Political furore over Australian government’s bank guarantee

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Just a week after the Australian government announced plans on October 13 to guarantee bank deposits, an extraordinary political furore erupted in parliament and in the press over the terms and conditions. The events last week have shone a little light on the way in which the government and state bureaucracy have made available huge sums of public money to shore up the country's largest institutions and wealthy elites.

The divisions that emerged last week were in marked contrast to the near universal support in the political and media establishment when Prime Minister Kevin Rudd and Treasurer Wayne Swan announced the measure. Amid growing nervousness about the stability of the banking system, there was not a whisper of criticism as the government provided banks with an open ended guarantee for all deposits and overseas borrowings to the extent of more than $2 trillion.

The uproar broke out last Tuesday with a frontpage lead in Rupert Murdoch's *Australian* accusing the government of failing to heed Reserve Bank warnings that a blanket guarantee was leading to "serious dislocation in the entire financial system". The opposition Liberal Party and its parliamentary leader Malcolm Turnbull, a former merchant banker, jumped on the bandwagon, lambasting Rudd and Swan for incompetence and demanding the tabling of the correspondence. When Rudd declared that Treasury had reassured him that the Reserve Bank supported the scheme, Turnbull asked if Treasury Secretary Ken Henry would be sacked if that proved to be false.

In unprecedented scenes last Wednesday, opposition politicians in the Senate estimates committee subjected Henry to an eight-hour grilling on the bank deposit scheme and an associated $10 billion stimulus plan. At one point, it appeared that treasury secretary could be found in contempt of parliament when he refused point blank to divulge details of his correspondence with Reserve Bank Chairman Glenn Stevens. A treasury official half jokingly offered Henry a small toothbrush for a possible trip to jail.

An exasperated Henry told the committee that he "would not normally entertain questions such as this one, and in my 24 years of appearance before committees never have". The Treasury chief also declined to answer questions on the structure of the guarantees, saying consultation was still proceeding with the finance industry. "In my view, it would be better if we had not had any media reporting of this issue," he said. Henry categorically declared that the *Australian* article had been wrong, prompting Murdoch's newspaper to publish Stevens's advice from October 17 in its pages the following day.

The Labor government was left scrambling to put a lid on crisis, accusing the opposition of jeopardising the country's financial institutions and promising to finalise a fee structure for the bank guarantee that would end the "market distortions". As the debate continued in parliament last Thursday, Rudd accused Turnbull of "recklessness". Treasurer Swan promised to work out details of the deposit scheme, adding: "This is where the Opposition really do not get it; this material is commercially sensitive."

The material is not only commercially but politically sensitive. From the outset, the Labor government has sought to ensure that no public discussion take place over the way in which the profits of the major banks have been guaranteed even as ordinary working people face the prospect of losing their jobs, their homes, and superannuation funds. Last week's uproar provided a revealing insight into the process.

Firstly, the government, Treasury and the Reserve Bank were all thrown into crisis by the threat of a global financial meltdown. Even as Rudd and Swan reassured the markets that Australian banks were sound, one country after another was announcing guarantees on bank deposits that threatened a run on Australian institutions. After toying with a limited guarantee for deposits up to $20,000, the government and its advisers rushed to announce its unlimited plan in a state of panic.

The unanimous initial support for the scheme had one purpose: to ensure that the public would be kept in the dark about its implications. No one asked the obvious questions. What would happen if this unlimited guarantee was called upon in the event of a major bank collapse or collapses? Where would the money come from to pay the tens or hundreds of billions of dollars involved? The government has provided the banks with an open-ended guarantee that the public purse will bail them out. Any costs will inevitably be imposed on ordinary working people in the form of higher taxes and savage cutbacks to social spending.

None of the commentators even hinted that the government was setting the stage for massive bank bailouts. Instead media attention focussed almost exclusively on a $10 billion stimulus package involving one-off handouts to retirees, carers, low-income families and home buyers designed to provide an immediate boost to consumer spending and slow the slide into recession. The package was no more than window-dressing, however, designed to demonstrate the government's largesse to the poor even as it offered to bail out the country's largest financial institutions potentially to the extent of trillions of dollars.

Market dislocation

All that changed last week. What prompted the *Australian* and the parliamentary opposition to act were powerful financial interests. It was rapidly becoming clear that the guarantee to the banks was disadvantaging institutions outside the banking system as panicked investors switched their funds to safer havens. As Stevens explained: "The problem we face is that the sudden (and substantially irrational) demand for guaranteed instruments is creating—or is about to create—serious dislocation in the financial system."

Investment funds not covered by the bank guarantee began to freeze redemptions. Three of Australia's largest financial institutions—Perpetual Ltd, AXA Asia Pacific and Australian Unity—suspended payments on some investors' funds, following Challenger Howard, the country's biggest mortgage fund, which froze redemptions earlier in the week. According to various estimates, about 32 property and mortgage funds have now suspended funds totalling between $15 billion and $20 billion, cutting off payments to up to 180,000 investors, large and small.

The Australian Financial Markets Association (AFMA), which represents many of the funds, warned of wider repercussions if its members collapsed, saying they had about $400 billion invested in liquid assets, such as bank bills, certificates of deposit and cash. The AFMA claimed that foreign banks with local branches not included in the government's guarantee, had also bled "hundreds of millions of dollars" in the past two weeks.

Paradoxically, the decision to provide a government guarantee to one part of the banking and financial system has exposed its vulnerability as a whole. The international financial crisis and rapid plunge towards global recession foreshadows a massive shakeout that will lead not only to the collapse of weaker institutions but the consolidation of the stronger ones. The guarantee potentially gives the major banks an enormous advantage over rival non-banking institutions in attracting worried investors.

Several of the non-bank operators had already frozen funds well before the guarantee plan, under the pressure of the global credit crunch and property market slump that began with the US sub-prime crisis in mid-2007. *BusinessSpectator* columnist Stephen Bartholomeusz observed: "And, the moment the guarantees were announced, there were inevitably going to be unpleasant and unavoidable knock-on effects for those institutions and entities outside the boundaries of the guarantees."

Even among the "big four" banks—Westpac, Commonwealth, National Australia and ANZ—signs of weakness have emerged, with ANZ announcing a 21 percent drop in full-year profits last Thursday due to a sharp rise in bad debt charges as a result of the global credit crunch. Referring to bank collapses around the world, ANZ Chief Executive Mike Smith warned that a new financial services industry paradigm would emerge from what he described as "much worse than Armageddon."

As pressure mounted last week from the non-banking sector, the Rudd government announced that it intended to charge a fee to banks for providing the government guarantee on large deposits. The imposition of a fee on the banking sector might encourage investors to look for high rates of return from other institutions. How high the fee was set, at what level it would cut in and whether it would uniformly applied to all banking institutions were all issues that potentially gave commercial advantage to one sector or another.

Last Thursday night the chief executives of the big four—Ralph Norris of the Commonwealth Bank, Gail Kelly of Westpac, John Stewart of National Australia Bank and Mike Smith of the ANZ—flew into Canberra for yet another meeting with Rudd and Swan in a bid to hammer out the details. Treasurer Swan announced the scheme the following day: a fee of between 0.7 percent and 1.5 percent on deposits over $1 million. Not only are the fees substantially less than the British model which charges a flat 2 percent, but the lower fee of 0.7 percent will apply to banks with a better credit rating—namely the big four.

None of this was primarily about protecting the deposits of ordinary working people. It was simply the guise under which Labor government provided a financial lifeline to the banking system—above all, to the very largest Australian banks. The actual cost of the guarantee will only become apparent in the months ahead as the global financial storm takes its toll. But like the economic crisis as a whole, the burden of the huge liabilities on the public purse will inevitably be imposed on the working class.

Treasury Secretary Ken Henry's adamant refusal last week to divulge details of his correspondence with the Reserve Bank was not simply a senior bureaucrat seeking to protect his job and reputation. Rather he was above all determined not to set a politically dangerous precedent that would potentially expose the inner workings of government and the state apparatus on behalf the country's wealthy corporate elite at the expense of the majority of the population.