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THE POLITICS OF BANKING POLICY IN AUSTRALIA: THE WALLIS INQUIRY, THE AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY, AND THE 'FOUR PILLARS' POLICY

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ABSTRACT

The aim of this thesis is to identify, explain and discuss factors leading to the creation of the Wallis Inquiry and the Australian Prudential Regulation Authority (APRA), and the government's adoption of the 'four pillars' policy during the Wallis era (1996-97). The thesis demonstrates that the government set the regulatory policy agenda and controlled the direction of change by pushing its solutions through against all of the then existing key financial regulators and most of the key private sector actors.

The central theoretical conclusions emerging from the empirical inquiry presented in the thesis are threefold. First, the policy network framework (Coleman, 1996) and the three phase adjustment model (Reinicke, 1995) are not very useful explanatory frameworks in the Australian context whereas the governmental agenda setting framework (Kingdon, 1984, 1995) is highly useful for understanding policy process and the three policy outcomes. Specifically, the policy network framework and three phase adjustment model both of which concentrate on the 'power' variables and role of institutions in financial policymaking, fail to appreciate the role that knowledge and actors external to the financial policy community play in policymaking. Second, knowledge about the obsolescence of institutionally based financial regulation and that of the economic and social consequences of bank mergers were highly significant independent variables rather than the power variables (i.e., state capacity and bank power). In particular, the 'twin peaks' model as knowledge about alternative financial

regulatory policy to the then existing institutionally based regulatory arrangements was a powerful change agent. In a similar vein, knowledge about the economic and social consequences of bank mergers (i.e., branch closures, job reductions, and reduced consumer choices) acted as a kind of barrier to the interests of the banks by making the bank merger policy debate 'exoteric' rather than 'esoteric': The merger policy debate was public rather than private, formal rather than informal, and political rather than technical. As a result, the merger policy discussions were not limited to a small number of influential public and private sector institutions. Finally, contrary to the institutional arrangements and the predictions of the state capacity framework in theory and practice which pointed to weak state capacity in financial policymaking, the Australian State guided by the Treasury Department and the Treasurer has been the main steering agent in determining the financial regulatory policy agenda and the direction of policy change in an anticipatory fashion during this period.

STATEMENT OF AUTHORSHIP

This thesis contains no material which has been accepted for any award or any other degree or diploma in any university or other institution. It is affirmed by the candidate that, to the best of his knowledge, the thesis contains no material previously published or written by another person, except where due reference is made in the text of the thesis.

Signed [redacted] Caner Bakir

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LIST OF ACRONYMS AND ABBREVIATIONS

AAPBS	Australian Association of Permanent Building Societies
ABA	Australian Bankers' Association
ACA	Australian Consumers' Association
ACCC	Australian Competition and Consumer Commission
ALP	Australian Labor Party
AFIC	Australian Financial Institutions Commission
AGPS	Australian Government Publishing Service
AMP	Australian Mutual Provident Society
ANZ	Australian and New Zealand Banking Group Ltd
APRA	Australian Prudential Regulation Authority
ASC	Australian Securities Commission
ASIC	Australian Securities Investment Commission
Banking Act	*Banking Act 1959*
BCA	Business Council of Australia
BIS	Bank for International Settlements
CBA	Commonwealth Bank of Australia
CFS	Council of Financial Supervisors
CM	Colonial Mutual Life Assurance Society Limited
EPAC	Economic Planning and Advisory Commission
FSI	Financial System Inquiry
FSU	Finance Sector Union of Australia
IAIS	International Association of Insurance Supervisors
IMF	International Monetary Fund
IOSCO	International Organisation of Securities Commissions
ISC	Insurance and Superannuation Commission
N	Number
NAB	National Australia Bank
NBFI	Non-bank Financial Institution
NFF	National Farmers' Federation
NM	National Mutual Holdings Limited
NSW	New South Wales
NSWFA	New South Wales Farmers' Association
OECD	Organisation for Economic Co-operation and Development
PFE	Public Financial Enterprise
RBA	Reserve Bank of Australia
SSA	State Supervisory Authority
TPA	*Trade Practices Act 1974*
US	United States
UK	United Kingdom
WBC	Westpac Banking Corporation

CHAPTER ONE

INTRODUCTION

1.1 Scope of the study

In 1996, Australia was one of the few countries to have reviewed its financial system when there was no crisis and the existing regulatory system was apparently working well. The Financial System Inquiry (hereafter referred to as the Wallis Inquiry) was established on 30 May 1996 by the Howard coalition government to review the financial system in Australia. Following the Inquiry, Australia's focus on institutionally based regulatory arrangements shifted towards a functionally based regime[1] with two new prudential[2] and disclosure[3] regulators (one for institutions and one for markets). Why the government established the Inquiry and what role the Inquiry played in financial policymaking will be the key questions to be addressed first in the thesis. Such an analysis will also be preparatory to a contextualisation and examination of the Inquiry's two significant

[1] There are two conceptual approaches to financial regulation and supervision: the institutional versus functional dichotomy (Hogan and Sharpe 1987, Hogan, 1997; Mayer, 1997; Valantine, 1997). Functional regulation treats all providers of functionally equivalent products or services equivalently. The nature of financial products is important in functionally based financial regulation. There are two categories of products: those which involve a binding contract on the part of the institution offering the product that will not fall in value (e.g., deposits) and those investment products where the investor bears the risk not the institution (e.g., managed funds). The first refers to prudential regulation while the second refers to the prevention of individual risks enforced by disclosure regulation. On the other hand, institutional regulation treats all similar institutions similarly. The Australian financial regulatory system shifted from institutional (i.e., institution specific) to functional (i.e., product specific) regulation after the Wallis Inquiry (see Thompson, 1998, 1999; Thompson and Gray, 1999). For historical evolution of institutional regulation in Australia, see Thomson and Abbott (2000); for a comprehensive treatment of prudential regulation in Australia before the Wallis Inquiry, see EPAC (1991); FSI Discussion Paper (1996, Appendix C).

[2] Prudential supervision aims to ensure the soundness of deposit-taking financial institutions through supervising their risk-taking.

[3] Disclosure supervision is to do with consumer protection rules which aim to ensure that retail customers have adequate information and are treated fairly.

policy outcomes: the establishment of the Australian Prudential Regulation Authority (APRA) –a single agency responsible for prudential regulation of the deposit-taking institutions (e.g., banks, building societies, credit unions, insurance companies, and superannuation funds), and the introduction of the 'four pillars' policy –the government ban on in-market mergers among the four biggest banks, the National Australia Bank (NAB), Westpac Banking Corporation (WBC), Australian and New Zealand Banking Group (ANZ) and the Commonwealth Bank of Australia (CBA).

Accordingly, the subject matter of the thesis is three case studies of the politics of banking policy in Australia during the Wallis era (1996-97). The subjects covered in the case studies include the creation of the Wallis Inquiry and the APRA, and the adoption of the 'four pillars' policy. These policy outcomes are the three dependent variables of the thesis.[4] Through backward looking research, the study will investigate how and why these policy outcomes occurred. In doing so, th thesis examines a critical component of the domestic political economy: the Australian financial system. By analysing the agenda setting process and the policy debate, the thesis identifies key actors involved in the policymaking process, analyses their vested interests, and the coalitions that form around 'who gets what' as well as conflicts over the distribution of political and economic power among key public and private sector (or societal) actors.

[4] Dependent and independent variables are the concepts used by scientists in performing an investigation. Goel (1988, p.8) defines term 'variable' as "property that varies." Dependent variable is a variable which changes in response to changes in the independent variable.

The remainder of this chapter is divided into three sections. The importance of the research will be discussed in the first section. The major concepts, theoretical frameworks and their assumptions as well as the major research questions and the research proposal will be introduced in section two. The organisation of the thesis will be outlined in the third section.

1.2 The Significance of the Research

The Australian financial system has been studied extensively by finance and economics academics, and finance journalists (see, for example, Felmingham and Coleman, 1995; Edey and Gray, 1996; Edey, 1996; Lewis and Wallace, 1997; Drake, 1997; Carew, 1998; Kent and Debelle, 1999; Brouwer, 1999; Gizycki and Lowe, 2000). However, contemporary aspects of the politics of banking in Australia have not been sufficiently studied by political scientists. To illustrate, Australian politics and public policy literature exclude in depth analyses of banking policy outcomes (for example, see Bell and Wanna, 1992; Capling and Gallingan, 1992; Corbett, 1996; Head and Bell, 1994; Woodward et al. 1997; Fenna, 1998).[5] Governmental financial system inquiries in Australia are also significant because of the past reforms which resulted from their recommendations (Lewis, 1997; Harper, 2000). More interestingly, the role of

[5] There are also some liberal and radical studies of Australia's foreign investment policy in 1970s and 1980s which partly referred to the banking sector (for the former, see Kasper, 1984; for the latter, see Crough and Weelwright, 1981). The history of the relations between the Australian Labor Party and banking community before the Campbell Inquiry can be considered as historical background in Australian banking politics, see May (1968); Love (1974). For a study of Australian banking politics between 1960 and 1980 as a process of class formation and conflict from a Marxist perspective, see Tsokhas (1984, ch.4).

such inquiries in government and business relations in Australia, and the setting of agendas are completely neglected research areas of Australian public policy research (see Stewart, 1994; 1999; Warhurst, 1997, Fenna, 1998). This thesis aims to fill these gaps in the Australian political science and public policy literature.

It is possible to see a simplistic and over generalised treatment of banking politics which is contracted to professionals in banking. For example, Dixon and Mara (1994) from National Australia Bank Limited, provided a descriptive account of banking politics in a book titled *Government and Business Relations in Australia* (Stewart *eds.*, 1994). Their understanding of 'policy dynamics' is limited to two interest intermediation institutions which in fact have no significant role in Australia's financial policymaking in the 1990s, namely the Australian Bankers' Association (ABA) and the Business Council of Australia (BCA).[6] In addition, Dixon and Mara (1994) conclude that:

> To some, banks are ogres wielding enormous *economic power* and *influence* while to others, banks are merely the *messengers* of government policy. The latter, while obviously simplistic, is closer to the truth. (p.284, my italics)[7]

However, what is meant by the terms "economic power" and "influence" of banks is not explored.[8] The dimensions of power – power 'over,' or power 'to do ......t,'

[6] The thesis will show in Chapter eight that the ABA was not a key player pressuring for the industry, and the BCA did not play a significant role in financial policymaking during the Wallis era.

[7] This conclusion reminds what Don Price said some time ago: "What you stand [for] depends on where you sit" (quoted in Moran, 1984, p.47).

[8] Murray et al. (1995) in *Current Sociology*, aim to provide the assessment of corporate power in Australia. They also refer to the financial industry. However, their assessment is based on the interpretation of such indicators as sectoral distribution of earnings, wealth of the top Australian corporate individuals and families, balance sheet statistics and so on. In other words, their study, apart from being descriptive, does not address the economic and political power potential of the corporations. For excellent frameworks for the assessment of the political and economic power potential of financial firms and their regulators, see Coleman (1996, chs.1-4).

etc. are not addressed. In addition, Dixon and Mara's account, summarised above, is far from being accurate.

It is argued (Atkinson and Coleman, 1989a,b, 1992; Coleman, 1996) that there are two main approaches to industrial policy: anticipatory and reactive. Anticipatory policies aim to promote a change in industry and to help industry to adjust to emerging challenges posed by competitive pressures via government intervention (Coleman, 1996, ch.4). Strong states can adopt anticipatory policies by intervening in markets to promote industrial change and to help industry to adapt to competitive pressures.[9] On the other hand, weak states are assumed to adopt reactive policies that are basically responses to political pressure from business. It is generally held that the Australian State cannot make policies in an anticipatory fashion because the State and business are fragmented. For Head and Bell (1994, p.60) and Bell (1993, 1997a,b), only in rare instances where there are alliances between the State and powerful interests, can anticipatory or proactive policies be observed in Australia. Their account confirms Atkinson and Coleman's (1989a, p.60) previous thesis about Australia that "the most common arrangement involves a reactive approach to industrial policy and a pressure pluralist network." Conversely, according to Capling and Galligan, "the state has always been the main steering agent in Australia's political economy" (Capling

[9] In this thesis, the term state or the nation state is frequently used synonymously with the concept of the government. The context should make it clear whether the reference is to an elected government, or to the distinct state institutions.

and Galligan, 1992, p.3). Pusey (1991), like Capling and Galligan, also provide a state-centric account of Australian policymaking arguing that; centralised state bureaucracies (the Treasury, Finance, and Prime Minister and Cabinet departments) drive the Australian State's actions. For Pauly (1988, p.154), the Australian State appeared "relatively stronger" in comparison to the US and Canada in financial regulation in the 1980s. Critical theoretical questions emerging from these discussions for the rest of the thesis are as follows: Was the Australian State the main steering agent during the Wallis era? Was it strong enough in the financial services industry to follow anticipatory policies? Or, did Australia adapt a reactionary financial regulatory policy? Or, was it a weak State acting strong during the Wallis era due to its coalition with strong economic interests? Did the Treasury bureaucrats drive the State's actions?

For Peter Drucker (1989), finance is the 'driving force' and the 'fly-wheel' for the rest of the market economy. According to John Zysman (1983, p.308), the financial services industry is "the eyes and hands of the state's industrial brain." Accordingly, the financial industry plays a leading role in the economic growth and development of countries in the world. Australia is no exception. Any government "has always been much more concerned about who was providing credit, and in what form, on what terms, simply because this affected not just one sector of the economy but all of them, and was also much more open to abuses of partiality or fraud" (Strange, 1998, p.27). If "finance calls the tune" (Cerny, 1993, p.4) and "the real economy dances to the fast or slow rhythms of financial markets" (Strange, 1998, p.180), why, then, was it that in depth analyses (e.g., case studies) of the contemporary aspects of politics of banking has been largely ignored by the Australian politics and public policy literature? The blame for this neglect lies mainly with the academics working in these fields. Susan Strange's general critique of political scientists is relevant in this context:

> And as for political scientists and other social scientists, their interest in, and understanding of, the niceties of all financial matters is so limited that even when these innovations [technical and technological innovations in finance] are seen by financial journalists and practitioners to have fundamental political and social significance, only a few academics have been able to share this important perception. (Strange, 1998, p.29)

1.3 Theoretical Frameworks and Research Questions

The thesis employs the explanatory case study method. The explanatory case study approach is required by the research because 'how' and 'why' questions are posed; the researcher has no control over events; and the focus is contemporary phenomenon within a real-life context. The theoretical explanations are provided through linking real life situations to theoretical discussions and ordering the data chronologically.

Radaelli observed that "[m]ore recently, scholars have emphasised the role of knowledge and in so doing treat the concepts of 'power' and 'knowledge' as *opposites*, in order to outline different approaches to the study of the policy process" (Radaelli, 1995, p.160). Accordingly, the thesis refers to both 'power' and 'knowledge' variables in the analysis of the policy process and the policy outcomes.

Yin (1994, 1997) suggests that the case studies are used to *test rival theories and their propositions* in order to arrive at analytic generalisations.

Accordingly, alternative explanations of the policy outcomes suggested by relevant theoretical frameworks are also examined. What will be the rival theories of this thesis? Specifically, the policy network framework (Coleman, 1996) and the three phase adjustment model (Reinicke, 1995) are representatives of models based on a 'power perspective' whereas the governmental agenda setting framework (Kingdon, 1984, 1995) is based on a 'knowledge perspective' of the policy process. Policy research is interdisciplinary (Heclo, 1972, Yin, 1994, Scharpf, 1997). Accordingly, the thesis prefers these frameworks, since they transcend rather than reproduce the boundaries set by academic disciplines. The explanatory power of the thesis will be increased in the testing of these three competing theories.

Policy network analysis as a typology of interest intermediation has become a dominant paradigm for the study of public policy in order to assess national policymaking from a domestic point of view at the sectoral level in the government–industry relations literature (see, for example, Wilks and Wright, 1987; Atkinson and Coleman, 1989a; Smith, 1993; Coleman, 1996; Rhodes, 1997; Marsh, 1998).[10] The 'policy network' and 'policy community' constitute

[10] Borzel (1998, p.255) groups policy networks literature into two broad categories: 'interest intermediation school' which ("interprets policy networks as a generic term for different forms of relationships between interest groups and the state") and 'governance school' ("as a mechanism of mobilising political resources in situations where these resources are widely dispersed between public and private actors"). To illustrate briefly, Coleman (1996), Atkinson and Coleman (1989), and Coleman and Skogstad (1990) mainly used their policy networks framework to analyse policymaking process at the sectoral level from telecommunications to meat processing to textiles to finance. Wilks and Wright (1987), on the other hand, apply their policy networks framework at the sub-national level. Rhodes (1997) has mainly used his policy networks model to analyse intergovernmental relationships between local and national governments. Not surprisingly, there is no agreement in the definition of policy network and community concepts in the public policy literature. This research refers to policy networks literature in the interest intermediation school.

two of the most significant concepts discussed in the literature.The 'policy community' points to key regulators and regulated firms within the boundaries of a specialised policy area. The concept of a 'policy network' refers to a set of relationships linking key public sector actors (regulators) and key private sector actors (regulated groups) within the policy community. These two concepts point to stable relationships and stable memberships where other interests and actors are excluded.[11] Thus, it is assumed that a policy process is limited to a small number of influential public and private sector institutions. In particular, it has been argued that policymaking in financial services is esoteric; private and technical (Moran, 1991; Coleman, 1996). Policy outcomes and the power of the state to adopt an anticipatory policy in policymaking are explained according to the type of policy network dominating an issue. The statement that the policy networks affects policy outcomes is the main argument underlined in the policy network literature (see Coleman, 1996; Daugbjerg, 1998; Thatcher, 1998; Borzel, 1998; Coleman and Perl, 1999). Not surprisingly, the core argument of the network thesis is that "policy change generally took place only when the relevant 'policy community' agreed it was necessary and consensus existed on the direction of

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[11] Policy community and network concepts assume stable membership and stable relationships respectively. As Jordan and Richardson (1982, pp.93-4) argued:

> The logic of negotiation also suggests that policy-makers in both government and groups will share interest in the avoidance of sudden policy change. Working together they will learn what kind of change is feasible and what would so embarrass other members of the 'system' as to be unproductive.

As Richardson (2000, p.1007), in his critique of the policy network approach, recently puts it, "[t]he explicit assumption of stability of relations and stability of actor participation (almost exclusiveness) is evident in most attempts to refine the original policy community and policy network concepts" (see also Maloney and Richardson, 1995).

change" (Richardson, 2000, p. 1006).

The policy network framework emphasises the role of power – "a communication medium through which a power-holder puts limits on the range of actions that might be selected by some other social or political actor" and of institutions in the political process and policy change (Coleman, 1996, p.19). The relationships between organised interests and the state are regarded as the key factors in determining policy network structures. In turn, political processes and sectoral policies are analysed in terms of policy network structures. According to William D. Coleman, there are three critical variables in establishing policy networks at the banking sector level (Coleman, 1996). The first criterion is the degree to which the state bureaucracy is autonomous (i.e., state capacity). It is assumed that:

> The degree of state capacity affects the options available to policymakers when faced with the kinds of rapid change associated with [financial] globalisation. As state capacity increases, policymakers are provided with more latitude to choose whether to follow an anticipatory or a reactive approach to policymaking. (Coleman, 1996, p. 79)

According to this perspective, a policy network dominating the policy area affects a policy outcome.

Following Coleman (1996, ch.4), a framework for the assessment of state capacity in the banking sector will be applied in this thesis. It is assumed that the power and autonomy of the State in relation to societal actors is the defining feature of a political system. Since financial services policies are generally directed by finance ministries, central banks, and regulatory/supervisory agencies, an analysis of the institutional context for the exercise of state power is required.

To do so, Coleman (1996, p.67) proposes two parameters: (1) "When one agency [i.e., Treasury and RBA] clearly dominates the other, the state does not maximise its own power potential and becomes more vulnerable to pressure from societal actors"; (2) "The capacity of states to approach policymaking in an anticipatory fashion will be greater when policymaking responsibilities are confined to a smaller set of actors."

The second criterion is the economic power potential of banks.[12] It is assumed that the banks' economic power potential provides these firms with a considerable potential to exert pressure over government to influence policy outcomes. Thus, following Coleman (1996, ch.2), there are four assumptions guiding the thesis's assessment of the economic power potential of the major banks: (1) universal banks which engage in a wide range of financial services will have a higher potential to influence more of the behaviour of their clients and to increase their overall size than narrow banks or specialist banks (Coleman, 1996, pp.20-7); (2) banks that draw their customer base from divergent classes in society will have a greater power potential than those whose activities tend to be limited to one class or a narrow set of societal groups (Coleman, p.20); (3) banks that have a strong presence in overseas markets may increase their power potential in their bargaining with state (p.32); (4) banks that have strong ownership ties with non-financial firms may influence the behaviour of these

[12] The word "potential" is used here because there is no automatic transfer of a power potential into an exercise of power.

companies and, in turn, may dominate and control the economy which add to their power potential (p.36).

The third criterion is the analysis for the capacity of interest intermediation systems to translate economic power into political power. Coleman (1996, ch.3) offers four parameters for the analysis of organisational power: (1) the degree of competition among associations for members; (2) The internal resources of associations; (3) The presence of horizontal linkages between associations; (4) The level of vertical integration in the associational systems. However, organised interest groups are not the only venues where banks' economic power is translated into political power. As Coleman (1996, p.48) states, "[e]lite networking, policy specialists and government relations divisions…constitute one means by which financial services firms may translate their power potential into the exercise of power." The thesis will examine whether the major banks exercised political influence collectively through the Australian Bankers' Association (ABA) or individually.

The second theoretical model to be utilised in the thesis will be the 'three phase adjustment model' devised by Wolfgang H. Reinicke (1995). The purpose of the model "is to account for divergence in policy responses and results among individual countries, in light of increasing international economic integration *and* to understand why and how these responses change over time" (Reinicke, 1995, pp.1-2, original emphasis). Thus, it is reasonable to use the framework in the Australian context. The model is composed of mobilisation, conflict and resolution phases. There are three main assumptions corresponding to each of these three phases: (1) key public sector or private sector actors most threatened by a particular challenge will be the first to *mobilise* and pressure for a policy change that redresses their political and/or economic loss; (2) mobilisation of such actors generates a *conflict* with different actors in the same policy community resisting proposed policy change, since it is likely to redistribute benefits and costs; (3) "*Resolution* is achieved when the institutions initially disadvantaged by the external economic shock succeed in introducing policy responses which redress their loss in economic and/or political power" (Reinicke, 1995, p.18, my emphasis). Accordingly, the basic premise of the model is that financial policy agendas are set and policy changes are generated by a reactive response of the financial policy community.

The third theoretical tool to be employed in the thesis is the 'governmental agenda setting framework' developed by John Kingdon (1984, 1995). Kingdon offered the framework as a means of understanding agenda setting in government and policy change. It is assumed that policy change is the result of the role of individuals and knowledge rather than the outcome of structural circumstances. For Kingdon, the governmental (or political) agenda is composed of three independent processes: problems, policies, and politics (Kingdon, 1995, pp.16-8). Problems may come to the fore, for example, due to crisis, feedback, or interest groups. Policies refer to "a process of gradual accumulation of *knowledge* and perspectives among the specialists in a given policy area, and the generation of policy proposals by such specialists" (Kingdon, p.17, my emphasis). Politics refers to recognition of problems due to a change in national mood, government, interest group behaviour etc. It is assumed that knowledge plays a significant role in recognising problems and generating solutions (Kingdon, 1984,1995). And policy change occurs when influential individuals (i.e., 'policy entrepreneurs') can 'couple' problems, policies, and politics. However, according to Kingdon (1984, 1995), this is possible only when a short run opportunity (i.e., 'policy window') is opened for entrepreneurs to push certain policies, solutions, or just bring attention to a particular problem.

Accordingly, the thesis will work through two power dependent frameworks –the policy network framework (Coleman 1996) and the three phase adjustment model (Reinicke, 1995)– as competing models against the governmental agenda setting framework (Kingdon, 1984, 1995), both of which emphasise the role of power and institutions rather than that of knowledge and individuals in the policy process. In particular, both the policy network framework and the three phase adjustment model concentrate on the 'power' variables and the role of institutions in financial policymaking. They emphasise the economic and political power of the institutional actors and their relationships in explaining the policy process and change. They also focus on the characteristics of processes where many of the actors are organisations rather than individuals, representing an institution and acting on its behalf. Both assume that policy change emanates from the policy community. Both argue that policy change generally takes place only when key regulators and regulated firms in a policy domain agree it is necessary and a consensus exists on the direction of change; and the new policy ideas emanate from a policy community. On the other hand, the governmental agenda setting framework emphasises the role of knowledge –"[a] well-probed belief, whether empirical or evaluative" (Lindblom, 1990, p.123)– and individuals (i.e., policy entrepreneurs) in the policymaking process rather than that of power and institutional arrangements. Knowledge can take many forms. It is not just information but ideas, interpretation, judgement and understanding. In the field of public policymaking, knowledge derived from experience is also important (for the significance of knowledge in the investigation of policy process, see Radaelli, 1995, 1997; Kingdon, 1984, 1995; Sabatier, 1988, 1998).

The origins and the consequences of policy debate and policy outcomes in the thesis are analysed by examining the evolution of the policymaking process with special reference to these rival explanations. In doing so, the strengths and weaknesses of these frameworks are tested against empirical evidence of the case studies in the Australian context. From this perspective, the main question guiding the investigation is why and how the Wallis Inquiry and the APRA were created and the government came to adopt the 'four pillars' policy.

Although these research questions express the analytical interests of the investigation, they do not point to its direction. As Goel (1988) notes, "[s]cientific explanations are statements about relationships between independent and dependent variables" and "studies of social and political phenomena require the assessment of the effects of several independent variables on a dependent variable" (p.10). Thus, following the research questions, a theoretical proposition (hypothesis) about causal relations – answers to the 'why' and 'how' questions –

that led to the policy outcomes should be defined. It is suspected that the policy outcomes examined occurred due to knowledge about social and economic consequences of bank mergers, and knowledge about obsolescence of institutionally based prudential regulation rather than the power of key private sector actors and their regulators. This proposition helps to focus attention on data relevant to 'knowledge' and 'power' variables. However, one should note that since the context is the major part of this research, the study would likely have more independent variables than the study proposal points out. This is also one of the features of policy research (Yin, 1994, 1997; Scharpf, 1997). Accordingly, case studies may offer additional independent variables that are highly relevant to the policy outcomes.

To sum up, the concepts of 'power,' 'policy community,' 'policy network,' 'policy entrepreneur,' 'policy window,' and 'knowledge' are frequently used and discussed throughout this study in order to point to theoretical issues. In turn, the explanatory capabilities of 'power' variables (i.e., state power and bank power), propositions used in the adjustment model and the policy network framework, as well as the 'knowledge' variables and assumptions of the agenda setting framework are tested against empirical evidence. Consequently, if one explanation is to be valid, the others cannot be. Specifically, the presence of 'knowledge' as an independent variable (predicted by this study) should preclude the presence of 'power' as an independent variable (predicted by the three phase adjustment model and policy network framework). In this perspective, as Yin (1994, pp.108-9) puts it, "the successful matching of the pattern to one of the rival explanations would be evidence for concluding that this explanation was the correct one (and that other explanations were incorrect)." In doing so, the investigation will be internally validated.

1.4 Organisation of the Study

Clearly, the financial regulatory changes that came with the establishment of the Inquiry, the creation of the APRA, and the government's 'four pillars' policy that followed the Inquiry were the significant financial policy outcomes in contemporary Australian financial politics. It is the purpose of this study to analyse why and how these outcomes occurred. In order to carry out such an analysis, Chapter two provides a theoretical discussion for examining the process of domestic policy change. In doing so, it draws mainly from public and private theories of regulation, policy network literature, the three phase adjustment model and the agenda setting process that examines the politics of domestic policy change. Chapter three explains why and how the case study method is adopted in the thesis. Chapter four is divided into two main parts. The first part provides the necessary historical background and a brief analysis of the regulatory structure of the Australian financial system before the Wallis Inquiry, with special reference to the Australian State's capacity in financial policymaking. The second part of the chapter reviews the bank merger regulations in Australia before the Inquiry. Chapter five aims to understand why and how the Wallis Inquiry was established and its role in the government–business relations. Chapter six, which focuses on the APRA case, breaks down the regulatory policy preferences of the banking policy community to test the state capacity framework in practice. Chapter seven provides the assessment of the four major banks' economic power potential, that may have affected who got what in the bargaining relationship with the Australian government during the Wallis period. Chapter eight analyses the economic power potential of the major banks over the Liberal Party and how they translated this potential into exercise of political power influencing the merger policy outcome, and why they failed. Chapter nine is the conclusion. It summarises the three case studies and considers the theoretical, analytical, and policy lessons that can be gleaned from them.

CHAPTER TWO

THE POLITICS OF FINANCIAL POLICY CHANGE: CURRENT THEORETICAL FRAMEWORKS

2.1 Introduction

It has been indicated in the introductory chapter that the subject matter of the thesis is the three case analyses of the politics of banking policy in Australia. The subjects covered in the cases include establishment of the Wallis Inquiry, the Australian Prudential Regulation Authority and the government ban on in-market mergers among the four biggest banks: the 'four pillars' policy.

This chapter will discuss the main concepts, theories, theorists, and methodological approaches relevant to the research topic. In other words, what follows is not a definitive survey but rather an attempt to explicate some of the most important theoretical aspects that have relevance to this study. In doing so, it aims to justify the topic. A methodological rationalisation of the research necessitates understanding the history of the topic. As Hart (1998) suggests: "History is the assumptions and definitions other researchers have employed to the study of topic" (p.173). He argues that "chronological narrative is the most common arrangement for presenting the methodological story [of] how the topic was defined, established and developed" (p.173). With this perspective, this chapter provides a chronological review of literature which specifically deals with politics of policy change in the financial services industry in a world of global finance. Such a review has one main feature: theoretical approaches to the public policy analysis are reviewed with special references to relevant contemporary literature on Australian banking politics. In doing so, this chapter aims to present theoretical questions to be investigated empirically in this study.

The chapter is divided into five sections. The first section describes 'private interest' and 'public interest' theories of regulation in economics literature with particular emphasis on their application to Australian financial politics in the 1980s. The second section introduces and discusses policy network frameworks with special reference to the Australian debate. Section three critically reviews the three phase adjustment model. Section four briefly refers to the governmental agenda setting framework because it will also be introduced along with the empirical evidence in Chapter five. The conclusion summarises the major points justifying the topic and methodological approaches employed in the thesis.

2.2 Economic Approaches to Regulation: Public and Private Interests

The *Routledge Dictionary of Economics* (Rutherford, 1995) defines regulation as "partial or complete intervention in the economic decision-making of a firm or other economic institution by a government or one of its agencies" (p.389). The justifications for an economic and financial regulation are market failures (the malfunctioning of a market due to imperfections in it such as the inadequate and unequal information available to market participants), externalities and the lack of a market for a particular good or services (e.g., public goods).[1] According to the 'public interest' view, regulations exist to correct market failures

[1] For main texts on economic and financial regulation, see Stigler (1971); Bailey (1987); Kahn (1988); Utton (1986); for a positive political economy analysis of financial regulation, see Kroszner and Strahan (1997, 2000).

and consumer protection. This approach is often called 'public interest theory' of regulation because regulatory intervention occurs primarily to maximise the economic well-being of a society as a whole, or to maximise social welfare (Joskow and Noll, 1981). Investor and consumer protection through, for example, prudential and disclosure regulation are some of the major rationales given for public intervention into the markets (Stigler, 1971; Bailey, 1987). Kroszner and Strahan (2000, p.4) also emphasised that "[a] public interest argument is often used to mask the private interests that the intervention serves."[2]

The 'private interest theory' of regulation views the regulatory process as one of interest group competition: regulatory or deregulatory policy outcomes are seen to result from the political power exercised by well organised groups in the face of ineffective and more dispersed groups (Stigler, 1971; Peltzman, 1976, 1989). In other words, the private interest theory of regulation understands the regulatory process as one in which well-organised interest groups use the political power of the government to capture rents at the expense of more diverse groups. According to this theory, regulated groups may be sufficiently powerful that they influence the regulatory bureaucracy to serve their own interest. They 'capture' the regulators. Hence the name 'capture theory' of regulation (see Stigler, 1971; Peltzman, 1976, 1989; Becker, 1983). Thus the power of interest organisations provides a key to understanding policy changes. It is assumed that "regulated

[2] Kroszner and Strahan identify key challenges to the public interest theory:

> Many forms of regulation are hard to understand from a welfare-maximising point of view. Entry restrictions that protect banks or other financial institutions from competition, portfolio restrictions that hinder diversification, deposit insurance systems that exacerbate moral hazard problems, and geographic restrictions that have prevented expansion within a country or across national borders are generally difficult to rationalise on public interest grounds. (Kroszner and Strahan, 2000, p.4)

groups may be sufficiently powerful that they influence the politicians and the regulatory bureaucracy to serve primarily the interests of those subject to regulation" (Kroszner and Strahan, 2000, p.4).[3]

Kroszner (1998, p.4) argues that public and private interest theories are not necessarily mutually exclusive nor exhaustive, "they do have different implications for regulatory reform" (see also Kroszner and Strahan, 1997). Ian Harper (1986), an eminent Australian professor of finance, in his seminal article had already analysed the Australian deregulation in the early 1980s by referring to 'public interest' and 'private interest' theories of regulation. He explained why Australia's financial markets have been deregulated and deregulation has occurred so quickly. He showed that the regulators and the regulated firms jointly realised that the regulation no longer served their respective ends. This led to the rapid demise of the regulations. In particular, Harper (1986) argued that economic changes (higher levels of inflation and government budget deficits, technological changes in finance) and increasing integration of domestic and international financial markets together shifted public and private actors' perceptions of the regulatory structure at the time. In turn, the rapid demise of financial regulation following the Campbell Inquiry in the 1980s "can be traced to the joint realisation by the monetary authorities and the regulated institutions that the regulations no longer served their respective ends" (Harper, 1986, p.37). Harper claimed that "This conjunction of 'public interest' and 'private interest' in financial deregula-

[3] I would like to thank Michael T. Skully for pointing to the theories of regulation in the economics literature.

tion can in turn be traced to the unique ability of financial markets to generate close substitutes for existing financial products at low cost" (Harper, p.37). According to Harper,

> [t]he fundamental lesson of the Australian experience of financial deregulation is the crucial role of substitution. The common factor leading to the disenchantment of both public and private interests with the system of financial regulations was the incentive it gave for evasion through the growth of substitute financial products and services [via financial innovation]. (p.47)

It will be interesting to examine whether a move towards functionally based regulatory arrangements with new regulators was due to a joint realisation of key regulatory authorities (public sector actors) and key regulated institutions (private sector actors) during the Wallis era (see Chapters five and six for the analysis of this issue).

2.3 Policy Network Framework

Scholars working in the field of comparative public policy (CPP) have studied domestic political responses to external economic shocks in terms of the characteristics of national policy network (Katzenstein, 1978; Zysman, 1983; Coleman, 1996).[4] Their purpose is to explain cross-national differences in policy responses to a common external shock (for example, see Katzenstein, 1978; Zysman, 1983; Atkinson and Coleman, 1989a; Coleman, 1996). From this perspective, Peter Katzenstein (1978, pp.11,13) first introduced the concept of 'policy network' as a set of relationships linking public actors (decision-makers) and private actors (interest groups) in the formulation of public policy. The main

[4] For excellent reviews of policy networks literature, see Borzel (1998) and Thatcher (1998).

purpose of Katzenstein is to use the 'policy network' concept for the comparison of national political systems. According to Katzenstein, the policy network reflects the structure of the state and society.[5] And, the degree of centralisation in society and in the state, and the degree of differentiation between the two, are the critical variables in the establishment of a policy network. Katzenstein (1978) makes a strong state and weak state distinction. He argues that the more centralised a state, the stronger it is *vis a vis* organised societal interests; and the stronger the state, the more it can intervene in a nation's industrial sectors. Centralisation refers to the degree to which decision making power is concentrated in the hands of a relatively small number of officials. And differentiation refers to the degree to which these officials act autonomously from societal interests (Katzenstein, p.323). Once these two are determined, the policy network could be identified and "the range and type of policy instruments likely to be associated with such a network could be established" (Atkinson and Coleman, 1989a, p.50).

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[5]Rhodes's point can be regarded as a representative of the policy network analysis: "[t]he policy network approach is a modern variant of the institutional approaches to politics...[it] focuses on institutions, the links between them and behaviour within institutional contexts" (Rhodes, 1997, p.12, see especially ch.4). The literature, known as new institutionalism, also focuses on the policy responses of an individual country to external economic pressures (see March and Olsen, 1984 and 1989; Hall, 1986). Reinicke (1995), in his discussion of current theoretical frameworks, refers to comparative political economy (or comparative public policy) and new institutionalism literature separately before introducing his adjustment model. Since Reinicke fails to refer to policy network analysis in public policy literature, he could not recognise the fact that policy network and policy community concepts have been developed to describe state and interest groups behaviours in contemporary societies by emphasising their institutional characters. There are two consequences drawn from this point for the rest of the chapter: First, this chapter intentionally disregards literature on the new institutionalism. Second, it discusses policy network analysis, since it is an institutionalist approach emphasising a patterned interaction of institutions among themselves (see, for example, Rhodes 1988; Marsh and Rhodes, 1992; Atkinson and Coleman 1989a,b; Coleman and Skogstad, 1990; Coleman 1996; Rhodes 1997, especially ch. 4; Marsh, 1998; Marsh and Smith, 2000). The thesis will give special emphasis to Coleman's work on policy network, since it is the eminent and typical example of the policy network analysis in financial services industry.

Katzenstein's formulation represents a macro-level conceptualisation of a policy network. In other words, it provides macro-level analysis concerning the broader structures and processes of government within which a network operates (see Katzenstein, 1978, ch.9). Accordingly, a change in a policy network is defined in terms of broad macro-structural transformations such as a major shift in the state capacity or a major change in relations between societal and state actors due to broad social, historical or economic changes or ideological shifts in government (see, for example, Katzenstein, 1978, pp.323-9; Marsh and Rhodes, 1992, pp.257-61).[6] Katzenstein's work is significant because it focuses on the distinction between state and society and the distinct policy network within each state in order to assess the power of the state to facilitate; to lead or participate in the process of industrial adaptation and economic growth.

Katzenstein's strong state and weak state discussion was apparently influential over Louis Pauly (1988), a Canadian international political economist, who discussed the political economic story of foreign bank entry into Australia in connection with a larger comparative work on the politics of bank regulation in the United States (US), Japan, Canada, and Australia. Pauly illustrated how the interplay of domestic and international pressures from government and business, working differently in each country, has moved international banking toward somewhat common standards.

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[6] As Katzestein wrote sometime ago:

> The contemporary structures of advanced industrial states are rooted in some of the major historical transformations of the past: the elimination of feudalism, the unfolding of the industrial revolution, and the building of the modern state. Except in the most extreme circumstances, negotiations on current issues in the international political economy will probably reflect, rather than reshape, these historically-evolved domestic structures. (Katzenstein, 1978, pp.323-4)

In regard to the Australian case, Pauly (1988) argues that the Australian Labor Party (ALP) opened the Australian banking market to foreign competition because:

> ... it adopted the bankers' agenda: deregulation, internationalisation, and financial liberalisation. And it did so willingly, under the banner of economic growth, competition, and market solutions. (p.119)

In Pauly's view (1988, p.154), Australia, together with Japan, "had the most centralised public sectors with respect to financial regulation." Therefore, "governmental influences also predominated in debates over reform [opening Australia's domestic banking markets to foreign-owned institutions in the 1980s]." Accordingly, the Australian State appeared "relatively stronger" (Pauly, p.154).[7] In this instance, Pauly basically follows Katzenstein's (1978, p.323) formulation that strong states can intervene in markets. Furthermore, the domestic policy debate was not vulnerable to external pressures because "geographical distance...appeared relatively more impervious to outside influences...respective debates on foreign bank access were therefore more obviously dominated by domestic interests" (Pauly, 1988, p.154). The thesis will examine Pauly's (1987, 1988) notion that whether the Australian State was as strong in the banking sector in the 1990s as it had been in the 1980s.

Katzenstein's strong-weak state distinction has been criticised for being simplistic on the grounds that it does not reflect "complex reality" (Atkinson and

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[7] Based on comparative analysis, he argues that:

> A global village does not spontaneously spring up; it must be created. Politics within distinct state structures remains the axis around which international finance revolves...states remained the central actors in the real global village. (Pauly, 1988, pp.2,7)

Coleman, 1989a, pp. 50-1; Zysman, 1983; Wilks and Wright, 1987, pp.281-5). John Zysman (1983), for example, claims that the strong and weak state notion is too aggregate; its synthesis is too generalised and static. Michael Atkinson and William D. Coleman (1989a), eminent Canadian scholars of comparative public policy, argue that:

> Determining just what constitutes centralisation and differentiation is difficult in the abstract and is rendered only slightly more tractable by comparing nations ... more complicated patterns of centralisation and differentiation are likely to emerge on closer examination of particular sectors. (pp.50-1)

Therefore, Atkinson and Coleman (1989a,b) provide a modification and expansion of Katzenstein's formulation in order to reach a meso-level analysis that deals with the pattern of interest group intermediation at the sectoral level.[8] It is the view of Atkinson and Coleman that key sectoral actors and bureaucratic agencies "form the core of 'policy network' at sectoral level" (Atkinson and Coleman, 1989a, p.47). Following Katzenstein (1978), they claim that "[t]he amount of centralisation in society and in the state, and the degree of differentiation between the two were the critical variables in the establishment of policy network" (p.50).

Atkinson and Coleman (1989a,b) develop network typologies to link the 'structural' features of state, society and policymaking. They argued that the type of state capacity and degree of societal mobilisation determines the category of policy network which shapes (or determines) a policy outcome (Atkinson and

[8] The difference between the comparative and domestic public policy studies is found in their central analytical focus. The former is concerned with the cross-country differences in the policy response to a common external shock (i.e., globalisation of finance) while the latter focuses on the nature of relationships between state and societal actors in order to understand the type of sectoral policies.

Coleman, 1989a,b; Coleman, 1996). They aim to describe relationships in particular policy areas that will assist in understanding policy processes and policy outcomes. In order to do so, they use 'state capacity' and 'societal mobilisation' as two different dimensions to identify six *ideal* typologies of policy network at the sectoral level.[9]

First, state capacity is conceptualised in terms of autonomy (degree to which ultimate decision-making power is concentrated in the hands of a relatively small number of officials) and concentration of power (degree to which these officials act autonomously from societal organisations determine state capacity). Following Zysman (1983, p.300), they argue that "the more centralised, autonomous and elitist a state bureaucracy and its administrative core, the greater this [state] capacity" (Atkinson and Coleman, 1989a, p.52). Second, the capacity to mobilise the interests of employers is also regarded as a critical variable in the policy network as it "will help to determine whether and in what way major socio-economic producer groups can make a contribution to policy development and implementation" (p.54). As shown below in Table 2.1 (p.29), these two dimensions are used to establish six types of policy network: corporatism, concentration, state-directed, and different types of pluralist network: parentela pluralism, clientele pluralism and pressure pluralism (Atkinson and Coleman, 1989b, pp.82-94).

[9] Capacity of interest organisations to transform economic power into political power are assessed to analyse business power. Features of state and business power are used to identify the policy network dominating a sector. In doing so, network theorists explain policy outcomes by these network characteristics. However, as will be detailed later, the assessment of the Australian Bankers' Association's power is not relevant in the Australian context because it is not a significant interest organisation in financial policymaking.

Table 2.1 Conditioning Factors for Policy Network

Mobilisation of business interests	State Structure			
	High autonomy, high concentration	Low autonomy, high concentration	High autonomy, low concentration	Low autonomy, low concentration
Low	State-directed	Pressure Pluralism	Pressure Pluralism	Parantela Pluralism
High	Concentration	Clientele Pluralism	Corporatism	Industry dominant Pressure Pluralism

Source: Atkinson and Coleman (1989a, p.54).

Atkinson and Coleman (1989a) claim that "the nature of industrial policy employed in a sector is closely linked to the character of the policy network" (p.60). They show how different policy networks emerge to support alternative industrial approaches and how a disjunction between network and approaches can produce a policy failure. To do so, they primarily concentrate on the types of policy network and the patterns of interaction between them. Accordingly, they distinguish between two approaches to industrial policy: anticipatory and reactive (Atkinson and Coleman, 1989a, p.60).[10] For Atkinson and Coleman (1989a,b), pluralist networks cannot proactively respond to the policy demand of industry sectors. They argue that state-directed, corporatist, clientele pluralist or concertation policy networks are able to deal with anticipatory, long-term policies (Atkinson and Coleman, 1989a,b).

According to Atkinson and Coleman, Australia most commonly adapts reactive industrial policy as a response to political pressure from business:

> The nature of industrial policy employed in a sector is closely linked to the character of the policy network. In the United States, Britain, Canada, Australia and New Zealand, the most common arrangement involves a *reactive approach to industrial policy and a pressure pluralist network.* Even at sectoral level,

[10] These concepts have already been introduced in Chapter one, sections 1.2 and 1.3.

> where business organisation is often mobilised and state structure more variable, the state is predisposed to leave business alone. *Policies are responses to political pressure from business.* They tend to be *ad hoc*, uncoordinated with previous decisions, and oriented almost entirely to the short term. Other than discussions about specific, short-term problems, the state administration requires little from business and business makes few demands of the state. (Atkinson and Coleman, 1989a, p.60, emphases added)

However, two Australian political economists, Ann Capling and Brian Galligan (1992, pp.60-2) criticise the Atkinson and Coleman approach and its application to Australia. They argue that Atkinson and Coleman's account has "the conceptual error of overgeneralising the features of policy network" (p.60). Capling and Galligan (1992) further argue that:

> The problem with the Atkinson and Coleman approach, and its application to Australia, is the pluralist bias that puts too much weight on the structure of pressure groups and not enough on the state. In their analysis the state is overly determined by the pressure pluralist network. (p.60)

On the other hand, Capling and Galligan (1992), in referring to their analysis of the manufacturing industry in Australia, argue that "just how wrong this is with respect to Australia is brought out in subsequent chapters which demonstrate the primary role of the state in the establishment, coordination and dismantling of the national policy protection" (p.60). They focus "primarily on the state because [they] see it as the primary focus and instrument of policy change." Contrary to Atkinson and Coleman's view, Capling and Galligan "locate the main source of dynamism not in the fluctuating strength or weakness of business or the organisational coherence of business interest groups but primarily within the political process and the state in its relations with business and interest groups" (pp.61-2).

They also draw attention to the

> conceptual error of overgeneralising the features of policy network from corporatist and statist countries such as the smaller European states and Japan. A strong state does not necessarily require a corresponding concentrated organisation of business groups in order to implement industry policy. In fact, state action may well be a substitute for strong business, as was the case with the 'state socialism' in early Australia. (p.61)

Finally, they conclude, "the state has always been the main steering agent in Australia's political economy" (p.3).

Contrary to Capling and Galligan's (1992) account, Bell (1993) argues that Australia has a relatively weak 'industrial state.' Brian Head and Stephen Bell (1994) also provide a general support for the Atkinson and Coleman (1989a) thesis:

> Instances of strong state coordination or centralisation are rare in Australian experience. The fragmentation of the Australian state further limits the degree of state autonomy from important economic interests and limits the capacity to implement state-led policy initiatives. Moreover, business interests are often fragmented, and business associations are often unable to provide effective leadership. None of this facilitates anticipatory, proactive, or coherent policymaking.[11] (p.60)

However, Bell (1997b, p.17) shares the Atkinson and Coleman's (1989a, p.60) view that Australia together with other Anglo-Saxon states occupies a 'weak' state category. According to Bell (1997b):

> The State's role in Australian federal industry policy points to what, on many occasions, has been the limited autonomy of the State. Overall, I argue that the Australian State, at least in this policy area [manufacturing], has been more like a weak state that can sometimes, depending on the conjuncture [i.e., alliance between state and powerful economic interests], 'act strong.' (p.366)

[11] The Australian state apparatus is regarded as fragmented because:

> State authority is divided between federal, state and local government levels and, in this system, the responsibilities and policy capacities of national and regional governments are defined by constitutional mandate ... Australian federalism has produced a complex and often contradictory set of structures, in many cases fragmenting 'national' policymaking and opening many points of influence for economic interests (Bell, 1997b, pp.30, 32).

Bell (1997a,b) agrees with Capling and Galligan that the State has been an active player in the Australian political economy, but unlike these authors, he argues that "the State's role in Australian federal industry policy points to what, on many occasions has been the limited autonomy of the state" (Bell, 1997a, p.366). For Bell, occasions where the State can be strong or weak as a player depends on the issue of coalition between state and societal forces:

> [O]n those occasions when the [Australian] State has displayed initiative and a degree of autonomy from pressing social or class forces, this has always been arranged on the basis of the coalition model of state autonomy...coalitions of state and societal actors whose actions and choices are shaped by the institutional and policy terrains found within state or societal institutions. (Bell, 1997a, p.367)

Following these debates on state strength and approach to industrial policy, it will be interesting to investigate whether the Australian State was strong enough in financial policymaking to adopt anticipatory (or reactive) policies.

Michael Pusey (1991), like Capling and Galligan (1992), also offers a state-centric account of Australian policymaking. According to Pusey (1991) centralised elitist state bureaucracies (the Treasury, Finance, and Prime Minister and Cabinet departments) drive the Australian State's actions. He argues that the key bureaucracy was inspired by the ideology of economic rationalism that "swept" Canberra (Pusey, 1991, p.106).

Statist accounts of Capling and Galligan (1992), and Pusey (1991) are not without criticisms. Bell (1997a,b) rightly criticises both accounts on the ground that they only take state-centric factors into account. In his critique of Capling and Galligan, Bell (1997a, p.366) charges that their analysis focuses "almost exclusively on state-centred explanatory variables." He argues that:

> There is nothing in this account that systematically links state action to wider social forces, to free trade pressures from a range of economic interests, or that

> seriously addresses the issue of relative state and societal powers. Indeed, for a book dealing with manufacturing industry policy, the political role of manufacturers and their collective associations is virtually ignored. (p.366; 1997b, pp.47-9)

Bell (1993, 1994, 1997a,b) emphasises the socially embedded nature of state action and underlined occasions when the State had limited autonomy. In regard to his critique on Pusey (1991), Bell correctly claims that:

> Pusey's approach fails to offer a serious analysis of the context, particularly of the administrative issues, the wider economic context and the societal and economic interests, which confronted or pressured the Australian State in the 1980s, and to which Pusey's bureaucrats responded. It is no doubt true that Canberra's bureaucrats wield considerable power, but to analyse state action only in terms of bureaucratic power leaves out too many other important explanatory factors. (Bell, 1997a, p.356, see also idem., 1997b, pp.47-8)

The lesson derived from the debate articulated by Atkinson and Coleman (1989a), Capling and Galligan (1992), Pusey (1991), Head and Bell (1994) and Bell (1993, 1997a,b) is that state strength is about the study of state and society relations. Thus, a balanced perspective of state-centred and society-centred explanatory accounts should be presented in the analysis of Australian financial regulatory politics by taking into account the interaction of state and societal power variables in the formulation of regulatory policies.

The application of the policy network framework to the comparative and domestic public policy fields are not essentially different as Coleman (1996) demonstrates in his highly significant comparative analysis of financial systems.[12] Coleman (1996) uses the policy network framework for the analysis of both industrial policy at the sectoral level and the comparative analysis of nation-

[12] Such a separation of the network analysis between the two fields may give the impression of artificiality, and it may be open to discussion. However, the reason for the separation in this section is related only to practical considerations (see fn.5 above on p.24).

states' capacity to respond to the changing global system in the financial services industry. Coleman's analysis is noteworthy because it is the first attempt to apply the policy network approach to cross-national comparative analysis of the financial services industry in light of financial globalisation. Coleman (1996) concludes that "a new 'esoteric politics' has taken hold where the policy game continues to be structured to favour the interests of large, financial services firms over other interests" (pp.x-xi). He also indicates that financial services politics covering banking and securities markets is esoteric (private and technical) in the United Kingdom (UK) as well as in Canada, France, Germany, and the US.[13]

Coleman (1996) reveals how five nation-states adapted to challenges posed by financial globalisation by reforming their financial services policies. The study focuses heavily on the organisation of state functions and characteristics of political institutions. Coleman (1996) argues that "an assessment of state power must take account of the properties of a policy network, the structures that characterise the relationships between societal and state actors" (p.68). Accordingly, Coleman identifies the appropriate category of the financial policy network in countries analysed in order to identify the nature of banking policy employed (i.e., reactive or anticipatory policy approach). According to Coleman (1996), the central question to be addressed in banking policy analysis is which network dominates a sector. He illustrates that divergences in domestic policy responses to external economic challenges are explained by differences in the structure of the national policy network.

[13] Chapter eight will refer to Coleman's (1996) discussion on esoteric politics with special reference to the 'four pillars' policy.

Table 2.2 Power and the Policy Process

Power potential of financial services firms	Strong state capacity	Weak state capacity
Higher potential	Comprehensive bargaining; power-sharing. Corporatist network *most likely*	Firm-dominated policy process. Clientele network *most likely*
Lower potential	State-dominated policy process. Clientele network *least likely*	Narrow issue bargaining. Corporatist network *least likely*

Source: Coleman (1996, p.79).

Table 2.2 summarises the possible *ideal* types of policy outcomes predicted by Coleman's framework (1996). By applying the model, he found substantial differences in banking policy networks, with Germany and France exhibited strong corporatist characteristics (strong state capacity) whereas Canada, the US, and the UK were more pluralist (weak state capacity). Here, Coleman (1996, pp.13-5) confirms the previous prediction of Atkinson and Coleman (1989a, p.60) that the US, the UK, and Canada would have reactive approaches to policymaking and a pluralist network.

There are three important parameters used by Coleman (see also Atkinson and Coleman, 1992, p.168): (1) state structures; (2) industry organisation; and (3) systems of interest intermediation at the sectoral level. They must be addressed in order to analyse industrial policy effectively. They are significant because they determine the category (or typology) of a policy network. A combination of these three criteria leads to identification of three *ideal* types of policy network dominating the banking sector:

> Corporatist networks tend to encourage concertation and problem-solving; clientele networks will also support a problem-solving style, but with state agencies quite dependent on state actors for expertise, information, and direction; pressure pluralist networks create conditions more supportive of bargaining and confrontation. (Coleman, 1996 p.80)

The first parameter (state structure) assumes that the large number of key agencies in the banking policy network and conflict between the perspectives of the Treasury and the Central Bank, lower state capacity (Coleman, 1996, ch.4). Thus, the state becomes too weak to provide strong leadership or direction for the financial services industry. Accordingly, Coleman develops a state capacity framework to assess whether a state has capacity to follow anticipatory or reactive policies in the industry (Coleman, 1996, ch.4). For Coleman, state strength in banking can be measured in terms of degree of centralisation of the state apparatus (i.e., number of regulatory institutions participating in supervision and policymaking) and a balance between the perspectives of the Treasury and the Central Bank (1996, ch.4). Chapter four of this research utilises Coleman's framework for state capacity in banking. And, Chapter six applies the model into practice.

In relation to the second parameter (i.e., industry organisation), Coleman (1996, ch.2) suggests the assessment of the economic power potential of banks by analysing their economic strength. This strength can be gauged by their business powers with special reference to their competitive positions within the financial services industry, their customer base, the level of their global activities, and their ownership relationships. Chapter seven provides the assessment of the economic power potential of major four banks. This potential may affect who gets what in the banks' bargaining relationships with the Australian State during the Wallis period. Such an analysis will also review the main features of the financial services industry in Australia.

The third parameter is interest intermediation. Atkinson and Coleman (1989a,b) and Coleman (1996) elaborate on the 'business interest mobilisation' concept in order to calculate to what extent a policy community is mobilised to assume a role in the making and implementing of a policy. However, this framework will not be used in the thesis. In Chapter eight, it will be illustrated that the key private sector actors in Australia preferred to transfer their economic power potential into the exercise of political power individually rather than collectively. Thus, the Australian Bankers' Association (ABA) was not a significant player in mediating the transformation of the major players' (i.e., the big four banks') economic power into political power during the Wallis era. Consequently, a framework of analysis developed by Coleman (1996, ch.3) for evaluating the capacity of interest intermediation systems to transform economic power into political power is not employed by the thesis. Rather, elite networking, political lobbying and political donations by key institutional and individual players as avenues for translation of economic power into exercise of political power are emphasised in Chapter eight.

2.4 The Three Phase Adjustment Model

By implementing micro-political analysis of policymaking, Wolfgang H. Reinicke (1995), reveals a multitude of changes in the interests, coalitions and power constellations among private and public sector actors and institutions in US financial system, in the absence of any macrostructural adjustment. These changes have opened alternative channels for policymaking leading to substantial adjustments in the regulatory framework governing US financial markets by circumventing traditional mechanisms for policymaking. Reinicke provides a detailed discussion of both the unsuccessful attempts to repeal the law that separates commercial from investment banking (the Glass-Steagall Act) and the successful raising of the capital standards of US commercial banks. Divergences in policy outcomes and policymaking processes are investigated by referring to the two cases. A broader conclusion that can be drawn from this study for the global political economy is that because the US has structural power (influence over political and economic outcomes) in global politics (Strange, 1986, 1994), it can initiate international-level regulatory coordination coupled with domestic-level regulatory reform to restore regulatory authority of its bureaucratic institutions and that of economic interests of its financial institutions.

Reinicke (1995, pp.8-14) claims that the reasons why and how networks mobilise; and how conflicts over who gets what are resolved, are fundamental problems in the policy network literature. Thus, Reinicke (1995, ch.2) develops the three phase adjustment model[14] to analyse the regulatory policies. The adjustment model which is composed of *mobilisation*, *conflict*, and *resolution* phases is built around an analysis of the three interrelated questions: how do external challenges *mobilise* the policy network; what are the dynamic processes of *conflict* through which the financial policy community responds to such

[14] Reinicke does not refer to the policy community concept. Apparently, the policy network concept covers the policy community concept in his study:

> For the purpose of clarity, a policy network is the overarching concept that is being examined here. The policy network consists of a set of institutions whose interests and relationships to each other define the network (e.g. centralised vs decentralised). Institutions in this perspective are thus actors that shape policy outcomes. This does not mean that single individuals cannot have a major influence on policy outcomes. When this is the case, the analysis will draw specific attention to it in order to distinguish between actors as individuals and actors as institutions. (Reinicke, 1995, n.15, p.22)

challenges? and how do these processes of conflict culminate in the eventual *resolution* of challenges?

> Each of the questions posed above corresponds to a particular phase in the process of adjustment. The first phase that of *mobilisation*, in which the external challenge penetrates the domestic policy network and activates a specific set of institutions in that network to respond. The second phase is that of *conflict*, in which the institutions mobilised by the challenge form coalitions, promote policy initiatives, and engage in political bargaining aimed at formulating responses to the challenge. Over time, this process involves shifts in the interests, coalitions, and powers of the institutions in the policy network, which in turn give rise to changing policy responses. The final phase is that of *resolution*, in which the process of institutional coalition-building bargaining culminates in a policy outcome which is seen as resolving the particular challenge. (Reinicke, 1995, pp.13-4, original emphases)

The mobilisation stage constitutes the initial phase of the three phase policy adjustment process. It is assumed that globalisation of finance poses several challenges on economic and political interests of state and societal actors in a national economy. Accordingly, actors most threatened by a particular challenge will be first to mobilise. The first question addressed in this initial phase is; whose interests are threatened? Private sector institutions generally mobilise and demand government action to protect or redress their economic loss. In this way, what kind of compensatory policy changes those threatened will seek is the second question to be addressed in the mobilisation stage. However, any challenge creates its winners as well as losers. Further, the proposed policy changes, since it is likely to redistribute benefits and costs, will inevitably mobilise different actors in the same policy community. Then, the third major question in this stage is to be asked: Which other institutions will be next to be mobilised into the debate on policy response?[15] Renicke states that:

> Because each challenge mobilises a different initial group of institutions and generates a different set of proposed policy changes, each challenge activates a

[15] Policy network literature does not address the three questions posed in the mobilisation stage.

> different segment of the policy network in response to those proposed changes. (Reinicke, 1995, p.15)

Thus, conflict is the second stage of the model. The subsequent evolution of the mobilisation process, and of the changing stream of policy responses that it generates, provides the analytical focus of this phase. There are three sets of factors that will be discussed in the conflict phase. The first set of factors is related to the identity and interests of the institutions who initially reacted to the challenge.

> By setting the policy agenda for the response process, those institutions shape the terms of debate on how to respond to the challenge. They determine what type of policy changes will be debated, and influence the direction in which the debate on policy responses evolves. (Reinicke, 1995, p.16)

In other words, the policy agenda is set by the policy community (i.e., key regulatory bureaucracy and regulated institutions) and *what* is debated and by *whom* is the first set of factors inherited from the mobilisation stage.

On the other hand, "the second set of factors influences *how* those issues will be debated" (Reinicke, 1995, p.16). As discussed previously, each challenge activates certain actors of the policy network and generates a particular range of diverging interests among the institutions involved. "As a result, each challenge sets up the institutional framework within which debate takes pace, and also determines the array of interests involved in that debate" (Reinicke, pp.6-7). In real life, as time goes on, each challenge itself is changing, hence it produces an evolving set of continuous pressures. Thus, the perceived interests of the institutions in the policy community, as well as the patterns of conflict and coalition building among the institutions change.[16] "As a result, the intensification of the challenge can accelerate the speed at which the policy network moves towards resolution of the challenge, and broaden the scope of the proposed policy changes" (p.7). The third set of factors includes the changing character of the challenge itself:

> Rather than regarding an external shock as a single, discrete event, it is more accurate to view the shock as an evolving set of continuous change, so do the perceived interests of the institutions in the policy network, as well as the patterns of conflict and coalition-building among institutions. (Reinicke, 1995, p.17)

In other words, vested interests within the financial policy community are in a constant state of change as interests and coalitions adapt to an evolving external challenge and its respective challenges on political and economic power of financial actors. The main strength of the adjustment model *vis a vis* the policy network framework lies here. The three sets of factors in the conflict phase discussed above provide the basis for comparing divergence in policy responses across cases. By analysing the conflict phase in two cases, it would be possible to analyse and understand two different policy processes of policy debate and conflict by two challenges posed by financial globalisation.

Resolution is the last phase of the adjustment process. According to Reinicke (1995), "[r]esolution is achieved when the institutions initially disadvantaged by the external economic shock succeed in introducing policy

[16] What has been discussed in the conflict phase is not addressed convincingly in the policy network literature. Especially, network typologies developed fail to address the dynamic character of external challenge and its consequences on evolving who gets what discussions among actors in the policy community.

responses which redress their loss in economic and/or political power" (p.18).[17] Reinicke (1995, pp.18-9) also suggests that policy resolutions refer to two basic dimensions: content and level. Content refers to the substantive details of policy decisions. The content reflects the nature of the original challenge, the way in which the policy community was mobilised, and the process of conflict over how to respond to the challenge. It is assumed that, over time, the process of conflict among these institutions gives rise to a changing set of policy responses which ultimately culminates in a policy decision. The level of policy resolution refers to domestic-level regulatory reform and international-level regulatory coordination.

However, the adjustment model is by no means original. Edward J. Kane (1981) used the concept of 'regulatory dialectic' to explain financial regulation as a dynamic process of conflict and resolution between opposing political and economic forces:

> This concept [regulatory dialectic] embodies an interpretive vision of cyclical interaction between political and economic pressures in regulated markets...Market institutions and politically imposed restraints reshape themselves in a Hegelian manner, simultaneously resolving and renewing an endless series of conflicts between economic and political power. (Kane, 1981, p.355)[18]

Kane (1977) argued that "introducing political power into economic affairs initiates a dialectical process of adjustments and counter adjustments" (p.55).[19] According to Kane, "the dialectical *conflict* can *resolve* itself" in this process (1977, p.56, emphases added). Although Reinicke (1995) does not refer to Kane

[17] However, the resolution may not be always favourable to those initially disadvantaged. I am indebted to Dennis Woodward, Australian political economist, for the point.

[18] Kane (1981) was mistaken in using words 'cyclical interaction' in pointing to the Hegelian dialectic. Conversely, the Hegelian dialectic points to the linear understanding of conflict and resolution processes of historical development whereby more advanced synthesis is achieved by the interaction of thesis and antithesis.

[19] Here, Kane (1977) did not mention the Hegelian dialectic.

(1977, 1981), apparently his adjustment model is influenced by the adjustment process generated by 'regulatory dialectic' which involved conflict and resolution stages where interaction of economic and political powers take place in regulatory policy issues. The thesis will test whether the adjustment model is relevant to explain the policy process and the cases.

2.5 Governmental Agenda Setting Framework

As has been shown so far, both policy community/network frameworks and the three phase adjustment model cover interaction where policy choices are made between key public and private *institutional* actors in the policy process. However, as John Kingdon (1995, pp.2-3) states the policy process is composed of four stages; "(1) the setting of agenda, (2) the specification of alternatives from which a choice is to be made, (3) an authoritative choice among those specified alternatives, as in the legislative vote or a presidential decision, and (4) the implementation of the decision."[20] The thesis is not only interested in the interactions among key actors (the second stage of a policy process) but also the agenda setting process. Thus, the first stage of policymaking is analysed through Kingdon's (1984, 1995) pioneering governmental agenda setting framework. Such an analysis will provide useful theoretical insight to the investigation. For practical reasons, the agenda setting framework will be presented in detail in Chapter five where it has been applied. Thus, a brief overview of the framework will be sufficient for this section. According to Kingdon (1995, pp.16-8),

[20] The thesis limits itself with the first two stages and does not deal with legislative and implementation processes relating to the APRA and the 'four pillars' policy outcomes.

governmental (or political) agenda is composed of three independent processes: problems, policies, and politics. Policy change happens only when policy entrepreneurs using windows of opportunity can combine problems, policies (e.g., solutions), and politics (e.g., change in government). Thus, the role of individuals (e.g., policy entrepreneurs), actors external to the financial policy community (e.g., the Australian State), and knowledge in the policy process, and their influence on policy outcomes will also be analysed in the thesis. Moreover, why and how the financial policy community itself changes will also be addressed (see Chapters five and six).

2.6 Conclusion

So far, key relevant studies of Australian financial politics and competing theoretical tools widely used in the literature on financial regulatory politics are introduced. In doing so, background information is provided for the theoretical discussions on the relevance of these previous works to the case studies. Theoretical implications of empirical evidence derived from the cases will be related to the theoretical discussions presented in this chapter. In doing so, theoretical models and explanations will be tested against the evidence by comparing the cases (see Chapter nine).

The thesis will explain what happened in Australia during the Wallis era (1996-97) with special reference to the Wallis Inquiry, the APRA and the 'four pillars' policy. In this view, the method is to describe feasible and theoretically interesting ways of interpreting the financial policymaking process with published accounts as well as interviews which are set against them. The three theoretical perspectives focus on different types of empirical evidence, but also complementary in that they enable the same events to be looked at from somewhat different angles (Allison, 1971).

Frameworks for the analysis of state capacity, the agenda setting process, and economic power potential of banks will also be introduced along with their application in Chapters four, five, and seven respectively. Specifically, the policy outcomes investigated by the thesis are interesting test cases of the capacity of the network approach which shows both stability and exclusiveness to explain the policy process with particular emphases on 'power' variables during the Wallis era. Accordingly, Chapter four will benefit from the state capacity framework developed for the assessment of state power in the banking sector. Chapter six will analyse this state capacity in practice. Similarly, explanatory power of the three phase adjustment model developed for understanding the domestic financial policy process will be tested against the Australian evidence throughout the thesis. Chapter five will apply a framework for the governmental agenda setting process which emphasises the role of individuals and knowledge in policymaking will also be used to understand the financial political process and policy outcomes. Chapter seven applies a framework for the assessment of the economic power potential of the big four banks. And, Chapter eight will examine transmission of the banks' economic power potential into political power in practice.

CHAPTER THREE

METHOD

3.1 Introduction

The aim of this chapter is to demonstrate why and how the case study method will be employed and what data sources will be utilised in the thesis. The explanatory case study method is used to describe and discuss the policy debate surrounding the establishment of the Wallis Inquiry and the APRA, and the 'four pillars' policy outcomes. The thesis concentrates on the political behaviour of individual and institutional private and public sector actors, as well as the Australian State on big bank mergers and single prudential regulator issue areas during the Wallis era (1996-97).

A combination of interviews and written sources is the main approach to data collection. The interviews were held with some of the very senior people involved in the debate. The interview participants provided critical and valuable information about the Inquiry process and the policy outcomes. All interviewees preferred anonymity but most of them allowed recording. The interviews with 14 respondents took place in the three major Australian cities: Melbourne, Sydney and Canberra between February – May 2001. Submissions made to the Financial System Inquiry (1996) by some of the key private and public sector actors and the Final Report of the Inquiry (1997) were analysed. Daily newspapers and weekly financial press were also widely used as media sources. Other textual sources included memoirs, reports and press releases of the government bodies and private institutions.

This chapter is divided into five sections. Section one provides a bird's eye view on the basic premises of the policy research that distinguish it from other social science research. Section two discusses why the case study method is adopted by the thesis. Section three introduces the research design of the thesis. Section four illustrates the data sources. The conclusion summarises the main argument that case analysis was chosen, since the case study method provides detailed and qualitative empirical material for the actual policy outcomes. Such data also help to establish a link between theory and practice that relates the actual policy contexts.

3.2 Main Features of Public Policy Research

According to Goel (1988, p.2), "political science is the discipline that seeks to explain the political behaviour of individuals and the behaviour of political institutions." However, this definition is limited, since it disregards the political behaviour of non-political institutions such as multinational companies. Political behaviour of the four biggest Australian banks is examined in detail in Chapter eight. Broadly speaking, the study of politics is developed in two broad approaches: behaviouralism which focuses on individual and group behaviour; and traditionalism which emphasise legalistic, historical, and philosophical approaches to the study of political life (for the history, development, methods and the scope of political science, see Kweit and Kweit, 1981).

Public policy is "the courses of action pursued under the authority of governments" (Heclo, 1972, p.85). In this context, public policy refers to the courses of action undertaken by government which include formal outputs such as government regulations and legislation. Accordingly, the APRA illustrates the significant policy change in prudential regulation. It is also possible for public policy to involve forms of non-intervention or maintenance of the status quo. As Heclo (1972) notes, "[a] policy, like a decision, can consists of what is not being done – for example, the inaction which prevents 'costs' already affecting some groups from being removed" (p.85). The 'four pillars' policy by preserving the government's policy ban on domestic mergers among the four big Australian banks represents inaction.

Quasi-experimental research design concentrates on how a factor (independent variable) affects the aspect of reality the researcher wants to explain (dependent variable). It tries to test statements about relationships between dependent and independent variables under *ceteris paribus* conditions (hypothesis). It also uses quantitative techniques to identify the degree and direction of these relationships:

> … a consistent preference for designs searching for the *effects* of a particular explanatory variable rather than for the *causes* of a particular empirical outcome; in fact, all their methodological recommendations for coping with the small-N problem have this "forward looking" character. (Scharpf, 1997, p.24, original emphasis)

Thus, statistical method is used in these studies because statistics show correlation rather than causation. Policy research, however, differs from this forward looking analysis. As Scharpf argues:

> In policy research, however, the questions that political scientists are expected to answer are typically *backward looking*, starting from an *explanandum* or a dependent variable at the other end of the hypothetical chain of causation. Here the expected end product is not the empirical confirmation or disconfirmation of single-factor hypotheses but rather explanations of particular policy choices or

predictions of the political feasibility of particular policy options. (Scharpf, 1997, p.27, original emphasis)

In a similar vein, the thesis starts from dependent variables (the three case studies). Then, through a backward looking perspective, it identifies the most significant independent variables causing these outcomes.

Finally, policy research is interdisciplinary. As Heclo notes, "the disciplinary boundaries for the study of public policy are necessarily quite fluid" (Heclo, 1972, p.85). The thesis has also an interdisciplinary perspective in describing and explaining the behaviour of actors. Thus, it refers to relevant works in political economy, comparative political economy, international political economy, public policy, economics, and finance literature (see Chapter two). Accordingly, the thesis benefits from frameworks that transcend rather than reproduce the boundaries set by academic disciplines.

3.3 Case Study Method

As a research tool, the case study is used largely in policy and political sciences, and public administration research and social science theses (see Heclo, 1972; Greenstein and Polsby, 1975; Yin, 1994; Rhodes, 1997a, ch.4; Marinetto, 1999).[1] According to Yin (1994), "the case study is the method of choice when the phenomenon under study is not readily distinguishable from its context" (p.3).

[1] For the nature and use of the case study in research particularly in the social sciences, see Agranoff and Radin (1991); Feagin, Orum and Sjoberg (1991); Stake (1995); special issue of *Current Sociology* 40 (1992); for a useful introduction for political science research process, see Burnham (1997).

Thus, case study research is to be preferred when circumstances and research problems are appropriate. For Yin (1994), an explanatory case study is required when 'how' and 'why' questions are posed; when the researcher has little or no control over events; and when the focus is a contemporary phenomenon within some real-life context:[2]

> [A case study] is an empirical inquiry that investigates a contemporary phenomenon within its real life context; when the boundaries between phenomenon and context are not clearly evident; and in which multiple sources of evidence are used. (p.13)

The scope of the thesis satisfies these three main requirements of an explanatory case study method. In particular, it aims to understand and explain contemporary Australian banking policy with special reference to the three cases by using different sources of evidence. And, like the works of Allison (1971), Hall et al. (1975) and Marinetto (1999), this research attempts to benefit from the explanatory utility of case studies.

In the American methodological thought there is a 'fashion' that statistical methods are seen as desirable whereas case study methods are treated as type of data (for extensive review of this issue, see Platt, 1992). A similar tendency is emerging in Australian literature (for example, see recent issues of *Australian*

[2] There may be exploratory, descriptive or explanatory case studies (Yin, 1994). And the types of research questions determine not only the appropriate type of case study but also a research strategy (or method) (see Yin, 1994, ch.1). For example, exploratory cases primarily deal with 'what' questions while explanatory cases concern with 'how' and 'why' questions. The survey as a strategy, like case study strategy, requires no control over behavioural events and focuses on the contemporary events. However, in the survey, 'who', 'what', 'where', 'how many', and 'how much' are the forms of research questions rather than 'why' and 'how' questions as it has been in explanatory case studies. In other words, choice between a survey and case study method are primarily determined by the type of the research questions (for relevant situations for different research strategies, see Yin, 1994, Figure 1.1).

Journal of Political Science). Thus, the preference for case studies over statistics in the present investigation is to be justified.

There are three main reasons why the case study method rather than a statistical method are adopted in the thesis. First, the case study method "depends on the use of – and ability to integrate in converging fashion (some would say "triangulate") – information from multiple sources of evidence" whereas the quasi-experiment method heavily relies on "quantitative data collection" (Yin, 1997, p.69). Following this perspective, the thesis benefits from qualitative and quantitative data in building the facts and conclusions which are expressed in both quantitative (see, for example, Chapters seven and eight) and qualitative terms (see, for example, Chapters five and six).

Second, the case study method considers context as an essential part of the phenomenon being examined. As Yin (1997) puts it:

> [T]he method implicitly assumes a richness of data because a case study is intended to examine a phenomenon in its real-life context ... A major technical concomitant is that case studies will always have more variables of interest than data points, effectively disarming most traditional statistical methods, which demand the reverse situation. (p.70)

In other words, a case study shows causation rather than correlation and deals with the context rather than crude external aspects. Accordingly, the role of contextual conditions is included in the analysis of the three cases (see especially Chapters four and five).

Finally, the case study method helps linking real life situations to theoretical discussions and propositions especially by *testing rival theories*. As

Yin notes:

> The process of generalising the results of [single or multiple] type of case study depends on the development, testing, and replication of theoretical propositions (analytic generalisation) – rather than any notions based on selection of numeric samples and extrapolating to a population (statistical generalisation). Especially helpful is the specification and testing of *rival* theories or explanations, which can even take place within a single case study; in a multiple-case study, one possible rationale for case selection is that certain cases have been included because they represent rivals. (Yin, 1997, p.70, emphasis in the original)

As has been indicated in Chapter one (section 1.3), the concepts of 'knowledge' and 'power' are regarded as opposites in policy research. Accordingly, alternative explanations of the policy outcomes are suggested by representatives of models based on 'knowledge perspective' and 'power perspective' of the policy process. In this perspective, the thesis refers to both 'power' and 'knowledge' variables and respective theoretical frameworks in the analysis of the policy process and the three cases (see also section 3.4).

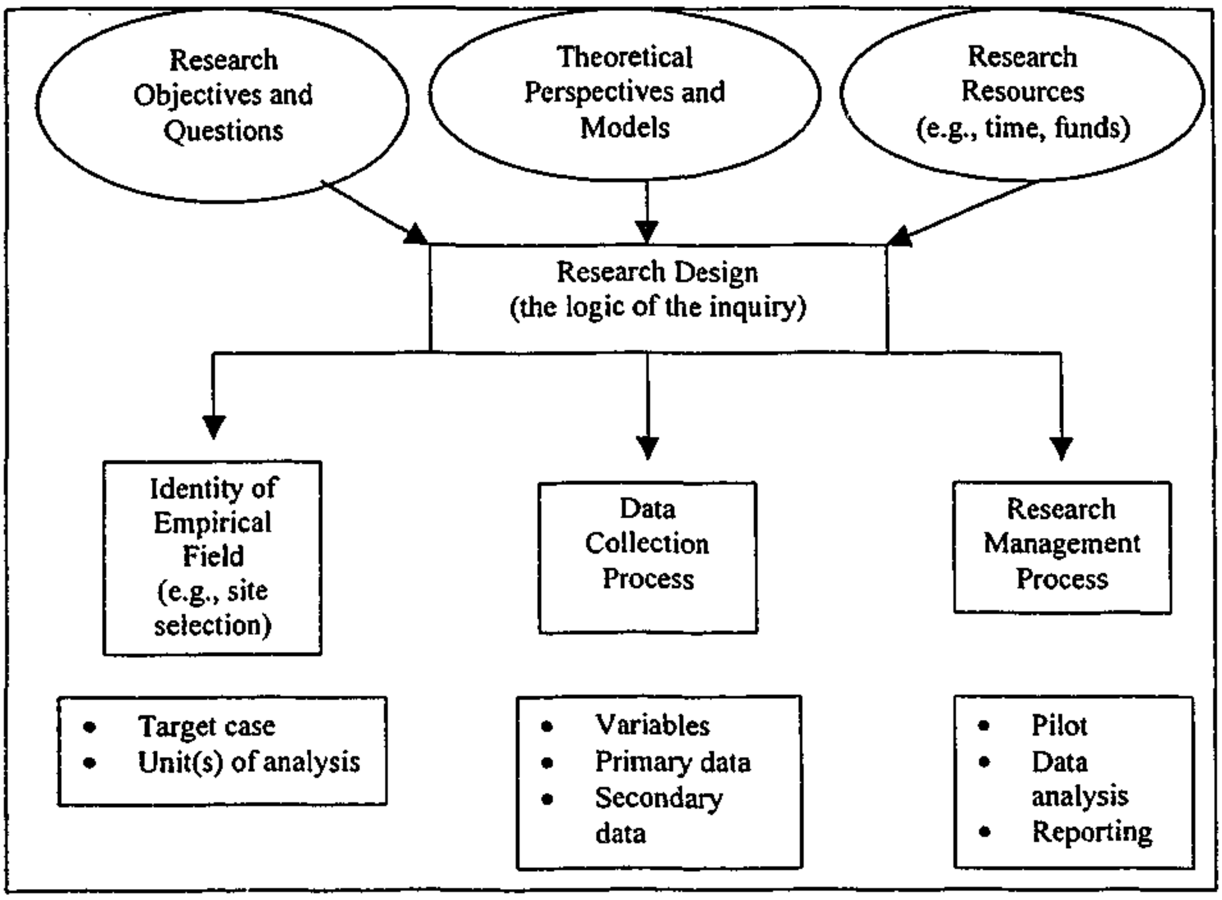
To sum up, the explanatory case study method as an empirical, scientific method is used throughout this investigation and preferred to statistical inquiries. The method aims to achieve construct validity which requires the researcher to use the correct measures for the concepts being studied; internal validity which demonstrates that certain conditions lead to other conditions and requires the use of multiple pieces of evidence from multiple sources to uncover convergent lines of the three cases; external validity which reflect whether or not findings are generalisable beyond the three cases; and reliability which refers to stability, accuracy and the precision of measurement (for discussion of these four criteria, see Yin, 1994, pp.33-53). In this context, the thesis is achieving construct validity through qualitative and quantitative evidence from written sources and interviews, a chain of chronological evidence, and reviews of key informants such as international and domestic conference participants. Internal validity is ensured by considering rival explanations of the policy process (i.e., role of 'power' and 'knowledge' as independent variables). External validity is also achieved because the research findings enable analytical generalisations regarding the role of the state, the bureaucracy, financial system inquiries, individuals, and knowledge in the Australian political economy. Finally, the reliability of the research findings can be tested by other researchers with special reference to its research design and the three case study database constructed.

3.4 Research Design

This research is case-specific and post hoc. It adopts the research design framework developed by Yin (1994, 1998). This framework, in Yin's words, is "the logical sequence that connects the empirical data to a study's initial research questions and, ultimately, to its conclusions" (Yin, 1994, p.19). It is illustrated in Figure 3.1 (p.54). It has been adopted by this thesis because it fits well – particularly for the research objectives and questions that are going to be examined.

Following Yin (1994, 1998), research design of this thesis is based on five components: (1) identification of dependent and independent variables; (2) major research question guiding the investigation; (3) research proposition reflecting important theoretical issues; (4) the logic linking data to the proposition; (5) the criteria for analysing and interpreting the empirical evidences.

Figure 3.1 The Central Function of the Research Design



Source: Yin (1998, p.237).

As has been indicated in the introduction section, the Wallis Inquiry, the APRA, and the 'four pillars' policy outcomes are the three dependent variables, whereas 'knowledge' and 'power' are the independent variables of the thesis. In particular, this research aims to explain 'how' and 'why' the Inquiry and the APRA was established, and the 'four pillars' policy was adopted by the government. Thus, the explanatory case study method is adopted due to its ability to provide detailed analysis of 'who did what, how, and why.' This thesis also tackles the following questions: What was the Inquiry's role in Australian financial politics? Were the APRA and the 'four pillars' policy outcome products of bargaining between key players of the financial policy community or of state intervention? Was 'knowledge' or 'power' the most significant and important independent variable explaining these policy outcomes? Were there any other significant independent variables leading to the policy outcomes?

Answers to these questions will identify relevant independent variables (or causes of policy outcomes). It is predicted that the three policy outcomes occurred due to knowledge about obsolescence of institutionally based financial regulation and knowledge about social and economic consequences of bank mergers rather than the power of the key private sector actors and their regulators.

This research proposition helps to focus attention on data relevant to 'knowledge' and 'power' variables. In order to do so, the thesis will benefit from three competing but at the same time complementary theoretical frameworks. The policy network framework (Coleman, 1996), and the three phase adjustment model (Reinicke, 1995) are representative of models based on 'power perspective' whereas Kingdon's (1984, 1995) governmental agenda setting framework is based on 'knowledge perspective' of the policy process. Finally, the research proposition will be linked to the data with special reference to these three theoretical tools.

3.5 Data Sources and Analysis

The key strength of the case study method involves using multiple sources and techniques in the data collection process (see Marinetto, 1999, pp.68-76; Yin, 1994, p.13; Hakim 1992). A variety of sources of evidence (or data gathering methods) such as the analyses of primary and secondary written sources, and interviews are used in the case studies. This also allows case studies to present more rounded and complete accounts of issues and processes studied. Moreover, the questions guiding the investigation will be asked of the various sources of quantitative and qualitative evidence. As a result, construct validity of the case studies can be attained by the convergence of multiple sources of evidence. In this perspective, the analyses of primary and secondary written sources, and interviews are the main sources of evidence in the thesis.

Written documents are useful and relevant in developing the case studies. As Marinetto notes, "[t]he use of documents in developing policy case studies is ubiquitous" (1999, p.68). Accordingly, Hansard (the official written record of the proceedings of the Parliament), the Financial System Inquiry Final Report (FSI, 1997); the government's response to the recommendations made by the Inquiry, annual reports and press releases of respective public sector actors were fruitful sources of documentary evidence for developing the case studies. Moreover, publications of international intergovernmental institutions (IMF, World Bank) and international organisations (OECD, BIS, Group of Ten) were also used.

Non-governmental written sources (e.g., memoirs, newspapers, academic journals, books, and magazines) will also be extensively used throughout this study. Social science secondary literature on the politics of banking was also used. Among these sources, newspaper articles were of utmost importance to figure out chronological developments in the policymaking process as "causal sequences must occur linearly over time" (Yin, 1994, p.139). The discussions and explanations of the cases will be presented chronologically by utilising the descriptive and analytical information in newspapers and other periodicals. The analysis of chronological developments benefits from Lasswell's questions: "Who says what in which channel to whom with what effect?" (Lasswell, 1948, p.37). Although these questions are not formally used to present evidence under separate sub-headings due to practical reasons, they guided informally the researcher's analysis of chronological developments and their presentation in the thesis. Accordingly, political discourse analysis is also used as an approach to process data. Moreover, articles from periodicals also set out the events prior to and after the Wallis Inquiry in a wider historical context. These articles were also useful to identify key actors to be interviewed for the research.

Submissions made to the Financial System Inquiry by key private and public sector actors were also analysed in order to identify the actors' vested interests. For example, because the Wallis Committee recommendations affect institutions most likely to gain or lose from the government's acceptance of them, the Australian financial policy community articulates and defends explicit positions in their submission to the Inquiry (see especially Chapters seven and eight). In this respect, selections of the relevant submissions constituted a good starting point for articulating concerns, positions and policy preferences of private and public actors. In order to do so, Carol Lee Bacchi's (1999) "What's the problem?" approach (a focus on problematization of policy proposals rather than problems in order to analyse political actors' vested interests in proposed solutions) will be utilised (see Chapter five).

Apart from the submissions, the analysis of articles relevant to the case studies published in the financial press (or business pages of news papers), company reports; working papers etc., are also likely to contribute to the design of case studies and interviews. However, these documents will be carefully used and not be accepted as "literal recording of events that have taken place", since they are mainly written for "some specific purpose and some specific audience *other than* those of the case study being done" (Yin, 1994, pp.81-2, emphasis in the original). Therefore, the research does not solely rely on written primary and secondary sources. Thus, alternative sources of information which refer to those policy outcomes and policy debates are developed through interviews.

Marinetto (1999, p.70) claims that "[i]nterviews can form a highly significant and effective source of information in developing case studies." Similarly, Yin notes (1984) that "One of the most important sources of case study information is the interview" (p.88). In particular, open-ended interviews are most commonly used in case studies (Yin, 1984., p.89). Interviews are preferred in the thesis, since they can focus directly on the three cases of the thesis. The interviews took place in Melbourne, Sydney and Canberra between February–May 2001. The selection of participants was done on the basis of the secondary literature and by snowball sampling. The interviews lasted for 45-60 minutes. The 14 elite interviews included the Treasury (N=3), the APRA (N=5),[3] the ACCC (N=1), and the FSU (N=1) senior officials, a member of the Wallis Committee as well as senior members of the Senate Economics Legislation Committee from the

[3] Senior APRA officials interviewed were holding senior positions at the RBA during the Wallis era.

ALP and Liberal Party (N=2) and a senior member of the House Standing Committee on Economics, Finance and Public Administration from the ALP.[4]

Initially, the interviews consisted of a mixture of open- and close-ended questions. Close-ended questions helped to test some of the major premises of the three phase adjustment model and policy network framework. In particular, they not only provide insights into banking politics which cannot be captured in public statements but also suggested sources of corroboratory evidence. The open-ended questions proved highly useful as they allowed the interviewees to serve as informants creating the framework for explanation in the thesis. Interviewees preferred to keep their anonymity. All except for the Treasury officials, consented to recording. However, quotations from the Treasury interviews are precise reconstructions from notes. It can be asserted that some of the interview participants could afford to be candid and so provided insightful comment and information. This was mainly due to the fact that the policy debate took place some time in the past and their anonymity was ensured. The interviews were transcribed and analysed with the help of the software package, Nud-Ist.

In summary, primary (e.g., interviews and government publications) and secondary sources (e.g., books, memoirs, newspaper and journal articles) are to be consulted as they relate to the topic of the thesis. They are to corroborate and augment evidence from other sources (Yin, 1994, p.81). Particularly, original inputs from interviews and written primary sources are used to relate the cases

[4] Except for the then chief executive officers of the four major banks, the Treasurer, Peter Costello, and the Wallis Inquiry chairman, Stan Wallis, the research managed to interview all targeted interviewees holding considerable knowledge in same aspects of the policy debate.

with broader points. Accordingly, a combination of interviews and written sources will be the main approach to data collection. Further, the data used in this study will be both quantitative and qualitative. When the research has been able to corroborate interview evidence from published sources, the latter quotation has been preferred. Data collected for the case studies is organised and documented in detail through computerised files, tapes and published documentation.[5] The database can be the subject of separate, secondary analysis, independent of the findings of this investigation by any other investigator. In order to deal with the reliability problem of the method employed in the thesis, the documents are kept in the case study databases, and the study design has been explained in detail in this chapter. In other words, a reliability check by another investigator repeating the same procedure (i.e., research design) should produce the same results.

3.6 Conclusion

The chapter demonstrated that the explanatory case study method, which also gathers data from the interviews and documentary analysis, will be employed in the thesis. The research satisfies three key elements of a case study method: (1) the dependent variables are analysed within their real life context; (2) the boundaries between the outcomes and the context are not clearly evident; (3) multiple sources of evidence are used. In particular, the explanatory case study method is adopted by the thesis because it primarily deals with the 'how' and 'why' questions. Accordingly, it investigates 'how' and 'why' the Inquiry, the

[5] Newspaper articles and refereed publications are documented chronologically according to relevant subjects.

APRA and the 'four pillars' policy outcomes occurred. The primary focus is on the policymaking process at the sectoral level rather than policy implementation.

The study assumes that 'knowledge' about social and economic consequences of bank mergers, and about obsolescence of institutionally based prudential regulation may be highly significant and important independent variables rather than the 'power' of state and societal actors reflected in the policy network in explaining the policy outcomes. Thus, 'knowledge' and 'power' are regarded as the two independent variables upon which such propositions, research questions and reviews of literature are based.

Moreover, the case study method, by definition, is not just descriptive. It is also for testing models and theories in political science (see Greenstein and Polsby, 1975; Yin, 1994). Empirical evidence is tested against main assumptions of the three theoretical tools. Thus, the main strategy adopted by the thesis in linking case study evidence to theoretical discussions is to follow a theoretical proposition with special reference to the three phase adjustment model, policy network framework, and governmental agenda setting model. In particular, the case study method will enable this research to test the strengths and weaknesses of these theoretical models in the Australian context. Furthermore, case studies can also permit comparisons and generalisations. The divergence in the response pattern of the policy community can be explained through cross-case comparisons.

The thesis benefits from qualitative and quantitative data. The main approach to data collection involves qualitative interviews, and written primary and secondary sources. The data have been ordere hronologically. Since cause and effect are not reversible in time, this allows for causal inferences. Theoretical explanations are provided, since there are theoretical frameworks tested against empirical evidence. Analytical generalisations will also be possible if data support the theory. The explanatory power of the thesis will increase as competing theories are tested. If one independent variable (i.e., knowledge) plays a significant role across the cases of the thesis, one may speak of replication which is different from the enlargement of a sample in statistical tests.

CHAPTER FOUR

STATE CAPACITY AND FINANCIAL REGULATION: THE PRE-WALLIS PERIOD

4.1 Introduction

The objectives of financial regulation and supervision in a financial system are stability, efficiency and consumer protection. Thus, there are three main areas of financial regulation: prudential, consumer protection (or prevention of individual risks), and competition policy (or merger regulations) (OECD, 1992). This chapter considers the institutional regulatory framework in the Australian financial industry before the Wallis Inquiry.[1] Its objectives are threefold. First, it introduces the regulatory framework that prevailed before the Inquiry with special reference to the bank prudential regulation and bank merger regulation in Australia. In doing so, it identifies key public sector actors responsible for the regulation and supervision of the industry. Secondly, it analyses institutional arrangements in financial regulation. Such an analysis assists in the understanding whether the Australian State is likely to have a reactive approach to the industrial policy as has been predicted by Atkinson and Coleman (1989a). In order to do so, it employs the state capacity framework

[1] Private and public actors find an opportunity to articulate their concerns, positions and policy preferences, and possibly influence the politically feasible set of policy outcomes when Australian Financial System Inquiries take place. This chapter does not concern itself with a political economic analysis of 'who gets what, and how' from the Campbell Inquiry. For such analyses focusing on the foreign bank entry in 1984 with special reference to the submissions made to the Campbell Inquiry, see Pauly (1987, 1988), for application of public and private interest theory of regulation to the Campbell Inquiry, see Harper (1986).

developed by Coleman (1996, ch.4).[2] In turn, the chapter will offer background information for Chapter six where the empirical evidence associated with the case on the Australian Prudential Regulation Authority (APRA) is linked to the theoretical propositions of the framework.[3] Thirdly, it will identify key players and issues in the bank merger policy. In doing so, it will offer background information for Chapter eight where the 'four pillars' policy is investigated.

The rest of this chapter is organised as follows: the first section introduces a framework for the assessment of state capacity in the financial services industry. The second introduces the main legal features of a financial regulation. This background leads into section three which illustrates the main features of the mega bank regulatory politics in Australia. The conclusion summarises the main finding arising from the application of the state capacity framework.

4.2 State Capacity in the Financial Services Industry: A Theoretical Assessment

At this point, the framework for the assessment of state capacity should be introduced briefly. The political institutional context in which private sector actors operate is important in domestic politics. As Coleman notes:

> Financial services policy is directed by state agencies. The resources, expertise, and values of these agencies, and the interrelationships among them, play a crucial role in determining how policy is made and what form outputs take. (Coleman, 1996, p.67)

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[2] The framework was developed for the comparative analysis of the financial services industry among developed countries, to assess state power and autonomy. Therefore there is no bias in using this framework for the Australian context.

[3] The predictions of the framework presented here will be compared to the empirical evidence in Chapters five and six.

For Coleman (1996), the notions of state autonomy and strength have led to the concept of a "state's capacity to develop a strategy of action in response to changes resulting from globalisation" (p.73). He argued that strong states have capacity to follow anticipatory policies, whereas weak states have capacity to adopt reactive policies. Anticipatory industrial policies aim to encourage and facilitate change in an industry so that the industry adapts to the challenges posed by financial globalisation. According to Atkinson and Coleman (1989a), "[w]hat distinguishes an anticipatory approach from a reactive one is the predisposition on the part of the state to intervene in the industrial organisation of the sector ... [anticipatory policies] aim beyond existing products and organisation" (p.61). In other words, through state intervention into the markets, anticipatory policies aim to promote industrial change and competitiveness in response to challenges posed by globalisation. According to Coleman (1996), state strength and weakness at the sectoral level in the financial services industry is based on (1) the *balance* between the perspectives of the Central Bank and the Finance Ministry; and (2) the degree to which ultimate decision-making power is *concentrated* in the hands of a relatively small number of officials. Following Katszenstein (1978) and Zysman (1983), Coleman argues that two properties of the regulatory agencies are important:

> First, finance ministries and central banks bring different perfectives and kinds of expertise to the policy process. The power of the state will be maximised when the institutions ensure that there is a *balance* between these two perspectives in the policy process. When one agency clearly dominates the other, the state does not maximise its own political power potential and becomes more vulnerable to pressure from societal actors. (Coleman, 1996, p.67, original emphasis)

Following this perspective, this chapter investigates whether there was a *balance* between the Reserve Bank of Australia (RBA) and the Treasury Department.

Coleman details the second property:

> Second, when faced with the rapid changes associated with globalisation, states may seek to engage in broader, longer-term *anticipatory* policymaking. The capacity of states to approach policymaking in an anticipatory fashion will be greater when policymaking responsibilities are confined to a smaller set of actors. As the number of state actors participating in the policy process increases, the problems of coordination and consensus-building intensify. (Coleman, 1996, p.67, emphasis in the original)

Accordingly, this chapter also explores whether financial policymaking was limited to a small number of state actors.

Consequently, there are three sets of questions that have to be addressed:

> First, is there a balance between the perspectives of the central bank and the finance ministry? A balance permits formulation of policies that are more likely to address the competing objectives coming from financial services firms, their clients and the public interest. Second, is this balance achieved in an environment characterised by concentration rather than bureaucratic competition? The positive coordination that comes from a concertation, problem-solving style helps create a synergy that optimises overall policy performance. Finally, is the number of agencies involved in policy-making small and thus more likely to pose fewer obstacles to coordination of perspectives and views? We assume that state structures with these properties will be better placed to engage in broader, longer-term anticipatory policy-making in the face of globalisation. (p.74)

In addition to these parameters of state capacity, Coleman (1996) argues that "an assessment of state power must take account of the properties of policy networks, the structures that characterise the relationships between societal and state actors" [where the structures take a pluralist network form] "the state shares the exercise of political power with one or more key societal groups" (p.68). Atkinson and Coleman (1989a, p.60) have already argued that the Australian networks confirm the pressure pluralist model and Australian State has a reactive approach to industrial policy. Similarly, Head and Bell (1994) confirmed Atkinson and Coleman's (1989a) view that "[i]nstances of strong state coordination or centralisation are rare in Australian experience due to fragmentation of the Australian State and business interests which, in turn, facilitate neither state-led or business-led leadership for anticipatory, proactive or coherent policymaking" (p.60).

In relation to the Wallis era, the assessment of the state capacity to engage in anticipatory or reactive policymaking requires the assessment of the roles of the financial regulators, and their regulatory policy preferences and interaction with the State. Did institutional arrangements in Australia favour low state capacity? Was the establishment of the APRA a reactive response of the Australian State to financial regulation? This chapter deals with the former question while Chapter six will examine and discuss the latter in detail.

4.3 The Financial Regulatory Framework before the Wallis Inquiry

It extends beyond the scope of this section to fully discuss the factors associated with the history and evolution of financial prudential regulation, its practical and theoretical aspects, and bank mergers in Australia. Furthermore, a burgeoning literature on the subject already devotes itself to this task. For present purposes, however, it is important to understand the regulatory framework and bank merger regulations which prevailed before the Wallis Inquiry. An analysis of these will be preparatory for further analyses in subsequent chapters which also refer to state capacity in practice during the Wallis era (Chapter six) and the significance of the role of the Treasurer in bank merger assessments (Chapter eight). In order to put prudential regulation and the regulation of mergers into a financial regulation context, 'a typology of regulation' presented by the Organisation for Economic Cooperation and Development (OECD), should be briefly introduced.

As shown in Table 4.1 (p.69), prudential regulation is an essential objective of financial policy for attaining the objective of the prevention of systemic risks (risk of widespread contagion-failure in a company spreads to entire organisation and/or industry) while the regulation of bank mergers performs the same function for the objective of the promotion of systemic efficiency (the efficiency of national financial system by promoting competition) in a financial system. Prudential regulation involves the supervision of balance-sheet ratios with special reference to capital adequacy or liquidity and of norms aimed at a proper diversification of risk exposure (OECD, 1992, pp.34-5). In other words, institutions are regulated with a view to minimising their chance of insolvency – inability to meet demands of creditors which may lead to bankruptcy. The merger regulation, on the other hand, mainly refers to preventing "undue concentration of economic power" (OECD, p.32).

Table 4.1 Types of Financial Regulation

Prevention of systemic risks
A. Restriction of market forces
Price regulation
Fixing interest rates
Permitting price cartels
Direct lending controls and compulsory investment schemes
Restrictions on cross-border capital flows
Restrictions on the range of activities [of banks]
Specialisation of bank
Compartmentalisation banking/securities/insurance
Separation of banking and commerce
Restrictions on cross-border financial services
Restrictions on establishment [of banks]
B. Prudential regulation
Supervision of balance-sheet ratios and risk diversification*
On-site inspection and external auditing
Prevention of individual risks
Quality standards and codes of conduct
Disclosure and information requirements
Deposit protection schemes
Promotion of systemic efficiency
Prohibition of restrictive business practices and cartels
Regulation of mergers

Source: OECD (1992, p.33).
Note: * including risks from off-balance sheet activities.

This section specifically deals with the financial regulatory arrangements whereas the next section examines the role of the Australian Competition and Consumer Commission (ACCC) and the Treasurer in mergers among deposit-taking institutions with special reference to the 'six pillars' policy.

The prudential framework before the Wallis Inquiry was institutionally based, with separate agencies regulating different classes of institutions. The RBA had responsibility for prudential supervision of banks. The Insurance and

Superannuation Commission (ISC) had responsibility for insurers and superannuation funds. The state and territory-based State Supervisory Authorities (SSAs) were responsible for the day-to-day supervision of building societies, friendly societies and credit unions under the administration of the Australian Financial Institutions Commission (AFIC). In addition to these prudential regulatory institutions, consumer protection was ensured by the Australian Securities Commission (ASC) which reported to the Treasurer and was responsible for the management of the Corporations Law throughout the Commonwealth, States and Territories.[4] Finally, the Council of Financial Supervisors (CFS) was responsible for the coordination and cooperation among these supervisory agencies. In addition to these financial regulatory institutions, there was the ACCC which was responsible for competition policy. This policy also included the assessment of bank mergers (see Figure 4.1 on p.72). In the following paragraphs, the main functions of these regulatory agencies will be introduced in order to demonstrate the institutional nature of prudential regulation in Australia before the Wallis Inquiry.

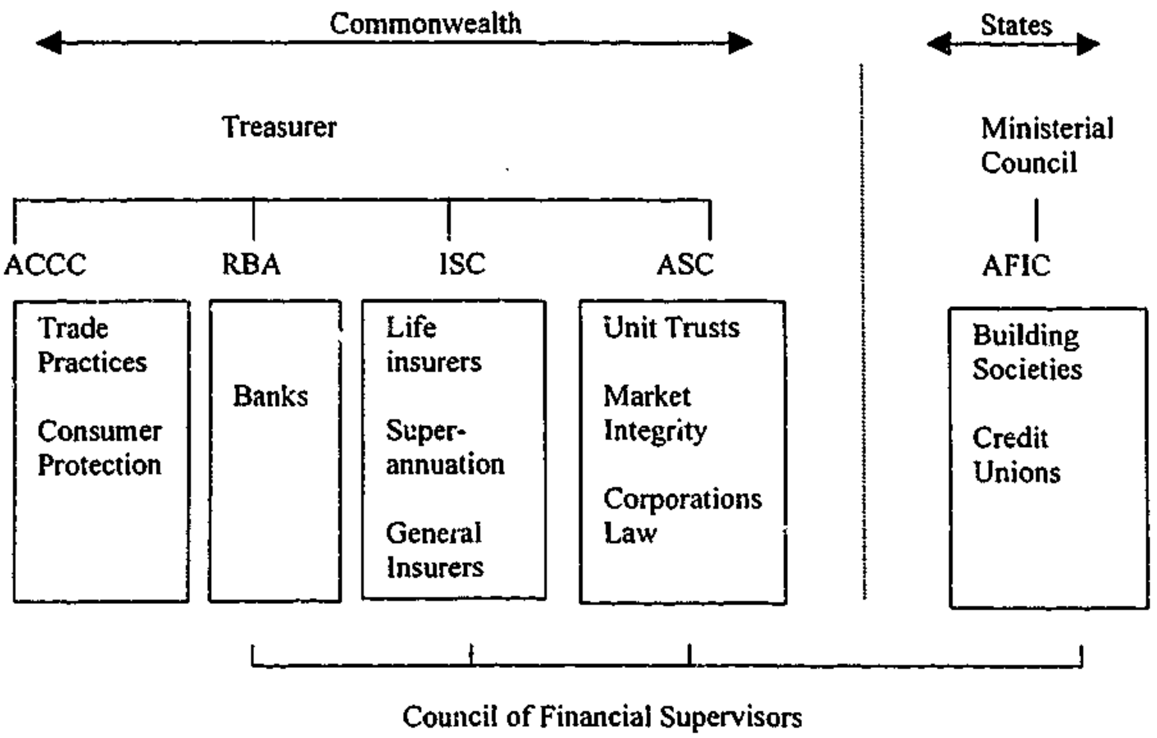
[4] Commonwealth and Federal are used as synonymous terms throughout this thesis in connection with Australia's national government in Canberra.

The institutional approach to the prudential supervision of the Australian financial industry was largely a product of history. Under the Australian Constitution (see, part v s.51, p.xiii) regulation of the financial industry was divided between the Commonwealth and the States. Accordingly, the legislative power is distributed between Commonwealth regulatory agencies (e.g., RBA) and the state and territory-based regulatory agencies (e.g., AFIC and SSAs). As Thomson and Abbott (2000) point out:

> The existing institutional boundaries are mainly a result of historical accident rather than of natural market segmentation or public policy design, and reflect the traditional division of responsibilities of different financial intermediaries and evolution of regulation along institutional rather than along functional lines...Part v s51 xiii of the Australian constitution gives the Australian government power to make laws concerning operation of banks and the issue of currency. This section has always been interpreted as meaning that other financial institutions (with the exception of insurance that also has its own clause in the Constitution) would come under the jurisdiction of the state parliaments. (pp.75-6)

In sum, the *fragmented* institutional regulatory structure was largely a product of history, since the constitutional responsibilities for regulation were divided between the Commonwealth and the State regulatory agencies (Goldsworthy et al. 2000, p.2).

Figure 4.1 The Institutional Approach to Regulation: The Pre-Wallis Framework



Source: Goldsworthy et al. (2000, p.2).

As Figure 4.1 illustrates, the regulation of financial intermediaries, broadly defined, was split between the RBA (banks), the ASC (unit trusts, merchant banks, finance companies and pastoral finance companies),[5] the ISC (insurance companies) and the AFIC/States (building societies, credit unions). The RBA, the ASC and the ISC had responsibilities at the Commonwealth level. These agencies were reporting to the Treasurer. The AFIC was operating at the State/Territory level and was reporting to the Ministerial Council of Financial Institutions. A brief discussion on this institutional framework is presented below with special

[5] The ASC was responsible for the regulation of fundraising, securities and futures markets and the exchange activities of these firms (market integrity) as well as for the administration and enforcement of the Corporations Law.

reference to the supervisors.

The Bank Supervision Department of the RBA was established in 1984. The RBA was responsible for the prudential supervision of banks authorised under the *Banking Act 1959*.[6] The act specified two broad objectives for bank supervision: "to protect the depositors of banks and to supervise banks to minimise the potential for problems to arise in the banking sector which might cause instability in the broader financial system" (CFS, 1997, p.53).[7] Following the Campbell Inquiry, supervisory arrangements became "more formalised" when financial markets were deregulated (OECD, 1992, p.82).[8] A bank supervision unit was established by the RBA in 1984. Amendments to the *Banking Act* in 1989 gave the RBA explicit powers for prudential supervision of banks. It was also greater power to seek information from banks for prudential purposes and to investigate their affairs (OECD, 1992, p.82). The prudential regulation by the RBA covers: capital adequacy; liquidity management; large credit exposures; foreign exchange exposures; off-balance sheet exposures; ownership and control; and banks' associations with non-banks.

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[6] These include Australian-owned banks, foreign subsidiary banks and branches of foreign banks.

[7] The main aspects of banks' activities covered by the prudential statements include: ownership and control, capital adequacy, liquidity, large credit exposures, impaired assets, associations with non-bank entities, funds management and securitisation activities, and external auditor arrangements.

[8] Financial deregulation in Australia gained ground in the mid-1980s after the Campbell Inquiry recommendations. Key steps in deregulation in the 1970s and 1980s were the removal of controls over bank interest rates, freeing up of interest rates on government securities in 1979 and 1981, floating the exchange rate in 1983, and finally opening up the banking system to foreign competition in 1985. For an examination of developments in Australian financial markets, see FSI, 1997, ch.14.

However, the RBA's prudential authority did not cover the entire spectrum of deposit-taking institutions across Australia such as building societies, friendly societies and credit unions. Therefore, the AFIC was the national supervisor of building societies, credit unions and friendly societies under the Financial Institutions (FI) Scheme. The formation of the AFIC was in response to the collapse in June 1990 of Pyramid Building Society, Victoria's biggest building society owned by the Farrow group building societies[9] (see Burrell, 1990, p.55; Carmichael, 1992, pp.254-6; and Thomson and Abbott, 2000, p.76). Jeffrey Carmichael, the then chairman of the AFIC, clearly makes the point:

> To some Pyramid was a disaster, to others it was a opportunity to press for long overdue reforms. While Pyramid may have been an extreme case, it was not the problem with the industry. Pyramid was symptomatic of an approach that ran through the industry in a number of states...In particular, it highlighted the enormous interstate differences that existed in legislation and the way in which that legislation was being enforced. The problem was more than just a matter of dissolving the various pieces of legislation into one. The interstate barriers of non-uniformity had unbalanced the playing field. In Queensland, building societies, for example, were restricted to lending only against fully insured mortgages. In Victoria, some building societies were little more than property development companies. It was like trying to have a State of Origin football match in which every state played its own code of football...It [the collapse of Pyramid] created an air of cooperation probably never before seen among the States. (Carmichael, 1992, p.254)

The AFIC was modelled on the rules applied by the RBA to the banking system such as eight per cent capital adequacy ratio. The AFIC's key responsibilities were to promote integrity and efficiency of the FI Scheme; maintain the effective implementation of prudential and other standards; and ensure a uniform system of supervision of these institutions by SSAs across Australia (Carmichael, 1992,

[9] To get around the limitations of building society regulation, Farrow established a variety of finance companies and mortgage trusts that allowed the group to operate interstate.

p.255). Accordingly, the FI Scheme had very similar principles to those adopted by the Reserve Bank. There were eight SSAs; the New South Wales Financial Institutions Commission, the Victorian Financial Institutions Commission, the Register of Financial Institutions, the Western Australian Financial Institutions Authority, the Queensland Office of Finance Supervision, the South Australian Office of Financial Supervision, Registrar of Financial Institutions, and the Tasmanian Office of Financial Supervision. In other words, "AFIC set the prudential standards and coordinated the supervision of FI Scheme institutions while the day-to-day supervision rested with the individual SSAs" (Goldsworthy *et al.*, 2000, p.3). And "[e]ach SSA was responsible for ensuring that those building societies registered in its jurisdiction complied with AFIC's standards" (Goldsworthy *et al.*, p.3). In other words, there were eight autonomous state supervisory agencies located in each of the six state territories in Australia.

The ISC was established in 1987 as the financial supervisor of the insurance and superannuation institutions. It derived its supervisory powers from Acts of Parliament.[10] The ISC had two main supervisory roles: First, prudential supervision of the insurance and superannuation industries in the interests of policyholders and fund members; secondly, supervision of compliance by superannuation entities and Retirement Savings Accounts providers. Financial

[10] Separate regulation covered the regulation of life insurance companies (Life Insurance Act 1995), general insurers (Insurance Act 1973) and superannuation funds (Superannuation Industry (Supervision) Act 1993). The ISC also had responsibility for market integrity and consumer protection in relation to insurance and superannuation products.

stability, effective competition and investor protection were the three key policy objectives of the ISC.

The ASC, which began operations on 1 January 1991, had multi-geographical responsibility for the administration of the Corporations Law at Commonwealth, States and Territories level in order to protect consumers of financial products from fraud and market manipulation, and to promote confidence in the integrity of the securities and futures markets. "The ASC seeks to maximise the credibility of Australian corporations and securities markets" (CFS, 1997, pp.58-9). In other words, the regulation of companies and of the securities market (eg., debentures, stocks, and bonds) was the responsibility of the ASC.

These four supervisors had a joint meeting every three months for a meeting of the CFS. The Council was formed in 1992[11] to improve coordination and communication among the four main financial regulatory agencies (RBA, ISC, ASC and AFIC) in the supervision of *entities* in financial conglomerates.[12] Its activities focused on eliminating "regulatory gaps, overlaps, and on harmonising the regulators' inconsistent treatment of products" (FSI, 1997, p.647). During the mid-1990s, the CFS focused on the supervision of financial conglomerates. As a result, "the CFS has served as a forum to develop principles

[11] The CFS was a product of the Martin Committee (1991, p.233) which has emphasised that "the continuing trend within the financial system for the creation of financial conglomerates creates a need for closer coordination between the various supervisory organisations."

[12] Technological and technical innovations in finance enable financial firms to diversify their activities and provide a wider range of services. This is resulting in financial conglomeration where traditional boundaries between different types of financial firms are blurring (see Tripartite Group of Securities, Insurance and Bank Regulators, 1995).

of supervision based on a 'lead regulator' model" (FSI, p.646). Under this model "all entities of a conglomerate are assessed on a stand-alone basis by their respective regulators" (p.646). In other words, the CFS designate one supervisor as 'lead regulator,' but that supervision of the individual units of a conglomerate remain with the individual supervisors. Thus, conglomerate activities across business lines are distributed in the lead regulator model. To illustrate this, in the case of a group whose main business was banking, the RBA would be the lead regulator, while the ISC would take the lead role where insurance was the group's largest single activity. In addition, an assigned lead regulator reviews the whole group. To sum up, the lead regulator model based on institutionally based financial regulation was being undertaken in Australia under the leadership of the CFS. Close coordination among regulators is required in this regulatory arrangement. As the Wallis Report puts it:

> Financial conglomerates have complex links among their constituent entities of different types. This is especially so for full-service and internationally operating conglomerates. Therefore, in order to meet their individual objectives, the financial regulatory agencies must work in close coordination, sharing detailed information, reaching common views on such things as group wide risk management systems and intra-group financial relations, and if necessary handling jointly any emergencies. (FSI, 1997, p.542)

In other words, under the leadership of the CFS, Australia adopted a lead regulator model as a response to the growth of financial conglomerates. With this model, the same corporate entity offers both banking, insurance and investment products. However, the CFS did not promote the application of harmonised rules to all financial institutions or products, since it was not itself a statutory body, nor was it a prudential supervisor or regulator in its own right. In other words, the statutory responsibilities and powers of the CFS members had not been changed with its creation.

Apart from these industry regulators, the Markets Group at the Treasury was charged with advising the government on a framework of legislation and financial services industry supervision. In other words, the Treasury was not the supervisor or the regulator of the industry. However, as will be detailed in Chapter six, the Treasury drove the State on the re-configuration of the regulatory system during the Wallis period. Moreover, the Treasury bureaucrats were highly influential and wielded considerable power during the policy process, leading to the regulatory change resulting from the Wallis Inquiry.

So far, it has been argued that the distinctive feature of the prudential regulation of the financial system in the pre-Wallis era was the fragmentation of regulatory bodies at the Commonwealth and State/Territory level. Furthermore, the deposit-taking institutions were supervised by different supervisory bodies according to their name or legal title. Accordingly, the fragmented institutional arrangements in Australia should have provided low state capacity. In particular, there are three possible reasons. Firstly, the large number of key agencies (RBA, ISC, AFIC with SSAs, ASC) in the policy network should have lowered state capacity. Specifically, there were three main prudential regulators (RBA, ISC, AFIC) as well as eight autonomous state agencies (SSAs). Thus, there were 11 separate public sector actors responsible for the administration of prudential regulation of various financial institutions in Australia. Secondly, the relationship between the RBA and the Treasury had been less balanced. The RBA not only acted as banking supervisor, but also had primary responsibility for formulating and implementing banking policy whereas the Treasury had no direct or ancillary role in the regulation or supervision of financial services firms. The Treasury had only an advisory role on financial issues to the government. However, as will be detailed in Chapter five, the Treasury dominated the policy process during the Wallis era. Thirdly, no structure existed that would encourage concertation between the RBA and the Treasury in financial regulation.

4.4 Bank Merger Regulations before the Wallis Inquiry

This section considers the merger laws and policies in the financial sector, and their administration with special reference to the role of the ACCC and the Treasurer in the *Trade Practices Act 1979*, *Banking Act 1959* and the *Bank (Shareholdings) Act 1972* and the *Insurance Acquisitions and Takeovers Act 1991*. It will be shown that the ACCC administers section 50 of the *Trade Practices Act* at the Commonwealth level and reports to the Treasurer. The Treasurer has the discretion under banking, insurance and foreign investment legislation to reject a proposal with special reference to public interest considerations.

The ACCC was formed on 6 November 1995 by the merger of the Trade Practices Commission and the Prices Surveillance Authority.[13] It had consumer protection responsibility for financial services and also enforced the competition

[13] The establishment of an Independent Committee of Inquiry into national competition policy in 1992 led to the establishment of the ACCC which was in line with the then Prime Minister Paul Keating's campaign for microeconomic reform (*Age* 16 October 1992).

laws contained in the *Trade Practices Act 1974*. The ACCC was the only national agency dealing generally with competition matters and the only agency with responsibility for enforcement of the *Trade Practices Act* and the associated State/Territory legislation. The ACCC implements national competition policy which "seeks to facilitate effective competition to promote efficiency and economic growth while accommodating situations where competition does not achieve efficiency or conflicts with other social objectives" (*Independent Committee of Inquiry into Competition Policy in Australia*, 1993, p.xvi).

The banking and insurance laws were assessed under the *Trade Practices Act 1974* by the ACCC. The point was well made in the Wallis Report:

> Laws governing mergers in the financial system are contained in banking and insurance legislation as well as in the *Trade Practices Act 1974* ... The Trade Practices Act provides a set of economy wide competition laws including provisions governing mergers...In brief, s.50 of the Trade Practices Act prohibits mergers and acquisitions which would have the effect, or likely effect, of substantially lessening competition in a substantial market for goods or services. Whether a specific merger would breach the s.50 test is a matter for determination on the facts at the time of its proposal. In the first instance, the Australian Competition and Consumer Commission (ACCC) may form a view in relation to a particular merger and advise the parties accordingly. However, any view so formed does not of itself prevent the merger from proceeding. If a merger proceeds in circumstances where the ACCC has formed the view that it would breach s. 50, the Commission may apply to the Federal Court to have the merger declared in breach of the law – in which case penalties may be applied and the merger prevented or overturned. The Trade Practices Act also provides a process whereby authorisation can be granted, on public benefit grounds, for mergers which would otherwise breach s.50. Under s.90(9) of the Act, the ACCC may grant an authorisation to an applicant if it is satisfied:
>
> *in all the circumstances that the proposed acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place*...(Quoted in FSI, 1997, p.418, original italics)

As shown above, the ACCC plays a competition watchdog role in evaluating mergers under the *Trade Practices Act 1974*.

However, potential mergers between Australia's banks need to gain prior approval of the Federal Treasurer under Section 63 of the *Banking Act (1959)* and the *Banks (Shareholdings) Act (1972)*. Thus, like the ACCC, the role of the Treasurer in mergers among deposit-taking institutions has been very significant in Australia. Therefore, it should be examined closely. The Treasurer's powers to approve or reject mergers are stipulated under section 63 of the Banking Act 1959 which is widely understood as being an integral legislative requirement that underpins the government's bank merger policies. According to the *Banking Act 1959*: "Section 8 prohibits a company from carrying on a banking business without an 'authority'; section 9 provides for applications for banking authorities to be made to the Treasurer" (Baxt, 1990, p.6). The Banks (Shareholdings) Act also limits the proportion of voting shares which an individual or associated persons may hold in a bank. For example, "[t]o ensure a wide spread of ownership in order to minimise the possibility of a bank being prejudiced by the influence or varying fortunes of a particular shareholder" [*Banks (Shareholdings) Act 1972*] "[l]imits individual shareholdings in banks to 10%, subject to exemptions granted by the Treasurer for shareholdings of up to 15%, or by the Governor-General for shareholdings above 15%" (FSI, 1997, p.732). Exemption from the 15 per cent limit may be given where it is considered to be in the national interest. In other words, "[a] national interest test is applied to determine whether or not an exemption should be granted" (FSI, p.422). It is important that the ultimate political responsibility rests with the government for a decision in which all citizens have a substantial interest, both economic and social. The Treasurer may approve bank mergers if considered to be in the national interest.

> The Treasurer has powers over bank mergers under the *Banking Act 1959* and the *Banks (Shareholdings) Act 1972*. The Banking Act provides for the authorisation of banks and for the imposition of conditions on bank authorities. It also requires authorised banks to seek the prior consent of the Treasurer to effect a sale, amalgamation or reconstruction, or to form a partnership or association (s. 63). The Act provides no guidance on how the Treasurer is to exercise this discretion beyond stating that the Treasurer's consent shall not be unreasonably withheld. (FSI, 1997, p.421)

In its submission to the Wallis Committee, the Treasury sheds light on the public interest factors that the Treasurer considers in practice:

> [A]ny prudential considerations, the potential efficiency gains resulting from any rationalisation, and any potential losses resulting from reduced competition in the financial sector. (Treasury, 1996a, p.143)

The *Insurance Acquisitions and Takeovers Act 1991* also provided analogous powers to the Treasurer:

> These [powers] give the Treasurer the power to stop the acquisition, or issue, of shares in Australian registered insurance companies which would result in a person controlling 15 per cent or more of the shares. If an unauthorised action is carried out, the Treasurer can make a divestment order. This law states that its objectives are to protect the public interest in a number of ways, including by protecting prudential standards, preventing unsuitable persons from being in a position of influence, and preventing undue concentration of economic power. While the primary focus of these objectives is prudential, this legislation also gives the Treasurer scope to regulate acquisitions in the insurance industry on competition grounds. (FSI, 1997, p.422)

In other words, the Treasurer must be notified if share acquisitions or issues would result in a controlling interest of more than 15 per cent. The Treasurer then has 30 days to provide a conditional or unconditional approval or to issue a restraining order (FSI, 1997, p.338). In practice, "many acquisitions are authorised by the ISC under a delegation from the Treasurer" (1997, fn.13, p.338). The Keating government introduced the 'six pillars' policy preventing in-market mergers between the biggest four banks and two insurance companies on 23 May 1990.[14] The 'six pillars' policy was introduced to prevent undue concentration of economic power which was maintained mainly through the legal powers of the Treasurer over mergers among big financial companies which would create new financial conglomerates.

4.5 Conclusion

The degree of state capacity affects the type of the financial industrial policy adopted by policymakers in a world of global finance (Coleman, 1996). As state capacity increases, policymakers have options to choose whether to follow an anticipatory or a reactive approach to policymaking (Coleman, 1996, ch.4). According to Coleman, as capacity decreases, states are likely to adopt a reactive approach. The second section of this chapter has focused on the institutional arrangements to assess the Australian State's potential to engage in anticipatory policymaking.

The analysis based on Coleman (1996, ch.4) in this chapter suggests that institutional arrangements in Australia favoured low state capacity. The large number of key state agencies in the financial policy network has lowered the state capacity. There were 13 financial regulatory agencies (RBA, ISC, ASC, AFIC, eight SSAs, and ACCC) sitting at the core of the policy network. The Australian constitution encouraged fragmentation rather than centralisation among

[14] A brief history of the 'six pillars' policy is provided in Chapter eight.

Commonwealth regulators (eg., RBA, ISC, ASC) and the state- and territory-based regulatory agencies (eg., AFIC/SSAs). The CFS aimed to achieve coordination among the financial regulators. However, the CFS had no centralised regulatory powers. Specifically, principal responsibility for the design of regulations, their implementation, and for the supervision of banking firms was lodged with the RBA. Moreover, the Treasury Department had no supervisory role in the financial regulation. Thus, there was no concertation and balance between the RBA and the Treasury as the RBA had the policymaking and implementation responsibility. The application of the parameters of institutional structure supports Atkinson and Coleman's (1989a, p.60) assertion that the Australian State has a reactive approach to industrial policy. Accordingly, it is expected that the empirical evidence on the establishment of the Wallis Inquiry (Chapter five) and the APRA (Chapter six) should support this prediction.[15]

The chapter has shown that the institutional arrangements in financial regulation were pointing to the weak state capacity in Australia. Moreover, it also emphasised that the ACCC and the Treasurer were the key state actors in merger policy discussions. The third section of the chapter underlined the distinctive institutional framework –the Treasurer's veto power in the bank merger issues. The final decision on bank mergers was not left to the bureaucracy (ie., ACCC) but to the Treasurer in Australia. The point becomes significant in the analysis of the 'four pillars' policy in Chapter eight.

[15] However, as will be detailed in Chapters five and six, contrary to the predictions of the state capacity framework, the Australian State showed leadership in pursuing anticipatory policymaking in the financial services industry.

CHAPTER FIVE[1]

THE CASE OF THE WALLIS INQUIRY

5.1 Introduction

On 2 March 1996, the Liberal Party won its first federal election after 13 years of Australian Labor Party (ALP) rule. On 30 May 1996, one of the first acts of the Treasurer of the Howard Coalition government, Peter Costello, was to establish the third major national Inquiry to review the Australian financial system (later known as the Wallis Inquiry).[2]

The reasons for the establishment of the Inquiry were puzzling. Interviews with very senior insiders revealed quickly that the then existing regulatory system was apparently working well, and there was no visible external or domestic threat challenging the political authority of the then existing industry regulators, and/or economic interests of key private sector actors (i.e., the four major banks and the two biggest insurance companies). For example, in the words of a senior bureaucrat:

> We did not need the [regulatory] change and in fact that is why the debate was funny. We can see there was no natural constituency demanding change because the system was working well ... [In addition] the Inquiry was not critical in the sense that there were not any pressures out of the market such as failures or anything else. (Interview, 19 February 2001)[3]

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[1] A version of this chapter entitled "Who needs a review of the financial system? The Case of the Wallis Inquiry" was submitted to the *Australian Journal of Political Science* in June 2002. It is currently being revised and will be resubmitted. This paper will also be presented at the 50th Australasian Political Studies Association conference (refereed), Canberra in October 2002. It will be published on the conference web site <http://arts.anu.edu.au/sss/apsa/>.

[2] For comprehensive overviews of the Wallis Report, see Harding (1997); Harper (1998); Perkins (1998).

[3] Similar comments have been made more than one insider.

If the then existing regulators and regulated firms in the financial services industry were not pressuring for regulatory change, and there was no market failure necessitating a case for the government's regulatory intervention, then why was it that the government established the Inquiry?

How governmental agendas are set, who affects them and why, and why some decisions, rather than others, are made by governments have always been among the central questions in policy analysis (Downs, 1972; Kingdon, 1984, 1995; Baumgartner and Jones, 1991, 1993). The purpose of this chapter is to discuss the central features of the agenda setting process in financial regulation in Australia with special references to those questions.[4] The context of the research concerns the central premise of the financial regulatory change proposed by the Wallis Inquiry (FSI, 1997) and adopted by the Howard government: the reorientation of the then existing institutionally based financial regulation towards a functionally based one with new prudential and disclosure regulators. Specifically, this chapter takes a closer look at the governmental agenda setting process and the role of the Inquiry in financial policymaking.[5] The theoretical underpinning of the discussion emanates from John Kingdon's pioneering work on governmental agenda setting (Kingdon, 1984, 1995). This will involve applying a framework of interpretation based on three policy streams within the

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[4] Broadly speaking, here 'agenda setting' refers to the process by which issues rise to prominence in political discussion in society.

[5] The term 'agenda' is defined as "the list of subjects or problems to which governmental officials, and people outside of government closely associated with those officials, are paying some serious attention at any given time" (Kingdon, 1995, p.3).

process: problems, policies and politics. Kingdon's framework will be introduced during the discussion.

The remainder of the chapter is divided into six sections. The first section will summarise the current state of knowledge on the role of the Inquiry in Australian financial policymaking. The second shows that the bureaucratic agenda of the Treasury Department included financial regulatory change from institutional arrangements towards a functional one with new prudential and disclosure regulators. The abstract financial regulatory model (i.e., the 'twin peaks') and its specific solutions were already available. The Treasury sold this 'twin peaks' idea to the then Labor government Treasurer and Liberal Party opposition shadow Treasurer before the 1996 federal election. However, the Treasury needed political leadership to push its proposals. The third section argues that a 'political window' was opened following the federal election. The new government was keen to achieve financial regulatory reforms to proactively address future regulatory challenges and the new Treasurer wanted to consolidate his power within markets and politics. Costello as a 'policy entrepreneur' coupled the Treasury's solutions to problems and to political process. The fourth section argues that the Wallis Committee was a blend of 'representative' and 'expert' committees rather than an 'impartial' one. Thus, it was not independent of both government and business. In fact, it was 'packed' by the government in accordance with its regulatory policy preferences. Requesting advice from this apparently 'independent' Committee, the formal and transparent Inquiry process helped the government to appear more democratic in policymaking. However, as the fifth section argues, this was not a case of the government pressuring for its policy preferences over the financial services industry. In fact, the Wallis Inquiry was used as a 'venue' to generate the industry and public support for the regulatory changes. It was used to build a network of alliances within and outside the parliament. The concluding section summaries these discussions.

5.2 A Previous Work on the Role of the Wallis Inquiry in Australian Policymaking

As Presser (1994, p.1) noted "Royal commissions and public inquiries have a long history in Australia..." The role of financial inquiries (or task forces) in government–business relations in Australia, however, has not been subject to extensive research.[6] There is only one study by Chaudhri and Samson (2000) which examine financial services (Wallis Inquiry) and wool (Wool Industry Future Direction Task Force, 1999) task forces to illustrate the dynamics of Australian government–business relations in a game theory context. Regarding the Wallis Inquiry, they argue that:

> The Wallis task force was conducted essentially *independently* of government, and involved wide and deep consultation with the major business players, as well as with consumer groups, government departments, and other stakeholders...Like the wool task force, the financial-services Inquiry provided a process in which the gaming of government and business could be considered *independently* of these players. (Chaudhri and Samson, 2000, p.25, emphasis added)

Chaudhri and Samson (2000) argue that task forces in Australia comprise people "generally *independent* of both business and government," and "the

[6] However, there are studies on public inquiries and their role in policymaking. See, for example, Weller eds. (1994); Prasser (1992).

Australian government uses task forces as vehicles to periodically *intervene* in and adjust policy frameworks, and to create new policy and a new set of dynamics for business–government relations and behaviours" (pp.19, 22, my emphases).[7] They are also explicit that the government could not make proactive decisions in the restructuring and regulation of business: It is the Australian companies that "*anticipate changes* in business environment," not the governments which "are responsible for setting rules of competition and regulating the strategic games that the private sector plays" (p.21, emphasis added).

Although not discounting completely this perspective, this chapter will show that the Wallis inquiry and its members were not independent of both government and business, and the establishment of the Inquiry was the government's anticipatory approach to adjust regulatory arrangements to cope with future changes in the industry.

5.3 The Treasury Department, Problems and Policies

Many assume that:

> There can be no denying that Treasury's relative status and influence in Canberra has declined in the last twenty years. Although Treasury is still very powerful, it is no longer pre-eminent. (Bell, 1997b, pp.34-5, Shann, 1987)

Following Shann (1987, p.24), Bell (1997, p.34) argues that the "[Treasury] never dominated microeconomic advice [e.g., advising on financial regulation]." It is suggested that "Treasury's relative position has been weakened somewhat by the

[7] However, it is interesting to question that if a task force (e.g., the Wallis Inquiry as they argued) is independent of the Australian government, how does the government use it as a vehicle to intervene in markets?

rise in policy influence of the Reserve Bank of Australia" (Bell 1997, 35; see also Shann, 1987, pp.25, 27),[8] and the splitting off of Finance from the Treasury on 18 November 1976 by Malcolm Fraser, in part, ended "its dominance over economic advice and expenditure policy" (Wanna, Kelly and Forster, 2000, p.95; Shann, 1987; Bell, 1997).[9] Conversely, the rest of this chapter will show that the Treasury was the pre-eminent bureaucratic institution in financial policymaking during the Wallis era.

The Treasury is one of the key public sector actors within the 'official family'[10] of Australian economic and financial policymaking. One of its policy objectives is the "promotion of an efficient, competitive and stable Australian financial system" (Treasury, 1998, p.11). In order to do so, it advises the government on financial system laws[11] and on "policy processes and reforms" (Treasury, 2001, p.7).

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[8] It is argued that deregulation of the 1980s, particularly the decision in 1983 to float the Australian dollar and abolish exchange controls, which the Treasury previously controlled itself, strengthened the role of RBA in economic policymaking while weakening that of the Treasury (see also Schedvin 1992, 548-9; Edwards 1996, 330-1; Macfarlane 1998, Bell 2001, 463).

[9] The Treasury opposed Fraser's desire for a substantial devaluation of the Australian dollar in 1976. The conflict resulted in major institutional change that undermined the Treasury's power: the creation of the new Department of Finance in charge of public expenditure issues. For detailed discussions on splitting the Treasury, see Wanna, Kelly and Forster 2000, chs.4-5.

[10] Toohey (1994, p.150) uses the term 'official family' as "the main economic advisory bodies …[which]… include the departments of Treasury, Finance, and Prime Minister and Cabinet, the Reserve Bank and the Industry Commission" in order to point to actors who input into economic policy. However, as will be shown later, the family members do not have equal powers. In fact, the Treasury dominated and shaped the policy debate during the Wallis era.

[11] For example:

> The Treasury through its Markets Group, is charged with advising the government on policies and a framework of legislation and industry supervision that assist in increasing the efficiency, competitiveness and stability of Australia's financial system. The Treasury is also responsible for advising government on retirement income policies, including in relation to superannuation. (Memorandum, 1999)

The Treasury and its proposals are important relative to other agencies due to its traditional function as a financial controller, a combination of neutrality and superior knowledge monopoly, responsibility for the whole Australian economy, and a dedication to giving advice based on the public interest (Whitwell, 1986, pp.20-4). The Treasury is the principal adviser of the Treasury Ministers and is directly accountable to the Treasurer. It is a public actor in its own right in the domestic policy processes (Whitwell, 1986). As a former deputy Treasury head, David Morgan, stated in an interview with national ABC television in 1993: "Treasury have always had its own agenda, always will have" (quoted in Toohey, 1994, p.152).

A review of the regulatory structure of the financial industry had been on the bureaucratic agenda of the Treasury before the election in March 1996 (*Australian Financial Review* 5 February 1996). The Treasury had tried to transfer its nongovernmental, 'systemic' agenda to a governmental, 'formal' agenda through mobilising the then Treasurer and shadow Treasurer. Ralph Willis, the then Labor Treasurer, and Costello, the then Liberal opposition Treasury spokesman, adopted the Treasury's agenda for financial regulatory reform before the election (*Sydney Morning Herald* 3 January 1996). As a senior respondent observes:

> The Treasury had actually pushed the opposition and the government. Before the time of the election both [Willis and Costello] agreed to have an inquiry. Whenever that happens you see hands of bureaucrats behind the curtain. (Interview, 30 May 2001)

Specifically, Costello and Willis publicly favoured a functional approach to prudential supervision, and the consolidation of prudential regulators as opposed to the then existing institution specific regime (see *Sydney Morning Herald* 24 January 1996). To illustrate, Willis flagged the need for changes to bank regulation (*Sydney Morning Herald* 3 February 1996). He accepted that the distinction among financial institutions had been blurred to the point where new rules may be needed (*Australian Financial Review* 2 February 1996). Similarly, Costello announced in November 1995 that the opposition Coalition would also undertake a comprehensive review of financial industry regulation (*Australian Financial Review* 2 February 1996; *Sydney Morning Herald* 3 February 1996). Costello argued that: "regulation should not be based on the institution concerned but the function or service provided by that institution, be it superannuation fund, major bank, regional bank or mortgage lender" (quoted in *Australian Financial Review* 5 February 1996). Both Willis and Costello shared similar views on the review of the Australian financial regulatory structure.[12] However, the Treasury's problem was that it had difficulty connecting its solutions to the political leadership during the years when Paul Keating was Prime Minister. The Labor government was not considering such a review, as Keating once declared (*Sydney Morning Herald* 3 February 1996). In response to Keating, Costello said in December 1995 that: "Mr Willis wants to follow the Coalition policy. Mr. Keating does not. Mr Willis is right" in restating the Coalition policy position (cited in *Sydney Morning Herald* 3 February 1996).

Why was the Treasury demanding a policy change? A senior respondent

[12] Willis and Costello did not respond the researcher's request for interview in 2000.

makes the point:

> The main bureaucratic interest of the [Treasury] department was due to its concern surrounding potential unstated liabilities associated with compulsory superannuation. The Treasury wanted more supervision of the superannuation sector. There was an agenda there. (Interview, 30 May 2001)

Superannuation is a key element of government policies to address the long-term consequences of an ageing population.[13] Thus, it is both a public policy instrument and a financial product. Accordingly, there was a case for prudential regulation of the superannuation sector.[14]

As Kingdon (1995) suggests, there are three kinds of processes involved in determining the governmental agenda – problems, policies (or solutions) and politics. For Kingdon, first contributors to governmental agendas might be "problems pressing in on the system" (p.16). In the Australian context, there were not financial problems pressuring for a regulatory change. However, there was a belief that the institution specific regulation was constraining the industry.

Policy makers can learn about problems through three mechanisms: dramatic events (e.g., crises), changes in widely respected indicators (e.g., crime

[13] The Wallis Report found that:

> Australia's ageing population has led successive Commonwealth governments to mandate compulsory superannuation to encourage individuals to bear greater responsibility for their retirement funding. This has resulted in a growing proportion of the nation's financial wealth being invested in superannuation relative to other investment vehicles. In addition, it has caused a shift in household assets towards market linked investments, meaning that households are directly bearing a greater proportion of investment risk than in the past. (FSI, 1997, p.119)

[14] It has been pointed out that:

> The compulsory nature of some superannuation savings, the lack of choice for a large number of members, the mandatory long-term nature of superannuation and the contribution to superannuation of taxation revenue forgone provide a case for prudential regulation of all superannuation funds, even where investors have knowingly accepted market risk. (Superannuation Working Group, 2001, p.2)

rates, cost indices), or feedback that there might be a problem which needs addressing (Kingdon, 1995, pp.16-7). In Australia, the Treasury feedback brought future regulatory problems to the government's attention. In regard to financial regulation, the Treasury highlighted the policy problem: the need to address future regulatory challenges in a world of global finance where sectoral, institutional and product boundaries were blurring: "Whether, from a functional perspective of evolving institutions, markets, and products, institutionally based regulation is appropriate will increasingly be open to question" (Treasury, 1996a, p.24). It argued that the institution specific regulatory structure made banks special. This in turn gave rise to a moral hazard (which occurs when consumers' deposits enjoy government protection)[15] and systemic problems (problems in individual institutions which threatened knock-on effects through the financial system as a whole) (Treasury, 1996a, pp.3, 17).

Again, as Kingdon (1995) suggests, a second contributor to governmental agendas "might be a process of gradual accumulation of *knowledge* and perspectives among the specialists in a given policy area, and the generation of policy proposals by such specialists" (p.17, my emphasis). The financial industry institutions are increasingly selling a wider variety of products under one roof (financial conglomeration) due largely to technological innovations. Such developments are accelerating a need for functional regulation with two main

[15] It has been argued by the Treasury that consumers assumed that the RBA's supervision implied that bank deposits were guaranteed by the government, and that this guarantee also extended to superannuation, and the life and general insurance products offered by the banks (Treasury, 1996a, p.4).

regulators which treat all providers of functionally equivalent products or services equivalently. For the Treasury (1996a), the main benefits of these changes would be fewer regulators as well as the development of appropriate regulatory arrangements that would minimise arbitrage, duplication, inconsistencies and gaps that might increasingly become main features of the then existing system. The Treasury emphasised the significance of a functional approach to ensure competitive neutrality:

> Ideally, products, intermediaries, or markets providing similar financial services should be subject to similar regulation. This could be defined as a 'functional' approach to regulation. Different regulatory treatment of similar institutions, products of markets can result in 'regulatory arbitrage', with wasteful time and effort directed at exploiting regulatory loopholes. (Treasury, 1996a, p.21)

According to the Treasury, there was a policy solution available to policy makers, namely the establishment of a functionally based regulatory structure via the creation of new regulators: "one option [was] the prospect of amalgamating the RBA [Reserve Bank of Australia] and the AFIC [Australian Financial Institutions Commission] to form a single 'prudential' regulator, and combining the ISC [Insurance and Superannuation Commission] and the ASC [Australian Securities Commission] to form essentially a 'disclosure' regulator" (Treasury, 1996a, p.4).

In the interviews conducted by the researcher, the Treasury senior bureaucrats frequently used words "twin peaks model" in referring to the Treasury's proposal for the financial regulation (prudential and disclosure regulators constituted 'twin peaks'). Where did this idea of 'twin peaks' come from? There is no simple answer as it is difficult to track the origins of policy ideas. Nevertheless, the rationalisation of the regulatory framework quite clearly represents an elaboration of an idea put forward by Michael Taylor, former officer of the Bank of England, and the then director of a course in financial services regulation at London Guildhall University. Taylor, in an article entitled ''Twin Peaks': A regulatory structure for the new century' which was published by the Center of the Study of Financial Innovation in December 1995, was the first academic to advocate functionally based financial regulation with prudential and disclosure regulators. The model proposed the consolidation of all prudential and all consumer protection responsibilities into two separate agencies.[16] Particularly, significant factor behind the need for the 'twin peaks' approach was knowledge about the obsolescence of institutionally based regulation in the financial services industry where institutional, sectoral, and product boundaries were blurring due to technological changes (Taylor, 1995).

"Taylor's article was floating around [in 1996]" (Interview, 19 February 2001) said one senior bureaucrat (see also *Australian Financial Review* 2 September 1996).[17] It is highly probable that the Treasury bureaucrats, who

[16] Although Taylor proposed the model for the UK, its influence in Britain was more limited. Taylor disagreed with the decision to create a single regulator (i.e., Financial Services Authority) for the UK.

[17] Taylor's 'twin peaks' paper was cited in the Inquiry's Discussion Paper (FSI Discussion Paper, 1996, p.415). Oddly it was neither cited in the bibliography to the Inquiry's final report (FSI, 1997) nor in that of the Treasury submission (1996). In their submissions to the Inquiry, on the other hand, National Australia Bank (NAB, 1996, ch.6, p.12) provided support whereas the RBA (1996, p.131) offered alternatives to the 'twin peaks' model with direct references to Taylor (1995).

always monitored academic developments closely, were influenced by Taylor's 'twin peaks' idea. In addition, the Wallis Committee met with a large number of organisations and individuals both in Australia and overseas and some members of the Committee also met Taylor.[18] As Taylor, in a personal correspondence on 12 May 2002, noted "I also met Jeff Carmichael and Ian Harper, then members of the [Wallis] commission, when they passed through London as part of a fact-finding trip in the first half of 1996." In the words of a senior official who also highlighted this trip to London, the 'twin peaks' idea was "very influential over the Wallis Committee" (Interview, 19 February 2001). [19]

The transfer of ideas and lesson drawing are common as states are increasingly facing similar problems (see Rose, 1991; Dolowitz and Marsh, 1996). As Rose (1991, p.3) argues:

> Every country has problems, and each think that its problems are unique ... However, problems that are unique to one country ... are abnormal ... confronted with a common problem, policy makers in cities, regional governments and nations can learn from how their counterparts elsewhere responded. (cited in Dolowitz and Marsh, 1996, p.343)

Here, "policy transfer, emulation or lesson drawing" basically refer to "a process in which *knowledge* about policies, administrative arrangements, institutions etc. in one time and/or place is used in the development of policies, administrative arrangements and institutions in another time and/or place" (Dolowitz and Marsh, 1996, p.344, my emphasis). Arguably, the 'twin peaks' model as knowledge about

[18] Appendix B of the Inquiry final report lists all the institutions and individuals that the Committee met with (FSI, 1997, pp.717-22). Oddly enough, Taylor was forgotten in this list. In addition, he was not affiliated with any of the listed institutions at the time.

[19] Evidence for the possible influence of the 'twin peaks' idea on the Wallis Committee is based on more than one interviewee using this expression of their own volition.

alternative financial regulatory policy to the then existing institutionally based regulatory arrangements was transferred to and decontextualised in Australia during the Wallis era.

Knowledge in the form of a new idea may be a powerful change agent. As Richardson argues:

> New ideas have a virus-like quality and have an ability to disrupt existing policy systems, power relationships and policies...Extending our 'virus' analogy policy stakeholders are increasingly internationalised – they, literally, travel a lot and meet all sorts of other policy stakeholders from foreign systems. They bring new ideas and policy frames back home. Thus, like natural viruses, policy viruses spread too. For well established policy communities who have long-held the 'franchise' for a policy area, new ideas are a *potential* threat, unless they emanate from the community itself or can be adapted to suit the existing needs of the community. (Richardson, 2000, p.1018, his emphasis)

Following Richardson's 'virus' analogy, the virus of 'twin peaks' was carried first by the 'Treasury block' and then by the Wallis Committee. As will be detailed, the 'twin peaks' idea posed a vital threat to the existence of financial policy community.

In sum, although the Treasury itself was not a financial industry regulator, it was a pre-eminent actor in financial regulatory politics. It proposed and supported the 'twin peaks' idea of a single prudential regulator which treats all providers of functionally similar products or services equivalently, and a single disclosure regulator responsible for consumer protection. As well, before the election on 2 March 1996, the Treasury convinced both Willis and Costello of the validity of the idea. The solutions were already existed, and were waiting for an influential political actor to connect them to problems and to the political process. Thus, the Treasury needed someone to push the proposals. The policy window "an opportunity for advocates of proposals to push their pet solutions, or to push attention to their special problems" (Kingdon, 1995, p.165) was opened after the election. Then, there was a new political leadership keen to achieve financial regulatory reforms and a new Treasurer who wanted to consolidate his power within markets and politics.

5.4 Politics and Coupling

A third influence on a government's agenda is political processes such as public opinions, interest group behaviours, and changes in government which may establish new agendas or modify existing ones (Kingdon, 1995, p.17). The establishment of a new government was an important political event affecting the financial regulatory policy agenda in the Australian context.

The March 1996 federal election was the start of a period of Coalition rule, not seen since the 1983 Labor victory. The result of this political event facilitated the transmission of the idea of regulatory change into the governmental agenda. As one government official noted: "Treasury's challenge for the future is to take advantage of a new government that wants to implement policies that it supports" (quoted in *Australian Financial Review* 8 August 1996). Kingdon (1995) suggests that "Agendas are not first set and then alternatives generated: instead alternatives must be advocated for a long period before a short-run opportunity [policy window] presents itself on an agenda" (p.215). In the words of Kingdon, a 'political window' for the 'twin peaks' idea was opened with the new government and the Treasurer.[20]

In the agenda setting processes, according to Kingdon, problems, policies, and politics flow independently but policy change happens on occasions when they can be coupled (Kingdon, 1995, pp.172-79). This coupling happens when policy entrepreneurs, individuals who invest their effort in order to implement policies they favour, seize a short run opportunity (a 'policy window') to push for the solution or to focus attention on a certain problem (Kingdon, pp.179-84).[21] Kingdon (1984, p.214; 1995, ch.8) argues that individuals (i.e., policy entrepreneurs) "perform the function of coupling solutions to problems, problems to political forces, and political forces to proposals. Costello performed this coupling work following the election of March 1996.

Victor Hugo wrote that: "greater than the threat of mighty armies is an idea whose time has come" (quoted in Kingdon, 1984, p.1). The time of the 'twin peaks' idea came with Costello who on 3 March 1996 acted as a purposeful entrepreneur to focus attention on the problem and to push the favoured solutions (*Australian Financial Review* 4 March 1996). In his first press interview on 13

[20] Kingdon (1995, p.174) notes that there are two categories of policy windows: "problem window...opened by a problem that presses in on government," and "political window...opened by an event in the political stream – a change in administration, a shift in national mood, an influx of new members of Congress."

[21] Kingdon (1995, p.179) defines policy entrepreneurs as people who are "advocates who are willing to invest their resources – time, energy, reputation, money – to promote a position in return for anticipated future gain in the form of material, purposive or solidary benefits."

March 1996, he coupled problems,[22] solutions and political opportunities:

> The regulatory framework is hopelessly out of date. You have superannuation funds that are now in home lending and are essentially running banks and you have banks coming into superannuation – you have got different institutions offering the same product, different regulators regulating the same product because they are offered by different institutions. Why do not we cut all that away and say whatever the nature of the financial institution we will have a regulator covering prudential [requirements] and a regulator covering consumer protection and we can sweep a whole lot of that away? (quoted in *Australian Financial Review* 14 March 1996, see also Costello, 1997b)

The adoption of the Treasury agenda by Costello, however, was not the only factor behind the establishment of the Inquiry on 30 May 1996. With the Coalition coming to power after 13 years of ALP rule, he also had his own political interests. Campbell (2001, p.267) emphasised that "only Howard and one other minister [John Moore] had served in Cabinet before...which highlighted not just the government's inexperience but the fractiousness of some of its members as well." As such, the capabilities of Costello as a new Cabinet minister and a Treasurer were unknown for markets and politics[23] (*Australian* 16 March 1996; Aubin 1999, pp.201, 236-7). Thus, Costello, "[f]or all his high profile and his undoubted skills in political combat, remained largely an unknown quantity" (Aubin, 1999, p.201). Moreover, Australia's business and financial community thought that Costello might not be the right person for the job (*Australian* 16 March 1996). Therefore, the successful handling of the Inquiry and the Cabinet endorsement of its key recommendations would serve two political purposes for Costello: it would strengthen his move towards the party leadership, and it would

[22] Of course, in the cut and thrust of political debate, arguments for the Inquiry were inevitably framed in terms of the need to react to problems. As will be detailed later, the problems, however, were those likely in the future not those in the past.

provide him with the opportunity to prove to the financial community that he had both policy depth and competence. Consequently, one of Costello's first acts was to establish the Wallis Inquiry as a major review of the financial system. As a senior respondent observes:

> If you are a Treasurer who wants to be a Prime Minister then one of the best things that you could do is to have a financial market inquiry ... One reason why [the Wallis Inquiry] is done is for the political advantage of the Treasurer. Paul Keating was his [Costello's] predecessor. He used [inquiries] exactly the same way. If you are a Treasurer and you are trying to gain a profile, credibility and respect what better thing could you do? Lets do something for the financial system that does not necessarily serve them but generate some respect and activity in the financial services sector. Then they will boost you into other areas because they have got influence and money... (Interview, 30 May 2001)

Thus, the establishment of the Inquiry provided, at least in part, a political advantage for the Treasurer. Perhaps, Costello had learned from John Howard and Paul Keating, both of whom had instigated financial system inquiries as Treasurers, and both of whom had subsequently been elevated to the Prime Ministership.[24]

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[23] Costello was elected a member of the House of Representatives in 1990. During the period the Liberal Party was in Opposition until 1996, he served as shadow minister in a number of areas including shadow minister for finance and shadow Treasurer.

[24] Both Howard and Keating established financial system inquiries as Treasurers before they ran for Party leadership and the Prime Ministership. To illustrate briefly, in January 1979, Howard established the Campbell Committee of Inquiry into the Australian financial system as the Treasurer of the Fraser government. The Committee presented the final report to Howard on 29 September 1981. In September 1985, his colleagues elected Howard as leader of the Liberal Party. He subsequently became Prime Minister on 11 March 1996. Paul Keating became Treasurer when the ALP returned to government on 11 March 1983. On 15 October 1983, he formed the Martin Committee of Review to assess the Campbell Report. In February 1984, the Martin Review Group endorsed the Campbell Report. Keating served as a Treasurer until 1991. He replaced Bob Hawke as leader of the ALP and Prime Minister in December 1991 and led the ALP to the fifth term of government in March 1993. Unsurprisingly, 28 days after the Cabinet endorsement of the Wallis recommendations on 2 September 1997, Costello's claim for future leadership was for the first time on a newspaper headline (*Australian Financial Review* 30 September 1997). A search by 'Costello and leadership' words in all Australian news headlines in Dow Jones Interactive database has produced 52 hits between 1 January 1998 and 22 May 2002.

The government was also keen to establish such an inquiry which was one of its election promises (*Money Management* 21 March 1996, pp.24-6). As a senior bureaucrat articulates:

> We had [a] few special factors. One was [a] new government which was elected in 1996. I think it was interested in achieving some reforms in the Australian financial system. That was [the] thinking behind establishing the Wallis Committee. (Interview, 19 February 2001)

Many assume that:

> [Treasury bureaucrats] began actively questioning the theoretical bases of government intervention...They became less convinced governments had the capacity to anticipate changes in the economy, or of the benefits of short-term 'fine tuning' ... Treasury's capacity to provide long and –short-term economic policy advice ... was increasingly coming under challenge. (Wanna et al., 2000, p.72)

In fact, the desire to achieve financial regulatory reform of the industry was also the Treasury guided government's proactive approach to policymaking rather than a reactive one. The government intervened in the markets in the absence of market failures or crisis. As a senior bureaucrat puts it:

> That is the difference from overseas situations where there were crisis led changes. We were quite unique in that sense ... This was a kind of *proactive approach*...it may happen in another government, alternative government as well, who knows. (Interview, 19 February 2001, my emphasis)

Costello also voiced the government's engagement in broader, longer-term anticipatory policymaking to promote change and to help the industry to adapt future competitive challenges:

> The competitors to banks in the future will be, as we are already seeing in this country, anyone who has access to a customer base and access to technology. Telecommunications companies have the customer. They have the software. To the extent that they undertake risk, they could well be engaged in banking or like conduct ... The opportunity is now, for Australia to try and leapfrog a decade or two, to try and *anticipate the change*, to try and put in place a system that will best allow for us to cope with it. (cited in *Sydney Morning Herald* 22 June 1996, emphasis added)

To sum up, the establishment of the Wallis Inquiry was also the government's proactive approach to anticipate changes in the financial business environment and to adjust the regulatory framework accordingly. As will be detailed in the following sections, the Inquiry's role in Australian financial policymaking was not only to create and structure the 'public agenda' in accordance with the 'governmental agenda,' but also to provide an opportunity for regulatory policy change through establishing alignments within and outside the parliament.

5.5 Members of the Wallis Committee

Pusey (1991) in his research on the Australian Public Service examined the political, social and economic attitudes of 215 senior public servants including Treasury executives, and found that in their approach to government policy the majority were economic rationalists. He claimed that key rationalist bureaucracies (the Treasury, Finance, and Prime Minister and Cabinet departments) captured politicians when their senior civil servants formulated and implemented public policies. The Treasury senior advisers are probably among some of the most influential advisers to the government. In regard to regulatory policy change, for example, Greg Smith, the then head of the Financial Institutions Division at the Treasury, who later became the head of the Wallis Inquiry Secretariat, was very active in pressing for the policy change. A senior bureaucrat, for example, identifies Smith as "one particular person who felt very strongly that there was a need for [regulatory] change" (Interview, 19 February 2001) at the Treasury. Maley (2000), in referring primarily to the Keating years (1991-96), also argued that ministerial advisers play a very significant role in agenda setting in Australia. When Costello became the Treasurer, he had four advisers all of whom had previously worked in the Treasury.[25]

Costello, in consultation with his advisers and the Treasury, appointed the members of the Wallis Inquiry panel and its secretariat, and drew up its terms of reference. Although Costello said that: "the government does not start off with preconceived results in mind [and] it [the Wallis Committee] is genuinely independent" (quoted in *Sydney Morning Herald* 1 June 1996), the Committee members were nevertheless selected from among those who had already subscribed to the 'Treasury consensus' (i.e., the twin peaks model). As one senior Treasury official put it in interview: "You would not put people into the Inquiry if they would not believe in case in regulatory change ... You want people thinking in the right direction" (Interview, 16 April 2001).

The Wallis Committee was a blend of 'representative' and 'expert' committees rather than an 'impartial' one.[26] The five members of the Committee were market-oriented individuals from within the financial services industry and academia. The composition of the membership showed that some of them were representatives of particular interests (professionals working in the financial

[25] They were Peter Boxall (principal adviser), Matthew Ryan (senior adviser), Nigel Bailey (adviser) and Rebecca Flint (assistant adviser). The three most senior advisers of Costello met formally every Friday for 60 to 90 minutes with the then Secretary of the Treasury and his deputies (see *Australian Financial Review* 8 August 1996).

[26] This classification draws on the pioneering work of Clokie and Robinson (1937) in relation to Royal Commissions. They classified commissions by type: 'representative' commissions include members of interest groups; 'expert' commissions are composed of specialists on a specific subject; and 'impartial' commissions promise independent inquiry depending on the definition of impartiality. This classification is seen to be just as relevant to committees and inquiries given the similarity of importance and function (see Rhodes, 1975, ch.2; Weller, 1994)

services industry) whereas others were expert individuals having highly technical knowledge relevant to the deliberations of the Committee. Various societal groups from banks to insurance companies and consumer groups, in turn, welcomed the Committee members and the Inquiry's terms of reference (*Australian Financial Review* 31 May 1996).

Stan Wallis, the Inquiry Chairman, was the individual representative of Australian big business. He was the then president of the Business Council of Australia which is "the most significant voice of big business on economic issues" (Head, 1997, p.347). Before the March 1996 federal election, Wallis voiced the need for more reform: "In recent years, I think the foot's gone off the pedal in terms of that reform process and Australia is just not achieving the potential that it could otherwise do" (cited in *Sydney Morning Herald* 2 March 1996). He was also a professional as the then director of Australian Mutual Provident Society Limited (AMP), the insurance and funds management giant of the financial industry.[27] The AMP was a typical example of life offices and insurance companies moving into the banks' traditional territory. For example, it established its Priority One subsidiary, a direct-selling mortgage company that provided bank-like services from cheques, and credit cards to saving products even though it did not have a banking licence and therefore could not accept deposits. Accordingly, Wallis had first-hand knowledge of the institutional, sectoral and

[27] The final report of the Inquiry has a section on the brief background of its members (FSI, 1997, p.v). Wallis's previous affiliation with the AMP just before joining the Committee was not mentioned in the section. Instead, Wallis's previous career as Managing Director of Amcor Ltd between 1977 and 1996 was indicated.

product blurring in the industry. Thus, Wallis was supporting financial supervision based on functions rather than institutions[28] (*Sydney Morning Herald* 1 June 1996).

Another member of the Inquiry from the industry was Linda Nicholls. She was a full-time financial company director and consultant.[29] In a speech in February 1996, she described the existing financial regulatory system as one of "fragmentation, duplication and incoherence" (quoted in *Sydney Morning Herald* 22 June 1996). She also said:

> In the past, when banking without banks threatened, regulators stepped in to ensure Australian household customers and their banking went back to banks...We have housing loans available from banks under the RBA, from life offices under the ISC and from Aussie Home Loans under the ASC...the challenge for future governments of Australia today was adjusting Australia's financial laws and regulations not just to accommodate banking without banks, but to take advantage of its potential to foster more saving and better investing for Australians. (quoted in *Sydney Morning Herald* 22 June 1996)

The third 'representative' member of the Inquiry was Bill Beerworth. He was a solicitor and a merchant banker experienced in Takeovers and Trade Practices Law.[30] His views on prudential regulation were not publicly known. As a senior bureaucrat noted, among the members of the Committee, "the only unpredictable one was Beerworth" (Interview, 20 February 2001).

The Wallis Committee also included highly influential 'expert' people

[28] Not surprisingly, the AMP in its submission into the Inquiry proposed functionally based prudential regulation with new prudential and disclosure regulators (see AMP, 1996, pp.vi, viii, 3, 10). The issue has been discussed in detail in Chapter six, section 6.2.

[29] She was former executive director of County NatWest Australia Investment Management Limited which operated in the investment (fund) management business between 1986 and 1997. It was sold to the NAB in October 1997.

[30] He was principal partner of the corporate and financial advisory firm, Beerworth and Partners Limited.

from academia. As a senior bureaucrat noted, "two academic members, [Ian] Harper and [Jeffrey] Carmichael, were clearly influential" (Interview, 20 February 2001). Ian Harper was a professor of International Finance at the Melbourne Business School. The *Sydney Morning Herald* notes that: "in evidence before the Martin Committee into the banking system in 1991, he also sought to argue for a more equal regulatory treatment of deposit-taking institutions, whether they be banks or co-operatives or mutual organisations" (cited in *Sydney Morning Herald* 22 June 1996).

Jeffrey Carmichael was also working as a professor of Finance at Bond University.[31] Carmichael had publicly noted the dismantling of market boundaries and a need to reconsider institutionally based regulation to cope with future changes. As he stated in a speech to a seminar in 1995:

> The boundaries that we observe between markets today could disintegrate very quickly...the focus of regulation (in the financial services industry) beyond 2000 will shift away from institutional supervision to supervision of markets. The emphasis will shift to establishing the legal and ethical frameworks within which commerce will take place in different markets and away from detailed supervision. (quoted in *Sydney Morning Herald* 22 June 1996)

Discussions in this section confirm Dibelius's observation in the Australian context:

> The statesman who nominates the commission can almost always determine the course that it is going to take, since he will have a pretty good knowledge beforehand of the minds of the experts whom he puts on it, while of course, avoiding any appearance of 'packing' of his team. (Dibelius 1930, quoted in Bulmer, 1980, p.3)

To sum up, the Wallis Committee was 'packed' by the government in accordance with its regulatory policy preferences.

5.6 The Inquiry Process

On 10 April 1996, Costello urged the industry to prepare its submissions to the Inquiry immediately (*Australian Financial Review* 11 April 1996). Public submissions were preferred in order to break down vested interests in the regulatory structure. In doing so, the government aimed to coordinate its financial regulatory policy closely with its business community. As Costello put it:

> Everyone is going to get a fair hearing. I have not predetermined the outcome. It is a question of running a cogent argument. Everybody is going to get an opportunity to have their say on this. If anybody does not like (the idea of super-regulator) they can come into this inquiry and state the reason they do not like it ... At the end of the day the inquiry will come up with certain recommendations that the government will accept, reject or change. (cited in *Australian Financial Review* 11 April 1996)

In announcing the terms of reference of the Inquiry, Costello stated that it was established in order to examine the results of financial deregulation in Australia after the Campbell Inquiry,[32] analyse the forces driving further change, and make recommendations on the future regulatory arrangements[33] (FSI, 1997, p.vii). The

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[31] He had 20 years with the RBA and served as chair of the AFIC and the Queensland Office of Financial Supervision.

[32] Anderson (1993, p.59) is mistaken that the Campbell Inquiry was "the first Inquiry" into the Australian financial system. In fact, there were three major reviews of the Australian financial system: the 1936 Royal Commission, the Campbell Inquiry (1981), and the Wallis Inquiry (1997). There were also two minor inquiries established by the Labor government (elected in early 1983) to evaluate the Campbell Inquiry recommendations: the Martin Review Group (1984) and Martin Committee Report (1991). These inquiries followed major reforms consistent with the Campbell study's market-oriented approach. As Lewis noted: '[t]he two Martin Committee reviews had the more limited purpose of reviewing the deregulatory processes set in train by the Campbell Inquiry' (Lewis, 1997, fn.2, 230). For excellent comparisons of the three major inquiries, see Lewis (1997); Valentine and Edwards (1998).

[33] The Inquiry was established by Costello with the following mission:

> The Inquiry is charged with providing a stocktake of the results arising from the financial deregulation of the Australian financial system since the early 1980s. The forces driving further change will be analysed, in particular, technological development. Recommendations will be made on the nature of the regulatory arrangements that will best ensure an efficient, responsive, competitive and

government drew information in the form of submissions from individuals, firms, interest associations and bureaucratic institutions. Following the release of the Discussion Paper (see FSI, 1997, pp.711-22) the Inquiry received a total of 268 initial submissions and a further 155 supplementary submissions. The procedure of public submissions and the transparent inquiry process was no doubt seen as facilitating a close cooperation between business and the government in order to build political support for the regulatory change both inside and outside of the parliamentary arena (for example, see *Sydney Morning Herald* 14 April 1997, 20 August 1997; *West Australian* 3 September 1997). The observation made by Peters and Barker (1993) seems highly relevant to the Wallis Inquiry process:

> If government is willing to allow groups in society to put forward their ideas for serious consideration, then any policy-making must be seen as properly democratic, rather than imposed along preconceived lines. Further, this openness to participation may allow government to co-opt the groups which do participate; having had their say once, the groups should be expected to keep quiet even if the decision goes against them. Thus, taking even requesting advice helps democratic governments to legitimate their decisions. (Peters and Barker, 1993, pp.1-2)

Although the Treasury made an independent submission to the Inquiry as would any other interested public and private sector actor, behind the scenes it also dominated the Inquiry process. The Inquiry secretariat, which wrote the final report of the Inquiry, was located in the Treasury building in Canberra. The Treasury provided eight staff out of 14 to the secretariat including its head (Treasury, 1996b, p.2; table 12, p.75). As a senior bureaucrat observes "obviously the secretariat of the Committee came mainly from the Treasury so the Treasury

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flexible financial system to underpin stronger economic performance, consistent with financial stability, prudence, integrity and fairness. (FSI, 1997, p.vii) had a significant influence" (Interview, 19 February 2001). The composition of this team that supported the Committee members, and its physical location, mirrored the Treasury's desire to retain influence over the Inquiry as it derived its power "also from access to, and sometimes monopolisation of, information" (Whitwell, 1986, p.24).[34]

The Treasury's influence, however, was not limited to its role in the selection of the members of the Committee or its domination of the secretariat. It was also influential over the Wallis Committee in devising its recommendations. A member of the Committee replied to the question of whether there was a significant Treasury proposal which was not accepted by the Committee in the following way:

> I do not believe so. The converse is not necessarily true. There might have been something we said there that would not have been accepted by the Treasury. (Interview, 30 May 2001)

On 18 March 1997, the Wallis Committee made 115 recommendations which added up "to a call for radical reform of financial sector regulation" (Harding, 1997, p.17).[35] Two of the more controversial recommendations of the Wallis Committee on the prudential regulation were Number 31 and 32. The former recommended the creation of a single prudential regulator to replace the RBA, the ISC and the AFIC while the latter said that this agency should not be

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[34] Apparently, data required was collected on the Treasury computers and evaluated by the secretariat using Treasury economic models.

[35] The Inquiry estimated that the total cost to users of Australia's financial system in 1995 was approximately $41 billion (FSI, 1997, p.204). The committee argued that significant efficiency improvements would be achievable through the establishment of functionally based regulation. It was estimated that a 10 per cent improvement in efficiency would translate into savings of over A$4 billion per annum.

the RBA. Not only the regulators at the time, but also some of the regulated firms such as the Commonwealth Bank of Australia (CBA), the Australian and New Zealand Bank (ANZ) and the Westpac Banking Corporation (WBC) criticised these proposals and argued that the RBA should retain its role as a prudential regulator (*Age* 11 April 1997; *Australian Financial Review* 24 April 1997).[36] Particularly, David Murray, the then managing director of the Commonwealth Bank, argued that Australia was in danger of a US savings and loans-style crisis if it adopted the Inquiry's recommendations on product specific supervision (*Age* 11 April 1997). However, technical dominance of the Inquiry panel enabled the regulatory discussions to be framed in a way which was difficult for opposition voices to challenge. Thus, the *raison d'etre* of the Committee was to provide the intellectual justification for the regulatory change. For example, Carmichael (*Herald Sun* 28 April 1997) and Harper (*Australian Financial Review* 13 May 1997) generated credible academic arguments that were then arguably used as a lobbying tool in order to achieve a degree of professional 'capture' of the policy debate and frame policy issues in a way which was difficult for such opponents to challenge. After underlining the obsolescence of institutionally based prudential

[36] Specifically, the Australian Bankers' Association (ABA, 1996, p.iii), the ANZ (ANZ, 1996, pp.3-6); the WBC (WBC, 1996, pp.4,8,12), and the CBA (CBA, 1996, p.10) were criticising a move towards functionally based regulation and the establishment of a single prudential regulator. In addition, the radical proposals that favoured a functional and product-based approach to prudential supervision as opposed to the then existing institutionally based arrangements, led to the close alliance of the RBA, the ISC and the ASC to defend their regulatory territory (*Sydney Morning Herald* 1 June 1996; *Australian Financial Review* 3 June 1996, 9 September 1996). For detailed discussion, see Chapter six.

regulation, Harper, in response to Murray, argued that:

> About half of the world's central banks do not act as prudential regulators within their jurisdictions...Central banks are, first and foremost, banks. They understand banking and do not profess expertise beyond the confines of traditional bank functions, like deposit taking and payments. But these functions increasingly will be provided by institutions very different from banks. We need a regulator whose expertise is not restricted to a sub-set of institutional types...There is a second reason for separating prudential regulation from the central bank. So long as the central bank is associated with prudential regulation, it is implicitly seen to guarantee the liabilities of those it regulates - such as the Reserve Bank's "implied" guarantee of bank deposits. There is, of course, no explicit guarantee of deposits. Such a guarantee did exist in the sad case of the S & Ls raised by David Murray, giving rise to "moral hazard", which caused the crisis. It is important that, over time, people come to see that the Reserve Bank does not guarantee banks. Bringing a wider range of institutions under the prudential wing of the Reserve Bank would make it even harder to underline the absence of a formal guarantee (and potentially create a "moral hazard" problem of our own). (*Australian Financial Review* 13 May 1997)

Such responses from the Committee members to the critiques of the regulatory change also allowed the Treasury consensus to be promoted in the political arena by an apparently 'independent' or 'autonomous' source of advice. For example, the then opposition Treasurer, Gareth Evans, welcomed the Wallis mandate on prudential regulation[37] and gave Labor's first detailed response to the report in August 1997:

> As a country we must put in place a new regulatory framework to accommodate the tremendous changes that are occurring. This is exactly what the Wallis report recommends...We see the creation of a single national prudential regulator is this form as desirable. While the current system generally works well, there are *no compelling arguments against moving to a new structure* that will accommodate more naturally the profound changes that are taking place in the financial services market. (*Sydney Morning Herald*, 20 August 1997, emphases added)

[37] *Sydney Morning Herald* points out that "Evans's response also indicates that the Reserve Bank and three of the major banks [ANZ, CBA, WBC], which have been lobbying hard against the prudential shake-up, may be about to lose out" (*Sydney Morning Herald* 8 July 1997).

The ALP's support cleared the way in the Senate for the government to fully embrace its regulatory policy agenda.[38]

The Treasury was also playing the leading role in preparing a Cabinet submission which would outline the government's full response to the Wallis report.[39] Consequently, a Treasury taskforce for this purpose was established (*Sydney Morning Herald* 8 July 1997). Smith, along with Costello's advisers, also participated in a special Cabinet meeting to decide on the Inquiry's recommendations (*Sydney Morning Herald* 29 August 1997). In other words, given the fact that the report was in line with the Treasury's main policy preferences manifested in its Inquiry submission, it influenced the Cabinet submission. On 2 September 1997, the government fully accepted 114 of the 115 recommendations.[40] The central premise of the financial regulatory changes proposed by the Inquiry and adopted by the government was the reorientation of the then existing institutionally based prudential regulation[41] towards a

[38] The Howard government did not have the numbers to control the Senate and therefore any legislation could be blocked, amended or delayed in the Senate if the opposition were to vote against the government. Accordingly, the ALP support for the regulatory change was significant. Thus, Costello had to tread a more cautious path than Keating did with the Martin Inquiry which was essentially commissioned to sell microeconomic reform agenda of the Campbell recommendations to the ALP ranks (Carew, 1992, pp.97-8; Edwards, 1996, pp.205-8).
[39] Some of the Cabinet members in 1996 also worked previously with the Treasury. They were, apart from Howard and Costello, Peter Reith (the then Minister for Industrial Relations), Alexander Downer (the then Minister for Foreign Affairs), and John Fahey (the then minister for Finance and Administration).
[40] The only recommendation partly accepted by the government was number 83, which advocated removal of the six pillars policy – government ban on in-market mergers among the big four banks and any of the big two insurance companies. The government replaced the six pillars policy with the four pillars policy which only prevented the mergers and takeovers between the four major banks.
[41] Prudential regulation aims to promote prudent behaviour by financial institutions so as to they will be able to meet their obligations to their customers.

functionally based one.[42] The result was the creation of a new single prudential regulator: the Australian Prudential Regulation Authority (APRA) taking prudential regulatory powers of the Reserve Bank of Australia RBA, ISC and the AFIC. The second institution established following the Inquiry's recommendations was the Australian Securities and Investment Commission (ASIC) which became the disclosure regulator responsible for consumer and investor protection. It took consumer protection responsibilities in the area of finance away from the ASC, the ISC and the Australian Consumer and Competition Commission (ACCC). With the creation of the APRA[43] and the ASIC,[44] the focus of the financial regulation shifted from institutions to functions although all of the then existing financial regulators and some of the key private sector actors opposed it (for detailed discussion, see Chapter six, section 6.3). Consequently, since the 'twin peaks' idea as a policy virus did not emanate from the financial policy community (i.e., key regulators and regulated firms) itself, it destabilised the community.

[42] Before the Wallis Inquiry, the Australian prudential regulatory structure was institutionally based and was composed of four main industry regulators. The RBA had responsibility for banks; the ISA had responsibility for insurers and superannuation funds; the state and territory-based State Supervisory Authorities had responsibility for building societies, friendly societies and credit unions under the administration of the AFIC; and the Australian Securities Commission was responsible for the enforcement of the market conduct and disclosure requirements. For detailed analysis of the institutional and functional changes in prudential regulation, see Goldsworthy *et al.*, (2000); Thompson (1999); Hogan and Sharpe (1997).

[43] As a result of the change in the focus of prudential regulation with the establishment of the APRA and the consolidation of the then existing regulatory institutions, the ISC, the ASC and the AFIC were abolished while the RBA lost its bank regulatory powers.

[44] Previously, responsibility for market integrity and consumer regulation of financial services was shared by a variety of agencies, with most based on the institutional form of the service provider: The ISC in relation to life insurance, general insurance and superannuation products, and insurance brokers; the ASC in relation to securities dealers, investment advisers, futures brokers and advisers, collective investment schemes and debentures; the ACCC in relation to economy wide business conduct laws and price monitoring.

5.7 Conclusion

This chapter has identified the three main reasons behind the establishment of the Wallis Inquiry. First, the review of the then existing regulatory structure was on the agenda of the Treasury department. It pushed for functional regulation with new regulators, and sold the idea to both the then Treasurer Willis and the then opposition Treasurer Costello before the 1996 federal election. Second, when Costello became the new Treasurer, he was keen to establish the Inquiry in order to gain a profile, credibility and respect from the financial community. He was also keen to gain a substantial political victory for leadership within the Liberal Party with the Cabinet endorsement of the Inquiry's key recommendations. The Treasury solutions seem to have been there, connected later to the problems and to the political process by Costello. Finally, the Howard government supported the establishment of the Inquiry as it aimed to be proactive in the achievement of regulatory reform in the financial services industry despite the fact that the then existing regulatory system was working well and there was no external constituency pushing government for a change. This evidence does not support the prediction of the three phase adjustment model which assumes that financial policy changes take place as a *reactive response* to challenges which threaten economic interests of private sector financial institutions and/or political power of their regulators (see also Chapter two, section 2.4).

Before the Inquiry was established, the government had already provided answers to the questions 'What should we do?' and 'How can we do what we have already decided to do?' as the regulatory framework (i.e., the twin peaks model) was already in existence and the 'Treasury block' (i.e., the Treasury and the Treasurer) had exercised great influence to set the regulatory policy agenda and accordingly provided policy prescriptions. Contrary to the accounts of Shann (1987) and of Bell (1997b, p.34) that the Treasury was no longer pre-eminent in policymaking, this chapter has also shown that the Treasury was the pre-eminent bureaucratic institution in financial policymaking and it dominated microeconomic policy advice on financial regulation during the Wallis era.

The Wallis Committee members were selected from industry and academia. They were among those who had already subscribed to the 'Treasury consensus.' The Committee, in turn, was 'packed' by the government. In the consultative process of the Inquiry, both the industry regulators and regulated institutions had to face this already structured and to some extent unveiled agenda: a shift towards functionally based regulation from one that was institutionally based with the new prudential and disclosure regulators. Thus, the role of the Wallis Inquiry, which was not independent of both the government and business, was to legitimise the government's intervention into the financial regulatory structure through transferring the government's agenda into a public agenda.

CHAPTER SIX

THE CASE OF THE APRA

6.1 Introduction

Chapter five has shown the pre-eminent role that the 'Treasury block' (the Treasury and the Treasurer) played in financial regulatory politics. This chapter aims to look at regulatory policy preferences of key public (regulatory agencies) and private (regulated firms) actors of the financial policy community. This chapter applies the state capacity framework to practice. Specifically, it examines whether the policymaking was confined to a small number of state actors, and whether the Australian State had problems of coordination and consensus-building between the Reserve Bank of Australia (RBA) and the Treasury during the Wallis era in regard to the change in financial regulation. It is expected that a fragmented regulatory structure and lack of institutionalised concertation between the RBA and the Treasury illustrated in Chapter four should not enable the State's anticipatory intervention to the markets. The empirical evidence will be used to address the following theoretical questions: Was the APRA outcome due to the financial policy community? Was the three phase adjustment model relevant to the understanding of this regulatory change?

Furthermore, this chapter also investigates the institutional policy preferences and manoeuvres of key institutional actors to test the theory against the empirical evidence. It will examine regulatory policy preferences of financial regulatory institutions and regulated firms in detail by examining the Wallis

Inquiry submissions of these actors, the interviews conducted by the researcher, and the financial daily press. The chapter will also refer to the policy preferences of the Australian Bankers' Association (ABA).[1] In order to do so, it will be guided by Carol L. Bacchi's (1999) 'What's the problem?' approach – "a shorthand for 'what's the problem represented to be?" to analyse "the ways in which issues take place within [political] discussions" (p.1). Bacchi suggests "shift our analysis from policies as attempted 'solutions' to 'problems', to policies [or policy proposals/recommendations] as constituting competing interpretations of representations of political issues" (p.2). This perspective not only offers partly competing approach to the interpretation of this thesis's empirical evidence (i.e., a focus on problem representation rather than problem identification and definition) but also complementary analysis (i.e., looking at the vested interests at stake in postulated solutions or policy proposals).

The rest of this chapter is divided into four sections. The first section breaks down the regulatory policy preferences of the six key financial sector actors as well as that of the ABA. It will show that except for the National Australia Bank (NAB), all major banks –Westpac Banking Corporation (WBC), the Australia and New Zealand Banking Corporation Limited (ANZ), and Commonwealth Bank of Australia (CBA)– as well as the ABA were against the prudential regulatory change. They were in favour of the status quo. On the other

[1] Although the ABA is not a key player in the process, it claims to represent the general interests of the Industry. Thus, the relevant proposals presented in the ABA's submission will be referred to along with the key private sector actors –four major banks and two insurance companies– for informative purposes. In doing so, smaller banks' and the majors' general perspective can be reflected.

hand, the two biggest insurance companies – the Australian Mutual Provident Society (AMP) and the National Mutual Holdings Limited (NM) – along with the NAB supported the creation of a new prudential regulator. The second section investigates the policy proposals of key industry regulators to uncover problem representations. It will argue that the RBA, Insurance and Superannuation Commission (ISC), the Australian Securities Commission (ASC), and the Australian Financial Institutions Commission (AFIC) were hostile to any suggestions of eroding their regulatory and bureaucratic power. This section will also make brief references to the policy proposals of the 'Treasury block' which has been discussed in detail in Chapter five. The third section will claim that although there was a conflict between the 'Treasury block' and the industry regulators that were allied with most of the major banks, the financial regulatory change that came with the APRA was government's proactive approach to financial policymaking. The conclusion argues that the APRA was the product of the government's anticipatory engagement in financial policymaking.

6.2 Key Private Sector Actors and the ABA on Prudential Regulatory Change

The ABA, the WBC, the ANZ, and CBA vocally asserted that the RBA should retain responsibility for bank supervision and that there was no need to create a mega-regulator to oversee the financial system. The ABA supported the preservation of the institutionally based regulatory system in its submission. It proposed the following:

> It is *institutions* which either stand behind their products or fail, institutions must be the prime focus of prudential supervision and how it is organised, rather than generic functions. While convergence and disaggregation are occurring in the

financial system, nevertheless at present, and for a considerable time to come, most banks and indeed most other distinct types of financial institutions (such as insurance companies) will most likely continue to be identifiable in terms of which is their dominant business. Moreover, the skills of regulators supervising different types of financial institutions, will continue to be quite different – given the very nature of their balance sheets. (ABA, September 1996, p.iii, emphasis in original)[2]

The four major banks also made individual submissions to the Inquiry in addition to a joint submission through the ABA. The WBC, like the ABA, demanded the preservation of the institutionally based prudential regulatory structure, since "different supervisory skill requirements dictated that regulation of banking and insurance promises should be carried out by different regulators" (WBC, 1996, p.4; see also p.12). Thus the WBC did not favour a single regulator for the financial services industry, but coordination among different supervisors by a lead regulator[3] (WBC, p.5). The WBC was also the most conservative of the three banks in its recommendations. It suggested that the RBA should regulate all deposit-taking institutions: banks, credit unions and building societies, and retain all prudential supervision functions (pp.4, 12). Again the WBC defended the status quo and proposed that the ISC should retain responsibility for insurance companies, superannuation funds and friendly societies. Also, it recommended that the government should retain existing policy which prohibits mutual organisations, like the AMP and the NM, from establishing or owning banks in their own right (p.8).

[2] It is very interesting to note in retrospect that when the government moved to bring all deposit-taking institutions under one regulatory umbrella following the Wallis recommendations, the then ABA chief executive Tony Aveling welcomed the move (see ABA Media Release, 11 March 1999).

[3] The WBC stated the key reasons for not favouring a single regulator as:

> the risk of an over concentration of power in one authority; the 'moral hazard' risk that the lender of last resort responsibility which must attach to the bank supervisor will be viewed as applying to all other types of institutions and activities; and the risk of there being dis-economies of scale in the cost of a single regulator. (1996, p.5)

Like the WBC, it emphasised that "…banking regulation served us well in an international context and we would want to preserve that advantage going forward" (ANZ, 1996, p.3). Therefore, it supported the lead regulator model for the prudential supervision of financial conglomerates (ANZ, p.3). ANZ proposed that "the AFIC/SSA regulatory framework be dismantled and that building societies and credit unions be supervised by the RBA" (p.6). Like the WBC, the ANZ suggested that "the RBA would be the sole prudential supervisor for all deposit-taking institutions: banks, building societies and credit unions" (p.6).

Along with the ABA, the WBC, and the ANZ, the CBA argued that the RBA should retain responsibility for bank supervision and that there was no need to create a single prudential financial regulator. The CBA called for consolidation of the then current regulatory structure by creating two agencies to undertake all financial supervision (CBA, 1996, ch.5). However, it proposed a different version of functionally based prudential regulation. It adopted its own version of the 'twin peaks' model for regulation. According to the CBA, the RBA should be a 'Systemic Risk Regulator' and should only be responsible for banking supervision. Thus it was supporting the extension of the regulatory powers of the RBA.

Contrary to these big three banks and the ABA, the NAB proposed that a single regulator regulating all deposit-taking institutions should be established. Furhermore, the NAB requested that the RBA should not be the banking supervisor and should be primarily responsible for monetary policy (see NAB, 1996, ch.6). The NAB's problem representation was different from other major banks: "Australia's current institutionally based regulatory system seems unlikely to provide the best framework for achieving the optimal combination of systemic stability, economic efficiency and competitive neutrality" (NAB, p.2). The NAB drew attention to ways of combining supervisory responsibilities in a single agency (p.12). The NAB's submission was closer to the 'Treasury consensus' as it demanded functionally based financial regulation. Thus the most noteworthy support from the key players of the banking sector to the establishment of a single prudential regulator came from the NAB.

Like the NAB, the biggest two insurance companies – the AMP and the NM – argued in favour of moving prudential regulation outside of the RBA. They demanded the establishment of a new single regulator as the most appropriate means to supervise financial conglomerates. This reflected their belief that the RBA supervision tilted the playing field in favour of the banks.

The AMP, where Stan Wallis was director before joining the Wallis committee, supported the establishment of a single regulator incorporating the prudential responsibilities of the RBA, the AFIC, the ISC and the ASC as the most appropriate means to supervise financial conglomerates. According to the AMP, prudential "regulation can be distinguished from other regulation, directed more towards the integrity and even-handedness of financial markets and products" (AMP, 1996, p.10). The AMP, like the NM, emphasised the opportunity for regulatory arbitrage,[4] the unequal distribution of the regulatory burden. It also highlighted the risk of contagion occurring within a conglomerate group and the risk it posed for the systemic stability under the then existing

[4] The institutional prudential regulation was favouring conglomerates combining both a bank and an insurance subsidiary by opening opportunities for regulatory arbitrage shifting business into other segments of the group which enjoy lower regulatory costs. The AMP highlighted the effect of different capital adequacy requirements applicable to banks and life insurers in Australia: "a bank needs to hold A$65,800 in capital for a typical $1 million life insurance portfolio, while a life office would need capital of A$116,178 for the same portfolio" (AMP, 1996, ch.3, p. 13).

regulatory regime[5] (see AMP, 1996, ch.3). According to AMP, the RBA should be responsible for the management of monetary policy and it should closely monitor the financial system for systemic risk (AMP, p.21).

The NM proposed the establishment of a new single prudential regulator "initially through the existing structures of the RBA, the ISC, the AFIC and the SSAs and the minor prudential functions of the ASC in relation to securities dealers" (NM, 1996, p.i, and ch.6). According to the NM, an approach to financial regulation should be "based on the nature of products and risks undertaken rather than the institution providing them, thus removing existing regulatory inconsistencies in relation to products of a similar nature" (NM, p.i). Consequently, the then existing "regulatory inconsistencies, gaps and overlaps could be removed" (p.iii).

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[5] It argued that institutionally based regulation in general, and the RBA supervision of banks in particular was creating an uncompetitive environment that favoured banks and conglomerates combining banking (deposit-taking) and insurance. It questioned the legitimacy of the protection afforded all banks by the RBA on the basis of systemic risk. It argued that the costs of supervision would be transparent, and the perception that "banks cannot fail" could be addressed. It referred to a Newspoll survey that found that "less than 15 per cent of respondents understood that the bank life insurance subsidiary was not afforded 'bank' protection" (AMP, 1996, ch.3, p.17). Around two-thirds who were aware they had bought their product from a subsidiary believed it was fully or partially backed by the reserves and capital of the bank. The fact that consumers are purchasing products on a mistaken view of "protection" is conferring some competitive advantages on bank products across the spectrum. It claimed that:

> With a single prudential regulator approach, the costs of supervision would be transparent, and the perception that "banks can't fail" could be addressed. On this basis there should be no difficulty in having a single prudential regulator supervise capital-backed (ie, banking and insurance) products and retail products offered through funds managers. On balance, the single prudential regulator model may also offer some administrative economies and more effective communication and hence supervision of each business within conglomerates, and across the group. A single regulator would enable, through proper transparency and coordination, the adequate assessment of the financial position of a conglomerate as a whole. In that way it would help protect against contagion within the group from occurring, and on a larger scale, protect the system against systemic risk. (AMP, 1996, ch.3, p.12)

Table 6.1 Prudential Policy Preferences of Key Private Sector Actors

	Policy Debate	
Key Societal Actors and ABA	Single regulator for prudential supervision	Status quo: institutional supervision
ANZ	No	Yes
CBA	No	Yes
WBC	No	Yes
ABA	No	Yes
NAB	Yes	No
AMP	Yes	No
NM	Yes	No

So far, it has been illustrated that the three big banks (WBC, ANZ, CBA) and the ABA objected to the establishment of an APRA–like institution (see Table 6.1). In other words, they were proponents of the preservation of institutionally based prudential regulation led by the RBA. On the other hand, the NAB's proposal was almost identical to the regulatory policy preferences of the Treasurer and the Treasury department. Namely, it proposed that prudential regulation should be functionally based, with a single agency regulating different classes of institutions providing similar products and services. The AMP and the NM were also proponents of this view. It can thus be argued that there was no consensus over the prudential regulatory change among the key private sector actors of the financial policy community.

6.3 Key Regulatory Actors and the Treasury on Prudential Regulatory Change

The then existing financial industry regulators, namely the RBA, the ISC, the ASC, the SSAs and the AFIC –whose political capacity and existence would likely be undermined by the new regulatory regime– did not welcome the Inquiry. It became clear that the review would examine the regulatory role of these agencies. Accordingly, the RBA realised that its bureaucratic powers in bank regulation would be under threat. As a very senior RBA official at the time said, the RBA "argued that it should retain bank supervision, [and] it argued against the formation of a single regulator like APRA" (Interview, 19 February 2001). The RBA argued that the then existing supervisory arrangements were working well and the system was dynamic enough to cope with change. In addition, there was no deficiency in the system which would justify the costs of radical change. It was also important that the central bank be a bank supervisor because banks were systemically important in the system. As the then RBA senior official put it:

> The Reserve Bank argued against change partly [because] the system that we had in Australia had worked quite well. And there was no strong reason to change. Any sort of change in that nature involves transitional costs, and there should be a good argument on cost benefit grounds to make the change before you do that. There is also [the argument] that it was very helpful [for the] Reserve Bank in monitoring economic conditions and making decisions about monetary policy to have cross knowledge of what was happening in banking system. [This knowledge] only comes from being [a] supervisor or a regulator of that system. [Moreover] in the absence of any other good reason for making the change there was not [a] case for removing bank supervision out of the Reserve Bank. (Interview, 19 February 2001)

Graeme Thompson, the then RBA deputy governor, boldly underlined that the RBA would resist any moves on the part of the government to narrow its role or to divide up its functions as a result of the Inquiry (*Australian Financial Review* 23 May 1996). Thompson argued that "despite claims that banks and insurance companies are 'converging' by offering similar products, there remained a clear division between these two finance categories with different regulatory needs" (quoted in *Age* 6 September 1996, see also Thompson, 1996a,b). In other words, "a bank balance sheet and an insurance company balance sheet remain very different, and the relevant supervisory techniques are correspondingly dissimilar" (cited in *Age* 6 September 1996). Therefore, the then existing institutional prudential regulatory structure should be preserved because the differences in the structures of balance sheets and the risks involved called for institutional supervision. Thompson was also concerned about the moral hazard problem whereby "the public could come to perceive that the investment performance of the latter was protected by supervision in the way it provides some comfort about bank deposits" (cited in *Age* 6 September 1996). Brian Gray, the then head of bank supervision at the RBA, described prudential regulatory proposals of the 'Treasury block' as "naïve conceptually" (*Sydney Morning Herald* 24 March 1997).[6] In other words, senior officials at the RBA questioned the impact of change on the overall stability in the financial system. These policy perceptions derive from the mandate of the RBA for which these officials work.[7] Consequently, any proposal challenging the RBA's regulatory authority in the industry faced strong resistance from these officials.

The ISC commissioner at the time, George Pooley, former Treasury senior official, like Thompson and Gray, strongly resisted the idea of prudential supervisory change in the focus of regulation at a conference held shortly after the Treasurer's announcement of the Inquiry.[8] In response to Peter Costello's support of a move to a functionally based regulatory system, Pooley said that financial supervision was "necessarily institutionally based and cannot be functionally based" (*Sydney Morning Herald* 1 June 1996). According to Pooley, due to the nature of the different business undertaken by banks and non-bank institutions (e.g., insurers) different "tools and techniques" were needed in order to assess the

[6] The RBA senior officials preferred to use 'alternative view' pointing to the Treasury consensus.
[7] The RBA was mainly responsible for monetary policy and banking regulation for systemic stability.
[8] Surprisingly, a year later, he said he was "pleased with the thrust of the report as it relates to the ISC" and the ISC "gained" greatly with the creation of the APRA (Cited in *Sydney Morning Herald* 14 April 1997).

prudential standing of a life insurance company as opposed to a bank or other institutions (*Sydney Morning Herald* 14 April 1997).[9] Not suprisingly, in its submission, the ISC did not favour a single prudential supervisor and functionally focused supervision. It supported a 'solo plus' approach, "where 'solo' refers to specialised supervision of deposit takers, insurers and fund managers at the financial entity level (whether by separate agencies or divisions of the same agency), and 'plus' refers to an additional layer of supervision at the financial group or conglomerate level" (ISC, 1996, p.v). It noted that "treating financial institutions differently for regulatory purposes accommodates institutional diversity, provides consumers with a choice, and is consistent with international practice" (ISC, p.v). The ISC favoured this approach "...because it is evolutionary and consistent with the international direction being taken by the Joint Forum on the supervision of international financial conglomerates" (p.viii). In order to do so, the ISC suggested an upgraded Council of Financial Supervisors where the RBA would also supervise the non-bank financial intermediaries as well as banks, and ISC would concentrate on the core functions of prudential supervision (p.viii).

The ASC also supported the preservation of the status quo. As the then deputy chairwoman Lynn Ralph of the ASC said "there was a risk that the Inquiry was throwing the baby out with the bathwater by ignoring the benefits of the current system" (*Sydney Morning Herald* 1 June 1996). The ASC doubted that

[9] Non-bank deposit-taking institutions such as building societies and credit unions did not demand the establishment of a new national regulator, instead they "had a preference for the prudential regulator being the Reserve Bank because it is the major existing prudential regulator and has the expertise and standing to assume responsibility for prudential oversight of all financial institutions" (AAPBS, 1996, p. iv).

coordination and saving benefits would be achieved with a single regulator, since "[a]t this time, we have no details on what the potential savings might be, or, more importantly, what the costs of change might be, and further substantial study should be undertaken before this option could be realistically considered" (ASC, 1996, p.v). Overall, the ASC was in favour of only minor changes in regulation: " the current regulatory scheme is basically sound…the regulatory expertise and issues of style and culture of regulation" were more important than changes in administrative structures (*Australian Financial Review* 9 September 1996). However, the ASC was sceptical about a single regulator: "The ASC is not well placed to assess whether the benefits, including economies of scale and scope, of a single prudential regulator would outweigh the advantages of specialist expertise of the current individual prudential regulators in this area" (ASC, 1996, p.v).

The AFIC, like the three regulators, argued that prudential supervision of deposit-taking institutions must be institutionally based (AFIC, 1996, p.7). It was also against the nationwide supervision: "As these [non-bank deposit-taking] institutions are geographically widespread and local knowledge is important, supervision is best delivered at a regional level" (AFIC, p.7).

On the other hand, as Chapter five has already shown, the Treasury and the Treasurer proposed the consolidation of financial regulatory institutions by a nation-wide single regulator with a functional focus on prudential regulation. Furthermore, the Treasury suggested separating monetary policy and prudential supervision within the RBA. These proposals were similar to that of the NAB, the AMP, and the NM.

Table 6.2 Prudential Policy Preferences of Public Sector Actors

Key State Actors	Functionally based supervision & single regulator for prudential supervision	Status quo: institutional supervision
Treasury	Yes	No
RBA	No	Yes
ISC	No	Yes
AFIC	No	Yes
ASC	No	Yes

To sum up (see Table 6.2), all financial regulators were against the establishment of a new single regulator such as the APRA. They argued that there was no need for such a regulatory change. In fact, the status quo would protect their bureaucratic powers in financial regulation. Private sector players had different views on the regulatory change. However, except for the NAB, big banks and the ABA were against the establishment of a single prudential regulator. They also favoured the preservation of the institutionally based prudential regulation and preservation of the RBA's regulatory powers. In contrast, the NAB, the AMP, and the NM were broadly in agreement with the regulatory change towards functionally based regulation and the establishment of a new single prudential regulator (see Table 6.1, p.125).

How does this empirical evidence relate to the predictions of the framework for the assessment of state capacity in policymaking? As it has been introduced in Chapter four (section 4.2), there are two parameters that determine the state capacity to adapt anticipatory financial policies in the banking sector: (1) "a balance between the perspectives of the central bank and the finance ministry"; and (2) "the [small] number of agencies involved in policymaking" (Coleman, 1996, p.74). It is assumed that "state structures with these properties will be better placed to engage in broader, longer-term anticipatory policy-making in the face of globalisation" (Coleman, p.74).

Empirical evidence in this chapter has shown that although the number of financial regulators was high, there was a consensus among the then existing financial regulators that the institutionally based regulatory framework (or status quo) should be preserved. However, there was a conflict between the regulatory vision of the 'Treasury block' and that of the four main financial regulators.

Moreover, there was no attempt to resolve the regulatory differences between the 'Treasury block' and the financial regulators at the time. However, although the Treasury did not take a direct or ancillary role in the regulation and supervision of financial services firms, it was dominant in the making of financial services policy (see Chapter five).

And, finally, Atkinson and Coleman (1989a, p.60) argue that Australia has a pressure pluralist policy network and has a reactive approach to policymaking.[10] Accordingly, in the light of the state structure with these properties in practice (large number of regulatory agencies involved in the policymaking and implementation, conflict between the 'Treasury block' and the RBA; and lack of institutionalised concertation) one should expect low state capacity in Australia leading to reactive rather than anticipatory policymaking.

6.4 The APRA: Anticipatory Approach to Financial Regulation

As has been detailed in Chapter five, the members of the Wallis Committee suggested functionally based financial regulation with two new

[10] It is assumed by these authors that thanks to pluralist networks, financial firms attempt to influence the exercise of political power, thus reducing the State's strength at sectoral level.

regulators. The Inquiry's recommendations on prudential regulation were that it should be imposed on deposit-taking institutions, insurance and superannuation firms by a single commonwealth prudential regulator (see FSI, 1997, pp.306-17). The APRA, as a single national regulator of all deposit-taking institutions, should be separate from, but cooperate closely with, the Reserve Bank of Australia (FSI, pp.317-38). In other words, a single regulator would replace the three supervisors as a prudential regulator and this agency should not be the RBA. The government accepted these recommendations and established the APRA.

The adaptation of the Wallis recommendations by the government meant that the RBA was only responsible for money policy, and lost its prudential regulatory functions. The ISC, the AFIC and the SSA's were the biggest losers, since they were abolished. The ASC transforming into ASIC emerged as a regulator of disclosure, enhancing its power. As a result, banks and non-bank deposit-taking institutions (e.g., building societies, credit unions, friendly societies) were subject to similar levels of supervision by the APRA. In other words, the APRA would regulate all deposits in the same way, whether held by banks, credit unions or friendly societies. Therefore, in the eyes of depositors, all deposit-takers would be equally safe. The establishment of APRA also made it easier for non-bank financial institutions to compete with banks on a more level playing field and become challengers. Thus competition in the industry would increase.

Anticipatory policies aim to promote change in industry and to help industry to adjust emerging challenges posed by competitive pressures (Coleman, 1996, ch.4). The establishment of the APRA was the government's anticipatory response to policymaking. As a senior APRA officer notes:

> [A] lot of countries did review their regulatory system when problems [started] falling like bricks from the sky, [since] there were [financial] crises. There [had] to be some sort of change. Governments have to say we are responding to [the] [crises] and we are going to respond in the following way. [This] is a reactionary approach, but what we observe here [in Australia] is a *proactive approach* that says we do need change [to prevent possible crises from occurring] ... [T]here was a strong sense that [the financial system] was changing. This [brought you to an] *anticipatory point*. [To achieve this] group-wide risk management system [were] put in place. (Interview, 19 February 2001, emphases added)

The knowledge about the institutional blurring in the financial services industry was a significant factor behind the policy change. The same respondent continues:

> [Government] recognised the fact that the financial sector had changed and was becoming more unified [as] conglomerates [became a] more dominant form of institution. To put it simply, if institutions [are] managing themselves as conglomerate groups then it is perhaps sensible for regulators to [also] be in conglomerate groups. Rather than having them [the regulators] sitting in different buildings and [in] different cities [why not] have them all under the one regulatory agency. (Interview, 19 February 2001)

Another senior bureaucrat makes a similar observation:

> The sources of changes that I am referring to [are] like [the] growth of financial conglomerate groups that combine banking, insurance and funds management under one common ownership. [This results in] some blurring between the differences in products [the] insurance companies and banks offer. [We have seen a growth in] cross-border activities and increasing globalisation of financial systems. [These] trends are common in the more developed [and industrialised] countries and over the past decade have resulted in debate about [more] efficient regulatory arrangements. (Interview, 19 February 2001)

There is no doubt that the state capacity framework provides a useful, systematic means of analysing state strength at sectoral and industrial level. However, to analyse state capacity only in terms of institutional arrangements leave out too many other important explanatory factors. This is generally the problem with the institutionally-centred explanations (e.g., policy network framework and three phase adjustment model) which pay particular emphasis on the assessments of power. As shown in this chapter, the then existing regulators of the financial industry resisted the re-orientation of an institutionally based regulatory regime towards a functionally based one. The coalition formed by the prudential regulators of the financial services industry to resist the creation of an APRA like regulator was an example of Scharpf's 'joint decision trap' "in which the beneficiaries of the status quo can block all reforms, or at least extract exorbitant side payments" (Scharpf, 1997, p.144). However, as Peters suggests, "...states grant power to networks to make, or influence, decisions and ultimately can take it away...[because existing] networks may approximate the world of the 'joint decision trap', and decision-making by least common denominator, described by Fritz Scharpf" (Peters, 1997, p.57). In the face of such sub-optimal decisions, "the role of government then becomes providing the leadership to shape the debate and move decisions away from that lowest common denominator realm into a more socially desirable space" (Peters, p.57). The Australian State addressed the decision trap problem through the establishment of new prudential regulator (i.e., APRA) while abolishing some of the then existing regulators (i.e., ISC, AFIC, and SSAs) and taking prudential regulatory powers from the RBA. This finding does not support the argument that the Australian State is weak and it can act strong only in times when there is a coalition between the state and strong economic interests (Bell, 1994, 1997a,b). Conversely, this chapter has illustrated in detail that the government set the regulatory policy agenda and controlled the direction of change by pushing its solutions through against the policy preferences of the then existing key financial regulators, and some of the key private sector actors. The support of the NAB, the AMP and the NM for the 'Treasury consensus' cannot be considered as an example of Bell's "coalition model of state autonomy" (Bell, 1997a,b) because at best this can only be considered as an alliance between the State and *some* of the key societal actors.[11]

6.5 Conclusion

The Australian financial regulatory structure was institutionally based and was composed of 12 financial regulators: the RBA, the ISC, the ASC, the AFIC (the four key financial regulators) and eight SSAs. Therefore, it was fragmented (see Chapter four). These key industry regulators were united for the preservation of the institutionally based arrangements and were not supporting a regulatory change towards functionally based financial regulation and the creation of single prudential regulator. Particularly, banking and insurance sectors regulators (i.e., the RBA and the ISC) strongly opposed the regulatory vision of the Treasurer and the Treasury. Moreover, private sector actors such as the WBC, the ANZ and the CBA from the industry, along with the ABA, also resisted the proposed change. Consequently, prudential regulatory change (i.e., the establishment of the APRA) was not due to a joint realisation of key regulatory authorities and key regulated institutions as it had been in the 1980s (Harper, 1986).[12]

Interestingly, the main agency pushing for the regulatory change was the Treasury which did not take a direct or ancillary role in the regulation and supervision of financial services firms (see Chapter five). Accordingly, there was conflict between the Treasury and the RBA over the prudential regulatory policy

[11] For further discussion on Bell's perspective, see chapter two, section 2.3.
[12] For discussion, see chapter two, section 2.2.

change. Thus, one should expect low state capacity which makes it difficult to consolidate several regulators and prudential regulatory powers under one agency. However, the APRA case does not confirm these major assumptions of reactive policymaking in the financial services industry. Conversely, although the institutional arrangements (see Chapter four), and the conflict between the RBA and the 'Treasury block' in practice favoured low state capacity (or a reactive approach to the financial policies) in banking policy, the governmental influences predominated the regulatory debate and policy outcomes (see also Chapter five). This was not due to centralised public sectors as it had been in the 1980s (Pauly, 1987, 1988).[13]

The Australian State was an actor external to the financial policy community in setting the regulatory policy agenda and initiating policy change in financial regulation. The Australian State was a strong player in the financial services industry. It changed the existing policy network and community by abolishing the old and establishing the new. Moreover, although the Treasury was not a regulatory institution it played pre-eminent role in the financial regulatory change. This chapter also suggested that the financial policy community was not the creator of the policy change. In fact, it was the product of policy change and was functioning within the context determined by the State. The finding is also consistent with the argument in Chapter five that direction of the policy agenda was determined by the government guided by the Treasury and the Treasurer.[14] In

[13] For discussion on Pauly's perspective, see Chapter two, section 2.3.
[14] In addition, the role of individuals such as policy entrepreneurs (e.g., Costello), the role of the government as an actor external to the policy community and the role of knowledge as an independent variable in policymaking are also to be considered in policy research (see also Chapter five).

this context, the research also supports previous studies, particularly on the manufacturing industry that the state is the main steering agent (Capling and Galligan, 1992) in the Australian political economy.[15] Finally, the significance of the Treasury in driving state actions in Australia supports Pusey's previous finding on the significant role of the Treasury bureaucracy in policymaking (Pusey, 1991).

[15] For discussion on the state strength in Australian political economy, see Chapter two, section 2.3.

CHAPTER SEVEN[1]

ECONOMIC POWER POTENTIAL OF THE BIG FOUR AUSTRALIAN BANKS IN THE 1990s

7.1 Introduction

Banks play a key role in encouraging and gathering savings that finance a country's economic growth through lending to firms (Kroszner, 2000). Furthermore, banks also play significant roles in the domestic politics of financial services in a world of global finance (Zysman, 1983; Moran, 1991; Reinicke, 1995; Coleman, 1996). Australia is no exception.

Given the importance of banks to the economy and to financial policymaking, the special attention on the economic power potential of banks is defensible.[2] The major banks' – National Australia Bank (NAB), Westpac Banking Corporation (WBC), Australian and New Zealand Banking Group (ANZ), and Commonwealth Bank of Australia (CBA)– economic power potential that may affect who gets what in their bargaining relationships with the Australian state during the Wallis period (1996-97) will be examined in this chapter. In so doing, this study will assess the extent of this power by utilising the framework developed by Coleman (1996, ch.2). It will examine the biggest four Australian banks' economic power potential by assessing their economic strength, whether

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[1] A version of Chapter four entitled "Economic Power Potential of the Four Major Banks" was submitted to the *Australian Journal of Political Economy* in December 2001. Following the journal reviewers' suggestions, the paper will be revised for resubmission.

[2] In this study, the power is understood as "a communication medium through which a power-holder puts limits on the range of actions that might be selected by some other social or political actor" (Coleman, 1996, p.19).

gauged by their business powers with special reference to their competitive positions within the financial services industry, their customer base, the level of their global activities, and their ownership relationships and interlocking directorates with non-financial firms.[3] In this context, there are three assumptions guiding the investigation: (1) financial firms that occupy a wide range of market segments with significant market share and a divergent customer base hold higher economic power potential than those who do not; (2) those financial firms that have high levels of global activity (i.e., overseas business, staff based overseas, and income generated overseas)[4] are more likely to have higher domestic power in policymaking than those that concentrate solely on domestic markets; (3) financial firms that have significant ownership positions and interlocking directorates in domestic, non-financial companies may have more economic weight and thus more economic power potential than those companies that do not have such ties.

It will argue that the major banks (or the majors) hold considerable economic power potential to influence the range of financial policy options considered by the state. The majors collectively hold about two-thirds of the Australian banking sector assets, and they are the largest financial institutions in Australia with a high level of global activity. Each of these banks provides the full

[3] Interlocking directorates are added in this chapter to Coleman's framework.

[4] Coleman (1996, pp.32-7) prefers foreign banks' market share in host countries and the share of domestic banks in international activity. In doing so, he aims to measure whether domestic banks have retained strong control over both international and domestic activity located in their respective countries. However, this chapter prefers to use the three global ratios (overseas business, staff based overseas, and income generated overseas) in order to locate the major banks' level of global activity.

range of financial services to all sectors of the economy, from traditional banking functions to insurance, superannuation and funds management. This analysis will also provide with an opportunity to present the main features of the Australian financial industry in the 1990s.[5]

The rest of this chapter is divided into five sections. The first section investigates the major banks' market share. The second section shows their customer base. The third section examines these banks' global activities. The fourth section looks at ownership ties and interlocking directorates between the banks and non-financial firms. The conclusion will summarise the main finding that the major banks have significant potential to realise political gains from their economic power.

7.2 Market Share and Economic Power Potential

Banks which are permitted by their regulators to engage in a wide range of financial services will have a higher potential to influence more of the behaviour of their clients and to increase their overall size than narrow banks or specialist banks (Coleman, 1996, pp.20-7). Although there were no formai restrictions separating banking, insurance, and securities activities in Australia, the financial industry was strongly segmented along institutional lines prior to the 1980s. On the one hand, bank activities were heavily regulated in terms of the types of

[5] The researcher has already acknowledged that the series of assertions linking the concrete factors of market position and the power potential is a limited analysis. How the banks exercised their economic power *over* customers, firms and government *in practice* is to be analysed in detail. Next chapter will analyse how the major banks transmitted their economic power into the exercise of political power over government with special reference to the 'four pillars' policy.

products they were allowed to offer, government-imposed interest rate controls, and balance sheet restrictions (see Carron, 1986; Edey and Gray, 1996; Drake, 1997; Kent and Debelle, 1999). On the other hand, non-bank financial institutions (NBFIs) such as building societies, credit unions, merchant banks (or money market corporations) and finance companies were lightly regulated (Skully, 1987). The NBFIs were providing "mortgage loans, instalment credit, and other specialist finance, satisfying the demand that banks were unable to meet on account of regulatory constraints" (Bain and Harper, 1999, pp.16-7). To illustrate, finance companies were providing direct lending for consumer goods while the banks were restricted by the government regulations (see Lewis and Wallace, 1997, ch.8). Building societies were employing more competitive strategies – longer opening hours, higher interest rates on deposits, and higher proportion of property valuation for home purchases– than banks (Lewis and Wallace, 1997, ch.5). Consequently, the NBFIs were increasing their market share at the expense of banks before the deregulatory period of the 1980s.[6] The deregulation of the 1980s ended most controls over bank lending, foreign bank entrance, and capital controls. It allowed banks to compete against finance companies in the wholesale market, and building societies and credit unions in the retail market. As a result, over the two decades between 1980 and 2000, banks, fund managers and insurance companies have expanded their market share at the expense of the NBFIs (see Table 7.1).

[6] However, it should be noted that as a response to regulatory restrictions, each of the major banks had substantial ownership relationships with the NBFI.

Table 7.1 Assets of Financial Institutions in Australia as a Percentage of Total Assets of the Financial Industry, 1980-2000

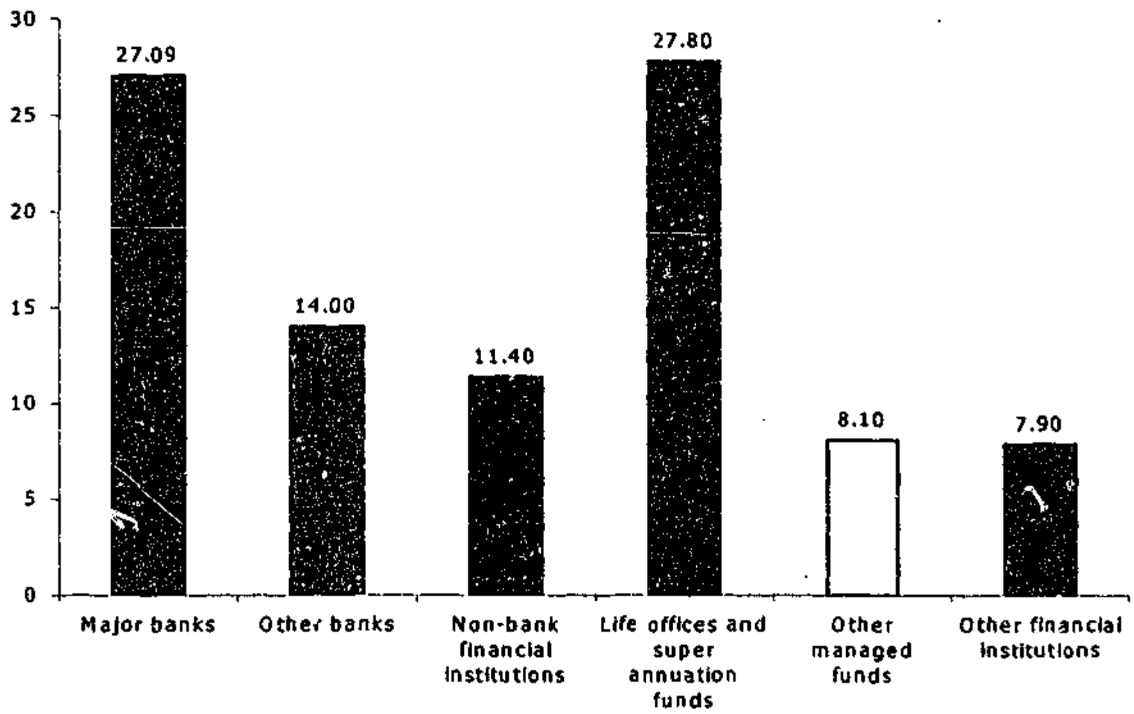
	1980	1985	1990	1995	2000
Banks	42	41	44	46	47
NBFIs	30	28	19	14	12
Life and Superannuation	19	19	22	27	28
Other managed funds	1	4	6	6	9
Other	8	8	8	7	4

Source: Kent and Debelle (1999, Table 2); *Reserve Bank of Australia Bulletin* (August 2001, Table B.1).
Note: Excludes assets of the Reserve Bank of Australia.

Table 7.1 demonstrates the changes in the market shares of the main types of financial institutions in Australia. It indicates that the share of banks has increased by 5 percentage points from 42 per cent in 1980 to 47 per cent in 2000 while that of the NBFIs has declined from 30 per cent to 12 per cent during the same period.[7] In the mid-1990s, the financial conglomerates became the dominant institutions, accounting for about 80 per cent of the financial industry in Australia (RBA, 1996, p.109). Increased domestic and global competition, due to deregulation and financial globalisation processes, was one of the main reasons which produced the dominant position of financial conglomerates in the industry in the 1990s (FSI, 1997, ch.4; Bain and Harper, 1999). Each of the major banks, as the largest Australian financial conglomerates, has more than 75 per cent of its total assets in banking business. Funds management lead the second main activities of these banks, with assets ranging from 5 per cent to 25 per cent, whereas insurance and stockbroking each occupying less than 5 per cent of total assets (*Council of Financial Supervisors*, 1997, p.67).

[7] The NBFIs were consolidated into the bank parent following the deregulatory 1980s. Thus, the significant movement in asset shares resulted from these developments.

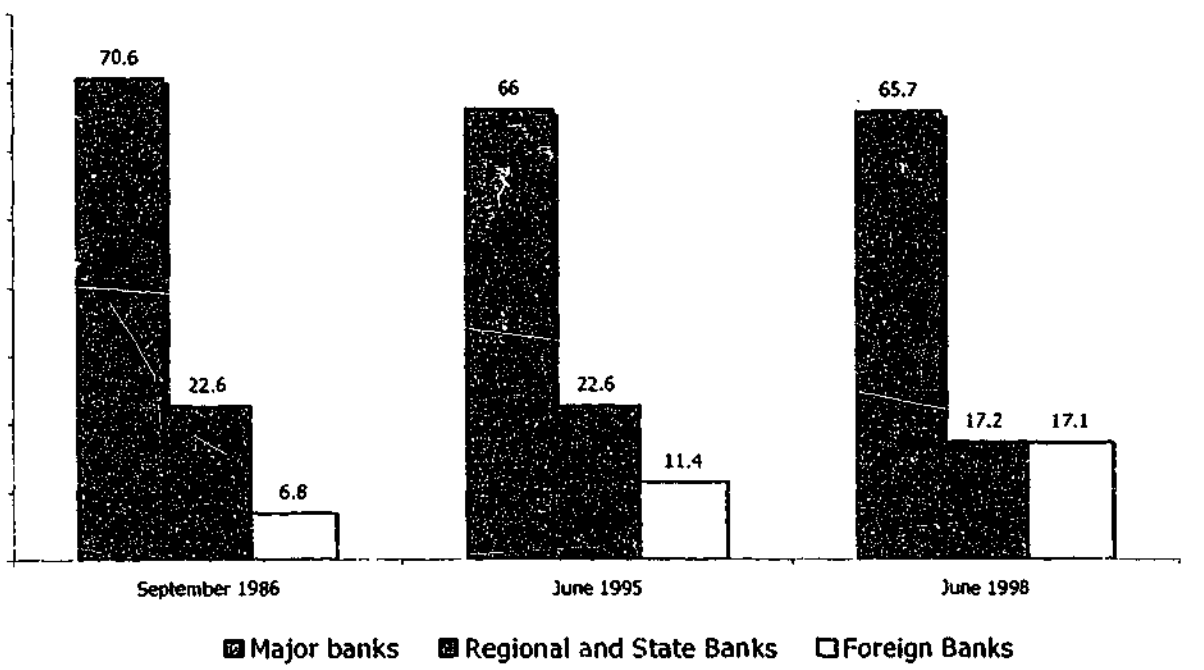
Figure 7.1 Majors' Assets as a Percentage of the Financial Services Industry, 1997



Source: *Reserve Bank of Australia Bulletin* (August 1998, Table B.10).
Note: Excludes assets of the Reserve Bank of Australia.

Figure 7.1 shows financial institutions' market share in the finance industry. The banking sector, including major banks and other banks, dominates the industry with its 41 per cent of total industry assets. The big four banks' 27 per cent share in the industry total assets was almost equal to that of the insurance and superannuation funds in 1997.

Figure 7.2 Banks' Market Share as a Percentage of Total Bank Assets



Sources: *Reserve Bank of Australia Bulletin* various issues.
Note 1: Excludes assets of the Reserve Bank of Australia.
Note 2: There was no state bank in 1998.

Figure 7.2 provides details of the composition of total bank assets. The major banks also have a very strong position within the banking sector, with 66 per cent market share whereas foreign banks, and state banks and regional banks as a group each had only 17 per cent market shares in June 1998.

Most foreign banks could not obtain banking licences and establish subsidiaries until 1985[8] when Australian banking was opened to foreign bank

[8] However, despite these restrictions foreign banks participated in the financial industry through corresponding arrangements with Australian banks, through representative offices, and through the activities of foreign-owned merchant banks (Skully, 1989; Edey and Gray, 1996, pp.26-9).

competition[9] (see Pauly, 1987). In February 1985, 16 foreign banks were permitted to establish local banking subsidiaries but they were required to confine their deposit-taking activities to the wholesale market. In 1992, the foreign banks were allowed to establish branch operations to conduct wholesale banking. Retail banking could only be conducted through a locally incorporated subsidiary on the grounds that local supervision and the depositor protection arrangements of the *Banking Act* (1959) could be applied. Consequently, although the foreign banks' share in the banking sector has increased substantially from almost 7 per cent in September 1986 to about 17 per cent in June 1998, they could not make an impact on the dominant position of the major banks in the retail and commercial market (see Figure 7.2, p.144).[10]

State banking is the direct involvement of the state in the allocation of credit (Zysman, 1983; Coleman, 1996, pp.41-4; Verdier, 2000). Thus, the level of state banking affects the economic power of banks. Accordingly, if the assets of financial firms are transferred from the public sector to the private sector, private banks will have significant power potential (Coleman, 1996, p.42).[11]

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[9] Only two foreign banks operated continuously as authorised banks: The Bank of New Zealand and the Comptoir National d'Escompte de Paris (Banque Nationale de Paris from 1966) which established their operations in 1874 and 1880 respectively. They were granted banking licenses to operate a branch in 1945. The share of these foreign banks in total banking assets with their two branches was one per cent in 1984 (Kent and Debelle, 1999, Table 1).

[10] However, foreign banks dominate the wholesale banking sector. As the Wallis report puts it:

> At December 1996, there were 73 merchant bank groups (comprising 134 individual registered institutions) operating in Australia with around $60 billion in total assets. Around 95 per cent of assets are held by foreign owned merchant bank groups, 36 of which are subsidiaries of foreign owned banks. (FSI, 1997, pp.348-49)

[11] Following Coleman (1996, ch.2), the word "potential" is used here because there is no automatic transfer of a power potential into an exercise of power.

Table 7.2 Numbers and Assets of Deposit-taking Institutions, 1990-1999

Deposit-taking Institutions	Number of Institutions		Per cent of Total Assets of Deposit-taking Institutions		Per cent of Total Assets of the Financial Industry	
Major Australian Banks	1990	1999	1990	1999	1990	1999
Privately-owned	3	4	44.4	62.6	21.7	29.0
Government-owned	1	0	14.9	-	7.3	-
Other Australian Banks						
Privately-owned	9	8	5.7	17.1	2.8	8.0
Government-owned	4	0	15.4	-	7.5	-
Foreign-owned Banks	18	36	10.8	15.6	5.2	7.2
Building Societies	51	19	6.4	1.8	3.1	0.8
Credit Unions	279	219	2.4	2.9	1.2	1.3
Total					**48.8**	**46.3**

Source: Gizycki and Lowe (2000, Table 2).

Table 7.2 shows deposit-taking institutions' numbers, and their assets as a share of the total financial intermediation sector and total financial industry. Five majority-owned government banks, including the largest (the CBA) and fifth-largest (State Bank of Victoria) banks controlled more than 30 per cent of the total assets of the deposit-taking institutions and 15 per cent of the financial services industry in 1990. Today, there are no government-owned banks in Australia. During the 1990s, they were all privatised or sold.[12]

As the Wallis report puts it:

> Consistent with the recommendations of the Campbell Report, governments at both State and federal levels have gradually withdrawn from direct ownership of financial institutions in the period since 1981.The Commonwealth Government has progressively privatised the Commonwealth Bank, with an initial public offering in 1991, and a subsequent float of the remaining equity in July 1996. State governments have also sold or privatised State financial institutions, including: in 1991, the Victorian Government sold the State Bank of Victoria to the Commonwealth Bank; in 1992, the NSW Government finalised the sale of the NSW Government Insurance Office and, in December 1994, sold the State Bank of NSW to Colonial Mutual Life; and, in 1995, the South Australian

[12] The CBA, one of the largest four private banks, was among these privatised state banks. It was established in 1911 by the federal government as a commercial and savings bank. The Industrial and Finance Department of the CBA provided state banking functions to provide credit to small firms in 1946 (Verdier, 2000, p.286). The CBA was fully privatised in 1996.

Government sold the State Bank of South Australia to Advance Bank. (FSI, 1997, p.592)

As such, the Australian State has less influence on the banks' commercial lending decisions as the major banks continue to operate wholly in the private sectors of the financial industry and dominate all retail market segments.[13] This economic power potential may provide these firms with a significant leverage in their bargaining with the state over some of the financial policy outcomes.

The regional banks were former state banks or building societies, and they specialise in lending on home mortgages.[14] As building societies converted into regional banks, their number reduced from 51 to 19 between 1990 and 1999 respectively, while their market share in deposit-taking institutions declined from 6.4 per cent to 1.8 per cent during the same period (see also fn.6, p.141). On the other hand, there was no corresponding increase in the number and the market share of the privately-owned banks as the major banks absorbed many of these banks through takeovers during the 1990s.[15] Thus, it can be asserted that

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[13] According to the government, on the other hand, such privatisations reduced the government's risk in ownership:

> The PFEs [Public Financial Enterprises] listed under actual or proposed privatisations ... [in 1995] ... accounted for more than half of the total assets of the PFE sector excluding the RBA at the start of the decade. This represents one of the most significant developments in the PFE sector, and will ensure a corresponding reduction in the exposure of governments to risk through their ownership of PFEs. (*Budget Statements 1995-96*, 1996, pp.6-17, cited in FSI, 1997, p.131)

[14] Some examples of the regional banks created from the building societies operating in the early 1990s include Advance Bank, Bank of Melbourne, Challenge Bank, Metway Bank, and St George Bank.

[15] For example, the CBA acquired the State Bank of Victoria in 1991; and the WBC acquired the Bank of Melbourne in 1996. The New South Wales (NSW) Government sold the State Bank of NSW to the Colonial Mutual Life Association in 1994 which was acquired by the CBA in 2000.

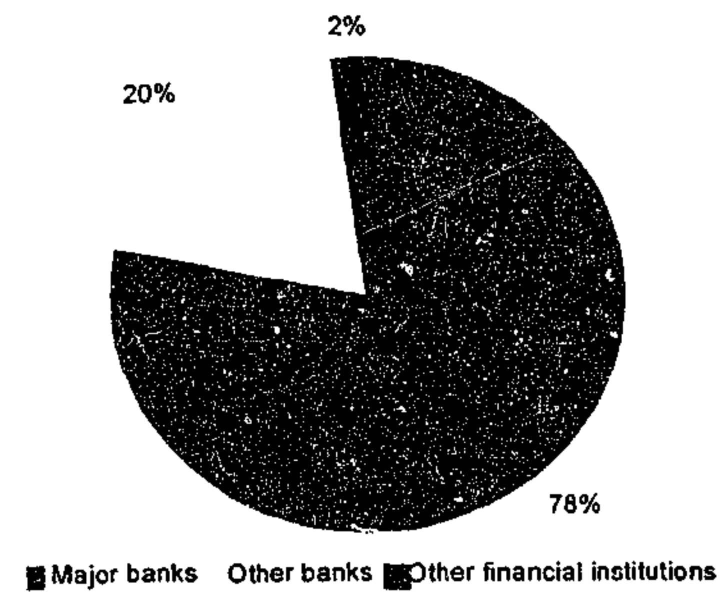
takeovers of regional and state banks were the key avenues for the big four banks to consolidate their economic power.

7.3 Customer Base and Economic Power Potential

Customer base is also a significant factor contributing to the economic power potential of individual financial firms. Particularly, financial firms that draw their customer base from divergent classes in society will have a greater power potential than those whose activities tend to be limited to one class or a narrow set of societal groups (Coleman, 1996, p.20). In this section, the major banks' share in small business, home lending and other retail sectors of the industry will be analysed to identify whether they have a broad customer base or not.

It is generally assumed that regional banks and non-bank deposit-taking institutions (e.g., building societies and credit unions) mainly deal with retail customers and smaller business while commercial banks largely serve industrial and commercial firms. As such, the major banks' shares in small business and home lending may be good indicators of whether they serve a broad social base.

Figure 7.3 Small Businesses' Main Financial Institution as a Percentage, 1995

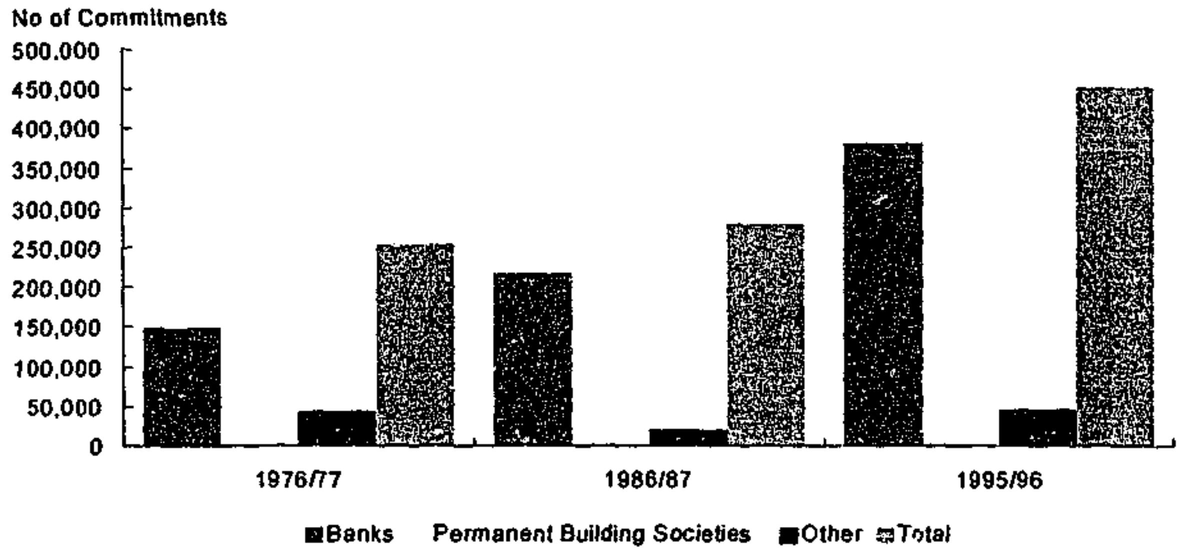


Source: Brian Sweeney and Associates in Yellow Pages (September 1995, p.18, cited in FSI, 1997, p.443).

As shown in Figure 7.3, the Australian banks, with 98 per cent share, dominate the small business lending market. Specifically, the four major banks as a group are the main source of finance for small businesses, with 78 per cent market share whereas other banks and non-bank financial institutions have only 20 per cent and 2 per cent share respectively.[16]

[16] The big four banks held 62 per cent of commercial lending (excluding housing loans) provided by the banking sector to non-financial institutions in June 1998 (calculated from *Reserve Bank of Australia Bulletin*, August 1998, Table B.10).

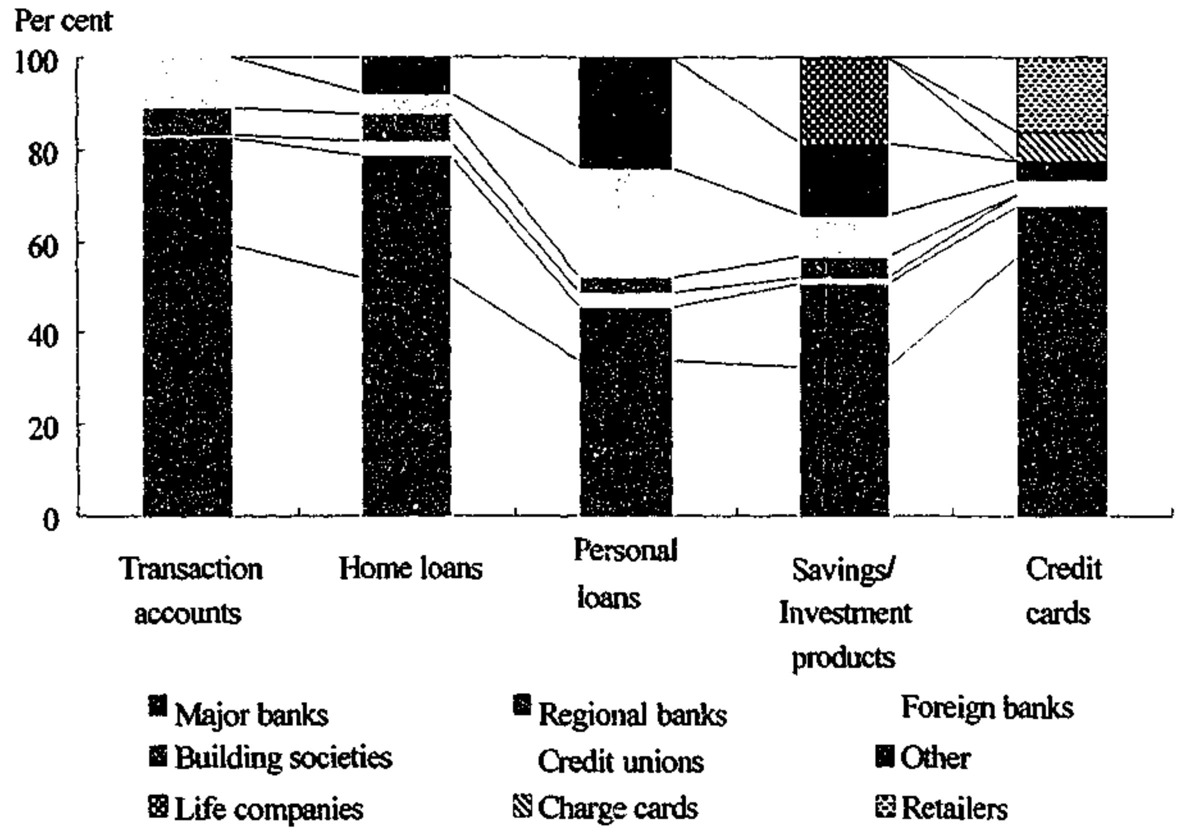
Figure 7.4 Home Lending Commitments by Lender, 1976-1996



Source: Australian Bureau Statistics Catalogue. no. 5609.0 (cited in FSI, 1997, p.625).

Figure 7.4 shows that the major banks had about 450,000 home lending commitments in 1995-96, compared with only about 150,000 commitments in 1975-76; over the same period that of the permanent building societies decreased from about 60,000 to less than 30,000. Moreover, the major banks provide 70 per cent of total housing loans in the banking sector (calculated from *Reserve Bank of Australia Bulletin*, August 1998, Table B.10). Although building societies are specialised in the provision of housing loan finance in Australia, their role in home lending has almost disappeared over the same period (see also Table 7.2, p.144). Although other non-bank institutions such as mortgage originators increased their market share gradually, they are far from posing a challenge to the banks' dominant market position.

Figure 7.5 Market Share of Institutions by Number of Accounts, 1996



Source: Roy Morgan Research (cited in FSI, 1997, p.459).

The major banks offer the full range of products as reflected in their high market shares for most financial products, as seen in Figure 7.5. For example, they have a diverse clientele in most retail market segments, such as home loans, personal loans, savings and investment products, and credit cards.

To sum up, the major banks offer the full range of financial services and products with significant market shares in the various segments of the financial services industry and with a broad customer base.

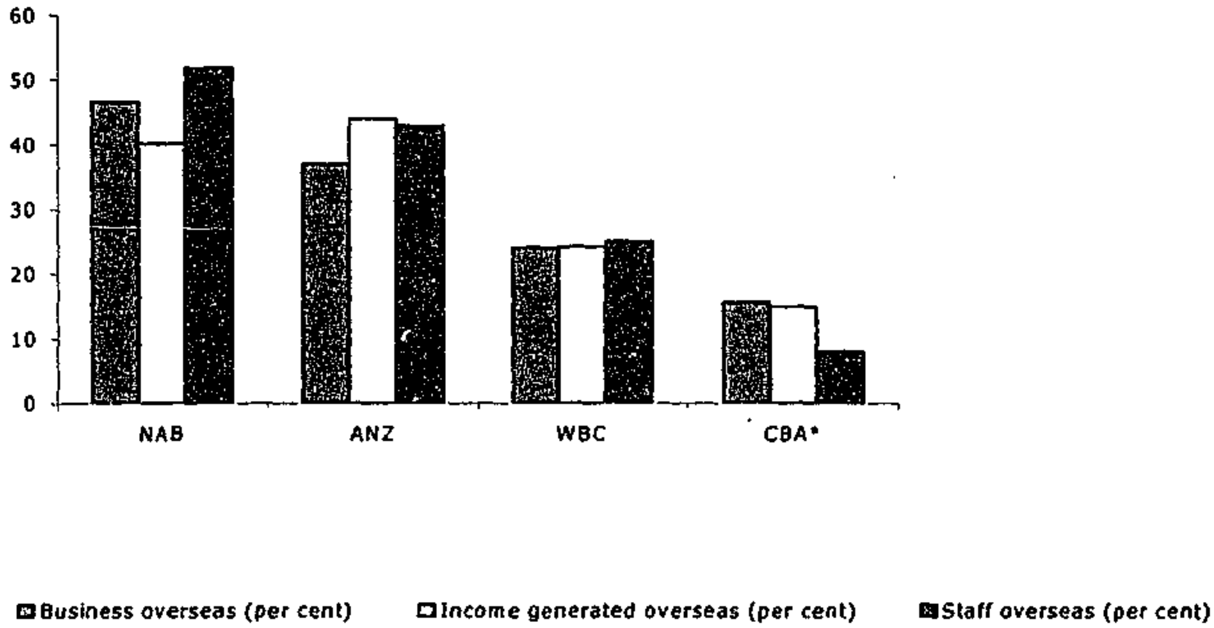
7.4 Global Activity and Economic Power Potential

Financial globalisation generally refers to the growing mobility of capital across borders and integration of national markets into a global one (Garrett, 1995; Strange, 1996, 1998). Frieden (1991) has effectively demonstrated how liquid and mobile financial capital restricts domestic policymaking autonomy of nation states. In a similar vein, in order to support the thesis that mobile firms are in a better bargaining position than immobile states and workers, Kenneth P. Thomas (1997, p.55) argues that capital mobility –"the potential to coordinate production on a wide-ranging geographic scale"– affords multinational firms an advantage over states in their bargaining relationships.

Similarly, banks that have a strong place in global markets may increase their power potential in their bargaining with the state (Coleman, 1996, p.32). And, it can be asserted that the major banks' economic power potential in the domestic policymaking process is also affected by the level of their global activities, which increase their flexibility in location decisions. For example, the NAB threatened the coalition government to move offshore unless the four pillars policy (the government's policy which prohibits in-market mergers among the major banks) was removed (*Illawarra Mercury* 14 December 1998).[17] In this section, the international mobility of the big four banks is measured by the level of their global activity.

[17] Furthermore, Don Argus, then managing director of the bank, left "instructions for the bank's executives to relocate part of the NAB's foreign exchange division to the United States" in order to "lend weight to future threats by the NAB to move its headquarters overseas if the government maintains the four pillars policy" (Ferguson, 1999, p.62).

Figure 7.6 The Major Banks' Global Activity as Percentages of Business, Income and Staff Overseas, 1997



Sources: *Banker* (February 1999, pp. 40-1); *CBA Annual Report* (1998, p. 42; 1999, p.7).
Note: *CBA data are for 1998.

Figure 7.6 illustrates the largest four Australian banks' position in global activities with special reference to three global ratios: business overseas (overseas assets/total assets), income generated overseas (overseas income/total income), and staff overseas (overseas employees/total employees). The chart shows that, among the big four banks, the NAB and the ANZ have placed a significant proportion of their assets abroad, with their business overseas ratio of 47 per cent and 37 per cent respectively in 1997. The NAB and the ANZ also had 40 per cent and 44 per cent of their income generated overseas respectively, whereas the staff abroad is 52 per cent and 43 per cent respectively in the same year. They were followed by the WBC and the CBA which had 25 per cent and 8 per cent of their staff abroad respectively with the income generated abroad 24 per cent and 15 per cent respectively. Finally, it should be noted that the major banks' return on assets were higher than that of the regional banks whose business remained solely domestic (Tripe and Matthews, 2000, pp.26-7).[18]

7.5 Ownership Ties, Interlocking Directorates, and Economic Power Potential

Depth of the ownership relationship between banks and non-financial firms is also associated with the issue of power (Hilferding, 1910, p.225; Coleman, 1996, p.36). By holding large shares of industrial companies, banks may influence the behaviour of these companies. Banks, in turn, may dominate and control the economy which add to their power potential. The ownership ties between financial and industrial corporations are regulated under the *Banking Act* (1959) and *Banks (Shareholdings) Act* 1972. The *Banking Act* requires the separation of the ownership of banks from activities in non-financial sectors of the economy in order to achieve widespread ownership of deposit-taking institutions (FSI, 1997, pp.336-42). The *Banks (Shareholding) Act* requires a person to seek approval from the Treasurer to hold more than a 15 per cent stake in financial intermediaries which are defined as the banks and NBFIs (comprising permanent building societies, credit cooperatives, authorised money market dealers, money market corporations, finance companies, pastoral finance companies and general financiers). The Act seeks to promote a wide dispersion in bank ownership to

[18] This did not, however, prove that it was the majors' global activities that contributed more to their profits than their domestic operations.

minimise the possibility of a bank being prejudiced by the influence or varying fortunes of a particular shareholder. Dispersed ownership rules in Australia protect institutions against undue influence by a major shareholder and creates a broad interest group in the shareholder base. As a result, these ownership rules may limit the influence of financial and non-financial firms on each other.

An interlocking directorate, "having a director of a company board sitting on another firm's board, thereby being in a position to feed back information from a wider corporate scan" may also add to corporate economic power (Murray, 2001, p.5). Banks control the direction of credit (or lending) which may be affected by such interlocking directorate networks. As Mintz and Schwarts argue, "Interlocking directorates are not a source of hegemony but a method for managing discretion ... bank centrality in this context reflects the dominant position of financial institutions in capital-flow decision making" (Mintz and Schwarts, 1985, p.250, cited in Murray, 2001, pp.7-8). Murray (2001) examined such interlocks and their trends by analysing the top 30 Australian companies which also included the major banks in 1992 and 1998. The Australian evidence regarding banks over this six-year time period suggests that there is "a lack of centrality of bank directors on boards of industrial enterprises in Australia" (Murray, 2001, p.12). However, the ANZ was an exception in 1992 and it was accompanied by the NAB "each with five central interlocks" in 1998 (Murray, p.17). Consequently, it can be asserted that among the four major banks, the NAB and the ANZ added to their economic power potential due to their interlocking directorates with non-financial corporations in the 1990s.

7.6 Conclusion

Although, the ownership restrictions between banks and non-financial institutions may limit the major banks' power to influence behaviour of non-financial firms, these banks were in a position to limit the range of options available to non-financial firms through their control over credit; the centrality of their interlocking directorates in non-financial firms (particularly, the NAB and the ANZ); and their dominant position in financial markets during the 1990s. This influence over non-financial firms would, in turn, be a factor that limits the policy options considered by the Australian State during the Wallis era. Furthermore, they had a bargaining power over the State due to their high potential to coordinate their business activities globally.

The analysis of the market shares and customer bases across the sectors of the financial services industry suggested that the banking sector dominated the industry and the major banks occupied a very powerful position within the sector and the industry. Specifically, the major banks had moved significantly beyond their traditional customer base (lending to commercial and industrial firms) as they had considerable shares in home and small business lending as well as retail savings and consumer products. Thus, they had a broad customer basis that draws on several classes in society. In addition, the major banks through their control over credit in a range of financial market segments where there were no state-owned banks might be able to influence behaviour of non-financial institutions and to exert considerable pressure in some of the State's financial policy choices. The data on the global activities of the majors also suggested that they, particularly the NAB and the ANZ, had considerable activity overseas which also added to their domestic strength as these firms have the potential to coordinate their financial activities on a global basis.

This chapter has argued that the major banks have significant potential to realise political gains from their economic power. However, this analysis can only be preparatory to the study of the 'four pillars' case. Accordingly, whether the majors had considerable financial leverage over the Liberal Party, and how their economic power potential was transferred into political power to influence the merger policy outcome will be addressed in the next chapter.

CHAPTER EIGHT[1]

THE CASE OF THE 'FOUR PILLARS' POLICY

8.1 Introduction

The Wallis Inquiry was asked to consider the regulatory framework (for the Inquiry's terms of reference, see FSI, 1997, pp.vii, 707-9). One aspect of the regulatory framework is the power granted under *the Banking Act* and *the Insurance Act* to the Treasurer to determine whether or not mergers can take place. Among the deliberations of the Inquiry, the big bank merger policy received the greatest media and public attention.

The Wallis Committee made 115 recommendations on 18 March 1997. The government fully accepted 114 of these 115 recommendations on 2 September 1997. The only recommendation not fully accepted was number 83, which advocated removal of the 'six pillars' policy – government ban on in-market mergers between the biggest four banks and two insurance companies.[2] The government partly accepted the recommendation and replaced the six pillars policy with the 'four pillars' policy which only prevented the mergers between the biggest four banks (or the major banks).[3]

[1] A version of Chapter eight entitled "Four Pillars Policy: Resistance to Financial Globalisation?" was presented at the Australasian Finance and Banking Conference (refereed) in Sydney in December 2001. Revised version of this paper entitled "Politics of Big Bank Mergers in Australia: The Case of 'Four Pillars' Policy" was also submitted to the *Australian Journal of Political Science*. Following the journal reviewers' suggestions, the paper will be revised and resubmitted.

[2] The policy prevented three different types of potential mergers: mergers between the four largest banks; two largest insurance companies; and any of the four largest banks and two largest insurance companies.

[3] Throughout this study, merger refers to "an amalgamation of two or more firms into a new firm" (Rutherford, 1996, p.296).

The government's 1997 bank merger decision has been a key intervention shaping the direction of bank consolidation in Australia as such mergers significantly accelerated from 1997 through 1999 in the developed economies (Larosiere and Barthalon, 2001; Group of Ten Report, 2001; Berger et al., 2000; Chorafas, 2000, pp.231-36; Rhoades, 2000). Furthermore, the Australian response to mega bank mergers does not support the claim that "There is no evidence that regulators have interfered in banking mergers other than to push a weak, nearly insolvent bank into the arms of a strong bank to save it from bankruptcy" (Chorafas, 2000, p.230).

The Australian position was unusual in many respects with the exception of Canada. The then Canadian Finance Minister, Paul Martin, established the MacKay Task Force into the Future of Financial Services in Canada at the end of 1996. Before the Task Force released its findings, the Bank of Montreal and Royal Bank of Canada announced a merger proposal on 23 January 1998 in order to create a Canadian-based globally competitive bank. In April 1998, the Canadian Imperial Bank of Commerce and Toronto-Dominion Bank made a similar statement. Although the Task Force recommended that policy prohibition on mega mergers among financial institutions should be abandoned, Martin blocked the mergers from proceeding on 14 December 1998. He announced that "the mergers were not in the best interest of Canadians and would not be allowed because they would lead to an unacceptable concentration of economic power in the hands of fewer and very large banks; a significant reduction of competition; and reduced policy flexibility for the government to address potential future prudential concerns" (Group of Ten Report, 2001, p.208). Tickell (2000) in his excellent political analysis of the Canadian case argues that the banks' merger proposals were rejected due to tactical and structural reasons: Tactically, they played badly by announcing the merger proposals before the report of the Task Force: "Their pre-emptive announcement may have successfully forced the Task Force into allowing the mergers (although the Task Force might have arrived at that conclusion anyway), but it also allowed opposition voices to join the fray early...they [the four banks] drew attention to their market power while simultaneously allowing opposition to the principle of mergers to grow" (Tickell, 2000, p.169). And, structurally "they were unable to present their interests as being those of business as a whole and because their influence is generally waning" (Tickell, 2000, p.169).[4]

In Australia, as will be shown, not only did the banks have significant economic power potential over the government that has been translated into exercise of political power, there was also a consensus within the financial policy community for the removal of the merger policy ban. Moreover, the banks' hands should have been further strengthened by the Inquiry which also recommended that the policy should be abandoned. Why was it that the government did not abandon its major bank merger policy ban?

[4] For the comparison of the domestic competition issues regarding bank mergers and the process of merger review by competition regulators in both Australia and Canada with special reference to mega bank merger policy bans, see Goddard (2000). Although Gouvin (2001, pp.402, 406) cites MacKay Task Force as 'McKay,' he provides a useful account of the Canadian case in regard to the North American Free Trade Agreement.

Moran (1984) defined British banking politics as 'esoteric' prior to 1970.[5] By this he meant that the term 'esoteric' points to a private, informal and technical tendency in banking policy discussions. In the comparative analysis of five countries, Coleman (1996, p.xi) also finds that financial services politics covering banking and securities markets is still "esoteric ... where the policy game continues to be structured to favour the interests of large, financial services firms over other interests" in the UK as well as in the USA, Canada, Germany and France.[6] For Coleman (1996, p.93), "banking and securities policy communities remain relatively closed to interests other than those of financial services firms ... [t]he technical expertise and knowledge required for policy formulation acts as a kind of barrier to interests outside financial services ... [i.e.,] depositors, investors, and the broad public." Following Moran (1991, p.13), Coleman argues that financial services policymaking remained esoteric in a *new way* in the 1990s: Financial policy "is more formalised, juridified and institutionalised ... only the privileged few can really participate, a few that is comprised of professionals working for financial services firms and for state agencies, usually finance ministries and central banks" (Coleman, 1996, pp.9-10).

[5] Moran (1984) first made the distinction between the concepts 'esoteric politics' (private, informal and technical) and 'exoteric politics' (open, formal and partisan) in financial policymaking.
[6] Mega bank mergers took place during the second half of the 1990s in four of these five countries (excluding Canada): Citigroup and Bank of America Corp in the US; HSBC Holdings and National West Bank in the UK; Deustsche Bank and HypoVereinsbank in Germany; and Credit Agricole Groupe and BNP Paribas in France emerged as a result of such mergers (see *Banker* July 2000, p.176, July 1999, p.94, July 1998, p.98, May 1998, p.5). In these four countries, contrary to Canada and Australia, Finance Minister's (or Treasurer's) approval of bank mergers is not required (see Group of Ten Report, 2001, pp.98-104, 106-8). Thus, it may be that the much more esoteric process is, in part, the effect of how decision-making takes place. I would like to thank William D. Coleman for the point.

On the other hand, as will be documented, the Australian debate on the big bank merger policy was 'exoteric': It was public rather than private, formal rather than informal, and political rather than technical. The policy process was not structured to favour the interests of the biggest four banks, as it was not limited to the financial policy community due largely to knowledge about bank mergers.[7] This chapter will argue that knowledge on the social and economic consequences of the banks' rationalisation decisions (i.e., branch closures, job losses and reduced consumer choices) was responsible for both the exoteric nature of the merger policy debate and the 'four pillars' policy (the government ban on in-market mergers among the four major banks).

The remainder of this paper is divided into eight sections. The first describes briefly the 'six pillars' policy. The second discusses key public and private sector actors' merger policy preferences. The third examines the banking policy community's policy preferences over the issue of the mergers. The fourth argues that the majors' economic power potential and how they transmit this

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[7] In Canada the policy debate on mega mergers became exoteric due to the Canadian banks' tactical mistake. Then, they failed to gain business and public support. As Tickell puts it:

> While the history of regulatory change and a public perception that charges in Canada were very high had left the banks with few friends, the [MacKay] Task Force effectively *depoliticised* future bank reform and reflected to perfection the ways in which technocrats have increasingly come to dominate what are effectively political decisions in finance (Tickell, 2000, p.157, my emphasis). [However] in the period between the inauguration of the Task Force and its final report in November 1998, the future of Canadian financial services became much more than something that could be decided by technocrats and industry experts. The merger announcements effectively created the conditions for the *repoliticisation* of the process (Tickell, 2000, p.163, emphasis added)... If the banks had waited until the Task Force had reported, they would have been able to point out that a review had taken place which had taken exhaustive evidence into account, and that would have allowed the Finance Minister to refer to technocrats. (Tickell, 2000, p.169)

power into exercise of political power. The fifth argues that the majors used rhetoric of financial globalisation to convince the public for the repeal of the policy. The sixth shows that the merger policy debate was inclusive of affected interests due to knowledge about social and economic interests of bank mergers. The seventh argues that the banks waged a battle for 'esoteric' politics of bank mergers and the Liberal Party tried to erode the 'four pillars' policy technically with the removal of the Treasurer's veto power through technical provisions in some of the Wallis bills at the legislative stage. The conclusion summarises the main argument that the knowledge mainly driven by community experience on the social and economic consequences of bank mergers broadened and politicised the merger policy debate during the formal inquiry process which, in turn, led to a strong opposition within and outside the parliamentary area demanding the preservation of the policy ban.[8]

8.2 The 'Six Pillars' Policy[9]

May (1968, p.1) notes that "[s]uspicion of bankers, particularly private bankers, and more generally of the 'money-power' has a long history in radical and reformist politics [of Australia]."[10] In particular, the Australian Labor Party

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[8] The research methods used in this study have been qualitative. A combination of interviews and written sources was the main approach to data collection. The interviews were held with 14 very senior people with intimate knowledge of the policy debate during the Wallis Inquiry.

[9] A full treatment of the factors associated with the history and evolution of bank merger regulation, and discussion of its practical and theoretical aspects in Australia extends beyond the scope of this paper. For a comprehensive review of the Australian merger policy, see special issue of the *Australian Economic Review* 31(1); Goddard, (2000).

[10] For extensive literature covering this history, see Kelly (1976); Love (1974); Gollan (1968); Crisp (1950).

(ALP) has a long distrust of the 'money-power.' Pauly neatly summarises this point:

> The history of Labor [Party], Australia's oldest party, was profoundly shaped by its reaction to domestic and international financial forces – the "money power." Aside from consistently opposing encroachments by foreign financial institutions, the Party has long struggled with the domestic banks over credit allocation, loan pricing, profitability, and related matters. During periods of Parliamentary control this hostility led the Party to several highly significant actions. In 1911, it created the Commonwealth Bank, later split into Australia's central bank (the Reserve Bank) and the government-owned Commonwealth Banking Corporation; in 1945 it extended wartime controls to curb interest rate increases and provide a direct means of affecting monetary aggregates; two years later the same Labor government nationalised all private domestic banks, an action overturned only by an appeal to the Privy Council in London after an intensely bitter fight; finally, in 1975 the Party laid on the private banks part of the blame for its unorthodox dismissal from office following the turbulent Whitlam years. (Pauly, 1987, fn. 38, p.24)

In particular, the ALP's bank nationalisation attempt in 1947 generated the most severe battle between the banking community as a whole and the Labor government (May, 1968). Arguably, the public announcements of the mergers between the Union Bank and the Australasia Bank, and that of the National Bank and the Queensland National Bank in February 1947 and March 1947 respectively were among the reasons that facilitated the Chifley Labor government's nationalisation decision on 1 May 1947.[11]

[11] May (1968, p.12) outlines Labor's reasons for nationalisation:

> He [Chifley] said the government believed complete control over banking was essential, especially in view of the unstable economic conditions overseas which could affect Australia. Additionally, the banks must never again be allowed to pursue a policy opposed to that of the government, as they had during the depression.

Bank nationalisation led to the heavy defeat of the Chifley government by the Liberal-Country Party coalition in the 1949 federal election. The are four main reasons behind this electoral defeat. First, the nationalisation "galvanised the anti-Labour parties..."; second, "never before or since, nor for such a sustained period, have the anti-Labour forces had anything approaching the campaign funds for their cause which were, directly and indirectly, lavished on them between August, 1947, and December, 1949"; third, "the many thousands of man-hours devoted by bank officers to the task of defeating the Chifley government..."; fourth, "the electorate's fear of nationalisation, socialisation or socialism..." (May, 1968, pp.126-27).

The ALP's suspicion of 'money-power' revived on 2 April 1990 when Australia and New Zealand Banking Group Limited (ANZ) and National Mutual Holdings Limited (NM) announced plans to merge in order to form the largest financial conglomerate in Australia.[12] Paul Keating, the then Treasurer in the Hawke Labor government, withheld approval and opposed the merger on competition grounds (Keating, 1990). Keating stated that the proposed merger between the major bank and the major life office might not be allowed, even though it would have been approved previously by the Trade Practices Commission (now Australian Consumer and Competition Commission, ACCC).[13] In announcing his decision, Keating (1990) stated that the merger would "detract more from effective and vigorous competition than is in the national interest." Coinciding with this decision, Keating announced the 'six pillars' policy on 23 May 1990.[14] The policy blocked mergers among any of the largest four banks: the National Australia Bank (NAB), the Westpac Banking Corporation (WBC), the Commonwealth Bank of Australia (CBA) and the ANZ;[15] or the largest two

[12] The search for diversification including bringing different financial services such as banking and insurance under one roof as well as economies of scale in order to compete in a global banking environment were counted among the chief reasons behind the merger motives among the financial firms in Australia (see *Australian Financial Review* 22 April 1988).
[13] In fact, the Trade Practices Commission approved the merger on competition grounds (see Goddard, 2000, fn.20, p.193).
[14] Ian Harper (2000, p.67), member of the Wallis Committee, is mistaken that the 'six pillars' policy was introduced "in the late 1980s."
[15] There were seven major banks before the mergers in 1979 and in the second half of 1981 which reduced the number of major private banks to three. In October 1979, the ANZ's takeover of the Bank of Adelaide was approved by the Treasurer. In June 1981, the structure of the banking sector changed significantly with the creation of two new banking groups: the Westpac Banking Corporation (a merger of the Bank of New South Wales and the Commercial Bank of Australia) and National Banking Corporation (a merger of the National Bank of Australasia and the Commercial Banking Corporation of Sydney Ltd). For examination of structural, economic and strategic factors which led to these mergers of 1981, see Stearn and Tress (1983).

insurance companies: the Australian Mutual Provident Society Limited (AMP) and the National Mutual Limited (NM).

The 'six pillars' policy was a political/administrative decision which did not require new legislation. It was framed under Section 63 of the *Banking Act 1959* regarding banks[16] and under Section 5(1) of the *Insurance Acquisitions and Takeovers Act 1991* in relation to insurance companies.[17] These banking and insurance laws provided an institutional framework that gave the Treasurer the right to approve or refuse a merger between the major banks and insurance companies on the basis of public interest. Thus, these acts are the legislative basis of the policy as they require the Treasurer's consent before a deposit-taking institution (bank, credit union or building society) or an insurance company can amalgamate, enter a partnership with another financial firm or a reconstruction. As will be discussed in the next section, the financial policy community (key regulators and regulated firms in the financial industry) agreed that both the Treasurer's veto power and the 'six pillars' policy should be abolished.

8.3 Financial Policy Community on the Merger Policy

Chapter five has argued that Costello created the Inquiry to consolidate his

[16] The Act does not provide guidance on how the Treasurer is to exercise his discretion while stating that the Treasurer's consent shall not be unreasonably withheld. In practice, the Treasurer considers:

> any prudential considerations, the potential efficiency gains resulting from any rationalisation, and any potential losses resulting from reduced competition in the financial sector. (Treasury, 1996, p.143)

[17] These laws required any party wishing to buy more than 15 per cent of a bank or insurance company shares an approval from the Treasurer.

power within markets and politics. In regard to bank merger policy, Costello did not rule out the possibility of the policy change following the establishment of the Inquiry. Rather, he stated that "the question of mergers is to be fully investigated [but] the policy would remain in force at least until the government receives and considers the Final Report of Inquiry" (cited in *Sydney Morning Herald* 31 May 1996). In fact, Costello, in the words of a senior Labor member of the House of Representatives Standing Committee on Economics, Finance and Public Administration, was "very pro getting rid of 'four pillars'" (Interview, 22 January 2001).[18] He indicated that the Wallis Committee's recommendations on bank mergers would be pivotal: "There is going to be no merging of the majors until this Inquiry is done" (quoted in *Australian Financial Review* 11 April 1996). However, the Committee was not independent of both government and business, and was 'packed' by the government in accordance with its regulatory policy preferences (see Chapter five). Not surprisingly, the Committee was largely composed of the proponents of mega bank mergers. Stan Wallis, who was a professional as the then director of the AMP, supported the removal of 'six pillars' policy (*Australian Financial Review* 25 June 1996, *Australian Business Intelligence* 1 April 2000). Apart from Wallis, Ian Harper, professor of finance at Melbourne University, and Bill Beerworth, a lawyer and a merchant banker experienced in *Takeovers and Trade Practices Law*, had pro-merger views within the Committee (see Harper 1999a,b; 2000; *Australian Financial Review* 27

[18] Costello also publicly pretended that he did not want mergers among the majors (*Australian Financial Review* 20 March 1996, 5 February 1996).

November 1998; *Sydney Morning Herald* 10 June 1996; *Sunday Age* 19 April 1998; *Age* 18 June 1998). Arguably, one of the government's initial aims was to legitimate the repeal of the 'six pillars' policy through the Inquiry's recommendations.

When the Liberal Party established the Inquiry, the majors initially mobilised for the removal of the policy ban on domestic mergers. As a senior Labor member of the Economics References Committee in the Senate at the time observed:

> They [major banks] were one of the most effective and powerful lobby groups behind the scenes. They pushed this [Howard Coalition] government very hard. (Interview, 14 February 2001)

The majors had government relations divisions and expert professionals which enabled them to build up their own policy expertise to define their own interests and to translate those interests into policy recommendations.[19] Because the Wallis Committee's recommendations would affect institutions most to gain or lose from the government's acceptance of them, the majors articulated and defended explicit positions in their submissions to the Inquiry. The major banks, along with the largest two insurance companies, unanimously supported that the 'six pillars' policy should be abolished (NAB, 1996, p.9; CBA, 1996, ch.5; WBC, 1996, p.8; ANZ, 1996, p.2; AMP, 1996, p.2; NM, 1996, ch.5).

The key bureaucratic institution in the merger policy discussions is the

[19] The Australian banking community has a long history and strong experience in direct lobbying through their public and government relations departments. An interest in such departments was born in response to the nationalisation attempt in 1947 (May, 1968, pp.129-30).

ACCC in Australia. Mergers are assessed under Section 50 of the *Trade Practices Act* (TPA) and administrated by the ACCC (for the legal aspects of the merger policy, see Goddard, 2000; Baxt, 1990). The ACCC (1996) also wanted the removal of the Treasurer's merger veto power. Specifically, it sought to have the *Banking Act* (s.63) amended to make it explicit that the Treasurer's consent should not be withheld on competition grounds. A very senior ACCC bureaucrat at the time explained this policy position:

> If there are reasons connected with prudential policy as to why someone else should be able to veto bank mergers then I have no problem with that. What I am not enthusiastic about is the situation where the government of the day makes the competition policy judgements on mergers. I think that is the best left to the ACCC and processes of the Trade Practices Act ... Treasurers may have legitimate role for other reasons such as prudential policy but not for competition policy. (Interview, 1 March 2001)

This policy position of the ACCC was welcomed by the majors. In an attempt to leave the merger decisions to technocrats and industry experts, some of the major banks proposed that this merger assessment should be left to the ACCC and the TPA. For example, the WBC and the CBA proposed that the Treasurer's veto power in assessing a proposed merger on competitive grounds should also be removed (WBC, p.1996, 8; CBA, 1996, p.11).[20] Particularly, the WBC criticised the Treasurer's powers under banking and insurance laws, which had no application under the TPA, for lacking transparency and creating uncertainty (WBC, 1996, ch.9). With the removal of the Treasurer's powers on merger issues, the accountability for such a decision would be removed from those who are

[20] The ABA also proposed a similar proposal (ABA, 1996, p.iv).

publicly accountable to a bureaucratic entity. The merger discussions, in turn, would remain largely 'esoteric'. In fact, this would end the government's capacity to continue to have the policy. The Treasury Department is not a regulatory institution but the key policy adviser to the government. As Chapter five has shown, the Treasury is the pre-eminent bureaucratic institution determining the Inquiry's recommendations. Therefore, its view on the merger policy is important. The Treasury (1996) did not explicitly favour the retention of the policy. In fact, it adopted a similar line with the major banks and the ACCC, namely that merger issues should be left to the ACCC and the TPA (Treasury, 1996, pp.5, 117). Also, there was no noteworthy resistance to merger policy change from the Reserve Bank of Australia (RBA).[21] To sum up, there was a consensus on the direction of the merger policy change between the key regulator and regulated firms as well as the Treasury.[22]

8.4 Corporate Politics

Economic power provides financial firms with a potential to influence public policy outcomes (Coleman, 1996). The NAB, the ANZ and the WBC had

[21] In fact, Bernie Fraser, the then governor of the RBA in 1996, publicly favoured big bank mergers:

> To maintain profitability as (profit) margins decline, banks will have to reduce their costs or increase fees ... Rationalisation of branch networks is one way of reducing costs, but the scope for further cost savings through this channel will depend in part on [merger] policy. (cited in *Sydney Morning Herald* 6 July 1996; see also *Sun Herald* 7 July 1996)

[22] However, as will be detailed later, the policy change did not occur in spite of this consensus in banking policy community.

considerable economic power potential[23] to influence the then insolvent Liberal Party's banking policies as its chief donors[24] and fundraisers[25] in the 1990s. Among these banks, the NAB had the most significant financial leverage over the Liberal Party as its banker and the largest corporate donor. As the senior member of the House of Representatives Standing Committee on Economics, Finance and Public Administration at the time observes:

> The Liberal Party did get a whole lot of financial support from the NAB ... The major banks donate a lot more to the Liberal Party than they donate to the ALP. They are a strong contributor. So there is a big pressure there. (Interview, 22 January 2001)

To illustrate, the Party owed A$10 million to the bank. The Liberal Party's then federal Treasurer Ron Walker, millionaire property developer, gave a *verbal* guarantee to Don Argus, the NAB's former managing director and the chief

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[23] Following Coleman (1996, p.47), the word "potential" is used here because there is no automatic transfer of a power potential into an exercise of power.

[24] According to the figures released by the Electoral Commission between 1992 and 1997, the political donations of the major banks to the Coalition reached around A$1.95 million (or 11 per cent of the Coalition's total of A$177 million) whereas the ALP received around A$701,020 (or 5 per cent of the Labor's total donations of A$128 million) from the majors despite being in government for the bulk of the same period (see *Australian Financial Review* 18 March 1998; 2 June 1997). According to these figures, the WBC remained the most generous supporter of political parties. However, it should also be noted that figures released by the Electoral Commission did not actually disclose the true magnitude of financial benefits because the *Electoral Act* was not requiring disclosure of all political donations (see *Australian Financial Review* 20 April 2001). For instance, loans made to political parties and donations made through foundations were not captured by the Commission's reports.

[25] Foundations are the main vehicles to mask corporate donations to political parties. To illustrate, Charles Barrington Goode, the then chairman and the director of the ANZ, was also the director of the Cormack Foundation and had significant ties with the Liberal Party. The foundation was the biggest individual donor which gave A$800,000 to the Victorian Liberal Party in 1994-95 financial year (*Australian Financial Review* 2 February 1996). It raised and donated A$1.5 million to the Party in 1995-96 financial year (*Australian Financial Review* 4 February 1997).

executive officer, for the bank's loans to the Liberal Party in 1992 (*Australian Financial Review* 31 July 1998). Apparently, a verbal guarantee from Walker was enough for Argus to extend the Party's overdraft for three years between 1992 and 1995. Furthermore, in order to force the Liberal Party to pay the debt, the NAB would have liquidated the Party's premises. As Colin Gracie, the Party's former corporate services manager, noted:

> Subsequently, the Party was unable to repay the loans at the time required by the bank, and the bank called upon Mr Walker to honour his guarantee ... In 1995, in order to prevent the possibility of the NAB from selling the Party's headquarter premises to enable repayment of loans, Walker provided a written personal guarantee to the bank. (cited in *Australian Financial Review* 5 March 1996)

It was only in 1995 when Walker personally guaranteed the Party's debt of A$10 million (*Sydney Morning Herald* 21 February 1996). Accordingly, the NAB effectively bankrolled the election campaigns of the insolvent Party by extending its A$10 million debt through highly generous overdraft facilities[26] before the federal election in 1996 (*Australian Financial Review* 5 March 1996, 31 July 1998; *Sydney Morning Herald* 21 February 1996). As Walker, whom the Party had become indebted, said "Argus is the backbone of this [the 1996 federal election] campaign" (cited in *Sydney Morning Herald* 20 April 1996).

The NAB did not hand over millions of dollars to the Party without expecting a return on its investment. It used the policy of stick and carrot to

[26] An overdraft is a credit facility which is given by a financial institution to a corporation. The aim is to allow a bank's customer to obtain credit on its current account in excess of the account balance.

exercise its financial leverage over the Party in the wake of the Inquiry. On the one hand, it was using the policy of stick when it required the Party to repay its debt in 1996. Not surprisingly, the Party was unable to repay the loans at the time when required by the bank. Thus, Argus called upon Walker to honour his guarantee. Walker personally repaid A$4.75 million Party debt to the NAB in the 1996-97 financial year which covered the Wallis Inquiry period (*Australian Financial Review* 31 July 1998). On the other hand, the NAB was using the policy of carrot when it did write off the loan of A$1 million to the Liberal Party in 1996 (Ramsay, Stapledon and Vernon, 2001, fn.117, p.26). It also continued to support the Party with substantial overdrafts with A$1 million credit facility in 1998 (*Sydney Morning Herald* 28 September 1998). Apparently, corporate political donations and lending to the Liberal Party were used to advance the economic power of some of these banks over the government at the height of the merger policy discussions.[27]

There are various means by which the largest four banks translate their economic power into the exercise of political power. The Australian Bankers' Association (ABA) can be regarded as a political lobbying group for the banking community as a whole. The ABA did not play a significant role in mediating the majors' economic power into political power. As a senior Labor member of the House of Representatives Standing Committee on Economics, Finance and Public

[27] For a discussion on a link between corporate donations and political leverage in Australia, see Gallop (1997).

Administration also observes:

> The [ABA] has not been very successful as a lobby group for anybody ... Because the industry is so competitive and so much dominated by commercial inconfidence that the ABA really cannot be a peak body. (Interview, 22 January 2001)

In addition to the majors, the ABA also represents smaller regional banks which, however, supported the preservation of the Treasurer's powers under the *Banking Act* (see, for example, Bank of Melbourne 1996; Advance Bank 1996). The majors were unable to present their individual interests as being the common interests of the banking sector.

Accordingly, the major banks preferred to transmit their economic power into exercise of political power individually rather than collectively.[28] Elite networking was a significant avenue available to the senior managers of the major banks to translate their policy preferences to the executive members of the government. For example, the banks' chief executives belonged to the Australian powerful corporate elite (*Australian Financial Review* 20 October 1995).[29] As a Howard staffer once pointed out: "they are quarantined as top-table people, those he [Howard] sees at business and industry functions and to whom he speaks at those functions" (cited in *Sydney Morning Herald* 14 September 1996; see also *Age* 30 March 1996).[30] In addition, the NAB and the ANZ hired highly influential

[28] This finding confirms Bell and Warhurst's (1992, p.65) argument that large firms "become more actively involved in the policy process [in Australia]."
[29] For example, Goode was among the most powerful eight corporate individuals in Australia in 1994 (*Business Review Weekly* 23 May 1994, pp.47, 114).
[30] Argus also wrote letters to Howard and Costello expressing his concerns over the government's decision to ban mergers between the largest four banks in May 1997 (*Australian Financial Review* 21 May 1997).

ex-Liberal lobbyists to steer the government towards allowing major bank mergers (*Australian Financial Review* 23 July 1997).[31]

8.5 Financial Globalisation Rhetoric

Each of the largest four banks in Australia is a financial conglomerate with a broad customer base dominating almost all market segments within the retail and wholesale sectors of the industry (see also FSI, 1997, chs. 4, 15).[32] Moreover, they are among the most profitable[33] and largest[34] Australian institutions. They are also considered to be among the world's top banks[35] (*Banker* February 1999). In addition, they were among the top nine institutional globalisers in Australia while their chief executives were among Australia's top individual globalisers

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[31] Argus hired Michael Kroger, the former president of the Victorian Liberal Party, to lobby the government on its major bank anti-merger policy in 1997 (*AAP News* 26 November 1998; *Australian Financial Review* 30 November 1998; *Sydney Morning Herald* 25 November 1997). Kroger and Costello are very close friends (Carney, 2001). Their long-time friendship goes back to 1975 when they were students at Monash University (Carney, 2001, p.51). In addition to Kroger, the NAB also hired Ian Kortlang, the principal of Gavin Anderson Kortlang, a public relations consultant and lobbyist close to the Liberal Party (*Australian Financial Review* 23 July 1997).

[32] The growth of conglomeration by banks became significant in the Australian financial industry by the early 1990s (see Bain and Harper, 1999). In the late 1990s, financial conglomerates were the dominant institutions accounting for about 80 per cent of the total financial system in Australia (see *Reserve Bank of Australia* 1996, p.109). In June 1995, they were controlling 75.5 per cent of total branches and 66 per cent of total assets in the banking sector (*Reserve Bank of Australia Bulletin*, August 1995, September 1995). For a comprehensive review of the banking sector in Australia, see *Reserve Bank of Australia Bulletin*, (March 2000, pp.16-25); Kent and Debelle (1999); Lewis and Wallace (1997); Financial System Inquiry (FSI 1997, chs. 14-5).

[33] *Business Review Weekly* in its 500 biggest Australasian companies survey noted that the NAB, the CBA, the ANZ and the WBC were ranked the first, the fourth, the fifth and the seventh respectively in net profits totalling A$2,869 billion in 1997 (*Business Review Weekly* 28 April 1997, p.66).

[34] The NAB, the CBA, the ANZ, and the WBC were ranked among the biggest ten companies in Australasia as measured by market capitalisation in 1997 (*Business Review Weekly* 28 April 1997, p.66).

[35] To illustrate, the NAB, the WBC, the ANZ and the CBA were ranked in 64th, 84th, 89th, and 101st respectively among the world's top 1000 banks in total assets in 1996 (see *Banker* July 1997, p.147, February 1999).

(see Sklair, 1996, table 2, pp.19-24).

Rhetoric or "the art of words and persuasion" plays a central role in any policy debate (Parsons, 1995, p.177). In particular, the 'rhetoric of globalisation' is increasingly used to explain and justify policy decisions by public and private sector actors as well as governments (see Tickell, 2000; Conley, 1999). The objectives of bank mergers have often been conceived in a rhetoric of financial globalisation that "by becoming larger, they [banks] stand a better chance of competing both domestically and internationally" (IMF 1998, 183; see also Dymski, 1999; Jones, 1998; *Banker* July 1997). In the case of the government's bank merger policy, the banks realised that they also needed to make their case before the Australian people. Specifically, the majors used the rhetoric of financial globalisation in an effort to transfer their corporate agenda into a public agenda and influence the policy debate. They argued that the main forces driving consolidation elsewhere were the similar forces which confront Australian banks: pursuing economies of scale and scope, and obtaining better access to capital and human resources (*Banker* April 2000, pp.29-30, 60-2; Argus, 1998, p.40; Westfield, 1997, pp.47-8; *Australian Banker* April 1996, p.44).

The rhetoric of financial globalisation was channelled into public opinion-making processes through the financial press or business pages of newspapers which stand at the "crucial intersection between the world of finance and the world of government" (Palmer, 1970, pp.98-9, cited in Parsons, 1989, p.4; see also Dye, 2001, ch.6). Among the big four banks, the NAB was the strongest lobbyist using 'financial globalisation' rhetoric in its media campaigns.[36] As one very senior bureaucrat at the ACCC observed:

> The [banking] industry also arranged a lot of newspapers trying to make that [mergers] agenda ... In terms of vested interests on the side of those who want the change [of bank merger policy] were most of the largest four banks. The National [Australia Bank] had been particularly prominent. (Interview, 1 March 2001)

Argus asserted that "we have not got the size we want ... and we have got to fill that gap" (cited in *Business Review Weekly* 18 August 1997, p.20). He believes that the world banking industry requires massive global banks (*Australian Financial Review* 17 July 1996; 29 July 1997; 9 March 1998). Accordingly, he claimed that the Australian financial companies needed to build a critical mass in the domestic market if they were to become big enough to compete internationally (*Age* 25 June 1996).[37]

Opposition forces within and outside the parliament accused Argus of

[36] There were two major reasons for the NAB's prominence in pressuring for the policy change. Firstly, Argus was among the strongest proponents of financial globalisation in the banking community (*Australian Financial Review* 13 September 1997). Secondly, the NAB was the only 'global' Australian bank with the integration of its international operations and strategies to form global networks (for the NAB's global strategies, see Bain et al., 1999; Argus, 1998). On the other hand, the ANZ, the WBC and the CBA are multinational banks which "own and control branches and/or affiliates in more than one country" (Jones, 1992, xiii, cited in Bain et al., 1999, p.2). It should also be noted that among the majors, the CBA was relatively the least active bank pressuring for the policy change. The CBA was previously a government-owned bank that built with its clients in Australia. Thus, it did not have international business expansion like the NAB and the ANZ did. Arguably, this was the main reason behind the CBA's relative passivity in using globalisation rhetoric (for the conceptualisation of such individual large firms as political actors in the public policy process, see Sally 1995, 1996).

[37] The ANZ or the WBC were regarded as the NAB's takeover targets (*Age* 30 July 1996). Although Bob Joss, the managing director of the WBC at the time, did not engage in a strong public campaign like Argus, he echoed the views of Argus (*Australian Financial Review* 8 August 1996). He told shareholders that "well-conceived, well-planned and well-executed in-market mergers are very powerful strategies" (cited in *Age* 21 January 1997).

having a strong influence on the Inquiry in the wake of the NAB's donations to the Liberal Party and its strong media campaign (*Age* 11 September 1996).[38] In particular, the close relationship between the bank and the Party increased the speculation that the Inquiry was set up to ease bank merger rules (*Business Review Weekly*, 3 February 1997, p.14). Moreover, the view among commentators and opposition forces was that the Inquiry's conclusions on the policy had already been decided by some of the major banks (*Age* 11 September 1996; *Sydney Morning Herald* 6 July 1996; see also *Sun Herald* 7 July 1996).

8.6 National Politics

Not surprisingly, the pressure for merger policy change generated by the major banks activated opposition forces whose own interests would be affected by the proposed policy changes. A series of responses to the banks' mergers agenda came from employee, customer and farmer interest organisations as well as from the formal political area. The Finance Sector Union of Australia (FSU), an interest organisation of bank employees, drew attention to the employment effects and the growing problem of access to financial services due to branch rationalisations[39] (FSU, 1996, pp.ii-iii; *Sydney Morning Herald* 17 August 1996; *Australian Financial Review* 16 September 1996). The FSU emphasised that the removal of

[38] Argus rejected the criticisms: "Apart from the fact that such views demean the reputations and quality of the Inquiry panel, they also demonstrate ignorance of the realities of today's banking and financial services industry" (cited in *Age* 11 November 1996).
[39] The FSU was representing the interests of 115,000 staff employed in the banking, insurance, credit union and friendly society sectors in 1995.

the 'six pillars' policy would not mean just one big bank merger but two.[40] It referred to research by McIntosh Baring in 1996, *Australia's banks, a ready reckoner*, which showed that 35,000 jobs would be lost as a result of such an amalgamation process (FSU, 1996, p.13).[41] In the light of these possible future consequences of mega bank mergers, the ALP's then shadow Treasurer, Gareth Evans, made the Party's position on the issue clear:

> The Inquiry has enormous implications for employment, particularly in regional Australia where branch banking has already become a dying service ... A green light for any merger between the major banks would mean the immediate loss of thousands of jobs, with rural and regional Australia particularly hard hit. (cited in *Sunday Age* 19 May 1996)

Along with the FSU, the Australian Consumers Association (ACA) claimed that branch closures would mean reduced consumer choice and the banking sector was not creating significant competitive benefits for retail consumers in such banking services as credit cards, personal loans and deposit products (*Sun Herald* 7 July 1996; *Sunday Age* 19 April 1998).

These arguments were also translated into a concern and support that the FSU and the ACA received from farmers and rural communities in general (New South Wales Farmers' Association, 1996, p.4). The National Farmers' Federation

[40] A merger between the two banks would certainly force the remaining two big banks to get together (*Australian Financial Review* 30 November 1998).
[41] The figure corresponds to almost 22 per cent of the total number of employees (160,150) working in the four major banks in 1996 (for distribution of employees among the four banks, see *Banker* July 1997, p.142). Employment in the financial services industry declined from 365,000 (almost 4.5 per cent of total wage and salary earners) in 1990, to below 300,000 (or 3.5 per cent) in mid-1995 (NAB, 1996, ch.1, p.11). 40,000 full-time jobs over the five years between 1992 and 1997 were lost alone from the four major banks (*Hansard* 22 April 1998, p.336). During the six years between 1990 and 1996, the biggest four banks, especially the CBA and the WBC, cut 47,000 jobs (*Sydney Morning Herald* 4 March 1997).

(NFF), a peak association established in 1979 which has been associated traditionally with the National Party, believed that little consideration had been given to the needs of people in rural Australia in 1997. The NFF (1997) stated that the rationalisation of branch networks[42] and unemployment would pose serious economic and social consequences for the rural community:

> When bank branches close, people in rural communities have to travel greater distances to access bank services and deal with the inconvenience and added costs involved. When people travel to larger centres they also conduct other business there, reducing the viability of local businesses and other service providers. The loss of jobs can result in the out-migration of households and the loss of business and participants in community organisations. (*National Focus* 11 February 1997)

Accordingly, consumer, employee and farmer pressure groups formed an opposition alliance coupled with political support from the ALP.

The Liberal Party also felt pressure from a number of sectors including some of its traditional constituent groups. The business community was the core constituency of the Party (Brett, 1997, pp.148-66). However, contrary to the major financial institutions, as one top bureaucrat observed, the non-financial big business community did not "care" about the outcome of the merger debate whereas small business[43] was "quite concerned" (Interview, 1 March 2001). The

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[42] In October 1996, the ANZ announced a minimum of 110 branches to be closed around Australia and up to 7,000 jobs to be shed in order to cut costs and increase efficiencies (*Sydney Morning Herald* 28 October 1996). The number of bank branches fell by 557, or close to 8 per cent between 1993 and 1996 (*Reserve Bank of Australia Bulletin*, November 1996, p.2). The WBC and the CBA together accounted for 38 per cent of this decline (*Reserve Bank of Australia Bulletin*, November 1996, p.2). It was also noted that between June 1993 and June 1996, the number of bank branches in non-metropolitan areas (i.e., rural and coastal areas) fell from 2,315 to 1,993 or by 13.9 per cent (Beal and Ralston, 1997, p.126).

[43] Small business is defined as one that is independently owned and employs fewer than 20 people (McLennan, 1997, p.1).

small business sector constituted almost 50 per cent of the workforce in all private sector business employment with 3.5 million people in 1996 (see McLennan, 1997, p.1). This sector was expecting better deals in small business lending[44] from the banks when the Liberal Party came to power.[45] It was concerned that consolidation would have a negative effect on the availability of credit to small businesses and communities.[46]

There is also strong empirical evidence to support the long-term impacts of branch closures such as depressed economic activity in rural Australia (Beal and Ralston, 1997; *Sydney Morning Herald* 25 June 1996). Furthermore, there is no empirical evidence that greater size necessarily leads to a greater efficiency that would reduce the cost of financial transactions in Australian banking (Walker, 1995).[47] For example, the banks' fee income grew continuously and fees paid by households grew faster than fees for business during the 1990s (*Reserve*

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[44] Small business lending refers to business loans of less than A$500,000. The indicator of competition in lending is basically measured by the margin between the cash rate and the average rate paid by small business on variable-rate loans (*Reserve Bank of Australia Bulletin*, October 1997, p.11). This margin in variable-rate loans for small business was around 5 per cent whereas it was only 3 per cent for large business and less than 2 per cent for housing loans between 1995 and 1997 (see *Reserve Bank of Australia Bulletin*, October 1997, pp.6-13).

[45] For example, Rob Bastian of the Council of Small Business Organisations of Australia said:

> The Government has also said it would look at ways to help small business get better access to equity capital. We expect good things because I believe John Howard has a good feeling for the sector. (cited in *Sunday Age* 10 March 1996)

[46] There was no empirical evidence supporting improvement in small business lending and bank mergers in Australia (for the findings on decline in small business lending due to bank consolidation in the US, see Berger, 1997; Walraven, 1997; Berger et al., 1995).

[47] Anderson, in referring to the evidence following the Campbell Inquiry, argued that "[p]olicies to increase competition can, and in the case of Australian financial markets did, lead to greater inefficiency and act to entrench dominant oligopolistic institutions [i.e., the largest four banks]" (Anderson, 1993, p.71). For the international evidence supporting the lack of relationship between size and efficiency, see Siems (1996); Deloitte Touche Tohmatsu International (1995); Berger and Humphrey (1992).

Bank of Australia Bulletin, June 1999, pp.1-3).[48] Furthermore, the major banks' justifications for bank mergers was further hampered by their domestic market position as the most profitable and largest institutions in Australia; and their reasonable place in the world banking ranking.

Not surprisingly, the majors had a negative public image.[49] As the social and economic consequences of previous bank mergers (i.e., higher unemployment, lesser banking services and competition) were fresh in the minds of Australians, it became difficult for banks to make a successful case with billion dollar profit results and million dollar executive salaries (*West Australian* 2 December 1996).[50] As the Labor Senator put it:

> Everybody knows somebody who has direct experience with lesser services [and] higher fees. And banks are not doing it for your good ... They have massive profits on the back of higher fees and less services. (Interview, 14 February 2001)

Accordingly, the 'bank mergers debate' was politicised and opened to the large number of stakeholders and the general public due partly to knowledge on the

[48] Between 1991 and 1995, the average of the major banks' fee charges increased by twofold in account servicing fees and more than 30 per cent in transaction fees (*Reserve Bank of Australia Bulletin*, June 1999, table 1).

[49] As the *Age* notes:

> Yet, with rapid change [in deregulated financial industry] has come renewed cynicism among depositors that, on the whole, banks are more accountable to shareholders than depositors. Events like the Pyramid collapse, the sale of the State Bank of Victoria, massive profits and high charges have renewed a tradition of public suspicion of the power of banking institutions. Small business, seen as a captive market, has been caught in the crossfire, with real interest rates still higher than they were 10 years ago. (*Age* 11 April 1997, see also Weerasooria, 2000, ch.6)

[50] For example, the NAB recorded Australia's biggest corporate profit with A$1.97 billion in 1995 (*Age* 1 January 1996). Also, the four major bank chief executives' total earnings reached around A$5 million in 1996 (*Australian Financial Review* 18 December 1996).

effects of the bank mergers. As a senior Liberal member of the Economics and Legislation Committee in the Senate at the time observed:

> At that time, some people were concerned about the consequences of mergers as it worked out in practice with the closure of branches, reduction of physical working services, replacement by electronic services and so on. A broader cross section of the public became concerned about banking issues. Earlier on when we were talking about the mergers it was a bit *'esoteric'*, theoretical. Now it is down the ground. Some of the consequences become apparent. I think that had broadened the debate publicly. (Interview, 8 May 2001, emphasis added)

On 24 March 1997, the Wallis Committee submitted its 700-page final report containing 115 recommendations to the government. Argus also knew that the Committee had proposed the removal of the 'six pillars' policy before the release of the Wallis report. Therefore, the NAB stepped up the pressure on the government ahead of the release of the Wallis report, urging it to fully implement the Inquiry's recommendations (*Age* 5 April 1997). Not surprisingly, the Committee recommended the 'six pillars' policy and the Treasurer's power of veto for the purposes of assessing the competition implications of a merger under the banking and insurance laws should be abolished (FSI, 1997, p.428). In terms of procedure, it suggested that the competition policy should solely be administered by the ACCC under the provisions of the TPA to test the potential anti-competitive effects of mergers (FSI, 1997, p.425). In so doing, the Wallis Committee sought to remove this veto power to depoliticise the issue of bank mergers.

Costello had opportunity to observe strong public and political reaction to the bank merger policy change during the Wallis era. Specifically, he worried that Argus's pressure would jeopardise the thrust of the Inquiry (*Australian Financial*

Review 24 March 1997, 7 April 1997). Further, the possibility of massive job losses after a big bank merger could have posed a political risk to Costello as well. As Terry Aulich, a former Labor Senator, observes: "[t]he political danger for Costello is that he might be seen as the person who accelerated job losses in the industry" (cited in *Business Review Weekly* 21 April 1997, p.26).[51] Apparently, the 'exoteric' nature of the meger policy debate made it difficult for Costello and the Liberal Party to justify the full repeal of the 'six pillars' policy. The government, in turn, could not fully accept the recommendation. Instead, it replaced the 'six pillars' policy with the 'four pillars' policy, which continued to block mergers between the major banks while allowing mergers between any one of the big banks and the two big insurance companies. In response to the Wallis recommendations on the merger policy, Costello announced that he intended to retain his veto power under the *Banking Act 1959*.

> In exercising these [merger] powers I will take into account but will not be limited by assessments by the Australian Competition and Consumer Commission ... in relation to competition considerations and the advice of the relevant prudential regulators on prudential considerations. (cited in *Canberra Times* 10 April 1997)[52]

The preservation of the Treasurer's veto power meant that the ultimate political responsibility rested with the government for a merger decision in which all

[51] The then senior Labor member of the House of Representatives Star_ Committee on Economics, Finance and Public Administration makes a similar observation:

> From an electoral point of view, there was enormous backlash if the banks bought each other because there would be enormous job fallouts. There had already been massive job fallouts just through natural downsizing attrition ... They [the majors] have not recreated those jobs ... I think, in a political sense, the Treasurer has got to be sensitive to that. (Interview, 22 January 2001)

[52] However, these public statements of Costello were not genuine. As will be shown in the next section, the government introduced the Wallis package of bills in 1999 to finance sector reform that took away the Treasurer's discretion over bank mergers under the *Banking Act*.

citizens had a substantial interest, both economic and social. Costello, however, did not rule out the possibility of the repeal of the 'four pillars' policy in order not to alienate the Liberal Party's chief corporate donors:

> [The four pillars] will be reviewed when the government is satisfied that competition from new and established participants in the financial industry, particularly in respect of small business lending, has increased sufficiently to allow such mergers to be considered. (cited in *The Dominion* 10 April 1997)[53]

As a Wallis Committee member interprets Costello's words, "... what he means is until such time as the political row that he believes would ensue you know has calmed down" (Interview, 30 May 2000).

In spite of the government's formal policy position, the major banks have pressed repeatedly for the repeal of the policy ban, however. On the eve of October's federal election, the merger issue was pushed again by the banks. To persuade the public about the need for mergers, Argus shifted his treatment of globalisation and presented it somewhat differently. He used nationalist themes in pushing for the mergers to be allowed that create 'national champions' – companies which are big enough to compete in world markets.

> I am sure that if a [foreign] predator came down and tried to take over National Australia Bank, I would be wrapped up in the Australian flag very quickly. It would be a shame to lose national icons, but equally think is a shame to restrict national champions. (cited in *Australian Financial Review* 12 May 1998)

However, there was still public disdain for banks such that any relaxation of bank merger policy would mean the political risk of antagonising voters. In particular, the knowledge of public opposition to the removal of the 'four pillars'

[53] Howard made a similar statement that the ban on mergers between the banks would remain until it was proved there was more competition in small business lending (*Age* 12 April 1997).

policy was evidenced by an opinion poll in November 1998. Newspoll conducted a public opinion poll based on interviews with 1,200 people across Australia on bank mergers (*Australian Financial Review* 27 November 1998). The poll indicated that almost two-thirds of the Australian public was against the mergers among the four major banks and one-third of respondents was less likely to support a Party that allowed a merger.[54] The report showed that:

> Views about bank mergers amongst the largest four banks are very firmly held, and given the high intensity of opinion will be difficult to change quickly ... Approximately two-thirds of marginal-seat voters are strongly against the government changing its policy to permit mergers. The political risk of supporting mergers can therefore safely be assumed to be very high. (cited in *Sydney Morning Herald* 28 November 1998)

It found that 62 per cent of Australians opposed the government changing its merger policy, while just 15 per cent were in favour (*Australian Financial Review* 5 December 1998). Job losses, branch closures, and higher fee charges were the main reasons for public opposition to the big bank mergers.

Because of the threat of electoral backlash, elected officials are expected to respond to the public's policy preferences (Jacobs and Shapiro, 2000). The

[54] Arguably, among others, the banks' campaign that place financial globalisation as a major drive behind mergers proved counterproductive for generating mainstream public and political support for their campaign. Tickell's observation seems highly relevant in this context:

> As globalisation –or at least a sense of globalisation– becomes increasingly pervasive in the way that we live and think about our lives, there has been a discernible reaction against it. However, because it is all but impossible to oppose the global in the abstract, opposition to particular concrete manifestations of it come to the fore. (Tickell, 2000, p.166)

Howard government is no exception.[55] It is assumed that politicians attach a great value to public opinion (Downs, 1957). The Howard government was the first Australian government to rely on regular Party polling to adjust its political messages and ensure that it closely monitors voter concerns (*Australian Financial Review* 14 March 1996). On 23 November 1998, shortly after the re-election of the coalition government, Howard with the opinion poll results in his hand restated that the government would not change its big bank merger policy:

> [W]e would not agree to any mergers taking place, any further mergers of the majors, in other words we'd maintain what's called the four pillars policy, until we are satisfied that there were a greater level of competition than now exists. (Howard 1998)

Moreover, Argus became the prime target of the National Party politicians. As Woodward notes "the National Party emerged as the political arm of rural interest groups ... [It] has relied on the support of both farmers and those living in regional Australia generally" (Woodward, 1997, p.189). Australia Farmers had gained greater access to the Liberal-National coalition government through the National Party (Beresford, 2000, p.119). The NFF claimed that "economic and social effects [of bank branch closures] place the sustainability of rural

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[55] Apparently, the majors' media campaigns were not successful in telling the public what to think about merger policy debate. Dye's comments on media effects in public policymaking may be relevant in regard to the majors' media campaign failure:

> Viewers and readers frequently screen out messages and opinions with which they disagree [i.e., selective perception] ... [and] So many messages are directed at viewers and readers each day that they cannot possibly process them all. [i.e., information overload] ... [selective perception and information overload] severely reduce the ability of the media to shape opinion on issues on which the masses have already formed views. (Dye, 2001, p.114)

communities at risk" (*National Focus* 11 February 1997). As the maintenance of rural communities was thought to be at risk, so was the electoral base of the National Party.[56] Ron Boswell, National Party Senate leader at the time, stated "no matter how Don Argus rattles the sabre, the National Party is totally opposed to bank mergers" (quoted in *Australian Financial Review* 9 December 1998). De-Anne Kelly, the National Party Queensland Member of Parliament at the time, joined the row:

> The four pillars are set in concrete, despite any bank chief executive officer's media campaign to change it. Mr Argus is going to have to look after his customers better -a whole lot better- if the four pillars are ever to become two. (cited in *Australian Financial Review* 9 December 1998)

In addition, the then Victorian National Party Senator Julian McGauran threatened the Liberal Party that any move to abolish the 'four pillars' policy would meet stern resistance from backbenchers (*Australian Financial Review* 9 December 1998).[57] The National Party was itself under extreme political pressure to fight off a challenge from Pauline Hanson's One Nation Party in its electoral heartland (Kingston, 1999). Consequently, the Liberal Party also faced very strong political opposition from the National Party galvanised by Argus's massive public campaign.[58]

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[56] The serious implications of bank mergers in rural and regional Australia were recognised by the ALP, which was also competing for rural and regional votes before the 1998 federal election. Evans argued that 102 country communities lost their bank branch between 1995-1998 and a further 201 rural towns were under threat (*Age* 17 July 1998).

[57] McGrauran's threat was credible, as the National Party was powerful enough to exert pressure on the Liberal Party in the coalition than its limited electoral support would suggest (see Woodward, 1997, p.197).

[58] Not surprisingly, Liberal Party's rationalist policy agenda is at odds with National Party. For a number of previous political strategies adopted by the National Party to prevent decline in rural employment and population, see Woodward, 1997, pp.189-192; for the interaction of interest

8.7 A Battle at the Legislative Stage

The 'four pillars' policy, as Joss said, is "always something that is appropriate to be on the table –before elections, during elections and after elections. It ought to be a matter for determination by the ACCC" (cited in *Sydney Morning Herald* 30 April 1998). The majors were convinced that pressuring senior executive members of the government and trying to persuade the Australian public for the repeal of the merger policy would not be viable options to achieve their corporate interests. However, they did not lower their guard. They started legislative lobbying over merger regulation in order to effect a package of legislation to give effect to the Wallis recommendations. As the then senior Liberal member of the Senate observed in May 2001:

> Over the last 18 months or so the banks have become more active in talking directly to backbench Members of Parliament than they were previously. I guess they recognise that they can deal with some of the issues that relate to them. They have got to cast their information and lobbying a bit wider than just at the executive. Certainly, in an earlier period they were not active [in legislature]. It was due to recognition that a lot of these issues have broad electoral sensitivity and therefore dealing purely with the executive and bureaucracy is not going to get the outcome they might seek. (Interview, 8 May 2001)

Among the largest four banks, the NAB was the most pre-eminent one in this legislative lobbying. The bank appointed Philip Ryan, a strategic marketing expert and former Tasmanian Liberal adviser, to lobby the Liberal backbenchers in the Senate and the House of Representatives in October 1997 (*Australian Financial Review* 27 October 1997). Ryan also activated elite networking between Argus and backbenchers. One of these backbenchers was Joe Hockey, the Minister for

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organisations and the Liberal and National Party in a comparative perspective, see McEachern, 1992.

Financial Services and Regulation at the time.[59] Not surprisingly, Hockey, on 27 November 1998, stated that "The 'four pillars' policy is in place and the government is committed to it. But, all policies are under review and that's one of them" (Thomson, 2000). Geoff Prosser, former Liberal Member of Parliament, unveiled the government's adoption of the majors' corporate agenda: "Now we need to abolish the 'four pillars' policy. If we are confident about our prudential regulation and supervision, the level of competition in banking sector, and the power of the ACCC, then a merger between the four big banks should not be resisted" (*House Hansard* 8 December 1998, p.1628).

It became clear that the government's previous public announcements on its intention to preserve the 'four pillars' policy and the Treasurer's veto powers should be taken with a grain of salt.[60] The aim was to make future merger assessments 'esoteric' by removing an important legislative safeguard for the 'four pillars' policy: the veto power of the Treasurer. The major banks' merger policy concerns were addressed by the Liberal Party through specific, technical changes in the language of some of the reform bills implementing the Inquiry

[59] As the *Australian Financial Review* (27 October 1997) reported:

> Ryan ... arranged a lunch in Sydney for senior NAB executives, major NAB corporate clients, and two Liberal backbenchers on the House of Representatives Finance and Public Administration Committee, Mr Joe Hockey and Dr Brendan Nelson.

Ryan also arranged a lunch between Cheryl Kernot, former Australian Democrats Leader, and Argus (*Canberra Times* 6 April 1997).

[60] As Dye (2001, p.77) notes:

> Politicians know that the memory of voters is short, but the memory of contributors [i.e., donors] is more lasting. The further away in time the next election is, the more likely it is that the dilemma will be resolved in the contributor's favour.

recommendations in March 1999.[61] As the senior Labor member of the House of Representatives Standing Committee on Economics, Finance and Public Administration, observes:

> The Treasurer has said nothing when the legislation came out before the Parliament. Joe Hockey was taking the lead with this legislation. I would not suspect that the Treasurer and Joe Hockey would like to see the 'four pillars' gone ... The legislation would lead to the demolition of the 'four pillars' policy ... The legislation looked like where they wanted to go; certainly demolition of the 'four pillars' policy. (Interview, 22 January 2001)

In specific terms, the *Financial Sector Reform Bill (Transfers of Business) 1999* and sections in the *Financial Sector Reform (Amendments and Transitional Provisions) Bill (No.1) 1999* stipulated that the mergers could be decided by technocrats and industry experts. The former made it technically possible for the bills to operate to erode the 'four pillars' policy as the Treasurer's consent to mergers was not required while the item 51 of schedule 2 of the latter amended Section 63 of the *Banking Act 1959* so that the Treasurer's consent in mergers was no longer required if Australian Prudential Regulation Authority (APRA) makes an order to that effect (see Minority Report, 1999; Conroy, 1999). In other words, not only the Treasurer's veto power would be removed but also the ACCC's role in merger assessments would be eroded under these reform bills.[62] These were not unintended consequences of drafting of the reform bills. Given the major banks'

[61] On paper, the government proposed an innocent mechanism that would facilitate the transfer of business for credit unions, building societies and friendly societies to the Commonwealth prudential regime from the states and territories. The formal aim was to protect depositors or policy owners where a financial institution is in distress. However, this mechanism also applies to the majors eroding the ACCC's and the Treasurer's role before mergers can occur between the majors.

[62] Section 12 of the Bill stated that the APRA *may* consult with other regulators including the ACCC and the ASIC about the competitive and corporate effects of transfers need to be assessed.

massive efforts for the removal of the merger policy ban by repealing the Treasurer's merger veto power, clearly this was a deliberate effort of the government to make merger policy discussions 'esoteric.' As a result, merger decisions could be left to civil servants and could be structured to favour the interests of these large financial firms over other interests.

However, the *Financial Sector Reform Bill (Transfers of Business) 1999* was rejected on 29 March 1999 in the Senate by the votes of the opposition. The ALP in its Minority Report (1999) to the Senate argued that the reform bills "could technically allow banks to short circuit the four pillars policy." Simon Crean, deputy leader of the Labor opposition at the time, detailed the required amendments:

> [The ALP] condemns the government for proposing a mechanism important details of which are yet to be prescribed by legislation; rejects the government's attempts to water down the requirement for the Treasurer consent to transfers of businesses under the Bill; rejects the government's attempts to exclude the ACCC from any role of assessing the transfer proposals; calls on the government to confirm that it will not use the provisions of this bill to relax its 'four pillars' policy. (*House Hansard* 29 March 1999, p.458)[63]

The government did not have any choice but to accept the amendments that had been put by the opposition as it did not have a majority in the Senate. The Treasurer's merger veto power was emphasised. The *Financial Sector Reform (Amendments and Transitional Provisions) Bill (No.1) 1999* was amended so as to preserve the need for the Treasurer to give or refuse his consent to mergers and

[63] Among the interest organisations opposing the merger policy change, the FSU was the only active one in the legislative debates. On 29 April 1999, the FSU appeared before the Senate Economics Legislation Committee to argue that government was trying to dismantle the 'four pillars' policy by eroding the Treasurer's veto powers, and the ACCC's role in merger process.

acquisitions under the *Banking Act 1959*. The amendments also extended this requirement for transfers of business occurring under the *Financial Sector Reform (Transfer of Business) Bill 1999*. These bills passed through the Senate on 27 May 1999.[64] As a result, bank merger decisions were not left to the bureaucracy. As in most competitions, the legislative process has its winners and losers. The majors lost another front in their battle.

8.8 Conclusion

The issue of whether or not to allow mergers between the largest Australian banks has been the subject of an on-going policy debate over the past six years, effectively since the establishment of the Wallis Inquiry. During the Wallis era (1996-1997), not only did some of the big banks exert a good deal of influence initially in the debate and have a strong economic power potential over the Liberal Party, there was also a broad consensus within the financial policy community for the policy change allowing mergers among the biggest four banks and the removal of the Treasurer's veto powers. Also, the Wallis committee recommended the abandonment of the merger policy ban. However, the government could not accept the recommendation.

This chapter has shown that the knowledge about the social and economic impacts of the bank mergers which made the policy debate exoteric (political and public) by including interests outside financial services (i.e., employees,

[64] Following the approval the Senate's amendments by the House of Representatives, these bills became effective in July 1999.

customers, farmers, and the broad public) which, in turn, created significant pressure over the government for the retention of the policy. Thus, the merger policy discussions were not esoteric, technical and limited to a small number of influential public and private sector institutions leaving policy discussions vulnerable to be structured to favour the interests of large, financial firms over other interests. In fact, the banking policy community had to deal with other actors external to the community in the policy process. Also, an expectation of large reductions in the banking sector workforce and consumer access to financial services due to branch closures if the mergers took place as well as lack of evidence supporting the potential of mergers to achieve greater efficiency through scale economies, to generate public benefits contributed to the decision. Accordingly, the knowledge acted as a kind of obstacle to the interests of the major banks by including actors external to the policy community as well as the broad public. The chapter has also outlined the significance of the state intervention and electoral politics in one of the most prominent global trends in financial services industry: mergers among big banks.

CHAPTER NINE

CONCLUSION

9.1 Introduction

The aim of this thesis has been to identify, explain and discuss factors leading to the creation of the Wallis Inquiry and the Australian Prudential Regulation Authority (APRA), and the government's adoption of the 'four pillars' policy during the Wallis era (1996-97). The thesis has found that the then existing financial regulatory framework was apparently working well. There was no challenge to the economic interests of key private sector financial institutions, nor to the political authority of key state actors regulating the financial services industry. Accordingly, the then existing financial policy community did not mobilise for the establishment of the Inquiry and the changes in financial regulatory arrangements. This thesis explained what actually happened in Australia in the breakthrough years of the Inquiry with special reference to the three theoretically interesting and competing but also partly complementary perspectives. The central theoretical conclusions emerging from the empirical inquiry presented in the thesis are threefold. First, the policy network framework and the three phase adjustment model were not very useful explanatory frameworks in the Australian context, whereas the governmental agenda setting framework was highly useful for understanding the policy process and the creation of the Inquiry and that of the APRA. Second, knowledge about the obsolescence of institutional financial regulation and that of the economic and social consequences of bank mergers were 'highly significant independent variables rather than the power variables. Finally, the Australian State, guided by the Treasury Department and the Treasurer, has been the main steering agent in determining the financial regulatory policy agenda and the direction of policy change in an anticipatory fashion during this period.

9.2 Research Findings

The thesis has found that the governmental agenda setting framework of John Kingdon (1984, 1995) was highly relevant. It explained the financial agenda setting process and regulatory changes undertaken in Australia following the Wallis Inquiry (1996). The framework also helped to examine the role of the Inquiry in the policy process. Chapter five has illustrated that the financial regulatory change was on the bureaucratic agenda of the Treasury. The abstract financial regulatory model (i.e., 'twin peaks') and its specific solutions were already out there. Accordingly, the Treasury proposed functional regulation with new prudential and disclosure regulators taking on the prudential regulatory powers of the Reserve Bank of Australia (RBA), Insurance and Superannuation Commission (ISC) and Australian Financial Institutions Commission (AFIC), and consumer protection responsibilities of the Australian Securities Commission (ASC), the ISC and the Australian Competition and Consumer Commission (ACCC) respectively. The Treasury sold this idea to the then Labor government Treasurer and Liberal Party opposition shadow Treasurer before the March 1996 federal election. However, Treasury's problem was that it had difficulty connecting its solutions to the political leadership during the years when Paul Keating was Prime Minister. The 'political window' was opened following the federal election. The new government was keen to achieve financial regulatory reforms to address future regulatory challenges proactively, and the new Treasurer wanted to consolidate his power within markets and politics. Treasurer Peter Costello coupled the Treasury's solutions to problems and to the political process as a 'policy entrepreneur.' He established the Wallis Committee which was not independent of both government and business. Rather, it was 'packed' by the government in accordance with its regulatory policy preferences. The role of the Inquiry was to legitimise the government's policy preferences publicly, and to transfer the 'governmental agenda' into the 'public agenda.' However, this was not a case of the government pressuring for its policy preferences over the preferences of the financial services industry. In fact, the Inquiry was used as a 'venue' to generate industry and public support for the regulatory changes, and was used to build a network of alliances within and outside the Parliament.

The State's strength in banking has been measured in terms of the existence of institutional arrangements ensuring a balance between the perspectives of the Treasury and the Central Bank and the degree of centralisation of the state apparatus (i.e., the number of regulatory institutions participating in supervision and policymaking) in Chapter four. The application of these two parameters of the framework to the institutional arrangements in Australia has shown that: (1) There was no emphasis on an institutionalised concertation between the RBA and the Treasury; (2) the number of state agencies participating in the policy process was high (the four key financial regulators and the Treasury, as well as eight State Supervisory Agencies and the ACCC). Accordingly, institutional arrangements were pointing to low state capacity (or a weak state) where policymaking is more reactive than anticipatory in character.

It was illustrated in Chapters five and six that the major policy debate over the regulatory policy change revolved around the idea of functionally based financial regulation and the establishment of a single prudential regulator. Neither key private sector firms nor key public sector agencies regulating the industry pressed for the financial regulatory change. In fact, most of the actors from the RBA and the ISC to the Australia New Zealand Banking Limited (ANZ), Westpac Banking Corporation (WBC), and the Commonwealth Bank of Australia (CBA) resisted the proposed regulatory change. In other words, there was an alliance between the key public actors and most of the key private sector actors. Arguably, the desire of these actors to preserve the status quo was an example of what Scharpf (1988, 1997) called the 'joint decision trap', producing sub-optimal solutions to regulation as regulatory costs associated with the institution specific regulatory arrangements which would be producing inefficiencies and reducing competition within the industry. Particularly, the idea of a new prudential regulator consolidating the then prudential regulatory powers of the financial regulators attracted strong criticism from the financial regulators and most of the key private sector actors. In regard to the first parameter of the state capacity framework, there were different regulatory policy preferences between the Treasury and the RBA. Moreover, there was no attempt to balance their differences. The Treasury dominated the policy process as a strong arm of the government although it was not a regulator but an adviser to the government. In regard to the second parameter, all regulatory/supervisory agencies participated in the policy debate. Thus, financial policymaking was not confined to a smaller set of regulators. Accordingly, the application of the two parameters in practice has also shown that the State should not have maximised its own political power potential and should not have adopted anticipatory policies in finance.

However, contrary to the institutional arrangements and the predictions of the framework in theory and practice, which pointed to the weak state capacity for financial policymaking, the Australian State adopted an anticipatory approach to financial regulation, rather than a reactive one. The establishment of the Inquiry and the APRA were the State's anticipatory response to the blurring of institutional, sectoral and product barriers within the financial services industry. The empirical evidence detailed in Chapters five and six has indicated that the then financial regulators and three major banks (i.e., ANZ, WBC and CWB) neither agreed to the change that came with the APRA nor were able to stop it. Like turkeys facing Christmas, the regulatory consolidation with a functional focus took place whether they liked it or not. Essentially, as shown in Chapter five, the Treasury department and the Treasurer formed a 'block' pushing for the establishment of the Inquiry due largely to their respective bureaucratic and personal agendas. The 'Treasury block' seized an opportunity for regulatory change with the new government and was able to push their solutions through against the then existing industry regulators and the three major banks. Thus, financial regulatory change did not occur because there was a financial policy community or network. Accordingly, the change in the financial regulatory arrangements could not be attributed primarily to the behaviour or characteristics of the financial policy community as such (see Chapters five and six). Thus, prudential policy change was not endogenous to the financial policy community and network. Conversely, exogenous forces were at work beyond the control of the key members of the regulatory policy community. There were two main exogenous factors that provoked and shaped the policy change. The first was State intervention into the regulatory arrangements to adjust financial regulatory arrangements to the anticipated future regulatory problems. The second was knowledge about the obsolescence of institutionally based prudential regulation that made the 'twin peaks' idea a viable solution to the regulatory problems that may become acute in the near future. The Australian State addressed the 'decision trap' problem through the establishment of a new prudential regulator (i.e., APRA) while abolishing some of the then existing regulators (i.e., ISC, AFIC, SSAs) and taking prudential regulatory powers from the RBA. This evidence supports Peters's (1997, p.57) suggestion that the role of the government "becomes providing leadership to shape the debate and move decisions away from lowest common denominator realm [i.e., joint decision trap] into a more socially desirable space." The government set the regulatory policy agenda and controlled the direction of change by pushing through its solutions against all of the then existing key financial regulators and most of the key private sector actors.

Chapters five, six, and eight have argued that the three phase adjustment model developed by Reinicke (1995) is not explanatory in analysing the policy outcomes. The interviews quickly revealed that the then existing regulatory framework was working well from the perspective of the regulators and those financial firms which were regulated by them at the time. Accordingly, the financial policy community was not pushing for a regulatory change or a financial system inquiry. Thus, there was no mobilisation stage where the actors were expected to lobby for the establishment of the Inquiry or for a financial regulatory change. Contrary to the expectations of the adjustment model the policy changes were not a function of the mobilisation, conflict and resolution phases where key public and private sector actors interact and bargain. In fact, these three phases (mobilisation, conflict, and resolution within the policy community) occurred as a response to government intervention, in order to prevent the regulatory policy changes which disturbed the well established policy community. As has been illustrated in Chapter five, the Australian State acted as an actor external to the policy community and steered the regulatory policy change. Thus, policy change did not emanate from the policy community. Moreover, other stakeholders (farmers, bank employees, and customers) as well as the general public were significant external actors in the 'four pillars' policy debate and outcome (see Chapter eight). As a result, policy change can occur regardless of mobilisation of the regulatory agencies and regulated institutions.

Chapter seven argued that the major banks hold considerable economic power potential to influence the range of financial policy options considered by the Australian State through their significant market shares in the industry and in the banking sector, their broad customer base and global reach. Among the four major banks, the two Melbourne based banks – the NAB and ANZ – added to their economic power potential through interlocking directorates with non-financial corporations.

Chapter eight highlighted the significant financial leverage of some of the major banks over the Liberal Party. It argued that the big four banks individually transmitted their economic power into the exercise of political power through government relations divisions and policy experts, which enabled them to build up their own policy expertise to define their vested interests and to translate those interests into policy recommendations. Instead of the lobbying of the Australian Bankers' Association, the elite networking and hiring of influential lobbyists were principal venues for transmitting this power potential into the exercising of political power. The major banks' hands should have been further strengthened because the ACCC was also demanding removal of the 'four pillars' policy. In other words, because there was also a consensus within the financial policy community for the removal of the merger policy ban. However, the banks failed in spite of the support of the ACCC for the removal of the policy ban, and their massive powers over the government and the Liberal Party. Thus, 'power' variables did not explain the 'four pillars' policy outcome. The government's merger policy ban has been a key intervention shaping the direction of bank consolidation in Australia; such mergers significantly accelerated from 1997 through 1999 in developed economies. The Australian response was special because knowledge about the economic and social consequences of bank mergers (i.e., branch closures, job reductions, and reduced consumer choices) acted as a kind of barrier to the interests of the banks by making the policy debate 'exoteric' rather than 'esoteric': the policy debate was public rather than private, formal rather than informal, and political rather than technical. As a result, the merger policy discussions were not limited to a small number of influential public and private sector institutions (i.e., the ACCC and the major banks). Within and outside the parliament, oppositional forces that included bank employees and customers, farmers, the National Party and the ALP mobilised against the removal of the government's policy ban. In addition, there was very strong public opposition to the removal of the merger policy ban as evidenced by an opinion poll. Thus, with the strong likelihood of an electoral backlash, it was politically unpalatable for the Liberal Party to be supportive of the merger policy change. If the Wallis Committee's recommendation of the removal of the Treasurer's veto powers were accepted by the government, future merger policy discussions would be esoteric, technical and limited to a small number of influential public and private sector institutions. As a result, political accountability and public participation in merger policy decisions would have been excluded, leaving policy discussions vulnerable to be structured to favour the interests of large, financial firms over other interests.

9.3 Theoretical Discussions

The study's theoretical discussions focus on specifically public policy by emphasising the role that knowledge and actors external to the policy community play in the policy process. However, the theoretical critiques provided here can be seen as a contribution to a larger set of literature that tends to focus on institutional aspects of the politics of domestic policy change with particular emphasis on 'power' variables. As Marinetto (1999, p.66) noted: "The case study can potentially explore a wide array of scenarios and situations that are relevant to theoretical discussions."

Does policy network analysis have any shortcomings in the light of empirical evidence generated from the three case studies? While acknowledging its appeal, the thesis has put forward a critical view about the usability of the policy network frameworks to domestic financial policy analyses. There are six main weaknesses of the framework identified by this research. First, a change in a policy network may not occur due to broad macro-structural transformations as has been assumed by policy network analysts. In fact, in the absence of a major shift in the state capacity or a major change in relations between societal and state actors due to broad social, historical or economic changes or ideological shifts in government, a government as an external actor may change the policy network and community (see Chapters five and six). A government may set and control the policy agenda, seize power over the key regulatory bureaucracy and regulated firms (i.e., policy community), and eventually change the relationships therein (i.e., policy network). In other words, a policy community may lose control of policy framing and agenda setting and may react to an agenda set and controlled by a government. In addition, policy communities can be changed and new ones can be established by the government's decisions. Second, knowledge may be a powerful exogenous change agent for the financial policy community. Network analysts have ignored the role of knowledge or ideas in the financial policy process. Framing of policy problems based on knowledge can be a strong change agent exogenous to the policy community especially if it does not emanate from the community itself. This finding supports Maloney and Richardson (1995), Richardson (2000, pp.1017-20), and Radaelli (1995). Third, individuals (i.e., policy entrepreneurs) rather than the policy communities (i.e., key institutions) may also play a significant role in agenda setting and policy change. A policy change is not necessarily a function of the policy community/network but, may be in part a function of the policy entrepreneurs who catalyse the change. A policy change may be the result of individual entrepreneurship rather than the outcome of structural circumstances. This finding supports Kingdon (1984, 1995) and Radaeli (1995). Fourth, as Chapter eight has shown, merger policy change did not take place despite the fact that the relevant policy community (the major banks and the merger regulator –ACCC) agreed it was necessary and consensus existed on the removal of the merger policy ban and the Treasurer's merger veto powers. Fifth, the network analysis concentrate largely on the power of bankers' interest organisation in financial policymaking (see Chapter one, pp. 11-2). In fact, large banks may prefer pressure the government individually (see Chapter eight). Finally, the policy network approach and network models are largely used in order to assess national policymaking at sectoral level from a domestic point of view. Accordingly, which network dominates a sector is the central question to be addressed in banking policy analysis (Coleman, 1996). Today, however, sectoral, product, and institutional boundaries among financial institutions are blurring. Thus, financial conglomerates are increasingly becoming significant in financial services industries across the world, as in Australia (see also BIS, 1995). As has been shown in Chapter seven, the four big banks as financial conglomerates had considerable shares in different sectors of the financial services industry.[1] Also, financial regulation is moving towards product based regulation by a single or two regulators rather than institutionally based regulatory arrangements where different regulators are responsible for different types of financial institutions across the world.[2] Accordingly, the usability of the network framework is open

[1] Furthermore, financial conglomerates are not likely to continue to be identifiable in terms of which area of business they are dominating. For example, the merger between the Colonial Mutual Limited and State Bank of New South Wales in 1994 was a significant case in point. Its insurance, funds management and banking assets were of similar size(for example, see *Colonial Limited Interim Result* 1999). Following this example, it becomes clear that policy network analysis is facing such challenges in identifying policy preferences of such private actors in national financial policymaking processes.
[2] For example, single financial regulators were established in England, China, Germany and France during the second half of the 1990s.

to question because it is becoming increasingly difficult to analyse which policy network dominates, for example, banking, insurance, and securities sectors of the financial services industry, as societal actors are also dominant across the various sectors of the industry (see Chapters six and seven). Thus, it can be claimed that sectoral policy communities and networks in the financial industry are also converging.[3] Accordingly, the thesis did not aim to identify the types of 'banking' and 'securities' policy communities in Australia.

The state capacity framework, an integral part of policy network analysis, also has flaws. Arguably, one of the major weaknesses of the framework is its assumption that equates the state to its institutions (i.e., the state strength in financial services industry is a function of bureaucratic centralisation and a balance between the Treasury and Central Bank). In fact, a state may have its own interests not necessarily equivalent to, or fused with, the interests of its bureaucracy.

Of course, the financial policy communities and networks are important because in a political process actors interact and bargain. Government consultation in policymaking takes place via policy communities and networks. Moreover, policies are implemented through policy communities. However, as Chapters five and six illustrated, the State as an actor external to the policy community/network and new policy ideas based on the knowledge about functionally based prudential regulation, and social and economic consequences of bank mergers were exogenous shocks at work. Arguably, such forces were

[3] For a general discussion, see Bakir (2000).

more important as sources of policy change than were policy network characteristics. In addition, notions of state power alone cannot explain the policy change. The State has at different times been a strong and a weak actor in the making of industrial policy (Bell, 1993, 1994, 1997a,b). The role of policy entrepreneurs, institutional and individual actors external to policy communities as well as knowledge and ideas should also be considered in policy analyses.

The evidence that governmental influences dominated the regulatory debate during the Wallis era supports Pauly (1987, 1988). However, this was not due to centralised public sector actors as it had been in the 1980s (see Chapter six). The thesis has also supported Capling and Galligan's (1992) account that the State was the main steering agent in financial policymaking during the Wallis era (see Chapters five and six). Also, the support of the NAB, the Australian Mutual Provident Society (AMP) and the National Mutual (NM) for the 'Treasury consensus' cannot be considered as an example of Bell's "coalition model of state autonomy" because, at best, this can only be considered as an alliance between the State and *some* of the key societal actors (Bell, 1994, 1997a,b). The Treasury was a very influential source of advice to the government during the Wallis era and played a major role in financial regulatory changes. Contrary to contemporary view (see Bell, 1997b, p.34; Shann, 1987), the Treasury was pre-eminent in microeconomic policy advice whereas the RBA had very limited influence on the financial policymaking process.

The three phase adjustment model has been the second theoretical tool employed in the thesis. The model assumes that policy changes take place as a result of conflict resolution between key public and private sector actors. The model comprising mobilisation, conflict and resolution phases is based on the assumption that the institutional actors respond to the challenges that threaten their economic and/or political power: "Their response takes in the form of pressure for policy changes which will *redress* the loss in political and/or economic power which the challenge generated" (Renicke, 1995, p.14, my emphasis; for discussion see ch.2, section 2.4). Accordingly, a financial policy change originates from within the reactive response of the financial policy community. The major weakness of the framework lies in this assumption. In fact, a policy change may occur when neither financial regulators nor regulated firms pressure for a regulatory change.

Will the empirical evidence of the thesis offer any critique to the adjustment model? There are four criticisms of the model posed by the thesis. First, the model, like the policy network frameworks, relies on economic and political power variables to explain policy process and change. Thus, it ignores the possibility of regulatory policy change that can be generated by knowledge and ideas rather than power. Second, the significant role of actors external to the policy community is completely ignored. In fact, the policy network as a whole may be more open and vulnerable to external influences than network theorists had assumed. Actors external to the policy community, such as states, the broad public, and other stakeholders (e.g., employees, farmers, and consumers) may have a significant impact on the policy network and policy outcomes (see Chapters five, six and eight). Third, as Chapter six has shown, regulatory institutions can also mobilise to prevent policy change which would threaten their existence and/or regulatory powers. Similarly, as Chapter eight has shown, private sector actors can mobilise not only to redress their economic loss as has been assumed by the model but also to *consolidate* their economic gains. Finally, agendas may not primarily be set by the policy network. The government may set the agenda to which the network reacts.

It is no doubt true that power is a significant explanatory variable. Thus, the assessments of institutional power are important in politics. However, to analyse the political process only in terms of power variables (e.g., bureaucratic power, bank power, interest association power, state power etc.) excludes too many other important variables. This is the problem with the policy network framework and three phase adjustment model; the significant role of knowledge, individuals, and actors external to a policy community in a policy process is simply neglected or relegated to a 'residual effect' category. This section has argued that the policy network framework and three phase adjustment model, both of which concentrate on the 'power' variables and role of institutions in financial policymaking, fail to appreciate the role that knowledge and actors external to the financial policy community play in policymaking.

9.4 Directions for Future Research

Although domestic factors and influences largely determined financial policy outcomes in Australia following the Inquiry, the role of extra-territorial influences in financial policy changes should not be ignored in the 'politics of financial policy change.' Financial policy is one of the most internationalised policy environments. The impacts of financial globalisation on domestic financial policymaking and convergence in financial regulation are increasingly observed across developed countries[4] (see Coleman, 1996; Coleman and Perl, 1999). The international norms in finance are institutionalised by transnational financial policy communities such as the Bank for International Settlements (BIS)[5], the International Organisation of Securities Commissions (IOSCO)[6] and

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[4] Just to mention a recent example from among many, *Townsville Bulletin* (17 May 2002) reported that "Australia will be forced to adopt internationally imposed accounting practices after the body [Australian Accounting Standards Board] that sets standards released a new policy statement yesterday." The chairman Jeffrey Lucy of Financial Reporting Council (FRC), which advises government on accounting standards, said that:

> This will mean continued harmonisation and convergence of Australian standards with those issued by the International Accounting Standards Board and the International Federation of Accountants-Public Sector Committee. (*Townsville Bulletin* 17 May 2002)

[5] The Basel Committee on Banking Supervision which is set up under the auspices of the Bank for International Settlements (BIS). The Basel Committee on Banking Supervision is a Committee of banking supervisory authorities which was established by the central bank Governors of the Group of Ten countries in 1975. It consists of senior representatives of banking supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, Netherlands, Sweden, Switzerland, United Kingdom and the United States. It usually meets at the Bank for International Settlements in Basel, where its permanent Secretariat is located.

[6] The IOSCO was established with the objective of improving market regulation, establishing standards in securities regulation and providing assistance in international enforcement matters in 1984. For detailed account of the IOSCO, see Underhill (1995, pp.251-78).

the International Association of Insurance Supervisors (IAIS)[7] to harmonise and standardise regulations, and practices (see also FSI, 1997, chs. 7,11,15). Norms of these transnational financial policy networks are increasingly adopted by developed nations including Australia. Accordingly, how and why these norms penetrate into domestic policymaking, and with what effect, requires further research. For example, the APRA is a member of both the domestic and transnational financial policy community. Arguably, due to its overlapping memberships, it mediates between these two communities.[8] Thus, Kingdon's concept of 'policy entrepreneur' who couples problems with policy solutions and political processes, may provide, as Coleman and Perl (1999, p.707) suggested, "a basis for further developing this aspect of mediation." What are the dynamics of the relationships between the "transnational financial policy community" and the 'Australian financial policy community'?; Is APRA a 'mediator' translating international norms domestically?; If so, how does

[7] The IAIS, established in June 1994, is comprised of national insurance regulators and supervisors from over 100 jurisdictions. The objectives of the IAIS are as follows: setting international standards on insurance regulation, assisting members in complying with the IAIS standards at national and international levels developing cooperation among members, and coordinating work with other national and international financial institutions (see <http://www.iaisweb.org> accessed 15 September 2000).

[8] For example, the Basel Committee on Banking Supervision under the aegis of the BIS, has proposed an update to the methodology banks use to calculate their capital (New Capital Accord) on 16 January 2001. The accord deals with a global benchmark on how much capital banks and other financial institutions must have to be financially sound. The committee has asked countries from all over the world to make submissions on proposed changes to the Basel Capital Accord until July 2001. On 1 July 2001, AAP Information Services reported that: "APRA today released information on the submission it made on behalf of Australia's financial institutions." Apparently, the harmonisation and standardisation of national financial regulations with international norms are *mediated* by APRA. It may be claimed that international norms can be internalised domestically or they can penetrate into domestic policy networks and contribute to a domestic policy change through cross-border activities, relationships and interests of such state actors.

APRA, in the words of Coleman and Perl (1999), as a member of 'a transnational expert community' in financial regulation mediate between national and transnational financial communities? How does APRA form the Australian view and transmit policy preferences of the 'domestic financial policy community' to the transnational financial policy community, with what effect, why? and as Coleman and Perl (1999, pp.708-9) question: "What is the impact of particular mediation efforts on the legitimacy of certain political ideas or of particular political groups, and on the distribution of power within, and across, policy communities?" These very interesting and important questions would seem to provide a worthy agenda for future policy research in the politics of financial policy change in Australia. Such analyses may also be linked to broader 'global public policy networks' or 'global governance' discussions (Reinicke 1998, 1999).

Chapter eight contrasted Australian (and, to a lesser extent, Canadian) experience of bank mergers with that in other developed economies. It showed that the debate over bank mergers was 'exoteric' in Australia, and became so in Canada following a tactical error by the big Canadian banks, but has been 'esoteric' in other jurisdictions. While this characterises the distinction between Australian/Canadian experience and that elsewhere, it deserves more adequate explanation. A comparative work addressing the following questions might be important: Why was the debate in Australia exoteric from the outset? What, if anything, is distinctive about Australia's institutional framework which politicised the debate? Why is public opinion in Australia and Canada so strongly galvanised against bank mergers when this has not occurred elsewhere?

There is also less research on the analysis of legislative stages in financial regulation. How and why regulations evolve as they do and what forces can lead to their durability as well as their potential for change can also be analysed statistically with special reference to the legislative process (see Kroszner and Strahan, 2000). For example, political-institutional factors on voting patterns, as well as the impact of private interest groups and bureaucratic interests concerning the Financial Sector Reform Bill (1999) can also be assessed. It is possible using a longitudinal perspective to examine the legislative reform of bank regulation (e.g., prudential regulation) between 1980-2000. This examination would provide detailed descriptions of its legislative history and its amendments generated by pressure groups and political preferences during the legislative process. There are a number of issues that can be analysed: (1) Votes by members of the Senate on amendments and its final passage; (2) the relation between money, constituency and votes; (3) influence of intra-and inter-sectoral rivalries on the outcomes; (4) legislator ideology and partisanship (especially the roles of Economics Legislation Committee and Economics References Committee in the legislative process). In doing so, it would be possible to examine the question of whether private interest group factors or the political factors have greater power over the legislative amendments and the introduction of new acts. These kinds of questions would provide an important agenda for future policy research in financial regulation.

This thesis has shown that there was no evidence of a joint realisation by key private sector actors and their regulators in the financial industry that the then existing institutionally based financial regulatory arrangement was not serving their respective ends as it had been in the 1980s (Harper, 1986). In fact, contrary to the expectations of the policy network framework and the adjustment model, neither the key regulatory agencies nor the key regulated institutions were pressuring for the establishment of the Wallis Inquiry and demanding regulatory change. The evidence from this study suggests that an approach similar to John Kingdon's (1995) pioneering work might best identify the agenda setting process and the policy outcomes. The fundamental lesson of the Australian experience of financial re-configuration is the crucial role of the government and knowledge in providing direction for the policy process. The government provided the leadership to shape the debate and the policy outcomes in an anticipatory fashion during the Wallis era. As has been shown in Chapters five, six, and eight, knowledge about obsolescence of institutionally based prudential regulation and that of economic and social consequences of bank mergers were highly significant independent variables in the policy process rather than the 'power' variables considered in Chapters four and seven.

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