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The truth about house prices

The crisis in housing affordability traces back to John Howard's actions half a century ago and the lack of political will since. *Mike Seccombe* reports.

John Howard was at the scene of the original crime. He left his fingerprints.

The year was 1964. Howard was a decade from entering federal parliament, and almost two decades from securing his place in history as the only Australian treasurer ever to simultaneously preside over double-digit unemployment, interest rates and inflation.

But already he was championing ruinous economic ideas. One of them planted an early seed of Australia's housing affordability crisis, which has driven much of Australia's growing inequality over recent decades.

Economist and vice-chancellor's fellow at the University of Tasmania Saul Eslake tells the story. He says the high home-ownership rates that are a cornerstone of the Australian Dream were substantially a development of the decade or so after World War II.

"Over a 14-year period, between the censuses of 1947 and 1961, the Australian home-ownership rate rose by about 17 percentage points, from 53.4 to 70.3 per cent," Eslake says. "And that was despite the fact Australia's population was growing at an unprecedented pace of more than 3 per cent per annum, as a result of the post-war migration boom and baby boom."

It happened, he says, due to government policy. Not only did government make finance more available through the war service loans scheme and

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First home ires

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through the fostering of savings banks and building societies, it also got directly involved in the business of building houses. As many as one-in-five new homes was built by state or federal governments.

"Quite often those homes were not very well built, nor built in the most desirable locations," Eslake concedes, "but particularly after the Menzies government tweaked the schemes established by the Curtin and Chifley governments – so they built houses for sale, not exclusively for rent – the supply of housing more than outran the very large increase in demand due to population increase."

Notwithstanding the fact the existing policies worked, there were those who advocated a different approach. Rather than just building houses for people, they argued, the government should give prospective home owners money to help them buy houses.

"In 1964, at the urging of the NSW division of the Young Liberal Movement, the Menzies government introduced the first home savings grant scheme," Eslake says. "The president at the time was one John Howard."

That first home savings grant scheme gave up to $500 to "married or engaged couples under the age of 36" at a rate of $1 for every $3 saved in an "approved form" – usually a bank or building society – in the three years before buying their first home, provided that the home was valued at no more than $14,000.

It was but the first of many similar policies that have been "switched on and off by state and federal governments over the decades whereby governments give money to young home buyers," Eslake says.

He has documented the long history of such schemes in various places, including in his 2013 submission to the senate economics references committee inquiry into the housing market. Eslake's submission was titled *Australian Housing Policy: 50 years of failure*.

"It's hard to think of any government policy that has been pursued for so long, in the face of incontrovertible evidence that it doesn't work, than the policy of giving cash to first home buyers in the belief that doing so will promote home ownership," Eslake wrote in that submission.

The fact long recognised by Eslake and many others, including the Treasury department and Productivity Commission, is that these schemes do not work and are, in fact, counterproductive, as they push up housing prices.

The evidence is right there in the statistics: home-ownership rates reached their highest point in 1961, and have since declined, despite all the money doled out. And housing has become ever more expensive in real terms.

Thirty-six years after his first damaging intervention, Howard did it again. In 2000, 10 years after the Hawke government abandoned its first home owners' scheme, Howard and his treasurer, Peter Costello, brought one back.

It was a shocker. Most, if not all, previous schemes had applied an income test, a limit on the price of the house to be bought, an age limit on the buyers, a requirement that the home be new, or some combination of those constraints. But the Howard–Costello scheme came without any income test or limit on house price. The purported reason was to compensate for the costs of the new GST, but the scheme covered existing dwellings, which were not affected by the GST.

But that was not the worst crime Howard and Costello committed against housing affordability. The greater offence was the previous year, when the government decided to halve the rate of capital gains tax.

First, though, a little more about government incentives for young buyers, which live on now. Indeed, a new one was announced in Victoria just this week.

The Andrews Labor government announced that from July, first home buyers purchasing a property worth less than $600,000 will pay no stamp duty, and those purchasing homes up to $750,000 will get reductions on the duty, regardless – and this is important – of whether they buy new or established homes.

A minor variation on the same old theme, Eslake says.

"A fundamental principle, born out of experience, is that anything that allows Australians to pay more for housing than they otherwise would has one and only one result: that Australians pay more for housing than they otherwise would," he says. For example, a $500,000 house in Victoria would normally attract stamp duty of $22,000. Therefore, a first home buyer who had a budget of $500,000 would previously have thought the most they could pay for that house is $478,000. But, says Eslake, "if that buyer doesn't pay stamp duty, the temptation for the buyer is to say, 'Aha, I can now spend $500,000 on that house.' ... The same is true of this idea that pops up now and then of allowing people to draw on their superannuation. That would allow people to put down bigger deposits and as a result pay more for the housing."

The Victorian government's housing package also included a pilot scheme under which it would allocate $50 million over two years, starting next January, to take an equity share of up to 25 per cent in some first home buyers' houses. The government reckoned the "shared ownership" plan would help about 400 first home buyers.

The scheme even received a guarded endorsement from the federal treasurer, Scott Morrison, who called it "very interesting" – although he said he would prefer that the private sector provide the equity investment.

There is speculation that the federal budget may include a similar measure, giving firms such as big super funds a valuable new asset class in which to invest.

In fact such equity arrangements involving government have existed for many years in South Australia and Western Australia.

John Oliver, the chief executive officer of South Australia's government HomeStart Finance authority, says it has entered into about 1500 such arrangements – which he called "shared appreciation loans" – since 2005.

"We take a stake in the house of up to 35 per cent," he says, "and there is no interest payable on that, but we share in the capital gain when that borrower sells or refinances somewhere down the track."

The shortcoming of the scheme as a means of addressing housing prices, however, is apparent even in the descriptor "shared appreciation".

For such a scheme to work, it relies on houses appreciating in value. That is to say, the whole idea rests on the assumption that house prices will keep going up.

So while it might help some hard-up individuals who can't get into the housing market otherwise, it would seem unlikely to cool the housing market overall, unless it worked to expand supply by applying only to new dwellings.

The West Australian variant of the shared equity scheme, Keystart, requires that the house be new. The South Australian and Victorian schemes do not.

But the booming housing market complicates even the laws of supply and demand, says Professor Peter Phibbs, chair of Urban and Regional Planning and Policy at the University of Sydney. Unlike most other goods – he mentions bananas, cars and televisions – buyers do not expect property to depreciate in value over time.

So when prices rise, people are inclined to buy in, hoping to get a piece of the action. What we have is more a problem of demand than supply.

That is not to say supply is a non-issue, but it is more complex than our leaders pretend.

"There's a lot of blame-shifting going on," Phibbs says, noting that the federal government points the finger at states, and that states point their fingers at local government.

"Turnbull and co talk about fixing the planning system. Well, in Sydney and Melbourne the planning approvals are running about double the construction rate. The problem is that if you are a developer, the last thing you want to do is improve supply."

A lot of other factors have combined to increase demand and therefore house prices. Low interest rates are one. As Eslake notes, average mortgage rates since the mid-1990s are about half what they were over the previous 20 years, allowing people to borrow more for the same share of their income.

Another is the greater availability of money. Banks have relaxed their lending criteria over time, requiring smaller deposits and factoring in women's income.

Yet another is increasing income inequality, in part due to market forces and in part fostered by government, notably again the Howard–Costello government – and to a lesser extent the Rudd government – which devoted much of the gains of the mining boom and asset sales to income tax cuts, heavily skewed towards high-income earners.

Then there is Australia's rapid rate of population growth. Economists left, right and centre – Judith Sloan, Richard Denniss and Eslake respectively – have lately pointed to this. The bipartisan commitment to a "big Australia" has seen population increases of 300,000 to 400,000 a year. More than half of that growth comes through immigration.

Whatever the long-term cultural and economic benefits, the immediate effect is to put pressure on not just housing but on all the associated infrastructure.

"The thing that's very different about Australia, on a world scale, is that we have really rapid population growth in our cities," Phibbs says. "The rate of growth in Sydney and Melbourne is probably double what it is in most world cities. And that's put continuous pressure on prices."

The reality is that in a post-industrial society, most of the economic growth and most of the well-paid jobs are to be found in city centres. So people need either to live close to those centres or to be able to get there efficiently. Phibbs says a key to affordable housing is transport policy, to link cheaper housing to jobs.

You wouldn't think something so obvious could overcome ideological grounds. But former prime minister Tony Abbott was actively hostile to public transport. His 2009 conservative manifesto *Battlelines* included a chapter, "Kings in Their Own Cars", that argued for less investment on "inefficient, over-manned, union-dominated, government-run train and bus systems".

Serious people know what needs to be done. Reserve Bank governor Philip Lowe, for example, told the house of representatives economics committee a couple of weeks ago that instead of trying to "induce" households to spend on household consumption, a better strategy would be to create new assets.

"The best new assets to create in our country at the moment are infrastructure assets, particularly in transportation networks. It is probably the best housing affordability policy – investment in transportation infrastructure."

The Labor shadow minister for infrastructure, transport, cities and regional development, Anthony Albanese, whose record of pushing such infrastructure is strong, immediately seized on Lowe's comments and cited official data showing little had changed in policy terms despite the change of Liberal leader.

Albanese cited official figures from the Department of Infrastructure and Regional Development showing the government had committed to spending $34 billion on infrastructure to 2018-19, which contradicted the government's claims it would spend $50 billion. And he cited various transport projects around the country that had been canned by this government. It was political point-scoring, but the arguments were valid.

Back to John Howard and the second reason he, along with Peter Costello, deserve special mention in relation to the house-price boom.

Through the 1970s and '80s, average house prices stayed pretty constant at just above two-times average household income. In the '90s, that ratio worsened somewhat, to average 2.8 times. Then in a very short space of time, about the start of the millennium, prices shot up to more than four-times household income.

The cause was tax policy. Not so much negative gearing, which existed long before that, but the halving of the capital gains tax. Where gearing property had previously worked more as a tax deferral mechanism – owners of rental property took a loss now, but paid the full rate on capital gains at sale time – it became a tax minimisation strategy. That is, they claimed a loss now and only paid half the capital gains tax.

That's when investors began flooding the market, outbidding would-be owner-occupiers and driving up prices. And home-ownership rates have fallen as a result.

Attempts to dismantle this system have been met with hostility. Labor had a scheme at the last election, but went quiet after wild attacks from the Coalition.

"When Labor proposed making changes," Richard Denniss says, "lots of people screamed, 'House prices might fall, house prices might fall.' Well, I thought that was the point."

The Australia Institute's chief economist notes that many of those same people are the ones who now talk about boosting supply. "But if that worked, wouldn't that reduce prices, too?" he says.

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"They are trying to come up with solutions that don't upset wealth or power."

Phibbs also is sceptical.

"They don't want to push prices down. If they really wanted to do something, it's just a no-brainer. Look at those tax subsidies for investors. The political position on housing affordability is to act concerned but do nothing."

Fittingly, he quotes John Howard: "Nobody's ever complained to me about their house price going up." ●

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