What are the best economic policies to curb alcohol consumption?

The Economic Alcoholic

Hi, my name's Gary and I'm a recovering alcoholic.

The drinking started when my wife left me in 2005. I was so lonely and alcohol was the only thing that filled me with the warmth and comfort I had lost. The problem crept up on me slowly. To start with, it was just a few pints down the pub with some mates to cheer me up, then it became a regular occurrence, and before long I found myself drinking at home, alone. I knew the effects that drinking has; I knew of the risks of mouth and throat cancer, liver failure and strokes, but I didn't care. I was already too dependent.

Over the years, I became sick of doctors and friends telling me to quit. Doctors would remind me that it was selfish alcoholics like me who sucked £2.7 billion out of the NHS annually and friends would warn me that over 9000 people died from alcoholism every year in the UK. I couldn't escape the statistics; the death toll has tripled in 25 years, the UK is seventh in the world for its alcohol consumption, another 90,800 people will die in a decade. It's not my problem, I'd say.

I hated the government for all the policies it implemented to try and drive my bottle and I apart; tax rises, banning promotional offers in pubs, and minimum prices on booze. Obviously, I denied that I was the problem; instead I blamed drunken teenagers who vomit and fight in the street after a night of bingeing. But, I've come to realise that we're all to blame for Britain's shameful alcohol problem. I've been sober for almost a year and I'm ready to start paying back what I stole from society.

I think everyone has always assumed that France is the booziest nation in the world...they drink constantly; it's a way of life for them. So naturally, I was amazed when I heard that the UK had overtaken them in alcohol consumption. How was this possible? Okay, they've raised the age of purchasing alcohol from 16 to 18 but we've already done that. And it was way back in the 1990's that they banned alcohol advertising - even going as far as to call the 'Heineken Cup' the 'H Cup'! So why this difference in alcohol consumption? Alcohol is not as big a deal in France as it is in Britain. People here, especially teenagers, are obsessive about alcohol, whereas in other European countries, this attitude is non-existent. And what about Germany? Everyone knows that they're huge on producing beer; personal favourites of mine included Becks and Warsteiner, and yet, like France, in the last few years their consumption has fallen, whilst in the UK it has risen. German laws concerning alcohol are lax; you can buy alcohol at 16, and bars don't have closing hours. Why then, is there such a different attitude towards alcohol consumption over the English Channel? Is it our policies or our people that need changing?

Before I sobered up, alcohol tax was my number one enemy. In late 2008 the Labour Government raised duty on alcohol to around 8% on most drinks. I mainly drank spirits at this time, so it added a whopping 53p to each bottle. They said it was to offset the cut in VAT from 17.5% to 15%, introduced to encourage people to buy more goods and services in the recession. I felt specifically targeted but it didn't deter me from drinking; I simply switched to cheaper brands. Regardless of how much the tax increases damaged my bank balance, I still bought the booze. For alcoholics, increases in prices matter not, but perhaps for others who have not slipped so far, demand may be affected.

In its March budget this year, the Labour government put alcohol duty up by 2%, in line with inflation, and introduced a specific cider tax of 10%. This was predictably followed by national outrage, with cider drinkers and producers protesting furiously. It even provoked the mass joining of the Facebook group 'Leave our cider alone!' Fortunately for all cider lovers, plans for this policy were dropped, as there was considerable opposition towards the move and the Government ran out of time to pass the bill before Parliament was dissolved for the General Election.

Whilst I do empathise with the cider lovers, I now see the benefits of raising the tax, which before I didn't appreciate in my blurry, inebriated state. Governments do this to make consumers pay for the cost to society of their drinking - I believe it's called internalising the negative externality - making the social cost equal to the private cost to the individual. Obviously, it was hoped that this measure would curb alcohol consumption, as people wouldn't buy as much booze; and in the current economic climate, it would also help cut the deficit.

But, how do governments put a price on alcohol's cost to society? Even Albert Einstein himself couldn't possibly add up the cost of the police hours and medics' time wasted, or the cost to local councils of cleaning up towns every weekend; not to mention long term expenditure for treating alcohol related illnesses, or increased unemployment due to alcoholism. How then does the Government figure out the amount of tax to put on alcohol? It can only be an educated guess but they must give it a try.

So, where's the proof that this tax policy actually works? As I already said, it didn't stop me drinking; I just switched from Remy Martin to cooking brandy! I remember being chuffed when I heard that it would mainly affect teenage drinkers as I blamed them for all the tax increases. But as well as constraining teenagers, others on relatively low incomes will also suffer, as a rise in alcohol tax would mean that buying booze would become a greater percentage of their earnings. They might think twice when they see the price. Admittedly, this policy can be unfair because the taxes also hit people who only drink occasionally, penalising them for something they're not responsible for, but that's how it has to be.

Another thing that irked me was the suggestion of banning promotions, such as 'all you can drink for £10' and 'the pay on the door - free drinks inside' offer. Fortunately for me, this wasn't implemented until after I sobered up! In April 2010, the first phase of the mandatory code for alcohol sellers came into force which banned all these offers, as well as speed drinking competitions. Another proposal is to ban 'happy hours', which has already been implemented by pubs which are members of the British Beer and Pub Association. It has also asked bars and pubs to offer free tap water, which encourages consumers to space out their drinks. A similar suggestion is to lower the price of soft drinks which would definitely be good for me as I'm sworn off booze for good now!

Jessica Hawley
Stratford upon Avon Grammar School for Girls

Unfortunately, a study done by the Sheffield University found that banning promotions on alcohol only affects a small proportion of drinks sold. These policies rely on consumers making the right decision; deterrents won't stop them consuming. When I was an alcoholic, banning promotions annoyed me, but ultimately, it didn't stop me buying drinks.

There is much discussion about banning alcohol advertising, as in France. In 2009, the British Medical Association called for this ban to curb the binge drinking culture in Britain. According to the BMA, it has been proven that there is a correlation between alcohol advertising and alcohol consumption. But would such a ban actually help?

Cigarette advertising is now illegal in this country and fewer people now smoke - so it might work with alcohol too. However, it could turn alcohol into a forbidden substance, making it seem even cooler to go out and get drunk. Also, if advertising was banned, firms would lose over £180 million a year, not to mention cuts in tax revenues for the Government – difficult in the current economic climate. So, perhaps a compromise could be introduced. Adverts could be banned before the 9pm watershed. This transfers responsibility to parents – expose children to the advertising and accept the potential consequences.

Everyone knows that TV adverts glamorise alcohol, portraying a sophisticated and cool image to impressionable children. I say that if they're going to be exposed to the upside of alcohol through advertising, then they should be informed of the downside too. It's been suggested that primary school children should receive better alcohol education, as within the current curriculum, it's only briefly touched upon. However, if Government was to implement this, parents may protest. It's understandable, they don't want their kids growing up too fast, but this is the real world, and children can't live in a protective bubble forever. Unfortunately, this policy will have a time lag, children need to grow up before we can see if it has any effect – but try it we should!

Now for the big one - the policy that all alcohol lovers dread; putting a minimum price on booze. There has been much talk this year within government about setting a minimum price on alcohol, at between 40 and 50p per alcoholic unit. That means the average price of a 6 pack of lager would be £6! Not good news. However, the policy would be extremely effective; the Government's Chief Medical Officer said that it should lead to 3,400 fewer deaths and 100,000 fewer hospital admissions, as well as a dramatic lowering of crime rates. Yes, this would be the most effective policy in curbing alcohol consumption.

Problems with this policy are similar to the problems with tax rises, impacting on teenagers and those on lower incomes, whilst punishing moderate drinkers. This was Gordon Brown's argument against this policy; he said it would cause 'the responsible, sensible majority of moderate drinkers to have to pay more or suffer as a result of the excesses of a minority'. I apologise that I was once one of these excessive individuals and I agree that it isn't right that everyone should suffer because of mistakes made by a minority. This policy is harsher than just raising alcohol taxes, because it prevents people from finding a cheaper alternative. Naturally, there will always be variation in the price of alcohol, but this would prevent alcohol from being ridiculously cheap. The policy is untested and so its effects are unknown, but as alcohol consumption in UK is still on the increase, perhaps it's necessary for a harsher policy to be introduced?

If I was Prime Minister and God bless the country if I were, I would implement all of these policies. I feel that the only way to curb alcohol consumption through the use of economic policies is by combined effort. Increasing prices through tax rises and minimum pricing would reduce demand, banning or curbing advertising would deter demand and better alcohol education would cause consumers to demand knowledgably. I do not feel that any of these policies would be effective enough alone, but combined, they could make a real difference.

Throughout the years that I was an alcoholic, I experienced many attempts by the Government to discourage my habit, all unsuccessfully. So, what eventually made me lay down the bottle? It wasn't tax increases. It wasn't anti-alcohol campaigns. It wasn't the banning of promotions. It was reality. One day, I looked in the mirror, and I saw an unshaven, bedraggled, *old* man looking back at me and I didn't recognise him. It was at that point that I realised that enough was enough. I needed to sober up and rearrange the mess that was my life.

Yes, economic policies have their place in curbing alcohol consumption, but at the end of the day, there's only so much the Government can do. The final decision to beat the bottle must come from us, the consumer.

Foreign aid hinders development. Discuss.

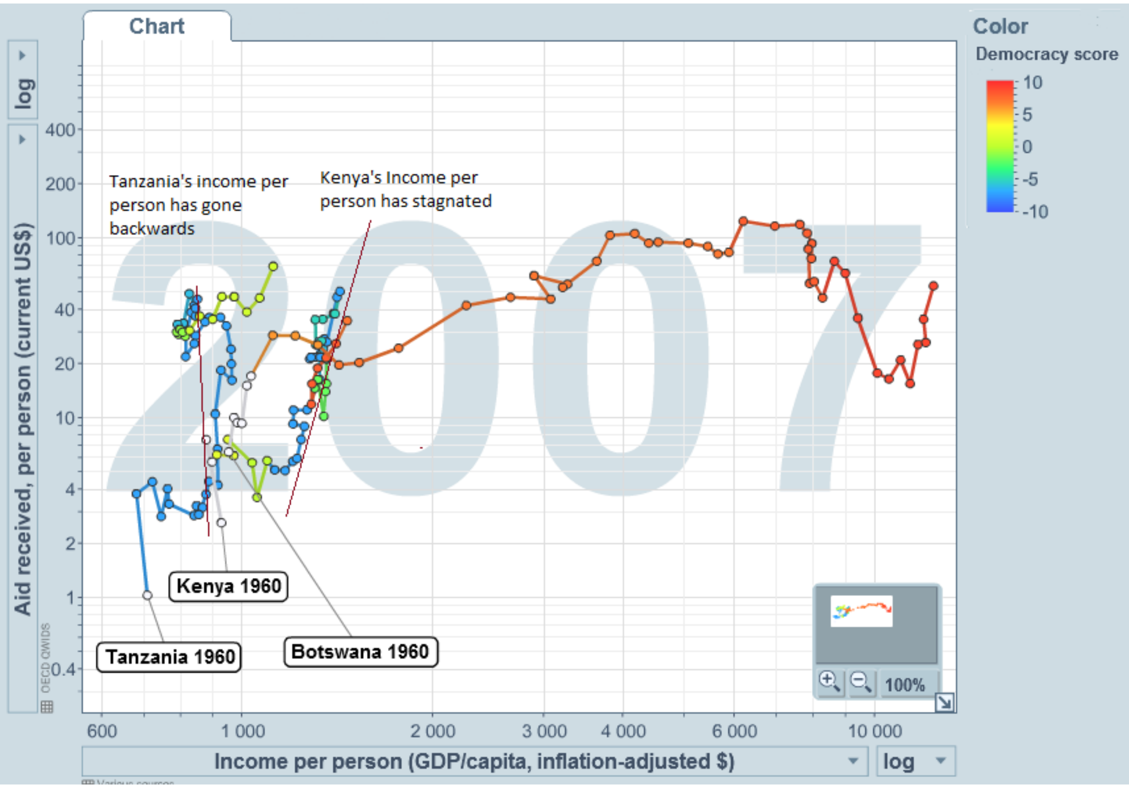
The first question that must be asked is: what is development? Development is the transitions from low wealth economies to high wealth ones through the improvement of the economic, political and social wellbeing of the population. Africa has received over $1 trillion in Aid since the 1950s, and the major question is whether this huge amount of capital funnelled into Africa has been effective or not at development. There have been situations where aid has been used effectively to grow a country, and in turn allow development of healthcare and education and other basic infrastructure, which has tremendously improved the lives of millions of Africans. In other situations, aid has been devastatingly mismanaged; used as funds to fund military expenditure, been siphoned off by the government into Swiss bank accounts while their population has starved, or has been spent on projects which have no economic value whatsoever. Consequently, it seems hard to polarise the debate either way. There is such a broad range of successes and failures of foreign aid that it cannot be completely argued either way. Instead, the approach that must be taken by foreign donors is how their aid can be more effectively harnessed. Therefore, the argument is this: aid has hampered development not because it is an inherently malign influence, but because it hasn't been targeted at the areas where it is the most effective at economic growth, and consequently development.

One of the main arguments against foreign aid, as stated by Dambisa Moyo in *Dead Aid* is that foreign aid has encouraged a dependency culture in Africa, which has stifled entrepreneurship. As external resources have been invested in Africa, Africans have been consuming them; resources such as food and medicine from foreign NGOs and governments. They have not used resources to invest and grow. Part of the problem is the type of aid foreign donors have been giving. Food and medicine, although vitally important to curb the effects of famine, drought, disease and epidemics will not produce any long term benefit to the country, and only alleviate short term crises. If we look at it in terms of Game Theory, it is better to be in absolute poverty and get food and assistance from foreign organisations, than investing some of those resources into growing a few crops, and being relatively less impoverished, and receiving far less aid from abroad. The payoff is much lower. Furthermore, foreign aid severely hampers domestic producers, because they cannot compete with free food from foreign companies, and the massively subsidised western agricultural producers. The food aid given to Africa correlates with surpluses in the West. Consequently there is no incentive for any form of productive economic activity. Also, aid can cause unbalanced appreciation, which can result in the Dutch Disease phenomenon. Countries which are dependent on aid are at the mercy of the global economic situation; in recessionary periods a government's foreign aid commitment is one of the first areas to be cut. However, this view is too simplistic; it does not differentiate between the different types of aid. It is focusing on humanitarian aid, and of course humanitarian aid will never help a country grow, because its purpose is to just alleviate short term problems and crises. Foreign intervention can increase the amount of economically active people in an economy;

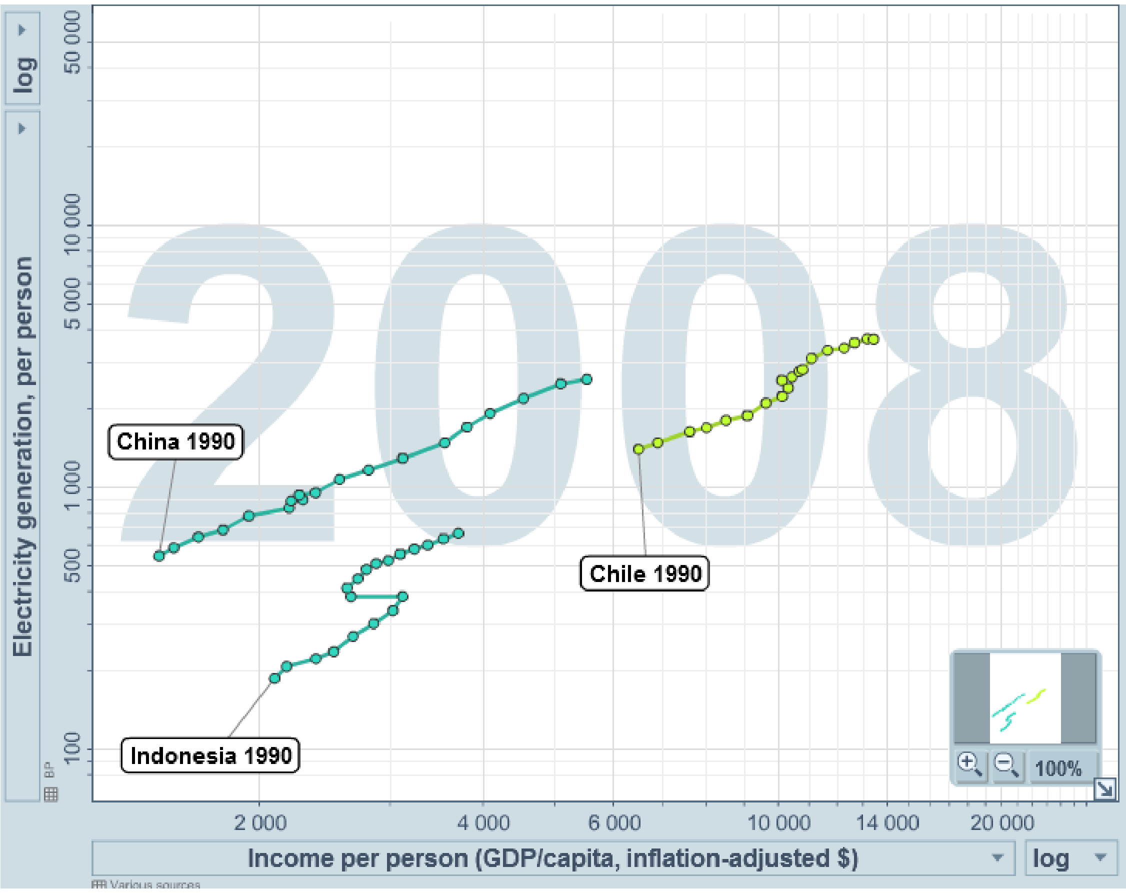
if there is less death through disease, and less people who are economically dependent on the state or family members, growth and development can then occur. Far from creating a dependency culture, aid allows people to shift resources away from subsistence to investment; if they no longer need to buy food, it allows them to grow businesses, and be economically active.

As Andrew Mwenda, a journalist from Tanzania noted at a TED conference in 2007, foreign aid “poisons governments”. In most countries around the world, governments do not rely on foreign aid. Instead, fiscal and budgetary integrity is based upon raising revenues through taxation. However, African countries, which on average receive 13-15% of their GDP as aid, can rely far less on their population to generate revenue. As a result they have far less fiscal integrity and transparency as they know their spending is being backed up by foreign money. Therefore they are not responsible to the people for which areas they allocate their budget to. This can cause an inefficient allocation of resources, due to information failure. Local businesses, entrepreneurs and families know where government money can be most effectively spent. Instead, with unfortunate regularity, African government either spend money on grandiose projects, like Omar Bongo of Gabon, who spent $250 million on a new presidential residence. Far too much money as been spent on state run industries, usually owned by a relative of the person in power, which are completely inefficient, and mired by corruption, like Nigeria’s state run oil industry. Firms which are designed to provide jobs for the leaders own tribe, and where there is one typewriter for three people. Or, on the other hand, African government have to listen to foreign creditors who decide where money should be invested, who likewise suffer from information failure. This includes the ‘roads to nowhere’ exemplified by a unfinished motorway in Capetown. Foreign aid also raises the spectre of corruption. As Martin Meredith points out in *The State of Africa*, the World Bank estimates that around 40% of Africa’s wealth is held offshore, a large proportion of which is foreign aid siphoned off by governments and individuals. Therefore, it seems that because money is being wrongly invested by governments, or is outright stolen by them, foreign aid has not helped development at all. Instead, it has hindered Africa’s progress; it reduces the accountability of African governments, as they have no incentive to instigate meaningful democratic or economic reform which could promote development. Aid funds can sustain their power by diverting it into paying for arms and military hardware.

Foreign aid is only effectively used when there is a strong, transparent and corruption free government. A perfect example of where development aid has worked is in Botswana, where the government has used foreign capital efficiently and intelligently. Botswana has managed to achieve prolonged economic growth after independence from Britain in 1966. Botswana boosts one of the highest GDP per capita in the whole of Africa, at around $12,000. She also boasts one of the most diverse financial sectors in the whole of Africa, as well as significant government revenues from diamond mining. Other countries with significant diamond deposits such as Sierra Leone, whose government descended into cronyism, saw aid mismanaged and diamond revenues going into the hands of individuals. Botswana, although running a small budget deficit has set a standard of government fiscal and economic responsibility that most African countries have not yet reached. Botswana used foreign aid, with loans from the World Bank, extremely effectively in setting up its mining industry. In effect, she used aid to invest in infrastructure to set up diamond mining which would then provide much of the government's revenue. Or, in classical economical terms, capacity building and shifting out Botswana's LRAS curve. As shown by the graph, Botswana used its rising aid allocation effectively at development, whereas Tanzania and Kenya are only starting to move forward. It is also interesting to see the correlation between a functioning government and income as well; Botswana's economy has been well run by the government. Tanzania's democracy score has improved over the last couple of years and income per person has shot forward. This suggests that aid has been a vital part of Botswana's current prosperity compared to the rest of Africa. Aid has not hindered development, but it has to work in conjunction with good governance in order to be effective.



Economic growth is the key to development, and therefore aid cannot solely facilitate development. It needs to be used in conjunction with other tools to promote economic growth and consequently development. Foreign aid can be used to finance other development projects such as microfinance. Microfinance aims to deliver small loans to people who can then start up their own businesses; this can greatly improve their incomes by moving them out of food poverty. This allows them to more readily afford healthcare and education. Worker productivity and efficiency can also increase. As businesses develop, support industries will also grow; a net growth in the economy. This increases taxable revenue, which the government can then use for development, through building schools, hospitals, and other infrastructure. However, there are plenty of caveats to this theory; good governance must be ensured, so revenues are allocated efficiently, and are not moved overseas. The other problem is the areas which foreign aid has funded have not really contributed to economic growth or development. Foreign NGOS and governments tend to spend money on headline grabbing projects such as new schools, and clinics. However, infrastructure has largely been ignored by foreign donors. This point has been made by Ngozi Okonjo-Iweala, the former finance minister of Nigeria. She also points out that development projects are usually inefficient, because they are not usually supported by developments in infrastructure. A clinic in a rural area will not provide optimal healthcare at maximum capacity if there are not enough paved roads or regular electricity supply.



There is a strong correlation between the scale of infrastructure and income per person, as shown by the graph. Infrastructure is also vital for economic growth as well as development projects. With infrastructure like paved roads and developed ports, costs to firms decrease and competitiveness rises. Countries can then grow through international trade. However, infrastructure, as with any form of development has to be done through effective governance to be effective. There are many cases of ‘white elephants’ in Africa, and lucrative contracts to set up infrastructure going to the friends and family of whoever is in charge. Foreign aid can also be effective if it is used in conjunction with the private sector. Foreign aid can help the private sector though enterprise funds, equity and technical assistance. Giving equity to small and medium size businesses allows them to expand and benefit from economies of scales, which can improve their international competitiveness. Giving technical assistance to developing countries increases efficiency and reduces dependence on foreign support, which then reduces dependence on foreign aid. Through growth in private enterprise and infrastructure governments gain increased revenue through tax receipts, which then can be used to invest in social programs to increase development.

Aid itself is not a panacea of the problems that Africa faces. Aid can only be a small part of a wide range of tools that can bring about development. Aid has to be used in conjunction with private investment, and internal entrepreneurship in the countries where development aid is required. Although there are arguments that aid hinders development, because it encourages corruption or encourages a culture of dependency, they are not really criticisms of aid itself, but criticisms of human nature. Humanitarian aid is vital in keeping people alive and keeping order, but it can never solve Africa's problems, only the symptoms. Aid can only be positive if it is used where there is good governance, and a government which knows where aid resources can be applied most effectively. Aid itself is not innately harmful to development, but aid has had the picture of being an ineffective tool for development because it has been poorly invested and foreign resources have not been used efficiently. There is not a one dimensional solution to the problems that Africa faces, but aid can play an important role in a far wider framework of development.

Bibliography:

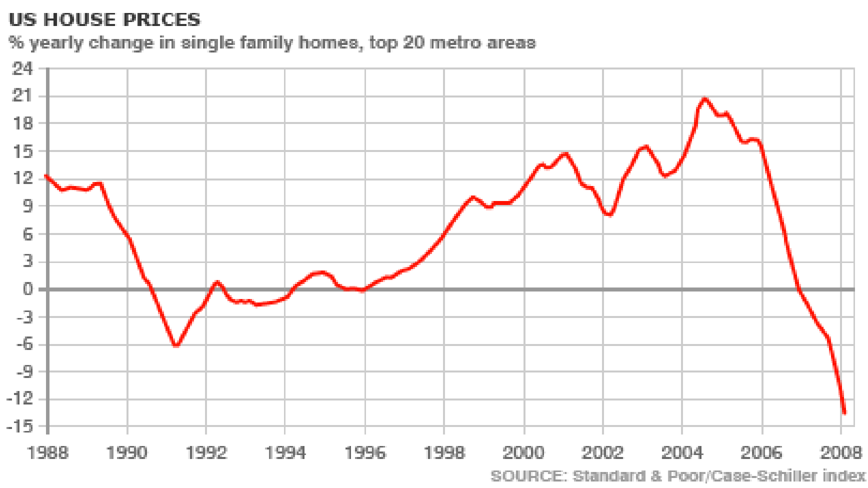
- The State of Africa: A History of Fifty Years of Independence; *Martin Meredith*
- Dead Aid: Why aid is not working and how there is another way for Africa; *Dambisa Moyo*
- Development Assistance and Economic Growth; A Case Study of Botswana, *Ken Togo, Yoshida Wada*
- Ngozi Okonjo-Iweala
- Andrew Mwenda
- Hans Rosling
- Gapminder

Housing bubbles have, in the past five decades, become an ever occurring feature in the global economy. Within the extensive field of economics, two critical questions have always been posed upon the topic of housing bubbles: why do they occur, and how can we prevent them? These complex questions cannot be solved with a simple solution, but must be evaluated from various demand, supply, and behavioural perspectives.

To realistically analyse housing bubbles, we must first contextualise them in relation to their significance in recent years. In Britain alone, the average house price is 35 times what it was in the 1970's, with London experiencing increases of 40% in the last three decades [17]. This rapid rise in house prices has been mirrored throughout global markets; both in Continental Europe, America, and Australia. Spain encountered house price rises of over 200% within an 11 year period [14]. However, this was perceivably unsustainable, with the adage of the inevitable bursting of the bubble. During the global recession, the multiple phantom bubbles burst, sending shockwaves throughout the financial markets, and causing job losses in excess of 15 million worldwide [3]. To answer why this occurred, we cannot, as many have done, simply blame it on the disastrous deregulation of the subprime mortgage market. This was a contributory factor in expanding the housing bubble, but other critical factors also created the bubble phenomenon. The prolonged low interest rates and population growth fuelling demand, the supply factors of excessive construction and tax reliefs making supply lucrative, and most crucially, the behavioural motives of home buyers collectively mustered the global housing bubble.

Upon talk of exemplar housing bubbles, most economists simply plunge into the tangled weave that is the American subprime mortgage market. However, other large economies also suffered with bubbles; surprisingly one of the worst countries to suffer a demand triggered housing bubble was Australia. Since 2007, Australia has seen a sustained high level of immigration [1]. This has caused demand for housing to rise, fuelled further by stamp duty exemptions and government grants. The Reserve Bank of Australia reported that first home buyers had inflated prices by up to $3 billion, due to the excessive demand and limited supply of housing [1]. What must be noted is that housing is very inelastic in demand (due to being a necessity). Therefore, these inflated prices eventually caused Australians to take out risky loans to pay for these over demanded (and therefore inflated priced) houses. As a consequence, private debt as a percentage of GDP more than doubled to reach a staggering 160%. The desperate nature of some first time home buyers further inflated prices, and between 1998-2008 caused price rises to step 264% above inflation [1]. These optimistic beliefs about house prices were both unjustified and unsustainable, leading to a bursting housing bubble. The British and American housing market bubbles were caused by similar underlying principles; however the existence of deregulated mortgage markets worsened this in America.

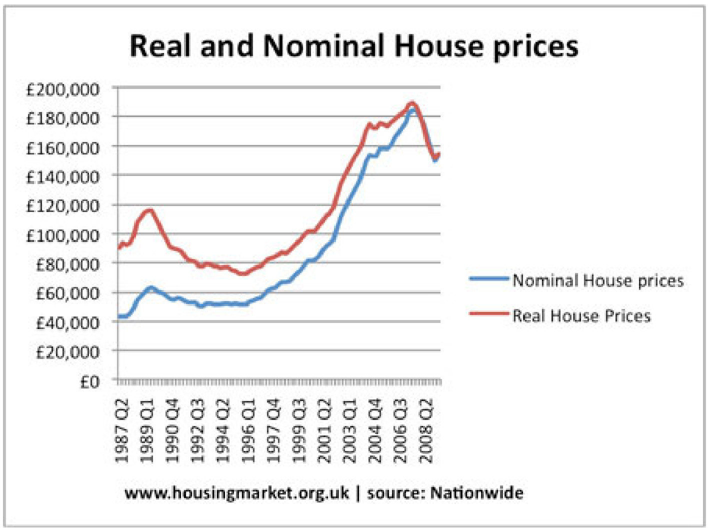
Figure 1



Following the famous 'bubble burst' crash in 1989, Figure 1 [18] illustrates how house prices of average American family homes sustained rises from 1991-to 2001 of over 21%. Despite the 8% dip in 2001, there was another inflationary rise in 2002 to 2005 by nearly 12%. The abundance of "non doc" loans dramatically fuelled this. Eased availability of credit, regardless of an individual's financial status, enabled millions to take out risky loans. In San Diego in 2004, 80% of all loans issued were subprime mortgages [9]. This, combined with historically low interest rates, facilitated hawkish speculation. Many brought homes to intentionally sell them off for a quick profit but in the midst of money making madness, they ignored key fundamentals which would cause the prices to crash back down. As prices rocketed, and with $300bn of loans taken out in 2005 alone [16], people couldn't afford to pay for these homes, so demand fell thus causing prices to fall. However, the sub prime debt still remained, and when house prices fell below mortgage repayment costs, millions began defaulting on their loans and fell into "negative equity". British banks also suffered from the American housing crash, as holdings in liquidised American investment banks like Lehmann brothers (who heavily dealt in sub prime mortgages) became worthless. This domino effect was due to the initial demand fuelled housing bubble, and so to some extent the availability of these phantom loans played a significant part in causing a housing bubble.

The lack of regulation within the financial system has often been blamed for the unsustainable ascent of house prices. However, historical examples including Spain and Germany defy this very claim. The Spanish banking sector is internationally respected for its stringent regulations on speculative securities and the availability of credit. Yet between 1990- 2009, it has experienced an unprecedented housing bubble, with prices rising by over 200% [14]. The Spanish bubble was generated by people spending in align with their assumed high housing wealth. This caused the savings rate to fall by half to just 3% in 2007 [3]. The construction bubble had risen to 12.3% of GDP in 2007, and sustained supply eventually exceeded demand, causing an inevitable housing bubble burst. This had disastrous effects on Spain's economy, leaving 900,000 construction workers unemployed [15], fuelling the unemployment rate to soar to 19% [3], (9% above the EU average of 10% [4]). Alongside Spain, Germany is another example of a country whose housing bubble was initiated by supply rather than demand. Post cold war, the German government desperately needed to boost Berlins' housing market, and so introduced generous tax incentives. The incentives enabled thousands of Berliners to neutralise investment costs, and encouraged a huge housing bubble to occur. However, over time the tax incentives advocated the overestimation of demand, and like Spain, supply exceeded demand. The bubble once again burst, causing a German recession in 2001 (19). Notably, in both countries investors brought in expectation of capital appreciation, rather than on underlying principles. Therefore, we can also imply that behavioural factors are key causes of housing bubbles.

Some may disregard behavioural factors to be causes for housing bubbles; however, behavioural causes may also provide solutions. It may be extremely controversial to suggest ignorance amongst first time home buyers; however the undifferential nature with which they cannot detangle real and nominal changes in interest rates and GDP, appear to be key to questioning why bubbles occur.



“Figure 2”

Figure 2 [11] illustrates how price distortions endorse housing bubbles. For householders who cannot differentiate between the nominal house prices and inflation adjusted house prices, they may assume their assets are soaring, potentially double their realistic valuations. Furthermore, households are increasingly encouraged to view housing as in important life long investment. With families growing, the demographic of national home buyers also alters the demand, and thus the price of housing. UK home ownership rates of people aged 30 went from 60% in 1978, to 80% in 1996[7]. Similarly Figure 3 [10] shows the rise in % rates of British homeownership within the past two decades, with ownership rates now at 70%+. The steady increase in rates of homeownership in the UK reflect the view that housing is now an essential investment to make, and so as demand for this increases (as people wish to secure these essential assets and begin the assent on the property ladder) this ultimately forces prices to rise. Therefore, it can be said that the needy attitude of home buyers’ drives up demand, and (in the case of the subprime mortgage market) causes the housing bubble to further inflate.

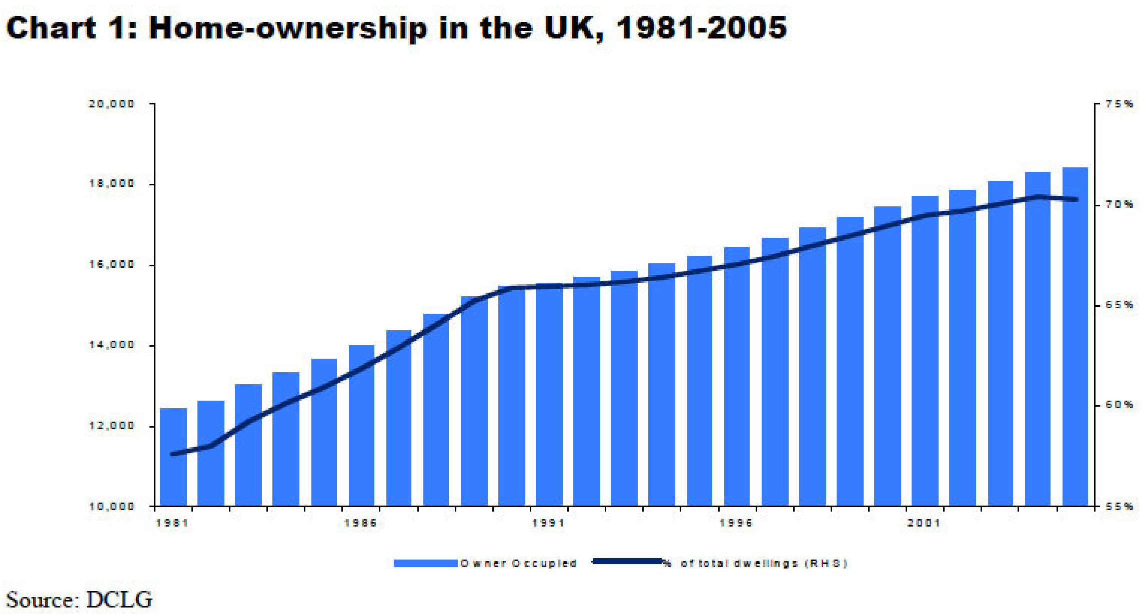


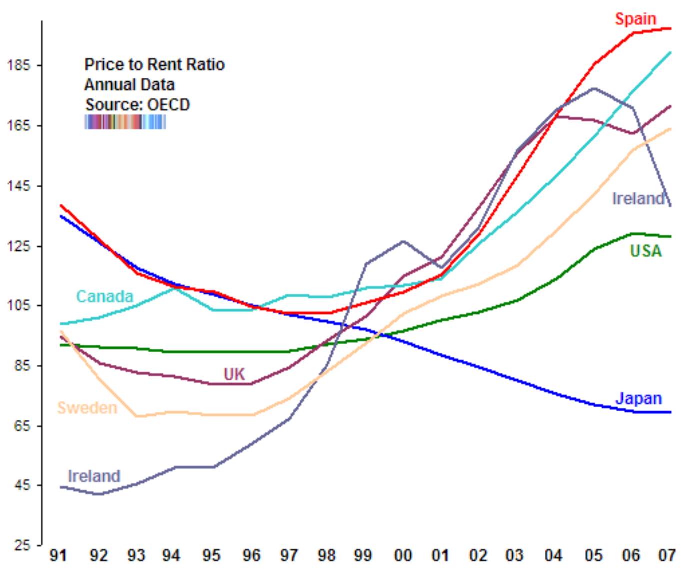
Figure 3

Diagnosis complete, we must now look at how to prevent housing bubbles from reoccurring. Diehard Keynesians would argue- REGULATION! It cannot be ignored that to avoid such costly mistakes like subprime mortgage crashes, and to control this factor from inflating housing bubbles, some form of regulation is needed. A very stable economic model and possible source of inspiration is the heterodox Austrian business cycle [2]. Centrally, it explains that the boom and bust generated by excessive unsustainable credit expansion inevitably diminishes investment opportunity. This is because it leads to a misallocation of resources, with a large majority being pumped into the construction sector, thus increasing the bubble. This could certainly be better regulated using the Austrian model, and a reduction in fractional reserve banking could help to better control this housing bubble. It's understandable that fractional reserve banking is a skeletal part of most financial institutions; however, if a bank kept a certain % of its deposits, it wouldn't have as much lose capital to invest in risky subprime mortgage markets, and therefore wouldn't continue to fuel a housing market bubble.

Others may argue that monetary policy should provide the key tool to preventing housing market bubbles. With most of Europe and America on base rates of below 1%, it is understandable, that during recession it is essential to maintain growth and so keep these low interest rates. However, (once on the road to sustained growth) if we aim to prevent another housing bubble, a higher interest rate must be a tool used to control the availability of credit. If speculators' costs of borrowing are higher, this may deter them from risky investments due to the opportunity costs being higher. If the "flippant" rational activity is controlled, then future housing bubbles may be averted.

Again, deriving from the Austrian economic model, fiscal measures would also help to prevent another global housing bubble. The Austrian market currently has a "speculative tax" in place. This is a system by which gains sold within 10 years are considered "speculative", and are therefore taxed the same rate as income tax [12]. Additionally, the French tax system can also be given merit, as the total 27% liable tax on property prohibits excessive risk [5]. Not only does this fiscal deterrent raise government revenues, but it also imposes a financial deterrent on speculators from infiltrating the market and distorting prices, so prevents housing bubbles.

Finally, the mindset of investors and first time buyers must be altered if the global markets are ever to withdraw from the housing bubble cycles. Investors simply buy on belief that prices must rise. This is unrealistic, and lessons should be learned from German, Spanish and American housing bubble bursts. As in Germany, (where home ownership is 42% [8]), renting should be encouraged rather than risky subprime mortgages. Figure 4 [6] shows rent vs. price assets of global markets. Sweden's economy is realistic. However, Spain's ratio's misaligned 26% above Sweden's. This price to rent ratio distortion magnifies bubbles, and can only change if the mindsets of investors and buyers alter to be more realistic and sustainable. Another solution to curb a bubble would be to increase state owned housing. In the UK 3.6 million of the 20.5 million residential



"Figure 4"

dwellings are owned by the council [13]. If this was to increase, one could infer that the poorest homeowners who are susceptible to buying sub-prime mortgages would no longer do so. Therefore a reduction in the sub prime mortgage market is likely to deflate a potential bubble. This solution would be incredibly costly however, and may cause an increase in the already ample £163bn budget deficit [20].

In conclusion, it can be said that the global housing bubble hasn't been a by-product of the risky subprime mortgage market as many originally thought, but instead caused by an amalgamation of demand factors, supply factors, and most critically behavioural economics of investors and homeowners. It is from this behavioural perspective that effective solutions can be derived to prevent another bubble, and through the monetary, fiscal, and regulatory measures explained, it can be ensured that future house bubbles can be averted. Loosely following Austrian economic theory, one can assume that with a partial control on fractional reserve banking and fiscal deterrents, risk and reality will be adequately calculated, and so bubbles will hopefully be a rarity.

Bibliography

1. *Australian property bubble.*
   Available: http://wapedia.mobi/en/Australian_property_bubble

   Last accessed May 2010.

2. *Austrian Business Cycle Theory: A Brief Explanation*. Dan Mahoney. (2001)
   Available: http://mises.org/daily/672

   Last accessed May 2010.

3. *Blame it on the bubble*. Dean Baker. (2010).
   Available: http://www.guardian.co.uk/commentisfree/cifamerica/2010/mar/08/financial-crisis-subprimecrisis/print

   Last accessed May 2010.

4. *Euro area unemployment rate.*
   Available: http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/3-30042010-BP/EN/3-30042010-BP-EN.PDF

   Last accessed May 2010.

5. *French Taxes and Taxation in France*.
   Available: http://www.french-property.com/reference/taxation.htm

   Last accessed May 2010.

6. Global Real Estate Ratios. Barry Ritholtz. (2008).
   Available: http://www.ritholtz.com/blog/2008/11/global-real-estate-ratios/

   Last accessed May 2010.

7. *Home-ownership and saving in the UK.* James Banks and Sarah Tanner, Institute for Fiscal Studies. (2000).

   Available: www.cml.org.uk/cml/filegrab/pdf_pub_hf_45-4.pdf.pdf?ref=3275

   Last accessed May.

8. *Home sweet home*. Available:
   http://www.boston.com/news/world/europe/articles/2006/02/12/home_sweet_home/
   Last accessed May 2010.

9. *Housing and behavioural finance*. Mayer and Sinai. (2007). Available:
   http://www.bosfed.org/economic/conf/BehavioralPolicy2007/papers/Housing-Behavioral-Boston-Fed-v9.pdf
   Last accessed May 2010

10. *Problem of rising house prices.* (2010).
Available: http://www.mortgageguideuk.co.uk/blog/

Last accessed May 2010

11. *Real and Nominal House Prices.* (2009). Available:
http://www.housingmarket.org.uk/housing/real-and-nominal-house-prices/08/.

Last accessed May.

12. *Rental income tax is high in Austria. (2008*).
Available: http://www.globalpropertyguide.com/Europe/Austria/Taxes-and-Costs
Last accessed May 2010

13. Social housing in the UK.
Available: http://www.socialhousingaction.com/social_housing_in_the_uk.htm Last accessed May.

14. *Spain in real trouble.* (2009). Available:
http://www.globalpropertyguide.com/Europe/Spain/Price-History

Last accessed May.

15. Spanish property bubble. (2006)
Available: http://www.spanishpropertyinsight.com/market/spanish-property-bubble.htm

Last accessed May 2010.

16. *The new road to serfdom: An illustrated guide to the coming real estate collapse.* Michael Hudson. (2006).
Available:http://www.insurgentamerican.net/download/MichaelHudson/Hudson_RoadToSerfdom.pdf
Last accessed May 2010.

17. *UK house price history.*
Available: http://www.britsandmortar.com/UK-house-price-history

Last accessed May 2010.

18. *US economy at a glance*.(2008)
Available: http://news.bbc.co.uk/1/hi/7373158.stm

Last accessed May 2010.

19. *Why the Global Housing Market Boom Bypassed Germany*. Mark Waffel. (2008). Available:
http://www.spiegel.de/international/business/0,1518,552901,00.html Last accessed May 2010.

20. £*163bn budget deficit isn't perfect wedding gift for the happy couple.*

Tomos Livingstone. (2010)

Available: http://www.walesonline.co.uk/news/columnists/2010/05/15/163bn-budget-deficit-isn-t-perfect-wedding-gift-for-the-happy-couple-91466-26449639/

Last accessed May.