The GFC and bank taxes

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Outline

- The Global Financial Crisis
- The G20 and countries responses
- Discouraging risky behaviour
- Protecting Tax-payers
- Guarantees
- What is Australia doing?

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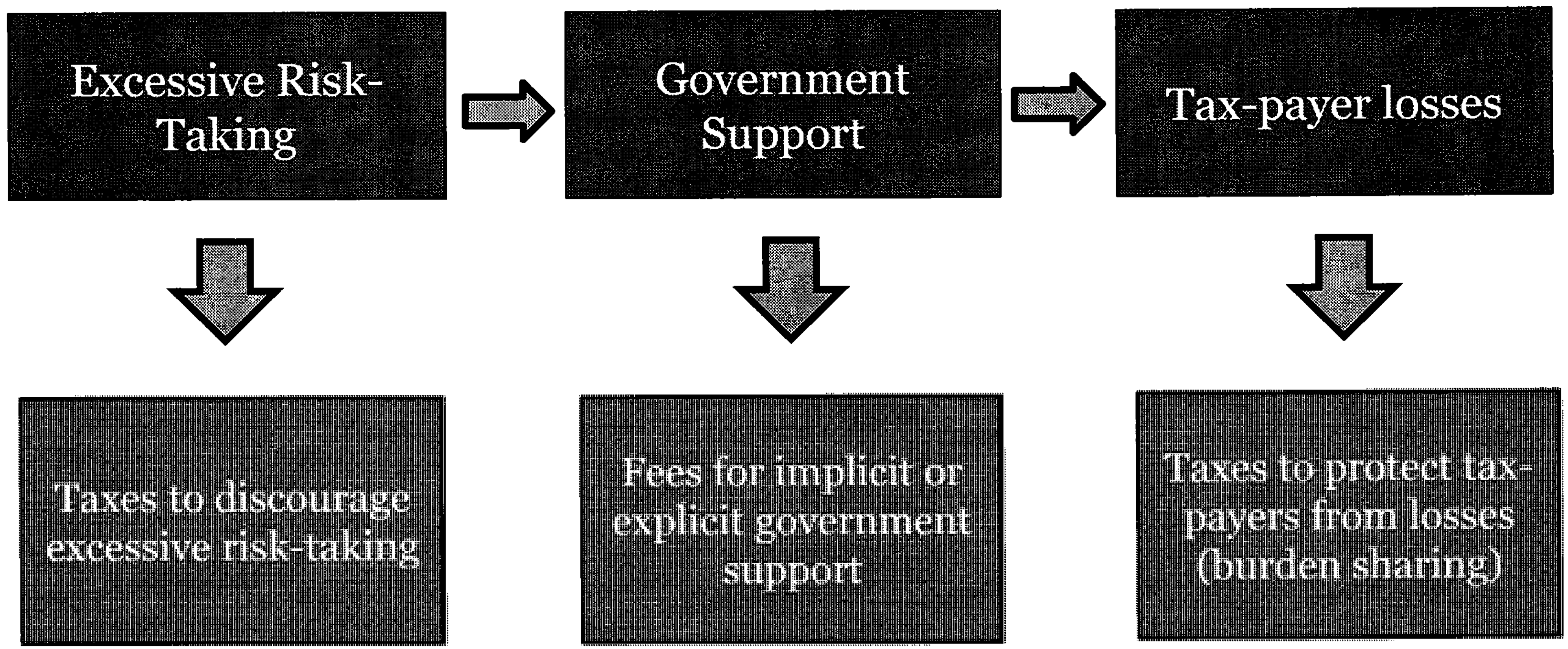
The GFC and Taxes



The G20 Response

- ✓ Enhanced Regulation
- ✓ Enhanced Supervision
- ? Bank Taxes

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Bank Taxes

- Discouraging Excessive Risks
- Burden sharing
- Charging for a guarantee

Reasons for bank taxes

Discourage Excessive Risk	Protect Taxpayers/ Burden Sharing	Pay for Guarantees	Other
Transactions Assets/Liabilities	Ex-Ante Levy Resolution Funds Ex-Post levy	Implicit Guarantees Deposit Insurance Liquidity support	Reduce debt Raise funds for social causes Punish Banks

These objectives are not mutually exclusive

Discouraging risk-taking

- Prudential Regulation
- Taxes

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Taxes to discourage excessive risk

Financial Transaction Tax	Penalise excessive speculative behaviour
Financial Activities Tax	Reduce incentive to seek excessive profit
Liabilities Tax	Encourage less risky funding profile
Asset Tax	Penalise risky exposures

Financial Transaction Tax

AKA – Tobin Tax or "Robin-Hood" Tax

A small tax on all financial transactions designed to reduce "speculative" trading and to raise significant revenue

Effective at raising revenue – but not necessarily at reducing risk

Liabilities Tax

A tax on banks funding sources – similar to liquidity rules

Example – UK bank tax

- Designed to reduce risk by taxing s/t liabilities
- Not a significant source of risk – banks have a central role in "maturity transformation"
- Taxing this behaviour may be distortional

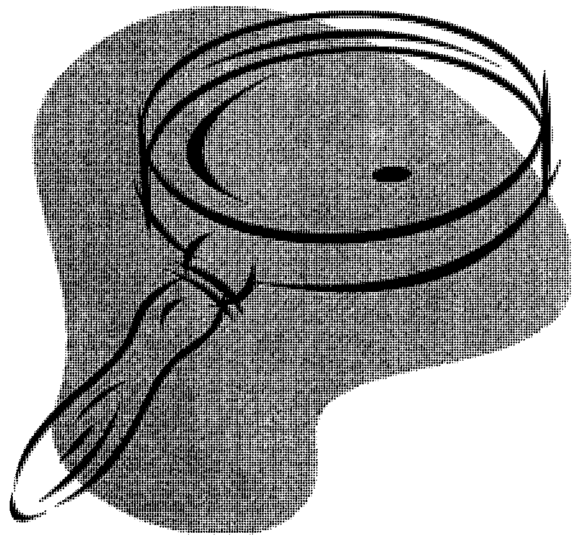
Assets Tax

- Taxes banks exposures – similar to capital
- Example – French bank tax
- Would tax risk-weighted assets, to discourage risky behaviour

Issues with a tax - to reduce risk

- A tax needs to be broad-based or it can easily be avoided
  - But being broad-based may mean it can't effectively target specific risks.
  - It may also mean that low-risk behaviour is also punished
  - It needs to have broad coverage
- "Set and forget"– Could make supervisors more complacent
- Potential distortional effects
- Costs may be borne by consumers

Effective supervision is the most important element



Protect Tax-payers/Burden Sharing

Ex-Ante Levy	Up front levy to build funds for resolution (e.g. Financial Stability Charge)
Resolution Fund	Development of a hypothecated resolution, or
No Resolution Fund	Collected as general revenue
Ex-Post Levy	Levy on 'survivors' to recover costs

Ex-Ante vs Ex-Post

	Ex Ante	Ex Post
Pros	• Can target specific risks • Raises Revenue	•Unlikely to be distortional or increase moral hazard • More efficient • May encourage banks to self regulate
Cons	• Potentially distortional • May increase moral hazard	• Institutions taxed when they can least afford it • Taxes only survivors • Less effective at reducing risk

Hypothecated Fund vs General Revenue

Hypothecated fund

- Increased moral hazard?
- Could put pressure on governments to intervene too early
- Unproductive use of funds
- Doesn't reduce debt

General Revenue

- Need to be able to raise funds in a crisis

Moral Hazard

- A *perceived* guarantee that a bank cannot fail may lead to increased risky behaviour
- Any tax must be developed so that it does not increase moral hazard
  - Broad Coverage
- Moral Hazard can be reduced may be reduced by
  - An effective resolution regime
  - Vigilant supervision

Alternatives to taxes

- Capital surcharges
- Contingent capital
- Bail-in Instruments

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Is a tax an effective way to address Too-big-to-fail?

- Systemically important banks may have an implicit guarantee of "bail-out"
- Taxing only TBTF banks has two problems
  - It could exacerbate moral hazard
  - It could create a run on smaller banks
- However, taxing all banks could
  - Impose costs on a bank without a guarantee
  - Create an obligation to "bail-out" non systemic banks

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Summary

- Bank taxes are one response to the crisis being considered
- No global consensus on introducing a tax
- Countries taking individual action
- Taxes are unlikely to be effective at reducing risk

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Thank you

Questions?