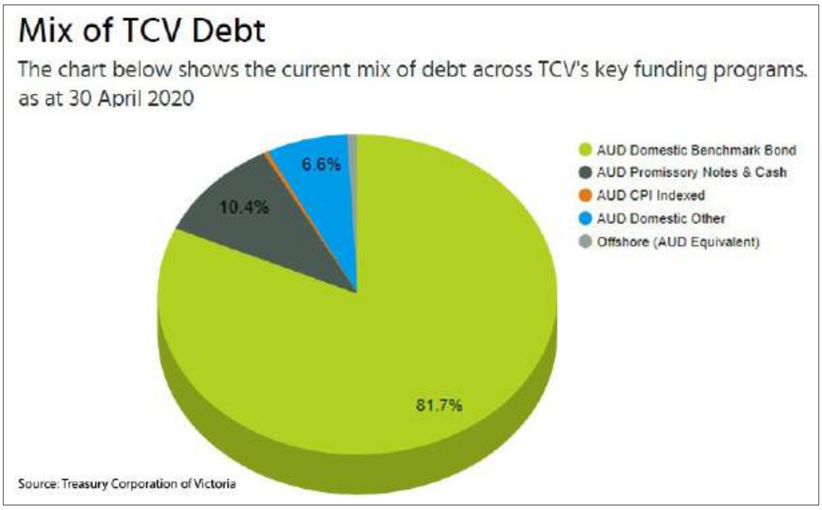
Debt strings attached to Wall Street, not China

By Elisa Barwick

Australia's future development is being held hostage to overseas funding, recruited from international markets and central bank bailouts. The economic crisis we face today demands an emergency reconstruction program. It must be recognised by all elected representatives as the impetus to ditch the ties to an imperial past that persist today through "free market" funding mechanisms, which prevent Australia achieving financial sovereignty.

Building on criticism of Victoria's cooperation with China's Belt and Road Initiative (p. 6), the Liberal parliamentary opposition recently demanded the state government reveal if it is funding its $24.5 billion coronavirus response with money from China. This is highly unlikely, as these politicians know, because all Australian governments—state and federal—are bound by the conventions of our system and are funded in the same way. The scandal sparked in the 1970s by Prime Minister Gough Whitlam's attempt to bypass standard procedures and borrow money directly from Middle Eastern countries, known as the Khemlani affair, is testimony to how tightly controlled that system is.



State and federal governments make up for shortfalls in their budgets by issuing bonds. Those bonds are sold at auction, with more than half being purchased by foreign investors, including foreign central banks, investment banks, hedge funds, and asset managers (including pension funds). The rest are bought by Australian banks, superannuation funds, institutional investors and by the Reserve Bank when it is running a quantitative easing program.

Through this system, Australia has been a beneficiary of US Federal Reserve money-pumping which is propping up the corrupt too-big-to-fail banking system that has looted the real economy for decades. A January report by the Australian Office of Financial Management (AOFM) stated that many offshore hedge funds purchasing Australian government securities (AGS) "fund their positions in AGS through the repo market" (short-term lending based on "repurchase agreements"), and even that "Hedge funds have primarily driven the growth in using repo to fund their holdings of AGS." Hedge funds can be "opportunistic", says AOFM, hence many "trade in and out of positions rapidly".

The September 2019 US repo crisis coincided with a spate of hedge fund shutdowns and freezes on withdrawals, and the Bank for International Settlements (BIS) noted in its December 2019 Quarterly Review that hedge funds had been demanding more cash in the form of repos. The BIS warned that "sustained disruption" of the repo market "could quickly ripple through the financial system", stressing that this was one of "the most damaging aspects of the GFC". This recognition contributed to the Fed's drastic and continuing interventions in repo markets. Many hedge funds specialise in trading risky, speculative instruments called derivatives, which contracts are also taken out by both state and federal Australian governments to offset risk. The Australian Treasury states that "The CGS [Commonwealth Government Securities] market underpins a number of important derivative markets that play a crucial role in managing financial risk."

Also of note in terms of investments in both federal- and state-issued Australian government bonds: If offshore investors are grouped by country, most are from Japan. There is also a secondary market where bonds are resold; this amounted to around $1.3 trillion in 2018-19, over twice the volume of total bonds on issue. Some 62 per cent of this amount was transacted with offshore counterparties, with Asian countries comprising the greatest purchasers. In terms of what AOFM identify as "key investors", namely those with major holdings, Europe, Japan and North America are ahead of Asia (excluding Japan). In both the primary and secondary markets, however, what is clear is that the issuers of the bonds have no say in whose hands they end up.

State governments

States established centralised borrowing authorities to raise funds for state government and government trading enterprises. They also issue bonds which are purchased by investors. Victoria's authority is the Treasury Corporation of Victoria (TCV). Given costs associated with the pandemic, TCV expects an additional $10-14 billion above planned funding requirements, bringing the total to around $20-24 billion for 2020-21. This is raised via four security issues to domestic and international finance markets, including its Domestic Benchmark Bond Program, Euro Medium Term Note Program, Domestic Promissory Note Program and Euro Commercial Paper Program.

Offshore borrowing is a very small proportion of the TCV's total funding programs (graph). Offshore holdings are just 0.9 per cent whereas domestic benchmark bonds (where the government "maintains a minimum amount outstanding in the bond at any given time") comprise 81.7 per cent; 10.4 per cent are Promissory Notes and cash, and 6.6 per cent are other domestic issues. The Reserve Bank of Australia reported in a 2011 bulletin: "State treasury corporations fund themselves almost entirely in the domestic market, with domestic bonds constituting over 90 per cent of the outstanding stock of semi-government [state] bonds."

There is nothing treacherous to see here, but funding to build the nation cannot rely on fickle market mechanisms that in reality are beholden to City of London-Wall Street banks. The free market was a British imperial creation, fashioned as a more subtle way of controlling nations after the USA achieved its independence. "[F]ree markets are an ideological mirage", summarised Prof. Prem Sikka, a British activist accountant, in a 24 August 2019 article published by Left Foot Forward. Free markets in fact colonised the state, with the finance industry dictating the terms.

It is time Australia returned to the mission which once made it great—the establishment of a national credit bank to fund the development of the nation, so we are no longer dependent on overseas borrowing and the whims of the *captured* free market.