



PREMIER John Howard took a gamble when he threatened to make Australians pay a new tax - and then invited them to vote for him on October 3. The gamble paid off. Although his Conservative coalition lost seats, Howard was returned to power with a working majority and a mandate to introduce a goods and services tax (GST).

The Australian government served notice of its plans when it published *Tax Reform: Not a new Tax: A New Tax System* in August. The GST was hailed as a radical restructuring of taxation, with the promise to reduce income taxes.

In fact, Howard's fiscal philosophy is rooted in conventional thinking. Taxation invites payers to avoid payments.

Howard's plans are likely to cause grief in Australia. But that is not how he sees it, according to his report which offers majestic claims: "The tax reform which is necessary for Australia... is not reform narrowly focussed on establishing a new tax, but reform which delivers a new tax system: a system which is built on a lower tax burden and which is fairer, more internationally competitive, more effective, and less complex". The consumption tax would appeal to "the sense of equity and fairness that has always been part of the Australian way".¹ Can Howard deliver?

THE ONE policy which Australia could have elevated into a radical plan is based on revenue from land.

Australia is one of the former British colonies which adopted land taxation as an important revenue raiser at the beginning of the century. If this policy had been applied

Howard's Way to Taxation

consistently the outcome for the Australian economy - persistent booms and slumps throughout the 20th century - would have been different. Economists are consistent in concluding that a public charge on the rent of land would not distort people's economic behaviour.

This is how the analysis is presented in one Australian textbook: "Who ultimately pays taxes on the value of land? If the same tax rate is applied to land in all uses, the relative profitability of different uses will be unaffected, and thus a landlord will not be tempted to change the allocation of his land. Land will not be forced out of use, because land that is very unprofitable will command little rent and so pay little tax. Thus there will be no change in the supply of goods that are produced with the aid of land, and, since there is no change in supply, there can be no change in prices. The tax cannot be passed to the consumers. Farmers will be willing to pay exactly as much as they would have offered previously for the use of land. The prices of agricultural goods and the prices paid by tenants for land will be unchanged, and the whole of the tax will be borne by the landlord. The incomes earned by landlords will fall by the full amount of the tax, and land values will fall correspondingly (because land is now a less attractive investment relative to, say, bonds than it was previously)."²

Australian history provides sufficient empirical evidence to demonstrate the economic and ethical benefits of land rents as a

source of public revenue.³ Unfortunately, Howard's plan makes no provision for upgrading the land tax which is employed by many Australian municipalities, even though he admitted in the *Australian Financial Review* (10 12 91): "I do not deny that all taxes - with the exception of those on economic rent and inherited wealth - have some employment and economic growth effects." But there is no indication in the government's report that it understands the distinctive character of charges on rental income. It lumps the land tax along with the payroll tax into a single paragraph with no proposal to elevate it into its reform strategy.

HOWARD returned to power with the benefit of good economic news, but it won't last according to Bryan Kavanagh, Director of Westlink Property Consultants and Research Director of the Melbourne-based Land Values Research Group.

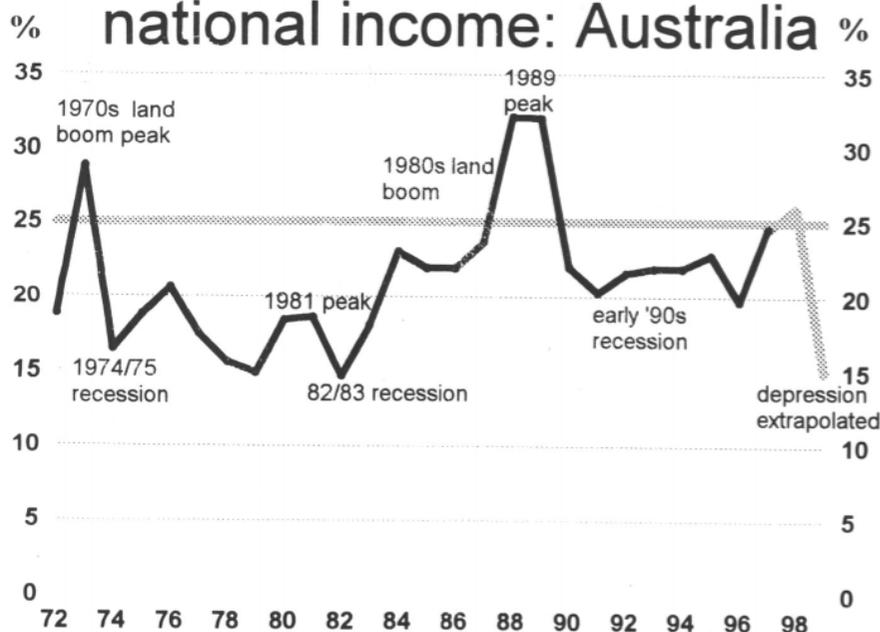
The June quarter growth in GDP was a healthy 3.9%. Unemployment was declining. But the statistics continued to disguise the underlying realities, helped by theoretical bias against some of the variables that matter. For example, in October the Consumer Price Index (CPI) data was the first in a new series to exclude mortgage interest and consumer credit charges. This change was presented as a bid to widen the index. Policy will be shaped by the headline CPI rate rather than the underlying rate. So as the asset value of land in the future begins to rocket and consumers overstretch their borrowing capacity to fuel a new spending spree, the signals that the economy is heading for a land market-driven boom will be muted until it is too late.

It looks as though Howard has scraped back into power just in time. Because according to Kavanagh the land market is heading for a peak. In Melbourne, inner city residential property values increased by 30-40% over the past year. In Sydney, property prices "have gone wild". It won't last, and downturns in land values always presage an economic recession. The graph (left) shows real estate peaks in 1973, 1981, 1989 and 1998. Explains Kavanagh: "Putting them into the context of the 54-year Kondratiev long wave, 1973 was at the peak whereas the massive 1989 peak was well into the downward wave of the cycle. Australia is heading for a severe depression, and Howard's tax reforms will deepen the trough as people cut back on spending to try and avoid the GST".

References

- ¹ *Tax Reform: The Howard Government's Plan for a New Tax System*, Canberra: Commonwealth of Australia, 1998.
- ² R. Lipsey, P. Langley & D. Mahoney, *Positive Economics for Australian Students*, London: George Weidenfield & Nicholson, 2nd ed., 1986, p.393.
- ³ R. V. Andelson, *Land-Value Taxation around the World*, 2nd edn., New York: Robert Schalkenbach Foundation, Ch. 21.

Ratio of real estate prices to national income: Australia



Source: Land Values Research Group 1998