

Submission to the Senate Standing Committees on Finance and Administration

regarding the

Investment Funds Legislation Amendment Bill 2021

from

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BACKGROUND

I am a former biomedical research scientist who has worked in health policy for many years in both Australia and the United States.

I have a PhD in biochemistry from the John Curtin School of Medical Research at the Australian National University and my post-graduate research, undertaken at the Uniformed Services University of the Health Sciences (the US Department of Defense medical school) in Bethesda, Maryland was in the area of infectious diseases.

I have worked as a senior advisor on health policy for the Democrats in the US House of Representatives, for the Labor Party in the Australian Parliament, and for the US Surgeon General in the Obama Administration.

I am currently an Adjunct Associate Professor at the Menzies Centre for Health Policy and Economics at the University of Sydney.

My submission addresses only the provisions of the *Investment Funds Legislation Amendment Bill 2021* (the Bill) that relate to the Medical Research Future Fund (MRFF).

This submission represents my own opinions and is based on my recent analysis of funding supported by the MRFF which was published on Croakey Health Media¹.

¹ <https://www.croakey.org/an-investigation-of-the-medical-research-future-fund-produces-24-pressing-questions/> and <https://www.croakey.org/what-is-needed-to-deliver-on-the-investment-in-the-medical-research-future-fund/>

SUMMARY

- The Medical Research Future Fund currently has \$22.028 billion in capital and returns on this investment have averaged 4.8% per annum since the inception of the Fund.
- The 2021-22 Budget Papers show that revenue from this investment is expected to deliver \$940.9 million in 2022-23, \$979.5 million in 2023-24 and \$1,067.6 million in 2024-25.
- However, the Budget Papers from 2019-20 to 2021-22 and the provisions of this Bill indicate that from 2022-23 a maximum of \$650 million will be available each year for disbursement for research activities.
- The actual funding provided for research may be considerably less than this: the 10-Year Investment Plan refers to \$5 billion over 10 years.
- This is considerably short of the \$1 billion per year promised when the MRFF was established.
- The rationale provided for this disbursement limit indicates that a new investment mandate will be implemented that is, at least in the short term, riskier than the current approach. There is no transparency about what this will involve.
- No explanation is provided for:
 - Why the previous funding commitment is now being abandoned – at a time when biomedical research has never been more important and research funding is scarce; and
 - The fate of the returns on investment that are not transferred to the MRFF special account for distribution for research.

RECOMMENDATIONS

1. That the capital in the MRFF is capped at the level indicated in the June 2021 Quarterly Report (ie \$22.028 billion).
2. That all future revenue derived from this investment is provided to the MRFF special account for the management and funding of research activities in accordance with the MRFF Strategy and Priorities, without limit to the annual amount.
3. That, to the extent that annual revenue provided to the MRFF special account exceeds \$1 billion, consideration is given to using these additional funds to provide research support to grantees, especially those in academic institutions.
4. That this Bill includes provisions to make the finances of the MRFF more public and more transparent.

ANALYSIS

When the MRFF was announced in 2014, the stated commitment was to the provision of \$1 billion a year from 2022-23 for research.

“Distributions from the MRFF to medical research will be around \$1 billion by 2022-23. This will double the Government’s direct medical research funding.”²

“The Fund will eventually provide around \$1 billion per annum in additional funding for medical research and medical innovation.”³

The data in Table 1 outline what the Federal Budget Papers, including the Finance Department Portfolio Budget Statements (Outcome 2), from the years 2019-20 to 2021-22, say about MRFF funds and their availability over the forward estimates.

An explanation of the terms:

- MRFF special account: This is the figure usually reported as MRFF expenditure – it is the sum of project payments + management fees
- Opening balance: The amount of capital in the fund
- Revenue: Income derived from the capital
- Management fees: Funding to the Future Fund for management and administration
- Transfers to special account for project payments: Funding distributed for research

These figures do not align with those provided by the MRFF 10-Year Investment Plan⁴ (see Table 2). Note that if management fees (as given in Table 1) are included, then the alignment is closer.

Neither the Budget Papers nor the Investment Plan show that the MRFF has met its goal of distributing \$500 million annually by 2019-20 and it will not meet – by a considerable margin – the goal of distributing \$1 billion in the year 2022-23.

There was a delay in the MRFF reaching full capitalisation and the Budget Papers indicate that revenues will not reach \$1 billion until 2024-25. The drop in predicted revenue for 2021-22 is unexplained – it may reflect concerns that investment returns may be affected by the economic consequences of the coronavirus pandemic, including actions by the Reserve Bank of Australia.

It is apparent that the Government has long had the intention to restrict the investment revenue transferred into the special account; as early as the 2019-20 Budget, the transfers to the MRFF special account from 2021-11 are indicated as limited to \$650 million. This decision was clearly made well ahead of any impact from the pandemic.

According to the Budget Papers, a total of \$882.5 million will be held back over the four years 2021-22 to 2021-25. This is occurring even as the MRFF is over-capitalised by more than \$2 billion.

² <https://archive.budget.gov.au/2014-15/glossy/Health.pdf> page 5

³ <https://ministers.treasury.gov.au/ministers/joe-hockey-2015/media-releases/medical-research-future-fund-bill-passes>

⁴ <https://www.health.gov.au/resources/publications/medical-research-future-fund-mrff-10-year-investment-plan>

Table 1

	2018-18	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
	\$m	\$m	\$m	\$m	\$m	\$m	\$m
MRFF special account							
2019-20 budget	239.9	459.9	658.7	733.4	738.5	-	-
2020-21 budget	-	418.7	660.2	734.9	740.1	740.1	-
2021-22 budget	-	-	631.2	544.9	740.0	741.8	743.1
Opening balance							
2019-20 budget	9,453.6	17,301.1	20,052.8	20,269.8	20,499.7	-	-
2020-21 budget	-	17,585.1	20,433.8	20,662.8	20,908.6	21,160.8	-
2021-22 budget	-	-	20433.8	20,895.4	21,114.8	21,314.1	21,551.8
Revenue							
2019-20 budget	256.9	689.5	875.7	963.3	974.3		
2020-21 budget	-	55.3	889.2	980.8	992.8	1,003.3	-
2021-22 budget	-	-	1,092.8	764.3	940.9	979.5	1,067.6
Management fees							
2019-20 budget	25.0	73.6	86.1	87.4	88.5	-	-
2020-21 budget	-	26.0	87.6	89.0	90.8	91.0	-
2021-22 budget	-	-	58.6	89.9	90.9	91.8	93.1
Transfers to sp acc for project payments							
2019-20 budget	214.9	386.4	572.6	645.9	650.0	-	-
2020-21 budget	-	392.7	572.6	645.9	650.0	650.0	-
2021-22 budget	-	-	572.6	455.0	650.0	650.0	650.0

Table 2. MRFF Budget from 10-year Investment Plan

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
	\$m	\$m	\$m	\$m	\$m	\$m	\$m
MRFF special account	204.2	392.5	578.8	627.5	567.5	540.6	527.1

The rationale provided for the changes outlined in the Bill is that:

The legislative amendments to the MRFF will enable the Government to issue a new investment mandate with a higher benchmark rate of return that will increase expected earnings and better align the fund's benchmark rate of return with the growth in the health-related costs. This will have a positive impact on the underlying cash and fiscal balances, reflecting higher projected investment earnings (net of investment costs). A higher benchmark rate of return will increase the risk of short-term losses, but that will be offset by higher expected earnings over the medium to longer term.

In this light it is instructive to look at the investment approach to date.

Quarterly portfolio updates are available for the MRFF which is one of five funds managed by the Future Fund Board of Guardians.⁵ The most recent report, for the quarter ending June 30, 2021, show the MRFF then had \$22.028 billion in invested funds and the returns for the 2020-21 financial year were the highest in the history of the Future Fund.

The current target for the return on investment for the MRFF is set as the RBA cash rate plus 1.5 - 2.0 percent per annum over the long term, with an acceptable but not excessive level of risk. This is less than that for the four other funds managed by the Future Fund.

From inception, the target has averaged 2.6 percent per annum; the average return from has been much higher than this, at 4.8 percent per annum. For 2020-21 the target return was lower – 1.6 percent – because the RBA cash rate is low (0.1 percent).

But the Future Fund's management delivered spectacular results as the pandemic economy was so much stronger than predicted. The MRFF reported a 10.9 percent return on investment, which means that the revenue for 2020-21, predicted to be \$764.3 million (see Table 1) was of the order of \$2 billion.

That means that the figure previously quoted of \$882.5 million that will be held back from research over the four years 2021-22 to 2021-25 is dramatically more, around \$2.1 billion. Presumably these extra funds, in whole or in part, account for the increase in the MRFF capital level.

If the benchmark rate of return was increased to reflect the growth in health-related costs what would that rate be?

The 2021-22 Budget Papers show that total health expenses are projected to increase by 2.0 percent in real terms between 2020-21 and 2021-22, before decreasing by 2.1 percent by 2024-25.⁶ Real spending on Medicare and the private health insurance rebate is expected to increase by 3.4 percent from 2021-22 to 2024-25. Real federal spending on public hospital funding is expected to increase by 9.5 percent over the forward estimates.

As it currently stands, with the MRFF balance at over \$22 billion, a 4.5 percent target would return more than \$1 billion annually. But this is a level that is already being achieved, with relatively low risk. The Government has not explained why higher investment risks are needed, and why the target return needs to be linked to growth in health-related costs rather than, for example, growth in research-related costs.

⁵ <https://www.futurefund.gov.au/investment/investment-performance/portfolio-updates>

⁶ https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/BudgetReview202122/HealthOverview

Research Australia has made the case⁷ that a substantial increase in the Research Support Program is needed just to maintain the levels of research support funding for research projects at their current already inadequate level. The cuts to the Research Support Program beyond the one-off boost in 2020-21 represent a real and continued threat to the capacity of universities to use MRFF funding to undertake research.

There seem to be some concerns related to the impact of the pandemic on investment returns, but these are not reflected elsewhere in Government statements or policy or in the management of other future funds. In an opinion piece published last month, the Treasurer, Josh Frydenberg said, “Our economy is in a stronger position to recover than even a year ago.”⁸

Future Fund Chairman, Peter Costello, has recently outlined how the Future Fund is taking on more risk – which is in part what this Bill proposes – but he also states that the risk dial is still pointed to conservative because “The money belongs to taxpayers”.⁹

There are three important reasons why more transparency is needed around this proposed legislative change:

1. The \$20 billion that makes up the capital of the MRFF is savings taken from the Health and Indigenous Affairs portfolios. This increases the onus on the Government to show that these funds are returned as investments in research and translation efforts to improve the health of all Australians and especially the lives of Aboriginal and Torres Strait Islander people.
2. The push to move up the risk curve to increase returns on investment is undermined by the fact that, to date, these have been considerably more than expected and there is currently at least \$2 billion in additional funds available for distribution for research. While some small move is likely justified, there is no value from squirrelling away funds that could be used to deliver research outcomes that will improve Australians’ health and healthcare costs.
3. The original commitment was for MRFF disbursements to double the Government’s funding for biomedical research. However, NHMRC funding provided through the Medical Research Endowment Account over the forward estimates is increasing by only 1 percent per annum (in real terms this is a decrease) and MRFF funding is only 65 percent of that promised. Budget Papers show for biomedical research over the forward estimates is flatlining.

A 2014 report¹⁰ prepared by Deloitte Access Economics for the Australian Society for Medical Research found that every \$1 from the MRFF invested in medical research returns \$3.39 in future health and productivity gains (this assumes Federal and State government health system expenditure will grow at an average of 6.8 percent per annum).

The report finds that the MRFF contribution to health research and development has the potential to enhance the longevity and quality of life for all Australians, and concomitantly slow the

⁷ https://treasury.gov.au/sites/default/files/2021-05/171663_research_australia.pdf

⁸ <https://joshfrydenberg.com.au/latest-news/why-australias-economy-will-get-through-this-crisis/>

⁹ <https://www.theaustralian.com.au/business/beware-the-reckoning-warns-future-fund-chair-peter-costello/news-story/e4376814e015319b7b67baa3f9293f05>

¹⁰ https://asmr.org.au/wp-content/uploads/library/ASMR%20Deloittee%20Report_MRFF.pdf

burgeoning health expenditure trajectory. The Government's proposed legislative changes would undermine that potential and the commitments made at the time the MRFF was established. Promises that funding clawed back now will deliver more funding at some future, undefined time ring hollow given the urgent need for research efforts to tackle key health problems that beset Australia now.