PUBLIC SECTOR OVERSEAS BORROWING POLICY
IN THE SEVENTIES

by

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This thesis is the result of my own work and includes nothing which has been done in collaboration. All sources have been fully acknowledged.

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PREFACE

Up until the seventies, the Commonwealth's post-war overseas borrowing policy was generally considered to be a technical matter best left to the Government's economic experts. Public capital inflow remained relatively unimportant during this period as private capital inflow alone more or less offset Australia's current account deficit and provided the required additional resources for development. In such an environment, the primary objective of official overseas borrowing policy was to provide a relatively continuous but very modest addition to Australia's resources.

However, the Commonwealth was to foreshadow this narrow approach to public sector overseas borrowing in the aftermath of the fourfold increase in the world price for oil in 1973/74, which radically changed the international economic environment, upsetting traditional international capital flows and transforming institutional borrowing arrangements in overseas markets. The resulting reappraisal of government overseas borrowing in the following few years saw this narrow area of economic policy become increasingly "politicized" (i.e. the economic and political variables influencing the decisions of the policy makers became increasingly enmeshed) and choices about public external borrowing tended to be determined more frequently than in the recent past by political factors.
This politicization of Commonwealth overseas borrowing during the seventies can be illustrated by examining three major policy developments in detail. These were, in chronological order, the Labor Government's attempt to finance public sector resource projects via a four billion petrodollar loan in 1974/75 (the so-called "loans affair"), the Liberal-National Country Party (or Coalition) Government's overseas borrowing program between 1977 and 1979, and the establishment of the infrastructure program in 1978. Although government overseas borrowing is generally undertaken to assist the financing of the current account deficit and provide additional resources to the public sector, it is useful to examine these three particular policy initiatives in terms of the Commonwealth's primary objective in each case. In this regard, the substantial overseas borrowing program undertaken by the Coalition in 1977 was primarily directed towards shorter term balance of payments considerations; whereas the Connor loan and the infrastructure program were undertaken in pursuit of the longer term goals of economic growth and the reallocation of resources.

The reemergence of public overseas borrowing as a significant instrument of external policy was directly related to the decline in direct private capital flows after the mid-seventies, which left Australia's balance of payments weak and unstable. Various policy options were tried prior to the Coalition Government's decision to temporarily increase the level of its overseas borrowings to bridge the gap between the current account deficit and private capital inflow. This decision resulted in approximately $3300 million being
officially raised offshore between 1977 and 1979 before the external account began to stabilize. The Government had been willing and able to use its very high international credit rating to obtain large amounts of foreign funds from various markets to bridge the temporary shortfall in private capital inflow at a time when an underlying adjustment of the exchange rate was judged to be avoidable and undesirable. This was the first time that the Commonwealth had undertaken overseas borrowing on the basis of shorter term balance of payments considerations on such a scale.

By contrast, the break with the post-war borrowing practice of relying almost exclusively on the private sector to provide additional resources from overseas for economic development took place in two phases. Firstly, in 1974/75 a Labor Minister, Mr. R.F.X. Connor, attempted to obtain an unprecedented loan of US$4000 million (Aust$3.036 million), from the newly emerging capital markets in the Middle East, in order to fund public sector development projects. The decision to seek such a loan not only reversed the Federal Labor Party's traditional opposition to foreign capital but also involved a radical departure from all previous Commonwealth overseas borrowing practice and procedure in terms of the size of the proposed loan, its source, its purpose, its terms and conditions and the method by which the Government tried to raise the funds. Although no funds were ever raised, the proposed petrodollar loan and its aftermath temporarily increased the political sensitivity of Commonwealth overseas borrowing in Australia.
Secondly, in 1978 the Commonwealth accepted a new category of borrowings under Loan Council arrangements, which permitted state government authorities to borrow funds overseas to develop physical capital (such as ports, railways and electricity generating facilities) primarily to assist the development of large private sector resource projects. The Coalition’s infrastructure guidelines permitted these authorities to seek new money loans off-shore for the first time since the mid-thirties and, as a result, the Commonwealth lost its monopoly over the public sector’s fund raising activities overseas.

These three overseas borrowing initiatives all reflected the interaction between narrow technical and economic criteria, institutional influences and political considerations in determining government policy and point to the increased politicization of the process during the seventies. The two economic development-oriented proposals (the Connor loan and the infrastructure program) were essentially political choices based on non-economic criteria. Moreover, these decisions were influenced by political conflict between different levels of government, despite the fact that the States had ceded the overseas borrowing perogative to the Commonwealth in the thirties. Furthermore, although the Coalition’s 1977-79 borrowing program was apparently dictated by economic imperatives, its timing was strongly influenced by political factors such as the media, interest group pressure, the Government’s electoral mandate and the political environment.
This politicization of overseas borrowing policy was associated with a broad change in attitude by the two major political parties, particularly Labor, toward public sector loan raising offshore. In fact, these policy initiatives encouraged successive Federal Governments away from the cautious overseas borrowing of the past and set the stage for the rapid rise in the level of public sector external debt recorded in the eighties.

The purpose of this thesis is to outline the significant developments in Australia's overseas borrowing policy during the seventies, to examine the major influences affecting these decisions about the role of public sector capital inflow in the economy and to discuss the outcome in terms of the Commonwealth Government's political and economic objectives at the time.

The opening chapter provides the historical context for government overseas borrowing activities during the seventies by briefly tracing the role played by foreign capital (both public and private) in assisting Australia's economic growth and maintaining her external balance since the mid-1880s. The chapter also examines the attitudes of the major political parties towards capital inflow, particularly public borrowing, which resulted in the lowest levels of Commonwealth external debt since the depression.

Chapter II looks at the Commonwealth’s decision to borrow extensively overseas as part of a balance of payments stabilization program. First, the policy issues confronting
Australia's external accounts in the mid-seventies are examined, particularly trends in the capital account and the influence of the international economy on Australia's external outlook during this period. This is followed by a brief description of the way overseas borrowing policy has generally been determined in Australia and a survey of the role of the Commonwealth Government, the Loan Council, the bureaucracy and political factors in the policy making process. The chapter concludes by setting out the major influences, both economic and political, on Commonwealth overseas borrowing during the seventies.

The following chapter analyses the available statistical material on official overseas borrowing between 1970 and 1980 to discern the main trends in public capital inflow during this period and to help assess the impact of the Coalition's overseas borrowing program on the balance of payments and the economy. A schedule of all official overseas loans raised by the Commonwealth during this decade is set out in detail in the appendix.

The main features of the two programs involving large-scale government overseas borrowing for development purposes are examined in Chapters IV and V. The Connor loan is the subject of the former and the infrastructure program is covered in the latter. Both chapters explore in detail the development and implementation of these initiatives, including the main forces determining these decisions, as well as their impact on public overseas borrowing practice and the economy.
The final chapter provides a general overview of the politicization of public overseas borrowing policy during the seventies and examines the effectiveness of the decisions taken in terms of the Commonwealth's policy objectives. The final section discusses some of the implications arising from these developments in government overseas borrowing policy for the Australian economy.

This study is based on numerous public sources of material about the legislative process and government economic policy, such as the Budget Papers, Hansard records, statistics from the Australian Bureau of Statistics (ABS), reports and statistical information from the Reserve Bank of Australia (RBA), Treasury papers and official press releases. This data was supplemented by secondary sources such as published interviews and private discussions with individuals involved in the economic policy process during this period as well as newspaper reports and other publications on aspects of the topic.

The thesis does not address itself in any detailed way to private capital inflow, despite the fact that this is the major component of Australia's capital account and dominates the country's overall balance of payments position. This is because the level, form and characteristics of private foreign investment are, broadly speaking, the product of normal commercial influences whereas public capital flows and government decisions to borrow overseas are particularly susceptible to non-economic, non commercial criteria. This
makes any significant increase in the level of government overseas borrowing worthy of separate examination.

That being said, the thesis has not attempted any detailed analysis of the impact of public sector capital flows on the economy for two major reasons. Firstly, it is not possible for the most part to separate in any meaningful way the impact of government overseas borrowing from the overall impact of private capital inflow. Secondly, in cases where some separation would be possible (such as via infrastructure financing), a full cost/benefit analysis of each project would be beyond the scope of this paper, although the results of the few such published analyses have been incorporated where appropriate.

Although much of the material covered has already been examined (particularly the "loans affair" episode), this study utilizes an original framework for analysing these events in terms of the politicization of the policy making process surrounding Commonwealth decisions on public sector overseas borrowing. As a result, the thesis provides fresh insights into Commonwealth overseas borrowing policies and their implication for the Australian economy.
CH. 1 THE HISTORICAL CONTEXT

Except for a brief period early in this century, Australia has traditionally been a net importer of capital although Australia's reliance on this source of capital formation has gradually diminished. In the 1880s, net overseas borrowing financed around 50% of gross capital formation; this ratio had fallen to around 11-12% by the nineteen-sixties and to only 8% a decade later (1).

The composition of this capital inflow has also varied. Private foreign investment, in the form of both loans and equity, has played a major role in the Australian economy. In fact, over the first three post-war decades, private capital (predominantly in the form of equity investment) was responsible for virtually all net capital inflow (2). However, public overseas borrowing has also played an active role and, in certain periods (such as during the 1880s and 1920s), has been a major determinant of domestic economic activity in Australia.

This chapter examines the historical role played by the public sector, up until 1970, in attracting and obtaining overseas capital to supplement international reserves and domestic resources available for economic growth. The chapter is split into three sections—prior to the Financial Agreement, 1930 to 1950 and 1950 to 1970. The first section explores the changing
role of public and private overseas capital in the Australian economy to 1930 and the Commonwealth's emerging control over public overseas borrowing. The second and third sections trace the Commonwealth's role in providing foreign capital between the depression and World War II, and in the post-war period, as well as briefly sketching the policies of the major federal political parties towards overseas capital during these decades. Despite different political approaches, overseas borrowing policy gradually became the province of the bureaucrats.

A. Public Overseas Borrowing Prior to the Financial Agreement

The Early Years

In the early years of Australia's development, the public sector played a major role in attracting capital to the domestic economy. The reorientation of British investment towards her dominions after 1850 provided both the public and private sectors with new opportunities for borrowing (3) and overseas borrowing increased rapidly. Between 1871 and 1891, the government sector accounted for some 58% of the total amount borrowed by Australia in London, its sole overseas market, with the level of colonial government borrowing increasing more rapidly after 1883(4).

The availability of relatively "cheap" money may well have encouraged heavy overseas borrowing. During the eighties, colonial governments were able to borrow at fixed interest
rates of between 3.5% and 4.5% (5) and, as these governments had the guarantee of public revenues, their securities frequently attracted more favourable terms and conditions than Australian private interests. Competition for funds in London between the two sectors increased after 1870 and, over the final three decades of the nineteenth century, the public sector borrowed some 60% of total overseas funds (6).

The public sector’s access to overseas funds was reflected in its contribution to gross capital formation. At the beginning of the 1860s, capital outlays were evenly divided between the public and private sectors and, for the next two decades, the public sector’s share "fluctuated between one-half and one-third of total capital formation as it steadily yielded ground to the private sector" (7). Then, during the eighties, public investment regained its former levels and, late in that decade and during the depression in the 1890s, it became the dominant contributor to Australia’s capital formation, much of it financed from overseas.

The colonial governments invested predominantly in transportation (railways and to a lesser extent roadworks) in an effort to connect major population centres and facilitate the movement of exports to port. Initially, funds were spent in a cautious, piece-meal way, which tried to take account of the rate of return on the investment. However, increasingly a variety of social criteria were used to justify government expenditure and, during the eighties, political rivalry between the colonies encouraged further heavy spending. For example,
between 1882 and 1891, some 6,000 miles of railway were built, but much of it was inefficient and wasteful, contributing little to export proceeds.

But irrespective of the productivity of the borrowed funds, the loans had to be serviced. In 1883, total interest and dividends due abroad amounted to 20% of export proceeds and, by 1890, this had risen to more than 40% of export receipts. During this time, public debt interest payable overseas had risen almost 70%, from $6.8 to $11.4 million and, by 1890, accounted for almost half of all export proceeds consumed by payments due to borrowing (8). The provision of public infrastructure in an uncoordinated and wasteful fashion by competing colonial governments had failed to stimulate the necessary export earnings to service the rising level of imports and growing burden of debt.

In fact, Australia's balance of payments in the late nineteenth century had become increasingly dependent on substantial official and private borrowing overseas, an imbalance which was exposed by the cessation of capital inflow from Britain in the 1890s. In 1891, colonial governments were unable to borrow at accustomed rates and, by 1893, following growing publicity about Australia's mounting interest payments, the London market had dried up. In the absence of capital inflow, the economy was unable to sustain its previous level of capital expenditure or service its external debts without significantly lowering consumption. The process of adjustment took the form of a severe depression involving a rapid fall in national income,
bankruptcy of many financial institutions and businesses, and high levels of unemployment.

Nevertheless, although the burden of meeting fixed interest charges on their external debt became acute during the early 1890s, the colonial governments did not default on any of their loans. And, with the exception of Victoria, they returned to the London market to raise small loans as their economies began to recover later that same decade.

After Federation

Federation added the Commonwealth to the list of public sector borrowers although prior to 1914, the new government borrowed little at home or abroad. During the first decade of the twentieth century capital flowed out or only trickled into Australia and it was not until the economy began to pick up towards the end of that period that capital inflow began to recover. Recovery was aided by significant state government borrowing to meet rising private demands for infrastructure in the form of railways, roadworks, harbour facilities, water and sewerage and energy services. The public sector was again providing around 50% of Australia's gross capital formation.

Public sector debt overseas grew rapidly after 1914, far more rapidly than in the early years of the century and, between 1914 and 1921, more than $333 million was raised overseas by the public sector. However, twice as much was raised
domestically, as the London market was unable to meet the
states' heavy demands for development funds, and by 1921 only
45% of a total public debt of $1656 million was due overseas
(compared with more than 66% in 1914) (10).

After 1921, the public sector was again able to obtain funds
abroad and, of the $552 million borrowed by governments and
their authorities between 1921 and 1929, 73% was raised in
London and New York. Only 20% was raised in the latter market
mostly in the closing years of the decade (11). By 1929, 52% of
a total public debt of $2208 million was held overseas.

Unlike the eighteen-eighties, heavy overseas borrowing by the
public sector in the twenties had not been the result of supply
conditions. This was not a period of "cheap money". Australian
governments were often forced to pay interest rates of between
5.5% and 6.5%. Rates on the New York market were sometimes
even higher (12). Rather, governments were borrowing to meet
the capital needs of early industrialisation and the costs of
the Bruce-Page Government's immigration program, coupled with a
strong demand for social asset formation by a population
accustomed to a certain standard of living (13). As their
demands increased, overseas borrowing by the various
governments became increasingly competitive and unproductive.
The Commonwealth began to look for ways of controlling public
sector borrowing.

The_Financial_Agreement
Soon after Federation, the Commonwealth began to seek ways to consolidate the public debt and coordinate future public sector borrowing, putting forward specific proposals in 1905 and again in 1908. However, the States rejected these initiatives because they feared that, firstly, if the Commonwealth took over their debts (as provided for under Section 105 of the Constitution) they would lose control of their "vote winning" loan expenditure programs and, secondly, the proposals would permit increased federal control over state development policies (14).

With the tremendous increase in Commonwealth borrowing on the domestic market due to the war and the increasing demands for capital funds by the States, the problems of excessive recourse to loan funds and of damaging competition between governments became more critical. It was the need to coordinate this chaotic scramble for funds on domestic (rather than overseas) markets which, in fact, motivated the Commonwealth's desire to establish a loan council.

In London, competition amongst the various Australian public sector borrowers was not such a problem as all issues were arranged through the one underwriting firm of R. Nivison and Co. However, although the initial impetus for coordination did not come from overseas borrowing, by the early twenties the Commonwealth was feeling the pressure from its obligation to convert its accumulated wartime debt on the London market in the face of increasing demands for overseas funds by the States (15).
In May 1920, the States and Commonwealth agreed that, in principle, the Commonwealth should have sole borrowing authority. But despite this apparent unanimity, the July Premiers' Conference saw the States reject the Commonwealth's proposal that, inter alia, the Commonwealth should coordinate all domestic borrowings and be the sole borrower overseas for the next three years. The larger States believed that little would be gained by such a reduction in their borrowing independence as they could already borrow at equivalent rates to the Commonwealth (16).

But the Commonwealth continued to press for agreement and, in May 1923, put forward a further memorandum, entitled "Coordination of Borrowing". This again argued the need for a sinking fund for the management of accumulated debt and for a loan council to coordinate public borrowing. Finally, at the Premiers' Conference in June of that same year, the parties agreed to establish a voluntary Loan Council (consisting of Commonwealth and State Treasurers) to regulate the order various public borrowers came on the market and to set up a sinking fund for all new loans (17). The States agreed to the proposal because, firstly, the Loan Council was only advisory and, secondly, the Commonwealth not only agreed to vacate the domestic market but also to pay one-third of the interest for the first five years of the life of any loan it raised in London on their behalf (18).

The voluntary Loan Council met on 15 different occasions and
operated with moderate success during the next five years, despite the withdrawal of NSW between 1925 and 1927 when J.T. Lang was Premier (19). Many of the arrangements which later applied under the Financial Agreement were developed and tested during this period. Loans were raised domestically in the name of the Commonwealth on behalf of the States and, although all governments continued to borrow on the London market on their own account, it was generally on a more coordinated basis. Some Commonwealth loans were raised on behalf of the States on the London and New York markets (20) and there was discussion about including the borrowings of semi-government authorities in the arrangements. But definite action on this front had to wait until the following decade.

Nevertheless, the experience of these Commonwealth raisings paved the way for the establishment of the Australian Loan Council under the Financial Agreement signed in December 1927. This agreement was finally ratified by all State Parliaments and a national referendum on the eve of the depression in 1929. The Loan Council was granted statutory authority to coordinate and regulate all government borrowing. The Commonwealth became the central loan raising body for all governments and overseas loan raising by States virtually ceased. The Commonwealth, as the agent of the Loan Council, was able to raise one loan under these new arrangements before the London market closed in 1929 (21).

The Depression
Overseas borrowing, particularly by the public sector, played a significant role in the severity of the depression of the 1930s in Australia, although the immediate cause was a drastic fall in the value of the country's exports (22). By 1929, capital inflow had virtually ceased and Australia's international reserves were close to being depleted attempting to meet the nation's overseas obligations.

Behind the immediate liquidity crisis was a fundamental disequilibrium in the balance of payments, which had become heavily dependent on overseas capital, particularly public overseas borrowing. While not as significant as in the 1880s, capital inflow financed some 20% of gross capital formation during the twenties and a persistent current account deficit. Australia was the largest government borrower in the London market during this decade and 70% of total foreign capital inflow was borrowed by the public sector (23).

This heavy overseas borrowing was accompanied by a growing interest burden, the majority of which was fixed in the form of government loan interest. In 1921, overseas public interest payments represented some 2.3% of gross national product. By 1929, this figure had risen to 3.4%. More significantly, there was also a rapid increase in the proportion of export income committed to meet overseas payments. In 1920/21, interest and dividend payments abroad together accounted for some 17% of exports. But by 1928/29, 28% of export income was being consumed in this way. During the depression, interest liabilities rose as high as 40% of export earnings (24).
One of the major reasons for the interest burden rising more rapidly than export income and import replacement during the twenties was the nature of the externally financed investment provided by the public sector. Such investment was not subject to the profitability criteria of the market place. Social asset formation in the cities added little to national income or export earnings. Nor did investment in branch railway networks which paid scant regard to private sector requirements. The appearance of many, often competitive state semi-government authorities, which publicly supplied a wide range of marketed services, ensured a continuing demand for long-term, low return finance (25).

By 1929, therefore, the balance of payments was extremely vulnerable to changes in the international environment and this sensitivity was largely due to public sector overseas borrowing policies. Even worse, the governments were borrowing heavily on overdraft and carrying out low return public works on the basis of anticipated loan raisings. This practice led to rapid accumulation of short-term debt, which intensified the immediate liquidity crisis when long-term funds dried up.

At first, gold was sold to finance external obligations and then, in 1930, an agreement was reached for partial mobilisation of the banks' reserves to meet government commitments overseas. The exchange rate was depreciated and tariff barriers raised to reduce imports. In June 1931, the Government adopted the so-called "Premiers' Plan". This was a
deflationary package, which reduced government expenditure, converted internal government debt to lower rates of interest, increased taxation and reduced bank interest rates. The result was large scale unemployment (20% of union members), falling production and heavy loss of income and economic growth. The measures taken by the Commonwealth to correct the balance of payments disequilibrium were essentially a reaction to market forces with little attempt to ameliorate the effect of the depression on the community at large. Recovery was slow, the external debt burden remained heavy and public sector overseas borrowing for new money purposes was virtually non existent during the next two decades (26).

B. Government Overseas Borrowing between 1930 & 1950

The Decline in Debt

Between 1930 and 1950, there was a dramatic decline in public sector overseas borrowing, compared with the activity of the twenties, as the Commonwealth borrowed overseas overwhelmingly to convert existing debt. The first conversion took place in 1932 when the British Government permitted the refinancing of a NSW loan and, between then and 1936, Australia played a dominant role in conversion operations in the London market accounting for some 80% of total conversions. These loan conversions were all made at lower rates of interest and enabled Australia to reduce her interest burden (27).
During the thirties, the Commonwealth raised only three long-term new money loans. The first was on behalf of W.A. in 1937, for 0.266 million pounds sterling, to purchase a coastal vessel. Two other cash loans - one in 1938 and one in 1939 - amounting to 8 million pounds sterling were also raised. Both were for defence purposes, so the Commonwealth did not have to seek Loan Council's approval as such borrowing was specifically exempted under the Financial Agreement (28).

With the change of government in the forties, the Commonwealth adopted an even more restrictive policy toward overseas borrowing as it began to reduce Australia's overseas indebtedness. For example, between June 1933 and June 1941, sterling debt had remained almost constant but, during the next eight years, it fell by nearly 20% or some 386.5 million pounds sterling. These redemptions were accompanied by loan conversions at lower rates of interest on the London and, later, the New York market. No US dollar debt fell due until 1946. However, between 1946 and 1947, the Government was able to convert loans of 128 million US dollars from 4.5-5% to less than 3.75% debt (29).

The result was that by 1949 the public sector's interest liability on its overseas debt had fallen to around 3.1% of the value of exports and represented only 4% of Australia's foreign exchange reserves. This compared with 16.5% of exports and 42.6% of overseas reserves in 1939 and 25.5% of exports and 47.3% of overseas reserves in 1930. This decline reflected not
simply falling interest rates but an actual fall in the level of official securities domiciled overseas - from $1310 million in 1933 to $1299 million in 1940 and $1099 million by 1950 (30).

With negligible overseas borrowing by the public sector during the period, any deficit on current account had to be financed by private overseas investment. In contrast to the trend in government borrowing, the level of private overseas investment in the twenties was sustained during the thirties and rose sharply in the forties. Between 1930/31 and 1939/40, private foreign investment in Australia amounted to some $200 million, roughly equal to total capital inflow. After the war, this rate increased with some $538 million being invested between 1940/41 and 1949/50, at a time when public debt was reduced by approximately $219 million. So by 1950, the ratio of net private income payable abroad to export income at 6.9% was more than double the ratio for government overseas interest (31).

The decline in government borrowing overseas was not matched by increased domestic borrowing as public capital works expenditure also declined. Although capital investment remained more or less evenly divided between the private and government sectors up until the mid-thirties because of the depression, the role of the public sector then began to decline. By 1939, it was responsible for only 43% of gross capital formation. This trend was temporarily interrupted by World War II, following which the Government had to finance a backlog of public infrastructures as a precondition for
post-war economic recovery. These capital works were, however, funded from recurrent income or domestic borrowing as there was no return to government overseas financing during the forties. The private sector remained the major supplier of funds for capital investment in Australia (32).

The thirties and forties saw public capital inflow virtually halted as the Commonwealth struggled to correct the balance of payments disequilibrium after the excesses of the twenties. The non-Labor Government managed Australia’s official overseas debt essentially by converting maturities at lower rates of interest as they fell due. But during the forties, the new Labor Government adopted a policy aimed at significantly reducing the level of outstanding public external debt. The following section examines the rationale behind differences in government policy during this period.

Government_Borrowing_Policies

The crushing burden of overseas debt suffered by Australia during the depression understandably affected community attitudes towards government overseas borrowing, although concern about the level of debt had been rising throughout the twenties. The matter had been frequently debated in Federal Parliament (33) and the referendum to amend the Constitution to establish a Loan Council to regulate government borrowing received a "yes" vote from 74% of the electorate - a remarkably high level of support (34).
Given that the level of official overseas debt greatly accentuated and, in part, precipitated the intense economic difficulties experienced by Australia during the early thirties, many would have blamed their misery during the depression on imprudent government overseas borrowing. The two groups, which held this view most strongly, were the Australian Labor Party (which fragmented into warring factions over policies to cope with the debt burden) and its traditional supporters, the trade unionist (who suffered the brunt of unemployment and income loss).

The Scullin Labor Government was swept to power in a landslide victory in October 1929 but, a little more than twelve months later, had become the centre of intense political controversy as the economy plummeted into depression. With spiralling unemployment and a mounting budget deficit, Labor was split over the appropriate course of action for the economy. The centre group, led by Prime Minister Scullin and Treasurer Theodore, wanted to follow a path of mild deficit expansion to provide unemployment relief. The right wing of the party, under J.A. Lyons, fearing the inflationary effects of such a policy, favoured the financial orthodoxy of trying to balance the budget by cutting wages and increasing taxes. A third faction, led by NSW Premier Lang, wanted to repudiate overseas debt contracts if assistance from the U.K. was not forthcoming. These divisions within the Government soon become public (35).

In February 1931, the Premiers tentatively agreed to Theodore's plan of mild reflation provided the banks would support it.
However, a dissenting report, which advocated the deflationary policies put forward by a British adviser (Sir Otto Neimeyer) and the Chairman of the Commonwealth Bank Board (Sir Robert Gibson), was released simultaneously. This completely undermined the Government's position (36) because, despite repeated attempts, the Scullin Government had failed to gain control over its own monetary policy and remained dependent on the goodwill of the conservative banks. Although the Commonwealth Bank had assumed many of the functions of a central bank, it was governed by a board which was totally outside the control of the Cabinet and Parliament. Consequently, the Bank's chairman was able to refuse to carry out Labor's monetary policy (37). Furthermore, Scullin was unable to change the legislation under which the Bank operated because of the opposition of a hostile Senate (38).

With the banks officially opposed to the Government's policy, the Senate defeated Theodore's Fiduciary Currency Bill, which sought to authorise the printing of 18 million pounds for unemployment relief and aid to wheat farmers (39). Weakened by the parliamentary defection of both the Lyons' group and the Lang faction, Theodore and Scullin were finally forced to abandon their policy of mild reflation and agree to the Premiers' Plan, which was implemented in mid 1931 (40).

However, a large body of Federal Labor Members of Parliament were totally opposed to this course of action and, to avoid a permanent split in the Labor Party, Scullin permitted a 'free' vote on the legislation. This strategy was only temporarily
successful as the Government was defeated on the floor of the House in November 1931 on another matter. At the following general election, Labor was resoundingly defeated by Lyons' new United Australia Party, and remained divided and disillusioned until after John Curtin became leader in 1935. Labor did not regain electoral confidence until the end of the decade.

Labor's bitter experience during the early thirties had its roots firmly planted in government overseas borrowing policies during the twenties and the lesson was not lost on the party. The Curtin-Chifley Government came to power in 1941 determined that the war would be financed as much as possible by those who were waging it and not by future generations (41). This central theme was translated into a policy of financing the war from revenue, taxes and domestic loans, while actively seeking to reduce the level of official overseas debt and interest liabilities. This overseas borrowing policy was pursued throughout the Government's term in office with leading Labor members frequently expressing their general opposition to excessive government overseas borrowing based on Australia's experience during the depression (42). The Government's sentiments can be summed up by Chifley's declaration that overseas borrowing was a policy of "last resort" (43).

Although Labor's borrowing policy largely reflected the lingering hostility towards government overseas debt felt by its members and much of the community, it also reflected an upsurge in nationalism and self-reliance experienced in Australia during and after the war. Moreover, given the tight
monetary conditions in international markets and the lack of alternative uses for Australia's overseas reserves, Labor's policy also made sound economic sense in terms of rational debt management. In the early post-war period, Australia accumulated currency reserves from her UK exports; yet much of the capital equipment needed by the nation could only be purchased in the US economy with US dollars. So mounting sterling reserves were not particularly valuable to the economy and were sensibly used to redeem London debt as it fell due (44).

Furthermore, it is doubtful that the Commonwealth would have been able to raise a new money loan overseas during the forties had it decided to seek one. Australia had been almost totally excluded from the London market since the thirties and was unable to raise a cash loan there until 1958, despite active enquiries throughout the fifties. The New York market was also very tight with no new money being raised by Australia between 1928 and 1956 (45) and the Swiss market was not successfully accessed until 1953/4. The only other possible major source of funds was the International Bank for Reconstruction and Development (IBRD). However, the lending policies followed by the Bank during the forties tended to exclude countries like Australia, although this was soon to change. In fact, with the exception of the IBRD, this same tight supply situation faced the non-Labor Government after it resumed office in 1950 (46).

Even so, towards the end of the decade when acute dollar shortages were beginning to hamper Australia's development, the Chifley Government started to explore the possibility of a
dollar loan as a way of obtaining essential capital equipment from the United States (47). An IMF drawing was made to enable Australia to meet its import obligations in October 1949 and, just before the elections in December, the Prime Minister had begun to try and soften the ALP’s attitude towards loans from abroad (48).

By contrast, the non-Labor parties did not share Labor’s hostility toward government overseas borrowing. The Lyons’ Government was content to convert maturing debt at lower rates of interest and showed little inclination to reduce Australia’s outstanding overseas obligations. During the forties, the conservative parties became more and more critical of the Labor Government’s failure to borrow overseas (49) and, towards the end of 1949, the Opposition was arguing strongly that a dollar loan was essential to obtain vitally needed capital goods for development suggesting that the IMF, US Export-Import Bank, IBRD and the New York market should all be explored as a matter of urgency (50). On being elected to power in December of that year, the Menzies Government began an active search for overseas funds.

C. Commonwealth Overseas Borrowing between 1950 & 1970

The Return to Overseas Borrowing

During the 1950s and 1960s, the public sector again became an
active, although cautious, overseas borrower. The level of overseas debt (measured by the value of official securities on issue overseas) rose almost continuously from $1099 million in 1950 to a high of $1698 million in 1969, before falling back to $1580 million by the close of the decade.

Throughout the period, the Commonwealth was virtually the sole public overseas borrower as the borrowings of semi-government authorities had also been brought under Loan Council control after the signing of the Gentlemen's Agreement in 1936 (see Appendix I). In fact, there were only a few new loans raised abroad by semi-government and local authorities (51) and only two borrowings by a State. In 1952/3, South Australia was permitted by Loan Council to borrow the equivalent of $7.8 million overseas under Clause 4(2) of the Financial Agreement for the Radium Hill project and, in 1963/4, the Western Australian Government borrowed the equivalent of $2.6 million overseas to finance the purchase of the Midland Railway Company (52).

Between 1950 and 1970, gross overseas borrowing by the Commonwealth totalled approximately $1900 million, $746 million (or 39%) of which was borrowed during the first decade. The vast majority of these funds were raised as new money loans. Net overseas borrowing by the Commonwealth was considerably less at $666 million. In the first decade, net overseas investment in Australian public authority securities domiciled overseas was approximately $385 million with the remaining 42% being taken up in the second decade (53).
In the early fifties, the Commonwealth's sole source of funds was the IBRD and, between 1950 and 1962, it received 7 loans totalling $373 million from the Bank. But gradually other markets were tapped. In 1953, a small Swiss loan was raised and, two years later, the first Canadian dollar loan was arranged in 1955. Soon after, Australia was able to borrow in the reopened New York (1956) and London (1958) markets. By the end of the 1950s, New York had become Australia's major market as unfavourable conditions largely prevented further borrowing in the UK. The Commonwealth raised loans in two additional new currencies during this period - in Dutch guilders in 1961 and deutschmarks in 1967 - and in the mid sixties was also able to tap the emerging Eurodollar market (54).

Following the lessons of the depression, the Commonwealth had taken deliberate steps to diversify its sources of funds. Up until 1950, public overseas borrowing had been predominantly in sterling with some US dollar loans. By the end of the sixties, almost 21% of securities on issue overseas were domiciled in markets other than London and New York - 14.5% in deutschmarks, 4% in Swiss francs and the remainder in Canadian dollars and Dutch guilders. But despite active diversification, the majority of Australia’s overseas debt continued to be held in either sterling (32%) or US dollars (47%) (55).

At first, all overseas funds were technically negotiated for the Commonwealth's own loan program "as an additional borrowing authority over and above the States' programs" (56). This was
done in the case of the first five IBRD loans, the first two
Swiss loans and the first Canadian dollar loan. But as
requirements changed, the Commonwealth was able to raise funds
directly for the States' programs, rather than these programs
having to be financed by the Commonwealth issuing counterpart
funds in Australian currency.

During this period, the Commonwealth also raised funds on
behalf of its own authorities. For example, the proceeds of
the seventh IBRD loan in 1962 were on-lent to the Snowy
Mountains Hydro Electric Authority to assist in the financing
of the hydro-electric scheme in NSW and, in 1956, the proceeds
of an IBRD loan, together with those of a private U.S. loan,
were on-lent to Qantas Airways Limited (QAL) for the purchase
of aircraft and equipment. The Commonwealth continued to
borrow regularly on behalf of QAL and the domestic airline
carrier, the Australian National Airlines Commission (ANAC),
for similar purchases. After 1960, many of these loans were
facilitated by financial institutions, such as the
Export-Import Bank of the United States, and the U.S. aircraft
companies.

After 1966, the Commonwealth borrowed directly from the
Export-Import Bank to finance substantial purchases of defence
material and equipment (including the F111 aircraft) from the
United States. These credit arrangements were authorised and
and, by the end of the decade, the Commonwealth had drawn $365
million under these arrangements.
As would be expected, total interest payable abroad on public authority securities domiciled overseas increased steadily throughout the period; in fact, more than doubling from $38 million in 1950/51 to $87 million in 1969/70. Since the outstanding offshore debt only rose by one-third, this increase in interest payable abroad also reflected a rise in the average rate of interest payable on such borrowings - from 3.3% in 1950/51 to 5.5% in 1969/70 (57).

Interest rates during the period reflected the shortage of international capital with overseas loans at rates generally exceeding the internal bond rate after 1955/56 (58). By 1965, with the US interest equalisation tax (59) and UK restrictions on capital exports, rates in international markets had risen above the historically high levels of the twenties. The Government, in fact, repaid some maturing loans in 1966 rather than refinance at rates of 6.75-7.5% (60). Nevertheless, during the final years of the decade, the Commonwealth continued to borrow despite coupon rate peaks of 7.5% for aircraft and 7.25% for general purpose loans.

The States had to take their share of these higher cost loans but did so under increasing protest (61) and eventually the Commonwealth was forced to cede ground. After 1962, no overseas borrowings were allocated to the States (62) and, in 1966, the Commonwealth agreed to refinance all state debt maturing overseas during the subsequent three years at domestic market rates of interest. This covered a period in which a
large series of state loans, mostly borrowed in the twenties or earlier, reached maturity. This arrangement was extended and all loans raised overseas continued to be allocated to the Commonwealth (63).

During the fifties and sixties, the Government's overseas borrowing program represented only about 0.4% of gross domestic capital formation, 14% of the combined Commonwealth and State loan programs and around 9% of the total works and housing programs for the two decades compared with 20% of gross domestic capital formation and some 60% of net loan expenditure during the twenties (64). The proceeds of the overseas loans during the period helped to finance public sector capital formation and there is some evidence to suggest that the proceeds of the loans were used more productively than in previous decades (65).

However, the dominant role in providing additional resources from overseas for Australia's economic development was played by the private sector. Between 1950 and 1970, total net private capital inflow equalled some $8440 million. The vast majority of this — $6446 million or 76% — flowed into Australia during the sixties, averaging some 28.5% of all net private investment during the period and 11% of total gross capital formation (66).

Under these circumstances, Commonwealth overseas borrowing played only a marginal role in the economy. Although the Government saw the proceeds of overseas loans as a useful way
of strengthening foreign reserves (67), borrowing abroad was not a tool of external policy and rarely financed a significant proportion of the external deficit. Although the statistical relationship between increases in the current account deficit and the level of government capital inflow does suggest that Commonwealth borrowing had some sort of stabilising effect on Australia's balance of payments in this period (68), its role in external policy was minor. Nevertheless, compared with the preceding two decades, a new era of public sector borrowing overseas was opened up in 1950 by the Coalition under Prime Minister Menzies.

Public Policies towards Overseas Capital

Soon after gaining office, the Menzies Government signalled a major policy change by announcing a "great loan scheme for development purposes" (69), which heralded the first of the IBRD loans made available to Australia under revised eligibility criteria. The Government actively sought funds throughout the fifties, although its borrowing intentions continued to be restrained by the severe shortage of international capital (70). During the sixties, rising interest rates became an additional deterrent to substantial overseas borrowing.

Faced with a pressing need for additional development capital and the limited availability of official funds from abroad, the Menzies Government set about attracting direct private foreign investment to supplement domestic resources and its efforts
(71) were rewarded by steadily rising private capital inflow. In fact, by the late sixties, Australia with its stable political environment and lack of restrictions on foreign investment, abundant mineral resources and a variety of subsidies, tax concessions and incentives had attracted a flood of private overseas capital.

However, Australia's "open door" policy towards overseas investment did cause some disquiet within the community, the Parliament and even the Coalition (72). As a result, the Menzies Government appointed the Vernon Committee to survey the economy and recommend, inter alia, strategies to deal with foreign investment. In its final report in May 1965, the Committee suggested that the level of capital inflow be restricted and proposed selective controls over foreign investment. But when the report was made public in September, it was rejected by the Prime Minister because it involved too much planning and was severely criticised for its approach to foreign investment by the Treasury (73).

Nevertheless, the Government did take some ad hoc action (74) in response to growing community concern about foreign ownership and the political desirability of trying to allay these fears. The non-Labor Governments of the fifties and sixties accepted the advice of their economic experts that Australia required high levels of private foreign investment to help develop the nation's resources and that this should be supplemented by a small but active government overseas borrowing program; a policy which received varying support from
the Federal Labor Party.

Although there was general political agreement that Australia needed additional capital resources from overseas to assist economic development, the Opposition gradually changed its attitude toward the composition of this capital inflow. At first, the Federal Labor Party apparently preferred this capital to be in the form of private foreign investment because of the accompanying much needed technical expertise and because it did not involve the servicing of fixed interest debt (75). Federal Labor members retained their traditional opposition to what they saw as "excessive" overseas borrowing by the public sector (76) arguing that overseas funds carried very significant costs and that governments should not borrow abroad if funds were available in Australia.

Gradually, however, Labor began to lose its enthusiasm for private foreign investment as overseas profit flows during the sixties made the cost of direct private capital inflow more apparent. As early as 1959, two leading left-wing Labor members, J.F. Cairns and T. Uren, were arguing that overseas capital should be obtained via government borrowing rather than private investment (77) and, as the level of foreign investment in Australia rose and community concern increased, the ALP began to focus its political attack on "unplanned indiscriminate" private capital inflow. Opposition spokesmen called for its restriction and suggested ways of reducing the country's dependence on it. For example, both W. Hayden and R.F.X. Connor put forward schemes to establish domestic
investment funds for development purposes (78) while others suggested that the Commonwealth should play a more active role in seeking overseas loans, particularly on a government-to-government basis (79).

Consequently, Federal Labor gradually became less critical of the Coalition Government’s official overseas borrowing policy. This was partly because of the manageability of the Commonwealth’s overseas loan program due to the increasing capacity of the economy to service the gradually accumulating debt. But it was also because the foreign ownership and control problems posed by high levels of direct investment from overseas had become more apparent.

So, despite some difference in approach, the post war period saw general acceptance of the Commonwealth’s policy of supplementing overseas reserves and domestic resources through a modest program of overseas borrowing. There was broad political agreement on Australia’s need for additional resources from overseas and the Commonwealth’s borrowing program became a matter for the economic technocrats who had the responsibility for managing the economy’s external accounts, official reserve assets and the country’s overseas debt. But this narrow technical approach to post-war Commonwealth overseas loan raising was swept aside by the politicians of the seventies.
CH. II FINANCING THE BALANCE OF PAYMENTS

The traditional financing pattern of Australia's balance of payments has relied on private capital inflow more or less offsetting a chronic current account deficit. However, this pattern was disrupted in the seventies due to exceptional disturbances in the international economy, which upset normal capital and trade flows with, inter alia, a marked fall in direct investment flows. As a result, private capital inflow dried up and Australia faced a severe imbalance in her external account.

The Commonwealth had a range of policy instruments - devaluation of the currency, deflation of the economy, adjustments to capital and import controls or export incentives - to use separately or together to correct any "longer term" external account disequilibrium. But in the seventies the Commonwealth used large-scale official overseas borrowing to finance a "temporary" weakness in the capital account - a policy which had no post-war precedent. The policy making process which led to this decision is the major focus of this chapter.

Balance of payments policy, like all macroeconomic policy, tends to be shaped not only by economic considerations but also by political factors. The policy approach for managing a current account deficit, for example, would be affected by
economic factors such as the level of a country’s international reserves, the size and expected duration of the disturbance, the state of the domestic economy and the impact of any corrective action on other policy goals, such as reducing inflation. Decision makers also take account of additional factors such as the distribution of the costs of adjustment and the impact on employment and income levels.

But beyond the economic criteria, policy outcomes can also be affected by more diffuse, non-economic factors, such as the political processes and organisations through which a policy must pass, the role of powerful individuals in key institutions, past patterns of policy making, ideological considerations and the current political environment (1). In fact, political considerations can be more important than economic imperatives in determining economic policy outcomes. The next two sections examine the economic rationale behind the decision to use Commonwealth overseas borrowing as an instrument of balance of payments policy and the final section discusses the policy making process surrounding the external account in the late seventies.

A. Capital_Inflow_and_the_Balance_of_Payments

To place the Commonwealth’s 1977-79 overseas borrowing program in its economic context, it is necessary to examine briefly the role played by capital inflow in Australia’s external account. This section summarises the major components of the capital account and outlines the major trends in its magnitude and
composition over the period.

**Trends in the Capital Account**

The balance of payments is a systematic record of a country's economic transactions during a given period between its residents and residents of the rest of the world. It measures the movement of foreign exchange into and out of the country. The record includes flows of real resources and changes in foreign financial assets/liabilities, as well as unrequited transfers.

The balance of payments is divided into two major sections - the current account and the capital account. The current account records the value of all goods and services traded during a given period as well as financial payments/receipts. In Australia, the f.o.b. value of total exports has generally exceeded the f.o.b. value of total imports, resulting in a positive balance of trade. However, this positive trade balance has been continuously swamped by the deficit of net "invisibles" - net services, which consists mainly of transportation, travel and government receipts/expenditures, and net property income and transfers. As a result, Australia's balance on current account (i.e. the balance of trade less net invisibles) has generally been in deficit.

The other major component of the balance of payments is the capital account, which basically records changes in the level of Australia's foreign financial assets and liabilities. It
consists of two major sections - government and private capital flows. Broadly speaking, the former represents government overseas borrowing, which has generally been a very small element of the total inflow of foreign capital into Australia.

The major components of the latter are foreign investment in enterprises in Australia and Australian investment abroad, although the latter was relatively insignificant during this period. Overseas investment in companies has accounted for practically all identified private capital inflow in Australia and, as estimated by the ABS, comprises two broad categories - direct investment and portfolio and institutional loans. Direct investment refers to inflows of capital which are accompanied by some degree of control, or potential control, by the foreign investor over the target enterprise and includes notional inflows of undistributed profits from foreign owned resident companies. Portfolio investment and institutional loans generally refer to inflows of capital not accompanied by such control and include loans raised by Australian private companies and public non-monetary enterprises (such as statutory authorities) as well as foreign portfolio investment in Australian companies' securities. Although this division of private capital flows roughly approximates a split between equity capital and loan capital, it should be noted that direct investment does include some debt transactions.

The impact of capital inflows on the balance of payments and the economy depends partly on the form it takes. Broadly speaking, investment in other than loan form has added to the
TABLE 1: NET OVERSEAS INVESTMENT IN ENTERPRISES BY FORM OF INVESTMENT 1970/71 - 1979/80

<table>
<thead>
<tr>
<th>YEAR</th>
<th>DIRECT $M</th>
<th>%</th>
<th>PORTFOLIO AND INSTITUTIONAL LOANS $M</th>
<th>%</th>
<th>TOTAL $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970-71</td>
<td>896</td>
<td>(56)</td>
<td>695</td>
<td>(44)</td>
<td>1591</td>
</tr>
<tr>
<td>1971-72</td>
<td>870</td>
<td>(60)</td>
<td>584</td>
<td>(40)</td>
<td>1454</td>
</tr>
<tr>
<td>1972-73</td>
<td>399</td>
<td>(85)</td>
<td>70</td>
<td>(15)</td>
<td>469</td>
</tr>
<tr>
<td>1973-74</td>
<td>616</td>
<td>(100)</td>
<td>-120</td>
<td>(-)</td>
<td>496</td>
</tr>
<tr>
<td>1974-75</td>
<td>657</td>
<td>(66)</td>
<td>346</td>
<td>(34)</td>
<td>1002</td>
</tr>
<tr>
<td>1975-76</td>
<td>578</td>
<td>(67)</td>
<td>283</td>
<td>(33)</td>
<td>861</td>
</tr>
<tr>
<td>1976-77</td>
<td>1063</td>
<td>(69)</td>
<td>475</td>
<td>(31)</td>
<td>1538</td>
</tr>
<tr>
<td>1977-78</td>
<td>1041</td>
<td>(79)</td>
<td>278</td>
<td>(21)</td>
<td>1319</td>
</tr>
<tr>
<td>1978-79</td>
<td>1337</td>
<td>(68)</td>
<td>620</td>
<td>(32)</td>
<td>1958</td>
</tr>
<tr>
<td>1979-80</td>
<td>1540</td>
<td>(51)</td>
<td>1476</td>
<td>(49)</td>
<td>3016</td>
</tr>
</tbody>
</table>

Average 1970-71 - 1979-80 900 (66) 471 (34) 1370

Source: ABS Cat. No. 5303.0 1982-83
productive capacity of Australia's economy and generated
profits and dividends payable overseas, although not all such
income is remitted. The actual amount of this income tends to
vary with conditions in the Australian economy, falling when
the level of activity falls and vice versa. Long-term loan
capital from abroad has much the same effects as inflows of
equity capital except for two notable exceptions. Firstly, the
fixed nature of the resulting liability means that regular
interest payments must be met during the life of the loan and
the capital must either be repaid or refinanced at some
specified date irrespective of the loan's productivity or lack
of it. Secondly, loan capital does not involve questions of
foreign ownership and control of Australian enterprises (2).

During the seventies, the level of private capital inflow
varied significantly. In the early years of the decade, the
very high rate set in the late sixties continued with private
inflow reaching record levels in 1970/71 and 1971/72. Then in
1972/73, there was a sharp drop with private investment falling
to less than a third of the inflow in the previous year.
Similar levels were recorded the following year with a slight
recovery in 1974/75. In 1975/76, the level again fell back
before making a slow and uneven recovery over the rest of the
decade.

The variation in the level of foreign investment in Australia
disguised a gradual but marked change in its composition (see
Table 1). Traditionally in post-war Australia, the major
component of private capital inflow has been direct investment,
### TABLE 2: BALANCE OF PAYMENTS - CAPITAL ACCOUNT ($M)

<table>
<thead>
<tr>
<th>Year</th>
<th>Government Capital Inflow</th>
<th>Private Capital Inflow</th>
<th>Portfolio and Total Direct Institutional Loans</th>
<th>Total Private Capital Inflow</th>
<th>Net Apparent Private Capital Inflow</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970/71</td>
<td>-70</td>
<td>896</td>
<td>695</td>
<td>1591</td>
<td>1467</td>
</tr>
<tr>
<td>1971/72</td>
<td>-83</td>
<td>870</td>
<td>584</td>
<td>1454</td>
<td>1310</td>
</tr>
<tr>
<td>1972/73</td>
<td>-60</td>
<td>399</td>
<td>70</td>
<td>469</td>
<td>422</td>
</tr>
<tr>
<td>1973/74</td>
<td>53</td>
<td>616</td>
<td>-120</td>
<td>496</td>
<td>176</td>
</tr>
<tr>
<td>1974/75</td>
<td>-19</td>
<td>657</td>
<td>346</td>
<td>1002</td>
<td>848</td>
</tr>
<tr>
<td>1975/76</td>
<td>-44</td>
<td>578</td>
<td>283</td>
<td>861</td>
<td>728</td>
</tr>
<tr>
<td>1976/77</td>
<td>243</td>
<td>1063</td>
<td>475</td>
<td>1538</td>
<td>1509</td>
</tr>
<tr>
<td>1977/78</td>
<td>1504</td>
<td>1041</td>
<td>278</td>
<td>1319</td>
<td>841</td>
</tr>
<tr>
<td>1978/79</td>
<td>1361</td>
<td>1337</td>
<td>620</td>
<td>1958</td>
<td>1719</td>
</tr>
<tr>
<td>1979/80</td>
<td>-34</td>
<td>1540</td>
<td>1476</td>
<td>3016</td>
<td>1631</td>
</tr>
</tbody>
</table>

Source: ABS Cat. No. 5303.0 1982/83
accounting for more than 90% of the total in the fifties and more than 70% in the sixties. The late sixties, however, saw a sharp rise in portfolio investment and institutional loans and this trend continued for the first two years of the seventies before the contribution of portfolio investment and institutional loans temporarily returned to levels more akin to those experienced in the early fifties and direct investment resumed its traditional importance. But, after the mid-seventies, loan capital picked up again to average 36% of the total private investment, with a very rapid increase in its contribution to 49% recorded in 1979/80. The dominance of direct investment in enterprises in Australia's capital account was under challenge by the private sector's thirst for overseas loan capital - a challenge which was won in the early eighties.

The capital account of Australia's balance of payments during the period is summarised in Table 2. Net apparent capital inflow, which approximates total foreign investment (both public and private)(3), substantially reflected trends in private capital inflow. The lowest level for two decades was recorded in 1972/3 and, after 1976/77, capital inflow began to show signs of an uneven but definite recovery. When fluctuations in government and private overseas capital flows tended to be complementary during the first two and last four years of the decade, total net apparent capital inflow remained consistently high. But between 1972/73 and 1975/76, the capital account recorded markedly lower levels of inflow, similar to annual inflows of a decade earlier.
<table>
<thead>
<tr>
<th></th>
<th>70/71</th>
<th>71/72</th>
<th>72/73</th>
<th>73/74</th>
<th>74/75</th>
<th>75/76</th>
<th>76/77</th>
<th>77/78</th>
<th>78/79</th>
<th>79/80</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance of Trade</td>
<td>427</td>
<td>928</td>
<td>2183</td>
<td>956</td>
<td>790</td>
<td>1524</td>
<td>1096</td>
<td>856</td>
<td>686</td>
<td>2760</td>
</tr>
<tr>
<td>Net Apparent Capital Inflow</td>
<td>1404</td>
<td>1822</td>
<td>362</td>
<td>485</td>
<td>761</td>
<td>385</td>
<td>1942</td>
<td>2503</td>
<td>3552</td>
<td>1702</td>
</tr>
<tr>
<td>Change in Official Reserve Assets</td>
<td>3</td>
<td>544</td>
<td>1079</td>
<td>-384</td>
<td>-460</td>
<td>-1053</td>
<td>-190</td>
<td>-474</td>
<td>-167</td>
<td>-348</td>
</tr>
<tr>
<td>Official Reserve Assets (end period)</td>
<td>2280</td>
<td>3764</td>
<td>4248</td>
<td>3560</td>
<td>3493</td>
<td>3086</td>
<td>3312</td>
<td>3225</td>
<td>3885</td>
<td>5681</td>
</tr>
</tbody>
</table>

Sources: ABS Cat No. 5303.0 [83]
Impact on the Balance of Payments

A summary of movements in the balance of payments (4) is set out in Table 3. During the first two years of the decade, large private capital inflows more than offset the current account deficit, giving Australia a payments "surplus" (see net official monetary movements). In 1972/73, the sharp fall in private capital inflow was more than offset by a surplus on current account (due to a very large surplus on the balance of trade) and net official monetary movements remained positive. However, from 1973/74 onwards, the increasing current account deficit was not offset by capital inflow and official reserve assets began to fall.

Since 1950, Australia has traditionally recorded a deficit on current account but this has been more or less offset by private capital inflow. This relationship is illustrated in Graph 1, which superimposes the current account deficit/surplus on total capital inflow each year and shows that private capital inflow more or less covered the current account deficit up until 1974. Although notoriously volatile, private capital inflow tended to fluctuate around a rising trend after 1952.

But the situation changed in the seventies. Private capital inflow fell from the record levels of the early decade to around 25-50% of this inflow between 1972/73 and 1975/76, followed by a slow and uneven recovery. Although net apparent capital inflow averaged $1540 million annually between 1970 and
GRAPH 1
CAPITAL INFLOW & CURRENT ACCOUNT
in the post war period

$ Billion


□ Current Account  + Net Capital Inflow

GRAPH 2
CAPITAL INFLOW & CURRENT ACCOUNT
in the seventies

$ Billion


□ CAD  + Private Capital  ◇ Net Apparent
1980, and was only marginally below the average annual current account deficit of $1560 million, there was a marked deterioration in the level of private capital inflow after 1971/72. As a result, for the rest of the decade, average annual capital inflow accounted for only approximately 84% of the current account deficit. Between 1975/76 and 1979/80, this percentage dropped to just over 80% despite heavy public borrowing during the period. If the public component is subtracted, average private capital inflow during these five years accounted for barely 58% of the current account deficit. These trends are illustrated in Graph 2, which shows private capital inflow, net apparent capital inflow and the current account deficit during the seventies. It is apparent from this graph that between 1973/74 and 1979/80, private capital inflow continuously failed to offset the deficit on current account.

The extent and duration of the fall in private capital inflow and the compensatory rise in public sector borrowing during the seventies is even more apparent as a percentage of GDP. Graph 3, which sets out private and public capital inflow as a percentage of GDP, shows that government borrowing rose to almost 2% of GDP in 1977/78, its highest post-war level. Private capital inflow, on the other hand, languished well below 2% of GDP between 1973 and 1979.
GRAPH 3

Net Apparent Inflow of Capital

Percentage to gross domestic product

B. The Impact of the International Economy

Explanations of movements in Australia's capital account in the past have tended to focus on short-term fluctuations in private capital inflow due, for example, to exchange rate speculation or interest rate differentials (5). However, longer term patterns are a little more difficult to account for although it is clear that capital inflow broadly responds to changes in the relative attractiveness of Australia as an investment outlet, which in turn is determined by developments in the international economy as well as by domestic economic policies. For example, there seems to be some inverse correlation between domestic credit expansion and private capital inflow (6), which can partly explain the high levels of foreign investment during the early seventies, the subsequent weakness between 1972/73 and 1975/76 and its gradual recovery by the end of the decade. However, during the seventies, exogenous variables (such as world recession and the energy shortage) were also crucial determinants of the level of foreign investment in Australia. The impact of external shocks are the subject of this section.

The International Setting

The decade opened with a commodity boom, which saw primary producing countries (like Australia) experiencing buoyant growth and favourable terms of trade. Strong export performance was frequently accompanied by large net inflows of capital boosting international reserves and putting pressure on
exchange rates (7). At the same time, these capital flows were also putting intolerable pressure on the international currency system.

Up until 1971, the Bretton Woods Agreement had facilitated 25 years of relatively stable, unparalleled economic growth accompanied by a measure of stability in both exchange rates and domestic prices (8). But toward the end of this period, rising inflation and chronic imbalances in payment relationships between the major industrial countries (at the heart of which was the large US trade deficit) had developed. Explosive movements of capital on top of this disequilibrium resulted in the suspension of dollar convertibility in August 1971 (9).

Despite attempts to realign the major world currencies at the Smithsonian meeting in Washington in December, financial relationships remained without a firm foundation in any internationally agreed set of rules. The growing mobility of international capital and the expansion of the Eurocurrency market aggravated currency instability and government authorities were apparently reluctant or unable to prevent large global capital movements. By 1973, most major trading nations had moved to adopt various degrees of floating exchange rates accompanied by a relaxation of controls on international capital movements (10).

The first oil crisis occurred just as the boom of the early seventies began to lose momentum. In October 1973, the OPEC
nations raised the price of oil by 70%, cut production and placed a total embargo on supplies to certain countries. This was followed by a further price increase of 130% in December — in all a quadrupling of the world oil price (11). Economic growth fuelled by cheap energy was no longer possible.

Although production and trade embargos were lifted, this rapid upsurge in the price of oil imports not only fuelled world inflation but depressed economic activity. In the industrial nations, inflation accelerated from an average of 7.9% in 1973 to 13.6% in 1974 (12). Most countries took steps to curb imported price increases and these anti-inflationary policies further slowed economic growth. By mid-1974, the world economy was experiencing an unexpectedly severe and widespread recession with virulent inflation, declining economic production and sharply rising unemployment (13).

The first OPEC oil price rise in 1973/74 produced a radical transformation of the global balance of payments system resulting in a massive imbalance in international payments. The collective surplus on current account of the traditional oil exporters increased from around US$6000 million in 1973 to US$70,000 million in 1974, a rise of more than US$60 billion in one year. On the other hand, oil importing nations recorded a collective deficit of some US$51 billion on current account in 1974, compared with a current account surplus in 1973. And the combined current account deficit of other primary producers rose from US$9 billion in 1973 to US$28 billion in 1974 (14).
The current account deficit of oil importing nations was initially financed by running down international reserves. But as the world recession deepened and the OPEC nations were unable to increase their imports sufficiently to offset their trade surpluses, the corresponding deficits were financed by borrowing on international markets. Although developing countries were hardest hit, many industrial countries were also heavy borrowers. (15).

World economic recovery from the recession was slow and uneven as persistent inflation and/or poor balance of payments performances restricted expansionary policies. Primary producers faced continuously declining terms of trade after 1974, which intensified their external problems. But with the gradual relaxation in deflationary measures by many major industrial countries, global payments imbalances diminished and world economic indicators began to show consistent signs of recovery.

But just as the OPEC surplus had virtually disappeared, the second oil crisis occurred. Revolution in Iran led to a sharp decrease in oil output and exports, which led to a scramble for available oil supplies, both for consumption and to boost stocks (16). As a result, oil prices increased sharply around mid 1979, and again later in the year with some further rises in the first half of 1980. By the middle of that year, the price of Saudi Arabian light crude was almost double its price of a year earlier (17). These increases triggered the reemergence of inflation (from an average of 7.7% in 1978 to
12.8% in 1980 among the industrial nations), a slowdown in economic growth and the reappearance of large external imbalances.

By 1980, oil exporting nations had a combined current account surplus of some US$111 billion, compared with US$63 billion in 1979 and US$6 billion in 1978. The counterpart of this was that the industrial nations had a combined current account deficit of more than US$38 billion in 1980 compared with a deficit of US$5 billion in 1979 and a current account surplus of US$33 billion in 1978. And the combined current account deficit of the non-oil developing nations more than doubled between 1978 and 1980 to US$88 billion and their net external borrowing rose from US$38 billion in 1978 to US$50 billion in 1980 (18).

As a result of continued overseas borrowing to finance these deficits, long-term world debt rose to around US$250 billion by the end of 1979, twice the amount outstanding at the end of 1975 and almost three times the corresponding level in 1973. Although much of the rise reflected the effects of inflation on the value of international debt, there was also a rise in the level of outstanding debt to total exports of goods and services (from 70% in 1973 to around 80% in 1979) and to world gross domestic product (from 14% in 1973 to 18.5% in 1979) indicating a rise in the level of real, not simply nominal, debt (19). This growing debt burden added to international financial instability.
This instability was compounded by three other factors. Firstly, the concentration of debt among a relatively few developing nations. For example, in 1978 only 8 countries held 68% of new bank debt and, by the end of 1982, 20 major borrowers accounted for 73% of the non-oil developing countries' total debt (20). This meant the failure of just one of these economies would have major repercussions for the international financial system. Secondly, these borrowers were facing rising debt service costs as interest rates, particularly on private loans, increased sharply after 1979. For example, the 25 major borrowers faced an average interest rate of 7.3% in 1978 but 4 years later, it was 12.1% (21). Thirdly, there was a move to shorter maturities by debtor nations. For example, in 1977-79, the short-term debt of oil importing developing countries was approximately 15% of their total debt but this had risen to 20% by 1982. The relationship between fixed repayment obligations and returns generated by debt-financed long-term projects had deteriorated markedly.

In sum, the decade of the seventies witnessed major disturbances in the world economic environment, which resulted in a marked increase in international financial liquidity and instability. This upset the established pattern of international capital flows.

**Capital Flows**

Foreign investment has played an important role in the international economy since the latter part of the nineteenth
century. Following the slow growth of the thirties, there was an upsurge in capital flows after World War II, the majority being in the form of direct investment. Between the early 1960s and the mid 1970s, there was further growth in international direct investment led by the USA (22).

But then the rate of growth of such capital slowed, falling from 12.6% per annum between 1960-73 to 11.9% per annum between 1974-79. Given the notably higher rate of inflation (9.1% pa compared with 4% pa OECD averages), there was a sharp deceleration in real terms. This was accompanied by a general weakening of domestic investment in most OECD countries, which meant less buoyant and more uncertain market prospects.

Moreover, the fall in the level of direct investment flows was accompanied by a change in the distribution of such investment away from many traditional importers of capital, such as Canada and Australia. For example, direct investment inflow to Canada fell from 16.2% of the total between 1961-67 to 3.2% between 1974-78 while for Australia the figures were from 15.6% to 9.5% (23).

At the same time, the oil crisis created new demands for external financing. Oil importing nations were suddenly faced with large external deficits and, to maintain growth rates, they sought finance from international markets to help pay for their imports. The vast majority of these deficits were financed by government external borrowing. Between 1974 and 1978, some 50% of the cumulative current account deficit for non-oil developing countries was financed by commercial banks.
and another third by loans from official sources (24). As a result, government and government-guaranteed debt of Third World nations more than doubled after 1974, and their financing requirements were still growing at the end of the decade (25).

International markets were able to meet this rising demand by recycling OPEC surpluses. Although the oil exporting nations had experienced an unprecedented build-up in foreign currency claims in 1973/74, they were reluctant to use these for direct investment. Instead, the bulk of their overseas investment was in financial assets - United States securities, other official and private securities of industrial Europe as well as domestic bank and Eurocurrency deposits (26). The OPEC nations favoured relatively secure but profitable short-term investment opportunities, which put their surpluses at the disposal of the international banking system.

Although the banks were at first reluctant to use these short-term funds for long-term investment, loan syndication and roll-over credits permitted Western commercial banks to use petrodollar deposits to finance medium term loans. In fact, the banks played the dominant role in recycling the OPEC surplus to countries with balance of payments deficits and, as a result, international banks were financing more than 50% of LDC debt by 1980 compared with only 12% in 1972 (27). By comparison, the role of international organisations in the recycling process was a modest one (28).

Supply conditions faced by international financial institutions
became increasingly liquid as markets were fed by the US current account deficit and OPEC surpluses, aided by flexible exchange rates and the freer movement of international capital. The size of the Eurodollar market more than trebled from US$390 billion in 1974 to US$1525 billion in 1980 (29). Although this may not have represented a net increase in the supply of international funds, it permitted a significant rise in their velocity (30).

As a result, finance was readily available to most borrowers at increasingly competitive rates. For example, the average spread on Eurocurrency loans (i.e. the margin over the London Inter-Bank Offered Rate) to developing nations fell from 1.57% in 1976 to 1.09% in 1978 (31). By late in the decade, real interest rates were negligible or negative as inflation rates and supply conditions made borrowing from the international commercial banks very attractive. In fact, many nations were able to arrange profitable refinancings, raising new loans to repay earlier loans carrying higher interest rates (32). A good international credit rating was a passport to large supplies of relatively cheap overseas finance.

These changes in international capital flows inevitably affected traditional importers of capital, like Australia. The emergence of massive payments imbalances and the decline in attractive investment outlets saw a check in private direct capital flows as international funds were diverted to pay for energy imports (i.e. for current consumption rather than long-term investment). Australia was faced with a current
account deficit which was not being offset by private capital inflow. But the means of financing this potentially temporary disequilibrium were available. Supply conditions in international markets made government overseas borrowing an attractive policy option for bridging the gap until private capital inflow returned to more normal levels.

Private capital inflow did recover after 1979 primarily as a result of the second oil crisis which renewed uncertainty about energy supplies. This spurred efforts to find alternative energy sources and brought relief from the balance of payments restraint to resource-rich nations, like Australia, as large flows of private capital sought investment opportunities in "cheap" energy countries and in energy resources which offered economic alternatives to liquid fuels.

C. The Change in Borrowing Policy

The disruptions to world capital flows in the seventies forced the Commonwealth to reassess its post-war approach to overseas borrowing and led to its decision to embark on a large-scale overseas borrowing program - a program which had no post-war precedent in terms of magnitude or duration. Following a brief summary of the political and institutional setting, this section examines the policy making process surrounding the Commonwealth's decision to increase the level of its overseas borrowing to bridge the temporary gap between the current
account deficit and private capital inflow.

Details of the institutional arrangements covering government overseas borrowing are set out in Appendix I. The key constitutional role in determining the amount, conditions and timing of official borrowing abroad belongs to the Loan Council. Although this body consists of the six State Premiers, as well as the Prime Minister or Treasurer, the Commonwealth is normally able to dominate the Council. This is partly inherent in its disproportionate powers and responsibilities under the Financial Agreement (33). However, Commonwealth control was reinforced in the fifties with the adoption of the underwriting agreement, which offered the States a guaranteed level of loan funds each year as the Commonwealth undertook to finance any shortfall in their programs (34). This agreement increased the Federal Government's bargaining power to such an extent that any policy making role of the Council in the area of overseas borrowing has normally depended on the Commonwealth's advice.

Traditional and legal responsibility for raising all public loans overseas lies with the Commonwealth Treasurer (as the agent of Loan Council) and his department. In addition, the Treasurer and Treasury are responsible for managing Australia's external account and overseas debt. However, despite this formidable array of formal powers, the Treasurer has not always been able to ensure his views on overseas borrowing prevail in Cabinet.

The major source of technical advice on Commonwealth overseas
borrowing is the public service. Almost exclusively, this advice comes from the Treasury, after consultations with Attorney-General's Department on technical aspects of the borrowing legislation and with the market on commercial aspects. In fact, the Treasury itself retains such a unique body of expertise in the overseas borrowing arena that its control is virtually impregnable. Nevertheless, like other policy making institutions, Treasury's views are vulnerable to challenge by powerful political figures and their advisers.

The policy making process also involves the interrelationships within this institutional framework - among the members of Cabinet, the Government and Loan Council as well as between the Commonwealth and its advisers. Moreover, the final outcome may also be modified by or reflect the action of powerful interest groups, anticipated media reaction, political ideology, past practice in the area, the electoral mandate and/or the political environment.

All these factors must be taken into account in any examination of Australia's overseas borrowing policies in general and the Commonwealth's decision to utilize large-scale loan raising abroad to finance the current account deficit in 1977 in particular. Although non-economic criteria were of significance in the timing of that decision, the policy itself seems to have been the outcome of predominantly economic considerations.
Economic conditions during the early seventies left little place for official overseas borrowing. Heavy private capital inflow resulted in record levels of foreign exchange reserves, which continued to accumulate into 1973, and the authorities were occupied with measures to correct this situation (35).

Nevertheless, the Coalition Government continued to borrow small amounts overseas. In January 1972, a 100 million deutschmark loan was floated in Germany (the first money raised there in two years) essentially to maintain the Commonwealth's access to this large and important capital market. This was followed in July by a 10 billion yen loan in Tokyo, which was designed to establish Australia's position in a strong, new market. Such activity was in line with the Coalition's past practice of maintaining a modest but active overseas borrowing policy on official account (36).

After December 1972, given similar economic circumstances but a different historical perspective, the new Labor Government chose not to continue an active borrowing policy (37). Instead, heavy private capital inflow was moderated by a revaluation of the dollar - first in December, then in February 1973 and again in September of the same year - and a strengthening of capital controls. This led to a sharp contraction in foreign investment but, with high international reserves, the Commonwealth remained virtually absent as a borrower from overseas markets for some two years, with no new money loans being raised until 1975.
But from mid 1974, these policies were gradually reversed as the economy slowed down and the balance of payments weakened. The Government began to expand domestic credit rapidly in an attempt to stimulate the economy. Mainly for domestic reasons, tariffs were again increased, capital controls were first eased (June and August) and then suspended (November) and the Australian dollar was devalued against gold and the US dollar by 12% (38).

Moreover, Labor's apparent reluctance to seek overseas funds gradually diminished. In October 1974, a DM200 million loan was refinanced and, by 1975, there was a minor net addition to Australia's overseas indebtedness as new money was raised for on-lending to Commonwealth authorities, the airlines and for housing. However, although in November 1974 Treasurer Crean pointed out that the government could assist a flagging balance of payments by supplementing private capital inflow with government overseas loans (39), the Commonwealth continued to finance the external deficit from the high level of accumulated reserves. Actual official overseas borrowing during this period remained the lowest in years.

In the event, the Coalition became increasingly critical of the Commonwealth's failure to borrow. Late in 1974, Shadow Treasurer Lynch claimed that Labor's "virtual moratorium" on overseas borrowing since assuming office had exacerbated the substantial capital outflow and consequent liquidity difficulties then being experienced (40) and the Coalition
continued to espouse the virtues of a more active policy of overseas borrowing on official account - a policy it resumed soon after its return to office in 1975.

**Rejection of the Borrowing Option**

However, past practice by Coalition Governments had not involved large-scale overseas borrowing on official account to support the balance of payments through a prolonged "temporary" disturbance. When faced with this option, the Government initially refused to adopt it, despite the economic arguments for such a policy and the urgings of its official economic advisers. The major factors which determined Australia’s external economic policy at this time were the role played by the Prime Minister, Mr. Fraser, and the ideology and electoral mandate of the Coalition, which helped create a hostile political environment toward government overseas loan raising.

Upon its return to office in late 1975, the Fraser Government was faced with speculative capital outflow and a fall in international reserves. The Treasurer quickly rejected the devaluation option arguing that such action could not be justified in terms of Australia’s balance of payments position (the balance of trade was in surplus) and outlook (capital inflow was expected to recover with the change in domestic policies), that the reserves were strong ($2.5 billion) and that such a policy ran counter to its principle priority of curbing inflation (41). The Commonwealth was listening to its economic advisers.
The Treasury had convinced the Labor Government in 1975 that inflation was the country's "most menacing enemy" (42) and found the Coalition a willing ally when it resumed office. Treasury's strategy for the balance of payments was to avoid a devaluation (because of its inflationary impact) by financing any external deficit through overseas borrowing until the capital account strengthened. It argued that the exchange rate was not fundamentally unsound given the healthy trade balance and an expected recovery in overseas investment (43). Officials apparently expected that moderately higher levels of overseas borrowing (a figure of $1000 million was quoted in The Bulletin in July) would be sufficient to bridge the temporary deficit on external account as, given Australia's long-term prospects, Treasury was confident private capital inflow would soon resume its former levels (44).

In 1976, the Federal Treasury was playing a dominant role in economic policy making. It had won the confidence of the Coalition principally by its stand against the Connor loan in 1974/75 and had gained support for its economic policies from both major parties. The Treasurer, Mr P. Lynch, was sympathetic to his department's views and tended to support the Treasury brief with vigour. As a result, many of Treasury's policies were adopted during this year (45).

But despite the department's apparent strength, by mid 1976 the Treasury's strategy for managing the external account had become the subject of increasing doubts amongst members of the
Coalition. At the heart of the Government's concern was the failure of the economy to improve during 1976. The Coalition had campaigned in 1975 as better economic managers who would return Australia to economic prosperity. Yet by mid 1976, there were no signs of any improvement in economic growth. Moreover, the Coalition was ideologically opposed to any strategy which required the "productive" sectors (the exporters and import competing manufacturers) to bear the brunt of the anti-inflation strategy.

As the year wore on, the strong conservative rural interests within the Fraser Cabinet became increasingly unhappy with the decision to maintain the exchange rate. Their concerns were expressed by the leader of the National Country Party (NCP), Mr. J.D. Anthony, in September (46) and, although he denied any disagreement with government policy at that time, he had always accorded a high priority to raising exporters incomes by generally supporting devaluation (47). In 1973, he opposed proposals to "float" the Australian dollar relative to that of the United States when the latter was depreciating against most currencies (48). However, later that same year, he became a strong advocate of such action when the American dollar began to appreciate (49). The priority given to Australia's exporters generally led the NCP to favour devaluation and a paper produced by Anthony's department, which was leaked to the press in October, suggested this remained the preferred option (50).

As a farmer, Prime Minister Fraser shared many of the views of
the NCP, particularly on devaluation and revaluation. He had strongly criticised Labor's 1972/73 revaluations because of the disadvantage to the rural sector (51) and always gave high priority to the export sector. Despite his initial acceptance of the Treasury strategy, the Prime Minister became increasingly concerned as private capital inflow and the economy remained sluggish. He began to seek ways to encourage more rapid economic growth (52).

Given their ideological commitments, the Prime Minister and his NCP colleagues were susceptible to pressure from rural and mining exporters and import-competing manufacturers, who claimed a devaluation was necessary to assist development by improving export competitiveness and encourage capital inflow. Organisations, such as the Australian Mining Industry Council with strong ties to the NCP, repeatedly put forward the case for devaluation (53) with little public opposition, and reports of delays in development projects by overseas investors increased the pressure on the Coalition.

In the event, the Government's commitment to maintaining the exchange rate through overseas borrowing was never spelt out. In fact, despite a $309 million drawing from the IMF in July (54) and a planned US$300 million overseas loan in September, the Treasurer continued to stress that there had been no change in his Government's overseas borrowing policy. The new raisings simply reflected the Commonwealth's view that an active overseas borrowing policy on official account was appropriate (55). In Parliament, he explicitly rejected any
suggestion that the Government was "endeavouring to borrow its way out of a devaluation" (56). Such statements reduced the efficacy of the Treasury strategy by casting doubt on the Government's repeated denials of any intention to devalue (57). The Treasurer did not actually spell out the strategy until October after a further $200 million had been borrowed (58) and capital outflow was well established.

In early November, the borrowing strategy was complemented by tighter monetary policy but the drain on reserves continued - between July and November, overseas reserves fell by some $470 million despite substantial net official borrowings (59). Two weeks later, the decision to maintain the dollar was again reviewed and the Coalition was presented with two options - a substantial devaluation or borrowing a further $1000 million overseas on official account as well as probable recourse to IMF drawings (60).

Despite strong Treasury support for the second option, the Cabinet preferred the former (61). The currency was devalued on the grounds that it would end speculation, encourage capital inflow and improve Australia's international competitiveness. The Government's anti-inflation strategy was salvaged by further tightening fiscal and monetary aggregates to try and reduce the impact of the devaluation on prices. New exchange rate arrangements were also established, which meant that the Australian dollar was henceforth to be valued in terms of a variable link to a trade weighted "basket" of currencies (62).
In rejecting the borrowing option, the Government argued that to have continued to support the balance of payments by massive loan raisings abroad, firstly, may not have been possible if large enough sums were unavailable to cover the anticipated fall in reserves. And, secondly, even if possible, the option was too costly and may not have ended speculation (63). In fact, overseas funds were available at relatively modest rates of interest and, given the number of large successful borrowings undertaken by other countries (64), the Government would not have been unaware of this. As devaluation was not without "cost" in terms of increased inflation, this option appears to have been more attractive for reasons other than the official ones.

The Coalition's rejection of the borrowing option was largely determined by the ideological beliefs and priorities of the Prime Minister and his Country Party colleagues and their desire for a quick recovery in economic growth. But the seeds of Treasury's defeat lay in the political environment of the time. Only one year earlier, the Coalition Parties had strenuously attacked the Labor Government's attempt to borrow US$4000 million overseas, partly on the economic grounds of the "massive foreign exchange gamble" involved and the impact of the enormous debt burden on future generations. Prime Minister Fraser had argued that Labor had been careless and unconcerned about the national interest even contemplating raising such an amount and other leading members of the Coalition made similar comments (65). Due to the strategic role this affair played in the defeat of the Labor Government, Commonwealth overseas
borrowing remained highly politically sensitive and the Coalition was not unaware of this when it opted for devaluation.

In fact, the Fraser Government defended its decision not to borrow overseas in terms of financial prudence and responsibility, contrasting such action with that of their predecessors. For example, in reply to an Opposition question about the rejection of Treasury advice, the Prime Minister responded (in part) as follows:

"Does anyone in the Parliament suggest that they would opt for a borrowing of $1000 million? I could understand the Opposition doing it. It was prepared to borrow $4000 million from Khemlani. But so far as the Government and these Parties are concerned, there is only one responsible choice, faced with those options. Devaluation was the only responsible option open to the Government" (66).

Later in response to media questions, he demanded "Is there a man here who would say they would sooner put Australia into hock to the tune of $1000 million rather than devalue?" (67). The Treasurer made similar comments (68) and Treasury advice began to look irresponsible and imprudent. That same month, the Government had announced that, to assist the policy making process, Treasury was to be split into two departments - Finance and Treasury - with Lynch retaining responsibility for both (69).
As well as being a negative influence on the borrowing option, the political environment also played a more positive role in the decision to devalue. This was partly because the Coalition had justified its refusal to vote on supply in 1975 not simply on the Labor Government’s "improprieties" but also on its "gross mismanagement" of the economy (70). To maintain electoral credibility, therefore, the Coalition Government had to prove itself to be a more effective economic manager than its opponents (71). However, Treasury’s policies for recovery involved gradually returning the economy to a path of sustainable non-inflationary growth by maintaining relatively tight monetary and fiscal conditions. So the economy remained sluggish in the short-term and the Government became obsessed with the need to stimulate economic growth firstly through "export-led" (1976/7), then "investment-led" (1977/8) and finally "resources-led" (1979/80) recoveries. The "export-led" recovery was to flow from devaluation.

Moreover, the media helped foster a favourable political environment for devaluation. Firstly, it had been instrumental in exposing and orchestrating the "loans affair", which left the taint of irresponsibility on all large-scale overseas borrowing by the Commonwealth. Secondly, the media had fed investors’ doubts about the firmness of political support for the exchange rate. This culminated in articles being published by the *Age* newspaper about the divisions within Cabinet at the 7 November meeting, which reported that the Prime Minister and his deputy were "soft on devaluation". This left the borrowing option without credibility and virtually assured the
devaluation.

In sum, the 1976 devaluation was a political decision in which the role of the official economic advisers was eclipsed by that of the politicians reacting to non-economic factors, such as pressure from special interest groups, the perceived electoral mandate and the political environment. Given the possibility of minimising its inflationary impact, devaluation had the dual appeal for the key rural elements in Cabinet of assisting many of the Government's supporters at the same time as encouraging growth in a sluggish economy through increased exports, import replacement and a stronger capital account. The borrowing option, on the other hand, offered none of these "benefits" and the Cabinet's doubts were fuelled by the Coalition's own 1975 rhetoric and the media's use of it. Perhaps some government members even feared that such a large-scale overseas borrowing program would expose much of the furor over Connor's proposed loan as unfounded.

Borrowing as an Instrument of Balance of Payments Policy

However, faced with a similar balance of payments problem one year later, the Government reversed its 1976 stance and opted to help finance the current account deficit with a large-scale overseas borrowing program on the expectation that private capital inflow would revive. The major factor in this policy reversal was a markedly different political environment, which enabled the Government's official economic advisers to reassert
their control over external policy.

As before, private capital inflow fell away sharply in mid 1977. As before, the balance of trade remained relatively strong and, following a revaluation of Australia's gold holdings, international reserves were adequate. Although the inflation rate had fallen from around 13% in 1975/76 to 10% in 1976/77 (72), it remained a serious problem and continued to be the target of restrictive monetary and fiscal policies. The economy, far from booming after the 1976 devaluation, remained sluggish.

In this situation, Treasury argued that high labour costs and inflation were continuing to impede economic recovery and must remain the centre of the Government's economic strategy (73). This advice was reflected in the 1977/78 Budget Speech in which the Government reaffirmed its basic objectives as maintaining the underlying trend to lower inflation and promoting moderate non-inflationary growth (74). Treasury also wanted to maintain the exchange rate at a level where, in the short term at least, it could contribute to the anti-inflation objective. This could only be done if international reserves were supported by an official overseas borrowing program (75).

This time the Government had to accept the advice of the economic experts. Monetary and fiscal policy were already tight and further compression of imports would have had unacceptable consequences for economic growth. Tariffs and import restrictions were not short-term options and a further
devaluation was neither economically nor politically feasible. This was because, firstly, the Government had seen that some of the major benefits claimed for the 1976 devaluation (such as stopping currency speculation and encouraging private capital inflow) were only temporary. Secondly, a further devaluation would have sparked off a new round of price rises just as Australia’s inflation rate was beginning to resemble those of her major trading partners. And, thirdly, the previous devaluation had improved the competitive position of her exporters and import competing manufacturers.

But equally as important were two major changes in the political environment. Firstly, by August 1977 the Prime Minister had begun to consider an early election (76) and a further devaluation would have been politically damaging for the Coalition. During the campaign, the Government wished to present itself as a responsible economic manager intent on reducing the level of inflation to promote sustainable economic growth and increased employment opportunities. A further devaluation would have destroyed this image. Instead the election strategy involved a policy of actively encouraging overseas investment in Australia’s abundant mineral resources via a mixture of "salesmanship" and incentives to the large mineral development projects, such as the North-West Shelf (77). The Prime Minister and Treasurer Lynch were both able to campaign on the $6 billion worth of major new investment projects that were poised to commence in Australia (78) as evidence that an "investment led" recovery was underway.
Secondly, the high level of political sensitivity surrounding large-scale overseas borrowing by the Commonwealth since 1975 had been neutralised by the Federal Labor Party’s support for the Treasury strategy. In 1976, Opposition spokesmen such as Whitlam, Hayden, Keating and Hurford had attacked the Commonwealth for discarding the borrowing option. They had argued that the devaluation was unnecessary and could have been successfully avoided if the Government had taken an early stand in support of the exchange rate (79). In 1977, the Opposition continued to call for action to defend the dollar (80). Shadow Treasurer Hayden urged the Government to announce a substantial and comprehensive overseas borrowing program (81) and when it did, the Leader of the Opposition only criticised the action as “tragically late” (82). Labor could no longer accuse the Government of financial irresponsibility in the way the Coalition had done so successfully in 1975.

The resulting political consensus on the overseas borrowing strategy left the Treasury virtually free to manage the external deficit without political constraint. Despite being split into two departments after the 1976 devaluation and the establishment of additional centres of alternative economic advice (83), Treasury remained the Commonwealth’s most powerful economic adviser. With the support of the Reserve Bank, the Treasury was able to pursue its external policy throughout the remainder of the seventies.

Initially, the Coalition announced only its intention to seek “a moderate level of overall capital inflow on both private and
government account to supplement the resources available to the country for development purposes" (84) - similar to announcements in 1976. But two weeks later on 25 August 1977, the Treasury's strategy of borrowing overseas to support the balance of payments was spelt out in detail. This time the Treasurer made it clear that, given the low level of Australia's official overseas debt and the current favourable terms for overseas loans, the Government would not hesitate to use Australia's high international credit rating to finance any temporary deficit on the capital account (85).

In September, an official borrowing program of $1.7 billion was announced (86), which included loans from Germany and the Eurodollar market as well as two placements with the Bank of International Settlements (BIS). The program was completed by the end of March 1978. In May and June, there were two further official raisings abroad - US$250 million and 300 million dutch florins (87), making total Commonwealth borrowings of some $1.8 billion (including the BIS drawing) in 1977/78.

In the second half of the financial year, there had been a turnaround in the capital account due, not only to improved terms of trade and a net inflow of trade credit, but also to the Government's firm indication that it would continue to support the exchange rate (88). Anticipating a further weakness in capital inflow, the Government announced additional developments in its on-going official borrowing program in July 1978 (89). Throughout the next few months, the Government's intention to support the exchange rate in this way was
constantly reaffirmed (90). Over the year, gross raisings by the Commonwealth came to approximately $1560 million, the majority being raised in the first half. Private capital inflow had almost ceased by late 1978 (due to interest rate differentials, increased domestic liquidity and uncertainty) but the need for further loans quickly abated as the trade account improved and capital inflow picked up during the second half of 1978/79. In fact, no new money loans were raised after early April (91).

Despite the new flexible arrangements established in December 1976, the Treasury also held the exchange rate constant between February and August 1977 to help reduce inflationary pressures in the economy. But as capital outflow increased, the exchange rate had to be gradually adjusted downward to avoid the full appreciation associated with a weakening US dollar. Nevertheless, the overseas borrowing program on official account insulated the exchange rate from the major weakness in the capital account at that time (92). It remained a major arm of external policy until the balance of payments strengthened the following year as private overseas investment was attracted by Australia’s relatively cheap energy resources.

Over a period of 18 months between September 1977 and February 1979, new money loans of more than $3000 million were raised overseas to help finance Australia’s current account deficit. This policy of supplementing international reserves through a large-scale overseas borrowing program on official account broke with the Commonwealth’s post-war pattern of modest
government borrowing abroad and, although the rationale for the new policy was principally economic, the timing of its implementation had clearly been determined by political factors.
CH III GOVERNMENT OVERSEAS BORROWING IN THE SEVENTIES

A. Overseas Loans Raised by the Commonwealth 1970-1980

This chapter analyses the available statistical material on Commonwealth overseas borrowing during the seventies with a view to discerning the main trends in terms of magnitude, source of funds and terms and conditions. Then, as far as possible, the effect of this inflow on the balance of payments and the economy in general is examined with a view to assessing the effectiveness of the Commonwealth’s borrowing program between 1977 and 1979.

Magnitude

Between 1970/71 and 1979/80, the Federal Government raised more than $5206 million, compared with $1154 million in the sixties and $746 million in the fifties. The vast majority of these raisings were for new money involving some 87 loans and $5078 million dollars. In fact, during this period, there were only four official conversion loans, totalling $128 million and representing a mere 2.5% of total proceeds. A schedule of the Government’s gross overseas raisings by market between 1970/71 and 1979/80 is at Appendix II.

As one would expect, the distribution of these gross borrowings was far from even over the decade with the majority of the
funds being raised in the late seventies. Almost 81.6% was borrowed during the last four years with nearly 64% of gross Commonwealth offshore borrowing being raised in only two of those years—1977/78 and 1978/79. This bunching of overseas loan raising is even more apparent in the net official borrowing figures. During the 10 years to 1979/80, Commonwealth net borrowing overseas totalled $3345 million and was heavily concentrated in the late seventies. Appendix III, which provides a summary of the Commonwealth’s official gross and net borrowings, shows that gross redemptions exceeded gross borrowings in the first four years of the seventies with only minor net borrowings of $1.7 million taking place in 1974/75. In the first seven years of the decade, only 6% of the net overseas funds were borrowed, compared with 94% in the last three years from 1977/78 to 1979/80. Net borrowing in only two of these years (1977/78 and 1978/79) accounted for almost $3000 million or more than 88% of the total. The Government’s response to the deterioration in the country’s balance of payments deficit in the late seventies reversed Australia’s declining dependence on official overseas borrowing.

Stated Purposes

The use of foreign loan proceeds which are set out in the budget papers each year have primarily an accounting or legal purpose as it often relates simply to the legislation under which the loan was carried out. The purpose of many overseas loans could be described either according to the use made of the foreign currency and/or its local currency equivalent.
### TABLE 1: ALLOCATION OF FOREIGN CURRENCY PROCEEDS 1970/71-1979/80
- approximate $ Australian million equivalents -

<table>
<thead>
<tr>
<th>Loans Raised Overseas</th>
<th>Refinancing of Maturing Debt</th>
<th>Defence Purposes</th>
<th>Transport (Airlines &amp; Shipping)</th>
<th>On Lending Purposes (Airlines lending Purposes)</th>
<th>Unspecified Purposes</th>
<th>As % of total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>US</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>West Germany</td>
<td>89</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Switzerland</td>
<td>39</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Netherlands</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>U.S. Defence Credits</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commonwealth Authorities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>. QAL</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>. ANAC</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>. ASC</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>. AIDC</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>128</td>
<td>161</td>
<td>347</td>
<td>56</td>
<td>4514</td>
<td></td>
</tr>
<tr>
<td>As % of total</td>
<td>2.5</td>
<td>3.1</td>
<td>6.7</td>
<td>1.0</td>
<td>86.7</td>
<td></td>
</tr>
</tbody>
</table>

Derived from Appendix II and III
This was because for those loans which were not being used solely to finance current overseas transactions, the foreign currency proceeds were added to Australia's international reserves and in turn the Reserve Bank credited the Commonwealth with the equivalent in Australian currency. However, with some loans, such as those used for refinancing or for financing imported capital equipment, the foreign currency proceeds were spent by the Commonwealth or its authority offshore and no counterpart funds were accredited in domestic currency to the Government for these loans (1).

Nevertheless, an allocation of foreign currency proceeds raised during the seventies into the broad categories set out in Table 1 does provide some insight into the use to which these funds were put. The most striking feature of the period is that the vast majority of the proceeds (some 86.7%) were for unspecified Commonwealth purposes, reflecting its balance of payment policy between 1977-79. The remaining 13% have been allocated among four separate categories, with more than half of this amount on-lent to Commonwealth authorities. As already noted, there was technically almost no refinancing of maturing debt from the funds raised offshore, although debt was redeemed throughout the period. Moreover, only a small proportion of total funds raised was directly allocated for defence purposes under the Defence Credit arrangements. The distribution of foreign currency proceeds over the decade, set out in Table 2, also illustrates the marked change in the Commonwealth's borrowing pattern after June 1977 as proceeds from the heaviest years of loan raising were for the Commonwealth's own purposes.
### TABLE 2: DISTRIBUTION OF FOREIGN CURRENCY PROCEEDS 1970/71-1979/80

- $ Australian million equivalents -

<table>
<thead>
<tr>
<th>Year</th>
<th>Refinancing of Maturing Debt</th>
<th>Defence Purposes</th>
<th>Transport Imports (Airlines &amp; Shipping)</th>
<th>Other Purposes</th>
<th>Unspecified Purposes</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970/71</td>
<td>-</td>
<td>64</td>
<td>47</td>
<td></td>
<td>15</td>
</tr>
<tr>
<td>1971/72</td>
<td>-</td>
<td>46</td>
<td>84</td>
<td></td>
<td>27</td>
</tr>
<tr>
<td>1972/73</td>
<td>-</td>
<td>51</td>
<td>31</td>
<td></td>
<td>28</td>
</tr>
<tr>
<td>1973/74</td>
<td>-</td>
<td>-</td>
<td>16</td>
<td></td>
<td>-</td>
</tr>
<tr>
<td>1974/75</td>
<td>107</td>
<td>-</td>
<td>67</td>
<td>56</td>
<td>42</td>
</tr>
<tr>
<td>1975/76</td>
<td>-</td>
<td>-</td>
<td>81</td>
<td></td>
<td>198</td>
</tr>
<tr>
<td>1976/77</td>
<td>-</td>
<td>-</td>
<td>21</td>
<td></td>
<td>438</td>
</tr>
<tr>
<td>1977/78</td>
<td>21</td>
<td>-</td>
<td>-</td>
<td></td>
<td>1738</td>
</tr>
<tr>
<td>1978/79</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
<td>1557</td>
</tr>
<tr>
<td>1979/80</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
<td>471</td>
</tr>
<tr>
<td>TOTAL</td>
<td>128</td>
<td>161</td>
<td>347</td>
<td>56</td>
<td>4514</td>
</tr>
</tbody>
</table>

Derived from Appendix II & III.
Defence borrowing from the Export-Import Bank of the USA was designed to assist the financing of general defence equipment from the United States, an arrangement set up during the sixties. Between 1965/67 and 1972/73, there had been a series of borrowings amounting to some $526 million under these arrangements (2). These credit arrangements were cancelled in June 1973 and total US defence credit borrowings of $161 million represented only 3% of total proceeds. The debt, however, continued to be redeemed and by 1980 redeemptions had exceeded borrowings by some $227 million during the decade.

Since 1957, the Commonwealth had also regularly borrowed on behalf of QAL and ANAC. In these cases, the Government was the borrower in the first instance and then the proceeds were made available to the domestic authority on the same terms and conditions as those under which the Commonwealth had borrowed the money. The authority was responsible for repayment of interest and principal and bore any exchange rate risk (3). Borrowings for QAL and ANAC were considered to be specialised financial arrangements related to particular requirements of the airlines for the purchase of specified imports - namely aircraft and related equipment. Borrowings for airline authorities amounted to almost $299 million.

During the Labor years, this type of financing was extended to two other Commonwealth authorities - the Australian Industry Development Corporation (AIDC) and the Australian Shipping Commission (ASC). Funds for the AIDC were to be on-lent to the
private sector for general development projects with a 
legislative limit on overseas borrowing of $250 million (4). 
In 1974/5 and 1975/6, some $56 million was raised offshore 
directly by the Commonwealth for on-lending to the AIDC. The 
ASC, on the other hand, was seeking to finance the purchase of 
two bulk ore carriers from Sweden to be delivered in July 1976 
and May 1977 (5) and almost $50 million was borrowed by the 
Commonwealth on behalf of this authority between 1974/5 and 
1976/77. However, this type of Federal Government borrowing was 
short-lived.

The Commonwealth had been guaranteeing overseas loans for the 
private Australian airline company, Ansett, to enable it to 
purchase aircraft on conditions similar to ANAC and, in 
1976/77, it decided to make similar arrangements for 
Commonwealth transport authorities. Soon after, the Qantas 
Airways Limited (Loan Guarantee) Act of 1976 granted the 
Treasurer authority to guarantee loans raised by QAL to finance 
three Boeing 747s under certain conditions (6). This became 
accepted practice and the Commonwealth ceased borrowing 
overseas on behalf of federal instrumentalities.

So although there were no Commonwealth raisings on behalf of 
it's authorities after 1977, the authorities continued to borrow 
abroad adding to total capital inflow. This complemented the 
Commonwealth's large overseas borrowing program in the latter 
part of the seventies, as did borrowings by state 
semi-government authorities after 1978.
Sources of Funds

The Commonwealth followed a policy of diversifying the currencies in which it borrowed in order to minimise the effects that adverse exchange rate movements would have on Australia's international indebtedness. At the same time, the Government gave due regard to the interest rates applying in each market. As a result, the Commonwealth raised loans on most major international capital markets - specifically the United States, Germany, Switzerland, Japan and the Netherlands. No money was raised during the decade in sterling or Canadian dollars, two currencies which had been utilised in the past. Some 38% of all funds raised was in US dollars (including Eurodollars). The next most popular currencies were the Japanese yen (including Euroyen), German marks and Swiss francs which together accounted for a further 54% of gross raisings. The balance (8%) was raised in guilders. Table 3 sets out gross Commonwealth overseas borrowing by currency.

The US dollar market provided approximately $1985 million during the decade with the majority of funds being raised after 1975. In the first half of the seventies, Commonwealth loan raising in New York was almost entirely for defence or for on-lending to DAL or ANAC. The first Commonwealth public loan of the decade took place in 1975 for the stated purposes of housing for the States and on-lending to AIDC and ASC. Loans for on-lending to the transport authorities continued to be raised there until the end of 1976/77 but Commonwealth loan raising for its own purposes was becoming increasingly
TABLE 3: GROSS OVERSEAS BORROWING BY THE COMMONWEALTH  
1970/71 - 1979/80  
BY CURRENCY

<table>
<thead>
<tr>
<th>Market</th>
<th>Gross Overseas Currency (Millions)</th>
<th>Australian Dollar Equivalent (Millions)</th>
<th>% of Total Raisings</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Dollar*</td>
<td>$2303</td>
<td>1985</td>
<td>38.1</td>
</tr>
<tr>
<td>Switzerland</td>
<td>SF 1637</td>
<td>732</td>
<td>14.1</td>
</tr>
<tr>
<td>Germany</td>
<td>DM 2590</td>
<td>1012</td>
<td>19.4</td>
</tr>
<tr>
<td>Japan*</td>
<td>¥ 260,000</td>
<td>1063</td>
<td>20.4</td>
</tr>
<tr>
<td>Netherlands</td>
<td>DF1 1060</td>
<td>414</td>
<td>8.0</td>
</tr>
<tr>
<td>TOTAL</td>
<td>-</td>
<td>5206</td>
<td>100.0</td>
</tr>
</tbody>
</table>

* incl. Euro $, ¥  
Source: Appendix II
important. In 1977/78, US dollar borrowings consisted entirely of public loans officially allocated to housing, roads, education, urban transport and capital assistance to the States. In fact, 71% of total US dollar loans to the Australian Government were made in these two years with no activity on the US market for the remainder of the decade.

The second largest source of funds was the Japanese market - a new market utilized by Australia for the first time in July 1972, with a small public loan raising of $28 million. The yen market provided a further $103.5 million between February 1978 and November 1979 in five major loans. The heaviest period of borrowing was in 1978/79, with loans representing 55% of the total funds raised in Japan. The raisings were formally allocated to urban transport assistance and capital assistance for the States.

Germany provided the third largest source of funds totalling the equivalent of approximately $101.2 million, $89.5 million of which was used to refinance maturing debt. The Commonwealth utilised the German market throughout the period, although significantly more after 1976/77. Up until mid 1976, only 19% of the funds borrowed in marks during the seventies had been raised. After an absence of one year, the Commonwealth raised the equivalent of $48.6 million (or 48% of the total) during 1977/78. The final two years of the decade each saw raisings of less than half this amount. Except for two loans for QAL in March and July 1975, German mark proceeds were utilized like the others of this ilk for unspecified Commonwealth purposes
although formally allocated to the States for housing, roadworks or capital assistance.

Loan raising on the Swiss market was a little less active with some $732 million being borrowed there during this period. Some $39 million was for redemption purposes, including the early redemption of a 1982 bank loan in April 1978 to take advantage of lower interest rates. Prior to 1976, all Commonwealth raisings were private loans for the airlines although the proceeds represented only 10% of the total funds raised during the seventies. The first public loan took place in March 1976 and over the following two years the level of Commonwealth activity rose sharply. During 1977/78 and 1978/79, more than $610 million was borrowed, representing 83% of total funds raised, and were formally allocated to the States for capital works, capital assistance and education.

The only other source of funds during the period was the Netherlands, which provided almost $414 million in five loans between 1971 and 1979.

As a result of this borrowing pattern, the distribution of the Commonwealth overseas debt among various markets changed markedly over this period (see Table 4). As at June 1970, the vast majority (79%) of securities on issue overseas were still repayable in either US dollars (47%) or sterling (32%). The next most important market was West Germany, where 14.5% of the Commonwealth's overseas debt was domiciled. The remaining 6.4% was distributed among Switzerland, the Netherlands and Canada.
TABLE 4:
CHANGE IN DISTRIBUTION OF SECURITIES ON ISSUE OVERSEAS
AMONG VARIOUS MARKETS BETWEEN 1970/71 AND 1979/80

<table>
<thead>
<tr>
<th>MARKET</th>
<th>As at 30 June 1970</th>
<th>As at 30 June 1980</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Securities on Issue</td>
<td>%</td>
</tr>
<tr>
<td></td>
<td>Overseas $M</td>
<td></td>
</tr>
<tr>
<td>London</td>
<td>502.7</td>
<td>31.8</td>
</tr>
<tr>
<td>United States</td>
<td>747.4</td>
<td>47.3</td>
</tr>
<tr>
<td>West Germany</td>
<td>229.0</td>
<td>14.5</td>
</tr>
<tr>
<td>Switzerland</td>
<td>61.2</td>
<td>3.9</td>
</tr>
<tr>
<td>Japan*</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Netherlands</td>
<td>7.9</td>
<td>0.5</td>
</tr>
<tr>
<td>Canada</td>
<td>32.1</td>
<td>2.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1580.3</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

*Includes borrowing on Euro$ and Euro Yen markets

Source: BP GS on Issues - Table 3, p.20
June 1970
GSI June 1980 - Table 4, p.24
At that time, no overseas borrowing had taken place in Japan. By the end of the decade, the distribution of the Commonwealth’s external debt was more evenly divided among the major markets, although the US dollar retained its dominant position (31.4%). The securities domiciled in the UK market had been replaced by funds from West Germany (25%), Japan (19%) and Switzerland (14%). Sterling debt had been reduced to less than 2% and Canadian dollar debt had almost ceased to exist.

**Terms_and_Conditions**

For some years during the decade, international borrowers enjoyed an era of "cheap money". In fact after 1973, real interest rates (defined as the difference between nominal interest rates and the inflation rate) were negative in most major international markets. Compared with the late sixties and early seventies when real interest rates were positive, the United States, French, German, Japanese and United Kingdom markets all experienced negative rates after the first oil shock. Although these had recovered somewhat by 1975, periods of weakness remained during the second half of the decade. For example in Germany and Japan, the rate was negative again in 1976/77 before gradually recovering and, in the United States, rates did not become positive until 1980. Then real interest rates began to rise rapidly and by 1981 were positive in all five countries (7).

These trends formed the background for the borrowing terms offered to the Australian Government between 1970/71 and
1979/80. The terms and conditions of loans floated by the Commonwealth for its own purposes in New York, Tokyo, Germany, Switzerland and the Netherlands are set out in Appendix IV. Amounts raised, interest rates paid and maturities obtained varied quite markedly from market to market, even though most of these raisings were concentrated in the second half of the decade.

In New York, amounts varied from US$100 million in 1975 to a $350 million Eurodollar raising in March 1978, which was the largest fixed interest placement by a foreign government in the Eurodollar market at that time (8). All eight borrowings were public loans, usually involving two or three tranches for different periods and different rates of interest. Final maturity dates were between 5 and 20 years with an exceptional 4 year maturity for the large Eurodollar loan. This was because of the considerably higher interest rates at the longer end of the market for dollar loans at that time. However, more commonly, loan tranches involved repayment by yearly instalments over a period of up to 14 years. (9).

Coupon rates of interest also varied from 7.5% for the first tranche of the September 1977 Eurodollar loan to a high of 9.125% in May 1976 and again in May 1978. However, average interest rates paid were remarkably stable rising from 8.6% in 1974/75 to 8.7% in 1975/76 before returning to the previous average the following year. Then in the first half of 1977/78, the average rate fell to 8.2% before recovering to 8.5% during the last six months of the year. The interest cost to the
Commonwealth reflected this trend dropping from an average 8.92% for the May 1976 loan to 8.19% in September 1977 before climbing back to an average cost of 9.04% for the May 1978 loan. This change in the cost of the loan did not reflect rises in flotation expenses or management fees but rather changes in overseas interest rates. For example, total expenses for the September 1977 loan represented some 2.13% of the amount borrowed compared with the high cost loan raised in May 1978, for which expenses represented only 1.07% of the amount borrowed.

The Commonwealth raised four public loans and three institutional or private loans in Tokyo varying from 10000 million yen in 1972 to 50000 million yen in 1978. Final maturity dates varied from 5 to 20 years with the borrowings being concentrated towards the longer end of the market. The coupon interest rates on these loans fell initially from the 6.9% paid in 1972 to 6.6% in February 1978. After a brief rise on two institutional loans in October, the interest rate fell to a low of 5.6% on the first tranche of the public loan in November. However, by 1979/80, the rate had risen steeply to over 8%.

The interest cost to the Commonwealth followed a similar pattern rising from an average of 6.5% for the November 1978 loan to 8.56% for a 30000 million yen borrowing one year later. Flotation expenses varied from between 1.93% in 1972 to 2.18% in 1979 on public loans, and from 0.26% to 0.53% on private loans in 1978/79.
In Germany, the Commonwealth raised five public loans, seven institutional or private loans and two redemptions. Amounts varied between 50 million and 500 million deutschmarks and final maturity dates ranged between 5 and 15 years. The coupon interest rates paid in the German market tended to fall from a high of 10% in 1974 (paid for a conversion loan) to a low of 5.25% in 1977, before rising to 8% by February 1980. The cost to the Commonwealth of the new money loans ranged from a low of 5.61% in 1977 to a peak of 8.64% in 1975 for a private loan. The cost of the two conversion loans which preceded it were even higher. Flotation expenses varied from between 3.1% in 1972 to 2.58% in October 1977 on public loans and from a low of less than 0.01% on the 500 million deutschmark loan to 1.64% in February 1980 on private loans. The expenses for the two conversion loans were 2.2% and 2.7% of the loans' face value.

The amounts borrowed by the Commonwealth in two public, three private and two conversion loans between 1975 and 1979 on the Swiss market varied from SF50 million to SF400 million both borrowed in 1976. Final maturity dates varied from 4 years for a loan essentially for conversion in 1978 to 15 years for a public loan in 1976. Interest rates paid for Swiss francs were very low for most of the decade falling from a high of 8% for a conversion loan in 1975 to 6.75% in 1976 before plunging to less than 4% for the remainder of the period. In the Commonwealth’s peak borrowing years between April 1978 and March 1979, rates varied between 3.1% and 4%.
The cost in terms of interest payable was also low in these later years ranging between 3.25% (the lowest rate paid during the decade) and 4.15% in 1978/79. However, the exchange rate risk with a hard currency like Swiss francs was high. Flotation expenses varied between 4.18% in 1975/76 to 2.06% for a private loan and 3.48% for a public loan, both in 1979. Three earlier loans carried no expenses for flotation.

Five private loans were raised in dutch guilders varying from 60 million guilders in 1971 to 300 million in 1978. Maturity dates varied from 5 to 15 years and interest rates between 7.63% in 1978 and 9.25% in 1979, the highest interest paid during the period. This was reflected in the highest cost to the Government for a loan during the seventies at 9.33%.

The sources, interest rates and duration of loans raised by the Australian Government for Commonwealth authorities and for defence purposes are set out in Appendix V and VI.
B. Balance of Payments Effects

The Commonwealth's overseas borrowing program in the seventies made an important contribution to Australia's international reserves at a time when private capital inflow was weak. Although the increase in loan funds raised led to a relatively rapid rise in the level of outstanding overseas debt and interest obligations, the costs were well within the economy's capacity to service.

Contribution to International Reserves

Table 5 places the Commonwealth's overseas borrowing and the consequent movement in overseas debt within the context of the balance of payments during the seventies. The table shows that the financing requirement from Australia's international reserves would have been much greater had it not been for the large balance of payments loans under the special borrowing program in 1977/78 and 1978/79.

The amount secured through public debt movements during the decade was approximately $2851 million, equivalent to almost 19% of the deficit on current account while private capital inflow covered a little more than 80%. Although there was little or no role for Commonwealth overseas borrowing during the first half of the decade, this changed after 1975/76 and, for two years, capital inflow on official account was a key factor in financing the balance of payments, accounting for some 50% of the current account deficit in 1977/78 and 37% in
TABLE 5: MAJOR COMPONENTS IN AUSTRALIA'S BALANCE OF PAYMENTS
$ MILLION

<table>
<thead>
<tr>
<th>YEAR</th>
<th>PRIVATE CAPITAL (including balancing item)</th>
<th>MONETARY MOVEMENTS WITHOUT CHANGE IN PUBLIC DEBT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>CURRENT ACCOUNT BALANCE</td>
<td>GOVERNMENT CAPITAL</td>
</tr>
<tr>
<td>1970-71</td>
<td>-802</td>
<td>-70</td>
</tr>
<tr>
<td>1971-72</td>
<td>-343</td>
<td>-83</td>
</tr>
<tr>
<td>1972-73</td>
<td>+715</td>
<td>-60</td>
</tr>
<tr>
<td>1973-74</td>
<td>-909</td>
<td>+53</td>
</tr>
<tr>
<td>1974-75</td>
<td>-1219</td>
<td>-19</td>
</tr>
<tr>
<td>1975-76</td>
<td>-1404</td>
<td>-44</td>
</tr>
<tr>
<td>1976-77</td>
<td>-2432</td>
<td>+243</td>
</tr>
<tr>
<td>1977-78</td>
<td>-3043</td>
<td>+1504</td>
</tr>
<tr>
<td>1978-79</td>
<td>-3676</td>
<td>+1361</td>
</tr>
<tr>
<td>1979-80</td>
<td>-2003</td>
<td>-34</td>
</tr>
<tr>
<td>Totals</td>
<td>-15116</td>
<td>+2851</td>
</tr>
</tbody>
</table>

Source: ABS Cat No 5303.0 1982-83
1978/79. Without this inflow, the run down in reserves would have been more than five times the actual monetary movements in those years.

This was the first time in the post-war period that official overseas borrowing had been used on this scale to finance an external deficit. Prior to 1977/78, only minor use had been made of government borrowing abroad, the heaviest years being in 1958/59 when government inflow contributed about 19% of the current account deficit and in 1967/68 when it covered around 16%.

Table 6 sets out the level of official reserve assets as a proportion of total imports during the period. This shows that, despite heavy government borrowing abroad, international reserves slipped to their lowest levels of the decade in 1977/78 and 1978/79—representing only 29% of imports. Public capital inflow accounted for 47% of official reserve assets and 90% of foreign exchange reserves in 1977/78 and the following year, these figures were 35% and 86% respectively. Without net government inflow, assuming the demand for imports had remained unchanged, official reserve assets would have fallen to 15% and 14% of imports respectively.

Taking the decade as a whole, without the inflow of $2851 million on official account, official reserve assets at June 1980 would have been only $2830 million or 18% of imports. Based on past criteria, the Government would have considered reserves of this magnitude too risky and would have been forced
TABLE 6: OFFICIAL RESERVE ASSETS AS PROPORTION OF TOTAL IMPORTS
$ MILLION

<table>
<thead>
<tr>
<th>YEAR</th>
<th>IMPORTS</th>
<th>OFFICIAL RESERVE ASSETS (END PERIOD)</th>
<th>RESERVES AS PERCENTAGE OF IMPORTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970-71</td>
<td>-3790</td>
<td>3764</td>
<td>99</td>
</tr>
<tr>
<td>1971-72</td>
<td>-3791</td>
<td>4248</td>
<td>112</td>
</tr>
<tr>
<td>1972-73</td>
<td>-3808</td>
<td>3560</td>
<td>62</td>
</tr>
<tr>
<td>1973-74</td>
<td>-5754</td>
<td>3493</td>
<td>46</td>
</tr>
<tr>
<td>1974-75</td>
<td>-7652</td>
<td>3086</td>
<td>39</td>
</tr>
<tr>
<td>1975-76</td>
<td>-7922</td>
<td>3312</td>
<td>32</td>
</tr>
<tr>
<td>1976-77</td>
<td>-10350</td>
<td>3225</td>
<td>29</td>
</tr>
<tr>
<td>1977-78</td>
<td>-11150</td>
<td>3885</td>
<td>29</td>
</tr>
<tr>
<td>1978-79</td>
<td>-13326</td>
<td>5681</td>
<td>36</td>
</tr>
<tr>
<td>1979-80</td>
<td>-15029</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
to take some alternative action to correct the external situation, such as further dampening internal demand. On this basis, the role of official overseas borrowing was vital during the late seventies in maintaining international reserves at an acceptable level.

Moreover, this sustained program of government borrowing overseas would also have had the indirect effect of stabilizing private capital inflow. Although the turnaround in the capital account at the end of the decade owed much to the new investment opportunities in energy resources after the second oil price rises in 1979, the Government's large-scale borrowing discouraged private capital from leaving the country in the expectation of a devaluation of the Australian dollar and gradually restored confidence in the exchange rate and the country's economic outlook.

**Increases in Servicing Costs**

Interest liability on Commonwealth overseas securities has declined as a proportion of Australia's total interest liability for most of the post-war period - from 25% in 1945/46 to a low of 6.9% in 1975/76. Since then, however, the level more than doubled to reach 16% in 1979/80 (10). Overseas interest liability per head has followed a slightly different trend but had also fallen to very low levels by 1973/74. Between then and the end of the seventies, the overseas interest liability per head increased more than five fold to reach $26 per head by 1980.
Over the decade, the interest liability on total official external debt rose from around $84 million at June 1970 to $380 million at June 1980, a rise of approximately 350%. But despite this dramatic increase, only a very small percentage of export receipts were needed to pay the interest due on Australia's overseas borrowings during the decade, reaching a peak of only 2.6% in 1978/79. Table 7 sets out the relationship between government interest liability and export earnings in the seventies and selected earlier years.

Prior to World War II, the percentage of exports consumed by official overseas interest payments was much higher than post-war levels when, by comparison, overseas interest liability was very slight. Despite heavy borrowing by the Government during the late seventies, overseas interest liability as a percentage of exports barely returned to levels recorded in the sixties. So although there was a rapid increase in interest liability in the second part of the decade (quadrupling between 1975/76 and 1979/80), it was rising from a very low base. At the same time, export earnings almost doubled, largely offsetting the increase to leave the level of interest liability only marginally above its level at the beginning of the decade.

The costs of servicing overseas loans are reduced not only by export expansion but also by other factors, such as import replacement activities. Table 8 relates interest liability to gross domestic product (GDP) during the seventies and provides
TABLE 7: GOVERNMENT OVERSEAS INTEREST LIABILITY AS A PERCENTAGE OF EXPORT RECEIPTS

<table>
<thead>
<tr>
<th>YEAR</th>
<th>OVERSEAS INTEREST LIABILITY ($m)</th>
<th>EXPORT RECEIPTS ($m)</th>
<th>OVERSEAS INTEREST LIABILITIES AS A PERCENTAGE OF EXPORTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1926</td>
<td>48.0</td>
<td>308</td>
<td>15.6</td>
</tr>
<tr>
<td>1929</td>
<td>55.0</td>
<td>296</td>
<td>18.6(a)</td>
</tr>
<tr>
<td>1939</td>
<td>51.6</td>
<td>331</td>
<td>15.6</td>
</tr>
<tr>
<td>1949</td>
<td>35.7</td>
<td>1042</td>
<td>3.4</td>
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<tr>
<td>1959</td>
<td>51.9</td>
<td>1612</td>
<td>3.2</td>
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<tr>
<td>1969</td>
<td>86.7</td>
<td>3217</td>
<td>2.7</td>
</tr>
<tr>
<td>1970/71</td>
<td>84.6</td>
<td>4217</td>
<td>2.0</td>
</tr>
<tr>
<td>1971/72</td>
<td>82.6</td>
<td>4719</td>
<td>1.7</td>
</tr>
<tr>
<td>1972/73</td>
<td>74.2</td>
<td>5991</td>
<td>1.2</td>
</tr>
<tr>
<td>1973/74</td>
<td>61.6</td>
<td>6709</td>
<td>0.9</td>
</tr>
<tr>
<td>1974/75</td>
<td>80.0</td>
<td>8442</td>
<td>0.9</td>
</tr>
<tr>
<td>1975/76</td>
<td>94.0</td>
<td>9446</td>
<td>1.0</td>
</tr>
<tr>
<td>1976/77</td>
<td>141.2</td>
<td>11446</td>
<td>1.2</td>
</tr>
<tr>
<td>1977/78</td>
<td>270.9</td>
<td>12006</td>
<td>2.3</td>
</tr>
<tr>
<td>1978/79</td>
<td>363.9</td>
<td>14072</td>
<td>2.6</td>
</tr>
<tr>
<td>1979/80</td>
<td>380.2</td>
<td>18589</td>
<td>2.1</td>
</tr>
</tbody>
</table>

(a) At 30 June 1931, overseas interest liability approximated 40% of export earnings

Source: 1926-29 Tbl. XVI Pomroy, op cit, p157
ABS Cat. No 5303.0 1982/83
comparative figures for selected earlier years. This shows that the proportion of GDP devoted to overseas interest payments fell dramatically after the war and continued to do so until reaching an all time low of 0.12%-0.13% in the mid-seventies. Despite more than doubling from this level by the end of the decade, overseas interest liability as a percentage of GDP remained insignificant. This reflected the large increase in GDP due to rapidly rising prices (which reduced the real burden of the debt) as well as increased productive capacity resulting from domestic saving and direct investment during the decade.

However, interest liability on overseas securities is not the only cost of foreign borrowing. The principal must also be repaid or converted. A major cause of the difficulties experienced on Australia's external account during the depression was the Government's need to meet its repayment obligations when it was unable to rollover its loans. Even in normal circumstances, any significant bunching of principal repayments could pose liquidity problems.

In June 1970, outstanding Commonwealth debt was $1580 million, of which $1261 million (or 80%) fell due over the next 10 years. At June 1980, total overseas debt obligations were $3336 million, of which $4763 million (or 88%) fell due in the following decade. So during the seventies, actual repayments had more than trebled and had apparently become more concentrated as average loan life shortened.
TABLE 8: GOVERNMENT OVERSEAS INTEREST LIABILITY AND AUSTRALIA'S GROSS DOMESTIC PRODUCT

<table>
<thead>
<tr>
<th>OVERSEAS INTEREST LIABILITY AT JUNE 30</th>
<th>AMOUNT $M</th>
<th>GDP $M</th>
<th>OVERSEAS INTEREST LIABILITY AS PER CENT OF GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1926</td>
<td>48.0</td>
<td>1606</td>
<td>3.0</td>
</tr>
<tr>
<td>1929</td>
<td>55.0</td>
<td>1632</td>
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<tr>
<td>1939</td>
<td>51.6</td>
<td>1754</td>
<td>2.9</td>
</tr>
<tr>
<td>1949</td>
<td>35.7</td>
<td>4329</td>
<td>0.8</td>
</tr>
<tr>
<td>1959</td>
<td>51.9</td>
<td>12463</td>
<td>0.4</td>
</tr>
<tr>
<td>1969</td>
<td>86.7</td>
<td>27762</td>
<td>0.3</td>
</tr>
<tr>
<td>1970-71</td>
<td>84.6</td>
<td>33737</td>
<td>0.25</td>
</tr>
<tr>
<td>1971-72</td>
<td>82.6</td>
<td>37677</td>
<td>0.22</td>
</tr>
<tr>
<td>1972-73</td>
<td>74.2</td>
<td>42903</td>
<td>0.17</td>
</tr>
<tr>
<td>1973-74</td>
<td>61.6</td>
<td>51347</td>
<td>0.12</td>
</tr>
<tr>
<td>1974-75</td>
<td>80.0</td>
<td>61748</td>
<td>0.13</td>
</tr>
<tr>
<td>1975-76</td>
<td>94.0</td>
<td>72825</td>
<td>0.13</td>
</tr>
<tr>
<td>1976-77</td>
<td>141.2</td>
<td>83144</td>
<td>0.17</td>
</tr>
<tr>
<td>1977-78</td>
<td>270.9</td>
<td>90251</td>
<td>0.30</td>
</tr>
<tr>
<td>1978-79</td>
<td>363.9</td>
<td>102070</td>
<td>0.36</td>
</tr>
<tr>
<td>1979-80</td>
<td>380.2</td>
<td>114464</td>
<td>0.33</td>
</tr>
</tbody>
</table>

Source: 1926-39 - Pomroy Tbl XVII p158 - note figures are for GNP in those years.
GDP - ABS 5204.0 1980-81, p1 and 61
Nevertheless, the average Commonwealth repayment burden on annual export earnings (should conversion not be practical) had actually fallen. For example, average annual repayments on $1281 million at June 1970 represented 0.4% of GDP in that year and 3.2% of export receipts, while the average annual repayments on $4766 million at June 1980 were 0.4% of GDP in 1979/80 and 2.6% of export receipts. So despite a sharp increase in actual average annual repayments over the decade, the burden on export earnings had fallen. Servicing payments on Commonwealth overseas debt remained so modest that they would not have represented a significant percentage of even drastically reduced export earnings. For example, if the peak repayment of $740 million falling due in 1983/84 had to be met with only 50% of the 1979/80 level of exports, the burden on export receipts would still have been only 8%.

**Capacity to Service the Debt**

The period between 1970/71 and 1979/80 saw a very rapid increase in Commonwealth overseas debt (as measured by the level of official securities domiciled overseas). As at June 1970, the Australian currency equivalent of the Commonwealth's securities on issue overseas was $1580 million. By June 1980, this had risen to more than $5396 million - an increase of $3816 million or 242% in only ten years. The figures for government securities on issue overseas between June 1946 and June 1980 are set out in Appendix VII.

As would be expected, the rapid rise in Australia's overseas
debt during the seventies was concentrated in the latter half of the decade. Up until the mid-seventies, securities on issue overseas per head of population continued to decline in line with the general post-war trend, reaching the lowest levels since the thirties. But after 1976, the level of overseas debt per head began to increase rapidly, almost doubling in a single year, mirroring the Commonwealth's large-scale overseas borrowing program after June 1977.

The rapid increase in Commonwealth overseas debt during the seventies was in sharp contrast to the preceding post-war years which had seen only a modest rise in securities on issue overseas — from $1142 million in June 1946 to $1580 million in June 1970. This represented a rise in overseas debt of some $438 million or a 38% increase over 25 years. During the post-war years up to 1970, overseas debt had been accumulating at an average rate of some $17.5 million per year compared with the decade of the seventies when it accumulated at an average rate of $382 million each year.

These trends can be traced in the figures for Commonwealth overseas debt in $A billion (Graph 4) and as a percentage of gross national product (Graph 5). In 1950 Commonwealth debt represented more than 21% of GDP but by 1970 this had fallen to a little over 5%. This downward trend continued until 1976, when Commonwealth debt reached a record low of 1.8% of GDP, before increasing sharply to the end of the decade.

But despite the rapid rise between the middle and the end of
GRAPH 4
COMMONWEALTH EXTERNAL DEBT
in the post war period

$ Billion

GRAPH 5
COMMONWEALTH EXTERNAL DEBT
AS A PERCENTAGE OF GDP

% OF GDP

Years

Securities on issue
the decade, the level of Australia's official external debt remained historically low. Table 9 sets out the level of securities on issue overseas as a percentage of both GDP and export receipts during this decade and for selected years after the war by way of comparison. At the beginning and end of the seventies, the level of external debt to GDP was approximately the same at 4.7%, while its ratio to exports had actually fallen from 37% to 29%. This compares with a ratio to GDP of 25% and a ratio to exports of 104% in 1948/49. Prewar levels were even greater. For example, in 1931 government external debt represented some 99% of GDP before declining to 59.5% in 1936 and 40.9% in 1941 (11). By any measure, the level of Commonwealth external debt at the close of the seventies was very prudent.

Nevertheless, no borrowing is without cost and all external borrowing imposes a burden on the balance of payments and the economy. There are a number of variants of debt service ratios, which can be used to try and assess a country's capacity to support its external debt, although all have their limitations in terms of assessing actual levels of supportable debt. In Australia, deriving this ratio is complicated by the fact that it is not possible to split debt service indicators into "public" and "private" categories because, in ABS statistics, the interest and capital repayments on public authorities' overseas debt are included in private sector debt. However, until the late seventies, direct borrowing by semi-government authorities was almost non-existent and borrowings by Commonwealth authorities had been relatively
<table>
<thead>
<tr>
<th>YEAR</th>
<th>GOVERNMENT DEBT ($M)</th>
<th>GDP ($M)</th>
<th>GDP I AS % OF GDP II</th>
<th>EXPORTS ($M) I AS % OF GDP IV</th>
</tr>
</thead>
<tbody>
<tr>
<td>1949</td>
<td>1088</td>
<td>4329</td>
<td>25.1</td>
<td>1042</td>
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<td>1959</td>
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<td>12463</td>
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<tr>
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<td>1970-71</td>
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<td>33737</td>
<td>4.6</td>
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<td>1971-72</td>
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<td>3.8</td>
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<td>1972-73</td>
<td>1265</td>
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<td>5991</td>
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<td>2.0</td>
<td>6709</td>
</tr>
<tr>
<td>1974-75</td>
<td>1183</td>
<td>61748</td>
<td>1.9</td>
<td>8442</td>
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<tr>
<td>1979-80</td>
<td>5396</td>
<td>114464</td>
<td>4.7</td>
<td>18589</td>
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</tbody>
</table>

Source: Budget Paper No 7 GSOI 1970-71 p31 and 1979-80 p30
ABS Cat No 5303.0 1982-83
ABS Cat No 5204.0 1981-82
small. So trends in Commonwealth interest liabilities and repayments relative to export and GDP growth more or less covered public sector servicing costs during the seventies and, as the ratios themselves remained so low, it is not unreasonable to assume that these figures provide a reasonable indication of Australia's capacity to service its public debt.

As we have seen, Commonwealth overseas interest liabilities as a percentage of both exports and GDP remained very small along with the level of repayments. When the average principal repayment percentages are combined with interest liability, the debt service ratio of 4.7% of export receipts in 1980 had actually fallen from 5.3% in 1970. These figures clearly illustrate that the large-scale overseas borrowing program of the late seventies did not present an onerous burden on the balance of payments as the repayment and interest costs were well within the economy's capacity to service. The Commonwealth's decision to manage its current account deficit by compensatory financing was, therefore, a reasonable and appropriate policy during a period of world recession and limited private overseas investment, particularly for a resource rich country like Australia, which is highly dependent on private capital inflow and earnings from primary exports.
C. Effects on the Economy

Although the more important role played by Commonwealth overseas borrowing during the seventies remained overshadowed by that of private capital inflow, its contribution to maintaining Australia’s economic growth in the latter part of the decade was significant.

The Role of Commonwealth Borrowing

For most of the decade, private capital inflow retained its dominant post-war role by covering the lion’s share of the current account deficit and providing the vast majority of additional resources available to the economy, accounting for almost 81% of the external deficit. However, the figures for private capital inflow also include borrowings by public sector authorities, and by the end of the decade, these borrowings were becoming significant. For example, under the infrastructure program, state semi-government authorities officially borrowed $465 million in the final two years of the decade. At the same time, non-conventional borrowings by public enterprises had also increased and Commonwealth authorities (such as the AIDC, ASC, AWC and the airlines) were also accessing overseas markets. Given this situation, public sector borrowing would have accounted for more than the 19% of total capital inflow recorded by Commonwealth overseas borrowing.
Moreover, Commonwealth overseas loan raising did temporarily dominate capital flows to Australia. In 1977/78, proceeds from such loans exceeded the inflow of capital on private account and represented around 60% of total capital inflow. But this was exceptional. The only other years in which Commonwealth borrowing made a significant contribution to capital inflow was in 1978/79, when it represented some 38% of total inflow and in 1976/77 when it accounted for almost 13%. Therefore, despite the increased significance of public sector capital inflow during this decade, private overseas investment retained its dominant role in the Australian economy.

Nevertheless, public overseas borrowing did provide Australia with much needed additional resources for growth when traditional levels of private foreign investment temporarily fell. However, the crucial factor is the use which was made of these additional resources because this determined whether the Australian economy could generate sufficient additional production and income to finance the cost of such inflow. Unfortunately, it is not possible to determine the use made of Commonwealth funds raised overseas in any precise way as the contribution made by most of these loans to gross domestic capital formation cannot be isolated. Although loans for aircraft and defence purposes can be tied to particular expenditures, borrowing for general purposes is rather different as it is not related to any particular program of public capital formation. Rather these loans are a means of supplementing resources available to the economy in general and the vast majority of Commonwealth borrowings overseas between
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1970 and 1980 fell under this general purpose category (12).

The immediate impact of the Commonwealth's 1977-79 borrowing program on the domestic economy would have been minimal as the loans were used primarily to bolster the international reserve position. Any potential increase in the domestic money supply from these loan raisings was more than offset by the continuing current account deficit, which private capital inflow was failing to finance. The immediate inflationary impact of the program was thus neutralised by the external drain on domestic liquidity, which left control of the money supply within manageable limits. Nevertheless, these borrowings did provide additional resources to the economy, which enabled Australia to finance a higher level of imports and to maintain a higher level of growth than in the program's absence. Whether this resulted in a sufficient expansion in the economy's capacity to provide the wherewithal to service the additional debt, however, is impossible to estimate with precision because of the inseparability of the effects of public and private capital flows.

Nevertheless, although there is no direct correlation, one indication of the use to which additional resources made available to the economy via Commonwealth borrowing overseas were put can be gained by examining the level of government consumption and investment during the decade. Appendix VIII sets out the consumption, saving, investment and net lending to overseas during this period and shows that government consumption rose from 12.6% of national income in 1970/71 to
16.4% in 1979/80 at a time when national savings fell and private consumption remained relatively static. In addition, although both private and government investment as a percentage of national income declined during the period, the Government's share of gross fixed capital expenditure rose from around 31.5% to 34.6%, reaching peaks of around 39% in 1975/76 and 1977/78 (13). This suggests that the role of the public sector in the economy in general had been expanding, despite the Coalition's attempts to reduce the Commonwealth's deficit and the PSBR. Hence public sector borrowing abroad during this period seems to have contributed to the enlarged role played by governments, in consumption in particular, in the Australian economy.

Alternative_Policy_Options

Commonwealth overseas loans provided additional resources to the Australian economy which permitted a higher level of imports than would otherwise have been possible. The result appears to have been a steadier rate of growth and a less depressed economy. To test such a proposition, this section explores the possibility of managing the external account during this period via an alternative policy or combination of policies.

Devaluation, deflation, import restrictions and export and capital incentives were all utilised during the second half of the decade. Following the cuts of 1973, tariffs were once again raised to provide increased protection for local industry and were accompanied by a growing use of import quotas. The
currency was devalued in late 1976 and deflationary policies of varying strength were also pursued. These actions were supplemented by export promotion and increasingly flexible foreign investment policies.

If the Government had attempted to correct the external situation in 1977 by a further large devaluation of the exchange rate, it is by no means certain that any lasting improvement in Australia's competitive position could have been achieved. Although there is some evidence to suggest that Australia's export performance in the manufacturing field did improve after the 1976 devaluation, this was only after a lag of some 18 months (14). Furthermore, to avoid its inflationary impact, the exchange rate adjustment had to be accompanied by stringent fiscal and monetary measures, which held down the level of economic activity over the next two years in an attempt to reduce the import-led rise in the price level. But in the absence of such action, any positive effect on the competitive position flowing from the devaluation would have quickly been eroded by inflation.

With Australia's central wage fixing system and her relatively high level of inflation in the late seventies, it was highly probable that domestic price and wage spirals would have been stimulated by any further devaluation. Repeated use of this instrument to overcome the effect of a persistent capital account weakness would need to have been accompanied by greater and greater monetary and fiscal restraint, resulting in further falls in income and higher unemployment.
In fact, some economists suggested that if the 1976 devaluation had been less or had been avoided by additional overseas borrowing, Australia may have had a reduced inflation rate and lower unemployment in 1977, as the rest of the world experienced a slowing of inflation over this period (15). For some time after November 1976, Australia's inflation rate remained relatively high, which led to speculation about the possibility of a further devaluation in 1977 - an illustration of the vicious circle of devaluation adding to inflationary pressures, which in turn create the need for a further devaluation to retrieve international competitiveness. In Australia, such expectations were present to some extent despite the deflationary policy of the Government.

In the absence of overseas borrowing, therefore, the Commonwealth would have been forced to adopt more severe deflationary policies than it, in fact, did with a consequent further lowering of income and increase in unemployment. In addition, the depressed level of economic activity in Australia would have reduced the number of attractive investment opportunities for long-term private capital, perhaps exacerbating the weakness in the capital account and prolonging the recession.

Further compressing the demand for imports would have reduced the level of capital goods available to the economy, given that the construction phase of many major resource projects involved a high demand for capital-intensive infrastructure, most of
which came from overseas. This would have also delayed economic recovery as would a general increase in tariffs or quotas. Given that Australia already had relatively high levels of protection, further rises would have supported inefficient (as well as efficient) industries, increasing the domestic misallocation of resources and lowering productivity, as well as raising the possibility of international retaliatory action. Such a policy would also have been inconsistent with Australia's adherence to international agreements such as the General Agreement on Tariffs and Trade.

Given these alternatives, therefore, the Commonwealth's large-scale overseas borrowing program in the late seventies was the most appropriate way of maintaining economic growth in the face of a prolonged weakness in the capital account as it avoided severe reductions in domestic demand (and the consequent falls in incomes, employment and living standards) and encouraging the return of private overseas investment. Governments can generally borrow at rates which are often less costly than the rates at which resources can be made available through the private sector and, in the late seventies, the availability of large amounts of relatively "cheap" international finance further reduced the cost of borrowing the necessary funds. Moreover, the level of Australia's overseas debt was at an all time low, so the Commonwealth was a highly rated international borrower with few concerns about the adverse effects of rising levels of external debt on the domestic economy. Given a strong balance of trade and Australia's economic potential, the Government could
confidently expect that, by financing a higher rate of growth than would have been possible had it been forced to correct the full extent of the external imbalance via devaluation, deflation and/or increased import barriers, Australia's productive capacity would increase sufficiently to repay the loans with interest as they fell due.
As soon as the post-war backlog had been overcome in the fifties, there was a relative decline in public investment in infrastructure. This accelerated during the sixties as mineral discoveries and the growth in mineral exports began to outstrip industrial development (1). The mining industry gradually assumed a primary role in Australia's economic growth.

The development of Australia's mineral resources was largely left to the private sector, which made an increasing contribution to the cost of its own infrastructure (2) during the late sixties and early seventies. The private developers, however, worked closely with State Governments which owned nearly all mineral resources and were, therefore, directly responsible for their development.

During this period, the Commonwealth's role was restricted to the provision of financial incentives to the mining industry and the active encouragement of private overseas capital. From the fifties, federal policies were increasingly designed to attract sufficient private foreign investment to develop Australia's resources without direct public sector participation. The relative decline in public investment in infrastructure was accompanied by a fall in net public overseas borrowing.
However, by the seventies, circumstances had begun to change. The benefits of private foreign investment in the mining sector were less obvious. The rising world demand for mineral and energy resources saw producers demanding and receiving better prices for their exports and improved returns on their foreign-owned mines and oil-wells. These and other factors, both external and domestic, contributed to the development of more interventionist mineral resources policies by the Federal Government in Australia. This, in turn, encouraged more active and direct participation by the States in an effort to protect their prerogatives in the area (3).

In fact, the increase in the public sector's role in resource development was accompanied by another break with post-war overseas borrowing policy. The change was epitomised by two public sector proposals involving large amounts of overseas capital to finance a more direct government role in the development of Australia's resources. These proposals were the Gopper loan and the infrastructure program. This chapter is concerned with the former and examines the Labor Government's overseas borrowing proposals in 1974/75 and their impact on Commonwealth overseas borrowing policy. The Coalition's infrastructure program is discussed in the following chapter.

A. The So-called "Loans Affair"

When it first came to power, the Labor Government was remarkably reluctant to borrow funds abroad. However, this cautious policy under Treasurer Crean was discarded late in
1974 (along with Treasurer Crean) as the Government began an active search for funds among the newly acquired oil surplus of the OPEC nations. This change in policy was exemplified by two major attempts to raise a very large loan overseas outside traditional financial channels - one by the Minister for Minerals and Energy (Mr Rex Connor) and one by the Deputy Prime Minister and Treasurer (Dr. Jim Cairns) - although numerous other deals were also in the making during this period. However, the Government's most significant effort to raise petrodollars to fund economic development projects was the Connor loan and it is the primary focus of analysis in this chapter.

The Connor loan attempt represented a rejection of the policy of the former Labor Treasurer, who saw no virtue in chasing after petrodollars through intermediaries or agents (4), as well as a reversal of the ALP's traditionally cautious attitude towards Commonwealth overseas borrowing. But more significantly, the proposed loan represented a radical departure from normal loan raising procedures and all previous Commonwealth borrowing practice. In fact, it was unlike any previous government overseas loan in terms of size, terms and conditions, its purpose, the source of the funds or the method of raising the money.

Up until this time, the largest single borrowings by the Commonwealth were from the IBRD in 1950 and 1962, amounting to some $90 million each, and a drawing under the defence arrangements of up to $97 million in 1967. The largest public
loan had a face value of around $50 million and was raised in October 1963 in London. By comparison, Connor was proposing to borrow more than $3000 million in one operation—33 times the size of the largest loan to that time. Moreover, the terms and conditions of the proposed borrowing were at odds with previous loans. The most recent preceding public raisings in the early seventies had attracted market rates of interest and loan periods of 8–15 years with the repayment of principal and interest taking place during the life of the loan. But the Connor proposal involved a compound interest rate, which was below market rates, and repayment of interest and principal in a single tranche at the end of the 20 year borrowing period.

In the past, the Commonwealth had borrowed in the well-established markets of Europe and the United States, only adding the highly respected Japanese market in 1972. The Labor Government, however, was proposing to borrow funds from the newly emerging markets in the Middle East, where large petrodollar balances were accumulating. In the past, the Commonwealth had used its borrowed funds to supplement its overseas reserves and to finance state public works, federal authority loans or defence equipment—generally accepted public sector activities. However, the proceeds of the Connor loan were to be used by the Commonwealth as direct, non-equity capital for development infrastructure and energy projects, which threatened the existing balance between the public and private sectors in the Australian economy.

Finally, to avoid unwanted publicity, the Labor Government
attempted to by-pass normal loan raising procedures involving the Treasurer and his department, the Loan Council and the Parliament. These normal loan raising procedures are set out in Appendix IX. Instead, the Minister for Minerals and Energy proposed to secretly negotiate the loan himself through an intermediary from outside established international banking circles.

For all these reasons, the Connor loan was bound to attract political controversy. Although no money was ever raised, the unorthodox attempt to seek overseas funds was probably the single most important ingredient in the downfall of the Whitlam Government. During its course, both Lairns and Connor were forced to resign from the Ministry, not for seeking money overseas, but for misleading Parliament about their loan raising activities. This provided the Opposition with the "reprehensible circumstances" it needed to justify effectively blocking supply in the Senate. The result was a constitutional crisis, which ended in the dismissal of the Labor Government in November 1975.

The following section explores the genesis of Labor's unorthodox overseas loan raising policy and its attempted implementation. The second section looks at the rationale behind the Connor loan and the dominance of political factors in the decision-making process. To assess the implications of this policy initiative, the chapter concludes with a discussion of the financial and economic effects of raising such a loan and the impact of the "loans affair" on government overseas.
borrowing.

The Connor Loan

The Minister for Minerals and Energy began searching for sizeable amounts of overseas loan capital at least as early as September 1974 (5). That same month, Mr Clyde Cameron (Minister for Labor and Immigration) located a potential source of funds and, in October, arranged a meeting between Connor and this contact (Mr Karidis) and his lawyer. Acting Prime Minister Cairns was also present. During the discussion, Connor expressed a strong interest in obtaining a large overseas loan if a suitable source of funds could be found (6).

As a result of his enquiries, Karidis was eventually put in contact with Mr. Hirath Khemlani. Khemlani was the manager of a trading firm, Dalamal & Sons (Commodities) Limited in London, which had business in the Middle East. This put him in contact with oil interests with large sums of money although Khemlani himself had not previously negotiated any loans (7).

On 11 November 1974, Karidis introduced this man to the Minister and his departmental head (Sir Lennox Hewitt). Following further discussion and checks on Khemlani's credentials, Hewitt confirmed in writing the Government's interest in borrowing up to US$4000 million overseas. Armed with this letter, Khemlani left Australia to try and set up the loan. Although not directly involved, the Prime Minister was
aware of and an enthusiastic supporter of Connor's proposal (8).

By the first week in December, Khemlani submitted an offer of funds to the Government and oral confirmation was received from the Commonwealth's legal advisers in London that the money had been deposited with a first class bank. The offer involved a loan of US$4000 million for a period of 20 years and at a compound rate of interest of 7.7%. The loan was to be repaid in full with all interest outstanding at the expiry date. A commission of 2.5% (US$100 million) was to be paid by the lender and the loan was to be drawn down over one month (9).

At this stage, the Minister sought legal documentation for the proposed loan from the Solicitor-General and Attorney-General's Department to enable the Government to borrow on behalf of Connor's authorities - the Petroleum and Minerals Authority, the National Pipeline Authority and the Atomic Energy Commission. At a meeting on Friday 6 December in Sydney, the drafting of the appropriate documentation was discussed by representatives from the merchant bank, Darling and Co Ltd, and their legal advisers, Freehill Hollingdale and Page, and officials from the departments of the Attorney-General and Minerals and Energy (10). Here officials pointed out not only that Connor's public authorities did not have an appropriate borrowing authority but that the proposed loan would need Loan Council approval.

Khemlani arrived in Sydney on the Saturday morning with his
colleagues and draft documentation for the loan. The agents stressed the need for complete secrecy for the proposal at least until the proceeds were available. This reinforced Connor's desire to keep the matter out of the press until it was finalised (11). The documentation was crude with no principal identified and a request for a higher than normal commission, which the agents claimed that the Minister had already agreed to pay (12).

These and other matters were the subject of meetings between the Commonwealth and its advisers all weekend. On the Sunday, Darling and Co presented its advice on the cost of the borrowing, which concluded that the terms and conditions were very advantageous to the Government (13). But the legal problems remained.

These were again the subject of discussions between the Prime Minister, Cairns, Connor, the Attorney General and senior officials from the departments of Prime Minister & Cabinet (PMC), Attorney-General's (AGs) and the Solicitor General on Monday 9 December in Canberra. Finally, at the urging of officials from AGs, the head of the Treasury, Sir Frederick Wheeler, was included in the discussion to help clarify Loan Council procedure and practice, along with the Governor of the Reserve Bank and the Chairman of the Commonwealth Bank (14).

Wheeler was immediately concerned about the magnitude of the proposed loan as well as the use of intermediaries to raise the money. Standard borrowing procedures for the Australian
Government before entering substantive negotiations involved:

- identification of the principal;
- availability of funds to be proven;
- cost of funds to be competitive;
- offer to satisfy Loan Council; and
- documentation to satisfy Treasury and AGs.

Wheeler felt these conditions had not been met and set about checking Khemlani's credentials through Treasury's London representative without informing the Government. The following day, a minute signed by Mr. J. O. Stone (then Deputy Secretary of Treasury) was sent to the Treasurer at the Department of Minerals and Energy alerting him to his department's concerns about the loan (15).

Discussions between Khemlani, Ministers and officials went on all week with the claimed need for speed and secrecy on the part of the lenders and the legal requirements of the Financial Agreement continuing to be the major stumbling blocks. To meet the need for secrecy, the Government considered proceeding through the Commonwealth Trading Bank, which was to act as the borrower and retain the funds overseas until they could be used domestically. But the plan had to be abandoned after grave misgivings were expressed by the Chairman of the Bank (16). Then the Attorney-General, Mr Lionel Murphy, suggested the possibility of a "temporary purpose" borrowing given that the money was to be used to solve the temporary problems of looming unemployment and the energy crisis. There would then be no
requirement to inform Loan Council and the loan could simply be ratified there at a later date.

Officials from the Treasury and ABS advised against this course of action as it was in conflict with all past interpretations, undertakings and practice in the Loan Council. However, the Solicitor General agreed with Murphy that such an interpretation was arguable in law (17). But even using this procedure, the problem of the commission still remained unresolved as this could not be paid without the approval of Parliament and the Labor Ministers rightly assessed that this was unlikely, given a hostile Senate.

Nevertheless, despite the outstanding difficulties and the reservations of their advisers, Connor and Whitlam decided to go ahead and pressed on with the preparation of an Executive Council Minute to authorise the loan. Throughout Friday 13th December, meetings took place at various departments and the Prime Minister’s Lodge to finalise the documentation for signature that evening as Whitlam was leaving Australia the following day (18). Throughout these discussions, Wheeler remained adamantly opposed, urging the proposal be aborted. As a result, the Treasurer’s name did not appear, as was customary, on the authority. According to Connor, he had asked if Cairns’ name should be on the document given that loan raising was the responsibility of the Treasurer but when the Secretary of the Treasury objected very strongly to this action, his own name was inserted instead (19).
The Executive Council Minute was signed by Whitlam, Connor, Cairns and Murphy that evening at the Lodge and ratified by the Governor-General the following day. Under this authority, Connor had approval "to borrow for temporary purposes a sum in the currency of the USA not exceeding the equivalent of four thousand million dollars and to determine on behalf of Australia the terms and conditions of the borrowing" (20). The explanatory memorandum attached to the minute stated that "the Australian Government needs immediate access to substantial sums of non-equity capital from abroad for temporary purposes, amongst other things, to deal with exigencies arising out of the current world situation and the international energy crisis, to strengthen Australia's external financial position and to provide immediate protection for Australia in regard to supplies of minerals and energy and to deal with current and immediately foreseeable unemployment in Australia". The Minister later explained that the loan was to be used to fund the necessary infrastructure for the emergency development of Australia's energy resources (21).

On 14 December, the Prime Minister and his party (including the Secretaries of A&Ps and Minerals and Energy) left on a mission to Europe. Negotiations with Khemlani were continued by Connor in consultation with officials from all previously contacted departments. A draft acceptance for the loan was drawn up, with special attention to ensure that there would be no liability for payment by the Government to its agent and that any commission would be paid by the lenders through a reduced commission rate, thus avoiding the need to seek Parliamentary
approval (22).

Before leaving Australia on 16 December, Khemlani was given this draft acceptance as well as a letter of identification. The letter referred to Reserve Bank officers accompanying Khemlani to Zurich to identify the principals and verify the location of the funds. The agent was most unhappy with these arrangements and all attempts by the Australian officials to confirm the offer failed (23).

Treasury was again excluded from the loan raising process following the drafting of the documentation for Khemlani and, according to one source, this was on Connor's orders (24). Nevertheless, the department continued to try and terminate the negotiations. On 20 December, Treasury sought advice from AGs on the possibility that Hewitt's letter of 12 November could be construed as an implied contract adding fuel to the already bitter relations between the two departments. Wheeler kept urging Treasurer Cairns, who was acting Prime Minister, to terminate Connor's authority (25).

On Saturday 21 December, officials from Treasury, the Reserve Bank, AGs and M&E met with Cairns, Murphy and Connor. The Minister for Minerals and Energy outlined the Commonwealth's inability to verify the funds and agreed to terminate negotiations with Khemlani (26). A telex was sent in Connor's name notifying the intermediary and the bank that the Government had decided not to pursue the matter (27). However, despite an explicit request in the telex, there was no
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acknowledgement from Khemlani - apparently because Connor secretly renewed contact with the agent the next day and sent him to see Hewitt, who was by then in London (28).

Treasury drew up the documents for Cairns and the Executive Council Minute revoking Connor's authority was signed on 7 January 1975 at a meeting in Sydney, which was presided over by the Governor-General and attended by the Vice-President of the Council (Mr Frank Stewart). The Government later said that the authority had been withdrawn because it conflicted with the refinancing of a deutschmark loan (29).

Nevertheless, throughout January, the search for overseas funds continued in secret with negotiations taking place between Connor and his department head, on the one hand, and Khemlani and his principals on the other. Treasury tried vainly to keep track of Connor's activities. On 31 December, Cairns signed a letter (drafted by Treasury) asking Connor to forward copies of all relevant communications between his office and department and Khemlani and the banks for follow-up action. A second letter was sent on 23 January but there was no response from the Minister or his department (30).

Late in January, Connor sought approval from Whitlam for a second authority to borrow, prior to meeting with Khemlani. The Treasurer was not informed of this request and was not present at the Executive Council meeting on 28 January, which reinstated Connor's authority. The meeting was attended by the Governor-General, Connor and Murphy and this time a borrowing
of up to US$2000 million was authorized (31).

The next day, the agent was back in Canberra for discussions with the Minister (32). Negotiations continued to founder on the Government's desire to identify the principal and verify the funds before giving any commitment. To help overcome this, as well as to "wash" the loan (33), Khemiani proposed the use of a reliable bank to act as a trustee. The Moscow Narodny Bank in London was chosen and Khemiani continued to try and bring the proposal to fruition (34).

By the end of February, the Seattle First National Bank (Switzerland) entered the negotiations as a possible assembly point but had been replaced by the Overseas Development Bank in Geneva in early April. At this stage, the negotiations were still such a well kept secret that the Australian Ambassador in Berne was unable to identify Khemiani to the Geneva bank because he had never heard of him or the loan authority. He sought instructions from Canberra (35). When Wheeler heard of the Ambassador's request, he made another attempt to bring the loan negotiations under Treasury control. He convinced Cairns to cable Whitlam and Connor urging that, before any further action was taken, the whole matter be discussed by the Prime Minister, himself and Connor plus appropriate officials (36). But again Treasury was ignored.

On 10 April, Wheeler discussed the Khemiani negotiations with Cairns once more (37) as it appeared that the Minister for Minerals and Energy was contemplating having his borrowing
authority raised to US$8000 million presumably to make use of all the funds his agent claimed were available. According to documents published in the National Times, Wheeler informed Cairns of plans by Whitlam and Connor to hold an Executive Council meeting to be convened by the Vice President of the Council. The Treasurer subsequently complained to the Prime Minister about not having been consulted or kept informed. In the event, the meeting was never held but negotiations between Connor and his intermediary continued unabated (38).

On 20 May, because of an impending loan negotiation in New York, the Treasurer obtained agreement to revoke Connor’s authority. But that was not the end of the Minister for Minerals and Energy’s loan negotiations and nor had he been the only Labor Minister engaged in such activities during this period, as the following sections explain.

The Cairns Loan

Despite his initial scepticism about Connor’s use of an intermediary, the Treasurer himself was drawn into a similar search for loan funds a few months later. He was convinced that new sources of finance in the Middle East could be tapped by the Australian Government (39) and began to seek ways of doing this. One avenue he explored was through direct contact with officials from Saudi Arabia on the possibility of intergovernment arrangements between the two nations on oil and
food. After officials from Treasury had made preliminary soundings, these contacts matured into discussions with the Saudi Arabian Monetary Authority (SAMA) in March 1975 about a possible loan for the AIDC. However, these negotiations founded on the terms of the loan and were terminated in mid-1975 (40).

Initially, Cairns seemed to share Treasury’s view about the folly of seeking loans through unorthodox channels. When the Melbourne businessman, Mr George Harris, approached the Treasurer in December 1974 about a loan proposal, he responded with a standard polite “brush-off” drafted by his department. Treasury followed up by obtaining Cairns’s approval to a procedure whereby all such offers of loan funds made to the Treasurer were to be referred directly to the department for action (41).

However, over the next few months, Cairns became less enamoured with his department’s advice on a range of matters. For example, in February, he was publicly criticising Treasury’s approach to the economy (42) and as far as overseas borrowing was concerned, he became increasingly convinced that Australia would only be able to tap large sums of loan money outside conventional international banking channels and saw Treasury’s approach as “too timid and conservative” (43).

So, in March 1975 when Harris and his colleague proposed to Cairns that they seek out sources of overseas funds for the Government, the Treasurer listened. He was sceptical that the terms they suggested were available and later claimed that he
had refused to sign a letter agreeing to pay Harris a
commission if he was able to locate suitable funds.
Nevertheless, such a letter was signed by the Treasurer and
dated 7 March 1975 (44). The following Monday, the Treasurer
agreed to let the two businessmen make enquiries and gave
Harris a letter, dated 10 March, stating that the Australian
Government was willing to borrow funds at appropriate terms and
conditions (45). Soon after, Cairns left with Senator Mreidt
for discussions in the Middle East and Harris began his own
search for funds.

The Treasurer had authorised Harris to seek loan funds against
earlier advice from his department and without its knowledge,
or the knowledge of Cabinet. However, Treasury's London
representative soon heard of both the letters and, on 3 April,
Wheeler raised the matter with Cairns. The Treasurer agreed he
had given Harris some "credentials" but said there was nothing
specific in them. The Secretary urged they be withdrawn but
took no further action at that stage, not having seen a copy of
the letters. Cairns, on the other hand, felt that Treasury was
over-reacting and that he was entitled to obtain information
about available funds however he could (46). He remained
unconcerned about the activities of Harris, which he saw only
as "information gathering" and not loan negotiating.

In mid-April, Harris requested a stronger negotiating authority
from the Treasurer. But Cairns, aware of the difficulties the
Connor-Khemlani negotiations were causing, refused to tighten
up the wording. However, he did sign another two letters for
Harris, authorising him to make enquiries and agreeing to pay
an appropriate commission in the event of a successful loan -
but not in the terms that Harris wanted (47).

The businessmen then flew to London and called on the
Australian High Commissioner, Sir John Bunting, with the
letters. This visit was reported to Wheeler by his London
representative, and copies of the April letters were cabled to
the Treasury. As soon as Cairns returned from his overseas
mission, Wheeler consulted him about the visit and was told
that Bunting should authenticate the letters for Harris if
requested to do so. The Secretary remained unable to convince
the Treasurer that his actions were involving the Government in
a grave financial risk.

Before taking the matter further, Wheeler decided to seek legal
advice from Attorney-General's in an effort to determine
whether the letters could involve the Government in an
unwarrented legal liability. This request was made on 6 May
1975. It was framed in a hypothetical manner to disguise the
authorship of the letters as the advice was sought without the
Treasurer's knowledge (48).

The Harris enquiries continued through May. On 22nd of the
month, Cairns left Australia to attend an OECD meeting in Paris
and was apparently planning to meet Harris later for further
discussions before referring any offer to Treasury officers for
detailed examination (49). But by this time, news of the Labor
Government's unorthodox loan negotiations had begun to reach
the Opposition and the press, and for the first time senior Ministers became concerned. Two days after Connor's authority had been revoked and the same day as Cairns left Australia, the issue was discussed by the Prime Minister, the Acting Treasurer, Mr Bill Hayden, and officials.

As a result, the following day, PM&C requested a legal opinion on the Connor-Khemlani documents from AGs. The Secretary of the department responded orally "on the basis of the information he was given". A few days later, on the same basis, AGs responded to Treasury's earlier written request about the Harris letters supplying similar advice - that is, it was conceivable that the intermediary could in law be regarded as the Government's agent (50).

On 28 May, Whitlam discovered that Treasury had twice taken independent and unauthorised action to check on the decisions of Labor Ministers without their knowledge - firstly, to investigate Khemlani's credentials in December and, secondly, to seek legal advice on the Treasurer's letters to Harris. The Prime Minister ordered an immediate investigation and Wheeler was severely rebuked. The Prime Minister later tried to have him removed as Secretary of the Treasury but without success. Government relations with the department reached new depths (51).

In the meantime, the Treasurer's activities were the primary focus of attention. After further discussions with the Prime Minister and Hayden, Wheeler cabled Cairns that same day with
AG’s advice on the Harris letters, urging him to immediately cancel any accreditation given to the businessman (52). Cairns subsequently contacted the Prime Minister and was asked to return to Australia.

The following day, Whitlam sent a letter to Connor and Cairns requesting copies of all documentation on any overseas loan negotiations, and demanding that “for the present” any proposals for further borrowings be referred to him. Except for the pending US$100 million bond issue in New York, the Prime Minister directed that current discussions were “to be stayed for the time being” except with his express approval. Hayden instructed Wheeler to respond to this request and sent a copy to Cairns (53). Connor presumably instructed Hewitt to do likewise although, as later events proved, not all documentation was provided.

Cairns spoke to the Prime Minister in Canberra on Monday 2 June about Attorney-General’s advice that an agency relationship could conceivably exist between the Treasurer and Harris. Because of the “unwisdom of his action”, the Prime Minister considered Cairns should not remain as Treasurer. Although the Secretary of AGs, Mr. C. Harders, subsequently modified his view in the light of further information supplied by the Treasurer, it was too late for Cairns. He was replaced by Hayden and the Prime Minister publicly stated that all unorthodox loan raising activities had ceased (54). Unfortunately, the Government neglected to inform Khemlani.
A few weeks later, Whitlam discovered that Cairns had misled Parliament in reply to a question in the House on 4 June 1975. At that time, when asked if he had ever signed a letter which offered a commission of 2.5%, Cairns had emphatically denied it (55). Less than a week later, the Treasury representative in New York cabled the contents of the 7 March letter to his department. This letter, addressed to Harris, stated in part that:

"The Australian Government is interested in exploring available loan funds from overseas. In the event of a successful negotiation...and provided the interest rate for a term loan does not exceed 8% pa in total, we would be prepared to pay a once only brokerage fee of 2.5% deducted at the source to you and/or your nominees..."

(56)

After the matter had been brought to his attention on 1 July, Whitlam sought an explanation from his Minister on the discrepancy between the letter and his 4 June reply to the House. Cairns only defence was that, as he had no recollection of signing such a letter, he had not intentionally misled Parliament. The response did not satisfy the Prime Minister, who dismissed Cairns from the Ministry.

The Aftermath

To try and neutralise the avalanche of bad publicity the Government's unorthodox loan raising activities were attracting
by this time, Whitlam called a special sitting of the Parliament on 9 July 1975 (57). During the debate, the Government tabled a large number of documents relating to the negotiations to try and refute the Opposition's allegations of impropriety, illegality and corruption. However, the Coalition continued to point to the Government's unconventional use of the "temporary purpose" clause of the Financial Agreement as proof of the Commonwealth's "unconstitutional" behaviour in trying to avoid Loan Council perusal. As all documents relating to overseas loan offers had not been tabled, the Government was unable to shake off the accusation of a "cover-up".

At a special sitting of the Opposition-controlled Senate on 16 July, an attempt was made to interrogate senior public servants and, later, Karidis. But nothing more damaging to the Government was revealed and the press began to lose interest in the affair. However, news of a continuing relationship between Connor and Khemlani revived media enthusiasm.

Despite Whitlam's request of 13 June and Connor's confirmation five days later that action had been taken to terminate any discussions involving loan raisings (58), this was not in fact the case. Negotiations had continued and this was made public when, following Connor's blunt denial of further contact with Khemlani, the Melbourne Herald published a telex to the agent from the Minister dated 23 May 1975, three days after his authority had been revoked (59).
In the face of this evidence, the Prime Minister asked Connor to stand down from the Ministry. On Tuesday 14 October, Caucus reluctantly accepted the Minister's offer to resign and his commission was terminated (60). The following afternoon at a press conference, the leader of the Opposition, Mr Malcolm Fraser, announced that the Coalition would defer the budget in the Senate. This decision to in effect block supply had been triggered by the Government's loan raising activities, which Fraser claimed had been marked by scandals, attempts to evade the constitution and the removal of two of the most senior men in the Government.

At the Opposition's request, Khemlani returned to Canberra with more loan documents but little further was revealed. On 20 October, a NSW solicitor, Mr Danny Senkey, issued a summons against Whitlam, Connor, Cairns and Murphy for conspiring to contravene the Financial Agreement and to deceive the Governor-General. He also petitioned the House of Representatives and the Senate for all relevant documents which had been tabled in Parliament (61).

On 11 November, the Whitlam Government was dismissed by the Governor-General because it could not obtain supply. The Coalition parties were installed as "caretakers" until an election could be held in December. They had given an undertaking that they would not pursue investigations into the Connor-Khemlani negotiations but, throughout the election campaign, allegations about the Labor Government's loan raising activities continued (62).
One month later, the Coalition parties were swept to power with an overwhelming majority. The notorious "loans affair" had played a key role in the dismissal of Prime Minister Whitlam and the destruction of the first Federal Labor Government in Australia since 1949. Raising a Commonwealth loan overseas had lost some of its banality.

B. The Rationale Behind the Connor Loan

The policy making process surrounding the Connor loan was unprecedented in the annals of Australian overseas borrowing. To understand not just how but why the Labor Government embarked on such an unconventional course of action is therefore important. This section seeks an explanation for the most unorthodox features of the Commonwealth's decision to try and borrow petrodollars - the size of the loan, the use of intermediaries, and the insistence on secrecy, which forced the Government to search for ways of avoiding normal loan raising procedures - and illustrates the dominance of political factors in the decision-making process.

Why US$4000 Million?

Increased overseas borrowing by the Commonwealth makes economic sense in a situation of low international reserves and a large balance of payments deficit. This was not the case in 1974 as
Australia's overseas reserves were very healthy despite a weakening external account. Governments have also raised funds overseas to supplement the domestic resources available for development or to access a new market. But loans raised for these purposes in the past had been very modest. So why did the Labor Government seek to borrow such an enormous sum of money overseas in 1974/5? The answer seems to lie with the Minister for Minerals and Energy - in his "great dream for Australia" (63) and his almost unchallengeable position within his own party.

Connor's dream involved the development of Australia's resources by and for Australians. He opposed the country's increasing dependence on rising levels of foreign investment and in the sixties was suggesting alternative methods of financing such development (64). Following his appointment as Minister for Minerals and Energy, Connor led a fierce crusade for Australian ownership of the nation's natural resources. His proud boast in 1975 that he had "stood in the path of those who would have grabbed the mineral resources of Australia" (65) was supported by the dramatic fall in foreign overseas investment between 1973 and 1975. The second phase of his policy was to increase Federal Government participation in exploration and development of mineral resources (using public authorities such as the PMA and AEC) in partnership with private enterprise (66).

Connor's economic nationalism, therefore, led inevitably to a far more active and direct role for the Commonwealth in
Australia's overall economic development, given that the country's mineral sector was then the major source of growth. His goal was a prosperous Australia, which owned and controlled its mineral wealth and used it for the benefit of all its people. He was convinced that this was only achievable through Federal Government action.

Connor's vision was backed by an encyclopaedic knowledge of his portfolio and a formidable intellect. His answers to Parliamentary questions, for example, were unusually detailed and technical, and his speeches provided a wealth of authoritative information about all areas of his portfolio. Through his personality and sheer range of knowledge, he dominated the Caucus, its committees and Cabinet in his chosen field (67).

Connor had worked on and developed the ALP's mineral and energy policy over many years (68). In 1968, Whitlam appointed Connor as ALP spokesman on minerals and energy and he wrote the first detailed policy in the area, which was adopted at the 1969 National Conference of the ALP. The 1971 and 1973 Conferences expanded and clarified the general thrust of his ideas, while the Terrigal Conference in February 1975 resoundingly endorsed Connor's policies and adopted a resolution at his instigation requiring 100% Australian ownership of all energy resources (69). The ALP resources platform was Connor's bible and his commitment was total (70).

But the Minister's political muscle came not only from his
commitment and knowledge but also from the support he received from the Prime Minister, the Caucus and much of the community. One key to his power was a strong personal relationship with Whitlam based on mutual respect and trust. During Whitlam’s struggle for the leadership of the ALP in the sixties, Connor supported him and, on attaining government, he was rewarded with the portfolio he desired. In return for this opportunity to implement his resource policies, Connor gave Whitlam undivided loyalty (a loyalty which forbade him from defending himself in public after his dismissal by Whitlam) (71).

For his part, Whitlam respected Connor for his vision, intellect and knowledge. He also liked his tough style, which often mirrored his own approach of "crash through or crash" (72). He shared Connor’s feelings of nationalism and became a strong advocate of his quest for overseas funds (73). Moreover, the Prime Minister lacked any expertise of his own in the area of minerals and energy and, as a result, he increasingly relied on and trusted Connor’s judgement in these matters. This also meant he was reluctant to interfere in Connor’s activities (74). He made no attempt to monitor his Minister’s actions even after the loan attempt was clearly getting out of hand.

When the matter became the centre of public controversy in May 1975, Whitlam only requested that Connor put aside the project for the time being and accepted his word that this had been done. He never sought to take full control of the affair by ensuring the relationship with Khemlani had been terminated in writing and acknowledged.
The backing of the Prime Minister was reinforced by the support Connor received from his Labor Party colleagues, the rank and file and the general public. After the 1974 election, the Minister for Minerals and Energy topped the ballot for the Ministry and was at the peak of his stature and popularity among the party when he decided to use Khemlani to search for petrodollars. He retained this position of awe among his colleagues until well into 1975.

Moreover, Connor and his colleagues believed that his resource policies had strong public support and that the purpose of the petrodollar loan ("Australianisation" of the mining industry) was only an extension of the Government's popular policy of reducing the level of foreign ownership in the nation's resources. Opinion polls had shown a rising community concern about the level of foreign ownership since the sixties. For example, in 1968 and June 1972, 88% of people thought there should be a limit on foreign buying of shares. This figure had risen to 91% by November 1972 and, of these, at least 70% did not want overseas control of any Australian company (75). After 12 months of a Labor Government, a Gallup poll reported 44% of Australians thought the Federal Government was not doing enough to control overseas ownership (only 11% said "too much") and some 86% agreed that overseas companies should be required to have a set minimum Australian shareholding (76).

From its first Cabinet meeting, Labor was intent on developing Australia's resources "without letting them pass into foreign hands" (77). The Government had campaigned and won on a policy
of increasing local ownership in both the 1972 and 1974 elections (78). The Prime Minister later claimed that perhaps the decisive issue in 1974 was his Government's commitment to the greatest possible measure of Australian ownership of the nation's mineral wealth (79). Not unreasonably, therefore, Labor felt it had an electoral mandate for a minerals and energy program, which took account of the public's concern about rising levels of overseas ownership.

Connor's vision and its apparent public support inexorably pushed the Labor Government into direct participation in resource development: a policy which required significant capital expenditure. The amounts of capital involved in resource development were enormous. The Department of Minerals and Energy estimated that the total value of Australia's resources at that time was around $5700 billion (80). In 1974, the Chairman of the AIDC claimed that Australia needed $16000 million over the next 10 years to develop her resources and former Prime Minister and Treasurer McMahon made much the same estimate (81). In July 1975, representatives from the mining company, Conzinc Riotinto Australia suggested that more than $4000 million would need to be invested to boost mineral production if Australia was to maintain her position in world mineral trade by 1980 (82). Other estimates suggested that the NW Shelf project alone would require such an investment (83) and the AIDC was actively examining participation in investment projects involving about $6500 million in 1975 (84).

Therefore, if the Government meant to make an impact on
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Therefore, if the Government meant to make an impact on
"Australianising" resource development, it clearly needed a great deal of money, and Connor's original quest for US$4000 million was based on expected capital needs estimated by industry sources themselves (85). Against this background, the amount of funds sought by the Minister starts to be comprehensible.

Clearly obtaining these funds from within Australia was virtually impossible at a time when most Labor Ministers were already competing for funds for their own pet projects - for example, Uren was intent on improving urban infrastructure and Hayden was trying to implement Medibank. With these and other demands on public funding, the budget deficit had already ballooned. The domestic economy of 1974 was too weak to permit a further diversion of its limited resources away from the private sector, so Connor's only option was to seek funds from overseas, like other nations at that time (86). Although the disruption to the international economy at that time provided new opportunities for offshore borrowers, it was Connor's "dream", not economic imperatives, which led Labor's kitchen cabinet to agree to an overseas borrowing exceeding $3000 million in 1974.

Why Use Intermediaries?

The political decision to ignore normal Commonwealth loan raising procedures and use an intermediary to obtain overseas funds was justified by the Government in terms of the unprecedented international situation. However, the decision
owed at least as much to Labor's distrust of the Treasury at that time and the free-wheeling style of Connor and his departmental head, Hewitt.

As we saw in Chapter 2, developments in the world economy had a marked impact on the demand for and supply of international finance. For the first time, the OPEC nations held huge capital surpluses for which they cautiously sought investment outlets in Western Europe and the United States. The Australian Government decided to investigate these new sources, with Opposition approval, as Cairns later explained to the House:

"Since... the increase in the price of oil, an amount of some $60,000 million has changed direction - it has come under the control of different people, and a large amount of that money was being invested for wealthy individuals in various financial circles in Switzerland and elsewhere in Europe.

"I think that this Government, as did every other Government, had a responsibility to ascertain the circumstances of those funds."(87)

The Government was aware that this massive disruption to international payments had upset the established banking system, which at first was hesitant to use its short-term petrodollar deposits and even temporarily limited the number they accepted (88). The OPEC nations consequently used a
variety of outlets for their oil revenues, including agents and middlemen, to help place their funds. The growth of financial intermediaries outside established banking circles mushroomed and by 1975 new Arab banks were also vying for business on international markets (89). Borrowers were able to raise large loans directly from OPEC nations (90), including at least one Australian firm (91).

The Government's official reason for using intermediaries was that "the orthodox financial institutions... (had failed)... to cope with this unprecedented flood... (of petrodollars)... the merest trickle... (of which)... goes to Australia" (92). But as well as the desire to obtain a greater share of this new pool of funds, the decision also reflected the Government's dissatisfaction with the terms being offered by established international banking institutions at the time and their apparent refusal to actively compete with one another (93). However, the key to Labor's use of intermediaries lay in its relationship with the Treasury, the department with the expertise in and responsibility for administering the Commonwealth's overseas borrowing program. Although it had been challenged in the past (94), Treasury had always retained control of official overseas loan raising — that is, until 1974.

When the Labor Government took office in 1972, it was suspicious of the public service in general and the Treasury in particular (95) after 23 years in opposition. During this time, the shadow cabinet had built up its own informal networks
of economic (and noneconomic) advice. In office, these networks were semi-formalised by the employment of economic advisers by a number of Ministers (96) and the appointment of Dr H.C. Coombes as the Prime Minister’s personal economic adviser and of Professor F. Gruen as economic adviser to his department. The Priorities Review Staff was another attempt to establish an alternative centre of economic advice.

As a result, Treasury’s jealously guarded role as the Government’s principal economic adviser (97) came under challenge. This was reflected in the minor part it played in some significant economic decisions, such as the 25% tariff cut and in wages policy, during the Government’s first 18 months. Moreover, in 1973, its advice on the need for fiscal restraint went largely unheeded as Treasurer Crean sought softer options to permit the implementation of some major election promises (98). However, relations between the Government and its traditional economic advisers remained open and many of Treasury’s policies, such as revaluation and restraining the monetary aggregates, were accepted and implemented.

The high point of Treasury’s influence in those early years came after the May 1974 election when it convinced the Prime Minister of the pressing need for an anti-inflation policy — “a short sharp shock” to reduce demand pressures (99). The approach was embodied in Whitlam’s speech to the Premiers’ Conference in early June when he stated that the Government was determined to reduce the threat of serious inflation through tighter fiscal and monetary policy (100). With this support,
the monetary aggregates were tightened and Treasury set about finalising the details of its fiscal package.

But the majority of Caucus remained sceptical and, when the economy began to slide into recession, opposition firmed. Treasury's July mini-budget contained significant measures to lower expenditure and increase taxes but, despite the Prime Minister's support, Cabinet and Caucus refused to accept most of these proposals. Rejection of Treasury advice left the Government without an economic strategy and the Treasurer delivering a speech full of hardline rhetoric to announce an emasculated mini-budget (101).

The policy vacuum was filled by a variety of departments, outside advisers and Ministers (102) and, during the budget discussions, relations between Cabinet and its official economic advisers deepened into dislike and distrust as each viewed the economy from totally different perspectives (103). Undeterred, Treasury continued to urge the Government to adopt more restrictive policies, despite indications of a flattening world economy, arguing that the Commonwealth must budget for a substantial domestic surplus in order to control inflation (104).

In the event, the Government completely rejected Treasury's submission; a reaction encouraged by an incident which left Cabinet with the impression that the department had deliberately attempted to mislead them as to the size of the domestic surplus (and therefore the degree of economic
restraint) that it was proposing (105). Senior Ministers (led by Cairns) and their advisers devised an alternative economic strategy and the Government opted for a mildly expansionary budget (106). Treasurer Crean and his department had been moved to the sidelines of the economic debate.

Relations deteriorated further when the Government accused Treasury of failing to keep Ministers informed about the full extent of the contraction in the money supply over this period, which was subsequently revealed in RBA statistics. The department was severely rebuked by Whitlam and publicly castigated by other members of the Government (107). From then on, there was continuous debate in the press and in the Parliament about the breakdown in the relationship between the Commonwealth and its traditional economic advisers. There was talk of dividing Treasury, getting rid of Wheeler and of establishing alternative economic policy making bodies (108). Finally, in November 1974, Whitlam sacked Crean as Treasurer and replaced him with Cairns. Cairns had been the architect of the expansionary economic policies, which Labor was following and which were anathema to Treasury. The department had been deliberately isolated by the Government under a powerful but unsympathetic Minister, which temporarily neutralised its influence over the conduct of economic policy.

The Minister for Minerals and Energy had followed the economic debacle with Treasury without being a major participant. But "Connor's scorn for cautious accountants" (109) and Hewitt's dislike of Treasury (his former department) meant that the
relationship between the Government's official economic
advisers, on the one hand, and Connor and his own department,
on the other, were already strained. These factors plus the
Minister's freewheeling style, which was reinforced by the
modus operandi of his departmental head, made their attempt to
avoid normal loan raising procedures almost inevitable.

Connor tended to be a loner as a Minister, believing he should
have total freedom to determine matters within his own
portfolio, subject only to the overriding power of Cabinet and
Caucus (110). This meant he often acted unilaterally without
consulting his colleagues, let alone their departments (111).
He had no time for "red tape" or bureaucratic procedures which
slowed down his actions. This was illustrated most aptly in
his approach to obtaining information about the mining
industry. He simply orally requested Mr. T.Fitzgerald, former
financial editor for the Sydney Morning Herald, to assess the
contribution by the mineral industry to the national economy.
No consultancy fees were paid and the work was serviced by
Connor's department. The work was initiated in September 1973
and the report was completed in March 1972 (112) - a remarkably
short period when measured against the record of other
government enquiries.

Connor's style, in fact, had a certain resemblance to that of
Sir John Gorton, former Liberal Prime Minister between 1968 and
1971. Gorton too was contemptuous of "red tape" and had little
respect for the bureaucracy or its sensitivities, especially if
its procedures acted as a break on his actions (113). He also
shared Connor's nationalistic sentiments (114) and even supported some of the Minister's policies from the Opposition benches (115). But, more significantly, Gorton's relationship with his departmental head was the forerunner of the relationship between Connor and the same man, Sir Lennox Hewitt.

Gorton appointed Hewitt to head the Prime Minister's department after being impressed by his ability, determination and capacity for work over a number of years. As a Treasury Deputy Secretary on defence matters, Hewitt had many dealings with Gorton, who was then Minister for the Navy. Hewitt left Treasury when he failed to succeed Sir Roland Wilson as Secretary in 1966 and joined the Universities Commission, where he again worked with Gorton who by then was Minister for Education (116).

Hewitt's appointment by Gorton to head his department soon after he became Prime Minister removed the public servant from a relative backwater to a position of power and he rewarded the Prime Minister with his dedication and loyalty. He even moved his office from the department to Parliament House - more like a Ministerial adviser than a public servant. Given the Prime Minister's penchant for a Presidential-style of leadership, which left little time for consultation with Cabinet, Gorton relied heavily on his Secretary's advice (117).

The extent to which Gorton and Hewitt acted in concert to bypass normal government decision-making procedures was
illustrated by the 1968 decision on a new oil pricing policy. The Minister responsible for the Government's resources policy (such as it was) was Mr Fairbairn and his department of National Development had been considering the question of an appropriate price for Bass Strait oil for some time. An inter-departmental committee (consisting of National Development, Treasury, Trade and Customs) had discussed the options and an independent adviser had been appointed. But before Cabinet was able to seriously debate the issue, the Prime Minister put forward a package that he and Hewitt had secretly negotiated with ESSO-BHP. Cabinet had little option but to agree (118).

This course of action by the Liberal Prime Minister and his departmental head was mirrored in the secret negotiations held by Connor and Hewitt with Khemlani, and was based on a similar relationship between Minister and his chief bureaucratic adviser. Hewitt had again been rescued from the bureaucratic wilderness, where he had been banished after Gorton was deposed as Prime Minister and, like Gorton, Connor was rewarded with his Secretary's total loyalty. He shared the nationalistic outlook of both his former and present Minister as well possessing a great respect for Connor's knowledge and expertise. Consequently, Hewitt prosecuted his Minister's policies with vigor, despite occasional doubts, once he became convinced that Connor wanted something implemented (119).

This partnership meant an inevitable clash with Treasury. The relationship between the two departments in 1974 was barely
civil and positively poisonous by mid-1975 (120). Hewitt apparently had good reason to depise his former department following a so-called "whisper" campaign in 1966 to denigrate his qualifications and which he felt prevented him from being appointed to head the Treasury. He had left the department soon after and actively participated in Gorton's attempt to curb McMahon's and Treasury's authority in the late sixties (121).

As Secretary of Minerals and Energy, Hewitt had inherited the old department of National Development, which had been left with one full division, six branches and one second division officer in 1972 (122). He expanded it to nine divisions, 19 branches and 31 second division officers by 1975. He brought a large number of personnel in from other departments, including Treasury, and by 1975 more than 60% of his senior officers (at or above level 3 in the second division) had come from departments or authorities in which Hewitt had held a senior position (123). But despite the rapid growth of his department, Hewitt still felt unable to recruit adequate staff because of the lack of support among the bureaucratic hierarchy (124).

However, with the help of its powerful Minister, Hewitt's new department was not only able to defend its own area of responsibility from "outside interference" but also encroached on areas of policy traditionally belonging elsewhere (125) and Treasury was no exception. For example, the Government's foreign investment guidelines nominated the Minister for Minerals and Energy as the contact point for all major mineral development proposals leaving him the authority to refer to
other Ministers matters which came within their areas of responsibility — such as matters on foreign ownership and financing to the Treasurer. In June 1974, an interdepartmental committee, which included Minerals and Energy, was established to screen new foreign investments and, in October of the same year, it was Connor who announced the Government's policy for the development of uranium resources, including the foreign investment guidelines (126).

Clearly, Connor did not share Treasury's traditional view that the public sector was a much less efficient user of resources than the private sector and, given the department's record in the area (127), he and Hewitt were aware of the potentially powerful opposition to their loan proposal from that quarter. Once Treasury heard about their plans for public sector involvement in mineral development. The freewheeling, daring style of Connor and Hewitt led them to try an alternative method of raising the funds, which would minimise Treasury interference. And as neither had had any experience in Commonwealth overseas loan raising before (128), they tended to dismiss Treasury's warnings about the dangers of using intermediaries as predictable, conservative obstructionism.

Why the Secrecy?

The loan negotiations between Connor and Khemlani were kept hidden from most of the Cabinet, the Loan Council, Parliament and the public. This desire for secrecy motivated the four-man
kitchen cabinet’s search for ways to avoid the publicity inherent in normal loan raising procedures and led finally to the unorthodox attempt to borrow under the “temporary purpose" clause of the Financial Agreement.

The initial reason for secrecy seems to have been twofold - coming from both the lenders’ and borrowers’ desire to avoid publicity until the loan had been finalised. As the funds were to be borrowed from Middle East sources, a request for minimal publicity was not unusual. The Arab States seemed to have an ambivalent attitude towards lending and normally were quite averse to any publicity being given to loan negotiations. For example, SAMA placed considerable importance on confidentiality in regard to loan matters during its discussions with Cairns in March 1975 (129) and, although it was not the source of Connor’s loan, a similar attitude from other Arab lenders could have been expected. In addition, any sensitivity that Arab principals may have had to publicity would have certainly been reinforced by the inexperienced intermediaries’ desire to protect their own competitive position and give themselves time to set up the loan.

On the other hand, secretly negotiating a loan project of this nature and presenting the signed deal to Parliament would have appealed to Connor’s secretive nature. The Minister rarely shared information, particularly about his "grand vision" for Australia. He was always reluctant to deal with the press and only gave piecemeal information to Parliament about the details of policy. He rarely made Ministerial statements, preferring to
use "Dorothy Dix" questions to provide specific information about current issues and occasionally simply announced new policies in debate (130).

In this case, all four Ministers were aware that the proposed loan and the purpose for which it was to be used would be opposed by powerful sections of the community. There was every reason to assume that the proposal would be opposed in Parliament and that the Opposition would use its numbers in the Senate to block any associated Loan Bill. In such circumstances, Connor was keen that the negotiations should stay out of the press until the matter was finalised to avoid any possibility that the project be aborted by political opposition (131).

Moreover, the States would have opposed such a borrowing because it threatened their autonomy. The Liberal States, and particularly those of Western Australia and Queensland, were trenchant critics of Connor and totally opposed to the Federal Government interference in resource development (132). There had been frequent clashes over the renewal of offshore oil exploration permits and the use of export controls and one State even threatened to secede. All States (both Labor and Liberal) had challenged the Government's seas and submerged lands legislation in the courts and the four non-Labor States challenged the Petroleum and Minerals Authority Act (133).

Under the Financial Agreement, the loan only required the approval of a majority of Loan Council, a majority which the
Commonwealth could have expected to hold with two Labor States. However, the Treasury would have made Ministers aware of the 1956 Loan Council resolution, which required that the terms and conditions of all loans be approved by at least three Premiers, a vote the Government could not have hoped to attain. Given the atmosphere of urgency surrounding the proposal and the Government's strained relationship with Treasury, the Commonwealth did not have the time or the means to explore other unorthodox but perhaps less questionable options than the use of the "temporary purposes" clause, which may have allowed Labor to proceed with its plans despite the expected state and parliamentary opposition (134). Nevertheless, given the depth of antipathy between some State Governments and the Commonwealth at this time, even if such an alternative was feasible, it would not have escaped publicity. The only way to keep the loan secret was to avoid telling the States as well as the Parliament until it had been completed.

Connor may have agreed to keep the loan secret without being aware of the difficulties such a commitment would involve. He and Hewitt had been holding discussions with the intermediary for about a month before other public service advisers were consulted and neither Connor nor Hewitt had any detailed knowledge of government loan raising procedures or the legal requirements. This was increasingly apparent once public service advisers were brought in and the Minister impatiently faced numerous delays caused by what he saw as mere legal technicalities (135).
But whatever the original rationale, once the Government had decided to take the path of a "temporary purpose" borrowing, secrecy became imperative (136). This ensured that the loan negotiations with Khemlani would remain shrouded in mystery until the Coalition and press forced disclosure in mid-1975.

C. Economic & Financial Implications of the Connor Loan

This section examines the economic and financial implications of the Connor loan, not because they are the only or even the most significant ones, but rather because they are the most relevant to Australia's economic development and the role played in it by government overseas borrowing policies.

Moreover, an examination of these implications helps to explain some of the political controversy which the proposal generated at the time.

The Economic Implications

The major economic implications of such a loan were the increased burden of overseas debt, the inherent exchange rate risks and the impact of the proceeds on Australia's economy. The venture, in fact, involved the nation in unnecessary risk, much of which could have been eliminated if Labor had undertaken their project in a series of smaller loans.

Had the 4000 million petrodollar loan been completed (ie, if
$3036 million had been raised), the level of Australia's overseas debt would have more than trebled from around $1200 million in December 1974 to more than $4200 million with a single borrowing. The level of Commonwealth external debt would have risen from 1.5% of GDP to 6.6% of GDP in one year and this stock of debt would have then continued to grow until the repayment date in 1974, at which stage the principal and accumulated interest would have equalled some $13385 million—more than four times the original borrowing (137).

This loan would, therefore, have had significant implications for debt management, particularly in terms of the repayment of interest and principal at the end of the period. At the time, the maximum repayment of overseas obligations in any one year was around $218 million in 1969/70 with some $214 million falling due in 1974/75. Eight years later in 1982, after the extensive borrowings by the Coalition, Australia's projected maximum overseas debt obligation in any one year was still less than $700 million (138).

The massive "bunching" of repayments, therefore, represented by the $13.4 billion due in 1994 could have caused a severe liquidity crisis for Australia's balance of payments. However, even such a large repayment would have been reduced by inflation and may have been managed with appropriate sinking fund arrangements, assuming the investment of the money generated sufficient government receipts, either directly or through an expanded productive base, to meet the obligation when it fell due. But it was a gamble.
Borrowing $5.036 billion would have meant that the level of Australia's overseas reserves doubled. Nevertheless, this problem could also have been managed. The Government planned to invest the funds overseas until they were needed and, given the low effective rate of interest to be paid by the borrower, could have done so without the costs to the economy normally associated with excessive overseas reserves. Under such an arrangement, the funds would not have had a major impact on the domestic money supply and would have been earning a higher rate of interest than the Government had to pay to the lender.

Another major problem arising from Connor's large one-off loan raising was a reduction in the efficacy of overseas borrowing as an instrument of external policy during the second half of the seventies and eighties. This was because the capital expenditure requirements for the proposed resource projects would not have necessarily coincided with balance of payments requirements. On the other hand, such a loan would have reduced the dependence of Australia's balance of payments on higher and higher levels of inherently unstable private capital inflow, and may have led to a smoother, more sustained growth path for the economy in the longer term.

The terms of the Khemlani offer were very favourable to the borrower with an effective real interest rate representing a negative real rate of return to the lender, assuming world inflation rates continued at 8-10% per annum. Although the proposed compound interest rate converted to an equivalent
simple rate of interest of 17%, the Government's financial
advisers, Darling & Co Ltd, argued that to view the cost of the
the loan in this way was fallacious as the accumulating
interest, in fact, made new funds available each year for
government use. The loan, therefore, was more accurately
viewed as a loan of $13385 million at an effective rate of
7.95% per annum, drawn down by $3036 million immediately, with
the balance over 20 years. This way the effective interest
rate was calculated at between 7.7% and 8.03% (139).

However, the size of the proposed loan and its terms and
conditions were out of line with market experience at that
time. Although some very large Eurocurrency credits had been
arranged in the first quarter of 1974, including a US$2500
million credit facility for Britain and a US$1500 million one
for France, there had been a marked slow down in lending by the
end of the year (140). There were a few large borrowings again
around mid 1975, including a report that the French Government
was negotiating with the Saudi Arabian Government for a loan of
up to US$1750 million for 7-10 years at a fixed interest rate
(141), but nothing in the class of the Khemlani offer. In
fact, the largest reported loan raising to the end of the
decade was a US$3 billion stand by credit facility for Canada,
which was later reduced to US$2.5 billion (142).

But as well as the magnitude of the loan offer, the effective
interest rate of 7.95% was also well below prevailing market
rates at that time. Although the six month Eurocurrency
deposit rate was falling, yields were around 10% in late 1974.
The reported Arab-managed loan offers usually involved rates of 10.5-10.75% although the IBRD was offered a US$750 million loan with an 8.5% coupon rate from SAMA during that period (143). No official borrowings were reported with compound rates.

These and other features of the Khemlani offer increased the likelihood that the funds would never be made available to the Government. In fact, the proposal resembled previous unfounded offers of money by intermediaries to various Australian Governments over the years (144). These unsolicited loan proposals tended to follow a pattern, which usually included large amounts beyond the capacity of a single individual, principals who were rarely identified, interest rates and conditions at variance with current market terms overseas and very high commission rates. The presence of these features suggested that Mr Khemlani was dealing in what the press called "funny money".

But assuming such a favourable loan had been successfully negotiated, it would still have involved an enormous exchange rate risk. For example, the Hawke Government's 10% devaluation in 1983 would have involved additional repayments of $1340 million on the original loan, while the 21% decline in the Australian dollar relative to the US dollar in early 1985 would have added a further $2800 million - more than double Australia's outstanding debt in 1974. Such risks were inherent in a debt portfolio in which loans denominated in US dollars rose from 36% of total outstanding debt in June 1974 to around 84% after the Connor loan. Australia had not had such a
concentration of debt in a single currency since before the war and, given the nature of the proposal, the situation would have been impossible to correct before the mid-1990s.

The purpose of the loan also had important economic implications. The funds were to be used by the Commonwealth as direct, non-equity capital for development infrastructure and an energy program. The specific projects mentioned by Whitlam and Connor included natural gas pipelines in South Australia, Western Australia and NSW, petrochemical plants at Dampier and Redcliffs, uranium mining and milling plants in the Northern Territory, rail electrification in the four eastern states and the upgrading of major coal ports in NSW and Queensland. There was also some suggestion that part of the funds could be used to purchase Australian interests in foreign-owned resource companies (145).

As the loan was to be used for domestic purposes, to the extent to which the funds were spent locally (rather than on imports) they would have added directly to private sector liquidity. Had the funds, or even part of the proceeds, been spent by the Government on development projects or other domestic needs in the short term, the resulting expansion in the money supply would have meant the already high inflation rate in 1974/75 would have risen even higher. However, given that the bulk of the proceeds were to be held offshore and only brought in as needed, the impact of the loan on domestic liquidity and the management of the economy would have been tractable for the most part. But, if this were the plan, it is difficult to see
how the Government could economically justify the need for a single borrowing of that size.

But the use to which these funds were eventually put was even more crucial. On the one hand, many new resource projects, including many of those the Government was examining, required foreign capital for development and Connor was trying to obtain this capital without sacrificing Australian ownership of the projects. His loan would have reduced the need for direct private foreign investment in the economy and its associated costs (such as, loss of local control, higher levels of income payable abroad, reduced government revenues resulting from various financing policies available to overseas companies and problems of managing domestic liquidity under a managed exchange rate). As a result, the level of foreign ownership in the resource industries could have been expected to fall.

On the other hand, however, this increase in direct public sector investment, financed via overseas loan raising, would have meant not only the loss of benefits arising from much direct foreign investment (such as improved technology, management expertise and access to overseas markets) but also reduced the economy's flexibility and increased the risk of misallocating resources.

The Labor Government was assuming that the development projects financed by the loan moneys would be productive, so generating sufficient direct surpluses or, through the increased rate of economic growth and growth in government revenues, to provide
funds for the repayment of the principal and accumulated interest in the mid-1990s without placing severe strain on the balance of payments or the economy. In this regard, the Minister for Minerals and Energy claimed that the profit alone from the proposed projects would have been one and a half times the value of the original loan (146).

But, as many of the planned projects were long-term, low return infrastructure (such as rail electrification and electricity generation) or of unproven commercial viability (the petrochemical plants), the assumption was not without risk. Governments have frequently failed to seek the full economic cost of their infrastructure from the private projects which have benefited from its construction (147). Furthermore, the lack of commercial expertise available in, or even to, the public sector (especially the Commonwealth, given that mineral development was a state responsibility) plus the uncertainty of mineral export markets during a period of world recession, increased the likelihood that some of the projects at least would not have proved viable, let alone profitable, by the 1990s. To the extent that the public sector proved to be a less efficient user of resources than the private sector, the efficiency of the economy as a whole would have been reduced and consequently would exhibit a lower rate of growth than in the absence of government intervention.

Yet the debt obligation would have remained fixed and, unlike private direct foreign investment, would have to be serviced with or without the hoped-for profits. To the extent that the
loan funds were used for unproductive purposes, even for worthwhile projects which failed, the obligation to repay the debt would have imposed serious pressure on the economy and the balance of payments. This could have resulted in a fall or stagnation of income flows, savings, public revenues and the external earnings available for domestic use, and severely limited potential economic growth and access to overseas resources.

The financial implications of the Conner loan emanated from Treasury's loss of control over the loan raising process, the use of intermediaries and the attempt to avoid the Loan Council. The breakdown in the Labor Government's relationship with its own loan raising department left it without any expertise in the area and without a source of technical advice it could trust at a time when it planned a major innovation in Commonwealth overseas borrowing policy.

Conner and Hewitt do not appear to have understood the full implications of the avenue they were pursuing and dismissed Treasury's warnings as ideological obstructionism. On the other hand, Treasury itself was not entirely blameless for this impasse. The department had not made any effort in tendering its advice to take account of the Government's economic goals by offering policy options, particularly for the 1974 budget. Moreover, many of its own actions (such as secretly checking on Khemlani and failing to advise the Government of the full
extent of the monetary contraction in July/August 1974) appeared hostile to the Government.

In the event, the department actually surrendered its loan raising responsibilities in an effort to keep Treasury and its Minister "untainted" by the Kheamei exercise, so losing any chance of influencing these loan raising activities. If Treasurer Cairns, rather than Connor, had been granted the Executive Council authority in December, the actions of the Minister for Minerals and Energy would have been more circumscribed, and he and his department would have found it much more difficult to avoid Treasury scrutiny. If the Secretary of the Treasury had insisted, and continued to insist, that the Treasurer's responsibility for overseas loan raising be recognised by vesting him (rather than Connor) with the authority to borrow, the department would have remained, at least legally, part of the negotiations and could not have been so easily excluded. After the initial failures, Treasury may have then been in a position to bring the affair to a definite close.

However, too much cannot be made of this. Given Connor's power, Cairn's ambivalence and the Government's complete distrust of Treasury advice, it is difficult to see history being rewritten. Nevertheless, the Government's loss of expert advice decreased the effectiveness of the search for petrodollars and increased the financial risks of the venture. By turning to an unknown intermediary, with no previous experience in international borrowing, Connor opened up the possibility of
fraud, payment of financial fees without receiving funds and the loss of Australia's international borrowing reputation.

There was the real potential for fraud in the loan arrangements with Khemlani. As no interest was to be paid by the borrower during the life of the loan, a lender may not have become aware that he held a forged document (such as a promissory note) from the Australian Government until the expiry of the 20 year loan period when the Commonwealth could face payment for moneys never received. For this reason, the scope for deception was broad and was a source of grave concern to the Treasury and the Reserve Bank (148). The resulting publicity, however, made such an outcome remote.

A second financial risk arose from the possibility that an agency relationship would be established between Khemlani and the Government, which could make the latter liable for millions of dollars in commissions whether or not any loan funds were successfully raised. Other governments had been caught in such a situation (149). However, Connor and Hewitt seemed well aware of the possibility and were scrupulously careful to guard against this possibility. In the event, no agency relationship was ever established.

The use of intermediaries involved two other financial gambles, which did not pay off. One was that a single agent would be able to raise the large sum of money desired and, in this respect, the Government was left empty-handed. The other involved the Commonwealth being able to retain control over its
own loan raising activities and this also proved to be impossible. As the news of Khemlani's efforts began to spread throughout the world's financial centres, it stimulated a host of other intermediaries and fringe operators into searching for loan funds for the Australian Government. Although Connor closely supervised Khemlani's activities, he could not control the ripple effect of enquiries by his, and later Cairn's, own agents. As a result, the Government was overwhelmed by loan "offers" and persons claiming to be acting as its agent in these matters.

The Government took another major financial gamble when it decided not to consult the Loan Council prior to obtaining the 20 year loan on the grounds that the money was to be used for "temporary purposes". Although Whitlam continually denied there was any intention to by-pass Loan Council procedures as the Commonwealth planned to submit the loan for ratification (150), the Executive Council Minute of 14 December 1974 clearly authorised Connor to borrow money without any requirement for prior consultation. This action had serious financial implications for the nation.

Firstly, had any funds been raised, the States could have taken the matter to the High Court where the Commonwealth stood a good chance of having the loan declared unconstitutional (151). Not only would the proceeds of the loan have been lost but the outcome would have damaged Australia's reputation as a reliable borrower. Such legal action would have had deleterious long-term effects on the country's international credit rating.
and access to off-shore funds in the future. In fact, the Federal Labor Government was taken to court for this potential breach of the Financial Agreement but not by the States. A private solicitor issued the summons against Whitlam, Connor, Cairns and Murphy late in 1975 apparently for the political purpose of discrediting their Government. The defendants were finally discharged in 1979 after the Coalition Government refused to release all relevant documents. In the end, this legal action went beyond the "loans affair" and threatened all Australian politicians by exposing the possibility that, if this case was successful, the past decisions of any politician could be the subject of examination and they themselves the subject of prosecution by the courts.

Secondly, the Connor loan attempt highlighted the powerful position of the Commonwealth in overseas loan raising activities, despite attempts by the States to maintain their power to monitor the Federal Government's loan program through the Loan Council. Had Labor controlled Parliament, it could have conceivably raised the funds under the defence provision of the Financial Agreement without consulting the States. Or, provided the Government could obtain the votes of three Premiers to achieve the necessary majority approval for the terms and conditions of its loans, it would also be able to raise funds in the face of opposition from the major States. Although unsuccessful, Labor's attempt to borrow petrodollars highlighted potential extensions of the Commonwealth's financial powers via its use of loan moneys to avoid traditional methods of financial control (152).
D. The Impact on Overseas Borrowing Policy

Since 1975, much has been written about the immediate political impact (153) and legal ramifications (154) of the "loans affair" but its economic and financial implications or its more pervasive effect on the political environment have received less attention (155). However, these more indirect effects contributed to the politicization of the policy making process which resulted in significant, if subtle, changes in the policy making procedures surrounding government overseas borrowing as well as modifying loan raising programs later in the seventies.

The political impact of the "loans affair" went beyond the role it played in the constitutional crisis of 1975 and consequent dismissal of the Labor Government because the aftermath of these events continued to pervade the Fraser administration. The sacking of the Labor Prime Minister by the Governor-General created a public furore, which politically split the nation. Consequently, even after their overwhelming victory in the December election, a taint of political illegitimacy hung around the Fraser Government, which kept it on the defensive (156).

Because the Coalition had justified its actions in 1975 on the basis of the Labor Government's inability to manage the economy and the incompetence and impropriety of its administration, it
is not surprising that these themes pervaded the policies of
the Fraser Government, particularly in the initial years. To
justify its role in the dismissal, the Coalition had to prove
to be a competent economic manager and restore Australia's
prosperity as soon as possible. As a result, there was a
continuous search by Fraser and his colleagues for an "instant"
solution to the country's economic ills, despite Treasury
advice that none existed. As we saw in Chapter II, this quest
influenced the Commonwealth's overseas borrowing policy in
terms of its 1976 decision on the exchange rate and, as Chapter
V will show, its 1978 decision on infrastructure.

The Borrowing Program

Although the Connor loan was totally unsuccessful, it
indirectly continued to influence the Commonwealth's overseas
borrowing program after 1975. As the "loans affair" had
triggered the political demise of the Whitlam Government,
Khamiani's petrodollar loan became a "reverse" yardstick
against which all Commonwealth overseas borrowing was measured.
This was because the bitterness of the Labor Party, the
willingness of the Fraser Government to remind the public of
Labor's incompetence and the avid interest of the media, which
had directly assisted in investigating and exposing the story,
combined to ensure that, for a time at least, political factors
continued to play a key role in Commonwealth overseas borrowing
policy.

The defeat of the Whitlam Government did not remove the
unfortunate episode of the petrodollar loan from the public arena. The whole affair was debated again by the Parliament and the media during the first half of 1976 as former Labor Ministers were accused and finally cleared of any attempt to obtain financial "kick-backs" from the proposed loans (157). The Khemlani loan became part of the devaluation debate later that same year and Whitlam’s attempt to prosecute the author of a book about the era provoked further media interest (158).

By 1977, the Coalition Government’s own overseas borrowing program was underway, the size of which began to invite comparisons with the $3 billion loan that Connor had been seeking and the financial prudence of the action. This ensured a continuing debate about the Commonwealth’s borrowing policies for the next two years (159), fuelled initially by the resignation of Ellicott and the 1977 election campaign. In August 1977, the Attorney General resigned stating that the "loans affair" had claimed another victim, after the Cabinet tried to influence him to end the criminal proceedings Sankey V. Whitlam & others (160). This trial, which continued until 1979, and the Coalition’s borrowing program helped ensure the Labor Government’s petrodollar loan stayed in the minds of the community and that certain Commonwealth overseas loan raising activities remained politically sensitive.

As well as the Coalition’s decision not to embark on the large-scale overseas borrowing program in 1976, this sensitivity pervaded the potential sources of loan funds available to the Government. A successful Commonwealth loan
from the Middle East had become highly unlikely. The most obvious new market was Saudi Arabia where SAMA was willing and able to lend large amounts of money to the Australian Government, although there remained unresolved problems with the terms of such a loan. However, after 1975, the raising of Arab funds became politically suspect and this was reinforced by SAMA's own borrowing procedures. The Authority's desire for secrecy during negotiations and minimal publicity for any loan concluded meant that Australia's normal loan raising procedures were almost impossible to follow.

The "delicate political implications" of the Middle East as a source of government loans was still apparent in 1981, when a proposal to explore loan raising possibilities in Saudi Arabia received front page coverage in a major daily newspaper on the eve of the departure of senior Treasury officials (161). The article referred to a letter from the Secretary of the Treasury to his counterpart in the department of Foreign Affairs stressing the need for discretion about the proposal "for reasons associated with past sensitivities in this area of the world". Overseas borrowing policies were again debated in Parliament. Such media reaction continued to make the Commonwealth very wary of direct loans from the Middle East and, for whatever reasons, no money has ever been raised there.

However, the furore surrounding the Connor loan never affected the terms and conditions under which the Commonwealth borrowed overseas, despite repeated claims that it would do so. Obviously the affair had the potential to severely damage
Australia's international standing as a borrower and much was made of this by the media and other political commentators at the time (162). But, throughout the period, Australia's credit rating remained unchanged.

The Commonwealth's securities rating was first upgraded from a single-A rating to a triple-A rating in October 1974 by Moody's Investors Service, a large New York credit rating agency, after discussions in New York with Treasurer Crean (163). In June 1975, after Labor's unorthodox loan raising activities became public, this rating was reaffirmed by Standard and Poor's Corporation, the largest New York agency (164). Furthermore, there was no evidence that the ability of the Government to raise overseas loans had been impaired (165), although no public borrowing was undertaken by Labor after May 1975.

The first major overseas loan raised following this period was in March 1976 under the Coalition and was very successful. During his speech announcing the DM100 million loan, Treasurer Lynch noted that its terms included the "lowest coupon rate for any foreign borrower in the German market place since July 1973", which reflected the very high borrowing status of the Government (166). The Coalition continued to borrow large sums of money offshore throughout the remainder of the decade at very competitive rates.

The Policy Making Process

As we have seen, the unorthodox policy of seeking a petrodollar
loan through an intermediary was a political decision taken by a "lone-wolf" Minister with no loan raising experience and against the advice of the Government's legal and economic experts. The policy was not discussed by Cabinet or Caucus — only by a "kitchen" cabinet consisting of Whitlam, Connor, Cairns and Murphy — and implemented without the knowledge of the Loan Council, Parliament or the public.

After he realised the political implications of such a policy, Prime Minister Whitlam moved to return all overseas borrowing to the hands of the Treasurer. At a press conference in June, he publicly announced that no person had authority to do anything in relation to borrowings by the Australian Government unless it was done with the Treasurer's authority (167). By this stage, the Treasurer was Hayden, who apparently shared his department's views on such matters (168).

Upon assuming office, the Coalition moved quickly to reconfirm and formalise Whitlam's action. In a press release on 17 December 1975, Treasurer Lynch stated that all matters relating to borrowings by the Australian Government were subject to the Treasurer's authority and that no person had the authority to do anything in regard to these matters without the authorization of the Treasurer. Treasury's traditional role as government loan raiser was also reconfirmed as the Treasurer categorically stated that, under no circumstances, would he or his staff consider any loan proposals directed to them, and then set out new guidelines for unsolicited loan offers "to avoid any possible repetition of the former Government's
These were based on Treasury's former internal guidelines for such offers but the criteria were now public and were issued to all Ministers and their Departments. In addition, the guidelines were more comprehensive and specifically geared to avoid the dangers inherent in a Connor-type loan. For example, no request for a mandate, letter of identification or similar document would be considered by the Government and agreement would have to be given to disclose the name of the principal to Parliament and to the public.

As well as reinforcing the role of the Treasury, the new guidelines also incorporated normal loan raising procedures involving the Loan Council and Parliament. There could now be no provision for secrecy for Commonwealth loan raising and all documentation had to be consistent with the Government's legal and other requirements. Furthermore, any decision to proceed with such a borrowing would be contingent on legislative authority being available and authority from the Loan Council being obtained before hand.

The Coalition Government was scrupulous in abiding by these guidelines and normally referred to individual loans having the approval of the Loan Council in its press releases. Soon after gaining office in 1983, the Hawke Labor Government reconfirmed and reissued the guidelines. However, the Commonwealth has apparently felt no need to make legislative changes to ensure that unorthodox loan raising activities could not occur again.
The lesson of the Whitlam Government's demise perhaps seems enough.

The "loans affair" also touched Commonwealth loan raising procedures through its impetus to the States' efforts to obtain increased access to overseas funds. The Connor loan highlighted not only the possibility of obtaining large amounts of international development finance at highly competitive rates but also the implications for state autonomy of Commonwealth control of such funds. If Connor had been successful in raising his money, the States would most likely have received their share of the funds in some form of tied grant. In this way, the Federal Government could have influenced the location, timing and conditions under which major resource projects got underway in each State, as well as initiating development of its own in the territories. The States' search for sources of finance capital encouraged the growth of "non-conventional" funding techniques and led to the development of the infrastructure program, both of which are discussed in the following chapter.
Like the Labor Government before it, the Coalition also adopted a borrowing policy which involved seeking large amounts overseas for development purposes. This policy was embodied in the infrastructure program which permitted state semi-government authorities to borrow new money offshore for the first time since the depression. Although these authorities had been able to raise conversion loans in international markets for their existing overseas debt (1), they had been restricted unwillingly to the domestic market for their Loan Council programs (2). So the 1978 decision by the Commonwealth to reverse this situation marked a significant change in Australia's public sector overseas borrowing policy.

Many features of the infrastructure program bore a strong resemblance to the Connor petrodollar loan of 1974/75. Both represented the largest direct public sector involvement in development to be financed by overseas funds since the twenties — a major break with post-war overseas borrowing practice. Both involved very large amounts of capital — Connor sought the Australian equivalent of some US$4000 million overseas (ie. around $3000 million) and, by 1980, forward estimates for projects under the infrastructure program were around $4700 million (3) — and projected very similar expenditure schedules through to the early 1990s.
In fact, many of the same infrastructure projects were included in both schemes - the up-grading of the coal loaders in NSW and Queensland, rail electrification projects, the Dampier-Perth pipeline and the Redcliffs petrochemical plant. Whitlam claimed that the 1978 program included overseas borrowings "for projects which, with the sole exception of the Melbourne Trade Centre, had been among those which... (Labor)... was proposing to finance with any loans .... Connor raised" (4).

However, because the infrastructure program of the Coalition Government was not directly motivated by a desire to increase the level of Australian ownership in resources, Connor's public sector development projects, such as the mining and milling of uranium in the Northern Territory, were not included. Nevertheless, despite this shift in emphasis from public to private sector development, the state authorities' infrastructure projects faced the same difficulty of finding appropriate economic criteria for determining their economic viability as would have those of the Labor Government.

Both schemes were motivated and shaped more by political considerations than economic imperatives. Although each Government hoped the additional funds would assist economic recovery and growth, their principal economic advisers had argued that short-term economic management required different action. In both cases, the Treasury advised against the borrowings because such funds threatened other economic goals, such as controlling inflation and increasing economic
efficiency. This advice was overridden in both 1974 and 1978 by the Government's political strategy for economic development. However, the vigor with which Treasury opposed the infrastructure program never matched its implacable opposition to the Connor loan because of the latter's ideological goals and unorthodox means.

Nevertheless, the primacy of political motivation in the development of these programs did not mean that economic factors were without relevance. For example, the threatened energy crisis in 1973/74 and again in 1979 stimulated the Federal Government to seek funds to develop Australia's own energy resources. The international situation provided the rationale and the source of funds for large scale development. Uncertainty on world financial markets led to a capital drought and weak private capital inflow into Australia during this period while high levels of international liquidity facilitated the raising of large government loans. These economic considerations provided the framework for the political decisions to seek public sector funds overseas by Connor and by the Coalition via the infrastructure program.

However, the similarities between the two schemes have tended to be lost in their obvious differences. Firstly, no money was ever borrowed by Connor, whereas some $1.2 billion had been borrowed overseas under the infrastructure program by the early eighties. Secondly, despite the hopes of the States, the total financing of projects approved under the Coalition's scheme was not provided by overseas markets. This contrasted sharply with
the apparent intentions of the Labor Government.

A third difference was the role of the Commonwealth. Whereas Connor's key fiscal agent was to be the National Government, the infrastructure program was designed to permit nearly all moneys to be expended under State Government control. Consequently, the attitude of the States to each scheme was in complete contrast. The Premiers were relentlessly opposed to the Connor loan but, six months later, had initiated discussions with the Commonwealth on the possibility of an infrastructure program designed to raise large amounts of public overseas capital to fund many of the same projects. This volte-face reflected the change in the Federal Government's political complexion and centralist tendencies. The level of potential Commonwealth interference in the traditional responsibilities of the States in terms of resource development were minimised in the state-initiated infrastructure financing arrangements and, consequently, the program received their enthusiastic support.

But the major difference between the Connor loan and the infrastructure program was the policy making process surrounding each scheme. On the one hand, the petrodollar loan was initiated by a Commonwealth Minister without consulting Cabinet and implemented against the advice of most of the Government's legal and economic experts and without the knowledge of the Loan Council, the Parliament or the public. When the plan was revealed, it was strongly opposed by the Coalition, the States and the media. On the other hand, the
infrastructure program was initiated by the States and was the subject of extensive consultation between State and Federal Governments and their officials before receiving the approval of Cabinet and Loan Council. The process was the subject of numerous progress reports and was generally supported by the media and the Opposition throughout the early years of its existence. After the guidelines were accepted, all loans raised overseas under these provisions had to obtain Loan Council approval and were routinely reported to the Parliament and the public.

This chapter outlines the birth and development of the infrastructure program and explores the dominant role played by political factors in the policy making process. The impact of the overseas funds raised under this program on Australia's economic development and Commonwealth overseas borrowing policies is discussed in the final sections.

1. The Infrastructure Program

Its Origin

The initiative for the infrastructure program came from Sir Charles Court, Premier of the resource-rich State of Western Australia. In his policy speech of March 1974, Court announced that his Government would seek approval for the State to borrow funds outside normal Loan Council programs to enable it to
provide infrastructure to encourage Australian participation in large development projects (5). But, after obtaining office, Court had to wait for a propitious moment to approach the Commonwealth (6).

This was provided by a political change at the Federal level. In January 1976, soon after the Coalition came to power, the Premier went to discuss his ideas with Prime Minister Fraser. Court was aware of the superficial similarities between his proposition and the Connor loan and was quick to emphasise the lack of scope for "backalley Khemlani-type" operations under his arrangements (7). He was proposing that state authorities be permitted to raise overseas loans outside Loan Council programs, with the approval of State and Federal Treasuries and the full knowledge of the Loan Council.

The matter was raised again in a general way at the Premiers' Conference in February. After some discussion, Court agreed to put forward a formal submission to Loan Council at the June 1976 meeting (8). The Loan Council referred the proposal to a committee of State and Commonwealth Treasury officials and work commenced on an examination of the financing needs for public sector infrastructure, especially to assist development projects (9).

As the other Premiers realised the potential of such a change to the Loan Council's borrowing arrangements, they also became enthusiastic advocates of the scheme and, at their request, the terms of reference of the initial report were expanded to
include consideration of special borrowing requirements to cover development projects in other than remote areas (10).

The Treasurer and the Commonwealth Treasury were the only ones to express doubts (11). The proposed relaxation of the rules to enable the semi-government authorities to borrow abroad had a number of worrying features and the department was not convinced that the problems of infrastructure financing could not be solved within existing Loan Council procedures using temporary special additions to deal with the extra demands being placed on the States (12).

The Commonwealth Treasury held the view that the Federal Government should virtually be the only governmental borrower overseas. This partly reflected the experience of the 1920s and the fear that a return to earlier borrowing policies would complicate the Commonwealth's borrowing program and could lead to damaging competition for funds between various governments. But it also reflected Treasury's desire to maintain control over the amount of public sector borrowing overseas for national debt management, monetary and external policy reasons (13).

Furthermore, permitting semi-government authorities access to overseas markets threatened the Government's anti-inflation strategy (14). The department's fears were embodied in a letter from Treasurer Lynch in July 1977, responding to comments on the outcome of the Loan Council on infrastructure. He stated that overseas borrowing was not the answer to
Australia's development needs as such loans added to the money supply in much the same way as the Government printing money. Such action, therefore, fed inflation and retarded long-term development. In fact, he argued, there was a continuing need for State as well as Federal public sector restraint in order to rein-back total government spending and the money supply to reduce the inflationary pressures on the Australian economy (15).

A third Treasury concern about the infrastructure program was based on its traditional opposition to increasing the role of the public sector, which had been notoriously inefficient at covering the "opportunity cost" of its investment. The department had argued, in its 1972 paper on overseas investment, that the private sector should supply its own development infrastructure, especially in remote areas for single risky projects (16) and expanded on this theme throughout the period (17).

Treasury's doubts about the new policy found their way into the first officials' report on infrastructure financing, which contained conflicting advice from State and Federal Treasuries (18). The report was presented to Loan Council in July 1977 with the Commonwealth Treasury still opposing the scheme. This was reflected in the Treasurer's opening address, which suggested that more time was needed to consider the matter and noted that the Commonwealth believed there were important advantages in the existing borrowing arrangements for statutory authorities in terms of national economic management and the
cost of public sector borrowing (19).

In the event, consideration of the report took place at a special meeting in October 1977 and, despite Treasury misgivings, the Commonwealth indicated that it would be willing to adopt a more flexible approach to Loan Council procedures. In-principle agreement was reached that a working party of officials should report back on how the rules governing infrastructure financing could be made more flexible. All the details of the new arrangements were finally agreed to except for the Commonwealth's right of veto, which was vigorously opposed by the States (20).

In an effort to reach final agreement on the infrastructure financing guidelines, the Prime Minister wrote to all Premiers on 10 March 1978 signifying that the Commonwealth would be prepared to accept them (21). Some Premiers continued to balk at the requirement to obtain the Commonwealth's approval for all infrastructure proposals put to Loan Council but the Federal Government made it clear that its responsibilities for national economic and financial management could only be discharged effectively if it retained the veto. The Commonwealth's view was that the proposed infrastructure guidelines took account of the needs of the States for finance flexibility, while at the same time being consistent with its own responsibilities (22).

The Federal Government lobbied hard for acceptance of its point of view. The Prime Minister wrote to each State Premier three
times during the months leading up to the Loan Council urging them to agree without further delay so that they could submit projects for Loan Council consideration in June. By May, his persistence was rewarded and the Premiers tentatively agreed to the voting arrangements on the understanding that they would be reviewed in three years time (23).

At its meeting on 22-23 June 1978, the Australian Loan Council formally adopted the new guidelines for considering infrastructure proposals for special additions to the normal annual semi-government authorities’ borrowing programs and for overseas borrowing by these authorities (24). It also agreed to establish a working party of State and Commonwealth officials to examine and report back to the Loan Council as soon as practicable on the infrastructure proposals that had been submitted at the meeting. The working party was instructed to recommend which projects should be supported and to establish a responsible time scale and phasing for the scheme (25). Loan Council had officially given birth to the infrastructure program.

The Program’s Development

Details of the new guidelines are set out in Appendix I but in brief they involved a new category of borrowings by semi-government authorities for development infrastructure of a kind normally supplied by Governments but which could not be accommodated within the resources available to the State or its authority, and which needed to be undertaken within a
relatively short time span. Each project was to be judged in terms of factors such as its viability, significance for development, and importance and urgency. Approval of each project required a simple majority, including the Commonwealth.

There was also provision for borrowing the approved funds for these projects overseas (26) assuming this did not run counter to the Commonwealth’s fiscal, monetary or external objectives or its overseas borrowing activities (27). Again approval of the amount, terms and conditions of each loan was subject to a Federal Government veto.

The States had submitted a number of possible projects to the June 1978 meeting and these had been examined and reported on by October of that year. The officials’ recommendations provided a basis for further Loan Council deliberations on the projects to be accepted for the scheme (28).

Given the economic environment at the time, it would not appear to have been an ideal time for the States to be seeking additional finance for new capital projects. The Commonwealth was grappling with relatively high inflation, trying to reduce the budget deficit and growth in public sector expenditure (29). In his speech to the Premiers at the June Conference, the Treasurer had noted that both the Commonwealth’s budget deficit and the public sector borrowing requirement (PSBR) had to be restrained. To this end, the State and semi-government loan programs for 1978/79 had been reduced in real terms and the 1978/79 budget had raised taxes and reduced government
expenditure. Moreover, the Treasurer continued to point out that overseas borrowing did not provide a "painless" basis for increased government spending (30).

But despite Treasury's warnings, the Government remained wed to its desire for quick economic growth. The Prime Minister was convinced that the infrastructure program could play a key role in fulfilling this need (31) calling acceptance of the guidelines an "historic decision" which had great significance for Australia's future growth. In late 1978, while paying lip-service to Treasury's anti-inflation strategy, Fraser was arguing that a "responsible" borrowing program would greatly assist new resource development signalling that the Coalition was prepared to accept increased public expenditure by the States for infrastructure (32).

At the Loan Council meeting on 6 November 1978, consideration was given to twelve infrastructure projects - two each from NSW, Victoria, Queensland and Tasmania, three from Western Australia and one from South Australia. The projects included the upgrading and building of coal loading facilities, electricity generation projects, water supply and rail facilities, the Dampier-Perth pipeline, a petrochemical plant at Redcliff in South Australia and the World Trade Centre in Melbourne.

All 12 submitted projects were accepted, despite the fact that some did not appear to fit the criteria for approval (33). No state raised major objections about any of the other proposals.
and, despite Treasury doubts, nor obviously did the Commonwealth (34). In his press release announcing the decision, the Prime Minister listed the factors which had been taken into account during Loan Council's considerations. These included not simply the projects' contribution to the development of Australia's national resources but also to the balance of payments, to strengthening the structure of industry and to increasing employment (35).

This refinement of the original criteria permitted the Loan Council to accept the World Trade Centre because the provision of integrated facilities for exporters would presumably help develop overseas markets and assist the balance of payments. However, the project was only approved on the condition that no other State submitted a similar proposal. Similarly, the water supply projects in Tasmania, which were aimed at improving the services of metropolitan Hobart, were approved on the grounds that the project would contribute to that State's industrial development.

Total financing for the 12 projects provided for a borrowing program of $1767 million over eight years, commencing with borrowings of $158 million in 1978/79. All applications for overseas borrowings in connection with these approved projects required separate Loan Council consideration although, given the economic circumstances of the time, the Commonwealth indicated that such requests would receive favourable consideration during the remainder of the financial year. In fact, 96% of the $149 million actually borrowed by state
authorities under the program by June 1979 had been raised overseas (36).

The infrastructure program was expected to be a continuing one with new projects being added as the original ones progressed to completion. But, in view of the size and initial concentration of the borrowings approved at the November meeting, the Commonwealth indicated that it would not favour any additions to the program for the next three years (37). But this decision, which reflected Treasury’s attempts to keep the program manageable, was soon discarded.

At the June 1979 meeting, only seven months later, the Loan Council gave "in principle" approval to two new projects for inclusion in the infrastructure program — a power supply for the Portland aluminium smelter in Victoria and electrification of the Brisbane railways. Although these projects were to be the subject of further examination by officers, $8 million for the rail electrification was approved at this meeting. Furthermore, despite the Commonwealth’s apparent concern to reduce the PSBR, it agreed to consider additional projects from the States under the infrastructure guidelines (38).

At the same time, the guidelines for overseas borrowing by state authorities were refined following a report from officers on procedures for coordinating government overseas borrowing. This seemed to be accompanied by a tightening up of the States’ access to overseas borrowing and, as a result, only 75% of approved borrowings in 1979/80 were raised offshore.
While the Treasurer and the Treasury continued to press the need for expenditure restraint to reduce the public sector's pressure on financial markets because it threatened to "crowd out" worthwhile private development (39), a majority of the Fraser Cabinet remained convinced that further government action was required to encourage resource development in Australia. This conviction was reinforced by the sharp rise in oil prices after mid 1979 and culminated in a "national program to expand coal-based electricity generation and transmission within the infrastructure financing framework" (40).

This program involved the accelerated development of Australia's massive reserves of coal for export and for electricity generation. The Commonwealth invited the States to reassess the prospective demand for electricity and, if necessary, to submit proposals for new coal-based electricity projects for consideration under the infrastructure guidelines with a view to rapidly increasing the nation's supply of electricity. The invitation stressed that such projects were to involve new and accelerated electricity generating schemes, not simply substitute for projects already approved under other programs (41). Although the Commonwealth stated that all newly submitted proposals had to be evaluated with regard to the infrastructure guidelines, alternative sources of finance (including internal funds) available to the authorities and in the light of the Federal Government's overall economic policy objectives at the time, the announcement was an open invitation to the States to increase their demand for infrastructure funds
and they were not slow to respond.

One month later in December, the Loan Council considered another report by State and Commonwealth officers on a further 11 projects, which were "designed to accelerate .. national development" (42). Nine of these were approved for infrastructure funding - two each for NSW, Queensland and WA and one each for Tasmania and the Commonwealth. The agreed total borrowing program of $800 million was to be spread over the years to 1986/87, and included $489 million for electricity generation, $182 million for rail electrification, $33 million for conversion from oil-fired generation and $75 million for other infrastructure facilities.

For the first time, the Commonwealth itself had put forward its own programs but only one, a rural sector telecommunications network, was included at that meeting. The Federal Government also indicated it would support the electrification of the Sydney to Melbourne rail link subject to the agreement of the relevant States and, in the meantime, it would undertake a feasibility study with a view to reporting to the June 1980 meeting. A second joint study was to be made of the practicality of electrification of all government railways.

The December meeting witnessed a further relaxation of the infrastructure guidelines as projects no longer had to directly contribute to resource development, exports or employment but simply result in a more rational utilisation of Australia's energy resources. In view of the international oil price rises
taking place, this included any project which reduced the
cconsumption of oil. Hence such proposals as the upgrading of
public transport in Brisbane, the electrification of the
Gosford-Newcastle line and Tasmania's project to reduce the use
of the oil-fired thermal station at Bell Bay were accepted. In
fact, one of the projects rejected at that meeting, the Murdoo
Soluc pipeline in Victoria intended to increase the water
supply of the Geelong and Bellarine Peninsulas, was later
admitted to the program after further consultations with and
representations from the Victorian Government (43).

Although the infrastructure program had increased rapidly, its
initial financing needs remained relatively small. During the
second year, special borrowing additions totalling some $479
million were approved for the two groups of projects. Of this,
$429 million had been actually borrowed by June 1980, $39.4
million by state authorities. Seventy-five percent of the
total or $323 million was raised overseas.

The Fraser Government was gratified by the positive response of
the States to its energy development program at the December
1979 meeting and the States reacted by submitting further
projects, which were duly assessed by officials and considered
by Loan Council at its June 1980 meeting. As a result, eight
additional proposals, which involved indicative borrowings of
$1552 million over the years to 1989/90, were admitted to the
program. These projects - four for Victoria, two for WA and
one each for NSW and the Commonwealth - involved some $1426
million for electricity generation and distribution, $62
million for the Adelaide-Crystal Brook railway to be built by
the Federal Government and $63 million for other state
infrastructure projects. A further proposal, involving some
$182 million for the electrification of the Waterfall/Port
Kembla railway in NSW, was also approved for inclusion in the
program soon after the June meeting.

Therefore, by the end of the decade, some 29 infrastructure
projects with total projected borrowings of $4900 million (in
June 1980 prices) over the years to 1989/90, had received Loan
Council approval under the 1978 guidelines. These projects and
their actual borrowings to 1982 are set out in Appendix IX. In
addition, NSW and Queensland submitted major proposals for
accelerated large-scale expansion of electric power generation,
which were referred to a working party of officials for
examination. As well as these, a number of projects involving
the electrification of resource railway lines were identified
as future candidates for inclusion in the infrastructure
program, with the Commonwealth indicating its support for most
of them (44).

However, this meeting proved to be the high water mark for the
program as the Commonwealth Government began to realise it had
opened a Pandora's box. There seemed to be practically no
limit to the number of development projects the States would
seek to finance in this way. Proposals were continually rushed
forward often encouraged by private developers and the
Government began to realise that the program was getting out of
hand.
In June 1980, in line with its policy advice for managing the potential mineral resources boom (45), Treasury had put forward a submission to the Government again setting out its reservations about the infrastructure program and its implications for the Commonwealth’s anti-inflation policy (46). This submission argued that the infrastructure program had to be brought under control by more careful scrutiny of all future borrowing proposals as well as by requiring the States to examine the possibility of rescheduling or modifying currently approved proposals by delay or cancellation, or by increasing their own financial contribution or that of the private developer, to reduce financing demands.

However, as the outcome of the Loan Council meeting showed, Treasury’s advice was not acceptable at a time when the Fraser Government was gearing up for an election in October. The election strategy involved “talking up” the prosperous future lying ahead for all Australians in the wake of the resources boom and the decisions taken at that Loan Council meeting were intended to show the Government’s commitment to Australia’s rapid economic development (47). In his energy policy statement in August, the Prime Minister claimed that the role of Government in the provision of infrastructure was vital to ensure that potential private sector development would not be held back and pointed out to the Parliament how the Commonwealth had encouraged the States to bring forward proposals for electricity projects. He noted that this had resulted in borrowings of $3 billion being approved under the
infrastructure program for schemes related to electricity
generation estimated to cost some $7.4 million and that the NSW
and Queensland Governments were seeking a further $4.4 billion
in borrowings for additional projects (48). The infrastructure
program had become an integral part of the election strategy
(49).

But with the election safely behind them, the Coalition became
more receptive to Treasury's views. The Fraser Government was
now able to return to its original priority of controlling
inflation and, in this context, was soon emphasising the
pressing need to restrain growth in the public sector to make
room for private sector development (50). Treasurer Howard
circulated the department's earlier submission on the
implications of the burgeoning infrastructure program to his
colleagues and, in March 1981, the Prime Minister wrote to the
Premiers expressing his concern about the size of the
infrastructure program, foreshadowing the need for action to
remedy the situation (51). Following the Commonwealth's review
of its own expenditure functions in April, the Government was
determined to ensure that the States also played their part in
the necessary restraint (52). This sounded the death knell for
the infrastructure program and, at a Loan Council meeting in
May 1981, the Treasury strategy for scaling down state
borrowing demands was spelt out (53). When the States were
unable or unwilling to take the required action, the
Commonwealth had no alternative but to force financial
restraint on all Loan Council borrowing in June (54).
B. *The Rationale Behind the Program*

The infrastructure program was conceived and developed within a totally orthodox policy making framework although the new financing guidelines were the outcome of political, rather than economic, factors. The policy was supported primarily by the development-minded "landed gentry" of Cabinet – the Prime Minister and his senior Country Party colleagues – and the State Premiers, against the opposition of both Treasurers Lynch and Howard and their department. The key roles in the policy making process were played by the Prime Minister and the West Australian Premier. This section identifies the major impetus behind the introduction of the infrastructure financing arrangements and the political rationale for the Commonwealth's acceptance of a diminution of its control over public sector borrowing at a time of overall expenditure restraint.

*The Support of the States*

The idea of an infrastructure program originated in Western Australia under the championship of Sir Charles Court, an indefatigable promoter of economic development. In opposition during 1973/74, he had constantly attacked the State Labor Government for not standing up to the Whitlam Government over its resource and foreign investment policies (55). In office, he led the States' condemnation of the Commonwealth's actions in the area, principally because its policies had caused a slowing of resource development in Australia (56). When the Coalition was returned to power federally, Court was determined
to see economic development pick up as soon as possible and
this, he felt, would require government financing to encourage
private foreign investment again (57).

He wanted extra financial assistance from the Commonwealth to
support major new public sector energy projects in his State,
some of which he soon obtained. In July 1977, he was granted a
special addition of $24 million over three years for the
conversion of the Kwinana power station to dual coal and oil
firing. The following year, a special permanent addition of
$18 million (to improve WA’s per capita share of the basic
program) was approved as well as a special temporary addition
of $48 million for electric power development at Muja (58).

But a looming problem remained — that of finding some $400
million to finance the Dampier-Perth pipeline, which was
essential for developing a domestic market for North West Shelf
gas and hence the economics of the project (59).

In addition, the Premier’s enthusiasm for changing the
Gentlemen’s agreement to permit States to finance these
expected huge demands for development infrastructure was
fuelled by the increased availability of large quantities of
loan funds overseas in 1975 and the revelation of the Labor
Government’s search for petrodollars. During the year, he
visited the United States and Japanese banking institutions to
canvas the possibilities for state authorities to borrow on
these markets. He became convinced that large sums of money
were available at interest rates well below those in domestic
markets and was determined that the States should gain access
to them (60).

Prior to the late seventies, the States had had little exposure to offshore funding but, as the statutory authorities' need for funds started to outstrip normal loan authorities from Loan Council, they began to explore alternatives. The larger authorities increasingly engaged in funding capital imports via extended payment agreements and trade credit arrangements (61) and the electricity authorities, in particular, became significant users of such financing techniques. But these devices were not adequate to meet their total financing needs and, following Connor's lead, the States and their authorities began to explore other avenues of obtaining direct access to overseas finance.

Although the guidelines finally accepted by Loan Council tried to limit off-shore borrowing by state authorities to exceptional circumstances, the Premiers saw access to overseas markets as the key to infrastructure financing. Their hopes were clear in their public pronouncements (62) and the immediate scramble for funds after the acceptance of the guidelines at the June 1978 Loan Council meeting. Queensland's Treasurer went to Tokyo, New York and London with a prospectus suggesting the need for some $1000 million over the next 20 years and the Western Australian Premier did a similar round talking of raising the same amount by 1979 (63). By the time Loan Council actually approved the first set of projects, the WA State Energy Commission accompanied by two senior WA Treasury officials were already seeking funds in Tokyo, Europe
and the USA (64).

The active support for the new program from all the States was understandable in the circumstances of financial restraint after 1975. The very favourable financial provisions made at the Premiers' Conference in the first half of the decade contributed to the apparently sound financial position for the States under the Coalition's "new federalism" policy. This, in fact, disguised a drastic decline in State capital funding between 1976 and 1980 from both grants and borrowings. The Fraser Government cut specific purpose payments and froze Loan Council borrowings and capital grants, which resulted in a squeeze on capital funds and left the States little room for financing large new demands for infrastructure capital (65).

So the States seized on the concept of a new category of borrowings as a way of increasing their access to funds for capital purposes without affecting the financing of the normal programs. Furthermore, provided the approved projects were economically viable, they would be self-sustaining in terms of earning enough income to pay interest and capital repayments.

The States saw the program providing new development infrastructure, with which they would be able to attract resource projects, at little cost to themselves in terms of their own budgets (66). In addition, these funds could be borrowed at lower cost overseas than domestically. To the States, the international market seemed to offer an untapped reservoir of development finance. All they needed to do was to convince the Commonwealth that demand for such financing was
essentially "market controlled" and therefore should be outside Loan Council's purview.

The Support of the Commonwealth

The key factor in the Federal Government's acceptance of the infrastructure program was the role played by the Prime Minister, ably supported by his department and Country Party colleagues. As we have seen, in the early years of discussions between the Commonwealth and the States, the impetus for change came from the Premiers, particularly those from Western Australia and Queensland. But, by 1977, Fraser began to see the political possibilities of such a program and became an enthusiastic convert, lobbying the States personally to accept the guidelines and submit projects for consideration. After November 1978, it was he, and not the Treasurer, who announced new developments and extolled the virtues of the program. One year later, he was pushing the States to put forward even more projects (67). The Prime Minister had taken over the development of the infrastructure program.

Fraser had continually espoused a "pro-development" philosophy. In his maiden speech in 1956, he pursued this theme claiming that "any sacrifice in the present would be well worthwhile" for Australia's future development. In his vision of the future, which included such schemes as damming the Urdd and Fitzroy rivers and building a national communications network, he showed no ideological bias against public sector involvement in development projects. In fact, he extolled the virtues of
the Snowy Mountains Scheme and Port of Portland project as good examples of the public sector's role in Australia's development (68).

In this same speech, he recognised the link between inflation and government spending but nevertheless opted for more of the latter to assist development. This linkage and what to do about it became the dilemma Fraser found himself in as Prime Minister in the second half of the seventies. While he accepted the Treasury's view of the importance of reducing the inflation rate for sustained economic growth, he also thought it was vital that the Government encourage private sector development (69). He increasingly saw Federal government policy as a trade-off between resisting inflation and encouraging development and, despite Treasury's advice, often opted for the latter. In his view, "what is economically most desirable has to be weighed in the balance against other goals and in some instances give way to them" (70).

This drive for economic growth was strongly supported by senior Ministers of the NCP, with whom Fraser shared a common ideology. They were less concerned with reducing public sector expenditure than ensuring the economy returned to a path of strong growth and frequently pursued these policies against the advice of the Treasurer and his economic advisers (71). The press release on the national energy program in 1979, reporting on the Commonwealth's invitation for new electricity projects under the infrastructure guidelines, was indicative of this "development push" outside Treasury. Despite the fact that the
borrowing program was the responsibility of the Treasurer, the invitation was put forward by the Deputy Prime Minister and Minister for Trade and Resources (Mr Anthony) and the Minister for National Development. The departments of these Ministers plus the Department of Industry and Commerce, headed by Lynch, became increasingly involved in promoting the benefits of resource development (72).

The potential role of the infrastructure program in Australia’s economic development ensured it of Cabinet’s enthusiastic support at the start of the so-called "resources boom" in the late seventies. Moreover, it offered the Commonwealth the opportunity to participate in decisions to allocate particular amounts to particular States for individual resource projects - a power it did not normally have. This made Loan Council, which the Commonwealth was able to control, a potential forum for coordinated decision-making on major infrastructure projects, increasing the ability of the Federal Government to influence the direction and speed of Australia’s economic development.

But this was not the only advantage that adoption of the infrastructure guidelines offered the Commonwealth. Firstly, by providing a major opportunity to cooperate with the States on a proposal of national significance, the borrowing arrangements were in line with the policy of "new federalism" proclaimed in September 1975 by the Coalition parties. This policy was intended to reverse the centralism of the Whitlam years, restore responsibility and accountability to the States
(mainly through tax sharing arrangements) and encourage a cooperative relationship between the two levels of government (73). The infrastructure program embodied all these goals and did so at no direct cost to the Federal budget.

Secondly, the proposal permitted the Commonwealth to restrict its budget deficit by cutting down on financial assistance to the States in areas in which it was more directly involved. In this way, the additional amounts made available to the States through the infrastructure program, none of which would be attributable to or raised by the Commonwealth, tended to be at least partly offset by cut-backs in normal Loan Council borrowings and associated capital grants to the States.

Thirdly, permitting state authorities to borrow overseas added to the total level of capital inflow at a time of weakness on the capital account. In 1978, the Commonwealth was committed to supporting the exchange rate through its own borrowing program and, under these circumstances, a steady, controlled level of state authority overseas borrowing could assist the balance of payments and ease the burden on the Federal Government.

The Commonwealth's decision to accept the new guidelines also reflected the reality of state authority borrowing practices, which increasingly involved financing techniques outside Loan Council control (see Appendix 1 for details). In the absence of the infrastructure arrangements, the Government feared that the States would make greater use of "off-program" funding over which it had no control at all. In fact, Court had already
started discussions about the possibility of building the Muja D power station under a leasing arrangement in which the Federal Treasury stood to lose considerable amounts of tax revenue in terms of depreciation allowances on an essentially publicly-owned utility (74). If the other States followed suit, not only did the Commonwealth stand to suffer a sizeable revenue loss but also loss of control over public sector overseas borrowing.

At least by agreeing to the infrastructure guidelines, the Federal Government temporarily removed a major motivation for such uncontrolled financial arrangements. In return for some relaxation over state borrowing arrangements, the Commonwealth retained the veto over all direct public sector overseas loans and obtained information about the amounts, purpose, terms and conditions and timing of all trade credit arrangements entered into by the States, although leasing continued to remain outside the ambit of the Loan Council. At the same time, the Commonwealth could claim a specific financial role in assisting Australia's economic development. So, in terms of short-term political gain, the Federal Government had backed a winner.

C. Implications for Economic Development

Analysis of the implications of overseas borrowing under the infrastructure program for the Australian economy is complicated by a number of factors. Firstly, the impact of the
foreign component of funds raised for such expenditure cannot be successfully isolated. Secondly, at this stage, projects funded under the infrastructure program have suffered extensive revision and delays in completion, following the downturn in world energy prices after 1982, and most are yet to start generating income to cover their costs. Thirdly, a comprehensive cost/benefit analysis of each of the twenty-odd projects which received overseas funds under the infrastructure program is simply beyond the scope of this paper (75).

A further complication arises because the infrastructure program itself was emasculated in the early 1980s before any of the projects were completed. The Commonwealth's refusal to accept additional projects and its attempts to reduce the potential borrowings of those already approved marked the end of the infrastructure program. Then in June 1982, the Loan Council decided to exempt the borrowings of major electricity authorities from program control under the Gentlemen's Agreement and this moved 14 of the 29 approved projects outside the infrastructure program along with the vast majority of the approved funds (76). Although this change meant that initially probably more (rather than less) funds would be borrowed by these authorities for their energy projects, the concept of a special category of borrowings to cover development infrastructure had disappeared.

Additional Resources

Nevertheless, as originally conceived, the infrastructure
program did increase the allocation of public funds to the resources sector of the economy. There was a rapid increase in planned public sector infrastructure during the late seventies, much of it financed through the Loan Council. By 1980, the infrastructure program alone covered approved projects involving total expenditure of almost $5000 million with projects covering similar amounts awaiting approval (77). As can been seen from Appendix X, these projects were heavily concentrated in electricity generation, which consumed the lion’s share of the funds raised under the program to 1982. This was contrary to initial expectations that the program would be dominated by expenditure on infrastructure to support the North West Shelf project. In fact, such funding was dwarfed by outlays on electricity projects.

With this concentration on energy resources, the infrastructure program’s potential contribution to Australia’s development prospects was and remains significant. For example, infrastructure borrowing for projects of particular relevance to the aluminium industry involved some $3100 million towards prospective total outlays of $7400 million (in 1981 prices) and the projected demand of the proposed aluminium smelters accounted for approximately 50% of the additional capacity provided by these projects (78). Financing of these projects was also assisted by sources of overseas funds which avoided Loan Council purview (79) but by June 1982, when the infrastructure program as a significant category of funding ceased to exist, actual borrowings by State and Commonwealth authorities amounted to $2058.5 million (80).
The provision or prospective provision of additional infrastructure by the public sector reduced the risks associated with the development of major private sector resource projects and encouraged mining companies to further expand their lists of development projects (81). In 1980, the Federal government claimed that some $29000 million in investment projects was in the "committed" or "final feasibility" stage - more than double the level of projected investment of a year before and almost five times the level anticipated in 1977 (82). By 1981, the figure had risen to $35 billion. Although a number of these "committed" projects were, in fact, mutually exclusive and many, like the proposed aluminium smelters, were extremely vulnerable to conditions in world markets, government expenditure on infrastructure was a determining factor in whether many of these projects proceeded (83).

Cost of Borrowing

However, raising these funds for development infrastructure was not without cost. The state authorities were faced with rising levels of fixed servicing payments on these loans, in the form of increased interest and amortization costs. In addition, the economics of borrowing offshore which had attracted state public borrowers in the first instance, have been eroded by exchange rate movements. As we have seen, one of the reasons the States wanted access to overseas markets was because international interest rates were considerably lower than
domestic rates. But to obtain these interest rate savings, the States increased their foreign currency exposure at a time when Australia moved to a floating exchange rate. Although steps were taken by some authorities to provide reserves to fund losses associated with adverse exchange rate movements (some funded on the basis of the interest rate saving made from borrowing offshore), full forward exchange cover was not a realistic option for long-term loans (84).

In the event, the marked weakness exhibited by the Australian dollar in 1985 exposed the inadequacy of these precautions. For example, Elcom faced "paper" losses of some $600 million on its overseas borrowings by mid 1985 while its estimated interest rate savings was only around $174 million (85). In fact, all the major state electricity authorities faced a similar situation in the mid-eighties where the original cost of borrowing offshore had been increased dramatically by movements in the exchange rate.

**Use of Additional Resources**

The costs associated with public sector borrowing abroad must be offset if Australia is to obtain a net benefit from borrowings under the infrastructure program. In relation to overseas funds, this would depend on the additional resources so provided being used productively to expand the income generating potential of the economy. However, in this regard, there are a number of areas for concern about the use made of infrastructure funding by the States.
Firstly, the Loan Council failed to become an efficient forum for the coordination of the public sector's provision of resource development infrastructure, which markedly reduced the productive potential of such investment. The weakness arose not only because of direct political pressures but also flowed from difficulties inherent in the assessment process itself, which failed to recognise the political realities of the federal system.

As we have seen, some projects were approved which had only limited potential for assisting economic development, despite a procedure requiring the prior examination and evaluation of each project by a working party of officials. In fact, Loan Council sometimes approved projects before officers had had an opportunity to assess them (for example, the Brisbane rail proposal) and sometimes against their advice after an evaluation had been made (for example, the Melbourne Trade Centre). In addition, the procedure was such that officers were forced to rely on information provided by the proponent government, which left primary responsibility for any cost/benefit analysis with the public authority concerned (86). Some States saw the assessment as "interference" in matters which should be their responsibility alone and consequently provided only minimal data on their proposals (87). Advice by officers on the merit of proposals tended to be couched in very general terms as it was extremely difficult for proposals put forward by one Government to be properly assessed by officials of other Governments. In fact, all States were wary of voting
against a proposal because of possible retaliation by others against their own proposals.

As a result, it was virtually impossible to make a judgment involving comparisons between States or even to establish a rational timetable for projects without appearing to favour some States over others. The infrastructure program therefore tended to develop on a "first-come first-served" basis, which encouraged States to put forward proposals simply to maintain a share of the funding. "Examination, discussion and voting... (were) ... guided by politics rather than assessed (economic) need (88)."

Another factor which operated against infrastructure funds being invested in a way which covered their "opportunity cost" to the public sector was the attitude of some States toward the program. The primary state requirement for a project was that it be "self-sustaining" i.e. earn enough income to pay interest and repay capital (89). In fact, many Premiers appear to have used the provision of infrastructure on concessional terms as a way of attracting new resource projects to their State. For example, the State Electricity Commission of Victoria (SECV) agreed to provide transmission facilities to the developers of the Portland aluminium smelter, with the assistance of the Victorian Government, at a substantial discount (90). According to a Federal Treasury estimate, this action could be worth some $15-20 million annually to the developer in the early years of the project (91) substantially reducing the benefits flowing to the community from the establishment of the smelter.
During the late seventies and early eighties, States competed with each other in offering such concessions to attract industry (92). This competition manifested itself particularly in electricity pricing where individual States offered very generous terms to attract energy intensive resource industries, such as aluminium smelters, to their own territories (93). A not untypical result was revealed by a government inquiry into the SECV in 1980, which found that the utility's tariff policy, particularly its concessions to large users, had resulted in its failure to generate sufficient funds for expansion (94).

Even the normal pricing practices of the state electricity commissions, which involved covering current operating costs and debt charges and providing for some internal financing of new capital expenditure, did not cover the full "opportunity cost" of the inputs of production. This, the Federal Treasury argues, does not facilitate the most efficient allocation of productive resources in the economy and, partly as a result, would not maximise the addition to real incomes in Australia from the exploitation of valuable natural resources (95).

A third factor mitigating against infrastructure funds being utilised to generate sufficient income to offset their cost was the problem of finding appropriate economic criteria for determining the economic viability of the public projects they financed. The majority of the infrastructure projects which involved electricity, gas and water, port and rail facilities, were tied to private sector, energy-based resource projects,
which had been encouraged by further rises in oil prices in the
late seventies. These private developments involved very long
lead times and very high levels of overseas borrowings to
finance them. So when the "resources boom" of 1980/81 turned to
a recession in 1982 and many of the potential resource projects
failed to materialise.

This situation left some State Governments heavily committed to
costly infrastructure which could no longer be used to fully
recoup outlays and interest liability. For example, because of
the downturn and oversupply in the aluminium industry, the
Portland transmission line (estimated to cost around $200
million in 1982) may well be limited to carrying only one
quarter of the smelter power it was designed to handle, which
would considerably reduce its revenue earning potential (96); the Dampier Parth pipeline project has required significant
financial concessions by the Federal Government to enable the
WA government to meet its commitments (97); and the electricity
industry generally has found itself with considerable
oversupply following its expansion at the end of the decade to
meet prospective sharp increases in demand, increases which
evaporated along with the resources boom (99).

In fact, during the period, the public sector took on much of
the risk associated with resource development, which had become
increasingly expensive and subject to the vagaries of world
markets - risk if the private sector had had to assume, would
have considerably reduced Australia's investment in the
resource sector in the early eighties. Until the long lead
times are passed and market conditions enable viable projects to generate income, the States will be faced with continued energy surpluses from their investments. Yet their interest commitments on the money borrowed to finance this infrastructure must be met now. This situation is placing considerable strain on the revenue generating potential of these authorities and putting pressure on State Governments to provide additional finance from public moneys to assist them.

This dilemma is illustrated by the findings of a recent cost-benefit analysis of the North West Shelf gas project, which projected that the impact of the supply of natural gas on the SECGWA was likely to be negative. Although the study concluded that the net national benefits would be positive, providing a "social" rate of return for the project well in excess of 10%, SECGWA itself would face a net cost equivalent of $25 million per annum between 1984 and 2004 (9%).

All these factors suggest that, in the short term, public overseas borrowing for infrastructure is not generating sufficient funds to cover its servicing costs. However, in the longer term, net benefits to the Australian community would depend on whether sufficient income-generating projects were attracted by the provision of this additional infrastructure and whether such projects are required to provide an appropriate return on the public sector's capital through realistic public utility charges for railway services, electricity, water supply, port facilities and roads as well as the payments of appropriate royalties or other taxes. Given
current trends in world energy prices, there is cause for concern.

D. The impact on Overseas Borrowing Policy

The infrastructure program changed Australian overseas borrowing practice by removing the Federal Government's monopoly over offshore markets. However, the guidelines ensured a relatively orderly approach to international markets and, to date, there have been no signs of detrimental competition between Governments for funds. In fact, permitting state authorities to borrow offshore temporarily enhanced the role of the Loan Council, which administered the new guidelines, and demonstrated the political efficacy of including the States in resource policy decisions. However, the rapid growth in the program and the magnitude of the funds being borrowed offshore by state authorities has significant implications for Commonwealth overseas borrowing in the future.

Policy Making Process

The infrastructure guidelines provided the first major opportunity for the States to access international markets for new money raisings since the late twenties, when the depression put an end to their chaotic and competitive overseas borrowing programs. However, in agreeing to some relaxation in its control in 1978, the Commonwealth was cognisant of the need to avoid any repetition of harmful competition between various
public sector borrowers as this would have undermined the concept and purpose of both the Financial and Gentlemen's Agreements. To do this, the Commonwealth retained the right of veto over all authorities' approaches to overseas markets, firstly, to raise a loan and, secondly, over the terms and conditions of any approved loan. In 1990, additional guidelines limited States to borrowing 25% of their approved infrastructure program overseas in the first half of the financial year, with a general overall limit of 50% annually (100). Moreover, the States were excluded from public markets and restricted in the kind of security they could issue (101) to further minimise any detrimental impact on the Commonwealth's borrowing status.

Although many of the original restrictions have now been relaxed, public sector overseas borrowing has remained relatively controlled and orderly with no signs of damaging competition between borrowers. Governments have generally adhered to the guidelines and followed the agreed loan raising procedures. All approved infrastructure funds borrowed in international markets during this period have been raised in a totally orthodox manner.

The new guidelines temporarily enhanced the role of the Australian Loan Council as it became responsible for evaluating and approving individual projects put forward by its members as well as overseeing all subsequent loans raised. Although the Commonwealth held a veto over these functions, it seemed loath to use it in the early years of the program.
Consequently, the Loan Council approved almost every project put forward by its members and their authorities were able to borrow the majority of the funds offshore (see Table 1). It was not until the early eighties that the Commonwealth exercised its veto to halt the growth in the infrastructure program and to limit the amount of approved funds borrowed offshore.

But when the state authorities found they were unable to raise sufficient funds through the infrastructure program, they again turned to finance arrangements which were not subject to Loan Council purview. This subsequent growth in "off-program" funding soon overhauled the new status of the Loan Council and, as a result, its enhancement as an economic institution affecting Australian government capital markets in the late seventies was shortlived.

In fact, state borrowing overseas outside Loan Council’s purview, or unconventional borrowing, became the subject of increasing concern in the Federal Treasury as the states continued to borrow significant sums in direct contravention of Commonwealth attempts to reduce the level of borrowing by the public sector (102). The techniques utilised included sale and lease-back transactions, leveraged and financial leases and deferred payment arrangements, most of which involved overseas financing. By the early eighties, only around 50% of funds raised by Governments and their authorities were subject to Loan Council approval and, by 1983/4, this had fallen to about one quarter (103). Consequently, as part of the 1982 arrangements freeing electricity authorities from borrowing
<table>
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<th>YEARS</th>
<th>PROPOSED PROJECTS</th>
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<th>TOTAL FUNDS BORROWED $m</th>
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<td>-</td>
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Source: Budget Paper No. 7 various years and press releases.
controls, the Loan Council was provided with information for
the first time about all "off-program" financing (instead of
only trade credits) in an attempt to assess the problem and
bring it back under Loan Council purview. Since then, an
agreed global limit on state authority borrowing has included
all such unconventional borrowing.

One other effect the infrastructure program had on the policy
making process was to demonstrate the political efficacy of
including the States in decisions covering mineral policy, even
those involving loans. Between 1972 and 1975, the Labor
Government found it was unable to get much of its national
resources program underway because of the State's opposition to
its centralist approach. The "loans affair" was partly a
reaction to this situation and highlighted the immense
difficulties facing a Federal Government which chose to borrow
funds to "finance either the nationalisation of mineral
resource industries or the launching of new resource
developments, since such initiatives would certainly be opposed
by most of the States" (104).

By contrast, the Coalition Government chose to work with the
States to implement its mineral policies and, through them, was
able to raise much of the finance it considered was needed to
launch the so-called "resources boom". Nevertheless,
Australia's resource development remained essentially state
(and private sector) business. Although the Federal Government
may have modified state development plans at the margin, it
saved no real control over resource development through the
infrastructure program. So, although this tactic proved far more successful in terms of achieving limited Federal resource policy goals than Connor’s loan attempt, it did not provide an answer for a more interventionist Government (like Labor) seeking direct federal participation in the development of the nation’s resources.

The Borrowing Program

The Commonwealth’s overseas borrowing program was initially unaffected by the increased activity of the state authorities offshore. Although the borrowings of the latter added directly to the money supply and were treated like private capital inflow for balance of payments purposes, the amounts involved were relatively small and did not add unduly to the domestic money supply or otherwise conflict with national economic objectives. In fact, they made a valuable contribution to Australia’s relatively weak capital account in 1978/79 and early 1979/80.

However, by the early eighties, borrowing under the infrastructure program was becoming more significant. The actual amounts borrowed by state authorities (105) are set out in Appendix XI for the years 1978/79 to 1981/82. Of the total funds borrowed by the States under the infrastructure guidelines, some 64% of the moneys raised were from international markets. The largest borrowers were the three biggest States, which together raised more than 80% of the infrastructure funds. South Australia raised the least and
only 24% of this was borrowed overseas.

There was considerable variation in the amounts raised offshore over these years between different States. For example, NSW's program varied from being entirely raised overseas in 1978/79 to only 16% being borrowed there two years later. Victoria, on the other hand, consistently raised more than 50% of its program offshore as did the late starters, Western Australia and Queensland. Overall, the level of funding in international markets also fluctuated from very high levels during the first two years of the program to a low of less than 40% in 1980/81 before returning to 67% the following year. These changes partly reflected variations in Australia's external situation. Private capital inflow recovered strongly in 1980/81, putting pressure on the monetary aggregates; so the Commonwealth was reluctant to grant state authorities excessive recourse to overseas markets, which would have exacerbated the situation under the pegged exchange rate system. On the other hand in February 1982, Loan Council's relaxation of the offshore borrowing limits reflected the Commonwealth's reaction to a weaker than expected trend on the external account (108).

Total borrowings overseas under the infrastructure program to 1981/82 are summarised in Table 2. During the first four years, the States borrowed some $1238 million overseas although less than 40% of this amount had been borrowed by the end of the decade. Although these were relatively modest overseas borrowings for the late seventies and early eighties, they were not without significance in terms of total Commonwealth

<table>
<thead>
<tr>
<th>YEAR</th>
<th>NSW</th>
<th>VIC</th>
<th>QLD</th>
<th>SA</th>
<th>WA</th>
<th>TAS</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978/79</td>
<td>79.0</td>
<td>45.0</td>
<td>19.0</td>
<td>143.0</td>
<td></td>
<td></td>
<td>365.6</td>
</tr>
<tr>
<td>1979/80</td>
<td>103.0</td>
<td>100.0</td>
<td>84.0</td>
<td>15.3</td>
<td>20.0</td>
<td>322.3</td>
<td></td>
</tr>
<tr>
<td>1980/81</td>
<td>32.0</td>
<td>87.0</td>
<td>70.0</td>
<td>30.2</td>
<td>12.9</td>
<td>232.1</td>
<td></td>
</tr>
<tr>
<td>1981/82</td>
<td>151.6</td>
<td>120.2</td>
<td>134.5</td>
<td>20.0</td>
<td>71.8</td>
<td>42.5</td>
<td>540.6</td>
</tr>
<tr>
<td>TOTAL</td>
<td>365.6</td>
<td>352.2</td>
<td>288.5</td>
<td>20.0</td>
<td>117.3</td>
<td>94.4</td>
<td>1238.0</td>
</tr>
<tr>
<td>PERCENTAGE</td>
<td>29.5</td>
<td>28.5</td>
<td>23.3</td>
<td>1.6</td>
<td>9.5</td>
<td>7.6</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Budget Paper No 71982/3 p37
overseas borrowing during this period. As Table 3 shows, except in 1978/79 when the Commonwealth was involved in large-scale loan raising abroad for balance of payments purposes, State overseas borrowing under the infrastructure program was the equivalent of more than 60% of gross Commonwealth raisings and, in one year, exceeded them by around one third.

These trends in overseas borrowing under the infrastructure program heralded a rapid increase in loans raised offshore by public authorities in the years to follow. By June 1980, the gross external debt of public non-monetary enterprises was approximately $1439 million, of which almost 33% had been contributed by infrastructure borrowings. Two years later, the outstanding debt of these authorities had risen to $3050 million, of which total infrastructure borrowings accounted for more than 40% (107). This increase is even more pronounced over a longer period. Between 1977/78 and 1979/80, the level of outstanding external debt by public non-monetary enterprises rose two and a half times from $579 million to $1439 million. But over the following five years, this outstanding debt rose more than seven-fold to $13.4 billion. So although the explosive growth of infrastructure borrowing per se had been checked by the early eighties, the level of approved infrastructure borrowings continued to permit significant state offshore loan raising and will continue to do so until at least the end of the decade. Hence the Commonwealth must take state authorities' borrowings into account when determining the level of its own program in the light of its external, monetary and
TABLE 3: TOTAL OVERSEAS BORROWINGS BY STATE AUTHORITIES UNDER THE INFRASTRUCTURE PROGRAM AS A PERCENTAGE OF TOTAL COMMONWEALTH BORROWING 1978/79 - 81/82 ($Am)

<table>
<thead>
<tr>
<th>YEAR</th>
<th>GROSS COMMONWEALTH (1)</th>
<th>GROSS STATE INFRASTRUCTURE (2)</th>
<th>(2) AS A PERCENTAGE OF (1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978/79</td>
<td>1557.1</td>
<td>143.0</td>
<td>9</td>
</tr>
<tr>
<td>1979/80</td>
<td>471.3</td>
<td>322.3</td>
<td>68</td>
</tr>
<tr>
<td>1980/81</td>
<td>173.1</td>
<td>232.1</td>
<td>134</td>
</tr>
<tr>
<td>1981/82</td>
<td>919.0</td>
<td>540.6</td>
<td>59</td>
</tr>
</tbody>
</table>

Source: Budget Papers No 7 & 8 various years.
fiscal policies at the time as well as the implications of the resulting levels of public external debt.

Although interest and principal repayments are the responsibility of the state authorities concerned, unless these loans are rolled over or the resulting infrastructure generates sufficient foreign exchange to cover the necessary outflows, the foreign currency impact of the repayments have to be considered by the Federal Government. Semi-government authorities face very large refinancing tasks over the next few years with $1-1.5 billion maturing annually as most borrowing has been done with four year maturities. In the absence of an increased private capital inflow, the Commonwealth may have to cover the foreign currency impact by borrowing money itself overseas to avoid unwanted exchange rate implications.

The Commonwealth also has ultimate responsibility for all government-backed borrowers and the debts they incur. Given the early pricing policies used by the state authorities to cover the cost of infrastructure they financed with overseas loans, the magnitude of the borrowings undertaken and their consequent exposure to exchange rate loss, some state authorities may not be able to generate sufficient revenues to meet all offshore debt repayments, particularly if the anticipated demand for Australia's energy resources continues to fail to materialise. If this situation placed sufficient pressure on state finances, the Commonwealth itself may be forced to take over the repayment of some authorities' overseas debt, which would involve the Federal Government in further overseas loan raising
to cover overseas maturities as they fell due.

So despite the demise of the infrastructure program, the overseas fund raising activities of semi-government authorities will continue to have significant implications for the level and timing of the Commonwealth's overseas borrowing program and the management of Australia's external debt for the foreseeable future.
The general way in which overseas borrowing policy is formulated and the major influences on Commonwealth decisions about public sector loan raising overseas in the seventies has been discussed in the preceding chapters. This chapter draws together this work to highlight the politicization of the policy making process (ie. the increasing inseparability of economic and political variables) during this period and to examine the effectiveness of the decisions taken in terms of the Commonwealth Government’s policy objectives at the time. The final section discusses some of the implications for the Australian economy flowing from these developments in government overseas borrowing policy.

**Politicization of the Policy Making Process**

Compared with the rest of the post-war period, the major Commonwealth decisions about public external borrowing during this decade generally owed more to political influences than economic considerations. Even the Coalition’s balance of payments borrowing program, which was developed and supported by the Government’s economic advisers in the Treasury, was strongly influenced by non-economic considerations.

The situation facing Australia’s external accounts after 1975 required some corrective action and the preferred option of the Treasurer and the Treasury was that the Government borrow...
extensively overseas to support the capital account until private capital inflow resumed its former levels. This preference reflected the strong anti-inflationary stance of the economic advisers, who judged that an adjustment to the exchange rate was both avoidable and undesirable. An overseas borrowing program would enable the exchange rate to be maintained at a level where, in the short run, it could contribute to the anti-inflation objective.

But despite this economic support, the overseas borrowing option was not chosen in late 1976 primarily because of non-economic considerations. The Coalition’s decision to abandon the Treasury strategy and devalue the Australian dollar was strongly influenced by the hostile political environment for large-scale government overseas loan raising and by its own electoral mandate as a better economic manager.

By the following year this situation had changed. The Opposition’s support for the overseas borrowing option significantly reduced any potential electoral liability attached to this course of action and, coupled with the apparent ineffectiveness of the 1976 devaluation, the Coalition had little option but to accept the advice of its economic experts. Economic considerations had resumed the dominant role in determining Commonwealth overseas borrowing policy.

The objectives of the other two major borrowing initiatives during the decade were overtly political. Despite the ideological gulf between them, both the Connor loan and the
infrastructure program effectively reallocated resources to the public sector in an attempt to fulfill each Government's perceived electoral mandate. The rationale for the Connor loan was the political objective of increasing Australian ownership of the nation's mineral resources, a policy which had strong support within the electorate at that time. The major rationale for the infrastructure program was the political search for improved economic growth without resorting to stimulatory domestic policies. In 1975, Fraser had promised the electorate that his Government would cut back public spending and the Commonwealth budget deficit and return the economy to the path of strong, non-inflationary growth from which it had strayed under Labor. The infrastructure program was part of this strategy.

Both schemes were opposed by the Government's principal economic advisers largely because the Treasury was philosophically opposed to an enhanced role for the public sector in Australia's economic development. Although the department's attitude toward the Connor loan was hardened by the unorthodox approach to overseas loan raising taken by Labor in 1974, the economic advisers considered that potential long-term benefits from either scheme would be outweighed by the adverse effects on the economy through increased inflationary pressures and reduced efficiency. However, this advice was disregarded by both Governments because wider political goals were judged to be more important.

The dominance of political considerations can also be seen in
the way each of these overseas borrowing initiatives was developed. Under Labor, the petrodollar loan was pursued by a Minister outside the Treasury portfolio with the full support of the Prime Minister and a few of his Cabinet colleagues. Treasury, the department responsible for Commonwealth loan raising, was excluded from the process. Although this was not the case with the infrastructure program, the Prime Minister did become the driving force behind the scheme and overrode strong opposition from the Treasurer and his department.

Furthermore, political factors played a dominant role in determining policy outcomes. The political environment, including the interests of the States, strongly favoured the implementation of the infrastructure program. This effectively left the Treasury and the Treasurer isolated and unable to dissuade the Coalition from its course until after the end of the decade. In terms of the Connor loan, although Treasury was again virtually alone in its opposition to the decision, it had strong political support outside the Labor Cabinet once the proposal became public. The hostile political environment then turned an indiscretion into a political nightmare.

Assessment of the Outcome

The Commonwealth's long-standing policy that Australia should, within the constraint of overall external viability, be a net importer of goods and services to supplement domestic resources, has provided the potential for a faster rate of economic development than would otherwise have been possible.
In the post-war period to 1970, the flow of foreign investment had tended to be in the form of equity rather than loans and the overseas resources had generally been used to finance higher levels of capital expenditure. Australia was thus able to sustain almost continuous current account deficits with the Commonwealth doing little more than ensuring a stable, profitable environment for private foreign investment in the sixties.

But in the seventies the magnitude and composition of capital inflow changed. This considerably weakened the efficacy of this strategy and led to the Commonwealth's decision to temporarily supplement private capital inflow and support the balance of payments through extensive public borrowing overseas. Such a policy was entirely appropriate for a capital importing nation like Australia with very low levels of outstanding debt and strong export potential. As we have seen, this borrowing policy meant that the Government was able to correct the external imbalance without resorting to more restrictive domestic policies or inefficient trade distorting policies such as import quotas. From both an economic and political point of view, the 1977-79 borrowing program was both efficient and efficacious.

However, the Commonwealth's use of overseas borrowing to directly enhance the prospects for economic growth had a more chequered career. The Connor loan was a disaster from a political viewpoint as not only was no money raised for the original purpose of "creating a strong, prosperous Australia,"
which owned its own resources" but the political furor surrounding the loan raising attempt was a key factor contributing to the Whitlam Government's demise. From an economic viewpoint, the policy was a high risk option even without any funds being raised. Although in the absence of a successful loan there was no direct economic impact, the "loans affair" itself became a significant non-economic factor in public overseas borrowing, influencing the timing of the Coalition's balance of payments borrowing program and encouraging the States' search for additional offshore capital.

The economic success (or otherwise) of the infrastructure program remains in doubt at this stage although it appears that, for the most part, public overseas borrowing for resource infrastructure developed in the early eighties is not yet generating sufficient funds to cover servicing costs. Given current trends in mineral commodity prices, the medium term outlook is also clouded.

But at the political level the infrastructure program was very effective as part of the Coalition's successful "resources boom" election strategy in 1980. The program helped provide a stimulus to economic growth (directly through increasing public expenditure and indirectly through encouraging additional private sector resource projects) while permitting the Commonwealth to "cut back" government spending. Moreover, it was billed as a major success in terms of cooperative federalism. In this way, the program assisted the Government to fulfill various electoral commitments and win office again
in 1980.

To achieve this, the Commonwealth had to cede control of overseas borrowing, a sphere of economic policy which it had dominated since the depression. The States once again gained direct access to international markets, the Commonwealth's monopoly in the area was broken and its ability to determine the size and direction of the public sector's overseas borrowing program severely weakened. The longer term consequences of this in terms of increasing publicly guaranteed overseas debt are discussed in the following section.

*Implications for the Future*

There was more than a fourfold increase in Commonwealth loan raising abroad between 1970 and 1980 and, although this meant a relatively insignificant increase in the proportion of GDP represented by public external debt over the decade as a whole, the rapidly rising trend in government overseas borrowing established in the late seventies continued and escalated in the following decade. This was encouraged by changes in attitude by both federal parties, but particularly by Labor, towards government loan raising overseas and the impetus this change provided to the States.

*Policies of the Federal Parties*

Coalition policy on overseas borrowing by the public sector was
marked by two major changes. Up until 1977, the conservative parties had supported an active but modest Commonwealth overseas borrowing program since they assumed office in 1950. But international economic conditions in the mid-seventies forced the Coalition to break with past practice when it found that the traditional support role played by public capital inflow was no longer appropriate and decided to utilize large-scale overseas borrowing to help finance the current account deficit. Secondly, the fairly consistent view on the Commonwealth's part dating from the thirties, that the Federal Government should virtually be the sole government borrower overseas, was abandoned in 1978 when the Coalition agreed to allow state semi-government authorities direct access to overseas markets. These two policy initiatives by the conservative parties increased loan raising on international markets not only by the Commonwealth but also by the States and their authorities.

The adoption of these changes was facilitated by the Federal Labor Party, which finally abandoned its traditional opposition to government overseas borrowing - during the seventies, Labor gradually stopped considering such action as a policy of "last resort". As we have seen, the aftermath of imprudent government loan raising in the twenties led Federal Labor to reject borrowing abroad as a policy option except in very special circumstances. As a consequence, when in office during the forties, Labor repaid overseas loans in an effort to reduce the Commonwealth's external debt burden. This attitude was still apparent in the fifties and sixties and lingered in a
reluctance to borrow overseas by most of the Whitlam Government between 1972 and 1975.

Connor cast all this aside and, in December 1975 when the Coalition was returned to power, Labor's defeat was again closely tied to imprudent loan raising activities in international markets. But this time there was no rejection of the overseas borrowing option by the federal party. In 1976 when the Commonwealth was reluctant to continue its loan raising activities, Labor publicly urged the Coalition to borrow offshore and criticised its failure to do so. The Labor Opposition, in fact, gave general support to the Coalition Government's 1977-79 borrowing program (although not without trying to gain political mileage out of the rising level of Australia's overseas debt) and it fully endorsed the new infrastructure financing arrangements.

As a result of these changes in attitude, overseas borrowing to supplement the balance of payments and provide additional funds for development became an acceptable policy option for all Australian Governments. This bipartisan approach to government loan raising overseas removed the political brakes of the past, which by 1975 had resulted in Australia's lowest level of international debt for 50 years.

impetus_to_the_States

The States had generally been keen overseas borrowers, frequently pushing the Commonwealth to raise more funds from
international markets. But the second half of the seventies saw
renewed pressure for direct access to such funds, partly
because of the increasing demands being placed on the States in
terms of development infrastructure, coupled with the financial
restraint enforced by the Commonwealth on capital funds and the
more favourable international borrowing climate.

However, the Labor Government's attempt to by-pass the overseas
borrowing requirements of the Loan Council in 1974/75 also
played a role in the States' scramble for overseas funds at
this time. Firstly, the episode confirmed their worst fears
about conceding regulation of state loan requirements to the
Commonwealth as the Connor loan would have meant significantly
increased federal control over State development policy. This
increased the determination of the States, particularly
resource-rich Queensland and W.A., to access overseas markets
for themselves. Hence the impetus behind the infrastructure
program. Secondly, the attempt by Whitlam's "kitchen" cabinet
to avoid normal Loan Council procedures for the proposed
petrodollar loan encouraged the States and their authorities to
seek access to overseas markets by similarly unconventional
means.

These activities weakened compliance with the intent of the
Financial and Gentlemen's Agreements, which was reflected in
the rapidly rising level of unconventional or "off-program"
funding by state authorities. The consequent decline in Loan
Council control over total government borrowing also reflected
the Commonwealth's compliance in and responsibility for the
public sector's increased use of overseas funds during the period.

**Beyond the Seventies**

As a result of these policy initiatives and changes in attitude, public capital inflow increased sharply toward the end of the decade. By the following decade, these developments had contributed to the rapid accumulation of public and publicly guaranteed debt. Commonwealth debt more than doubled from around $5.7 billion or 4.9% of GDP in 1980 to around $12.9 billion or 6.2% of GDP by 1985 (1). But more significantly, over the same period, overseas borrowings of public trading and other financial enterprises rose even more rapidly. The outstanding debt of these public authorities increased almost ten-fold from around $1.4 billion in 1980 (1.2% of GDP) to $15.4 billion or 7.3% of GDP in 1985.

This upsurge in public sector borrowing overseas saw the level of total public external debt rise from $7.1 billion (6% of GDP) in 1980 to $28.3 billion (13.5% of GDP) in 1985. As a consequence, the public sector's servicing payments on external debt have also risen substantially during the eighties so that in 1985 public interest payments alone represented 9.2% of Australia's exports of goods and services.

But despite this rapid growth, Australia's sovereign borrowings remain relatively moderate particularly when the Commonwealth's official reserve assets are taken into account. In 1985,
Australia's overseas reserves stood at $13.5 billion, more than enough to cover all outstanding Commonwealth external debt. Although comprehensive data is not available, it appears that a number of other debtor OECD countries (including Canada, Sweden, Denmark and New Zealand) have larger public sector debt levels than Australia (2).

In fact, although Australia's overseas debt has risen very sharply in the eighties, it is clear that the bulk of the increase has been incurred by the private sector (see Graph 6). As at June 1985, gross external debt outstanding was $68.7 billion of which $40.4 billion or 59% was owed by the private sector. In net terms, the private sector's share was 66 per cent (3).

Nevertheless, even though the growth in private sector borrowing has far outstripped that of the public sector, the trend in public and publicly guaranteed debt is a cause for concern. This is not simply because all government overseas borrowing adds directly to Australia's fixed interest bearing debt, which must be serviced irrespective of the overall state of the economy and the productiveness or otherwise of the resulting investment. More significantly, decisions involving public sector overseas borrowing are particularly susceptible to non-economic criteria and, for this reason, the likelihood that the additional resources provided to the economy in this way will add sufficiently to the productive capacity to cover the resulting debt obligations is severely reduced. Even with public enterprises following increasingly commercial criteria,
GRAPH 6

AUSTRALIA'S EXTERNAL DEBT

NET DEBT

[Bar chart showing the external debt of Australia, categorized by Commonwealth (CWEALTH), PNME, and PRIVATE sectors, from 1970 to 1985.]
returns on public investment have generally remained long-term and low. This has been exacerbated by the downturn in the early eighties in the resources sector, which much large-scale infrastructure was designed to service. Many of these public sector projects continued, despite falling private sector demand for them, further reducing the likelihood that expected returns will be able to service the interest rates on the funds borrowed to construct this infrastructure (4).

Furthermore, the increase in Australia's public foreign liabilities has been associated with historically large public sector borrowing requirements, which include not only an enlarged Commonwealth budget deficit but also rising levels of state government and semi-government authority debt. Consistently high levels of public borrowing to finance these deficits have forced up domestic interest rates to such an extent that the private sector has been partly "crowded out" of the local market choosing instead to borrow cheaper funds in international markets (5).

But in the final analysis, it is a country's capacity to service the debt that is important irrespective of which sector has borrowed the funds. Based on present evidence, there are grounds for concern about the degree to which the additional overseas resources have been used to increase the economy's productive capacity and create the means to meet future debt payments. National accounts data suggest that the additional real resources made available through the current account deficit are no longer being used to finance higher levels of
investment at given levels of consumption. Instead, the investment share of national income has been consistently lower than in the period up to the early 1970s and there is a clear upward trend in consumption (caused in the main by higher government consumption) with no decline in foreign savings. So while Australia's foreign liabilities continues to grow rapidly, the capacity to service those obligations, as reflected in the rate of investment, has been in relative decline (6).

To cover and reduce Australia's high debt servicing burden, there needs to be a major expansion of export earnings. However, over the past decade, the country's trading performance has been relatively poor. For example the international purchasing power of Australia's largely commodity-based exports, by comparison with other major trading nations, has fallen in the decade to 1985 and the decline in our terms of trade has escalated dramatically over the past year or so. More importantly, the export outlook for the rest of the eighties is very uncertain with international commodity prices remaining weak, subsidised competition rising and growing protectionist pressures limiting access not only to new but traditional markets (7).

Moreover, despite the poor outlook for Australia's major exports, the demand for imports can be expected to remain strong as long as the economy continues to grow. This is largely because of the rundown in Australia's manufacturing sector and the economy's consequent reliance on imported
capital goods. In this situation, Australia’s historically large current account deficits could remain for some considerable time and external indebtedness would continue to increase.

In fact, many of the trends present in the twenties have reappeared in Australia’s external situation in the eighties— a balance of payments increasingly dependent on capital inflow, a rising level of potentially unproductive government overseas borrowing and large increases in fixed overseas capital obligations, accompanied by a potentially deflationary situation for our major exports and a slowing in the economy’s capacity to generate the means of servicing a growing external debt. Developments in public overseas borrowing during the seventies, particularly the marked expansion of external borrowing by public enterprises as a result of successive relaxation in Loan Council constraints since 1978, have contributed markedly to this situation. The politicization of Commonwealth overseas borrowing policy does not appear to have enhanced Australia’s economic outlook.
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27. Gilbert, Loan_Council... op.cit., p188, 190-1.

28. Ibid., p171.

29. Ibid., p269.

30. Ibid., p271 and Budget Paper No 6, "Government Securities on Issue" (GSOI), various years.


32. Butlin, Barnard & Fincus, op.cit., p34 Table 2.3.


35. Gilbert, Loan_Council... op.cit., p130-32.

36. The Lang Government flatly rejected both proposals arguing instead that all domestic debt be refinanced at a 3% interest rate and that payments of all overseas interest be suspended.
until foreign bondholders agreed to convert Australian overseas debt to similar rates of interest. Accordingly, in March, Lang refused to meet NSW's share of overseas interest obligations and the Commonwealth was forced to arrange payment.

37. see Gibson's statements at the Senate hearings in May 1931, CPD V129 p1615-32.

38. For example, in July 1930, the Senate successfully referred the Central Reserve Bank Bill to a select committee thus defeating Labor's attempt to create a central reserve bank, CPD V123 p1334 & V125 p3945-57,3966.

39. CPD V128 1931 p300.


41. Whittington, op_cit, p76.

42. For example, during the 1946/7 budget debate, Scullin referred to the "wild" borrowing policies in operation when he became Prime Minister in 1929 which, he said, had ruined Australia's credit. He commended Chifley's success in reducing international debt. Similar sentiments were echoed by other government members throughout the period, see budget speeches in 1943/44 & 1944/45, CPD V187 p2449-50, 12.7.46 & V198 p234-8 8.7.48 as well as CPD V198 p536 10.7.48, p755 22.9.48 & p843 25.9.48; V202 p234-5 26.5.49; & V204 p275 15.3.49.

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64. Ibid , p277 and Budget papers, various years.

65. Gilbert makes this point based on IISU criteria and a decline in Australia's propensity to import, Loan_Council op_cit, p280-1.

66. Interim Report of the Committee of Inquiry, op_cit, p76-78 and TEP No9, op_cit, p178.

67. see CPD V9 p1903 26.10.55, V13 p1108 3.10.56, V34 p505 7.3.62, V50 p37 8.3.66 and V59 p1467 15.5.68.

68. Gilbert, Loan_Council op_cit, p278.

69. CPD V206 p7 22.2.50.

70. For example, in 1956 the Treasurer pointed out that the limited supply of funds and the extremely keen competition for them meant that, despite Australia's high credit rating, the Commonwealth's access to overseas finance was severely restricted - see CPD V12 p82 30.8.56, V217 p37-8 6.5.52 and V25 p2472 10.11.59.

71. For example, CPD V12 p137 1956, Prime Minister Menzies

72. As early as 1963, Deputy Prime Minister McEwen pointed out that Australians were living beyond their means by "selling a bit of our heritage every year" and claimed not to support unlimited or indiscriminate capital inflow - Victorian Country Party Conference, April 1963 and CPD V37 p180-2 15.8.63.

73. CPD V47 p1081-6 21.9.65.

74. For example, it established the Australian Resources Development Bank in 1967 to mobilise blocs of domestic capital and, in 1970, the Australian Industry Development Corporation to raise foreign debenture capital to be on-lent to Australian firms. These institutions and the 1969 guidelines on capital dilution plus a variety of ad hoc measures (such as government action to block takeovers of Australian businesses in 1966, 1968 and 1970) were the first signs of a national Coalition policy on foreign investment in Australia.

75. See Evatt's comments in Sydney_Morning_Herald 27.11.53, CPD V6 p617 11.5.55 and V14 p470 3.4.57.

76. For example, CPD V210 p1267 24.10.50, V219 p1797 19.9.52, V6 p644-45 11.5.55, V7 p455 7.9.55, V14 p712-13 10.4.57.

77. CPD V24 p969 15.9.59.

78. CPD V52 p326 23.8.66 and V54 p435 7.3.67.

79. CPD V57 p2788 8.11.67, V59 p1840-1 30.5.68 and V62 p413, 424 5.3.69.

NOTES CHAPTER 2


2. TEP No.1, op. cit, p57-61.

3. Net apparent capital inflow consists of investment in Australian enterprises, government capital movements, Australian investment abroad, short-term trade credit between enterprises in Australia and unrelated enterprises abroad and non-official monetary sector transactions.

4. Balance of payments data suffer from a number of deficiencies such as time lags in collection and processing, inappropriate or insufficient coverage and incorrect valuation and timing.
Consequently the data is subject to frequent and often quite significant revision. Nevertheless, historical series do provide broad indications of trends in the balance of payments. For further discussion see ABE, "Balance of Payments Australia - Concepts, Sources and Methods", Canberra, 1981 particularly pp7-8.


15. For example, 1974-77 was the period of heaviest borrowing in Canada's history to that time and her international debt increased by more than $20 billion. Italy, France, Britain and Japan were also large-scale OECD borrowers. See J. Wilczynski, "East-West Banking and Finance and their Relevance to Australian and Canadian Interests", *Institute of Soviet & East European Studies* Working Paper No.9, Carleton University, Ottawa Feb 1978, p36; IMF, Annual Report 1973/74 pp14-15; and L.G. Franko and M.J. Seiber (eds), *Developing Country Debt*, Pergamon Press Inc, USA 1979 p19.


28. The IMF's role was modest partly because borrowers preferred to obtain funds without the economic restraints imposed by the Fund and partly because the resources of the IMF were simply not up to the task. RBA, Annual Report 1975/76 and Indec's, State of Play, An Indec's Economic Special Report, George Allen and Unwin, Sydney, 1980 p48.
32. Laulan, op cit, p104.
33. Up until 1944, this was done by resolution of Loan Council (before being formalised in a new clause under a Federal Labor Government). In addition, the Commonwealth acts as its major borrowing agent and the Federal Treasury acts as the Council's secretariat. The voting rules mean that the agreement of only two states is normally needed to provide the Commonwealth with the simple majority necessary to gain approval for its proposals, and the exclusion of the federal government's defence and temporary purpose borrowings from the need to gain Loan Council approval gives the Commonwealth additional flexibility and control. For further details see Gilbert, Future op cit.


36. CPD V78 p3192 25.5.72 and V79 p147 15.8.72.

37. For example, in 1973 the Defence Credit arrangements with the USA were cancelled and borrowing overseas for transport capital equipment was discouraged (see CPD V90 p1868 26.9.74).


39. Treasurer's Address to CEDA 22.11.74.

40. CPD V91 p2471 16.10.74.


42. Budget speech 1975/76 p2.


44. Treasury was generally supported by the RBA although the latter was less certain of the revival in private capital inflow during the late seventies - see Jolley, *op cit*, p128, Budget Paper No.2 1976/77 p25 and Commonwealth Record V1 No.21 p1371.


46. Speech to Chamber of Manufacturers of NSW, 13.7.76 and CPD V100 p985 14.9.76.

47. see CPD V74 21.11.71 p2810, V90 25.9.74 p1787, V97 p2315 21.10.75 and V104 4.10.77 p1561.

48. CPD V82 8.3.73 p421.

49. CPD V87 5.12.73 p4318.


51. CPD V79 p1051 13.8.72, V83 p1842 8.5.73 and V86 p2516 23.10.75.


53. *The Melbourne Age*, 14.5.74 and CPD V100 23.9.76.
56. CPD V100 p707 7.9.76.
57. see Commonwealth Record V1 No. 49 p619 7.9.76 and V2 No. 21 p1371 22.11.76 and CPD V100 p1362 23.9.76.
58. Commonwealth Record, V1 No. 16 p1034 20.10.76.
60. CPD V102 p2949, 2962 30.11.76.
63. CPD V102 p2947-49 30.11.76.
64. For example, France arranged a loan for US$1750 million in 1975 and was quickly followed by OPEC financing packages of US$1.4 billion for Italy and Ireland in March 1976, and US$1000 million for Spain and Venezuela in June and September respectively - Commonwealth Treasury, "International Market Conditions", RLI Canberra, 1975-76.
65. CPD V97 p3603-7, 3638, 3658 1975 and The Melbourne Age 21.7.75.
67. Transcript of AM program on ABC radio 30.11.76.
68. CPD V102 p3021-22 1.12.76.
70. CPD V97 p2203 16.10.75.
73. Ibid 1977/78 p32.
74. CPD V106 p44 16.8.77.
75. Budget Paper No. 2 1977/78 p34.
76. CPD V106 p319 17.8.77, V107 p2477 27.10.77 and reports in The Australian, August 1977.
77. CPD V106 p575 24.8.77 and CPD V107 p2803 1.11.77.
78. Ibid, pp2603 and Treasury Press Releases No.135 3.11.77 and No.151 28.11.77.

79. For example, CPD V102 p2954-6, p2957, p2965 30.11.76 and p3380, p3625-6 7.12.76 and V103 p25-6, 34-5 15.2.77.

80. CPD V104 p506 23.3.77.


82. Commonwealth Record V.2 No.48 p1352.

83. For example, additional Ministerial staff and the Coalition's Economic Panel and the Economic Consultative Group.


86. Treasury Press Release No.106 by Minister Assisting the Treasurer 27.9.77.


90. For example, see Treasurer's press statements of 16.9.78, 5.10.78, 23.1.79 and 14.2.79.


92. Treasury Press Release of 5.2.78, Commonwealth Record V3 No.4 p82-3.

NOTES CHAPTER 3


4. see Loan (AIDC) Bill and CPD V92 28.11.74 p4279-80.

5. CPD V94 p1668 16.4.75.

6. CPD V102 p2716-17 16.11.76.

8. CPD V108 p906 4.4.78.

9. Budget Paper No.6 (Government Securities on issue), Table 3 p15-20 1979-80.


12. TEP No.1, op_cit, p62-3.


NOTES: CHAPTER 4

1. Butlin, Barnard and Hincus, op_cit, p37-41.

2. The use of the security deposit system in Queensland and the development of the Pilbara iron ore development in WA are both examples of private sector funding of infrastructure.


4. see F. Creen's speech to CEDA 22.11.74 and The Australian 11.1.75 p1.


8. CPD V95 p3612-13 & p3655 9.7.75; Khemlani, loc_cit, p10; and Whitlam, truth op_cit, p44-5.

9. The equivalent at that time of approximately $A3056 million. With an emission rate of 98 percent and the commission of the negotiator, the net amount to be borrowed was US $3820 million ($A2900 million) - see the Draft Acceptance CPD V95 p3615-16.
9.7.75.

10. see Transcript of Danny Sankey V Edward Gough Whitlam, James Ford Cairns & Lionel Keith Murphy, Court of Petty Sessions, Queanbeyan, 1979 p368-89 & p736-82 and CPD V95 p3614 9.7.75.

11. Khemiani, loc_cit, p7.15.


13. Memorandum from Darling & Co, Merchant Bankers, see CPD V95 p3615 9.7.75.


16. see Sankey transcript, loc_cit, p874-v00 and Sexton, op_cit, p154.

17. Sankey transcript, loc_cit, p638-77 & 742-57. The Attorney-General’s argument had been put forward earlier in a paper by Mr. Peter Bailey, Assistant Secretary of the Revenue, Loans and Investment Division in the Commonwealth Treasury in the fifties (see p717).

18. see Larkin’s minute of 23.5.75 published in Senate Debates V64 p2609-11 12.6.75.


20. Executive Council Minute published in Senate Debates V64 p2725 19.7.75.

21. CPD V95 p3611-12 9.7.75.

22. CPD V95 p3616 9.7.75 and Khemiani, loc_cit, p23-4.


26. National_Times 1919; Sexton, op_cit, p159; and Cairns, op_cit, p94.


29. Whitlam, i.uth op.cit., p55 and CPD V95 p3595 9.7.75.

30. Treasury Minute, December 1974, CPD V95 p3569 9.7.75.


32. Senate debates V64 p2624 12.6.75 and Khemlani, loc.cit., p54.

33. That is, to increase the rate of interest to cover the cost of the commission — see Khemlani, loc.cit., p49.

34. CPD V95 p3529-22 9.7.75 and Khemlani, loc.cit., p55-60.


37. CPD V95 p3525 9.7.75.


39. CPD V95 p2927 24.10.74.


41. CPD V95 p3565 & 69 and Treasury Minute of December 1975 p3569 9.7.75.

42. "Monday Conference", ABC TV 24.2.75.

43. CPD V95 p3563 9.7.75 and Cairns, op.cit., p94.

44. Nagy's statement in CPD V95 p3629-30 9.7.75.

45. see letter in CPD V95 p3559 9.7.75.

46. CPD V95 p3565, 3569 9.7.75 and the annotation to Treasury Minute in CPD V95 p3574 9.7.75.

47. see Nagy's statement in CPD V95 p3559-60 & 3560 9.7.75.

48. CPD V95 p3560 & 3570 9.7.75.

49. see Nagy's statement in CPD V95 p3630 9.7.75.

50. Harder's letter in CPD V95 p3576-7 9.7.75.

51. National Times, 16-21 June 1975 p6; Prime Minister's press conference 10.6.75; Whitlam, i.uth op.cit., p48; and Sunday Telegraph, 15.6.75. This was not the first time that
Wheeler's position had been under threat, see Cairns, *Op Cit*, p95.

52. *Wheeler's Minute* in CPD V95 p3566-7 9.7.75.

53. *Treasury Minute* in CPD V95 p3572 9.7.75.


55. CPD V95 p2994 4.8.75.

56. CPD V95 p3589 9.7.75.


58. CPD V97 p1925 October 1975.


60. *Prime Minister's statement* 14.10.75.

61. CPD V97 p2325 21.10.75.

62. For example, the Queensland Premier's allegations that Labor Ministers received "kick backs" from the loan.

63. CPD V106 p509 23.8.77.

64. CPD V54 p4335 7.3.67.

65. CPD V95 p3625 9.7.75.

66. see CPD V88 p190 7.3.74 & p1154-5 8.4.74, V91 p2995 29.10.74 and V93 p1041 5.3.75.


68. For example, in 1966, he was talking to Caucus of a national pipeline grid (see Stevenson, *Op Cit*, p34) and Keating's comments in CPD V106 p511 23.8.77.


70. CPD V92 p4213 27.11.74.


72. For typical examples of his style see CPD V88 19.3.74 p543, 2.4.74 p836-9 and 8.4.74 1154-5.

74. For example, the Fraser Island decision set out in Kelly, *Unmaking*, pp.12-13 and the incident with the Secretary of Foreign Affairs referred to in CPD V91 p2293-95 15.10.74 and set out in Sexton, *op.cit*, p105-6.

75. For example, Roy Morgan and ANCF reports in *Canberra Times* 30.11.72 p17.

76. For example, ANCF report in *Sydney Sun* 13.11.73 p5.

77. Whitlam, *Truth*, *op.cit*, p44.

78. see November 1972 and April 1974 Election Policy Speeches by E.G. Whitlam.

79. CPD V95 p3598 9.7.75.

80. Ibid p3610-11

81. CPD V89 p661 25.7.74

82. CPD V95 p3598 9.7.75.


85. Interview with Dr. M.H. Casey in Nov 1963.

86. For example, South Korea announced its intention to borrow US$43300 million in foreign loans to finance a large number of development projects in 1974. See Commonwealth Treasury, "International Market Conditions" 22.2.74.

87. CPD V95 p3201 3.6.75.


90. For example, in mid-1975 France was negotiating to borrow up to US$1750 million - see Treasury, "International Market Conditions" 25.7.75.

91. For example, Australian National Hotels through Tjuringa Securities raised some $6 million in Saudi riyals for 5 years at 8.75%.

92. CPD V95 p3611 9.7.75.

93. See Cairns, *op.cit*, p70 and Senate Debates V64 p2593-4 12.6.75.

94. For example, Trade’s fight against Treasury opposition to establish the AIDC – see CPD V95 p3652 9.7.75.
95. For example, Cameron's comments that treasury advice was always wrong - see CPD V83 p1559 2.5.73.

96. For example, B.Brogan with Cairns, P.F.McGuinness and P.McAuley with Haydon and M.Koating with Uren.

97. Examples of treasury's territorial battles include the department's successful opposition to the Vernon Committee's proposals in the mid-sixties and its attempt to scuttle the IMPACI model of the inl see National Times 14-17 June 1976.


100. The Prime Minister's speech to Loan Council included statements such as "inflation must be cured. The government is determined to curb it" and similar sentiments were expressed by Treasurer Crean at the Australian Finance Conference, Canberra 24.6.74.

101. CPD V89 p504-10 23.7.74 and Whitlam, Govt op_cit , p207.


103. For example, compare the sentiments expressed in the Treasury Minute by J.O.Stone reproduced in Sexton, op_cit , p56-9 and speeches by K.Willis (CPD V91 p2649 22.10.74) and F.Crean (13.4.73).

104. CPD V91 p2639 22.10.74.


106. Made more expansionary by subsequent action.

107. For example, see CPD V92 p2669 22.10.74 and p3942 25.11.74 and Whitlam, Govt op_cit , p208.

108. For example, at the ALP Conference at Terrigal in 1975, in various media reports and in CPD V91 p2643 22.10.74.

109. Sexton, op_cit , p93.

110. CPD V106 p513 23.8.77.

111. For example, his decision to reissue export permits for Fraser Island without consulting Dr. Cass, who was the Minister for the Environment - see CPD V95 p2478-80 20.5.75.
112. CPD V91 p3283-4 31.10.74.


114. For example, his actions in relation to foreign investment — see Aitchison, *op cit*, p136.

115. For example, the expansion of the AIDC’s powers, the seas and submerged lands legislation and the Pipeline Authority.


118. See interview with Prime Minister Gorton 11.12.68 reported in Reid, Gorton *op cit*, p163-5.


120. Senate Debates V64 p2608-9 12.6.75 and Whitlam, *I report* *op cit*, p46.

121. Reid, Gorton *op cit*, p119.


123. CPD V96 p563 27.8.75.


125. For example, the attempt to acquire a division of CSIRAC in mid-1975.


127. See Whitlam, *Boy* *op cit*, p232, 674-5.

128. Despite 13 years in Treasury, except when he acted as Secretary, at no time did Loan Council matters form part of Hewitt’s responsibilities. Senate Debates V64 p2778 16.7.75.

129. CPD V95 p3208 3.6.75.

130. See, for example, CPD V106 p511 23.8.77 and CPD V95 p3398 3.6.75 and Matter of Public Importance CPD V95 2.6.75.


132. For example, NSW’s opposition to the Pipeline Authority building the NSW section of the gas pipeline instead of the private company AGL; Victoria and WA’s opposition to the
failure to renew offshore oil exploration permits and Queensland's objections to export controls.

133. See Canberra _times_ 10.12.73 and Stevenson, _op.cit._, p68-72.


136. _Ibid._, p41.

137. All calculations are based on the original offer of December 1974 and set out in _CPD V95_ p3615 9.7.75.

138. Budget Paper No.6 (GSU1) 30.6.82 p35.

139. See Darling and Co's Memorandum _CPD V95_ p3615 9.7.75.


141. _Ibid._, 25.7.75.

142. _Ibid._, 5.5.78 and 13.10.78.

143. _Ibid._, 29.11.74 and 6.12.74.

144. See schedule of unsolicited/ unconventional loan offers set out in Senate Debates _V64_ p2697-2700 9.7.75.

145. _CPD V95_ p3599, 3612 & 3654 9.7.75.

146. _Ibid._, p3611.

147. See TEP No.8, _op.cit._, p42.


149. Lloyd and Clark, _Kerr_ _op.cit._, p145.

150. Sankey transcripts, _loc.cit._, p670.


152. Sawyer, _op.cit._, p82-6 & 90.

153. For example, see books by Reid, Lloyd and Clark, Kelly and Sexton.

154. For example, see books and articles by Sawyer, Colin Howard and Evans.

155. For example, see K.W. Arndt, "The Economics of the Loan

155. For example, there were frequent public rallies and protests against the Government in 1975 and even 1977 with many prominent individuals publicly challenging the legitimacy of the Coalition’s behaviour in 1975 and the Prime Minister continually found it necessary to defend the role played by the Governor-General and the Senate in 1975.

157. For example, CPD V98 p780-85 18.3.76; V99 p2103-99 6.5.76; The_Melbourne_Age 8,17,20 May 1976; Sydney_Morning_Herald 7,10,11,12 May 1976; The_Adeelaide_Advertiser 3.5.76.

159. This included Matters of Public Importance and an attack on the Opposition by the Prime Minister see CPD V111 p1709-17 11.10.78; V112 p3019 17.11.78; and V114 p1919-27 8.5.79.

160. CPD V106 p721 6.9.77.

161. The_Melbourne_Age 24 and 28 November 1981.

162. For example, see Reid, Whitlam op. cit, p254; Sunday_Mirror 7.8.75; and The_Melbourne_Age 5.7.75 p1.


164. CPD V95 p3600 9.7.75.

165. see The_Melbourne_Age 5.7.75; Senator Wreidt’s comments in Senate Debates V86 Nov 1975; and the activities of Mr Todd on behalf of the Premier of Queensland – see CPD V99 p2183 May 1976.

166. CPD V99 p527 4.3.76.

167. Press Conference 10.6.75.

168. see Hayden’s letter 10.3.75 published in The_Melbourne_Age 9.7.75.


170. ACLR, GP 811, p76.

NOTES CHAPTER 5

1. For example, the Brisbane County Council refinanced a loan in New York in 1955 and in London in 1960.

2. For example, in the fifties, Elcom applied to borrow in USA but was refused (CPD V219 p1682 1952) and the Brisbane County
Council apparently tried unsuccessfully to borrow in Switzerland (Brisbane press March 1959).

3. Although not all these funds were to be borrowed abroad, the states' original concept was that all approved projects could be fully financed from overseas if necessary.


5. _WA Parliamentary Paper No. 156_ 17.4.74.

6. _WA P.D. V206_ p2925 12.11.74; _V207_ p207 20.3.75; & _V208_ p1827 12.8.75.

7. _West Australian_ 17.1.76 p3.


9. Press release by Prime Minister 6.11.78.


14. This strategy, for example, was set out in the Minister Assisting the Treasurer's speech on 11.6.76 and Treasury Press Releases of 1.6.76 and 18.6.76.


16. TEP No.1, _op.cit_, p93.

17. For example, in its submission to the Senate Standing Committee on National Resources in 1981, see TEP No.8.


19. Treasurer's speech to Loan Council 1.7.77.


22. _Ibid_ V3 No.11 p272 and _CPD V109_ p1774-5 4.5.78.


26. The guidelines also permitted overseas borrowing under the normal semi-government program in exceptional circumstances see Budget Paper No.7 (Payments to and for the States) 1978/79.


29. For example, see Treasury Press Release No.3 issued by the Minister Assisting the Treasurer 17.1.78.

30. Speech to Premiers Conference 22.6.78.

31. Prime Minister's Address to the Nation, 12.11.78.

32. Prime Minister's electorate talk 5.11.78.


34. Canberra Times 7.11.78 p1.


39. For example, see Treasurer's statements in press releases No.62 2.7.79 and No.83 9.8.79; his budget speech 1979/80 and CPD V115 21.8.79 p105-9.


41. Ibid p3.

42. Prime Minister's Press Release 7.12.79.


44. Prime Minister's electorate talk 29.6.80.

Policy", quoted by Opposition Leader Hayden in a speech to Sydney Journalist Club on 13.10.80.


47. see Prime Minister's electorate talk 29.6.80.


51. Sydney Morning Herald 29.7.82.

52. Prime Minister's electorate talk 5.5.81.

53. Treasurer's speech to Premiers' Conference 4.5.81 and Treasury Press Release 10.6.81.

54. Treasurer's speech to Premiers' Conference 19.6.81.


56. WA PD V207 15.4.75 p798.

57. WA PD V213 7.10.76 p2975-7.


60. West Australian 17.1.76 p3.


62. see Court's comments on borrowing needs 17.5.78.


64. National Times 18.11.78 p65.


67. Prime Minister's telex to Premiers in 1979 reported in Melbourne Age 21.12.81.
68. CPD V9 p149-52 1986.
69. see Kelly, Hawke op_cit , p89; Edwards, op_cit , p32-3; and Jolley, op_cit , p233.
70. Prime Minister's speech to SA Liberal Party 5.12.80.
71. Australian Financial Review 6.7.84.
74. National Times 18.11.78 p68.
75. Une such study on the N.W. Shelf, for example, took a team several years work and the report is of a similar length to this paper.
76. Treasurer's Press Release No.104 24.6.82.
78. TEP No.5, op_cit , p54-5.
79. For example, by June 1984, Elcom had $330 million in accumulated trade credits.
80. Budget Paper No.7 1982/3 p34.
81. For example, see comments by the General Manager of CSR Ltd in Australian Financial Review , 30.11.81.
82. Press Release by Mr. P. Lynch 1.7.80 (CWith Record V5 No.26 p9/2).
83. For example, Alcoa's smelter at Portland and the N.W. Shelf gas project.
84. These losses are calculated by comparing the Australian currency equivalent of funds actually raised at the time overseas loans were drawn with the current Australian dollar equivalent of foreign currency involved.
86. CPD V112 p3019 17.11.78.
88. ACIR, op cit, p79.
89. See Court's comments - WA PD V220 p5664 28.11.78.
90. See comments of the Chairman of SECV reported in Melbourne Age 21.2.81.
91. TEP No.8, op cit, p53.
92. Such competition can lead to lower royalties, lower contributions to infrastructure needs by private developers, lower environmental standards and lower user charges for facilities, reducing the benefits to the community from resource development.
94. See the Cochrane Report on power pricing for Alcoa commissioned by the Victorian Government.
95. TEP No.8, op cit, p36.
104. Stevenson, op cit, p82.
105. No funds were borrowed offshore by Commonwealth authorities under the infrastructure program.
NOTES CHAPTER 6

1. see "Foreign Investment in Australia", ABS Catalog No. December 1985 Quarterly, RBA Statistical Bulletin Dec 1984 p369,374 and Budget Paper No.1 1985/86. Unless otherwise stated, all borrowing figures in this section have been taken from these sources.

2. For further information about Australia's comparatively moderate level of public overseas debt see Budget Paper No.1 1985/86 and the speech by Secretary of the Treasury (B. Fraser) to 14th Conference of Economists, University of NSW, 16.5.85 p5.

3. The major factors which have been responsible for the rapid increase in Australia's external debt include:
   - an initial impetus from the surge in resource related investment in the early eighties;
   - historically large current account deficits which have risen from around 2 percent of GDP in the 1970s to 4.75 percent in the 1980s;
   - a substantial increase in the proportion of capital inflow represented by debt rather than equity, which primarily reflected developments in project financing as well as a general world wide trend toward greater use of debt financing. As a result, over three quarters of Australia's current account deficit is now being financed by borrowings; and
   - as the vast majority of Australia's external debt is denominated in foreign currency, valuation effects over recent years have added considerably to its in value.

4. A similar point of view was expressed by J.O. Stone (former Secretary of the Treasury), "1929 and all that...", Shann Memorial Lecture, University of WA 27.8.84 especially p7-9.


6. see EPAC Paper No.6, op cit, p5-8 and Budget Statement No.1 1985/86 p17-19.

APPENDICES

I. Institutional Arrangements for Government overseas borrowing.


IV. Terms of Flotation of Australian Government Loans by Market.

V. Loans Raised for Commonwealth Authorities by Market.

VI. Loans Raised by the Australian Government for Defence Purposes.


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    Total Funds Borrowed by the States under the Infrastructure
APPENDIX 1

Institutional Arrangements for Government Overseas Borrowing

Australian Government borrowing is largely controlled by the Financial Agreement, which was entered into by the Commonwealth and the States in 1927. Under this agreement, the Australian Loan Council was established to coordinate all Commonwealth (except for defence and temporary purposes) and State Government borrowing and, under the Gentlemen's Agreement of 1936, this control was extended to the borrowings of semi-government and local authorities.

The Financial Agreement 1929

The Financial Agreement was approved by the Commonwealth with the passage of the Financial Agreement Act 1928 and by each State Parliament. The Federal Constitution was subsequently altered by the insertion of Section 105A and the original agreement validated by the Financial Agreement Validation Act 1929. The Agreement may be varied or rescinded by the parties under Section 105(4) of the Constitution and, in fact, has been amended four times - in 1934, 1944, 1966, and 1976 (1).

The major purpose of the Agreement was two-fold - to enable the Commonwealth to take over the unpaid balance of each State's gross public debts at that time and to establish a mechanism for controlling government borrowing in the future. The intention was to avoid further damaging competition for funds
among the various Governments and to increase the efficiency, economy and prudence of public loan raisings.

To coordinate public sector borrowing by Australian Governments, the Agreement made provision for a Loan Council (clause 3). The Australian Loan Council consists of a representative from the Commonwealth and from each State. The Commonwealth representative is the Chairman (clause 3(3)). Each State has one vote while the Commonwealth has two votes and a casting vote (clause 3(14)). Most decisions are passed by a simple majority although there are a few which require unanimity.

The Loan Council determines the aggregate amount to be borrowed by Australian Governments each year, its distribution among the participants and the allocation of the proceeds of Commonwealth borrowing, prescribes maximum terms and conditions for various categories of borrowings, regulates the timing of public loans in Australia and sets the terms, conditions and timing of all government overseas borrowing (2).

However, there are two important exceptions under the Financial Agreement to this general oversight by the Loan Council. One exception is "loans for defence purposes approved by the Parliament of the Commonwealth", which are specifically excluded from the Agreement in clause 3(8). The other is borrowings "solely for temporary purposes" pursuant to clauses 5 and 6. Nowhere in the Agreement, however, is the meaning of "temporary purposes" defined.
With these exceptions, clause 3(8) requires the Commonwealth and each State to submit a program annually for the amount of new money each requires to be raised by way of loans and, under clause 3(13), the amount each requires for conversion, renewal or redemption of existing loans during the financial year. The aggregate amount for the annual loan program is then decided by a majority vote of Loan Council although its distribution must be agreed to unanimously. From time to time, the Loan Council also sets the maximum limits for interest, brokerage, discount and other charges on all such loans.

Actual borrowing under the Financial Agreement must be carried out by the Commonwealth (clause 4(1)) with two major exceptions. Firstly, a State may borrow moneys within the State from authorities, bodies, funds or institutions established under Commonwealth or State law and from the public by counter sales of securities (clause 5(1)). However, any securities so issued are to be Commonwealth securities (clause 5(2)). Secondly, a State may borrow moneys outside Australia in the name of the State and issue its own securities for the moneys so borrowed if it has the unanimous approval of the Loan Council (clause 4(2)). However, the Commonwealth is required to guarantee any such borrowings and the moneys so borrowed are to be treated as those of the Commonwealth for the purposes of the Agreement.

Under these arrangements, State Government overseas borrowing virtually ceased leaving the Commonwealth responsible for
raising all offshore funds. As a matter of agreement with Loan Council, all proceeds from government borrowing overseas have been allocated wholly to the Commonwealth since the mid-sixties. However, in return for this control, the Commonwealth must submit its own borrowing program to Loan Council (except borrowings for defence or temporary purposes) and gain its approval for the terms and conditions of all overseas loans.

The Gentlemen’s Agreement 1936

The Commonwealth wished to further extend its control over public sector borrowing to cover semi-government authorities for a number of reasons. Firstly, they competed with government loan programs. Secondly, they could be used by the States to gain additional funds outside Loan Council control. And thirdly, by creating additional semi-government authorities, a State could continue to increase its access to “off-program” funds as borrowings by the smaller authorities were exempted from Loan Council control. The questions raised by such borrowings were the subject of various Council resolutions in the thirties, which were finally formalised in an agreement in 1936 (3).

The Gentlemen’s Agreement lays down procedures and rules for borrowings on domestic and overseas markets by authorities which are constituted under Commonwealth and State law (4). However, unlike the Financial Agreement, the Gentlemen’s Agreement is not backed by the force of law and has been amended from time to time by a decision of Loan Council. Under
the agreement, Loan Council determines a total annual borrowing
program for all semi-government and local authorities in a
process similar to the one followed to determine government
borrowing under the Financial Agreement. However, decisions on
all matters require only a majority vote.

The Gentlemen's Agreement resulted in the Commonwealth gaining
control over all offshore borrowing by state authorities and,
consequently, such borrowings virtually ceased until the
seventies.

Infrastructure Guidelines 1978

The Gentlemen's Agreement was amended to take account of the
infrastructure guidelines, which were adopted by Loan Council
in June 1978. These new arrangements extended the agreement to
include a new category of borrowings, comprising special
temporary additions to the annual larger authorities' borrowing
programs (ie "semi-government programs") to assist in financing
the provision of infrastructure. These borrowings were
confined to exceptional cases which:

- could not be accommodated within normal resources
  available to the Government and its authority;
- were for the provision of services normally supplied by
  the public sector;
- had special significance for development; and
- required outlays within a relatively short time span.
Each request was assessed by the Loan Council taking account of the project's viability, its importance for development and urgency, its special significance for the economic development of Australia, the extent to which alternative sources of funds were available and the need for the special addition. Approval of any special addition under these guidelines, including its forward borrowing program, required agreement by a simple majority, which must include the Commonwealth (5).

However, these guidelines also recognised that, in exceptional cases (for example, if funds could not be obtained on satisfactory terms on the domestic market or if there was some advantage from a mix of local and overseas funding) there could be a need for the authorities to seek funds offshore. In such circumstances, Loan Council approval could be sought for an overseas borrowing under the infrastructure or normal semi-government borrowing program.

Clause B(xiii) of the Gentlemen's Agreement set out the arrangements governing all proposals for overseas borrowings by semi-government and local authorities. Except for trade credit arrangements, all such borrowings were charged against the approved borrowing program of the relevant State or the Commonwealth. Loan Council approval was then required by the borrowing authority before it made an approach to any overseas market and again for the terms and conditions of any subsequently arranged loan. The guidelines noted that in considering any proposal for an overseas borrowing, the Chairman of Loan Council could take account of the implications
of the proposed borrowing for the Commonwealth's fiscal, monetary and external policy objectives, and its own overseas borrowing activities. So the Commonwealth, through its veto, continued to control the amount, timing and terms and conditions of all conventional overseas borrowing by these authorities.

Overseas borrowings by semi-government authorities were originally limited to certain forms (primarily borrowings from or through commercial banks and other approved financial institutions) to avoid any adverse competition between them and the Commonwealth while still permitting the authorities access to a large pool of funds at satisfactory cost. These restrictions were substantially modified in mid-1984. All exchange risks on such borrowings are born by individual authorities although the borrowings are generally guaranteed by the State Government concerned.

The importance of the infrastructure guidelines was significantly reduced by the decision in June 1982 to exempt State electricity authorities (the largest borrowers under the scheme) from Loan Council restrictions, leaving them largely free to set the size, terms and conditions of their borrowing program. However, even under these new arrangements, all overseas borrowing remained subject to Commonwealth veto.

Off_Program_Funding

Semi-government authorities have made increasing use of
overseas funds which fall outside the control of the Commonwealth as they do not require Loan Council approval under the provisions of the Gentlemen's Agreement. Such finance is called "off program funding", the most common forms being trade credit or deferred payment arrangements and leasing.

The former were systematised, following Loan Council's review of semi-government borrowing arrangements, when new guidelines were issued in 1978 for trade credit financing of capital equipment purchases by State and Commonwealth authorities (6). The result was that, while overseas trade credits which complied with certain guidelines remained exempt from Loan Council approval, all now had to reported to the Treasury.

The guidelines required that overseas borrowing via such trade credit arrangements be confined to the financing of direct overseas expenditure, not involve the issue of negotiable securities, or the provision of any guarantee by the authority of the obligations of a third party. Drawdowns had to coincide as far as practicable, in amounts and timing, with payments due to the supplier or contractor. In addition, the terms of any proposal had to be in accord with international conventions relating to trade credit arrangements and not run counter to Commonwealth exchange control requirements.

The use of leasing techniques to pay for capital equipment provided semi-government authorities with additional overseas funds outside Loan Council control. Most leasing arrangements (eg leveraged leasing, finance leasing, sale-and-leaseback)
usually involved the transfer of all or most of the risks and
benefits of ownership of the leased plant or equipment from the
lessor (e.g., private overseas finance company) to the lessee
(e.g., the state authority). This provided the former with
additional tax benefits not normally available and the latter
access to overseas loans without the necessity of obtaining
Loan Council (or Commonwealth) approval.

The Federal Government has taken a number of measures to reduce
the loss to Commonwealth revenue posed by leasing finance,
mainly by alterations to the depreciation allowance (8).
Moreover, all such "off program" funding techniques have now
been incorporated into an agreed global limit on public sector
borrowing by the Loan Council in an attempt to curb their
burgeoning growth (9).

Notes
2. TEP No.9, op.cit, p55.
4. Commonwealth Treasury, "Institutional Arrangements for Public
   Sector Borrowing in Australia", Canberra, March 1980.
5. Budget Paper No.6 (GS01), 1979/80, p32.
6. The Gentlemen's Agreement, as amended 19 June 1981, ABPS
   Canberra 1981 and Senate Debates 18.11.81 p2323.
## COMMONWEALTH BORROWING OVERSEAS 1970/71 - 1979/80, A-CASH LOANS

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<tr>
<th>AMOUNT (FACE VALUE)</th>
<th>INTEREST RATE % p.a.</th>
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### COMMONWEALTH BORROWING OVERSEAS 1970/71 - 1979/80, A-CASH LOANS

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* Borrowed in European Unit of Account when 1 EUA = 1 US $
### COMMONWEALTH BORROWING OVERSEAS 1970/71 - 1979/80, A-CASH LOANS

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- Public loan for AIDC and ASC
- Private loan for ANAC
- Private loan for Qantas
- Public loan for Qantas, ANAC, ASC and ATS for Housing
- "
- "
- Private loan for Qantas
- "
- Private loan for ANAC
## COMMONWEALTH BORROWING OVERSEAS 1970/71 - 1979/80, A-CASH LOANS

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* $US300 million raised in Europe
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* Proceeds raised in Europe
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DESCRIPTION

- Public loan for C'wealth
- Private loan for Qantas
- Private loan for ATS for Housing
- Direct bank loan with right of assignment for ATS for Housing
- Direct bank loan for PTS for capital assistance
- Private placement for PTS for capital assistance
- Public loan for ATS for Housing
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SUB TOTAL SF 1531.75

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**SUB TOTAL $1,060.00**

**$A 413.543**
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### SUMMARY OF COMMONWEALTH GROSS AND NET BORROWING ($Am) - 1970/71 TO 1979/80

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#### SOURCES:
Commonwealth Government Finance, Australia and Predecessors ABS Catalogue No. 5502.0
**APPENDIX IV**

**TERMS OF FLOTATION OF AUSTRALIAN GOVERNMENT LOANS IN U.S.A. 1970/71-1979/80**

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(c) Raised for OAL, ANAC & ASC as well as Commonwealth purposes
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1970/71 - 1979/80

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<td>49,650</td>
<td>40,000</td>
<td>40,000</td>
<td>29,925</td>
<td>19,850</td>
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<td>519</td>
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<td>OTHER EXPENSES ¥ Millions</td>
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<td>123.29</td>
<td>3.614</td>
<td>13.608</td>
<td>32.616</td>
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<td>NET PROCEEDS ¥ Million</td>
<td>9,807.3</td>
<td>48,576.7</td>
<td>39,896.4</td>
<td>39,786.4</td>
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<td>98.07</td>
<td>97.15</td>
<td>99.74</td>
<td>99.47</td>
<td>97.91</td>
<td>97.09</td>
<td>99.62</td>
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<tr>
<td>YIELD TO MATURITY %</td>
<td>6.90</td>
<td>6.685</td>
<td>7.10</td>
<td>7.60</td>
<td>5.66</td>
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<td>7.65</td>
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(a) For selling, underwriting and/or management
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<td>TYPE OF LOAN</td>
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<td>INTEREST RATE %</td>
<td>7.75</td>
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<td>8.25</td>
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<td>ISSUE PRICE/ DISBURSEMENT %</td>
<td>100</td>
<td>100</td>
<td>100</td>
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<td>.05</td>
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<td>99.372</td>
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<td>99.50</td>
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<th>Lender/Manager</th>
<th>Amount (Face Value)</th>
<th>Interest Rate</th>
<th>Issue Price/Disbursement</th>
<th>Final Maturity Date</th>
<th>Aust. Dollar Equivalent</th>
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<td>QAL</td>
<td>&quot;</td>
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<td>Chase Manhattan Bank (CM)</td>
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<td>99.75</td>
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<td>MGT</td>
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<td>EIB &amp; Boeing</td>
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<td>100</td>
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<td>EIB &amp; Boeing Co. of U.S.</td>
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<td>EIB &amp; Boeing</td>
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<td>1.526</td>
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### U.S. DOLLARS

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<tr>
<th>Date of Raising</th>
<th>Authority</th>
<th>Lender/Manager</th>
<th>Amount (Face Value) M</th>
<th>Interest Rate %</th>
<th>Issue Price/ Dispersion %</th>
<th>Final Maturity Date</th>
<th>Aust. Dollar Equivalent $M</th>
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<tr>
<td>1973/74</td>
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<td>EIB</td>
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<td>100</td>
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<td>EIB</td>
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<td>Private Export Funding Corporation (PEFC)</td>
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<td>&quot;</td>
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<tr>
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<td>100</td>
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<td>.474</td>
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<td>EIB</td>
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<td>EIB</td>
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### GERMAN MARKS

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<th>Amount (Face Value) M</th>
<th>Interest Rate %</th>
<th>Issue Price/ Dispersion %</th>
<th>Final Maturity Date</th>
<th>Aust. Dollar Equivalent $M</th>
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<tbody>
<tr>
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<td>-</td>
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<td>-</td>
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<td>15.07.80</td>
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## APPENDIX V

**LOANS RAISED FOR COMMONWEALTH AUTHORITIES BY**

**MARKET 1970/71 - 1979/80 (continued)**

<table>
<thead>
<tr>
<th>Date of Raising</th>
<th>Authority</th>
<th>Lender/Manager</th>
<th>Amount (Face Value) M</th>
<th>Interest Rate %</th>
<th>Issue Price/Disbursement %</th>
<th>Final Maturity Date</th>
<th>Final Aust. Dollar Equivalent $M</th>
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<td>Swiss Bank Corp</td>
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**TOTAL**

|                      |           |                      |                       |                 |                             |                     | 403.788                          |

Derived from GSOI-various years

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<th>INTEREST RATE</th>
<th>MATURITY DATE</th>
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<td>16.675</td>
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**TOTAL $161,005 M**

Derived from Government Securities on Issue, various years
### SECURITIES ON ISSUE OVERSEAS - $A Equivalent

**AT 30 JUNE 1946 TO 1980**

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<th>YEAR</th>
<th>SECURITIES ON ISSUE OVERSEAS $Am (a)</th>
<th>PER HEAD OF POPULATION $A</th>
<th>AS % OF TOTAL SECURITIES ON ISSUE</th>
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<td>1,580.247</td>
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(a) Converted to Australian Currency at rates of exchange on the dates indicated.
<table>
<thead>
<tr>
<th>YEAR</th>
<th>TOTAL SECURITIES DOMOCILED OVERSEAS $Am (a)</th>
<th>TOTAL SECURITIES PER HEAD OF POPULATION $A</th>
<th>AS % OF TOTAL SECURITIES ON ISSUE</th>
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<tr>
<td>1971</td>
<td>1,545.929</td>
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<td>1,422.490</td>
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<td>1,264.854</td>
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<td>1974</td>
<td>1,031.776</td>
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<td>1980</td>
<td>5,396.403</td>
<td>369.21</td>
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(a) Converted to Australian Currency at rates of exchange on the dates indicated.

## APPENDIX VIII

### CONSUMPTION, SAVING, INVESTMENT AND NET LENDING TO OVERSEAS

(as a percentage of National income)

<table>
<thead>
<tr>
<th>Year</th>
<th>Consumption</th>
<th>Saving (b)</th>
<th>Investment</th>
<th>Net Lending to Overseas (e)</th>
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<td>Government</td>
<td>Total</td>
<td>Private (c)</td>
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<tr>
<td>1970/71</td>
<td>61.3</td>
<td>12.6</td>
<td>73.9</td>
<td>26.1</td>
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<td>61.4</td>
<td>12.9</td>
<td>74.3</td>
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<td>1972/73</td>
<td>61.3</td>
<td>12.9</td>
<td>74.2</td>
<td>25.8</td>
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<td>62.1</td>
<td>13.5</td>
<td>75.6</td>
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<td>1974/75</td>
<td>61.5</td>
<td>15.1</td>
<td>76.6</td>
<td>23.4</td>
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<td>1975/76</td>
<td>61.3</td>
<td>15.9</td>
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<td>22.8</td>
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<td>1976/77</td>
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<td>16.4</td>
<td>77.5</td>
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<td>1977/78</td>
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<td>17.0</td>
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<td>20.1</td>
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<td>1978/79</td>
<td>61.9</td>
<td>16.6</td>
<td>78.5</td>
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<tr>
<td>1979/80</td>
<td>61.8</td>
<td>16.4</td>
<td>78.3</td>
<td>21.7</td>
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(a) Private consumption includes unidentified consumption (statistical discrepancy)

(b) Defined as national income (GDP plus net property income from overseas plus net transfers from overseas) less consumption less the statistical discrepancy.

(c) Private gross fixed capital expenditure plus changes in stocks

(d) Gross fixed capital expenditure of public enterprises and general government

(e) Equals balance on current account plus net undistributed and/or attributable abroad

Sources:

Australian National Accounts - ABS Cat. No. 5206.0
- ABS Cat. No. 5207.0

Balance of Payments - ABS Cat. No. 5302.0
APPENDIX IX

Commonwealth Loan Raising Procedures

The Treasurer is the Minister traditionally responsible for all matters relating to overseas borrowings by the Commonwealth. Normal practice involves the Treasurer seeking the concurrence of Cabinet to an overall approach to overseas borrowing for the financial year as well as the Commonwealth submitting a loan program, covering its own needs during the following twelve months, to the Loan Council for approval. Borrowings by the Federal Government (except for defence borrowings authorised by the Parliament and borrowings for temporary purposes) are limited to this approved annual program although it generally includes a substantial contingency component (the so-called "hunting licence") to allow the Commonwealth flexibility to pursue its economic responsibilities without the need to obtain Loan Council approval for an increase should conditions require this during the year (1).

Once he has obtained these approvals, the Treasurer thereafter decides the particular composition of the program with the advice of his department. The Treasury obtains information about conditions on overseas markets from its own overseas representatives as well as established financial institutions, including the brokers and the central banks. The Government has tended to retain particular lead managers for its loans in each major market - Morgan Stanley and Co Inc in New York,
Deutsche Bank in the Eurodollar market, SG Warburg in London and Nomura Securities Company Ltd in Tokyo - which also provide regular reports on market developments. 

The size of the annual borrowing program depends firstly, on the level of maturities of overseas debt in the year, and then on such factors as overall market conditions, whether there were particular balance of payments/exchange rate or monetary management reasons for aiming for a certain level of borrowings and the implications of possible programs for the level of official foreign debt and its service costs. The Commonwealth's choice of market, currency and borrowing instrument is determined by a multiplicity of additional factors, the underlying objective being to seek the most efficient, cost effective method of government fund raising (2).

The executive power to borrow is vested by the Australian Constitution in the Queen and is exercisable by the Governor-General in Council (ie the body of senior Government Ministers, who advise the Governor-General in regard to his exercise of the executive power). In respect of individual overseas loans, the Governor-General in Council is formally required to determine the maximum amount to be borrowed. However, he delegates his other relevant powers (such as determining the terms and conditions of the borrowing) to the Treasurer (3).

As a matter of courtesy, Premiers are advised when negotiations
have progressed sufficiently to indicate that a loan would probably be forthcoming but, normally, are only consulted on the terms of the loan a few days before the Commonwealth actually commits itself. Consultations are by telegram and approval is sought on a "worst possible terms" basis. Loan Council approval of the terms and conditions of all loans have traditionally been considered to be subject to a 1956 resolution, which requires the concurrence of at least three Premiers (4).

At about the same time, an Executive Council Minute is used to authorise a person to act on behalf of the Commonwealth to carry out the activities necessary to raise the loan. Customarily, this authority is given to the Treasurer to borrow a specified sum on terms and conditions approved by not less than three Premiers. Certain persons are also authorised to sign the agreements relating to the loan on behalf of the Commonwealth as well as to countersign securities. After the loan is finalised, the Premiers, Parliament and the public are advised of the final details (5).

The Parliament has the power to enact legislation with respect to borrowing and is required to authorise the issue of securities and the expenditure of loan proceeds as well as appropriate funds for principal and interest payments (6). Funds raised overseas, therefore, cannot be spent except in accordance with an appropriation of the Parliament. This is set out in section 83 of the Constitution, which specifies that "no money shall be drawn from the treasury except under
appropriation made by law". This means that to use the proceeds of any overseas loan, the Government must have Parliamentary approval in the form of an appropriate Act.

Notes

3. Ibid., p20.
## Approved Infrastructure Projects and their Financing

### Additions to Larger Authorities' Programs - State & Commonwealth Distribution 1978/79 to 1981/82 ($m)

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<td>96.5</td>
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<td>-</td>
<td>-</td>
<td>76.8</td>
<td>167.1</td>
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Source: Budget Paper No.7, 1975-76 to 1982-83
### APPENDIX XI

**FUNDS ACTUALLY BORROWED OVERSEAS AS A PERCENTAGE OF THE TOTAL FUNDS BORROWED BY THE STATES UNDER THE INFRASTRUCTURE PROGRAM**

**1978/79 - 1981/82**

($ million)

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<td>TOTAL</td>
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<td>% O/S</td>
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<td>TOTAL</td>
<td>149.0</td>
<td>143.0</td>
<td>96%</td>
<td>399.4</td>
<td>322.3</td>
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**Source:** Derived from Budget Paper No 7 1982/83 P36&37

**Note:** No funds were borrowed overseas by the Commonwealth under the Infrastructure Program
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