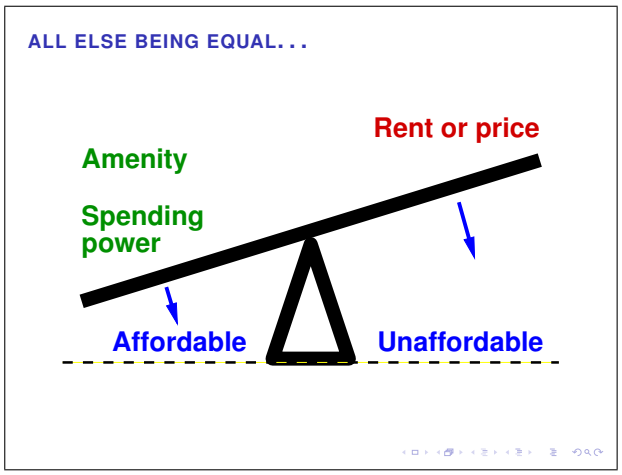
Effects of taxes and transfers on housing affordability

Presentation* by **Gavin R. Putland** to Informa Australia's
2nd Annual Housing Affordability Congress

Melbourne, December 10–11, 2008

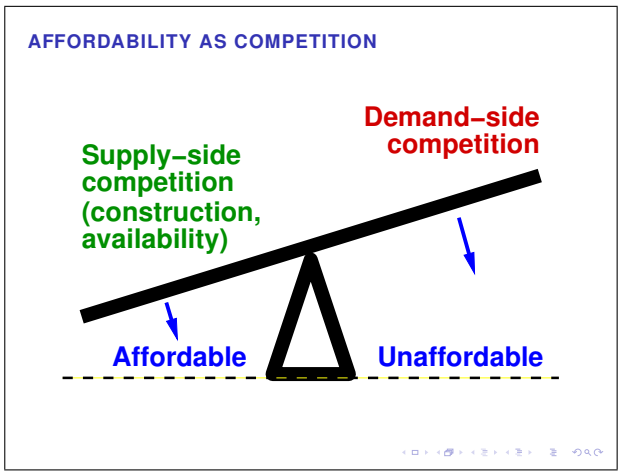
Thank you, Professor Berry.



Low rents or prices do not affordability make. Of course, *all else being equal*, a lower rent or price makes housing more affordable. But so does greater **amenity** (or **utility**) of accommodation for the same rent or price. And *all else being equal*, more **spending power** for prospective renters and buyers makes housing more affordable.

But the trouble is: *not all else is equal*, because the variables are not independent. Rents and prices obviously tend to increase with amenity. Greater spending power tends to be competed away in higher rents and prices. And crucially, some aspects of what I call "amenity" are *manifested as spending power*; for example, better public transport reduces travel costs, especially car-related costs, leaving greater capacity to spend on housing.

So you can't just weigh these variables against each other—and excuse me for drawing a seesaw instead of scales, but it matches the aspect ratio better (not to mention being easier to draw). You can't just weigh amenity and spending power on one side, against rent or price on the other, because the variables are not separately assessable. Instead, you have to look for some *other* variable that determines the balance.



That variable is competition: **affordability** of housing is the *competitive advantage of renters and buyers* relative to lessors and sellers; *more* competition on the *supply* side, or *less* on the *demand* side, makes it easier for renters and buyers to afford housing—all other variables considered.

Equivalently, the ***un*-affordability** of housing is the intensity of the competition that you have to *win* if you want somewhere to live. That intensity is *reduced* by having *less* competition on the *demand* side, or *more* on the *supply* side.

I labour that point because the precise meaning of affordability is obviously crucial when we try to devise tax and transfer policies to enhance affordability, and especially when we look for **empirical evidence** on how taxes affect affordability. To my knowledge there isn't much evidence on how taxes affect *nominal rents or prices*. But there's plenty of evidence on how taxes affect *building activity* and hence the supply of housing—and that's what matters.

* Due to a late reduction in the available time, several decisions to include or omit parts of the prepared text were made "on the fly". The present reconstruction of the speech therefore relies partly on memory, and may not be exact. Footnotes were added later, partly in order to reinstate omitted points.

THE EMPIRICAL EVIDENCE

Steven B. Cord:
- "**The 238 Report**" (online) and
- "**The Golden Key to Continuous Prosperity**" (book)

(Google on the titles).

Further summaries and references are on the **CD-ROM** or

au-lvrg.blogspot.com (2 items).

To observe an economic effect of a tax policy, you need to compare jurisdictions that are similar in all respects except for the tax policy under study. In practice that usually means comparing nearby *local* government areas, using either a **synchronic** method, in which different jurisdictions are compared over the same time frame, or a **longitudinal** method, in which you look at what happens after one jurisdiction changes its policy and check that it doesn't happen in other jurisdictions that didn't change their policies.

Comparisons between local governments tend to focus on the *rating system*: whether rates are levied on the **site value**, which is the value of the land alone; or the **capital-improved value**, which is the combined value of land and buildings; or some compromise between the two extremes.

Prof. Steven Cord has collected no fewer than 238 exhibits of evidence related to rating systems—including site-value rating, which he calls **land rent taxation**. In ch. 3 of his book he says (and I quote):

> 45 studies conclude that when a town adopts land rent taxation, a spurt in new construction and renovation results.
>
> 63 studies conclude that towns switching from taxing buildings to taxing land always outconstructed and outrenovated their comparable neighbors who were subject to the same economic-growth influences... [Unquote.]

Other studies looked at other issues and didn't contradict those findings.

Prof. Cord goes into details on American studies done in the last 30 years. Australian studies go back much further. The research arm of Prosper Australia is the Land Values Research Group, whose founding director was Allan Hutchinson [1907–1988], whose shoes I'm now trying to fill.

In a study published in 1945, Hutchinson divided Melbourne's local government areas into six zones according to distance from the CBD. The outer three zones were numbered 4 to 6, and each of them contained a mixture of rating systems. In the years 1928–42, the number of dwellings constructed per acre was 50% higher in the site-value-rating areas than in other areas for zone 4, and more than twice as high for zones 5 and 6. On those figures—and here's the rub—Hutchinson concluded that if all councils in greater Melbourne had used site-value rating over the study period, the extra construction would have *eliminated Victoria's housing shortage*, which was then estimated at 40,000 dwellings.

There were other studies in Melbourne, including longitudinal studies, which you can read about on the CD-ROM. And they tell the same story: *site-value rating is more conducive to construction* than systems that include buildings in the rating base.

Now that should be obvious, shouldn't it? If you tax values of buildings, there will be fewer buildings and smaller buildings. But if you tax land there won't be less land, because *land isn't produced by taxpayers*. So keeping rates off buildings is good for construction, and for all the industries upstream and downstream of construction, and for all the industries that need accommodation for workplaces and workers—in other words, the whole local economy.

And ratepayers tended to agree—if anyone bothered to ask them.

In 1896, ratepayers in New Zealand got the right to demand a local referendum to decide the rating base. By 1982, 90% of councils had adopted **land value rating** by *ratepayer-initiated referenda*. But it seems that someone didn't approve. Starting in 1988, Christchurch and Dunedin exploited legal loopholes to impose **capital value rating** while bypassing the right to a referendum, and the Mayor of Wellington did the same by a process that was apparently illegal. The central government, which was a Labour government, didn't close the loopholes. It abolished the right to a referendum, retrospectively legalized the actions of the Mayor of Wellington, and gave the man a knighthood. Since then, the fraction of councils using land value rating has fallen from 90 percent to 42 percent.[1]

Meanwhile in Victoria, site-value rating was less prevalent, mainly because local referenda were less prevalent. From 1920 to 1986, there were 90 ratepayer-initiated local referenda on the rating system; and in 70 out of 90 cases, the voters chose site value. But again, the powers that be decided that the voters had it wrong, and the State Government took away the right to a referendum. I believe that was in about 1994, in which case the offending central government was of the opposite political

[1] In 2007, a so-called independent inquiry recommended that capital value rating be promoted across the country, ostensibly because there's less data on land sales than on sales of land plus buildings—conveniently forgetting that you can't value a house-land package without at least *implicitly valuing the land*, because the land value is the component that varies with "location, location"; conveniently forgetting that whenever someone buys a property and demolishes the building, the price paid for the bare land is the purchase price plus the demolition cost; and of course without mentioning the long history of direct democratic mandates for land value rating. The chairman of that inquiry is now on the panel of the Royal Commission on Auckland Governance, whose terms of reference are constrained by the previous inquiry. "Never hold an inquiry unless you know the outcome." [This note was part of the prepared text, but was omitted due to the time constraint. See also the author's submission to the Royal Commission.]

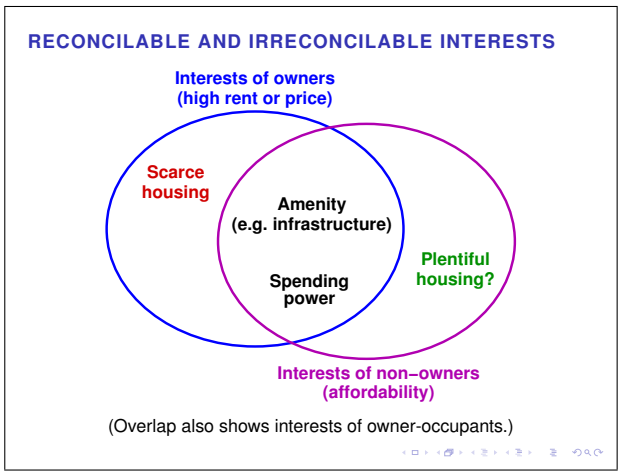
colour to that in New Zealand. Since then, every Victorian council that used site-value rating has abandoned it, except Monash in south-eastern Melbourne; and the new Monash council has just declared that the last domino is about to fall. The City of Monash was created by merging Waverley and Oakleigh. Waverley adopted site value by a ratepayer-initiated referendum in 1956. In 1945 and again in 1985, the Oakleigh council tried to abandon site value, but was overruled by the ratepayers. This time the ratepayers won't have the final say.

So who pulls the strings? Clearly it's not a case of incumbent property owners, in general, trying to suppress new competition, because that doesn't explain the referendum results. It has to be a narrower interest group. To work out who it is, follow the money. If building values are brought into the rating base while total revenue stays the same, who gets the biggest reduction in rates? Obviously those with the highest ratios of land values to building values. That means big-time land speculators, including land-banking developers—not home owners, not providers of rental housing, and, perhaps counter-intuitively, not farmers; in rural locations, large land *areas* don't imply high ratios of land *values* to building values.

The speculators will point out that under **capital-improved value** rating, or **CIV**, vacant land can be taxed at a higher rate. But that still leaves the problem that a suburban property owner who replaces low-density housing with medium-density housing is taxed on the additional building value, and thereby penalized for competing with the land-bankers beyond the urban fringe. Speaking of which, look at what happened to Melbourne's urban growth boundary—and the companion policy of building higher-density housing in existing suburbs, which would have competed with the land bankers.

And if we didn't have governments taking the side of big landowners against small owners, we'd have the media taking the side of small owners against non-owners. When land values rise, any consequent increase in rates or land tax can't leave the owners worse off, because the market value already allows for the tax implication. But the media never tell you that. Instead, whenever there's a Municipal Valuation, the media tell you about the poor ratepayers who are "suffering" because the values of their homes have increased by more than the average. And whenever land prices are rocketing, they tell you about the poor mum-and-dad property investors who are "suffering" because they've suddenly become millionaires. They were playing that song in Western Australia on Monday.

In view of all that, if housing affordability were a zero-sum game between property owners and the rest of us, or even between big owners and small owners, then we might as well give up. Fortunately it's not a zero-sum game.



Remember Venn diagrams? Inside the blue circle on the left, we have the interests of landlords and sellers; and inside the purple one on the right, we have the interests of renters and buyers.

Property owners *as such* want higher rents and prices, which could be achieved through

- greater *amenity* (for example by provision of infrastructure), or
- more *spending power* for renters and buyers, or
- a weaker competitive position for renters and buyers, through *scarcity of housing*.

Only the last of those is against the interests of renters and buyers. Meanwhile renters and buyers *as such* want a competitive advantage, which might be

- a means of getting greater *amenity*, or
- a result of more *spending power*, or
- a means to *lower rents or prices*.

Only the last of those is against the interests of owners *as such*. And it's simply the exterior of the blue circle.

What belongs opposite "Scarce housing"? For the moment I've placed "Plentiful housing", which clearly belongs inside the affordability circle, but has a question mark as to whether it also belongs inside the owners' circle.

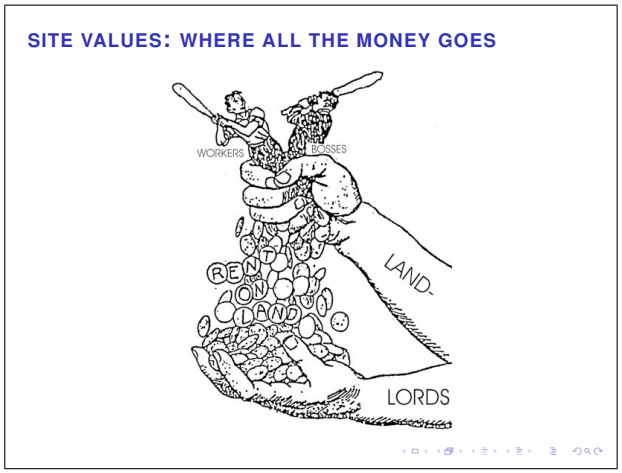
Now, I keep saying "*as such*" because ordinary home owners, who don't own any other property, have a foot in each camp: next time they have to move, they'll be *lessors or sellers of their old homes*, and *renters or buyers of alternative homes*. So the interests of owner-occupants are in the overlap. And the interests of *owners as such* are *not* the interests of owner-occupants, but the interests of *investors*.

But of course owner-occupants are the majority. So the political power of investors consists in their ability to persuade owner-occupants to take a one-sided view of themselves—to think of themselves as owners, not occupants; as prospective lessors or sellers, not prospective renters or buyers. And the fact that owner-occupants regard high home prices as a good thing shows that investors

are winning the propaganda war—which is further proof that if anything is to be done about housing affordability, there's got to be something in it for investors; otherwise it won't happen.

So consider the options on the diagram. To *restrict the supply of housing* is at best a zero-sum game in which owners win and non-owners lose. If *higher spending power* comes from taxpayer-funded subsidies, then the taxes and subsidies are also a zero-sum game. But if it comes from *better infrastructure*, that's a net increase in the wealth and income of the community, making it possible for both owners and non-owners to share in the gains. So if there's to be a politically feasible solution, infrastructure is the key.

But to understand infrastructure, we have to understand the origin of site values—loosely called **land values**.



A **site** is a piece of ground or a piece of space, whose value includes the value of any *attached rights*, such as the right to build on that ground or into that space, but *excludes* the value of any actual building(s). Individuals and corporations can't create or eliminate sites. Governments can *effectively* create sites, by rezoning land for more intensive uses; but private entities can't.

So from the private viewpoint, *the supply of sites, including residential sites, is fixed*. This is true not only of the *overall* supply, but also of the supply within acceptable distance of any particular services or infrastructure or job opportunities. For property developers, who have the means to develop new estates, the supply of residential sites is limited by the willingness of governments to rezone land for residential use. For ordinary home buyers, who have the means to build dwellings or get them built, but not to develop new estates, the effective supply is further limited by the willingness of big developers to develop and re-sell their "land banks". For renters who lack the means to build dwellings, the supply of sites is effectively determined by the supply of dwellings. But for everyone, the supply of sites is limited. Yet access to suitably located sites is essential to economic participation. Therefore *rents and prices of sites are competed upward until they absorb the people's capacity to pay*.

This mechanism affects employers as well as workers. If workplace laws favour bosses, the gains are competed away in the commercial land market. If they favour workers, the gains are competed away in the residential land market. Either way, a landowner wins—as the old cartoon implies.

But for workers, if wages rise, so does the cost of housing. If childcare or transport or food gets cheaper, the cost of housing eats up the savings. In short, there's an equilibrium at which everything gained in the rest of the economy is competed away in the housing market. But the *intensity of the competition* determines the point of equilibrium.

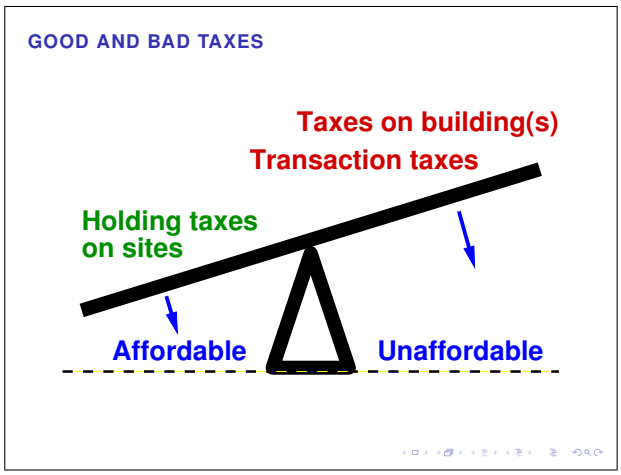
Therefore, for renters and home-buyers *as a class*, the only gains that are *not* competed away in the housing market are those that are delivered *through* the housing market by enhancing the competitive advantage of renters and buyers—and that's the very definition of affordability. So it seems that *housing affordability is the fundamental problem of economic justice*.

And that's not all. If any jobs are to be created,

- the employer must be able to pay the rent or mortgage on the business premises out of the proceeds of the business, *and*
- the workers must be able to pay the rents or mortgages on housing within commuting distance of the premises, out of wages that the employer can pay out of the proceeds of the business.

So affordable access to sites, including residential sites, is a prerequisite for economic activity. Combining this with the decisive influence of housing affordability on equity, we see that housing affordability is not a peripheral issue. **Affordable access to sites, including residential sites, is *the* fundamental economic problem**. In particular, solving the housing problem is not a luxury that can be put on the back burner while we deal with the looming recession; it's a *prerequisite* for dealing with the recession.

So what does that mean in terms of taxes and transfers? We can lay down four general principles.



First, as you know already, it's better to tax sites than buildings, because taxes on buildings deter construction.

Second, it's better to tax holdings than transactions. A **transaction tax** is one for which the tax liability is attached to an *avoidable economic exchange*—the "transaction". In contrast, a pure **holding tax** is a periodic tax

payable by the owner of an asset regardless of any transactions (such as rent payments) that occur during the period of ownership; for example local rates, whether on site values or combined values, are holding taxes. I'll use the term "**transfer tax**" to mean a tax payable at the time of transfer of an asset, but not necessarily proportional to the transfer price; so a "transfer tax" is a transaction tax in *form* but not necessarily in substance.

A pure holding tax on a site can't reduce the supply of sites, and can't reduce the availability of sites for housing, but can only encourage a site owner to use the site productively in order to cover the tax (or sell the site to someone who will). But a transaction tax can inhibit the supply of housing *even if the transaction concerns a site*.

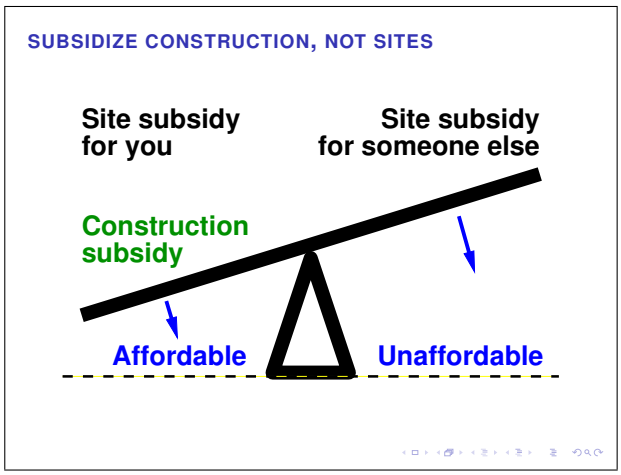
For example, a tax on the *rent actually paid* for sites would be a transaction tax; it would make landlords less inclined to offer sites for rent, and therefore raise rents. But a periodic tax on the *values* of sites is a pure holding tax and has the opposite effect; owners can't avoid the tax by withholding sites from the market, but must either *cover the tax* by finding tenants, or *avoid the tax* by selling the sites; and to attract tenants or buyers, they have to moderate their rent demands or price demands. That's what site-value rating does, and what land tax does.

A site-holding tax doesn't reduce affordability for buyers, because it's compensated in the purchase price: in effect, the so-called "tax" is the rent paid for a portion of the site value that is retained by the government, while the purchase price covers the privatized portion. To put it another way, the price is the present value of the future rent savings, so any tax that cuts into those savings reduces the present value in the same proportion.

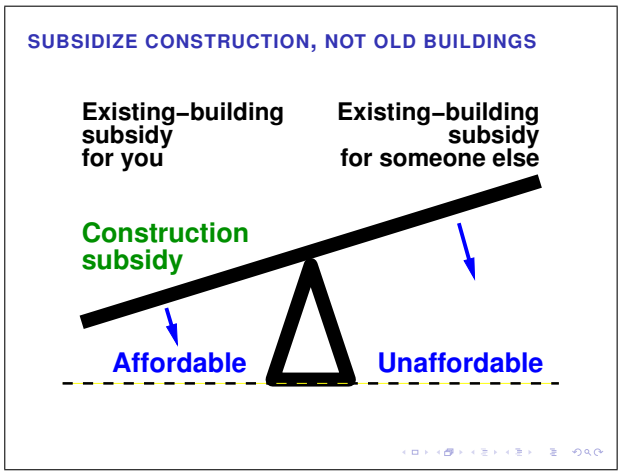
Furthermore, if the site-holding tax is high enough, it becomes uneconomic to hold the site for speculative purposes, so that genuine buyers are further assisted by not having to compete with speculators.

According to the first two principles, **conveyancing stamp duty** is doubly evil: it's a transaction tax on a base that includes buildings. Even if it were levied on the site value alone, it would still be a transaction tax and would still impede the transactions needed to bring housing to market, making housing less affordable.

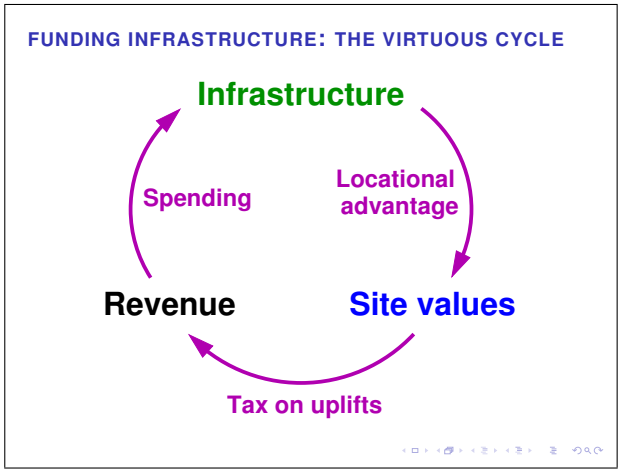
But if stamp duty were payable by the *seller*, and proportional to the *real increase* in the site value since acquisition, it would have the *substance* of a *holding tax*, because the tax liability would accumulate during the period of ownership and would only be *realized*, not created, by the sale. The modified duty couldn't make an otherwise profitable resale unprofitable, and couldn't increase a loss. So the tendency to impede sales would be much reduced, and sites would more readily come onto the housing market, improving the bargaining positions of tenants and buyers—the more so because the modified duty would reduce the attractiveness of capital gains relative to current income, so that owners would seek income by building houses and offering them to tenants or buyers.



The **third principle** has two parts. If we must have subsidies, or even "tax expenditures", then the equivalent of taxing sites instead of buildings is to *subsidize buildings instead of sites*. So that's the first part.



But in the end, the supply of buildings can be increased only by *construction*, not by the mere acquisition of existing buildings. So the second part is to target new construction. If we offer the subsidy for *new buildings* but *not* for previously occupied buildings, that will encourage builders because they'll know that prospective buyers will have an incentive to prefer new buildings. So that'll do the job.



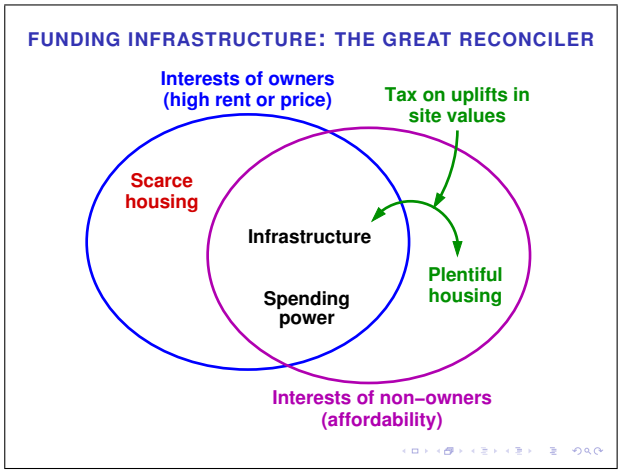
The **fourth principle** is the long-anticipated connection between affordability and *infrastructure*. If site values absorb capacity to pay, and if the presence of infrastructure confers an advantage on sites in certain locations, then people will be able to pay more for those sites. So they will. And the **locational advantage** is *entirely expressed in site values*—not the values of any buildings, because the value of a building is limited by the cost of constructing an alternative building, whereas a site has a location, and therefore a locational value, even if no building yet occupies it.

Furthermore, the benefit of an infrastructure project can be measured only by the price that people are willing to pay for it, and whatever part of that price is *not* paid in **user charges**—fees, fares, tolls, and so on—is paid for access to *locations* that benefit from the project—in other words, site values.

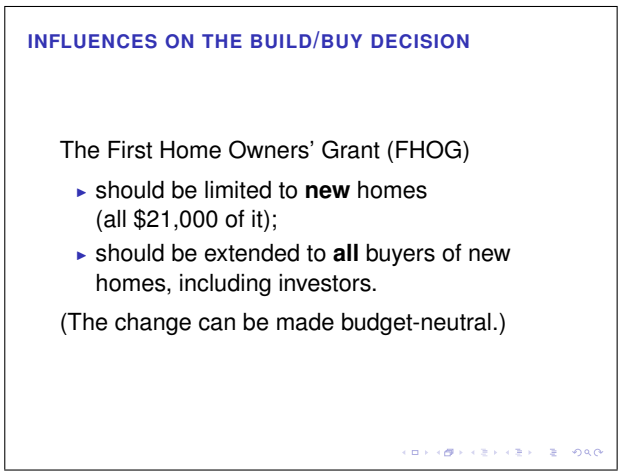
Therefore, if the benefit of an infrastructure project exceeds the cost, whatever part of the cost is *not* covered by user charges can be covered by taking back a sufficient fraction of the **uplift** in site values.

Conversely, if a government, through the tax system, claws back a fraction of all uplifts in site values, it has an incentive to invest in infrastructure that *increases* site values. This is clearly to the advantage of the site owners, who retain the rest of the uplifts. And crucially, these uplifts *don't* damage affordability, because they reflect greater amenity, not higher rents or prices for *given* amenity.

So the fourth principle is: Finance infrastructure by taxing uplifts in site values. And which taxes are suitable for that purpose?



The ones that satisfy the first two principles: **holding taxes on site values**—the ones that improve the bargaining positions of renters and buyers, and therefore make housing more affordable on balance, *even if nominal rents and prices rise* due to better infrastructure. By preferring holding taxes on site values, we can reconcile the owners' desire for higher nominal values, due to infrastructure, with the renters' and buyers' desire for a stronger bargaining position, due to more supply.



The third principle was that subsidies or tax concessions should be directed at new construction, not sites or existing buildings.

The present "**negative gearing**" deduction, and the 50% **discount for capital gains**, and the first $14,000 of the **First Home Owners' Grant**, all violate this principle, not only because they (unavoidably) apply to sites along with buildings, but also because they're available for *old* buildings. The second fault is easily fixed.

In the case of the First Home Owners' Grant, the whole of the grant should be available only for new homes.[2] But having been limited to *new* homes, it could easily be extended to *all* buyers of new homes, including investors, to stimulate the construction of rental accommodation. And because the grant is a fixed sum per dwelling, an investor would have an incentive to build a larger number of cheaper dwellings rather than smaller number of more expensive ones, so that the increase in supply would be concentrated at the entry level of the market, where it's needed.

Because *first* home buyers and *new*-home buyers historically account for similar fractions of turnover in the market, the change would be roughly budget-neutral, and could be made exactly so by adjusting the size of the grant.

[2] Due to a slump in construction after the introduction of the GST, Australia's economic growth was negative in last quarter of 2000. This result was released by the Bureau of Statistics on March 7, 2001, so that the Howard government had the rest of the month to do something to prevent a second consecutive quarter of negative growth (a technical recession). Within two days, the government introduced the Commonwealth Additional Grant (CAG). This was a temporary supplement to the First Home Owners' Grant (FHOG) and was available for new homes only. The following weekend there was a surge in attendance at new home displays. A technical recession was averted. After this emergency, if the government had been chiefly concerned about housing affordability, it would have phased out the original grant and kept the supplement. Instead, it phased out the good policy and kept the bad one. In 2008, in response to the global credit crunch, the Rudd government increased the FHOG, making $14,000 available for the purchase of any home and a further $7000 in the case of a new home. Again it took a looming recession to extract a targeted stimulus for construction; the housing problem alone was not enough. But on this occasion, the $7000 for a new home will not be enough to avoid recession.

Full deductibility of interest & expenses
("**negative gearing**")

- should be allowed for **new** homes but *not* for **future** purchases of established homes;
- could be allowed for share purchases in **new** floats but *not* for future purchases of shares in established companies;
- (for property) could be contingent on having a **tenant** in place.

(The changes would be revenue-positive.)

Property investors don't "provide" housing unless they *build new homes*, or cause them to be built. Those who buy established homes don't add to the overall supply, but merely turn homes for sale into homes to let. That doesn't address the overall shortage. It doesn't even address the shortage of *rental* homes, because the reduction in the supply of homes for sale throws potential owner-occupants onto the rental market.

So if the "negative gearing" deduction were really intended to stimulate the supply of rental housing, as advertised, it would be available for new homes but *not* for future purchases of established homes.

In case anyone offers the threadbare excuse that this would create a difference between taxation of property and taxation of shares—conveniently ignoring all the other differences—one could make a similar change for shares, allowing negative gearing for new floats, but not for future purchases of shares in established companies.

One of the present differences between property and shares is that deductibility of current expenses on an investment property is contingent on making the property available for rent. But it's *not* contingent on actually *having a tenant*. If it were, owners would be more conservative in their rent demands, to make sure they get tenants.

Discounting of capital gains

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- could be allowed for share purchases in **new** floats but *not* for future purchases of shares in established companies.

(The changes would be revenue-positive.)

Discounting of capital gains could also be limited to new homes; and again, if you want it, there's an equivalent reform concerning taxation of shares. And these changes, like the changes to negative gearing, would have a positive impact on the budget.

SPECIFIC TAXES...

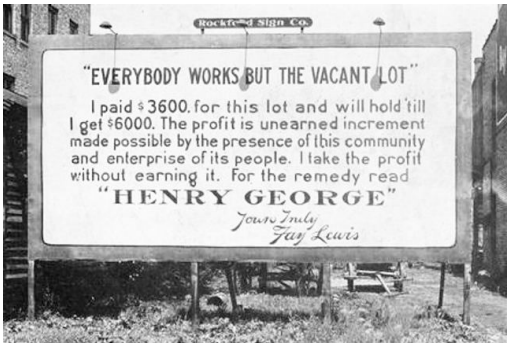
GST : **G**rossly **S**crewed-up **T**ax?

For a brief summary, see the CD-ROM. For more ideas, Google on "*How the Left could learn to love a retail tax*".

In the program I promised to say something about the **GST**. I almost wish I hadn't, because proposing a line of reform almost requires a separate paper—and indeed I've written an article, which you can find online by searching on the title. For the moment I'll just note that there are three basic ways to understand the GST: a Goods & Services Tax, or a Value-Added Tax, or a consumption tax. But whichever way you conceptualize it, the way it applies to housing departs from the concept, and departs in such a way as to make housing less affordable! The main paper on the CD-ROM goes into slightly more detail on the contradictions in the present tax,[3] and the online article suggests an alternative.

[3] "If the GST is understood literally—as a **Goods and Services Tax**—then homes should be zero-rated because they are not goods or services. But in fact new homes are fully taxable. This tends to reduce the number built, hence the number available for rent. If the GST is understood as a **Value-Added Tax**, as it was called by its European inventors, then it should apply to all capital gains on real estate. But in fact it does not apply to capital gains on second-hand homes. This increases the competitive advantage of repeat buyers relative to first-time buyers (who have no capital gains to spend), and increases the attractiveness of capital gains relative to rental income, so that owners are more likely to leave properties off the rental market. If the GST is understood as a **consumption tax**, then it might well provide a rebate for essential items such as homes. Indeed the FHOG was originally meant to compensate for the GST; but the FHOG was payable to first home buyers for new and established homes, whereas the GST is applicable to all buyers of new homes only—as this writer claims that the FHOG *should* be! A 'consumption' tax might also apply to the *holding of irreplaceable assets* such as sites, with the result that site owners would need to generate income from the sites; but the GST does not."

LAND TAX STOPS THIS!



[digitalgallery.nypl.org.]

When this sign was written, probably just over 100 years ago, there was apparently no such creature as a dole bludger. But there *was* such a creature as a land bludger. **Land tax**, most famously advocated by Henry George, makes it uneconomic to hold land idle for speculative purposes. Indeed Prof. Cord reports (and I quote):

> After Pittsburgh increased its land-tax rate (but not its building tax rate) in 1979 and again in 1980, its construction increased fully 6.2 times faster than U.S. construction during the same period of time. [Unquote.]

Land tax is like site-value rating: it's a pure holding tax on site values, and therefore tends to *reduce rents and prices* by pressuring owners to seek tenants or sell their sites. The tax can't be passed on to tenants in higher rents, because it's not a cost of *letting* the land, but only a cost of *owning* it.

It's not like sales tax. A *sales tax* can be shifted onto the buyer because the tax is a cost of selling. The seller holds out until someone offers a sufficient price to cover the tax, and is *able* to hold out because the tax isn't payable until the item is sold. *If* the tax were payable whether the item were sold or not, then the seller might be forced to sell in order to pay the tax, and the selling pressure would tend to *reduce* prices. And that's how land tax works; it's payable whether the land is let or not, and therefore creates pressure to let, which tends to reduce rents.

No reputable economist says that land tax is passed on in higher market rents. Some economists *do* claim that because land tax exempts owner-occupied residential land, it induces sales of rental homes to owner-occupants and therefore reduces the supply of homes to let, raising their rents. This claim seems to forget that demand, like supply, can move from the rental market to the owner-occupied market. But even if the claim is true, it only means that rents are higher than they would be if land tax were extended to owner-occupants; it *doesn't* mean that rents are higher than if there were no land tax at all. And it doesn't mean that a tax increase causes a rent increase, because a tax increase makes it harder for owners to tolerate vacancies.[4]

So property investors can't pass on land tax in higher rents. So they don't like it. So they campaign against it—by pretending that they *can* pass it on! I quote from a press release dated 7th November 2008:

> Landlords will pass on to tenants, the people who can least afford it, the 25% increase in land tax proposed by the Rees Government. [Unquote.]

Municipal rates, which should be on site values, have been polluted by vested interests. Even in Queensland and NSW, where site-value rating is mandatory, there are *defacto* building taxes disguised as "**service charges**" of so much per year per dwelling, or per some other unit related to a dwelling.

But just in case there's any decency left at local or State level, one of the papers on the CD-ROM (or aulvrg.blogspot.com[5]) explains how a council could *change to site-value rating without creating winners and losers in the transition*. It requires a slight modification of the site-value system, but retains the essential feature that *building doesn't increase the rates bill*.

SPECIFIC TAXES (CONTINUED)

Conveyancing **stamp duty** could be

- replaced by land tax (economically sound, politically risky); *or*
- apportioned to the **unearned increment** in the site value and (nominally) payable by the **vendor**.

I've already explained that stamp duty, if we must have it, should be *payable by the vendor* and *proportional to the real increase in the site value* since acquisition.

Does that mean the burden would be shifted from buyers to sellers? No, actually. Think of the GST: it's payable by the seller, but nobody thinks the seller bears the whole burden. If a transfer tax is payable by the *seller*, the seller will try to *add* it to the price. If it's payable by the *buyer*, the buyer will try to *subtract* it from the price. In the end, the tax will be shared between the buyer and the seller in inverse proportion to their bargaining power, regardless of who nominally "pays" it. The modified stamp duty is payable by the seller simply because the seller already knows what the site value was at the time of acquisition,

[4] Similarly, a land-tax exemption or reduction does *not* lead to lower rents, but rather makes it easier for owners to hoard vacant properties—*unless*, of course, the exemption or reduction is *conditional on having a tenant in place*, in which case landowners will build houses and seek tenants in order to get the tax advantage. But strangely, those who demand land-tax exemptions and reductions never ask for any such condition to be attached.

[5] This address is out of date; see blog.lvrg.org.au instead.

and is therefore better able to estimate the tax. It's a matter of convenience and transparency.

SPECIFIC TAXES (CONTINUED)

Lump-sum **infrastructure levies** on developers could be

- replaced by land tax (economically sound, politically risky); *or*
- payable on resale of each lot, and apportioned to the **unearned increment** in the site value

(where "unearned" means net of costs).

Property developers claim that lump-sum **infrastructure levies** are "passed on" in prices of new housing lots. What they don't tell you is that the market value of land is raised by *permission to develop it*, and raised again by the *public provision of infrastructure* upstream or downstream of the new estate. So the infrastructure will raise the prices of developed lots, whether the developers contribute to the cost or not. And of course they'd rather not.

But in fairness to developers, under the present arbitrary system, there's nothing to stop the levies from being so high that they make development unviable, in which case development will be delayed until prices rise enough to cover the levies.

That scenario is easily prevented by reforming the levies along the lines that I've already suggested for stamp duty.

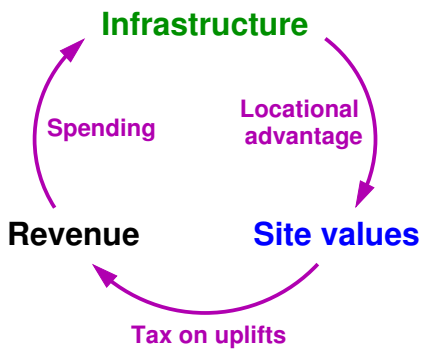
SPECIFIC TAXES (CONTINUED)

Payroll tax could be

- replaced by land tax (economically sound, politically risky); *or*
- replaced by the redesigned stamp duty (proportional to the unearned increment, payable by the vendor).

Construction involves labour. So **payroll tax** obviously impedes construction and inflates its cost. You can't modify payroll to make it harmless; you have to replace it with something else. And one possible candidate is the modified stamp duty. For Victoria, I've seen a rough calculation suggesting that a rate of 20% of the real increase in the site value would replace the old stamp duty, while 37% would replace both the old stamp duty and the old payroll tax.

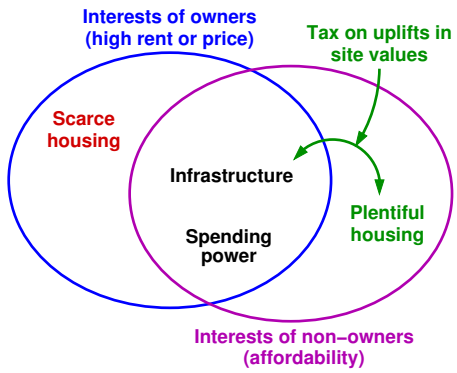
WHAT SMART PROPERTY OWNERS WANT...



My story has a lot of villains, but it ends on a conciliatory note.

Property owners want infrastructure, and the surest way to give it to them is to pay for it by recycling some of the resulting uplifts in site values, leaving the rest of the uplifts as a net gain for the property owners. This is *not* a tax increase for the purpose of paying for infrastructure; it's a redesign of the tax base, so that *future* investment in infrastructure pays for itself by expanding the tax *base* without any further changes in tax *rates*.

...ALSO HELPS BUYERS AND RENTERS



The kinds of taxes that are suitable for "recycling" also happen to provide incentives, or remove disincentives, for site owners to build accommodation and offer it to tenants and buyers. This improves the competitive positions of tenants and buyers, so that when *all* variables are considered, housing is more affordable.

Thank you, Mr Chairman.