Raising Government debt during COVID-19

October | 2020
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 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 decades² allows them to take a longer-term view in evaluating the costs and benefits of the individual programs that comprise their COVID response.

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

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

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.

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

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
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:

### Phases of recovery

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

### Alignment to principles

- 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.

<table>
<thead>
<tr>
<th>National business cyber resilience</th>
<th>Principles</th>
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<tbody>
<tr>
<td>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.</td>
<td>1 2 3 4 5</td>
</tr>
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<tr>
<th>Skills</th>
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<tr>
<td>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.</td>
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<th>Access to early childhood education</th>
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<tr>
<td>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.</td>
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<tr>
<th>Digital transformation</th>
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<tr>
<td>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.</td>
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