

Debt Death and Deadweight

CHAPTER 5

Systemic integrity: the Australian model

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IMAGINE the opportunity presented to rational people who were transported onto virgin soil and given the chance to create a new society. What would their blueprint look like? Such a prospect is not fantasy. The history of colonialism is replete with cases where that was a real prospect. Australia provides us with a test case for examining a theoretical model against what people actually accomplished.

The earliest phase of settlement was not a desirable beginning. Australia was treated by the UK Government as a dumping ground for the people whom it wished to expel. A fleet of eleven convict ships set sail for Botany Bay in 1787, landing on what became Sydney, New South Wales. Penal colonies were established in Tasmania in 1803 and Queensland in 1824. Western Australia, founded in 1829 as a free colony, received convicts from 1850. Penal transportation dropped off significantly in the 1840s, with the last convict ship arriving in Western Australia on 10 January 1868. The free colonies were populated by people whose ancestors had been rendered landless by earlier generations of aristocrats and gentry. Australia offered them a refuge and the means of earning a living.

There would come a point when the settlers realised that they had to lay the financial foundations for a commonwealth that straddled a vast continent. How would rational people create the infrastructure for a political and economic system that would integrate the population into a viable social system? How would they amass the funds to invest in the huge infrastructure that they would need, to link the scattered settlements? If highways and railways were to be constructed to serve the emerging economy and the new settlements, it would not make sense to import the UK's abusive tax regime and funding arrangements which, taken together, created destructive cycles of boom and bust. *To achieve the most effective outcomes, at the quickest pace,*

while emancipating people to achieve their aspirations, the ideal source of revenue was the rent of land.

Beginning in the 1850s, municipalities began to levy a rate on unimproved land values. This contrasted with Britain's property tax, which imposed the charge on the value of buildings as well as land. In Australia, starting with nothing, incentives had to be maximised to construct new commercial and residential properties. The wisdom of excluding improvements prevailed.

The dynamism that emerged may be inferred by comparing US GDP *per capita* with Australia's. In 1820, Australia's output was \$400 compared to the \$1,257 in the US. Fifty years later, in 1870, Australians were generating \$3,273. The US had merely doubled its revenue to \$2,445.¹ By 1890, in *per capita* terms Australia was the richest nation on earth!

State land taxes were introduced in the six states: South Australia (1884), New South Wales (1895), Tasmania and Western Australia (1907), Victoria (1910) and Queensland in 1915. A graduated federal land tax was enacted in 1910, with the intent of breaking up large landholdings.

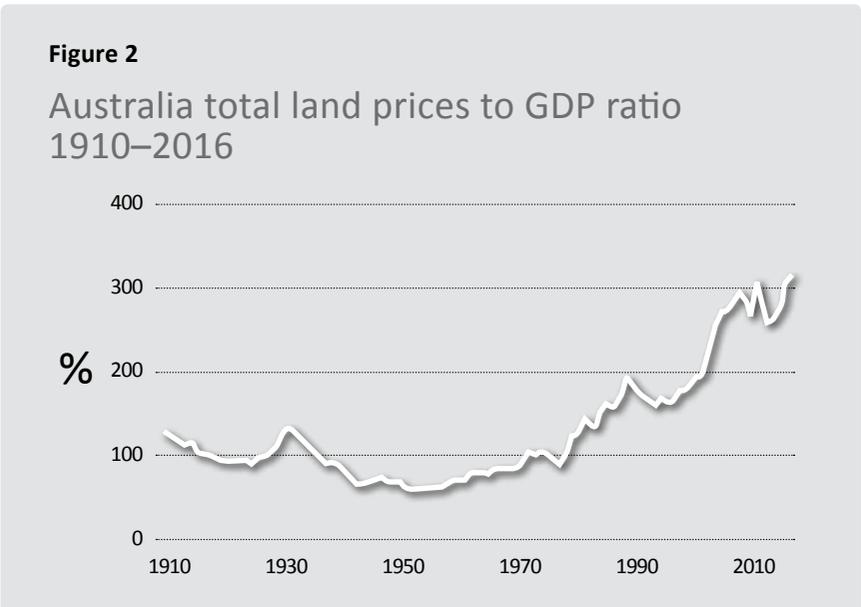
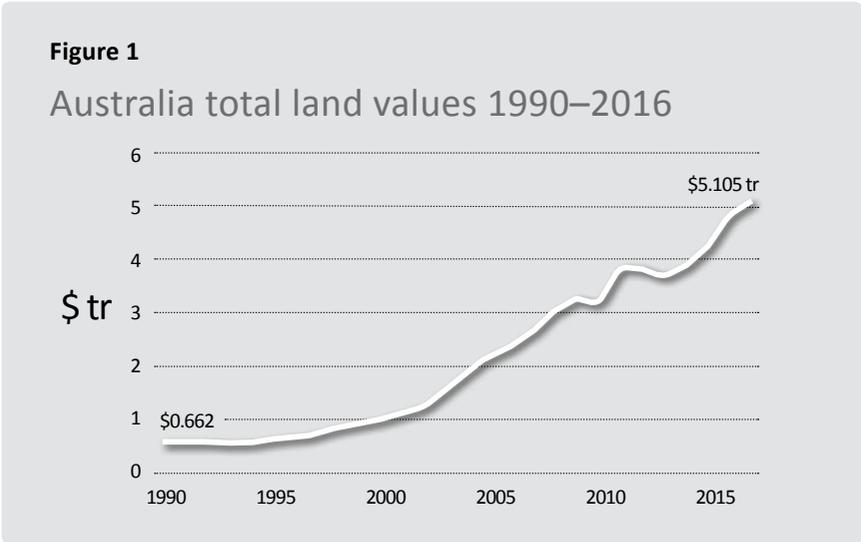
Part of Australia's success must be attributed to the rich natural resources buried in the territory. But this is not a sufficient explanation for the rapid growth of prosperity. Many countries in Africa are richly endowed in valuable resources, but they continue to suffer from what some economists call the 'resource curse'. This concept draws attention to the social pathologies that arise when the rents of the commodities are not cycled back into those territories to fund social development. In Australia, nature's generous gifts were combined with an enlightened fiscal policy. Central to the successful jump into the high-growth stakes were the economic incentives that flowed from a revenue system that did not discourage people from working, saving and investing.

Once Australian society had matured, however, the rent-seekers began to work away at the political system. They wanted to reduce the revenue from rent; which meant that they had to countenance the taxes that imposed deadweight losses on the population. The federal land tax was abolished in 1952. The five state governments continue to levy a direct charge on the market value of land.

The administrative infrastructure for the valuation of land is one of the best in the world. The New South Wales Valuer-General's website explains how land is valued separately from building values.² Drawing on data from official sources enabled Bryan Kavanagh of the Melbourne-based think-tank Prosper Australia to construct the following two figures.

1. Maddison (2007), p.104, Table 2.9b. Comparison in 1990 Geary-Khamis \$.
2. http://www.valuergeneral.nsw.gov.au/land_values

Figure 1 tracks land values since 1910. Figure 2 plots the ratio of land prices to GDP over the course of the 20th century up to the present.



Source: ABS, Coleman, Dwyer, Herps, Scott

With the passage of time, the early wisdom waned: there emerged a class of rent-seekers who made it their business to diminish the amount of rent that was collected to fund public services. Australia became a victim of the boom/bust property cycle. Despite the land tax, so much rent was being capitalised

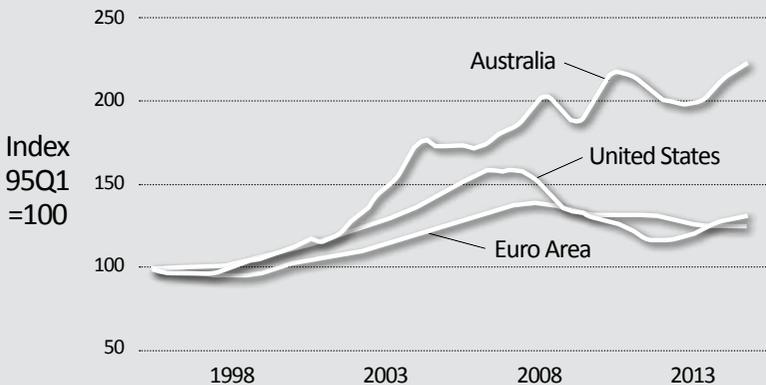
into the selling price of land that Australia ended up importing a crippling disease from the motherland: *land speculation!*

Australia has experienced five post-war real estate booms: the 1960 boom which saw the Menzies Government reduced to a one-seat majority in the ‘credit squeeze’ election of 1961; the 1973 commercial land bubble which heralded the recession of 1974/75 and saw the Whitlam Government dismissed; the 1981 residential bubble which burst into the 1982/83 recession and defeated the Fraser Government at the 1983 election; the 1988/89 commercial bubble which broke into the 1991 recession and saw the Keating government hold on in the 1993 election; and the current hyper-inflated residential bubble that has extended ever since 1996 and still awaits its inevitable resolution. Both Liberal and Labor governments have pointedly fed this bubble, for fear that it would burst on their watch. As this appears to be the paramount, if unstated, consideration, it is unsurprising that the economy and wages are floundering.

Today, Australia’s property markets are bucking the global trends. Thanks to China as a hungry customer for Australia’s mineral resources, coupled with the Rudd Government pumping more than A\$50bn into the economy to keep the bubble inflated, the 2008 crisis was not as severe as in Europe or the USA. Figure 3 illustrates the dangers: Australia’s housing market is rocketing away, and it will eventually end in tears.

Figure 3

House market developments risk macro-economic stability



Reviving the wisdom of the settlers

The efficiency and ethics of governance regressed in the 20th century. The major indicator for this qualitative change is the character of fiscal policy. Over the decades, the incremental shift in the structure of taxation favoured tools for raising revenue which abused the creative potential of the population.

Economists can measure the damage which those taxes inflict. Bryan Kavanagh has estimated that the average annual excess burden since 1972 was \$2.34 for each dollar of taxation raised.³

At present, complacency prevails among policy-makers as they celebrate the fact that Australia is one of the least corrupt nations on earth. According to Transparency International, Australia is near the top of the rankings, at 13th out of 176 countries.⁴ Nonetheless, Australia has had its share of scandals involving both politicians and entrepreneurs. Many of these involved property deals, such as those that implicated the late politician Sir Phillip Lynch ('Stumpy Gully Phil'). A new book by two academics (Murray and Frijters 2017) provides insights into the 'grey gifts' handed out between contacts and friends in Australia. More often than not these have related to real estate.

There is room for improving the moral fabric of the body politic. But how is that to be achieved on a cost-effective basis? Griffith University in Queensland has developed one methodology, which it calls the National Integrity System Assessment (NISA). This is designed to lay bare the interlocking relationships between people and institutions, to expose failings in behaviour. Their metaphor is that of the bird's nest, "*in which a multitude of often weak institutions and relationships can combine to more effectively protect and promote the fragile goal of public integrity*" (Sampford, Smith and Brown 2005). Unfortunately, this approach relies on accommodating and deploying existing regulatory and legal tools.

- ▶ If there are structural flaws in the foundations of the system, the NISA model accommodates them in the process of mitigating their impact.
- ▶ As problems accumulate, the regulatory strategy requires ever-more complex oversight tools for combatting them, along with new palliative policies.
- ▶ The costs of compliance and enforcement increase, as the existing tax regime raises additional revenue to fund the palliative policies.

The alternative, holistic approach to remedial action is based on fiscal reform. This works by removing the temptations that currently reward bad behaviour.

3. <http://thedepression.org.au/why-economies-are-failing/>

4. https://www.transparency.org/news/feature/corruption_perceptions_index_2016

If government was to overhaul the tax structure, replacing the deadweight taxes with charges on rents, the flow of net income that is currently circulating in society would be reduced. The logic underpinning this thesis is as follows.

When government fails to collect a nation's socially-created rents, that revenue stream is detached from its moral anchorage. We must emphasise that, unlike wages, this is the stream of value which the whole population helps to create on a cooperative basis. When rent is rendered footloose, it is 'up for grabs' by anyone in a position to exploit connections to the centres of power. The whole of society is made to suffer. Two examples illustrate this insight.

- ▶ **In Italy**, some construction companies operate as 'fronts' for mafia-type operations. They extract the nation's net income through contracts to construct highways or public buildings. One strategy: short-change the public by delivering substandard products. Costs are cut to maximise profits. Public buildings have been known to collapse because of the use of sub-standard materials.⁵
- ▶ **In China**, some developers are accumulating fortunes by bribing local government officials to secure land leases at less than market price. The developers construct buildings and pocket super-profits – the value of the land that ought to have gone into the public purse.

This kind of behaviour, as a social process, is thwarted when governments are obliged to administer the nation's rents on a transparent and accountable basis. If a nation's rents are collected and invested for the common good, nothing is left to fuel corruption. Corrupt practises are less likely, when criminals turn their attention to wages and entrepreneurial profits! People jealously guard their earned incomes. They are unwilling to part with them unless under direct duress (the highway robber model).

By monitoring the flow of rent, and holding government accountable for the way in which it is collected and spent, the integrity of the social system is elevated. It is no accident that, in the rankings on corruption produced by Transparency International, Denmark and New Zealand are placed 1st and 2nd. Both countries adopted the use of the land value tax early in the 20th century. And while the proportion of revenue collected directly from rent has been reduced since World War 2, those two societies continue to benefit from the era of ethical finance (these and other cases are fully described in Andelson 2000).

5. The *modus operandi* of criminal gangs which target the public purse was documented in a recent trial in which 41 people were convicted of skimming money from public contracts in Rome. What was characterised as a Mafia operation included former politicians and local officials (Politi and Ghiglione 2017).

Dr Terry Dwyer, a Canberra-based tax lawyer who has served as advisor to the Department of Prime Minister and Cabinet, has demonstrated that *land rent is more than adequate to replace Australia's income and company taxes* (Dwyer 2003). That assessment exposes the lie in the standard textbooks on economics, which seek to trivialise rent. They report, without offering evidence, that economic rent in countries like the UK and US is of the order of between one and four percent of national income. If economists would like to rescue the integrity of their discipline, they could do worse than to start with a forensic examination of Australia, the country where a proper assessment of land rent has finally emerged.

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