

# WORKING PAPERS IN ECONOMICS

NEW BANKS IN AUSTRALIA

by

W.P. HOGAN

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1. Perspective

During the 1980s radical changes were made to the structure of the financial services sector in Australia. Most striking was the reversal of longstanding policies on participation in banking and foreign ownership of banks. While decisions on the entry of new banks were the most important of the many changes invoked in this period no less startling for its impact was the decision to allow incorporated member firms and abandon fixed brokerage fees for trading in equities on the Australian stockmarket.

These remarkable developments drew their impetus, in Australia as with other countries, from those events in the 1970s which saw the abandonment of 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 financial markets were left 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 a number of occasions and are not the province of this contribution.[1,7,12,13]

The initial step within Australia in response to these events was to adopt a managed floating of the exchange rate whereby daily adjustments were made against a trade-weighted basket of currencies.[14] But the decision of far-reaching importance was the establishment of a committee to inquire into the Australian financial system late in 1979. The work of this committee laid the foundations for the subsequent changes made to the structure of, and modes of operation in, the Australian financial services sector.[4]

While the focus of this contribution is on banks, this must not be interpreted as diminishing in any way the importance of other

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1. A shortened version of this paper was presented to the Second Australasian Banking and Finance Conference held in the University of New South Wales on 30 November and 1 December under the title, "The Entry of New Banks in Australia".

developments in the domestic arrangements and foreign connections of Australian financial markets. The Australian foreign exchange market ranks seventh or eighth amongst exchange markets around the world. Nor are transactions confined to trading in the Australian dollar. Third currency trading, mainly in U.S. dollars and another currency, comprised 42 per cent of gross transactions according to the Reserve Bank survey in April 1989.[18] Both the financial futures and equities options markets grew rapidly during the decade, the former with trading links to foreign futures exchanges.[3]

This contribution looks initially to the circumstances leading to the opening up of the Australian financial services sector, to new banks and foreign participation. This is followed by a section which treats the aims of this new programme. Following sections examine the experiences of the new banks directed mainly to an analysis of market penetration and earnings.

## 2. The Setting

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 more familiarly known as the Commonwealth Bank of Australia (CBA). 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.<sup>2</sup>

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) both operating as branches rather than subsidiary companies of their parents. 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 1989.<sup>3</sup>

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

As already mentioned, the establishment of the Committee of Inquiry into the Australian Financial System during 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

2. 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.
3. The Australian Bank was acquired by the State Bank of Victoria in February 1989.

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 business.[4] The effect of the discussions and deliberations reflecting the workings of that Committee was to foster an environment 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.[19] 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.[19,p.71]

It is well to recall the policy environment in December, 1983 when this Report was lodged. Earlier that month the Australian dollar had been floated and virtually all exchange controls on capital flows abolished. New financial arrangements were being implemented so the opening up of banking was just a matter of when and by how much.

Even so it was not until early September 1984 that the Australian Government decided to call applications for new bank authorities from foreign institutions.[9] At the same time the Bank of China was permitted to take up a branch banking authority which had been in abeyance for more than a decade; the authority for a Taiwan-based bank had lapsed in 1972.[10] In the event some 42 applications were submitted in response to this call. It should be understood that domestically-owned intermediaries were able to apply at any time for a banking authority.

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 this context. Should application of that requirement have risked the loss of a potentially effective new bank then relaxation of the condition restricting foreign ownership was essential. In this respect the Government found the arguments of the Campbell Committee more persuasive than those of its own Review Group.[4, paragraph 25.59]

The Government did not indicate how many new authorities would be issued, again a departure from the suggestions offered in the Martin Report. However, the broad impression from the announcement was a need for Australian equity participation and the granting of a relatively modest number of new banking authorities involving foreign participation, perhaps a few more than the upper limit of six suggested in the Martin Report.

Announcement of the successful foreign applicants was not made public until towards the end of February 1985 when some sixteen banking groups were invited to apply for an authority to undertake banking business in Australia.[11] 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 for some of the successful applicants!<sup>4</sup> The list of the sixteen successful applicants to whom invitations were issued is shown in Appendix C along with those other new banks with predominantly Australian ownership. The 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. A further consideration was reciprocal access to foreign

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

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.

While most attention has been given to foreign participation in banking, new authorities were also issued to domestic financial intermediaries wishing to convert their existing activities to banking. Virtually all these conversions were made by building societies. Of the twenty-three new banking groups established in the 1980s, sixteen had foreign connections being the fifteen invited ones and Macquarie Bank which, while being of predominantly domestic ownership, has some 30 per cent foreign equity. Of the other seven, Australia Bank was established ab initio in 1981 and six were formed from one or more building societies.<sup>5</sup> Brief details of the origins of these new locally-owned banks are also shown in Appendix C. 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.

### 3. The Objectives of the New Banks Policy

On the two occasions when the Federal Government announced the calling of applications from potential foreign banking participants and then the successful ones invited to seek banking authorities, there were statements on the purposes to be served by this new banks policy.[9,11]

The two main objectives spelt out in both these statements were stated to be:

5. Another three building societies were absorbed by new and established banks.

- (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.

A more innovative and competitive financial sector was therefore an intermediate target. The ultimate objective was to ensure that producers of goods and services, outside the financial sector, were to be supported in their efforts to expand real output, employment and exports.

Participation by foreign banks in Australian banking was perceived as advantageous because of their "extensive involvement ... in many overseas markets of interest to Australian exporters, while Australia should also gain through the new banks access to the world's major capital markets".[11, p.2] The first point would suggest an emphasis on trade finance and related financial services. The second one - access to capital markets - is a bit of a puzzle as it is not obvious why a trading bank authority would confer advantages of access to foreign capital markets not enjoyed by those foreign banks having merchant banks and representative offices already in Australia.

As mentioned in the preceding section, another aim was to ensure reciprocal access for Australian banks in foreign banking markets, most specifically the Japanese one. The selection of three Japanese banks - Tokyo, Mitsubishi and the Industrial Bank of Japan (IBJ) - was part of extensive negotiations on mutual access to markets.[11,p.3] In an important sense the determination of the number of possible new banks within Australia was linked to "... countries with which Australia has a significant commercial and economic relationship".[9, p.3] Thus authorisation of new banks was tied up with bilateral international negotiations on entry to financial services markets around the world.

If the issues arising over international reciprocity in access to financial markets are straightforward, the same cannot be claimed about the reasons and means for securing the intermediate objective

of an efficient domestic banking market and then, once attained, its reflection in higher output and employment. The two major reports on banking and the financial system - the Campbell Report and the subsequent Report from the Martin Review - broadly reflect a judgement on the need for more competition amongst banks and hence support for new banks being introduced in Australia.

In order to promote this enhanced competition the new banks could be expected to "... undertake a wide range of banking business without requiring that they undertake all of the activities regarded as the general business of banking." [19, paragraph 6.18] This stance from the Martin Review linked the degree of specialisation of an applicant to the deficiencies in particular services within banking. Given this judgement on the basis for promoting efficiency and competitiveness, it cannot be surprising to read also of opposition to any requirement for new banks to develop a branch banking network.<sup>6</sup> Yet all these suggestions do not offer specific points on which to judge whether or not the objectives of the new banks policy are being met.

The Campbell Report offers more guidance. It acknowledges one impact of direct controls on banking being to curtail competition amongst individual banks. Nevertheless the dismantling of those controls would not necessarily ensure a more competitive milieu. The Report hints at the possibility, no stronger than that, of the banks "... conducting relatively high cost operations at relatively generous earnings margins - by international standards." [4, paragraph 25.8] The implication of such a possibility is that banks were operationally inefficient.

The Campbell Committee may well have been cautious in its public commentary. That possibility of operational inefficiency is the

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6. Such a provision would have been startling in light of the restrictions on the two foreign banks with branches in Australia, namely BNP and BNZ, requiring them to get permission from the Federal Treasurer before opening any new branches. [19, paragraph 2.11] The Campbell Report is explicit in making the point that these two banks were discouraged from expanding their retail banking network. [4, paragraph 25.4]

crux of the Committee's argument for the entry of new foreign banks. Only with the entry of such new banks would it be possible to ensure a healthy and vigorous competitive environment in a relatively few years. An entry policy allowing only for new domestically-financed banks might be effective in a much longer time-span. In making that judgement the Committee was explicit in its reasons; "... the small (and declining) number of licensed banks now in existence, their traditional management attitudes, and the difficulties that a new domestic institution may have in breaking into established markets, given the size and cost advantages of existing banks in many areas of activity." [4, paragraph 25.10] Of these three reasons, the second one points to rigidity of bank management and, by implication, inefficiency.<sup>7</sup> Apart from queries about operational efficiency there are also hints of concern about the dynamic efficiency of banks by which is meant capacity to adapt to changes in the available technology, the economic climate and market preferences. [4, paragraph 32.24]

Assessments of the extent to which the objectives of the new banks policy have been met should rest mainly upon evidence on operational and dynamic efficiencies. That evidence would be conveyed in data on the productivity and efficiency of banks, old and new. Cross-section data would permit analysis of propositions about the relative efficiency of domestic and foreign-owned banks. Changes in the measures of efficiency and productivity would give some insight on the responses of old banks to the entry of the new ones.

#### 4. The New Banks' Experiences: Market Penetration

Entry of new banks has changed the pattern of banking activity both in the trading and savings banking spheres. Some of the entrants, such as Citibank, secured authorisations to pursue

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7. The subtlety of the hints in the Campbell Report recall a famous commentary, "... people in monopolistic positions will very often be people with sharply rising subjective costs; if this is so, they are likely to exploit their advantage much more by not bothering to get very near the position of maximum profit, than by straining themselves to get very close to it. The best of all monopoly profits is a quiet life." [5]

both types of 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 data for the four majors combined and all the smaller banks is shown for total Australian liabilities in Table 1 and for total Australian assets in Table 2. 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 are assessed using data at June for 1987, 1988 and 1989 as well as December, 1988.

The interpretation of the data shown in columns 2 to 5 of each table must be understood. Many of the newly-authorized banks already had an established business in Australia through merchant banking activities, 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 a previous incorporation as a building society. 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 the initial base. Details of this adjustment are explained in Appendix A.

The initial base business for each entrant was 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 was first announced. The value of that initial base business was then deducted from the reported value of business for June 1987 and subsequent months listed in Tables 1 and 2.

The effect of this adjustment is to provide a means for comparing how the business of each entrant has grown from inception

Table 1: Australian Liabilities, All Trading & Savings Banks  
(% Market Shares)

Banks	December 1984 (1)	June 1987 (2)	June 1988 (3)	December 1988 (4)	June 1989 (5)
1. Four Majors	80.72	72.83	71.82	71.54	70.28
2. Other Old	19.28	19.80	19.66	19.32	20.16
a. BNZ	0.23	0.85	0.58	1.07	0.98
b. BoQ	0.22	0.18	0.22	0.25	0.27
c. BNP	1.01	0.67	0.57	0.60	0.59
d. AusB	0.47	0.29	0.19	0.18	0.11
e. SBNSW	4.68	4.39	3.88	3.87	4.12
f. SBSA	3.12	3.50	3.85	3.68	3.83
g. RIBWA	1.90	2.25	2.38	2.21	2.39
h. SBVic	6.71	7.16	7.10	7.00	7.43
i. Tas Svg	0.39	0.23	0.22	0.21	0.22
j. TasB	0.35	0.28	0.26	0.25	0.22
3. Total: All Old	100.00	92.63	91.48	90.86	90.44
4. New Banks: All	-	7.37	8.52	9.14	9.56
a. Macquarie	-	0.15	0.21	0.24	0.28
b. Bankers Trust	-	0.51	0.47	0.47	0.46
c. BoA	-	0.07	0.10	0.05	0.06
d. Barclays	-	0.54	0.66	0.67	0.78
e. CHASE AMP	-	0.70	0.81	0.86	1.02
f. China	-	0.02	0.02	0.02	0.03
g. Citibank	-	1.43	1.45	1.45	1.63
h. Deutsche	-	0.15	0.21	0.19	0.14
i. HongKong	-	0.48	0.51	0.64	0.75
j. IBJ	-	0.14	0.20	0.21	0.23
k. Lloyds NZA	-	0.08	0.08	0.11	0.10
l. Mitsubishi	-	0.12	0.19	0.19	0.21
m. NMRoyal	-	0.48	0.65	0.65	0.75
n. Natwest	-	0.97	0.75	0.72	0.57
o. Singapore	-	0.07	0.18	0.21	0.19
p. Standard	-	0.46	0.33	0.22	0.12
q. Tokyo	-	0.22	0.18	0.17	0.25
r. Advance	-	0.67	1.17	1.39	1.35
s. Challenge	-	0.11	0.33	0.53	0.51
t. PIB	-	-	0.01	0.00	0.03
u. Metway	-	-	-	0.05	0.10
5. Total: Old & New	100.00	100.00	100.00	100.00	100.00

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. Did each new bank do much better than hold on to what it brought to Australian banking?

The results shown in Tables 1 and 2 are revealing of sharp differences in performance. The impact on liabilities may be spelt out. Between December 1984 and June, 1989 total banking liabilities in Australia grew from A\$104.7 billion to A\$256.1 billion, this being a rise of 144.6 per cent. But about A\$10.8 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 1989 was A\$140.6 billion, arise of 134.3 per cent. A rise of such magnitude, including A\$23.4 billion for all new banks, should allow a basis for looking at the effects of entry.

With these adjustments it can be seen that the entrants secured 9.56 per cent of the liabilities business quite apart from what they brought with them and slightly more - 9.65 percent - of assets business. This penetration was at the expense of the four major trading banks whose share fell from 80.72 per cent in December 1984 to 70.28 per cent in June, 1989. The other old banks taken together improved their command of the liabilities market by a small margin, from 19.28 per cent to 20.16 per cent. As most new banks came in between late 1985 and mid-1986 the penetration to the extent of nearly 10 per cent should not be dismissed lightly. Some new banks quickly established a foothold, others have not. Amongst the smaller old banks the competitive thrust from entry brought a renewed vigour, most notably some state banks and the Bank of New Zealand."

The estimates for market penetration by new banks in the asset market provide results more or less in keeping with what is

8. In view of the losses recently incurred by the Bank of New Zealand and the State Bank of Victoria, this relative expansion may now be curtailed.

Table 2: Australian Assets, All Trading & Savings Banks  
(% Market Shares)

Banks	December 1984 (1)	June 1987 (2)	June 1988 (3)	December 1988 (4)	June 1989 (5)
1. Four Majors	80.62	73.27	71.49	71.57	70.20
2. Other Old	19.38	19.77	19.54	19.18	20.15
a. BNZ	0.43	0.99	1.00	1.06	0.99
b. BoQ	0.22	0.21	0.24	0.26	0.28
c. BNP	0.98	0.65	0.57	0.58	0.56
d. AusB	0.52	0.31	0.20	0.19	0.13
e. SBNSW	4.84	4.62	4.55	4.48	4.86
f. SBSA	3.07	3.37	3.53	3.41	3.53
g. RIBWA	1.92	2.16	2.23	2.29	2.36
h. SBVic	6.67	6.95	6.75	6.47	7.01
i. Tas Svg	0.38	0.23	0.21	0.20	0.21
j. TasB	0.35	0.28	0.25	0.24	0.22
3. Total: All Old	100.00	93.04	91.33	90.75	90.35
4. New Banks: All	-	6.96	8.67	9.25	9.65
a. Macquarie	-	0.20	0.23	0.30	0.31
b. Bankers Trust	-	0.53	0.46	0.47	0.44
c. BoA	-	0.07	0.10	0.05	0.07
d. Barclays	-	0.47	0.60	0.61	0.73
e. CHASE AMP	-	0.54	0.69	0.85	0.88
f. China	-	0.04	0.05	0.04	0.04
g. Citibank	-	1.33	1.45	1.38	1.62
h. Deutsche	-	0.09	0.32	0.36	0.40
i. HongKong	-	0.46	0.54	0.62	0.73
j. IBJ	-	0.15	0.36	0.24	0.23
k. Lloyds NZA	-	0.09	0.09	0.10	0.08
l. Mitsubishi	-	0.15	0.20	0.22	0.24
m. NMRoyal	-	0.47	0.64	0.65	0.72
n. Natwest	-	0.99	0.89	0.99	0.75
o. Singapore	-	0.08	0.17	0.19	0.18
p. Standard	-	0.46	0.32	0.21	0.12
q. Tokyo	-	0.15	0.15	0.15	0.23
r. Advance	-	0.66	1.15	1.33	1.32
s. Challenge	-	0.03	0.26	0.45	0.44
t. PIB	-	-	0.00	-0.01	0.03
u. Metway	-	-	-	0.05	0.09
5. Total: Old & New	100.00	100.00	100.00	100.00	100.00

found from the liabilities side. As is evident from the series shown in Appendix A the value of assets exceed the value of liabilities in Australian banking business, A\$280.1 billion at June 1989 compared with A\$256.1 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 trading 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. [6,p.8]

Analyses of the adjusted series shown in columns 2 to 5 of Tables 1 and 2 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 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 the columns. In Table 3 an assessment is made of the relative impact of each of nineteen new banks, the fifteen foreign banks which accepted invitations to seek banking authorisations, the Bank of China and the three new domestically constituted banks. The two more recent domestic entrants, PIB and Metway, are excluded. 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 1989 by which time the initial phase of entry was over.

Only four new banks look to have lost their way; these are the ones listed in columns 1 and 2 of Table 3. Seven of these banks, marked by an asterisk in the table, have secured 5 per cent or more of the total adjusted market share secured by the new banks as a

whole. However, Natwest has taken a drop of about 45 per cent in its share of that total between June 1987 and June 1989. Only Citibank and Advance Bank hold more than 1 per cent of the total adjusted banking market in Australia. Furthermore they have in a

Table 3: Market Penetration by Entrants; 1987 to 1989

Not Significant (1)	Decline from Initial Penetration		Sustained (4)	Accelerated (5)
	Much Down (2)	Still Significant (3)		
1. Bank of America	Lloyds NZA	Bankers Trust	Macquarie	CHASE AMP*
2. China	Standard	Citibank*	Barclays*	Deutsche
3. -	-	Natwest*	IBJ	Hongkong*
4. -	-	-	NMRoyal*	Mitsubishi
5. -	-	-	Tokyo	Singapore
6. -	-	-	-	Advance*
7. -	-	-	-	Challenge

Note: (1) No gains from a negligible market share  
 (2) Sharp deterioration to a slender market share  
 (3) Relative decline but share remains substantial  
 (4) Adjusted Market Share at June 1989 higher than at June 1987  
 (5) Adjusted market share at June 1989 15 per cent or more higher than in June 1987.  
 \* Entrants with more than 5 per cent of the adjusted market share held by all new banks at June 1989.

few years secured a market share greater than all the old small banks other than those owned by state governments.

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 point to a very heavy commitment to asset expansion. For Challenge the rapid expansion in housing finance during 1987-88, bolstered by the 50 per cent risk-

weighting under the new capital adequacy provisions, is the most likely one.

These estimates of market penetration should be qualified in one most important respect, namely they reflect banks' performance as measured by balance sheet activities. Yet this decade has witnessed the rapid growth of off-balance sheet exposures mainly the result of the proliferation of derivative instruments such as forward, futures, options and swaps. The nominal value of these exposures are about three times the value of balance sheet activities according to a commentary out of the Reserve Bank.[2] The relative market presence of any one bank must reflect these exposures as well as the conventional measures depicted in preceding paragraphs and tables.

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. Data for two large Australian banks, NAB and Westpac, are shown for 1988 in Table 4. This material is in terms of nominal and risk-adjusted values." Comparisons between the two 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 about one half of that same relationship for Westpac which is over three times. 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 one-quarter for NAB and one-third 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-adjustment values for the "on" and "off" balance sheet items shown in columns 1 and 2.

9. 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 risks.

Table 4: Asset Measures; NAB & Westpac, 1988  
(\$ millions)

	NAB (1)	Westpac (2)
1. Balance Sheet Assets		
(a) Nominal Values	63,800	84,579
(b) Risk-Adjusted	49,500	60,992
2. Off-Balance Sheet Exposure		
(a) Nominal Values	101,600	260,689
(b) Risk-Adjusted	12,000	19,305
3. Total Assets and Exposures		
(a) Nominal Values	165,400	345,268
(b) Risk-Adjusted	61,500	80,296
4. Ratio of Risk-Adjusted Assets and Exposures to Balance Sheet Assets (3b + 1a)	0.964	0.949

Sources: (a) National Australia Bank - data from the 1988 Annual Report, page 9; this data may best be described as a stylised version of the structure of assets and exposures late in 1988.

(b) Westpac - data from the 1988 Annual Report as at 30 September 1988, page 86; data for off-balance sheet exposures is shown there in greater detail.

The significance of the calculations in Table 4 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. If the average for Australian banking is about three times which is what is shown for Westpac, and NAB is much less, then some of the smaller banks could be well in excess of this ratio. Some hints of this possibility may be gleaned from data similar to that for NAB and Westpac on American banks. This is shown in Table 5.

The estimates shown in Table 5 point to a wide range of experiences in the fostering of off-balance sheet exposures amongst U.S. banks. Only with data akin to that for the two Australian banks presented in Table 4 would it be possible to be more certain. However, the substantial differences in nominal values of assets and exposures between NAB and Westpac reduce to a relatively small variation between them when the risk-adjusted assets and exposures are compared with the nominal value of assets; this is shown in Table 4, item 4.

Table 5: Balance Sheet Assets and Risk-Adjusted Assets Plus Exposures, U.S. Banks 1988  
(US\$ billions)

	Total Assets (1)	Total Risk-Adjusted Assets plus Exposures (2)	Ratio 2 + 1 (3)
Citicorp	207.67	242.21	1.166
Chase Manhattan	97.46	103.37	1.061
BankAmerica	94.65	94.25	0.996
J.P. Morgan	83.92	61.86	0.918
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.

That same ratio is measured for major U.S. banks in Table 5. For some banks the value of risk-adjusted assets and exposures exceed by a substantial margin the nominal value of assets; ratios well in excess of unity are revealed for Citibank, Bankers Trust and Manufacturers Hanover. The probabilities are that these three banks have exposures well beyond three times the values of balance sheet assets. Other U.S. banks with that ratio around unity are likely to be somewhat similarly placed.

The point to be made is that subsidiaries and affiliates of these banks in Australia probably reflect similar business strategies. 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.

##### 5. Structure of Liabilities

No less revealing is the structure of liabilities. In Table 6 the proportion of total liabilities held as deposits are shown for the new banks and the summary totals for the four majors and the other old trading banks. This series is based upon the trading banks alone

mainly because most new banks are authorised solely as trading banks and the great bulk of savings banks' liabilities are deposits.

Initially the new banks made few efforts to build a significant deposit base though there were strong exceptions such as the Bank of Singapore which probably reflected the retail banking posture of its parent, the Oversea-Chinese Banking Corporation. Hence the new banks, with very few exceptions, drew funds to support their lending by issuing bills in the money market, funding in foreign capital markets and drawing on their parent banks. This approach to funding assets exposed them to market risk arising mainly from

Table 6: Trading Banks' Liabilities; Proportion of Deposits

	%				
Trading Banks	December 1984 (1)	June 1987 (2)	June 1988 (3)	December 1988 (4)	June 1989 (5)
1. Four Majors	65.9	55.5	48.9	50.1	49.7
2. Other Old	56.2	50.9	49.2	50.1	54.3
3. Total: All Old	64.4	54.7	49.0	50.1	50.5
4. New Banks: All	-	17.8	19.0	32.8	44.9
a. Macquarie	-	27.6	24.3	63.5	45.8
b. Bankers Trust	-	0.6	6.1	36.0	45.1
c. BoA	-	23.1	13.5	64.1	69.5
d. Barclays	-	15.9	18.2	31.7	57.4
e. CHASE AMP	-	31.6	35.3	45.7	46.1
f. China	-	28.9	38.0	29.4	23.6
g. Citibank	-	2.7	5.9	5.6	19.5
h. Deutsche	-	12.1	27.5	37.5	38.9
i. HongKong	-	11.5	12.7	41.3	56.5
j. IBJ	-	3.9	14.2	27.3	31.8
k. Lloyds NZA	-	14.1	11.1	36.4	56.2
l. Mitsubishi	-	27.6	28.4	39.9	60.9
m. NMRoyal	-	12.7	8.9	14.0	44.6
n. Natwest	-	36.9	23.8	23.3	43.8
o. Singapore	-	52.3	57.5	25.7	58.8
p. Standard	-	20.2	24.3	44.0	52.6
q. Tokyo	-	19.0	23.3	51.0	45.0
5. Total: Old & New	64.4	50.5	45.4	48.1	49.8

variability in rates for the Australian dollar. Given those possibilities such banks had to be active in these and other markets to hedge their risks.

Up to the middle of 1988 the Reserve Bank was in a quandary over policies towards the new banks. It wished to ensure that they flourished as trading banks; this meant developing a substantial deposit base in Australia and less reliance on foreign funding. [15,p.34] The then response of the new banks was that such measures were costly.[16, p.32] A proportion of deposits had to be held in a statutory reserve deposit on which a much less than market rate of interest was paid. Furthermore, the new banks had to bid for deposits at full market rates whereas the larger old banks retained a proportion of lower cost deposits, reflecting an advantage of an extensive branch banking network.

The RBA has frowned upon the new banks obtaining guarantees from parent banks for some of their dealing and corporate lending activities, the view being that the new banks should stand on their own positions being separate legal entities incorporated within Australia rather than appear to be branches of the parent bank.[16.pp.32-33] Yet guarantees in some form or other have always been prominent in the workings of merchant bank subsidiaries in Australia. Again the RBA could not press heavily on the new banks without jeopardising their competitive basis because if they were to prosper they could not generate cost disadvantages to benefit their non-bank competitors.

However the statutory reserve deposit(SRD) 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.[17] 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 remove impediments to the competitiveness of banks.

During the past year the new banks have built up their deposits to the point where their liabilities structure with respect to deposits is generally indistinguishable from the old trading banks. However the bulk of these deposits have been secured in the interbank market at rates matching those in the short-term securities market so most new banks may still be at some competitive disadvantage against banks with a branch network. The major exception to this pattern is Citibank. While new banks have been adjusting the old ones, especially the majors, adapted their funding practices quite rapidly particularly with the issuing of commercial bills. Experiences with liabilities management would not suggest an inability amongst the established banks to adapt to changing market conditions.

#### 6. Earnings

Two banks, not yet mentioned, are provocative of questions about banking strategies of entrants. 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. Data on these ratios for most of the entrants and some of the old ones are shown in Table 7.

In this table the same ratios are shown for the merchant bank affiliates of the new banks. The same pattern emerges with the superiority of the affiliates of Bankers Trust Australia and Macquarie Bank most obvious. Given the range of activities pursued by both these new banks, including funds management and stockbroking, there seem good reasons for judging them to be investment houses with a banking authority. In effect they have somewhat similar banking strategies aiming at specific market niches linking corporate banking with funds management and supported by foreign exchange and funding activities.

It would be wrong to attribute the high earnings and market penetration by Bankers Trust Australia, Macquarie Bank and 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. Other entrants had equally long exposures to the practices of the financial services sector with the running of non-bank financial intermediaries. Explanations for their superior performances must lie in other spheres such as professional competence and effective pursuit of well-chosen strategies.

Table 7: Operating Profit to Average Assets, 1988  
(%)

	Bank		Merchant Bank	
	Total Assets (1)	Net Assets (2)	Total Assets (3)	Net Assets (4)
<u>I: New Banks</u>				
Macquarie Bank	2.23	25.3	2.95	37.3
Bankers Trust	2.31	29.6	5.23	95.4
Bank of America	-0.13	-1.4	-0.60	-6.8
Barclays	0.02	0.3	0.75	5.0
CHASE AMP	0.12	1.6	0.11	2.1
Citibank	1.41	13.7	*	*
Deutsche	0.19	1.9	*	*
Hongkong	n.a.	n.a.	1.71	19.4
IBJ	0.63	7.0	0.28	16.0
Lloyds NZA	0.99	10.1	1.82	27.8
Mitsubishi	0.37	4.9	0.10	4.7
NM Royal	0.24	3.5	0.83	7.3
Natwest	-1.05	-15.9	-2.67	-31.3
Standard	0.18	2.1	-1.26	-7.3
Tokyo	0.32	4.1	0.24	4.9
Advance	0.65	9.8	-	-
Challenge	0.74	13.0	-	-
<u>II: Old Banks</u>				
Westpac	0.91	16.6	1.43	27.8
ANZ	0.73	11.7	0.63	18.3
NAB	0.95	14.9	0.58	13.6
Commonwealth	0.58	11.2	0.52	13.7
SBNSW	0.34	5.9	-	-
SBVic	0.52	16.7	0.81	23.2
RIBWA	0.37	8.0	-	-

Source: Peat Marwick Hungerfords, 1989 Financial Institutions Performance Survey, Sydney 1989; pp. 38.

Note: \* Merchant banking activities included in banking activities.

Yet the explanation of superior returns on assets should also be linked to those off-balance sheet exposures treated in the preceding section. On the admittedly limited evidence about such

exposures of U.S. banks shown in Table 5 the two most prominent in 1988 were Citibank and Bankers Trust. Hence the relatively high earnings on assets in their Australian activities probably 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.

Those banks such as Advance, 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.

#### 7. Efficiency

The treatment of the new banks has so far dwelt upon market penetration and earnings. But, as was noted in Section 3, much of the justification for the application of the new banks policy rested upon the stimulus to operational and dynamic efficiency being imparted by their introduction 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. 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 asset values and net worth are avoided.

Productivity is addressed by a measure which reflects the valued added in banking. The particular measure is the ratio of operating income to operating expenses. Again it reflects the expenses or costs required to generate an operating income. With this approach the relative distribution of business on and off balance sheet is set aside. The actual measures used in these two compilations for examining efficiency and productivity are set out in Appendix B.

Data for many old and new banks is set out in Table 8 for the two years 1987 and 1988 where there is sufficient material to treat many entrants. The productivity measures show a fairly uniform result in 1988 across the old banks with the exception of the Australian Bank (AusB) which in many respects should be treated as a new one. The contrast with the array of new banks is vivid. Amongst that group the variability is surprising with some such as Citibank and IBJ recording performances well ahead of their peer group as well as the old banks. Yet more than half the newcomers were performing below the levels attained by the old banks.

The estimates of simple and weighted means for the two groups are revealing of superior performances by the old banking group. Measures for two years do not allow much perspective on the responses of the old banks to the entry of many newcomers. However the weighted mean estimates point to positive responses by the older banks in terms of efficiency and productivity. This phenomenon along with what was observed with liabilities management points toward dynamic efficiency gains by most old banks responding to the heightened competition.

Performances recorded by the new banking group offer little evidence of progress after the experiences with initial entry. Many entrants are relatively small, a feature noted in Table 3, though clouded by the lack of information on off balance sheet exposures. However, many of the new banks are faltering in their efforts to gain a position in banking business.

However, competitiveness with its reflection in efficiency and productivity is not determined by groups of banks, rather it is the individual newcomers which challenge the older banks. On these measures the strongest contender is Citibank despite even higher measures recorded by a couple of the smaller newcomers. With Macquarie Bank and Bankers Trust, the results confirm the judgement that much of their balance sheet profitability noted in Table 7 reflected off balance sheet exposures. With both these banks productivity is akin to that of the four major trading banks while efficiency remains higher reflecting the particular market strategy each has fostered.

Advance Bank exhibits the characteristics of the old banks in productivity and with efficiency the state banks being the last three recorded old banks in Table 8. There are two explanations for the relatively weak efficiency of the state banks and the Commonwealth Bank. The first is that those banks are ones with large savings banking functions with a mass of small accounts as measured by the balances held in them. This feature is labour intensive reflecting the costs of servicing this mass of small accounts. The alternative explanation is that the productivity of these banks is extracted by the staff mainly through over-manning of positions. In effect union demarcation and staffing claims have no counter-weight in claims of shareholders. This alternative explanation gains weight from the comparable performance of Advance Bank just three years after conversion from a building society and exhibiting the characteristics of a savings bank.

In summary efficiency and productivity improvements have been recorded by the old banks. Given the two years for which these measures apply not too much can be made of the impact of the newcomers. However those gains against the stagnation for the new banks as a whole does suggest that the positive responses amongst most old banks reflected influences beyond broad market influences affecting all banks. Nevertheless a few new banks are exhibiting levels of efficiency and productivity well beyond those found in the old banks.

Table 8: Efficiency and Productivity, 1987 &amp; 1988.

Banks	Operating Profit to Operating Expenses Ratio (%)		Productivity (%)	
	1987	1988	1987	1988
<b>I. Old</b>				
ANZ	19.5	21.7	149.1	141.2
Commonwealth	13.0	16.5	125.0	140.2
NAB	25.2	26.2	146.4	150.1
Westpac	20.5	28.3	138.5	151.3
BoQ	17.4	19.9	133.0	138.3
AusB	2.2	4.0	105.3	109.8
SBNSW	11.0	13.3	132.6	139.9
RIBWA	15.5	17.5	130.8	135.1
SBVic	16.5	19.1	129.7	140.1
Simple Mean	15.6	18.5	132.3	138.4
Weighted Mean	18.9	23.0	139.0	145.3
<b>II. New</b>				
Advance	19.3	18.6	137.5	140.4
Challenge	-	15.3	146.4	126.9
Macquarie	35.4	37.9	141.9	152.6
Bankers Trust	51.1	30.3	177.9	149.4
BoA	10.2	-4.0	120.6	95.6
Barclays	11.5	0.5	122.0	101.7
CHASE AMP	0.4	5.3	100.4	105.1
Citibank	19.3	54.0	196.3	199.7
Deutsche	7.5	13.6	107.7	126.5
IBJ	62.0	86.3	191.6	231.1
Lloyds NZA	32.8	45.0	169.9	175.8
Mitsubishi	17.1	32.7	139.5	157.0
NM Royal	4.5	5.8	105.1	107.2
Natwest	-7.9	-21.1	90.5	79.5
Standard	25.4	6.7	137.2	106.7
Tokyo	23.9	17.1	149.1	130.3
Simple Mean	20.8*	21.5	139.1*	136.6
Weighted Mean	16.8*	16.4	135.0*	129.9

Source: The explanation of the compilation of this table is treated in Appendix B.

Note: \*Excluding Challenge Bank.

### B. Banks and the Stockmarket

At the same time as domestic banking was being opened to newcomers and remaining barriers to international financial transfers were abandoned, the stockmarket was subject to major reconstruction with the abandonment of fixed commissions in equities markets and prohibitions on incorporation of member firms. These changes were initiated from the beginning of April 1984.

The impact of these changes is depicted most summarily in Table 9. Undoubtedly the structural change in membership arrangements was made easier by the expansion in equities turnover from 1984 to late 1987. That doubling of turnover in two successive years more than made up for the reductions in unit brokerage charges following the abandonment of fixed commissions. That same phenomenon may well have clouded the judgement of many financial intermediaries including banks, who bought into and then incorporated member firms. Moreover the explosive growth in trading on options and financial futures markets from 1985 would have further bolstered the earnings of the newly incorporated broking firms.

Table 9: Australian Stockmarket; Activity and Structure

Year ended 30 June	Value of Turnover Equities		Member Firms			Firms' Employees
	Total \$bn	Corporate	Partner- ships	Total		
1983	6.7	14.1	-	107	107	2804
1984	12.4	30.6	-	105	105	3383
1985	15.4	50.6	25	80	105	3987
1986	31.4	71.8	48	53	101	4808
1987	60.5	112.9	76	38	114	7182
1988	68.2	107.5	88	24	112	7102
1989	49.5	62.9	97	7	104	6023

Source: Australian Stock Exchange, Annual Reports; 1986-87, 1987-88 and 1988-89.

In five years the traditional natural persons partnership has nearly been swept away though its apparent demise can be exaggerated. One of those partnerships remains amongst the leading broking houses. Moreover some partnerships chose to incorporate without changing significantly the ownership of the broking firm. This seems true for about 25 incorporations.

Since October 1987 member firms have been strained by the problems arising from the fall in market turnover, most obviously declining earnings. The critical feature is the market concentration

of the past two fiscal years. In 1986-87 the ten leading firms held 54.24 per cent of the turnover, some 104 firms shared the rest. In 1987-88 the share held by the leading ten jumped sharply to 65.41 per cent leaving 35.59 per cent for the remaining 102 firms. By 1988-89 the share of the leading ten was slightly down to 62.77 per cent with 94 firms having 37.23 per cent. Most member firms have endured harsh trading conditions over the past two years even though market share is not necessarily a guide to profitability. Institutional business largely determines market share and that has meant slim brokerage margins and exposure to the risks of principal dealing commonplace.

While the Australian Stock Exchange does not list the ten leading firms, an unofficial though informed commentary provides insight; this is shown in Table 10. Six of these firms are owned outright by banks authorised to conduct business in Australia. They are shown with their broking subsidiary depicted in brackets according to the ranking in Table 10 as follows:

Natwest Australia (1), Westpac (3), ANZ Bank (5), Deutsche Bank (7), Barclays (8) and Macquarie (10).

Table 10: Leading Ten Broking Firms, 1988-89.

Firm	Rank	Market Share %
County NatWest	1	10.15
McIntosh	2	7.75
Ord Minnett	3	7.42
Potter Partners	4	6.82
ANZ McCaughan	5	6.73
J.B. Were	6	5.80
Bain and Co.	7	5.35
BZW Meares	8	5.05
Potts West	9	4.40
Macquarie Equities	10	3.30

Source: Australian Financial Review; 12 October 1989, p. 88.

Of the other four, McIntosh is linked to Security Pacific which is not an authorised bank in Australia and Potter Partners has ties with S.G. Warburg. Were and Potts West are Australian member firms with the latter still a natural persons partnership.

Thus six of the fifteen authorised banks having equity links to broking forms, as listed in Appendix D, enjoy relatively strong positions in broking and related activities. But, as in other stockmarkets a bank affiliation is no guarantee of market standing or profitability. In contrast some independent broking firms have been able to match or better their bank-affiliated rivals.

## 9. Summary

Some observations can be offered on the workings and effects of the new banks policy inaugurated in 1985. On policy, 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. The grounds for restraints on ownership have not been clearly specified while empirical evidence for their justification is inconclusive.[8] 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 four 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.

Some tentative points may be made about recent Australian experiences after the radical changes in banking inaugurated during 1985. With securitisation of many banking assets, epitomised by the proliferation of markets for derivative instruments, banking is being increasingly dominated by professional skills rather than 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. Skill rather than size looks to dominate such markets more so than hitherto.

In retail banking a critical mass is deemed essential for the efficient management of liabilities and assets portfolios and the development of markets in related financial services. Most newcomers on the Australian scene are still struggling. With Advance Bank exhibiting most evidence of capacity to secure a firm position even if on a regional rather than a national basis, the emphasis on scale may be exaggerated. Certainly this possibility arises with the relative success of Advance Bank when measured against similar old banks, especially those owned by Australian governments.

What has been witnessed with banking and broking in Australia do 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 for reasons already mentioned. Others have a tenuous hold in banking and even more so with broking. Most foreign entrants appear to rely upon trade and payments connections out of their international banking networks and, in some cases, access to capital markets in the home country of their parent bank.

Locally-based newcomers are not apparently intimidated by the market presence of these large international banks. This is most evident with the performance of Macquarie Bank. Thus one of the major arguments for the entry of foreign banks offered by the Campbell Committee, to which reference was made earlier, seems to have been too pessimistic. Within broking Wern maintains its standing while independent of ties to domestic or foreign banks and investment houses.

Although data on operational and dynamic efficiencies within banking are scant and limited to the observations over two years, a tentative appraisal does not suggest consistent weakness amongst the old banks, far from it. The major trading banks have recorded efficiency and productivity gains at a rate enjoyed by few new ones. The efficiency gains are being made and this may reflect responses to the claims of new banks. On the available evidence Citibank

as the main contender to challenge the standing of the large old banks in Australian banking.

Judgements about the banking industry are handicapped by the lack of public information. Despite the newly-instituted requirements for risk-adjusted capital adequacy measures, data on off-balance sheet exposures are not available for most banks. Those exposures are as important a measure of each bank's activity as the balance sheet items. The authorities supervising the banking industry could be expected to collect monthly data on these exposures for each bank just as they have for balance sheet items over many decades. Without such information assessments of market performance by individual banks are partial. Analyses of the impact of the startling changes witnessed in this decade are handicapped by the failure to make public the off-balance sheet exposures.

Appendix A: 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 basis for reconciling the data for the old banks with that for the new ones is set out in Tables A1 and A2 which list the Australian liabilities and assets at December 1984 and June 1989.

The procedures applied 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 June, 1989.

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

Table A1: Australian Liabilities, All Trading & Savings Banks

Banks	December 1984		June 1989			
	\$m (1)	% (2)	Original \$m (3)	Series % (4)	Adjusted \$m (5)	Series % (6)
1. Four Majors	84542	80.72	172289	67.28	172289	70.28
2. Other Old	20199	19.28	49586	19.36	49417	20.16
a. BNZ	449	0.43	2401	0.94	2401	0.98
b. BoQ	227	0.22	653	0.25	653	0.27
c. BNP	1055	1.01	1444	0.56	1444	0.59
d. AusB	488	0.47	277	0.11	277	0.11
e. SBNSW	4899	4.68	10104	3.95	10104	4.12
f. SBSA	3272	3.12	9390	3.67	9390	3.83
g. RIBWA	1995	1.90	5853	2.29	5853	2.39
h. SBVic	7032	6.71	18217	7.11	18217	7.43
i. Tas Svg	412	0.39	528	0.21	528	0.22
j. TasB	370	0.35	719	0.28	550	0.22
3. Total: All Old	104741	100.00	221875	86.65	221706	90.44
4. New Banks: All	-	-	34198	13.35	23430	9.56
a. Macquarie	-	-	942	0.37	682	0.28
b. Bankers Trust	-	-	1154	0.45	1139	0.46
c. BoA	-	-	505	0.20	159	0.06
d. Barclays	-	-	2006	0.78	1905	0.78
e. CHASE AMP	-	-	2639	1.03	2494	1.02
f. China	-	-	72	0.03	70	0.03
g. Citibank	-	-	4286	1.67	4002	1.63
h. Deutsche	-	-	368	0.14	351	0.14
i. HongKong	-	-	2143	0.84	1838	0.75
j. IBJ	-	-	600	0.23	556	0.23
k. Lloyds NZA	-	-	810	0.32	252	0.10
l. Mitsubishi	-	-	542	0.21	505	0.21
m. NMRoyal	-	-	4133	1.61	1828	0.75
n. Natwest	-	-	1413	0.55	1400	0.57
o. Singapore	-	-	500	0.20	475	0.19
p. Standard	-	-	730	0.28	287	0.12
q. Tokyo	-	-	631	0.25	602	0.25
r. Advance	-	-	5589	2.18	3313	1.35
s. Challenge	-	-	2927	1.14	1257	0.51
t. PIB	-	-	808	0.32	74	0.03
u. Metway	-	-	1400	0.55	241	0.10
Total: Old & New	104741	100.00	256073	100.00	245136	100.00

Table A2: Australian Assets, All Trading &amp; Savings Banks

Banks	December 1984		June 1989			
	\$m (1)	%	Original	Series	Adjusted	Series
			\$m (3)	% (4)	\$m (5)	% (6)
1. Four Majors	88357	80.62	187919	66.92	187919	70.20
2. Other Old	21236	19.38	54127	19.28	53948	20.15
a. BNZ	475	0.43	2660	0.95	2660	0.99
b. BoQ	245	0.22	740	0.26	740	0.28
c. BNP	1068	0.98	1491	0.53	1491	0.56
d. AusB	573	0.52	353	0.13	353	0.13
e. SBNSW	5299	4.84	13006	4.63	13006	4.86
f. SBSA	3362	3.07	9447	3.36	9447	3.53
g. RIBWA	2107	1.92	6329	2.25	6329	2.36
h. SBVic	7305	6.67	18771	6.69	18771	7.01
i. Tas Svg	419	0.38	560	0.20	560	0.21
j. TasB	383	0.35	770	0.27	591	0.22
3. Total: All Old	109593	100.00	242046	86.20	241867	90.35
4. New Banks: All	-	-	38760	13.80	25821	9.65
a. Macquarie	-	-	1134	0.40	828	0.31
b. Bankers Trust	-	-	1311	0.47	1188	0.44
c. BoA	-	-	573	0.20	182	0.07
d. Barclays	-	-	2160	0.77	1955	0.73
e. CHASE AMP	-	-	2631	0.94	2357	0.88
f. China	-	-	153	0.05	96	0.04
g. Citibank	-	-	4885	1.74	4343	1.62
h. Deutsche	-	-	1137	0.41	1081	0.40
i. HongKong	-	-	2331	0.83	1943	0.73
j. IBJ	-	-	694	0.25	603	0.23
k. Lloyds NZA	-	-	837	0.30	208	0.08
l. Mitsubishi	-	-	707	0.25	642	0.24
m. NMRoyal	-	-	4531	1.61	1932	0.72
n. Natwest	-	-	2155	0.77	2015	0.75
o. Singapore	-	-	542	0.19	483	0.18
p. Standard	-	-	855	0.30	318	0.12
q. Tokyo	-	-	691	0.25	610	0.23
r. Advance	-	-	5980	2.13	3521	1.32
s. Challenge	-	-	3082	1.10	1175	0.44
t. PIB	-	-	883	0.31	88	0.03
u. Metway	-	-	1488	0.53	253	0.09
5. Total: Old & New	109593	100.00	280806	100.00	267688	100.00

"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 central question as to whether each new bank did much better than hold on to what it brought into Australian banking may be answered from the adjusted series (columns 5 and 6) of Tables A1 and A2. A negative value means that the entrant did not hold onto its initial position. Improvement on what it brought to Australia banking is measured for its extent by the positive value and share recorded in columns 5 and 6.

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 A3. The entries in rows 3a, c and d are the same as entries in Tables A1 and A2 for row 4m, columns 3, 5 and 6.

Table A3: 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 1989. 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 is to secure an estimate of those liabilities and assets of the predecessor intermediaries later constituting the initial business of the new banks. Nearly all the new banks had business activities in Australia prior to authorisation as banks; witness the number of new banks with merchant banking subsidiaries and affiliates disclosed in Table 3. Moreover some new banks, like many of the old ones, partly or wholly own finance companies and more recently stockbroking firms. Few new banks entered Australian banking without substantial prior participation in Australian financial markets.

However, compilation of that predecessor business now incorporated in banking activities has defied measurement to this point. But 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.

### Appendix B: Measuring Efficiency and Productivity

Two measures are employed in this analysis one being based upon the ratio of operating profits to operating expenses as a measure of efficiency and the other being a productivity measure expressed as operating income in relation to operating expenses. Both measures avoid the problems arising with measuring assets when so much banking business is conducted off the balance sheet.

The actual ratios measured are based upon data provided in the Peat Marwick Hungerfords 1989 Financial Institution Performance Survey (Sydney, 1989; pp. 38). In this Survey the following definitions apply:

- (a) Operating Profit is after tax or tax equivalent and before minority interests and extraordinary items;
- (b) Operating Expenses are total expenses less interest expense and doubtful debts expense;
- (c) Productivity is operating income as a percentage of operating expenses; and,
- (d) Operating Income is defined as net interest income plus other operating income less doubtful debts expenses.

While these measures may be subject to some variation between banks as the accounting procedures are not completely uniform, they provide a useful guide to relative performance.

In the Survey data is directly available on productivity and operating profit. The remainder of the data is derived from various ratios offered in that Survey. The estimate of Operating Expenses is derived from two ratios Operating Profit/Average Total Assets and Operating Expenses/Average Total Assets with Operating Profit directly given. With that information on Operating Expenses it is then possible to derive the two components of the Productivity measure. This was necessary to weight the contribution of each bank to a weighted mean.

Appendix C: 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. though the original proposal was for Australian minority participation. Operations commenced on 19 May, 1986.
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.
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. (This new bank is not covered in this review.)

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 D: Banks and Stockbrokers

I: Authorised Banks' Affiliations with Member Firms

Bank	Firm	Ownership Ties %
1. ANZ	ANZ McCaughan	100
2. National Australia	A. C. Goode	100
3. Westpac	Ord Minnett Paterson Ord Minnett	100 50
4. New Zealand	BNZ Norths	100
5. SBNSW	First State Securities	100
6. SBVic	Burdett, Buckeridge and Young	50
7. Macquarie	Macquarie Equities	100
8. Bankers Trust	BT Stockbroking	100
9. Barclays	BZW Meares	100
10. Citibank	Citicorp Scrimgeour Vickers Australia	100
11. Deutsche	Bain	50
12. HongKongBank (through Wardleys)	James Capel Australia Hartley Poynton Nevitts Phillips Henderson Ward Shadforth	100 50 50 50 50
13. Natwest	County Natwest	100
14. Singapore	BOS Stockbroking	49.9
15. Standard Chartered	Pring Dean	50

II: Foreign Banks Not Authorised Banks in Australia

Bank	Firm	Ownership
16. CIBC	D & D Tolhurst	50
17. Credit Lyonnaise	CL-May Mellor Laing Cruickshank	100
18. Lambert	BBL-Mullens	100
19. Midland	Dominguez Barry Samuel Montagu	100
20. Security Pacific	McIntosh Hamson Hoare Govett	41
21. Societe Generale	Kyle Securities	75

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