Community Service Obligations in Australian Retail Banking – Fact or Fiction?

By

Julia Lynch
BAgSc (UQ), GDipEcon (NE), MEc (NE)

A dissertation submitted in fulfilment of the requirements for the degree of Doctor of Philosophy at Charles Sturt University

August 2014
# Table of Contents

List of Tables ......................................................................................................................... iv  
List of Figures .............................................................................................................................. v  
List of Abbreviations .................................................................................................................. v  
Certificate of Authorship .......................................................................................................... vi  
Acknowledgements ................................................................................................................... vii  
Abstract ....................................................................................................................................... viii  

Chapter 1 Introduction ............................................................................................................... 1  
1.1 Background .......................................................................................................................... 3  
1.2 Rationale for the Study ......................................................................................................... 4  
1.3 Structure of the dissertation ................................................................................................. 7  

Chapter 2 What are Community Service Obligations? .......................................................... 9  
2.1 The theoretical underpinnings of the reform process in Australia .................................... 9  
2.2 Competition Policy and CSO Policy Development ......................................................... 16  
2.2.1 Microeconomic reform and Competition policy in Australia .................................. 16  
2.2.2 Reform of Government Business Enterprises and the need for CSO definition .......... 21  
2.2.3 Characteristics of CSOs ............................................................................................... 24  
2.2.4 Funding of CSOs .......................................................................................................... 26  
2.2.5 CSO definition .............................................................................................................. 29  
2.3 Corporate Social Responsibility ......................................................................................... 31
4.2.1 Principles of Regulatory design for Social Welfare

4.3 The Framework for classifying Social Welfare Issues as Community Service Obligations

4.4 Chapter Summary

Chapter 5 Community Service Obligations and the Australian Retail Banking Sector

5.1 Why Retail Banking as an application for the Decision Framework?

5.2 Step 1 of the Decision Framework: Is the Issue Identified in Deprivation or Social Exclusion Indicators?

5.2.1 Definition and dimensions of financial exclusion in Australia

5.2.2 Response to Financial Exclusion in Australia by Charities, Government and the private sector.

5.2.3 Decision on Criteria

5.3 Step 2 of the Decision Framework: Is financial exclusion the result of market failure?

5.3.1 Competition in Australian retail banking

5.3.2 Government Regulation and Financial Exclusion

5.3.3 Decision on Criteria

5.4 Step 3 of the Decision Framework: Is this an issue that Government Agrees to Address?

5.4.1 Decision on Criteria:

5.5 Step 4 of the Decision Framework: Policy Options for Addressing Financial Exclusion
5.5.1 The Policy Objective .......................................................... 123
5.5.2 Policy Options ................................................................. 125

5.6 Step 5 of the Decision Framework: Preferred policy option ........ 134
5.7 Step 6 of the Decision Framework: Market –Based Solutions or Community Service Obligations? ........................................ 137
5.8 Chapter Summary .................................................................. 140

Chapter 6 Conclusions ................................................................ 142
6.1 Main findings of the Research ................................................ 142
6.2 Further research opportunities ................................................ 146
6.3 Summary ............................................................................... 146

Appendix 1 The market failures that justify regulation in the financial services sector ................................................................. 148

References ............................................................................... 154

List of Tables

Table 3.1: The Essentials of Life 2010 ........................................... 58
Table 3.2 Support for Essentiality for Selected Non-Purchasable Items (weighted percentages) .......................................................... 60
Table 3.3 Australian Government Social Inclusion Indicators ........... 61
Table 3.4 The Brotherhood of St Lawrence and Melbourne Institute of Applied Economic and Social Research Social Exclusion Indicators ....... 63
Table 3.5 Social Exclusion Indicators derived by the Social Policy Research Centre (UNSW) ........................................................... 65
Table 5.1 Dimensions of Financial Exclusion .............................................. 98
Table 5.2 Types of Products that Address Financial Exclusion .................. 99
Table 5.3 NILS, StepUP and AddsUP program details ............................. 103
Table 5.4 NILS loans in 2009-2010 by State .......................................... 104
Table 5.4 Consumer credit requirements for lenders other than ADI’s .... 117

List of Figures

Figure 3.1 NSW Social Benefit Bonds ......................................................... 51
Figure 3.2 Development of Deprivation Indices ....................................... 58
Figure 4.1 Regulatory Response Range ...................................................... 77
Figure 4.2 Regulatory Response Spectrum ............................................... 78
Figure 5.1 The Reach of Microfinance Programs in Australia ................. 106
Figure 5.2 Policy Options on the Regulatory Spectrum ......................... 125

List of Abbreviations

Community Service Obligations (CSO)
Council of Australian Governments (COAG)
Corporate Social Responsibility (CSR)
Government Business Enterprise (GBE)
Government Trading Enterprise (GTE)
Certificate of Authorship

I hereby declare that this submission is my own work and to the best of my knowledge and belief, understand that it contains no material previously published or written by another person, nor material which to a substantial extent has been accepted for the award of any other degree or diploma at Charles Sturt University or any other educational institution, except where due acknowledgement is made in the thesis. Any contribution made to the research by colleagues with whom I have worked at Charles Sturt University or elsewhere during my candidature is fully acknowledged.

I agree that this thesis be accessible for the purpose of study and research in accordance with normal conditions established by the Executive Director, Library Services, Charles Sturt University or nominee, for the care, loan and reproduction of thesis, subject to confidentiality provisions as approved by the University.

Name: Julia Mary Lynch

Signature:

Date:
Acknowledgements

A/Professor Greg Walker supervised this thesis. He continually encouraged and helped me through this process by being always willing to listen. In my many moments of self-doubt he remained positive and enthusiastic about the project. I am very grateful for his kindness and patience.

The Faculty of Business at Charles Sturt University provided support for this work, both through time and money. I am grateful to Professor Lesley White and Professor John Hicks as Deans of the Faculty of Business for their support.

Finally, I would like to thank all of my family, whose love and support is indeed a precious and wonderful thing.
Abstract

In this dissertation it is argued that the concept of Community Service Obligations needs revisiting in light of the changes to the assessment of disadvantage in social policy. The origins of CSO policy development were grounded in the microeconomic reform process of the 1990’s. This process was conducted with the objective of improving efficiency in government business enterprises rather than improving delivery of social policy. This had the unfortunate consequence of providing a definition that was limited in scope and was focused on a post hoc justification for the retention of social programs that were not couched in broader themes of social policy. Recent developments in definitions of disadvantage, deprivation and social exclusion suggest that there may be further use for Community Service Obligations as a policy instrument for delivering specific types of social welfare.

A new definition of a CSO is developed in this dissertation, informed by and reflective of, the changing focus of social policy where disadvantage is now assessed in term of social exclusion and deprivation, rather than by the single dimension of poverty. A decision framework has also been developed to enable the assessment of the existence of new CSOs within a sector or industry. In this dissertation this new definition and decision framework is applied to the retail banking sector in Australia to determine if the issue of financial exclusion satisfies the criteria for the existence of CSOs in that sector. In this application, it is determined that there is no CSO in retail banking in Australia.
Chapter 1

Introduction

“Over many years economists have developed a reputation for hostility to distributional issues. Some economists appear to treat them as ‘soft’ and secondary in importance to ‘hard’ issues like efficiency and productivity. That approach is a mistake” (Dr Ken Henry 2009:22)

This dissertation examines the issue of whether there are Community Service Obligations (CSOs) in Australian retail banking. But in examining that issue undertakes the more significant work of re-defining and linking CSOs to the broader social policy framework and develops a decision framework for the identification and implementation of a CSO in a particular industry or sector. It examines the origins of the definition for CSOs, which arose not as a deliberate and determined part of social policy, but as a by-product of the microeconomic reform process in Australia. As competitive principles were applied to Government Business Enterprises (GBEs), to improve efficiency, a myriad of practices were uncovered that could not have been sustained in a competitive firm. These practices which included things like over-staffing to provide employment in regional areas and providing pricing discounts to certain users based on geographical location or financial status were now the subject of intense scrutiny.

Those which State and Federal governments decided had merit in a social policy context, remained and were re-named CSOs, with funding guidelines in place to minimise the interference with competitive operations elsewhere
in the GBE. This lead to the unusual situation of having some small parts of social policy delivered through business and no mechanism by which new CSOs could be identified, other than ‘at the behest of government’.

This development of CSO policy left two questions unanswered. First, what types of social policy needs are likely to be CSOs, that is those goods and services delivered in-kind rather than through a cash transfer? Second, when is a CSO the preferred mode of delivering social policy?

In order to decide if CSOs ‘exist’ in a sector where they are not currently defined, the definition of a CSO needs to be reflective of the current needs of social policy, rather than a construct of imposing competitive principles onto GBEs. There is no rationale why CSOs would be only restricted to GBEs other than that is where they were first defined.

In order to link CSOs to developments in social policy, where different methods of assessing disadvantage have led to a focus on in-kind delivery of assistance, a new definition and decision framework needs to be built. The focus in social policy has shifted from one centred on income distribution to one focused on capabilities of individuals, with poverty seen as but one source of severe capability deprivation (Sen, 1999).

By redefining CSOs in line with these developments, they can be incorporated into the ‘main stream’ in terms of social policy responses now, rather than languishing as a by-product of a productivity reform process that occurred two decades ago.

In order to answer the question posed in the title of this dissertation—Do CSOs exist in Australian retail banking? A new definition is proposed for
CSOs and a new decision framework has been developed to assist in identifying when they are the most appropriate form of assistance.

1.1 Background

The role of government and business in a modern economy is clearly defined in neo-classical economics. The role of business is to maximise profits and government’s role is to put in place regulation to address those issues that will lead to a non-optimal allocation of resources. These market failures include a lack of competition, commonly owned resources such as the environment, the existence of external costs and benefits in production or consumption and public goods. In Australia, the policy processes around addressing these issues are clearly defined and developed. In addition to these areas where markets are not optimal in terms of allocating resources, there is also the acknowledgement that even when all these market failures are addressed, there will remain an unequal distribution of those resources in society.

In short, in an allocatively efficient economy, where social welfare is maximised in the Pareto sense; we will be left with an inequitable society unless government take a redistributive role.

The notion that businesses have responsibilities to the societies in which they operate has been developed in the management literature and is known as Corporate Social Responsibility (CSR). But any CSR activity that business undertakes that does not lead to profit maximisation comes at a cost not just to the firm or business who willingly embraces CSR but to the
economy as a whole as it imposes dead weight losses and reduces societal welfare.

So what level of redistribution is the correct one? Or to put it another way what level of inequality are we prepared to accept in modern Australia? This is a question that is at the heart of social policy and is one that is ultimately decided through the political process, as Australians decide on the type of society that they want to inhabit not through individual business action. As Henry states:

“Today we should be thinking about the role of public policy in giving people the capabilities to choose lives of value for themselves” Henry (2009:23)

In giving people capabilities, government still have a responsibility to ensure that the way that this is done follows the principles of good policy design. That is, once the policy objective has been decided, there are in all probability a number of different ways that it can be met. These different policy objectives will have different strength and weaknesses or costs and benefits. The policy option chosen should deliver on the objective, at the least cost, not just in terms of public finances, but also in terms of overall cost.

1.2 Rationale for the Study

The rationale for this study lies in the need to identify a framework for deciding what services or products justify being provided to individuals in Australia on the basis of maintaining some basic standard of living. These services or products need to have some basis for being provided in-kind as opposed to being acquired by individuals as part of purchased goods and
services. Community Service Obligations was a term developed during the 1990’s in Australia to describe goods or services provided directly or on non-commercial terms to specific groups of consumers by Government Business Enterprises (GBEs). The introduction of Competition Policy meant that these social activities of GBEs now needed to be identified and funded by a specific policy directive in order to be maintained. In many instances these social programs were not grounded in any specific policy objective and so were removed to the greater benefit of both other customers of the GBE, who had been cross subsidising the programs and to the efficiency and competitiveness of the economy as a whole.

The policy development of the early 1990’s was a great tool to provide a framework for clarifying what existing non-commercial activities were going to continue (as CSOs) and those that were going to be retracted. While these changes were a huge leap forward in the development of CSO policy, the initial decision of what makes CSOs the appropriate delivery channel for some policy and not others is still an area that has not been defined – beyond the ‘will of the Minister’ argument.

For example, how are Ministers to come to a decision as to whether a new policy initiative is a CSO versus something that can be funded and delivered through other social policy channels or indeed can be provided by the market? In effect, what are the defining characteristics of CSOs and how do they interact/complement with a broader social policy agenda and its delivery. Or are they something to be considered entirely separately from other social policy?
Currently policy makers have no apparent way of evaluating the need for a new CSO. Indeed a CSO is not defined as an entity. It is only identified by its mechanism of delivery. In order to address these issues and questions, this thesis seeks to introduce a new definition of a CSO together with a decision framework for applying this new definition.

The lack of means of defining a CSO and then deciding the most appropriate method of delivery has meant that Governments are susceptible to calls, from community groups and other lobby groups, for CSOs to be imposed on industries, with no valid or solid basis for evaluating the worth of these calls. The absence of a sound decision framework can lead to knee-jerk policy responses instead of a more considered response which aligns with already determined government priorities. In addition, the proposed framework anchors the new CSO into a more broadly defined and accepted set of policy objectives in the social welfare goals of governments.

In the time since the introduction of Competition policy in the 1990’s, there have been significant developments in the measurement and design of social policy which need to be taken into account. There is already a defined process for evaluating proposals for government intervention in the private sector on the basis of market failure and the all-important public interest test that any intervention must satisfy before becoming policy. So the development of this decision framework in this thesis complements this existing public interest test, which ascertains intervention on the basis of efficiency, with a framework for assessing intervention, on the basis of equity.
The decision framework developed in this thesis is intended as a tool for use by government decision makers when determining when a new claim for government intervention on the basis of equity, rather than market failure, is a justifiable claim for government intervention by means of a CSO.

1.3 Structure of the dissertation

In chapter 2 of the dissertation, Community Service Obligations are defined and discussed. The microeconomic reform process that led to the development of the current CSO policy is analysed and the theoretical underpinnings of that reform process reviewed. This is important as it demonstrates that the developments in microeconomic reform led to the advent of CSO policy in Australia, rather than it being developed as mechanism for achieving specific social policy outcomes. The theoretical underpinnings of Corporate Social Responsibility - businesses developing and delivering on social objectives - is reviewed and the conflict with neo-classical welfare economics examined in the final section of this chapter.

In chapter 3, current developments in social policy are discussed. This includes the movement away from using and measuring poverty as a means to assess disadvantage both in the academic literature and in government policy frameworks.

The multifaceted nature of disadvantage has spawned a new way assessing an individual’s level of social exclusion and deprivation, which is now viewed as a more appropriate target of social policy than just measuring income levels. As many of these goods or services are non-purchasable, it does mean that a method of in-kind delivery may be needed to deliver
improvements against a social policy objective that seeks to address these issues. This forms the basis of the linkage between social policy developments and the need for a new definition of CSOs.

In chapter 4, a new definition of CSOs is presented, based on the analysis and discussion of the preceding two chapters. The principles of good regulatory design are examined and are used as the basis for the development of a decision model. This definition and decision model is a way of classifying and identifying new CSOs as they arise and ensures that they are linked to the major social policy themes of social exclusion and deprivation, rather than being a stand-alone entity on the periphery of relevance. This decision model in conjunction with the new definition of the CSO constitutes the major contribution of this research to the body of knowledge on this topic.

In chapter 5, the decision model is applied to the Australian retail banking sector. This sector was chosen as a test for the model because there is a strong connection in the literature between social exclusion and financial exclusion. The decision points of the model developed in chapter 4 are applied to retail banking, with the outcome noted at the end of each section. A policy objective of addressing financial exclusion is developed and policy options for achieving this objective discussed. The option of in-kind delivery of products through a bank to address aspects of financial exclusion is one of the options considered.

In chapter 6 the conclusions of the dissertation are made and areas for future research identified.
Chapter 2

What are Community Service Obligations?

Community Service Obligation (CSO) policy was formulated as part of the reform of Government Business Enterprises in Australia in the 1990’s. These reforms were part of the economy wide process in Australian, known as microeconomic reforms and subsequently Competition Policy reforms that took place from the mid 1980’s until the early 1990’s. In this chapter the underlying theoretical rationale for the reform process is examined and the impetus for the definition of Community Service Obligations discussed. The current definition is explained and the methods that can be used for CSO funding are analysed. The CSO approach is then contrasted with the Corporate Social Responsibility (CSR) approach that has developed in Management theory and practice and the incompatibilities of that theory with economic theory highlighted.

2.1 The theoretical underpinnings of the reform process in Australia

This process of moving the Australian economy to a more competitive basis has its theoretical roots in contemporary neo-classical economic theory. These policies were adopted because they were believed that they would deliver benefits to the Australian population. In this section the neo-classical economic theoretical underpinnings of the reforms are examined, the role of government and business in the economy discussed and the importance of competitive markets in delivering maximum social welfare outlined.
The competitive market model in economic theory is recognised as a benchmark model of market behaviour that is rarely replicated in real world markets. The assumptions of the model include that there are a large number of sellers that are independent of each other supplying the market with an identical product. So long as consumers have perfect knowledge regarding prices then clearly all firms must be charging the same prices. Any attempt to increase prices would lead to a loss of customers while any attempt to undercut the price by a single firm would lead to all firms reducing their price in order to stay in business.

Obviously rarely is consumer demand so straightforwardly responsive in the real world, as Varian (1984:82) states “this competitive story represents a limiting case of market behaviour that is useful for economic analysis, just as a study of a frictionless system is useful for a physicist”. So in this model both firms and consumers are price-takers with no one individuals actions having any bearing on market price which is the marketing clearing price set by the interaction of total demand and industry supply – consumers decide how much to consume at the given price and producers decide how much to supply.

The profit maximisation condition for a price taking firm is:

$$\text{Max } p y - c(y),$$

where \( y \) is output, \( p \) is the price per unit and \( c \) is the cost. The first order condition therefore is:

$$p = c'(y^*) \text{ for } y^* > 0.$$
This equates to the price being equal to the marginal cost of producing the unit and the second order condition is that:

\[ c''(y^*) \geq 0 \] or that marginal cost at the profit maximising output \( y^* \) is increasing.

In the long run there are two critical influences on the competitive firm’s behaviour. The first is free or unrestricted entry and exit of competitors and the second is the technological adjustments that firms make so as to produce the equilibrium level of output at least cost.

So in summary the perfectly competitive market structure means that both producers and consumers are price takers and that firms maximise profit when they produce the level of output where the price they receive for the last unit sold just covers the cost of producing it and in the long run they will produce that output in the most technically efficient manner so as to minimise costs. In addition long run profits are limited by the entry of new firms to zero economic profit. It should be noted that a large number of firms is not essential in delivering a competitive market outcome.

The contemporary approach to measuring competitiveness in an industry is based on the concept of contestability, developed in the seminal article by Baumol in 1982. The key concept developed in this theory is that a contestable oligopoly will produce a competitive outcome, provided that there are no barriers to entry and that exit is costless in the sense that costs of entry can be recouped and capital is saleable or reusable. In this case entrants will be drawn into an industry when existing operators are earning
above normal profits. The key part of the theory rests on the notion of potential competitors.

If existing firms in the industry are behaving competitively and not earning super-normal profits then no firm will be attracted into the industry and a competitive outcome is possible with high market concentration.

The benefits of the pursuit of competitive forces is summarised by Jones:

“Competition is the spur which ensures, at least in the long run, that firms are responsive to the demands of consumers, their production costs are kept to a minimum, their profit margins are not excessive and they are technologically progressive. Even if firms pursue objectives other than profit maximisation the discipline of competition in both the market for their output and the market for their assets (that is, the stock exchange) limits the extent to which they can depart from economically optimal behaviour. Only to the extent that firms can achieve freedom from competition through the possession of monopoly power or restrictive trade practices can they escape the discipline of the market. Jones (1994:83-84)

In addition to these benefits, more importantly, competitive markets play a critical and central theme in the normative branch of economics known as welfare economics. Consumer choice theory links consumer demand for goods and services to levels of utility of well-being of households in the economy. Vilfredo Pareto first defined criteria for evaluating changes in society’s welfare that didn’t require cardinality in household utility functions which meant that the restrictive assumption of comparability of household utilities was no longer necessary.
Instead for any given distribution of goods and services among households in the economy (a state) a utility vector that comprises all households utility exists – let’s call it A.

If there is an alternative distribution which results in state B, then state A dominates state B if any household in A has a higher level of utility than in B and no household has a lower utility. State A can be said to have a higher level of societal welfare than state B by the strong Pareto criterion. If the utility of every household is higher in A than in B, A is preferred according to the weak Pareto criterion. So a change in which at least one household is better off and no household is worse off is a Pareto improvement. If there is a change in which some households are better off and some worse off, then it is said to be Pareto non-comparable. If there is no state in which a Pareto improvement can be made – that is no further changes can be made that can make a household better off without making another worse off – the state is said to be Pareto optimal.

What is of critical importance is the link between Pareto optimal states and the outcome of a competitive general equilibrium. A competitive general equilibrium exists when a set of relative commodity and factor prices are established which results in all markets clearing – that is supply and demand are equal. From the existence of this competitive equilibrium the two fundamental theorems of welfare economics can be proved (see Varian 1984 and Arrow, 1951).

The first theorem is:

*Under certain assumptions, a state resulting from a general competitive equilibrium is Pareto optimal (Direct theorem)*
The second theorem is:

*Under certain assumptions, every Pareto optimum state can be realised as the outcome of a competitive equilibrium given the distribution of claims on income. (Converse theorem).*

So what do these theorems mean for the role of government, business and households (consumers) in the economy? The key relevance of these theorems is that they link the welfare consequences of society to the outcome of the market mechanisms. Adam Smith first raised the notion of the “invisible hand” of the market mechanism delivering benefits to society as a whole even though each participant acted solely out of self-interest.

The first theorem is basically the same principle, suggesting that in a competitive market system participants can each pursue their own self-interest without regard for any notion of “social good” and as a result an allocation of resources will result which is socially desirable according to the Pareto criteria. The assumptions that underlie the competitive market model include all participants, both consumers and producers, being price-takers, households are assumed to maximise utility, while firms are assumed to be profit maximisers. Of particular significance is that there is assumed to be no instances where the market fails to be perfectly competitive. However any instances of actual markets differing from the ideal competitive model are recognised and grouped under the term “market failures” in economic literature.

The second theorem of welfare economics is said to be prescriptive as opposed to the descriptive nature of the first theorem.
In essence this theorem implies “that ideally governments can be limited to a redistributive role rather than a planning or allocative role in the economy. Allocative decisions need only be made when there are bona fide cases of market failure.” (Broadway and Bruce, 1984:83).

Market failures, or known cases of where a decentralised market mechanism will not deliver a Pareto optimal solution, can be grouped into several areas. These are non-competitive behaviour by market participants, externalities arising from a lack of property rights, externalities arising from jointness in production or consumption, including pure public goods, asymmetric information and non-convexity in production or consumption – usually found in natural monopoly.

Governments due to their legal powers of coercion and revenue raising powers through taxation have a role in “correcting” these cases of market failure through regulation relating to market behaviour, the levy of non-distorting lump sum taxes or the provision of subsidies.

Essentially this is the policy approach taken by the Australian government in the microeconomic reform stage and in the development of the National Competition Policy. In essence, competitive markets deliver allocative, productive and dynamic efficiencies in most instances.

That is the goods and services that society most desires and produced with the minimum required inputs within a market system that is adaptive and able to increases output from a given endowment of inputs over time. Prices for outputs and prices paid for inputs are important in determining the allocation of resources between different industries.
The best allocation is one that reflects society’s preferences. Improvements in allocative efficiency will increase national income in a way that is consistent with society’s values and preferences.

The role of government in this process is to establish a regulatory framework where competitive forces are encouraged and intervention by government in allocation of resources is done to correct an identifiable market failure. Governments also have a charter to intervene to overcome inequitable distribution of society’s resources or in common day policy-speak to provide a welfare ‘safety net’ for those members of society who require assistance. Social policy is formulated by governments and delivered by both government agencies and charitable and religious organisations.

2.2 Competition Policy and CSO Policy Development

In this section the process of policy formulation for CSOs is explained. The definition of Community Service Obligations has been deliberately left until after the process of policy formulation has been examined as it forms an important part of the context for the current definition in use in Australia.

2.2.1 Microeconomic reform and Competition policy in Australia

Australian Commonwealth and State governments developed their respective policy frameworks on CSOs as part of the economy wide reform and structural adjustment of the Australian economy known as “microeconomic reform”. Because this process is critical in the way that CSOs are defined in Australia and because the theoretical underpinning of
the reform process are important in the analysis of CSOs in a wider context, these reforms are examined in some detail in this section.

Australian governments for most of the 20th century pursued a broad range of development and redistribution objectives which included policies of protection of industries from import competition, centralised industrial and wage determination systems, a high rate of immigration and government ownership and control of economic infrastructure (Productivity Commission 1999).

These policies had widespread popular support which ensured their survival even if that came at a cost to the average standard of living (Pincus, 1995). However during the late 1960’s and 1970’s the cost of these policy goals was increasingly questioned through inquiries such as the Vernon Committee (1965) and the Jackson Committee (1975). There was an increasing realisation that perhaps the policy goals could be pursued by a more direct and less costly means (Productivity Commission, 1999).

Pressure to reform intensified in the 1980’s from two directions. On the domestic front, slow growth in output and incomes persisted and concerns about prices for exports – which were overwhelmingly commodities, led to exchange rate and current account pressures (Productivity Commission, 1999). In addition, other countries such as the United Kingdom and the United States had already commenced major policy reform agendas in response to “ongoing stabilisation policies, technological change and global pressures” (Productivity Commission,1999:8, Williamson 1994). The impact of globalisation for a small country like Australia cannot be overstated. The need to restructure the economy so that Australia could
participate in the growth in world trade and attract vital capital investment was paramount. (Productivity Commission, 1999).

So the structural change from an inward looking import replacement focused economy to a flexible, responsive and globally focused economy commenced in 1983 with the deregulation of the financial sector by the newly elected Commonwealth Government.

The reforms had a strong macroeconomic motivation, that of improving the effectiveness of monetary policy instruments but there also were important initial steps in internationalising the economy through the removal of exchange rate controls and the floating of the Australian dollar (Productivity Commission, 1999)

So in summary, the motivation for the process of microeconomic reform in Australia,

“stemmed from a concern to maintain and improve Australian living standards. It became increasingly apparent from the mid-1960’s that longstanding government policies- whatever their success in the past- were imposing costs in terms of holding back growth in living standards. Concerns about the effects of these policies intensified in the 1970’s and 1980’s as growth in living standards slowed and prospects for recovery looked grim. Policy reform was introduced to help rekindle sustainable growth in output and living standards.” (Productivity Commission 1999:5).

As the reforms progressed it became evident that further gains would be limited by the existing legal frameworks that limited the reach of the Trade Practices Act. This was made explicit by the then Prime Minister Mr
Hawke in the Building a Competitive Australia statement made on 12 March 1991,

“The Trade Practices Act is our principal legislative weapon to ensure consumers get the best deal from competition. But there are many areas of the Australian economy today that are immune from that Act: some Commonwealth enterprises, State public sector businesses, and significant areas of the professions. This patchwork coverage reflects historical and constitutional factors, not economic efficiencies; it is another important instance of the way we operate as six different economies, rather than one. The benefits for the consumer of expanding the scope of the Trade Practices Act could be immense: potentially lower professional fees, cheaper road and rail fares, cheaper electricity.”

The importance of the development of the National Competition Policy was further highlighted in the One Nation statement made by the new Prime Minister Mr Keating on 26 February 1992, when it was identified as one of the seven elements of the government’s economic and social strategies for 1990’s.

Following an inquiry into competition policy conducted by Professor Fred Hilmer which reported in August of 1993, six policy proposals were put forward

1. Extending the reach of the Trade Practices Act to unincorporated businesses and State and Territory government businesses so that the competitive conduct rules that were in the existing Act apply to all business activity in Australia.

2. Provision for third party access to nationally significant infrastructure.
3. Introduction of competitive neutrality so that government business did not enjoy unfair advantage when competing with private business.

4. Restructuring of public sector monopoly businesses to increase competition.

5. Review of all laws which restrict competition and

6. Extending prices surveillance arrangements to State and Territory government businesses to deal with those circumstances where all other competition policy reforms prove inadequate.

The policy principles were accepted by the Council of Australian Governments (COAG) in April 1995 and the Competition Policy Reform Act 1995 was created which effectively amended the competitive conduct part of the Trade Practices Act and extended the coverage to State, Territory and local government businesses and unincorporated bodies.

An important component of the process was the Competition Principles Agreement which outlines the principles agreed to by governments in relation to prices oversight, structural reform of public monopolies, and review of anti-competitive legislation and regulation, third party access to services provided by essential facilities, the elimination of net competitive advantages enjoyed by government business where they compete with the private sector, and the application of these principles to local government.
2.2.2 Reform of Government Business Enterprises and the need for CSO definition

The extension of competitive principles to Government Business Enterprises was a central component of the National Competition Policy process. These entities generally were sole providers of essential infrastructure and utility services such as electricity, water, telecommunications, ports, airports and postal services. There were also instances of government owned enterprises that were not sole suppliers but were in direct competition to privately owned business (Qantas, the Commonwealth Bank, State government insurance providers, State banks as examples). The reform of these businesses was a central plank of the microeconomic reform process due to three factors (Productivity Commission, 1999). First the overall size of the sector and its significance in economy (10 per cent of GDP in 1992-93) meant that its performance mattered in overall terms to the national economy.

Second these business entities in general provided goods or services that were inputs to other industries which had to compete internationally. If these key inputs were themselves produced inefficiently then this would significantly impact on the efficiency of downstream users. The third reason for the imperative for reform was the government budgetary position. The GBEs had traditionally been a huge drain on government budgets through the funding of operating losses and investment and the need to stem this budgetary drain and to have these GBEs make a positive contribution through dividends to State and Commonwealth government budgets was a major incentive for reform.
The introduction of competition and competitive practices into GBEs meant that many previous practices and activities that had been undertaken as part of business operations were highlighted. This included a large amount of welfare policy that over the years had been delivered through these entities that may have been in response to an explicit directive of government or may have been a decision made within the entity itself. Once the national performance monitoring of GBEs was introduced it required some explicit policy for defining and costing these activities which would impact on the GBEs financial performance measures. The types of practices varied between states, regions and entities and ranged from concessional prices to certain user groups and in certain regions, employers of last resort. These practices came to be known as Community Service Obligations and a key part of GBE reform process was the definition review and costing of these programs.

The reform of GBEs and the move towards commercial practice meant that these services or programs needed some explicit policy directive to justify their delivery.

Competition Principle 3 (shown in full below) deals directly with the introduction of competition into GBEs and specifies in part (f) that the “merits of any community service obligations undertaken by the public monopoly and the best means of funding and delivering any mandated community service obligations” need to be subject to review prior to the introduction of competition or the entity is privatised. (COAG, 1995).
Before a Party introduces competition to a market traditionally supplied by a public monopoly, and before a Party privatises a public monopoly, it will undertake a review into:

(a) the appropriate commercial objectives for the public monopoly;
(b) the merits of separating any natural monopoly elements from potentially competitive elements of the public monopoly;
(c) the merits of separating potentially competitive elements of the public monopoly;
(d) the most effective means of separating regulatory functions from commercial functions of the public monopoly;
(e) the most effective means of implementing the competitive neutrality principles set out in this Agreement;
(f) the merits of any community service obligations undertaken by the public monopoly and the best means of funding and delivering any mandated community service obligations;
(g) the price and service regulations to be applied to the industry; and
(h) the appropriate financial relationships between the owner of the public monopoly and the public monopoly, including the rate of return targets, dividends and capital structure.

Source: COAG 1995

In order to comply with this principle, all State Governments developed a policy position on the identification and funding of Community Service Obligations. The impetus for this identification was the need to clearly identify in financial accounts those programs that the entity is now doing which are non-financial and to receive compensation/reimbursement for undertaking those activities at the request of and behalf of governments.

Furthermore, because there was to be national monitoring of the performance of the State based GBEs, the definition and methodology for estimating costs needed to be consistent across GBEs and across States.
“A clear definition is necessary to enable more accurate estimation of the cost of the services and evaluation of the commercial performance of the enterprises” (Standing Committee on National Performance Monitoring of Government Trading Enterprises 1994:1)

2.2.3 Characteristics of CSOs

In developing the definition of the CSO the Steering Committee grouped the characteristics of a CSO into three broad categories. First, the CSO has the characteristic of being a directive of governments, second the activity would not be supplied in the normal commercial operations of the GTE and third that the service provides some identifiable community or social benefit.

The first characteristic, the CSO being an explicit directive of government, is necessary to distinguish activities which the entity may or may not provide on commercial grounds with those that it has a specific directive to conduct. This can include a directive to not supply or implement decisions which the GTE would do on commercial grounds for example price increases or pricing decisions that reflect the cost of supply which mean residents of certain areas would face much higher prices for services than those in other areas.

As the SCNPMGTE summarises:

“It seems essential that a CSO be defined as an explicit and specific public requirement or directive to GTEs in order to identify which services are CSOs, to be able to estimate the cost of the service accurately and to assess the impact on government directives to GTEs on their performance” (Standing Committee on National Performance Monitoring of Government Trading Enterprises 1994:3)
The second characteristic of CSOs is that the service would not be supplied or not be supplied on the same terms if the government directive was not in place. In general this leads to the assumption that CSOs must be loss making and therefore any activity undertaken by a GTE that is loss making must in turn be a CSO.

However many private firms undertake loss making activities as part of their commercial operations, for example national uniform pricing is regularly adopted by commercial firms even though the costs of provision may differ between regions. It enables national prices to be advertised and it is administratively simple. When the costs of accurately pricing to reflect the costs of provision are greater than the price differences that will be generated by pricing ‘correctly’ it is far more efficient to take minor losses in some areas than to impose greater costs to eliminate them. In addition many GTEs are natural monopolies and therefore, governments regulate pricing to promote allocative efficiency, as pricing decisions on normal commercial criteria would lead to inefficiencies.

This may well mean that the production of the service is loss making for the GTE and it would behave differently if left alone to pursue a commercial agenda.

When considering definitional issues the SCNPMGTE made the following recommendation with respect to regulatory directives relating to pricing,
“The Steering Committee considers that directives to GTEs to meet allocative efficiency objectives which would not otherwise be achieved through the commercial decisions of enterprises should not be treated as CSOs” (Standing Committee on National Performance Monitoring of Government Trading Enterprises 1994:7)

The third characteristic of CSOs is that of having a social policy objective. Broadly, any intervention by governments to improve efficiency in resource use can be constructed as having social policy objectives (see Section 2.1 of this chapter). However CSOs have more typically been associated with the narrower definition of having income redistribution characteristics. These may include making services more affordable for some groups (vertical equity) and /or making services and pricing uniform across regions (horizontal equity).

### 2.2.4 Funding of CSOs

An important consideration in the provision of CSOs is the means by which they are to be funded. This was of particular concern when the CSO policy was being developed as the way that these programs are funded may impact on the resource efficiency, to varying degrees and so choices have to be made about the pros and cons of each method.

The first funding method is through cross-subsidisation where a group of consumers is forced to pay the direct costs of providing the CSO. For example users located in the city may face a price above their marginal cost in order to provide the service at the same price to regional users who face a higher marginal cost due to the increased costs of provided service in a
regional setting. In order for CSOs to be funded by cross-subsidisation, the service provider must be protected through regulatory arrangements from competition.

If these regulatory arrangements weren’t in place a competitor would enter the industry and undercut the price to those groups of consumers providing the cross subsidy. This restriction of competition into potentially competitive markets would have significant implications for the efficiency of resource use.

A further type of cross subsidisation is imposing a levy on all users of the service – not just those that are receiving the benefit. In this way the cost is made explicit however any additional cost per unit will impact on demand and a sub-optimal amount of the good or service will be consumed.

A further consideration is that, like a straight cross –subsidisation, the cost of providing the social program is limited to just those in the community using the service or consuming the good, whereas it may be more appropriate for these types of policies to be funded from general taxation revenue.

It is generally considered more efficient to provide a direct cash transfer for income support to consumers rather than specific service or goods. In this way they can spend the additional cash they receive in pension or other welfare payments on goods or services of their choosing thereby increasing their personal utility and contributing to increased social welfare (see Section 2.1). However there arise issues with cash transfers when attempting to achieve horizontal equity through income support.
For example if regional users are to be subsidised the “cash grants provided in lieu of subsidised electricity, postal and railway services in rural areas would create significant incentives for non-rural residents to claim the grants as well” (SCNPMGTE 1994: 37). There is a ‘moral hazard’ problem in delivering social welfare objectives through cash transfers, however and this is particularly exacerbated when children are involved. Cash payments intended to provide access to basic needs such as housing, and food may instead be spent on discretionary consumption and so the social welfare objectives are not achieved.

Studies have shown (Nicholls and Zeckhausers 1982, Dye and Antle 1986, Blackorby and Donaldson 1988 and Ross 1991) that a combination of in-kind and cash transfers may reduce the costs and improve the targeting of programs despite the reduction in individual utility and the subsequent loss that this causes in social welfare terms. (SCNPMGTE 1994:38)

The third way that CSOs can be funded is through a direct transfer or payment to businesses to provide the identified CSO from consolidated taxation revenue. The advantages over cross-subsidisation are that efficiency effects are reduced and that regulatory protection against competition for the business providing the CSO through cross–subsidisation is not required. In addition it makes the funding of the social welfare program the responsibility of all taxpayers – not just the users or purchasers of a particular good or service. Direct funding of the CSO also allows the provision to be undertaken by the private sector as it bids for the right to provide the CSO to a specified standard at the lowest cost.
In this way efficiencies in the actual provision of the welfare are encourage through the process by which it is funded. It should be recognised that any programme funded from general tax revenue also effects and impacts on efficiency of resource use as the raising of revenue through taxation causes a reduction in disposable income and therefore dead weight losses.

2.2.5 CSO definition

The definition of Community Service Obligations almost universally accepted by the Australian States and Territories is the one developed by the Industries Commission and the Steering Committee on National Performance Monitoring of GTE’s (SCNPMGTE).

“A CSO arises when a government specifically requires a public enterprise to carry out activities relating to outputs or inputs which it would not elect to do on a commercial basis and which the government does not require other businesses in the public or private sectors to generally undertake, or which it would only do at commercially higher prices” (Industry Commission 1994:).

The Western Australia Community Service Obligations Policy outlines some typical examples of activities that would meet this definition of CSOs.

Welfare objectives imposed by government on GTE’s through price concessions on services provided to a particular group of users, e.g. various concessions provided to disadvantaged groups that are not driven by commercial objectives;

A government requirement that the GTE provide some form of industry assistance, e.g. the provision of subsidised services to private companies which is not commercially justifiable; and
The losses incurred by an agency as a result of a government directive that a service be provided to all users at a uniform price regardless of geographical location, where the price is less than the avoidable cost of supply to some customers. (WA Treasury, 2000:4).

What is most notable about these definitions is that they give no direction or guidance in deciding when an industry or sector may have Community Service Obligations and when it is appropriate for governments to intervene in these industries/sectors to achieve social objectives.

They provide a framework for separating non-commercial activities from commercial ones for Government owned trading enterprises in order to increase the transparency of financial reporting in these entities and allow comparisons to be made about the efficiency or otherwise of their performance.

Under this definition and because of the way that CSOs were defined in Australia, they only exist in trading enterprises of governments. In these State governments CSO policy documents it is clear that GTE reform was the driving force in articulating a policy on CSOs, rather than some fully formed view of this as a means of delivering social policy.

For example the Western Australia policy notes in its introduction that

“the unambiguous articulation of GTE objectives and the clear identification and subsequent compensation for any social obligations that GTE’s are directed to undertake is consistent with the overall thrust of GTE reform”. (WA Treasury, 2000:4).

The reform of GTEs as a starting point for definition and identification has resulted in a limited application of the concept of CSOs in Australia.
example, are social objectives the sole preserve of governments to provide? In the next section the Corporate Social Responsibility literature will be examined and analysed against the social welfare criteria discussed in section 2.1 of this chapter.

### 2.3 Corporate Social Responsibility

Management practice and literature would certainly suggest that there is a valid justification for business to deliver social objectives. The development of the Corporate Social Responsibility branch of management theory supports just this notion – that modern day corporation have a requirement to act in a socially responsible manner that is above and beyond their legal obligations.

#### 2.3.1 The development of Corporate Social Responsibility Theory

The concept of Corporate Social Responsibility is today well ingrained in management literature, teachings and practice. In comparison to economic theory it is a relative newcomer, with the development of CSR being in the last 50 years and originating in the United States of America. Even though it is now a widely accepted doctrine, well established in management practice there is still no universally accepted definition of what it is. However, the relationship between business and society has been central to issues in Western societies since the Industrial Revolution. It is a widely accepted premise that business plays an important role in producing goods and services that society demands in return for profit. What is perhaps less clear is what restrictions or constraints should be placed on this profit.
maximising behaviour to ensure that business operates for the good of society as a whole. (Blowfield and Murray 2008).

The heart of the debate today about corporate responsibility is the “desirability and effectiveness of market-based solutions to social and environmental challenges, and in particular, their voluntary and self-regulatory nature” (Blowfield and Murray, 2008:13).

2.3.1.1 CSR Theory Development

The development of the theory of Corporate Social Responsibility began in the 1950’s with the publication of Howard Bowen’s book in 1953 titled “Social Responsibility of the Businessman”. In this seminal work, Bowen establishes a definition of social responsibility.

“It refers to the obligations of business men to pursue those policies, to make those decisions, or to follow those lines of actions which are desirable in terms of the objectives and values of our society”. (Bowen 1953:6).

Carroll (1999) nominates Bowen as the “Father of Corporate Responsibility” for the significance of this work in beginning the development of this branch of management theory. During the 1960’s and 1970’s definitions of corporate social responsibility proliferated in the academic literature (see Davis 1960, Fredrick 1960, McGuire 1963, Davis 1967, Davis 1973 for seminal works in this area). However to this day there is really no clear definition of CSR. What developed in these earlier years was the shift in focus from the actions of an individual businessman to the notion that corporate responsibility related to the corporation or enterprise as a whole.
In his 1967 work Davis states that:

“Social responsibility moves one large step further by emphasising institutional actions, and their effect on the whole social system. Social responsibility, therefore, broadens a person’s view to the whole social system” (Davis 1967:46).

In 1973 Davis revisited the concept again in an article Carroll (1999) refers to as a landmark, in which he assessed the case for and against business assumption of social responsibilities. In this article he declared that “social responsibility begins where the law ends. A firm is not being socially responsible if it merely complies with the minimum requirements of the law, because this is what any good citizen would do.”(Davis, 1973:313).

This concept was also put forward by two economists Manne and Wallich in 1972 in a debate regarding the meaning of CSR between the two that was published in The Modern Corporation and Social Responsibility. Manne argued that to qualify as a socially responsible action it must be voluntary, its marginal returns be less than other expenditures that the corporation could make and that it is actual corporation expenditure rather than a “conduit for individual largesse” (Manne and Wallich, 1972:4-6). Professor Wallich presented his definition as “I take responsibility to mean a condition in which the corporation is at least in some measure a free agent. To the extent that any of the foregoing social objectives are imposed on the corporation by law, the corporation exercises no responsibility when it implements them.” (Manne and Wallich, 1972:40).
This concept of voluntary action is a continuing theme in the development of the CSR concept, however it does little to clarify what it is that business are actually responsible for. (Blowfield and Murray, 2008).

In 1979, Carroll presented a now widely cited and utilised framework for understanding the different facets or areas of social responsibility. The four areas of responsibility that he identified were:

1. Economic responsibility - the fundamental responsibility of business to produce goods and services and in return to generate a profit.

2. Legal responsibility – the obligation that business has to generate profits and conduct their business within the law.

3. Ethical responsibility – ethical expectations of a company

4. Discretionary responsibilities – otherwise called philanthropy which is the voluntary actions that a company can take on issues or areas where there are no clear societal expectations.

The most recent move towards clarifying the scope and extent of embedding CSR into a firms operations was the release of ISO 26000 in 2010. The Social Responsibility standard provides guidance of how an organisation can operate in a socially responsible way. The standard defines the objective of social responsibility as

“to contribute to sustainable development. An organization’s commitment to the welfare of society and the environment has become a central criterion in measuring its overall performance and its ability to continue operating effectively. This, in part, is a reflection of the growing recognition that we need to ensure healthy ecosystems, social equity and good organizational governance."
Ultimately, an organization’s activities depend on the health of the world’s ecosystems”. (Discovering ISO26000 2014 p5).

The ISO standard has as a component Core Subject 6 Consumer Issues and specifically, in Section 6.7 refers to Access to Essential Services. This deals with the access to those services that are considered essential to a person’s well-being such as electricity, water, gas and telephone. The standard states that:

“Although the state is responsible for ensuring that the right to satisfaction of basic needs is respected, there are many locations or conditions in which the state does not ensure that this right is protected. Even where satisfaction of some basic needs is protected, the right to essential services, such as electricity, gas, water, waste water services, drainage, sewage and telephone, may not be fully protected. An organization can contribute to the fulfilment of this right” (ISO 2600 p 57)

The standard then goes on to state in the section on related actions and expectations that

- in setting prices and charges, offer, wherever permitted, a tariff that will provide a subsidy to those who are in need;

This in essence sums up the issue that economists have with the CSR doctrine. These laudable statements ignore the substantial effects of providing such a tariff on other consumers and on the economy as a whole through lower business profitability. In the next section the tensions between economic theory and CSR theory will be examined and discussed.

2.4 The differences between CSR and Welfare Economics

In contrast to CSR theory, contemporary microeconomic welfare economics as outlined in section 2.1 of this chapter, postulates that the greatest social
role that business can play in maximising society’s welfare is to maximise profits. These two viewpoints are entirely consistent when social responsible behaviour actually contributes to the firm’s profitability.

For example investments by mining companies in a town’s infrastructure or leisure facilities can be applauded as being ‘community minded’ but may make perfect business sense if those investments help attract and keep skilled staff. The friction between the two ideologies comes when business undertake activities that are deemed socially responsible come at the expense of profitability. The role that firms’ profits play in determining the allocation of scarce resources is completely ignored in the CSR literature apart from the observation made by Carroll in his 1999 review of the definitional construct of CSR

“... many today still think of the economic component as what the business firm does for itself, and the legal, ethical and discretionary (or philanthropic)components as what business does for others. Although this distinction is attractive, I would argue that economic viability is something that business does for society as well, although we seldom look at it this way” (Carroll, 1999:284).

The issue here is that to economists the ‘social’ role of business is to make profits because in this way society’s scare resources are allocated efficiently. The most famous denunciation of CSR was made by Milton Friedman in the 1970 article published in the New York Times Magazine. In essence he denigrates CSR as a fundamentally socialist doctrine at odds with a democratic market based society. He argues that the development and implementation of social policy is the preserve of democratically elected representatives rather than this role being performed by CEOs.
Where CSR activities conducted by a business, are activities that would not be done otherwise (the discretionary activities from Carroll’s definition) he likens the CEOs role to tax collector on one hand and tax spender on the other. However unlike a Government policy development process that uses taxpayer funds the CEO has not been elected and the social activities that the CEO is spending shareholders/customers/workers money on has not been endorsed by society as a whole but is merely considered important by the CEO and the board of directors. He summarised his argument at the conclusion of the article,

“But the doctrine of "social responsibility" taken seriously would extend the scope of the political mechanism to every human activity. It does not differ in philosophy from the most explicitly collectivist doctrine. It differs only by professing to believe that collectivist ends can be attained without collectivist means. That is why, in my book Capitalism and Freedom, I have called it a "fundamentally subversive doctrine" in a free society, and have said that in such a society, "there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.” (Friedman 1970)

However, in the 40 years, since this article was published, the notion of a ‘socially responsible business’ has become a commonly accepted one, with triple bottom line reporting now being a normal part of companies annual reporting requirements. But the distinction needs to be made between businesses responding to consumer expectations and businesses behaving in a completely altruistic way. Consumer expectations about how their products are produced have changed significantly in the time since
Friedman’s article was published. Consumers are far more informed about supply chain issues today and so business have responded to this change in demand by offering consumers what they want and are willing to pay for – the competitive market at work.

There is a body of research that finds that the market value of firms that are actively engaging in CSR expenditure have higher values than they would have otherwise (see McGuire, Sundgren and Schneeweis 1988, Godfrey 2005, Luo, and Bhattacharya, 2006 and Flammer 2011 and 2013). In Flammer studies the conclusions are that over time, the negative stock market reaction to eco-harmful behaviour has increased, while the positive reaction to eco-friendly initiatives has decreased. This is directly attributable to the ‘normalisation’ in consumers’ minds of firms behaving in an environmentally sustainable way. Where once it was a ground breaking initiative, now it is an expected part of ‘doing business’.

As CSR is ‘normalised’ in business practice, it is providing consumers with a product or services which reflect the standards and values of the societies in which they operate. There is no conflict between management and economic theory in these instances. It is when firms are acting as philanthropists that tensions arise between this branch of management theory and economic theory.

Relying on business to fulfil social responsibilities can be said to be against the best interests of society, when viewed through the lens of economic theory, as moving the focus of business from profit maximisation results in lower social welfare. This is the theoretical position taken in this thesis.
This aspect of CSR is not acknowledged – that it will actually reduce efficient resource allocation and therefore impose costs on the economy as a whole. So in attempting to address social needs it is in fact reducing the capacity of the economy to address them. It should be acknowledged that not all profit maximisation activity and social activity are mutually exclusive in business. There are many instances where firms in responding to consumer concerns have changed their production processes to reflect changing societal norms or practices. One such example is animal welfare issues surrounding meat production where consumers now desire free range chicken and sow stall free pork. These types of practices are often cited as instances of when “corporate social responsibility pays” meaning that it makes good business sense to adopt CSR. This is an entirely disingenuous position as – the business case for CSR is merely firms maximising profits by reflecting the change in demand from their customers. In this way business had always been linked to societal standards and so claiming that they are leading societal norms rather than responding to them in order to build a justification for a managerial theory is misleading.

2.5 Chapter Summary

In this chapter it has been shown that the process of CSO development in Australia came not from a theoretical perspective as a desirable and justifiable way to deliver social policy but rather as a by-product of deregulation and the subsequent introduction of Competition Policy, as non-economic services or programs were uncovered which were too politically sensitive to unwind. In light of this back-to-front approach at the time of
their initial development the delivering of social policy via CSOs surely warrants more analysis. How do CSOs, as they currently stand, mesh with the broader landscape of social policy? Is there an expanded role that CSOs could play in relation to delivering social policy? Have there been changes social policy objectives or goals since CSOs were developed? Are there industries/sectors such as the banking sector where the government no longer has an ownership interest that exhibit features that society believes constitute CSOs? What makes a CSO a CSO? Does society have some expectation of some services that are best delivered through the business model as opposed to just a cash transfer? The development of CSO policy in Australia against the backdrop of microeconomic reform and competition policy implementation in GBEs has resulted in a limited application and use. In the next section recent developments in social welfare policy, where poverty is not measured exclusively in terms of income, is examined.

This broadening of the definition of those in society that are in need of assistance and support may provide an opportunity for a redefining of what CSOs are and how they can be used to address the issue of social disadvantage in Australia.
Chapter 3

Developments in Assessing Social Disadvantage

The microeconomic reform process that occurred in the US, UK and Australia from the mid-1980’s onwards changed the way that governments saw their role in relation to markets and the role that they could play to maximise social welfare. Since the mid-1990’s, there can be said to be an equally seismic and on-going change in relation to how governments define and assess social disadvantage. It is indeed an almost natural progression in the continuum of reform that the large areas of market failure that are inevitable in a market economy, environmental issues and social equity, become the next focus of government policy development and reform.

CSOs were developed in the first phase of the reform process as a way of dealing with a range of social programs that were delivered by GBEs. As a policy or tool that governments use to deliver social policy objectives, it would seem that a review of the definition of CSOs is justified in light of the changes in the definition and assessment of social disadvantage that has occurred subsequent to the development of CSO policy. A revised definition and process of CSO identification may be warranted in order to integrate this policy more broadly with the overall changes in social welfare policy that have occurred since its inception.

In this chapter, the contemporary approach to assessing disadvantage and deprivation is examined and the current indicators of deprivation and social
inclusion discussed. In subsequent chapters this will form the basis of a revised definition and application of CSOs.

3.1 Current Social Policy Developments– It Isn’t All About the Money

Social policy can be said to be the area of government policy that addresses the unequal distribution of income that may be the result of an economy that is functioning well in terms of allocative efficiency. Until recently, much of the focus of social welfare policy concentrated on the issue of poverty solely in terms of income. Recently this has changed to focus on deprivation (those missing out on the distribution of benefits from economic prosperity) and social exclusion (those that are left out). This was originally driven by Amartya Sen’s work 1987 work, The Standard of Living, which argues that well-being measures needed to be expanded and broadened to a notion of capability. These functional capabilities are the substantive freedoms that people have a reason to value rather than access to resources or measures of utility or happiness. This work has formed the basis of the UN’s Human Development Index. Within his work, poverty is reframed as being capability deprivation as it limits capability that people have to achieve outcomes that they have a reason to value. However poverty is only one aspect of capability deprivation and so social policy needs to be based on more than merely the absence of money.

3.1.1 Poverty is more than just a lack of income

People are defined as living in poverty if their incomes are so inadequate as to preclude them from having an acceptable standard of living (Combat
Poverty Agency, 2002). Implicit in this definition is the need for a judgement to be made as to what constitutes an acceptable standard of living and the level of income needed to attain it. The Henderson poverty line was used extensively in Australia to measure the rate and growth of poverty in Australia.

The line, or income below which households were deemed to be poor, was a reflection of living standards and circumstances at the time of its development, so its use today is of limited value in understanding the circumstances and lives of the poor. Most Australian studies of poverty now use a poverty line set at 50 per cent of median income but there is widespread recognition that this contains an element of arbitrariness (Wilkins et al. 2011:34). The other issue with the use of poverty lines as a measure of social disadvantage is that as social welfare payments are generally established around the 50 per cent median – the sensitivity of the poverty rate to small changes in the ‘line’ is very high. Conversely small changes in the rates of those social welfare payments can have a relatively large impact on the reportable rates of poverty (Saunders and Wong, 2012:7).

There is a growing recognition that poverty is not simply about income, although it is a useful way to measure it, but rather that the notion of poverty needs to encompass a reflection of the living conditions faced by those described as poor. For this reason, the use of poverty lines as a means of defining poverty have been criticised on three fronts. First, poverty lines studies that use an income measure to define those in poverty are out of touch with the lived realities of poverty (Lister, 2004). Second, the use of a
poverty line may fail to link the actual living conditions of those found to be poor with what is perceived as poverty (Whiteford, 1997) and third, the judgements used to identify poverty using an income poverty line are subject to criticism (Saunders & Tsumori, 2002).

Another issue is that income as a measure of poverty doesn’t encompass the other resources that individuals can draw on in times of low income, such as accumulated wealth, access to credit and family networks (Boarini & d'Ercole, 2006). So an individual may have a low income but would not be said to be living in poverty, given their access to these other resources. The link between income and poverty therefore becomes tenuous when these factors are recognised as important (Saunders, Naidoo, & Griffiths, 2007). In addition there is an argument that measuring consumption rather than income is a more appropriate reflection of people’s standards of living.

“When measuring the resources available to an individual it is preferable to quantify expenditure rather than income. Expenditure generates the flow of services from which material well-being is derived. Income, in contrast, provides the capacity to purchase things ... generally income is valued not for its own sake but for the ability it provides to buy goods and services. It is thus more satisfactory to measure directly the level of goods and services bought” (Travers and Richardson, 1993: 24)

However, this method suffers from the same conceptual limitations as using income as a measure of poverty. In recognition of the limitations of using income as a means of measuring social disadvantage, that is low income may increase the risk of poverty but may not always result in poverty, new indicators of disadvantage have been developed (Saunders and Wong,
Measuring income levels does not necessarily demonstrate the existence of poverty and therefore new indicators are being developed that “identifies unacceptable living standards (as in the case of deprivation), or by adopting an approach that broadens the underlying causes beyond those relating to a lack of economic resources (as in the case of social exclusion)” (Saunders and Wong 2012: 8).

3.1.2 The relationship between poverty and deprivation

Recognition of the limitations of using income as the sole measure of poverty stimulated the emergence of themes in the poverty literature, namely deprivation and social exclusion. Deprivation first emerged as a broader descriptor of poverty in Townsend’s work in 1979. He defined poverty as

> “Individuals families and groups in the population can be said to be in poverty when they lack the resources to obtain the types of diet, participate in the activities and have the living conditions and amenities which are customary, or at least widely encouraged or approved, in the societies to which they belong. Their resources are so seriously below those commanded by the average individual or family that they are, in effect, excluded from ordinary living patterns and activities”. (Townsend, 1979:31).

The link between deprivation and poverty is made when a lack of resources is cited as the main cause of the deprivation (Saunders, Naidoo, & Griffiths, 2007). To make the definition by Townsend one that can be used to assess deprivation, Saunders and Wong (2012), identify two key elements. First the goods and services which are customary or at least widely encouraged or approved need to be identified and second that those who don’t have
these items are constrained from doing so by a lack of resources. So deprivation can be defined as “an enforced lack of socially perceived necessities (or essentials)” (Mack & Lansley, 1985:39).

Saunders and Wong (2012:12) note that Townsend’s definition makes clear that deprivation may be because of factors other than income “including poor working conditions, inadequate neighbourhood facilities, lack of access to appropriate health services or barriers that prevent people participating in widely practised and endorsed community activities”. So this means that poverty and deprivation are different even though “evidence that deprivation exists can help to identify the level of resources needed to avoid poverty” (Saunders and Wong, 2012:13).

Deprivation and poverty are closely linked but are not the same in that it is also possible to experience deprivation while not necessarily being poor and to be poor while not necessarily deprived (Saunders, Naidoo, & Griffiths, 2007). Deprivation indicators have been used initially by Townsend, (1979), and then refined by Mack & Lansley (1985), Gordon & Pantazis, (1997), Gordon & Townsend, (2000) and Gordon (2006) and Levitas, (2006), to establish a more meaningful poverty line. These indicators are also useful in their own right as a means to develop a more appropriate policy response to the issue of deprivation and poverty (Saunders, Naidoo, & Griffiths, 2007).

3.1.3 The relationship between Poverty and Social Exclusion

The concept of social exclusion was first developed by Lenoir, (1974) as a way of identifying those excluded from the French welfare system and
therefore unable to participate in different spheres of social and economic activity.

Issues surrounding the definition of exclusion (Saunders, Naidoo, & Griffiths, 2007) resulted in a group of leading British researchers proposing the following working definition.

“Social exclusion is a complex and multi-dimensional process. It involves the lack or denial of resources, rights, goods and services, and the inability to participate in the normal relationships and activities, available to the majority of people in society, whether in economic, social cultural or political arenas. It affects both the quality of life of individuals and the equity and cohesion of society as a whole.” (Levitas, et al, 2007:9).

Although the definition of poverty by Townsend directly cites lack of resources as a cause of social exclusion, this theme was not been developed in the literature on social exclusion (Saunders, Naidoo, & Griffiths, 2007).

The British Government placed exclusion at the core of its social policy in 1996, identifying it as a priority for research funding through the Economic and Social Research Council. In 2000 the European Union Heads of State agreed to the Lisbon Agenda which places social inclusion and social cohesion at the centre of the European social policy agenda (Atkinson, 2007). Australia has followed this trend with the South Australian government establishing a Social Inclusion Initiative in 2002 and other states incorporating the notion of social inclusion into their social policy frameworks.

Nationally, the Australian government has adopted a social inclusion approach by establishing the Social Inclusion Unit in the Department of
Prime Minister and Cabinet that supports the Australian Social Inclusion Board that advises the government on how to monitor and address forms of exclusion. The Australian Government has developed a social inclusion strategy founded on the view that:

“Social inclusion means building a nation in which all Australians have the opportunity and support that they need to participate fully in the nation’s economic and community life, develop their own potential and be treated with dignity and respect. Achieving this vision means tackling the most entrenched forms of disadvantage in Australia today, expanding the range of opportunities available to everyone and strengthening resilience and responsibility” (Australian Government 2009:2)

The elevation of social inclusion as a specific agenda for social welfare has broadened the notion of disadvantage from one focused on economic resources to one of processes, institutional and structural factors

“It has focussed attention onto a debate about the role of barriers that prevent certain individuals or groups from accessing the labour market, financial services and other services that are often provided at a local area level” (Saunders and Wong 2012:17).

The distinction between deprivation and exclusion and their relationship to the traditional concept of poverty as a measure of societal disadvantage are summarised as

“Thus while deprivation has been better used to define poverty, social exclusion has been seen as offering an alternative broader approach that opens up issues associated with the role of institutional structures and processes”. (Saunders, Naidoo, & Griffiths 2007:12).
This broadening of the agenda regarding social inclusion and deprivation has also resulted in a corresponding realignment of how the effectiveness of social programs and initiatives are measured and funded. In the next section, the developments related to funding will be discussed, in the context of both the UK and in Australia.

3.2 Current Developments in Social Policy Financing – It’s all About the Impact.

The changes to developments in assessing how social policies are financed are as dramatic a shift as the developments to determine who is in need of assistance, discussed in the previous section. In this section the changes to social financing will be discussed, including the issue of measuring and funding for social impact.

Traditionally in Australia it has been common for governments to award contracts for service provision of social programs to religious and other not-for-profit agencies, funded by taxpayers. However, there is a growing trend towards socially responsible investment funding ‘socially responsible businesses and programs’. In particular there are two types of innovation in funding for social programs, one involving the capital markets (social benefits bond) and the other involving the establishment of a wholesale bank to provide finance to social investment financial intermediaries (Big Society Capital in the UK). In this section the development of these financing innovations will be discussed and evaluated.
3.2.1 Social Benefits Bond (NSW Government)

The NSW Government has introduced a trial of using the capital markets as a means not only to raise funds for social programs but also as a way to increase the effectiveness and reduce the overall costs of those programs to taxpayers. Two Social Benefit Bonds were launched in the Australian market in 2013, the first of these type of bond in Australia. (The UK is the leading issuer of this type of bond but only commenced in 2010, so the market could be said to still be in the very early stages of development. Figure 3.1 outlines the details of the two bonds that have been issued.

The key difference between this type of financial instrument and having programs funded out of consolidated revenue are that payments are made on the basis of meeting pre-specified outcomes, for example an outcome may state that the funded program will reduce the rates of recidivism in the target group by 10%. If this outcome is not achieved by the service provider there is no payment and, depending on how the bond is structured, investors will lose all or part of their capital and/or receive no interest payments. The key features of a Social Benefit Bond are that the outcomes must be agreed to between the government and the service provider and they must be measurable.
Because the government only pays when targets are achieved, these types of bonds shift the risk of the program onto investors, away from taxpayers. In the main these investors, particularly when capital is at risk will be charitable institutions and philanthropic investors who may have typically donated money in the form of grants in the past. The risk or likelihood of re-payment is not a downside risk for them but rather an up-side as they previously had no expectation of recouping capital.
The Social Benefit Bonds are particularly useful in funding programs that focus on prevention. These areas can provide significant savings to government in the form of avoided costs ie the avoided cost of a child entering care or the avoided cost of a person being convicted and jailed, and improved social outcomes for clients, but due to the lack of immediacy of need can be easy to defer in times of budgetary pressures.

The bonds form part of a larger world wide movement towards “Social Impact Investing” where investment aims to achieve positive social outcomes in addition to generating a financial return.

Like the CSR doctrine examined in Chapter 2 of this dissertation, this represents a dismissal of profit as a deliverer of societal benefits. That is in achieving profit, business and companies are pursuing some morally inferior outcome and one furthermore that damages society by not addressing its core needs. To intimate that investing in a profitable business that abides by laws designed to protect consumers and employees in addition to the environment, somehow delivers a sub-optimal social outcome is dismissing the real benefits that profits bring in terms of signalling the most socially desirable use of scarce resources.

In the next section the establishment of Big Society Capital by the Government of England will be reviewed as an alternate means of funding social programs in countries under budgetary pressure.
3.2.2 Wholesale Capital Market Development (Big Society Capital UK Government)

Big Society Capital, a wholesale bank, was established in 2012 in the UK by the government. Its capital base was funded through reclaimed dormant bank accounts (£400 million pounds) and a £50 million pound contribution from each of the four banks (Barclays, HSBC, Lloyds Banking Group and RBS). The bank’s contribution was part of a broader range of reforms, referred to as the Merlin Agreement, negotiated as part of the UK government’s response to the GFC, where they committed taxpayers’ funds to recapitalise UK banks through partial and full nationalisation.

Big Society Capital has as its vision:

“A vibrant diverse, well capitalised and sustainable social investment market in the UK, through which social sector organisations can access appropriate and affordable finance and support to grow their positive impact on society”

The mission of BSC is twofold, as an investor and as a ‘champion’ for the social investment market. As an investor BSC aims to:

- To have a transformative impact on the social investment market in the UK by supporting social investment finance intermediaries to become financially robust and able to:
- Attract greater and more diverse sources of investment;
- Effectively and efficiently channel appropriate and affordable capital to the social sector; and
- Provide effective financial and business support services to the social sector.

As a champion BSC aims to:
To increase awareness of and confidence in social investment by:

- Promoting best practice and sharing information;
- Improving links between the social investment and mainstream financial markets;
- Working with other investors to embed social impact assessment into the investment decision-making process


In effect the UK government is ‘making a market’ by establishing a wholesale bank which lends to bodies that are lending to clients on the basis of social impact rather than profit. In doing so, as per the BSC mission statement, it hopes to foster the development of a private market in social investment. As part of this, the BSC has established an outcomes matrix which represents a map of need in the UK representing nine outcome areas which are deemed as necessary for a person living in the UK to have a full and happy life. It uses this as a tool to measure the Social Investment Financial Intermediaries application for funds as the basis of its lending, to assess viability in the absence of the usual banking criteria of profitability. In addition, it states that it hopes it will bring a collective language to measuring social investment and to this end has been adopted by the UK government as a means of measuring the social impact of their programs and policies. This matrix represents a very advanced framework for the analysis of social impact and has very detailed outcomes and measurements under each category in the matrix.

While these measures about increasing and expanding the pool of funds available for ‘social investment’ all sound laudable there is a worrying
theme of language used in BSC’s literature and in vodcasts recorded on their website. The opportunity as an investor to make a ‘positive social impact’ rather than just a financial profit is continually extolled – seemingly ignoring the very real and very positive benefits that investing on the basis of profits brings to society.

Making surplus funds available to be invested in profitable business provides benefits to individuals and families by providing meaningful and sustainable employment. In addition, as investment funds flow to business of high profitability, due to increased returns, these funds are being used to produce goods and services that society deems desirable and therefore higher levels of social welfare are achieved. If available funds are continually diverted away from profitable investment into investments of lower profitability but ‘higher social return’ as measured by the matrix, then overall levels of social welfare will decline over time. If this profit-making generates undesirable social outcomes – such as environmental spill overs – then the ineffective action by government to internalise the externality is the culprit – not the profitability of the firm. There may be a set of investors who will maximise their utility by investing in goods or services which may not have profit maximisation as their only goal much the same way that some people contribute large amounts of their income to charities rather than consume it. But to actively promote this type of investment as preferable, rather than a niche of the total investment market would seem to be at best misleading.

It may be that the development of this wholesale bank is simply a means for the Government outsourcing social programs on the basis of public finance
concerns. Certainly the establishment capital of BSC was a masterstroke in terms of public finance – to establish an on-going fund from dormant bank accounts and as a quid pro quo from the banking sector at a time when the government held significant leverage over the sector was inspired.

The creation of the outcomes matrix is also a commendable development in order to develop an assessment of how well the investments met their objectives. However, the problem of giving control over social spending to the market means that Governments have forfeited policy control. The investments will be market driven on the basis of outcomes that investors are seeking rather than a comprehensive social policy agenda developed by an elected government. If we start from the reasonable point that social inequality is a market failure then in effect, the government has devolved back to the market an issue that was the result of the failure of the market the first time. Why would the expectation be that the second round attempt will deliver outcomes more desirable than the first? Furthermore, does a divergence between the two mean that the government becomes, in effect, the lender of last resort and picks up the expenditure for programs that investors don’t want to provide funds for but that has been deemed to be an important area of expenditure to produce socially desirable outcomes? Or does the government elected by the citizens cede all of its responsibilities in this area to the market.

The development and performance of the private social investment market is still in its infancy but there do seem to be some conceptual issues here that may prove to be difficult to overcome in the long run and may prove to outweigh the short run public finance benefits.
In addition, unlike the UK, Australia has yet to develop a framework that is as comprehensive in its agreed areas of need and while there may be significant similarity to those areas identified in the UK, there may well be some marked differences due to differences in cultural and social expectations. In the next section the development of indicators of disadvantage in Australia is discussed.

3.3 Indicators of Deprivation and Social Exclusion in Australia

The Social Policy Research Centre at the University of New South Wales has developed a set of indicators for deprivation and social exclusion based on a community wide survey, conducted in 2006 and 2010. For discussion of the survey methodology and how the indicators were derived see Saunders and Wong 2012. The importance of deriving indicators of deprivation and exclusion from the wider community is critical to the results obtained. The broader community identifies those services and features of life that it considers necessary to maintain an acceptable standard of living in Australia today – and as such they reflect the values of the whole community – not just those who are said to be living in poverty.

3.3.1 Deprivation indicators

The process for developing a set of deprivation indicators is threefold. First, it involves identifying the items that are regarded by the majority of the population as being necessary or essential. Second, those who do not have the items or services are identified and third a distinction is made between those that don’t have it because they don’t want it and those that don’t have
it because they can’t afford it. It is the last category that constitutes those that are deprived. The following diagram illustrates this process of developing a set of deprivation indices and then subsequently using them to identify deprivation.

Figure 3.2 Development of Deprivation Indices

Source: Saunders and Wong (2012:13)

The ‘Essentials of Life’ as derived through the survey work done by the SPRC, are outlined in Table 3.1. These items are purchasable items deemed to be essential by a community wide survey.

Table 3.1: The Essentials of Life 2010

<table>
<thead>
<tr>
<th>Classification of Needs</th>
<th>Set of needs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Material Needs</td>
<td>Warm clothes and bedding, if it is cold</td>
</tr>
<tr>
<td></td>
<td>A substantial meal at least once a day</td>
</tr>
<tr>
<td></td>
<td>A washing machine</td>
</tr>
<tr>
<td>Classification of Needs</td>
<td>Set of needs</td>
</tr>
<tr>
<td>-------------------------------</td>
<td>-----------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Accommodation needs</td>
<td>A decent and secure home</td>
</tr>
<tr>
<td></td>
<td>A roof and gutters that don’t leak</td>
</tr>
<tr>
<td></td>
<td>Secure locks on doors and windows</td>
</tr>
<tr>
<td></td>
<td>Furniture in reasonable condition</td>
</tr>
<tr>
<td></td>
<td>Heating in at least one room of the house</td>
</tr>
<tr>
<td>Health – related Needs</td>
<td>Medical treatment if needed</td>
</tr>
<tr>
<td></td>
<td>Able to buy medicines prescribed by a doctor</td>
</tr>
<tr>
<td></td>
<td>Dental treatment if needed</td>
</tr>
<tr>
<td>Children’s needs</td>
<td>Children can participate in school activities and outings</td>
</tr>
<tr>
<td></td>
<td>A yearly dental check-up for children</td>
</tr>
<tr>
<td></td>
<td>A hobby or leisure activity for children</td>
</tr>
<tr>
<td></td>
<td>Up to date school books and new school clothes</td>
</tr>
<tr>
<td></td>
<td>A separate bed for each child</td>
</tr>
<tr>
<td>Social Functioning Needs</td>
<td>Regular social contact with other people</td>
</tr>
<tr>
<td></td>
<td>Presents for family or friends at least once a year</td>
</tr>
<tr>
<td></td>
<td>Computer skills</td>
</tr>
<tr>
<td></td>
<td>A telephone</td>
</tr>
<tr>
<td></td>
<td>A weeks holiday away from home each year</td>
</tr>
<tr>
<td>Risk protection Needs</td>
<td>Up to $500 in savings for an emergency</td>
</tr>
<tr>
<td></td>
<td>Home contents insurance</td>
</tr>
<tr>
<td></td>
<td>Comprehensive motor vehicle insurance</td>
</tr>
</tbody>
</table>

Source (Saunders and Wong, 2012:38)
In deriving deprivation measures, there is, by nature of what you are trying to assess, an element of being able to purchase the items. There are however many items that are non-purchasable that can be deemed essential, and when someone is unable to access them they could be said to be living in a state of deprivation. The section of the study that derived these indicators can be broken into two parts – the first relating to individual items such as being treated with respect and supportive family relationships (for a full list of these items see Saunders and Wong 2012:40). The second part of the non-purchasable items that are considered essential relate to services and facilities and the availability of these within a local area in Table 3.2 below.

Table 3.2 Support for Essentiality for Selected Non-Purchasable Items
(weighted percentages)

<table>
<thead>
<tr>
<th>Item</th>
<th>Percentage support among survey respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>A safe outdoor space for children to play at or near home.</td>
<td>95%</td>
</tr>
<tr>
<td>Streets that are safe to walk at night</td>
<td>97.2%</td>
</tr>
<tr>
<td>Good public transport in the area</td>
<td>91.7%</td>
</tr>
<tr>
<td>Access to local doctor or hospital</td>
<td>99.3%</td>
</tr>
<tr>
<td>Access to bank or building society</td>
<td>88.6%</td>
</tr>
<tr>
<td>Access to public telephone</td>
<td>81.3%</td>
</tr>
<tr>
<td>A local park or play area for children</td>
<td>91.3%</td>
</tr>
<tr>
<td>Access to a bulk-billing doctor</td>
<td>94.6%</td>
</tr>
<tr>
<td>Access to a chemist</td>
<td>96.4%</td>
</tr>
</tbody>
</table>

Source (Saunders and Wong, 2012:40)
3.3.2 Social Inclusion indicators

There are currently three sets of social inclusion indicators that have been developed in the Australian context. The Australian Government has produced a set of indicators which it uses to measure its performance in promoting social inclusion. The Government has produced two reports titled *How Australia is Fairing* in 2009 and 2012 drawing on ABS data. The indicators of social inclusion that it uses cover 3 broad areas of resources, participation and entrenched disadvantage. These indicators are shown in Table 3.3 below, sourced from the 2012 report.

Table 3.3 Australian Government Social Inclusion Indicators

<table>
<thead>
<tr>
<th>Participation</th>
<th>Resources</th>
<th>Multiple Disadvantage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employment rate</td>
<td>Low economic resources</td>
<td>Feeling of safety</td>
</tr>
<tr>
<td>Children in jobless families</td>
<td>and financial stress/material deprivation.</td>
<td></td>
</tr>
<tr>
<td>Long term income support recipients</td>
<td>Persistent low economic resources</td>
<td></td>
</tr>
<tr>
<td>2. Learn</td>
<td>6. Health and Disability</td>
<td>12. Multiple and Entrenched disadvantage</td>
</tr>
<tr>
<td>Young people not fully engaged in education or work</td>
<td>Employment rate of people with long term health conditions</td>
<td></td>
</tr>
<tr>
<td>Year 12 equivalent attainment</td>
<td>Employment rate of people with mental illness</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Self-assessed health</td>
<td></td>
</tr>
<tr>
<td>3. Engage</td>
<td>7. Education and Skills</td>
<td></td>
</tr>
<tr>
<td>Contacted family/friends</td>
<td>Literacy and numeracy</td>
<td></td>
</tr>
<tr>
<td>Participation in</td>
<td>Adult literacy and</td>
<td></td>
</tr>
<tr>
<td>Participation</td>
<td>Resources</td>
<td>Multiple Disadvantage</td>
</tr>
<tr>
<td>-------------------------------</td>
<td>------------------------------------------------</td>
<td>-----------------------</td>
</tr>
<tr>
<td>community groups</td>
<td>numeracy</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Early child development</td>
<td></td>
</tr>
<tr>
<td>4. Have a voice</td>
<td>8. Social Resources</td>
<td>9. Community and</td>
</tr>
<tr>
<td>Participation in civic</td>
<td>Support from family/friends in times of crisis</td>
<td>Institutional Resources</td>
</tr>
<tr>
<td>engagement activities</td>
<td>Autonomy – having a voice in the community</td>
<td>Access to public or</td>
</tr>
<tr>
<td></td>
<td>Access to the internet</td>
<td>private transport</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Access to health</td>
</tr>
<tr>
<td></td>
<td></td>
<td>service providers</td>
</tr>
<tr>
<td></td>
<td></td>
<td>10. Housing</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Homelessness</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Housing affordability</td>
</tr>
</tbody>
</table>

The Melbourne Institute of Applied Economic and Social Research and the Brotherhood of St Laurence have collaborated to produce another set of indicators of social exclusion. The methodology is based on the concept, as embedded in the other indicators, that exclusion is multidimensional. The data used to measure the level of social exclusion are drawn from the Household, Income and Labour Dynamics in Australia (HILDA) survey, a national survey collecting socioeconomic data from a nationally representative sample of the Australian population. Social exclusion is derived by the weighted sum of exclusion across the seven domains where each domain has an equal weight and all indicators with each domain have
an equal weight. The final score out of seven indicated the level of social exclusion where zero indicates fully included and seven indicates the highest level of social exclusion.

Table 3.4 The Brotherhood of St Lawrence and Melbourne Institute of Applied Economic and Social Research Social Exclusion Indicators.

<table>
<thead>
<tr>
<th>Domain</th>
<th>Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td>Material Resources</td>
<td>Low income</td>
</tr>
<tr>
<td></td>
<td>Low net worth</td>
</tr>
<tr>
<td></td>
<td>Low consumption</td>
</tr>
<tr>
<td></td>
<td>Financial hardship</td>
</tr>
<tr>
<td></td>
<td>Financial status (added in 2010 for methodological consistency)</td>
</tr>
<tr>
<td>Employment</td>
<td>Jobless household</td>
</tr>
<tr>
<td></td>
<td>Long term un-employment</td>
</tr>
<tr>
<td></td>
<td>Unemployment</td>
</tr>
<tr>
<td></td>
<td>Underemployment</td>
</tr>
<tr>
<td></td>
<td>Marginal attachment to the workforce</td>
</tr>
<tr>
<td>Education and skills</td>
<td>Low education</td>
</tr>
<tr>
<td></td>
<td>Low literacy</td>
</tr>
<tr>
<td></td>
<td>Low numeracy</td>
</tr>
<tr>
<td></td>
<td>Poor English</td>
</tr>
<tr>
<td></td>
<td>Little work experience</td>
</tr>
<tr>
<td>Health and disability</td>
<td>Poor general health</td>
</tr>
<tr>
<td></td>
<td>Poor physical health</td>
</tr>
<tr>
<td></td>
<td>Poor mental health</td>
</tr>
<tr>
<td></td>
<td>Long term health condition or disability</td>
</tr>
<tr>
<td></td>
<td>Household has disabled child</td>
</tr>
<tr>
<td>Social connection</td>
<td>Little social support</td>
</tr>
<tr>
<td></td>
<td>Infrequent social activity</td>
</tr>
<tr>
<td>Domain</td>
<td>Indicators</td>
</tr>
<tr>
<td>-----------------</td>
<td>------------------------------------------------</td>
</tr>
<tr>
<td>Community</td>
<td>Low neighbourhood quality</td>
</tr>
<tr>
<td></td>
<td>Disconnection from community</td>
</tr>
<tr>
<td></td>
<td>Low satisfaction with neighbourhood</td>
</tr>
<tr>
<td></td>
<td>Low membership of clubs and associations</td>
</tr>
<tr>
<td></td>
<td>Low volunteer activity</td>
</tr>
<tr>
<td>Personal safety</td>
<td>Victim of violence</td>
</tr>
<tr>
<td></td>
<td>Victim of property crime</td>
</tr>
<tr>
<td></td>
<td>Feeling of being unsafe</td>
</tr>
</tbody>
</table>


Finally the Social Policy Research Centre at the University of New South Wales based the development of the social exclusion indicators used in their study on the definition of social exclusion developed by the London School of Economics Centre for the Analysis of Social Exclusion (CASE), which is based on the premise that exclusion exists when people do not have the opportunity to participate in key activities in their societies. The indicators are produced below in Table 3.5.
Table 3.5 Social Exclusion Indicators derived by the Social Policy Research Centre (UNSW)

<table>
<thead>
<tr>
<th>Disengagement (9 indicators)</th>
<th>Service Exclusion (10 indicators)</th>
<th>Economic Exclusion (8 indicators)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No regular social contact with other people</td>
<td>No medical treatment if needed</td>
<td>Does not have $500 in savings for use in emergency</td>
</tr>
<tr>
<td>Did not participate in any community activities in the past 12 months</td>
<td>No access to local doctor or hospital</td>
<td>Had to pawn or sell something, or borrow money in the last 12 months</td>
</tr>
<tr>
<td>Does not have a social life</td>
<td>No access to dental treatment if needed</td>
<td>Could not raise $2000 in a week</td>
</tr>
<tr>
<td>No annual week’s holiday away from home</td>
<td>No access to bulk-billing doctor</td>
<td>Does not have more than $50,000 worth of assets</td>
</tr>
<tr>
<td>Children do not participate in school outings or activities</td>
<td>No access to mental health services</td>
<td>Has not spent $100 on special treat for self in the last 12 months</td>
</tr>
<tr>
<td>No hobby or leisure activity for children</td>
<td>No child care for working parents</td>
<td>Does not have enough to get by on</td>
</tr>
<tr>
<td>Couldn’t get to an important event because of lack of transport in last 12 months</td>
<td>No aged care for frail older people</td>
<td>Is currently unemployed or looking for work</td>
</tr>
<tr>
<td>Could not go out with friends and pay my way in the last 12 months</td>
<td>No disability support services when needed</td>
<td>Lives in a jobless household</td>
</tr>
<tr>
<td>Unable to attend wedding or funeral in last 12 months</td>
<td>Couldn’t keep up with payments for water, electricity, gas or telephone in the last 12 months</td>
<td></td>
</tr>
</tbody>
</table>

Source Saunders and Wong (2012)

It is clear from the three differing measures of social exclusion, that there is significant agreement on the aspects and contributing factors. What differs between the SPRC and the BSL/MIAESR approaches is essentially the data used to measure the extent of social exclusion in Australia. For the purposes of this dissertation, these differences in measurement are not relevant, what is relevant is the underlying factors that contribute to social exclusion. In
order to inform any changes in the definition and way that CSO policy is
developed, consistency between the multiple factors that cause exclusion is
important rather than the differences in extent due to different data sources.

In the next section the link between disadvantage and CSOs will be
established.

3.4 The link between Social Disadvantage and Community
Service Obligations

As any current discussion of poverty and inequality is far broader in scope
than a measure of income, it follows that any discussion of how government
assistance might be provided to those in the community in need of support
must encompass a discussion of providing that support in a form other than
cash transfer. When looking at deprivation indices it is apparent that some
items considered essential, like access to medical services and transport are
non-purchasable, so increasing welfare payments will do very little to
address this aspect of social disadvantage.

Indeed the notion of social exclusion is one based on the fact that economic
resources alone do not prevent social disadvantage and so it surely follows
that the way in which governments address the issue of social disadvantage
has to be multidimensional encompassing both cash and in-kind transfers.
Access to goods and services provided by both the private sector and
government and opportunity to participate in key activities in society cannot
solely be addressed by increasing transfer payments to particular groups in
society. One possible approach that will be explored in this dissertation is
via a redefined system of CSOs.
The indicators of deprivation and exclusion would seem to be a solid place to begin in order to develop some criteria or decision framework for deciding what might constitute a government’s service obligation. This would enable calls for government service obligations that frequently arise in the community to have some basis for inclusion or rejection based on a framework that is grounded in the Australian communities’ expectations of the minimum requirements for a ‘decent’ standard of living.

If it is accepted that the concept of inequality encompasses more than just low income, it seems reasonable that delivery of government assistance to alleviate social disadvantage as an in-kind transfer would be termed a Community Service Obligation. However, the development of CSO policy in Australia failed to incorporate a framework for deciding what a CSO is and what it is not. CSOs are merely defined as being a function provided by a GBE at the request of government that cannot be provided on commercial terms.

In the face of developments in social policy this would seem to be a weak definition and furthermore there is still no decision criteria for evaluating new claims or calls for CSOs.

At the time that GBEs were brought into line with Competition Policy Principles, extensive processes were established around the definition and establishment of CSOs. These sought to make clear the origins and subsequent funding of CSOs – placing the responsibility for determining CSOs with the Minister of the day – rather than a decision made by the GBE – which had been common practise in the past. This change in policy development ensured that CSOs were linked to government policy.
initiatives and were costed and funded in a way which did not interfere with the competitive pricing of the goods and or services offered by the GBE. In this way the inefficiencies associated with cross-subsidisation were avoided and CSOs became like other social policies of the government – funded out of consolidated revenue.

The policy development of the early 1990’s was a great tool to provide a framework for clarifying what existing non-commercial activities were going to continue (as CSOs) and those that were going to be retracted. While these changes were a huge leap forward in the development of CSO policy the initial decision as to what makes CSOs the appropriate delivery channel for some policy and not others is still not an area that has been defined – beyond the ‘will of the Minister’ argument.

For example, how are Ministers to come to a decision of whether a new policy initiative is a CSO versus something that can be funded and delivered through other social policy channels? In effect, what are the defining characteristics of CSOs and how do they interact/complement with a broader social policy agenda?

3.5 Chapter Summary

In this chapter, the new focus of social policy, on broader issues than just income, have been discussed and examined. These new ways to assess the level of disadvantage focus on factors that contribute to and exacerbate social exclusion and deprivation. Due to the nature of these problems it is much more likely that these issues are unable to be addressed through cash transfers and so naturally lend themselves to in-kind provision. There are
three indicators of social exclusion developed for Australian circumstances, one developed by the Australian Government within the broader context of its social exclusion strategy, one by the Melbourne Institute of Applied Economic and Social Research in conjunction with The Brotherhood of St Lawrence and the third were developed by the University of New South Wales Social Policy Research Centre. All three sets of indicators point to similar sources of disadvantage and give an important indication of social exclusion and deprivation in Australia.

The link is then established between this changed assessment of disadvantage and the provision of in-kind assistance. As social exclusion is based on the fact that economic resources alone do not prevent social disadvantage, the case is made that the government response to the issue of social disadvantage has encompassed both cash and in-kind transfers.

In the next chapter a new definition/framework for deciding what is and what is not a CSO will be proposed.
Chapter 4

A New Definition and Decision Framework
for Community Service Obligations

At the time that GBEs were brought into line with Competition Policy Principles, extensive processes were established around the definition and establishment of CSOs. These sought to make clear the origins and subsequent funding of CSOs – placing the responsibility for determining CSOs with the Minister of the day – rather than a decision made by the GBE – which had been common practice in the past. This change in policy development ensured that CSOs were linked to government policy initiatives and were costed and funded in a way which did not interfere with the pricing of the goods and or services offered by the GBE. In this way the inefficiencies associated with cross-subsidisation were avoided and CSOs became like other social policies of the government – funded out of consolidated revenue.

The policy development of the early 1990’s was a great tool to provide a framework for clarifying what existing non-commercial activities were going to continue (as CSOs) and those that were going to be retracted. While these changes were a huge leap forward in the development of CSO policy, the initial decision of what makes CSOs the appropriate delivery channel for some policy and not others is still an area that has not been defined – beyond the ‘will of the Minister’ argument.
For example, how are Ministers to come to a decision as to whether a new policy initiative is a CSO versus something that can be funded and delivered through other social policy channels or indeed can be provided by the market? In effect, what are the defining characteristics of CSOs and how do they interact/compliment with a broader social policy agenda and its delivery. Or are they something to be considered entirely separately from other social policy?

In this chapter, a new definition of a CSO and a decision framework for applying this definition is proposed. It attempts to define what a CSO is. Currently policy makers have no apparent way of identifying a new CSO. This means that Governments are very susceptible to calls for CSOs to be imposed on industries from community groups and other lobby groups, with no valid or solid basis for evaluating the worth of these. This absence of a sound decision framework can lead to knee-jerk policy responses instead of a more considered response which aligns with already determined government priorities. In addition, it anchors the new CSO into a more broadly defined and accepted set of policy objectives in the social welfare goals of governments. There is already a defined process for evaluating proposals for government intervention in the private sector on the basis of market failure and the all-important public interest test that any intervention must satisfy before becoming policy.

This decision framework is intended as a tool for use by government decision makers when determining when a new claim for government intervention on the basis of equity, rather than market failure, is a justifiable claim for government intervention by means of a CSO.
4.1 A new definition of CSOs

The current definition of a CSO (as identified in Chapter 2) is

“A CSO arises when a government specifically requires a public enterprise to carry out activities relating to outputs or inputs which it would not elect to do on a commercial basis and which the government does not require other businesses in the public or private sectors to generally undertake, or which it would only do at commercially higher prices” (Industry Commission, 1994).

The new definition of CSOs, proposed in this dissertation is based on the issues and analysis in the preceding chapters. The key points being that new developments in social policy and the two themes of deprivation and social exclusion result in the impossibility of addressing these objectives through increasing transfer payments. These issues are such that they cannot be solely addressed through increases to social security payments, they are issues that need to be addressed through in-kind transfers. The types of services provided in this way need to be part of a set of identified needs that have been adopted as those that are central to alleviating deprivation and/or social exclusion, such as those discussed in the preceding chapter.

By anchoring the concept of CSOs as part of the broader social policy framework they are less likely to be used as a mechanism for delivery of knee-jerk policy responses to rent seeking interest groups wanting regulations to be imposed on business for activities or services which have no basis either by addressing market failure or equity issues in the economy. Irrespective of whether business or governments incur the costs, these impositions on business activity impose costs on the economy and result in lower social welfare. By linking CSOs to an equity issue that cannot be
addressed in any way other than by a direct provision of goods or services through a business, whether a GBE or a private business, means that all other means of delivering the policy objective need to have been eliminated. It also implicitly means that the costs of delivery through a business have been judged to be acceptable in pursuing the objective on equity grounds.

The decoupling of CSOs from provision of activities provided through GBEs is essential to anchoring the new CSO in a broader social welfare framework. The initial development of the CSO was the by-product of the introduction of Competition policy principles to government owned businesses. A re-orientation of the policy is needed to, first, allow new CSOs to be developed based on an alternate criteria and second to acknowledge that CSOs can be more than just a by-product of the introduction of Competition policy.

The further component is the assumed superiority of cash as a means of meeting the majority of social welfare needs.

When the definition of disadvantage in society is expanded to include more factors than just income and when the definition of disadvantage includes items/services which cannot be purchased then clearly extending more cash in the form of increased benefits is not going to address the underlying problem. So there clearly is a role for non-cash assistance to be provided that is directly linked to the indicators of deprivation and social inclusion, measures that the Australian government has prioritised in its social welfare agenda. Given the nebulous development of CSOs when they were first muted in the early to mid-1990s, surely a far more worthy and appropriate use for the term and the underlying philosophy, that of providing in-kind
benefits directly to recipients through business, should be re-orientated towards delivering on these areas that have been identified as being significant in promoting exclusion and deprivation.

The traditional line among economists is that the individual is the best person to address his or her own utility and so assistance is preferably delivered as cash payments. This is because cash grants do not create the deadweight losses in consumption that would result from the distortion of relative prices associated with subsidies on goods or services (see Joseph 1939 and Hicks 1939 for proofs of this statement). Cash enables the individual to ‘customise’ the mix of goods or services which best meet their own needs and circumstances and in this way maximise their utility, a key factor in maximising social welfare in the economic sense.

In this way outcomes from the assistance will be maximised as governments are not delivering goods and services that the clients do not value or have no use for. The high ground becomes less solid around this argument that cash is the most efficient way to deliver and achieve increased welfare levels when dependents are included (Ross, 1991). By default we extend the assumption that care-givers will maximise their family’s welfare through sourcing goods and services that benefit the family as a whole. But is this the case and how autonomous can we allow recipients of welfare to be in deciding the mix of goods and services that they and their families consume? An example of where this was considered not to be working was in Aboriginal communities where the consumption of alcohol with government benefits was considered to be having adverse health effect on individuals and the families that they supported. Ultimately government
assistance by means of cash transfers on welfare grounds was encouraging socially adverse outcomes for the individual and the dependents of that individual.

In light of this analysis, the following definition of a CSO is proposed in this dissertation:

A CSO is a good or service that is provided through a business at the request of government in order to meet a stated social policy objective, linked to social inclusion and deprivation, that cannot be achieved through a cash transfer, or other market-based delivery channels.

In the remainder of this chapter, contemporary principles that guide the design of regulation will be discussed and then a decision framework is proposed based on this new definition of CSOs.

4.2 Regulatory Design

In this section the principles that underpin regulatory design will be discussed. “Regulations are the requirements imposed by governments that influence the decisions and conduct of business, other organisations and consumers” (Productivity Commission, 2012:10). These regulations are the end product of a policy process that starts with a desire to change the current situation – or a problem that is within the sphere of government to address. For the most part however there is recognition that competitive market forces will deliver optimal socially desirable outcomes. The instances where this isn’t the case are termed market failure and can be grouped into
four areas, lack of information, monopoly power, externalities and social objectives such as income distribution or social equity.

In order to achieve a specific policy objective, regulation needs to be designed to deliver the objective at the least cost – these costs include actual dollar costs but more importantly also include economic costs such as the distortions induced by the regulations which can include for example lower levels of investment. Good regulatory design has the following characteristics as identified by the OECD (Organisation for Economic Co-operation and Development, 2005):

- **Serve clearly identified policy goals and be effective in achieving those goals,**
- **Have a sound legal and empirical basis,**
- **Produce benefits that justify costs, considering the distribution effects across society and taking economic, environmental and social effects into account**
- **Minimise costs and market distortions**
- **Promote innovation through market incentives and goal-based approaches**
- **Be clear, simple and practical for users**
- **Be consistent with other regulations and policies**
- **Be compatible as far as possible with competition, trade and investment-facilitating principles at domestic and international levels.**
The existence of a market failure does not automatically mean that a regulatory response is required. Indeed, the do-nothing option should be the first option considered when designing good regulation (Findlay, 2000). The extent and type of response is determined by interaction of the likelihood that the event will occur coupled with the extent of the impact that the adverse event will have. The extent of the governmental response needs to be commensurate with the frequency and cost of the failure that the intervention is trying to correct. The following diagram shows this trade-off and the level of regulatory response required.

*Figure 4.1 Regulatory Response Range*

This can also be presented as a spectrum, moving from the do nothing option through to the explicit government regulation option. It should be stressed that the do-nothing option is as legitimate an outcome as the explicit government regulation outcome, if the issues have been assessed via
a similar evaluative process. However it should also be noted that a ‘first-best’ policy solution may not be available in a given situation. This does not imply that the do nothing option is then the only alternative. ‘Second-best’ policy options, are viable options if they improve welfare outcomes that which would occur if no action were taken.

**Figure 4.2 Regulatory Response Spectrum**

Regulation in areas of business activity, such as overcoming or regulating for a lack of competition in a sector are much more straightforward than regulating services to achieve outcomes of equity. In the first instance, a lack of competitive pressure can be shown to exist and a cost benefit analysis done to establish the effectiveness of imposing regulation that will have a positive payoff for society as a whole. Regulation is only introduced when there is a clear beneficial outcome for society – the regulation must pass the public interest test meaning that the net benefits to society exist. This test or principle was introduced as part of the Competition Policy reform process and represented a change in mindset away from automatic
introduction of regulation to one where overcoming the market failure delivered clear benefits despite the costs, to society as a whole.

4.2.1 Principles of Regulatory design for Social Welfare

In introducing regulation regarding services to achieve equity goals, the process is less cut and dried. Many forces determine what the policy stance of the day will be regarding equity provision in society and these by their nature will develop, change and evolve over time. What were acceptable government social policy objectives 50 years ago are unlikely to be acceptable as social policy objectives in today’s society. There are however some principles that guide the development of social policy design at the program level. Several differing principles are in the public domain, for example the Henry report on taxation (2009:17) identifies the following design principles for the tax and transfer system as a whole: equity, efficiency, simplicity, sustainability and policy consistency. An alternative but very closely related set of principles for social welfare program design have been developed by Stanton and Herscovitch through the Crawford School of Public Policy at ANU. These principles have been termed the five ‘Es’, equity, effectiveness, employment, efficiency and economy (Stanton and Herscovitch 2013)

The principle of equity is central to social policy design. It has two dimensions, vertical equity and horizontal equity. Vertical equity is about supporting those in society with fewer resources than others – it is the basis for the ‘welfare safety net’ and the philosophical basis of the progressive taxation system (Stanton and Herscovitch). It is basically the belief that
those with more resources should support those in society with fewer resources and underpins the very existence of social policy.

Horizontal equity is the principle that those individuals with similar resources should be treated equally. Stanton and Herscovitch make the point that “in practise this means taking account of the impact of dependants on financial capacity at all income and assets levels” (2013:8). It could also be argued that horizontal equity implies that individuals of similar financial capacity should be treated equally regardless of location. This principle underpins many of the existing CSO provisions and is an argument that is frequently relied on, particularly with respect to the provision and pricing of telecommunication services.

The principle of effectiveness is about how well a scheme delivers what it was designed to deliver. Simplicity of design and implementation is critical to achieving effectiveness. The recent move towards a Disability Insurance Scheme was in part prompted by a desire to drastically simplify the process of accessing funding for services for which people were deemed eligible to receive.

Efficiency has several aspects to it but essentially means that the correct payments are made in a timely fashion to the intended recipients while protecting the incentives for people to pursue self-sufficiency objectives. Programs can be said to be target efficient when they limit the extent of benefit leakage to individuals who were not the intended recipients. A program is administratively efficient when it is delivered in a least cost fashion, on time. In reality there can be significant trade-offs between these two efficiencies.
For example the changes to the private health insurance rebate scheme make for greater complexity as the rebate is now means tested with a sliding scale of rebates depending on income. This would decrease the administrative efficiency as the scheme has become more complex to administer but would have increased the target efficiency as high income earners are excluded. The economically efficient component of efficiency is that the scheme produces as little disincentives to private endeavour as possible – that is that the incentives for work and saving remain in place.

Economy is about minimising budgetary costs, both program costs and administration costs. This is a principle that is common across all government intervention and is not unique to the design of social welfare programs. Well-designed schemes are taken up by the intended recipients at the minimum possible expenditure by government that achieves the desired policy objective.

The final ‘E’ is employment which is deemed so important to social policy that it warrants its own category despite being able to be categorised as part of the broader concept of social and economic engagement. There is a premise inbuilt into the system of social welfare in Australia, that people who can work have an obligation or in fact a moral duty to do so (Stanton and Herscovitch 2013). Indeed the social security system is part of the wider government obligations which has a strong commitment to full employment and provides a range of workplace protection, such as minimum wages.
Indeed the workplace is a key driver of social change as anti-discrimination laws and other equal opportunity measures have been ‘delivered’ through the workplace.

In the next section a decision framework is proposed for classifying social welfare issues as CSOs. The framework is designed to be used to classify new and emerging issues.

**4.3 The Framework for classifying Social Welfare Issues as Community Service Obligations**

The following decision framework is proposed as a means of clearly defining what types of government intervention on social policy grounds is a CSO. It is intended that this framework be used as a basis for classifying new claims for CSOs from the community and interest groups and also to be used as a means of ensuring that current CSOs still retain some merit in terms of achieving the government’s social policy objectives.

The first step in classification is to link the issue with a clearly stated social policy objective. Social inclusion and deprivation are now the overriding themes of social policy, rather than the more narrow focus on poverty. Does the issue being considered fall within one of the indicators of deprivation and exclusion that have been generated as a means to measure social inclusion and the progress that has been made towards this policy goal?

For example, much of this policy objective deals with access to services – so an issue that could be considered here, that would satisfy this criterion, would be the access to medical services for Australians in regional and
remote communities. So an issue that fits or falls within a stated objective is the first step of the decision process.

The next step in the decision process is to ensure that the issue isn’t the result of a market failure. That is, that the reason that there is an issue is because of the existence of asymmetric information, a public good, a lack of competition (or the existence of monopoly), or issues related to commonly owned resources that can prevent markets from operating efficiently and can result in socially undesirable outcomes. This is an important component of the decision process as the principles of good policy design include pursuing the first best solution as the preferred option. Using social policy to compensate for undesirable outcomes generated by a market failure is a blunt policy instrument which may not be effective and may raise second round effects which over time may prove to be as large an efficiency cost in additional to having a social undesirable outcomes as the original market failure. If the issue is the result of a market failure it is far more desirable to attempt to rectify it at its cause rather than to design policy to redress the consequences or outcomes of that market failure.

There is a well-established process of policy development in this area that arose from the Competition Policy reforms where any regulatory impost must satisfy the public benefit test before being introduced (see Fels 2001 and Queensland Government Treasury Guidelines 1999 for more information regarding this test and its application in the legislative process).
This involves satisfying the criteria that the regulations will result in benefits to society that exceed the costs. The recognition that regulation imposes costs as well as delivering benefits was an important component of the Competition Policy reforms and inherently recognises that not all cases of market failure need regulatory intervention – only those where the benefits exceed the costs and therefore deliver a net benefit to society.

If an issue arises that is considered significant but doesn’t currently fall within a stated policy objective then rather than provide a one-off response to the single issue, it is more appropriate to have a review of the policy framework in order to ascertain if this issue warrants inclusion or if policy objectives need to be altered. In this way the overall policy objectives are not undermined by knee jerk responses to single issues. Rather individual policy responses can be co-ordinated to ensure that they are consistent within the overall government objectives. It may be that decision makers reject the need to take action on this issue at this time, for example if a new social policy directive has recently been announced or if a review is planned in the future. It would not be realistic to suppose that each issue that arises that currently doesn’t fit within the stated policy be reviewed for inclusion on a case-by-case basis. Rather it would be expected that either action be rejected outright or inclusion deferred until after a holistic review process has been completed.

It may also be that the issue does fit within the government’s policy objectives but that it chooses not to take action on this particular issue. This may be because the private sector is already addressing the issue and any government action could crowd out the market solutions or it may be
that the government has decided that the issue does not warrant action due to its minor nature. In the first instance, the private sector may provide efficient solutions to issues that fall within governments social policy objectives, for their own profit maximising rationale. If this is the case then any regulatory intervention to achieve a similar objective would be counter-productive both from a government budgetary perspective and from an efficiency perspective. If the private sector is willing and able to address the issue then they are far better at providing the service than governments would be through regulation. In addition, since their decisions are made for profit maximising purposes any action by governments will decrease their profits and so decrease overall social welfare. It may be that private sector provision of the good or service may be a defensive strategy, in order to ward off governments imposing more costly regulation on the industry. In either case it is in the government’s interests to have the private sector delivering a solution either proactively as part of their overall business plan or as a defensive strategy. An example of where private sector solutions have addressed issues that were of concern is in the banking sector. Most banks provide an option of a fee free account for welfare benefit recipients, who have no choice but to receive government assistance via a bank account.

This option is provided voluntarily by the banking firms with no regulation governing their actions, even though it could be considered the government’s responsibility to provide the fee free accounts, given that they deliver their assistance in this manner.
It may be also that directly dealing with the market failure to eliminate the exclusion and deprivation may be difficult to apply in practise and another viable option is being provided by charitable organisations that have a history of providing assistance to overcome these issues. In these cases it may well be more effective and efficient to have this continue with some additional government assistance to that agency.

At this stage of the decision making process, we have an issue that fits within the government’s overall stated social policy objectives, is not the result of market failure, and the private sector is not addressing or likely to address in the future. The next question that decision makers need to ask is how best to address this issue, given that the government has made a decision that the issue warrants some action.

There is a view that an individual is the best judge of his or her needs and so the majority of government welfare assistance to individuals is delivered as a cash transfer, with those recipients deciding how best to allocate this budget to meet their own needs depending on their unique circumstances. In the majority of cases this is the preferred delivery channel for welfare as it prevents the government from providing goods or services that recipients neither want nor can use while those things that may be of more benefit are not provided. In addition, a good or service that may be desired and needed by one individual or family may not be useful to another individual or family because of geographical location, cultural background or other circumstances.

By delivering assistance via a cash transfer, governments are allowing recipients’ the dignity of meeting their own needs and also preventing
wasteful and costly delivery of goods or services that do not address needs. So working from the premise that that “cash is king” what are the circumstances when cash delivery is not the preferred model for government assistance? This study has shown that to be the case when the issue is one of access to a particular service that is not just due to a lack of funds – the necessities of life that prevent deprivation and encourage social inclusion. When social policy objectives cannot be met by increasing welfare payments to recipients then the good or service needs to be delivered by some other means.

The spectrum of policy options left to fulfil the stated policy objective, after increased transfers have been eliminated, falls into two broad categories. Market based policy solutions that encourage rather than dictate, are appropriate in some circumstances when a light regulatory response will achieve the stated policy objective. Encouraging behavioural changes through market based incentives is always the first best option, as the costs of regulation are minimised. It should be stated that achievement of the policy objective, at least cost, is what determines the policy option response.

If it transpires after the policy options have been examined and evaluated that the good or service needs to be delivered through a business to certain locations or to certain groups of consumers directly, then a Community Service Obligation exists in that particular sector or industry.

Governments need to provide this form of social welfare in-kind regardless of whether it is a good or service provided by the private sector or through a government business enterprise.
What makes a CSO a CSO is not who the provider is but the fact that in order to achieve a specific social policy objective it needs to be made available to recipients by government directly or more likely by contracting the private sector to supply it.

The decision framework is summarised in the following diagram and this is used in the next chapter to evaluate whether CSOs may be present in the Australian retail banking sector.
Is issue identified in deprivation or social exclusion indicators?

Yes

Is the issue due to market failure?

Yes

Adopt established process to address market failure. No CSO identified

No

Review indicator criteria

No action required. No CSO

No

Is the issue due to market failure?

Yes

Review indicator criteria

No action required. No CSO

No

Is issue identified in deprivation or social exclusion indicators?

Yes

Is this an issue that Government agree to address?

Yes

Identify policy options to address stated objective.

No

Is this an issue that Government agree to address?

No

Identify policy options to address stated objective.

No CSO identified

No CSO identified

Undertake review of policy options to ascertain most efficient way of achieving the stated objective.

Support market-based policy solution based on review.

No CSO identified

Direct delivery of service or good identified as the most efficient way to achieve the stated policy objective based on review.

CSO identified
4.4 Chapter Summary

In this chapter a new definition of Community Service Obligations has been developed, based on the changes and developments in social policy since the original definition was developed in 1994. At that time, the definition of a CSO within a Government Business Enterprise was seen as a necessary step to improve the efficiency of those enterprises, rather than as an important component of social policy. As such the policy and the CSOs that were defined by it remained as a regulatory oddity. The definition proposed in this dissertation situates the notion of a CSO firmly within social policy and specifically as a means of addressing issues of exclusion and deprivation.

In order to support the implementation of the new definition a decision framework has been developed to enable governments to identify an issue falls within the bounds of being a CSO. This decision framework formalises the process of identifying when a CSO exists in an industry or sector and therefore removes the likelihood of ill-considered and knee-jerk policy responses by the government of the day to rent-seeking lobby groups.
Chapter 5

Community Service Obligations and the Australian Retail Banking Sector

In this chapter, the framework developed in Chapter 4 is applied to the Australian retail banking sector in order to answer the central question of this dissertation. Each decision point of the framework will be applied to retail banking in Australia in order to ascertain the answer to the question - Does a CSO exist in Australian Retail Banking?

In the first section, the rationale behind applying the framework to retail banking is discussed. In the following sections of this chapter, each question poised in the decision framework developed in this dissertation, to determine the existence of CSOs, will be discussed and evaluated before the next question is applied. In this way, the newly developed definition and framework for identifying CSOs will be applied to retail banking in Australia.

5.1 Why Retail Banking as an application for the Decision Framework?

The Australian retail banking sector, faces continual political and public pressure surrounding their activities. Despite the stability and performance during the Global Financial Crisis, touted as ‘the envy of the world’ by the Treasurer Hon. Wayne Swann, the Australian banking sector is routinely admonished for being ‘greedy’, for acting non competitively and for not
acting in the best interests of their customers and for not providing services that enhance social cohesion and inclusion. Since the deregulation of the sector in the mid 1980’s the banking sector has routinely been accused of being non-competitive and recording low customer satisfaction levels. These accusations are in the main, directed at the major Australian banks known as the Big Four (Commonwealth Bank of Australia (CBA), National Australia Bank (NAB), Westpac and ANZ), but more recently have also come from other competing Authorised Deposit Taking Institutions (ADI’s) such as the credit unions and building societies (see Deloitte Access Economics, 2013.).

The GFC added more fuel to the general discontent surrounding banks and their role in modern economic society. The role that some banks played, specifically in the US, in extending home loans to individuals and families that were at best marginal in terms of loan quality and then re-packaging and on-selling these loans with credit ratings that did not reflect the underlying riskiness of the original loan, has left a bitter aftermath regarding bank behaviour. Deeper public unrest occurred when billions of taxpayer dollars were directed into the banking systems in the US, the UK and Europe to support the balance sheets of banks that were then threatened by investment in these assets. While the bailouts were undeniably necessary to prevent a far worse outcome in terms of the world economy, this public finance investment in the banking system is not easily understood by individuals who face deep cuts to Government services that they consume.
Indeed, the failure of the credit rating agencies to adjust the credit rating on these loans of declining quality is a market failure that is best addressed by directly regulating the behaviour of the credit rating agencies.

So demand for regulation regarding bank behaviour towards their customers and their broader role in society has continued and indeed strengthened in the aftermath of the GFC. A common theme in any discussion of the post GFC banking system includes calls from the public for the sector to be regulated with ‘Community Service Obligations’ style requirements to be mandated by governments. However, in the absence of a framework to define CSOs in the context of new developments in social policy in Australia, this issue will not be and has not been satisfactorily resolved.

The reasons cited above provide a justification for this sector to be used as an application for the CSO framework developed in Chapter 4. In the succeeding sections of this chapter each decision in the model is considered in relation to retail banking in Australia.

5.2 Step 1 of the Decision Framework: Is the Issue Identified in Deprivation or Social Exclusion Indicators?

Access to banks and/or building societies and having access to emergency funds and insurance products, were identified as important in avoiding social exclusion and deprivation in the indicators that were outlined in Chapter 3. Indeed, the issue of financial exclusion, as this circumstance is termed, has spawned a myriad of research on just this facet of exclusion,
within the broader construct of social exclusion. Financial and social exclusion are highly correlated with the same groups of people generally excluded from both social goods and financial goods, including many who are unemployed, have disabilities or who face language or cultural barriers (Landvogt, 2008). Previous studies have agreed that those more likely to be suffering from financial exclusion include Indigenous Australians; people who are long term unemployed, sole parents with young children, people with disabilities and refugees (see Connelly and Hajaj 2001, Wilson 2002, Link 2004 and Howell and Wilson 2005).

The definition, dimensions and extent of financial exclusion in Australia are examined in this section.

5.2.1 Definition and dimensions of financial exclusion in Australia

The extent of financial exclusion in Australia ranges from between 1 to 17 percent of the population, depending on the definition used to define the issue. Typically definitions of financial exclusion from the USA and UK focus on financial product ownership as the indicator of exclusion. So those not having a bank account are counted as excluded while those that do are counted as included. However, these definitions are not really transferable to the Australia because, unlike the USA and the UK, government welfare payments are paid into bank accounts, so there is only less than 1 per cent of the population who are “unbanked” compared too much higher rates in these other two countries.
A common definition of financial exclusion was developed by Connelly and Haja (2001:4)

“a lack of access to financial services by individuals or communities due to their geographic location, their economic situations or any other ‘anomalous’ social conditions which prevents people from fully participating in the economic and social structures of mainstream communities”

An alternate definition was proposed in the Link report of 2004, commissioned by ANZ is broader in scope and represents and shift away from the notion of product ownership as the key assessment of whether someone is excluded or not.

“Financial exclusion is a lack of access by certain consumers to appropriate, low cost, fair and safe financial products and services from mainstream providers. Financial exclusion becomes more of a concern in the community when it applies to lower income customers and/or those in financial hardship. Financial exclusion is observable at individual, family or household level, but can also be heavily concentrated in suburbs or regions and sometimes among ethnic minorities in a suburb or region. Financial exclusion can sometimes apply to individual small businesses, NFP (not-for-profits) and other community enterprise organisations” (Link 2004:144).

Despite this broadening of the definition, the Chant Link report estimated 6 per cent of Australians were financially excluded, using product ownership as its delineating feature. So those that had inappropriate insurance coverage or had very high credit costs were still said to be included, as they met the condition of having the product.

A further definition was proposed by Burkett and Sheehan building on the Chant Link definition but also explicitly liking the notion of financial
exclusion to the broader concept of social exclusion and deprivation (discussed in Chapter 3).

The definition of financial exclusion developed in their study is:

“a process whereby a person, group or organisation lacks or is denied access to affordable, appropriate and fair financial products, with the result that their ability to participate fully in social or economic activities is reduced, financial hardship is increased and poverty (measured by income, debt and assets) is exacerbated. Addressing financial exclusion is not merely about service provision; it also included capacity building and structural change” (Burkett and Sheehan 2009:3)

Connelly in a report published by The Centre for Social Impact defines financial exclusion in its annual report “Measuring Financial Exclusion in Australia” as:

“Financial exclusion exists where individuals lack access to appropriate and affordable financial services and products – the key services and products are a transaction account, general insurance and a moderate amount of credit” (Connelly 2013: 6)

In the annual measurement of financial exclusion, the 2013 CSI study concluded that around 17.1 per cent of the adult population in Australia were either fully excluded or severely excluded according to the above definition. Fully excluded individuals (1.1 per cent) had none of the 3 basic financial products, transaction account, credit card or general insurance while severely financially excluded individuals (16.6 per cent) had only 1 of the three products (the vast majority had a transaction account only).

This translates in real terms to a total of 3,123,519 adult Australians being classified as either fully or severely excluded.
Interestingly, according to this definition, only 39.7 per cent of Australian adults are fully included, owning all 3 products, with a huge 42.6 per cent classified as marginally excluded, primarily on the basis of not owning a credit card, but having a transaction account and general insurance. These numbers are based on a face to face survey with 50,000 respondents conducted by Roy Morgan research (Connelly 2013).

While this measurement is certainly valuable information about financial exclusion in Australia, the link to product ownership may be a blunt tool for assessing the complexity of financial exclusion. For example defining people as marginally excluded on the basis of not having a credit card may be a little misleading if individuals in this group choose not to have one for very sound financial management reasons, rather than being excluded from having one. Given that the average rates for product ownership among the Australian population are 96.9 per cent for transaction accounts, 80.5 per cent for general insurance and 43.3 per cent for credit card it would appear that this would warrant further investigation – are they excluded or do they choose not to own? In addition, there are many other ways to access small to medium amounts of credit other than through a credit card. There are a plethora of niche, non-bank providers of small unsecured loans for short term financing needs and a range of in-store-financing options for longer term specific purchases such as furniture. So credit card product ownership may not be an accurate indicator of access to credit for households.

Despite these issues with the study it remains the most comprehensive study on the incidence of financial exclusion in Australia.
Some additional complexities around the dimensions of financial exclusion in Australia are investigated in the Burkett and Sheehan study (Burkett and Sheehan, 2009:4).

**Table 5.1 Dimensions of Financial Exclusion**

<table>
<thead>
<tr>
<th>Dimension of exclusion</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Availability</td>
<td>The kind of service needed does not exist at all or does not exist in an individual’s locality</td>
</tr>
<tr>
<td>Access</td>
<td>A lack of access to particular kinds of financial services because of structural factors or issues that an individual faces (such as credit rating, language or physical disabilities)</td>
</tr>
<tr>
<td>Awareness</td>
<td>A lack of awareness of fair products or a lack of capacity to engage with services. This could be as a result of inadequate promotion of basic, fair, products by financial service providers.</td>
</tr>
<tr>
<td>Appropriateness</td>
<td>Products are not appropriate to an individual’s needs (such as small regular repayments on loans for someone on a limited budget) or cultural background (Islamic banking services)</td>
</tr>
<tr>
<td>Affordability</td>
<td>Inabilities to afford existing products (for instance, few insurance products exist for people living on low income) or the cost structures mean that people with few financial resources are charged more.</td>
</tr>
</tbody>
</table>

The types of financial services that the financially excluded require or areas that could be addressed to promote financial inclusion are included in the table below. This is drawn from work by Burkett and Sheehan (2009:5)
Table 5.2 Types of Products that Address Financial Exclusion

<table>
<thead>
<tr>
<th>Products</th>
<th>Needs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal credit</td>
<td>Access to small amounts of credit (less than $5000), at fair and affordable rates with non-exploitive conditions</td>
</tr>
<tr>
<td>Micro-business credit</td>
<td>Small amounts of start-up and growth capital with minimal or no security requirements</td>
</tr>
<tr>
<td>Saving</td>
<td>Incentives for starting and maintain small savings plans</td>
</tr>
<tr>
<td>Insurance</td>
<td>Affordable small insurance policies to cover essentials(such as home contents) with payment arrangements that suit people living on low incomes</td>
</tr>
<tr>
<td>Remittance</td>
<td>Affordable, safe and reliable options for remitting funds and depositing these funds in poorer overseas countries</td>
</tr>
<tr>
<td>Superannuation</td>
<td>Mechanisms for ensuring contributions (particularly employer contributions) for people living on low incomes who are employed casually</td>
</tr>
<tr>
<td>Financial advice</td>
<td>Financial counselling for crisis management, but also advice regarding financial management on low incomes</td>
</tr>
<tr>
<td>Bill payment</td>
<td>Mechanisms whereby people living on low incomes can break down bill payment into instalments and access options such as direct deductions from Centrelink or split accounts from banks.</td>
</tr>
</tbody>
</table>

Developments in financial markets and in technology have enabled new solutions to arise to address some of these issues.

Crowd funding is now one way that small businesses or individuals can access funds to start a new business venture or to engage in a particular project that may subsequently lead to new business developments. Individual investors contribute small amounts to projects that they think are worthwhile or they have a particular connection with via the Internet, with
terms and conditions about return and capital recovery clearly specified. The amount of risk they are assuming is very small because they are only contributing a small proportion of the overall capital required. In this way small businesses that are unable to source funds from traditional lenders can go directly to savers who are prepared to incur the risk. In this way tiny amounts of savings are by-passing traditional intermediaries and are now being invested directly with small and start-up enterprises. As the amount invested by each individual is relatively small, the total risk of the project is spread across many and therefore enables the finance to be provided at reasonable rates of interest. If the finance was provided by a single lender, the riskiness of the project would make the cost of finance prohibitive.

This list of services and needs is a more comprehensive set of financial issues than the definition used by the Centre of Social Impact in their measurement study.

This is also a reflection of the differing definitions used to discuss financial exclusion, with the Burkett and Sheehan definition broader in scope and complexity, making it of course much more difficult to measure.

Regardless of definition used, the CIS study is the largest single study of financial exclusion in the world and it is alarming that 17.7 per cent of adult Australians are considered to be at best severely financially excluded.

In the next section within this decision criterion, the response to the issue of financial exclusion by charities, governments and the private sector is examined. The current response is important when it comes to framing policy options in response to this issue further in the decision framework. It
may provide the opportunity for further responses by government to ‘piggy-back’ onto programs already delivered by charities and the private sector.

5.2.2 Response to Financial Exclusion in Australia by Charities, Government and the private sector.

In this section the current response to the issue of financial exclusion by charities, governments and the private sector is examined. The term used to describe financial serves to the marginalised or excluded is microfinance, a term more commonly associated with services provided in less developed economies. However, in essence the function is the same – providing services to individuals and families who are not able to access the services and/or products from main-stream finance providers. Exclusion from mainstream financial service providers centres primarily on being excluded from access to credit. The market has historically provided a solution to this issue in the form of ‘loan sharks’, pawn brokers and pay-day lenders. These private market operators have filled a market niche in providing mostly small amounts of credit at extortionate rates of interest to vulnerable people and communities excluded from main-stream banking services.

The microfinance services described in this section look at responses from charities, governments and the private sector that provide an alternative to these forms of finance. The market generally does provide a solution where there is demand for a product or service but in the case of access to finance, it seems that this market generated solution is one, that in a modern economy, we cannot live with.
5.2.2.1 Microfinance in Australia

In Australia, micro-finance is defined as:

“Microfinance is a set of tools, approaches and strategies addressing the needs of people who are financially excluded. Microfinance offers low income people access to basic financial services such as small loans, savings, insurance, bill-payment and money transfer facilities, superannuation and financial advice. Microfinance seeks to provide fair, safe and ethical financial services for people, who, because of their circumstances, are not able to access mainstream financial services. Its purpose is to alleviate and eliminate poverty. Therefore exploitive, predatory or unfair lenders are not included in the definition.” Burkett and Sheehan (2009:2)

The primary response to financial exclusion in Australia has been driven by the Good Shepherd Sisters, a religious order of nuns within the Catholic Church.

Through their microfinance agency they administer small interest free loans through a network of 228 accredited providers at 650 locations in Australia. (Good Shepherd, 2014) The No Interest Loan Scheme (NILS), which began in 1981, has been supported by the National Australia Bank (NAB) since 2003. It has assisted around 125,000 people who could not obtain finance through the financial system. The Good Shepherd microfinance agency in partnership with the NAB also offers two further programs, StepUP, a semi-commercial loan product and AddsUp, a saving plan product. Details of the eligibility criteria and terms are in Table 5.3.
Table 5.3 NILS, StepUP and AddsUP program details.

<table>
<thead>
<tr>
<th></th>
<th>NILS</th>
<th>StepUP</th>
<th>AddsUP</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type of service</strong></td>
<td>No Interest Loan</td>
<td>Low Interest Loan</td>
<td>Matched Savings Product</td>
</tr>
<tr>
<td><strong>Eligibility</strong></td>
<td>Health care card holders or low-income earners</td>
<td>Health care card holders, Pension Concession Card holders, and Family Tax Benefit Part A</td>
<td>Borrowers who have completed a NILS or StepUP loan</td>
</tr>
<tr>
<td><strong>Amount</strong></td>
<td>Up to $1,200</td>
<td>Up to $3,000</td>
<td>Savings of $500 are matched dollar for dollar</td>
</tr>
<tr>
<td><strong>Interest</strong></td>
<td>None</td>
<td>5.99% per annum</td>
<td>None</td>
</tr>
<tr>
<td><strong>Purpose</strong></td>
<td>For essential household items and services</td>
<td>For cars, car repairs, household items, computers, medical and dental services, .Can be used for more than one item.</td>
<td>To encourage ongoing savings once NILS or StepUP loan is complete</td>
</tr>
<tr>
<td><strong>Providers</strong></td>
<td>Community providers</td>
<td>Community providers with NAB</td>
<td>NAB</td>
</tr>
<tr>
<td><strong>Process of application</strong></td>
<td>Interview with a community provider</td>
<td>Community provider assists with completing application, then if successful the loan is provided by NAB</td>
<td>Referral by community provider to NAB</td>
</tr>
<tr>
<td><strong>Period of time</strong></td>
<td>Repayments over 12 months</td>
<td>Repayment over 6 months to 3 years</td>
<td>Savings over 6 - 12 months</td>
</tr>
</tbody>
</table>

(Source: Good Shepherd website http://goodshepherdmicrofinance.org.au/)

To give an idea of the scale of the NILS program, in 2009-2010 the active capital base was just over $17 million, with $8.75 million new loans written,
a total of 10,014. The number of active loans in the same period was 10,989. The allocation of loan funds by State is in Table 5.4 below.

**Table 5.4 NILS loans in 2009-2010 by State**

<table>
<thead>
<tr>
<th>State</th>
<th>Loan Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Victoria</td>
<td>$8.75 million</td>
</tr>
<tr>
<td>New South Wales</td>
<td>$3.5 million</td>
</tr>
<tr>
<td>Queensland</td>
<td>$2.2 million</td>
</tr>
<tr>
<td>Western Australia</td>
<td>$1.7 million</td>
</tr>
<tr>
<td>South Australia</td>
<td>$387,500</td>
</tr>
<tr>
<td>Tasmania</td>
<td>$300,000</td>
</tr>
<tr>
<td>Northern Territory</td>
<td>$232,000</td>
</tr>
<tr>
<td>Australian Capital Territory</td>
<td>$68,000</td>
</tr>
</tbody>
</table>

(Source: Good Shepherd website http://goodshepherdmicrofinance.org.au/)

Collaboration between Good Shepherd, the NAB and the Victorian Government has established a shop front service - Good Money - in Geelong and Dandenong. These retail financial centres are intended to provide financial counselling and education as well as access to the NILS, StepUP and AddsUP products. The shop front delivery mode is in part in response to the prevalence of pay-day lenders and pawn shops that had a physical presence in these regions where financial exclusion was greatest.

The ANZ also has an involvement in microfinance, providing a matched saving product – SaverPlus, in conjunction with the Brotherhood of St Lawrence. It is similar in design to the AddsUP program, but it is to encourage low income earners to save for education related expenses. The program, involves building financial capability with a requirement to attend financial education and training sessions.)
The Commonwealth, Victorian, New South Wales and Queensland Governments have all contributed in some way to the microfinance programs administered by the Good Shepherd Foundation. This support has been in the form of funding to support the extension of the NILS network, promotion of the Scheme through the Offices of Fair Trading and in Victoria, support for two financial centres to provide access to the schemes and also education and options to clients, rather than providing capital to be used to make loans.

The reach and scale of are two measures that are important in order bring context to the discussion on micro-finance. Reach being the level of disadvantage that the programs target – the poorer or more disadvantaged the clients – the greater the reach of the program. Scale refers to the numbers of clients assisted – the reach of a program may be shallow but the numbers assisted or scale may be significant. To illustrate this point, the reach of current microfinance programs in Australia is illustrated below in Figure 5.1 (Burkett and Sheehan 2009:19).

The analysis includes a breakdown of reach between the semi-commercial approaches, which include the types of programs like the StepUP loans, justice/welfare approaches (such as NILS) and mutual aid approaches, built on informal systems and include things such as Savings and Loans circles.
The reach of the microfinance programs currently is to the working poor and those on fixed income/welfare recipients and as discussed previously in this chapter the scale of these programs are small relative to the number of Australians that are categorised as being financial excluded.

There is certainly a strong charitable response and to a lesser degree a private market response to the issue of financial exclusion in Australia. Both the NAB and to a lesser extent, ANZ, provide finance to support micro-finance programs developed and administered by charitable organisations as part of their Corporate Social Responsibility program.

The microfinance programs offered by Good Shepherd are well structured and have a graduating effect for a client, successful completion of a NILS loan acts as eligibility for a StepUP loan which then contributes to eligibility to the AddsUP program. The program design has the desirable characteristic of building financial capability.
While this investment in micro-finance is commendable by these two financial institutions, what is striking is the un-coordinated and as hoc nature of the policy response on financial exclusion at the governmental level. Surely if financial exclusion is a genuine social issue and given that it has close ties with social exclusion, an identified government policy objective, it is, then the response of government to address it on a national basis is less than adequate, both in terms of scale and reach.

The most long established and successful micro-finance program in Australia had a scale of 21,003 new and active loans in 2009-10 when the CSI estimate for those Australian adults suffering severe exclusion in the same period was 16.4 per cent of the population. (total(0.8 per cent and severely 14.8 per cent) or in excess of 2.5 million people (Connelly 2013). The scale of the Australian response to the issue of financial exclusion could be said to be little more than tinkering around the edges based on this data and furthermore geographic location would seem to be a very real determinant of the level of access to the service.

5.2.3 Decision on Criteria

From the discussion above, it can be seen that the Australian retail banking sector operates in an area that has been identified as being important in terms of alleviating deprivation and social exclusion in Australia. So in terms of applying the CSO framework developed in this dissertation– the issue that we are examining in applying that model – Australian retail banking- meets the criteria at this first stage of the application.
Outcome: Issue is consistent with the broad social policy objectives of social inclusion and deprivation; proceed to the next decision point.

5.3 Step 2 of the Decision Framework: Is financial exclusion the result of market failure?

The next stage of the framework is to ensure that the issue, identified as important in terms of addressing deprivation and social exclusion, is not a market failure issue - that is the result of a lack of competition, the presence of an externality or asymmetric information or a public good.

The Australian banking system is governed by substantial regulation. This regulation is justified on the basis of two market failures. The first due to the public good nature of financial system stability and the second due to asymmetric information inherent in depositor/financial institutions relationship (Edwards and Valentine, 1998). For a discussion of these market failures and the regulatory response see Appendix 1.

In this section, the discussion will focus on the likelihood that financial exclusion is the result of a market failure, or the result of regulation to
overcome other market failures in banking. The data on financial exclusion indicates that Australia has very high participation rates for holdings of bank accounts, primarily a result of the way that government payments are made. The causes of exclusion in Australia tend to be in the area of access to credit and insurance products. As this dissertation deals with the existence of CSOs in the retail banking sector, the exclusion from insurance products is outside the scope of this study. The access to credit is the focus of the following discussion and the remainder of the dissertation.

Lending to customers on low incomes is a risky activity and one which Australian banks may choose not to engage in for a number of reasons. One reason, which relates to the area of market failure, is that the retail banking sector is not competitive and so lower value customers with riskier profiles are excluded, as a lack of competitive pressure means that returns are maximised by not servicing this market segment. The discussion in the next section is focused on the competitiveness of the sector, specifically with reference to concentration and the subsequent pricing of retail products.

5.3.1 Competition in Australian retail banking

As in any other sector, competition in banking delivers important benefits to households and business. These benefits in banking include access to a range of financial products, at lower prices with increased choice of products. (Reserve Bank of Australia, 2014).

Unlike other sectors however, the business of banking carries inherent instabilities, attributable to the maturity transformation function of intermediation. The existence of asymmetric information and moral hazard
exacerbates this inherent instability by encouraging risk taking behaviour. (Reserve Bank of Australia, 2014). Competitive forces and competition is a dynamic process that can exacerbate some of the risks that are already present in the banking sector. When this is coupled with the large social losses society that are realised in the event of bank failures, there is by necessity a trade-off in the sector between competition, efficiency, financial stability and ultimately economic growth (Reserve Bank of Australia, 2014). See Appendix 1 of this dissertation for the discussion of the interaction between competition and financial sector stability.

5.3.1.1 Competition, concentration and market power

The Australian retail banking sector is dominated by the ‘Big Four’ CBA, NAB, Westpac and ANZ, who collectively control around 90 per cent of system assets. Superficially, this degree of concentration in the market structure may indicate a lack of competition in the sector and hence a possible rationale for the existence of financial exclusion in Australia.

However caution needs to be exercised when making judgements about market structure and competition in financial institutions. (Davis, 2007 and OECD, 2010). A high level of market concentration is a necessary but not sufficient condition alone for conclusions to be drawn about the extent of competition in an industry (ACCC, 1999). The contemporary approach to measuring competitiveness in an industry is based on the concept of contestability, developed in the seminal article by Baumol in 1982. The key concept developed in the theory is that a contestable oligopoly will produce a competitive outcome, provided that there are no barriers to entry and that exit is costless in the sense that costs of entry can be recouped and capital is
saleable or reusable. In this case entrants will be drawn into an industry when existing operators are earning above normal profits. The key part of the theory rests on the notion of potential competitors. If existing firms in the industry are behaving competitively and not earning super-normal profits then no firm will be attracted into the industry and a competitive outcome is possible with high market concentration. Valentine and Ford (2001:41) summarise by concluding that the “contestability of an industry cannot be judged on the number of institutions in the market or on whether or not new organisations are entering the market”.

This dominance of market share has enforced a commonly held view that banks have considerable market power. The Commonwealth Government seems to share this concern, the banking sector being subject to the “four pillars” policy which prevents the merger of two or more of the major banks – the only industry to have such a policy.

This provision is over and above the fact that any merger would need to convince the Australian Competition and Consumer Commission (ACCC) that competition in the relevant markets would not be substantially reduced a requirement under Section 50 of the Trade Practises Act (Valentine and Ford 2001). Federal Treasurers since 1997, most notably Mr Costello and Mr Swann, had stated publically that mergers between the ‘Big 4’ would not be approved.

Market definition is also critical when assessing competitiveness (King, 2005). The objective of which is to identify competitors who through demand or supply substitutability can constrain the exercise of market power of the firms in question (Jones, 2002). The financial services industry
consists of distinct sub markets including investment products such as deposit accounts, shares and fixed interest securities, loans and credit cards, risk management products such as insurance and derivatives and tax advantaged instruments such as superannuation (Valentine and Ford, 2001). Some of these markets are obviously and visibly highly competitive, for example home lending, while competition in others such as deposit accounts are more difficult to assess.

Evaluating the competiveness of banking on the basis of price is also problematic, given that the prices of financial products also incorporate information about risk and liquidity in addition to the degree of competition. (Beck, 2007 in Reserve Bank of Australia, 2014).

Price competition includes the interest rate charged or paid on products as well as fees and charges payable and non-price competition can include loyalty programs and the amount of finance offered to borrowers as well as the terms of the loan (Reserve Bank of Australia, 2014). Looking at the spread to the cash rate for individual products as a means of assessing competitiveness in individual markets is problematic due to the interaction of competitive forces in funding and lending markets (Reserve Bank of Australia, 2014). Indeed, since the GFC, as the pricing of risk returned to a more rational basis, the spreads above cash rates for many products have risen considerably as bank’s funding costs have increased. It would be an error to attribute this increase in spread to a lessening of competitive forces in the sector.

A more correct, though still not perfect, measure of bank margins is the net interest margin, approximating the difference between the banks average
lending and borrowing rates. Competitive pressures resulted in the halving of banks net interest margins between the late 1980’s and the on-set of the GFC (Reserve Bank of Australia, 2014). Despite the changes in rates in individual markets, post GFC, the net interest margins remain at historic low levels, indicating that these competitive pressures are still at play in the sector. (Reserve Bank of Australia, 2014).

5.3.1.2 Competiveness in the Credit Card Market

Personal lending and more specifically, credit cards are the product that is specifically raised as a measure of financial exclusion in Australia (Connelly, 2014). In the past it has been an area where banks did exhibit un-competitive behaviour. After an extensive inquiry into the operation of credit card schemes in Australia, by the Reserve Bank, it was found that the fees paid by a merchant’s bank to a cardholders bank when a credit card transaction was made (interchange fee) had been set at a rate that was higher than the cost of provision of this service (Reserve Bank of Australia, 2002). Financial institutions promoted the use of credit cards, despite their relatively high costs of provision, as it was the payment instrument that generated the highest returns for them. The issue was that this price incentive was not the result of competition but rather a consequence of the regulations that govern credit card schemes (Reserve Bank of Australia, 2002).

The reforms made to credit card schemes as part of the broader agenda of improving the efficiency and competition in the payments system, also included removing restrictive practices in the card scheme rules. This included the rule that merchants couldn’t charge customers a surcharge for
accepting a credit card despite a higher cost for them in doing so. Collectively these reforms have resulted in “increased availability of credit cards, including low-rate and low-fee cards” (Reserve Bank of Australia 2014:163). This would indicate that the issue of financial exclusion is not a result of a lack of competition in the provision of credit cards.

There are still questions over fees and charges on transaction accounts and credit cards, particularly in relation to those charges referred to as exception fees. These include charges for overdrawn accounts and dishonoured payments on deposit accounts and charges payable for exceeding the credit limit and late-payments on credit cards and loans.

A class action has been brought against ANZ bank by account holders in the court system alleging that the exception fees charged for late payments, dishonoured cheques, over-limit fees on credit cards are penalties rather than a fee for service and as such are illegal. The case rests on the notion that these charges far exceed the costs incurred by the bank in dealing with these issues and so the fee is set to penalise customers.

5.3.2 Government Regulation and Financial Exclusion

While it is useful to rule out market failure as a cause of financial exclusion, it is also useful to examine if financial exclusion is the result of, or unintended consequence of government regulation of the sector. In appendix 1, the rationale for the government regulation of Banks and other Authorised Deposit Taking Institutions (ADIs) is outlined. These regulations, justified on the basis of systemic stability and depositor protection, may well result in
ADI’s choosing not to provide lending services to individuals that do not meet their lending criteria.

This is in fact the objective of the regulations – that banks individually and therefore collectively are not burdened with non-performing loans or bad debts that then threaten a bank’s viability and go on to threaten interbank liquidity and the financial sector as a whole. So if the effect of these regulations is to curb lending to higher risk individuals and businesses, then that restriction of access is weighed against the benefits that the restriction brings to the stability of the system as a whole. It would be hard to argue in a post-GFC world that regulations governing the extension of credit to those who may not able to re-pay it need to be relaxed.

In the United States, The Community Re-investment Act (CRA) was introduced in 1977, with the noble intention of breaking the practice of ‘redlining’, where real estate brokers would ring areas on a map that indicated regions or suburbs where lenders would refuse to make loans. These areas were generally populated by racially minorities and so the Act was an extension of the civil rights movement that occurred in the States (Gruen, 2009). The CRA encouraged the lending for housing to low and moderate income households, by assessing banks on their performance in relation to extension of loans to lower socio-economic groups in the banks regional footprint. The issue of the CRA and its role in the GFC is still hotly debated in the US – generally along political/ideological lines.

While the CRA is not responsible for the GFC, and indeed analysis shows that defaults on CRA type loans were lower than other loans in the lead up to the GFC, the introduction of the Act did have the unintended and
unforeseen consequence of normalising a lowering of lending standards for
mortgage finance in the USA. It is certainly one factor in emergence of the
GFC in the USA, along with many other factors (Gruen 2009) In this way,
the dangers of government meddling in market behaviour and the distortion
that regulation can cause in firm decision making is demonstrated.

The focus of this dissertation is not on access to housing finance however,
but on access to much smaller amounts of credit. There is no suggestion in
Australia that people on low incomes should be assisted into home
ownership through concessional credit or the lowering of credit standards by
lenders. In fact this would be viewed as a negative welfare response as
people become burdened with debt that they are unable to repay. However
the access to small amounts of credit, to purchase essential items like
household whitegoods, pay for education expenses or as a means of
smoothing variable income may alleviate aspects of deprivation.

Currently, the focus on government regulation in Australia at the consumer
level is on protecting consumers from the dangers of high debt and the
potentially exploitive practises of non-Authorised Deposit-taking
Institutions lenders (non-ADIs), rather than on opening up access to debt to
consumers who don’t currently satisfy lending criteria.

The Australian Investment and Securities Commission (ASIC) is
responsible for administering The National Credit Act 2010. This Act
covers consumer credit regulation and includes the licensing of credit
providers and the requirements for lenders to ensure that the contracts for
credit are reasonable and fair to the consumer. Tighter regulations were
introduced in 2013 governing the fees and charges payable on small and
medium loans provided by lenders other than banks, building societies and credit unions and other ADIs.

Table 5.4 Consumer credit requirements for lenders other than ADI’s.

<table>
<thead>
<tr>
<th>Type of Loan</th>
<th>Restrictions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small Loans ($&lt;2000)</td>
<td>Loans with a repayment time of less than 15 days are banned.</td>
</tr>
<tr>
<td></td>
<td>Loans with a repayment time of between 16 days and 1 year require a warning notification of alternative options that are available.</td>
</tr>
<tr>
<td></td>
<td>The following caps and limits apply on the type of fees and charges that are payable by the borrower.</td>
</tr>
<tr>
<td></td>
<td>A one-off establishment fee (of not more than 20% of the loan amount)</td>
</tr>
<tr>
<td></td>
<td>A monthly account keeping fee (of not more than 4% of the loan amount)</td>
</tr>
<tr>
<td></td>
<td>A government fee or charge</td>
</tr>
<tr>
<td></td>
<td>Default fees or charges (the credit provider cannot collect more than 200% of the amount loaned if there is a default),</td>
</tr>
<tr>
<td></td>
<td>Enforcement expenses</td>
</tr>
<tr>
<td>Medium loans (2001-$5000) with repayment period of between 16 days and 2 years</td>
<td>Fees on loans are limited to</td>
</tr>
<tr>
<td></td>
<td>A one-off fee of $400</td>
</tr>
<tr>
<td></td>
<td>A maximum annual interest rate of 48%, including all other fees and charges</td>
</tr>
<tr>
<td>All other loans including continuing credit contracts (credit cards)</td>
<td>For all loans of more than $5,000 or with terms longer than 2 years and all continuing credit contracts such as credit cards, the fees and charges allowable are capped and must not be more than 48% annually (including any establishment or other fixed fees).</td>
</tr>
</tbody>
</table>

These regulations were introduced in an attempt to control the consumer credit market that was taking place outside of ADIs, justified on the basis of protecting consumers from predatory and unscrupulous lenders. The
customer base for these types of loans is those that do not satisfy the lending criteria from the main-stream banking system and so seek out sources of finance with more accommodating lending criteria. The Act seeks to limit the practices of these lenders, in particular in relation to fees, charges and interest that are payable and the terms under which credit is extended. If these regulations restrict the access to finance by individuals on low incomes then it could be argued that it is with these peoples best interest in mind. If access to credit is problematic even from these lenders with more relaxed lending criteria for relatively small amounts of money, then it may be that there is no private credit market that can profitably lend to these individuals.

The answer therefore is not to reduce the protective regulations, as this would expose more individuals to long term hardship through debt repayment and exploitive terms and conditions.

5.3.3 Decision on Criteria

While there are market failures in the financial services sector and in particular banking, there are already regulations in place to deal with any lack of competition in the sector that may be affecting retail consumers and contributing to financial exclusion. The concentration of the Australian banking sector and the subsequent concerns regarding competition are cited by some as the basis for the imposition of Community Service Obligations as some sort of compensation for the lack of competition. The existence of above normal returns in the top four banks, if indeed after accounting for risk and capital base they are above-normal, does not justify imposing regulation on the industry as some means of compensating consumers for
abuse of market power. The framework developed in this dissertation rejects that argument and does not allow for that outcome for several reasons. First, those receiving the benefits may not be the group of consumers bearing the cost of the market power and so inefficient resource use will persist. Second, the cost of the regulation to the bank may be significantly smaller or greater than the amount of excess returns and may vary from year to year as market conditions fluctuate.

Using regulation to compensate for market power abuse is a blunt policy instrument which leads to second round effects which over time may prove to be as large an efficiency cost as the original abuse of market power.

The first best solution is for Governments to identify the source of the monopoly power and to attempt to remove impediments to competitive forces. The reform of the credit card schemes is an example of this type of action. If the sources of monopoly power cannot be isolated or imposing competitive forces leads to instability in the industry then some transfer of excess returns, similar to a resource rent, would be a more efficient solution.

The access to the financial system, including credit markets and the payments system is a question of equity rather than being the result or the consequence of market failure. There does not appear to be a case of market failure, which may warrant governments intervening on the basis of efficiency improvements. Indeed, an efficient financial system will price risk in such a way as to exclude some members of society, both in terms of affordability and in terms of satisfying criteria to be eligible regardless of the affordability issue. It is these financially excluded members of Australian society that are the subject of investigation in this dissertation.
However the existences of a group of excluded does not in itself constitute a case of market failure. The issue is one of social desirability and equity and these issues are ultimately decided by the community through the political process.

If society deems that universal access to financial services is important, then governments are the appropriate institution to develop policy to address this issue. This is the approach that has been taken in this dissertation with the existence of a potential CSOs, rooted in an overall theme of social policy that the Government has set as an objective that it is pursuing – in this case the goal of reducing social exclusion. This does not preclude delivery of the CSO being some form of public/private sector partnership, if that indeed is the more efficient way of addressing the issue. In fact, government may well “piggyback” onto existing market based solutions to enhance the social outcome of existing activities undertaken by the private sector.

**Outcome:** The issue is not the result of market failure or of government failure: proceed to the next decision point.
5.4 Step 3 of the Decision Framework: Is this an issue that Government Agrees to Address?

In this section of the decision framework, the government needs to decide what priority to give financial exclusion in the myriad of issues that it faces in the social policy landscape. An issue that is broad in its effect in terms of promoting social inclusion and addressing deprivation would obviously be prioritised over an issue that still contributed to these areas but to a lesser extent. For example, access to medical care and education may be seen as being a more pressing need than access to credit markets. However the issue of financial exclusion, like the financial system itself, does underpin and contribute to the ability for individuals to engage and participate in the modern economy.

So though it may appear to be a low priority issue in terms of need it may have a disproportionally large impact in addressing social exclusion and deprivation. This stage of the decision framework is important as Governments face many competing priorities for policy development and
funding. It is impossible to address all the areas simultaneously and so a deferment of the issue at a particular time is important to ensure that the framework is workable and accepted for use by practitioners.

5.4.1 Decision on Criteria:

For the purpose of demonstrating the application of the framework fully, we will assume that Government has prioritised this as an issue to be addressed.

The issue will be progressed to the policy option stage so that alternate ways to address financial exclusion will be evaluated.

**Outcome:** Issue is to progress to policy option stage: proceed to the next decision point.
In this section, a policy objective regarding financial exclusion is developed and the policy options for addressing that objective are examined.

### 5.5.1 The Policy Objective

A clear statement of the objective of the policy needs to be made before options can be formulated in response. The objective must be measurable so that the effectiveness and efficiency of the policy option chosen to achieve the objective can be assessed.

One of the key factors in framing the objective is how much financial exclusion is it desirable to alleviate from a societal point of view? Given the figures are that 17 per cent of Australian are financially excluded, a target of providing some form of assistance by 2020 to 1 million people...
would seem a sound place to begin. The objective specifies what you want achieved, in this case building capacity for more Australians to be financially included, and the policy options set out the differing ways that you can achieve it.

So a realistic policy objective may be:

*To increase the access to financial services that build financial capability, to those who are currently financially excluded, to 1 million Australians by 2020.*

Does extending the microfinance programs to welfare recipients with poor credit history or the destitute serve any purpose towards alleviating long term financial exclusion and poverty or does it in fact exacerbate those problems? It would be hard to argue that to extend more opportunities to incur debt to those who have demonstrated that they cannot repay would increase their own or societies welfare. It may be that the objective is met by a package of programs with different target groups as clients, hence the reference to building financial capacity in the objective.

It may be that budgeting skills and/or information about how to use a deposit card so as not to incur ATM fees would be of most use to those most financially excluded in terms of building financial capability, rather than extending the reach of a micro-finance program to include them – when their ability to repay is limited or non-existent even at zero or subsidised interest rates.

In developing the policy options to address the policy objective, the spectrum of regulatory response, outlined in Chapter 4, will be employed,
that is policy options will be structured as moving from the least regulatory imposition to the most.

5.5.2 Policy Options

In the following section, specific policy options for addressing the stated objective are identified and discussed. Four policy options have been identified as ways in which the policy objective can be met.

These options are summarised in Figure 5.2 and are ranged from the least interventionist in approach to the most interventionist.

Figure 5.2 Policy Options on the Regulatory Spectrum

<table>
<thead>
<tr>
<th>Policy Option 1</th>
<th>Policy Option 2</th>
<th>Policy Option 3</th>
<th>Policy Option 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase employment and education opportunities.</td>
<td>Provide financial advice and support through a matched saving program for low income households that are currently not eligible for personal lending products such as credit cards from the financial sector.</td>
<td>Support and Extend the Microfinance Programs currently funded and delivered by Good Shepherd/NAB.</td>
<td>Banks given a directive by Government to provide personal lending products to financially excluded Australians.</td>
</tr>
</tbody>
</table>

Market based policy options | CSO option

In addition, the options are identified as market based policy solutions (Options 1-3) and Option 4 is the CSO policy option. In the following
sections each of these options will be explained and evaluated to inform the decision making process in the next step of the framework.

5.5.2.1 Policy Option 1

**Increase employment and education opportunities.**

A fundamental approach to decreasing financial exclusion is to encourage and promote employment opportunities. Having the opportunity to work and earn a wage is a precursor to being included in the mainstream financial sector and is consistent with overarching principles of social policy design – as outlined in Chapter 4. Increasing welfare payments to tackle the issue of financial product affordability is problematic due to the disincentive that it creates for those on welfare to find work and the lack of financial capability building inherent in that strategy. The focus instead needs to be on creating opportunities and incentives for moving from welfare to work – viewing welfare as a safety net rather than as a permanent life condition. This is consistent with the current social policy framework in Australia. A focus on employment measures has the added advantage of tackling a number of the causes of exclusion and deprivation concurrently, rather than each issue in piecemeal way. As employment is a central tenant of social policy design that is being currently pursued, the issue of financial exclusion will also be addressed, albeit not explicitly, within the current employment programs.

Hand in hand with any discussion of employment is a discussion about education opportunities across an individual’s life.
Education is a pre-cursor to employment, particularly in a country like Australia, where we do not have a comparative advantage in low cost labour due to our population size. Opportunities for employment in the future will be dependent on the individuals having education and skills to offer potential employers.

This option needs to be recognised – even though it appears as more of a ‘do-nothing’ option than a deliberate response. The greater the efficacies of the current programs to move individuals into work the greater will be their opportunities for financial inclusion. There will also be members of society who because of age and physical or mental disabilities may be unable to work, so this option does not encompass a solution for these individuals.

This option can of course be pursued concurrently with other approaches, to ensure that those who because of circumstances cannot work are not excluded from the policy solutions.

5.5.2.2 Policy Option 2

Provide financial advice and support through a matched saving program for low income households that are currently not eligible for personal lending products such as credit cards from the financial sector.

A way of increasing financial capabilities is to give households the incentive and the skills to build savings.

Separate savings accounts can be established as part of the basic transaction account service that Financial Institutions currently provide, and small deposits diverted into this account on a regular basis. When the balance
reaches a certain figure – say $500 – the savings are matched by the government either fully or in some proportion – say $250 contribution for $500 saved. Like the SaverPlus programs currently run by the Brotherhood of St Lawrence and ANZ, part of the condition of involvement in the program is attendance at some financial education sessions where some budgeting skills and financial management skills are taught. Another facet of the ANZ program is that savings can only be used to purchase items needed for education or other skill building activities. This could be broadened to include items that directly benefit any children in the households, such as participation in out-of-school activities and experiences that enhance their well-being. However the more restrictive the conditions of the programs are, particularly in terms of how people choose to spend their component of the money, the less uptake of the program will be achieved.

The advantage of this type of program is that it does directly build an individual’s financial capability by showing them how to save and then providing some reward for that effort. The disadvantage is that the program reach will be shallow – only those on marginally low incomes will have the capacity to generate savings, however scale could be potentially large if there are significant individuals in this category.
5.5.2.3 Policy Option 3

Support and Extend the Microfinance Programs currently funded and delivered by Good Shepherd/NAB.

The Good Shepherd microfinance foundation, in partnership with the NAB has developed a very effective model for the delivery of microfinance through the NILS, StepUP and AddUP programs. A review of the NILS program, revealed that there is significant unmet demand in the community for the NILS loans based on affordability and that a recommendation of that review was to explore options to expand the program. (Good Shepherd 2014). What is attractive about the program from a policy option perspective is that it has an effective and established delivery model and it has participation from the financial sector in the form of NAB. The program could be extended with government support and funding into regional and remote areas where there may be significant need and limited access to alternate forms of assistance. Currently the program is focused mainly on Victoria and NSW, with the bulk of the NILS funds being extended to households in these locations. So access to effective microfinance programs in other regions is currently very small and an expansion of this program into other States and Territories warrants further investigation.

Another attractive feature of the program is that it is graduated; there is a clear pathway for recipients to become financially included as they move through the three different types of programs.
Financial capability is built as recipients move from re-paying a no interest loan to re-paying a subsidised loan to implementing an effective savings plan.

Unlike other welfare programs, a microfinance program can be a sustainable program once a capital fund is established. As money is repaid by program clients, the pool of funds that can be used for future clients is maintained. The re-payment aspect of the program means that after establishing the capital base for the program and allowing for a proportion of bad debts, the program doesn’t require budgetary input each fiscal year.

The other important aspect is that by having a partnership with a major financial institution such as the NAB, there is industry recognition of the program. The successful completion of a SepUP loan, for example, would then be recognised as an important in terms of meeting eligibility requirements for mainstream financial products in the future.

So this option has many advantages. The delivery process are tried and tested, there is already and industry partnership in place and the NILS component of the program is financially sustainable. The program currently is small in scale and has a relatively small reach. While any deepening of the reach may deliver questionable welfare benefits for individuals and society, the increasing the scale of the program could yield significant benefits.

5.5.2.4 Policy Option 4:

Banks given a directive by Government to provide personal lending products to financially excluded Australians.
The final policy option to be discussed is the direct directive by government to banks, building societies and credit unions that they must provide a credit service to those customers who hold transaction accounts with them and who don’t currently qualify for the commercial product. This service could take the form of a low limit credit card, with some concessional forms of interest rate or could take the form of small personal loans, similar to those provided under the StepUP program. The quantity and timeliness component of the policy objective would certainly be met by this policy option; however there are significant other issues to consider.

The first is the desirability of extending credit to all customers, regardless of their circumstances. It would require some limitation of the reach of the program to satisfy welfare considerations – and indeed to meet the policy objective. Just offering a credit product does not in itself build financial capability, even if the product is subsidised. To offer customers a debt product when they have no capacity to repay is destroying financial capability rather than building it. However each financial institution could develop and promote a product, similar to the StepUP program, where transaction account customers who had demonstrated capacity to repay a small loan at subsidised interest rates could be served by this product.

The benefit of this approach would be that as it is administered by a financial institution, it is satisfying the financial inclusion argument in a way provision by a charitable institution doesn’t. Those individuals currently excluded, apart from a transaction account, would develop a further direct relationship with a financial institution.
There would need to be clear restrictions on what the borrowing could be used for and what it couldn’t be used for to avoid potential distortions between those customers that qualify for commercial credit and those that don’t. If the subsidised credit could be used for any item, then there would be a huge incentive for those at the margin to arrange their affairs to qualify for the subsidised product.

There is also the issue of who is responsible for the program costs. If banks are compelled to absorb the losses that they incur through offering a non-commercial product, then in effect the cost of the program would be subsidised by other bank customers, and given the elasticity of demand around retail versus corporate banking, these would in all probability be other retail customers. So some customers would incur higher credit costs in order to subsidise non-commercial loans. If government subsidised the program and incurred the costs, which would be more fitting with current CSO funding principles, then the level of re-imbursements would need to be negotiated and agreed upon – so transaction costs and the potential for banks to overstate costs would be large.

Irrespective of who pays the costs of the program, there is a risk that the development and implementation will have distortive effects across all the banks personal lending products. The lowering of lending standards to groups previously considered non-commercial, can have the effect of gradually lessening the lowering of lending standards to all customers. This slow erosion of standards can go unnoticed and cause no adverse effects when other economic factors are favourable, ie times of low unemployment and high rates of economic growth. But as was seen with the GFC, when
these factors change, all of the risk built up in individual institutions or in the system as a whole can have devastating effects on individuals, institutions and the economy as a whole.

On a positive note, this is the one policy option that moves the financially excluded right into the financial system. Even though the personal lending product may not be a commercial one, that fact that it is developed, administered and delivered by a financial institution rather than a charitable organisation does change the tenor of the assistance. It moves it from being a welfare program to one where servicing all customers regardless of location or financial circumstance is the normal business model. By directing the financial institutions within the sector to develop lending products for all customers, this policy option really does make clear that society has an expectations that banks do have an obligation to provide services to all Australians – a Community Service Obligation

This sounds like a laudable intent, until the downside risk for the individual is included in the discussion. The people that do not currently qualify for commercial credit products are on very low income, almost certainly unemployed, or employed sporadically on low wages, with no assets. These people have no protective buffer in their personal finances. If individuals that have accessed these products are unable to afford to repay during the term of the loan due to a change in their circumstances, which because they have no buffer can be quite small, then they and their dependants will be in a more severe state of deprivation than before the assistance was provided. By attempting to financially include these Australians, the policy will have made their lives, and critically the lives of their dependents, worse.
5.6 Step 5 of the Decision Framework: Preferred policy option

In summary, the first best option to tackle financial exclusion in the longer term is to focus strategies and programs on employment and education. In many respects financial exclusion is a result of lack of employment and so to address the issue through any other approach is tantamount to treating the symptom rather than the cause of the problem. This is a policy option that won’t meet the timeline and scale of the policy objective but to pursue any other policy option without recognising the central role of education and employment and the part they play in reducing financial exclusion would be flawed.

Of course there will be members of society, who because of health or physical disabilities are unable to work. Obviously this policy option will not cater to these Australians and this should not be overlooked.

In order to provide an option that delivers a timelier outcome, and meets the needs of those excluded from employment, then other options or combinations of options can be used in conjunction with option 1. Options 2 and 3 are preferred over option 4, as they carry more chance of successful outcomes for recipients with the least chance of negative consequences, both for recipients and for society as a whole. Unlike the first three options which can be classed as market based solutions, option 4 is the most regulatory intrusive policy. It has the largest risks associated with it – not just for government, but for the individuals to be assisted, for the banking sector and for the economy. The advantages of option 4 are that it does
integrate the financially excluded into the financial system by having products developed specifically for their needs by financial institutions.

However the risk of distortions in lending standards being transmitted through other personal lending products, the transaction costs associated with negotiating the cost of the service with governments to reimburse the banks, or the effect that increased credit costs will have across the economy if banks are forced to internalise the cost, all add up to make this option the most costly to government. This is in addition to the substantial risk that the overall welfare of individuals who access the service will be reduced.

The policy options can also be assessed against the “Five ‘E’’s of social policy design, developed by Stanton and Herscovitch (2013), which were explained in Chapter 4. A summary is provided here. The first is equity, essentially the principle that those with more should pay more, but also encompassing horizontal equity as well which means those with the same circumstances are treated equally. The second E is effectiveness which is an assessment of how well a program delivers what it intends to deliver. Efficiency is the measure of how well a program delivers the correct payments or benefits to the intended recipients without undermining self-sufficiency objectives and Economy is minimisation of budgetary costs to government. Employment is the premise that people have the moral obligation to work if they are able. In Table 5.5, the four policy options are assessed and summarised against these five criteria in order to give an overview of the desirability of each of the policy options presented in this dissertation.
<table>
<thead>
<tr>
<th>Policy Option 1</th>
<th>Equity</th>
<th>Effectiveness</th>
<th>Efficiency</th>
<th>Economy</th>
<th>Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Meets vertical equity principles. Horizontal equity an issue in terms of program reach in rural and remote locations in Australia.</td>
<td>Broad range of outcomes from this option over a longer time period may mean that assessment of effectiveness is difficult</td>
<td>This approach promotes self-sufficiency</td>
<td>Addressing the issue of financial exclusion this way means that no additional budgetary costs are incurred</td>
<td>The central theme of this option is to promote employment</td>
<td></td>
</tr>
<tr>
<td><strong>Policy Option 2</strong></td>
<td>Meets vertical equity principles. May be an issue with rural and remote Australian accessing the scheme impacting on horizontal equity</td>
<td>The matched savings means this option more likely to build financial capability but the eligibility may mean that scale and reach is limited</td>
<td>This option protects self-sufficiency principles</td>
<td>Matched savings program means that budgetary costs are minimised</td>
<td>Requirements of eligibility do not detract from the employment principle.</td>
</tr>
<tr>
<td><strong>Policy Option 3</strong></td>
<td>Meets vertical equity principles. May be an issue with horizontal equity unless program is delivered in regional and remote areas</td>
<td>Established program that has already proven effectiveness in delivering short to medium term finance to the financially excluded.</td>
<td>Established program that has developed guidelines for eligibility that minimise the interference with self-sufficiency</td>
<td>Partnership arrangement with charity and financial institution mean that budgetary costs are shared and therefore costs to government minimised.</td>
<td>Requirements of eligibility do not detract from the employment principle.</td>
</tr>
<tr>
<td><strong>Policy Option 4</strong></td>
<td>Meets vertical equity issues more effectively if government pays for program. Horizontal equity may be less of an issue with this option as financial institutions have greater reach and presence than other institutions.</td>
<td>Implementation by financial institutions probably results in high level of effectiveness – financial inclusion is likely to result.</td>
<td>Eligibility criteria and program constraints critical to protecting self-sufficiency principles. May be large transaction costs involved</td>
<td>May be large budgetary costs and in additional wider efficiency costs</td>
<td>Program design is critical to not interfere with the employment principle.</td>
</tr>
</tbody>
</table>
5.7 Step 6 of the Decision Framework: Market–Based Solutions or Community Service Obligations?

In this chapter the retail banking sector in Australia was chosen to demonstrate the newly developed framework for assessing the existence of CSOs. The issue of financial exclusion fits into the broader social policy focus on social exclusion and deprivation and in this way satisfied the first criteria in the CSO decision framework. In the following section the issue of market failure in the banking sector as a cause of financial exclusion was discussed. This is because inherent in the CSO decision framework is the belief that symptoms of market failure need to be addressed through correcting the market failure at the source rather than applying band-aid or compensatory solutions to consumers such as CSOs. No market failure was found to be the cause of financial exclusion. For the purposes of fully illustrating the framework, it was assumed that government wish to take action on the issue and a policy objective was developed. Four policy options were discussed as a means of meeting the objective. Three of these options were classed as market based solutions, as they used collaboration with financial institutions and/or charitable organisations to deliver the programs. Option 4 was the direct provision of lending products to the financially excluded by financial institutions – a CSO.

This option is at the most extreme end of the regulatory spectrum, requiring an Act to be able to compel banks to undertake this service.

In order to make a definitive decision on the issue of the existence of CSOs in retail banking a Cost Benefit Analysis of all the policy options would
need to be undertaken. This would also need to include the approach where options are used in some combination with each other. Only then can a statement be made regarding the most effective way to address financial exclusion in retail banking.

However it is unlikely given the qualitative assessment that option 4 would be the preferred option. If the perceived benefits of this option, primarily that it does integrate all Australians into the financial system by forcing banks to develop lending products that they would not do on a commercial basis, outweighed the costs then this would have been the preferred option and it could be said that CSOs do exist in Australian retail banking. But the potential costs of this option in terms of reduced welfare to the very individuals that you are intending to assist, in addition to the potential devastating side effects in the long term to the economy make this option not a preferred one at the qualitative stage.

So we can conclude that there is no CSO in Australian retail banking, that in fact the provision of lending products through financial institutions to those currently excluded it is not a valid or desirable way to address the issue of financial exclusion in Australia.

Other options such as the continued focus on employment and education as a holistic means of addressing social exclusion and deprivation would yield more long term effective outcomes. In addition if the government did feel that they needed to address the issue in the short term, matched savings programs and ‘piggybacking’ onto the existing programs developed and administered by the Good Shepherd foundation in partnership with the NAB would be a more effective, less interventionist path to take.
In terms of providing an application for the decision framework developed in this dissertation, the analysis of the existence of CSOs in retail banking provided an effective test. The framework focused the attention on the issue in the sector that may be contributing to social exclusion and deprivation, rather than the typical list of disgruntlement about fees, charges and interest rates that are the subject of so many inquiries or commentary regarding the banking sector. Any issues such as these would be the result of a lack of competition in the sector – a market failure – of which there is no evidence. In addition there is already significant regulation in place to protect against this form of market failure. In narrowing the focus for the CSO decision down to issues that may be contributing to exclusion or deprivation, the chances of addressing these issues in a consistent manner and to actually make some progress in tackling the multi-dimensional nature of these problems is enhanced. So CSOs can be an effective social policy tool in delivering in-kind assistance through a business in order to address the issues of disadvantage in society.

This is in contrast to their role now, which is not linked in to any overall social policy program. The step in the framework, ruling out market failure as the source of the issue, forces policy makers to tackle the issue in a ‘first-best’ way. If the issue is caused by a market failure then that needs to be addressed in the first instance. Any further policy development based on equity is flawed until the policies to address the market failure have been seen to work.

Political will or the right of the government not to address the issue is an important step in the framework. Policy development is a complex process
of negotiation and consensus about what issues to tackle and how to tackle them. Recent events in policy development, namely the mining tax and the carbon tax are lessons in how sound policy ideas became undermined in the implementation phase. It is the right of the elected government to choose not to proceed to a development phase with a particular policy issue.

Identifying and arranging the policy options along the regulatory spectrum is also useful and essential to good policy design. In this way the policy option with the lightest regulatory impact that meets the policy objective is a more likely outcome. Dividing the policy options into market based approaches and then the direct provision or CSO option also ensures that if and when a CSO is determined to be the desirable outcome to meet the stated policy objective that a rigorous analysis has been done to prove it to be the case. In this way possible distortions that direct provision of in-kind goods or services can potentially deliver have been taken into account in the decision making process.

5.8 Chapter Summary

In this chapter the CSO definition and decision framework were applied to Australian retail banking. This sector was chosen as one that was an appropriate application of the m framework due to the continued calls for governments to intervene in the sector and impose regulations on banks behaviour. The absence of any model to ascertain the existence of CSOs in the sector meant that there has never been any effective means of addressing or rebutting these demands for regulatory action. The decision steps of the framework were applied to the retail banking sector. The first step was to ensure that there was an issue in retail banking that was linked to social
exclusion and deprivation. The issue of financial exclusion was shown to be one that appears in the indicators of social exclusion in Chapter 3 and a wealth of literature on the topic links it firmly to the broader issue of exclusion. The idea that financial exclusion could be the result of market failure in the banking sector was examined as the next step of the decision framework. A lack of competitiveness may lead to certain groups of consumers not being serviced by the sector, but the evidence does not lead to that conclusion. The next step of the framework was the willingness of government to address the issue. In the interests of fully applying the model, an assumption was made that this issue would be progressed. In the next stage of the framework the specific policy objective that would address financial exclusion was developed and possible policy options proposed. Three of these options were classified as market based approaches and the fourth was the CSO policy option.

These options were then qualitatively assessed as to the costs and benefits and also assessed against the five ‘E’s’ of social policy design outlined in Chapter 4 of this dissertation. A full cost-benefit analysis would need to be undertaken to definitively determine if the CSO option was the preferred means of addressing financial exclusion. However, based on the qualitative analysis, the likelihood of this option having a satisfactory CBA seems remote. There are just too many risks and potential costs associated with this option for it to be the preferred method of reducing financial exclusion.
Chapter 6

Conclusions

Does the reality that some Australians are excluded from some services provided by the retail banking sector provide a justification for the existence of a Community Service Obligation? This is the question that was considered in this dissertation. But there was no way to answer this question at the beginning of this project. The way in which CSO policy was developed in Australia and the resulting definition of a CSO was problematic in determining the existence of previously undefined CSOs. So in order to answer this question a new definition of a CSO was developed and a decision framework built in order to establish if a CSO was the preferred policy option for addressing financial exclusion. These two outcomes are the major contributions of this research.

6.1 Main findings of the Research

In chapter two, the development of CSO policy in Australia was reviewed. The purpose of this was to establish that CSO policy was a by-product of implementing efficiency and productivity improvements in GBEs as part of the implementation of the Competition Policy principles. These reforms have delivered many benefits to Australian society in terms of increased welfare as competitive pressures drive prices lower and allow better resource allocation throughout the Australian economy.

However part of the reform of GBEs was the identification and justification for many social programs that they had been delivering on an ad hoc and uncoordinated way. Many of these programs were not retained in the
process of reform and those that were considered too important or too politically sensitive to remove were retained. The CSO was born but remained an anomaly of the reform process rather than a considered policy within the social policy sphere. This development process meant that CSOs were not linked to developments in social policy and were seen as merely a way of ensuring that politically sensitive assistance was delivered in a way that did not interfere with the efficient operation of the GBE.

The result of this development process was that the definitions of a CSO was created as a means to justify some parts of social policy being delivered through GBEs, rather than from a perspective of ‘what are the specific social policy objectives and how can we best deliver on these objectives’. It could be said that CSOs were developed’ post hoc’ and this has contributed to the inability to define more CSOs with the definition developed in this way. In addition it is impossible to definitively say when a CSO is more likely to be the preferred delivery option. What types of social policy warrant being delivered in-kind through a business as opposed to through cash transfer? None of these issues were addressed in the initial development of the policy and these points were drawn out in Chapter 2 of this dissertation in order to develop a rationale for the investigation of a new definition for the CSO.

In the remainder of the chapter the practice of business voluntarily delivering social objectives in addition to their profit objective was reviewed. Corporate Social Responsibility (CSR) is a management doctrine that postulates that business has a social responsibility, a theory at odds with contemporary neo-classical welfare economics, where profit maximisation
results in a maximisation of societal welfare. So at the conclusion of chapter 2, the current definition of CSOs was shown to be deficient and the expectation that business could or should deliver CSOs voluntarily was demonstrated to be flawed.

In chapter three, the changes to the way that disadvantage is assessed - moving away from poverty as the sole means of measuring disadvantage to the multifaceted analysis of social exclusion and deprivation was reviewed. This change in policy focus has resulted in a corresponding shift in how best to provide assistance to those said to be excluded and deprived. Often it is not appropriate to provide greater levels of cash transfers as this, in cases of entrenched disadvantage, may in fact exacerbate the problem (Henry 2009). So there is now a definite role for in-kind provision of goods or services, justified on the basis of meeting specific objectives in social policy. There are already robustly developed sets of indicators of social exclusion and deprivation for Australian. It is argued that these indicators are the appropriate place to start in any revised definition of CSOs as these are the goods and services that are more likely to be unable to be addressed through cash transfers.

In chapter four, the findings and justifications of the preceding two chapters are brought together and a new definition of CSO is proposed.

A CSO is a good or service that is provided through a business at the request of government in order to meet a stated social policy objective, linked to social inclusion and deprivation, that cannot be achieved through a cash transfer, or other market –based delivery channels.
This definition ensures that a CSO is a recognised part of social policy and means that new CSOs can be assessed in line with social policy principles. To compliment the new definition, a decision framework is also presented in this chapter, reflective of the principles of good regulatory design. These two outcomes of the research mean that the validity of new CSOs can be assessed against broader social policy principles. The decision framework presents a way that the CSO, as the chosen delivery mechanism, can be shown to be the most effective way to deliver the specific policy objective. In this way CSO can become an effective, yet robust policy instrument of social policy.

In chapter 5, the initial question proposed in this dissertation is now able to be assessed. The development of the new definition and decision framework enables the issue of financial exclusion to be assessed using the decision framework to determine if in-kind provision of retail banking services to all Australians is a CSO. That is, is this direct provision of services justifiable and the most appropriate way for government to address the issue of financial exclusion if it chose to do so?

The answer to the question is less important than the ability to now assess it, as the focus of this research was in developing the decision framework based on the new definition. However, the conclusion of this dissertation is that the existence of CSOs in Australian retail banking is a fiction. The provision of credit products to those with limited means to repay at the request of government in order to alleviate financial exclusion would not be sound policy either politically or on the basis of meeting social policy objectives.
6.2 Further research opportunities

In order to continue to test and establish the decision framework, a range of potential CSOs could be tested. An interesting analysis would be the reassessment of the existing CSOs, defined in the original policy development phase, such as the subsidisation of electricity and water costs, to see if these policies remained as CSOs under the new definition. It may be the case that some of these CSOs are related to areas identified as being casual in social exclusion and therefore warrant retention. However it may also be likely that some of the policies originally classed as CSOs are now not meeting any policy objective or are meeting an objective that is no longer relevant. A review of all CSOs, using the decision framework would be a useful addition to the public policy debate.

Another potential research area is to assess the likelihood of CSOs in a range of industries and sectors that are linked to the indicators of exclusion tables and then complete the analysis by developing policy options to assess if the CSO is the preferred policy option in these cases.

A ranking table of need could be developed of areas for government to address through direct provision of services or goods through businesses.

6.3 Summary

In this dissertation it was argued that the concept of Community Service Obligations needs revisiting in light of the changes to the assessment of disadvantage in social policy. The origins of CSO policy development were grounded in the microeconomic reform process of the 1990’s. This process was conducted with the objective of improving efficiency in government
business enterprises rather than improving delivery of social policy. This had the unfortunate consequence of providing a definition that was limited in scope and was focused on a *post hoc* justification for the retention of social programs that were not couched in broader themes of social policy. Recent developments in definitions of disadvantage, deprivation and social exclusion suggest that there may be further use for Community Service Obligations as a policy instrument for delivering specific types of social welfare.

A new definition of a CSO was developed in this dissertation, informed by and reflective of, the changing focus of social policy where disadvantage is now assessed in term of social exclusion and deprivation, rather than by the single dimension of poverty. A decision framework was also been developed to enable the assessment of the existence of new CSOs within a sector or industry.

This new definition and decision framework was applied to the retail banking sector in Australia to determine if the issue of financial exclusion satisfies the criteria for the existence of CSOs in that sector. In this application, it is determined that there is no CSO in retail banking in Australia.
Appendix 1

The market failures that justify regulation in the financial services sector

The avoidance of financial crises is the main motivator for the extensive regulation that exists globally in the financial services sector. The long held view that the industry is inherently unstable and susceptible to crises and runs has been supported by the work of Bryant (1980) and Diamond and Dybvig (1983), with the development of rigorous analytical models, and of course by recent events. The basic issue is one of liquidity. Banks hold only a small amount of liquidity on the sound assumption that only a small percentage of depositors will make a call on their funds at any one time. However, if the viability of the bank is threatened, then it makes sense for depositors to want to withdraw their funds and to be first in line to do so, as it is known that not all depositors will be able to retrieve their money. Hence the banks liquidity crisis becomes a reality regardless of whether the initial concern over viability is valid or just a rumour. The resulting panic in one financial institution can spill-over into general concerns about all banks and runs can occur on banks that were not involved in the original “crisis”, either through depositor panic or liquidity becomes threatened due to the linkages in the interbank depositor market with the original bank. This is known as contagion a problem unique to financial institutions (Valentine et al 2006).

Unlike previous bank crisis’, the global financial crisis originated in wholesale markets rather than retail markets and the ex-ante evidence has
shown that “professional investors in these kinds of funds were even more flighty and prone to runs than retail depositors” (Reserve Bank of Australia, 2012). The costs of crises has been extensively examined in the literature (see Borddo et al 2001, Hoggarth, Reis and Saporta 2002; Boyd, Kwak and Smith 2005; Honohan and Laeven 2005). These studies reveal that when the cost of the crises has been measured as the lost output relative to a benchmark, such as an economy’s trend growth rate, the average costs are high and the variation in the amount of costs is large (Allen and Carletti 2007). During the latest crisis the cost was clearly large in terms of both actual expenditure by governments supporting banks liquidity and in terms of the spill-overs to the real economy as the reduction in credit and liquidity translated into reduction in demand for goods and services. This includes direct government bailouts of financial institutions and other corporations that were severely affected such as the car industry. It also includes fiscal support for stimulating demand across the economy, stimulating demand in financial markets through the program of Quantitative Easing and lost GDP as a result of recession. This process of assistance is in many cases ongoing and so the full extent of the GFC is yet to be finalised. The first round response of the G20 nation’s co-ordinated approach to the crisis, interventions involving cash infusions, debt guarantees and other assistance is estimated by the IMF to amount to in excess of $10 trillion.

This figure as staggering as it is does not include the spill-over costs in terms of reduced GDP to the world economy. Clearly, given these findings the prevention of financial crises and systemic stability is the primary motivation of the policy makers, but this needs to be balanced with the
desirability of having a competitive financial sector. This is a particularly relevant trade-off because the GFC demonstrated that excess risk taking by any one financial institutions did not just provide a stream of benefits and losses that were incurred by owners but rather the benefits through higher returns were captured by owners but the losses were nationalised as these institutions were bailed out by governments.

Depositor protection is considered to be an appropriate regulatory response to the issue of systemic stability, however until the GFC Australia did not have such a policy. By guaranteeing deposits, governments are seeking to counteract the rational response to doubt over the banks viability, which is the withdrawal of those funds. In October 2008 the Australian Government introduced a 2 tier depositor protection scheme – the Government Guarantee Scheme for large deposits and wholesale funding and the Financial Claims scheme for deposits under $1million. The GGS was closed to new liabilities on 31 March 2010 and those protected under that scheme were able to continue on a fee paying basis. A permanent guarantee capped at $250,000 per account holder per ADI was introduced on 1 February 2012 under the Financial Claims Scheme, giving Australia its first on-going retail deposit protection program.

This depositor protection was introduced to prevent a spill-over of contagion to the retail level. The measures taken to address the liquidity issue at it source, the wholesale level, were by necessarily much more direct and included, at least in the US and the UK, the nationalisation of financial services firms.
The market failure of asymmetric information is generally addressed through the requirement for institutions to have enhanced disclosure obligations. In this way investors can make more informed choices, although Edwards and Valentine note that “the general principle leaves a great deal of room for debate over the most useful way to bridge the information gap” (1998:307). The financial services sector faces some of the most onerous reporting requirements of any private sector companies. Regular data reporting to APRA is a condition of the banking license in Australia. The intention is to provide a regulator with oversight authority so that they can assess compliance to capital adequacy standards and assess the viability of the financial institution and its risk control practises.

Regulatory arrangements in Australia, proposed by the Wallis Inquiry and subsequently adopted by the Howard Government in 1998, include the creation of three ‘mega regulators, the Australian Prudential Regulation Authority (APRA) which is responsible for the prudential supervision of all deposit taking institutions, superannuation funds and insurance companies.

The Reserve Bank of Australia (Reserve Bank of Australia) which is responsible for monetary policy, systemic stability and the payments system, and the Australian Securities and Investment Commission (ASIC) which is responsible for market integrity, consumer protection and regulation of corporations.

In the post – GFC world the issue of the appropriate form and level of financial regulation has been a consuming theme. The Financial Stability Board provides an overview of the scale and scope of the financial reforms, summarised in Davis (2012):
Strengthening bank capital and liquidity requirements and raising standards for risk management (Basel III)

Addressing risks posed by Systemically Important Financial Institutions (SIFI's) and improving resolution regimes (including strengthening deposit insurance and core financial infrastructure)

Improving OTC derivative markets

Strengthening accounting standards

Strengthening adherence to international supervisory and regulatory standards

Reforming compensation practices to support financial stability

Developing macro prudential frameworks and tools

Expanding and refining the regulatory perimeter.

Financial reform and indeed financial regulation as a whole has as its objective that it improves the key economic functions of the sector. Davis (2012: 39) notes that these functions are

“ex ante information generation and capital allocation; monitoring and corporate governance; facilitation of trading, diversification and management of risk; mobilisation and production of savings; ease of exchange of goods and service. Implicit in achieving these outcomes is the objective of avoidance of financial crisis”

He goes onto note that measuring the effectiveness of the regulatory change in achieving improvements in these functions is problematic, with in general greater attention paid to simpler measurement techniques such as checklists
about the inclusion of best practise standards and codes rather than the most
rigour empirical research on whether the core functions of the sector are
being performed more efficiently as a result of the regulation.
References


Stanton, D., and Herscovitch, A. (2013)


