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# *Foreign Banks in the Pacific: Some History and Policy Issues*

**by**
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**Foreign Banks in the Pacific: Some History and Policy Issues**

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**Abstract**

Foreign banks now dominate retail banking in the territories, commonwealths, and nations of the Pacific Islands. Generally, banking is highly concentrated, with two Australian banks dominating the Australian sphere of influence, and three French banks dominating the French sphere. The situation in the U.S. sphere is a little more diverse, though in all three spheres there are situations of monopoly. The foreign banks have certain desirable attributes but also limitations. Locally-owned banks have complementary strengths, but also over-riding weaknesses. Government-owned banks have had a particularly unsuccessful history as political lending has frequently led to the banks' failure. On balance, banking in the region calls out for innovative responses.

Keywords: foreign banks, Pacific islands, bank failure

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**Foreign Banks in the Pacific: Some History and Policy Issues**

## 1.0 Introduction

The problems facing the small, island economies of the Pacific are well known. They include remoteness (and concomitant high transportation costs), economies that depend on a limited range of exports of primary commodities, tourism, remittances and transfer payments, and exposure and vulnerability to natural disasters (Briguglio1995). Armstrong and Reed (2002) correctly criticize the view that these characteristics imply constraints to economic growth. As Cole (1993) points out, government policies of import substitution and domestic self-sufficiency have played an important role in the stagnation of the economies. What none of the studies have addressed is what role remoteness, small scale, narrow economic base, vulnerability, and misguided policies have played in the banking systems. As Chand (2002) points out, today the islands still lack financial depth, something that is a symptom and arguably also a cause of disappointing economic growth.

The story of the evolution of banking in the Pacific Islands has never been told. The foreign banks' presence in the islands was often of such peripheral importance to the banks that several biographies of banks important to the region make no mention of the banks' presence in the islands, or limit their mention to labels on maps of the banks' global span (e.g., Amos 1948, Merrett 1985, Bussière 1992, and Ackrill and Hannah 2001). Still, some articles have appeared on the Australian banks (Hirst, et al. 1982, and Merrett 2002), or on a specific country, such as Papua New Guinea (PNG) and Fiji (Matthews and Tripe 2002).

The paper does not deal with offshore banking. A number of countries, perhaps most notably Nauru and Vanuatu (de Fontenay 2000), offer themselves as offshore centers. However, almost by definition such activities involve the local economy only through the fee income that they generate for the government. The banks involved do not operate in the local economy and generally have no personnel in the jurisdiction that sanctions them.

The discussion below initially proceeds along three dimensions. The discussion of the temporal dimension recaps briefly the general tenor of developments from the late nineteenth century to the present. The discussion of the organizational dimension provides a précis of the most active banks in the region. Lastly, the discussion of the geographic dimension groups the various islands into three spheres of influence—the Australian, the French, and the American—identifying the historical evolution of the foreign presence for each jurisdiction within each sphere. For our purposes, what defines a sphere is the national origin of the major foreign banks, though this now correlates strongly with the history and political economy of the islands in each sphere. The penultimate section discusses the nature of some of the banking problem facing banks operating in the Pacific islands and the role of regulation. The final section is a conclusion.

## 2.0 The Temporal Dimension

The temporal divisions we use to highlight broad geopolitical trends—the Exploitative Era (c. 1850-1914), the Concessionary Era (1918-1945), the National Era (1945-1975), and the International Era (1975-date)—are Robinson's (1964). The reason we use them is because Robinson's classification is the only one extant that seeks to describe the co-evolution of international business and its environment.

Robinson's Exploitative Era is the era of the establishment of colonialism. During this period, Britain, France, Germany, and the U.S. vied to establish colonies, or at least claims, over the islands of the Pacific. Banking penetration was, however, limited. Banks from Australia or New Zealand established branches in Papua or Fiji, and Banque de l'Indochine established branches in Tahiti and New Caledonia.

The Concessionary Era was essentially a transitional period. In the Pacific islands, banking expansion after the First World War essentially came to a standstill. During the War, banks from Australia and New Zealand had followed Allied forces into what had been German-owned New Guinea and Samoa, but that seems to have been all. For instance, in 1939 Gilbert & Ellice Islands Colony first requested that BNSW establish banking facilities. In correspondence, the Suva Manager argued however, that "Whilst it would be an excellent thing for the Colony to have a Branch of this Bank at Ocean Island, it would probably turn out a very unprofitable undertaking for the Bank." Yamasaki (1931) reports that there were no banks in the Japanese mandates; instead, the populace relied on the Post Office for their limited banking needs.

The National Era was a period of decolonization, nationalism, Êtatism—state-led industrialisation—and a stigmatisation of private firms, and especially multinational firms. In many countries, especially in former colonies, governments nationalized the foreign banks and often the domestic banks as well. In the Pacific Islands, as Cole (1993) points out, governments encouraged production for local needs behind tariff walls, and imposed licensing frameworks that supported inefficiency and a lack of entrepreneurial spirit, instead of encouraging the private sector to seek export opportunities and to be competitive internationally. There was little of the nationalization of foreign banks that occurred in Latin America, Africa, the Middle East, and Asia. However, with independence, which came first to the Australian sphere, if at all, there was a tendency for governments to wish to localize banking. This took the form of creating locally incorporated banks often on the foundations of a foreign bank, with the government taking a minority or majority position in the new institution. Some governments established their own commercial banks or fostered the emergence of locally owned banks.

The International Era is one of increasing openness in which governments at best, court, and at worst, accept, the entry of multinational enterprises such as banks. This period saw an initial rush by foreign banks from outside the Pacific or from its fringes to establish themselves in the region. It also saw some banks with a presence in one sphere establish themselves in another. What has followed in the 1990s is consolidation, with a few foreign banks coming to dominate each sphere as they acquired the unsuccessful forays. Also, some of the banks that local governments had acquired or established have since been privatized, often to foreigners, and often after disastrous performance.

## 3.0 The Organizational Dimension

Two **Australian** banks, ANZ and Westpac, are actively establishing their presence in commercial banking in the Pacific. ANZ was the result of the 1952 merger of Union Bank of Australasia (est. 1837 as an Anglo-Australian bank) and Bank of Australasia (est. 1835). In 1970, ANZ Bank merged with the English, Scottish and Australia Bank (est. 1852 as an Anglo-Australian bank) to form Australian and New Zealand Banking Group. ANZ's first entry into the Pacific islands dates back to 1880 when Union Bank established a branch in Fiji. ANZ's only presence in the Pacific islands outside the Australian sphere is its recent acquisition of Amerika Samoa Bank.

Westpac is the result of the 1982 merger of Bank of New South Wales (BNSW) and Commercial Bank of Australia. BNSW, established in 1817, was Australia's oldest bank. Westpac concentrates its activities in Australia, New Zealand, and the Pacific islands. Westpac's presence in the Pacific islands dates back to 1901 when it opened a branch in Fiji. Westpac did try to extend its presence in the Pacific beyond the Australian sphere when it acquired banks in New Caledonia and Tahiti, but it has since sold these to French banks.

Commonwealth Bank Corporation, which the Australian government established in 1912 but ultimately privatized (1991-96), had a presence in PNG and the Solomon Islands that it turned over to the respective governments on independence in the 1970s. Fortuitously, it has recently acquired a subsidiary in Fiji (see below). National Australia Bank had branches in PNG and the New Hebrides but withdrew some time ago.

The two primary **French** banks are Société Générale and BNP Paribas. From 1888 to 1990, Banque de l'Indochine (later Banque Indosuez) was the primary bank as it had the monopoly on note issuance. It lost its note-issuing functions in the mid-1960s; in the late 1980s, it decided to convert itself into an investment bank and to withdraw from most of its overseas retail banking activity. No French bank has any operation in its own name in the American sphere, though BNP Paribas gained an indirect presence in Guam and Saipan through its ownership of First Hawaiian, which it acquired in 1999.

No **United States** or other foreign bank has a dominating presence within the U.S. sphere. In the 1970s and 1980s, Bank of America, Chase Manhattan, and Citibank made some forays. Only Citibank's branch in Guam remains. The important participants in the region now are the Guamanian banks, Pacific Bank and Bank of Guam (see below), and Bank of Hawaii and First Hawaiian Bank.

In 1858, local businessmen opened Bishop & Co. as a banking partnership under the laws of the Kingdom of Hawaii. After numerous acquisitions and name changes, in 1969 the bank adopted the name First Hawaiian Bank; it is now the oldest financial institution in Hawaii. First Hawaiian has branches in Guam and Saipan.

Bank of Hawaii (BoH) was established in 1897 and adopted its present name in 1931. In the early 1960s it established branches in Guam and Saipan, but its active international expansion dates to the five years starting in 1993. Then it began to expand aggressively. By 1999 the bank was faced difficulties and started to cut back, subsequently selling or closing all of its operations in the Pacific islands outside the American sphere, and some within it.

**Other foreign banks** include the then government-owned Bank of New Zealand (BNZ), which was an early participant, opening branches in Fiji and Samoa. However, the bank got into difficulties in the late 1980s and sold these operations. From 1969 to 1986 National Bank of New Zealand (NBNZ) had a branch in the Cook Islands. In the 1970s and 1980s, the British banks Barclays and Lloyds expanded in the region. Barclays had branches or equity stakes in banks in Fiji, Nauru, Tuvalu, and Vanuatu; all are gone. Lloyds, which has wholly owned NBNZ since 1966, opened a short-lived subsidiary in PNG. Hongkong and Shanghai Bank (HSBC) established branches in Fiji, the Solomon Islands, Vanuatu, Guam, and Saipan; the last survivor, the agency in Guam, closed in 2002.

The foreign banks from outside the Pacific islands that have survived to the present have tended to specialize in ethnic banking. That is, they serve communities made up of emigrants from the banks' home countries. The primary examples of this are Bank of Baroda (Gujeratis in Fiji), Habib Bank (Moslems in Fiji), Metropolitan Bank and Trust and Allied Bank (Filipinos in Guam), and Maybank (Malaysian Chinese in PNG).

**4.0 The Geographic Dimension**

Again, it is the predominance of banks from Australia, France, or the United States that distinguishes the Australian, the French, and the American spheres of influence. The spheres of influence also tend to have currencies in common though the situation in the Australian sphere is mixed. Some islands such as Fiji, Papua New Guinea, Samoa, Solomon Islands, Tonga, and Vanuatu have their own currency. Kiribati, Nauru, and Tuvalu use the Australian dollar, and the Cook Islands and Niue use the New Zealand dollar. There are arguments for having the countries in the Australian sphere use the Australian dollar (de Brouwer 2000), but so far they do not. The islands in the French sphere use the French Pacific Franc, which is fixed to the euro. The islands in the U.S. sphere use the U.S. dollar.

The Australian banks dominate an area that was originally composed of British colonies (such as Fiji or the Gilbert and Ellice Islands), Australian mandates (such as New Guinea), and New Zealand mandates (such as Samoa). Although banks from the U.K. and New Zealand operated in what is now the Australian sphere, these have all left. Since the mid-1980s, Australian banks have come to own all New Zealand's major commercial banks, except for NBNZ, which Lloyds Bank still owns.

The French sphere comprises the French Overseas Territories of New Caledonia and French Polynesia. The once Anglo-French condominium of the New Hebrides (now Vanuatu) has clearly slipped into the Australian sphere.

The American sphere consists of the various islands that the U.S. acquired by conquest of the Spanish (Guam), by treaty (American Samoa), or as U.N. Trust Territories after the defeat of the Japanese (such as the Marianas, the Marshall Islands, Micronesia, and Palau). The primary foreign banks in the American sphere today originate in Guam or Hawaii. Banks from the U.S. mainland have a presence in Guam, but no longer elsewhere.

**4.1 The Australian Sphere:**

NBNZ opened a branch in Rarotonga in the **Cook Islands** in 1969. In 1986 NBNZ sold its banking license to the newly-incorporated European Pacific Banking Company Ltd. (EPBC). Although the legal hand-over took place overnight, certain expatriate staff stayed on until their contracts ended, with the last leaving in December 1988. EPBC conducted its business mainly in the Cook Islands, Sydney, and Singapore. It had a subsidiary, European Pacific Trust Company Ltd. (Cook Islands) which carried on its business mainly in the Cook Islands where it provided banking and corporate administrative services. In 1988 Westpac purchased the operations of EPBC and ANZ established a branch that it still maintains.

The Cook Islands government established Bank of the Cook Islands in 2001 by merging Cook Islands Development Bank (est. 1979) and Cook Islands Savings Bank. Bank of the Cook Islands provides developmental loans for local businesses as well as a commercial banking service.

The first bank in **Fiji** was the Fiji Banking and Commercial Trading Company Limited, which Auckland investors established in 1873. It was under-capitalized so its owners sold it in 1876 to BNZ as its principle shareholders and directors were also shareholders in BNZ (Chappell 1961). The next to enter was Union Bank of Australia, which established a branch in 1880 that it closed in 1895. In 1951, Union Bank's successor, ANZ, returned to Fiji with a representative office that it upgraded to a branch. In 1985, ANZ acquired Barclays Bank's operations in Fiji, which Barclays had established in 1973. Shortly thereafter, ANZ acquired Citibank's operations. Then in 1990, ANZ acquired BNZ's operations. Most recently, in 2001 ANZ bought Bank of Hawaii's three branches in Fiji; BoH had entered in 1993 with a branch.

In 1901, BNSW (now Westpac) opened a branch in Fiji. It grew organically until 1988 when it acquired the operations of HSBC. HSBC had established the branch some 18 months earlier but the post-coup environment appeared unpromising. ANZ and Westpac each now account for over 40% of the market.

The Fijian government established the National Bank of Fiji (NBF) in 1974 on a foundation of the Savings Bank of Fiji, itself the former Post Office Savings Bank. Until the 1980s, Commonwealth Bank provided technical assistance and seconded some personnel. By mid-1995, NBF was running bad and doubtful debts of at least US$90 million, which eventually rose to US$220 million, or 8 percent of Fiji's GDP. The debtors were mostly prominent citizens who were never prosecuted; they also lost no collateral, the bank having never asked for any (Walsh 2000). The government responded to public outrage and media scrutiny by minimizing the seriousness of the situation, resisting demands for a public enquiry, and by attempting to muzzle the press.

In 1996-7 the government split NBF into the Asset Management Bank, which would be responsible for winding down the commercial and non-performing loan, and NBF proper (Waqabaca 2000). The restructuring included a reduction in the number of branches, particularly in rural and outlying areas, from 124 to 66. In late 1998, the government drew on the national provident fund to make good the financial shortfall. Then in 1999, it privatized NBF, selling 51% to the Australian company, Colonial Ltd., which had been operating in Fiji as a life insurance company since 1876. (Colonial also had the option to raise it stake to 75%.) Colonial changed the bank's trading name to Colonial National Bank. (Colonial Ltd. also owned State Bank of New South Wales, which it had bought in 1994.) Then in 2000, now-privatized Commonwealth Bank of Australia bought Colonial Ltd., and with it Colonial's stake in Colonial National Bank.

In addition to these banks, two banks from the Subcontinent also operate in Fiji: Bank of Baroda (BB) opened its first branch in 1961, and Pakistan's Habib Bank opened a branch in 1991. BB, which claims 10% of the Fijian banking market, mainly services the Indian community, especially the Gujerati storekeepers. (Baroda is a city in Gujerat.) Habib Bank caters to trade with South East Asia and to Moslems (Skully 1997).

In 1992, Merchant Bank of Fiji commenced operations under a license that permitted it to take deposits only in excess of F$10,000 per depositor. Lastly, Citibank had as many as three branched in Fiji but left in 1978.

Before World War II Commonwealth Banking Corporation operated an Agency on Ocean Island (Banaba), **Kiribati (ex-Gilbert Islands).** The only bank in Kiribati today is Bank of Kiribati (BOK). It has its origins in the branch on Tarawa that BSNW established in 1970 and which also took over the Government Savings Bank. In 1972

BNSW established an agency on Betio Islet. Then in 1984 the original agreement between BNSW and the Government in the Gilbert and Ellice Islands Colony expired and now Westpac and the government of Kiribati formed BOK as a joint venture. Westpac contributed its operations and received 51% of the new bank; the government took 49%. BOK also fulfilled the functions of a reserve or central bank (Stone 1990). In 1996 the government passed a law authorizing foreign banks to establish themselves in Kiribati in competition with BOK. When in 2001 the government sought to reduce Westpac's share in BOK from 51 to 49%, Westpac sold its shares back to the government. The government then privatized the bank, selling 75% to ANZ.

In 1968 the government of **Nauru**, which had achieved independence in 1967, authorized BNSW to open a branch that would function also as the official bank, thus combining central and commercial bank functions. This was BNSW's first branch outside the territories of the British Commonwealth. The agreement gave BSNW a 10-year monopoly but included the proviso that the government could take over the branch at any time after 15 months had elapsed. In 1976 the government exercised its option by establishing Bank of Nauru to acquire BNSW's branch. The government now turned to Barclays Bank, which received a 10-year management contract and took a 10% stake in the bank. In 1985, Barclays Bank did not seek to renew its contract, instead selling its stake to the government. Bank of Nauru essentially collapsed in 1995 but apparently has been limping along ever since.

Westpac opened a branch in **Niue** 1988 that is currently the only commercial bank in the country.

The first banks in **Papua** were BNSW and Union Bank of Australasia, both of which established branches in Port Moresby in 1910. In 1916 Commonwealth Banking Corporation (CBC) followed the Australian army into **New Guinea**, opening a branch in Rabaul and agencies elsewhere; however, Union Bank closed. In 1942, both BNSW and the CBC suspended operations as the Japanese Army captured many of the towns in which the banks had branches and agencies, and bombed Port Moresby. Both banks resumed operations later, CBC possibly in 1944 and BNSW in 1946.

In 1953, ANZ Bank opened a branch in **Papua New Guinea.** The next to enter was National Bank of Australasia (NBA), which opened a branch in 1957.

In 1974, as independence for PNG approached, NBA converted its branches into a locally incorporated subsidiary with the name Bank of South Pacific. It did so to comply with the new government's desire that all banks operating in PNG be locally incorporated (Merrett 1985, pp. 301-2). The Commonwealth Bank formally handed over its PNG operations to the newly created and government-owned Papua New Guinea Banking Corporation (PNGBC). CBC retained a restricted branch in Port Moresby that it apparently later closed. In 1975, BNSW incorporated its local business in Bank of New South Wales Ltd. (PNG). In 1976, ANZ Bank converted its branch operations to a subsidiary: ANZ Ltd. (PNG). In 1979, ANZ (PNG) sold 15% of its shares to two public entities.

In 1983 the government of PNG invited foreign banks to open affiliates. in the country The entry conditions were that the foreign parent could only own 49%, but that Bank of Papua New Guinea (the central bank) would buy that portion of the remaining shares that local investors did not take up. Banque Indosuez established Banque

Indosuez Niugini—49% Indosuez, 41.5% BPNG, and the remainder public. Lloyds Bank established Niugini-Lloyds Bank—49% Lloyds, 35.8% BPNG, and the remainder public.

Today, the four banks in PNG are Bank of South Pacific (BSP), ANZ, Westpac, and Maybank. In 1993, now National Australia Bank sold its 87% stake in Bank of South Pacific to National Investment Holdings Limited (NIHL), which shortly thereafter acquired the outstanding 13% as well. In 2002, BSP acquired 51% of PNGBC in a privatization. The IMF and World Bank had made privatization of PNGBC and several other government corporations a condition for further assistance. Sixty percent of PNGBC's loans had gone to 1% of the population. These large loans performed so poorly that they threatened the bank's liquidity and even its solvency (Chand 2002). After acquiring PNGBC, BSP absorbed it, giving the government a 25% share in BSP in return for its 49% stake in PNGBC.

ANZ bought Niugini-Lloyds Bank in 1990 and merged it into ANZ (PNG). Then in 2001, it bought Bank of Hawaii (PNG). BoH had entered in 1997 by buying Banque Indosuez Nuigini.

Westpac owns 89.9% of Westpac Bank Limited (PNG), the former Bank of New South Wales (PNG). Local interests hold the remainder.

Malaysian Banking Corporation (Maybank) established Maybank Ltd. (PNG) in 1994 with a branch in Port Moresby. Maybank serves Malaysian and Singaporean firms in PNG. It also provides remittance services for expatriates living and working in PNG. Malaysian Chinese are the largest group of ethnic Chinese in PNG and Malaysia-based companies dominate the logging industry (Inglis 1997).

There are three commercial banks in **Samoa**: ANZ Bank (Samoa), Westpac Bank Samoa, and National Bank of Samoa. The first bank to arrive was BNZ, which established a branch in 1915 in the wake of the New Zealand forces' seizure of the German colony. Then In 1959, BNZ incorporated Bank of Western Samoa to take over its branch. This was initially a 55-45 joint venture between BNZ and the government, and acted as the bank of note issue from 1960 to 1980. In 1991, ANZ acquired 50% of Bank of Western Samoa from BNZ and 25% from the Government of Western Samoa. It acquired the remaining 25% in 1995. In 1997, ANZ changed the bank's name to ANZ Bank (Samoa).

Westpac Bank Samoa dates back to 1977 when Pacific Commercial Bank (PCB) opened for business following the acquisition by Westpac of a position in Pacific Savings and Loan Company (est. 1969), in which BoH had had an ownership interest since 1971. In 2001, BoH sold its interest in PCB (42.7%) to Westpac, which also owned 42.7%. Westpac gave Samoan investors, who held the remaining 14.6% of PCB, the opportunity to sell their shares at the same price it had paid BoH. Westpac now owns 93.5% of Westpac Bank Samoa and Samoan companies and individuals own 6.5%.

In 1995, the government helped a consortium of about 50 local investors establish National Bank of Samoa by helping them to purchase the Post Office Savings Bank. The government wanted a locally owned alternative to the Australian banks, which it viewed as focusing on the needs of the wealthier segments of the community. The International Finance Corporation has assisted NBS through its South Pacific Project Facility (SPPF) with a view to making NBS a template for commercial banking projects in other small

Pacific island nations. NBS targets SMEs and especially other SPPF-supported companies.

There are three commercial banks in the **Solomon Islands**: National Bank of the Solomon Islands (NBSI), ANZ, and Westpac. The NBSI, now 100% locally owned, has a 42% share of the market, with many clients who are small retailers. In 1981, Commonwealth Bank of Australia, which had entered in 1951 by establishing a branch, transferred its operations to the National Bank of Solomon Islands, in which it took a 51% share, the government holding the minority portion. In 1994, BoH bought CB's shares; in 2002, BoH withdrew by selling its shares to the government. NBSI is said to be close to insolvency, as political instability has left the economy in tatters.

ANZ commenced operations in Honiara in 1966 and Westpac commenced operations there in 1985. In 1988, Westpac also acquired the Solomon Islands Banking Corporation, a subsidiary of HSBC. HSBC had established a branch in 1973.

There are three commercial banks in **Tonga**: Bank of Tonga, ANZ, and MBf Bank. Bank of Tonga commenced operating in 1974 as a joint venture between the Bank of New Zealand (BNZ; 20%), Westpac (20%), Bank of Hawaii (BoH; 20%), and the Government of Tonga (40%). (The government reserved the right to sell 20% to the public at some future date). In 1990, BNZ sold half its shares to Westpac and half to BoH, giving each of them 30%. In 2001, BoH sold its shares to Westpac. The Tongan government still owns 40%.

In 1993, ANZ established a branch, and MBf Limited, a Malaysian company, established MBf Bank Ltd. Tonga. (MBf stands for Malaysian Borneo-finance.)

The National Bank of Tuvalu (NBT) commenced operations in **Tuvalu** (ex-Ellice Islands) in 1981 as a joint venture with Barclays which took a 25% stake and a management contract (Stone 1990). (Around 1976 as separation of the Ellice Islands from the Gilbert Islands loomed, Westpac established an agency agreement with the Cooperative operating there; NBT then took over the agency.) When Barclays' contract expired in 1985 Barclays sold its shares back to the government. Westpac replaced Barclays and took a 40% stake as well as a 10-year management contract. In 1995, Westpac sold its shares to the government, which now owns 100% of NBT. In 1999 the government merged NBT and the Development Bank of Tuvalu to establish a single, multipurpose bank.

There are four commercial banks in **Vanuatu** (ex-New Hebrides): National Bank of Vanuatu (NBV), ANZ, which operates as both ANZ Bank (Vanuatu) and Banque ANZ Pacifique, Westpac, and Equity Investment Bank.

The government established NBV in 1991. In 1998, the government had to restructure and recapitalize NBV (de Fontenay 2000). It also transferred to NBV the remaining good assets of the Development Bank of Vanuatu (DBV; est. 1993). Still, in 2001 NBV announced an audited loss of vt19.6 million (US$120,000) caused by write offs for bad debts and other problems. The government also established an Asset Management Unit to recover and manage more than US$25 million in debts for the Vanuatu National Provident Fund, DBV, and NBV. The government put the Unit under new management in 2001.

ANZ commenced operations in the New Hebrides in 1971. In 1985, it acquired the operations of Barclays Bank, which had entered in 1972. In 2001, ANZ bought

BoH's 95% stake in Banque d'Hawaii (Vanuatu), and renamed it Banque ANZ Pacifique. This gave ANZ a combined market share in excess of 60%. BoH had established Banque d'Hawaii (Vanuatu) by buying a majority stake in Banque Indosuez Vanuatu (BIV). In 1993, BoH bought out Indosuez, though the government initially retained a 20% stake. Banque Indosuez traced its presence back to Banque de l'Indochine's establishment of a branch in Port Vila in 1948. It incorporated its branches in 1978 to form BIV. The government took its stake in 1983 using an IMF loan as the source of its funds (Skully 1987). At the time, BIV was acting as the de facto central bank for a number of functions, though not as the monetary authority.

Bank of New South Wales entered in 1971. Commercial Bank of Australia, which later merged with BNSW, entered the next year, as did HSBC. In 1988, now Westpac expanded by acquiring the operations of HSBC.

In 1971 Commercial Banking Company of Sydney opened a branch primarily to do offshore business; the bank closed it in 1977. National Bank of Australasia (NBA) opened a branch at Vila in 1972 to handle the business of Australian companies operating on the island and the newly registered Burns, Philp & International Trustee Company in Vila. The New Hebrides became a convenient tax haven for Australian companies but when the Labor Government stopped this capital flight the Australian banks had to survive on the international business they could attract. NBA closed its branch in 1979.

Equity Investment Bank is privately owned and commenced operation in 1998. In addition to the four commercial banks, there is European Bank, which was established in 1972 and has held a full banking license since 1995. European Bank operates as the only private bank, providing services to companies and high-net-worth individuals. It is a wholly-owned subsidiary of European Capital Corp. of Delaware.

**4.2 The French Sphere:**

The first bank in **French Polynesia** was Banque de l'Indochine, which opened a branch in Papeete, Tahiti in 1905. It then functioned as the bank of issue until 1967. Currently, there are three commercial banks in the territory: Banque de Polynésie, Banque de Tahiti, and Banque Socredo.

Banque de Polynésie is now the successor to Banque de l'Indochine. Société Générale established Banque de Polynésie in 1973, taking 80% of the shares while selling local investors the remainder. In 1998, Westpac sold its operations to Société Générale, which merged them with Banque de Polynésie. Westpac had acquired then Indosuez's operations in 1990, when Indosuez was converting itself into an investment bank and was divesting itself of almost all of its remaining overseas retail banking operations.

Banque de Tahiti is now a subsidiary of France's Caisse Nationale des Caisses d'Epargne (CNCE). Crédit Lyonnais and Bank of Hawaii (20%) had established Banque de Tahiti in 1969. In the 1990s, Crédit Lyonnais ran into difficulties at home, and as a condition of its rescue, disposed of many of its overseas operations. So in 1996, BoH acquired majority ownership of Banque de Tahiti. Then in 1998, BoH acquired 70% of Banque Paribas Polynésie and integrated the operations in with Banque de Tahiti. Paribas had established Banque Paribas Polynésie in 1984. Lastly, in 2001, BoH sold its 96% stake in Banque de Tahiti to CNCE.

Banque Socredo was established in 1984, but traces its ancestry back through the Société de Crédit et de Développment de l'Oceanie to 1863 and the creation of the Caisse Agricole de Tahiti. Until the arrival of Banque de l'Indochine, the Caisse or its successors issued banknotes for the territory. Today, Banque Socredo has an alliance with BNP Paribas and still combines development banking with commercial banking.

The first bank in **New Caledonia** was Banque Marchand, a Paris-based overseas bank specializing in the territory, which established a branch in 1871. In 1874, its main shareholders transferred its assets to the newly formed Banque de Nouvelle-Caledonie, which then survived only until 1877 (Skully 1987). The next bank to enter was the Banque de l'Indochine, in 1888. It became the bank of note issue, a role it retained until 1966. Currently there are three commercial banks: Société Générale Calédonienne de Banque (SGSB), BNP Nouvelle Calédonie, and CNCE.

SGCB is the successor to Banque de l'Indochine. Société Générale established SGCB in 1971 to take over its recently established branch. However, the ancestry traces back through Société Générale's purchase in 1998 of Westpac's operations, including its 13 branches. Westpac, in turn, had acquired the operations of Banque Indosuez in 1990. At the time, Banque Indosuez was the largest bank with about a 30% market share. Still, now Crédit Agricole Indosuez has returned to New Caledonia through a branch of Banque de Gestion Privée Indosuez, which it recently established.

Skully (1987) reports that CNCE had been operating in New Caledonia since 1928. In 2001, CNCE bought BoH's operations. In 1974, Bank of Hawaii (20%), Crédit Lyonnais, and local investors established Banque de Nouvelle Calédonie in Noumea. In 1996, Bank of Hawaii acquired most of Crédit Lyonnais' holdings to attain a 91% ownership, and then the next year changed the bank's name to Bank of Hawaii-Nouvelle Calédonie. In 1998, BoH acquired Banque Paribas Pacifique and integrated it with Bank of Hawaii-Nouvelle Calédonie. In 1971, Paribas and BofA had established a subsidiary in New Caledonia, Banque de Paris et des Pays-Bas Nouvelle Calédonie, with BofA owning 30%, and the rest of the shares being in the hands of Paribas and local investors. This became Banque Paribas Pacifique in 1984. In the early 1970s, Paribas and BofA were co-operating in Europe and other parts of the world (Bussière 1992).

Banque Nationale de Paris (BNP) established its first branch in 1968. In 1978, BNP converted its branches into a subsidiary under the name BNP Nouvelle Calédonie. In 1990, BNP bought one of Indosuez's branches when Indosuez withdrew (see below).

In 1991, BNP Nouvelle Calédonie established its 51%-owned subsidiary, Banque de Wallis et Futuna. This was two years after Banque Indosuez had closed its branch at Mata-Utu, leaving the territory of **Wallis and Futuna** without any bank.

### 4.3 The American Sphere:

The U.S. government established Bank of American Samoa in **American Samoa** in 1914. Bank of Hawaii acquired the bank in 1969.

In 2001, ANZ completed the acquisition of Amerika Samoa Bank (ASB; est. 1979) that it had begun in 1999. At the time of the acquisition, ASB was the second-largest bank in the country with a 44% market share. ASB has one overseas branch in Honolulu that it opened in 1997 to serve Samoans in Hawaii.

The oldest financial institution in **Guam** and the Marianas is Bank Pacific (est. 1954), the former Guam Savings and Loan. Locally owned, it also has offices on Saipan and Palau. The other major locally owned bank is Bank of Guam (BoG; est. 1972). BoG now has branches in Micronesia, San Francisco (1982), and Tokyo (1985). In the mid-1980s, when Bank of America withdrew from the region, BoG picked up its branches.

Two Hawaiian banks have a substantial presence in Guam also. The oldest is Bank of Hawaii, which opened a branch in 1961. In 1986, BoH bought the operations of Bank of America, and in 1987, those of Chase Manhattan Bank. First Hawaiian opened a branch in 1970 and had two branches by 1998. Until 2002 Guamanian law prevented off-island banks from maintaining more than two branches, however the Supreme Court of Guam then ruled that off-island banks already in Guam could open branches in the same manner as Guamanian banks could. First Hawaiian, which in 2001 had acquired Union Bank of California's two branches, had sued to escape having to close them. The deal allowed First Hawaiian to leapfrog over Citigroup to a 20% market share behind BoG and BoH. After the decision BoH immediately merged in First Savings and Loan, which it already owned, and which had six branches.

Citigroup (Citibank) had opened its branch in Guam in 1969. Union Bank of California's presence dated back to Bank of Tokyo of California's entry in 1974.

Metropolitan Bank and Trust, a Philippine bank established in 1962 as a bank of, and for, the Filipino-Chinese community, entered in 1975, and now holds the largest share of the remittance market. Allied Bank (est. 1977), also a Philippine bank, has a wholesale branch in Guam. It owns Oceanic Bank (San Francisco), which has a branch in Guam. The Filipino community accounts for a little more than 20% of Guam's population.

Taiwan's First Commercial Bank opened a branch in 1977 or so, one of the first two overseas branches it had established, and is still present. HSBC had entered in 1976 or so, but apparently withdrew in 2002.

In 1989, Saitama Bank opened a finance unit in Guam for financing and consulting for development projects in Guam and surrounding islands. It was the first entry by a Japanese financial institution, not counting Bank of Tokyo's indirect entry. Saitama Bank later merged into Asahi Bank, which established a branch that has since closed. Several other small, local banks or financial institutions also operate on Guam.

In 1982, the Government of the Marshall Islands (80%) and local investors (20%) established Bank of Marshall Islands as a locally owned bank to serve the **Republic of the Marshall Islands**. In 2001, the U.S. Government agreed to permit the bank to qualify for coverage by the Federal Deposit Insurance Corporation (FDIC); it was only the second bank outside the U.S. to so qualify.

Earlier, BoH had established a branch in Majuro in 1961. In 2002, unable to find buyers for the branch, BoH closed it. There is one other bank, Bank of Guam, which entered in the mid-1980s when it acquired Bank of America's Majuro branch.

There are now two commercial banks in the **Federated States of Micronesia**: Bank of Guam and Bank of the Federated States of Micronesia (Bank of Micronesia). Bank of Guam entered in the mid-1980s by acquiring Bank of America's branch on Chuuk. The State and Federal governments established Bank of Micronesia in 1985 and own 80%; local investors own 20%. The bank has qualified for FDIC coverage and was the first bank outside the U.S. to do so. In 2000, Bank of Micronesia opened a small-loan branch in Saipan, which is home to several thousand citizens of the Federated States.

Bank of Hawaii had opened a branch, on Yap, in 1970. However, in 2002, unable to find buyers for its three branches in Ponape, Kosrae, and Yap, BoH closed them.

Bank of Hawaii opened its first branch on Susupe (Saipan) in the **Commonwealth of the Northern Mariana Islands** in 1971. First Hawaiian entered in 1997 by establishing a branch. Then in 2001, First Hawaiian bought Union Bank of California's branch. Union Bank's branch dated back to Bank of Tokyo of California opening a branch in 1974.

Bank of Guam has four branches and its presence dates back to Bank of America's withdrawal in 1981. BankPacific also has a branch.

In 2002, Bank of Saipan went into receivership, and HSBC closed the branch it had established some six years earlier. There may be some other small, local banks.

When Bank of Hawaii opened a branch in the **Republic of Palau** in 1961, it was the first bank on the island. Bank of Guam has a branch, and its presence dates back to 1984 when it took over Bank of America's branch. Guam's Bank Pacific and Taiwan's First Commercial Bank each have a branch. Several other small, local banks may exist as well, such as Bank of Palau (est. 1985) and Pacific Savings Bank.

## 5.0 Banking Issues

Geography is obviously a critical issue for banking in the Pacific Islands. Of the 19 jurisdictions we discussed above, all but PNG qualify as small countries if one uses one-million persons as the dividing line between small and not small. PNG, with perhaps four-million-plus inhabitants, alone accounts for some 60% of the Pacific islands' total population of 7 million inhabitants. The second-largest entity is Fiji, with some 800,000 inhabitants. In terms of land area, PNG accounts for 84% of the Pacific islands' 215,000 square miles.

Most of the Pacific islands have narrow export structures, something that makes them vulnerable to supply shocks such as natural disasters and crop failure, external demand shocks, and also major political disturbances (de Brouwer 2000). In an econometric study of Fiji, Samoa, Tonga, and Vanuatu over the period 1981-1999, Jayaraman (2001) found a great vulnerability to cyclones for these islands' economic growth. Natural disasters can place considerable pressure on financial systems (Benson, et al. 2001). Residents draw down deposits and seek increased credit to rebuild. They also may need to delay repayment of existing loans or may even default on loans. External demand shocks can have similar effects. What this means is that banks whose operations remain within one country, whether the banks are locally owned or subsidiaries of foreign banks, are vulnerable to these supply and demand shocks. The key problem is that the banks' asset base is too narrow. That is, their loan portfolios suffer from a lack of diversification in terms both of geography, despite the distances that some of the Pacific island states cover, and industry. By contrast, Shiers (2002) found the not-surprising results that economic diversity reduces bank risk, and that branching also reduces bank risk.

Obviously, the banks can protect themselves against the effect of natural disasters by lending only to entrepreneurs who can pledge insured buildings as collateral. If the banks do so, however, they limit the amount of lending they can do. Similarly, if the banks invest some of their funds abroad, absent some mechanism for loan swapping between Pacific island banks, this reduces their risk, but at the cost of reducing the credit available locally.

Permitting branches of foreign banks incorporated in Australia, France, or Hawaii to operate locally solves some of the problems. Deposits in a branch are claims on the whole banks, not just the local entity, as is the case with a subsidiary. Thus, even if a branch's loan portfolio suffers from an external demand shock or a natural disaster, the parent absorbs the loss, leaving depositors unaffected. Unfortunately, the tendency in the National Era, at least within the Australian sphere, was for local governments to insist that foreign banks incorporate their branches locally.

Permitting foreign banks to operate as branches could bring another benefit. Because it is cheaper to establish a branch of the parent rather a subsidiary (see below), banks might be more willing to enter smaller markets if this option were open to them. One cannot make much of this, though. Currently, Westpac and ANZ have a large presence in both PNG and Fiji and apparently are finding it profitable (Mathews and Tripe 2001). However, even though Fiji permits branches of the parent, the last foreign entrant was Habib Bank in 1991. In PNG, by contrast, having to operate via a subsidiary did not deter Maybank from entry. Furthermore, given all the withdrawals from the region of the last two decades, it is not clear who the potential entrants would be.

If the Pacific island countries were to permit foreign banks to operate as branches of the parent, in some case even converting back to their earlier practices, not all foreign banks would do so. When a bank has sufficient assets at risk in a foreign location there may come a time when it becomes sensible to incorporate locally. Generally, a branch costs less to establish than a subsidiary. There are no costs of incorporation, no need to report annually or quarterly to local registrars of companies, no need for a board of directors, and so forth. However, Du (2003) makes a novel and striking argument that carries over to this case. He points out that multinational companies may borrow from local banks to enlist the services of those banks as monitors of local operations. The local bank, as local creditor with often first rights to any assets in bankruptcy, has an incentive to intervene quickly if it senses problems. Similarly, a foreign bank with a number of branches in a country thousands of miles from home, dependent on the local economy about which the parent knows little, may decide that by incorporating locally, it enlists the governance services of the local central bank and local depositors. These parties are more likely to sense and react to some problems that headquarters, dependent on reports from its managers, might be unaware of. Thus, when the assets at stake are large enough and the local regulatory authorities are capable, the foreign parent may decide that the costs of incorporation are an acceptable cost for improved governance. For instance, in the French sphere the foreign banks converted voluntarily to local incorporation. Thus in New Caledonia, BNP converted in 1978, when the number of its branches reached five.

Even if foreign banks continue to operate as branches of the parent, foreign banks come with a handicap. Berger et al. (2002) argue, on the basis of theories of incomplete contracting, that small banks may do better than large banks at processing soft information. Bank lending to small firms is one area that relies heavily on soft information even in developed economies, and even more so in developing economies where the infrastructure to produce hard information is, at best, nascent. Berger et al. (2002) find that large banks are less willing than small banks to lend to firms that do not keep formal financial records and that are more likely to have impersonal, shorter, and less exclusive relationships with borrowers. By necessity, the foreign banks that expanded in the Pacific islands are large. It follows, then, that the foreign-owned banks will tend to neglect lending to small firms. Several of the governments in the islands have remarked on such a tendency, and have responded by fostering the creation of locally owned banks.

Locally-owned banks and credit cooperatives can escape the problem of headquarters responding to issues of size and distance by relying on hard numbers rather than soft information. However, they still suffer from lack of diversification. Credit cooperatives can, conceptually at least, also get around problems of communal land tenure. As Skully (1997) points out, the virtual absence of secure land rights in the South Pacific prevents borrowers from using land as security for a loan from a bank or other financial institution, impeding private sector access to finance. (He further argues that the problem is not communal ownership of land as such but rather the lack of effective leasehold title system that includes full transferability.) Mutually owned credit institutions can use social ties and pressure to enforce repayment, and so rely on what one might call "social collateral" rather than real property as collateral. Guinnane (2001) has an informative article about the success of rural credit cooperatives in Germany in the late nineteenth century. However, he has an equally informative account of the failure of such cooperatives in Ireland, suggesting that they are not a panacea (Guinnane 1994). The Irish credit cooperatives were unable to attract to membership the more prosperous locals who, in Germany, provided crucial monitoring and expertise and rural Irish members proved reluctant to force their neighbors to repay loans. As the point-counterpoint between Gregory (1999) and McGuire (2000) suggests, this could be an issue in the Pacific islands region as well. Lastly, the Irish cooperative movement also never developed the strong central auditing federations that supervised and certified German cooperatives. This is something that would be difficult to develop in the Pacific too, given distances and political and ethnic fragmentation.

In several of the Pacific islands, governments have created government-owned banks. In general, the history of the government-owned banks has not been good. In the Pacific the poor performance of government-owned banks has not been due to the problems of a lack of diversification, alluded to above, but rather to problems of governance. In a wide-ranging study Dinç (2002) found that government-owned banks increase their lending in election years, and restructured and overdue loans also increase. Despite the claim that government-owned banks fund projects private banks cannot finance, government-owned banks tend to fund the government by holding more government debt than private banks hold. Both government-owned and private banks hold a similar share of loans to assets on average across the electoral cycle.

As Sevic (2001) points out, in small states the relationship between citizens, civil servants, and politicians is often close. The government-owned banks are thus vulnerable to problems of cronyism, support buying, and corruption. Casual observation would suggest that the problem takes time to emerge. Initially, the banks may have management contracts with a foreign bank and seconded managers. But in time, management changes, and politicians wake up to the possibilities.

In Fiji and PNG, the governments have been forced to privatize the banks they owned, following financial scandals. The National Bank of Vanuatu had to be re-organized and recapitalized between 1998 and 2001. The Bank of Nauru and the National Bank of the Solomon Islands have either failed or are close to failure.

## 6.0 Conclusion

Foreign banks have been operating in the Pacific islands since the late nineteenth century. Today, a handful of banks from Australia, France, Guam, and Hawaii dominate banking in the region. However, banking is highly concentrated with two Australian banks dominating the Australian sphere of influence, and three French banks, the French sphere. The situation in the U.S. sphere is a little more diverse, though in all three spheres, there are numerous situations of monopoly.

Although the foreign banks bring certain benefits to the countries in which they operate, they also have limitations. On the one hand, the banks can benefit from scale economies, and depositors in the banks benefit from the protection of the capital of a large, well-regulated and supervised institution that further benefits from geographic and sectoral diversification. On the other hand, by their very nature, the foreign banks are likely to limit their lending to the most creditworthy borrowers, especially well-established firms with collateral to pledge.

Forcing the foreign-owned banks to incorporate locally, and attempts to create locally-owned banks, risks creating vulnerable institutions that will very possibly, at some time, require rescue as a result of the consequences of natural disasters or demand shocks. However, the device of creating government-owned banks has been even less successful, as most have succumbed eventually in scandals of mismanagement, looting, and cronyism. Developing efficient, safe, and locally responsive banking systems in the Pacific islands will require innovations in banking practices and institutions.

**Sources**

The information on the opening dates for the Australian banks comes primarily from Scully (1980 and 1987), as does some of the history of the development of banking in the Australian sphere. Meuleau (1990) provided information on the early development of banking in the French sphere. Much of the most recent information came from the Web sites of the banks themselves and from press reports. Jennifer Campbell of Barclays' Archives, Victoria Akrong and Lucy Rantzen of Westpac's Historical Services, Bernard McGrath of National Australia Bank Archives and Hugh Boyle of National Bank of New Zealand's Archives provide many useful and interesting details concerning their banks' histories.

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