The states must now look to land taxes

by Leith van Onselen

With the states turning down the Turnbull Government's offer of levying their own income taxes, Prime Minister Malcolm Turnbull is now insisting that they will have to raise their own taxes, including from land, before asking Canberra for more funds.

From the Australian Financial Review:

While the states welcomed the federal government's offer on Friday of $2.9 billion between them for hospitals to 2020, they did not draw attention to an agreement that they will improve their tax systems to reduce economic disincentives.

"We'll agree to consider income tax sharing within the current envelope and in return, states will consider state tax reforms which would, in turn, support economic growth," Mr Turnbull said after negotiating with the premiers...

Treasury modelling confirms, at a cost of around 70¢ for each dollar collected, state-based stamp duties on property as the biggest drag on economic growth. Axing them would produce a 1.5 per cent increase in GDP, or $24 billion, without directly changing the amount of tax raised...

With the states facing ballooning health care costs as the population ages, they will eventually be forced to raise their own taxes.

Thankfully, they have at their disposal one of the most efficient source of tax available – land taxes – which actually create positive welfare gains to the domestic population since non-resident home owners are also taxed (see below chart).

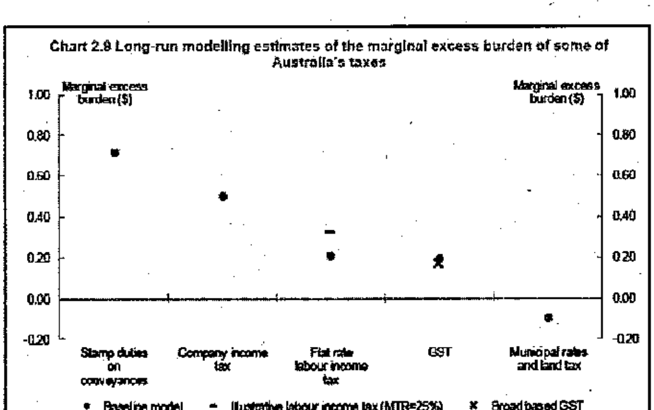

Chart 2.8 Long-run modelling estimates of the marginal excess burden of some of Australia's taxes

Source: Australian Treasury

As mentioned in the article, the biggest efficiency gains will be had if the states also abolish stamp duties when shifting their tax bases towards land taxes, which cost the economy around $0.70 per dollar collected

There are also other reasons to endorse a shift away from stamp duties towards broad-based land taxes.

First, stamp duty is an inherently volatile source of taxation revenue for state governments, since it is critically dependent on both the volume of housing transfers as well as the price at which those homes transact. By contrast, land tax receipts have proven to be a remarkably stable source of revenue when compared against stamp duties, since they are not affected by transaction volumes.

Second, stamp duties unfairly penalise people that move to homes that better suit their needs. Obvious examples include baby boomers downsizing from large family homes and young growing families upsizing to bigger family-friendly homes. Such disincentives inevitably lead to an inefficient use of the housing stock, such as empty nesters occupying large homes with multiple spare bedrooms. Stamp duties also hinder labour mobility since they discourage workers from relocating closer to employment.

Finally, land taxes would assist in the provision of new housing. They would help to make infrastructure investments self-funding for governments, since any land value uplift brought about through increased infrastructure investment (e.g. new roads, trains, etc) would be partly captured by the government via increased land tax receipts. Accordingly, governments would be more likely to facilitate development, rather than act to restrict it in a bid to save on infrastructure costs.

A broad-based land tax would also penalise land banking and land vagrancy, effectively increasing the supply of land in the process and bringing new homes to market more quickly.

Shifting the states' tax bases towards land taxes is a no-brainer on both efficiency and equity grounds and hopefully the upcoming funding squeeze will force the states to reform.