Making Australian Housing More Affordable

Submission to the Senate Economic References Committee on Affordable Housing

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Rising house prices are making housing increasingly unaffordable for more and more Australians. I congratulate the members of Senate who resolved to consider what can be done to redress this chronic problem, and hope that this submission may help in the inquiry process. I have been analyzing the political economy of housing in Australia for more than four decades and welcome this opportunity to share some thoughts on the matter.

First we need to challenge the view, commonly conveyed in the media, that rapid housing price inflation is beneficial. The question should be: good for whom? There are losers as well as winners in a game such as this. Existing home owners and those owning rental properties may benefit in terms of capital appreciation. On the other hand, those who are seeking to become first homeowners must pay ever higher entry prices, making homeownership an increasingly unattainable goal for many households. Tenants meanwhile face escalating rents as the owners of their homes seek to maintain the rate of return on the current market value of their assets. In the private rental sector, the proportion of tenants experiencing housing stress (officially defined as households spending more than 30% of their income on housing) is approximately 33%. This proportion rises to over 53% for lower income households (defined by the ABS as those in the second, third and fourth quintiles of the household income distribution). A public housing alternative is not readily available for most of these households because of the stringent criteria of personal disadvantage that limit access to the woefully inadequate public housing stock. In this context, **the eminently reasonable goal of affordable and decent housing for all Australians becomes ever more elusive in practice**.

The situation is exacerbated by the currently low interest rates. One might expect that ‘cheap money’ would enable more low to middle income households to borrow in order to buy. But it also fuels the herd behavior of buyers fearful of ‘missing out’, thereby pushing market prices further up. It also has some **awesome historical equivalents, such as the sub-prime mortgage market collapse** in the United States that precipitated the global financial crash of 2007-8. That was the terrible fallout of a process that involved people on modest incomes seeking to borrow to buy houses – and vigorously encouraged by lending institutions to do so – without due regard to their capacity to service the debt. Where future incomes are unreliable, especially because of insecure jobs, this can be a disastrous recipe for the individuals and families caught up in this process, as well as for the macroeconomic situation more generally.

Even those homeowners who are 'enjoying' the fruits of capital appreciation in real estate values may find that **the gains are illusory**. The fact that the market value of your property has risen does not increase your economic wellbeing unless you sell up and relocate to cheaper housing elsewhere (or go to live in a tent). And, if you do so, your prospects of future capital appreciation are then likely to be lower. So the 'windfall gain' that benefits property owners goes hand-in-hand with a 'lock-in' effect that tends to make the apparent gain largely unrealizable – unless they own more than one property.

Looked at from a political economic perspective, the problems that underpin these difficulties in the housing situation are fourfold – relating to (1) economic inequality; (2) the land speculation that drives inflationary processes; (3) the perverse incentives embedded in current tax arrangements; and (4) the inadequate stock of public housing.

Let's consider each aspect in turn, with a view to seeing what needs to be done to turn the situation around…

Economic Inequality

Inequality is the most obvious source of the problems, as it is with so many political economic difficulties. If all households had similar incomes, housing markets could operate on a relatively level playing field, reconciling the interests of buyers and sellers with diverse preferences for housing types and locations. However, in a society of glaring wealth inequalities, the sorting process has a more **coercive and cumulative character**. As the political economist David Harvey has persistently pointed out, the rich command space while the poor are trapped in it.

The contrast between wealthy suburbs and areas with poor housing is the physical expression of a deeply divided society. Of course, people's capacity to service a mortgage or to pay market rent varies markedly according to their income. So **it is very difficult to achieve the social goal of decent and affordable housing for all without addressing the economic forces that generate those inequalities**. It is not just that some people derive income from capital while others only derive income from labour. Nor that some people benefit from inherited assets while others do not. These processes are compounded by the way in which **housing inequalities interact with labour and capital market inequalities to create cumulative patterns of social advantage and disadvantage.**

Solving the problem of housing affordability cannot be disentangled from the process of creating a more egalitarian society – an aim that Australian social surveys commonly show is supported by the majority of the population. I therefore encourage the members of the inquiry panel to pay particular attention, under the **fifth term of reference**, to all policy measures that would have egalitarian effects on the distribution of income and wealth, thereby preventing the ongoing polarization between 'haves' and 'have nots'. The role of progressive income tax reform and the potential role of inheritance taxes warrant particular attention. On the other hand, I recommend abandoning first home buyer subsidies, which have the perverse effect of fuelling the house price inflationary process and therefore compounding the general problem of housing unaffordability in the long term.

Housing and Land

It is also important to recognize that house price inflation has some special features that differentiate it from inflation affecting other goods and services. Housing is purchased both for its ‘use value’ (the benefit of having a nice place to live or even just a roof over your head) and for its ‘exchange value’ (the benefit of having an asset that can be sold at a market price). It is the latter aspect – particularly the possibility of buying housing as a means of accumulating wealth – that accentuates the demand for housing. It also highlights **the key role of land, an asset whose supply is fixed by nature** (even though the form and intensity of its use can be variable).

When people talk about homeownership, they are normally referring to an asset that combines housing and land: the former sits on the latter. Land is normally the largest component in the exchange value of the combined asset. Indeed, over time, the value of housing typically deteriorates as the building gets older and needs repairs or renovation, while the value of land goes on increasing. This is most obviously the case in the inner parts of large cities where land values are many multiples of the value of similar sized areas in rural areas or on the fringes of metropolitan regions. As populations grow, urbanization continues and cities spread, the demand-supply relationship creates persistent inflationary pressures.

While it is not true that the rate of return on land always surpasses other assets, land is a predictably sound investment in the long term for those that can afford to purchase it. It is also a focal point for sometimes spectacular windfall gains. While land prices don’t rise uniformly over time, they tend to exhibit a ratchet effect, surging upwards, leveling off and then surging again. This is ripe territory for speculation, the more so when local government re-zoning suddenly increases the value of agricultural land on the edge of growing cities. Little surprise, then, that there are recurrently corrupt relationships between landowners, developers and particular local governments (as has been recently revealed in the Sutherland Shire in southern Sydney). More generally, **it is the combination of its fixed supply and its potential for speculative gain that makes land a very special asset**. There can be no effective solution to the housing affordability problem that does not recognize this feature.

One implication of this reasoning is **the importance of the spatial form of urban development.** Vigorous decentralization policy can play a significant role in reducing land price inflation in the major cities and nationwide. By contrast, releasing more land on the urban fringes provides only temporary respite and can in the long-run do more harm than good. Such land releases are quickly absorbed into the overall working of the metropolitan land and property markets. By contrast, creating new cities in regional and rural Australia would both ‘take the heat off’ the metropolitan areas and give a much needed boost to regional localities that currently need economic stimulus. It is essential that any such decentralization programs should also focus on policies for job-creation or job-transfer to those non-metropolitan regions: so housing development must be integrated with urban and regional economic policy.

Tax reforms

Tax reforms provide the most immediate means by which governments can address the factors generating land price inflation and housing unaffordability. The key reform relates to **land taxation** (or 'site revenue capture' as some prefer to call it). A uniform tax applied to the value of all land would drive out the speculative element from the market. Indeed, if the government captured the economic surplus that is currently privately appropriated by landowners, it would only make sense for people to hold land for its use value - whether for housing, agricultural or other commercial purposes. There could then be no significant speculative gain, and land ownership would not be a vehicle for capital accumulation. Land price inflation would then be relatively stabilized.

The current forms of land tax implemented by State governments do not achieve this outcome because the land tax rates are low and the exemptions are very extensive. A more comprehensive, nationwide land tax system would need to replace or supplement these State taxes. Four supplementary reasons for taxation reform of this sort are as follows: [1] putting more emphasis on land taxation reflects a broader environmental rationale of reorienting taxes towards the use of nature; [2] in a world with increasingly mobile financial capital and complex tax minimization arrangements, land is a relatively effective tax base because it cannot easily be hidden; [3] land tax that applied to all residential properties would have the effect of discouraging some of the foreign purchases that have been driving up housing prices in Australia's major cities recently; and [4] a comprehensive land tax could replace stamp duties on property transfers that currently have the perverse effect of retarding mobility and creating unwarranted inefficiencies in the use of the existing housing stock. For all these reasons **a nationally uniform land tax, with minimal exemptions, has a key role to play in creating greater housing affordability in the long run.**

Short of this proposed comprehensive change in the land tax system, there are other **more modest possibilities for reform. The current income tax provision for negative gearing is the most obvious case in point.** It currently creates a strong incentive for people seeking capital accumulation to get into debt-financed real estate. Owning rental property is a tax-advantaged form of asset-holding. It creates inefficiencies and distortions in housing markets as well as compounding tax-advantaged inequities. Politicians have shied away from cracking down on this tax loophole because many Australian people now have a stake in its perpetuation. But it needs to be done. A modest first step could be to require claimants for negative gearing to declare the rental contracts that apply to their property – in other words, to show that the property is actually used for rental. It is not unreasonable to ask claimants of any tax concession that they produce the relevant documentary evidence. Nor would it be unreasonable to insist that only the income from the rental can be set against the mortgage interest payments (i.e., to 'quarantine' the tax concession).

The **current capital gains taxation arrangements also need to be on the agenda for reform**. The Howard Government effectively halved the rate of capital gains tax; and thereby made income from the sale of assets, including land and housing, more lowly taxed than income from work. Is there really any sound case for that difference of tax treatment? Indeed, some would argue that income from capital, including wealth held as land, is 'unearned income' and should therefore be taxed at a higher, not a lower, rate than income from labour. But a level playing field seems the most politically neutral position. **There is a strong case for modifying the income tax provisions so that all income from whatever source, and without any allowable deductions, is liable to the same rate of tax.**

Public housing

Turning from taxation to government expenditure, there is also much potential for redress of housing stress. Expenditure on public housing is the clearest focal point. Public housing received major public support from State governments in the aftermath of the Second World War. In South Australia, there was a particularly effective process of public housing provision administered by the SA Housing Trust. It is not 'un-Australian'. But support for public housing has dwindled nationwide in the intervening years. The provision of public housing remains primarily the responsibility of State governments and, almost without exception, they have been niggardly in funding it, preferring to put more emphasis on privatized housing arrangements.

The result is that public housing has become a residual sector, catering primarily for people with special and multiple needs which render them incapable of surviving in the private rental sector. So, marginalization and stigma have become the pervasive characteristics of this housing sector, reducing public support for what should be, in principle, a viable housing alternative for a broader stratum of Australian society. International experience, such as in the Netherlands, shows that a good supply of public or social housing can underpin a much better functioning housing market.

Towards a coherent response…

There are connections between the remedial policies discussed in this submission. First, a more progressive and redistributive tax system would redress the fundamental problem of economic inequality that underpins so many of the problematic features of housing markets. Second, a reorientation of the tax arrangements to discourage land speculation and eliminate the favourable treatment given to homeowners would reduce inflationary pressures and create more equality of treatment between homeowners and renters. Extending land tax, abolishing negative gearing and reforming capital gains tax should be priorities. Third, these taxation reforms could increase government revenues and thereby

finance a substantially larger supply of public housing, taking the pressure off the private rental sector and helping to make housing more affordable for the bulk of the population.

I strongly urge the members of the Australian Senate, and all people who are involved in the formulation of public policy, to consider these progressive political economic principles and possibilities. **Otherwise 'a fair go' for all Australians will become an ever-more unrealizable aspiration.**