Reduce tax on residential mobility
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Published in:
VOX : Research-based Policy Analysis and Commentary from leading Economists

Citation for published version (APA):

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How can Europe increase structural growth? This column argues that labour market flexibility is a major barrier to labour movement is rigidity in the housing market, abolishing transfer taxes on residential property could result in gains of up to 0.4% of GDP.

The first EU council president Herman Van Rompuy has recently announced plans for a follow-up on the Lisbon Agenda. The next European summit will be focused on how to increase structural growth in Europe. Increasing labour market flexibility should be at the top of the agenda.

A new and challenging idea proposed by Andrew Oswald (1999) suggests that a lack of labour market flexibility may arise from rigidities in the housing market. Oswald proposes that high transaction costs may limit residential mobility and reduce the willingness of homeowners to offer their houses outside their own region.

Following from this idea, we argue that an abolishment of transfer taxes on residences in combination with a reduction in the general subsidy of owned residences, would increase residential welfare and increase labour market flexibility.

**Transfer taxes are substantial**

Transfer taxes are a major part of the transaction costs of residential mobility. Figure 1. Transaction costs in the housing market in Europe

Remarkably, governments impose additional burdens in the form of transfer taxes, on top of high transaction costs due to costs and commissions. These taxes range from 0.6% in Denmark to 12.5% in Belgium. Rather than promoting mobility, governments thus directly add to rigidity in the housing market and cause substantial losses.
Welfare gains of abolishing transfer taxes

Simply abolishing these transfer taxes would result in welfare gains. Table 1 provides a ratio for the welfare gains of abolishing transfer taxes by calculating the deadweight loss associated with these taxes (Van Ewijk et al. 2007).

The deadweight loss can be expressed as ½ \( \varepsilon t \), where \( t \) stands for the tax rate and \( \varepsilon \) the elasticity of the tax base for the tax rate. A reasonable approximation for \( \varepsilon \) is eight as reported by Ommeren and Van Leuvensteijn (2005). Table 1 reports for each European country the ratio of welfare effects that follow from the observed tax rate and the size of the tax base as percentage of the value of the residential property. The range reflects differences in interpretation as to whether the notary costs and commission fees are interpreted as a real social cost or as an indirect tax due to regulation.

Table 1. Welfare gains from the abolishment of transfer taxes on residential property in 20 countries

<table>
<thead>
<tr>
<th>Countries</th>
<th>Welfare effect in billions of euros (2006)</th>
<th>Welfare effect as percent</th>
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</thead>
<tbody>
<tr>
<td>Austria</td>
<td>0.08-0.30</td>
<td>0.03-0.11%</td>
</tr>
<tr>
<td>Belgium</td>
<td>1.27-2.40</td>
<td>0.40-0.76%</td>
</tr>
<tr>
<td>Denmark</td>
<td>0.00-0.03</td>
<td>0.00-0.02%</td>
</tr>
<tr>
<td>Finland</td>
<td>0.02-0.11</td>
<td>0.01-0.06%</td>
</tr>
<tr>
<td>France</td>
<td>1.44-7.41</td>
<td>0.08-0.41%</td>
</tr>
</tbody>
</table>

Source: Belot and Ederveen (2005)
Germany 0.40-1.88 0.02-0.08%
Greece 1.60-3.19 0.75-1.49%
Ireland 0.60-1.21 0.35-0.69%
Italy 3.75-14.04 0.25-0.95%
Luxembourg 0.03-0.11 0.09-0.33%
Netherlands 0.71-1.42 0.13-0.27%
Portugal 1.20-2.52 0.77-1.62%
Spain 3.24-9.17 0.33-0.94%
Sweden 0.02-0.16 0.01-0.05%
Switzerland 0.07-0.32 0.02-0.10%
UK 0.09-0.62 0.00-0.03%
Total 14.52-41.70 0.13-0.38%

Source: Van Ewijk and Van Leuvensteijn (2009)

We estimate that abolishment of transfer taxes on residential property would result in an increase somewhere between 0.15% and 0.40% of GDP in the 16 European countries presented above. Welfare gains would be especially large in absolute terms in France, Italy and Spain countries, transaction costs are relatively high compared to the average. In Italy, the maximum loss is relatively high because the overall transaction costs on the housing market in Italy are 19% (see Figure 1).

Increase labour market flexibility

In addition to these welfare effects, these measures would improve labour market flexibility. From a microeconomic perspective, the housing status of an individual agent can interfere at different stages of the labour market dynamics. Transaction costs associated with distant moves typically hamper the mobility of workers. The way in which transaction costs influence unemployment is more complex though. Unequal transaction costs may lead to an increase in the steady state.

The way in which transaction costs influence unemployment is more complex though. Unequal transaction costs may lead to an increase in the steady state. This is in line with Oswald’s finding of a positive association between the fraction of homeownership and aggregate unemployment.

Fiscal prudence: Reduce subsidies to homeowners

If governments combined a reduction in transfer taxes with a reduction in subsidies for homeowners, then fiscal prudence in the long run would become a key element of this fiscal measure. The transfer tax is paid instantly when the home is bought while the subsidy is a flow of montly transfers to the homeowner thereafter. This means that the fiscal stimulus of the reform will gradually reduce the value of the home due to falling house prices. This measure could increase confidence in the housing market. If governments abolish taxes and remove subsidies then fiscal prudence would be good for governments and people alike.
In many European countries, promoting homeownership is an official objective of government policies, usually supported by favourable tax regimes. A traditional argument for promoting homeownership is that homeownership creates positive externalities (i.e. homeowners take more care for the neighbourhood). Although these externalities are found to exist, their size is probably insufficient to warrant policy interventions (Glaeser and Shapiro 2002). In the end, the arguments for promoting homeownership are weak.

There is therefore a general tendency to reduce the (implicit) subsidisation of homeownership. The subsidy is still considerable in many countries (Hendershott and White, 2000).

Conclusion

Governments have the option to kill at least two birds with one stone. Abolishing transfer taxes on residential property would stimulate the economy in the short run and improve the flexibility of the economy structure. Transfer taxes provide additional labour market flexibility, because it enables homeown to take jobs outside their own region reducing the inflow in unemployment and increasing the outflow of unemployment. Combined with a reduction in subsidies in the housing market, this measure would also reduce fiscal policy in the long run.

References


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