



The Eighteen-Year Real Estate Cycle

By Dr. Mason Gaffney

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The Eighteen-Year Real Estate Cycle

Much is being said about the accurate predictions that seem to have been based on this phenomenon (and at this year's CGO conference in Cleveland, the matter will be explored further). To help focus our thoughts on this complex subject, eight Georgist thinkers recently participated in an email conversation, excerpted here.

Lindy Davies: How sure are we about the 18-year cycle in the 21st century? What's the reliable evidence? How confident can we be in this pattern as a predictor?

Mason Gaffney: Moderately confident. History says people don't learn; their lust for unearned increments takes them over after a while. It's like watching fireweed take over a field after it's burned over; there's a regular ecological succession from

burn to climax. However, specifics make a big difference. Why was there no crash in 1911? I think it was the rise of property taxes and frequent reassessments, led by the likes of Richard Hurd, Lawson Purdy, Tom Johnson, Hazen Pingree, Taylor of San Francisco and another Taylor in Vancouver, Dunne in Chicago, et al. Why was the period from 1857-73 only 15 years? You'd think the Civil War would have slowed down the cycle, but something speeded it up. Why do so many economists studying cycles fail to emphasize the ones that we and Homer Hoyt highlight? What alternative measure are they using?

Fred Harrison: We can be sure of the repetition of the 18-year periodicity (+/-), subject to the absence of relevant overwhelming shocks to the capitalist order. Those shocks include (1) a world war, or (2) a reduction in the privatized portion of rental flows to the point where the incentives to speculate in land are significantly diminished. None of the responses to this latest crash alters the DNA of the capitalist system. So there is no reason to believe that past history won't be repeated.

Lindy Davies: What is the role of this idea in the overall Georgist-movement strategy? What opportunities does it afford us? How should we use them?

Mason Gaffney: Central. As we approach within, say, five years of the fatal date we should be committed automatically to snap out our lethargy, review the symptoms and ask, "Is this the big one?" At all times it should make us demand frequent reassessments. Why did Henry George fail to call the crash of 1893?

Fred Harrison: The capacity to predict turning points has attracted the attention of “the system’s” power brokers. The media attention has been unparalleled. The 18-year prediction has not only secured me publicity in the UK’s national media, but also international media like the BBC TV World Service. The 18-year formulation is entering the analysis of financial advisors. For example, Mark Dampier of Hargreaves Lansdowne (funds under management: £10bn), regularly mentions my book *Boom Bust* in his articles. In an interview with a magazine published by another asset management company (*The Liontrust Magazine*, No. 5, p. 10) Dampier says: “What annoys me is that all the economists and politicians got it wrong. These things work in 18-year cycles and it was very predictable. The cause of the problem was land prices being too lightly taxed. Until this is reformed, these 18-year cycles will reoccur.” Politicians have got the message. Vince Cable MP — the only British Parliamentarian to come out of this mess with reputation enhanced — cites my book in his newly published book on the credit crunch as a source for his work. John Calverley, now based in Toronto as Head of Research for Standard Chartered Bank, has just published his book: *When Bubbles Burst: Surviving the Financial Fall-out* (London: Nicholas Brierley), which acknowledges indebtedness “for this insight on the 18-year cycle to Fred Harrison.” When I met Calverley, he was Chief economist and Strategist of American Express Bank. So the 18-year cycle has registered at the level of description of the economy. But the bait has not yet been taken on the policy prescription, even by Vince Cable who hosted a seminar in the Houses of Parliament, which I addressed.

Which brings me to the question: what is the role of this idea in the Georgist movement? None. The Georgist movement is locked in a time warp, collectively lacking the imagination and drive to exploit the economic crisis to advance the agenda of

fiscal reform. Instead of throwing all available resources into the fray, those who control the purse strings (notably, Schalkenbach) are like frightened rabbits frozen in the middle of the road. There are exceptions, and they know who they are.

Ed Dodson: We should be doing all we can to bring our analysis into the mainstream dialogue. This is what Fred is doing with his *Renegade Economist* project. No doubt, we ought to be doing much more to get more video material produced that would support what is already being done by Fred Harrison and others.

At a far lower level of impact, I have been giving talks to groups on the business cycle and on the debt crisis. These have been well-received but not generated any media coverage (although I had a long discussion on the phone with a Fox business news reporter and an email exchange with a New York Times reporter, who asked for a copy of my analysis).

Lindy Davies: What potential pitfalls are there in emphasizing the 18-year real estate cycle?

Fred Harrison: They shoot the messengers of bad news. There is also the problem of relying just on history to repeat itself. No matter how strong the empirical evidence, to be credible the 18-year periodicity needs to be explicable in theoretical terms. I am keen to have the theory subjected to forensic examination, either to shoot it down or verify it. Without a theoretical underpinning, the skeptics can get away with saying “the future will be different this time.” That’s what they began telling me in 2005, arguing against my prediction that this cycle would end in a depression. On Friday, in Dublin, I stood in a soup kitchen outside a friary. This wasn’t ever supposed to happen again. In

today's *Daily Telegraph* I read the following words by Berkeley Professor Barry Eichengreen: "It's a depression all right."

Mason Gaffney: Pitfalls can be found in making it rote, by the calendar, without looking at particulars of the time. Crying wolf discredits one worse than not crying at all. This happened to Ravi Batra, 2000. Nouriel Roubini seems to have survived it — we should find out why. Why does Henry George's theory fail to fit all the facts as, for example, laid out by Hoyt?

Lindy Davies: Obviously there's a cycle, and patterns can be observed. But how do we know we aren't begging the question, optimistically nudging the data to fit a model?

One thing I wonder about is how the cycles could continue with such regularity after Keynesian intervention, politically-influenced monetary policies, and highly-lubricated global flows of capital, and goods. Many factors are different, at different stages of history. Recessions have been global in their effects before, of course, but the near simultaneity of the current one seems new. What is so powerful about the 18-year pattern that could allow it to recur under so many different sets of influences?

Ed Dodson: Not that many years ago, I had some reservations based on the strength of "externalities" (e.g., conventional fiscal and monetary tools applied by governments), but the global nature of the collapse — as forecasted by our leading analysts — has made a believer out of me.

Fred Foldvary: The average period, 18 years, could well be a coincidence. While the 18-year duration from 1990 led to an accurate prediction for 2008, I think the period can be different, and was different sometimes, so we should not get too hung up

on the number 18. It is an average, probably nothing much more than that.

Lindy Davies: Not too much has been said about the cause of the cycle's regularity. Fred Harrison discussed a theory of a natural agricultural cycles that I thought was persuasive for early iterations of the cycle, and even in the Homer Hoyt era, but in recent decades with huge industrial farming, food being shipped and processed all over the place, it seems unlikely to me that such an antique process would still be so powerful as to force itself all the way from the farm to today's cosmopolitan consumers!

Fred Harrison: I have attempted a theoretical formulation. I have failed to engage any academics in critiquing my theory. Two Georgist professors of economics disagree with my theory without offering reasons for rejecting my hypothesis. Since writing the book, I have come across one further piece of evidence that supports my hypothesis of the 14-year property cycle that gives shape to the long-run business cycle.

Lindy Davies: In general, it seems to me that there are so many powerful mitigating factors that positing an eternal 18-year cycle seems simplistic.

Fred Foldvary: It is simplistic, if we expect it to make precise predictions. We know it is a relatively long cycle, because it takes several years to recover from the recession or depression, as at first vacancies get filled. Then real estate development takes years, and then the speculators jump in for a few years. I think the 18-year period is just a statistical average.

Policy can alter the timing. Some have asked why Japan has not followed an 18-year cycle. But the Japanese banks did not clear

their bad debts, as is being done in the US. Wars and policies can alter the timing. WWII prevented the next real estate boom, and the cycle was disrupted in the 1970s by high inflation.

Ed Dodson: What I see is that externalities that used to make property markets somewhat local have become globalized and intricately connected. The creation of bank holding companies doing business all parts of the globe has been a powerful change in how property markets are fueled by credit.

Lindy Davies: OK. So we have a very strong theory, right in Henry George's work, of the basic underlying cause of the pressures that lead to periodic slowdowns. We also have a rather persuasive update from Mason Gaffney explaining how the phenomena of EZ mortgage credit and sprawling infrastructure investment leads to an over-supply of buildable land, and in turn to a price drop that leads the recession, rather than follows it as George predicted. However, when we come to the 18-year cycle, we observe it empirically — more or less. But we're a little shaky on the "why" of it.

Is it possible to bridge the gap between a clear, well-supported theory explaining the causes of cycles in general and a quite indistinct grasp of the cause of their regular timing?

Wyn Achenbaum: Sprawl is not a new phenomenon. Subways and commuter trains started making once-distant exurbs into daily-commute suburbs before 1900, I think. And certainly the construction of some major bridges and highways in the 50s and 60s played into that.

Somewhat, but not entirely, waggishly, I suggest that it may have something to do with either a forgetting curve or a turnover of who is of prime investing age.

Might be interesting to look at something like Piketty & Saez's income series (albeit a less-than-ideal measure) which runs currently from 1916 to 2006, to see if there are any patterns in that data, either in income concentration or the aggregates. (Can be found in Saez's webpage at Berkeley.)

To what degree is the cycle a local phenomenon: that is, when something big happens in a city, such as San Francisco's earthquake, does the cycle there look different from that of the aggregate of other cities?

Mason Gaffney: Looking at data randomly is a good way to go batty: there is so much, and of such low quality. That is why the NBER, under founder Wesley Mitchell, never solved any mysteries (except how to entrench itself in the profession).

Lauchlin Currie perceived one key variable in his "Decline of the Commercial Loan," ca. 1930. Vertical integration had proceeded so far that more and more industries were internally financed, taking away business from banks, and jeopardizing the money supply, he said (and I say turning them towards risky mortgages). Once you get a key idea like that, you can look for evidence.

Boom regions that receive inflows of capital, like Riverside County, CA, also bust more extremely. "Dull" regions like the Dakotas enjoy cycles of much less amplitude, up and down. Capital-exporting regions may even move contra-cyclically, as some suggest England did in the 1930s.

Harry Pollard: Just to go over the basics little bit. I would argue that land costs are continually pushing against the edge of the envelope, taking everything that is possible to take. In an

advancing economy, this might work well with producers being saved from bankruptcy by their increased receipts.

However, entrepreneurs being what they are, it is likely that they will invest in a high land price in the expectation that they will be bailed out by the economy. The trouble is that if, for any reason, the economy does not advance, or stops advancing, these people who are barely making it are immediately in trouble and begin going out of business. Hence, Henry George's great point that the condition that leads to depression is not overproduction or underconsumption but underproduction.

Our controlled economy has ways of dealing with an economy that is not advancing fast enough and is showing weakness. Perhaps the most obvious one is inflation. The effect of inflation is to allow easier payback of a contract with cheaper dollars. It keeps the entrepreneurs alive. However, whatever peculiar things they do to keep the economy going, the fact is that it is existing on a knife edge waiting for a trigger that will send it into the discard. The trigger can be anything. The dozens of theories of depression are actually theories of triggers — the events that send us over the brink.

Dan Sullivan: It's not so important whether the cycle is always 18 years, or sometimes 17 and sometimes 19, except to the speculators themselves, who want to time their bets.

The important message for us to get out is that these crises are not precipitated by recent events. That is, the recent behavior of various scoundrels, from Enron to Bernie Madoff, are results of the crash, not causes of it. If recessions occur with regularity, then the causes are fundamental and ubiquitous causes. Idiosyncratic events are largely irrelevant, except as scapegoats.

Harry Pollard: If there is an 18 year cycle, political action is so intrusive that much time has to be spent explaining why — because of politics — the cycle isn't accurate. For example, I'm not sure how the S&L disaster fits in, but in the 80's and beginning 90's more than 5,000 banks and credit unions failed. (We are looking at a couple of dozen, now.) It was a classic Georgist scenario, but do we include the S&L mess in the 18 year cycle?

I go along with Fred Foldvary on the cycle. We can look at the history and perhaps pull something out, but I reserve judgment on the hypothesis. However, its greatest advantage is that it gets publicity for Fred Harrison and some others. They will get more media attention. Maybe this is the breakthrough they need.

We should realize that acceptance of the hypothesis stems out of desperation. Without the Georgist analysis, they haven't a clue about what is happening. They are likely to grab any straw they can find and the 18 year cycle is now on the table — with major promotional effects. Even if it is refuted, it doesn't matter. It offers a little hope that someone knows what's going on. Let's hope we can take full advantage of it.

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