

## **PRACTICAL PROBLEMS, and SOLUTIONS**

The immediate practical problem is that we have a worsening subprime crisis in rural areas and are doing nothing. Second-wave events are now evident. These will compound individual and national losses while fostering contagion.

Current denial and inaction are a disgrace. Problems that were initially manageable are becoming far less tractable. Needless wealth destruction across the nation is extensive. It is time for clear thought, commitment and action.

Many issues were canvassed in **“Subprime agriculture, and Australia?”** Despite apparently wide readership, response has been muted as a combination of denial and “startled rabbit” syndrome stymie progress.

***The ARDB is designed to improve our national ability to address critical financial problems and practical challenges - specifically in Agriculture, associated industries and infrastructures - now and into the future.***

While details will need to be fleshed out, the ARDB offers a sensible and responsible way forward. No alternative solution has been offered. It seems prudent and responsible to Act so as to develop and implement this proposal for a Board charged with specific responsibilities to be set up within the RBA.

## **POSITION**

The key step embraced in the Bill is to set up a Board with responsibilities for areas of finance that are currently unaddressed.

Just as foreign loan and other financial fiascos saw the establishment of APRA, so also increasingly evident failures in industry finance and growing liquidity challenges demand more complete and focussed institutional capacities.

Problems are most acute in Agriculture where major inadequacies in financial products, servicing and governance are evident.

In addition to previous submissions, I would now also offer brief comment on organisational and perceptual issues that are impeding effective responses to identified problems.

I am very grateful for the opportunity to address the Senate Economics Legislation Committee. I applaud its earlier works and look forward to a similarly thorough Inquiry report. I stand ready to assist the Committee, and other responsible organisations, and welcome questions and comments in any areas, today and as appropriate in the future.

Mark McGovern,  
18<sup>th</sup> March 2015

## **ORGANISATIONAL ISSUES.**

*Australians need to organise themselves so as to better meet the current and potential challenges. The times have changed but we have not responded.*

### **1. Institutions have ignored significant realities**

In 2007 RBA Deputy Governor Ric Battelino raised concerns about badly mismatched balance sheets in Australia. A few months earlier a survey commissioned by a Senate Committee had revealed that two thirds of Australians considered themselves good investors but a similar majority did not consider risk and return. All were ignored.

Today we live with the legacy. Balance sheets have deteriorated across the country. “Unconsidered risks” and “unrepayable debts” have damned many and raised risks across the whole financial system.

Well-founded concerns were expressed by these and other senior parties before the GFC hit. Seven years on, responses are negligible, or worse. Instead the trick has been to blame individuals.

Meanwhile, as problems festered unchecked, the well being of Australians deteriorated - particularly in highly exposed sectors such as Agriculture.

***An ARDB would help rectify institutional failures.***

### **2. Liquidity management is deficient**

Central banks were primarily established to provide liquidity from a lender of last resort. Around the world, funds have been used to stabilise failing financiers, borrowers, product lines and systems. Arguably, financiers have been inappropriately favoured *without addressing the central problems of inadequate financial products and unrepayable debts.*

***The ARDB would provide a vehicle for responsible liquidity management, debt rectification and product development.***

### **3. Internalising financial responsibilities can improve performance**

Central banks have tended to not raise funds on their own account. Instead funds have been transferred from others: the accounts of governments (“bail outs”), depositors (“bail ins”) and easy target groups (“bail ups”).

This is just opportunistic subsidy harvesting. Funds transfers just spread problems with nothing really solved. Major moral hazard issues develop.

Instead we need a “work with” model of responsible collaborative advantage.

***The ARDB would work with other parties in the financial system so as to self manage problems. Government budget costs and risks would fall.***

### **4. Enhanced capacity is needed in critical operational and strategic areas**

New times have brought new challenges. Institutional capacities need to be improved in several areas, with priorities to be determined by an independent Board.

***ARDB goals would likely include:***

- ***to monitor and foster responsible financial behaviours (micro-prudential)***
- ***to target potential financial breakdowns before they become serious (early intervention),***
- ***to seek prudent risk and funds allocations (financial balance),***
- ***to stabilise and help renew selected key capacities threatened by undue financial stresses (strategic intervention) and***
- ***to minimise needless wealth destruction and impoverishment (supporting the third RBA charter responsibility)..***

### **5. Analytical and policy capabilities in public agencies need renewal**

Submissions to the Inquiry from public agencies have been worryingly limited as are a variety of related public policy documents.

Flawed data analysis, mistakes in critical assumptions and reliance on opinion rather than well reasoned argument are all evident.

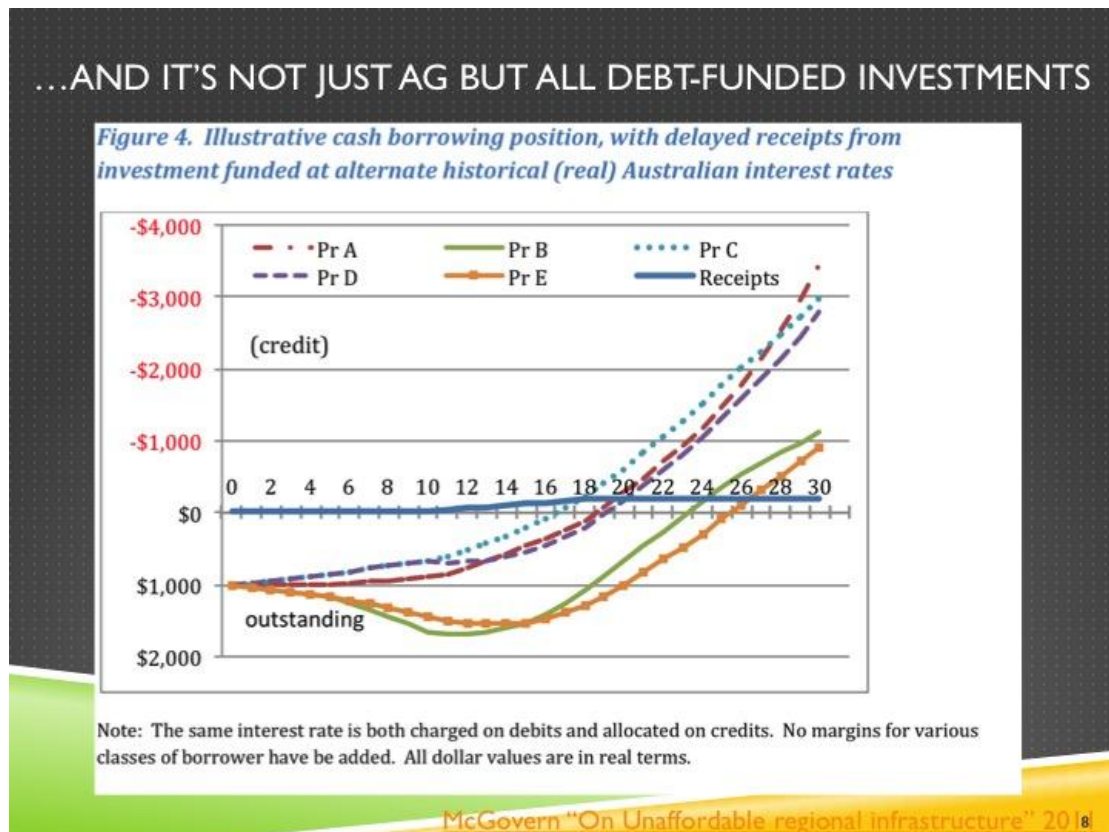
***ARDB activities would aid the development of more adequate and robust analysis and policy documents.***

## PERCEPTUAL PROBLEMS.

### 6. Rectifying unsustainable circulation of capitals trends is most critical

Naïve RBA interest rate setting since 1980 has slowed the circulation of capital and inappropriately transferred funds from borrowers to lenders.

The illustration shows the effects of different real interest rate profiles on the same investment revenue stream.



Cohort A C D commencement years were 1905, 1940 and 1970

Cohort B commenced in 1925 and was affected by years of depression and war.

Cohort E which commenced in 1980 and completes during 2010 was affected by years of growth and modern monetary policies.

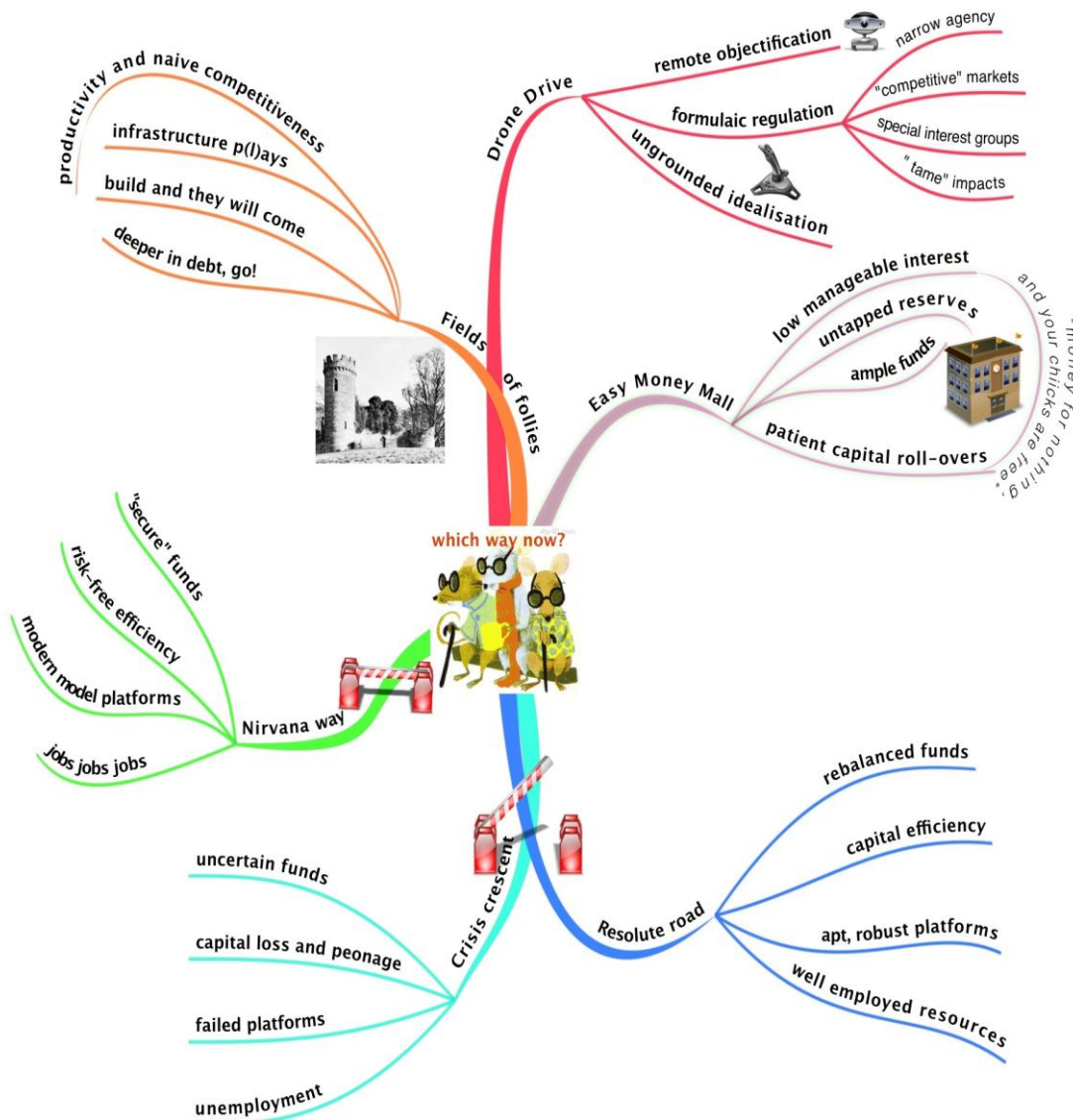
This is a central issue in the performance of investments. After 30 years with the same investment return profile, some find themselves with three times the "money in the bank" than others. Banks capital is needlessly tidied up longer, regressing capital productivities. Returns transfers and limited capital formation weaken economic resilience at the enterprise, regional and national levels.

***An ARDB would internalise considerations of interest rate effects on capitals and enterprise sustainability.***

## 7. Changing the dominant mindset will foster productive change

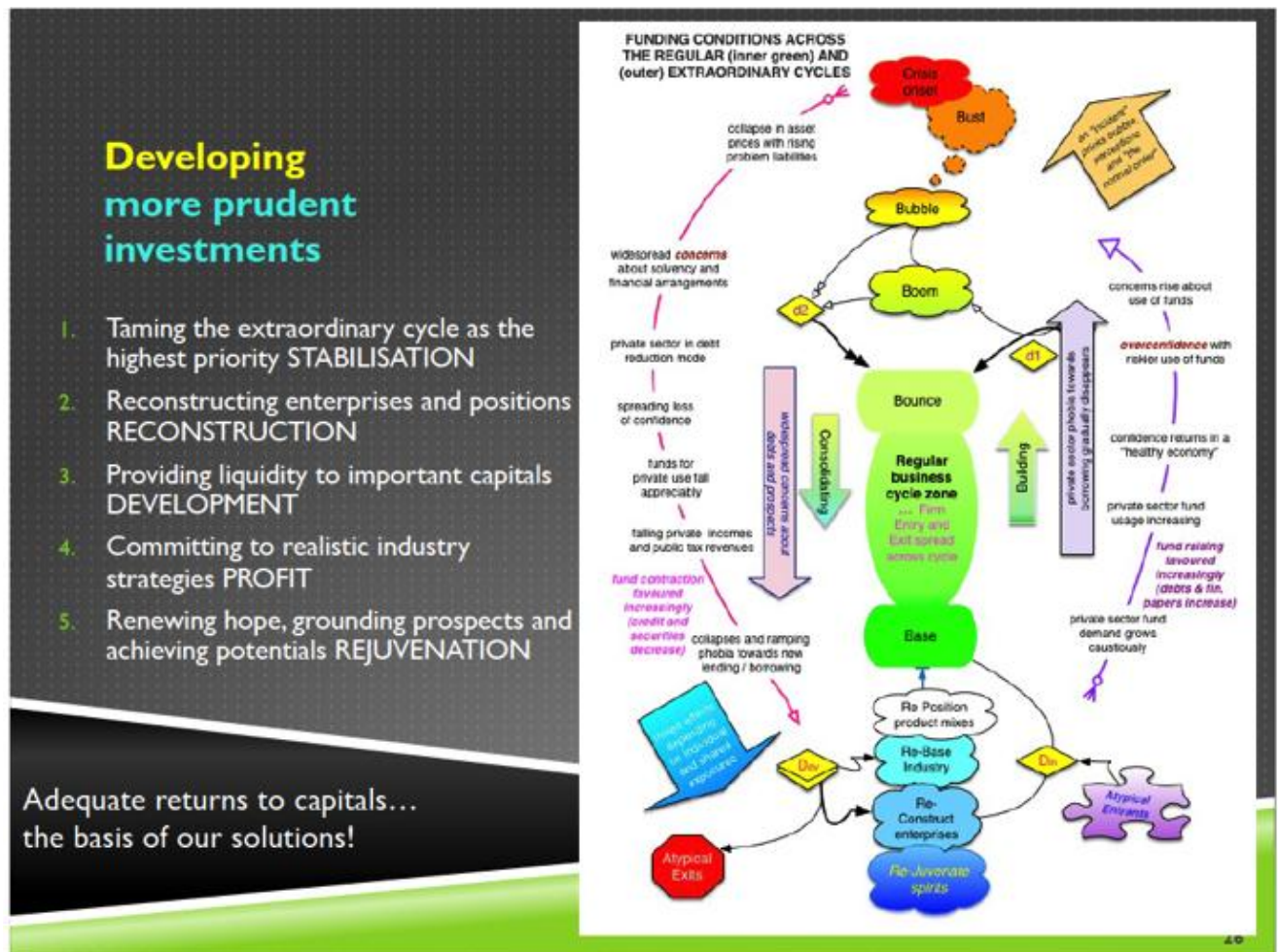
The ideas that for many years guided our progress lead to the GFC.

We need to critically evaluate old ideas and actively explore new ideas, and approaches if we are to move from Crisis Crescent. Sadly, some believe we are still on Nirvana Way. Money Mall is increasingly “Hard” not “Easy”.



***Developing institutional capacities via the ARDB is part of restoring a prosperous path to the future, in the bush and beyond,***

## 8. Green Zones, Extraordinary Cycles and Investments provide a context



Investment desirability and returns vary with the state of the economy.

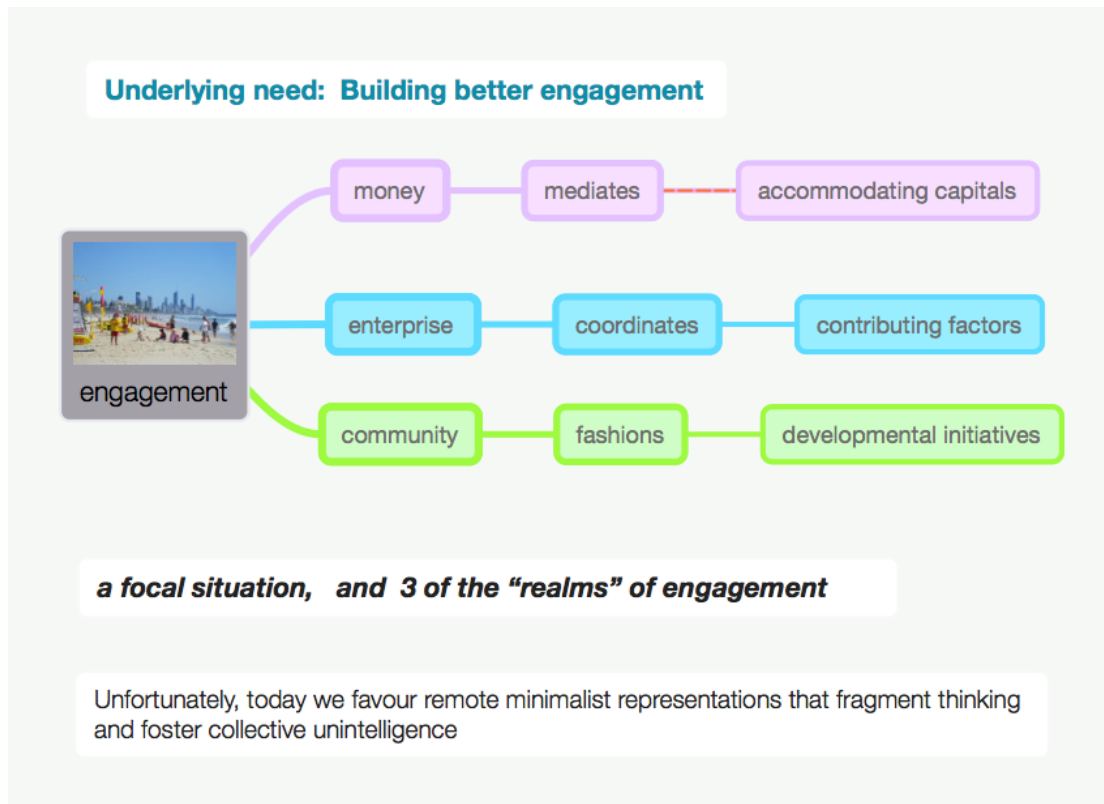
Balance sheet stresses arise where there are mismatches.

Balance sheet recessions left unattended can be prolonged and broadly impoverishing .

Policies need to adapt to the cycle, and green zone thinking needs to be challenged.

***The ARDB can help with cycle management if its investigations allow for significant dis-equilibrium events.***

## 9. Rebuilding engagement is the key political and societal challenge



Our understanding has become fragmented. We segregate finance, economy and society – and then some seek primacy for their preferred “realm”.

GFC “recovery” policies overseas have been notable for their strong favouring of finance, and of “Queen Street over Country Road” in Australia.

We have lost track of the need for mutually complementary contributions. Collaborative advantage and “Work with” approaches recognise this foundational need.

***The ARDB can help build appreciation of, and manage the effects of, financial products, interest rate arrangements and the like on the resilience and successes of variously engaged parties.***