Financial Deregulation in Australia in the 1980s

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Abstract
This article examines the process of financial deregulation in Australia during the decade when Australia's financial system changed from a highly regulated system to a system with few quantitative or qualitative controls, a freely floating exchange rate and a deficit fully financed by the market. While existing accounts have tended to focus on a single explanatory variable (such as an ideological shift or economic pressures), this article argues that policy outcomes were the result of a more complex interaction of ideology, economic forces, institutional structures and political interests. In analyzing the effect of these significant influences, the article provides a more complete picture of the deregulatory process and places the Wallis Report in context.

1. Introduction

With the recommendations of the Wallis Report currently being considered by government, it is timely to look back at financial deregulation in Australia in the 1980s. If adopted, the recommendations of the Wallis Report will be the latest changes in a process which started in the late 1970s. But where did pressures for change come from in the late 1970s? Were policy makers simply reacting to economic pressures or were other factors at work? If other factors were at work, did each factor operate independently? If not, how did they interact? Were their effects consistent? This

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article examines the process of financial deregulation in Australia during the decade when Australia's financial system changed from a highly regulated system to a system with few quantitative or qualitative controls, a freely floating exchange rate and a deficit fully financed by the market. In so doing it answers the questions posed earlier and places the Wallis Report in context.

Throughout most of the post-war period, the Australian financial sector consisted of a regulated banking sector and a less regulated non-banking sector. The banks accepted government controls because government regulations also placed restrictions on the activities of the non-bank financial institutions (NBFIs), and, more importantly perhaps from the banks point of view, they were protected from international competition by a *de facto* prohibition on the entry of new banks into the Australian banking system (Harper, 1991: 65).

All this changed very rapidly in the 1980s. The rapidity of the change has been attributed to an ideological shift and is seen as evidence of the first fruits of the triumph of economic rationalism. For example, Helleiner (1994: 163) believes that:

> ... liberalization decisions in New Zealand and Australia can generally be explained by an ideological shift in favor of a neo-liberal conception of finance within the newly elected Labour governments in each country from the mid-1980s.

Others, such as Harper (1986: 47) turn to economic forces as the explanation for the rapid deregulatory process:

> ... the unique feature of the Australian experience of financial deregulation – the rapid pace and extensive coverage of the process – are the result of ... the fungibility of money and finance ... The unique feature of financial markets is that the developments of substitutes via financial innovation tends to be less costly than is the case in markets for non-financial goods and services.

This article argues that, while changes in ideology, or ideas, and economic forces were important, the structure of the financial sector itself and the perceived political interests of the Labor government elected in 1983 also affected the speed of the deregulatory process. The remainder of the article examines the impact of each of these influences in turn, while the concluding section integrates the analysis by looking at how these four factors (ideas, economic forces, institutional structures and political interests) interact to affect policy outcomes.

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2. Ideas

While deregulation of Australia's financial system actually began under the Fraser Government and the interplay of factors was more complex than an ideological shift within government, ideas were significant. The pressure for a public inquiry into Australia's financial system is perhaps the most important example of this. Moreover, opposition to the inquiry in certain sections of the bureaucracy, stemming from a reluctance to abandon policy levers thought to be necessary for controlling the economy, also arose from ideas about the appropriate role for, and operation of, economic policy.

Although the possibility of a review of the financial system was briefly canvassed by the LNP Coalition during the 1975 and 1977 election campaigns – prompted primarily by a concern over lack of funds to small businesses (Harper, 1986: 42) – the idea was dropped after each election (Pauly, 1987: 33). There was no consensus of opinion within the financial policy community supporting a review of the financial system, although industry groups were lobbying for the relaxation of controls in specific areas. The main beneficiaries of regulation, the NBFIs, were not in favour of comprehensive reform, although they were keen to see the end of the banks' monopoly on dealing in foreign exchange, arguing that foreign exchange licences should be separate from banking licences (Phillips, 1995). The NBFIs which were subsidiaries of overseas banks wanted bank status in Australia (Phillips, 1995). The banks were also selective about how the financial system should be deregulated (Argy, 1995). Just as the NBFIs wanted an end to the banks' monopoly over foreign exchange transactions, the banks were united in wanting an end to the currency hedge market. The banking community was less united, however, over the process of reform – whether the financial system should be deregulated, or whether financial controls should be extended to cover NBFIs. For example, the Australian Bankers Association 1978 discussion paper highlighted the erosion of market share because of the banks' inability to compete with the less regulated non-banking sector and put forward two possible solutions; relaxing regulatory controls on banks, or (the option initially favoured by some of the banks) neutralizing the discriminatory impact of controls by extending them to cover NBFIs (Pauly, 1987: 35).

Opposition to comprehensive deregulation was even stronger within certain sections of the bureaucracy (Macfarlane, 1991: 61). The Treasury, while happy to deregulate interest rates, was not in favour of deregulating the exchange rate (Treasury, 1981: 101-102), nor the entry of foreign banks (Davis and Lewis, 1982: 538). Furthermore, the Treasury believed it was dangerous to hold a public inquiry without first ascertaining what would

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emerge from that inquiry (Argy, 1995). For example, in the mid-1970s when John Hewson (as advisor to the then Treasurer, Phillip Lynch) wrote a paper recommending an inquiry into the Australian financial system, senior Treasury officials (Sir Frederick Wheeler, Treasury Secretary and John Stone, Deputy Secretary) informed Hewson that the last thing Australia could afford was the financial sector looking at itself (Hewson, 1995). While the Reserve Bank was committed towards moving towards a more market-based system, there was internal debate within the Bank about how fast this movement should be, with the then Governor (Sir Harold Knight) generally favouring a more conservative approach (Phillips, 1995).

The greater readiness of the Reserve Bank to move (however slowly) towards a more deregulated financial system was probably the result of institutional and intellectual factors – the fact that the Reserve Bank was more involved in the market (Phillips, 1995) and the influence of officials within the Bank, such as Austin Holmes, who were important in building a stronger intellectual case for change (Johnston, 1995). For example, Holmes was an early exponent of the view that direct controls over banks were ineffective because they encouraged the growth of unregulated alternatives, and, even in the 1950s, was advocating abolition of interest rate ceilings on home finance (Carew, 1989: 94).

Pressure for a wide-ranging public inquiry into Australia's financial system was only coming from the Treasurer's office. The Treasurer's Ministerial advisor (Hewson) had previously worked at the International Monetary Fund (IMF) on international capital markets and the effects of controls on markets. Hewson's experience at the IMF undoubtedly influenced his views on the need for change and his belief that a public inquiry would greatly assist moves toward a market-based system (Hewson, 1995). Although Hewson had been unable to persuade Lynch to support the idea of a public inquiry, he was able to convince the man who replaced Lynch as Treasurer in 1977 (John Howard) of the need for public inquiry into Australia's financial system.

Cabinet agreed to establish the Committee of Inquiry into the Australian Financial System (Campbell Committee) in February 1978. At that time primary producers were prospering, so the National (Country) Party were not worried about the possibility of deregulation in the financial sector (Sinclair, 1996). In any event, the National Party was well aware of the negative effects of government controls on their constituents. These concerns were reflected in the on-going tug-of-war between the LNP government, which wanted as low an exchange rate as could be manipulated, and the Treasury, concerned about inflation rather than rural exporters, which

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wanted as high an exchange rate as could be manipulated (Visbord, 1995; Perkins, 1987: 48). This on-going tug-of-war was manifested within the policy community as bureaucratic in-fighting, couched in political and economic terms, between the Prime Minister's representative, the Treasury's representative and the Reserve Bank over how the exchange rate should be set (Phillips, 1995). Those within Cabinet who were less enthusiastic about deregulating the financial system, saw the inquiry as a politically acceptable way of postponing decisions, or felt the outcome of the inquiry could be controlled if necessary (Pauly, 1987: 35).

When Treasury realized it had lost the argument and an inquiry was inevitable, it then tried to constrain the terms of reference and staff the inquiry with people sympathetic to Treasury concerns. However the head of the inquiry (Keith Campbell) was selected in the Treasurer's office. Furthermore, both the Treasurer's office and the Prime Minister's office (where John Rose was also committed to the idea of comprehensive reform) had an input into the selection of other committee members (Hewson, 1995). Thus, the members of the Campbell Committee were drawn from the financial policy community and given terms of reference which were much more wide-ranging than either the Treasury or the Reserve Bank would have liked (Phillips, 1995).

The influence of ideas on the process of financial deregulation was not confined to ideas about appropriate policy outcomes. Changes motivated by institutional structures and economic forces (discussed in the following section) assisted those pushing for reform by reinforcing within the policy community a belief that financial deregulation was inevitable. The Campbell Committee started its inquiry in January 1979. At that time those working on the inquiry believed there was plenty of time – it might be many years before the financial system was substantially deregulated (Argy, 1995). However, by the time the Committee presented its report to the Treasurer in September 1981, a number of significant changes (such as the introduction of a tender system for the sale of Treasury bonds) had already been made. Campbell used to joke that 'if we don't hurry up with our report, there will be nothing to report on – it will all have happened' (Argy, 1995).

Although the Treasury argued against the entry of foreign banks during the Campbell inquiry with senior officials, such as Stone, wanting to maintain the oligopolistic structure of the industry (Argy, 1995), the banks themselves were divided on this issue. Some banks were happy to see foreign banks allowed into Australia, arguing that with many countries insisting on reciprocal preference, this was the only way they could expand overseas (Phillips, 1995). Others believed that the entry of foreign banks

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would be destabilizing and disruptive, with foreign banks having an unfair competitive advantage (Argy, 1995) because of their experience in operating in an unregulated environment (Davis and Lewis, 1982: 536). They therefore argued that the entry of foreign banks should be delayed until some years after the rest of the financial system was deregulated (Davis and Lewis, 1982: 536).

However, the bank mergers of the early 1980s were seen by other members of the financial community as acceptance by the banks that foreign bank entry was going to happen sooner rather than later (Argy, 1995; Phillips, 1995; Ward, 1995).[1] In fact in 1966, the ANZ Bank was anticipating foreign bank entry as likely within the next five years (Merrett, 1985: 256). The Treasury approved these bank mergers precisely because of their belief that domestic banks needed to be strengthened in order to better prepare them for what everyone anticipated would be strong competition from foreign banks (Argy, 1995). The Fraser Government made an in-principle decision to admit foreign banks in January 1983, but the March Federal election intervened before the matter could be taken any further. Thus, it was the Hawke Labor Government which invited sixteen foreign banks to establish operations in Australia in February 1985. Evidence of widespread acceptance of the inevitability of foreign bank entry is also seen in the fact that when the Labor Government was preparing to deregulate bank entry, the Treasurer (Keating) had to spend much more time convincing other elements of the ALP of the benefits of increased competition from a limited number of foreign banks than he did other members of the financial sector (Ward, 1995).

As noted at the beginning of this article, financial deregulation in Australia cannot be explained solely by the concept of 'ideas'; institutional structures and economic forces were also at work.

3. Institutional Structures and Economic Forces

In Australia, institutional structures have tended to intensify economic pressures for change. Regulations imposed on the financial sector during World War II led to the creation of a two-tiered system of banks and NBFIs which developed because regulatory controls restricted the amount of finance the banking system was able to make available for such purposes as housing or investment funds. However, as the non-banking sector grew, the banks began to lose market share. Even as early as the 1950s, an increasing volume of transactions were being intermediated outside the banking sector and, by the late 1960s, the banking sector was under

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considerable pressure from the growth of NBFIs (Grenville, 1991: 12-15). Banks responded to the competitive threat posed by NBFIs by establishing their own non-bank subsidiaries, thereby contributing to the increasing volume of transactions being intermediated outside the regulated banking sector. The downward trend in the market share of banks in the 1960s was greatly accentuated by the sharp rise in inflation in the 1970s. Rises in inflation led to rises in nominal interest rates in the unregulated sector of financial markets and regulated interest rates lagged behind making this sector less attractive to depositors. Thus, the combined assets of merchant banks, building societies and cedit unions increased over six times between 1970 and 1980 compared with an increase of about three and a half times for bank assets (Lewis and Wallace, 1985: 6-7).

The growth of alternative financial services and products, facilitated by advances in communications and data processing technology, also took place in overseas markets. The increasing integration of world financial markets meant that where domestic controls raised the relative cost of transactions, such transactions were more likely to be carried out off-shore (Harper, 1986: 41). Thus, in Australia, as the regulated sector continued to shrink relative to that of the unregulated sector, existing regulatory controls, and the monetary policy they were designed to support, became increasingly ineffective.

RBA officials were aware throughout most of the 1960s and the 1970s that the regulatory system was not working as well as it had in the past, and this contributed to an acceptance within the Bank of the need to move toward a more deregulated system (Johnston, 1995). However, there was still a variety of views within the Bank as to how fast and to what extent the system should be deregulated (Phillips, 1995). For example, in the early 1970s there were tentative moves towards deregulation. Credit directives were eased; quantitative lending controls were suspended; banks were allowed to offer market rates on some of their deposits; the statutory reserve deposit ratio was reduced; and interest ceilings on loans of more than $50,000 were removed (Grenville, 1991: 18). These moves were largely reversed in the latter half of the 1970s, when interest rate ceilings were restored and statutory reserve deposit requirements were tightened (Grenville, 1991: 19). The range of views within the financial policy community was reflected in debates about whether equity in the financial system would best be served by removing existing controls or extending those controls to cover the NBFIs (Phillips, 1995). The *Financial Corporations Act*, which contains provisions to apply direct controls to the operations of a wide range

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of NBFIs, was passed into law in 1974, although Part IV (the control sections of the Act) were never put into effect (Phillips, 1984c: 154).

However, because the Reserve Bank was aware that official control of the price of Treasury notes was causing distortions in interest rates elsewhere in the system, a tender system for the sale of Treasury notes was introduced in December 1979 (Phillips, 1995). This change was initially opposed by the Treasury because it believed the government should get its money as cheaply as possible and therefore monetary authorities, not the market, should determine the price of funds (Phillips, 1995). However support for this (and other changes) was coming from within the Treasurer's office, as well as from the influential Department of the Prime Minister and Cabinet (PM&C). Furthermore, politicians were attracted by the political advantages of the tender system, especially the fact that the government would no longer have to face criticism from those adversely affected every time there was a change in Treasury note interest rates (Phillips, 1995).

Government control over the price of Treasury bonds was also causing distortions elsewhere in the system. The Reserve Bank was aware of the need for change (Johnston, 1995), although an unwillingness on the part of the Treasury, the RBA and the Prime Minister (Malcolm Fraser) to trust the market led to a brief flirtation with a 'tap' system[2] for selling Treasury bonds before a tender system was introduced in June 1982 (Phillips, 1995). The introduction of a tender system for the sale of Treasury bonds was an extremely significant step in the process of freeing monetary policy of institutional constraints because, with the Reserve Bank no longer forced to buy the government bonds not taken up by the market, the deficit was now funded by the market and not the government, which meant that the deficit could be financed without affecting monetary policy. The tap system for selling Treasury bonds was introduced on a trial basis on the understanding that its operation would be reviewed 'when sufficient experience had been gained in operating the new arrangements' (Phillips, 1982: 101). As part of that review the Reserve Bank canvassed the views of other members of the financial policy community. Industry groups (including banks, merchant banks, stock brokers, money market dealers and the larger institutional investors) all supported the move to a tender system for the sale of Treasury bonds (Phillips, 1982: 103).

Further relaxation of interest rate controls came in December 1980 when the interest rate ceiling on deposits with trading and savings banks was removed. Relaxation of interest rate controls also aroused relatively little conflict within the financial policy community. Because Australia did not issue a lot of government bonds during the late 1970s and early 1980s,

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monetary authorities were not unduly concerned about the effect of deregulated interest rates on debt service levels. Interest rate controls were designed to assist macro-economic management and to achieve certain social goals. By the late 1970s the Treasury believed that interest rate controls were impeding rather than assisting macro-economic management and such controls were no longer a cost-effective way of achieving social policy goals (Argy, 1995). If governments wished to pursue social goals, the Treasury believed other more explicit policy instruments were preferable (Argy, 1995). The banks were happy to see interest rate and credit controls removed because this decreased the competitive advantage enjoyed by the NBFIs and made it easier for the banks to attract funds.

Once begun, movement toward a deregulated system acquired a certain momentum, in that as some controls were removed, others became unnecessary. When the price of Treasury notes and later Treasury bonds were determined by the market rather than the government, there was no need for captive markets, nor the regulations which supported them, such as the '30/20' arrangements or portfolio controls on banks (Phillips, 1995). Similarly, once the exchange rate was deregulated many of the exchange controls which existed to support the managed exchange rate and protect foreign exchange reserves were unnecessary (Phillips, 1984a: 135). Deregulation of the foreign exchange market also meant there was no longer any reason to continue to restrict foreign exchange dealing to banks (Hughes, 1995).[3]

Perhaps the most obvious example of how economic forces, intensified by the existing regulatory framework, affected policy outcomes is seen in the events leading up to the floating of the dollar in December 1983. The crawling peg method of fixing the exchange rate was generating large capital inflows and outflows and these large fluctuations in monetary aggregates were restricting the Reserve Bank's ability to operate monetary policy.

> ... in the ten years between, say, 1973 and 1983, we saw a period of rapid and wide-ranging innovation in financial markets ... This period was also associated with the growth of the currency hedge market and the activities of the merchant banks in that market ... There was increasing scope, through the hedge and currency futures markets, for exchange rate speculation ... Our system of fixing the exchange rate, together with some of our exchange controls ... offered some stimulus to speculation based on what the pundits thought we might do with the rate on the following day or over a fairly short period ... The Australian dollars added to, or removed from, the domestic financial system as a result of these transactions had an effect on interest rates ... In other words, as a

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> result of our exchange rate management system, Australia had elected, not necessarily consciously, to take the world's financial volatility rather less on the exchange rate and rather more on domestic financial conditions and domestic interest rates (Phillips, 1984a: 132-134).

Reserve Bank views on the need for a float developed gradually. The RBA had tried a number of alternative strategies during the last years of the Fraser Government, but when these failed to rectify the situation, senior Reserve Bank officials believed the only remaining option was to float the dollar (Phillips, 1995). In the words of the then Governor of the Reserve Bank, R. A. Johnston:

> The restoration of the March depreciation had convinced a lot of people that the existing system was unacceptable. We didn't make a formal decision to float until the deathknock. We said that if the existing system can work then we will give it a try but it didn't look hopeful (cited in Kelly, 1992: 87).

However while Reserve Bank officials were becoming increasingly convinced of the need to float the dollar, the head of the Treasury (John Stone) remained implacably opposed (Kelly, 1992: 81-82). The Treasury had argued against deregulating the exchange rate during the Campbell inquiry (Treasury, 1981: 101-102) and in spite of the economic pressures generated by the managed exchange rate, Stone continued to believe that the costs associated with a deregulated exchange rate outweighed the benefits. For many years the Treasury had tried to maintain a slightly overvalued exchange rate in order to control inflation (Harper, 1986: 41) and Stone believed that deregulation of the foreign exchange market would remove an important constraint on governments adopting inflationary policies.

The conflict generated within the financial policy community over this issue delayed the decision to float the dollar. In October 1983 a capital inflow crisis again raised the question of deregulating foreign exchange markets. The Treasurer (Paul Keating):

> ... knew the decision was historic; he knew the consequences were unpredictable. He didn't want the markets, domestic and abroad, thinking that the Australian treasury had opposed the move. Both for the record and his own reassurance Keating wanted the treasury on board (Kelly, 1992: 83).

Although the Treasurer and his office, the Prime Minister and his office, PM&C and the Reserve Bank believed the exchange rate should be deregulated (Visbord, 1995), Stone's continuing opposition to the float meant a

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compromise position was adopted where a number of changes were made to foreign exchange arrangements short of actually floating the dollar.[4] While these changes reduced the potential for speculation against the Australian dollar, they did not remove all speculative avenues, and, in the first week of December 1983, 'strong rumours developed that the Australian dollar was about to be appreciated sharply, [with the Reserve Bank buying] almost $1.5 billion of foreign exchange in just a few days with indications that a lot more was to come' (Phillips, 1984b: 147). On this occasion, economic pressure was sufficient to overcome the Treasurer's desire for policy consensus. Although Stone continued to argue against deregulation of the foreign exchange market, the Prime Minister and the Treasurer decided to float the dollar and remove all exchange controls except for controls on investments in Australia by foreign governments, their agencies, or foreign banks (Hawke, 1994: 246).[5]

In removing the majority of exchange controls at the same time as floating the dollar, Australia went further than most other countries in deregulating its foreign exchange market. The business community had been lobbying for their removal for years and was delighted with the decision (Johnston, 1995). PM&C regarded exchange controls as a regulatory burden on business which did not serve any useful purpose and had also been trying to get the government to agree to their removal for years (Visbord, 1995). Although the previous Prime Minister (Malcolm Fraser) had been relatively open-minded on the issue at the time, the Treasury, and consequently the Treasurer, opposed their removal (Visbord, 1995). The Treasury's opposition to removing exchange controls sprang from its distrust of international markets and its belief that exchange controls (and a managed exchange rate) gave Australia a better chance of controlling its own economic destiny (Phillips, 1995).

In spite of the fact that removal of exchange controls reduced Reserve Bank functions, senior Reserve Bank officials supported their removal because the controls were no longer achieving their original purpose and were causing distortions. Exchange controls were originally introduced to keep money in Australia, but throughout the 1970s the Reserve Bank was more worried about keeping capital out of the country. Thus, 'the Bank felt that exchange controls were a bit like the guns at Singapore – they turned out to be facing in the wrong direction' (Johnston, 1995). Furthermore, by the early 1980s there were so many ways of getting around the regulations (such as under and over invoicing, changing the nature of transactions, off-shore deals etc) that Reserve Bank officials had serious doubts about their effectiveness (Johnston, 1995).

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Although senior Reserve Bank officials believed exchange controls should go, they did not believe that removal of almost all exchange controls was politically possible. Therefore, when summoned to Canberra on 9 December 1983 to discuss the looming foreign exchange crisis, senior RBA officials went into the meeting with the proposal to remove, not all exchange controls, but only those necessary in order to float the dollar (Phillips, 1995). The Reserve Bank's 'War Book' – a document dating back to 1975 which had been put together to take advantage of windows of opportunity which might emerge to move toward deregulation of the exchange rate and exchange controls – reflected this expectation (Phillips, 1995). However a window of opportunity far wider than anticipated arose during that 9 December meeting. John Phillips (then Chief Manager, Financial Markets Group) describes what happened.

> ... I was asked by Hawke [the Prime Minister] what I thought would happen after the float. I was telling him what I thought would happen to the exchange rate and currency flows depending on what we did about exchange controls and Hawke, at the end of my exposition, turned round to Bob Johnston and said 'if you had the option of getting rid of all the exchange controls, Governor, would you do it'?[6] And that's how we got rid of all the exchange controls because Bob [Johnston] turned round to Don Sanders [the Deputy Governor] and myself and said, 'what do you think'? Our view was that it would be difficult to manage, but if the window of opportunity was there, you'd better take it, because you never knew if you would ever get another chance. So that's how they all went (Phillips, 1995).

4. Political Interests

Both the Treasurer (Keating) and the Prime Minister (Hawke) were convinced of the need to float the dollar for economic reasons. However the decision to deregulate the foreign exchange market also served a wider political purpose in that the decision established Labor's credentials as an effective modern party able to deal sensibly with fundamental economic issues.

The Hawke Labor Government was anxious not to repeat the mistakes of the previous Whitlam Labor Government (1972-1975) and therefore sought to balance the interests of the business community and the labour movement (Galligan and Singleton, 1991: 3). One element in Labor's strategy to manage the political relationship with business was to adopt economic settings that were broadly compatible with the needs of private

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capital accumulation (McEachern, 1991: 136). At the same time, Labor's balancing act required policy decisions which publicly signalled its pro-business sympathies (Walsh, 1991: 44). Floating the dollar fulfilled both these requirements.

> The float had a psychological significance almost greater than its monetary effects. It sealed a *de facto* alliance between the government and the financial markets; it made Keating hero of the markets. For a while Labor became the fashion within the financial sector and even in sections of the corporate sector (Kelly, 1992: 77).

Approval even extended to the international arena when Keating received the 1984 *Euromoney* award for Finance Minister of the year.

However political interests did not always work to expedite change. This is clearly seen in the fact that even after the Labor Party had embraced deregulated outcomes in other areas of the financial sector, the electoral consequences of an increase in housing interest rates meant that it was not until April 1986, when the flow of funds through savings banks had substantially declined, that the interest rate ceiling on new home loans was lifted, thereby releasing more funds to satisfy unmet demand (Perkins, 1989: 42). Even then the ceiling on existing loans was maintained.

Similarly, although a belief that the pace of change would continue to increase was prevalent among the policy community by the time the Campbell Committee presented its report to the Treasurer, political actors were less sure. In 1981 primary producers were beginning to feel the effects of a serious drought and the National Party, worried that any precipitate action would take Australia deeper into recession, believed further relaxation of regulatory controls should wait until economic conditions improved (Sinclair, 1996). The Liberals were also less than enthusiastic, with the Prime Minister worried about the effect of deregulated interest rates on the cost of housing finance (Argy, 1995; Hewson, 1995; Phillips, 1995). The fact that the LNP government had been returned with a reduced majority the previous year no doubt increased the Prime Minister's concern about the electoral consequences of any rise in housing interest rates. The Prime Minister's office and his department (PM&C) went through the Campbell Committee Report to identify what was politically dangerous, and the Prime Minister was ready to shelve the report when the Treasurer convinced the Prime Minister to set up a task force to work with Treasury on the implementation of the report (Hewson, 1995). Hewson and Rose were appointed to the task force and they saw it as their job to maintain the momentum of reform (Hewson, 1995).

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Although the task force was biased towards deregulatory outcomes, it was operating in a political environment. Phillips, another member of the task force, said that:

> ... effectively all the decisions that were made on the task force were political decisions, the ones the government thought were politically OK they accepted, and the ones they thought were not politically OK, they didn't accept (Phillips, 1995).

Consequently the first submission the task force took to Cabinet (September 1982) was rejected because it went too far, too fast (Phillips, 1995). Although it did not recommend floating the dollar, other recommendations to do with the foreign exchange market were regarded as unacceptable at the time (Phillips, 1995).

The second submission was more cautious in its approach to the foreign exchange market, recommending that the issue of the exchange rate be left to a later date (Phillips, 1995). However it did recommend removal of almost all restrictions on interest rates, a recommendation which was unacceptable and resulted in further redrafting (Phillips, 1995). The entry of foreign banks proved less contentious with Cabinet accepting the recommendation in the second submission (December 1982) that bank entry be deregulated by initially licensing six foreign banks (Phillips, 1995).

Reaction to the Campbell Committee Report by the Labor Party was also governed by political considerations, with the Shadow Treasurer (Ralph Willis) highlighting a litany of possible adverse consequences:

> Total deregulation of the financial markets, as advocated by the report, would bring about higher interest rates, increased government taxes and charges, less finance for housing, a more volatile exchange rate, greater foreign ownership and less control by government over the form or pace of development of the Australian economy (cited in Langmore and Quiggin, 1994: 69).

Opposition to foreign bank entry was being urged by the left-wing of the ALP and the two bank unions – the Australian Bank Employees Union and the Commonwealth Bank Officers Association (Pauly, 1987: 54). Union opposition later proved to be one of the biggest barriers Keating had to overcome in persuading the ALP to accept the entry of foreign banks (Ward, 1995). In the end, Keating did a deal with the Australian Council of Trade Unions (ACTU) which supported the bank employees position on the entry of foreign banks. In return for muted and strictly formal opposition to foreign bank entry, the government promised to consult the ACTU on

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entry criteria for foreign banks and to retain the ceiling on housing interest rates (Pauly, 1987: 76).

Although the ALP opposed the LNP government's plan to allow six foreign banks into Australia, threatening to block the legislation in the Senate (Pauly, 1987: 63),[7] Keating was personally interested in the idea of financial deregulation, particularly deregulation of the banking sector (Ward, 1995). Initially, Keating's views were influenced by his dislike of the domestic banks rather than any intellectual commitment to market-oriented outcomes (Ward, 1995). Keating saw the banks as institutions which were politically sympathetic to the Liberal Party, and which had done very little to support small business, farmers and 'the little Aussie battler' (Ward, 1995; Hughes, 1995). Keating believed deregulation would force the banks to be more competitive and improve the services available to individual depositors and small businesses (Ward, 1995).

Less than a month after the ALP had been threatening to block government legislation in the Senate, Keating (as Shadow Treasurer) announced that if the ALP won office it would commission another review of the financial system (Pauly, 1987: 63). In making this announcement Keating was attempting to manage the political process of moving the ALP away from its stated policy of opposition to foreign bank entry. The Martin Review Group was subsequently established in June 1983. Those within the Labor Party who had supported the 1982 change to the party platform reflecting opposition to financial deregulation and the entry of foreign banks, did not see this review as an automatic endorsement of financial deregulation (Langmore, 1995). But for those, like Keating, who supported the idea of further financial deregulation, the Martin Review Group provided a way in which the ALP could claim ownership of a process begun under the previous LNP government (Hawke, 1994: 235).

In discussing the entry of foreign banks, the Martin Review Group recommended that for any bank, 'the maximum share [of equity] to be held by foreign investors be 50 per cent' (Australian Financial System, 1984: 71). With this recommendation, the Martin Review Group revealed its awareness of the political realities within which it operated. The Campbell Committee rejected any local equity requirements (Australian Financial System Inquiry, 1981: 446). Foreign banks did not want it and the domestic banks were worried that the main source of local equity would be insurance companies whose existing branch networks would give the foreign banks an even bigger competitive advantage (Pauly, 1987: 62). However the 50 per cent local equity requirement mollified those within the Labor Party

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who distrusted foreign investment and were dubious about the benefits of allowing foreign banks into Australia (Ward, 1995).

In the end practical considerations forced the government to waive the 50 per cent local equity requirement. Initially everyone believed about six foreign banks would be allowed in, but the number grew as various interests were accommodated (Phillips, 1995). A balance had to be maintained, for example, between British, European, American and Japanese banks. State banks lobbied for the entry of specific banks with which they had business dealings, and the large insurance companies, such as National Mutual and the AMP Society, also had preferences for specific banks (Phillips, 1995). With a final list of sixteen foreign banks, it simply was not possible for that number of banks to find local equity partners.

5. Conclusion

Even after this relatively brief examination of the process of financial deregulation in Australia during the 1980s, it is clear that the policy outcomes cannot be explained adequately with reference to a single explanatory variable. Ideas, economic forces, institutional structures and political interests all affected policy outcomes. Moreover, no single factor dominated and the factors did not operate independently of each other. For example, economic forces generated pressure for change and this pressure was intensified by the structure of the financial sector and ideas about appropriate policy outcomes and instruments. At times, political interests also worked to expedite change, although this was not invariably the case.

As identified by Harper (1986), economic pressures were generated as the growth of financial alternatives in both overseas and domestic markets meant banks lost market share and an increasing volume of transactions began to be intermediated outside the regulated banking sector, thereby rendering existing controls, and the monetary policy they were designed to support, increasingly ineffective. The existence of a two-tiered system of banks and NBFIs accelerated this trend. Furthermore, although the banks and the NBFIs were divided by the degree to which they were subject to government regulation and, to a lesser extent, by the type of lending carried out by each type of institution, the Australian financial sector was not highly segmented. For example, retail banks were allowed to trade in, as well as to underwrite, government bonds and, prior to deregulation, there was not a large market in non-government securities, with stockbroking firms conducting what underwriting and dealing there was.

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Although the NBFIs were the main beneficiaries of the regulated system and were worried that deregulation would destroy the competitive advantage they had previously enjoyed over the more regulated banking sector (Argy, 1995), the NBFIs were able to identify potential benefits in a deregulated system and therefore did not argue against the concept of a less regulated financial system.

> I do not disagree at all with the overall claim that less regulation in the capital market would be a good thing (Campbell, 1982: 424).

NBFIs wanted the removal of controls which prevented them dealing in foreign exchange (Phillips, 1995) and also wanted access to the cheque payment system (Keating and Dixon, 1989: 44). Opposition to financial deregulation was further muted by the decision of some NBFIs to acquire bank status (Keating and Dixon, 1989: 44).

The fact that both banks and NBFIs were not opposed to the idea of financial deregulation and could identify potential benefits in a deregulated system made it easier for politicians to pursue a deregulatory agenda, although political interests did not always work to expedite change as politicians remained sensitive to the electoral consequences of specific decisions.

The effect of ideas on policy outcomes can be seen in the fact that while bureaucratic actors, especially the Treasury, were reluctant to abandon policy levers they saw as necessary for controlling the economy, this reluctance gradually lessened as the notion of controlling the economy was replaced by the idea of managing the macro-economy (Phillips, 1995). Thus, the growing consensus within decision-making elites about appropriate policy outcomes and instruments during the 1970s and 1980s, also played a part in facilitating the process of reform.

Financial deregulation in Australia in the1980s was not the result of any one overwhelming factor, but proceeded rapidly because institutional structures, ideas and (to a certain extent) political interests intensifed the effects of economic forces. All these factors are still important influences on policy-making in Australia. Policy formulation in responce to the Wallis Report can be best be understood if attention is not confined to any single factor.

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Appendix: Names and Relevant Positions of Those Interviewed

Fred Argy
Treasury officer, seconded to be Secretary of the Campbell Committee

Ross Garnaut
Senior Economic Advisor to the Prime Minister 1983-1985

John Hewson
Economic Advisor the Treasurer 1976-78

Barry Hughes
Economic Advisor to the Treasurer 1983-1988

Robert Johnston
Governor, Reserve Bank of Australia 1982-1989

John Langmore
Economic Advisor the Treasurer 1983
MHR (ALP) 1984-1996

John Phillips
Chief Manager (Financial Markets Group), and Adviser, RBA 1983-1987

Ian Sinclair
MHR (National Party) since 1963
Minister for Primary Industries 1975-79
Leader, National Party 1984-89

Ed Visbord
First Assistant Secretary Economic Division, PM&C 1975-79
Deputy Secretary, PM&C 1979-86

Barbara Ward
Advisor to Paul Keating 1979-1985

Notes

1. The only exception was the merger of the Bank of Adelaide and the ANZ Bank in 1979 which was required by the Reserve Bank because of the financial problems being experienced by the Bank of Adelaide (Phillips, 1995).
2. Under the tap system the Reserve Bank still set the price of Treasury bonds.
3. Portfolio controls on savings banks were relaxed in August 1982. The '30/20' rule was abolished in September 1984 and the Liquid and Government Securities (LGS) convention was replaced by Prime Assets Ratio arrangements in May 1985. NBFIs were granted licences to deal in foreign exchange in June 1984.
4. The Reserve Bank altered the time for setting the exchange rate against the US dollar from the beginning of the day to the end of the day; abolished the limits which banks were required to deal in spot US dollars; widened the spread between interbank buying and selling rates; and deregulated the forward exchange market (Phillips, 1984a: 134).

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5. These controls were retained because the government did not want the Australian dollar to develop into an international reserve currency (Phillips, 1984a: 135).
6. Although Hawke's senior economic advisor (Ross Garnaut) was generally opposed to exchange controls, he did not suggest to the Prime Minister that such a question be asked (Garnaut, 1997).
7. The Treasury countered such threats by announcing that the licensing of foreign banks would be done under discretionary authority without reference to Parliament (Pauly, 1987: 63).

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