Budget must check Australia out of never-ending debt and deficit

Josh Frydenberg must take maximum advantage of the strong recovery to signal productivity-enhancing transmission, tax and superannuation structural reforms that can accelerate fiscal repair.

Stephen Anthony*Contributor*

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Federal budget night on Tuesday will be another doleful reminder of just how far Australia's fiscal stocks have fallen since the halcyon days of John Howard and Peter Costello.

Do you remember the time back in the mid-2000s when the federal government had negative net debt? It was back then that we used to talk about the possibility of structural reforms. Could it be the two issues are linked?

There are several important things Treasurer Josh Frydenberg, seen here on March 24 with Treasury Secretary Steven Kennedy, can do on Tuesday night. **Alex Ellinghausen**

Not any more. Not even close.

Following on from the global financial crisis and now the pandemic indiscriminate stimulus – timely, temporary and terrible – we expect the budget to contain deficits in excess of $60 billion in every year of the forwards and beyond. This implies a large underlying structural deficit and now a rising debt stock subject to an escalating average cost of borrowing.

Hence, we project a multi-decade string of deficits with the stock of government net debt to gross domestic product to nearly double in the 2040s.

A big debt stock policy in our view is the Roach Motel of economic policies. You can check in but never leave.

It will certainly bust the Goldilocks conditions that prevail in March 2022 that has allowed for the simultaneous golden mean of low unemployment and inflation in Australia in the aftermath of the COVID-19 pandemic.

Immediate headache

The debt build-up leaves little scope for funding major structural spending fixes. Nor does it provide any buffer against other national emergencies and global risks. Our analysis says that we should take remedial action now to guard against the uncertain but possible prospect of a future crisis.

The good news is that our Modern Monetary Theory-like expansion of the central government balance sheet (through co-ordinated Reserve Bank and Treasury stimulus) since March 2020 has produced boom times for many. Too many, and certainly many of the wrong individuals and businesses.

Unfortunately, the bill for this largesse is about to fall due and creates an immediate headache for the RBA and later the Treasury.

What can Treasurer Josh Frydenberg do on Tuesday night?

While he can't reverse previous mistakes – that is spilt milk under the bridge – he can take maximum advantage of the strong recovery on his watch. He should signal generational productivity reforms and deal with the leaky buckets of the federal budget that are drowning the bottom line.

Top of the measures list should include:

The long-standing lack of structural policy reform in Australia since the early 2000s and the present COVID-19 crisis has caught our nation short.

First, restructuring of the national electricity grid. Those who argue that solar and wind should quickly replace coal and gas-fired generation by 2030 to meet a zero emissions objective don't acknowledge the full price tag.

At Macroeconomics Advisory, we have estimated that the cost of replacing existing thermal power with solar and wind and back-up will be in excess of $150 billion. That impost is likely to be borne by governments/taxpayers.

But there is a way to avoid most of these transition costs and perhaps restore some of our old manufacturing base sourcing cheap, emissions-free, reliable energy.

The thermal option

One little known option that is apparently ready to go is long-term thermal storage. It is a scalable and compact way of storing energy that provides relatively cheap, very-long-duration back-up for intermittent systems. Even better, it is a leading-edge Australian-based technology.

The technology sources flake graphite locally to manufacture energy storage blocks that are fitted within energy storage cells. The critical breakthrough is that these cells operate at a very high operating temperature range with virtually unlimited cycles and can be charged and discharged simultaneously.

This unique capability enables them to drive the large-scale turbines used in coal-fired power stations. Heating cells with solar and wind generation and then using this heat to drive these turbines means it can deliver dispatchable power through the existing infrastructure in the Hunter and La Trobe valleys.

The technology fits Angus Taylor's far-sighted plan to support technologies even if the execution of the strategy is floundering.

Who would have thought risk-averse bureaucrats would use it to dole out big dollars to foreign-sourced solar (including solar thermal), wind and, now, hydrogen.

Why not just back the thermal option that appears to require no assistance whatsoever? It may just offer the good folks at the Energy Security Board the level of energy security to allow them to sleep nights.

Second, tax reform. Distinguished economist Ross Garnaut reminds us of the prevalence of "economic rents" in the Australian economy and the need to replace company taxes and stamp duties with a cash flow tax and land taxes.

Single national public default scheme

A cash flow tax allows for the immediate write-off of capital expenditure by business. Workers need better machines and software to raise output, and this means immediate deductibility without debt funding.

Third, retirement superannuation.

The idea is to establish a single national public default scheme – a future fund offering a menu of plain vanilla retirement incomes products – that could use its balance sheet to efficiently convert lump sums to annuities, avoiding duplication and permitting the investing of retirement dollars in ways that better match overall system asset and liability structures, and so raising overall risk-adjusted returns.

The specialist retirement fund would effectively act as an agent of government selling annuities to prospective retirees – that is, selling a top-up to the age pension. An upper limit ceiling could be placed on the size of the annuity to limit the public subsidy associated with the scheme.

We argue that a single national default scheme for the retirement phase could help to improve the efficient transfer of member dollars through default superannuation from the accumulation phase into a more valuable income stream for retirees.

Right now, there is not a clear-cut and cost-effective longevity product for retirees to purchase. For retirees, decision-making is more a lottery game than a predictable and efficient value transfer.

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This reform would hopefully reduce reliance on the full and partial pension through time by raising confidence in all phases of default superannuation system.

Privately, fund chief investment officers will concede a single fund structure is inevitable because it is the structure needed to take personal investment risk out of retirement.

The case for the single fund structure will become more obvious during the next sustained bear market. It also begs the question of whether government should offer free default fund options for each age group in the accumulation phase and just scrap super concessions entirely.

The long-standing lack of structural policy reform in Australia since the early 2000s and the present COVID-19 crisis has caught our nation short.

In 2022, Australia faces simultaneous risks in the international economic and security environment and fundamental fissures in the federal budget.

So, budget 2022 must reject a "free money" big debt policy that is the Roach Motel that will leave the Australian economy less scope to manage the major challenges ahead.

Stephen Anthony is chief economist at Macroeconomics.