AusCID

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Mr B Comley
General Manager
Commonwealth Debt Management Review
c/o Department of the Treasury
Langton Crescent
PARKES ACT 2600

Dear Mr Comley

**Review of the Commonwealth Government Securities Market**

The Australian Council for Infrastructure Development (AusCID) is pleased to have the opportunity to comment on the costs and benefits of maintaining the Commonwealth Government Securities Market.

While it is appropriate for others to address the more technical questions raised in the discussion paper, *Review of the Commonwealth Government Securities Market*, AusCID can address select issues relevant to infrastructure investment and delivery.

As the principal representative of investors, operators, financiers and service providers to public infrastructure, AusCID's key concern is the adverse impact that elimination of the Commonwealth Government Securities (CGS) market is likely to have on investment in public infrastructure in Australia via increased cost of financing such projects.

In its discussion paper the Commonwealth Treasury states that 'The CGS market, and its associated derivative markets, are the primary vehicles in Australia for managing interest rate risk', noting that 'the existence of efficient derivative markets for managing interest rate risks may lower the cost of borrowing for corporates.'

AusCID considers that there is no doubt that the cost of finance would increase for all borrowers/issuers in Australia if the bond market were abolished. Investors in infrastructure projects would most likely fare worst due to the higher risk parameters surrounding these projects.

If debt providers are unable to hedge interest rate risk efficiently in future, then it is likely that they will:

- demand a higher premium in the first place;
- scale down the size of the lending they are prepared to make in the first place; or
- lend a lot greater percentage of funds offshore.

This will mean that issuers who are large enough will more than likely go to the offshore markets, and those who are not will be forced back to the banks with the subsequent loss of transparency and higher funding costs. AusCID is concerned that, given banks' aversion to risk and their capital adequacy requirements, abolishing the GCS market could significantly increase the cost of capital for infrastructure borrowers in particular, and reduce investment activity in this area.

While there may be alternative financial risk management instruments to the GCS market, most notably corporate bonds and interest rate swaps, these are widely considered sub-optimal as their efficiency ultimately depends on the existence of an efficient and liquid underlying 'zero-risk' bond market.

It should be noted that this comes at a time when states and territories increasingly turn to the private sector to assist them in meeting Australia's infrastructure needs. Four state and one territory have introduced public private partnership policies which explicitly promote the involvement of the private sector in infrastructure financing and provision.

The Commonwealth has also released the *Commonwealth Policy Principles for the Use of Private Financing* to apply to arrangements where private finance is used to procure major infrastructure or assets.

Also at a Commonwealth level, the Deputy Prime Minister and Minister for Transport and Regional Services has recently released the *AusLink Green Paper. Towards a National Land Transport Plan.* The Green Paper states:

> "AusLink will promise sustainable national and regional economic growth, development and connectivity by contributing to an integrated land transport network which ….is planned, funded and managed efficiently, within a framework of reciprocal responsibility by all levels of government and with the involvement of the private sector".

The Deputy Prime Minister has stated that he expects that the AusLink package will lead to 'increased spending on roads and railways, as a result of increasing the involvement of the private sector' noting that the Green Paper proposes 'encouraging reciprocal responsibility - encouraging the joint and complementary development and funding of projects between governments, and with the private sector, to increase the level of available funding.'

In conclusion, evidence suggests that abolishing the CGS market is likely to increase the cost of finance, with negative implications for infrastructure provision around Australia. Given that Australia already suffers an infrastructure deficit and maintenance backlog, elimination of the Commonwealth Government debt market is clearly not in Australia's interest. Furthermore, it would be difficult to re-establish the bond market if required - once investors have moved offshore it may be difficult to encourage them to return to Australia to invest.

We urge the Government to retain a liquid and viable bond market to allow investors to effectively manage interest rate risk and to continue to invest in essential infrastructure.

We hope you find these comments useful.

Yours sincerely

Dennis O'Neill
Chief Executive Officer