Incidence of bank levy and bank market power

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Discussion by Koen Schoors
General comment

• It is a very clear, simple and interesting paper
• Using an Hungarian natural experiment on bank asset taxation and wonderful data
• To ask a more general question about who pays the burden of a bank asset tax
• To which most would like to know the answer
How the Burden of a Bank Asset Tax Is Divided

1. When supply is more elastic than demand . . .

2. . . . the incidence of the tax falls more heavily on borrowers . . .

3. . . . than on big banks.
So what is the question and what is the answer?

• Question: Who is paying the tax on big Hungarian banks’ assets?

• Answer:
  – It turns out their borrowers are
  – especially borrowers that cannot easily walk away (the inelastic ones)
  – Big banks’ existing household borrowers foot the bill.
  – But their new loan applicants do not
What does this mean?

• Hungary taxes big banks, but these fully shrug it off to existing household borrowers, so what?
• One could claim this is an efficient tax
  – Transfer from existing borrowers to the government
  – But no deadweight loss
• Not really:
  – We WANT big banks to shrink because their size has a negative externality (it is Pigovian tax)
  – But making banks pay back the too big to fail subsidy does not seem to work really well
Is it really true?

- There is a consistent and very robust positive sign for small loans to non financial companies
- The crucial assumption is that households are less elastic because of switching costs
  - But does this not depend on retail bank multimarket contact in the region you live?
  - Often you can only change to other big banks that also pay the tax
  - In other words: are bank size and switching costs not positively correlated?
Is it really true II?

• Why make assumptions about demand elasticity
  – All the data to calculate depend elasticity are there
  – So why not separate on the basis of elasticities and have bank/loan type fixed effects?

• Control variables
  – Should be included also with an interaction for big banks, as this is the reason for their inclusion

• Why only lending rates?
  – Big banks could lower deposit rates more or charge larger fees
Is it true III?

It seems as if the effects may be absent or even change sign if the time window is shortened.

But this seems the opposite

This is the effect
Something that boggles me badly

• The point of the paper is that big banks make existing household borrowers pay the tax, since
  1. Big banks can unilaterally change interest rates,
  2. Household borrowers cannot get away

• But if this is true, then why did banks not already increase the interest rates before the tax?
• Possible answer: collusion between big banks in their reaction on the levy, but less so before.
• In this case the tax has worked as a coordination device for the collusion of big banks: ugly
How the Burden of a Tax Is Divided

1. When demand is perfectly inelastic, the incidence of the tax falls completely on borrowers.

2. ... the incidence of the tax falls completely on borrowers...

3. ... So why do they wait?

Rate without tax | Rate borrowers pay with tax
---|---
Price | Price

Supply | Demand
---|---
Quantity | Quantity

Elastic Supply, Perfectly Inelastic Demand

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Conclusion

• It is very interesting and surely I tend to believe the found stylised facts
• It follows that the net welfare effect of a tax on big banks is uncertain
• If market power is strong and collusive spirits are not kept in check, the tax on bank assets may make things worse