Raising Government debt during COVID-19

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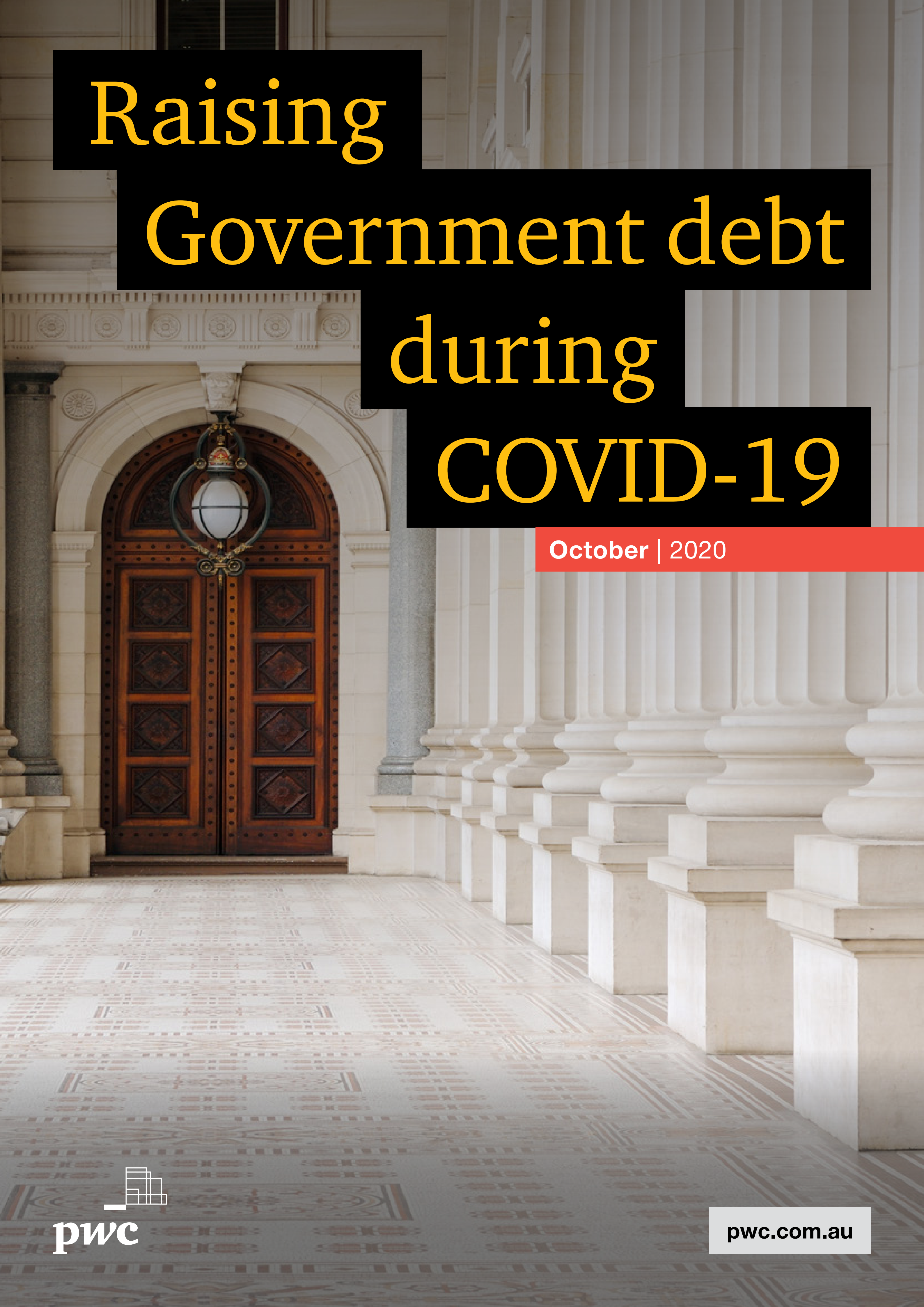

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Principles for raising government debt during COVID

The COVID-19 pandemic has ravaged economies around the world. Australia has avoided some of the most severe impacts, despite a second wave of infections in Victoria, but the economic cost will still be substantial. The drop in private sector spending and dramatic rise in unemployment has triggered a response from government at all levels with additional targeted spending.

Between them, the Commonwealth, state and territory governments have delivered fiscal stimulus up to the Federal July 2020 Economic and Fiscal Update in response to COVID-19 equating to approximately 17% of GDP. In August 2020, the Governor of the Reserve Bank urged all governments to further increase fiscal stimulus in the order of 2% of GDP to fund programs that directly create jobs.[1]

The case for investment

Historically, governments have limited debt-funded investment to capital projects and infrastructure, not wanting to crowd out private investment or incur high repayment costs. However, in the current economic and fiscal environment, the the RBA has recommended all levels of government engage in debt-driven spending. Doing this now has several benefits:

- Borrowing costs are at historically low levels, meaning the growth benefit could outweigh the cost of the debt with the right program spending.
- There is limited potential to crowd out private investment due the inherently uneconomic nature of many investments being considered.
- Debt stocks will be manageable and even low compared to other jurisdictions.
- There is limited tax revenue to fund fiscal stimulus.

If this debt-driven spending is targeted at job creating and productivity boosting initiatives, it has the potential to drive economic growth and boost future government revenue over the long term in excess of the cost of debt incurred.

If not now, when?

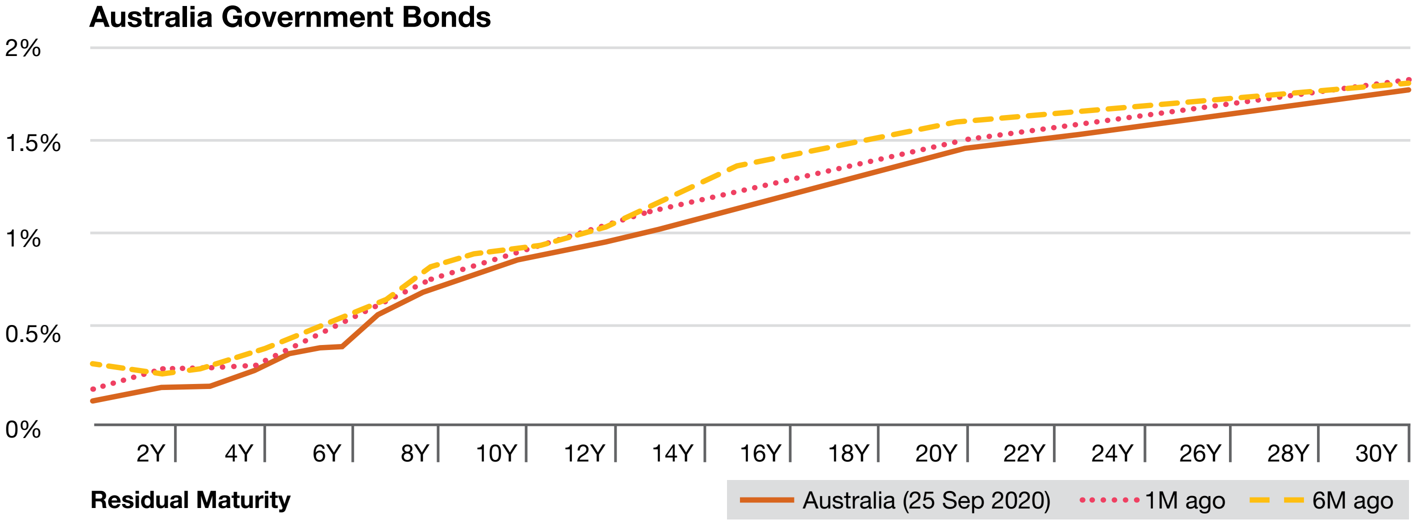
Yields on Australian Government Bonds have been at historic lows since before the pandemic. But demand for longer-term bonds (up to 30 years) remains strong, reflecting market confidence in Australia's long-term economic prospects.

The ability of governments to 'lock in' new debt at interest rates in the order of 2-3% for three decades[2] allows them to take a longer-term view in evaluating the costs and benefits of the individual programs that comprise their COVID response.

[1] RBA (21 August 2020) Dr Philip Lowe - National Cabinet Submission

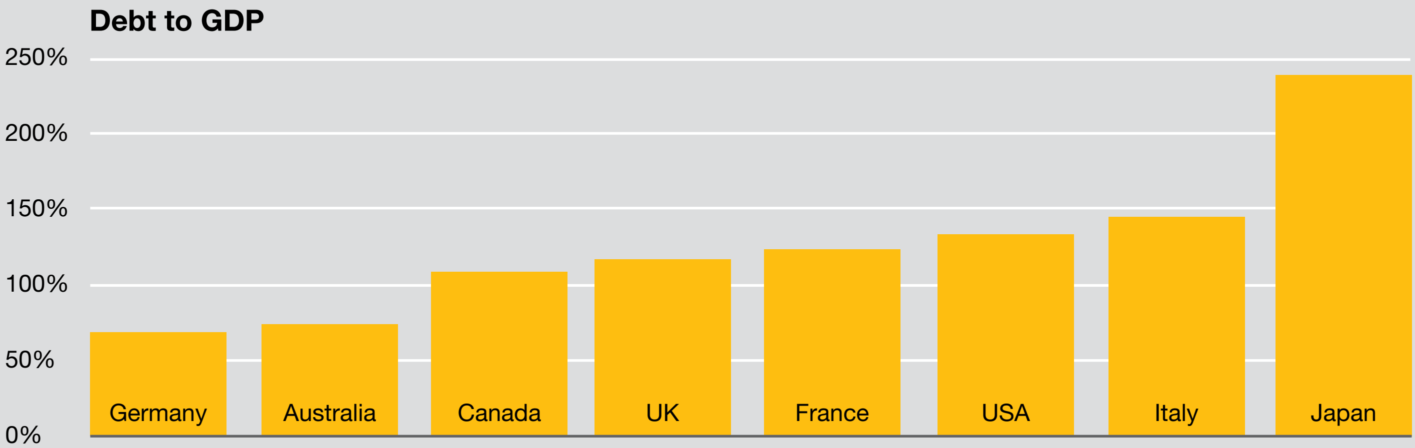
[2] Australia 30 Years Bond – Historical Data (25 September 2020) World Government Bonds http://www.worldgovernmentbonds.com/bond-historical-data/australia/30-years/

Australia Yield Curve
25 Sep 2020



Australia also went into the COVID-19 pandemic with relatively manageable levels of public debt by international standards. Before the pandemic, Australia's public debt as a proportion of its economy was lower than any of the G7 industrialised nations except Germany.[3]

This puts Australian governments in an extremely strong position to use debt-funded fiscal policy interventions to support demand and drive our economic recovery.



There is already public acceptance of the role of debt in funding infrastructure when the rationale is clearly communicated.

For a post-COVID stimulus, this can be achieved through clear articulation of a fiscal strategy that will see a return to surplus over the medium term.

Broadening the role of debt in fiscal strategy

Governments can continue to utilise debt to invest in assets as they have in the past, but they would benefit from taking a broader view of what constitutes an 'asset'. The scale of pre-COVID investment in the infrastructure sector means that the civil construction industry is already operating near capacity.

In order to deliver the required level of stimulus while ensuring value for taxpayer dollars, governments should now be looking to invest in other efficiency and productivity enhancing investments.

The types of non-capitalised 'assets' governments should be seeking to invest in include:

- structured data (i.e. asset information as an asset)
- critical systems resilience
- workforce capability and human capital
- intellectual property (e.g. developing and codifying processes and technical innovations).

[3] https://data.oecd.org/gga/general-government-debt.htm

Five additional debt-raising principles for COVID

Given both the capacity of jurisdictions to support expenditure with further debt, and the call on Governments for stimulatory spending, there is the opportunity to use debt as part of fiscal stimulus measures that satisfy five key criteria.

In developing programs that meet these criteria, principles of good policy design must also remain and would include clarity of outcomes being targeted and robust governance to ensure those outcomes are realised or the program is altered as it matures.

1. Enduring and productivity enhancing	Programs should seek structural productivity boosts that will endure beyond the life of the program.
2. Self-correcting	Programs should be designed to self-correct, with demand for the expenditure inherently falling away as the economy recovers enabling the program to be withdrawn in future (i.e. is not a structural feature of the budget) or to transition to a sustainably funded program in future (e.g. through ongoing savings in other programs).
3. Simple and at scale	A program should be clearly bounded with transparency that debt is being used to fund it. It should be easily understood to enable households and the private sector to understand, leverage and co-invest. The programs should be few and at scale to reduce administrative overhead and enhance speed of execution.
4. Multiplying	Programs should aim to boost complementary investment by the private sector or other levels of government.
5.Targeted	Programs should bias towards transfers and expenditure for groups with a high marginal propensity to consume to maximise the increase to aggregate demand, and with clarity on the target timeframes to ensure the fiscal stimulus is realised when it is most needed.

The relative importance of the application of these principles for post-COVID-19 debt raising will vary as jurisdictions move through the phases of recovery as outlined in the table below:

As the recovery progresses, the principles for debt funded expenditure become more limiting. The pace of recovery will vary between States.

Phases of recovery

Crisis	Recovery	Stabilisation	Normalisation
• Significant public health restrictions remain in place • Normal economic activity still significantly dislocated	• Long term stability and predictability in public health restrictions • All sectors of economy operating in some form • Demand still suppressed	• “COVID normal” attained • Demand and investment returning to normal but outlook uncertain • Structural changes to economy still underway	• “COVID normal” (or vaccine) • Global economic conditions stabilised • Consumer and business sentiment returned to pre-COVID levels.

Alignment to principles

Principle	Crisis	Recovery	Stabilisation	Normalisation
Productivity enhancing		✓	✓	✓
Self correcting	✓	✓	✓	
Simple and at scale	✓	✓	✓	
Multiplying	✓	✓		
Targeted	✓	✓		

Applying these principles to raise debt post-COVID

These five principles can be applied to a range of potential policy choices governments may make to provide fiscal support as Australia emerges from the health crisis and reboots the economy. We have provided a few examples here for consideration.

	Principles
National business cyber resilience To support the resilience of Australian business, an initiative could be delivered to educate businesses about cyber threats, provide advice about how to build cyber knowledge and capability, connect them with resources to improve the resilience of their business to cyber threats and provide grants for cyber tools.	1 2 3 4 5
Skills Training is critical to boost the productivity and earning potential of Australians. Existing initiatives funded by some governments that could be extended or adopted in other jurisdictions include one off free or subsidised online courses, and vocational education and training for skills shortages including health, aged care and ICT.	1 2 3 4 5
Access to early childhood education Improved access to early childhood education is associated with better long-term educational outcomes, driving higher productivity. It also removes an impediment to increased labour force participation in the short term, driving immediate economic growth.	? 2 3 4 5
Digital transformation Australians are relying on their government now more than ever. Improving digital services and data use now will enable governments to deliver services more efficiently and effectively into the future. Initiatives could include digital IDs, single login for all services and monetary incentives for citizens to update their online government profile.	1 2 3 4 5

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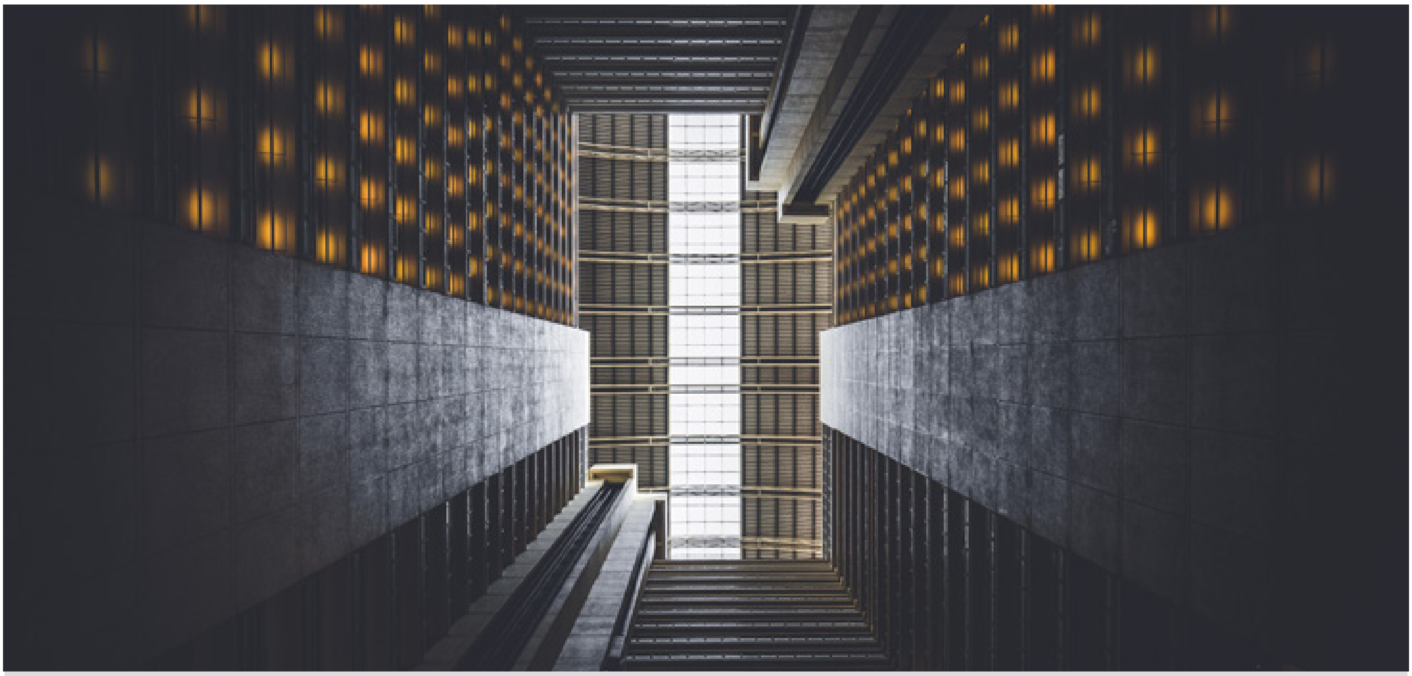

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