132nd Henry George Address by Prof. Ross Garnaut

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Transcript of the original audio

Australia: Made for Free Trade and a Tax on Rent

Thanks, Tim, and very good to be here with this group of people. Very good to know that such a group still gathers 132 years after Henry George came to Sydney and Melbourne.

Thanks, Emily, for all your care, and thanks to Matt and James who carried me up the stairs. Without their help, I might have been speaking from a position where I could see you even less well than sitting here.

Anecdote re: IRS v Esso

When Tim described the continuing influence of Anthony Clunies Ross and my work on mineral tax that began half a century ago, I wondered about that. But then I remembered the big tax case between Esso and the American Internal Revenue Service in the US Tax Court in Washington,.*IRS versus Esso*., 1998. The case settled out of court for a large sum, that I thought could have been larger, The case hung on whether the British Petroleum Revenue Tax on North Sea oil was a tax on income, creditable against US income tax, or a royalty, which would only have been deductible.

Both sides were referring to our book Taxation of Mineral Rent. Anthony Clunies-Ross was a wonderful man and scholar from Melbourne, who died in Scotland eight years ago. Esso had engaged large numbers of barristers from London and New York. The IRS had advised me that many of the defendant's barristers would cross-examine me and that I should expect a week before the Court. About an hour into the first cross-examination, the defendant asked for an adjournment. The Esso lawyers, returned after half an hour. "Your Honour" their spokesman said, "we have no further questions of this witness ". I asked the IRS legal team what had happened. "They worked out ", I was told, "that their prospects were better the less time the judge spent listening to you".

Henry George's legacy

It's remarkable that this society has an annual dinner and lecture 132 years after the great man visited Australia.

We don't have a Parkes, Reid or Lyne lecture. Those three Premiers of New South Wales through the 1890s were substantial historical figures. Neither do we have a lecture to remember any of the 5 Victorian Premiers of that decade.

Henry George certainly left his mark.

Bede Nairn's brief entry on George in the Australian Dictionary of Biography marks George down as a minor figure. That's not right.

George's *Progress* and Poverty sold several million copies. There is no near comparator for a book about economics. The world population then was one fifth of what it is today. and the literate proportion of the smaller world population a small proportion of humanity today.

The main ideas in George's work seem to me to be broadly right now, as they were then.

George supported free trade. That's as important now as ever for global development and Australia's prosperity and place in the world.

He wanted to tax land and other rent as the main source of government revenue. Rent taxes raise revenue without sacrifice of total income and output. Governments spend a lot more now than then. Then there was no Medicare. No government then thought about spending $369 billion on nuclear submarines. It may have been realistic to think of rent taxes raising most government revenue back in the 1890s. We need other sources of taxation today, but we would be better governed if taxation of rent contributed a much higher proportion of the total. Back then, Australian discussion of rent focused on the great agricultural and pastoral properties that had passed into private ownership with small payments unrelated to actual economic value.

George also wanted to promote competition and break up monopolies whenever this was possible. He noted that some economic activities are not suitable for competition and so are natural monopolies. It wouldn't be economically efficient to have multiple electricity suppliers running multiple transmission lines down the same street. George wanted natural monopolies to be held in public ownership. Railways were the most important natural monopolies in the 1890s.

George & Pigouvian taxation

Where the activities of one firm imposes costs on others, George wanted to tax them to deter the activities and to balance the cost. That's relevant to my work on climate change in the tail end of my career over these last 16 years,

Taxing comprehensively one such external cost, carbon emissions, would raise over $70 billion this year with today's European carbon price and exchange rate, and this year's expected Australian carbon volumes. We had a very good carbon price for two years, from 1 July 2012 to 30 June 2014. I've worked on many areas of public policy over a lot of years and have learned that modelling of economic effects of new policy is usually only the roughest of guides to what actually happens. In the case of carbon pricing, the modelling for my Climate Change reviews and the Commonwealth Treasury predicted outcomes with

close accuracy—the increases in prices of goods and services as reflected in the Consumer Price Index; the tax cuts and social security increases to make sure that there was no reduction of real incomes for people on low and middle incomes; the assistance for trade-exposed and emissions-intensive industries; and the reductions in emissions.

The Gillard Government, through Minister for Climate Change Greg Combet, reached agreement with the EU to merge the Australian and European Emissions Trading Schemes from 1 July 2015. The second Rudd government brought the date forward to 1 July 2014. That would have equalised carbon prices in Australia and Europe; provided Australia with secure access to European markets for products of what we are now recognising as Superpower industries; and ensured that competitors in third countries who were not facing similar incentives to reduce emissions did not receive an unfair advantage. Prime Minister Abbott got rid of carbon pricing the day before we were due to join the EU ETS, on the 30th of June 2014.

Without the Abbott blot, the Commonwealth government could be collecting over $70 billion a year from the ETS. That's not a tiny bit of money. We could pay for the nuclear submarines with five or six years of the carbon price. One year would pay for more than two years of Medicare. We could cut every personal tax rate by 30% from the highest to the lowest. Some members of the Australian Parliament support raising the GST rate to pay for cuts in income tax rates. Re-introducing the European-linked carbon price would give all of the presumed benefits of a higher GST—and efficiently reduce carbon emissions as a bonus.

We wouldn’t raise $70 billion per annum forever from a carbon price. The Government wants Australia to have net zero emissions by 2050. In a talk to the Melbourne Energy Institute earlier today, I said we would be richer if we got to zero emissions by 2035. The carbon price revenue would phase out over a generation. In the meantime, it would pay for a lot of tax reform.

And in the past we have had to pay for tax reform. When John Howard introduced the GST, the compensating income tax cuts and expenditure increases cost over 1% of GDP more than the GST raised. In today's GDP, that’s an increase in the budget deficit of more than $25 billion to make the GST package politically more acceptable. The really hard part of tax reform to improve equity and increase efficiency is the transition. By the time we had zero net emissions and so ceased to receive revenue from carbon pricing in 2035 or 2050, the new and more efficient tax system would be generating large economic benefits that would make their own case for continuing with it.

George’s *Protection or Free Trade*, rent, and the historical Australian case for protection

Back in 1986, Kym Anderson and I published a book on Australian protection. We noted George's influence in the attractive policies of the New South Wales Free Trade governments supported by Labour in the 1890s. That's a really interesting period for Georgists in particular and for Australians and Australian public policy in general. The young Labour Party was strongly committed to a more equitable distribution of income and wealth. The understanding that held together Premier Reid and the Free Trade Governments and the Labour Party was around collecting more revenue from sale and leasing of land and

using that to make up for revenue losses from free trade and the introduction of Australia's first old age pensions and some other social security payments. Victoria headed in another direction, favouring protection and collecting less revenue from land. That led to a battle between Free Trade and New South Welsh interests led by Reid and Protection and Victorian interests led by Deakin through the first decade of Federation. That's mostly another story.

There's no doubt about the Georgist influence on the excellent innovations in trade and financial policy in New South Wales in the 1890s. And there's no doubt about the Georgist influence through Marion and Walter Griffin on the financial model applied to Canberra from its commencement of Canberra in 1927. The Griffins were fans of Henry George. Canberra had in place for several decades a fiscal system with no private freehold land, long leases of land from the Government, and payments for land leases, periodically adjusted, that were meant to reflect economic value. Prime Minister John Gorton mucked up the arrangements in the hope of winning one seat. But he didn't win the Canberra seat. In the twenty first century, only the Teals, Independents, Greens and Labor win Canberra seats. I hope that John Gorton's ghost thinks that his 1969 policy was an awful waste.

Free trade became anathema or curiosity or joke to most Australians in the generations that followed Federation. Hancock's marvellous book "Australia," published almost a century ago, has a chapter about Australia's love of protection. Australians loved even the word itself with all of its friendly connotations. But protection was costly for Australians. The intellectual rationalisation of Australian protection was worked out in the 20s by a few economists from Tasmania with very good minds: Giblin, Brigden and Copland. Copland ended up being the first Professor of Economics and Giblin the first Ritchie Research Professor of Economics at The University of Melbourne.

The three Tasmanian economists and one other were commissioned to write a report on the Australian Tariff for the Bruce Government. The Brigden Report actually advised caution on the level of the tariff. But it is famous for developing what came to be known as the Australian case for protection. The idea is that in a country whose main exports depended on land, protection effectively placed a tax on export revenue and therefore on the rent of land used to produce exports, and increased demand for labour in the import-competing industries. Increased demand for labour either put upward pressure on wages or allowed more immigration. Protection was an indirect tax on rent, which paid for more employment or higher wages.

The logic of the Brigden Report is sound as far as it goes. But it misses the point that if higher wages and employment is the goal, you could get more of it at the same cost to owners of the land used for exports, or the same amount at less cost to exporters, if you tax rent directly and use the proceeds directly to support labour in one form or another.

Protection in practice was very costly for Australia. On the eve of the First World War we had the highest per capita average real incomes in the world. Our wages were the highest in the world. People in other economically advanced countries wrote about Australia being the working man's paradise. We lost that favourable position through our poor economic performance as protection rose between the wars. Per capita real income in the US and several other countries rose above levels in Australia. The slide down the per capita real

income table continued after the Second World War. Gradually economists and others began to notice that protection was contributing to the slow rate of increase in living standards relative to other developed countries. The critique of protection grew from the 1960s but nothing much was done about it for quite a while. The Whitlam Government implemented the 25% tariff cut in 1973 but introduced new protectionist measures when unemployment rose for other reasons in 1974 and 1975. The Fraser Government greatly increased protection in the most protected industries, mainly through quantitative restrictions on trade.

Prime Minister Hawke set us on a path to having an open economy, by combining economically efficient trade policies with use of the budget to raise living standards of the general population. The Hawke government reintroduced Medicare after its abolition by the Fraser Government. It extended and strengthened the social security system, including through expanded family payments. The superannuation system was extended to cover almost all workers. There was a big increase in expenditure on education, with large increases in the proportion of children finishing high school, and the proportion going on to tertiary education. Total factor productivity grew faster than in any other developed country in the 1990s for the first time in Australia's history since Federation.

Garnaut citing Friedman citing George on Protectionism

Despite the successes from the reform era of the late twentieth century, Australians tired of open trade. We have been drifting back to protection in recent years. If we partially reverse the reform policies that gave us sustainable increases in living standards, don’t be surprised if we reverse the increases in living standards as well. I don't cite Milton Friedman on everything but he's sound on free trade. Here is Friedman citing George:

"It's a very interesting thing that in times of war we blockade our enemies in order to prevent them getting goods from us. In times of peace we do to ourselves by tariffs that which we do to our enemies in times of war."

Samuelson, Solow and the erasure of land rent in neoclassical economics

Kym Anderson and I discussed the Australian and international literature on the Australian case for protection in that book four decades ago. Marion Crawford Samuelson, published an article that put the Australian case clearly. Then her husband Paul Samuelson, probably the most influential American economist in those decades, developed an elegant neo-classical model that purported to present the Australian case for protection. In the model, in a country that had an abundance of capital and a shortage of labour relative to the rest of the world, protection would shift the distribution of income towards labour as anticipated in the Australian case for protection. But Samuelson’s model was a huge oversimplification of what had been a different Australian case. There was no land in the Samuelson model, yet the core of the Australian case was that protection operated as an indirect tax on land. Samuelson omitted land from his simple and elegant model because the algebra didn't work if you included a fixed factor of production.

Samuelson was a colleague at the Massachusetts Institute of Technology of the young economist Bob Solow. Solow was working on a theory of economics growth based on the

Samuelson-type neo-classical model in which there was free movement of capital and labour, automatic adjustment of labour and capital to changes in wages and interest rates (and therefore no unemployment), and no land.

At exactly the same time in he 1950s, Trevor Swan at the Australian National University was working on growth models of a similar kind (Vines, forthcoming 2025). Swan and Solow are recognised as having both developed the model that is the foundation of subsequent growth theory. Swan tried to keep land in his model to make it more realistic. He recognised that economic growth would be associated with rising land rents and their effects on income distribution and the growth process.

Solow's model without concern for a fixed factor of production was simpler, more elegant, less realistic and won the Nobel Prize for Economic Science. It set economics on a wrong course. Half a dozen years ago my close friend and colleague Max Cordon showed me a letter that he had just received from Bob Solow. Six decades after Solow's article, Bob wrote to Max:

"We conventionally allocate all of the value added to either compensation of labour or return to capital, to capital as debt and equity. That would be fine if there were perfect competition. In reality there is a third component, monopoly rent. It gets allocated to labour and capital in unknown proportions. What one would like to see is a three-way breakdown in market return to labour, market return to capital and rent."

Changing role of rent

Henry George in the 19th century focussed on agricultural and urban land rents in the United States, where rising incomes and a rapidly growing population was raising the rent value of land. Moving from New York to California helped George to recognise the pivotal role of economic rent in economic growth. Growth in population and demand for goods and services in New York had made land more expensive. George foresaw that Californian land would eventually be expensive like New York land. He started to think about how a tax on the increasing value of land could generate value for the community rather than delivering windfall benefits to individuals.

George focussed on agricultural and urban land rents. But at other times and in other places other sources of rent were important. Piketty's "Capital in the Twenty First Century" presents the results of painstaking statistical work using the official records of the major developed countries. In the couple of decades before the Civil War, half of the value of capital in the southern states of the United States was the capital value of the slaves—the capitalisation of the rent value of slaves. At the time, agricultural land and urban land generated rent, but the rent of slaves was the big one. At different times in history, different sources of rent have been important.

The rent share of income has become much more important so far in the 21st century. We are seeing this in many countries but especially in Australia. We are seeing it in the rising profit share of national income. The large increases in the profit share sit uncomfortably alongside a falling price of capital in competitive markets. In that old Solow growth model, if the price of capital falls, without any change in technology, labour and capital move smoothly

from one activity and technology to others. As capital becomes cheaper, you get a movement towards more labour-saving technology which is associated with higher wages.

Keynes' on the falling cost of capital

Ninety-three years ago, John Maynard Keynes, the world's greatest public intellectual in the 20th century, wrote an essay tor his Cambridge students: "Economic Possibilities for our Grandchildren".

Remember the context of the time: the rise of fascism in Europe; the attraction of fascism and Communism in Britain; division in society; unemployment around 30%. It was a time for holding out hope of progress in a capitalist democracy. He went through the arithmetic of continued capital accumulation and technological progress. Putting aside the effects of unnecessary wars and economic depressions, the economy's productive capacity would increase many times. Savings out of increased income would provide an abundance of capital. Demands for investment would decline as a share of the economy. Capital would be abundant and interest rates fall to very low levels. No-one would have a very high income simply because they owned a lot of capital. High incomes would come only from innovation and entrepreneurship--producing new goods, or old ones in more productive ways. That would make labour scarce and expensive. The real rate of return on low-risk investment would be low.

Now, the real rate of return on low-risk investment in the twenty first century has fallen much as Keynes expected it to do. The average interest rate on long sovereign debt in most developed countries has been lower than the inflation rate over the past decade and a half. The real cost of long-term safe debt has been negative or zero or slightly positive.

In Solow's model, with perfect competition and no rent, this abundance of capital would lead to lower returns on business investment and a higher labour share of total income. But exactly the opposite has happened. In the last decade, we've seen an historic increase in the profit share and fall in the wage share of national income.

The increase in the profit share of total income as measured in the national accounts has no precedent in our history. It began in the first decade of the century, and has gone much further and faster since then. T**he only explanation for such a divergence between the rate of return on competitive riskless capital and actual business rates of return as reflected in the profit share of GDP is a rise in rent.**

What has caused the rise of rent? There is an extensive recent literature on this question. It has been developed best in the US, partly because the US has a larger and more diverse economics profession, and partly because they seem to have better data. There is also an extensive recent literature on the fall in real interest rates in competitive markets.

The increase in the profit share and the fall in the wage share is actually bigger than the statistician makes it look. When Qantas paid CEO Joyce tens of millions in recent times, that would be mostly classified in the wages and not the profit share. The Joyce arrangements are not unique, or even unusual today. They were unknown in the twentieth century. There has been an explosion of executive remuneration this century, starting in finance and other

high-rent parts of the private sector and extending into the public sector including the Universities. It has gone much further in Australia than in Europe or Japan. It was apparent in the US before Australia, but seems to have caught up in Australia over the past decade—and may have gone further when size of enterprise is taken into account.

Much of the increase in executive remuneration shows up in the wage and not the profit share. But it is really the sharing of rent between owners and managers of businesses in rent-rich sectors. But the lift in the income share is large even counting executive income as wages, so we can make the point without challenging the established statistical base.

The increase in rent is happening in the other English-speaking developed countries but seems to have gone furthest in Australia. Why is it so?

Reasons for the increase in profit share

One is the huge growth in the role of minerals and mineral rent in the economy. That followed the growth in Northeast Asian and especially Chinese demand for our minerals. From 2002 until 2012, the then most populous country on Earth experienced the fastest sustained rate of growth over a decade of any substantial country ever. And the Chinese pattern of growth was highly complementary to our resources. Chinese growth required iron, fossil energy, other metallic minerals, wool and other raw materials in immense quantities. There was a huge increase in demand for Australian exports and a big lift in prices and profitability of Australian export commodities, especially the minerals. This was Australia's China resources boom.

The boom eased from 2012 with changes in China's pattern of growth, and is changing again post-COVID. But much of the boost to global demand for minerals remained. Prices eased from the giddy heights of 2012, but remained much higher than before the China resources boom. On average and in real terms, the price of iron ore over the last half dozen years is about four times as high as it was in 1990s. It went much higher during the China Resources Boom, and at times has dipped lower, but the average that can be expected in future is several times higher than in the last decade of last century. After all the fluctuations and adjusting for inflation, coal and gas prices in normal conditions seem likely to settle at about double their levels in the 1990s. The last year and a half have been abnormal and prices much higher, through the disruptions following the Russian invasion of Ukraine. A wide range of other products behaved similarly. Prices of commodities used intensively in the zero carbon economy—so-called critical minerals—have increased in larger proportions.

The large miners were making good profits from their established Australian mines in the 1990s, There has been a huge increase in rent for anyone with an established mining business. Already in the 90s, we had begun to see effects of rising demand for minerals in China and other Northeast Asian countries. I wrote that story in my 1989 report to the Commonwealth Government, *Australia and the Northeast Asian Ascendancy*. By the end of the century, mining contributed 5% of Australian GDP. That ratio has increased to 15% since then.

We went through a period towards the end of the last century when exports of manufactures, services, minerals, and agricultural products were of similar value. Now minerals are twice

the value of all the others put together.

The division of costs between rents and real costs are very different from the four sectors. Payments for labour are very much lower for mining than for the other sectors. In the last quarter of 2022, mining profits exceeded those of all other sectors of the Australian economy added together. Yet mining employed only about 2 percent of the Australian labour force.

Taxing mineral rent

The increase in the annual value of mineral sales over this century is over two hundred billion dollars per annum in today's purchasing power. We apply the corporate income tax at 30% of the value of accounting profits. This is after artificial deductions for costs attributed to offshore "marketing hubs" and services of other kinds in low-tax countries. High proportions of the increase would be rent. The corporate income tax collects a modest minority of the rent for the public revenue. A general reduction in the corporate tax rate, as sought by the Business Council of Australia on behalf of big foreign and Australian business, would reduce the tax on mineral rent with very little positive impact on the level of investment or output in the mining industry.

The states have constitutional rights to minerals and powers over mining royalties. They have the rights and responsibilities to require payments from private companies equal to the value of the resources for access to mineral resources. The value of the resource is the economic rent. The states apply royalties in various forms and at various rates, which are deductible against income for Commonwealth income tax purposes. These collect rent, but usually take forms that reduce investment and output in marginal activities as well. The rates are generally low, so the balance between avoidance of distortion and collection of rent is calibrated in favour of avoiding distortion. The Australian system of horizontal fiscal equalisation reduces States' incentives to extract the rent—under the principles applied by the Commonwealth Grants Commission, the state receiving royalties eventually retains only its national population share of total payments for mineral leasing. Western Australia's objection to this principle led to the Morrison Government's agreement on a floor to the Western Australia's share of the GST pool. The issue will arise in Queensland as the Grants Commission brings the State's new coal royalties to account in distributing GST revenues. Mining companies now use the redistribution of State royalties under the Commonwealth Grants Commission in political debate about economically rational pricing of access to mineral resources.

Western Australia applies a 5-7% royalty to the value of iron ore sales. This might have corresponded to a reasonable share of the mineral rent in the 1990s,but represents a small proportion of the total today. It generates large State revenues that are large enough favourably to transform the State's budget.

The Queensland government has raised significant total royalties from coal mining from low royalty rates. When coal prices rose strongly in response to the Russian invasion of Ukraine, it introduced higher rates of royalty when coal was sold at high prices—with a maximum ad valorem rate of 40 percent applying to a substantial proportion of revenue when prices were at their peaks in 2022 and early 2023. This favourably transformed Queensland budget

prospects. A large part of the increased revenue was used to fund energy infrastructure for the transition to zero net emissions. Part was used to shield lower income power users from energy price increases that would otherwise have followed from the Russian invasion of Ukraine. Part strengthened the long-term fiscal position by reducing public debt.

New South Wales mines contribute a substantial proportion of Australia's coal exports. The Government raises significant revenues, but at rates that leave most of the rent with the mining operators. So far Governments have chosen not to increase the proportion of rents going to the public revenues as payment for public resources being depleted by mining.

The Commonwealth administers mining leases only offshore. The Hawke Government came to office committed to introduce a national resource rent tax, but limited its application to offshore petroleum when the States declined to cooperate. Western Australia joined the Commonwealth to application of a resource rent tax in one onshore petroleum field. The Commonwealth's resource rent tax raised substantial taxation but was rendered much less effective by changes in deductions for processing not directly related to exploration and mining in the early 2000s and in response to industry pressures at the time of debate over mineral rent taxation that followed the Henry Tax Review.

The Henry Tax Review commissioned by the Rudd Government proposed the comprehensive taxing of mineral resources by the Commonwealth Government. This was linked to a recommendation to lower the rate of corporate income tax. It would have had the effect of shifting a substantial part of the tax burden from the general corporate taxpayer to the mining industry. As minerals prices have turned out, it would also have greatly strengthened the Commonwealth's general fiscal position, including as coal and gas prices rose in response to the disruption of global markets after the Russian invasion of Ukraine.

The Henry Review recommendation on resource rent taxation had several weaknesses. It introduced a novel taxation model without the prior public discussion that would have allowed the building of support within the community. The novelty made it easy for vested interests to misrepresent its character and effects. Extensive public discussion and understanding is a precondition for successful reform. And the tax itself contained one structural weakness. It proposed to balance the 40 percent tax on positive cash flows (the rate of tax in the Hawke Government's resource rent tax), with a payment for unsuccessful exploration and development expenditure paid at the time of surrender of a mining lease. Such a payment for negative cash flows is sound in principle, and is a feature of the reform of business taxation that is advocated later in this lecture. But delaying payment until surrender of the lease required the investor to believe that the taxation regime would remain stable over a long period. Some would have discounted the value of the payment for the chance of changes in the regime.

There is no more important issue in Australian taxation reform than replacing current arrangements by efficient mineral rent taxation. That requires large analytic effort and effective political leadership. Success would bring high rewards to the Australian polity, and I expect electoral rewards to the Government that is seen as being responsible for a good outcome.

The Henry Review proposals and carbon pricing were both defeated by massive campaigns

by vested interests, harnessed by the Commonwealth Opposition of the day led by Tony Abbott. When Abbott won government in 2013, it encouraged vested interests to see investment in the political process as a rewarding path to defeat of proposals for reform in the public interest that challenge their own interests. I myself do not see this as a sound interpretation of what happened in 2013. And if it were, I think that Australians' commitment to the integrity of our democracy would allow that perspective to be challenged politically.

I have spent a lot of time in this lecture on mineral rents. They are more than half the rents in the Australian economy over the past year, and are growing rapidly. I will run through more quickly the other main sources of rents. These others are the main sources of the rise in rents in other countries, and they have been causing the rent share of income outside mining to rise in Australia—more strongly in Australia than in other developed countries.

The Network and Intellectual Property Rents of Information Technology

The new information technology industries draw rents form two sources—networks with characteristics of natural monopolies; and intellectual property protected by patent. They are the source of much of the increase in global rents in the twenty first century. Once established, they are well protected from new competitors by the usual network economies. Once established, they serve new customers at very low marginal costs and with little incremental fixed expenditure. Their sales account for a large and rapidly growing share of expenditure everywhere. They contribute to the low share of investment in expenditure, and through the high rents incomes to the high savings shares of incomes that are contributing to low real interest rates on low-risk debt in competitive markets.

Australia cannot expect to establish a competitive supply of information technology services. The ACCC has identified some measures that can improve the competitive environment, without fundamentally changing the oligopolistic structures, We should do what we can. And Australia can ensure that the public revenue receives a reasonable proportion of the rent generated by sales within Australia. This is best achieved by denying deductions against corporate income as assessed for corporate income or cash flow tax purposes, of payments for imported services that are not associated directly with supply to the Australian taxpayer.

Urban land rents

The increases in land and housing costs in Australia over the past couple of decades have transformed unfavourably the lifetime economic prospects of younger Australians who do not have the support of wealthy relatives. That's a tragedy. There are two sources of higher house prices. One is the increased rent value of land, that is capitalised in the asset price. The other is the fall in the discount rate—that increases the capital value of a stream of rents. I have already mentioned that interest rates on low-risk debt have fallen to near zero in real terms in the twenty first century, and won't go further on that in this lecture.

Taxing the rent would reduce the capital value of the asset. Its worth discussing why the rent value of land has increased, as well as how it should be taxed. The value of land in a good urban location is the difference between the cost of the land on the frontiers of the city—the open fields being subdivided on the way to Ballarat--and the value of the land in good

locations.

That differential, which sets the value of land in the attractive areas, is very much affected by the quality of transport and communications. We haven't invested in transport infrastructure in line with the growth of our population. We are starting to catch up in recent years, but have a long way to go. The new transport infrastructure increases the value of some urban land, while reducing the scarcity or rent value of other property. Taxation on the increases in land values resulting from improvement in transport infrastructure is an important source of public revenue in some of the countries and cities that have managed the transport infrastructure problem best. Changes in urban planning that allow denser housing near the centres of urban employment and the transport nodes will also reduce land scarcity and rents throughout the city.

High population growth from immigration increases the scarcity and rent value of land—especially if it has not been carefully calibrated to expansion of supply of transport and other urban infrastructure. Australia (and New Zealand, Tim, our Chair, reminds me) currently stand out with immigration rates that are extremely high by international and our own historical standards. Immigration brings many benefits for Australians. But the rates since its resumption after COVID have been beyond the capacity of our infrastructure to absorb. It is much of the reason for the extraordinary shortage of housing and increases in land values and rents. Let's make sure we tax land rents in the public interest, But lets also think more strategically about the contributions of immigration and underinvestment in transport infrastructure to the increases in land prices.

Standard monopoly and oligopoly is more serious here than elsewhere

So the larger role of mining and higher population growth are two large reasons why the rent share of income has risen more in Australia than elsewhere. A third is that standard monopoly and oligopoly are more serious and have deteriorated more in Australia than elsewhere. The Qantas story that's become news over the last few weeks is one manifestation of a much more general problem. Increased concentration of banking business is a large problem. Four big banks all putting up their interest rates or putting them down on adjacent days by the same amount. No effective competition. They know how to work together.

I worked with Hawke on the liberalisation of the financial system in the mid-1980s. That was meant to increase competition. It did for a while. The older participants in this meeting will remember the state banks, the building societies, the credit unions that played a large role in accumulating household savings and providing housing loans 40 years ago. The increased concentration in banking has its parallels in many sectors—although not all as extreme as in banking.

Australians have been in denial about increasing oligopoly and the rise of rents. A very good book has just come out by an American academic Phillippon an American academic, discussing how much less effective competition is in the US today than in Europe. Europe has done much better than the US. Amongst other things, the EU has had stronger antitrust laws and enforcement. He says that one of the reasons is that many countries becoming part of the one market disrupted the organisation and effectiveness of national business

lobbies that place pressure on the policy-making and enforcement process.

The problem is much greater in Australia than the US, and has probably deteriorated more in recent times. And in America there has at least been much serious analysis and discussion of the problem in recent years. We haven't done as well in Australia. There have been lonely minds and contributors in discussion in the Henry George Society, in and around the ACCC including through its past senior executives, our few genuinely independent think tanks. But discussion has been at the fringes of policy-making.

There are signs that this is changing. There have been two splendid speeches on the issues over the past month. One was by Andrew Leigh, Minister Assisting The Treasurer on Competition Policy.—a highly reputed Professor of Economics at the ANU before entering Parliament and still a highly productive contributor to Australian economic analysis beyond his official responsibilities. He spoke about the Australian oligopoly problem at the Conference of Economists in Brisbane in July. Drawing on the international literature, amongst other things he draws attention to the ways in which more powerful oligopoly has increased profit margins and placed downward pressure on wages. The second was by Rod Sims, former Chair of the ACCC, a few days ago. He presents data in awful detail on the reduction in numbers of suppliers in many Australian industries, to levels that are inconsistent with effective competition. It is more good news that the Treasurer has just established a review of competition policy, to which Leigh and Sims will contribute in different ways. I made my own contribution to the discussion in the ACCC's 2023 Bannerman lecture a few months ago.

So while the problem of increasing rents is growing, we are starting to focus on it. Now is the time to focused on the rise of rents, policy to slow or reverse the increase, and taxation reform to secure for the public revenue part of the rents that cannot be removed by sound policy.

Add up all the opportunities for economic reform to reduce economic rents or to tax them efficiently and equitably and you have a transformational economic reform programme to increase productivity and equity. Resource rent taxation. Tax on carbon externalities, Tax on land and housing rent—and urban infrastructure and planning and immigration adjustments to reduce urban land rents. Increased competition.

And to provide an overarching framework for raising revenue from business rents, the replacement of standard corporate income tax with a tax with cash flow as a base.

Cash Flow Tax

Craig Emerson, Reuben Finighan, Stephen Anthony and I proposed the replacement of the standard corporate income tax by a cash flow tax in a paper in the Australian Economic Review in December 2020. The Cash Flow Tax would be a tax on economic rent. The paper focussed on replacement of the corporate tax, but it actually could be a tax on all business income.

The Cash Flow Tax, or Business Rent Tax, would
--allow immediate deduction of any capital expenditure

--provide a cash credit at the tax rate for negative cash flows.
--deny any deductions for interest or any other payments for financing, and
--deny a deduction for imports of services, unless those imports of services related directly to provision of the service within Australia.

The paper proposes various practical details and costings, and suggests transitional arrangements.

The cash flow tax is a tax on economic rent. On average, firms in competitive businesses would pay little or no tax. The successful would pay tax at the designated rate; the unsuccessful would be reimbursed their losses at the tax rate. Competitive businesses include the marvellous restaurants of Melbourne, most of whom struggle to survive, many without surviving. Those who are actually making losses would get a bit of a payment, and those who are making profits would pay a bit at the tax rate.

Companies that are innovating would find this tax system very much more congenial, than the corporate income tax. The current tax system systematically discriminates against any company that takes a risk and cannot rely on deductions against a secure flow of established income. For the innovator with limited secure cash flows, there is asymmetry between treatment of success and failure. Success is taxed, and failure is not compensated. This is different from the company with a secure flow of rents. Think Rio Tinto or Qantas or Westpac. And if they make some investment, they know that if it is unsuccessful, they will be able to deduct the cost against income for standard income tax purposes. So the cash flow tax supports innovation. It also supports the firm that is investing and expanding.

We calculated, based on public information, that at a 30% tax rate the cash flow would be roughly revenue neutral over time, even if the expected positive effect on investment, innovation and output did not materialise. The suggested transitional arrangements may make it revenue negative in the early years and revenue positive in later years. Any decision on application would require analysis of revenue impacts based on information available only to the tax office.

Companies that are innovating and investing at high rates would pay less tax than under current arrangements. Companies that are receiving high rents and not investing much would pay more. The tax is less vulnerable to international tax avoidance than the corporate income tax in its current form.

Now is the time for the cash flow tax and for other reform measures to make Australia a more prosperous and equitable economy and society and successful democratic polity. There is a lot of work in turning these broad thoughts into a programme for effective reform, in explaining and in building support for the programme. That is a task for this venerable society in its 133rd year, Prosper Australia. There is a large challenge of political leadership in making at happen.

Some of the policy disappointments of the twenty first century so far may discourage ambition for Australia. The lesson of our history is that our democratic polity is capable of productive change when some Australians are prepared to put the necessary effort into development of ideas, public education and political leadership.

I have pointed to a few indications this evening that after a dark decade, the prospects of reform to increase prosperity and equity in Australia might be turning a little bit. Let's, we who have been thinking about these problems for a long time, let's help things turn.