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Five Reasons Why the Government Should Abandon the Bank Tax

The Government announced major changes to the banking sector in the 2017-18 Budget, including:

- A tax of 0.06% on the liabilities of the four major banks plus Macquarie.
- Forty per cent of a banking executive's variable remuneration must be deferred for at least four years.
- The Australian Prudential Regulatory Authority (APRA) will be given powers to require banks to change their remuneration policies.
- The Australian Competition and Consumer Commission (ACCC) will undertake a residential mortgage pricing inquiry until 30 June 2018.[1]

Additionally, the Prime Minster said the ACCC would be watching the banks "very, very closely" should they decide to pass the cost of the bank tax onto borrowers.

1. The Changes to the Banking System are Illiberal

At the heart of a liberal society is the free enterprise system where people are free to run businesses in a way they see fit. Free enterprise, along with the rule of law, trade, and property rights have made Australia one of the most prosperous nations.

However, the Government's proposed changes will undermine the free enterprise system by effectively turning banks into an arm of the bureaucracy. APRA's new powers to regulate executive remuneration and the ACCC's role in price oversight means the government is taking increasing control of the way in which banks:

- Pay senior staff
- Price financial products and services
- Manage their commercial risks.

Further, the new bank tax is arbitrary.

- It will apply to just five companies.
- It is not based on any economic, financial, or public policy principles.
- The Treasurer has cited the bank's lack of popularity amongst voters as justification.

2. The Tax will be Paid for by all Australians

All taxes are paid for by people, either workers, consumers, or shareholders. The bank tax will be no exception to this. A 2010 study by the International Monetary Fund found similar taxes introduced in European countries:

- Increased loan rates
- Discouraged investment
- Reduced asset creation
- Permanently reduced GDP
- Had a negative impact on bank risk
- Increased the probability of a default. [2]

In Australia's case it is likely that the majority of the tax will be passed onto consumers due to our uncompetitive and highly concentrated banking sector.

David Murray, AO and former Chair of the Abbott Government's *Financial System Inquiry* in 2014, argued "if the banks pass this [the tax] on, the Treasurer has just tightened monetary policy by 12 to 25 basis points and the sectors most at risk are housing borrowers and small and medium enterprises."[3]

What is not passed onto consumers will be passed onto shareholders, which will affect all Australians due to compulsory superannuation.

3. The Changes to the Banking System are an Exemplar of Bad Policy Process

Consultation was practically non-existent:

- Stakeholders were not consulted on the merits of the proposed changes.
- Stakeholders were then given just two days to comment on technical details.
- The banks were required to sign non-disclosure agreements before being provided with details of the proposed tax.

This lack of consultation:

- Is inconsistent with the Government's own *Guide to Regulation* which states "Policy makers should consult in a genuine and timely way…"[4]
- Deprived stakeholders and citizens of the opportunity to participate in a democratic decision-making process.

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Even Treasury officials were "unable to explain important elements of the bank tax, including … how [the tax] might impact the broader economy."[5]

The poor policy process has resulted in substantial design flaws. For example:

- NAB is expected to pay more tax than Commonwealth Bank ($245 million versus $220 million post-tax) even though NAB is much smaller than Commonwealth Bank ($790 billion versus $972 billion in assets).[6]
- Total revenue may fall $2 billion short of what was forecast.[7]

4. The Wage and Price Controls will Distort the Financial System

The central role of financial intermediation is to allocate resources and risks to their highest valued use. Market prices provide a signal to banks about where financing will deliver the greatest economic and social returns. Muting these price signals with bureaucratic control will:

- Reduce the efficiency of financial intermediation
- Lower productivity
- Reduce economic growth.

Further, the proposed regulation of executive remuneration will discourage the recruitment of high quality senior management. The Productivity Commission has argued that Australia already has a low quality of senior management and this explains half of the difference in multi-factor productivity between the US and Australia.[8]

5. The Bank Tax will Discourage Investment in Australia

The arbitrary nature of the tax has created uncertainty for prospective investors and will discourage investment into Australia.

A number of business leaders have noted this problem.

- CEO of Qantas, Alan Joyce, said the Government faces capital flight "unless it better explains the $6.2 billion bank levy and reassures investors that other profitable sectors won't be hit."[9]
- Joyce also asked: "are we going to just start having an imposition on any profitable businesses out there and a policy for more taxes when businesses do well?"
- Former CEO of the NAB, Don Argus, said: "Business would now be starting to think, 'well am I next?'"[10]
- Managing Partner of Real Investment House, Andrew Papageorgiou, argued that "regulatory risk for the [financial] sector has never been higher."[11]

Investing in Australia is already an unattractive prospect. Australia has one of the highest corporate taxes in the developed world, a highly inflexible labour market, and significant over-regulation and red tape. The bank tax will further discourage business investment, which is forecast to fall to a record low of 9% of GDP by 2020.[12]

Conclusion and Recommendations

The Government's proposed changes to the banking sector should be abandoned. The changes are illiberal, amount to the quasi-nationalisation of the major banks, and will permanently reduce economic growth.

Instead, the government should:

- Significantly liberalise the financial sector to increase competition by cutting regulation and red tape.
- Reduce the company tax rate to increase investment.
- Eliminate the implicit taxpayer bail-out of banks to remove moral hazard and reduce market concentration.

To repair the Budget the Government should reduce expenditure, delegate education, health, and environment policy functions to state governments, and reduce regulation and red tape to increase economic growth, employment, and wages.

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1 Morrison, Scott, "Building an Accountable and Competitive Banking System", Media Release, (9 May 2017)

2 International Monetary Fund, "Financial Sector Taxation: The IMF's Report to the G-20 and Background Material", (September 2010)

3 Ryan, Peter, "Federal budget 2017: David Murray slams bank levy, says passing on to consumers could mean significant rate rise", (10 May, 2017), available at: http://www.abc.net.au/news/story-streams/federal-budget-2017/2017-05-10/federal-budget-2017-david-murray-says-banking-levy-very-bad-idea/8513934

4 Commonwealth Government, "The Australian Government Guide to Regulation", Canberra, Australia, (March, 2014)

5 Chung, Frank, "'This is a shambles': Treasury officials couldn't answer basic questions on bank tax, ABA says", (11 May, 2017), available at: http://www.news.com.au/finance/business/banking/this-is-a-shambles-treasury-officials-couldnt-answer-basic-questions-on-bank-tax-aba-says/news-story/70122465338d14614088aa9d16e51ecd

6 Figures on tax payments from Crowe, David, "Mirrson faces bank claims of $2bn tax gap", *The Australian,* (23 May 2017). Figures on asset values from Commonwealth Bank and National Australia Bank 2017 half-yearly results.

7 Crowe, David, "Morrison faces bank claims of $2bn tax gap", *The Australian*, (23 May 2017)

8 Productivity Commission, "Increasing Australia's Future Prosperity", Productivity Commission Discussion Paper, (November 2016), pg. 10

9 Durkin, Patrick, "Bank 'tax grab' will spook investors: Don Argus, Alan Joyce, Andrew Thorburn", *Australian Financial Review,* (11 May, 2017)

10 Ibid

11 Shapiro, Jonathan, "Budget 2017: Are Australia's banks on the road to nationalisation?" *Australian Financial Review,* (10 May, 2017)

12 Wild, Daniel, "Business Investment in Australia Now Lower than Under Whitlam", Institute of Public Affairs, Melbourne, Australia, (2017)