Chapter 11

SECTORAL AND SOCIAL ASSISTANCE

11.1 Principles Which Should Govern Assistance

The Campbell Committee addressed the provision of sectoral and social assistance in some detail in chapter 36 of its Final Report. Broadly, it argued that where the Government wished to pursue social objectives, direct fiscal subsidies were strongly favoured in preference to financial regulation for the following reasons[1]:

- *Efficiency* - Fiscal intervention can be designed to interfere less with resource allocation decisions since competitive market forces will still have full scope to operate. The distortions associated with regulation are less likely to occur.

- *Effectiveness* - Fiscal intervention addresses more directly the sector or activity to be assisted. It is therefore less likely to have an adverse impact on the target group.

- *Equity* - Distribution of the cost of assistance through the taxation system is a more equitable way of apportionment than regulation, which requires customers of regulated institutions to shoulder most of the burden.

- *Accountability* - Assistance provided through the Budget meets the criterion of open accountability. Intervention through financial regulation often does not.

The Campbell Committee's views remain as valid today as they were then.

Similar views were expressed in the Hilmer Report on National Competition Policy. While acknowledging that situations might arise where competitive market conduct may achieve economic efficiency, but at the cost of other valued social objectives, the Report concluded that:

> "... if a government chose to favour a particular sector or activity for strategic, social or political reasons, it will generally be more efficient to provide direct budgetary assistance. While subsidies of this kind may impact on competition between subsidised and non-subsidised sectors or activities, the efficiency losses will often be less than those associated with permitting anti-competitive behaviour. Moreover the transparency of the assistance will ensure that the desirability of that special treatment is subject to regular scrutiny"[2]

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1 *Report of the Australian Financial System Inquiry*, 1981, page 628

2 *National Competition Policy, Report by the Independent Committee of Inquiry* (Hilmer Report), 1993, page 89

11.2 Provision of Social Assistance Through Banks [3]

There have been a number of instances in recent years where Governments have sought to influence financial flows, prices or other banking activities, as they relate to specific sectors of the community, through direct intervention, if not formal regulation. Examples of these include the following:

- the pressure by the former Commonwealth Government (and sustained for a time by the ACCC) on banks not to impose account keeping fees or increasing other fees on *retail transaction accounts* where this would increase their overall income;
- pressure by the former Commonwealth Government for banks to increase *their lending to small business*; and
- the *Farm Debt Mediation Act (NSW),* which imposes compulsory mediation in relation to farm debts before creditors may take possession of a property or other enforcement action under a farm mortgage.

11.2.1 Retail transaction accounts

The 1995 PSA Inquiry into bank fees and charges made a number of recommendations which, if fully implemented, would have had the effect of:

- preventing banks charging account keeping fees on low balance accounts;
- requiring banks to restructure fees so as to achieve a better relativity between fees on retail transaction accounts and the costs associated with transactions;
- preventing banks from increasing revenue from fees; and
- removing fee exemptions provided by banks to certain classes of customers.

The then Government exerted considerable pressure on banks to abolish account keeping fees altogether, with the Treasurer requiring banks to respond to the PSA Report with their proposed fees and charges, which should not include account keeping fees. The Chairman of the ACCC has since made it clear that he is opposed to banks increasing their income from fees:

> "I would remind the banks that the PSA did recommend that any changes to fee structures should occur in a revenue-neutral way. The ACCC would be highly concerned, as would the community, if changes in bank fee structures claimed to be cost-justified led to higher profits."[4]

The Coalition Government has recently indicated that it would not intervene in bank fee setting practices, subject to there being extensive competition among the banks.

It is not proposed to review here all the issues associated with the PSA Report. But there are some important issues which highlight the adverse repercussions for efficiency - and

3 Banks, including Westpac, provide considerable support and assistance to the communities in which they operate. For example, Westpac funds a rescue helicopter service in several States. This section is not about whether or how banks undertake their social role, but about governments' requiring banks to take actions to support certain sectors which may not be inconsistent with their commercial activities.

4 *ACCC Media Release*, 29 February 1996

even for the underlying social objectives - which can flow from intervention of this kind. These include the following:

- Such intervention forces banks (and other deposit-taking institutions) to price services in a way which means that profitable customers cross-subsidise unprofitable ones. The issue of cross-subsidisation was discussed in Chapter 4. The key issue is one of competitive neutrality: banks risk losing their more profitable customers to niche competitors, such as the mortgage originators, or even other banks, which do not have to carry this burden.

- Preventing banks from responding to pressures on their interest income, discussed in Chapter 4, by increasing fee income from other sources, restricts their flexibility to change the mix of their revenue over time. This may have adverse prudential repercussions in a rapidly changing market place.

- If banks are unable to price services in a way which encourages customers to make more cost-effective transactions (eg. charging for excessive over-the-counter transactions), they will be limited in their ability to reduce their cost structures. This will also lead to greater inefficiency through the allocation of excessive resources to transaction handling across the whole banking system.

- Removal of exemptions from fees for certain customer segments would reduce the strategic flexibility banks have to develop close relationships with customers they believe are or will be profitable in future.

Westpac supports the need for customers to have affordable access to a bank account and has established a fee structure which gives all its customers the option of a reasonable number of free transactions before fees apply. But unless banks have the flexibility to remove cross-subsidies, the banking system will remain locked into the ways and cost structures of the past and will be increasingly uncompetitive with new and lower cost competitors. This is not compatible with having "an efficient, responsive, competitive and flexible financial system".

***Recommendation 11.1*: Banks should be able to use fees to encourage customer transaction usage that reflects the underlying costs.**

***Recommendation 11.2*: Where the Government is concerned that the charging of such fees will cause particular problems for some sectors of the community, it should seek to resolve these problems through the provision of subsidies through the budget.**

11.2.2 Pressure to increase lending to small business

In 1993-94, the then Government sought to exert pressure on banks to lend more for small business, at a time when lending for business generally was at lower levels than was considered desirable by the Government. There were suggestions that small businesses were bearing the brunt of a reaction by banks to the bad debts they incurred to larger businesses in the 1980s. At the time, banks argued that the problem was one of demand, not supply and resisted this pressure.

Statistical information subsequently collected by the Reserve Bank indicated that small business loans account for about one third of total business credit provided by banks[5]. A survey of small to medium sized metropolitan businesses commissioned by the Reserve Bank confirmed that small businesses did not have a problem with bank lending, with the criterion “reluctance to lend” ranking only 14th out of 18 sources of dissatisfaction with banks.[6]

This is a good example of the risk of not using soundly based evidence as a basis for decisions. Undue pressure by the Government on banks to lend more to small business could lead to businesses taking on higher levels of debt than they can afford, with these unsound lending decisions having adverse consequences for the stability of banks.

11.2.3 Farm Debt Mediation Act (NSW)

There can be no argument that mediation can at times be useful for businesses which are having difficulty meeting their obligations to lenders. However, Westpac believes that enforcing **compulsory** mediation on banks through regulation is inappropriate:

- as its effectiveness will depend on both parties being willing participants;
- the associated bureaucratic processes are time consuming and costly; and
- it does nothing to avoid the problems arising in the first place.

In addition, compulsory mediation on an industry-wide basis may involve a form of ‘moral hazard’ in that it may encourage farmers to be less than prudent about management of their debt in the expectation that mediation will provide them with debt forgiveness if they encounter problems. In delaying action by banks to recover funds owing to them, it may also mean that the debt continues to increase, extinguishing the equity that farmers may have in their properties.

If Governments and their agencies wish to assist farmers who are experiencing financial difficulties, it would be more efficient, more effective and more equitable for this to be done through fiscal subsidies, where appropriate, as well as through actions by Commonwealth and State rural counselling services to encourage:

- financial planning as an integral part of daily farm management by primary producers;
- primary producers to access professional advice as part of the lending process; and
- early recognition by primary producers of their financial problems.

[5] In December 1995, bank loans outstanding of less than $500,000 amounted to nearly $50 billion out of $155 billion to all businesses. In 1995/96, Westpac approved approximately $5 billion in loans to small and medium businesses.

[6] *Bank lending to small businesses*, Reserve Bank Bulletin, April 1994

It is in the banking industry's interests to assist farmers in the resolution of their financial difficulties and it has shown that solutions can be developed to farmers' problems without compulsion. Westpac has a long history of supporting the rural sector through good and bad times[7]. This is particularly reflected in its decision to voluntarily extend mediation to farmers in all States. It sees this as having major benefits for its relationship with farm customers. The Australian Bankers' Association and Queensland Farmers' Federation are also in the process of concluding an integrated Farm Finance Strategy, which it is intended to extend to other states. This strategy focuses on:

- access to professional advice by the producer;
- early recognition of financial problems;
- resolving financial problems; and
- voluntary mediation.

***Recommendation 11.3*: In the interests of efficiency, effectiveness and equity, Governments looking to resolve the financial difficulties faced by farmers should provide programs to assist farmers to address their underlying problems, while leaving it to the rural and banking industries to develop supporting arrangements on a voluntary basis.**

11.3 Conclusion

The provision of sectoral or social assistance through banks is inconsistent with efficiency and, in particular, with the principle of competitive neutrality, to the extent that with the disaggregation of banking and emergence of niche competitors, many of the new players will not carry this burden. It adds to the costs of financial institutions, reduces their flexibility in meeting customer needs, and distorts financial flows and thus the efficiency with which resources are allocated.

***Recommendation 11.4*: In future all proposals which are intended to achieve sectoral or social objectives through the financial system should be the subject of regulatory impact statements as proposed in Recommendation 6.21. These statements should explicitly address the implications for the four criteria identified by the Campbell Committee: efficiency, effectiveness, equity and accountability.**

[7] In recent years, Westpac has strengthened its commitment to the rural sector by developing a highly specialised approach to lending, opening Commercial Agribusiness Centres, staffed with specialist staff, to meet the needs of the rural sector. It currently has $2 billion in business loans outstanding to farmers. It has also implemented a drought relief policy, a strategy involving the use of Agricare Centres to improve the handling of impaired (or non-performing) agribusiness loans.