Briefing Note

The Proposed Privatisation of the State Bank of NSW: Background Issues

by

Jan Newby

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1 OUTLINE

Since 1988 there has been discussion about the future of the State Bank of New South Wales. In April 1990 'it was reported that Bankers Trust Australia had prepared a valuation on the State Bank of New South Wales and that this was the third in the past two years'[1]

In preparation for this eventuality, the State Bank of New South Wales was corporatised by the *State Bank (Corporatisation) Act, 1989.*

On 25 November, 1993 the Premier of New South Wales announced plans for the Government to sell its interest in State Bank of New South Wales by restricted trade sale, excluding the four Australian nationally operating banks.

The Government's preferred terms for the sale are:

- Overall retention of the existing staff and branch structure
- The bank's headquarters to remain in Sydney
- The bank to remain a viable independent entity

In the Governor's Speech at the opening of the fourth session of the fiftieth Parliament on 1st March, 1994, it was stated 'the Government has already announced its intention to sell the State Bank. The sale would reduce the State's debt by $18.4 billion, remove a potential financial exposure and enable the Government to focus more clearly on its core functions'.

On 5th May 1994 the Treasurer the Hon Peter Collins announced the field had been reduced to one, Colonial Mutual Life Assurance, which was the bidder most prepared to meet the Government's requirements. This bidder is currently undertaking limited due diligence (that is undertaking a detailed investigation to verify the truth of the information about the State Bank's assets and liabilities) and the requisite legislation to allow finalisation of the sale is expected to be introduced in the Budget sitting of Parliament in September, 1994.

This Briefing paper outlines:

- Privatisation: the pros, the cons and the process
- The experience of privatisation in Australia and other countries: UK

[1] Kent Consulting Group Pty Ltd. 'State Bank of New South Wales Limited. Discussion and Analysis of some issues relating to the Proposed Privatisation of State Bank of New South Wales. Preliminary Comments. June. 1994. Page 1.

and New Zealand
- State Banks of Australia: the current situation
- The history of the State Bank of NSW
- The issues involved in the privatisation of the State Bank of New South Wales
- Political party statements and policies on the privatisation of the State Bank of New South Wales

2 PRIVATISATION: THE PROS, THE CONS AND THE PROCESS[2]

The Arguments for Privatisation

Privatisation means the transfer of the activities and assets of the state from the public to the private sector.

In many countries in the 1970s, government expenditure and involvement grew in many areas; welfare and social security being major examples. At the same time, in response to such economic changes as the oil shock, economic performance declined. Disquiet grew about economic fluctuations, the effects of high levels of public expenditure and the failure of many government welfare and other programs to deliver what had been promised.

In the 1980s and 1990s, the theory of economic rationalism (or the 'new right') has become influential in many countries including the United Kingdom, the United States, New Zealand and Australia.

The basic premises of the theory of economic rationalism hold that society has a natural tendency to order and that the economy, left to itself, in the long run will work in society's interest. Thus government should not interfere in the market system.

The assumptions underpinning the arguments for privatisation are as follows:

The market is the best regulator of economic activity. Thus governments should not interfere as enterprises will be most productive if they are exposed to the full range of market forces. If the market is allowed to operate freely,

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[2] Many of the arguments and examples in this section are taken from 'Privatisation' by Barbara Page, New South Wales Library Background Paper, 1986 and 'The Privatisation Game' Consuming Interest. No. 53. October/November/December, 1992. Australian Consumers Association. Pages 8-11.

market competition and the expression of consumer preferences or choice will ensure that resources such as capital and labour will naturally flow to those areas where they will be more productive. This will maximise economic growth and consumer sovereignty and everyone will benefit. Intervention in this process by, for example, regulating sections of the economy such as wages or interest rates or by subsidising or protecting producers or consumers will distort the market. This will have an adverse effect on rates of economic growth and the consumer's freedom of choice.

There are a related and converse set of arguments for reducing public sector activity which hold that the public sector is inefficient and unproductive and that big spending by government, funded by public sector borrowing and taxation, reduces private initiative and crowds out private sector activity.

'The assumption that the public sector is inefficient rests on the grounds that it does not have to face the sanctions or tests of the market which induce efficiency in the private sector. For much of the public sector there is no "profit" test. If an organisation is a public enterprise or statutory body it may be subject to government directives which prevent it operating efficiently in market terms. A private firm would not have these constraints.

Much public sector activity is classified as unproductive because it is concerned with goods or services that are not marketed (and thus cannot be easily priced).

Some services (such as the provision of some social welfare benefits) are seen as both unproductive and wasteful by providing benefits to those who are not in genuine need.'[3]

Thus, to summarise, advocates of privatisation hold that it:

- Ensures better efficiency and improved products and services
- Leads to a smaller government sector
- Enables an enterprise to attract capital in its own right without being a burden on the State
- Enables governments to pay off or retire debt

Counter Arguments to Privatisation

A range of counter arguments have been raised to those for privatisation:

[3] 'Privatisation' by Barbara Page. NSW Parliamentary Library Background Paper. 1986 pages 4 and 5.

1 The private sector is not as efficient or competitive as economic rationalist theory suggests. While many parts of the private sector are competitive, large bureaucracies and/or monopolies tend to be inefficient, no matter who owns them.

2 The government may need to intervene in the market for social or economic reasons such as:

- To provide goods and services, which, left to the market, would not be provided at all, eg defence
- To ensure social justice and equity, by for example, maintaining cross-subsidisation of essential services
- To ensure minimum standards (eg food additives)
- To regulate the use of scarce resources (eg water or radio frequencies)
- To ensure a competitive market (Trade Practices Legislation)

3 In practice, private enterprise may seek to reduce competition and take advantage of monopoly. The recent Hilmer Report on Competition in Australia[4] addressed some of these issues.

4 Smaller government is not necessarily associated with greater economic growth. When the annual percentage growth of Gross Domestic Product (GDP) for a range of countries are compared, many countries with larger government sectors than Australia are performing well, while others with smaller government sectors are not performing well.

5 Privatisation does not necessarily result in a reduction of government debt. Privatisation is a way for governments to reduce their debt but selling assets to fund deficits depletes the capital accumulated in the private sector. (See Point 6 below). Only assets which are making a profit or have the potential to make a profit can be sold. Thus demand for services provided by government may continue to grow and at the same time, reduced revenue can result in higher taxes, higher charges for services or a reduction in services.

6 Privatisation does not necessarily reduce a State or country's capital requirements. Many governments cannot afford to provide the funds

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[4] 'National Competition Policy. Report By the Independent Committee of Inquiry. Chaired by Professor F. Hilmer. 1994. and 'National Competition Policy. Report by the Independent Committee of Inquiry (The Hilmer Report)' by Jan Newby. Briefing Note No. 1, 1994. NSW Parliamentary Library.

for the recapitalisation or expansion of an enterprise. Privatisation of the enterprise means that capital for growth can come from the markets and not from government borrowing. However, privatisation does not reduce the overall capital requirement but merely transfers the aggregate demand for funds from one sector to another.

The Objectives of Privatisation in New South Wales

A consultant's report on privatisation of the State Bank cites a paper entitled 'Government Trading Enterprises Reform Committee: Privatisation Policy, Process and Program' prepared by the NSW Treasury[5] as follows:'It is important that privatisation is not seen as an end in itself but as a means to an end. The ultimate objective should in fact be improved economic performance and hence better living standards and higher employment. The key objectives are seen to be the following:

- focusing the Government on its core social and regulatory policy and services responsibilities, leaving commercial activities to private enterprise which is best suited to doing it.

- improving productive efficiency (ie minimising cost) through exposing activities to market scrutiny, including scrutiny by debt and equity markets and the threat of bankruptcy and takeover;

- achieving allocative efficiency (meeting the needs of consumers at prices which reflect the cost of provision) by linking privatisation with enhanced competition;

- providing financial benefits (reduced financial risk; avoiding the need to support the capital requirements of commercial entities; potentially generating a higher return than can be achieved by continued public ownership; and facilitating debt reduction) which will help safeguard the State's AAA rating;

- provision, where appropriate, of an effective regulatory framework to promote efficiency and protect consumer and community interests,

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5 NSW Treasury 'Government Trading Enterprises Reform Committee: Privatisation Process and Program' 1983, as quoted in Kent Consulting Group 'State Bank of New South Wales Limited. Discussion and Analysis of Some Issues Relating to the Proposed Privatisation of State Bank of New South Wales. Preliminary Comments. Sydney. June 1994. Pages 3-4. The Report was commissioned by the Financial Services Union (State Bank Branch).

without any conflict with the government's interest as owner;

- facilitation, where appropriate, of a broader capital market and wider share ownership.

Not all the objectives itemised above can be achieved in each case. There are in fact conflicts between a number of the objectives which necessitate tradeoffs being established. For example, the maximisation of financial benefits to the Government will conflict with encouraging competition or curbing monopoly powers by appropriate regulatory framework. Hence it is important to establish for each privatisation the proposed objectives in order to develop the appropriate approach and properly assess the results achieved.'

The Process of Privatisation

Privatisation is commonly achieved by four methods:

1 Sale - either outright or selling parts of an enterprise

2 Contracting out

3 Liberalisation of the Market

4 Deregulation

Methods of Privatisation

1 Sale

The most usual method of privatisation in Australia is the sale of government assets to the private sector. This can occur through:

- a float on the stock exchange (as was the case with the GIO)
- an outright sale of the whole enterprise (as is being proposed for the State Bank of New South Wales),
- the sale of parts of the enterprise (so-called 'hiving off').

The sale price of an enterprise is affected by the existing monopoly situation, the amount of debt the enterprise is carrying and the state of the market.

The problems with a sale include:

- privatisation through the sale of assets may not result in a reduction in the size of the public sector as measured by state expenditure. Revenue from the sale of the asset may only postpone the need to rein in government expenditure.

- the asset may be underpriced at the time of the flotation or sale

- a sale may not achieve the goal of stimulating greater competition in the market because:

    - the government may wish to retain a significant control in the enterprise

    - a large part of the attractiveness to the private sector of many state enterprises is its monopoly status, which if retained after a sale, does not increase the competitiveness of the market

- if the main aim of privatisation is market liberalisation and deregulation, then this will have to be achieved before the asset is sold, usually by the processes of **corporatisation** and/or **commercialisation.**

Corporatisation is a process whereby the structure of a State enterprise is changed so it is the same as a publicly listed company. The government is the sole shareholder and the company is required to pay a dividend to this shareholder. This process is often the first main step towards an asset sale.

Commercialisation is the use of private sector management methods such as 'user pays' principles and the removal of cross-subsidisation on services within an organisation.

Selling part of a public enterprise or 'hiving off'

This process involves the government retaining ownership of part of an enterprise (usually an unprofitable or socially necessary operation) and selling off the rest. This process is sometimes termed 'privatising the profit and socialising the losses'.

2 *Contracting Out*

Contracting out is a process whereby some functions carried out by a government organisation (eg school cleaning services) are contracted out to the private sector. This process can raise efficiency and lower both costs and prices and thus benefit both the government and consumers. If performance standards and accountability are clearly set, contracting out can achieve efficiency. However, contracting out can lead to a lack of government control and accountability of contractors. Government contracting, unless rigorous and ethical contracting procedures are set, can lead to abuse and corruption.

3 Liberalisation of the Market

This means opening up the market to competition - the government sector and publicly provided services such as water, health services and education services.

The problem with this initiative, is that often private sector (monopoly) business needs to be liberalised and this, ironically, often requires government intervention with anti-monopoly legislation.

4 Deregulation

Another method of privatisation is deregulation which means reducing the extent of government regulation of economic activity and allowing the market forces to operate more freely. Recent Australian examples include deregulation of telecommunications, of the airlines, interest rates, allowing the entry of foreign banks and the liberalisation of foreign investment policy.

The arguments for deregulation centre around the point of view that government regulation is often costly and inefficient. Costly, in terms of administration costs, for government to administer the regulations and for businesses to comply. Inefficient in that regulation can often distort the market. Another problem is that the effect of a regulation is not always that which is intended.

However regulation has often been introduced by government at the request of business.

Of these types of privatisation, the method that has been chosen by the New South Wales Government for the State Bank of New South Wales is privatisation by outright sale.

3 THE EXPERIENCE OF PRIVATISATION IN AUSTRALIA AND OTHER COUNTRIES: UK AND NEW ZEALAND

Australia[6]

The privatisation debate first came to prominence at the Federal level in Australia in the late 1980s when the Australian Industry Development Corporation (AIDC) was privatised, as was AUSSAT. It was also at this time that the issue of privatising Qantas was raised in Caucus by the Prime Minister and Treasurer. Recent Australian Labor Party Federal conferences showed strong opposition to privatisation. In 1989, the Federal Opposition published its policy 'Privatisation - The Australian Way' in which it stated that in its first term of government it would give priority to the sale of: Aussat, Australian Airlines, AIDC, Australian National Lines, Commonwealth Bank, Domestic and International Airport Terminals, Housing Loans Insurance Corporation, Medibank Private, OTC (49%), Pipeline Authority, Qantas and the Snowy Mountains Engineering Corporation. This document was shortly responded to by 'Privatisation - Not the Australian Way', prepared by the ACTU with sponsorship by 12 key unions. Meanwhile, while the debate continued, the Federal Government initiated the corporatisation of a range of government enterprises so as to put them on a semi-commercial basis. In 1990, however, a special national conference of the Labour Party voted to sell Australian Airlines to Qantas, to sell 49% of its share in Qantas by way of a float, and also the expansion of the role of the private sector in the telecommunications industry. As a result of this decision, the Federal Government expects to raise $3 billion from sales of these assets.

The Commonwealth Bank has been partially (49%) floated. As well Australian Embassy land in Tokyo, the Commonwealth phosphate rock stockpile, the Defence Service Home Loan scheme, the Primary Industry Board, the Commonwealth Serum Laboratories and the Snowy Mountain Engineering Corp have been sold. The operation of many Australian Post Offices has been contracted out.

The sale of the Australia National Line, the Moomba-Sydney Gas Pipeline, the Australian Industry Development Corporation, Cockatoo Island, the Housing Loan Insurance Corporation and government stockpiles of uranium are currently on the agenda. The potential for privatisation of Telecom, ABC,

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[6] The information in this section comes from an article by Russell Miller 'Public or Private - Where are We? The Case for a Government 'For-Sale' Sign.' in Journal of the Securities Institute of Australia. March 1991. p.28-33.

SBS, Australia National Railways, Comcar, the Government Property portfolio and Medibank Private has also been raised.

While these potential sales are on the agenda, the pace of actual privatisations has slowed because of the economic climate. The float of Qantas has been put back to at least 1995 because of the aviation industry downturn, and the sale of the Housing Loans Insurance Corporation has been deferred. The sale of the Australian National Line and the Federal Airports Commission will be addressed at the annual conference of the Australian Labor Party to be held in September.

NSW

The NSW Government has actively pursued a privatisation program since the 1988 Report on State Finances prepared by Charles Curran which recommended that the government move to corporatise its statutory authorities. In 1989 the *State Owned Corporations Act* was passed which provides the basis for corporatisation of individual government enterprises.

This Act is likely to become a blueprint for similar legislation in other Australian States. In 1989 the NSW Grain Corporation Ltd was created, followed in 1990 by the creation of the State Bank of New South Wales Limited, and the privatisation, by way of public float, of the Government Insurance Office which changed its name to GIO Australia.

The NSW Government has also privatised the NSW Investment Corporation, the Egg Corporation, First State Computing, the State Clothing Factory and the MSB Coal Loader.

According to a report in the *Sun-Herald* of 24/10/94, as well as the State Bank, the NSW Treasury (according to a draft document 'Privatisation Policy, Process and Program') has recommended that ten State Government Trading Enterprises be sold including: Forestry Commission pine plantations, Electricity generating, State Transit Authority, State Rail Northern coal freight, Hunter Water Corporation, School Furniture Workshop and Government Cleaning Service.

Victoria

The State Bank of Victoria was privatised in 1990. The State Electricity Commission, most bus services, hospital and school cleaning services have been privatised and many country train services have been replaced by private bus services. Many local government services, including community services and parks and gardens have been contracted out to private tender. The TAB (Tabcorp Holdings) is currently being privatised. Privatisation of the Transport Accident Commission (which deals with third party car insurance) is expected and there has been discussion of privatising the State Electricity Commission of Victoria, the Gas and Fuel Corporation, Melbourne Water, cemeteries and prisons.

ACT

In 1989, the ACT established the Priorities Review Board to identify a range of options for privatisation and corporatisation. Following on from the work of this Board, a range of privatisation and corporatisation projects were announced.

Queensland

A discussion paper was produced in 1991, proposing legislation similar to NSW to provide a framework for corporatisation. The current (Labor) government chose not to act on this paper. However on 1/6/94, it was reported in the *Australian* that 'the Queensland Government will sell or borrow against State-owned ports, toll roads and buildings to pay for new infrastructure considered too risky to win commercial support. (This) major policy shift breaks the Government's commitment to limit new borrowings to economic projects able to service their debts and exposes it for the first time to large scale privatisation.'

Western Australia

Western Australia intends to sell its R & I Bank.

South Australia

A new South Australia Asset Sales Task Force has been set up to sell State assets so as to cut State debt. The State Government's 57% owned gas distributor, Sagasco, has been sold.

United Kingdom[7]

After its election in May 1979, the Conservative Government, led by Margaret Thatcher, undertook a radical and systematic program of deregulation, denationalisation and privatisation of industry and services. Between 1981 and 1990 the following government owned companies were privatised: Cable and Wireless, British Aerospace, (1981); Amersham International, Britoil, (1982); Associated British Ports, (1983); Enterprise Oil, British Telecom, (1984); British Gas, (1986); British Airways, Rolls Royce, British Airports Authority, British Petroleum (31.5%), (1987); Water Authorities and Electricity generation and distribution (1990)[8].

This privatisation program has been achieved by a number of public share floats, tender offers, management buy-outs and private sales.

The end result is that a large number of 'traditional U.K. nationalised industries are being transformed from large public monopolies into private ones, or sometimes into private duopolies, accompanied by a new extensive set of regulatory apparatuses. Even the water and electricity industries which were not privatised as monopolies or duopolies, have attracted an extensive regulatory apparatus.'[9]

Thus a wide range of activities undertaken by the government of UK ten years ago: airports, telecommunications, gas supply, water supply, dockyards, are now undertaken by private companies owned by private citizens.

New Zealand

Since 1984, New Zealand has undertaken a radical and far-reaching program of State asset sales. Former State-owned enterprises sold, (1992),[10] include:

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[7] Much of the information in this section comes from 'Privatisation. The UK Experience and International Trends.' ed. Robert Fraser. Keesing's International Studies. Longman, London. 1988.

[8] Source: Thompson, G. 'The Private Paradox' Australian Left Review. No. Vol. 124. December, 1990.

[9] Ibid p. 54.

[10] Rosenberg, W. 'New Zealand Can be Different and Better' New Zealand Monthly Review Society Inc. Christchurch. 1993. pages 136-139 and Duncan, I and Bollard, A. 'Corporatization and Privatization: Lessons from New Zealand' Oxford. Auckland. 1992, p. 37.

NZ Steel, Petrocorp, Health Computing Service, DFC, PostBank, Shipping Corporation, Air New Zealand, Landcorp (financial instruments), the Rural Bank, Government Printing Office, National Film Unit, Communicate NZ, State Insurance Office, Tourist Hotel Corporation, NZ Liquid Fuel Investment, Maui Gas, Synfuel Stocks and Current Assets, Telecom, Export Guarantee Ltd, Housing Corporation Mortgages, Government Supply Brokerages, Bank of New Zealand and various parcels of Forestry cutting rights. Since 1992, other state-owned enterprises have also been privatised.

According to Ian Duncan and Alan Bollard[11] the overall effects of corporatisation and privatisation in New Zealand include the following:

1 A large number of layoffs of staff

2 A negative effect on inflation from price increases by privatised companies

3 Capital restructuring, that is, capitalisation by government has put government financial accounts under some stress. Upon corporatisation, some state enterprises went to capital markets to fund restructuring and for several years were the dominant source of business investment. The temporary strong demand for funds led to high interest rates in NZ and may have exacerbated some private sector crowd-out in the capital market.

4 The movement of assets and liabilities in the overseas capital accounts out of the government sector into the private sector.

5 Debt retirement. Overall, asset sales have raised about $11 billion in revenue to date. This was a main rationale for the program of sales. In general, the funds earned from sale have been committed to debt reduction. However, the potential impact of this has been offset by continuing financial deficits throughout the period. Different regimes have been followed with respect to domestic and to overseas debt repayments. In an attempt to reduce the exchange rate effects of large capital movements, a policy of repaying debt in the currency of the sale was adopted. In 1989/90, the government policy was to retire debt. In 1991 the policy changed - the government would use asset sales to retire overseas debt. Only by 1989, did the taxes paid by former state enterprises to government start to raise substantial amounts of money.

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[11] Duncan, I and Bollard, A. 'Corporatization and Privatization. Lessons From New Zealand. Oxford. Auckland. 1992.

6 The goal of privatisation was an improvement in productive efficiency and consequently in allocative efficiency.

The financial demands of corporatisation exacerbated the structural fiscal deficit in New Zealand. This has meant that stabilisation has taken longer to achieve than would have otherwise been the case. This in turn has exacerbated the capital inflows that have contributed to high interest rates and high real exchange rates.

4 STATE BANKS OF AUSTRALIA: THE CURRENT SITUATION

(Information from the *Financial Review* of 16/4/93)

NSW

1991-92 profit of $25.6 million. (March 1994 half year profit of $19.7 million). Set for privatisation in 1994. 7% of national market.

Victoria

The State Bank of Victoria was sold to the Commonwealth Bank in 1991 following the collapse of finance subsidiary Tricontinental in 1990. The total cost to the Victorian taxpayers estimated at $3 billion. Rationalisation program led to wholesale closure of many State bank branches across the State.

South Australia

The Government rescues the State Bank in February 1991 with promises of $1 billion. In May 1992 more than $4 billion in non-performing loans were transferred to State Treasury. In September 1992, Premier John Bannon resigned before a Royal Commission Report. The total cost to South Australian taxpayer was estimated at $3 billion. The Government plans to sell bank. In March 1993, the Prime Minister, The Hon P Keating, promised to pay State government $600 million on sale of bank to help reduce debt. This bank has 2% of the national market and nearly 50% of local (state) market.

Western Australia

The R & I bank lost $116 million in 9 months to Sept 1991. State government capital injections totalled $145 million in 1991 and 1992. The net profit of $27.8 million in year to Sept 1992. The Government is considering a partial float. This bank has 24% of the local market.

Tasmania

The State owned Tasmania Bank was rescued in June 1991 through a merger with the State Bank of Tasmania creating Trust Bank with assets of $1.4 billion. State Treasurer lodged $25 million deposit in perpetuity with Trust Bank. Considering share issue.

5 THE HISTORY OF THE STATE BANK OF NEW SOUTH WALES

Background[12]

The State Bank of New South Wales has its origins in Australia's first saving bank - Campbell's Bank. This bank was founded in 1819 and its original function was to take deposits and make loans to people whom the trading or commercial banks of the day turned down as customers. Campbell's Bank then became the Government Savings Bank of New South Wales which the *Commonwealth and State Banks Agreements Ratification Act* of 1931 divided between the Commonwealth Savings Bank and the Rural Bank of New South Wales. This Act established the Rural Bank, in 1933, in its role as a financier of the rural and housing sector of New South Wales.

In November 1981, the Rural Bank became the State Bank of New South Wales.

The termination of the Amalgamation Agreement between the Commonwealth Bank and the State Bank of NSW in December 1987 allowed the State Bank to return to the savings bank arena.

The bank was corporatised by the *State Bank (Corporatisation) Act 1989* in May 1990. Corporatisation aims to make the Bank as much like a private sector bank in shape, structure, form and regulation as possible, independent from the Government yet still accountable to the Government for its performance. Following corporatisation, a number of new directors with substantial business experience were appointed to the Board.

As at the end of March, 1994, the Bank is the sixth largest in Australia and third or fourth (by assets or deposits respectively) in New South Wales with a network of 639 customer service centres and retail agents, plus 64 banking centres and about 4750 employees.

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[12] This brief history is from 'The State Bank of New South Wales Limited and Privatisation' State Bank of New South Wales Limited. September, 1990.

6 THE ISSUES INVOLVED IN THE PRIVATISATION OF THE STATE BANK OF NEW SOUTH WALES

Reasons for privatisation of the State Bank

- Banking is not a core function of government
- Benefits of a sale would exceed those of retaining it
- Debt retirement
- Adverse effect of exposure (by way of government guarantee) on NSW's credit rating.

At present the government of New South Wales has a guarantee on the State Bank's $18.7 billion of deposits and borrowings.

For the purposes of rating NSW's credit worthiness, credit rating agencies like Moody's Investor Services[13] say that NSW has $49 billion in debt and contingent liabilities.

(However, there is a potential conflict in arguing that there is a risk to the Government's credit rating in retaining ownership of the bank, while at the same time offering the bank for sale and not damaging investor confidence in it).

According to the NSW Treasurer, the Hon Peter Collins (as reported in the *Financial Review* of 1/2/94) the maintenance of State's AAA credit ratings is generally held to be predicated on debt levels of less than 15% of gross State product. NSW debt is inside (but still uncomfortably close) to that critical limit at around 13-14%. Selling the State Bank is intended to reduce the Government's debt.

- The State Bank's market share-building technique has been to sell home loan products with comparatively low interest rates. At the same time, it has been offering comparatively high deposit interest, which means a very tight margin. Thus the bank needs a lot of free capital to maintain its profitability. Because the State Bank is expanding, it will require a $300 million capital injection in the next few years, which the Government would have to provide if it still owned the bank.

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[13] Moody's Investor Services is one of the information banks (others include Australian Ratings Pty Ltd, Dun and Bradstreet and Standard and Poors). A credit rating is a measurement of the creditworthiness of an individual or business. The rating is based on the opinions of banks and other financial institutions, plus investigations of financial stability and credit history. In the 1994 Interim Report of the State Bank of New South Wales, the short term rating given by Moody's was P.1 and the long term rating was Aa2.

Methods of privatisation

- *100% float on the share market (as per the GIO)*

The State Bank does not have the earnings record to justify a popular float. According to a report in the *Telegraph Mirror* of 26/11/93, as the State Bank had just announced a $74.6 million loss for the year ended 20/9/93, the bank needs more time to improve its performance, so as to attract a higher price.

- *100% sale to another bank*

The government has ruled this option out because it wishes to maintain competition and preserve branches and staff numbers.

- *Merger with other State Banks in South Australia and Western Australia, followed by a float*

This option is ruled out because the other State Banks are not in a financial position to undertake this exercise (See Section 4).

- *A partial sell-off, perhaps to a foreign bank, with a float of the rest*

The problem for a foreign bank is that buying into a mature and extremely competitive market mainly in one state would not make much sense. The State Bank is also an unusual business in that it has a high rural exposure and a high proportion of transitional business partly because of its low interest housing loans.

Implicit in these different methods of privatisation is a conflict between maximum return to the government and achieving political and economic goals such as ensuring competition, ie maintaining jobs, branches and creating competition in the banking sector.

- *A restricted trade sale*

The option which has been chosen to sell the State Bank is a restricted trade sale, excluding the four major trading banks. A number of conditions have been set down by the Premier, The Hon John Fahey[14]. These conditions are that the purchaser should:

- accept all assets and liabilities of the State Bank
- maintain the existing staff and branch structure
- keep the bank's headquarters in Sydney
- maintain the State Bank as a viable independent entity in its present form

Price

According to the Manager of the State Bank, as reported in the *Sydney Morning Herald* of 16/5/94, the State Bank has paid dividends of $360 million to the State Government over the last 10 years. This has to be balanced against the rumoured current low sale price of $500 million.

Various estimates and methods of estimation have been given of the sale price of the State Bank. These estimates range from a low of $400 million and a high of $1.1 billion.[15]

Given the present market and the constraints of the tendering process, the latest estimates hold that as the State Bank's net asset backing, excluding future income tax benefits, is around $500 million, the Government could make it a condition of a tender that there be a minimum bid of $500 million.

Chronology of the Process of Privatising the State Bank of New South Wales

May, 1990	The State Bank of New South Wales was corporatised in May 1990 by the *State Bank (Corporatisation) Act, 1989.*
Nov, 1993	The Premier announced plans for the Government to sell its interest in the State Bank of New South Wales by restricted trade sale.
Jan, 1994	Deadline for expressions of interest.

[14] The Hon. J. Fahey, Premier of NSW. Press Release. 'Sale of State Bank of New South Wales'. November 25, 1994.

[15] See *Sydney Morning Herald* of 25/11/93 and *The Financial Review* of 23/11/93.

Thirty two organisations submitted expressions of interest.

Seven organisations made indicative expressions of interest: Lloyds Bank, Hong Kong and Shanghai Banking Corporation, Colonial Mutual Life, GIO Australia, MLC, Advance Bank and the AMP Society.

Two organisations (MLC and Colonial Mutual Life) proceeded to the third and final stage of due diligence.

The other bidders have withdrawn for several reasons: the price was beyond the means of the bidder, the Bank was unattractive to the bidder or the bidder was unable to proceed because it was unable to obtain Reserve Bank approval for the purchase without selling down its interests.

June, 1994 The Colonial Mutual Life Insurance signed a conditional agreement to buy the State Bank, depending on a satisfactory due diligence search (inspection of the financial records) being completed. According to the *Telegraph Mirror* of 8th June 1994, the sale price is likely to be between $300 - $600 million. Negotiations are still continuing.

CML may face Reserve Bank difficulties in that as an insurance company, it is a 'mutual' which would have to 'demutualise' or become a company with share capital in order to obtain a banking licence.

'In addition, there are other restrictions, including those under the *Banks (Shareholdings) Act* requiring the Commonwealth Treasurer's Approval to hold more than 15% of a bank and to obtain this approval, the applicant would need to demonstrate why it is in the national interest for that organisation to hold more than 15% of the SBN.'[16]

The sale is likely to be finalised in August 1994. Legislation revealing the winning bidder and the sale price is expected to be tabled in Parliament in September, 1994.

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[16] Kent Consulting Group. 'Discussion and Analysis of Some Issues Relating to the Proposed Privatisation of State Bank of New South Wales'. 1994. Page 9.

7 POLITICAL PARTY STATEMENTS AND POLICIES ON THE PRIVATISATION OF THE STATE BANK OF NEW SOUTH WALES

Coalition (State Government)

The *Hon George Souris*, Minister for Finance and Assistant Treasurer (*Sydney Morning Herald* of 24/4/93):

'Our argument is that the State Bank should not be owned by the government because it performs no government functions. It makes no sense for the Government to own it, the bank has been fully corporatised and should be owned by shareholders who want to be in the banking business'

The *Hon Peter Collins*, Treasurer, quoted in the *Financial Review* of 22nd January, 1994 expressed a preference for a new player. The various alternatives mentioned by Mr Collins included an offshore bank capable of taking over the State bank network and ready to enter mainstream banking, an existing regional bank or a non-bank financial institution like an insurance company. Mr Collins was quoted as saying 'for policy and strategic reasons, such as jobs and competition, it is better not to have the four main banks as buyers. The government wants to sell in a rising market and is refusing to shift another cent into the State Bank's capital.'

The Australian Labor Party (State Opposition)

The *Hon M Egan*, MLC, Shadow Minister for Finance and State Development, said in a Press Release of 2/8/93, that 'The State Bank must not be subjected to a 'fire sale'. If the State Bank is to be sold it must be at the right time and for the right reasons. Now is definitely not the right time. Last week KPMG Peat Marwick's *1993 Financial Institution's Performance Survey* ranked the State Bank of NSW as the second worst overall performer out of the nine State and Regional banks, slipping down one ranking from 1991. The Premier is trying to flog off a poorly performing asset into a buyer's market. The long term interests of this State will be better served by dramatically lifting the performance of the State Bank rather than simply rushing the Bank's sale ...'

The State Opposition, quoted in the *Telegraph Mirror* of 26th November, 1993, also argues that the bank, which has just announced a $74.6 million loss for the year ended Sept 30, needs more time to get its house into order so as to attract a higher price. It would need another two years to establish an earnings record before it could be floated.

The *Hon R Carr* MP, Leader of the Opposition, was reported in the *Telegraph-Mirror* of 8/6/94 as wanting to block the sale. He claimed Colonial Mutual intended to sell off the State Bank immediately to one of the major banks which would almost certainly cause staff cuts and branch closures.

Independents

Ms Clover Moore, MP

In a Press Release of 26/11/93, Ms Moore stated "While I am aware that the Government is keen to reduce its liabilities and to avoid making an injection of capital, I want to be sure that the sale of the State Bank is no fire sale ... there have been arguments that it would be better to wait for a few years because of the substantial losses announced this month, and the extent of problem loans. Some business commentators believe a delay in sale of the State Bank would be advisable. The government will need to address these issues to gain my support. I am very concerned that the sale of the bank does not jeopardise jobs ... I am conscious that the Opposition has an interest in delaying the sale of the bank until after the election."

Australian Democrats

Mr Richard Jones, MP

In a Press Release of a letter, dated 31/8/93, Mr Jones said '... if the bank is to be sold at some later date, then it should be capable of being floated. There is no way I will support the sale of the Bank at this time just to assist in shoring up the State Budget. When the Bank has had a string of good profits like those in the late 80s, then it may be possible to consider whether or not the Bank should be sold. I think it would be irresponsible to consider selling the bank at this time.'

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