BANKS AND SOCIAL RESPONSIBILITY

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Rather than providing a detailed response to recent events within the banking industry, this paper reflects on standards that need to be upheld.

The banking industry now touches on all aspects of our economic life. It would be difficult to find a household that banking has not affected; even pension and other support payments require a bank account. As Mr Farmer argues in the conclusion to this chapter titled Should Basic Banking be seen as an essential service?, it appears that 'access to banking services has become a prerequisite for community participation'. Should our governments require our banks to provide a basic banking service for everyone?

The ACSJC would welcome feedback on the paper and questions raised within it, for possible use in our quarterly newsletter Justice Trends.

+ William Brennan
Chairman, ACSJC
Bishop of Wagga Wagga
20 July 1993.
INTRODUCTION

Banks and bankers have in recent years occupied prominent positions on the Australian public's 'hate list'. People have argued that bankers have abdicated their social responsibility. Have bankers been fairly treated? Have their customers?

While in many ways banking is like any other industry, there are important differences. Banking penetrates almost all households and all business enterprises. Like the legal and education systems, banking services are a necessary foundation for the rest of the economy. Moreover, when banks tighten or ease their lending conditions, either through imposed monetary policy or their own internal guidelines, almost all business and personal customers are directly or indirectly affected.

Banking has been and still is a highly regulated industry. In addition to its own legislative framework, it has its own regulatory authority, the Reserve Bank of Australia, dedicated to preserving the safety, and public perception of the safety, of banks. It has also had three major government inquiries in a decade. Scarcely a year has gone by without a major change in banking regulation. The largely deregulatory phase of changes in the early 1980s has been followed by a systematic re-ordering of prudential supervision.

Some have lauded the deregulated financial sector, citing greater diversity and tailoring of banking services. But this does not appear to be a view generally held by the public, who might only have noticed uncomfortable interest rates and new banking charges.

A significant part of the poor popular image of banks is clearly misplaced. The most prevalent misconception (often shared by the non-financial media) attributes to banks, rather than to those regulating monetary policy, the prevailing levels of market interest rates. The extended period of very high market interest rates in 1989, a deliberate policy of the monetary authorities, undoubtedly made 'bank-bashing' more widespread and strident.

None the less there remain a number of issues in regard to banks and banking for those interested in social justice.
At the core is a fundamental concern not restricted to banking but shared by a host of industries and parts of the public sector that have experienced greater exposure to market forces: Does a shift towards a freer, more market-driven (albeit still regulated) industry weaken or advance social justice?

There are also specific banking issues: Is retail banking competitive enough to ensure that margins are not excessive? Are all deposit products priced competitively? Is credit card pricing fair? Is basic banking an essential service and, if so, should its pricing and provision be left to the free market? Are consumers of banking services informed and skilled enough for free markets? Do a small number of dominant banks and a multitude of insignificant retail consumers represent a level playing field?

But first this paper will survey relevant biblical and Church teaching and propose a framework of social responsibility. From here it will consider the basic question of whether freer markets tend to lead to more socially responsible actions and whether banking has public good aspects that make free markets inadequate. From here the paper will get into specifics: the deregulation of the 1980s and particular issues of banking practice or mispractice. The structure and operations of the banking industry are covered in an appendix.
Not surprisingly, there is little detailed teaching on modern banking issues; rather only broad themes on which a Christian stance may be founded.

Many would be aware of the Old Testament teaching against the practice of usury or the taking of interest.\(^3\) Interestingly, the Hebrew word for interest comes from the verb *to bite*. Closer inspection of the references, however, shows that emphasis is on discouraging this practice with 'your brother', rather than with those outside one's group. As well as indirectly suggesting that the charging of interest was widely practised, the Old Testament laws and prophetic condemnations principally show concern for the divisive intrusion of this commercial practice into the body of the chosen people.

One needs also to remember that the Old Testament period covered the gradual transition from bartering with cattle or other movable produce to weighed precious metals and thence to minted coinage (appearing around the time of the Babylonian exile in 6th Century BC). This trend towards money could easily have been linked with protestations about increasing commerce, urbanisation and cultural mixing. Moreover, money-changers in the Hellenistic period, if not before, were generally conspicuously located near religious sites as the places not
only of congregation but also increasingly of commerce. On balance it is surprising that there is no significant condemnation of money and money-changers in the Old Testament.

New Testament teaching on banking is also imprecise. There is an acceptance of the practical reality of interest and of debts and their consequences, and there is a continued stress that such practical matters should not come before mercy and between brethren, and certainly not before one’s relationship with God. ‘Render therefore unto Caesar the things which are Caesar’s; and unto God the things that are God’s.’

Beyond this level of acceptance we come to the creative tension between the worldly wisdom of the ‘wise steward’ and the folly of the ‘new creation’. To which of these elements do we turn when we look at issues of economics, banking and social responsibility? Clearly the realm of worldly wisdom provides more pragmatic guidance, and is comfortable accepting and using such social constructs as markets. The new creation, the new life, perhaps has little place for the obligations of banking or for so many other pragmatic social conventions, but it seeks more to transcend rather than to condemn them. On balance New Testament teaching appears broadly to encourage worldly wisdom’s development of social institutions to achieve worthy goals, but with the constant reminder that these human pursuits remain incomplete.

The early and medieval Church cemented the Old Testament prescription against usury, at least among Christian brethren, reaching its formal condemnation at the Third Lateran Council in 1179. The medieval doctrine of the just price represented an attempt to apply Christian ethics to every part of life. Essentially it perceived justice to require every transaction to return equivalent value to both parties. In the case of a loan there was considered to be no change in the value of money merely due to the passage of time and hence no intrinsic basis for interest or anything other than repayment of principal. However, this strict position was modified to permit the payment of interest when a loss of opportunity, such as an alternative income-earning investment, was suffered by the lender. The growing practice of charging interest as commerce and banking grew in later medieval and early modern times was justified along these lines, despite many Scholastic writers retaining their condemnation of usury.

In more ‘scientific’ modern times, the idea of a just price has lost much of its support. Modern Church teaching
appears to accept the classical economic idea of prices constantly varying to reflect market circumstances and of interest being simply the price that balances and rations the demand for and supply of funds. Rare now in western countries are arguments against interest per se.

However, while markets may be accepted as providing an efficient decentralised rationing tool, they are not accepted as a necessarily appropriate or final arbiter of social justice.

The mechanisms of the market offer secure advantages: they help to utilise resources better . . . nevertheless, these mechanisms carry the risk of an 'idolatry' of the market, an idolatry which ignores the existence of goods which by their nature are not and cannot be mere commodities . . .

Market economics must ‘... be guided by the common good and be at the service of human dignity and human rights’.12

This continues the broad theme that nothing of commerce, nothing pragmatic, should usurp higher claims on humanity — the markets and the competitive forces that shape market equilibrium have no claim to a paramount role in humanity’s conduct. They are part of this world, a world in which the Christian is to be wise, but also a world of the new creation.
WHAT IS SOCIAL RESPONSIBILITY?

We will take the ideas previously mentioned for our framework of social responsibility. A socially responsible action is, then, one that serves human dignity and rights and furthers the common good. Human rights include freedom and autonomy as a member of a larger community. Community and the common good encompass the world as we know it, including the physical and psychological environments.

In looking at banking we come more readily to the economist's notion of an optimal economic outcome. This implies that for a given initial allocation of resources among economic agents (that is, people), there is no possible outcome where an individual can be made 'better off' without another 'losing'. While embodying the idea of individual autonomy, this theoretical economic utopia is a somewhat pale version of the goal of social responsibility. It does not, for example, concern itself with the realism of its assumptions about the autonomy of the individuals involved; it does not allow for hard decisions about a fairer reallocation of the 'initial' resources, or for developments over time; and when you start talking about psychological factors, well, economists generally throw up their hands. But it is a start.
The core question is whether freer market forces imply a gain for society as a whole. It is certainly not clear that the general public shares the confidence felt by many economists and bankers that these two are linked. Nor is their degree of confidence always well founded. This applies in particular to the loose notion, popular in some quarters, that free markets necessarily lead to a better result for everyone. This proposition cannot be proven with realistic assumptions, and this paper’s aim is not to attempt to do so, but rather to give some meaning to the idea of free markets to those people who have to cope with them. The strengths and limitations of free markets will be explored by way of a simple example.¹³

Consider an isolated valley in which only two people live, both making bread and producing milk and cheese. It is quite possible that one might prefer or be better at bread-making than the other. If so it is likely that eventually the two will freely agree to specialise and then trade some of their produce. This might only occur for some of their production, or they might specialise entirely and each only produce bread or dairy goods. Economies of scale and the continued building of skills are likely to help this process towards specialisation and trade. Importantly, we can be confident that both would consider them-
selves better off, or they would return
to looking after themselves.

Sounds ideal. There is no need for
some puppeteer (or regulator) from
the next valley to determine the ex-
change rate between bread and milk.
Moreover, the arrangement is adapt-
able. Should the wheat harvest
flourish and the bread-maker make
more bread, the freely agreed
bread/milk exchange rate will
probably adjust as the bread-maker
has more bread to exchange than
before and wants more of the limited
quantity of milk and cheese to go with
it. Again, both are likely to consider
themselves even better off with trad-
ing than without. Should the dairy
farmer discover the method of making
butter he or she would be likely to be
able to bargain for more bread, but again
with both feeling they have gained.
After all, if trade occurred the extra
bread would be voluntarily given.

Should the population of bread-
makers and dairy farmers flourish,
trading would become even more es-
established. Should too many of the
valley’s population produce bread,
then the amount of milk and cheese a
loaf of bread buys would fall, and
some (probably the least efficient)
bread-makers might change to
producing milk and cheese. Alterna-
tively, some dairy farmer might
specialise in milk, others in cheese
and, by doing so, both increase their
productivity and quality. Again, all in
the valley would probably see them-
selves as gaining from the develop-
ment.

The power of this flexibility and free
decentralised decision-making is seen
as the hallmark of a free competitive
market — a hallmark sometimes
stated as ensuring that everyone
benefits from free trading.

It is possible to construct simple
models built either on economies of
scale or on the idea of people having
different skills (or ‘comparative
advantage’) that ‘prove’ that such
specialisation with free-market trad-
ing inevitably leads to benefits for all
participants.

However, in practice the valley may
well have developed differently. A
bread-maker might steal cheese from
a dairy farmer who is occupied with
milking the cows. Or the bread-
makers might agree to hide some of
their bread and persuade the dairy
farmers that bread is very scarce and,
consequently, each loaf should be
worth much more milk. Or the bread-
makers might deliver poor-quality
loaves made with dust rather than
pure flour.

Alternatively, the dairy farmers might
be twice the size of the bread-makers
and simply demand or take bread. Or
perhaps bread-makers are never taught to count and are regularly deceived. Or the tradition of the valley might be that dairying is considered a closed and more noble profession than that undertaken by those involved in mere crop-growing, milling and baking. Any of these might restrict the amount of dairy products produced and ensures their high price in terms of bread. Historically, there have been more questionable rationales than these for privilege and restricted entry.

So what has happened to the free-market utopia? Some often forgotten elements, or ground rules, are missing. They include a legal framework that ensures that each person can make free decisions to exchange — that is, is protected from theft and intimidation, and from deceit, unacceptable quality or non-compliance with an agreed bargain. There needs to be freedom to change industries. Enough information and basic levels of skills and education are also required to have confidence that both parties know what they are trading.

Clearly there is a role for law and order, for regulation to eliminate barriers to entry and to ensure fair play and for pro-active supervision to ensure that the participants' information and judgement skills are sufficient. Only as adequate ground rules are in place, and participants become sufficiently informed and capable, are the benefits of free markets, influencing decisions on pricing and the amounts produced, traded and consumed, likely to be realised.

Are these groundrules in place in banking? Are there effective barriers preventing new banks emerging? Are both sides to a banking transaction sufficiently informed to ensure a fair and non-intimidated market? Only with such ground rules is the power of freer markets likely to be pulling in the social interest.
Even if these ground rules are in place there is an argument that suggests that more competitive markets will not always, by themselves, produce the best outcome for society. This argument points to parallels between some banking services and goods and services such as defence, roads or communications networks. The distinguishing factor is that it is not practical to package and sell the good or service separately to individual consumers.

For example, how can you restrict the benefits of defence purchased by one buyer from being felt by his or her neighbours? Given this, how much defence would an individual buy? Rationally, most would buy none and instead rely on the defence bought by their neighbour. Because of this free ride ability these 'public goods' tend to be undersupplied (compared with the aggregate underlying demand) if left to individual purchasing decisions in a free-market environment.

Consequently, these goods have traditionally either been provided by governments with funding via taxation or their supply has been controlled or facilitated in some way. Governments have been awarded the social responsibility to ensure that the right level of these 'public goods' is provided.
ARE THERE PUBLIC GOOD ASPECTS TO THE BANKING INDUSTRY?

The most obvious public good aspects to the banking industry are perhaps the confidence that is held in money as a means of transaction and the security that is associated with banks as a place to store savings. Our decentralised economy with its level of individual economic freedom is implicitly built on trust in money as a means of exchange in return for goods or services. Yet no one person would be prepared to pay for the achievement and maintenance of this trust. Clearly we have a public good that needs to be provided at a suitable level for society as a whole.

Similarly, trust in the security of our banking system as a place to preserve and store savings needs to be built and maintained by the community at large, rather than left to individuals.

Instead governments have either provided or ensured the provision of these goods. The Reserve Bank prints the notes, the Treasury mints the coinage that comprises our currency. The government and the Reserve Bank regulate the banking industry to ensure that it is and is perceived to be a secure haven for savings. But it is not possible to demarcate cleanly where the public good elements end.

For example, traditionally cheques have been regarded as essential components of the transaction system. More recently, credit card payments and electronic payments have assumed
far greater importance. All of these are provided by the banking industry, and the regulatory bodies are less centrally involved than with currency.

Moreover, the safety of deposits (and indeed of the transaction systems) cannot be separated from the broad perception of a bank itself. News of large loan losses, questions of ethics — indeed any behaviour of a bank — inevitably impinge on the public trust in the banking system. Consequently, there is a public good argument that optimal levels of public trust in the banking system will not be achieved unless some additional constraints are placed on bank behaviour beyond those demanded by individual consumers. Such consumers might be attracted to the better interest rates offered by a more risky bank, relying on others to ensure that the riskiness of the banking system as a whole is kept within appropriate bounds.

A third public good aspect is the breadth of the payment system. It is clearly an advantage to all if the various payment systems have full national or international coverage. A company paying its staff can then do so through one magnetic tape to its bank which remits salaries to bank accounts across the system. A mail-order sales group can reasonably restrict itself to credit card purchases because of their wide usage.

A fourth and perhaps less traditional public good argument can also be made. Banking performs the lubricating role between other components of the economy, not only in channelling funds from depositors to those seeking funds for capital investment, but now also by mediating between entities' different risk profiles with risk management products. Many of these new risk management products, such as swaps and futures, require some infrastructure such as an exchange or clearing house and certainly a level of trust and liquidity before they can be used — both public good elements. Left to themselves, banking consumers are unlikely to demand the full prudential safety from these new products that collectively they might be prepared to pay for.

It is clear, then, that intervention is required to ensure that the banking and payments systems hold the appropriate level of public trust and develop in an appropriately prudential manner to continue to hold this trust while meeting the changing needs of their users.

Moreover, given these public good aspects, it can be said that banking probably has a higher social responsibility than other industries. But it is not alone; others in such company would include, for example, communications and media services, education and medical services.
HO
W SHOULD
THIS APPROPRIATE
LEVEL OF PUBLIC
TRUST IN BANKING
BE ACHIEVED?

In some industries with public good aspects an appropriate level of trust is achieved by the service being provided via the public sector. Defence and policing services are obvious cases, and few would lament that public provision. In others appropriate provision is achieved by subsidising the cost of the good in question; for example, in some private public transport networks.

However, these are not the only ways in which public goods are handled. Standards of safety and training that underpin the public's faith in various industries, such as medicine, are achieved not solely by public provision but by accreditation of those who practise and subsequent regulation of their behaviour. In such industries it is not practical to demarcate the desired public good, such as safety, and thus promote it separately from the goods and services being consumed.

It is along these lines that the banking industry has been modelled. Some components of the desired public trust have been achieved through public provision; for example, the printing of currency, the banking supervisory services and the recent expansion of registry services by the Reserve Bank, and the work of the Australian Securities Commission. But public provision risks losing some
of the flexibility also required of a banking system. Equally or more important to the achievement of the appropriate level of public trust in banking has been the effect on banking behaviour achieved by formal conditions attached to the banking licence and the consequent formal and informal influence this licensing provides the Reserve Bank over each bank.

Together these means have modified the behaviour of banks and bankers from what would have occurred in a freely competitive environment.

Achievement largely by regulation or formal or informal code of behaviour rather than simply by public provision or subsidisation shifts some of our focus to the regulator, namely the Reserve Bank. If the regulator influences the behaviour of the industry, we need to consider whether the regulator's goals are in line with our understanding of social responsibility.

But first we need to move beyond the general to the specific issues of banking today and of the deregulation that has shaped its character.
The word deregulation requires clarification. Very few would advocate an unregulated banking sector. With public confidence in the safety of the payments system and in bank deposits a paramount requirement, the need for some prudential ground rules is almost uniformly supported. The debate and deregulation of the 1980s has been concerned with the nature of these rules and, in particular, whether there is a need to control the type, quantity and price of a bank’s services as closely as was done in the post-war period until the 1980s.

Problems with pre-deregulation retail banking

First let’s consider some of the perceived shortcomings in the financial system, particularly in the retail component, that deregulation was intended to address.

In the 1970s the trend for retail depositors and borrowers to move from banks to non-bank financial institutions such as building societies strengthened. There were more intending home mortgage and other borrowers than the banks could service while subject to the prevailing interest rate controls and lending volume constraints. Banks rationed their available funds by utilising conservative loan-to-valuation ratios, by imposing savings history requirements on intending borrowers and by
being relatively inflexible in the loan structures offered.

Other institutions, such as building societies and finance companies, were subject to different and generally easier regulation and consequently were often able to be more flexible, albeit at higher interest rates. The higher lending rates permitted them to offer more attractive interest rates for funds, thus attracting depositors away from banks.

Depositors were further attracted out of the banking system in the early 1980s with the launch of cash management trusts, which offered close to professional market interest rates. This development might appear to be a simple case of competition, but if so then it was largely competition between regulatory regimes and not between individual financial institutions. Indeed many of the finance companies were in fact owned by banks, and business was often retained within a banking group. One result was to shift retail customers to less regulated segments of the financial sector, generally without the customers being fully aware of the difference. Another was the continued reduction in the proportion of the financial system (the banking sector) over which the monetary authorities' policies directly applied (from 95% in 1936 to 58% in 1980). 14

Moreover, the banks' means of rationing available loans was likely to be administratively more costly and less flexible and hence less efficient than rationing via price (that is, by varying interest rates). Equally, though less seen as a problem by retail customers, bank competition for deposits other than by price probably led to inefficiencies such as excessive unfocused image advertising, an overextended branch and agency network, and unnecessary and expensive face-to-face handling of banking transactions. While each of these offers some positive benefits, the benefits need to be balanced against costs incurred elsewhere (such as in lower deposit interest rates).

For those customers who remained with banks the choice of services was often limited. Imposed interest rate and term regulations restricted the services banks could offer. In addition the banks, experiencing more demand than they could meet, had little incentive to make their products flexible.

Interest charges on variable-balance loans (such as overdrafts, credit cards and mortgages) were calculated on a daily balance basis, whereas interest on most variable-balance retail deposit accounts was calculated on the minimum monthly balance. Competition among banks was not enough to force a change in this practice.
(which would increase the cost of existing deposits). Nor at that time was there enough customer awareness or any effective consumer lobby seeking a consistent approach to advertised product interest rates.

Even when, before deregulation, bank interest rates did follow rises in market rates, a large proportion of retail depositors missed out. Higher deposit interest rates and better access conditions were generally only offered selectively on new deposit products aimed at the more aware retail customer. Customer awareness and competition was not enough to force banks to adjust their rates on their traditional deposit range.

Critics consequently saw benefits in opening up a relatively protected and constrained banking system to competition, including from foreign banks and global financial markets. Implicit was the view that the banks had become a little inflexible and heavy — showing in overgenerous staffing and staffing conditions, and in poor industry performance compared with other industries, and likely to be constraining international competitiveness of other Australian industries.

The process of deregulation

Despite some minor loosening of banking regulations (for example, interest rate controls for large loans and deposits) in the 1970s, it was not until after the Campbell Inquiry released its Final Report in September 1981 that a strong momentum for replacing intrusive regulatory controls with market mechanisms emerged. In 1982 constraints on bank deposit terms were substantially eased, direct guidance on bank lending volumes ended and constraints on savings bank assets eased.

Although the trend towards relying on changing interest rates as the prime instrument of monetary policy was already in train, it was the December 1983 floating of the Australian dollar by the new Labor Government that made the trend irreversible. By removing any material barrier to global financial markets, the government virtually committed itself to a complete deregulation of Australia’s interest rates. If customers could relatively freely invest or borrow overseas at market interest rates with forward exchange cover, then domestic constraints would quickly be bypassed. Indeed it took less than thirty months before all bank interest rate controls, including those on the politically sensitive new housing loans, were removed.

Now, if they wish to use monetary policy to restrain or stimulate the economy, the monetary authorities exert pressure directly on interest rates, particularly on the call and
short-term interest rates at which the Reserve Bank deals directly with financial institutions. The monetary authorities rely on this pressure to influence both the rates at which banks and other financial institutions lend and take deposits from their customers and that this cost of funds will in turn affect their customers' economic decisions. (Perhaps not surprisingly, the first time this mechanism was used, in the late 1980s, it took a longer period and higher interest rates than many expected for the 'tightening' message to get through effectively.)

This reliance on interest rates contrasts with earlier constraints on bank lending volumes, either by quotas or via increasing the proportion of loanable funds banks need to lodge at the Reserve Bank. Though used effectively over earlier decades, these policies had encouraged the movement of business away from Australian banks to non-banks and foreign institutions, thus reducing the size of the sector over which the policies operated.

The deregulatory changes towards free interest rate and currency markets were the more public offspring of the Campbell Inquiry, whose terms of reference had emphasised the importance of efficiency and the then government's free enterprise objectives. None the less, the Campbell Inquiry was also concerned with the safety of the banking system and the necessary prudential controls to achieve it. Rather than closely prescribing a bank's business, the Campbell Inquiry suggested reliance on the bank's capital or equity base. Measures of its adequacy had to take into account the bank's assets and business mix.

These capital adequacy requirements were introduced gradually in the second half of the 1980s in line with or slightly ahead of comparable developments overseas. Replacing the protection offered by tight controls over the banking industry, this shift permitted both the influx of foreign banks and a new banking environment encouraging innovation and flexibility subject to competitive forces — and the maintenance of adequate capital.

With the changes of the 1980s much of the vision of the Campbell Inquiry has been achieved: '... a more open and flexible financial system, substantially free of intrusive government controls and regulations'.

Deregulated retail banking: An assessment

Some of the results of deregulated retail banking are fairly clear.

Product innovation and diversity has accelerated, including a wide range of...
products made possible by deregulation: interest-paying cheque accounts and wider ranges of term deposit and housing loan packages (including low-start, fixed rate, variable repayment frequencies, etc). Price rationing has largely replaced less efficient rationing of available lending funds and has improved overall returns to savers. The banking sector has reclaimed much of the retail drift to non-bank financial institutions of the 1960s and 1970s. Some of the inefficiency of consumers needing to deal with more than one type of institution has been reduced, and regulatory control has tended to become more uniform and effective. Indeed the rationalisation in the supervision of the banking sector has encouraged a similar rationalisation for other components of the financial system.

Competition between individual banks for both deposit and loan business has grown. Increased competition in turn has contributed to a growing customer awareness (albeit slow) of the differences between banks and between products, and appears to be increasing consumer mobility between banks. People are more aware of interest rates and the effects of their changes. Similarly, awareness of differences in terms and conditions attached to banking services has been gradually enhanced.

In corporate banking competition sharpened significantly, particularly with the arrival of foreign banks in the mid 1980s. Indeed it is now considered to have been excessive and a major contributor to significant bad debts recorded by the banking sector.

Other results are more contested:

- Have retail banking margins widened with deregulation?
- Has retail banking become truly competitive?
- Are there winners and losers from the shift to deregulation?
- Have banks, with stronger economic power, abused customer ignorance and inertia (such as with passbook savings and credit cards)?
- Should basic banking be regarded as an essential service?
- Is there a need for a on-going social justice watch-dog?
Much was made in the press of whether banking margins widened after deregulation and whether retail banking margins are subsidising loss-making corporate banking.

It is essential to understand the jargon. The absolute level of market interest rates (as dealt in the professional market for substantial amounts) depends on the monetary authorities' setting of monetary policy. It is the Reserve Bank that sets the overnight rate around which all short-term market interest rates revolve. Expectations about inflation in conjunction with the operations of the monetary authorities largely determine long-term market interest rates.

Banking margins refer to the interest rate spread between the interest rate of a bank product and the relevant market interest rate. These margins have to cover any credit risk, any human or computer handling costs, any prudential reserve cost and a sufficient return to the bank's shareholders for the capital involved. Such a return on capital clearly needs to exceed the yield on risk-free government bonds — that is, it needs to be higher in high interest rate periods.

Banks do not use particular deposit products to fund particular loan products; rather they raise funds via a range of deposit products, all with
their own interest rate and handling cost structures, and lend via a range of lending products. So it is not very useful to look at a spread between particular products, such as between new housing loans and savings investment accounts. Not only do each of these have a range of possible interest rates, but they also have different volume and term characteristics — housing loans have grown rapidly and are generally for terms of up to twenty-five years while savings investment accounts have not grown significantly and are generally available at call.

As a general rule each deposit and loan product needs to justify itself by comparison with the relevant market rate (the rate at which funds could be raised or lent to the money market with very low handling costs). So the margin on savings investment accounts would be the spread between the average interest rate paid and a short-term money market rate.

Problems still remain. For example, housing loan rates were capped at 17% in 1989 following an agreement with the government while appropriate market rates rose above 18%. Clearly bank profitability at this time had to come from greater margins on other, particularly deposit, products. Increasingly, however, each deposit and loan product is being forced to stand on its own feet.

One of the trends in banking margins since the early 1980s has been a gradual shift from deposit margins to lending margins. This shift reflects both inertia in bank rates in earlier decades as inflation and market rates rose and the earlier regulatory caps on bank lending rates. Both of these factors have been removed by deregulation.

Clearly, then, suggestions that bank margins have widened unfairly need to be carefully appraised. First, the effect of market rate movements needs to be removed. Secondly, the rising of both bank deposit and lending rates relative to market rates needs to be allowed for. While absolute rates increased (until 1990) and many lending margins have increased, deposit margins have generally narrowed.

On balance, although particular products such as credit cards and traditional passbook accounts warrant special attention (given below), there is no convincing evidence that overall bank margins have widened over the past decade of deregulation. Rather they appear to have narrowed. The issue was addressed fully by the Martin Inquiry and has recently been covered directly by the Reserve Bank, which notes:

On their Australian domestic business, it is estimated that average net spreads for the major bank groups were about 5 per-
percentage points in the first half of the 1980s and about 4.5 percentage points in the second half. In 1990 and 1991, average net spreads fell to 4 percentage points or less.

There is, however, more evidence of a shift in the balance between margins on corporate and retail banking. Problems with availability and clear interpretation of data preclude any simple conclusions, but this paper agrees with the general consensus that corporate margins declined markedly during the 1980s while retail margins did not.

Probably the narrowing of margins in corporate banking was temporarily overdone in the initial competition with the newly established foreign banks. None the less, even with the banks’ experience with rising corporate bad debts, corporate margins appear to be well below pre-deregulation levels. But does this mean that they are being subsidised by retail banking? It depends largely on interpretation. The Martin Inquiry reports that the Reserve Bank ‘does not believe that consumers are now subsidising loans to big business but deregulation has removed the “heavy cross-subsidisation in banks that went in the other direction”.’

The Reserve Bank sees the change as removal of an inappropriate pre-deregulation subsidy to consumer banking whereas many consumer welfare groups see the trend as a new unfair subsidy by the retail sector. Underlying the Reserve Bank’s contention is the belief that a freer, competitive market has emerged and is less likely to allow cross-subsidisation than the previously more regulated market. Whether the deregulated market is competitive enough for this confidence is addressed below. After that the issue of winners and losers from the deregulatory shift is also addressed.
Although the number of banks has increased sharply since the early 1980s, the new foreign banks have had a very minor impact on retail banking, and some of the growth in bank numbers simply reflects an offsetting reduction in non-bank financial institutions such as building societies. In particular the increase in dominance of the four major banks, with roughly three-quarters of the retail market, and some lingering suggestion of collusion in price-setting between these four, raises doubt as to whether there is effective retail banking competition.

It is a critical question as only an affirmative response will give confidence that use of freer market forces will improve the efficiency of the financial system.

This was one of the Treasurer’s terms of reference to the Martin Inquiry in October 1990. Another related term of reference was to consider whether the profitability of the banking sector was appropriate. The record bank profits of the late 1980s that underlay this reference have, however, been succeeded by some very poor results.

The Martin Inquiry considered banking competition at length. It noted that although there were more than thirty licensed banks, the average retail customer effectively had a choice of the four majors and perhaps a State bank and one or two new banks.
(generally ex-building societies). This choice could be substantially restricted in smaller (e.g. rural) communities or where consumers were restricted to banks within walking distance.

The inquiry concluded that a range of six or so banks, together with non-bank financial intermediaries (building societies, credit unions etc) represents a reasonable choice for most consumers. Indeed there are some arguments (supported by the current reduction in bank staffing levels) that Australia, with less than eighteen million people, is still oversupplied with banks.

The committee, however, appropriately expressed concern over any increase in the current concentration of the banking industry. Any combination of the current four 'majors' would significantly change the current balance of four roughly equal competitors to one bank having a dominant lead on its two remaining rivals. In line with this concern for ensuring continuing competition, the government's refusal to allow the ANZ and National Mutual Life to merge should be generally supported.

But even without further concentration, comfort in a 'reasonable choice' of retail banks depends on the banks operating competitively; that is, in a non-collusive manner. Confidence would be undermined if the four majors were to form a cartel and effectively make joint decisions on product interest rates and conditions. Such a cartel need not be formally organised, but rather could rest informally on an understanding that one bank operates as a price-setter with the others following. Information on such informal understandings is, not surprisingly, often anecdotal and open to varying interpretations.

No formally organised banking cartel appears to exist. The last such entity, formally organised to control the jointly launched Bankcard product, was disbanded in the late 1970s after trade practices legislation was enacted.

The signs of an informal cartel between the majors are ambivalent. Each monitors the others' product rates and conditions closely, and changes in rates and product conditions frequently occur close together. But this can also be characteristic of competitive markets, and certainly there is great variation in which bank leads the changes.

Indeed, the price leader in banking, if there is one, is the Reserve Bank of Australia as the operator of the nation's monetary policy. In the vast majority of cases major bank interest rate changes have closely followed those in official interest rates, with only jockeying for position between
the major (and lesser) banks. Moreover, there are regular ‘discussions’ between the Reserve Bank and the majors (sometimes all together) about the state of the banking industry and apparently including, from time to time, suggestions by the Reserve Bank as to the main focus of future banking interest rate shifts. Even in its public announcements of official interest rate changes, the Reserve Bank can be disingenuous:

Contrary to some media reports, the Reserve Bank has not been pressuring the banks to reduce their lending for housing. Rather, it has been making the point that, from a macro-economic perspective, the housing area does not need further special encouragement for new borrowers at this time and that the Bank would wish to see further reductions in lending rates concentrated in the business area.25

Deregulated guidance includes not only such ‘suggestions’ but also the occasional formal agreement, such as in September 1989 when the banks agreed to cap the ‘deregulated’ home lending rate at 17% in return for the monetary authorities increasing the interest rate paid on banks’ compulsory deposits with the central bank.

It is difficult not to see this set-up as some kind of officially directed cartel. Such arrangements do not encourage completely independent setting of product rates by each bank. Price-setting might be more independent than it was before deregulation, but it is still a long way from the decentralised decision-making of free markets. There might, of course, be strong pragmatic arguments in favour of this continued involvement of the monetary authorities — but, to the extent that they are involved, the monetary authorities must also accept some responsibility to ensure that bank interest rates, in their entirety, are appropriate. The Reserve Bank’s general defence that it is concerned primarily with macro-economic factors does not fully excuse its selective intrusion in the setting of bank product interest rates.

In a competitive market all bank products would be subject to market forces, and all would be affected by shifts in official and other rates. This has not been the case — products such as credit cards and traditional passbook savings accounts have changed remarkably little since the early 1980s. If the official focus had spared time for credit card debtors or traditional passbook savers as well as for home and business borrowers, this is unlikely to have been the case.

An additional restraint on competition is the degree of difficulty a consumer faces in shifting from one bank to another. Changing banks involves
not only legal, government and bank charges to (say) transfer a mortgage or other debt but also the sheer time and annoyance in rearranging financial arrangements involving, for example, new account identification requirements and redirecting automated salary and other payments.

Despite these impediments, there are clear signs that banking is more competitive than it was. Banks are launching new products to steal an edge on their competitors. Banks are heavily cutting their costs, including staffing, to compete as lower-cost producers. Product rate changes, even apart from those induced by official policy, are more frequent and more responsive to market conditions. Banks are advertising more competitively in terms of rates. These improvements are largely the result of the deregulation of the financial system and the general move in the economy towards more free market practices.

But the potential for collusion (including that inspired by the monetary authorities) between the major banks is real. It requires a continued emphasis on competition by such bodies as the Trade Practices Commission and the Prices Surveillance Authority to ensure that the current competitive fervour in retail banking is extended and not gradually eroded. In addition the monetary authorities need to be more mindful of social justice as well as macro-economic priorities, particularly if they impede competition via deregulated guidance.
Have there been losers from deregulation?

Even if deregulated freer markets adapt appropriately and fairly in the future, there remains the potential for some to be losers in the shift from more regulated banking. Some sectors of the community with protected positions before deregulation have lost those positions without compensation. Such people might now have a greater choice of banking services and might benefit from a more efficient financial sector overall, but have lost previously held buying power in the market relative to others.

For example, a small business with a well-used cheque account and overdraft facility will probably be a net loser from deregulation due to sharply higher transaction fees and relatively higher borrowing margins. Similarly, a retail customer with only a low-balance transaction account will probably be a net loser through deregulation as rising transaction fees emerge (offset by higher bank deposit rates not received by low-balance depositors).

Note that we are not saying that the changes are necessarily inappropriate. The use of freer market forces encourages people to choose and pay separately for the services they use. So, for example, two customers with the same average deposit balance but with very different transaction levels might have been given the same inter-
est by a bank before deregulation. The low transactor was effectively subsidising the person with numerous transactions as the deposit interest rate was kept low enough to cover the average transaction handling cost. Since the early 1980s there has been a gradual move towards higher deposit interest rates coupled with the spread of ‘user pays’ transaction fees. There will always be debate on how these fees should be calculated, with the banks generally saying they are well under true cost, but it is difficult to disagree with the principle — particularly when it might encourage retail consumers to adjust their banking behaviour to reduce unnecessary transactions.

But even in this light it is difficult to generalise that retail banking customers have come through the deregulation process at a relative disadvantage to others such as large corporate clients. Both retail and corporate segments cover a wide range of situations: a retail customer with bank investments might well have benefited with deposit rates moving closer to market rates. Corporate clients with high transactional activity and lower credit ratings might not have gained.

It is also difficult but important to consider the overall and longer-term gains of having a more efficient financial system. It would be to the whole community’s benefit if funds were allocated to more productive rather than less productive investments.

Moreover, allowing that the corporate sector might have been major beneficiaries from deregulation does not necessarily mean that retail customers lost an offsetting amount. The real losers include bank staff, whose numbers have fallen sharply and whose job security and conditions have suffered, and possibly bank shareholders.

Other specific losers from deregulation would include those who, because of disability, poor English or poor financial or technological literacy, require extensive face-to-face banking services. The free advice and services that banks provide as part of a customer relationship have been and will be under increasing pressure in a deregulated environment in which staff time needs to be more accountable and linked to some profit-oriented bank product. It is also less likely that tailored product innovation will reach the specific needs of small disadvantaged groups.

It is not that banks are unsympathetic to the plight of such disadvantaged groups or that they would be unaware of the image benefits that might accrue to publicised sympathetic action. However, the balance of forces operating within a bank has shifted
with deregulation towards giving greater weight to actions that justify themselves on profit-making (or cost-cutting) grounds.

Did bankers have a social responsibility to withstand these competitive pressures as they affect some or all of these disadvantaged groups? If so, what was the deregulation meant to achieve? Or, given that the deregulatory shift to these market forces was a deliberate and considered government policy, should the government have compensated or ensured protection for some or any of these losers — the high transactors, the small to medium-sized borrowers, the disadvantaged sectors, the bank staff — or did they consciously decide that the loss of market power by these groups was appropriate?

Against the background of all Australians being challenged to be more productive, the ‘losses’ of the wider groups should be seen as part of the cost of moving to a more efficient financial system and economy that will benefit all in the long run. For example, high transactors have benefited in the past unfairly, to the detriment of low transactors and restraining the efficiency of the financial sector.

But most of us would feel that it is a different situation for the disadvantaged sectors such as the physically disabled, the illiterate and the financially illiterate, who also lose as their particular needs receive less treatment in a competitive banking environment. Most would feel that these groups have a good case either for budgetary assistance or for pro-active remedial action such as financial literacy campaigns, or by ensuring, via widening the meaning of a banking licence, that these groups continue to receive appropriate banking attention. Not that such action is without cost to the rest of us, but this cost would be deemed appropriate and the effects of deregulation to these groups unintended.

The view expressed by some that the budgetary assistance mechanism, as opposed to other alternatives, should always be used to avoid any distortions in the banking system seems a little naive. We do not have a pure free market that should not be tainted; rather we need to adjust the ground rules (including consideration of all likely effects) to achieve an appropriate banking market. The most pragmatic solution clearly depends on the nature of the problem. For example, providing the blind with enough budgetary assistance to employ sighted companions is unlikely to be as productive as directly encouraging banks to (say) include a voice option and touch-identifiable keys on their automatic telling machines.
We need to ensure that disadvantaged groups, further disadvantaged by the shift to deregulation, are not forgotten but that the most pragmatic remedial action is taken. As there is no government agency clearly responsible for considering this issue, it might be appropriately handled by a church or peak social service body. The dignity of the people concerned, as well as their economic well-being, needs to be considered.
Traditional passbook accounts paid interest at 3.75% (6% if more than $4000) throughout the record market interest rates of the 1980s. Balances remained at around $9 billion, despite other call deposit accounts paying substantially higher interest.

Banks defended their practice to the Martin Inquiry principally on the basis that high handling costs offset the low deposit interest rates paid on these and on cheque accounts.26 Clearly some accounts, such as high transaction cheque accounts, would have significant handling costs. But traditional passbook accounts, many largely dormant, do not easily fall into this category. In any case handling costs would not rise and fall to offset market interest rate movements. If competitive forces had been at work, or if banks had felt an obligation to maintain an equivalent return to their customers on this product, the interest rate on these passbook balances would have changed frequently during the 1980s.

The banks adopted a policy of product differentiation and marketed only some products (such as investment savings accounts early in the 1980s and later term deposits) on the basis of competitive interest rates. Some call products, particularly those with large rolling balances, were allowed, without any advice to the cus-
tomar, to become less rate-competitive as market rates rose. The banks’ more aware (and more mobile) depositors and borrowers benefited to the extent that customer inertia or ignorance left deposit balances at well below market rates (even after allowing for handling costs), with this ‘subsidy’ permitting lower borrowing rates and higher rates on competitive deposits.

Product differentiation is by no means unusual and can lead to added value via a meaningful extension of customer choice. This is not evident in the above case, however, where there was often not a great difference in the products offered (minimum balance and transaction sizes being only minor modifications). It is hard to conclude anything other than that the banks were simply taking advantage of customer inertia and ignorance. Ignorance here includes not knowing the current bank product rate level. Despite recent improvements, even now not all bank product rate changes are advertised in the press and certainly are not advised to each customer (even when statements are despatched or passbooks updated).

Remember that much of the benefits of free market forces (such as efficiency) are based on assumptions of participants being adequately informed and capable. The above practice seems to represent a rather hollow form of consumer sovereignty and to undermine confidence that deregulation will achieve its limited promise. Proactive adjustment of the ground rules is required and is being partly achieved in many ways ranging from such initiatives as the pension deeming arrangements (clumsy though it may be) to the State and, more recently, Federal Government initiatives to improve disclosure requirements.

Customer ignorance has also been seen as contributing to poor choices of retail banking products, such as inappropriate or excessive debt or guarantor commitments, unaware acceptance of unfair financing conditions or rates and undue reliance on credit cards for continuing debt. These issues have been addressed fully by consumer groups and have resulted in sharply increased efforts to improve disclosure standards for financing products and bank codes of conduct covering dealings with their clients.

The extent of time taken and the conflict between banks and the state consumer affairs bodies over proposed uniform credit legislation should not in itself be seen as problematic. Indeed it should be seen as symptomatic of a long-overdue consultative (and gradual consensus-forming) process of bringing banking and consumer realities together.

Since the late 1980s significant progress has been achieved. The 1988
electronic funds transfer code of conduct, now contractually part of every EFT transaction, has proved that an effective and acceptable code can be developed and enforced. The banking industry’s ombudsman scheme, prompted certainly by community and government pressure, was none the less a voluntary initiative of the banks and has worked extremely well, including at the intangible level of gradually communicating to consumers that they have rights when they experience a problem at the bank counter. Possibly more importantly, it has prompted each retail bank to upgrade and stress its internal dispute resolution mechanisms on the grounds of both justice and good commercial practice.

Why are further prompts for such initiatives necessary? The Martin Inquiry looked at the issues of disclosure and the banker–customer relationship in depth and included pragmatic consideration of the various alternatives. It concluded that 'market forces are not of themselves sufficient to ensure that bank services are delivered on fair and equitable terms' and recommended both the consultative development of a general banking code of conduct under the auspices of the Trade Practices Commission and, where appropriate, modifications to banking legislation. Although consumer groups sought greater statutory enshrinement of consumer protection, this was rightly felt to be dangerous and inflexible given the rapid changes in the financial system. A banking code of conduct is, at the time of writing, being developed by the Trade Practices Commission and the Federal Treasury. It is assumed that the views of consumer lobby groups as well as banks will contribute to the result. A consultative development and continuing review of the code should enhance protection as well as ensuring that the various parties continue to talk together. Bankers will recognise consumer lobby viewpoints; lobbyists will be acquainted with the costs and pragmatic considerations of the programs they seek.

One can almost see these positive steps as a consequence of deregulation: the changes in banking, including those contrary to retail consumers, both aroused consumer discontent and, directly and indirectly, enhanced public awareness of banking issues. This public prominence has led to stronger remedial action.

But in addition to these steps now in train, longer-term work is also required in related areas, such as improving financial literacy education at schools and in the community and more staff training within financial institutions.
Credit card interest rates have also received extensive if not balanced media attention. Much has been made of the stubbornly high interest rates until recently, with most above 20%. With the normal monthly payment cycle and the varying additional interest-free periods it needs to be noted that about a third of the credit card debt that the banks fund does not earn them any interest. While nominal interest rates might be 21–22%, the effective interest rate that a bank earns might be closer to 14%. The fees paid by the merchant on credit card sales (ranging from close to zero up to 5%) were, however, originally meant to cover this non-interest-earning debt as well as part of the transaction handling costs.

Two government reports, the Damania and Gaudion Reports of 1989, attempted to consider all aspects of the banks' credit card operations and concluded that the operations were either just breaking even or still earning a loss on the banks' overall investment. The Prices Surveillance Authority commenced a fresh analysis in June 1992 as recommended by the Martin Inquiry and found that credit cards had recently become profitable. Indeed, the sharp drop in both market and other bank interest rates since the record levels of 1989 would suggest that credit card interest rates might have stayed excessive
throughout 1992 even after two
drops. Certainly the dearth of changes
in credit card interest rates over the
decade before 1992 suggests that they
were not competitively priced.

There are other issues involved rather
than just the interest rate level. The
banks have argued for the freedom to
apply an annual card fee. They note the
existence of a significant body of card-
holders who use the card primarily as a
cost-less transaction card with free
credit by regularly paying off the debt
before the monthly due date. They
point to the non-interest-bearing debt
of these (on average higher-income)
card-users as the basis for the above
market interest rates charged to those
unable to pay off their debt. It is dif-

cult to disagree that such a cross-

subsidy from poor to rich is inap-

propriate, nor that transactions via
credit cards should not avoid fees that
are appearing on many other ac-

counts. If unnecessary transactions
cost the economy, there is no reason
why those able to use credit cards
should be able to avoid a pricing dis-

incentive. To the extent that state laws
are hindering such sensible change
they should be deregulated.

But are the banks’ actions flawless?
Why do ten of the twelve cards of-

fered by the four majors still have in-

terest-free periods in addition to the
monthly payment cycle? 31 Could it
be that banks are afraid of losing
higher-income customers to other
banks? Perhaps even if they make little
or no profits on their cards the banks
feel that the overall customer relation-

ship is profitable and worth maintai-

ning. Given that card operations are
long-term and capital-intensive and
only part of a bank’s overall retail
banking service, such an approach is
quite reasonable and likely. It does,
however, undermine the banks’
reliance on product profitability to
justify current high credit card rates.

Arguments by the banks that credit
card problems are due to the fact that
their pricing is still regulated sit poor-
ly with the bank practice that requires
merchants to charge the same for both
cash and credit card purchases. As the
Martin Inquiry concludes, this is
‘contrary to the user pays philosophy
supported by banks. The cash cus-

tomer should not be required to sub-

sidise the credit card customer’. 32

Change in bank credit card arrange-
ments are clearly overdue. Action is
required if those unable to repay
credit card debts have these debts
compounding at rates in excess of
20%, supposedly to subsidise those
who can. This is neither economically
fair nor socially supportive of the
common good. Credit card pricing is
not one of banking’s success stories,
with anecdotal evidence that banks
were more interested during the 1970s and 1980s in increasing market saturation than in giving thought to the impact of the much-marketed interest-free period on various consumers. Certainly credit cards appear to be a less competitive component of retail banking (not solely due to legislative constraints) and one that warrants close attention by consumer regulatory authorities, as is being given at the time of writing.
SHOULD BASIC BANKING BE SEEN AS AN ESSENTIAL SERVICE?

By the year 2000 (not so far ahead now) it has been projected that 95% of wages and salary payments and 70% of shopping will be conducted electronically. Most pension and other support payments require a banking connection. Various surveys suggest that approximately 5% of adult Australians do not have a banking account. Simultaneously the ‘user pays’ fees trend on banking products is likely to be increasingly extended, particularly on the less profitable low-balance transaction accounts which are more likely to be held by the poor. There is a danger of growth in the ‘unbanked’, a new grouping effectively excluded from economic citizenry.

In many overseas countries, refusal by banks to cash cheques for certain people or refusal to allow them to open accounts has resulted in governments requiring banks to provide a basic banking service to all. Although variously defined, such a service seems to include:

- a safe, accessible place to store money,
- a mechanism to obtain cash from the account,
- a mechanism to make third-party payments,
- an ability to cash government cheques and to deposit third-party cheques, and
- a zero or capped low overall cost.
Variations seem to rest on the number of fee-free transactions permitted and whether both face-to-face and automated banking services are included.

Although anecdotal evidence suggests that some banks have referred undesirable customers elsewhere, such as to the Commonwealth Bank, Australian banking does not seem to have a significant problem with refusal to accept certain customers — but the trends are in place. The Martin Inquiry recommended that the retail banks and the Department of Social Security together explore the development of a basic banking product to be made available to all. If the banks should choose not to respond to this initiative, some compulsion would appear appropriate to ensure that an element of divisiveness in the community is avoided. This could be done simply by making a basic banking product a condition of being granted a banking licence.

There will be those who argue that such social assistance should be provided from the budget and not within the banking system. This is ludicrous — how much would have to be paid to such ‘unbankable’ consumers before they become attractive? Banks themselves benefit from the structure of the banking system and its regulation (for example, via the Reserve Bank’s role and perceived protection) in a host of ways other than by budgetary assistance. Moreover, it is not just a question of ensuring the financial system’s ground rules to protect the disadvantaged. The value of the financial system to all its participants, private business and government agencies alike, partly depends on its full coverage.

The question of basic banking service, however, extends beyond the economic arguments of efficiency and coping with public good aspects. With the intrusion of banking into so much of modern economic life, access to banking services has become a prerequisite for community participation — it has become an essential element in the preservation of the dignity and rights of the individual.
CONCLUDING ASSESSMENT

It is difficult not to see advantages to the community as a whole in the deregulatory shift from direct and intrusive banking controls to an industry where banks, within a system of overall prudential supervision, are encouraged to compete in product range and pricing.

However, this paper has endeavoured to show that the questions we need to ask and the issues we need to address go beyond supporting or lamenting the deregulatory changes of the 1980s. What was and is essential is establishing and maintaining the ground rules within which freer market forces can operate, ground rules that ensure desirable outcomes both economically and in terms of social justice.

Those who argue in simplistic terms against regulation on the grounds that it fetters banking competition need to be reminded that competition in banking is not assured given the dominance of the major banks, the almost cartel-like arrangements with the Reserve Bank of Australia, the uneven power balance between banks and the typical retail consumer and the experience with bank actions on traditional deposit and credit card products. They might also be reminded of the value of the Reserve Bank’s supervision and depositor protection charter, which the banks and the whole community enjoy.
Ensuring that the competitive impetus of the 1980s is maintained and directed to the community’s benefit will require a continuing conscious watch-dog role by the relevant regulatory authorities including the Reserve Bank of Australia (responsible for monetary policy and banking supervision), the Trade Practices Commission (responsible for competition policy and increasingly for consumer protection) and the various governments themselves. Much has already been achieved, and many areas of remaining concern are being addressed at the time of writing.

A few issues, however, appear to have been neglected. The accidental casualties of deregulation, the disadvantaged community groups, those who were poorly placed to jockey for position in the freer market or who relied on banks’ paternalistic ‘free’ service, appear to need advocacy to achieve pragmatic remedial action, whether this be compensation from the budget or modification of the community’s expectations of banking licenceholders. And, equally fundamentally, a basic financial literacy campaign, integrated into our education systems, is needed to supplement the efforts to achieve more balanced banking practices.

Most importantly, the community needs to believe that it has the right to demand a financial system that meets its requirements and that evolves via consultation with all parties. Not only do the current reform initiatives need to be nurtured to completion but ‘ownership’ of the future financial system must be seen to be vested in the community it serves. As the Reserve Bank told the Martin Inquiry:

It is never simply a matter of there being regulation or market forces, and those elements need to be mixed up in a way that is calculated to generate the greatest possible benefit for the majority of Australians.

So were and are bankers at fault? The corporate excesses of the 1980s are well known and undoubtedly affected the general level of ethics throughout business and banking management. Certain decisions and non-decisions as far as retail banking are concerned must rightly now be making certain bankers squirm. But there are probably few industries or human endeavours where this is not the case.

As the Reserve Bank is fond of saying, banks and regulators are learning from their mistakes. The danger is that over time they will forget. And that over time the broader community, the rest of us, will let them.

Finally, when we have altered the law, established codes of conduct, equipped consumers with skills and rights of
redress, provided protection for the disadvantaged — when we have exhaussted the wisdom of the 'wise steward' we need to remember that we are not done. There will always be new modifications to these ground rules required for 'free' markets to work, always exceptional circumstances that call the banker to move beyond them, always the call of human dignity and human rights and always the call of the 'new creation'.
APPENDIX:
AN OVERVIEW OF
AUSTRALIAN
BANKS AND THEIR
OPERATIONS

The report *A Pocket Full of Change* (released by the Martin Inquiry in November 1991) describes the banking industry as the key group within the Australian financial system. In June 1991 Australian banking group assets exceeded the asset totals of non-bank financial intermediaries (NBFIs) (such as finance companies, building societies and merchant banks) and of life office and superannuation funds combined. Since the early 1980s banks have reclaimed business from the NBFIs.

The Australian banking industry comprises the four major nationally operating banks, the state banks, some smaller domestic (generally niche or regionally operating) banks and seventeen foreign banks. The four major banks (ANZ, Commonwealth, National Australia and Westpac) continue to dominate the industry with almost three-quarters of total Australian bank deposits. The state and smaller domestic banks (some of which were formerly building societies) tend to operate in regional or niche markets. The foreign banks have generally involved themselves in wholesale or corporate rather than retail banking, with the largest, Citibank, holding just over 2% of Australian deposits.

Compared with eight other major economies Australia has, adjusted for
population, 'the second largest overall banking distribution network behind France' and scores highly for branch and agency networks, for automatic telling machines and for electronic funds transfer outlets.\textsuperscript{41}

Clearly the character of a bank will vary according to its size and background. Given their retail banking dominance this appendix will look at a typical major bank to better understand the people on the other side of the bank counter.

The typical major bank has around 30,000 full-time staff and four thousand or so part-time staff working primarily as branch tellers or customer service staff over peak times. These staff are spread between head office and around 1300 branches, ranging from two-person outlets to the largest offices with hundreds of staff. In addition the bank also has an agency network to support (the Commonwealth has by far the largest with about 4600 agents).\textsuperscript{42}

These branches (and to a lesser extent agencies) spread across Australia generally need to provide identical banking services with up-to-date records; internal communications consequently present a major problem for the bank. During the 1970s and 1980s all of the major banks have achieved an integrated on-line national computer network which allows simple banking services to be handled uniformly. These massive computer systems have, however, generally been product-based, so the bank's information on a particular customer is often split between a number of product systems. This helps to explain why customers often have to provide the same information, such as name and address, for each of their various accounts. Most large banks are still endeavouring to bring their different systems together to improve their risk management, marketing and customer service and to reduce their labour costs.

Before a new bank policy or product can be launched, effective handling capacity has to be installed all over Australia. Systems have to be tested. Instructions have to be printed and distributed to each point and read and understood by the thousands of staff involved. The logistical pressures might be compounded by national advertising deadlines and campaigns conflicting with local conditions not understood at the bank's head office. Not surprisingly, difficulties and confusion arise at the branch counter causing customer annoyance.

A large proportion of bank staff are relatively young and inexperienced, reflecting both a high turnover of young branch staff throughout the 1980s and increasing diversity and
complexity of banking products, which have at times outstripped staff training. Banks have recently increased their efforts to retain experienced staff, especially women, with more flexible working arrangements. The high staff turnover has also reduced because of recent high unemployment.

Partly to counter these communication, training and customer service problems the typical major bank has established a level of specialisation in its branch networks to handle the more complicated types of business. This generally includes the establishment of corporate centres to win and service business accounts as well as regional groupings of retail branches with additional expertise and control in the regional office. An earlier attempt to give local managers directly more discretion in lending and business accumulation has largely been absorbed into these regional offices, partly in response to bad debt experience.

The typical major bank is still confronting the basic problem of encouraging its branch staff to ‘service its retail customers’ rather than just handle transactions. This is exacerbated both by strong pressures on profitability that force banks to reduce operational costs and by the long lead times required for changes to the computer systems that support existing banking products (and determine their handling). The pressure on operational costs has made its mark on bank staff levels, with the typical major reducing numbers by more than 5000 (or 15+) since the late 1980s (largely through natural attrition and reduced recruiting).

The complexities and capital intensity of computer systems and the need for bank-wide profit and risk management ensures that a relatively strong head office exists in the bank. It is this head office that determines the products that will be offered, the price at which they will be offered and how the transactions are to be handled and reported. It is not surprising that branch staff sometimes feel as if they are sandwiched between irate customers and an inflexible head office.

Lending decisions are controlled by a hierarchy of delegations ranging from the local manager (say, up to $300 000) through regional manager (say, up to $3 000 000) to head office (say, up to $15 000 000) and, for more substantial exposures, a credit committee made up of members of the bank’s board. Such a credit committee might meet weekly, while the board itself would meet monthly to review the overall strategic direction and performance of the bank. Operational management of the bank, including
major product rate changes, would normally be facilitated by a daily meeting of the senior head office department heads with the chief executive officer. There have been examples where the relatively rigid product guidelines and delegation structures have influenced some local managers to channel certain business proposals into less appropriate products where the delegation or handling procedures are easier.

Banks offer a wide range of loan, deposit and other services to the full spectrum of retail, corporate, inter-bank and international customers. Table 1 provides perspective via a simple balance sheet breakdown of the average major bank.

Such are the institutions that deal with hundreds of thousands of customers each day, accepting deposits and making withdrawals over the counter, via a machine or via automated payments, and lending money such as through a credit card purchase, a house mortgage or through honouring a cheque on an overdraft account. These are the complicated entities that almost all Australians face, with varying degrees of satisfaction.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
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<tr>
<td>Housing loans</td>
<td>Cheque accounts</td>
</tr>
<tr>
<td>Credit card loans</td>
<td>Traditional passbooks</td>
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<tr>
<td>Other personal loans</td>
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<td>Capital</td>
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Table 1 Components of a typical major bank's balance sheet

Table 1 provides perspective via a simple balance sheet breakdown of the average major bank.
ENDNOTES


2 A brief authoritative list of the changes in banking regulation over the 1970s and 1980s can be found in B. W. Fraser, 'Financial deregulation and the rural economy' in the Reserve Bank of Australia's Bulletin, March 1990, and in Appendix 1 of the Reserve Bank of Australia's Submission to the House of Representatives Standing Committee on Finance and Public Administration, January 1991.


5 Such as in Matthew 18:23-35.


7 Mark 12:17.


9 Such as in John 13:34, 2 Corinthians 5:17 and Matthew 9:17, and indeed as foreshadowed in Isaiah 65:17-25.


11 Pope John Paul II, Centesimus Annus, p.40 cited in Department of Social Development and World Peace, A Preliminary Summary of 'Centesimus Annus', Washington DC.


13 This is not intended to be a rigorous treatment of the 'perfect competition' ideal type discussed in pure economic theory; rather an example of the mutual gains of decentralised and flexible decision-making intrinsic in the popular understanding of competitive forces. For a more theoretical discussion of
competition theory, with relevance to the financial system, see A Pocket Full of Change, pp. 63–7.

14 As measured by the banking sector’s share of total financial intermediary assets, p. 25, A Pocket Full of Change, 1991.


16 For a detailed record of the changes in banking regulation over the past two decades see either ‘Financial deregulation and the rural economy’ in Reserve Bank of Australia Bulletin, March 1990 or Appendix 1 of Reserve Bank of Australia, Submission to the House of Representatives Standing Committee on Finance and Public Administration (the Martin Committee), January 1991.

17 Campbell Committee, Australian Financial System Inquiry, 1981.


20 A Pocket Full of Change, p. 93.

21 As measured by share of Australian deposits — see endnote 39.

22 See A Pocket Full of Change, Sections II and V.

23 A Pocket Full of Change, p. 370.

24 See A Pocket Full of Change, pp. 121–8.

25 Statement by the Governor, Mr B. Fraser, entitled ‘Monetary policy’, Reserve Bank of Australia (No. 92(11), 6 May 1992.

26 A Pocket Full of Change, p. 367.

27 See, for example, the submissions of Australian Federation of Consumer Organisations, Australian Consumer Association and Australian Financial Counselling and Credit Reform Association to the Martin Inquiry.

28 A Pocket Full of Change; see in particular chapters 20 and 21.

29 A Pocket Full of Change, p. 388.

30 The reports and their outcomes are described in A Pocket Full of Change, p. 359.

31 A Pocket Full of Change, p. 360.

32 A Pocket Full of Change, p. 365.

33 From a submission to the Martin Inquiry.

34 For a good coverage, see Singh, Supriya, ‘The consumer and financial institutions: Access, information and prudential supervision’, Part 2 of submission by AFCCRA, ACA and AFCO to the Martin Inquiry, pp. 4–9.

35 For a brief summary, see A Pocket Full of Change, p. 448.

36 Governor of the Reserve Bank of Australia, evidence to the Martin Inquiry, p. 431.

37 Formally the House of Representatives Standing Committee on Finance and Public Administration.

41 *A Pocket Full of Change*, p. 49.
43 Data compiled from Tables B1, B2, B4 and B5 of Reserve Bank of Australia Bulletin, May 1992, after discussion with Reserve Bank staff. Data corresponds to all Australian banks but remains representative of the majors on account of their dominance and because the other corporate-focused (largely foreign) banks and retail-oriented former building societies tend to balance each other. The figure for traditional passbook deposits, a residue from earlier decades, however, might be understated for the majors.
Have banks and bankers been fairly treated in recent years? This paper examines social responsibility and the banking industry.

*Banks and Social Responsibility* begins with a survey of relevant biblical and church teaching on banking and proposes a framework of social responsibility for the industry. The question of whether freer markets lead to more socially responsible actions is considered and specific issues of deregulation and banking practice are examined.

David Farmer shows in this paper that ultimately banks are also called to promote human dignity and human rights and offers ways to understand and work with the banking industry to achieve these goals.

David Farmer is a Sydney-based freelance writer and consultant. He holds honours degrees in economics and theology and has spent fifteen years working with one of the major Australian banks. His current interests include education, the arts, developments in interactive multimedia, banking and finance.