AFTS Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600 12 October 2008

This private submission to the review of Australia's taxation system has implications for the current financial collapse, insofar as it offers a quick exit strategy.

The AFTS document *Architecture of Australia's Tax and Transfer System* provides a correct formula at '*Appendix B: What are the potential tax bases?*'

(1) $Y_t = rR_t + wL_t + iK_t$

That is, all revenues ultimately fall on returns to the three factors of production; land (R), labour (L) or capital (K). The respective factor incomes rent (r), wages (w) and interest (i) when added for a given time period (t) make up the nation's income (Y).

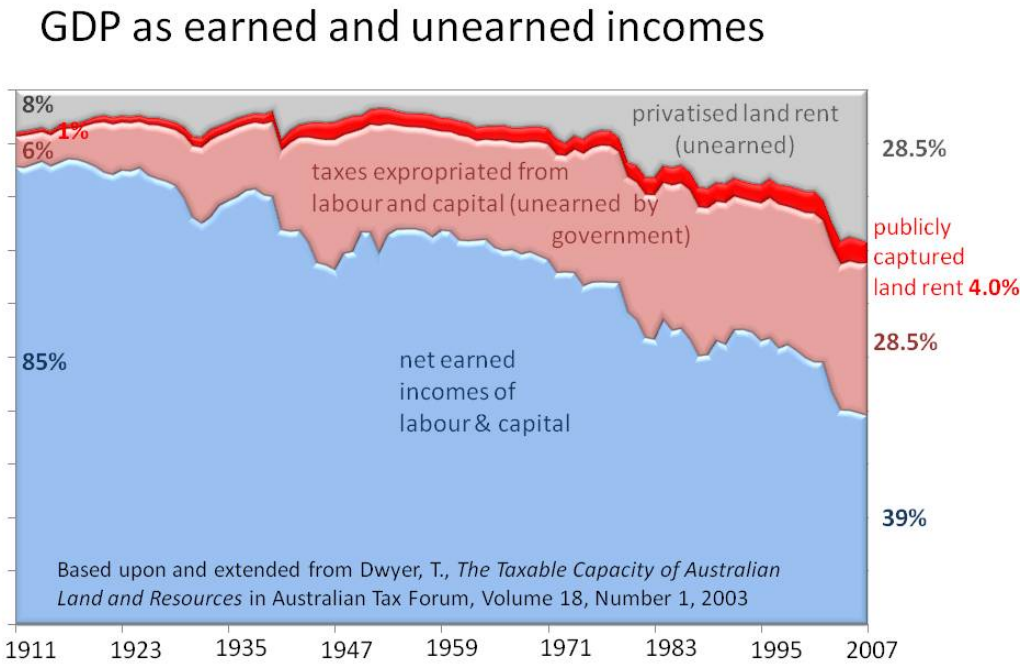
However, the analysis of the three basic factor incomes that can be sourced for revenue then proceeds to get lost in the algebra. The waters are also muddied by the introduction of the terms 'income taxes' and 'consumption taxes'. Income and consumption taxes, of course, may be applied to any or all of the three factor incomes! Thereby, the analysis fails to make the most obvious point which we take up here:

(2) $Y_t - rR_t = wL_t + iK_t$

Or, national income minus rent (a community surplus generated by the mere existence of population and public infrastructure), leaves labour's wages and capital's income altogether untouched by taxation!

As Australia's GDP for 2007 was approximately $1 trillion in 2007, the following chart showing the break-up of its GDP since 1911 may be used to demonstrate that we captured only $40 billion of our 'unearned' $325 billion in publicly-generated land rent by way of rates, land taxes and stamp duties on conveyances in 2007. (ABS Catalogue 5506.0) This meant that it was necessary to tax the earned wages of labour and the earned interest of capital to the tune of $285 billion in order to derive Australia's gross revenue of $325 billion. This had grave ramifications.

Australian companies and individuals behave logically. As wages and interest were taxed heavily, they increasingly directed their attention to rent-seeking in real estate - because that is what the Australian tax regime encouraged them to do. Accordingly, since 1999 land rents have been capitalised into the kind of enormous bubble in real estate prices that has historically heralded economic recession and depression.

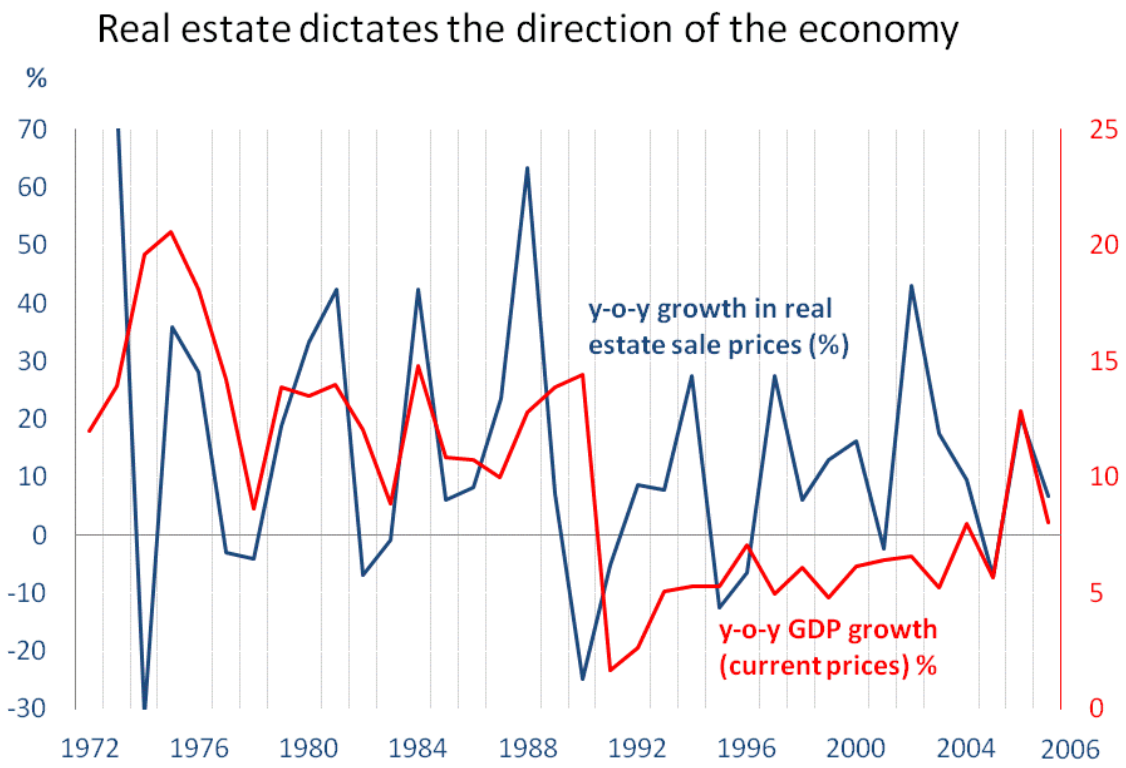


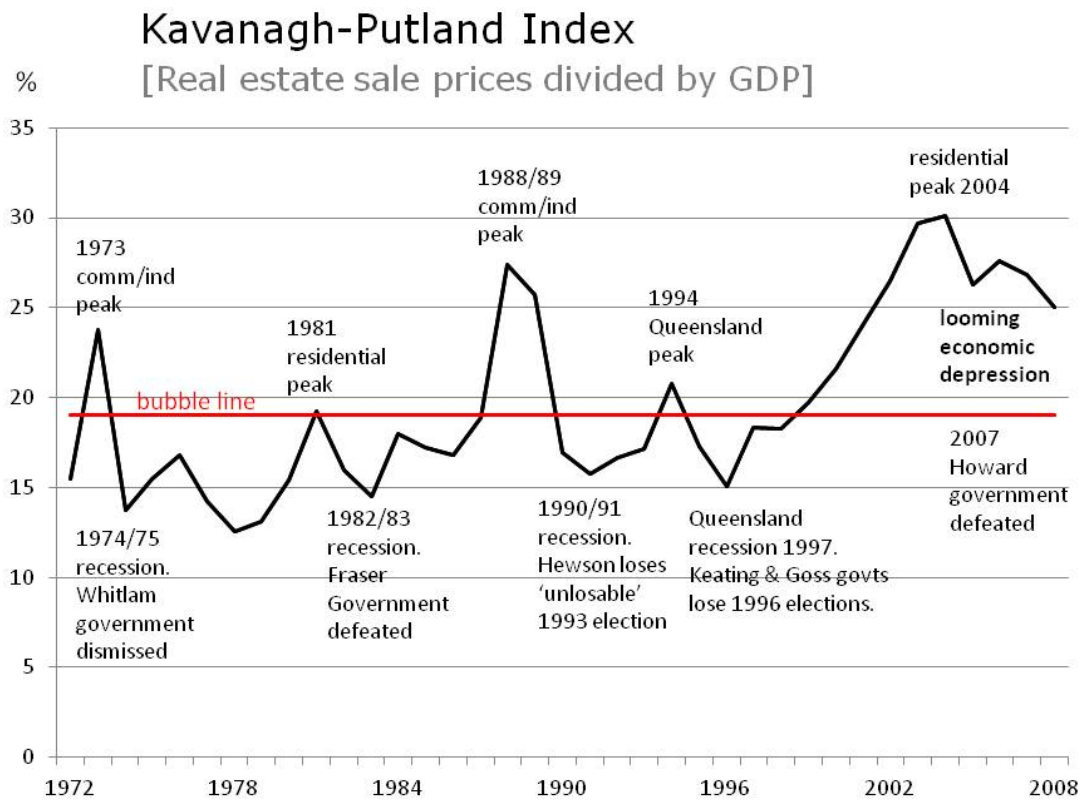

The growth in Australia's land rent can be seen to have increased substantially in the 1970s and 1980s, following the Whitlam government's decision in the early 1970s to fund a major part of local government, and the abolition of state and federal death duties at the end of the 1970s.

The chart demonstrates that the 'take home' pay of labour and capital has declined to 39.0% of GDP. Although this is supplemented by a share of publicly-created land rents, the fact that the wealthy own more real estate and the most valuable real estate - whilst the poor own none, and the lower middle class relatively little - assists to explain the complicity of a failing tax regime in aiding and abetting Australia's widening poverty gap.

The two charts on the following page attest to the rationale of this submission: that the tax system is directly responsible for encouraging the land price bubble which is poised to burst in Australia, as have the residential real estate bubbles in the US and across much of Europe. The first chart demonstrates that the much smaller real estate market nevertheless sets the course of the economy. The second chart divides Australia's total real estate sales prices by its GDP, to provide an index, not only quantifying and defining real estate bubbles, but also forecasting political outcomes and the direction of the economy. I trust this submission assists the AFTS review panel to understand that greater capture of Australia's annual land values and a concomitant reduction in job-destroying taxation is urgently required if we are to reverse the process described herein, and to recover quickly from the current turmoil on world financial markets.

Bryan Kavanagh


Real estate dictates the direction of the economy
%
70
60
50
40
30
20
10
0
-10
-20
-30
25
20
15
10
5
0
y-o-y growth in real estate sale prices (%)
y-o-y GDP growth (current prices) %
1972
1976
1980
1984
1988
1992
1996
2000
2004
2006


Kavanagh-Putland Index
[Real estate sale prices divided by GDP]
%
35
30
25
20
15
10
5
0
1973 comm/ind peak
1974/75 recession. Whitlam government dismissed
1981 residential peak
1982/83 recession. Fraser Government defeated
1988/89 comm/ind peak
1990/91 recession. Hewson loses 'unlosable' 1993 election
1994 Queensland peak
Queensland recession 1997. Keating & Goss govts lose 1996 elections.
residential peak 2004
looming economic depression
2007 Howard government defeated
bubble line
1972
1978
1984
1990
1996
2002
2008