Australian Government

Economic Reform Roundtable

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## Budget sustainability and tax reform

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Manager
Media Unit
The Treasury
Langton Crescent
Parkes  ACT  2600
Email: media@treasury.gov.au

*In the spirit of reconciliation, the Australian Government acknowledges the Traditional Custodians of country throughout Australia and their connections to land, sea and community. We pay our respect to their Elders past and present and extend that respect to all Aboriginal and Torres Strait Islander peoples.*

# Budget sustainability and tax reform

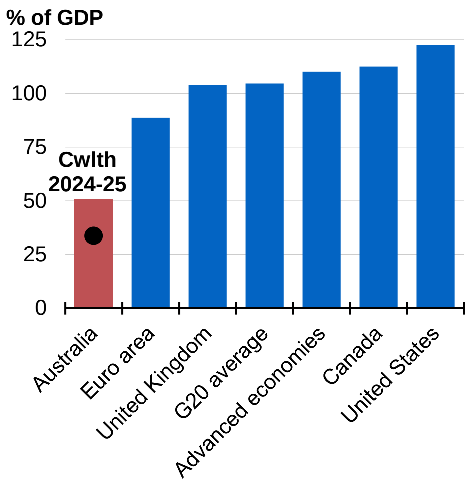
Budget sustainability is a critical foundation to growing living standards over time. It ensures we can sustainably fund the services Australians rely on, respond to shocks and maintain the confidence of international capital markets.

The structure of our tax system is an important component of budget sustainability, along with high quality and efficient government spending. Our tax system and quality of public spending also have important implications for productivity and intergenerational equity.

# Recent trends

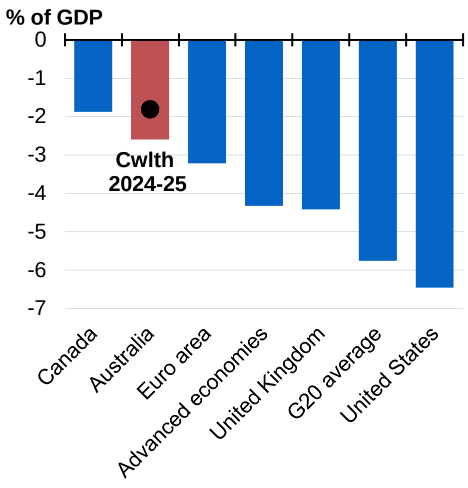
- Australia has one of the strongest fiscal positions amongst peer economies. This includes lower general government debt-to-GDP than the G20 average and all major advanced economies, and smaller deficits expected in 2025 than most (Charts 1 and 2).
- Australia is one of only nine countries to maintain a AAA sovereign credit rating from all three major ratings agencies.

Chart 1: International comparison of general government gross debt (2025)




Source: Treasury, International Monetary Fund.

Chart 2: International comparison of general government fiscal balance (2025)

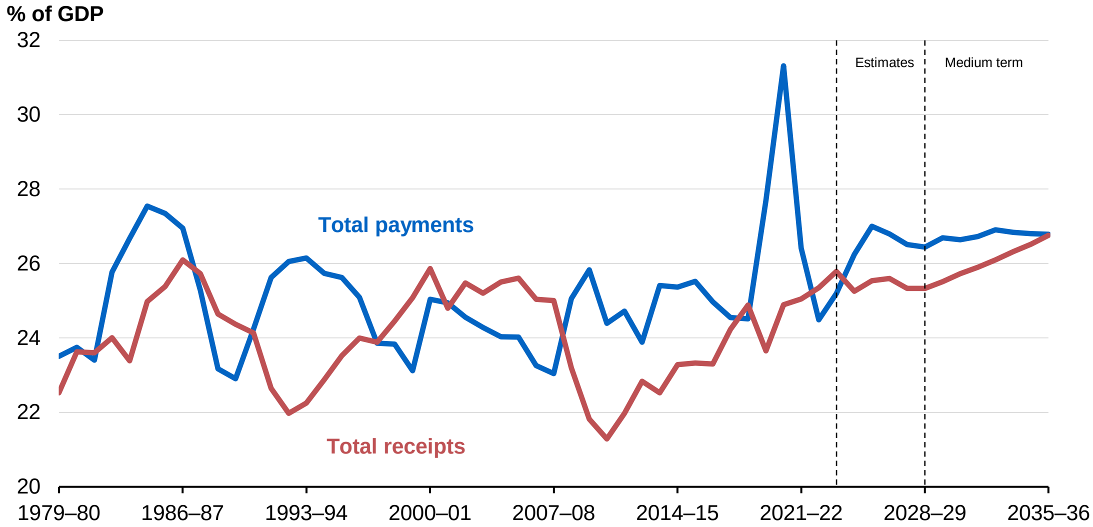



Source: Treasury, International Monetary Fund.

- Budget surpluses were delivered in 2022–23 and in 2023–24. This was the first time in almost two decades that consecutive surpluses were achieved.
- The return to surplus was primarily driven by lower payments, with payments as a share of GDP falling from its peak of 31.4 per cent of GDP in 2020–21 to 24.4 per cent of GDP in 2022–23. The reduction in payments reflects the end of pandemic support, limiting real spending growth, and finding savings.

- Tax receipts also contributed to the improvement in the budget position, with taxation as a share of GDP rising from 22.7 per cent of GDP in 2020–21 to 23.4 per cent of GDP in 2022–23 (Chart 3).
- The Budget is expected to have returned to deficit in 2024–25. The Budget has been in deficit for 14 out of the last 20 years, including every year in the decade prior to COVID. Preliminary advice indicates that the deficit in 2024–25 is expected to be around ½ per cent of GDP, around half the size of the estimated deficit at the 2025–26 Budget. The Budget is forecast to continue to be in deficit over the forward estimates by an average of 1.2 per cent of GDP. Over the decade prior to COVID, deficits averaged 2.2 per cent of GDP.
- The return to deficit reflects higher payments and lower receipts. Payments as a share of GDP are forecast to rise from 25.2 per cent of GDP in 2023–24 to 26.4 per cent of GDP in 2028–29. Receipts as a share of GDP are forecast to fall from 25.8 per cent of GDP in 2023–24 to 25.3 per cent of GDP in 2028–29.

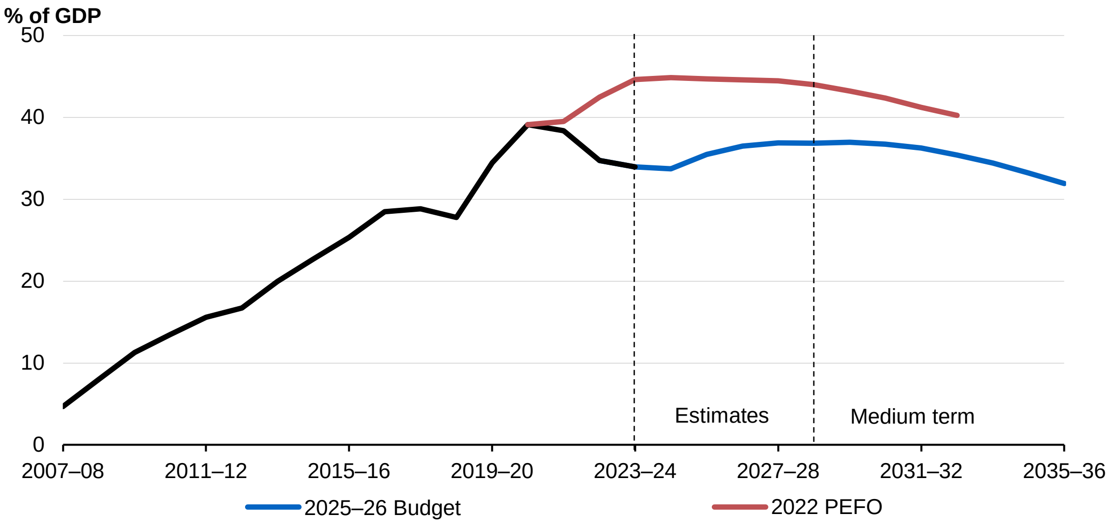
Chart 3: Payments and receipts, 2025–26 Budget




Source: Treasury.

- Since the Global Financial Crisis, the Australian Government's gross debt has grown steadily, before sharply increasing during COVID to reach a peak of 39.1 per cent in 2020–21 (Chart 4). Fiscal repair since then has seen progress on gross debt, which has fallen to an estimated 33.7 per cent in 2024–25. Gross debt-to-GDP is expected to next peak at 37.0 per cent in 2029–30 and then fall to 31.9 per cent by 2035–36.

Chart 4: Gross debt



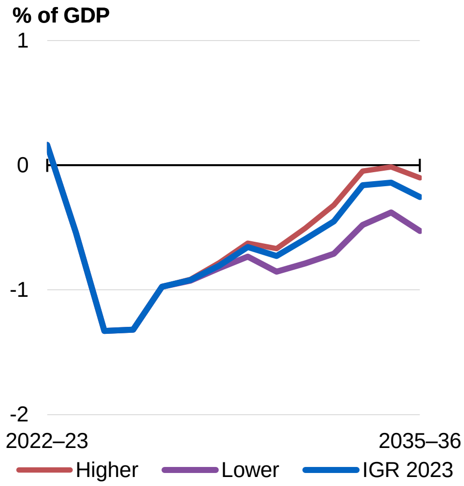

Source: Australian Office of Financial Management, Treasury.

# Structural challenges

**Broader economic trends, including the path of productivity growth, will impact the Budget over coming decades.**

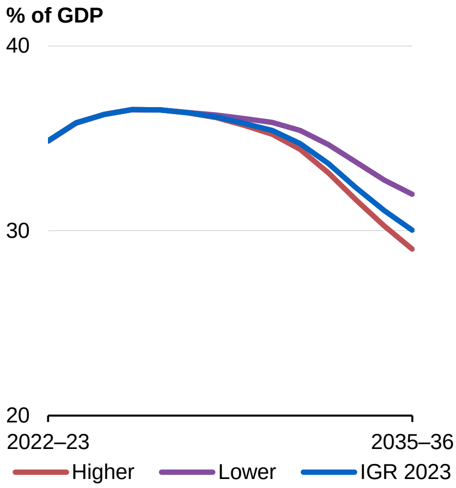
- There are several long-term structural trends that will continue to affect Australia's Budget. These include population ageing, expanded use of digital and data technology, climate change and the net zero transformation, rising demand for care and support services, and increased geopolitical risk and fragmentation.
- Slow productivity growth would make it more difficult to maintain a sustainable budget position into the future. The 2023 IGR estimated that if productivity growth was 0.3 percentage points lower from 2027–28 (at 0.9 per cent instead of 1.2 per cent annually), the budget deficit and debt would increase by 0.3 and 1.9 percentage points of GDP by the mid–2030s (Charts 5 and 6).

Chart 5: Productivity effects on underlying cash balance




Source: Treasury.

Chart 6: Productivity effects on gross debt

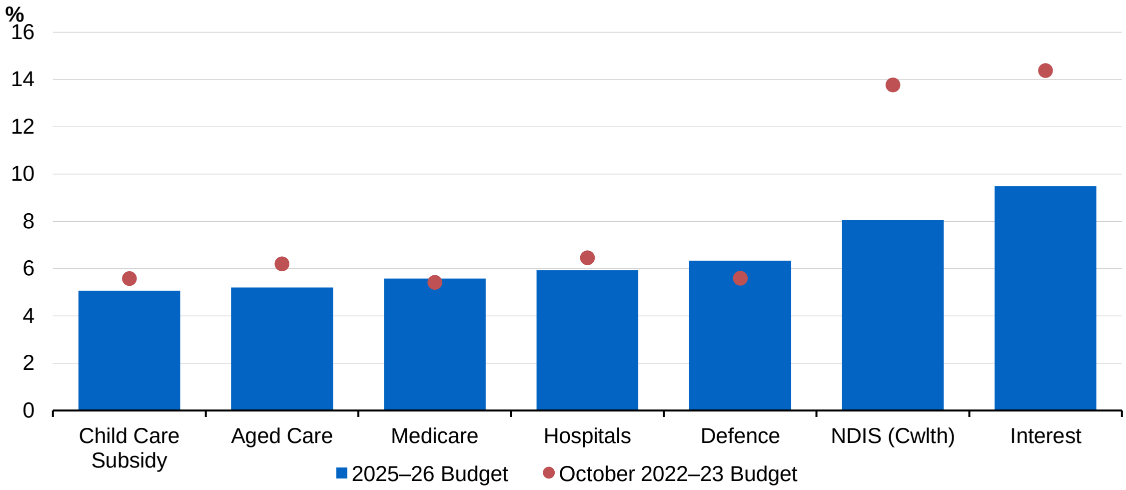



Source: Treasury.

**Pressures on Government payments are expected to grow, driven by defence and care services.**

- While significant efforts have been made to reduce spending growth in interest costs, the NDIS and aged care, there are seven key structural spending pressures on the Budget (Chart 7).
  - Interest costs are projected to grow by 9.5 per cent per annum over the medium term. This is much lower than the 14.4 per cent average three years ago, but current growth rates will see interest payments as a share of GDP rise to 1.4 per cent by 2035–36.
  - The NDIS (Commonwealth) is projected to grow around 8 per cent per annum over the medium term. This is consistent with the NDIS Sustainability Framework and is much lower than the 13.8 per cent projected three years ago. However, this is still faster than nominal GDP growth. The increase in growth is being driven by sustained increases in demand and average payments. More than ten years into the scheme, the NDIS continues to see strong growth in participant numbers, particularly children, with approximately 10 per cent of children aged 5 to 7 on the NDIS. Participants' average budgets are growing at more than 5 per cent per annum.
  - Defence spending, which is already the Commonwealth's second largest payment, is expected to grow faster than GDP to support a more capable and self-reliant Defence Force that can safeguard Australia's security into the future.
  - Hospitals funding is forecast to grow around 6 per cent per annum over the medium term. A key driver of costs in the health sector has been the rising price of delivering care, for example the National Efficient Price for hospitals has grown by 12.3 per cent for 2025–26.
  - Medicare is projected to grow by 5.6 per cent per annum over the medium term, driven by investments to strengthen Medicare, such as the expansion of bulk billing incentives, and the ongoing growth in the use of medical services funded through Medicare.
  - Aged care costs are projected to grow by 5.2 per cent per annum over the medium term. Long term, Australia's ageing population will continue to drive demand for aged care. The Government's recent reforms to aged care are helping to moderate growth, which was expected to be 6.2 per cent per annum three years ago.
  - Childcare costs are expected to grow by 5.1 per cent per annum over the medium term, driven by increasing demand for early childhood education and care services and the Government's policies to reduce out-of-pocket costs for families.

Chart 7: Fastest growing major payments over the medium term, per annum



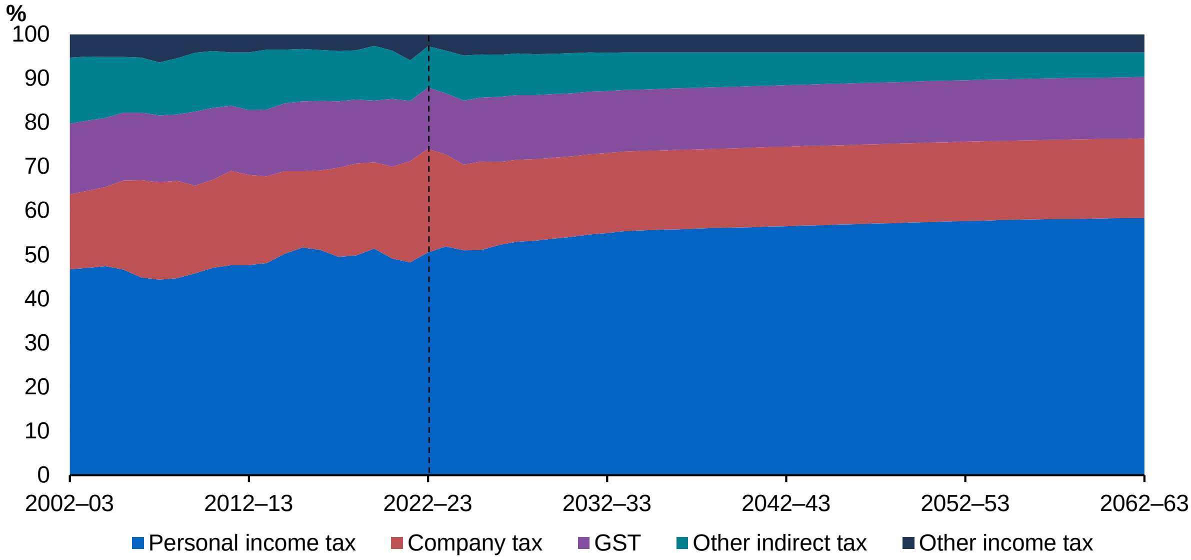

Source: Treasury

Note: Growth rate for October 2022–23 Budget is 2022–23 to 2032–33. For 2025–26 Budget it is 2025–26 to 2035–36.

**The tax system is under pressure from demographic and economic shifts, and its design is critical to productivity, budget sustainability and intergenerational equity.**

- Structural changes to the economy, including an ageing population and the transition to net-zero, are expected to change the composition of the revenue base.
- The share of indirect taxes will fall, as the decarbonisation of the transport industry and changing consumer preferences erode the fuel and tobacco excise bases. This will increase reliance on the income tax base, which is expected to comprise an increasing share of total tax receipts (Chart 8).

Chart 8: Composition of tax receipts, 2023 IGR

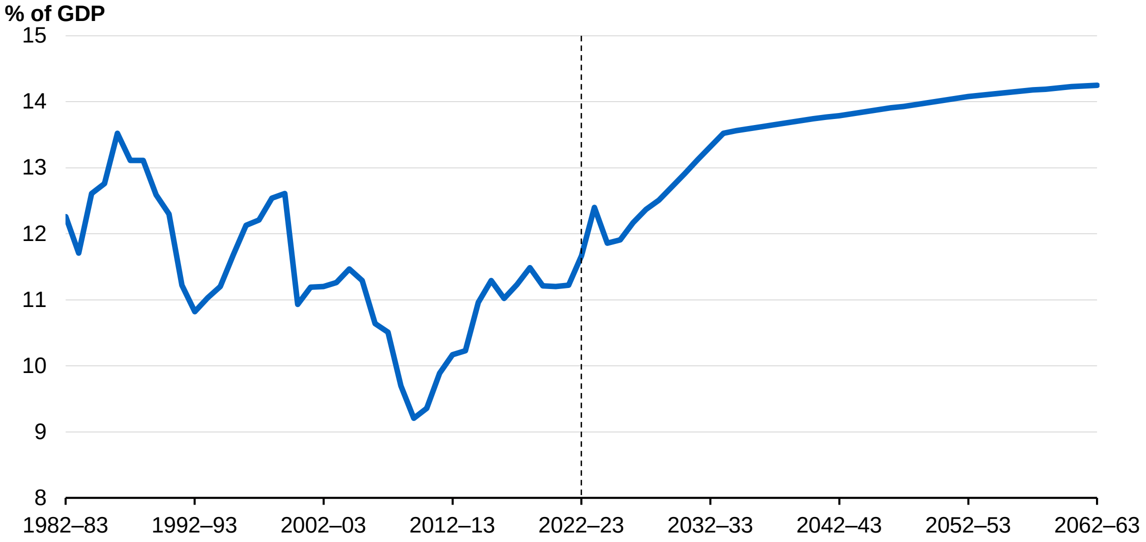



Source: Treasury, 2023 IGR.

Note: Personal income tax is predominantly composed of salary and wages income. The remaining share is savings income such as capital gains, net rent, trust distributions, dividends, interest as well as business (sole trader) income. Other indirect tax includes excise and customs duties, visa application charges, the wine equalisation tax, the luxury car tax and the major bank levy. Other income tax includes fringe benefits tax, petroleum resource rent tax and superannuation fund taxes.

- A smaller share of the Australian population are set to shoulder the burden of generating income tax revenue as the population ages. In 1982–83, there were 6.6 working-age Australians for each Australian over 65. Over the 40 years to 2022–23, this has fallen to 3.8 and it is projected to fall to 2.6 by 2062–63. Tax changes have also seen the income tax burden on older Australians decline: only 16 per cent of Australians aged 70 and over paid income tax in 2022–23, down from around 30 per cent in the 1990s.
- Over time, without government intervention, bracket creep will also result in rising average tax rates. High effective marginal tax rates (including means testing of benefits) can disincentivise labour market participation and savings and discourage investment in skills. These effects may be particularly pronounced for second earners – often women. High marginal tax rates can also exacerbate tax planning.

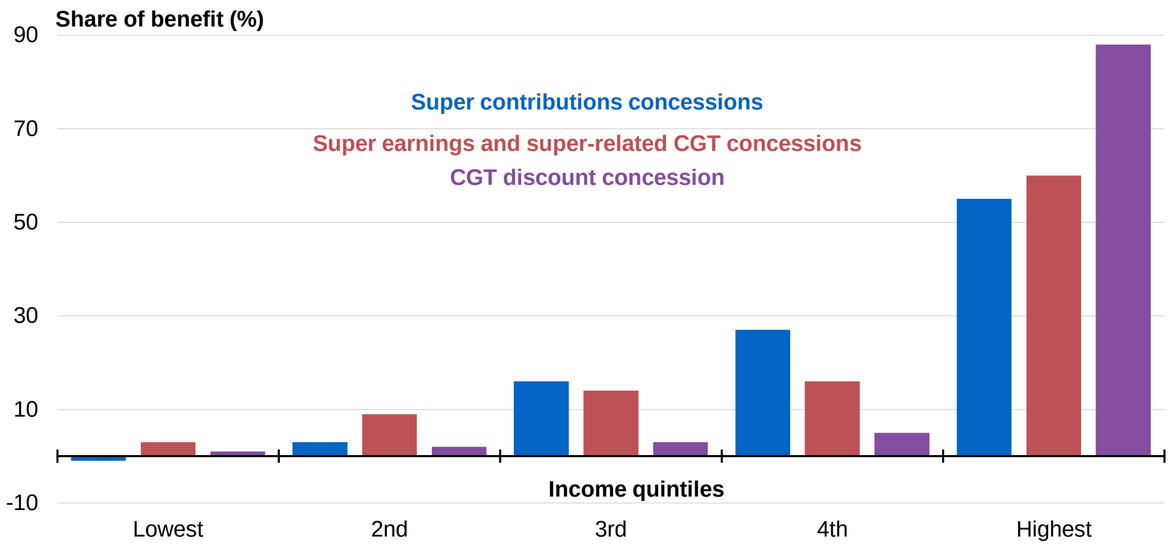
Chart 9: Personal income tax receipts, 2023 IGR




Source: Treasury.

- Inconsistent taxation of passive income is also distorting how and where people save and creating opportunities for tax planning. Some of the largest tax concessions tend to disproportionately benefit higher income earners (Chart 10) and labour income is generally subject to higher headline tax rates due to concessions on most savings income.

Chart 10: Share of benefits of largest tax concessions




Source: Estimates from 2024–25 Tax Expenditures and Insights Statement.

Note: Superannuation non-lodgers excluded from chart.

- Company tax is significantly impacted by the outlook for the mining industry which accounted for 39 per cent of company tax in 2022–23, up from 5 per cent in 1999–00. Going forward, company tax collections will be exposed to changes in the value or composition of our resources exports as a result of the global energy transition.

- Company tax settings can also distort business decisions and disincentivise investment, which can result in lower productivity, fewer jobs and lower wages. For example, current settings involve a mix of approaches, differing treatment of debt and equity financing and a headline tax rate that is relatively high by international standards.
- Indirect taxes (including the GST and excise equivalent duties) have fallen from 29 to 22 per cent of total tax receipts over the 20 years to 2023–24. This trend is expected to continue as technological developments and changing consumer preferences erode the fuel and tobacco excise bases.

# Work done or underway

**More work is required to make the Budget more sustainable over time, but the Government has made significant progress in recent years.**

- The underlying cash balance improved by a cumulative $207 billion over the seven years to 2028–29 from the 2022 Pre-election Economic and Fiscal Outlook (PEFO) to the 2025 PEFO – the largest nominal improvement in a parliamentary term.
- Since the 2022 PEFO, the Government identified around $100 billion in savings and spending reprioritisations.
  - These savings and reprioritisations have improved both the budget bottom line and the quality of government spending. For example, the Government reformed the Infrastructure Investment Program to ensure a more integrated, strategic and sustainable approach to projects, while remaining committed to an over $120 billion 10-year infrastructure investment pipeline.
- Further, the Government returned almost 70 per cent of tax receipt upgrades to the Budget over the last term, totalling $248.6 billion.
- Real payments growth was constrained to be an average of 1.7 per cent per year over the seven years to 2028–29, around half the 30-year average of 3.2 per cent.
- The Government has made significant progress in addressing longer-term structural spending pressures. This includes:
  - Legislation to progress the Independent NDIS Review's recommendations to make the NDIS more sustainable and deliver on National Cabinet's commitment to the NDIS Financial Sustainability Framework – estimated to reduce growth in the NDIS by around $60 billion over 10 years.
  - Aged care reforms that will save around $11 billion over the next 11 years, while delivering much better care and choice.
  - At the 2025–26 Budget, gross debt was expected to be $177 billion lower in 2024–25 than forecast in the 2022 PEFO – helping to avoid $60 billion in interest costs.
- In addition, the Government continues to deliver a substantial tax reform agenda which includes:
  - Delivering two more tax cuts to every Australian taxpayer in 2026 and 2027, adding to the first round delivered in July 2024, which will provide meaningful cost-of-living relief, return bracket creep and boost labour supply (especially for women and lower income Australians) (Chart 11).

– Making the tax system simpler for workers by announcing a $1,000 instant deduction for work-related expenses to apply from 2026–27.

– Ensuring the Australian community receives a fairer return from its natural resources through reforms to the Petroleum Resource Rent Tax (PRRT).

– Helping small businesses to invest by announcing the extension of the $20,000 instant asset write-off for a further 12 months until 30 June 2026.

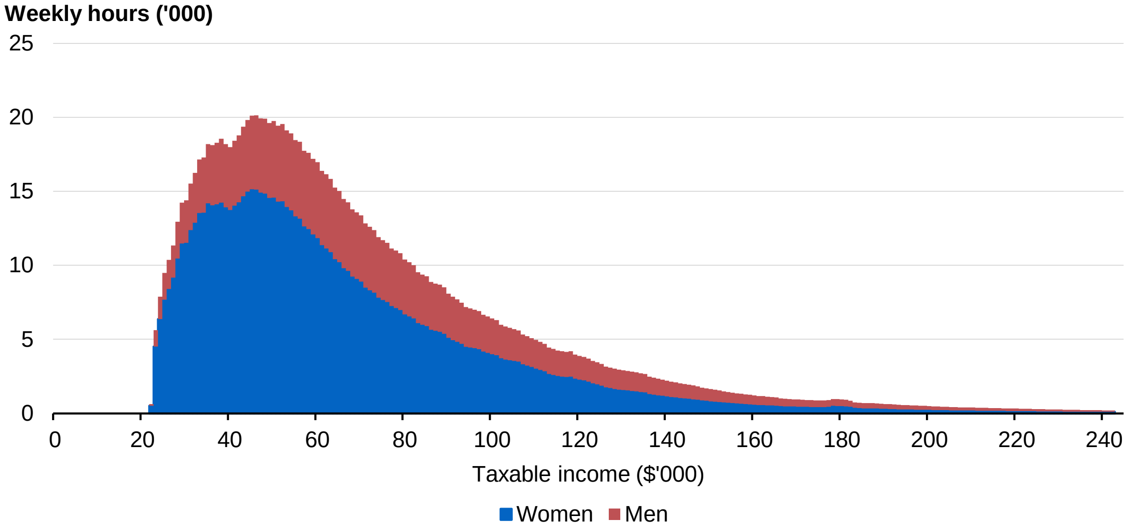
– Supporting the construction of homes, including affordable homes, through new tax breaks for the build-to-rent sector.

– Supporting private sector investment to build a stronger, more diversified and more resilient economy powered by renewable energy through critical minerals and hydrogen production tax incentives.

– Making superannuation tax concessions more equitable and sustainable by reducing the tax concessions available to individuals whose total superannuation balances exceed $3 million.

– Improving tax transparency and integrity through multinational tax reform and investment in tax compliance programs.

Chart 11: Expected change in weekly hours worked from combined tax cuts, by sex and taxable income




Source: Treasury analysis

Note: Shows the distribution of the expected increase of 1.3 million hours worked per week by sex and taxable income (in $1,000 income brackets).