THE AUSTRALIAN
Australia's national daily newspaper

Business
An efficient land levy could fund cuts to costly stamp duties and company taxes

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882 words
29 April 2015
The Australian
AUSTLN
Australian
29
English

Numerous studies over many years have shown that taxes cost us much more than just the dollars we pay and that some taxes cost more than others.

But governments haven't done much about it for many years. Both federal and state governments should use information on the real costs of taxes to drive both tax and spend reforms.

Every extra dollar of tax raised costs Australian citizens at least $1.29. The extra 29c "marginal excess burden" (MEB) reflects costs arising because taxes distort our decisions. For example, stamp duties discourage transactions that would otherwise make both buyers and sellers better off. Company taxes deter investment and personal income taxes distort our labour supply decisions.

The 2010 Henry Tax Review identified Australia's top-10 revenue-raising taxes: together, they generate 90 per cent of Australian tax revenues.

Governments should use this information in making expenditure decisions. They should attach a $1.29 cost to each dollar of spend whenever they consider spending taxpayers' money. The extra 29c is the weighted average of the MEBs (see chart). Those MEBs are, if anything, understated; for example, some don't allow for the costs of distortions caused by exemptions and non-uniform rates.

If governments did count each dollar as $1.29 many expenditures would fail the cost-benefit test. Government spend — and the excess burden of taxation — would fall substantially.

Governments should also use this information to reform taxes. As our three levels of government raise more than $415 billion of tax revenues in total annually, the real cost of taxation to Australian citizens is at least $485bn, including at least $70bn of excess burden. The average excess burden of 17 per cent is less than 29 per cent, as MEBs rise with revenues raised.

Ideally, if we could abolish all existing taxes and replace them with a perfectly efficient (zero MEB) tax, we'd be $70bn better off.

Some taxes can be near-perfectly efficient. Unfortunately, they can't raise anywhere near the amounts our governments spend.

Take land taxes which, due to the immobility of land, is very efficient. While poorly designed existing land taxes have a MEB of 9c per dollar raised, a well-designed land tax that was applied at a uniform rate to all unimproved land would have the lowest MEB of our top-10 taxes. Treasury estimates that as it wouldn't distort our decisions and would be partly borne by foreigners, an efficient land tax would have a negative MEB of 10c.

When Henry George advocated that governments raise all tax revenues through a "single tax" on land in 1879, the size of government was so small as to make this eminently feasible.

Unfortunately, the enormous size of government today means it no longer is. The total unimproved value of all land in Australia is about $4.3 trillion. Attempting to raise $415bn annually from land taxes would completely wipe out land values and therefore raise nothing at all.

Nevertheless, we can reduce the excess burden considerably by cutting taxes with the highest MEBs and raising those with the lowest. MEBs vary enormously — from 85c (stamp duties on commercial conveyances) to negative 10c (an efficient land tax).

Land taxes can't provide the complete solution, but they can play a valuable role. If used to fund cuts to our most costly taxes, they can make us much better off. Here's just two examples.

Stamp duties have the highest MEB of our top-10 taxes. Abolition of stamp duties could be funded simply by removing existing land tax exemptions, which distort land use. This would reduce the total excess burden by at least $7bn.

Company taxes have the second-highest MEB. But they generate a greater total excess burden because they raise much more revenues. Funding a halving of company taxes through a 0.6 per cent land tax would reduce the total excess burden by at least $12bn.

These two reforms alone would reduce the total excess burden by at least $19bn (27 per cent) — or more than $800 per man, woman and child per annum. Substantial further gains can be realised through other tax reforms.

The federal government could act unilaterally to fund the halving of company taxes with a land tax. It levied land taxes until 1952 and can reintroduce them at any time without impinging on states' rights to continue to levy their land taxes.

State governments could unilaterally abolish stamp duties funded by broadening the land tax base. But politics makes state tax reform particularly difficult. The federal government could act as circuit-breaker. It could adopt an incentives-based approach by tying grants to specific tax reforms — as the National Competition Policy agreement did with some success. Or it could play hardball and simply remove states' powers to levy stamp duties and other highly inefficient taxes.

Our governments can make citizens substantially better off through both tax and spend reforms. However, these gains will be fully realised only if they account for the real costs of taxes in both tax and spending decisions.Professors Paul Kerin and Christopher Findlay are with the School of Economics at the University of Adelaide.

Document AUSTLN0020150428eb4t00017

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