The Elected Representative's Guide

to

Site Revenue for Public Finance

Why Victoria needs more land tax, not less

Why Victorian local councils need Site-Value rating, *not* Capital-Improved-Value taxation

by

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To the memory of

Allen Fairhall KBE

24 November 1909 — 3 November 2006

Minister under Menzies, Holt, McEwen, and Gorton
Joint Patron of the Land Values Research Group
Author of *Towards a New Society*
Advocate of Land Value Taxation

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LETTER TO THE READER

Dear Member or Candidate,

We have produced this Information Kit on the assumption that, as a member of or candidate for the Victorian State Parliament or as a Councillor for a Victorian municipality, you seek nothing but the welfare of your electorate and its citizens.

It is greatly concerning that in recent years both the government and opposition and most minor parties in the State Parliament have turned land tax into something of a scapegoat, whilst many councillors appear unaware of the enormous advantages that site rating can bring to a municipality. Some members of parliament even seem to be under the impression that land taxes damage home affordability or increase the price of land, when the opposite is actually the case.

We can only assume that such an approach is formed from ignorance rather than malice. *Land tax or site rating is not just one means of raising revenue for the public good; it is the best means.*

This Information Kit serves to remedy some of the misconceptions concerning land tax and site rating. Unlike taxes on goods and services, site rating cannot be passed on to the consumer. Likewise site rating contains no deadweight loss to production. Contrary to common belief, site rating or land tax does not increase the price of land; indeed, the imposition of such a fee reduces the price.

In 2001 the State Government's *Review of State Business Taxes* (the **Harvey Report**) recommended a 2.89% land tax on business holdings. Such a land tax also involved removing stamp duties for business transactions (i.e. general insurance, third party insurance, life insurance, property conveyances, unquoted marketable securities, mortgages, non-residential leases, and rental agreements), and reducing payroll tax.

The Report claimed, quite accurately:

"Land tax is potentially the most efficient tax base available to the State Government. It is currently under-used. Victoria has the lowest reliance on land tax of any state, and no state currently levies land tax efficiently. Imposing a low flat-rate land tax with no threshold (replacing the progressive land tax scale that had led to aggregation avoidance, the flight of capital from Victoria and complexity that delivers little to growth) is seen as creating the least distortion to business decision-making to invest or locate in Victoria" [p. *viii*].

Attention is also drawn to the Commonwealth Productivity Commission report *Directions for State Tax Reform* (1998). That report stated:

"There appears to be considerable scope for the States to place greater reliance on land tax as a source of revenue. Extending land tax to owner-occupied housing, as New South Wales has done recently, would ensure more equitable treatment of home owners and renters. It is clearly unfair that home owners, who tend to be more affluent than renters, are exempt from land tax. Such a move would improve the efficiency and fairness of the land tax" [p. *xxxi*].

Currently public concern with land tax arises from recent rapid rises in land values and the harshly progressive implementation of the tax. Reducing land tax will simply exacerbate speculative bubbles in land prices at the expense of productive investment — and increase the potential for economic crashes as the bubbles burst.

Custodians of the economic well-being of this state and its municipalities must put aside partisan differences and assess the beneficial economic effects of land tax and site rating.

You are welcome to contact **Prosper Australia** for further discussion on this matter. Rest assured that we will do our utmost to support those politicians and councillors who are also advocates for public revenue to be funded through the site value of land.

I am particularly thankful for the works of Phil Anderson (in particular the paper "Victoria's Municipal Rating System", published by the Australian Institute of Urban Studies, 1991), the Economics Group of the Australian Housing Industry Association, and the U.S.-based School of Cooperative Individualism.

Yours sincerely,

Lev Lafayette.

SITE RATING IN VICTORIA: THE FACTS

In 2004, Victoria's 2.36 million properties were valued at $771 billion. A low annual tax rate on such a vast asset value can make a significant contribution to the public treasury. In Australia, the local level of government makes the most use of this source of revenue.

Local councils in Victoria must value property in one of three ways: (i) **capital-improved value** (**CIV**), which is the total market value of the land plus buildings and other improvements; (ii) **net annual value** (**NAV**), which is the property's current net annual rent (at least 5% of the CIV for a commercial property and exactly 5% for residential property); or (iii) **site value** (**SV**), which is the market value of the land only.

In any other debate about taxation, it would be considered self-evident that taxing a producible commodity discourages its production. Applying this premise to local rates, one would conclude that because the CIV and NAV include values of buildings while the SV does not, the use of SV rating would maximize construction of buildings and the economic benefits that flow therefrom, including adequate supplies of housing and business accommodation. Nevertheless, in 1993, Victoria's Office of Local Government recommended that all newly amalgamated councils adopt CIV [*Rates: Proposals To Improve Victoria's Municipal Rating System*, Office of Local Government, 1993]. At the time of the release of the report, the breakdown of rating systems was as shown in Table 1.

Table 1: Numbers of municipalities with various rating systems in Victoria, 1993. The so-called "shandy" was an average of SV and NAV rating. [Source: *Victoria's Municipal Rating System*, Australian Institute of Urban Studies, 1996.]

Region	**SV**	**NAV**	**CIV**	**shandy**	**Total**
Metropolitan:	26	27	1	1	55
Provincial:	21	23	–	–	44
Rural:	55	142	12	1	210

Under legislation subsequently passed by the Kennett government, councils may apply different rates for different land uses if, and only if, they assess property according to capital-improved value (CIV). This allows councils, for example, to set a lower rate in the dollar for farm and residential land and a higher rate for commercial and industrial land. There is no limit on the number of differential rates that can be levied, but the highest differential rate can be no more than four times the lowest differential rate.

Not surprisingly, nearly all Victorian councils felt compelled to use the capital-improved value in order to obtain the proffered flexibility. This blatant preference for CIV rating, imposed from the top, swept aside dozens of local plebiscites which had voted for SV over other valuation systems, often with overwhelming margins.

Today, only Monash Council retains SV rating. The positive effects of this choice are readily apparent:

Monash has the largest number of both businesses and jobs among the 11 municipalities. It performs a key role in providing employment to people living in other parts of the region, particularly in the newly established and growing suburbs of the outer south-east.

As a result, of all the 11 municipalities, Monash is the most influential provider of household disposable income to residents in neighbouring municipalities. Unlike some municipalities that provide jobs and therefore household income primarily to their own residents, Monash is a key provider of income to the residents of Greater Dandenong, Casey, Knox, Cardinia, and Kingston. There is a high level of interdependency between Monash and the other 10 municipalities in the region. Not only is it an important jobs hub, but Monash also is a major generator of wealth in the region. After Kingston, it has the highest export output per capita of all municipalities in the region. It also is the least dependent local government area in the region on government transfer payments to residents, indicating on average a high degree of employment and wealth among its residents.

— *Prosperity for the Next Generation*, City of Monash, 2001.

LAND TAX IN VICTORIA: THE FACTS

In the past the State of Victoria has shown great leadership in using site value as a source of public revenue.

The State first introduced a land tax in 1877 (Land Tax Act 1877, No. 575) with the express purpose of breaking up large estate holdings and to spur productivity. This tax was the first of its kind in Australia (and preceded South Australia's general income tax by seven years).

The system proved so successful that in 1910 the Commonwealth introduced site revenue for public finance (Land Tax Act 1910, No. 21). Prior to that the Commonwealth gained revenue through customs and duties, which contradicted the political objective of free trade between the States. A Land Tax Office, the predecessor of the Australian Tax Office, was introduced in the same year.

According to the ATO's own web site:

"In 1910 a land tax was introduced by the Commonwealth Government to provide for the defence of the nation and to prepare for a major increase in migration. The land tax was also introduced to encourage large landholders to subdivide their land and sell it to settlers. Many large landholders were wealthy Englishmen who would rarely visit or use their land. Introducing a land tax encouraged them to sell to settlers who would use the land productively" [*Australian Tax History*, April 7, 2003].

In 1915 the Commonwealth introduced taxes on personal income and undistributed company profits. The name of the Land Tax Office was changed to "Taxation Office" to reflect the new sources of revenue. These included an "Entertainment Tax" introduced in 1917 (which remained in force until 1953), and a War Tax on postage stamps (which remained in force even after the legislation was removed in 1920). In 1952 the Commonwealth land tax was abolished and management of land tax was left to the States.

In Victoria, the Land Tax Act 2005 imposes an annual tax on the total taxable value (previously known as the **unimproved value**) of all land owned in Victoria, excluding exempt land, at midnight on 31 December of the year preceding the year of assessment. Land Tax is assessed on a calendar year basis. The State Revenue Office (SRO) issues assessments during the period March to June each year.

Hence the 2006 assessment is calculated on the total taxable value of all land owned (either solely or jointly) at midnight on 31 December 2005. Your Land Tax bill is calculated by selecting the appropriate tax rate from the table showing the scale of tax rates and applying this figure to the total taxable value of all land you own, excluding any exempt land.

The following three tables show the new (2006) land tax scale for trusts (Table 2), compared with the land tax scale for non-trust taxpayers for 2006 (Table 3) and 2005 (Table 4). [Sources: Baldwin's Lawyers and Consultants, 2006; Victorian State Revenue Office, 2006.]

Table 2: Land tax scale for trusts, 2006. The top special trusts rate of 3.5% will be progressively reduced in line with prospective reductions in the top rate of tax applying to non-trust taxpayers.

Total Unimproved Value	Special Trusts Rate
$0 - $19,999	Nil
$20,000 - $1,189,999	$200 + 1% of the value exceeding $20,000
$1,190,000 - $1,619,999	$11,900 + 1.5% of the value exceeding $1,190,000
$1,620,000 - $2,699,999	$18,350 + 2.25% of the value exceeding $1,620,000
$2,700,000 and over	$42,650 + 3.5% of the value exceeding $2,700,000

Table 3: Land tax scale for non-trust taxpayers, 2006.

Total Unimproved Value	2006 Land Tax Rates
0 - $199,999	Nil
$200,000 - $539,999	$200 plus 0.2% of the value exceeding $200,000
$540,000 - $899,999	$880 plus 0.5% of the value exceeding $540,000
$900,000 - $1,189,999	$2,680 plus 1% of the value exceeding $900,000
$1,190,000 - $1,619,999	$5,580 plus 1.5% of the value exceeding $1,190,000
$1,620,000 - $2,699,999	$12,030 plus 2.25% of the value exceeding $1,620,000
$2,700,000 and over	$36,330 plus 3.5% of the value exceeding $2,700,000

Table 4: Land tax scale for non-trust taxpayers, 2005.

Total Unimproved Value	2005 Land Tax Rates
0 - $174,999	Nil
$175,000- $199,999	$175 plus 0.1% of the value exceeding $175,000
$200,000 - $539,999	$200 plus 0.2% of the value exceeding $200,000
$540,000 - $709,999	$880 plus 0.5% of the value exceeding $540,000
$710,000 - $849,999	$1,730 plus 1.0% of the value exceeding $710,000
$850,000 - $1,129,999	$3,130 plus 1.75% of the value exceeding $850,000
$1,130,000 - $1,619,999	$8,030 plus 2.75% of the value exceeding $1,130,000
$1,620,000 - $2,699,999	$21,505 plus 3.0% of the value exceeding $1,620,000
$2,700,000 and over	$53,905 plus 4.0% of the value exceeding $2,700,000

Notice that, although trusts now pay more tax than non-trust taxpayers for low-value holdings, the change between 2005 and 2006 favoured owners of the most valuable holdings, *even if the land was owned through trusts*.

Furthermore, in the 2005-06 Victorian State Budget, the Treasurer announced a capping measure whereby the actual Land Tax for 2006 will be the lesser of the 2006 notional tax and 150% of the 2005 notional tax, regardless of whether the taxpayer's land holdings have increased, decreased, or remained the same.

Implicit in these changes is the assumption that, while an increase in one's *earned* income is a windfall justifying an automatic mathematical increase in one's tax contribution, an *unearned* increase in the value of one's land holdings is a misfortune demanding "relief" from the mathematical tax implications, even if one's cash flow is such that one can afford to acquire additional land at the same time! But, as this Section purports to be concerned with facts rather than value judgments, we simply spell out the assumption without further comment.

How Prices of Land and Housing are Determined

The price of land, like the price of anything else, is obviously determined by supply and demand. But in the case of land (and other natural resources) both supply and demand have peculiar characteristics.

Fixed supply of land

First it must be understood that the term **land**, in the economic sense and certainly for the purposes of land value taxation, refers only to the **unimproved** value of resources and opportunities provided by nature. Thus *the supply is always fixed*. Even the extraordinary efforts evident in the Dutch dikes did not create more *economic* land; rather, the original shallow bay was land in the economic sense, and the construction of the dikes and drainage of the bay were **improvements** thereto.

So-called "investment" in land is therefore fundamentally different from investment in capital equipment, such as buildings (or dikes). Putting money into construction, for example, creates a new asset (a building) from human labour and machinery. Both the asset and its construction contribute to employment and further economic growth (the multiplier effect). In contrast, the mere purchase of economic land provides no new goods, as *the land already existed*. The purchase of land is actually a form of **saving** rather than a form of investment — like putting money in the bank instead of spending it on new productive assets. It is well known that when a central bank raises interest rates, thereby encouraging saving rather than investment, it suppresses economic activity. For the same reason, any policy that artificially encourages the purchase of land also *suppresses economic activity*. It also raises the price of land at the expense of those who need it for useful purposes.

In a country as large and as sparsely populated as Australia, emphasis on the fixed supply of land may strain credulity. Indeed, the fixed *overall* supply is a third-order issue. More important is that, from the viewpoint of private entities (individuals and firms), the supply of land zoned for particularly lucrative purposes (e.g. housing or commerce) is also fixed. This form of scarcity is emphasized by developers who complain about restrictive zoning practices and delays in approvals of development, blaming these things for the high prices of newly developed residential lots.

But even that is only a second-order issue. The most spectacular growth in property values has occurred not at the city fringes, where zoning and development approvals are most influential, but in prestigious suburbs close to the CBD and/or the coast [see e.g. http://henrythornton.com/blog.asp?blog_id=725]. This sensitivity to *location* arises because, from the viewpoint of private entities, *the supply of land within a particular distance of particular infrastructure, markets, services, or natural attractions is fixed*. That is the most important sense in which the supply of land is fixed, and the most important reason why for economic purposes, even in a country with a low overall density of population, land is scarce.

The limited supply of land, whether it is understood as the limited overall supply or the more limited supply of suitably located land, means that *land is a monopoly*. To argue that land is not a monopoly because one can buy land from competing sellers is like arguing that Microsoft Windows is not a monopoly because one can buy copies from competing retailers. As all legal copies of Windows come from one source (Microsoft), so all land comes from one source (nature). The limited supply of land also means that *the present owners of land automatically constitute a cartel*, even if they make no effort to organize themselves as such.

Variable supply of buildings

The limits on the supply of land do not apply to buildings. If the demand for *buildings* increases, participants in the free market can augment the supply and thereby offset the upward pressure on prices. This mechanism does not work with land. Consequently, increases in the prices of house-land packages (often erroneously called "house prices") are almost exclusively due to increases in land prices. A recent report of the Housing Industry Association Economics Group shows how land prices have increased enormously over the decades, while the prices of buildings have increased only in line with general inflation (see the table below). In fact, due to technological progress, the cost of building a house has *declined* very slightly over the last fifty years *in real terms*.

Table 5: Typical prices of new houses and housing lots (standardized to a 135m^2 house and a 700m^2 lot).

	1973	1983	1993	2003
House:	$14,000	$35,000	$75,000	$112,000
Land:	$6,900	$15,800	$49,000	$107,000

Speculative demand

Concerning the *demand for land*, two points should be noted. First, as illustrated by the high prices and high growth in prices in inner suburbs, the demand for land is *location-specific*. Second, as land values tend to increase, the demand for land includes a significant **speculative component** — that is, a desire to buy land simply in order to resell it later for a higher price ("primary" speculation) or avoid buying it later at a higher price ("secondary" speculation). Because speculation requires holding land for a time, it represents a net addition to the demand for land and therefore tends to increase the price, especially during **bubble** periods, when the price is supported by nothing more than the assumption that some other fool will pay an even higher price in the future. As primary speculators avoid commitments that might interfere with their ability to sell at the most opportune times, and as secondary speculators avoid commitments that might interfere with other plans, land held by speculators may be unavailable for construction or rent. This phenomenon is sometimes called an **artificial shortage** of land, but is more correctly understood as an artificial addition to demand (supply being fixed); but, whatever it is called, its effect is to raise prices and rents.

Land value taxation or SV rating *reduces the ill effects of speculation* to two ways. First, it imposes a holding cost on the land, making it less attractive to hold land in pursuit of capital gains *alone*, and obliging the owner to seek tenants (and, if necessary, build accommodation) in order to generate income to defray the tax. Second, it smooths out bubbles and bursts in the land market: in a rising market, the rising tax liability counteracts the urge to "buy in", whereas in a falling market, the falling tax liability counteracts the urge to "bail out".

However, for maximum effectiveness against speculation, *the tax must apply to site values alone*. If it applies to buildings, it will discourage construction just as speculation does. And for a given amount of revenue, extending the tax to the value of buildings implies a lower rate on the value of the land, hence a lesser countercyclical effect on the land market.

Location, location...

The influence of location on demand requires elaboration. When the market is rational (which is *not* the case during bubbles), the price of a **site** (i.e. a piece of ground or airspace) is the **capitalization** or **present value** of the anticipated future rental value. The rental value, in turn, depends on the opportunities — including public infrastructure, markets, services, and natural features — to which the site gives access by reason of its *location*. To the extent that these opportunities are due to economic activities, the activities are almost exclusively carried on by parties *other than the site owner*.

It follows that taxing the site value (or the increase in that value) in the hands of the site owner does not deter productive activity or raise prices downstream of that activity. In contrast, almost every other tax deters a productive activity *of the taxpayer*, and consequently reduces the supply and raises the price of every good or service that depends on that activity, forcing the central bank to counteract the inflationary pressure by means of higher interest rates, which further reduce activity.

The implications of the foregoing are simple and stark. Every time a government (Federal, State or local) introduces a new tax or rate on labour or capital (including buildings), it feeds inflation and stifles production of goods and services and construction of buildings, causing unemployment and housing stress. But every time a government instead raises revenue from land tax or SV rating, it dampens speculation, encourages production, reduces inflationary tendencies, promotes employment, and relieves housing stress.

Economic Effects of Taxes, Rates and Site Rents

The effect of taxation on the market for a good or service is shown in Fig.1. In the absence of tax, the price and the quantity supplied and consumed are given simply by the intersection between the supply and demand curves: the quantity is Q^1 and the price is P^1. If the good or service is taxed, the tax per unit is the gap between the price paid by the consumer (on the demand curve) and the price received by the supplier (on the supply curve). This gap is the height of the grey rectangle. The quantity supplied and consumed becomes Q^2 and the price paid by the consumer becomes P^2. The total revenue raised by the tax is equal to the tax per unit multiplied by the (new) quantity; this product is the area of the grey rectangle.

Fig.1: The effect of tax on production and consumption of a good or service. The quantity supplied and consumed falls from Q^1 to Q^2. The price paid by the consumer rises from P^1 to P^2. The grey rectangle's height is the tax per unit while its area is the total revenue raised.

If the supply and demand curves have equal and opposite slopes, as in this example, the tax raises the price paid by the consumer by the same margin as it lowers the price received by the supplier, so that the burden of the tax is equally shared between parties. The reader can easily verify that if the demand curve is steeper (i.e. if demand is **less elastic**), the consumer bears more of the burden, whereas if the supply curve is steeper (i.e. if supply is less elastic), the supplier bears more of the burden. Increasing the slope of either curve also reduces the margin by which a given tax reduces the quantity. In the extreme case in which the supply curve is *vertical* (**inelastic supply**), the entire tax burden is borne by the suppliers and the quantity supplied is not affected.

Now let us apply this to the land rental market.

If the tax is levied on the rent *actually paid*, then the "price" is the rent, while the "demand" is the quantity of land that would be rented (at the proposed price), and the "supply" is the quantity that would be offered "to let". In this case the supply curve is steep, but not exactly vertical, because owners can respond to higher rents by offering a greater fraction of their land to let. And if the supply curve is not vertical, consumers (in this case tenants) bear some of the tax burden.

But of course a land tax or SV rate is not levied on the rent *actually paid*. It is levied on the capitalized land value, which is proportional to the *potential* rent, which is incurred either by tenants (by renting the land) or by owners (by *not* offering the land to let). So the relevant "supply" is not the quantity of land that would be offered to let at the proposed price, but rather the quantity *potentially* available for rent. This quantity is indeed fixed, so that the supply curve is indeed vertical. And the relevant "demand" is not the quantity that would be rented at the proposed price, but rather the quantity that would be rented *or* withheld by owners — both options being "demand" in the sense of excluding others from both occupying the land and paying the price. This quantity is obviously sensitive to price and would be variable if the "supply" were not fixed; that is, the demand curve is not vertical. Thus we have the extreme case in which suppliers bear the whole tax burden.

The implication is that *a tax on the value of land will not raise the rent paid by tenants or reduce the quantity of land rented*. In the words of Samuelson and Nordhaus:

"The striking result is that a tax on rent will lead to no distortions or economic inefficiencies. Why not? Because a tax on pure economic rent does not change anyone's economic behaviour. Demanders are unaffected because their price is unchanged. The behaviour of suppliers is unaffected because the supply of land is fixed and cannot react. Hence, the economy operates after the tax exactly as it did before the tax — with no distortions or inefficiencies arising as a result of the land tax" [*Economics*, 16th ed., p.250].

In Fig.1 we see that if consumers bear some of the tax burden, they do so because suppliers can respond to the tax by restricting supply, forcing the price point "up the demand curve". In this way, some of the tax is "shifted" onto consumers. Hence a tax on *actual rent paid* can be partly shifted onto tenants, because landlords can respond to the tax by offering less of their land "to let", thus reducing the supply. The same is true if the tax base includes buildings (as with CIV or NAV), because the supply of buildings is not fixed; if buildings are taxed, fewer will be built, and the restriction of supply will shift some of the tax onto tenants. But if the tax is levied on *potential* rent, it cannot affect the relevant measure of supply. Consequently taxes on land values cannot be "passed on" to tenants or "shifted" onto tenants.

There are other arguments that lead to the same conclusion. For example, the market rent of land is not determined by some tax-inclusive cost of supply, because there is no cost of supply. Rather, the market rent is determined by competition among potential tenants. The effect of the tax is simply to take some of that market rent (or potential rent) from the landlord.

(This does not stop landlords from claiming that land tax is passed on. But if they could pass it on, why would they complain about it? The truth is that landlords dislike land tax because they *cannot* pass it on, but campaign against it by claiming that they *can* pass it on!)

Note, however, that when we say that the supply of land is fixed, the word "supply" refers to the *stock* of land, not the rate of turnover of that stock. So the thesis that land taxes cannot be shifted is true of *holding* taxes on land, not turnover taxes on land. For example, it is *not* true of a stamp duty on property conveyancing, even if the duty is levied on the land value alone. But it would be more nearly true of a stamp duty levied on the *increase* in the land value since the last transfer of title, because in that case, as with a holding tax, the tax liability would accumulate during the holding of the asset and would only be *realized* on transfer of the asset.

Of course, when we apply the foregoing analysis to the labour market, we find that payroll tax reduces the number of people employed and increases the cost of employing each one. The latter effect, in turn, raises prices. And when we apply the analysis to goods and services in general, we find that GST reduces consumption and raises prices.

Adam Smith's "canons of taxation"

Nadia Weiner, Director of the Adam Smith Club of Sydney, has summarized Adam Smith's views on taxation as follows (our emphasis added):

Although Adam Smith is often quoted, the so-called "Father of Economics" has rarely been read, either by his detractors or his admirers. Consequently he is often misunderstood.

Smith, who made such a strong stand against the protectionist mercantile system of trade of his day, devoted over one third of his masterpiece, *An Inquiry into the Nature and Causes of the Wealth of Nations,* to discussing the subject of government revenue and the methods by which it may be best collected, including new taxes. This is not generally known.

When examining the different forms of taxation, Smith adheres to four maxims which a good tax should conform to:

1. "The subject of every State ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the State."
2. "The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to ever other person."

3. "Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it."
4. "Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the State."

Bearing all these things in mind, there are two types of taxation which obtain Smith's recommendations: a tax on luxury consumables and a tax on ground-rents (the annual value of holding a piece of land).

On the subject of luxury consumables, he is adamant about the definition of "luxury" and of "necessary." By his definition, a "necessary" may vary from place to place and from time to time. At the time of his writing, linen shirts, leather shoes and a minimum of food and shelter were definitely to be regarded as essential to a minimum decent standard of living. Taxes on salt, soap, etc., he harshly criticized as inequitably taking from the poorest elements of society. Taxes on luxuries, which were to include tobacco, he considered excellent in that no one is obliged to contribute to the tax: "Taxes upon luxuries have no tendency to raise the price of any other commodities except that of the commodities taxed... Taxes upon luxuries are finally paid by the consumers of the commodities taxed, without any retribution."

More deserving of praise is the tax on ground-rents: "**Both ground-rents and the ordinary rent of land are a species of revenue which the owner, in many cases, enjoys without any care or attention of his own... The annual produce of the land and labour of the society, the real wealth and revenue of the great body of the people, might be the same after such a tax as before. Ground-rents, and the ordinary rent of land are, therefore, perhaps the species of revenue which can best bear to have a peculiar tax imposed upon them.**"

Excise, customs, taxes on profits, were, according to Smith, either expensive to collect, as in the case of excise, or disincentives to produce, as in the tax on profits. He reserves harsh words for taxes which occasion the invasion of privacy, and on the subject of excise he says: "To subject every private family to the odious visits and examination of the tax-gatherers ... would be altogether inconsistent with liberty."

The harshest condemnation of all, however, was for taxes upon labour: "In all cases, a direct tax upon the wages of labour must, in the long run, occasion both a greater reduction in the rent of land, and a greater rise in the price of manufactured goods, than would have followed from a proper assessment of a sum equal to the produce of the tax, [levied] partly upon the rent of land, and partly upon consumable commodities."

Note that in Smith's writings, "**ground-rents**" are the rents of land under buildings, excluding the buildings themselves and any other improvements, while the "ordinary rent of land" means the rent of land for *agricultural* purposes, including improvements on such land. On the distinction between the two, he wrote:

Ground-rents seem, in this respect, a more proper subject of peculiar taxation than even the ordinary rent of land. The ordinary rent of land is, in many cases, owing partly at least to the attention and good management of the landlord. A very heavy tax might discourage too much this attention and good management. 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.**

— *The Wealth of Nations*, V.ii.76 (emphasis added).

The modern equivalent of the boldfaced statement is the view that public infrastructure should be funded out of the increases in land values attributable to that infrastructure — of which we shall have more to say below.

VIEWS OF LATER ECONOMISTS

The preference for ground rents (site revenue) as a tax base was not peculiar to Adam Smith, but was an enduring feature of classical political economy. It was expressed more strongly by David Ricardo (1772–1823), and more strongly again by John Stuart Mill (1806–1873).

The neo-classical revolution (late 19th century) trashed the language of classical political economy by conflating land with capital and rent with interest, with the result that the advocacy of site revenue, which relied on the classical distinctions, was consigned to the fringes of economic debate.

Nevertheless, as the following examples show, the benefits of taxing site values rather than capital and labour were admitted by some of the greatest economists of the 20th century, including liberals and conservatives, Wets and Dries, Keynesians and anti-Keynesians.

Dear Mr. Gorbachev...

Four current or future Nobel laureates, namely James Tobin, Franco Modigliani, Robert Solow, and William Vickrey, were among the 30 prominent western economists who signed a letter to Mikhail Gorbachev dated November 7, 1990. The letter said in part (with our emphasis):

Your plans for freely convertible currency, free trade, and enterprises undertaken and managed by individuals who receive the profit or bear the losses that result from their decisions are all highly commendable. But there is a danger that you will adopt features of our economies that keep us from being as prosperous as we might be. In particular, there is a danger that you may follow us in allowing most of the rent of land to be collected privately.

It is important that the rent of land be retained as a source of government revenue. **While the governments of developed nations with market economies collect some of the rent of land in taxes, they do not collect nearly as much as they could, and they therefore make unnecessarily great use of taxes that impede their economies** — taxes on such things as incomes, sales and the value of capital.

Social collection of the rent of land and natural resources serves three purposes:

- First, it guarantees that no one dispossesses fellow citizens by obtaining a disproportionate share of what nature provides for humanity.
- Second, **it provides revenue... without discouraging capital formation or work effort, or interfering in other ways with the efficient allocation of resources**.

- Third, the resulting revenue permits utility and other services that have marked economies of scale or density to be priced at levels conducive to their efficient use.

The rental value of land arises from three sources. The first is the inherent natural productivity of land, combined with the fact that land is limited. The second source of land value is the growth of communities; the third is the provision of public services... **The component of land value that arises from community growth and provision of services is the most sensible source of revenue for financing public services that raise the rental value of surrounding land. These services include roads, urban transit networks, parks, and public utility networks for such services as electricity, telephones, water and sewers... When governments collect the increase in land value that results from the provision of services, they are able to offer services at prices that represent the marginal social cost of these services, promoting efficient use of the services**...

Under the next nine headings we offer further quotes from individual economists, including two of the signatories of the above letter.

John Kenneth Galbraith - Winner, Presidential Medal of Freedom, 1946 & 2000:

"If a tax were imposed equal to the annual use value of real property ex its improvement, so that it would now have no net earnings and hence no capital value of its own, progress would be orderly and its fruits would be equitably shared."

Galbraith (1908–2006) was a liberal, a Keynesian, and an institutionalist, who criticized the mathematical models of neo-classical economists as being divorced from reality. He taught at Harvard before and after World War II. During the war he wielded enormous power as President Roosevelt's "price czar", managing to contain inflation in a time of extreme *over*-employment, whereas present policies assume that inflation cannot be contained except by maintaining a pool of unemployed. Galbraith also served in the administrations of Presidents Truman, Kennedy (as Ambassador to India), and Johnson. His numerous books, notably including *American Capitalism* (1952), *The Affluent Society* (1958), and *The New Industrial State* (1967), established him as one of the great communicators of his profession.

Paul Samuelson - Nobel laureate in Economics, 1970:

"Our ideal society finds it essential to put a rent on land as a way of maximizing the total consumption available to the society... Pure land rent is in the nature of a `surplus' which can be taxed heavily without distorting production incentives or efficiency. A land value tax can be called `the useful tax on measured land surplus'."

Samuelson (b. 1915) received the Bank of Sweden Prize in Economic Sciences in Memory of Alfred Nobel (commonly called the Nobel Prize in Economics) "for the scientific work through which he has developed static and dynamic economic theory and actively contributed to raising the level of analysis in economic science".

While Galbraith questioned the use of mathematics in economics, Samuelson raised it to new heights of abstraction, e.g. in his monograph *Foundations of Economic Analysis* (1947, 1983). But Samuelson does not profess strong views on free markets vs. intervention. Samuelson is a long-serving professor of economics at MIT and the author (later co-author) of the influential textbook *Economics*, first published in 1948 and still in use.

Milton Friedman - Nobel laureate in Economics, 1976:

"There's a sense in which all taxes are antagonistic to free enterprise. And yet we need taxes... So the question is, which are the least bad taxes? In my opinion the least bad tax is the property tax on the unimproved value of land, the Henry George argument of many, many years ago."

— Interview in the *Times Herald* (Norristown, PA), December 1, 1978.

"I share your view that taxes would be best placed on the land, and not on improvements..."

"Yes, there are taxes I like. For example, the gasoline tax, which pays for highways. You have a user tax. The property tax is one of the least bad taxes, because it's levied on something that cannot be produced — that part that is levied on the land."

Friedman (1912–2006) was a Dry, a libertarian, a member of the Republican Party, and a leading light of the right-wing school of economics at the University of Chicago, where he was a long-serving professor. He was awarded the Nobel Prize "for his achievements in the fields of consumption analysis, monetary history and theory and for his demonstration of the complexity of stabilization policy".

Friedman was a former Keynesian who became the leading monetarist. His "permanent income hypothesis" states that individual consumption is based on long-term expected income rather than short-term actual income. This was a blow to the Keynesian doctrine that fiscal policy should be used as a counter-cyclical instrument. A further blow was his empirical demonstration that *short-term* fluctuations in economic output have more to do with the money supply than with fiscal policy. As the need for price stability constrained monetary policy, there seemed to be no scope for counter-cyclical intervention by governments.

Herbert Simon - Nobel laureate in Economics, 1978:

"Assuming that a tax increase is necessary, it is clearly preferable to impose the additional cost on land by increasing the land tax, rather than to increase the wage tax — the two alternatives open to the City. It is the use and occupancy of property that creates the need for the municipal services that appear as the largest item in the budget — fire and police protection, waste removal, and public works. The average increase in tax bills of city residents will be about twice as great with wage tax increase than with a land tax increase."

Simon (1916–2001) received the Nobel Prize "for his pioneering research into the decision-making process within economic organizations". This research, in which he coined the terms "bounded rationality" and "satisficing", was concerned with the effect of cognitive limitations on economic decision-making. This required him to master cognitive psychology and artificial intelligence so that he could model the whole problem using computers. Thus he became something of a latter-day Renaissance man, receiving prestigious awards in computer science and psychology in addition to the Nobel Prize in economics.

Simon's views on land tax were not mere academic acknowledgments, but were offered as practical advice to the people of Pittsburgh, where Simon was a professor at Carnegie Mellon University.

James Tobin - Nobel laureate in Economics, 1981:

"I think in principle it's a good idea to tax unimproved land, and particularly capital gains (windfalls) on it. Theory says we should try to tax items with zero or low elasticity, and those include sites."

Tobin (1918–2002), one of the signatories of the aforesaid letter to Gorbachev, was a professor at Yale for half a century. He was awarded the Nobel Prize "for his analysis of financial markets and their relations to expenditure decisions, employment, production and prices". In 1958 he developed a model for estimating a dependent variable that is observable only when it is positive. In 1969 he proposed the so-called ***q*** **ratio** as a predictor of capital investment by listed companies — with mixed success. But he is perhaps best known for proposing a tax on foreign exchange transactions to discourage currency speculation and to defray the expenses of the United Nations and international aid projects.

Tobin was a Keynesian of mathematical bent. He briefly served as an advisor to President John F. Kennedy.

Franco Modigliani - Nobel laureate in Economics, 1985

Modigliani (1918–2003), another signatory of the letter to Gorbachev, was an Italian of Jewish descent who settled in the USA in 1939, became an American citizen in 1946, and taught at MIT from 1962 until his death. But it was during his previous appointment at Carnegie Mellon that he made his most important discoveries. He was awarded the Nobel Prize "for his pioneering analyses of saving and of financial markets" — in particular, the life-cycle hypothesis on saving and (in collaboration with Merton Miller) the conditions under which debt financing and equity-financing confer the same value on a firm.

James M. Buchanan, Jr. - Nobel laureate in Economics, 1986:

"The landowner ... who withdraws land from productive use to a purely private use, should be required to pay higher, not lower, taxes..."

So wrote Buchanan in "The Economics and Ethics of Idleness" [*American Journal of Economics and Sociology*, vol.60, no.5, pp. 181–191, November 2001]. Most advocates of land value taxation would be content if the unproductive owner of land merely paid the *same* tax as the productive owner — instead of less tax, as is the case with CIV or NAV rating, payroll tax, income tax, GST, etc. Buchanan went further, implying that those who waste their land should be not only unrewarded, but penalized.

Buchanan (b. 1919), having been a self-described "libertarian socialist" as an undergraduate, rapidly became a libertarian free marketeer at the beginning of his graduate studies at Chicago. He received the Nobel Prize "for his development of the contractual and constitutional bases for the theory of economic and political decision-making". With Gordon Tullock, he founded the field known as public choice theory, which is characterized by the application of economic methods to political questions. His work includes an analysis of "logrolling", i.e. trading of votes by legislators.

Robert Solow - Nobel laureate in Economics, 1987

Solow (b. 1924), another signatory of the letter to Gorbachev, received the Nobel Prize "for his contributions to the theory of economic growth". His growth model separates the effect of inputs from the effects of technical progress. He was a Keynesian. He served as an advisor to President John F. Kennedy, and taught at MIT for almost 40 years.

William Vickrey - Nobel laureate in Economics, 1996:

"Economists are almost unanimous in conceding that the land tax has no adverse side effects... Landowners ought to look at both sides of the coin. Applying a tax to land values also means removing other taxes. This would so improve the efficiency of a city that land values would go up more than the increase in taxes on land."

"Equity and efficiency are both served by having landlords contribute to the network costs of the services so as to enable their prices to be brought closer to marginal cost. In the long run the increased efficiency of the local economy would tend to redound to the benefit of the landlords by raising their market rents by more than the amount of the subsidy."

"If landlords in a community could be made aware of their long-term interests, they would voluntarily agree to tax themselves on a site-value basis to subsidize utility rates so as to permit them to be set at close to the efficient level, and find that the rental value of their land had risen by more than the amount of the tax subsidy."

"Landowners, as the owners of the principal non-movable asset, ... reap any gain from the improvement in the operation of the city or locality engendered by bringing utility prices closer to the efficient marginal cost level."

"Use of land rents, or, at least, of a major fraction of them, for public purposes is therefore not merely an ethical imperative, derived from categorization of these rents as ... private appropriation of publicly created values, but is, even more importantly, a fundamental requirement for economic efficiency."

Four of these quotations are collected in Riley, *Taken for a Ride* (Teddington, UK: Centre for Land Policy Studies, 2001). As if they were not enough, Vickrey also signed the letter to Gorbachev.

Vickrey (1914–1996) and James A. Mirrlees (b. 1936) shared the Nobel Prize "for their fundamental contributions to the economic theory of incentives under asymmetric information". Vickrey was also a major contributor of the theory of congestion pricing. That was to become the final irony of his life: three days after his Nobel prize was announced, he died of a heart attack while stuck in a traffic jam. But a congestion pricing system was later implemented in London.

Vickrey was a Quaker. During World War II, as a conscientious objector, he spent part of his alternative service designing an inheritance tax for Puerto Rico. His PhD thesis (Columbia University, 1948) was titled *Agenda for Progressive Taxation*. He taught at Columbia for the rest of his career.

In Vickrey's statements, note the recurring message that *better services increase land values*. Substantial taxation of land values would recycle some of that increase to the public treasury, so that the government would have an incentive to provide more services, so that the landowners would get more windfalls. This does *not* mean that affordability of accommodation would suffer, because the increases in property values would reflect greater utility, not higher rents of prices for *given* utility. But, taking other tax adjustments into account, it *does* mean that **property owners stand to gain from substantial marginal taxation of land values**. The conclusion is counterintuitive, but inescapable.

POLITICAL VIEWS

Labor

According to T.A. Cohen, "[L]and taxation became a leading principle with all classes supporting the Labour movement" [*Labour and Industry in Australia* (London, 1918), vol.4, p.1836]. Henry George, author of *Progress and Poverty*, toured Australia in 1890, lecturing on the advantages of a tax on unimproved land values. Such a tax was supported by the Labor Party from its foundation in 1891. The Federal Platform of the party initially supported a flat-rate tax. At the 1905 Federal Conference this was changed to a graduated tax — against the advice of Senator George Pearce, who argued that it was better for the working man to pay the full land tax than to bear what would inevitably be a much higher burden under any alternative indirect tax. A threshold of £5000 was adopted in 1908, and remained in place for 47 year in spite of numerous attempts to restore the original policy.

In 1910, the Labor government of Andrew Fisher introduced the first Federal land tax in Australia. Concerning this event, Labour Minister Clyde Cameron wrote to Treasurer Frank Crean on June 27, 1974:

"As a matter of historical record it should not be forgotten that in 1910, the Fisher Labor government was actually elected to office on the sole issue of the taxation of unimproved land values. As well as being a more just method of receiving revenue than the imposition of indirect tax upon the necessities of life, it is the one kind of tax that has to be paid by those best able to pay it..."

In 1953, after the Menzies government abolished the Federal land tax and left the field to the States, the Federal Labor leader Arthur Calwell denounced the move in these terms:

"We of the Australian Labor Party have always believed that the land is the patrimony of the people and that nobody has a complete and absolute title to it... The land belongs to the people, and its use must be safeguarded and protected at all times..."

"We have always believed in the land tax, and when happy days come again we shall restore the measure imposing the tax to the statute book of this country."

— *Hansard*, vol.221, pp. 165–170 (February 24, 1953).

Labor MHR Ted Peters added:

"Down through the years nobody has been able to refute the logic of Henry George's beliefs in respect of the taxation of land... As a member of the Australian Labor Party, I enter an emphatic protest against this *sectional* reduction of taxation."

— *Ibid.*, pp. 180–181 (emphasis added).

In 1955, the ALP Federal Conference increased the proposed land tax threshold to £10,000. The 1957 Conference, on the motion of Clyde Cameron (South Australia), unanimously deleted the threshold altogether; but the printed Platform deleted not only the threshold but the entire land tax policy, and incorrectly credited a Queenslander with moving the motion. At Cameron's prompting, the amended policy was reinserted in the printed 1959 Platform. But in 1964 it was dropped from what purported to be the record of the 1963 Platform, and it has been omitted from the ALP Federal Platform ever since. While the apportionment of blame is not clear, it is perfectly clear that the Federal land tax was *unconstitutionally* dropped from the ALP Platform without any Conference decision to that effect. [Cf. Clyde Cameron, *How Labor lost its way*, speech opening the South Australian HQ of the Henry George League, May 13, 1984.]

At one of the early cabinet meetings of the Whitlam government, Cameron proposed reviving the Federal land tax. Crean promised to refer the matter to Treasury. Nothing happened. Cameron's subsequent letter to Crean (quoted above) was an attempt to expedite the process. Again nothing happened, and the dismissal of the Whitlam government ended the matter.

Liberal

Alfred Deakin (Prime Minister 1903-1904, 1905-1908, 1909-1910) understood that free enterprise means dismantling the last vestige of feudalism, namely monopolization of land. Accordingly, like Winston Churchill in the United Kingdom, he was a supporter of land tax, declaring that:

"The whole of the people have the right to the ownership of land and the right to share in the value of land itself, though not to share in the fruits of land which properly belong to the individuals by whose labour they are produced."

Morris Thomas Williams (d. 1996), who for some years was President of the Henry George League (Victoria), also served as Liberal MLA for Box Hill and then for Doncaster. On December 1, 1982, he is recorded in *Hansard* as saying:

"If we are to have public expenditure, governments must have revenue... However, that taxation must be collected in the fairest method, and that is why I believe in land tax. It is a fair tax. Further, it is a growth tax."

Sir Allen Fairhall, who died as this Information Kit was being edited and to whom it is accordingly dedicated, was a Federal MP from 1949 to 1969 and a Minister under Menzies, Holt, McEwen, and Gorton, and in the opinion of some commentators could have become Prime Minister had he wanted the job. He was of the conservative wing of his party. But as the Member for Paterson he saw how those who put the Hunter Valley to good use were penalized while those who speculated on it were rewarded. In his retirement he wrote the book *Towards a New Society*, advocating the replacement of the present tax system by one based on land value taxation. In his preface he wrote:

"Around the world the demand for land rights becomes ever more strident. The possibility of eventual confrontation between the `haves' and the `have nots' on the land question awaits only an awakening by the landless masses to the enormity of the crime involved in the denial of what must surely be the most basic of human rights to share equitably in the bounty of the earth."

A letter published in the *Australian Financial Review* on December 10, 1991, says in part:

"I do not deny that all taxes, with the exception of those on economic rent and inherited wealth, have some [adverse] employment and economic growth effects."

Although the author of the letter did not say so, the archetypal example of "economic rent" is of course the rent of land. The author was the Hon. John Winston Howard.

The State Liberal leaders who are now promising to reduce or phase out land tax, and who imagine that in so doing they are pandering to the interests of property investors, would do well to recall the advice of William Vickrey.

National

One might think that farmer and graziers, as big land holders, are implacably opposed to land tax. Such a view would be mistaken for at least three reasons. First, the tax is on the *value* of the land, not the area; and the most valuable land holdings are in city centres, not rural districts. Second, in rural districts as in cities, land tax can pay for infrastructure that increases the value of the land by more than the amount of the tax. Third, farmers and graziers, as small business operators, are especially averse to compliance costs, which are negligible for land tax but significant for many other forms of taxation.

Many rural politicians have been strong advocates of land tax. A notable example is Robert Barbour (1827–1895; MLA for Murray, NSW; founder of the Farmers' and Settlers' Association), who advocated land leasing tax as a means of ensuring legitimate property ownership and development. A commission of inquiry established by the Country Party in 1933 determined that site value was the most effective means of public finance in municipalities.

In recent years the National Party has recognized the capacity of land tax to support development for the benefit of its traditional constituency [cf. Peter Ryan's press releases of March 30, 2005, and December 19, 2004]. Meanwhile its calls for "land tax relief" contradict this stance and, if successful, will allow speculators to accumulate larger holdings for the same tax bill. The party must make up its mind whether it wants to support rural development or rural speculation; if the former, there must be lower taxes on labour and capital and higher taxes on mere ownership of land.

Green

"From a `green' perspective, land tax is a useful tool in discouraging the excessive and wasteful use of land. That is, the prospect of paying a high rate of land tax can be expected to discourage people from purchasing more land than they need directly for their own purposes. It accords with the principle that people should be taxed according to their use of scarce environmental assets."

So wrote Frank Stilwell and Kirrily Jordan ["The political economy of land: Putting Henry George in his place", *Journal of Australian Political Economy*, No.54 (December 2004), pp. 119–134; http://jape.org/jape_54_08_Stilwell.pdf]. But, as is shown by the following statement by Lee Rhiannon (NSW Greens MLC, May 13, 2004), Greens have looked at land tax for more than environmental reasons:

"The Greens support the concept of a land tax. It's a small tax on the wealth built up by property investors, who have made major gains as land values have risen."

The remarks of Stilwell and Jordan also address the issue of equity in that land tax or SV rating, by discouraging unnecessary land purchases, discourages speculation. This means greater affordability of housing as prospective buyers and renters no longer need to compete with speculators. But it also means more compact cities with less sprawl, hence shorter commuting distance, hence less pollution.

The Greens' current national economic policy [s. 3.3.25] supports a **"gradual shift from work-based taxes to resource-based taxes, including taxes on fossil fuel usage; emissions into air, water or soil; use of forest, ocean, freshwater and other finite resources; land sites according to land value; electromagnetic spectrum assets; and oils and minerals."**

The acknowledgment that taxation is better based on resource usage than on productive activity is commendable, but is contradicted in the same document by recommendations for higher company tax and additional transaction taxes. In practice, there is also a tendency to downplay land value by comparison with the other resources named. This attitude forgets that while a bare city block may not seem important from an ecological viewpoint, it is still a natural resource and is enormously important from an economic viewpoint.

EVIDENCE

Camberwell, 1920s

In *A History of Camberwell* (Lothian Publishers, 1980, p.86), Geoffrey Blainey wrote:

"A few hundred people owned large areas of cow paddock and market garden and vacant land and refused to sell them for housing partly because they believed the speculative value of the land would rise. Such people blocked Camberwell's growth and contributed little to its municipal revenue. At Camberwell junction and other shopping centres, owners of old wooden shops were paying smaller rates than the enterprising landlords who built expensive shops and attracted business to the centre. In residential streets, landlords who allowed houses to go unpainted paid smaller rates, while the landlord who improved his property and therefore the neighbourhood's appearance and land values was penalised for his enterprise with higher taxes. The reformers argued that a new method of municipal taxation would accelerate the pace of Camberwell's growth and improve the quality of the suburb. Calling for a referendum, they carried the poll after a fierce campaign and Camberwell and Caulfield became the first Victorian municipalities to tax the land and not the buildings. From 1922, the new method of taxation undoubtedly forced many large landowners to release vacant land for house building..."

In the five years prior to 1923, the total number of dwelling permits issued in Camberwell was 2051. In the following five years the number increased to 4373. Camberwell tops suburban building statistics until 1943.

Victorian councils, 1920s–1940s

In 1949 the Land Values Research Group published "Rising Municipal Costs: A Comparison of the Relative Abilities of Alternative Rating Systems to Provide Increased Rate Yield". This was a survey of the per acre increase in rate yield for seven (then) outer suburban areas using SV rating (site only) and ten which used NAV rating (site and buildings), over a 20-year period. The SV councils were Brunswick, Coburg, Camberwell, Caulfield, Essendon, Oakleigh, and Sandringham. The NAV councils were Brighton, Footscray, Hawthorn, Kew, Malvern, Northcote, Moorabbin, Preston, Williamstown, and Heidelberg. The per acre increase in rate yield was £9.3s for the SV councils, and £6.2s for NAV councils. In other words, the use of site-value rating led to greater gains in property values.

Victoria, 1927–1951

The American Institute of Economic Research conducted a study of building activity in Victoria from 1927 to 1951, and reported that "All councils that had changed from NAV in the 1940s [to SV rating] were shown to have experienced marked increases in building activity immediately after the rating change, above what would be expected."

In suburban areas, construction occurred preferentially in SV-rating municipalities.

Rural Australia, 1929–1958

In 1963 the Land Values Research Group published "A Study of the effects of local government rating systems upon the social and economic development of the Australian states". The results showed that those states which had greater use of site value had greater improvements in the amount of acreage being used for crops (see Table 6). In other words, where site value taxation existed, farmers were encouraged to put the land to use.

Table 6: Change in acreage under crops in SV-rating States and NAV-rating States during two time intervals. (*Note:* During the war years agriculture was under government direction.)

1929–1938		1946–1958	
SV rating	**NAV rating**	**SV rating**	**NAV rating**
Qld +66% NSW +22% WA +3% (+21% total)	SA -5% Vic -10% Tas -8% (-8% total)	Qld +76% NSW +5% WA +71% (+35% total)	SA +7% Vic -6% Tas -6% (-1% total)

Victorian councils, 1945–1975

When actually given the choice, Victorian voters almost always preferred site value (SV) rating to other rating systems. But when *not* given the choice, they usually got NAV. Table 7 shows the results of plebiscites and referenda (if any) conducted in various municipalities between 1946 and 1975. The percentages quoted are for SV.

Table 7: Percentage support for SV rating in plebiscites and referenda in Victorian municipalities.

Municipality	Year	% for SV
Box Hill	1946	56%
Footscray	1946	NA (for NAV)
Moorabbin	1946	61%
Northcote	1946	57%
Preston	1946	67%

Municipality	**Year**	**% for SV**
Kew	1947	52%
Brighton	1948	NA (for NAV)
Echuca	1948	No Poll
Collingwood	1949	NA (for NAV)
Frankston	1949	68%
Northcote	1950	50% (NAV majority)
Heidelberg	1951	66%
Kew	1951	53%
Ringwood	1951	58%
Bellarine	1952	NA (for NAV)
Nunawading	1952	59%
Wangaratta	1952	NA (for NAV)
Woorayl	1952	NA (for NAV)
Frankston	1953	57%
South Barwon	1953	57%
Eltham	1954	52%
Sale	1954	72%
Warrnambool	1954	No poll (for SV)
Castlemaine	1955	61%
Malvern	1955	65%
Springvale	1955	No poll (for SV)
Broadmeadows	1956	76%
Mildura	1956	78%
Wangaratta	1956	81%
Waverley	1956	82%
Keilor	1957	77%
Swan Hill	1957	61%
Traralgon	1957	53%
Wodonga	1957	61%
Ararat	1958	No poll (for SV)
Benalla	1958	80%
Daylesford	1958	NA (for NAV)

Municipality	Year	% for SV
Moe	1958	67% (for SV)
St. Arnaud	1958	NA (for NAV)
Bairnsdale	1959	NA (for NAV)
Doncaster	1959	52%
Maffra	1959	NA (for NAV)
Maryborough	1959	67%
Stawell	1959	70%
McIvor	1961	62%
Malvern	1961	72%
Tallangatta	1961	56%
Traralgon	1961	No poll (for SV)
Hastings	1962	NA (for NAV)
Croydon	1963	57%
Korumburra	1963	53%
Diamond Valley	1964	No poll (for SV)
South Melbourne	1964	63%
Bacchus Marsh	1965	NA (for NAV)
Knox	1965	60%
Morwell	1965	NA (for NAV)
Sherbrooke	1965	65%
Sunshine	1965	NA (for NAV)
Castlemaine	1967	73%
Cohuna	1967	59%
Healesville	1967	NA (for NAV)
Kerang	1967	54%
Kerang	1967	75% (boundary change)
Croydon	1968	60%
Horsham	1969	65%
Kilmore	1970	52%
Buninyong	1971	53%
Tallangatta	1971	65%
Orbost	1972	61%

Municipality	Year	% for SV
Melton	1973	57%
Kew	1975	67%

ERRORS AND DISTORTIONS

The effects of the recent land-price bubble on land tax and rates have led to some highly tendentious reporting.

Claim: "Victoria's contentious land tax is forcing businesses to close, with the loss of jobs, higher rents for caravan park residents and millions of investment dollars leaving the state" [Russell Skelton, "Soaring Land Tax Costs Jobs, Investment", *The Age*, Nov.21, 2004].

Fact: There is no mechanism by which land tax can cost jobs or be passed on in rents. The only "investment" that it can deter is the purchase of land, which does not create more land, but rather raises prices of whatever land is available. You can tax Victoria's land as heavily as you like and not one square metre of it will flee across the border into NSW.

Claim: D & J Evans Hardware, on Camberwell Road, was unable to pay its $120,000 land tax bill, so it would close and 32 employees would lose their jobs [same article].

Fact: Six days later, a story by Alana Rosenbaum in the same paper revealed that Evans Hardware sold its site to Woolworths for a cool $15.25 million. Poor Evans Hardware! Woolworth's supermarkets are of course major employers. And of course Woolworths would henceforth pay the land tax. So the land tax bill was so onerous that Woolworths was willing to pay $15.25 million *up front* for the privilege of paying the land tax in perpetuity!

Claim: The Whitehorse Inn of Hawthorn was forced to close because the publican, Jim Ryan, was unable to pay the land tax bill which had increased from $1440 in 1998 to $40,000. Some 15 staff would lose their jobs. The lessee (Ryan) was liable for the land tax because he had signed a contract allowing the owners (Lazzacorp Pty Ltd) to charge their land tax to the lessee [Farrah Tomazin in *The Age*, Feb.15, 2005].

Fact: Lessees paying their landlords' land tax has been likened to employees paying their employers' company tax. By the time Mr Ryan got into trouble, such clauses in lease contracts (known as **tax-increment clauses**) had been banned, but contracts signed or renewed before the ban were grandfathered. When the Parliament banned such clauses, it could have capped land tax increases for lessors in grandfathered tax-increment contracts in order to protect the lessees, but it didn't. So the problem was not with land tax as such, but with the legislators who first botched the initial implementation and then botched the correction. Moreover, the agenda of the City of Boroondara Urban Planning Special Committee reveals that the owner of the hotel site was planning to redevelop it as an office complex with restaurant, *employing more people* than the hotel, and with parking for more than five times as many cars as the hotel could accommodate. All this was in accordance with the Council's plan to develop West Hawthorn as a "specialist business support centre".

By the way, Mr Ryan's problem reinforces the point that *land tax cannot be shifted onto the tenant*. In a free market, the landlord must charge a rent that tenants can pay, regardless of what the land tax may be. Tax-increment clauses attempt to defy the market by locking in tenants and making them pay. But then the landlords find themselves trying to get blood out of a stone.

Claim: Publican John Ribbands of the Metung Hotel was facing a land tax bill of almost $81,000, which had doubled in a year [Kirsty Simpson in *The Age*, Mar.6, 2005].

Fact: The Metung Hotel is described on its own web site as "The pub with the million dollar views!" From the information on the site, it would appear that Mr Ribbands sold out, and that the new owners promptly renovated the place and are planning further capital works. And of course the new owners will pay the land tax from now on. While the sale price is not specified, we are confidant that Mr Ribbands is not destitute.

Those who use steep increases in land tax as an argument against using land tax as a major source of revenue (or at all) fail to mention two things. First, if land tax were imposed at a *flat rate*, an increase in the land value would not cause a higher fractional increase in the tax bill. Second, if a significant land tax bill were the rule rather than the exception, it would discourage speculation and therefore stabilize the growth in land values, suppressing speculative bubbles and the associated *sudden* increases in taxable values.

RECOMMENDATIONS

The theory and observations detailed above have clear implications for policy.

First, if ever the State Government was going to do away with local referenda on rating systems and impose a system from the top, that system should have been site value (SV). This is the only system that can be defended on economic grounds. Conveniently, it is also the only system that could have been defended on the basis that "the people have already spoken."

Second, in view of the pernicious effects of rating systems that include buildings in the tax base, one should be highly suspicious of all other recurrent taxes (or "levies" or "charges") that increase with the quality or quantity of accommodation provided by the taxpayer. Such taxes vary from place to place and may go under such names as garbage collection levies, water access levies (not to be confused with consumption charges), emergency service levies, etc. Consideration should be given to rolling all such taxes into SV rates (if at the local level) or land tax (if at the State level). This is especially the case with imposts that purport to pay for services that *add locational value to land*.

Third, because conveyancing stamp duties, like CIV and NAV rates, apply to buildings as well as land, and because stamp duties can be passed on in prices of homes, consideration should be given to replacing stamp duties with land tax. As the Productivity Commission suggested in its report on first home ownership, the extension of land tax to owner-occupied homes might be acceptable as a *quid pro quo* for the abolition of stamp duty.

Fourth, if the abolition of stamp duty is thought to be politically impossible, then at least stamp duty should be reformed so as to reduce its effects on turnover and housing affordability — e.g. by apportioning the duty to the *increase in the site value* since the last transfer of title.

Fifth, whatever else happens, land tax needs a broader base and flatter rates. Complaints about sudden increases in land tax assessments are due to the combination of high thresholds, progressive rates, and speculative bubbles encouraged by insufficient land tax! Responding to such complaints by cutting land tax is treating the symptom while feeding the cause.

Sixth, *payroll tax must go*. The popular perception that payroll tax destroys jobs is quite right. Payroll tax is also hated by employers — especially those who are just big enough to be liable for it — because of its compliance costs. Its abolition would therefore be not only economically responsible, but also popular. Thus the abolition of payroll tax would be an attractive political sweetener for a substantial extension of land tax — especially in respect of land tax payable on commercial and industrial premises, of which the owners or tenants are likely to have substantial payroll tax expenses.

Dr. Terry Dwyer (Visiting Fellow, National Centre for Development Studies, Asia Pacific School of Economics and Management, ANU) is the author of "The Taxable Capacity of Australian Land and Resources" [*Australian Tax Forum*, vol.18, pp. 21–68 (April 2003); http://prosper.org.au/files/taxable_dwyer.pdf]. We give him the last word by quoting his conclusion:

Previous attempts to measure the value of Australian land have tended to focus on its position as part of national wealth rather than its annual taxable capacity. It appears land income has been under-estimated. However, it is possible to generate an almost century-long series to compare land income to Australian taxation revenues and thus see the large scope for replacing other taxes with economically efficient taxes on land and resource rents.

The logical implication is that Australia could choose to make a fundamental shift in tax policy. Australia could increase Federal reliance on land revenues and use the proceeds to make substantial cuts to marginal personal and company income tax rates. Australia could become a tax haven and out-compete Hong Kong and Singapore in attracting regional or international headquarters or investment. There is nothing inevitable about Australia being a generally "high tax" country which discourages investment nor is it inevitable that Australia becomes a branch office economy. Australia may have different forms of land resources to Saudi Arabia or Brunei but, like Hong Kong and Singapore, Australia's land is worth a fortune as a tax base. Australia is as well positioned to finance large cuts in personal, corporate and consumption tax rates (or even abolition of one or more of these) through taxing land incomes.

Rather than complaining about the so-called "dark side of globalisation" and joining in OECD complaints about the threat of other countries' supposedly "harmful tax practices" to OECD tax revenues and redistributive social spending, Australian policymakers and commentators would be better advised to look at what they stand on — "black gold" can mean dirt and mere location as well as oil. In a world where capital is mobile and labour supply is shrinking in line with demographic decline, an immobile tax base is the only tax base which makes economic sense. Australia is indeed a lucky country to have in its land and resource values a tax base of such large potential. But is it a clever enough country to use that potential tax base to its advantage?

APPENDICES

About Prosper Australia

Prosper Australia, formerly known for many years as the Henry George League, is an independent and self-funded association based in Melbourne, Victoria, and inspired by the theories and proposals of the American economist and social reformer, Henry George (1839–1897). We are not affiliated with any political party, but members of all mainstream political parties are welcome to join us. As is evident from the views of some of Australia's founding politicians, the idea of deriving public income from site rentals was at one time highly influential but was not, and is not, intrinsically partisan.

Our journal *Progress* has been published since 1904, and reached a circulation of 20,000 in its early decades.

Over the years many Victorian local governments decided, usually through a plebiscite of the ratepayers, to adopt site value rather than capital-improved value or net annual value as the basis of municipal rates. This was usually in the eastern suburbs. The resulting wealth and economic development of those areas stands as stark and obvious historical evidence of the advantages of site value.

In the 1970s a change to the law in Victoria meant that viewing a public valuation of a land title incurred a charge of $1 when it had previously been free. This seriously damaged our capacity to engage in large-scale statistical analysis. Worse came in the 1990s, when local councils were amalgamated and placed under political pressure to levy rates on Capital-Improved Value, and the price of viewing valuations was increased to $20 per title.

While the objectives of Prosper Australia are overwhelmingly supported by economists and by empirical analysis, State politicians and local councillors often seem unaware of the issues at hand and have been highly susceptible to the pressures of vested interests and the mass media. For the good of their State and their communities, it is important that politicians and councillors be well versed in the advantages of site rental for public finance. We therefore urge you to consider joining us.

To join us via the internet, visit our web site at http://prosper.org.au and click on "Join".

Revision history

The original version of this document, under the title *Site Revenue for Public Finance*, was written by **Lev Lafayette** (http://levlafayette.com) and was submitted to the executive of Prosper Australia on October 26, 2006.

On October 27, Bryan Kavanagh suggested some textual corrections and clarifications to the original version. On October 28 he recommended the longer title *The Elected Representative's Guide to the History and Efficacy of Site Revenue for Public Finance*.

Mr Kavanagh's version was converted to HTML by Gavin R. Putland (http://grputland.com), who further edited and (rarely) corrected the text. Superfluous formatting due to the file conversion was removed and a minimal style sheet, with printing instructions, was added. The paragraphs around Table 1 were reordered for continuity. Tables 2 to 4 were reworded and reordered for easier comparison, with consequential amendments to the text. Wording was amended where necessary to ensure that real property was not classified as "goods". The various ways in which the supply of land is fixed were enumerated so as to explain why land can be expensive in a sparsely populated country. Rational and irrational influences on land prices were distinguished and the former related to location via rental values. The significance of land speculation and the effects of land tax on speculation were further explained. The section on "Economic effects of taxes, rates and site rents" was rewritten so as to distinguish between actual and potential rents, in order to pre-empt the usual spurious argument alleging that land tax can be shifted. Another quote from Adam Smith was added and placed in context. Biographical notes on other economists were minimized, removing content licensed under the GNU Free Documentation License and enabling release under a Creative Commons license. Sources were located for some of the quotes from these economists. Further quotes from William Vickrey were added and commented upon. Introductory and/or concluding comments were added to some sections. The section "Labor" (formerly "A Labor view") was corrected with reference to Clyde Cameron's speech *How Labor lost its way* (1984). Some discussion of "taxable capacity" was discarded, lest it give the impression that the limited capacity of a tax base is an argument against its use; but the associated quote from Terry Dwyer was retained and used as the overall conclusion. The recommendations were slightly augmented and more tightly integrated with the rest of the document. The entire text was copy-edited. The dedication, copyright notice, and revision history were added. As a compromise, the title was changed to *The Elected Representative's Guide to Site Revenue for Public Finance*, with emphasis on the words "Site Revenue for Public Finance". The result was Version 2006.11.22.GRP.

Version numbers contain their respective dates in the form *yyyy.mm.dd*.

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