

Malcom Turnbull has promised tax cuts for middle-income earners [in the next budget or even earlier](#). The short-term political benefits of pre-election tax cuts are not in doubt. But unless the government is willing to increase taxes elsewhere to pay for these sweeteners, there will be longer-term costs for the budget and the economy. And younger Australians will wear these costs.

Young people will pay the price

If the government goes ahead with tax cuts and nothing else changes, we can look forward to the announcement in the 2021 budget of Australia's 13th successive budget deficit. This is despite the fact Australia is in the midst of the [longest period of uninterrupted economic growth](#) anywhere in the developed world. And the unlucky recipients of this legacy of poor budget management are the young.

[Grattan Institute research](#) shows that each year the government runs a A\$40 billion deficit, it increases the lifetime tax burden for households headed by a person aged 25 to 34 by A\$10,000. This is based on the share of debt they would have to repay - with interest - over time. With each successive budget deficit, the tab grows for today's young Australians.

And the government is magnifying the cost of future economic downturns. Australia was well placed to respond to the global financial crisis because of its healthy fiscal position. But with net debt now sitting at A\$322 billion (18.4% of GDP), the government has less room to respond if there is another serious downturn.

Middle-income earners are hit by bracket creep

In the [2017-18 budget](#), the government was clear: if the senate won't support spending cuts, then tax increases will have to do the "heavy lifting" on budget repair. And this heavy lifting is largely happening through bracket creep – growth in income taxes as a share of wages.

Middle-income earners are particularly hurt by bracket creep. Based on the wages growth projected in the 2017 budget, the average tax rates for people in middle-income groups will increase by between 1.9 and 2.9 percentage points by 2021. For example, a person earning A\$50,000 a year will go from paying an average tax rate of 17.1% in 2017 to 19.5 % in 2021 – and that's before the government's proposed increase in the Medicare levy.

No government likes to go to an election with taxes going up, so the temptation to “give back” bracket creep was always going to prove irresistible in next year’s pre-election budget. And as the prime minister flagged, there is also an economic case for such tax cuts. High marginal tax rates for middle income earners can significantly affect incentives to participate in the workforce, particularly for for [women with children in childcare](#) .

Tax cuts will blow the surplus

But the kicker is the effect of the promised tax cuts on the budget bottom line. The Australian government has been running budget deficits since 2009. In the last budget, the treasurer promised a [return to surplus in 2021](#) .

That promised surplus always relied on [optimistic assumptions](#) : strong wages growth, healthy growth in profits, government spending restraint, and, importantly, no cuts to income taxes. The government’s proposal is light on details, but even modest cuts to tax rates could eliminate the forecast surplus.

For example, if the government was to reduce the tax rate only in the middle bracket (A\$37,000-\$80,000) from 32.5% to 30%, the cost to the budget bottom line would be about A\$7.3 billion in 2021 , almost wiping out the promised A\$7.8 billion surplus.

If Malcolm Turnbull wants to cut income taxes but is still serious about delivering on his commitment to return the budget to surplus, then he will need to look elsewhere for revenue. Winding back [the capital gains tax discount or negative gearing](#) , better targeting of [superannuation tax concessions](#) and [tax breaks for older Australians](#) , or [increasing or broadening the GST](#) are just a few policies we could suggest.

But if the PM pursues the sugar hit of tax cuts without the difficult work on paying for them, then politics will once again have trumped policy and the economic future of today’s young Australians.

Young Australians will wear the costs of Turnbull's middle income tax cut

Written by Danielle Wood, Program Director, Budget Policy and Institutions, Grattan Institute

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