The Financial Sector and Deregulation in Australia: Drivers of Reform or Reluctant Followers?

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Abstract:
This paper argues that contrary to pluralist theory, a key feature of financial deregulation in Australia was the lack of support from financial sector interest groups. An examination of the Campbell Inquiry (1979-1981) reveals that deregulation was not initiated by either the regulated banks or unregulated non-bank financial institutions (NBFIs). In fact, both groups were resistant to change prior to the establishment of the Inquiry. During the Inquiry, neither group advocated wide-ranging deregulation, arguing for the retention of many of the financial regulations.

Key words: financial deregulation, banks, NBFIs, Campbell Inquiry

Introduction
Between World War II and the late 1970s, Australia’s financial system was heavily regulated. There were controls over many aspects of finance, domestically via regulation of the quantity, type and pricing of banking services, and externally through a managed exchange rate system and regulation of foreign exchange and foreign bank entry. However, from the early 1980s, in a major redirection of policy, the financial system was deregulated. The Campbell Inquiry into the financial system (1979-1981) was central to the process of financial reform. The establishment of the Inquiry marked the beginning of a deliberate program aimed at comprehensive financial reform, and its Final Report (AFSI 1981) provided a consistent case for extensive deregulation, based on the benefits to be gained from increased competition and efficiency in a free market.

A strand of policy choice theory, pluralist theory, emphasises the role of interest group pressure in initiating policy change. Many OECD countries deregulated their financial systems in the 1970s and, in some cases, reform was the result of vested interest group pressure. For example, in the United States, Bell has argued that banks and financiers were “chaffing at the bit under the restrictive financial controls” (Bell 1997, p.104). They lobbied
the government to remove the financial regulations and allow them to compete in international markets, envisaging greater opportunities and higher profits without the constraints of post-war regulation. Harper (1985) has taken a similar perspective on financial deregulation in Australia, arguing that the financial sector played a strong role in initiating the shift away from the regulatory system. This paper challenges the pluralist perspective, arguing that it is inappropriate in the Australian context: far from the financial sector initiating deregulation, the reforms were implemented *despite* opposition from both the regulated banking sector and the non-bank financial institutions (NBFIs).

The Existing Theory: Interest Group Pressure

Between the early 1940s and late 1970s, Australia had a two-tier financial system, consisting of regulated trading and savings banks, subject to the Banking Act, and NBFIs that were relatively free of regulation. The rationale behind this system was that financial intermediation was largely synonymous with banking when the regulations were imposed at the beginning of the post-war period (Merrett 1991, p.8; Schedvin 1992, Ch.1). However, during the 1950s and 1960s, a number of NBFIs emerged, including finance companies, merchant banks, building societies and credit unions, and began to challenge the dominance of the banks.

These institutional changes in the financial sector were partly due to the increasing development of the economy and the consequent need for a more sophisticated financial system (Arndt & Stammer 1965, p.187; AFSI 1980, pp.97-9; Carew 1991, p.110; Goldsmith 1969). However, they were also due to the bank regulations. Harper (1985) stressed that many of the regulations impeded the banks’ ability to compete with the NBFIs. Thus, government-imposed ceilings kept bank interest rates below market levels, and quantitative lending policy restricted bank loans to maintain tight monetary conditions. In addition, asset ratio requirements on banks exceeded commercially determined holdings and prevented the banks from competing on an equal basis with NBFIs (AFSI 1980, pp.97-100; Edey & Gray 1996, p.6; Harper 1985, pp.4-5). The asset controls on savings banks were particularly prohibitive because the bulk of their assets were tied up in prescribed holdings of government securities.

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1 In fact, Harper argues deregulation was outcome of public and private interest: role of public sector in deregulation discussed elsewhere; this paper focuses on role of private sector.
2 In 1953, the trading and savings banks accounted for 88% of the total assets of the financial intermediaries sector (excluding the central bank). The next largest group, pastoral financiers, had only 4% of total assets (Edey & Gray 1996, p.7; Schedvin 1992, p.3).
3 Some NBFIs were subject to some state government controls, but these were much less onerous than the controls over banks. For more detail on the regulations applying to the NBFIs see AFSI 1980, p.100.
that paid very low returns (ABA 1979, 2.2.119, 2.2.123). Finally, maturity restrictions prevented the banks from entering the market for short-term funds.

Harper commented that the financial regulations “had always disadvantaged banks to some extent relative to non-banks”, as evidenced by their loss of market share (Harper 1985, p.5). However, in the 1970s, a combination of economic changes increased the burden of the regulations and further weakened the competitive position of the banks relative to the NBFIs (Harper 1985, p.i). These economic factors were the catalyst that led to deregulation because they greatly accelerated the decline of the banking sector relative to the NBFIs and led the banks to reassess their attitude towards regulation. In particular, Harper regarded the advent of inflation, technological advances, and the internationalisation of markets as the most important cause of deregulation, because they “significantly altered” the impact of the regulations to the disadvantage of the banks (Harper 1985, p.i). First, interest rate and maturity controls became more onerous as they prevented the banks from responding to customer demands for higher nominal rates and shorter-dated claims in the environment of high and variable inflation. In addition, captive market regulations, which forced the banks to hold significant quantities of government securities and central bank liabilities, became a heavier burden as their rates of return did not keep pace with inflation (Harper 1985, p.4). By contrast, the less regulated NBFIs were able to offer higher rates of return and more flexible financial instruments (Harper 1985, pp.3-4). Rapid advances in information-processing technology in the 1970s also pushed the banks in favour of deregulation (Harper 1985, p.7). The technological changes greatly increased the opportunities for, and lowered the cost of, financial innovations, enabling the NBFIs to develop services that were close substitutes for bank services (Harper 1985, p.8). Finally, greater integration with international financial markets increased the disadvantages of regulation for the banks because they allowed companies greater access to offshore financial markets, which offered cheaper and more accessible funds than the regulated banks (Harper 1985, p.10).

The end result of these economic changes was “a growing perception amongst regulated institutions that the costs of regulated status outweighed the benefits” (Harper 1985, p.i). Consequently, Harper concluded, “the obvious solution for the banks was to seek the removal of their regulations” (Harper 1985, p.24). The banks did not consider extending the scope of the regulations as a way of coping with the impact of the economic changes on the regulatory system because they realised that new products and alternative unregulated markets would evolve (Harper 1985, p.30). In addition, Harper argued that the banks were joined in their

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4 It was crucial that financial products and services were uniquely ‘fungible’ or substitutable (Harper 1985, pp.8-9, 29-30).
push for deregulation by the NBFIs which desired equal access to the cheque payments services, foreign exchange licences, and lender of last resort (LLR) facilities enjoyed by the banks (Harper 1985, p.25). Thus, the banks and NBFIs turned against regulation and renegotiated in favour of deregulation.

A New Interpretation

The theme of this paper is that the pluralistic approach to policy change is not an appropriate explanation of financial deregulation in Australia. While it is plausible a priori, a detailed examination of events leading up to deregulation reveals that deregulation was not an “obvious solution” to the banks. Many bankers were not the economic rationalists that the pluralist approach implies, and it was not apparent to them that the burdens of regulation outweighed its benefits. If the bankers were interested in any deregulation, it was only in limited and specified areas where it would benefit them. As Bob Edgar, an economist on the Research Directorate of the Australian Bankers’ Association (ABA), observed, “The banks were genuinely caught in a notion that they believed in free enterprise, but weren’t quite sure why it should affect them” (Edgar 1999). Moreover, the NBFIs were not the cohesive group that the pluralist analysis implies and many of them were opposed to deregulation also.

The Banking Sector

Although the pluralist approach does not focus upon this issue, many financial regulations conferred significant advantages upon the banks. Exclusive access to lender-of-last resort facilities and an implied guarantee in case of failure gave the banks an unsurpassed reputation for safety and stability that attracted many customers. Regulations gave the banks monopolies over cheque payments services and foreign exchange transactions: the latter was particularly valuable, as it was highly profitable and the Reserve Bank bore all the risks. Entry regulations prevented competition from foreign banks and ensured the domestic banks’ semi-monopolistic positions. The burden of controlled interest rates on loans was offset by controls on deposit interest rates and the prohibition of interest payments on current accounts, which provided the banks with a large source of low cost funds.

Harper focussed on the impact of regulations on banks’ market share, but an even more important factor to the banks was profit. The regulatory system ensured substantial profits. As Lewis and Wallace commented, the banks were “captives” but “in a gilded cage” (Lewis & Wallace 1993, p.5). Although the controls on the composition of bank asset portfolios limited profitability, entry barriers – both to foreign banks and to NBFIs in terms of access to the payments system and foreign exchange dealing – enhanced it. Profitability grew steadily over the 1960s and 1970s despite declines in market share (Edey & Gray 1996, p.31).
The balance of burdens and benefits flowing from the regulatory system meant that many bankers were deeply ambivalent towards deregulation. The bankers knew how to operate within the regulatory system, creaming off the best loans, and taking few risks to gain substantial profits. They realized that a freer financial system meant competition, risk, and the end of what had been a very profitable and convenient bankers’ club. Financial deregulation would mean competition from NBFIs, the entry of foreign banks, and the removal of privileges such as exclusive foreign exchange dealing. Many bankers had become complacent and comfortable within the existing regulatory system, and their desire for greater freedoms conflicted with their conservatism and attachment to the status quo. The banks were used to operating in a closed, oligopolistic structure and to a tradition of non-price competition, whereas deregulation was a great unknown and its benefits and disadvantages were uncertain.

As Alistair Maitland, the ANZ economist during the Campbell Inquiry, remarked, deregulation “was a total change in their environment, it was a sea change, not just a gradual change” (Maitland 1999). Peter Mair, a Reserve Bank official, and a member of the Campbell Inquiry Secretariat, commented:

Bankers of course never like change. Over the years, banks have built various defensive walls around themselves, that are just accepted as part of the fabric, with nobody really understanding or challenging what they do, and banks realise that change runs the risk of destabilising those sort of rackets that they run. So by and large, banks are implacably opposed to change (Mair 1999).

Maitland and Edgar worked together with the banks to formulate the submission of the Australian Bankers’ Association to the Campbell Inquiry. They recalled that senior bankers in particular tended to be the most ambivalent towards change, and many were rigidly opposed to deregulation (Edgar 1999; Maitland 1999). As the banks had been regulated since the beginning of World War II, many bankers had never worked in an unregulated environment, and the conservative senior bankers preferred to stay within the limited sphere of banking that they knew best. Maitland explained:

Within the banks, there were huge variances of opinion between senior bankers as to whether we should even be talking about deregulation. I mean, this was a cosy industry, where you made a lot of money out of being protected, where the government set the rate at which you could borrow funds and lend funds, and anything you did to spend the margin in between just decreased your profitability (Maitland 1999).

Maitland recalled many of the older long-serving bankers complained to the ABA economists: “these things here [the regulations], they’ve worked well. Why are we playing? It’s not broken” (Maitland 1999). In fact, there was not even agreement that interest rate
controls should be removed – some senior bankers wanted the government to continue to regulate deposit interest rates (Maitland 1999).

Most of the younger generation bankers were less conservative, and wanted greater freedom to conduct their banking business. They disliked government interference in the amount and direction of their lending and the composition of their assets, and they resented the low returns paid on prescribed assets, which they described as “meagre” and “completely unrealistic” in their submissions to the Campbell Inquiry (ABA 1979, 2.2.97). However, they were far from supporting free financial markets. While they favoured the abolition of interest rate and maturity controls, they did not want to see the loosening of entry regulations that protected the banks from domestic and foreign competition, and ensured their privileged position within the financial system.

All bankers were apprehensive about the prospect of free entry to banking markets, which limited the bank industry’s desire for deregulation. As Michael Waterhouse, a Treasury officer on the Campbell Inquiry, commented:

> They had mixed feelings about [deregulation], about their ability to cope, because they realised it wasn’t just a question of deregulating, that it was also likely to be a question of foreign banks being allowed into the country (Waterhouse 1999).

Unlike the American banks, which saw a “world of financial opportunity” (Bell 1997, p.104) beyond the domestic regulatory system, the Australian banks were much more insular. As Pauly pointed out, the banks were strongly opposed to foreign bank entry (Pauly 1987, pp.35-9). Their opposition was clearly expressed in the individual bank submissions to the Campbell Inquiry and in the statements made by bankers at the Inquiry’s public hearings (AFSI 1979, p.1114; ANZ 1979; CBCS 1979; Pauly 1987, pp.40-41). For instance, the ANZ submission argued that foreign bank participation should be limited to offshore transactions such as lending to non-residents, and the General Manager of ANZ admitted to the Campbell Committee “I’m not in favour of the admission of foreign banks to our market” (in Pauly 1987, pp.40-41). The CBCS submission recommended against granting bank licences to any foreign banks and it especially opposed foreign bank participation in the profitable foreign exchange market (CBCS 1979, p.9). The head of the CBCS, Vic Martin, compared the foreign banks to savage dogs, exclaiming, “Here we are, we have been on a chain for a long time. And if you have a dog on a chain you do not let the most savage dog in the district at him until you have let him off that chain” (AFSI 1979, p.1114). During the 1980s, when the push for deregulation was well underway, the banks became interested in expanding overseas, which in many cases required granting reciprocal rights to foreign banks to enter Australian markets (Carew 1989, p.101; Pauly 1987, p.57). Thus, reciprocity issues would influence the
banks to accept foreign bank entry so that they could themselves expand overseas. However, such issues were not a strong incentive to the banks until well after the initial push for financial deregulation had begun (Pauly 1987, p.26). In their submissions to the Campbell Inquiry, the banks made no mention of reciprocity issues, and they could see no advantages to themselves from foreign bank entry (Pauly 1987, p.26). As Pauly commented:

> It would not be until about 1983 that concerns on this score would have even a modest impact on the joint public position of the domestic banks. In the long debate over foreign bank entry, the domestic banks consistently supported the existing protectionist policy. Their domestic concerns clearly outweighed their international concerns throughout (Pauly 1987, p.26).

As well as foreign competition, the prospect of greater competition from domestic financial institutions was of great concern to the banking sector. Edgar observed:

> People had a lot of focus on foreign banks, but in reality I think the greatest issue was the domestic competitors, the building societies. … There was always more concern about the other financial institutions and their ability. The banks’ market share at that point was falling very rapidly without foreign bank intrusion. It was largely the unregulated sector of the market that was growing – the merchant banks ... the building societies ... and the finance companies (Edgar 1999).

As noted above, the NBFIs were already growing at the expense of banks’ market share, but they were not able to encroach into areas protected by regulation. While the banks were keen to see the removal of the regulations that prevented them from competing with the NBFIs, they wanted to retain the entry restrictions that protected them from domestic competitors. The extent of banking sector ambivalence towards deregulation and fear of competition from NBFIs can be gauged from the fact that the banks gave serious thought to supporting the extension of the banking regulations to the NBFI sector (Pauly 1987, pp.37-44). This option existed under Part IV of the Financial Corporations Act (FCA, 1974), but it had never been declared. In 1978, an ABA discussion paper responding to the erosion of the banks’ market share put forward two options: relax the direct controls or extend them to cover the less regulated NBFIs (Pauly 1987, p.35). When the Campbell Committee was established, the banks were still divided over which course of action to support (Edgar 1999; Maitland 1999; Pauly 1987, p.35). Edgar recalled:

> The Whitlam Labor Government drafted the FCA in 1974 with the objective of enhancing the central bank’s monetary policy powers by extending the bank controls to the rapidly growing NBFIs. In the event, the only portions of the legislation that were put into force were those obliging the NBFIs to provide statistical information on their operations to the RBA, and to hold advisory meetings with the RBA. The vital Part IV of the Act was not proclaimed.
There was always this bit of ambivalence on behalf of the banks: did they want less regulation for the banks, or did they want more regulation for the unregulated sector? ... The banking industry was very split. ... I think they probably approached [the Inquiry] with some degree of apprehension (Edgar 1999).

The banks did not form an organised united front in favour of either option until the Campbell Inquiry was established because they were reluctant to change and strongly opposed some elements of deregulation.

Thus, there was much division and controversy over deregulation and, far from pushing for reform, many bankers approached it with a certain amount of disquiet and uneasiness. The banks certainly did not have a role in initiating the Campbell Inquiry into the financial system, which was established in 1979. Alan Coates, a member of the Campbell Committee, recalled that within the banking system “no-one was that vocal” about deregulation. He commented, “The system had sunk into a sort of a routine of comfort, really” (Coates 1999). The banks did not want an investigation that might force them into more deregulation than they desired and their concerns about the effects flowing from such radical, far-reaching changes inclined them to cling to the familiar status quo. Thus, there was no push within the banking sector for radical financial reforms.

However, once Inquiry was established, the banks realized that they would have to make their minds up in favour of one position to ensure that any changes were not to their disadvantage. In fact, this was not a quick or easy process. The submissions of the individual banks to the Campbell Inquiry reflected the ambiguity of many bankers towards deregulation – for instance the Commercial Banking Company of Sydney (CBCS) argued in favour of extending the regulations to NBFIs, and the ANZ Bank urged caution in removing deposit interest rate controls (ANZ 1979; CBCS 1979). Subsequently, however, the banks agreed to let their industry association, the ABA, represent them in all their dealings with the Inquiry. Under the umbrella of the ABA, the banks finally chose to support deregulation rather than extending the regulations to the NBFIs. Despite the conservatism of some more elderly bankers, most bankers agreed that deregulation of interest rates, asset ratios, and lending restrictions were desirable to allow the banks greater freedom to conduct their banking business.

The joint ABA submission, presented to the Campbell Inquiry in August 1979, strongly advocated the removal of the interest rate regulations and a shift towards a competitive, market-oriented financial system (ABA 1979, 1.10.6; Edgar 1999). For instance, the submission declared:

The way forward towards greater efficiency in the financial system is seen by the banks to lie in the abandonment of much of the present system of selective regulation and control over limited areas of financial intermediation. Instead, the monetary
authorities should be pursuing broadly based controls, within which a more competitively based system responsive to market forces can evolve (ABA 1979, 1.0.3).

The submission firmly rejected the extension of regulations to NBFIs, declaring it “very much a ‘second best’ approach which would not produce the desired efficiencies in the long term” (ABA 1979, 1.0.19). The ABA submission warned of the practical difficulties and costs of extending the bank regulations to cover more than 700 registered non-bank corporations (ABA 1979, 1.11.10) and, during the Campbell Inquiry’s public hearings, the Chairman of the ABA added that, in any case, “direct controls merely lead to the ability to escape them through another venture” (Dobbie in AFSI 1979, p.310). Thus, a change occurred in the banking sector’s public stance on financial deregulation once the Inquiry was established.

However, the fact that the banks chose deregulation was much more a product of chance and the influence of economists than the rational cost-benefit analysis suggested by the pluralistic perspective.6 Moreover, the sentiments expressed in the submission in favour of efficiency and competition were not applied to all sections of the financial system. The banks delegated the drafting of their submissions to the ABA’s Research Directorate, made up of ABA and bank economists (Edgar 1999; Mahar 1999). These economists were much more liberal than many of the bankers and it was really they who pushed the banks to argue for financial deregulation. Two of the economists on the ABA Research Directorate were Alistair Maitland, ANZ’s representative economist, and Bob Edgar, who worked for the ABA. They commented that many of the ABA economists, unlike the bankers themselves, were influenced by economic liberal ideas and wanted a more efficient market-oriented financial system (Edgar 1999; Mahar 1999; Maitland 1999). As Maitland commented:

The people on the [Australian] Bankers’ Association were all the economists of the banks, so you had a group of people who by training and background and education were free marketeers basically, which was well away from where the elders in the banking industry were (Maitland 1999).

Edgar, for instance, argued that the financial regulations were illogical and archaic: “the logic of why [they were] put in as a wartime control in 1939 was gone” (Edgar 1999). He explained:

“The classical thing at the time, which was obvious to everybody, was housing interest rates. ... I mean, how was the regulation of housing interest rates helping the poor? ... The poor were the last people to get a housing loan. You had to save for fifty years, and build up a qualifying this, and then you’ve got the cocktail loans ... you

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6 This section is based upon anecdotal evidence from members of the ABA, including Bob Edgar and Alistair Maitland. Access to the ABA’s archives was not available.
had a little bit from the savings banks, a little bit from the trading bank at a higher
interest rate, and then a bit from the finance company – so-called cocktail loans. I
mean, it wasn’t helping the poor. You just had to look at the construction of some of
these regulations – you had to say ‘what’s your purpose? Let’s look at the outcome’. I
mean it was just pathetic” (Edgar 1999).

Likewise, Maitland argued that the free market was a superior form of economic organisation
to a regulated system:

“Every time you put controls in place the market finds a way around it, so therefore
you have inefficient markets because it’s having to do things because it’s contrived,
rather than because it’s efficient. And I’ve never known politicians to be very good
regulators of markets. I think when they interfere you then end up with distortions,
which then allow for political manipulation, which invariably favours some groups
over others” (Maitland 1999).

The general stance of the ABA economists was indicated by their decision to commission
Professor Ian Sharpe to write the introductory chapter of the ABA submission. Sharpe was
then Professor of Economics at Newcastle University, and well known for criticism of the
financial regulations, which he argued were “perverse”, “obsolete”, and “an inheritance of the
1930s”, and needed to be swept away in “the pursuit of an efficient system geared to free
enterprise objectives” (ABA 1979, 1.0.25).

While most bankers did want very limited deregulation once the Campbell Inquiry was
established, they did not share the economists’ focus on the benefits of free markets. They
remained very circumspect and selective about the reforms that they supported, as was
apparent in their submissions to the Campbell Inquiry and their comments during the
Inquiry’s public hearings. Consequently, the banking industry at the time of the Campbell
Inquiry was split into two groups with quite different goals: the ABA and bank economists,
who wanted a free financial market, and a larger group of bankers who were driven far more
by pragmatic commercial interests and who wanted much more limited and selective
deregulation.

Obtaining the bankers’ approval for the ABA submission was not an easy process: it was both
long and arduous, and at times there was uncertainty over whether the banks would indeed
support the submission (Maitland 1999). Maitland and Edgar related that the more free market
stance taken in the ABA submission came about because the ABA economists convinced the
bankers that their arguments for financial deregulation had to be intellectually consistent or
the Campbell Committee would not take them seriously. The ABA economists pointed out
that the free market approach they had argued for in relation to interest rate and other direct
controls logically implied freedom of entry to banking markets. Maitland recalled advising the banks, “You can’t ask for freedom to compete and then say but no-one else is allowed to compete with you” (Maitland 1999). Thus, if the banks wanted interest rate controls on lending removed, then controls on deposits had to go; likewise, they could not argue for greater operational freedoms in the domestic market yet support foreign entry restrictions. The economists pointed out that the banks’ arguments for selective deregulation were not logical. Maitland recounted:

The economists just said, ‘Look we can’t operate! You can’t ask for freedom in one part of the market, and government control in another, so that you got the benefit of both’ … I remember going to my Chief Executive of the day and saying ‘I can’t write this report, I’ll have to put a personal disclaimer in if the banks sign off on this, because it’s just not logical in economic terms’ (Maitland 1999).

The economists pushed the view that financial deregulation was a package – the banks couldn’t argue for some parts of it and not others: they must accept it all or none of it. In this way, the ABA economists pushed the banks into a position in favour of extensive financial system deregulation. Thus, it was the economists, not the bankers themselves, who really formulated the banks’ position in favour of deregulation once the Campbell Inquiry was underway. The ABA economists drove the industry submissions, and significantly directed the views of the banking industry towards deregulation. The economists propelled the banks into publicly supporting a much more deregulatory position than they initially had done. As Edgar remarked:

At the time the initial submission of the banks went in, I would say it had been far more led by the specific committee … of the bankers’ technical people. I think they knew far more about it and understood far more the implications of the submission than the chief executives of the banks. They [the chief executives] gradually got to know it through all the supplementary and subsequent stages, but I think the submission itself cast the die that said we’re going in the direction of competition, versus the direction of further extended regulation (Edgar 1999).

As Edgar commented, without the contribution of the ABA economists, the banks might have argued for an extension of the regulations:

Basically, I think it had a bit of an accidental nature to it. With somebody more forceful and more energetic arguing the other case [for the extension of regulations], I think the other case could easily have won. But in the end the Australian Bankers’ [Association’s] case … effectively won the day (Edgar 1999).

Edgar recalled that Ian Sharpe was particularly influential in this respect:

“Ian Sharpe … really took the banks by the hand, and really led them down the track of the tremendous contortion that they would get themselves into, if they argued for
the status quo or the extension of regulation. I think he actually won the intellectual argument” (Edgar 1999).

The influence of the ABA economists is evident in the banks’ careful efforts to couch their arguments in terms that would be likely to convince the Campbell Inquiry of the merits of reform: thus, although they cited the damage to their own commercial interests caused by certain regulations, they were careful to emphasise that the regulations had an adverse impact on efficiency and competition in the financial system as a whole. For instance, although the banks complained in the ABA submission that the interest rate ceilings and maturity and lending restrictions were “unfair and inequitable” and “discriminatory” (ABA 1979, 1.10.6; see also 1.9.12), they also emphasised the broader negative impact upon the efficiency of the financial system, stating that the regulations segmented financial institutions, impaired efficient resource allocation, and fostered an uncompetitive environment, which reduced incentives to innovate or adopt new products and technologies (ABA 1979, 1.0.9, 1.10.1, 1.10.6). The ABA submission argued, “relaxation of these banking controls would permit a more competitive financial environment and a more efficient allocation of resources” (ABA 1979, 1.9.12). Likewise, arguments for the removal of asset restrictions were justified by the argument that “for a financial intermediary to be effective and efficient, it must be free to structure its assets in response to market forces without artificial interference” (ABA 1981, G9; see also ABA 1979, 3.3.38). In addition, the banks extended their call for the liberalisation of interest rates applying to banks to those applying to government securities, acknowledging that this would provide a firmer basis for shifting from direct controls to open market operations (ABA 1979, 1.10.2, 3.3.5-6, 3.3.11, 4.3.12-16; ABA 1981, A38-40).

Opposition to certain areas of deregulation was couched in more muted language than had been used in the individual submissions. Nevertheless, the banks’ opposition to extensive deregulation remained clear. Thus, the ABA submissions did not argue outright against the removal of entry restrictions, but they sought to rationalise delays and limitations. As Pauly commented, the end result was that “tortured prose sometimes barely concealed attempts to avoid the logic of deregulation and freer entry” (Pauly 1987, p.40). The submissions to the Campbell Inquiry and the public hearings bore witness to the conflict between the interests of the bankers and the economists’ free market agenda. While the individual submissions had strongly opposed foreign bank entry, the joint ABA submissions declared that the banks had no “philosophical objection” (ABA 1979, 1.0.20) to foreign entry, but in practice it was unnecessary and would lead to few benefits. The banks considered that competition was already sufficient due to the “large numbers of foreign banks already conducting near-banking operations in Australia” (ABA 1979, 1.0.20), and did not believe that foreign banks could
offer any benefits not already provided by the domestic banks (ABA in AFSI 1982a, p.381). The ABA submission reminded the Inquiry that foreign entry restrictions applied to other industries (ABA 1979, 1.0.20). Moreover, the banks argued that foreign bank entry could cause instability unless it was delayed to allow them sufficient time to adjust to domestic deregulation:

The direct controls on Australian trading banks … have caused many distortions in the system, not the least of which has been the encouragement of excessive non-price competition, which in turn has resulted in undue cross-subsidisation of Australian banking services. While the ABA acknowledges that this should be corrected for allocative and efficiency reasons, the banks’ ability to do so is limited while controls still exist, and it will require time to make appropriate changes to avoid causing unnecessarily abrupt social and economic impact. Early entry of strongly based and experienced overseas banks would be to give such new entrants an unfair advantage for some period of time (ABA 1981, G35).

The ABA submissions stressed that if foreign banks were permitted to enter Australian markets, they should do so in a “controlled, progressive and orderly” manner (ABA in AFSI 1982a, p.377; ABA 1979, 3.3.71), and they suggested a delay of several years between domestic deregulation and foreign entry (ABA in AFSI 1982a, p.383).

Likewise, despite their statement that “financial regulation should be non-discriminatory, allowing finance to be provided in the most efficient manner and by the most efficient intermediary” (ABA 1979, 2.3.3), the banks resisted having to compete with the NBFIs in traditional banking markets (Edgar 1999; Maitland 1999; Pauly 1987). The ABA submissions claimed that although the banks had “no objection” to licensing NBFIs as banks (ABA 1979, 3.3.66), the economy was better served by a few rather than many banks (ABA in AFSI 1982b, p.378). They also stated that competition was already sufficient in foreign exchange dealing and payments, so that further (NBI) entrants would not enhance efficiency (ABA in AFSI 1982a, pp.378-79; ABA 1981, G7; ABA 1979, 1.0.22, 1.9.16; Edgar 1999). The submissions downplayed the benefits of the entry regulations, arguing that the “many so-called advantages constitute burdens in practical terms” (ABA 1981, G8). For instance, the banks argued (despite the profits they made in foreign exchange dealing) that their exclusive access was not a “distinct advantage” because of the costs of administering and complying with exchange controls, and the narrow margins available in conditions of “keen competition” (ABA 1981, G7). Likewise, the ABA submissions noted the heavy costs involved in setting up and maintaining cheque facilities, and they held that NBFIs already derived “considerable benefit from arrangements made with individual banks concerning use of the payments system” (ABA 1981, G8). Access to Reserve Bank LLR facilities enhanced the banks’
reputation for soundness, a significant advantage in the uncertainty of the 1970s (AFSI 1980, p.100). Nevertheless, the banks argued that “the advantage of ‘LLR’ to banks … is minimal”, and referred to it as “a safety valve operated for the benefit of the community” (ABA 1981, G8).

Thus, the ABA economists kept the bankers within the free market paradigm, but only in the letter not in the spirit. Despite the more market-oriented ABA submissions to the Campbell Inquiry, the banks were not really committed to free financial markets – as P.J. Williamson, a member of the Campbell Inquiry’s Secretariat, pointed out:

“What the ABA are proposing … is clearly not complete laissez faire. … Whilst many of the present competitive burdens would be removed from banks, the calls for free market forces seem somewhat muted in the area of banks’ present privileges” (Williamson 1982, p.425).

The banks were driven by pragmatism, rather than by any intellectual influences – they wanted limited deregulation where the effect of the regulations disadvantaged them, but they opposed foreign entry and did not want competitive neutrality with NBFIs. Privately, the banks continued to resist the removal of regulations that were to their advantage. Their support for deregulation remained extremely limited, and did not extend to the removal of bank privileges or the ban on foreign bank entry, although the need to justify the retention of any regulations limited their ability to oppose change once the Campbell Inquiry was established.

The Non-Bank Financial Institutions

The drive for financial deregulation did not originate with the non-bank sector either. The pluralist view regards deregulation as the outcome of interest group pressure, which in the context of the financial sector includes pressure from NBFIs as well as banks. Harper’s position was that the NBFIs joined the banks in their call for deregulation because they desired equal access to the cheque payments services, foreign exchange licences and lender of last resort facilities enjoyed by the banks (Harper 1985, p.25). However, while this position appears credible, it does not take into account the complexity and diversity of the NBFi sector in Australia. The NBFIs were a very diverse group, and many of them – particularly amongst the finance companies – were subsidiaries of the banks, set up to avoid regulations. These institutions had little voice of their own in the debate on financial system change (Mair 1999). Other groups of NBFIs, particularly the building societies, credit unions, and merchant banks, did support deregulation but only once the Campbell Inquiry was set up and the initial drive towards reform had already occurred.
Prior to the establishment of the Campbell Inquiry, it was not in the interest of the NBFIs to actively push for deregulatory change. Although the NBFIs would have preferred more freedoms for themselves, such as access to foreign exchange dealing and LLR facilities, they did not want the banking sector controls to be loosened. They could offer higher interest rates and more flexible financial products than the regulated banks, and owed some of their growing market share to the regulatory system. As Coates commented, “Some of [the NBFIs] were doing very well out of the fact that it was a regulated market. So they had a bit of a conflict there” (Coates 1999). In many ways, the NBFIs would have preferred to maintain the status quo. Mike Waterhouse, a Treasury official on the Campbell Inquiry’s Secretariat, recalled:

They weren’t pushing for [an inquiry], and it wouldn’t make very much sense for them to push for it. … The downside was always going to be for them that the banks were deregulated. Seeing that they were growing at the banks’ expense, it wasn’t going to make an awful lot of sense to push for an inquiry that was likely to lead to something that was counter to their interests (Waterhouse 1999).

Consequently, until the Campbell Inquiry was established, the NBFIs did not come forward with proposals for change (Phillips 1999; Waterhouse 1999). Richard Beetham, from the Financial Institutions Division of Treasury, remarked:

[The NBFIs] weren’t in favour of deregulation of the banks. They kept very quiet – [it was] very difficult for them to argue against the deregulation of banks. I mean, it just would have been so hypocritical for them to do so. Let’s say that they didn’t go around enthusiastically endorsing the concepts, nor providing any support (Beetham 1999).

Once the Campbell Inquiry was set up, the NBFIs did come down in favour of deregulation, because they realised some kind of change was imminent. They wanted to ensure it was to their advantage, and did not involve the declaration of the Financial Corporations Act, which would see the banking sector regulations extended to cover NBFIs. They were loath to oppose deregulation once the Inquiry was established for fear that the regulatory system would expand to encompass the NBFIs as well as banks. However, the initial drive for deregulation and an inquiry did not come from the non-banks. The Australian Merchant Bankers’ Association (AMBA), like the ABA, had great difficulty reaching consensus on the key issues before the Campbell Inquiry (Pauly 1987, p.47). They realised that it would be inconsistent to argue for the retention of interest rate regulations on banks whilst they remained free. Consequently, even though the NBFIs did not actively favour interest rate deregulation because the regulations gave them a competitive advantage over the banks, their submissions to the Campbell Inquiry advocated this reform and recommended a shift to market-based
monetary policy (AMBA 1979, pp.27-8, 48-9). In addition, the NBFIs called for Part IV of the FCA to be rescinded. The life insurance and pension funds argued that the government should pay market interest rates on government securities, because they were adversely affected by the controlled rates paid on the prescribed assets (Life Insurance Federation 1979). Both building societies and merchant banks insisted that the banks should pay interest on current and cheque accounts, rather than continuing to obtain the funds for free (Australian Association of Permanent Building Societies (AAPBS) 1979; AMBA 1979, pp.27-8, 30).

Given that the NBFIs could not support the status quo, the deregulatory reforms that they were most interested in were the removal of the domestic entry regulations, which imposed a de facto ban on the licensing of domestic institutions as banks, while giving banks exclusive access to foreign exchange dealing, the payments system, and lender of last resort facilities with the Reserve Bank (Pauly 1987, p.49). The AMBA submission suggested a new “tiered” banking system, under which merchant banks would be granted limited banking licences allowing them to deal in foreign exchange and giving them access to Reserve Bank lender of last resort facilities (AMBA 1979, p.36, Pauly 1987, p.47). The credit unions and building societies stressed that they wanted access to the cheque and payments systems, and argued in favour of additional licensing of domestic institutions (Pauly 1987, p.49).

Building societies and credit unions opposed foreign bank entry, but submissions from two NBFI groups were in favour. The submissions of the Life Insurance Federation of Australia supported foreign bank entry (Life Insurance Federation of Australia 1979, 3.2.3.1). It saw foreign entry as the best chance for diversification – following the Campbell Inquiry, the two largest insurers entered banking markets through joint ventures with foreign banks (Pauly 1987, p.49). The AMBA submission was also compatible with foreign bank entry, though because its members included the merchant banking arms of domestic banks, AMBA was not a strong advocate (Pauly 1987, p.47).

**Conclusion**

This paper has argued that financial deregulation did not emanate from financial industry pressure for reform. While the NBFIs and some bankers favoured selective deregulation, none wanted to see broad-ranging structural reform. The pluralist perspective exaggerates the extent of financial sector support for financial deregulation because it underestimates the advantages of the regulatory system and the bankers’ inherent conservatism. The banking sector’s desire for deregulation conflicted with the conservatism of many individual bankers, and their attachment to the status quo. This, combined with the fact that the banks were still making substantial profits under the regulatory system despite the decline in their market
share, meant that they gave serious consideration to supporting the extension of regulations to
the NBFIs. The NBFIs were unenthusiastic about financial deregulation because the
regulations gave them a competitive advantage over the banks, whereas the impact of
deregulation was uncertain. Consequently, they were reluctant to push for structural changes
that had unknown and potentially negative effects upon their commercial interests. The
financial sector’s submissions to the Campbell Inquiry argued for a limited selective program
of deregulation, with regulations retained where it suited their own interests. The banks
wanted to exclude foreign entrants, and to keep their monopoly access to the payments system
and foreign exchange dealing. The non-banks, seeing some deregulation as inevitable, pushed
for equal privileges to the banks, but they had little interest in pushing for broader aspects of
deregulation because they did not want the banks to enjoy more freedom. Thus, all of the
submitters qualified their calls for financial deregulation in some respects. As one of the
Committee members, Alan Coates, remarked “Everyone sought to protect their own part of
the system” (Coates 1999). Thus, contrary to pluralist theories of policy change, neither the
banking sector nor the NBFIs actively favoured deregulation or made any attempt to promote
financial reform in Australia.

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