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**Working Paper**

## Housing Capital Gains Taxes to Mitigate the Century Plus of Housing Booms and Busts

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# Bonn Econ Discussion Papers

Discussion Paper 11/2009

Housing Capital Gains Taxes to Mitigate the Century  
Plus of Housing Booms and Busts

by

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# Housing Capital Gains Taxes to Mitigate the Century Plus of Housing Booms and Busts

Robin Pope, University of Bonn\*

Housing and commercial property booms and busts have been a recurrent feature of developed economies for well over a century with all their personal, economic and environmental damage. Over the century plus, official sectors have displayed imperfect understanding of when a boom is unsustainable. Thus as regards the 2007-2009 US housing bust, well into this millennium, reputable current and prior actors in the official sector and official sector research papers, saw the US housing spurt as sustainable, and some even now see it as caused by an unpredictable productivity shift that began only in 2004, eg James Kahn. Greater efforts to discern wise voices by studying the past predictions of those with published opinions should be made and their wisdom used in discretionary monetary policy. But no matter how great our efforts to identify the wise, since an official sector is made of humans, we cannot anticipate its becoming consistently become infallible in this regard in the future. Further it is grossly inefficient and an unreasonable burden on the monetary wing of macroeconomic management to seek to control housing price bubbles exclusively via monetary policy.

It is desirable to bolster discretionary monetary policy with fiscal policy including in the form of automatic fiscal policy cycle smoothers that do not rely on the official sector correctly identifying the sustainability of the current state of the housing market. We already employ automatic cycle smoothers for the real sector in the form of taxes on outcome, income and profits, taxes that rise and fall automatically with the cycle. Many developed countries also have some (inadequate) cycle smoothing in the equities market in the form of capital gains taxes. What virtually no country has is a comprehensive capital gains tax on the main form of assets held by individuals, namely owner-occupied homes.

The best automatic cycle smoothers are moreover progressive taxes. A progressive capital gains tax on consumer price deflated house prices furnishes such an automatic stabilizer. It should be paid on all owner occupied houses (not merely on those bought for investment), and paid on accrual (but at a lower rate than on realized sale to reduce adjustment costs). Its introduction will require minute and careful preparation to familiarize the public with their advantages and with all the costs burst bubbles impose on them. This is in order to avoid democratic rejection of the measures by a population of actual and would-be house-buyers, as noted in my testimony to the New Zealand Parliament in 2007. Now, with the populace in righteous and justified outrage at the tax burden this burst housing bubble is causing in many developed countries, is the ideal time for instituting this buffer against the next housing bubble being so extreme.

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