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FINANCIAL REVIEW

Ending up with the wrong effect

Parliament has stopped short of rewriting section 46 of the Consumer and Competition Act to include an "effects test" no fewer than 11 times since 1976. The Turnbull government now says that it is going to do so.

The effects test was a recommendation of the Harper review of competition laws in 2015. But the big winners are small business lobbies and their Nationals party allies, who were promised a review of the effects test by new Prime Minister Malcolm Turnbull in the deal to form a government after Tony Abbott had rejected the Harper finding. The populist big-business-bashing appeal for the politicians is obvious, though the change also has many respectable backers such as ACCC chairman Rod Sims.

The new test will take away the burden of proving intent or purpose in anti-competitive behaviour. Instead, companies can be pursued simply for the anti-competitive effects felt by others. A second change will scrap the need to prove how a company has "taken advantage" of its market power. This legally vague wording, critics claim, has allowed companies to get away with locking out smaller rivals through devices like land-banking, cornering suppliers, and price bundling. No other country, they say, has set such high bars for proving predatory behaviour.

Yet there were good reasons why so many people hesitated so often in changing the law in the past. They were afraid of another effect: chilling competition by mistake. Instead of big competitors smothering innovation and investment, an overzealous competition law would do the same thing. The Harper review itself was well aware of the dangers, and was arguably lukewarm about the changes. While it agreed that the "take advantage" wording was too vague to be of any use, it also added two directions to the courts to offset the potential for anti-competitive rulings following a change.

It's hardly in the spirit of agility encouraged by the Turnbull government to have companies put themselves in legal jeopardy every time they consider an expansion. The case for curbing the power of big business is much weaker in the protected, over-regulated and duopoly-dominated Australian economy of the 1970s through to the 1990s.

Globalisation and digital disruption has made much more of the economy subject to foreign competition, including big retailers. The traditional big corporation/small business divide is disappearing in a welter of new players and shifting technological boundaries.

The Australian Financial Review Business Summit brimmed with such examples over the past two days. Mr Turnbull says that the change is an example of his government's consultative style. But the government has not made a compelling case to weigh down the transformation of the economy with another complex layer of legal ambiguity.

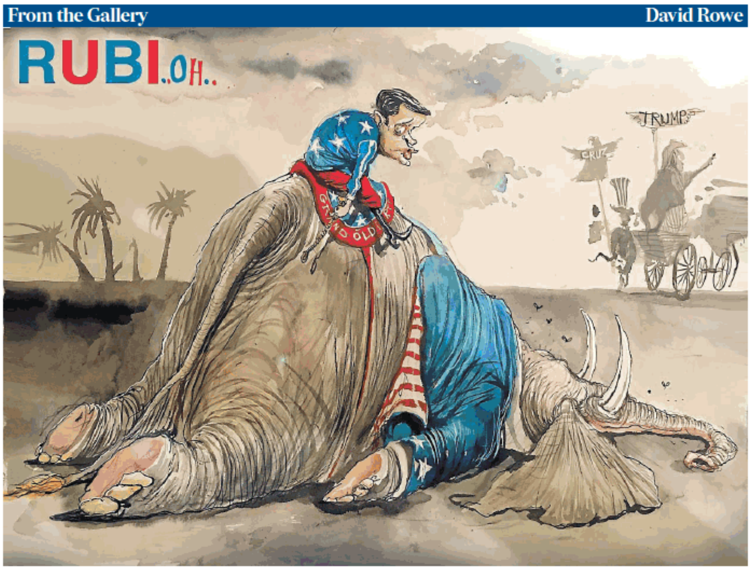
Backpacker tax stinks

The government's decision to review the planned "backpacker tax" is welcome as the new tax is a another piecemeal change to an already fiendishly difficult system, which will reduce the labour supply for the key hospitality and horticultural sectors. The additional expected revenue is just $110 million a year.

Under the tax changes set to take effect from July 1, those on working holiday visas will be required to pay a punitive 32.5 per cent tax from the first dollar and 35 per cent tax on employee contributions to super, which they get back when they leave.

The $18,000 tax-free threshold may well be too high, as too many people may be paying no tax while receiving various family payments. However, the backpackers are not going to require government services such as schools for their children or the aged pension. We want the right balance of taxing backpackers without driving them to other countries, so that they will do the harvesting and hospitality jobs that Australians often will not do. Australia needs more revenue but not through a piecemeal change that will hurt efficiency in fast growing export industries.

From the Gallery | David Rowe



Tax breaks, and myths for rent

Negative gearing
Owner-occupiers and foreign investors will drive new housing even if tax incentives for investors are taken away.

Richard Holden

Saul Eslake

As Australia debates our housing affordability crisis there has been an increasing willingness to contemplate things that were previously unthinkable, including changes to negative gearing, which have long ago been made in other countries, but which have until recently been strenuously resisted here.

The financial system inquiry, led by David Murray, and the Henry tax review argued that negative gearing was expensive, distorting, and a risk to financial stability. The Business Council of Australia recently suggested ending negative gearing. And, of course, the Labor Party has announced a plan to grandfather existing negatively-geared property investments and allow it in the future only for new construction. We, too, have pointed out the array of problems created by negative gearing and argued for a transition away from it.

Other than the Property Council of Australia and the Coalition government— who have transparent interests in opposing changes – the sole voice opposing changes has come from a recent report by property consulting firm BIS Shrapnel.

Defenders of negative gearing – including the obvious vested interests associated with the property sector and, perhaps more surprisingly (given his previous depiction of it as a form of tax avoidance), Prime Minister Malcolm Turnbull – have launched a classic "scare campaign" warning of the "unintended consequences" of "tampering" with it.

An effort to put some meat on this skeleton has been provided by a recent report by property consultant BIS Shrapnel.

The BIS Shrapnel report (and a recent opinion piece by its author on these pages) asserts that rents will rise significantly and property values will fall if changes to negative gearing are made. There are serious issues with the logic of these assertions. They are internally inconsistent, fly in the face of evidence, and contradict basic economic principles.

The first assertion is that rents will rise because new housing construction would fall due to reduced expectations of returns for investors in new housing. This rests on the completely false assumption that negative gearing would continue to be allowed for assets other than housing – making it a lot easier for the authors to assert that investment flows would be diverted away from housing. The BIS report goes on to claim that when investors subsequently sell the property it would not be new construction, hence not available for negative gearing, and the allegedly lower resale price would make it less attractive in the first place.

This completely ignores the fact that 76 per cent of purchasers are owner-occupiers, who are currently not eligible for negative gearing. There would be absolutely no change to the incentives of the great bulk of purchasers, which raises serious doubts about BIS's assertion.

Moreover, combining the latest Foreign Investment Review Board figures, with ABS figures for lending to Australian investors, reveals that foreign investors put between three and four times as much into the purchase or construction of new dwellings as Australian investors, and nearly as much as owner-occupiers do. And, of course, foreign investors can't access negative gearing. Given this, it's far from obvious that investors will have the market power to raise rents in the way that the BIS report assumes.

But there is also evidence on the matter. When the Hawke-Keating government removed negative gearing for a time in the 1980s, rents did not spike, nor did new construction plunge. Even the BIS report admits (but then ignores) this.

Furthermore, we have recently seen a live experiment of what would likely happen under the change Labor proposes. In the last five years every State and Territory government has shifted new home buyer grants away from existing construction to new construction only. These are much like the incentives for new construction proposed by Labor.

These amounts are large: between $7000 and $14,000. Interestingly, that is roughly the amount of the tax benefit that Mr Treasurer Scott Morrison's somewhat mythical negatively geared nurses and police officers receive under current arrangements. Has there been a spike in rents as a result? Has new construction plummeted? No, and no.

The scare campaign against changes to negative gearing ignores key facts about the housing market, ignores the compelling available evidence, and is logically flawed. We shouldn't be the least bit scared of a sensible transition away from negative gearing. We should welcome the positive impact it will have on housing affordability, financial stability, and the budget.

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