Competition in banking: level playing field needed

BANKING has been going through a period of rapid and profound changes, including new technological capabilities for processing and transmitting data, the growing interdependence of economies and interpenetration of financial markets, and the breaking down of barriers between financial institutions. To shed more light on these developments and their implications for policy, the Committee on Financial Markets of the Organisation for Economic Co-operation and Development (OECD) has carried out an extensive enquiry into banking structures and regulations in the OECD countries. The enquiry covers six areas:

(a) The internationalisation of banking.
(b) Banking and electronic fund transfers.
(c) Banking and monetary policy.
(d) Prudential supervision in banking.
(e) Asset and liability management.
(f) Competition in banking.

OECD has now published a report, *Competition in Banking,* prepared by Mr G. Broker, head of the Financial Markets Division of OECD, with the assistance of national experts. Following is a summary of the report.

The competitive structure of the markets for financial services has undergone profound changes since the early 1960s. The pace and scope of structural changes affecting competition in these markets, notably as regards institutional features of the supply side, have considerably increased since the mid-1970s or so under the impact of an accelerating and self-reinforcing process of domestic financial deregulation and international liberalisation, a much more volatile national and international economic environment and rapid advances in telecommunication and computer technologies.

Retail banking has become a most important sector within the financial services industry in OECD countries. Product competition has become particularly sharp in the markets for household savings as this large and ever-increasing pool of investable funds has attracted an increasing number and a widening range of competitors from inside and outside the banking system.

One feature of the retail markets has been that the rise in incomes and wealth has meant a considerable improvement in the household sector's debt service capacity which has increased the scope for household sector borrowing. For example, household sector debt as a percentage of liabilities of all domestic non-financial sectors increased between 1960 and 1984 in Australia from 22.3% to 32.1%, in Japan from 15.9% to 22.5% and in the United States from 29.1% to 33.7%.

'Surge in demand for loans'

The 1960s and 1970s saw a considerable surge in demand for housing loans for the construction and acquisition of owner-occupied houses and dwellings, including secondary residences. Not all countries were affected by the boom in consumer loan and housing loan activity in the same way. Differences in the level of income and wealth played a considerable role in explaining country differences in this field. In some countries demand for housing loans was particularly strengthened by public policy designed to promote private home ownership. In other countries housing loans were restricted in the context of structural economic policy designed to promote industrial development and the growth of export industries as a matter of high priority.

Initially, those types of financial institutions which traditionally had close links with small savers, such as savings banks and building societies, benefited most from the expansion of private income and financial wealth. Larger commercial banks often reacted at a later stage. In some countries commercial banks were prevented from moving massively into the retail market through both branching restrictions and controls on interest rates applying to retail deposits.

Australia illustrates the position well. Between 1960 and 1970 the balance sheets of "other deposit taking institutions" increased by 10.3% per year compared with 7.2% for commercial banks; between 1970 and 1980 the other deposit taking institutions had the edge with a 16.9% growth rate compared to 14.5%; however, between 1980 and 1984 commercial banks showed a 22.6% growth rate compared with 13.5% for other deposit taking institutions. Canada, Japan, the Netherlands and Sweden show the same pattern.

One paragraph concentrates particularly on competition in the

46 →

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housing finance sector. This is reproduced in full in the accompanying box.

Financial policy in OECD countries has increasingly focused on the objective of improving the efficiency of the financial system without, however, neglecting the objectives of ensuring the stability and soundness of the financial system and maintaining an adequate level of investor protection. A wide variety of measures has been taken, including:

(a) Deregulation of interest rates and fees and commissions for financial services and prohibition of cartel arrangements.
(b) Increasing the number of competitors through providing more scope for de-specialisation and diversification and by removing obstacles to the domestic and cross-border expansions of banking networks.
(c) Increasing investor and borrower choices through encouraging the creation of a wide range of new financial assets and debt instruments.
(d) Removing obstacles to free lending and investment decisions of banks and other institutions by abolishing or easing direct lending controls and mandatory investment regulations.
(e) Improving the visibility of financial service markets through better information.
(f) Forestalling the anti-competitive concentration movement in banking and finance by merger and ownership control.

It is widely accepted in OECD countries that free price competition in the financial services markets has a favourable impact on the functioning of the financial system and on the allocation of resources. Supporting the general trend towards despecialisation by widening the range of permissible activities and products of financial institutions has been increasingly accepted as a policy approach towards promoting competition and hence improving the efficiency of the financial sector. Formerly highly specialised financial institutions have thus been enabled to seize more flexible and dynamically new business opportunities.

It is accepted that a number of conditions need to be fulfilled to ensure that market forces work properly and that competition is maintained at an appropriate level. These include:

(a) Competition should take place on a level playing field, that is, market participants should compete on equal terms and conditions so that there is equality of competitive opportunity.
(b) Competition should be subject to agreed rules of the game.
(c) Club arrangements should not give rise to anti-competitive practices and co-operation agreements.
(d) Anti-competitive effects of concentration and dominant positions of market participants should be avoided. ■

Competition in Banking, OECD, 1989.

Competition in housing finance

HOUSING finance is an area which in many countries has been subject to considerable government intervention designed to promote social housing, to facilitate access of families to private home ownership, or to improve the mechanisms for channelling more savings into the housing sector generally. Moreover, the scope for competition in this segment of retail banking has been subdued in many countries. Nevertheless, in those segments of the housing finance markets in which market forces have been allowed to play a role, increased competition, often stemming from commercial bank entry into the housing loan market, has resulted in wider choices available to private customers as regards suppliers, financing techniques and instruments and has led in some countries also to a conspicuous reduction in borrowing costs. Particularly noteworthy is the proliferation of innovations in housing finance that was experienced in countries in which high and volatile rates of inflation and interest rates created considerable problems for the debt service capacity of private households. Loan characteristics designed to bring the time path of debt service payments more in line with the expected time profile of private household income received special attention. Another area of noteworthy improvement concerns the administrative procedures connected with housing finance operations and with changes in house ownership and a related transfer of debt to the buyer. Banks have increasingly offered special services which simplify such procedures for the customer, notably if various sources of housing finance such as employer loans, and first and second mortgage loans are involved. Thus, a policy of more reliance on market forces, ie on private institutions' initiatives and innovative skills, has, on the whole, led to an increase in the availability of funds for housing finance purposes and an improvement in the quality and convenience of related services.