Business Council of Australia

SUBMISSION

Submission to the Senate Inquiry into the Major Bank Levy Bill 2017

JUNE 2017

www.bca.com.au

The Business Council of Australia is a forum for the chief executives of Australia's largest companies to promote economic and social progress in the national interest.

This Bill warrants scrutiny

The Business Council of Australia welcomes the opportunity to provide a submission to the Senate Inquiry into the Major Bank Levy Bill 2017. Further scrutiny of the Bill is welcome given the number of uncertainties around the levy's impact and implementation, compounded by poor policy process to date.

While we understand the difficult position the government is in and the need for budget repair, there is no substitute for a credible strategy to contain growth in government spending. The haste with which the levy has been introduced has left all stakeholders – government, companies and the community – with a great deal of uncertainty around the consequences of the levy's introduction. It also sets a poor precedent for future development of public policy.

Businesses are also concerned that there is a real prospect that this 'one-off' revenue raising measure could become the norm now that the genie is out of the bottle. The tax system should not be changed through ad hoc measures designed to be a quick fix to the budget problem. Higher taxes are not budget savings and will only dampen growth and incomes over time.

In its scrutiny of the Bill we would encourage the Committee to satisfy itself that: the Bill has been subject to proper assessment (including of the regulation impact statement); the rationale of the Bill is both clear and consistent (for example, if it is for budget repair there should be a sunset clause); and the potential impact of the threshold over time be explored.

Recommendations

- The levy should be introduced with a sunset clause so that it expires when the budget returns to surplus. It should not be used as an ongoing revenue raising measure.
- There should be a legislated fully independent and transparent review of the levy after 3 years. The review should be brought forward in the event of an economic shock or major developments in the banking sector.

Poor policy, poor process

The levy is poor public policy, the problems of which have been compounded by poor process. Both the policy and the way it was introduced increase sovereign risk, undermine investor confidence and raise the question – which industry is next? The levy also represents another 'one-off' in a long line of 'one-offs' that undermine investor confidence.

This is a highly complex area and it will take time to consider the myriad of issues and consequences of its introduction, including risks to market stability and liquidity. The policy design and its rushed implementation risk unintended consequences, deterring investment and distorting genuine commercial activities. This has already been illustrated through the limited consultation to date. For example, a delayed start date reflects the complexity and issues with the implementation that were not originally expected.

Poor policy assessment

The Explanatory Memorandum (EM) notes that the levy will have a 'negligible impact on the real economy'. Most policies, in isolation, are likely to have a small impact on the economy. The appropriate benchmark is whether a policy will have a net positive or a net negative effect on the economy. To assist the Senate's deliberations, all the analysis and modelling of the levy should be made public.

Dismissing the impact on the economy as 'negligible' sets a disturbing precedent against which to assess and develop public policy. It opens the door to the introduction of policies with 'negligible' harmful impacts, the cumulative effect of which will compound into something more substantial. In addition, this approach belies the signalling effects of the policy – which are not negligible.

Policy uncertainty undermines business investment

The Business Council is concerned about protracted subdued business investment, now at its lowest level as a share of GDP since June 1994. While there are many factors contributing to this weakness, policy uncertainty in an unfavourable political climate is a key factor. There has been a discernible shift towards policy intervention in business and markets, often accompanied and even justified by anti-business rhetoric. This is having a negative impact on the real economy and international perceptions of Australia.

All too often, regulation and intervention have become the first resort of policy-makers to deal with a perceived market failure, with cost-benefit assessments either bypassed or, as with this Bill, given mere lip service. Seeking to regulate every market imperfection risks undermining the incentives that drive businesses to invest and innovate in the first place. In addition, we have seen governments abruptly shift positions and even tear up contracts, increasing risk premiums for future projects.

The bank levy is the most recent in a long line of 'one-offs'

While individual policy decisions may be downplayed as 'one-offs', taken together, such behaviours and interventions are having significant ramifications, increasing risk and chilling decisions to invest in Australia. Businesses are understandably unsure about what will happen next. These atmospherics are not conducive to a rekindling of confidence and 'animal spirits'.

Other recent examples include: mooted royalty changes in Western Australia; pressures on LNG exporters to restrict exports; state governments repudiating major infrastructure contracts and delaying major project approvals; uncertainty around foreign investment assessment criteria resulting in late-in-the-day rejections of proposals; and changes to the temporary migration scheme that will limit access to people with the global skills and experience essential for complementing new investment and productivity improvements.

No clear policy rationale

The policy rationale behind the levy is unclear, and the arguments in support of the levy are contradictory. The main policy intent of the levy appears to be a combination of budget repair and a 'fair contribution' from banks holding liabilities above an arbitrary threshold.

If the object of the levy is to assist with budget repair it should be introduced with a sunset clause, rather than become an ongoing revenue raising measure. The levy also effectively represents double-taxation of some of Australia's most successful companies. The EM notes the profitability of the affected banks but does not mention that they pay $11 billion of company tax each year, employ about 130,000 Australians and contribute to the superannuation of millions more.

The EM also states the levy will provide greater fiscal capacity to accommodate shocks (such as the global financial crisis) and improve competition. While the government accepted the Financial System Inquiry objective that the financial system should be 'unquestionably strong', the design of the levy creates a disincentive to hold high quality and longer term borrowings. These are critical for building liquidity buffers and withstanding any crisis – contrary to the government's stated aim.

The levy as a tool for promoting competition

It has been argued that the levy will improve competition in the banking sector. Paradoxically, it has also been argued that banks should not change rates and fees in response to the introduction of the levy.

As Box 1 illustrates, an impost that increases the price of one source of an input will have price and quantity impacts in both input and output markets. The bank levy can only benefit untaxed banks if costs and market prices (lending rates) of taxed banks increase, and the costs of untaxed banks do not rise in line with those of taxed banks. If lending rates of taxed banks do not increase then untaxed banks cannot benefit (unless they are perfect substitutes for major banks and essentially take over all their business, which is highly unlikely).

Banking and digital competition

The levy also ignores the fact that banks increasingly face new forms of competition in both the digital world and from non-banks. Competitors may not require the same infrastructure as banks while also being able to provide consumers and businesses with access to credit and other financial products.

The committee should therefore consider how the levy will affect banks not currently liable for it, including online competitors. Relatedly, the committee should explore the rationale for the threshold of $100 billion of liabilities.

The levy should be reviewed

The Business Council believes consultation around the levy should continue, even if it passes into law, to ensure its operation does not undermine other regulatory objectives and policies. The legislation should embed a fully independent and transparent post-implementation review of the levy after 3 years to assess what impact the policy has had, including against its stated objectives. This review should be brought forward in the event of an unexpected economic downturn or major developments in the banking sector.

Who bears the burden?

Any tax impost in any market will have consequences for prices and/or quantities. The burden of the tax (who really pays it) will be determined by relative demand and supply elasticities.

The bank levy imposes a tax on some sources of funds for some banking institutions. Taxing one source of an input means the tax has a very narrow base which makes it is highly distortionary. That is, the economic cost of raising a dollar of revenue will be high.

In the first instance, the levy will encourage taxed banks to shift to sourcing more funds from untaxed sources such as domestic deposits. This will increase demand for these funds and drive up their prices. In the case of deposits, this will benefit savers.

Higher deposit rates will increase costs for untaxed banks as well. They will try to tap into other sources of funds, which may limit cost increases for them and give them some degree of competitive advantage. But many smaller banks are highly dependent on local deposits and may have limited capacity to switch.

Higher cost for banks (taxed and untaxed) will translate into higher lending rates. The extent of the increase in rates will depend on the price sensitivity of demand of borrowers relative to the elasticity of supply of bank lending, but it is likely that both banks and borrowers will bear some of the tax. The only case in which none of the burden is passed on to consumers is where consumer demand is perfectly elastic – an extreme and highly unrealistic proposition.

The net result is that the levy will mean that both lending and deposit rates are likely to rise while total lending will fall. Total returns to banks will fall. This is consistent with international evidence which have shown levies have led to banks supplying fewer loans, raising lending rates and increasing deposit rates, with most of the burden borne by borrowers.

The remainder of the levy may be borne by shareholders through lower total returns. However, shareholders operate in competitive markets as well and will not accept a permanently lower return on equity.

BUSINESS COUNCIL OF AUSTRALIA
42/120 Collins Street Melbourne 3000 T 03 8664 2664 F 03 8664 2666 **www.bca.com.au**