



EXECUTIVE SUMMARY

Inquiry into housing policies, labour force participation and economic growth

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Inquiry panel members

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| Michael Fusarelli | Department of Family and Community Services, NSW Government |
| Shane Garrett | Housing Industry Association Ltd |
| Michael Lennon | Housing Choices Australia |
| Paul McBride | Department of Social Services, Australian Government |
| Marty Robinson | Treasury, Australian Government |
| Iain Scott | Department of Social Services, Australian Government |

Executive summary

- This Inquiry presents evidence on how housing policies might promote labour force participation and economic growth through four channels—housing supply responsiveness, labour mobility, employment decisions and consumption.
 - Despite strong evidence of housing’s large presence in the economy, it is often viewed as an adjunct of social policy with few economic consequences. The Inquiry findings highlight a critical need to reposition housing from the periphery to a more central place within economic policy debates.
 - In terms of housing supply responsiveness, structural impediments may be weakening the trickle down of new housing supply to lower income groups, with potentially adverse implications for their ability to secure housing closer to where jobs are located. Hence, targeted government intervention might be needed to ensure adequate supply of affordable housing to vulnerable groups at the lower end of the market.
 - Private renters exhibit higher residential mobility rates than those in other tenures. Because Commonwealth Rent Assistance is transferable, it provides opportunities for individuals to move to regions with better economic prospects.
 - There is a case for implementing reforms to alleviate the adverse impacts of home ownership related tax concessions on labour mobility. However, there is a trade-off here because there is some evidence of home ownership’s positive impacts on workforce engagement, and as a financial source of parental support for education and business start-ups.
 - Reforms that strengthen public housing tenants’ incentives to work will have only small positive effects on employment rates. An integrated approach that addresses multiple barriers to employment (e.g. drug and alcohol abuse programs, mental health skills and so on) is likely to be a more effective approach.
 - A strong link exists between house price changes and consumption for middle aged and older households. The take-up of further debt among highly leveraged households exposes them (and the macroeconomy) to significant risk if house prices fall, or if interest rates rise. Hence, monetary policy levers, while not directly housing related, have important influences on housing wealth related consumption effects.
 - There is little systematic integration of housing policy interventions at various government and spatial levels, nor is there an overarching agency that articulates how these interventions impact on economic outcomes nationally. A more considered and coordinated policy treatment of housing as an economic asset that has implications for nation-wide economic growth is clearly overdue.
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Key findings

This Inquiry has generated a comprehensive evidence base to guide policy formulation that promotes labour force participation and economic growth in Australia. We focus on four key channels through which housing policies might affect labour force participation and economic growth—housing supply responsiveness, consumption, mobility and employment decisions.

Housing supply responsiveness

The estimated price elasticity of new housing supply is 4.7 per cent for houses and 3.9 per cent for units. These supply responses translate into a very small increase in the housing stock. Large increases in real house prices are needed to enable housing supply to match demand pressures resulting from population growth (assuming other supply drivers are unchanged).

The supply of units is overwhelmingly concentrated in job-rich areas. As the market penetration of units has grown, especially in our major cities, the urban network linking jobs and residences could be strengthened by these developments. A likely by-product is shorter commutes, which can be an important boost to productivity, especially in large metropolitan economies. New housing supply, and especially the supply of units, appears to be concentrated at the upper end of the price distribution. However, new housing supply in high price segments should theoretically push down the prices of existing properties as purchasers of new housing vacate their established properties. But this process does not seem to be working effectively in practice. It may be that structural impediments are weakening the trickle-down impact of new supply to lower income groups, with potentially adverse impacts on their ability to secure housing closer to where jobs are located.

Restrictive planning policies are more likely to hinder supply if they render development unprofitable. Indeed, developers will often be willing to work through restrictive controls if they can generate profit from a site. From a developer's point of view, a critical aspect of the planning system is the degree of certainty and consistency of advice that planning officers provide.

We find that the supply of units is less responsive to changes in price than houses. A key factor could be the greater complexity of the multi-unit development process. By the time a developer has secured the land and the necessary development approvals the market may have changed, and the development may no longer be profitable. This adversely impacts the quantity and timeliness of new unit supply in response to price shocks.

Consumption

A strong relationship exists between house price changes and household consumption for middle aged and older households. These results are consistent with the hypothesis that increases in house prices affect household consumption through the relaxation of a credit or collateral constraint that enables households to increase their borrowing in order to finance consumption. Following the global financial crisis (GFC), highly leveraged home owners have become more conservative. Conversely, the consumption outlays of investors—especially investors with debt—exhibit greater responsiveness to house price increases after the GFC. Indeed, the role of the collateral channel was amplified for investors following the GFC.

Labour mobility

Significantly higher rates of mobility are exhibited by individuals in private rental tenures than other tenures. Thus high and rising rates of home ownership can impede mobility and adjustment in the labour market. After controlling for a range of other characteristics, owner-occupiers with low loan-to-value ratios exhibit the lowest rates of geographic mobility. Among the unemployed, owner-occupiers with low loan-to-value ratios report lower rates of job search.

Further, the minimum wage at which unemployed searchers are willing to accept a given job offer is approximately 6 per cent higher for owners with low loan-to-value ratios than outright owners (after controlling for a range of observable characteristics).

Employment decisions

Housing assistance to private rental and public housing tenants has few employment effects. Among those eligible for Commonwealth Rent Assistance (CRA) and employed, its removal would only lift the predicted rate of continued employment from 91.1 per cent to 91.4 per cent. If a Job Commitment Bonus¹ of \$2,500 were extended to all working age public housing tenants in receipt of income support payments, our model predicts that a little under 1 in 100 tenants eligible for Newstart or Youth Allowance would become employed.

On the other hand, higher levels of housing wealth seem to help older 'inactive' owners regain employment, and assist precariously employed younger owners to secure employment. In addition, rising levels of mortgage indebtedness are associated with longer working lives. Our model estimates indicate that for persons aged 45–54 years old in 2001, mortgagors' odds of leaving the labour force at any given point in time are only 19 per cent of outright owners' odds of leaving the labour force (*all else equal*). For persons aged 55–64 years old, mortgagors' odds of leaving the labour force at any given point in time are 27 per cent.

Beneficiaries of parental cash transfers or bequests are more likely to hold a bachelor degree than matched non-beneficiaries. The proportion of beneficiaries in the labour force is roughly the same as non-beneficiaries, but a significantly higher proportion are self-employed.

Policy development options

The Inquiry highlights ways in which housing markets and outcomes can be incorporated into economic policy thinking and decision-making in Australia. Specifically, the Inquiry findings give rise to a range of policy development options across different policy levers and tiers of government in Australia. At the federal level, these include CRA, fiscal measures and monetary policy. At the state level, the key relevant levers are public housing as well as planning and land use regulations. Local governments also share responsibility for the latter. Across all government tiers, large-scale subsidised delivery of affordable housing will need to be considered.

Commonwealth Rent Assistance

The evidence offered in this report confirms previous research findings which concluded that reforms to housing assistance are unlikely to have more than a small impact on employment participation. Because CRA is designed such that it is only withdrawn after entitlements to other income support payments (ISPs) is lost, it is a minor influence on the incentive to work. However, because it is geographically transferable, CRA can assist eligible individuals and households to move to regions with better economic prospects. Given the considerable heterogeneity in rental market conditions across Australia, there is a case for providing CRA at rates that match regional circumstances. This may enhance the ability of individuals to move to areas that offer better opportunities for employment and economic advancement, albeit with higher housing costs.

¹ For more information on the Job Commitment Bonus, refer to the Department of Human Services (DHS) website: <https://www.humanservices.gov.au/customer/services/centrelink/job-commitment-bonus>.

Public housing

Public housing tenants have very low employment participation rates that have prompted some commentators to argue that it is due to welfare dependence. Our modelling results suggest that even though the typical public housing tenant can replace a relatively high fraction of 'in work income' when not working, these blunt financial incentives are not the main cause of their low rate of employment participation. Public housing tenants are a severely disadvantaged group who face multiple barriers to employment. Reforms that strengthen financial incentives to work will have only small effects on employment rates. An integrated approach that addresses barriers to employment for those in public housing (e.g. drug and alcohol abuse programs, mental health, skills and so on) is likely to be a more effective approach to improving the employment outcomes of public housing tenants. In addition, public housing policy could be revisited to ensure that such assistance is delivered in ways that are 'work friendly'. For example, there are barriers to inter-regional moves motivated by employment opportunities because a commute to the new job is not feasible, while a residential move could result in the loss of a subsidised and secure public housing tenancy. Reforms to allocation rules, or financial assistance to assist with higher housing costs on moving out of public housing, might assist.

Large-scale subsidised delivery of affordable housing

Policy thinking across all tiers of government around solutions to supply-side issues need to extend beyond traditional calls to release more land to narrow the gap between supply and demand. Structural impediments may be weakening the trickle-down impact of new housing supply to lower income groups, and adversely affect their ability to access housing in job-rich areas. Hence, targeted government intervention might be needed to ensure an adequate supply of affordable housing to vulnerable groups through direct subsidies, or indirect measures that improve financial incentives for profit-maximising developers to supply housing at the lower end of the market.

Planning and land use regulations

Thinking on planning reform should also extend beyond a simplistic notion that more planning controls mean weaker supply responsiveness. Hence, planning reforms need to focus on improving certainty and consistency throughout the planning process, in order to minimise potentially adverse impacts on profits for developers. In addition, the complexity and length of the multi-unit development process can be reduced if a more efficient land assembly and approval process were made available.

Fiscal measures

The institutional environment in Australia is characterised by favourable tax treatment for owner-occupied housing with implicit and explicit policy settings favouring owner occupation as a preferred housing tenure. At the federal level, these include tax exemptions such as the Capital Gains Tax exemption, and direct subsidies such as First Home Buyer grants. At the state level, they include land tax exemptions and stamp duty concessions. While such a bias may be justified given the extent of private and social benefits that derive from owner occupation, it can also create distortions in both housing and labour markets. The favourable tax treatment of home ownership is associated with a lower geographic mobility of individuals and households who own their home, and ultimately, the efficient functioning of labour markets. The replacement of stamp duties or transaction taxes with a broad-based land tax has been widely advocated because it is a potentially revenue neutral way of effectively addressing these market imperfections. Reforms in this direction have been introduced in the Australian Capital Territory, and this could be a signal motivating similar reform initiatives from the other state governments, though cooperation with the Australian Government is a likely pre-requisite. There is good

reason to believe that this reform package would ease inflationary pressures in housing markets and so improve the overall efficient functioning of the economy.

The accumulation of housing wealth by older Australians can be the source of positive labour market outcomes from three angles, though they have somewhat mixed implications for policy development. First, higher levels of housing wealth seem to help older 'inactive' owners regain employment. Second, recipients of intergenerational transfers have more financial assets that can act as a buffer to meet income shocks, and collateral to relax borrowing constraints. In view of these differences beneficiaries might take more risks, and are in a better position to borrow, whether it is to take advantage of educational opportunities, or finance business start-ups.

However, it is important to empirically explore these ideas and establish whether intergenerational transfers are a source of dynamism and innovation (e.g. business start-ups); or, alternatively, contributing to a growing wealth inequality with the children of parents that lack large amounts of wealth failing to meet their educational and employment potential.

Third, growing numbers of Australian households are taking on higher levels of mortgage debt (relative to household incomes) and paying down their mortgages later in life. One interpretation is that increasing longevity has encouraged many Australians to plan longer working lives; carrying higher levels of mortgage debt later in life is therefore a financially prudent way of smoothing consumption over a longer life. On the other hand, there is the argument that soaring real house prices have not been anticipated, and as a consequence home buyers borrowed more in order to climb the 'housing ladder'. This is a source of 'mortgage stress' that is prompting mortgagors to extend their working lives. Both perspectives predict longer working lives; if this prediction is confirmed by the evidence it would assuage fears about productivity slow down due to population ageing related drops in participation rates.

Monetary policy

In countries that have experienced deleveraging since the GFC, attention increasingly has focused on the impact of debt on consumption. The take-up of additional mortgage debt among already highly leveraged households through the 'collateralisation effect' exposes those households to the risk of significant loss if house prices fall, or interest rates rise. This in turn may pose a systemic risk for the macroeconomy. Macro-economic policy-makers should take note of the potential risks associated with high levels of household debt and rising household income-to-debt ratios. Despite the significant benefits from a flexible mortgage system that allows households to borrow against their housing equity, there is a downside of repayment and investment risks that could be triggered by house price declines. In a number of countries with similar situations, regulations have been implemented to limit the growth of household indebtedness and the need to ensure robust prudential regulation remains an important policy priority.

The importance of housing policy integration

This research highlights the importance of applying housing policy thinking within Australia's multi-level system of government comprising federal, state and local levels. Because the Australian Government does not currently operate an explicit or overarching housing policy, housing policy interventions are spread across a range of portfolios including social security, tax, planning, etc., and each government tier has some responsibility for housing outcomes that influence the housing-economy link differently. Within the context of this Inquiry, we have found that:

- Subsidised delivery of affordable housing and planning regulations have impacts on housing supply responsiveness, which in turn affect access to housing that is close to job opportunities.

- CRA's transferable nature leads to greater opportunities for eligible individuals and households to move to regions with better economic prospects. On the other hand, public housing could be revisited to ensure that such assistance is delivered in a way that does not impede labour mobility.
- Housing-related fiscal measures, in particular those that affect incentives to accumulate wealth in owner-occupied housing, have important influences on the economy. On the one hand, they can adversely affect labour mobility. On the other hand, they can encourage workforce engagement and have potentially positive intergenerational impacts through parental support for further education and business start-ups. Growing mortgage indebtedness in later life can also lead to extension of working lives.
- Monetary policy levers, while not directly housing related, have important influences on housing wealth related consumption effects.

Overall, the Inquiry presents a comprehensive set of conceptual and empirical findings that collectively highlight a fundamental need to reposition housing from the periphery to a more central place within economic policy debates. A much deeper appreciation of the consequences of housing policies for economic outcomes is necessary if the potential for housing policy to promote economic growth is to be realised. A more considered and coordinated policy treatment of housing as an economic asset that has implications for nation-wide economic growth is clearly overdue.

The study

This Inquiry offers an integrated suite of quantitative and qualitative analyses to inform the following policy issue:

How might a range of housing policy mechanisms be implemented to support labour force participation and promote economic growth?

Despite strong evidence of housing's significant presence in the economy, it has traditionally been viewed by Australian commentators as an adjunct of social policy with few economic consequences. Indeed, housing is often viewed as a socially driven expenditure rather than as an essential infrastructure with growth and productivity benefits to the economy. Since the global financial crisis (GFC), there has been greater acceptance of the importance of the housing market to overall economic performance and financial stability. However, the literature suggests that there has been little appetite to rethink how housing policy levers could be exploited to achieve improved outcomes for the economy in the post-GFC era.

Yet, a plethora of policy instruments at federal, state and local levels influence the ways in which housing affects the economy. Some of these policy levers have direct impacts; others less so. For instance, policies that fall clearly within the housing sphere include CRA, public housing, planning regulations and subsidised affordable housing programs. Some other policy instruments do not strictly have housing objectives but nonetheless have significant impacts on housing outcomes (e.g. fiscal policy, monetary policy).

The Inquiry draws on an integrated economics, governance and spatial framework as well as empirical evidence to shed light on whether some of the causal mechanisms linking housing and economic growth are significant in Australia, including housing supply responsiveness, consumption effects, labour mobility and employment decisions. The policy implications of the findings are considered within an Australian-specific multi-level governance framework, as well as through varying spatial scales. Because the Australian Government does not currently operate an overarching housing policy, housing policy interventions are spread across a range of portfolios including social security, tax, planning, etc., and each government tier has some responsibility for housing outcomes that influence the housing-economy link differently. This

report fills an important gap in Australian research on the links between housing and the economy by generating an array of up-to-date empirical estimates that can be drawn on to inform housing policy reform in ways that promote labour force participation and economic growth.

The Inquiry evidence is generated from a mixed methods framework comprising four sets of quantitative exercises, two sets of qualitative analyses, and a national policy review. All the analyses are underpinned by extensive reviews of the international and Australian literature, which inform the development of methodological details and enhance interpretation of the Inquiry findings. The sample scope is Australia-wide across all the analyses within the Inquiry. Two criteria were consistently applied in the choice of datasets across all analyses—first, the timeframe should cover both the pre-GFC boom and post-GFC recovery years, and second, it should reflect the latest data available at the commencement of the analysis.

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