The Inter-State Commission

A. PRELIMINARIES

1. Identity

Section 101 of The Commonwealth of Australia Constitution Act provides that there shall be an Inter-State Commission within the Commonwealth. It shall have the powers of adjudication and administration deemed necessary for the execution and maintenance, within the Commonwealth, of the provisions of the Constitution relating to trade and commerce. In addition, it shall have such other powers that the Commonwealth and the States deem necessary to achieve its objectives.

2. Objectives

The objectives of the Inter-State Commission (ISC) shall be to implement such policies for the Commonwealth and the States as would:

(a) establish full employment;
(b) sustain economic growth;
(c) facilitate price stability;
(d) avoid undue foreign debt;
(e) contribute towards balanced fiscal outcomes;
(f) nurture all industries;
(g) make possible economic independence and self-reliance;
(h) enable unfettered international movement of capital;
(i) achieve financial stability;
(j) foster economic stability;
(k) ensure justice in economic policy;
(l) apply sound governance over economic policies; and
(m) support democracy in economic institutions.

3. Membership

(a) The members of the Inter-State Commission shall be appointed by the Governor-General in Council. Nominees shall be selected from elected members of the Commonwealth and State Governments.

(b) The ISC shall elect a Chairman and a Secretary.

(c) The Chairman shall be responsible for calling meetings of the ISC, and for the conduct of those meetings.

(d) The Secretary shall be responsible for the administration of the ISC, including ensuring that the decisions of the ISC are put into effect. The draft agenda is to be prepared by the Secretary with the concurrence of the Chairman. The Secretary shall be responsible for the operation of the ISC Secretariat.

(e) The ISC may appoint Directors responsible for sectors of the economy and for the operation of the ISC.

(f) The ISC shall meet at least twice each calendar year.

(g) Members shall hold office for up to seven years, provided that they continue to be members of a Commonwealth or State House of Parliament and at the pleasure of the Governor-General in Council.

(h) The ISC shall conduct an election of officers following every election of the Commonwealth Parliament.

(i) Each members shall receive an allowance of $10,000 per month or such remuneration as Parliament may fix.

4. The Reserve Bank of Australia

(a) The Reserve Bank of Australia (RBA) shall be responsible for putting into effect the policies of the ISC. These include:

- implementing its exchange rate policy;
- holding foreign currency reserves;
- monitoring bank lending activities; and
- ensuring that financial institutions comply with the rules and guidelines of the ISC.

(b) All banks, including State Banks, are to establish a Reserve Deposit Account with the RBA. The reserve deposit accounts are to be used to make interbank settlements. Also, purchases and sales of domestic notes and coins are to be made through the reserve deposit accounts.

(c) The RBA shall report regularly to the ISC on its progress in implementing its policies, upon the effectiveness of those policies and on any other matters that the ISC may require of it.

B. POLICY INSTRUMENTS

5. Bank Lending to Reserve Ratio

(a) From the date that the ISC determines, each bank is to establish a Reserve Deposit Account with the RBA. A bank may contribute to its Reserve Deposits (RD's) using funds received in transfers from inter-bank settlements, and by selling to the RBA:

- domestic bank notes and coins; and
- foreign currency.

(b) Likewise, a bank's RD's may be reduced when their RD's are paid as transfers to other banks in the process of undertaking inter-bank settlements and when banks purchase from the RBA:

- domestic bank notes and coins; and
- foreign currency.

(c) The ISC is to determine a Bank Lending to Reserve Ratio (BLRR) that determines the additional amount of bank lending permitted for each bank relative to the growth of its Reserve Deposits. The BLRR may be determined as a range, or matrix of ratios, to apply according to the level of the RBA's Foreign Currency Reserves and the rate of inflation such as shown in the table in paragraph 11(b).

(d) For the purposes of the Inter-State Commission, banks are financial institutions that accept, hold and transfer deposits. Financial institutions that accept and hold deposits but do not transfer deposits are not classed as banks for the purposes of the BLRR. It is the ability of the financial institution to transfer deposits which makes them negotiable instruments and determines that they are an entity that must comply with the BLRR requirement. Also, any institutions that guarantee the securities of other entities are required to comply with the BLRR. In addition, any institution that issues securities, or financial or other instruments of exchange, that are not guaranteed by a bank,

yet are negotiable, is subject to the same requirements as apply to banks. The policies applying to banks apply to those institutions, in so far as they are relevant.

(e) The BLRR applies to the *growth* in bank lending relative to the *growth* in Reserve Deposits. Two forms of lending are to be regulated using the BLRR. These are loans that are shown on the bank's balance sheet and those in the form of guarantees of securities. During the first year of the BLRR arrangements, the RBA may purchase government securities[1] from banks to increase their RD's for the purpose of providing funds for inter-bank settlements.

(f) Banks may issue guarantees for purposes other than securities. While those guarantees may not constitute part of the money supply, banks may receive funds in exchange for these guarantees. Those funds should not be intentionally or inadvertently used to raise the bank's lending capacity. Therefore, such guarantees are to be subject to the BLRR.

(g) To facilitate the regulation and monitoring of these loans and guarantees, each bank is to advise the RBA each month of the total amount of its loans and guarantees. To establish the starting position, each bank is to advise the RBA of the initial amount of its loan outstanding on its balance sheets and of its off-balance sheet commitments on the day before the BLRR is to apply. (The amount of a bank's total loans outstanding on their balance sheet includes holdings of government and other securities.) The initial amount of a bank's Outstanding Loan Commitments (OLC) shall become its initial Certified Outstanding Loan Commitment (COLC). The amount of a bank's off-balance sheet commitments for securities, including bank endorsed securities, are the bank's Security Guarantee Commitments (SGC). A bank's initial SGC shall become its initial Certified Security Guarantee Commitment (CSGC). All Other Guarantees and Commitments (OGC) on the day before the BLRR rates apply are to be the bank's initial Certified Other Guarantees and Commitments (COGC). Any Reserve Deposits (RD's) held by the RBA on the day before the BLRR applies shall be the banks' initial Committed Reserve Deposits (CRD's).

(h) The COLC, CSGC, COGC and CRD's of a bank established after the introduction of the BLRR shall be the opening amount of its OLC, SGC, OGC and RD's on the day that it was established as a bank.

(i) The BLRR is to apply to the *growth* each month in each bank's Outstanding Loan Commitment (OLC), Security Guarantee Commitment (SGC) and Other Guarantees and Commitments (OGC) above the amount of its COLC, CSGC and COGC. The ISC may redefine the components included in each of these categories and what are the reporting requirements, as it sees fit.

(j) Once the BLRR is in force, each bank is to report each month to the RBA on the total amount of its OLC, SGC and OGC. If a bank's RD's are sufficient to comply with the BLRR, then:

- the bank's reported OLC shall become the bank's Certified Outstanding Loan Commitments (COLC);
- the bank's reported SGC shall become the bank's Certified Security Guarantee Commitment (CSGC);
- the bank's OGC shall become the bank's Certified Other Guarantees and Commitments (COGC); and

[1] The total amount of government securities that the RBA may purchase from banks is not to exceed 25 percent of the growth in foreign currency reserves purchased by the RBA since the introduction of the BLRR. This requirement is necessary to prevent the growth of RD's generating excessive bank credit and depleting foreign currency reserves.

- the RD’s that each bank is required to hold to comply with the BLRR for its COLC, CSGC and COGC shall become its Committed Reserve Deposits (CRD’s).

(k) The BLRR is to apply to the sum of the growth of OLC, SGC and OGC above their respective COLC, CSGS and SOGC. If the balance of any of the OLC, SGC or OGC declines below their respective COLC, CSGC or COGC, that reduction cannot be used to increase the balance of the other guarantees or forms of lending.

(l) If a bank’s RD’s are insufficient to comply with the BLRR requirements, then the bank may not increase its OLC, SGC and OGC until the RBA authorises it to do so. Even so, if the bank’s RD’s are greater than its CRD’s, it may raise the amount of its COLC, CSGC and/or COGC as far as it is able to do so and remain compliant with the BLRR. To the extent that it does so, its RD’s would become CRD’s. A bank whose RD’s have proved insufficient, may continue to lend and/or provide guarantees up to the level of its COLC, CSGC and COGC when their OLC, SGC or OGC are below their respective certified levels subject to the constrains specified in the table in paragraph 17(d).

(m) A bank with insufficient RD’s to comply with the BLRR requirements is not to engage in any activity that would raise its OLC, SGC or OGC while they exceed their respective certified amounts. When a bank that had insufficient RD’s is able raise its Reserve Deposits sufficiently to comply with the BLRR requirements, it may, with the approval of the RBA, raise its COLC, CSGC and COGC accordingly and continue its lending activities.

(n) If a bank’s Reserve Deposits (RD’s) fall below its Committed Reserve Deposits (CRD’s) then the bank is required to respond and take action to raise its RD’s to at least the amount of its CRD’s.

6. The Base Currency Unit (BCU)

(a) The Base Currency Unit (BCU) is a unit of account the value of which is defined according to a basket of currencies. The Inter-State Commission may modify the basket as it sees fit.

(b) The initial value of one BCU is defined as value of the sum of the amounts of the following currencies:

Currency	Currency	Units of Currency
Canadian Dollar	CAD	4.80
Swiss Frank	CHF	3.40
Chinese Yuan Renminbi	CNY	49.20
Euro	EUR	13.40
Pound Sterling	GBP	5.90
Indian Rupee	INR	585
Japanese Yen	JPY	962
South Korean Won	KRW	4,660
United States Dollar	USD	14.10

7. The Exchange Rate

(a) The ISC shall put in place policies to adjust the value of the Australian dollar against the BCU to attain full employment. An example of how that policy may be presented is shown in paragraph 9(d).

(b) The RBA is to implement the ISC’s exchange rate policy. To that end, the RBA may apply a maximum exchange rate, or an exchange rate cap, defined in terms of BCUs. The RBA would offer to purchase foreign currency at that cap price.

(c) When the RBA has accumulated the equivalent of more than 2.5 months of imports in foreign currency reserves, the RBA may apply a minimum exchange rate or floor price. To create the floor, RBA would offer to sell foreign currency from its foreign currency reserves at the floor price. The ISC should provide guidelines to determine the range within which the exchange rate may trade and the pace at which that range may be adjusted. These guidelines should be used to control inflation, as shown in the tables in paragraphs 11(d) and 11(e). Banks would pay for the foreign currency bought at the floor price using funds from their Reserve Deposits. When the RBA sells foreign currency, it not only reduces the bank's RD's, but it also takes money out of the economy and reduces banks capacity to increase their lending. Changes to the exchange rate cap and floor should be made slowly to minimise speculation and allow the economy to adapt to the changes.

(d) The ISC arrangements ensure that the banking system can finance Australia's foreign exchange requirements. Therefore, the Commonwealth does not need to turn to any other finance markets to do so. That capacity enables the Commonwealth to be independent and set its own exchange rate to achieve its own objectives and avoid relying upon the foreign exchange market to set the rate.

8. The Level of Foreign Currency Reserves

(a) The RBA is to hold Foreign Currency Reserves to ensure that the Bank can meet the Commonwealth's foreign currency requirements at the exchange rates that it has established. The ISC determines is to determine a target range for Foreign Currency Reserves in terms of months of imports and may vary that target range as it sees fit. Also, it may vary the BLRRs in response to the levels of Foreign Currency Reserves to contribute to the stability of those reserves as shown in the table in paragraph 16(b). ISCs manage only the Foreign Currency Reserves of the RBA and the banks. Foreign currency reserves held by governments and the private sector are not available to the banking system and are not to be included in defining the level of Foreign Currency Reserves that the ISC manages.

(b) When the BLRR arrangements come into effect, the banks, and other financial institutions to which the BLRR applies, may not raise the level of their foreign debt, either directly or indirectly, other than to hold the deposits of foreign banks and other foreign entities. This requirement is intended to prevent banks from raising their foreign debt to raise their Reserve Deposits.

(c) If the RBA's holdings of Foreign Currency Reserves exceed the ISC target holdings, it may sell foreign currency to purchase domestic financial assets such as government securities.

PART D: STRATEGIES

9. Full Employment

(a) The ISC must determine what it considers to be its target for full employment. That may be defined as a level of unemployment or comprise target levels of unemployment for a range of age categories. Also, the ISC may define what it considers to be unemployment for the purposes of its economic policies. The strategy for raising employment is to use export income, and other foreign currency receipts, to stimulate the economy.

(b) The first step towards full employment is to stabilise the exchange rate by applying a cap to the exchange rate. If demand is insufficient to achieve the target level of employment, the ISC is to slowly devalue the Australian dollar against the BCU until the demand for domestic products is sufficient to attain its full employment target.

(c) Before the ISC can put its employment policies into effect, it must ensure that the Bank Lending to Reserve Ratio (BLRR) arrangements are in place. Also, the ISC is to determine the initial exchange rate cap or maximum exchange rate in terms of BCUs. The maximum exchange rate may be determined as the exchange rate on a specific day, such as the business day before the exchange rate policy is to be put into effect. The RBA would purchase foreign currency on the foreign exchange market at the cap price and credit the bank's Reserve Deposit accounts. The foreign currency purchased would be added to the RBA's foreign currency reserves. The banks receiving the Reserve Deposits would make a corresponding credit in the accounts of those customers that received the foreign currency. Those funds credited would immediately enter the economy as additional export income and other foreign currency receipts. When spent, they can be expected to generate additional employment.

(d) The ISC is to advise the RBA of its target range for unemployment. The purpose of devaluing the currency is to increase domestic demand for domestic products and raise the income of exporters. Also, it lowers the relative prices of domestic products and raises demand for domestic products. The speed at which the exchange rate cap is lowered may be varied to speed up or slow down the growth of employment. Indicative rates of adjustment for a ceiling or "cap" are presented in the following table.

	Indicative Adjustment Rate for the Exchange Rate Ceiling				
Rate of Unemployment	>5.0%	4.9%-4.0%	3.9%-3.0%	2.9%-2.0%	<2.0%
Adjustment rate when cap is Binding					
Rate per business day	-0.010%	-0.008%	-0.005%	-0.002%	0.000%
Effective rate per annum	-2.5%	-2.0%	-1.3%	-0.5%	0.0%
Adjustment rate when cap is Not Binding					
Rate % per business day	-0.04%	-0.03%	-0.02%	-0.01%	0.00%
Effective rate per annum	-10.5%	-7.8%	-5.1%	-2.5%	0.0%

(e) The ceiling, or cap, is said to be "binding" when the RBA has purchased foreign currency to enforce the ceiling in the previous business day. If the RBA has not engaged in purchasing foreign currency on the previous business day, then the cap is said to be not binding.

(f) When the rate of unemployment reaches the target range, the exchange rate cap may be stabilised and a floor put in place and raised to collar the exchange rate at that level. If the exchange rate cap was not binding and the rate of growth of employment was greater than desired, it may be necessary for the ISC to apply and raise the exchange rate floor before employment has reached its target range.

(g) There may be circumstances, such as inflation, that impinge upon the ISC and the RBA'a ability to apply the ISC's employment strategy. These should be expected. There are likely to be other constraints that affect the economy, and these may influence the speed of change. The ISC and the RBA should respond to these as they occur. Also, different sectors of the economy are likely to respond at different speeds to the changing conditions. Therefore, the ISC and the RBA are to be careful when lowering the exchange rate to allow these industries time to respond, so as to ensure a soft landing and avoid unnecessary inflation.

10. Economic Growth

(a) The ISC strategy for bring about economic growth is to cause disequilibrium in international trade: that is, to ensure that international receipts are greater than international payments. Economic growth involves moving the economy from the current equilibrium position towards

another equilibrium position with higher income. When the economy reaches equilibrium (where international receipts and payments are equal) it stops growing. The task of maintaining economic growth requires the continual increase of exports and other foreign receipts which in turn raises imports and other foreign currency payments. The additional foreign currency received from the additional exports is available to pay for the additional expenditure on imports. That makes the process sustainable.

(b) Disequilibrium is to achieve by raising export incomes, and other foreign income and receipts. Those additional funds would raise total spending for both domestic products and imports. The additional exports sales together with the additional spending on domestic products would both generate additional employment.

(c) The ISC may define its target for economic growth in terms of per capita incomes, national income or other measures of economic welfare. It has a range of policy options to raise and control the rate of economic growth, depending upon the circumstances in the economy. While unemployment exceeds the ISC targets, the exchange rate adjustments will generate economic growth. Once full employment is attained, other measures would be required.

(d) One approach is to raise foreign currency receipts by developing new products and making existing ones cheaper by improving productivity, investment in capital and technology. The second approach is to raise demand from among trading partners. If trading partners were to adopt the ISC approach to economic management, any growth in their income would raise their imports which is likely to raise export income and stimulate the Australian economy.

(e) Bank lending can raise demand by accelerating the speed at which money from the growth of trade flows into the economy. The growth in export incomes would raise bank Reserve Deposits with the RBA, enabling banks to increase their lending and stimulate the economy. However, when that money was spent on imports, it would reduce bank Reserve Deposits and that would constrain further growth in bank lending. Therefore, bank lending cannot be relied upon to sustain an increase in incomes in the long term. That is why money from export growth is a better approach to raising incomes. When imports subsequently rise, the economy has the foreign currency reserves to pay for them. Therefore, export growth is a sustainable source of economic stimulus and growth.

(f) There may be other constraints that slow the rate of economic growth in an economy that the ISC must consider. Some past policies may need to be revised in the light of the ISC approach to managing the economy. Those policies may include wages policies, competition policies, privatisation policies, savings policies, education policies, industry policies and trade policies.

(h) Economic growth may be raised by improving the efficiency of the economy, including its infrastructure, legal/judicial system, health policy and education system. There may be constraints in the form of accepted norms that may be difficult to remove. One of the ongoing tasks of the ISC shall be the review of business regulation with a view to ensuring that regulation applies only to those businesses and business activities that need to be constrained.

11. Price Stability

(a) Price variations are a signal to the market and are an important part of how the economy functions. They should be considered a normal part of economic activity. Some price changes are beyond the control of the national economy. For example, a rise in international oil prices is likely to be beyond the control of the ISC. Therefore, it would be futile for the ISC to respond to inflation caused by such price rises. The ISC should establish a clear statement of its targets for inflation and identify those forms and sources of inflation that it is able to address.

(b) There are two basic sources of inflation that the ISC may wish to respond to. They are inflation from excessive monetary growth and inflation imported through the price of foreign products. Inflation from excessive monetary growth can be managed primarily by reducing the growth of bank credit. That may require the ISC to reduce the BLRR. Establishing predetermined BLRR responses to inflation contributes to price stability and avoids the ISC having to meet to respond to every change in the rate of inflation. To adopt such an approach, the ISC must determine a trigger rate of inflation for domestic products (other than in response to a natural disaster or other significant non-monetary events), above which a policy response is applied, as shown in the table below. In that table, Foreign Currency Reserves are defined in terms of the equivalent number of months of imports[2]. The BLRR rates vary according to the rate of inflation (horizontal axis) and the level of Foreign Currency Assets held by the RBA (vertical axis). The rates apply to the growth each month in each bank's loans, guarantees and commitments. The table provides an indicative array of bank lending to reserve ratios. The ISC is to determine the array that it considers most relevant to the economic conditions.

	Indicative Bank Lending to Reserve Ratios					
Rate of Inflation	>10.0%	9.9%-7.0%	6.9%-5.0%	4.9%-3.0%	2.9%-2.0%	<2.0%
Level of Foreign Currency Reserves (in terms of Months of Imports)						
<3 0	1.0	1.5	3.0	4.0	5.0	6.0
3.0-3.9	1.0	1.7	3.7	5.0	6.0	7.0
4.0-4.9	1.0	1.8	4.3	6.0	7.0	8.0
5.0-5.9	1.0	2.0	5.0	7.0	8.0	9.0
6.0-6.9	1.0	2.1	5.5	7.8	8.9	10.0
7.0-7.9	1.0	2.3	6.0	8.5	9.8	11.0
8.0-8.9	1.0	2.4	6.5	9.3	10.6	12.0
9.0-9.9	1.0	2.4	6.8	9.6	11.1	12.5
10.0-10.9	1.0	2.5	7.0	10.0	11.5	13.0
11.0-12.0	1.0	2.6	7.3	10.4	11.9	13.5
>12.0	1.0	2.6	7.5	10.8	12.4	14.0

(c) The process of devaluing the currency to raise employment and provide economic growth is likely to raise the price of imported products and that inflation could feed through to domestic products. If the ISC were devaluing its currency, imported inflation may be reduced by slowing the pace of devaluation.

(d) Also, the ISC may take money out of the economy by selling foreign currency to the market. The following table presents an indicative range of depths for the floor to sit below the exchange rate cap. These would assist in controlling inflation.

[2] For example, if country's level of imports were in the order of $600 billion per annum and the Foreign Currency Reserves were in the order of $100 billion, then its foreign currency reserves would be the equivalent of 2 months imports.

	Indicative Level of the Floor below the Ceiling Exchange Rate					
Rate of Inflation	>10.0%	9.9%-7.0%	6.9%-5.0%	4.9%-3.0%	2.9%-2.0%	<2.0%
Level of Foreign Currency Reserves (in terms of Months of Imports)						
<3 0	2.0%	2.8%	3.6%	4.4%	5.2%	6.0%
3.0-3.9	1.6%	2.1%	2.6%	3.0%	3.5%	4.0%
4.0-4.9	1.4%	1.7%	2.0%	2.4%	2.7%	3.0%
5.0-5.9	1.2%	1.4%	1.5%	1.7%	1.8%	2.0%
6.0-6.9	1.0%	1.2%	1.4%	1.6%	1.8%	2.0%
7.0-8.9	0.8%	1.0%	1.3%	1.5%	1.8%	2.0%
9.0-12.0	0.6%	0.9%	1.2%	1.4%	1.7%	2.0%
>12.0	0.5%	0.8%	1.1%	1.4%	1.7%	2.0%

(e) The RBA would offer to sell foreign currency to the foreign exchange market at the floor price to enforce that floor. Selling foreign currency is intended to reduce banks' RD's and reduce their capacity to issue loans. Adjustments to the floor should not be made suddenly, particularly if they are binding. An indicative rate for the speed of adjustment of the floor, or minimum, exchange rate is presented in the following table.

	Indicative Adjustment Rate for the Exchange Rate Floor				
Rate of Inflation	>5.0%	4.9%-4.0%	3.9%-3.0%	2.9%-2.0%	<2.0%
Adjustment rate when floor is Binding					
Rate per business day	0.020%	0.010%	0.008%	0.005%	0.002%
Effective rate per annum	5.1%	2.5%	2.0%	1.3%	0.5%
Adjustment rate when floor is Not Binding					
Rate % per business day	0.10%	0.06%	0.03%	0.02%	0.01%
Effective rate per annum	28.4%	16.2%	7.8%	5.1%	2.5%

(f) The floor is said to be not-binding when the RBA did not sell any foreign currency at the floor price on the previous day of business. It is the responsibility of the RBA is to continue to keep the exchange rate within the band (or such other limits that the ISC may determine) between the floor and the ceiling.

(g) In circumstances of excessive inflation, or excessive monetary or economic growth that may threaten inflationary pressures, it may be advisable for the ISC to raise the exchange rate floor so that the RBA can sell more foreign currency reserve assets and reduce the banks' RD's.

(h) If the currency is stable and the economy continues to be confronted with excessive imported inflation, the ISC may choose to inflate the currency against the BCU. It should be noted that this may have implications for the rate of economic growth and the level of employment. Also, the ISC may choose to appreciate of the value of the BCU. Again, such an appreciation should be done slowly with daily or weekly adjustments. Another short-term option may be to reduce import tariffs. However, that may cause fiscal problems.

12. Foreign Debt

(a) The ISC manages the foreign debt created by or within the banking system. The full employment and price stability strategies, considered in Sections 9 and 11, build foreign currency reserves, and those reserves reduce net foreign debt in the monetary system. The RBA is to collect data on the foreign debt and foreign currency assets of the banks and report them to the ISC,

together with the RBA's own foreign currency assets and debt. The data can be collected at the same time as the banks report on their outstanding loan commitments. From the time that the BLRR is put in place, banks and other institutions required to hold RD's, are not to increase their foreign liabilities, other than in the form of current deposits of foreign banks and other foreign entities.

(b) The first step for the ISC to reduce net foreign debt is to cap the value of the Australian dollar to enable the monetary system to start building up foreign currency reserves. As explained in Section 5, the RBA is to purchase foreign currency assets on the foreign exchange market and credit the banks' Reserve Deposit Accounts. Those foreign currency purchases would immediately reduce the net level of foreign debt.

(c) The growth of bank credit may continue to raise foreign debt, initially. That is because the growth of bank credit is likely to continue to finance national expenditure in excess of national income and cause imports to exceed exports. Once the RBA has a binding floor on the exchange rate, the reduction in RD's caused by its purchases of foreign currency will reduce and eventually prevent the excessive growth of bank credit that would otherwise have raised foreign debt. That is, the BLRR requirements would prevent banks from lending the country further into debt.

(d) Many foreign exchange transactions are between banks. When banks make their inter-bank settlements, those transactions may affect their individual RD's but not the overall capacity of the banks to lend nor the overall level of foreign debt.

(e) Non-bank entities may continue to borrow from foreign sources. The growth of the foreign currency reserves in the RBA ensures that when those entities repay their debts, the banking system has the foreign currency reserves necessary to repay those debts. If those foreign debt repayments were significantly large, they could reduce the NMA's foreign currency reserves. However, those debt repayments would reduce the RD's of the banks. That would constrain the banks capacity to lend until their RD's, and the RBA's foreign currency reserves, were replenished. Thus, the ISC arrangements constrain the economy from going further into debt.

13. Balanced Fiscal Outcomes

(a) The ISC does not directly manage public finances. Rather, it aims to put in place an economic environment conducive to maximising the income of the Commonwealth and, thereby, the income of Commonwealth, State and Territory governments. By maximising employment opportunities, it minimises the need for social security payments to the unemployed and thereby reduces the demands upon public finances.

(b) Even so, government revenues may be insufficient to finance all public expenditure. In that case, the ISC is to encourage governments to ensure that their taxes and other revenue are sufficient to finance their operating[3] expenditures.

(c) Governments unable to finance their operating expenditures from their public revenues pose a threat to the stability of their economies. That is because they may need to continue to borrow funds at a time when the economic conditions warrant that lending be constrained. Lending at such times could reduce foreign currency reserves and inhibit the RBA's ability to finance international transactions and maintain the value of the currency.

(d) For the purposes of the ISC's policies, government loans are treated the same as the loans of the private sector. Therefore, public sector borrowings reduce the banks' capacity to lend to the

[3] Operating expenditures are the regular recurrent expenditure of governments. It excludes capital and other discretionary expenditure.

private sector. To maximise the capacity of the private sector to access funds for investment, public capital expenditure should be financed from taxes and other government income when possible.

(e) For the purposes of the ISC's macro-economic policy, public expenditure is to be defined in terms of cash flow. Depreciation of public assets is not treated as an expenditure and expenditure cannot be offset by the accumulation of non-monetary assets. Such practices are normal in business to give the appearance that costs are spread over a number of years so as to allow businesses to show a profit to shareholders earlier than otherwise would have been the case. However, government is not a business, and it does not pay dividends. For the purposes of determining the amount of government expenditure in its budgets and accounts, expenditure on capital items is to be treated as public expenditure and not an investment in an asset.

14. Nurture All Industries

(a) The ISC's BLRR arrangements manage the growth of demand to ensure that foreign currency reserves are not depleted. That policy frees the exchange rate as a policy instrument to ensure full employment and to move to a stable rate to enable all industries to prosper from the growth of international trade.

(b) Therefore, the exchange rate does not need to rise when exports rise. It means that any the growth of exports does not reduce the incomes of existing exporters. When the exchange rate rises in response to a rise in exports, the reduced export incomes has driven existing exporters with lower margins out of business. The ISC arrangements enable existing exporters to continue to receive the same income as before the growth in exports. It enables them to continue to prosper together with the new exporters.

(c) Under systems that required the exchange to rise in response to the growth of exports, the higher exchange rate would make imports cheaper than domestic import competing products. That would drive consumers to buy the cheaper imports rather than the domestic product. The lower demand for domestic products would undermine and destroy those domestic industries. The stable exchange rates under the ISC arrangements ensures that import competing industries can continue to prosper.

(c) The ISC's process for optimising and stabilising the exchange rate allows additional funds to enter the economy, raising the demand for all products. That rising demand enhances the prosperity of all industries. All industries can prosper without the risk and fear that the exchange rate may rise and make them uncompetitive. The system ensures that all industries can compete fairly in business, both on the domestic market and in international markets.

15. Economic Independence and Self Reliance

(a) The optimum exchange rate established under the ISC's approach to maximising employment and balancing international payments, enables the Australian economy to become independent and self-reliant. The policies and procedures ensure that the economy can sustain its level of expenditure without relying on other countries or entities to support it. That is not to say that the economy cannot benefit from assistance. However, if that assistance were not available for any reason, the Commonwealth should be able to continue to prosper.

(b) As the ISCs implement these policies, it will be ensuring that the Commonwealth has a sound monetary system. The growth of the RBA's foreign currency reserves would provide the economy with the confidence and the ability to maintain a stable currency that is freely convertible into other currencies. The economic growth engendered by these policies enable the economy to attain, and sustain, full employment and improve its self-reliance. Within the new monetary and economic

environment, the economy becomes more independent and able to follow its own aspirations and apply its own social and economic policies.

(c) When the ISC applies its procedures, it will be encouraging the development of Australian industries and ensuring that the economy spends within its means. Governments may choose to borrow foreign funds to invest in infrastructure and finance other developments. If they do, the structure that the ISC puts in place will ensure that, if the government has the local funds to repay its debts, the monetary system will have the foreign currency necessary to meet those commitments.

16. Unfettered International Movement of Capital

(a) The large foreign currency reserves fostered under these ISC arrangements ensure that there is no need to restrict international capital movements. Such movements do not threaten the stability of the currency. Therefore, it is not necessary for the ISC, nor the RBA, to restrict the international movement of capital funds. That is not to say that the economy must allow all forms of capital inflow and outflow.

(b) Capital outflows can be expected to reduce banks' RD's. If those RD's were excessively reduced, the BLRR guidelines would automatically restrict the growth of bank credit. That may constrain investment in the economy. However, if financial markets are operating efficiently and effectively, economies in need of capital for investment would be expected to pay higher interest rates and that would attract foreign capital. Countries that have surplus funds can be expected to pay lower interest rates. Therefore, it would be expected that investors in those economies would move their funds to economies that have a greater need for capital and, therefore, pay higher interest rates.

(c) The ISC arrangements reduce exchange rate risk for international investors. They are likely to be more willing to invest in Australia because they can be confident that they will be able to repatriate their funds when they wish with little exchange rate risk. Therefore, the unfettered international movement of capital together with the stable monetary system under the ISC style of policy is likely to make available to Australia a more efficient and effective international capital market.

17. Financial Stability

(a) This ISC approach to managing bank lending generates financial stability because it ensures that banks have the resources to meet their commitments. The requirement to hold reserve deposits with the RBA and to use these to make interbank settlements and meet foreign currency commitments ensures that any bank that starts to have problems are automatically and immediately constrained from extending further loans and expanding its difficulties.

(b) The reserve deposit requirements ensures that banks build up substantial resources that are available to them to settle their commitments without having to borrow additional funds. Those deposits impede the effect of bank failures impinging upon the stability of other banks. Even if a bank failure does affect other banks, the banks' large holdings of RD's contribute substantially to their ability to meet their commitments.

(c) The procedures presented in the table in the following paragraph, ensure that there is a clear and automatic process known to the banks that they must follow if their RD's are insufficient. That requirement provides banks with a strong incentive to meet their BLRR commitments and remain solvent. It is a process that automatically prevents banks from growing their business unless they are stable and secure. Banks can be expected to make it a priority to manage their RD's, not only to look after their customer's interests, but also those of their shareholders.

(d) The following table sets out the constraints to apply to banks and their activities while their Reserve Deposits are below the amount of their Committed Reserve Deposits. These limitations are intended to ensure that banks remain stable and do not trade themselves into difficulties. They come into effect one year after the Reserve Deposit requirements are put in place. That delay is intended to give banks time to establish and stabilised their Reserve Deposits and meet minimum requirements. Note that during the first year, there may be an opportunity for banks to sell government securities to the RBA to increase their RD's[4].

Reserve Deposits relative to Committed Reserve Deposits.	Default Restriction Apply to Banks with Reserve Deposits less than their Committed Reserve Deposits
<100%	The bank is not to raise its OLC above its COLC, its SGC above its CSGC nor its OGC above its COGC.
<90%	The bank is not to make any new guarantees or commitments other than for securities.
<80%	The bank is not to secure or guarantee any more securities.
<70%	The bank is not to issue any further loans.
<60%	The bank is to dispose of any holdings of non-government securities and not purchase any additional non-government securities.
<50%	The bank is to dispose of any government securities it may hold and is not to purchase any additional government securities
<40%	The bank is to dispose of any other assets that are not necessary for its banking business and is not to purchase any other assets that are not necessary to its banking business.
<30%	The bank is to sell any remaining financial assets that may be sold to other banks or financial institutions.
<20%	The RBA is to negotiate with the bank and other banks as to whether the bank may be taken over by another bank or banks. Any bank or banks that takes it over must have Uncommitted Reserve Deposits sufficient to enable that bank to continue to lend after it has taken over the target bank.
<10%	The bank ceases to be classed as a bank. It ceases to have access to inter-bank settlements. The RBA is to organise for it to be classed as a non-bank, deposit-taking financial institution. Remaining Reserve Deposits may be used to settle any outstanding commitments to other banks and the remainder may be transferred to the RD's of the institution that is the banker for the former bank, or as agreed between the RBA and the former bank.

(e) The ISC's approach to managing bank lending avoids the use of interest rates. That improves the financial stability of the banks because raising interest rates can undermine the capacity of

[4] See paragraph 5(e).

existing borrowers to repay their loans. That is particularly relevant if the loans outstanding have variable interest rates. Banks may fail if borrowers are unable to repay their loans. Also, if a bank had a large portfolio of loans issued with fixed interest rates and market interest rates rise, they may face rising costs but a fixed income, leading to financial instability. The ISC approach to managing bank lending provides greater stability to the financial system because it does not use interest rates as an instrument of economic policy.

18. Economic Stability

(a) Economic stability is be fostered under the ISC arrangements because it uses predetermined processes to respond automatically to destabilising changes in the economy before they become critical. Also, the ISC has a range of policy instruments available to it to address different problems. Furthermore, the ISC policies promote a robust economy with full employment, economic growth, stable prices, declining net foreign debt and accumulating foreign currency reserves. These all contribute to economic stability.

(b) The ISC puts in place a range of action plans to response to a range of situations. They include measures to lower the BLRR and reduce the growth of bank credit if inflation occurs or foreign reserves decline. That approach does not necessarily reduce economic growth because additional income from trade can continue to stimulate the economy without inflating prices.

(c) If unemployment were to rise, the economy would respond automatically by devaluing the currency to make domestic products relatively cheaper and raise demand for them, thereby creating additional employment.

(d) While natural disasters or other physical, social, political and economic crises will occur, the monetary system is most likely to continue to be stable, allowing the continued functioning of government, business and household sectors. The large level of foreign currency reserves fostered under the ISC arrangements enable the economy to continue to function and pay for imports, even if export incomes are suddenly reduced.

(e) The foundations for the stability of the economy are the foreign currency reserves. If foreign currency reserves start to fall, the ISC has procedure in place to automatically stabilise them. Also, the ISC may take direct action in response to a crisis by lowering the BLRR.

19. Justice

(a) The ISC processes enhances justice for all participants in each economy. They establish a monetary system that ensures that the contributions of economic entities to the economy are rewarded appropriately. One of the major forms of injustice that the ISC arrangements address is the injury to domestic producers caused when the growth of exports inflates the value of the exchange rate. Justice is restored by putting in place policies that stabilise the exchange rate and enable all industries to prosper from international trade without adversely affecting another. These policies are the same as those used to provide full employment, economic growth, stability and avoid undue foreign debt.

(b) The result of all these policies is that the economy rewards all economic entities according to their contribution to the economy. The policies ensure that when exports increase, manufacturers who produce for the domestic economy prosper, along with the exporters. Also, exporters are not disadvantaged when other exporters increase their exports. The exchange rate is stable to bring prosperity to all industries.

(c) The amount that banks are allowed to lend is managed so that it does not drive the country into debt nor undermine the welfare and real incomes of those who have worked and contributed to the economy.

20. Sound Governance

(a) Monetary policy is the heart of economic policy. Money is the blood of the economy. It is used by every facet of the economy, including the government, primary industry, manufacturing, finance and household sectors. Therefore, it needs to be managed responsibly and fairly for the benefit of all sectors of the economy.

(b) In order to achieve that objective, the ISC is established as a separate government entity responsible for determining monetary policy. Monetary policy includes policies relating to the exchange rate, the growth of the money supply, the source of monetary growth, the security of the banking industry, the security of the economy, inflation and interest rates.

(c) To ensure accountability to the public and all stakeholders, each member of the Inter-State Commission (ISC) is required to be an elected representative of the Commonwealth or a State Government.

(d) The separation of the ISC, the entity responsible for determining monetary policy, from the RBA, the institution responsible for implementing the policy, improves the independence and transparency of the ISC. Also, it reduces the opportunity for the regulated entities to lobby the ISC.

21. Democracy

(a) Monetary policy has been left out of the democratic process in Australia. That has meant that there has been an opportunity for it to be prejudiced and misdirected away from the objective of maximising the welfare of the Commonwealth. The Inter-State Commission (ISC) is made up of members who have been democratically elected to office. That means that they are accountable to their respective elected governments and to the people that elected them, for the policies that they apply. An ISC of democratically elected members is more transparent and more likely to ensure that economic policy is directed at improving the welfare of the whole nation than a board of unelected experts, bankers and/or industrial representatives.

29. Glossary of Acronyms

BLRR	Bank Lending to Reserve Ratio
COGC	Certified Other Guarantees and Commitments
COLC	Certified Outstanding Loan Commitments
CRD's	Committed Reserve Deposits
CSGC	Certified Security Guarantee Commitment
ISC	Inter-State Commission
BCU	Inter-State Commission Currency Unit
RBA	National Monetary Authority
OLC	Outstanding Loan Commitments
OGC	Other Guarantees and Commitments
RD's	Reserve Deposits (with the RBA)
SGC	Security Guarantee Commitments