Submission on the Budget Savings (Omnibus) Bill 2016

Submission

The Australia Institute
September 2016

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Level 5, 131 City Walk
Canberra, ACT 2601
Tel: (02) 61300530
Email: mail@tai.org.au
Website: www.tai.org.au

Introduction

The Australia Institute is pleased to be able to make this submission to the Economics Legislation Committee for its inquiry into the Budget Savings (Omnibus) Bill 2016.

The Bill consists of disparate measures. Presenting the measures in one Bill risks depriving each measure of due scrutiny.

Nonetheless, most of the measures in the Omnibus Bill can be grouped into two categories: measures that would reduce support for innovation in Australia, and measures that would contribute to, rather than address, inequality in Australia. At a time when povery and inequality are high and steadily worsening, the government has made it an early priority in a new Parliament to introduce a range of measures that would impact most on lower income groups, . Government policy should aim to reverse the growing inequality in Australia, as argued in the first section of this submission.

The single biggest example of a policy with this effect is the proposed cut to government benefits - “Closing carbon tax compensation”. The Australia Institute recently released a discussion paper on this topic, which is attached at the end of this submission.

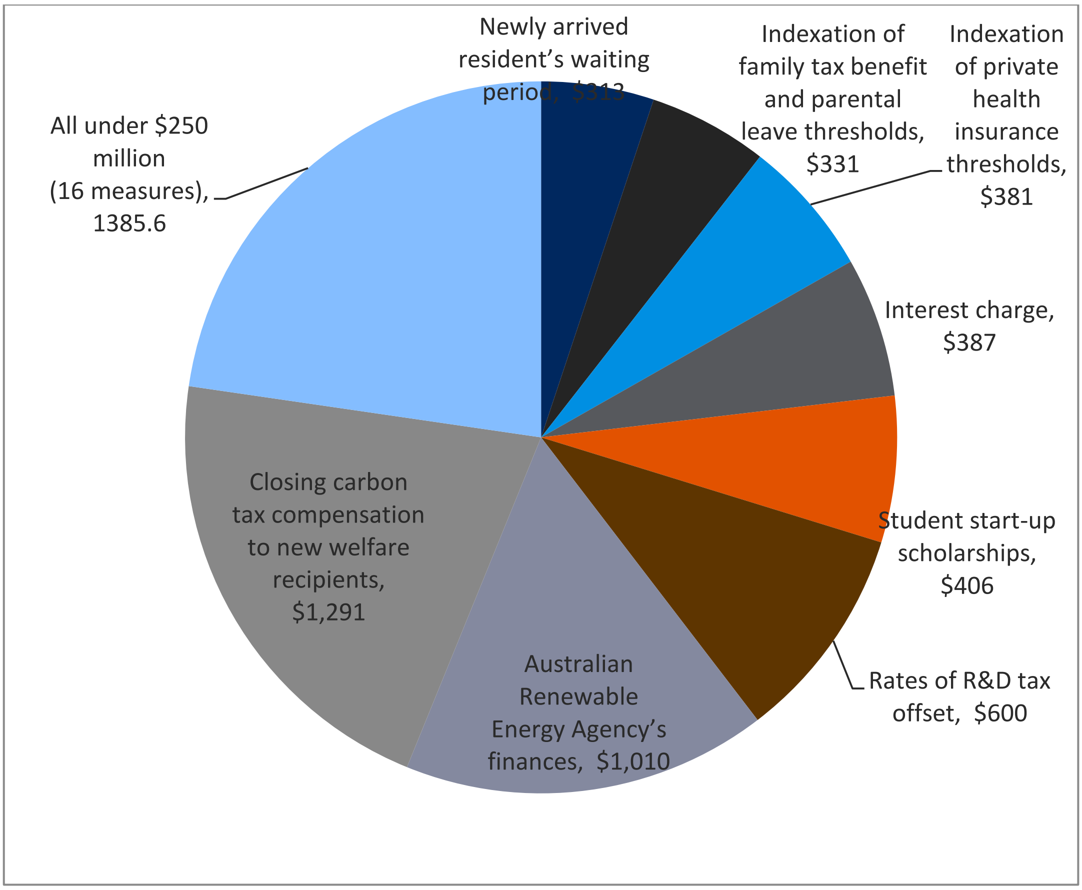
At a time when the government is promoting an ‘innovation agenda’, it is also seeking to cut support for innovation. This includes effectively abolishing the Australian Renewable Energy Agency (ARENA) by cutting all of its remaining grant funding, including $1 billion from the over estimates and a further $0.3 billion beyond estimates. At the same time the government has announced new funding for fossil fuel research. This is a trend back towards energy R&D funding policy from previous decades.

Changes to the rates of the R&D tax offset also reduce the overall level of support for R&D. Innovation – both through research and teaching – would be at risk through cuts to the higher education sector.

Where existing programs that support equity or innovation are not achieving their stated aim, the funding should be redirected into programs that do.

Figure 1 shows how the cuts are allocated across the various measures in the Omnibus Bill.

Figure 1: Allocation of the cuts in the Budget Savings (Omnibus) Bill 2016



As can be appreciated from Figure 1, just a small number of measures contribute to well over half the total savings of $6.1 billion. We estimate that $3.77 billion or 62 per cent of the $6.1 billion in savings identified in the Omnibus Bill comes at the expense of lower income people, with the rest coming mainly from higher education and innovation.

This submission concludes with comments on individual measures in Bill. Where TAI offers no comment on a measure should not be taken as endorsing the particular measure.

On the need to address inequality

The latest ABS figures show that Australia has experienced a slow but steady worsening in inequality in recent years and decades. For example, in the last two years the top quintile has seen their household income increase by $490 a week from $4,512 per week to $5,002 a week. By contrast the bottom quintile has seen their income increase by just $22 a week from $413 to $435 a week.[1]

Inequality with respect to wealth is more extreme than income inequality with the average household in the top quintile holding a net worth of $2.5 million compared with the bottom quintile owning assets worth just $35,600—a ratio of 71 to one. Over the last decade that ratio increased so that in 2003-04 the wealth of the top quintile was 57 times the bottom quintile compared with the ratio of 71 on the latest figures.

Over just the last two years the wealth per household increased by $189,400 for the top quintile and just $2,900 for the bottom quintile. The total amount of income received by the top quintile increased from $405 billion in 2011-12 to $456 billion in 2013-14.

IMF WORK ON INEQUALITY

In recent years the International Monetary Fund (IMF) has devoted considerable resources to the study of inequality and how inequality is both undesirable in its own right but is detrimental to the various economic indicators that point to economic growth and living standards. Essentially, if a country wants to be a high income, high growth economy then it needs to pursue egalitarian policies. In a speech the IMF Managing Director, Christine Lagarde, quantified the impacts when she said:

> Our research shows that, if you lift the income share of the poor and middle class by 1 percentage point, then GDP growth increases by as much as 0.38 percentage points in a country over five years. By contrast, if you lift the income share of the rich by 1 percentage point, then GDP growth decreases by 0.08 percentage points. One possible explanation is that the rich spend a lower fraction of their incomes, which could reduce aggregate demand and undermine growth.[2]

[1] Figures for this and the next two paragraphs rely on ABS (2015) *Household income and wealth, Australia, 2013-14*, Cat no 6523.0, 4 September.

[2] Lagarde C (2015) 'Lifting the small boats', Address at Grandes Conferences Catholiques',

A recent research paper said in regard to the emphasis on economic growth ‘It would still be a mistake to focus on growth and let inequality take care of itself, not only because inequality may be ethically undesirable but also because the resulting growth may be low and unsustainable’.[3] Yet that seem precisely what the Coalition Government has in mind with the various measures in the Budget Savings (Omnibus) Bill 2016 as well as failed measures from the 2014 budget in particular.

On the question of policy measures the IMF in an article by some of it’s senior economists,[4] has just made a very strong statement on inequality and blamed a lot of the fiscal austerity measures introduced in advanced countries. For example it referred explicitly to ‘fiscal consolidation, sometimes called “austerity,” which is shorthand for policies to reduce fiscal deficits and debt levels’ and said

> The costs in terms of increased inequality are prominent. Such costs epitomize the trade-off between the growth and equity effects of some aspects of the neoliberal agenda.

Not only is inequality a result of austerity budgets but inequality itself reduces the prospects of the economy as a whole. The IMF points out:

> Increased inequality in turn hurts the level and sustainability of growth. Even if growth is the sole or main purpose of the neoliberal agenda, advocates of that agenda still need to pay attention to the distributional effects.

They elaborate and in a passage that is worth quoting in full they say:

> The evidence of the economic damage from inequality suggests that policymakers should be more open to redistribution than they are. Of course, apart from redistribution, policies could be designed to mitigate some of the impacts in advance—for instance, through increased spending on education and training, which expands equality of opportunity (so-called predistribution policies). And fiscal consolidation strategies—when they are needed—could be designed to minimize the adverse impact on low-income groups. But in some cases, the untoward distributional consequences will have to be remedied after they occur by using taxes and government spending to redistribute income.

Brussels, 17 June at http://www.imf.org/external/np/speeches/2015/061715.htm accessed 14 September.

[3] Ostry JD, Berg A and Tsangarides CG (2014) ‘Redistribution, inequality, and growth’, *IMF Staff Discussion Note, SDN/14/02*, p. 27 at http://www.imf.org/external/pubs/ft/sdn/2014/sdn1402.pdf

[3] Department of Human Services

[4] Ostry JD, Loungani P and Furceri D (2016) ‘Neoliberalism: Oversold?’ *International Monetary Fund, Finance and Development*, June Vol 53(2)

> Fortunately, the fear that such policies will themselves necessarily hurt growth is unfounded.

'Predistribution' policies are important and for example the Gonski reforms [5] were a deliberate strategy designed to break the cycle of poverty and low incomes when poor children from deprived backgrounds are not given the opportunity to catch up to their peers. We take up some of these themes below.

The neoliberal agenda produces what the IMF refers to an 'adverse loop' when it says:

> …since both openness and austerity are associated with increasing income inequality, this distributional effect sets up an adverse feedback loop. The increase in inequality engendered by financial openness and austerity might itself undercut growth, the very thing that the neoliberal agenda is intent on boosting.

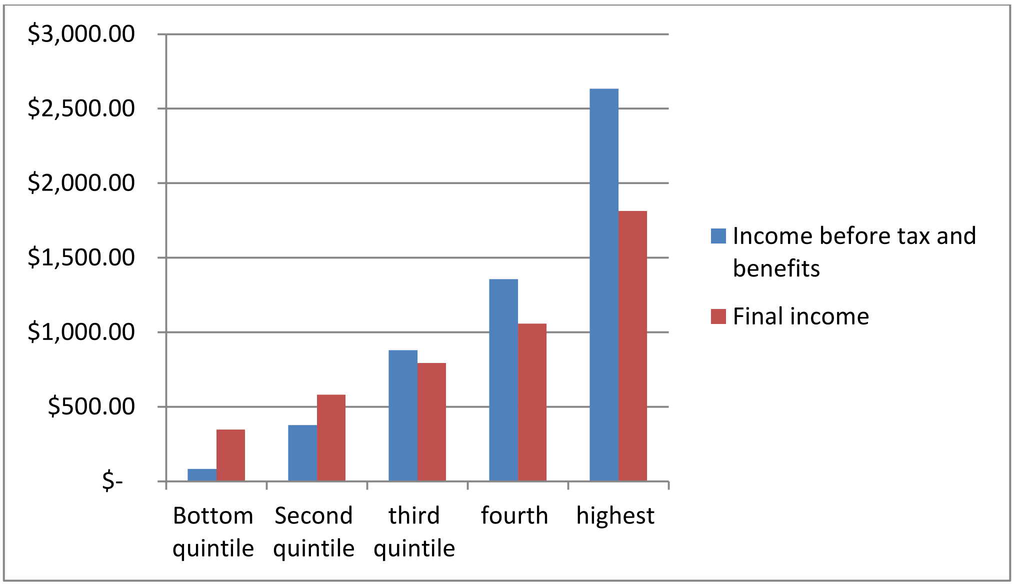
We share the IMF's views on the devastating neoliberal agenda and so oppose many of the measures in the Budget Savings (Omnibus) Bill 2016.

REDISTRIBUTIVE ROLE OF THE AUSTRALIAN TAX/TRANSFER SYSTEM

Statistics published by the ABS allows us to make some estimates about the extent to which Australia's tax and welfare system redistributes income towards greater equality. Those estimates are summarised in Figure 1which shows the income quintiles before and after the effects of taxation and government pensions and allowances.

[5] Named after David Gonski the chair of the panel that produced Review of funding for schooling (2011) *Review of Funding for Schooling—Final Report*, December which produced a plan for making sure all school children had sufficient resources required to receive a good level of education.

Figure 2: Income distribution before and after tax and benefits by quintiles



Source: ABS (2015) Household income and wealth, Australia, 2013-14, Cat no 6523.0, 4 September.

Figure 1 clearly shows that Australia's tax and benefits system is doing its job in redistributing income from higher in the income distribution to lower. However, many of the changes in the Budget Savings (Omnibus) Bill 2016 have the effect of weakening the redistribution evident in Figure 1.

GOVERNMENT BENEFITS IN KIND

Australia has had a long standing commitment to what we now refer to as the social wage and, as we outline below, this commitment continues to be very popular.

Traditionally it is almost impossible to quantify the impact of government spending on the distribution of income but it can be appreciated by looking at the extremes. The very rich do not need a public health and education system and given our progressive tax system they would probably do much better if public health and education were eliminated altogether. By contrast very low income groups who enjoy public health and education services get a net benefit since they pay very little by way of taxation (just the GST on outlays). At the extremes it is easy to appreciate that government services act as a means of redistributing resources. To be more specific than that we have to rely on some assumptions and rough calculations.

Government spending at all levels of government was estimated by the ABS to reach $578.6 billion in 2013-14.[6] That is $24,800 per person. In return we pay taxes including two Commonwealth taxes, taxes on individuals and the GST. A good deal of government is also financed by company taxes, excise duties and other taxes, fees and charges. But we try to keep things simple here and ask how much do you have to earn before the value of what you receive from government equals the value of what you personally contribute to government.

If you are a single Australian (without dependents) by the time we count income tax, the Medicare levy and the GST you receive more from the government than you contribute in tax when you reach an income of over $80,000. Above that you pay more in tax than on average someone gets out of the system. That puts you roughly in the top 25 per cent of income earners.

A double income family of four (two adults and two children), by contrast, breaks even at a combined income of around $234,000. The two adults on equal incomes would have to be in the top 7 per cent of earners. A single income family of four (two adults and two children) breaks even at an income of around $240,000 which means the income earner is in the top 1.5 per cent of the income distribution.

So a cut to government services used to reduce taxes is likely to benefit singles in the top 25 per cent of earners, but among families it is likely only to benefit double income families where each adult earns in the top 7 per cent or single income families where that earner is in the top 1.5 per cent.

[6] ABS (2013) *Australian system of national accounts, 2012-13*, Cat no 5204.0, 1 November. Since these calculations were originally made there has been new data but the general conclusions are likely to remain the same.

Alternative policies

People who make objections to spending cuts are often asked what they might do instead. The case for cutting government spending at the moment is weak we would make the following comments.

The measures in the Omnibus Bill would make cuts of $6.1 billion over the forward estimates; mainly covering the four years 2016-17 to 2019-20.

The Government could save more than that in each year of the forward estimates by abolishing the Fuel Tax Credits Scheme. Just abolishing the share going to the mining industry would save approximately $10 billion over forward estimates according to TAI estimates. We have also made the case for greater reforms to the unsustainable superannuation concessions, requiring very high income earners to pay a minimum level of tax (the "Buffet rule"), reform of negative gearing policies and preferential taxation of investments over work, the introduction of estate duties and many other revenue measures.

The Australia Institute has modelled the budgetary and distributional impacts of these measures, for example:[7]

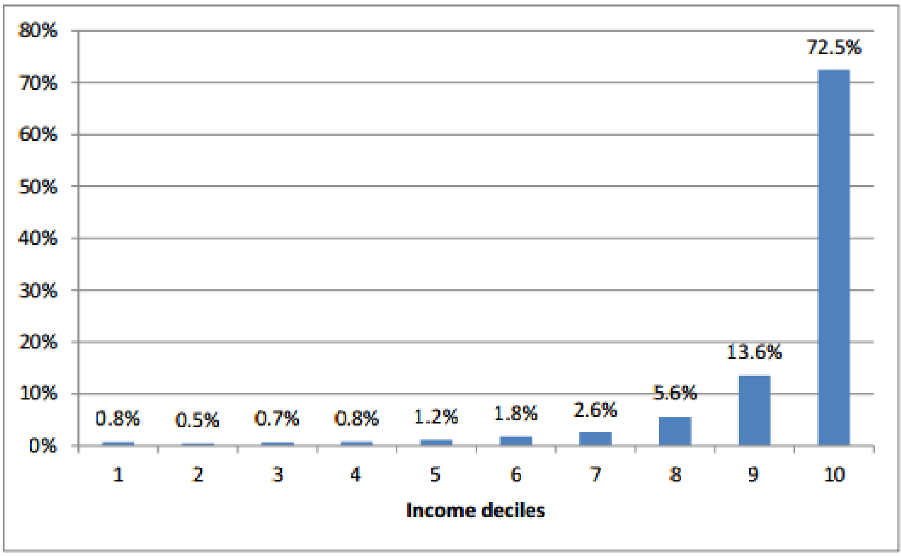
Table 1 – Modelled policies and revenue impact

Revenue measures	Estimate of revenue raised ($m)
Super tax concessions	$9,616
Restrictions on negative gearing	$3,491
Scrapping the capital gains tax discount	$4,039
Introducing a Buffet rule	$2,492

Source: NATSEM Modelling, in Grudnoff (2015) *It's the revenue stupid Ideas for a brighter budget*

[7] Grudnoff M (2015) *It's the revenue stupid: Ideas for a brighter budget* - http://www.tai.org.au/content/its-revenue-stupid-ideas-brighter-budget

Figure 1 – Income distribution of budget savings of four modelled policies



Source: NATSEM Modelling, in Grudnoff (2015) *It's the revenue stupid Ideas for a brighter budget*

It is encouraging to see the Treasurer now acknowledge Australia has an "earnings problem" however this is not reflected in the Omnibus Bill.

While such measures do increase revenue, they do so through reducing spending: spending that occurs through 'tax expenditures'. Allowing certain individuals or companies to pay less tax has the same effect on the budget as giving them money.

Many forms of direct expenditure are needed most by lower income groups. By contrast, many tax expenditures -- such as negative gearing, the capital gains tax discount, and concessions on superannuation -- overwhelming accrue to the highest income groups and reinforce wealth inequality. Taking these reforms would derive far greater savings. They would improve rather than exacerbating inequality, and without undermining innovation.

The omnibus bill measures

CHAPTER 1 MINIMUM REPAYMENT INCOME FOR HELP DEBTS

This measure reduces the annual income at which university and VET graduates with a HELP balance make repayments to the government.

The first thing to note is that this measure is listed as having a trivial impact on the budget. The Explanatory Memorandum figures suggest that over the forward estimates this measure will increase the budget balance by only $3.3 million. Given the likely errors in this sort of estimate we might as well pencil in zero.

It appears this measure is being accounted in cash terms, instead of fiscal terms as is typical. Accounting is cash terms in preferable as the cash balance is the focus of virtually all of the commentary.

Over time, reducing the minimum repayment income for HELP will increase repayments from those on lower incomes. Despite its low contribution to the budget over estimates, over time this measure would impose additional hardship by reducing the disposable income and capacity to save on the part of lower income graduates and those who do not complete their studies. In general such changes would impact women in particular; people early in their careers as they cope with relatively low pay in junior positions but attempt to establish homes and families; people who choose socially beneficial but lower paying careers Unlike countries like Germany, where higher education is fully publicly funded through general progressive taxation, Australia requires graduates to make private contributions. The HELP system is designed to help smooth these costs over time, in correlation with the private benefits resulting from study. While qualifications increase average graduate incomes, there remains a large range of lifetime incomes within graduate cohorts. The fact that some graduates do not 'repay' is a design feature, not a flaw.

Rather than seeking only to recover more private contributions from lower income groups, where greater private contributions are deemed necessary, the government should prioritise linking contributions relative to private benefits, rather than to the nominal level of graduate HELP balances.

CHAPTER 2 INDEXATION OF HIGHER EDUCATION SUPPORT AMOUNTS

This measure changes the indexation arrangements for education outlays from the Higher Education Grants Index (HEGI) to the Consumer Price Index (CPI), with effect from 1 January 2018. HEGI is linked to costs relevant to higher education, namely labour costs in the Professional Services sector.

This measure will have the effect of reducing outlays by $44.9 million in 2019-20 and by bigger amounts in every subsequent year. Changing index benchmarks sounds rather technocratic but it means real reductions in the resources committed to higher education. Specifically, costs are likely to increase faster than resourcing, risking decline in the quality of research and teaching at Australian higher education providers.

This directly impacts Australia's higher education sector at a time when Australia is supposed to be supporting an innovative industry strategy.

Returning to the situation prior to the introduction of HEGI will see the earlier pressures again increase and force the sector to again advocate for re-indexation.

The measure may also increase the substantial incentives for universities to use student revenue to fund research instead of spending it on student education. As The Australia Institute and others have pointed out, universities have increasingly used student revenue to fund research.[8] If research resourcing declines relative to research costs, this may increase pressure to cross-subsidise from students, even if student revenues also decline relative to teaching costs.

CHAPTER 3 REMOVAL OF HECS-HELP BENEFIT

The HECS-HELP benefit reduces HELP balances for those studying in particular courses, such as for early childhood education, to encourage study in these courses. The Ex Mem says the benefit has not been successful as it has been less used than expected.

In general, increasing HELP balances increases lifetime repayment pressures on lower income graduate groups more than higher income groups. This measure increases HELP balances for cohorts likely to earn lower lifetime incomes.

[8] Swann T (2015) *Not 'How High' But 'For What'?,* The Australia Institute

The government should be looking to redirect this funding into more effective programs to support demand for courses where necessary, and doing so in ways that link private contributions more closely to private benefits.

CHAPTER 4 JOB COMMITMENT BONUS

This measure involves a saving of $242.1 million over the forward estimates. The Ex Mem says 'analysis of the program awareness and impact identified that the program has not had a significant impact on young job seekers either obtaining or remaining in employment' (p 7). If that particular part of the labour market assistance program is not working very well it should be channelled into areas that will work.

CHAPTER 5 AUSTRALIAN RENEWABLE ENERGY AGENCY'S FINANCES

The Australian Renewable Energy Agency (ARENA) provides grants to renewable energy R&D to reduce costs and increase uptake.

This measure is carried over from the Abbott Government's 2014 Budget and it effectively abolishes ARENA by removing all of its funding. It would save $1 billion over estimates and a further $300 million in later years.

Most Australians oppose these cuts. Commissioned by The Australia Institute, ReachTEL conducted a nation-wide survey of 10,271 people on the evening of 30 August 2016.[9] Respondents were asked about cutting $1 billion in funding from ARENA and whether the Senate should block or oppose that legislation:

- 56 percent of respondents said the Senate should not pass the cuts to ARENA. Only 21 percent said they should pass the cuts.
- Amongst voters for non-Coalition parties, most voters wanted the Senate to block the cuts, including 68 percent of Labor voters.
- More Coalition voters want the Senate to block the cuts than support the Senate passing them.
- There was a clear majority against passing the cuts in every state.

The government says it is repurposing ARENA as a loan making body. ARENA would deliver loan and equity financing from funds already available to Clean Energy Finance

[9] The Australia Institute (2016) *Poll: Electorate reject ARENA cuts, backs new mechanism to retire coal* , Press Release, 1 September, http://www.tai.org.au/content/poll-electorate-reject-arena-cuts-backs-new-mechanism-retire-coal

Corporation; this would be called a “Clean Energy Innovation Fund”. But ARENA is already an effective Clean Energy Innovation Fund.

ARENA has made Australia a world leading country when it comes to renewable energy R&D. Without grant funding, many projects supported by ARENA could not happen. If these projects do not occur, innovations risk getting stuck in the ‘valley of death’ pre-commercialisation. This puts the growing sector at risk and along with it jobs and investment. Australia will benefit less from lower cost clean energy and find it harder to reduce emissions. Innovations and talent may move to other countries and if this doesn’t happen the world risks a slower uptake of renewables.

While the government is seeking to cut funding to ARENA’s grant funding allocation, in the last year the Turnbull Government has provided a range of new grant funding to fossil fuel research, including $24 million for Carbon Capture and Storage, $15 million to a “Oil, Gas and Energy Resources Growth Centre” and $4 million for gas research at the CSIRO.

Cutting ARENA’s funding while providing new fossil fuel R&D funding is a return to Australian energy R&D policy from the 1980s and 90s. Saving ARENA would return Australia to a world leader and secure the benefits of innovation in renewable energy.

CHAPTER 10 NEWLY ARRIVED RESIDENT’S WAITING PERIOD

Many migrants have to wait 104 weeks before being allowed to access social security payments. However family members of Australian citizens or long-term permanent residents are exempt from this measure. The government proposes to remove that exemption. This measure will impose additional hardship on migrants who find it difficult to obtain work in Australia.

CHAPTER 12 INTEREST CHARGE

This measure applies in the case of people with a debt to the social security and family assistance payments. The proposal is to recover the debt plus a charge of seven per cent over the market interest rate.[10] This seems to be another example of a cruel measure designed to impose additional hardship on the poor and vulnerable in

[10] The 90-day bank accepted bill rate.

Australia for a very small change in the fiscal balance. The rationale appears to be that debts to the Tax Office attract a similar interest rate. But people who are late paying their tax would appear to be completely different. These would include various categories of tax avoiders and evaders.

CHAPTER 16 CARER ALLOWANCE

At the moment carers can claim the allowance after the caring responsibilities begin and receive 'back pay' of up to 12 weeks. This measure proposes to limit payments until the time of the claim (or contact with the department). Given that caring responsibilities can begin in quite traumatic circumstances this change seems cruel and harsh.

CHAPTER 17 INDEXATION OF FAMILY TAX BENEFIT AND PARENTAL LEAVE THRESHOLDS

Family tax benefits are means tested payments with thresholds indexed for inflation. However, indexation had been paused until July 2016 with indexation due to restart on July 2017. This measure seeks to continue that pause until July 2020.

Over the forward estimates this measure will take $330.9 million away from families but the impact builds up momentum so that by 2019-20 $162.4 million will be taken from families and that should remain the case with family payments forevber lower by approximately $162.4 million.

CHAPTER 21 CLOSING CARBON TAX COMPENSATION TO NEW WELFARE RECIPIENTS

In the 2016 budget the government announced that it would close carbon tax compensation to new recipients of government welfare benefits. This will have the effect of reducing the amount paid to welfare recipients. This will save the government $1,291.2 million over the forward estimates.

The clean energy supplement was not the only part of the compensation package for the carbon price. The other main feature of was income tax cuts, which the government is not proposing to cut.

Scrapping the clean energy supplement would reduce government payments to a large number of new welfare recipients, including people on the aged pension, Carers, as well as Austudy and Abstudy recipients. The list of welfare payments that receive the clean energy supplement can be found in Table 2.

Table 2: List of welfare payments receiving the clean energy supplement

Welfare payment
ABSTUDY Living Allowance
Age Pension
Austudy
Bereavement Allowance
Carer Payment
Commonwealth Seniors Health Card
Disability Support Pension
Family Tax Benefit
Farm Household Allowance
Newstart Allowance
Parenting Payment
Partner Allowance
Sickness Allowance
Special Benefit
Widow B Pension
Widow Allowance
Wife Pension
Youth Allowance

The amount of the clean energy supplement that is received for selected welfare payments is set out in Table 3. The dollar amount that individuals and couples receive on Newstart is set out in Table 4.

Table 3: Rates of the clean energy supplement for selected government payments

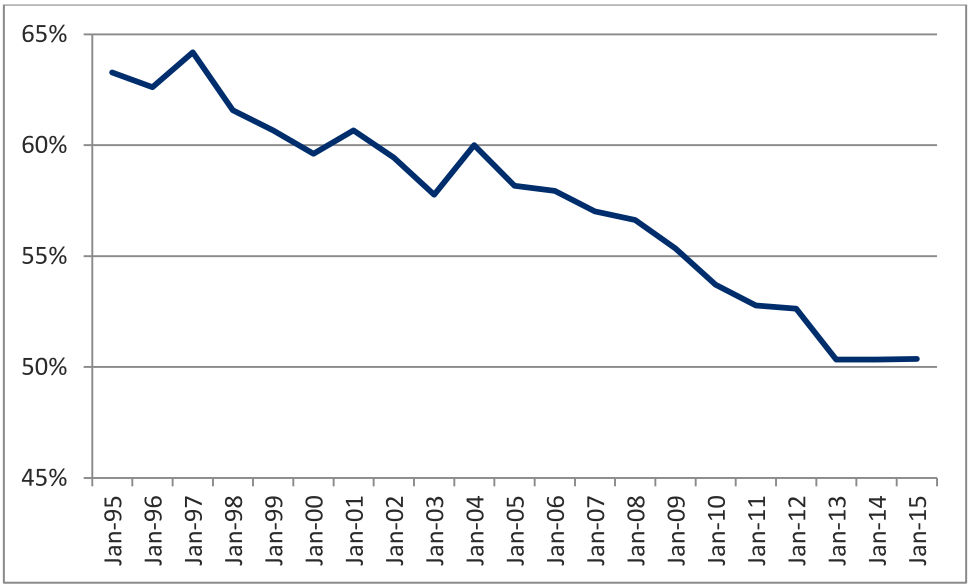
Living Situation	Clean energy supplement payment (per fortnight)
Newstart single, no children	$8.80
Newstart Single, with a dependent child or children	$9.50
Newstart Partnered	$7.90 (each)
Age pension single	$14.10
Age pension partnered	$10.60 (each)
Parenting payment single	$12.00
Parenting payment partner	$7.90

Table 4: Rate of Newstart Allowance for individuals and couples

Living Situation	Maximum fortnightly Newstart payment
Single, no children	$527.60
Single, with a dependent child or children	$570.80
Partnered	$476.40 (each)

Newstart is indexed to the Consumer Price Index (CPI) which tends to rise more slowly than wages. This can be seen in Figure 1 which shows the ratio of unemployment benefits to Adult weekly ordinary time earnings (AWOTE). Unemployment benefits used to be 63 per cent of AWOTE in the mid-1990s. It has fallen to 50 per cent today.

Figure 1: Ratio of unemployment benefits to AWOTE



The business community has pointed out that unemployment benefits have not been keeping pace with community standards and that they are now inadequate. KPMG said:

> "Due to political rhetoric, payments for those who are unemployed have fallen behind other payments, to the point that it is commonly recognised that Newstart is inadequate, and significantly so."[11]

[11] Aston (2016) Raise the dole, spend less on the dying, says multinational accountancy firm KPMG, *SMH*, April 29, available at <http://www.smh.com.au/federal-politics/political-news/raise-the-dole-spend-less-on-the-dying-says-multinational-accountancy-firm-kpmg-20160428-gogzmh.html>

The Business Council of Australia (BCA) has also argued for Newstart to be increased, claiming that its inadequate rate was acting as a barrier to employment. They also argued against the government's claim that a higher rate of Newstart would discourage people from seeking employment.

> *"A disproportionately low rate for the Newstart allowance will not, in and of itself, act as an incentive for people to return to work."* [12]

The government has justified the removal of the clean energy supplement because it was introduced as compensation for the carbon price, which has now been removed and so the government argues it is no longer necessary. This is a reversal from the Coalition's previous position. Before the 2013 election they promised to repeal the carbon price but retain all the compensation[13].

But the clean energy supplement was not the only part of the compensation package for the carbon price. The other main feature of was income tax cuts.

Income tax cuts

The tax cuts involved an increase in the tax-free threshold from $6,000 to $18,200 from 1 July 2012, but the package also included an increase in the marginal tax rates from 15 to 19 per cent for incomes from 18,200 to $37,000. From $37,000 to $80,000 the rate was increased from 30 to 32.5 per cent.

The impact was to limit the benefit at $80,000 and beyond (to just $3) and maximize the benefit at $1,830 for those at $18,200. Those people got the full benefit of the increase in the bottom threshold without experiencing the increases in the marginal rates beyond that point. There was to be a further increase in the bottom threshold which was never implemented but which would have given at least $300 to everyone.

In the 2011-12 MYEFO the cost of the package was expected to be as set out in the following table. Note that the second increase in the bottom threshold was due to come in after these years.

Table 4

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[12] Karvelas (2012) Business Council of Australia calls for lift in dole payments, *The Australian*, August 13, available at <http://www.theaustralian.com.au/national-affairs/business-council-of-australia-calls-for-lift-in-dole-payments/story-fn59niix-1226449033615>

[13] Macintosh (2013) Abbott's balancing act: keeping the compensation while axing the carbon tax, *The Conversation*, May 17, available at <https://theconversation.com/abbotts-balancing-act-keeping-the-compensation-while-axing-the-carbon-tax-14393>

	2011-12	2012-13	2013-14	2014-15
Cost $m	$0	$3,350	$2,370	$2,320

The first year cost looks peculiar and is probably explained by accrual complications. The costs shown in 2013-14 and 2014-15 are closer to the on-going costs of that compensation for taxpayers that we might expect today.

There should be two offsetting factors on the likely value of the change in later years. First, there is the natural growth in the number of tax payers and second, there will be some fall in the value of the tax cuts as incomes gradually increase. These offset each other so the net effect is likely to be very small. Given that the cost now should be running at something of the order of $2.1 billion per annum or some $8.4 billion over the forward estimates. This would be a conservative estimate.

The government has chosen to remove the compensation only from those on government payments from 20 September 2016. In a rather bizarre twist, those people who receive a new benefit between 20 September 2016 to 19 March 2017 will receive the supplement only for it to then be withdrawn as of 20 March 2017. All new recipients from 20 March 2017 will be denied the supplement. This will create a two-tiered system in the short term.

CHAPTER 22 RATES OF R&D TAX OFFSET

This measure would reduce R&D support to the private sector, through the R&D Tax Incentive, by $600 million over estimates from 2017-18, or $200 million a year.

The R&D Tax Offset is, in effect, an undirected matching grant for private sector Research and Development. The R&D tax offset now gives a 45 or 40 per cent refundable tax offset for the first $100 million pa of eligible expenditure and 30 per cent (equivalent to the company tax rate) for expenditure in excess of $100 million.[14] In other words, for taxpayers spending more than the $100 million threshold, the excess is treated as the same as any business expense.

The R&D tax offset is an expenditure item that replaced the earlier R&D tax concession. A 2015 report to the Senate Economics Committee outlines the R&D Tax Incentive constituted "Almost 92 per cent of Australian Government Budget assistance

[14] The higher rates apply to taxpayers with annual turnovers less than $20 million (except those owned by a tax exempt entity) and the lower rate applies to all others.

for private sector science, research and innovation"[15] and "is estimated to amount to $2,929m, or 30 per cent of expenditure" on R&D.[16]

This means the proposed cut is equivalent to around 7 percent of current Australian government support for R&D through the R&D Tax Incentive and around 2 percent of Australian government R&D spending overall.

There has been a long running debate about the effectiveness of attracting and stimulating R&D activity through tax incentives, instead of other mechanisms such as more directed grants programs -- as Australia already provides in the higher education sector and from the numerous agriculture industry R&D corporations.

If the government thinks that the incentive is not effective at stimulating additional R&D in Australia, or requires further directing, the savings from this measure should be redirected to other programs.

Australia once had a much more generous R&D tax concession that allowed an eligible entity to deduct 150 and later 125 per cent of *all* the relevant expenditures. The rationale of a generous R&D tax concession was provided by the Industry Commission[17] (now Productivity Commission). Among other things it said:

> Governments have an essential role to play. Knowledge inevitably spreads and may be used in a multitude of ways never initially envisaged. Its benefits are difficult to constrain or quarantine. When individuals create new knowledge, they do more good for the community than they know or can personally benefit from. Governments therefore need to underpin and supplement the processes of knowledge creation, if these wider benefits are to be adequately realised. This is among the most difficult, and important, tasks of government policy.[18]

Specifically in relation to the 150 tax concession the Industry Commission urged the government to retain the concession at the then rate. At the present company tax rate of 30 per cent the 45 per cent R&D tax offset would be equivalent to the 150 tax concession. However, when the Industry Commission examined the issue the company

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[15] Green, R (2015) *Australia's Innovation Future - A Report on the Structure and Performance of Australia's National Innovation System*, page 25, attached to http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Innovation_System/Report

[16] Green, R (2015) *Australia's Innovation Future* page 18.

[17] Industry Commission (1995) 'Research and Development', *Report no 44*, 15 May.

[18] Industry Commission (1995) 'Research and Development', *Report no 44*, 15 May, p 1.

tax rate was 36 per cent[19] implying that the 150 per cent deduction increased the implied R&D tax offset rate to 54 per cent.

Given the importance of R&D and the much higher support given in the past we think the cut to R&D spending should be resisted. We also note that the Prime Minister's innovation statement included improving the effectiveness and integrity of the current R&D tax incentive.[20] Reducing the value of the R&D tax offset seems to be going in the opposite direction.

[19] Previously it had been even higher at between 45 and 49 per cent from the 1940s to much of the 1980s.

[20] http://www.innovation.gov.au/system/files/case-study/National%20Innovation%20and%20Science%20Agenda%20-%20Report.pdf

Appendix

Attached is *Inequality & poverty in Australia: The case against the removal of the clean energy supplement*
http://www.tai.org.au/sites/defualt/files/TAI%20Briefing%20Note%20-%20Poverty%20Line%20-%20August%202016.pdf