THE IMPORTANCE OF UNIMPORTANCE

New Zealanders, the nicest people on earth, need to toughen up on the rest.

Put plainly, as it is shaping up, the Commerce Commission's banking market study should be considered an opportunity missed. The draft report suggests the Commission is passing over an opportunity to do what should be done by a nation – New Zealand – uniquely well placed to grab it and take it.

What New Zealand – or Australia – does in deciding its policy settings is mostly irrelevant in the broad sweep of global affairs. Taken together, the population of both is less than one-half of one percent of the global population – New Zealanders number one-fifth of those in Australia.

New Zealand, being 'unimportant' on this score, becomes very important a global level when it is able to do something distinctly differently. New Zealand, taking a different approach to regulating retail banking, could change a policy paradigm in place, globally, that has failed, globally. Sadly New Zealand is not shaping up to meet this challenge.

Retail banking in New Zealand is dominated by Australian banks. These 'foreign' banks operate in such a same-same way it effectively substitutes arrangements more akin to a profiteering cartel than a genuinely competitive market place. New Zealand banking should not be beholden to a similarly failed market culture in Australia.

New Zealanders should be asking why its policy makers are letting 'foreign' banks profiteer at the expense of the New Zealand community. There is no need to do this, and the offence does not stop at profiteering – it extends, as the Commission also finds, to the efficiency and fairness of fundamental national infrastructure monopolised by a 'foreign' cartel.

Now, the Commission, having found these shortcomings, is looking for a market response that will be 'disruptive'. As the draft report reads, the reform intended to be 'disruptive' would be mainly about making 'account-portability' easier. An interested observer might reasonably wonder if bank customers would see as 'substantially disruptive an opportunity to only choose between the same-same low-grade options the major banks are offering.

Beyond that, the idea of nurturing a minor bank to the status of 'disruptor' is probably fanciful over any reasonable time frame.

An inclination to do nothing

The draft report of the market study is apparently not inclined to consider much in the way of changes from the banking-policy model entrenched in most national banking systems.

On the face of it, the outcome of the market study will simply endorse the global consensus – the usual lamentations, of no-apparent-competition, coupled with too-vague proposals aimed at fostering disruptor-competitors.

Never mentioned is the probability that any genuinely disruptive competition would be mostly unsettling to banking regulators having to imagine doing their jobs very differently. There is a code of silence among retail banking regulators globally and the 'safest' strategy for regulators is to do and say nothing different.

Such combinations of very obvious shortcomings, with hopes for something to turn up, are all too common. It is the same across the ditch to say nothing of most other national systems locked into monopolised markets for retail banking services that fail to deliver what their communities need at a fair price.

The people, of course, having no idea of what could be, must remain silently content with what served up to them. Communities are not well served by banks that cannot fail because they are underwritten by the very people they are dealing with unfairly.

New Zealand v. Australia – let the competition begin!

There was some irony over 2023 in the conduct of 'retail bank inquiries' in both New Zealand and Australia by their competition commissions,

That both Commissions have then come to a similar preference for 'easier account portability' to address the very obvious lack of competition in the retail banking arena is more disappointing than ironic. As noted, the answer to the need is hardly likely to given by account portability.

This disappointment is especially so in respect of New Zealand which is so well placed to make a difference.

As to what that 'difference' could be, and how it might be made effective, the Appendix to this submission (*Banking on Silence*) is as relevant to New Zealand as it is to Australia and probably more so.

Retail banking systems are effectively nationalised, globally

On any objective criteria, retail banking systems globally, including in New Zealand and Australia, are thinly disguised public utilities operating unfairly and inefficiently. The wider community is mesmerised with government guarantees of the solvency of banks that provide banking and payments facilities that, while usually working reliably, are doing so in a way that is inefficient and unfair.

The end of this 'no stopping – no turning' road is now clearly in sight. The outcome will mainly benefit mundane bankers pocketing obscene salaries, as well as regulators and politicians spared the emotional and electoral turmoil of an about-face, newly explaining to the community why they misled it for decades.

There is no need to put up with such a dumb deal for the New Zealand community.

The dumb deal includes major banks taking easy profits (running to $ billions) by not paying interest on deposits in transaction accounts. This while deceptively engineering a perception that most bank services to consumers are free of any material charge in the minds of their customers. Truth told, most banking service costs are recovered from excessive merchant transaction fees built into higher sales prices paid by, but not evident to, consumer customers.

New Zealand could buck this deceptive system at small cost, and large benefit, to itself. Floating the prospect that it might would be far better than just surrendering to a flawed consensus that New Zealand has no need for. Taking a stand to call out the nonsense of the global consensus in place would be the right thing to do – the importance of unimportance could not be more clearly expressed.

An action plan

One simple single step would put a stop to most of the nonsense now entrenched.

All banks in New Zealand would be obliged to pay taxable interest income, at least the cash rate, on all deposits, including on all deposits in transaction accounts.

There would be attendant consequences consistent with restoring a proper market, with a proper pricing system, to banks providing account keeping and transaction services.

New Zealand alone, among a usual reference group of like-nations, is well placed to do so.

If ANZAC concepts of courage have contemporary relevance, New Zealand is honour bound to have a crack.

Peter Mair

April 2024

https://comcom.govt.nz/__data/assets/pdf_file/0027/347373/5BPUBLIC5D-Draft-report-Personal-banking-services-market-study-21-March-2024.pdf

APPENDIX

DISCUSSION PAPER / PETER MAIR / MARCH 2024

BANKING ON SILENCE

A commitment to silence is covering up flaws in the conduct and regulation of retail banking. The regime in place is conducive to systemic instability, monopolisation, inefficiency and unfairness.

A damaging silence demands to be broken.

– the indictment

Banks not paying interest on deposits in everyday transaction accounts is unacceptable -- banks invest the funds deposited and take the profits. The profits are volatile – recently surging, as the cash-rate went to 4%. These profits do not fairly belong in banks' hands. Rather, they belong in the customers pockets as taxable income and, as tax paid, in government coffers.

Calling out this anomaly is not rocket science. Being wrong, in-principle, is one thing. Much worse, is the reality. Major banks are, unfairly, not paying $30 billion in interest on some $750 billion in deposits in transaction accounts. These 'profits' do not belong in banks' hands.

In short, digital deposits with banks in transaction accounts, having displaced cheque and banknote payments, are now the relevant 'cash-currency' for the economy. These deposits, by value, fund almost every funds transfer and payment transaction.

– calling out the official silence about this unfairness

Over ten months last year the ACCC addressed a brief from the Treasurer to inquire into the policies and practices of the major banks setting interest rates on deposits.

[*https://www.accc.gov.au/inquiries-and-consultations/retail-deposits-inquiry-2023*]

Reporting in December, what the ACCC did say was so predictable it raises the question of why the ACCC needed to be involved. It was a job that could, and should, already have been done by the consumer-protectors -- ASIC overseeing the code of banking practice and, as backstop, the CFR (Council of Financial Regulators) coordinating regulatory responses.

[ASIC oversees – *The Banking Code of Practice – a set of promises about how banks will behave when dealing with current and potential customers*............ The Council of Financial Regulators (CFR)*“............. recognises the benefits of a competitive, efficient and fair financial system”.*]

Questioning why the ACCC was involved is sharpened when the focus shifts to what the ACCC did not say.

The ACCC chose to ignore the unfairness and the wider consequences of major banks not paying interest on deposits in transaction accounts. No catchy acronym comes to mind but 'TADs' (transaction-account-deposits) will do. (This 'tad' is not 'a little' -- it is 'a lot').

Ignoring this issue was not an oversight. The ACCC Chair, a decade-long member of the RBA's Payments System Board (PSB), would know about retail payments systems -- including issues associated with everyday transaction accounts.

It is now clear that the ACCC's brother regulators knew it would not deal with TADs. No brother-regulator made a published submission to the ACCC – they would have if TADs were in the ACCC's sights. The banks also knew that TADs were not on the agenda – had TADs been up for investigation, the Australian Bankers Association would have had a serious bout of emotional incontinence.

So, as the record stands, the ACCC accepted a brief to inquire into banks policies for interest rates paid on retail deposits, and then excluded TADs from the scope of its inquiries.

Doing so, without explanation, is unacceptable – conduct unbecoming.

All this studied disinterest was superficially at odds with an inquiry headlined “*the ACCC's retail deposit interest rates inquiry”***.** The ACCC ignored requests to address TAD practices and consequences.

On reflection, possibly speculatively, passing this ball to the ACCC shielded Treasury from criticism for itself ducking the issue – also ignoring it – in the development of a 'strategic plan for the payments system'.

[https://treasury.gov.au/publication/p2023-404960 A Strategic Plan for Australia’s Payments System – June 2023.]

This Treasury plan was itself remarkable. It was presented as a plan for the future without a proper survey of the ground it was planned to build on. Treasury also ignored submissions detailing flaws in the foundations of retail banking and payments systems.

Another disturbing aspect was a submission from the ACCC Chair to Treasury about its strategic plan. The ACCC submission stressed the importance, to a well functioning market, of both 'competition' among providers and 'fairness' in their dealings with the customers.

Having promoted these 'principles' to amend the Treasury's plan, the ACCC implicitly endorsed the contrary -- by ignoring TADs as deposit products in reach of its own inquiry. TADs underwrite the unfair and unassailable competitive advantage the major banks have and which the regulators condone. On the 'fairness' front it is directly contrary to condone the major banks not paying some $30 billion in interest to customers on TADs.

The ACCC submission, dated 8 February 2023, is here:

https://www.accc.gov.au/system/files/ACCC%20%20Submission%20in%20response%20to%20Strategic%20Plan%20for%20the%20Payments%20System%20Consultation%20Paper.pdf

Not to labour the point unnecessarily, consider these extracts of 'key principles' the ACCC proposed to Treasury:

- **About competition***…..........'competition' should be included as an additional key principle …........... a key driver of efficiency, innovation, and ensuring accessibility (including consumer choice and lower prices).…..........it is fundamental to consider competition when considering regulatory responses across the sector.*

- ***About fairness** …......... 'promoting a safe and resilient payments system' can only be achieved with comprehensive and robust consumer safeguards. Comprehensive consumer protections …..........must be a part of the regulatory design process.*

Put sharply, it is not possible to reconcile the principles advocated to Treasury, by the Chair of the ACCC, with the sign-off of the 'deposits inquiry' report ten-months later. The ACCC did not take the opportunity to propose making the retail deposit market more competitive and fairer.

This background reflecting is not complete without mentioning a scene-setting 2021 report from a consultant Treasury commissioned to review the regulatory architecture of the Australian payments system. It is notable for an unfortunate observation:

The emergence of this new [payments system] *ecosystem has already begun, with developments such as buy-now-pay-later and cryptocurrencies showing the way*

Talk about endorsements coming down to earth with a thud, the burnt sticks of BNPL and cryptocurrency skyrockets are now languishing, exposed as almost irrelevant to the future of retail payments.

Taking all this ready-fire-aim stuff together, it opens a view that commissioning the ACCC inquiry into retail deposits was inappropriate. Buying time, and disinterest, with a faux promise – just kicking down the road a can of worms that no one in the regulatory cabal wants opened.

If so, the 'all this' is not right, so to speak: the following tells a story.

THE REGULATORY CONTEXT

A royal commission into misconduct in the retail banking and financial system ran through

2018. The prelude saw burgeoning revelations overwhelm political resistance before misconduct was exposed with an aftermath of penalties and compensation paid.

This royal commission – making dramatic revelations – was, however, not properly empowered or fully informed. The RBA was not called. No one was asked 'how did this happen?'. A concurrent inquiry by the Productivity Commission, into competition in the Australian financial system, was of no consequence. Disappointments are par for the course when officials float illusions of another independent inquiry into financial system matters – never has been, never will be.

Also disappointing, the royal commission over, major financial institutions are again not being 'fair' in dealings with their customers. Disinterested regulators are turning a blind-eye to continuing unfairness. A silence-is-golden mantra among the regulators is hiding plain truths and not addressing real issues.

Five primary regulators come under the general oversight of the treasurer – Treasury, RBA, APRA, ASIC and ACCC. Variously, these agencies are represented on a raft of domestic and international boards and policy agencies.

Among the regulators there is lingering confusion about their responsibilities. Two local subsidiary bodies are chaired by the RBA -- its Payments System Board (PSB) and the CFR (Council of Financial Regulators). The CFR and PSB, expected to coordinate overall regulatory and industry outcomes, have disappointed

A closed group is locked into an atrophied regulatory consensus. Putting aside expectations and promises not kept, regulators default to silence – unable to see or speak about systemic flaws or correct them.

– **'independence' to do nothing**

Problems are buried alive when the independence given to regulators, includes the 'independence' to not do something that should be done.

No expert-oversight body is in place to hold regulators accountable -- the ruling consensus ensures they are not. In the wash up, decisions akin to dereliction of duty are silently condoned by the group.

There are arrangements in place for regulators to front parliamentary committees. These hearings are not the stuff of 'accountability'. The House Economics Committee hearing of the RBA in February 2024 is illustrative. In due course it will be interesting to see if the committee follows up on this offering from the RBA about the payments system:

The government is …........ modernising the legislation to allow the RBA to regulate the new and diverse set of participants much more effectively. Once this legislation is passed, we will be embarking on a wholesale review of our retail payments regulation to identify any areas where competition, efficiency and safety could be improved.

Whatever might be in mind for this 'wholesale review' , will its reach extend to TADs?

Treasury aside, the regulators have 'primary' and 'other', conflicting, responsibilities.

Resolving the contradictions and conflicts sees a preoccupation with 'no-change' masquerading as *'stability'*. The conflicting responsibilities, mainly about promoting competition and protecting consumers, are sent to some limbo from which a promised resurrection is denied.

Ironically, 'stability in the moment' often entails decisions that further undermine stability in the future. Australia is not alone. Instability becomes a self-sustaining cycle of 'crisis and rescue', now being choreographed by central banks globally. Making 'stability-first' the ruling mantra conveniently handicaps the concurrent pursuit of systemic 'efficiency' and 'competition' and 'fairness' – characteristics now rarely evident.

The regulatory framework for the retail financial system is not fit for purpose. Regulators staying silent is no substitute for candour when stability, efficiency and fairness is being undermined.

ACCC – RETAIL DEPOSITS INQUIRY

There is a long historical tail to the contemporary story. The focus here is on present shortcomings and prospects for what could be done better.

The ACCCs retail deposits inquiry is an illustrative case study in the coupling of 'independence', to ignore things, with the attendant silence not meeting an obligation to speak up clearly. Daily, the community sees an ageing former ACCC Chairman, now sponsored by the ACTU, showing how systemic flaws can be seen, recognised for what they are, and decried.

The narrow focus of the ACCC saw the major banks being slow in passing on higher interest rates to depositors. Only doing so only with complex products and tactics. A deception so confusing to their customers it denied many a durable benefit. To an interested observer, this is 'misconduct'. The ACCC had an obligation to link this misconduct to TADs.

All that aside, this ACCC report was the more remarkable for what it did not say.

By value, most retail deposits are held in everyday transaction accounts on which no material interest is paid (TADs). Inexplicably, the ACCC conducted its inquiry as if these deposit products were not relevant. A letter posted to the Chair of the ACCC (and PSB member) asked why the inquiry excluded deposits in transaction accounts. A response, signed-off by a 'correspondence officer', did not answer the question. A follow-up request, for a more substantial response cleared by the Chair, ducked again – "the ACCC will not be revisiting these issues".

– **no one was surprised**

Wilful-blindness at the ACCC is not surprising – none of the other regulators has any intention of seeing or saying anything about the TAD anomaly either. Nonetheless, that the regulators, collectively, would be so agreed is itself an issue worth exploring.

The regulators' determination to ignore this issue is a fair focal point – the silent nonchalance across five national regulators is unacceptable.

- big bucks are on the TAD table

The studied disinterest of the regulators in TADs is all the more surprising when the numbers at stake, and the consequences, are so substantial.

Monetary-aggregate statistics suggest the 'interest free' deposits in transaction accounts with the major banks, could run to some $750 billion (cf. half or more of $1.5 trillion in M1 other than cash).

The regulators' disinterest means there are *missing-numbers* -- no statistics are collected about 'deposits in everyday transaction accounts' (TADs) on which no material interest is paid'. That regulators apparently do not want to know the numbers is disturbing.

Working with illustrations based on $750 billions, and a cash rate of 4%, the interest currently not-paid to customers on TAD deposits runs to some $30 billion annually. The banks' 'profit' from investing these interest-free deposits has surged since mid-2022.

Let the mind roam over variations in the cash-rate over the past 40 years – 5% to 15% to 0% and back to 4%. The contribution of interest-free deposits to the annual revenue of banks has notionally ranged from $40 billion, to $110 billion, to 'zero', to $30 billion now – say, back to some $40 billion annually at a 'normal' 5%.

The apparent disinterest of regulators in the instability of the 'soft' TAD revenue flows to banks seems to say – 'we don't ask and we don't want to know -- so we do not have to do anything about it'. The game played is about silence – keeping everyone else in the dark and, one might say, disinterested.

STABILITY? COMPETITION? EFFICIENCY? FAIRNESS?

(a) STABILITY: TAD-rents destabilise the financial system

Explanations for recurrent instability, among other problems, often lie with regulators letting volatility in these monopolistic rents unfold unchecked. Rents, incidentally, that regulators gifted to the major banks.

All the regulators are in the gun for this – Treasury, RBA, APRA, ASIC and the ACCC. What do these agencies not understand about the banks, first, unfairly taking interest due to depositors as windfall profits for themselves and, next, the consequences of wide swings in the value of the profits. The consequences of banks not paying interest on TADs compromise systemic stability, prudential management, competition and fair-play.

Just to recap.

- Windfall profits for the majors underwrote destabilising and monopolising power plays after the cash-rate hit 15% in the 1980s. A local banking crisis in 1990 left two majors on the ropes among other collateral damage.

- Even so the majors soon owned the game – no more state banks, foreign banks sent packing, take-overs of building-society banks and insurance companies. There was some political pay-back – bank supervision was transferred from the RBA to APRA – but no policy response to correct the problem. No one said what the RBA should have done but did not do.

- Later, as the cash rate fell, to zero eventually, a rug was pulled from the capital positions of the majors. This realisation was addressed with some urgency circa 2014 by another 'independent-inquiry'. Problem was the usual flow of 'regulatory rents' had a very substantial present-value akin to de-facto capital for the major banks. Falling cash-rates eroded these TAD-rents, leaving the majors somewhat bereft and short of capital.

- Recently, with the cash rate surging to 4%, TAD-rents are back in play. Majors are kicking tyres, considering buying 'rents' from smaller players. The ACCC rejected one takeover only to see it approved on appeal. No one seems to realise that takeovers need to be headed off by fixing TAD-like flaws. There are only bureaucratic niceties in demanding that takeover plans be 'notified' to the ACCC for approval – once merger plans are in play the game is usually over. Fixing market failures is the challenge not taken up.

Surely someone needs to say and do something to avoid systemic instability. All the regulators should be keen to correct flaws that may promote instability among financial institutions as well as putting efficiency, competition and fairness in the social dumpster.

Stability is important – one could ask why systemic instability remains built in.

.. imprudent prudential supervision

Sound prudential supervision of banks and other financial institutions is critical to systemic stability.

The 1988 foray of central banks into prudential supervision (bank capital rules) was unsound – so unsound it led to the global financial crisis. Various later iterations, of a rules-based approach to the problem, may not be much better.

Major banks are too-big to fail and any problems with smaller banks are typically buried – merged into a major bank. As the system is now designed, there can only ever be fewer major banks not more. The pursuit of prudence requires a revolution. Bank boards and management should not be left to semantic-scheming to game bureaucratic capital rules.

Conjure a market-based regime where bank boards and managers were proudly advertising their competence and commitment to soundly prudent financial management.

One encouragement to such a regime would see banks split their deposit books evenly between 'government guaranteed deposits' and 'subordinated deposits' at risk – ranking behind shareholders funds in a liquidation. Market analysts would soon keep tabs on the risks to depositors and shareholders.

(b) COMPETITION: monopolised industries are not competitive

Only lip-service is paid by regulators to promoting competition in retail financial markets. As is, the major banks have, in TADs, unassailable competitive advantages gifted by and protected by regulators. There is no commitment to pursue anything like a genuinely and fairly competitive market for retail financial services.

Exploited customers are exhorted to 'shop around' for a better deal. The ACCC refined this advice with a proposal to make bank accounts more easily portable. Spare my days, the customers well know the futility of confronting a look-alike united-front with major banks running a same-same game.

Customers do not understand, and are not told, how the banking and payments system operates. Community perceptions are confused. A community seeing change in the way payments are made, may wrongly attribute the changes to competition.

The regulators, and the CFR and PSB, have charters variously proclaiming the importance of competition. None has a charter to foster predatory takeovers, protect monopolisation, shield inefficiency or let the customers be exploited – yet, that is what happens. We do not, however, get the 'stability' for which the rest is routinely sacrificed.

A brief recap.

Up to the 1990's at least the RBA was primarily responsible for regulating banking and retail payments systems. It left a legacy that lingers unquestioned.

The RBA now chairs the CFR, the only agency with some semblance of responsibility to coordinate oversight of the financial system. The CFR, a sad disappointment, could give way to more independent oversight, policy-audits and regulatory coordination.

In the 1980s it was globally fashionable to deregulate financial systems in favour of freer markets. Central banks delivered a curate's egg – one rotten part is in focus here.

Left in place was a regulation from the 1930s precluding banks paying interest on at-call deposits in transaction accounts (TADs). Overlooking the need to reconsider this policy in the 1980s was a major mistake.

All hell broke loose in the late 1980s as free-market interest rates went higher – in Australia to 15% p.a.. In short order, locally, the major banks used the windfall surge in their profits to take over the retail financial system – not just other banks but aggressively moving into insurance, funds management, stock-broking et.al. With the instability and a banking crisis, any prospect of additional competition vanished. In short. major banks running riot in the wake of regulatory mistakes abused their market power, regulators did nothing to correct their mistake. Four decades on nothing much has changed. The 'why' of all this needs to be asked and answered.

Competition is important – one could ask why perverse regulations deny real competition.

(c) EFFICIENCY: regulators protect systemic inefficiency

Without competition it is fanciful to expect the provision of retail financial services to be efficient. The retail payments system is rife with inefficiency entrenched and protected by regulators.

The retail banking and payments system, a major national industry, operates without a price system, without prices paid directly by their customers for the services they use. The importance of a price system to proper resource allocation is day-one of economics-101.

People accept paying explicit, cost-related prices for day-to-day essentials – with one exception -- apparently, bank accounts and transactions must appear to be free of charge. Market disciplines essential to efficiency in retail banking are simply absent – an absence contrived and fostered by a regulatory regime no longer fit for purpose.

The shift to electronic funds transfers is essential to payments system efficiency. The steady progress to electronic payments creates an illusion of efficiency that is inconsistent with the reality. Inefficiency, condoned by regulators, is built into the retail payments system in ways that the community is not told and does not understand.

The beneficiaries of this inefficiency are major banks and their card-scheme associates.

Lazy profits from not paying interest on TADs allow banks to cross-subsidise inefficient, high-cost services. Insult is added to this injury when the customers are misled to see banking and payments services as 'free of charge'.

The deception here is destructive -- among others, the ACCC chose not to expose it.

For starters the customers, not paid interest on their deposits in transaction accounts, are misled into a barter deal – free transactions for free-deposits. Not only are the customers routinely robbed in this uneven deal, so also is the Treasury/ATO denied tax on the income in kind paid to customers as free-services. Any similar barter scheme would likely be shut down.

Beyond this deception, banks charge merchants high fees for retail transactions – high-fees which merchants recover from customers in surcharges or higher prices. The customers do pay, they pay heaps but do not understand the mechanics. A most egregious example being the (ad valorem) % fees so unfairly charged for card transactions. Per-cent -of-value fees should for transactions be outlawed. The collusive trade-practice arrangements operated by major banks in association with Visa and MasterCard are tantamount to a profiteering cartel.

The regulation of retail payments systems was delegated to the RBA's PSB some 25 years ago. It was given a charter to manage risk and promote efficiency and competition in the payments system, albeit consistent with overall stability of the financial system. In the event, the concept and emotion of 'disappointment' has rarely been more applicable and shows no sign of being relieved. The ACCC report overseen by a long-term member of the PSB did not help.

d) **FAIRNESS: it is unfair to not pay a market rate of interest on deposits**

Rhetoric about 'protecting the customers' flows from regulatory spruikers – not least ASIC and ACCC to say nothing of the tacit acceptance of the RBA/PSB/CFR, APRA and Treasury.

Currently bank depositors are not being paid some $30 billion or more, in interest, on their deposits in transaction accounts. The customers would like the interest due added to their account balances – then choosing to buy account keeping and transaction services from a provider offering a fair deal.

The game being played, in clear sight of government and the regulators, now sees the major banks unfairly pocketing the profit surge after interest rates went to 4%+. That is just so not right. Looking back a bit, not paying interest when rates were 15% in the 1980s, was grand larceny – delivering windfall profits that robbing-banks used to further disadvantage the community with predatory power plays driving out competitors.

DISMISSING THE PUBLIC INTEREST

The silence of the regulatory cabal on TAD issues exposed so far has another dimension all together.

Regulators condoning major banks not paying interest on transaction account deposits, spills over into another level of disregard for the general public interest.

That exposition requires a brief diversion.

There are linked policy issues associated with TADs. As alluded to, the shift to a less-cash society is quickening. Digital-cash money in transaction accounts is displacing conventional-cash to become, practically, the national currency.

Jumping to conclusions, to retain the interest of gentle readers, the bottom line below proposes withdrawing $50 and $100 notes from from circulation.

Understanding policy issues associated with the transition to a digital-cash economy is in reach of a brief primer:

- Most, as well as commercial bankers and central bankers, understand that the anonymity of banknotes (essentially a deposit with the central bank) precludes the payment of interest to the holders of banknote-deposits. The central bank holds interest-earning assets, government bonds, funded by the banknote deposits.

- Taken together, the central bank makes a profit from investing the interest-free banknote-deposits. The note-issue profit is passed to Treasury, available to pay for general government outlays.

- Extending the story to the retail banking arena reveals a situation that is both remarkable and untenable.

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- By value, most payments are made by electronic transfers of money held as digital-deposits in accounts with banks. The remarkable reality is that no interest of any consequence is paid on most deposits held in these transaction accounts. Rather the profit banks make, investing the interest-free deposits, is kept by the banks. The flow of profit to banks surged as the cash rate went to 4%+ recently.

- What is considered untenable, is banks' being entitled to keep the profit on their investment of the interest-free deposit funds. This profit does not fairly belong in banks hands. Rather, banks could and should pay interest at a market rate to their depositors on all deposits – including deposits in transaction accounts.

Presenting this story differently, the government could continue to take the profit from the digital-deposits base that is now the national currency. Not an easily credible proposition perhaps -- it would require either banks keeping TADs in zero-interest reserves with the central bank, or its equivalent a tax on banks digital deposits to take the profit to consolidated revenue. [This latter option was used in the 1850s as state governments levied taxes on the banknotes then issued by private banks – before the federal government took over the national note issue.]

The practical option now is probably requiring banks to pay their customers interest on all deposits – 'the cash-rate' at least – including on deposits in everyday transaction accounts.

This would not be some resurrection of direct controls on banks, rather it would be consistent with established policy. The means-test for social security benefits requires applicants to include, as income, a deemed rate of return on passive assets. By extension, banks would be required to notify customers of their deemed taxable-income from passive assets, their 'interest-free' deposits. Customers would soon want the interest added to their account balances.

This step would likely see banks paying interest on TADs of some $30 billion or more, annually. Income tax would be payable on the interest income and the transition would see banks charging customers directly for account keeping and transaction services.

Provision would be made to ensure 'fee-free' basic banking services remained available to social-security recipients. Covering the cost would see tenders called for providing the 'fee-free' services -- the winning providers being paid to do so from the budget. No need for fear mongering about pensioners left at the mercy of banks.

The transition would need to be carefully managed. It should be put in train sooner than later – this, lest the retail banking system remains unstable, not competitive, inefficient and unfair.

LESS-CASH NOT NO-CASH – REMOVE THE $50 AND $100 NOTES

Reality is confronting the RBA's note-issue business.

Truth told, Australians enjoy convenient use of some cash but no longer really need notes in denominations greater than $20.

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The national note issue is a policy problem. Of the $100 billion of notes on issue, the community uses some for small purchases and puts some aside as a precaution. The problem is that most of the $90 billion, in $50 and $100 notes, is not 'in circulation' in any meaningful sense.

These notes are hoarded – by those evading tax on cash income and, mainly, probably, by age-pensioners putting cash under-the-bed to inflate pension entitlements. Means-testing entitlements to age pensions encourages the secret hoarding of banknotes.

Consider why Australians hold some $4,000 in banknotes per head, while New Zealanders get by with less than half that. Most of this difference is explained by Australia means-testing age-pension entitlements, which NZ does not. The taper rate on age-pension entitlements delivers an extra $70 in pension for every $1000 less in disclosed assets. This – 7% p.a. tax-free – encourages secretly hoarding banknotes.

The RBA earns some $4 billion investing the $100 billion used to buy its banknotes. Conversely, the government, which owns the RBA, loses more from its net budget position to pay the hoarding-inflated pension entitlements and associated concessions.

Taking $50 and $100 notes out of circulation is a looming political issue.

One of the more remarkable bits of this developing banknote story is the ever so cautious and reluctant way the RBA is dealing with it. Talk about being dragged 'k&s' to the debate. Only very recently has the RBA recognised and accepted that 'hoarding' is a major factor driving the demand to $50 and $100 banknotes.

Recognising the full implications at the RBA is still a challenge not met. Rather the lingering story from the RBA management is that 'we do not know where the $100 notes are' followed by jocular remarks to the effect of 'I do not have any'.

Give us a break – the RBA is apparently running a $100 billion business it says it does not understand.

Truth told, the RBA may not want to know. If the $50s and $100s are taken out of the game, the value of notes on issue would fall away sharply along with the profit on the note-issue which the RBA has first crack at to fund its operations.

Alternatives open include some combination of RBA funding provisions being brought within the discipline of budget funding – as applies to other policy agencies – and responsibility for the note-issue (like the coin issue) being transferred back to Treasury, where it was until 1911.

The current circus, robbing Peter to pay Paul, is an embarrassment.

End-piece

…..........what more can one say …....... perhaps put in place a banking royal commission trusted to do a job that no one else is willing to even think of doing.

Peter Mair / March 2024