IS THERE NO END TO ECONOMIC DÉJÀ VU?

The Land Value's Research Group's ***Bryan Kavanagh*** *had this published in Melbourne's "Age" on November 20. Some of the dopey editing has been rectified!*

Nothing changes. In the 1970s, the collapse of Mainline Corporation and Cambridge Credit heralded a recession in the wake of the 1973 real estate bust. In the early 1990s it was Pyramid Building Society, Tricontinental and the State Savings Bank of Victoria in the wake of the 1989 real estate bust. We'll no doubt learn shortly which building developer or bank will come to be seen as the harbinger of this particular financial collapse.

Why don't we simply put an end to these damaging real estate bubbles? Recent US experience confirms that bubble-affected mortgages offer lenders no real security, so why didn't APRA and the RBA act to protect Australians and their banks from this real estate binge we've experienced since 1999? Did they simply get drawn up into the buzz and hype of it all? If they and other economic analysts fail to respond to cause and effect, are we simply to emerge from this financial mess in a few years time, only to have to be put through it all again in the next recession due about 2026? It seems that everybody except those responsible for protecting us from these financial disasters can write this very repetitive script.

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In an article "**Resource rents hold the property key**" in THE AGE on 15 June 2005, I wrote that "economic growth is primed to tank into a major deflation", so we shouldn't be considering interest rate rises. The RBA then proceeded to make seven one-quarter per cent rises over the next three years, because it curiously espied inflation to be the threat to the economy. The bank took cash rates from 5.5% to 7.25% and put many individuals and businesses under significant financial pressure in so doing. Now that the RBA has finally come to recognise that the real risk to the economy is a price drop in assets, it has belatedly reduced the interbank overnight rate to 5.25%, a remarkable decline of 2.0% in just two months. But it's all too late, because the problem with an asset deflation is that people won't be conned into spending now that they see they'll be able to buy things cheaper in six or twelve months time.

So what's the answer? Well, it's clearly not to be found in conventional economics texts. Nor will it come from those economists advocating bailouts and Keynesian pump-priming techniques "in order to restore confidence in the system." As the problem is more deep-seated than a crisis in confidence, a fundamental structural change is needed to free ourselves from the crisis that will arise when, as with the US and UK, our real estate bubble finally bursts.

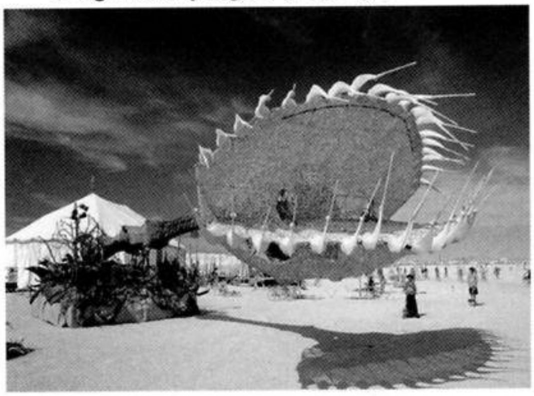
As our authorities have failed to address asset bubbles, we now have to allow real estate and share markets to find their real levels, without federal government interference. The updated first home owner's grant towards the purchase of an existing home is a disgraceful waste of money. An image springs to mind: housing minister Tanya Plibersek trying to pump up the housing bubble with a bicycle pump on the one side as air escapes from a gigantic hole in the other. It appears the government, like some sort of tout, is trying to entrap young buyers into purchasing in a collapsing real estate market, where they could be left seriously exposed after the decline in prices. It's business as usual, folks!

The Land Values Research Group (LVRG) has long advocated greater capture of publicly-generated annual land values, both as a means of keeping the lid on real estate bubbles and reducing taxes on those people endeavouring to partake in pursuits more productive than real estate speculation. If this were conducted on a large enough scale to secure the results, it would put dollars in peoples' pockets and get the real economy back to work. People usually acknowledge the principle, but then venture the ironic addendum, "Good luck with that one!", knowing that it's a difficult program to get up politically because policymakers can't be educated to the stimulus that the tax system currently provides to the generation of land price bubbles.

Political denial plays a part, too. In his early chancellorship of the UK exchequer in 1997, Gordon Brown went so far as to claim that he had eliminated the boom bust cycle. Here in Oz, Peter Costello congratulated himself for running surplus budgets while he presided over inflating the greatest real estate bubble in our history. Perhaps denial and political inertia on boom-bust connotes that some people believe it's more important to retain the cycle than to address and eliminate it? It's presumably a job for someone else.

The LVRG's incoming Director, Dr Gavin Putland, has a response to the impasse that might hopefully receive a fair hearing from Dr Ken Henry's "Australia's Future Tax System" review panel. The fact that Putland's doctorate is in electrical engineering and not in economics leaves his mind unburdened by the modern dogma that land and capital act together and behave as one. Accordingly, his knowledge of the elements of taxation policy is estimable.

Dr Putland's submission advocates an optional system, whereby companies and individuals, whether as owners or tenants, might opt to remain in the existing tax system, or out of it by choosing to enter into a contract with the ATO to convey an annual share of the notional rent of their site which is initially equivalent to the taxes they currently pay. Revenue-neutrality is maintained on a case-by-case basis, and the simplicity of the idea, plus the fact that the proposal is entirely voluntary, offers an exit strategy from boom bust cycles. Who would be niggardly enough to oppose an optional tax system in which no one will pay any more tax? The enormous projected savings in compliance costs is the obvious selling point. The usual noisy clamour from those who object to significantly higher property-based revenues



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may be met with the response, "Well, you don't have to opt in."

My own study early last year "**Unlocking the Riches of Oz**" suggested that Australia's tax system is symptomatic of many around the world which encouraged the speculative bubble whilst discouraging industry and thrift. In the case of the $1 trillion Australian economy, taxation since 1972 has suppressed and damaged it to the tune of at least another $1 trillion by being passed on in prices, by compliance costs, and the productivity lost in recessions that have followed the bursting of each real estate bubble.

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We can either reverse or repeat the process that channels us into financial devastation every 18 years or so. If we put the suggested holding charge on the use and abuse of the sites we hold or occupy, and remove taxes from individuals and businesses trying their best to be productive, Australia may obviate future financial meltdowns. We don't have to ape the arrant nonsense to counter the bust being exhibited and already found wanting in the US and UK, which Mr. Rudd seems to be bent on copying. Unlike the US and UK, up-to-date land valuations are assessed on all properties in Australia. If we wished, we could use the fact to our everlasting advantage. ■