

The ongoing property boom in Sydney and Melbourne, have spurred the ongoing question of housing affordability and the role of the government in addressing this issue. Australia has faced an unrelenting wave of real estate speculation, which has driven the median house price to median disposable income ratio to record highs^[1]. The property boom has placed increasing pressure on Australian businesses and landless families who are battling with the rising unaffordability of living expenses. Political pundits and the news-media were quick to place the blame on the supply of housing and the lack of development of 'higher-density' urban planning. Alternatively, environmentalists have criticised rising urbanisation and the resulting urban sprawl. Nevertheless, these arguments fail to acknowledge two underlying facts: the supply of land is fixed, and it is land, not structures, that appreciate in value.

Unlike capital, land does not depreciate and does not require maintenance to maintain its value. The value of land is derived solely from its economic potential and thus location. In effect, land value is dependent on public infrastructure in its surrounding area and from the activity of other people. Landowners gain an unearned income from the benefits of their vicinity^[3]. As a result, investors have become more focused on realising capital gains than developing a productive business, leading to unused land and vacant lots. Urban sprawl is also worsened, ultimately resulting an economic distortion where valuable land lies unused whilst productive businesses operate far away from major economic centres. A solution to this problem is a tax on the value of land (LVT) and a gradual removal of transfer (stamp) duties in the property market^[6].

Although Australian states do currently administer a form of land tax, this system has become spoiled through persistent lobbying by various interest groups. The introduction of LVT is a progressive system that that disincentivises the inefficient use of land and raises the cost of speculation^[2]. Additionally, LVT avoids the market distortions caused by the current transfer duty system.

Stamp duty depresses economic activity and raises economic transaction costs. A 2010 Treasury Report^[4] emphasised the inefficiency of stamp duty, noting it was due to its discouragement of commercial and residential property transactions. It is also unequitable to people who are forced to move more as they bear more tax, disincentivising movement and preventing free transfer of labour, worsening congestion in cities and lowering productivity. The effective tax rate of stamp duty also falls with occupancy duration; resulting in a system that is complicit in the current buy-and-hold real estate speculation market.

Stamp duty effectively disincentivises productive activities and generates a dead-weight loss (DWL) in the economy with the seller bearing most of the tax burden. This DWL is the result of a tax on property and not land, wherein the supply of property is fluid whereas the supply of land is fixed. This DWL is summarised in Appendix A.

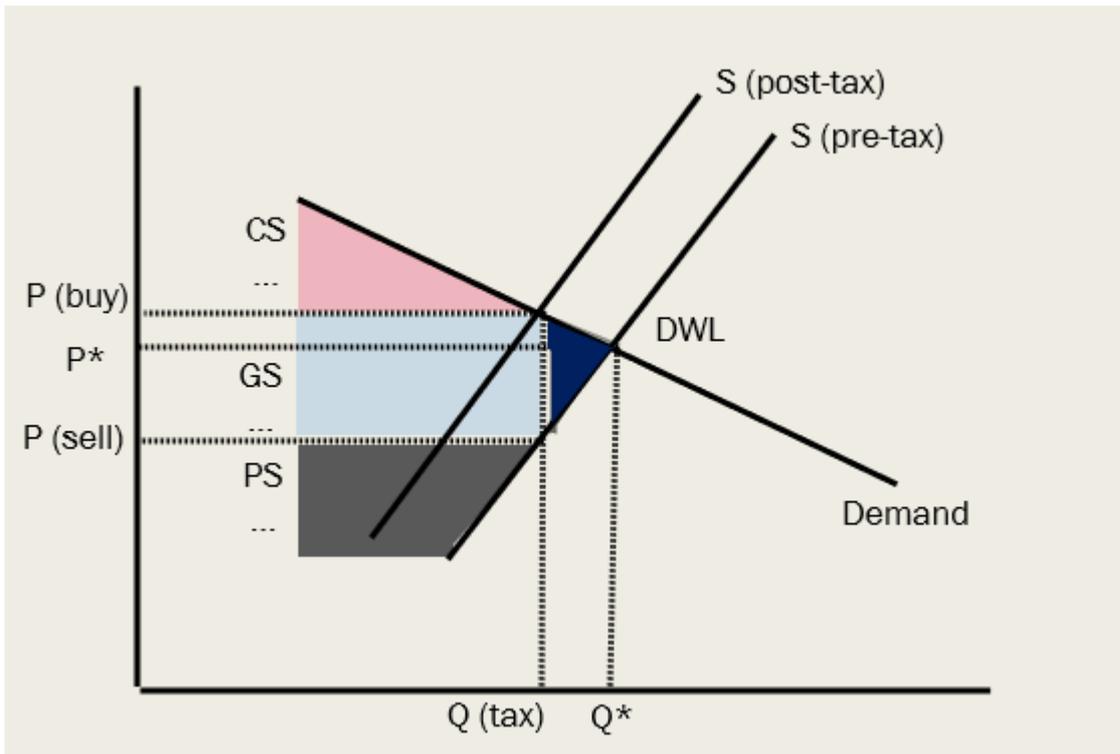
On the other hand, taxation of land does not distort economic activity. As the supply of land is perfectly inelastic, a tax on land results in no DWL for society (see Appendix B). This effect has been well documented in economic literature, whereby a well-designed proportional tax on the value of land has no impact on allocative efficiency. Furthermore, a LVT can help offset market failures resulting from inefficiencies in capital markets. Currently, higher-capital market participants can acquire capital more cheaply, resulting in a comparative advantage in holding assets. Gaffney (1973)^[8] highlighted that land value taxes displace interest costs of holding land in the capitalisation process and would result in a reduction in the comparative advantage of these entities. This leads to a more equitable property market. Higher-capital market participants would be forced to enact economic development on their land holdings to offset the tax, leading to more efficient resource allocation. Investing in land is disincentivised, drawing savings towards more productive investments^[7]. Thus, a LVT decreases investor demand for land and decreases vacancy rates - lowering property prices and increasing housing affordability. Based on these factors, a LVT has the potential to become a better than neutral taxation system.

Land value tax also promotes equality in the distribution of property. Greater and more valuable land-holdings are disproportionately owned by ratepayers with greater ability to pay, as a result a tax on land fosters vertical equity. This accurately targets the far greater issue of wealth inequality (See Appendix C & D). Additionally, land taxes will ultimately allow for cuts in other more detrimental forms of taxation, thus allowing for greater economic efficiency. Administratively, collection of LVT is low-cost because, unlike profit, land cannot be easily hidden or expatriated.

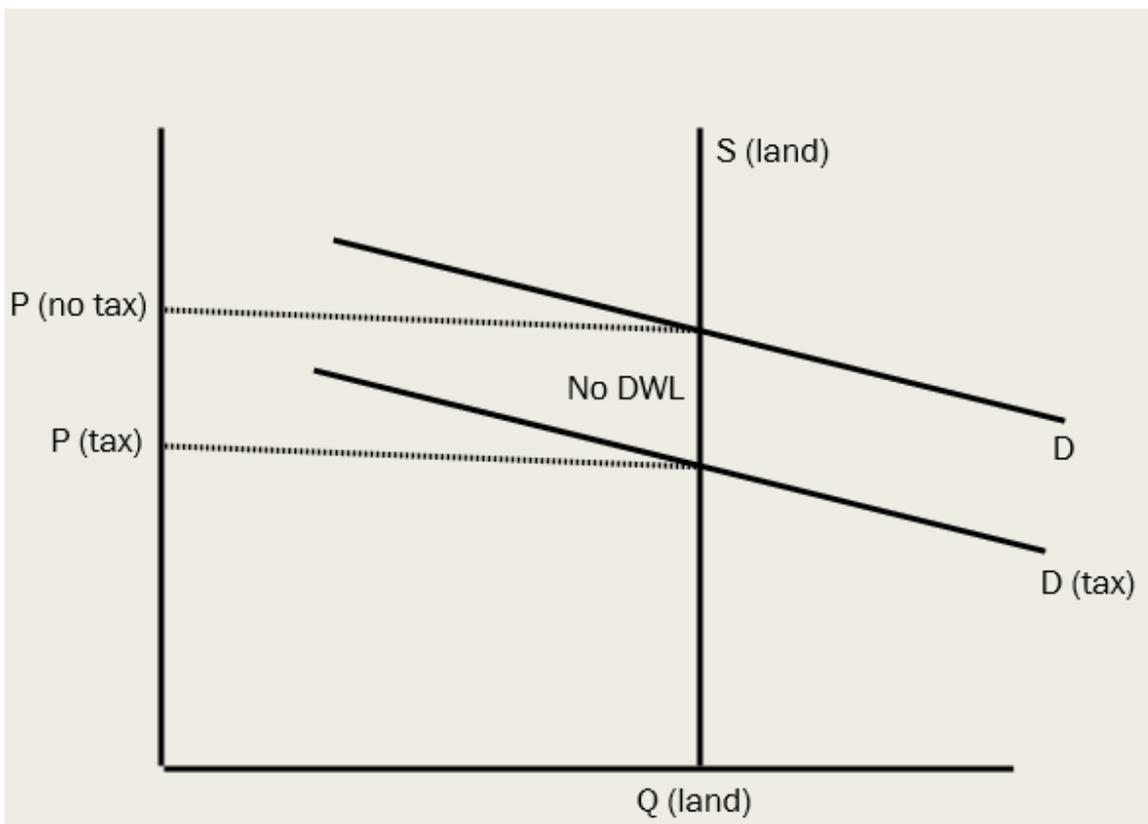
As a result, an expansion of the current LVT system should be pursued, with the ultimate removal of transfer duty. A proportional tax rate system would improve allocative efficiency and generate social gains. Furthermore, the LVT system should be structured to place no liability on most agricultural and other low-value land. Conversely, higher-value land should be taxed at differentiated rates based on the prevailing per-square-metre value.

The most significant challenges facing the implementation of LVT is public perception and the development of an equitable tax rate. Introduction of a land-tax system would be met with unconstrained opposition from landowners, who are likely to label the system unfair. A common argument against LVT is that it is a confiscation of benefits received from an asset that was purchased out of the landholder's taxed income, however, these benefits are unearned gains, the result of positive externalities and not the landholder's own economic input. Arguably the largest challenge stems from drafting an equitable LVT policy that allows some concessions for lower-income earners and low-value land and managing an effective transition away from the stamp duty. By replacing stamp duty with a land value tax, outcomes for government, taxpayers and market participants can be improved. Overall economic efficiency can be enhanced, resulting in greater housing affordability, improved allocative efficiency and a better tax system.

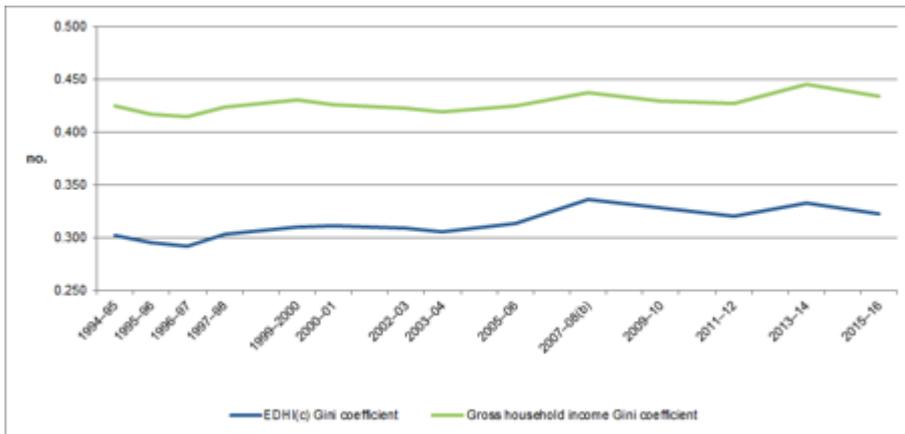
Appendix A Market Effect of Stamp Duty



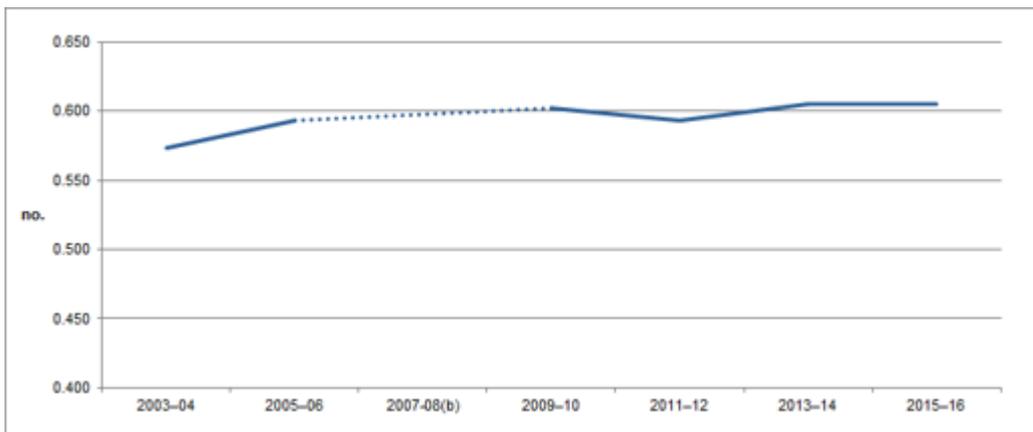
Appendix B Market Effect of LVT



Appendix C Income Gini Coefficient



Appendix D Wealth Gini Coefficient



Appendix E Reference List

- [1] Smith, R. (2015). *A Land Value Tax could fix Australasia's Housing Crisis*. Retrieved 15th of August from <https://theconversation.com/a-land-value-tax-could-fix-australasias-housing-crisis-49997>
- [2] Crowley, F. (2017). *How a land tax could solve many economic headaches*. Retrieved 15th of August from <https://www.rte.ie/eile/brainstorm/2017/1017/912913-how-a-land-value-tax-could-solve-many-economic-headaches/>
- [3] E.S.L. (2015). *Why Henry George had a point*. Retrieved 15th of August from <https://www.economist.com/free-exchange/2015/04/01/why-henry-george-had-a-point>
- [4] Department of the Treasury. (2010). *Australia's Future Tax System*. Retrieved 15th of August from http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/Publications/Papers/Final_Report_Part_1/preface.htm
- [5] Deloitte Access Economics. (2015). *The Economic Impact of Stamp Duty: Three Reform Options*. Retrieved 15th of August from <https://www2.deloitte.com/au/en/pages/economics/articles/economic-impact-stamp-duty-reform-options.html>
- [6] Hilber, CAL and Lytikainen, T (2012) "Stamp duty and household mobility: Regression discontinuity evidence from the UK", London School of Economics and Political Science.
- [7] ACIL Allen Consulting. (2016). *Land Rates: An Economic Assessment*. Brisbane.
- [8] Gaffney, M. (1973), "Tax Reform to Release Land" in Clawson, M. (ed.), *Modernising Urban Land Policy*, Baltimore: Johns Hopkins University Press; pp. 115-151; reprinted in Wenzer, K. (ed.), *Land Taxation: The Equitable Source of Public Finance*, London: Shepherd-Walwyn, 1999, pp. 58-99.