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‘Never had it so good’?

The Concealed Costs of Financial Exposure

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This work contains no material which has been accepted for the award of another degree or diploma in any university, and to the best of my knowledge and belief, this thesis contains no material previously published or written by another person except where due reference is made in the text of the thesis.

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§ INTRODUCTION §

Living Standards: The Neglected Dimension

In 2012, Genworth, a leading Australian credit underwriter and provider of mortgage insurance, released ‘Streets Ahead’, its latest report on homebuyer confidence in Australia. ‘Streets Ahead’ detailed that “a general rise in the cost of living” was the major factor underpinning mortgage stress levels in Australia (Genworth, 2012: 8). Another report by the Fujitsu ratings agency in 2010, also identified that cost of living was the major source of mortgage stress (Fujitsu, 2010: 29).

Such private indicators are far from conclusive, and indeed organizations such as Genworth and Fujitsu (as profit seekers and rentiers) have their own agendas. However, their information on the perceived rise in the cost of living, signifies that something is at odds with the ‘never had it so good’ narrative surrounding living standards in Australia; a narrative that has come to define the conventional political discourse. The discrepancy between these two narratives manifests in more informal ways, such as popular concerns surrounding the implementation of the carbon tax, or public opposition to programs of privatisation based on cost of living concerns.

How can it be that Australians have ‘never had it so good’ when there exists this popular perception that increasing living costs are a major constraint?

The conventional narrative describing Australian prosperity over the past 40 years depicts a household characterised by expanding consumption capacity, and new opportunities for participation. In 2011 (and in response to the emergence of ‘Occupy Sydney’), commentator Scott Steel wrote, that Australians are in a “state of denial” as to “the reality of our privileged circumstances” (2011). Steel’s point was that, over the past 40 years, all Australians have got richer due to a policy program that has “actually solved most of the big problems that other nations are still grappling with” (2011). Similarly, the latest AMP.NATSEM report stated that, in comparison to 1984, the average Australian family is \$224/week ahead, with the benefits spreading to both high and low income families (Phillips, *et. al.*, 2012). Moreover, this ‘never had it so good’ narrative is one endorsed and espoused by prominent public institutions that account for household standard of living in Australia: notably the Australian Bureau of Statistics (ABS) and the Australian Treasury.

Certainly, a narrative of increasingly accessible consumer durables, of increasing levels of wealth, and of household participation in previously excluded activities is not inaccurate. However, the narrative neglects a critical dimension of the story. A dimension that, as indicated by the Genworth and Fujitsu reports, households themselves have not failed to perceive.

This dimension is not inequality, although this is an important complimentary area of concern. Nor is my explanation located in ideas, such as those of commentator Clive Hamilton, who attribute this apparent paradox to greed, individualism and a growing sense of entitlement. Other scholars, such as Sharon Beder (2000) or Gary Cross (1993) have discussed the time pressures and money stresses associated with the consumption and production requirements of ‘modern’ capitalism. However, I am concerned with a different material factor underlying such pressures – a factor separate from debates about greed, consumption and happiness.

The critical factor I identify as missing from the ‘never had it so good’ narrative is the process of financialisation. More specifically, I am concerned with the transfer of financial risk and the way this is impacting negatively on households, in ways not acknowledged in the conventional cost of living measures.

The proposition I develop in this thesis is that, in Australia over the past 40 years, there has been a structural shift that has systematically integrated households into financial activities. This structural shift has transferred onto households the financial risks associated with accessing subsistence items such as housing, health, education and an income. I show that household risks are distinct – that they cannot be priced and traded as conceived in the idealised theories of finance – and that this is particularly the case for working class households, which, as defined by their limited ownership or control over assets, are constricted in their ability to engage with financial risk. The distinctive nature of household risk entails particular costs; costs that are inadequately incorporated into conventional measures of living standards.

The inadequate account of the costs associated with household risk reflects the conceptual challenge posed by the changing and increasingly financialised household. When, for example, the 1907 Harvester Judgement determined an ‘adequate’ living wage, there was no expectation that households would have to negotiate the risks associated with financial markets. Now, however, households are increasingly cast as financially literate investors, capable of navigating complex financial markets and risk exposures in their daily functioning. In today’s context, a failure to transcend ‘pre-financialised’ conceptions of living standards therefore results in an inability to identify the other side of the ‘never had it so good’ coin.

Accordingly, I have structured this thesis to: firstly, explore the costs incurred by the Australian household, particularly the working class household, in the transfer of financial risk; and, secondly, identify the reasons for the neglect of such costs from the standard ‘never had it so good’ narrative. In chapter 1, I develop – both conceptually and empirically – an account of the costs absorbed by households

through risk shifting processes. I also consider the particular implications of these processes for the living standards of the 'financially illiquid' working class household. In chapter 2, I turn to explorations of the politics of measurement, focusing my discussion on the ABS's Consumer Price Index (CPI) and, in chapter 3, the Treasury's Wellbeing Framework (TWF), as politically significant examples of such measurements and frameworks. The CPI's and TWF's differing treatments of the financialised household are of critical import. They exemplify a state of affairs whereby working class households are increasingly drawn into more and more processes of risky financial calculation, yet in a way that systematically conceals the costs absorbed through these very processes.

Locating my Perspective

The failure to adequately conceptualise of financialisation as a *structural shift of risk onto working class households*, is a critical factor behind the neglect to account for the financial costs absorbed by households in recent decades. While it may be far from controversial to claim that we live in a world that has seen the mass expansion of financial motives – “every man (women and child) is now a speculator” (Fraser, 2006: 1) – the actual term financialisation has no universal meaning. There is a tendency to characterise recent transformations either in terms of the structural changes affecting household income and expenditure, or in terms of individuals engaging in more and more risky activities, thus neglecting the other corresponding (and critical) dimension.

Significant contributions by Marxian and other radical scholars outline structural ‘neoliberal’ or ‘financial’ changes in the Australian economy, and the impact that such changes have had on the Australian household (see, for example, Stilwell & Jordan, 2007; Cahill *et. al.*, 2012; Anderson 1999; Cahill, 2005 and Chester, 2012). Policy doctrines of deregulation and privatisation have led to changing patterns of household provisioning, whereby engagement with private markets is increasingly necessary in order to access subsistence items. These policy doctrines have also resulted in working conditions that are less and less tied to cost of living adjustments, and thus decreasingly protected from the dictate of private capital.

These structural accounts of neoliberal changes have raised critical concerns surrounding the market imperatives imposed in work, social and domestic life.

However, such narratives can be complemented by a direct exploration of the transfer of risks implied in the neoliberal turn.

Conversely, Marxist economists such as Costas Lapavistas, Ben Fine or Paulo dos Santos have highlighted the financial aspects of such neoliberal processes, affording particular attention to the increasing levels of household debt. Dos Santos writes that changes in the banking sector have “forced individuals into debt and necessitated the transfer of growing shares of their income” (2009: 192). Such concern with household debt is far from confined to Marxist scholars, as reflected by publications from the Reserve Bank of Australia (RBA), which focuses on the implications of what constitutes a ‘sustainable’ level of household indebtedness (Kent *et. al.* 2007: 146). Similarly, post-Keynesian Steve Keen focuses on the impact of levels of private debt on the stability of the economy (2009: 347). These debt-focussed accounts have a popular and intuitive appeal in the context of a very high percentage of household debt in relation to disposable income in Australia – which rose from 40% in the 1970s to over 150% in 2011 (Freestone *et. al.*, 2011: 64). This appeal has only grown since the ‘bursting’ of the subprime mortgage bubble in the United States.

These studies open up critical connections between neoliberalism and finance. However, the scope of inquiry of these studies is restricted to the concrete and (relatively) straightforward-to-measure changes in price or income levels, and in particular, to the causes and consequences of household debt. These scholars do not develop a systematic analysis of the kind I am about to undertake: an analysis of the broader and more diverse costs associated with the underlying transfer of financial risk.

Risk is an aspect that is far from neglected in other areas of study. Indeed, a wealth of literature has emerged in recent years, dedicated to unpackaging the increasing pervasiveness of risk in daily life. This literature has come from across the political spectrum, including the economic mainstream.

Risk is hardly a new concept for neoclassical economists. In 1951, notable economist Kenneth Arrow wrote of the:

... intrinsic uncertainty in possible outcomes... [and] the importance of a realistic theory explaining how individuals choose among alternate courses of action when the consequences of their actions are incompletely known to them (1951: 404, quoted in Banerjee and Ewing, 2004: 22).

More recently, economists such as Robert Shiller (2003) and Joseph Stiglitz (2009) have, in their differing ways, concretely applied Arrow's insights to examine the risk-exposed household. Importantly, both these theorists have acknowledged the difficulties that risk poses for households – a consequence of incomplete risk markets or behavioural irrationalities. Such difficulties result in the “failure to bring the advantages [of risk trading] shared by the clients of Wall St to the customers of Wall Mart” (Shiller, 2003: 1).

These orthodox accounts have a common strength in identifying the prominence and pervasiveness of risk in contemporary capitalism. However, these perspectives largely fail to locate such ubiquitous risk within the significant structural changes identified by the ‘neoliberalism’ literature. The lens for viewing increasing risk-exposure is in terms of the preferences and choices of individuals, abstracted from the changing patterns of expenditure of the state and employers that have underpinned household engagement with financial activities.

Scholars from other theoretical traditions have therefore located the risk-exposed individual or household within broader social changes. In 1992, Ulrich Beck wrote *Risk Society: towards a new modernity*, asserting that modern capitalism has shifted from an industrial to a risk society, whereby “individuals reflect upon and flexibly restructure the rules and resources of the workplace and of their leisure time” (1992: 3). That is, an ‘individualised’ society has developed that both affords individuals new opportunities for self-development, but also results in these individuals absorbing increasing levels of risk. Notably, however, and perhaps reflective of the era in which he wrote, Beck made no substantial reference to financial risk.

Beck's thesis nonetheless inspired a wave of particularly post-structuralist engagement with financial risk. For example, Paul Langley explores the new relationship that individuals and households have formed with capital markets, whereby risk is constructed as an opportunity to be embraced, but with the potential of damaging outcomes:

While many individuals and households undoubtedly gain from recently formed relationships with the capital markets, the material effects of these relationships are also highly divisive and, at points of crisis in particular, can be disastrous for those involved (2008: 14).

Similarly, sociologist Leonard Seabrooke outlines the way that individuals, through access to finance or credit, have become embedded in cumulative financial processes, and the negative implications this may have, particularly for those in lower income groupings (2006).

Jacob Hacker's comprehensive book *The Great Risk Shift* locates the pervasiveness of household risk in the pursuit of a particular policy framework, driven by a "personal responsibility crusade" (2006: 9). Hacker describes the transfer of what was previously socially dispersed risk onto individual household units, stating that: "work, family and public and private benefits have all grown more risky at roughly the same time" (2006: 5). A similar perspective has been developed by Elizabeth Warren¹ who discusses the requirement for families to engage in financial activities such as unaffordable credit or complicated loans "to keep safe... and let them earn a living" (2006: 14).

Yet even these more holistic accounts, with their differing emphasis, afford no scope for accounting for financialisation as a process of risk shifting inextricably linked to capitalist class relations, as identified by Bryan *et. al.* (2009: 120). In chapter 1, I return to the centrality of class, and not just as a distributional category but because of labour's innate illiquidity in financial markets. But the implication here is that even theorists such as Hacker, who directly link increasing levels of risk to changing policy

¹ Elizabeth Warren implemented the Troubled Asset Relief Program (TARP) then headed consumer protection inside the Federal Reserve in the immediate aftermath of the Global Financial Crisis.

frameworks, conceive of risk as a pervasive characteristic that households are no longer protected against, rather than as a cost that has been systematically transferred onto households, and onto working class households in particular. This conception means that while Hacker, Warren or Seabrooke may offer comprehensive engagement with the shifting of risk, there is a layer to the financial dimension of risk shifting that is left unaddressed: risk is not taken into account in the quantified measures of household living standards. I identify this failure to quantify the costs of financial risk, as a critical factor in the apparent paradox between data supporting the ‘never had it so good’ narrative, and perceptions surrounding increased living costs in Australia.

I am therefore concerned in this thesis with demonstrating the limitations of conventional institutions that are responsible for measuring and accounting for living standards in Australia. Specifically, I am concerned with the limitations of these institutions to quantify the costs of the financial shift of risk onto households, and in particular working class households.

CHAPTER 1:

THE RISK-EXPOSED

AUSTRALIAN HOUSEHOLD

Over the past 40 years, changing expenditure patterns by the state and employers have required households to manage an increasing array of financial transactions and risk exposures. Households have had to engage with these transactions and risk exposures in order to maintain access to subsistence items. In this chapter, I outline the importance of incorporating the costs associated with such risk exposure into the way that we account for living standards in Australia, particularly for working class households.

There are two critical dimensions to consider when addressing the issue of household risk: (i) the risk return of capital investment; and, (ii) the financial illiquidity of households.

Firstly, accounting for the costs associated with household risk can be conceptualised as akin to capital investment. It is undisputed that capital investment involves exposure to varying degrees of risk, and that such exposure represents a cost above and beyond the cost of an underlying asset. My argument here is simple – apply a risk return calculus to the risk-exposed household.

However, this argument for applying the risk return calculus to households only goes so far. The argument neglects the second dimension relating to the specific character of household risk, and in particular working class household risk: namely, illiquidity. Such illiquidity means that – in the context of structural changes to the financial architecture – households have had little option other than to engage with increasing levels of financial risk, and that such pervasive risk and insecurity cannot be readily hedged. The risk absorbed by households, and working class households in particular, therefore entails particular costs beyond those of, and thus requiring different treatment to, risk-exposed capital.

I have structured sections 1.1 and 1.2 of this chapter to explain these two dimensions, and thus my conceptual argument of the costs absorbed by the financialised household. I then, in section 1.3, offer empirical evidence to support this conceptual argument. Developing such an account of the costs associated with household risks is critical, as is exemplified when I consider, in chapters 2 and 3, the prominent ways in which living standards are measured and addressed in Australia.

1.1 The Cost of Financial Risk

It is an undisputed assertion that, in relation to firms or governments, exposure to financial risk entails a cost. Since the development of the Capital Asset Pricing Model (CAPM) in the 1950s, it has been well established in financial literature that governments and firms face significant levels of exposure when investing: “risk is at the centre of all investment decisions” (Bernstein, 2007: 4; see also Reinsdorf, 2011: 7; Arrow, 1951). This exposure to financial risk (of varying degrees), represents a cost above and beyond the costs of an underlying asset. Frameworks for valuing investment must therefore account for risk exposure, which orthodox economists do by utilising the risk-adjusted measurement ‘alpha’ in their equilibrium models.

My point here is not to affirm the accuracy of CAPM model for pricing an individual security or portfolio. In spite of its wide application, CAPM faces significant conceptual criticism both within and between disciplines, with theories on how to calculate and convert the value of risk being heavily contested. For example, theorists within the mainstream ‘search for alpha’; post-Keynesians contend that market uncertainty means that alpha cannot be determined; while Marxists debate the material basis of risk’s underlying value. My point is rather that, when it comes to investing, it is undisputed that risk exposure represents a significant cost that requires some form of risk-return calculation.

The pervasive risks to which people are increasingly exposed in their home and working lives (as I empirically outline in section 1.3) represent a cost just like the ‘alpha’ factored in a firm’s or a government’s investment decision. That is,

households now *face the prospect* of incurring costs above and beyond the direct costs observed in changing price, debt or income levels. Such underlying costs may be difficult to conceptualise or quantify. Furthermore (as I outline in section 1.2), these costs are distinct from those facing firms. However, the existence of such costs, a point so established in relation to capital, should not be denied.

Yet there exists an anomaly, whereby the importance of applying a risk-return calculation for household financial activity continues to fall off the analytical radar. In chapter 2, I explore the practical consequences of this anomaly, by examining the Consumer Price Index's conceptual treatment and attempted incorporation of various aspects of household finance. I examine its ability to account for both concrete price changes of financial items, and also the implicit costs – the household 'alpha' – of risky financial exposure. Here we see some of the issues that I have identified in the previous paragraphs come to a head.

Overcoming anomaly?

As issues of pervasive risk become increasingly central to the depiction of households, the neglect of household risk exposure has not gone unnoticed, not least of all within orthodox economics. Economists such as Shiller and Stiglitz have, in their different ways, concretely applied some of the neoclassical treatment of capital risk to the risk-exposed household. Their work is particularly significant because of its influence on the treatment of household finance within parts of the political mainstream, including the Australian Treasury. Stiglitz and Shiller expand on the orthodox treatment of finance as represented by Kenneth Arrow (1951; see also Edward Bernstein, 2007). Arrow explained not only the intrinsic uncertainty in almost every investment decision, but also the difficulties of trading in risk, where information problems, contractual problems and externalities result in incomplete risk markets (Arrow in Banerjee & Ewing, 2004: 26).

Both Shiller and Stiglitz explore the risks that households now decide to expose themselves to, and the difficulties that households face through such exposure. That is, distorted market conditions preclude individuals from realising their optimal risk preferences; from “ascertaining the precariousness associated with various lending provisions as well as the steps that can be taken to offset such precariousness” (Stiglitz, 2009). They identify three particular difficulties that can arise: (i) households may be restricted or unable to access important risk markets to offset and manage their exposure; (ii) irrationality may lead individuals to engage in activities and undertake decisions that undermine their own interests (a point informed by the significant growth in behavioural economics over recent years, see for example Barbaris & Thaler, 2002: 2); and, (iii) there may exist particular products that are excessively uncertain and volatile.

Shiller and Stiglitz therefore identify particular difficulties that households face as a result of increased risk exposure. They advocate policies to address these difficulties, such as the development of insurance markets for house prices or income, programs for financial literacy or regulation of particular products (Stiglitz, 2009). Together they apply some of the implications of orthodox economics to the risk-exposed household, supporting a policy framework that allows individual households to better manage their risk exposures, just like capital.

However, and in so doing, both scholars neglect to account for the *actual costs* associated with such risk levels, and fail to consider the specific character of household risk, and in particular working class household risk. I consider the issue of actual costs in the next section.

1.2 The costs for working class households

For the average working class Australian household, engagement with finance is dictated by a need to access subsistence items such as housing, healthcare and income. This dictated engagement does not preclude instances where households may decide, for example, to invest savings in a particular financial market. However, there remains a fundamental difference between a working class household investing in a pension fund or health insurance scheme, and the choice of a firm – or indeed a household with surplus assets – to invest in a share or equity market.

The distinct character of working class household risk is due to its financial illiquidity.

Conventional financial theory assumes that assets are liquid for the individual holder. However, the major assets owned or controlled by working class households are (i) the ability to work, and (for some) (ii) housing. Both these items are integral to daily functioning. Given a limited range of alternative acquisitions able to sustain subsistence, these assets cannot be readily sold without threatening subsistence and are therefore – to quote orthodox economist John Campbell – “illiquid and untradeable” (2006: 1559).² The ability to work (or ‘human capital’) entails the receiving of an income but not the ability to sell claims on that income, making it “idiosyncratic in practise... and [therefore] unhedgeable” (2006: 1559). That is, working class reliance on a wage for subsistence purposes differentiates, and places

² Campbell, however, does not frame illiquidity in terms of class, rather stating that all households are defined by a limited ownership or control over assets (2006: 1558).

limitations on, ‘the ability to work’ in comparison to other tradeable assets. Housing is illiquid in the sense that there is little scope for individuals to shift their investment in housing in response to, or in anticipation of, changes in the economic landscape. Working class households, who purchase housing primarily as a place to live, are disinclined to treat their home as an asset to be bought and sold in response to short-term price movements in real estate prices. Furthermore, the high costs of selling, and long settlement periods, define this market as illiquid irrespective of the intentions of the house owner.

In engaging with finance, working class households are therefore in an inherently different position from those firms, governments or wealthier households that have control or ownership over a significant portfolio of assets. For example, significant wealth may result in the need to work being optional, or ownership of multiple houses often means that any one of them can be relatively liquid. This distinctiveness of working class households has two critical implications given the structural changes that have transferred financial risk from the state and corporate sector onto households (see section 1.3).

Firstly, financial illiquidity underscores the lack of choice or agency that working class households have in individually absorbing what were previously often socially dispersed risks. Such households, not controlling alternative forms of wealth, cannot ‘opt-out’ of engaging with the risks of financial markets whilst maintaining access to subsistence items. For example, when accessing higher education, working class households generally have little ‘choice’ whether or not to participate in the Higher Education Contribution Scheme (HECS),³ while those with an expanded asset portfolio may be able to pay the up-front fees. Simultaneously, working class households are forced to take on particular risks and the potential financial and non-financial costs that such risks entail. For example, if the costs associated with comprehensive car insurance or dental check-ups (and to a lesser, but nevertheless

³ Reforms to HECS in 2005/06 renamed the scheme HECS-HELP (Higher Education Loan Provision), which retains the same principles as HECS. See the Australian Government’s ‘Study Assist’ website for further clarification: <http://studyassist.gov.au/sites/StudyAssist/>.

increasing, degree income insurance) are too high; households take on the risks associated with not having the protection provided through such coverage.

Secondly, financial illiquidity restrains the ability of households, once engaged with finance, to adequately manage their risk. Working class households are heavily constrained in their capacity to on-sell or hedge their financial exposure, through, for example, the diversification of assets, let alone to expand their asset portfolios through speculation. By the same token, such limited resources mean that working class households are far more susceptible, particularly when exposed to volatility, to becoming “locked in” via credit and insurance markets to reinforcing cycles of risk and debt (Bryan *et. al.*, 2009: 470). For example, they are far more constrained than firms in their ability to hedge against changes in interest rate markets, and rapid changes may force them to turn to other credit sources to cover unexpected costs.

The critical point is that a narrative of working class risk exposure, or an application of a household risk-return calculus, must account for the limited ability to avoid or reduce such pervasive levels of risk. This is something that is pervasively neglected in existing literature.

Orthodoxy hits a wall

When orthodox economists consider households in their theories of financial calculation, they incorporate households into a discourse of individualism, markets and efficiency, conceiving of all household risk akin to that of a firm or government. This discourse dissolves the category of class. The financial significance of differing levels of asset ownership is discounted, with risk only receiving treatment to the extent that it facilitates or fails to facilitate the ability of individuals to optimally utilise risk markets. Economists such as Shiller and Stiglitz therefore remain constrained to a discourse that cannot incorporate factors that are not reducible to particular market or behavioural distortions. There is no scope for considering the

systemic costs of risk that cannot be hedged, due to the illiquidity of working class households.

A consideration of illiquidity is critical because conceptions of risk in terms of individual choice and opportunity translate into the treatment afforded the financialised household in the political mainstream. In chapter 3, I examine the Australian Treasury's Wellbeing Framework (TWF) as a practical application of the discourse of individualism and efficient markets. I focus on the ability of the TWF, which does actually incorporate risk and complexity as key dimensions of wellbeing, to account for the social particularities of working class financialised existence.

In this section, I have outlined the way in which prevailing conceptions of financial risk are unable to come to terms with the financialised household, with particular emphasis on the limitations of such conceptions to deal with risk as it manifests itself for working class households. This discussion provides the foundations for analysing the prominent ways in which risk is accounted for in cost of living measurements and in 'wellbeing' policy frameworks. I now turn to an empirical investigation of the way in which financial risk has come to the fore in working class daily functioning.

1.3 Risk Shifting: The Evidence

In the introduction, I framed financialisation as a process of risk shifting, whereby the growth of market criteria has come to characterise both patterns of household expenditure and the provisioning of income. Here I nominate the key manifestations of risk shifting in relation to households (both at home and at work), for these are the sorts of processes that measurements of working class living standards are failing to capture.

(i) Changing Patterns of household expenditure:

In this sub-section, I outline the changing patterns of household expenditure, which have been underpinned by policies of deregulation and privatisation, and the shift of risk that such policies have involved. I begin by documenting some prominent examples of the shift of financial risk. Equally as important, however, as these notable manifestations, are the less prominent, and even subtle, instances of financial calculation. Indeed, it is less the case that all households have engaged with overwhelming levels of risk in specific areas such as housing or superannuation (although this may occur), but more that risk itself has come to pervade ever increasing facets of daily functioning.

a) Superannuation

Changing patterns in the provision of retirement income over the past 40 years provide an illustrative example of the risk shifting process. Certainly, at this stage, superannuation schemes have not replaced pensions, and the proportion of eligible people receiving the Age Pension sat at 68% in June 2008 (ABS, 2009a). Of the 43% of retired Australians who have received some form of superannuation payment, the ABS notes that for the vast majority such payments are “not sufficient to guarantee a comfortable standard of retirement living” (ABS, 2009a).

At the same time, ‘investing’ in superannuation schemes rather than relying solely on government pensions is both a legal requirement, as well as increasingly necessary for households to maintain pre-retirement standards of living. Before the implementation of the National Superannuation Scheme in 1992, which instituted the compulsory employer payment, award superannuation had legislated individuals to invest proportions of their income (Bryson, 1994: 303). The number of workers making payments to super schemes had risen from 40% in 1983 to 72% in 1991 (1994: 303). As of 2007, the proportion of employees with superannuation coverage had risen to 94% (ABS, 2009a). Correspondingly, the proportion of eligible recipients receiving the maximum Age Pension fell from 67% in June 1991, to 56% in June 2008 (ABS, 2009a). Indeed, the ABS states that: “It is expected that superannuation will eventually replace taxpayer funded income support as seniors’ main source of income in retirement” (2009a).

The trend towards superannuation is of critical importance. It is reflective of successive and continuing government policies, which mandate that workers invest significant proportions of household income in share or equity markets, leaving households exposed to the volatility of such markets. Households are also responsible for discerning between a variety of different options in terms of fund managers and tailored packages. Mike Rafferty and Serena Yu depict the risk exposure resulting from such “privately managed, mandatory, defined-contribution pension financing”

(2010: 60), by measuring superannuation returns during the Global Financial Crisis (GFC) in 2008. In Australia, real investment return from superannuation was -26.7%, a negative return second only to Ireland out of nine OECD countries (Germany, Netherlands, United Kingdom, United States, Japan and Canada), and well below the OECD average of -17.4% (2010: 61).

Therefore, even if superannuation is, in theory, able to provide households with a comfortable retirement income (whether alongside the pension or potentially in-and-of-itself in the future), the responsibility for absorbing the volatility of market driven post retirement income is being increasingly shifted from the state and onto households.

b) Housing

Housing is another critical area of household expenditure where changes have left households far more exposed to the risks associated with financial volatility.

As I outlined in the introduction, considerable attention has been given in recent years to the increasing levels of household debt resulting from the rising costs of housing (see for example Keen, 2009; Yates, 2011). Judith Yates thus recorded in her address to the 2011 Reserve Bank of Australia (RBA) conference:

Prior to the 1970s a household on average weekly earnings had a borrowing capacity that was more than adequate to fund purchase of a median price dwelling. The foundations of this high and stable home ownership rate began to be challenged from about the mid 1980s with an emerging divergence of house prices in relation to income and, specifically, with the emergence of a deposit gap between what a household on average weekly earnings could afford to borrow (based on a 30 per cent repayment to income ratio) and median house prices (2011: 14).

Indeed, between 1984 and 2004, housing as a total share of household expenditure increased from 14.5% to 18.3% (Rafferty & Yu, 2010: 57).

However, a focus on such concrete changes in costs captures only part of the picture. The Fujitsu Mortgage Stress-O-Meter recorded that between late 2007 and 2008 – a period over which debt levels had stagnated – mortgage stress levels more than quadrupled, with the most significant cause identified to be high interest rates (Fujitsu, 2010: 31). The rising costs associated with housing therefore represent not only a growing requirement of repayments, but a growing exposure to interest rate volatility. This signifies the increasing degree to which the consumption of housing has become a financial process as competition has been introduced into the housing market, with interest rates no longer regulated and set at a discount rate from commercial loans (Rafferty & Yu, 2010: 50).

Such changes to the regulation of interest rates may have created opportunities for choice. Yet the fact that interest payments rise to assume a higher and higher proportion of disposable income make the decision surrounding the purchase of a house more and more critical, and place considerable requirements of calculation and choices about an uncertain future. The volatility of purchasing a house was exemplified in the early 1990s, when households with variable loans had to come to terms with interest rates of up to 17%. Additionally, the securing of a loan involves important calculations, surveys and judgements between different loans and interest payment plans, alongside the negotiation of bank fees. Given that home ownership levels sit at 70% (ABS, 2009c: 4), the fact that purchasing a home involves such financial exposure represents a significant cost for the Australian household.

c) Insurance

The past 15 years have witnessed a similar trend in the provisioning of healthcare. In 2008, 53% of the Australian population had private health insurance (ABS, 2008). This was a significant change from the declining trend in the 1980s and 90s, following the implementation of Medicare. In these decades, the percentage investing in private health insurance had fallen from 80% in 1970 to 30% in the mid-1990s (Flood *et. al.*, 2004: 370).

This trend towards investment in private health has been underpinned by government policies, such as private subsidies, which have facilitated access to private health insurance. In 1999, the government introduced a 30% Private Health Insurance Rebate scheme and sold off *Medibank Private*.

The trend has also been underpinned by a relative decline in the coverage and provisioning provided through Medicare. Data that gives an aggregate picture on this issue is difficult to locate. Indeed, insurance status, while identified as a potential variable, has not been used in the Australian National Health Survey (Australian Institute of Health and Welfare, 2012: 4). John Dwyer from the Evatt Foundation stated when considering levels of satisfaction with the Australian healthcare system that there is a lack of “empirically verifiable research... as there has been no in-depth community dialogue” (Dwyer, 2006).

Nevertheless, there is evidence that many Australians are turning to private health insurance in order to guarantee adequate healthcare cover. This is the conclusion found by the Evatt Foundation:

Australians are only too well aware that their healthcare system is increasingly unreliable, indeed dysfunctional. Public hospitals have major problems because of ever-increasing demand, under-funding and shortages of health professionals... Planned surgery is rationed. General practitioners must raise their fees to survive. The fees for specialists make it increasingly difficult for many citizens to benefit from their care. *Individual financial capacity is increasingly a major determinant of health outcomes.* (Dwyer, 2006, italics added).

The Evatt Foundation’s view is reinforced by particular indicators from ABS data, such as that on patient experiences of health services. A 2009 survey found that people without private health insurance were: twice as likely not to have seen a GP; twice as likely to have found cost a barrier in accessing their medication; and, half as likely again to have delayed or not seen a specialist (ABS, 2009b). In relation to hospital services, the ABS concluded that “people who felt their health was excellent, very good or good were one and a half times more likely than people who felt their health was fair or poor to have been treated as a private patient” (ABS, 2009b).

Furthermore, in 2008, the ABS conducted an extensive survey that found that the most common reason of those surveyed (59%) for not having private health insurance was that they were unable to afford it (ABS, 2008).

This trend towards private provisioning has resulted in households facing a trade-off between the risk of not having access to quality healthcare, and the costs associated with private health insurance. These latter costs themselves involve an increasing exposure to volatility and risk, as well as an increasing responsibility for complex calculations and decisions surrounding particular providers and schemes.

Health insurance is the most significant of an array of insurance markets, which, alongside credit markets, have become increasingly pervasive in daily life. Households have to make decisions about the extent to which they engage with – and thus gain the coverage of – compulsory car and contents insurance, as well as newly emerging insurance markets. Such markets cover a range of both old and new products from mobile phones and other durables, to current and future income streams, to personal matters of illness, disability or death (Rafferty & Yu, 2010: 50).

d) Tertiary Education

Changing patterns of provision with tertiary education depict a similar trend. Since the 1980s, successive governments have introduced, and progressively increased, the levels of a ‘user pays’ system of fees. In 2002, 67% of higher education students were required to pay HECS and 79% had ‘chosen’ to defer their payments, with the ABS predicting that these percentages would only increase in following years (ABS, 2004a). The accessing of education therefore necessitates financial calculation. Increasing costs substantially intensify the requirement that students responsibly evaluate the value of going to university in terms of future job prospects, i.e. the value of ‘investing in (their own) human capital’. Furthermore, students must choose

between taking on debt through HECS, which the majority then pay off well into their working lives, or paying fees upfront and receiving a 20% discount.

e) Utilities

The same narrative of financial calculation describes the accessing of utilities. Policies of privatisation and decreasing price regulation have opened up markets for corporate investment in areas previously defined by public ownership. Changes in, for example, telecommunications and electricity, have shifted significant costs onto households (Cahill, 2005: 18; Anderson, 1999: 11), and have left households exposed and responsible for subsequent fluctuations in prices. Fundamentally, such changes have been characterised by the emergence of a choice between providers with complex contracts that are unlikely to be comprehended by the majority of citizens (or at least requiring significant financial literacy in order to interpret), entailing unclear and uncertain obligations for households to ‘responsibly’ manage into the future.

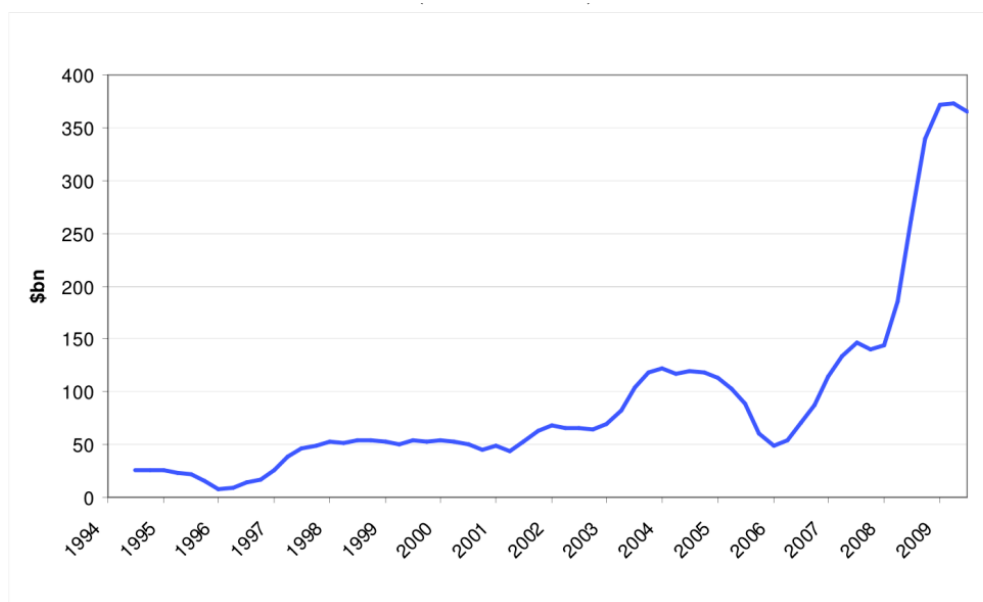


These five instances of changes household expenditure have left households little option but to engage with an increasing array of risk exposures and responsibilities in their daily lives. Households are impelled to engage with these risks in order to maintain access to many subsistence goods and services, as well as gain access to emerging consumer items. This engagement raises particular issues for working class households, given their limited options in terms of engaging and being able to offset such risky exposure. Furthermore, as structural changes have necessitated such financial engagement, a cultural shift has also ensued: credit-financed consumption or systems of ‘user-pay’ HECS are becoming the expected norm, woven into the fabric

of household expenditure patterns. This can be seen on an increasingly continual rather than ad hoc basis.

Such changes result in a growing level of household volatility. The following graph on the volatility of household wealth, constructed using RBA data by Rafferty and Yu, gives some aggregate picture of household risk. Detailing changes between 1994 and 2009, this graph depicts the extent to which household wealth is now exposed to changes in capital markets. We see that levels of volatility skyrocketed between 2008 and 2010, given the financial turbulence that characterised this period.

Figure 1: Volatility of Household Wealth, 1994-2009 (\$AU billions)



Source: Rafferty & Yu (2010: 54)

Moreover, this graph, and the household risk exposure it reflects, only captures a part of the picture. The RBA data is limited to concrete changes in price volatility of particular assets and liabilities. This graph has therefore been constructed based on changes in the prices of financial assets (deposits, reserves of life offices and pension funds, shares and other equity and unfunded superannuation); non-financial assets (consumer durables and dwellings); and liabilities (RBA, 2010a). While the data offer an indication of the extent to which households are embedded in financial exposures,

the data do not account for the costs associated with such risky exposures. That is, the data are not conceived in applying a risk return calculation to households. Applying this calculation would require, not only accounting for the concrete changes in the price levels of, for example, superannuation schemes, but also compensating for the risk entailed in investing in such schemes.

The methodology for calculating such risk would be very contentious, and is far beyond the scope of this thesis. It is nevertheless clear that households are facing significant risks in their daily expenditure patterns, which represent pressing considerations when accounting for household cost of living.

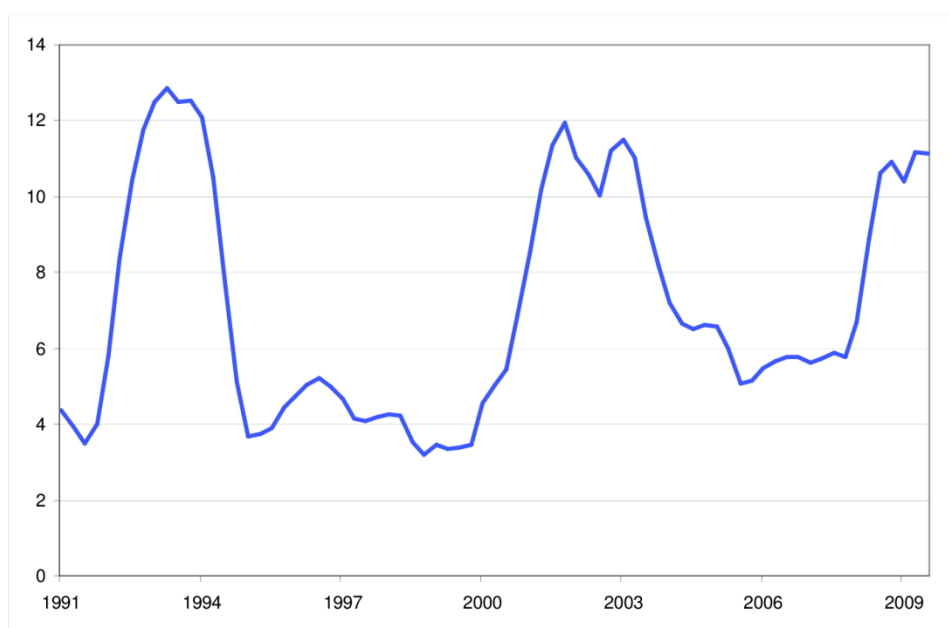
(ii) Changes in the labour market

Increasing levels of volatility in expected household income have reinforced the volatility in household expenditure. Over the past 40 years, labour market changes have made security of employment, wages and conditions (and, as I have outlined, security of pensions), far more precarious. There are several dimensions that I briefly consider in the following paragraphs.

In the 1960s, approximately 90% of Australian workers were full-timers (Watson, 2003: 47). As of May 2010, this proportion had fallen to 63.3% (ABS, 2010a). Of those employed, 36.7% were correspondingly part-time workers, and 21% (18% part-time and 3% full-time) were employed on a casual basis (ABS, 2010a). Certainly, these changes in employment status indicate some desire for greater flexibility in the workforce. However, they are also reflective of an increasing contingency of employment. For example, 25% of all part-time workers state that they would prefer to work more hours (ABS, 2010a). Furthermore, such static and aggregate statistics often don't capture many labour market contingencies: including underemployment; the number of long-term unemployed no longer looking for work; and the short-term nature of many employment options.

A second major consideration is that of income insecurity. In examining the setting of pay for employees in 2010, the ABS concluded that ‘Award only’ was the least common method of setting of pay (15.2%), with the most common methods being collective agreement (43.4%) and individual agreement (37.3%) (ABS, 2010b). This data on the setting of pay is reflective of a trend whereby, particularly since changes to the Accord laws in 1987, wage rises are increasingly tied to productivity rather than cost of living adjustments (Chester, 2012: 156). While this trend does not necessarily signify increasing levels of risk, it does leave income levels far more vulnerable to fluctuations in the macro economy. Such vulnerability is reflected in the following graph on income insecurity, which demonstrates the exposure of income levels to such fluctuations.

Figure 2: Income Insecurity – Volatility of Average Weekly Ordinary Full-time Earnings, 1991-2009 (\$AU)



Source: Rafferty & Yu (2010: 60)

Significantly these data are based on average *full-time* earnings, and account for the trend changes in earnings over time. As Rafferty and Yu note such data demonstrate that during a recession (as we can glean in light of the current crisis) pressure on wages and hours manifests itself in rising income insecurity (2010: 59).

There is a further dimension to consider: namely, a trend of households shifting from a reliance on one income to a reliance on two. This trend, the correlation between this trend and the increasing risks and costs associated with household expenditure, and the implications for households, have been documented by Elizabeth Warren in relation to the United States:

... the majority of families now have both parents rising at dawn so that they can both pull in paychecks... As a result, they have lost the parachute they once had in times of financial setback—a back-up earner who could go into the workforce if the primary earner got laid off or was sick... and for families where every penny of both paychecks is already fully committed to mortgage, health insurance, and other payments, then the loss of *either* paycheck can send them into a financial tailspin (Warren, 2006).

It is a similar story in Australia. In 2011, ABS data on the employment status of ‘couple families’ by age of youngest dependant, records that on average both people were employed in over 60% of families (ABS, 2011e). For couples with youngest dependent between 10 and 14, the proportion was 75% (ABS, 2011e). Even for families with a dependant under 4, the figure was still over 50% (ABS, 2011e). Critically, the change in composition of the labour market results in households being doubly exposed to increasingly insecure employment conditions (particularly to changes in income levels), and to ‘external’ factors such as illness or misadventure.

This increasing contingency within the labour market often entrenches and reinforces the levels of precariousness associated with changes in household expenditure. As Rafferty and Yu state:

As these fixed costs rise, and as more household labour has been added to the paid workforce to meet those costs, the household is now more sensitive to any shocks on either the cost or income side (2010: 56-57).

For example, one of the main findings of a 2004 report on casual work, was the correlation between financial insecurity and casual work:

Trouble with financial planning, borrowing and saving for retirement are amongst the significant financial costs of casual work (Pocock *et. al.*, 2004: 7).

Similarly, it is increasingly the case that the only available response to mishaps in the workforce is to engage with more financial products. In such situations households may turn to credit markets, for example borrowing further against a mortgage or acquiring a personal loan, but also increasingly to insurance markets, with, for example, insurance on current income streams becoming more and more common (Bryan *et. al.*, 2009: 462).

1.4 Conclusion

In this chapter, I have considered the distinct costs associated with household risk, and in particular working class household risk, and offered empirical support for the pervasiveness of such risk in daily life.

I have shown that the past 40 years has been characterised by a shifting of financial risk, which Jacob Hacker describes as a shift of socially dispersed risk onto individual household units (2006: 5). Financial products, motives and calculations are pervading evermore facets of daily life alongside an increasing contingency of employment. Access to subsistence items requires households to expose themselves to the uncertain, insecure and volatile conditions of private markets. In so doing, they *face the prospect of losing* access to those same subsistence items, because of the volatility inherent within such private markets.

The trend of increasingly pervasive financial risk is true for all households, but it is working class households that have incurred particular structural costs in the risk shifting process. This incurring of costs results from not only the increasing contingency of the labour market, but also due to the illiquidity of working class households' primary household assets – subsistence goods and services. Working class households have far less opportunity than a firm, government or even household with significant asset holdings, to manage increasing costs and to reduce risk exposure.

The process of financialisation, therefore, has resulted in working class households absorbing increasing levels of financial risk; levels that represent a significant cost to be quantified when accounting for living standards in Australia. An account of this process of risk shifting remains missing from the conventional ‘never had it so good’ narrative, and the measurements and policy frameworks underpinning it. It is to such measurements and policy frameworks – namely, the CPI and TWF – that I now turn.

CHAPTER 2:

THE CONSUMER PRICE INDEX

The Consumer Price Index (CPI) is the principle measurement used to ascertain the living costs of the Australian household. It is a macroeconomic indicator of great political and economic influence, directly informing government, with notable import on the pursuit of particular monetary policies. The CPI also informs private investment decisions and is used ‘as a means of maintaining dollar values’ – such as in the adjustment of welfare benefits, wages,⁴ and individual contracts, and the determination of acceptable rental agreements or insurance cover levels (ABS, 2011c). As the Australian Bureau of Statistics (ABS) notes, “the CPI directly or indirectly affects all Australians” (ABS, 2010c: 7).

Despite this widespread influence, the CPI has been unable to account for the significant shift of financial risks onto the Australian household, as played out over the past 40 years. This neglect reflects the CPI’s systematic exclusion of household financial activity, an exclusion that occurs on two conceptual levels: (i) at the level of categories and methods of measurement; and, (ii) at the level of accounting for financial risk.

Firstly, the categories and methods of measurement with which the ABS constructs the CPI, result in the exclusion of many financially linked items. In terms of

⁴ Since changes to the Accord Law 1987, however, the principle purpose of the CPI is no longer the indexation of wages, with wages rather increasingly linked to productivity (ABS, 2011c).

categories, the CPI has, since its inception in the 1960s, been based on the conceptual distinction between relevant consumption expenditure and ‘out-of-scope’ investment expenditure (ABS, 2011c). Methodologically, the CPI excludes prices for which no reliable and stable method of calculation – free from short-term volatility – can be constructed. Given that financial activity does always involve ‘investing’ in an asset, and is often characterised by excessive price volatility, such categories and methods result in an index that systematically excludes the costs associated with household finance.

Significantly, this exclusion of financially linked items also reflects the political function performed by the CPI. Due to its ‘principal purpose’ of informing RBA monetary policy, the CPI must necessarily exclude any prices that reflect fluctuations in interest rates, and thus the RBA cash rate. Capturing the costs associated with increasingly pervasive financial markets is thus, at best, of secondary importance.

Secondly, and on another conceptual level, the ABS affords no consideration to incorporating the costs associated with household risk into the CPI. That is, the ABS is limited by its conceptual treatment of household finance as “exchanging one form of asset for another” (ABS, 2010c: 28), which considers only the concrete price changes of particular assets and not the costs associated with risk exposure. Even if the ABS were to come to terms with the limitations of its methodology and categories, – as it has attempted in relation to financial services (detailed in section 2.2) – the CPI would still not apply to households a risk return calculation, as categorically applied in relation to capital.

The costs of finance and of financial risk have, however, come to characterise working class daily life in recent decades. These costs are now critical factors when determining household inflation, standard of living or adequate wages. While in the 1960s, the accessing of subsistence items may have largely fallen into a simple category of ‘risk-free’ consumption, the same cannot be said today. Such access requires households to ‘invest’ in assets and an increasing array of financial

(particularly credit and insurance) products, and therefore to engage with the risks and volatility associated with financial markets. In not accounting for such changes, the CPI remains a “pre-financialised” index, leaving the risks absorbed by working class households over recent decades hidden and concealed.

In developing this proposition, I structure this chapter as follows. In section 2.1, I outline the historical development, purpose and construction of the CPI, and identify some of the conclusions drawn from the measurement in relation to living standards in Australia. In section 2.2, I explain the CPI’s practical treatment of household financial activity. In demonstrating the systematic exclusion of many household financial activities, I link this treatment to the political function of the CPI and its connection with the RBA cash rate. In section 2.3, I return to the critical consideration of household risk, explaining that all these debates surrounding the relevance of household finance rest on a purely distributional – and thus risk-free – understanding of financial activity. This final point in particular signifies the emerging incoherence of the CPI at a time when household engagement in financial activities has not only blurred the distinction between consumption and investment expenditure, and made volatile prices a characteristic of daily life, but has also resulted in pervasive exposure to financial risk.

2.1 What is the CPI?

The CPI is an index that measures the price increases experienced by the metropolitan Australian household.

Retail Price indices had first been used in World War One to calculate the extent to which workers were affected by changing wartime prices, and thus to determine an appropriate increase in real wages to maintain real living standards (ABS, 2011c). The CPI itself was first introduced in the 1960s. Measuring quarterly changes in retail prices, the design of CPI was largely consistent with these earlier indices. However, it aimed to compile a series of shorter-term indices that could be linked in longer-term series, replacing the former emphasis on long-term trends (ABS, 2011c).

The CPI determines household inflation by measuring the price changes of household consumption goods and services. Such prices are determined by calculating the cost of purchasing a fixed 'basket' of consumer items of a constant quality and similar characteristics that is judged to be representative of a household's expenditure during a particular time period (ABS, 2011c). In calculating the index, each item in the basket is accorded a numerical 'weight' to reflect its importance to household expenditure in relation to other goods and services consumed (ABS, 2010c: 38). The basket is broken into numerous categories and subgroups, such as food and non-alcoholic beverages, and housing. The CPI therefore allows the prices across a diverse range of items with different unit or quantity measurements to be calculated and compared (ABS, 2011c). As a temporal index, these comparisons occur across

specific, and in the case of the CPI, quarterly, time periods. A particular ‘base’ or reference period is selected, against which all other measurements are compared.

The formal method utilised by the ABS to calculate the CPI is the ‘acquisitions’ method. This method includes only the costs of the goods and services acquired (or received) by the reference population in the particular time period, regardless of the period in which payment or use occurs (ABS, 2011c). This distinction is significant given that consumers may acquire, use, and pay for goods and services in different time periods. That the ABS employs the acquisitions method signals both its recognition of the role of credit in household expenditure, but also its decision to separate the costs associated with credit from consumer expenditure. Prior to 1998, the CPI had been measured according to the ‘outlays’ approach that incorporated the costs of all goods and services for which payments were made, regardless of the source of funds. As I outline in section 2.2, this change in method was significant in that it was driven by the perceived vulnerability of the outlays approach to changes in interest rate levels. These levels are, firstly, not considered relevant to household consumption; and secondly, reflective of changes in the RBA cash rate: a position that is unfeasible given the purpose of the CPI of informing RBA policy.

The CPI is subject to ongoing revision to account for changes in the consumer basket and maintain its relevance as an index. Changes in ‘weight’ across time periods are referred to as quantity changes. The prices calculated also account for changes in quality; that is, whether items have been changed or modified such that their value changes for the consumer. In such cases the ABS removes any change in price that is attributable purely to change in quality (ABS, 2011c). The CPI is therefore consistently reviewed and re-weighted every six years (at which point a new series is released) to account for such quantity and quality changes, as well as to review the prevailing methods of classification and sampling. For example, the 2011 16th series CPI adjusted the consumer basket to account for the increased accessibility, affordability and quality of electronic items:

Following the 15th series review, the base weight for audio, visual and computing (AVC) equipment was 1.5 per cent, but by the June quarter 2011 the effective weight for this component had declined to just 0.5 per cent, given the large price declines that had occurred... However, the new weight is similar to that in 2005, reflecting the fact that households have purchased more AVC goods as prices have declined (RBA, 2011).

Continual revisions have led to considerable changes in the make-up and scope of the CPI, but have not changed its original purpose and function of measuring consumer price inflation.

That inflation in the price of a basket of consumption goods and services (as calculated by the CPI) has not exceeded the increase in working class income, is generally accepted to reflect positively on the standard of living in Australia in recent decades. That is, that the conclusions drawn from CPI data support the dominant narrative of growing real wages, and of an Australian household that ‘has never had it so good’. This understanding is reflected in the Assistant Governor of the RBA Phillip Lowe’s 2011 address:

Since 2000, the economy-wide real consumption wage has increased by around 25 per cent, which represents a substantial increase in the purchasing power of the average wage (Lowe, 2011).

Furthermore, the CPI also indicates that the variety, quantity and quality of many items now included in the household consumption basket has significantly expanded over the past 40 years, which has also had a positive effect on living standards. The previously mentioned example of increased accessibility, affordability and quality of computers exemplifies this.

Certainly, the narrative that the CPI depicts of an increasing abundance of relatively affordable consumer durables is not inaccurate. However, it only captures part of the story. Despite constant review and revision, the simultaneous ascendancy of financial risks in daily life remains absent from such a narrative, with significant political repercussions. In addressing this critical point, the following sections outline the CPI’s conceptual engagement with household finance, and in particular financial risk.

2.2 The ABS's Treatment of Household Finance:

Its Approach to Finance and Consumption

The ABS explains its treatment of household finance in its review of the 16th series CPI:

The creation or extinction of financial assets/liabilities by lending, borrowing and repayments, are financial transactions that are different from expenditures on goods and services and take place independently of them. For example, households may borrow in order to finance final expenditure (e.g. on housing, holidays or medical services). A financial transaction merely rearranges the individual's asset portfolio by exchanging one type of asset for another, as such no consumption occurs (ABS, 2010c: 38).

The treatment outlined here overwhelmingly excludes household financial activity from the CPI. The systematic exclusion occurs on two conceptual levels: (i) at the level of categories and methods of measurement; and, (ii) at the level of accounting for financial risk. I have divided consideration of these two levels across sections 2.2 and 2.3 within this chapter.

On one conceptual level, the CPI – informed by its political function of informing monetary policy – employs categories and methods of measurement that exclude many financially linked items from the consumer basket. There are two particular features of the CPI that lead to such exclusion: firstly, the conceptual distinction between household consumption expenditure and household investment expenditure; and secondly, the exclusion of 'volatile' prices for which the CPI is unable to construct a stable method of calculation. Behind such definitional and methodological

difficulties is a political narrative, with the ABS particularly stringent about excluding any prices that embody changes in interest rate prices. This is due to the causal relationship between the CPI and RBA monetary policy, with the CPI an input in the determination of the RBA cash rate. It would involve a circular logic for the CPI to also reflect changes in the RBA cash rate.

Notwithstanding the conundrum posed by such circularity, such exclusions result in a ‘pre-financialised’ CPI: a measure that adopts categories and methodologies that are unable to account for those changing patterns of household expenditure that have made engagement with volatile financial activity (investment) a condition of access to many *consumption* items. In the remainder of this section, I detail how these definitional and methodological, and indeed political, limitations translate into the CPI’s treatment of household finance.

However, before I outline these limitations in the CPI’s treatment of household finance, it is important to outline the second conceptual level, whereby the CPI is limited by its understanding of household finance as simply “exchanging one form of asset for another” (ABS, 2010c: 28). This conception of household finance cannot account for the fact that different assets carry differing levels of risks, irrespective of their dollar value. As I established in the previous chapter, the cost of such differing levels of risk is a fact well established in relation to capital, yet the CPI denies the same risk return calculus when calculating household living costs. The implication of this second conceptual level is that even if or when the ABS attempts to incorporate ‘investment’ or ‘volatile’ items into the CPI, or indeed its complementary Analytical Living Cost Indexes, the ABS is only accounting for the concrete fluctuations in particular asset prices, not the underlying risk exposure that is not reflected in such dollar values. I return to this second and critical limitation in section 2.3 of this chapter.

(i) A measurement of consumer expenditure

The CPI is conceived in determining household inflation according to the changing prices of all important *consumption* goods and services. The ABS defines consumer goods and services as those items “from which households directly derive utility or satisfaction” (ABS, 2011c). Here, consumer expenditure is necessarily distinguished from investment activity, which involves the acquisition and financing of assets or business related purchases, and delayed utility or satisfaction.

Household financial activity is categorized as investment, which is “different from expenditure on consumer goods and services” (ABS, 2010c: 28), and is thus ‘out of scope’ of the CPI. The exclusion of household financial activity is exemplified in the ABS’s treatment of three prominent areas of financial activity: namely interest rates, superannuation and life insurance:

- *Interest Rates:* With the exception of the indirect fees embedded in interest rate margins (see part iii), the ABS classifies interest rate payments as expenditure for the purpose of investment: “Interest paid is not a charge that is within scope of the CPI basket” (ABS, 2011c). This is despite the fact that the underlying asset upon which the interest is being paid may be classified as part of household consumption.
- *Superannuation:* Consistent with its treatment of interest rates, the ABS classifies expenditure on superannuation as for the purpose of investment, with the exception of the costs of the financial services provided in relation to superannuation products (see part iii). Payments on premiums and contributions are excluded from the CPI.
- *Insurance:* The CPI does include an insurance category within its consumer basket. However, it is limited to comprehensive insurance for dwellings and motor vehicles, and compulsory third party motor vehicle insurance services. This definition leaves most forms of insurance relegated to the category of investment; including health insurance, life and disability insurance, various

insurance products related to guaranteeing income or the value of assets such as superannuation investments, and the everyday insurance which is increasingly available in the purchase of many consumer durables.

The ABS has not always separated such ‘assets’ from questions of household consumption. In the 1960s the CPI did treat the vast majority of the costs associated with housing, retirement income and healthcare as processes of household consumption. For example, prior to 1986 the CPI measured interest-rates as part of the cost of owner-occupied housing before such costs were associated with “financing the acquisition of assets” (RBA, 1998: 2). However, financialised expenditure is now determined to be for the purpose of investment and excluded from the measure.

This separation of financialised investment from household consumption neglects a critical point: that financial investment has become a condition of access to subsistence items. Therefore, although these three areas of activity do always involve investing in an asset, financial changes mean that such assets are far from separate to questions of ‘direct utility’. The interest paid in securing a loan is not separable from the utility value of the underlying asset being serviced. Expenditure on superannuation is not only a legal requirement, but also necessary for guaranteeing an adequate income during retirement. And while, in the 1960s, public healthcare was seen as sufficient to meet an average working family’s health needs, today these same needs increasingly require investing in private health insurance. Household finance has therefore blurred the distinction between consumption and investment. In today’s context, a ‘subsistence wage’ must cover not only the income necessary to spend and save in order to access particular consumer durables, but also the income necessary for households to access, through financial channels, those goods and services no longer covered by governments or particular industries. However, the CPI does not account for such changes, constrained by the ‘pre-financialised’ definitions and categories in which it was conceived.

(ii) A stable measurement

The ‘pre-financialised’ nature of the CPI is also exemplified in the ABS’s exclusion of prices of many items that are vulnerable to market volatility, and for which no consistent and robust method of measurement can be developed.

The ABS is forthright in discussing the methodological difficulties that volatile prices pose for the CPI. As a smooth time series, the CPI relies on being able to measure and compare the stable prices of goods and services, separating the underlying inflationary trend from short-term fluctuations in prices (ABS, 2010c: 26). The importance of this separation is reflected in the considerable attention afforded to measuring the price changes of particularly volatile items such as petrol and food. Both items remain included, given the ABS’s commitment to “reflect the real world volatility that may occur in contemporary movements in prices” (ABS, 2010c: 26), but are calculated at a higher frequency than other goods and services.

Other volatile prices, however, for which the ABS has been unable to develop a ‘sufficiently robust’ method of calculation, remain excluded from the CPI. This has applied particularly to those items associated with financial activity given that household expenditure on risky items is reflected in volatile and fluctuating prices.

This exclusion of financially linked items is reflected in the ABS’s decision to change from the ‘outlays’ to the ‘acquisitions’ method of calculation. The outlays approach incorporates the costs of all items for which payments are made, regardless of the source of the funds, and thus includes any ‘follow-up’ costs such as interest rate charges or payments for the flow of services imputed over the life of the original underlying asset. The ABS determined that the incorporation of such variable and unpredictable ‘follow-up’ costs left the CPI excessively vulnerable to the impact of external pressures, including (as I outline below) changes in the RBA cash rate (ABS, 2010c: 42). By contrast, the adopted acquisitions approach avoids such variable and

unpredictable costs, by incorporating only the expenditure on goods and services actually received during the reference time period.

The shifting of financial risk onto working-class households, however, means that such volatile ‘follow-up’ costs (including costs affected by changes in RBA policy) have become a feature of daily life. In a similar and related way to ‘investing in assets’, such costs are now an obligation in order to maintain access to the subsistence items of adequate housing, retirement income, healthcare, education, and, increasingly, a stable income. In this context it is important to remember that household consumption is financed more and more through credit, and thus the ‘volatile’ interest payments and penalty charges associated with credit markets. Furthermore, credit fueled consumption is occurring in an increasingly *de jour* rather than *ad hoc* basis. The prevalence of credit is reflected in the ratio of household debt to income, which rose from less than 40% in the late 1970s to over 150% in 2011 (Freestone *et. al.*, 2011: 64). The prevalence of penalty charges is exemplified in the current class action being run by Australian law firm Maurice Blackburn, against the “unfair” exception fees of late credit card payments, bounced cheques or overdrawn accounts (Ockenden, 2012). The action involves 170,100 bank customers in relation to \$223 million in fees, which is only “skimming the surface” of the \$1.3 billion that banks charged in fees in 2009 (Watson, 2012).⁵

These ‘follow-up’ costs signify that the impact of volatile financial markets are no longer external to household consumption, and have instead become a determining factor in many aspects of household expenditure. For example, household expenditure on the interest rates paid in servicing a home loan is often directly affected by external fluctuations, including, notably, changes in the RBA cash rate. The Genworth report on homebuyer confidence (as cited in my introduction), after stating that Australia has one of the largest percentages in the world of homeowners with a variable mortgage

⁵ The income banks earn from fees *charged to households* has actually been falling since this highpoint in 2009. In 2010, banks charged Australian households \$652 million in such “exception” fees (Watson, 2012).

rate, contends that changes in the RBA cash rate have a major effect on homebuyer sentiment:

It does not take much of an increase or decrease of cash rates for this to feed through directly into homebuyer pockets and homebuyer sentiment (Genworth, 2012: 1).

Even in cases where interest rates are fixed, banks take into account the volatility or risks of financial markets in the setting of such fixed rates. Similarly, household decisions of how much income to place in superannuation funds, or which provider to utilise, are increasingly affected by considerations relating to the volatility of financial markets. This was exemplified by the negative effect of the GFC on retirement income (as I outlined in chapter 1), and the response of many households who attempted to shift savings to less exposed funds.

Evidently, there is considerable overlap between the exclusion of prices due to volatility and those excluded as ‘out-of-scope’ investment expenditure. This signifies the inseparability of ‘investment’ activities and exposure to financial volatility, both of which remain systematically excluded from the CPI.

(iii) Attempted incorporation of financial services

The limitation of excluding financially linked items has not gone unnoticed by the ABS. This recognition is reflected in the ABS’s attempt to incorporate the fees and charges associated with financial services into the index.

In recent years, the national and international statistical community has afforded considerable attention to the question of whether certain aspects of household financial activity fall into the category of consumption. In 1997, a review conducted of the 13th series CPI concluded that the costs associated with the provision of financial services constitute a component of household consumption expenditure

(ABS, 1997). Financial services referred to “all those services acquired by households in relation to the acquisition, holding and disposal of financial and real assets” (ABS, 1997). While the “acquisition, holding and disposal of financial assets” was still considered investment expenditure, the fees and charges paid in relation to such assets were determined to “represent a payment by households for a service they obtain”, and were thus determined to be conceptually significant in the measurement of household inflation (ABS, 2010c: 12).

The ABS identified many examples of financial services, including: financial advice; currency exchange; deposit and loan facilities; services provided by fund managers, life insurance offices and superannuation funds; stockbroking services; and, real estate agency services (ABS, 1997). From September 1998 to December 2003 an experimental index of two expenditure classes was established to measure the price change for those services the ABS deemed the most significant and for which it felt able to construct a sufficiently robust and stable measure (ABS, 2005). The first class of the experimental index was the deposit and loan (D&L) facilities – or banking services – provided to households by financial institutions (ABS, 2004b). Significantly, the D&L facilities included both direct *and indirect* charges. Direct charges refer to explicit payments such as monthly fees, transaction (ATM) fees, access fees, arrangement or cessation of products fees and account keeping fees. Indirect charges refer to the often-unobservable fees embodied in interest rate margins, consisting largely of the income earned by banks when lending funds at a higher rate of interest than they pay on deposits. Financial institutions regularly substitute direct and indirect charges (as both represent a payment for a service). The second expenditure class of the experimental index was labelled ‘other financial services’ and, due to concerns of reliability and stability, was restricted to those services provided by stockbrokers and real-estate agencies (ABS, 2011c).

The outcomes of the 13th series review and the subsequent establishment of an experimental index were consistent with reviews and discussions taking place throughout the international statistics community, although the ABS was alone in including the indirect charges component. In 2005, the ABS therefore introduced

financial services, based on this experimental index, into the 15th series CPI. However, in the subsequent 16th series CPI, the ABS announced the decision to remove the indirect charges component from the D&L subgroup (ABS, 2011a).

The volatility surrounding the measurement of indirect charges had always posed a significant challenge for the ABS, exemplifying the ABS's concern surrounding the inclusion of volatile costs. This is because the indirect costs embedded within interest rate margins, as the name implies, are not directly observable. It is only the prices of services bundled in interest rate payments (the actual fees and charges), separate from the interest rate itself, which are accounted for. Furthermore, the amounts paid as interest margins on any single product vary significantly, depending on factors such as the type of account, the frequency of particular transaction types, the account balance and the total volume of business that the customer conducts with the service provider (ABS, 2010c: 12).

In light of such complexity, the ABS calculated indirect costs based on a 'reference rate of interest', with the value of services provided to a borrower corresponding to the difference between the amount of interest paid, and the amount that would have been paid if a reference rate was used (ABS, 2005).⁶ Significant discussion and debate was held at a national and international level about how to calculate a 'pure' or stable reference rate that would not be vulnerable to volatility (see for example ABS, 2010c: 11; Mink, 2011: 5). The ABS determined that the mid-point between the borrowing and lending rate would provide a "pragmatic and stable" rate (ABS, 2010c: 11).

However, during the GFC, the calculation of indirect charges proved to be too unstable for the CPI, reinforcing the view of many within the international statistical community. The 16th series review thus stated that: "The GFC has demonstrated that the ABS methodology used to calculate indirect fees is not sufficiently robust" (ABS,

⁶ See ABS (2011c) for a detailed explanation of the reference rate of interest.

2010c: 16).⁷ Of particular concern was that the reference rate proved highly susceptible to fluctuations in interest rate movements, and was thus vulnerable to changes in the RBA cash rate. Given the relatively large weight (4%) of the D&L subgroup, this correlation had a considerable effect on the whole CPI. For example, the D&L index rose by 16% over the year to September 2008 (in response to interest rate changes), which added almost $\frac{3}{4}$ of a percentage point to CPI inflation (RBA, 2010b).

The concerns outlined by the ABS mirrored the concerns raised by the RBA in its submission to the 16th series review, namely:

... the degree of volatility and correlation with the Bank's policy interest rate; the sampling methodology underlying the estimation of household interest margins; and its large weight in the CPI (RBA, 2010b).

The ABS therefore resolved, in accordance with the RBA's recommendations, to exclude such indirect charges until the key concerns associated with an acceptably robust (not volatile) estimation of price changes were addressed (ABS, 2011b). The ABS also announced the construction of a new index to incorporate such indirect fees and charges. As I outline below, this new index complemented a number of alternative Analytical Living Cost Indexes.

Significance of Removal:

In announcing the omission of indirect fees and charges, the ABS emphasised their belief that “conceptually both indirect and direct charges should be included... as they are [both] real payments for services consumed by households” (ABS, 2011b). However, the omission is symptomatic of the definitional and methodological weaknesses in the CPI's systematic exclusion of ‘investment’ and ‘volatile’ items. These weaknesses manifest in two ways.

⁷ In addition to such methodological problems, concerns were also raised in relation to the accuracy of the data, with the high quality detailed data required from financial institutions unavailable (ABS, 2010c: 16).

Firstly, the exclusion is consistent with the ABS's continued treatment of other types of financial services. Despite now being classified as items of household consumption, many of these services have never been incorporated into the CPI due to similar concerns surrounding the volatility of calculation. For example, in discussing the treatment of services associated with superannuation and life insurance, the ABS was resolute that such services "are within the conceptual scope of the CPI" (2004b). Nevertheless, the costs remain excluded because "the complexity of the charging arrangements... and the industry itself, makes it difficult to create a robust and representative price measure" (ABS, 2004b).

Secondly, the exclusion of indirect charges is consistent with the CPI's treatment of the vast majority of household financial activity, as outlined at the start of this section. That is, while the ABS has determined that financial services fall into the category of consumption expenditure, the remainder (and majority) of financial activity – including the financial items to which such financial services often pertain – remains classified as investment activity (ABS, 2010c: 12).⁸ The difference in classification is exemplified by the necessity for the D&L index to not embody changes in interest rate levels, which are still classified as investment expenditure.

Furthermore, the separate index that the ABS has constructed to measure indirect charges is consistent with the ABS's construction of many such alternative indexes. Labelled Analytical Living Cost Indexes, these "true" cost of living indexes measure the prices of items that cannot be incorporated into the CPI but are nevertheless recognised as representing a cost for households:

With the change of principal purpose and design of the CPI in 1998, the ABS developed a series of analytical measures specifically designed to measure changes in living costs (ABS, 2010c: 40).

⁸ This distinction is made clear by the ABS:

Deposits and loans themselves are not consumption goods or services. However, financial institutions provide services such as financial intermediation (matching the requirements of borrowers with lenders), security and automatic teller machine access. These services are consumed by households and therefore fees associated with them should be included in a CPI. (ABS, 2010: 12).

These indexes are based on the outlays approach, and while they may be far from comprehensive in their coverage of financially linked items, they do include items such as interest payments and financial services.⁹

In constructing such indexes, and like its attempt to incorporate financial services, the ABS acknowledges the changing nature of household expenditure: that questions of consumption capacity, a subsistence wage and standard of living no longer occupy a separate sphere to financial activity. However, in relegating consideration of such financial costs to alternative indexes, the CPI – as the measure that directly informs policy and is used as a macro economic indicator – remains largely ‘pre-financialised’.

(iv) The politics of financial exclusion

Underpinning much of the exclusion of financially linked items is a political narrative, whereby the CPI must necessarily exclude prices that are vulnerable to changes in the RBA cash rate. This requirement is because the principal policy purpose of the CPI is to directly inform RBA monetary policy, which means that it is ‘unfeasible’ for the CPI itself to reflect the RBA cash rate. The RBA explained this problem when justifying the 1986 removal of interest rates from the CPI:

The inclusion of interest changes meant that some movements in the CPI were a mechanical result of movements in the monetary policy instrument, rather than reflecting genuine pressures in the economy: a rise in interest rates to contain inflationary pressures would initially increase the CPI. This leads to an obvious problem if monetary policy were to be evaluated using such a measure of prices. (RBA, 1998: 2).

The CPI’s principal policy function has therefore underpinned a number of financially significant decisions. In addition to the decision to remove interest rate payments

⁹ Since these alternative indexes began in 1998, living costs across household types experienced an average rise of 52.8% in comparison with a 49.1% rise in the CPI over the same period (ABS, 2010c). The CPI therefore rose slower than alternative indexes, despite the latter’s significant exclusion of house prices.

(which also reflected the context of growing commitment to a monetary policy based around inflation targeting), the CPI's policy function also underpinned the 1998 decision to change from the outlays to the acquisitions method of measurement. Furthermore, this function underpins the continuing exclusion of indirect fees and charges, because such charges embody interest rate volatility and thus changes in the RBA cash rate.

The CPI therefore prioritizes elements that go towards informing monetary policy, even if this is at the expense of measuring cost of living. Indeed, this is explicitly acknowledged by both the RBA (2010b) and the ABS:

The principal purpose of the Australian CPI is to measure inflation faced by consumers to support macroeconomic policy decision-making... [and] not to reflect all out-of-pocket expenses (ABS, 2010c: 4).

In an increasingly financialised world, there is a politically necessary gap between measuring lived changes in costs of living – for which interest rate payments are a significant consideration – and the requirements of the CPI to feed into the inflationary calculation of the RBA. This contradiction underpins the failure of the CPI to reflect many of the costs of financial engagement; costs that now characterize day-to-day consumption expenditure.

2.3 The ABS's Treatment of Household Finance:

Its Approach to Household Risk

This chapter has thus far outlined the ABS's systematic exclusion of household financial activity from the CPI, and identified some of the reasons for this exclusion. However, the preceding discussion has remained silent on the 'hidden' dimension of risk. The ABS's silence on this dimension means that even if the ABS was to overcome the methodological and political barriers and incorporate financial costs, it would still only incorporate part of the costs associated with household finance: namely, the concrete changes in the prices of particular items/assets. It would not measure the risk exposure – the implicit uncertainty and precariousness embodied in increasing dimensions of household consumption – that is not reflected in such prices. It is towards the 'hidden' dimension of risk that I now turn.

In chapter 1, I established that since the development of the Capital Asset Pricing Model (CAPM) in the 1950s, it is an undisputed assumption that investing involves exposure to financial risk, and that such risk represents a cost above and beyond the cost of the underlying asset (Reinsdorf, 2011: 7). Neoclassical equilibrium models assume that risk exposure will be compensated by a risk premium and higher expected rate of return. Extensive attention is afforded to developing complex methods and devices of risk management, such as products to hedge against interest rate and foreign exchange rate exposure. Indeed, such risk management has become an integral part of the business of financial institutions, corporations and governments (Grahl & Lysandrou, 2003: 678). While the appropriate method for pricing risk may remain

heavily contested, there is no question that such costs exist to be modeled, accounted for and addressed.

However, there is no consideration from the ABS of applying a risk-return calculus to the risk-exposed household, even when the ABS attempts to account for household finance. This lack of consideration is because the ABS conceives of household finance as simply “exchanging one form of asset for another” (ABS, 2010c: 28), which affords no scope for accounting for the fact that different assets expose households to differing levels of precariousness or uncertainty. Such precariousness and uncertainty, however, now characterise daily life, with significant components of consumption buttressed by the hedging of risk. This includes the risk of being precluded from future consumption and the risks associated with an increasingly contingent labour market. The ABS has remained silent on such changes. This means that even if the ABS were to put the issue of price volatility aside (as it has been able to do with food and petrol); even if it were able to convince the RBA that it was acceptable that the CPI embodied changes in the RBA cash rate; and, even if it were to incorporate all those prices that it currently relegates to alternative indexes (superannuation, interest rates etc); it would still only recognise the concrete price changes and not the implicit costs – the household ‘alpha’ – of financial risk.

Given that the CPI is the major measure of household inflation in Australia, this silence on the question of household risk represents a significant oversight. Many financial costs now absorbed by households, such as those associated with retirement income or fluctuations in the labour market, were accounted for when they were covered by the state or capital. However, there is no ‘alpha’ to account for the risks now absorbed by households as they access such subsistence items.

Indirect Charges debate:

The discrepancy in the treatment of the risk-exposed household is reflected in the international debates surrounding the measurement of indirect fees and charges. These debates relate to the definition and treatment of indirect charges – labeled FISIM: ‘Financial Intermediation Services Indirectly Measured’ – in both consumer price indices and also in measurements of the risk management and liquidity transformation undertaken by financial and non-financial institutions.

In relation to these institutions, one of the main reasons for incorporating FISIM charges is to account for the risks faced in investing, given the growing international consensus that FISIM charges faced by financial institutions reflect the risk and maturity structure of financial assets and liabilities. Marshall Reinsdorf from the US Department of Commerce states that a financial institution’s value added must be adequate to compensate for inherent levels of risk (2011: 7). Similarly, Reimund Mink from the European Central Bank makes the recommendation that FISIM charges be incorporated in such a way that allow the degree of default risk to be calculated (2011: 16).

This treatment stands in stark contrast to that afforded to the FISIM charges relating to household consumption. Here, there has been no discussion of adjusting a household’s ‘value added’ to account for the risk exposure embedded in increasing forms of household expenditure. Instead, and reflecting the position adopted by the ABS, the focus is on finding a stable reference rate of interest unaffected by the volatility of financial markets and the RBA cash rate. As stated by Derick Cullen from the ABS, the aim is to find a rate that “provides some insulation from the impacts of interest rate movements that characterised the global financial crisis” (2011: 4). While significant emphasis is placed on the importance of accounting for the risk associated with the FISIM charges in relation to capital, there is no question of affording the same treatment – the same account of the costs associated with exposure to financial risk – to households.

The CPI's neglect of household risk signifies a critical conceptual limitation, beyond that of particular categories, methodology or political purpose. It means that even attempts to transcend the problems identified in the previous two sections will only afford a part of the picture of household costs. Until the importance of the risk return calculus in relation to households is acknowledged, the CPI will remain a measure stuck in the 1960s, concealing the significant financial costs now absorbed by the Australian household.

2.4 Conclusion:

Over recent decades a significant shift has occurred, transferring the risk and costs associated with accessing an increasing array of subsistence items onto households. As I outlined in Chapter 1, the accessing of housing, adequate healthcare, retirement income, education, and a secure income necessitates engaging with risky financial activity. Indeed, that the minimal financial services subgroup alone accounts for 5% of the CPI weighting pattern (ABS, 2011c), elucidates the importance of financial activity when it comes to questions of consumer inflation, standard of living or subsistence wages.

The pervasiveness of such household financial activity remains systematically neglected by the CPI. On one conceptual level, the exclusion of both investment related and volatile expenditure, with an underlying political necessity of not embodying interest rate volatility, leaves the CPI heavily biased against accounting for the changes to the ‘financialised’ household’s expenditure patterns. This bias is exemplified by the failure of the CPI to incorporate the indirect fees and charges associated with financial services.

On another conceptual level, I have also outlined a more fundamental limitation: the failure of the CPI to account for the costs associated with financial risk above and beyond the cost of the underlying asset. In excluding the costs associated with risk, the CPI loses contact with the ‘real’ costs of securing long-term levels of consumption.

The neglect of financialised risk is far from isolated to the CPI, whose treatment of financial activity is both conceptually and methodologically consistent with the recommendations of the International CPI manual (ABS, 2010c: 44). Nevertheless, the CPI's neglect is of particular importance given the central role of the CPI in "assisting government economists in conducting general economic policy, especially monetary policy" (ABS, 2011c). The cost of risk is absent from key policy areas such as the indexation of wages and welfare benefits, as well as RBA interest rate policy. This neglect only gains a greater significance when the class dimension of financialisation, as I outlined in chapter 1, is factored into the equation, whereby working class households face particular costs due to their illiquidity. These political implications exemplify the significance of a pre-financialised conception of household consumption, which leaves the CPI increasingly anachronistic in an era characterised by financial risk.

CHAPTER 3:

THE TREASURY WELLBEING

FRAMEWORK

The central responsibility of the Australian Treasury is to develop policy frameworks to improve the wellbeing of the Australian people. In 2004, it released the Treasury Wellbeing Framework (TWF), identifying five key constituents of wellbeing: (i) the level of opportunity and freedom that people enjoy; (ii) the level of consumption possibilities; (iii) the distribution of those consumption possibilities; (iv) *the level of risk* that people are required to bear; and, (v) *the level of complexity* that people are required to deal with (The Treasury, 2009[2004]: 6; italics added). Unlike the analysis that underlies the CPI, the Treasury does identify risk and complexity as central dimensions of wellbeing (or living standards). This has not, however, translated into a systematic account of the pervasiveness of risky, complex and costly financial activities in the daily life of the Australian household.

The absence of a comprehensive account of risk is because the Treasury conceives of the existence of household risk and complexity akin to the individual preferences of a firm or government. For the Treasury, the increasing prominence of risk and complexity reflect the ability of individuals to utilise new markets and products to increase their consumption capacity, have more flexibility in the workplace, or engage in hitherto precluded speculative behaviour. Levels of risk and complexity therefore require treatment only to the extent that there is a mismatch – resulting from

distortions to an otherwise efficient market – between the optimal preferences of individuals and the levels of risk and complexity actually borne. The Treasury’s treatment of risk and complexity reflects the ‘critical’ treatment of finance represented by Robert Shiller, as I outlined in chapter 1.

The focus on the ‘risk preferences’ of households affords no scope for accounting for the structural shift of financial risk onto households (and attendant levels of complexity). Additionally, there is no account of the financial illiquidity of households, particularly those of the working class. These dimensions are not reducible solely to individual calculations of preferences, and therefore require different conceptual treatment to risk-exposed capital.

I have structured this chapter to explore the limitations of the TWF when it comes to dealing with the costs of household risk, particularly as such costs manifest for working class households. In section 3.1, I explain the central role of the Treasury, and the factors that underpinned the 2004 release of the TWF. I then explore the apparent chasm between the significance that risk and complexity are afforded within the TWF, and the neglect of such dimensions in the vast majority of the Treasury’s practical activities. In section 3.2, I relate such neglect to the Treasury’s “generalised utilitarian” (The Treasury, 2009[2004]: 6) conceptualisation of risk and complexity. In section 3.3, I outline the Treasury’s ensuing policy prescriptions. The stated purpose of these prescriptions is to account for and address the costs absorbed by an increasingly financialised household. Instead, I argue that they legitimise and reinforce the household as the site of absorption of these costs.

3.1 The TWF in Context:

(i) Background

The Treasury performs a critical function within the Australian Public Service, as the government department directly responsible for developing economic policy and preparing the Federal Budget. As stated in its mission statement, the Treasury is expected to base decisions according to the long-term wellbeing of all Australians: “to anticipate and analyse policy issues from a whole-of-economy perspective” (The Treasury, 2009[2004]: 6). Since its inception in 1901, the Treasury has developed conceptual methods by which recent trends in the economy can be assessed, and appropriate policy responses can be formulated. The 2004 TWF represents the latest of such methods. The framework identifies the five above outlined dimensions, including both exposure to risk and levels of complexity, found to be the most pertinent for wellbeing.

The TWF was conceived to extend conceptions of wellbeing beyond that of GDP or consumption capacity, embodying a growing recognition within the mainstream of the limitations of relying solely on such indicators. As Treasury Secretary Martin Parkinson states, the TWF: “encourages a broad assessment of the costs and benefits of policy proposals” (2011: 77). The recognition of the need to consider factors beyond GDP is far from new, either within the global intellectual community or in government agencies such as the Treasury. The Treasury published an article as early

as 1973, in response to concerns about the environmental limits to growth,¹⁰ with the purpose of acknowledging that: “economic growth is not a comprehensive measure of changes in the welfare or wellbeing of the community” (The Treasury, 1973: 5).

While, however, critiques of growth measures have an established history, the focus on developing more positive alternative measures is a more recent objective. The TWF draws extensively on Amartya Sen’s ‘capabilities framework’¹¹ to develop its ‘generalised utilitarian’ approach that:

... incorporates a range of determinants for utility (beyond income and GDP), and also a range of constituents of utility (beyond just individual happiness) (The Treasury, 2009[2004]: 4).

This recent drive for a more comprehensive range of indicators reflects a growing global concern around prominent issues such as environmental sustainability and global development. Critically, it also reflects a growing concern about the effects of household engagement with finance.

These concerns surrounding household finance have increased since the TWF was released 8 years ago, particularly given the onset of the GFC. The IMF has acknowledged that the household has become the global financial system’s “shock absorber of last resort” (2005: 89). In 2008, the then French President Nicholas Sarkozy convened a global commission (the Commission on the Measurement of Economic Performance and Social Progress) led by notable economists Joseph Stiglitz, Amartya Sen and Jean-Paul Fitoussi. The commission addressed the discrepancy between aggregate data and perceptions on questions surrounding living standards: “a gap so large that it cannot be explained by reference to money illusion or human psychology” (Stiglitz *et. al.*, 2009: 7). For Stiglitz *et. al.*, a central element underpinning this discrepancy was increasing levels of economic insecurity resulting from “major changes in how households function” (2009: 14-15).

¹⁰ See for example Herman Daly, (1977) *Steady-State Economics: The Economics of Biophysical Equilibrium and Moral Growth*, W. H. Freeman, San Francisco.

¹¹ By capabilities, Sen is concerned with the actual freedom we have to promote or achieve the various combinations of functionings that we have reason to value (Sen, 1999: 74). See for example Amartya Sen, (1999) *Development as Freedom*, Oxford University Press, Oxford.

Since Stiglitz *et. al.* released their findings in 2009, the Treasury has repeatedly affirmed the findings' importance and emphasised that such findings inform the Treasury's conceptual approach to wellbeing. For example, in a Treasury report on living standards, Gruen *et. al.* stated the general understanding that:

As the 2009 Stiglitz-Sen-Fitoussi report argued... broader measures of resources and income are called for... [and that] measuring 'full income' must be a part of the research agenda (2011: 89).¹²

Gruen *et. al.* also emphasized that this understanding informs the five dimensions – including risk and complexity – that are afforded prominence within the TWF (2011: 82).

(ii) TWF in practice

The TWF's inclusion of risk and complexity actually places the Australian Treasury a step ahead of many in the international policy community. For example, the 2006 OECD report 'Alternative Measures of Economic Wellbeing', also focussed on the importance of extending the determinants and constituents of economic wellbeing beyond those of economic resources. The OECD gave considerable attention to the dimensions of leisure time, inequality, environmental factors and social indicators, yet neglected to consider the costs associated with financial risk (Boarini *et. al.*, 2006).

The prominence of risk and complexity within the TWF has not, however, translated into systematic treatment when it comes to the Treasury's practical activities. Only three articles published in the Treasury's journal *Economic Roundup* – the TWF itself and two subsequent explanatory articles (see Banerjee & Ewing, 2004; Sandlant, 2011) – have afforded considered attention to the relationship between risk and complexity and wellbeing. In the rest of the Treasury's extensive statements and publications on broader policy priorities, levels of risk and complexity receive

¹² For further Treasury references to the Stiglitz-Sen-Fitoussi report see also Henry, 2010: 18, 20; Kelly & Gorecki, 2010: 8; Gorecki *et. al.*, 2011: 11.

minimal mention. A paradigmatic example of this is found within Treasury Secretary Martin Parkinson's article 'Sustainable Wellbeing' (2011). The first half of the article outlines the TWF, and argues its importance for "a broad assessment of the costs and benefits of policy proposals" (2011: 77). The second half of the article is dedicated to detailing challenges facing policy makers: emerging economies; technological development; demographic changes; and climate change (2011: 82). There is, however, no mention of the way in which dimensions such as risk and complexity actually relate to such challenges. A similar neglect characterises the annual articles released in *Economic Roundup* on the 'Opportunities and Challenges facing the nation' (2010b). For example, Ken Henry identifies an aging population as a key challenge facing the Australian community. He subsequently emphasises the importance of a policy framework that facilitates fiscal sustainability and economic flexibility to deal with such a challenge (2010b: 13), but fails to engage with the risks for households implied in the current provision of retirement income.

Furthermore, since the TWF's publication in 2004, numerous papers have been published in *Economic Roundup* with detailed assessments of both the ways in which factors beyond GDP or consumption capacity can be incorporated into calculations of living standards, and the importance of doing so. Environmental sustainability is often the pre-eminent example. The importance of accounting for the costs associated with increasing levels of risk and complexity, however, receives no mention. One example from 2006, just 2 years after the release of the framework, saw social indicators such as leisure time, income distribution both between and within households, self-sufficiency and health, and subjective measures such as happiness, identified as important factors for policy consideration (Coombs, 2006: 19). Another example from 2010 offered a detailed assessment of how to account for questions surrounding environmental sustainability (Henry, 2010a). Both articles quoted Stiglitz *et. al.* in affirming that "what we measure shapes what we collectively strive to pursue" (2006: 14). However, both neglected to consider the importance of measuring risk or complexity, overlooking the implications of the structural shift towards financialisation.

The Treasury does acknowledge that a gap exists between the wellbeing framework and practical activity. In fact, at repeated points Treasury representatives rationalise the importance of such a gap, stating “the framework is a tool for guidance, developed with the intention to provide a broad assessment of the costs and benefits of all policies” (Kelly & Gorecki, 2010: 3). As such, the TWF is a “descriptive tool not an analytical framework” (The Treasury, 2009 [2004]: 4) and cannot be applied as a “simple policy checklist” (Parkinson, 2011: 77).

This simple rationalisation however does not explain the particular neglect of risk and complexity, and why the costs and implications associated with risk and complexity – and not those relating to, for example, environmental sustainability – consistently fall off the analytical agenda. Identifying this particular neglect of risk and complexity is my focus in the following section.

3.2 The Treasury's Conception:

Finance as Individual Choice

(i) Treasury's conceptualisation of risk and complexity

People have different preferences regarding risk, depending on factors such as their relative financial security, their aspirations for the future, or their desire for risk as a good in its own right (The Treasury, 2009 [2004]: 11).

The Treasury's inclusion of risk and complexity does signify a recognition that individuals participate in risky financial transactions. This inclusion has not, however, translated into an adequate account of the pervasive 'wellbeing' costs associated with increasing levels of risk, nor the repercussions of such costs for households, particularly working class households. This results from an approach "grounded in welfare economics and utilitarianism" (The Treasury, 2009 [2004]: 11). This approach conceives of financial activity in terms of individual preferences, and is predicated on the existence (or potential existence) of efficient markets to facilitate such preferences.

Following the analytical approaches of economists such as Shiller, the Treasury's treatment of risk and complexity is based on applying the orthodox understanding of the risk intrinsic in every investment decision to the financially exposed household. The prominence of risk and complexity is thus conceived in terms of new opportunities afforded for individuals to realise their preferences. In discussing the

relationship between optimal risk allocation and expanded opportunities and freedoms, the Treasury states that “Risk trading enables greater choice with regard to risk borne, and provides opportunities for entrepreneurial activity” (The Treasury, 2009 (2004): 15).

Within this discourse, the Treasury frames instances where financialisation impacts negatively on households as market failures. The Treasury’s solution to these market failures is to build new market processes and train market participants. There is no actual measure of the deleterious consequences of risk (and complexity), even in terms of efficiency losses. Risk and complexity are therefore conceived to negatively affect wellbeing, and thus become considerations for government policy only to the extent that market distortions prevent individuals from realising their preferred levels of risk and complexity (The Treasury, 2009 [2004]: 11).

The Treasury identifies three sources of market distortions: (i) sub-optimal market structure and information; (ii) irrational market actors; and, (iii) particularly excessive products. Firstly, the Treasury identifies the existence of incomplete risk markets resulting from “failures of information, contractual problems and externalities” (Banerjee & Ewing, 2004: 26). This reasoning is consistent with the ‘Shiller’ conceptualisation of finance that asserts that ordinary people’s lack of access to financial markets, devices and services “must be overcome if society is truly to democratise finance” (Shiller, 2003: 13). Secondly, the Treasury identifies distortions resulting from individual irrationality, where “people’s expected utility functions may not necessarily be well-ordered” (Banerjee & Ewing, 2004: 29). This concern (also consistent with the perspective of Shiller) is informed by behavioural economics, and specifically by the work of Nicholas Barberis and Richard Thaler who state that:

Some features of asset prices are most plausibly interpreted as deviations from fundamental value, and that these deviations are brought about by traders who are not fully rational (2002: 2; see also Shleifer, 2000: 24).

Such psychological biases and quirks undermine the assumption that there exists a knowable fundamental value that is recognisable to all participants and facilitates

optimal resource allocation (The Treasury, 2009[2004]: 11). The third reason is identified by the Treasury's Corporations and Financial Services Division manager Richard Sandlant in his post subprime-mortgage article 'Consumer Financial Protection': namely, the emergence of "excessively complex and risky products" (2012: 38). That is, that the difficulties involved in managing particularly volatile products are beyond the capabilities of even the most financially responsible of investors.

The Treasury therefore identifies that sub-optimal markets, behavioural irrationalities, or excessively volatile products, may result in levels of risk and complexity that do not match individual preferences. In such circumstances, certain policies may be justified to facilitate the realisation of optimal preferences and improve wellbeing. These policies include: the development of more efficient or missing risk markets to facilitate trading in human capital (Banerjee and Ewing, 2004: 31); educational policies to address "issues of context, paths and perceptions" (2004: 42); and, regulation against particularly volatile products (Sandlant, 2012: 38). For example, the Treasury advocates the "simple, low cost default superannuation product" MySuper to offer individuals lower levels of exposure to risk and complexity in their retirement investments (Sandlant, 2011: 39). Such policies allow households, like capital, to better manage their risk exposure, signifying the implicit acceptance by the Treasury that households can be conceived of as akin to capital. I outline such policy implications in section 3.3.

(ii) Finance – the neglected cost

The Treasury's treatment of risk and complexity may have incorporated household consumption into the discourse of financial calculation in a way that the CPI has not, and even identified particular difficulties, such as the asymmetric ability of individuals to trade particular resources, or to deal with the risks of excessively volatile products. However, this treatment has not translated into a comprehensive account of the implications of such financial activity for household wellbeing. Neither

has it translated into an account of the particular risks absorbed by working class households.

In chapter 1, I identified that over the past 40 years a significant transfer of risks and complexity has occurred from the state and corporate sector onto households. Processes of deregulation and privatisation have resulted in a significant decline in the public provisioning of important household items, while simultaneously facilitating the development of financial markets as alternative methods of provision. These changing patterns of household expenditure have been reinforced by simultaneous changes in the labour market, where job security, consistency of available work, level of income, and employment conditions, have all become increasingly precarious.

Recognition of such transformations underpinned the recommendations of the aforementioned report by Stiglitz *et. al.*, and its explicit recognition that households face new costs that reflect changes beyond that of the individual:

There have been major changes in how households and society function. For example, many of the services people received from other family members in the past are now purchased on the market. This shift translates into a rise in income as measured in the national accounts and may give a false impression of a change in living standards, while it merely reflects a shift from non-market to market provision of services (2006: 14).

The report subsequently underscores the need for a ‘household perspective’ in measuring wellbeing that accounts for (among many other factors) the “growing insecurity” facing households, and also factors such as the declining social benefits coming from the government, interest payments on household loans, and household liabilities (2006: 13). Stiglitz *et. al.* do not, perhaps, afford the financialised household the prominence it has received in my thesis, but they nevertheless recognise that ‘major changes’ have occurred beyond that of individual preferences, whether or not affected by sub-optimal market conditions. These major changes have entailed a significant cost for households that their counterparts of 40 years ago did not have to negotiate.

These changes are particularly significant for working class households. As I outlined in chapter 1, this is because working class households hold illiquid assets and have a limited access to financial markets.

Financialisation is therefore characterised by a *structural and unequal shift* of the risks (and complexities) involved in accessing household subsistence items and an income. The nature of household risk requires different conceptualisation and treatment to the risk-exposed firm or government, in that the risks and complexity absorbed by households cannot be accounted for purely in terms of individual risk return calculi. This difference is particularly the case for the ‘illiquid’ working class household. The Treasury’s abstraction of individual preferences affords no scope for considering the costs signified by such structurally increasing levels of risk and complexity. Furthermore, the orthodox models underpinning the TWF are based on a direct denial of innate financial illiquidity, for they assume that individuals are able to manage and hedge against increasing levels of risk and complexity, whereby “diversification is essential for all investing” (Bernstein, 2007: 9).

The failure to engage with structurally increasing levels of risk and complexity raises critical questions about the capacity of the Treasury’s individualist discourse to explain economic processes, and also raises critical questions for the ‘never had it so good’ narrative that the Treasury assumes when engaging in its important political activities.

3.3 The Treasury's Treatment of Risk:

A Restricted Policy Framework

The Treasury's practical engagement with risk and complexity is confined to particular and isolated areas: namely, those areas in which the previously outlined 'distortions' prevent individuals from realising their optimal risk or complexity preferences. The Treasury's policy program is therefore based on identifying and evaluating specific inefficiencies, with particular focus on locating instances of irrationality and developing strategies to make market participants more rational.

An example of such a policy program is concretely outlined by Richard Sandlant, who identifies four pillars to address 'sub-optimal' levels of risk and complexity: (i) financial literacy; (ii) financial advice from accessible and impartial sources; (iii) financial product disclosure; and (iv) financial product regulation (2012: 37). The stated goal of these four pillars is to improve wellbeing through the provision of financial protection. Consumers are empowered to engage with risk and complexity on a more equal playing field, and utilise markets to their advantage (2012: 35). These strategies, however, assume that once such pillars are in place, 'rational' individuals will have all the skills and tools needed to negotiate increasing levels of risk and complexity. Therefore, while these pillars in part fall into the policy domain of consumer protection, they are also conceived in encouraging households to be active and informed risk traders, akin to the model of rational actors as developed by Shiller. This conception affords no space for considering the actual consequences and wellbeing costs of increasing levels of risk or complexity. Instead, such treatment

legitimises and reinforces households as responsible for such increasing levels, further cementing the household as ‘shock absorber of last resort’.

For example, in dealing with income insecurity, the Treasury supports the development of markets for income insurance, which individuals can use to realise their optimal risk preferences (Banerjee & Ewing, 2004: 31). The development of such insurance markets is seen to overcome the asymmetries resulting from the difficulties of trading in human capital, particularly if this happens alongside education that supports consumers so that they “can understand the key risks before making a decision to invest” (Sandlant, 2012: 37). The negative impact that increasing levels of income insecurity and volatility may be having on wellbeing is not a consideration.

Furthermore, and ironically, this kind of ‘investment’ expenditure in insurance markets is deemed desirable by the Treasury in the name of living standards, but is at the same time explicitly precluded as relevant to household inflation within the CPI.

In this section, I have outlined a critical inconsistency of the TWF. We can see that rather than developing ways to account for and address the pervasiveness of risk and complexity of daily life, the Treasury’s pillars of protection instead legitimise such pervasiveness. Further, there is no accounting for the particular difficulties that risk exposure poses for ‘illiquid’ working class households.

HECS: an illustration

The Higher Education Contribution Scheme (HECS) is a paradigmatic example of the ways in which a policy, advocated by the Treasury to address adverse risk and complexity and offer protection, acts to legitimise the transfer of financial risk.

The Treasury conceives of education as an investment in human capital, whereby individuals decide to invest so as to increase their potential future access to higher incomes. However, the Treasury also acknowledges that, lacking collateral, individuals are unable to either access or guarantee such future earnings, or even guarantee that they will finish a degree. These difficulties create significant barriers for investment: “Education is an investment that can sometimes fail, with the possibility of significant costs for little or no gain” (Banerjee & Ewing, 2004: 41). In addition, it is often the case that individuals (students) making investment decisions lack even the collateral needed to secure the loan. The Treasury thus identifies “the unsecured nature of loans for education” (2004: 40). Such insecurity both dissuades financial providers from supplying the needed collateral, and also, where providers do decide to supply such collateral, the insecurity makes them likely to charge a higher premium. These difficulties faced in investing in education reflect the difficulties posed by an inability to trade in human capital, which limit the capacity of individuals to utilise credit and other financial markets to their advantage (2004: 40).

In response to these difficulties, the Treasury advocates government supported HECS to facilitate both the smooth functioning of existing markets, and also the development of absent risk markets. This is because HECS is able to overcome the contractual and informational risk constraints otherwise faced in private provision. HECS does this by securing a contract over the whole of a working-life, making the loan much less vulnerable to short-term evasion; and also by pooling the risk, minimising the impact of individual failure to finish a degree or secure a higher income (2004: 40-41). Furthermore, given the premiums and contractual agreements that students would have to otherwise enter into in the accessing of private loans, HECS “substantially reduces the risk levels faced by individuals choosing to enter the higher education system” (2004: 41). HECS thus represents a policy that allows students to realise their ‘optimal preferences’, through the government facilitation of incomplete markets for risk.

The Treasury’s appraisal of HECS through such a paradigm, affords no scope for considering the increasing levels of risk and complexity that students now face as a

result of changes in public provisioning. These changes have structurally shifted the exposure involved in accessing education onto students, regardless of individual preferences. Equally, and even if the Treasury outlines the difficulties of trading in human capital, there is no scope for accounting for the particular effect that such changes have had on students from working class households. In view of their illiquidity, these households generally have little option whether to participate in the HECS scheme in comparison to those with an expanded asset portfolio who may be able to pay the up-front fees. Furthermore, under the Australian *Bankruptcy Act 1966*, HECS is not provable in bankruptcy and may thus be recovered after bankruptcy (Australian Taxation Office, 2012). This particular feature of HECS further restricts the ability of those with a HECS debt to operate akin to risk-exposed capital.

The Treasury's approach to HECS demonstrates that, even in the isolated areas where risk and complexity are treated as important factors for policy development, the Treasury's discourse of individual preferences precludes a consideration of the costs associated with broader societal changes. Instead, the translating policy prescriptions act to reinforce individuals as financial players. At the same time, we can see that in casting such educational costs as investment, the drain of such expenditure on standard of living (via fees and loan repayments), remains systematically excluded from measures such as the CPI.

3.4 Conclusion:

In including exposure to risk and complexity as two of the five determinants of wellbeing, the TWF does to a degree remedy the neglect of financialised daily life that characterises the CPI. Like Shiller and Stiglitz, the Treasury has brought the household into the discourse of financial calculation.

The recognition that financialised life exists has not, however, translated into a treatment of risk and complexity that accounts for the pervasive, uneven and often concealed ways that risky financial activity has infiltrated daily life. Equally there is not any account of differential effects of risky financial activity, particularly as it manifests for the illiquid working class household. This limited account results from the Treasury's conceptualisation of household finance in terms of individual preferences, and the assumption of the existence – or at least potential existence – of liquid risk markets that facilitate the realisation of such preferences. Levels of risk and complexity are thus indicative of the expanded opportunities offered to individuals through new avenues of participation, with the exception of areas where particular distortions have undermined the realisation of optimal risk preferences.

A narrative of particular distortions means that the Treasury is only able to frame the some of the problems associated with financial risk, and not actually account for increasingly pervasive risk when it comes to questions of measurement. The Treasury therefore advocates policies (such as HECS) that focus on facilitating people's 'rational' management of their risk exposure, through the development of missing markets, programs of financial literacy, and certain product regulation. Such policies

reinforce individuals as financial actors, capable of negotiating complex financial markets and risk exposures. In this context, it can be seen that the TWF actually moves from being a measure of wellbeing, to a ‘cost of disutility abatement’ framework. In so doing, the framework acts to legitimise and reinforce households as the absorbers of the costs associated with financial risk.

The Treasury is far from isolated in letting considerations of systemic risk and complexity fall off the analytical agenda. However, the Treasury’s practical treatment of household finance is particularly significant given the important function that it plays in the Australian political landscape. It means that the Australian institution charged with maximising the wellbeing of the Australian household, and utilising considerations of wellbeing to inform government policy, neglects to account for the significant consequences of the financialisation of working class daily life. This fact has even greater importance given the Treasury’s repeated assumptions that living standards continue to progressively increase, on the basis that GDP is increasing, and that other social and subjective measures are positively correlated to GDP (Coombs, 2006: 19). We can see, however, through the analysis that I have outlined in this chapter, that its explicit support of the ‘never had it so good’ narrative of the Australian household is based on methodologically weak assumptions, and a failure to grapple with the structural character of financialisation.

§ CONCLUSION §

Over the past generation, an economic transformation has taken place [...] the once-secure family that could count on hard work and fair play to keep it safe has been transformed by current economic risk and realities. Now a pink slip, a bad diagnosis, or a disappearing spouse can catapult a family to newly poor in a few months (Warren, 2006).

The past 40 years has been characterised by a structural transfer of financial risk. The Australian household has had little option but to absorb the increasingly pervasive risks associated with accessing both subsistence goods and services, and an income. Such pervasive risks have significant implications for household standard of living, as indicated above by Elizabeth Warren (who headed Consumer Protection inside the US Federal Reserve after implementing the post-GFC Troubled Asset Relief Program). I have identified how these pervasive risks are particularly the case for the ‘illiquid’ working class household, whose lack of tradeable assets leave them few, if any, low-risk options in their increasingly financialised lives.

However, an account of the implications of financialised daily life, and in particular a quantification of the costs associated with pervasive risk, continues to fall off the analytical agenda. This neglect of household risks is anomalous to the treatment of risk-exposed capital. In relation to capital, convention dictates that: “a good financial system manages risk in ways that enable higher risk activities to be undertaken for higher return” (Stiglitz, 2009). In contrast, conventional accounts of living standards in Australia – as represented by the Consumer Price Index and the Treasury Wellbeing Framework – neglect to quantify the costs of household risk.

It is this general neglect, which has been both theoretical and empirical, that I've identified as a critical factor in the apparent paradox between the conventional 'never had it so good' narrative, and household concerns surrounding living costs in Australia.

The Neglect of Risk: A Technical Problem?

In many ways, I have framed the issues relating to the neglect of household risk as technical problems. I have examined the ‘pre-financialised’ conceptions or methods of classification, which have prevented the ABS and Treasury from adequately engaging and quantifying the consequences of risk-exposed daily life.

For example, for the CPI to offer an adequate account of the financialised household’s cost of living, it must necessarily break down the conceptual distinction between stable consumption and risky investment expenditure, and apply some form of risk return calculus to households. However, in order to measure household, and not capital, inflation, the CPI must necessarily conceive of households as occupying a separate sphere to capital, and thus to risk-exposed financial activities. This methodological conundrum signifies further critical questions: what should inflation actually measure; what does inflation actually mean; and is the CPI correct in differentiating – and prioritising – a measure of household inflation from a measure of household cost of living?

As indicated by these broader questions, such ‘technical’ conundrums are far from limited to the CPI. Indeed, a similar tendency to conceive of household expenditure costs as separate to risk-exposed capital investment characterises the critical literature on neoliberalism that sets the backdrop for this thesis. This is despite the fact that

household engagement in such risky ‘capitalist’ activities underpins many of the neoliberal changes such literature depicts.

However, and significantly, the neglect of the CPI to account for household risk is not solely technical or analytical, and is inseparable from both the CPI’s political function and the political implications of accounting for household finance. Indeed, overcoming such limitations and finding ways to quantify household risk is precisely the tasks being undertaken in the reports commissioned by financial institutions Fujitsu and Genworth. As a leading provider of mortgage insurance, Genworth employs RFi Intelligence to:

... provide strategic research, market intelligence and advisory services... [in order to] identify customer needs and preferences, opportunities and threats in the competitive landscape (RFi, 2012).

Thus, in instances where institutions have an agenda of observing households as if they operate akin to capital, we can see such institutions finding ways of overcoming the technical barriers to calculating household risk.

It has therefore been important to examine the agenda underpinning the CPI’s ‘pre-financialised’ technical difficulties. The CPI’s purpose is to inform RBA monetary policy. The CPI must therefore, as explicitly stated by both the ABS and RBA, exclude interest rates, given that interest rates reflect changes in the RBA cash rate. Moreover, the incorporation of *any* financial activity poses political difficulties for the CPI, given that the RBA uses the CPI to set the interest rate to meet a medium term inflation-target, and in so doing regulates the income of households. To incorporate financial activities into the CPI would mean that, to some degree, the RBA would begin to regulate the income of capital. Within conventional political discourse, profits rates are not in any way conceived of as a rate to be regulated like that of consumer prices, and are emphatically separated from such oversight. These issues exemplify that the breaking down of the technical limitations of the CPI has significant implications far beyond particular adjustments to the measure.

The political implications behind such analytical or technical issues become even more apparent when considering the TWF, and its explicit attempt to incorporate levels of risk and complexity into conceptions of wellbeing. The TWF does extend its conceptual understanding and treatment of risk to the financialised household, developing a policy program of financial literacy to overcome the barriers to efficient and rational risk trading. In this sense, the Treasury's specific engagement with household risk is actually at odds with, and represents a conceptual improvement on, the CPI's systematic exclusion of the costs of household risk.

At the same time, however, the Treasury is unable to treat pervasive risk as signifying a cost borne by households, and thus as a critical factor when measuring wellbeing or formulating policy frameworks. This is because to do so would require engaging with the structural shifting of risk, and the particular costs this has resulted in for the illiquid working class household. Such engagement with systemic risk would shatter the Treasury's whole conceptual paradigm of an economy dictated by individual preferences and efficient markets. The TWF therefore sidesteps such structural concerns. In so doing, it shifts from a measure of wellbeing to a cost of disutility abatement framework, and advocates policies that embed households in their role as financial actors.

Therefore, although I have framed many of the issues posed by risk as technical, the CPI's and the TWF's differing (and even inconsistent) treatment of household risk, exemplify that the politics of such issues are critical. This political significance is not solely due to the CPI's and the TWF's functional significance in the Australian political landscape. Rather, we can see how the treatment of risk by the Treasury legitimises and reinforces households in their role as financial investors – as the 'shock absorber of last resort'. Indeed, the TWF justifies such activity in the name of improving wellbeing. At the same time, the treatment afforded by the CPI to household risk, systematically denies the relevance of risk-exposed investment for households when measuring household inflation.

A consideration of this dual process – whereby households are systematically integrated into financial activities, but in a way that denies the implications of these activities for living standards – will be critical in developing and formulating a practical response to financialisation. While I have not explicitly advocated such a response in this thesis, it is certainly implied and supported in many of my findings.

The Shifting of Risk: A Class Phenomenon?

In this thesis I have examined financialisation through the lens of class, focussing on the specific and significant impact that pervasive risk has had on the ‘illiquid’ working class household. This perspective has allowed me to explore the systemic and unequal nature of financial changes, and the particular costs that such changes have signified for working class households.

Bringing the costs of working class risk to the fore is particularly important, given that the mainstream narrative only reinforces risk-shifting processes in its recasting of *all* households as financial players. Households are assumed to be capable of managing and absorbing the increasing levels of risk-exposure, costs and complexity. Increasing resources are being poured into schemes of financial literacy or education, to afford people the ‘skills’ needed to responsibly manage an increasing array of financial assets. For example, in 2011, the national financial regulator the Australian Securities and Investment Commission (ASIC) released the *National financial literacy strategy* report, followed up with the launch of the ‘MoneySmart’ website, with the purpose of supporting households in “understanding money and finances and being able to confidently apply that knowledge to make effective decisions” (ASIC, 2011: 4).¹³ At the same time, as early as year 9 or 10, commerce and economics classes in the NSW school syllabus cover ‘the skills needed’ in weighing up different car, properties, insurance plans etc. Indeed, it is amidst such a backdrop that the Treasury’s policy

¹³ The report resulted in the launch of the ‘MoneySmart’ website that provides advice on a whole variety of financial areas such as managing money, credit cards, avoiding scams, superannuation and car loans, in order to afford people “the tips and the tools to help you make the most of your money” (ASIC, 2012: 4).

response to increasing levels of financial risk is to facilitate the development of new risk markets and programs of financial literacy. Across society, households are increasingly presumed to be risk savvy and responsible financial actors, who balance different options, engage in long-term planning, and absorb calculated levels of risk.

Such savvy and responsible financial activity, however, relies on having control or ownership over liquid and tradable assets. Yet it is precisely an absence of such assets that I have identified as defining working class households. With such little agency, and a restricted ability to hedge or diversify, the ‘risk preference’ of a working class household to purchase the credit and invest in the insurance products required in securing a home loan, is incomparable to the risk preference of a firm to invest in a particular hedge fund, or even the preferences of households with significant wealth holdings.

This restricted ability of working class households has significant consequences, particularly in periods of financial turbulence. The items that such households expose to the volatility and risks of financial markets consist of retirement income, housing, healthcare, education, telephone or utilities as well as current income levels. When the liabilities of households are affected by the volatility and instability that characterises financial activity, households therefore risk losing access to the basic necessities of daily life. This vulnerability was reflected in the drop in superannuation fund returns during the GFC, and it was also reflected in the devastating effects of the subprime mortgage crisis on many poor and working class households in America.

Exploring financialisation through the lens of class has therefore allowed me to challenge the orthodox narrative of individual preferences facilitated through efficient and liquid financial markets. This challenge is critical because such a narrative of risk savvy individuals allows for the continued neglect of the quantification of the wellbeing costs of financial risk.

At the same time, however, many of the processes associated with financialisation are certainly not class specific. For instance, there exists a significant disparity between different working class households in terms of their ability to manage such increasing risk-exposure. For example, the 17% of Australian households without access to a computer, or the 21% without access to Internet, the majority of which are lower income and/or elderly (ABS, 2011d), are exceptionally disadvantaged in their ability to perform such a financialised role. The class-based analysis I have adopted should therefore be conceived as opening up further questions on the unequal nature of financial changes according to other analytical categories such as income distribution, gender, age, household type etc.

Furthermore, financial risk has affected *all* households. That is, such risk shifting has also entailed significant costs for non-working class households regardless of their ownership or control over assets. This consideration raises further questions surrounding conceptions of households and class in a financialised world, and thus of the role of *all* households when putting forward alternative political agendas.

These questions are beyond the scope of this thesis. Here, I have rather used the lens of class to identify and explore a critical problem: namely, the absence of the quantification of the costs of financial risk in the mainstream ways in which living standards are conceived, measured and addressed in Australia. Until the risk-exposed working class household is reconceptualised, the prevailing political narratives will continue to conceive of the household as a financially literate risk trader, while neglecting to quantify the impact of risk for households. A synthesis will continue where policy frameworks such as the TWF cast households as capital, while cost of living measures such as the CPI emphatically treat households as separate from capital activities.

The costs of financial exposure absorbed by the ‘never had it so good’ Australian household will remain concealed.

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