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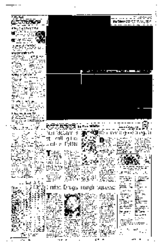

Cutting stamp duty will cost buyers

property **Alan Ahearne**

The housing market will recover only when sellers drop their prices, as abolishing stamp duty would just shift losses from developers onto taxpayers

SHOULD the Government cut stamp duty on houses in the next budget? The Construction Industry Federation (CIF) likes the idea and is calling for a reduction in the top rate of stamp duty from 9 per cent to 5 per cent "to bring stability to the housing market".

The CIF is not alone. Economists from financial institutions and several columnists with this newspaper are also strongly in favour of changes to the tax system that would reduce the amount of stamp duty payable when buying a house. Some critics of stamp duty are even calling for its abolition.

These critics argue that aspects of the current code for stamp duty are unfair. I tend to agree with them on that score. It doesn't seem particularly sensible, for example, that a buyer paying just above a certain threshold for a house must incur stamp duty at a higher rate on the entire purchase price.

Critics also see the abolition of stamp duty as a spark that will reignite activity in the housing market. After all, there is no doubt that housing transactions have stalled. Nothing is selling.

At first glance, you might think that slashing stamp duty is just what the doctor ordered for languishing house sales. But a closer examination of what ails the housing market suggests that cuts in stamp duty would probably do little, if anything, to boost transactions. And the outcome may be anything but fair.

The ongoing weakness in sales largely reflects the fact that potential first-time buyers are remaining on the sidelines. Many first-time buyers have been priced out of the market by the bubble in house prices. Some people who could afford to buy now are holding off because they expect that house prices will continue to decline. Homeowners looking to trade up are stuck because they can't find buyers for their current dwellings.

Contrary to what some observers believe, I doubt that media commentary about economic doom and gloom is playing much of a role in depressing transactions.

Let me offer you a sporting analogy. Before the Rugby World Cup, several astute commentators were pessimistic about the Irish team's prospects. Did these gloomy pundits talk down the Irish

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rugby team? Of course not.

First-time buyers make decisions based on what they see with their own eyes. The ongoing debate amongst analysts about prospects for housing is probably of second-order importance — at most. It makes as much sense to blame George Lee for housing misfortunes as to blame George Hook for our rugby misfortunes.

I have argued previously in this column that activity in the housing market will recover only when sellers drop their asking prices. If prices don't adjust, then the adjustment will continue to be borne by transactions.

It is important to think about who gains and who loses if and when house prices drop. The winners will be those looking to purchase a first home. Homeowners trading up will, on balance, be no better or worse off. They get less for their current homes, but pay less for their new homes. The unambiguous losers will be developers who paid too much for land during the boom and who will have to slash prices to shift their newly built houses. Buy-to-let investors will also take a hit.

Could the abolition of stamp duty unblock the housing market without the need for sharp price discounts? First-time buyers are already exempt from paying stamp duty, so they would not be directly affected by abolition.

The move in policy would mean that homeowners trading up would not have to pay stamp duty on their new homes. If these homeowners were to pass on most or all of the savings in stamp duty to first-time buyers by cutting the asking prices for their current homes, then sales may pick up. But that's a big 'if'. Moreover, though prices for larger homes (excluding stamp duty) would remain roughly unchanged, prices for starter homes would still fall.

Who would be the winners and losers in this scenario? As before, first-time buyers would gain. Homeowners trading up would again be no better or worse off. They would pay no stamp duty, but would have to cut the asking prices for their current homes. The key difference between this and the previous scenario is that developers selling large new houses (to those people trading up) would not have to cut their asking prices. And the loss to the Exchequer from forgoing stamp duty revenues would have to be made up by higher taxes elsewhere.

Abolishing stamp duty would therefore shift the losses from developers onto ordinary taxpayers. There's a term for such an outcome: it's called a bail out. And I can see no reasons, either on economic or fairness grounds, why taxpayers should be asked to bail out developers.

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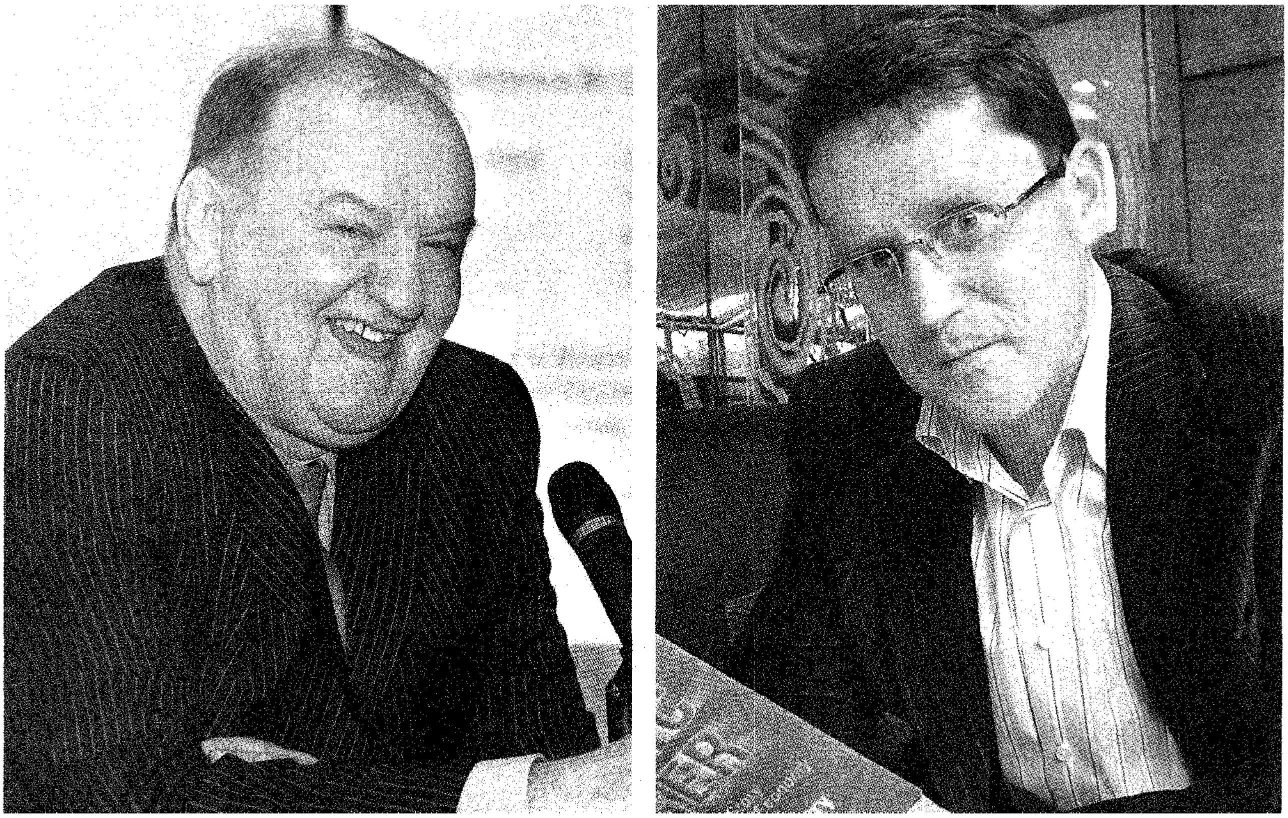

MAKES NO SENSE: **If you blame George Lee for the house price fall, you should blame George Hook for the rugby calamity**