

First Home Ownership
Productivity Commission Discussion Draft
Submission

The Commission has been asked to examine the efficiency of the housing market, with particular focus on possible impediments to first home ownership. It has presented a detailed discussion on the key issues and canvassed a number of options in its Discussion Draft. I do not believe, however, that the outcome of the Inquiry will address the concerns that lie at the heart of why the terms of reference were initiated.

While the terms of reference have been prepared using economic concepts, the vital issue of concern for the community and the Government is whether the market has got it “right” when it comes to housing prices. This is something of a conundrum: the theory that supports the development of market-based solutions says an assessment of such kind cannot be done objectively. While some aspects can be measured, there is always a component of efficiency that resists being gauged – even articulated.¹ If this were not so, governments could sensibly assume responsibility for all resource allocation decisions on behalf of the community.

I believe the concern with housing affordability is a manifestation of more fundamental issues associated with the application and presentation of the broader micro-economic reform agenda. The market reforms undertaken in Australia over the last twenty years were underpinned by a “leap of faith”. We cannot present conclusive evidence to prove one way or the other that the current approach to economic management is superior or whether prices are right – it is a gut feel.

This has had an unsettling effect within the community. It has also led to the seemingly contradictory scenario in which we have rising material wealth coupled with a growing sense of personal insecurity.

While the reforms have been a success in delivering economic prosperity, they have a limited recognition of the more fundamental human need: a sense of security beyond material possessions. With no solution apparent, people have been inclined to deal with this uncertainty by accumulating basic goods such as land and housing. This concern is also apparent in opposition to the reform of “essential” services such as water, electricity and transport.

I believe that the “over-cooked” housing market manifests these dynamics. As such, the anxiety over home ownership will only be addressed through economic policy if stakeholders restate what is fundamental in the free market philosophy. The question is not “Is housing affordability reasonable?” but, rather, why are we obsessed with asking such a question, given we already know there is no definitive answer?

Background

Since the mid-1980s, Australia has embraced the principles of free market economics. Based on observations made by Adam Smith in the 18th century, this philosophy states that the welfare of the community will be maximised when there is a voluntary exchange of goods and services between parties who act in a self-interested manner. A central belief holds that the prosperity of the wider community, through some mysterious process, will be promoted when this relationship is allowed to flourish. Less involvement from outside parties (eg government) means a greater prospect that common interests will be met, and a win-win outcome achieved.

¹ Economists often cope with this by using the term “dynamic” efficiency. It is something like that scene in *Reality Bites* when Wynona Ryder is asked to define irony. She can’t, but makes the point that she still knows it when she sees it.

The *laissez faire* philosophy of the free market is difficult to define. It is quintessentially poetic: less means more. It is about taking away rather than adding. As such, the free market is not a “thing”. Our best attempt at a definition must be framed in a negative way: it is that which prevails when impediments and the “dead hand” of government and bureaucracy are removed. The market is therefore literally “nothing” – yet we favour it because we believe it to be anything but. I suspect this is why Smith had to revert to a metaphor – the invisible hand – to evoke the positive attributes of the market.

All this presents a number of challenges when it comes to policy development. I believe that these issues have not been adequately identified by proponents of the free market and are at the root of many concerns, including why the Commission has been asked to examine matters such as the affordability of housing.

Nature of the “Problem”

The centre-piece of our current policy approach is unseen. Although invisible, market forces are nonetheless taken to be real when it comes to creating wealth for the community. We have a situation then in which the policy objective is real yet unable to be adequately defined and quantified. This quandary was effectively noted by the Commission in a recent inquiry concerning the national access regime:

The ultimate objective of access legislation is to enhance community welfare. In an operational sense, however, this is difficult to convey in a meaningful way. To this end, the objective of Part IIIA [of the Trade Practices Act 1974] has been couched in terms of promoting competition in the delivery of infrastructure services.²

A similar experience has been documented in the present Discussion Draft. The report (p. 139) infers that there remain inexplicable drivers for the extended upward trend in housing prices: “[M]arket fundamentals and policy settings do not explain all the recent growth in demand and house prices – especially in the past couple of years”. This should not be surprising, given that the alternative (ie the Commission could understand all aspects of house prices) would be contrary to economic theory concerning the market.

I believe the essence of the problem faced by economists is that human nature is disinclined to accept the vagueness that comes with defining the likes of a free market and the invisible hand. A statement such that the housing market should be efficient tends to become unacceptable over time, as it is not sufficiently tangible.³ Our preference for positive definitions places a greater emphasis on what can be seen and understood logically. As noted in the above quote, there is also a practical need to translate the efficiency objective into words for legislation and policy purposes.

All this can create a momentum that actually works against the core principles of the free market ethos. That is, we must add and create (eg arguments, legislation, regulation) in order to give effect to the ultimate objective of taking away. This process brings with it a considerable risk: because the measures used to pursue the vague efficiency objective are more concrete, we can become unduly focussed on the means at the expense of the ends. This tends to occur without us even realising it. One can only detect this “trap” if one is willing to consider it a fact that our reason alone cannot understand phenomena such as the invisible hand. This is difficult to achieve in an environment where there is a growing expectation that all decisions and policy positions can be justified and explained solely in rationalist terms.

Ironically, free-market economics has been given the tag rational when it is anything but. The invisible hand of the market is an utterly irrational “concept”. As noted above, there are quantifiable aspects to the relationship between a willing buyer and seller, but something “more” than facts and figures is involved. This renders the whole exercise beyond reason – an explicable plus an inexplicable gives an inexplicable.

² Productivity Commission (2001), *Review of the National Access Regime*, Report #17, AusInfo, Canberra

³ This has been experienced by the Commission over the years as it has often been criticized for being aloof and impractical concerning its pure approach to policy. The community wants hard answers and solutions – not an “air-fairy” philosophy that says that our economic future will be guaranteed if we remove all barriers and controls.

This relationship is also evident in economics itself. Supporters of the free market have tended to be rational in their arguments supporting a commonsense approach to managing our scarce resources, but it does not follow that the essence of what is being supported can be explained rationally. That is, one may use logical arguments to defend the legitimacy of the free market but such views are not necessarily intended to be used to define the market in a positive sense. Indeed, the supporting case for the market should always recognise that the core of what is being alluded to is, ultimately, ineffable and thus requires suspension of intellectual judgement – a leap of faith.

Of course, this proposition is readily lost in the process of giving it meaning. As our mind is inherently arrogant, one cannot expect it to ever sustain an admission that it cannot understand what we most wish to understand – even if it may feel beyond our reason. We cannot help but question what we cannot understand and in the process cause ourselves more and more frustration and dismay.⁴

Economic policy harbours a paradox within a paradox. In the first instance, reason alone cannot explain phenomena such as the invisible hand. While this irony may be identified and even accepted at some point in time it will tend to be forgotten, as we are predisposed to resorting to our minds in an effort to understand why this is so. That is to say, even though we may accept that there is no formula or literal representation of efficiency, we are fated to discount this realisation and continue to search for one in any case.

The effect of this is to take us further from what it is we wish to grasp and promote on behalf of the greater good.⁵ What we knew and enjoyed in a particular moment of clarity is immediately abandoned – and we feel the worse for it – as our minds cannot retain the idea that the paradox is, in a fundamental sense, impenetrable.⁶

Housing Inquiry

Over time, the market has become a “thing” in a positive sense. Our lack of acceptance that we cannot understand has rendered it a manifest contradiction and thus a source of growing conflict.⁷

For example, it is accepted that a housing market, as such, exists. Various facts, figures and trends (eg prices, size of house and land) encourage us to believe that we can understand why things are as they are. Our sophisticated technology adds to the flawed view that our ability to predict and control the market is imminent. All this achieves, of course, is a crowding out the mystery of the invisible hand, leaving our modern-day marketplace as an unstable forum for unproductive rent-seeking rather than a shared source of positive community.

If the economic paradox within a paradox is true but unrevealed, then a number of consequences would naturally follow. For example, it is likely that “supporters” of the market will engage in a pointless effort to justify policies that have an irrational component, even though there is no way of proving that the free market is the best approach. The resulting

⁴ The seemingly unsatisfactory idea that we are trapped within our boundless imaginations, unable to understand that we cannot apprehend what cannot be apprehended, was alluded to by Blaise Pascal in the 17th century when he wrote that the mind was a “misleading faculty which seems to have been implanted in us precisely to lead us into necessary error”.

⁵ It would seem that the right intentions are necessary but insufficient. The Commission recently commented on this in respect of economic regulation. Good intentions can not overcome the deep-seated dilemma faced by regulators: regardless of intent, they cannot avoid becoming part of the problem, as their mere existence institutionalises something less than a pure win-win.

⁶ I refer to this as “Louise’s Dilemma”, after the woman who revealed it to me – not in terms of the invisible hand, but in respect of my misguided efforts to understand, quantify and manipulate, for all the right reasons, the love she once offered me.

⁷ This is also the case with other vital aspects of man’s struggle for meaning, such as freedom, democracy, justice and the existence of a deity. In this regard, *hadith* (the collection of traditions and sayings of the prophet Muhammad) provides a sobering lesson for all policy makers: “Reflect upon God’s creation but not upon his nature or else you will perish”.

desperation and confusion is then likely to be latched onto by “opponents” of the market as evidence that the general philosophy is flawed. The conflict can feed into further tension and/or a willingness to promote policies that are more about placating anxious interest groups than solving the “problem”.

On this basis, I believe that the community in general is developing a growing insecurity based on a sense that our core economic philosophy is questionable. Our leaders within government and business are unable to remedy the situation, as they themselves are unable to feel the true nature of what it is they support. The economic community has not helped by failing to inform politicians and the like that a belief in the efficacy of the free market cannot be proved in an empirical or logical sense.

While economic reform has enhanced our material wealth, our lack of unreasoned faith in the policies that have supported it are causing a disquiet that is feeding into a frenzied grab for what is thought to be “more real” than the faith people ultimately crave. The community is beginning to hoard basic elements such as land and housing to compensate for the lack of a higher sense of contentment. Proposed policy solutions (eg first owners subsidy) do not offer any structural relief, as they are formed on the basis that what is needed is a “something” that can be seen and touched. People wish to get beyond possessions, yet we cope with this struggle by initiating policies that harp on the problem.

Conclusion

Australia is amidst a telling stage of its cultural and economic development. We are accruing the benefits of an extensive economic program of reforms that started in earnest in the mid-1980s, but at the same time feeling as though we have forgone some of the positives encompassed in the “good old days” of government, commerce and community. The pursuit of economic security has in some way undermined the goal for which it was originally enacted: to improve our well-being.

I believe what we have failed to acknowledge is the core paradoxes within economic theory. In order to promote economic prosperity, we potentially compromise what is “more real” than the wealth we create along the way. Competition, opportunity cost, best practice and other performance-based concepts have certainly been positive, but they also all appeal to the mind and its belief that all of importance can be made a thing to be controlled and manipulated. Even if for the right reasons, we then set out to regulate and distort in the vain hope that it will improve our welfare – when in fact it makes the situation worse.

Of course, this view, by definition, cannot be proved – its core proposition is that what is of ultimate importance cannot be comprehended by our reason alone.

A sense of security is more than what can be seen and quantified – it is a feeling that life is OK. Food, shelter and material possessions are necessary for our fulfilment, but they are not sufficient. The disquiet within the community is an intuitive awareness that something is missing, although it cannot be articulated other than to say “something is missing”. We have become caught up in a need to define things in a positive sense and in the process have pushed aside the mystery we need to give life a sense of completeness.

Economic policy can assist by acknowledging that the free market philosophy, while having a sound rational basis, is essentially about a leap of faith. As such, one cannot use rational thinking alone to justify its benefits. The market approach was initially adopted because it felt right. Recognition of such should lead to a different set of questions on why the housing market may be demonstrating “irrational” behaviours. We need to be asking why we are asking the question and if this need to ask is in itself part of the problem.

We should be looking to understand that faith cannot be explained or justified, as it is a shared experience.