

Sunday 31<sup>st</sup> October 2010

Attention: Senate Economics References Committee

Re: Enquiry Into:- Competition Within The Australian Banking Sector

Dear Mesdames et Messieurs,

I write in support of prudential banking regulation.

I object to unfettered laissez faire most particularly in the area of banking regulation.

Minimal but effective regulation of banks large and small is essential if the second great depression is to be avoided.

Also, bank competition if organised in a regulated way may lead to more valued and appreciated service to customers. This does not mean self regulation, often merely code for unfettered laissez faire.

Though bank competition may help avoid the prevalence of no value zero service retail banking, leadership by bankers themselves and sound economic leadership by ministers and regulators is essential. Some matters require leaders willing to educate and inspire others.

My submission is attached.

I ask that this contribution to this issue be considered by the members of parliament on the Committee.

Yours Sincerely,

Andrew Oliver

0.0	Index
0.0.1	Letter
0.1	Outcomes
0.2	Prudential Banking Regulation
0.3	How To Organise Regulation
0.4	Some Asides On Economic Theory
0.5	Value and Appreciated Customer Service
0.6	Bank Profits
0.7	The Education of Bank Management
0.8	Conclusion

## 1.0 Outcomes

Competition is a means, not an outcome as this enquiry's terms of reference would suggest.

My opinion is that the pursuit of happiness, valued and appreciated service to customers, and consumer sovereignty are outcomes relevant to banking regulation.

It is important not to put the cart before the horse and posit means as outcomes.

## 2.0 Prudential Banking Regulation

I remember my Nana telling me her father was almost ruined by bank failures in Australia in the 1890's. Without prudential banking regulation, the wrong sort of behaviour by bankers can lead to bank failures, the poor and ordinary people losing their deposits and investments, and even worse, deflation and depressions.

Economics textbooks might imagine the banker as soberly suited, a facilitator who marshals community savings and organises investment of the same in capital goods for manufacturers, miners, and farmers, and whose efforts make the wheels of industry go round.

Unfortunately in the roaring 1920's too many bankers behaved like dishevelled riverboat gamblers, stacking up the chips in casino capitalism's banks and stock exchanges.

Maybe it could also be said that between 1988 and 2008 during the long bull market, too many bankers did not invest the community's savings wisely and prudently.

A partial solution to this social problem - of bankers not investing depositors and investor's funds prudently - is prudential banking regulation by government enactments of legislation.

## 3.0 How To Organise Regulation

Minimal but effective regulation that is well targeted on the likely problem areas with as few questions on as few forms as prove absolutely necessary, as few regulators as prove absolutely necessary, and as little red tape for bankers as proves absolutely necessary require proper thought and consideration by legislators.

Technological change does impact on banking regulation. Years ago it might be adequate to protect small depositors by requiring, say, some percentage of a bank's overall deposits to be held in gold in a central bank so that there is something left if the bank fails. However, with some banks investing in derivatives and especially computer program trading of derivatives - investments little more than gambling anyway - the exposure to losses is so much greater that restrictions on where retail high street banks can invest depositor's funds are required.

Nevertheless it is important not to over-regulate lest later governments who have forgotten the lessons of history try to reintroduce unfettered laissez faire. Not only this, but excessive and badly targeted regulation make banking inefficient and make the Australian economy less internationally competitive.

Selecting the right people to be the regulators is necessary too. If the banking regulators believe in bank nationalisation, and have an agenda of regulation by stealth in order to consolidate all banks into one big people's bank, they will prove hopeless at minimal but effective regulation.

#### 4.0 Some Asides on Economic Theory

Economics is in part mathematics and statistics, in part commerce and commercial law, in part mass psychology.

To the extent that economics is mathematical in nature, some analysis of mathematical models and equations can help explain some things in terms of mathematical models of economic forces and conservation laws.

To the extent that economics is mass psychology, little can be done but to explain that human behaviour in some situations is often irrational, and that when a bank is known to be about to collapse people behave like lemmings running off a cliff and by all lining up to withdraw all their funds, make the bank failure happen.

From the standpoint of mathematical economics, the different ways that the conservation of money principle applies - even if only a first approximation - along different dimensions of the maps of economic equations can be used to see that the income and expenditure equation, perhaps a simple picture with savings, imports, exports, taxation, government spending, and investment values included, represents one dimension of the conservation of money, which imposes economic forces and multiplier effects. Another dimension of the conservation of money is the volume of money according to some definition, perhaps a simple picture with only cash and bank deposits and bank loans, which is conserved overnight by regulation and banking practice and it can be seen that this also imposes economic forces and multiplier effects.

The growth of credit can cause the volume of money to change slightly day to day as the different components flow into one another. This also is regulated by regulation and banking practice and imposes economic forces and multiplier effects.

To avoid sub-optimal equilibria in general for these non linear complex systems some regulation will prove necessary.

Badly designed regulation may prove worse than none at all. And regulation hijacked by economic interest groups uninterested in good governance of the economy is typical around the world.

It also has to be said that the commercial law favours limited joint stock companies, and disadvantages worker co-operatives. Proposals for reforming the commercial law were first put forward in the 1800's, but the right-wingers in that century won then and imposed the limited joint stock company on the world. Now with derivatives and other strange computerised commercial investment instruments, maybe we need to consider reforming the basic commercial law to avoid the problems these create ...

#### 5.0 Value and Appreciated Customer Service

Some economists have hypothesised that if there are three or four retail high street banks there will be more valued and appreciated customer service because a customer can shop around the three closest branches of the three or four competing banks.

I remember in the 1980's the State Bank of Victoria offered some service to ordinary small customers. One might get a telephone call from a teller telling one that to avoid some cheques bouncing would one deposit some amount by 2:45 p.m. that day. Nowadays the typical service most poor and ordinary people receive as bank customers is more like the computerised no value zero service banking that is spreading everywhere as bankers optimise their cost structures to maximise shareholder profits.

Bank nationalisation - i.e. creating one large people's bank - would only make this situation worse.

#### 6.0 Bank Profits

If banks are squeezed too much by regulation, by preventing them charging small fees for service, by setting interest rates by government decree, then they may become unprofitable and try to gamble internationally what funds they still have hoping to stave it off. This path leads to depressions ...

Nevertheless banks protected by government insurance of small deposits have some responsibility to return to the community a level of service and a responsible level of profit-taking. The minimal but effective regulation of banks should target only known problem spots. Such regulation needs careful consideration after much public debate and submissions.

## 7.0 The Education of Bank Management

Bank management, and most particularly local bank managers, have responsibilities to the community. Bank management are responsible for the poor service most poor and ordinary people receive nowadays. It is partly a reflection of the value free ethos in the education system that leads to this lack of leadership. And the solution to this problem lies in the education system too.

## 8.0 Conclusion

As a jaded former ALP member who resigned from the party in 2005, I am disappointed in both sides of politics. Demagogues may denounce bankers in the strongest terms, but the major parties must show leadership!

As a information technology worker - presently between jobs - with a mathematics degree my views on economics should be taken as not the views of an economist but those of someone interested in politics and the outcomes that I advocate for Australian banking reflect what I want for both myself and the poor and ordinary people I sympathise with.

I ask that this contribution be considered by the committee.