

High house prices: a blunder of our governments

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Synopsis

High and rising house prices in Auckland hog the headlines. The tax regime and bank lending practices are largely irrelevant to what has gone on. Instead, increasingly unaffordable house and land prices result from the collision of two, no doubt individually well-intentioned, sets of policies. Tight restrictions on land use crimp the supply of the sort of properties most people want to live in, while very high target levels of non-citizen inward migration persistently boost demand for housing. One or other policy might make sense, but together they represent a blunder that is enormously costly to the younger generation of Aucklanders.

Introduction

Last year, two eminent British professors published a very readable book called *The Blunders of our Governments*.

The book focuses on eleven specific “blunders” of British governments over the last 30 years or so. These blunders are not just about wrong judgement calls, or unforeseeable changes of circumstance, or about a partisan view of the merits of what a government was trying to achieve. They define a “blunder”:

as an episode in which a government adopts a specific course of action in order to achieve one or more objectives and, as a result largely or wholly of its own mistakes, either fails completely to achieve those objectives, or does achieve some or all of them but contrives at the same time to cause a significant amount of “collateral damage” in the form of unintended and undesired consequences....financial, human, political or some combination of all three.

Many of the individual British episodes won't mean much to New Zealand readers, but the poll tax is one blunder that lives in the memory, and should be familiar to anyone of a certain age.

¹ This text was the basis for an address to the Symposium NZ 2015, organised and hosted by PortfolioConstruction Forum.

My focus isn't on Britain, and it isn't on the political science questions the authors address of why and how such blunders happen. My proposition is simply that the absurdly high house (house+land) prices in Auckland are the result of blunders of our governments.

Median house prices in Auckland are now in excess of \$700000, and those in Invercargill are \$180000. That difference that is probably understated if anything, because they have large sections in Invercargill and increasingly often tiny ones in Auckland. The focus isn't in Parnell or Devenport prices - that capture the amenity value of living close to the heart of a fair-sized city. It isn't about small pockets where the fabled 'global elites' might live (here or in similarly afflicted cities like Sydney or London).

This is about comparisons between prices in middling suburbs - places like Oranga, not far from here, where I grew up - in Auckland, and across the country. They are the sorts of places where young families might reasonably expect to be able to buy. Instead, Auckland - which simply is not that big a city - now has among the higher house price to income ratios anywhere in the advanced world.

As often with these sorts of things, it isn't the people at the top who suffer. Mostly, it is the young and the poor, and in this city that disproportionately means Maori and Pacific people.

I'd make a couple of points up front:

- I'm not focused on the precise level of prices now or at any particular year. All sorts of things affect year to year fluctuations. My focus is on the big picture - the decades-long move to ever less affordable houses
- And please note the plural in my title. This isn't an opportunity to bag one political party or the other. These are, at very least, bipartisan blunders - the responsibility of the largely shared assumptions and priors of a succession of National and Labour-led governments over the last 25 years or more.

I'm also not suggesting evil intent or malevolence on anyone's part. That is the thing about these "blunders": smart people had ideas that seemed respectable, and often even more than respectable. But they have ended up inflicting huge collateral damage.

Other possible explanations

A lot of people would like you to believe that something about the tax system is a big part of the problem, or something about the banking system and the way it is regulated. They are wrong.

We have a single tax system for the entire country. Features of the tax system – capital gains tax or not, bright-line tests or not, loss-offsetting or not, depreciation schedules, land tax or not - just cannot explain the sort of differences we see in the data across perfectly pleasant regions in New Zealand.

Of course tax systems make some difference to asset prices. Lowering marginal tax rates, for example, might tend to lower high prices, and raising marginal tax rates should raise them. Over the last 15 years, we've raised and then lowered them, for not much overall change. Impose a comprehensive capital gains tax tomorrow and it probably would dampen house prices for a time -

across the country - but international experience (and I've looked at a lot of it) would have to leave you pretty sceptical that it would make much sustained difference (and especially to regional house prices differences).

A land tax appeals to a lot of economists. We had one in New Zealand for well over a hundred years - it was increasingly whittled away until it was finally abolished 25 years ago. Systematic land taxes aren't that common internationally, but imposing one would almost certainly lower land prices (urban and rural) perhaps quite substantially. It would do so across the country, and across all types of land. That would represent a huge windfall loss to many people - not just those who happened to be holding Auckland land through the most recent boom. And for those keen on the revenue, keep the possible magnitudes in perspective: long-term real interest rates, even in New Zealand, are now under 2 per cent. An annual tax of 1 per cent of the value of the land would be equivalent to an additional 50 per cent tax on the risk-free component of the land's return. I'm not necessarily opposed to a land tax, but I doubt the possibility of doing it well nationwide. A more realistic option might be, say, for the Auckland Council to move to land value rating, rather than capital value rating. Doing that would both encourage efficient use of land, and help ensure that those who hold undeveloped land have a more powerful incentive to release it onto the market.

And what about bank credit policies? Some commentators - Gareth Morgan probably loudest among them - have argued that because banks are required to hold less capital against housing loans than against business loans there is a systemic bias towards lending to housing, fuelling a housing and housing credit boom. But capital requirements are supposed to be aligned to risk, and lending secured on housing is generally much less risky than lending for other things (unsecured personal loans, property development, SMEs, or even dairy farms). This isn't just a proposition about the last few years - when there have not been many losses on New Zealand housing loans - it is a result across many countries and many decades. There are risks in housing lending, but they are a lot less than those in most other forms of lending. So markets, and regulators, expect banks to hold less capital against vanilla housing loans than against other types of loans.

As it happens, when people have looked into cross-country comparisons (which aren't always easy to do) they have found the New Zealand banks have higher risk weights on housing lending than their peers in most other advanced countries, including Australia. In other words, for a dollar of housing lending in New Zealand, more capital is held than would be held on the same sort of loan made in Australia, Canada, Sweden, or the United Kingdom. None of this proves the banks - or the Reserve Bank - have it right but there is no smoking gun in this area either. And remember, bank credit standards are pretty similar across the country - and Reserve Bank risk weight requirements certainly are - while all the fuss is about Auckland house prices. Banks can make a difference, in the short-run: competition for market share, perhaps especially in a particularly region, can affect credit supply etc. But here we are trying to make sense of long-term trends - 10, 20, or 30 years.

Interest rates are also sometimes blamed for high house prices. Again, no doubt the ebbs and flows of lending rates make a difference in the short-term, but it isn't a compelling story over the longer-haul. There are several strands to the story.

Interest rates are where they are for a reason. The OCR is not at 3.5 per cent (and expected to go lower) because a random number generator came up with the number, but because the Reserve Bank took a considered view that unless the OCR were this low, inflation would be undershooting

the inflation target. Whereas in 2007 so strong was demand (for goods and for assets) that New Zealand needed 8.25 per cent interest rates, now we need 3.5 per cent (or lower) and still struggle to keep inflation high enough. New Zealand sets its own interest rates – short term rates by policy, and long-term rates as markets price expected policy - based on economic conditions in this country.

Second, we have one interest rate for the entire country. And in much of the country, despite the low interest rates, real and nominal house prices are lower today than they were in 2007. There are really only two big exceptions. The first is Christchurch, where house prices and rents rose for obvious reasons - a big chunk of the existing housing stock was destroyed - and Auckland. That suggests we need to look for Auckland-specific factors to explain what is going on.

Finally, recall that what we loosely call a house price is actually the price of a bundle of a building and some land. In a well-functioning housing market, the value of the building will be much the largest component of the total. Building costs don't rise when interest rates are lower - if anything holding and working capital costs are lower than previously. So if lower interest rates raise anything it will be section prices. But even urban section prices are a bundle of unimproved land plus all the infrastructure costs (water, sewerage, roads etc). The latter are also a little cheaper to put in place when real interest rates are lower. Pure unimproved land is in fixed supply - no more New Zealand is being made. But pure unimproved land is also not particularly valuable: at the peak of the dairy boom, prime dairy land was selling for perhaps \$50000 a hectare (and a tenth of a hectare is a very generous urban section these days). Lower interest rates just don't make that much difference to the price of a house+land when land use is not tightly restricted.

Construction costs are often cited as a factor in the story of high New Zealand house prices. There may be something to this, but intensive scrutiny has not pointed to obvious areas where policy choices are responsible. Moreover, any issues in respect of construction costs are not, disproportionately, an Auckland phenomenon.

A collision of two sets of policies

Having dealt with some of the often-cited factors that don't seem to explain the Auckland house price story, I want to spend the rest of my time on my own story. My proposition is quite simple: taken over the medium term, Auckland house (house + land) prices are absurdly high because of the collision of two sets of policies, formulated (and apparently run) in isolation from each other:

- Central and local government laws, policies, attitudes and practices that have made it slow and expensive to bring new houses (house + land) to market
- Immigration policy, which sets out actively to bring in a large number of non New Zealanders every year.

It isn't that the Auckland Council and the land use rules here are necessarily any worse than those of councils around the rest of New Zealand - I'm not close enough to know, but I'd be surprised if they were. There are, no doubt, land use restrictions etc in Invercargill, but these things matter much more in Auckland because the population is growing quite rapidly. Mostly - and on average over

time - it is still growing quite rapidly because of the large scale trend immigration of non- New Zealand citizens.

But here let's deal with another straw man. It is sometimes suggested that high Auckland house prices are an inevitable feature of being a big city, and that New Zealand is unusual in the share of its total population that is in Auckland. I think I heard the Reserve Bank Governor suggest last week that among advanced countries only in Iceland did the biggest city have a larger share of total national population than is the case in New Zealand.

But this is just wrong. Quite a number of small advanced countries have big cities that make up a very large share of the national population. Definitions matter, of course, - what is the limit of the metropolitan urban area - but when I worked my way through a list of advanced countries the other day Auckland's size (in a country of 4.5 million) just didn't look that unusual by international standards. Tel Aviv makes up 45 per cent of Israel's population, and Dublin almost 40 per cent of Ireland's. Copenhagen, Vienna, Valetta, and Riga each look to make up at least as large a share of their respective country's total population as Auckland's does. Tallinn and Lisbon don't look to be much behind. And I gave up digging around the scale of the commuter zones around, say, London and Brussels.

What marks Auckland out from most of these cities is the sheer pace of growth of Auckland. I did some work a while ago trying to look at population growth in the largest cities in each advanced country in the post-war era. Across all advanced economies, as far as I could tell, only Tel Aviv had grown faster than Auckland. The issue has come into sharper focus as population growth in the rest of the country has slackened, or even started to go into reverse.

I'm not here today to discuss whether rapid population growth is a good or bad thing. Frankly, it depends. If it is natural increase, it is just private choices, which we have no reason to second guess. If it is mostly a response to new highly productive opportunities - think of the introduction of refrigerated shipping in the 19th century - it is probably mostly a good thing. If it is mostly because of a policy simply setting out to bring in lots of people, especially from poorer countries, the case is likely to be much harder to make successfully.

But if we are going to have rapid population growth in Auckland, and yet we don't have policies that enable new houses and land to come to market quickly and affordably, then it is no surprise that we have the mess we do. That mess involves huge gains to those who happened to own urban land, and an increasingly difficult time for the young and poor trying to buy a home and raise a family.

Nor is there any basis for simply saying that fast population growth makes house and land inflation pretty inevitable. It is a choice, and we seem to have chosen the option that bears heavily on the young and poor.

Houston is the best-known example of the alternative approach. I knew the stylised results - not much sustained real house price inflation in one of America's biggest and fastest growing cities, but when I checked the numbers again even I was sobered. Since 1979, the population of the Houston metropolitan statistical area has more than doubled, from 3 million in 1979 to 6.5 million last year. Over that period, real house prices have fallen in Houston. I haven't cherry-picked dates here either

- Houston had a boom that didn't peak until around 1983, and has seen quite material house price growth in the last few years (as the oil industry has been doing well).

By contrast, since 1979 Auckland's population has less than doubled, and Auckland house prices have much more than doubled.

In preparing for this talk, I dug through a few historical documents that mentioned urban planning. One - found somewhat at random - was an article from a 1962 edition of a Maori youth magazine, *To Ao Hou*², which ran as follows

Until recently, if you owned some land you could do what you liked with it. You could build a house, a factory, a shop, and it was nobody's business but your own..... So a time came when people decided that we must plan the development of our cities and our countryside, and that there would have to be a law to say what sort of building you could put on your land. That is why the Town and Country Planning Act was passed in 1953.

Or from the Ministry of Justice's website³ this quote from Hansard in 1926, when apparently the very first piece of town planning legislation was introduced. The Minister of Internal Affairs observed

Cities and towns in the Dominion at the present time have no schemes of town planning and the sooner the controlling authorities have the power and set to work and draft such schemes the better for themselves and the people generally.

Better for the Councils themselves perhaps - much more power for elected officials and their staff - but the rest of us might wish they had left well alone.

I'm no expert in the details of resource management law and practice, but from what I've read it wasn't until the 1950s that "town planning" became a major consideration. And, of course, the legislation changed repeatedly over the years, finally landing in the form of the Resource Management Act in 1991 - introduced by a Labour government and passed by a National government. Strangely - at least with the benefit of hindsight - key participants apparently regarded the RMA as being likely to represent an improvement, resulting in less restrictive planning regimes. That belief would have been consistent with the general thrust of policy, again under both governments at the time.

Quite what the RMA - and associated powers in, eg, the Local Government Act - meant for housing and urban land prices wasn't immediately apparent - probably not within places like the Ministry for the Environment, and certainly not in the wider economics and policy community. In that wider community at least. the whole panoply of rules around site coverage ratios, protection of view shafts, rules given effect to Council prejudices against "sprawl", and so on were all something of a mystery.

² <http://teaohou.natlib.govt.nz/journals/teaohou/issue/Mao38TeA/c11.html>

³ <http://www.justice.govt.nz/courts/environment-court/about-the-environment-court/History>

I remember being rather puzzled, and perhaps a bit disapproving, when Don Brash spent some Reserve Bank money in the mid 1990s on a report on some of these issues by the late Owen McShane. In 2002, just as the house price boom of the 2000s was about to get underway, the late Roger Kerr gave a speech “The Resource Management Act: Fundamentally Sound or Fundamentally Flawed”. Roger concluded that it was fundamentally flawed, and yet in the course of his speech there is no mention of house prices or urban planning issues at all. As late as 2006, the Reserve Bank/Treasury Supplementary Stabilisation Instruments report (of which I was a co-author) was surprisingly light on the supply side of the house price issue, just suggesting that more work needed to be done. Macroeconomists struggled to come to terms with the idea that these microeconomic provisions might make so much difference.

Part of the difficulty is that there is always a lot else going on in the economy - messages are never unambiguous, especially if one isn't looking for them. It wasn't really until the 2000s were well underway that affordability issues increasingly became apparent - and politically salient. The issues have come into sharper relief in the last five years, when there has been little overall credit growth, no booming economy, and declining rates of natural population increase. What that left, rather starkly, was a few stylised facts:

- Auckland prices rising far away from those in the rest of the country
- Continuing town planning restrictions, and new empirical evidence (eg Grimes and Aitken) on land prices just inside and just outside the Auckland MUL.
- The reports of bodies like the 2025 Taskforce and, later, the Productivity Commission
- Continuing large targets for non-citizen migrant inflows

Whatever the reason, everyone now recognises that supply - and supply restrictions - have been a big part of the story. It was a long time coming, but we are getting there now.

Of course, interpretations still differ a lot. The Chief Economist of the Auckland Council was in the Herald last week⁴ defending his Council on the grounds that they “actively stage the release of land to ensure seven years' supply of land is available at all times”, but isn't that a central planner's mentality to a tee? Land prices are telling him something important about supply. Hayek pointed out decades ago the rather obvious insight that governments didn't have the information to effectively coordinate all the activities, and reconcile needs and wants, in a modern economy. Local government is no better equipped. Housing is no simpler - indeed, it is harder, given the lead times in development and construction. If we want affordable housing in a city with a fast growing population, we probably need to put much more reliance on market processes. What if, for example, any land in Auckland City be automatically deemed able to have houses built on it? It wouldn't be the full answer by any means, and there are complex issues around responsibility for transport infrastructure in particular, but the knowledge that any land could be built on would be expected to quite quickly lower actual land prices. Existing holders of residential-zoned land would be keen to use that land, or sell it, before the land lost value. Expectations matter a lot, and there

⁴ 15 May 2015, “No, Mike, this crisis is not our fault”

wouldn't need to be huge amounts of new building for expectations about future potential supply to start adjusting⁵.

The same Chief Economist noted that his Council was "encouraging as much intensification as the community will allow", but seems oblivious to the likelihood that intensification isn't something that anybody really wants that much of in New Zealand. The Deputy Governor of the Reserve Bank recently fell into this trap - he suggested that more people should live in apartments, just as they apparently do in Sydney, without stopping to reflect that planning restrictions in Sydney are typically regarded as even more constraining than those in Auckland. People move to apartments partly because they are cheaper, because regulatory restrictions have pushed urban land prices so far out of reach.

I'm not suggesting that there should be no intensification. I don't have a view on the matter. I think we should let people's preferences dictate. Note, however, that cross-country historical evidence suggests that as countries become richer their big cities become less dense over time, not more so⁶. Space is a normal good - on average, people want more of it as they become richer. Consistent with that, it looks as though, when they can afford it, most people in countries like ours prefer to raise families in stand-alone houses with a garden and backyard etc. That should not be an impossible dream for ordinary families in a city of only 1.5 million people. But regulation - and associated practice - is fast making it so.

It isn't all the Council's fault, and it isn't all the government's fault either, and getting out of this mess now isn't easy even if everyone wanted to. And it is clear that there are some who don't regard these things as matters of choice or preference, but continue to adopt that 1926 philosophy. They have a vision for "the city", they know best what is in our interests, and the rest of us have to fit in. The same chief economist talked about the need to preserve "quality urban design" - by what standards, in whose interests, at what price, and so on.

If we can't, or won't, change the laws and practices around urban resource management - if we continue to allow councils to set rules that price out the young and the poor - then we really need to think again about immigration policy. A good start would be explicitly recognising the impact of active policy choices.

New Zealand's population has been growing for a long time. And as I noted, Auckland was one of the fastest growing large cities in any OECD country in the decades since WW2, but high house prices haven't always been a problem.

Part of that was because of the panoply of rules that were in place. In the post-war era, people wanting Housing Corp loans - the way most young couples (including my parents) got into their first homes - had to use them to build a new house. The whole focus of policy was on home ownership,

⁵ This is what I think is wrong with the recent argument from Westpac, that Auckland property prices are now being driven up by the prospect of liberalised laws/restrictions on eg apartment heights. The prospect of being able to use an individual piece of land more intensively will certainly tend to raise the relative price of that piece of land, but it is most unlikely that liberalisation will raise land prices more generally. It is an increase in actual and expected supply, and neither immigration policy nor natural increase is endogenously responsive to change in Auckland urban land supply. Improving supply, relative to any growth in demand, will lower land prices, not raise them.

⁶ <http://croakingcassandra.com/2015/03/30/richer-cities-become-less-dense/>

and homeownership meant construction . It was similar story in other countries - the UK and Australia for example⁷. Norman Kirk, who built his own house, was Mayor of Kaiapoi in the 1950s - one suspects the local borough council had a different attitude and perspective than most of those today.

That mix of policies and attitudes all broke down in the 1970s and 1980s. The government largely got out of housing finance, and when finance was provided it could be used for new or existing houses. And deliberately or otherwise the powers of local government officials and councillors grew, and their interests seemed to diverge from those of residents wanting affordable housing.

So under a quite different policy environment we coped with large immigration, and large natural population increase, in the 50s and 60s without seeing big house and land price problems. And in the mid 1970s immigration policy changed, so that Britons no longer had near-automatic access to New Zealand. Migrant numbers plummeted, and the large net outflow of New Zealanders to Australia - that continues to this day - began. From the mid 70s to the early 1990s, it wasn't that hard to meet housing demand - there wasn't much demand for new housing from either locals or immigrants. Overall population pressure was pretty weak, and it was more evenly spread across much of the country.

Immigration policy was reversed again in the late 80s and early 1990s. There were some very sensible changes, including a move to a points and skills based scheme, so that when we get migrants, we typically get pretty capable and skilled people.

Part of the change of policy seemed to involve a strange notion seemed to take hold that we should replace people that were leaving, as if the government knew better than people about the opportunities in New Zealand. But there also seems to have been some sense that if we were freeing up all sorts of other markets we should free up people movement: there were "gains from trade", benefits from a bigger population, gains from agglomeration and from diversity etc etc

What there wasn't was a proper public debate on the matter (or even, as far as I can tell, a very active one within government circles). It just happened - the sharp increase in migrant numbers didn't need Parliament's direct approval and even today the target level of non-citizen migration is just set by the Minister of Immigration (currently 135000-150000 permanent residence approval on a rolling three year basis). Many otherwise well-informed people are surprised to learn that there is even a target. But as a result, New Zealand has had among the very largest average rates of non-citizen inflows (net) anywhere in OECD.

And our government chooses how many non New Zealanders we allow in each year⁸, knowing that the bulk of them will gravitate to Auckland (even students who go to Otago or Canterbury will probably probably gravitate towards Auckland if they end up staying). Our good quality skilled immigrants aren't like illegal Mexicans in California or Texas: they don't want to live 17 to a house, but want good middle class housing much like we do.

⁷ John Kay discusses the UK experience here <http://www.ft.com/intl/cms/s/0/14cd1280-f25d-11e4-b914-00144feab7de.html#axzz3aSTV7oXE>

⁸ Australian immigration to New Zealand is unrestricted, but the numbers involved are small and quite stable.

That immigrants disproportionately come to Auckland isn't unusual - it is what we see around the world. Many of the people coming are used to bigger cities (whether from China, the UK, South Africa, India or the Philippines). Migrants might want the opportunities of a new country, but they always want connections to their own culture - the bigger city is more likely to offer the people, the food, religious practices etc that they are familiar with. Migration research shows that (quite sensibly) people congregate where people like them already are.

Debates about doing something about migration get frustrating around this point - lost in the headlines about large annual fluctuations (which are mostly about New Zealanders) at the expense of a focus on the underlying trends. As we all know, lots of New Zealanders come and go - more go than come back, but the cycles are large, and the relative health of the NZ and Australian economies is a big factor there. Immigration policy is not about New Zealanders - it never has been and never will be in a free society. And year to year fluctuations shouldn't be what bother anybody concerned with economic policy - in a year with a big inflow house prices might rise, and in a year with a big outflow they might tend to fall (houses are assets, asset prices fluctuate), but over time it is the average net inflow that affects average or trend demand for housing.

It is these averages that run head on into the effect of restrictions on supply of new housing/land. The fact that we have an average inflow at all, and its size, is all about how many people our government aims to bring in each year. That is pure choice. Of course, there are lags in the system, and when our economy turns down some people with approvals put off coming. So again, the issue isn't - and never has been - about controlling precisely each year's arrivals, but about the trend or average level. We have had an average net inflow of non-citizens of 40000 per annum since 2000. By contrast, in the 1980s we had an average inflow of only 10000. Those are really big differences (750000 people over 25 years) - that is now the difference between a rising population, and a population that would be flat or falling.

The difference is almost wholly all a matter of policy choice - our governments actively chose to bring in more people, at a time when the RMA and council restrictions were making new housing supply more difficult to get to market. The impact was not envisaged: it was a blunder. But it needs to be fixed at source, not by papering over symptoms.

Before wrapping up, I wanted to make just two final points. The first is that one way of looking at the Auckland issues is to look across all NZ regions: pretty much everywhere has supply restrictions, but places that don't have population pressures aren't seeing rising house prices. If anything, real prices are now falling, and if they are still too high - mostly still above the oft-cited three times income benchmark - are more or less affordable. The other lens on the issue is to look globally. What is happening in Auckland is not so different than what has happened in Sydney or London or San Francisco - and is very different to the situation in Houston or Atlanta. Tight supply restrictions and population pressures push prices sky high. Without such impediments to supply, real prices don't rise much or for long. And without population growth - as say, Japan or much of central and eastern Europe now - supply restrictions don't matter much for prices.

A common counter to the sort of story I've run here (that net supply is lagging behind effective demand) is to point out the real rentals for housing in Auckland have not increased much over the last 15 years. It is common argument, and I've run it myself. But I've also come to the view that it is a flawed argument. Back in the early 2000s, just before the house price boom got underway real

government bond yields were around 4.5 per cent. This year, the rate for a comparable term is around 1.8 per cent⁹. Real interest rates have fallen very substantially (albeit New Zealand's are still high by international standards). This is a case of the dog that didn't bark - we look at rents and think there is nothing interesting in the data, but there should be. With a fall in long-term bond yields, real yields on alternative assets should also have fallen. And as the Reserve Bank Governor has pointed out, rental yields in Auckland have fallen a long way. But they should have done - that is what alternative asset returns suggested. But without the flawed collision of policies, that resulted in the huge rise in real Auckland house prices, we should have expected to see nominal rents falling behind general inflation. With core inflation at present just above 1 per cent, perhaps we might have seen nominal rentals falling? That we haven't seen rents falling is another effect of these blunders of our governments.

Conclusion

House and land prices will always fluctuate. They are prices of assets, and that is what asset prices do. All sorts of events – news, “shocks” etc - cause prices to move from year to year. But Auckland prices - like those in a number of cities around the Anglo world - are crazy. “Crazy” here doesn't mean unsustainable - they could stay high for a long time, precisely because they are a reflection of a very bad combination of policy choices. Perhaps worse than “crazy” they are simply unjust. Probably no one would have signed up for that combination if the implications had been realised, and well-communicated, at the start. But no one did. That was a systematic, and now ongoing, failure of our governments.

There isn't really that much argument about the directions of the effects involved here:

- No one is really disputing that more houses and urban land would lower prices (based on more actual supply and expectations of more to come)
- No one really disputes that rapid population growth puts pressure on prices. But there is less recognition that the trend increase in Auckland population, now that NZ natural increase is so small, is mostly a policy choice

So we have two sets of policies that run headlong into each other. Each individually might make sense (I personally don't think the urban planning one does) but together they are disastrous for the young and the poor of this city. As I've set out on my blog, I don't think this has the makings of a financial crisis - not only will it take major policy change to induce a large **sustained** fall in real house prices, but the Reserve Bank's stress tests (recently reaffirmed by a Reserve Bank spokesperson¹⁰) show that the banking system is well-placed to cope even if it did.

There are no easy ways to deal with the housing supply regulatory issues. Of course, there are textbook answers, and I will run them as much as anyone, but this is a pretty pervasive problem around much of the bits of the world we compare ourselves - big cities in Britain, Australia, Canada, and on the two coasts of the US. Getting change is difficult – inherently political, and even if one side of politics managed to “crash through” (hard anyway, given MMP, local councils, and - in Auckland's case – the abolition of regulatory competition implicit in the move to a unitary council a

⁹ Data from 2016 and 2030 inflation indexed bonds, from the Reserve Bank website.

¹⁰ <http://croakingcassandra.com/2015/05/16/house-price-collapses-stress-tests-and-the-like-the-rb-speaks/>

few years ago) there would most probably be a significant counter-reaction once the other side regained office.

But I don't see how it is fair to keep on allowing sky high house and land prices - making large parts of whole generations dependent on the distant hope of an inheritance to get a decent house themselves. Things can be still done - not the slightly theatrical tax or banking things in the headlines in the last week, which will briefly paper over symptoms and make next to no long term difference, and just redistribute gains to some at the expense of others - about the role of policy in driving up the population. It is an active choice, made each year. Our population pressures aren't the result of a high birth rate (private citizen preferences) and we don't face the British situation of open EU borders. Since the evidence for the wider economic benefits to New Zealanders of immigration is pretty modest¹¹ if New Zealand governments wanted to do something serious about resolving the house price problems here in Auckland, doing something about target immigration (permanent residence approval) levels would probably be an important part of any effective strategy. It probably isn't ideal - housing markets, like other markets, should be able to cope better with the pressures and opportunities of population growth - but we don't start anywhere near an ideal point.

Altering the permanent residence approvals target takes no legislation - it could be done tomorrow. Of course, it wouldn't alter the inflow tomorrow, but the number of people coming would fall off pretty quickly, and expectations would soon alter house and land prices. Migration policy changes have made a big difference before (the bust after 1974). This needn't be a matter of turning off the tap completely - fortunately it is one of those instruments that can be calibrated. But if, say, the target level of non NZ migrants was halved that would still leave NZ with a relatively large net inflow but would take a lot of pressure off the housing market, especially in Auckland. We make policy for New Zealanders, and I'm sufficiently Rawlsian to think that the interests of those at the bottom should count for quite a lot. Some pressures, some relative price changes are unavoidable. But unaffordable house prices are just a (government) choice. When a growing proportion of those towards the bottom can't afford to buy a house in our largest (not very large) city, something is wrong. It is those blunders of our governments.

¹¹ See, for example, the material reviewed in Julie Fry's "Migration and Macroeconomic Performance in New Zealand: Theory and Evidence", New Zealand Treasury Working Paper 2014/10, April 2014