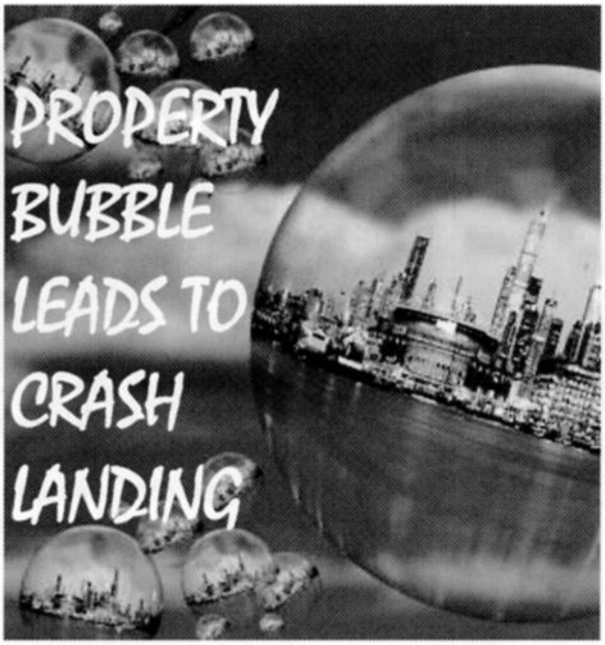


Melbourne geoist ***Bryan Kavanagh****, director of the Land Values Research Group, had this terrific analysis prominently printed in The Age on March 28, after which our website hits sharply spiked. Onya, Bryan.*

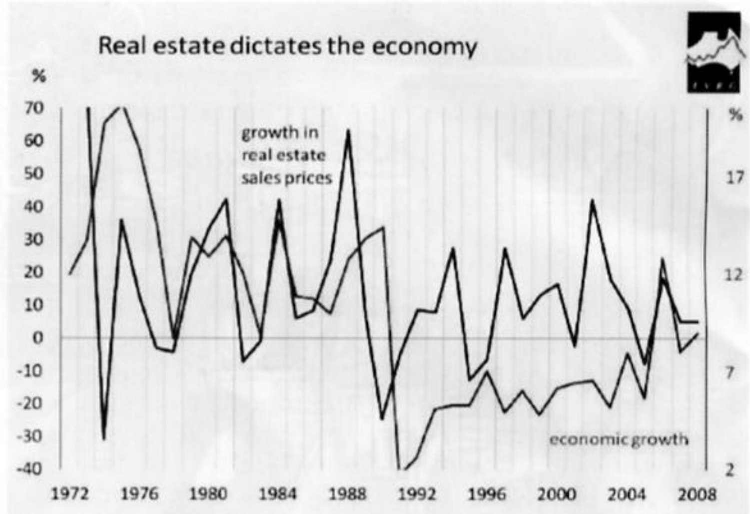
When it mattered, the US Federal Reserve, US banks and rating agencies failed the risk management test - in much the same way that Australia is now failing it.

There is a reason for this. None of these bodies comprehends the manner in which the real estate market *leads* and *directs* the economy. Many financial considerations flow from this, because businesses and individuals borrow against the escalating value of their property assets. So, when real estate bubbles burst and banks and mortgagors are left exposed, analysts flounder with such patently forlorn hogwash as "*business cycles and recessions are a natural part of the financial landscape*." Another popular knee-jerk reaction to systemic failure is simply to blame banks and borrowers. It seems anything will do, rather than tackle the fundamental flaw in risk management.

Here is an unyielding truth. A country cannot go into recession unless a real estate bubble has preceded it

The failure of derivatives will compound upcoming financial threat

Here is an unyielding truth. A country cannot go into recession unless a real estate bubble has preceded it. The great US land economist Homer Hoyt documented the fact back to the beginning of the 19th century. The Land Values Research Group (LVRG) recently defined and studied the effects of property bubbles in "*Unlocking the Riches of Oz: A Case Study of the Social and Economic Costs of Real Estate Bubbles 1972 to 2006*", which is freely available at www.lvrg.org.au. It concludes that the debt in the current residential bubble has hyper-inflated since 1999, and is about to come home to roost, despite sophisticated financial derivatives, hedge funds, collateralized debt obligations, credit default swaps, purportedly brought into existence to 'insure' that it cannot. The failure of derivatives will compound upcoming financial threat.



It is sobering, too, to note that the relative scale of our real estate bubble is considerably greater than that in the US. It is therefore irresponsible and incorrect to blame potential recession in Australia on some sort of spiritual emanations from US sub-prime mortgage lending. The truth is that we have an enormous debt bubble of our very own making and suffer the same vast hole in credit management which has again been exposed in the US. This will resolve itself with extreme prejudice to Australian society and requires immediate attention.

We may only solve the problem by shifting taxes off "goods", such as earning incomes, onto "bads", such as real estate speculation and rapidly escalating land prices. This, rather than the RBA continually ratcheting up interest rates, may actually get to grips with underlying inflation and the enormous folly of accepting bubble-inflated land prices as 'security' for loans.

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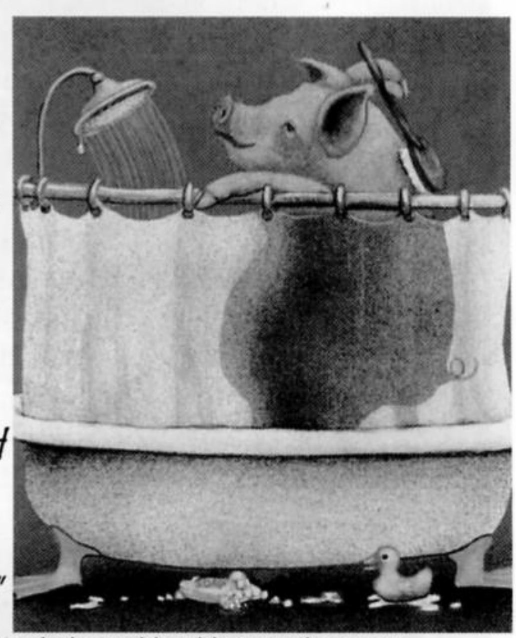
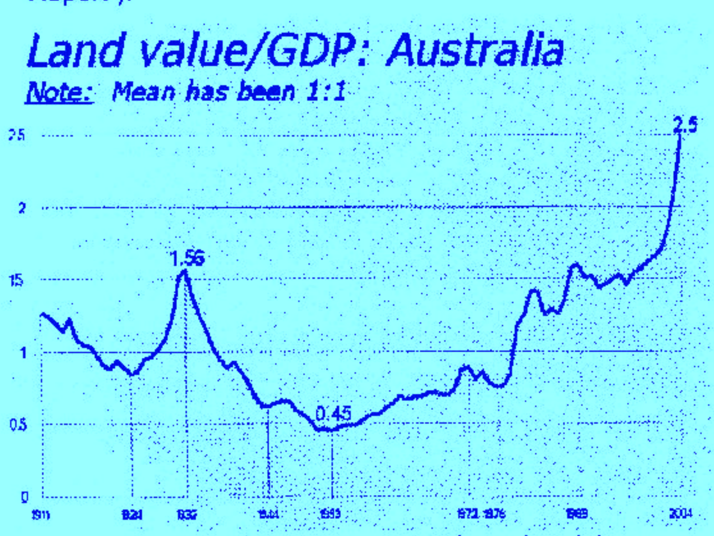


Although it has varied considerably over the years since 1911, the relationship between Australia's total land values and GDP has averaged one to one. Although it got to 1.56 in the 1930s depression, it now stands at a menacing 2.5 and a 'correction' is now inevitable. This mirrors situations around much of the western world, except France, which doesn't put real estate speculation on an untouchable pedestal as we have been inclined to do.

It is therefore irresponsible and incorrect to blame potential recession in Australia on some sort of spiritual e[illegible]ns from US sub-prime mortgage lending

When viewed in this manner as a long term analysis against rising GDP, it can be seen that land price bubbles are neither merely the result of population growth nor the under-supply of residential allotments, as argued on this page (March 13) by Alan Moran of the Institute of Public Affairs. Incredible numbers of existing vacant lots and underutilised sites would spill out into a *genuine* real market if we were to redress the imbalance between taxes on productivity and the puny levels of rates and taxes on socially-generated land values that fail to deter speculative land banking.

What form should the 'tax shift' take? First, we have to turn a deaf ear the ever-insistent call from self-interested property groups for greater tax incentives, or for council rates and State land taxes to be reduced to a mere revenue appendage, "*so that we my continue to provide housing for all Australians*". Rather, to encourage new housing construction and real wealth creation, we need to do precisely the opposite, by removing unproductive payroll taxes, stamp duties and up front development charges, and recouping these revenues through State land tax systems. At the same time, we should seize the opportunity to reform State land taxes, removing their curious exemptions, thresholds, multiple rates and aggregation provisions, along the lines thoughtfully proposed in Victoria's 2001 '*Review of State Business Taxes*' ("The Harvey Report").



Arguably, the best option would be to hand the governance of reformed State land taxes to the RBA as a tool to complement interest rate policy. A single rate land tax would apply Australia-wide to all privately-owned land, the revenue therefrom being delivered back to the States and Territories *in direct proportion* to the land values that raised it. By these means, it might be possible gradually to phase out more than rates, land tax and development charges from the 156 taxes recently condemned by the Business Council of Australia. Although a side effect would be to make housing more accessible and affordable for all Australians, the main thrust would be to reduce the *private capture* of *publicly-generated* land values. This would finally close the loophole in credit management through which truckloads of new financial 'products' have erratically been driven. By eliminating land price bubbles, it would no longer be possible to offer bubble-inflated assets as 'security' for loans.

If their children are unable to assist them, peo who are asset rich and income poor would be perr to defer their land tax liability by means of a charg title for the revenue foregone, to be collected wher pass from this world. And if proper arrangements v made for rates and land taxes to be deducted from incomes in installments, this would not convert the into income taxes, because it is the revenue *base* is paramount in producing an equitable revenue sy not the process by which they are collected.

This would finally close the looph in credit management through which truckloads of new financial 'products have erratically been driven

It is a very big call to expect rationality to over the property lobby's false and longstanding propag that rates and land taxes can be passed on in pric But why should this trouble them, as it so obviousl does, if they *are* able to pass them on in rents? Th truth of the matter is to be found in most economic textbooks: rates and taxes on land are the only for revenue that *cannot* be passed on. Of course, the property industry, along with everyone else, would benefit greatly from the resultant elimination of the boom and bust cycle.

If we are to encourage real prosperity and adc the upcoming recession effectively, the public sh understand the integral role played by perverse t regimes in risk management failure. It is far too important to be left in the hands of dithering neo-classical economists trained *not* to comprehend t complicity of taxation in inflating lethal land price debt bubbles.

The Land Values Research Group has documented thirty-four years of deadweight loss $1 trillion wrought upon the Australian economy l misbegotten tax policy. This has assisted to infla land price bubbles which, underpinning assets mortgaged to lending institutions as 'security', generated four national recessions and one Stat recession (to date) when the bubbles burst. Anot national recession looms. When policymakers ar forced to confront the gross illogic of this situatio may come to rectify systemic credit managemen failure. Not to attempt to do so sets in stone recurr bouts of financial meltdown and social distress.

****ooOOoo****