Liberalisation of Foreign Investment in the Australian Financial Sector

The following article is an edited version of a paper presented at the 26th Conference of Economists by Adam Boyton, International Structural Issues Section, International and Investment Division, Treasury.

EXECUTIVE SUMMARY

This paper provides a case study of Australia's experiences with the liberalisation of foreign investment as part of broader deregulation of the financial sector.

The paper finds that the liberalisation of Australia's foreign investment regime was an important driving force in providing a competitive stimulus to the financial sector, enhancing technical, allocative and dynamic efficiency.

There were also some transitional problems as participants in the financial sector learnt to adapt to the new deregulated and competitive environment. In particular, a sharp rise in non-performing loans and write-downs during the recession of the early 1990s, which were related in part to deregulation, resulted in some exits from the sector and the re-capitalisation of other institutions — although the overall stability of the financial sector was not called into question.

Overall, the benefits of foreign investment continue to be recognised by the Australian Government. Indeed, the Government recently announced it would further relax its foreign investment policy to consider a foreign takeover of one of the four major banks.

HISTORICAL REGULATION OF FOREIGN INVESTMENT IN THE FINANCIAL SECTOR

Between 1945 and the early 1980s new foreign banking businesses and foreign takeovers of existing banks were not permitted. Three foreign banking groups operating in Australia prior to 1945, owned by the Governments of China, New Zealand and France, were permitted to continue — although the Bank of China, which had established a branch operation in Sydney in 1942, ceased operations in 1972. These banks had limited branch representation and a relatively small share of Australian banking business.

Other foreign banks, while excluded from a formal banking presence, nonetheless participated in the Australian financial sector in various ways, including through correspondent relationships with Australian banks and through local representative offices, which facilitated activities such as their offshore lending to Australian borrowers. They also provided letters of credit to support borrowings on Australian money markets and had interests in Australian merchant banks[1] and other non-bank financial institutions (NBFIs) (Committee of Inquiry into the Australian Financial System 1981 and Edey and Gray 1996).

NBFIs were not subject to the same level of regulation as banks. Prior to the 1970s, there were no general restrictions on foreign investment in these institutions.[2]

In particular, foreign investors were able to invest in finance companies, which provided consumer credit for the purchase of household goods and motor vehicles, and finance to the business sector through leasing and commercial loans (although the finance company sector had become dominated by subsidiaries of the major banks).

In 1975 the *Foreign Takeovers Act 1975* was passed. The Act, and the broader provisions of policy, provided for approval of proposals by foreign investors for investment in the Australian economy, including for the establishment of new NBFIs, or acquisitions of existing ones, where substantial net economic benefits to Australia were demonstrated; or, if the net economic benefits were small, where there was an effective partnership in ownership and control between Australian interests and the foreign investor.

GENERAL FINANCIAL SECTOR REGULATION

Banks, in particular, were subject to a high degree of regulation, stemming from a desire on the part of authorities to use the banking sector as the conduit for monetary policy. By influencing the volume of bank lending, authorities sought to affect overall financial activity. To this end direct controls were applied, the most significant being controls on the interest rates banks could offer on their deposits and charge on their loans; limits on the maturity of term deposits; requirements that they hold a certain percentage of their assets in government

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1 Merchant banks are unlicensed and may not call themselves banks. They may accept, but not solicit, deposits directly from the household sector, nor may they issue cheques. However, apart from their money market activities, they undertake a wide range of corporate finance and corporate lending activities. Merchant banks were not subject to the restrictions on interest rates which formerly applied to banks, nor to other banking regulations (including prudential regulations) and hence had a competitive advantage over banks in some areas.

2 However, in 1968 the Government prevented a foreign takeover of one of Australia's largest life insurance offices.

securities; quantitative and qualitative lending restrictions; and requirements to hold special reserves on deposit with the central bank (Harper 1991).

NBFIs were less regulated than banks and operated with a higher degree of flexibility, enabling them to steadily increase market share as a result of the regulatory advantages they enjoyed. Building societies, in particular, benefited from the provision that savings banks hold more assets in the form of government securities than housing advances (Grenville 1991). Finance companies also grew in importance, satisfying the demand for the hire purchase of household durables. In an effort to share in this growth, by the 1960s, each of the major trading banks had acquired an interest in a specialist finance company (Financial System Inquiry 1997).

DEREGULATION OF THE FINANCIAL SECTOR AND THE LIBERALISATION OF FOREIGN INVESTMENT

In the early 1980s, inquiries into the Australian financial system recommended deregulatory measures to promote competition between existing banks and increase the efficiency of the financial system.

The Campbell Committee (1981)[3] doubted that the level of competition in banking was adequate to ensure maximum efficiency and maximum benefits for all consumers of banking services. It considered that Australian banks conducted relatively high cost operations (by international standards) and that some of those costs had emanated from the complex set of financial system controls.

To help promote increased competition in the financial sector, the Campbell Committee recommended a liberalisation of foreign investment policy in the financial sector, arguing that domestic institutions would be unable to provide as much competitive stimulus in the short term as the introduction of foreign banks. The Committee noted that:

- the number of licensed banks was small and declining;
- domestic institutions had traditional management attitudes; and
- the size and cost advantages of existing banks represented barriers to entry.

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3 The Committee of Inquiry into the Australian Financial System (the Campbell Committee) was established by the Government on 18 January 1979. Its final report, ***Australian Financial System Inquiry Final Report*** was received by the Government on 29 September 1981. The Campbell Committee also produced an interim report in 1980.

In contrast, the Committee considered that foreign banks could provide an effective competitive stimulus (particularly in the short term) as they:

- already had the resources and banking experience (especially in international trading and foreign exchange dealing) necessary to establish wide-ranging banking businesses in Australia;
- were often operating non-bank financial intermediaries in Australia, and thus, like many large non-bank financiers, faced lower economic barriers to entry than some other domestic entrants who were not currently in the financial sector;
- had internationally recognised standing as banks and should readily command the confidence of the Australian community; and
- were less likely to be deterred by risks and uncertainties, and possibly less than average profit levels, associated with early establishment years.

The Committee also felt that the entry of foreign banks would quicken the pace of integration between Australian and overseas capital markets; and that the introduction of foreign banks and the move toward a more competitive environment should present only minimal disruptions to banking operations, provided the rate of entry was carefully controlled. However, it considered that unrestricted entry of foreign banks could be disruptive as it might result in undue fragmentation of the financial system; over-aggressive competition; and a socially unacceptable loss of resident ownership and control.

The Martin Committee (1984)[4] broadly supported the proposals of the Campbell Committee regarding the entry of foreign banks. It considered that 'additional foreign participation in banking, albeit subject to specific limits, would be beneficial to the Australian community'.

The Government responded to these calls for increased liberalisation of foreign investment regime in the financial sector by inviting applications from domestic or foreign interests for a limited number of banking authorities in September 1984; and subsequently authorising fifteen foreign banks to commence operations in February 1985.

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4 The new Government commissioned a report on the Australian financial system on 29 May 1983. This report was to have regard to the Committee of Inquiry into the Australian Financial System (the Campbell Committee), the Government's economic and social objectives and the need to improve the efficiency of the financial system. The Government received the report, *Report of the Australian Financial System Review Group* (the Martin Report) on 21 December 1983.

Foreign investment policy governing the financial sector has been further liberalised since 1985:

- in 1986, the Government announced that investment in non-bank financial intermediaries would be approved unless considered to be contrary to the national interest (Foreign Investment Review Board 1996);
- in 1992, the Government stated that it would permit the issue of new banking authorities to foreign owned banks to operate branches in Australia, subject to certain conditions. These conditions included some restrictions on the acceptance of retail deposits by foreign bank branches; that the Reserve Bank was satisfied the bank and its home supervisor were of sufficient standing; and that the bank agreed to comply with certain Reserve Bank prudential supervision arrangements. Limits on the number of new banks that could be established were also removed in the same year, as was the restriction precluding foreign banks from bidding for the smaller Australian banks (that is, with the exception of the four major domestic banks) (Foreign Investment Review Board 1996); and
- in April 1997, the Government announced, in its initial response to the Final Report of the Financial System Inquiry (1997),[5] that it had decided to remove the blanket prohibition on a foreign takeover of the four major banks. Any proposed foreign takeovers or acquisitions would be assessed on a case by case basis on its merits in accordance with the Foreign Acquisitions and Takeovers Act. However, the Government also indicated that it would continue to apply the principle that any large scale transfer of Australian ownership of the financial system to foreign hands would be contrary to the national interest (Costello 1997a).

The Current Stance of Foreign Investment Policy

Australia has been an attractive destination for foreign investment reflecting, *inter alia:* a stable political environment; sound macroeconomic management; a well-qualified labour force; and a stable regulatory and policy framework.

> 'The Government's foreign investment policy is framed and administered with a view to encouraging foreign investment in Australia and ensuring that such investment is consistent with the needs of the community. The Government recognises the substantial contribution foreign investment makes to the development of Australia's industries and resources. Capital from other countries supplements domestic

5 The Financial System Inquiry (the Wallis Inquiry) was established by the Government in 1996 to review developments in the Australian financial system since deregulation, to consider the factors likely to drive further change, and to make recommendations for possible further improvements to the regulatory arrangements. The Inquiry presented it final report to the Government on 18 March 1997. The Inquiry also released a discussion paper in November 1996.

> savings and provides scope for higher rates of economic activity and employment. Foreign direct investment also provides access to new technology, management skills and overseas markets.' (Foreign Investment Review Board 1996).

Except for investment in specific sectors[6] the Government raises no objections to foreign investment proposals unless they are contrary to the national interest.

Foreign investment in the banking sector needs to be consistent with the *Banking Act 1959,* the *Banks (Shareholdings) Act 1972* and banking policy, including prudential requirements (Foreign Investment Review Board 1996). That is, foreign owned banks are subject to the same regulatory requirements as Australian owned institutions.

The Government permits the issue of new banking authorities to foreign owned banks, subject to prudential and competition considerations. These include that: the Reserve Bank is satisfied the bank and its home supervisor are of sufficient standing; the bank agrees to comply with the appropriate Reserve Bank prudential requirements; and the foreign bank expects to make a worthwhile contribution to banking services in Australia, and not merely add to the number of banks in the country.

Since 1986, foreign investment proposals relating to NBFIs have been approved unless considered contrary to the national interest.

Broader Financial Sector Deregulation

Along with liberalising foreign investment, broader deregulatory initiatives were also undertaken to improve the efficiency and competitiveness of the financial sector and to make Australian capital markets more internationally integrated and competitive.

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6 These specific sectors include real estate; civil aviation; shipping; the media (including broadcasting, newspapers and telecommunications) and banking.

THE EXTENT OF FOREIGN INVESTMENT IN THE FINANCIAL SECTOR

Following the liberalisation of Australia's foreign investment regime, the level of foreign investment in the financial sector has risen, as Table 1 shows.

Table 1: Level of Foreign Investment in the Financial Sector (end-June 1978 and end-June 1996)

	Total sector assets		Assets controlled by foreign owned institutions		Share of assets controlled by foreign owned institutions	
Category of Institution	$ billion		$ billion		per cent	
	1978	1996	1978	1996	1978	1996
Banks	44	483	3	70	7	15
Building Societies and Credit Unions	10	28	0	0	0	0
Merchant Banks	4	59	2	56	62	94
Authorised Dealers	2	4	0	4	22	100
Finance Companies	17	49	6	18	34	37
Other NBFIs	2	20	0	3	0	16
Life Companies	12	127	2	45	13	36
Non-Life Superannuation	9	154	0	42	0	27
Managers for Public Unit Trusts	-	55	-	23	-	42
General Insurance	6	58	2	18	33	31
Friendly Societies and Common Funds	-	13	-	0	-	0
Total Financial Sector Assets controlled by Foreign Institutions (per cent)					14	27

- data not available.
Sources: *Financial System Inquiry Final Report* (1997); *Australian Financial System Inquiry Interim Report* (1980) and Reserve Bank of Australia.

Foreign investment is greatest in the banking and merchant banking sectors, with substantial foreign investment also in life offices and non-life superannuation.

Merchant banking continues to have a high degree of foreign ownership of assets, reflecting, *inter alia,* a history of foreign control given the limited regulation of the merchant banking industry compared with the rest of the financial sector.

The share of banking assets under foreign control remains fairly low. This reflects the dominance of the 'big four majors' that, until recently, foreign investors have been precluded from acquiring. The 'big four majors' represented almost 80 per cent of banking sector assets at 30 June 1996. In addition, rationalisation among regional banks may have tended to limit the scope for significant levels of foreign investment in that part of the banking sector; although, in 1995 the Bank of Scotland purchased a 51 per cent stake in the Bank of Western Australia.

Table 2 shows the number of authorised foreign banks in Australia. It indicates that the 1985 and 1992 regulatory changes facilitated a significant expansion in the number of these institutions.

Table 2: Authorised Foreign Banks in Australia

	1984	1986	1988	1990	1992	1994	1996
Branches	2	3	3	3	3	8	17
Subsidaries	0	15	15	15	14	13	13
Total	2	18	18	18	17	21	30

Source: Reserve Bank of Australia.

THE PERFORMANCE OF THE FINANCIAL SECTOR SINCE DEREGULATION

Increased competition in the financial sector since deregulation, (including through the introduction of foreign institutions) has provided an impetus for domestic institutions to increase:

- technical efficiency (that is, outputs being produced at the lowest possible cost, using the minimum amount of inputs);
- allocative efficiency, or the extent to which prices reflect costs and funds are allocated to their best uses across the economy; and
- dynamic efficiency (representing the extent of innovation in the financial sector).

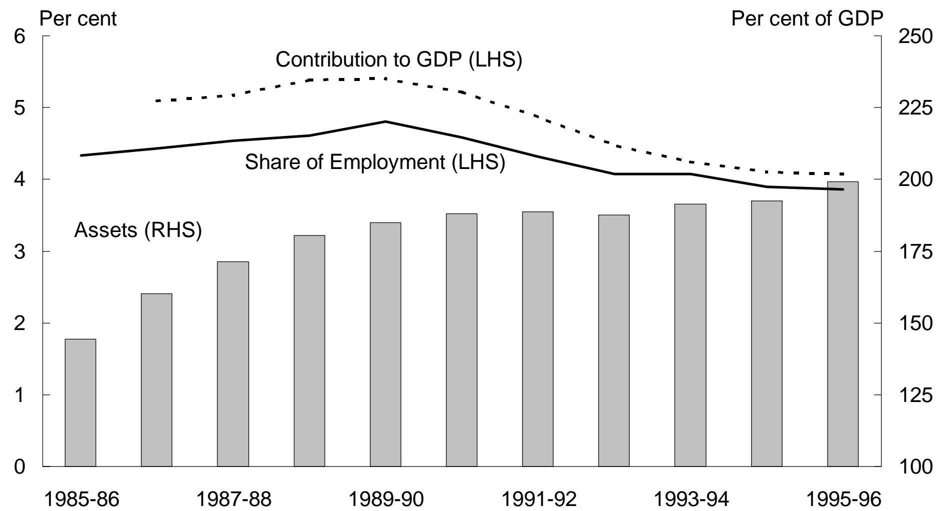
Technical Efficiency

There is evidence that the technical efficiency of the Australian financial sector has improved since deregulation, although international benchmarks suggest that there remains scope for further improvements.[7]

In addressing the question of improved efficiency in the financial sector since deregulation, the Financial System Inquiry (1996) noted that, notwithstanding the rise in financial assets as a share of Gross Domestic Product (GDP), the contribution of the financial sector to GDP has been declining (see Chart 1).

7 Data prepared for the Financial System Inquiry (1997) by the Reserve Bank covering the banking sector show that on international comparisons of price competitiveness, Australian interest margins are relatively high, while non-interest income is relatively low. In aggregate, overall banking sector revenue is at the 'high end of middle', while profitability is similar to comparable banks overseas. This conclusion does not; however, mean that the efficiency of the financial sector has not improved since deregulation, just that further improvements may still be possible.

Chart 1: Employment and the Contribution of the Financial Sector to GDP



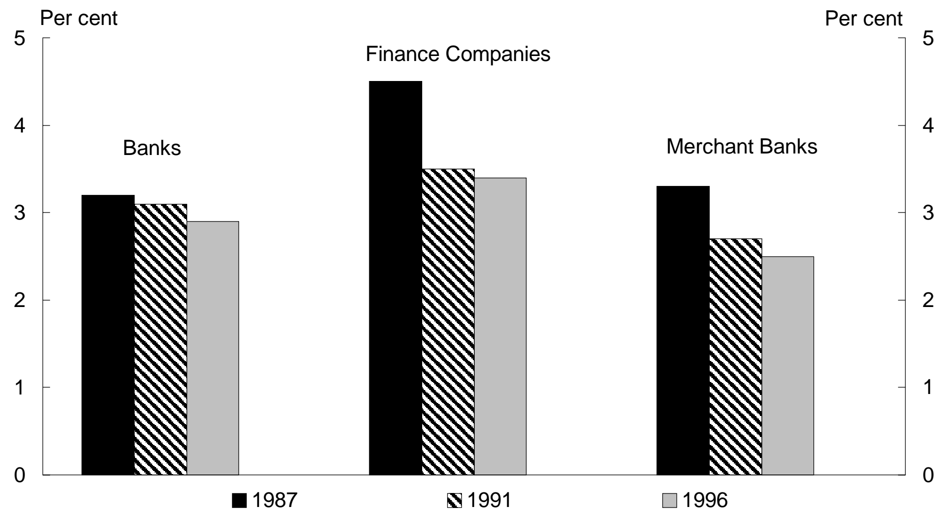
Sources: *Reserve Bank of Australia Bulletin*; ABS Cat. Nos. 5206.0 and 6248.0.

That is, the financial sector has been managing a greater amount of assets with fewer resources. The Inquiry found that these declining costs are primarily due to lower employment in the financial sector, driven by technological restructuring and enhanced efficiency.

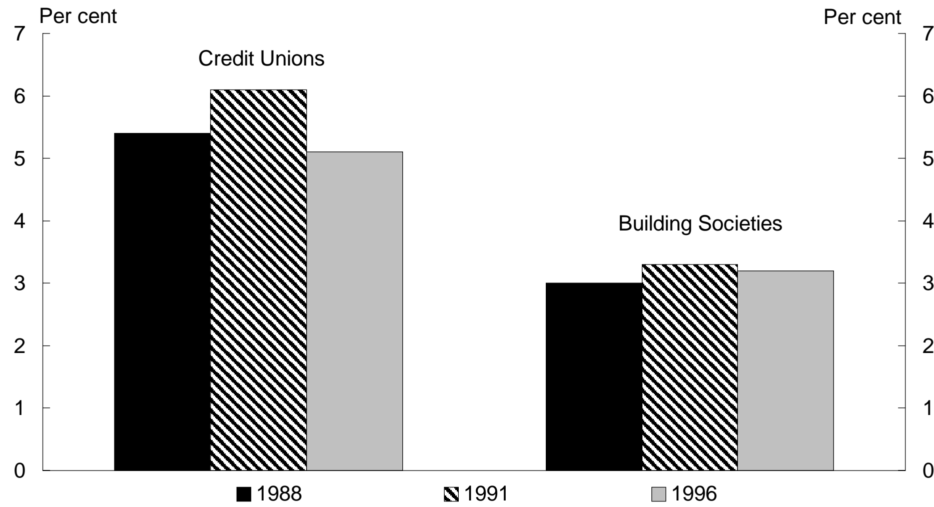
Increased competition in the financial sector (including through the introduction of foreign banks) has provided an impetus for domestic institutions to become more technically efficient, by reducing their costs of production.

Data from the KPMG survey on financial institutions performance (see Chart 2), show that over the period 1987 to 1996, the ratio of operating expenses to assets has fallen for banks, finance companies and merchant banks. The ratio of operating expenses to assets for credit unions also fell over the period 1988 to 1996, while the ratio for building societies increased — although the exit of many of the larger, more efficient institutions to become banks may have distorted the survey results (Financial System Inquiry 1997).

Chart 2: Ratio of Operating Expenses to Assets
Panel A



Panel B



Source: KPMG (1997).

Allocative Efficiency

Allocative efficiency can be enhanced by costs to consumers (that is, fees and charges imposed by financial institutions) reflecting the underlying costs of providing services (for example, through reducing the extent of cross-subsidies). By more closely equating prices and marginal costs, resource allocation can be improved.

One of the expected outcomes of financial deregulation was that there would be a reduction in banks' internal cross-subsidies that allowed some customers to access goods and services for less than their marginal cost, while others subsidised that consumption. Since deregulation, it is fairly clear that pressure on banks to relate their fees and charges more closely to the true costs of providing services has increased (Harper 1991). The increasing prevalence of fees and charges on retail banking accounts has reduced the extent of cross-subsidisation (and hence an inefficient allocation of resources) — although there is still some way to go, as less than 15 per cent of the costs of providing retail transaction accounts is offset through the collection of fees and charges (Prices Surveillance Authority 1995). Outside the retail banking sector, the Financial System Inquiry (1997) found that stockbroking commissions and bid and ask spreads (that is, the difference between buying and selling prices, in effect, a dealer's commission) in the money market and foreign exchange markets have fallen.

There is also evidence of improved allocative efficiency in the life insurance industry due to:

- a reduction in the ability of the larger players to cross-subsidise across products by the entry of niche insurers into the most profitable product markets;
- price competition coming from other parts of the financial sector that offer competing investment products;
- increased disclosure of fees and commission; and
- the trend towards unbundling of the risk and investment components of life insurance products making the returns on the investment component more comparable and transparent (Department of the Treasury 1996).

However, overall reductions in cross-subsidies have been fairly limited, although their incidence has fallen in recent years as larger institutions respond to niche competitors (such as mortgage originators — specialist institutions that only offer mortgages, raising funds on wholesale markets rather than through deposit taking).

Dynamic Efficiency

Dynamic efficiency refers to the extent of innovation and the speed at which new developments are adopted by firms. While much of the evidence in this area is anecdotal, some of the product development and innovation in the financial sector since deregulation is highlighted in Table 3. There had been some degree of innovation prior to deregulation; however, the extent to which institutions, particularly banks, could innovate with respect to pricing, for example, was limited.

Table 3: Product Innovations since Deregulation

1980-85	1985-90	1990-96
Card-access savings accounts	EFTPOS	Mortgage originators
PIN for debit and credit cards	ATM network linkages	giroPost
ATMs became widely available	Telephone banking	Financial EDI
Variable repayment home loans	Cash management accounts	Mortgage offset accounts
Monthly income term deposits	Housing bonds	Smart card trials
First cash management trusts	Equity and fixed rate mortgage loans	Mobile lending
Compounding term deposits	Home/personal computer banking	Mobile EFTPOS (taxis)
Daily interest cheque account	Payroll system	Equity participation in SMEs
VISA and MasterCard	Increasing derivatives trading	International ATM linkages
Automatic sweep facilities		

Source: Financial System Inquiry (1997).

The impact of foreign banks in promoting product innovation and development has been significant in a number of areas.

In retail banking, examples include the payment of interest on current accounts and improvements to credit card facilities by the foreign banking sector which were quickly taken up by Australian banks (Edey and Gray 1996). Foreign banks were often leaders in introducing electronic banking, providing more flexibility in business accounts and introducing revolving lines of credit secured against mortgages.

The main impact of foreign banks has been in the wholesale market, including merchant banking activities. In aggregate, the relative contributions of foreign banks to the foreign exchange market, the derivatives market and funds management are much greater than their share of assets (Fraser 1994). Foreign banks account for just over half the turnover in Australian foreign exchange markets and in the markets for interest rate derivatives. Foreign banks are also market leaders in various financial markets — they have pioneered new products (for example, binary options) and are the only significant suppliers of some specific financial services (for example, spot foreign exchange markets for currencies such as the Malaysian Ringgit and the Thai Baht).

Foreign bank entry has also resulted in improved access to international capital markets (Fraser 1994). The local operations of foreign banks have stimulated and facilitated the provision of funds from associated financial institutions overseas to companies and governments in Australia. Moreover, having important global financial institutions operating in Australia makes it easier for Australian companies and governments to issue securities on international capital markets and to use swaps.

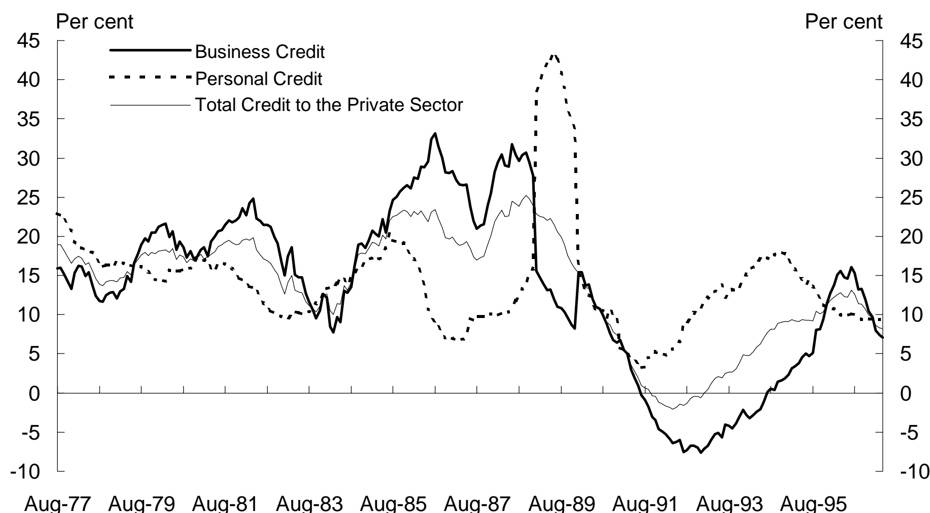
PRUDENTIAL ISSUES

While the Australian financial sector has a good track record for stability and reliability, deregulation of the financial system was associated with transitional problems that developed as financial intermediaries, consumers and businesses learned to operate in the new environment.

Growth in Credit

Although it had been hoped that deregulation would increase the availability of credit and enable banks to take on more risk, the very strong growth in credit extended to the business sector that followed deregulation (see Chart 3) was unexpected (Macfarlane 1991).

Chart 3: Growth in Credit Extended to the Private Sector by Financial Intermediaries



Source: *Reserve Bank of Australia Bulletin*.

Underlying this rapid expansion in credit were a number of demand and supply side factors.

Supply Side Factors

On the supply side, the resources available in the financial sector increased significantly over the period 1983 to 1988, with the amount of capital in the sector rising from $4.5 billion in 1983 to $20 billion in 1988. Over the same period, the number of banking groups operating in Australia rose from 15 to 34, while the number of merchant banks increased from 48 to 111 (Macfarlane 1991).

The introduction of new institutions (including foreign banks) and the significant increase in financial sector resources explains some of the rapid

growth in credit over the 1980s. It could also raise the question of whether too many new banking licences were issued.

Demand Side Factors

In Australia, along with much of the rest of the world, the level of corporate gearing increased significantly over the 1980s (Table 4). Underlying this trend in Australia was a rise in the number of highly leveraged corporate takeovers over 1984–87, while credit growth post 1987 was driven, *inter alia,* by the property boom. Contrary to popular perceptions, the increase in gearing was not just confined to more aggressive entrepreneurial companies, but was widespread (Macfarlane 1991).

Table 4: Credit by Sector (per cent of GDP)

		Business	Housing	Personal	Total
Australia	1980	26	18	10	54
	1990	58	20	12	90
United States	1980	52	40	14	106
	1990	64	54	15	133
United Kingdom	1980	18	20	3	40
	1990	42	48	8	97

Source: Stevens (1991) cited in Macfarlane (1991).

Declining Credit Standards

The combination of demand and supply side factors contributed to a general decline in credit standards. Other factors behind the decline in credit standards included inadequate risk assessment and monitoring of borrowers' financial situations (Reserve Bank of Australia 1990). Some of these deficiencies could be traced back to the former quantitative credit restrictions, under which banks did not have to judge credit risk to the same extent as they did under the new regime (in the regulated environment where the amount of credit they could extend was fixed, banks only lent to their safest customers).

As interest rates rose over the late 1980s, the fall in credit standards began to manifest itself in significantly higher levels of non-performing loans and write-downs, resulting in the re-capitalisation or takeover of some State based banks, and the closure of some NBFIs.

- The State Bank of Victoria was acquired by the Commonwealth Bank in 1991 following significant losses by its merchant banking subsidiary; while the Government of South Australia had to provide its State Bank with a substantial equity injection.

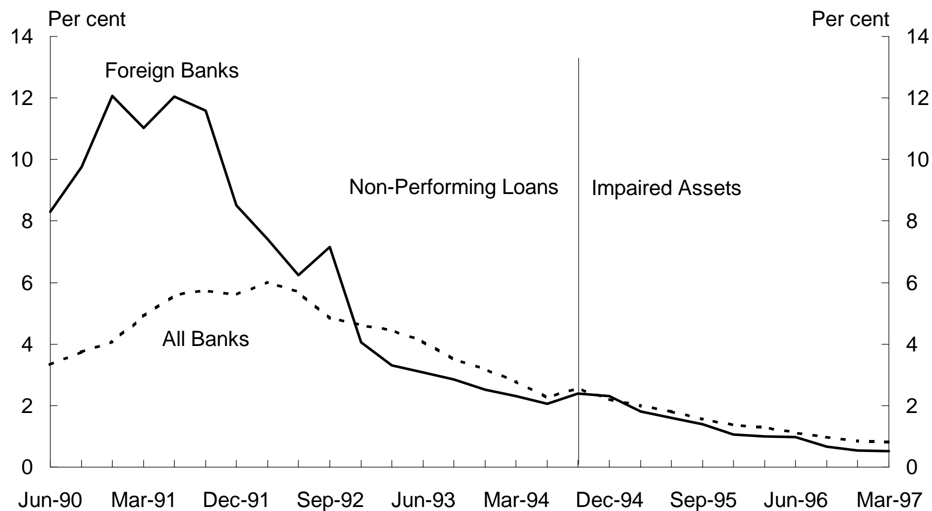
- Among the NBFIs, a Victorian based building society (Pyramid), a friendly society (OST) and a fund manager (Estate Mortgage) either collapsed or went into liquidation.

Losses flowing from non-performing loans and write-downs were not just restricted to State banks and NBFIs. As Chart 4 shows, foreign banks, along with domestic banks, were also carrying a significant level of non-performing loans during the recession of the early 1990s. The share of non-performing loans to total assets reached 12 per cent for the foreign bank sector in 1990-91, three times the average for the system as a whole (Fraser 1994).

The higher proportion of non-performing loans in the foreign bank sector, notwithstanding the experience of their parent institutions, suggests that the actions of the domestic banks in protecting market share might have contributed to foreign banks taking on riskier business. The domestic banks began reacting to the possibility of competition from foreign banks well before deregulation and foreign investment liberalisation, through mergers and acquisitions in the early 1980s. Domestic banks also sought to protect their position by competing vigorously for market share (Grenville 1991 and Fraser 1994). However, with the benefit of hindsight, this may have been an over-reaction. The significant advantage of large customer franchises and extensive branch networks enabled the domestic banks to maintain their retail businesses following the entry of foreign banks (Edey and Gray 1996), resulting in the new institutions competing almost exclusively in the business lending and wholesale sectors.

The nature of the supply side factors might also raise issues relating to how foreign investment liberalisation and financial sector deregulation were managed. It could be argued that staging or limiting the introduction of foreign banks might have proved more effective, through both limiting the resources available to the financial sector and reducing the extent of domestic banks' reaction to the competition posed by foreign institutions.

Chart 4: Non-Performing Loans/Impaired Assets as a Percentage of Total Assets



Source: Reserve Bank of Australia.

Nevertheless, the problems of the early 1990s did not threaten the broader stability of the financial system. They did, however, serve to reinforce the need for appropriate prudential standards and the importance of vigilance on the part of regulators and institutions themselves. Recent years have seen a return to more sustainable levels of credit growth and a significant decline in the extent of impaired assets.

OBSERVATIONS

While the introduction of foreign banks and the liberalisation of foreign investment policy has, on balance, been a positive experience, some transitional issues did arise.

The removal of quantitative restrictions on the provision of credit by banks, coupled with the fact that foreign banks tended to concentrate on business lending, did lead to lax credit standards in the provision of business credit.

The effects of this became fully apparent in the recession of the early 1990s as write-downs flowing from lax credit standards during the 1980s increased significantly, requiring the re-capitalisation of some institutions and the exit of others. Nonetheless, the overall stability of the financial system was not threatened — although the experience did serve to reinforce the objectives underpinning the changes in prudential standards implemented in the late 1980s. The appropriate prudential regime for the financial sector has also been an important element of the recent Wallis Inquiry.

There is little doubt that the entry of foreign banks provided a spur to competition. The threat of competition was sufficient to stir the domestic banks to considerable activity (in particular, mergers and acquisitions in the early 1980s), even before the foreign banks arrived (Grenville 1991 and Fraser 1994). However, the important advantage of large customer franchises and extensive branch networks enabled the major Australian banks to maintain their retail businesses against foreign banks (Edey and Gray 1996).

While the outcomes might not have been exactly what was predicted, this is not the benchmark by which the policy changes should be measured. Rather, the focus should be on how the system has developed and how it compares to that that existed in the pre-deregulation period. Given that focus, the evidence suggests that the Australian financial sector has become more efficient, more dynamic and more internationally integrated.

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