PETER MAIR / SUBMISSION TO SENATE ECONOMICS COMMITTEE INQUIRY

COMPETITION WITHIN THE AUSTRALIAN BANKING SECTOR

COMPETITION IN BANKING: ARE ALL CARDS ON THE TABLE?

For decades, Treasurers promising a more competitive banking system have stood powerless and mute as just the opposite unfolded. Almost unbelievably, cartel-like behaviour of banks is protected, not threatened, by reluctant regulators shunning the additional authority needed to address market failure.

Renewed political pressure to bring the banks into line will probably be no match for the banks and their hidebound regulators. A more competitively responsive banking system depends on the community first being persuaded to give up its mistaken attachment to 'free banking'. Hopefully, the committee will include a like sentiment in a reference for a review of the banking industry by the Productivity Commission.

A. THE POLITICAL AND MARKET POWER OF THE BANKS

The political and market power of the banks is rooted in the community's attachment to free-banking: the irony being that free-banking precludes new banks and the competition they could bring. Frankly, bank customers have no idea of what is going on: they are at the mercy of those that do but won't say, while taking advantage of the community ignorance.

Until the banks are no longer allowed to barter free transactions for interest-free deposits or to jointly set excessive prices for card transactions, there will be no material competition in retail banking and little incentive to greater efficiency.

There are no free lunches. In essence, bank revenue arising in interest not paid on transaction account deposits cross-subsidizes the substantial cost of providing free (underpriced) transaction account services. For credit-cards, the cost of free transactions, apparently paid by retailers, is actually recovered from customers paying prices for purchases that are loaded with the hefty fees retailers pay to banks. Free-banking is not free, the customers pay – they pay heaps.

The community mistakenly treasures a belief in free-banking (bar penalty fees for mistakes) oblivious to the hidden reality of, actually, overpaying for an inefficient payments system that is, nonetheless, very profitable to banks.

The more serious offence is bookable to the regulators – especially the Reserve Bank – that underwrite the market failure, doing nothing to inform and educate a community so mistakenly wedded to free-banking: Elizabeth Warren, a US consumer advocate on the rise, mischievously likens regulators playing this passive role to 'the lookout at a bank robbery'.

Historically, even our most fearless Treasurers have become politically incontinent at the mere suggestion that banks might levy explicit fees to recover the full costs of providing transaction account services. The prospects for such unseemly displays being repeated are only greater in the current climate of political skittishness that taints any sensible suggestion to confront community sensitivities, however foolishly mistaken.

The political reality dictating free-banking has a very unfortunate corollary. As things stand, the Productivity Commission, Australia's most competent and independent public policy agency, is unlikely to be given a brief to review the banking industry – because it would predictably find, as political innocents routinely do, that the policy settings underpinning free-banking (and no competition) are inappropriate to the point of incredulity.

There have been salutary lessons for many stumbling with an open mouth across the bank-fees minefield: naive politicians, including junior ministers, have been unceremoniously de-frocked for inadvertently finding and mouthing the truth, before being gagged.

Aside from the Productivity Commission, the fallback is presumably another politically appointed committee of inquiry. Been there, done that – not now, please.

Politically appointed committees bring mixed blessings: their acceptable findings, while sensibly pre-determined, accommodate bureaucratic power plays otherwise denied. Following the Campbell Committee (1981), the management of the Reserve Bank was destabilized for the best part of a decade. Similarly after the Wallis Committee (1997), the Reserve Bank was unsettled by the loss of its banking supervision functions and burdened with a responsibility for regulating retail payments, which it did not want. A decade on, the outcome has hardly been the best for the community.

No stability-regulator could be expected to make that job harder by opening up the monopolised payments operations of the too-big banks, and inviting new banks: current allocations of regulatory responsibility are not conducive to competitive banking.

A community not properly understanding retail banking operations can be excused for making political demands reflecting mistaken beliefs. The challenge, now, is for the truth to be told about banking-industry machinations.

Looking ahead the retail banking debate can be managed in two steps.

One, the Productivity Commission – independent but not compromised – should be asked to unravel the economics of retail banking: it's explanations of the barriers to competition and efficiency would set the agenda for a managed reform process.

To that end, the recent (Cooper) inquiry into superannuation illustrates how a chairman-led review can divine better policy outcomes for consumers dealing with businesses behaving badly. The banking industry could similarly be led to give up its prop of interest-free deposits and accept regulatory direction to redress related market failures – not least ensuring reasonable fees are levied as explicit prices for services provided.

B. THE REGULATORS (AMONG OTHERS) ARE AVOIDING KEY ISSUES

On a conservative reckoning, the 'interest free' deposits of individuals held in transaction accounts with Australian banks run to some $200 billion – and that total would be doubled if the similarly 'interest free' deposits held by businesses with banks were included.

Considering only the personal deposits, banks earnings on the investment of those 'interest free' funds would run to some $10 billion – a sum which, paid as interest on personal accounts, would attract income tax of some $3 billion. For reasons unexplained, banks are permitted to swap underpriced account-keeping and transaction services for interest free deposits in a barter-deal that avoids tax to the tune of $3 billion.

At the more general level, banks currently have some $20 billion p.a. as revenue which is ‘unaccountable’. There is no check on the disbursement of those earnings to depositors, even as untaxed income: historically, when interest rates were 15%+ in the 1980s, it is now clear that banks used that unaccountable income to defeat the competition posed by foreign banks, cash trusts and mortgage brokers among others.

One might think that such a substantial regulatory concession might be recognised and addressed by the regulators (among others) in their submissions to the banking competition inquiry: alas not – I can see no media reports of such recognition.

One might especially have expected the RBA to have openly identified the competitive consequences of banks – the major banks – enjoying such an obvious competitive advantage. The ‘alas not’ extends to no suggestions as to how such a substantial barrier to new-entry and competition more generally in retail banking might be addressed and corrected.

Beyond that, at page 11, the Reserve Bank’s submission included a paragraph – almost to the contrary -- which I am asking it to clarify.

Rates on at-call savings deposits – including bonus saver, cash management and online savings accounts – have also risen relative to the cash rate (from which these deposits are priced). ***The average rate on the major banks’ at-call deposits, which account for a little under half of their total deposits, is currently estimated to be around 40 basis points below the cash rate****.....*

I am at a loss to understand the highlighted text.

Having regard to the monetary aggregates published by the RBA, bank deposits of the public run to some $1200 billion in total, and deposits other than the nominated ‘at call’ deposits, probably run to some $1000 billion – more than 80%. [Current 200 / CDs 170 / fixed term 420 and – conservatively some half – 180 -- of ‘other deposits with banks’ would be transaction savings account deposits.]

If so, then it is questionable that: .... ***major banks’ at-call deposits...... account for a little under half of their total deposits.........***[and attract interest at a rate a little below the cash rate]

Whether or not the RBA may have made a descriptive mistake is something the Committee may want to clarify on Monday. Above all, the Committee should explore with the RBA the competitive consequences of the major banks being advantaged, unfairly, by the unrestricted bartering of ‘free services’ for ‘free deposits’: at base there is the de-facto subsidy from the public purse of some $3billion p.a. in income tax not paid on the interest which would reasonably be deemed to have been earned by individuals, and taxed, on deposits of $200 billion+.

In a retail-banking competition inquiry – how could this elephant not be mentioned

Peter Mair 9 December 2010