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Review of the
Reserve Bank of Australia
and Payments System Board
Annual Reports 2005
(First Report)

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Standing Committee on Economics, Finance and Public Administration

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Chairman's foreword

Two areas of economic importance to almost all Australians are monetary policy and the payments system. The Reserve Bank of Australia (RBA) plays a central role in both of these areas – for monetary policy through the Reserve Bank Board, and for the payments system through the Payments System Board (PSB).

The payments system, in particular, has been an area of contention in recent times. The RBA has pursued what some have termed an 'aggressive' reform agenda, with the consequences of those reforms subject to considerable debate.

Conversely, monetary policy has been relatively stable when compared with some of the more turbulent periods in Australia's history. Notwithstanding this, the RBA has lifted the cash rate by 25 basis points twice in the past eighteen months, which, in combination with record petrol prices, has caused some level of community concern.

The committee's February 2006 public hearing with the RBA was the third for the 41st Parliament. Once again, the committee had the opportunity to discuss some of the key monetary policy issues in this important public forum. Overall, the RBA reported that the Australian Economy, which is now in its fifteenth consecutive year of growth, is in a strong position. The RBA attributed Australia's continued growth to 'well above average' growth in the world economy and the emergence of China as an economic superpower.

While describing Australia's economic growth as 'impressive', the RBA did raise some concerns looking forward. In particular, it noted a 'large' current account deficit despite favourable export prices and terms of trade, increasing levels of household debt, and capacity constraints – reoccurring themes from the hearings in 2005.

In terms of interest rates, the RBA noted a number of factors which could put upward pressure on inflation: a high level of capacity utilisation, the tight labour market, and large increases in the cost for some raw materials. In May, interest rates were raised by 25 basis points in response to the realisation of some of these inflationary pressures.

Unlike previous RBA inquiries, this inquiry also included an extensive investigation of the payments system, with a particular focus on the RBA's recent and proposed reforms. The committee found, as has been evident in the media, there is a wide range of views on these reforms. The most contentious of these issues is undoubtedly the reduction of credit card interchange fees. On the one hand, the RBA argues that its reduction of these fees will result in cardholders facing truer price signals when using their cards, while also saving merchants and ultimately consumers millions of dollars each year.

Conversely, the two largest card schemes, Visa and MasterCard, among others, argue that there is no evidence of savings being passed through to consumers. They also argue that their competitors, the three-party schemes American Express and Diners Club, have been unfairly advantaged by the reforms.

The committee is not wholly convinced by either perspective with regard to credit card interchange fees. While there is no empirical evidence that savings have reached consumers, equally, there is no evidence they have not. Further, in competitive markets it seems illogical to suggest that lower costs for merchants do not result in lower prices for consumers. The committee concluded that the benefits of the reform, at this point, outweigh any alleged disadvantages.

Some other reform areas which the committee investigated included the lowering of EFTPOS and scheme debit interchange fees, the removal of the 'honour all cards' rule and the removal of the 'no surcharge' rule. Generally speaking, the committee found the RBA's rationale for these reforms reasonably sound.

One area of concern for the committee is Australia's evident shortfall in payments system technology. While we were once considered to be a world leader in this area, there was consensus during the hearings that we have now fallen behind. To remedy this concern, the committee recommend that those involved in the industry implement, or consider implementing in one case, a number of innovations, namely: PIN authorisations for credit cards, online functionalities for EFTPOS cards and chip technology for all cards.

On behalf of the committee I would like to thank all those who participated in this inquiry. In particular, I would like to thank the Governor of the RBA, Mr Ian McFarlane, and his staff who were, as always, forthright and helpful throughout this inquiry process.

The Hon Bruce Baird MP
Chair



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Membership of the Committee

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Terms of reference

The House of Representatives Standing Committee on Economics, Finance and Public Administration is empowered to inquire into, and report on the annual reports of government departments and authorities tabled in the House that stand referred to the Committee for any inquiry the Committee may wish to make. The reports stand referred in accordance with the schedule tabled by the Speaker to record the areas of responsibility of the Committee.

At its meeting on 8 December 2005, the Committee resolved that it would conduct an inquiry into the Reserve Bank of Australia Annual Report 2005. On 13 March 2006, the Committee resolved that it would conduct an inquiry into the Payments System Board Annual Report 2005.



List of abbreviations

ABA	Australian Bankers' Association
ACA	Australian Consumers' Association
ACCC	Australian Competition and Consumer Commission
AMPF	Australian Merchants Payments Forum
APCA	Australian Payments Clearing Association
APRA	Australian Prudential Regulation Authority
ATM	Automated Teller Machines
CAD	Current Account Deficit
CPI	Consumer Price Index
CUIA	Credit Union Industry Association
EMV	Europay, MasterCard and Visa
GDP	Gross Domestic Product
MIF	Multilateral Interchange Fees
PIN	Personal Identification Number
PSB	Payments System Board
RBA	Reserve Bank of Australia



Recommendation

4 The payments system—reforms and other matters

Recommendation 1

The committee recommends that card schemes, issuers, acquirers and merchants work together to improve Australia's payments system technology. In particular, the committee recommends that this partnership:

- Implements PIN-based authorisations for credit cards;
- Implements 'online' functionality for EFTPOS cards; and
- Considers the widespread adoption of chip technology.

