A basic guide to taxing economic rent in Australia

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ABSTRACT

Taxing economic rent is one key element in tax reform in Australia and sets possible directions for the future. This paper introduces readers to the ideas of Adam Smith and David Ricardo and others on rent to aid understanding of the debates about economic rent today. The discussion also includes the Petroleum Resource Rent Tax, the Australia's Future Tax System Report and the Minerals Resource Rent Tax. The thinking of Smith and Ricardo was that rent was unearned gain. It is unearned because it arises as a consequence of the nature of the holding, an exclusive property right against the rest of the world. The amount of the rent is judged by comparison with the landholding that was just adequate enough to sustain profitable production. The rent is that difference on return. In a world of economic rent today these ideas retain their relevance. The political compromise that is the Minerals Resource Rent Tax is so far removed from these Smith and Ricardo benchmarks that taxing the unearned gains of the mining and other companies arising from the landed and other monopolies they hold remains, although warranted, a task for the future and for a government with the resolve to take on the rich and powerful. We can argue for the future by drawing on the past.

I INTRODUCTION

This paper is an introduction to the ideas of the classical political economists to help us understand the current debates about taxing economic rent in Australia. This debate and hence this paper includes the Australia's Future Tax System Report (*Henry Tax Review*)[1] and economic rent tax regimes such as the Petroleum Resource Rent Tax (*PRRT*) and the more recently introduced Minerals Resource Rent Tax (*MRRT*). Resource rent taxes and proposals to expand land tax, itself a tax which captures economic rent,[2] form a major part of the Henry Tax Review and its recommendations.[3]

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1 Ken Henry et al, *Australia's Future Tax System Report to the Treasurer* (AGPS, 2010). There are 3 parts to the Report and they will in this paper have 3 distinct footnote references. 1 (a) Ken Henry et al, *Australia's Future Tax System Report to the Treasurer* (AGPS, 2010) Part One the Overview; 1 (b) Ken Henry et al, *Australia's Future Tax System Report to the Treasurer* (AGPS, 2010) Part Two Detailed Analysis Volume One and 1 (c) Ken Henry et al, *Australia's Future Tax System Report to the Treasurer* (AGPS, 2010) Part Two Detailed Analysis Volume Two. The link to the Final Report – all 3 sections plus other material - can be found here. <http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/pubs_reports.htm.>.

2 Ken Henry et al, above n 1 (b), 249.

The aim of the paper is to help readers understand the drivers generally of current and possible future rent tax changes to Australia's tax system and the rationale for and specifics of those changes as they are, or may eventuate.

Part II of the paper looks at what economic rent is. This will also involve going back to the ideas of Adam Smith and David Ricardo on rent and modern approaches to rent. Part III examines some of the key economic rent tax recommendations of the Henry Tax Review, especially resource rent tax and land tax. It looks at the more or less settled and stable PRRT and the recently introduced and seemingly more volatile MRRT and the move in the Australian Capital Territory to more fully tax land rents.

Part IV concludes by arguing that understanding today's debates about economic rent is enriched by looking at the early political economists and their discussion of monopoly, private property and rent and that these ideas can be a benchmark for the future in taxing economic rent appropriately.

I hope this discussion offers one or more ways of helping understand the context of resource rent tax laws and the wider drivers in Australia specifically and the much wider discussions about taxing all economic rent.[4] We cannot escape some attempt at understanding Smith and Ricardo on rent if we want to understand ultimately the PRRT, the MRRT, the Henry Tax Review rent tax recommendations and the Review's ruminations on various forms of economic rent. Let us start then by looking at what economic rent is and where the ideas came from.

II WHAT IS ECONOMIC RENT?

In essence economic rent is 'the excess payment received by a factor over the minimum required to induce it to do its work.'[5] The return is above the level required to compensate labour and, more importantly, capital.[6] Taxing that extra return, arguably even at levels close to 100 percent, will not change those investment and production decisions because the return is still above the level needed to reward capital.[7] Here is how the Henry Tax Review describes it:

> An economic rent is the excess of the return to a factor of production above the amount that is required to sustain the current use of the factor (or to entice the use of the factor).

3 Ibid. The resource rent tax recommendations can be found in Part One the Overview 89-90 and the land tax recommendations at 90. For a fuller discussion see Ken Hen Henry above n 1 (b) 217 and following pages.

4 For example John McLaren proposes looking at extending rent taxes to 'other resources such as timber, water, fish, hydro-electricity, geothermal electricity and industries such as airports, toll-roads and airlines.' John McLaren, 'Petroleum and Mineral Resource Rent Taxes: Could these taxation principles have a wider application?' (2012) 10 *Macquarie Law Journal* 69, 69,

5 W.H. Wessel, 'A Note on Economic Rent' (1967) 57(5) *American Economic Review* 1221, 1223.

6 Ken Henry et al, above n 1 (b), 171.

7 Ross Garnaut and Anthony Clunies Ross, *The Taxation of Mineral Rents* (Clarendon Press, 1983) 27.

> For example, if a worker is paid $100,000 but would still be willing to work at the same job if they were paid $75,000, their economic rent would be $25,000.[8]

Understanding this requires a look at the ideas of some of the classical political economists on rent. Put simply we cannot understand economic rent without also looking at the early debates on ground rent and its intertwining with concepts of and the reality of unearned gain. As Keiper puts it: 'In the many twists and turns of economic thought, land-rent has been supplanted gradually by a more generalized notion of economic rent, an element that can appear in any and all income payments. But, like its earlier counterpart, economic rent describes an unearned gain, a reward in excess of that required to bring forth a desired effort or function.'[9]Let us go back a little then to the era of the great political economists and the rise of capitalism to look at the first modern classical theories of rent.

A *What is Rent?*

The debates about rent gained real prominence with the development of capitalism and the destruction of feudal relations in Western Europe. Adam Smith described land rent in these terms: 'The rent of land, therefore, considered as a price paid for the use of land, is naturally a monopoly price. It is not at all proportioned to what the landlord may have laid out upon the improvement of the land, or to what he can afford to take; but to what the farmer can afford to give.'[10]

It is this monopoly element which hints at future theories of economic rent, those returns over and above the average expected after the costs of labour and capital are taken into account. The central idea underlying this approach appears to be that wealth should arise from effort, either as labour or worked for capital and not arise from privilege, least of all feudal privilege. Unearned gain is anathema to capital and its ideology of hard work. Taxing unearned wealth – the taxation of economic rents generally but in Smith's time rent from land and minerals – is the triumph of the idea of competition over the reality of bourgeois monopoly and in the case of land sometimes its triumph over feudal monopoly and its historical hangovers. The taxation of economic rent mimics the effect of competition by reducing to some extent the after tax returns to those receiving surplus-profit[11] and who for reasons of market monopoly or oligopoly or the monopoly that is private property in land are immune from the equalisation process applying to high profits that competition would reduce if it could operate in those markets. [12]

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8 Ken Henry et al, above n 1 (b), 171.

9 Joseph S Keiper 'Preface' in Clifford D Clark, Joseph S Keiper, Ernest Kurnow, Raymond Moley and Harvey H Segal *Theory and Measurement of Rent* (Chilton Company, 1961) ix.

10 Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations Volume One* (JM Dent and Sons, 1970) 131.

11 Karl Marx, *Capital Volume III* (Foreign Language Press, 1959) 743.

12 Ibid.

This may well explain why the idea that taxation should be imposed on economic rent in the form of resources and land is one of the key elements at the heart of the Henry Tax Review.[13] Another justification is that the revenue contribution from mining has been falling while profits have been booming.[14]

The Henry Tax Review recommendations on taxing resources and land mean we are witnessing a return to the very essence of Smith and Ricardo on rent. As Clark et al put it: 'Throughout a lengthy and sometimes contradictory treatment of land-rent, Smith consistently adheres to the proposition that rent is an unearned surplus which is appropriated by the landlords through the exercise of their monopoly power.'[15]

To some extent this view of unearned gain is explicable through the particular historical circumstances Smith and later Ricardo found themselves in. The incomplete bourgeois revolution in England[16] swept aside many of the barriers to capitalist development there but rather than destroying the power of the landed aristocracy incorporated that class into the structures of bourgeois power. While Smith had a distaste for landlords,[17] as David Harvey puts it: 'The Ricardians depicted landlords as parasites, as useless and superfluous holdovers from the feudal era.'[18]

As to the specifics of rent Ricardo argued that ...'[r]ent is that portion of the produce of the earth which is paid to the landlord for the use of the original and indestructible powers of the soil.'[19] Importantly Ricardo was careful to distinguish between payments to landlords and rent. While payments to landlords included rent, they also included interest and returns on capital.[20] Ricardo goes on to draw a nuanced distinction between rent as he defines it and the popular meaning of rent as payments to landlords. He says:

> It is often, however, confounded with the interest and profit of capital, and, in popular language, the term is applied to whatever is annually paid by a farmer to his landlord. If, of two adjoining farms of the same extent, and of the same natural fertility, one had all the conveniences of farming buildings, and, besides, were properly drained and manured, and advantageously divided by hedges, fences and walls, while the other had none of these advantages, more remuneration would naturally be paid for the use of one, than for the use of the other; yet in both cases this remuneration would be called rent. But it is evident, that a portion only of the money annually to be paid for the improved farm, would be given for the original and indestructible powers of the soil; the other portion would be paid for the use of the capital which had been employed in

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13 Ken Henry et al, above n 1 (a) xvii.

14 Ken Henry et al, above n 1(b), 226.

15 Clifford D Clark, Joseph S Keiper, Ernest Kurnow, Raymond Moley, Harvey H Segal, *Theory and Measurement of Rent* (Chilton Company, 1961) 13.

16 Perry Anderson 'Origins of the Present Crisis' in Perry Anderson, *English Questions* (1992, Verso).

17 Clark et al, above n 15, 25.

18 David Harvey, *The Limits to Capital* (University of Chicago Press, 1982) 331.

19 David Ricardo, *The Principles of Political Economy and Taxation* (J M Dent and Sons Ltd London 1973) 33.

20 Ibid.

> ameliorating the quality of the land, and in erecting such buildings as were necessary to secure and preserve the produce.[21]

In essence rent in Ricardo's eyes was the extra payment that went to fertile land compared to less fertile land. Here is how he put it:

> If all land had the same properties, if it were unlimited in quantity, and uniform in quality, no charge could be made for its use, unless where it possessed peculiar advantages of situation. It is only, then, because land is not unlimited in quantity and uniform in quality, and because in the progress of population, land of an inferior quality, or less advantageously situated, is called into cultivation, that rent is ever paid for the use of it. When in the progress of society, land of the second degree of fertility is taken into cultivation, rent immediately commences on that of the first quality, and the amount of that rent will depend on the difference in the quality of these two portions of land.[22]

It is thus the difference between the return on land which is just sustainable in terms of profitability and return on investment, what Garnaut and Clunies Ross describe as 'the proceeds of the least profitable [land] that will ever be in production,'[23] and the more productive land with its higher return as a consequence which is rent. This comparison and difference between a benchmark of adequate returns and greater returns – a form of unearned gain or reward 'on account of ownership and without any personal sacrifice'[24] - is at the heart of modern theories of economic rent.

Smith on occasion and Ricardo more rigorously regarded labour as the source of value. So how could land have intrinsic value if it contained no labour? For example Ricardo begins his great book on *The Principles of Political Economy and Taxation* by saying that '[t]he value of a commodity, or the quantity of any other commodity for which it will exchange, depends on the relative quantity of labour which is necessary for its production, and not on the greater or less compensation which is paid for that labour.'[25]

This seems to sit uneasily with Ricardo's idea that rent is a payment for 'the use of the original and indestructible powers of the soil.'[26] Rather than create value what the monopoly that is private property does is appropriate already created value.[27] Thus Marx argues private property is at the centre of the agricultural capitalist's seemingly secure world.[28] This ownership, argues Marx, is monopoly. He says that '[l]anded property is based on the monopoly by certain person over definite portions of the globe, as exclusive spheres of their private will to the exclusion of all others. With this in

21 Ibid.
22 Ibid 34.
23 Garnaut and Clunies Ross, above n 7, 4.
24 Ibid.
25 David Ricardo, above n 19, 5.
26 Ibid 33.
27 In Marx's thinking about rent this is one strand. Another strand has to do with the organic composition of capital and the exchange of goods above their prices of production, an analysis I will look at in more depth in a later article.
28 Karl Marx, above n 11, 600-601.

mind, the problem is to ascertain the economic value, that is, the realisation of this monopoly on the basis of capitalist production.' [29]

One point that Marx, following in the footsteps of Smith and Ricardo in this case, is making is that individual property contains within it its own monopoly – the exclusion of all others if necessary from productive activity on the particular piece of land. This is done for a payment that includes what Marx calls ground-rent, the amount 'which is paid for the use of the land as such – be it in a natural or cultivated state.'[30] One view is that rent arises from monopoly. One of the consequences of the increasing monopolisation of the global and Australian economies[31] may therefore be an increase in long term economic rent so taxing that makes both revenue and competitive sense[32] to a bourgeois state.

Marx thought that in agriculture the 'barriers to entry' that are private property could be permanent. Thus he says that:

> if capital meets an alien force which it can but partially, or not at all, overcome, and which limits its investment in certain spheres, admitting it only under conditions which wholly or partly exclude that general equalisation of surplus-value to an average profit, then it is evident that the excess of the value of commodities in such spheres of production over their price of production would give rise to a surplus-profit, which could be converted into rent and such made independent with respect to profit. Such an alien force and barrier are presented by landed property, when confronting capital in its endeavour to invest in land; such a force is the landlord vis-à-vis the capitalist.[33]

Landed property – agriculture *and* mining – present that permanent barrier by the very nature of the fact they are a form of monopoly ownership. In this sense, because landed property undermines the process of competition and the trend to the equalisation of profit rates towards an ever changing average, 'private property in land represents a barrier to the development of capitalism because the landowners only agree to its productive use after appropriating part of the mass of surplus value available for accumulation.'[34]

This prefigures the views of Garnaut and Clunies Ross who argue similarly that economic rent is an expression of the monopoly that is private property.[35] They say that '[t]he 'barrier to entry' that gives rise to what might appear to be transfer rent is the institution of property rights itself. Exclusive property rights are necessary to the emergence of mineral rent in the same way as they are to land rent.'[36]

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29 Ibid 601-602.
30 Ibid 605.
31 Ken Henry et al, above n1 (b), 8.
32 The tax mimics the effects of competition by reducing super profits downwards towards the average profit rate.
33 Marx, above n 11, 743.
34 Daniel Gaido, *The Formative Period of American Capitalism: A Materialist Interpretation* (Routledge, 2006) 33-34.
35 Ross Garnaut and Anthony Clunies Ross, above n 7, 33.
36 Ibid 34.

It is the monopoly that is private property; the ownership or access and production rights to land, that creates resource rents and land rents. With this insight in mind ulet us now turn now to the Henry Tax Review and its two major economic rent proposals – the taxation of resource rents and a land tax - to try to understand how the ideas of Smith and Ricardo have been approached, adopted and adapted to the debates in a modern context.

III THE HENRY TAX REVIEW

The Henry Tax Review has a tax vision for Australia. That vision long term is in large part to move to the taxation of economic rent and away from the taxation of ordinary income or capital.[37] This flows from its discussion and thinking about increasing the tax on immobile factors of production or their returns to enable a decrease in tax on mobile factors, such as highly mobile investment capital.[38] Thus for example the Henry Tax Review recommended that the Government adopt a resource rent tax, [39] a land tax[40] and consider an allowance for corporate equity.[41]

Internationally recognised tax economist John Freebairn has commented that '[a]ll parties to the current debate have missed the logic [of the Henry Tax Review] and offered second or worst-best scenarios.'[42] The logic of Henry, as Freebairn points out, is 'shifting the tax mix from mobile to immobile factors of production.'[43] Those immobile factors of production include resources, land and monopoly rents.[44] Further, removing special business concessions (for example accelerated depreciation,) to fund a lower internationally competitive company tax rate would attract foreign investment, keep more savings in Australia, leading to increased investment here over time.[45] This company tax cut would, according to Freebairn, 'lead to more capital and investment per worker, higher productivity and wages.'[46] This is the trickle-down theory of tax. Taxing capital less will evidently produce a capitalist nirvana.

The pressure from most major business commentators is for the Government to do something 'serious'[47] about reforming the tax system, rather than just cherry picking

37 Ken Henry et al, above n 1 (a), 25; John Freebairn 'Tax reform is wanting' *The Australian Financial Review* 19 March 2012, 54; John Passant and John McLaren (2011) 'The "Review of Australia's Future Tax System": Implications for Local Government in Australia and recommendations' (2012) 17 *Local Government Law Journal* 243, 255.

38 Henry et al, above n 1 (a), xxi-xxii.

39 Ibid 89.

40 Ibid 90.

41 Ibid 42.

42 John Freebairn 'Tax reform is wanting' *The Australian Financial Review* 19 March 2012, 54.

43 Ibid.

44 Ibid. See also Ken Henry et al, above n 1 (a), xvii.

45 John Freebairn, above n 42.

46 Ibid.

47 The Editor, The Australian Financial Review, 'Go back to Henry on tax' *The Australian Financial Review* 16 March 2012 50. This is just one of many Financial Review articles and editorials

bits and pieces of the Henry Tax Review.[48] Many commentators want governments to adopt a systemic approach to reform.[49] In fact that reform pressure will increase over time as the drivers for change that the Henry Tax Review identified – for example an ageing population, the mobility of capital, globalisation, technological change, the rise of Asia, the inefficiency of many of the current array of State and Territory and federal taxes[50] – all continue and place demands on Government and society to respond in a variety of ways to changing circumstances, including structural reforms to the tax system.

John Freebairn highlighted some of those implications for business tax reform and hence all of Australian society when he outlined some possible tax reform directions. They include:

- Broadening the company tax base and lowering the company tax rate;
- Replacing current state royalties on mining with an economic rent tax;[51]
- Shifting the tax mix away from taxes on mobile capital to immobile natural resources, land and monopoly rents;
- Symmetrical tax treatment of revenue losses and gains; and
- Removing stamp duties on property transfers and insurance.[52]

As Freebairn makes clear, one of those thoroughgoing structural reforms is taxing economic rent, something the Henry Tax Review recommends in the form of a resources rent tax and more broad based and progressive land taxes in the States and Territories.[53] Both resources and land are immobile factors of production. The Henry Tax Review also suggested examining an allowance for corporate equity (*ACE*) which basically means allowing a notional percentage of capital, possibly at the long term government bond or company bond rate as a deduction against assessable income. This would result in taxing company income only above that certain return level (taxing only the 'rent' above that level),[54] and as a consequence possibly freeing hundreds of

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arguing the same position of being bold and adopting fundamental and broad ranging tax reform along the lines that the Henry Tax Review recommended.

48 Richard Denniss, 'Choice on tax is simple' *The Canberra Times* 17 March 2012, 23.

49 Ibid. See also the editor, Australian Financial Review, above n 47.

50 Ken Henry et al, above n 1 (a), 3. See also John Passant and John McLaren (2011) 'The "Review of Australia's Future Tax System": Implications for Local Government in Australia and recommendations' (2012) 17 *Local Government Law Journal* 243, 257.

51 The Minerals Resource Tent Tax gives a credit to companies for State and Territory royalties and will tempt mining States and the Northern Territory to increase royalties and their revenue at a cost to the Commonwealth, not the companies involved. This is very bad tax policy design which locks in these inefficient taxes. Not surprisingly New South Wales, Western Australia and Queensland have increased some royalties which because of the credit under the MRRT is effectively these States 'bag snatching' Commonwealth revenue.

52 John Freebairn, above n 42.

53 Ken Henry et al, above n 1 (a), xvii.

54 Ibid 42.

thousands of companies from income tax.[55] The Business Tax Review Group, a group formed out of the Tax Forum,[56] recommended an ACE 'should not be pursued in the short to medium term but may be worthy of further consideration and public debate in the longer term.'[57] This was because 'the Working Group … found there [was] a lack of agreement in the business community to make … a trade-off' between base broadening and company tax cuts.[58] This was despite its attractiveness to the Australian Council of Trade Unions and unions representing blue collar workers who see manufacturing industry as effectively earning low returns which would be below the tax threshold under an ACE regime. If an ACE were adopted the end result, according to John Freebairn, could be a company tax rate of 40% to 50% on banks and resource companies and other monopolist industries.[59]

There is also in the Henry Tax Review some sort of commitment to the welfare state, reflected in the Review's comments about 'improving living standards, support for the needy, fairness, social advancement, security and protection of the environment.'[60] There is a stream of economic thought that believes that higher inequality leads to a less productive society, [61]or even to economic crises.[62] The Henry Tax Review's commitment to equity appears shallow and more about words than reality. For example Neil Brooks says: 'Somewhat surprisingly, Australia's Future Tax System had almost nothing to say about the use of the tax system to achieve a more equitable distribution of income…'[63] There is much in the Review that a free market government could adopt. As the author has previously written in this *Review*:

> The Henry Tax Review attempted to balance two competing views of the way forward for capitalism. The Final Report contains within it the seeds of both social democracy and neoliberalism, what I have called Keynesian neoliberalism. In fact much of the thrust of the Review is in designing a future tax system in which the burden of tax

55 Peter Martin, 'Zero tax proposed for most companies' *The Age* 6 December 2011, 2 <http://www.theage.com.au/business/zero-tax-proposed-for-most-companies-20111205-1ofk3.html>.

56 Wayne Swan, 'Business Tax Working Group – Membership and Terms of Reference' *Press Release* 12 October 2011 <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/123.htm&pageID=003&min=wms&Year=&DocType=>.

57 The Australian Government, the Business Tax Working Group, *Business Tax Working Group Final Report* (Commonwealth of Australia, 2012) v <http://www.treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2012/BTWG%20Final%20Report/Downloads/PDF/BTWG-Final-Report.ashx>.

58 Ibid.

59 Peter Martin above n 55.

60 Henry et al, above n 1 (a), xvii.

61 See, for example, Francisco Rodríguez 'Inequality, Economic Growth and Economic Performance A Background Note for the World Development Report 2000. He says 'there is very little evidence that inequality is good for growth.' <http://siteresources.worldbank.org/INTPOVERTY/Resources/WDR/Background/rodriguez.pdf>.

62 Mikael Feldbaum interviews Michael Kumhof, 'IMF economist: Crisis begins with inequality' *Eurozine* 9 March 2012 < http://www.eurozine.com/articles/2012-03-09-kumhof-en.html>.

63 Neil Brooks 'Taxing the wealthy' in Chris Evans, Richard Krever and Peter Mellor, *Australia's Future Tax System: The Prospects After Henry* (Thomson Reuters 2010) 197, 197.

> moves further and further on to so called fixed assets, in the main labour.[64] [Footnotes omitted.]

The author argues that the Henry Tax Review is in fact about shifting further the burden of taxation on to labour from capital,[65] either directly or indirectly. If so then taxing economic rent is arguably part of that shift specifically and more generally part of the move away from social democracy to neoliberalism.[66] This is because the initial beneficiary of the Rudd Government's proposed Resource Super Profits Tax (*RSPT*) would have been all profitable incorporated businesses through company tax cuts.[67] In this light, taxing economic rent can then be seen as being about reinforcing and further encouraging the shift of wealth from labour to capital[68] as well as being part of the process of entrenching the results of that shift over the last 3 decades in Australia, ever since the election of the neoliberal Hawke Labor Government in 1983.[69]

The first recommendation, the *grundnorm* if you like, of the Henry Tax Review was that:

> Revenue raising should be concentrated on four robust and efficient broad-based taxes:
>
> - personal income, assessed on a more comprehensive basis;
> - business income, designed to support economic growth;
> - rents on natural resources and land; and
> - private consumption.[70]

This appears to be the optimal tax differential tax agenda modified through the political reality of what is possible in tax reform today or into the future.[71] Dot point three

64 John Passant, 'Lessons from the recent resource rent tax experience in Australia' (2011) 10(2) *Canberra Law Review* 159, 174-176 <http://www.canberra.edu.au/faculties/busgovlaw/attachments/pdf/CLR-2011-Vol.-10-2-Symposium-edition.pdf>.

65 Ibid 177.

66 Ibid 174-176.

67 Ibid.

68 As Federal Labor MP Andrew Leigh points out on his blog, in an article called *Mind the Gap* 'work by the OECD reinforces the finding that the gap between rich and poor has widened in Australia over recent decades. True, the incomes of the poorest tenth of Australians have improved. But top incomes have increased faster still'. <http://www.andrewleigh.com/blog/?p=883>. According to the ACTU Economic Bulletin Issue 3, 1 October 2010 1, 'the profit share of national income is now near the record highs it reached in 2008, while the wages share of income is the lowest since 1964.' See <http://www.actu.org.au/Images/Dynamic/attachments/7126/Economic_Bulletin_Issue_3.pdf>.

69 Tom Bramble and Rick Kuhn, *Labor's Conflict: Big business, workers and the politics of class* (Cambridge University Press 2011) 104 – 110.

70 Ken Henry et al, above n 1(a), 80.

71 Another paper will explore the neoliberalisation of tax policy in Australia through the creeping influence and adoption of optimal tax theory. For a discussion of optimal tax theory and tax policy outcomes which explains both the theory and its slow long term adoption and application in tax reform thinking and practice see Robin Boadway, *From Optimal Tax Theory To Tax Policy: Retrospective and Prospective Views*, (Cambridge, Mass, MIT Press, 2012).

clearly has economic rent as its rationale.[72] So too does dot point two in relation to proposals for examining taxing only the economic rent of companies, one version of which is the ACE, a proposal as mentioned above now abandoned.[73]

Taxing economic rent in Australia is not new. Let us look briefly now at the history of resource rent tax in Australia and then the taxation of resource rents and the taxation of land proposed in the Henry Tax Review.

A *Resource Rent Taxation*

1 *The Petroleum Resource Rent Tax*

Australia has had a resource rent tax in operation for many years. The Petroleum Resource Rent Tax, legislated in 1987, but backdated to its announcement in 1984, applied to offshore petroleum. It is 'levied at a rate of 40% on the positive annual net cash flow of each petroleum project.'[74] It was a compromise after the Hawke Government failed to persuade Western Australia and Queensland to give up their inefficient royalties taxes for a share of the more efficient rent taxes imposed on resources. The compromise applied rent taxes to petroleum offshore - i.e. outside the jurisdiction of the States and Northern Territory but within the Commonwealth's jurisdiction, replacing in part a Commonwealth royalty regime on those projects. Changes made as part of the package to introduce the MRRT now mean that from 1 July 2012 the PRRT applies to offshore and onshore petroleum, 'including coal seam gas, tight gas and oil shale projects.'[75]

After more than 25 years of operation all the relevant players appear satisfied with the PRRT.

2 *From the Sublime to the Ridiculous*

The Henry Tax Review proposed that State and Territory mining royalties be abolished and replaced with a Commonwealth resource rent tax.[76] The reasons for doing this are that they are the resources of the States and Territories, i.e. public property, the return to the community is inadequate because, many of the royalties being output based, they are by and large unresponsive to changes in profit, royalties are inefficient, [77] and the resources are finite.[78] Because of the non-renewable nature of resources, mining companies earn economic rent,[79] in other words a profit well above that needed for

72 John Passant, above n 64, 179.
73 Ken Henry et al, above n 1 (a), 42-43.
74 Ken Henry et al, above n 1 (b), 226-227
75 Australian Taxation Office, 'Introduction to the extension of the petroleum resource rent tax' <http://www.ato.gov.au/content/downloads/prrt00323910.pdf>.
76 Ken Henry et al, above n 1 (a), xxi and recommendations 45-50, pages 89-90.
77 Ibid 47.
78 Ken Henry et al, above n 1 (b), 217.
79 Ibid.

investment and production in the mining industry to continue at what would be normal market levels.[80] The ghosts of Smith and Ricardo live on.

Ross Garnaut summarises the reasons for taxing resource rents in these terms:

> There are therefore two reasons to expect Australian governments to seek to extract the economic rent as revenue: it has lower economic costs than other forms of taxation; and it represents the value of public property that is being transferred to private ownership. Many Australians would add a third reason: that the recovery of mineral rent from the companies to which rights to mine have been allocated for the community represents a move to more equitable distribution of income, in a way that has lower economic costs than other measures to promote distributional equity. However, we have a strong basis for efficient resource rent taxation without going into the distributional issues.[81]

The Rudd Government unveiled the Resource Super Profits Tax (*RSPT*) when it released the Henry Tax Review, a tax based to a large extent, but with some major modifications, on the Review's recommendations. The mining companies' backlash against the RSPT destroyed a Prime Minister[82] and the new head of government, Julia Gillard, after negotiations with BHP, Xstrata and Rio Tinto,[83] introduced a much watered down tax, the Minerals Resource Rent Tax (*MRRT*).[84]

The MRRT applies from 1 July 2012 to around 320 companies instead of the 2500 that would have been taxed under the RSPT. [85] It taxes only super profits[86] on coal and iron ore rather than almost all minerals that would have been caught by the proposed RSPT.[87] Despite estimates it would raise $2 billion in its first year, itself a downgrade from the initial estimate of $3.6 billion,[88] it collected only $126 million in its first six months of operation.[89] This appears to be not because of market conditions as the Government argues[90] but because there are design faults in the tax, in particular the

80 John Passant, above n 64, 162-163.

81 Ross Garnaut, 'The new Australian resource rent tax', *The Australian* 21 May 2010 <http://www.theaustralian.com.au/business/the-new-australian-resource-rent-tax/story-e6frg8zx-1225869337321>.

82 John Passant, above n 64, 172-173.

83 They are the big 3 mining companies in Australia.

84 See John Passant, above n 64, especially 169-176.

85 Joe Kelly 'Prices boom hides mining tax shortfall after backdown over super-profits levy' *The Australian* 14 July 2010 < http://www.theaustralian.com.au/politics/prices-boom-hides-mining-tax-shortfall-after-super-profits-levy-backdown/story-e6frgczf-1225891697261>.

86 Essentially those profits are 'the assessable receipts less deductible expenditure less the uplift carry forward losses. The uplift factor is the long term bond rate plus 7 percent.' John McLaren, 'Petroleum and Mineral Resource Rent Taxes: Could these taxation principles have a wider application?' (2012) 10 *Macquarie Law Journal* 69, 76.

87 For a good, simple and understandable explanation of the workings of the tax, see John McLaren, 'Petroleum and Mineral Resource Rent Taxes: Could these taxation principles have a wider application?' (2012) 10 *Macquarie Law Journal* 69, 75-77.

88 John McLaren, 'Petroleum and Mineral Resource Rent Taxes: Could these taxation principles have a wider application?' (2012) 10 *Macquarie Law Journal* 69.

89 Sally Zou and Sunanda Creagh, 'Mining tax shortfall: the experts respond' *The Conversation* 8 February 2013 <http://theconversation.edu.au/mining-tax-shortfall-the-experts-respond-12105>.

90 Wayne Swan, 'Minerals Resource Rent Tax revenue' *The Treasurer Media Release* 8 February 2013

creditability of State and Territory royalties, the choice companies can make of market value of mines rather than historical cost for the tax's starting base and the down streaming of profits to avoid the application of the tax.[91] Even that incorrect $2 billion estimate was as much as $10 billion less annually than would have been collected under the abandoned RSPT.[92]

Advice to the Green Party from the Parliamentary Budget Office indicates that increasing the MRRT rate to 40%,[93] removing the market value starting base option and allowing royalties to be credited only at the rate they were on 1 July 2011 would bring in an extra $26 billion over the 4 year forward estimates period.[94]

Whatever the MRRT is, it is not a rent tax. It does not capture economic rent. The debacle that is the MRRT shows that the Henry Tax Review's vision of a shift to taxing resource rents as immobile factors of production more fully has suffered a major setback. Now it may be that the Review has planted the seeds for the future. Whether they sprout or not depends on the maturity of governments and Australian civil society to rise above petty politicking.[95] The failure of the Henry Tax Review resource rent tax proposal, the defeat of the RSPT as an option and the MRRT suggest this may be unlikely in the short to medium term. The author favours a full blown rent tax applying not just to all minerals but to all rents or super profits,[96] to use the large revenue from it for social democratic purposes[97] and thus improve the life of millions of Australians.[98].

<http://www.treasurer.gov.au/wmsDisplayDocs.aspx?doc=pressreleases/2013/019.htm&PageID=003&min=wms&Year=&DocType=0>.

91 David Uren, 'Treasury exposes mining tax flaws as Martin Parkinson blames Labor's concessions' *The Australian*, 15 February 2013 <http://www.theaustralian.com.au/national-affairs/treasury/treasury-exposes-mining-tax-flaws-as-martin-parkinson-blames-labors-concessions/story-fn59nsif-1226578314817>. If the profit can be allocated against downstream activity after extraction it is, so the argument goes, not economic rent and hence not caught by the MRRT. Unsurprisingly mining companies have claimed a large amount of the profit they make comes from their downstream activities. There are two answers. Tax Office audits could establish if in fact the profit arises in the extraction (rent) stage or downstream; and second the economic rent of minerals arises in part because of their finite nature so including downstream profits in the bundle of economic rents is arguably appropriate in any event.

92 Senator Bob Brown 'Mining tax needs review to ensure revenue for Australia's future' *Greens Press Release* 19 March 2012 <http://greensmps.org.au/content/media-releases/mining-tax-needs-review-ensure-revenue-australias-future >.

93 This was the proposed RSPT rate.

94 Senator Christine Milne, 'Second Reading, Minerals Resource Rent Tax Amendment (Protecting Revenue) Bill 2012' *The Senate* 28 February 2013 <http://www.openaustralia.org/senate/?id=2013-02-28.154.2>

95 Garnaut, above n 81.

96 Banks and supermarkets come to mind. John McLaren suggests extending rent taxes to 'other resources such as timber, water, fish, hydro-electricity, geothermal electricity and industries such as airports, toll-roads and airlines.' John McLaren, above n 87, 69, 69,

97 A Denticare scheme, addressing indigenous disadvantage, improving public health, education and transport, and addressing climate change through government owned renewable energy power stations are some options.

98 John Passant, above n 64, 161-163. See also more generally Clive Hamilton on progressive taxation as one of the great legacies of social democracy. Clive Hamilton, 'What's Left? The

B *Land Tax*

Essentially the Henry Tax Review recommended that there be a progressive rate land tax to replace inefficient stamp duties on conveyances and help fund the revenue needs of the States and Territories.[99] It was to be broad based and eventually include all land, although low value land, e.g. agricultural holdings, would be subject to a zero rate.[100] Again this was part of the Henry Tax Review's vision of a shift in the tax base from mobile to immobile factors of production to be used then to cut company tax rates, abolish inefficient stamp duties, attract or keep mobile capital here and develop a secure tax base to meet future societal needs.[101] The tax also has the potential to significantly improve GDP growth.[102]

The current State and Territory land taxes are inefficient.[103] As the Henry Tax Review says '[t]he efficiency cost depends on whether people change their behaviour in response to the change in price.'[104] Inefficient taxes adversely affect activity. The Review uses an example of a labour tax. It says that 'the measure of the inefficiency of a labour tax is not how much it raises the wage cost to firms, but how many workers are not employed as a result.'[105] A broad based land tax imposed on unimproved capital values is efficient, because, as the Henry Tax Review says 'the tax reduces the price of land but does not affect how it is used, or how much is used.'[106] The Labor government rejected the land tax proposal, perhaps in part because any such tax imposed would have seen a fall in prices for current landowners when they sold their property, offset by any reduction or abolition of stamp duty on the sale.[107]

Again, given the factors driving tax reform outlined previously, land tax is an issue which will not go away. In relation to land tax the Henry Tax Review may have planted the seeds for the future. In the Australian Capital Territory on 1 July 2012 the Government set in place a shift to taxing land more and away from taxing transactions. Essentially what it is doing is phasing out conveyance duty over time and abolishing insurance taxes. It will replace the revenue lost by making residential general rates (one form of land taxes) more progressive by introducing tax brackets and increasing marginal tax rates. The Residential Land Tax, which applies to private rental properties, will also be made more progressive.[108]

Death of Social Democracy' in 4 Classic Quarterly Essays on Australian Politics (Black Inc 2007) 1.

99 Ken Henry et al, above n 1(a) 90, recommendations 51 to 54.
100 Ibid.
101 Ibid xv to xxvi.
102 Ken Henry et al, above n 1 (b), 247.
103 Ibid.
104 Ibid.
105 Ibid.
106 Ibid.
107 Ibid.
108 ACT Treasury, Tax *Reform – A fairer, simpler and more efficient tax system* (Canberra 2012) <http://apps.treasury.act.gov.au/__data/assets/pdf_file/0008/399788/factsheet_Overview.pdf>.

The Henry Tax Review also recommended a land tax[109] because it had a strong commitment to taxing economic rent and taxing land taxes economic rent.[110] It did not accept the idea of land as the basis for all wealth but rather saw the unimproved capital value of land in neo-Ricardian terms as the surplus over and above the costs of production and adequate returns on them. So it adopts the Ricardian idea of ground rent as surplus, but not the Henry George idea of land as the foundation for all wealth. That it does so in terms of economic rent becomes clear when it says:

> Because land is immobile, it is 'fixed in supply'...
>
> The returns to the landowner tend to be made up of economic rent … Changes in the price of land — that is, the annual rental return — do not change the supply of land. The demand for land sets the rental return from the land and the amount of economic rent accruing to the owner.
>
> Economic rent is the return to the owner above that needed to keep the land in its current use. That is, it is the return once the owner has been compensated for the capital and labour they employ on the land. Economic rent therefore flows from the efforts of others, or simple luck. In particular, the economic rent of an owner's land increases as surrounding land increases in economic productivity (for example, from new roads built nearby), rather than the owner's investment in the productivity of their own land. Land rent is likely to increase in line with future population and economic growth, which increase demand for a fixed supply of land.[111]

Clearly land tax as economic rent is an important element of the thinking of the Henry Tax Review. This economic rent in land arises, according to Henry Tax Review, from 'the effort of others, or simple luck.'[112] One example of the effort of others is urbanisation or as the Henry Tax Review puts it:

> …the economic rent of an owner's land increases as surrounding land increases in economic productivity (for example from new roads built nearby), rather than the owners investment in the productivity of their own land.[113]

What the Henry Tax Review recognises is that human activity as a community changes the value of the land itself and that this indirect influence is reflected in increasing land values. However the idea that land has value separate from human activity is incorrect. Land is not the creator of value. Rather that value is produced in the process of production. As Marx put it: 'Landed property has nothing to do with the actual process of production. Its role is confined to transferring a proportion of the produced surplus value from the pockets of capital to its own.'[114] The ownership of land is one element in the distribution of that surplus value, in this case in the form of ground rent.

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109 Ken Henry et al, above n 1 (a), 89-90.

110 H William Batt 'The Compatibility of Georgist Economics and Ecological Economics' 2003 *Wealth and Want in 21st Century America* <http://www.wealthandwant.com/docs/Batt_GEE.html>.

111 Ken Henry et al, above n 1 (b), 249.

112 Ibid.

113 Ibid.

114 Karl Marx, above n 11, 800-801. See also David Harvey, above n 18, 359.

But the efficiency and other arguments made by the Henry Tax Review for a land tax, and the ongoing demand for a shift in the tax burden away from mobile factors like finance capital to immobile factors such as land, are not going to disappear. A broad based progressive land tax and the taxation of economic rent more generally, will remain, like a shelf company, ready for the plucking. As John Freebairn puts it the Henry Tax Review 'provides a rich agenda of benchmark reform options.'[115]

C *A Wider Rent Tax?*

The concept of economic rent and its taxation is not confined to resources or land. The Henry Tax Review recommendations do so limit them. For example, was the Henry recommendation for 'a uniform resource rent tax imposed and administered by the Australian government'[116] a case of hastening slowly on Henry's part, of sowing the seeds for an expansion of the taxation of resource rents at a later date into economic rent more generally? If so, then:

- the ferocious opposition to the Resource Super Profits Tax,
- the removal of the Prime Minister Kevin Rudd in response,
- the development of the suitably anaemic compromise[117] - the Minerals Resource Rents Tax - limited to iron ore and coal and as a consequence reducing the number of companies affected from 2500 to 320,[118]
- the lack of revenue the MRRT collected,

have all set the imposition of an effective minerals resource rent tax back years. The idea of extending rent taxes to other areas of the economy or even other resources has been banished to the cupboard of cowardly politics for perhaps decades. Intellectually, drawing on the ideas of the early political economists that rent is unearned income arising from monopoly, taxing economic rent is attractive but the political impediments to that are great. The failure of the Labor Party government to prosecute the resource rent tax agenda in the face of the fierce but predictable opposition of the mining company rentiers highlights the decline of Labor's role as the party of social democracy imposing solutions on capitalists for the benefit of capital.[119]

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115 John Freebairn, 'Overview of "Australia's Future Tax System"' in Chris Evans, Richard Krever and Peter Mellor, *Australia's Future Tax System: The Prospects After Henry* (Thomson Reuters 2010) 57.

116 Ken Henry et al, above n 1 (a), 90.

117 For a fuller discussion of this, see John Passant, above n 64.

118 Prime Minister, Deputy Prime Minister and Treasurer, Minister for Resources and Energy, 'Breakthrough agreement with industry on improvements to resources taxation' Press Release 2 July 2010 <http://www.pm.gov.au/press-office/breakthrough-agreement-industry-resources-taxation>.

119 John Passant, above n 64, 174-176.

IV CONCLUSION

Resource rent taxes and the proposed land tax are pincers in the movement towards taxing economic rent. The systemic drivers for such taxes will not diminish over time. They will increase. This will put the taxation of economic rent for both social democratic rhetorical reasons and revenue and redistributive reasons within capital more and more on the agenda.

However as the progress, or rather lack of it, towards the effective taxation of resource rents in Australia recently shows, starting with the grand vision of the Henry Tax Review and ending with the dog's breakfast of the MRRT, vested interests and those whose mantra is the unthinking chant of 'no new taxes' have combined to postpone rent tax reform in Australia for some time. Given the economic and societal pressures for reform this may be a case of winning the battle but losing the war; a holding operation if you like to stave off the inevitable.

The early political economists argued that unearned income was an impediment to the growth of capitalism. They pointed out that resource and land rents arise from the ultimate monopoly that is private ownership of land. These rents exist where the return to the landholder or exploiter of the land or minerals under it is greater than the minimum return necessary for the relevant activity to occur. Taxing such unearned gain can provide a real base for social spending as well as arguably increase the efficiency of the system. The paper has I hope explained the background to the ideas of rent and economic rent to help readers understand current rent tax reform debates in Australia and argue for the future by drawing on the past.