Rates to triple?

The source of the claim

On the back of a Liberal Party election brochure is a suggestion that the Government intends to triple residential rates.

In support of this claim it produces a table in the May 2012 *ACT Taxation Review* (The "Quinlan Review"), which models the effect on domestic rates if conveyancing taxes were to be replaced by increased rates.

The Quinlan Review's recommendation was not so explicit, however. Its recommendation (# 10) was:

> Abolish conveyance duty. In doing so:
>
> - pursue at least a 10 year, and up to a 20 year, transition plan to ameliorate the impact of the change on households;
> - have due regard for conveyance duty paid in the years leading up to the change, and
> - recognise the significance of the change and consult with the community on the transition plan. recommended abolishing conveyancing taxes

The Government has been even more hedged on its response:

> Agreed in principle – to be considered in future reform.
>
> As noted in response to Recommendation 2(a) [concerning the unfairness of conveyancing taxes], the Government acknowledges the unfair and volatile nature of this [conveyancing] tax.
>
> The Government also agrees that any reform of this tax will need to be over a very long-term, possibly extending to 20 years. Such a time frame is important so as not to create distortions in the market.

In the 2012-13 Budget, brought down in June, the Government gives a more explicit suggestion that it intends replacing conveyancing taxes with general rates, over a long period. Under the heading "Taxation Reform", its first three of five points are:

> The key elements of this strategic [the word "strategic' is not defined] reform are:
>
> - abolishing transaction taxes;
> - adopting General Rates as a broad based land tax for revenue replacement;
> - improving the progressivity of the revenue replacement base, i.e., General Rates;

Does this vindicate the Liberal Party's campaign?

Not entirely, for the picture is much more complex, as revealed in the Budget papers.

Budget projections

The following table is straight from the Budget:

It shows that in the year just past rates and conveyancing taxes raised $480 million, of which rates have contributed $210 million. A straight replacement would require a rates to rise by about 130 percent (=480/210). This is somewhat less than the tripling suggested by the Quinlan Review, but that is not to gainsay its analysis, which was undoubtedly based on much more than one year's data.

Selected taxation items $000

	2011-12	2012-13	2013-14	2014-15	2015-16
General rates	209 298	297 051	325 753	361 344	398 818
Conveyancing	267 878	272 609	284 118	291 250	296 259
Other	740 703	708 332	736 903	767 062	797 437
Total	1 217 879	1 277 992	1 346 774	1 419 656	1 492 514

Notably, over this period, rates as a percentage of ACT taxation rise from 17 percent of tax revenue to 27 percent of tax revenue, while conveyancing falls by a lesser amount (from 22 percent to 20 percent). Looking through the line items of taxation, it is apparent that the ACT Government expects fairly sluggish growth in other items, particularly land tax and gambling taxes.

In Australia, rates have traditionally comprised almost the entirety of local government taxation, with revenue boosted by grants from state and Commonwealth governments. Around 16 to 17 percent of total state plus local government taxation comes from rates, and ACT rates have been in this band for several years. The jump to 27 percent is a significant departure.

But it should be noted that much of this increase has already occurred in this (2012-13) financial year. People have received their rates notices, and will already have either paid them or made instalment payments. That is why the claims of a high rise are belated; they would have had more credibility had politicians made them before rates notices were sent out.

To take out the noise of population growth and inflation, the following table shows ACT taxation in real (2011-12 prices) terms, per capita:

Taxes per head constant 2011-12 prices (CPI based)

	2011-12	2012-13	2013-14	2014-15	2015-16
General rates	572	783	827	884	940
Conveyancing	733	718	721	713	698
Other	2 026	1 867	1 871	1 877	1 880
Total	3 331	3 368	3 420	3 474	3 519

The per-capita rate increase over the Budget period is 64 percent if based on 2011-12, but only 20 percent if based on the current 2012-13 year.

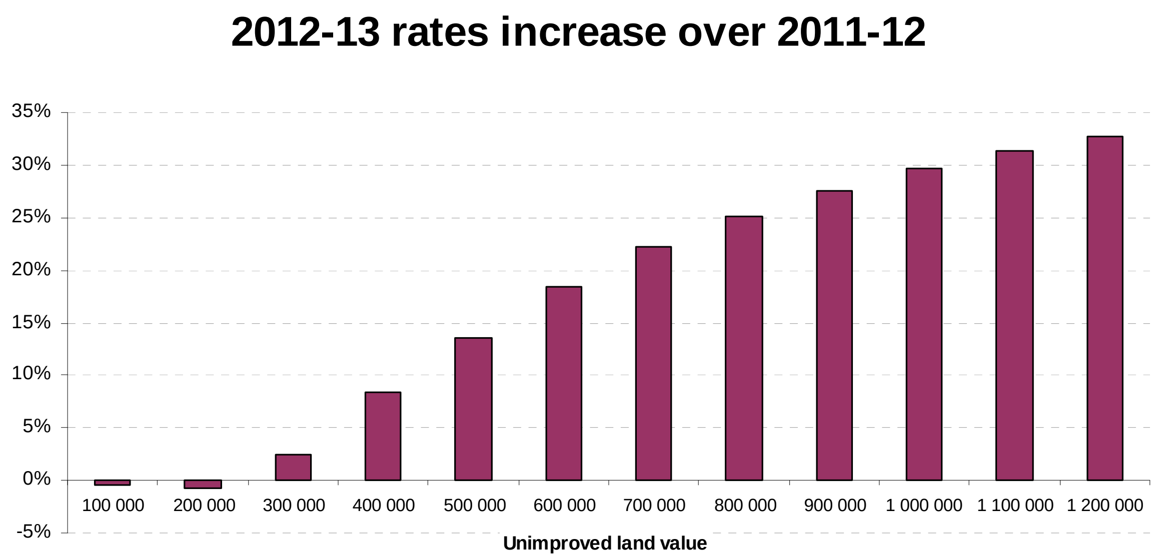
One qualification is that these figures include commercial rates, which are not separately identified in the Budget projections.

The main change is that residential rates have been made much more progressive with respect to land value. (Whether unimproved land values are fair is another matter.) The change is shown below.

ACT residential rates

	2011-12	2012-13	
Fixed charge	$555		$555
Valuation-based charge	0.272% of value over $16 500	0.2236%	on first $150 000
		0.3136%	on next $150 000
		0.3736%	on next $150 000
		0.4136%	on values > $450 000

The chart below shows how this increase has worked out over a range of land values. Note that for land valued at up to around $300 000 there has been essentially no change. Any rate changes for land in that range of values would result from changes in valuations.



It is not clear how rates will move in future years – whether the $150 000 steps will be expanded in relation to land, wages or CPI movements. The Government's Budget papers give some hint that rates will rise in line with the cost of providing labour-intensive municipal services, which suggests that they will rise in line with wages – about one percent ahead of consumer inflation.

Is it good public policy?

By the criteria of conventional taxation theory, rates are not good taxes. They relate to illiquid assets, the value of which people have no capacity to control. In particular they fall heavily on retired people who may be asset rich but income poor.

But state and local governments in Australia do not have access to a range of good taxes – "good" taxes being those which relate to capacity to pay, which are progressive with respect to means, which are simple to collect and which do not distort resource allocation. A tradeoff of rates for conveyancing may be a good second-best policy, for conveyancing taxes, by most criteria, are worse than rates. A bad tax is being replaced by a not-so-bad tax.

Australia has a huge public revenue problem. In 2004-05 taxes at all levels of government came to 30.8 percent of GDP; by 2010-11 they had fallen to 25.8 percent of GDP. There have been falls in company tax, GST, capital gains tax and property-based taxes because of the end of the boom (rather than any rate reductions), and a number of personal tax concessions introduced by the Howard Government. Had our taxes remained at 25.8 percent of GDP, our national taxation revenue would now be at least $69 billion higher. (Even 30.8 percent of GDP is low by OECD standards: the average tax across OECD countries is 35 percent of GDP.) Over this period GST, which is passed through to the states, has fallen from 3.9 percent of GDP to 3.4 percent, or about $6 billion, and the fall has been even greater in 2011-12.

Most of the loss of tax revenue has been at the Commonwealth level. Apart from the GST loss, states have been less affected. But states have strong cost pressures because they provide services which are intrinsically labour-intensive. Sixty percent of state outlays are for health, education and policing, all employing skilled labour, and with little scope for improvements in labour productivity.

Even if states had access to better taxes, are rates as undesirable as suggested by conventional economic logic? Perhaps not.

We normally think of progressivity in relation to income, but people's means relate also to their wealth, and one of the great changes in Australia has been a growth in wealth, and not just illiquid housing wealth. Between 2003-04 and 2009-10, average financial wealth per household, excluding superannuation, rose by $33 000 in real terms. In the ACT it was even greater – $70 000. This was in spite of the hit of the financial crisis of 2008.

One of the "reforms" of the Howard Government was to make superannuation tax free upon retirement, and to remove limits on withdrawal from account-based pensions. This means that for people who have retired, superannuation account balances are at least as liquid as other financial assets. (In fact more so because of their tax-free status.)

In the ACT over this period superannuation assets per household have risen by $84 000, compared with $43 000 nationally. Of course most of these assets would be in the accumulation phase and therefore locked in. We do not have separate figures for older ACT residents, but nationally aged couple households ("reference person" aged 65 or more) have had a $120 000 increase in superannuation assets, offset by a fall of $30 000 in other financial assets. Aged single households have not done so well.

Undoubtedly, these good fortunes relate to people moving into aged cohorts. People who were 65 in 2004 and 71 in 2010 have almost certainly seen their wealth go backwards.

In other words, increased rate revenue is perhaps a good way of tapping into the increased liquid wealth of those who will be retiring, compensating in part for an over-generous treatment of private pension income.

Of course, it is tough on existing retirees, and will continue to be tough on those who, through poor lifetime employment, or who will have had poorly performing superannuation (particularly in "retail" funds). But if the progressivity of the changes can be maintained (i.e. not impacting on properties up to $300 000) that effect will be ameliorated.

In the tradeoff with conveyancing, there should be some compensation for those aged people who want to move to a smaller house. (Ensuring suburbs have a range of housing, so that older people can move locally without breaking community connections, is important.)

In a broader context the tradeoff makes a great deal of sense. Conveyancing tax is an upfront tax, while rates are spread over time. It is hardly reasonable by any economic criterion to require taxes in advance of receiving public services.

Conveyancing taxes are taxes on mobility, discouraging people from moving closer to employment, and from shaping their housing to their changing needs, particularly family composition. There should be efficiency gains all around, particularly in terms of lower transport costs and better allocation of housing space. (In this regard an imported, but neglected reform would be to see the high-cost real-estate industry reduce its costs.)

And, to the extent that the tax changes will fall more on older, more established households, they should redress to some extent the way through higher education charges, and full absorption of infrastructure charges on new housing developments, the tax burden has shifted to younger people. Many older Australians, including this writer, have enjoyed the benefits of Commonwealth university scholarships, and in their 20s have bought houses at a time when local infrastructure was covered by taxpayers in general, and was not built into the housing price.

Finally, politically they make sense. Older Australians, even though they have enjoyed the benefits conferred on them by previous generations of taxpayers, are strongly loyal to the Liberal Party and its philosophy of tax reduction. It's a move that should cost few votes, and may involve a little restorative justice on baby-boomers.