TOP STORY FOR THE WEEK 24 May - 28 May 2021

Federal and State Budget Deficits

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Both the Federal and Victorian governments have released budgets in May with deficits projected well into the future.

Budget deficits do matter. Ultimately a decline in the standard of living for all Australians and, especially, all Victorians, will occur from flawed fiscal management reflected in persistent budget deficits.

Government deficits emerge when spending occurs today for the benefit of individuals today. Responsibly for payment though falls on future generations. Deficits which arise through the stabilising feature of spending commitments in a recession may be acceptable. Today, deficits have arisen through Governments imposing draconian controls over activity by the Australian population.

As a result, under the Federal government budget, Australian net government debt will rise to $980 billion in 2024/25, being 40.9% of GDP as shown in Table 1.

Table 1: Australian Government Budget 2021 - 22

	2019-20 $b	2020-21 $b	2021-22 $b	2022-23 $b	2023-24 $b	2024-25 $b
Underlying cash balance ($b)[c]	-85.3	-161.0	-106.6	-99.3	-79.5	-57.0
Per cent of GDP	-4.3	-7.8	-5.0	-4.6	-3.5	-2.4
Gross debt[d]	684.6	829.0	963.0	1,058.0	1,134.0	1,199.0
Per cent of GDP	34.5	40.2	45.1	48.6	49.7	50.0
Net debt	491.2	617.5	729.0	835.0	920.4	980.6
Per cent of GDP	24.7	30.0	34.2	38.4	40.0	40.9

Source: Australian Government Budget

Victorian debt, under the 2021 State budget, will rise to $155 billion in 2024/25, being 33.8% of GSP. Adding Commonwealth debt on top takes aggregate government debt for Victorian residents to approximately $400 billion or 74.7% of GSP, a debt of $60,000 per person in Victoria. It is a heavy responsibility for taxpayers in Victoria, one solely imposed by governments.

The relevant variables for debt servicing are relatively straight forward.

Increased private sector activity will drive higher government revenue. Population growth will also drive higher government revenue. With border controls in place, population growth will be limited, if not negative. In Victoria, the population declined in September quarter 2020 by 16,000. Private sector growth will be limited, reflecting restraint on population growth and international students and tourists.

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Government spending and RBA policy is providing immediate stimulus. Governments imposed restrictions on the private sector in 2020, driven by the pandemic. Now they are stimulating the economy by spending funded by debt and low interest rates. This represents steps towards a command economy. The extent of rebound in private sector growth is uncertain.

On the expenditure side, government programs can be changed but experience is clear that programs are not wound back, they only expand. Political will is lacking. Government employment follows a similar pattern, with increased staff and salaries locked in by lack of political will.

Interest rates on debt are at historical lows. This will persist as central banks, including the Reserve Bank of Australia, provide a favourable environment for funding government debt. It is not sustainable. Capital markets require real rates of interest for lending. Negative nominal and real interest rates only persist because of central bank policies of quantitative easing.

That leaves new or increased taxes as the only solution for a transition from high debt, as the Victorian government has demonstrated. Increasing taxes ultimately has the restraint of alternative locations for individuals and businesses.

A shift between states will occur. History demonstrates that people will move with business activity and employment between states in response to excessive taxes. Of concern for Australia is international competition on tax rates for both individuals and companies resulting in loss of private sector activity.

Persistent deficits mean increasing debt with, ultimately, higher interest rates payable on debt, despite RBA intervention. Reduced spending on government services will become essential. Discretion for meeting policy priorities of political parties will be reduced materially.

In the event of financial stress lenders can and will dictate terms of finance. Stress may be generated domestically or internationally and it can occur rapidly. Terms may dictate extensive restraints on an economy until a balance is achieved between debt and the ability to service the debt. Recession and rising unemployment will occur.

Consequences of persistent deficits and increasing debt in Australia will be higher interest rates and potentially a falling value of the currency. A declining standard of living will result. Higher interest rates will mean less spending capacity for all Australians. A fall in the currency means higher costs for imported goods and services. It will include a higher cost of overseas travel when permitted again.

Budget deficits do matter. Poor financial management will mean a declining standard of living for Australians.

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