

# Chapter 2

## Background and overview of the bill

2.1 The bill proposes that an ARDB be established as a third board of the Reserve Bank of Australia (RBA). In this chapter, the committee outlines the current role and functions of the RBA and its two boards, before examining the role of the previous Commonwealth Development Bank and the proposed ARDB.

### *Current role of the Reserve Bank of Australia*

2.2 The Explanatory Memorandum indicates that the RBA already has the necessary regulatory framework, powers and relevant duties legislatively assigned to be able to constitute the ARDB as a third Board within the Reserve Bank of Australia.<sup>1</sup> The RBA is Australia's central bank, and is responsible for:

- Australia's monetary policy;
- maintaining the stability of the financial system;
- ensuring the stability, efficiency and competitiveness of the payments system;
- providing certain banking services to the Australian government, overseas central banks and official institutions;
- designing and issuing Australia's banknotes;
- managing Australia's gold and foreign exchange reserves; and
- providing specialised banking services to the Australian government, various government agencies, and a number of overseas central banks and official institutions.<sup>2</sup>

2.3 The Reserve Bank Act provides that the RBA is to act as a central bank and, subject to that Act and the *Banking Act 1959*, the RBA 'shall not carry on business other than as a central bank'.<sup>3</sup> Section 8 of the Reserve Bank Act outlines the RBA's general powers, which are as follows:

The Bank has such powers as are necessary for the purposes of this Act and any other Act conferring functions on the Bank and, in particular, and in addition to any other powers conferred on it by this Act and such other Acts, has power:

- (a) to receive money on deposit;
- (b) to borrow money;

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1 Explanatory Memorandum p. [1].

2 Reserve Bank of Australia, [www.rba.gov.au](http://www.rba.gov.au) (accessed 18 December 2013); *Annual Report 2013*, October 2013, pp. 3–4.

3 *Reserve Bank Act 1959*, s. 26.

- (c) to lend money;
- (d) to buy, sell, discount and re-discount bills of exchange, promissory notes and treasury bills;
- (e) to buy and sell securities issued by the Commonwealth and other securities;
- (f) to buy, sell and otherwise deal in foreign currency, specie, gold and other precious metals;
- (g) to establish credits and give guarantees;
- (h) to issue bills and drafts and effect transfers of money;
- (i) to underwrite loans; and
- (j) to do anything incidental to any of its powers.<sup>4</sup>

2.4 The RBA currently has two boards that, between them, are responsible for determining the RBA's policies on the matters entrusted to the bank. These boards are the Reserve Bank Board and the Payments System Board. The Reserve Bank Board is responsible for the RBA's monetary and banking policy and the RBA's policies on all other matters except for its payments system policy, which is the responsibility of the Payments System Board.<sup>5</sup>

2.5 The Reserve Bank Board is chartered with ensuring, within the limits of its powers, that the RBA's statutory powers, other than those that relate to the safety and stability of the payments system, are exercised in such a manner as will best contribute to:

- the stability of the currency of Australia;
- the maintenance of full employment in Australia; and
- the economic prosperity and welfare of the people of Australia.<sup>6</sup>

2.6 Within the limits of its powers, the Payments System Board is charged with ensuring that the RBA's payments system policy and the exercise of its statutory powers that relate to the payments system are exercised in a way that will best contribute to:

- controlling risk in the financial system;
- promoting the efficiency of the payments system; and
- promoting competition in the market for payment services, consistent with the overall stability of the financial system.

2.7 In relation to the RBA's powers and functions under Part 7.3 of the *Corporations Act 2001* that address the licensing of clearing and settlement facilities,

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4 *Reserve Bank Act 1959*, s. 8.

5 *Reserve Bank Act 1959*, ss. 8A(1)–(3).

6 *Reserve Bank Act 1959*, s. 10(2).

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the Payments System Board is required to exercise these in a way that will best contribute to the overall stability of the financial system.<sup>7</sup>

2.8 Both boards are required to ensure, again within the limits of their powers, that the policies they develop are 'directed to the greatest advantage of the people of Australia'.<sup>8</sup>

### **Commonwealth Development Bank and the RBA's former role in rural credit**

2.9 In his second reading speech, Senator Xenophon stated that the proposed ARDB would, 'in a sense', be similar to the former Commonwealth Development Bank.<sup>9</sup> The following section provides a brief outline of the history of the Commonwealth Development Bank and the RBA's former role in rural credit.

#### ***History of the Commonwealth Development Bank***

2.10 Between 1960 and 1974, the main function of the Commonwealth Development Bank was to provide finance related to primary production and industry undertakings (particularly small undertakings). In 1974, the bank was allowed to provide finance for tourism development projects. In 1978, the lending activities of the bank were widened further to cover business activities generally, with a focus on small business.<sup>10</sup> Lending would occur in cases where the provision of finance was desirable and the finance was not otherwise available, either in full or in part, on reasonable and suitable terms and conditions.<sup>11</sup> The legislation also provided that the Development Bank should have regard 'primarily to the prospects of the operations of that person becoming, or continuing to be, successful' and not necessarily 'the value of the security available in respect of that finance'.<sup>12</sup>

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7 *Reserve Bank Act 1959*, s. 10B(3)(b) and (c).

8 *Reserve Bank Act 1959*, ss. 10(2) and 10B(3)(a).

9 Senator Xenophon, *Senate Hansard*, 5 December 2013, p. 953.

10 Department of the Parliamentary Library, 'Commonwealth Banks Amendment Bill 1978', *Short Digest of Bill*, no. 78/28 (10 April 1978), [http://parlinfo.aph.gov.au/parlInfo/download/legislation/billsdgs/3161177/upload\\_binary/3161177.pdf](http://parlinfo.aph.gov.au/parlInfo/download/legislation/billsdgs/3161177/upload_binary/3161177.pdf) (accessed 2 July 2014), p. 1; *Commonwealth Banks Act 1959*, C1959A00005 (23 April 1959), ss. 72, 73; C2004C02847 (27 October 1993), ss. 72, 73.

11 *Commonwealth Banks Act 1959*, C2004C02847 (27 October 1993), s. 72.

12 *Commonwealth Banks Act 1959*, C2004C02847 (27 October 1993), s. 73.

2.11 Along with the Commonwealth Bank of Australia (CBA), the Commonwealth Development Bank was converted from a statutory authority into a public company in 1990.<sup>13</sup> The Development Bank was made a subsidiary of the CBA.<sup>14</sup> Following the sale of the Commonwealth of Australia's last holding in the CBA, in July 1996 the fully privatised CBA purchased the Commonwealth of Australia's remaining shares in the Development Bank. The Development Bank was absorbed into the CBA's business banking division.<sup>15</sup>

### *RBA's former role in rural credit*

2.12 In addition to the role previously performed by the Commonwealth Development Bank, the RBA also had a former role in the provision of rural credit. The RBA provided the following history of this function:

In the past, the RBA (and prior to 1959, the Commonwealth Bank) has had a broader role in the rural sector. Between 1925 and 1988 the Rural Credits Department (RCD) provided seasonal credit for periods of up to one year to statutory marketing authorities and rural cooperative associations to facilitate the marketing, processing and manufacture of primary produce. It also extended research grants and fellowships for projects associated with the promotion of primary production.

The RCD was created when the size of the rural sector meant that its demand for seasonal finance was very large relative to the capacity of private financial markets. By the 1980s, however, the commercial banking system had become the primary source of rural credit, and bank lending techniques had become well suited to the variable financing needs of rural producers. A major part of RCD advances had started moving to the financial markets in 1979, when the Australian Wheat Board began issuing commercial paper. Interest rates on RCD loans had also become more closely aligned with commercial rates and, by mid-1984, all were at fully commercial rates.<sup>16</sup>

2.13 Treasury noted that the 1981 Campbell Committee inquiry into the financial system recommended the phasing out of the RBA's Rural Credits Department

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13 *Commonwealth Banks Restructuring Act 1990* and Commonwealth Bank of Australia, 'Privatisation (1991) and subsequent developments', [www.commbank.com.au/about-us/our-company/history/privatisation.html](http://www.commbank.com.au/about-us/our-company/history/privatisation.html) (accessed 7 July 2014).

14 Department of the Parliamentary Library, 'Commonwealth Bank Sale Bill 1995', *Bills Digest*, 1995–96, no. 49, [http://parlinfo.aph.gov.au/parlInfo/download/legislation/billsdgs/F5K20/upload\\_binary/F5K20.pdf](http://parlinfo.aph.gov.au/parlInfo/download/legislation/billsdgs/F5K20/upload_binary/F5K20.pdf), p. 3 (accessed 7 July 2014).

15 Commonwealth Bank of Australia, *Annual Report 1997*, [www.commbank.com.au/about-us/shareholders/pdfs/annual-reports/1997\\_Annual\\_report.pdf](http://www.commbank.com.au/about-us/shareholders/pdfs/annual-reports/1997_Annual_report.pdf) (accessed 7 July 2014), pp. 13, 23.

16 Reserve Bank of Australia, *Submission 93*, p. 4.

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'with the view that private markets were well equipped to meet rural financing needs'.<sup>17</sup>

### *The proposed ARDB*

2.14 In his second reading speech, Senator Xenophon advised that the bill was intended to provide a means to 'overhaul' rural policy by establishing a body with 'the power to make a real, long term difference'. Senator Xenophon argued that 'government grants and programs were no longer enough':

Rural and regional Australia is struggling. We have heard over and over again the challenges communities are facing, and how they are trying to survive. In recent years, they have borne the brunt of extreme weather events, a high Australian dollar, and a lack of support from State, Territory and Federal Governments...Rural and regional areas are, in many ways, the lifeblood of our country. Certainly, our farmers play an incredibly important role both in our economy and our food security. Without their produce, we are all vulnerable. People living in rural and regional areas face challenges on almost every front. In terms of healthcare, of education, of aged care, and of employment, they have to fight to be counted. If rural and regional communities do not receive the support they so desperately need, the impact on the rest of Australia will be significant, in both economic and cultural terms.<sup>18</sup>

2.15 Senator Xenophon concluded:

We cannot ignore this problem any longer. Australians living in rural and regional communities deserve better. They deserve security, and they deserve to know the Government is taking meaningful steps to fix this problem. The measures in this bill will bring about real and long lasting change. And that change will not only benefit rural and regional communities, but the rest of Australia as those communities flourish.<sup>19</sup>

### *Purpose of the bill*

2.16 The ARDB would be 'a specific entity tasked with examining, reconstructing and improving the financial status of the Australian agricultural sector and its associated industries and infrastructures'.<sup>20</sup> According to the Explanatory Memorandum, the ARDB activities would relate to agriculture and associated industries and infrastructure and help to develop:

- the resilience, capabilities and ongoing financial viability of Australia's food and natural fibre systems;

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17 Treasury, *Submission 133*, p. 10.

18 Senator Xenophon, *Senate Hansard*, 5 December 2013, p. 953.

19 Senator Xenophon, *Senate Hansard*, 5 December 2013, p. 953.

20 Explanatory Memorandum, p. 1.

- a profitable farming sector exercising good stewardship of the resources associated with production;
- effective ways to mitigate the impacts of adverse events, particularly those associated with natural disasters, market failures and inadequate commercial financial arrangements; and
- the capability of agriculture to contribute more fully, responsibly and reliably to the economic prosperity and welfare of the people of Australia and the peoples of other nations.<sup>21</sup>

2.17 The bill seeks to empower the ARDB to do this by determining and giving effect to the RBA's 'rural reconstruction and development policy'. The rural reconstruction and development policy would relate to the following three tasks:

- The 'facilitative task'—to aid better financial decision making by businesses— involves researching, reporting on and helping to develop the resilience, capabilities and ongoing financial viability of Australia's food and natural fibre systems, as well as any other Australian industries or sectors that need, or may need, reconstructing or development. The bill would require that this task must be conducted in a 'timely' way.<sup>22</sup>
- The 'development task'—to help ensure that needed development funds are offered from appropriate sources in ways that support capital formation and reduce risk—involves developing and offering financial arrangements, and reviewing financial arrangements, to contribute to the development of Australian agriculture, associated industries and infrastructure.<sup>23</sup>
- The 'reconstruction task'—to assist financial transactions—involves 'fairly, reasonably and effectively' reducing or eliminating the debilitating effect of those financial arrangements related to financial arrangements that, because of certain specified circumstances, reduce or threaten the ongoing viability or sustainability of enterprises in Australian agriculture or associated industries.<sup>24</sup>

2.18 The ARDB would be required to ensure, within the limits of its powers, that the rural reconstruction and development policy was 'directed to the greatest

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21 Explanatory Memorandum, pp. [1–2].

22 Dr Mark McGovern, *Submission 129*, p. 4 and See schedule 1, item 14, proposed paragraph 10BB(2)(c).The three tasks are outlined in schedule 1, item 14, proposed subsection 10BB(2).

23 Dr Mark McGovern, *Submission 129*, p. 4 and See schedule 1, item 14, proposed paragraph 10BB(2)(c).The three tasks are outlined in schedule 1, item 14, proposed subsection 10BB(2).

24 Examples of circumstances specified include: the design of the financial arrangements, market failure and natural disasters. See schedule 1, item 14, proposed paragraph 10BB(2)(c).The three tasks are outlined in schedule 1, item 14, proposed subsection 10BB(2).

advantage of the people and industries of Australia'.<sup>25</sup> The ARDB would also be required to ensure that the RBA's powers were exercised in a manner that best fulfilled the three set tasks in ways that were timely, equitable and transparent, and with due regard to economic responsibility.<sup>26</sup>

2.19 The bill proposes that to give effect to the policy, the ARDB would have the power to use the capital the RBA holds as Australia's central bank.<sup>27</sup> Section 28 of the Reserve Bank Act would be amended to allow the capital held by the RBA for its functions as a central bank to also be used for the RBA's rural reconstruction and development policy (a policy that the bill would, if passed, require the ARDB to establish).

### *Reserve Bank Reserve Fund*

2.20 The RBA's capital includes the Reserve Bank Reserve Fund.<sup>28</sup> In its most recent annual report, the RBA described the primary purpose of the Reserve Fund as providing 'a capacity to absorb losses when it is necessary to do so'.<sup>29</sup> In October 2013, the government announced a grant of \$8.8 billion to strengthen the position of the Reserve Fund. The *Mid-Year Economic and Fiscal Outlook* released in December 2013 provided the following information on the types of losses the Reserve Fund needed to absorb in recent times and the reasons for the government's decision to make a grant to the Fund:

The strong and sustained appreciation of the Australian dollar from 2009 caused the RBA to record large financial losses in 2009–10 and 2010–11 as the value of its foreign currency assets declined in Australian dollar terms. This coincided with global interest rates declining to historical lows, reducing the RBA's underlying earnings.

The resultant losses were absorbed by the Reserve Bank Reserve Fund (RBRF), reducing the balance to significantly below the level now considered prudent by the Reserve Bank Board based on its most recent assessment of the risks to the RBA's balance sheet...

The low level of the RBRF has not posed an immediate risk to the solvency of the RBA and has not impaired its operations. Nevertheless, on current projections, it would take many years to build the RBRF to the level deemed prudent by the Board—15 per cent of assets at risk—through the

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25 Schedule 1, item 14, proposed paragraph 10BB(4)(a). The inclusion of the words 'and industries' distinguishes this requirement from the duties imposed on the Reserve Bank Board and the Payments System Board which only refer to the people of Australia: see paragraph 1.14–1.15.

26 Schedule 1, item 14, proposed paragraph 10BB(4)(b); Explanatory Memorandum, p. [4].

27 Schedule 1, item 14, proposed subsection 10BB(3), and item 20.

28 *Reserve Bank Act 1959*, s. 29.

29 Reserve Bank of Australia, *Annual Report 2013*, p. 71.

usual channel of retaining profits, leaving the RBA financially exposed in an uncertain global environment.

The Government has therefore decided, following consultation with the Reserve Bank Governor, to provide a one-off \$8.8 billion grant to the RBA to strengthen its financial position. The grant safeguards the credibility and independence of the RBA, putting beyond doubt its ability to perform its key functions at the heart of Australia's financial system and to meet any challenges that may lie ahead in a volatile global economy.<sup>30</sup>

2.21 It should be noted that if a policy determined by the Reserve Bank Board and a policy determined by the ARDB are inconsistent, the Reserve Bank Board's policy prevails and the ARDB's policy has effect as if it were modified to remove the inconsistency. The Treasurer would resolve any disagreement between the Reserve Bank Board and the ARDB as to which of the Boards would be responsible for determining the Bank's policy on a matter.<sup>31</sup>

#### *Financial statement*

2.22 The bill does not contain a financial impact statement.

#### *Membership*

2.23 The membership of the ARDB would consist of nine members, including the RBA Governor, a member of the Reserve Bank Board or an RBA staff member (the RBA's representative), and seven other members appointed by the Treasurer.<sup>32</sup> Of the seven members, the Treasurer would appoint for a specified period not exceeding five years—an economist; an accountant; a banker; a representative of the States and Territories; and a farmer. They would be required to have rural and agricultural experience.<sup>33</sup>

#### *Relationship with Parliament*

2.24 Under proposed subsection 10BB(5), a House of the Parliament, a committee of a House, or a joint committee of both Houses may request the Board:

- to take a matter into account in performing the Board's functions; or
- to report to the House or committee on a matter relevant to the Board's functions.

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30 Australian Government, *Mid-Year Economic and Fiscal Outlook 2013–14*, December 2013, p. 37.

31 Schedule 1, Item 15.

32 The bill requires that the seven other members must include: an economist; an accountant; a banker; a representative of the states and territories; and a farmer. Schedule 1, item 19, proposed section 25NA.

33 Explanatory Memorandum, p. [5].

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***Committee view***

2.25 While the provisions of the bill are straightforward in articulating the intention to establish the ARDB, the implications of establishing such an entity raised some concerns. In the following chapter, the committee examines the perceived need for the establishment of the proposed ARDB.

