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Resource rents hold the property key

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Analysts and policymakers may learn a valuable lesson from the history of Ireland, writes Bryan Kavanagh

After his bloody victory in Ireland (1649-52), one of the first things Oliver Cromwell did was to establish the annual worth of the lands of Ireland. William (later Sir William) Petty won the tender to value the newly conquered land by using cheap labour in the form of some of Cromwell's by then unemployed soldiers.

He trained them in valuation techniques, including how to survey the whole of Ireland, and oversaw the professional completion of the valuation contract within 13 months.

Petty was a larger than life character whom some hold to be the father of modern economics and its first econometrician. At one point he is said to have commented on the extent of the Irish holding that Sir Hierome Sankey, one of Cromwell's more formidable knights, had chosen for himself following the invasion of Ireland. Insulted, the brawny knight challenged the notoriously near-sighted Petty to a duel, offering Petty the choice of weapons and location.

When the almost blind Petty chose broad axes in a darkened cellar, Sir Hierome retreated gracefully after finding reason to reconsider the seriousness of Petty's offence.

Both Cromwell and Petty saw the need to know the annual value of Ireland's natural resources, but the modern neo-classical economist is all but clueless on the quantum of resource rent within the economy, or for that matter to where it disappears.

He is even heard to say that as we no longer exist predominantly in rural communities, land-based revenue systems are no longer appropriate; this, despite the fact that the greater part of land rent is now located within our large cities.

Whereas it was accepted in Petty's day that the annual rent of land was a surplus that came about by the mere existence of community, and its collection and use was the cheapest and most equitable source of revenue, we are now educated to forget that. As the annual value of our natural resources is privately expropriated, it has become necessary to levy myriad taxes on all sorts of productive activities. In 2002, only $19.2 billion of Australia's $180 billion of publicly created natural resource rents was captured for public purposes. The $160.8 billion forgone in resource revenues was gratefully received by Australia's property owners, but this bonanza came at enormous cost to the country. The growing quantum of Australia's resource rents and taxes has been at the expense of the net incomes of labour and capital, especially since 1972 where, as a proportion of GDP, taxes have increased by 28 per cent, the nation's rent has escalated 125 per cent and net incomes have declined by 35 per cent. Accordingly, it is possible to argue that the real battle is not between capitalist and worker, but between most Australians and the relatively few rent-seekers who capture the greater part of our national resource rents.

The Russian economist Nikolai Kondratieff did not have any explanation for the cause of the 50 to 60-year-long wave cycles he discovered in his studies of 140 years of the economies of the US, Britain, France and Germany. However, cycles of boom and bust seem to be inextricably linked to the failure of economies to capture the national rent for their coffers, and to the consequent escalation in land prices and taxes levied on productive work. Where most modern economic analysts don't like to acknowledge the existence of the Kondratieff wave because it is suggestive of their impotence during its deflationary decline, it is possible to clearly show the inflationary, then deflationary, courses of the fourth Kondratieff wave within the economies of Australia, the US and Britain. The end of each of the three preceding long waves was defined by economic depression.

The chart displays the relationship of Australia's total real estate sales to GDP. At the bursting of each property bubble (that is, those parts of the graph exceeding the empirical 19 per cent "bubble line") the economy has declined into recession as the graph cut back below the 19 per cent mark. The period shown represents the second half of the fourth Kondratieff wave, and it is apparent that as property sales to GDP increased, GDP growth has tended to decline.

So, whereas low tax rates and deflated land prices assisted post-war GDP recovery until the outset of the 1970s, increments in taxation, inflation and interest rates since that time have ensured that Australians have taken their eyes off the ball. We began to follow the dictates of the tax regime to play another game altogether, namely, that of real estate speculation.

We have now inflated the current residential bubble to voluminous proportions and economic growth is primed to tank into a major deflation.

In the week ended June 3, Treasurer Peter Costello warned that the Reserve Bank of Australia should not increase interest rates. Early the following week, the RBA seemed to have listened.

However, Costello's advice may have been redundant in the current deflationary environment, because the next adjustment of Australian interest rates would more properly be down.

If we wish to arrest the decline into financial collapse,it may be time for analysts and policymakers to consider to what extent Petty's national rent offers potential to slash the taxation of productive activity. Replacing taxes with resource rents could also help to keep the lid on skyrocketing land prices, which have played such a destructive role in Australia's economy during the second half of the fourth Kondratieff wave.

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