BANK FOR INTERNATIONAL SETTLEMENTS

Oporezivanje nekretnina i makro-financijska stabilnost

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Views expressed are those of the presenter and not necessarily those of the BIS.

Monetary policy / financial stability perspective on property taxes

Apart from loose monetary policy, favourable tax treatment of owner-occupied housing has contributed to an upward bias in house prices

- Very few countries have provisions on imputed rental income from owner-occupied housing as part of taxable personal income
- But most allow deduction of interest payments on housing loans
- Real estate ownership, capital gains from appreciation of housing values, transfers of housing property are generally taxed lightly
- No comparable tax advantages for property renters
  - → Induces bias towards housing ownership
  - → … and towards debt financing in housing markets
  - → "Low-for-long" monetary policy reinforces this bias
  - → Supplement macroprudential measures with real estate based taxation

Some empirical results[1]

- Increases in housing-related taxes have significant negative effects on housing credit
  - Study looks at taxes and subsidies that affect the cost of home ownership and housing transactions
  - Unlike measures affecting credit supply and demand, taxes and subsidies are likely to affect house prices regardless of whether households are credit-constrained
- Typical increase in housing-related taxes moderates real credit growth rate by 3–4 percentage points over the same horizon

[1] K Kuttner and I Shim (2016): "Can non-interest rate policies stabilize housing markets? Evidence from a panel of 57 economies", *Journal of Financial Stability*, vol 26, pp 31-44.

Public finance view of property taxation

Look at desirable properties of real estate based taxes

- Should not distort resource allocation
- Ought to be easy and relatively cheap to collect
- Should have automatic stabiliser properties
- Transparent: taxpayer knows which taxes, how much, why, at what gvt level she/he pays
- Should treat taxpayers fairly/equitably:
  - Horizontally: taxpayers in similar financial condition should pay similar amounts in taxes
  - Vertically: taxpayers who are better off should pay in relative terms at least as much in taxes as those who are less well off

Public finance view (cont)

- Property taxes can be imposed on:
  - actual and imputed rental income
  - ownership of land, housing, other real estate
  - transfer of ownership
  - change in the value of real estate owned

- Forms include:
  - Integrated with income taxes – actual and imputed rental income, real estate capital gains taxes
  - Gross or net wealth taxes
  - Estate, inheritance or gift taxes

Why property / wealth taxation nevertheless matters for macro-financial stability?

And how can property / wealth taxation be reformed to support macro-financial stability?

Why property / wealth taxation matters for macro-financial stability?

1. Residential investment and house price dynamics strongly affect the business cycle and resource allocation
2. Monetary policy has distributional consequences
3. Wealth inequality has greatly increased over the past few decades – intergenerational wealth inequality due to housing ownership has consequences for monetary and financial stability policies
4. "Financialisation" of housing – important link between business and financial cycles

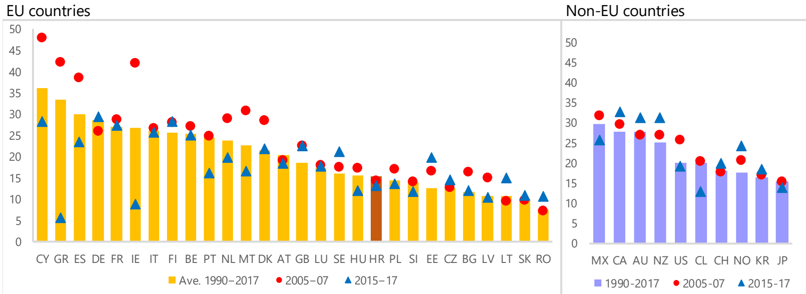
(1) Macroeconomic effects of residential investment and house price dynamics

- Residential investment is a key driver of growth, and housing accounts for a large share of household expenditure
  - → Need to take this into account for macro-financial stability
- Nominal house prices tend to rise faster than inflation, but are often only partly included in the CPI
  - → Disregarding house price inflation may create false sense of complacency about price stability, inaction bias
- House prices are highly persistent – not easy for monetary policy alone to affect upward or downward trend

Residential investment – key driver of growth

– construction of new dwellings, expansion/improvement of existing ones
– 20% of total investment in EU countries, 1990–2017 average

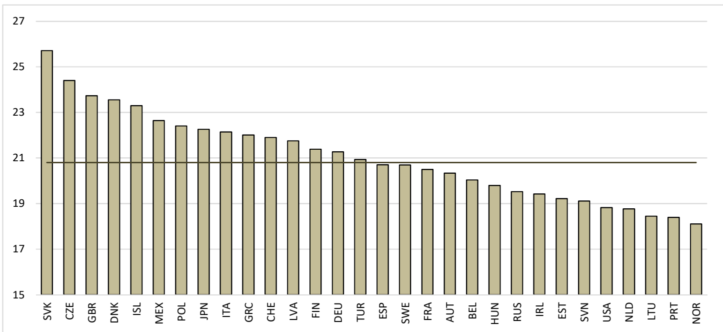
Residential investment: share in total investment (per cent)



Note: Countries ordered by average share of residential in total investment, 1990-2017.
Sources: National data; BIS; authors' calculations.

Housing accounts for a large share of household expenditure

Household expenditure on housing
As a percentage of household gross adjusted disposable income, 2005–16 average

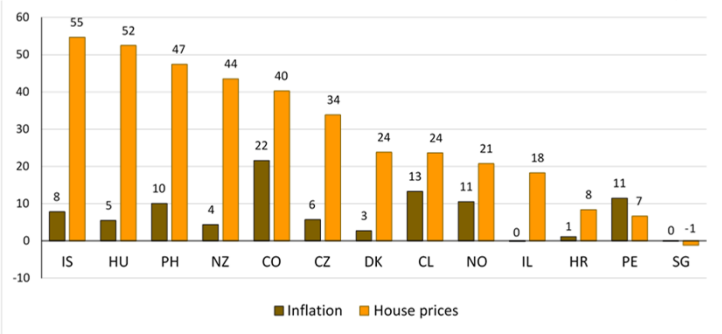


Source: OECD, *How's Life? 2017 Measuring Well-being.*

Nominal house prices tend to rise faster than inflation

Inflation and house prices

Cumulative growth, 2015–18, in percent



Sources: BIS residential property price statistics; national data; BIS calculations.

House prices are highly persistent – not easy to reverse a trend

Upswings and downswings in house prices[1]

In years

Table 2

	Nominal				Real			
	Advanced economies		EMEs		Advanced economies		EMEs	
	Ups	Downs	Ups	Downs	Ups	Downs	Ups	Downs
Total	759	96	285	56	506	255	192	118
Average length	12	5	8	4	6	6	6	5
Maximum length	50	18	22	6	22	18	10	10
Most frequent length	4	4	4	3	3	4	3	3
Median length	10	4	7	4	5	5	5	5
Number of up/downswings	62	19	36	13	82	46	34	23
Percent of total sample period	80	10	66	13	54	27	45	28
Years in the sample	950		429		943		423	

[1] Upswings (downswings) are defined as periods of house price increases (decreases) sustained in an individual country for three years or more. See Appendix Tables A1–A4 for country detail.

Sources: BIS residential property price statistics; authors' calculations.

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(2) Monetary policy has distributional consequences

- Housing is typically the largest asset owned by households …
- … housing-related debt is their largest liability
- As house prices and mortgage debt are interest-rate sensitive, monetary policy affects households' net income and wealth positions through the housing market
  - → Monetary policy inevitably has distributional consequences. These depend on the distribution of housing wealth and debt
    - – Lower-income households need to borrow more relative to income to buy an apartment or house
    - – Other things equal, changes in policy rates disproportionately affect more indebted, lower-income households

(3) Housing and intergenerational wealth inequality

Three examples

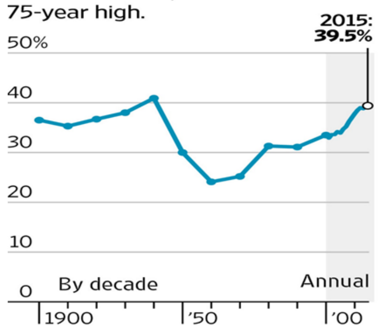
i. Households in the 55–64 age group have 3–6 times higher net housing wealth than those younger than 34 (AU, DE, FR, US)

ii. Rise in UK household wealth in 2007–15 = £2.7 trillion, o/w housing wealth accounts for 35–40%
   - 2/3 of the increase in wealth went to the 65+, the remaining 1/3 to those aged 45–64 (Haldane, 2016)
   - Those aged 16–34 saw their wealth decline by 10% in 2007–15

iii. Younger generations continue to live in the family home for longer, or get more help with housing expenses from older relatives
   - In the US, almost 40% of 18- to 34-year olds were living with parents and other family members in 2015, compared with less than 25% in the 1960s
   - In the UK, the share of young adults living with their parents increased from 21% to 25% between 1996 and 2016

Welcome Home

The percentage of 18- to 34-year-olds living with parents and other family members hit a 75-year high.



Notes: 1900 to 1970 data are from the Decennial Census records, 1980 to 2015 from Current Population Survey; Including stepparent, grandparent, other relative(s)
Sources: U.S. Census Bureau; Trulia
THE WALL STREET JOURNAL.

Housing wealth distribution – macro-financial implications

- When house prices rise …
  - Older households' net housing wealth increases, debt servicing costs as a share oh house price fall, C↑
  - Younger households' access to housing deteriorates …
  - … but this may be offset if mortgage lenders loosen their lending standards
- When house prices fall …
  - Older households' net housing wealth decreases, debt servicing costs as a share oh house price rise, C↓
  - Younger households' access to housing should improve …
  - … but not if mortgage lenders tighten their lending standards

(4) "Financialisation" of housing

- Over time, broader access to housing loans, longer maturities and securitisation have boosted the sensitivity of house prices and housing credit to interest rates (Diamond & Rajan, 2009)
- UK homeownership rate increased sharply after mortgage market liberalisation in early 1980s (Ortalo-Magné & Rady, 1999)
- Over time, housing construction regulations have been tightened in most countries, limiting housing supply
- This has further increased the sensitivity of house prices to changes in financing conditions (Glaeser et al, 2005)
- Financial cycle can be identified from medium-term fluctuations in credit and house prices (Drehmann et al, 2012)

Which policies could help with (1) – (4): Monetary? Macroprudential? Tax? Supply-side? Combined?

Monetary policy: some findings on interest rates, house prices[1]

- Changes in interest rates have a small but significant impact on house price changes
- Need to consider cumulative effect – interest rates do not affect house prices on impact, but gradually over time (up to 5 years later)
- Changes in both short-term and long-term interest rates matter
- In addition, the level of interest rates affects house prices
- And the level of US interest rates affects house prices in other countries, notably small advanced economies, but also EMEs
  - → Monetary policy cannot address the housing cycle on its own, needs support of other policies

[1] From G Sutton, D Mihaljek and A Subelyte (2017): "Interest rates and house prices in the United States and around the world", BIS Working Papers, no 665, October.

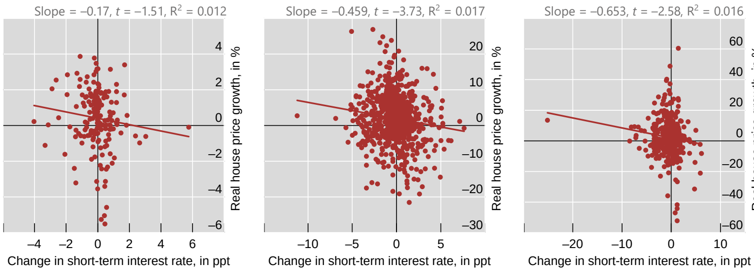
Interest rates don't affect house prices immediately…

Contemporaneous changes in real house prices and nominal short-term interest rates

Sources: Bloomberg; CEIC; Datastream; IMF, *International Financial Statistics*; national data; authors' calculations.

Interest rates affect house prices with (long) lags

Changes in real house prices and lagged nominal short-term interest rates[1]



[1] Interest rates were lagged by eight quarters for the United States and two years for other advanced economies and EMEs.

Sources: Bloomberg; CEIC; Datastream; IMF, *International Financial Statistics*; national data; authors' calculations.

G Sutton, D Mihaljek and A Subelyte (2017): "Interest rates and house prices in the United States and around the world", BIS Working Papers, no 665, October.

From MP to macroprudential measures

- We still need MP action: although short-term interest rates cannot rein in house price growth on their own, raising them gives time to supervisors to tighten oversight of mortgage lending
- How far could macroprudential measures help deal with housing booms and busts – unsettled question
- Two views:
  - Use MPR as other short-term counter-cyclical tools
  - Use MPR as structural policy measures – once set, resist temptation to use them as counter-cyclical tools

Macroprudential measures (cont)

Why structural view makes sense – example on distributional issues

- Monetary policy affects households' net income and wealth positions through the housing market
- The effects depend on the distribution of housing wealth and debt
- How the intergenerational distribution ultimately plays out depends on how the net gains or losses that accrue to the older households are shared with younger ones
- This may in turn depend on credit constraints and prudential regulation
- In principle, macroprudential policy could help reconcile the goals of restraining house price growth and easing young families' and first-time buyers' access to housing

Macroprudential measures (cont)

- In practice, balancing the two goals is difficult
  - Tighter LTV or DSRs could help restrain house price inflation and maintain affordability
  - But may also lead to higher down payment requirements, reducing housing access for younger households and first-time buyers
  - This may give rise to demands for fiscal measures to ease access to housing for some population groups
  - If introduced, such measures would add another layer of policy interventions in credit and housing markets – and might give rise to further demands for intervention
    - → Treat borrower-based macroprudential measures as structural: once set, resist temptation to fine tune them / use them as counter-cyclical tool

From macroprudential to supply-side measures

Another example of why the structural MPR role makes sense: proliferation of building regulations

- Why overburden macroprudential policy (and MP) with fighting the symptoms that result from distortions in other policy areas?
- Case in point: proliferation of building regulations, many of which protect existing owners or may be outdated, and thereby restrict the supply of land for development, distort house prices
- Use instead supply-side measures: release more urban land for development, relax building restrictions that protect current owners or no longer make sense, encourage rental markets, build some public housing
- Where used (eg SG), supply-side measures could deal with many unintended consequences of housing financialisation

What role for property and wealth taxation?

Proponents of the view that property taxation should support MP and MPR in dealing with housing booms:

- Abolish deductibility of mortgage interest payments from income tax
- Tax imputed rental income of homeowners
- Tax capital gains on property values, either as part of income tax or a wealth tax
- Assess and tax the value of real estate property, either as a separate tax or as part of a wealth tax
- Use stamp duties/transaction fees to discourage frequent purchases/sales during housing booms

What role for property and wealth taxation (cont)

Problems with this eclectic view

- No matching between instruments (ie elements of the tax system) and targets (cyclical/structural aspects of the housing market)
- Hard to change one element of the tax system on its own – need to consider trade-offs, work in second-best policy environment

What role for property and wealth taxation? (cont)

Examples of trade-offs that arise with partial tax reforms:

- Abolish deductibility of mortgage interest payments from income tax
  - Households only or businesses as well?
- Tax imputed rental income of homeowners
  - How do you assess IRI from scratch (eg with small rental market/high home ownership rate)? How do you explain the concept to the public, lawmakers, government?
- Tax capital gains on property values, either as part of income tax or a wealth tax
  - Assessment of gains? Exemption for residence? For inheritors from close family?

What role for property and wealth taxation? (cont)

Trade-offs with partial tax reforms (cont):

- Assess and tax the value of real estate property, either as a separate tax or as part of a wealth tax
  - At local or state level?
  - Who assesses taxable value? How?
  - Own residence vs apartments for rent? Own business premises?
- Use stamp duties/transaction fees to discourage frequent purchases/sales during housing booms
  - Responsible authority?
  - Monitoring of cycle? Benchmarks for action?
  - Tracking transactions, under-reporting?

What role for property and wealth taxation? (cont)

Trade-offs with partial tax reforms (cont):

- All of the above
  - Political support?
  - Competent authorities?
  - Coordination among authorities?
  - Homeowners with low income, pensioners?
  - Transitional arrangements / grandfathering provisions?

Summing up

- Public finance and monetary policy/financial stability experts have different policy objectives and analytical frameworks in mind when discussing property taxation, speak different languages
- Economics, political economy of property/wealth taxation much more complicated than what MP/FS experts assume when they call for tax policy to support MP and MPR
- To change consistently a critical number of elements, need strong institutional and governance arrangements, coordination with other authorities
- The opportunity to establish a consistent framework for wealth and property taxation arises maybe once in a generation

  → Key parameters of property/wealth taxation should also be treated as structural, not counter-cyclical instruments

  (Possible exception: stamp duties/transaction fees)