

Government Spending and Inflation: What the Headline Leaves Out

Australian government spending has risen in real terms. But whether that spending is inflationary depends on what is bought, who receives it, how it is financed and whether it competes for scarce resources.

A short data-based review | September 2026

The simple claim

The familiar argument is straightforward: government spending increases demand, demand adds to inflation, and the Reserve Bank must respond with higher interest rates. There is truth in that chain, but it compresses several quite different economic processes into one sentence.

The better starting question is: how much has Australian government spending actually increased after inflation?

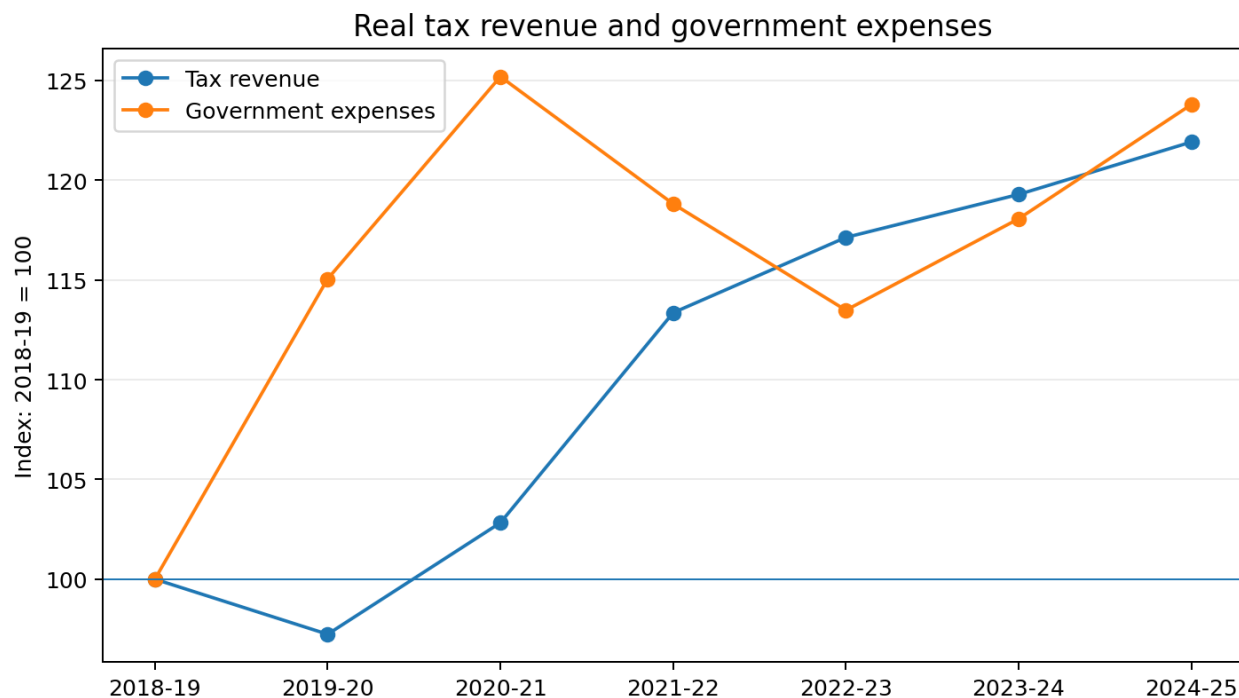


Figure 1. Real tax revenue and government expenses, CPI-adjusted. Source: ABS; calculations use 2018-19 = 100.

Spending has grown - but so has taxation

From 2018-19 to 2024-25, all-Australia general-government expenses rose from about \$678 billion to \$1.031 trillion in nominal terms. After allowing for CPI inflation, that is roughly a 24% real increase, or about 3.6% a year.

Tax revenue rose from \$560.1 billion to \$839.0 billion. On the same CPI basis, the real tax take rose by about 22%, around 3.3% a year. Thus both sides of government became larger in real terms, while expenses grew somewhat faster than tax revenue.

Real fiscal index	2018-19	2024-25
Tax revenue	100	122
Government expenses	100	124
Social protection	100	134
Health	100	122
Education	100	115

The composition matters. Social protection has grown considerably faster than education, while health has broadly tracked the growth in taxation. A dollar spent on a pension, a nurse, a railway or imported defence equipment does not have the same inflation pathway.

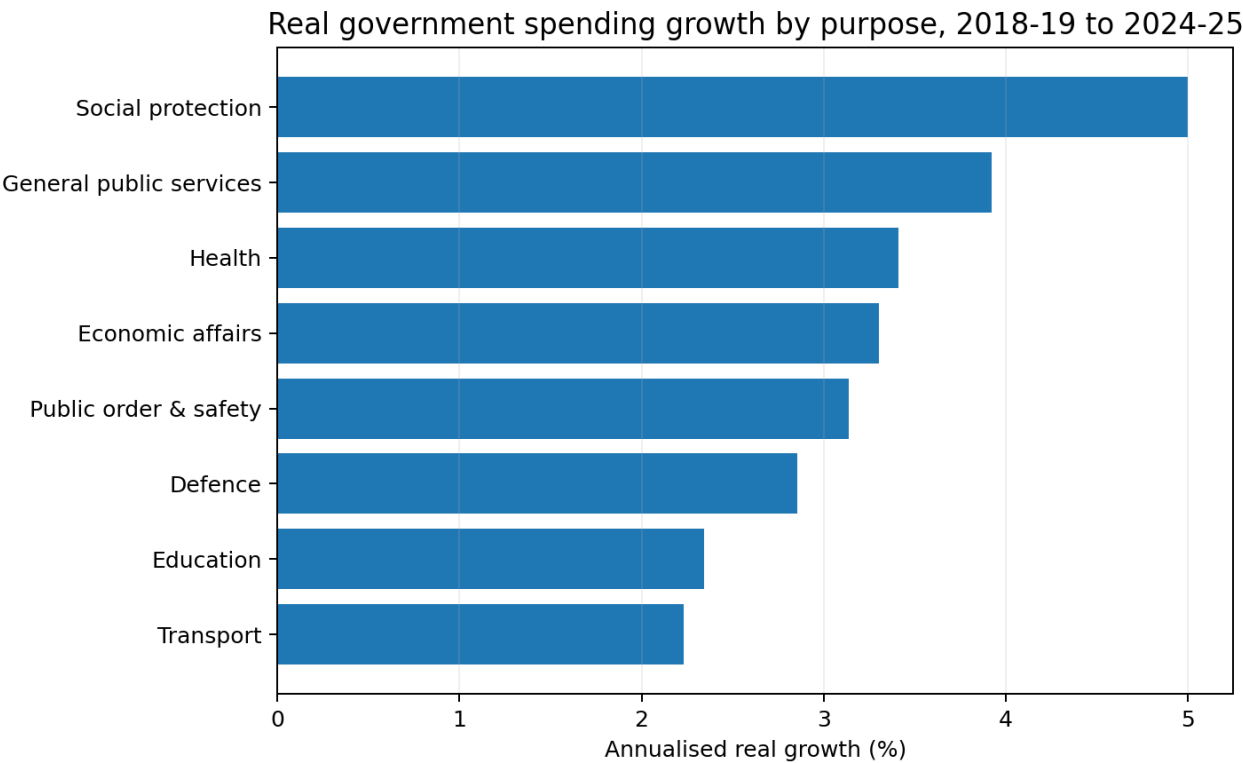
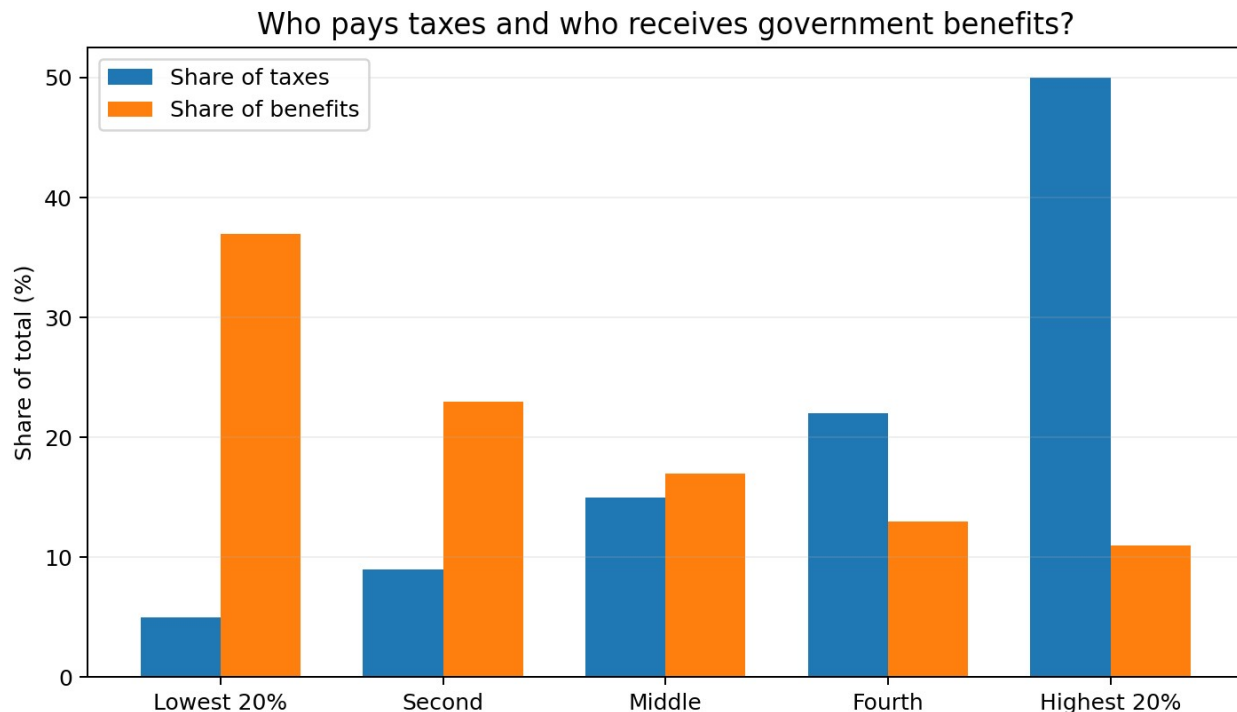


Figure 2. Approximate annualised real growth by spending purpose. 2024-25 category values reconstructed from ABS published shares and rounded.

Who pays and who receives?

Government spending is also distributional. The ABS fiscal-incidence study shows that Australia's progressive tax-and-transfer system shifts resources across income groups. In the 2015-16 study, the highest private-income quintile paid 50% of measured taxes but received 11% of measured benefits; the lowest quintile paid 5% of taxes and received 37% of benefits.



*Figure 3. Distribution of measured taxes and government benefits by private-income quintile, 2015-16.
Source: ABS fiscal-incidence study.*

This does not tell us whether redistribution is good or bad. It tells us that a debate presented as being solely about 'government spending' also contains a distributional choice. Cutting expenditure and returning the money through tax reductions changes who controls the spending power.

A tax cut does not make the money disappear

Suppose government cuts spending by \$100 and returns the full \$100 as a tax cut. If households spend \$80 and save \$20, the first-round reduction in demand is only \$20, not \$100. The composition of demand has changed: less public demand, more private demand.

That private spending may itself flow into supply-constrained areas such as housing, health services, insurance, energy or other services. The inflation effect therefore depends on where the money goes, not simply on whether government or households write the cheque.

The important distinction: demand versus capacity

The strongest inflation case arises where government competes directly for resources already in short supply. Infrastructure projects can compete with private housing, mining and data-centre construction for engineers, electricians, builders, materials and equipment. Health, education and care spending can compete for scarce skilled labour.

The RBA's August 2026 assessment describes continuing domestic capacity pressures, particularly in market services and new dwellings, and notes that construction demand can create spillovers when sectors compete for the same resources.

But cutting those services also removes output. A nurse's salary is government expenditure, but the nurse produces health-care capacity. A teacher produces education capacity. Reducing those jobs can lower demand today while also reducing service capacity, taxable income and potentially future productivity. Some displaced households may require additional government support.

Borrowing matters too

The fiscal path since COVID is not a straight line. Real expenses surged during the pandemic, then fell sharply as emergency programs ended. By 2022-23 government had returned to an operating surplus. Since then real expenses have again risen faster than revenue, and the 2024-25 all-government operating balance was a deficit of \$8.2 billion. General-government net borrowing was \$69.3 billion and net debt reached \$954.9 billion.

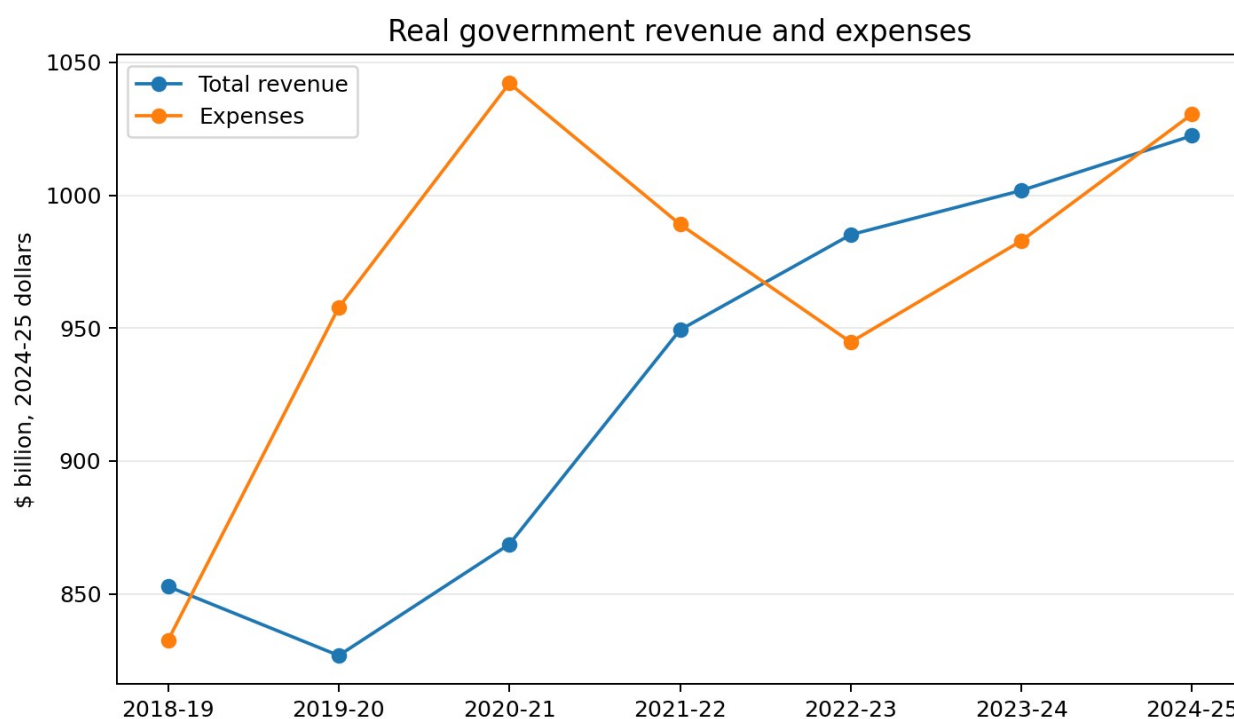


Figure 4. Total revenue and expenses expressed approximately in 2024-25 dollars. The COVID fiscal shock and subsequent consolidation are clearly visible.

A better inflation question

The useful question is not simply: **"Is government spending causing inflation?"**

It is: how much has real spending increased, what is it buying, who finances and receives it, how much is debt-financed, and does the spending compete for resources that are already scarce?

A pension transfer, a hospital nurse, a railway project and an imported defence system can each cost \$1 billion, yet have very different effects on current demand, domestic resource scarcity and future productive capacity.

In short: government spending can contribute to inflation, particularly when it bids for scarce domestic resources. But treating every government dollar as equally inflationary misses taxation, redistribution, private-sector substitution, borrowing and the productive services created by the expenditure.

Appendix: the numbers behind the article

A. Real revenue, expenses and taxation

Year	Real revenue \$b	Real expenses \$b	Real tax \$b
2018-19	853	832	688
2019-20	827	958	669
2020-21	869	1042	708
2021-22	949	989	780
2022-23	985	945	806
2023-24	1002	983	821
2024-25	1022	1030	839

Values are approximate 2024-25 dollars using CPI. CPI is a general deflator rather than a government-specific price index.

B. Spending by purpose

Purpose	2018-19 nominal \$b	2024-25 approx. \$b	Real growth pa
Social protection	189.6	312.2	5.0%
Health	138.5	208.2	3.4%
Education	105.1	148.4	2.3%
General public services	71.9	111.3	3.9%
Public order & safety	35.5	52.6	3.1%
Defence	34.7	50.5	2.9%
Transport	33.8	47.4	2.2%
Economic affairs	31.1	46.4	3.3%

2024-25 purpose amounts are reconstructed from ABS published percentage shares of \$1,030.5b total expenses, so minor rounding differences are expected.

C. Inflation-exposure framework

Type	Immediate channel	Resource constraint	Future capacity	Example
Cash transfers	Indirect household demand	Depends on what recipients buy	Low direct effect	Pensions/family payments
Public services	Direct labour demand	Can be high for skilled labour	Often high	Health/education/care
Infrastructure	Direct construction demand	Can be very high	Potentially very high	Rail, hospitals, power
Imported procurement	Demand leaks offshore	Lower domestic pressure	Varies	Imported defence equipment

Sources

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Notes: Calculations are rounded. CPI adjustment is used for accessibility and consistency with the article; more specialised national-accounts deflators can give somewhat different real-growth estimates. The fiscal-incidence distribution is from 2015-16, the latest full ABS study of this type, and should be read as evidence of the structure of redistribution rather than a precise 2026 distribution.