

# BIGGER TAX BURDEN WON'T HELP THE YOUNGER GENERATIONS

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## Introduction

Jim Chalmers' fifth budget will entrench bigger government partly paid for by higher taxes. Even with the eye-opening proposal to cut 300,000 people from the National Disability Insurance Scheme, expansion of the low-productivity 'care economy' has ratcheted up the size of government to a new peak. Tuesday night's budget injects a further fiscal stimulus that Reserve Bank governor Michele Bullock warned would add to the inflationary shock from the Middle East oil crisis and force another central bank cash rate hike.

The bottom line that Dr Chalmers downplays — the headline cash balance — is forecast to widen from \$22 billion in 2024-25 to \$48 billion this year to \$64 billion next financial year, equal to 2.1 per cent of GDP. With no credible 'fiscal rules' to discipline political pressure for more spending, the Centre for Independent Studies recommends the focus shift to this headline measure. This would alert the public more accurately to the growth of off-budget government spending that feeds into the public debt.

A large parliamentary majority has given Anthony Albanese and his ambitious treasurer the opportunity to jack up taxes, even though they promised voters they wouldn't. Dr Chalmers' economic roundtable in August lured business into signing onto an 'intergenerational equity' agenda. In practice, this means increasing taxes on capital, and particularly on property investors, to help finance bigger government. Tightening the tax treatment of capital gains and negative gearing will actually lead to fewer houses being built, according to the budget's own estimates, along with a small increase in rents.

But the modest increase in the tax take from property investors helps finance the new \$250 tax offset for 'working' Australians that Dr Chalmers is keen to build on as he shifts the tax burden from labour to capital. The problem is that taxing capital

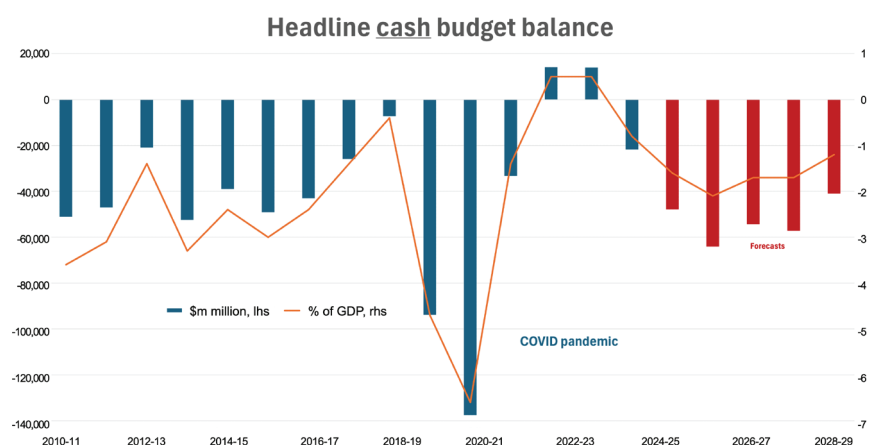
more will mean less capital for labour to work with. By further stifling productivity, that will limit wage gains for the younger generation of workers who will be required to shoulder the trillion dollars or so of debt. Here are the main takeouts of our team of economists and researchers. — **Michael Stutchbury**

## Accountability

### The real deficit

The headline cash balance (hidden in the tables at the back of the budget documents) includes the government's off-budget spending monuments. It is the best measure of the government's growing footprint on the economy. The government's preference for concealing massive spending 'off budget' means the headline deficit is substantially larger than the underlying deficit. But all this additional spending is in play — the economy doesn't care which side of the budget it comes from!

The headline cash deficit for 2026-27 will be a whopping \$64.1 billion (2.1% of GDP). This will be a significant deterioration on the \$47.9 billion deficit expected for the current year ended June 2026. There has been some improvement since last December's MYEFO update, thanks to the Iran war and some savings, but not enough to close the imbalance. Instead of curbing its instincts to spend money into any crisis, the government chose the alternative path, ramping up its spending footprint.



Source: Budget Papers, Optimal Economics.

Sadly, the fiscal rules did not return. Rules such as a spending cap as a share of GDP, public debt targets and restrictions on real growth in spending are critical guard-rails and would help deliver fiscal sustainability.

With the government projecting budget deficits for a decade, Australia's debt pile will continue to grow. Some near-term refinancing fun and games will keep the balance below \$1 trillion for a while but will not be enough to hold back the debt tide. Our national debt will equate to 40% of GDP before too long. — Stephen Walters

The deficit has been revised down slightly but is still higher in the budget year than the current year. Real growth of government expenditure (or 'payments' in budget-speak) is set to moderate from 4.3% in 2025/26 to 1.3% in 2026/27 (and zero in per capita terms), which would help ease aggregate demand pressure in an economy that may be cooling anyway. Against that, the 'Table of Truth' reveals that net policy decisions actually add to payments in 2026/27 and the following year. The NDIS cuts are substantial but don't happen in the short term. The overall impression is that the government did not try very hard to find short-term spending cuts.

Then we have all the 'below the line investments' that inflate the headline deficit but not the underlying deficit. These increase from \$20 billion in 2025/26 to \$33 billion in 2026/27 and the headline deficit widens from \$48 billion to \$64 billion. That doesn't look counter-inflationary. — Robert Carling

### **Growth and inflation**

The budget projects sluggish growth in the economy of just 1.75% in the year ended June 2027 and only modest improvement in 2027-28. The economy cannot grow much faster than this because it already is bumping up against capacity constraints. As the RBA Governor said last week, we have "a supply problem". Treasury's economic forecasts are more optimistic than those of the RBA.

The Treasury forecasts that inflation will peak this year and start trending down. This, though, assumes an early end to the war in Iran, but no one has a clue how that will happen, including President Trump. The clear risk is that the war persists and inflation doesn't come down. That would mean even more hikes in interest rates.

The budget also assumes that unemployment rises from here. So, we will suffer an unhappy confluence of rising joblessness and elevated inflation. It's not the stagflation of the 1970s, but there definitely are echoes. — Stephen Walters

### **Lack of fiscal rules**

There is no significant change to previous waffly statements of the government's fiscal strategy. For example, the budget is to be brought into balance "over time". There are no quantitative fiscal rules to discipline future

budget decisions. The strategy continues to emphasise the underlying cash balance while large so-called 'financial investments for policy purposes' are placed 'below the line' and inflate the headline cash balance, which the budget reports but downplays. These 'investments' average \$24 billion a year in the next four years and result in a cumulative headline deficit of \$217 billion over those four years compared with the underlying deficit of \$122 billion. That is a very big gap.

### **Fiscal stance**

The key question about the fiscal stance in the current inflationary environment is whether fiscal policy continues to fuel inflation as it has in recent years or makes a shift to leaning against inflation by curbing expenditure and cutting the deficit in the short-term.

Here the picture is mixed. The budget at least does not commit to a lot of new spending on temporary and superficial 'cost of living' relief measures which only fuel the inflation problem they purport to address. The 50% cut in fuel excise is not extended beyond 30 June – or not yet, at least. There is no repeat of the electricity bill rebates. There are some other measures badged as cost-of-living relief, but which could have been adopted for other reasons, such as new PBS listings. — Robert Carling

### **Spending**

The budget forecasts government spending growing faster than the economy, with average real growth around 2% out to 2029-30. This is even after the claimed 'savings' are banked. The 'Table of Truth' in the budget, which explains policy and parameter variations, shows spending more than \$18 billion higher in 2026-27 alone.

The budget's main expenditure measures are:

- Gross 'savings' of \$64 billion have been baked into the forward estimates — more than half of this is bringing the NDIS back under control. The means to do so, however, have not been specified.
- Other savings include a \$2.7 billion reduction in the use of consultants and \$3 billion from paring back the private health rebate for people aged over 65.

New spending on:

- Another \$2.4 billion of untargeted cost of living relief for households affected by the war in Iran;
- Defence — \$14 billion of additional spending as part of a long-term commitment to lift defence spending to 2% of GDP;
- \$10.7 billion to lift diesel and jet fuel security to 50 days, from the current 30 days;
- \$2 billion to help connect water and sewerage for housing developments; and

- More funding for the Suburban Rail Loop in Melbourne — another \$3.8 billion committed on top of previous promises. — Stephen Walters

## Increasing taxes

This budget contains more tax policy changes than we have seen for a long time — unfortunately of the wrong kind.

For Dr Chalmers the boat has now come in. Having added a touch of Robin Hood to the stage 3 income tax cuts in 2024 and implemented his high-balance superannuation tax (albeit not in the form he wanted), in this budget he has put the capital gains tax discount, negative gearing and trusts on the legislative chopping block. Who needs an open, consultative tax reform review when all that can be achieved by dissembling (some would say lying) around elections and sneaking up on you once they are over? What's left for the chopping block? Franking credit refunds? Capital gains tax on the family home? Death duties? We don't know, but don't bother asking Chalmers.

### ***CGT and negative gearing***

The tax changes in this budget are pretty much as telegraphed in recent weeks. The surprise is that they don't take effect until 2027 or 2028, but that is of little comfort for those affected.

The capital gains tax changes will increase the effective tax, and substantially so in the case of high-return assets. They will also make the tax more complex and fiddly on compliance, especially without full grandfathering. Even if there was a case to increase CGT for investment housing, there wasn't for other assets such as shares, but Labor is doing it across the board anyway. The government says this goes back to the original 1985 CGT design (which indexed the cost base of assets to the CPI) but does not mention that five-year averaging also was part of that design but is not coming back. It all sits oddly with a stated intention of using the budget to spark investment and productivity growth.

### ***Intergenerational***

Just as there was no strong case for scrapping the 50% CGT discount, there is also no strong case to tamper with negative gearing and taxation of trusts. They just fit the 'intergenerational' vibe of the moment. Think of it as identity politics applied to tax policy. But the strange thing is that while the old and asset-rich are hit, younger people really don't get much out of it. The consensus view among economists is that rents will go up slightly and house prices will go down a bit, which doesn't add up to much for young people. Most young wage earners won't see their marginal tax rate cut at all; they just get the two \$5 a week tax cuts (in July 2026 and July 2027) as reannounced in this budget and a newly-announced \$5 a week Working Australians Tax Offset (WATO). It

appears to take this awkward form rather than a simple increase in the tax-free threshold solely to deny it to people who don't work but have investment income — it's the intergenerational vibe again. — **Robert Carling**

The government framed the budget around "intergenerational equity". It has been sold as a budget to offer young Australians hope. But that claim doesn't stand up to scrutiny. "Equity" has been realised by raising taxes on Australians who have saved and invested in property or shares.

The tax increases affecting Australians who have invested money and who are — almost by definition — older than those who have not had as many years to save, are presented clearly. The benefits to younger Australians of increasing tax on investments are less clear. Between a very small tax cut and the Working Australians Tax Offset (WATO), which is effectively a \$250 bonus to be paid at the end of the 2028 financial year, the purported "rebalancing" of income from people who derive their income from assets to people who receive their income from wages is minimal.

The government is trying to buy the votes of young Australians at a bargain-basement price. In exchange, it is raising capital gains tax and ending negative gearing — vehicles that older generations were able to use to become financially secure and independent.

The budget will benefit young Australians who have already managed to save a deposit, those who expect to inherit or who have already received significant financial assistance from their families. Other young Australians, who are saving and investing to build a home deposit or create an alternative path to financial security, will find themselves in a worse position. If they invest their savings, they will pay more tax on any gains. This represents a step backward for aspiration.

Since the government is not using the proceeds of the increased tax to pay down debt, all young Australians will also inherit a greater share of national debt. This means that, in the name of "equity", the opportunity to build wealth is curbed, while the amount of tax which will be needed to pay interest on shared debt will increase.

Our research found that young Australians already believed before this budget that they would have to pay more tax in future. This budget has locked that in. — **Parnell Palme McGuinness**

## Housing infrastructure

The budget contains two big packages to address housing; on taxes and infrastructure. Public commentary has focused on the tax changes but the infrastructure policy is probably more important. And here the government is more on the money. A restriction of negative gearing and replacing the 50% discount on capital gains with index-

ation, contrary to widespread views, will improve housing affordability only slightly. Treasury estimates this will temporarily reduce the rate of growth of housing prices by 2 percentage points, while increasing rents slightly.

Moreover, because the changes are grandfathered, their contribution to revenue and intergenerational equity is minimal in the short run, though will build over time. For the government, the selling point is that it will boost the number of home owners by 75,000.

Previous budgets have substantially increased spending on public and social housing. However, to increase housing supply, it is not necessary for the government to build more housing. The private sector is busting to build. The government just needs to get out of the way and remove unnecessary obstacles. This budget shows a welcome change in direction, spending \$2 billion on enabling infrastructure, such as roads, water and sewers. This removes bottlenecks that had been restricting market supply, unlocking an estimated 65,000 new homes. That works out at \$31,000 per new home, a far better bang for the buck than the government building the homes.

Infrastructure grants will be conditional on state and local governments removing further obstacles in the way of housing supply. Coupled with the commitment of serious money, this places the government firmly in the YIMBY camp in housing debates. If this leads to a more permissive approach by states and councils, it may prove to be the most consequential housing measure in the budget. — **Peter Tulip**

## Tobacco excise drop

Funnily enough, ignoring how taxes affect incentives can send the forecasts up in smoke. The budget papers are now revealing the catastrophic failure that is Australian Tobacco Control policy.

In the five months since MYEFO was released the government has downgraded its budget revenue forecast for tobacco excise by 25.8% — or down \$8 billion over five years. Budgeted revenue for this financial year is down by 65% on last year's forecast. By contrast, the evidence suggest that nicotine usage in Australia is rising.

What is also rising is the violent crime associated with our Tobacco Wars. The associated costs too. Australia is engaged in a suburban arms race where the price for a packet of illegal cigarettes is paid in firebombed shop-fronts, soaring insurance premiums, and a police force

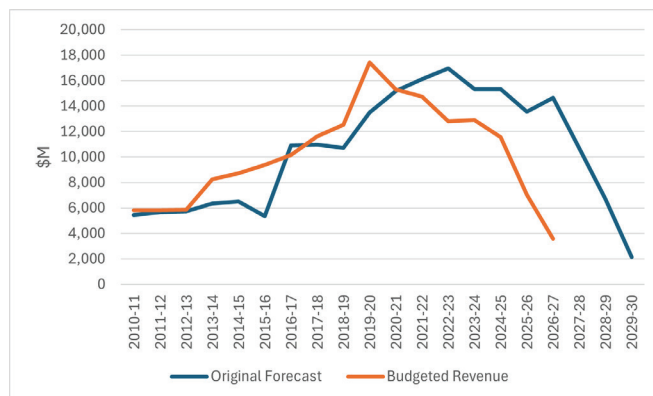
being forced to confront a black market the government's own policies have created.

Yet, in Canberra, there seems to be official indifference to this issue. The government coyly describes the problem as follows:

The downgrade reflects the significant downward revision to tobacco excise receipts, partly offset by an increase in fuel excise receipts. This is due to persistently weaker-than-expected collections and a weaker outlook for excisable tobacco volumes over the forward estimates.

There is a 'weaker outlook' or, as some might say, criminals have successfully outcompeted the government for revenue. Just last week Customs Minister Julian Hill said Australia would not surrender its health policy to criminals. No need to 'surrender', the budget papers shows that war has been lost.

**The graph below shows data captured from the budget papers.** The blue line is the original budgeted amount for Tobacco Excise (a 3-year forecast) and the orange line the actual budgeted amount in any given year.



Prior to 2020, the forecasts and the budgeted amounts were similar, with budgeted amounts usually exceeding forecasts. That changed very quickly. Even now, Treasury is playing catch-up with its forecasts. The gap between the forecasted amount and the budgeted amount is large and growing.

On these trends it won't be long before the government earns no excise from tobacco and the entire market is supplied illegally. Australia won't just have surrendered its health policy to criminals but its tax policy too.

— **Sinclair Davidson**

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