The Pathology of Income Maldistribution

An Index of the Wealth-Poverty Gap in Australia (1951-2000)

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THE CAUSE of society-wide poverty remains controversial among scholars despite two centuries of systematic study. The elusiveness of the explanation is the result of faulty diagnosis, claims Tony O'Brien.

There is no mystery. Poverty is an institutionalised process that escapes democratic action because governments fail to bring one explanation into focus: the tax policies which they enforce. Conventional taxes penalise people who add value by their work and savings, while enabling those who extract value from the wealth of the nation to escape without compensating the losers.

The legally sanctioned forces that restrict the freedom to earn a living, and which prevent the accumulation of wealth by all but a relatively few privileged people, are to be observed in the land market. The laws that prescribe this outcome are not "natural". The correct rules for public finance have been elucidated in the economic literature ever since Adam Smith's *The Wealth of Nations*. Governments choose to turn a Nelsonian blind eye towards them.

Australia, because it continues to levy direct charges on the income from land, affords researchers the opportunity to isolate the impact of the land market on people's lives. This case study identifies what the author claims are the primary elements of the Wealth-Poverty Gap, on which economists may build a deeper analysis of the dynamics of social impoverishment.

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AUSTRALIA, in common with most communities across the world, is confronted by a host of seemingly intractable dilemmas. We see levels of unemployment which most economists predict will rarely again fall much below 5%. As workforces continue to be "downsized", and remaining jobs casualised, growing stress levels stretch families to breaking point. Education and other civil institutions are being ransomed to corporate sponsors and public assets are given away at fire-sale prices.

The productive capacity of nations across the developed and developing world continues to rise. Inflation, we are told, has largely been tamed. We get cleverer by the minute, enabling us to produce more goods with less labour. And yet the gains are even more unevenly divided between the rich and the poor than they ever were. Under the present social rules, there is no reason to expect a reversal in this tendency.

The fact that there is a wealth-poverty gap is axiomatic. We do not question it. In fact, we hardly think about it. We now assume it to be part of the natural order; which comfortingly absolves us from responsibility for it. Is such a gap a natural phenomenon, or does it arise because of the perversion or denial of some economic fundamental? To whose scientific discipline does it then fall to investigate and elucidate the mechanisms that produce it? Surely this is the realm of the economist?

Defining the gap between rich and poor

LIKE MOST other industrialised nations, Australia has in the past half century made substantial gains in terms of the production of wealth, albeit it often at a high environmental cost.

Those great gains were due in all cases to an inventiveness that enables us to produce more with less effort – the goal of all technological developments. But if our productive power has increased so massively, and yet the returns to labour have to all intents and purposes remained static, where have the gains gone?

Before we can identify possible explanations for this growing income disparity, we need to reflect on the performance of a range of economic indicators. The relationship between several of these may offer clues to the cause of the wealth-poverty gap.

Table 1 shows the percentage increase, in real terms, of a number of economic trends during the last 50 years. All dollar values on which percentage changes in these tables are calculated were converted to equivalent year 2000 Australian dollars using the Long-term Consumer Price Index series published by the Australian Bureau of Statistics as a deflator.[1] Inflation was in the order of 1500% over the half century to 2000. Percentage changes shown are real changes.

One striking contrast revealed by the data in Table 1 is the mammoth 750% increase in land values, which have soared by around 6% per year, compared with average wages, which have increased by little more than 1% per year over the last 30 years. The minimum wage has risen by only 0.8% per annum in real terms over almost a century![2]

Productive capacity has escalated beyond the wildest dreams of the present generation's grandparents, and yet the returns to labour have all but stood still. In terms of job-satisfaction and quality of life, in fact, the returns, in the reckoning of many, have actually declined. The contrast with trends in the land market is remarkable. Land values in Australia in 1959 stood at around $A100 billion in today's dollars. Less than 40 years later that value had burgeoned to $A750 billion.[3] Estimated site rents, although collated over a shorter span, reflect a similar tendency for values in the land market to eclipse increases in the other factor and consumer markets. The site rent estimates are based on property sales for each of the years indicated and are calculated as the average annual yield (currently around 7%), on total unimproved land values. Unimproved land values are estimated to average 65% over all sectors, commercial, residential and rural.

The land values referred to in the table are unimproved land values. Any real increase in the cost of building, either commercial or residential, over the 50 year period, appears to be minimal. Both labour and material costs in the residential and commercial construction industries have remained all but static due largely to mechanisation and a host of labour saving, high-output equipment and processes, as well as low wage growth and lower demand for labour. The Housing Construction Cost Series monitors a real fall in housing construction costs (labour and materials, excluding land) of 0.7% between 1950 and 1985.[4]

The *Housing Construction Cost* Series referred to in the table was discontinued in 1985. Sources for an identical series from 1986 have as yet proved elusive. However, other indicators suggest a continuation of the trend of zero or at best very low real growth in house construction costs. According to the Reserve Bank of Australia's *Other Price Indicators*,[5] between 1979 and 1999 the cost of housing construction materials, adjusted for inflation, fell by 9.6% in real terms (around 0.5% per annum). This reflected continuing efficiencies in the types, sourcing and use of materials. Average wages, reported in Table 1 above, over the same period, rose by approximately 1.2% per annum. This suggests that from 1985 to 1999 there was an annual increase in the material component of only 0.7% per annum, or around 10% over the 14 years to 1999. By combining this information, we reach an overall change of 9.5% over the 50 years, or 0.18% per annum. As a general rule it seems that most manufactured and processed goods get cheaper to produce as efficiency increases. This being so, and given a continuation of the very low rate of increase in the minimum wage, we would expect at least stagnation, if not an absolute fall in unit construction costs.

The comparison between the real annual land value increase of 6% and that of the house construction cost index highlights the fallacy embedded in some of our most sacred economic myths. One of these is that "house prices are constantly on the rise"; "the safest investment is in bricks and mortar"; or "the family home is the most reliable hedge against inflation". The price of *houses*, like the value of all man-made objects, naturally diminishes as the component parts decay. "Rust never sleeps," sang Neil Young back in the distant early eighties; and it doesn't; it consumes capital.[6] These objects require constant and regular infusions of capital to maintain their value. This contrasts with land and other natural resources, the values of which rise with no injection of capital at all. While we quietly sip a beer at the pub on Sunday, the land on which our "castle" sits becomes more valuable, in capital terms, and the rent, or imputed rental income, rises inexorably. It will be more valuable when we get home than it was when we left.

Other indicators in Table 1 that warrant close scrutiny are the labour and GDP figures.

In the last 12 years, total hours worked has increased by 1.3% per annum. GDP per capita has been enjoying a steady average increase of close to 2.27% per annum.

The comparison between the percentage rate increase of wages for full time workers and that of part time workers is also revealing. The increase in part time work (predominantly casual) at the expense of full time employment (mostly permanent, with holiday pay, superannuation, sick leave, etc), exposes the real impact of casualisation on job security, the cost of which includes personal stress and social breakdown.

The clues that expose the poverty gap

FIGURES 1 AND 2 (*on pages 50 and 51*) illustrate changes in selected elements from Table 1. These highlight relationships that may enable us to identify the nature of the wealth poverty gap.

Figure 1 graphically illustrates the significant divergence between land price and wages. If extrapolated over the next two decades (*see Figure 3, on page 65*), assuming no dramatic intervening force, we must expect a continuation of this divisive course. Global warming may be debatable, but the accelerating expansion of the wealth-poverty gap is, by any historical indicator one wishes to consult, as certain as sunrise. The land and wages series highlights the ever-expanding gulf between the rich and the poor: land price increases inexorably, while wage growth is virtually stagnant. Every gain made by increased efficiency, "workplace reform", new inventions, computerised work environments, casualisation of employment, the sourcing of cheap labour offshore, etc, feeds into land price. The gulf gets wider. This

To compare with UK and US currencies, exchange rates on 9 June 2000 for the Australian dollar were: A$1=US$0.59 UK£0.39

Table 1 Percent change Economic indicators 1950 to 2000

Economic Indicator	Series span	Total Period years	Overall change %	Av'ge real annual change %
LAND				
Capital value of land[1]	1959-96	37	752.12	5.80
Estimated site rent[2]	1973-98	25	399.45	6.65
ASSETS				
Dwelling assets[3]*	1961-99	38	584.31	3.39
Business assets[4]*	1961-99	38	567.43	3.30
Total wealth[5]*	1961-99	38	423.22	2.67
TAXATION				
Taxes *per capita* of whole population	1950-97	47	292.81	2.95
PRODUCTION				
GDP chain volume[6]	1952-00	48	557.14	4.02
GDP *per capita* of whole population	1952-99	47	176.66	2.27
GDP per labour hour	1988-00	12	20.20	1.68
GDP *per capita* of working population	1960-99	39	125.00	2.10
LABOUR[7]				
Employed persons part time	1979-00	21	152.06	4.53
Employed persons Total	1979-00	21	47.30	1.90
Aggregate weekly hours worked[8]	1978-99	21	47.4	1.86
Total hours full and part time workers	1988-00	12	17.01	1.32

Employed persons full time	1979-00	21	28.32	1.23
House construction costs (labour & materials)[9]	1950-85	35	-0.66	-0.02
INCOME				
Household disposable income[10]*	1960-00	40	117.15	1.96
Average annual earnings all employees[11]	1969-99	30	39.49	1.12
Minimum wage[12]	1907-00	93	102.00	0.76
POPULATION				
Population growth	1951-99	48	134.17	1.79

* adjusted for inflation and population.

1 *Report on General Revenue Grant Relativities 1999*, Commonweath Grants Commission, Volume III, Appendices and Consultants' Reports, Consultancy by Australian Valuation Office 1998, pp 373-413. I have adjusted the figures between 1993 and 1996 inclusive, to include rural land values, which were excluded from the official valuations in 1993. Rural values, when last assessed (1992), equated to 11.18% of total land values. In 1984 they made up 19.6% of total values. I have therefore added 11% to the figures in the official tables for the years 1993 to 1996.

2 Based on records maintained by the Land Values Research Group, Melbourne. These figures record estimates based on Victorian figures, of total Australia-wide real estate sales over the period. Site values are assumed to be approximately 65% of capitalised values. The site rent is calculated as the yield on the capitalised values for each of the years in the survey.

3 *Economic roundup, Australian Net Private Wealth 2000*, Table 1(b): "Real private sector wealth at market value" (a). Treasury Historical Data. (See also fig 3 above).

4 *Economic roundup, Australian Net Private Wealth 2000*, Table 1(b): "Real private sector wealth at market value" (a). Treasury Historical Data.

5 *Economic roundup, Australian Net Private Wealth 2000*, Table 1(b): "Real private sector wealth at market value" (a). Treasury Historical Data. Total business assets and total dwelling assets do not add up to total wealth due to a net liability consisting mainly of foreign debt, which in 1999 was estimated to be A$537 billion against foreign investments valued at A$230 billion.

6 Statement 9: The Public Sector (from *The 1999-2000 Budget Papers*).

7 Extract from Reserve Bank of Australia Gross Domestic Product Income component. Table G11 to September 1999.

8 Reserve Bank of Australia Table GO6 Labour to Sept 1999.

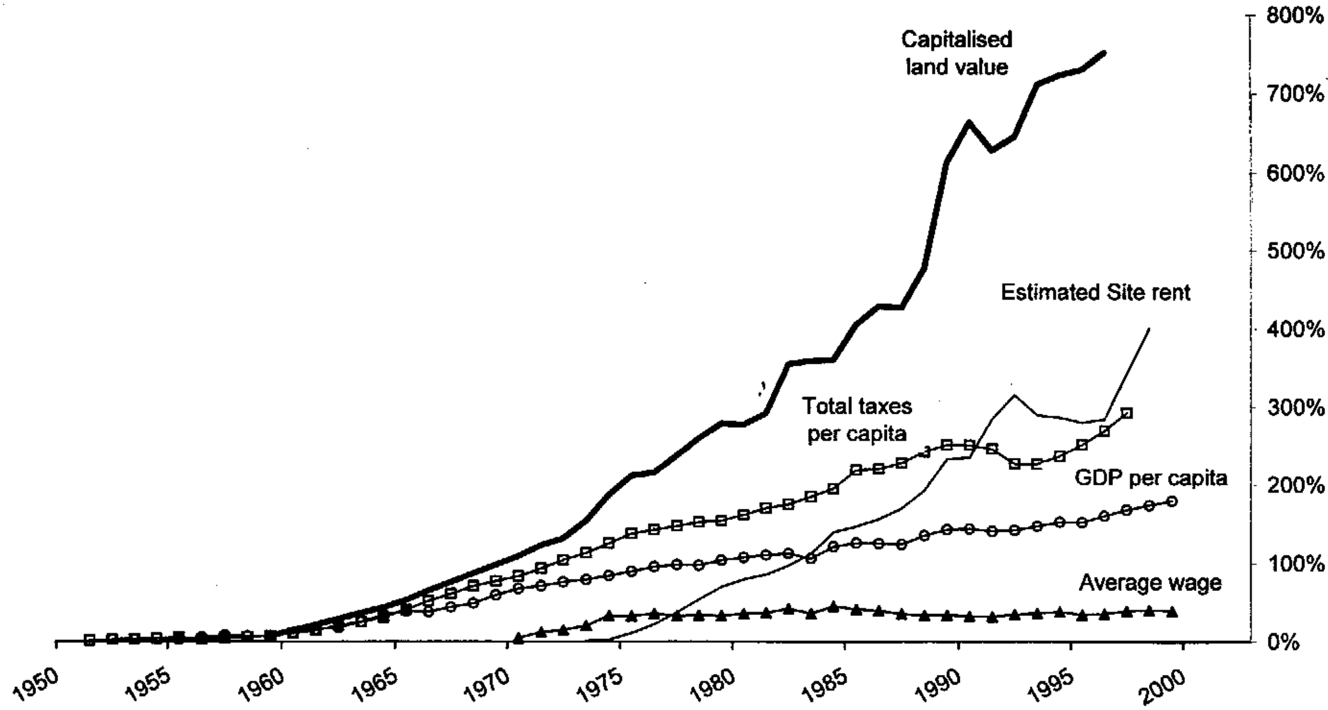
9 Wray Vamplew (ed.), *Australian Historical Statistics*, Fairfax, Syme & Weldon Associates, 1987, p.357.

10 Reserve Bank of Australia: GDP, Income component G11 to September 1999. The rise in disposable household incomes cannot, even roughly, be equated to a rise in individual incomes, since over the designated period a large number of households moved from one income earner to two, as more women entered the workforce; i.e., a very large number of households went from being one-income to two-income households. I calculated the percentage increase in this category by "deflating" the gross household disposable income by the percent rise in population over the same period; hence the designation "adjusted for population". Because of the difficulty of defining the annual fluctuations in the number of income earners in a household, the average and minimum wage statistics are a much truer indicator of percentage change in wages.

11 Reserve Bank of Australia, Prices and Output, table GO 5, Quarterly Labour costs.

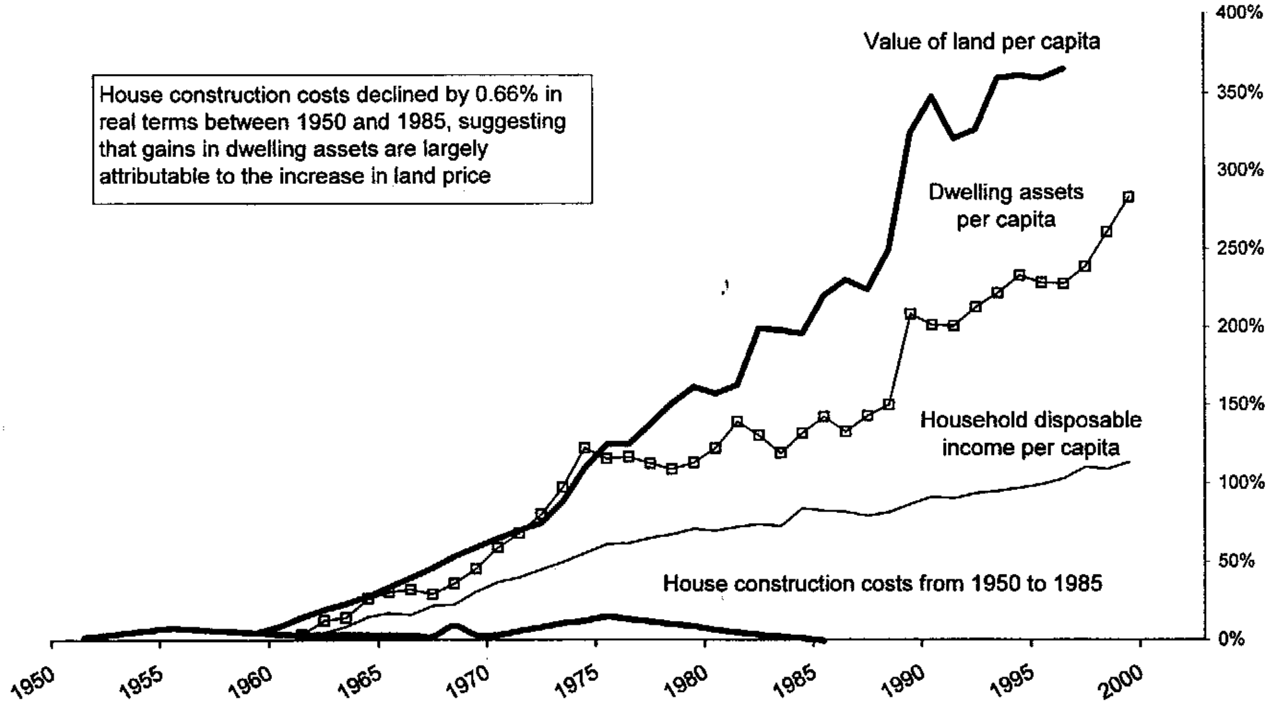
12 *Australian Historical Statistics, op. cit.*, p.155.

Figure 1
Percentage change in selected economic indicators, Australian (1950-2000)



SOURCE: Based on data from the following: 1999 2000 Budget Papers Statement 9; Reserve Bank of Australia Bulletins, Treasury Historical Data; Economic roundup, Australian Net Private Wealth 2000; Vamplew, op. cit., 1987. Incomplete data, i.e., those not spanning the 50 years from 1950 to 2000, are still valid in that they indicate the "trend gradient" of that series and therefore may be validly compared to those series which span the whole period. For example, the wages line, although only starting around 1972, nevertheless shows a very slow real increase over the 30 years to 2000 as compared with, say, the capital-value-of-land line over the same period, (1972 to 2000). The site-rent line, starting at the same time, shows a similar rate of increase to the capital-value-of-land line, which is what we would expect.

Figure 2
Real per capita percent change of selected economic indicators (1950 to 2000)



epidemic of inequity marches on as the rate of global corporatisation gathers pace, obliterating national and cultural institutions, trampling on justice and spreading its destructive social and personal consequences.

Income distribution in Australia – a new scale

IN AUSTRALIA, in 2000, the value of all the land, excluding improvements, is estimated to be around $A1,200 billion (US$700 billion).[7] This land value is divided among about seven million households which have either purchased (40%) or are purchasing (25%) their homes, another unknown number who hold commercial or agricultural sites, and approximately 2.2 million households representing close to 6 million people – one third of the population – who own zero assets.[8]

Among those who hold no land at all, and whose asset wealth is zero, is a substantial number of people whose incomes hover at the lower end of the mean minimum wage; that is, those currently receiving around $A250 per week. Below them are those on the dole, pension or some other welfare payment, with young single people receiving $A163 per week or a youth allowance of $A133 per week. Single pensions are $A183 per week. The poverty line for single individuals in 1995 was $A215, and for a couple with four children $A521 including nominal housing costs of $A70 and $A105 respectively. The most generous of these payments are still well below the poverty line. In 1990, approximately 840,000 "income units",[9] representing around 13% of the population, had incomes *below* the poverty line.[10]

In 1973, about 800,000 people in Australia were classified as "in poverty". By 1990 this number had swollen to just short of one million, representing 16.7% of "income units". Poverty rates among the Aboriginal people are around three times the average for the non-indigenous community. One cannot get poorer than that without dying; and a disproportionately large number of Aboriginal people, both young and old, do just that.

The Australian Bureau of Statistics special report into poverty cited above states:

> The overall poverty rate was broadly constant at around 10% in the decade up to 1981-82. Over this period, poverty declined markedly among single people but increased among couples, with and without children. After 1981-82, the overall poverty rate rose steadily, reaching 16.7% by 1989-90. This period also saw a substantial reversal of the earlier decline in poverty among single people, whose poverty rate almost doubled from 10.7% to 20.4%.
>
> One of the factors underlying the increase in poverty after 1981-82 is the fact that the poverty line itself increased in real terms by 1.2% a year between then and 1989-90 - corresponding to a total real increase of just over 10%. However, this is to be expected of a relative poverty line in a period when real community

incomes are rising. The real annual increase in the poverty line in the 1980s is actually lower than between 1972-73 and 1979-80, when the poverty line was adjusted in line with average weekly earnings.[11]

In 1996, the Australian "wealth pie" could be sliced up and apportioned, in terms of wealth by percentage of population, as illustrated in the table below: The Commonwealth Treasury lists the following categories in its compilation of net wealth from which the values in this table are derived: Dwellings, Business assets, Consumer durables, Government securities, Investment abroad, Money base, less Foreign liabilities. Net wealth in 1996 was distributed as shown in Table 2:

Table 2 Wealth distribution in Australia (1996) at current values[24]

% of population 1996	No of individuals	Av'ge wealth per capita (A$)	% of total wealth	Value of assets owned (A$ bn)
1	183,000	2,355,190	20	431
10	1,830,000	353,550	30	647
40	7,320,000	131,150	45	960
19	3,477,000	29,050	5	108
30	5,490,000	0	0	
100	18,300,000	117,267	100	2,146

SOURCE: Derived from figures in Laurie Aarons, *Casino Oz*, Sydney: Goanna Publishing, 1999, p. 16.

Most of the broad middle band of the population, that is the 40% referred to in Table 2, had as their sole asset the family home, the average value of which at the time was around $A132,000. In 1998, the median value of dwellings for capital cities was $A164,000, and the national median $A145,200. The wealthiest 11% owned a healthy 50% of the nation's assets, while the poorest 30% owned none. That is a wealth-poverty gap of significant proportions![12] The gap gets even larger at the extremes, as Travers and Richardson, in their book *Living Decently*, point out: "The richest 1% of the adult population owns about 20% of private wealth; the richest 10% own half the wealth and the poorest 30% have no net wealth (although they may own consumer durables and a car)".[13]

In a 1998 report in *Business Review Weekly*, Ed Shann wrote: "The very rich have certainly become richer, and the number of millionaires is multiplying...In the six years since 1993, the number of millionaires [in Australia] went from 71,700 to 208,000. Their share of the wealth has gone from 11.1% in 1993 to 23% in 1998. From 1993 to 1998 the total wealth of millionaires rose $A288 billion and of the 9.1 million non-millionaires by $A329 billion".[14]

In the same journal, a spokesman for Access Economics (economic advisers to the Federal Government) quoted from their own research: "There are now about 9.4 million 'income units' in Australia, 2.6% of which are millionaires. There are about 250,000 people with assets between $A900,000 and $A1 million, and Access believes that the number of Australian millionaires could double over the next 12 months".[15]

The report continued: "Increases have occurred for high-income and low-income earners: between 1982 and 1994, incomes in the two lowest income groups increased 6% and 7%, and income in the two highest income groups rose 12% and 3%. Income growth at the lower levels has been spurred by increases in social security that have occurred despite tighter fiscal management. The reference to government taxation transfers in the form of welfare payments is significant. These were not the main source but the *sole* source of any income rise in the lower socioeconomic groups. Without this government intervention, the gap would have been significantly wider, and the pain of "reform" much less bearable. Nevertheless, even such costly infusions have not enabled low incomes to keep up with real increases in the CPI.

A recent article in *The Australian* confirms the continuing persistence of this trend:

> Australia is a deeply divided rich-get-richer nation, in which both the winners and losers of almost two decades of economic and social upheaval are baffled and angry at the destruction of the fair-go society, according to new research.
>
> Economic research conducted for The Australian by Canberra University's National Centre for Social and Economic Modelling (NATSEM) shows that in the 15 years to 1996-97, the number of middle-income earners shrank from 45 per cent to 37 per cent.
>
> The median earnings figure – the latest of which, for August last year, is $A552 a week – is the level at which half the work force earns more and half less.
>
> The earnings of full-time employees on less than half median earnings fell by an average of 2 per cent in real terms over the 15 years to 1996-97, while earnings for those on more than 175 per cent of the median rose by 18 per cent.
>
> That meant a fall of $A4 a week at the bottom and a rise of $A229 at the top, with the gap widening even more for women.
>
> The country is also dividing geographically. In the 10 years to 1996, average gross household incomes in the poorest five postcodes fell in each state except NSW, rising there by only 1 per cent. In the richest five postcodes, there were increases of between 14 per cent and 18 per cent in NSW, Victoria, Western Australia and Queensland.[16]

The crisis in income distribution is a world-wide phenomenon. The *World Wealth Report 2000*, produced by Merrill Lynch and Gemini

Consulting, alluded to in the above BRW article, states that there are seven million people in the world with more than US$1 million. The number of millionaires and the wealth they hold grew 18% during 1999, to US$25.5 trillion. The largest growth in millionaire numbers occurred in Asia. Merrill Lynch predicts that the financial assets of millionaires will grow 12% a year over the next four years. By 2004, there will be an estimated 8.5 million millionaires in the world, with a combined wealth of US$45 trillion.[17]

But before we can hope to identify policies that might lead to the elimination of the wealth-poverty gap, we need to clarify some key concepts. Wealth is a measure of disposable income that is surplus to what is required to achieve a socially acceptable standard of shelter and sustenance. These standards will vary between cultures. Poverty may be measured on exactly the same criteria. A special report in the Australian Year Book of 1996 offers the following statements on poverty.

> The World Bank has defined poverty as an inability to attain a minimal standard of living. This is a general definition which can be applied to different national situations according to the specific meaning given to the concept of a standard of living and how the minimal level is determined.
>
> The United Nations Development Programme (UNDP) has emphasised this point, noting that: "Poverty is the greatest threat to political stability, social cohesion and the environmental health of the planet".
>
> In rich countries like Australia, poverty is conceived in relative rather than absolute terms. This implies that poverty is defined not in terms of a lack of sufficient resources to meet basic needs, but rather as lacking the resources required to be able to participate in the lifestyle and consumption patterns enjoyed by other Australians. To be relatively poor is thus to be forced to live on the margins of society, to be excluded from the normal spheres of consumption and activity which together define social participation and national identity.
>
> The first systematic attempt to estimate the extent of poverty was undertaken in the mid-1960s by a group of researchers at the Institute for Applied Economic and Social Research (IAESR) at Melbourne University. The research team, led by IAESR Director Professor Ronald F. Henderson, estimated poverty in Melbourne using a poverty line for a reference two-adult, two-child family set at an income equal to the value of the basic wage plus child endowment payments (later called family allowances).
>
> This poverty benchmark was chosen because of its relevance to Australian concepts of minimum income, but also because as a proportion of average earnings and average incomes it was similar to poverty lines used in other countries. It was regarded by the research team as an austere measure, likely to produce lower-bound estimates of poverty.
>
> Updating the poverty line by average earnings was replaced by the use of

> household disposable income per capita in 1981, the latter measure being more comprehensive in scope but also preferable because it incorporates changes in personal tax payments.[18]

The report highlights the fact that the definition and quantification of poverty continues to be hotly debated by theorists and statisticians. But from a subjective point of view, although we may not be able to define its pathology with clinical precision, it is a condition which we would all recognise immediately if we were personally infected. Those who have experienced its embrace would immediately recognise its distinctive taste and smell, and the scratch-proof itch it produces. Its impact on individual patients manifests in a wide variety of symptoms. It causes many to first abandon their self respect by being forced to submit to private or government charity; then, often, in an attempt to immunise from further pain, to turn to drink or drugs; to wife and child abuse; to succumb to physical and mental illness; chronic depression; to develop criminal perversions; and ultimately, if driven to extremes, to bloody revolution. Such is the gall of poverty.

Land price defines the wealth-poverty gap

WE NOW RETURN to the question posed at the outset. If our productive power has increased so massively, and yet the returns to labour have to all intents and purposes stood still, where have the gains gone? Where else but land price? Surely it is this which ultimately defines the Wealth-Poverty Gap? It is the gap between privately monopolised land values and the poverty line.

Our historical perspective allows us to discount many other possible answers. We can see that the economic solutions so far tried – and just about everything has been tried – have been to little avail. The list is a long one. It includes:

- Price controls, manufacturing subsidies, export assistance and preferential tariffs.
- Wage controls, wage subsidies, arbitrated wage fixing, tax write-offs, appeals for corporations to develop social consciences, and work for the dole.
- Enterprise start-up assistance packages, re-training schemes and closer industry involvement with the design of education curriculums.
- Tax summits, community consultations and study tours around the globe.

All the available possibilities seem to have been exhausted. None has succeeded in achieving anything but the most marginal and short-lived impact. We are driven to the view that policy makers have somehow overlooked or ignored some fundamental element in the economic equation. Have we focused on symptoms and been blind to the gnawing cancer which is slowly consuming its host?

We read the headlines reporting the results of surveys around the world that reveal the wealth-poverty gap is expanding. It never contracts. Many of the articles are written in a tone of surprise. After the latest efforts, be they the expansion or imposition of "free" trade; arbitrated minimum wages, increased welfare expenditure, programs to boost employment in depressed regions, successful trade union campaigns, the result is always the same; not sometimes – always! What conclusion can be drawn from this other than that wages are not the cause of the problem, they are an effect of a deeper malaise?

In Britain, New Labour raised people's expectations by embarking on a programme of poverty alleviation after the election of May 1997. The results, unsurprisingly, were not encouraging. They were summarised in these terms:

> The income gap between rich and poor has widened to its highest level since Margaret Thatcher was in office, official figures show.
>
> The findings are bound to cause embarrassment to the Government, which announced plans yesterday to alleviate poverty among Britain's poorest communities.
>
> The figures from the Office of National Statistics (ONS) revealed that in the 1998-99 financial year, Britain's highest earners enjoyed their biggest share of the national-income cake since inequality peaked in 1988. The recent increase in inequality followed several years in the 1990s in which the earnings gap narrowed.
>
> The ONS report overshadowed the launch of a 10-year drive by John Prescott to revitalise Britain's run-down inner city areas. Promising a "war on poverty", the Deputy Prime Minister said: "We need now to move from communities defined by reliance on benefits to communities characterised by employment and enterprise."
>
> According to the ONS, the top fifth of earners in 1998-99 took a 45-per-cent share of the money people have to spend after paying taxes and receiving benefits. This was up from a low of 43 per cent in 1995-96.
>
> In contrast, 6 per cent of disposable incomes went to the poorest fifth of earners in 1998-99 – down from 7 per cent in 1995-96, and 10 per cent in 1978.[19]
>
> No one would dispute the Blair government's desire to improve the situation for the swelling ranks of the poor in the UK, but their schemes have failed and will continue to fail because the architects of these schemes have refused to investigate, or have been blind to, the cause of poverty. They assume, as most do, that it is somehow preordained.

Every government attempts to tackle this ever-pressing issue. Each new leadership aspirant, either prior to or soon after winning office, mobilises a band of experts to plan an attack, either cynically or genuinely, on this relentlessly-expanding gap.

But they have all failed. Those responsible for these experiments, the "fiscal analysts", the true owners of the epithet "dismal science", have given the noble science of economics a bad name. Could it be that rather than continue with the unscientific method of these let's-try-this-and-see-if-it-works school of economic blunders, we should first attempt to define the correct question.

Taxation and free trade DONALD J. JOHNSTON, Secretary-General of the OECD, reviewed the role of taxation in an editorial in an OECD newsletter entitled "Taxation and Social Progress". He insisted that free trade, one of the cornerstones of economic rationalism, has not yet had a chance to bestow its blessings. He fails to see that what he calls free trade is not free at all, but is protected and mandated by the wealthy industrialised countries at the expense of the poor, and that it is accelerating the transfer of wealth from the poorer to the wealthier countries.

> Taxation should be seen as a building block of society, provided it has the necessary attributes of transparency and fairness. Let me expand on that thought.
>
> Since my arrival at the OECD I have sought to emphasise the importance of the triangular paradigm of social progress. That means keeping economic growth, social cohesion and good governance in balance with each other. Without any one of these elements social progress risks being arrested, or at least retarded.
>
> The broadly supported agenda of free trade and investment is an extremely effective engine of economic growth. Its ability to create wealth is virtually irrefutable. Yet there are many increasingly articulate constituencies who resist globalisation. Why? In part because they have not yet seen benefits flowing to them. They see riches on Wall Street, but not necessarily on Main Street. Gains will come from liberalisation, but if we are to maintain the momentum in liberalisation of markets worldwide, those gains must be felt by all. How? There is no simple answer, but education, training, and social programmes that facilitate adjustment will all contribute. And most of them will be financed through taxation. However, taxation is not an easy area to get right. It never has been and it probably never will. But when collected judiciously and deployed effectively, tax acts as a tool of good governance, allowing economies to grow while helping to improve society as a whole.
>
> One key point is that taxation is no longer simply the territory of individual governments. The removal of capital controls and the continuing liberalisation of the financial markets together with the emergence of global communication technologies have accelerated the pace of integration of national economies. They have increased the cross-border mobility of capital and investment and also encouraged large corporations and financial institutions to develop global strategies....

> But the collection of taxes is only one vitally important part of the fiscal conundrum. The other is how to spend the tax income among the competing needs of modern democracies in a way that assures and enhances the conditions of wealth creation without intervening in the process of wealth creation itself. That is probably the most daunting challenge for governments as we enter the 21st century. Only by meeting it will we be able to keep the triangular paradigm in balance.[20]

Johnston claims that "There is no simple answer" to poverty. He knows that governments have been applying "solutions" for over a century, without success. His views are, by and large, shared by most world leaders and most mainstream economists. He proposes strategies for a problem whose causes neither he nor they understand! Is that credible governance? He expresses the belief that a solution will probably never be found anyway! Is that the language of science? He is essentially saying, and echoing the views of all the Western powers: "We have a bottomless bag full of possible solutions to a problem, the cause of which we can't define; and we predict that these answers will fail to have any meaningful impact on poverty anyway." He appears to be promising, "from here on, in terms of social equity, it's downhill all the way!" This is the counsel of despair. What a grim future this offers to the increasing number of the world's population afflicted by poverty.[21]

The impact of tax transfers on disposable incomes

FOR LOWER INCOME earners in Australia, tax transfers have barely, if at all, succeeded in maintaining real incomes, let alone contributed to any real gain, despite some extremely large increases. Table 3 shows the disposable income of the poorest 10% actually declining between 1982 and 1994, despite an increase of 51% in tax transfers. Such transfers are wage subsidies, which tend to conceal the increasing prevalence of sub-standard wages. This, ultimately, is a government subsidy to landowners; for the savings made by employers or sole producers are translated into higher actual or imputed rents. For the statistical proof of that classical economic theory, look again at Table 1 and its accompanying charts.[22]

Table 3 highlights increasing income inequality despite the determined efforts of government. Whereas in 1982 the gap between the lowest and highest deciles was 4.7 times, a decade later it had climbed to 5.75 times, and must inevitably continue until and unless the cause of that inequity is identified and remedied.

The quest for solutions

IN ATTEMPTING to understand the pathology of this great and growing world epidemic of poverty, wouldn't the scientist, in attempting to develop a workable theory, first identify, isolate and evaluate the elements in the new theory? In the case of an economic

Table 3 Average annual net impact of income tax and tax transfers on working families with dependant children, by private family income decile, 1982 to 1994 (in 1993–94 dollars)[36]

Decile	1981-82				1993-94			
	Private Income	Disposable Income	Impact of government		Private Income	Disposable Income	Impact of government	
			Income change	% change			Income change	% change
	$	$	$	%	$	$	$	%
1 (bottom)	13,036	14,847	1,821	14	9,672	14,590	4,918	51
2	24,481	23,481	-2,002	-8	22,902	23,910	1,008	4
3	30,771	27,042	-3,731	-12	29,802	27,352	-2,450	-8
4	35,195	30,275	-4,919	-14	36,208	31,228	-4,980	-14
5	39,469	33,015	-6,454	-16	42,494	35,310	-7,184	-17
6	44,091	35,973	-8,118	-18	48,648	39,421	-9,227	-19
7	49,660	39,821	-9,839	-20	55,180	43,734	-11,447	-21
8	56,569	44,168	-12,401	-22	62,591	48,334	-14,257	-23
9	66,853	50,796	-16,059	-24	75,054	55,899	-19,155	-26
10 (top)	102,203	70,036	-32,168	-31	121,616	83,831	-40,785	-33
All	46,346	36,954	-9,394	-30	50,757	40,385	-10,372	-20

SOURCE: From Table A4, *The Changing Burden Of Income Taxation On Working Families In Australia*, John Landt and Gillian Beer, Discussion paper no. 29, April 1998, p. 19, NATSEM National Centre for Social and economic Modelling, Faculty of Management, University of Canberra.

theory, the elements are those that are critical to production and exchange. Having identified them, the next step would be to test the theory. If these tests failed to produce a satisfactory result, the investigator may – as our governments and corporation-funded think tanks have indeed done – try again. And if the results still fail to satisfy the predictions or expectations, then I suppose we can explain yet further attempts in terms of showing due diligence. To persist with further attempts, however, it would be necessary to conceal the futility of our efforts by parading political concern for the devastation surrounding us. At some stage, however, scientists might say to themselves: "Rather than continuing to dream-up and apply endless variations of our theory, perhaps we might re-examine our primary assumptions?"

As logical and as infinitely rational as that conclusion seems to be, it is not the rule that is applied in economic analysis or in related policy-making. For the last century Neo-classical and Marxist economics have included land in the term capital and land rent in profit. Neo-classical economists still insist, in defiance of all logic, that land is capital, and that its role is insignificant in the complexities of modern economics. Any attempt to revive the centrality of land as an analytical category is shouted down as "belonging to an agrarian economy, and no longer as important as it may have been".

I wonder whether the challenge, thrown down by Thorold Rogers in his seminal work on the history of English labour, has yet even been acknowledged, let alone heeded. In *Six Centuries of Work and Wages*, he states:

> A science which detects a disease has its use if it can point out how the disease has arisen, and thus can check the development of that which would make the malady continuous and permanent. That science, however, takes a far higher place which is not only accurate in its diagnosis but skilled in the proper therapeutics. But the discoverer of true causes has travelled a long way on the road to the remedy. And this, if it be rightly taken, is what the historical economist may effect, but the theoretical economist has mistaken.[23]

From the evidence we have assembled, we are driven inevitably to the conclusion that land value is a major factor in the operation of the economy, and that if its raw unimproved value is privately monopolised by a small part the population, there will be a substantial negative impact on the distribution of wealth and the incidence of poverty.

J.S. Mill highlights this point in his *Principles of Political Economy.* He writes:

> The requisites of production being labour, capital, and natural agents; the only person, besides the labourer and the capitalist, whose consent is necessary to production, and who can claim a share of the produce as the price of that consent,

is the person who, by the arrangements of society, possesses exclusive power over some natural agent. The land is the principal of the natural agents which are capable of being appropriated, and the consideration paid for its use is called rent. Landed proprietors are the only class, of any number or importance, who have a claim to a share in the distribution of the produce, through their ownership of something which neither they nor any one else have produced. If there be any other cases of a similar nature, they will be easily understood, when the nature and laws of rent are comprehended.

It is at once evident, that rent is the effect of a monopoly; though the monopoly is a natural one, which may be regulated, which may even be held as a trust for the community generally, but which cannot be prevented from existing. The reason why landowners are able to require rent for their land, is that it is a commodity which many want, and which no one can obtain but from them.[24]

Mill's suggestion that landowners, being too numerous to combine, have no ability to exact the highest rents seems hardly relevant in the face of the market pressure which drives rent up regardless of the spread of ownership, to levels at which commercial and private tenants can only just survive.

What are the lessons for those charged with designing remedial policies? Adam Smith's contention in the dawning light of the Industrial Age would still appear to have merit. After discussing the subject of government revenue and the methods by which it may be collected, he points to two types of taxation which he believed best fitted his famous criteria; a tax on luxury goods and a tax on ground-rents (the annual value of land). On the subject of ground rents, he wrote:

Both ground-rents and the ordinary rent of land are a species of revenue which the owner, in many cases, enjoys without any care or attention of his own. The annual produce of the land and labour of the society, the real wealth and revenue of the great body of the people, might be the same after such a tax as before. Ground-rents, and the ordinary rent of land are, therefore, perhaps the species of revenue which can best bear to have a peculiar tax imposed upon them.

Ground-rents seem, in this respect, a more proper subject of peculiar taxation than even the ordinary rent of land. The ordinary rent of land is, in many cases, owing partly, at least to the attention and good management of the landlord. A very heavy tax might discourage too, much of this attention and good management. Ground-rents, so far as they exceed the ordinary rent of land, are altogether owing to the good government of the sovereign, which, by protecting the industry either of the whole people, or of the inhabitants of some particular place, enables them to pay so much more than its real value for the ground which they build their houses upon; or to make to its owner so much more than compensation for the loss which he might sustain by this use of it. Nothing can be more reasonable than that a fund which owes its existence to the good government of the state should be taxed peculiarly, or should contribute something more than the greater part of other funds, towards the support of that government.[25]

A direct tax upon the wages of labour, therefore, though the labourer might perhaps pay it out of his hand, could not properly be said to be even advanced by him; at least if the demand for labour and the average price of provisions remained the same after the tax as before it. In all such cases, not only the tax but something more than the tax would in reality be advanced by the person who immediately employed him. The final payment would in different cases fall upon different persons. The rise which such a tax might occasion in the wages of manufacturing labour would be advanced by the master manufacturer, who would both be entitled and obliged to charge it, with a profit, upon the price of his goods. The final payment of this rise of wages, therefore, together with the additional profit of the master manufacturer, would fall upon the consumer. The rise which such a tax might occasion in the wages of country labour would be advanced by the farmer, who, in order to maintain the same number of labourers as before, would be obliged to employ a greater capital. In order to get back this greater capital, together with the ordinary profits of stock, it would be necessary that he should retain a larger portion, or what comes to the same thing, the price of a larger portion, of the produce of the land, and consequently that he should pay less rent to the landlord. The final payment of this rise of wages, therefore, would in this case fall upon the landlord, together with the additional profit of the farmer who had advanced it. In all cases a direct tax upon the wages of labour must, in the long-run, occasion both *a greater reduction in the rent of land, and a greater rise in the price of manufactured goods*, than would have followed from the proper assessment of a sum equal to the produce of the tax partly upon the rent of land, and partly upon consumable commodities.[26]

Land is as essential to the economy as is labour and capital; but it is, by any logical analysis, a distinct and unique element. Unless we recognise this fact; unless we abandon the conventional habit of conflating land into capital, we will never remedy the personal and social problems that stem from the pathological mal-distribution of wealth. If we accept the proposition that land is a species of capital, the cause of the grotesque imbalance portrayed in Table 1 will remain inexplicable.

By treating land as a separate category, however, we immediately shed light on the paradox. We can now offer fresh perspectives on issues like: Why do advances in technology and productivity hardly benefit the ordinary wage earner at all? And: how does a highly productive society continue to exclude millions of people by pushing them down to levels that are either barely above, and more often below, the poverty line?

Mill articulated the increasing complexity of the classic liberal-democratic dilemma, which he foresaw would require a sophisticated solution, when he wrote:

The social problem of the future we considered to be, how to unite the greatest individual liberty of action, with a common ownership in the raw material of the

> globe, and an equal participation of all in the benefits of combined labour. We had not the presumption to suppose that we could already foresee, by what precise form of institutions these objects could most effectually be attained, or at how near or how distant a period they would become practicable.[27]

Henry George, the 19th century American social reformer, had the courage and clear insight to identify, with precision, a policy that would harmonise public and private interests:

> Material progress makes land more valuable, and when this increase in value is left to private owners, land must pass from the ownership of the poor to the ownership of the rich ... There is only one way ... in which ... working people may be secured a share in the land of their country ... – the taking of the profits of land ownership for the community.[28]

Perhaps the root of our problem is that the solution is not hidden in some as yet undiscovered economic paradigm, it is right under our feet.

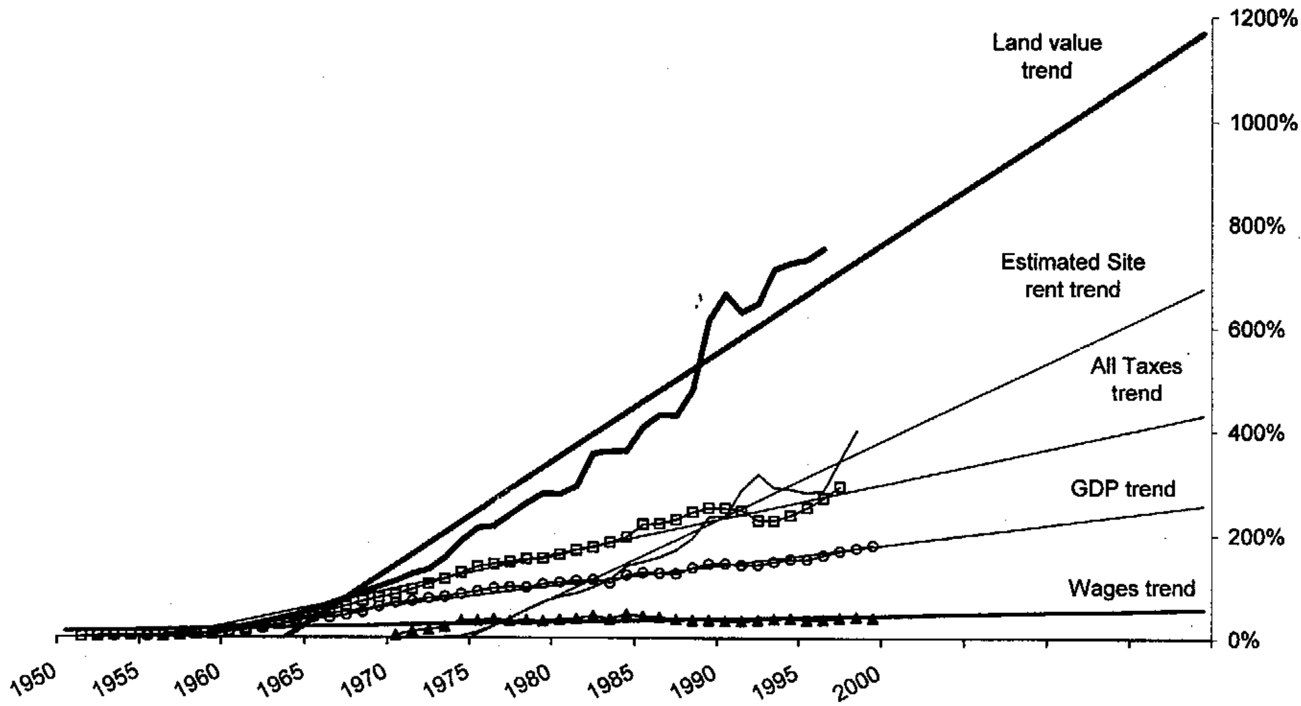
The trends to 2020

IF THE TRENDS suggested in Table 1 continue, by 2020 we could see a further real 60% increase in land price, a similar rise in site rents, a 55% rise in taxes, yet wages barely rising at all in real terms. Again, if current government fiscal practices continue, tax transfers to those on welfare must increase, placing an even greater burden on wage earners. How long will it be before this burden becomes absolutely insupportable?

Given the critical significance of the economic rent of land and natural resources in the economy, predictions that fail to recognise the uniqueness of these economic factors will be fatally flawed. Government policies that rely on such flawed predictions will be, at best, inadequate and inevitably regressive; and the contributions of economists to enlightened policy-making will continue to be questionable. Frederic L Pryor, Professor Emeritus of Economics at Swarthmore College in the US, undertook a survey of economists' views of the trends in the US economy in the 21st century in which he predicted that social scientists would be hostile to the results.[29]He admitted: "This study would meet with a barrage of criticism about the hubris of economists, our dismal record as forecasters, our methodological inadequacies, and the narrowness of our scientific vision. Such observations are, of course, true..."[30] As difficult as any economic forecasting is, if we omit land and resources from the calculations, we might as well not bother.

None of the long term trends will change unless we display the boldness, honesty and social sensibility to challenge the prevailing economic "wisdom" that seems to hold governments in thrall. If economics is a science, the first essential stage in the analytical process is observation, which must not be clouded by preconceived cultural notions

Figure 3
Projections to 2020 of selected Australian economic trends



that blur land, resources and man-made wealth into the terms *property* or *capital*. Science which is coloured by preconceptions is not science at all; its currency is faith, not reason.

Fiscal reform: the democratic challenge

WHAT IF the sum we now pay in taxes were diverted into wages; and what we are now paying in economic rent were paid as "taxes"? Would wages climb on a gradient similar to the historic trend that tracked land values? Is that such an outrageous notion – that if the present productive capacity and energy were freed of taxes, people could receive and revel in the benefits of their own and their communities' labour? People need to view that question as a key test of the legitimacy of western democratic institutions.

Such a reform would enable government to at least maintain its present levels of revenue while reducing administration costs. This would result not only in the increased capacity of government to fund infrastructure; there is much empirical evidence to suggest it would also generate a surplus that could be distributed as a *citizens' dividend*. The increase in demand for goods and services stemming from this structural reform of public finance would boost the economy and launch the process of reducing and finally eliminating the destructive wealth-poverty gap.[31]

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2 The arbitrated minimum wage in 1907 was £2.2s per week. This converts to $A4.20. Given an inflation factor of 47.166, this was equivalent to $A198 in 2000, representing an overall rise over the 93 years of 102%. The low pay threshold was given as $A408 in 1997. *The Book of Australia*, Watermark Press, 1997, ABS CPI Long term Price Series, *Australia Now, a Statistical Profile*. The average earnings figure does not reflect reality for most workers. According to Yvonne Dunlop (*Labour Market Outcomes of Low Paid Adult Workers*, Centre for Strategic Economic Studies, Victoria University, Melbourne), over the period of her survey (1995 to 1997), the low pay threshold (55% of the average or $A408 for a 38 hour week) represented about 73% of the median hourly earnings for all full-time and part-time workers. Arbitrated minimum wage in 2000 was $A400.40.

3 Figures for up to 1996 are based upon Commonwealth Grants Commission,

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4 Vamplew, *op. cit.*, p.357.

5 Reserve Bank of Australia Table G0 3 'Other Price Indicators', July 1979 to September 1999.

6 Line from *Hey Hey, My My, (into the black)*, lyrics and music Neil Young and Jeff Blackburn from the album Rust Never Sleeps, Neil Young & Crazy Horse, Reprise 2295, released 1979.

7 Figures are based on the Commonweath Grants Commission Report on General Revenue Grant Relativities 1999, Volume III, Appendixes and Consultants' Reports", Consultancy by Australian Valuation Office 1998, pp. 373-413. Calculations used are derived from figures from ABS, *The Australian System of National Accounts 30th June 1998*. I have extrapolated the 7% increase in land values a further year up to June 2000 from June 1998. See also ABS, *Housing Occupancy and Costs Australia 1995-96*. An alternative calculation based on Dwelling assets recorded in *Australia's net private Wealth in the Economic Roundup – Summer 2000*, Table 1(a) *Nominal Private Sector Wealth at market value*, from the Commonwealth Treasury, was calculated as follows. Capitalised values of private sector dwellings for 1999 was $A1357 billion. I took residential unimproved site values to be 65% of capitalised values, and this to represent 75% of all sites residential, commercial and rural, thus giving a total unimproved site value of $A1176 billion for 1999 and with an increase, estimated by the ABS of 7%, to 2000; a current value of $A1258 billion. The *Dwelling Assets* referred to in the Treasury table include neither vacant residential land, nor the estimated value of non-rateable land of $38 billion suggested in the National accounts referred to above. The choice of 65% as the ratio of unimproved site value to Capital Improved Values is accepted by most valuers as a reasonable average over all sectors.

8 Housing, Home Ownership and Renting, *Australia Now – a statistical profile.*

9 The ABS defines "income units" as: "single persons, or groups of related persons within a household whose income is assumed to be shared. Income sharing is assumed to take place within couples and between parents and dependent children. It is assumed that decisions concerning the purchase of a home are also generally made by adults in such units". There are currently 9.4 million Income units divided into approximately 7 million households. An income unit therefore would roughly equate to two persons.

10 Peter Saunders, "Income and Welfare, Poverty and Deprivation in Australia", *Year Book Australia, 1996.*

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