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A Critical Decision

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I have devoted a significant slice of my 50 years in financial services, and have exerted considerable effort, trying to persuade governments of all colours to position Australia as a regional financial centre. I was far from being alone, but as successful as Australia's financial sector has been and still is, and as talented as the people who work in it are, I have been forced to recognise the reality that there is no serious political appetite to achieve it.

Accordingly, as someone who has been in the thick of it, I now find it wryly amusing that arguments are being advanced to oppose the merger of Singapore's stock exchange (SGX) with the Australian Securities Exchange (ASX) because it will supposedly end, for all time, Australia's (Sydney's) dream of becoming a regional financial hub.

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Given where Australia's priorities lie, people who think like this live in a dream world. To be a high value adding regional centre requires a different mind-set and approach to policy settings than those we are comfortable with. When we block mergers, impose price controls, bash banks, or single out an industry for higher taxes, we perhaps underestimate the impact on management and long term investment. Managers come to view their best options for expansion as being abroad, merging with foreigners, or, moving domicile. Investors will follow. Significant foreign investment and initiatives are deterred in favour of more friendly shores. This is the story of ASX.

The present merger proposal is not an ambush. Nor is the ASX Board's positive recommendation to shareholders a hasty grab for the money. It is the culmination of more than a decade of thoughtful, informed, analysis from the inside as to what the best directions for ASX and the markets it operates are. It is the result of countless meetings with peer exchanges around the world. It has involved making judgements on what actions other exchanges might take which, over time, could marginalise ASX and its markets. Assessments have been made as to who may be compatible and which jurisdictions added value. Talks have ensued, but none offered the fit of Singapore.

When in 1998 the Australian Competition and Consumer Commission (ACCC) rejected ASX's bid for the Sydney Futures Exchange (SFE), it consigned ASX to a non independent future. In the seven years it took for the ACCC to finally approve the merger, most major stock exchanges in our region and some major exchanges outside it, had emulated Australia's aborted lead. This robbed ASX of a significant first mover advantage depriving it of scale and scope and an unrepeatable regional leadership position. There can be no doubt that the 2006 merger of ASX and SFE, when it came, was a huge benefit to both markets and to

Australian financial services generally, but it came too late to fully leverage this success internationally.

Then came the push to open up the Australian securities markets to competition. The regulatory architecture was changed to suit the aspirant competitors, disadvantaging ASX. ASX was criticised for being expensive, slow to transact, bureaucratic and monopolistic, all the attributes those now opposing the SGX merger dispute. However, once again the damage was done and, with its share price sliding as a consequence of policy settings, the inevitable merger was constructed – now with Singapore gifted higher market value currency with which to negotiate. Nationalistic sentiment to the effect that Australia has a larger, more efficient or lower cost exchange than Singapore is irrelevant if policy settings erode the market value of those attributes.

Those contemplating the national interest case must consider equally the future of ASX and Australia's capital markets should the merger be blocked, as well as the benefits, if it proceeds.

Writing in a recent edition of the Wall Street Journal, Professor Paul Rubin asserts that with international commerce, positive thinking doesn't come naturally to people because we harbour zero sum instincts. Indeed, critics are already suggesting (after paying \$ 8 billion) SGX will ignore the many advantages that ASX offers, resulting in a zero minus outcome. This is irrational and overlooks synergies, scale economies and revenue leverage which should result. Moreover, job numbers are not fixed and there is no law which says the best jobs will go to Singapore. The common purpose of this merger is to grow the new entity in the most effective way, exploiting opportunities not open to ASX or SGX separately. And both companies have worked constructively together in the past. They know, trust and respect one another.

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If the merger proceeds, the two exchanges, will operate under their own jurisdiction, and ultimately trade their full suite of stocks and derivative products. This will be a boon for local pension funds which are becoming overly weighted in Australian securities.

Singapore itself has been cited as a reason to reject the merger. While some of Singapore's administrative arrangements may differ from our own, those who imply some Australian superiority should first consider the extraordinary success of the island state and the conditions of its people compared to most of the rest of Asia. It is a standout, lacking any natural resource base other than the skill, drive and education of its people.

It is true neither SGX nor ASX has achieved its regional aspirations or strategic goals. But Singapore is closer. It is an Asian insider at a pivotal time and has close relationships with both China and India in the corporate listings and trading area. Unsurprisingly, ASX has been singularly unsuccessful with this, Australia being regarded as too remote and inwardly focussed. The merger should soften this perception. It is to be hoped that the decision makers in Canberra spend a lot of time thinking about this.

The recent global stock market recovery may give the impression that the global financial crisis is behind us and that we are back, more or less, to business as usual. This is a dangerous and misleading view.

The Western world, including Japan, is still on life support with little evidence of any autonomous improvement. Contagion from Europe's sick economies remains a risk, as does the sheer magnitude of the US debt and deficit problems accentuated by the actions of the US Federal Reserve. The American national debt currently stands at \$14 trillion or around 100 per cent of US GDP. The debt of all US governments, financial institutions and households (total debt) is now \$50 trillion, equivalent to more than \$600,000 for an American family. Total funded and unfunded liabilities in the US are estimated to be \$200 trillion. And the numbers

continue to grow. The US government spends \$1.60 for every dollar it receives. This is an unsustainable situation and, as the saying goes, "When something is unsustainable it cannot continue".

The relevance to Australia and the ASX/SGX merger is that perceptions, historic relations and conventional wisdom are in for a game change. The US dollar is likely to lose its reserve status. China and India will increasingly become the economic centre of the world. Western military, financial and cultural influence will go into relative decline. Developing economies will outperform large developed ones and, investment flows will adjust accordingly. While these changes won't all occur overnight, the trend which is already clearly discernable, will gather momentum. It will challenge our beliefs and assail our comfort zones.

In this scenario Singapore is well placed to become Asia's Switzerland and, Australians, as continuing shareholders in the combined entity, will reap the rewards. However, without SGX, ASX will find it extremely difficult to participate in any meaningful way. Furthermore, if the merger doesn't proceed, it will send negative signals to international investors and listed companies, and confirm many Asian prejudices about Australia's insularity and its Western centrality.

Without involvement in regional or global consolidation, ASX would be consigned to a purely domestic market franchise. It will be marginalised by market fragmentation at home and exchange mergers abroad, making Australian capital markets more costly and volatile to access. ASX will eventually lose relevance and international appeal.

Those who think that, if rejected, Singapore will be back, should think again. New Zealand continues to rue its rejection of ASX 12 years on.

I have no direct financial interest in the outcome of this merger, but along with every other Australian, I and my children have a significant stake in an enlightened decision.

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