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Taxing the Banks
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In the wake of the Global Financial Crisis, there is widespread international consideration of proposals to impose specific taxes (levies) on banks (and some other financial institutions). The UK has already done so in the budget of 22 June 2010 and the French and German Governments have also announced their intentions to impose some form of bank balance sheet levy.

While some see such an impost as an *ex post* charge for the costs incurred by governments and national economies for excessive risk taking by banks which led to the GFC, most support is based on a forward looking view. Thus the IMF argues that "[e]ven countries that provided little or no support to their financial sectors during the recent crisis should consider forward-looking contribution schemes."[1]

But there is not unanimous support for such an approach, as reflected in the recent communiqué of the G20 leaders Toronto Summit declaration.

"We agreed the financial sector should make a fair and substantial contribution towards paying for any burdens associated with government interventions, where they occur, to repair the financial system or fund resolution, and reduce risks from the financial system. We recognized that there are a range of policy approaches to this end. Some countries are pursuing a financial levy. Other countries are pursuing different approaches."[2]

This reflects the fact that other strategies such as increased risk-based capital requirements are an alternative to taxation of banks in terms of their potential effects on risk-taking. There is also relatively little evidence on what effects such taxes would have, and how best to structure them.

The UK levy (to operate from January 2011) is to be set at an initial rate of 0.04 per cent, eventually rising to 0.07 per cent, of a bank's aggregate liabilities excluding tier 1 capital (equity), insured retail deposits, repo funding backed by sovereign debt, and any retail insurance policy liabilities. There is also a reduced levy rate for long-term wholesale liabilities, reflecting the intention of the levy to encourage adoption of funding arrangements less exposed to instability. In this regard, it would have interactive effects with Basel II proposals for a *Net Stable Funding Ratio* requirement.

In the US, proposals for a levy funded *Systemic Dissolution Fund* as part of the *Dodd-Franks Wall Street Reform and Consumer Protection Act* were dropped in late June compromise negotiations in favour of expanded resolution powers for the FDIC, although President Obama apparently favours a "bank tax".

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[1] http://www.imf.org/external/np/g20/pdf/062710b.pdf
[2] http://www.g20.org/Documents/g20_declaration_en.pdf

There is no apparent Australian Government support for any introduction of a bank-specific tax, with much rhetoric flowing from the industry about Australian banks not having needed Government support - with this weakening arguments for any imposition. And given the recent experiences with minerals taxation, the Government is unlikely to want to rush into any other tax proposal specific to a major industry such as banking.

But there are at least three reasons why this matter should be seriously examined in Australia.

One can be found in the IMF quote referenced above – such taxes have a forward looking basis. They aim to induce behaviour less likely to create systemic crises and also partially internalize the externalities created by systemically important banks in this regard. Financial and economic theory is struggling to catch up and adequately explain the evidence of abundant financial instability we have seen over the years, but the conventional wisdom now seems to be that banking and financial systems are exposed to instability and systemically important banks play a major role in creating that exposure.

A second reason is that it is simply not true to say that Australian banks were not subject to substantial government support during the GFC. An initial blanket guarantee of bank liabilities, was followed by the wholesale funding guarantee scheme. And while the latter involved guarantee fees, those fees were substantially lower than those charged by other governments and even further below the risk premium assessed and required by the financial markets at the time. Yes, the Australian government received a fee for taking on risk, but the fee was well below what could have been charged (and alternative funding costs faced by the banks) and in that way was a subsidy to banks and their shareholders.

Third, it is now accepted that "Too Big To Fail" is the modus operandi of governments and financial regulators when dealing with systemically important financial institutions. While that does not include all banks in Australia, it is hard to escape the conclusion that TBTF operates for at least the four majors. The IMF has estimated the net effect of the TBTF policy as a subsidy of funding costs for such institutions in the order of 20 basis points.[3] A tax of equivalent magnitude would thus seem justifiable – in the form of a "user-pays" charge.

The preceding arguments do not necessarily imply that a "big bank tax" is appropriate for Australia. It may be that financial stability concerns can be adequately addressed through other regulatory initiatives (such as capital adequacy requirements). But they do suggest that such proposals should not be dismissed out of hand, and warrant further investigation (including of likely consequences). At the very least, if such levies/taxes become widespread internationally (as appears likely) justification of their non-imposition will require Australia to be able to demonstrate, in the spirit of international collaboration and fairness, that there are sound reasons for not doing so.

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[3] http://www.imf.org/external/np/g20/pdf/062710b.pdf