Aged-care costs risk AAA rating

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The federal government's AAA credit rating is at risk of being downgraded in the long term unless "radical structural reforms" are taken to deal with budget pressures caused by the ageing population, a global credit rating agency says.

The warning from Standard & Poor's came as a new report by a former Treasury economist said the Gillard government was relying on 50-year-high terms of trade to return the budget to surplus and urged it to cut spending by $30 billion to $40 billion over the next three years to put the budget on a sustainable footing.

The budget bulletin *The Return to Surplus?* published today by Canberra-based consultancy Macroeconomics, says that if Australia had the same terms of trade (export prices relative to import prices) as Britain, the United States and Greece, it too would be in the "economic doghouse".

"Without the 50-year record terms of trade, there will be no return to surplus during this decade," the 70-page report by Macroeconomics director Stephen Anthony says.

"Once commodity prices normalise, the budget will return to deficit."

Record commodity prices will contribute $230 billion to commonwealth tax receipts between 2004-05 and 2013-14, but "none of this has been saved for a rainy day", it says.

Stripping out these windfall revenue gains from above-average commodity prices, the structural balance of the budget is forecast to record a deficit of $57.6 billion in 2010-11.

The structural deficit will persist and be in the red by $49 billion, Macroeconomics calculates.

Mr Anthony's team forecasts the structural deficit will improve slightly as the fiscal stimulus unwinds, but says the government's 2 per cent cap on real spending growth will not be enough.

"This cap cannot provide a quick fix to drastically improve the structural budget position in the short term," the report says.

The warning follows advice in Treasury's Red Book about the structural challenges the budget faces, as the mining boom eventually slows and the ageing population adds to fiscal pressures.

Treasury says even though the budget is on track to record a cash surplus in 2012-13, it will be in structural deficit until 2018-19.

Standard & Poor's said yesterday the ageing population would add "substantial pressure on economic growth and public finances" in the long term and proposed "radical structural reforms" including freezing all age-related spending at current levels of GDP to deal with the problem.

"Our AAA rating on Australia would likely come under increasing pressure in around 20 years," S&P says. "By 2040, we expect that Australia's fiscal indicators will have weakened such that they would be more in line with sovereigns currently rated in the AA category."

Total age-related spending is expected to jump from 9.6 per cent of GDP to 14.4 per cent of GDP by 2050, as the share of the working population falls from 67 per cent to 59 per cent.

This means there will be a larger proportion of people relying on the government-funded age pension and public health expenditure and a smaller share of workers paying income tax.

The report notes Australia is ahead of most other countries in addressing the challenges through reforms aimed at raising productivity and workforce participation, improving healthcare efficiency and compulsory super.

Australia and Switzerland would be the last two countries to lose their AAA credit ratings, S&P says.

Treasurer Wayne Swan was in New York, where he toured the New York Stock Exchange. His spokeswoman said the S&P report was a "ringing endorsement" of the government's economic management.

"Like much of the world, Australia faces significant economic challenges from an ageing population – but we will tackle these challenges from a position of strength."

On budget sustainability, his spokeswoman said the government was delivering the fastest fiscal consolidation since at least the 1960s.

"To put this in perspective, our spending cap will limit real growth in spending in the next few years to around half what it was in the last five years of the Howard government.

"In the past three budgets we've made $83.6 billion in savings to meet the cost of key reforms, and we intend to continue that discipline."

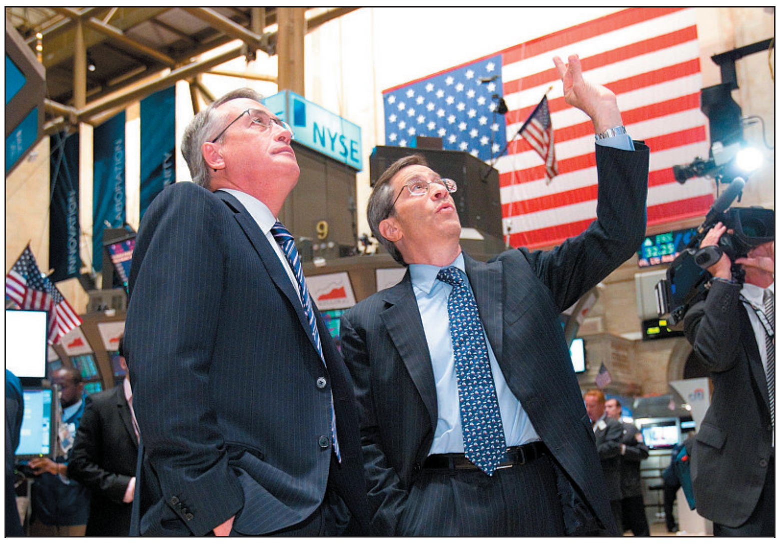
However, the Macroeconomics report questions the Rudd-Gillard government's savings claims, using figures from the budget papers.

"By our reckoning, in 2½ budget rounds since coming to office, new net discretionary spending (including fixed asset purchases) totals $113 billion, including temporary global financial crisis stimulus spending worth around $70 billion," it says.

"Much of the $43 billion increase in the permanent discretionary spending base has been devoted to increasing the age pension for Australian seniors, which whilst admirable for struggling pensioners, was very irresponsible for those who are well off."

Mr Swan's office had not seen the report, so declined to comment on the claim.

Swan unruffled by record $A, page 14



Wayne Swan, at the NYSE with its chief operating officer, Larry Leibowitz, on the trading floor on Monday (US time).