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Neoclassical economics has a clear definition of a competitive market, but it has been so debased by Australian politicians and business leaders that it now borders on meaningless.

According to mainstream textbooks,a competitive market is one in which there are lots of buyers and sellers, none of whom have any market power. Buyers are well informed, they shop around on price, and suppliers make only enough profit to cover their costs.

The Australian Bankers Association must be reading some different textbooks. According to a press release by the ABA's Steven Munchenberg, the banking industry is "fiercely competitive", despite the fact that of the 100 banks, credit unions and building societies trading in Australia, the big four banks have 84 per cent of home lending. Neoclassical textbooks describe such a market as an oligopoly.

According to CANSTAR, the difference between the mortgage rates of the big four and those of the mutually owned banks, building societies and credit unions is 0.4 percentage points. On a $300,000 mortgage that's a potential saving of $1200 per year.

But according to the ABA, "banks routinely offer discounts of around 70 basis points [0.7 points] off the advertised standard variable rate to approved customers. This is because the Australian mortgage market is fiercely competitive and Australian mortgage customers have a lot of choice . . ." These claims, if they are true in the traditional sense of the word, raise more questions than they answer.

If the big banks are so willing to cut rates when asked politely by customers, why are they so determined not to when asked by the Treasurer? Surely they could save themselves a lot of bad press by reducing their advertised rates by the full amount of RBA reductions and offering slightly smaller discounts?

In the traditional definition of a competitive market, well informed buyers behave rationally and shop around on price, which raises the question; what percentage of mortgagees are irrationally paying substantially higher interest rates than they need to? The ABA suggests that there are more than 500 mortgage products. If customers spent 10 minutes looking at each, it would take them 83 hours to compare. In the textbook, the search for the perfect product is costless in time and money.

Which brings us to another question; if the banking market is so competitive, why do the big four banks spend more than $1 billion per year on advertising? The ABA regularly tells us that banks have no choice but to pass on the rising costs of borrowing to their customers. It follows then, that they have no choice but to pass on the costs of their advertising to customers. But if advertising makes their products more expensive, and rational consumers shop on price, why would the banks make themselves uncompetitive by driving costs and prices higher than necessary?

The answer to this last question sums up much of what's wrong with the Australian banking industry, and the way successive governments have dealt with its market power. Put simply, the big banks' market power comes largely from the fact that when the banking system was opened up to new competitors, the big four had a huge head start. They have since spent the past decades consolidating this market power by buying up their mid-sized rivals and spending a fortune on advertising to reinforce the public's existing apprehensions and preconceptions.

Consumer deposits in all Australian banks are guaranteed by the government. But millions of Australians believe that the big four banks are "safer" and, in turn, pay tens of thousands of dollars more in mortgage interest payments than a "rational" consumer would.

The reason that both the big banks and successive governments are so keen to describe the banking industry as "competitive" is that the textbooks say there is little need for consumer protection regulations in such a market. That's one bit of the neoclassical textbook the ABA agrees with.

Wayne Swan has referred to the credit unions, building societies and mutually owned banks as the "fifth pillar" of the banking system, but if he really wants to put cash in the pockets of "working families" he needs to use his office to reassure Australians that switching away from the big four is not just profitable, but prudent.

Meanwhile, the millions who are paying the advertised price for their mortgage should simply print out the ABA's press release and demand a 0.7 percentage point discount from their bank manager.

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