# SOCIAL POLICY IN THE POST-COVID WORLD

## PRESENTATION TO THE BOARD OF THE COUNCIL TO HOMELESS PERSONS

4TH OCTOBER 2021

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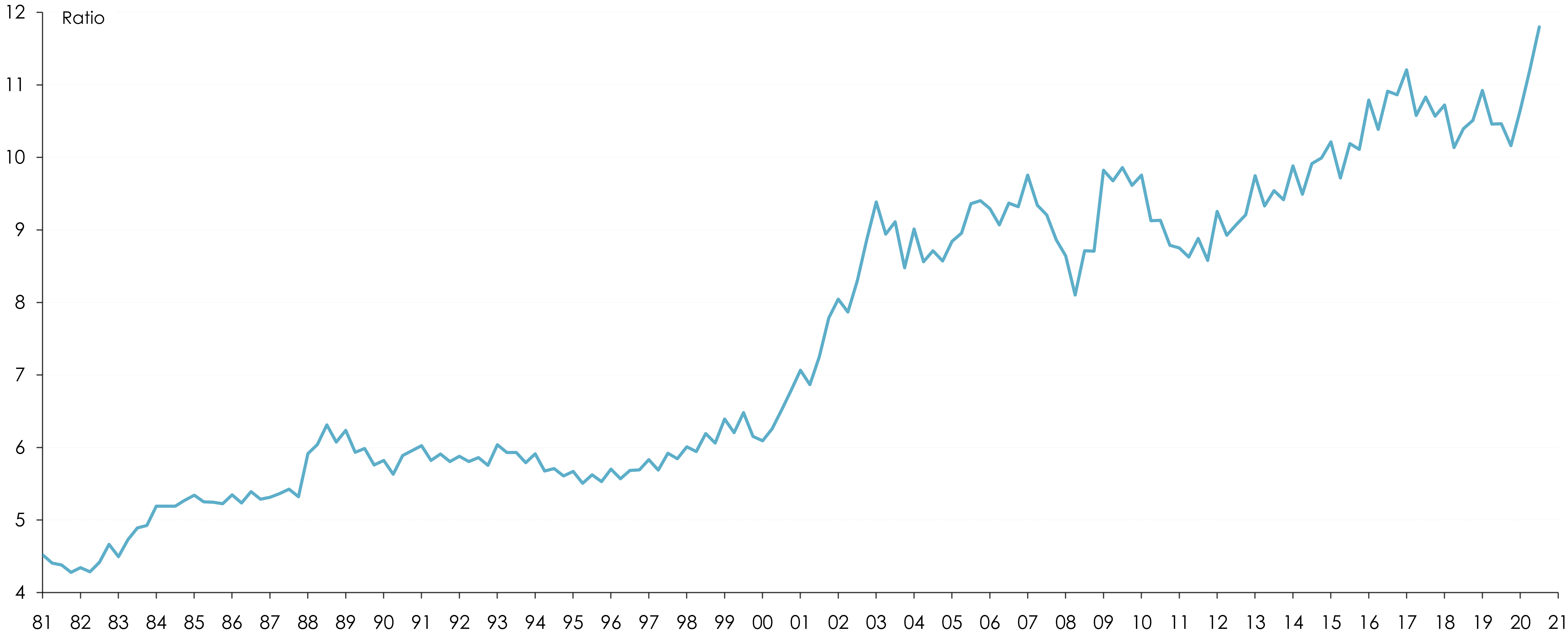
INDEPENDENT ECONOMICS

# Housing affordability

# Housing affordability has begun to deteriorate again …

## Ratio of median residential property prices to average household disposable income




*Note:* 'Median residential property prices' are as reported by CoreLogic; 'average household disposable income' is household disposable income as reported in the quarterly national accounts divided by the civilian working age (15+) population as reported in the monthly labour force surveys.
*Sources:* CoreLogic; ABS, *Australian National Accounts: National Income, Expenditure and Product*, June quarter 2021 and *Labour Force, Australia*, August 2021.

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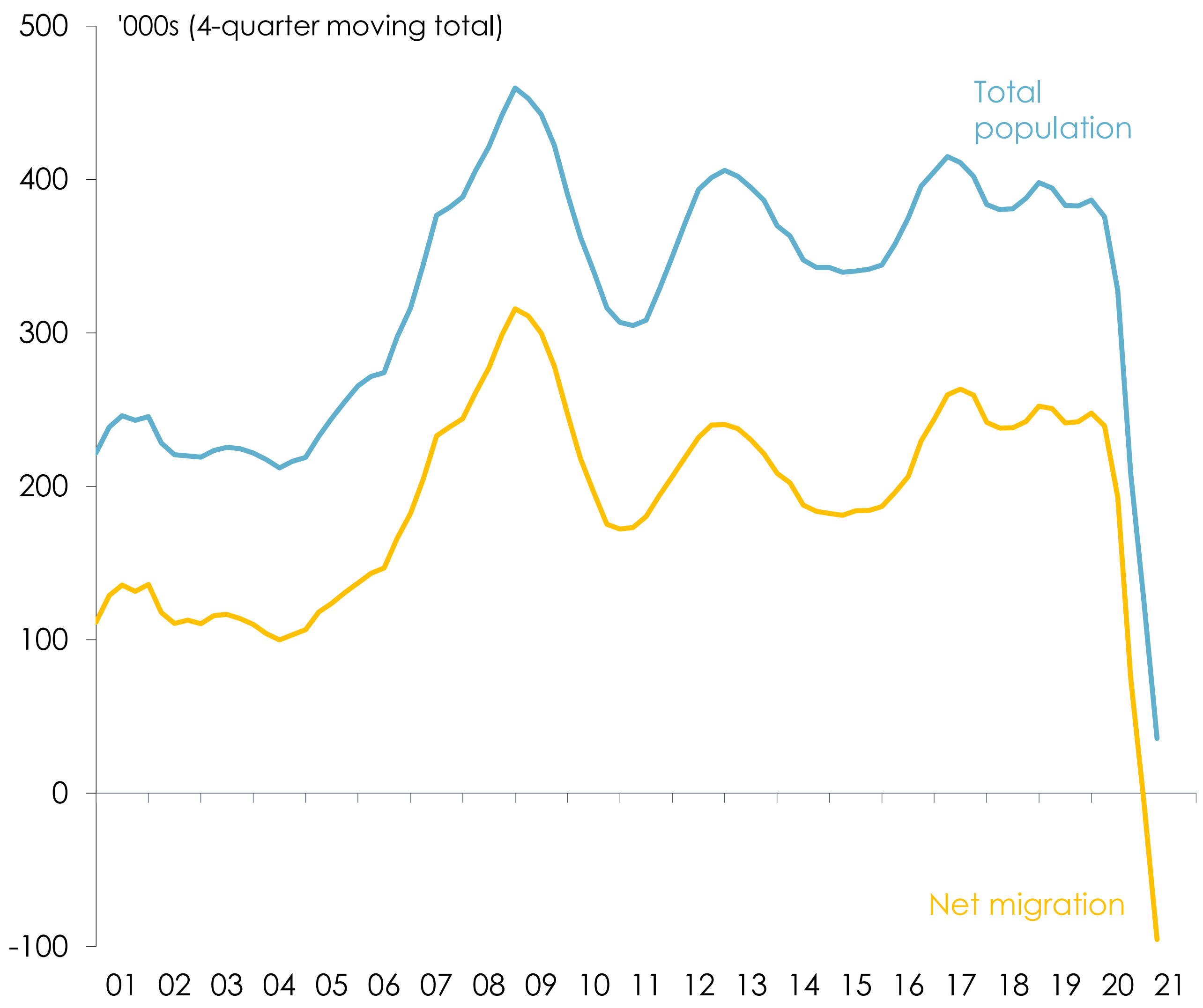
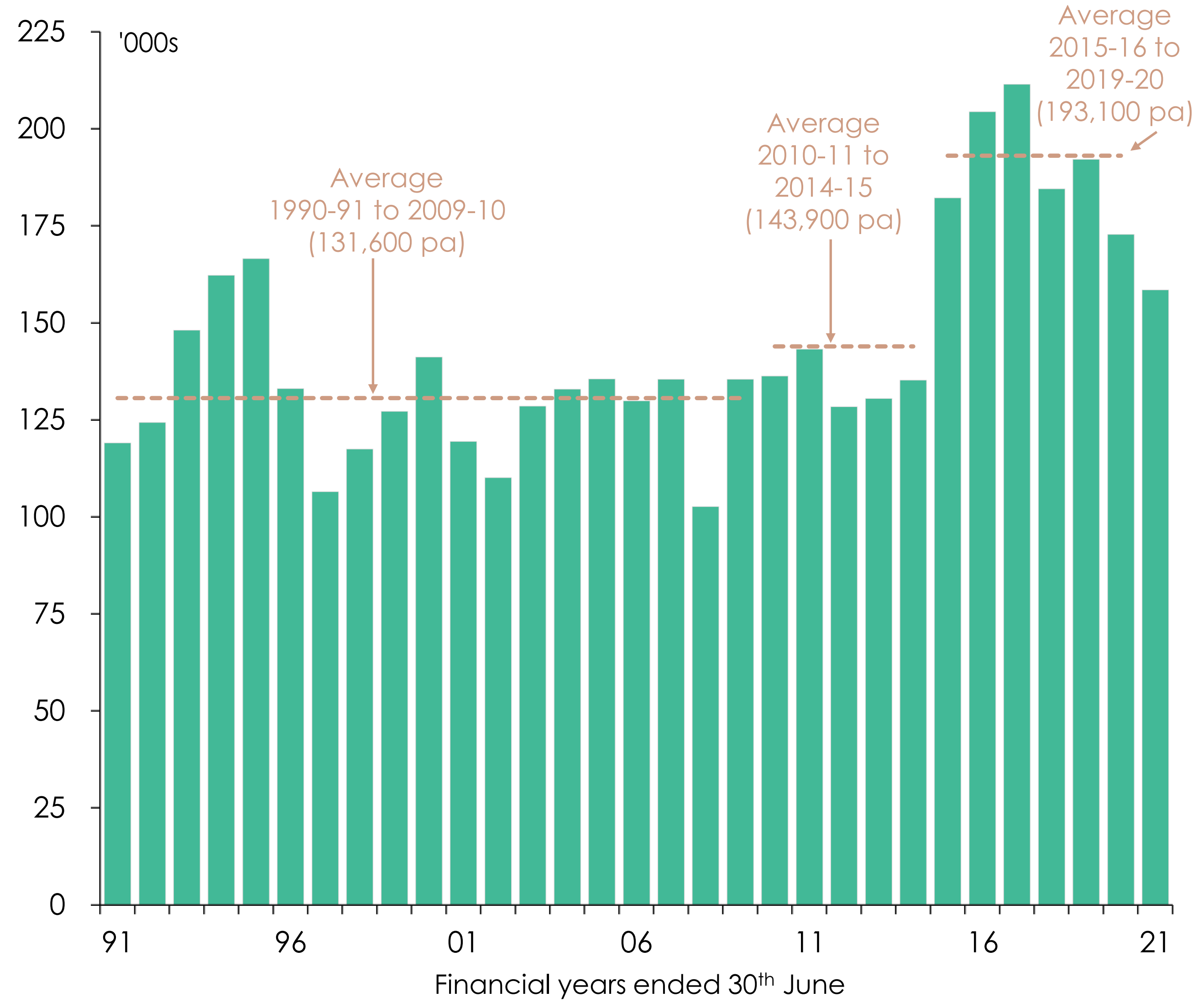
# Despite an apparently significant reduction in 'underlying' demand …
# … and a significant increase in 'supply'

## Net immigration and population growth




## Net change in the stock of dwellings




*Sources:* ABS, National, state and territory population, March 2021; Reserve Bank of Australia, Household and Business Balance Sheets (Statistical Table E1).

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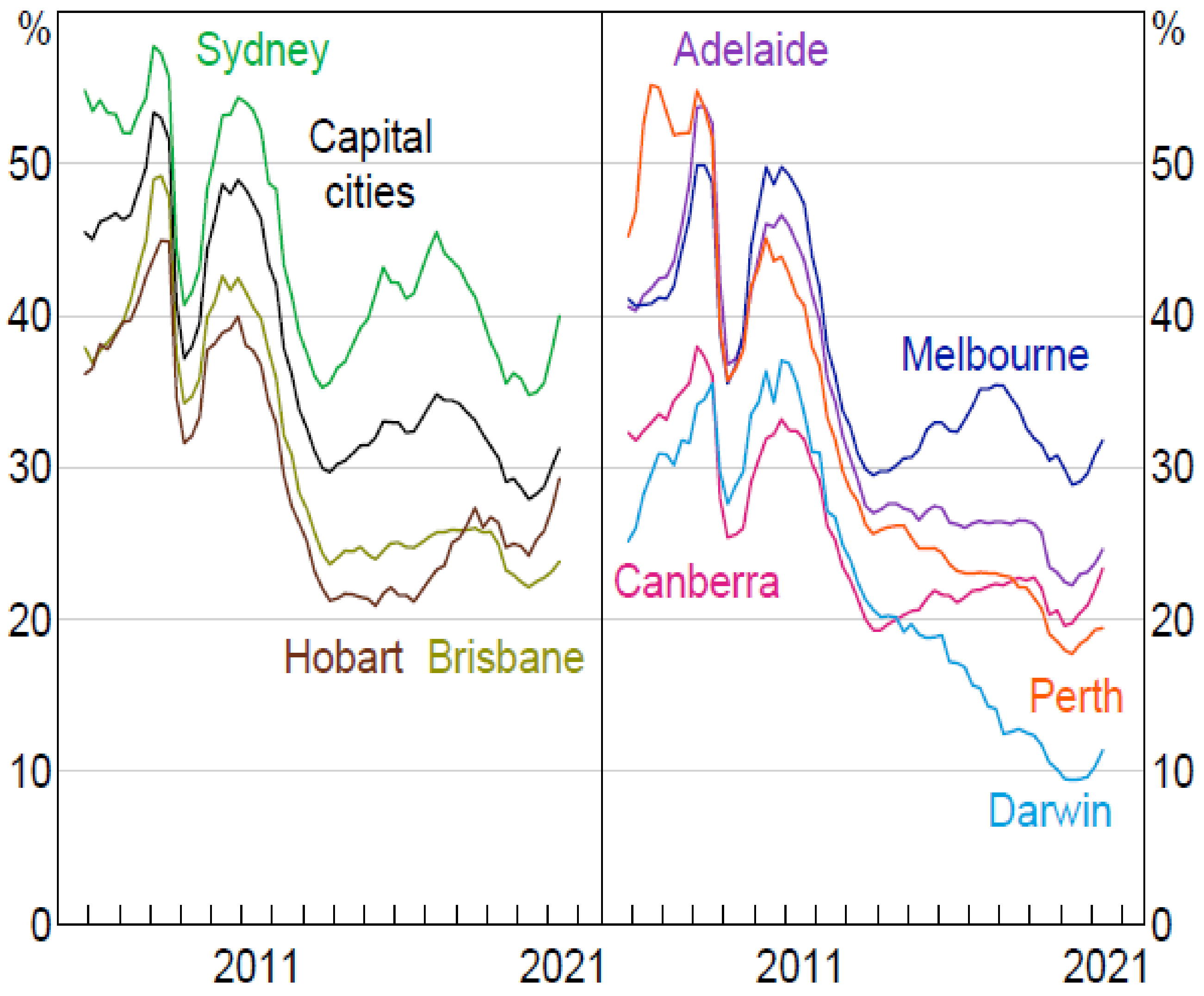
# Why has this happened?

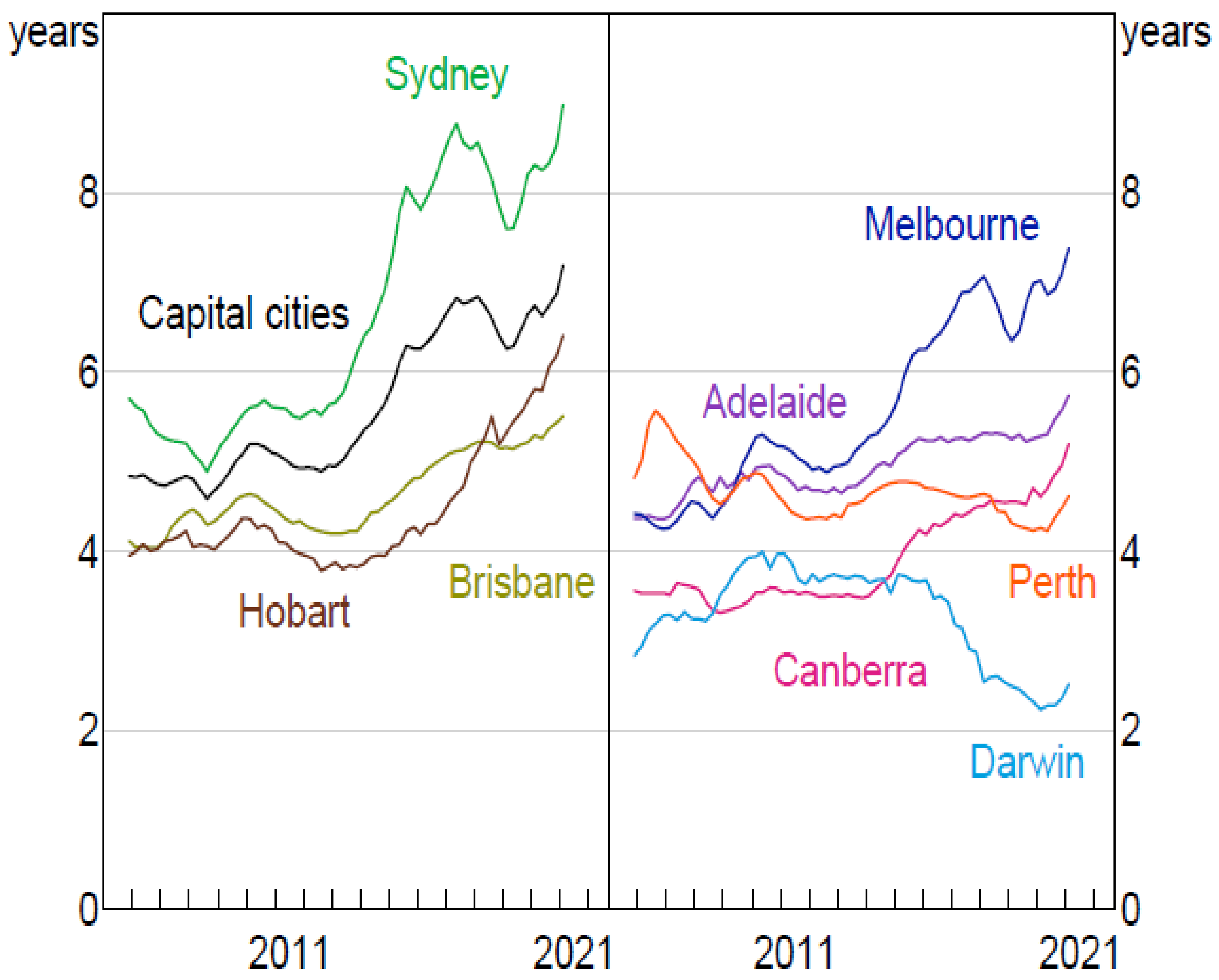
- Interest rates (including on mortgages) have been reduced to record lows, and the RBA has repeatedly emphasized that they're going to stay at record lows until 2024
  - and from a broad macro-economic policy perspective this has been absolutely the right thing for the RBA to have done
  - it has been done almost everywhere across the 'developed' world (and in most 'emerging' economies as well)
- Unlike the last period when interest rates were reduced to (what were then) record lows – during and after the global financial crisis – credit has been readily available
  - the banking system has been both willing and able to lend
  - and with demand for loans from business remaining subdued, banks have been especially keen to lend for housing
  - there appears to have been some relaxation in lending standards
- The Commonwealth and state governments have (again) 'stepped in' with enlarged cash grants to first home buyers
  - and, as always, these have ended up adding to the price of both existing and new housing
- The Commonwealth Government has also introduced other schemes designed to encourage people to spend more on housing (withdrawals from superannuation, and guarantees for low-deposit borrowers)
- Investors have come back into the market, confident that their preferential tax treatment will remain intact whatever the outcome of the next election
  - following Labor's decision to walk away from the policies on 'negative gearing' and the capital gains tax discount which it took to the 2016 and 2019 elections
  - in marked contrast to the decision by the New Zealand Labour Government (in March this year) to go much further in reducing tax incentives for property investment than Australian Labor had ever proposed

# Mortgages have become easier to service – but deposits have become harder to accumulate

## 'Mortgage serviceability'



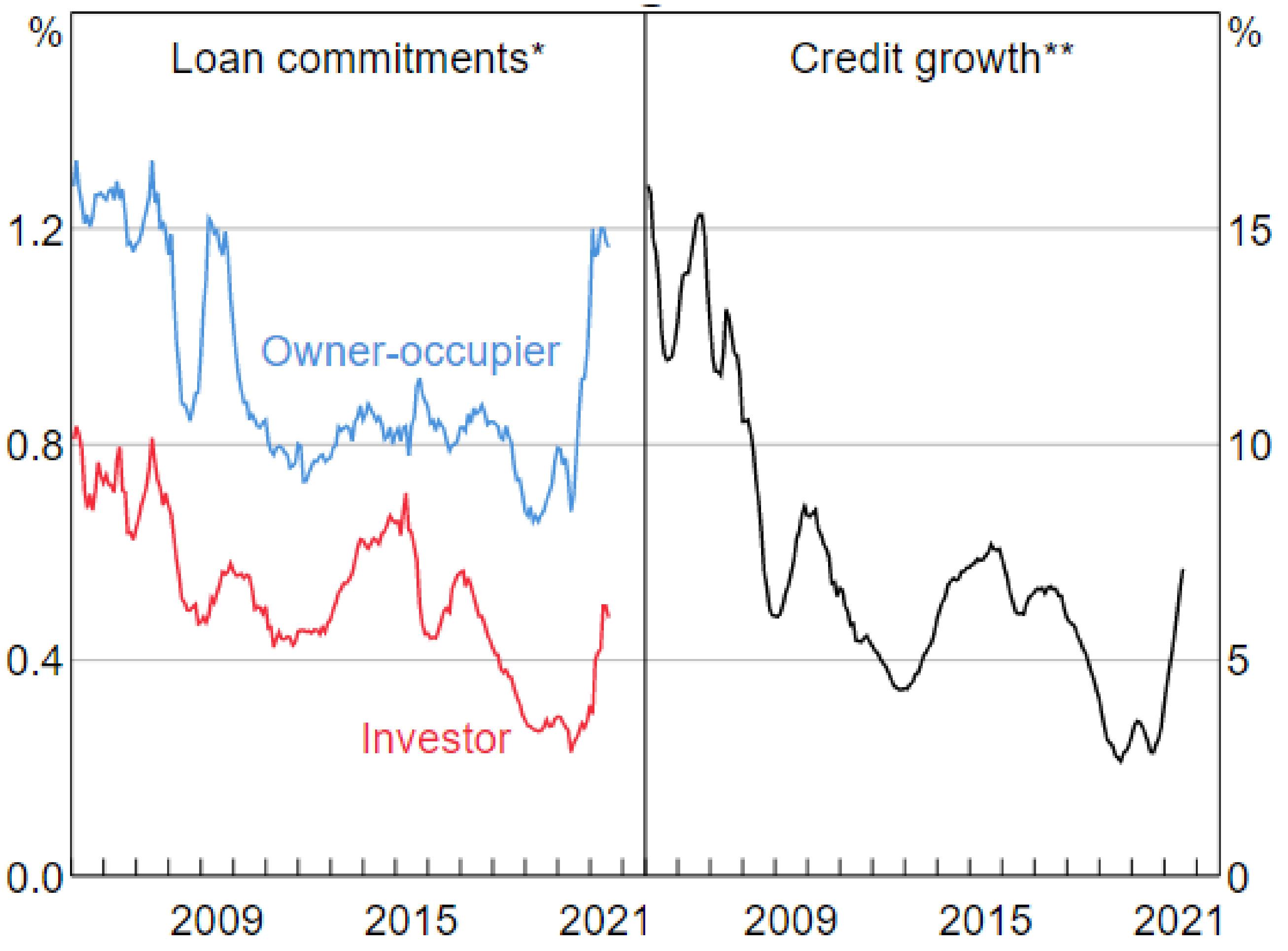

## Average time to save a deposit




*Note:* 'Mortgage serviceability' is the percentage of median gross household income needed to service a variable-rate mortgage with an 80% loan-to-value ratio for a median-priced dwelling. 'Time to save a deposit' is for a 25-34 year old household saving 20% of median gross income. *Source:* Reserve Bank of Australia, Submission to the Inquiry into Housing Affordability and Supply in Australia, House of Representatives Standing Committee on Tax and Revenue, September 2021.

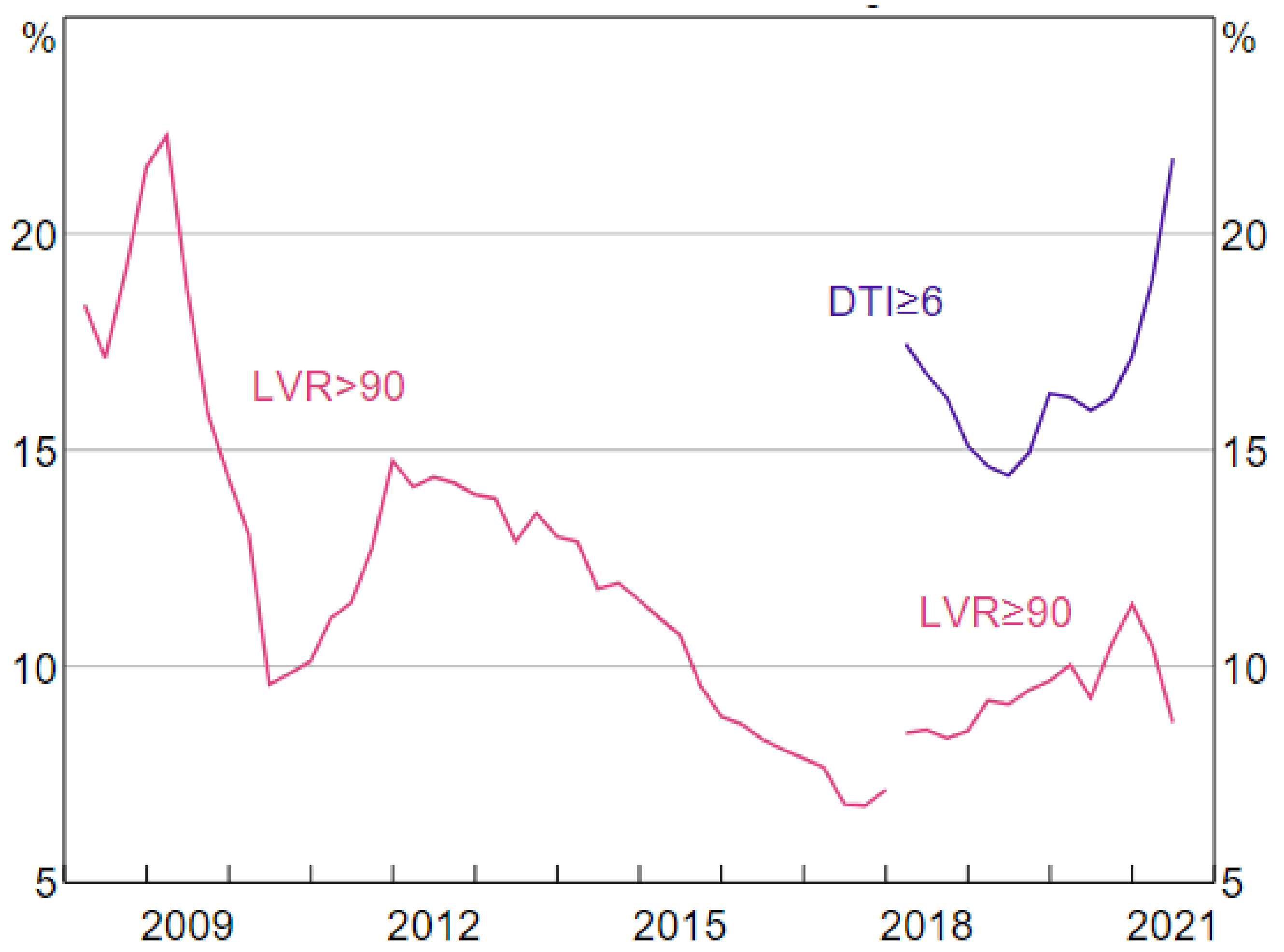
# Mortgage finance has been readily available … and there appears to have been some relaxation of the terms on which it's available

## Housing credit




* As a share of total housing credit; excludes refinancing
** Six-month-ended annualised terms

## Characteristics of housing loans




* LVR series breaks at March 2018 due to reporting changes

*Source*: Michele Bullock, Assistant Governor (Financial System), Reserve Bank of Australia, The Housing Market and Financial Stability, Online address to Bloomberg Inside Track, 22nd September 2021.

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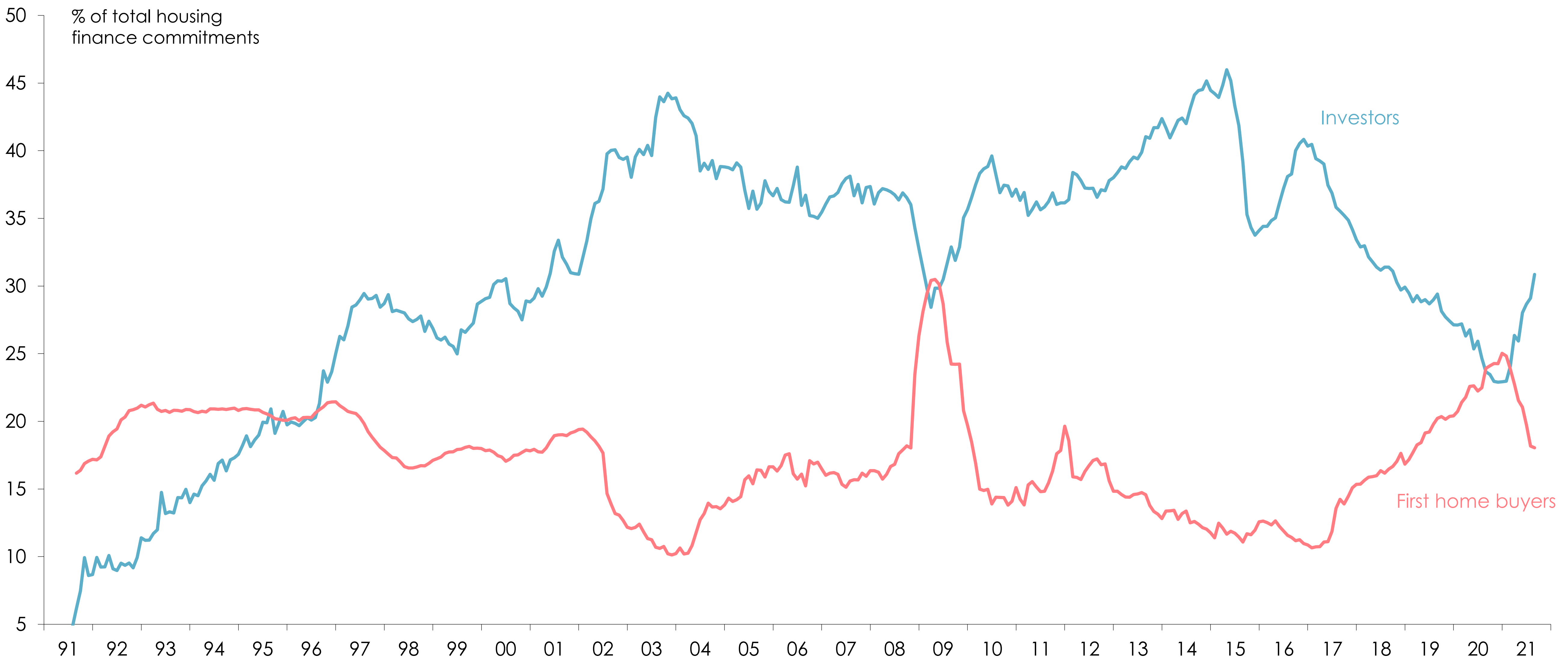
# Property investors are once again 'squeezing' first-home buyers out of the market

## Share of housing finance commitments going to first-home buyers and to investors




*Note:* Housing finance commitments exclude re-financing. *Sources:* ABS, , [Lending Indicators](), August 2021; [Housing Finance, Australia](), November 2018.

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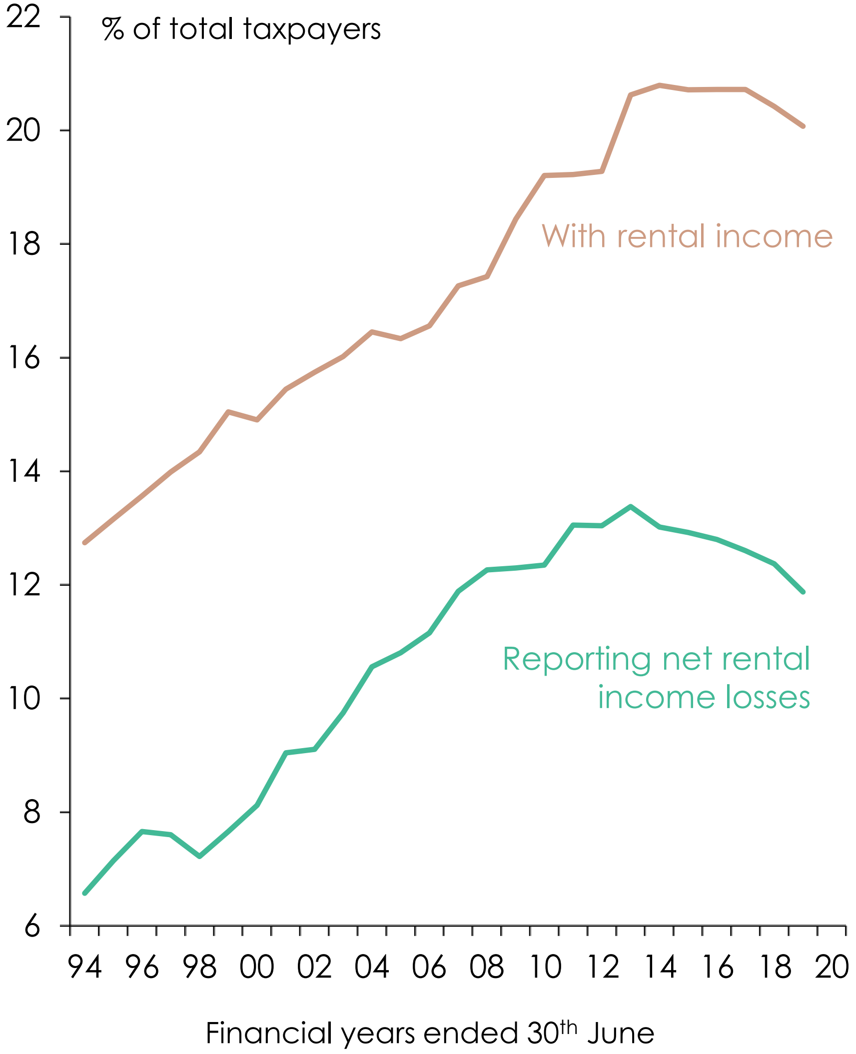
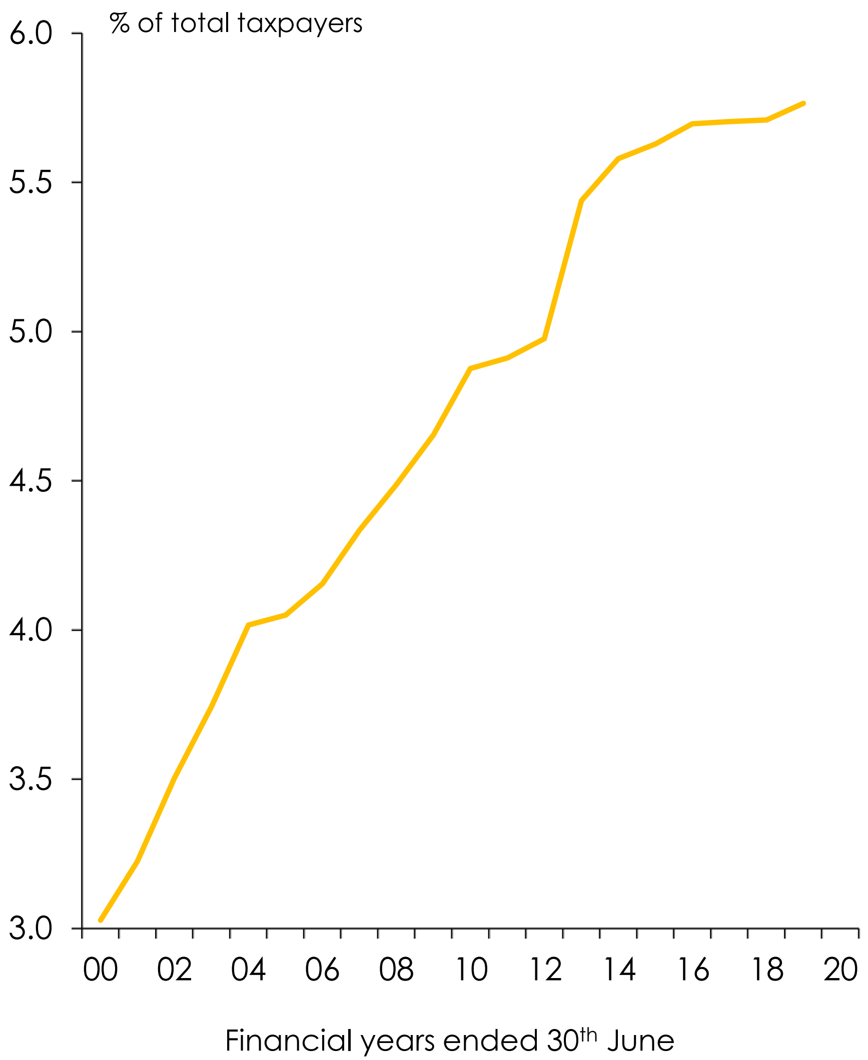
# ‘Negative gearing’ is alive and well, even though declining interest rates have made it harder to be 'negatively geared’

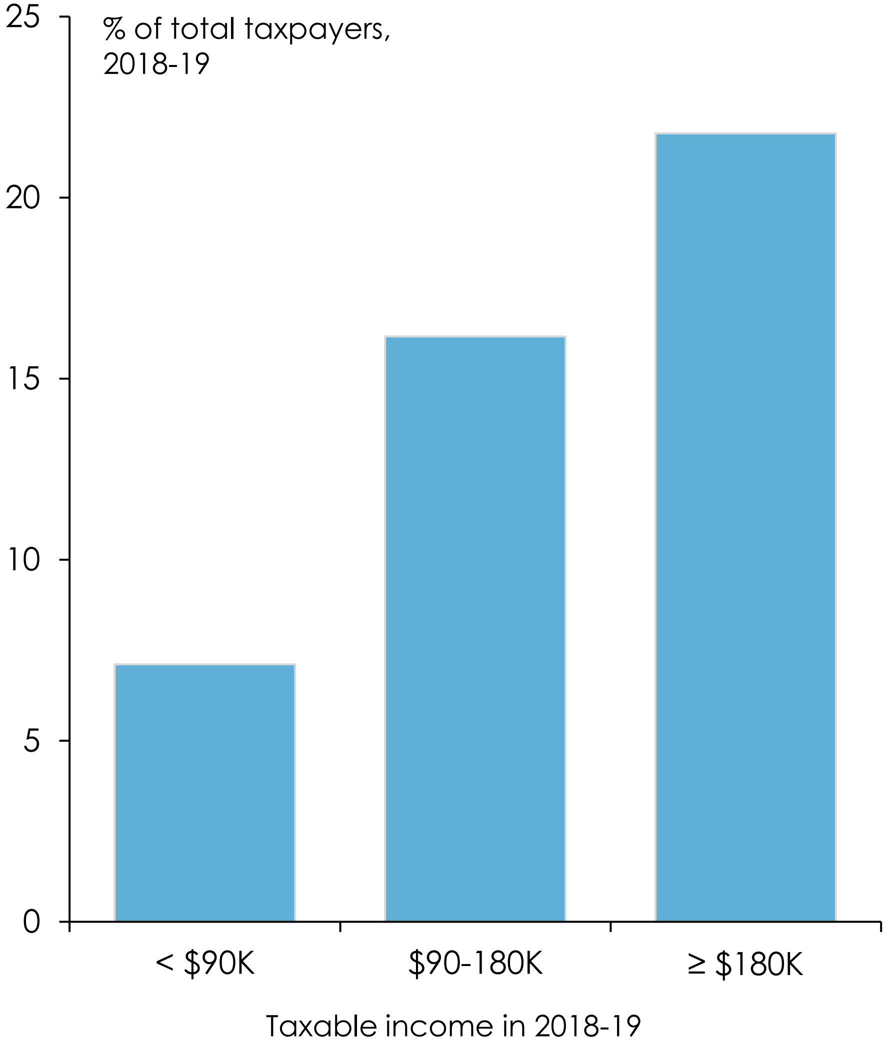
## Percentage of individual taxpayers with rental income




## Percentage of individual taxpayers with 2 or more rental properties




## ‘Negatively geared’ property investors by taxable income






*Source:* Australian Taxation Office, Taxation Statistics 2018-19, Individuals.

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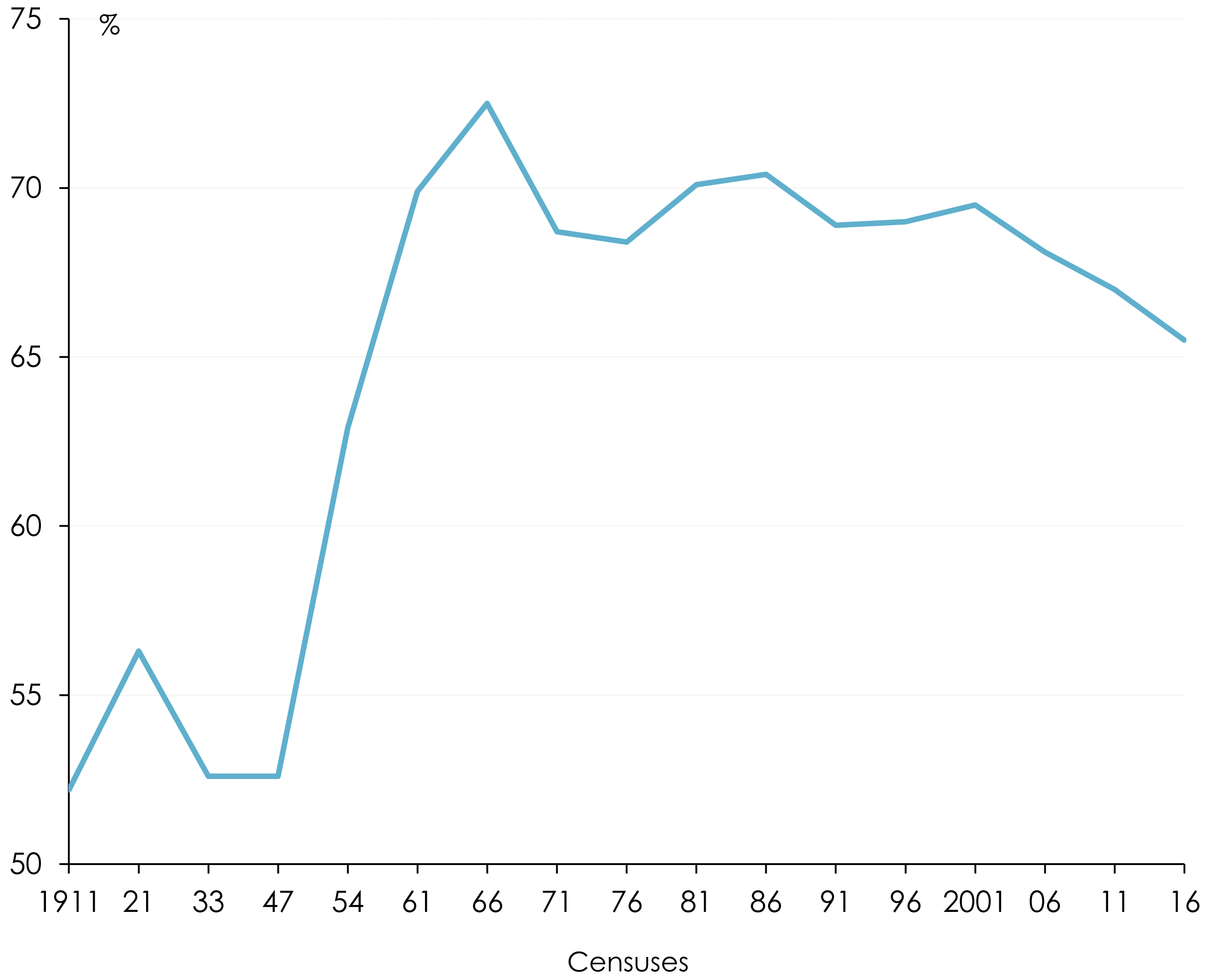
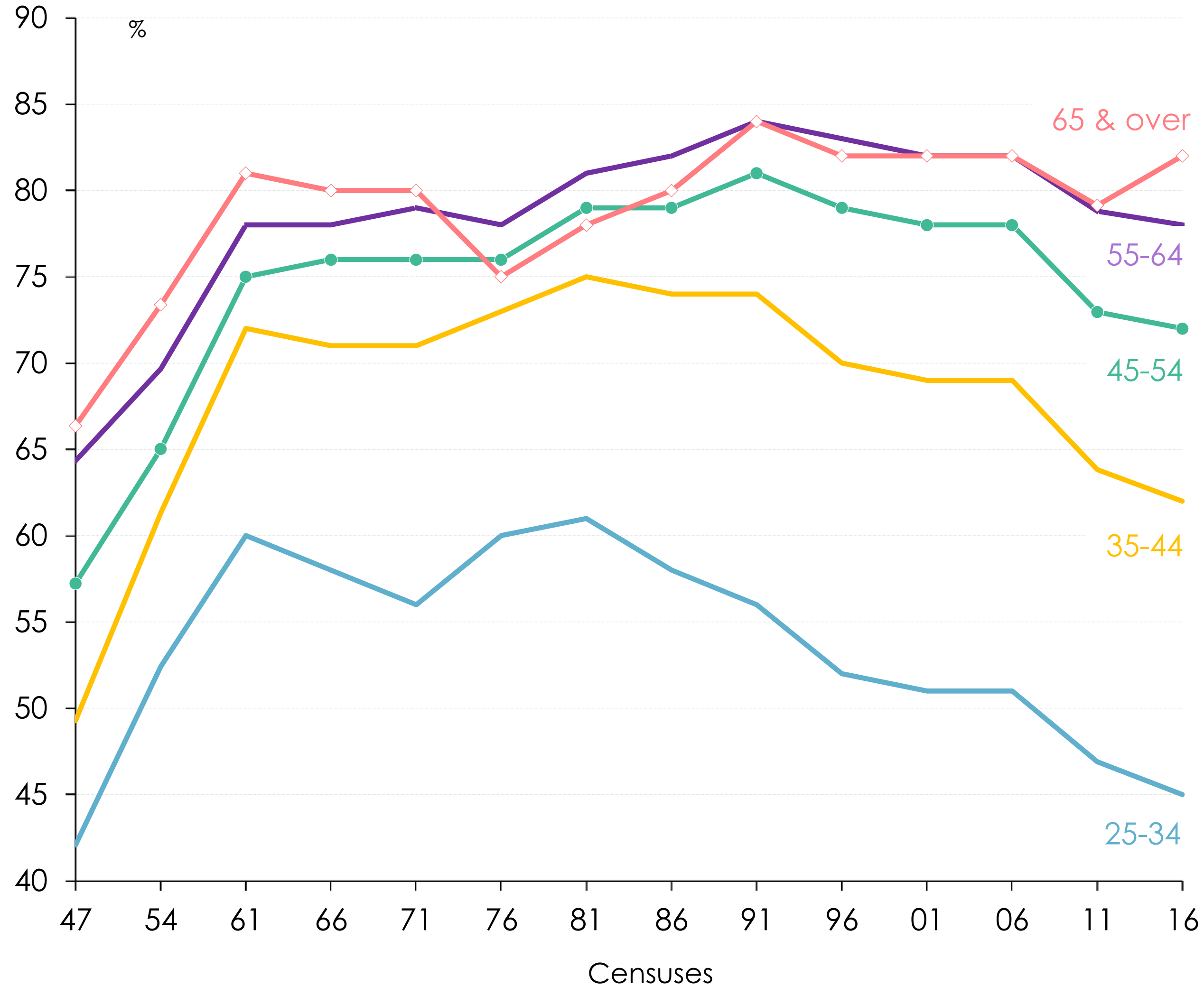
# The home ownership rate at the 2016 census was the lowest since 1954 – and for some age groups it was the lowest since 1947

## Overall home ownership rates at Censuses




## Home ownership rates by age group




*Sources:* ABS, *Census of Population and Housing: General Community Profile, Australia, 2016* and *Historical Census Data*; Judith Yates, "Explainer: what's really keeping young and first home buyers out of the housing market", *The Conversation*, 12th August 2015,

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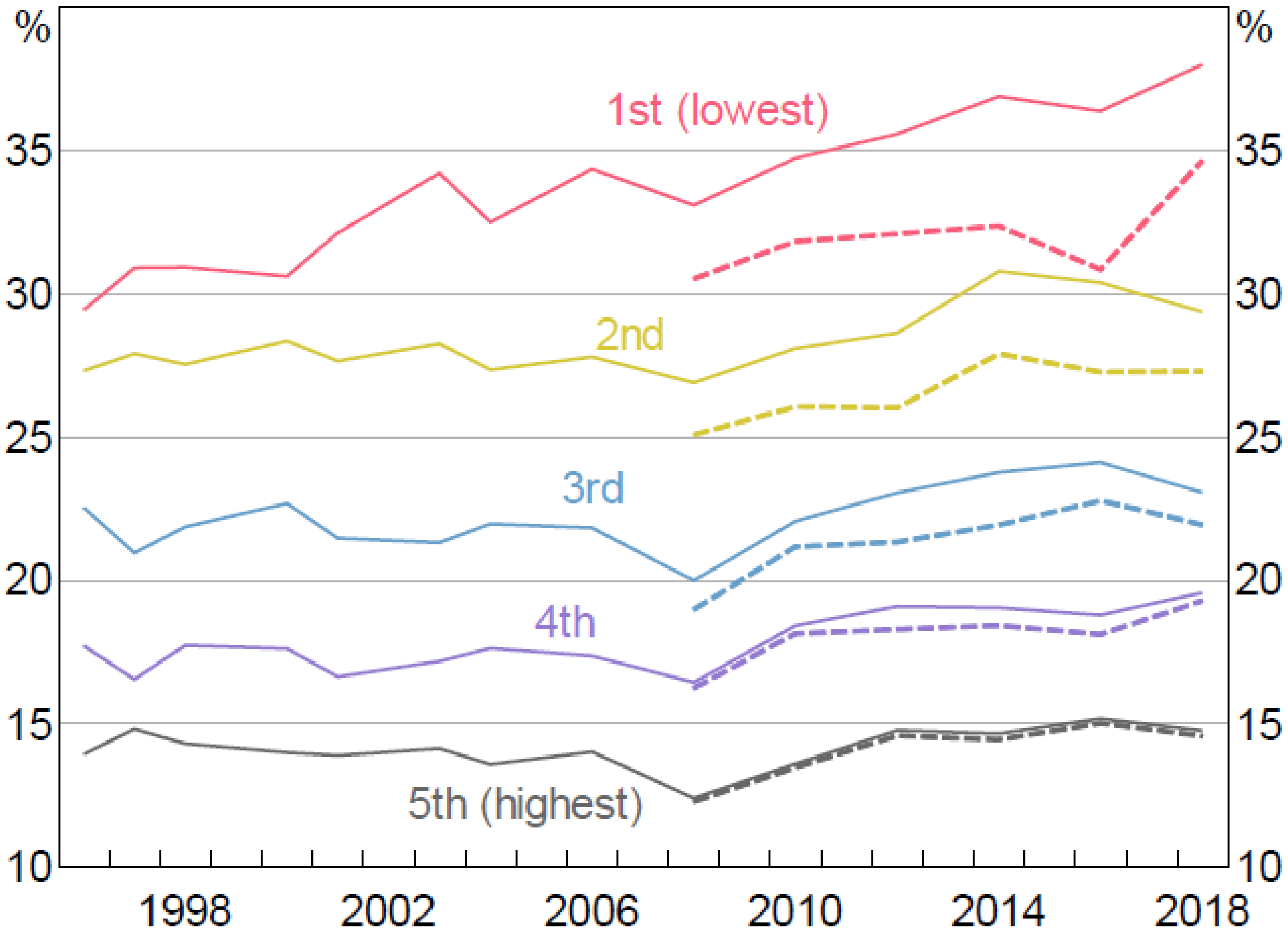
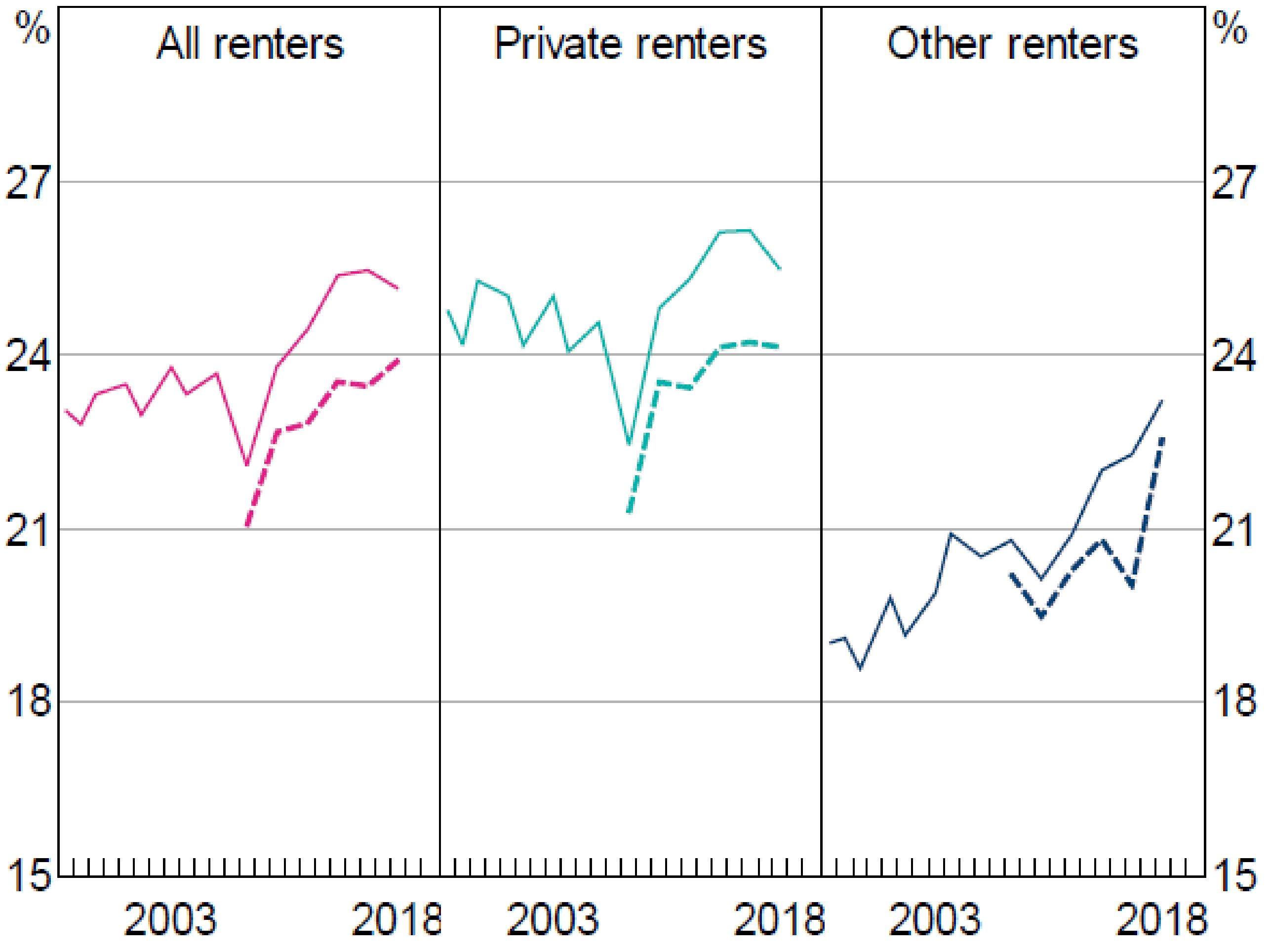
# Declining home ownership rates have exacerbated the difficulties facing low-income rental households

## Rent as a percentage of disposable income, by income quintiles




* Dotted lines include an adjustment for rent assistance received

## Rent as a percentage of disposable income, by tenure type

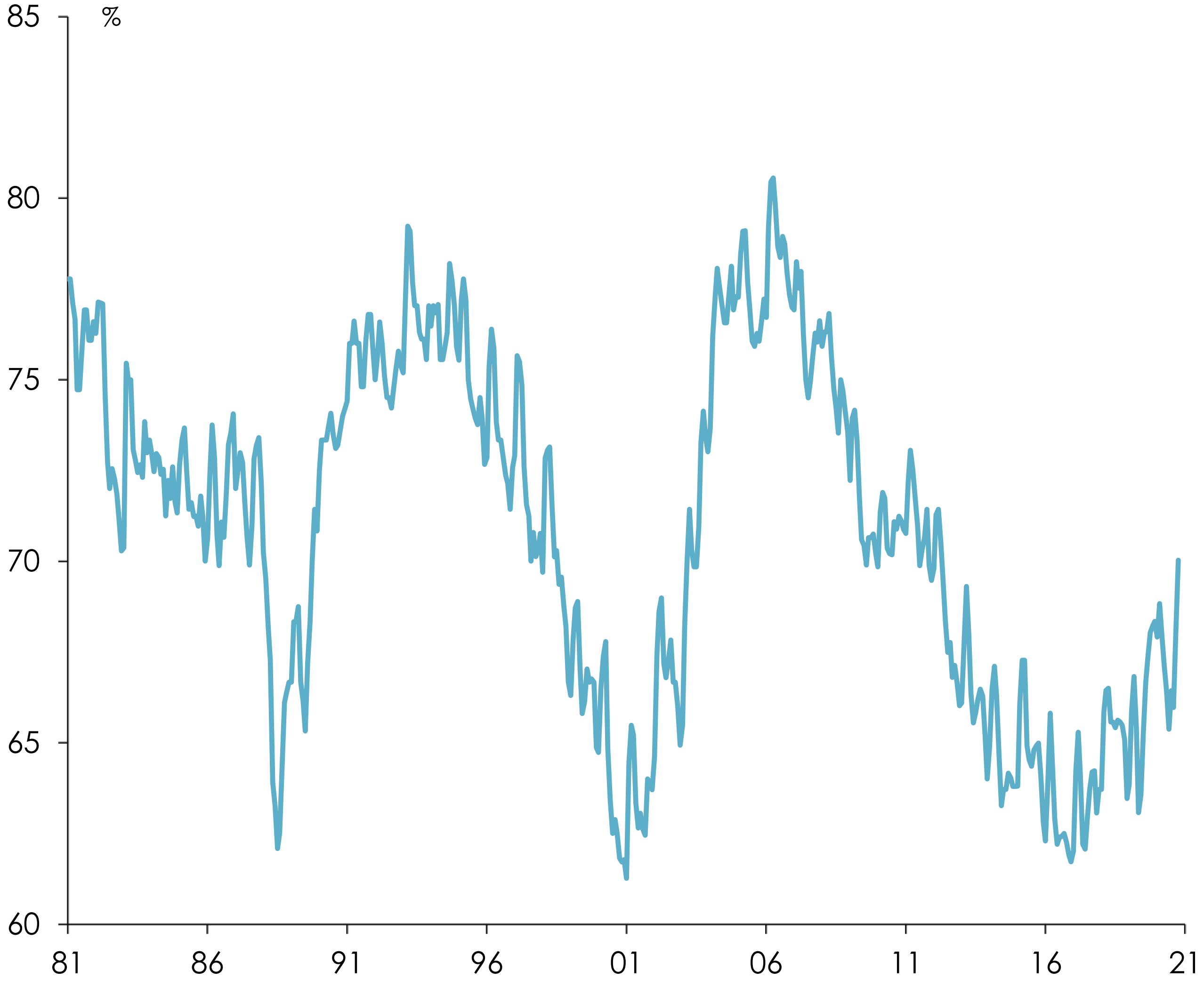



* Dotted lines include an adjustment for rent assistance received

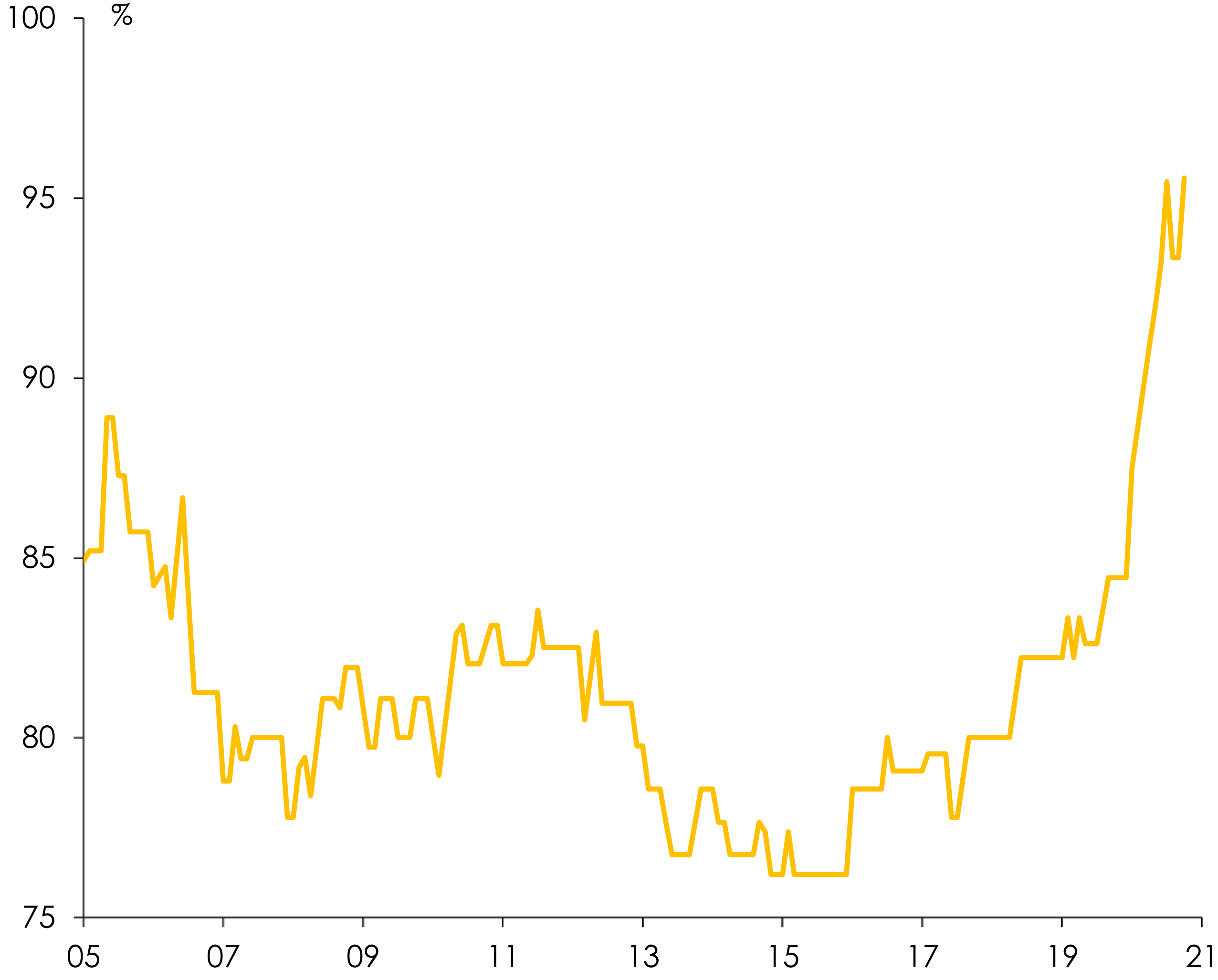
*Source:* Reserve Bank of Australia, Submission to the Inquiry into Housing Affordability and Supply in Australia, House of Representatives Standing Committee on Tax and Revenue, September 2021.

# Deteriorating housing affordability, especially for renters, is no longer just a big capital city problem

## Median home sale prices in regional areas as a percentage of capital cities prices




## Median rents in regional areas as a percentage of capital cities rents




*Source:* CoreLogic.

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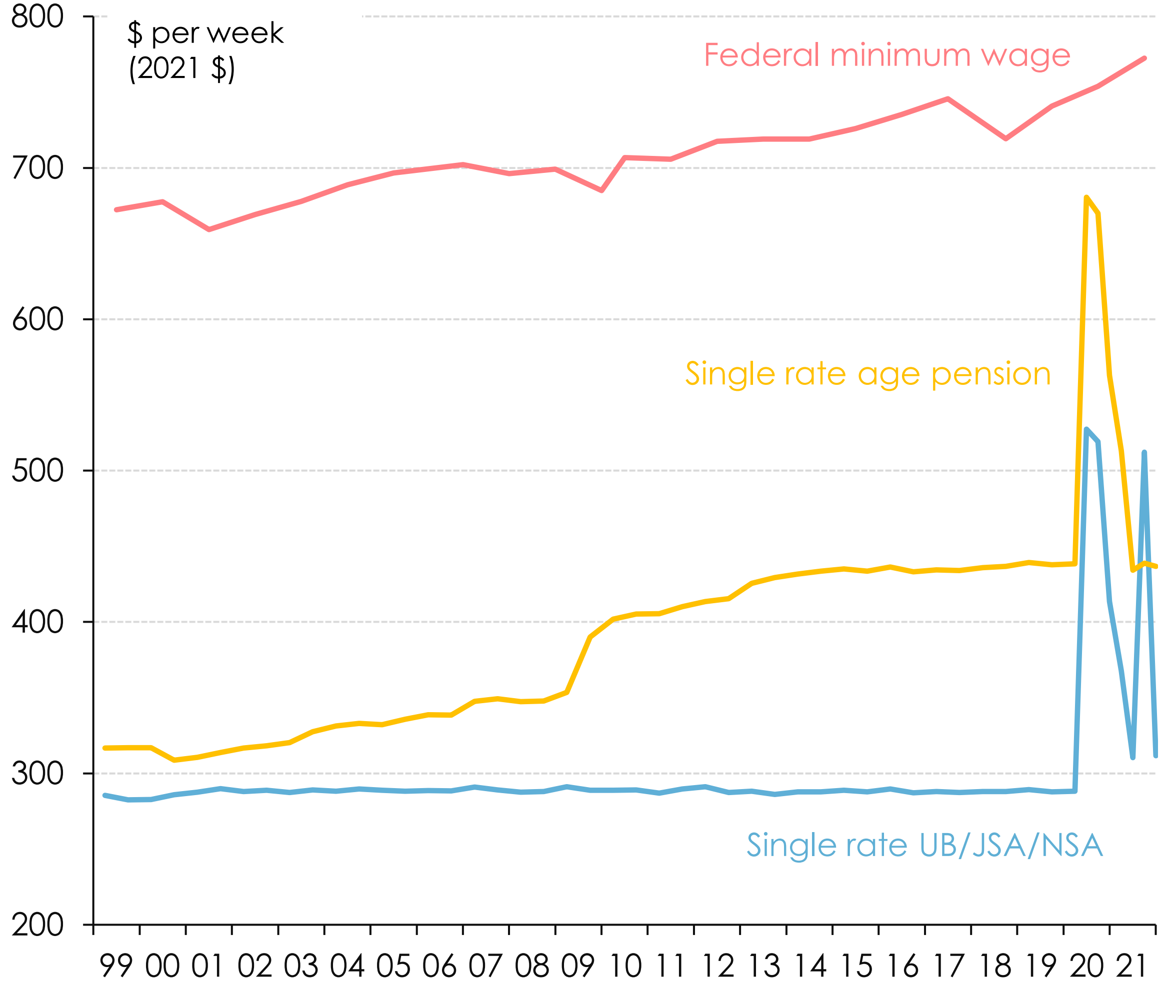
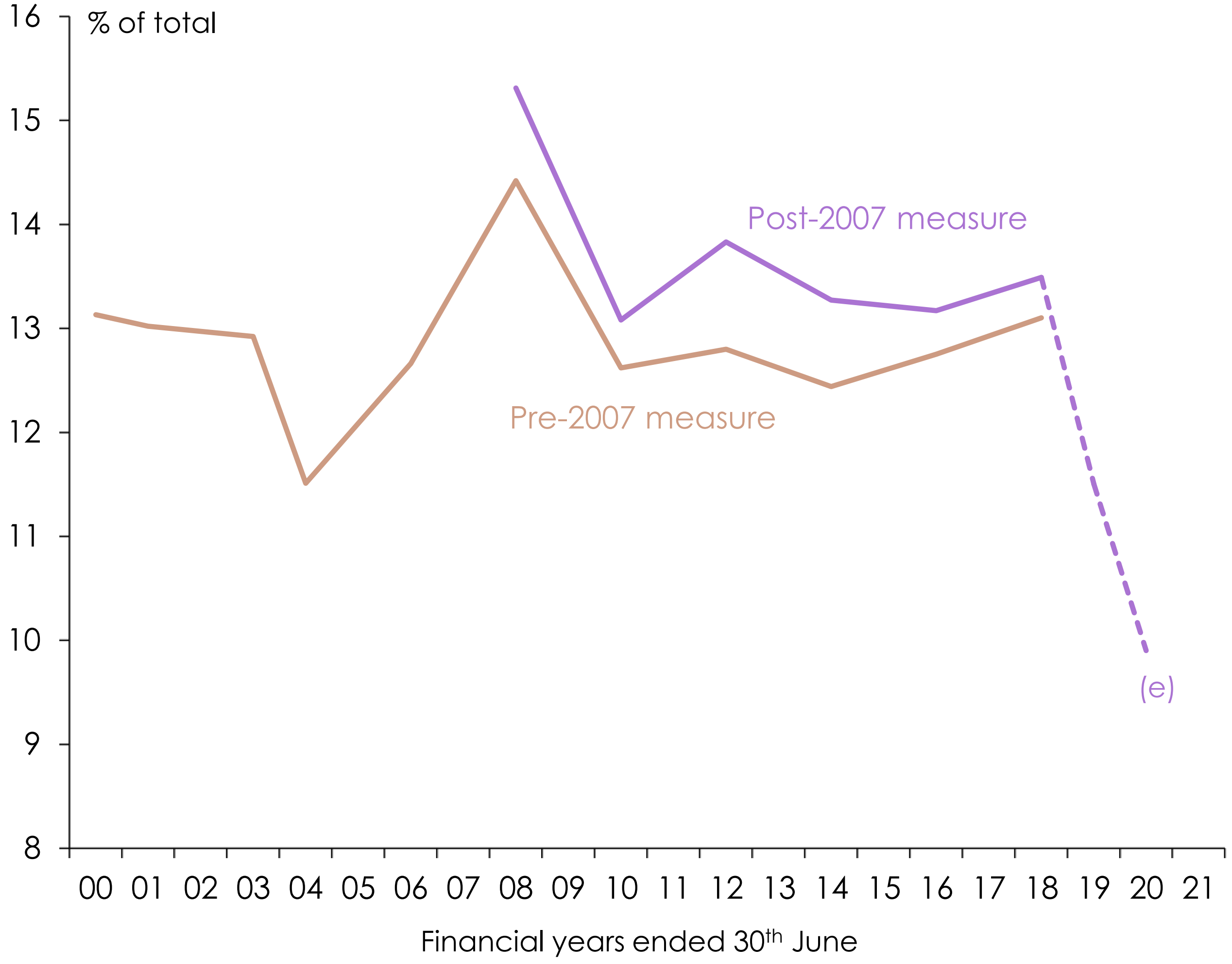
# Covid-19 and poverty

# The additional income supplements introduced during Covid-19 had a significant (but temporary) impact on the number of people in poverty

## Selected income support payments and the Federal minimum wage in real terms




## Proportion of Australian households living in poverty




*Note:* Levels of income support include Coronavirus supplement from April 2020 until March 2021, and additional income support payments from July to December 2021. 'Poverty' is defined as less than 50% of median household income after allowing for housing costs. Pre- and post-2007 measures reflect the incorporation of additional sources of income such as employee fringe benefits. *Sources:* Australian Government, Social Security Guide - 5.2 Historical rates; Fair Work Ombudsman, Minimum Wages; ACOSS and University of New South Wales, Trends in poverty, all people, 1999-00 to 2017-18 and COVID income support: Analysis of income support in the COVID lockdowns in 2020 and 2021.

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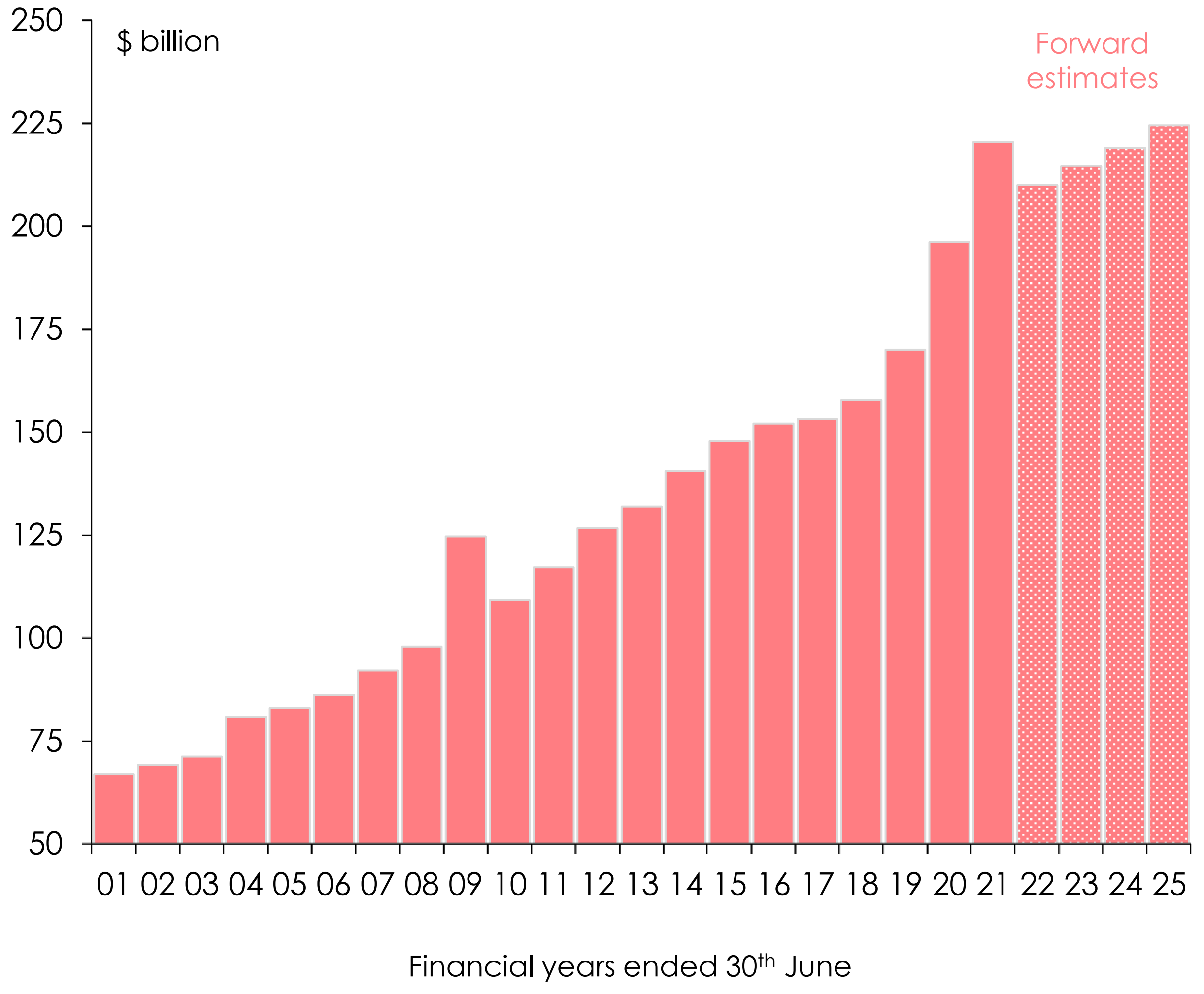
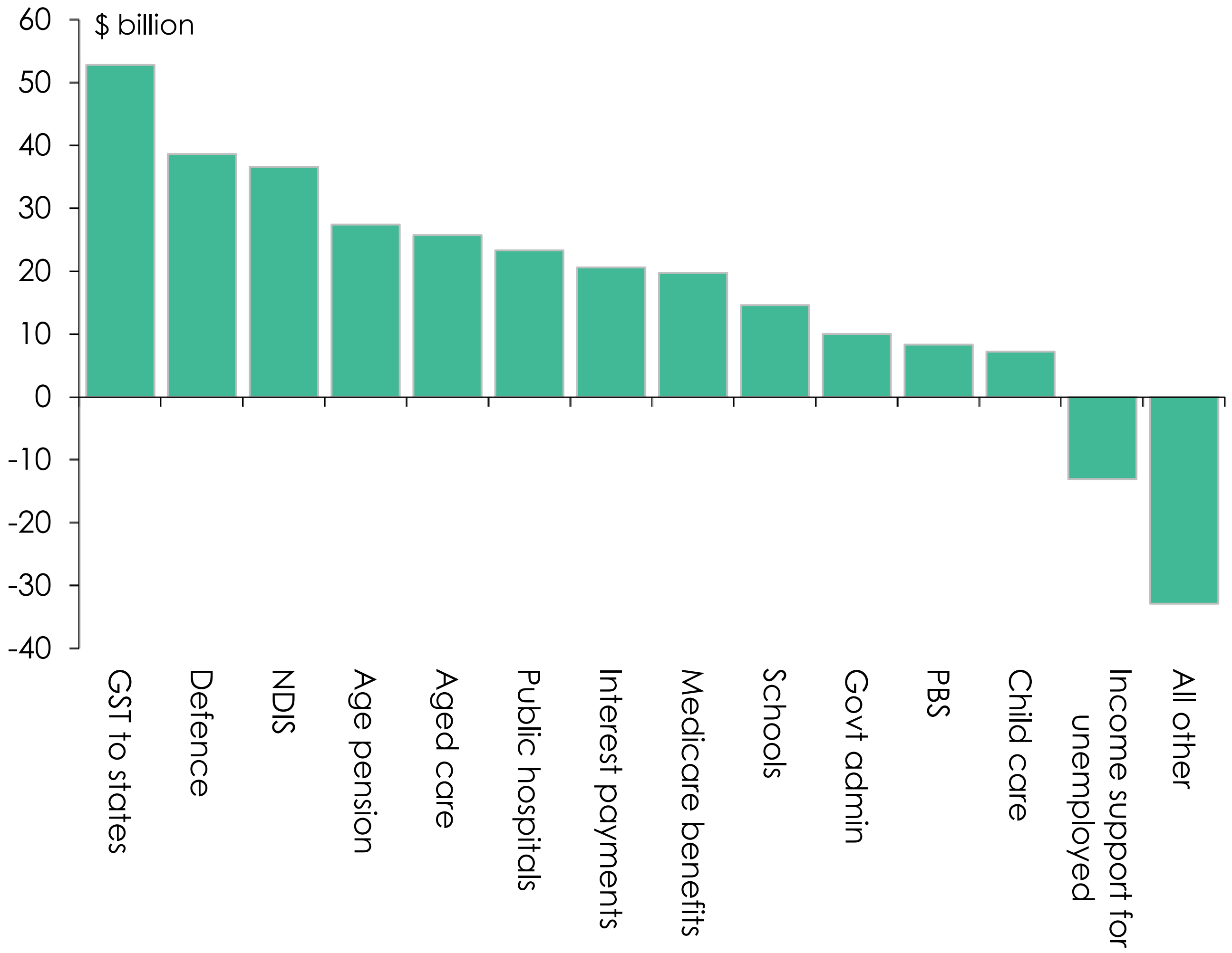
# This additional income support cost at least $18bn – which the Government believes can't be sustained longer-term given other spending pressures

## Commonwealth Government spending on social security and welfare




## Projected increase in Commonwealth Government payments, 2020-21 to 2031-32




*Sources:* Australian Government, Australian Government, *Final Budget Outcome 2020-21* (and previous issues), and 2021-22 *Budget Paper No. 1, Statement 3: Fiscal Strategy and Outlook*; Parliamentary Budget Office, *Beyond the Budget: Fiscal outlook and scenarios*, 21st September 2021

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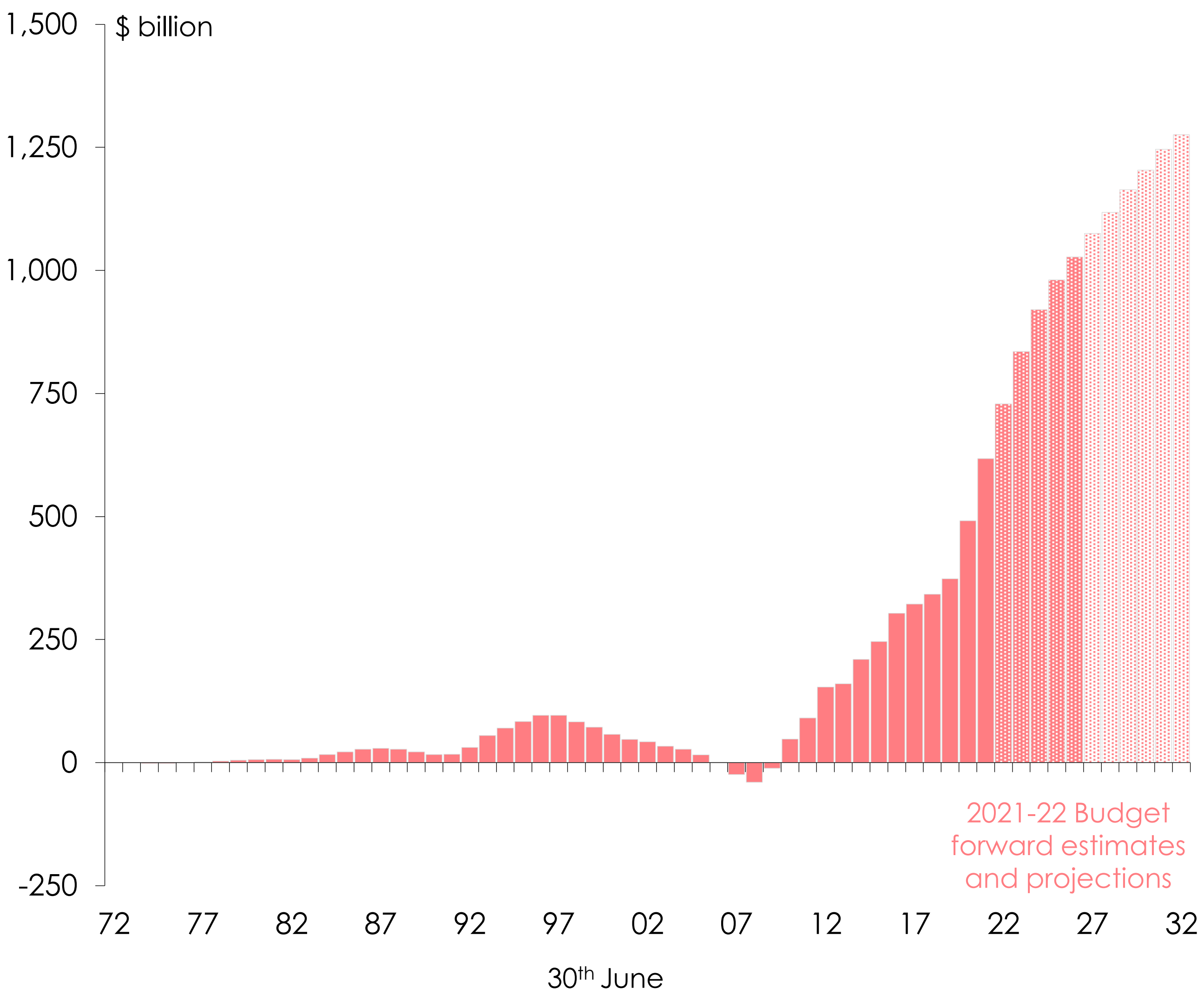
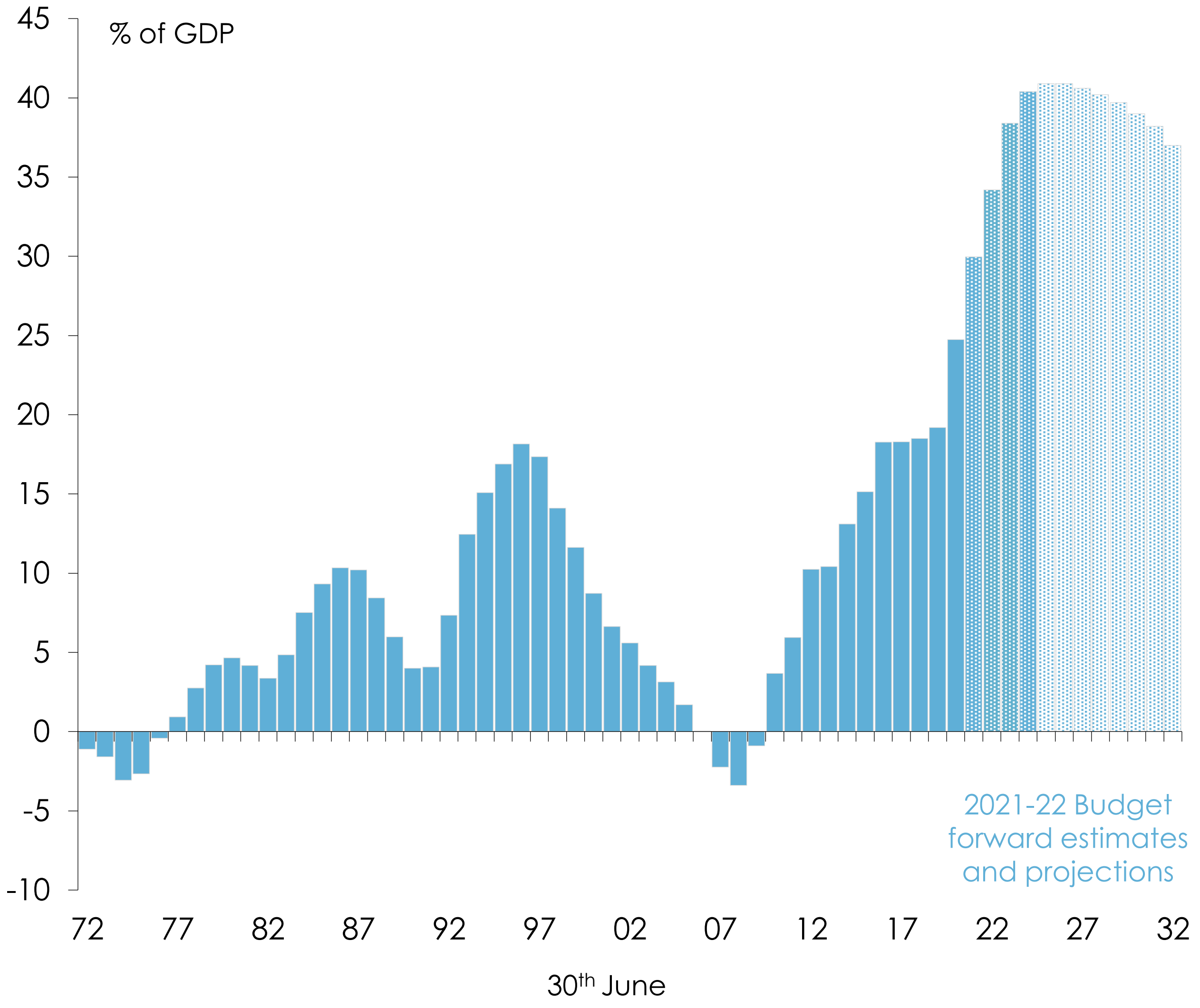
# Fiscal policy and the Commonwealth Budget

# The Commonwealth Government has accumulated a significant increase in debt as a result of the large deficits it has run in response to Covid-19

## Commonwealth Government net debt




## Net debt as a percentage of GDP




*Note:* 'Net debt' is the interest-bearing liabilities (mainly government bonds) less the sum of selected financial assets (cash and deposits, advances paid and investments, loans and placements). *Source:* Australian Government, *2021-22 Budget Paper No. 1 - Budget Strategy and Outlook - Statement 11*.

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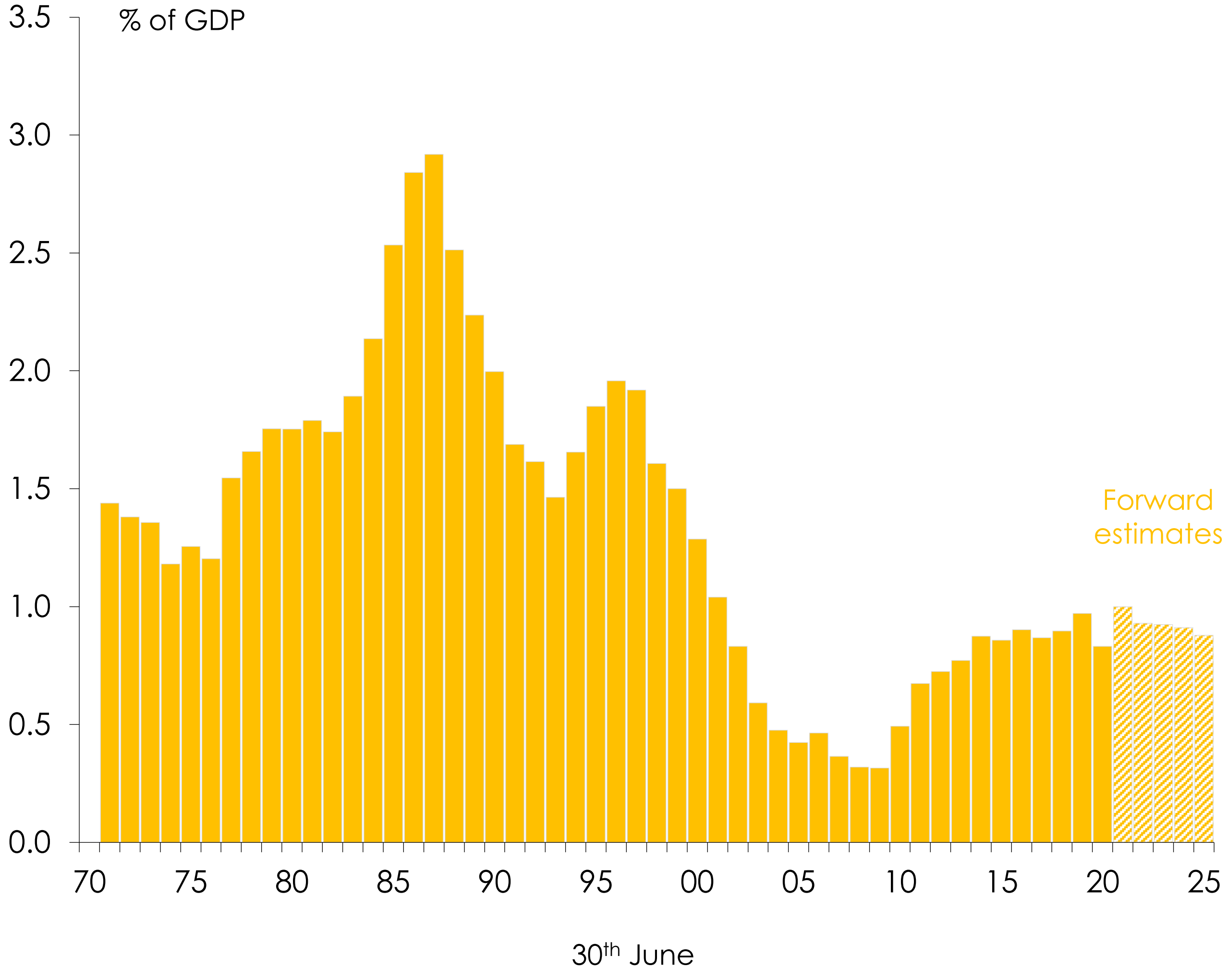
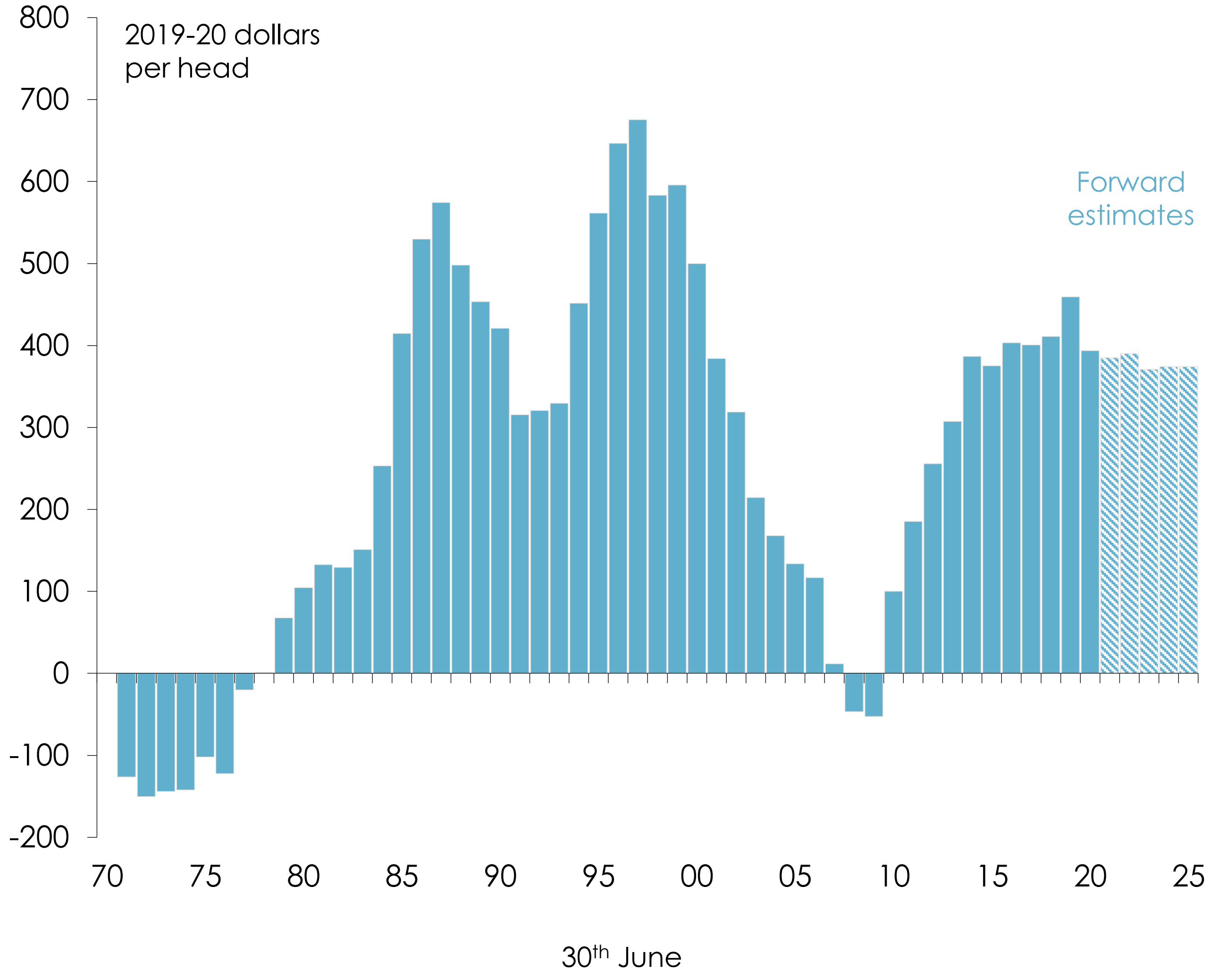
# Large as this net debt is, because interest rates are so low, the cost of servicing this debt (interest payments) is *not* especially high

## Commonwealth Government interest payments as a percentage of GDP




## Commonwealth Government net interest payments per head of population in 2019-20 dollars




*Source:* Australian Government, *2021-22 Budget Paper No. 1 - Budget Strategy and Outlook - Statement 11*.

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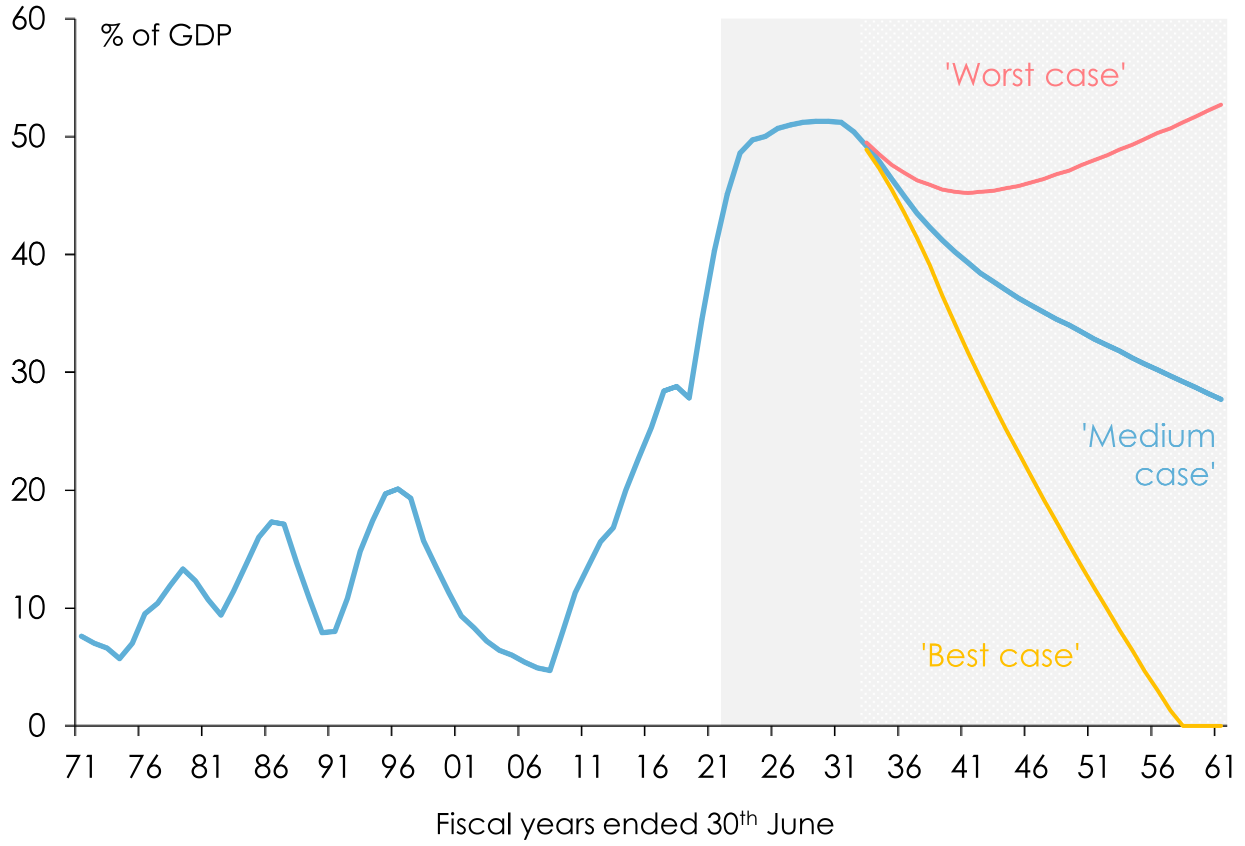
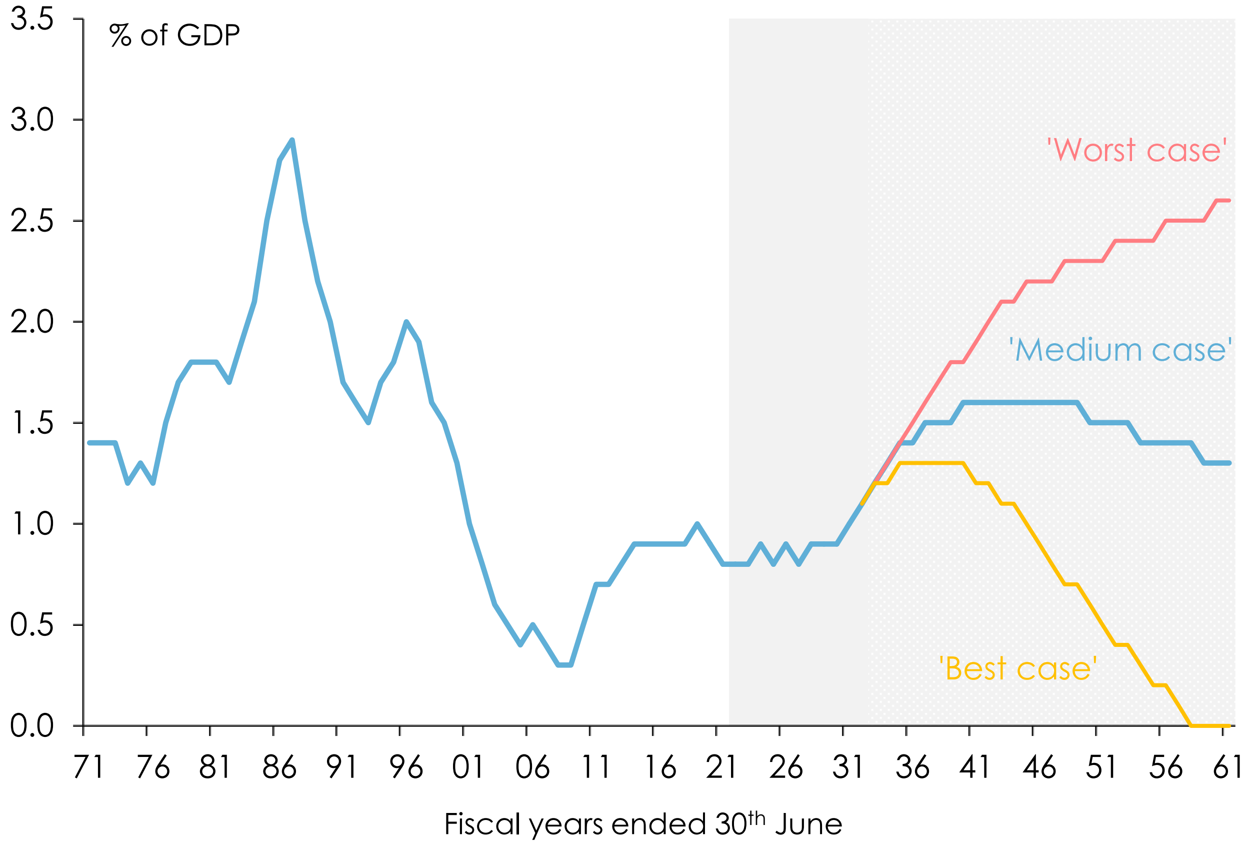
# Analysis by the Parliamentary Budget Office suggests the debt which the Government has incurred *is* sustainable under a wide range of scenarios

## PBO projections of Commonwealth Government gross debt




## PBO projections of Commonwealth Government interest payments




- **The PBO derived projections of gross debt and interest payments over the next 40 years based on 27 combinations of different assumptions about economic growth, interest rates and the budget balance**
- **Under all of these scenarios (even the 'worst case'), both total debt and debt-servicing costs remain within the bounds of historical experience**

*Source:* Parliamentary Budget Office, *Beyond the Budget: Fiscal outlook and scenarios*, 21st September 2021.

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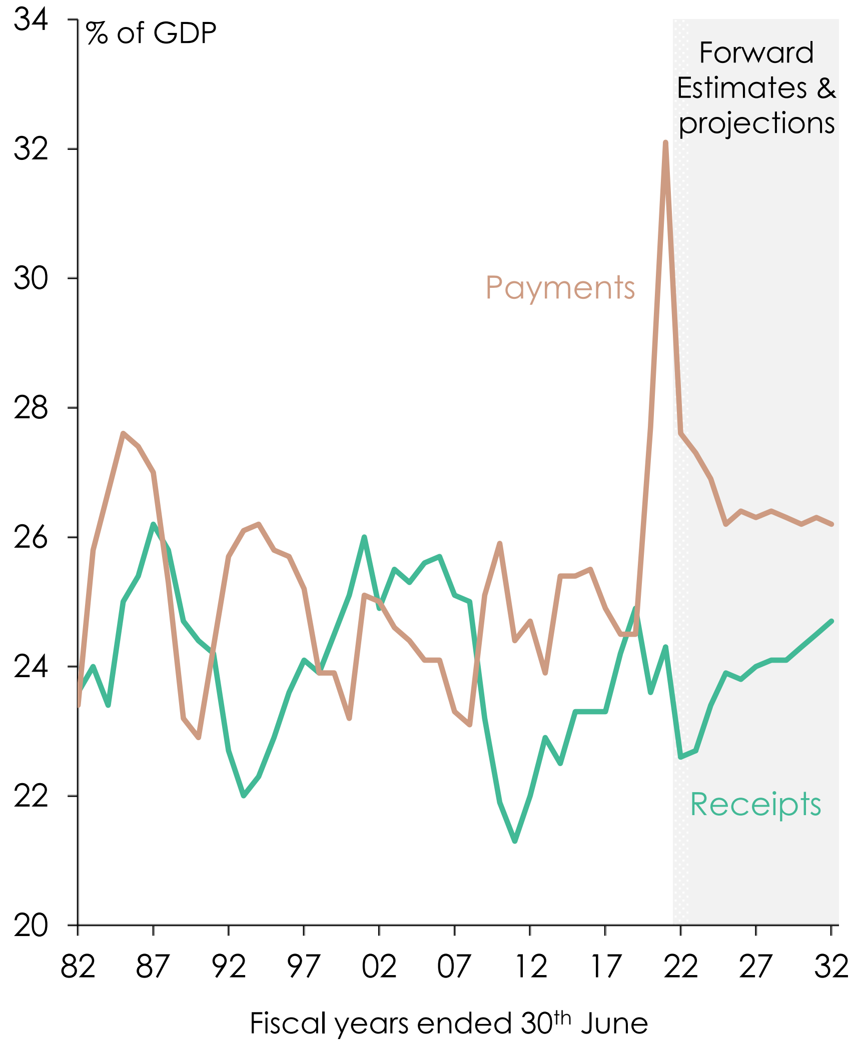
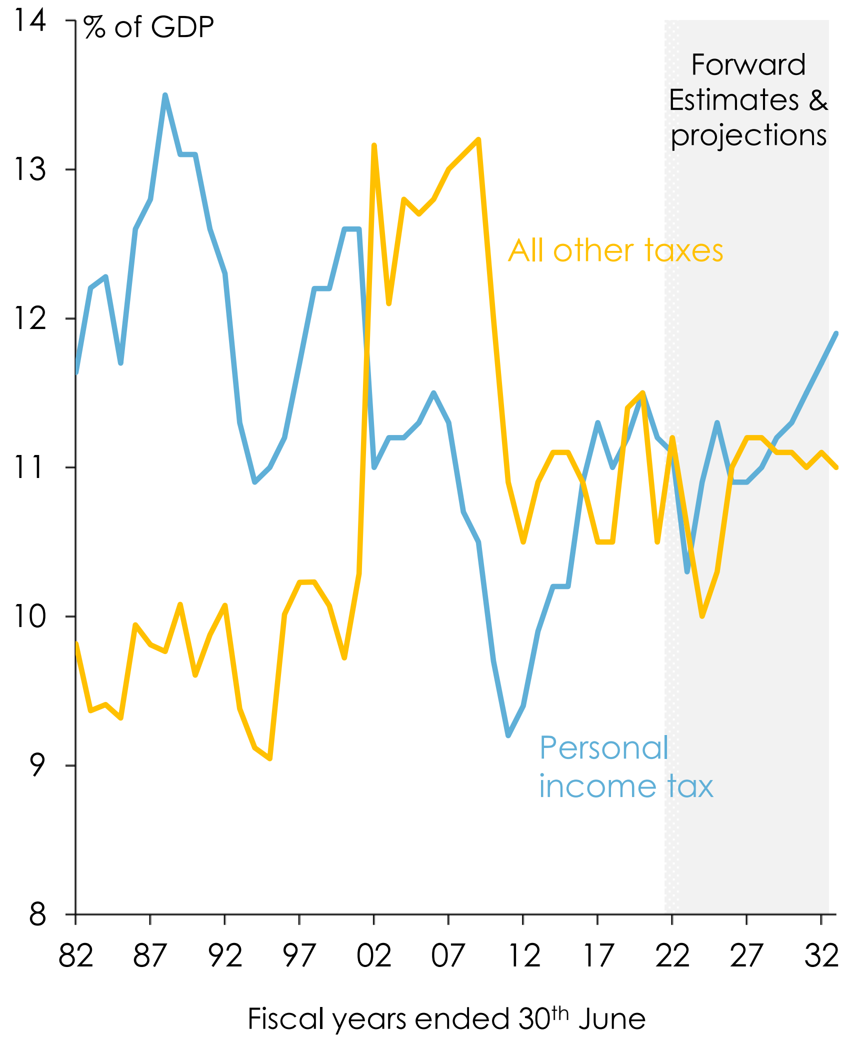
# The problem is that the Government will be relying solely on rising personal income tax collections to keep the deficit on a declining path

## Commonwealth Government receipts and payments




## Personal income tax and other tax receipts as pc of GDP




## Personal income tax receipts as a pc of total tax receipts


*Source:* Parliamentary Budget Office, *Beyond the Budget: Fiscal outlook and scenarios*, 21st September 2021.

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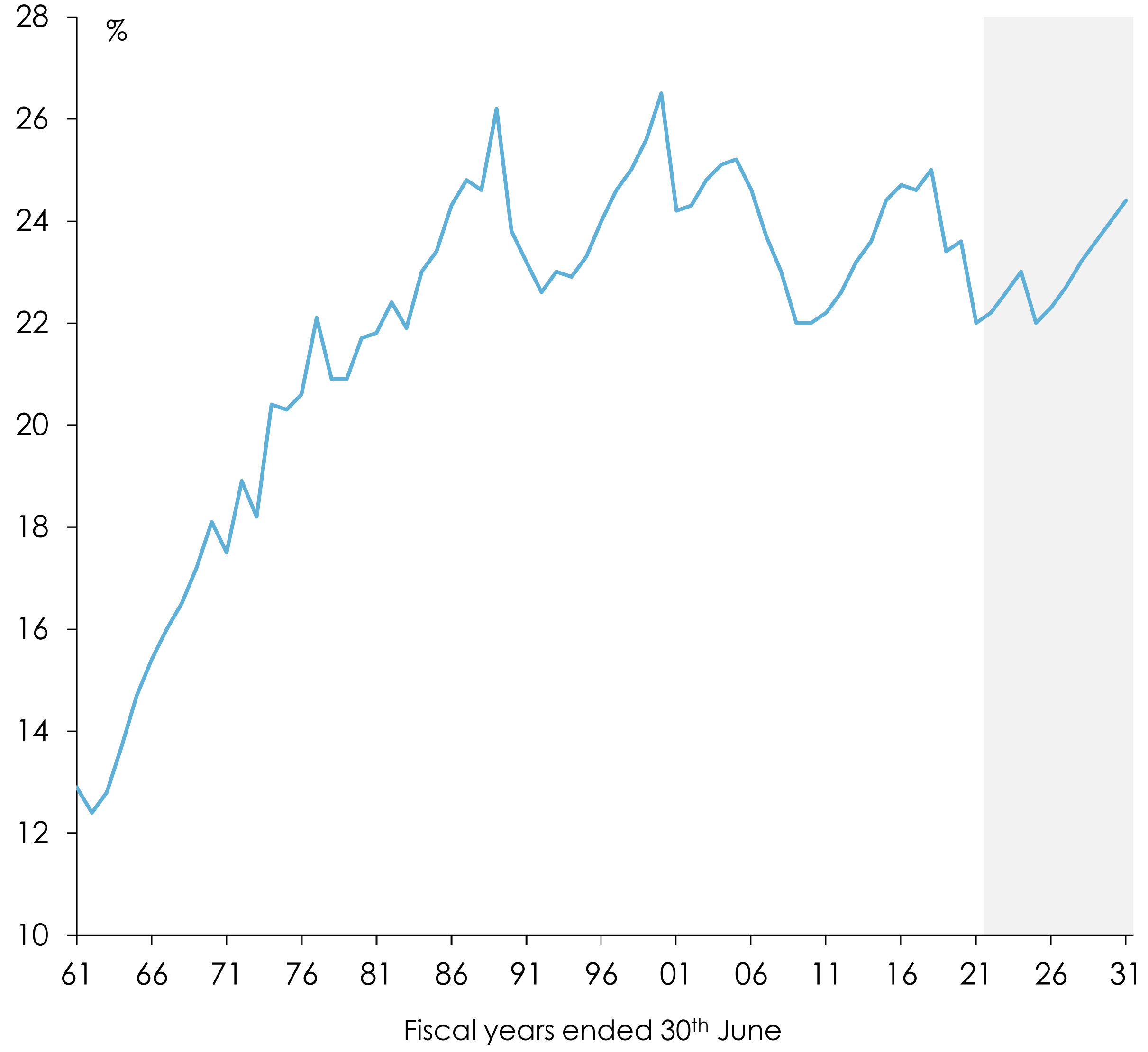
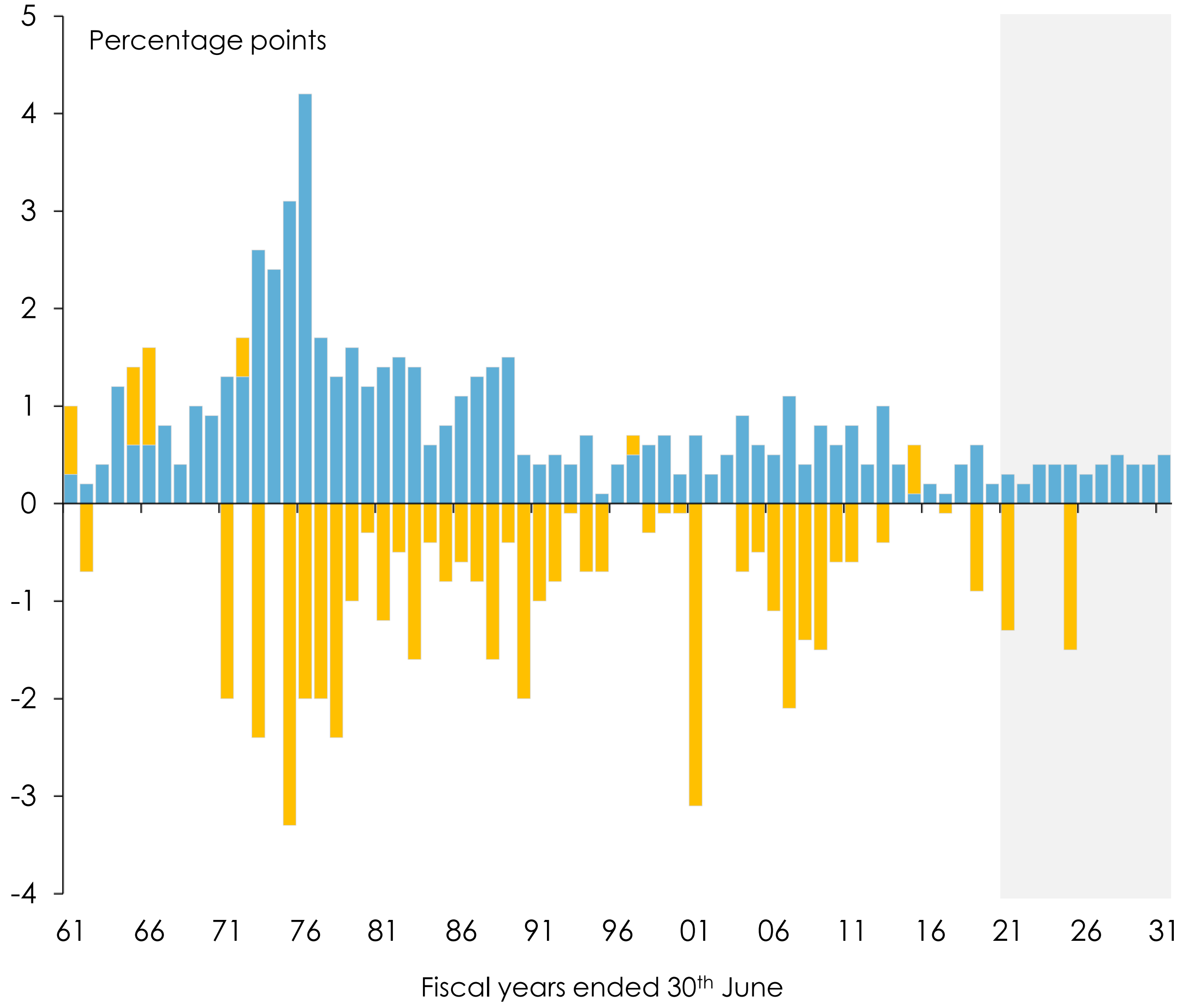
# And the prospective increase in personal income tax collections *isn't* the result of a conscious policy decision, but is rather due to 'bracket creep'

## Average personal income tax rate




## Source of changes in average personal income tax rates




*Source:* Parliamentary Budget Office, Bracket creep and its fiscal impact, 29th September 2021.

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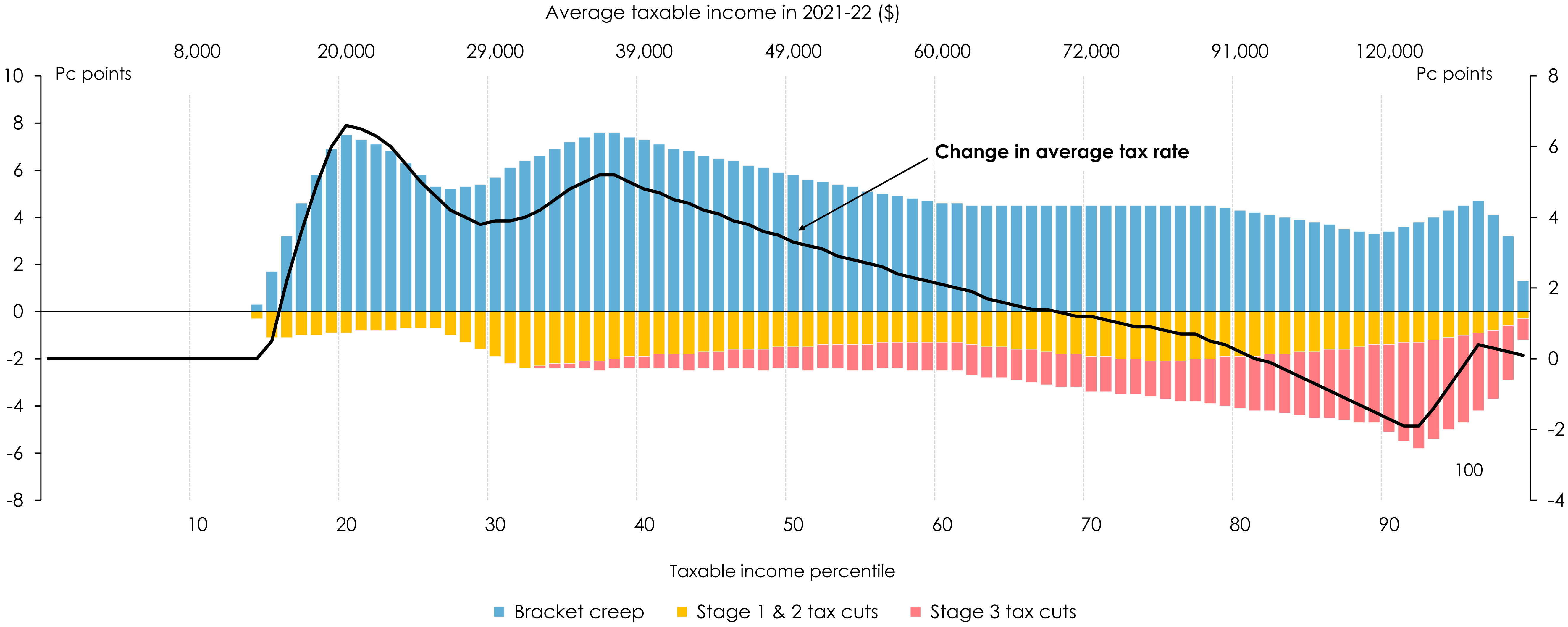
# 'Bracket creep' disproportionately impacts taxpayers with incomes of between $20,000 and $50,000 per annum

## Change in average tax rates between 2021-22 and 2031-32 by taxable income percentile




*Source:* Parliamentary Budget Office, *Beyond the Budget: Fiscal outlook and scenarios*, 21st September 2021.



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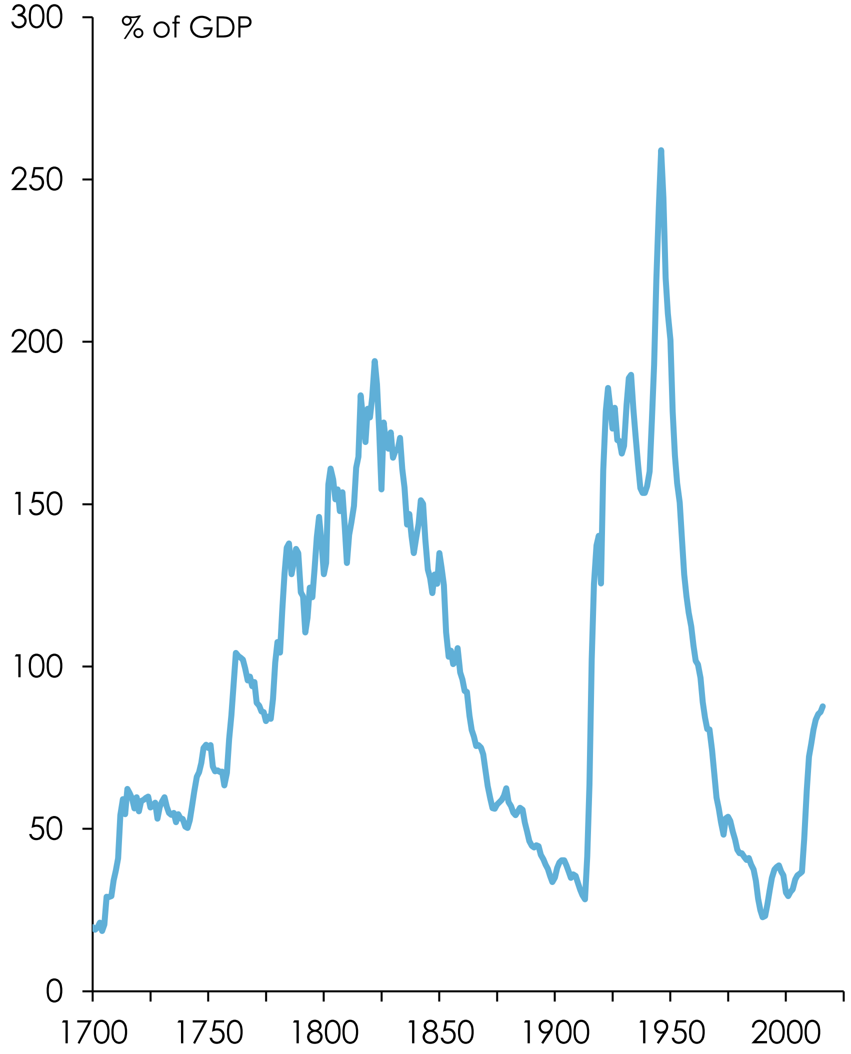
# Does the debt have to be 'paid off'?

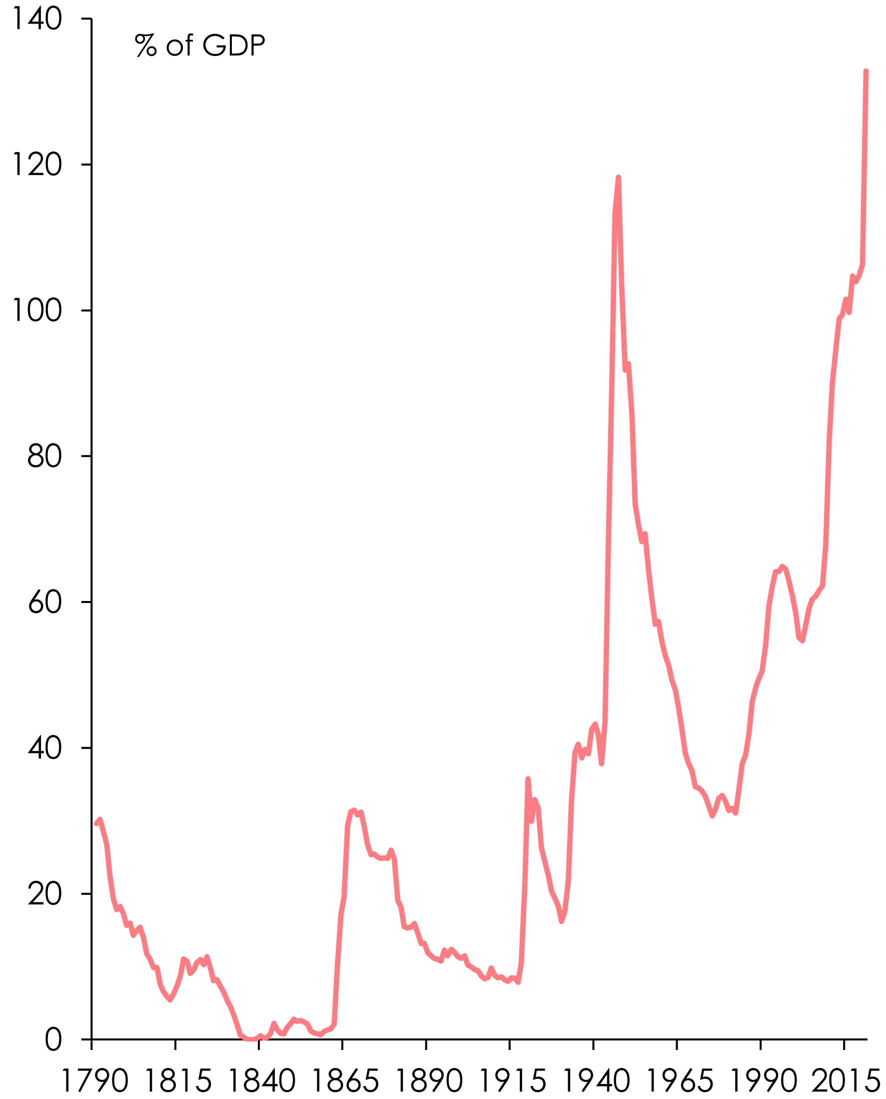
- There is no principle of economics or public finance which says that the optimal level of debt for a government is zero
  - households usually want to pay off their debts because people don't like to leave debts to their children
  - but governments don't die – there is no compelling reason for them to 'pay off' debts by some arbitrary date
- On the contrary, where government spending produces benefits for future generations of taxpayers as well as the present one, 'inter-generational equity' considerations suggests that paying for some of that spending through debt which future generations of taxpayers will service is both fair and reasonable
  - in other words, the level of debt which a government owes shouldn't be evaluated independently of what it has been used for
- Very few governments have ever completely 'paid off' their national debt
  - the English/British/United Kingdom Government has always had some debt outstanding since at least 1693 (when the Bank of England was founded)
  - President Andrew Jackson reduced the US national debt to less than US$40,000 during his second term in office (1832-36) but apart from those two years the US Federal Government has always had some national debt outstanding
- Australian Governments had much higher levels of debt, as a proportion of GDP, from the time of Federation until the early 1960s, than it does now or is likely to over the next decade
- As with households, the critical question is not how big the debt is, but rather what has it been used for, and can it be serviced without requiring either crippling levels of taxation and/or unsustainable (or undesirable) cuts in other areas of spending

# Governments rarely 'pay off' their debt

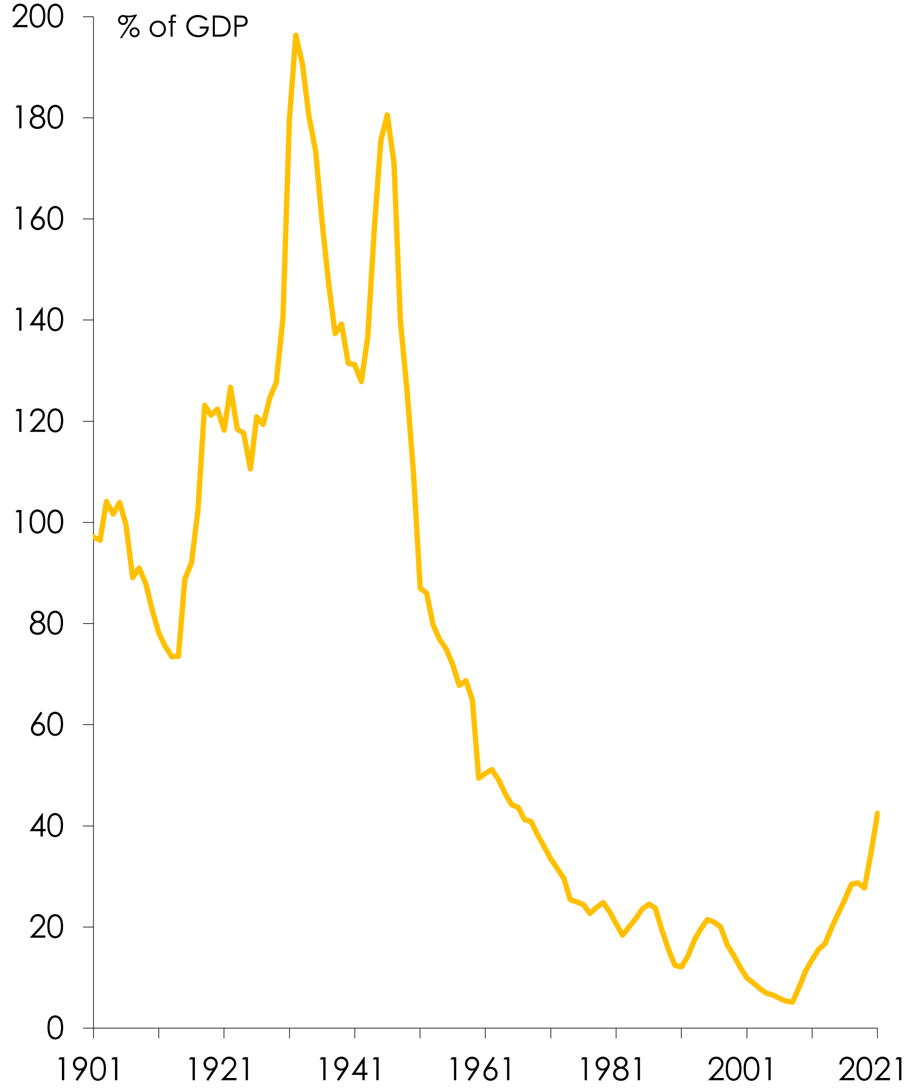
## England/Great Britain/United Kingdom national debt




## US Federal Government debt




## Australian Government debt




*Sources:* Bank of England, A millennium of economic data, Version 3.1; US Treasury, Historical Debt Outstanding; US Census Bureau, *Historical Statistics of the United States Millennial Edition Online*; Katrina di Marco, Mitchell Pirie and Wilson Au-Yeung, A History of public debt in Australia, Australian Treasury January 2009.

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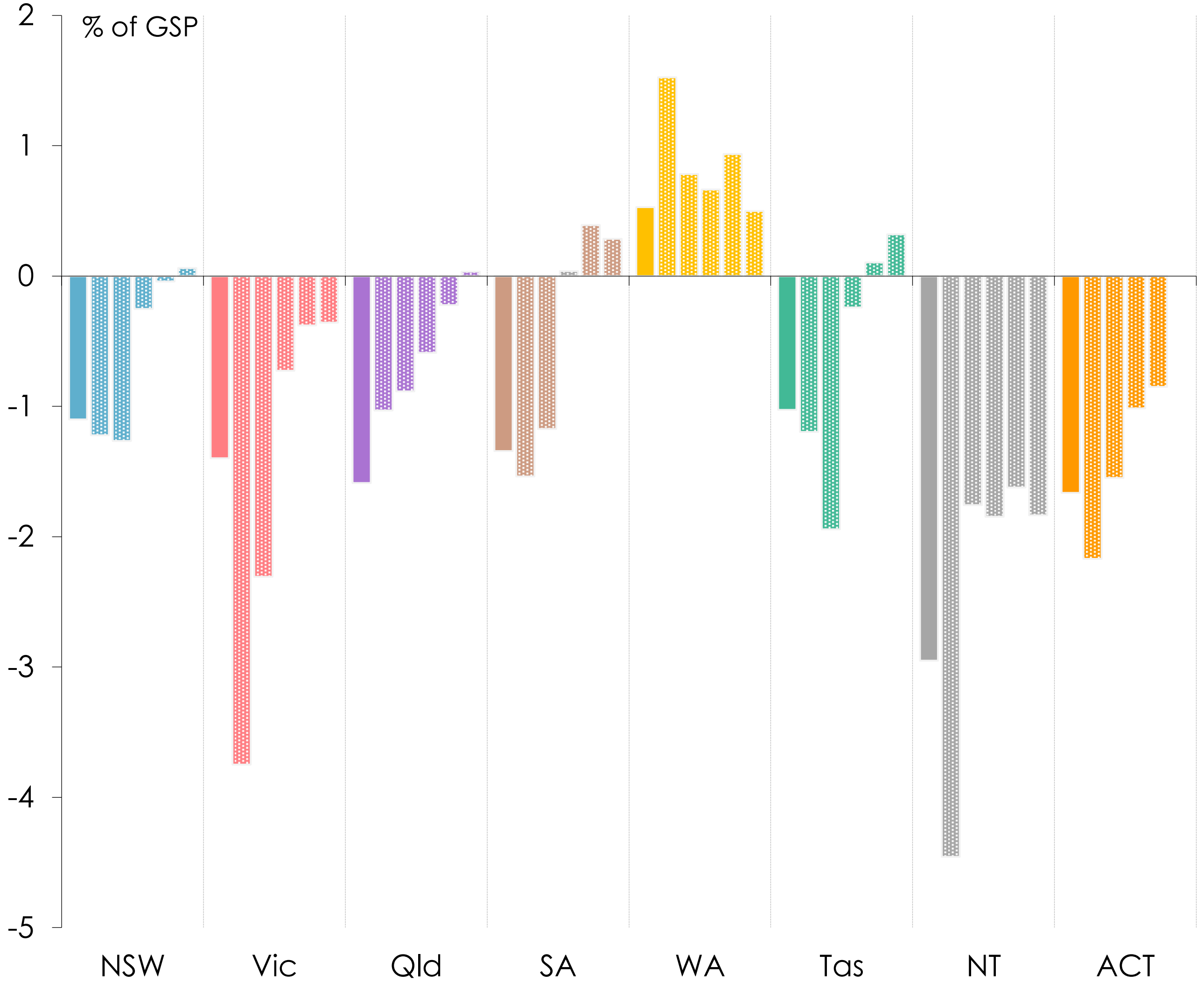
# State and Territory government finances

# State Governments have a lot of power, but are still financially dependent on the Commonwealth

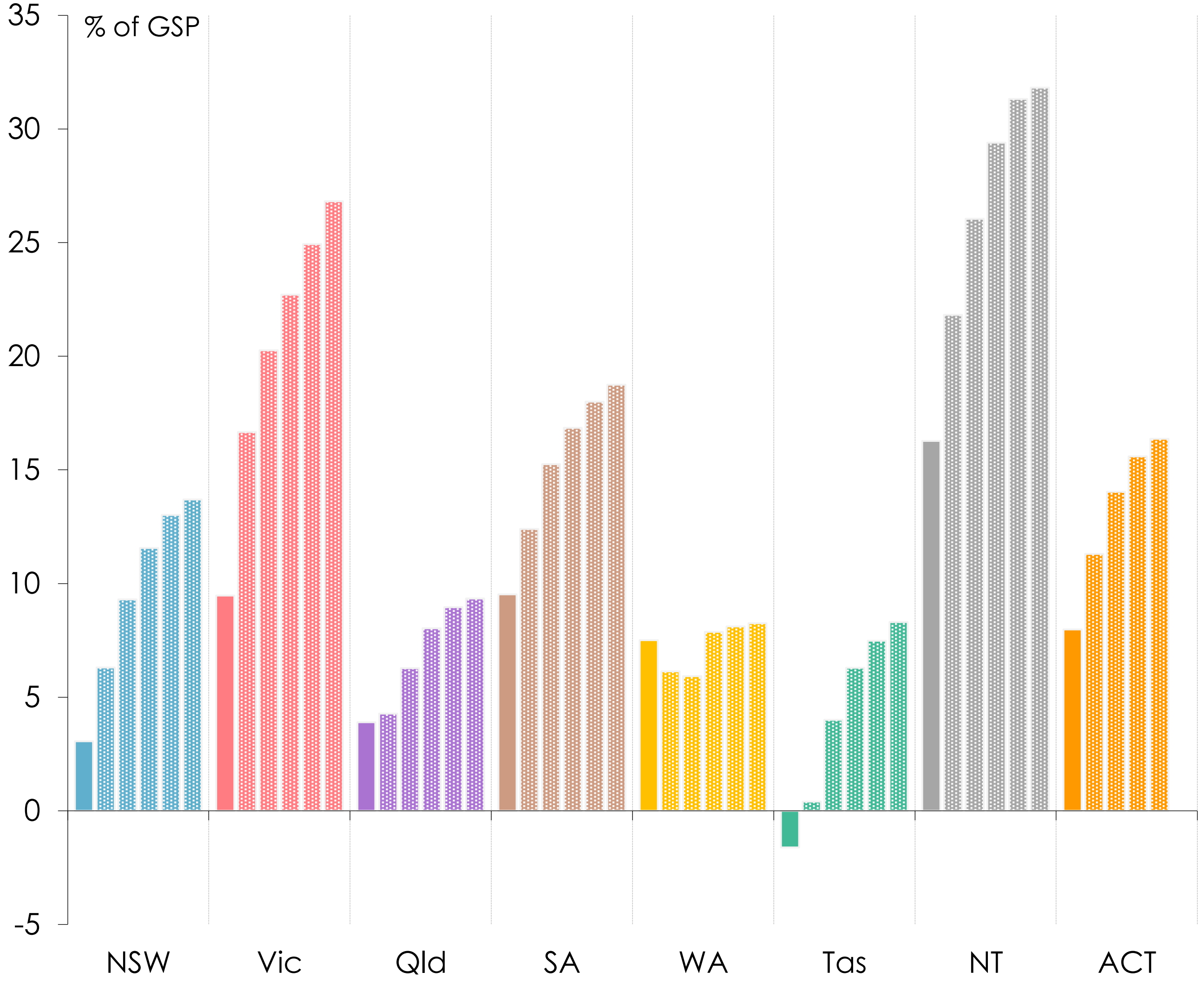
- The Australian Constitution left the States "legally free, but financially bound to the chariot wheels of the Commonwealth"
  - Alfred Deakin, Australia's second Prime Minister, *The Morning Post*, London, 12th May 1902
- States and territories account for around 40% of total government 'operating expenses', and for nearly 50% of all capital spending (58% if GBEs are included) …
- … but they raise only 16% of all taxation revenue collected by governments
  - largely as a result of provisions in the Constitution, and the way they've been interpreted by the High Court since the 1920s
  - although states and territories have also debased the revenue sources which they do have by granting such large exemptions eg from payroll tax, land tax and stamp duties
- In 2021-22, 50% of the states' and territories' total revenue will come from grants (including their shares of GST revenue) from the Commonwealth
  - ranging from 36% for Western Australia to 83% for the Northern Territory
- The high degree of 'vertical fiscal imbalance' in the Australian federation (by comparison with other nations with federal systems) has however enabled Australia to pursue an unusually high degree of 'horizontal fiscal equalization'
  - which is an important reason why the differences in living standards and public service provision between Australia's richest and poorest states and territories are much smaller than in, eg, the US, Canada or even Germany
- However this long-standing Australian tradition is now imperilled by the 'corrupt bargain' over GST revenue distribution which the Morrison Government imposed three years ago in order to appease WA

# The fiscal positions of the states and territories vary considerably, with WA the strongest, and Victoria and the NT the weakest

## States and territories – 'net operating balances'




## States and territories – net debt




*Note:* Estimates are for the 'general government' sector, ie excluding GBEs, etc. 'Net operating balance' is the difference between 'operating expenses' (ie excluding net purchases or leases of non-financial assets). Estimates of nominal gross state product (GSP) for states and territories other than NSW and Victoria are derived from State or Treasury estimates of real GSP growth combined with Federal Treasury estimates of the (national) GDP price deflator. *Sources:* State and Territory 2021-22 Budget Papers, except for the ACT, 2020-21 Budget Papers.

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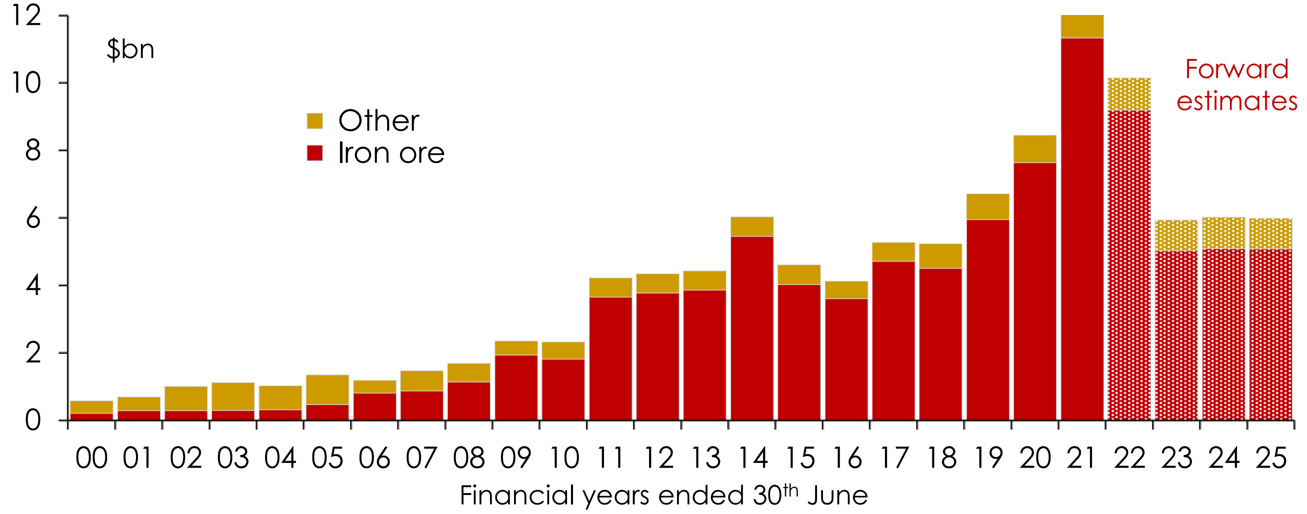
# In 2018, the Federal Government ‘changed the rules’ in response to a sustained campaign from successive Western Australian governments

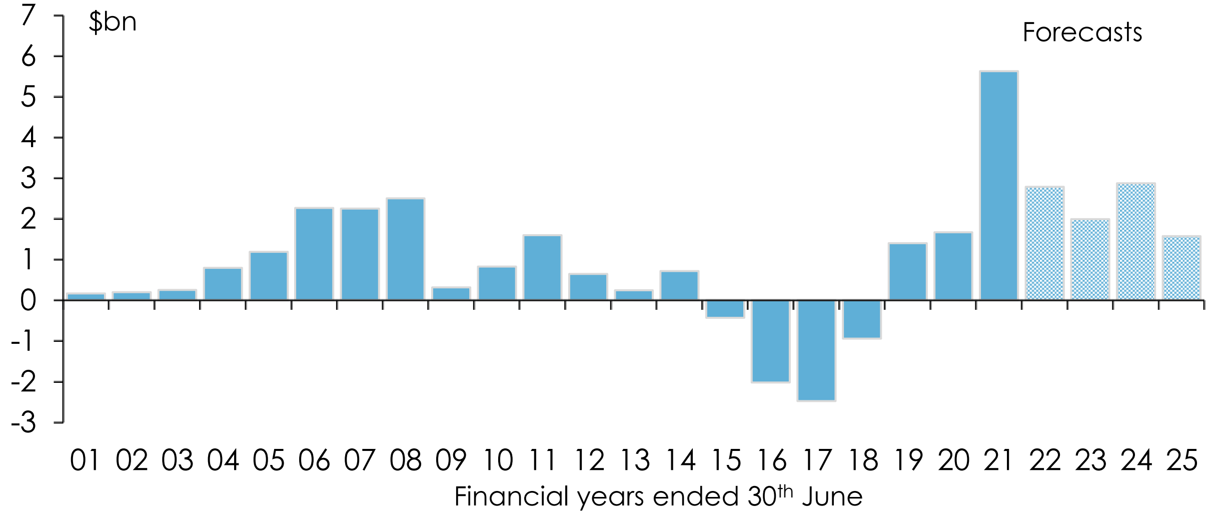
- Although Western Australia had been a beneficiary for almost 70 years of ‘horizontal fiscal equalization’ (HFE) as administered by the Commonwealth Grants Commission, once the ‘resources boom’ had transformed its finances to the point where it became a (significant) contributor to the ‘pool’ from which HFE is funded (since 2000, GST revenue) rather than a ‘drawer’ from it, WA started agitating vociferously for changes to the ‘rules of the game’
- In particular, WA sought to have revenue from mineral royalties excluded from the Grants Commission’s assessment of states’ ‘fiscal capacity’, and for the inclusion of a binding minimum or ‘floor’ underneath the share of GST revenue which any state could receive as a proportion of its share of the national population
- After years of ‘batting away’ WA’s demands (assuaging them instead by making a series of ‘one-off’ grants to WA outside of the GST revenue-sharing process), and following an inquiry by the Productivity Commission, in 2018 the Federal Government ordained changes to HFE which largely met WA’s demands:
  - over the next five years, the ultimate objective of HFE will transition from lifting the ‘fiscal capacity’ of all states and territories to that of the ‘fiscally strongest state’ to lifting them to the stronger of NSW or Victoria; and
  - introduction from 2022-23 of a requirement that no state or territory receive less than 70% of what it would have obtained under an ‘equal per capita’ distribution of GST revenues, increasing to 75% in 2024-25 (even if this means that it is not possible to raise the fiscal capacity of weaker states or territories to the stronger of NSW or Victoria)
  - the changes were accompanied by a guarantee that up until 2026-27 no state or territory would be worse off than it would have been without these two changes (with the Federal Government providing the funding for any such guarantee if required)
- At the time these changes were made, it was widely assumed that the ‘resources boom’ was over, and that iron ore prices would average US$55/t (fob) over the following four years
  - in which case, WA would have ceased to be the ‘fiscally strongest’ state (as it had been), and its share of GST revenues would have gradually returned to more than 70% of what it would have obtained under an equal per capita distribution
- But with iron ore prices much higher than assumed at that time, WA will get to keep a larger share of its windfall gains than it would have done under the old ‘rules’
  - this is now likely to cost the Federal Budget at least $15bn – more than twice as much as originally forecast – and after 2026-27 this cost will be shouldered by the other states and territories

# The Commonwealth Government will be adding $10bn+ to its deficits in order to boost Western Australia's surpluses by a similar amount …

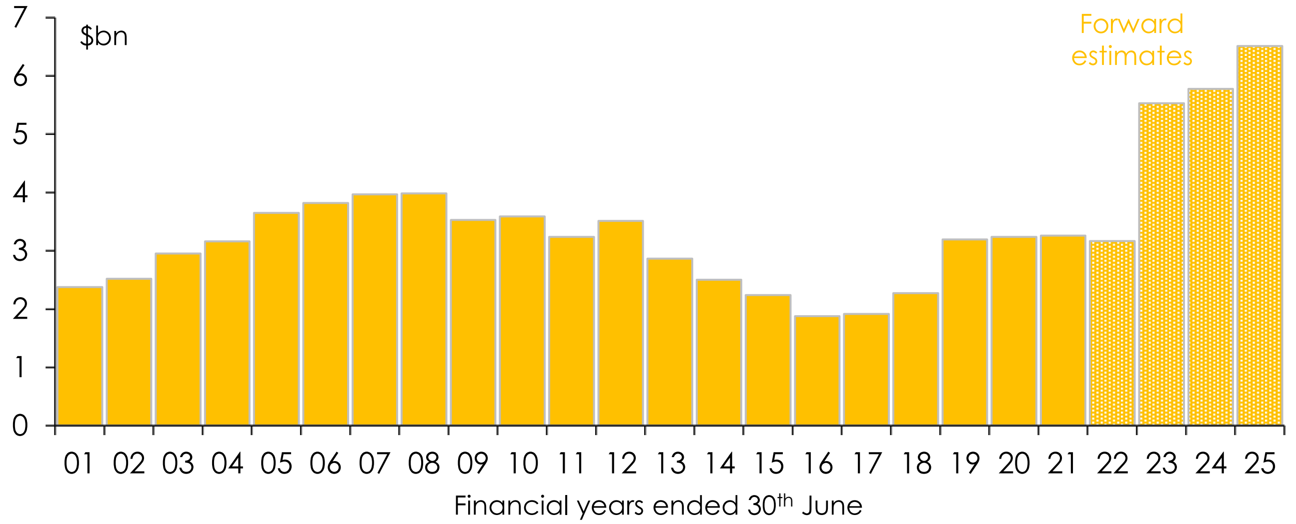
## Western Australia mineral royalty revenue



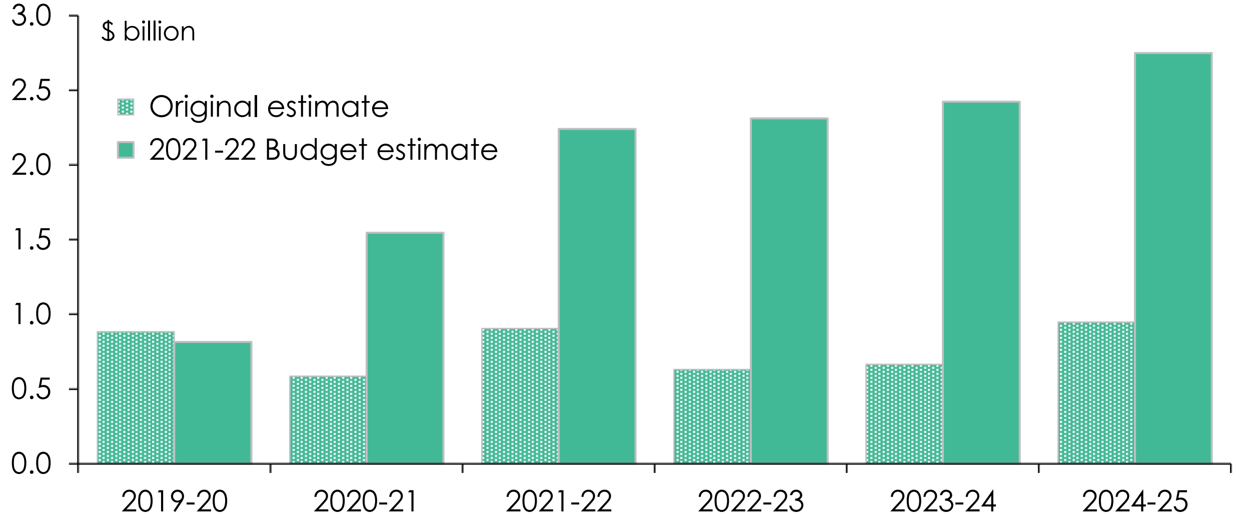

## Western Australia 'net operating balance'




## Western Australia share of GST revenue




## 'Transitional guarantee' cost to the Commonwealth




*Note:* WA's GST share includes 'top up payments' from 2017-18 through 2020-21. *Sources:* Government of Western Australia, 2021-22 *Budget Paper No 3 - Economic and Fiscal Outlook*; Australian Government, *2021-22 Budget Paper No. 3 - Federal Financial Relations*.



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# … until 2027-28, when the cost of the 'corrupt bargain' will be transferred to the eastern states and territories

## Victorian Treasury estimates of impact on state and territory budgets when the Commonwealth Government's 'transitional guarantee' that 'no state or territory will be worse off than it would have been under the 'old rules' expires in 2027-28

| Scenario | NSW | Vic | Qld | WA | SA | Tas | ACT | NT |
|---|---|---|---|---|---|---|---|---|
| 1: NSW and Vic stamp duty growth slows | -250 | -196 | -124 | 1,636 | -17 | 2 | -7 | 29 |
| 2: A decrease in WA's mining revenue | -105 | -67 | -6 | 1,185 | 18 | 14 | 1 | 35 |
| 3: Replicate mining boom scenario | -1,365 | -1,178 | -846 | 4,856 | -258 | -70 | -70 | 6 |
| 4: Replicate 2011-12 relativities | -208 | -193 | -142 | 1,611 | -21 | 1 | -8 | 35 |
| 5: Replicate 2010-11 relativities | -332 | -287 | -224 | 1,955 | -46 | -7 | -14 | 29 |
| 6: Relativities return to 10-year average | -1,198 | -1,009 | -744 | 4,360 | -220 | -58 | -60 | 2 |

*Note:* Figures are in $mn. Source: Government of Victoria, *2021-22 Budget Paper No. 5 - Statement of Finances*.

# This 'corrupt bargain' is for Western Australia what Xi Jinping would call a 'win-win outcome' – whatever happens to the iron price, WA wins

- If the iron ore price falls to less than about US$ 70/tonne, then Western Australia's share of GST revenues will increase back towards a notional equal per capita share – as it should do, and as it would have done under the 'old rules'
- But if the iron ore price remains at elevated levels, Western Australia won't see its share fall to any less than 70% (or 75% after 2024-25) of what it would receive under a notional equal per capita distribution of the GST revenue – no matter how much revenue it might be raking in from mineral royalties
  - the same would also apply if WA ends up raking in billions from royalties on (for example) lithium ores, with which it is also richly endowed, as a result of surging world demand for minerals used in batteries
- In other words, no matter what happens to the iron ore price, Western Australia 'wins'
- Until 2026-27, Western Australia's gains are at the expense of the Federal Government
  - which, under the 'transitional arrangements' provided under this 'corrupt bargain', will be adding to its budget deficits and debt in order to transfer additional revenue (over and above what WA would have received under the 'old rules') to the only government in Australia (and one of the few in the world) which is running, and expecting to run, budget surpluses
- But as things presently stand, from 2027-28 onwards, Western Australia's gains will be at the expense of the other states and territories
  - whose GST shares will be artificially lower than they 'should' be so that WA's share can be larger than it 'should' be
- Note that if the iron ore deposits which are the basis of WA's extraordinary revenue-raising capacity had been in, say, Broken Hill, rather than the Pilbara, NSW would not get to keep them in the way that WA will
  - because an integral part of the 'corrupt bargain' is that 'horizontal fiscal equalization' no longer seeks to raise the 'fiscal capacity' of the 'fiscally strongest' state (WA) but rather to the stronger of NSW or Victoria

*Note:* The use of the phrase 'corrupt bargain' in this presentation is, intentionally, an illusion to the popular description of the 'deal' by which John Quincy Adams became the sixth President of the United States after the election of 1824, rather than Andrew Jackson who actually won that election. It is not meant to imply that any party to the changes to the GST revenue-sharing arrangements referred to in this document has in any way personally profited or gained from it.

# Q & A

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