

The Economic Risks of the Tasmanian Government's Approach to Budget Repair

McKell Institute Budget Report No. 3

About this report

The McKell Institute is an independent, not-for-profit research organisation dedicated to advancing practical policy solutions to contemporary issues.

This report has been prepared by the McKell Institute Vic/Tas with the support of Unions Tasmania.

The report was prepared on the lands of the Palawa and Wadawurrung people.

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Executive summary

This is the third report in the McKell Institute's State Budget series, and adds to previous reports by examining the economic risks arising from the Tasmanian Government's approach to budget repair.

Drawing on the modelling undertaken by the Department of Treasury and Finance as part of its *Tasmanian Fiscal Sustainability Report*, the analysis finds there are serious economic risks associated with the Government's decision to use only spending cuts to restore the State's finances, as well as the timeframe within which they propose to implement those cuts. These risks include:

- An increase in the State's unemployment rate to more than 7 per cent
- A loss of approximately 5,000 jobs, with no recovery until at least 2040
- Approximately 7,000 people exiting Tasmania's labour market within two years
- Approximately 11,000 people leaving Tasmania
- Lost economic activity reaching \$5 billion per year by 2040

The report suggests that, should these risks be realised, Tasmania would certainly be experiencing a recession based on the criteria advocated by respected economist Saul Eslake.

Drawing on recent economic data, the report also finds there is a considerable risk the Tasmanian economy is performing more poorly than Treasury had assumed at the beginning of the year, and is doing so in a more challenging external environment defined by ongoing conflict in the Middle East. The report finds that, while more data is needed to confirm the current state of the economy, commencing a program of fiscal consolidation from a weaker economic starting point could make the impact of the Tasmanian Government's budget cuts even more damaging.

The report concludes by urging the Tasmanian Government to reconsider its approach to budget repair, especially if the State's economy deteriorates, with a view to adopting more balanced and less economically-harmful measures.

The economic impact of budget cuts

The 2026/27 State Budget was prepared in the context of growing and justified concern about Tasmania's public finances. In August 2024, economist Saul Eslake published his *Independent Review of Tasmania's State Finances*, which highlighted a large and growing fiscal imbalance, and found that, without corrective action, Tasmania's financial position would become worse than any other state or territory by 2027.¹ In November 2025, ratings agencies Moody's and S&P Global both downgraded Tasmania's credit rating, with Moody's stating the decision was due to the "sharp rise in the state's debt burden and growing interest costs".² Perhaps most alarmingly, in February 2026 the Department of Treasury and Finance published its *Tasmanian Fiscal Sustainability Report 2026*. It found that without action the budget would be impossible to repair by around 2030 due to rapidly increasing borrowing costs, and linked such a scenario to the financial crises previously faced in Greece and Puerto Rico.³

Both Eslake and Treasury offered some analysis of the economic impact of various options to restore Tasmania's financial sustainability. Eslake, in finding it would be "difficult and undesirable" for a large part of the budget repair task to be achieved through spending cuts, explained that "cutting 'operating' expenses would have a bigger adverse impact on the Tasmanian economy, and on the most needy or vulnerable Tasmanians, than raising revenues by an equivalent amount".⁴ In doing so, he noted that "state taxes paid by businesses are deductible against federal company tax, and at least part of any increase in state taxes paid by individuals would be absorbed by lower saving", recommending a range of state taxes be lifted or broadened.⁵

In the *Fiscal Sustainability Report*, Treasury undertook detailed modelling of a range of budget repair pathways, including the time period over which the repair was undertaken and the measures used to achieve it. It found relying exclusively on spending cuts, as opposed to a combination also including revenue raising and capital restraint, would produce the most damaging and protracted negative economic effects of all options.⁶ It also found that returning to a balanced budget with five years, as opposed to a longer 10- or 15-year period, would come with the most severe short-term economic trade-offs.⁷

As has been noted in the McKell Institute's previous budget reports, the most damaging of these options is essentially the path the Tasmanian Government chose in the 2026/27 State Budget. The Government has repeatedly ruled out imposing new taxes or increasing the rate of existing ones, and proposes to return to a fiscal surplus within just three years. As the *Fiscal Sustainability Report* highlighted, the economic risks of this approach are substantial.

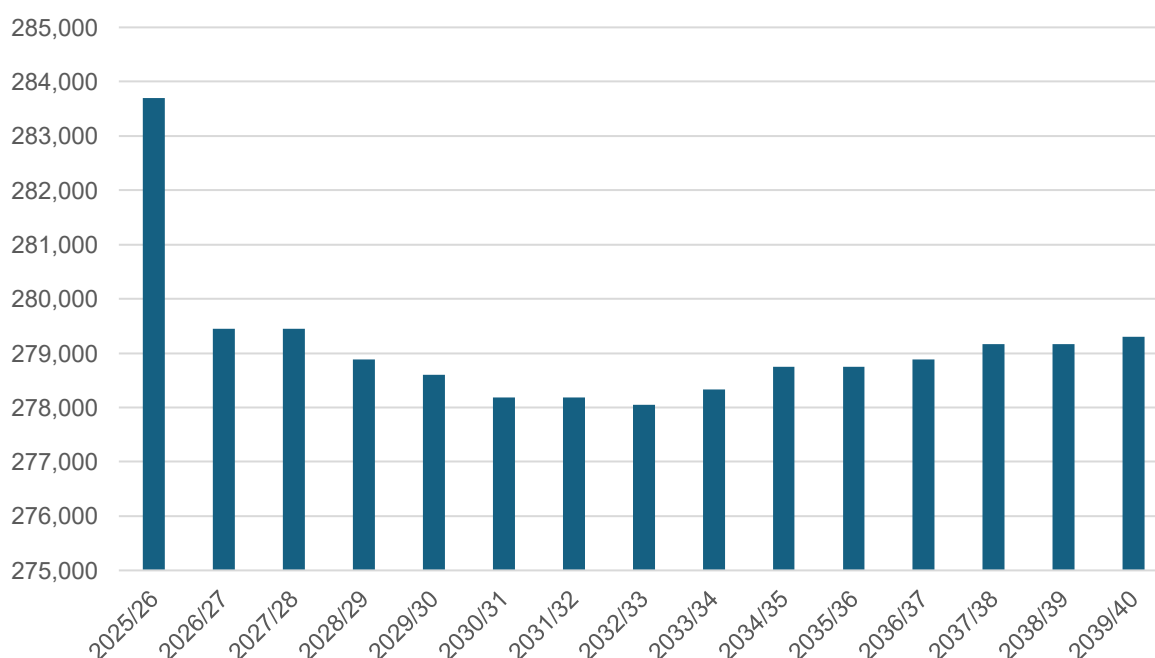
Under Treasury's expenditure-only, five-year scenario, Tasmania's unemployment rate is expected to rise rapidly in the first year of budget repair, from an average in 2025/26 of just over four per cent, to around 6.5 per cent across 2026/27.⁸ This would clearly

meet the definition of an economic recession long advocated by Saul Eslake: an increase in the unemployment rate of more than 1.5 percentage points within 12 months.⁹ Treasury's modelling indicates the unemployment rate would then fall back below five per cent in 2027/28, where it would remain all the way out to 2040.

However, this is not necessarily the short-term economic impact such a trajectory implies. This is because the reason the unemployment rate returns below five per cent is that Treasury anticipates a major decline in labour supply, rather than a return to employment growth.¹⁰ In other words, people will leave the state or give up looking for work altogether, rather than find new jobs.¹¹ Under the expenditure-only, five-year scenario, Treasury forecasts a two per cent decline in the size of the labour force in 2027/28, followed by a further decline of approximately 0.4 per cent the year after. This would be the equivalent of approximately 7,000 Tasmanians leaving the labour force within two years.¹²

This long-term impact can also be seen in Treasury's forecast for total employment, which under the same scenario it expects to fall 1.5 per cent in 2026/27, with zero growth or further, smaller declines anticipated all the way to 2033/34.¹³ Over the current budget period, this would equate to the loss of more than 5,000 jobs, with no recovery to 2025/26 employment levels at any point before 2040. Put another way, Treasury expects that undertaking budget repair within five years, using only expenditure cuts, will leave a permanent scar on Tasmania's labour market.

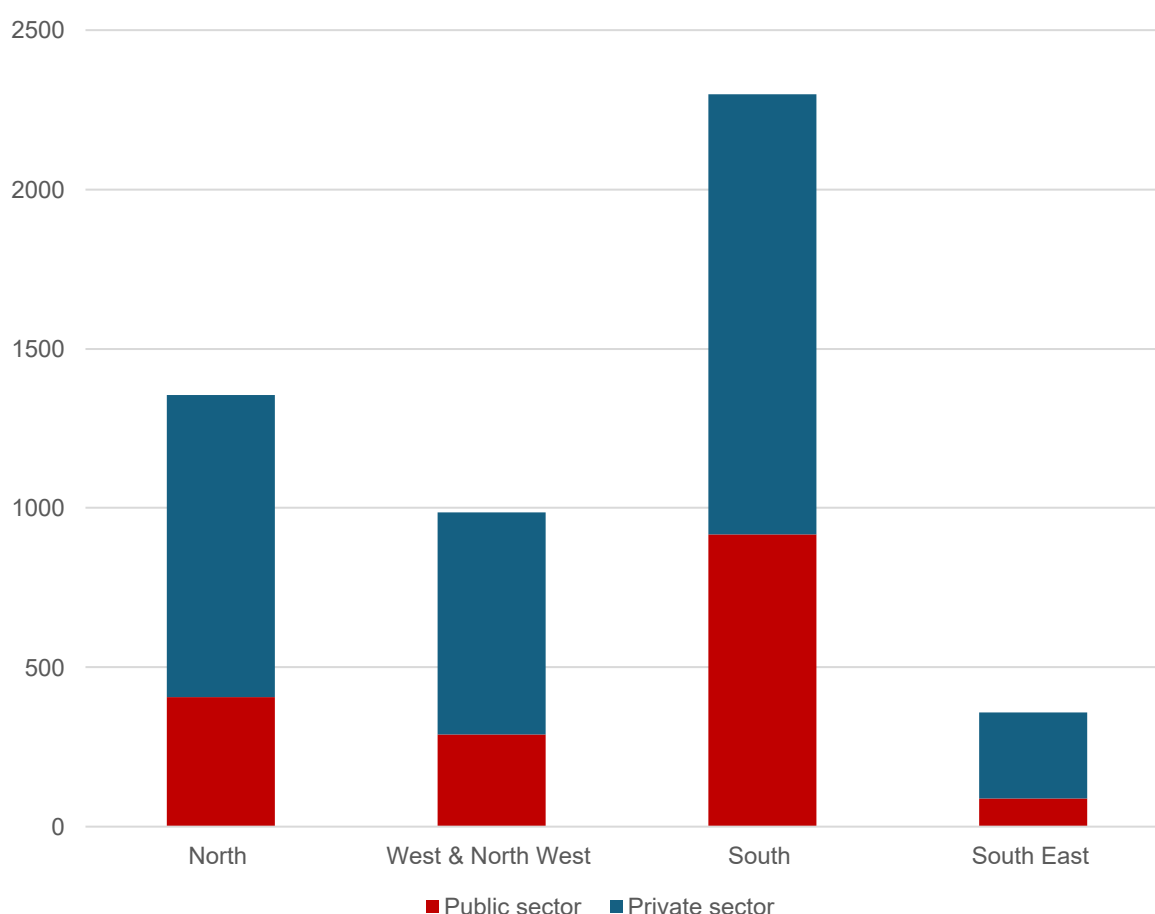
Chart 1: Forecast total employment under expenditure-only, five-year budget repair scenario, 2025/26 to 2039/40



Source: *Tasmanian Fiscal Sustainability Report 2026*¹⁴

The impacts of these job losses would be felt across Tasmania. While Hobart has more State Government employees relative to its share of total Tasmanian employment, other regions are not as underrepresented as many people believe. Approximately 27 per cent of all jobs are located in northern Tasmania, against 24 per cent of all state service employment. Less than 20 per cent of all jobs are in the north west, against 17 per cent of state service employment. Assuming the 1,700 job cuts planned by the Tasmanian Government are implemented relative to the current distribution of state service employment, more than 400 jobs would be cut from the north, nearly 300 from the north west, and nearly 100 in the south east. Assuming further that the job losses projected in the *Fiscal Sustainability Report* occurred broadly in line with Tasmania's current regional employment distribution, the Tasmanian Government's approach to budget repair might trigger the loss of a further 950 jobs in the north, 700 in the north west and 270 in the south east.

Chart 2: Estimated regional breakdown of job losses by sector



Source: *Tasmanian State Service Annual Report 2024/25*; Australian Bureau of Statistics¹⁵

Treasury anticipates that prolonged weakness in Tasmania's labour market will have substantial implications for the state's population. Tasmania's resident population is expected to fall two per cent in 2027/28—matching the decline in the labour force—

and by a further 0.5 per cent in 2028/29. It would not, under this scenario, return to current levels at any point before 2040. At its peak, this would equate to a loss of approximately 11,000 people from Tasmania, and would have serious long-term economic risks in the context of an already ageing population.¹⁶

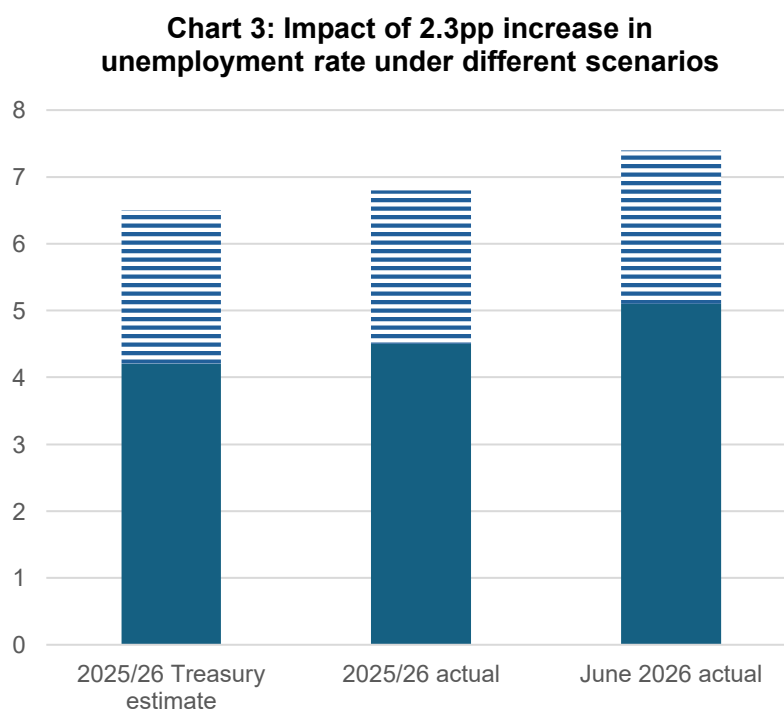
Treasury anticipates significant consequences for Tasmania's economic growth to follow from these outcomes. While their modelling projects annual growth to remain positive even under its expenditure-only, five-year scenario, it nevertheless suggests such an approach would trigger a decline in gross state product growth from approximately 2.6 per cent in 2025/26 to 1.1 per cent in 2026/27.¹⁷ Growth would continue to be below long-term average rates until 2040, with annual growth exceeding two per cent only twice, and even then, only marginally. The result of such prolonged weakness would leave Tasmania's economy more than \$5 billion smaller by 2040, or more than eight per cent, than would be expected if long-term growth rates continued.¹⁸ Put another way, this means one in 12 jobs that should have existed in 2040 will not, one in 12 businesses that should have been operating will not, and one in every \$12 that should have been spent in the economy will not. It is a dismal vision for Tasmania's future, yet one the Tasmanian Government appears willing to embrace.

The current economic environment

Several data sources suggest Tasmania's current economic environment might not be as robust as Treasury had assumed in the *Fiscal Sustainability Report*. In turn, there is an emerging risk that pursuing rapid budget repair through expenditure cuts alone could produce even worse economic outcomes than those outlined in their report.

This is because the impact of reducing public expenditure will have different consequences depending on the amount of spare capacity in the economy. When the economy is performing strongly, people displaced from public sector employment are more likely to find work in the private sector, particularly where the two sectors draw on the same pool of workers. Similarly, businesses with income derived from public spending will be more able to replace that income with private demand when the broader economy is growing strongly. When the economy is weaker, by contrast, reductions in public sector employment and spending can exacerbate existing economic problems by reducing demand at a time when there is already significant spare capacity.

In the *Fiscal Sustainability Report*, Treasury anticipated an unemployment rate for 2025/26 of 4.2 per cent.¹⁹ Trend data from the Australian Bureau of Statistics shows an average unemployment rate across the period of 4.5 per cent, with unemployment at the end of the period reaching 5.1 per cent.²⁰ An increase in the average unemployment rate of 2.3 percentage points across 2026/27—as projected in the expenditure-only, five-year scenario in the *Fiscal Sustainability Report*—could see unemployment average close to 7 per cent over the year, with a peak above that.

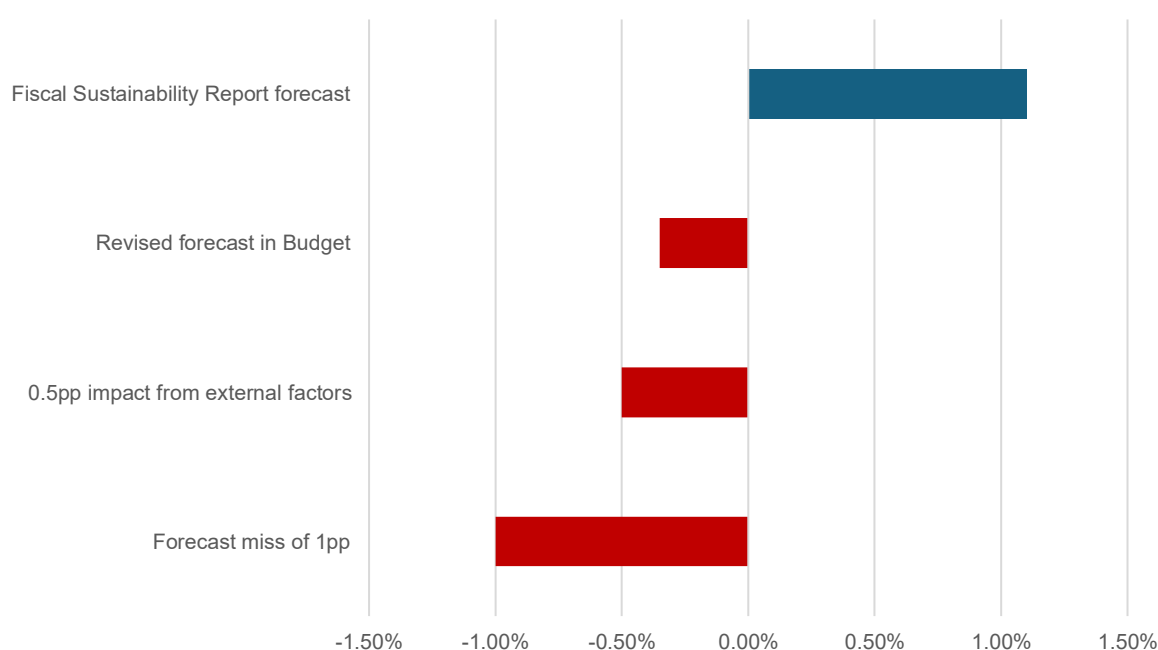


Source: *Tasmanian Fiscal Sustainability Report 2026*; Australian Bureau of Statistics, Labour Force

The *Fiscal Sustainability Report* also assumes Tasmania's economy will have grown by 2.6 per cent in 2025/26. Growth is then projected to fall by 1.5 percentage points to just over 1 per cent in 2026/27, following the introduction of major cuts to public expenditure and the associated economic impacts. While the final State Accounts will not be released until later this year, there are several factors suggesting growth for 2025/26 could be lower than Treasury initially expected. A weaker starting point would in turn increase the risk of a deeper economic downturn.

The State Budget, released several months after the *Fiscal Sustainability Report*, has instead projected growth of 2.25 per cent in 2025/26.²¹ An equivalent reduction to the forecasts in the *Fiscal Sustainability Report* would reduce growth in 2026/27 to just 0.75 per cent. Indeed, this is what the recent State Budget projected.²² Additionally, Treasury's Budget forecasts in the past two financial years have been 0.8 percentage points and 1.25 percentage points above the final outcome.²³ A similar downside miss this year would mean the Government was embarking on its budget repair program from a substantially weaker economic baseline than initially assumed. A similar miss for 2026/27 would mean the Tasmanian economy would contract for an entire year.

Chart 4: Downside risks to growth in 2026/27



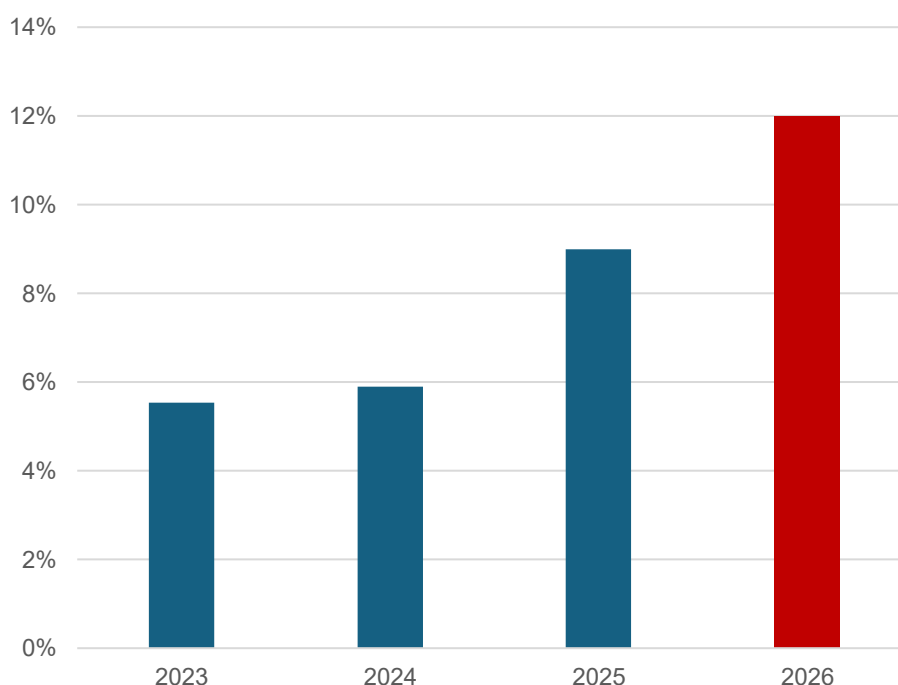
Source: *Tasmanian Fiscal Sustainability Report*; *Tasmanian Budget*²⁴

Additionally, the broader national and international context could prove more challenging than assumed in February. The current conflict in the Middle East, which has led to large fuel price rises and higher inflation more generally, began the very day after the *Fiscal Sustainability Report* was released. Interest rates, which in February were expected by markets to be 4.17 per cent by June 2027, are now expected to reach 4.91 per cent.²⁵ Both of these factors could have substantial impacts on

household spending, which is the largest contributor to domestic demand and which Treasury correctly noted in the Budget has to this point continued to be strong.²⁶ A deterioration in conditions arising from global and national factors could compound the economic impacts of State Government budget repair policies.

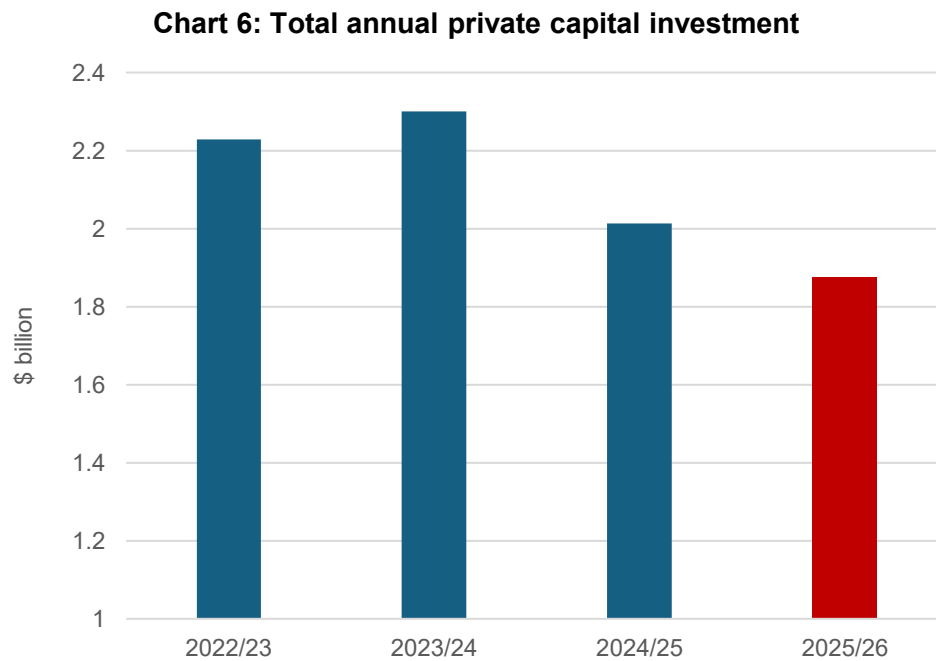
Indeed, several signs point to potential weakness emerging in household spending. In August, in seasonally-adjusted terms, Tasmania recorded the equal-largest decline in monthly household spending of any state or territory.²⁷ This was led by a decline in discretionary spending, potentially suggesting growing financial pressure at a household level. Hobart's hospitality sector has suffered a series of high-profile closures recently, and an audit of the city's retail occupancy rates has shown vacancies have doubled from 5.9 per cent in 2024 to 12 per cent today.²⁸

Chart 5: Hobart CBD retail shopfront vacancy rate



Source: City of Hobart; The Mercury²⁹

The broader Tasmanian economy is also showing signs of stress. Construction work performed in the June quarter fell 9.5 per cent compared to the March quarter, or by 4.3 per cent compared to the previous year.³⁰ Private capital investment had its weakest three months in trend terms since the COVID-affected December 2020 quarter, with annual investment down more than \$400 million compared to 2023/24.³¹ Major employers in the north of the state, such as Liberty Bell Bay and Boag's, have recently announced their closure, while several major developments including the Strait Hotel proposed for Burnie have been cancelled.³²



Source: Australian Bureau of Statistics³³

What this demonstrates is that not only is the Tasmanian Government proposing to adopt the most economically-damaging approach to budget repair, but that there is a real risk it will now be doing so in the context of a deteriorating economic environment. While more data is needed, especially the final gross state product growth figures for 2025/26, the Tasmanian Government should be conscious of the potential multiplying effect of its budget cuts, and should be willing to adjust its budget repair strategy as required.

Conclusion

This report has examined the economic risks associated with the Tasmanian Government's approach to budget repair. Drawing on the modelling undertaken by the Department of Treasury and Finance in the development of its *Tasmanian Fiscal Sustainability Report*, the report has found there are serious economic risks associated with the Government's decision to use only spending cuts to restore the State's financial position, as well as the timeframe within which they propose to implement those cuts. These risks include:

- An increase in the State's unemployment rate to more than 7 per cent
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The report suggests that, should these risks be realised, Tasmania would certainly be experiencing a recession based on the criteria advocated by respected economist Saul Eslake. Longer term, the Government's approach to budget repair would diminish the economy for more than a decade, and a permanent scar would be left on the State's labour force.

Drawing on recent economic data, the report also found there is a considerable risk the Tasmanian economy is performing more poorly than Treasury had assumed at the beginning of the year, and is doing so in a more challenging external environment defined by ongoing conflict in the Middle East. The report explored the potential impact of commencing a program of fiscal consolidation from a weaker economic starting point, and found that it would make the impact of the Tasmanian Government's budget cuts even more damaging.

Accordingly, the report recommends the Tasmanian Government reconsider its approach to budget repair, both in terms of the measures used to restore a position of fiscal sustainability, and the timeframe in which that is achieved. This is especially so if economic data continues to point towards worsening conditions. In the face of advice from the Treasury that the approach being taken is the most damaging of all possible options, to do otherwise would cause needless harm to Tasmania's economic prospects, and to the lives of the thousands of Tasmanians who would find themselves without a job or a future in this State.

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- ⁴ Eslake, Independent Review of Tasmania's State Finances, pp. 6-7.
- ⁵ Ibid., pp. 7-8.
- ⁶ Department of Treasury and Finance, Fiscal Sustainability Report, pp. 58-9.
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- ¹² Australian Bureau of Statistics, Labour Force, Australia, August 2026 (published September 2026), Table 007, available [here](#).
- ¹³ Department of Treasury and Finance, Fiscal Sustainability Report, p. 138.
- ¹⁴ Ibid. Note that exact figures are not provided and have been derived from Figure A8.4.
- ¹⁵ Tasmanian Government, Tasmanian State Service Annual Report 2024–25, Hobart, 2025, p. 60; Australian Bureau of Statistics, Labour Force, Australia, Detailed, March 2026 (published April 2026), Table MRM1, available [here](#).
- ¹⁶ Department of Treasury and Finance, Fiscal Sustainability Report, p. 140.
- ¹⁷ Ibid., p. 137.
- ¹⁸ Ibid., p. 108 (long-term average GSP scenario) and p. 82 (expenditure-only, five-year scenario).
- ¹⁹ Ibid., p. 139. Note the actual figure is not listed, and has instead been derived from the relevant graph.
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- ²² Ibid.
- ²³ For 2023/24 growth, see Tasmanian Government, Tasmanian Budget 2024–25, Budget Paper No. 1, p. 28, available [here](#); for 2024/25 growth, see Tasmanian Government, Tasmanian Budget 2025–26, Budget Paper No. 1, p. 30, archived 2 June 2025, available [here](#).
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- ³² Advocate, 'Penguin colony sinks Errol Stewart's \$35m Camdale hotel plan', 26 August 2026, available [here](#).

³³ Australian Bureau of Statistics, Private New Capital Expenditure and Expected Expenditure, June 2026 (published August 2026), Table 10, available [here](#).