Keynote Address to the Revenue Summit 2022
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Expenditure and Revenue: You Can't Have One Without the Other

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****CHECK AGAINST DELIVERY****

My heading today is stolen from Frank Sinatra's great song "Love and Marriage". Those below 60 can Google the song, and some may want to Google Frank Sinatra.

While Sinatra sings of "love and marriage", and a "horse and carriage", as being inseparable, time has ended these necessary associations.

But expenditure, and the revenue needed to pay for it, cannot be separated for long.

This is why we are here today.

Today I want to make three points.

1. Australia needs higher taxation for a number of reasons.
2. There are some false arguments against higher taxation.
3. While Australia has likely maxed out on income taxes, there are other tax options that can be pursued if they are explained well to the public.

I will now explain these three points.

1. **Australia needs higher taxation for a number of reasons.**

Today's Summit is called a Revenue Summit. It could equally be called a "What do we want Australia to be Summit?". Yes, a little wordy, but consider this. Our political debate is currently in favour of relatively low taxation, and so relatively low government spending. But is that truly what we want?

According to Australia Institute numbers, and as also quoted by Ross Garnaut recently, Australia's tax/GDP ratio is 5.7% lower than the OECD average. We are the 10th lowest taxing country of 38 developed countries.

The fundamental question is whether Australians are comfortable with relatively lower taxation and so relatively low government expenditure.

I believe, as one important example, that we need higher expenditure to raise wages in key sectors such as education, health and aged and child care.

There have been, frankly, irritating longstanding complaints, certainly pre pandemic, that it is too hard to get, for example, enough nurses and teachers. The problem is that each is funded by an entity that has excessive market power; governments. There is very little competition to recruit teachers and nurses.

If you are a teacher or nurse, then you will likely work in the public system with only one employer. That employer has decided not to attract sufficient staff.

How do I know that? Because there is a simple answer to the need for more staff in a market economy: pay them more!

In the education and caring areas of the public sector we seem to pay below market rates and then complain that we cannot find enough staff.

According to research done for me by the Australia Institute a high school teacher with 10-20 years' experience on average gets paid $86,900. A tax lawyer with 1-3 years' experience on average earns $136,216, and we know where their salaries go after that.

We could do the same comparison with nurses and aged and child care workers.

We are sending an unmistakable signal about our community priorities.

And the fact that most of the workers in these sectors are women raises a whole range of other issues for our society.

Another example of the need for higher government expenditure is the transition to a low carbon economy. The size and speed of the transition we are aiming for will need additional government expenditure, albeit alongside considerable private sector expenditure.

Suggestions for higher taxation are often met with immediate scorn and dropped.

I have long felt that if you cannot explain your ideas to the wider community then there is a good chance that your arguments are wrong. However I think many good ideas are put to the community without sufficient explanation and dwell time so the arguments can be sensibly weighed. Ideas are often mentioned, there is an instant negative reaction, and so the ideas are dropped.

Public policy change requires a serious investment from politicians and others.

My point today is that if you are against higher taxation then you are against higher government expenditure. Some people explicitly are against both. Many, however, do not realise that in opposing taxation they are opposing extra spending on health, education and much else.

Some contrary arguments will put.

First, some will argue that it is OK to run budget deficits. Budget deficits are indeed fine for a while, and can certainly be beneficial to stabilise the economy, but much depends on where we are in the economic cycle. If we are in recession, or our terms of trade are at a low point, fine. But we are not. As Ross Garnaut has said… “We (currently) have large deficits when our high terms of trade should be driving surpluses”. (1)

Further, continuing deficits need to be funded. This can occur by commercial borrowings, which will eventually hit an interest burden ceiling, or by the Reserve Bank printing money, which after a while will debase the currency and cause inflation.

Further, unfunded deficits, or printing money, will be inflationary at full employment, and we want our economy to be running at full employment.

Second, some will argue that our net debt to GDP ratio is low by international standards at around 40% for all levels of government, which it is projected to reach in 2024-5, so we have scope to borrow more. Ross Garnaut sees our current debt levels as “eye watering” and says… “We need unquestionably strong public finances to have low cost of capital, private and public, for our Superpower transformation, and to shield us from a disturbed international economy and geo-polity”. (2)

That is, he argues we need more revenue to decrease our debt burden and so sustain the spending levels we have now.

I agree, for both reasons Ross gives. We are undertaking a large carbon transition that needs significant private and public expenditure, and we need strong finances so we are prepared for the next shock in this very uncertain world in which we live.

Only by raising taxes will we get our debt and deficit under control. I can see no other practical way.

Philip Lowe, the RBA Governor, has said we can address our high debt and our many pressing expenditure needs in one of three ways: raise taxes, cut other expenditure or grow the economy.

While there will be areas of expenditure that can be cut back, I strongly doubt there is enough in this to allow us to reduce our debt or meet other pressing expenditure needs.

To grow the economy we need a focus on promoting competition, and in many ways in Australia we are doing the opposite, so we are a long way from doing what is required to grow the economy. And when the right approach is taken, which I will do all I can to promote, the benefits will take time to come through.

We are left with the need to raise taxes.

2. **There are some false arguments against higher taxation.**

Today I shall just deal with two.

First, is the concern that increasing taxes inevitably damages the economy. This blanket statement is wrong. Just as with company expenditure, the question must be the rate of return on that expenditure and, of course, how efficient the taxes are.

Of course, if you raise taxes and then completely waste the proceeds the concern would be correct. But if the objective is to improve quality in education, health and child care, as examples, there is the potential for economic benefit that can more than offset any harm from higher taxation.

Thomas Piketty shows that in 1900 selected European nations raised and spent under 10% of national income, compared to todays 47%. As he says, since then our economies have prospered in part from the resultant spending on health, education, welfare transfers and better public administration. (3)

Indeed, there is an argument that in addition to boosting competition and so dynamism in our economy, improving our education, health and child care are among the most important things we can do to boost Australia's low productivity.

Further, cross border studies show no negative correlation between taxation levels and GDP per capita; indeed, some show that higher taxation and so spending can be linked to greater prosperity. (4) Clearly this applies only up to a certain point.

There are three objectives we all have for our society: to be sustainable, to be fairer and to be prosperous.

Many want higher government expenditure because they want a fairer society. I would argue we should not overlook the benefits to our prosperity of better education, health and the like.

Second, is the argument that we must remove all waste from government programs before we seek to raise revenue to fund greater expenditure. By all means make government programs as efficient as possible, but some will always see some waste, particularly given the wide range of objectives such programs seek to meet.

Let's also be clear here that there can be significant waste in private sector expenditure; as but one example, look at the waste we have seen in expenditure written off in new billing systems.

Of course, if there is significant waste in a particular program then this must be addressed before putting more money in.

But let's not use a broad statement about waste as a reason not to meet community needs; doing so is to raise a hurdle bar that can never be jumped.

3. **While Australia has likely maxed out on income taxes there are other tax options that can be pursued if they are explained well to the public.**

Australia has likely maxed out on raising corporate or personal taxes. We are already heavily reliant on these two taxes as they amount to more than 70% of our tax revenue, and high tax rates encourage unfortunate behaviour to minimise tax as Australian rates are generally higher than those levied overseas, or can become a disincentive to effort.

With all this in mind I see five important areas of focus when considering raising taxation, as follows. I will only discuss them briefly as my point is to show that they are credible sources of taxation which should be capable of being sold to the public if the appropriate time and effort is taken.

1. Stop transfer mispricing.
2. Raise more revenue from energy and mining companies.
3. Impose a carbon tax.
4. Have all States and Territories introduce a broadly based tax on land, that can be levied at different rates to meet their funding needs, and to replace stamp duty.
5. Introduce a new way of paying for roads.

1.1 Stop transfer mispricing.

I start on this topic for a reason. No company wants to pay more tax than it absolutely has to, and some, hopefully a clear minority, will go to what can only be described as immoral lengths to avoid their tax obligations.

How can we expect people to respond to the need for more taxation when some companies are deliberately not meeting their obligations?

A few years ago we had the release of the Luxleaks and Paradise Papers. These uncovered confidential emails showing a number of multinational companies deliberately used the tax havens of Luxembourg and Bermuda to structure their affairs so that their Australian subsidiaries earned very little or no observable profit and so paid very little or no tax in Australia.

In recent years many mining, digital/IT and other companies have reached settlements with the ATO in the $billions to pay previously unmet tax obligations. Well done ATO!

In the Australian context, deliberate transfer mispricing largely occurs in inbound loans and outbound commodity exports.

With inbound loans there have been blatant examples. Companies, for example, borrowing in a jurisdiction where they pay no tax at 1%, and on-lending the money to their Australian subsidiary at 9%. The ATO has done a good job to deal with such behaviour, and the Government has passed laws to help them particularly to deal with very high gearing levels.

More could be done so that, say, Australian subsidiaries can claim no higher % of debt than the entire worldwide group has, and can only borrow at rates consistent with what the group pays. That is, more mandating of arrangements to remove what could be seen as “grey” areas.

With commodity exports we have Australian operations being charged excessive fees for, say, marketing. These fees are often set by benchmarking against an arm’s length transaction with a very small player which is then applied to the Australian operation which is massively bigger.

Courts around the world seem to have struggled with the fact that a minor player may have no choice but to de-risk its local operations and market through another entity and pay high fees, whereas the Australian operations could do its own marketing at a fraction of the fee charged.

The rules relating to arm’s length transactions need to recognise that those with no bargaining power will pay many times what larger players should pay.

1.2 Raise more revenue from the economic rent of energy and mining companies.

The war in Ukraine has led to high energy prices and windfall gains for many companies. The head of the UN, Secretary General Antonio Guterres, has urged countries to tax what he terms “excessive” oil and gas profits that have largely resulted from this. (5) This is a highly unusual policy intervention from the Secretary General.

The EC has just imposed excess profit taxes on energy companies. (6)

In his recent Summit speech Ross Garnaut said: “We are kidding ourselves if we think no deep wounds will be left in our polity from high coal and gas and therefore electricity prices bringing record profits for companies, and substantially lower living standards to most Australians”.

He raises a good point. We need to consider political economy issues as we worry about the sovereign risk of imposing new taxes on sunk investments. I think those political economy issues need greater than usual weight given the ease with which support for democracy and a market economy can be lost.

Further, it has always seemed to me that it is smaller and uncertain economies who put total emphasis on sovereign risk arguments. Clearly the EC has no such concerns.

With all the above I think the question is not whether we should tax these above normal returns, but how.

Australia has a Petroleum Resource Rent Tax (PRRT), but no Minerals Resource Rent Tax (MRRT). We need both to operate at sensible levels.

As the ANU’s Tax and Transfer Policy Institute explains, there is clear logic in taxing economic rents. (7) These are returns above what is needed to attract commercial investment and the argument is that they should be shared with the owner of the resources, the Australian people.

(a) PRRT

The essential criticism of our PRRT is the extremely high rate of return allowed on past investment before the tax takes effect. In 2019 the former Government lowered the extremely high rate of return of 15% above the long term bond rate on expenditure to 5%, going forward.

That is, past calculations would remain, using the 15% rate, but such amounts still to be recovered would be taken forward at 5% above the long term bond rate. This still sees the oil and gas companies benefitting from the past excessive 15%.

With the current political resistance to change in mind one simple tax bring forward idea is to legislate that, when current year profits are above a certain level, then only, say, two thirds can benefit from the carry forward of past losses, and the remaining third is subject to PRRT without the uplift.

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This would bring in immediate money, and the unclaimed losses would go forward with the 5% rate. That is, you are brining forward future tax at a discount rate of 5% above the bond rate.

This cannot be called punitive. And it would smooth out PRRT collections over time.

MRRT

There is clear and well-established logic for having a resource rent tax apply to mining companies, well before the Henry Tax Review recommended one.

Here you have a nation's assets, attainable at varying cost levels largely determined by the accessibility of the resource, facing wildly varying prices that can be influenced significantly by outside events such as a war in Ukraine. This can result in large, fortuitous increases in profits that need to be shared with the community that owns these ore bodies.

Not only is this required in a just society, but absent an MRRT governments will enforce arbitrary measures as Queensland has just done with its large increase in coal mining royalties.

I have personally negotiated MRRTs all around the world. Pushback against the concept of an MRRT is as illogical as it will be strong. Once companies know that it will happen, however, following a strong government statement, sensible negotiations can occur.

Thresholds for and the levels of such a tax should not be too difficult, provided they can be easily explained to the general public. I would apply an MRRT to existing projects, just as was the Queensland coal royalty increase, and certainly not use asset values based on current market values.

Perhaps the strongest practical argument against a MRRT is that the States and Territories see minerals as their tax base. I believe mineral resource rents are better taxed at the Commonwealth level. The appropriate tax base for extra State and Territory revenue is land; see 1.4 below.

1.3 Impose a carbon tax.

This is both necessary and conceptually obvious. It is necessary to get the changes in behaviour needed to tackle climate change, and conceptually obvious since, in economic terms, this is needed to deal with the negative externality that is carbon.

We tax cigarettes heavily because of the negative externalities that flow from smoking, particularly the high costs to our health system. The same logic suggests we should put a tax on carbon. ANU's Tax and Transfer Policy Institute has put out a very clear paper on externalities (8).

More important, however, how do we expect the widespread changes needed to occur to tackle climate change if we do not alter relative prices in favour of low carbon activity? We can use taxes on what we wish to do less of, or subsidies on what we wish to do more of. The reality is that taxes are the only option given our financial position.

Carbon taxes would also be more equitable than other measures. This is a key point. Many want subsidies for, say, electric cars or rooftop solar panels, but as the theme of todays conference suggest, all these must be paid for.

It is easy to see that subsidising solar panels is regressive as the subsidy is currently paid for by all energy users, but those who live in flats, or who rent, cannot gain the subsidy. Subsidising electric vehicles will favour the richer members of our society as they are the only ones who can currently afford these high-priced cars.

A carbon tax, however, will raise considerable revenue, much of which can be used to offset the impact of such a tax on the less well off. They can be insulated, so only those better off will incur the tax.

It is baffling that we have a significant majority of Australia's population wanting action on climate change, but the idea of a tax on carbon is instantly condemned.

Or are we only in favour of this massive change to our way of living provided it is completely painless?

No such transition can be painless. We need to decide whether we are serious about climate change. If we are then it can be funded by a tax that will have the benefit of directly changing behaviour while insulating low income earners from its effect.

1.4 Have all States and Territories introduce a broadly based tax on land, that can be levied at different rates to meet their funding needs, and to replace stamp duty.

Trevor Rose and Professor Bob Breunig from the Tax and Transfer Policy Institute (TTPI) at ANU, of which Bob is the Director, argue that the best way to pay down Australia's debt using the tax and transfer system is via a 0.1% tax on the unimproved value of land over 33 years. (9) That rate goes to 0.6% to repay the debt in 10 years.

Bob Breunig, Ken Henry, Ross Garnaut and Dominic Perrottet all agree that doing more to tax land makes sense. They may not all agree on much else.

Bob Breunig's Tax and Transfer Policy Institute at the Australian National University puts out extremely informative Tax Facts, and I have already referred to some of them. The one on land tax (10) has calculated that the unimproved value of land in Australia is $5,660 billion. It says "…land tax is a highly desirable form of taxation".

Most States and Territories impose land taxes on investment properties which raise revenue at a level that equals about 0.2% of unimproved land value. A tax rate of 1% would raise an amount that would be just under 10% of all taxation by all Australian governments. I am not suggesting a 1% rate; simply showing that a land tax has great revenue raising potential.

The TTPI says a land tax is simple, produces a steady revenue stream and would encourage the best use of land. I would add that it:

- is based on assets that cannot be moved
- is proportional to people's land holdings where the poorest can have no holdings and the richest people can have considerable holdings. It is therefore a progressive tax.

Agricultural land could be excluded either by design or by some form of value of land holdings to qualify. Rural land is just 6% of total land value.

Not only is this an efficient tax, but it can also replace a very inefficient tax which is stamp duty on transactions, which would equate to another 0.2% of unimproved land value.

1.5 Introduce a new way of paying for roads.

We need to do this for two reasons.

First, as more vehicles become electric, they will not be paying the current charge for using roads which is the excise on petrol and diesel.

Many argue EVs should not pay a road user charge as a way of encouraging EV sales. The problem is that such a subsidy is highly regressive. As I have said, currently only comparatively well off people can afford EVs, while the less well off continue to pay petrol excise. This is poor public policy.

If EVs are not subject to a road user charge now, then it will be hard to introduce such a charge when EV take up is more widespread. This could see motorists not paying for road use and road funding coming from taxes all pay whether they drive a car or not. This is again poor public policy.

Second, such a charge can be levied in a way that spreads road usage a little bit more outside peak times and reflects the damage done to roads. Drivers would pay more for driving at certain high usage times, and only a minor change in traffic makes a huge difference in traffic congestion, and trucks would pay more because they weigh a lot more and it is weight that largely drives road damage.

We would have less need for more road spending, and the burden of road user charging distributed more equitably.

Concluding comments.

The key message from the above is that choices must be made.

If you want more spent on health care or education, then taxes must rise.

If you argue we should recognise the damage being done by carbon emissions and that we need to provide incentives for low carbon activity, then support a carbon tax.

Finally, if you want a lower cost of capital and a resilient Australia then support immediate increases in taxation to reduce Australia’s debt.

However, you look at it I think Australia needs some increase in taxes.

And sensible, saleable options are available if we all put in the effort.

As I said earlier, I think many good ideas are put to the community without sufficient explanation and dwell time so that the arguments can be sensibly weighed. Ideas are often mentioned, there is an instant negative reaction, and so the ideas are dropped.

Public policy change requires a serious investment from politicians and others.

So, thanks to the Australia Institute for putting on this event.

NOTES

(1) Ross Garnaut, Jobs and Skills Summit-Dinner Speech, 1 September, 2022.
(2) Ross Garnaut, Jobs and Skills Summit-Dinner Speech, 1 September, 2022.
(3) Thomas Piketty, “A brief history of equality”, P123, Harvard University Press, 20222.
(4) Matt Grudnoff, “Tax and wellbeing: the impact of taxation on economic wellbeing”, Australia Institute, October 1, 2020.
(5) CNBC politics, August 3, 2022.
(6) Economist, September 15, 2022
(7) TTPI, Tax Fact #8, “Good tax policy: Taxing economic rents, May 2019.
(8) TTPI, Tax Fact #4, “Good tax policy: Taxing negative externalities”, April 2019.
(9) Trevor Rose and Robert Breunig, “Paying back Australia’s COVID-19 debt, TTPI Working Papers, July 2022.
(10) TTPI, Tax Fact #15, “What is land tax?”, November 2020.