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Budget Monitor

A second surplus: once more with feeling

1 May 2024

Deloitte
Access Economics

Budget Monitor is a source of independent projections of the Federal Budget, including detailed estimates of future spending and revenues.

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Executive summary

A second surplus: once more with feeling.

Budget aggregates

Based on updated economic parameters and policy announcements to 18 April 2024 – and assuming no further material increases in spending – Deloitte Access Economics estimates an underlying cash surplus of $13.4 billion in 2023-24. The budget balance is expected to return to deficit in 2024-25. Net debt is expected to improve to 18.1% of GDP in 2023-24 compared to 18.4% estimated in the 2023-24 Mid-Year Economic and Fiscal Outlook (MYEFO).

Budget forecasts

$ billion	2023-24	2024-25	2025-26	2026-27
Underlying cash balance % of GDP	0.5%	-0.3%	-0.7%	-0.4%
Fiscal balance % of GDP	0.6%	-0.5%	-0.6%	-0.5%
Revenue % of GDP	26.8%	25.7%	25.5%	25.7%
Expenses % of GDP	25.8%	25.9%	25.9%	25.8%
Net debt % of GDP	18.1%	18.2%	18.7%	18.8%

Source: Deloitte Access Economics. Forecasts incorporate policy announcements to 18 April 2024 and updated economic parameters.

Economic drivers

A resilient labour market and higher-than-assumed commodity prices helped to deliver the first underlying cash surplus in 15 years in 2022-23. While not quite as strong in 2023-24, the economic backdrop is still expected to help in delivering a second consecutive surplus in 2023-24.

Revenue

The 2024-25 Budget is expected to reveal almost $50 billion in upward revisions to revenue over the four years to 2026-27, compared to what was forecast in the 2023-24 MYEFO handed down in December.

Expenses

Parameter variations and policy decisions to 18 April 2024 (plus an adjustment for the expected change in the distribution of the GST to the states and territories) are expected to increase spending over the four years to 2026-27 by $0.4 billion relative to forecasts in the 2023-24 MYEFO.

Budget backdrop

The context for the 2024-25 Budget is complex. Much of the global economy has the wobbles. Domestic inflation is in retreat, but is still not quite where it needs to be. The Australian economy is in a precarious position, with household spending and dwelling investment both in the doldrums, and the relief of the redesigned Stage 3 tax cuts and stronger real wage growth still not realised. On top of that, a federal election is due in the next 12 months or so, meaning this could be the last budget before the writs are issued.

The highwire balancing act of supporting growth but not reigniting inflation is the stuff of budget nightmares. The Treasurer is therefore right when he talks about a greater 'degree of difficulty' in achieving a surplus for a second time, even if at least part of that messaging is surely intended to enable a greater level of crowing when that surplus is announced.

The underlying cash surplus in 2022-23 – ultimately inked at $22.1 billion – came with a sense of the unexpected. It was the surprise surplus, underpinned by cyclically serendipitous commodity prices and labour market outcomes as Australia emerged from the pandemic.

Rather than a surprise, a second consecutive surplus would come with a greater degree of ownership and authority. An opportunity, perhaps, for a government to talk up its economic credentials. Indeed, announcing another year with the budget in the black will no doubt be a proud moment for the Federal Government. Consecutive budget surpluses for the first time in almost 20 years. Underlined. Exclamation mark. And once more with feeling…

What could possibly go wrong? As Deloitte Access Economics noted in the previous edition of *Budget Monitor* released in November 2023, the problem with a fiscal plan that relies on banking upside revenue surprises is that it focuses on the short term.

It does little to firm the foundations of the long term budget position. That is best illustrated by the fact that the current string of surpluses is very likely to stop at two. With revenue projected to go backwards in 2024-25 as the redesigned Stage 3 income tax cuts come into effect and cyclical headwinds hit company taxes, the budget will be back in the red next year even if spending holds steady as a share of GDP.

The fiscal position looks increasingly dire the further out one looks. With a set of known spending challenges looming on the horizon (and the likelihood of plenty of currently unknown spending challenges, too) the budget needs reform on both the tax and spending side to shore up Australia's fiscal health for the long term.

There is still no credible action plan, for example, to suture the extraordinary growth in the cost of the National Disability Insurance Scheme (NDIS), while the budget allocation earmarked for defence has swollen remarkably. At the same time, the tax system is not fit for purpose – particularly, but certainly not solely, because of its heavy reliance on personal and company income tax. Australians will need to pay more tax in the years ahead in order for governments to afford the raft of long term spending promises made by both major political parties. How that tax is raised matters enormously for Australia's prosperity.

Australia's deep, long term fiscal deficit threatens to be eroded further if new industry policy is poorly designed or poorly implemented.

The Prime Minister's speech on the *Future Made in Australia* policy in April shocked many. The reaction from the country's economists has been swift and loud.

It's an important debate because the global context is defined by fragmentation, a retreat from globalisation, a narrow nationalism across democratic and non-democratic states, and a new triangulation of economic growth, technology, and national security. In a world with these dynamics, policy objectives have become more complex.

Value for taxpayers and return on investment for the economy over the medium to long run is paramount. A policy that violates the largely bipartisan economic orthodoxy requires careful explanation. Indeed, any argument for the *Future Made in Australia* policy must surely be heavy with nuance, emphasising the complexity of balancing the aims of the policy with its obvious costs.

But nuance has been sorely missing from the explanation and communication coming from the Federal Government. The justification for the policy is that "*the world has changed*", that "*others are doing it, therefore so should we*" and that "*protectionism is the new competition*". Meanwhile, critics have variously been labelled flat-earthers, out of touch with reality, or simply out of their depth.

That is not nearly good enough.

The *Future Made in Australia* policy is unlikely to stack up when considered using orthodox economic models because it will impose economic costs that outweigh the economic benefits.

Solar panels built in Australia, for example, will be more expensive than those that can be purchased from China. There will only be a market for Australian-made panels if the price of Chinese-made panels is artificially raised by tariffs, quotas or other distortions in the market.

Why would the Federal Government seek to implement a policy which will impose higher prices on Australian consumers and greater costs on the Australian economy? The only conclusion is that *Future Made in Australia* is not an economic policy. That is, those advocating for the policy must be taking a broader view of the costs and benefits than orthodox economic models would imply. The costs of the policy are clear. But what are the benefits?

If, for example, there was a risk that Australia would not be able to obtain solar panels from China in the future because of a bifurcation of global trade, the implications would be significant. This is a lesson from the pandemic that must loom large in the minds of policymakers.

A proper debate on the *Future Made in Australia* policy must focus on the costs and benefits of both doing nothing – if the world has changed – alongside the costs and benefits to taxpayers and consumers from interventions.

This is not simply an academic thought experiment but is front and centre in one of the most significant policy announcements of the Albanese Government.

To date, the case for the *Future Made in Australia* policy has not been made, and the debate has been too narrowly focused. A wider and more detailed explanation of the policy merits by those arguing the case is sorely needed.

Budget forecasts

Deloitte Access Economics' forecasts for key budget aggregates are shown in Table i.

A second surplus still isn't a *fait accompli*, but Deloitte Access Economics is expecting that it will come to fruition, forecasting an underlying cash surplus of $13.4 billion for 2023-24 compared to the -$1.1 billion deficit forecast in the 2023-24 MYEFO. That surplus will be a product of both further write-ups in company and personal income tax revenue, and spending restraint.

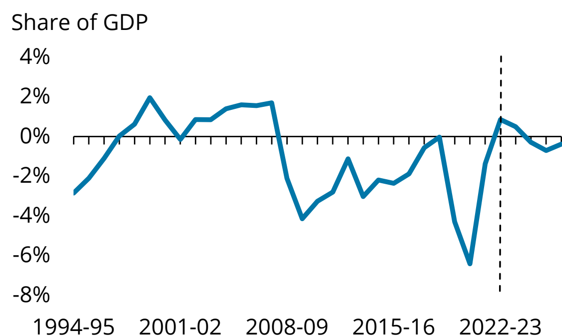
Company taxes are delivering windfalls because Treasury's commodity price assumptions are once again proving too conservative. After Treasury added $9.2 billion to this year's company tax forecast in the 2023-24 MYEFO, Deloitte Access Economics now estimates that stash will be a further $14.5 billion larger.

The resilience of the labour market means taxes on individuals have also outperformed forecasts. Treasury added $10.7 billion to this year's individual tax revenue forecast in the 2023-24 MYEFO. Deloitte Access Economics expects a further $5.6 billion to be added to that haul.

These windfall gains are offsetting write-downs elsewhere with taxes on superannuation funds and the petroleum resource rent tax underperforming.

The overall outperformance of the nominal economy compared to the forecasts in the 2023-24 MYEFO is set to deliver the government some $14.8 billion in additional revenue in 2023-24.

Chart i Underlying cash balance to GDP



Source: Deloitte Access Economics, based on Commonwealth of Australia data

Provided the government holds the line on spending, that will be enough to deliver a second consecutive cash surplus.

So far, so good. Differences between Deloitte Access Economics' latest economic forecasts and those in the 2023-24 MYEFO – the so-called parameter variations – indicate spending will be $9.6 billion lower than expected in the 2023-24 MYEFO over the four years to 2026-27, including $800 million lower in 2023-24.

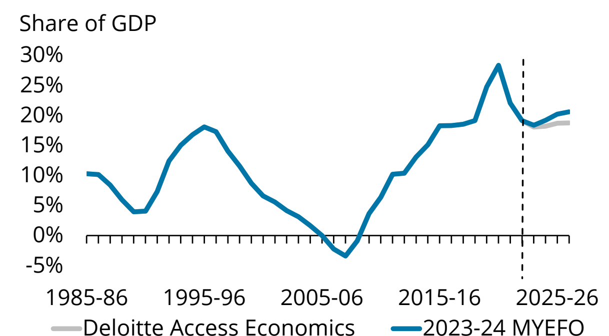
At the same time, costs associated with the new policy measures shown in *Budget Monitor* (only those that have been announced between the 2023-24 MYEFO and 18 April 2024) are expected to add an estimated $6.1 billion to net spending over the forward estimates, including just over $200 million in 2023-24.

Taken together, parameter variations and announced policy decisions (plus an adjustment for the expected change in the distribution of the GST to the states and territories) are expected to increase spending over the four years to 2026-27 by $0.4 billion relative to forecasts in the 2023-24 MYEFO. That result broadly reflects decreases in spending due to parameter variations offset by increases from announced policy decisions and GST outlays.

Indeed, there is a list of reasons why government spending needs to be restrained in the short term, from inflation and capacity constraints to the fact that revenue is projected to go backwards in 2024-25 as the redesigned Stage 3 income tax cuts come into effect and cyclical headwinds hit company taxes. Even if spending holds steady as a share of GDP, the budget will be back in the red in 2024-25.

For now, however, a cumulative improvement in the underlying cash balance of $48.2 billion over the four years to 2026-27 will mean another downward revision in the forecast for net debt. Net debt is expected to average 18.4% as a share of GDP over the four years to 2026-27, compared to the 19.8% of GDP forecast in the 2023-24 MYEFO (see Chart ii).

Chart ii Net debt to GDP



Source: Deloitte Access Economics, based on Commonwealth of Australia data

Alternative policy settings

Recent editions of *Budget Monitor* have proposed several tax reforms to help address Australia's structural budget deficit, while also improving the equity and efficiency of the tax system. Two major reforms put forward in recent editions were a simpler and lower rate of personal income tax, and a broader and higher GST.

Deloitte Access Economics has not softened its view that Australia needs a major rethink on tax policy. The budget's revenue base is forecast to grow by just 1.5% of GDP over the next four decades, with personal income taxes doing the heavy lifting. On the other side of the budget, spending on health, aged care, the NDIS, defence and interest payments is forecast to grow by more than 5% of GDP over the next 40 years.

Australia desperately needs a fiscal strategy to close this funding gap in an efficient and equitable way. But the political reality is that major tax reform is off the table, at least for the foreseeable future. In that context, this section of *Budget Monitor* has been repurposed to 'debunk' two smaller tax reform ideas that are more likely to be at the forefront of the current policy debate on Australia's housing challenges. Those policies are lowering the capital gains tax discount from 50% to 33.33%, and abolishing the ability to negatively gear residential rental income.

Deloitte Access Economics has analysed these two policies in terms of their effect on both the housing market and the budget (assuming that the policies would be phased in gradually over five years). These reforms would have a small, positive fiscal impact – jointly raising some $12.1 billion over the next three years.

Both reforms would modestly reduce house prices, although they are hardly game changers for housing affordability. But while the economic arguments for a lower CGT discount are robust, abolishing negative gearing is a red herring in the housing debate.

Table i Budget projections

	Outcome 2022-23	Forecast 2023-24	2024-25	2025-26	2026-27
Budget aggregates, $ billion					
Revenue (accrual)	668.4	715.5	713.0	740.2	777.2
% of GDP	26.1%	26.8%	25.7%	25.5%	25.7%
Taxation revenue	618.3	664.1	661.9	688.5	723.6
% of GDP	24.1%	24.8%	23.9%	23.8%	23.9%
Non-taxation revenue	50.1	51.4	51.1	51.7	53.7
% of GDP	2.0%	1.9%	1.8%	1.8%	1.8%
Expenses (accrual)	637.0	689.6	717.7	751.4	782.4
% of GDP	24.9%	25.8%	25.9%	25.9%	25.8%
Fiscal balance	21.9	17.0	-13.8	-18.3	-14.8
% of GDP	0.9%	0.6%	-0.5%	-0.6%	-0.5%
Official forecast of fiscal balance	21.9	2.4	-24.8	-33.0	-22.9
Difference in fiscal balance	0.0	14.5	10.9	14.7	8.0
Underlying cash balance	22.1	13.4	-7.9	-20.4	-11.5
% of GDP	0.9%	0.5%	-0.3%	-0.7%	-0.4%
Official forecast of underlying cash balance	22.1	-1.1	-18.8	-35.1	-19.5
Difference in underlying cash balance	0.0	14.5	10.9	14.7	8.0
Net cash flows from investments in financial assets[1]	-8.0	-5.6	-14.1	-16.6	-15.0
Headline cash balance	14.1	7.9	-22.0	-37.0	-26.5
% of GDP	0.6%	0.3%	-0.8%	-1.3%	-0.9%
Official forecast of headline cash balance	14.1	-6.7	-32.9	-51.7	-34.5
Difference in headline cash balance	0.0	14.5	10.9	14.7	8.0
Net debt	491.0	483.1	505.1	542.1	568.6
% of GDP	19.2%	18.1%	18.2%	18.7%	18.8%
Official forecast of net debt (% of GDP)	19.2%	18.4%	19.5%	20.5%	20.8%
Economic forecasts, % growth					
Real GDP	3.2%	1.5%	1.7%	2.2%	2.2%
Employment^	3.5%	1.5%	1.2%	1.7%	1.4%
Unemployment rate*	3.6%	4.3%	4.7%	4.7%	4.6%
Consumer price index^	6.0%	3.6%	2.5%	2.5%	2.5%
Wage price index^	3.7%	4.0%	3.3%	3.2%	3.1%
Nominal GDP	9.8%	4.3%	3.8%	4.5%	4.5%

Rates of growth in all tables (unless otherwise indicated) are 'year average percentage changes' – the percentage change between the year indicated and the prior year. ^Employment, consumer price index and wage price index are through the year growth to the June quarter. *Unemployment rate is the rate for the June quarter. 'Official forecasts' refer to projections in the 2023-24 MYEFO. [1] Net cash flows from investments in financial assets for policy purposes. Prior to 1999-00 these flows were known as 'net advances'.
Source: Deloitte Access Economics, Commonwealth of Australia.

Budget backdrop

From housing to manufacturing, economic policy makes an appearance.

This edition of *Budget Monitor*

Budget Monitor provides an independent view on the Federal Budget.

Unless otherwise indicated, the official forecasts shown in this issue of *Budget Monitor* are drawn from the 2023-24 Mid-Year Economic and Fiscal Outlook (MYEFO).

To produce the budget forecasts presented in this report, Deloitte Access Economics has updated the 2023-24 MYEFO figures by incorporating:

- Latest actual Commonwealth Monthly Financial Statements data for 2023-24 published by the Department of Finance and available up to March 2024
- The effect of policy decisions announced by the Federal Government up to and including 18 April 2024
- The effect of changes in economic parameters based on Deloitte Access Economics' latest forecasts and therefore capturing any difference between those forecasts and Treasury's view of the economic outlook included in the 2023-24 MYEFO.

Deloitte Access Economics' latest economic forecasts were published in the March 2024 edition of Business Outlook and released publicly on 22 April 2024.

This edition of *Budget Monitor* includes analysis showing the budget implications of a number of alternative tax policy settings. This analysis should be considered with reference to the assumptions and caveats included throughout this report. Importantly, the modelled policies do not represent an exhaustive set of reform options.

The remainder of this backdrop describes a complex economic and policy context for the release of the 2024-25 Budget, including a discussion of the Federal Government's *Future Made in Australia* policy.

Back to the *Future Made in Australia*

For at least the past 30 years, economists have been in broad agreement about the policy settings which best promote growth, lift productivity and improve living standards for people around the world. Those economic policy settings have reinforced a global 'order' among the majority of countries, including a shared understanding of the mutual prosperity available from, for example, closer trade ties or the free flow of capital.

It has, at times, been an uneasy consensus. The imposition of self-serving subsidies by a hegemon here. The deliberate currency devaluation by an emerging export powerhouse there. Overwhelmingly, however, the post-Cold War order has endured.

That is, it seems, until now.

The list of structural economic, geopolitical and technological changes which have shaped today's world is too long to list exhaustively. The unrelenting rise of China, the dislocation imposed by the COVID-19 pandemic, Russia's increasingly isolationist posture, the hollowing out of the middle class in the United States and other advanced economies, and changing technology and security challenges provide just a flavour.

Whether triggered by some combination of these or other trends, the statement from US Secretary of State Anthony Blinken in late 2023 that, "*what we're witnessing now is more than a test of the post-Cold War order. It's the end of it*" is hugely revealing.

Other serious and senior economists and policymakers have made similar points. As early as April 2022, US Treasury Secretary Janet Yellen coined the term 'friend-shoring' when she said, "*we cannot allow countries to use their market position in key raw materials, technologies, or products to have the power to disrupt our economy or exercise unwanted geopolitical leverage. Let's build on and deepen economic integration…with the countries we know we can count on.*"

And it's not just the Americans. Former European Central Bank President and former Italian Prime Minister, Mario Draghi, has been asked by the European Commission to draft a report on the bloc's competitiveness, due out in June. He recently gave a preview of his recommendations, noting that, "*others are no longer playing by the rules, and are actively pursuing policies to enhance their competitive positions…We need a European Union that is fit for today's and tomorrow's world. What I'm proposing… is radical change*."

Indeed, that change is already here. The Biden Administration's Inflation Reduction Act (IRA) – an extraordinary half-trillion dollar package supporting a range of clean energy, manufacturing and related domestic industry development objectives – is the most obvious case in point, but there are others, from Canada, Japan, South Korea and the Eurozone.

Even so, the Prime Minister's speech on the *Future Made in Australia* policy in April shocked many. The reaction from the country's economists has been swift and loud.

It's an important debate because the global context is defined more by fragmentation, a retreat from globalisation, a narrow nationalism across democratic and non-democratic states, and a new triangulation of economic growth, technology, and national security. In a world with these dynamics, policy objectives have become more complex.

Value for taxpayers and return on investment for the economy over the medium to long run is paramount. A policy that violates the largely bipartisan economic orthodoxy requires careful explanation. Indeed, any argument for the *Future Made in Australia* policy must surely be heavy with nuance, emphasising the complexity of balancing the aims of the policy with its obvious costs. But nuance has been missing from the explanation and communication coming from the Federal Government. The justification for the policy is that "*the world has changed*", that "*others are doing it, therefore so should we*" and that "*protectionism is the new competition*". Meanwhile, critics have variously been labelled flat-earthers, out of touch with reality, or simply out of their depth.

That is not nearly good enough.

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Solar panels built in Australia, for example, will be more expensive than those that can be purchased from China. There will only be a market for Australian-made panels if the price of Chinese-made panels is artificially raised by tariffs, quotas or other distortions in the market.

Why would the Federal Government seek to implement a policy which will impose higher prices on Australian consumers and greater costs on the Australian economy? The only conclusion is that *Future Made in Australia* is not an economic policy. That is, those advocating for the policy must be taking a broader view of the costs and benefits than orthodox economic models would imply. The costs of the policy are clear. But what are the benefits?

If, for example, there was a risk that Australia would not be able to obtain solar panels from China in the future because of a bifurcation of global trade, the implications would be significant. This is a lesson from the pandemic that must loom large in the minds of policymakers.

The Biden Administration is pursuing the IRA and related policies such as the CHIPS Act to counter China's rise and to seek to reassert its status as global hegemon. It must therefore have placed a premium on energy, technology and national security. Put another way, the Biden Administration must be of the view that the cost of ceding ground to China in areas such as energy and technology security outweighs the economic and fiscal cost of the IRA.

Australia is not the United States. It simply does not have the fiscal or economic clout to implement policies that mimic the IRA. Nor is Australia's position as a global power under threat from China's rise. In short, Australia has neither the motive nor resources to follow the United States down this path.

A proper debate on the *Future Made in Australia* policy must focus on the costs and benefits of both doing nothing – if the world has changed – alongside the costs and benefits to taxpayers and consumers from interventions.

This is not simply an academic thought experiment but is front and centre in one of the most significant policy announcements of the Albanese Government.

To date, the case for the *Future Made in Australia* policy has not been made, and the debate has been too narrowly focused. A wider and more detailed explanation of the policy merits by those arguing the case is sorely needed.

Australia's housing challenge

Recent editions of *Budget Monitor* have called out the lack of significant reform that could shore up the nation's finances and the prosperity of future generations. Deloitte Access Economics has at times sounded like a broken record in calling for bolder reform. But successive governments are failing to address the country's most pressing economic challenges.

One of those challenges – and the one which has taken centre stage in the policy debate this year – is Australia's housing disaster. Vacancy rates at record lows, rental prices growing at a rampant pace, and house prices breaching new highs even amid elevated interest rates have dramatically eroded housing affordability.

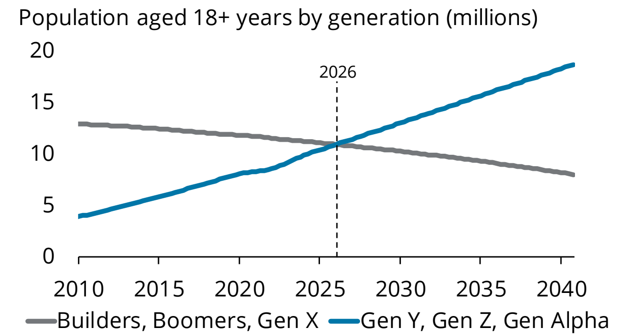
The root cause of this problem is simple. Australia is not building enough dwellings to keep up with population growth. Yet fixing the problem is anything but simple. Housing is a policy area that needs coordinated reform across three levels of government. That is not something Australia does very well.

And yet the calls for change are only likely to grow louder. As shown in Chart 1, Deloitte Access Economics expects that in 2026, the generational bloc of Gen Y, Gen Z and Gen Alpha (that is, those born in 1980 and later) will make up a greater share of the voting public than the Builders, Boomers and Gen X bloc that has dominated election outcomes in past decades.

Previous governments have made housing policy decisions for a voter base that has generally benefitted from higher house prices and demand side tax settings.

As the voter base swings toward younger generations, the net winners from the current tax policy settings are likely to lose sway with policymakers – indeed, the next federal election, due within the next 12 months or so, will be the last where Australia's older generations hold the majority of votes. The speed of change is fascinating. The younger generational bloc is expected to account for 49% of Australian adults at the 2025 federal election, but accounted for fewer than 40% at the 2019 election and fewer than 18% when Labor won in 2007. The rising voting power of younger Australians may mean that the political incentives will increasingly nudge decision making away from the status quo. But this is not a perfect analysis, of course. Plenty of older Australians vote for policies that benefit younger generations, and plenty of younger Australians own a home (or stand to inherit from their parents one day).

Chart 1 Voting age population by generation



Source: Deloitte Access Economics, Australian Bureau of Statistics

Should a future government seek to make some policy changes in the housing space, there are three types of levers that can be pulled: demand levers, supply levers and distributional levers. Of those policies that are the remit of the Federal Government, the housing debate almost inevitably leads back to a debate on two demand side levers: the capital gains tax (CGT) discount and negative gearing.

The calls for these tax changes – and other, more significant housing reforms – are only likely to grow louder. The reality, however, is that neither negative gearing nor the CGT can significantly shift the dial on housing affordability. And while there is strong economic rationale for a less generous CGT discount, the case for restricting the use of negative gearing is less convincing.

In principle, the CGT discount is a simple way to account for the effect of inflation and ensure investors only pay tax on real capital gains. But the CGT discount of 50% is too generous. This leaves capital gains undertaxed relative to other forms of income, distorts the allocation of capital and attracts excess investment into assets like residential property. As investors seek out lower taxed capital gains, property prices are pushed higher and the home ownership rate falls.

A CGT discount of 33.3% would do a better job at adjusting for inflation and reducing the tax related incentives to invest in property. Deloitte Access Economics estimates it could reduce dwelling prices by around 2%. That's not a game changer for housing affordability, but it's a good outcome from a tax policy that more broadly improves the equity and efficiency of the tax system. The fiscal impact of a lower CGT discount is estimated be an average of $6 billion a year over the first ten years – assuming the policy is phased in over a five-year period.

The case for tweaking negative gearing is more complex. One of the fundamental tenets of our tax system is that the costs incurred in earning an income can be deducted from taxable income. Another is that things like rental income can be combined with an individual's taxable income from other sources like wages. These principles minimise the influence of the tax system on incentives to invest, which leads to more efficient allocation of capital across the economy.

Allowing investment properties to be negatively geared – that is, allowing net rental losses to be deducted from other sources of taxable income – is an example of the tax system protecting incentives to invest. Taking this away has the potential to shift a disproportionate level of risk onto investors, blunt the incentives to invest, and increase the economic cost of the tax system.

But what about the implications for housing affordability? Negative gearing is largely only a problem due to its interaction with the CGT discount. As the CGT discount attracts excess capital into residential property, negative gearing reduces the holding cost for investors, crowding even more capital into residential property. Investors can further bid up property prices and weather more costly net rental losses in order to earn an undertaxed capital gain. If capital gains were taxed at a fairer rate, the incentive to make annual losses on an investment property diminishes significantly.

The fiscal and economic impacts of CGT and negative gearing reforms are further unpacked in the Alternative Policy Settings section of this report. But the broader challenge in housing policy is that only so much can be achieved with demand side tax levers. The big wins are overwhelmingly on the supply side, in areas such as migration, training and state-level tax, regulatory and planning policies.

Migration is one supply side lever that it is critical to get right. Migrants are too often the scapegoat for our housing woes. They should be part of the solution. Yes, migrants boost housing demand. But migrant construction workers can be a key lever in boosting Australia's capacity to build more homes. The focus needs to be on getting the migration mix right, and making better utilisation of migrants skills once they do arrive, rather than restricting the number of migrants. Similarly, training is another area where Australia can do better, with stronger incentives to get more Australians into trades.

Yet beyond training and migration, meaningful reforms largely need a collaborative approach across all three levels of government. For example, stamp duty has long been one of the costliest taxes imposed in Australia. It prevents the existing housing stock from being used as efficiently as it should be. And yet the structure of the Federation means that states and territories are fiscally impeded from moving away from this destructive tax. Any serious efforts to abolish stamp duty will likely need to be underpinned by some level of financial support from the Commonwealth, in a broadly similar way that the Federal Government's $3.5 billion in incentive payments to states and territories, embedded in the National Housing Accord, is helping to incentivise regulatory and planning reform.

This is an area of reform that cannot wait.

Where are all the workers?

Australia's workforce needs reshaping to meet the economy's future needs.

The country's economic goalsetting is asking a range of industries to grow quickly – both now and in coming decades. But that growth will not happen without the workers needed to fuel it. As a result, workforce pressures are piling up and present a key challenge for governments and businesses.

Despite the recent surge in net overseas migration, there are only so many workers to go around. Faster growth in some areas necessarily means slower growth – or indeed backward steps – in others.

That rebalancing of the workforce has long been a feature of the Australian economy. A decline in traditional manufacturing and agriculture, along with increased workforce participation – particularly of women – has allowed some industries to grow as a share of the economy. Part of that story is one of productivity growth and comparative productivity levels across industries. That has allowed, for example, manufacturing and agriculture to reduce reliance on workers, while the care economy continues to rely on workers to deliver personal support.

The process of reshaping the economy has been one of decades, not years. That said, it is notable that the care economy has been growing more rapidly in the period since the 2008 financial crisis – in part, a reflection of the rollout of the National Disability Insurance Scheme (NDIS), which has underpinned an enormous burst of employment.

But it isn't just the care economy where labour is in high demand. While unemployment is creeping up from post-pandemic lows, there remains a struggle for many employers to find qualified staff. The Skills Priority List maintained by Jobs and Skills Australia lists 35% of occupations as in shortage, with many of them tied to areas of national priority. And still, greater challenges lie ahead. Across a handful of industries, labour is likely to remain in short supply, with that list led by disability support, aged care, health, residential construction, defence, energy and the net zero transition, and now, homegrown manufacturing and mineral processing in line with the Federal Government's *Future Made in Australia* policy.

To be clear, the workforce demands of those industries will be on top of the perennial struggle to find the teachers, paramedics and police officers needed to deliver key services.

All of these workforce pressures are influenced by government decisions and national priorities. Unsurprisingly, many reflect the fastest growing areas of government spending. Put simply, Australia cannot deliver on social policy promises, adequately invest what is required to make the transition to net zero, or solve the housing crisis, without addressing these workforce pressures. Expanding key sectors of the workforce will require some combination of higher productivity, higher migration, and a better allocation of workers.

Boosting productivity growth is always a key goal of economic policy. Lifting productivity in those sectors that can best take advantage of new technologies and approaches is key to releasing workers to other, growing sectors which may be more labour intensive.

Importantly, Australia needs to work harder to lift productivity in those sectors which have traditionally struggled with low productivity growth. That includes the care sector, where productivity growth is hard to achieve, but could go a long way to addressing workforce challenges in the long term.

Migration too has the potential to provide targeted relief from workforce pressures. For some sectors such as health, migration already accounts for a significant share of workforce growth. In other sectors like construction, there is the potential to do more.

There is also the potential to do more in improving the way scarce workers are allocated across the economy. That means ensuring wages provide the right incentives to attract workers to areas of shortage – something that has been helpful in disability support in recent years and will now be helpful in aged care after recent Fair Work Commission decisions. It also means ensuring the training system is up to the task of transitioning workers between different sectors and is ready to teach the emerging skills needed for the jobs underpinning the net zero transition.

Breaking down barriers that stand in the way of workers joining growing sectors will be important too. It will mean addressing gender imbalances by, for example, increasing the share of women in construction and the share of men in the care sector.

Some of this may be a matter of altering attitudes to jobs that don't tend to attract the prestige that they deserve. It doesn't help that many parents and teachers – and even governments – push young Australians to go to university rather than seek a pathway to the jobs of the future through technical education.

Overall, planning to grow the share of the workforce in priority areas is also a plan to reduce the share of the workforce in other areas. What Australia increasingly needs is a strategy to help workers leave struggling sectors for jobs in priority areas. The alternative is to continue to pull workers from adjacent sectors only to cause workforce shortages there too.

Economic outlook

Disruption, delays and data. Awaiting a pivot to growth.

The Australian economic outlook

Nominal GDP and the terms of trade

The Australian economy has spent 2024 to date in a holding pattern. International disruptions and a backlog of homebuilding complicate the picture for a data dependent central bank, delaying a pivot to growth.

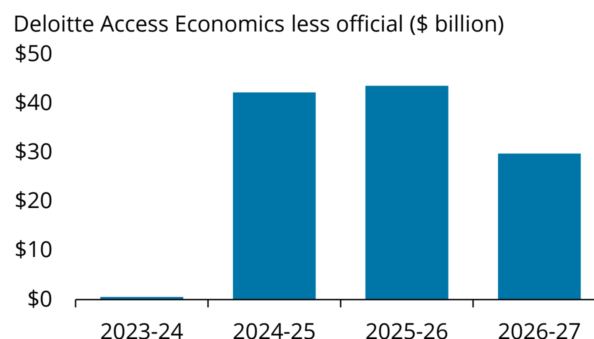
Following strong growth in 2022-23, Deloitte Access Economics expects nominal GDP growth to moderate to 4.3% in 2023-24 before slowing further to 3.8% in 2024-25. This is still a more positive outlook than Treasury's gloomier forecast of a slowdown to 2.3% in 2024-25. As a result, Deloitte Access Economics expects the nominal economy to be almost $40 billion larger on average each year from 2024-25 to 2026-27 compared to the official forecasts (see Chart 2).

In 2022-23, elevated commodity prices and high inflation boosted tax revenue, delivering the first underlying cash surplus in 15 years. Commodity price movements in the first half of 2024 have been a tug-of-war between slowing global demand and the growing risk of supply side disruptions. This tension has resulted in a stalemate in recent months, but the balance continues to be tilted to the downside. Even so, commodity prices are likely to remain above Treasury's assumptions, which helps to explain the difference in forecasts of nominal GDP.

Deloitte Access Economics also continues to expect inflation will decelerate more quickly than the official estimates, though the path is likely to be bumpy. More generally, cyclical revenue windfalls are expected to fade over the forward estimates reflecting easing commodity prices amid softer demand from China.

That's important because it has been the cyclical rebound from the COVID-19 pandemic which has bolstered commodity prices and nominal economic activity, and in turn underpinned a surge in tax revenue over the last two years. That budget boost was never going to be a sustainable or structural.

Chart 2 Difference in nominal GDP forecasts



Source: Deloitte Access Economics, based on Commonwealth of Australia data. Note: Data shows the difference between the latest Deloitte Access Economics forecasts and the official forecasts published in December 2023.

The real economy

Deloitte Access Economics is forecasting real economic growth in Australia of just 1.3% in calendar year 2024. Outside of the pandemic, that would be the weakest growth since the early 1990s recession. Elevated inflation and higher interest rates continue to weigh on household purchasing power and spending.

Some important positives have continued to support growth. Australia's population grew by 2.5% in the year to the September quarter of 2023 – the fastest annual rate on record – spurred on by record overseas arrivals, historically low departures, and a slight improvement in the natural increase (births less deaths).

Labour demand has remained a key positive as well. The unemployment rate remains low and strong growth in the Australian working age population has aided employment gains. As a result, personal income tax revenue in 2023-24 – shown elsewhere in this report – is expected to come in well ahead of the latest official forecasts in the 2023-24 MYEFO.

There are also some factors that will support growth over the horizon – the long-anticipated (and now revamped) Stage 3 tax cuts come into effect from 1 July, while real wage growth is also expected to strengthen across 2024-25.

Those positives are weighed against some near term challenges.

Labour market indicators suggest market conditions have cooled, with broader economic weakness and the impact of interest rate increases stalling momentum. That is despite the unemployment rate holding steady in recent months. By the end of 2023-24, more than 370,000 jobs are expected to have been created in Australia over the year, though employment growth is forecast to stall in 2024-25 with just 113,000 jobs expected to be added. Deloitte Access Economics expects the unemployment rate to increase to 4.7% by the June quarter of 2025 as employment growth slows.

The Australian economy is currently negotiating an air pocket in growth caused by low residential construction activity and bleak household spending. The extent to which those current conditions are managed before tax cuts and stronger real wage growth take hold will be the defining feature of 2024. On balance, Deloitte Access Economics is of the view that 2024 will need to be the year that Australian policymakers pivot from containing inflation to boosting growth.

Some of that pivot is already in train, particularly in the form of tax cuts. As the housing construction sector churns through an existing backlog of projects, a lift in dwelling commencements will also help to make it feel as if the economy is gaining some momentum.

The 2024-25 Budget is likely to be remembered for how well it balances the near term, competing priorities of supporting growth but not exacerbating inflation. Getting that balance right should mean keeping the RBA at bay in the short term, and helping to provide the room for rate cuts sooner rather than later.

Deloitte Access Economics expects real economic growth to slow to 1.5% in 2023-24 before lifting to 2.2% by 2026-27.

Table 1 Australian economic forecasts (% growth)

	History 2022-23	Forecasts 2023-24	2024-25	2025-26	2026-27
Gross domestic product					
Household consumption	5.0%	0.1%	1.8%	2.2%	2.3%
Dwelling investment	-3.8%	-1.9%	4.3%	11.4%	9.2%
Business investment	8.6%	5.4%	1.6%	2.7%	2.9%
Public final demand	2.4%	4.0%	2.1%	2.8%	2.6%
Gross national expenditure	3.5%	1.2%	2.1%	2.9%	2.8%
Real GDP	3.2%	1.5%	1.7%	2.2%	2.2%
Nominal GDP	9.8%	4.3%	3.8%	4.5%	4.5%
Prices and wages					
Consumer price index^	6.0%	3.6%	2.5%	2.5%	2.5%
Wage price index^	3.7%	4.0%	3.3%	3.2%	3.1%
GDP deflator	6.4%	2.7%	2.1%	2.2%	2.2%
Terms of trade	-0.3%	-4.4%	0.0%	0.7%	0.6%
Labour market and population					
Participation rate*	66.6%	66.6%	66.6%	66.6%	66.5%
Employment^	3.5%	1.5%	1.2%	1.7%	1.4%
Unemployment rate*	3.6%	4.3%	4.7%	4.7%	4.6%
Population	2.2%	2.2%	1.5%	1.4%	1.4%

Note: Base year for real data is 2021-22. Rates of growth in all tables (unless otherwise indicated) are 'year average percentage changes' – the percentage change between the year indicated and the prior year. ^Employment, consumer price index and wage price index are through the year growth to the June quarter. *Unemployment rate and participation rate is the rate for the June quarter.
Source: Deloitte Access Economics, Australian Bureau of Statistics

Revenue

Yet another revenue write-up expected to underpin a second surplus.

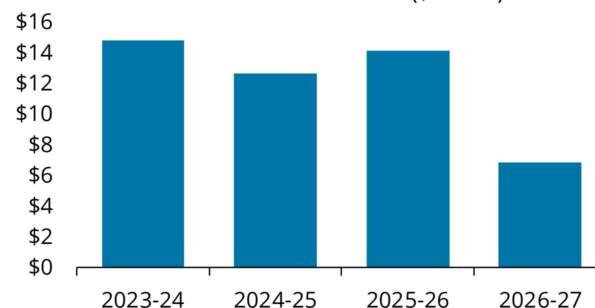
Overview

Revenue write-ups were the good news story in both the 2023-24 Budget and MYEFO, as official predictions for the nominal economy proved far too conservative. The gap between Treasury's forecasts and the actual path of the economy has narrowed recently, but solid revenue write-ups are still set to be unveiled in the 2024-25 Budget.

Company taxes are delivering windfalls because Treasury's commodity price assumptions are once again proving too conservative. After Treasury added $9.2 billion to this year's company tax forecast in the 2023-24 MYEFO, Deloitte Access Economics now estimates another $14.5 billion should be added to that write-up.

The resilience of the labour market means taxes on individuals have also outperformed forecasts. Treasury added $10.7 billion to this year's individual tax revenue forecast in the 2023-24 MYEFO. Deloitte Access Economics now projects another $5.6 billion to be added to that haul.

Chart 3 Revenue forecast compared to 2023-24 MYEFO



Source: Deloitte Access Economics, based on Commonwealth of Australia data

Table 2 Accrual revenue estimates ($ billion)

	2023-24		2024-25		2025-26		2026-27	
	Official estimate	*Budget Monitor*	Official estimate	*Budget Monitor*	Official estimate	*Budget Monitor*	Official estimate	*Budget Monitor*
Individuals[1]	336.6	342.2	326.8	333.0	346.6	352.0	370	373.8
Company tax	140.3	154.8	136	148.0	132.9	144.3	141.8	148.1
Superannuation fund taxes	15.7	12.1	23.2	18.4	23.4	20.8	25.6	22.6
Other income tax[2]	6.6	5.7	6.3	6.2	6.2	6.1	5.8	6.2
Total income tax	**499.2**	**514.9**	**492.3**	**505.7**	**509.1**	**523.3**	**543.2**	**550.6**
GST	88.2	89.0	92.6	93.7	98.8	100.0	105.0	105.7
Excise and customs duty	47.4	45.1	49.1	46.9	50.3	48.9	52.2	50.7
Other indirect tax[3]	14.5	15.1	15.1	15.7	15.9	16.4	16.0	16.5
Total indirect tax	**150.0**	**149.2**	**156.8**	**156.2**	**165.0**	**165.2**	**173.2**	**172.9**
Total taxation revenue	**649.3**	**664.1**	**649.1**	**661.9**	**674.1**	**688.5**	**716.3**	**723.6**
Non-taxation revenue[4]	**51.4**	**51.4**	**51.2**	**51.1**	**51.9**	**51.7**	**54.0**	**53.7**
Total revenue	**700.6**	**715.5**	**700.3**	**713.0**	**726.0**	**740.2**	**770.4**	**777.2**

Note: Official estimate refers to the 2023-24 MYEFO. 1 Individuals includes gross income tax withholding, gross other individuals less refunds. 2 Other income tax includes fringe benefits tax and petroleum resource rent tax. 3 Other indirect tax includes wine equalisation tax, luxury car tax, major bank levy, agricultural levies, and other taxes. 4 Non-taxation revenue includes sales of goods and services, interest, dividends and distributions, other non-taxation revenue. Source: Deloitte Access Economics, The Commonwealth of Australia

These windfall gains are offsetting concerning write-downs elsewhere with taxes on superannuation funds and the petroleum resource rent tax underperforming.

The overall outperformance of the nominal economy is set to deliver the government around $14.8 billion in revenue write-ups in 2023-24. Provided the government holds the line on spending, that should be enough to deliver a second consecutive cash surplus. But at $13.4 billion, the surplus is expected to be smaller than the one recorded in 2022-23. And it's likely to be the last surplus for the foreseeable future.

It's a case of more money, more problems for the government. The current surge in tax receipts is temporary, but the budget's structural challenges are not. Indeed, there is a list of reasons why government spending needs to be restrained in the short term, from inflation and capacity constraints to the fact that revenue is projected to go backwards in 2024-25 as the redesigned Stage 3 income tax cuts come into effect and cyclical headwinds hit company taxes. Indeed, even if spending holds steady as a share of GDP, the budget will be back in the red in 2024-25.

Deloitte Access Economics' revenue forecasts are compared to the latest official estimates in Chart 3 and Table 2 on the previous page.

Individuals and other withholding tax

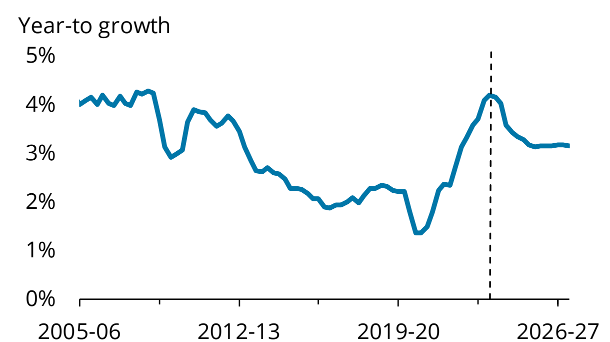
Gross income tax withholding

The single largest component of tax revenue – income tax withholding – has outperformed expectations through 2023-24 on the back of Australia's resilient labour market. Even with real economic growth forecast to slow to 1.5% for the year, a 3.8% unemployment rate in March was not far off a 50-year low of 3.5%. Strong migration numbers have boosted Australia's working age population and total employment is up 2.4% in the year to March. That leaves income tax withholding on track to beat the official forecasts from 2023-24 MYEFO, although the write-up will be smaller than it was six months ago.

Deloitte Access Economics expects the labour market to soften further over the next year, even as real economic growth begins a slow recovery. Where the official forecasts from the 2023-24 MYEFO have an unemployment rate of 4.5% at the end of both 2024-25 and 2025-26, Deloitte Access Economics expects the unemployment rate to reach 4.7%. But this additional labour market slack is offset by Deloitte Access Economics' stronger forecasts for overall employment growth.

Wage growth is expected to peak at 4.0% in the June quarter of 2023-24 before moderating to 3.3% over the following 12 months. Treasury's medium term forecast for wage growth is slightly stronger than that of Deloitte Access Economics. Stronger employment growth this year has Deloitte Access Economics' forecast of the total wage bill outperforming Treasury's forecasts in the near term. But weaker wages growth leaves the total wage bill growing at a slower rate in 2026-27.

Chart 4 Wage Price Index



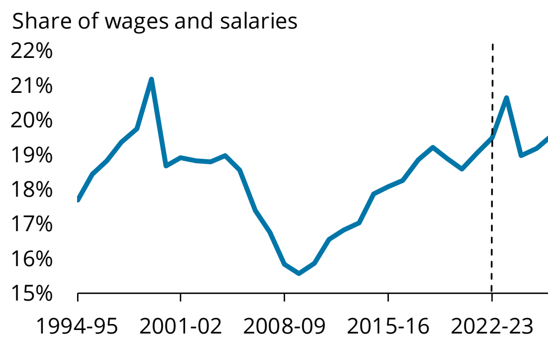
Source: Deloitte Access Economics, Australian Bureau of Statistics

The major policy change announced since the 2023-24 MYEFO is the redesign of the Stage 3 income tax cuts, which will come into effect from 1 July 2024. The new rates will reduce the marginal tax rate that applies to income between $18,200 and $45,000 to 16%. The 37% rate will be retained for incomes between $135,000 and $190,000, whereas the previous package was set to effectively abolish this bracket. Meanwhile, the 45% rate that was to be pushed out to income over $200,000 has been brought back to income over $190,000. The redesign means that every taxpayer will now get a tax cut from 1 July 2024. However, relative to the previously legislated Stage 3 package, high income earners are set to save considerably less. Those earning $200,000 and above are set to pay $4,546 more per year than they would have under the old Stage 3 package, with the savings redistributed as modest tax cuts to low- and middle-income earners. Most taxpayers – those earning between $45,000 and $135,000 per year – will save $804 in tax each year.

Deloitte Access Economics expects a 2.5% decline in gross income tax withholding revenue in 2024-25. The revised Stage 3 tax cuts are expected to underpin a fall in the average income tax rate from an estimated 20.7% in 2023-24 to 19.0% next year.

But these income tax cuts are a one-off. With no further policy changes in the pipeline, bracket creep is expected to see the average income tax rate claw its way back to 2023-24 levels within around five years. Overall, Deloitte Access Economics anticipates income tax withholding to be a cumulative $14.6 billion higher than the official forecasts over the forward estimates.

Chart 5 Average rate of personal income tax



Source: Deloitte Access Economics, Australian Bureau of Statistics

Gross 'other individuals' tax

'Other individuals' includes taxes on non-wage incomes such as from unincorporated (often small) businesses, as well as on farm incomes, interest, rent and dividends, plus taxes on some wages and salaries not in withholding tax. After surging by 22% in 2022-23, 'other individuals' tax revenue is forecast to grow by a robust 8% in 2023-24. Rapid population growth and historically tight rental markets have led to strong growth in rental income, while higher interest rates have continued to lift the incomes of savers. This has offset a softer year for farm incomes and more modest growth in the income of unincorporated businesses.

Growth is expected to come to a halt in 2024-25. While rental prices will continue to soar, interest rate cuts are finally on the horizon. Weaker profits over the past six months have also put downward pressure on dividends and CommSec estimates a 12-month forward-looking dividend yield of 3.9% for the S&P/ASX 200 index, below the long-run average of 4.7%. Even with growth flatlining, Deloitte Access Economics is forecasting a cumulative $4.7 billion more revenue from 'other individuals' over the four years to 2026-27 than was forecast in the 2023-24 MYEFO.

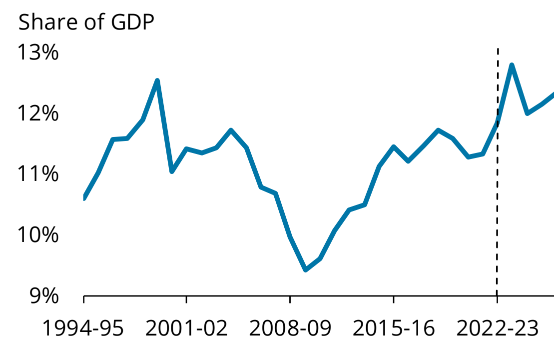
Income tax refunds for individuals

Refunds normalised in 2023-24 after the low and middle income tax offset extension led to a one-off surge in 2022-23. Deloitte Access Economics expects relatively stable refunds over the next four years, broadly in line with official forecasts.

Total revenue from taxes on individuals

Total revenue from taxes on individuals is forecast to outperform the official forecasts by a cumulative $21.0 billion over the forward estimates. At a projected 12.8% of GDP in 2023-24, taxes on individuals will rise to be the highest level as a share of the economy in 35 years. This highlights the importance of the redesigned Stage 3 tax cuts, which are set to see that share fall to 12.0% next year.

Chart 6 Taxes on individuals as a share of GDP



Source: Deloitte Access Economics, Australian Bureau of Statistics

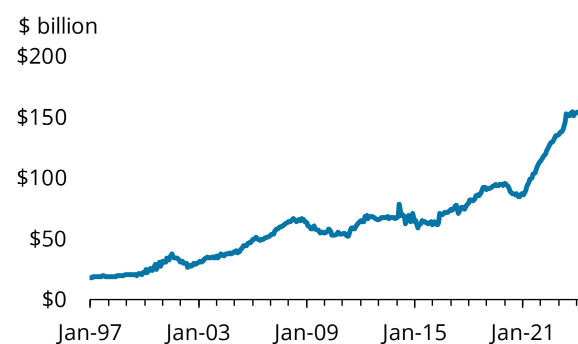
Company and other (non-personal) income tax

Company income tax

Company income tax has done a lot of the heavy lifting when it comes to revenue upgrades in recent years. After soaring to a record high of $153 billion in 2022-23, company income tax revenue is outperforming expectations again.

Deloitte Access Economics projects company tax revenue to hit $154.8 billion in 2023-24 – $14.5 billion more than projected in the 2023-24 MYEFO, largely due to the official assumptions for commodity prices in 2023-24 and 2024-25.

Chart 7 Company tax, rolling 12 month total



Source: Deloitte Access Economics

Commodity prices have had a volatile year. After an unexpected rally through the final six months of 2023, iron ore prices fell all the way back to where they started by April 2024. Coking coal prices followed a broadly similar trajectory. But volatility aside, both prices have been far more resilient than assumed in the 2023-24 MYEFO. Thermal coal prices have also stubbornly defied Treasury's assumption that they would halve in the year to September 2024.

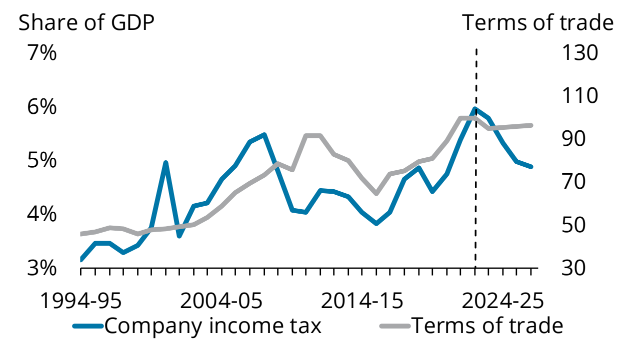
The conservatism in Treasury's assumptions is by design. The 2023-24 MYEFO assumptions included a fall in the iron ore price from US$105 per tonne in September 2023 to US$60 per tonne a year later. At the halfway point, the iron ore price has softened, but nowhere near enough to make the Treasury assumption look likely to be met. Meanwhile, coking coal was assumed to fall from US$264 per tonne to US$140 per tonne, while thermal coal was forecast to more than halve from US144 per tonne to $US70 per tonne.

None of these commodity price assumptions are likely to be achieved. And that's the big reason why Deloitte Access Economics is projecting an additional $14.5 billion in company tax revenue than the official estimates for 2023-24.

More realistically, the Department of Industry is currently forecasting the iron ore price to be US$86 per tonne in March 2025, coking coal to be US$212 per tonne, and thermal coal to be US$129 per tonne. Outside the mining industry, profits are expected to be relatively soft amid Australia's slowing economy. Combined with more normal mining profits, company tax revenue is forecast to fall from $154.8 billion in 2023-24 to $148.0 billion in 2025-26. That's still a considerable upgrade over the latest official forecasts, with Deloitte Access Economics projecting a total of $44.2 billion more revenue from company income tax over the four years to 2026-27.

The official forecasts are likely to be revised up in the 2024-25 Budget, as commodity price assumptions from the 2023-24 MYEFO are pushed out by a couple of quarters. But the overall preference for conservatism is unlikely to be watered down, which means more (albeit smaller) revenue upgrades from company tax are likely to be realised in future budgets.

Chart 8 Company tax and terms of trade



Source: Deloitte Access Economics, Australian Bureau of Statistics

Fringe benefits tax

In line with the unexpectedly strong labour market and wage bill, Deloitte Access Economics projects fringe benefits tax (FBT) revenue to grow to $5.0 billion in 2023-24. That would be a 21% increase on the previous year, and $800 million above the 2023-24 MYEFO forecast. Deloitte Access Economics' forecasts of FBT collections are a cumulative $2.8 billion above the latest official projections over the next four years.

Petroleum resource rent tax

Petroleum Resource Rent Tax (PRRT) collections have dwindled in 2023-24.

Asian liquified natural gas (LNG) prices fell below US$10 per million metric British thermal units (mmBtu) in March 2024 – trading close to a three-year low and well below the record prices from mid-2022. Prices are broadly expected to hold in this range for the next three years. This will see continued pressure on profits, although the elevated level of geopolitical uncertainty presents plenty of upside risks to gas prices.

Oil prices have been volatile in 2023-24. After tumbling from over $90 to $75 in late 2024, the price of Brent crude has climbed back toward the high $80 range by April. Investors are balancing the potential for broader conflict in the Middle East with renewed concerns for global inflation and growth. Prices are likely to remain volatile, and as long as global conflict drags on, oil and gas prices should be considered a potential upside risk to PRRT collections.

But the roadblock for PRRT revenue is policy, not commodity markets. The 2023-24 Budget announced that the Government would introduce a 90% cap on the proportion of PRRT assessable income that can be offset by deductions, as well as a number of integrity measures.

This was expected to be introduced by 2024-25 and generate $2.4 billion in additional revenue over the forward estimates. The problem is that this announcement created an incentive for companies to bring deductions forward into 2023-24 and reduce the deductions that would be subject to a 90% cap in the coming year. In the 10 months since the policy was announced, just $402 million was collected in PRRT revenue. That compares to $2.3 billion collected in the same 10 months a year earlier.

Deloitte Access Economics forecasts PRRT revenue to be $1.7 billion below the official forecasts in 2023-24 before recovering back toward the projections in the 2023-24 MYEFO over the forward estimates.

Superannuation fund taxes

Superannuation taxes are levied on contributions to and earnings from super. Superannuation tax collections are projected to rise 17% to $12.1 billion in 2023-24. This marks a solid recovery from 2022-23, when superannuation tax revenue fell 61% amid higher interest rates, a weak growth outlook and soft investment performance.

The unexpectedly strong labour market and employment growth has added to superannuation contributions this year, while greater optimism around a soft landing and an oncoming rate cutting cycle have boosted investment earnings. Both the ASX200 and the S&P500 indexes hit record highs in March 2024.

The superannuation guarantee rate is scheduled to increase from 10.5% to 12% by 2025-26. This will drive strong growth in tax on contributions over the forward estimates. Earnings growth is expected to continue its strong recovery in 2024-25. And the Government's proposal to introduce an additional 15% tax on earnings from super balances over a $3 million threshold is expected to add around $2 billion of revenue in 2025-26.

Even so, Deloitte Access Economics' projections for superannuation tax revenue are $3.6 billion below the latest official forecasts for 2023-24 and another $10.3 billion below official forecasts over the subsequent three years.

The low tax rate on earnings, combined with a strong preference for Australian shares (and franking credits) and a low effective rate of tax on capital gains means the total tax take from superannuation is struggling to keep pace with rapid growth in the sector.

Goods and services tax

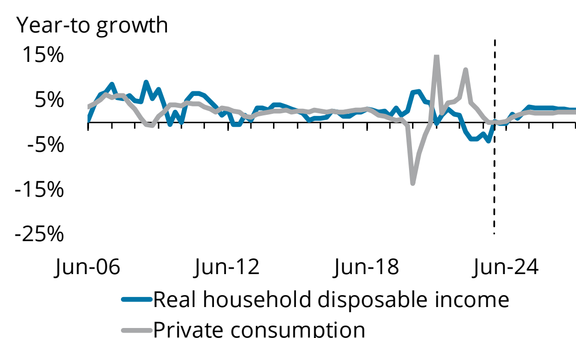
Consumer spending and dwelling construction are two of the key drivers of Australia's goods and services tax (GST) revenue. They are also two components of the Australian economy that have struggled the most this year.

Private consumption is forecast to grow by just 0.1% in 2023-24 and even that anaemic growth rate was only possible thanks to Australia's rapid population growth. Household spending per capita is declining rapidly as cost of living pressures continue to weigh on finances. But the moderation in inflation means that real wages are finally inching up again, and personal income tax cuts and potential interest rate cuts are now on the horizon. That's expected to see private consumption growth recover to 1.8% in 2024-25.

Dwelling construction activity is projected to fall 1.9% in 2023-24 on top of a 3.8% decline in 2022-23. High interest rates and elevated construction costs continue to weigh on demand, while the supply side has failed to recover from rapid post-pandemic price rises, supply constraints, and insolvencies.

Supply constraints are expected to restrict the recovery in residential building activity to 4.3% in 2024-25. But growth is expected to accelerate markedly in 2025-26 and 2026-27 as Australia works toward ambitious new dwelling targets.

Chart 9 Consumer spending and real household disposable income



Source: Australian Bureau of Statistics, Deloitte Access Economics

Deloitte Access Economics forecasts GST revenue to grow by just 1.3% in 2023-24 after surging 14.2% in 2022-23. Average annual growth of 5.9% is forecast for the subsequent three years. Deloitte Access Economics' forecasts are a cumulative $3.8 billion above the official forecasts throughout the forward estimates.

Excise and custom duties

Excise duties

Excise duties apply to a range of products, most notably petroleum products, beer, spirits and tobacco. The excise is paid on the volume of products manufactured in Australia and rates are typically indexed twice per year in line with the Consumer Price Index (CPI).

With elevated inflation flowing through to index rates, excise collections are projected to grow 18.2% in 2023-24. The growth has largely been driven by petroleum products, as conflict in the Middle East and global supply constraints have kept oil prices higher than expected. That is driving Deloitte Access Economics' forecasts for excise collections a cumulative $4.2 billion higher than official estimates over the four years to 2026-27.

Other structural trends continue to influence excise revenue including the fact that Australians are drinking less (which hurts excise collections based on volume) and increasingly moving toward electric and low emission vehicles.

Customs duties

Import volumes fell broadly late last year with consumption, capital and intermediate goods all declining in December quarter. This reflects weak demand among both households and businesses as cost of living pressures mount. The Federal Government's commitment to remove 'nuisance' tariffs on $8.5 billion worth of annual trade is a sensible reform that should boost the productivity of importing businesses, with a minor impact to revenue.

Deloitte Access Economics projects customs duty revenue to fall 18.1% in 2023-24 and gradually recover over the following three years. Overall, Deloitte Access Economics is forecasting a cumulative $11.7 billion less revenue than the official forecasts over the four years to 2026-27.

Other indirect tax

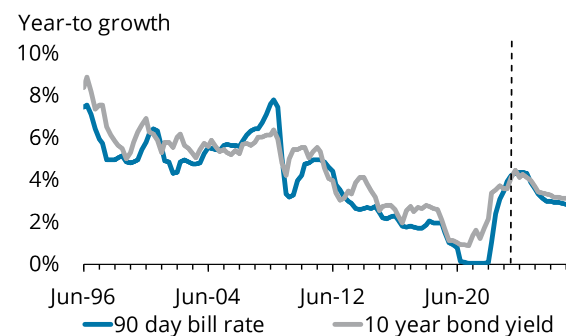
Other indirect taxes include the major bank levy, the Wine Equalisation Tax (WET), agricultural levies and broadcasting fees, as well as other tax revenues collected by Commonwealth agencies. Deloitte Access Economics expects other indirect taxes (which includes agricultural levies, broadcasting fees, and bank levy collections) to broadly track in line with official forecasts in each year to 2026-27.

Non-taxation revenue

Interest receipts

The Australian Government owes a lot of money, but it also lends money. Interest payments on money lent by the government is recognised as non-taxation revenue. These interest receipts come from the states, cash balances held with the RBA, other financial assets, and on money earned from the Commonwealth guarantee on some of the borrowings of the commercial banks. Higher interest rates are expected to drive the government's interest revenue to $10.0 billion in 2023-24. The RBA is expected to make modest cuts to the cash rate in 2024-25, but interest rates will remain higher than they were over the past decade. Deloitte Access Economics' forecasts for interest receipts are broadly in line with the latest official forecasts throughout the forward estimates.

Chart 10 Interest rates



Source: Deloitte Access Economics

Dividend receipts

The RBA was one of the main sources of dividend revenue for the government over the years. But as bond yields surged through the recent rate hiking cycle, the RBA's equity position deteriorated to negative $17.7 billion. The RBA is not expected to pay a dividend to the government for many years to come. Total dividend receipts are expected to increase in 2023-24 after falling to a low last year. But without an RBA dividend, receipts are expected to remain below 2021-22 levels over the forward estimates period.

Other non-taxation revenue

Other non-tax revenue includes revenue from the direct provision of goods and services and amounts paid by the states to the Commonwealth for the provision of GST collections, as well as earnings from the Future Fund. Deloitte Access Economics expects other non-tax to fall modestly in 2023-24 and recover throughout the forward estimates.

Expenses and budget aggregates

A growth and inflation balancing act.

Overview

The previous issue of *Budget Monitor* released in November 2023 explored the predilection of Australian Treasurers to spend 'surprise' revenue windfalls on all manner of political promises. The current Treasurer has avoided that same folly – in part because an elevated inflation environment has afforded little room for higher government spending – and is set to shortly announce a second consecutive surplus as a result.

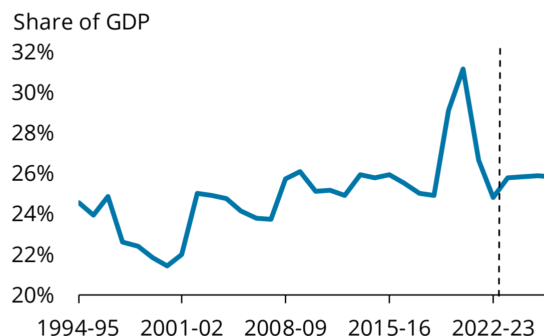
Viewed from the dire fiscal position seen during the worst of the pandemic years, the turnaround in the state of the Commonwealth's books is extraordinary. There is no doubt that it has been aided by a resilient labour market and Treasury's perennially conservative commodity price assumptions. But without spending restraint, that unforeseen surge in revenue would not have translated into a surplus, let alone two, and could possibly have forced the RBA to push interest rates even higher.

The second surplus still isn't a *fait accompli*, and the Treasurer has been talking up the 'degree of difficulty' in its execution.

But Deloitte Access Economics expects that it will come to fruition and is forecasting an underlying cash surplus of $13.4 billion for 2023-24 compared to the -$1.1 billion deficit forecast in the 2023-24 MYEFO.

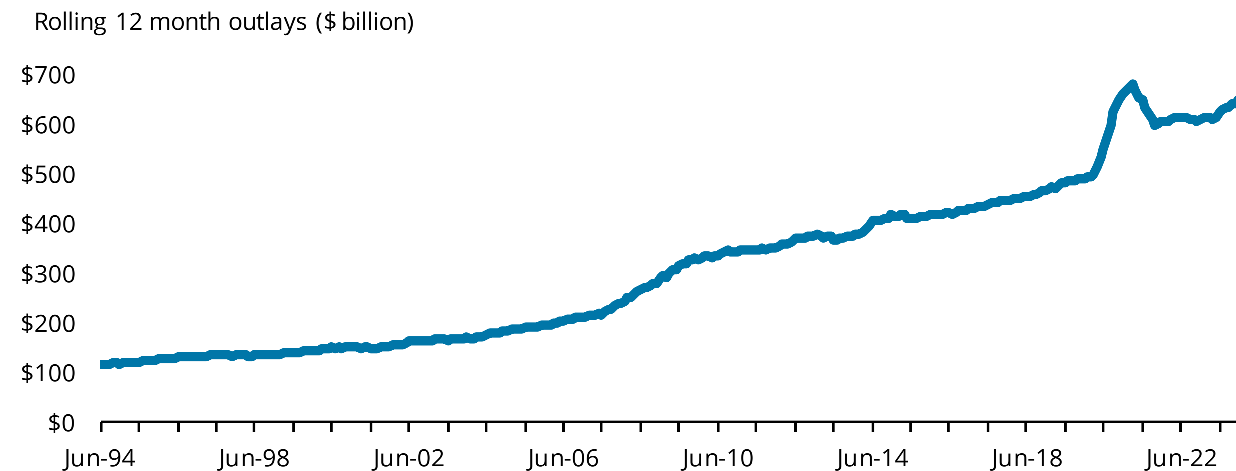
That will also mean the 2024-25 Budget will reveal yet another downward revision in the forecast for net debt. Net debt is expected to average 18.4% as a share of GDP over the four years to 2026-27, compared to the 19.8% of GDP forecast in the 2023-24 MYEFO.

Chart 11 Accrual spending as a share of GDP



Source: Deloitte Access Economics, based on Commonwealth of Australia data

Chart 12 Federal spending, rolling 12 month total



Source: Based on Commonwealth of Australia data

Unfortunately, 2023-24 may be the last year in this short string of surpluses. A weakening economy and lower commodity prices are likely to be a key contributor to a deteriorating fiscal position over the forward estimates. But it is the expenditure side of the budget where the key challenges lie, both in the short term and the long term.

The short term is dominated by the tug-of-war between lingering inflation on one side and the calls for further cost of living relief and pro-growth spending on the other. Throw in the fact that the next federal election is likely only around 12 months away – with all the spending incentive that provides – and the result is a set of competing priorities that would keep any Treasurer up at night. Much of this is a timing problem – inflation is retreating (albeit now slower than the RBA had hoped), but the 2024-25 Budget will need to carefully balance spending priorities without putting further pressure on inflation.

The longer term spending challenges are less like a tug-of-war and more like a snowball rolling downhill. Many longer term drivers of spending have been known about for some time, such as the ageing population presenting a demographic headwind to labour supply and adding to spending on health and aged care. Others are more recent and, in some cases, self-inflicted. The budget will continue to feel the squeeze from the GST top-up deal, in which states and territories are compensated for GST revenue lost due to WA's guaranteed share of the tax allocation (now estimated to cost around $50 billion over the decade to 2028-29). Added to that is the rapidly growing cost of the NDIS, a commitment to lift spending on defence to 2.4% of GDP within a decade, higher welfare and education costs, and the as-yet unknown cost of the *Future Made in Australia* policy. Taken together, the conclusion that the size of government will be much larger in the future than it has been in the past appears unavoidable.

As Deloitte Access Economics has previously noted, the tax system – particularly its heavy reliance on personal and company income tax – is not fit for purpose now, let alone for the future. Australians will need to pay more tax in the years ahead in order for the budget to afford the raft of long term spending promises made by governments of both political persuasions.

For now, Deloitte Access Economics expects an improvement in the underlying cash balance of $48.2 billion over the four years to 2026-27 compared to the forecasts outlined in the 2023-24 MYEFO.

Expenses

Effect of parameter variations

Differences between Deloitte Access Economics' latest economic forecasts and those in the 2023-24 MYEFO – so-called parameter variations – provide the basis for some of the adjustments from the official forecasts. The expenses reconciliation is shown in Table 3 below.

Spending is forecast to be $9.6 billion lower than expected in the 2023-24 MYEFO over the four years to 2026-27 as a result of parameter variations. Compared to the economic forecasts in the 2023-24 MYEFO, Deloitte Access Economics is anticipating slower inflation and wage growth over the next four years. Other things equal, that implies less government spending over time. Working in the opposite direction, Deloitte Access Economics forecasts a higher unemployment rate, increasing spending in the form of unemployment benefits.

The largest driver of changes due to parameter variations is public debt interest (PDI). Deloitte Access Economics' expectations of a better budget bottom line means the government is forecast to incur less debt than is assumed in the 2023-24 MYEFO. The lower level of debt is enough to save an estimated $7.1 billion on interest payments over the four years to 2026-27 compared to the 2023-24 MYEFO estimates.

In terms of specific drivers:

- Activity: Deloitte Access Economics uses the unemployment rate as a proxy for the impact of economic activity on government spending. The beginning of 2024 saw unemployment fall below 4.0%. That fall is expected to be unwound over the next 12 months and Deloitte Access Economics' forecasts of the unemployment rate are slightly higher than Treasury's in 2024-25. This difference adds to government spending.
- Exchange rates: Differences in exchange rates affect the budgeted cost of interest payments, defence purchases, foreign aid, and embassy spending. Insignificant differences in the current forecasts for exchange rates are expected to have minimal implications for spending.
- Prices: Inflation is falling and is expected to be 3.6% over the year to June 2024, less than the MYEFO forecast of 3.75%. Lower price growth compared to Treasury's previous expectations will slightly reduce spending given that a range of payments are indexed to consumer prices.

- **Wages:** Variations in wages affect outlays both directly (via higher wages for the public service) and indirectly (via programs that are effectively partly indexed to wage costs). Wage growth is expected to be similar to Treasury estimates in 2023-24 and 2024-25, though lower in subsequent years.
- **Interest rates and the budget balance:** The cost of PDI can vary due to changes in the size of the debt, and changes in the interest rate charged on that debt. Deloitte Access Economics is expecting slightly lower government interest rates than were assumed in the 2023-24 MYEFO, along with an improvement in the budget balance. That results in lower interest payments than otherwise anticipated.

Table 3 Expenses reconciliation ($ billion)

	Forecast 2023-24	2024-25	2025-26	2026-27
Official accrual spending	689.3	716.0	751.9	783.5
Budget Monitor accrual spending	689.6	717.7	751.4	782.4
Difference on accrual outlays	0.3	1.8	-0.5	-1.1
Effect of parameter variations (net, including public debt interest)	*-0.8*	*-1.7*	*-3.4*	*-3.7*
Effect of policy decisions (net)	*0.2*	*2.4*	*1.8*	*1.8*
GST adjustment	*0.8*	*1.1*	*1.1*	*0.8*
Effect of parameter variations				
Unemployment	0.1	0.4	0.4	1.0
Exchange rates	-0.1	0.0	0.0	0.0
Consumer price index	-0.3	-0.8	-0.9	-0.8
Wages	0.0	0.1	-0.5	-1.1
Public debt interest variation	-0.6	-1.3	-2.4	-2.8
Total effect of parameter variations (net)	**-0.8**	**-1.7**	**-3.4**	**-3.7**
Effect of policy decisions taken since 2023-24 MYEFO				
Agriculture, Environment and Water	0.0	0.0	0.0	0.0
AG, Defence, Home Affairs, Emergency Management and VA	0.0	0.7	0.7	0.7
Child Care, Education, Skills, Training and Youth	0.0	0.3	0.3	0.3
Climate Change and Energy	0.0	0.1	0.1	0.1
Communications and the Arts	0.0	0.0	0.0	0.0
Families, Social Services, NDIS and Government Services	0.0	0.0	0.0	0.0
First Nations	0.0	0.9	0.2	0.2
Foreign Affairs and Trade	0.1	0.0	0.0	0.0
Health and Aged Care	0.0	0.0	0.0	0.0
Infrastructure	0.0	0.0	0.0	0.0
Secure Jobs and Industry	0.0	0.3	0.3	0.3
Treasury, Finance, Housing and the Public Service	0.0	0.0	0.2	0.2
Other	0.0	0.0	0.0	0.0
Total effect of policy decisions (net)	**0.2**	**2.4**	**1.8**	**1.8**

Note: Effect of policy decisions taken since election have been identified by Deloitte Access Economics from public sources and include decisions announced to 18 April 2024. While the intention is to include all announcements, the list may not be exhaustive.

Effect of policy decisions

The Government has claimed to have already announced the big spending items to appear in the 2024-25 Budget, presumably aiming to downplay the overall increase in expenditure given the higher inflation environment. Those big items have included an increase in defence spending to a total of $330 billion over the decade to 2033-34, paying superannuation on government paid parental leave, and funding for remote housing in Northern Territory. The revamping of the Stage 3 tax cuts will also be centre stage on budget night, though this is a rearrangement of previously promised money rather than new spending.

Of the additional $50 billion announced for defence over the decade to 2033-34, some $2.7 billion will occur over the forward estimates period, while the Government's announcement that it will pay superannuation on paid parental leave has been estimated by the Association of Superannuation Funds of Australia to cost $200 million per year.

The Northern Territory has been a focus of new funding announcements, including:

- An increased investment in remote housing ($2 billion over 10 years, and an additional $120 million over first three years)
- An additional $737.7 million from 2025 to 2029 for public schools
- Strengthening financial wellbeing support ($6 million).

New announcements have also included commitments for Australia's transition to net zero emissions:

- Establishing the Solar SunShot program ($1 billion)
- Funding for the Net Zero Economy Agency ($189.3 million over four years, with a further $53.5 million per year ongoing)
- Developing a hydrogen hub in North Queensland ($49.9 million).

Other new funding announcements include:

- Increasing funding for WA public schools by $777.4 million
- Funding an early education and care trial in Nowra, New South Wales ($9.5 million).

In all, costs associated with the new policy measures shown in *Budget Monitor* are only those that have been announced between the 2023-24 MYEFO and 18 April 2024, and are expected to add an estimated $6.1 billion to net spending over the forward estimates.

Total accrual spending

The overall impact on accrual spending is shown in Table 3 above.

Taken together, parameter variations and policy decisions (plus an adjustment for the expected change in the distribution of the GST to the states and territories) are expected to increase spending over the four years to 2026-27 by $0.4 billion relative to forecasts in the 2023-24 MYEFO. That result broadly reflects decreases in spending due to parameter variations offset by increases from policy decisions and GST outlays.

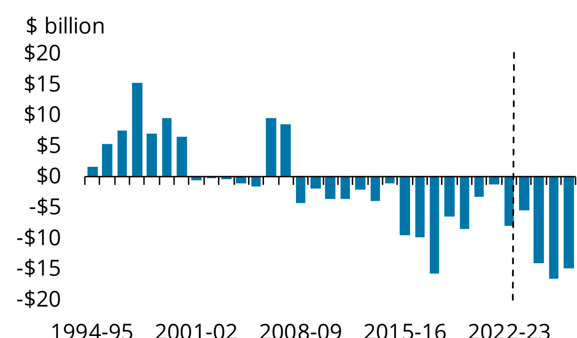
Net advances and other matters

Net advances are the final element needed to estimate the headline cash balance. Headline deficits have been worse than underlying deficits over the past decade.

As seen in Chart 13, that trend is expected to worsen still as a result of governments' increasing penchant for parking funds to pay for large spending promises in 'off budget' entities.

That term is a misnomer, of course. 'Off budget' doesn't mean that you can't find the policy in the budget papers. It is better described as 'indirect', 'alternative' or 'balance sheet' financing – the money still appears on the balance sheet and in the headline cash balance, but not in the (typically referenced) underlying cash balance.

Chart 13 Difference between the headline and underlying cash balance



Source: Deloitte Access Economics, based on Commonwealth of Australia data

The budget balance

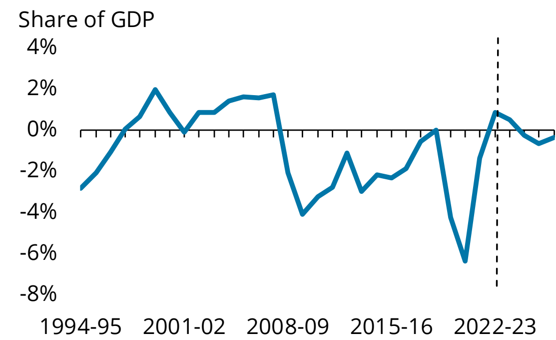
Overall budget aggregate projections are shown in Table 4 below.

Deloitte Access Economics expects an underlying cash surplus of $13.4 billion in 2023-24. That represents an improvement of $14.5 billion compared to the -$1.1 billion deficit forecast in the 2023-24 MYEFO. Over the four years to 2026-27, Deloitte Access Economics expects a cumulative improvement in the underlying cash balance of $48.2 billion compared to the latest official forecast.

Across the four years to 2026-27, a relatively small underlying cash deficit equivalent to 0.2% of GDP is expected on average (Chart 14).

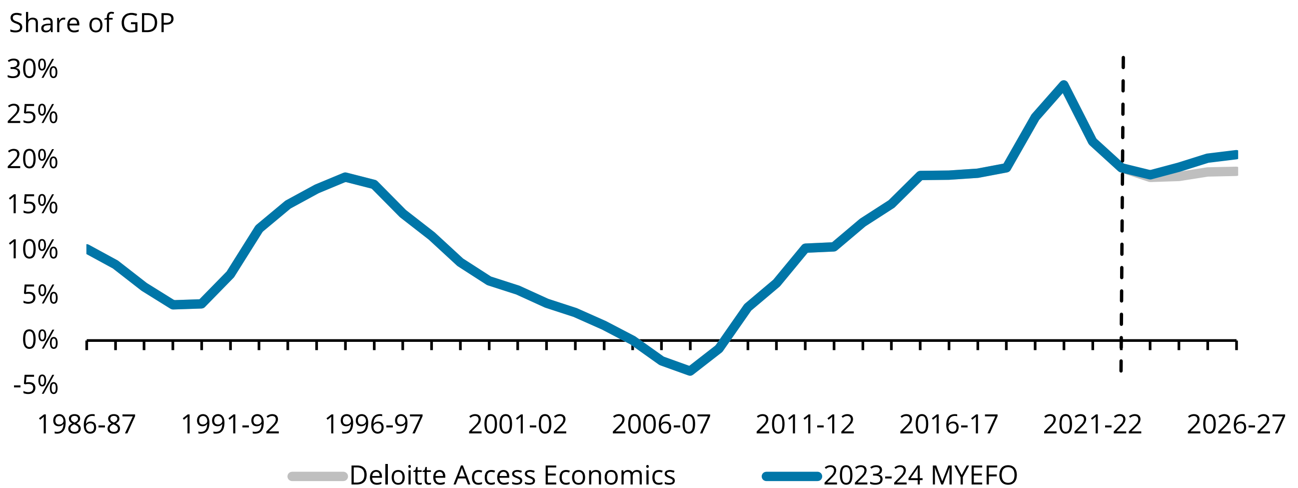
Net debt is also expected to be in a better position over the forecast period than was expected in the 2023-24 MYEFO. The official forecasts assumed net debt would climb to 20.8% as a share of GDP by 2026-27. Deloitte Access Economics' forecasts incorporate a marginally flatter profile for net debt as a share of the economy, as shown in Chart 15 below.

Chart 14 Underlying cash balance share of GDP



Source: Deloitte Access Economics, based on Commonwealth of Australia data

Chart 15 Net debt as a share of GDP



Source: Deloitte Access Economics, based on Commonwealth of Australia data

Table 4 Overall budget projections

	Outcome 2022-23	Forecast 2023-24	2024-25	2025-26	2026-27
Budget aggregates, $ billion					
Revenue (accrual)	668.4	715.5	713.0	740.2	777.2
% of GDP	26.1%	26.8%	25.7%	25.5%	25.7%
Expenses (accrual)	637.0	689.6	717.7	751.4	782.4
% of GDP	24.9%	25.8%	25.9%	25.9%	25.8%
Operating balance	31.4	25.9	-4.7	-11.2	-5.1
% of GDP	1.2%	1.0%	-0.2%	-0.4%	-0.2%
Fiscal balance	21.9	17.0	-13.8	-18.3	-14.8
% of GDP	0.9%	0.6%	-0.5%	-0.6%	-0.5%
Official forecast of fiscal balance	21.9	2.4	-24.8	-33.0	-22.9
Difference in fiscal balance	0.0	14.5	10.9	14.7	8.0
Underlying cash balance	22.1	13.4	-7.9	-20.4	-11.5
% of GDP	0.9%	0.5%	-0.3%	-0.7%	-0.4%
Official forecast of underlying cash balance	22.1	-1.1	-18.8	-35.1	-19.5
Difference in underlying cash balance	0.0	14.5	10.9	14.7	8.0
Net cash flows from investments in financial assets[1]	-8.0	-5.6	-14.1	-16.6	-15.0
Headline cash balance	14.1	7.9	-22.0	-37.0	-26.5
% of GDP	0.6%	0.3%	-0.8%	-1.3%	-0.9%
Official forecast of headline cash balance	14.1	-6.7	-32.9	-51.7	-34.5
Difference in headline cash balance	0.0	14.5	10.9	14.7	8.0
Net debt	491.0	483.1	505.1	542.1	568.6
% of GDP	19.2%	18.1%	18.2%	18.7%	18.8%
Official forecast of net debt (% of GDP)	19.2%	18.4%	19.5%	20.5%	20.8%

Source: Deloitte Access Economics, The Commonwealth of Australia

1 Net cash flows from investments in financial assets for policy purposes. Prior to 1999-00 these flows were known as 'net advances'.

Alternative policy settings

What (and what not) to do on housing policy.

Recent editions of *Budget Monitor* have proposed several tax reforms to help address Australia's structural budget deficit, while also improving the equity and efficiency of the tax system. Two major reforms put forward in recent editions were a simpler and lower rate of personal income tax, and a broader and higher GST.

Deloitte Access Economics has not softened its view that Australia needs a major rethink on tax policy. The budget's revenue base is forecast to grow by just 1.5% of GDP over the next four decades, with personal income taxes doing the heavy lifting. On the other side of the budget, spending on health, aged care, the NDIS, defence and interest payments is forecast to grow by more than 5% of GDP over the next 40 years.

Australia desperately needs a fiscal strategy to close this funding gap in an efficient and equitable way. But the political reality is that major tax reform is off the table, at least for the foreseeable future. In that context, this section of *Budget Monitor* has been repurposed to 'debunk' two smaller tax reform ideas that are more likely to be at the forefront of the current policy debate on Australia's housing challenges. Those policies are:

1. Lowering the capital gains tax discount from 50% to 33.33%; and

2. Abolishing the ability to negatively gear residential rental income.

Deloitte Access Economics has analysed these two policies in terms of their effect on both the housing market and the budget (assuming that the policies would be phased in gradually over five years). As shown in Table 5, these reforms would have a small, positive fiscal impact – jointly raising some $12.1 billion over the next three years.

Both reforms would modestly reduce house prices, although they are hardly game changers for housing affordability. But while the economic arguments for a lower CGT discount are robust, abolishing negative gearing is a red herring in the housing debate – an argument that is unpacked further below.

Phasing in a more equitable CGT discount

Lowering the CGT discount is a sensible proposal not just in relation to housing, but to improve the overall equity of the tax system. It's a policy that Deloitte Access Economics has advocated for over many years, including in recent editions of *Budget Monitor*.

The current CGT discount allows individuals to apply a 50% discount to their net capital gain before tax on any investments that were held for at least one year prior to sale.

Table 5 Estimated revenue effect from alternative policy proposals

	2023-24	2024-25	2025-26	2026-27
Policy cost, $ billion				
Reducing CGT discount to 33.33%	-	1.9	1.7	3.4
% of GDP	0.0%	0.1%	0.1%	0.1%
Abolishing ability to negatively gear residential rental income	-	1.1	1.7	2.3
% of GDP	0.0%	0.0%	0.1%	0.1%
Total	-	3.0	3.4	5.7
% of GDP	0.0%	0.1%	0.1%	0.2%

Source: Deloitte Access Economics

The rationale for this discount is sound. It compensates investors for inflation under the principle that individuals should only pay tax on real capital gains, rather than the capital gains that are purely a result of broader price inflation.

A CGT discount is a simple way of implementing this principle. And simple is generally good when it comes to designing a tax. But at 50%, the size of the CGT discount is too large. It does a poor job of approximating the actual effect of inflation. As a result, investors are overcompensated and end up facing a much lower effective tax rate on capital gains than they would on other sources of investment income. This under-taxation of capital gains leads to some inequitable outcomes in the way income is taxed, and it also leads to some inefficiencies in the housing market.

The overly generous CGT discount attracts an outsized share of investment into certain types of assets – the types of assets that investors purchase with the intention of realising a capital gain down the track, rather than realising a profitable revenue stream over the life of an investment – such as residential property. Potential property investors can bid up property prices to the point that the net rental yield on a property can fall toward zero, or even into negative territory, because the investment thesis is about realising an 'undertaxed' capital gain down the road. The less tax that is imposed on that capital gain, the more 'pain' an investor is willing to wear over the lifetime of an investment in order to earn that capital gain. The net result is to push property prices higher than they would be if capital gains were taxed at a fairer rate.

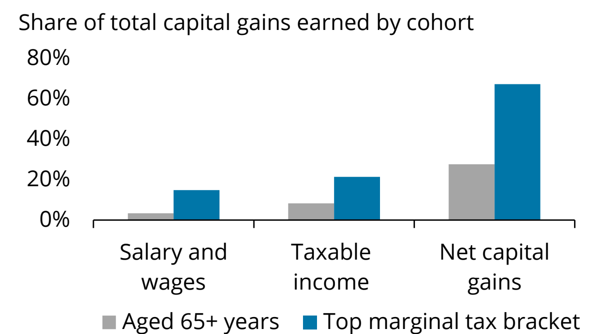
A CGT discount of 33.33% would do a better job of approximating the effect of inflation, especially over the investment timeframes that are typical of residential property investors. The lower discount rate would reduce the after-tax value of a capital gain and, everything else equal, reduce the price that an investor would be willing to bid for a residential investment property.

Deloitte Access Economics has previously estimated that a lower CGT discount could reduce the residential property price by around 2.3% on average, though the effect would not be uniform across the market. Property markets that are dominated by investors would see a larger drop in prices, while areas that are largely owner-occupied would see minimal effect on property prices.

Other studies that have been published on the house price effect of the CGT discount arrive at similarly modest estimates. While it's certainly not the silver bullet to Australia's housing woes, it is a step in the right direction. Most importantly, it's a step in the right direction from a policy that improves the equity and efficiency of our tax system more broadly.

Chart 16 shows that capital gains are disproportionately earned by wealthier and older taxpayers in Australia. A total of two thirds of net capital gains went to people in the top tax bracket in 2020-21, and around a third went to people over 65 years old. Those two points are interrelated, as it takes years to build up the wealth required to purchase major assets. With younger, wage-earning taxpayers on track to foot a much larger share of the Federal Budget over the medium-to-long term, it's time to start shifting a fairer share of the tax burden onto wealthier, asset-owning taxpayers.

Chart 16 Share of capital gains earned, 2020-21



Source: Deloitte Access Economics, Australian Taxation Office

Deloitte Access Economics suggests that a CGT discount of 33.3% could be phased in gradually over a five year period in order to minimise volatile movements in asset markets. This reform is estimated to raise an average of $7.0 billion over the first three years to 2026-27, and in the order of $8.5 billion per year a decade after introducing the policy. Just over one third of the additional revenue would be raised from capital gains on real estate, with the remaining revenue coming from capital gains on other assets such as shares.

Removing negative gearing of residential rental income

The other tax issue that is frequently lumped into the housing debate alongside the CGT discount is negative gearing. Proponents suggest removing or restricting investors' ability to negatively gear residential rental income as a means to reduce investor demand for residential property and ease pressure on house prices.

But while increasing the tax burden on property investors is certainly one way to put downward pressure on house prices, negative gearing isn't the right lever to pull.

Two fundamental principles of the Australian tax system need to be considered in this argument:

1. The cost incurred in earning income is deductible from taxable income.
2. Sources of income such as net residential rental income should be added to and/or deducted from an individual's taxable income from other unrelated sources (such as wage income).

The first principle is more commonly accepted than the second. Just as a business can deduct costs from gross profits, property investors should also be able to deduct rental costs from gross rental income. Where a business pays tax on net profits, a landlord pays tax on net rental income. Limiting the ability to deduct rental costs from rental income would create an obvious distortion in the tax system, with a strong influence on incentives to invest. The second principle is central to the negative gearing debate. Proponents of negative gearing reform argue that negative net rental income (i.e. net rental losses) should not be deductable (or the deductions should be limited) from other unrelated income such as wages. Yet just as there are sound economic arguments for the first principle, there are equally sound arguments for upholding the second.

Allowing net rental losses to be deducted from other sources of taxable income (i.e. 'negative gearing') protects the incentive to invest. Removing negative gearing would shift a disproportionate level of risk onto property investments relative to alternative types of investments. This would blunt the incentives to invest in property relative to other assets and lead to a costly reallocation of capital.

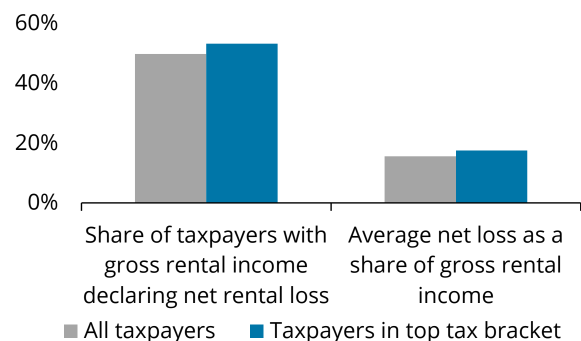
Like the CGT discount, negative gearing reform would only unlock modest improvements in housing affordability.

Deloitte Access Economics has previously estimated that limiting negative gearing to new housing would reduce dwelling prices by an average of 2.3%. This broadly aligns with other published studies that have estimated changes to both the CGT discount and negative gearing would have a relatively modest effect on property prices.

Such a modest improvement in housing affordability could be worth pursuing if the reform made broader economic sense (as is the case with the CGT discount). But it's not worth pursuing at the cost of additional distortions in the tax system (as is the case with restricting negative gearing for certain investments). In fact, negative gearing is largely only a housing problem through its interaction with an overly generous CGT discount. The incentive to hold a loss making investment property only exists because of the ability to earn an undertaxed capital gain. If capital gains were taxed at a fairer rate, the incentive to make annual losses on an investment property would diminish significantly.

Finally, it's not clear that there are the same equity concerns around negative gearing as there are for the CGT discount. Just under 50% of taxpayers with gross rental income in 2020-21 recorded a net rental loss. This ratio was only slightly higher at 53% of taxpayers in the top tax bracket. That doesn't suggest high earners are unfairly taking advantage of negative gearing.

Chart 17 Net rental losses by taxpayer type, 2020-21



Source: Deloitte Access Economics, Australian Taxation Office

Deloitte Access Economics estimates that removing negative gearing of residential rental income could raise an average of $5.1 billion over the three years to 2026-27, and more than $5.0 billion in the tenth year after the introduction of the policy change. This assumes the policy would be phased in over a five-year period (for example, by imposing an 80% cap on net rental loss deductions in year one and reducing the cap to 0% after five years). This cost accounts for a modest reduction in CGT income, as investors would be able to deduct increased holding costs from future capital gains.

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