UNTAXING SHELTER

Submission to the Inquiry in to First Home Ownership

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Excise - A hateful tax levied upon commodities

Samuel Johnson, Dictionary of the English Language (1755)

Housing is a composite product of land and buildings. As Adam Smith and John Stuart Mill recognised, it is not possible to analyze the impact of taxation on housing without carefully distinguishing between the impact of taxes on land as opposed to those on buildings. It is also necessary to distinguish between transfer taxes, holding taxes and income taxes.

It is not possible in a short submission to canvass the full history of the theory of land value taxation and I must refer the Commission to my Harvard PhD thesis *A History of the Theory of Land-Value Taxation*, a copy of which is deposited in the National Library of Australia.

The short answer to the Commission's questions on taxation and housing is as follows:

> *All taxes on land or buildings, except holding taxes on the unimproved value of land which do not vary with its use, must increase the cost of housing.*

To understand why this is so, one must grasp the concept of a "lump sum" tax. The essential idea behind a lump sum tax is that no behavioural response of the taxpayer can alter the tax burden. Only a lump sum tax is truly neutral. Other taxes produce what is called an "excise effect" as the tax drives up the price of a good or service and thereby imposes a burden on the consumer.[1]

Taxonomy of land and building taxes

Before applying this concept, it is necessary to set out a taxonomy of land and building taxes.

Building taxes

- Income taxes
    - Taxes on actual (not imputed) rent
- Construction & transfer taxes

Stamp duties
Building approval levies by councils
GST
Capital gains tax

Holding taxes

Rates on improved value

Land taxes

Income taxes

Taxes on actual (not imputed) rent

Transfer taxes

Stamp duties
Developer levies
GST
Capital gains tax

Holding taxes

Rates on unimproved (site) value
Land tax

Comments on economic effect of taxes

The following comments do not pretend to be exhaustive analyses but are directed to explaining why and how various taxes may adversely affect the supply of housing services to consumers, including first home buyers.

Building taxes

Income taxes

Taxes on actual (not imputed) rent

Such taxes are not lump sum taxes. They can lead to behavioural responses and higher costs of housing..

In the long run, taxes on the rent of residential buildings must be passed on to tenants as consumers. Investors in buildings must expect to get the going rate of return on capital invested in new buildings and owners of old buildings would expect to get the going rate of return on new investment as these buildings are replaced or refurbished. The going rate of return on capital

> investment in a small country such as Australia will be largely determined by international capital markets.
>
> Apart from this long-run effect, any increase of taxes on actual rent may be met by investors with a shift of their capital from rental use to owner occupation. Calls for removal of negative gearing of real estate investment overlook both this theoretical possibility and the practical experience of the 1980s which showed that investors in residential housing might respond in this way. In short, while first home buyers may *temporarily* benefit if investors were forced to dump existing housing stock, in the long run higher net income taxation of residential rents is not in the interests of renters, including those who are trying to save for home purchase.

Construction & transfer taxes

Unlike land, buildings can be constructed. As taxes on building construction are usually levied as transfer taxes, the two are discussed together here. The essential point is that taxes on the construction of a building or on its handover by the builder to its owner or upon the builder prior to construction will all be passed on to the building purchaser or user. This is because, in the long run, profits on capital, and wages of labour, employed in the building industry cannot be kept below returns available to labour and capital in other industries.

It is sometimes suggested that transfer taxes such as GST or stamp duty can be passed backwards to land developers and therefore are borne by the landholders whose land is purchased for development.[2] This is a profound mistake in analysis. A transfer tax is *not* a lump sum tax - it *does* distort inter-temporal housing and land availability. Because a transfer tax only applies when land is transferred it can be avoided by the simple expedient of not selling. Transfer taxes such as stamp duty, GST and CGT all therefore create "lock in" effects.[3] The vendor has the choice of selling now or later - thereby deferring tax. Just as a tax on land in one use but not in another use can create "excise effects" so a tax on land sold now but not on land unsold can create incentives to speculative holding of land off the market till the price rises sufficiently to reward the landholder.

An elegantly expressed argument in favour of a swap from stamp duty on land to a land tax on holding land was given by John Stuart Mill, who wrote "All taxes must be condemned which throw obstacles in the way of the sale of land, or other instruments of production. Such sales tend naturally to render the property more productive. A seller, whether moved by necessity or choice, is probably someone who is either without the means, or without the capacity, to make the most advantageous use of the property for productive purposes; while the buyer, on the other hand, is at any rate not needy, and is frequently both inclined and able to improve the property, since, as it is worth more to such a person than to any other, he is likely to offer the highest price for it. All taxes, therefore, and all difficulties and expenses, annexed to such contracts, are decidedly detrimental; especially in the case of land ... too great facilities cannot be given to enable land to pass into the hands, and assume the modes of aggregation or division, most conducive to its productiveness. ... All taxes on the transfer of land and property should be abolished; but as the landlords have no claim

to be relieved from any reservation which the state has hitherto made in its own favour from the amount of their rent, an annual impost equivalent to the average produce of these taxes should be distributed over the land generally in the form of a land tax."[4]

Stamp duties

As John Stuart Mill recognized, stamp duties on sale of houses and land are detrimental to the interests of purchasers (and sellers). They are not lump sum taxes, as they may be avoided by the expedient of not selling or, so far as the building component is concerned, by allowing the value of the property to depreciate. The (Harvey) Victorian Review on State Business Taxes was (rightly) unimpressed by stamp duty and recognized its distorting consequences.[5]

Building approval levies by councils

In recent years, local government councils in Sydney have used development approvals for renovations or house extensions as a form of taxation, the fees demanded no longer bearing any real relation to the cost of any service required by homeowners. These levies may be seen as transfer taxes on the delivery by builders of extensions to homeowners, just as stamp duty is a tax on the delivery of a new home by a builder to a homebuyer. In both cases, there is an adverse excise effect on the purchaser. To the extent that building approval levies increase the cost of improving the existing housing stock, first home buyers are disadvantaged - the choice of buying an existing dwelling and improving it is rendered more costly.

Clearly such taxes on habitation are not lump sum taxes and force people to either make do with less or, in some cases, abandon the idea of extending altogether.

GST

Although the GST is supposed to be a tax on goods and services or on final consumption, it is also imposed on transfers of real estate in many situations[6], such as the development and sale of new housing estates. In this regard, the GST is just like a Federal stamp duty and has similar excise effects on homebuyers. However, unlike stamp duty, GST is not payable on sales of existing homes by homeowners and, in the case of first home buyers, the adverse "excise effect" of the increased tax burden on building and construction costs has been mitigated to some extent by the first homebuyer's grant (better seen as a tax offset than a "subsidy").

Clearly, GST is not a lump sum tax on housing as its quantity depends on the value of new house construction and may be expected to be "passed on" to the purchaser, like stamp duty and developer levies, as the homebuilder has the ultimate option of deploying his capital in another trade.

Capital gains tax (CGT)

Although CGT is not imposed on owner occupied dwellings, it is imposed on sales of rental dwellings. Unlike stamp duty or GST, capital gains tax is computed on a "net gain" rather than "gross sale value" basis. It therefore operates like a variable transfer tax or sales tax with like excise effects.

Holding taxes

Rates on improved value

In some States, local government rates are assessed on improved land values and, to that extent, are taxes on buildings. One can view a holding tax on a building as an excise tax on its creation. For example, at a 10% discount rate, a 2% annual tax on building value is equivalent to a 20% tax on handover on construction. Fortunately, most States have abandoned the pernicious policy of taxing buildings or improvements.[7] In New South Wales, rates on buildings were abolished by the Carruthers Government in 1906, as a very sensible measure to avoid the perpetuation of slums. New York City's slums are, in part, due to its perverse policy of taxing buildings.

These taxes are not lump sum taxes and produce behavioural responses (such as allowing buildings to fall into dilapidation). They reduce the quality and quantity of building stock available to renters and homebuyers.

Land taxes

Income taxes

Taxes on actual (not imputed) rent

Although a tax on the economic rent of land has, since Ricardo's time and before, always been regarded as a neutral tax, the income tax on *actual*, received, rent is not such a tax. First, income tax on land rent is a tax on *net* income which can be affected by deductions such as interest on borrowings or losses. Second, the income tax no longer taxes imputed rent (if it did, it would have to extend so-called "negative gearing" to homebuyers). Third, taxation of rents may be affected by tax treaties. Essentially, an income tax only taxes land rent when land is rented out but not when used by the owner occupier. This bias against making land available to renters may be offset (in an arbitrary way) by "negative gearing" (loss yield situations). An income tax cannot be considered as a true tax on economic rent which is non-distorting.

Transfer taxes

Stamp duties
GST

These are taxes on turning land over to a new owner to put it to better use. They must therefore lower the productivity of land, including land for housing

Capital gains tax

Although the statistics do not break out capital gains tax collections as taxes on land or buildings, the economic reality is that buildings depreciate in real terms. If a capital gains tax is imposed (as a logical tax would be) only on real, rather than nominal, gains it could be generally assumed that the capital gains tax was a tax on transfers of appreciating land, not on buildings. Although it is sometimes suggested that the 50% capital gains tax "concession" has driven up land prices, such comments ignore the fact that the 50% CGT "concession" was merely a replacement for indexation and averaging. More importantly, such comments do not understand that land prices are pushed up by transfer taxes in the first place, *not by their absence or partial remission*. Because transfer taxes such as CGT are imposed on a realisation basis, the landholder can "hold out" and pass the tax on by refusing to sell until prospective purchasers meet his price. This, at least, is the position in the normal situation of a growing economy and, unless the vendor is financially distressed, he can usually ride out temporary periods of depressed demand.

Developer levies

As noted above, all these taxes can be passed on to homebuyers and renters.

In regard to developer levies, a disturbing tendency has been the increased resort to "upfront" user charges or developer levies to finance the cost of long-lived infrastructure which benefits more than the immediate user in space or time.

What has been forgotten in the rush to embrace "user pays" is that the correct economic prescription is "beneficiary pays". Where an asset such as a dam or reticulation system adds value to land both now and in the future it is sensible, rational and optimal to eschew upfront user charges (on young homebuyers, for example) and use loan finance with the loans to be amortized by rates charged on the value of the land benefited by the infrastructure.[8] This simple approach was the basis of Australian local and semi-government finance for decades and conforms to Harold Hotelling's prescription in his famous article.[9]

It is somewhat sad that Australia's land value rating system of financing

public works which enjoyed the endorsement of such eminent economists as Harry Gunnison Brown, Harold Hotelling and William Vickrey has been so carelessly abandoned in favour of less efficient and less equitable user charges (which in many cases amount to double charging[10] and bear particularly hard on young families who face infrastructure charges much heavier than their parents did). A country which has not the wit to recognize its own better experiments is not a particularly clever country.

Holding taxes

Land tax

In theory, State land taxes should be something like a lump sum tax. In practice, they are better described as corrupted land taxes. They are not lump sum taxes for 2 reasons - the exemption of owner-occupied housing and the principle of aggregation for rate progression. Existing land taxes are not neutral in that they discriminate against renters (the option of selling to owner occupiers can allow owners to pass on the land tax to renters). They also generate distortions in ownership (witness the intricate "land-rich" company provisions.). If land tax were imposed without regard to the use of the land and without regard to other parcels of land held by the owner, it would be a non-distorting lump sum tax. Unfortunately, it is not. Part of the resentment against land tax seems to arise from the fact that it is now seen (rightly or wrongly) as a selective "envy" tax, rather than a general tax such as a rate which calls upon all to contribute to common expenditures on an equal footing.

Rates on unimproved (site) value

Rates on the unimproved (site) value of land are, however, nearly as close as we can get to a true lump sum tax which does not distort the supply of housing or push up prices of housing to families. Why is this so?

First, rates on site values exempt improvements - there is no excise tax imposed on *dwellings*.

Second, rates on site values cannot be avoided by leaving land idle or withholding it from the market (as can transaction taxes such as stamp duty, CGT, GST etc). The rates force the landholder to think about putting the land to its highest and best use because they reflect market values (what other prospective owners might want to do with the land).

Third, unlike avoidable taxes (and because they cannot be avoided), onerous rates are capitalized in lower market prices for land. The landholder who sells to a new homebuyer cannot pass on the burden of rates - the purchaser discounts the net burden of rates and makes allowance for rates in the purchase price. To the extent that rates are capitalized in a lower market price

for land, the young homebuyer is relieved of the need to borrow so much - he pays rates in lieu of - *and not in addition to* - interest on his housing loan.

When are rates not really taxes at all?

This brings us to the question of beneficial rates, discussed in Marshall's *Principles of Economics* and in recent literature on the "Henry George Theorem"[11] or the "George-Hotelling-Vickrey Theorem".[12] An insight of Henry George was that public works can be funded from the land rents they create. Vickrey and Stiglitz (who called this result the "Henry George Theorem") demonstrated that, under certain conditions, a tax on site rents could cover the cost of public goods as the benefits of the expenditure were capitalized in land values. Other economists have also explored the theme.[13]

The basic intuition is simple. Essentially not all taxes are bad - or even true taxes. A rate on land values, levied to pay for construction of roads, water, gas, electricity reticulation systems, phone lines or local public services, adds value to the lands serviced - the land captures the value of the external benefits provided by the infrastructure. Hence a land value rate is a *natural access charge* to finance the "access deficit" which arises when infrastructure is priced at optimal marginal cost to users.[14]

It is the failure of recent government policies to understand the basic economics that land is not capital and that land captures externalities by virtue of spatial location which has led to an erroneous policy of pegging or reducing rates in favour of loading more and more user charges on young homebuyers and others. When Sydney councils shifted from rates finance to user charges for garbage collections, Elizabeth Bay properties enjoyed substantial rates reductions - and market prices jumped accordingly. Similarly when water rates ceased to be based on land values, the windfall of rates reductions was capitalized in higher market prices. No one can avoid a rate - it will be reflected in the value of his land, but if a State government is so foolish as to shift local government finance away from land onto "users" the waived rates are immediately capitalized into higher market prices for land.

Marginal cost pricing and lump sum financing of infrastructure

One of the most celebrated problems in economics is the problem of financing economically efficient marginal cost pricing. Harold Hotelling in his famous 1938 *Econometrica* article explicitly pointed out that land taxes could cover fixed infrastructure costs allowing pursuit of marginal cost pricing where there was unused capacity over a spatial network such as railway system or an electricity transmission system.[15] Hotelling was scathing about the fallacies of "full cost recovery" from "users" when it came to infrastructure pricing and would be astonished to discover that Australia has shifted away from rating to finance fixed infrastructure costs towards a policy of "full cost recovery"[16] from homeowners, developers and their customers - often young homebuyers.

Inter-generational inequality of opportunity

Not only is the policy of full cost recovery of infrastructure costs from developers and homebuyers inefficient, it is also unfair. From an inter-generational equity perspective, what has been going on with the shift to "user charges"on inflated asset bases is a form of "pulling up the ladder" after getting on the ship (or, more precisely, into the property market). Another way of looking at it would be to say one generation is selling its children into debt slavery (to pay for things which the previous generation took as sunk costs previously financed by rates capitalized in land values).[17]

Macroeconomic influences on land values

It is rarely appreciated that much government spending sustains high land values. For example, the exemption of the family home from the assets test leads adult children to urge parents to remain in houses too big for their needs.[18] But if the taxpayer is financing the parent in the last years of life why should not the taxpayer recoup that subsidy by a charge registered on the house after the death of the survivor of a pensioner couple? Why should a young family with 4 children renting in Bankstown, hoping to save for a home, be asked to pay taxes to subsidize the inheritance of a North Shore residence by a couple of adult professional children. One can oppose death duties bitterly while being equally against the idea that taxpayers should be asked to subsidize inheritance *de facto*. Every dollar taken in tax from a renting working family to subsidize pensioner occupation of outsize homes is a dollar less they have to save for their own home (and a dollar capitalized tenfold in a higher price of the housing they are saving for).

In like manner, many other public spending programmes (such as suburban railway deficits) sustain land values. Users and taxpayers often so add value to lands they do not own and will never own.[19] Even more to the point, trying to finance infrastructure by selective and ad hoc charges on "users" or just on a few developers actually hurts landholders because infrastructure is under-used or not built to optimal capacity - leading to partial sterilization of the land's real potential. As Hotelling realized, it is better for *all* landholders to contribute ratably to a common infrastructure project than leave their lands unserviced, unusable and unrentable.

Centralization and over-urbanization

So far, little attention has been paid to whether, taken as a whole, modern tax-transfer systems create an inbuilt bias to unhealthy over-centralization of population and markets into massive conurbations.

Since before World War II, Australia has seen the relative and absolute decline of many regional population centres and smaller towns. Could it be that the overall fiscal system has had a pervasive influence in distorting the spatial pattern of economic activity, driving population ever more into the great cities and sending house prices ever higher?[20] What natural economic laws can explain why Sydney is heading for more than 4 million people while, say, Newcastle, Bathurst or Lismore remain so small by comparison?

This writer has never seen a thorough study of fiscal impacts on population distribution but wishes to suggest it is a field crying out for close study. On the face of it, any income tax system based on realized money income must discriminate against working in remoter locations - the extra income required for children's education at boarding school or university is taxed rather than being accepted as compensation for locational disability compared to a standard suburban taxpayer. The regional manufacturer gets income tax deductions, it is true, for his higher freight and communication costs but his urban competitor does not get asked to contribute more to the fisc for the provision by society of a ready market of 4 million souls or hundreds of thousands of potential workers to hand.
On the face of it, one can see an argument that taxes based on income or sales (including GST) have an inherent anti-regional bias. By contrast a tax on site values would be lower in regional centres reflecting lower public service provision and less abundant social externalities. If I am to pay the same taxes as a manufacturer and employer if I succeed against the odds in a country town as compared with what I will pay if I succeed with the advantages of a metropolitan market, why should I take on the extra risk of locating outside a capital city? And if all think as I do, how will industry ever grow in rural and regional Australia?

These observations are offered not as definitive conclusions (time and space do not permit that here) but as a research agenda on a matter of vital social and economic importance. If it can be demonstrated rigorously that current taxes and spending programmes create a bias in favour of metropolitan over-expansion, then *a major macro cause of rising suburban land prices* will have been identified.

Intuitively, something does seem wrong. There is no shortage of land in Australia per head of population, but there is a shortage of land where jobs are to be had - that is, in our great cities. Solving this imbalance may hold the key to making housing affordable, while creating a healthier and more balanced lifestyle for the huddled masses of our cities.

The current New South Wales Premier, Mr Carr, appears to consider Sydney "too big" and he may well be right in that view. However, State Government policies to repress new land sales or to force urban in-fill[21] may only make a rabbit warren out of Sydney and send house prices soaring with an added, but politically manufactured, scarcity value.[22] Nor is it socially helpful or just to "blame" *foreign* migrants for crowding our cities - there has been massive internal migration into capital cities ever since World War II. The reality is that many city dwellers would happily leave the cities if they could be sure of well-paid work for themselves and their children, as well as health and educational facilities, in regional centres.

A fresh approach?

Clearly, housing is becoming a major social and economic problem. As was observed in Communist Eastern Europe, like birds, people do not breed without a place to nest - they need homes to raises families in. A housing affordability crisis can accentuate a demographic implosion. But an imploding population means an imploding economy and imploding treasuries.[23]

Governments need to -

$	get rid of transfer taxes which add to the cost of housing

$	use holding taxes such as rates to encourage land to come onto the market to be put to its best and highest use

$	use rating to expand the supply of serviced land by earmarking rates for infrastructure expansion and refurbishment.

What may really be needed is Federal-State fiscal co-operation to look at disincentives to regional urban growth so that the pressure on Sydney and other metropolitan centres is relieved *naturally* by growth and opportunities not being stifled elsewhere. Rather than making Sydney unattractive, unpleasant or unaffordable, policy should be looking to making regional centres viable places for employment and living. It should be a priority to re-shape Australia's fiscal system so that taxes better reflect a charge for the amenity of social goods rather than a penalty on enterprise.

If it be right to think that income and sales taxes tend to concentrate economic activity, whereas a rate on site values is neutral and does not penalize decentralization of economic activity, then it would make sense to shift Federal and State tax bases more towards the rating system. This could encourage decentralization, revive regional centres, take pressure off urban land prices and create better living and housing conditions for all.

There is no reason why one could not have in this country a tri-partite sharing of the rating base.[24] A Federal rate could be earmarked towards national capital works; the State rate levied for State public works with local and semi-government authorities charging for local and regional infrastructure.

In addition to being earmarked for the provision of infrastructure (whether directly by public bodies or as private-public partnerships), the revenues from a shared rate base could be applied towards getting rid of inefficient taxes on land. For example, a Federal rate could finance the abolition of capital gains tax on real estate, removing a transfer tax on its movement to its highest and best use. Similarly, a State rate could finance the abolition of stamp duties (as John Stuart Mill suggested over 150 years ago) and the current inefficient land taxes. The removal of rate pegging at the local level could finance the abolition of regressive user charges and development levies which have made life harder for young homebuyers.

Given the atrocious history of Australian Governments in raising taxes wherever they can, one naturally hesitates before making any suggestion for "tax reform". The phrase has been so abused as an excuse for repeated bureaucratically-inspired violations against taxpayers that it has almost become a "badge of fraud". That is why strict earmarking of any tripartite rate revenue is urged. If rating revenue is strictly applied to removal of less efficient Federal, State and local taxes, charges and levies and to augmenting the supply of serviced land through improved infrastructure, the public could have some assurance that "tax reform" was, for once, not a cloak for tax increases.

A creative shift from inefficient, supply-strangling ,"lock-in" taxes on land transfers to supply-augmenting holding charges such as rates (hypothecated to tax abolition and infrastructure development trust funds) could be a "win-win" for both governments and taxpayers.

- $ Government revenues would benefit as land was redeveloped on the basis of its highest and best use.

- $ Taxpayers would benefit both from abolition of transactions taxes and improvement or refurbishment of infrastructure which adds value to their lands.

- $ Homebuyers would benefit because they would no longer be asked to pay upfront for infrastructure which would be amortized by future rate collections. Further, private-public partnerships providing the infrastructure would not need to include such recouped capital costs in their regulatory capital bases for "user charges" so that families would not be charged twice (or thrice) for assets they had already funded.

There is no Constitutional[25] or economic[26] reason why one could not have a joint Federal/State infrastructure works/tax relief fund with sub-accounts for each taxing jurisdiction and use it to -

- $ defray infrastructure costs in servicing new homes (an annual rate instead of an upfront charge on young marrieds)

- $ cover water (dam and pipe) fixed costs

- $ defray access deficits for other network infrastructure eg gas, electricity, phone lines (on condition the capital costs get removed from the base used by regulators to set user charges on consumers)

- $ replace Commonwealth grants to local government

- $ replace inefficient land taxes, stamp duties and CGT on real estate.

The proposal put forward is not novel. It is quite easy for Federal, Sate and local governments to share the land tax base through imposing their own rates on a common land value base. They are all doing so, in a very inefficient and haphazard way, at present with multifarious taxes and charges. It would be far better for homebuyers, families and consumers if they did so efficiently and used the revenues to get rid of taxes and user charges for infrastructure which push up the cost of housing, the cost of living and which feed into higher wage costs.

Conclusion

Home is where the heart is. Housing is a key element in the creation and supply of productive labour. The current housing price escalation will have adverse economic as well as social consequences when the bubble collapses and population declines. The classical economists were not perhaps so wide of the mark in suggesting that unless people can afford

the necessities of life, such as housing, they will cease to reproduce. The wits might remark that instead of “Advance Australia Fair” it will be a history of “Farewell Australia”.

Though economics was dubbed the “dismal science” by Carlyle, and this submission has touched on some gloomy reflections, its underlying purpose is to suggest that economics has some positive things to say which may well brush aside such gloomy prognostications. Adam Smith was, at heart, an optimist, like the French Physiocrats, who believed that understanding natural economic laws could help the human legislator make wise positive laws.

Genuine, co-operative, Federal, State and local legislative reform of tax and infrastructure funding could do much, both at a macro and micro level, to stop the land price spiral and make housing affordable for those minded to bring forth the next generation of Australians.

ENDNOTES

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1. The fact that, in general equilibrium, a tax on capital might also in theory reduce net returns to investors does not negate the excise effect on consumers and, from a practical point of view, may be ignored in a world where capital returns are set by global markets. Note also that those consumers who give up buying the taxed product have not thereby "avoided" the tax - they have suffered a forced shift to less preferred consumption alternatives while the Treasury gets nothing from them, the classic example of the "excess burden" of a tax. This explains Dr Johnson's definition, which reflected popular opposition to the eighteenth century argument that excise taxes were "voluntary taxes".

2. This appears to be the view of Professor Abelson of Macquarie University, as set out in recent letters to the Australian Financial Review (AFR). As I sought to point out, that view was not accepted by either Adam Smith or John Stuart Mill and overlooks the fact that land made available in different time periods represents different "services". A transfer tax can be avoided *pro tempore* by withholding land from the market. This means that the tax capitalization which occurs under holding taxes cannot be assumed to operate for transfer taxes. See letters to the AFR of 17 and 20 June, 2, 4 and 8 July 2003. (copies attached).

3. One of the worst consequences of imposing CGT on homes or abolishing "negative gearing concessions" (and of the existing stamp duties) is that increased costs of re-location would impede labour mobility. "Negative gearing" often occurs where a homeowner has to rent out his house while moving with his family to take up a new job elsewhere .

4. See Mill, John Stuart (1849-1872) Book 5, Chapter 5, Section 1, pp 858-859. Access Economics (2003) gives a modern version of the argument against stamp duty.

5. See (Harvey) State Business Tax Review Committee (2001) pp 36-39, 49-51, 74-78

6. As land transfers are not part of "final consumption", this raises questions about the essential validity of the GST legislation in terms of its "one subject of taxation" under s 55 of the Constitution, but that is not a concern of this paper.

7. Local government building/extension approval levies represent an unfortunate and obnoxious recrudescence of this pernicious policy.

8. For fuller discussions see Dwyer and Larkin (1995) and Dwyer and Lim (1999). Many of the criticisms made there of naive "user pays" approaches to infrastructure financing appear to be shared by the Allen Consulting Group (2003).

9. See Hotelling (1938) at pp 300-301 where he explicitly endorses unimproved land value rating for infrastructure such as bridges. He would presumably be dismayed to learn Australia has dropped this traditional system in favour of the defective American system of "user charges" he so carefully critiqued - exemplified in his biting remark that the economic principle involved was "such plain common sense

that toll bridges have now largely disappeared from civilized communities".

10. Water charging on allegedly "commercial" "user pays" principles has actually resulted in cost over-recovery and high rates of return on actual historic costs. Walker (1993) pointed out that public sector accounting for water authorities has often employed techniques which result in false or misleading figures showing low profitability when the reality is that water authorities have been more profitable than most listed industrial companies.

11. See Marshall *Principles of Economics* Appendix G and Mieszkowski and Zodrow (1989).

12. See Vickrey (1977). Vickrey was a professor at Columbia University and a Nobel Prize winner as well as a President of the American Economic Association. This article demonstrates a version of the George-Hotelling-Vickrey Theorem on how and when it is efficient to tax land values to fund public works and how the revenue may be adequate. Arnott and Stiglitz (1979) examine the generality of the Henry George Theorem that, in cities of optimal size, aggregate land rents equal expenditures on public goods. Stiglitz was formerly Chairman of the US Council of Economic Advisers, World Bank chief economist and is now at Columbia University. Both Vickrey and Stiglitz were Nobel prize winners in economics.

13. For example, Krelove (1992) examines the efficiency of land rent taxes and concludes that "in Henry George economies, an optimal allocation is an equilibrium outcome."

14. Something which appears to have escaped the notice of most utility reformers and regulators.

15. See, for example, Kanemoto (1984) who explores the Henry George Theorem in relation to financing the fixed costs of loss-making, increasing returns to scale, railways from land rents.

16. Often even involving spurious "costs" of revalued sunk capital.

17. Such an inter-generational "Ponzi scheme" when pushed to the limit becomes ultimately unsustainable - eventually the over-taxed later generations defend their living standards by ceasing to reproduce - as Adam Smith and John Stuart Mill suggested. In turn, land values collapse with a decline in population and effective demand. However, along the way, a lot of social unhappiness is created and society is weakened: a human society which ceases to breed is hardly in a prosperous state, resembling more the Later Roman Empire than Victorian Britain's Age of Progress.

18. The writer is acting against personal interest in raising these questions.

19. The writer again declares acting against personal interest in that, as an investor, he looks for precisely this fortunate outcome. As a distinguished professor of economics once remarked to him "if one is condemned to live in a corrupt system, it is preferable to be a beneficiary than a victim."

20. It is interesting to note that massive urbanization throughout the world has proceeded side by side with increases in income and sales taxation since World War II. This does not demonstrate causality but does suggest inquiry.

21. Urban in-fill has been promoted in some quarters as a cost saving measure which promotes efficiency. But it may not always be so efficient. It may add to local traffic congestion and strain the capacity of existing infrastructure. Streets, sewer pipes and sub-stations built for houses may have to be rebuilt to serve adequately a row of apartment blocks.

22. The current fashion in some circles to deplore the Australian love of the "quarter acre block" may forget that this cultural preference arose as a reaction to crowded slums in London and elsewhere. Young families often prefer space and some privacy. What is a sensible lifestyle choice for a single person or retirees (a unit with no garden) may not be a sensible housing choice for a young family with six healthy boys. Given the concern that politicians and public servants have been expressing about the fiscal consequences of a declining population, it may be counter-productive to seek to deny young families the choice of a house on quarter acre block. After all, Australia does have more land than most countries and overseas visitors often comment on how few towns there are between cities.

23. Like parasites, avaricious treasuries do destroy themselves with their hosts, as Gibbon noted in chronicling the role of oppressive taxation and population decline in the fall of the Roman Empire. But this is little consolation to oppressed taxpayers. The only philosophical consolation available to them is the reflection that their bloodlines may outlast nation states, just as there are families in Italy today who can trace their ancestry back past Republic, Kingdom, city state and Holy Roman Empire.

24. Dwyer (2003) shows land values have kept pace with taxation growth over most of the last century, so there is no question of the rating base being inadequate (even before one allows for the beneficial effects of infrastructure spending on land values).

25. The Commonwealth levied land tax up to 1952. States, local and semi-government authorities have always had the power to rate, charge or tax land. They can (and do) co-exist legally as simultaneously taxing authorities. There is nothing to stop them using a common definition of unimproved land or site value and designating one authority to collect their legislated rates for them on that basis.

26. Unlike income taxes or sales taxes where difficult questions of territorial jurisdiction arise and where cascading of taxes may destroy trade and commerce, rates posses 2 signal advantages. First, the tax is territorial - there is no dispute possible over whether a parcel of land lies within a town, State or the Commonwealth. Second, multiple rates are all capitalized: it is impossible to over-tax land values - the market value will drop if the taxes being imposed are not accompanied by collateral benefits for the land. As the market value drops, so does the scope for further taxation by any of the "competing jurisdictions". This process of tax capitalization not only means that these rates are "lump sum" in the sense of not distorting production or

consumption decisions but it also means that there is a natural limit to how far the authorities can collectively tax - the market price of land can never be driven below zero.

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