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Four pillars will become shaky house of cards

- **Henry Ergas**
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A package meant to show the government is doing something could inflict serious harm.

ANYONE who believes that allowing gravel to call themselves boulders will convert a rock garden into Stonehenge urgently needs a dosage check. And that Wayne Swan and Joe Hockey seem to be sharing the meds hardly adds to one's confidence in the proposed banking reforms. But even putting the pebbles-into-pillars fantasies aside, the real trouble with the reforms is that they could inflict serious harm, merely so as to show that the government is "doing something".

The proposed ban on "price signalling", whatever that means, highlights the flaws.

Banks, like any other business, have a legitimate interest in informing their customers about likely trends in prices. That helps customers plan, and may also give them the time to shop around if they believe there are better deals to be found. Moreover, masses of research shows consumers react far better to price increases if they are forewarned and understand why they occur.

As a result, one would want convincing evidence before prohibiting firms from disclosing their pricing intentions. But rather than demonstrate there is a problem that needs fixing, the Treasurer merely says that the proposed ban "covers a gap in [the] Trade Practices Act" relative to "laws [that] already exist in the US, the UK and Europe".

That claim is at best misleading. American, British and European Union competition law would not prohibit the disclosure of price information unless it formed part of, or otherwise supported, explicit or tacit collusion; under the government's proposed approach, the conduct could be prohibited even if there were no collusion and no prospect of it.

Rather, all it requires for conduct to be in breach is that one purpose of the disclosure is to substantially lessen competition, where that purpose may be inferred by a court, even if there is no evidence that such a lessening of competition was the company's aim or intention.

It is easy to say that no court would come to such a finding capriciously. And it is also easy to say that actually making out the proscribed purpose could be a challenge. But long experience proves that bad laws impose high costs: not least by creating uncertainty as to what is allowed and what is prohibited. That the prohibition comes with swingeing penalties only adds to the risk that it will chill desirable conduct.

This is not to argue that our competition laws are in perfect shape. Rather, the provisions that deal with price-fixing need to be simplified and clarified. But sensible policy would tackle these deficiencies directly. Instead, the Treasurer is fiddling at the edges, in the process undermining the laws' coherence and integrity.

That the proposed changes will only apply to banking makes matters worse. It is for good reasons that successive governments have emphasised the need to ensure the competition provisions apply to all sectors equally, avoiding distortions associated with artificial boundaries.

And if "price signalling" is indeed so serious a problem, why tackle it in only one sector? Surely this is merely an admission that the legislation is hastily designed and rich in risks and unintended consequences?

All that and more could also be said of the proposed ban on exit charges. Far from being a barrier to competition, these were brought in by smaller mortgage lenders as a way of recovering costs and capturing part of the gains from competing aggressively to attract customers.

That exit fees, set at a moderate level, would enhance competition is hardly difficult to understand: these fees increase the prize each firm gets from winning a customer and hence encourage them to invest in customer acquisition.

And if they can't recover those costs from exit fees, they will either invest less in acquiring customers or recover the costs of doing so in other, less efficient, ways.

One might hope this would lead to a cautious, evidence-based, approach. But no such fuddy-duddy attitudes here. Rather, preferring decisiveness to prudence, the government proposes a blanket ban on mortgage exit fees, despite a complete lack of any evidentiary basis for so drastic a measure.

Nor are the interventions aimed at assisting smaller lenders better thought through. Rather, these too raise obvious questions the Treasurer's statement simply ignores. How can extending the deposit guarantees be justified, especially given that these are not priced in a way that adequately reflects and mitigates the risk taxpayers bear from the insurance they are providing?

And surely encouraging banks and credit unions to advertise the fact that they are government guaranteed courtesy of the proposed new "Government Protected Deposits" symbol, presumably modelled on the Heart Foundation's tick, will reinforce expectations of unconditional bail-outs, increasing yet further the dangers of moral hazard?

As for an increased commitment of public funds to buying residential mortgage backed securities, this involves the commonwealth selling government bonds, a very low risk instrument, and using the proceeds to purchase an asset that has substantially higher risks: indeed, so high a risk that private buyers are reluctant to purchase RMBS at current prices.

What is proposed, therefore, is a deterioration in the quality of the balance sheet of taxpayers. That deterioration amounts to a subsidy from taxpayers to the issuers of RMBS.

But where is the evidence that the benefits from the subsidy outweigh its costs? Indeed, where are the estimates of just how large that subsidy is likely to be, and to whom it will accrue? And where is the analysis showing that what Australia needs is yet more lending on houses, this time funded by taxpayers?

Don't waste your time looking, for the answers are nowhere to be found.

Is this really what we have come to? That with considerable concurrence between government and opposition, policy for perhaps the most important, but also most vulnerable, part of our economy is being made without any kind of careful evidence or analysis?

If so, these measures, however limited their apparent scale, foreshadow a future that is truly frightening: in which it isn't Stonehenge, with its timeless pillars, that the government is building, but a shaky and expensive house of cards.