Billions of dollars wasted on grants to first home buyers

(Article by Saul Eslake, Director of the Productivity Growth Program at the Grattan Institute, published in the business pages of the Melbourne Age *newspaper, and in the online edition of the* Sydney Morning Herald*, on Wednesday 16th March 2011)*

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

The Federal Government began giving cash grants to first home buyers in 1964 when, at the urging of the New South Wales Division of the Young Liberal Movement (whose President at the time was a young John Howard), the Menzies Government began paying Home Savings Grants of up to $500 to 'married or engaged couples under the age of 36' on the basis of $1 for every $3 saved in an 'approved form' (generally, with a financial institution whose major business was lending for housing) in the three years prior to buying their first home, provided that the home was valued at no more than $14,000.

This scheme was abolished by the Whitlam Government in 1973 (in favour of an income tax deduction for mortgage interest payments by persons with a taxable income of less than $14,000 per annum); re-introduced under the name of Home Deposit Assistance Grants (without the age or marriage requirements and the value limits and with a larger maximum grant of $2,500) by the Fraser Government in 1976; replaced by the Hawke Government in 1983 with the First Home Owners Assistance Scheme, initially with a maximum grant of $7,000 (later reduced to $6,000) and subject to an income test; abolished by the Hawke Government in 1990; and then re-introduced as the First Home Owners Grant (FHOG) by the Howard Government in 2000, without any income test or upper limit on the purchase price of homes acquired, ostensibly as 'compensation' for the introduction of the GST (even though the GST only applied to the purchase of new homes, and not to existing dwellings which the majority of first-time buyers purchase). On two occasions since 2000, the FHOG has been temporarily increased in response to an actual or feared slump in housing activity (and in 2008, in response to a feared decline in house prices).

Over the past decade, most State and Territory Governments have 'topped up' the basic FHOG payments to first-time buyers with grants from their own resources, with some States providing even larger grants to buyers meeting certain additional criteria (for example, the Victorian Government provides an additional $5,000 for buyers of new homes in rural and regional areas). State and Territory Government also provide indirect financial assistance to first-time buyers by partially or totally exempting them from the stamp duty they would otherwise pay on their purchases.

Governments have thus been providing cash handouts to first-time home-buyers for almost half a century. Yet, strikingly, the home ownership rate has *never* been higher than the 72% recorded at the time of the 1961 Census, three years before the first of these schemes began. At every Census since then, it has fluctuated between a low of 68% (in 1976) and 72% (in 1971). At the past two Censuses (in 2001 and 2006) it stood at 70%.

Indeed the apparent stability of the overall home ownership rate conceals a substantial decline in home ownership rates among every age group below 50. Research by Sydney University's Judy Yates and Hal Kendig, and more recently by Flinders University's Joe Flood and Emma Baker, undertaken for the Australian Housing and Urban Research Institute, has shown that between the 1991 and 2006 Censuses, home ownership rates dropped by between 5 and 7 percentage points among households headed by each of the five-year age cohorts between 25-29 years and 45-49 years, by 4 percentage points among households headed by 50-54 year-olds, and by 2 percentage points among households headed by 55-59 year-olds. The only reason the overall home ownership rate hasn't fallen more dramatically is the substantial increase in the proportion of households headed by people aged 45 and over, among whom home ownership rates have always been significantly higher than among younger age groups.

In other words, the billions of dollars spent on cash grants to first home buyers (and for the first nine years of the FHOG Scheme's operations, expenditure on those grants exceeded $10 billion) have spectacularly failed to achieve the objective of increasing home ownership rates.

And it's pretty obvious why. Cash grants and other forms of assistance to first-time home buyers have served simply to exacerbate the already substantial imbalance between the underlying demand for housing and the supply of it – an imbalance which, according to the National Housing Supply Council, amounted to a shortfall of more than 200,000 dwellings as at June last year. In those circumstances, cash handouts for first home buyers have simply added to upward pressure on housing prices, enriching vendors (and making those who already housing feel richer) whilst doing precisely nothing to assist young people (or anybody else) into home ownership.

Contrast this with what happened when during the 1950s and early 1960s, when the Commonwealth Government provided low-interest loans to State Governments to construct dwellings for sale to eligible first home buyers. The home ownership rate rose from just under 53% at the time of the 1947 Census (a level unchanged from that reported in the first Commonwealth Census in 1911) to (as noted earlier) 72% at the time of the 1961 Census.

In other words, policies which added directly to the *supply* of housing worked. Policies which have, in effect, added only to the *demand* for housing (or, more strictly, increased the amount which people can afford to pay for housing), have conspicuously failed.

Why, then, have governments persisted with policies which have so miserably failed to meet their ostensible goals? The answer is, surely, that since around 70% of Australians live in homes which they (or members of their immediate family) already own, policies which make them *feel* richer (by inflating the value of what for most of them is their most important single investment) are much more popular than policies which might allow the small minority of Australians who don't currently own their own home, but would like to, to join them.

If governments *really* wanted to do something about housing affordability, they would abolish cash grants to first home buyers, and 'quarantine' tax deductions for interest paid by landlords to the value of the rent received in any given financial year (with any excess carried forward against the capital gains tax liability when the property is sold; and use the resulting savings to assist local governments to reduce up-front charges imposed on developers, and in various other ways increase the supply of low-cost housing. But I'd put more money on the chance of Andrew Demetriou becoming an enthusiastic supporter of a Tasmanian team in the AFL. And even more on the chance of Ireland making the next round of the cricket World Cup.

(Saul Eslake is a program director with the Grattan Institute. However the views expressed here are his own).