

INQUIRY INTO LAND TRANSFER DUTY FEES

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Unpacking the impact of stamp duties on resource mobility and productivity: Submission to the Economy and Infrastructure Committee

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1. Motivation for stamp duty reform

We congratulate the Legislative Council for initiating this inquiry into issues around land transfer duty fees (hereafter referred to as STPDY, or stamp duty). This is a serious issue for at least two related reasons:

1. Australia has a productivity problem; rates of productivity growth – the key determinant of real incomes and living standards, have fallen nationally and in Victoria.
2. Second, rising house prices, a tight rental market and falling rates of home ownership are causing consternation in the community, leading to calls for government intervention to make housing more affordable.

These issues are related because if policy settings mean that the community is not getting the most value from its stock of property, both productivity and housing affordability will be adversely affected. Hence, improving the utilization of and investment in residential and non-residential land and building will produce substantial productivity gains and assist housing affordability. For example, the Australian Bureau of Statistics reported that as of December 2022, the total value of residential dwellings in Australia was around \$9615 billion (ABS 2023). Clearly, even a small percentage improvement in the use of residential dwellings can result in huge benefits to society.

While STPDY is a major source of revenue for state governments to help fund public goods and services, studies have found that STPDY is an inefficient and inequitable

¹ The views expressed in this submission should not be attributed to the organizations in which individual authors currently work.

form of tax that imposes extremely high costs on society.² It is also a less stable source of revenue for state governments. To date, only two jurisdictions, ACT and NSW, have taken major steps to reform STPDY, and a newly elected government has committed to winding back the NSW reforms.

In contrast, Victoria still relies on STPDY as a major source of revenue despite multiple state-based reviews³ recommending that the state replace this form of tax with more efficient and equitable alternatives, such as land taxes and property uplift taxes. Furthermore, Victoria has increased its reliance significantly over the past three decades. For instance, STPDY increased from around 20 per cent of tax revenue in the early 1990s to more than 30 per cent today (see Figure 14 in Tilley 2022, p. 19),⁴ mainly due to bracket creep from rising property prices and changing tax rates.

Although Victoria has made some progress towards addressing this issue, such as the introduction of a property windfall gains tax, it nonetheless lags the ACT (and until recently NSW) on substantive STPDY reform. The introduction of a windfall gains tax in Victoria may indicate an intention to take a different approach to that of the ACT and NSW (at least until recently). However, there has been no public debate in Victoria in recent years about the benefits and challenges of reducing STPDY and how to find more efficient and equitable sources of revenues.⁵

The current inquiry can help to promote public debate and awareness about the effects of the tax system on productivity and housing affordability and the potential benefits and concerns about tax reform. It is pleasing therefore to see that the terms of reference require the Committee to examine the impacts of STPDY on several issues, including:

- (a) labour and capital mobility;
- (b) revenue predictability;

² See Section 3 of this submission.

³ Relevant reviews for Victoria include the Committee of Inquiry into Revenue Raising (Nieuwenhuysen 1983; see also Nieuwenhuysen 1985); the Review of State Business Taxes (Harvey et al 2001); and the Legislative Council Inquiry into State Government Taxation and Debt (VEDIC 2010).

⁴ The figures cited in Tilley include revenues from duties on insurance and motor vehicle transfers.

⁵ An exception was a 2011 draft inquiry report by the Victorian Competition and Efficiency Commission. This report identified a productivity-enhancing reform agenda for Victoria and chapter 5 dealt with state taxes, especially STPDY. The final report was never released by the Victorian Government. However, the draft report is publicly available [here](#).

- (c) efficiency of resource allocation;
- (d) effects on housing supply and development; and
- (e) overall tax efficiency.

This submission focuses on key elements of the terms of reference, namely the impacts of STPDTY on labour and capital mobility and on economic efficiency. In this submission, we outline a model for estimating these impacts and report preliminary findings on the breakdown of inefficiencies due to deadweight loss and resource misallocation; the magnitude of efficiency gains if STPDTY were abolished; and the aggregate impact on productivity and living standards. Our central conclusions, based on these preliminary results, is that the impacts on mobility and productivity are considerable, and that further work is required to refine the model for estimating the economic and distributional effects of STPDTY and broader tax reform.

Before outlining our model and preliminary results, the next section provides a brief overview of the economic effects of STPDTY.

2. Effects of STPDTY on economic efficiency and welfare

There are two main channels through which STPDTY affects efficiency and welfare.

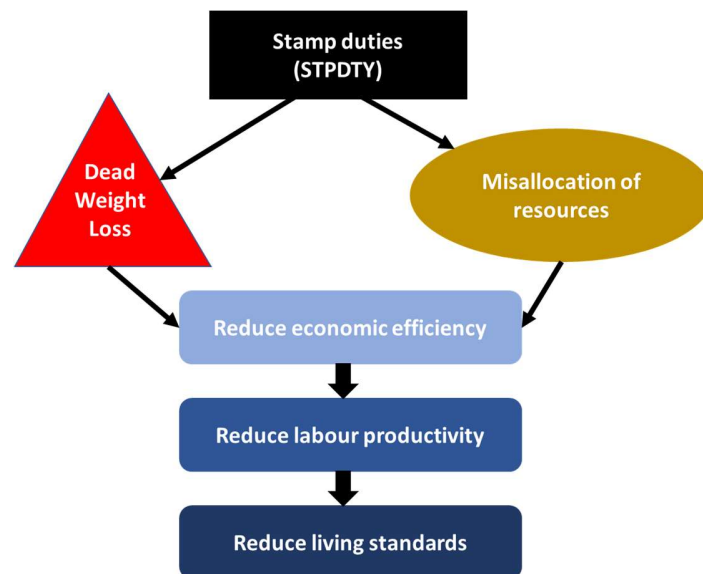
1. **The first channel is through deadweight loss arising from market inefficiency.** STPDTY creates a wedge between the prices paid by buyers and received by sellers, which affects property prices and turnover. STPDTY increases purchase prices, thereby making housing less affordable for households. But STPDTY also reduces the amount paid to the seller, thus discouraging some people from offering their properties for sale. As a result, turnover in the property market is lower than otherwise. This results in the loss of economic efficiency to society, often referred to as deadweight loss (DWL). The relative size of these effects and the incidence of STPDTY would depend on the size of the tax and demand and supply elasticities. This first channel is well understood.⁶

⁶ Demand and supply are also affected by changes in economic conditions, supply-side regulation, and other factors. A characteristic of housing markets is that demand for housing may change more

2. **The second channel is through resource misallocation due to hinderance to resource mobility.** STPDY increases the costs of moving, which can distort households' decisions about where to live and work. By restricting labour mobility, for instance, STPDY deters some workers from moving to areas with higher productivity industries, or to areas with severe skills shortages. This results in the loss of economic efficiency due to the misallocation of labour resources. STPDY also affects the decisions of firms to invest in new capital and expand their operations. The main problem is that the size of these effects is not well understood because the focus has been on the first (more easily measured) channel but not the second channel.

These two sources of inefficiency lead to lower labour productivity growth, which in turn slows the growth in living standards, all other things equal (Figure 1). Additionally, Box 1 presents the main drivers of Victoria's living standards and labour productivity.

Figure 1: Two main transmission channels of stamp duties



Source: authors.

rapidly than supply. During periods of rapid growth in demand for housing, new supply is typically slower to respond, thereby causing rapid price rises. In the longer term, the supply of properties may increase as new supply enters the market. The volatility of demand for housing also causes volatility in STPDY revenues, which complicates the management of state finances.

Box 1: Main drivers of Victoria's standard of living

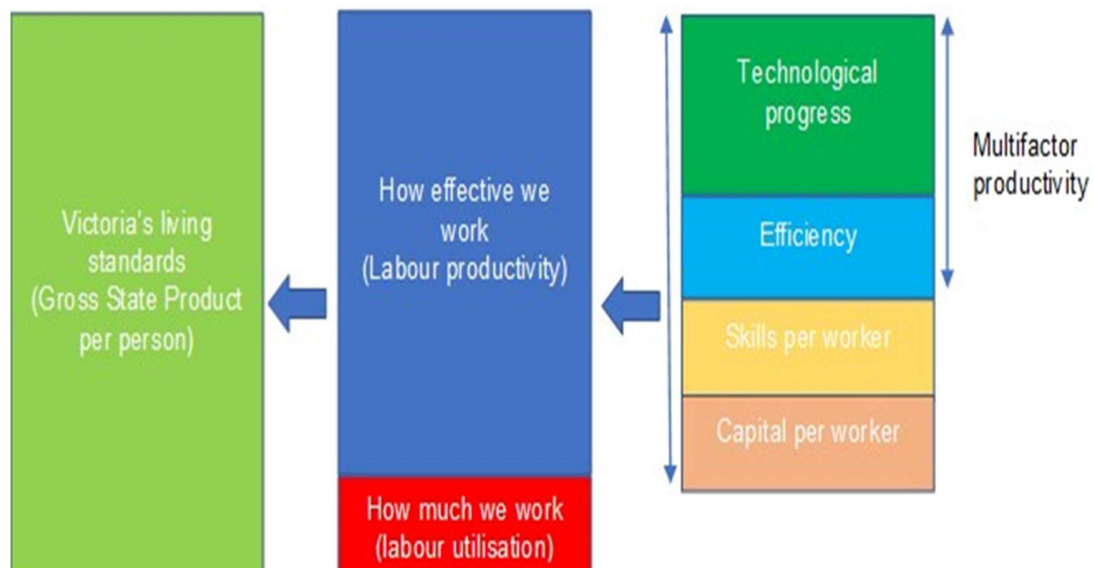
Victoria's standard of living depends on two factors (Figure 2):

- i. labour productivity, i.e., the value of what the Victorian economy produces per hour worked – how effectively we work; and
- ii. labour utilization, i.e., the average number of hours worked per person in the population in the Victorian economy – how much we work.

Labour productivity is the only component that drives increases in Victoria's standard of living in the long run because there is an upper limit on the number of hours that workers want to work, and on the share of the population in paid work.

Higher labour productivity can be achieved through technological progress and efficiency improvements. This component is usually referred to as multi-factor productivity. It sits on top of contributions associated with more skills per worker and/or more capital per worker (Figure 2).

Figure 2: Drivers of Victoria's living standards and labour productivity



Source: Chang, Findlay, and Whetton (2023).

3. Knowledge gap in previous analysis on stamp duties

The Henry tax review highlighted how STPDTY negatively affect efficiency and equality (Henry et al., 2009). STPDTY hinders the optimal allocation of housing resources by discouraging transactions and prevents people from moving to more suitable homes. Additionally, it unfairly burdens frequent movers regardless of their income or wealth. While it generates revenue for state governments, STPDTY is volatile and incompatible with modern tax systems.

Since the Henry review several studies have examined the impact of STPDTY on various aspects of the housing market, as well as the potential benefits of reform. These studies have consistently found that STPDTY has significant and meaningful effects on housing prices, market turnover, and homeownership, as predicted by economic theory (e.g., Davidoff and Leigh 2013; Deloitte 2015; Cho, Li, and Uren 2021; NHFIC 2021). Furthermore, research has demonstrated that land tax is a more efficient and equitable alternative to STPDTY, as it does not constrain mobility, and is fairer to those who move more frequently (Bentley and D'Cruz 2016; Clifford and Freebairn 2021). Research has also shown that replacing STPDTY with land tax would improve housing affordability and stimulate supply of new properties (Wood et al. 2012; Deloitte 2015; and NHFIC 2021). However, given that STPDTY is a significant source of revenue for state governments, it is also important to consider the broader fiscal implications of any proposed STPDTY reform (Wood, Ong, and Cigdem 2016).

While the basic economic effects of STPDTY on property prices, mobility, and equity are well understood, there is a lack of quantitative studies that assess the magnitude of these effects at the aggregate level. This knowledge gap is particularly critical because existing studies have primarily focused on the impact of STPDTY on the property market, overlooking the potential interference of STPDTY with the optimal allocation of labour resources and its implications for labour productivity, output, and welfare.

To this end, it is important to consider how STPDTY may constrain labour mobility, potentially impacting labour allocation across and within cities and, consequently, labour productivity and aggregate output. Our analysis aims to provide insights into these crucial issues and help fill the knowledge gap.

4. Our model

To assess the welfare costs associated with STPDY, we employ a static spatial general equilibrium model that builds on the framework developed by Hsieh and Moretti (2019) to examine the relationship between intra- and inter-city mobility.

a. Key features of the model

In our economic framework, the Australian economy consists multiple cities and households.

Cities

- Each city produces a homogeneous final good using a combination of capital and labour resources, given the available technology in that city. In other words, each city has a unique blend of technology.
- Both capital and labour can move freely between cities, but the relocation of labour may be hindered by associated moving costs.

Households

- Households supply labour to earn income at the prevailing market wage rate.
- Households select the city that maximizes their utility from the consumption of a bundle of goods and services, including the final good, housing services, local amenities, and their individual location preferences, given their income levels.
- Households bear the burden of STPDY included in the prices they pay for housing services.

Our model captures the two channels through which STPDY can impact social welfare as discussed in Section 2, namely, through (i) deadweight loss, and (ii) resource misallocation.

In the model, STPDY influences efficiency and productivity by increasing the barriers to movement of labour within a city. Such barriers can reduce the effective use of labour

within the city, leading to lower productivity and output for that city. In an ideal world, labour should move towards high-productivity cities until the marginal product of labour is equalized across cities, resulting in an optimal allocation of labour resources and the highest possible level of aggregate output. However, achieving such an efficient allocation is often difficult due to various factors, including variations in attractiveness and housing prices across cities. High STPDY exacerbates these variations, increasing the disparity in housing prices and reducing the allocative efficiency of labour resources across cities. As a result, aggregate output and household welfare are negatively affected.

While multiple factors affect the movement of labour, reducing STPDY helps to improve allocative efficiency, thereby increasing aggregate output and welfare for all households in Australia. Attempting to model these relationships helps to shed light on how reducing mobility barriers such as STPDY can lead to a more efficient allocation of resources, benefiting the economy as a whole.

Although the model is simplified, our objective at this stage is to gain an understanding of the scale of welfare losses to society caused by STPDY especially when mobility issues are considered.

b. Data

Our preliminary model uses Australian Bureau of Statistics data from various cities across Australia to determine the welfare effects of STPDY and the relative significance of each of the two channels.

c. Measuring welfare

To measure welfare, we use the standard approach adopted in economics. Specifically, we measure welfare by calculating the expected utility of the typical individual within the economy.

At the city level, individual utility is determined by real income per person, which is the nominal output per person divided by the cost of living within that city. Since individuals have the freedom to move between cities, their utility is expected to be equivalent

regardless of their city of residence. As a result, at the aggregate level, the expected utility is equal to the real output per person, which is the nominal output per person divided by the average cost of living across all cities. Therefore, our welfare measure is equivalent to real gross domestic product per person, which is a widely used, albeit imperfect, metric for assessing living standards.

5. Our preliminary findings

The model combines a variety of data on key metrics such as output, employment, wages, median housing prices, and average STPDY rates at the city level. To conduct our analysis, we calibrated our model using parameter values sourced from existing literature and applied counterfactual analysis to better understand the effects of STPDY.

Our research seeks to answer a critical question: What potential gains in welfare could Australia realize by replacing STPDY in all cities with a broad-based land tax? Our results indicate that economic-wide STPDY reform could increase measured welfare (based on real per capita output) by a very large amount. Our preliminary analysis suggested long-run gains in the order of 5 per cent, although further work is needed to improve this estimate.⁷ Of more significance, is the preliminary finding that the misallocation channel (the second channel) is a very significant factor, contributing to around three-quarters of the welfare gains, with the remaining one-quarter attributed to the elimination of deadweight losses incurred from STPDY (the first channel).

This result is for Australia as a whole, illustrating the potential benefits of a national approach to STPDY reform. However, we can also focus on individual states: our preliminary analysis suggests that if Victoria was to go it alone in replacing STPDY with a broad-based land tax, the measured national long-run welfare gain is also large at around 1.6 per cent.

Our findings have three significant implications for the ongoing debate over potential

⁷ Other studies from overseas studies have also found very large gains from reducing mobility barriers. For example, Bryan and Morten (2019) estimate a 22 per cent increase in labour productivity from removing barriers to internal labour migration in Indonesia. However, further research is needed to firm up our estimates, as the results are sensitive to several parameters affecting the relationship between mobility and STPDY rates.

STPDTY reforms:

- First, our results confirm the conclusions on STPDTY highlighted by previous reviews of state taxation. Our preliminary results indicate that STPDTY has quantitatively significant negative effects on social welfare, providing further support for calls to reform them.
- Second, our preliminary analysis indicates that the misallocation effect of STPDTY on aggregate output and welfare is considerably larger than the deadweight losses caused by reliance on STPDTY. Specifically, the misallocation effect is around 3 times higher than the deadweight losses. Therefore, our results suggest that the current focus of the debate on the conventional deadweight losses in the housing market may significantly understate the consequences of state reliance on STPDTY.
- Third, our results suggest there are significant advantages from all states reducing reliance on STPDTY but that there are still substantial gains available if Victoria goes it alone.

Our preliminary findings suggest that STPDTY can significantly impact both aggregate output and welfare. However, it is essential to note that the current model is highly simplified, reflecting its preliminary nature. To provide policymakers with more refined estimates, we would need develop a full-fledged dynamic general equilibrium model and calibrate it to reflect key features of the Australian economy, including at the state level.

We therefore plan to enhance the model in several ways.

1. Our simplified model measures only one-off welfare gains. We therefore plan to develop a dynamic spatial general equilibrium model to better reflect the reality that the productivity of cities is constantly changing.
2. The model can be developed to account for different groups of buyers with different sensitivity to STPDTY rates, including renters and investors. This will also permit further analysis of the differential effects of STPDTY reforms across the distribution of wealth.
3. As STPDTY is only one of many taxes affecting housing demand and supply, incorporating key features of Australia's tax system in the model will enable further assessment of the revenue effects of STPDTY reforms on state and federal budgets.

6. Conclusions

In conclusion, while some of the potential effects of STPDY are well understood, there is a need for further analysis of the magnitude of the economic and equity effects of state government reliance on STPDY. The preliminary results discussed in this submission suggest that STPDY has a major effect on interstate and intra-city mobility and that accounting for these effects significantly lifts estimates of the benefits of reducing state reliance on STPDY, even if Victoria proceeds alone. The preliminary results also highlight the benefits of a coordinated national approach to STPDY reform.

Further work is needed to build a richer model to improve these estimates, to look at the efficiency and equity effects on different groups, and to analyze the revenue and efficiency effects of tax reform scenarios. We encourage the Committee to support the development of transparent, independent, and rigorous research on the economic and equity effects of STPDY as part of future efforts to improve public understanding and debate about the benefits of reform.

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