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Price Drivers: Five Case Studies in How Government is Making Australia Unaffordable

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Executive Summary

Australia has become one of the most expensive countries in the world. Our cities' consumer goods, retail space, and houses are now much less affordable than in the international cities of London, New York and Singapore.

This monograph seeks to highlight key areas of price distortion through five case studies to show the role of government policies (taxes and regulations) in pushing up prices in each instance.

In the past years of the global financial crisis, Australia has been one of the best performing economies in the developed world. Thanks to cost of living pressures, many Australians do not believe they benefitted from these relatively benign economic circumstances. It is high time to change this. This is how.

Bananas:

- Dismantle the ban on importing fresh hard green bananas from the Philippines into the non-banana growing states of Tasmania, Victoria, ACT and South Australia, if not all states and territories.

Books:

- Repeal the '30 day rule' in the *Copyright Act 1968.*
- Allow a three-year adjustment period for the industry before the changes come into effect.
- Review the changes five years after the repeal.[1]

Cars:

- Abolish the remaining import duties to allow commercial importation of new vehicles.
- Abolish the Luxury Car Tax.
- Allow the private importation of used vehicles into Australia that are:
  – not older than 10 years and have not been driven more than 120,000 kms
  – only from the United Kingdom, the Republic of Ireland, Japan and New Zealand, and
  – fit to obtain a 'pink slip' on arrival.

Housing:

- Increase supply by encouraging councils to take on more residents through local government finance reforms that reward councils for accepting more residents. Policy recommendations are available in the CIS report *Australia's Angry Mayors.*[2]
- Abolish both negative gearing and first home buyers grants.
- Abolish or at least reduce stamp duty on property transactions.
- Cap infrastructure levies or replace them with funding streams based on income tax. Alternatively, give councils access to a share of the locally generated GST revenue.[3]

Retail:

- Support the Productivity Commission's recommendation to relax planning and zoning regulations to:
  – increase land supply for retail, and
  – prevent these regulations from being used by established retail-space owners as anti-competitive tools.
- Abolish commercial viability testing for new shopping areas.

While prices are the result of many circumstances and myriads of decisions, some beyond our control, it is clear that key policy changes would drive prices down. If government claims to be 'looking out' for all Australians, it should use its powers to relieve some of the cost pressures that all families bear.

Introduction

There is no shortage of signs that show how Australia's price levels have spun out of control:

- Sydney was ranked the sixth most expensive city (Tokyo, Oslo, Osaka, Paris and Zurich are more expensive while New York, Vienna, Rome and London are less expensive) in a comparison of 140 cities on the price of rent, electricity, public transport, private schools, and domestic help in the *Economist Worldwide Cost of Living survey 2011*;[4] the survey's findings were supported by the *Employment Conditions Abroad* (ECA) 2011 ranking[5] and Mercer's Cost of Living Survey 2011.[6]
- Online shopping with international retailers has been gaining popularity. Thanks also to a very favourable exchange rate and a lower international price level, Australians are finding bargains overseas that are worth shipping back home. The Productivity Commission estimates that 6% of total Australian retail sales are now online.[7]
- Despite the strong appreciation of the Australian dollar against the US dollar from 54 cents in 2002 to $1.06 in 2011,[8] the purchasing power of Australian consumers has not improved. Australian non-resource exports, which are becoming increasingly uncompetitive internationally, are transferring their increased costs to domestic consumers.[9] Meanwhile local retailers have been slow to pass on savings from the stronger dollar. Though import prices of consumer goods are the lowest in 19 years,[10] retail goods remain as expensive as before. Between June 2002 and June 2011, the Consumer Price Index (CPI) rose by 28%.[11]
- Australian house prices are another case in point. In the 1980s, houses used to cost an affordable three times the median household income.[12] In recent years, they have climbed to nine times the household income in Sydney, according to the 2011 *Demographia International Housing Affordability Survey*. And this is despite more households now having more than one breadwinner.

Australians are 'doing it tough'[13] and 'hard working' or 'forgotten' families'[14] are suffering from ever rising costs of living. Political leaders continually use such phrases to emphasise that they are conscious of the increasing cost pressures making the lives of ordinary Australians more expensive and less affordable. But perhaps politicians should offer solutions instead of platitudes to the voters, beginning with an acknowledgment of the role of government in rising prices.

Perhaps politicians should offer solutions instead of platitudes to the voters.

As Graham Richardson, political commentator and former politician, wrote about his political colleagues recently:

> They just don't seem to get that in the aforementioned suburbs nobody feels that things are good. People look at rising costs of living and shake their heads. Electricity prices have rocketed up so fast that many small businesses and households find it difficult to keep up with the payments. Similarly every time they go to the butchers, or the fruit and vegetable shop or the supermarket, they shake their heads in dismay.[15]

Not all these problems can be blamed on government policies. Some are the consequences of developments in international markets, which are beyond the control of any national government. The prime example of such exogenous price shocks are oil prices, which are formed on the global market. Australia has very little impact on the oil price and therefore has to act as a price taker.

Other prices are however influenced by government policies directly (import bans) or indirectly (policies promoting oligopolistic market structures) and can be visible (Goods and Services Tax (GST) or the Luxury Car Tax) or hidden (regulations).

As government policies affect the price mechanism in so many different ways, it is impossible to definitively explain the extent of the government's role in rising prices. This monograph aims to create awareness that government *does* influence price levels in more ways than is immediately apparent. Through its direct and indirect interventions in the market, government is one of the most important price drivers in Australia and responsible for the rising cost of living.

This monograph does not aim to take a comprehensive look at all Australian products and services markets. Nor is it meant to be an international benchmarking study such as the *Economist's* cost of living survey. Instead, it is a collection of five case studies that exemplify the hidden influences behind Australia's rising cost of living. Most people regularly eat bananas; buy paperback books, cars and houses; and shop in retail stores.

The touted compassion for 'hard-working' or 'forgotten' families doing it tough are hollow words unless politicians in government and opposition remove the interventions responsible for the high prices. Simple policy changes in the five cases studies could dramatically reduce the cost of living.

Going bananas over fruit prices

Bananas are Australia's top-selling fruit. Each Australian consumes about 13 kgs of bananas each year.[16] However, bananas do not owe their popularity to their price: they are among the more expensive items per/kg on the fruit menu.

Simple policy changes could dramatically reduce the cost of living.

By international standards, bananas are a luxury item in Australia. At the time of writing, bananas were selling for $13.98/kg, so 13 kgs would cost $181 per year.[17] In England, at a price equivalent AU$1.52/kg, 13 kgs of bananas would cost only $19 a year.

One explanation for such price differences is that Australia does not import bananas. The *Quarantine Act 1908* banned imports of biological material unless there no risk is in doing so.[18]

Since 1995, Filipino banana growers, who are the second-largest producers of bananas in the world and account for 12% of world banana exports, have been trying to export bananas to Australia.[19] An International Risk Assessment (IRA) carried out by the Commonwealth government in 2008 found that although Filipino bananas had up to 122 species of potentially harmful pests and diseases, only 21 were of an 'unacceptable risk' if no controls were put in place.[20]

Table 1: Banana prices April 2011 (AU$/kg)

Australia	$13.98[21] ($2.30 before Cyclone Yasi)
New Zealand	$2.20
United Kingdom	$1.52[22]
France	$1.19[23]
United States of America	$2.16[24]

Sources: Various.

Some argue these import restrictions come into conflict with our membership to the World Trade Organization (WTO). The WTO's *Agreement on the Application of Sanitary and Phytosanitary Measures* allows members to set the level of sanitary and phytosanitary protection they deem appropriate in respect to international trade.[25] Indeed in 2003, the Philippines applied to the WTO to establish a panel to dispute the validity of Australia's outright ban on banana imports.

The Australian apple industry upheld similarly strict import restrictions until January 2011. For the first time in 100 years, apples are being imported into Australia, initially from

China.[26] While the 600 tonnes imported equal only 1% of the Australian apple production, the apple market is technically open to foreign competition.

In May 2011, Prime Minister Julia Gillard accepted the WTO ruling that New Zealand apples be imported to Australia. Since 1921, Australia had protected domestic apple-growers from imports of Kiwi apples—apparently hazardous due to incidences of fire blight.[27] In 2007, New Zealand applied to the WTO, claiming the restrictions were a disguised trade barrier. In 2010, the WTO ruled that the ban was unacceptable and Australia was forced to accept foreign imports.

Foreign apple imports are expected to lower prices for Australian consumers by 20%.[28] According to the UN Food and Agriculture Organization (FAO), at US$1,543 per tonne, Australian apple prices in 2008 were double and even triple than in France (US$677), Germany (US$793), United States (US$498), South Africa (US$438), and the United Kingdom (US$1,109). New Zealand apples cost a mere US$562 per tonne. Chinese apples are estimated to be 18% cheaper than domestically produced apples and New Zealand apples are 61% cheaper in terms of their wholesale equivalent import price, according to the Centre for International Economics (CIE).[29] As a result of the imports, the CIE estimates Australian apple consumption will be 17% higher.[30]

A total ban on banana imports is not necessary.

Australian bananas are similarly uncompetitive by international standards. In 2008, (a period free from of cyclone damage) the price of bananas in Australia was US$1,572 per tonne—five times Malaysia's US$253. Bananas cost US$337 per tonne in South Africa and US$162 per tonne in the Philippines.[31]

Dismantling the biosecurity measures restricting the import of apples had no apparent side-effects, and there is no cause to believe that removing import restrictions on bananas would harm domestic growers. Restrictions are acting as protectionist, non-tariff trade barriers and unnecessary. A total ban on banana imports is not necessary because:

- First, the 'tropical race four Panama' and 'black Sigatoka' are soil borne diseases, carried by the banana plant, not in or by the fruit we would be importing into Australia.[32]
- Second, after the IRA on Filipino bananas in 2008, only 21 out of the 122 diseases identified had an unacceptable level of risk if no risk management protocols were put in place.[33] If import bans were lifted, a tariff and inspection system could be maintained at the border.
- Third, bananas from the Philippines are accepted by other countries such as New Zealand and Japan with high quarantine regulations.[34] Australia's banana market is one of the most regulated and protected in the world.[35]
- Finally, foreign bananas could be imported into states that do not grow bananas. As inter-state quarantine measures exist, especially in Queensland where 93% of Australian bananas are grown, bananas from the Philippines could be sold in Tasmania, Victoria, ACT, NSW and South Australia without coming into contact with Australian banana crops.

Three years after the IRA recommended allowing the conditional import of fresh hard green bananas from the Philippines, the bananas are yet to find their way to Australian supermarkets.

While import bans protect our banana industry from foreign pathogens, the industry is still exposed to Australia's variable climate and natural disasters. Tropical cyclones Larry in 2006 and Yasi in 2011 wiped out 95% of the banana crop in the Tully and Innisfail regions in Queensland.[36] With no alternative supply from overseas, the ensuing shortages led to dramatic price rises. In February 2011, banana prices rose from $2.30/kg before Cyclone Yasi to $13.98/kg after the cyclone.[37] The Melbourne Market in June 2011 reported that banana supplies had fallen to 15% of normal quantities since the cyclone.[38] Households even began planting banana plants in their backyards.[39]

What's more, it is the banana-growers who were *not* affected by the cyclone that were able to reap the higher prices. After all, they could now sell their crop in a depleted market.

Should consumers pay the price of such a protectionist policy? Imported bananas would not only create price competition among Australian producers but also stabilise prices after natural disasters

The banana industry employs more than 6,000 Australians[40] directly and claims to indirectly support 'thousands more jobs in areas such as research, development, farm technology, packaging, storage, refrigeration, transport, support services and more.'[41] Although our economy is close to full employment, these 6,000 employees can easily secure other work. The strongest opposition to opening the banana market is from far north Queensland, where 93% of total Australian production occurred in 2010.[42] The remainder supply was produced in northern NSW, southeast Queensland, and the Carnarvon and Kununurra regions in Western Australia and the Darwin region in the Northern Territory.[43] The Queensland government supports the banana industry to the tune of $750,000 each year, and a national levy on farmers is matched by the Commonwealth to promote R&D and marketing for the industry.[44] Despite government support, Queensland banana growers were relieved to learn that Minister for Agriculture Joe Ludwig would not relax quarantine laws after Cyclone Yasi.[45]

The Australian banana market is estimated to be worth $500 million annually, large compared to other fruit industries but nevertheless a minute percentage of our annual GDP.[46] Politically, the industry is concentrated and united under the single electorate of Kennedy, represented by Independent MP Bob Katter. But should all Australian banana buyers be paying what is effectively a banana levy to support a 6,000-person industry in one constituency?

Australia has not always grown all its bananas.

Bananas do not bring in export revenue either, as most of the produce is consumed domestically. Exports to Japan, Indonesia, Korea and New Zealand in 2007 amounted to a negligible 1% of total production.[47] Moreover, by world market standards, Australia is a relatively small producer of bananas (accounting for 0.28% of the global banana harvest in 2009).[48] Australia is not the major banana producing country we think it is.

Australia has not always grown all its bananas. Sixty years ago, Australia, as well as New Zealand, imported bananas from Fiji.[49] We banned imports only when domestic production was able to fulfil demand.[50] Now, an all-Australian banana supply increases prices for Australian consumers and exposes them to even higher prices in the wake of natural disasters. With Australian prices eight times the banana prices overseas (see Table 1) post-Cyclone Yasi, Australians (who continue to buy their annual 13 kilos worth) are paying an indirect $150 subsidy to the banana industry each year. Even the pre-Cyclone Yasi price of $2.30/kg was 50% more than the $1.52/kg in Britain.

If Australians love their Australian-grown bananas as much as the banana growers claim, they shouldn't be worried about the competition. Faithful customers can continue to subsidise Australian banana growers through higher prices, while others have a choice. Consumers should be allowed to decide how much they are willing to pay for the pleasure of eating all-Australian bananas.

Recommendations

- Import fresh hard green bananas from the Philippines to all states.
- If this cannot be done immediately, import Filipino bananas into non-banana growing states: Tasmania, Victoria, ACT and South Australia.

No country for bookworms

Booksellers Angus & Robertson and Borders Australia may have collapsed for a number of reasons but not because Australians no longer like reading books. Indeed, about 10 million

Australians or almost half the population buy and read books.[51] But technology has changed *how* we read (e-books on electronic devices like Kindle and iPad) and buy books (online) all over the world, not just in Australia.

However, Australia's high book prices make online book purchases, especially e-books, even more attractive. Consumers are also shunning Australian publishers and retailers more and more in favour of overseas booksellers because overseas imports under $1,000 are exempt from GST and are benefitting from a strong Australian dollar. In 2009, online sales represented 5% of the $2.5 billion spent on new books in Australia.[52]

But the main reason for Australia's high book prices is a law that is more than four decades old.

The *Copyright Act 1968* states that if an Australian publisher procures a book's copyright within 30 days of its overseas release (the '30 day rule'), Australian book retailers cannot import foreign published (and probably much cheaper) versions of the book. For practical reasons, individuals are exempt from these parallel import restrictions—otherwise customs officers would have to search every piece of baggage for books purchased abroad. Until the advent of the Internet and online shopping, Australians were held captive to the prices set by domestic publishers due to our isolation. But online shopping and this loophole of personal book purchases have made it possible for individuals to easily buy books abroad.

Australian prices are regularly double, if not three times, the price of overseas equivalents.

The rationale behind the *Copyright Act* was that by raising the prices of foreign books through the creation of an Australian monopoly, consumers could be diverted to Australian writers. However, there is little evidence this theory works in practice, mainly because books are not generic, substitutable goods. A crime story enthusiast keen to read Stieg Larsson's *Millennium* trilogy will not settle for an Australian crime series just because it is less expensive. Either the reader will pay the excessive Australian price for Larsson, borrow it from the library, or buy a cheaper international edition. According to a 2009 Productivity Commission paper, buying higher-priced Australian-published (not Australian-authored) books only helped Australian publishers and *foreign*, not Australian, authors.[53]

The price gaps are substantial. Australian prices are regularly double, if not three times, the price of overseas equivalents. The seventh *Harry Potter* paperback costs AU$21.95 in Australia compared to AU$6.09 in Canada. Similarly, the third book of the *Millennium* trilogy costs AU$6.55 in Britain compared to AU$24.95 here.[54] No wonder Amazon's UK website specifically targets Australians and New Zealanders, even offering free shipping on orders above £25. The antipodean customer is obviously becoming more and more valuable to Amazon, thanks to the enormous price differences.

The other great threat to the traditional, high-price Australian book market is the e-book—and e-books don't play by the rules laid down in the 1960s. Paper books all over the world are facing increasing competition from electronic copies or e-books being sold at much reduced cost. Wireless reading devices like a Kindle or an iPad provide easier and more affordable access to reading material. The initial investment in a Kindle (AU$240 on Amazon UK) or Apple iPad (AU$579 for the iPad 2) can easily be recouped (the Kindle edition of the third book of the *Millennium* trilogy is only AU$3.80). Kindle has its own store in the Amazon site.[55]

In June, Small Business Minister Nick Sherry predicted that in five years, bookshops will cease to exist but for a handful of specialist booksellers while e-commerce will dominate the book business.[56] Thomson Reuters forecast that e-books will outsell hard copies by 2018.[57] By then, the '30 day rule' will be redundant. Australian authors will face stronger foreign competition and local publishers will be able to do nothing about it.

It is obvious that Australian consumers are hurt by the import restrictions. But do they at least benefit Australian authors? No. The restrictions have not created a thriving Australian literary scene. It turns out that the printers and publishers are the biggest supporters of the restrictions. Consumers are supporting 300 jobs at McPherson's Printing, the largest printing business of a total 5,000 in Australia.[58] Most printers employ fewer than 20 people.[59]

In 2006, the Australian Bureau of Statistics (ABS) reported that 6,370 people were employed in book publishing and 37,500 in printing, including magazines, catalogues and paperbacks.[60] They are the direct beneficiaries of import restrictions, not authors. But should Australian book publishers and printers benefit at the expense of Australian consumers and increasingly uncompetitive booksellers?

Booksellers as well as consumers are paying the price for import restriction laws. In 2009, the Productivity Commission recommended repealing the '30 day rule' after three years to give the industry an adjustment period before changes come into effect, followed by a review five years after the repeal.[61] The commission also suggested that instead of trying to protect local writers by making foreign titles more expensive, direct grants could be given to local authors as a more transparent way of supporting the domestic literary scene.[62] Direct payments, though certainly not ideal, would still be better than industry-wide assistance. Retailers forecast that 3,000 jobs would be at risk from bookstore closures, and the commission's suggestions were rejected by then Arts Minister Peter Garrett and then Industry Minister Kim Carr. The Bob Carr-led 'Coalition For Cheaper Books' and former ACCC chairman Allan Fels supported the repeal of the restrictions, blaming the government for continuing to burden consumers with higher store prices.

Booksellers as well as consumers are paying the price for import restriction laws.

There are fears that the expanding online book retail scene would force independent booksellers out of the market. This has not happened in Britain where there is greater market segmentation. Supermarket chains Tesco and Sainsbury offer bestsellers en masse, while independent retailers focus on a more discerning consumer segment.[63] This model could work in Australia, too. Independent booksellers could continue to offer the books that Coles and Woolworths, if they were allowed to import cheaply, would never make space for in their aisles.

In 2009, Australians spent $2.5 billion on books.[64] If overseas books were 30% cheaper (a safe and conservative estimate) than their Australian editions, it would cost households only $216 a year than the current $308. The 75% price difference of the Harry Potter books would cost households only $77 per year for their literature, a startling saving of $231. With the savings from cheaper books, consumers would be able to buy more local literature and favour local writers on their merits, not their price.

Regardless, cheaper books are here to stay, thanks to e-commerce and electronic publishing. It is time for our 40-year-old copyright laws to reflect this new reality.

Recommendations

- Repeal the *Copyright Act 1968*'s '30 day rule.'
- As per the Productivity Commission's recommendation, allow a three-year adjustment period for the industry before changes come into effect and conduct a review five years after the repeal.

Driving Australians crazy

Why are cars so expensive in Australia? And what would make them cheaper?

For everyday items like bananas, books and DVDs, the price differences between Australia and other countries are immediately visible at retail and online stores. But Australian consumers are not aware of other items with vast price differences here and abroad.

For various reasons, Australians travelling abroad do not usually buy these items and government regulations make it onerous to import them into Australia. The best example of such items is cars.

Unless they are motoring enthusiasts, Australian tourists would not usually compare prices in foreign car dealerships. Moreover, importing cars is a far more complicated process (and a bureaucratic nightmare) than, say, ordering books from Amazon.

The Australian car market is heavily protected against international competition. Big car companies can import foreign cars, but private customers are at the mercy of the car dealerships in Australia. So for ordinary car buyers, there is no point comparing international car prices because there is no way they could realistically import a car they like and drive it in Australia.

It is for this reason that the cost of the same cars in Australia and abroad often escapes public scrutiny. In fact, the price differences between cars here and abroad may in some cases be much greater than the price differentials in books or clothing.

So how expensive are Australian cars compared to other countries? What are the reasons behind the price difference, and how far is the government to blame for it? What measures could and should be taken to make cars more affordable to Australian customers?

Comparing Australian and international car prices is not straightforward because cars are not generic products like bananas or DVDs. In today's world of mass customisation, cars are now being produced to suit individual buyers so no two cars are strictly identical. Moreover, the prices in Australia and international markets may vary for different segments of the car market. For example, one of the big price drivers, the Luxury Car Tax (LCT), only affects the upper end of the market.

The Australian car market is heavily protected against international competition.

For these reasons, it makes more sense to go through individual examples of comparable cars in terms of model, age and mileage to draw the right conclusions.

List prices of new cars are not particularly helpful because it is a well-known marketing practice in many countries to advertise moon prices that are then heavily discounted. The actual price is usually substantially different from the list price. Used car prices are a more sensible measure of comparison. Though they may be discounted, the difference between advertised and actual prices is usually not as large as for new cars. We have compared the least 'used' cars—those in their first 20,000 kms—to preclude deterioration as a price factor.

Online used car portals of the big car manufacturers are the easiest way to compare used car prices. Mercedes-Benz, for example, offers its customers around the world similar website tools to look for their desired used car model across all participating dealerships in their country. We used these tools to compare the prices of a Mercedes C-Class, C250 CGI sedan Avantgarde, registered in 2010 (no demonstrator), and with between 10,000 kms and 20,000 kms on the odometer in five countries.

- Australia: four results with an average advertised price of $70,564
- Germany: 29 results with the average price of EUR 31,171—or just under $42,000
- United Kingdom: 26 results with an average price of GBP 25,057—a little more than $38,000
- United States (C-Class, C300): US$26,500 to US$41,770
- New Zealand: one result (newer model registered in 2011) at NZ$69,990 ($53,000).

The Mercedes C-Class sedan is more expensive in Australia than in other countries.

Box 1: The Europa Car Price Report

The Europa Car Price Report regularly compares new car prices in EU member states. A comparison of the prices of three middle-class cars in five Eurozone countries, Sweden and Britain shows that in each case, the Australian price on average was far higher in Europe for all three cars: Mercedes C-Class (40% more); the Audi A4 (45% more); the BMW 320 (33% more).

Note: The LCT affects cars only above a threshold of $57,466 and only applies to the value above the threshold. So these three cars are not affected by the LCT.

European new car prices

Car	Country									
	Austria (€)*	Belgium (€)	Germany (€)	Spain (€)	France (€)	Sweden (€)	UK (€)	Average (€)	Europe average (AU$)	Australia (AU$)**
Mercedes C220 CDI	37 803	35 183	36 384	35 077	33 606	36 432	26 601	34 440	46 771	65 670
Audi A4 2.0 TDI	34 815	31 767	33 030	33 167	31 097	28 155	27 256	31 326	42 023	56 981
BMW 3 series, 320d	36 145	33 177	34 300	35 049	33 890	33 797	27 212	33 367	44 761	64 935

Source: European Commission, *Car prices within the European Union* (Brussels, January 2011).

* Includes taxes.

** Includes dealer delivery charges and NSW stamp duty.

Luxury car tax

The most obvious price driver in Australia for the true luxury cars such as the Mercedes S-Class is the LCT. Similar versions of a used luxury sports car, the Mercedes-Benz SL63 AMG, registered in 2009, with under 20,000 kms on the odometer, cost $358,747 in Australia; €104,900 ($142,000) in Germany; £92,655 ($142,000) in the United Kingdom; and US$108,065 in the United States. (In New Zealand, the car was unavailable.)

The most obvious price driver in Australia for the true luxury cars such as the Mercedes S-Class is the LCT.

However, even the LCT does not fully account for the vast price differences. The LCT is applied to the value of the vehicle above the LCT threshold (currently $57,466[65]) less GST. The LCT tax rate is 33% ($67,000 for the Mercedes-Benz SL63 AMG), and it does not explain the more than $250,000 difference between the same car in Australia and the United States.

Speaking against the idea of a price-based LCT is the fact that price is not necessarily an indicator of luxury. For some families, a second car below the LCT threshold may be a greater luxury than an SUV above the tax threshold for a family with many children. If the LCT was meant to reflect economic circumstances, it clearly fails to do so. Maybe redistributive goals could be better achieved through progressive income taxation instead. But even if the LCT fulfilled the goal of taxing luxury, why does it apply only to cars and not diamonds, caviar, champagne or yachts.

Further, high-end cars are often the most advanced, fuel-efficient, and safest on offer. It is ironic that government makes it difficult for us to drive such cars on Australian roads.

The lower end of the market shows another anomaly. Earlier this year, the *Sydney Morning Herald's Drive* magazine reported that Australian-made sedans were being sold for much lower prices overseas. Holden's Commodore SS is sold in the United States as the Pontiac G8 GT and costs about $30,000, roughly $15,000 less than it costs here.[66] The Camry, Toyota Australia's most popular export (mainly to the Middle East), is 25% cheaper abroad than in Australia.

Impossible imports

Another factor lifting the price level of Australian cars are the so-called Australian Design Rules. These rules specify specific safety, emissions and anti-theft standards that all Australian cars have to comply with. Standard features such as windscreen wipers, seatbelts and rear-vision mirrors are necessary. All other developed countries have similar rules in place. However, Australian rules differ slightly from other countries. The glass used for windscreens in North America, Japan or Europe may be only slightly different to Australia Design Rules but would require a new windscreen for the car to be sold in Australia. As a leading British car shipping company says, '[c]onverting a vehicle to full Australian Safety and Emission Control Standards is virtually impossible.'[67]

Even without those rules, the process of privately importing cars into Australia is so complex that it is almost impossible for private individuals other than migrants to import cars to Australia. The mandatory personal import approval from the Department for Infrastructure, Transport, Regional Development and Local Government is usually only available to migrants who have previously resided abroad. Only one car can be imported per person per five years, and the vehicle must have been 'owned and used' for a minimum of 12 calendar months before shipment. So Australians would have to live in the United Kingdom to import a car from there. And this car would not have to follow Australian design rules.

Other countries are far more open to international imports.

If it were not for the bureaucratic obstacles, we could be importing more cars from other right-hand drive countries, especially for higher value used cars. Shipping a car, even from Britain, costs only $2,000 to $3,000, but the tedious restrictions make it impractical.

As private imports are not a realistic option, and as Australian Design Rules vary from international standards, the Australian car market is effectively cut off from the rest of the world. Only cars imported through the channels of the big car manufacturers can find their way into Australia.

It should be noted that covert protectionism is also practised by governments' fleet purchases. In 2010, 45,929 vehicles were bought by states and territories while the federal government purchased 4,324. The government strictly stipulates that foreign-made cars can be imported only if there is a 'compelling need' not met by a local car.[68] In fact, Prime Minister Julia Gillard recently wrote to NSW and Queensland Premiers of her concern regarding the decline in purchases of Australian-made cars in government fleets.[69] The Australian share of government fleets had dropped from 64% in 2004 to 39% in 2010.[70] When governments buy Australian-made cars instead of potentially cheaper imports, Australian taxpayers are effectively paying the bill for the price difference—and the patriotic gesture.

Other countries are far more open to international imports. New Zealand, for example, receives large quantities of used Japanese cars. There are even companies in Japan specialising in shipping cheap cars to New Zealand.

This lack of competition, in conjunction with LCT and import duties, is keeping Australian car prices at an artificially high level. The market can be freed up in three ways.

1. Abolish the 5% customs duty on imported cars. It is an obstacle to free trade, and there is no economic justification for it.
2. Abolish the LCT. Indeed, this is what the Henry Tax Review also called for. In 2007–08, the LCT raised $464 million in revenue, or 0.1% of total taxation revenue.[71] It is a negligible tax in the federal budget but it grossly distorts the upper end of the car market. Besides, the LCT would have been more justifiable when Australia still had sales taxes. Under the current GST arrangement, it is hard to find a good economic argument for the LCT.
3. Allow private imports of used cars. The safety and roadworthiness can be ensured by importing cars that:
    - Are not older than 10 years and have not been driven more than 120,000 kms.

- Are from the United Kingdom, the Republic of Ireland, Japan and New Zealand (OECD countries driving on the left). As they are developed economies and comparable countries, there is every reason to believe that cars registered in these countries will be, for all practical considerations, as safe as cars in Australia. If a windscreen and a rear mirror are adequate for driving in the Scottish highlands or along the Ring of Kerry, they are certainly good enough to drive in NSW or South Australia.
- Undergo, on arrival at an Australian port, the normal procedure for a 'pink slip.'

Opening up this import route for used cars would not only make the market more competitive but make the local big car manufacturers adjust their pricing strategies. Where they were previously shielded from too much competition, they would not now have to compete more vigorously to keep pace with the much cheaper imports.

Second only to houses, cars are the most expensive assets purchased by a typical Australian household.

In the short term, Australian car prices would approach those in other big car markets. The Mercedes C-Class would fall from $70,000 to between $45,000 and $50,000—because that's what such a car sells for in Britain (plus shipping to Australia).

As imported cars become cheaper, so would Australian-made cars. If General Motors can sell its Commodore cheaper as a Pontiac in the United States and Toyota can offer its customers in Saudi Arabia a better deal than customers near its Victorian factories, then it is time to increase the competitive pressure on these companies in Australia.

Second only to houses, cars are the most expensive assets purchased by a typical Australian household. The prices of ordinary cars can easily be reduced by 20% to 50% by liberalising the Australian car market and opening it up to international competition—thus offering substantial savings to Australian consumers.

Recommendations

- Abolish the remaining import duties to allow commercial importation of new vehicles.
- Abolish the Luxury Car Tax.
- Allow the private importation of used vehicles into Australia that are:
  – not older than 10 years and have not driven more than 120,000 kms
  – only from the United Kingdom, the Republic of Ireland, Japan and New Zealand, and
  – fit to obtain a 'pink slip' on arrival.

Making housing less affordable, the Australian way

Compared with other international cities, housing in Australian capital cities is regularly reported as being among the least affordable. The price of a small apartment in Sydney or Melbourne would probably be enough to buy a reasonably sized family home in Berlin, Houston or Barcelona.

Whether our house prices are only subjectively high or whether there is a bubble is a matter of great debate. There are two schools of thought. Some economists like Professor Steve Keen from the University of Western Sydney have long argued that the Australian housing market is showing signs of a speculative bubble and is due for a correction in the near future. Other economists argue the opposite: strong demand and subdued supply have resulted in the current high level of house prices.

Which group of economists is right is an interesting question; however, we do not need to answer it here. Bubbles are by their very nature cyclical. Instead, we are concerned about the structural factors that are making Australian housing unduly unaffordable. To use an analogy, we are not concerned with the weather (current house prices) but with the climate (long-term housing affordability). And we are not discussing short-term influences on house prices but their long-term determinants.

The general aim of this monograph is to show how Australian governments have made life less affordable for Australians through the following:

- Land supply
- Tax incentives for property investors (negative gearing)
- Subsidies for owner-occupiers (first home owner grants)
- Stamp duties
- Infrastructure levies.

Compared with other international cities, housing in Australian capital cities is regularly reported as being among the least affordable.

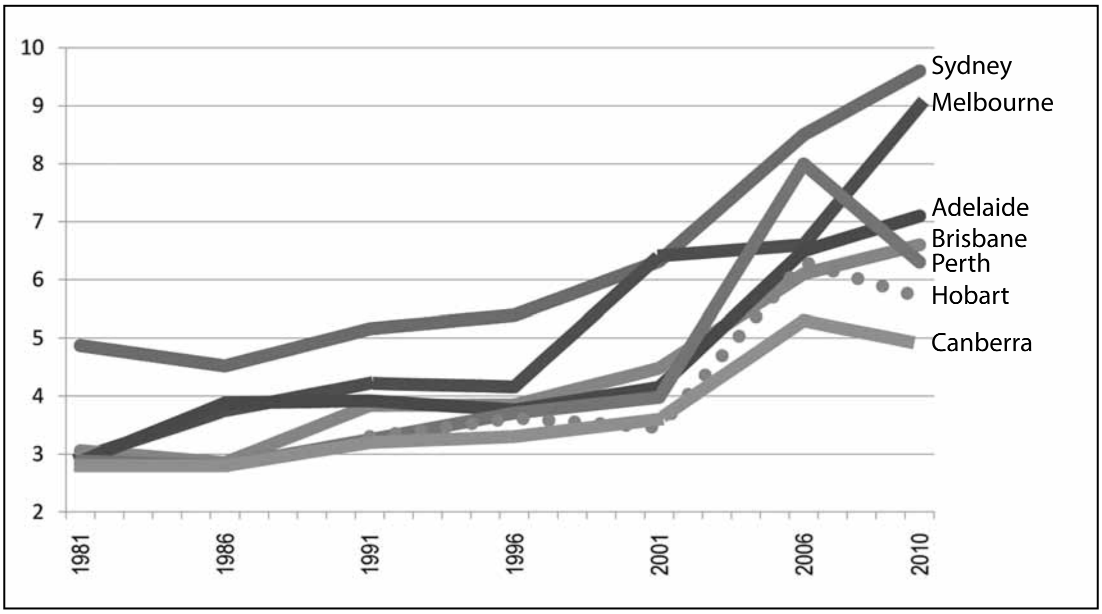
But first, let's see how expensive Australian housing is and how it compares to other property markets.

The Demographia reports use a very simple and straightforward methodology to evaluate housing affordability. They take the median house price in a city and divide it by the median household income in that city. The result is a measure that Demographia calls the 'median multiple.'

It is quite a crude measure since it ignores the nature of the property in question. By looking at household incomes instead of individual incomes, it potentially also understates the long-term development in house prices since there has obviously been a change in household composition (i.e. the shift towards double income households from the traditional household with a sole breadwinner). For these reasons, Demographia's 'median multiple' should not be over-interpreted.

Despite its shortcomings, the Demographia measure still offers a good shortcut to understanding various property markets, especially over longer periods of time. The following graph shows median multiples in several Australian cities over the past 30 years.

Figure 1: Housing affordability in Australia (1981–2010)



Source: Demographia Housing report.

These are not merely absolute changes in house prices but changes in the relation between house prices and income. So in Sydney, for example, the median household would now have to spend almost *10 times* its annual household income on the median Sydney house compared to fewer than *five times* the household income 30 years ago. Sydney is the most extreme case in Australia, but other Australian cities show similar trends.

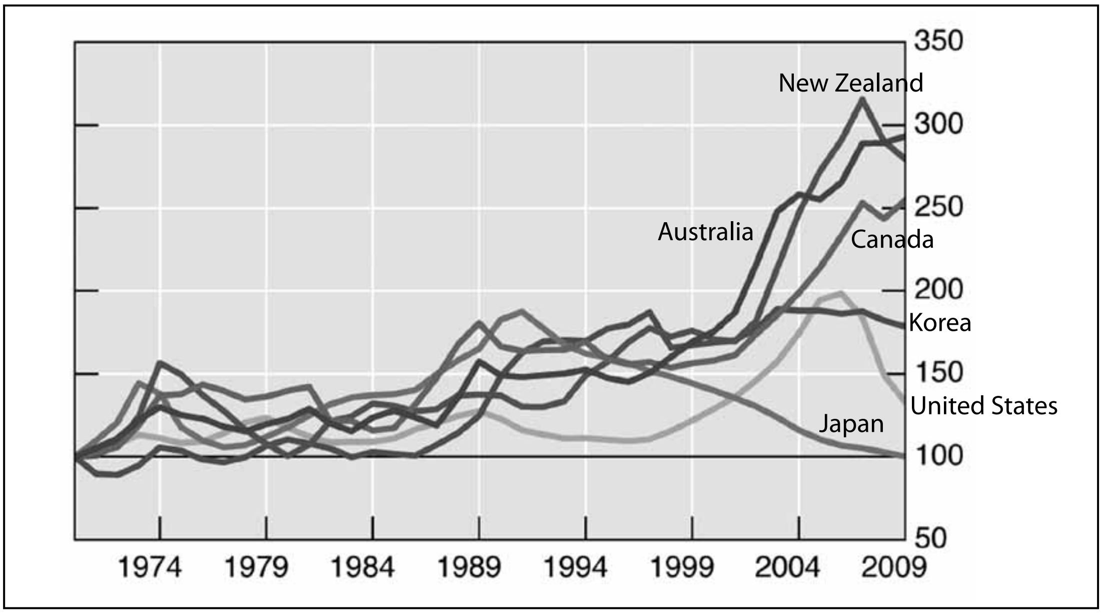
We can't deny that housing in Australia is in fact very expensive.

In Demographia's own methodology, housing is deemed affordable if the median multiple was less than a factor of 3. On this measure, Australian cities are severely unaffordable. In fact, in its latest study, only one other city was found to be more unaffordable than Sydney—land-scarce Hong Kong.

It is futile to speculate how much of Australian property prices reflect a bubble-like exaggeration. But we can't deny that housing in Australia is in fact very expensive. This is not just the normal outcome of a market equilibrating demand and supply but government interventions making Australian house prices systematically higher than they ought to be.

The long-term effects of these policies are apparent in inflation-adjusted property prices as calculated by the Bank for International Settlements. Real house prices are now three times higher than they were four decades ago. In comparison, not even the (now burst) US housing bubble was as big as Australia's house price boom.

Figure 2: Inflation-adjusted property prices (1970 = 100)



Source: Bank for International Settlements.[72]

Land supply

In theory, as a continent-sized country of just under 23 million people, Australia does not have a problem with land supply. Only a tiny fraction of habitable land is in fact built up.

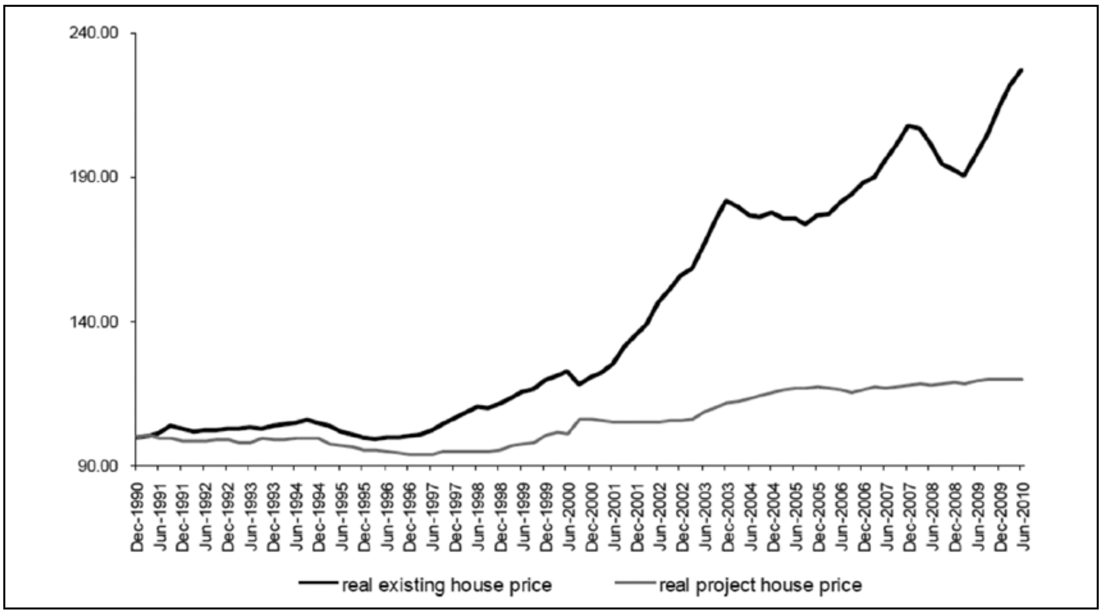
Despite this, land is still a very scarce resource in Australia. Part of this is due to its unique settlement pattern. The nation's population is concentrated in the capital cities and their metropolitan regions. Growth is inhibited in some of these capitals by natural boundaries like the Blue Mountains in Sydney's West or the Pacific Ocean in the East.

Land-use planning has also created artificial land scarcities. For example, Canberra has plentiful land, and yet its house prices are nearly as high as in the suburbs of Sydney or Melbourne.

It is difficult to estimate precisely how much such artificial land shortages have contributed to house prices increases. However, by comparing the developments of house prices and construction costs, it is possible to estimate the land component of house prices.

In December 2010, the Economics Group of the Housing Industry Association (HIA) did just that. Its report *Land Prices, House Prices and New Dwellings Costs* was based on a long-term study into the different components that determine Australian house prices.[73]

Figure 3: Real house prices in Australia (December quarter = 100)



Source: ABS, 'House price indexes,' Cat. No. 6416.0.

Figure 3 shows the inflation adjusted house prices (overall price of housing) and housing project cost (the construction cost of new housing). It is evident that house prices have risen far more than construction costs: the 'bricks and mortar' component of house prices has declined while the land component has increased. Land is the main culprit of house price inflation over the past 20 years. In fact, as a paper from the Reserve Bank showed, the gap between construction costs and house prices opened much earlier, going back to the 1960s.[74] However, this was a gradual process and the big acceleration only set in around the turn of the twenty-first century, as is visible in Figure 3.

House prices have risen far more than construction costs.

The HIA report strongly suggests that restrictions on land supply have been responsible for the rapid increase in land prices.[75] Although the authors acknowledge the lack of good data on land and house prices in Australia, the qualitative evidence clearly points in the direction of zoning and urban growth boundaries. These measures have restrained building activity so that construction could not keep up with demand. By 2029, the housing shortfall could reach 500,000 homes and apartments.[76]

Using data from the ABS and the Reserve Bank, economist Leith van Onselen estimated that the land component of Australia's housing stock is about 72%.[77] This finding is consistent with the divergent development between house prices and construction costs as described above.

The massive shortfall in land supply was also recently highlighted in a report of the Urban Development Institute of Australia (UDIA). Their research showed that over the past decade, the number of new lots has declined, as has the average lot size, while the median lot price has gone up across all capital cities. According to the UDIA, the consequences for housing affordability are dire:

> Land supply constraints are a significant contributing factor to Australia's current housing affordability crisis. Undersupply creates inflationary pressures in the land

market and because the price of land comprises a significant proportion of total housing costs, there is a knock-on effect in the wider housing and rental markets. Furthermore, limited supply not only increases the costs of new dwellings, but also impacts on established dwellings, as there is little market incentive for existing homeowners to sell below the price of a new house. Therefore, while new homes only contribute a relatively small portion of the total housing pool, prices for existing houses are potentially vulnerable to price increases driven by increases in the costs of developing new housing.[78]

Negative gearing

The tax system also works against affordable housing, most notably through negative gearing, a supposedly benign measure meant to increase housing supply.

Negative gearing has mainly increased the demand for housing.

The principle behind negative gearing is that property investors, whose capital costs exceed their rental income, can offset their net losses against their income tax liability. Such property investors are enticed to invest in rental properties by the prospect of capital gains in a rising housing market, but tax savings on their property losses make investing in housing an even more attractive option.

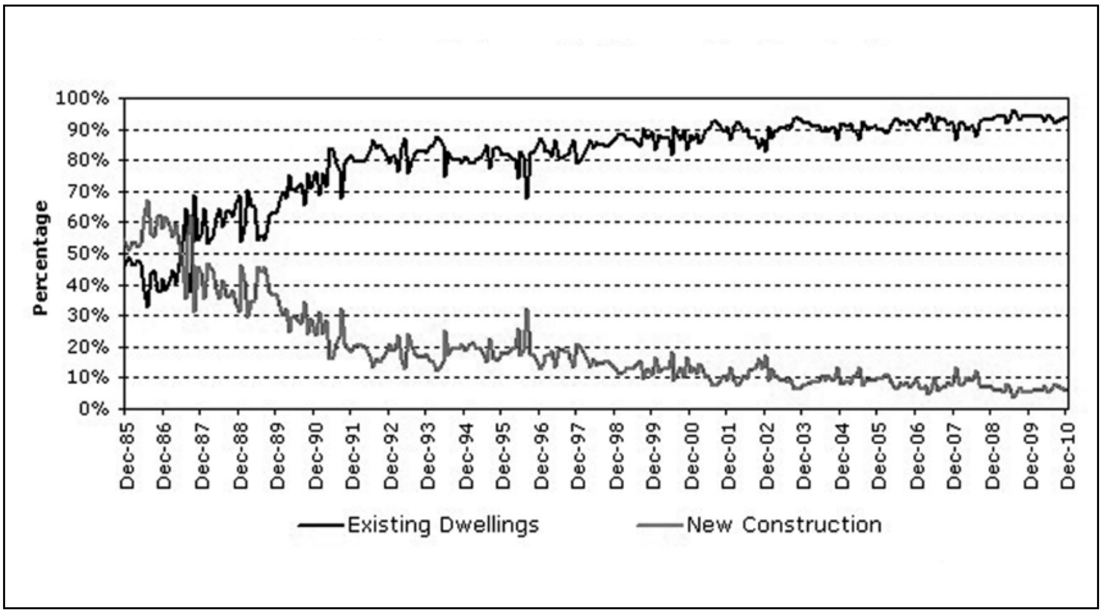
In theory, this favourable tax treatment could be an incentive to enter the property market as a builder-investor. In practice, the majority of properties bought as negative gearing objects have been existing dwellings. Far from helping increase the supply of new housing, negative gearing has mainly increased the demand for housing. This has pushed prices further upwards.

As economist Saul Eslake commented in an article earlier this year:

> 92 per cent of all borrowing by residential property investors over the past decade has been for the purchase of established dwellings, as against 82 per cent of all borrowing by owner-occupiers. Precisely for that reason, the availability of negative gearing contributes to upward pressure on the prices of established dwellings, and thus diminishes housing affordability for would-be home buyers.[79]

The development that Eslake refers to was visualised in a graph published on the economics commentary website macrobusiness.com.au:

Figure 4: Investment property loans: Existing vs new construction



Sources: RBA statistical tables and macrobusiness.com.au.[80]

For these reasons, the (partial) abolition of negative gearing was also recommended in the Henry Tax Review—only to be ruled out by the government. Henry and Eslake were in any case not the first economists to call for an end to negative gearing. The Reserve Bank and the Senate Housing Affordability report have made similar arguments.[81]

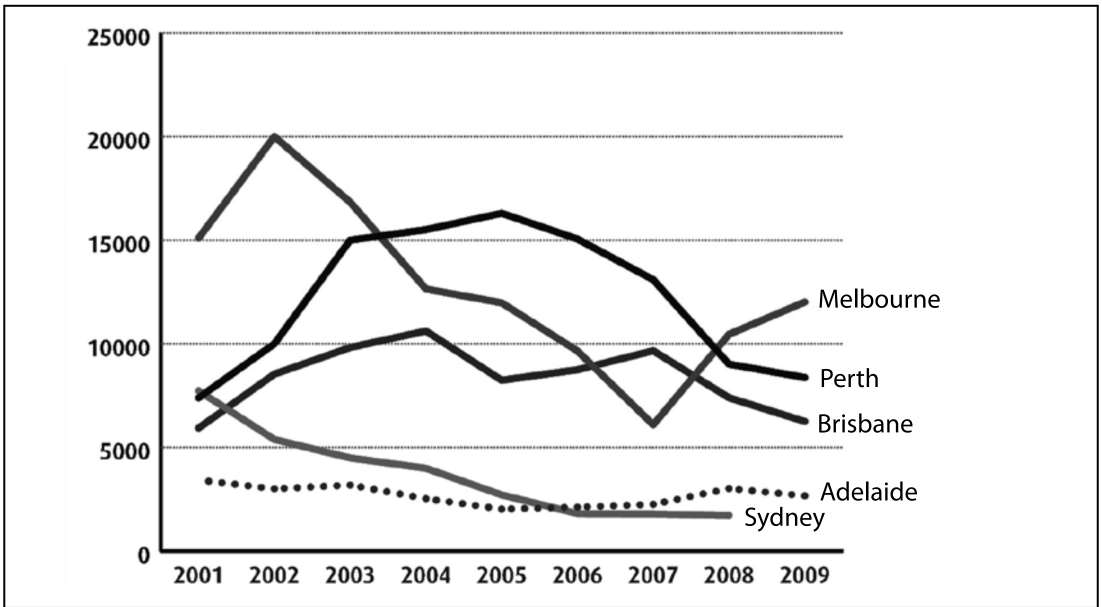
First home owner grants

Another supposedly benign intervention in the housing market has also had pernicious effects on housing affordability. Australian governments have been providing grants to first home owners for many years. The idea behind these grants is to make it easier for first-timers to enter the market by giving them some extra cash. The practical outcome has been very different.

First home owners grants would only make housing more affordable in general if the extra funds were used to increase construction activity and therefore the housing supply curve. There is, however, no evidence that the first home owners grants have led to any positive effect on the supply of housing. Rather, it has increased the financial firepower of would-be buyers and pushed up the demand curve.[82] Housing supply, on the other hand, has been rigid—not least because of supply constraints like the rigid planning and zoning laws mentioned above. According to the UDIA, the number of lots released has declined in nearly all states since 2001. (Figure 5)

There is no evidence that the first home owners grants have led to any positive effect on the supply of housing.

Figure 5: National findings of lots produced



Source: UDIA (National).[83]

Instead of making housing *more* affordable, the grant has made it *less* affordable by increasing the price of housing. Of course, the price increase of the average house may well have been smaller than the grant received by first-timers. However, for everybody else who did not qualify for the grant, housing has become less affordable as a result.

Housing in Australia is expensive, as mentioned before. But moving house is not cheap, either. Most of the costs associated with moving cannot be directly blamed on government. However, one important cost component can: stamp duty.

Stamp duties

The archaic tax of stamp duty varies from state to state, and some exceptions are available to first home buyers. Table 2 lists the costs for different property values (owner occupied, non first home buyers).[84]

Table 2: Stamp duty comparison

	$500,000	$750,000	$1,000,000	$1,250,000
ACT	$20,500	$34,875	$49,250	$66,125
NSW	$17,990	$29,240	$40,490	$54,240
NT	$20,429	$33,625	$46,000	$58,375
QLD	$15,525	$26,775	$38,175	$51,300
SA	$21,330	$35,080	$48,830	$62,580
TAS	$17,550	$27,550	$37,550	$47,550
VIC	$21,970	$40,070	$55,000	$68,750
WA	$17,765	$29,741	$42,616	$55,491
United Kingdom	AU$15,000	AU$22,500	AU$40,000	AU$50,000
Canada	AU$8,022	AU$17,172	AU$22,230	AU$27,287
Sweden	AU$7,500	AU$11,250	AU$15,000	AU$18,750

As a rule of thumb, the value of stamp duty on a house is roughly equivalent to the value of the car parked in its driveway. Taxation is also progressive, so stamp duties on higher property values are also relatively higher (as a percentage of the property value).

The discrepancies between the states are big and completely arbitrary: there is no economic rationale behind them. Selling a $1.25 million house in Victoria costs $21,200 more than selling a house of the same value in Tasmania. In a market economy, transferring property is a common activity, and yet it is severely hampered by stamp duties in Australia. This stops empty nesters from downsizing, and it potentially also stops people from moving in search of better employment opportunities. Who would be willing to sacrifice one year's worth of net income to move to a different city that promises only a moderately better paid job? Indeed Andrew Leigh finds that 'a 10 per cent increase in the level of stamp duty reduces the numbers of properties exchanged by 4–5 per cent if the increase is sustained over a three year period.'[85]

The direct effect of stamp duties is just to make housing less affordable.

From an international perspective, 'as a proportion of gross domestic product, taxes on financial and capital transactions in Australia, which mainly comprise stamp duties, are twice the average of OECD countries.'[86] Equivalent stamp duties in the United Kingdom, Canada and Sweden highlight the inflated duties in Australia.

The Henry Tax Review of 2009 found that the state stamp duty is an inequitable tax as housing consumption is just a fraction of a household's expenditure. Some households earning a certain income may prefer to invest in housing while others with the same income may choose to spend their money on a yacht.

Beyond being inequitable and inefficient, the direct effect of stamp duties is just to make housing less affordable. Potential buyers' budgets are diminished precisely by the amount of the stamp duty they have to pay. It is quite possible that without stamp duties, house prices would be higher (for precisely the same reason that they are higher because of first home owners grants). However, if supply were more flexible, the increase in the house price would not be equivalent to the stamp duty value.

The Henry Tax Review recommends the duty be replaced by more efficient means of raising capital.[87] Yet we can expect that states, which relied on stamp duty on conveyances for $12 billion or 12% of their revenue in 2009–10, will be reluctant to abolish such an easy source of revenue.[88]

Infrastructure levies

In recent years, local councils have increasingly resorted to using levies to pay for infrastructure investment. Such levies are first borne by property developers, who pass them on to their customers. Ultimately, it is the home buyers who have to bear these substantial infrastructure levies. In NSW, the levies are capped at $20,000 with some exemptions.

Given all these different types of intervention, there is no free market in housing. It is in fact one of the most highly regulated and distorted markets in Australia. All these interventions have made housing seriously unaffordable because the market is unable to supply for the demand. Government is perversely alleviating the situation by bolstering demand and making housing even less affordable.

There is no free market in housing.

Government can make housing more affordable and sustainable by dealing with supply constraints directly and making supply more responsive to price signals, encouraging councils to go for growth, and removing those policy interventions that artificially inflate demand.

Recommendations

- Increase supply by encouraging councils to take on more residents through local government finance reforms. See *Australia's Angry Mayors.*[89]
- Abolish both negative gearing and first-time buyers' grants.
- Abolish or at least reduce stamp duty on property transactions.
- Cap infrastructure levies or better replace them with funding streams based in income tax. Alternatively, give councils access to a share of the locally generated GST revenue.

Shop till you drop: The great retail rip-off

Australian retail is in crisis. For most of its history, Australia's geography ensured that its retail sector was shielded from international competition. Unlike in Europe, where shopping beyond national borders is often just a short drive away, Australian shops and department stores were so isolated that they had little to fear, least of all competition. Not only are other countries far away but in many cases, even the next big city is hundreds of kilometres away. This geography had created a very sheltered retail environment.

All this changed with the arrival of online retailers. Suddenly British books, American shoes, and Asian fashion stores were just a mouse click away from Australian consumers. The new transparency of the Internet revealed what many Australian tourists already knew from their overseas trips: Australia is a very expensive place to go shopping.

In fact, Australia is so expensive in some areas that it makes economic sense to have one's personal purchases—whether they are perfumes, DVDs, books, electronics or clothing—shipped halfway around the world. Even high postage and packing fees are not enough to deter Australian consumers from using their newly discovered freedom to shop internationally. E-commerce tripled from $40 billion in 2004–05 to $123 billion in 2008–09.[90] The strong Australian dollar in recent years certainly helped, too. Australia's traditional bricks-and-mortar retailers are finding it increasingly difficult to match the prices of international online competition.

It is against this background that some retailers launched a vociferous campaign against the tax exemptions available to online retailers. Currently, a threshold of $1,000 applies to international purchases. Online deliveries exceeding this value attract GST. Other purchases are GST free (and are usually also GST/VAT exempt in their countries of origin). The debate about the impact of international competition and its tax treatment became so heated that the federal government tasked the Productivity Commission with an inquiry into the state of Australia's retail sector.

While this inquiry is still underway (a draft report with draft recommendations was published in August 2010[91]), it is already emerging from the process that the retailers' protestations about unfair tax treatments are by no means the only factor in the decline of Australian retail. Though the commission tends to agree that GST should in principle be charged for overseas purchases (at least where it is economical to do so), the draft report also reveals that the lack of competitiveness of Australian retail cannot solely be blamed on this one factor. The overall problem is a lack of competition in the sector—for which there are several explanations, many of which have a government intervention at its core.

But first let us see how expensive Australia really is.

Table 3: International price comparison (prices have been rounded to the nearest decimal)

Product	Australia	Canada	United States	Japan	Germany
Lady Gaga Fame Monster	$ 27	$10	$ 9	$13	$11
LG 315L Top Mount Fridge Refrigerator	$749	$641	$760	NA	NA
Television: Samsung 51" High Definition Plasma TV	$999	$1086	$665	NA	$929
Running shoes: Asics Gel DS Trainer 16 (Men's)	$219	$197	$104	NA	$132
External hard drive (WD Elements desktop 1TB)	$ 84	$ 74	$ 67	$ 75	$ 77
IKEA- Kitchen 'Faktum Adel'	$ 4,936	$2,946	$ 2,330	$ 6,030	$ 3,758

Most expensive	Least expensive

The figures in the above table and the continuing trend towards online overseas purchases are symptoms of Australia's retail crisis. But what are its causes?

Retail rents

To begin with, Australian retail space is very expensive. High rent costs are reflected in higher sales prices, which are passed on to the customers.

In a recent survey of international retail space rents, Sydney's Pitt Street Mall (US$901 a year per square foot) beat the prestigious Champs-Elysees in Paris (US$873 a year per square foot).[92] Sydney is also more than twice as expensive as the Los Angeles Rodeo Drive (US$425) and almost seven times more expensive than Auckland's Queen Street.[93] In fact, Sydney CBD was beaten only by the top retail locations in New York, Hong Kong, London, Zurich and Milan.

Retail space across Australia's capital cities is also expensive. But in its submission to the Productivity Commission, Westfield, the biggest operator of shopping centres in Australia, argued that its shopping centres are not particularly expensive compared with average rents in its UK and US stores.

Table 4: Westfield's international retail rents (2010)

Country	Rents/sq m (Dec 2010)	Rents/sq m (Dec 2010) in A$ at current exchange rates	Rents/sq m (Dec 2010) in A$ at long-term average exchange rates
United States	US$629	A$586	A$830
United Kingdom	GBP825	A$1,270	A$1,857
Australia	A$1,428	A$1,428	A$1,428

Source: Pip Freebairn, 'Costs put local retailers at global disadvantage,' *The Australian Financial Review* (6–7 August 2011).

Westfield claimed that the high looking Australian rents would look much lower if they were discounted for the currently very strong Australian dollar. However, the exchange rate argument does not quite hold. Even after such discounting, Australian Westfield rents would still be significantly higher than its American stores. Before 2008, the pound sterling was at least as overvalued as the Australian dollar is today. More importantly, comparing rents in Westfield's Australian and British centres is not comparing like with like.

Australia's traditional bricks-and-mortar retailers are increasingly finding it difficult to match the prices of international online competition.

Westfield does not have many shopping centres in Britain. Shopping centres is not as widespread a retail concept in Britain as it is in Australia. Traditional high street shopping is still much more widespread in Britain than in Australia, where in many suburbs the big malls have replaced more traditional shopping precincts. Even in Sydney's Pitt Street Mall there is now a big Westfield centre.

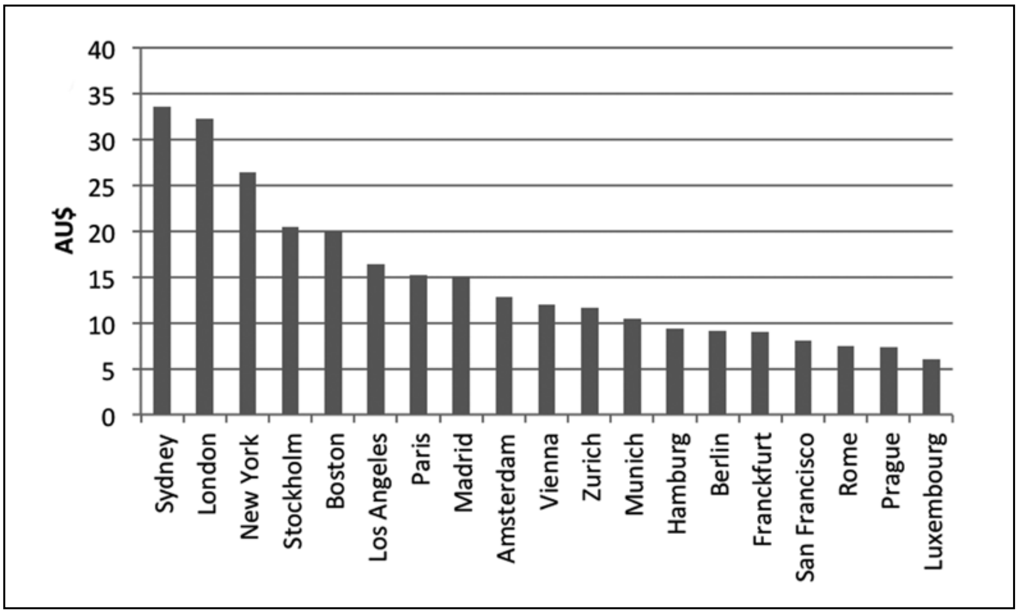
Westfield operations in Australia include more suburban rather than metropolitan prime retail locations, whereas in Britain it is the other way around. Once you take this into account, the Australian Westfield rents look even steeper in comparison to the quoted British rents.

Box 2: CBD parking comparison

A three-hour parking price comparison shows that Sydney is the most expensive of 19 cities worldwide. Parking for such a period is a typical cost that consumers have to factor in for trips to retail centres, especially if seeing a film. Even before accessing the high-priced retail, Sydney parking must be factored in to a 'trip to the shops.'

The Australian rents look even more outlandish when compared with rents paid in the top streets of American cities outside the big metropolises.

Figure 6: International prices for three-hour parking



Source: Hotelreservierung.de.[94]

Table 5: Annual square metre rents for prime retail (rounded to the nearest decimal)

	Annual rent per sq m (USD)	AUD equivalent
Cincinnati, OH	398	385
Denver, CO	377	364
Ft. Lauderdale, FL	431	415
Phoenix, AZ	409	395
Portland, OR	217	210
Seattle, WA	484	467
Stockton, CA	323	333

Source: Colliers Retail Highlights.[95]

Note: Rents and exchange rate as of 31 March 2011.

Of course, Cincinnati, Denver or Stockton is not comparable to Sydney Pitt Street Mall. But Westfield is not all about Pitt Street Mall, either, and it has shopping centres in places like Tuggerah, Warrawong and Innaloo. In fact, quite a large share of Westfield's Australian operations is not in prime CBD locations but in the suburbs. So the question has to be: Why are rents in Westfield's centres still so expensive? How can the *average* rent in an Australian Westfield centre be broadly equivalent to some of the more expensive US prime retail locations like Miami's Lincoln Road?

The answer to this question is barriers to entry in the retail market. The Productivity Commission shares this view. In its draft report on the competitiveness of the Australian retail sector, a large part of the draft recommendations are concerned with planning and zoning regulation. These land use plans have in the past made it difficult to provide more retail space where it was needed. In this way, the planning system has pushed up prices for land: these higher prices have then been passed on to consumers.

To make shopping in Australia more affordable, it is necessary to reduce rents.

The commission proposes a radical shake-up of the planning system to open up the market to new entrants.[96] This would require the reduction of restrictive planning requirements and the removal of commercial viability testing for new shopping areas. In a market economy, it is odd that government bureaucrats are charged with checking business propositions.

To make shopping in Australia more affordable, it is necessary to reduce rents because they are the main driver behind high retail prices. As the *Sydney Morning Herald* reported recently:

> The total occupancy cost of a small Australian fashion retailer is between 17 and 25 per cent of gross sales, according to Sydney-based Leasing Information Services. Data from the Washington, DC-based non-profit Urban Land Institute show the equivalent occupancy cost for fashion retailers in the US is about 7.6 per cent.[97]

The limited availability of retail space also makes it difficult for new competitors to establish themselves in the market. Discount retail chain ALDI has repeatedly complained about restrictive planning and zoning laws, which held back the chain's plans for expansion in Australia for many years.[98] Similar complaints have been made by retailer Costco, which felt that its plans to establish itself in the Australian market had been under attack from established retailers and shopping centre owners.[99]

Wages

Higher wages add to the cost of retail business and are passed onto consumers. Australia's minimum wage is relatively high at $15.51 per hour[100] compared to Canada ($AU9.69),[101] Britain ($AU9.27), and the United States ($AU6.90). In retail, a 'casual' employee level 1's award wage is $19.27.[102] Further, as a result of the recent award modernisation in Australia, penalty rates have increased. This discourages stores from extending trading hours where profitability would be reduced from a larger wage burden. The Productivity Commission acknowledges that shorter shop hours inconvenience buyers and encourage the shift to 24/7 online retail.[103]

As long as we continue to undersupply the market with retail space, make it harder to open new shops and shopping centres, and don't extend shopping hours, shopping will remain expensive in Australia. Until recently, consumers had no option but to pay whatever the retailers charged, but buyers now have the advantage of the high Australian dollar and can shop at local and international online stores.

Box 3: A trip to the cinema

As more and more cinemas are cropping up in shopping centres, retail rents also influence the cost of a ticket. Taking the family to a film is no longer affordable. Of eight countries, developed and developing, Australia's average ticket price is the highest by far.

Table 6:

Country	Average ticket price (AU$)	Average ticket price/ GDP per capita*	Screens/ millions of people	Admissions per capita (2010)
South Africa	0.51	0.93	17	-
South Korea	6.04	3.71	42	3.0
USA	7.51	1.63	128	3,9
Canada	7.62	2.02	86	3.1
France	8.58	2.19	88	3.3
Germany	9.06	2.34	58	-
New Zealand	8.55	3.06	-	3.6
Australia	12.98	3.22	90	4.3

Source: Screen Australia, 'Australia & the World; International Comparisons.'

Australians watch more movies than all the other cheaper-film-ticket nations and just as much as Americans. The above table shows that Australia had the highest number of admissions per capita of all listed countries in 2010. In 2008, we had the seventh highest annual film attendance per capita in the world.[104]

Australia's ratio of screens to millions of people does not account for the high price of cinema outings either. It makes sense for ticket prices to be lower in the United States with three times more screens than in Australia, but the Canadians have fewer screens than us and pay almost half the price. In fact, in 2008, Australia had the fifth most screens per million people in the world.[105]

The higher the Average Ticket Price relative to GDP per capita, the less affordable is the cinema ticket. Thus, while South Korea's ticket price is nominally cheaper than Australia's, the amount of income used to purchase the ticket is higher than in Australia. Nevertheless, after South Korea, Australians spend more of their income on tickets than the rest of the countries studied.

Perhaps South Africa's ticket price is so low because the cinema is the main form of visual entertainment for more of the population rather than in-home DVDs, etc.

Perhaps the two L's, labour and land, are to blame. Australia's minimum hourly wage is relatively high at $15.51.[106] For casual employees in the retail industry such as a cinema, the minimum hourly wage is $19.27 for those 21 years and older. The average national minimum wage is an equivalent $AU9.69 in Canada,[107] $AU9.27 in Britain, and $AU6.90 in America.

As most multi-screen cinemas are found in shopping centres, retail space adds to ticket prices. When Australian retail space is so high comparatively, this cost is passed onto Australian consumers.

The scarce supply of retail space, combined with high rents and wages, is not only affecting the retail industry but also the cultural sector, making a trip to the cinema a near luxury past-time.

We fully endorse the Productivity Commission's recently published draft recommendations on retail. The key to greater price competition in retail lies in the availability of land for retail development. Unlocking competition by deregulation the planning and zoning regime should therefore be put on the agenda. After the detailed work undertaken by the commission, there is no excuse for not reforming the sector. Australians should no longer be forced to shop online from international sellers to enjoy the benefits of a stronger dollar.

Recommendations

- Support the Productivity Commission's recommendation to relax planning and zoning regulations to:
  - – increase land supply for retail, and
  - – prevent these regulations being used by established retail-space owners as anti-competitive tools
- Abolish commercial viability testing for new shopping areas.

Conclusions

The old expression 'supply and demand' does not quite capture the way in which prices are determined in a modern economy. Price levels are the result of many circumstances and myriad decisions. They are the result of complex supply and demand mechanisms interacting in a largely government determined institutional framework.

The five case studies in this monograph show how government, with its taxes and regulations, has driven up the prices of the most essential consumer items.

That Australia is now one of the most expensive addresses on the planet was by no means unavoidable. Quite the opposite would have been possible. Our high dollar should have made imported consumer goods super cheap for Australian consumers. Our abundance of land should have given us the lowest land costs in the world. What we got instead is a country in which both products and land are much more expensive than in most other countries. For that, Australian consumers have to blame successive governments.

But there is some good news in this. Since the factors that render life in Australia unaffordable are predominantly home-made, they can be reversed. All it takes is political will.

Three groups of individual policies have had a positive price effect:

- policies that protect markets from imports (banana import restrictions, Luxury Car Tax, copyright laws relating to books)
- policies that artificially stimulate market demand (negative gearing, first home owners grants), and
- policies that increase the cost of factors of production (residential land supply, planning restrictions for new retail space).

Although we looked at only five case studies in this monograph, it is quite possible that similar restrictions are in place in other sectors. It is an ongoing task for government, but also for institutions like the Productivity Commission, to review such policies whether they are actually needed to reach a political goal or whether they have been put in place and kept there mainly to serve special interest groups.

For politicians who claim to be concerned about making the lives of ordinary Australians easier, tackling these price drivers should be a priority.

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