CHAPTER 4

Commonwealth Inscribed Stock Amendment Bill 2009

Purpose of the Bill

4.1 The Commonwealth Inscribed Stock Amendment Bill (CIS Bill) amends the *Commonwealth Inscribed Stock Act 1911* (the CIS Act) by inserting a new section 5A which allows the Treasurer to declare that a special circumstance exists which justifies an increase in the cap of Commonwealth Government Securities on issue.

4.2 Currently, the maximum face value of Commonwealth Government Securities (CGS) on issue is $75 billion. The CIS Bill proposes to allow the Treasurer to declare that special circumstances exist which justify an increase in the limit on the face value of securities on issue by $125 billion. A special circumstance could include, but is not limited to, a deterioration in global or domestic economic conditions or a deterioration in revenues.[1]

4.3 Other provisions of the CIS Bill provide that:

- at any one point in time, there can only be one declaration that there are special circumstances, that is the Treasurer can not make another declaration until the previous declaration is revoked;
- the declaration is not reviewable under the *Administrative Decisions (Judicial Review) Act 1977*; and
- the Treasurer will still be required to issue a direction under the CSI Act specifying the total amount of CGS that can be on issue within the cap.

Issues

4.4 A number of issues were raised in relation to the proposed increase in the cap of the CGS including: the cost of the debt; the attractiveness of CGS to investors; and the potential impact on exchange rates.

4.5 The Treasury indicated that the gross debt on issuance is currently $58.5 billion, which is 5.5 per cent of gross domestic product.[2] The additional $125 billion would be required to fund the proposed package and other funding needs of the Government including refinancing of existing borrowing lines.[3] The Treasury commented that the Government's borrowing requirement is 'largely due to the reduction in estimated tax receipts resulting from the deteriorating economic outlook

---

1 Explanatory Memorandum, Commonwealth Inscribed Stock Amendment Bill 2009, p.3.

2 Dr K Henry, The Treasury, *Committee Hansard*, 5.2.09, p.21.

3 Mr N Ray, The Treasury, *Committee Hansard*, 5.2.09, p.32.

and the unwinding of the commodities boom'. It was noted that since the Mid Year Economic and Fiscal Outlook, taxation receipts have been revised down by around $75 billion over the forward estimates. These falls in tax receipts, along with higher payments associated with the weaker economic outlook, account for around two-thirds of the overall borrowing requirement.[4]

4.6 Dr Ken Henry, Secretary of the Treasury, noted that:

> …we are making interest payments on that gross debt. We make interest payments in the form of coupons for people who hold Commonwealth government securities on that debt. But at the same time, we hold financial assets on the balance sheet; obviously in the Future Fund and other financial assets that we hold that more than offset that gross debt on issuance.[5]

4.7 In addition, the costs of the funds was explained thus:

> The cost of funds is going to depend on the maturity structure of the debt that gets issued, and we have not yet determined that because it would depend on market conditions. But at the moment I think our average cost of funds for new issuance is around about four per cent.[6]

4.8 Mr David Tune, Department of the Prime Minister and Cabinet, also commented in responding to a question on whether the increase imposed an unsustainable cost to the economy:

> It depends where your starting point is. If you are looking at reasonably low debt levels to start with, you trade off the costs around these things in the future against the benefits you get in the current period. As long as you do not move the country into huge, unsustainable debt levels—which this will not do; net debt will remain at a reasonable level and low by international standards—there is probably not a problem. But yes, there is a cost.[7]

4.9 Mr Greg Evans of the Australian Chamber of Commerce and Industry (ACCI) also recognised the necessity of a temporary deficit:

> We agree with the concept that there needs to be a temporary deficit to deal with the current economic circumstances. We are on record as an organisation as being fiscally conservative in these matters, so we believe that this is not the time to relax any sort of government discipline with respect to wasteful government spending or inefficiencies. They should also be dealt with. [8]

---

4 The Treasury, *Answer to Question on Notice*, 5.2.09.

5 Dr K Henry, The Treasury, *Committee Hansard*, 5.2.09, p.21.

6 Mr N Ray, The Treasury, *Committee Hansard*, 5.2.09, p.21.

7 Mr D Tune, Department of the Prime Minister and Cabinet, *Committee Hansard*, 6.2.09, p.36.

8 Mr G Evans, ACCI, *Committee Hansard*, 9.2.09, p.9.

4.10 Dr Henry went on to comment that in the UEFO it is stated that:

> As the economy recovers, and grows above trend, the Government will take action to return the budget to surplus by:
>
> • allowing the level of tax receipts to recover naturally as the economy improves, while maintaining the Government's commitment to keep taxation as a share of GDP below the 2007-08 level on average—
>
> taken together with the second dot point—
>
> • holding real growth in spending to 2 per cent a year until the budget returns to surplus—

4.11 Dr Henry concluded:

> I consider that there is good reason to expect that, with those two conditions satisfied when the economy is growing strongly, any increase in net debt due to the implementation of this package would be unwound over time. The reason I draw your attention to the first dot point is that that implies that the increase in net debt would be unwound over time without taxation increasing as a share of GDP above the 2007-08 level, on average.[9]
>
> …
>
> As I indicated the last time we met, obviously net debt will be reduced over time by future budget surpluses—that is the intention—and that would be true no matter how the budget surpluses were achieved, obviously. It could also be achieved by asset sales. That has certainly been a way in which debt has been reduced in the past. But, provided the budget achieves a headline surplus, and certainly if it achieves an underlying cash surplus in the way we measure these things these days, the net debt will be reduced. That is a tautology.[10]

4.12 A further issue raised during the inquiry was the attractiveness of CGS to investors when many other governments are also borrowing money to address problems in their economies. Dr David Gruen, Treasury, commented that for private investors 'there has been a huge reduction in appetite for risk, so investors are crying out for government assets, which they deem to be safe, so yields on government bonds all around the developed world are falling because demand is extremely strong for those sorts of assets'.[11]

4.13 In evidence, the Treasury responded to concerns that raising money in the bond market could lead to an increase in the exchange rate as foreign investors will purchase Australian dollars to buy bonds. A higher Australian dollar could impact adversely on export-oriented industries. Dr Henry responded:

---

9 Dr K Henry, The Treasury, *Committee Hansard*, 9.2.09, p.39

10 Dr K Henry, The Treasury, *Committee Hansard*, 9.2.09, p.40.

11 Dr D Gruen, The Treasury, *Committee Hansard*, 5.2.09, p.17.

A general view among macroeconomists would be that, if one country acting in isolation were to undertake an expansionary fiscal policy and that country had a freely floating exchange rate, then one of the consequences of that unilateral fiscal expansion would be that its exchange rate would appreciate. Obviously we are not in those circumstances. It is the case that governments around the world are undertaking expansionary fiscal policy. It may well be the case that, were Australia not to undertake an expansionary fiscal policy, our dollar would depreciate even further than it already has. Maybe that would provide some measure of support for some sectors of the economy that would benefit from a depreciating exchange rate, but it would also reduce forecast growth in the Australian economy in 2008-09 by ½ a percentage point and in 2009-10 by ¾ to one percentage point. Even taking into account the impact on the exchange rate of the fiscal stimulus, that would be the effect.

To put it another way: in making these forecasts, our modelling would have taken into account, at least to some extent, impacts on the exchange rate of the economic stimulus package that is here. Any economic stimulus package is going to directly benefit some sectors of the economy more than it does others; I suspect that is unavoidable. The same is true of monetary policy, as you know. Not everybody likes to see interest rates fall. Yet I think we all accept that, when the economy weakens, it is desirable that interest rates fall.[12]

12 Dr K Henry, The Treasury, *Committee Hansard*, 5.2.09, p.9.