duties is easier to accept if you explain that if income is taxed, why should capital not be taxed? Should there not be some balance here? Would it not make the increase in goods and services tax more palatable if the wealthy are also making a contribution on death?

Not only is it desirable to have reasonable notice of such a change, but it is important that time is given on assessment of duties enabling capital assets to be realised without too much stress. This would need to be a federal, not a state tax.

One difficulty with death duties is the complexity of the details and the steps that have to be taken to avoid asset shifting, particularly overseas, and the loop hole legal, accounting and tax advisers destroying the effectiveness of the legislation.

### 5. Discretionary Trusts

Some are suggestion that discretionary trusts should be taxed the same as companies, with down-stream credit for taxes paid.

### 6. Overall

Would tax reform have a better chance of success if when introducing changes to goods and services tax and death duties, that payroll tax is eliminated (as a disincentive to employment) and the additional GST is paid to state Treasuries to compensate. Increasing and/or widening the GST is a regressive tax in that it has a much greater impact on low-income earners with very little stress for high income earners. It is absolutely crucial that low-income earners should not be out of pocket for at least five years and appropriate adjustments should be made to the basic wage and to the benefits paid to the unemployed and retirees.

## Immigration

Another lever is migration. For good reason migration has collapsed during the COVID-19 disaster. Migration is a very important lever in growing our economy. It is hoped that with the COVID-19 pause in migration that our new migration policies can be more strategic. In doing so there are short, medium and long-term goals. Short term goals or targets require us to deal with the many shortages that exist in some segments. Medium and longer-term goals are likely to be quite different. Whatever they might be, we need to understand the requirement for infrastructure to cope with migration. Migration of 200,000 per year, or put in another way, 0.8% for immigration and 0.8% for fertility, amount to 1.6% which is almost equivalent to building two cities the size of Geelong (about 172,250 population) each year. This involves many schools, hospitals, public services, roads, etc. It is important to understand the connection between migration and infrastructure needs. You should not be frightened of this infrastructure burden as this includes large amounts spent on mining and business capacity, and so far, we seem to have been able to meet the infrastructure needs of the 1.6%.

The 2021-22 Budget Paper No. 3, Page 104, reveals serious issues with migration.

	2019-20	2020-21	2021-22	2023	2024	2025
Net overseas migration	194,000	-96,600	-77,400	95,900	201,100	235,000

With these forecasts it will be a long time before net immigration will have a positive effect on the economy.

## Population/Migration

What are the benchmarks and issues in integrating migration policy with population policy and trends?

An important benchmark is the number of Australians in work as percentage of the total population (worker percentage). The worker percentage is influenced by a number of factors:

- the fertility rate <sup>1</sup>
- the retirement age <sup>2</sup>
- life expectancy <sup>3</sup>
- the number of immigrants <sup>4</sup>
- age profile of immigrants
- productivity <sup>5</sup>

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<sup>1</sup> In the Intergenerational Report of (Insert date), (IGR), in 1961 the fertility rate was 3.5, in 2001 it was 1.7 and is now about 1.9. It is noteworthy that Peter Costello stated you should have one extra child for the nation. With his policies to support this, the fertility rate increased for a short time from 1.75% to 2.0%.

<sup>2</sup> According to IGR, the people working to those retired will reduce now from 5 to 1 to 2.7 to 1 by 2050. This is alarming. The labour force participation rate for people 15 years and over is expected to decline today from 65% to 61% in 2050. This will not help the growing of productivity and where regulation and legislation is stifling activity. It is expected that the annual average growth rate in real terms of 3.3% now will decline to 2.7% in 40 years' time. Further, government spending of 22.4% in 2015-16 will increase to 27% by 2050. All this is contributing to the decline in productivity and GDP per capita. In the 1990's productivity was 2.1% to about 1.9% now. Over the next 40 years it is projected to decline to 1.5%.

<sup>3</sup> According to the IGR people working over the next 40 years the number of persons aged over 65 will double and those over 85 will quadruple.

<sup>4</sup> According to IGR, people leaving Australia in 1981-82 was 83,000, and in 2011 it was 326,000.

<sup>5</sup> There has been a notable decline in our standard of living and under current polices it will continue to do so. To solve this problem, governments can either increase tax or reduce spending. Both reduce the standard of living. Instead, we will need to

There have been a number of trends in Australia which have, and if they continue, will have a dramatic effect on our economy. The fertility rate is declining and retirement age is static. The fewer the workers and the more over retirement age not working, places a strain on the funds required for government activity. Another benchmark, which has similar consequences, is the ratio of private and public sector to our GDP. The lower percentage of the private sector places the economy under stress as it is the private sector generally that is driving wealth creation and the public sector using contribution for community services. Community Services need to be reshaped. <sup>6</sup> For instance, our expenditure on health is now \$7.5b, and is projected to be \$12.8b in 2030 and \$22.9b in 2050.

What is clear from both the work percentage and the private and public sector percentage mix, is the lower the percentage of both means (and is well established), that the standard of living of all of us declines. Once in decline, it is very difficult to change and there can be a spiraling affect downwards.

With our retirement age remaining static, our life expectancy is increasing considerably and with medical science it is only likely to increase, and more people will reach 100 years of age. Our productivity or Gross Domestic Product (GDP) divided by our population is declining.

The worker percentage is declining and more and more people need to be supported by government. The government will need to increase taxes to support the way of life of every increasing number of retirees.

Migration can be positive if the numbers and profile of immigrants expands our workforce. The younger the better as it means longer-term in the workforce. <sup>7</sup> The older the immigrants the less time there is for them to gain retirement and health benefits.

It is hoped that immigration policy does not become politicised and we continue our humanitarian intake of at least 20,000 per year. The danger of partisanship is that the votes of immigrant, low-income workers would likely to vote Labor and skilled workers would vote Conservative, but this is a generalisation.

The government has recently announced that it would like to increase immigration to 180,000 in 2022-23 but in a very targeted way.

Many will argue that this increase is way too low. Historically immigration has been very successful in growing our economy. It has become even more important with the drop of our fertility rate and the aging of our population that we rebalance this through increased immigration. If immigrants coming to Australia immediately join the workforce, they are contributing to the very important ratio of the numbers of people within the workforce or hours worked to the total population.

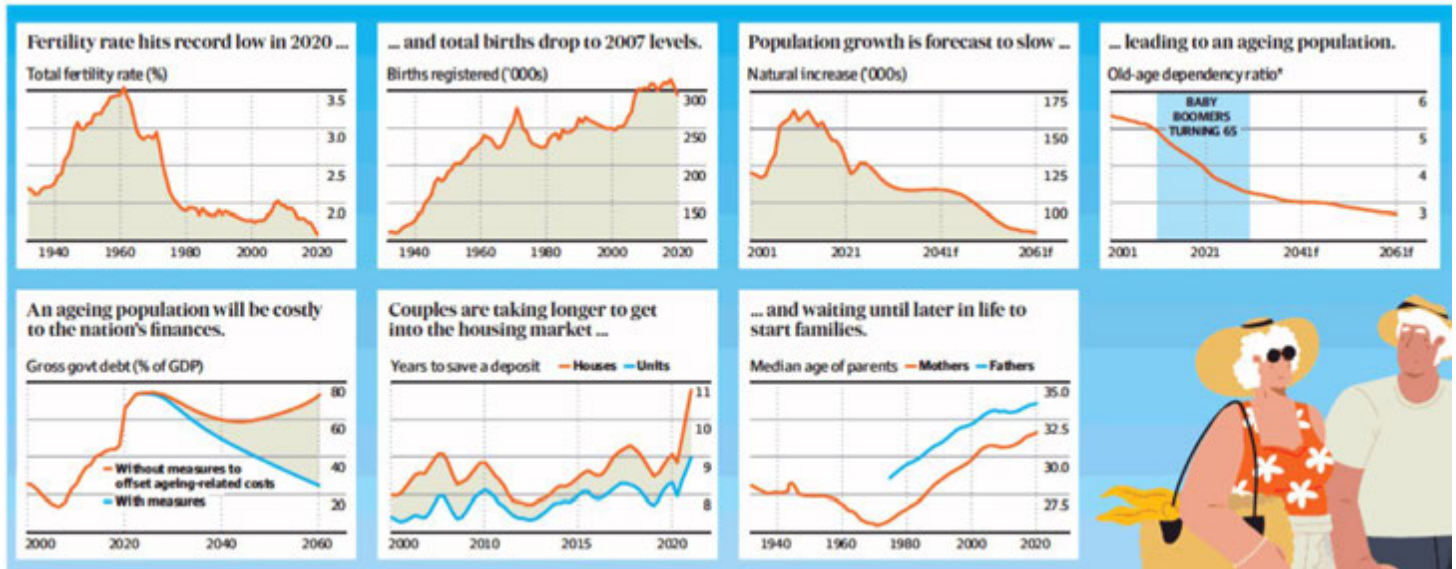
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review carefully workforce participation because this is what drives productivity. Productivity is the prime driver of our level of standard of living.

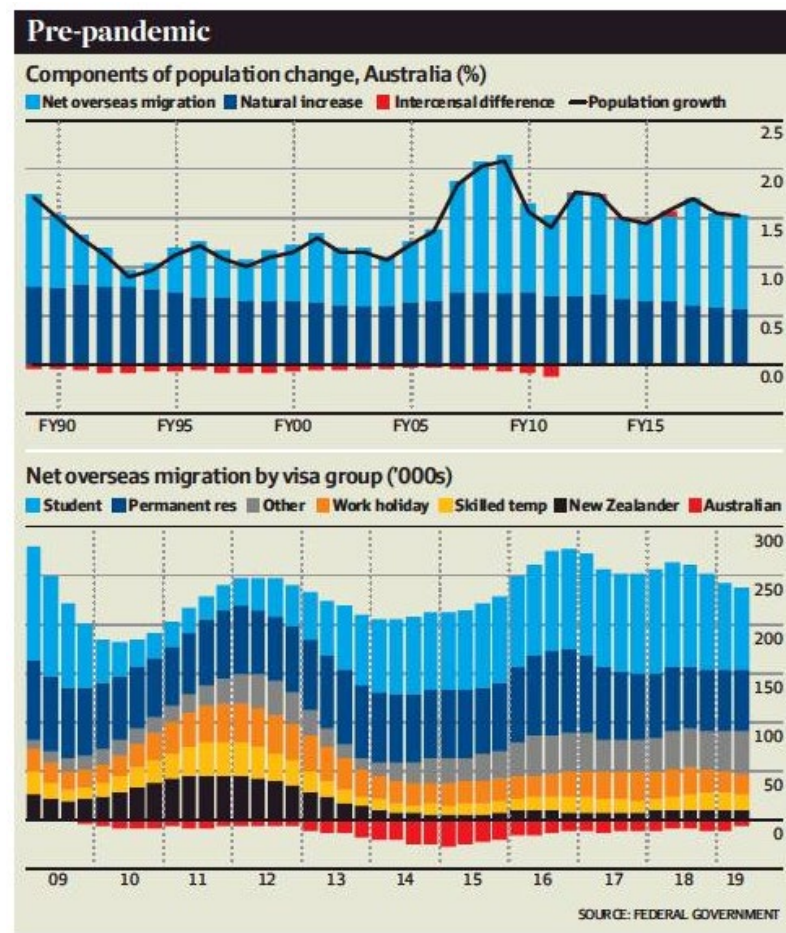
<sup>6</sup> For instance, our expenditure on health will rise from 4% of GDP in 2009-10 to 7% in 2049-50. Increased health spending for 65+ years will increase sevenfold, and for those over 85 years twelvefold.

<sup>7</sup> Why not encourage those coming to Australia for education and back-packing to stay on, join our workforce and become citizens rather than putting up so many barriers to stop them.

Some argue that if immigration is too high it stretches our infrastructure. It would be surprising if the number of immigrants arriving in current circumstances would cause such a problem. There is a fixed or variable component of infrastructure and similarly a variable or a semi-variable component and to the extent to which costs are fixed then migrants will make a contribution to the fixed costs. If we stay on the same path with reduced immigration, low fertility rate and an ageing population we are placing a monumental pressure on our ability to fund the current and ever-increasing welfare obligations. See below tables published in *The Australian Financial Review*.



*The Australian Financial Review*, 11-12 December 2021



*The Australian Financial Review*, 21 December 2021

## Superannuation

Should superannuation policy be changed, limiting the ability and circumstances which superannuation can be withdrawn enabling people to move on to a pension? Having said that, we need to be very careful about changes to superannuation policy because like many other countries Australia is well-endowed with superannuation and its contribution to assisting people in retirement. It is a significant cost both to employer and employee. For a low-incoming employee it takes a significant percentage of their income so in their interest we need to ensure that this is effective in helping them in retirement. If the superannuation amount is to be increased, we must make certain that it is helping people in retirement so taking the pressure off pensions. We need to protect many during their employment years accessing their superannuation because the compounding interest effect on these withdrawals dramatically affects the amount available in retirement and in some cases placing further pressure on governments.

It is questionable to the extent to which superannuation is taking pressure off the government in respect to expenditure on retirement. In an article by Tony Kaye in *The Australian* (30 November 2021), he has made some observations that give rise to concern about the effectiveness of superannuation. With male life expectancy going from 80.9 years in 2017-19 to 81.2 years in 2018-20; with women rising from 85.0 years to 85.3 years; means that increasing longevity is, and will, continue to cause a problem. The Association of Superannuation Funds of Australia believe most will spend all their superannuation in retirement and require government assistance. With people aged 60 years and over, who died in 2014-18, 80% had no superannuation before death. For those aged 80+ years, it was 90%.

This will create a large burden on government.

## Supply/Demand

Commentators accept that it is difficult to apply simple supply demand analysis to housing. Housing is a very complex product; it is not a commodity and there are multiple reasons for sale and purchase including occupation and investment.

First there is the occupier home owner who will enjoy the freedom from Capital Gains Tax (CGT), whilst the investor is driven by the benefit of negative gearing and the 50% GST discount.

The second factor driving demand is interest rates and the banks willingness to lend given the risk weighting applying to residential mortgages.

On the demand side, there are issues caused by limited supply. Regulation is driving up house prices. The regulatory impost and the developer tax instigated by some governments (NSW, Queensland and Victoria being the worst), is slowing down the rezoning and development of land. With limited supply, developers exacerbate the issue by staging and slowing down the release of housing. This would be readily solved by reducing some of the ridiculous regulations that applying to housing, rezoning and dramatically increasing the land available so that home owners have greater choice.



Local and state governments will not accept that they are responsible for the high cost of housing and land and the shortages. The bureaucrats in local government, the various planning agencies and the local government department are far more concerned with compliance, regulation, obeying rules for the sake of it and standardisation than outcomes. You do it my way or the highway. The rules-based regime stifles innovation and differentiation. See a quote from some of the wisdom of Adam Smith:

*‘The Man of System’ he says “is apt to be very wise in his own conceit; and is often so enamored with the supposed beauty of his own ideal plan of government, that he cannot suffer the smallest deviation from any part of it. He goes on to establish it completely and in all its parts, without any regard either to the great interests, or to the strong prejudices which may oppose it. He seems to imagine that he can arrange the different members of a great society with as much ease as the hand arranges the different pieces upon a chessboard. He does not consider that in the great chessboard of human society, every single piece has a principle of its own, altogether different from that which the legislature might choose to impress upon it.”*

There is a huge industry of professionals, including planners, demographers, accountants, engineers, lawyers (barristers and solicitors), etc., that make a substantial living out of this silo and rules-based regime. You cannot do anything without them. Some are wholly dependent upon this income. As years go by, it becomes more and more complex and we have an increasing number of professionals getting into the act like sub-sub categories of engineers.

There have been various inquiries looking at planning but usually they are dominated by people within the sector that are incapable or unwilling to undertake true reform. When another inquiry is announced the developers yawn – here we go again, there will be no effective reform and the prices of housing and land will continue to escalate. Attempts by the private sector to fund an independent inquiry into this has failed; the bureaucrats always win and do not want outsiders intruding on their space. The situation remains, we do not know how much the planning industry is costing us, nor is there any reasonable cost/benefit analysis done on the various silos.

Supply and demand is also influenced by demographic factors. Owners will want house prices to grow and prospective purchasers would want the opposite.

Unfortunately, governments introduce deposit subsidies that influence demand because of the votes that maybe earned.

There is also the issue of stamp duty, which is quite significant and impacts affordability and drives up price.

Another supply and demand issue is the structure of local, state and federal governments; affordability, although substantially influenced by local and state governments, voters nevertheless blame the federal government for affordability. It does not help the a local or state government to increase supply. For a local government this often comes with environmental and similar pressures. I would suggest without further analysis, but with intuition, supply is a far bigger cause of the problem than demand.

Some complain about the nature of housing as a product in that housing is created with a lack of sense of community. Whilst this might solve short-term problems in some areas there are often long-term community disadvantages. Further, there is a sense that in many of the sub-divisions housing has become a factory type product raising serious issues of amenity and individuality.

It can be seen that there is a myriad of issues that influence supply and demand. There is no silver bullet which can bring supply and demand into balance without a great deal of compromise and intergenerational transfer of wealth. So far, the conversation is influenced by the powerful interests or lobbyists who represent one of the silos or levers in this argument.

This is a large issue and any reform will take years. The difficulty is that whilst there are multiple levers, they cannot be exercised at the same time by any one level of government without affecting the other levers and government.

So long as the black hole exists and there is no structural reform, there is going to be a serious inter-generation transfer of wealth and a degree of divisiveness within the community to which no one can or will accept any responsibility.

It is these social and inter-generational issues that should be the drivers of reform and any delay will only increase the divisiveness.

### Will the bubble burst?

Without any material intervention, it is inevitable that the bubble will burst. History says it will. With the combination of inflation, low wages, high financial leverage of borrowers, high house prices and large amounts lent by the banks gives rise to a dangerous asset bubble. Invariably these bubbles burst as has happened in the past, because they are structurally unsound. With an election coming up it is difficult to see any serious policy changes taking place so maybe the bubble will not burst for at least another 12 months. In the meantime, we have boiling frog syndrome.

With the Reserve Bank now saying that the cash rate should be around 2.5%, it is inevitable that the banks will take advantage of this and further increase their rates.

As in the past, banks will survive this restructuring by taking a hit in one year and we should remember that many mortgages are insured so minimising bank loses but that will not detract from pockets of massive stress and unemployment in various areas of the community.

## Access to Information

One interesting aspect of decision making is access to information. With the growth of the public sector and the large communication teams each silo appoints, matched by corporate government relations teams, means that communication and messaging is being disrupted and managed in the interest of the particular entity with little regard to the public's right to know.

The growth in the communications industry has been extraordinary. Universities are turning out large number of graduates every year.

The main buttress to the communications industry is the media, particularly those involved with even modest investigative objectives, is profound. The imbalance of communication resources and independent analysis is extraordinarily low and challenging. It is becoming more and more expensive to get to the facts, and this is giving rise to more and more enquiries at various levels of the community to get to the truth.

The growth of the communications industry is almost matched by the growth of experts on almost every subject known to man. We have another large filter in the flow of information which is not helped by the growth in lobbyists, who seem to be the only ones that can influence outcomes. We are all being marginalised and mushroomed.<sup>8</sup>

## Multiple Levers

What we have is a number of levers, all of which are contributing to the explosion of house prices. You cannot solve the problem by changing one lever. You must be careful by making modest changes to the levers so that we do not put the economy under too much stress which would be counter-productive. The problem has been growing for some time, and like a battleship it cannot instantly change direction and in any event the politicians do not have the political will, capital or appetite for reform to make fundamental adjustments.

## Complicated Government Decision Making

Government decision making will be substantially restricted by the large impact of COVID-19 adding over A\$800b to our national debt.

Whilst inflation over time can reduce the effective cost of borrowings, it is the interest rate burden that is the problem. Increases in international interest rates for Australia, as a significant international borrower, means that small interest rate changes can be very detrimental to our national income.

It is only growth by productivity and efficiency, and not tax, that will keep governments in power.

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<sup>8</sup> Refer to *Refounding Democracy* by Lorraine Finlay in the IPAs Essays for Australia, Volume 1, 2021 where at page 27 Lorraine talks about the growth of the bureaucracy and the rise of the experts.

This is complicated by these decisions being a mixture of federal and state government decisions, with the complication of the economic and social objectives of governments. In one silo, for instance, there are nine federal, state and territory ministers involved. Multiply this sample by all the other silos then the numbers involved in decision making are incredible.

It is extraordinarily complex as to where money is allocated geographically and by individual infrastructure needs. The further complication is the lead time in putting in place infrastructure in place, as to where it is located and based on where the population of growth or contraction is taking place.

This is also linked to our wages policy because manipulation of wages can influence where people work. At the moment wages have become a smaller component of our economy is unfortunately macro policies by the government and the Reserve Bank is not helping wage growth. We are becoming a divided community with incomes of the rich in contrast to the real wages of those with less income. There is a cost-of-living crisis for low-income earners who are not only facing little wage growth but also material inflation in some essentials, for example, petrol. In some sectors, people losing their jobs due to technology are finding it difficult to find another job.

Is middle class is shrinking? It is difficult to get a realignment of wages between those of higher income and those, for instance, backed by unions where the wages are excessive such as maritime, fire fighters, train drivers and others in contrast to say nurses, school teachers and police officers. Even within the current slow wages' growth, there could be wage realignment that is not only good for the economy but a fairer realignment of the wage increases. The lever of pushing wage growth for the sake of it just to make the economy look better without there being any increase in the productivity of the economy is dumb.

Social pressure is also being placed upon the younger home buyers. House block sizes are shrinking as is the ratio of house to block. Sub-divisions are being created in outer metropolitan areas which are cheap and lack appropriate infrastructure and amenities. It is in these areas where mortgage pressure will arise and there is a danger of a concentration of failed borrowers which leads to pockets of unemployment, crime, drugs, alcohol, abuse, etc. One answer to this is that the young are encouraged to move in to regional areas where there is a lesser prospect of this happening.

Unfortunately, in Australia, we have a large concentration of population in the capital cities and we do not have the wide-spread of regional towns that exist in countries such as America where it is easier to be regionally based.

It is suggested that the lever of migration, which is slow to have any impact, can be justified simply on the basis of increased productivity.

## The Challenges of Reform

In reform, there are three policy aspects:

1. macroeconomic,
2. microeconomic, and
3. behavioural economic

Macro levers are blunt instruments and it is only out of the micro levers that you are able to target and optimise reform. People are not paying enough attention to behavioural economic reform. It is not helped by the deep division within the economics community as to the role of each.

Xavier Gabaix, a French-born Harvard Professor, is throwing light on this dichotomy. Unlike economists, we cannot make use of the large amount of information available to us and thus cannot be completely rational. We make choices about this information and this is influenced by behavioural issues. To put it brutally, you cannot assume that economics is a rational activity. What this means for us is that we should place much better information into the hands of the public. Explaining things in simple terms, not relying upon economists of mathematical equations based upon assumptions. Economist speak tends to confuse the situation where as if the vast array of information. We mortals need better messaging and not the obfuscation that comes from many economists.

There is another important dimension to this problem and that is the adverse consequences of the growing influence and control by government in our economy and our lives.

Professor Bradley Bowden, a professor at Griffith University and a fellow at the IPA, has written in the *2021-22 IPA Summer Review* an excellent article, *The Rise and Rise of a Modern State*. Bowden is deeply concerned on the growing government intrusion. Bowden's analysis is based upon the ratio of government expenditure as a percentage of GDP. It has increased over the years to a large extent in Australia, USA, UK and elsewhere, and was led by the UK.

This growing intrusion reflects significant behavioural change in a sustained attack on "individualism, self-reliance, individual choice and liberty". This reduces the room for individual choice, action and liberty. It inhibits entrepreneurship in people wanting to aspire and have a go. Bowden claims that it is the protagonists that are claiming the high, moral ground, and it is a negative to be a proponent. Laissez-Faire is a dirty concept and word.

The behavioural consequences of intervention cuts across Adam Smith's view of capitalism. Self-interest is a concept of mutuality as opposed to selfishness where there is no mutual benefit.

Self-interest since the days of Adam Smith, have delivered an industrial revolution and a huge improvement in our way of life. You only need to read Geoffrey Blainey's outstanding book, *Black Kettle and Full Moon*, to understand since Australia was settled, the massive improvement in almost all dimension of our lives. This is fading as governments increase regulation and intrude on our lives. This is what Professor Pickty, the famous French economist, misses in his analysis the growing number of super-wealthy, super managers and inherited wealth and those exiting the middle-class to become wealthy, and those dropping out at the other end with low incomes and little wages growth. According to Blainey, our way of life has improved dramatically and the issue

of redistribution of wealth is another debate. It is pleasing to see that some of the super wealthy are undertaking significant philanthropic effort and the question is – is it better for them to do that or for the government to take this in taxes and distribute it to more welfare benefits?

The recent Productivity Commission Issues Paper, *Housing and Homelessness Agreement Review*, released in December 2021 has come to some interesting conclusions about inheritances. Whilst the least wealthy were only around a quarter of the amount given to the richest, it nevertheless made a large difference to their lives. So far as the wealthy are concerned, it merely changed their trajectory and not their fundamental way of life. If there is to be any death duties they must be geared to the super wealthy.

Relating this all to Australia, it would be extremely difficult to recreate the iron ore mines of BHP, Fortescue and Gina Rinehart, who sometimes making margins of 50+% have developed enormous wealth for Australia and consequent taxes thus improving everyone's standard of living.

You can ask some interesting questions about the super wealth of say Forest and Reinhart

Are we better off with or without them?

What is the net contribution they have made to the community and the taxes, royalties and other payments to government plus taxes paid by employees?

Does it matter that they have extreme wealth?

Is it not what they achieved a reasonable reward for effort?

Would it have been better to tax them in lieu of their philanthropic donations?

What would they do if death duties were introduced?

Is it not easy to avoid death duties?

Will the wealthy move their activities off-shore?

What is the cost of collecting death duties? Is it an efficient tax?

Is it valid to say we pay CGT when realising an asset is not death, a form of realisation?

Do death duties satisfy those who are concerned about the rich and poor divide?

Is this divide likely to increase in the future?

Is the spending of death duties better than the philanthropic spend?

Is it possible that when we have more super wealthy, that philanthropy will increase?

By its very nature, there is no mutuality in welfare save for the social and humanitarian need to help this disadvantage. This can only be funded if we have taxes, and taxes are only derived if our corporations and individuals are successful. Where is the balance between taxing and benefits? It has to be through innovation and productivity gains where we achieve higher outputs for the same level of inputs. This is restricted if we have a shrinking middle class and a lack of people working as a percentage of total population.

There are some very difficult conceptual issues in this discussion and the simplicity of Adam Smith's writings require modification for today. No one has yet been able to articulate these issues in a convincing way like Adam Smith where we can understand and accept the dynamics of these conflicting issues. People like Professor Pickty, do not solve the problem by simply writing up the division of wealth, it is more complex than that.

It will take a bold government to deal with this structural problem but if we do not tackle it, we are causing long-term problems not only for a healthy structure of our economy but creating a deep and unnecessary divide within our community.

Perhaps if at the same time modest changes were made to all the levers it might be more palatable to the community. What is not analysed here is the interaction of these levers and the modelling that is required to get this right. It is hoped that those concerned about this problem, whether they be writers, analytics, bureaucrats or politicians, they try to pursue a holistic solution with first class modeling and a statement of the problem which is hoped would be accepted by all.

### What does all this mean?

To cut through the large group of decision makers, influencers and the fog, it will help if we have a simple list of things that we could consider. Agenda setting is important, otherwise one or more of the silos will capture the agenda and distort the conversation in its own interest. What should our objectives be, and what is it that we should try and influence in order to reach an integrated and whole solution, not contaminated by special interests. My suggestions for what should happen as a basis of a conversation is as follows:

- interest rates should rise modestly
- capital allocation rules should change to try and shift the volume of lending money away from lending into the business market rather than the housing market so that the economy remains stimulated via business lending
- banks make every effort to reduce housing market loans as a percentage of the total banks book and should reduce the mix of loans to reduce those with high LVRs and/or income to wage percentages
- first home owner's grants should be drastically curtailed
- supply and demand of new house and land packages could be brought into equilibrium by improving and making more efficient the development process; this coupled with increased supply; could in the medium term, bring down pricing of house and land packages
- modest changes should be made to capital gains tax on the realisation of value of a modest percentage only at the higher end of capital gains, with houses worth less than say A\$2mio free of CGT, making certain that new entrants are not penalised and that there can be some restraint on inter-generational transfer of wealth
- migration should resume but on a more intelligence basis and be more integrated with the infrastructure needs; this is both a short and long-term lever; in the short-term students should be encouraged to stay longer and in particular sectors should be encouraged to become citizens, and so obtain long working lives
- wages growth is important for consumer demand but there is likely to be greater consumer demand if the wages go to those who need it more, not those who are excessively paid
- policies should be developed to increase fertility and retirement age should be extended
- greater recognition of the role of productivity and efficiency to get the message through about the important of increasing the private sector percentage of GDP at the expense of the public sector; this is needed to boost GDP per capita
- consider death duties only for the super wealthy
- as productivity and growth is crucial to our future, should not productivity and its enemy, regulation, have a senior Cabinet position, as this is an activity transcending most of government?

## Modelling

This is extraordinarily difficult to model. What is it that we are optimising? Is it an improvement in our standard of living measured by GDP divided by population to reach the per capita benchmark? What are the flaws in this?

First, how is the extra income distributed? With the stress on low-income earners through inflation and rising prices, lack of job security and low-wage growth, they should receive a higher percentage per capita of the extra income.

Secondly, what about our balance sheet; a lot of government expenditure increases the value of the nation's assets but this becomes lost in the mist of time. With the focus on GDP, we lose sight of the strengthening of a nation's economy which is not reflected in a balance sheet. It will be much better if government expenditure was segregated in a way that would enable us to clearly separate the benefits paid as opposed to the amounts spent on infrastructure which improves productivity and efficiencies thus taking cost out of the economy. Some of the information provided by corporates to the shareholders, with a careful separation between income and capital, would be healthy. On the other hand, the expensing of our capital assets does make national accounting more conservative. The other side of this is the clarity about the number of benefits paid to our citizens and exactly who is funding it. It is the private sector that substantially does this, but governments all too often bite the hand that it feeding money into the system to fund benefits for our citizens. The stronger our private sector, the more able we are to fund benefits.

Where do our tax dollars go? Note from the table below, that the 2021-22 budget/personal income tax was 45.7% of revenue, with GST 15.3% and corporate at 19.7%. As for expenditure, 35.6% was for social security, with 16.7% for health, 7.3% for education and 5.8% for defence.

The operating deficit was \$154m, and the fiscal deficit was \$163m.

Revenue (\$b)	%
Individuals' income tax	45.3
Company and Resource Rent taxes	19.7
GST and other sales tax	15.3
Non-tax Revenue	8.0
Fuels excise	4.2
Custom duty	3.7
Superannuation taxes	3.0
FBT	0.8
Total	100.0

Expenditure or Benefit to Australians (\$b)	%
Social Security and Welfare	35.6
Other purposes	18.9
HED	29.9
<i>Health</i>	<i>16.6</i>
<i>Education</i>	<i>7.5</i>
<i>Defence</i>	<i>5.8</i>
All other functions	11.3
General public service	4.3
Total	100.0

Our social security, which is well over a third of our expenditure, depends upon a vibrant and successful economy, with full employment so that there is plenty of individual tax paid to Treasury. Government expenditure as a percentage of GDP is now 31.6%, where as in 2007-08 it was 23.1%. What about the Role played by the states? It is alarming if you look at Victoria. According to John Dagge, in the Herald-Sun, 31 December 2021, the number of executives in the Victorian public service as tripled from 2014 to 2021 the number of executives has swollen from



647 to 1,742. In terms of the public service, Victoria is by far the most expensive state or territory within Australia. It is noteworthy that this trend was well in place before the pandemic but the pandemic has been used by the Victorian Labor Government as an excuse for this exuberance. This tells you that the government must be concerned about this trend, but are they capable of dealing with it when much of their voting base in Victoria is the public service.

We have an existing and growing deficiency, which is being covered by increased borrowings.

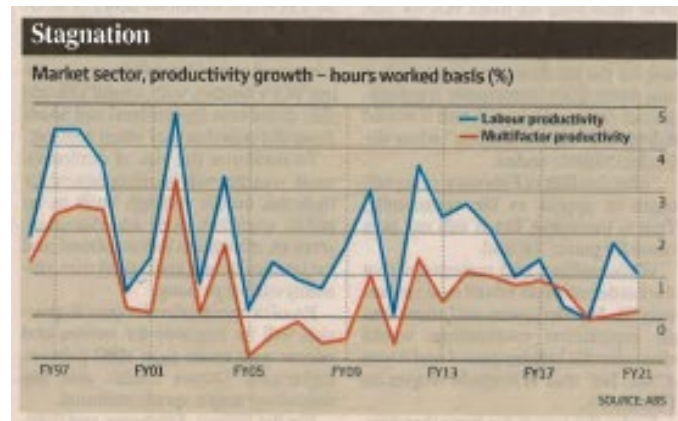
Excessive benefits and HED expenses, without a corresponding improvement in the private sector, will lead to more borrowings and the lowering of our standard of living, measured by income per capita. It is noteworthy in communist and many other countries, the public service expenditure is so large that it results in a material weakening in the standard of living. The dangers of the situation is that it can have a compounding effect, weakening social cohesion, and leading to corruptions, social disorder and non-payment of taxes. The latter being very prevalent in Italy, Greece and a number of South American countries.

We, therefore, need to nurture corporates and encourage the aspirations of employees wanting to get ahead, earn more income and accordingly pay more tax to support our welfare system. Rates of tax are crucial; too high they will dampen aspiration, too low and there will not be enough to fund the public sector.

To the extent that our standard of living is influenced by income per capita, it is a great shame that the budget papers do not enable you to identify those issues that drive productivity and efficiency, which should be included on the balance sheet and some treated as operation expenditure. Much of our infrastructure and some aspects of education drive productivity and efficiency. This analysis is worth undertaking to make the public realise that some expenditure will increase income in the short term and others in the long term being of a balance sheet items. As our economy is moving further towards a service economy this means that additional expenditure is of a tangible nature and thus difficult to capture on a balance sheet. This, of course, assumes that there is a reasonable redistribution of income stopping the imbalance as occurring between those with high and low income. Such an analysis would help people think and be more amenable to some government programmes and recognise that it is only their success that will enable a continual improvement in welfare benefits.

Identifying everything that drives efficiency and productivity in the categories of expenditure of their particular categories or silos and segmented either as an asset or an operating expense. Where an asset, presumably a calculation has been made as to its life and the amount to be written off each year. By focusing on these issues, it might help to highlight the importance of expenditure on productivity and efficiency as opposed to other services government provide such as the large 35% of expenditure that represents benefits to tax payers.

The following table shows Australia's fall in productivity and there is no reason to believe that this will not continue to decline. According to Paul Eslake in *The Australian Financial Review*, labour productivity has improved slightly but has fallen in transport and warehousing by 7.8% and in arts and recreation by 5.4% and mining by 3.5%. What a shame when productivity increases our standard of living.



Judith Sloan has written an excellent article of productivity in *The Australian* on 21 December 2021, where she analysis the issues driving productivity - Technical Allocative and Dynamic efficiency. You must not forget that much of these efficiencies are behavioural. See also the contribution by Deloitte Access Economics.

Mairead Davis, senior economist, and Pradeep Philip, partner, from Deloitte Access Economics published in *The Australian* (10 January 2022) have delivered some very good insights on what drives economies to generate growth, jobs and prosperity. These are:

1. innovation effort
2. investment prospects
3. productivity growth

With innovation, given the level of research and development, we are not doing well. R&D has shrunk in 2012 to 2.1% down to 1.5% in 2020. In the private sector R&D has flatlined.

Investment has similarly declined from 27% of GDP in 2010 to 23.9% in 2021.

With productivity over 25 years, labour has averaged 1.4% but over the past five years it has only been 0.3%. Similarly, multi-factor productivity over the past 25 years has been around 0.4% and just 0.01% over the past five years.

Deloitte's Economic Sophistication Index has Australia placed at 37, lower than place 11 for GDP per capita. Overall, this is a very bleak picture of the structure of the Australian economy.

The mirror of this is the large amount of government expenditure and household debt. Accordingly, to the IMF, our household debt has recently grown at the second highest rate in the world. Our debt represents 123% of GDP and Switzerland is only worse at 132%. See tables below.

### Central government debt as a proportion of GDP

Country	Debt 2000	Debt 2020	Percent increase
Australia	13.72%	44.1%	221.4%
United States	41.38%	119.01%	187.6%
UK	36.36%	103.5%	184.7%
South Korea	15.49%	42.38%	173.6%
Japan	94.18%	221.07%	134.7%
Spain	48.59%	107.55%	121.3%
Mexico	19.07%	42.05%	121.1%
France	48.58%	93.44%	92.3%
Singapore	83.84%	155.41%	85.4%
Brazil	62.65%	92.92%	48.3%
NZ	30.01%	43.64%	45.4%
Italy	105.95%	151.34%	42.8%
Canada	46.19%	59.28%	28.3%
Germany	38.23%	44.93%	17.5%
Turkey	37.18%	35.92%	-3.4%
Switzerland	22.10%	13.32%	-39.7%
Indonesia	87.44%	39.36%	-55.0%

Source: IMF Global Debt Database

### Household debt as a proportion of GDP

Countries with debt levels above 100 per cent

Switzerland	131.89%
Australia	123.53%
Norway	114.63%
Canada	112.13%
Denmark	111.58%
Netherlands	104.35%
South Korea	103.37%

Source: IMF Global Debt Database

*The Age*, 28 December 2021

Our increase in debt has been the greatest at 221% as compared to the USA at 188%. Modelling is only effective if each lever has received vigorous micro analysis and the dynamics of that lever understood, it is only then that you can then sensitise that lever by leaving all other levers constant. Then you add the other levers in all the various combinations. This requires some computer power.

What is it that we are modelling? Is it improvement in our standard of living, measured by extra income per capita? With the extra income we need to see that it goes to the people less well off.

The exercise alone in trying to develop a model would be very useful but the output may not be very convincing. Not to go down this path leaves a vacuum and this is difficult to determine the relative importance of all the levers. It is possible that people with far more talent than me could solve this problem.

There is much that can be achieved by a Minister for Productivity and Regulation, who can exercise all the levers of government and hopefully work with counter parts in the states and territories.

### Barriers to reform

Each lever is controlled by a very powerful silo. Most of these silos have mandates, some legislated, some not, but in any event have their own objectives, agendas, sometimes political agendas, and powerful communications teams to sprout their messages.

All the silos should be identified and segmented. An example is below. Whilst this is very crude, it is simply trying to identify all the players and the roles they play to ensure that everyone is involved.

	Decision Power	Information Providers	Lobbyists
Reserve Bank of Australia			
Australian Prudential Authority			
Central Banks			
Developer Industry			
Planning Industry			
Trading Banks			
Local Government			
– council			
– planning departments			
The planning bureaucracy			
Superannuation Industry			
State Government			
– Treasury			
– local government department			
federal government			
– Treasury			
– Department of Home Affairs			
– Immigration and Citizenship, etc			
Infrastructure			
– federal			
– state			

In seeking reform all these powerful silos need to be consulted. Not only is there a logistics challenge in bring these silos together but who should do that? The state or federal Governments?

## Leadership

This issue of co-operation and working together to find a solution is a massive challenge. It requires a state Premier or a Prime Minister or senior government minister to bring it all together. Unless there is not an environment of co-operation and a willingness to solve the problem, nothing will happen. It is easy for any one of these silos to frustrate the process.

The multi-faceted problem requiring a multi-faceted solution means that strong leadership is required to bring together all the dissidents to solve the problem. Without the exercise of critical leadership, we will continue down the path of having an entrenched, distorted economy.

The problem can only be solved if there is a consensus and agreement as to its definition. It is only against such a realistic assessment that appropriate short, medium and long-term objectives can be set. With an agreement on these objectives is it possible to develop definitive policies and there timing for implementation including staged implementation.

To get the conversation going my view of the situation is as follows:

- a very high level of debt in historical terms not helped or aided by deficits for a few more years
- a very high level of household debt compared to the rest of the world
- a substantial dependence on international debt to fund our growth so subject to the vagaries of international markets
- our banks (80% of the market) have way too much housing debt on their balance sheets at the expense of business credit
- a falling fertility rate, a low level of immigration with a falling percentage of workers to the total population and an ageing population
- housing affordability crises that is dividing the country
- government expenditure as a percentage of GDP, is too high and likely to increase
- in the international trade markets, we are too dependent on China
- falling productivity, and in particular R&D
- a federal structure which makes decision making very difficult
- a tax system which is working against the solution to our problem
- a political system that penalises reform

Our only saving grace is that many other countries in the world are in a worse position and some of the trends in Australia may be permanent international trends.

This problem is so difficult and entrenched that it requires the Prime Minister or a dedicated senior cabinet minister reporting to the Prime Minister, to bring together all the players and seek their co-operation like the appointment of a Minister for Productivity and Regulation. Even then you are left with a problem of how to involve the states. This looks a bit like Bob Hawke's famous parliamentary meeting for business and unions to achieve some form of consensus, which was very successful.