The Australia Institute
Research that matters.

Reading Between the lines this week:

1. Big four still laughing all the way to the bank
2. Lost on the road to enlightenment?
3. Give the gift of good ideas this Christmas
4. Recent publications
5. Recent media

Big four still laughing all the way to the bank

The Government and the big banks are slowly but surely redefining 'the problem' with banks. They are steadily steering the debate away from their outrageous profits and the fact that they increased their mortgage rates by nearly double the official interest rate rise in November and towards a conversation about 'competitiveness' and the ability of consumers to understand their bank statements. This is much safer ground for the banks.

Australia's big banks make more than $1,000 in profit from every man woman and child in Australia. They are among the most profitable banks in the world and, during the GFC, their profits fell to a mere $20 billion before tax. These profits will be barely, if at all, dented by the Government's latest 'package of reform'.

This doesn't mean that ideas such as banning exit fees, an inquiry into bank account portability and the provision of clearer information to people with mortgages aren't worth pursuing but the hard reality that governments and regulators do not want to confront is that 'competition' and 'deregulation' of the Australian banks has completely failed to reduce the profitability of the big banks. In fact, the opposite is of course the case. Their profits have been growing at around 15 per cent per year which, given the growth of the economy as a whole, is a remarkable 'achievement'.

In the words of the Former Governor of the RBA, Ian Macfarlane when speaking to the House of Representatives Economics Committee in 1999:

I, like you, have often wondered why banks are so profitable—and they certainly have been extremely profitable in Australia… They always were very profitable, let's face it. They were very profitable in the regulated phase, and some of us thought that those profit rates would go down in the deregulated phase, as competition heated up. So you can understand why people are very *interested in profits and very surprised that profits or rates of return on equity have remained so high.*

The key test for the Government's banking reforms is simple; will bank profits be lower in a year's time?

In the meantime The Australia Institute will continue to argue for more fundamental reforms. On Wednesday we will give evidence to the Competition within the Australian banking sector Senate inquiry and suggest that the Government:

- Cap fees to just cover the banks' costs
- Remove tax deductibility of bank advertising that is not genuinely informative
- Monitor interest rates so that they reflect objective risk assessments
- Examine the possibility of structural separation between deposit takers and lenders.

There is also a case for capping the remuneration of senior banking executives and linking their bonus payments to satisfaction on the part of all stakeholders, not just shareholders.

STOP PRESS - In the first few hours of trading this morning each of the big four banks' stocks was up more than one per cent, illustrating that the reform package won't seriously challenge bank profits.

Lost on the road to enlightenment?

Announcing his much anticipated banking reform package the Treasurer focused heavily on the notion of choice; that customers have the ability to 'walk down the road' to switch their accounts to another bank as a way of protesting against interest rate rises, or fees and charges. Yet, in reality, only 3 per cent of Australians each year choose to do so.

While economists assume that we all act rationally when making financial decisions, this is rarely the case. New research conducted by The Australia Institute and commissioned by Citibank shows that people make financial decisions in vastly different ways. Some consumers are hyper-vigilant, constantly shopping around for the best deal and investigating every possible alternative.

However, such people are the exception rather than the rule. 'Human calculators', people who consistently act in ways that economists would call 'rational', constitute only 22 per cent of the Australian population. The remaining three-quarters are subject to a range of behavioural 'biases' that can be to their financial detriment.

The report, *Evidence versus emotion: How do we really make financial decisions?* identifies a range of categories that we can use to better understand financial behaviour.

People who are 'overconfident' say that they are better than average at making good financial decisions, but they make basic financial errors (such as carrying a credit card debt from month to month). One in four people (28 per cent) fit into this category.

Those we call 'oblivious' are unaware of very basic information about their personal finances, such as whether their mobile phone plan provides good value or what their home loan interest rate is. A staggering 41 per cent of people are oblivious to such information.

Then there are the 'eternal optimists', people who take out a home loan without considering the possibility of losing their job or getting sick. This applies to 44 per cent of people who took out a mortgage recently.

One in three Australians (30 per cent) are 'playing catch up'—they use their credit card to pay essential bills but then don't pay off their credit card in full each month. These people are effectively paying high rates of interest on their food and grocery purchases, or visits to the doctor, because they have insufficient cashflow to cover all their bills on time.

One type of behaviour that results in obvious financial harm occurs when someone keeps substantial sums of money in a savings account but then doesn't pay their credit card off in full each month. The 'rational' course of action would be to pay down credit card debt to avoid high rates of interest, even if this means using savings to do so. But not everyone thinks in cold, rational terms about their financial situation; instead, they like to have a feeling of progress towards a savings goal. Our research shows that around one in seven Australians 'compartmentalise' their money in this way.

These categories, and the kinds of financial behaviour that they embody, reflect decades of research in the field of behavioural economics. By studying how human beings behave in the marketplace rather than relying on mathematical models, behavioural economists have shown that the textbook model of the hyper-rational consumer, someone who has access to complete information and evaluates every decision according to their personal self-interest, does not accord with reality.

So, while the Treasurer might be urging us to 'walk down the road to get a better deal', he shouldn't be relying on it. The banks employ teams of people to make it difficult for us to compare their products and switch to their competitors. Customers have to give up their weekends to do so. It might be called competition but it's not a fair fight.

CHOICE has launched a new campaign calling for more competition in the banking sector. To join the campaign, click here

Give the gift of good ideas this Christmas

If you would like to further assist us in conducting research that matters, please consider giving the gift of good ideas this Christmas by making a donation on behalf of friends or family.

You will receive a personalised gift certificate acknowledging the donation which can be presented to your loved one.

Please go to www.tai.org.au and click on the Christmas present at the top of the screen to make your donation.

All donations of $2 and above are tax-deductible and will be invested in new ideas and research that matters in 2011.

Recent publications

Rough trade - How Australia's trade policies contribute to illegal logging in the Pacific region, C Hoisington, 31 October
Long time, no see: The impact of time poverty on Australian workers, J Fear, S Rogers and R Denniss, 10 November
The Australian Government's solar PV rebate program, A Macintosh and D Wilkinson, 11 November
Submission on mining taxation, D Richardson, 24 November
Australian Financial Integrity Network, 2 December

Recent media

Sick workers too busy to see a doctor, study finds, *The Age,* 27 October
Go home on time day, *Life Matters*, 24 November
Money slipping through nation's fingers, *Sydney Morning Herald,* 1 December