The Australia Institute

Research that matters.

Corporate power in Australia

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TAI

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The Institute aims to foster informed debate about our culture, our economy and our environment and bring greater accountability to the democratic process. Our goal is to gather, interpret and communicate evidence in order to both diagnose the problems we face and propose new solutions to tackle them.

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Introduction

Some industries have far more political influence than others, and some political systems are more susceptible to the influence of industries than others. The relationship between the defence industry and the US federal government has been so strong for so long that the notion of 'Military-Industrial Complex' is widely used to analyse politics and economics in the US by analysts from across the political spectrum. In Australia, the Independent Commission Against Corruption (ICAC) is currently investigating evidence of the links between the previous NSW Labor Government and the mining industry. In the words of Geoffrey Watson, QC, the counsel assisting the commission:

> *If it is corruption, then it is corruption on a scale probably unexceeded since the days of the Rum Corps*.[1]

But while extreme cases such as the US government's relationship with the defence industry and cases of overt corruption attract substantial attention the systematic contortion of government policy to deliver benefits to particular industries is less widely discussed. Such indifference to this process, a process that can shift billions of dollars from one group in society to another can be explained in a number of ways including:

1) The volume of legislation that passes through our parliaments makes it difficult for anyone without large financial interests to monitor and evaluate all legislation with the potential to impact on an individual or organisation's interests.
2) The complexity of the legislation, particularly the way that pieces of legislation may interact with existing legislation or new legislation or regulations that are pending but not yet public makes it even more difficult for 'unvested interests' to understand the significance of particular policy change.
3) While community groups and NGOs typically herald the passage of legislation they consider favourable, business groups are typically more constrained when legislation that is favourable to their interests is passed.

These three explanations are buttressed by the economics of 'externalities'. Economists define an externality as the costs or benefits to accrue to an individual who was 'external' to a transaction. For example, if your neighbour buys a leaf blower for $100 it suggests that the neighbour values the leaf blower at more than $100 and that the shop values it at less than $100 so both are happy with the transaction. However, neither the neighbour nor the shop has considered how an 'external' party, such as you, feels about the leaf blower. Any noise pollution generated by the leaf blower is, therefore, considered to be an 'externality'.

Economists typically assume that there are no externalities when they analyse economic behaviour[2]. When 'small' externalities (such as noise from leaf blowers) exist they are typically ignored by policy makers but when 'larger' externalities such as radioactive waste are identified they are described as a form of 'market failure' that warrants government regulation. Whether or not the 'distinctive sound' of a Harley Davidson is a small externality that should be ignored or a larger externality that should be prevented through regulation is, of course, a matter of judgement.

Economists typically suggest that if the benefits of an activity to those who enjoy it exceed the costs of that activity to people who don't enjoy it then society is better off with the activity.

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[1] Lagan, B (2012), *A 21st Century Rum Rebellion*.

[2] That is, in perfect competition it is explicitly assumed that there are 'complete property rights' and, in turn, that no externalities exist. Hence in principle I have the right to quiet and, if the neighbour wants to use the blower he/she will have to bribe me into agreeing.

While it is hard to value the external costs and the benefits of activities such as leaf blowers and nuclear reactors, it is the job of politicians to value the political pain associated with supporting or opposing a particular policy. Politicians who are poor at making such choices are often replaced by those who are better at it.

Externalities help explain why governments are susceptible to lobbying and the influence of large corporations. Small changes in policy can deliver huge windfalls to a small group while imposing small costs on a large group. A policy change that costs each of Australia's 22.9 million residents a dollar per week would collectively cost us around $1.2 billion per year. A private company that thought it might gain 10 per cent of that cost ($120 million per year) would be highly motivated to engage lawyers, economists and lobbyists to help ensure the policy went ahead while few if any 'rational' individuals would spend much time or money to protect their $1 per week.

A successful politician likely possesses the ability to predict that a low profile policy change that would cost people $1 per week will deliver them little if any political pain from the citizenry. Furthermore, the successful politician will likely anticipate that political benefit will flow from a business community who, while relatively silent on the specifics of policy change, are more vocal in providing general support for a government that 'listens' and 'understands what business needs if it is to create jobs and opportunities for workers'. While the tendency amongst successful politicians to grant policy changes that harm a diffuse majority and help a concentrated minority is consistent with the economic analysis of externalities, it is likely enhanced even further by the willingness of such concentrated minorities to donate substantial amounts of money to politicians who are willing to 'listen'.

Of course not all industries benefit from the same policy changes and, in turn, not all businesses can be heard. For example:

- Policies that advantage the big banks may come at the expense of the small businesses who borrow from them and use their transaction services.
- Subsidies to speed up the rate of mining expansion come at the expense of the manufacturing industry who have to bid for the same pool of skilled labour.
- Policies that allow supermarkets to increase their market power come at the expense of the firms that supply food to those supermarkets.

Given that not all firms can get what they want from governments it follows that some firms must be more successful in encouraging governments to 'listen' to them than are others. Of course, if governments made decisions solely on the basis of the costs and benefits of their decisions to their constituents then policy choices would be made with reference to the broad interests of the community rather than the narrow interests of the industry lobbyists. However, as discussed above, when the costs of the policy change are diffused across the community and the benefits concentrated in the hands of a few there is likely to be a 'market failure' when it comes to the ear of government.

Which industries are the most influential?

In a recent book entitled *The Price of Civilisation*[3] the prominent US economist Professor Jeffrey Sachs argued that the four industries that dominate the US political environment are arms, finance, energy and health. However, the corporate sector itself wields enormous influence over governments. Big business exerts influence through campaign contributions, influence over university funding, sponsorship of think tanks and in other ways that create an agenda for low tax for the rich, low entitlements for the poor and poor services for the middle class.

[3] Sachs, J. D. (2011) *The price of civilization: Reawakening American virtue and prosperity.*

In articulating why he wrote his book Sachs argued that democracy itself was being threatened by the power and corruption of big business.

What then is the situation in Australia? Which industries appear to have disproportionate influence over Australian governments? While such an assessment can include a wide range of objective data the process inevitably involves subjective evaluation. With that in mind, the following sections make the case for the conclusion that the four of the most disproportionately influential industries in Australia are superannuation, banking, mining and gambling.

Superannuation

Employers in Australia are currently required by law to remove nine per cent of wage and salary earners pre-tax income and deposit it in an account that they cannot touch until they retire. The fees paid by individuals to the superannuation funds who manage these compulsory contributions range widely from around 0.5 per cent of the fund balance per year up to around four[4] per cent of the fund balance per year. With the average fee paid by Australians with a retail superannuation account being around two per cent[5], an individual with $100,000 is paying around $2,000 per year or nearly $40 per week in superannuation management fees. The average Australian with superannuation spends more on superannuation fees each year than they do on electricity.

The government recently announced that wage earners will be forced to contribute 12 per cent of their pre-tax income to compulsory superannuation which means that the annual fees on contributions will grow by 33 per cent. The annual fees paid to superannuation funds are already around $20 billion per year and the financial assets they manage on behalf of their members are in excess of $1,000 billion.

While it is inconceivable that any other industry could succeed in convincing governments to oblige customers to spend 12 per cent of their income on a particular product, the most surprising demonstration of the power of this segment of the financial industry is its ability to avoid scrutiny. Put simply, neither the government nor the Opposition are at all interested in examining whether the $30 billion annual cost of the tax concessions which augment the compulsory individual contributions deliver anything like $30 billion worth of benefits to the citizens that superannuation is allegedly designed to help.

The terms of reference for the allegedly ‘root and branch’ review of the Australian tax system prevented the then Secretary of Treasury Ken Henry from examining only two issues, namely, the rate of the GST and tax free status of superannuation payments to those over 60. To highlight the significance of this exclusion, it meant that the ‘root and branch’ review of the tax system was not allowed to consider the efficiency or equity of the current situation in which an individual with $25 million in super, which the ATO confirms exist, can withdraw $2.5 million per year and not pay a single cent in tax.

If power means never having to explain yourself, the superannuation industry has plenty.

Banks

The ‘big four’ banks in Australia take up four of the top eight spots in the list of the most profitable banks in the world and the most concentrated in the world. Overall, according to the IMF the Australian banking system is the most profitable in the world. Since the banking system was ‘deregulated’ in the early 1980s banks have increased their market share from

[4] Barrymore, K (2012) *How to fight super fund fees*.

5 Wealth Professional (2012) *SMSF fees lower than any other superannuation sector*.

around 50 per cent of the finance market to 90 per cent and, among the banks themselves the top four increased their share from two thirds to 83 per cent[6].

Over the period in which the big four banks acquired or merged with 15 of their rivals those responsible for regulating the banks have continued to refer to the industry as 'competitive' when it clearly demonstrates all of the characteristics, and profits, of a powerful oligopoly.

That said, in the period after the GFC, a period in which the market share of the big four banks surged from 74 to 83 per cent, there has been a significant shift in the language of regulators who now extoll the virtues of 'stability' in the financial system and refer explicitly to a trade-off between the degree of competition in banking (a goal to which they had previously claimed to aspire) and the stability of the financial system. That is, in an environment in which Westpac had been allowed to purchase St George the goalposts of completion were shifted too rapidly.

A clear demonstration of the power of the big banks over the parliament was demonstrated in late-2009 when the banks unilaterally increased their mortgage lending rates above the increase in 'official rates'. In response to the howls of outrage from the public the Coalition's Joe Hockey announced a '9 point plan' to rein in the banks[7], the Treasurer Wayne Swan announced a '5 point plan' to do the same[8] and the Greens announced their determination to drive profits and market share down and to ban ATM fees, a move supported by the entire cross bench.[9]

Not only did the banks stare down the entire parliament, they proposed a 'solution' that increased their market power and their profits further. Needless to say it was accepted. As was recently revealed in a Westpac document entitled 'Covered Bonds with the Institutional Bank', which was obtained by Fairfax journalist Michael West, the banks preferred 'solution' has had an 'extraordinary' impact on lowering their costs of funds, a reduction which has not been passed on to their customers.[10]

If power is defined as the ability to get the entire parliament to do the exact opposite of what they said they would then the banks clearly have significant power.

The mining industry

In 2012 the mining industry made 21.6 per cent of all profit in Australia[11] despite employing only 2.3 per cent of the workforce[12], and despite the fact that the mining industry is estimated to be 83 per cent foreign owned[13] . The mining industry regularly claims that 'ordinary mums and dads' are sharing in the enormous profits that are generated by selling the minerals owned by Australian citizens for record high prices. While it's true that 'mums and dads' with large superannuation balances get some benefit from the remaining 17 per cent of profit, it is also clear that one particular mother, Gina Rinehart, receives a larger than average slice of that remaining 17 per cent.

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[6] This section relies heavily upon Richardson, D (2012) *The rise and rise of the big banks: Concentration of ownership.*

[7] Hockey, J (2010) *It's time to talk banking*.

[8] Martin, P (2010) *Treasurer bashes bank profiteers*.

[9] Yeates, C (2010) *Crossbenchers join Greens' push against ATM fees*.

[10] Covered bonds are bonds that are backed by specific mortgages. In the event of a bank failing covered bond holders would not have to wait in queue with other creditors. Those bonds would survive and remain backed by specific securities.

[11] ABS (2012) *Australian System of National Accounts, 2011-12.*

[12] ABS (2012) *Labour force, Australia, Detailed, Quarterly, Nov 2012.*

[13] Edwards, N (2011) *Foreign ownership of Australian mining profits.*

The mining industry does pay tax on the profits it earns selling our resources, but when ATO and ABS figures are compared it pays the lowest rate of tax on profits of any industry. This is due primarily to the generous tax concessions that the mining industry has been granted.

Of course the miners argue that the royalties they pay to state governments for the minerals they extract should be considered as tax payments. While royalties, as compulsory payments to governments, can in some sense be considered a tax it is important to understand the purpose for which it is paid. In order for a baker to sell bread they must first purchase flour, the cost of which is considered a ‘cost of production’.

In order to acquire the minerals they sell, miners pay 'royalties' to the state governments who own those resources on behalf of their citizens. While the miners encourage us to focus on the small amount they pay us for our minerals, the real question relates to why governments are willing to sell coal and iron ore to mining companies for less than one tenth of market value?

The enormous profits of the Australian mining industry are largely based on their ability to acquire minerals from state governments at a low price before exporting them for a high price. These profits can be enhanced further via the granting of tax concessions to limit the profits tax payable, and further still by persuading state and federal governments to fund the infrastructure required to transport our resources to the ports from which they are transported.

The purpose of the first iteration of the mining tax, the proposed Resource Super Profits Tax (RSPT) was designed to collect around 40 per cent of all profit made from mining in Australia for the taxpayer. It was forecast to collect $9 billion by 2013-14. After a campaign against this tax by the mining industry a new version of the tax known as the Minerals Resource Rent Tax (MRRT) was negotiated directly between BHP, Rio Tinto, Xstrata and the new Prime Minister Julia Gillard. It is yet to collect a cent.

If power is the ability to write government tax policy while the same government builds your infrastructure for you then the mining industry has plenty.

Gambling

Compared to the industries mentioned above gambling is a small industry, but it is incredibly lucrative due to the tight regulatory restrictions on the establishment of new forms of gambling and new gambling venues.

It is often suggested that business groups are in some sense 'hostile' to regulation, preferring instead to operate in 'free markets'. In fact, the opposite is the case. Business hostility towards regulation is as self-serving as it is selective. Put simply, they oppose the regulations they don't like and they are silent about the regulations they do like. If forced to talk about the regulations they do like, they talk almost exclusively about how such regulations protect the community and, in an apparent oversight, rarely discuss how important the regulations they like are to their profits.

The profits of the gambling industry, like the telecommunications industry and the broadcast media, are almost entirely dependent on the power of regulators to prevent new entrants to their industry from undercutting them. In Australia no capital city has more than one casino, ensuring each casino has a local monopoly, and while there are plans for Sydney to host two casinos, there are also plans for the two casino owners to merge.

In the weeks prior to the proposal by the James Packer controlled Crown to develop a new casino in Sydney the NSW government changed its guidelines in ways which, as luck would have it, smoothed the way for the new proposal to be treated preferentially.

After the last federal election Prime Minister Gillard made a signed promise to the independent Member for the seat of Denison, Andrew Wilkie, that she would, in exchange for his support in forming a minority government, implement mandatory prior commitment technology to limit the amount of money gamblers could lose in a single sitting at a poker machine, a policy recommendation made by the Productivity Commission after an extensive inquiry. After pressure from the gambling industry she reneged on that promise.

If the ability to force a prime minister to break a written promise and risk losing her governing majority is evidence of power then the gambling industry has power.

Conclusion

It's not possible to clearly rank the power of the industries described above, but it is possible to argue that the inclusion of other industries is more justified. The media for example, while small and not very profitable, exert significant influence over public and political attention. Similarly, the defence industry in Australia, while small, manages to achieve bi-partisan support for the construction of $50 billion worth of submarines in, what we are told, are tough budgetary times.

The rhetoric of policy making in Australia and its reality have been diverging rapidly in recent years. The more that policy makers talk about 'evidence based policy' the more unwilling governments have become to offer even the slimmest of evidence to support some major policy decisions.

Many people seem to believe that there was a 'golden age' of reform during the mid-1980s to the mid-1990s in which major reforms such as the floating of the Australian dollar, the deregulation of the financial system and the privatisation of a wide range of public assets were achieved with broad political consensus.

A more cynical interpretation is that when the reform agenda increased the opportunities for large companies to make more money, own more assets and pay less tax there was bipartisan political support because of the strength of business support for the reform agenda. Reforms such as the mining tax, the carbon tax and gambling reform, on the other hand have been vetoed by the affected industries and, with such a veto in place, the government has found it virtually impossible to implement their reforms in their original guise. Forcing employees to pay an extra three per cent of their salaries and spending an additional $50 billion to buy new submarines, on the other hand, has attracted little attention or concern from business groups who favour 'free choice' over compulsion or fiscal conservatives who express concern about the adverse impact of public spending.

Perhaps the real test of power is the ability to get things done without anybody even noticing.

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