We have watched this movie before. The 2016-17 Budget is yet another budget projecting a gradual decline in government debt as a share of national output (Gross Domestic Product) over the next decade, from 18.9% of GDP today to 9.1% of GDP in 2026-27 .

This is fanciful on the basis of recent budgets, which have failed spectacularly at achieving debt targets, and a reasonable assessment of measures in this budget. For example, this budget continues to assume that the A$13billion of expenditure reductions and $1.5billion of revenue increases from previous budgets that the Senate has repeatedly knocked back will somehow be achieved in full.

If there is one lesson we should have learnt from the world economy since the financial crisis nearly eight years ago it is that debt really does matter. Net interest payments on the federal government's debt are currently over $11 billion (2015-16) or 0.7% of GDP which amounts to about $1000 per year for every taxpayer, or one third of the government's annual health expenditures.

Paying interest is fine as long as it is matched by revenue generated by the assets purchased by the borrowed money. In other words the ongoing cost of the debt must be offset by the ongoing benefits of the debt.

Can we say that about the government's net debt $285 billion or 17.5% of GDP? This debt was accumulated entirely since 2008. Over that time government net capital expenditure increased by only 2.2% of GDP. That leaves about 15% of GDP on debt-financed current expenditure. While it is true that some of that current expenditure has future social and economic benefits, such as education and health expenditure, it is highly unlikely to be self-financing.

And it has crowded out private sector investment and employment. In other words we are, and will be for some time, paying for yesterday's good things. We continue to steal from the future, and that's "no way to run a railroad" to quote the famous 1932 cartoon .

But worse, the credit rating agencies have warned us that our AAA credit rating is in serious jeopardy if we remain on our current debt trajectory.

The federal government has enjoyed a AAA credit rating from both credit agencies Moody's and Standard and Poor's since 2003 , and a AAA from Fitch since 2011. Our credit rating has not been downgraded since the 1980s, when both Moody's and Standard & Poor's downgraded us from AAA to AA1 and AA+ respectively in 1986, followed by a further downgrade by Moody's in 1987 and by S&P's in 1989.

These downgrades were accompanied by higher risk premia in government bonds of up to 50 basis points (half of one percent) which raised borrowing costs to the Australian Government and therefore taxpayers. For example if such an increase were to apply to all Australian Government debt the interest bill would increase by as much as $2.5 billion.

More importantly a rating downgrade would raise borrowing costs to all Australian firms and the higher quality (lower risk) firms would be the worst affected according to a recent international study of the effect of government credit downgrades.

Higher borrowing costs would flow on to households. Yet interest rates earned on savings would not rise as much if at all – the gap between borrowing and lending rates would widen – so there would be little or no silver lining for retirees and savers from a credit rating downgrade.

The rating agencies are doing us a favour. They are telling us the cold hard reality that debt does matter. The European Union is a sad case in point. Now nearly eight years after the global financial crisis its average annual economic growth rate is spluttering at about 1% and unemployment averages 9.7% . They are still running budget deficits of 3% of GDP and have government spending of 48% of GDP on average (compared to 37% for Australia including all levels of government). A good place to start in designing macroeconomic policy in Australia would be to look at what Europe has done and do the opposite, which is pretty much what the UK has been doing and it has been reaping the benefits.

It has run a more contractionary budget policy than Europe yet has enjoyed significantly higher economic growth and a significantly lower unemployment rate at just under 6% , on par with Australia. New Zealand has done the same – it has substantially reduced its government expenditure to GDP in recent years and has enjoyed a falling unemployment rate and while maintaining GDP growth close to 3% .

In the face of mounting evidence against bigger government as a way of lifting economic growth, and of the burden it imposes on future taxpayers, this federal budget has not done enough to reduce the budget deficit and in particular government spending, which is projected to decline by only 0.5% of GDP by 2020 compared with a rise in government receipts of 2.2% over that time . There is no escaping the need to further tighten our belts via lower spending and/or higher taxes.

The former would be preferable since higher taxes discourage work effort, saving and investing. We can either tighten our belts voluntarily and control the process, or have it imposed on us by credit agencies through higher interest rates, currency markets through a lower dollar which reduces our international purchasing power, and the labour market through higher unemployment.

When markets and credit agencies impose the medicine it is much more unpleasant and unpredictable than doing it ourselves.

*Ross Guest does not work for, consult, own shares in or receive funding from any company or organization that would benefit from this article, and has disclosed no relevant affiliations beyond the academic appointment above.*

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