Funding the Future from Surpluses AND debt

Part of the political price we've paid for economic reform has been the "dumbing down" of its basic logic. The undoubted need for responsible budgeting sees us in thrall to the now well entrenched bipartisan cult of reducing debt at all costs. The Liberals' Future Fund and the ALP's Intergenerational Fund take us one step further, moving from a commitment to budget balance over the cycle towards sustained budget surpluses – in the Liberal's case using budget surpluses to fully fund the Commonwealth superannuation liabilities by 2020. By my rough reckoning, that's a new commitment to a budget surplus of around $4 billion each year for fifteen years – quite a turnaround.

Yet, however simplistic the economics driving the Future Fund, no-one can doubt the timeliness of aggressively building surpluses during the good times – so we can aggressively fight the next economic slowdown. The trouble is that ever since Jeff Kennett left office leaving a huge budget surplus for the enjoyment of his political opponents, it's become politically savvy to sail much closer to the fiscal wind – to keep budgets in surplus, but only just.

If we need the inspiration of fully funding superannuation to motivate us to run large surpluses during a boom, well and good. Lets hope the position of strength that it builds for us will give us the confidence to expand fiscal policy aggressively in the next downturn. We have to make sure that the Future Fund is built to help facilitate this.

And I'm hoping this new focus on financial strength will be the beginning of a new prudence in government – which will place us in a sufficiently strong financial position for our politicians to finally be able to admit something that any economics student or company director can tell you. Prudent borrowing to invest has been a foundation of public and private wealth building since Adam was a lad.

And as for fully funding super, just between you and me, we can do it now! Over just a few years we should borrow the unfunded liability and invest it in a diversified portfolio of high growth investments here and overseas. Over any appreciable time it will earn around $2 billion more than the interest cost of the debt each year though of course, like dividends from the RBA or Australia Post, these returns could not be relied upon in any given year.

What's the catch? None really. Over a long period a debt-funded portfolio of real assets wouldn't just increase return. It would lower risk by correlating returns more closely with government's future liabilities and diversifying the Government's portfolio of assets. We should also move towards a more rational approach to debt more generally – enabling us to borrow to invest in assets such as economic infrastructure for instance.

However – learning from the mistakes of the past – we should continue to strengthen the institutions of budget transparency, prudence and flexibility. We should require independent and public cost benefit analysis for infrastructure investments. Fiscal transparency functions should be signed off by independent integrity agencies, like the Auditor General. Indeed such bodies should have a responsibility to publicly advise governments on managing fiscal policy the way the Productivity Commission advises government on microeconomic policy. This much could be promised in this election from government or from opposition. It was after all the Bracks Opposition that first promised the Auditor General's oversight of the Victorian budget.

Beyond this, governments should move towards giving such agencies a role in managing the fiscal balance in the same way we have independent oversight of monetary policy by the Reserve Bank – subject to overrule by the government of the day. This was suggested by the BCA a few years ago and continues to generate interest and support from American opinion leaders like former Deputy of the Fed, Alan Blinder and influential commentators in Europe and England. It is one of just four priorities for continuing economic reform set out by young Australian public policy graduates of Harvard in their recent book *Imagining Australia.*

Goodness knows when politicians will once again acknowledge the obvious – that however important it is, what we owe pales into insignificance compared to what we're worth. If one lacks the child's naivete, it takes a little courage to expose the emperor's minimalist fashion sense. But not a lot. It is harder to do this from Opposition, but when in Government the usual formula applies – you can change the game when you're right, you're acting from a position of strength and you can tell your story. In other words when you're showing leadership. And though it has its risks, so too does risk aversion. Remember how John Howard was thought of before he chanced his arm on tax reform? Though there's no risk free formula for political longevity, leadership is usually rewarded in the long run. It helps create political and economic momentum. People respect you for standing for something, and they might even come to value what you've achieved.

Borrowing to invest should not be scary, but thinking it has made it so. Somehow we've confused it with profligacy. After the thesis (debt and profligacy), came the antithesis (prudence without debt). Now for the synthesis (prudence with debt). We can't say with any certainty when the change towards more government borrowing will come, but come it will. How much better if it comes as a reinvigoration of our (now fading) preeminence in economic reform rather than as result of fatigue and indifference, and a slide back towards the mediocrity we once knew so well?

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