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The Campbell Committee Report [Australian Financial Systems Inquiry]

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The Campbell Committee report

The well-publicised 'Campbell Committee' was set up by the Federal Government to inquire into the efficiency of the operation of the Australian financial system. The last such inquiry was conducted in 1936 when the Federal Government appointed a Royal Commission on Money and Banking.

The Committee comprised four private sector persons experienced in finance, plus one Reserve Bank officer. Its Chairman was Mr Keith Campbell, Chairman of Hooker Corporation Ltd.

The inquiry's terms of reference required the Committee to look at the structure and methods of operation of Australia's banking system, non-bank financial intermediaries, the money market, the securities industry, the Reserve Bank and other financial institutions.

Also the Committee was asked to evaluate the form and extent of Government regulation and control of the financial system.

Borrowed finance has always played an important part in farming, but more so in recent years. Consequently the recommendations of the Campbell Committee which impinge directly on the financial system will be of importance and interest to farmers.

■ Relaxed Government controls could make bank rural lending policies more flexible.

*It is this consideration that motivated the following comments on the Campbell Report ***from the Marketing and Economics Branch.***



The Committee examined three main aspects in its investigations:

- *Efficiency* of the financial system, particularly where existing areas of Government intervention significantly affected the efficiency of the system. As a result the Committee recommended that where practicable, the degree of official intervention be reduced.
- *Competitiveness* of the financial system. The Committee considered that a competitive financial system should allocate funds in an efficiently neutral fashion, with investments priced according to risk/return trade-offs.
- *Stability* of the financial system. The Committee believed that its recommendations in this area would result in a more stable, better informed and fairer financial system.

The Committee's view of the *role of Government* also has had a major influence on its recommendations. This view is reflected in the first paragraph of the Report which says "... the most efficient way to organise economic activity is through a competitive market system which is subject to a minimum of regulation and Government intervention".

Nevertheless the Committee has recognised some rationale for Government intervention. It was concerned, in particular, with the

**The final report of the Committee of Inquiry into the Australian Financial System.*

extent of Government intervention, as members felt too much regulation would hinder the competitiveness and efficiency of the financial system.

Recommendations on the bank sector

The main recommendations of the report concerned the banking sector. Banks traditionally have been the major sources of finance for agriculture. As indicated in the following table, banks at present represent almost 60 per cent of total rural institutional indebtedness, and together with State banks and the Rural Adjustment Authority represent more than 80 per cent of institutional rural indebtedness.

The Committee's main recommendations on the bank sector relevant to agriculture covered three main areas:

- regulation of the banks;
- entry into the bank sector; and
- Term and Farm Development Loan Funds.

Regulation of banks

The Committee recommended that all existing controls on banks should be abolished.

Current Government controls on banks include:

- Interest rate controls, which include maximum interest rates on overdrafts under \$100,000, savings bank housing loans, and personal loans; and the requirement that banks do not pay interest on most current accounts.
- Maturity controls which prevent banks from accepting interest-bearing deposits for periods of less than 30 days or greater than four years.
- Lending controls, which limit the growth of bank advances.
- Reserve asset controls. These are of two types. The first is a Statutory Reserve Deposit (SRD) requirement. Under this requirement banks must lodge a certain proportion of their deposits with the Reserve Bank. The second is the Liquid Assets and Government Securities (LGS) requirement. The LGS is the ratio of a bank's holdings of cash and Government securities to its total deposits. Under this requirement by agreement with the Reserve Bank,

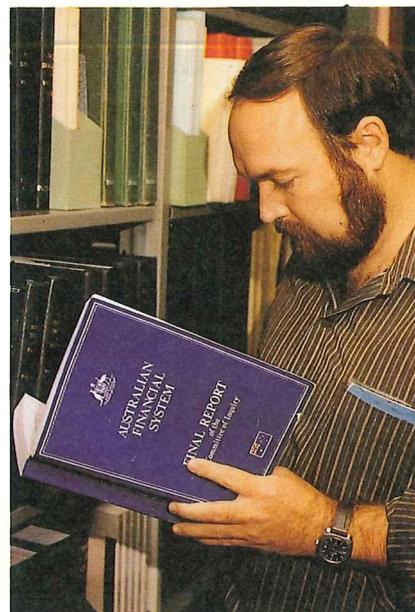
Rural institutional indebtedness				
	1971		1981	
	\$m	% of total	\$m	% of total
1. Major trading banks				
—Term loans	122	6	469	11
—Farm development loans	90	4	860	20
—Overdraft	782	37	1199	27
—Total	994	47	2528	58
2. Pastoral finance companies	333	16	325	7
3. Commonwealth Development Bank	192	9	337	8
4. Other Government agencies (incl. State banks & R.A.A.)	374	18	1057	24
5. Other	212	10	106	3
Total institutional indebtedness	2104	100	4363	100
P.I.B.A.	—	—	312	7

the banks must hold a minimum of 18 per cent of their deposits as cash and Government securities.

The Committee argued that the controls—particularly interest rate and lending controls—have encouraged depositors to place their money in non-bank institutions, thereby forcing banks to ration loans. In addition the controls have encouraged the banks to circumvent the controls by buying controlling shareholdings in other financial organisations such as finance companies and merchant banks, which either are not subject to any controls or to fewer controls. Consequently, the banks have lost some of their significance in the financial sector. Thus the extent to which the Government can control the total financial sector by controlling the banks alone is being diminished by the controls themselves.

The Committee believed that relaxing controls on interest rates would result in less stable bank and official interest rates, but was unlikely to increase the instability of other interest rates which might even become more stable. Indeed, if other interest rates did become more stable, then interest rates, on average, could be more stable than at present.

However, the Committee suggested that a form of reserve asset control—variable reserve asset ratio—should be retained. This would be similar to the current SRD requirement, but would be less flexible. Also, near-market interest rates would be paid on the deposits with the Reserve Bank.



■ Department of Agriculture economist N. F. Brown with the Campbell Committee report.

Entry into the bank sector

At present, anyone wishing to establish a bank first must obtain a licence from the Government. However, few licences have been issued since 1945—the only one in recent times being for the Australian Bank—indicating substantial disincentives.

The Committee recommended:

- Much freer entry to the bank sector by largely removing Government disincentives including relaxing the controls on the banks, repealing the Bank (Shareholdings) Act and reducing the criteria for obtaining a licence to prudential requirements only, and setting out the criteria clearly and unequivocally.
- That individuals or organisations should be able to apply for two types of licences—one to undertake the “general business of banking” and one for “specialised banks”.
- Rescinding the embargo on entry by overseas organisations. However, the Committee suggested that the rate of entry by these organisations should be carefully controlled by limiting the number of licences issued to them.

If these recommendations are implemented, and as a result the number of banks increase, competition within the bank sector should be greatly enhanced.

Term and Farm Development Loan Funds

The trading banks have provided long-term loans to the rural sector through the Term Loan and Farm Development Loan Funds since 1962 and 1966 respectively. The funds for these loans have been provided mainly from the banks' own resources, but until late 1978 were supplemented by funds released from Statutory Reserve Deposits.

The Committee recommended that the Government should not assist the banks to provide these loans through S.R.D. releases.

Recommendations on other rural financial organisations

The only other rural financial organisations on which the Committee made recommendations

were the Commonwealth Development bank, the Primary Industry Bank of Australia and the Rural Credits Department of the Reserve Bank. Apart from the Rural Adjustment Authority these are the only organisations that have any Government involvement.

Commonwealth Development Bank (C.D.B.)

The C.D.B. provides long-term loans to farmers for farm development and other purposes, generally at commercial interest rates. However, the C.D.B. is a lender-of-last-resort in that to be eligible for loans from it, applicants must have applied to other sources of funds and then have been

referred to the C.D.B. by one of those sources.

The C.D.B. differs from trading banks in that it assesses applications for loans on the basis of ability to repay the loan rather than just security and banking history.

The Committee recommended that the C.D.B. should be absorbed into the Commonwealth Bank over a period of time. It argued that following the relaxation of controls on them, banks should be able to provide the type of service to the rural community that the C.D.B. was set up to provide.

■ Farm development . . . a traditional area for farm loans . . . here featuring the blade plough. Photo R. Hann.



The Primary Industry Bank of Australia (PIBA)

PIBA was established in November 1978 as a joint venture between the Commonwealth Government, the major trading banks, and some State Government banks. PIBA is a re-finance bank. It does not lend direct to farmers, but through primary lenders such as the trading banks, State Government banks, C.D.B., and pastoral finance companies.

PIBA borrows most of its funds from the public. However, the Commonwealth has provided some funds at concessional interest rates—including some from the Income Equalisation Deposit Fund.

The Committee recommended that the Commonwealth Government should sell its shareholding in PIBA and that any assistance to PIBA should be through direct budget allocations rather than concessional loans from the Government.

Rural Credits Department

The Rural Credits Department of the Reserve Bank provides short-term loans to statutory marketing authorities and primary producer co-operatives to assist with the marketing, processing, and manufacture of primary products.

In the past, it has mainly provided funds to marketing authorities at concessional interest rates to finance 'first advance' payments on commodities such as wheat.

In view of the impact of these borrowings on the seasonability of the liquidity of the Australian financial market, and its belief that these funds could be obtained from the commercial market, the Committee recommended that the Rural Credits Department should be abolished. The Committee also suggested that if the Government wishes to assist these borrowings it should do so through direct budget allocations rather than through concessional loans.

Exchange rate policy and exchange control

A big proportion of Australia's agricultural output is exported. Consequently rural income is affected by world commodity prices and the

rate of exchange. Therefore exchange rate policy is of particular importance to rural industries.

Australia presently has a managed, flexible exchange rate, supported by a framework of exchange controls. The Australian dollar is fixed or pegged in relation to a 'basket' or group of currencies, weighted in importance mainly by the amount of trade conducted with Australia in each currency. The exchange rate is reviewed daily and adjusted by official action. This exchange rate system is often called a flexible peg.

The Committee was concerned about the flexibility of the present system, and therefore recommended a change to a more flexible system called a lightly managed float.

Under such a system the exchange rate is determined in the market and can change continuously. However, the Government can intervene (by open market purchases and sales of foreign exchange) to influence the exchange rate. The Committee also recommended the liberalisation of exchange controls to allow the foreign exchange market to become more efficient. Exchange controls take the form of restrictions on speculative transactions and capital transfers, limits to holdings of foreign currencies by residents and constraints on non-resident borrowings in domestic markets.

Implications for agriculture

Deregulation of the bank sector—especially of interest rates and maturity controls—could enable the banks to be more flexible in the types of loans and loan packages they offer. Also if liberalisation of entry requirements into the banking sector results in a greater number of banks and, hence, more competition between banks, there will be greater pressure on them to be more flexible in the types of loans and loan packages they offer.

Relaxation of the controls on banks, and the resulting increase in competition could also encourage the banks to place greater emphasis on the ability of an applicant to repay the loan and less on security and history of deposits with the bank concerned.

If this does occur, then the Commonwealth Development Bank will no longer be required. However, although the banks will be better able, and will have greater pressure on them, to be more flexible in the types of loans they offer, and to assess loans more on the basis of ability to repay, there is no guarantee that they will do this. The major trading banks have provided long-term loans to the rural sector—in the form of either Term or Farm Development Loans—since 1962. In July 1981, these were worth \$1,329 million, almost four times the lending of C.D.B. Yet so far, these banks have done little to develop any expertise in rural lending.

As a consequence, the C.D.B. should not be absorbed into the Commonwealth Bank until the banks fill the C.D.B.'s current role. While retention of the C.D.B. could hamper the rate at which banks develop better loan packages and turn to more appropriate assessment criteria, it would be preferable to removing the C.D.B., then finding that the banks were not prepared to fill the gap.

Deregulation of interest rates would result in less stable bank interest rates.

If interest rates do become less stable farmers—like other borrowers—will have to be more concerned about the size of the loans they can service, not only at current interest rates, but also at possibly higher interest rates in the future. Farmers, therefore, will need to be able to assess their ability to repay loans not only in an environment of fluctuating incomes, but also with variable interest rates—unless fixed interest rate loans become available. In addition, there will be greater need for bank managers to be better trained in rural finance and to understand the financial needs of farmers so they can assess better the ability of farmers to repay loans and to provide the best loan package for a particular situation.

Implementation of a managed float exchange rate system will mean that the exchange rate will better reflect market forces. Consequently, it may become even more volatile than at present.