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# Progress

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## ABOUT

Prosper Australia is a tax reform lobby group and think tank that is now 120 years old. It seeks to move the base of government revenues from taxing individuals and enterprise to capturing the economic rents of the natural endowment, notably through land tax and mining tax.

## JOIN US

If you like the ideas here, please join our organisation, Prosper Australia. Membership costs \$30 and includes a subscription to PROGRESS. Overseas members \$35. Progress subscription only \$15.



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# Editorial *by David Collyer*

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## The Lucky Country at the crossroads

We are at the unhappy juncture where young adults are excluded from home-ownership, many owners are trapped in houses that no longer match their needs, so-called investors are taking horrendous risks with debt, and government is too frightened to adjust economic policy in case it crashes the economy.

The urgent and important change before us is land reform – so all may reasonably aspire to own a parcel and the independence, privacy and security it provides. But that high principle of the Australian settlement – originally held by left and right, rich and poor – has been defeated by a conga line of ticket clippers pursuing a zero-sum game of sectional advantage. We know allowing all to flourish is the path to universal prosperity – genuine win-win. The sooner we resume that, the sooner we can depart our current difficulties.

Australian voters have learned to bristle when anyone talks tax reform. Their lived experience is

that any and all tax reform costs them money and transfers cold hard cash to the richest one per cent. Nobody likes writing a cheque to the government; and government wants a quiet life. But the cost of our suite of taxes, notable for their design whereby the statutory incidence falls on one party and the economic incidence on another, now costs us about 5-6 per cent of GDP in deadweight losses. Government collects 24 per cent of GDP while we pay 30 per cent. Every year, we tear up and throw \$93 billion on the ground.

The welfare losses here are staggering. We are driving with the handbrake on.

The case for land reform and tax reform makes itself. A nil-exemption land tax – whether state or federal – would correct much of these distortions. It would give government the fiscal space to remove those 125 taxes Ken Henry was so rude about. Let us begin by exchanging Stamp Duty for State Land Tax. You have nothing to lose.

### PROSPER IS MOVING TO RICHMOND

Prosper is excited to inform readers we are moving to the Lennox Street Exchange (LSX), an exciting co-working space in Richmond where we will be surrounded by professionals and entrepreneurs engaged in social media, marketing and creative endeavours.

The building at Punch Lane was sold last year. High rents and the need to cross-fertilise inspired our push into the LSX collaborative workspace.

This is a positive and exciting move. Operationally, little will change - we will still maintain our events calendar, agitate for reform and continue the bookshop.

LSX is just a few minutes walk from Richmond train station. Members and the general public are, as always, very welcome to visit.

It's been an incredibly successful time for Prosper at Punch Lane and while we are sad to move we are also very excited by the opportunities our new location presents.

Please note our new address - 285 Lennox Street, Richmond, 3121.

Regards, Jess Wright  
Office Manager

# Speculative Vacancies

by Catherine Cashmore

The fact that Australia has an affordability crisis is not in dispute. Rather, government inaction for more than a decade must be questioned.

Since the early 2000s, there have been three Senate Inquiries to tackle Australia's escalating land values and declining rates of homeownership, including Australia's Future Tax System Review that made a number of recommendations on housing reform.

The first inquiry conducted by the Productivity Commission in 2004, determined that prices had surpassed levels explicable by demographic factors and supply constraints alone. They stressed that a large surge in demand had rather been "predicated on unrealistic expectations (in a 'supportive' tax environment) of on going capital gains."

The second inquiry overseen by a Select Senate Committee in 2008, found that the average house price in capital cities had climbed to over seven years of average earnings and once again, they identified inequitable disparities in the overall fairness of the tax system, that had led to "speculative investment on second and third properties."

Australia's Future Tax System released in May 2010, stated that tax benefits and exemptions had been capitalised into higher land values, encouraging investors to chase 'large' capital gains over rental income and landowners to withhold supply.

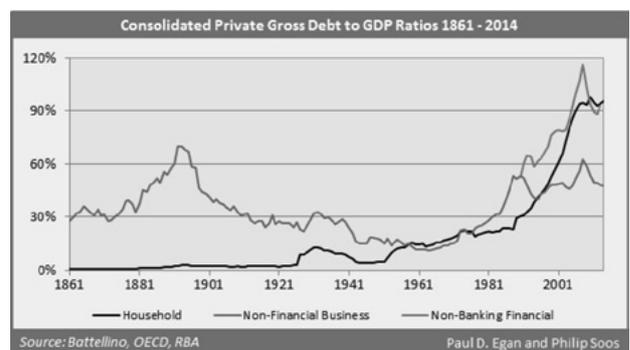
The third and last inquiry which is currently being conducted by the Senate Economics References Committee commencing in March 2014, received a key submission from Prosper Australia examining nine chief economic measures of land, debt, and finance – and found all to be at, or close to historic highs.



*"It took forty years from 1950 to 1990 for housing prices to double, but only fifteen years between 1996 and 2010 to double again."* (Soos, Egan 2014).

The submission demonstrated a sharp rise in the nominal house price to inflation, rent and income ratios, driven by a rapid and unsustainable acceleration of mortgage-debt relative to GDP.

The current trend dwarfs the recessionary land bubbles of the 1830s, 1880s, 1920s, mid-1970s and late 1980s that triggered economic havoc, leading Australian households to endure some of the highest levels of private debt in the developed world.



Today, the investor share of the market is close to 50 per cent. Investor finance commitments are rising at their fastest pace since 2007. Sixty-

five per cent of loans to investors are on interest only terms and 95 per cent of all bank lending is being channelled into real estate – mostly residential.

Yet despite these findings, policy makers and industry advocates repeatedly claim the primary driver of Australia's affordability crisis is a lack of supply – and increasing the stock of housing will reduce prices enough to rectify the problem without the need to address the demand side of the

equation through necessary and far-reaching tax reform.

Ultimately, this is not possible because our policies work directly against it.

Investor and housing tax exemptions worth an estimated \$36 billion a year, have distorted the Australian dream of owning a home into a vehicle for financial speculation.



Consequently, rising land values that impoverish the most vulnerable sectors of our community are widely celebrated - while Australia's federal members of parliament in possession of a \$300 million personal portfolio of residential dwellings, stand solidly against all recommendations from previous Senate Inquiries for meaningful and equitable tax reform.

*"The trends in the data suggest a sizeable majority of federal politicians have a vested interest in maintaining high housing prices, particularly since most have mortgages over their own investments." (Egan, Soos and Davis)*

Under current tax policy, investors that withhold primary land and dilapidated housing out of use are rewarded with substantial unearned incomes due to government failure to collect the economic land rent (the 'capital gains') society generates through public investment into social services.

The subsequent uplift in values that comes as the result of neighbourhood upgrades and taxpayer funded facilities – further accelerated by plentiful mortgage debt and restrictive zoning constraints, capitalises into the upfront cost of land by tens of thousands of dollars year on year. Yet rental incomes, at typically no more than \$18,000 to \$19,000 per annum are a mere trifle in comparison.

Figure 9: Gross Melbourne Rental Yields



In the 12 months to September 2014 alone, Melbourne's median house price increased by 11.7 per cent – over \$60,000. In contrast, gross rental yields at 3.3 per cent are currently the lowest in the country and the lowest on record.

This broadening divergence between rental income and 'capital growth' typifies the commodification of housing used only as a tool for profit-seeking gain.

Indeed, net rental incomes in Australia have been declining since 2001. Growth in both the relative and absolute number of negatively-g geared investors between 1994 and 2012 has soared by 153 per cent. In contrast, positively-g geared investors have increased by a much lesser 31 per cent.<sup>12</sup>

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*Large divergences between rental income and land price inflation thus produce an unhealthy challenge to both housing affordability and economic stability.*

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They lead to 'speculative vacancies' (SVs) – properties that are denied to thousands of tenants and potential owner-occupiers, lowering relative vacancy rates and placing upwards pressure on both rents and prices. The housing supply crisis is therefore greatly obscured by current vacancy measures that cannot identify sites that are withheld from the market for rent-seeking purposes.

The consequential subversion of housing policy is evident when it is considered that since 1996 Australia has built on average one new dwelling for every two new net persons nation wide. Yet over the same period, government legislation, politically manufactured to protect the unearned profits of a large cohort of speculative investors, has resulted in vacant median land prices on the fringes of Australia's capital cities ballooning from approximately \$90 per square metre in 1996, to over \$530 per square metre today.

Indeed, there is no better example of the astonishing escalation of land price inflation than the recent report of a Melbourne family who purchased a 108 hectare Sunbury 'hobby farm' in 1982 for \$300,000 and following new residential rezoning, have realised an estimated windfall gain of over \$60 million.

This means of 'creating wealth' common in most western nations sits at the root of many of our current economic and social problems. Our tax and housing policies shift income to landowners, eroding the living standards of future generations of

Australians who are required to shoulder an increasing burden of debt just to secure a foothold on the fabled ‘property ladder’.

The effect is to broaden the intergenerational divide as families are forced to live on the threshold, marginalised into areas lacking essential amenities and jobs, while 92 per cent of speculative investment into real estate pursues the ‘capital gains’ associated with second-hand dwellings, rather than increasing the stock of housing through the purchase of new supply.

Aided by a complicit banking system, Australia’s rising house prices produce wide ranging inefficiencies to the economy. High land prices damage Australia’s competitiveness with higher living costs. The resulting demand on both business and wages channels investment away from genuine value adding activities, leading to a gross and wasteful misallocation of credit to feed an elevated level of speculative rent-seeking demand.

The debilitating and destabilising effect on the economy can be evidenced clearly in a painful and rising trend of income and housing inequality that places an unsustainable strain on the capacity of the welfare state to compensate.

Australian’s like to think of themselves as a ‘*fair go*’ society –however, inequitable disparities in our housing, tax and supply policies result in an English-style class divide, evidenced in:

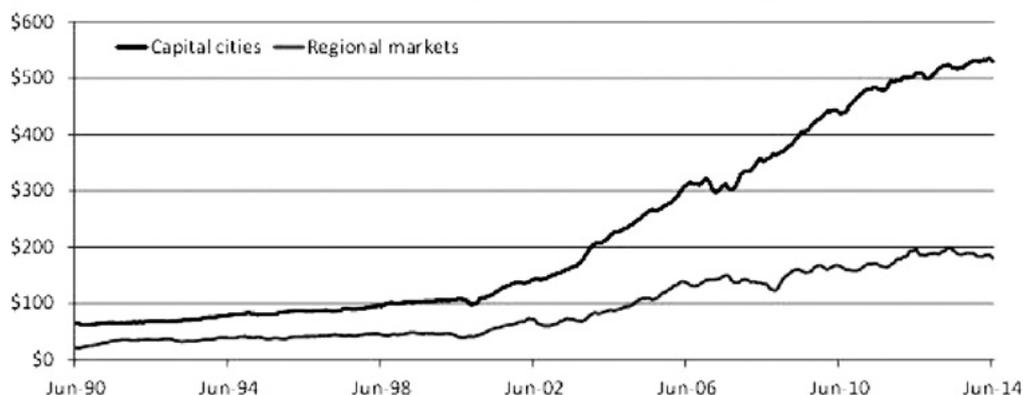
- Fewer Australians owning their homes outright [i]

- A rising percentage of long-term tenants renting for a period of 10 years or more[ii]
- A decrease in the number of low income buyers obtaining ownership, particularly families with children [iii]
- A drop in the number of affordable rental dwellings with a marked increase in the number of households in rental stress[iv]
- Greater requirements for public housing.[v]
- A rise in homeless percentages and those who drift in and out of secure rental accommodation –with ongoing intergenerational effects[vi]
- An increase in the number of residents living in severely crowded accommodation.[vii]

As many as 105,000 Australians are currently homeless, while between the dates of 1991 and 2011 homeownership among 25-34 year olds declined from 56 per cent to 47 per cent, among 35-44 year olds from 75 per cent to 64 per cent, and among 45-54 year olds from 81 per cent to 73 per cent.

Homelessness is often blamed on dysfunctional relationships, mental illness, drug abuse, domestic violence, job losses and so forth. But at the root lays an acute lack of affordable accommodation available for the most impoverished members of our community in need of both security and shelter. ‘Speculative Vacancies 7’ gives a unique insight into the impact of current housing policy by highlighting the total number of underutilised and empty residential and commercial properties currently

**Rolling quarterly median rate per square metre of land over time – combined capital cities vs. regional markets**



Source: RP Data

withheld from market.

Melbourne is a perfect case study for this report.

- Its real estate is ranked among the most expensive in the developed world
- It has dominated Australia's population growth, attracting the largest proportion of overseas immigrants, alongside strong immigration from interstate.

As government and the real estate industry are not sources of impartial information, the report adds a valuable dimension to understanding the divergence between real estate industry short-term vacancy rates (the percentage of properties available for rent as a proportion of the total rental stock) and the number of potentially vacant properties exacerbating Australia's housing crisis.

The full Speculative Vacancies report is at:

<http://tinyurl.com/mgyat57>

[i]ABS – In 1996/7, 42% of households owned their home without a mortgage. This proportion is now down to 31%

[ii]ABS – A third of all private renters are long-term renters (defined as renting for periods of 10 years or more continuously), an increase from just over a quarter in 1994

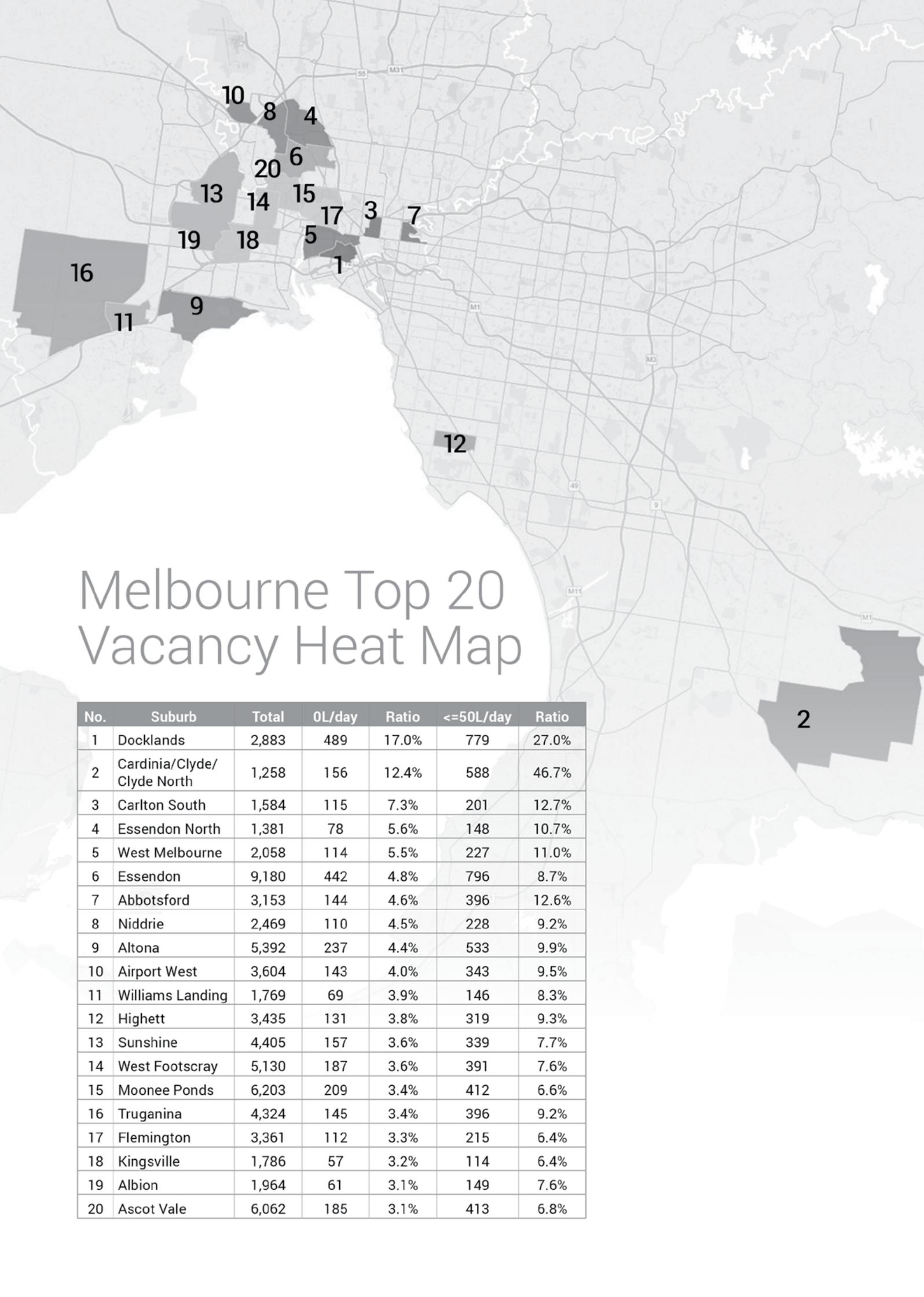
[iii]ABS – A drop of 49% to 33% between 1982 and 2008

[iv]ABS – In 2009–10, 60% of lower-income rental households in Australia were in rental stress.

[v]AHURI 2013 – 28% increased demand for public housing projected by 2023

[vi]ABS – Between 2006 and 2011 the rate of homelessness increased by 8% from 89,728 to 105,237

[vii]ABS – The total number of people living in 'severely' crowded dwellings jumped 31% (or 9,839 people) to 41,370 from 2006 – 2011



# Melbourne Top 20 Vacancy Heat Map

No.	Suburb	Total	0L/day	Ratio	<=50L/day	Ratio
1	Docklands	2,883	489	17.0%	779	27.0%
2	Cardinia/Clyde/ Clyde North	1,258	156	12.4%	588	46.7%
3	Carlton South	1,584	115	7.3%	201	12.7%
4	Essendon North	1,381	78	5.6%	148	10.7%
5	West Melbourne	2,058	114	5.5%	227	11.0%
6	Essendon	9,180	442	4.8%	796	8.7%
7	Abbotsford	3,153	144	4.6%	396	12.6%
8	Niddrie	2,469	110	4.5%	228	9.2%
9	Altona	5,392	237	4.4%	533	9.9%
10	Airport West	3,604	143	4.0%	343	9.5%
11	Williams Landing	1,769	69	3.9%	146	8.3%
12	Highett	3,435	131	3.8%	319	9.3%
13	Sunshine	4,405	157	3.6%	339	7.7%
14	West Footscray	5,130	187	3.6%	391	7.6%
15	Moonee Ponds	6,203	209	3.4%	412	6.6%
16	Truganina	4,324	145	3.4%	396	9.2%
17	Flemington	3,361	112	3.3%	215	6.4%
18	Kingsville	1,786	57	3.2%	114	6.4%
19	Albion	1,964	61	3.1%	149	7.6%
20	Ascot Vale	6,062	185	3.1%	413	6.8%

# Victorian Budget submission

by Karl Fitzgerald

## Introduction

Prosper Australia is an NGO advocating for an efficient taxation system by transferring taxes off the productive sector and onto the economic rents of land and land-like assets.

Successive Victorian governments have been proactive in the extensive re-zoning of landholdings. Significant expansions of the Urban Growth Boundary were justified by the urgent need for affordable housing. However, the continued land boom has provided a poor return for the community. Investor dominance has pushed First Home Owners (FHO) to record lows. A review of land and housing policy is vital for the financial sustainability of citizens and the state.

## Priorities

The Victorian government budget is currently well placed thanks to Stamp Duty revenues delivered by a booming property market. This healthy financial position offers the new administration time and space to engage in property and taxation reform.

We advocate the following policy reforms:

1. remove the First Home Owners Stamp Duty discount
2. reduce the Land Tax threshold
3. flatten the Land Tax rate
4. broaden Land Taxes to replace Stamp Duty
5. abolish the First Home Owners Grant
6. replace Developer Charges with a Value Capture system
7. return the Local Council rating base to Site Value
8. monitor the role of Speculative Vacancies in the housing supply crisis

## Remove the First Home Owners Stamp Duty discount

The Stamp Duty (SD) discount introduced July 2011 has delivered no discernible effect on housing prices, as economic theory would suggest and Figure 1 demonstrates.

The alleged saving in SD discounts were invariably bid away in higher house (read land) prices.

The SD discount has seen the loss in government revenue simply transferred to vendor and banking profits. The abolition of the FHO SD discount will return \$70m to the budget and have few market implications.



## Reduce the Land Tax threshold

From 2001 to 2008, the State government increased the Land Tax (LT) threshold from \$85,000 to \$250,000. This curtailed LT's effectiveness as a counterweight to land price inflation, encouraging land price appreciation.

In 2014, the owner of a \$330,000 site paid \$435 in LT while enjoying some \$60,000 in capital gains. This low LT charge provides little incentive to put land to productive use. This is compounded by Melbourne's median rents flatlining at \$18,000. This is less than one third of current capital gains. Under today's taxation regime, the incentives to hoard land for speculative gain outweigh renting out or developing a location.

The LT threshold must decrease over time.

Reducing the Land Tax threshold to zero on the \$330,000 site increases the holding cost of land to a still low \$660. However, this charge would come off the capitalisation rate, placing some downward pressure on land prices.

Whilst a minimal reform with limited budgetary significance, this market signal is important. It says that lazy land use will be penalised. An effective Land Tax system is an important tool for government: it politely insists land be put to its best and highest use.

## **Flatten the Land Tax rate**

The current progressive Land Tax regime is deeply flawed. A progressive LT rate leaves the government open to 'wealth envy' critiques.

By flattening the Land Tax rate, government acknowledges locational values do differ. Land in Toorak is more valuable than Melton. Land Taxes are a percentage charge on the land value. Higher land values in Toorak ensure a landowner naturally pays a higher amount under a flat rate LT system. A higher percentage is not necessary.

If the State government was to flatten the Land Tax rate, it would also address the Henry Tax Review concerns on agglomeration. The strength of this reform is that all land owners pay the same percentage. Locational values account for the varying privilege accorded by nature, infrastructure and culture. Choosing to occupy land is a deliberate decision, evidence of capacity to pay.

## **Broaden the Land Tax to replace Stamp Duty**

Stamp Duty is arguably the most inefficient tax levied. It is currently a \$36,000 impost on a Victorian household for moving closer to their work.

A broad based Land Tax on all Victorian land could be set at a low rate in the dollar to replace all of

Victoria's property taxes. In 2013-14, \$7.468bn was raised by Victoria's various property taxes. As of June 2014, Victorian land values were \$1,109.1bn. A 0.00674 rate in the dollar is capable of replacing SD, LT, the Growth Areas Infrastructure Charge (GAIC), the Fire Services Levy, the Congestion Levy and the Metropolitan Improvement Levy.

This would be a nation leading reform and result in a number of benefits:

- Cheaper housing
- Lower future debt
- Improved efficiencies (lower deadweight costs)
- Better for the local economy - more money spent locally
- Improved turnover in housing, leading to more suitable housing relevant to need
- Less congestion due to more moving closer to work.

A number of implementation strategies are possible.

## **Monitor the role of Speculative Vacancies in the Housing Supply Crisis**

For seven years we have conducted a yearly investigation into the number of vacant properties in Melbourne. We analyse abnormally low water consumption levels as a proxy for vacancy.

Prosper Australia's most recent report found 64,386 vacant properties, adding 3.4 per cent to SQM Research's conservative 2.5 per cent market vacancy rate. Our speculative vacancy rate looks at the entire housing stock. Vacancy statistics have typically analysed a smaller subset - those properties advertised available and vacant for three weeks or more. With investors running at 50 per cent of buyers and significant capital gains now so prominent, the import of letting out a property drops with each rise in property prices.

Many of the Speculative Vacancies identified could be subdivided as part of the Intensifying Melbourne agenda. An effective State Land Tax is essential to drive better outcomes.

The yearly Speculative Vacancies report continually reveals very high vacancy rates in Southbank, Docklands, Carlton South and the CBD. However, this hoarded supply is ignored in the Housing Supply Crisis meme.

Of note is the 23.2 per cent Speculative Vacancy rate in commercial land holdings. Massive sunk capital in this sector is undermining Victoria's business competitiveness.

We request the State government assist in our data monitoring and incorporate these findings into their land supply calculations.

## Return Local Councils to Site Value Rating

The Andrews government cap on local council rates may be good politics but it will lead to poor economic outcomes. The State government should encourage local council financial autonomy (especially in light of the trends announced in the Commission of Audit). This could be done by providing incentives for a return to Site Value Rating. This would do more to assist long term affordability and council efficiency than the rating cap severely undermining many NSW councils. Such rating caps have further centralised power. The continual under-utilisation of economic rents as a revenue source at both the local and state government level cede further centralisation of power to the federal tax base.

Capital Improved Valuation (CIV) rating ensures the family home pays more in council rates than the neighbouring land banker. Taxpayers should not be penalised for improving their homes via renovation (or installation of solar, water tanks). Under CIV (or NAV) rating, such improvements result in a higher rating burden. This subtle subsidy for land bankers adds pressure to our already sprawling city.

Further confusing the information available to FHBs on the macro level is the manner in which the 'housing supply crisis' meme has deflected attention away from the dominance of demand over supply. Melbourne's apartment market is a prime example. With record apartment supplies entering the market, FHBs have been forced to rationalise their price assessments into accepting that the best possible outcome is for the price of 2 bedroom apartments to remain flat.

However, both wage growth and inflation are flatlining. The conclusion must be that under the current taxation system, the housing market is incapable of meeting housing demand.

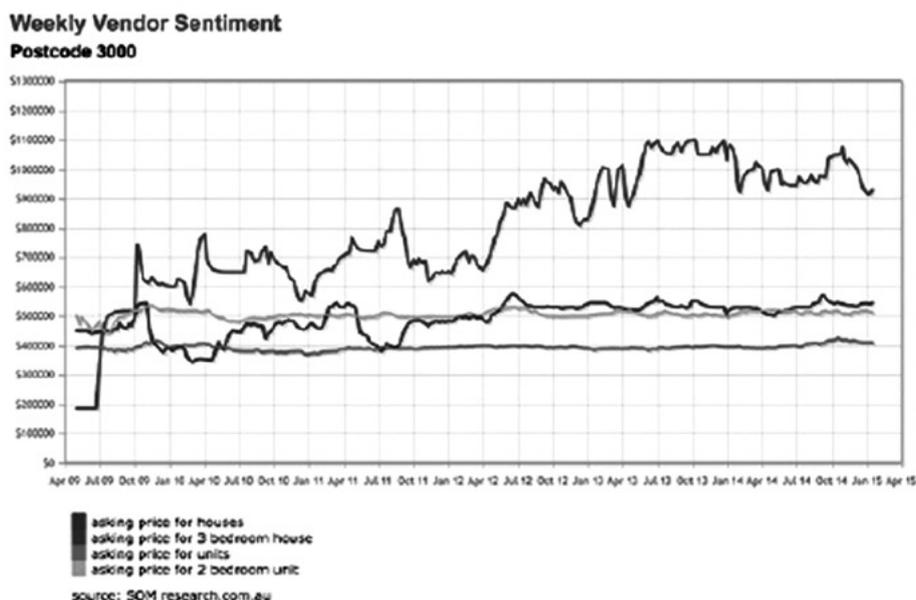
Instead, speculative demand takes priority in a world where mobile capital is scouring the globe for lightly taxed profits.

## Conclusion

There are substantial first-mover advantages available to any Australian state willing to step outside the conventional wisdom that high land costs are evidence of economic success.

High land prices stifle entrepreneurialism, transfer wealth from young to old and from low income earners to financiers. Such inequality slows the rate of growth.

As we have demonstrated, both the demand and supply side of the land market are working against affordable housing outcomes. Public policy must act as a counterweight to the natural advantages land owners enjoy over time.





# Parks and Nature Reserves, not Vacant Lots, Bring Nature

*By Frederick Subere-Albawy*

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In my neighbourhood, which has been around for over fifty years, I see many vacant blocks of land. There's one just around the corner, and another closer to the shopping centre. There is a very big empty block right across the road, directly in front of a bus stop, large enough for an apartment building and shops. There's even a block of land that has been subdivided into three plots, in which a developer would normally build three units. Only the back lot is built upon, and the front is vacant. In many cases, these vacant lots are filled with litter and weeds.

Vacant lots are the most visible evidence of how land values, which are created by community activity, are collected and speculated upon by private owners who did nothing to earn these rents and create no benefits for society.

When the owner of a block of land is entitled to land rents, now and in the future (an increase, in fact, in land rents due to increased economic activity in the community), they will speculate on their land. Land will be left vacant in the expectation it can be sold in the future at a higher price. Far from a benefit to our society, this is a cost to all, as land resources lie idle even when there is demand for locations on which to build homes and businesses. What is the point?

It's not freedom. The driving force behind land speculation is the government granted licence that guarantee owners of nature unearned rents. When land that is in high demand is left out of use, this restricts the freedom of others to live, work and trade.

Sometimes, it is said vacant lots bring nature to the city. In a place nearly completely built up, when owners leave lots vacant, they provide space for plant life to thrive, or so the argument goes. But to claim there are environmental benefits in vacant urban land is a fallacy.

## Ecosystems

Speculators keep their land vacant specifically because it has value in the future. Any habitats and ecosystems that develop on vacant lots will be destroyed when, in order to realise this future value, the property is cleared and built upon. In addition, since vacant lots are isolated enclaves in otherwise built-up areas, there is no continuity, so continuous and complete ecosystems (like in nature) cannot develop.

On the other hand, natural unsettled lands are like that because they are of little to no use to humans. Pristine lands are usually far from cities, farms, mines and so on. The only exception is where bushland reserves and national parks have been set aside by law, but suburban bushland reserves only make up a small proportion of land in Australia in its natural state. Land in its pristine state already contains complete ecosystems, which are not destined to be cleared. Land in pristine condition will remain so unless the land required for human activity increases, a phenomenon known as urban sprawl.

## Urban sprawl

Since speculators keep land vacant specifically because of its value, vacant land typically has a higher than average land value. This valuable land kept out of use means a greater amount of less attractive land must be used to accommodate homes and businesses that could not use the land left vacant. The result is the clearing and destruction of wildlife habitat in increased distances travelled, especially by car, resulting in increased pollution. A loss for the environment on two counts.

## Loss of neighbourhood amenity

But vacant lots in prime locations don't just have environmental impacts. They degrade neighbourhood amenity as well. There is an opportunity cost to leaving land vacant, as each

empty block means a community facility - a school, park or community centre – is not built, or is built in a different location.

Vacant blocks are a void, resulting in longer trips, increasing the distance between origin and destination, without creating extra origins or destinations. This is especially a problem in areas with walkability and commercial activity, as a good walking experience depends on human activity to provide pedestrian interest. Vacant lots create a vacuum, with nothing to interest passers-by (or potential passers-by, as an area with more vacant blocks will see less pedestrian use).

Even worse, vacant lots are a haven for unsightly litter and dumping, acting as both a blight to the attractiveness of any neighbourhood, and a burden to any ecosystems that happen to develop.

## **Affording a home and starting a business**

Vacant lots also contribute to difficulty buying affordable housing. A three bedroom home in a decent suburb in Perth simply cannot be had for less than \$400 000 (more for a single family home in a good location). Vacant land is land that could be used to provide housing, and when this land is not built upon housing supply is lower and prices higher. This is why the median house price in Perth is \$549 000 and why nearly ten thousand West Australians are homeless.

It also becomes more difficult to start a business when potential commercial sites (the most lucrative sites, since these see the most price appreciation) are kept out of use. The option of self-employment is mostly ruled out, resulting in more workers competing for less jobs. This means lower wages and greater income inequality.

## **Urban parks and reserves**

However, there is still a need for open space and nature in our cities and suburbs, for recreation and to absorb pollution. But allowing speculators to leave lots vacant is not the way to do so.

It's a matter of responsibilities and incentives really. A land speculator is under no responsibility for, and gains no profit from, promoting nature and providing community amenity, as all they must do to gain is hold the land and sell it at a higher price in the future. In fact, to build a park on a vacant block would add to the cost of and build community resistance to (as the community comes to appreciate its amenity) clearing and developing that land, reducing its value and potential sale price. So, to maximise their gains, speculators will keep their land vacant not only of buildings but also vacant of nature, to reduce the costs of future development.

Instead, land that is intended for use as a reserve, providing nature and amenity to the area, should be made a park, maintained by a local government, government department or non-governmental organisation. It will be their responsibility to maintain this land, and provide facilities to benefit the community. Indeed, governments will be incentivised to provide high-quality parks and reserves, if the tax base is the rent of the land around.

Vacant land and a good park are different: parks increase land values, while vacant lots decrease land values. Think of all the real estate listings that promote a property's proximity to a park because they increase the appeal and selling prices of homes. Imagine a listing promoting the vacant lot next door as a positive feature. Have you ever seen this? I thought not. Although there would be ads promoting the vacant lot itself as having developmental potential, this does not translate to the lot benefiting the community as a whole.

If the rent of land is collected by the community, the parks that are provided will increase the rent collected. More parks and better parks mean higher land values and greater rents. Governments will be incentivised to provide more and better parks, and these parks will pay for themselves.

# Carnegie's endowment

by David Collyer

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Prominent Australian investor Mark Carnegie has called for tax reform to end the policy and financial straight jacket we find ourselves in – pointing to land tax, a resources tax and a lift in the GST to 15 per cent.

He labelled the Abbott Government's upcoming White Paper on tax a waste of time, arguing that the Henry Tax Review has already outlined what needs to be done, and all that is required is a government with the courage to implement its recommendations.

“Tax needs to fall disproportionately on the rich – everyone agrees on that now,” he told the Australian Financial Review, a direct challenge to the Abbott government's obsession with sloughing the burden of taxation onto those least able to bear it. This government is practising class warfare – redistributing among winners and losers – rather than pursuing the economic Golden Age that could be ours.

While one could dispute his use of ‘disproportionate’, he does speak truth to power in pointing out the best economic path is land tax and resources tax. These tax bases hurt no one and using them would make room to remove the very bad taxes government has become addicted to – Stamp Duty and Payroll Tax come immediately to mind.

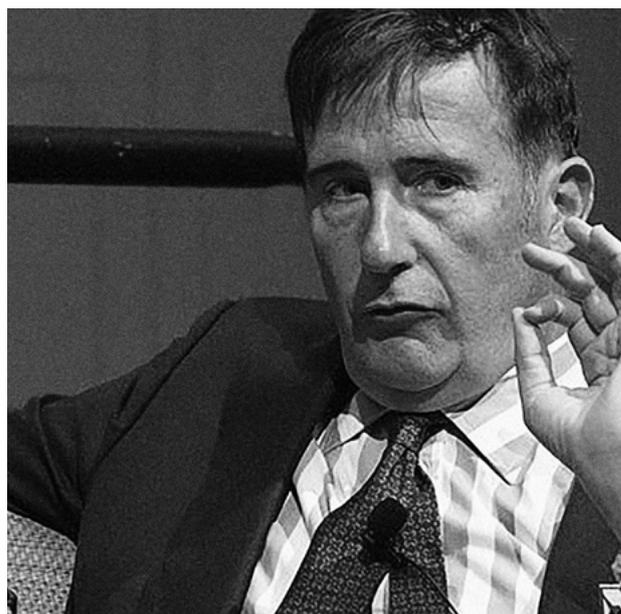
Mr Carnegie said the consumption tax should rise to 15 per cent but only with a carefully devised compensation package to protect the poor. His venture capital company, M.H. Carnegie & Co, is funding the Australian Council of Social Service to do modelling on how the most vulnerable can be protected in any tax reform. He hopes other reforms can overcome the inherently regressive nature of GST, an optimism few share.

Proposals to raise and broaden the GST are met by deep scepticism from voters whose lived experience is that change is usually at a cost to them. It is difficult to imagine even well-considered adjustment can overcome this.

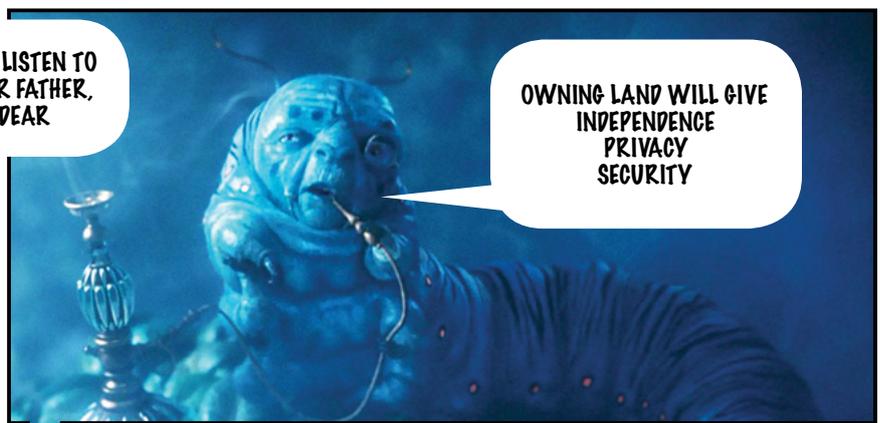
There are very low expectations that the Tax White Paper will deliver anything meaningful - it looks more like an attempt to delay and deflect tax reform.

As Carnegie suggests, we all know what needs to be done: tax lurks for the wealthy need to be closed and taxation shifted to efficient sources, notably land and resources.

Interestingly, if we embrace quality tax bases and reduce bad ones, the incentives for the wealthy to manipulate the system for advantage shrink mightily. Funny about that.



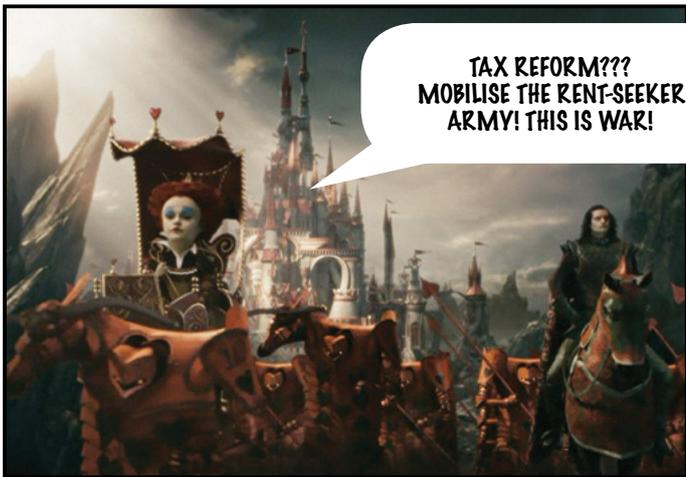
# Alice in the Land of Land





ONLY TAX REFORM CAN END DEBT-SLAVERY

TAX REFORM? WHAT'S THAT?



TAX REFORM??? MOBILISE THE RENT-SEEKER ARMY! THIS IS WAR!



ALICE CONFRONTS THE LAND SPECULATION JABBERWOCKY



IT ALWAYS DOES!

GREED WILL DEFEAT THE COMMON GOOD



SLASH!



YOUR BANK WILL SHRINK. YOU NO LONGER CONTROL OUR LIVES OR DESTINY



ALICE IS FREE. HER JOURNEY MAY BEGIN.

# Prosper's submission to the federal Tax White Paper

by David Collyer

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*Late last year, the Abbott government called for submissions on its tax reform white paper. Since the call, the popularity of the government has plummeted and the tax white paper deferred.*

*Prosper has serious concerns about the equity and economic efficiency of the reform proposals - notably broadening the GST, which is a regressive tax. Our submission spells out why.*

## Is broadening the GST really tax reform?

Members of the Abbott government has argued strongly for extending the GST base onto food and other exclusions negotiated to allow the passage of *A New Tax System (Goods and Services Tax) Act 1999*.

The GST has some virtues. It has low deadweight costs – provided it is universally applied – and is a distinct improvement on the scattered and inefficient sales tax regime it replaced.

However, it is regressive, falling most heavily on low and middle-income earners who spend a larger proportion of their incomes on food staples and cannot change their behavior without compromising nutrition. The rise in consumer prices reduces the purchasing power of after-tax wages with impacts on labour supply and nominal labour income.

The GST's reduction of after-tax labour incomes has a corollary - a significant lift in after-tax private capital incomes, as explained in KPMG Econtech's *CGE Analysis of the Current Australian Tax System*.

The benefits conferred on after tax private capital incomes are substantial, particularly as the main gains are enjoyed by a small proportion of citizens.

This burden-shifting between economic classes has not been openly discussed by economists and commentators, yet it is clear from citizen discussion they intuit the significance and do not like it.

We note and agree with Treasurer Joe Hockey's recent statements that middle income earners face effective taxation rates of 50 per cent due to bracket creep and the genuine risk of widespread work disincentives.

If Australia is to endure the upsets and costs of tax reform, we have an obligation to migrate to bases that economists can demonstrate have the following features:

- Nil deadweight losses
- Cannot be avoided or passed on
- Are equitable
- Reflect capacity to pay
- Can be universally applied

## Australian economic activity

The Australian economy faces serious challenges. The downturn in commodity prices means the very large investment in mining construction investment will generate modest returns in the short to medium term. Manufacturing activity has shrunk dramatically due to our strong currency and is set for further falls as car manufacturing ends. Prosper is, however, very optimistic about an eventual manufacturing and agricultural revival on a much lower Australian dollar.

Larger than all these negatives and a more difficult challenge for policy is land costs.

Australia is very richly endowed with land. This is a key national economic advantage over almost all competitor countries. Government has an unceasing obligation to nurture advantage in this by siding with the future (buyers) over the past (vendors).

Over the last 30 years, land prices have boomed – propelled by speculation, easy credit, restrictive planning and rising real incomes. On one hand, many have made their fortunes, on the other, first home buyers now find it nearly impossible to buy a house to start a family and enter the independence, privacy and security of property ownership except on extremely onerous terms.

Universal access to inexpensive land is a core economic and cultural Australian value.

An inefficient taxation system, comprised of high wage taxes and low land taxes, allows landowners to

expropriate 'geo-rent' (economic rent derived from land) by capturing the uplift in land values generated by taxpayer-funded infrastructure and rising economic productivity derived from labour and entrepreneurial activity. As property valuer Bryan Kavanagh notes: "...land price is actually the private capitalisation of imputed site rent remaining on a site, developed or undeveloped, after the deduction of government charges."

Because government has preferred to tax wages and enterprises ahead of land, the capital sum people are willing to pay for this asset is elevated by its privileged status. Counter-intuitively, reducing wage and business taxation and increasing land tax would not necessarily lower land prices, given the offset of increased final wages, profits, and real and imputed rents. This macro reform – urged on government by every independent tax review in living memory – would solidly correct the price/income and price/rent ratios.

If Australia wishes to escape or ameliorate the profound financial destruction of a bubble burst, the solution lies in this equation. Further, there are major economic benefits available in reducing deadweight costs and our very large tax expenditures by shrinking tax bases we know distort behavior and shedding the tax relief extended to preferred groups.

The generous scope of tax expenditures relating to the housing market has increased land costs. Tax expenditures are defined as a deviation from the commonly accepted tax structure, whether it is a tax exemption, concession, deduction, preferential rate, allowance, rebate, offset, credit or deferral. Australia has the highest rate of tax expenditures among our OECD peers, at more than 8 per cent of GDP.

Tax expenditures are vulnerable to lobbying, and compromise the fairness and efficiency of the tax system. Lavish tax expenditures for both owner-occupied and residential investment property has significantly worsened housing affordability. They allow landowners to capture greater amounts of land rent and prioritise unearned wealth and income over what is earned. Existing home owners capture the greatest benefit, ahead of first home buyers, investors and tenants.

The profound influence on human behavior of where and how governments choose to tax is amply demonstrated by the emergence of a very large cohort of negatively geared property investors – the overwhelming majority middle income earners seeking to escape the PAYE tax system, although the biggest income losses are made by high income negative gearers.

These tax expenditures, reinforced by already low property taxes, provide strong incentives to speculate

on housing prices. Investors perceive rental income as secondary to expected rises in capital prices, while first home buyers over-leverage themselves to enter a bubble-inflated market.

In Australia, a perverse culture of homeowner entitlement is compounded by a degenerate taxation system that penalises hard work and innovation, while rewarding speculation.

## A New Federalism

The ideal tool to moderate land bubbles and properly fund infrastructure already exists in the hands of state and territory governments: State Land Tax. Unfortunately, this tax has been so riddled with exemptions and concessional treatments it must be considered dormant. The states show no interest in, for example, removing conveyancing Stamp Duty or Payroll Tax – both very damaging tax bases – and funding this by also removing exemptions from SLT. They fear the political consequences.

We recommend the Abbott government introduce a nation-wide one per cent Federal Land Tax – fully rebatable on State Land Tax paid – to oblige the states and territories to migrate their revenue bases away from genuine economic injury. State governments could adjust their tax rules and keep every dollar the Federal Land Tax raises, to the great benefit of all Australians. The Commonwealth would be entitled to argue this intervention is for sound economic reasons and dissipate the political fallout.

Transitional arrangements would need to be considered. A logical solution is to credit all landowners with the amount of stamp duty paid and then deduct the hypothetical land tax they would have paid since the date of purchase. This would address much of the fairness question.

Placing state and territory finances on sound bases would vastly improve the federal system mandated by Australia's Constitution. It would also introduce a new dynamism into all levels of government and overall economic activity.

## Conclusion

The Abbott government is confronted by hard choices that will determine Australia's future economic character and direction. Investor activity is currently deflected to speculation in residential property, notably in Sydney and Melbourne, by the sum of the economic incentives available here and in investment alternatives. If government chooses to advance sectional advantage over the universal prosperity that would emerge from the tax reforms we suggest, both rich and poor would be diminished.

# Did Pope Leo XIII really condemn Henry George?

By John Young

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I maintain that there is no conflict between Henry George's land revenue thesis and Pope Leo XIII's defence of private property in the encyclical *Rerum Novarum*. Some Georgists will see my claim as clearly erroneous, and will point out that Leo strongly defended the right to private property in land, whereas George says time after time that private property in land is unjust.

To quote from the encyclical: "Man should not only possess the fruits of the earth, but also the very soil, inasmuch as from the produce of the earth he has to lay by provision for the future" (n. 7). These words occur in a section of the encyclical devoted to a defence of private property, with particular emphasis on property in land.

The crucial question is: Do George and the Pope use the term private property in the same sense? They don't. George sees private property rights as (almost) absolute, whereas Leo and the whole Catholic tradition regard all property rights as relative.

According to George there is an absolute right of ownership to things produced by labour, except in life or death situations. He concedes that one may take someone's horse if that is necessary for one's survival. But he illustrates his contention that what a man makes or produces is his own, against all comers, imagining travellers in the desert who have brought plenty of water, while other travellers have run short of water. The latter, he says, "...though they might ask water from the provident in charity, could not demand it in right" (*The Condition of Labor*, Henry George Foundation of Great Britain, 1930, p.42).

Contrast this with Catholic tradition about private property. When we look at what official documents of the Catholic Church say, we find that they classify

property rights as relative, not absolute. The *Pastoral Constitution on the Church in the Modern World*, issued in 1965 by the Second Vatican Council, expressed the traditional Catholic position about property. Starting from the premiss that "God intended the earth with everything contained in it for the use of all human beings..." it argues that private property must be so used that it benefits others (n.69).

The Constitution states: "If one is in extreme necessity, he has the right to procure for himself what he needs out of the riches of others" (Ibid.). A footnote refers to an article in the *Summa Theologiae* of St Thomas Aquinas, where Aquinas says that in cases of necessity it is morally lawful to take the property of others. He denies that this is theft (morally speaking) by the person in extreme need, because "that which he takes for the support of his life becomes his own property by reason of that need" (*Summa Theologiae*, II-II, q. 66, a. 7).

It "becomes his own property". That statement expresses the way Catholic authorities understand the concept of private property: not only land, but all property. It is essentially relative to the needs of others; it is never absolute, and therefore – in extreme cases – can cease to be the property of the rich and become the property of the needy.

Hence there is no conflict between George's statement that land should not be private property and Leo XIII's defence of private property in land, because George is speaking of an absolute right (subject only to a life and death situation), whereas Leo is defending a relative right – a right compatible with the public appropriation of rent.

In 1991 Pope John Paul II issued the encyclical *Centesimus Annus* to commemorate the centenary

of *Rerum Novarum*, and he noted that the amount of space Leo devoted to the question of private property shows the importance he attached to it. John Paul II then adds: “The Pope is well aware that private property is not an absolute value, nor does he fail to proclaim the necessary complementary principles, such as the *universal destination of the earth’s goods* (n.6; original italics).

Those Catholic authorities who claimed that George’s position was contrary to official Catholic teaching thought he advocated land socialism: the holder of land would be a tenant of the government. And some of his statements certainly give that false impression. Apart from the slogan “land should not be private property”, he speaks of “converting all occupiers into tenants of the State, by appropriating rent” (*The Irish Land Question*, Robert Schalkenbach Foundation, p. 54). In *Progress and Poverty* he states that, by appropriating rent, “...the State may become the universal landlord without calling herself so...” (book VIII, chapter 2, p. 406, Robert Schalkenbach Foundation, 1971).

This passage from *The Condition of Labor* expresses George’s thought very clearly: “We propose leaving land in the private possession of individuals, with full liberty on their part to give, sell, or bequeath it, simply to levy on it for public purposes a tax that shall equal the annual value of the land, itself, irrespective of the use made of it or the improvements on it” (p. 9).

There is no conflict whatever between this and the position of Leo XIII. Further, I would argue that Catholic social teaching leads logically to George’s solution of the land question. This follows from the often repeated contention of Catholic authorities that property rights are relative to the good of society as a whole, with particular regard for the disadvantaged.

To quote Pope John Paul II again, in *Centesimus Annus*: “God gave the earth to the whole human race for the sustenance of all its members, without excluding or favouring anyone” (n. 31).



# Englobo 2014 – landbank profits during an alleged housing supply crisis

by David Collyer

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*Land in Australia should be dirt cheap. All levels of government must explicitly recognise outstanding access to land for all is a key national advantage that simply cannot be imitated by other countries. For state governments, close scrutiny of planning and a review of exemptions from State Land Tax are fundamental to reducing land costs.*

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Listed property developers report their land holdings to the Australian Stock Exchange, which opens a window into the murky world of ‘englobo’ landbanking. Their 2014 annual accounts show they have 272,000 lots in development, with a disclosed end value of \$81 billion.

Sharemarket-listed developers are a minority of developers. Their lot sales are around 25.7 per cent of the approximately 65,000 national residential land sales in the same period identified by the Housing Industry Association<sup>1</sup>.

Land banking – an especially damaging form of rent-seeking – is more prevalent where land supply is constrained and planning approval processes slow and uncertain. Land banking is also only profitable where the market price of land is rising faster than the cost of capital.

In Australia, land cost increases have four drivers:

- restrictive planning,
- the easy availability of credit,
- the speculative appetite of buyers, and
- taxes, notably who pays and where it is taken.

Government has an evergreen task ensuring developers cannot corner the market by confirming and reconfirming land supply is contestable – i.e. there is always the opportunity for someone further afield to compete on price and undercut. Planning constraints, like urban growth boundaries, reduce contestability and the ability of competition (or the threat of competition) to hold down prices. They effectively allow oligopolistic returns by conferring market power upon landowners.

Withholding vacant land from use displaces activity and drives up land costs – to the great advantage of all who own developable land. Central to affordable, available land is whether land owners on the fringe are allocating land to best use according to price signals; or speculating in an asset class rather like gold bullion - holding rather than selling land into use.

Land is finite. No more of it can be made. However, growing cities nip at the low-value agricultural land on their periphery and developers transform these broadacres into house parcels, building roads and installing utility connections.

But there is a dilemma: agricultural land advantaged by rezoning is immediately revalued by the market to final lot value less engineering construction cost and an allowance for interest costs on holding. Developers must straddle this intersection or become price-takers - like the homebuyers they plan to sell to.

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<sup>1</sup> <http://tinyurl.com/m2rb7ps>

Urbis2 examined the benefits in a study of properties of between five and 15 hectares around Wyndham, Victoria and found the following uplift in the price of land when re-zoned to residential from rural:

Land outside but near urban growth boundary \$50 000 – \$100 000 per hectare

Rezoned urban growth zone away from existing development \$250 000 – \$400 000

Rezoned urban growth zone next to existing development \$60 000 hectare

## Landbank Duration

As a multiple of the past year's sales, listed developers hold approximately 14.9 years supply. This is a significant reduction from 2013, where developer landbanks averaged 19.3 years.

2 <http://www.thefifthestate.com.au/articles/how-much-does-rezoning-add-to-land-value/30279>

The recent convergence of landbanks around the average 14.9 year sweet spot suggests this is where maximum landbanker returns are currently found.

Lend Lease significantly reduced its landbank from 33.3 years in June 2012 and 28.2 years in 2013 to 19.1 years supply by steadily increasing development and adding to its raw holdings with restraint. The company will no doubt argue other factors are at play, yet it is beyond question holding land against such very distant objectives is an investment without skill and a poor use of shareholders funds.

Queensland developer Sunland has significantly increased its years of supply by increasing landholdings – from 4.3 years in 2012 to 12.5 years in FY 2014

At the short end of the range, home builder AV Jennings holds 7.3 years supply, mostly for its own use.

## Listed Developer landholdings

	Lots settled	Lots in development	Disclosed end value	Average lot value	Land bank	Debt/ debt+equity <sup>1</sup>
	2014	Number	\$ millions	\$'000	Years	
Australand <sup>2</sup>	1 287	19 450	7,500	259	15.1	34.6%
Sunland	446	5 556	3,200	174	12.5	19.4%
AV Jennings	1 254	9 214			7.3	20.3%
PEET	3 491	48 187	11 300	234	13.8	41.6 %
Cedar Wood Properties		>10 151				28.9%
Mirvac	2 482	30 538			12.3	45.8%
Lend Lease	3 425	67 560	37,700	558	19.1	32.5%
Stockland	5 219	81 510	20 400	250	15.6	28.5%
<b>Totals</b>	<b>17 604</b>	<b>2 72 166</b>	<b>81 100</b>	<b>NC</b>	<b>14.9<sup>3</sup></b>	

Source: ASX Company reports

## Developer Debt

Previous land price downturns have been characterized by developer bankruptcies as banks called loans to this traditionally highly-g geared and strikingly illiquid industry. Economic history shows these downturns destroy land developers who misjudge economic trends and carry high levels of debt into land price corrections.

Australia's listed developers have significantly and painfully reduced their debt since 2007 via capital raisings and asset sales. What little they do have is likely secured on their income-producing commercial and industrial properties. Organisationally, they could easily survive a major land price correction, though shareholders equity will shrivel mightily.

## Developer sought returns

Residential development at Stockland is around 20 per cent of its activities, yet the division made an EBIT profit margin of 23.4 per cent and a return on assets (ROA) of 12.2 per cent on core portfolio development. Stockland puts their workouts on impaired assets aside, and energetically points to a FY14 ROA on core projects of 18.4 per cent. One wonders why it bothers with commercial (ROA 8.4 per cent) and retail property or retirement villages (ROA 4.5 per cent) when residential development can provide such stellar returns. Investor activists take note.

## Planning

Planners err in thinking their rationing of urban land is a 'flow control valve' whereby the pressure on price can be carefully controlled. The reality is that they have an on/off switch for a nuclear chain reaction. This is why there are no urban economies that are just "slightly unaffordable"; data sets of median multiples (median house prices over median wages) tend to cluster around 3, and then around 6, with a tail going up to 12.

The removal or modification of regulatory constraints on the supply of land, along with more permissive planning policies and infrastructure provision, would increase competition amongst both developers and land owners, and limit their ability to ration sales and sustain high prices. Higher levels of competition would also deter land banking by increasing holding risk, as another nearby owner would always have the opportunity to offer into the market ahead of the land bankers.

While developers can rightly argue they are constrained by government planning controls, in practice, this is a feature not a bug. It provides an extremely high barrier to entry, confining development activity to those with deep, patient capital and the expertise to negotiate effectively with

government - over years in some cases.

Land under restrictive planning conditions switches from being regarded as a resource to be allocated to best use by the market, to a speculative commodity where motivations become inverted; because once the prices have started rising, the incentive is to withhold it while prices rise some more.

In unconstrained markets, developers tend to just watch out for farms coming up for sale as farms, somewhere within a brief drive of the existing urban area. The turnover of farms tends to be high enough for developers to avoid door-knocking and begging land owners to sell. Instead, developers are forced by urban planning into a gladiatorial contest to outbid each other for uncommitted, zoned land.

## Shrinking Lot Sizes

One of the few matters solely in the control of developers is the rate of release, drip-feeding sections at their preferred prices. Not content with this, developers have added a new wheeze: reducing lot sizes.

The argument floated around is that somehow all home buyers have abandoned the dream of a villa on a garden and now want a townhouse on 350 m<sup>2</sup> - never mind it will be on the outskirts. In Melbourne or Sydney this could be 60 km from the CBD. Smaller lot sizes are mainly achieved by reducing the depth of lots. Yes, the developer gets more lots per hectare, but must install more roads and utilities to achieve this. The loss of the prized Australian backyard and private open space will have major future social consequences.

## Land and Buildings

Australia's residential property price bubble is a land-only bubble. Construction costs have not budged for thirty years, as the chart below makes abundantly clear.

Australians already enjoy spacious and comfortable housing. Imagine if we could back this with inexpensive land - as it was until the mid-1990's

## State Land Tax

In one of the most anti-citizen regulatory changes I have ever observed, in June 2014 former Planning Minister Matthew Guy issued a blanket exemption from State Land Tax for all land within Melbourne's Urban Growth Boundary<sup>3</sup>, even 'shovel ready' land in competed Precinct Structure Zones.

The cost of freshly subdivided land on the outskirts of cities affects the market all the way to the centre. SLT is a small but insistent charge prompting owners to put land into use. Minister Guy removed

3 <http://www.prosper.org.au/2014/06/18/no-land-for-you-melbourne/>

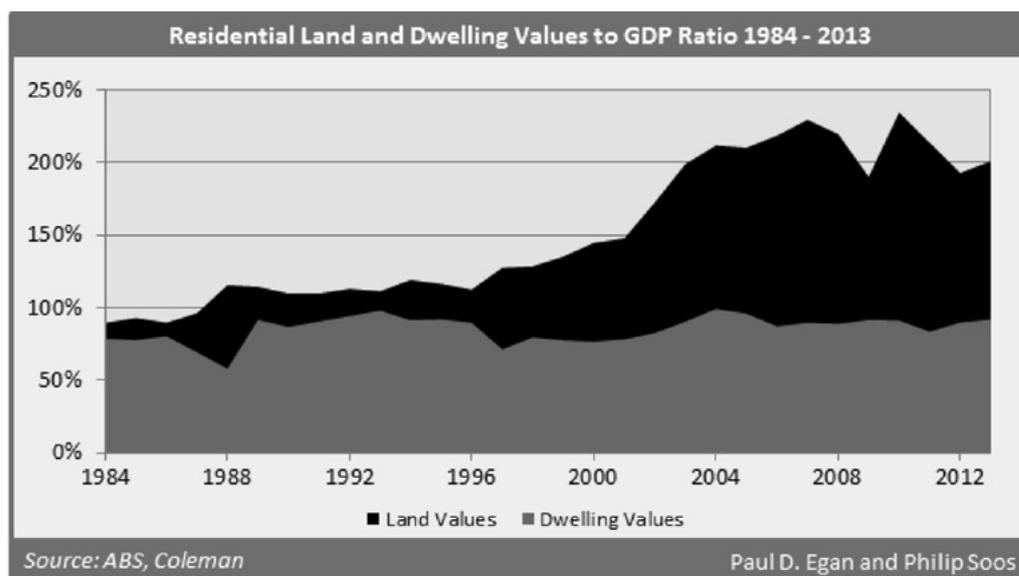
one of the few levers government has available to oblige developers to act.

Thus, The Great Australian Land Bubble goes on...

### Listed Developer Land Holdings June 2013

	Lots settled	Lots in development	Disclosed end value	Average lot value	Land bank	Debt/debt+equity[1]
	2013	Number	\$ millions	\$'000	Years	
Australand	1 788	18 900	7,600	402	10.5	43.0%
Sunland	662	5 322	3,000	563	12.4	3.3%
AV Jennings		9 952				23.4%
PEET	2 091	51 173	10,500	205	25.5	47.6 %
Mirvac	1 809	30 942			17.1	27.1%
FKP[2]	242	4 250			17.6	38.3%
Lend Lease	2 468	69 631	37,400	NC[3]	28.2	31.3%
Stockland	4 641	84 400	21,200	251	18.1	27.6%
Totals	13 701	264 618[4]	79,700	NC	19.3	

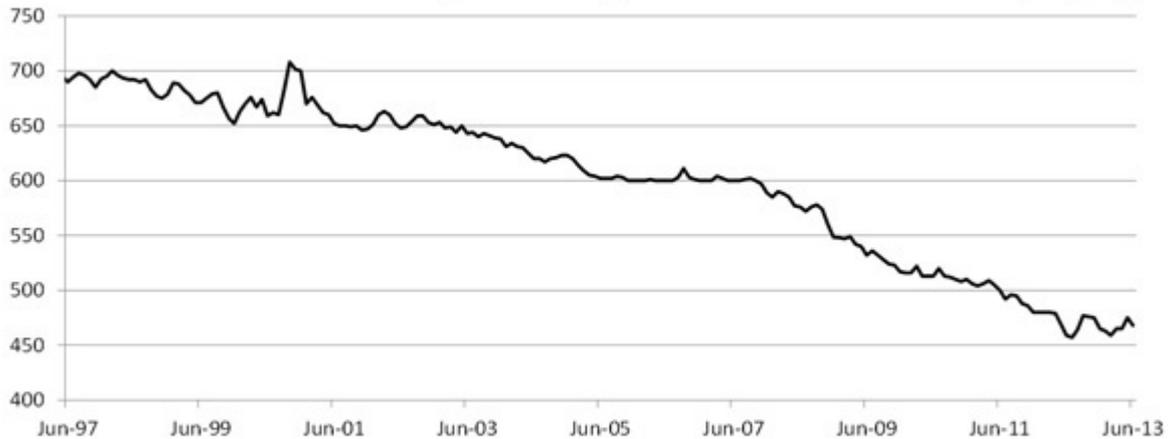
Source: ASX Company reports



## Listed Developer Land Holdings June 2012

	Lots settled	Lots in development	Disclosed end value	Average lot value	Landbank	Debt/debt+equity
	Year to 6/13	Number	\$ Billions	'000	Years	
Australand	1 108	21 300	8.0	531	19.2	40.0%
Sunland	672	2 889	1.1	380	4.3	9.0%
PEET	2 052	34 000	6.2	182	16.3	56.7%
Mirvac	1 807	29 787	10.6	356	16.5	25.9%
FKP	410	4 725	1.4	287	11.3	NC
Lend Lease	2 059	68 006	13.0	191	33.0	30.6%
Stockland	5 388	87 900	23.0	338	16.3	30.8%
Totals	13 496	248 607	63.3		Av18.4	

## Median combined capital city vacant land size (sqm)



Source: RP Data

Source: ASX Company reports

- 1 Debt calculations include derivatives liabilities
- 2 The takeover of Australand by Singapore-listed Fraser Centrepoint closed 5 September, with FCL owning 98.31% and expected to exercise compulsory acquisition rights.
- 3 Landbank by years calculation excludes CWP.



## Mikhail Gorbachev (1931 - )

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*“Natural rent must be a part of public revenue – what they don’t earn but rather what they simply receive from the nation, from nature.”*

*“Americans have a severe disease — worse than AIDS. It’s called the winner’s complex.”*

*“With Yeltsin, the Soviet Union broke apart, the country was totally mismanaged, the constitution was not respected by the regions of Russia. The army, education and health systems collapsed. People in the West quietly applauded, dancing with and around Yeltsin. I conclude therefore that we should not pay too much attention to what the West is saying.”*

*“Democracy is the wholesome and pure air without which a socialist public organization cannot live a full-blooded life.”*

If you were to ask Mikhail Gorbachev to summarise his life in less than 10 words, he couldn’t do much better than *“I rescued an empire then accidentally blew it up”*.

It’s a mighty task to encapsulate the life, achievements and failures of this pivotal 20th century figure, but here goes: he served as General Secretary of the Communist Party of the Soviet Union from 1985 until 1991, and as the first (and last) president of the Soviet Union from 1988 until its dissolution in 1991. Perhaps because he was the only general secretary in the history of the Soviet Union to have been born during the Communist rule, he made an astounding number of attempts (many unsuccessful) to reform Russia, the Soviet Union and the whole bureaucratic and political system that ran them. Along the way, he made historic peace overtures and ended the Cold War.

But Gorbachev had an even greater opportunity that is unique in the annals of history – to save Russia for the Russians. The entire lands and natural resources had not been privatized and, with the dissolution of the USSR looming, the greatest group of geoist minds ever assembled flew in to convince Gorbachev of his golden opportunity to collect the economic rent of land as the natural source of public revenue. Gorbachev had the chance but blew it big time, but let’s set this thing up.

Mikhail Sergeyeovich Gorbachev was born into a humble peasant Ukrainian–Russian family in 1931 and suffered the sort of special challenges and hardships which often mould a determined character – that is, if those hardships don't kill you first. As an infant, Gorbachev experienced the Soviet famine of 1932–1933 and recalled in a memoir that *“In that terrible year [1933] nearly half the population of my native village, Privolnoye, starved to death, including two sisters and one brother of my father.”* And the political system was just as brutal to young Gorbachev - both of his grandfathers were arrested on false charges in the 1930s and his paternal grandfather was sent to exile in Siberia.

Gorbachev was ten years old when the Nazis invaded the Soviet Union in 1941. His father was drafted into the Soviet military and Gorbachev spent four years living in a war-torn country and considered himself lucky to have survived that horrific conflict.

After the war, Gorbachev's father continued his work as a combine harvester operator with his mother also laboring in the fields. The razor-sharp young Gorbachev was an excellent student in school during the day and worked hard helping his father with the harvester after school and during the summers. At age 14, Gorbachev joined the Communist League of Youth and became an active member.

Gorbachev's restless inquisitive spirit compelled him to break free from the limitations of a rural backwater and he went for broke, applying to none other than the prestigious Moscow State University where he was accepted in 1950. He studied law as well as pursuing an interest which was to prove fateful for his stellar political career, for it was here that Gorbachev perfected his speaking and debating skills. Also at college Gorbachev met another student, Raisa Titorenko, who was to be the great love and support of his life.

He graduated in 1955 with a degree in law. While he was at the university, he joined the Communist Party of the Soviet Union and soon became very active within it. His relentless rise to the summit now began in earnest.

Crucially, Gorbachev was in the right place at the right time, attending the important twenty-second Party Congress in October 1961. Gorbachev made vital connections here and was promoted to a senior agricultural post in 1963, after which he worked hard to gain advanced tertiary qualifications in agriculture by correspondence. Important party members now recognised that his star was on the rise.



In 1970, he became one of the youngest provincial party chiefs in the nation, after which he helped reorganise the collective farms, improve workers' living conditions, expand the size of their private plots, and give them a greater voice in planning.

His achievements were now under closer scrutiny by party powerbrokers, and Gorbachev was soon made a member of the Communist Party Central Committee in 1971. Three years later, in 1974, he was made a Deputy to the Supreme Soviet of the Soviet Union and Chairman of the Standing Commission on Youth Affairs. He was subsequently appointed to the Central Committee's Secretariat for Agriculture in 1978 and in the following year was promoted to the Politburo, the highest authority in the country, receiving full membership in 1980.

What were the special qualities which catapulted someone from such an underprivileged background into the stratosphere of the Soviet hierarchy, at a time when the Soviet Union rivaled the USA for world domination?

One factor was undoubtedly the rare (within the Soviet Union) set of opportunities to travel abroad, profoundly affecting his political and social views in the future as leader of the country.

Rather than being brainwashed by ubiquitous Soviet propaganda, Gorbachev's childhood experiences had convinced him that the system needed profound restructuring. Gorbachev learned that he had to make some hard and unpopular decisions when he had the power to make them stick, such as his

restriction on the manufacture and distribution of alcohol, especially vodka.

From the early 1980s, his rise seemed unstoppable. Within three years of the deaths of Soviet leaders Leonid Brezhnev, Yuri Andropov and Konstantin Chernenko, Gorbachev was elected General Secretary by the Politburo in 1985. At the summit of the Politburo, he was its youngest member at only 54 years old in an institution that had been dominated by old military men.

Strongly believing that the Soviet Union needed massive liberalization in order to revitalize both the Soviet economy and society, Gorbachev immediately began implementing reforms and paved the way by getting rid of the worst of the Old Guard.

He initiated his new policy of *perestroika* (literally 'restructuring') and its attendant radical reforms in 1986 in an attempt to overcome the economic stagnation by creating a dependable and effective mechanism for accelerating economic and social progress. According to Gorbachev, *perestroika* was the "conference of development of democracy, socialist self-government, encouragement of initiative and creative endeavor, improved order and discipline, more *glasnost* (freedom), criticism and self-criticism in all spheres of our society. It is utmost respect for the individual and consideration for personal dignity." Nice idea, Gorby, but it never took off as intended.

Gorbachev's other big idea was the aforementioned *glasnost* in 1988, which gave new freedoms to the Soviet people, including greater freedom of speech. This was a radical change, as control of speech and suppression of government criticism had previously been a central part of the Soviet system.

Let's cut to the chase – how much geoist insight did Gorbachev possess? Well, although he's got the geoist gig in our journal, it must be said that he never really 'saw the cat', despite a few select quotations that might indicate otherwise.

He was, it should be said, prepared to make a few hard economic decisions. His primary goal as General Secretary was to revive the Soviet economy after the stagnant Brezhnev years. In 1985 he announced that the Soviet economy was stalled and that reorganization was needed, but it lacked geoist vision and was long on motherhood statements about technological solutions but short on actual economic reform. The Law on Cooperatives, enacted in 1988, was perhaps the most radical of the economic reforms during the early part of the

Gorbachev era. For the first time since Lenin's day, the law permitted private ownership of businesses in the services, manufacturing, and foreign-trade sectors.

Amongst all the other uncoordinated political and bureaucratic reforms set in motion, chaos took hold and the economic policy of Gorbachev's government gradually brought the country close to disaster. By the end of the 1980s, severe shortages of basic food supplies led to the reintroduction of the war-time system of distribution using food cards that limited each citizen to a certain amount of product per month.

Gorbachev had introduced policies with the intention of establishing a limited market economy by encouraging the private ownership of some areas of Soviet industry and agriculture. However, the still-cumbersome Soviet authoritarian structures ensured these reforms were ineffective and the shortages of goods available in shops grew worse. The goal of *perestroika*, however, was not so much to end the command economy but rather to make socialism work more efficiently to better meet the needs of Soviet consumers. The elimination of central control over production decisions, especially in the consumer goods sector, led to the breakdown in traditional supply-demand relationships without contributing to the formation of new ones. Thus, instead of streamlining the system, Gorbachev's decentralization caused new production bottlenecks.

Dark clouds were forming on Russia's horizons as *glasnost* hastened awareness of the national



sovereignty problem. The free flow of information had been so completely suppressed for so long in the Soviet Union that many of the ruling class had all but forgotten that the Soviet Union was an empire conquered through military force and consolidated by the persecution of millions of people, and not a union voluntarily entered into by local populations.

Gorbachev played an active part in these uprisings, although nobody predicted how rapidly they'd explode out of control. Throughout 1989 he had seized every opportunity to voice his support for reformist communists in the Soviet-bloc countries of Eastern Europe and, when communist regimes in those countries collapsed like dominoes late that year, Gorbachev tacitly acquiesced in their fall. As democratically elected, noncommunist governments came to power in East Germany, Poland, Hungary, and Czechoslovakia in late 1989–90, Gorbachev agreed to the phased withdrawal of Soviet troops from those countries.

But amidst this rush of events and upheavals that were becoming chaotic, Gorbachev wasn't watching his back. The Communist hard-liners who had replaced reformers in the government proved undependable allies, and Gorbachev and his family were briefly held under house arrest from August 19 to 21, 1991, during a short-lived coup by the hard-liners. After the coup foundered in the face of staunch resistance by Russian President Boris Yeltsin and other reformers who had risen to power under the democratic reforms, Gorbachev resumed his duties as Soviet president, but his position had by now been irretrievably weakened.

The coup was the end politically for Gorbachev. On 24 August 1991, he advised the Central Committee to dissolve, resigned as General Secretary and disbanded all party units within the government. Shortly afterward, the Supreme Soviet suspended all Party activities on Soviet territory. In effect, Communist rule in the Soviet Union had ended — thus eliminating the only unifying force left in the country.

Entering into an unavoidable alliance with the man holding all the cards, Yeltsin, Gorbachev supported measures to strip the party of its control over the KGB and the armed forces. On Dec. 25, 1991, Gorbachev resigned the presidency of the Soviet Union, which ceased to exist that same day.

As if Gorbachev's life wasn't already that of a tragic Shakespearean character, there was another whole dimension to this saga, and here we must examine Gorbachev's economic understanding, or lack of. Economics, besides a bit of market reform, was

never his focus but when the Soviet Union was collapsing he was the target of the most concerted education attempt by leading geoists in history. This is because Russia was in the unique position of not having privatized its land and natural resources and so reforms could be immeasurably more easily implemented. And if given this chance, Russia's subsequent economic progress could be a shining model for the world.

And so, on the initiative of economist Nicolaus Tideman (leading American geoist who visited Oz a few years ago), 30 prominent economists signed a letter dated November 7, 1990, advising Gorbachev to capture land rent to smooth the transition to a market economy. All but two of the signers were Ph.D. economists and many of them extremely prominent. Three of the signers, Franco Modigliani, Robert Solow and James Tobin (of Tobin Tax fame), had been awarded the Nobel Prize in Economics. One other signer, William Vickrey (noted geoist), was subsequently awarded that prize. Other signatories included leading American geoists Mason Gaffney, Lowell Harriss and Ted Gwartney.

Here are a few choice quotes from this brilliant open letter:

*"But there is a danger that you will adopt features of our economies that keep us from being as prosperous as we might be. In particular, there is a danger that you may follow us in allowing most of the rent of land to be collected privately.*

*It is important that the rent of land be retained as a source of government revenue. While the governments of developed nations with market economies collect some of the rent of land in taxes, they do not collect nearly as much as they could, and they therefore make unnecessarily great use of taxes that impede their economies - taxes on such things as incomes, sales and the value of capital.*

*All citizens have equal claims on the component of land value that arises from nature.*

*A public revenue system should strive to collect as much of the rent of land as possible, allocating the part of rent derived from nature to all citizens equally, and the part derived from public services to the governmental units that provide those services.*

*A balance should be kept between allowing the managers of property to retain value derived from their own efforts to maintain and improve property, and securing for public use the naturally inherent and socially created value of land."*

Yet this A-team of geoists who did their best to lobby Gorbachev's economic advisors were overwhelmed by a massively-bankrolled neoclassical push from Western interests to privatize Russia's natural resources, including land. Gorbachev didn't so much act, but failed to act in the short time he had before his downfall. After this, Boris Yeltsin presided over perhaps the biggest giveaway of natural resources in the world's history – the monumental disaster that is Russia today is the direct outcome of neoclassical economics prevailing.

Let's extend some understanding and forgiveness towards a man who basically meant well – no-one could deny that he was distracted by cataclysmic events. Perhaps he will be remembered for another set of achievements that is undeniably magnificent. Mikhail Gorbachev brought much peace to a world badly in need of it.

In contrast to his controversial domestic reforms, Gorbachev was largely hailed in the West for his 'new thinking' in foreign affairs. During his tenure, he sought to improve relations and trade with the West by reducing Cold War tensions. He established close relationships with several Western leaders, such as Helmut Kohl, Ronald Reagan, and Margaret Thatcher who famously remarked, "I like Mr. Gorbachev; we can do business together."

In 1985 that Gorbachev announced the suspension of the deployment of SS-20s missiles in Europe as a move towards resolving intermediate-range nuclear weapons issues. Later that year he proposed that the Soviets and Americans both cut their nuclear arsenals in half. The next year Gorbachev made his boldest international move so far, when he announced his proposal for the elimination of intermediate-range nuclear weapons in Europe and his strategy for eliminating all nuclear weapons by the year 2000.

But it was in 1989 that one of the defining moments of the 20th century occurred, when East Germans were suddenly allowed to cross through the Berlin Wall into West Berlin, following a peaceful protest against the country's dictatorial administration.

Rather than resorting to the usual Russian military crackdown, Gorbachev stated that German reunification was an internal German matter.

In recognition of his outstanding services as a great reformer and world political leader, who greatly contributed in changing for the better the very nature of world development, Gorbachev was awarded the Nobel Peace Prize in October 1990.

Gorbachev's subsequent years have been a complete anti-climax – perhaps even sad and a bit pathetic. After his resignation and the dissolution of the Soviet Union, Gorbachev did try to remain active in Russian politics but all attempts were flops. During the early years of the post-Soviet era, he expressed criticism at the reforms carried out by Russian president Boris Yeltsin – as well might anyone witnessing the great fire sale of Russian natural resources!

Following a failed run for the presidency in 1996, Gorbachev established the Social Democratic Party of Russia, a union between several Russian social democratic parties but resigned as party leader in 2004 after internal bickering. In any case, it was a dud party that was shunned by a nationalistic Russia yearning for its empire back. Gorbachev subsequently tried and failed to get 2 other parties off the ground, but he should have seen that he'd run his political race and it was time to do the retired statesman act.

Gorbachev, our little journal salutes you as a world leader who made important political reforms, even if they spiraled out of control. But that letter, Gorby, that letter!? Did that powerful geoist letter giving you the keys to Russian prosperity ever get plonked on your desk? I suspect that some evil neoclassical villain gave orders that the letter be intercepted and destroyed, and that this villain at this very moment is sitting in a darkened room slowly stroking a white cat.

*Next issue: Australian jurist, royal commissioner, historian and legal scholar, Rae Else-Mitchell*

# Land tax is simple and equitable

by Alex Schez

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Australians love their property. Whether it be their own place of residence or whether it be their nest egg investment place, Australians love to buy and accumulate property.

You don't have to look too far to see how the property obsession leaches into our culture. No dinner party anywhere can take place without someone interrupting the discussion with a synopsis of property prices and just how much the local gaffe in their neighbourhood went for. And our love of property has even reached into our dramatic heritage with contemporary Australian playwrights such as David Williamson filling his boots on the cultural psychosis of middle Australia's quest for that all important best house in the best street (or by the water if you're in Sydney).

For all that though, Australians do still spare a thought for housing affordability. Such thoughts may be short lived but we care nevertheless. As prices continue to rise for housing in our major cities, concerns manifest and policy solutions are raised. Will our children or grandchildren ever afford to own their own home?

Regrettably, you can't feel but a double standard when you listen to such complaints. After all, one person's exclusion from the market is another person's capital gain – but this observation has never seemed to feature widely. So it's no surprise that we look elsewhere for change. From removing or capping negative gearing, through to so called macro prudential measures on loan to value ratios and now even foreign investment restraints, all have been proposed to assist affordability. Add to these the recent policy ideas on accessing superannuation for housing or paying off stamp duty by instalments, all have been aired of late. But there amongst this menu, one measure is clearly missing that actually address affordability at its source – a broad based land tax.

The time has come for policy makers to go further

than in the past and actively look at measures that adjust the price of property assets and land values more broadly. This is where a broad based land tax comes into the fore. Land is perfectly inelastic – fixed in supply and completely immobile. (You can't move your land to a low taxed nation for example). This makes it a perfect candidate for taxation on efficiency grounds. A tax on land is borne by the asset holder – making the cost of land more affordable for the remainder. And given those with the most land (or the more expensive land) pay more tax, land tax is highly progressive and equitable. As the Australian Bureau of Statistics highlights, inequality in Australia is wider when taking into account assets and net worth than when taking into account income alone. A third of all wealth in the highest income quintiles is tied up in property compared to less than 20% for those on the lowest income quintiles. If you want a tax that doesn't distort incentives and targets the wealthy, then land tax should be clearly on the agenda.

Internationally the push for broader land taxes is gathering steam. The International Monetary Fund has called for governments to consider land taxes as an equitable and efficient form of taxation. The IMF has fallen clearly on the side that suggests that land taxes are efficient and equitable because their base is immobile and because their incidence is borne by capital and landowners. The Henry Tax Review also called on decision makers, particularly in the States, to examine expanding land taxes as a means of funding their spending commitments as populations age.

Regrettably though, politicians shy away from broad based land taxes in fear of scare campaigns. We can all recall the former Treasurer, Wayne Swan, ruling out the GST before the Henry Tax Review commenced but we forget that Mr Swan also quickly ruled out any effort on a land tax. The irony and contradiction of Mr Swan aggressively pursuing a resource rent tax but ignoring taxing the rents

from property owners was apparently lost on many economic commentators. At the end of the day, whether you get a windfall from a one off spike in commodity prices or you get a windfall on your property from a new piece of urban infrastructure, you are securing an economic rent. If you reside outside the major centres, nothing can be more galling than seeing property holders in Sydney's inner and eastern suburbs get windfalls in their property prices from investments in government provided infrastructure. All taxpayers bear the cost of these projects from general revenue, but all the upside is provided to those lucky (or should I say wealthy) enough to live adjacent to the new links. Some of these gains can and should be legitimately clawed back by government.

The potential for a scare campaign on a land tax for the family home is obvious. Who, for example, can forget Malcolm Fraser's efforts to handcuff Labor to a potential capital gains tax on the family home. And the plethora of exemptions and carve outs to existing State land tax arrangements are a testament that politicians have little stomach for extending land taxes to as broader base as possible, including the family home.

But yet, despite all the potential for hysteria, all Australians pay a land tax, they just call it a local government rate. Local councils have well established procedures to manage fairness and to deal with income poor households, allowing landowners to pay the tax by way of a liability on the future sale of the property. These arrangements can be easily applied if land tax arrangements were broadened beyond local government.

However, a prerequisite for the introduction of a land tax must be the removal of stamp duties

on property transfers or conveyances. To remove stamp duties on property and to replace them with an increase in tax other than a land tax would only provide a windfall to potential vendors, who would look to accumulate some or all of the stamp duty relief in their selling price. Similarly, applying a land tax and maintenance of stamp duties on property would be hitting potential purchasers twice.

Of all the taxes in the Australian taxation hierarchy, it is surprising that stamp duties are not seen for the pernicious tax they are. State governments get away with stamp duties because as any property buyer well knows, the pleasure from the purchase effectively camouflages the stamp duty hit. (Behavioural economists call this optimism bias or the valance effect). The States have an over reliance on property stamp duty taxes and when the property market is booming with trades, they enjoy budgetary windfalls. Like Federal company tax revenue during times of commodity price booms, such windfalls can mask a thousand sins. Surprisingly, the Murray review of Australia's Financial System did not consider the extent to which debt arising from stamp duty impositions beared down on the stability of the banking sector by loading up households with more debt than they would accrue in the absence of them.

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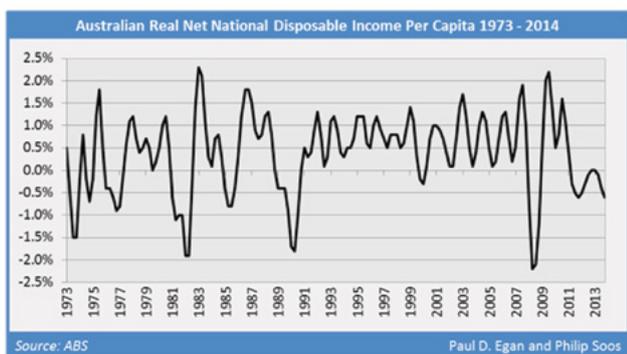
*Alex holds a Master of Economics degree and has lived all his life in southwest Sydney. He is a regular commentator on urban planning and transport issues, particularly as they impact on the outer suburbs of Sydney.*

# Real Incomes, Real Debt *by Philip Soos*

Real GDP is typically used as the proxy for economic growth, but real net national disposable income per capita (RNNDIPC) is a better measure as the Australian Bureau of Statistics notes:

Real net national disposable income is a key measure of Australia's economic wellbeing. It adjusts gross domestic product (GDP) for income flows between Australia and overseas, for changes in the relative prices of our exports and imports (the terms of trade) and for depreciation of fixed capital used in the production process, as these influences can increase or decrease the capacity of Australia and Australians to buy goods and services.

According to the quarterly data, Australia had experienced either zero or negative growth since Q1 2012. As commodity prices continue to plunge due to the worldwide surge in production, the terms of trade has fallen significantly, indicating RNNDIPC should remain negative in the future.

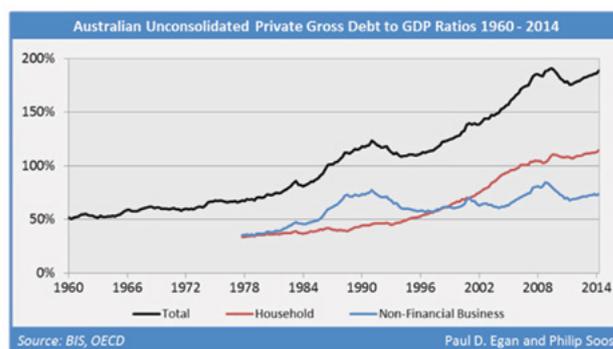


A major driver of economic growth is the acceleration of private debt. The exponential increase of household debt over the last two decades has boosted the economy, resulting in an extreme private debt burden. The Bank of International Settlements records unconsolidated household and non-financial business debts.

We know from the RBA the vast majority of household debt is mortgage debt, with a small remainder of personal debt. The latter is steadily decreasing in absolute terms and hence relative to the size of the economy since the Global Financial Crisis, but this unfortunately only makes more room for an increase in mortgage debt.

While Australia's non-financial business debt is quite low relative compared to other wealthy and rapidly developing nations (the OECD and BRIC), household debt is the real killer. As of Q2 2014, Australia is ranked fourth-highest, 0.3% behind third placed Netherlands, and we should pass them in the next quarter (Q3 2014).

Both Denmark and the Netherlands have been deleveraging since their housing bubbles burst during the GFC, but the fall in their nominal GDP actually keeps their ratios high (akin to Irving Fisher's debt deflation paradox). Switzerland, in second place, is continuing to leverage given their negative nominal cash rate of -0.75 per cent and housing bubble.



The Australian government has hoped the mining boom and FIRE (finance, insurance and real estate) sector would help grow the economy for the next couple of decades, while neglecting almost everything else. But the capital expansion phase of the mining boom has now passed, with falling commodity prices threatening the insolvency of the mining companies.

There is almost nothing left that is productive and large enough to fill the gap left by the end of the debt-financed housing bubble and mining investment boom. The economy is in a technical income recession, with negative real wage growth, increasing unemployment and underemployment and falling national income. A housing oversupply has damped rents to the point where they are falling in real terms.

Australia had the opportunity to invest in productive enterprise and engage in authentic tax reform, but the lack of genuine political and economic democracy has resulted in an economy that is steadily more inefficient and inequitable. The wealthiest 1% has feasted on a banquet of unearned economic rents, ensuring we will follow the path of the Eurozone and United States.

