Housing Industry Ploy

By Karl Fitzgerald

The HIA has released a report through the Centre for International Economics that attempts to gloss over economic theory and establish a dangerous meme. The CIE's Taxation of the Housing Sector report was quoted prominently in the AFR. Despite the GFC being caused by a global property (read land) bubble, the proposed solution will encourage more, not less speculative behaviour. The report concludes that all taxes on housing should be replaced with a new and broader GST. This is part of a global trend to switch taxes off wealth and place them on the under-educated poor with the regressive GST. A 10% tax on a $2 icy pole hits the disposable income of someone on $20,000 harder than a millionaire. It appears that such effects were not included in the modeling. But we are told the modelling will prove beneficial to GDP. We ask – which sector of the economy will benefit most?

There are a number of aspects to the report that are agreeable. Stamp Duty is the most inefficient of taxes. Replacing this income stream is where we differ. We believe this should be replaced with a Land Tax rather than a broader GST (on basic food). In the report we see statements such as 'raw land priced without distortion'. But yet the tables listed show how much have been hacked away from the effectiveness of Land Taxes. The raising of Land Tax thresholds in Victoria from $85,000 to $250,000 over the last decade sees the median block of land paying only $462. In Queensland, Land Tax has been virtually written off for affordable housing, where the threshold starts at $600,000.

Land prices have followed the rising Land Tax threshold increases, just as economic law dictates. Many are so used to being brow beaten over Land Taxes and municipal rates that they no longer understand how they work. Land Tax is quite simply a counterweight to mortgage debt. If two parcels of land are offered for sale and one has a Land Tax liability attached to it, the rational buyer will pay less for that location. This infers less mortgage debt for the consumer and less profit for the developer and the banks. Such a tax replaces a lifetime of bank interest payments with a lower Land Tax paid to government. The logical answer to 'raw land priced without distortion' is to increase Land Taxes to penalise speculation and inefficient land use. However, such taxes are seen as a threat to profits and thus think tanks like the CIE are generously funded to deflect attention from this progressive tax.

Land Tax is naturally progressive. Those earning higher incomes generally live in more valuable locations that are well serviced with abundant parks, good schools and natural beauty. This means their land values are higher. Land Taxes with yearly valuations take this into account. But we are told it is fairer to tax the core foods that so many survive on.

It is the low rate of Land Tax that has allowed land speculators to buy up large tracts of land in the surrounding areas of a city in the expectation that the city will grow outwards. When the bureaucrat gives his golden pen tick, changing land from rural to residential zoning, this is like a tattslotto bonanza for the lucky landowner. If a decent Land Tax system was in place, as soon as the re-zoning kicks in, so would the land valuation, ensuring that the people shared in this windfall, not just the lucky few. The resultant land supply would hit the market at a lower price.

One of the problems with the CIE report is that they compare apples with oranges. The GST is a transaction tax. It is charged at the point of sale (like Stamp Duty). Land Taxes are based on the length of ownership. They are a holding tax. It is stated by CIE that housing is taxed twice, once as it is built and then at an ongoing basis. We agree the taxes on conveyancing and stamp duties should be axed as countless State and federal Tax reviews have shown. The on-going holding charge, the Land Tax and municipal rates, must continue in acknowledgement that those who own land benefit from its naturally rising value. This is an unearned income that property owners receive when the wider public funds a new neighbouring train station, highway or even when volunteers plant trees in the local park. All these outcomes make a community more attractive, leading to land value increases.

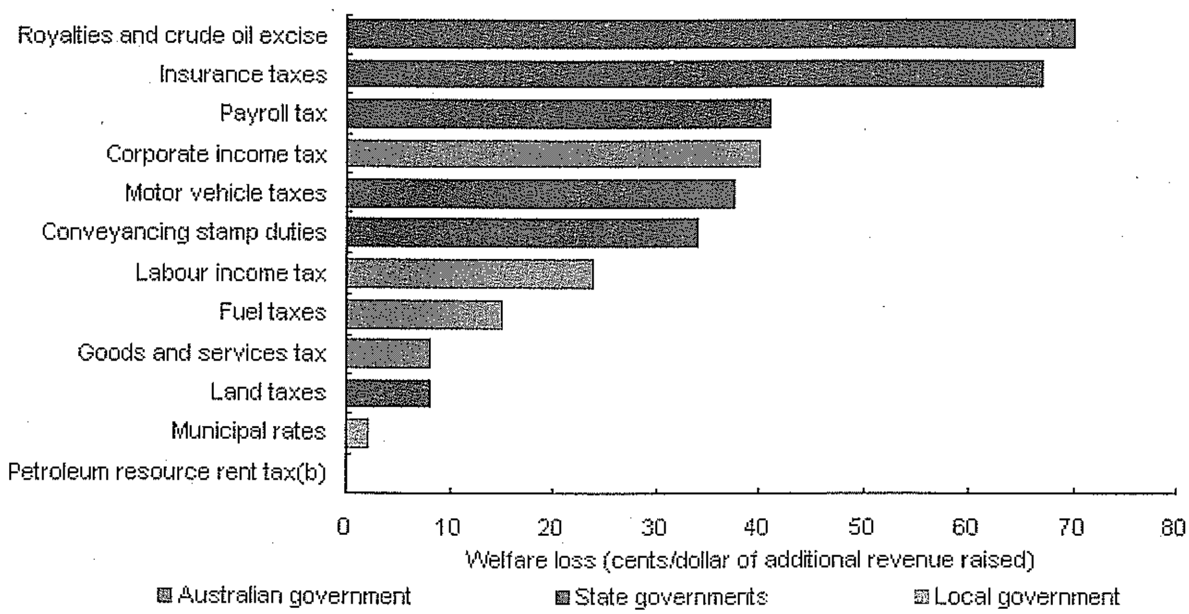
Land Taxes can infact be expanded to replace developer charges as a fairer way to pay for new infrastructure, as was the practice in the periods when we built entire new train lines. The 2010 KPMG Econtech report was referenced by CIE to 'prove' that GST was a greater contributor to GDP: Our $15 billion stamp duty and municipal rates reform (replaced by higher GST rate) without the $5 billion of productivity improvement would increase real GDP by 0.6 per cent

Perhaps a numberwang was involved in the modelling?

Municipal rates can be paid electronically in a matter of seconds. There is virtually zero compliance cost. The quarterly BAS statements that form the paper trail for the GST, are widely seen as the bane of small business' existence. Late Sunday nights are spent pouring over receipts, with entrepreneurs forced to work unpaid as a tax collector on behalf of the government. This is known as a compliance cost and is surely greater than an electronic payment and even paying conveyancing. Municipal rates (holding charges) should not be lumped in with conveyancing costs. This is a sleight of hand by the property lobby in an attempt to rid wealthy property owners of a tax they can't hide in a tax haven. In analysing the source to this meme, KPMG Econotech's CGE paper notes on p23:

"The fixed supply of land and other fixed factors means that they will bear the full incidence of the company tax that is applied to them"

This reflects an understanding that Land Taxes can't be passed on like GST can be, a further inefficiency for that tax. Economic theory hasn't been re-written there. Where did KPMG Econtech develop the thesis that GST is the more efficient tax? Much of it comes down to the impurities that have been allowed to enter the Land Tax system with regards to progressive Land Tax rates, the impact of thresholds and aggregations. We are strong proponents of a simplified Land Tax system that is set at a higher and flatter rate.



The economic efficiency of Australian taxes:
Most taxes result in some loss of economic efficiency. For example, a tax may reduce incentives for people to work or invest or induce them to alter their consumption patterns. This leads to losses in consumer welfare, which can be expressed relative to the amount of revenue raised. An efficient tax system involves taxes that result in low losses in consumer welfare per dollar of revenue raised.
This chart compares the marginal welfare loss arising from a small (5 per cent) increase in each of a range of major Australian taxes (marginal excess burden), estimated using the KPMG Econtech MM900 model. Source: KPMG Econtech (2009).

It must be strongly noted that the findings of KPMG Econtech and thus the CIE should not be taken as an excuse to remove potentially the most efficient of all taxes. This is the dangerous leap of faith the CIE and its backers are demanding governments support. Damagingly, KPMG Econtech critique the CIE model in their Henry Review paper (p23) Efficiencies of Taxes: However, the results of the CIE study do not allow an assessment of the relative inefficiencies of each tax. When discussing the efficiencies of taxation, surely the inefficiencies must be counted too! On p84 of the CIE report, following a discussion on the nature of housing supply being more elastic than housing demand:

It follows that consumers, that is, house buyers would end up bear (sic) most of the taxes discussed previously.

However, this ignores the role that land plays in the housing game. Land is needed first and foremost to build housing – it is not a given. This is glossed over. The incidence of Land Tax falls on the land owner. Unless economic theory has been re-written, this simplification in the modelling continues to smooth the ground for GST to 'become' more efficient than Land Tax. Gavin Putland writes extensively on the irregularities of housing supply as elastic vis land supply as inelastic in his Why Land Tax can't be shifted onto tenants.

To finish off we note from p74:

a $500 million reduction in most state, property specific taxes such as stamp duties, land tax and rates on dwellings, and replacement with a $500 million GST on food would increase national welfare (national consumption) by over $350 million due to reductions in distortions across the economy, but it would also increase the supply of housing considerably more, by over $400 million...

We ask:

- Whose consumption would increase by $350 million? The poor who face less discretionary income due to higher regressive GST charges or investors benefiting from lightly taxed capital gains enjoyed by the tax trickery of Self Managed Super Funds (where property investment is exempt from capital gains tax)?
- Small business who would no doubt face even higher rents when holding charges are removed?
- Why would there be less distortions in the economy? Simple and easy to administer taxes in the property sector would be shifted onto the retail sector where the administrative burden would increase.
- We are asked to accept that this will increase the supply of housing by $400 million. This implies that the retail sector should be slugged with this burden so we can build a whopping extra 800 homes (valued at $500,000 each).

Without some form of holding cost, there would be little encouragement for developers and speculators to put housing on the market to meet the prevailing market conditions. Those in control of our crucial housing supply have the upper hand. They can simply hold themarket to ransom.

Should an anonymous think tank be widely quoted that it is more efficient to allow one sector of the economy to enforce higher rents in the retail, commercial and household sectors as if this is solid economic theory? The property industry can act in this manner because they have an un-natural advantage over the productive economy. Their responsibility to shareholders demands that they engage in drip-feeding the market to maintain high prices, a practice that is ignored by the CIE report.

Lastly, the importance of Land Taxes is paramount when considering the consolidation of the Australian housing industry. Holding charges are vital to counter-balance the market power of the property industry.

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