Get taxes off the family home!

A SUBMISSION TO THE ***PRODUCTIVITY COMMISSION'S INQUIRY ON FIRST HOME OWNERSHIP***

by

PROSPER AUSTRALIA INC.
1/27 HARDWARE LANE, MELBOURNE 3000
(OCTOBER 13, 2003)

Contents

SUMMARY

The catastrophic decline in the affordability of housing, especially for first-time buyers, reflects a blowout in *land* prices caused chiefly by *impediments to the release of land* for housing, and by *transaction taxes* -- including those levied on developers to cover the costs of government services to new suburbs -- which are ultimately passed on to home buyers.

We submit that these causes would be alleviated or removed if some or all of the transaction taxes were replaced by a *holding tax* levied on the value of land (owner-occupied principal residences excepted) and payable by the owner of the land. In particular, greater use of land value taxation (LVT) would:

(i) Discourage speculative holding of land, which is responsible for booms and busts in the land market, hence booms and busts in the construction industry, hence financial insecurity for building workers, managers and support staff;

(ii) Force land speculators to sell or develop their land, thus increasing the stock of land available for housing, relieving the upward pressure on land prices, and reducing urban sprawl caused by the need to bypass wasted land;

(iii) Encourage developers to develop their land and resell it without delay, passing on the lower prices to consumers;

(iv) Recover the cost of infrastructure (and interest thereon) over the service life, thus removing the need for up-front charges which are a precondition for development, and which developers must therefore recover from consumers through higher land prices;

(v) Enhance equity by automatically recovering the cost of infrastructure from those who actually benefit from it through unearned increases in land values;

(vi) Improve transparency in government by eliminating the need for case-by-case decisions on developers' contributions to infrastructure costs, together with the attendant risk of inconsistency or arbitrariness;

(vii) Provide compensation, in the form of tax relief, to property owners whose land is devalued by nearby housing developments, thus reducing the fear of devaluation and the associated opposition to development (the ''NIMBY" effect);

(viii) Enable the reduction or abolition of payroll tax and stamp duties, which are passed on in prices of houses and developed land;

(ix) Eliminate some absurd instances of tax on tax, e.g. stamp duty on GST on other indirect State taxes embedded in prices;

(x) Reduce the compliance costs of the tax system, which are passed on in prices, including prices of houses and developed land.

To minimize other compliance costs, the processes for development approvals and building approvals should be as simple and uniform as possible.

As a means of reducing sprawl, LVT is preferable to arbitrary urban growth boundaries which inflate land values inside the boundaries and reduce values outside.

To ensure a sufficient supply of housing for low income earners to rent or buy, the stock of public housing should be continuously turned over, with the proceeds of sales used to construct more medium-density public housing.

Demand-side measures -- i.e. measures that boost the effective demand for housing by augmenting the spending power of buyers and renters -- are to be rejected because they would raise prices; indeed, by triggering a fresh ‘‘bull run” in the land market, they could raise prices more than they increase spending power. Most of the measures proposed by the highly publicized ‘‘Prime Ministerial Task Force on Home Ownership” belong to this category. A successful policy for improving the affordability of housing must rely on *supply-side* measures -- i.e. measures that encourage, or remove impediments to, the supply of housing and especially the release of land for housing. Such are the measures proposed in this Submission.

1. It's the land, stupid!

The surging cost of housing is not the fault of the development industry, whose profit margins are limited by competition among developers and are not unusually high in proportion to the risks and lead times involved. Even less is it the fault of the building industry, which is fiercely competitive and operates on dangerously narrow margins. In fact the real prices of new houses, excluding land and indirect taxes, are falling in the long term because of technological progress. Even if building prices rise in the short term due to cyclic increases in the demand for new buildings, there is precious little relief for builders and their suppliers and contractors, because the same demands that allow them to quote higher prices also cause their input costs to rise.

The tendency to blame developers and builders arises in part from inexact terminology. What a builder or home buyer calls ''land'' is not *raw* land, but **developed land**, i.e. land that has been serviced by roads, drainage, sewerage, water, electricity, etc., and which has been subjected to various government charges. To the extent that these services and charges are costs borne by developers *as a condition of development*, they must be recovered through the resale prices of developed land, or else development will become uneconomic and the supply of developed land will dry up. A more blatant inaccuracy is the habitual use of the term ''house prices'' to refer to **home prices**, i.e. prices of *house-land packages*, where ''land'' again means developed land. Thus the price of developed land is not simply the price of development nor simply the price of land, while the price of a home is not simply the price of a house. These distinctions, obvious as they are when stated plainly, are obscured by the prevailing terminology.

By comparison with this culture of obfuscation, the Housing Industry Association's report *Restoring Housing Affordability* [1] is remarkable for its clarity and candour. The first sentence of the overview of the report (p.1) declares:

> Rampant increases in the price of a block of land for new housing are strangling housing affordability.

Provided that ''land for new housing'' is understood as developed land, this statement is completely accurate. Even if the distinction between raw and developed land is overlooked, the emphasis on land is a quantum advance on the usual sterile debate about ''house prices''. (But so entrenched is the faulty terminology that even the HIA retains the term ''house price'' for the price of a house-land package, while distinguishing the ''land component'' of this ''house price''.)

One cause of surging land prices the *artificial shortage of land for development*, due to speculative withholding of land, red tape in the development approval process, and established residents' opposition to infill development. Another cause is the array of taxes and charges imposed by governments as conditions of development, including charges imposed on the pretext of funding urban infrastructure. The artificial shortage inflates prices of raw land, while the taxes on development inflate the price difference between raw land and developed land.

The effects of taxation on prices are subtle and frequently misunderstood. In particular, much popular discussion fails to distinguish between ''house-like assets'' and ''land-like assets'', and between ''transaction taxes'' and ''holding taxes''. These distinctions are critical in the analysis of ''taxes on land'' and necessitate further distinctions as to what we mean by ''land''. Accordingly, we make a theoretical digression.

2. Theory: Four crucial distinctions

(a) House-like assets vs. land-like assets

In a competitive economy, assets fall into two categories:

- Let us define **house-like assets** as assets that can be produced at will by private individuals or firms. These assets obviously include houses and other buildings. They also include machinery, consumer goods, and most other products of human effort.

- On the contrary, let us define **land-like assets** as assets that *cannot* be produced at will by private individuals or firms. These obviously include natural resources such as land, which are not ''produced'' at all. But they also include monopolies and privileges of all kinds, including those involving man-made objects. For example, a large physical network for delivery of services is likely to confer a monopoly, because new customers cannot be provided with an equivalent service at a competitive price except by connecting them to the *existing* network.

Taxation can reduce the supply of house-like assets by deterring their production. But it cannot reduce the supply of land-like assets, because such assets are no longer, or never were, in open ''production''.

(b) Improved land vs. unimproved land

Buildings, fences, walls and other recognizable artificial structures on or under land are called **improvements**. The **improved value** of a block of land includes the value added by such structures within the block. The **unimproved value** of the block excludes the value added by improvements within the block, but includes the **locational value** added by improvements on surrounding land -- including roads, power lines and other services that pass by just outside the block.

Improvements are house-like assets. The unimproved value is a land-like asset. In particular, the locational value is a land-like asset because the party buying the block usually cannot afford to add locational value by ''building up'' the surrounding area.

But the scope of the ''block'' is relative. For the consumer buying a single lot in a new estate, the block is the single lot, and the adjacent roads and other services provided by the developer add to the locational value, which is part of the unimproved value. But for

THE DEVELOPER, THE BLOCK IS THE WHOLE ESTATE, AND THE SERVICES PROVIDED BY THE DEVELOPER ARE IMPROVEMENTS TO THAT BLOCK. THAT IS, ROADS, FOOTPATHS, DRAINS AND SIMILAR SERVICES PROVIDED BY A DEVELOPER WITHIN AN ESTATE ARE, FROM THE VIEWPOINT OF THE DEVELOPER, HOUSE-LIKE ASSETS. THE IMPLICATION IS THAT TAXES ATTACHED TO THESE SERVICES AND PAYABLE BY THE DEVELOPER WILL DISCOURAGE THE SUPPLY OF DEVELOPED LAND.

[A MINOR POINT: THE ''SITE VALUE" (AS IT IS CALLED IN VICTORIA) OR ''LAND VALUE" (AS IT IS CALLED IN NSW) INCLUDES THE VALUE ADDED BY ''MERGED IMPROVEMENTS", SUCH AS HISTORICAL CLEARING OR GRADING, WHICH ARE EASILY MISTAKEN FOR THE ORIGINAL STATE OF THE LAND. THE ''UNIMPROVED VALUE" ATTEMPTS TO EXCLUDE MERGED IMPROVEMENTS. THE DIFFERENCE BETWEEN SITE VALUE AND UNIMPROVED VALUE IS USUALLY SMALL AND MAY BE IGNORED FOR PRESENT PURPOSES. BUT THE DIFFERENCE BETWEEN IMPROVED VALUE AND UNIMPROVED VALUE IS CRITICAL.]

(C) DEVELOPED LAND VS. RAW LAND

These terms have already been introduced. We mention them again to emphasize that ''developed" and ''raw" (i.e. ''undeveloped") are *not* synonymous with ''improved" and ''unimproved" respectively. A developed estate is substantially improved from the developer's viewpoint, but a vacant lot in that estate is unimproved from the buyer's viewpoint. A site that has been previously developed and improved (a **brownfield** site) may be raw from the viewpoint of a developer who intends to demolish everything and start again. The ''improvements" in this case have negative value, as they add to the cost of redevelopment.

(D) TRANSACTION TAXES VS. HOLDING TAXES

A **transaction tax** is one for which the tax liability is attached to an avoidable economic decision (the ''transaction"). A **holding tax**, on the contrary, is attached to an asset, and is payable by the owner of that asset regardless of any transactions that occur during the period of ownership.

In the case of a transaction tax, each party can avoid the tax by avoiding the transaction, and can use this option as leverage when negotiating the price. So, regardless of which party is legally liable to pay the tax, the going price will be such that the tax burden is shared by the buyer and the seller in proportion to their need to conclude the transaction; the party who can more easily avoid the transaction has more leverage and will therefore pay less tax. This logic applies even in the case of land-like assets; that such assets cannot be produced at will does not limit the rate at which they can be bought and sold, and places only an upper limit on the rate at which they can be rented and let. So a transaction tax on any kind of asset will be partly paid by the buyer; that is, *from the buyer's viewpoint, a transaction tax on any kind of asset will increase the price.*

In contrast, a holding tax on an asset encourages the owner to sell it and deters others from buying it. These influences must lower the price *in the short term*. For house-like assets, the tax discourages production, slowing the growth of stock and raising prices *in the long term*. But for land-like assets, there is no long-term adjustment of supply. So, *a holding tax on a land-like asset reduces the price.*

For example, municipal rates are holding taxes. If they are levied on improved values, they tax house-like assets, namely the buildings, thereby discouraging construction and raising prices of buildings in the long term. But if they are levied on unimproved values, they only tax land-like assets and consequently reduce prices.

To determine the effect of a holding tax on the **total cost of ownership** (TCO) of a land-like asset, we must compare the price reduction (or the interest thereon) with the annual tax liability. The price reduction is generally dominant, mainly because the holding tax makes it less attractive to hold the asset for speculative purposes (i.e. for a capital gain), so that speculators are driven out of the market and the TCO falls because of the reduced competition. The reduction in the TCO is clearer if the buyer is in a tax-exempt category while competing bidders are not. Consider, for example, a holding tax on residential land with an exemption for owner-occupied principal residences. The tax scares away speculators and reduces the prices that rental property investors are willing to pay. Thus the competition is reduced, allowing an intending owner-occupier to acquire the land for a lower price, but with no offsetting annual tax liability.

(E) Implications

The foregoing theory implies that housing affordability would be optimized by:

- *Removing all taxes on house-like assets in the housing supply chain, because such taxes are partly borne by home buyers;*
- Removing all transaction taxes in the housing supply chain, because such taxes are partly borne by home buyers; and
- *Replacing the lost revenue by means of a holding tax on the unimproved value of land, with an exemption for owner-occupied principal residences.*

3. Land speculation

> *Woe unto them that join house to house, that lay field to field, till there be no place, that they may be placed alone in the midst of the earth!*
>
> -- *Isaiah 5:8.*

Because land-like assets cannot be produced at will, their values are determined by demand and consequently increase in line with economic growth and population growth. This reasoning holds for unimproved land values. Even if land on the urban fringe remains readily affordable (which is *not* the case at present), the fringe does not stand still, but moves outward with urban growth. A piece of land on the fringe becomes outer suburban, then middle suburban, then inner suburban, its price rising as it is surrounded by an increasing density of amenities, and as planning authorities rezone it for more intensive (and hence more valuable) permitted uses.

As people observe these price rises, they want to ‘‘invest’’ in land to obtain capital gains. As they do so, their demand accelerates the price rises, inspiring more people to ‘‘invest’’, and so on, causing a runaway process -- a speculative **bubble**. This is accompanied by a construction boom as the ‘‘investors’’ try to service their debts by earning rental income. But eventually it becomes obvious that there is not enough rent to justify the prices paid, and the bubble bursts. So the construction boom also ends, causing unemployment in the building industry.

One way to avoid speculative bubbles in land prices is to impose a holding tax on the value of land, i.e. a **land value tax** (LVT). If the LVT rate is high enough, investors find it uneconomic to buy land for capital gains alone, and must use the land productively in order to cover the tax liability; and the higher the tax, the more productively the land must be used. Moreover, rises in land values are not so appealing when the annual tax liability rises proportionally, unless the income from the land also rises. For these reasons, a sufficiently heavy LVT ensures that land is priced according to sober estimates of its rental value, and suppresses the speculative mentality whereby this year’s exorbitant price is supported by the expectation that some other fool will pay an even more exorbitant price next year.

The speculative motive is harmful not only because it causes boom-bust cycles, but also because it represents a net addition to the demand for land, causing a general increase in prices. The additional demand manifests itself not only as willingness to buy, but also as reluctance to sell. Indeed, the ‘‘artificial shortage of land for development’’ is at least partly caused by speculators who own unused or underused land on the urban fringe, and who wait as long as possible before selling the land to developers. Because these speculators do not use the land optimally, a substantial LVT would force them to sell. Current municipal rates and State land taxes are not ‘‘substantial’’ enough for this purpose. But if the LVT were high enough to replace (say) payroll taxes, it would force significant tracts of hoarded land onto the market, giving developers access to an increased supply of land at lower prices.

The same tax would also ensure that developers pass on the savings to consumers and do not indulge in any hoarding of their own. Ideally, however, the value on which developers pay LVT should *not* include the value that they themselves add to the residential blocks by providing services such as roads and drains. This additional value is a house-like asset from the viewpoint of the developer. Taxing it, even with a holding tax, would tend to discourage development, reducing the supply of developed land and raising prices. But if developers pay LVT on only the raw land value, plus any value subsequently added by rezoning, policy change, demographic change, economic growth or public expenditure (e.g. on infrastructure), the burden will *not* be shifted onto home buyers.

Urban growth boundaries, such as the one imposed on Melbourne in October 2002, obviously exacerbate the effect of speculation: while the speculative motive creates an artificial demand for land, the growth boundary imposes an artificial limit on supply, which further drives up prices. Indeed, the growth boundary also increases the speculative demand because speculators, seeing that the city can no longer expand to accommodate the demand for land, expect land prices to rise faster than before. Their demand in turn amplifies the price rise. So, while growth boundaries are an understandable response to urban sprawl, they will cause explosive increases in land prices unless accompanied by measures that force more land onto the market within the boundary. LVT has this effect because it forces speculators to sell or develop their land. In so doing, it reduces the need for developers to ''leapfrog'' over speculators and thereby removes a major cause of urban sprawl, perhaps making growth boundaries unnecessary.

Governments still own significant tracts of land. The current low level of LVT means that governments earn very little revenue from land after it is privatized, so that, even if governments are minded to sell off some crown land for residential development, they are under pressure to delay the sale in anticipation of higher prices; in other words, governments are under pressure to speculate! Higher rates of LVT, by allowing governments to earn more revenue from this land after the sale, would make them more willing to sell. However, in view of the present unmet demand for public housing, it would often be preferable to construct public housing on crown land, thus keeping the land in public ownership for the time being (see Section 9 below).

When ''speculators'' trade in goods that are continually produced and consumed, they perform social service by providing inventories, absorbing gluts, relieving shortages, and smoothing out prices. However, speculation *on land-like assets* can only do harm by raising and destabilizing prices. When a society tolerates this latter kind of speculation, a certain socio-economic class finds it easier to make a living by land speculation than by production, so that overall production falls and the society becomes poorer. The same mechanism operates, *mutatis mutandis*, in societies that tolerate petty crime or corruption. If the consequences of land speculation seem less severe, that is because only the upper echelons of society can afford to indulge in it, while the rest still have to work for a living.

4. Infrastructure funding

> *... GROUND-RENTS, SO FAR AS THEY EXCEED THE ORDINARY RENT OF LAND, ARE ALTOGETHER OWING TO THE GOOD GOVERNMENT OF THE SOVEREIGN, WHICH, BY PROTECTING THE INDUSTRY EITHER OF THE WHOLE PEOPLE OR OF THE INHABITANTS OF SOME PARTICULAR PLACE, ENABLES THEM TO PAY SO MUCH MORE THAN ITS REAL VALUE FOR THE GROUND WHICH THEY BUILD THEIR HOUSES UPON, OR TO MAKE TO ITS OWNER SO MUCH MORE THAN COMPENSATION FOR THE LOSS WHICH HE MIGHT SUSTAIN BY THIS USE OF IT. NOTHING CAN BE MORE REASONABLE THAN THAT A FUND WHICH OWES ITS EXISTENCE TO THE GOOD GOVERNMENT OF THE STATE SHOULD BE TAXED PECULIARLY, OR SHOULD CONTRIBUTE SOMETHING MORE THAN THE GREATER PART OF OTHER FUNDS, TOWARDS THE SUPPORT OF THAT GOVERNMENT.*
>
> *-- ADAM SMITH (1723-1790),*
> *THE WEALTH OF NATIONS, V.II.76.*

The developer of a new suburb provides a range of reticulated services *within* the suburb. But those services are not activated until other agencies -- usually governments -- provide the necessary connections *between* that suburb and the rest of the city or State. The connections may include roads, public transport, drainage, sewerage, water, gas and electricity. In addition, every new suburb adds to the demand for State schools, public hospitals, police stations, emergency services, and other shop-fronts of government. Somehow, all this must be paid for.

To defray these infrastructure costs, State governments now make development approvals subject to the payment of various up-front charges by the developer. These charges, known as **development levies** or **infrastructure levies**, are defended on the ground that when permission is given to develop land, that land increases in value, giving an unearned windfall to the developer. Indeed it does. Furthermore, permission to develop is a land-like asset because it is a privilege conferred by the political system and therefore cannot be created by the developer or any other private agency. But because the development levies must be paid as a condition of development, they are *transaction taxes*. Developers who have acquired land can delay development until the land value rises sufficiently to cover the various levies, and then resell the developed land at the higher price. Alternatively, if developers decline to pay the requested levies, or if governments fear that no politically acceptable levy will cover their costs, development approvals are postponed indefinitely and the ensuing shortage of developed land forces up prices. Either way, *up-front development levies are at least partly shifted onto home buyers in the prices of developed land.*

As the HIA explains [1,pp.8-11], up-front development levies are objectionable on numerous other grounds. For example:

- *Because a separate deal must be struck for every development, there is a risk of inconsistency or arbitrariness.*

- It is inequitable to require residents of new suburbs to pay for their own infrastructure when the residents of established suburbs have had their infrastructure paid for by the wider community through general taxation. That the residents of new suburbs are more likely to be first-time buyers, who have the least capacity to pay, compounds the injustice.

- *It is inequitable to require today's residents to meet the entire cost of services that will confer benefits on future residents for several decades to come. It is also unnecessary, because the cost of acquiring a productive asset, including principal and interest (paid or forgone), can be spread over the productive life of the asset.*

- It is inequitable to require residents of new suburbs to meet the entire cost of services when some of those services, e.g. roads and public transport, confer ''spillover" benefits on established suburbs. Again the inequity is compounded by the concentration of first-time buyers in new suburbs.

All these problems would be solved if development levies were replaced by LVT. In particular:

- Like a development levy, LVT taxes the increase in land values caused by development approvals. But, being a holding tax on a land-like asset, LVT cannot be passed on to home buyers in higher land prices; on the contrary, by encouraging non-resident owners to resell land as soon as possible, it depresses the prices paid by home owners for developed land, just as it depressed the prices previously paid by the developers for the raw land.

- *LVT is consistent because it is governed by uniform legislation; it does not require case-by-case negotiation.*

- The benefits of public infrastructure turn suburbs into more desirable places to live and to do business, so that their land values increase. LVT, by taxing those land values, taxes the beneficiaries of urban infrastructure in proportion to their benefits, whether the beneficiaries are in new suburbs or established suburbs, and whether the infrastructure conferring those benefit is new or existing, or in the same suburb or further afield. Thus LVT is equitable according to the ''beneficiary pays" principle.

- *The value of land owned by a household or firm is a component of net worth and is correlated with income in a highly progressive manner; roughly speaking, there is a threshold income below which land ownership is virtually impossible, and above which the value of land owned rises rapidly with income. Thus LVT is also equitable according to the ''capacity to pay" principle.*

Admittedly, the proposed exemption for owner-occupied principal residences compromises equity in that owner-occupiers do not contribute to the financing of developments that enhance the value of their land. The reason for the exemption is that the benefits to owner-occupiers are not realized in the form of continuous cash flows, whereas the tax liability would be realized in that form. However, the ''beneficiary pays" principle still applies to commercial owner-occupiers and to commercial and residential landlords. This is a much broader application than that given by infrastructure levies, which tax the purchasers of new housing with only nominal regard for the benefits that they receive.

(The ''beneficiary pays" principle could be extended to some owner-occupiers, without sending them bills for LVT, as follows: The Commonwealth could reform the means-testing of welfare payments so as to include the entire value of owner-occupied principal residences in an assets test, and a portion of the payments withheld under the assets test in each local government area could be redirected to the relevant State and local governments. Of course, if such an assets test were implemented, there should be some compensating relaxation of income tests.)

The HIA [1,p.9] quotes the report of the Committee of Inquiry into Housing Costs (1978) in support of the contention that developers should *not* be responsible for the costs of incidental public works outside their estates. That report added:

> *The resultant capital deficiency, including any debt service component, should be made up by increases in rates and charges on all consumers...*

The HIA itself adds [1,p.10-11]:

> *Community-wide infrastructure such as emergency services, schools, hospitals,*

TRUNK TRANSPORT AND TRUNK SEWERAGE INFRASTRUCTURE SHOULD BE PAID FOR BY THE WHOLE REGION THROUGH GENERAL TAXATION MEASURES....

WHERE USER-PAYS FEES ARE DIFFICULT TO ASSESS, INCREASES IN THE GENERAL RATE PAYMENTS WOULD HELP TO SPREAD THE COST OF INFRASTRUCTURE PROVISION OVER A LONGER PERIOD, THEREBY LOWERING THE INITIAL AFFORDABILITY HURDLE FOR NEW HOME BUYERS.

FUNDING SUCH INCIDENTAL PUBLIC WORKS THROUGH LVT WOULD ANSWER THE HIA'S CALL. IN PARTICULAR, WE NOTE THAT ''RATES'' IN QUEENSLAND AND NSW ARE EXAMPLES OF LVT IN THAT THEY ARE LEVIED ON UNIMPROVED LAND VALUES.

IN SUMMARY, WE TEND TO AGREE WITH THE HOUSING INDUSTRY ASSOCIATION [1,P.2] THAT ''THE REFORM OF THE PRICING AND FUNDING OF URBAN INFRASTRUCTURE IS THE SINGLE GREATEST CHALLENGE TO THE AFFORDABILITY OF HOUSING.'' HOWEVER, THE ABOLITION OF UP-FRONT INFRASTRUCTURE LEVIES REQUIRES A NEW SOURCE OF REVENUE. WE SUGGEST LVT.

5. HIDDEN TAXES

> *My Lords and Gentlemen:*
>
> *A direct tax of seven percent would be a dangerous experiment and one likely to incite revolt. But there is a method whereby you can tax the last rag from the back and the last bite from the mouth without causing a murmur against high taxes, and that is to tax a large number of articles of daily use so indirectly that the people will pay without knowing it. Their grumblings will then be of hard times, but they will not know that the hard times are caused by taxation.*
>
> --- *WILLIAM PITT THE YOUNGER (1759-1806).*

A transaction tax opens a gap between the ''tax-exclusive'' price received by the seller and the ''tax-inclusive'' price paid by the buyer. The tax burden is shared between the buyer and the seller in proportion to their need to conclude the transaction. (That is, it is shared in inverse proportion to the price-elasticities of supply and demand.) The tax borne by the seller is the difference between the ''tax-exclusive'' price and the ''natural'' price that would prevail in the absence of the tax, while the tax borne by the buyer is the difference between the ''natural'' price and the ''tax-inclusive'' price. Hence the price that would prevail in the absence of the tax is generally *not* the ''tax-exclusive'' price, but is somewhere between the ''tax-exclusive'' and ''tax-inclusive'' prices. In that sense, the term ''tax-exclusive price'' is misleading.

Consequently, some care is required when interpreting reports such as these:

> The indirect tax paid on a typical new home now accounts for between 20 and 35 per cent of the total final price of a new house and land package....

> HIA estimates that $10.8 billion in indirect taxes (not including land tax and property rates) was levied on new housing in the 2002-03 year, a staggering average of $67,000 per house.

These statements in the HIA report [1,p.2] do *not* mean that abolition of the offending taxes would reduce new home prices by 20 to 35 percent or $67,000 per house. Some of the transaction tax burdens are borne by sellers, so that the ‘‘tax-exclusive” prices received by sellers would rise in the absence of the taxes. Nevertheless, if the taxes were abolished, the price reductions seen by home buyers would be a large fraction of the figures quoted, and it is quite correct to say that the indirect taxes in question are together equivalent to a GST of 20 to 35 percent (tax-inclusive). Moreover, as we shall see, there are other indirect taxes that affect housing costs but are not included in the HIA’s figures. So the housing industry, by complaining about transaction taxes in the housing supply chain, is promoting not only its own interests but also the interests of home buyers.

It is appropriate that the HIA has excluded land tax and property rates from the above calculations, because these taxes, provided that they are levied on unimproved values, are holding taxes on land-like assets, so that they are not passed on in prices. The following is a partial list of taxes that *are* embedded in home prices:

- **GST** is a transaction tax levied by the Commonwealth on all value added in the supply chain of a new house-land package. The result is that the purchaser pays GST on the final value. Federal ministers have obfuscated the effect of GST by pointing out that the tax applies only to *new* homes. But because established homes are in competition with new homes, and because taxes affect the total stock of housing mainly through their effect on the rate of new construction, any tax that inflates new home prices also inflates established home prices -- except that, in the latter case, the rise is pocketed by the seller instead of the Tax Office. If the GST were removed from new homes and applied to the value added on resale of established homes, the same competition would ensure that the price reduction on new homes would extend to established homes, with the GST borne mainly by sellers instead of buyers.

- ***Stamp duty*** *is a transaction tax levied by the States on the conveyancing of real property, including land and house-land packages, and on various insurance premiums connected therewith. It applies to established homes as well as new homes; but, as with the GST, its effect on home prices is determined mainly by its effect on new homes. By the time a new home is purchased by the owner-occupant, stamp duty has typically been paid several times on the same piece of land, and each price on which stamp duty is paid has been inflated by any previous applications of stamp duty. Furthermore, GST on the new house-land package is paid on the price inflated by previous applications of stamp duty, and the final stamp duty is paid on the GST-inflated price. These are cases of tax on tax. Historically, stamp duty began as a charge for the registration of contracts, to be paid on pain of invalidity. It is the tax that triggered the American Revolution and inspired Adam Smith to write: ‘‘There is no art which one government sooner learns of another than that of*

DRAINING MONEY FROM THE POCKETS OF THE PEOPLE."

- **Payroll tax** is a transaction tax levied by the States on wages and salaries, including those of the employees of developers and builders in the housing supply chain. Stamp duties and GST are levied on prices inflated by payroll tax; again this is tax on tax. Politically, payroll tax is the notorious ''tax on jobs". It is not the only tax that discourages employment, but it is the only one that was introduced for that express purpose: in Australia, payroll tax was first imposed by the Commonwealth in 1941 in order to discourage civilian employment of labour that was needed for the war effort. It was retained as a pure revenue measure after the war, and was handed over to the States in 1971.

These taxes are in addition to infrastructure levies, which have already been discussed at length. Prices inflated by infrastructure levies are subject to stamp duty and GST, leading to more tax on tax. GST, stamp duty and payroll tax are literally taxes on the family home, including the building. Payroll tax is not mentioned by name in the HIA report and is apparently not included in the HIA's estimates of the tax content of home prices. In any case, to minimize home prices is to maximize the extent to which the above taxes, including infrastructure levies, are replaced by LVT.

6. Hidden compliance costs

When a transaction tax is payable, the gap between the effective price received by the seller and the effective price paid by the buyer includes not only the tax, but also the cost incurred by the parties (or one of them) in calculating and remitting the tax -- i.e. the ***compliance cost****.*

All transaction taxes involve compliance costs. In contrast, LVT involves negligible compliance costs for the taxpayer. At worst, the taxpayer receives a bill in the mail and pays it like any other bill.

The effect on prices of transaction taxes and associated compliance costs is an illustration of a more general principle: Transaction costs inflate prices. As far as the effect on prices is concerned, it does not matter whether the transaction costs are paid to a government (as for transaction taxes), or to staff or suppliers or contractors (as for compliance costs), or to any other parties.

As examples of non-tax transaction costs in the housing supply chain, we may cite the costs incurred in complying with the different regulations on development and building in different local government areas, and of obtaining the necessary approvals. To minimize these costs and delays and their effects on home prices, the regulations and approval procedures must be as simple and uniform as possible; cf. [1,p.18]. To this end the States should be willing, if necessary, to use their legislative powers to impose some uniformity of regulations and procedures on the local governments within their respective jurisdictions. While this may seem harsh, it needs to be compared with the harshness of unaffordable housing.

It might be thought that compliance costs create jobs for the people who do the paperwork. However, if the economy can afford to pay a certain number of people to perform unproductive paperwork, then it could afford to pay more people (or pay the same people more!) to perform work that generates income to cover their salaries. In general, compliance costs divert resources from productive activities to unproductive activities, reducing the national income, hence the national capacity to employ and pay workers. Thus the evils of compliance costs, like those of land speculation, extend far beyond the effect on prices.

7. The NIMBY effect

While NIMBY (Not In My Back Yard) campaigns against proposed developments may profess altruistic motives, the original and decisive motive is usually the fear that the NIMBYists' properties will be devalued. If the development in question is a new residential estate, the feared devaluation may be caused by additional noise and traffic and the loss of rural or sylvan views. If the development involves medium-density housing and/or public housing, the fear may be compounded by prejudice concerning the kinds of neighbours who will inhabit such housing. By lodging objections against developments, opposing them in the land courts, and agitating for political intervention, NIMBYists slow down the supply of developed land and impose transaction costs on developers, who must then recover the costs from home buyers.

When properties lose value because of nearby developments, they lose locational value, which is part of their unimproved land value, so that they attract less LVT. This tax reduction is partial compensation for the devaluation. The higher the LVT rate, the greater the automatic compensation, and the less determined the opposition from NIMBYists. It is even possible, albeit more administratively complex, to provide a refundable LVT rebate which is attached to the devalued land and which, when capitalized into the fair market value, precisely cancels the devaluation so that the owner can sell the property without loss. Such a rebate could be funded by a sufficiently high rate of LVT on other land. But even without this refinement, increased reliance on LVT means fewer and weaker NIMBY campaigns.

8. *Implementation*

In essence, the nation needs to cut transaction taxes and make up the lost revenue by increasing LVT rates. Let us consider the three levels of government separately.

(a) Local

Local councils already impose LVT in the form of ''rates". In Queensland and NSW, the value of the land alone is rated. In other States, most councils rate the total value of the land and building(s), thereby discouraging construction and raising prices and rents; these councils should confine the tax to land values alone, and compensate for the lost revenue by increasing the LVT rate.

Local councils also raise revenue from various service charges in addition to ''rates''. Consideration should be given to removing these charges in favour of higher LVT rates, especially if the availability of the services enhances the value of land.

Because all of the aforesaid charges tend to appear on a combined ''rate bill'', and because the average bill need not change as a result of the reforms, the political cost of changing the tax base to land values alone should be minimal -- no greater than that of the annual or biennial round of valuations.

(b) State

The HIA estimates [1,p.13] that the annual revenue collected by State governments from new homes and home sites includes $6.38 billion in infrastructure levies and $1.31 billion in stamp duty. In addition, the States annually raise about $10 billion in payroll tax and $2.5 billion in land taxes. Both housing affordability and employment opportunities would be greatly enhanced if these four taxes were replaced by a flat-rate LVT. If owner-occupied principal residences are excluded from the tax base, the total taxable land value may be roughly estimated at $600 billion, giving an LVT rate between 3 percent and 4 percent (with no threshold). This is an average rate; the actual rate would vary from State to State depending on the taxable base and the revenue to be replaced. The calculation assumes that the stamp duties on sales of established homes would remain in place. But because the prices of established homes are limited by competition from new homes, this does *not* mean that prices of established homes would be inflated by stamp duty.

(N.B.: Landlords and their associations routinely claim that LVT is shifted onto tenants in higher rents. This claim *would* be true if LVT were a transaction tax which could be avoided by keeping the property vacant. But in fact it is a holding tax which is payable whether the property is occupied or not. And because LVT is levied on a land-like asset, it cannot raise rents in the long term by reducing supply. LVT encourages the owners of vacant land to improve it and let it to tenants in order to cover the tax liability. Likewise it encourages owners of vacant premises to seek tenants. Both mechanisms increase the supply of rental accommodation and strengthen the bargaining position of tenants relative to landlords, and therefore tend to reduce rents. Landlords resent LVT because it cannot be shifted onto tenants; but they campaign against it by claiming that it *can* be shifted!)

(c) Federal

While we affirm that the abolition of GST in favour of higher LVT would be good economic policy, we admit that the necessary LVT rate could be politically scary. But, because new homes set the price benchmarks for equivalent established homes, it is possible to remove the effect of the GST on home prices without sacrificing GST revenue. The method is to zero-rate new homes but apply the GST to the value added (capital gain) on sales of established homes. Because of competition from new homes, the GST on established

HOMES WOULD BE MOSTLY BORNE BY SELLERS, NOT BUYERS.

(AS NOTED ABOVE, THE COMMONWEALTH COULD ALSO INCLUDE THE ENTIRE VALUE OF OWNER-OCCUPIED PRINCIPAL RESIDENCES IN AN ASSETS TEST ON WELFARE PAYMENTS, AND REDIRECT A PORTION OF THE PAYMENTS WITHHELD IN EACH LOCAL GOVERNMENT AREA TO THE RELEVANT STATE AND LOCAL GOVERNMENTS. THIS WOULD EFFECTIVELY BROADEN THE LVT BASE TO INCLUDE SOME OWNER-OCCUPIED RESIDENTIAL LAND, BUT WITHOUT SENDING BILLS TO THE OWNERS.)

9. PUBLIC HOUSING AND THE RENTAL MARKET

Any realistic reduction in the cost of home ownership will still leave some families who cannot raise sufficient credit to buy a home, and who will consequently be obliged to rent. In addition there will always be some people who, for personal or professional reasons, actually prefer to rent rather than buy. Consequently, no discussion of affordable housing can be considered comprehensive unless it encompasses the rental market.

Residential rents are significant not only in their own right, but also because there is a nexus between rents and prices. Families seeking homes face a choice between buying and renting. If one option becomes more expensive, demand shifts away from it and re-balances the prices. Similarly, owners of investment properties have a choice between selling them and putting tenants in them. If one option becomes more attractive, owners become more willing to offer that option, and the shift in supply re-balances the prices. Therefore any policy that reduces rents will also tend to reduce prices, and *vice versa*.

LVT encourages the owners of vacant land to build houses and let them to tenants in order to cover the tax liability. Likewise, it encourages owners of vacant houses to seek tenants. Both mechanisms increase the supply of rental accommodation and strengthen the bargaining position of tenants relative to landlords, and therefore tend to reduce rents.

While LVT moderates rents for the benefit of all tenants, this by itself is not enough to meet the needs of the poorest. In the free market, property investors and developers may target *wealthy* buyers and tenants, in the hope of obtaining a high margin per customer, or *average* buyers and tenants, in the hope of reaching a large volume of potential customers. They are not likely to cater for the bottom of the market, where they face the combination of narrow margins and low volumes. The resulting shortage of low-cost accommodation is a case of **market failure**, which can be corrected only by some sort of government intervention.

The politically correct form of intervention is rent assistance for welfare recipients in private rental accommodation. That policy is self-defeating in that it allows landlords to charge higher rents than the market would otherwise bear. Landlords love it. The politically incorrect alternative is public housing. This policy is self-assisting in that it diverts demand from the private rental market and consequently reduces private rents. Landlords hate it.

At present, however, public housing authorities charge income-contingent rents which are substantially below market rents. The consequences of this attempt to defy the laws of economics are numerous and serious. For example:

- Income-contingent rents, combined with income tax, income tests on welfare, and income-contingent child-support payments, can very easily create effective marginal tax rates greater than 100 percent, in which case the tenant who works harder ends up poorer. Inevitably some tenants react to this manifest injustice by failing to declare income, and thereby become criminals.

- *THE SYSTEM EFFECTIVELY RUNS AT A LOSS, SO THAT GOVERNMENTS NEVER HAVE ENOUGH REVENUE TO SUPPLY ENOUGH PUBLIC HOUSING. HENCE THE WAITING LISTS ARE LONG AND THE DEPRESSIVE EFFECT ON PRIVATE RENTS IS SMALL.*

- The gap between public and private rents is a standing invitation to corruption. Public officials may demand some of the gap as a kickback for giving priority to a particular applicant. Similarly, tenants vacating public housing units can demand payments (e.g. ‘‘key money”) from incoming tenants.

THE SOLUTION IS TO TRANSFORM PUBLIC HOUSING INTO A MECHANISM FOR REDUCING MARKET RENTS AT THE BOTTOM OF THE MARKET, THUS ELIMINATING THE NEED FOR ACCOMMODATION AT SUB-MARKET RENTS. THIS CAN BE DONE, AT LITTLE OR NO COST TO TAXPAYERS, AS FOLLOWS:

(i) Gradually sell off well-located public housing units to private buyers, and use the proceeds of the sales to construct medium-density public housing on crown land (resuming land if necessary).

(ii) As private rents fall (because of increased supply), phase out rent assistance (causing further falls in private rents).

(iii) When private rents have fallen to levels comparable with public housing rents, offer public housing at full market rents, but continue turning over the public housing stock so as to maintain the oversupply and keep market rents low.

THIS SCHEME IS VIABLE, IN SPITE OF ITS TRADING IN A FALLING MARKET, MAINLY BECAUSE IT WOULD INVOLVE REZONING CROWN LAND (INCLUDING RESUMED LAND) TO MEDIUM-DENSITY RESIDENTIAL, THUS INCREASING ITS VALUE AT NO COST. THE PREFERENTIAL SALE OF ‘‘WELL-LOCATED” BLOCKS OF UNITS WOULD FURTHER OPTIMIZE THE REVENUE FROM SALES.

STEPS (I) AND (III) COULD BE IMPLEMENTED ENTIRELY BY STATE PUBLIC HOUSING AUTHORITIES. IN STEP (II), THE COMPLETE PHASE-OUT OF RENT ASSISTANCE WOULD REQUIRE COORDINATION WITH THE COMMONWEALTH, BUT A PARTIAL PHASE-OUT WOULD OCCUR AUTOMATICALLY BECAUSE THE LEVEL OF ASSISTANCE IS RELATED TO THE RENT. A COMPLETE PHASE-OUT WOULD ACCELERATE THE FALL OF PRIVATE RENTS, BUT IS NOT ESSENTIAL TO THE SUCCESS OF THE POLICY. IT WOULD BE REASONABLE, BUT PERHAPS OPTIMISTIC, FOR THE STATES TO EXPECT THE COMMONWEALTH TO INCREASE FUNDING TO THE STATES IN RECOGNITION OF THE SAVINGS IN RENT ASSISTANCE; BUT THE ABSENCE OF SUCH RECOGNITION WOULD NOT DERAIL THE POLICY.

THE ESSENCE OF THE POLICY IS THE DELIBERATE OVERSUPPLY OF THE LOW-COST HOUSING MARKET. THIS IS NOT WASTEFUL. IT IS A VERY EFFICIENT WAY TO EXPAND ACCESS TO AFFORDABLE HOUSING, BECAUSE IT REDUCES MARKET PRICES AND RENTS NOT ONLY OF THE HOUSING PROVIDED BY THE GOVERNMENT, BUT OF ALL COMPETING HOUSING. IT WOULD ALSO PROVIDE A STEADY STREAM OF GOVERNMENT CONTRACTS FOR THE HOUSING INDUSTRY.

10. Demand-side measures

> *A TAX UPON GROUND-RENTS WOULD NOT RAISE THE RENTS OF HOUSES. IT WOULD FALL ALTOGETHER UPON THE OWNER OF THE GROUND-RENT, WHO ACTS ALWAYS AS A MONOPOLIST, AND EXACTS THE GREATEST RENT WHICH CAN BE GOT FOR THE USE OF HIS GROUND. MORE OR LESS CAN BE GOT FOR IT ACCORDING AS THE COMPETITORS HAPPEN TO BE RICHER OR POORER, OR CAN AFFORD TO GRATIFY THEIR FANCY FOR A PARTICULAR SPOT OF GROUND AT A GREATER OR SMALLER EXPENSE...*
>
> *-- ADAM SMITH (1723-1790),*
> *THE WEALTH OF NATIONS, V.II.74.*

Most proposals purporting to improve housing affordability are **demand-side** measures, i.e. measures that make the competitors richer, so that they can afford to gratify their fancy for a particular spot of ground at greater expense. Familiar examples include the first home owners' grant (FHOG) and rent assistance for social security recipients in the private rental market.

On a graph of price vs. quantity, demand-side measures raise the demand curve and consequently raise the price at which the demand curve intersects the supply curve. The implication is that demand-side measures are at least partly self-defeating, because at least part of the benefit goes to the seller rather than the buyer. Geometry dictates that the price rise cannot exceed the rise in the demand curve. If we assume that the rise in the demand curve is limited by the extent to which the buyers have become richer, it follows that the buyer also gets some of the benefit. However, this assumption does not always hold. For example:

- The first home owners' grant can be used for a deposit, which is a specified minimum percentage of the loan. So the resulting increase in the amount that the buyer can borrow (and must pay back with interest!) can be much greater than the grant. Because buying power is largely determined by borrowing limits, there is nothing to stop the price from rising by more than the grant, in which case buyers are *worse off* in consequence of the grant.

- *BECAUSE THE HOUSING MARKET IS SUBJECT TO SPECULATIVE BUBBLES, THE PRICE RISE CAUSED BY AN INCREASE IN SPENDING POWER CAN TRIGGER A FRESH ''BULL RUN", WHICH IN TURN CAN CAUSE THE PRICE RISE TO OVERSHOOT THE INCREASE IN SPENDING POWER. THE BUYERS THEN FACE HIGHER PRICES, NOT ONLY IN RELATION TO THEIR WEALTH, BUT PERHAPS ALSO IN RELATION TO THEIR BORROWING POWER.*

It is clear from the above that the main beneficiaries of demand-side measures are current owners, who see their properties increasing in value. But there's a catch: other property values also rise. So if the only property that you own is your home, what you gain by selling your old home is lost when you buy the new one -- unless you trade down, which is not the preferred direction! Meanwhile, your children are among the losers because it is harder for them to enter the market. The only clear winners from a property boom are investors who own two or more properties, so that they can sell without buying again. Nevertheless, because ordinary battlers are easily convinced that they gain from appreciation of their one and only piece of real estate, and because the battlers and the investors together make a clear majority of the population, demand-side measures have become *de rigueur*. So, if a demand-side measure leaves buyers worse off, the current owners will presumably respond by calling for a fresh round of demand-side assistance, which will pump up their asset values still further, and so on -- until the market crashes, possibly bringing down the rest of the economy with it. At best, then, demand-side measures are poorly targeted because some of the benefits go to current owners. At worst, they are counterproductive and grossly irresponsible, harming the people they are supposed to help and placing the wider economy at risk.

So the following demand-side measures proposed by the Prime Ministerial Task Force on Home Ownership [2] are to be rejected:

- Shared equity schemes whereby, for example, a listed property trust contributes 30 percent of the purchase price of a home and bears 30 percent of any depreciation, in return for 60 percent of any capital gain;
- *HECS-style lines of credit that can be drawn down for mortgage payments during periods of reduced income*;
- Annualization of up-front Lender's Mortgage Insurance (LMI);
- *Pledges of intergenerational wealth transfers for home purchases*;
- Relaxation of deposit requirements;
- *Assisted savings schemes (or advances from superannuation) for home purchases.*

Any extension of the first home owners' grant is similarly to be rejected. However, there is merit in restricting the grant to *new construction*, in order to encourage first-time buyers to contribute to the *supply* of housing instead of driving up the prices of established homes. For the same reason, there is some merit in restricting property investors' concessions, such as negative gearing and discounting of capital gains, to new construction -- although the benefit of this reform must be weighed against the concomitant increase in compliance costs caused by the inevitable grandfathering of past investments.

These suggestions bring us to the other category of proposals for improving housing affordability, namely **supply-side** measures, i.e. measures that ease or encourage the supply of housing or of land for housing. On a graph of price vs. quantity, such measures shift the supply curve to the right and consequently lower the price at which the supply curve intersects the demand curve. Again, sellers get part of the benefit. This time, however, any multiplier effects favour the buyers by magnifying the price reduction. Of course this ''price reduction'' must be offset against everpresent forces, such as population growth and technological progress, which tend to increase land values. So supply-side measures are not guaranteed to *reduce* prices; but they are guaranteed at least to moderate any price rises that would otherwise occur.

11. Conclusions (addressing Terms of Reference)

ON THE QUESTION OF DEMAND-SIDE MEASURES VS. SUPPLY-SIDE MEASURES, THE HIA RIGHTLY SAYS [1,P.5]:

> Proposals to boost housing demand, in the absence of initiatives to increase the availability of land for development, would fuel pressures on housing prices and could well prove counterproductive. Closing the affordability gap should rely mainly on so-called supply side measures to reduce new housing costs.

THE SUPPLY-SIDE MEASURES THAT PROSPER AUSTRALIA WOULD RECOMMEND INCLUDE:

- Removing transaction taxes in the housing supply chain, including up-front infrastructure levies, stamp duty on new homes, and payroll taxes;
- *REDUCING COMPLIANCE BURDENS ON DEVELOPERS AND BUILDERS;*
- Boosting the supply of low-cost housing by turning over the stock of public housing on a revenue-neutral basis;
- *INTRODUCING A BROAD-BASED SYSTEM OF LAND VALUE TAXATION (I.E. A SYSTEM WITH MINIMAL EXEMPTIONS AND NO THRESHOLD) IN ORDER TO REPLACE THE LOST REVENUE FROM TRANSACTION TAXES, FORCE SPECULATORS TO PUT THEIR LAND ON THE MARKET, INCREASE PRESSURE ON LANDLORDS TO SEEK TENANTS, REDUCE LOCAL OPPOSITION TO NEW HOUSING DEVELOPMENTS, AND RELIEVE THE ANXIETIES OF POLITICIANS CONCERNING THE FUNDING OF INFRASTRUCTURE REQUIRED BY NEW DEVELOPMENTS.*

We shall now summarize our Submission under the Terms of Reference.

COMPONENTS OF THE COST AND PRICE OF HOUSING, INCLUDING NEW AND EXISTING HOUSING...

The cost of housing is inflated by all transaction taxes and compliance costs on developers and builders, and by municipal rates in so far as they apply to buildings, but *not* by holding taxes on land.

MECHANISMS TO IMPROVE THE EFFICIENCY OF THE SUPPLY OF HOUSING AND ASSOCIATED INFRASTRUCTURE...

If the rate of land value taxation (LVT) is high enough, infrastructure automatically pays for itself through increased land values in the serviced areas -- without impeding the supply of housing or of land for housing.

IMPEDIMENTS TO FIRST HOME OWNERSHIP, AND ... THE FEASIBILITY AND IMPLICATIONS OF REDUCING OR REMOVING SUCH IMPEDIMENTS...

The impediments to first home ownership include speculative holding of land, and transaction taxes in the housing supply chain. Both impediments can be lowered by replacing those transaction taxes by LVT. In our view, the transaction taxes that can be most feasibly removed are stamp duties on new homes, infrastructure levies, and payroll tax.

(A) THE IDENTIFICATION, RELEASE AND DEVELOPMENT OF LAND AND THE PROVISION OF BASIC RELATED INFRASTRUCTURE

LVT encourages the ''release" of land by discouraging speculative hoarding. It also encourages developers to develop and resell land promptly, and pays for infrastructure.

(B) THE EFFICIENCY AND TRANSPARENCY OF DIFFERENT PLANNING AND APPROVAL PROCESSES FOR RESIDENTIAL LAND

The essential point is that the processes should be as simple and uniform as possible, in order to minimize delays and transaction costs, both of which raise land prices paid by home buyers.

(C) THE EFFICIENCY AND TRANSPARENCY OF TAXES, LEVIES AND CHARGES IMPOSED AT ALL STAGES OF THE HOUSING SUPPLY CHAIN

Holding taxes on land-like assets -- such as LVT -- are efficient in that they do not discourage any productive activity, and transparent in that they cannot be passed on in prices. The same cannot be said of any other category of taxes.

(D) THE EFFICIENCY, STRUCTURE AND ROLE OF THE LAND DEVELOPMENT INDUSTRY AND ITS RELATIONSHIP WITH THE DWELLING CONSTRUCTION INDUSTRY AND HOW THIS MAY BE AFFECTED BY GOVERNMENT REGULATIONS

Development and construction are both competitive industries; they are not monopolies requiring regulation for the prevention of profiteering. The only significant monopoly in the housing supply chain is land ownership, which is a monopoly in the sense that every piece of land is unique and irreplaceable. This monopoly is adequately addressed by LVT, which discouraging hoarding of land.

(E) THE EFFECT OF STANDARDS, SPECIFICATIONS, APPROVAL AND TITLE REQUIREMENTS ON COSTS AND CHOICE IN NEW DWELLING CONSTRUCTION

While standards and other legal frameworks are necessary for public safety and the protection of consumers, again we stress that the rules must be simple and uniform in order to minimize costs and delays.

(F) THE OPERATION OF THE TOTAL HOUSING MARKET, WITH SPECIFIC REFERENCE TO THE AVAILABILITY OF A RANGE OF PUBLIC AND PRIVATE HOUSING TYPES, THE DEMAND FOR HOUSING, AND THE EFFICIENCY OF USE OF THE EXISTING RESIDENTIAL HOUSING STOCK

The replacement of transaction taxes by LVT would create a need for landowners to earn income from their land in order to cover the tax. This would encourage the release of land for housing, the construction of housing on that land, and the maintenance of high occupancy rates in the rental housing stock.

MECHANISMS AVAILABLE TO IMPROVE THE ABILITY OF HOUSEHOLDS, PARTICULARLY LOW INCOME HOUSEHOLDS, TO BENEFIT FROM OWNER-OCCUPIED HOUSING

The replacement of transaction taxes by LVT would increase the supply of housing overall, but would not secure an adequate supply at the bottom end of the market, which is not attractive to private investors. Accordingly, the supply of cheap housing should be artificially increased by continuously turning over the public housing stock, using the proceeds of sales to construct more medium-density public housing. This would drive down both rents and prices at the bottom of the market, for the benefit of intending renters and intending owner-occupiers.

RENT AND DIRECT OWNERSHIP SUBSIDIES, LOAN GUARANTEES AND SHARED EQUITY INITIATIVES

Rent subsidies increase rents. Subsidies, guarantees and purchasing partnerships would increase effective demand and consequently increase prices. In an already overheated market, that would probably trigger a fresh ‘‘bull run”, so that the consequent rise in prices would overshoot the increase in purchasing power -- an unmitigated disaster.

REFERENCES

[1] Housing Industry Association Ltd, *Restoring Housing Affordability -- The housing industry's perspective* (July 2003), http://www.buildingonline.com.au/media/housing_affordability_update_july03.pdf.

[2] C. Joye et al., *Summary of Findings for the Prime Ministerial Task Force on Home Ownership* (Menzies Research Centre Ltd, June 2003), available at http://www.mrcltd.org.au/content.cfm?PageID=Hot6&HOTFflag=1.

Disclaimer / declaration

THE REFORMS PROPOSED IN THIS SUBMISSION ARE AIMED SPECIFICALLY AT THE ISSUE OF HOUSING AFFORDABILITY AND HAVE BEEN INFLUENCED BY THE NEED FOR RAPID IMPLEMENTATION. THEY ARE NOT AS FAR-REACHING AS THE REFORMS THAT PROSPER AUSTRALIA WOULD PREFER IF THE TERMS OF REFERENCE WERE WIDER OR THE TIME FRAME LONGER.

THE MISSION OF PROSPER AUSTRALIA IS:

> *TO CREATE PROSPERITY AND FULL EMPLOYMENT BY COLLECTING THE RENTAL FROM LAND AND NATURAL RESOURCES INSTEAD OF TAXATION.*

THE PRINCIPAL AUTHOR OF THIS SUBMISSION IS DR. GAVIN R. PUTLAND, COMMUNICATIONS OFFICER FOR PROSPER AUSTRALIA.