

# HIGH *anxiety*

*In the rush to 'microeconomic reform' the public sector is undergoing a seachange. The role of public enterprises is up for grabs. Here Ian Rogers says farewell to the state banks of yore, but Steve Rix argues that making the public sector more efficient isn't enough.*



## STATE OF SHOCK

*Ian Rogers argues that, following the disasters in Victoria and South Australia, the days of the state banks may be almost over.*

**O**ne state bank has disappeared. Another has suffered astronomical losses, others are struggling with poor profits. Governments are reluctant to inject new capital to cover the damage. Do we really require state banks any more?

Australia's savings crisis has eroded confidence in an array of lesser rated financial institutions. Poorly supervised non-bank financial institutions collapsed, such as the Farrow group of building societies and the OST Friendly Society.

The biggest catastrophe was the collapse of the country's fifth largest bank—the State Bank of Victoria—in August 1990. Over the following months, state governments discovered the huge loss at the State Bank of South Australia, and confirmation of hard times at the R&I Bank in Western Australia, the State Bank of NSW, and of the Tasmania Bank. We have to ask: what are state banks for?

Established in the pre-war period, state banks had a dual role: to overcome the perceived hostility of the establishment banks to the aspirations for state-controlled development and to channel capital to housing and small business. After some trauma in the Depression years, the

state banks gathered consumer confidence, built a healthy share of the retail market, and dozed along as part of the easy oligopoly with the major banks. The state banks carved out a solid, sometimes large, share of deposits in their home states and built a solid loans book weighted towards home loans. Whatever the state bank's success in this area, their role changed radically in the last dozen years.

The realignment began with the NSW Labor government's decision to restructure the then Rural Bank of NSW as the State Bank of NSW and to begin reorienting this rural/small commercial bank towards main street, retail banking in the cities and a more aggressive approach to lending under the direction of Nick Whitlam.

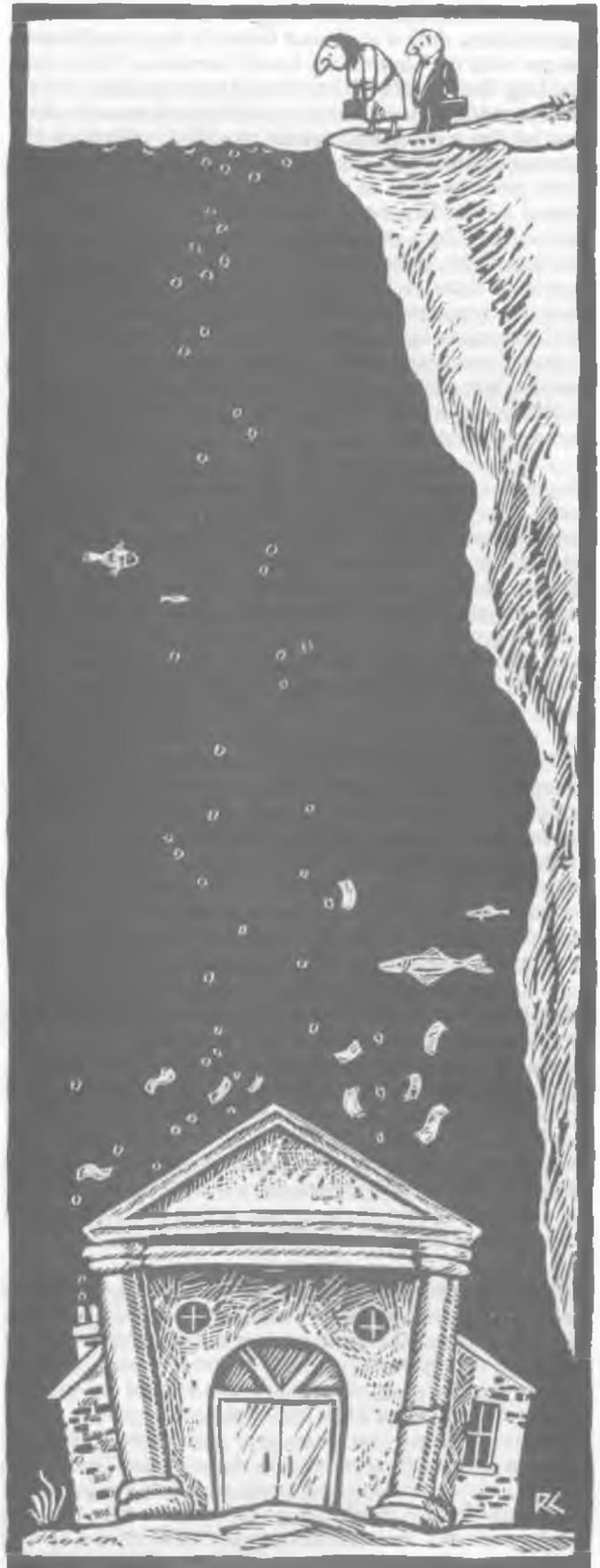
The new strategy helped the State Bank of NSW to tap the relatively cheap deposit base which sustains the major banks, and ultimately led to the bust up with the Commonwealth Bank and the abolition of the "savings bank" agreement in 1987. (This agreement followed the Commonwealth Bank's rescue of the then Savings Bank of NSW in 1929. The agreement prevented the NSW bank from operating in the savings bank area, while the Commonwealth Bank was obliged to pay half its savings bank profits in NSW to the Rural Bank.)

The Campbell inquiry into Australia's financial system signalled the beginning of dramatic changes to Australia's financial system, with deregulation finally introduced by the federal Labor government from 1983-85. With the major banks gearing up for deregulation, and with foreign banks soon to open, the management of state banks, and their state government owners moved to revamp their banks to keep them competitive in the new environment. Thus South Australia merged its state-owned savings and State Bank to create the beast that Timothy Marcus Clark, in conjunction with the Adelaide establishment, dragged to its knees.

The State Bank of South Australia bought finance companies, stockbrokers, merchant banks and even a New Zealand building society in its quest for greatness. State Bank Victoria acquired Tricontinental merchant bank with its independent board and ambitious managing director who, over five years, lumbered the government of Victoria with \$3.5 billion in bad debts. Western Australia revamped its Rural and Industries Bank, saddled it with an insolvent credit union, brought in private equity capital and set it loose on the world.

The state banks of NSW, Victoria, South Australia and Western Australia then fell over each other to mix it in the big time, opening offices or branches across South East Asia, Europe and North America. Lending boomed, with most of the asset growth coming from corporate transactions, steering the banks away from their residential base, while any slack in deposit growth was overcome by raising expensive, short-term deposits offshore.

Tasmania didn't have a state bank until 1987 when the Liberal government of Robin Gray bullied the Launceston Bank for Savings (a trustee bank, a beast peculiar to Tas-



mania, rather like a building society without any shareholders, only a bank and federally regulated) into a merger with the Launceston-based Tasmanian Permanent Building Society. The Hobart-based Savings Bank of Tasmania (another trustee bank) which had the sense to keep clear of the merger last month moved to take over the Tasmania Bank, with the government ploughing the purchase price back in as new capital, while Paul Keating offered a little largesse in the form of paying back some state debt." Gray recruited a former deputy managing director of the State Bank of NSW to head up the new Tasmania Bank, who promptly dragged the Tasmania Bank into syndicated lending, picking up small slices of big time corporate loans originated by his former mates in Sydney. Tasmania's losses may have been small by comparison, but still regrettable compared with the largely unblemished record of the two institutions which merged to make up the bank.

Queensland, so far, has escaped the ignominy of a "state bank". The Bank of Queensland, although 45% owned by the Queensland government, is really a private bank, and relatively unimportant, even in the Queensland banking market. However, the government of Queensland owns the Suncorp Building Society, part of the Suncorp insurance group. So far, Suncorp has stuck to its core business. The 1990 savings crisis helped Queensland Premier Wayne Goss get cold feet over his pledge to create a state bank.

In 1991 the position of the state banks is not a very encouraging one. They have lost some of the confidence critical to the fabric of the financial system and may have destroyed whatever role they could fulfil. Perhaps the state banks provide the only real competition to the oligopoly of the four majors. This is the principal argument advanced by State Bank of NSW managing director John O'Neill, citing the poor record of the foreign banks since they opened for business in 1985 and 1986.

Alas, John, that simply isn't true. Some foreign banks have been a success; even in the difficult retail market the major banks have worked so hard to protect. Citibank, Barclays, Chase AMP and National Mutual Royal Bank (now owned by ANZ) all made inroads into different niches of the banking market where many middle class and some not so middle class customers stood to gain from their entry. One of the benefits of foreign bank entry was to impose a degree of honesty in the structure and marketing of bank products to household savers.

With the entry of foreign banks, John O'Neill and all the rest were forced to state accurately the true yield on deposits instead of simple interest rates, to pay higher (if not high enough) interest rates on smaller accounts and follow the foreign banks in the move toward the calculation of daily interest. State banks played no part in any of these innovations—for years they had joined in the con trick on bank customers with the major banks. The truth is that building societies and credit unions have provided more competition in retail financial services than the state banks ever did. Perhaps lending activities offer a special role for state banks?

John Bannon seems to think he can save the State Bank of South Australia by retreating to its home base and focusing on smaller loan accounts, mainly housing, personal loans and some business lending. Sadly, John Bannon and the other state banks which are trying to do much the same thing have a problem.

Westpac, and all the major banks, think housing lending is just the go for the 1990s—or the next few years at least. With fewer bankable business loans to consider in the trough of a recession, the housing market is one of the few solid areas of growth. Because they strayed from their core business seven years ago, state banks may have destroyed whatever special franchise they once had in home building. More seriously, the savings crisis may have undermined the public's confidence in the state banks as deposit taking institutions. The mini runs on the Bank of Melbourne, Metway Bank, Tasmania Bank and the State Bank of South Australia demonstrate considerable nervousness about the home of household savings.

Despite the Reserve Bank's obligation to protect the interest of depositors (note carefully: deposits are not guaranteed), all banks aren't the same. In a "flight to quality", meaning safety, over the last half of 1990, deposits poured into the four major banks. Thus if the state banks lose their special capacity to raise cheaper deposits as "government guarantees" turn into amusing works of fiction, the state banks will have to compete with every other deposit-taking institution, offering higher rates to compensate for the perception of increased risk. That penalty on deposits wipes out the advantage the state banks may have had in cost of funds, and so wipes out any advantage they may have had on offering slightly cheaper mortgages.

Goodbye socially useful housing lending. Even if state banks could find a niche in housing lending and regain the confidence of depositors, it is perhaps time to acknowledge state governments shouldn't waste their time, or at any rate new capital, by encouraging the state banks in that area. This isn't because state governments shouldn't help leverage people into housing: they should. It's just that state governments in the last few years have discovered a much smarter means of doing so.

A little noticed development in housing finance over the last five years is that state governments have developed exciting alternatives for getting low income earners into private housing with private finance. For example, the NSW government-run Home Fund is the sixth largest lender for housing in Australia, outgunned by only the four major banks and the St George Building Society, and that gap is closing fast.

Thanks to the initiative of NSW Housing Minister Frank Walker in the mid-80s and with the work of bright bureaucrats in the Housing Department, the NSW government plans to lend \$1.5 billion to moderate and low income earners in 1990-91. The money is raised from professional investors (superannuation funds, life offices and the like) using a technique known as 'securitisation' by a part government-owned outfit called Fanmac which then lends

the money through Co-operative Housing Societies under terms and conditions set by the government.

The loans typically have fixed interest rates for an extended period, low deposit and low repayments over the early years of the loan. The objective has been to maximise borrowing power for low-income earners, using the credit support of the state and a minimum of on-budget subsidies to get borrowers into private housing. Although the scheme has some drawbacks, they typically allow marginal and low-income earners to borrow roughly twice as much as they could from a conventional bank loan and offer the certainty of repayment over the first ten years of the loan, eliminating the effects of changes in interest rates.

Other states have run similar programs, although on a smaller scale than NSW and with somewhat different conditions. Victoria, which has been lending \$300 million a year under a different scheme, late last year adopted the NSW model and expects to lend \$750 million in 1991.

With low income borrowers better serviced by these schemes, there isn't much of a social role in housing finance left for the state banks, dependent on short term deposits and hostage to fluctuations in interest rates. Perhaps, then, state banks have a role in venture capital, or providing finance for new and small business ventures, an area of the

Australian capital market which is hopelessly underdeveloped.

However, venture capital is also very hard work and very risky, as recent experience once again shows. Any deposit taking institution that becomes too heavily involved lending in this area risks losing depositor support and probably doesn't deserve the title 'bank'.

Should the state banks be sold? The Commonwealth Bank has already snapped up the sanitised portion of State Bank Victoria for a bargain \$1.6 billion (remember it bought NSW's first attempt at a state bank in 1929). The merger of the Commonwealth Bank with all the state banks has periodically been canvassed in Left circles in recent years, mainly as a way of ensuring the existence of a viable, strongly capitalised government owned bank. Last year's policy failure that allowed the federal government to announce the partial privatisation of the Commonwealth Bank without any examination of the merits—and particularly the finances—of that proposal rules out the prospect of friendly mergers with state-owned banks for the time being. An independent merger of all the state banks is also unlikely. Parochial considerations and the problem of the 'sovereign' guarantees make that unviable.

This leaves an expansion into other financial services as about the only area left for the state banks to participate in. A more broadly-based state government-owned financial services company would potentially have a stronger capital base and greater customer confidence. One solution to the dilemma of state banks may be to merge with state government's state insurance offices. The trend in other industrial economies is for bank and insurance companies either to merge or to compete in each other's traditional market.

As a result of the treasurer's repudiation of the ANZ-National Mutual Life merger last year, grand alliances of established providers of financial services fall outside current policy. However, state governments could easily merge their state banks and state insurers. This would create state-owned financial companies that were in touch with the evolution of the +financial marketplace, as the build-up in industry superannuation and changes in retirement benefit policies channel savings away from the traditional banking sector. It might also produce state bank/insurers with the financial strength and the will to begin investing in the longer term projects of which orthodox institutions remain wary.

The NSW government-owned GIO Australia is courting a building society in Western Australia, has aggressively moved into other state insurance markets, and has publicly declared its desire "to be privatised as a bank". Victoria is attempting to privatise its State Insurance Office to help cover the Tricontinental debt. The Queensland government insurance office, Suncorp, already owns a building society. State governments and their banks had better be quick: they have nowhere else to go.

IAN ROGERS recently left the *Australian Financial Review* to join the electorate staff of Senator Bruce Childs.

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