

SUBMISSION TO STANDING COMMITTEE ON INFRASTRUCTURE TRANSPORT AND CITIES –
TRANSPORT CONNECTIVITY ECONOMIC DEVELOPMENT AND VALUE-CAPTURE

The submission on the above will be made in two parts, Parts A and B

PART B

In Part A of this submission the concept of Expanding Nodular Development (END) of urbanisation as a model for the future for Australia was described. In brief, END is a workable means of curbing capital city growth, reducing congestion and associated costs, reducing infrastructure costs, reducing housing and building costs, enabling development within environmental constraints, and promoting regional development. It would achieve these outcomes by diverting capital city growth into planned compact satellite cities which would be self sustaining economically and culturally. Development would occur roughly in concentric waves around the existing capitals, to accommodate population growth.

In this section of the submission, Part B, a vehicle for enabling the financial underpinning of infrastructure in the END concept will be proposed and discussed. As alluded to in Part A, the proposed basis or vehicle for value capture to achieve this is Land Value Taxation (LTV).

THE BENEFITS OF LVT

LVT has been described by leading economists as a uniquely efficient tax, and the ideal method of raising revenue for governments. The only possible ways that revenue can be raised are by taxing land, labour, consumption or capital. Taxation of labour through personal income tax is the major source of revenue in most Western countries, with about 47% of total revenue originating from this source in Australia. Company tax accounts for about 23%, and Consumption tax, or GST for about 15%. The remaining 15% is made up by Customs and excises, Petroleum excises, superannuation tax, fringe benefit tax and other minor sources.

On the surface it seems that income tax is progressive and fair in that those who have the greater income pay a higher proportion of their income as tax. However, it suffers, from the point of view of economics, a number of disadvantages. Firstly, though easily levied on salaries and wages, it can be easily evaded by business. Secondly, the payment of large amounts of income tax discourages enterprise and hard work. Thirdly, it is a tax on a factor of production, and hence increases the cost of production, thereby reducing the competitiveness of production compared with that of other countries.

Consumption tax such as the GST and sales tax is effectively a tax on labour, since wages must be raised in order to pay it. As with income tax, the result is to increase the cost of a factor of production, with the same ensuing disadvantage – prices of goods must rise, making them less competitive in the market place. GST introduces unfairness against workers, since most business GST expenses are passed on and are thus effectively exempt. But ultimately the consumer must pay GST except for some items such as food and rent. Thus business profits increase at the expense of reduced disposable income for wage and salary earners. In addition, a broad based GST is regressive and unfair in that both rich and poor consume approximately the same basic necessities of life, yet the poor have to pay a greater proportion of their income as tax for those basic necessities. It would be easy to reduce the rate of GST in a designated LVT area such as END cities, in order to provide an

additional incentive for workers and business to move to END cities. GST could be halved or removed altogether in LVT areas, but only to businesses and sections thereof that are established in the area. Businesses would be able to sell goods and services to anyone, inside or outside the designated areas, thus giving them a price advantage, and so encourage merchants, manufacturers, builders, electricity and gas retailers and professional service providers who sell to end users to establish themselves in END cities. There would be incentive for workers to move to END cities because much or most of their purchases would or could be from local sources (e.g. supermarkets, clothing outlets, white goods suppliers, motor vehicles retailers and gas and electricity retailers), and they would therefore be GST exempt on most items, not just food and rent.

Taxes on capital can take the form of taxes on profits and taxes on buildings and plant and equipment. Taxation of profits reduces the capital available for investment, and thus has a negative effect on the productivity of labour. And companies can move their profits offshore to a country or tax haven whose taxation regime is more benign, through various accounting procedures, and so avoid much or all of their taxation responsibilities to the host country. This is a vexing problem not only for Australia, but for many Western countries, and is difficult to solve. In some cases, high rates of company tax may induce a corporation to move its operations to another country, thus negating a country not only taxation revenue, but also contributing to unemployment.

Taxation on buildings, plant and equipment, i.e. the improved value of the land, discourages the erection of buildings and investment in plant, and hence inhibits a factor of production whose function is to increase the efficiency and productivity of labour.

But taxation of land (land only, not including the value of buildings and plant and equipment), avoids all of the above problems. It does not retard production since capital since capital is not taxed. It does not retard consumption since consumption is not taxed. It cannot be avoided since the value of land is ascertained regularly by independent municipal authorities in accordance with demand, i.e. market value. It ensures the efficient use of land through the reduction or removal of speculation – no one will purchase land and pay substantial land taxes unless there is a use for the land. Because there is no speculation and therefore no super profits made by developers, land prices rise only as a result of demand, and the building of housing and commercial and industrial buildings becomes more affordable. Corporate land tax cannot be avoided by international companies since land cannot be moved offshore. Foreign investors who buy property must pay substantial land tax and put it to good use – they cannot simply hold it in the hope of rising values, a phenomenon in the Australian housing market, which is contributing to high housing prices. An objection raised against LVT is that most sales of property involve both land and buildings, and that it is difficult to differentiate between the two. But in Australia, the value of the land is determined each year by independent municipal authorities, therefore the scheme is easy to administer, with no disputes arising between sellers and purchasers as to what proportion of a sale is for land only.

But what about those who do not own land? Do they not have to pay taxes to contribute to the welfare of the nation? They should, and this can be accommodated under a total LVT scheme as discussed later. However, the establishment of a total LVT scheme would take time, perhaps several electoral cycles for a transition to be made from a predominantly income tax/ consumer tax base to a predominantly LTV base. In 2013-14 revenue from property to local governments was only about 3.5% of all government (i.e. federal + state + local) revenue. If calculated over the whole nation, assuming GST were to remain the same, and income tax revenue were to be reduced to 75% of the

present, land tax revenue would have to increase about 10 times the present revenue in order to compensate. At this time LVT must be supplemented with other forms of taxation during the transition, but general reduction of income tax and land tax can be more easily made in the context of the END model which is limited in extent. It has been estimated (Land Value Taxation in Australia and Its Potential For Reforming Our Chaotic Tax System - Karl Fitzgerald September 15, 2006) that an annual capitalisation rate of about 8% would have covered about 50% of all current revenues in 1983-84 had there been no exemptions. As property values have risen considerably since then, a target of 50% reduction of all current taxes is a conservative target to aim for in the END model.

LVT AS APPLIED TO THE END MODEL

The END model would apply Australia wide, to all capital cities. Essentially END cities would be Greenfield developments, though they are associated with small “seed” towns to launch their development through provision of initial infrastructure and labour to enable building to commence. The essential ingredient to the END model is the creation of business enterprises which would require labour. Labour will migrate to any place where employment opportunities exist. Hence it is important for END sites to offer economic advantages to business. It goes without saying that the sites must also offer natural advantages for production to a market which is existing or emerging. As discussed in Part A of this submission, Australia has natural advantages in flat open land, a mild climate and abundant sunshine, all ideal for intensive and efficient primary production such as horticulture, aquaculture, dairy, piggeries and poultry. This primary production leads to secondary production in the form of processing, manufacturing, and packaging and also to storage, transport and logistical facilities. The availability of cheap thermal energy will attract energy intensive industries such as the chemical, pharmaceutical and textile industries. The flow-on effect of primary and secondary industry is the necessary establishment of service industries – financial, retail, wholesale, health, education, entertainment, professional services etc. As discussed in Part A, the multiplier effect of primary plus secondary is about 7.5, i.e. for every primary and secondary job created, another 6.5 jobs are created in service industries. Hence there will be employment opportunities, so that the maxim “people should live where they work” can be achieved, with all the ensuing benefits of reduced congestion, reduced pollution, lower infrastructure costs and far less waste of time and energy. As discussed above taxation advantages enabled by LVT in the form of reduced income and consumer taxes would assist in the rapid enacting of this maxim. All of this should be seen in the context of the huge emerging markets in China, South East Asia, Korea, and India where a growing middle class is clamouring for high quality primary products for which Australia is renowned and can supply.

LVT CAPITAL ATTRACTION AND REVENUE DISTRIBUTION

LVT would play a vital role in attracting capital to END cities in the following ways:-

1. It would keep land prices low through the removal of speculative forces and stamp duty. Land prices would rise on demand, and initially prices on Greenfield sites would be low. Removal of stamp duty from vacant land prices in Victoria would lower land cost by about \$57,000 on a \$1,000,000 dollar property.
2. The application of LVT could be used to reduce company income tax to offset LVT. If the company tax rate could be reduced to 15% as should be possible with full implementation, from the present 30%, thus lowering it in relation to European countries, (the UK rate is 20%) and Hong Kong (16.5%) and Singapore (17%), a reduction in magnitude of this size would attract considerable initial capital, both from local and overseas sources. In the early stages of an END site development, LVT would be small, but reductions in income tax and GST would be high and immediate, encouraging rapid response from investors. A lower tax rate would also mitigate tax evasion and the migration of profits offshore.

3. LVT levied on the value of the undeveloped land would not discourage further investment by established enterprises. Thus buildings, plant and equipment can be augmented with no increase in taxes other than income tax from increased profits.
4. Revenue from LVT would be distributed to the three levels of government, federal, state and local. Depending on the nature and volume of expenditure at any particular time, the division of revenue among these three bodies can be adjusted from year to year. Thus initially a greater proportion could go to the State for works such as planning and the provision of infrastructure such as major roads, water supplies and waste treatment plants. Later a larger proportion could be apportioned to the local government for minor works, maintenance and community services. The federal government proportion would be used largely to compensate for loss of revenue due to reduced income tax. It would be low initially, and greater as the economy of the End city expands. In this way distribution is flexible, and a greater proportion of revenue can be directed towards infrastructure at a time when it is most needed.

LVT AND NON-LANDHOLDERS

LVT applies to land holders only, yet not all citizens are land holders. A large proportion rent their properties, not only domestically, but also commercially and industrially. All of these would not pay LVT directly, but would do so indirectly through their rent. The owner of the land would recover his LVT from the tenants through rent.

LVT AND DOMESTIC LANDHOLDERS

Domestic landholders own their own residential block, but they do not gain revenue from it. Yet as land values rise due to economic development, their LVT would increase and their overall tax burden could rise possibly to an unsustainable level. Should domestic landholders be compensated for a rise in LVT, when they collect no revenue from their land? A socially desirable outcome would be that they would be compensated, at least partially, since in Australia, home ownership is highly valued. One way that they could be compensated is through their income tax payments. Tax free thresholds could be introduced and adjusted so that LVT would be completely compensated with a neutral tax outcome. However, depending on the market forces driving up the value of land, this may not always be possible. Ultimately, if the land value increases to the point where LVT is too high for a domestic landholder, he will have to sell the land and buy in another locality where land values are lower. But if he buys in a LVT zone, he will not have to pay stamp duty! Selling land to make it usable to a person who is willing and able to use it is one of the advantages of LVT – it promotes the best use of land. Low effective use must make way for higher effective use. Of course zoning of land exclusively for a particular type of use, for example medium density housing, would mitigate excessive rise in land values for domestic landholders.

IMPLEMENTATION OF LVT IN THE END MODEL

The application of the END model would commence in the vicinity of all capital cities in Australia, hence across State and municipal boundaries. As discussed above, it also has enormous implications in respect of taxation, especially income tax and GST. For these reasons, the following guidelines are recommended;-

1. Overall administration of the model should be under the control of the federal government.
2. All END sites should be designated and geographically specified as LVT zones where LVT is collected on undeveloped land only, and where other taxes such as income tax, payroll tax, capital gain tax and GST are modified to dovetail with LVT.
3. Only those sections of a corporation or business which are physically located in an LVT zone would be eligible for income tax, GST and other tax concessions.

4. Rates for LVT would be assessed by the federal government in conjunction with the states and municipal associations, possibly on a site by site basis, but preferably across all END sites in order to give all sites the same tax advantages.
5. Distribution of LVT revenues would be determined by the federal government in conjunction with the relevant states and municipalities for each site, on a year to year basis in accordance with its requirements at a particular phase of development.
6. Planning of END cities and implementation of major works would be the responsibility of the States.
7. Planning of minor works, community works, and maintenance within END city precincts would be the responsibility of local governments
8. Regulation of capital inflow into the country, ownership rules for foreign investors would be the responsibility of the federal government.

IN CONCLUSION

From the foregoing discussion, an excellent case can be made for the use of LVT as a means of value capture for the building of infrastructure. The END model of urbanisation in Australia presents a long term means of developing an efficient, ordered, environmentally benign Australia, able to sustain a growing population to 40 million and beyond at the high living standards it is presently enjoying, in a world that is becoming ever more competitive, but one which also offers unprecedented opportunities for our economic prosperity.

The ball is in our court. Either we remain in our ever deepening inertial rut, or we break free with big and bold innovative ideas. In addition to offering obvious economic advantages, LVT as applied to the END model provides an entry into tax reform in this country, reform which is desperately needed, but is slow in coming – reform which would increase economic efficiency, which would reduce income and consumption tax to encourage economic growth, which would facilitate the distribution of adequate revenue to the States, and which would reduce tax evasion and the migration of capital. This reform could be tried and honed with the application of LVT in a limited way in END zones, before being extended into the wider community. With more favourable taxation regimes, capital can be attracted from local and overseas sources to develop the industry we need. More favourable regimes in the form of reduced GST in END zones would also be a further attraction for capital and labour to move to END cities

We have nearby markets for primary products, which together with free trade agreements which have recently been negotiated, are ripe for the picking. The opportunities are there, our ability and knowhow to capitalise on them is there, the strategies are there, and the capital and labour that is needed can be made available. All that is required is the political will to act with boldness, confidence and courage.

