Outgoing Reserve Bank Governor Glenn Stevens has delivered a strong warning about the need to face up to the issue of repairing the budget.

Stevens, who leaves his post next month, said that “we are kidding ourselves” if we thought a tough discussion about this challenge could be avoided. He highlighted the present gap between a general commitment to action and the unwillingness to make specific changes, after special interests kicked into the debate.

It was no coincidence that the path to budget balance had become a long one, he said. “Very low nominal GDP growth looms large in subduing revenue growth, because of the terms of trade decline. But when the terms of trade stabilise, weaker potential real growth per head of population will still be a problem.”

“More difficult choices will need to be made along the path of budgetary adjustment,” Stevens said.

“At present general public debate starts with commitment to the need for reform and for putting public finances on a sustainable medium-term track. But when specific ideas are proposed that will actually make a difference over the medium to long term, the conversation quickly shifts to rather narrow notions of ‘fairness’, people look to their own positions, the interest groups all come out and the specific proposals often run into the sand.”

“If we think this rather other-worldly discussion will not have to give way to a more hard-nosed conversation, we are kidding ourselves. That will occur should there be a moment of crisis, but it would be better if it occurred before then”.

Speaking in Sydney, Stevens stressed the limits of monetary policy to dial up growth. He said in the end the most powerful growth from low interest rates came when “someone, somewhere, has both the balance sheet capacity and the willingness to take on more debt and spend”. For policy makers looking for low rates to boost growth, the question was which entities in the economy could do this safely.

In Australia, gross public debt for all levels of government totalled some 40% of GDP, while gross household debt was about 125% of GDP.

“This is not unmanageable – but nor is it a low number. It’s an interesting question which sector would have the greater capacity to take on more debt, in the event that we were to need a big demand stimulus.”

He suggested the government had the capacity to take on more debt to stimulate growth – but such added debt had to be for the right purposes. “Let me be clear that I am not advocating an increase in deficit financing of day-to-day government spending. The case for governments being prepared to borrow for the right investment assets - long-lived assets that yield an economic return – does not extend to borrowing to pay pensions, welfare and routine government expenses, other than under the most exceptional circumstances”.

The gap in the recurrent budget had to be closed over a period, because increasing public debt that was not held against assets would become a problem.

“The point I am trying to inject here is simply that popular debate in Australia about government debt and how we limit or reduce it seems so often to be conducted while largely ignoring the size of private debt. To outside observers this seems odd. Foreign visitors to the Reserve Bank over the years have tended to raise questions about household debt much more frequently than they have raised questions about government debt. So the way ahead is going to have to involve a rather more nuanced consideration of all these issues,” he said.

Stevens said the Reserve Bank had run some risks by pushing interest rates so low – last week’s cut took the cash rate to 1.5% - but noted that there were always risk in action, or inaction. “Our job is not to avoid risk – it is to balance the various risks. To date, I think we have done that,” he said.

“Moreover, with the whole developed world in such a prolonged period of ultra-low rates, it would have been fanciful to think we were not going to be affected. But in the end, we are living in a world in which the ability of monetary policy alone to boost growth sustainably is very likely to be a good deal more limited than we might wish.”

Looking back, Stevens, who has been 10 years in the job, said that “over the past decade and in a very volatile world, Australia has achieved the inflation target, avoided a major economic downturn, seen remarkably little variability in real economic activity in the face of enormous shocks, experienced a fairly low average rate of unemployment, and had a stable financial system”.

The challenges ahead for Australia included sustaining a stronger growth outlook. To do this “more than adjustments to interest rates will be needed”.

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

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