

WORKING PAPERS IN ECONOMICS

NEW BANKS: IMPACT AND RESPONSE

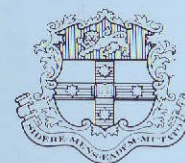
by

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New Banks: Impact and Response

1. Introduction

The past decade has seen a massive change in the competitive arrangements and structure of the financial services sector in Australia, most of all in banking.¹ Since the beginning of the decade some twenty-three new banks have entered the market.² This paper offers an appraisal of the experiences of nearly all these new banks since the commencement of business which, for the majority, was in 1985 and 1986 and the repercussions of their entry on the established or old banks. While this theme provides the main focus, attention is also given to questions about profitability and efficiency.

This opening up of banking, and restructuring in other parts of the financial services sector, have reflected a strategic shift in the ordering of economic arrangements, an event not often witnessed in such clear fashion. Restraints on entry had confined participation over more than forty years to those banks authorised at the beginning of the period. This restraint, combined with quantitative and qualitative controls over banking business, brought proliferation of non-bank financial intermediaries and segmented markets.

The extraordinary shifts in the strategies underlying economic and financial policies witnessed in Australia and other countries during the 1980s had their stimulus in those events during the 1970s which saw the abandonment of both fixed exchange rate regimes between major trading economies and the few slender ties of currencies to a fixed value expressed in terms of a gold price. By the mid-1970s participants in international banking and financial markets had to fend for themselves in a world of relative prices for the currencies in which liabilities and assets were denominated. Explanations for these developments have been explored on any number of occasions and are not the province of this contribution.(9,15,18)

¹ This paper is an extension of one offered at the Third Australasian Finance and Banking Conference in late November 1990.(11) I am indebted to Alison Harvie for help with data, and her and Jack Towe for sources of information. I am grateful to Professor Ian Sharpe for his comments on many aspects of this paper.

² The number of authorities issued to new trading and savings banks is much greater as the same institution may have both authorities, as in the case of Citibank, or a subsidiary may have a separate authority as with Civic Advance. This total does not include the Primary Industry Bank converted from a special purpose bank to a trading bank but being a subsidiary under that new authority of the Rural and Industries Bank of Western Australia. The distinction between trading and savings banks was abolished when amendments to the Banking Act were proclaimed in December 1989.

Public acknowledgement of the potential for shifting away from long established procedures in the ordering of the financial services sector came with the appointment of the Committee of Inquiry into the Australian Financial System early in 1979, familiarly known as the Campbell Committee.(5) However, well before that Committee reported its findings in September 1981, one financial innovation was inaugurated which altered irrevocably the structure of the financial sector. That innovation was the Cash Management Trust(CMT) introduced by Hill Samuel (now Macquarie Bank) in December 1980.(24,25) The CMT joined together household and wholesale markets for funds by offering a highly liquid income-earning financial asset not matched by any other instrument in the then segmented financial markets in which banks were not allowed to offer interest on demand deposits or fixed term deposits of less than three months.³ Moreover the innovation was not independent of later steps to bring many new banks to the Australian scene.⁴ The CMT was viewed by sponsoring merchant banks as a means of building a retail customer network to sustain banking business should an authority be granted later.(24,p.181)

Both the Campbell Committee and the later Martin Committee, set up in 1983 by the then new federal government to review the recommendations of the Campbell Committee, favoured the entry of new banks to Australia. However the federal government took a further nine months following receipt of the Martin review to determine the basis for seeking applications from foreign as well as domestic interests wishing to set up banks in Australia. A more detailed survey of the connections between these two reports and the authorisation of new banks is offered in Appendix A.

In September 1984 the Federal Treasurer called for applications from groups interested in the setting up of banks in Australia. (13) The purposes to be served by authorising new banks were stated to be:

- (a) the development of a more innovative, efficient and competitive financial sector; and,
- (b) conditional upon achieving this purpose, the fostering of higher real growth in output and employment.

The aim of a more innovative and competitive financial sector was therefore an

³ Controls over the maturities of bank deposits on which interest could be offered were not removed until August 1984.(7)

⁴ In 1981 the then new Australian Bank was prompt in combining a CMT with its deposit facilities so providing access to interest-bearing demand deposits. That bank commenced business in 1981 and introduced its CMT in November the same year. This new bank devised a sweep technique whereby excess deposits as specified by their holders were placed at call in the house CMT.

intermediate target. The ultimate purpose was to ensure that producers of goods and services, other than financial services, were supported in their efforts to expand real output, employment and exports.

When in February 1985 the list of successful foreign applicants was announced the same emphasis on the purposes of entry was stated. The main benefit was again seen as being their impact on the financial system as a whole. (14,p2) Mention was also made of the gains from access to the world's major capital markets, reciprocity in access to financial markets, and trade matters.

This paper looks initially at developments in banking and other forms of financial intermediation since the entry of new banks. In Part 3 detailed scrutiny of market penetration is offered treating both balance sheet and off-balance sheet activities of new and old banks. Later parts examine some issues bearing upon earnings and efficiency.

2. Structural Shifts in the Financial Services Sector

Any appraisal of the impact of the new banks cannot be treated in isolation from the activities of other financial intermediaries. With removal of market segmentation being one of the most prominent features of the process referred to as "financial deregulation", the actions pursued by banks, old or new, can only be understood in the context of the overall financial services sector. Any assessment is clouded by the transfers into banking business of those assets and liabilities held by various non-bank financial intermediaries (NBFIs) prior to their authorisation as banks.⁵ Without adjustment for such transfers, the effect of opening up banking to many newcomers would be overstated.

The RBA has provided a helpful general perspective on changes in market participation following the authorisation of the new banks from early 1985 onwards. (21) The most useful commentary on these changes is shown in Table 1 where the old or established banks as well as the new ones are shown separately but each grouped with their NBFI subsidiaries. In this way the transfer problem referred to in the preceding paragraph is avoided. These two groups are then compared with the rest of the NBFIs which covers merchant banks, CMTs, finance companies, building societies, credit unions and other financiers not linked to banks, old or new. A sub-group of this third category shows the share of assets in the financial services sector held by those NBFIs affiliated to

⁵ This adjustment problem is taken up in the next section where the market penetration of each new bank is scrutinised.

banks in other countries but which are not authorised banks in Australia.

Table 1: Financial Intermediation in Australia, 1984-89.

		(% Share of total assets in June)			
		1984	1987	1988	1989
1.	Old Banks & their NBFIs	68.0	64.0	64.0	65.5
2.	New Banks & their NBFIs	10.0	12.5	12.5	12.0
3.	Other NBFIs	22.0	23.5	23.5	22.5
	(a) Affiliates of non-resident banks	2.5	5.5	6.5	6.5
	(b) Others	19.5	18.0	17.0	16.0

Source: RBA (21, p.19)

The startling feature of this set of data is the sharp rise in the market share of the NBFIs affiliated to foreign banks not being authorised banks in Australia. The rise in their market share by more than 150 per cent between 1984 and 1989 is a remarkable outcome when the main focus of banking and financial policy was the fostering of banking competition. The gains of this group, admittedly from a very small base, outweigh those enjoyed by the new banks and their subsidiaries and exceed absolutely the market shares given up by the old banks and their subsidiaries or the rest of the NBFIs not tied to any bank.

An explanation for this unanticipated surge in market performance by these affiliates of non-resident banks is to be found in other decisions taken at the time the Federal Government decided to open up banking to new foreign participants. When announcing that decision in September 1985, the Federal Government accepted the need for rationalisation of the merchant banking sector which had the effect of permitting 100 per cent foreign ownership. Prior to this determination merchant banks were required to have Australian equity participation and this had produced by the early 1980s a Jacob's coat of multiple shareholdings. Restructuring into mainly single ownership brought a sharper focus to their activities and a clear basis for parent banks abroad to expand capital commitments. The effect has been to foster a market strength which seems to have more than met the goals of that restructuring; namely, "... strengthen the industry and facilitate its adaptation to change." (13; Appendix B, p.2)

Ownership restructuring is not the only explanation for the market surge by affiliates of non-resident banks. Up to late 1988 the new banks as with the old ones, were required to hold statutory reserve deposits at the RBA on which they received a much less than market rate of interest. Furthermore the activities of the new banks in both banking and non-banking business were subject to close scrutiny by the RBA during these initial years following entry. Hence these affiliates of non-resident banks should have enjoyed some competitive advantage to the chagrin of the new banks most of all.

When the performance of these restructured affiliates of non-resident banks is compared with the new banks group there can be little wonder about the impact of all these changes being felt in wholesale rather than retail banking. The new banks were not alone in seeking market share in that aspect of financial intermediation. (1.p.13) This phenomenon is also a salutary reminder that the market for many financial services is not the exclusive preserve of banks.

3. The Impact of the New Banks

Some twenty-two new banking groups have been established in Australia since the beginning of 1985.⁶ The details on each of these entrants is shown in Appendix B. Of these new banks sixteen are owned wholly or partly by foreign banks with all of them commencing operations during 1985 or 1986. The new banks of local origin have timed their entry over a longer span; three were authorised about the same time as the new foreign banks while the other three have come later. In addition to the twenty-two new banks an established though very small savings bank in Tasmania absorbed a building society during 1987.

Despite the relatively brief span since most new banks commenced business, effectively four years, repercussions for some participants have been experienced. Admittedly the collapse of the State Bank of Victoria (SBV) and its acquisition by the Commonwealth Bank late in 1990 cannot be attributed solely to heightened competition directly within banking.⁷ Yet the demise of the Australian Bank (AusB) with its absorption into the SBV early in 1989 most certainly, and the acquisition of the National Mutual Royal Bank (NMRoyal) by the Australia and New Zealand Bank (ANZ) in large part, must reflect this effect.

Whatever the performance of the new banks as a group, whether looked upon as a whole or divided between those with foreign and domestic affiliations the competitive impact is determined by each of them individually. Hence the assessment conveyed in this section looks at the activities of each new bank.

⁶ The Australian Bank which commenced business in 1981, is not treated as a new bank for the purposes of this paper. Its omission explains the difference between the twenty-three new banks mentioned at the beginning of this paper and the twenty-two referred to here.

⁷ The main losses in the SBV group, reported to be about \$2.75 billion, stem from the activities of its merchant banking subsidiary, Tricontinental Holdings Ltd. The strong competition in financial intermediation, depicted by affiliates of non-resident banks in Table 1, is inseparable from the purely banking experiences.

a) Market Shares

Entry of new banks has changed the pattern of banking activity. Some of the entrants, such as Citibank, secured authorisations to pursue both trading and savings banking business. In these circumstances the most effective means for grasping what has happened from entry is to combine trading and savings data for each bank or bank group. The abolition of the distinction between trading and savings banks during 1989 has made amalgamation of the data imperative for reasons of continuity. The data for the four major banks and all the smaller ones are shown for total Australian liabilities in Table 2 and for total Australian assets in Table 3. The initial series in column 1 of each table is for December 1984 prior to the entry of any new bank. The impact of the entrants on total Australian banking business is assessed using data at June each year up to 1990.

The interpretation of the data shown in columns 2 to 5 of each table is straightforward. Many of the newly-authorised banks already had an established business in Australia through merchant banking activities and finance companies, in money and foreign exchange markets, and corporate lending or, as is the case with a few new banks of domestic origin, housing loans through their previous incarnation as building societies. Hence each of the entrants would have brought a business base into banking. Such an "increase" in business within banking reflected simply the transfer of financial activity to banking from non-bank financial intermediation. To understand what the impact of new banks has been, it is necessary to determine just how the banking business of the entrants has grown from the initial base business they brought with them into banking. For that reason the data shown in columns 2 to 5 of each table has been adjusted to take account of that initial base. Details of the adjustment procedure are shown in Appendix C.

The effect of this adjustment is to provide a means for comparing how the business of each entrant has grown from inception against the performance of the old banks. Thus the "one-off" impact of transferring business into banking is eliminated. It permits an assessment of just how far the entrants have been able to penetrate the market previously the exclusive preserve of the old banks. Improvement on what each brought to Australian banking is measured for its extent by the positive share recorded in those tables.

The results shown in Tables 2 and 3 are revealing of sharp differences in performance. The impact on liabilities may be spelt out. Between December 1984 and June, 1990 total banking liabilities in Australia grew from A\$104.7 billion to A\$294.4 billion,

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Table 2: Australian Liabilities, Banks
(% Market Shares)

Banks	December 1984 (1)	June 1987 (2)	June 1988 (3)	June 1989 (4)	June 1990 (5)
Major					
a. ANZ	15.37	15.78	17.56	15.51	15.72
b. Commonwealth	23.65	19.28	18.19	17.13	16.95
c. NAB	18.51	18.79	17.60	16.31	15.90
d. Westpac	23.18	18.98	18.47	21.34	19.14
TOTAL: 4 MAJORS	80.71	72.83	71.82	70.28	67.71
Other Old					
a. BNZ	0.43	0.85	0.98	0.98	0.77
b. BoQ	0.22	0.18	0.22	0.27	0.27
c. BNP	1.01	0.67	0.57	0.59	0.65
d. AusB	0.47	0.29	0.19	0.11	0.07
e. SBNSW	4.68	4.39	3.89	4.12	4.86
f. SBSA	3.12	3.50	3.85	3.83	4.01
g. RIBWA	1.90	2.25	2.38	2.39	2.29
h. SBVic	6.71	7.16	7.10	7.43	6.53
i. Tas Svg	0.39	0.23	0.22	0.22	0.22
j. TasB	0.35	0.28	0.26	0.22	0.23
TOTAL: OTHER OLD	19.29	19.80	19.66	20.16	19.90
TOTAL: ALL OLD	100.00	92.63	91.48	90.44	87.61
New Domestic					
a. Advance	-	0.67	1.17	1.35	1.48
b. Challenge	-	0.11	0.33	0.51	0.52
c. Macquarie	-	0.15	0.21	0.28	0.44
d. Melbourne	-	-	-	-	0.18
e. Merway	-	-	-	0.10	0.26
f. PIBA	-	-	0.01	0.03	0.15
TOTAL NEW DOMESTIC	-	0.93	1.72	2.27	3.03
New Foreign					
a. Bankers Trust	-	0.51	0.47	0.46	0.65
b. BoA	-	0.07	0.10	0.06	0.13
c. Barclays	-	0.54	0.66	0.78	0.72
d. CHASE AMP	-	0.70	0.81	1.02	1.12
e. China	-	0.02	0.02	0.03	0.03
f. Citibank	-	1.43	1.45	1.63	2.29
g. Deutsche	-	0.15	0.21	0.14	0.54
h. HongKong	-	0.48	0.51	0.75	0.87
i. IBJ	-	0.14	0.20	0.23	0.31
j. Lloyds NZA	-	0.08	0.08	0.10	0.13
k. Mitsubishi	-	0.12	0.19	0.21	0.36
l. NMRoyal	-	0.48	0.65	0.75	0.75
m. Natwest	-	0.97	0.75	0.57	0.94
n. Singapore	-	0.07	0.18	0.19	0.17
o. Standard	-	0.46	0.33	0.12	0.08
p. Tokyo	-	0.22	0.18	0.25	0.26
TOTAL: NEW FOREIGN	-	6.44	6.80	7.29	9.36
TOTAL: ALL NEW	-	7.37	8.52	9.56	12.39
TOTAL: OLD & NEW	100.00	100.00	100.00	100.00	100.00

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Table 3: Australian Assets, Banks
(% Market Shares)

Banks	December 1984 (1)	June 1987 (2)	June 1988 (3)	June 1989 (4)	June 1990 (5)
Major					
a. ANZ	14.88	16.26	17.45	16.01	15.96
b. Commonwealth	24.21	19.32	17.89	16.57	16.61
c. NAB	18.59	18.71	18.21	16.68	16.50
d. Westpac	22.94	18.98	18.23	20.94	19.16
TOTAL: 4 MAJORS	80.62	73.27	71.79	70.20	68.23
Other Old					
a. BNZ	0.43	0.99	1.00	0.99	0.80
b. BoQ	0.22	0.21	0.24	0.28	0.28
c. BNP	0.98	0.65	0.57	0.56	0.64
d. AusB	0.52	0.31	0.20	0.13	0.09
e. SBNSW	4.84	4.62	4.55	4.86	4.79
f. SBSA	3.07	3.37	3.53	3.53	3.99
g. RIBWA	1.92	2.16	2.23	2.36	2.23
h. SBVic	6.67	6.95	6.75	7.01	6.52
i. Tas Svg	0.38	0.23	0.21	0.21	0.21
j. TasB	0.35	0.28	0.25	0.22	0.23
TOTAL: OTHER OLD	19.38	19.77	19.54	20.15	19.78
TOTAL: ALL OLD	100.00	93.04	91.33	90.35	88.02
New Domestic					
a. Advance	-	0.66	1.15	1.32	1.42
b. Challenge	-	0.03	0.26	0.44	0.45
c. Macquarie	-	0.20	0.23	0.31	0.46
d. Melbourne	-	-	-	-	0.22
e. Merway	-	-	-	0.09	0.26
f. PIBA	-	-	0.00	0.03	0.13
TOTAL NEW DOMESTIC	-	0.89	1.64	2.19	2.94
New Foreign					
a. Bankers Trust	-	0.53	0.46	0.44	0.60
b. BoA	-	0.07	0.10	0.07	0.14
c. Barclays	-	0.47	0.60	0.73	0.68
d. CHASE AMP	-	0.54	0.69	0.88	1.02
e. China	-	0.04	0.05	0.04	0.04
f. Citibank	-	1.33	1.45	1.62	2.35
g. Deutsche	-	0.09	0.32	0.40	0.52
h. HongKong	-	0.46	0.54	0.73	0.84
i. IBJ	-	0.15	0.36	0.23	0.31
j. Lloyds NZA	-	0.09	0.09	0.08	0.13
k. Mitsubishi	-	0.15	0.20	0.24	0.34
l. NMRoyal	-	0.47	0.64	0.72	0.73
m. Natwest	-	0.99	0.89	0.75	0.87
n. Singapore	-	0.08	0.17	0.18	0.16
o. Standard	-	0.46	0.32	0.12	0.07
p. Tokyo	-	0.15	0.15	0.23	0.24
TOTAL: NEW FOREIGN	-	6.07	7.03	7.46	9.04
TOTAL: ALL NEW	-	6.96	8.67	9.65	11.98

this being a rise of 181.2 per cent. But about A\$13.7 billion represented simply the transfer of business into banking as the previous activities of then non-bank financial intermediaries were re-designated. Thus the growth in sustained or adjusted banking business between December 1984 and June 1990 was A\$176.0 billion, a rise of 168.1 per cent. A rise of such magnitude, including A\$34.8 billion for all new banks, offers a means for looking at the effects of entry.

With these adjustments it can be seen that the entrants had secured by the end of June 1990, 12.39 per cent of the liabilities business quite apart from what they brought with them and slightly less - 11.98 per cent - of assets business. This penetration was at the expense of the four major banks whose share fell from 80.71 per cent in December 1984 to 67.71 per cent in June, 1990. The other old banks taken together improved their command of the liabilities market by a small margin, from 19.29 per cent to 19.90 per cent. As most new banks came in between late 1985 and mid-1986 penetration to the extent of about 12 per cent seems impressive in total even if spread across many entrants. Moreover the gains in market share accelerated in 1989-90 compared with the previous year even when allowing for the newer domestic banks authorised in the last three years.

The estimates for market penetration by new banks in the asset market provide results more or less in keeping with what is found from the liabilities side. As well the value of assets exceeds the value of liabilities in Australian banking business, A\$323.8 billion at June 1990 compared with A\$294.4 billion. This substantial difference reflects only in small part the funding of new foreign banks by their parent banks. This upward shift in the margin between assets and liabilities, especially for the four majors, reflects two features. First, with the virtual abolition of exchange controls in December 1983, the banks were able to draw funds from abroad to finance domestic as well as international operations. Secondly, the pattern of foreign borrowing to fund the substantial deficits in the Australian balance of payments on current account shifted during 1984-85 to a much greater reliance than hitherto on bank intermediation (8,p.8).

Analyses of the adjusted series shown in columns 2 to 5 of Tables 2 and 3 reveal striking variations in individual performances amongst the new banks and the smaller old ones. A note of caution must be entered at the outset; the data in the two tables are revealing only of the scale of banking business realised on the balance sheet of each bank and tell nothing about the quality or structure of each bank's activities.

Each of the new banks, whether linked to foreign ones or domestic in origin, have sustained their initial entry, some if only just. Failure would be shown by a negative sign in one or more columns. This assessment is based upon the initial market penetration recorded at June 1987 which is about 12 to 18 months after the commencement of business for most new banks and then at June 1990.

A number of new banks appear to have lost their way, most notably Standard Chartered Bank Australia. Eight of these banks have secured 5 per cent or more of the total adjusted market share secured by the new banks as a whole. The eight are Advance, Bankers Trust, Barclays, Chase AMP, Citibank, Hongkong, NMRoyal and Natwest. Yet some of the eight have not improved their market share much on what it was in June 1987 while one, Natwest Australia Bank, has lost market share. Only one of the eight, Advance Bank, has doubled market share between June 1987 and June 1990.

Just three banks - Citibank, Chase AMP and Advance Bank - hold more than 1 per cent of the total adjusted banking market in Australia. In a few years each has secured an adjusted market share greater than all the old small banks other than those owned by state governments, and in the case of Citibank exceeded the share held by the state-owned Rural and Industries Bank of Western Australia (RIBWA). Of the adjusted market share held by the new banks as a whole, these three banks have nearly 40 per cent.

Spectacular performances from modest initial bases have been recorded by two entrants, Deutsche Bank and Challenge Bank, the latter being a domestic creation from two building societies. The reasons for the rapid growth in asset portfolios by these two entrants are not obvious though the very high capital adequacy provisions in Deutsche Bank Australia during 1988 pointed to a very heavy commitment to asset expansion. During 1989-90 Deutsche Bank secured a share of banking liabilities commensurate with its Australian asset growth over the preceding three years. For Challenge the rapid expansion in housing finance during 1987-89, bolstered by the 50 per cent risk-weighting under the new capital adequacy provisions as applied in Australia from September 1988, is the most likely one.⁸

⁸ The gains shown in Tables 2 and 3 for new banks having their origins in whole or part from former building societies may be deemed not comparable with those of new foreign banks starting ab initio. The adjustment process, spelt out in Appendix C, excludes previous business associated with the branch network of the former building societies. The three new banks influenced in this way are Advance, Challenge and National Mutual Royal. This branch network may have allowed a more rapid expansion of the three than possible with just one or a few branches centrally located in capital cities.

Thus less than half the new banks appear to have secured a position in Australian banking in terms of market share as measured by size or speed of penetration. But one of them, National Mutual Royal, is disappearing as a separate entity into the ANZ Bank group while another, Natwest Australia, has slipped back from its initial standing in the market. Only three new ones seem to be sufficiently well placed to develop a base in Australian banking, at least on this evidence about market shares.

b) Market Shares: Re-interpretation

These estimates of market penetration must be qualified in one most important respect, namely they reflect the assumption that all those activities which might be deemed banking business were transferred into the new banks when they commenced banking business during 1985 or 1986 or later in the case of three new domestic banks. This assumption may be misplaced for some banks as the authorities recognised the costs, such as stamp duties, arising from the transfer of ownership from a NBF subsidiary to the authorised bank within the same corporate entity. Moreover, as mentioned already, the new banks attracted statutory reserve deposit requirements on the business brought into banking. Given the strong competitive environment across financial intermediaries, and not just within banking, to which attention has already been directed in the discussion of data in Table 1, the reluctance of some new banks to shift business from merchant banks and finance companies can be understood. Such a shift would have been competitively disadvantageous. Moreover the authorities could not press these new banks to assume cost disadvantages which could only benefit this non-bank competition.

However the statutory reserve deposit was replaced in September 1988 by a less demanding non-callable deposit amounting to 1 per cent of all liabilities, other than shareholders' funds, in trading and savings banks.⁽²⁰⁾ The rate payable on that deposit was increased from the 5 per cent it had been for many years to a rate being 5 per cent less than the market rate on short-term official paper. Both measures were in accord with policies to foster the new banks.

The authorities have never been explicit in their requirements about the proportion of business of a banking group which may be conducted in non-banking activities. One hint of the boundary perceived by the authorities was the decision by the RBA in June 1987 to declare Macquarie Bank an established bank for purposes of capital requirements.⁽¹⁶⁾ While that determination is not direct evidence of the authorities' position on the balance between banking and non-banking business, that step would not have been taken without regard for this feature. It is therefore significant that at the

end of that bank's fiscal year in which this determination was made, namely 31 March 1988, the proportion of banking business in the total asset activities of Macquarie Bank was just over 70 per cent.

Apart from Macquarie Bank there are six other new banks which appear to have taken some time to bring business from their NBFs into the authorised bank. They were Bankers Trust, Bank of America, Chase AMP, Citibank, Hongkong and Natwest. Scrutiny of the balance sheets and related information suggests that by the end of 1989, each of these banks had about 70 per cent of the group business within the bank.⁹

Thus the data shown in Tables 2 and 3 for each of these seven banks, and perhaps others, may be exaggerating the extent of gains in market shares. This means that some part of the gain in market share from 1987 to 1989 would reflect the transfer into banking of business which could have been transferred at the time the bank commenced business in 1985 or 1986. This effect, by which is meant the overstating of gains, would have been most pronounced in 1987 and 1988 though for a few this would have continued through 1989.

In Table 4 the shares of both assets and liabilities markets held by all the new banks, as shown in the previous two tables are divided between the banks not affected by the extent of the transfer of business into banking at the time of commencement, and the seven banks for which the market share should be adjusted. Adjustments to market shares to allow for the delayed transfer of business into banking apply to little more than half the total share secured by new banks as a whole.

Table 4: Potential Adjustment to Market Shares of New Banks, 1987-1990.

	June 1987	June 1988	June 1989	June 1990
1. Liabilities				
a. Banks Unaffected	3.06	4.22	4.79	5.95
b. Banks Affected*	4.31	4.30	4.77	6.44
Total	7.37	8.52	9.56	12.39
2. Assets				
a. Bank Unaffected	2.84	4.31	4.85	5.70
b. Banks Affected*	4.12	4.36	4.80	6.28
Total	4.96	8.67	9.65	11.98

Note: * Bankers Trust Australia, Bank of America, Chase AMP Bank, Citibank, Hongkong Bank, Macquarie Bank, Natwest Bank Australia.

⁹ The most comprehensive source of data is to be found in the annual survey conducted by KPMG Peat Marwick into financial institutions. During the past two years this has been entitled Financial Institution Performance Survey.

The re-interpretation of the evidence on market penetration offered in Tables 2 and 3 is about the path rather than the extent because the data for June 1990 may be taken as stabilised with respect to the balance of banking and non-banking business now that most disincentives for transferring have been removed; stamp duty considerations may still linger in some measure. The main feature of the re-interpretation is straightforward; market penetration by the new banks as a whole over the twelve months to the end of June, 1990 has been even stronger than the data in Tables 2 and 3 suggest. Up to June 1989 the market share of the new banks shown in Tables 2 and 3 is overstated. Thus the surge in their market share during 1989-90 is even bigger than the data shows. Hence the latter half of the last decade is best viewed as the phase covering the initiating of new banks' activities, not always very successfully, and only in the past year has the position of any of the new banks been consolidated sufficiently to allow for sustained penetration of the banking market in Australia.

c) Off-Balance Sheet Activities

The past decade has witnessed the rapid growth of off-balance sheet exposures mainly the result of the proliferation of derivative instruments such as forwards, futures, options and swaps. The nominal value of these exposures are about three times the value of balance sheet activities according to one commentary from the Reserve Bank.⁽⁴⁾ The market presence of any one bank must reflect these exposures as well as the conventional measures depicted in preceding paragraphs and tables so that reliance on specified balance sheet activities alone is a deceptive measure of market participation.

There is relatively little information on these exposures for individual banks in Australia even though the calculation of risk-adjusted capital adequacy provisions requires their determination. In Table 5 aggregate data on balance sheet assets and off-balance sheet exposures expressed in both nominal and risk-adjusted values is shown for the three publicly-listed major banks in Australia.¹⁰ Comparisons between the three banks show marked differences; off-balance sheet exposures of NAB are nearly 160 per cent, as measured by nominal values, of the balance sheet assets and this is about one half of that same relationship for ANZ and Westpac which is recorded as about three and a half times. These differences in commitments off balance sheet reveal a much greater variation in market presence amongst the three major publicly-listed banks than is conveyed by balance sheet data alone.

¹⁰ The risk for which adjustments are made in the new capital adequacy provisions is credit risk alone. There are no adaptations in this measure for other forms of risk such as interest rate and foreign exchange.⁽¹²⁾

Table 5: Asset Measures: ANZ, NAB & Westpac, 1989

	(\$ billions)		
	ANZ	NAB	Westpac
1. Balance Sheet Assets			
(a) Nominal Values	84.7	75.5	108.6
(b) Risk-Adjusted	65.2	56.6	74.8
2. Off-Balance Sheet Exposure			
(a) Nominal Values	204.1	117.7	374.4
(b) Risk-Adjusted	9.1	9.9	18.6
3. Total Assets and Exposures			
(a) Nominal Values	378.8	193.2	483.0
(b) Risk-Adjusted	74.2	66.5	93.4
4. Ratio of Risk-Adjusted Assets and Exposures to Balance Sheet Assets (3b + 1a)	.8760	.8808	.8600

Sources: ANZ - Annual Report 1989, Financial Statements 1989, page 36.
 NAB - Annual Report 1989, page 8. NAB does not provide a breakdown of exposures by categories.
 Westpac - Annual Report 1989, page 81.

When adjusted for credit risk, according to the broad categories laid down by the Reserve Bank, the ratio of exposures to balance sheet assets is about 15 per cent for ANZ, 17.5 per cent for NAB and 25 per cent for Westpac. This moderation of the relative size reflects different structures of balance sheet assets as well as exposures. This is apparent when comparisons are made between the nominal and risk-adjusted values for the "on" and "off" balance sheet items shown in items 1 and 2. Item 4 in Table 4 expresses the measure of risk-adjusted assets and exposures to the nominal value of balance sheet assets. This ratio may be perceived as the "risk ratio", based upon the Reserve Bank's weightings for credit risk, indicating relative risk exposures of the total business of each bank.

The significance of the calculations in Table 5 for the purposes of this paper is to point to the possibilities of some new banks having exposures well in excess of three times the nominal value of assets. Recent evidence provided by the Reserve Bank confirms the relatively heavy commitments of the new banks, especially those with foreign ownership ties, in off-balance sheet activities.⁽²²⁾ Whereas at the end of September 1989 new foreign banks (not the adjusted series used in Table 3), of which there are sixteen, had 9.4 per cent of total Australian balance sheet assets, they held 21.9 per cent of the gross or nominal value of total off-balance sheet exposures. Although this data is provided in terms of market share rather than basic data as shown in Table 5 the evidence points to the much greater participation of new banks in off-balance sheet activities relative to the old ones.

Some hints of this possibility may be gleaned from data similar to that for ANZ, NAB and Westpac on American banks. The risk ratio is measured for major U.S. banks in Table 6. For some banks the value of risk-adjusted assets and exposures exceed by a substantial margin the nominal value of assets; ratios in excess of unity are revealed for Citibank, Bankers Trust and Chase Manhattan to list three with ties into Australian banking.¹¹ Unfortunately it is not possible to derive estimates of the business structure for each of these banks in the same fashion as for the three major Australian banks.

Table 6: Balance Sheet Assets and Risk-Adjusted Assets Plus Exposures, U.S. Banks 1988

	(US\$ billions)		Ratio 2 + 1 (3)
	Total Assets (1)	Total Risk-Adjusted Assets plus Exposures (2)	
	Citicorp	207.67	
Chase Manhattan	97.46	103.37	1.061
BankAmerica	94.65	94.25	0.996
J.P. Morgan	83.92	61.86	0.737
Security Pacific	77.87	79.92	1.026
Manufacturers Hanover	66.71	76.11	1.141
First Interstate	58.19	52.67	0.905
Bankers Trust	57.94	66.91	1.155
Wells Fargo	46.62	42.46	0.911
First Chicago	44.43	47.47	1.068
PNC	40.81	32.70	0.801

Source: Salomon Brothers, A Review of Bank Performance: 1989 Edition, Figures 29 and 46.

The subsidiaries and affiliates of these banks in Australia probably reflect similar business strategies to those of their parents in the United States. Hence measures of market penetration reflecting only asset values will understate the relative contribution of some new banks, perhaps many, to total banking business in Australia. A focus on balance sheet business alone leads to misleading judgements on the impact of the new banks in the Australian banking market. Hence some qualification to the commentary about market penetration offered in the immediately preceding sections is necessary for an understanding of the relative contribution of the new banks especially the foreign ones. Clearly the market presence of some new banks, because of their commitments in off-balance sheet activities, is much greater than indicated by the market shares held in assets and liabilities markets.

Between the old and the new banks, ANZ and Westpac have pursued off-

¹¹ Aggregate data provided by the Federal Reserve Bank of New York shows that the risk ratio for the twenty largest banks in its district was 0.973 at 30 June, 1990. Official data for individual banks will be available quarterly from 31 December, 1990.

balance sheet business matching the new foreign banks in Australia. This response to the newcomers may have been shared by some state-owned banks. However, NAB and, probably, the Commonwealth Bank took a more conservative role in these activities.

d) Responses by Old Banks

The initial impact of the entry of new banks has been entirely at the cost, in terms of market share at least, of the four major banks though not uniformly so. Between December 1984 and June 1990 their share of asset business fell from 80.6 per cent to 68.2 per cent. For the smaller old banks the share was virtually constant around 19.5 per cent. Nevertheless the responses of individual old banks have varied greatly.

Amongst the four major banks the Commonwealth Bank has given up most market share. Even with the acquisition of the State Bank of Victoria, and supposing that bank's market share can be retained which must be a moot point, the expanded Commonwealth Bank would still have a smaller share of asset business than was recorded in December 1984. In this respect it is well to note that the Commonwealth and Westpac banks absorbed fully the initial impact in banking of all the new banks. Up to June 1987 these two bore the full brunt.

In marked contrast the ANZ Bank has increased its market share when compared with its position prior to the entry of the new banks. This strong competitive stance was most obvious during the 1987-88 fiscal year since when it has given up some of the substantial gain achieved in that period. A somewhat similar strategy has been fostered by Westpac which strove in 1988-89 to restore a market share which had eroded during the three preceding fiscal years.

National Australia Bank has not exhibited the same defensive policies as the ANZ Bank or Westpac. Instead there has been the appearance of a managed acceptance of a declining market share between 1988 and 1990. With its greater concentration on retail and commercial banking, NAB has offset the diminution in its Australian activities by expanding abroad, most notably in the United Kingdom and Ireland.

This contrast in responses between ANZ and Westpac banks on the one hand and NAB on the other is a reflection of the different measures taken by the three in their participation in off-balance sheet business. The ANZ and Westpac banks are the two out of the four major old banks seeking to match the new banks across all banking activities.

Disparate responses have been recorded amongst the smaller old banks though two of them are now being absorbed, namely the Australian Bank (AusB) and the State Bank of Victoria, by the Commonwealth Bank. The State Bank of South Australia is mired in bad and doubtful debts. None of the rest are now any more secure in their market shares than most new banks. Efforts by some, such as the Bank of New Zealand (BNZ), to build market share have been thwarted by losses associated with an expanded loan portfolio.¹²

4. Earnings

Acquisition of market share offers only a partial indication of capacity to sustain entry. Earnings to sustain participation are of equal importance. In Table 6 data is provided showing the operating profit after tax as a percentage of average total assets and average net assets during 1987, 1988 and 1989 for most banks in Australia. Although some reservations may be held on the comparability of the data, the series do allow an assessment of relative performance of new and old banks. Operating profit includes abnormal items.

The results for the three years are presented in three groups; the new banks with a weighted mean for all of them and then the old banks with the four majors shown separately from the smaller ones. These are shown in Table 7. There is a sharp distinction between the performance of the four majors and all the other ones. While the operating profit ratio for the four as a whole rose over the three years the results for the smaller old banks and the new banks fell away sharply on average in 1989. By that year the strains of heightened competition following on the entry of many new banks were being revealed in low operating profit ratios for most new banks and substantial losses for six of them. These profit ratios for 1989 are low by comparison with the mean for the four majors.

Amongst the four majors the performances recorded by the two which had pursued competitive strategies to match the newcomers across all activities, were not comparable to the other two. The relative position of ANZ and Westpac banks had not been sustained against NAB and the Commonwealth though still superior to nearly all the other banks, old and new.

Table 7: Operating Profit to Average Assets of Banks, 1987 to 1989

¹² The Bank of New Zealand, following recapitalisation in 1989 made necessary by losses exceeding capital and reserves, has now been restructured with non-performing loans of about NZ\$2.3 billion being hived off into a separate entity, Adbro Investments Limited.(2,3)

	(%)					
	Total Assets			Net Assets		
	1987 (1)	1988 (2)	1989 (3)	1987 (4)	1988 (5)	1989 (6)
I: NEW BANKS						
a. Foreign						
Bankers Trust	2.45	2.31	4.07	32.7	29.6	41.9
Bank of America	0.37	-0.13	1.42	4.0	-1.4	9.7
Barclays	0.40	0.02	-3.10	5.5	0.3	-46.8
CHASE AMP	0.01	0.12	-0.77	0.1	1.6	-16.4
Citibank*	0.45	1.41	1.26	5.2	13.7	12.1
Deutsche*	0.16	0.19	0.38	1.5	1.9	3.9
Hongkong*	0.64	n.a	-3.01	7.4	n.a	-44.0
IBJ	0.75	0.63	n.a.	7.8	7.0	n.a.
Lloyds NZA	0.83	0.99	-3.03	10.1	10.1	-13.1
Mitsubishi	0.25	0.37	0.14	3.1	4.9	2.5
NM Royal	0.24	0.24	0.27	3.7	3.5	3.7
Natwest	-0.30	-1.05	-0.06	-4.5	-15.9	-1.1
Standard	0.64	0.18	-3.94	7.9	2.1	-43.7
Tokyo	0.32	0.32	0.67	3.6	4.1	10.1
b. Domestic						
Advance	0.57	0.65	0.49	8.3	9.8	7.8
Challenge	n.a.	0.74	0.61	n.a	13.0	11.4
Macquarie Bank	2.45	2.23	1.97	30.0	25.3	23.1
All New: Weighted Mean	0.59	0.70	0.35	8.0	9.4	3.2
II: OLD BANKS						
a. Four Majors						
Westpac	0.69	0.91	0.82	15.6	16.6	13.3
ANZ	0.63	0.73	0.65	11.8	11.7	13.1
NAB	0.73	0.95	1.12	13.0	14.9	15.7
Commonwealth	0.47	0.58	0.86	8.7	11.2	16.3
Weighted Mean	0.64	0.81	0.85	12.4	13.8	14.4
b. Others						
SBNSW	0.27	0.34	0.39	5.0	5.9	8.1
SBVic*	0.45	0.52	-0.94	13.3	16.7	-34.0
RIBWA	0.33	0.37	0.07	7.0	8.0	2.1
SBSA	n.a.	n.a.	0.70	n.a.	n.a.	10.3
AusB	0.09	0.15	1.53	1.1	1.4	8.1
BoQ	1.05	1.17	1.22	8.0	9.0	11.2
All Old: Weighted Mean	0.60	0.76	0.71	12.0	13.4	12.7
III. ALL BANKS: WEIGHTED MEAN						
	0.60	0.75	0.64	11.2	12.6	10.8

Source: Peat Marwick Hungerfords, *Financial Institutions Performance Survey*, 1989 and 1990; Sydney; pp. 38 and 42 respectively.

Note: i) Some very small banks not shown are included in the estimated weighted means

ii) * Merchant banking results included in banking activities.

Two banks are provocative of questions about banking strategies of entrants

because of their high earnings ratios. They are Bankers Trust Australia and Macquarie Bank. These two banks have the highest operating profit to average total assets and net assets of any banks, old and new. The only other new bank anywhere near their profitability is Citibank.

It would be wrong to attribute the high earnings by Bankers Trust Australia, and Macquarie Bank and that combined with market penetration by Citibank Australia to their experiences in Australia with finance companies, merchant banking and funds management prior to entry into banking. These three new banks did not have such experiences exclusive to themselves. Explanations for their superior performances must lie in other spheres such as professional competence and effective pursuit of well-chosen strategies. Other entrants had equally long exposures to the practices of the financial services sector with the running of non-bank financial intermediaries.

Many newcomers were joint ventures of foreign banks with local partners and the rapid exit of those partners in the past couple of years attests to the weakness of that type of arrangement in banking. (6,p.7) That feature may explain the failure of Chase AMP to prosper when the U.S. parent bank might have been expected to emulate Citibank if not Bankers Trust. Experiences in the London eurocurrency market over many years, as summarily represented in Table 8, have shown up the competitive weaknesses

Table 8: London Eurocurrency Market Consortium Banks
(% share of market)

	Liabilities	Assets (or Claims)
February 1975	6.3	6.5
February 1980	5.3	5.4
February 1985	2.8	3.0
October 1988	1.6	1.9

Source: Bank of England, Maturity Analysis By Sector of Liabilities and Claims in Foreign Currencies. (Quarterly Bulletin, various issues).

of joint venture or consortium banks. During the 1970s such banks held a significant though still modest share of business but this deteriorated rapidly during the 1980s to the point where their contribution, being negligible, is no longer identified separately.

Explanation for these superior returns on assets by these three new banks should also be linked to those off-balance sheet exposures treated earlier. On the admittedly limited evidence about such exposures of U.S. banks shown in Table 6 the two most prominent in 1988 were Citibank and Bankers Trust. Hence the relatively high earnings on assets in their Australian activities may reflect commitments to off-balance sheet business

much above the average for Australian banks old and new. With Macquarie Bank fostering a similar pattern of business to Bankers Trust, the same possibility for a relatively high ratio of risk-adjusted assets and exposures to nominal asset values must be conceded.¹³

Those banks such as Advance, Barclays, Challenge and National Mutual Royal, having a retail banking orientation display a variety of experiences. Quite apart from market penetration, both Advance and Challenge have recorded earnings on average total assets much closer to those achieved by the major trading banks than most new banks with foreign ties. One reason for the relative success of the two local new banks must be their extensive branch network on which to build an effective funding base.

However those new banks having their origins in building societies have been affected in their earnings by conditions attached to their banking authority. Not all these banks were treated in the same way.¹⁴ All those banks which had converted from building societies prior to 2 April, 1986 were required to bring all housing loans under \$100,000 within a 13.50 per cent ceiling. However the Federal Government abolished this interest rate ceiling on all new housing loans provided by banks from 2 April, 1986. Hence building societies which converted to bank status after that date were not required to bring any housing loans within the ceiling.

Advance Bank was authorised prior to the benchmark date so that its old housing loans were bound by the ceiling. The same is true for the National Mutual Royal Bank for those loans approved through the National Mutual Permanent Building Society prior to its incorporation into the Bank. However, that Bank's takeover of the United Permanent Building Society came after 2 April 1986 so that loans made earlier were not subject to restraint. Newer banks not attracting the ceiling on their loans because they were converted to bank status later include Challenge, Metway and the Bank of Melbourne.

The effect of this ruling is to discriminate in the earnings between banks. Little wonder then that some new banks record lower earnings than others. This discrimination may help explain the moderate earnings performance of Advance Bank when compared with Challenge.

¹³ Bankers Trust Australia and Macquarie Bank exhibit very high expenses to total assets ratios compared with all other banks. This points to those two banks as the most committed in off-balance sheet and capital markets activities. Citibank does not appear to have emulated its parent bank to the same extent in Australia.

¹⁴ It is not the purpose of this paper to analyse discriminatory practices in the authorisation of new banks. Suffice it to say that a measure designed for old banks has had differential impacts on new banks reflecting simply the timing of entry into banking and not any prudential concerns.

5. Efficiency

The treatment of the new banks has so far dwelt upon market penetration and earnings. But, as was noted in Part 1, much of the justification for the implementation of the new banks policy rested upon the stimulus to operational and dynamic efficiency being imparted by their entry to the Australian banking scene. Hence some measures of efficiency and productivity amongst the old and new banks are central to a general appraisal of the initial effect of the new arrangements. In light of comments already made on the very limited availability of information on "off balance sheet" items, efficiency measures bearing upon assets utilisation are fraught with methodological weakness.

Given existing data limitations, the approach used is the analysis of income and cost elements across the banks. A measure of efficiency is the proportion operating profit bears to operating expenses. Operating profit has defined previously. Operating expenses are total expenses less interest expenses and doubtful debts expenses. This ratio tests the returns gained by owners in terms of the expenses (or outlays) required to generate such profits. In this way the uncertainties associated with measuring asset values and net worth are avoided.

Productivity is addressed by a measure which reflects to some degree the value added in banking. The particular measure is the ratio of operating income to operating expenses. Operating income is defined as net interest income (interest income less interest expense) plus non-interest income less doubtful debts expenses. Again it reflects the expenses or costs required to generate an operating income. With this approach any queries arising from the relative distribution of business on and off balance sheet are set aside.

Data for many though not all old and new banks is set out in Table 9 for the three years 1987 to 1989. A comparison of the weighted means for the old and new groups show the superior performance in efficiency and productivity of the old banks as a whole. However these results reflect the dominant role of the four major banks where the efficiency gains for three of them have been striking, especially for the Commonwealth. The other old banks have been much more variable with the imminent collapse of the State Bank of Victoria evident in the 1989 data. Amongst the government-owned banks the sharp improvement in efficiency and productivity between 1987 and 1989 of the Commonwealth bank contrast with the performances of the state banks.

Amongst the new banks there are vivid contrasts in performance. Those with performances comparable or superior to the four majors include Citibank, Bankers Trust, Macquarie Bank and, on the most recent evidence, Bank of America, Deutsche Bank and the Bank of Tokyo. The absence of 1989 data on IBJ Australia handicaps judgement on how that bank has fared in a year when many new banks fell behind badly. While this set of data reveals a very mixed result for the new banks, there are sufficient among them exhibiting relatively high standards of efficiency and productivity to ensure that banking markets remain not just contestable but contested during the 1990s.

Table 9: Efficiency and Productivity of Australian Banks: 1987, 1988 & 1989.

Banks	Efficiency			Productivity		
	1987 (1)	1988 (2)	1989 (3)	1987 (4)	1988 (5)	1989 (6)
<u>1. Old</u>						
ANZ	19.5	21.7	20.3	149.1	141.2	136.4
Commonwealth	13.0	16.5	26.1	125.0	140.2	147.6
NAB	25.2	26.2	37.3	146.4	150.1	162.5
Westpac	20.5	28.3	28.3	138.5	151.3	138.8
BOQ	17.4	19.9	23.5	133.0	138.3	137.1
SBNSW	11.0	13.3	13.9	132.6	139.9	123.5
RIBWA	15.5	17.5	3.3	130.8	135.1	107.6
S&Vic	16.5	19.1	-33.6	129.7	140.1	68.0
Weighted Mean	18.9	23.0	23.2	139.0	145.3	139.3
<u>2. New</u>						
Advance	19.3	18.6	14.8	137.5	140.4	120.9
Challenge	n.a	15.3	19.7	146.4	126.9	132.0
Macquarie	35.9	37.9	25.6	141.9	152.6	132.0
Bankers Trust	51.1	30.3	35.7	177.9	149.4	158.6
BoA	10.2	-4.0	49.0	120.6	95.6	168.1
Barclays	11.5	0.5	-60.8	122.0	101.7	35.5
CHASE AMP	0.4	5.3	-35.0	100.4	105.1	50.0
Citibank	19.3	54.0	38.7	196.3	199.7	164.2
Deutsche	7.5	13.6	31.7	107.7	126.5	152.2
IBJ	62.0	86.3	n.a	191.6	231.1	n.a.
Lloyds NZA	32.8	45.0	-121.2	169.9	175.8	-109.3
Mitsubishi	17.1	32.7	12.7	139.5	157.0	123.9
NMRoyal	4.5	5.8	6.9	105.1	107.2	108.5
Natwest	-7.9	-21.1	-1.3	90.5	79.5	100.6
Standard	25.4	6.7	-96.1	137.2	106.7	-43.2
Tokyo	23.9	17.1	41.9	149.1	130.3	167.6
Weighted Mean	16.8*	16.4	5.8**	135.0*	129.9	112.0**

Source: same as for Table 7.

Note: * excludes Challenge Bank

** excludes IBJ

6. Summary

Any assessment of the impact of the new banks must reflect the purposes of the entry policy initiated late in 1984. The aim was a more competitive and innovative financial services sector. The purpose of a more innovative and efficient financial market was to foster real activity in the economy. In this emphasis the focus is on the links between financial efficiency and business activities. This feature of the entry policy should be understood when comparing the relative effects of heightened banking competition on household users of financial services, the retail banking market, and business users comprising the corporate and wholesale markets.(17)

It is in these latter markets where entry has brought intense competition. With securitisation of many banking assets, epitomised by the proliferation of markets for derivative instruments, competition in banking has been dominated as much by professional skills as distribution networks. Bankers Trust Australia and Macquarie Bank are revealing of the significance of superior capacities in corporate and institutional activities bearing upon lending and securities markets, the latter both derivative and underlying. The impact of this competition has been to make funds available to business to the point where credit quality was of less concern than hitherto.(6,p.6) Whether business used those funds to sustain investment, employment, output and exports is a separate matter.

In retail banking a critical mass is essential for the efficient management of liabilities and assets portfolios and the development of markets in related financial services. The large branch network provides a ready access to the payments system and that access is the basis for the availability of relatively cheap deposits. Nevertheless some new banks, Citibank most of all, have sought means of securing a niche in retail banking though most newcomers are still struggling. Advance Bank and Challenge Banks exhibit most evidence of the capacity to secure a firm position even if on a regional rather than a national basis.

What has been witnessed within banking does not suggest that the large international financial intermediary has any clear advantages in securing positions in banking markets. The large internationally-operating financial conglomerate may successfully enter new markets; Citibank has established a profitable base if still relatively modest. Others have a tenuous hold in banking with every likelihood of reliance on parent banks to sustain their positions through the 1990s. If the two principals of National Mutual Royal Bank found it rewarding to sell their operation into ANZ Bank, though as a

joint venture this development was not surprising in light of experiences here and elsewhere, then the owners of new banks performing much less satisfactorily than NM Royal must be no less attracted to exit. That there may be further exits should be no surprise if only because the number of foreign banks invited to participate in Australian banking early in 1985 was much higher than had been expected when applications for new banking authorities were called.

Locally-based participants have not been intimidated by the market presence of large international banks. This is most evident with the performance of Macquarie Bank. Both Advance and Challenge banks have a sufficient base to ensure continuity if only as regional banks but in that role they may replace state banks in the second tier of banking. Efficiency and productivity characteristics point to that possibility.

The repercussions on the old banks from the entry of so many new ones has been felt more by the smaller old banks rather than the large ones. Responses from the four majors have varied with the two who sought to match new banks across the range of banking activity tested in their profitability, efficiency and productivity. That this happened should come as no surprise because one effect of heightened competition is to remove those quasi-rents enjoyed in the past from restraints on entry. At issue is whether gains in efficiency and productivity arising from heightened competition are taken in earnings or are distributed to customers through lower prices, by which is meant narrower margins. In corporate and wholesale banking the distribution of these gains to customers is most evident. Thus the main purpose of entry policy has already been realised. The new banks have served and will continue to serve their purpose, even with depleted ranks, so long as banking and other financial markets are contestable. (6,p.4)

Nevertheless points made and conclusions drawn in this paper must be qualified. The lack of data hampers the analysis of changes in market structures. Data has been available on a monthly basis for individual banks over decades. The proliferation of activities off balance sheet during the 1980s shows the need to publish that data on a comparable basis. The monetary authorities have been lax in their provision of this information and other data such as maturity structures of assets and liabilities.

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Appendix A: The Basis for Policy Changes

Prior to the authorisation of the new trading and savings banks, the banking industry was dominated by four major trading banks; namely, Westpac Banking Corporation, Australia and New Zealand Bank (ANZ), National Australia Bank (NAB) and the Commonwealth Banking Corporation familiarly known as the Commonwealth Bank of Australia. These four had about 80 per cent of all banking business. The last-mentioned is owned by the Australian Government. The other three majors are publicly-listed companies each of which had grown from merger or by acquisition of smaller trading banks during the previous ten years. Westpac came from the merger of the Bank of New South Wales and the Commercial Bank of Australia in 1982. National Australia Bank reflected the joining of the Commercial Banking Company of Sydney with the National Bank of Australasia. Both mergers were implemented in preparation for the expected growth in competition stemming from the likely relaxation of controls over banking activity and the expected entry of new banks on the Australian scene. ANZ Bank, a product of the merger of the Bank of Australasia and the Union Bank of Australia in 1951, had acquired the English, Scottish and Australian Bank in 1970 and the Bank of Adelaide in 1979.¹⁵

Other banks operating in Australia during the 1970s and early 1980s were much smaller than the four major trading banks. There were two foreign-owned banks of long residence, the Bank of New Zealand (BNZ) and the Banque Nationale de Paris (BNP). Apart from the minuscule Bank of Queensland (BoQ) there were a number of banks authorised under state legislation and not subject to federal banking scrutiny as is the case to this day. All being owned by respective state governments they were the State Bank of Victoria (SBVic), State Bank of New South Wales (SBNSW), State Bank of South Australia (SBSA) and the Rural and Industries Bank of Western Australia (RIBWA). They held about 16.5 per cent of all banking business. In 1981 an authority was given for a new trading bank, the Australian Bank (AusB), to commence business. Its progress was spasmodic culminating in its absorption into another bank during February 1989.¹⁶

Prior to 1985 each major trading bank had a savings bank subsidiary while the

¹⁵ The ANZ Bank acquired Grindlays Bank in September, 1984 thus symbolising moves by the three publicly-listed majors to substantially develop banking business outside Australia, New Zealand and the South Pacific. These three now have up to 40 per cent of business outside Australia. The Australian Bank was acquired by the State Bank of Victoria in February 1989. For the purposes of this study the bank is not treated as a new one because the conditions on which its banking authority was granted and the circumstances in which entry was made differed completely from those in the mid-1980s. This interpretation differs from the stance of the Reserve Bank of Australia which lists the Australian Bank as a new one.(19)

¹⁶ Now the State Bank of Victoria, less its bad debts, is being sold to the Commonwealth Bank.

state banks, apart from the one in New South Wales, had essentially savings bank functions. Then in Tasmania there were two trustee banks operating as savings banks; the Hobart Savings Bank trading as the Savings Bank of Tasmania (Tas Svg) and the Launceston Bank of Savings which after merging with a building society is now known as Tasmania Bank(TasB).

The establishment of the Committee of Inquiry into the Australian Financial System in January 1979 marked the initial step towards comprehensive change in the conduct of banking and the workings of the financial sector. When the Final Report of the Committee, familiarly known as the Campbell Report, was brought down in September 1981 the recommendations included proposals for the entry of new banks and the abandonment of many restrictions on the ways banks were allowed to conduct their business(3). The effect of those recommendations was to establish an impetus for change first witnessed by the merging of banks to create Westpac and NAB.

With the change of government in March 1983, the new administration convened a Review Group to consider and report on the many aspects of the Campbell Report bearing upon the stability and development of the financial system, participation in banking by domestic and foreign interests and the regulation of banking and non-bank financial intermediaries. That Group completed its report late in December 1983.(23) This Martin Report, named after the Chairman of the Review, recommended an increase in the number of banks though foreign participation should be limited to 50 per cent of the equity in any one new bank unlike provisions in the Campbell Report which suggested full foreign ownership as a possibility. Martin suggested the granting of 4 to 6 new banking authorities(23,p.71).

Even so it was not until early September 1984 that the Australian Government decided to call applications for new bank authorities. At the same time the Bank of China was permitted to take up a banking authority which had been in abeyance for more than a decade; the authority for a Taiwan-based bank had lapsed in 1972.

A concomitant provision was the announcement of amendments to the Banks (Shareholdings) Act 1972 to allow a single shareholder to hold more than 10 per cent of the shares with the approval of the Federal Treasurer and more than 15 per cent when such a relaxation was deemed in the national interest. Moreover, the Government stated its willingness to relax the 50 per cent upper limit on foreign equity should a proposal for a banking authority be viewed as having significant benefits to the economy.

The loosening of the formerly rigid condition requiring at least 50 per cent local

equity participation can only be understood in terms of the main aim of improved efficiency and competition in the financial sector. Should rigid application of that requirement have risked the absence of a potentially effective new bank then relaxation of the condition restricting foreign ownership was essential. Stimulus to efficiency and competition was more important than the number and ownership of new banks.

Nevertheless the reaction to the decision to invite 16 banks with foreign ties to establish banking operations in Australia, was surprise, if not disbelief, probably not least to some of the successful applicants¹⁷. One explanation for the much greater number than had been anticipated was the quality of the applicants and the likely benefits from their participation in the Australian financial sector.⁽¹⁴⁾ A further consideration was reciprocal access to foreign financial markets by Australian banks; an aspect made specific only in the case of Japan. Of the 16 offers, half involved some Australian equity participation with the possibility of another three introducing local equity once operations were firmly established.

Questions about foreign ownership along with the number of new banks to be authorised were the two dominating issues in the appraisals and critiques of proposals for opening up banking to new participants. Ownership and control of banks has had a lengthy and controversial history in recent decades most of all with the bank nationalisation issues of the late 1940s. Yet the grounds for restraints on ownership have not been clearly specified while empirical evidence for their justification is inconclusive.⁽¹⁰⁾ The provisions in a number of the new banking authorities provided for Australian equity participation. The experiences of the new banks concerned have meant the erosion of this provision. The minority Australian participants in five banks have been bought out by their foreign principals. Hence this reversion to full foreign ownership within a couple of years from entry bears ample witness to the dominance of concerns about competitiveness in banking over issues in ownership including Australian equity participation.

Appendix B: The New Banks

I. The Sixteen Invited Banks

1. Bankers Trust Australia Limited being a wholly owned subsidiary of the Bankers Trust Corporation. Operations commenced on 24 February, 1986.
2. Bank of America Australia Limited is wholly owned by Bank of America N.A.. Operations commenced on 19 May, 1986. Initially G.J. Coles Ltd. held 25 per cent of the equity but this was sold to the parent bank in June 1989.
3. Bank of Singapore (Australia) Limited was a publicly-listed company owned 81 per cent by the Oversea-Chinese Banking Corporation, Singapore. However the company was delisted in April 1989 when the parent OCBC bought out the minority shareholders to secure complete ownership. Operations commenced on 29 May, 1986.
4. Bank of Tokyo Australia Limited being a wholly owned subsidiary of the Bank of Tokyo. Operations commenced on 28 November, 1985.
5. Barclays Bank Australia Limited is a wholly owned subsidiary of Barclays Bank PLC. Operations commenced on 29 November, 1985.
6. CHASE AMP Bank Limited being equally owned by the Chase Manhattan Bank, N.A. and the Australian Mutual Provident Society. Operations commenced on 26 September, 1985.
7. Citibank Limited being a wholly owned subsidiary of Citibank N.A. Operations commenced on 11 December, 1985. A savings bank, Citibank Savings Limited, was also authorised.
8. Deutsche Bank Australia Limited being a wholly owned subsidiary of Deutsche Bank A.G. Operations commenced on 3 February, 1986.
9. HongKongBank of Australia Limited being a wholly owned subsidiary of the HongKong and Shanghai Banking Corporation. Initially there were minority Australian partners but they were bought out in June 1987. Operations commenced on 6 February, 1986.
10. IBJ Australia Bank Limited being a wholly owned subsidiary of the Industrial Bank of Japan. Initially there were minority Australian partners but they were bought out in December 1988. Operations commenced on 18 December, 1985.
11. Lloyds Bank NZA Limited is ultimately owned by Lloyds Bank PLC with the invitation extended to the Lloyds Bank subsidiary, The National Bank of New Zealand Limited. Operations commenced on 10 October, 1985.
12. Mitsubishi Bank of Australia Limited being a wholly owned subsidiary of the Mitsubishi Bank. Initially there were minority Australian partners but they were bought out in June 1989. Operations commenced on 17 January, 1986.
13. National Mutual Royal Bank Limited being equally owned by Royal Bank of Canada and National Mutual Life Association of Australia Limited. Operations commenced on 26 February, 1986. Savings bank authorities were also granted when the National Mutual Permanent Building Society was acquired on 26 February, 1986 and the United Permanent Building Society on 2 March 1987. This

¹⁷ The invitation not taken up was that to J.P. Morgan.

bank was bought by the ANZ Bank in April, 1990.

14. Natwest Australia Bank Limited is a wholly owned subsidiary of National Westminster Bank PLC. Operations commenced on 6 February, 1986.
15. Standard Chartered Bank Australia Limited is a publicly listed company owned 77 per cent by Standard Chartered Bank PLC. Operations commenced on 4 April 1986.
16. The invitation to J.P. Morgan & Company Incorporated to establish a bank was not taken up.

II: Other New Trading Banks

1. Bank of China was authorised to establish a branch bank in Australia by renewing an old banking authority historically held by a Chinese bank which had lapsed in 1972 when an authority held by a Taiwan-based bank was withdrawn. Operations commenced on 16 December, 1985.
2. Macquarie Bank Limited was established out of Hill Samuel Australia Limited. The original British parent company, Hill Samuel, continues to hold 30 per cent equity with 10 per cent voting rights. Operations commenced on 1 March 1985.
3. Primary Industry Bank of Australia Limited was authorised as a trading bank having been previously a special purposes bank owned by the major trading banks. It is in this reincarnation owned by the Rural and Industries Bank of Western Australia (RIBWA). Operations commenced under this new authority on 1 July, 1987.
4. Bank of Melbourne Limited was formerly the RESI-Statewide Building Society in Melbourne. Operations commenced on 1 July, 1989.

III: New Savings Banks

1. Advance Bank Australia Limited was a conversion from the NSW Permanent Building Society. Operations commenced on 1 June, 1985. It has a subsidiary Civic Advance Bank Limited being a former building society registered in the Australian Capital Territory, Civic Co-operative Permanent Building Society. This subsidiary commenced operations on 2 June, 1986.
2. Challenge Bank Limited was created from the merger of the Perth Building Society in Western Australia and the Hotham Permanent Building Society in Victoria. Operations commenced on 21 April, 1987.
3. Metway Bank Limited was a conversion from the Metropolitan Building Society in Queensland. Operations commenced on 1 July, 1988.

IV: New State Bank

1. Tasmania Bank Limited was established through the merger of the Launceston Bank of Savings, which was a trustee savings bank, and the Tasmanian Permanent Building Society. It commenced operations on 1 September, 1987.

Appendix C: Measuring the Impact of New Banks

To understand what the impact of new banks has been, it is necessary to determine just how the banking business of the entrants has grown from the initial base business they brought with them into banking. An assessment of how the twenty-one new banks which entered banking up to June 1989 have performed requires the elimination of this "one-off" transfer of business into banking. By eliminating this effect it is possible to compare the gains or otherwise of the new banks in their efforts to penetrate the banking market.

The procedures applied for reconciling the data for old and new banks in these two tables are readily explained. The initial base business for each entrant is determined by the value of liabilities or assets recorded in each monthly statement on banking statistics reported in the Commonwealth Gazette at the time when commencement of business is first announced. As these statements are averages of weekly returns in the month, the initial base business was determined in the first month for which there appeared to be an average over all the weekly reporting days. The value of that initial base business was then deducted from the reported value of business for subsequent months; for the purposes of this paper June in each of the years shown.

As is evident from the material in Appendix B most of the new banks commenced business in Australia late in 1985 or during the first half of 1986. In one case, the National Mutual Royal Bank, the initial entry in February 1986 was followed by an acquisition in March 1987 so that a double adjustment of the initial base had to be made. Only one old bank, the Launceston Bank of Savings, acquired a non-bank intermediary and a similar adjustment was made to that bank's series for June 1989. The name was changed to Tasmania Bank (TasB) at the time of acquisition, 1 September, 1987.

The effect of this adjustment is to provide one means for comparing how the business of each entrant has grown from inception against the performance of the old banks. With this adjustment the "one-off" impact of transferring business into banking is eliminated. It permits an assessment of just how far the entrants have been able to penetrate the market previously the exclusive preserve of the old banks.

The adjustment may be best understood by examining the procedure applied to one new bank. The National Mutual Royal Bank began on 26 February, 1986. The initial business brought into banking was identified as the Australian assets and liabilities reported for March 1986. These were A\$640 million and A\$806 million for liabilities and assets respectively. Then at the beginning of March 1987 an additional building society was acquired with liabilities and assets of A\$1665 million and A\$1792 million respectively. These starting values, being the measure of business brought into banking, were

deducted from the liabilities and assets of the new group to get an estimate of how much new business was gained after entry. The details of the adjustment are shown in Table C1.

Table C1: National Mutual Royal Bank: Adjustment Procedures

	(A\$ million)	
	Liabilities	Assets
1. Initial Banking Business	2305	2598
2a. Total Business, June 1987	3073	3405
b. Less Initial Business	2305	2598
c. New Banking Business	768	807
d. Adjusted Share %	0.48	0.47
3a. Total Business, June 1989	4133	4531
b. Less Initial Business	2305	2598
c. New Banking Business	1828	1932
d. Adjusted Share %	0.75	0.72

This adjustment is based upon the value of the initial base business of the entrants. It is a most conservative procedure in the sense that it yields the maximum gain to the newcomers. An alternative approach would be to estimate the initial base business not by value but by share of the total business and then to calculate whether or not the share of total business had grown from time of entry to June 1990. However this alternative procedure may be challenged on the grounds that entrants bring value of liabilities and assets into banking not market shares and what happens subsequent to entry with the growth of banking business will reflect the efficiency and skill of each bank. An adjustment based on this alternative approach would, compared with that used in this paper, diminish the impact of the new banks though the difference between the two series is small for the short period under review.

The preferred approach would be to secure an estimate of those liabilities and assets of the predecessor intermediaries later constituting the initial business of the new banks. Most new banks had business activities in Australia prior to authorisation as banks. Moreover some new banks, like many of the old ones, partly or wholly own finance companies and more recently stockbroking firms.

However, compilation of that predecessor business now incorporated in banking activities defies measurement. An accurate compilation of such business would permit the establishment of an adapted market share series from 1984. With such a series the differences between the total Australian banking business and the adjusted series, the latter being the basis in this paper for assessing market penetration, would be avoided. Thus the data on financial intermediation offered in Table 1 provides an alternative general perspective on the impact of the major structural changes in the financial services sector during recent years.

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