As debts mount, IMF calls for Australian budget “repair”

Nick Beams
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The Australian election campaign has demonstrated the unity between the Morrison Liberal government and the opposition Labor party on all major issues. It is clearly illustrated in their agreement to cover over the depth of the global economic crisis and its impact on the policies of whatever government comes to power after May 21.

Global commodity markets are in turmoil, inflation is running rampant, rising central bank interest rates are threatening to produce financial instability and a recession, and the debt of governments around the world is at record levels. But all of this is being ignored in the official campaign as both parties seek to promote the fiction that Australian capitalism can ride out the storms.

Above all they seek to cover over the implications of the massive increase in government debt because of COVID spending, much of it in billions of dollars to major corporations, and how it will be brought down. However, the issue of repayment is not being ignored by global financial authorities.

Last week at its semi-annual meeting in Washington, the International Monetary Fund (IMF) made it clear that, as the budgets of governments go deeper into the red, the task of “fiscal repair”—the cutting of government spending on vital social services and facilities—had to be undertaken.

Since the start of the pandemic Australia has recorded its three largest budget deficits in history. According to the IMF, of the 34 developed nations that it tracks, Australia will have the eighth largest structural deficit in the next financial year coming in at 3.6 percent of GDP. It also had one of the largest increases in gross debt in the developed world.

When the Liberal-National Coalition came to power in 2013, Australia’s gross debt was 30.5 percent of GDP. By next year it is predicted to double to more than 62.5 percent. At present the debt level is $899 billion but is expected to go beyond $1 trillion in the immediate future.

The debt has been incurred in a period of ultra-low interest rates. But this environment is now rapidly changing as central banks, including the Reserve Bank of Australia, move to lift their rates in response to rapidly accelerating inflation.

The pace of the change is indicated in the Pre-Election Economic Fiscal Outlook (PEFO), produced by the Treasury and Finance Department. The PEFO report estimated that government debt could end up $12 billion higher than forecast in the budget brought down just three weeks ago because of rising interest rates.

At last week’s IMF meeting, the head of its fiscal affairs department, Vitor Gaspar, said there were increasing risks for countries that had increased their debt levels during the pandemic. Countries such as Australia had to start “normalising” their fiscal policy.

“Treasuries in advanced economies must heed rising inflation. For the past two decades, they have benefited from declining debt service costs, stemming from trends both in nominal interest rates and neutral real interest rates.”

But in a situation of “high and volatile inflation, the attractiveness of sovereign bonds is undermined, making it harder to sustain elevated levels of debt.”

According to estimates by the *Australian Financial Review* (AFR), “whoever wins the federal election … will face 15 years of deficits and the need to find savings of $40 billion a year in the next few years.”

Commenting on the fiscal situation last month, Chris Richardson of Deloitte Access Economics said: “Making decisions to save more than $40 billion a year wouldn’t be a walk in the park. And neither side of

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politics will talk about this challenge—certainly not this side of the election and probably not afterwards either."

The issue, however, is being discussed in financial circles. In a recent policy paper, the Centre for Independent Studies insisted that the high debt had to be reduced.

"Fiscal policy will be grappling with the debt burden for many years to come," it said, "and the first task is to close the structural deficit that has opened up." This necessity had to "concentrate the minds of our economic policy makers" in future years.

The reduction in the deficit will not come about through increased taxes on corporations and higher income earners.

Campaigning in the Northern Territory over the weekend, Prime Minister Scott Morrison announced his Lower Tax Guarantee saying the government would deliver "$100 billion in tax relief over the next four years." Morrison claimed the tax break would benefit workers with mortgage repayments. But the measures, to which the Labor Party has agreed, are targeted almost exclusively at higher income earners.

This means that so-called "budget repair" will be aimed at spending cuts on vital health, education and other social services as military spending is boosted still further as part of the government's war preparations being directed against China.

The cuts have already been initiated in the recent federal budget in which a short-term "cash splash," consisting of minor tax adjustments plus a temporary reduction in fuel excise, was used to mask significant real cuts in health spending.

The Labor Party, having signed off on the government's cuts for higher income earners, has pledged that it will not make any tax changes beyond the implementation of the multinational tax agreement decided on by the Organisation for Economic Co-operation and Development.

Election campaigns in Australia, above all when dealing with economic issues, are always conducted as if the state of the global economy was merely a backdrop from which the "resilient" Australian economy was insulated.

This trend is even more evident in the current campaign amid warnings that the global financial outlook is being rapidly transformed.

In its *Global Financial Stability Report* issued last week, the IMF said the sharp rise in commodity prices, together with more prolonged supply chain disruptions, had led to a significant rise in inflation expectations.

"Financial stability risks have risen along several dimensions and the resilience of the global financial system may be tested," it said.

It warned that interest rates may rise above what has been priced in by markets and for many countries they may rise "well above their neutral level." That is, central banks may lift them to a rate that induces a recession.

So far, the Australian economy has benefited from rising commodity prices but that could rapidly change. AFR commentator Karen Maley warned in a column last week that the worsening economic outlook in China, resulting from the latest COVID outbreaks, coupled with the slump in the property market, would have an impact.

At present, the strong Chinese demand for steel and iron ore, which is providing a boost to the Australian budget, reflected the fact that many cash-strapped property developers were rushing to complete construction projects so they could sell apartments to use the cash to pay down debt.

"The problem is that when these part-finished residential projects are finally completed, Chinese demand for commodities is likely to suffer a brutal decline," she concluded.

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