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INQUIRY INTO LAND VALUATION SYSTEM

Organisation: Association for Good Government

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SUBMISSION TO THE INQUIRY INTO THE LAND VALUATION SYSTEM

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IS THERE A FUTURE FOR LAND TAX?

Following the wider investigation of New South Wales taxes by IPART in October, 2008 the Joint Inquiry is to be congratulated for selecting land tax for further investigation.

We thank the members of the Committee for the opportunity to make a submission on such an important subject. This Association, we believe, is the probably the foremost defender of land value taxation in this state.

THE PRESENT SITUATION OF LAND TAX

AN UNFLATTERING ASSESSMENT

The Review of State Taxation made a rather unflattering assessment of land tax. IPART gave scores *out of five* to eight taxes. Scores varied as each criterion was weighted differently. When efficiency was the major component of the score land tax came third among these eight taxes. Yet, whatever the weightings land tax always came last for simplicity. Its overall score was a rather poor 2.4 out of five.

However, it would be wrong to attribute these poor results to land tax itself. Rather they result from the interference of its more powerful adversary, the institution of private property in land.

It is ironic that property-owners whose influence brings these imperfections into the operation of land tax then use them to portray land tax as a bad tax. People think that the tax avoidance industry is centred on income tax. It would be truer to say that the tax avoidance industry is focused far more on land tax.

The periodical volatility of land values is also not the fault of land tax. Rather, it is due to the absence of land tax. The volatility of land values occurs because, from time to time, private landownership leads to a frenetic speculation in land values. Ironically again, this volatility in land values is used by property-owners to undermine land tax itself. In sum: the imperfections in the land valuation system are not inherent; they issue from the institution of private property in land.

A TRUER ASSESSMENT

This may be clearly seen when private landownership is absent.

Rent itself, as Ricardo demonstrated, is not in its origin a money amount but a surplus return to the same effort due to where the effort occurs. As a surplus product due to a location rent is peculiarly suitable as a tax. For example, as a surplus, it can be gathered in full. That is, it has no limit to its application as have other taxes.

When the possession of this surplus is made subject to a payment an income stream is created which may be paid either directly or indirectly to the community. Such an income stream from rent has the following characteristics.

1.*Transparency*:
It is not hard to understand why one location is more valuable than another. Its advantages are observable. Those who use land are usually quite aware of what they are paying for.

2. *Equity*:
Because a location is not produced by any individual land-holder but by the presence and activities of the community that surrounds the land, it is plain that rent is an income stream that belongs to the community. On the other hand, land tax, by taking away so-called windfall gains, reforges the all-important economic link between productive effort and reward. Thus, this revenue is not a *wealth tax* but *a charge for the benefits of a location.*

3. *Predictability*:
When this income stream from rent is captured by the community and spent upon useful infrastructure it not only raises incomes generally, it enhances the value of land; that is, this investment makes the income stream even bigger. Thus, it can be predicted that, barring some enormous social or natural catastrophe, land value will constantly grow. In fact, there is evidence that the increase in this income stream from a large public investment in infrastructure is many times the initial investment.

4. ***Efficiency*****:**
Quantitative re-assessments of this income stream are being made every day and in every locality. These give rise to the market in rents and land values. Most of this work is done, not by the Valuer-General, but by the real estate industry. Added to the material benefits outlined above in 3. and the ethical benefits outlined in 2.the public collection of land values collection allows for elimination of the administrative and 'deadweight' costs of taxes levied on individual incomes.

Because of its alliance of practical and ethical benefits it is no wonder the idea of the 'single tax' had great popularity toward the end of the nineteenth century.

SOME WEAKNESSES IN IPART'S ASSESSMENT

Read carefully the assessment of land given by IPART (pp. 59-60) is really a call for the removal of the impediments to the achievement of the practical and ethical benefits of land tax. It speaks, for example, of "the wide range of exemptions that narrow its base and encourage land to be devoted to exempt activities" (p.59). It speaks as well of the inequity of the exemption offered to home-owners while renters pay the land tax for their landlords. It points out that the threshold may suddenly and unexpectedly make a landowner liable to the tax.

However, it needs to be said that sometimes the Tribunal members who issued the report to the NSW Treasurer are themselves ensnared by the picture of land tax projected by property-owners. They say, for instance, that "To some extent, land tax is a tax on wealth …" (ibid.) even while vaguely acknowledging that land value is a locational value that results from the presence and activities of the community (ibid.). Following on from this misapprehension that land tax is a tax on private wealth, they then call land tax "a discriminatory tax on wealth because it applies to only one dimension of wealth – ownership of land assets". Such errors of understanding demonstrate the confusion caused in the understanding of land tax by the institution of private property in land!

THE FUTURE: THE UNIFICATION OF THE LAND TAX AND RATING SYSTEMS.

If one were free to begin again it might be easy to deal with this confusion in the understanding of the nature of land tax. One could then divorce the holding of land from the holding of its value. Sadly, that is not the case. The best that government can do is to put land tax into a form in which it may grow. What would this form look like? Where would it begin?

GENERAL PRINCIPLES OF THIS REFORM

Such a system of land valuation for purposes of taxation would necessarily be uniform and universal throughout the state even though it did not gather more revenue than it does at present.*

This immediately suggests the unification of the two land valuation systems that now apply in New South Wales. At present one land valuation is made for both rates and land tax; the essence of the reform would be to subject that valuation to the same conditions for purposes of taxation. In appearance this tax would resemble the rating system which, until 1972, functioned more universally than land tax and with far greater public acceptance and understanding.

Under such principles this unification would in time eliminate many of those accretions that now make both systems so confusing and complicated. These features include the thresholds, the exemptions given to the principal place of residence and to primary production, rate pegging, differential rates, and the increasing multitude of user-pays charges that encumber rates notices. In this form the notice of payment would resemble a rates notice issued in New South Wales before 1993.

*The option of increasing the land tax made by IPART (p.121) would need some tax reduction that gave relief to those that the increase affected. The only tax one could think of to do this would be the GST which, most unfortunately, is beyond the control of the states.

The state government would determine the common or flat rate needed to create the combined revenues from rates and land tax. The assessments would continue to be done by the state government through the Valuer-General (with a department more adequately funded than it is at present). The notices would be issued and the 'rate' collected locally. Some variant of a 'grants commission', given the expected amount of annual revenue to be raised, would apportion revenue between local and state governments without reducing local revenues, the surplus being forwarded to the NSW Treasury.

THE BENEFITS OF THIS REFORM

Centrally located municipalities could be expected now to contribute more to the common fund. With this excess now available from centrally located municipalities the state government would be able to undertake greater responsibilities in the more undeveloped rural and marginal areas.

The important thing to note is that the later natural expansion of this revenue, which would occur without increasing the flat rate, would begin to deliver to the state government increasing revenue gradually enabling it to reassume its proper role in the provision of roads and public utilities and to enjoy a greater financial and political independence from the Commonwealth. For, one thing is very certain: land tax is a 'big tax'.

Because one can anticipate a natural growth in revenue from rent it would be possible in time to reduce or eliminate Stamp Duty, Payroll Tax and other taxes that constrict the state's economy.

Such a system as this would also address the present anomaly in the rating system. That is that in centrally located municipalities with higher land values and already established infrastructures rates tend to be much lower than rates in outlying shires that are not only in need of extensive infrastructure but are encumbered by debt. This is the very opposite of what rent theory and ethics would suggest in that here we have marginal sites paying more 'land tax' than those that are centrally located.

RESOLVING THE POLITICAL PROBLEMS

An attempt has been made in the foregoing discussion to model the collection of revenue from rent upon the rating system that, in general, has a long history of public acceptance and understanding.

However, there are inevitably not only administrative problems to be dealt with in this reform there is the political fall-out. Thus, it is necessary before introducing this system to make a careful examination of how it would affect those residential and rural properties that presently are exempt from land tax. To what extent would these groups be disadvantaged by the wider use of land tax?

Effect Upon Industry and Commerce

It is certainly not everyone who will be disadvantaged! Many will gain under this system either directly or indirectly. Given that the revenue remains the same while those that contribute to that revenue are increased, the average burden to those who already pay land tax will decrease. This in the main will be companies using industrial, professional, and commercial land. These will become more competitive with other states and better able to offer goods and services at lower prices.

Effect Upon Rural Areas

In addition, it would be reasonable to expect that primary producers and householders in rural and marginal areas would not be disadvantaged were rates payments to drop and be replaced by land tax. Rates at present could be twice as much as in the cities' suburbs. The complaint outside the main cities is that mounting social and physical infrastructure costs are getting well beyond the ability of rural shires to cope with. Here because land tax would now be paid these areas might well expect the state to assume a larger responsibility for the provision of amenities and local roads.

It would seem that rural areas in general would be better and not worse off. This of course accords with rent theory which, when applied to revenue, tends to take taxation away from marginal areas, leaving them more scope for development.

Local shires and councils may wish to resist the responsibility of collecting this revenue. However, in reality, it will not involve much greater cost and, as has been said, its collection may well give these bodies a greater claim about how it is spent. In addition, it is the state government that bears the greater expense, that of assessing land values.

Effect Upon Urban Areas

It would appear then that those most potentially disadvantaged are householders in centrally located areas. Given the enormous number of such urban households compared to rural households and properties, an investigation could well discover that their additional burden involved in a combined land tax/council rate is smaller than one might expect. After all, the total land tax in New South Wales is only about $2 billion. Rates bills would still represent value for money since they would be probably still less than annual charges for electricity and telephones.

In addition, the lesser cost of the combined land tax/council rates to commerce and industry would certainly benefit urban dwellers in the provision of employment opportunities and lower prices for goods and services.

The fact is that wages are generally higher in urban areas and the ability therefore to bear the cost of higher land costs is greater, while the ethical case for urban dwellers to assume a larger liability given the much greater supply there of both private and public services is obvious enough.

Councils in the greenfields areas of the larger cities currently have very high standards that have to be met before housing construction is permitted. They should take a look at any country town. Here there are very often no footpaths, kerb and guttering, a minimum of street lighting, and a lack of paved or well-maintained roads.

A lowering of standards to what they were in the 1950s might well have a salutary effect upon land prices. The idea that the maintenance of high standards will generate higher land values is misplaced as what really raises land values is the growth of settlement. This reform would considerably improve the ability to pay of many of the more needy urban households. The universal application of land tax in urban areas may well cause valuable land now held out of its full use to be used.

REFORM OF THE TAX BASE

The Boom-Bust Cycle

In addition to not costing any individual effort (since land value is the product of collective effort), gains in land value commonly give a larger return in a shorter time than work. This makes land a very attractive investment. Thus, in addition to there being a market in land *to use* there is a competing market in the buying and selling of land (really rent) *for profit*. This results in periodic surges in land price as more and more people are drawn into speculations of future gain. Land prices then lose touch with rents and with reality.

When some authoritative figures point out the danger to the economy of this phenomenon, land prices temporarily collapse along with the financial system, leaving a recession and the anomaly of land valuations by government grossly in excess of rents and rental returns. This occurred most dramatically when governments all over Australia applied land valuations from 1989 (the ‘boom’) to 1990 (the ‘bust’).

Rent as the Tax Base?

Therefore, to eliminate or at least reduce volatility in land values the alternative of basing revenue upon *rents* rather than *the selling price* of land merits serious investigation. Since there will be some years before the next period of intense speculation begins there is an opportunity for the Valuer General investigate the feasibility of this giant reform in the tax base.

CONCLUSION

Thanks to the opposition of property groups not very much is collected directly from property taxes in New South Wales. This however presents an ideal opportunity radically to reform the system, delivering significant general improvements without greatly disadvantaging anyone.

Much has been said nowadays about the inevitability of the switch of taxation from the mobile factors of production such as labour and capital to the factor that is immobile, land. There is an increasing recognition by economists of the worth of taxing economic rent. Singapore and Hong Kong have made interesting improvements in land tax recently while, in Britain especially, there is frequent media mention of the agitation for an increasing role for land value taxation in public finance upon ethical grounds.

In view of these trends and the depth of material and ethical advantages it offers as a source of public revenue, the radical proposals for the reform of the land valuation system contained in this submission deserve serious consideration.

At bottom all that is really needed to see the greater use of land value taxation is a greater understanding of what it entails. It is indeed shameful that the teaching of economics in schools and universities virtually ignores both rent theory and the study of those economists such as David Ricardo, Johann von Thunen, James and John Stuart Mill, and Henry George who have demonstrated the ethical, economic and philosophical underpinning for the use of rent as a basis for public revenue.

Surely those in the Office of State Revenue who administer land tax could be encouraged to enhance their understanding of the subject. This Association conducts both introductory and advanced classes in the philosophy and political economy of rent that would certainly be of use.

A NAME?

Much can be conveyed by a name. Much can be achieved by a better name. Strictly speaking, what we are talking about is not a 'land tax' since technically its yield does not come from land but location. At the same timed it is not a tax* but a charge for privately- and publicly-produced benefits surrounding land. It is more truly a *Community Charge.*

*A tax is a levy on private wealth.

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