Alan Kohler's The Great Divide: Australia's Housing Mess and How to Fix It

Comment by Peter Tulip

Public discussion of housing policy suffers from undisciplined eclecticism. Too many commentators provide long, unstructured lists of multiple causes or conclude that the truth lies in-between competing explanations. This muddle reflects an inability or unwillingness to distinguish the important from the unimportant. Alan Kohler's Quarterly Essay *The Great Divide* and the accompanying media coverage are examples.

Instead, let's be clear.

Housing costs are high and rising because growing demand interacts with unresponsive supply. This has been going on since at least the 1970s.

Rising demand in turn reflects higher population, higher per-capita income, and (since their peak in the 1980s) falling real mortgage rates. As discussed below, taxes are not an important factor.

Unresponsive supply largely reflects zoning restrictions. If the housing market worked like other consumer goods markets, higher demand would have resulted in many more dwellings. Instead, restricted supply has resulted in soaring prices.

Alan Kohler gets much of this right. His analysis of the dimensions of the problem and how it is ripping the social fabric apart is readable and incisive. And his discussion of zoning restrictions is spot on. As he notes, zoning is estimated to have raised the price of housing in our biggest cities by hundreds of thousands of dollars. Those estimates are in line with an enormous body of research. (Full disclosure: Kohler cites my research on zoning approvingly).

Kohler covers a wide range of other issues. I confine my comments to my biggest concern: his over-emphasis of tax concessions. He argues that the interaction of negative gearing with discounted capital gains taxes is a major reason housing is unaffordable. There is no credible research supporting this claim.

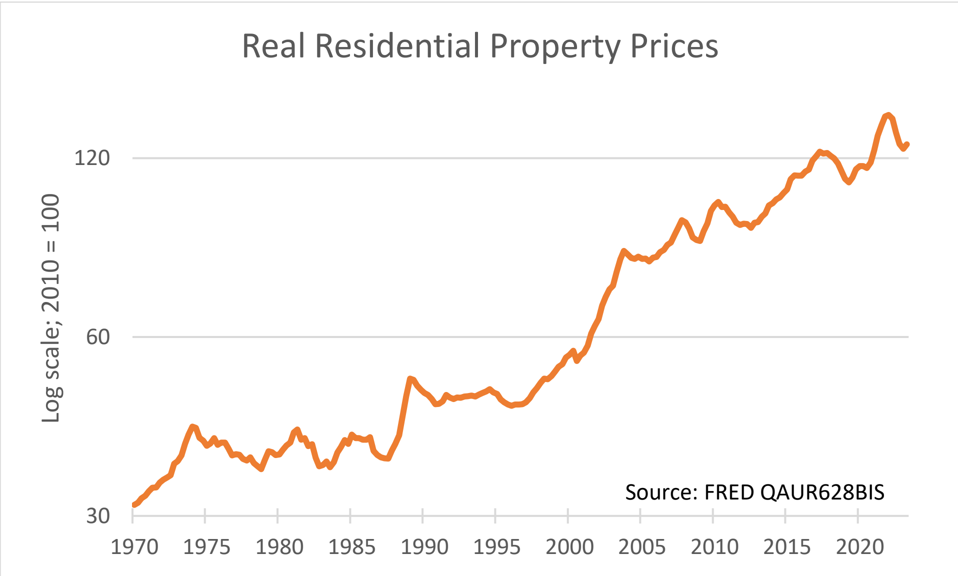
On the contrary, good researchers have estimated the effect of negative gearing and capital gains tax concessions on housing prices using different approaches and repeatedly found this effect to be tiny.

- John Daley and Danielle Wood (2016, Box 6) compare the revenue cost of the concessional treatment of capital gains tax and negative gearing to the value of the housing stock — and on that basis, estimate that the tax concessions may boost the level of housing prices by 1 to 2.2%.
- Gene Tunny (2018), using a similar methodology and assumptions to Daley and Wood, found larger impacts of up to 4% on house prices on average.
- The most detailed study is by Yunho Cho, Shuyun May Li, and Lawrence Uren (2023). In a micro-founded model, they find that removing negative gearing would reduce house prices by 0.9% and raise rents 2.5%.
- Deloitte Access Economics (2019) incorporate the tax concessions into the user cost of housing and estimate the effect that has on house prices using aggregate time series regression. They estimate the ALP's 2019 policy of restricting negative gearing to new housing and reducing the capital gains discount would reduce established dwelling prices by 4.6% and new dwelling prices by 3.6%. Effects of only eliminating negative gearing would be smaller.

In summary, negative gearing and the capital gains discount are estimated to boost house prices between 1 and 4%, while having a smaller negative effect on rents. Most of these estimates represent a long-run ‘one-off’ effect that would have been incorporated into housing prices decades ago.

It does not require technical research to see that the tax concessions are unimportant. Kohler points to the acceleration in prices after capital gains were discounted in 1999. However, the logic of that argument would imply that prices should have fallen by twice as much following the introduction of capital gains tax in 1985. Instead, prices rose. Taxes on investor housing were much lower in the early 1980s but prices were lower.

The evidence Kohler provides for a large effect of the tax concessions is a chart showing housing prices accelerated after 1999. That chart uses an arithmetic scale, which exaggerates the change. If instead, one plots house prices on a log scale — as is standard for variables subject to exponential growth — an acceleration can be seen but it is not dramatic and it begins before the tax change.



Empirical studies of housing prices (Saunders and Tulip, 2019; Abelson and Joyeux, 2023) attribute the faster recent growth to lower real mortgage rates and higher immigration. They give no role to tax concessions.

The fundamental problem underlying the housing crisis is that voters oppose more housing in their neighbourhood because they don’t know — or don’t care — about the harm this opposition does. That needs to be explained to them. Alan Kohler’s discussion of zoning restrictions and their effect on Australian society is very good in this respect. However, public education also requires paying attention to the research and not being distracted by unimportant side-issues.

References

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