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Submission re: the Major Bank Levy Bill 2017

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1. The case for the levy

The case for a bank levy should be made in the context of sound principles of public finance and effective prudential regulation. The Government has put forward a range of rationales for the bank levy, but it has not shared any detailed analysis showing how the levy links to these sound principles. Overall the rationales put forward fall short of a well-considered, balanced and solid case. The Major Bank Levy Bill 2017 should not be passed into law before such a case is presented and assessed.

The 'budget repair' rationale for the levy is weak

One mooted rationale for the levy is that successive governments have permitted public sector debt to increase, and that deficits are still too large. This is true, but these facts do not constitute a rationale for a levy on large banks. There are many other ways to improve the budget position, including spending cuts and more broad-based tax increases.

The Government has not shown that the levy would be a fair contribution from major banks to the community

The Government argues the levy is a 'fair contribution from major banks to the community'.

First, the levy might be thought to function like a tax on firms that earn supernormal profits. The explanatory memorandum for the Bill notes, correctly, that large Australian banks have earned a higher return on equity (ROE) in recent years than many banks in other high-income economies.

But banks elsewhere earned ROEs similar to those in Australia until the financial crisis, and the ROEs of many such banks are currently depressed due to losses incurred during the crisis and to continuing economic weakness in the Eurozone. Moreover, the large bank levy is nothing like a super-profits tax. It applies to an input, not to profits in excess of some claimed normal level. And it singles out only the largest firms in one sector, rather than applying broadly to all firms that earn

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above-average returns for shareholders. Such a super-profit tax might be justifiable, but any such tax should be broad-based. No analysis has been provided to support imposing a tax only on the banks.

A second basis for the levy might be that large banks benefit from a strong public sector balance sheet, because it reduces their funding costs. Systemically important banks (that is, banks that are judged to be so important to the financial system that they are 'too big to fail') get funding at a lower cost thanks to implicit or explicit support from a low-risk government. Because they may receive support from the state during a crisis, such as debt guarantee (as was given during the GFC), lenders assess the large banks' debt to be safer than the debt of banks that do not expect such support. The levy could be seen as an insurance premium for such support. But the Government has not provided any analysis to justify the size of the levy on the basis of the funding benefit.

A closely related funding benefit is that the funding costs for such systemically important banks are lower when funding costs to government itself are lower. The explanatory memorandum for the Bill notes this fact, and implies that it justifies the levy. But the government has not provided any analysis to link the size of the levy to this funding-cost benefit.

A third basis for arguing that the levy constitutes a 'fair contribution' is that financial services are currently subject to a lower tax rate than many other industries. The Goods and Services Tax does not apply to financial services. However, the Government has not attempted to make the case that the levy substitutes for the GST.

The Government has not shown that the levy would complement prudential reforms

The Government says the levy would complement prudential reforms. But the Government has not shared in any detail how the levy would dovetail with the rest of the Government's banking reforms and the broader prudential framework. If that framework is already being adjusted to make the big banks 'unquestionably strong' (by mandating that they fund a larger share of their loans from shareholder equity and other 'Tier 1' capital, for example), what is the purpose of a levy? Even if banks are not unquestionably strong, would the levy reduce risks in banking? Is the rationale for excluding smaller deposits from the levy, on the basis that small depositors are less likely to withdraw their money in a crisis, really valid? The Government has answered none of these questions.

Levelling the playing field is not a valid argument for the levy

Finally, the Government argues the levy would help 'level the playing field' between big and smaller banks. It is true that 'too big to fail' support helps to reduce the cost of finance to systemically important banks and that imposing a levy would offset this advantage. But increasing the cost of finance can be expected to increase costs to borrowers, so the benefit to smaller banks comes at a cost to borrowers. That is a weak justification for levelling the playing field.

2. The likely effects of the levy

Part of the burden of the levy is likely to fall on borrowers. The Government says the levy will not be passed onto borrowers because the big banks will fear losing market share to smaller lenders,

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which are exempt from it. But the big banks are likely to balance the loss of market share against the loss of profit. The European experience of bank levies introduced after the Global Financial Crisis suggests lending rates rise when levies are introduced. The Government says the ACCC's new 'price monitoring' function will limit rate rises. But an ACCC investigation is likely to find that banks lift lending rates when borrowing costs rise. Alternatively, shareholders can expect lower profits. Bank share prices fell on the day of the announcement, suggesting sharemarkets expect shareholders to lose something. Time will tell how much.

Banks can be expected to adjust their balance sheets in response to the levy. They may shift towards untaxed liabilities such as smaller deposits and equity, and may securitise more of their loans. That would reduce the impact on both shareholders and borrowers, reduce revenue from the levy, and may reduce some financial system risks and increase others. The Bill contains 'anti-avoidance' measures that, if interpreted and enforced strictly, may limit such responses.

3. Overall assessment

Most tax reform is about getting rid of specific taxes, which usually cost the economy more than general taxes (such as income, consumption, land, or profit taxes). Specific taxes are typically only a good idea if they are levied on activities that impose costs on the rest of the community, but which are otherwise unpriced. This is the rationale for pollution or congestion taxes, for example.

A case for the banking levy along the lines set out above could be constructed and tested rigorously, but the Government has not made such a case. Until this is done, the levy may be better seen as an emergency revenue measure made primarily for the purposes of budget repair, and as such should have a sunset clause.

The levy also entails a significant increase in ad-hoc banking regulation, in the form of output price monitoring and 'anti-avoidance' balance sheet monitoring. The compliance and other costs of such regulation may be substantial.