

POSITIONING THE FINANCIAL SYSTEM TO BEST ACHIEVE AUSTRALIA'S NEEDS

A. PREAMBLE ON FINANCIAL INQUIRY'S TERMS OF REFERENCE, TR1-7:

1. The intended focus of the Inquiry seems obscured. In respect of Item 2&7 in the Inquiry's draft Terms of Reference, the Inquiry is placed in a contradictory position. It cannot properly meet the declared objectives of the Inquiry in TR2 because it is unable to "make recommendations on the objectives and procedures of the Reserve Bank in its conduct of monetary policy". This limitation overlooks the fact that the Financial System needs coordination with the RBA and monetary policy, and cannot be divorced from APRA and other regulatory bodies.

2. The overall impression given by the TR's is that these are overly prescriptive of mundane detail rather than venturing into the underlying conceptual bases of the Financial System's operations, into removing obstacles, and advancing towards better meeting and promoting Australia's current and future needs.

3. Bearing in mind the genesis of the Global Financial Crisis, one might have expected the Inquiry to have even greater emphasis on the ambits of APRA, ASIC, ACCC in bank and non-bank products, on the practices, risks and financial security for superannuation and other participants in the Financial System, and surveillance on the huge markets in recent years for futures, swaps and other derivatives. These have vastly outstripped markets for more conventional govt. & corporate securities including equities (as quoted in my submission), and seem to have destroyed any earlier balance between Monetary/Financial and Fiscal Policies in the management of the Australian economy for its prosperity.

B. THE MEASUREABLE DEFINITION OF THE AUST. "ECONOMY", TR1&6:

1. For any "Economy", the basic unit is the transaction. Any person and entity may conduct a multitude of transactions in any given period and these in aggregate, comprise the "economy". What is most relevant for analysis purposes is the annual volume/value of these transactions (rather than the number). Each transaction typically represents an "exchange" of a subject item, with a buyer and a seller performing the transaction. The subject item of a typical transaction is described for present purposes as either being a Physical Goods & Services (G&S) category, or a Financial Asset/Liability (FA is +/L is -), where FA is simply a financial claim, such as a share, bond etc. and for which the issuer has a Liability. Thus the subject of a transaction is either a Physical or a Financial asset. (This classification corresponds with that adopted by the ABS). An "economy" represents the massive aggregate volume of transactions in Physical or Financial Assets, and for various reasons, it is important that the various categories be measureable and analysed for the national policy purposes to be outlined below.

2. This definition of the "economy" corresponds with reality. It contrasts with a common notion of equating the economy only or mainly with Gross Domestic Product (GDP) or with other important features of the economy such as employment, inflation, terms of trade, economic growth, etc.

all of the rest of the economy. Naturally, this distorts competition and profits, and causes the Financial System being a most inefficient and ineffective allocator of resources, and reflects a substantial subsidisation of the Financial sector. These are matters on which the Inquiry should report unfavourably in Terms of Reference 4,5 and 6.

D. FUNCTIONING OF THE FIN. SYSTEM RE "ROLE OF GOVT.", TR2,4,6

1. Govt. finances in Aust. are in crisis and for these reasons: The present Cwlth. Govt. inherited substantial spending commitments (NDIS, NBN, education etc); it inherited a wish-list of infrastructure etc. to cost nearly a trillion dollars; it inherited a substantial accumulated indebtedness unlikely to be paid off in the foreseeable future and certainly not before 4/5 years; there is the possibility of downturns of growth and demand in China, of weakening export prices, continued high levels of natural disasters, continued declines in manufacturing putting pressure on agency ratings, and more demands for Govt. assistance. Despite these crucial issues, the clear evidence that Australia is low-taxing by international standards, and the limits to revenue from traditional tax-sources, the Govt. is reluctant to raise rates on present taxes and to make use of new ones.

2. A good tax is one that minimises adverse reactions, judging from these four major criteria: minimises impact on employment and incentives, minimises collection-costs and is not hostile for social welfare. The GST performs poorly against these standards and any extension to food etc and/or raising of the \$10% rate, to cope with the crisis in Govt. finances described above, would be regrettable. Indeed, the complete replacement of the GST and the relief to its 2 million unpaid tax-collectors, via the re-installation of a broad-based financial tax of a few cents % to cover the \$50B pa GST receipts, would be welcome. There would be a boost to national productivity and abolition of red-tape if the onerous accounting of the 2 million GST tax-collectors was replaced by a simpler broad-based financial tax payable by the mere 50-100 financial institutions whose products are virtually untaxed at present.

3. If a financial tax was re-introduced (after the interval of about ten years), there would be a net gain to Govt., subject to any concessions/exemptions, and this would largely resolve the financial crisis described earlier. If the financial tax was to replace all or part of existing noxious taxes such as the \$50B pa from \$10% GST, the net gain to revenue would be smaller of course, but would also depend on whether the tax was to apply equally throughout the whole range of financial transactions.

4. Table 2 shows the gain to revenue from a 1 cent % and a 3 cent % fin. tax applied to the 2012-13 estimates of the various categories of financial transactions (before any concessions/exemptions and replacements of course). For example, if the tax was 3 cents % and applied only to bank accounts and foreign exchange (1+2 but omitting the investment-type bank accounts included in 5), the gain to revenue would be \$88B, as compared with \$131B if all financial transactions were taxed.

E. OTHER OBSERVATIONS ON A FINANCIAL TAX:

1. It is believed that the availability of statistics on financial transactions could be of assistance in the detection of money-laundering, tax-evasion and similar illegal or suspect activities.

2. Some EU members have govt. financial crises even greater than for Australia, ie proportionately higher tax rates and indebtedness, and worse employment situations. Consequently 11 of the leading members of the Euro-zone have EU Commission approval to implement a financial tax and plan to do so by May 2014. By having the tax apply to country of 'residence' rather than of settlement, they expect to offset the lack of the tax being universal, Italy is reported to have recently introduced a tax on five categories of financial transactions .

GOVT. REVENUE FROM A FINANCIAL TAX OF 1 OR 3 CENTS %: Table 2

2012-13 TRANSACTIONS (a)	\$000B	\$B REVENUE @		\$B CUMUL.REVENUE	
		1 CENT%	3 CENTS%	@ 1 CENT	@3CTS
(1) Bank op. a/cs Drs& Crs	250.0	25	75	25	75
(2) Foreign Exchange	42.4	4	13	29	88
(3)Mrkts:debt,swap,derivs.	40.9	4	12	33	100
(4) Shares,futures,options .	52.0	5	16	38	116
(5)Bk.bills,td's,cd's,trusts					
life,super,b/s,c/u etc.	50.0	5	15	43	131
Total Financial Transactions	435.3	43	131		

Sources:(2,3,4) Aust. Fin. Markets Asn.(AFMS); (5) derived from JPM 's "Nat. Bal. Sheets"(abbr.),Longman Cheshire .

F. CONCLUSIONS ON THE FINANCIAL SYSTEM, RT1-7:

1.Table 3 gives an indication of the rapid growth to 2012-13 in the market since the 2008-09 GFC for key derivatives, by comparison with Equities, ie with what could be regarded as a major, traditional financial asset.

12-13 MARKET COMPARED WITH MARKET FOR EQUITIES: Table 3

Futures in 12-13 compared with Equities	43 times:	only 24 times in 08-09
Swaps	9	5
Overnight Index swaps	8	1
Repurchase agreements	7	5

Source: AFMA 2012-13 Report.

2. The RBA's sole central bank instrument, is the interest rate it prescribes in the cash market for overnight funds, and it is a blunt instrument, with varying degrees of effectiveness. Moreover, the RBA itself describes its role in the exercise of this instrument as

being 'accommodative' rather than of actively countering economic trends in the way for example , that the Monetary authorities in USA are supplying funds to markets in attempts to revive activity, employment and growth, or in the way the previous Cwlth. Govt. said it used deficit-financed works expenditure in order to counter the GFC 's influence on the Aust. economy.

3. The present Cwlth. Govt. renounces the earlier policy but recognises the restraints on its traditional tax-sources, to adequately deliver on huge expenditure demands plus quickly repay accumulated indebtedness which might limit capacity to react against future adversity.

4. The broad-based Financial Tax has the economic and social justifications to both resolve the fiscal crisis as well to end the anomaly in subsidisation and resource mis-allocation policies, of heavily taxing the most productive activities, whilst allowing the bulk of the Australian economy to remain tax-free. In a matter of time, the political will should emerge for this anomaly to be resolved in the manner indicated above, I believe .



J.P McAuley, [REDACTED], Castle Hill NSW 2154 29.3.2014

John Patrick McAuley

ph 02 [REDACTED]

[REDACTED]@bigpond.com