In the long term, somebody has to pay to cut budget deficit

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For the sake of future generations we will all have to bear some pain now, writes ***John Daley***

Australian governments have a big problem. A new Grattan Institute report reveals they are at serious risk of posting annual deficits of 4 per cent of gross domestic product within the next decade. To balance their books governments will need to find savings and-or tax increases of $60 billion a year in today's terms.

Since they now spend about $500bn a year, $60bn is a lot of money. The good news is that it can be found - and it must be found. But it will require our leaders to show more courage than in recent memory.

In the past week, Wayne Swan and opposition Treasury spokesman Joe Hockey suggested they might back away from previous commitments to return the budget to surplus rapidly. While reaffirming that balanced budgets matter, both warned against austerity simply to create a surplus. But from where Australia is today, there is no way to create a surplus without austerity.

The Grattan report, ***Budget Pressures on Australian Governments***, examines the budgets of the commonwealth and the three largest states over the past decade, and the challenges they face to balance these budgets over the next one. The report finds that a combination of rising costs, likely shortfalls in tax revenue, the prospect of falling minerals prices and the need to fund big-ticket political promises risks turning the surplus forecast for 2015-16 into a 4 per cent deficit within a decade.

Australian government budgets have benefited from a series of free kicks over the past decade: a strong economy, the mining boom, and rising prices for minerals relative to other goods, so governments had more to spend.

And spend they did. In real terms, Australian governments are spending $42bn a year more on health than 10 years ago. The increase is equivalent to an extra 2 per cent of GDP. Many believe the increase is primarily due to our ageing population. In fact, people of all ages are seeing more doctors, having more tests and operations, and taking more prescription drugs.

Health spending is likely to continue to grow, and the free kicks that were taken in the 2000s need to be given back. As a result, Australian governments need to find substantial savings and/or tax increases to ensure their budgets are in surplus as they should be at this point in the economic cycle.

They have the power to do this. In the four years to 2012-13, the federal government implemented budget measures that improved the bottom line in the long term by $60bn. Cutting specific programs, increasing some taxes, and tightening up existing taxes all helped.

However, over the same period, other budget measures made the bottom line worse by $60bn in the long term. Governments increased the aged pension, cut income taxes, and spent on health, industry policy and the regions.

Taken together, these budget measures will do no more than cancel each other out, if one assumes the carbon pricing scheme and the Minerals Resource Rent Tax are unlikely to raise much revenue. Governments must take a further step.

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For a decade, they did not do enough to ensure that budgets would be in surplus when they came under pressure. John Howard's government cut taxes and introduced new welfare payments. After spending substantial sums to tackle the global financial crisis, the Labor government has been slow to bring the budget back into surplus after the economy recovered.

The spending goes on. The Gillard government has announced that it will fund, in partnership with the states, a national disability insurance scheme and a large increase in expenditure on schools. The opposition has promised new initiatives for paid parental leave and direct action on carbon.

These are big plans that cost money. It is not clear how they can be carried out while also repairing underlying budget positions.

Improving the structural position of budgets is inevitably painful in the short-term. But leaving them in structural deficit will cause even more long-term pain.

As many European nations have discovered, sustained deficits incur interest bills that can cripple a government's capacity to fund basic services, let alone new initiatives. Deficits reduce a government's flexibility in a downturn. They can also limit future borrowing, and therefore unfairly shift costs to the next generation.

In the past decade, politicians of all colours have allowed politics to trump good policy. They have been unable to resist pleasing voters and spending money. Our political debate has come to expect policies that leave no losers. Yet there is no way to reduce deficits while everyone stays a winner.

Australian governments must explain to the public that everyone needs to bear some pain in order to bring budgets under control, and pay for the things that are really important. Brave leaders must step forward and make tough policy choices to ensure our prosperity, now and for future generations.

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