27 November 2019

NSW Productivity Commissioner
c/o
NSW Treasury
52 Martin Place
Sydney NSW 2000

Dear Mr Achterstraat,

Prosper Australia welcomes the opportunity to provide a submission in response to the discussion paper *Kickstarting the Productivity Conversation.*

Prosper is an independent, not-for-profit organisation campaigning for economic justice. Our reform agenda derives from the work of nineteenth century philosopher, Henry George. Prosper's mission is to influence revenue policy by educating policy makers and the general public in the economics of locational advantage.

We have expertise in a number of areas relating to your work, most notably in analysis of state tax systems and design of property tax reforms. In recent years we have published several commissioned reports on these topics which you may find useful. These include:

- *Stamp duty to land tax: designing the transition* (2019), by Dr Tim Helm, a report considering how the transitional issues and political barriers standing in the way of this important reform can be overcome;
- *The transit transformation Australia needs* (2019), by Dr Chris Hale in conjunction with Prosper, which discusses beneficiary funding (value capture) for mass transit;
- *The First Interval - Evaluating ACT's Land Value Tax Transition* (2016), by Dr Cameron Murray, a report evaluating the economic effects of this reform and assessing the revenue potential from nationwide adoption of the ACT model of selling planning rights.

Our full report library may be found at www.prosper.org.au/reports.

Our submission is limited to comments only on aspects of the 'taxation' priority area and on the developer contributions issue identified within the 'planning' priority area.

Taxation – general comments

The discussion paper identifies six issues under the theme of 'modernising our tax system to help our economy grow'.

While we agree with the importance of each of these issues, we also suggest the greatest emphasis in identifying priority reforms must remain on the tax mix, not the design of each tax. Improving the tax mix by reducing or abolishing those taxes most harmful to productivity growth is where the greatest gains are to be made. Improving the design of taxes within the system is of second-order importance by comparison.

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While we acknowledge the discussion paper does discuss the tax mix as a productivity priority in some detail, and the commentary on stamp duty reform centres on this issue, we are also aware that as consideration of tax policy turns from high-level objectives towards specific details it can be easy to lose sight of the bigger picture for reform. We therefore urge your review to keep the objective of large-scale reform at the fore.

In that regard there are several more opportunities to raise more revenue from taxes on immobile bases, thereby allowing reductions in distortionary taxes, that were not covered in the discussion paper. These opportunities include:

- Raising more revenue from developer charges;
- Taxing rezoning windfall gains;
- Value capture from non-development properties;
- Capturing resource rents and rents from natural monopolies (e.g. gambling licences).

Prosper's submission to the *NSW Federal Financial Relations Review* outlined these opportunities in some detail. To avoid duplication we have not repeated this material here, but encourage you to consider the content of that submission.

<u>Taxation – stamp duty to land tax</u>

Section 7.3 of the discussion paper asks "What steps could the NSW Government take to reduce its reliance on transfer duty?".

Prosper has recently outlined a detailed plan for enacting a fair, efficient, and budget-neutral transition from stamp duty to land tax that need not impose significant political pain (see our report *Stamp duty to land tax: designing the transition*).

The plan involves:

- Credit against future land tax (i.e. a voucher) for duty-payers over the last 10 years, which would cover approximately 40% of property owners;
- Two optional elements:
    - An option for new buyers to opt-out from land tax, offered in the early years of the reform only;
    - A phase-in to the full land tax rate (e.g. over three years);
- A higher land tax rate for 10 years to recover the budget cost of these tax concessions, reverting to a revenue-neutral rate beyond that; and
- A universal tax deferral option, which would prevent any land tax payer facing liquidity issues, and with interest at commercial rates would also generate significant additional revenue for the state.

We see a land tax replacement for stamp duty as the only sensible option. The alternative proposal to replace stamp duty revenues by increasing or broadening the GST has numerous disadvantages by comparison.

One is distributional: it would result in windfall property price gains at the expense of any consumers not fully compensated through the income tax and transfer system. Another is that it would be significantly more difficult to implement, since it would require unanimous inter-governmental agreement, federal legislation, renegotiation of the GST-exempt boundary, and design of compensation for low-income households. Finally, it would further reduce states' autonomy over their revenue bases and accountability to their residents in relation to taxation.

Planning – developer contributions

Section 8.7 of the discussion paper asks "What principles could be applied to the developer contributions system to ensure transparent, consistent and efficient outcomes?"

The discussion paper explains well the need for an efficient contributions regime and how that relates to productive use of land and the productivity of the public infrastructure spend.

We agree that the design of development contributions is a topic ripe for clearer thinking; it is an area where principle has lagged practice, and practice in many ways has followed politics. There have been no clear answers put forward by either practitioners or policy analysts examining this topic (such as the Productivity Commission in its 2014 *Public Infrastructure* inquiry) to questions such as whether developer contributions ought to be seen and used as purely a cost recovery tool or whether they also ought to be employed in a broader value capture role, nor to questions over the appropriate scope of infrastructure that ought to be paid for by developers.

We also consider your discussion question to be the right one; the existing principles of 'nexus' and 'benefit apportionment' are useful but incomplete as a basis for policy advice, and establishing a clearer view of the what, why and how of developer contributions is a critical task.

Our views, elaborated on in our submission to the *NSW Federal Financial Relations Review*, are that:

- Capture of windfall gains from rezoning ought to be undertaken with instruments other than developer contributions – i.e. there is a role for two separate charges on development properties;
- The appropriate role for developer contributions is as a charge based on cost for the purposes of providing efficient development incentives;
- There is no rationale for less than full recovery of the development-related portion of the total cost of any infrastructure (determined via benefit apportionment);
- If inefficient costs are the costs incurred by the state in response to development, they are still the true social costs of that development – and so efficient development decisions (as well as equity with respect to division of the funding burden between developers and general taxpayers) are promoted by levying development contributions at actual, not efficient, costs;
- The appropriate role for rezoning value capture based on land value gains is to capture benefits otherwise received by landowners as an unearned windfall; and
- States should also endeavour to capture windfall gains from infrastructure delivery to non-development properties via other value capture instruments, such as a land value gains tax.

The 2^{nd} and 3^{rd} points amount to an endorsement of the views in the discussion paper, while the 4^{th} does not.

We are also unsure that the distinction drawn in the discussion paper between development-dependent costs and population-dependent costs, and the claim that efficiency in development

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patterns is served by imposing development contributions along these lines, is either correct in principle or workable in practice.

In principle, population growth is simply equal to the number of people finding residence in newly developed properties. So less development means fewer residents and a reduced need for 'population-dependent' infrastructure. This is because for any specific new development not to proceed results in lower overall housing supply, raising rents across the board and discouraging some prospective migrants. Conversely, the delivery of new 'population-dependent' infrastructure – say, a major new rail line to growth areas – tends to precede (and at best, be planned in an integrated fashion with) planning approval for more dwellings.

The causality between individual development decisions and population-dependent infrastructure thus runs both ways. All infrastructure is ultimately development-dependent, the differences being simply a matter of timeframe and the predictability with which the various arms of government provide it in response to (or in anticipation of) development. The risk in limiting developer contributions to a subset of infrastructure costs according to some arbitrary boundary of either time or predictability is that more development will proceed than is economically efficient given the costs of the population-dependent infrastructure that will inevitably be required in the long-run in response.

A better approach is to deem any infrastructure needed to preserve the quality of life for existing residents as the population grows as within the scope of developer contributions, at least in principle, even if apportionment is only possible at a city-wide scale and to a rough approximation in practice.

Concluding remarks

We are pleased to see a thorough, considered, examination of opportunities to enhance productivity being led at state level, and we commend the NSW Government for enabling this work to take place.

Although tax reform directions have been well covered in recent tax reviews, we urge you to keep these opportunities front-and-centre of your review – since there are strong indications that state tax reform is, indeed, the policy area where the greatest potential gains may be made.

We would welcome further engagement throughout the review.

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