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**The Loan Council, International Credit Ratings
and the Australian States: The Implications of State
Borrowing Regimes for Fiscal Federalism**

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ABSTRACT

Government borrowing occupies a special place in the history of the Australian Federation, particularly given its connection with the issue of revenue distribution between the states. The arrangements and rules that governed the borrowing of the States and the Commonwealth are encompassed within the Financial Agreement Act and the procedures of the Australian Loan Council. This system developed at the end of the 1920s and operated substantially unchanged for the almost the next seven decades of Federation giving the Commonwealth effective control of State borrowings. As such, it became an important contributor to the strengthening of the Commonwealth's position within Commonwealth-State relations over the twentieth century.

However, at the end of the 1980s, when the States were taking increasingly advantage of a deregulated financial system and easy access to global markets to bypass the formal controls imposed by the Loan Council, the Commonwealth turned to the markets for a solution. This move has meant that international credit rating agencies through the central part they play in the process by which State governments' raise funds, and as the 'standard bearers' for market discipline have had, and continue to have, a major role in shaping politics and public policy within the Australian States.

In a national economy transformed by globalisation, the role of credit rating agencies in the critical task of funding the public sector has put them in a position through which they have become part of the broader regulatory structure of fiscal federalism.

GOVERNMENT BORROWING- FROM “A RECURRING THEME” TO AN ENTIRELY NEW SCORE

Government borrowing occupies “a special place in the story of the Australian Federalism” even predating Federation itself. The co-ordination and control of borrowing has been “a recurring theme” in the relationship between the Commonwealth and the States; at various times taking centre stage in political and economic debate, but always connected to the perennial problem of revenue distribution.¹

Despite considerable debate on the issue during the conventions of the 1890s, the Constitution that came into force in 1901 gave the Commonwealth power to take over the pre-federation debts of the states but was silent on the issue of controls on future borrowings. But by 1919 both the states and the new Commonwealth government were borrowing heavily. On the Commonwealth’s part there was a need to redeem or convert war debt, while the states needed to fund development, particularly railways. The competition between them was both intense and economically damaging and created pressures that led to the formation of a voluntary Loan Council in 1923. This was followed by The Financial Agreement ratified by all Australian Parliaments in 1927-28 and a successful referendum in 1928 which allowed the Commonwealth to “make agreements with the States with respect to the public debt of the states”. Armed with these new powers, the Commonwealth validated the Financial Agreement and established the Loan Council.²

These formal arrangements remained in place for more than half a century. Up to the end of the 1970s the controls on borrowings by the States through the Loan Council mirrored the strict regulation that characterised the financial system in that period. The borrowing powers of the states were tightly controlled and the Commonwealth conducted all borrowings on behalf of the states. The Commonwealth was responsible for the national debt, with both levels of government contributing to a National Debt Sinking Fund. The Commonwealth in turn provided grants to the States to help them make interest payments on the debt raised on their behalf, and their contributions to reducing that debt through the Sinking Fund.

But by 1993 the States were responsible for managing their own debt; the requirement for Commonwealth and State borrowing to be approved by the Loan Council and the Commonwealth’s explicit power to borrow on behalf of the states had been removed, as was and the restriction on State’s borrowing through the issue of securities in their own name. As a consequence the borrowing arrangements of the Federation had become as “deregulated” as the nation’s financial system had during the 1980s, with the States active players in domestic and global financial markets. But while borrowing arrangements were deregulated they were not “unregulated”. Rather than being governed by constitutional provision, legislative scheme or political agreement they were now being regulated by the financial markets and in particular by an agent of the markets in the form of international credit ratings agencies.

Deregulation in both domestic and international financial markets during the 1980s created attractive opportunities for the States to raise funds. However, they were also pushed towards the markets by the Commonwealth Government as part of an overt strategy to restrain State borrowings. The Commonwealth’s Budget Papers record that changes to Loan Council

¹ Cheryl Saunders, "Government Borrowing in Australia," *Melbourne University Law Review* 17 1989 p.187

² Saunders, "Government Borrowing in Australia," p.187-9

borrowing arrangements throughout that period were designed to “facilitate financial market scrutiny of public sector finances via better reporting and so make jurisdictions more accountable to the markets”.³ These new financial arrangements have been described more colourfully as having “exposed the States’ soft underbellies to the sharp teeth of the CRAs, who immediately began to rate and re-rate the States with some enthusiasm”.⁴

The story of the change from the recurring theme of government borrowing through the Loan Council to a national fiscal symphony with an entirely new score; and moreover one conducted by “the market”, is part of the story of the impact of globalisation on Australian politics and the Australian economy. It is also an illustration of a change that has implications for both public policy generally and federalism in particular. This paper will look at how the changes that took place in the Loan Council during the 1980s that led the States to engage with the rating agencies as they sought to enter international financial markets, and as changes in Loan Council procedures allowed them to do so. It argues that the changes which gave rise to the increased importance of credit rating agencies are better understood when seen the context of the changes that led to the globalisation of financial markets.

These changes will be discussed within the context of what has been described as a system of “new global finance”⁵ that developed as a result of this globalisation, and the public role that credit rating agencies play within that system. In particular, the way in which they act as private makers of public policy, a role in which they “help to privatize policy making, narrowing the sphere of government intervention”⁶

NEW GLOBAL FINANCE AND THE CREDIT RATING AGENCIES

Randall Germain⁷ argues that the “motor force” for the global explosion of the availability of private credit through diverse global sources has been the “progressive privatization of the global credit system” after the end of the “quasi-public international organisation of credit” represented by Bretton Woods. It was a change which governments were hard pressed to control so that it became increasingly difficult to exercise public power over financial markets. Instead private monetary agents have become dominant over public authorities as the balance between the state and market authority was transformed with the state far less involved in the creation and allocation of credit. As a consequence “the power of private

³ Budget Paper No4: Commonwealth Financial Relations with other Levels of Government 1993-1994 PP90 of 1993. AGPS, Canberra, p.67 also ;K. T Davis, "Public Sector Securities Market" in M. K. Lewis, and R H Wallace, ed, *The Australian Financial System: evolution policy and practice* (Melbourne: Longman, 1997) p.436

⁴ David Hayward, and Mike Salvaris, "Rating the States: Credit Rating Agencies and the Australian State Governments," *Journal of Australian Political Economy* 34 1994 p.20

⁵ Timothy J Sinclair, "The Infrastructure of Global Governance: Quasi-Regulatory Mechanisms and the New Global Finance," *Global Governance* 7 2001;---, "Private Makers of Public Policy: Bond Rating Agencies and the New Global Finance" in A. Heritier, ed, *Common Goods. Reinventing European and International Governance* (Lanham: Rowman & Littlefield, 2002); Timothy J. Sinclair, "Passing judgement: credit rating processes as regulatory mechanisms of governance in the emerging world order," *Review of International Political Economy* 1, no. 1 Spring 1994;---, "Reinventing authority: embedded knowledge networks and the new global finance," *Environment and Planning C: Government and Policy* 18 2000

⁶ Sinclair, "The Infrastructure of Global Governance," p.441

⁷ Randall D Germain, *The International Organisation of Credit. States and global finance in the world economy* (Cambridge University Press: Cambridge, 1997) The argument developed in these paragraphs is based on Chapter 4 'The era of decentralized globalization'

monetary agents increasingly shapes the context of state action within the international organization of credit”⁸ The dominance of the market potentially compromises the ‘embedded’ nature of post-war liberalism. It limits, “The ability of states to maintain support for social welfare proportions of state expenses” which in turn has become “dependent on the willingness of private monetary agents to buy and hold public securities”⁹ This willingness is determined by criteria which are based around profit and maximization of market share. “Access to international credit will come ultimately to depend upon the fulfilment of these criteria, to the detriment of any number of public or private needs which fall under the category of basic or social needs”¹⁰.

The process of change has removed governments from the means to control the creation of credit and the criteria by which credit can be obtained. However, in this new global financial system there are new private regulatory structures which determine the conditions on which credit is obtained. Central to how they have developed in prominence and authority is the process of “disintermediation” or direct financing.

The work of Timothy Sinclair has formed the basis for the idea of the new global finance; a concept he uses to describe the consequences for global capital markets of the period of globalisation since the 1970s. The differentiating feature of the new global finance is the process disintermediation by which borrowers and lenders have moved away from the traditional financial intermediaries, such as banks, to transact directly with each other through financial markets. This has heightened the importance of other non-bank financial institutions such as mutual funds. In short the process removes the traditional bank as the middleman in the process of creating credit.

In a traditional bank mediated transaction a bank undertook to understand and assume risks on the money it lent on behalf of its depositors. In the case of direct financing that risk is more likely to be assumed directly as the depositor becomes a lender. The changing role for banks presents a problem for suppliers and users of funds.¹¹

Credit rating agencies are increasingly important institutions within the new global financial system characterised by a move to disintermediation or direct financing. It has heightened their role and their visibility as organisations with the capacity and knowledge to provide globally comparable information on risk. This has been further enhanced by the complexity of markets and their global geographic scope. The economies of scale they can capture have made them a viable alternative to traditional in-house research.¹²

While credit rating agencies have come to greater prominence over the past twenty years, they have a longer history, particularly in the United States. They developed from mercantile credit rating companies in the first half of the 19th century that rated the ability of merchants’ ability to pay their accounts. They first expanded into rating securities in 1909 when John

⁸ Germain, *The International Organisation of Credit. States and global finance in the world economy* p.25

⁹ Germain, *The International Organisation of Credit. States and global finance in the world economy* p.163-4

¹⁰ Germain, *The International Organisation of Credit. States and global finance in the world economy* p.132

¹¹ Timothy J. Sinclair, "Between State and Market: Hegemony and institutions of collective action under conditions of international capital mobility," *Policy Sciences* 27 1994 p136

¹² Andrew Fight, *The Ratings Game* (John Wiley and Sons: Chichester, 2001) p10

Moody started to rate US railway bonds.¹³ Credit rating agencies occupy a formal role in the US through the designation of the major agencies as National Registered Statistical Rating Organisations (NRSROs). Various pieces of legislation require that mutual organisations, such as pension funds, cannot invest in any security that is not rated as “investment grade” by an NRSRO. In the US the reliance on ratings extends to virtually all financial regulators, including the public authorities that oversee banks, thrifts, insurance companies, securities firms, capital markets, mutual funds, and private pensions.”¹⁴

For example, these rules provided the context for the South Australian government’s first contact with credit rating agencies when SAFA, its central borrowing authority, sought to gain access to the US commercial paper market for US denominated short term funds in 1984. This required SAFA to obtain a rating from the two major US rating agencies Moodys and Standard and Poors so that institutions could legally buy their securities.¹⁵

As financial markets became global so too did the US credit rating agencies expand into those markets. While their value to US investors was recognised by operators in other markets, clearly their growth also reflected the “structural power” of the US and the “head start” it gave US financial intermediaries.¹⁶

Sinclair uses the term “embedded knowledge networks” (EKNs) to describe the basis for the authority which credit rating agencies possess. Depending on circumstances, a variety of organisations act as EKNs; professional associations, research departments, even trade journals. They “possess authority because of their publicly acknowledged track records for solving problems, often acting as disinterested ‘technical’ parties in high-value high-risk transactions, or in validating sets of norms and practices for a variety of service-provision activities.”¹⁷

Sinclair suggests that as EKNs, credit rating agencies exercise authority over a transaction in two senses. First, they contribute to *control* in the financial system by constraining thinking to a range of possibilities and, as a consequence, shape the behaviour of market actors. Second they also *rule* in that they exercise a veto over certain options leading to changes in thinking and behaviour within markets.¹⁸

In relation to their role in the funding of the public sector they are influencing the shape and ownership of public infrastructure and the priorities of government. As their role has expanded they have become a form of private authority performing a quasi-public role of regulation. Central to the impact they have on government and the public sector in Australia is the overwhelmingly orthodox ideology they bring to their task which goes to the heart of the distinction between public and private goods. It is characterised by a belief in the need to reduce welfare expenditure in favour of income generating activity, to increase the influence of the

¹³ Richard Cantor, and Frank Packer, "The Credit Rating Industry," *Federal Reserve Bank of New York Quarterly Review* 19, no. 2 1994 p.2

¹⁴ Cantor, "The Credit Rating Industry," p.5

¹⁵ South Australian Financing Authority, Third Annual Report 1 July 1984 to 30 June 1985. Adelaide, Parliamentary Paper 48/1985, p.21

¹⁶ Leonard Seabrooke, "The Political Economy of direct financing: US Structural Power in International Finance" (MA Thesis, Flinders University of South Australia, 1998) p.44

¹⁷ Virginia Haufler, "Private sector international regimes" in R. A. Higgott, Geoffrey R. D. Underhill and Andreas Bieler, ed, *Non-State Actors and Authority in the Global System* (London: Routledge, 2000) p.488; also Sinclair, "Reinventing authority," p.122

¹⁸ Sinclair, "The Infrastructure of Global Governance," p.489; also, "Reinventing authority," p.443

private sector and, as far as possible, have services provided through the market or ensure full cost recovery of those provided through the public sector. Reducing debt, particularly through privatisation is also central to the agencies views of what goes toward creating a strong balance sheet.¹⁹

GLOBAL CHANGE AND AUSTRALIA'S FINANCIAL SYSTEM

The structure of the Australian economy in the 1980s, with its heavily traded currency, current account problems and exposure to debt, combined with relatively small size, resulted in a high degree of vulnerability to international market sentiment.²⁰ The structure of the economy made Australia something of a "leading indicator" of changes likely to occur from the pressures associated with globalisation.²¹ Changes in the Australian financial system were among the most important of the structural changes which "globalised Australia", particularly floating of the exchange rate in 1983 and financial deregulation in 1984.²² The sweeping changes that occurred by way of reductions or removals of controls over the Australian financial system during the 1980s changed it from one of the most controlled banking systems in the world to one of the least controlled.²³

The process started in the 1970s with the gradual removal of controls over bank interest rates but picked up speed in the 1980s following major reviews by high-level committees of enquiry. Reforms included the freeing up of interest rates on government securities and a new system of tender rates for new issues, and opening up the banking system to foreign competition. These changes led to the rapid growth in the size and sophistication of financial markets, a significant increase in the size of the financial sector relative to the overall economy and most significantly, "the shift away from traditional intermediation through balance sheets of financial institutions towards intermediation through markets".²⁴ The net effect was "a transformation of the Australian financial system from a relatively closed, oligopolistic structure in the 1950s and 1960s based predominately on traditional bank intermediation, to a more open and competitive system offering a much wider variety of services from an array of different providers".²⁵ The growth in direct financing through financial markets continued in the 1990s. However, this did permanently reduce the overall importance of the banks in the Australian financial system, who diversified the services they

¹⁹ Sinclair, "Between State and Market," p.459-60

²⁰ Stephen Bell, "Globalisation, Neoliberalism, and the transformation of the Australian state.," *Australian Journal of Political Science* 32, no. 3 1997 p.358

²¹ Herman Schwartz, "Small States in Big Trouble: State Reorganisation in Australia, Denmark, New Zealand, and Sweden in the 1980s," *World Politics* 46, no. July 1994 p.530

²² D Meredith, and B Dyster, *Australia and the Global Economy: Continuity and Change* (Cambridge University Press: Cambridge, 1999) p.322 They also include the ongoing reduction of tariffs among the main structural changes

²³ J. O. N Perkins, *The Deregulation of the Australian Financial System: the experience of the 1980s* (Melbourne University Press: Melbourne, 1989) p.1

²⁴ Marianne Gizycki, and Philip Lowe, "The Australian Financial System in the 1990s" in D. Gruen, and Sona Shrestha, ed, *The Australian Economy in the 1990s: Proceedings of a Conference held at the H.C. Coombs Centre for Financial Studies, Kirribilli on 24-25 July 2000* (Sydney: Reserve Bank of Australia, 2000) p.180

²⁵ Malcolm Edey, and Brian Gray, "The Evolving Structure of the Australian Financial System" in M. Edey, ed, *The Future of the Financial System: Proceedings of a Conference held at the H.C.Coombs Centre for Financial Studies, Kirribilli on 8-9 July 1996* (Sydney: Reserve Bank of Australia, 1996)

offered and transformed themselves from narrowly based intermediaries to broad financial services providers.²⁶

The changes in the financial system also led to a rapid growth in risk mediation and securitisation products. Gizycki and Lowe point to the emergence of a market for asset backed securities as the “clearest example” of the greater role played by markets in financial mediation, with the first securitisation programs being developed by state governments in the mid 1980s to finance loans to low income households.²⁷ As the financial markets expanded and deepened, state governments were willing and active participants in an environment in which the influence of credit rating agencies could only grow stronger.

But, traditionally the right of the states to borrow had been controlled through the Loan Council. The story of the entry by the states into the financial markets to create this new environment is also the story of fundamental change in the way in which the Loan Council operated, changes which mirror the disintermediation that occurred throughout the financial system.

CHANGE IN THE LOAN COUNCIL: MOVING TO THE MARKET

Under the arrangements that had operated since 1928, the Commonwealth acted as a financial intermediary between the States and financial markets. The States were able to take advantage of the Commonwealth’s credit status leaving the Commonwealth to mediate all of the risk. The changes saw the Commonwealth stand aside from its role as an intermediary, fully exposing the States to risk, and hence the need to establish and maintain their own credit rating which, as fiscal federalism engaged with the new global finance, would be monitored by the credit rating agencies.

In the 1980s the floating of the Australian dollar exposed the currency to market sentiment regarding the level of overall public sector debt in Australia given that the Commonwealth was ultimately responsible for that debt under the Financial Agreement. In the 1980s the need to reduce the Public Sector Borrowing Requirement (PSBR) encompassing the borrowings of the Commonwealth, the State’s and the Territories, added a new urgency to traditional round of spending reductions. For the Commonwealth the “audience” waiting for the result of Loan Council deliberations was as much “the markets” as it was the domestic political constituency.²⁸

While the Financial Agreement covered borrowing by the States it did not include borrowings by semi-government or local government authorities. From the outset attempts were made to restrain the borrowings of authorities, and to control the overall terms and timing of borrowings by requiring consultation with the Chairman of the Loan Council. However, this proved unsatisfactory and the consultation arrangements were formalised into what became known as the “Gentleman’s Agreement”. As the name implies, the agreement had no legal force, however, in later years the Commonwealth enforced the Agreement by making compliance a condition of underwriting arrangements.²⁹

²⁶ R Battellino, "Australian Financial Markets: Looking Back and Looking Ahead," *Reserve Bank of Australia Bulletin* 2000 p.19

²⁷ Gizycki, "The Australian Financial System in the 1990s" p.199

²⁸ . As a participant at Loan Council meetings through the 1890s I often watched as groups of Treasury officials anxiously discussed, and waited for, the reaction of "the market" to the deal they had invariably imposed on the State's

²⁹ Gizycki, "The Australian Financial System in the 1990s" p.203-4

These arrangements operated relatively unchanged until the 1970s when the borrowing arrangements within the Loan Council were completely recast in response to global financial deregulation and the growing sophistication of financial markets. This had led to a rapid growth during the 1960s and 1970s in the number of “authorities” seeking to enter the markets.

The first response was to devolve responsibility for compliance with Loan Council parameters for the terms and conditions of these loans to the individual states. However, towards the end of the 1970s, “the Loan Council began to re-examine and amend these controls to allow markets to cope with the increasingly large public sector borrowings and increasing sensitivity to yields offered on government securities. The markets themselves had also become a good deal more sophisticated, with wider and deeper secondary markets beginning to emerge, as were complex arrangements for coping with risk, including interest rate futures markets and expanded short term markets (e.g. bank bills and promissory notes). New financial institutions had also emerged, offering business and Government an increasingly wide range of services in a more competitive environment”.³⁰

In 1978 the Loan Council approved new guidelines for special additions to the borrowings of larger authorities for financing infrastructure, ostensibly in response to the resources boom. These changes also allowed for these borrowings to be undertaken overseas.³¹

In 1980 the Council adopted new arrangements which moved further in the direction of a market-orientated approach to borrowings by semi-government authorities. In 1982 all controls over the amount and terms of issue of domestic borrowings by electricity authorities were removed. At its meeting in June-July 1983, the Council “effectively completed a process of deregulation of semi-government authorities’ domestic borrowings” with its decision to remove all controls over the terms and conditions of borrowings by authorities.³²

By the mid 1980s it became clear that these arrangements were not able to restrain borrowings by state authorities and the central borrowing authorities which each of the States had established. In large part this was the result of state authorities resorting to what the Loan Council reports described as “non-conventional” financing arrangements particularly involving the sale and leaseback of public assets. By this time the Commonwealth was increasingly concerned with the total size of the PSBR and in particular that part of it which related to borrowings by the states. It was clear that the Loan Council’s rules were having little effect particularly as much of the increase was financed outside programs approved by the Loan Council.³³

Consequently, in June the 1984 the “Gentleman’s Agreement” was temporarily suspended and then in 1985 the Loan Council formally terminated. It was replaced by the concept of “Global Limits” by which the Commonwealth and the States agreed to voluntarily limit the

³⁰ Budget Paper No.7 Payments to or for the States, the Northern Territory and Local Government Authorities 1983-84. Parliamentary Paper 99 of 1983. AGPS, Canberra 1983. p.31

³¹ Budget Paper No.7 Payments to or for the States, the Northern Territory and Local Government Authorities 1978-79. Parliamentary Paper 208 of 1978. AGPS, Canberra 1978. p.32-3

³² Budget Paper No.7 1983. p.33

³³ Budget Paper No 1, Budget Statements: Budget and other Public Sector transactions since 1974-75 (Statement No 6). AGPS, Canberra 21 August. p.367-8

level of all new borrowings from all sources by their authorities, government owned enterprises and trusts.³⁴

This change was reinforced by in 1990 the decision that the States and Territories would progressively take over responsibility for their own debt. In a further move towards deregulation the Council also agreed to amend the Financial Agreement to allow the states the right to issue securities in their own name.

The decision to give the States' full responsibility for managing their own debt was aimed at increasing the ability of the markets to "regulate" their borrowings as it was expected to "... direct growing attention to the fiscal and debt management strategies of individual states".³⁵

By 1993 further changes had been made completing the process of deregulation which had begun in the 1970s. The changes recognised that the "global limits" approach had broken down in the face of the increased use of sophisticated financing techniques used by the states that had allowed the Loan Council and its rules to be circumvented.³⁶ As a result the global limit approach was replaced by the concept of a Loan Council Allocation (LCA). The LCAs were based on a measure of the deficit or surplus of each state as a measure of the financing requirement rather than their gross borrowings. Their aim was to capture transactions which had the effects of borrowings but were not formally classified as such.

The move to LCAs was accompanied by the development of uniform and more comprehensive arrangements for the reporting of public sector finances intended to meet the markets need for accurate and meaningful information about the level of net borrowings on the part of each of the states. The intention was to "facilitate financial market scrutiny of public sector finances via better reporting and so make jurisdictions more accountable to the markets".³⁷

The 1992 meeting of the Loan Council also agreed to amend the Financial Agreement to permit the states to issue securities in their own name in both domestic and overseas markets and to remove the requirement that borrowings needed to be approved under the provisions of that agreement.

Taken together, these changes completed the process which had been underway for more than a decade, of moving the control of government borrowing back into the market, and this establishing a new relationship between the public sector and the markets. As the Commonwealth budget papers described the process: "The changes in Loan Council arrangements broadly reflect the evolving nature of financial markets and their interaction with the public sector. The new arrangements are designed to enhance the role of financial market scrutiny as a discipline on the public sector and, in doing so, build on the changes instituted in the 1980s to enable the individual states to assume responsibility for managing their own borrowings and to be accountable to financial markets for their actions".³⁸

³⁴ Budget Paper No.7 Payments to or for the States, the Northern Territory and Local Government Authorities 1986-87. Parliamentary Paper 184 of 1986. AGPS, Canberra 1986. p.39

³⁵ Budget Paper No.4 Commonwealth Financial Relations with other Levels of Government 1990-1991. AGPS, Canberra 1990. p.64-6

³⁶ Budget Paper No.4 Commonwealth Financial Relations with other levels of Government 1992-1993. AGPS, Canberra, p.65

³⁷ Budget Paper No, 4 1992. p.67

³⁸ Budget Paper No4: Commonwealth Financial Relations with other Levels of Government 1993-1994 PP90 of 1993. p.65

IMPLICATIONS

The first and possibly most significant issue is the role of rating agencies in setting the parameters of public policy. Their impact strengthened as direct engagement by the States with global financial markets became a major part of the process of financing the public sector in Australia. Moreover, the critical role that ratings agencies play in funding the public sector has put them in a position through which they have become part of the broader regulatory structure of fiscal federalism.

From that vantage point they have not only moved State governments towards an embrace of the agenda of the markets, but have also kept them there. As private authorities performing a quasi-regulatory function they have contributed to the growing dominance of the market as a means of determining the nature and the means of distributing public goods. Today it would appear that the rating agencies have moved from being an instrument of, or means to entry into financial markets, to a significant arbiter of what comprises good government. The practical consequences of that dominance are seen at a number of levels. Most obvious has been the priority given in budgets to reducing debt and borrowing requirements by a combination of assets sales and reduced expenditure.

As well, the application of formal market competition principles, for example as expressed through National Competition Policy, have reshaped public sector enterprises and, along with the need to reduce debt, has provided a rationale for corporatisation, privatisation and public private partnerships.

It is easy now to recognise the shape and extent of the changes as a response by politicians and administrators to transform the public sector as part of a drive to make the Australian economy more internationally competitive. However, examining the evolution of the role that credit rating agencies play in financing the public sector adds to our understanding of how and why globalisation has changed politics and the development of public policy within the Australian states.

There seems little doubt that the economic and financial deregulation that has come in the wake of Australia opening its economy to global influences has accelerated the decline in the economic role of the states. In turn that has changed the nature of the Federation and added weight to the growth in the power of central government.

Finally, as regards the regulation of the federal relationship the role of ratings agencies demonstrates a new means of regulating a key aspect of that relation - fiscal federalism. The use of the market instruments, and reliance on market forces, and the participation of private market actors has becoming the new “recurring theme” of fiscal federalism, however, it is also a tune that that is being heard more widely.

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