acoss

Budget Priorities Statement

2016 - 17

Who we are

ACOSS is the peak body of the community services and welfare sector and the national voice for the needs of people affected by poverty and inequality.

Our vision is for a fair, inclusive and sustainable Australia where all individuals and communities can participate in and benefit from social and economic life.

What we do

ACOSS leads and supports initiatives within the community services and welfare sector and acts as an independent non-party political voice.

By drawing on the direct experiences of people affected by poverty and inequality and the expertise of its diverse member base, ACOSS develops and promotes socially and economically responsible public policy and action by government, community and business.

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Table of abbreviations

ACOSS	Australian Council of Social Service
ATO	Australian Taxation Office
CGT	Capital Gains Tax
CHP	Community housing providers
COAG	Council of Australian Governments
CPI	Consumer Price Index
CRA	Commonwealth Rent Assistance
DGR	Deductible Gift Recipient
DSP	Disability Support Pension
EMSN	Extended Medicare Safety Net
FTB	Family Tax Benefit
GDP	Gross Domestic Product
GFC	Global Financial Crisis
MYEFO	Mid-Year Economic and Fiscal Outlook
NAHA	National Affordable Housing Agreement
NRAS	National Rental Affordability Scheme
NCOA	National Commission of Audit
NPAH	National Partnership Agreement on Homelessness
PBS	Pharmaceutical Benefits Scheme
PC	Productivity Commission
PHI	Private Health Insurance
SNAICC	Secretariat of National Aboriginal and Islander Child Care
SAPTO	Senior Australians and Pensioners Tax Offset
SPP	Special Purpose Payment

Overview: a balanced approach to fiscal sustainability

Australia is a comparatively low taxing and low spending country, with the most tightly targeted income support system in the OECD. We are facing a medium term budget challenge, which must be addressed in a way that supports both economic growth and equity and gives people confidence that funding for vital services is secure into the future. This requires action to reform wasteful or poorly targeted tax and direct expenditures, investment to address gaps in the safety net and a fiscal commitment to fund health, education and social services through and beyond the forward estimates.

The 2016-17 Budget will be the first budget handed down by the current Treasurer under the leadership of the Prime Minister Turnbull. It will take place in a federal election year, in the context of major reform processes of taxation and federation arrangements and against the backdrop of a broader debate about economic reform. Key stakeholders have worked hard to build some common ground in this debate, including on the need to achieve structural budget balance progressively through a staged reform process over a ten year period. Business, union and community groups have also agreed that this should be achieved through a combination of tax and expenditure reforms, while creating space to address some serious holes in the social safety net including an increase to the unemployment benefit.

At the same time, there is a growing disconnect between the dominant political narrative about the challenges we face as a nation and what the community actually wants from our nation's leaders. As Ipsos research found in 2015, the public is yearning for leaders with long-term vision and plans to address the nation's social and economic issues and invest in Australia's future. Blame for Australia's economic woes has been attributed to "short-term thinking, corporate greed and political and economic mismanagement".[1]

Reflecting deep-seated concern at the emergence of 'two Australias', the community wants governments to plan for our future. Meanwhile, job security and underemployment feature among people's biggest worries, especially for young families with large mortgages, people approaching retirement age and those living in rural areas where employment options are particularly limited.

[1] Ipsos (2015) 'Community perspectives on social inequality', *Mind and Mood Report*, http://www.acoss.org.au/wp-content/uploads/2015/06/Ipsos-ACOSS-Report_Final.pdf

To set a path to achieve budget balance fairly, in the 2016-17 Budget the Government should:

1. Set a path towards structural reform of the tax system that delivers increased revenue fairly and efficiently, supports economic growth and encourages investment in productive economic activity. This must include major reforms to superannuation and housing tax concessions to ensure these concessions fulfil a legitimate purpose;
2. Invest in the capacity, health and wellbeing of people who are unemployed by delivering a modest increase to the unemployment benefit. This should be complemented by investment in effective programs to equip people who are unemployed long term to return to paid work;
3. Invest in a new national affordable housing strategy through a capital injection, creation of a new rental investment incentive, establishment of a new financing mechanism to attract institutional investment at scale, a boost to Rent Assistance and appropriate indexation of housing and homelessness funding. Action to relieve housing stress cannot be deferred for another year;
4. Redirect wasteful expenditure in the health system to improve the quality and accessibility of health services, including oral and preventive health services, for people on low incomes; and, finally
5. Abandon proposed cuts to income support that would adversely affect people on low and moderate incomes, which have not yet passed the Parliament. These have now been on the budget books for two years, undermining budget transparency, and include:
    a) Reducing Family Tax Benefit Part B to single parent families and abolishing end of year supplements, without offsetting measures;
    b) Freezing family payment rates;
    c) Change to the age of eligibility for the Newstart Allowance, which would require unemployed young people to survive on the lower youth payment for longer;
    d) The introduction of waiting periods to access income support;
    e) And a range of other measures.[2]

[2] Including freezing the free area for allowances which will reduce incomes and incentives for those working part-time; and abolishing the Pensioner Education Supplement, which will result in income losses of $36 for eligible recipients, including many single parents.

The first two budgets under the Coalition Government have aggressively pursued expenditure savings while deferring major reform of the tax system. With the exception of some appropriate retargeting of assistance which ACOSS has supported (e.g. the reforms to the Age Pension assets test), the overall impact of this approach has been to impose the burden of budget restraint on those who can least afford it – people on low to moderate incomes who rely on government payments and supports. Our analysis estimates $15 billion over four years in cuts to basic services and supports over the last two budgets, in addition to the projected loss of $80 billion in Commonwealth funding to the states and territories for health and schools over a decade. We cannot risk any further undermining of our social protection system without increasing poverty, social exclusion, community division, inequality, and poorer population health outcomes.

The continuation of an unbalanced approach to fiscal repair which relies exclusively on spending cuts would be economically, socially and politically irresponsible. With our spending already so tightly targeted to people on lower incomes, such an approach will only further hurt the people whom we should be supporting to improve their living standards.

ACOSS believes that the case for tax reform is compelling and has worked actively with diverse stakeholders and with government to build momentum for reform and to identify shared goals. We believe that reform must be structural and must grow the revenue base fairly, steadily and efficiently. It must focus on major tax concessions which have unintended or inequitable impacts including superannuation and housing investment concessions. We would however be very concerned by the announcement of a reform package which reduced the overall progressivity of the tax system (for example through a tax mix switch from personal income taxes towards consumption taxes), relied on compensation to cure inequities in the package, or which failed to grow the revenue we need to adequately fund health, education and social service costs.

Together with our state and territory counterparts, we have developed a proposal for coordinated tax and federation reform to strengthen the Commonwealth/State revenue base and introduce greater certainty for people about the level of service access they can expect to receive into the future[3]. This would be achieved through the development of community service guarantees in major areas of shared government responsibility, for example health, housing, disability and early childhood education

[3] ACOSS and the State and Territory Councils of Social Service (2015): *Fit for purpose: a federation that guarantees the services people need* Available: http://www.acoss.org.au/wp-content/uploads/2015/10/COSS-federation-framework_FINAL.pdf

and care. Community service guarantees would specify a set of services that are available to those who need them, regardless of income or where they live. The Commonwealth Government would be responsible for ensuring that guarantees and related outcomes are achieved, while State and Territory Governments would be responsible for planning and delivery of the services. Costs would be shared according to a formula set in legislation and would be properly indexed to reflect projected increases in future costs. In return for these funding guarantees, State and Territory Governments would be required to provide services in a cost effective way, for example through investment in prevention and health promotion and reform of funding to hospitals to increase cost efficiency.

Coordinated reform in this way would help to build public confidence that increases in public revenue would be directed to fund essential community services, and that this funding would be prevented from being readily taken away in future. The Government should ensure that, in moving to develop a tax reform package, it provides certainty for the community about future health, education and social service funding arrangements through such a guarantee. We propose a fairer way to finance future guaranteed increases in health funding as the population ages – by tightening the tax treatment of superannuation fund earnings to increase the proportion of those over 65 years paying income tax (currently less than 20%) when they can afford to do so. A secure retirement is as much about access to affordable health care as it is about adequate income.

We support the appropriate targeting of government assistance and have demonstrated our readiness to endorse reforms that reduce expenditure on particular social programs or payments where we felt this could be better spent. To this end, we supported reforms to the pension assets test and the abolition of the Seniors Supplement to reduce assistance to older people with greater means. We backed the tightening of the Family Tax Benefit Part B income test under the previous Government from $150,000 to $100,000 and have indicated support for further reforms to family payments to more effectively direct assistance to families on the lowest incomes (e.g. through reduced assistance to couples with older children under Part B and the gradual phase out of supplements in order to boost payments for single parents and families with older children). We also advocate for a reduction in the level of child care subsidy paid to higher income households with a view to diverting funds towards families struggling with the costs of care or otherwise disadvantaged (for example, in a remote area).

However, there is a limit to how much more tightly we can target assistance in a system that is already more tightly targeted than almost every other OECD country and has the lowest unemployment payment. Expenditures on social security payments are lower than comparable countries: in 2012, they were 8.6% of Gross Domestic Product (GDP) compared with an OECD average of 12.4%.[4] Despite assertions that expenditures on working age payments are a growing pressure on the Federal Budget, the facts are that there has been a long term decline in reliance on working age payments, falling from nearly one in four in 1996 to less than one in five in 2014.[5] In 2014-15, working age payments such as Newstart Allowance, Disability Pensions and Parenting Payment made up just 30% of social security expenses.[6] As a result of these factors and the efforts made by the previous and current Government to reduce social security expenditures, there is now limited scope for further tightening of eligibility for assistance. To date, there has been little attempt by governments to direct the savings gained from tightening access to payments to those areas where it is most needed. This budget must mark a departure from this approach by returning some of the savings recouped to address the gaps in the social safety net, starting with an increase to the unemployment payment.

Through the National Reform Summit, business, community and union groups, including ACOSS, have agreed, as an overarching fiscal goal, that the budget should be progressively returned to structural balance over ten years through a staged reform process. The groups have also agreed on a number of fundamental fiscal policy principles, including that:

- Governments have a key role to play in delivering quality services, a social security safety net and economic and social infrastructure essential for economic growth;
- All expenditure programs, including direct and tax expenditures, should be subject to rigorous evaluation to ensure efficiency and effectiveness over time;
- Where major spending program redesign is undertaken, it should seek to improve service quality and equitable access, not just efficiency;
- Income support payments should be targeted to those who most need them and gaps in the safety net closed, such as by improving the adequacy of income support for unemployed people, affordable housing for people on the lowest incomes and services to people with a disability;

[4] OECD Social expenditure data base. See http://www.oecd.org/social/expenditure.htm.
[5] Peter Whiteford, 'Is Welfare Sustainable?' *Inside Story*, 26 November 2015. Available at: http://insidestory.org.au/is-welfare-sustainable
[6] Australian Treasury (2015): *Budget Paper 1 2015-16* Commonwealth of Australia available at: http://www.budget.gov.au/2015-16/content/bp1/html/bp1_bs5-01.htm. Total social security expenses includes family payments.

- People on low incomes or who are otherwise vulnerable should be protected from the impacts of fiscal reform.[7]

We encourage the Government to build on these foundations in developing its fiscal strategy for the next financial year and beyond.

The economic and fiscal outlook

While GDP is expected to grow over the coming years, growth expectations were revised down in MYEFO to 3%. Unemployment is forecast to fall slightly over the forward estimates, from 6% in 2015-16 to 5.5% in 2018-19 but will remain fairly high. Wages growth, which has been slow, is projected to be moderate (up slightly from 2.5% in 2015-16 to 3% in 2018-19).

The estimated 2016-17 Budget cash deficit is $33.7 billion.[8] Spending as a proportion of GDP is projected to be down over the forward estimates, but revenue is also projected to decline due to falling commodity prices, weaker wage and population growth and weaker equity markets.

Overview of recommendations

We propose that modest additional expenditures of the order of $3.5 billion ($6 billion in 2017-18) in key priority areas be funded by savings measures, worth an estimated $4 billion ($9.5 billion in 2017-18).[9]

Most of our revenue measures would not take effect until at least 2017-18, when the deficit would be reduced by approximately $4 billion. Our proposals would set the budget on a sustainable trajectory, with the impact of taxation changes growing in value over time and steadily eroding the budget deficit. This approach is consistent with the two stage reform approach agreed by business, union and community groups with a two year planning and an eight year transition phase. Strengthening economically efficient tax bases and promoting stronger investment will help make room for necessary future expenditures in such areas as health, aged care and disability services as the population ages. Importantly, fiscal rules must be flexible enough to enable the reallocation of spending between portfolios where there is a pressing imperative to do so and this is in the national interest. The reallocation of resources to reduce poverty nationally is such a case.

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[7] Extracted from the 'Statement from the National Reform Summit', a joint statement endorsed by the Australian Chamber of Commerce and Industry, the Australian Council of Trade Unions, the Australian Council of Social Service, the Australian Industry Group, the Australian Youth Affairs Coalition, the Business Council of Australia, COTA, Seniors Australia,

[8] MYEFO 2015-16, Table 1.1, at: http://budget.gov.au/2015-16/content/myefo/html/01_part_1-01.htm.

[9] All costings are estimates and intended as a guide only.

Proposed new expenditures include the following key recommendations (for full list, see table 1):

- Increase allowance payments, including the unemployment payment, by $53 per week for single people (costing $1400 million in 2016-17; $1600 million in 2017-18);
- Index allowance payments annually to wages (costing $60 million in 2016-17; $100 million in 2017-18);
- Establish an Affordable Housing Growth Fund (costing $750 million in 2016-17; $1000 million in 2017-18);
- Increase the maximum rate of Rent Assistance by 30% (costing $750 million in 2016-17; $770 million in 2017-18);
- Increase investment in community services to previous funding levels and index community services funding to wage movements ($370 million in 2016-17; $2213 million in 2017-18); and
- Extend DGR status to a wider range of charities to support funding diversification ($700 million in 2016-17; $800 million in 2017-18).

Reallocation of existing expenditure is proposed in a number of areas to improve targeting and/or impact. A number of these proposals are revenue neutral, while others would involve some new investment, but with additional costs offset by savings. Recommendations include:

- Redirecting funds for ineffective employment programs, especially Work for the Dole, to more effective and flexible employment assistance;
- Restructuring the family payments system to better target assistance and reduce child poverty through the gradual phase out of end of year supplements (and redirection of savings from legislated changes to Part B for couples), offsetting losses for low income families through indexation of Family Tax Benefit (FTB) Part A to wages, the introduction of a new middle benchmark for Part A and a new Sole Parent Supplement paid at a higher rate than the current Part B payment;
- Redirecting part of the savings achieved through reform of housing tax concessions to fund a rental investment incentive for new housing stock, paid at a higher rate for affordable dwellings;
- Redirecting health expenditure through the removal of the Private Health Insurance Rebate and the Extended Medicare Safety Net to public hospitals and community based services and increased investment in preventive and dental health care services;

- Retargeting investment in early childhood education and care by reducing the subsidy rate and cap for higher income households, to ensure that low income families can access a minimum of 2 days of education and care per week (regardless of activity) and to fund an Aboriginal and Torres Strait Islander community based program;
- Simplify and better target concessions for superannuation contributions through the creation of a two-tier annual rebate paid into the fund, that is capped at a contribution level sufficient to support (along with the Age Pension) an acceptable retirement income for a typical worker (revenue neutral).

Revenue and savings measures include the following key recommendations (for full list, see table 1):

- Abolish certain Capital Gains Tax concessions for small business assets (saving $0 in 2016-17; $1000 million in 2017-18);
- Tax superannuation fund earnings more consistently (saving $0 in 2016-17; $1300 in 2017-18);
- Restrict the Seniors and Pensioners Tax Offset (SAPTO) to pensioners (saving $200 million in 2016-17; $200 million in 2017-18);
- Increase the superannuation preservation age to align it with the Age Pension age (savings beyond the forward estimates);
- Remove grandfathering arrangements for concessions for non-superannuation termination payments and unused leave ($400 million in 2016-17; $500 million in 2017-18);
- Curb the use of private trusts to avoid personal income tax (saving $0 in 2016-17; $1500 million in 2017-18); and
- Curb the use of private companies to avoid personal income tax (saving $0 in 2016-17; $1000 million in 2017-18).

Finally, the 2016-17 Budget should include an analysis of the impact of budget measures on different households. Prior to 2014, the budget papers included budget outcomes tables showing the distributional impact of budget measures on real disposable incomes. These tables were not published in the 2014-15 or 2015-16 budgets, resulting in a loss of transparency. The budget papers should include an analysis of budget impacts by reference to income quintile, household type (e.g. couple household with children, single parent with children, single person etc), gender and key population groups (people with disability, Aboriginal and Torres Strait Islander people etc). This would be an important step in improving budget transparency and government accountability for budget impacts on individuals and families.

Table 1: Summary of recommendations

Proposed budget measure	Cost ($million in 2016-17)	Saving ($million in 2016-17)
Expenditure measures		
Strengthen flexible investment in people unemployed long term by redirecting resources from Work for the Dole and the Job Commitment Bonus	$80m ($130m in 2017-18)	
Increase allowance payments by $53 per week	$1400m ($1600m in 2017-18)	
Index allowance payments to wages	$60m ($100m in 2017-18)	
Establish an independent commission to advise Government on payment rates	$5m ($7m in 2017-18)	
Reform family payments to reduce child poverty and better target to need	Revenue neutral [10]	
Establish an Affordable Housing Growth Fund	$750m ($1000m in 2017-18)	
Establish a housing finance intermediary	$20m ($35m in 2017-18)	
Increase Commonwealth Rent Assistance by 30%	$750m ($770m in 2017-18)	
Index the National Partnership Agreement on Homelessness	$3m ($3m in 2017-18)	
Improve adequacy of indexation of the National Affordable Housing Agreement	$13m ($27m in 2017-18)	

[10] Estimated to revenue neutral. Detailed modelling is required to assess budget impacts of proposed changes.

Proposed budget measure	Cost ($million in 2016-17)	Saving ($million in 2016-17)
Reduce subsidy for higher income households and redirect savings to address gaps in childcare package for low income families	Revenue neutral[11]	
Index community services funding to wage movements	$370m ($373m in 2017-18)	
Restore funding for community services to pre-2014 budget levels	$0m ($1840m in 2017-18)	
Establish an innovation fund for government-funded community services	$10m ($15m in 2017-18)	
Support Aboriginal and Torres Strait Islander representation in national policy processes by funding institutional capacity of National Congress	$3m ($5m in 2017-18)	
		Net total (cost): $3464 ($5905 in 2017-18)
Tax and savings measures		
Limit deductions for expenses related to passive investments, including housing, to income from the same assets (redirecting a proportion to fund a new rental incentive)		$500m ($1000m in 2017-18)
Remove Capital Gains Tax concessions for small business assets		$0m ($1000m in 2017-18)
Target superannuation concessions to low and modest income earners		Revenue neutral
Extend 15% tax to super fund earnings in pension phase in stages, restrict tax avoidance opportunities using super post-retirement		$0m ($1300m in 2017-18)
Abolish the Private Health Insurance Rebate (redirecting half the savings to public hospitals and community based health services and		$3300m ($3400m in 2017-18)

[11] Estimated to revenue neutral. Detailed modelling is required to assess budget impacts of proposed changes.

Proposed budget measure	Cost ($million in 2016-17)	Saving ($million in 2016-17)
delivering additional investment in preventive and dental health services)		
Restrict Senior Australians and Pensioners Tax Offset (SAPTO) to pensioners		$200m ($200m in 2017-18)
Increase the superannuation preservation age over time		$0m ($0m in 2017-18)[12]
Remove grandfathering arrangements for concessions for non-superannuation termination payments and unused leave		$400m ($500m in 2017-18)
Curb the use of private trusts to avoid personal income tax		$0m ($1500m in 2017-18)
Curb the use of private companies to avoid personal income tax		$0m ($1000m in 2017-18)
Extend Deductible Gift Recipient status	$700m ($800m in 2017-18)	
Abolish the Extended Medicare Safety Net		$410m ($420m in 2017-18)
		Net total (savings): $4110 million ($9520 million in 2017-18)
TOTAL COST	$3464million ($5905 million in 2017-18)	
TOTAL SAVINGS	$4110 million ($9520 million in 2017-18)	
NET TOTAL (Saving)	$646 million ($3615 million in 2017-18)	

[12] Impact beyond forward estimates.

Securing the revenue we need to meet the community's needs

Australia is the sixth lowest taxing country of 34 OECD countries, ahead of only Mexico, Chile, the United States Switzerland and Korea.[13] In the year of the Global Financial Crisis (GFC), tax revenue fell by 2% of GDP. Eight years later, it is still 1.4% of GDP less than its pre-GFC level of 23.7% of GDP.[14] The main reason for this very slow revenue recovery is that the mining boom has subsided and has not been replaced by new drivers of economic growth. This is the main reason that the budget is now in deficit, together with the impacts of a range of generous tax breaks, rebates and spending measures introduced during the boom years, particularly by the previous Coalition government.

It is clear that both Federal and State tax revenues will have to increase in future years to help restore public budgets and meet the cost of services for an ageing population, including funding growing areas of priority expenditure such as the National Disability Insurance Scheme and needs based schools funding. This should be done in a way that minimises any harm to equity or economic development. Income tax bracket creep cannot do all the work to restore public revenue. On the other hand, we cannot afford a repeat of the eight successive income tax cuts that seriously eroded income tax revenues during the 2000s. Income taxes are the fairest way to raise public revenue and governments should strengthen that tax base, not undermine it. This can be achieved by removing or reducing the impact of the most poorly designed, inefficient and inequitable tax shelters.

Whenever the income tax 'base' is narrowed by deliberate tax shelters or unintended loopholes, this means that higher tax rates are required to raise the same amount of revenue. This is inefficient as well as inequitable. There is a case for taxing investment income at lower rates than income from paid work on economic efficiency grounds given that capital is more mobile and sensitive to tax levels. It is vital, however, to ensure that taxes on different investment incomes are as consistent as possible. Otherwise, the tax system will distort economic decision-making in ways that are harmful to Australia's economic development.

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[13] OECD, Revenue Statistics, OECD Member Countries: Comparative Tables. Available at: https://stats.oecd.org/Index.aspx?DataSetCode=REV Data for 2013.
[14] http://www.budget.gov.au/2015-16/content/myefo/download/MYEFO_2015-16_Final.pdf

1.1 Investment income

A good example of the impact of these distortions is the 50% discount on tax rates for capital gains received by individuals and trusts. Treasury estimates that the lost revenue from this tax break costs $6 billion per annum. This encourages excessive speculative investment in property and other assets yielding capital gains and it is one of the reasons for the steep inflation in home prices we have experienced since the late 1990s. The concessional treatment of capital gains compared with other investment income (such as interest and active business income) diverts investment from other purposes as well as fuelling boom and bust cycles in the economy. The concessional tax treatment of capital gains also overwhelmingly benefits the top 20% of taxpayers, who receive two-thirds of all capital gains.

This tax distortion is exacerbated by the unlimited deductions for losses on investments in property and other assets yielding capital gains such as shares, agricultural schemes, and collectables. Australia is unusually generous in placing few restrictions on these deductions. This has encouraged the practice of 'negative gearing' where investors (especially in property) deliberately incur losses on their investment for a number of years to maximise deductions against their other income. These deductions (including interest on loans) are poorly matched with income from the investment, which mainly takes the form of capital gains. The deductions are typically claimed against wages which are taxed every year at the individual's marginal tax rate, but income from these investments mainly takes the form of capital gains which are only taxed at half that rate, and often years later when the asset is sold. The result is an even stronger tax bias in favour of debt-financed investment in property shares and other assets.

Negative gearing is discussed further in Chapter 4 (Housing). Our proposal is to quarantine deductions for expenses relating to passive investment in housing, shares, collectables and similar assets purchased after 1 January 2017 to offset income received from those assets, including capital gains realised on their subsequent sale. Assets acquired before that date would be 'grandfathered' so that deductions can still be claimed under the present rules. Part of the revenue saved from this reform would be used to introduce an investment incentive (tax offset) for new housing dwellings whose construction costs fall below a (relatively high) value. The incentive would be paid at a substantially higher rate (either as a tax offset or direct payment) for the construction of new dwellings used to provide affordable housing (where rents are held at least 20% below market rents). This tax offset or payment would be available for a maximum of ten years following construction. These new investment incentives would form part of a wider set of affordable housing policies discussed in Chapter 4. Unlike negative gearing they should strengthen investment in new housing stock and could support institutional investment in rental housing. As part of the broader affordable housing strategy in Chapter 4, targets should be set for the share of housing attracting the incentive that is affordable. The impact of the incentive on rental housing investment, especially affordable housing, should be reviewed within three years of its implementation.

To reduce the distortion of investment decisions by the 50% tax discount for capital gains, the Henry Report recommended a common (lower) tax discount for most major forms of investment income apart from superannuation and owner occupied housing. This would increase tax rates on capital gains and reduce those applying to other investment incomes such as bank interest and housing rents. This proposal has merit but is best introduced as part of a wider reform of the tax system. A sensible place to begin reform of the tax treatment of capital gains in this budget is to reduce the additional concessions that apply to capital gains realised on the sale of certain small business assets. The current 50% tax discount is doubled in many cases, and there are exemptions for capital gains held for over 15 years and those used for 'retirement purposes.' Together, these concessions mean that many small business owners can avoid paying Capital Gains Tax (CGT) altogether, an outcome that is inequitable and hard to justify.

The original purpose of the additional small business concessions was to enable small business owners to use the sale of their business assets to fund their retirement. However this is a risky approach to retirement saving and these special tax breaks encourage over-investment in business assets as against other strategies to improve business profitability and to save for retirement. Small business owners should be encouraged to save for their retirement through superannuation rather than by avoiding tax on capital gains.

The integrity of the CGT system would also be strengthened by our recommendations to reduce opportunities for the avoidance of CGT by shifting assets into self-managed superannuation funds, discussed below.

Recommendation 1: Deductions for expenses for investments in assets such as property and shares should be limited and the existing tax concessions for residential property investment replaced by a new rental housing investment incentive.

(1) Income tax deductions for expenses (such as interest payments on debt) relating to passive investments in such assets yielding capital gains (such as housing, shares and collectables) should be limited to income received from those assets, including capital gains realised on subsequent sale. This should apply to all new investments of this type entered into after 1 January 2017.

(2) Part of the revenue saved from this measure should be used to introduce a two-tier rental housing investment incentive paid as an annual tax offset for a fixed period of ten years in respect of new dwellings or improvements for residential rental purposes, below a fixed construction cost. A substantially higher rate would apply to dwellings defined as 'affordable rental housing', as part of a wider package of incentives to support investment in affordable housing.

Saving: $500 million ($1,000 million in 2017-18)

Recommendation 2: Certain CGT concessions for small business assets should be removed.

The following tax concessions for capital gains from the disposal of small business assets should be abolished from 1 July 2017:

- The additional 50% discount for these capital gains;
- The exemption for gains on assets held for over 15 years; and
- The exemption for gains used for retirement purposes.

Saving: $0 ($1,000 million 2017-18)

1.2 Retirement incomes

The current set of retirement and age-based tax concessions are not fit for purpose. Along with the Age Pension and essential services such as health and aged care, their purpose should be to enable people to achieve an acceptable living standard in retirement. Instead, they have become a wealth and estate management tool for higher income earners, who do not need additional public support for their retirement, and are unlikely to rely on an Age Pension in any event. This is undermining the personal income tax base for older people at a time when expenditures on health and aged care for an ageing population are projected to increase strongly. At the same time, the majority of wage earners are short changed by the present superannuation system, often paying more tax on their superannuation contributions than they would on their wages. This problem will soon be exacerbated by the removal of the Low Income Superannuation Contribution.

Superannuation tax concessions are the largest component of tax expenditures, totalling $30 billion in 2015-16, broadly equivalent to the cost of the Age Pension.[15] Tax concessions for contributions are poorly targeted, saving high income earners over 30 cents in tax per dollar contributed by their employers while low income earners typically pay 15 cents in the dollar more in tax than they would on their wages. Far from alleviating budget pressures as the population ages, current superannuation tax expenditure settings are contributing to our budget problems. Some 30% of the value of superannuation tax breaks goes to the top 10% of income earners and only 20% are received by the bottom 50% of income earners.[16] Men in the top 10% of the wage distribution receive more from government in superannuation tax exemptions than they would if they received the full Age Pension.[17] For a system that was at least partly intended to relieve government reliance on public funding as the population ages, this is a poor public policy outcome.

The unfair and complex system of tax concessions for superannuation contributions (including the deduction for contributions by self-employed people and the co-contribution) should be replaced with a simpler taxation structure in which contributions are taxed at the employee's marginal tax rate and an annual superannuation rebate is paid into their superannuation account. Tax would be deducted by employers from the contributions they forward to superannuation funds and the rebate would be paid by the Australian Taxation Office (ATO) into the fund at the end of the tax year.

The rebate would be structured according to a '100-20-20' formula: 100% rebate up to a low level of annual contributions, plus a 20% rebate up to an annual concessional contributions cap of $20,000.

The purpose of the 100% (dollar for dollar) component of the proposed rebate is to boost superannuation savings for people on very low incomes, especially women in low paid part time jobs. This 100% component would be paid in respect of all annual contributions up to a low cap, for example $500 which is close to the minimum annual employer contribution required under the superannuation guarantee.

[15] Australian Treasury (2015): *Mid-Year Economic and Fiscal Outlook (MYEFO)*, Commonwealth of Australia. Available: http://www.budget.gov.au/2015-16/content/myefo/download/MYEFO_2015-16_Final.pdf

[16] Treasury (2013) *Highlights of Treasury paper presented to Superannuation Roundtable in April 2012*, Commonwealth of Australia.

[17] Ibid.

The purpose of the 20% rebate for contributions above this (low) level is to support compulsory saving for retirement and encourage voluntary saving to achieve an acceptable standard of living in retirement. The 20% rebate would be capped at a lower level than the current concessional cap ($30,000 to $35,000) - for example $20,000. This level of annual contributions should be sufficient, over a typical career, to enable a fulltime employee on the median wage to attain an adequate retirement income, taking account of Age Pension entitlements. As the Grattan Institute has shown, contributions above this level (around one-quarter of average fulltime earnings) are usually made by people with high incomes, or as part of a tax avoidance strategy post-retirement (discussed below).[18]

The proposed rebate would simplify the system and make tax support more visible to encourage retirement saving. Although it would not be income-tested, it would greatly improve equity in superannuation. It is consistent with the superannuation reform proposals in the Henry Report, except that it would not reduce employees' current disposable incomes. It would leave the majority of superannuation fund members (up to annual incomes of around $150,000 where contributions are below $20,000) better off in retirement, while curbing concessions for the top 10% or so of taxpayers.

The annual contributions cap would be adjusted to ensure that the replacement of existing tax concessions for contributions with the new rebate is revenue neutral (so the $20,000 figure is illustrative).

To limit tax concessions for superannuation fund earnings and benefits for people contributing large amounts to superannuation, the 'non-concessional contributions cap' should be reduced from three times the (now lower) concessional cap, and people should no longer be allowed to accumulate the annual cap over a three year period. Higher contributions caps for older workers and lifetime contribution caps may appear to be fair at face value but in overall terms they mainly benefit people on the highest incomes, who have the greatest capacity to take advantage of these concessions. They are also contrary to the purpose of superannuation which is to support long term saving, rather than 'last minute' contributions.

Retirement-related tax concessions are seriously undermining the personal income tax base among older people. As the population ages, governments will face increasing and legitimate demands on health and aged care services. However, less than 20% of individuals over the age of 64 pay any income tax, despite increases in the incomes of this age cohort from employment, investments and superannuation. This is not sustainable. Due to growth in user charges for aged care and the Government's

[18] Grattan Institute (2015), 'Superannuation tax targeting.'

2014 Budget decision to cut the indexation of health funding for the States (reducing funding by $14 billion in a decade's time), older people are increasingly worried that health and aged care services may be not available to them when they are needed. We need serious policy changes to equitably and sustainably meet the health, aged care and other needs of an ageing population without imposing unaffordable user charges or co-payments for universal services.

The fairest way to pay for the increasing cost of these services is through the personal income tax system so that people contribute according to their ability to pay. We propose that the income tax be strengthened in three ways for this purpose, and that the revenue savings be earmarked (though, as with the Medicare Levy, not strictly hypothecated), to restore sustainable funding for health and aged care:

- By broadening the income 'base' for the Medicare Levy;
- By restricting SAPTO to pensioners;
- By taxing superannuation fund earnings (but not benefits) at the same 15% rate in the 'pension phase' as in the 'accumulation phase'.

The 2% Medicare Levy is levied on much the same basis as personal income tax. This means that individuals can avoid contributing to the cost of essential health care services using tax shelters such as capital gains, salary sacrifice arrangements, negative gearing, and private companies or trusts. As an alternative to increasing the Medicare Levy off its existing tax 'base' to improve funding for health services, we propose that these forms of tax-sheltered income be included in the base. This is similar to the current treatment of tax shelters in some social security income tests. Ideally, these tax shelters would be comprehensively reformed, but broadening the base of the Medicare Levy in this way would be a first step in that direction.

SAPTO is one cause of revenue erosion. What began as a rebate to prevent maximum rate pensioners from having to pay tax has become a general tax free threshold of $32,000 for singles and $58,000 for a couple over 64 years in addition to any tax free superannuation payments. This is 50% higher than the effective tax free thresholds for people of working age. It cannot be justified on work incentive grounds since additional tax breaks for older workers are as likely to encourage them to retire later (because they can reach their retirement income target sooner) as to remain in paid work for longer.

The treatment of superannuation fund earnings in the 'retirement phase' adds to the ways in which well-off individuals can legally avoid paying income tax once they reach 55 years or over. When taxes on most superannuation benefits for people over 60 years were abolished in 2006, during the boom era, this was not accompanied by the removal of the tax free status of fund earnings for funds paying a retirement pension. As a consequence of this decision, and also the introduction of 'transition to retirement' pensions for people aged 55 years and over, older people can 'churn' their wages and other investment income though their superannuation accounts and reduce their effective tax rate on at least part of that income to zero or 15%. They can do so without actually saving more for retirement. Superannuation in the retirement phase has become a tax avoidance tool rather than a retirement income system. The use of this churning strategy to avoid personal income should be curbed by subtracting any benefit payments from annual contributions attracting tax concessions so that only net contributions are taxed at the concessional rate.

People can also avoid paying tax on capital gains accrued through their working lives by keeping assets in a self-managed superannuation fund until they reach the age of 60 and the fund pays them a pension, at which point the fund's earnings, including capital gains, are normally tax free. Similarly, they can avoid paying tax above 30% on income from assets held in a private company and then pay zero tax on such income once they reach 60 years.

Individuals can readily avoid the existing 17% tax on superannuation assets passed to their estate by shifting superannuation assets from concessional to non-concessional accounts. In this way, superannuation has become an estate management tool as well as a tax avoidance tool.

A key flaw in the tax treatment of superannuation in retirement is the artificial distinction between a 'contributions phase' (pre-retirement) in which fund earnings are taxed at 15% and a 'pensions phase' (post-retirement) in which they are tax free. This distinction is artificial, because individuals can contribute to superannuation and be paid a superannuation pension at the same time.

The Henry Report recommended that fund earnings be taxed at the same rate in both phases, though at less than 15%. Given the fiscal challenges facing this and future governments as the population ages, and the fact that taxes on superannuation benefits have been abolished, there is a strong case for applying the standard 15% tax rate to fund earnings in both phases. This simple change would greatly improve the integrity of the income tax system for older people and raise revenue for health and aged care services. In addition, steps should be taken to ensure that accrued capital gains from assets held in self-managed funds are properly taxed in retirement, and that the 17% tax on superannuation assets passed on to a fund member's estate cannot be avoided. The purpose of superannuation is to improve retirement incomes, not those of adult children.

To keep the economy growing and fund essential services as the population ages, it is vital that more mature age people retire later, and retire gradually by working on a part-time or temporary basis after leaving their fulltime jobs. An important policy change to encourage people to do so is to raise the preservation age for access to superannuation from 55 years so that it eventually meets the forecast Age Pension age of 67 years (with exemptions for particular groups). A lower qualifying age for superannuation than for the Age Pension cannot be justified.

The preservation age should continue to rise beyond the legislated age of 60, at one year per annum from 2025, until it reaches age 67 in 2032. Such a policy would be much fairer and cause less hardship than an increase in the pension age, since most people who rely mainly on social security in mature age are those who have little choice but to retire at 67 or earlier – such as people with disabilities or caring responsibilities, and Aboriginal and Torres Strait Island people who have a much lower life expectancy.

A higher preservation age is likely to have a substantial impact on the workforce participation decisions of those who do have a choice to retire later (mainly people on higher incomes). Even if the immediate effect on their disposable incomes is not substantial (given that most baby boomers currently have low superannuation balances), it would send a strong signal to employers and employees that people are generally expected to work until at least 67 years.

Although this reform would not begin to affect access to superannuation until 2025 (by which time we expect typical retirement ages will have increased significantly), early access arrangements should be established for individuals who have little choice but to retire sooner due to disabilities or caring roles. Options include allowing access from age 60 (the preservation age that will apply when the proposed reform commences in 2025) for people whose impairments or caring roles would ordinarily qualify them for certain social security payments (whether or not they actually receive a Disability Support Pension or Carer Payment), or by allowing withdrawals earlier than the preservation age for any purpose up to modest annual and lifetime limits. If implemented in conjunction with an increase in the level of compulsory saving this should have no adverse impact on living standards in retirement, and in any event many people on low incomes have as much need to draw upon their savings (for example due to unemployment, or to meet child rearing costs) during working life as they do after retirement. Account should be taken of the lower life expectancy of Aboriginal and Torres Strait Islander peoples.

Recommendation 3: Simplify concessions for superannuation contributions

(1) All tax concessions for superannuation contributions should be replaced in a revenue neutral way by a two-tier annual rebate paid into the fund, that is capped at a contribution level sufficient to support (along with the Age Pension) an acceptable retirement income for a typical worker.

(2) The rebate would be structured according to a '100-20-20' formula, as follows:

- 100 cents per dollar contributed from any source up to $500 (indexed to movements in average fulltime earnings), to support retirement saving by low paid part-time workers and replace the superannuation co-contribution;
- Plus 20 cents per additional dollar contributed from any source up $20,000 indexed to movements in average fulltime earnings (less than the present concessional contribution caps of $30,000 and $35,000).

(3) The rebate should be reduced to the extent that an individual withdraws funds from their superannuation account in the same year as they make a contribution, so that only net additions to savings attract a tax concession.

(4) The annual non-concessional contributions cap should be reduced from six times to three times the concessional cap, and the ability to contribute up to three years' contributions within the cap in a single year should be removed.

Cost: Revenue neutral

Recommendation 4: Superannuation fund earnings should be taxed more consistently to help pay for health and aged care services:

(1) The 15% tax on fund earnings in the accumulation phase should extend to the pension phase over a five year period from July 2017 (with a 3% increase each year).

(2) This tax should be offset by a 15% rebate (minus any imputation credits) for taxpayers over the preservation age whose income (including Age Pension, earnings and investment income) falls below that taxpayer's tax free threshold (taking account of the proposed adjustments to the SAPTO). The rebate would be calculated each year by the ATO and deposited into a superannuation fund chosen by the taxpayer.

(3) Ensure that capital gains accrued during working life are taxed appropriately when assets held within self-managed superannuation funds are disposed, or on retirement.
(4) Ensure that transfers from superannuation accounts to the estates of deceased fund members (apart from spouses and dependent children) are taxed at the statutory rate (17%).
(5) Revenue collected from these measures (which would rise substantially in later years) should be earmarked (along with the Medicare Levy) for public expenditure on health and aged care services.

Saving: $0 ($1,300 million in 2017-18)

Recommendation 5: Restrict SAPTO to pensioners

SAPTO should be restricted to individuals entitled to a social security pension, and redesigned to exclude income within the pension 'free area' from tax.

Saving: $200 million ($200 million in 2017-18)

Recommendation 6: Increase the preservation age so that it corresponds to the Age Pension access age by 2027.

The preservation age should be progressively raised from 60 years (the present legislated target) to 67 years by 2032, subject to (and conditional upon) the following exceptions:

(1) Allow continued access to superannuation from 60 years for individuals who are unable to continue in paid work due to disabilities, poor health or caring roles. This may include those whose impairments or caring roles would ordinarily qualify them for certain social security payments (such as the Disability Support Pension or Carer Payment).
(2) Alternately, if superannuation guarantee contributions are increased above 9.5%, allow all superannuation fund members, after at least five years of saving, to withdraw a modest proportion of their superannuation balance for any purpose, within lifetime limits, before they reach the preservation age.

(3) In raising the preservation age, make allowance for the lower life expectancy of Aboriginal and Torres Strait Islander peoples.

Saving: $0 million ($0 million in 2016-17)[19]

1.3 Other proposals to strengthen the personal income tax base

The House of Representatives Taxation Committee recently recommended that the Government give Treasury an ongoing mandate to conduct prioritised reviews of tax expenditures and publish the results.[20] If the Government subjected tax expenditures to the same rigorous budget scrutiny as direct expenditures, it could save billions of dollars every year. Large tax expenditures have risen by $22 billion in the last two years and now amount to 7.8% of GDP.[21]

Revenue savings from the handful of major tax expenditures could save at least as much as is achieved through regular reviews of a much larger number of smaller direct expenditures. For these reasons, the OECD has suggested that tax expenditures that are comparable with direct expenditures should be included within any public expenditure 'ceilings', and the following guidelines were developed under its auspices:

- 'Under nominal or structural deficit or operating/current balance rules tax expenditures should either be included in the total expenditure cap that is set every year during budget preparation or in a special tax expenditure cap.'
- 'All tax expenditures should be reviewed in the same way as regular expenditures in the annual budget process. They should be reviewed by the financial staff of spending ministers and the budget bureau in the same way as regular expenditures.'[22]

Tax expenditures that are poorly targeted or difficult to justify include:

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[19] The Productivity Commission estimated if the preservation was increased to 65 by 2043, workforce participation among older workers would rise by around 2 percentage points in 2055 and revenue and expenditure savings of the order of $7 billion would accrue in that year. See Productivity Commission (2015): 'Superannuation policy for post-retirement.'

[20] Standing Committee on Tax and Revenue (2015): *The Tax Expenditures Statement*, Nov 2015. Available: http://www.aph.gov.au/Parliamentary_Business/Committees/House/Tax_and_Revenue/Tax_Expenditures/Report

[21] Ibid.

[22] OECD (2004) *Best practice guidelines: off budget and tax expenditures.* GOV/PGC/SBO(2004)6 at 4.

- SAPTO, discussed above;
- The Private Health Insurance (PHI) Rebate[23]; and
- 'Grandfathering' arrangements for previous tax concessions for non-superannuation termination payments and unused leave entitlements, apart from bone-fide redundancy payments.

While the above tax expenditures are an intentional part of the taxation system, unintended tax shelters also undermine the integrity of the tax system. For example, relatively well-off individuals can avoid personal income tax by diverting and 'sheltering' their income or income producing assets in structures such as discretionary trusts and private companies, or combinations of the two.

Private trusts (especially discretionary trusts) can be used to avoid income tax by splitting income with a family member, delaying or avoiding payment of CGT, and by passing on the benefits of investment tax breaks from the trust to its beneficiaries (unlike the tax treatment of companies). Although the intention of the current tax policy is that any income that is not taxed in the hands of beneficiaries is instead taxed in the hands of the trust, this is not consistently applied. In addition, as 'Operation Wickenby' revealed, private trusts are often used to evade tax by making transfers of assets or income more difficult to trace. Private trusts are much more widely used than in the past both for investment and active business purposes. The number of private trusts grew by 50% from 470,000 to 713,000 over the decade to 2012.[24] A major reason for this is their use to avoid income tax.

The Review of Business Taxation (Ralph Review)[25] recommended that private trusts be taxed as companies to improve consistency in the tax treatment of different entities. This would also curb tax avoidance through private trusts by imposing a 30% withholding tax on income received by the trust, by requiring the actual distribution of income not retained in the trust to beneficiaries as shareholders, and by denying them the 'flow through' of tax preferences which applies to trusts (but not companies). On the other hand, it would enable high income earners to exploit the gap between the company tax rate and higher personal tax rates by retaining income in the company, so this weakness in the tax treatment of private companies would have to be resolved.

[23] This rebate is mainly paid as a direct grant, though some claim it as a tax offset. Proposed changes to the rebate are discussed further in Chapter 4.

[24] Australian Taxation Office (2012): *Taxation Statistics*, Commonwealth of Australia. (2012-13), Trusts, table 1. Available: https://data.gov.au/dataset/taxation-statistics-2012-13/resource/79aeec03-7596-47f8-86db-b02ca6496699

[25] Review of Business Taxation (1999): *A Tax System Redesigned: More certain, equitable and durable*. Available: http://www.rbt.treasury.gov.au/

We propose that private trusts (both fixed and discretionary) be taxed as companies, subject to exemptions along the lines recommended in the Ralph Review, including complying superannuation funds and disability trusts.

The use of 'cashbox companies' to avoid personal income tax by retaining income in a private company should be curbed by taxing retained earnings (minus a reinvestment allowance) in private companies at the top marginal tax plus Medicare Levy. This tax treatment would also apply to private trusts taxed as companies under the change proposed above. Where the owner of the private company would ordinarily face a lower personal tax rate than 30%, they could distribute company income to themselves in the form of dividends or higher wages.

Recommendation 7: Tax expenditures should be intensively reviewed each year by the Treasury and Expenditure Review Committee and poorly targeted tax expenditures should be reduced or abolished:

(1) From 1 July 2015 the following tax concessions should be removed or tightened:

- The Private Health Insurance Rebate should be abolished [26]
- 'Grandfathering' arrangements for previous tax concessions for non-superannuation termination payments and unused leave (apart from bone-fide redundancy payments) should be removed.

(2) The Government should identify those tax expenditures that have a similar character to direct expenditures, attribute them to the relevant expenditure Departments, and include them in an annual Expenditure Review process through a process of 'envelope budgeting.'

Saving: $400 million ($500 million in 2017-18)

Recommendation 8: The use of private trusts to avoid personal income tax should be curbed:

From 1 July 2017, private trusts (both discretionary and fixed) should be taxed as companies (consistent with Recommendation 9 below). This would not apply to collective investment vehicles or certain categories of excluded trusts including complying superannuation funds, disability trusts, and trusts established pursuant to court orders.

Saving: $0 ($1,500 million in 2017-18)

[26] The savings in direct expenses arising from this measure are costed in Chapter 5.

Recommendation 9: The use of private companies to avoid personal income tax should be curbed.

From 1 July 2017, income retained in private companies, apart from a reinvestment allowance comprising a fixed proportion of the assets of the company, should be taxed at the top marginal rate of personal income tax plus Medicare Levy.

Saving: $0 ($1,000 million in 2016-17)

1.4 Taxation of charities

The tax treatment of charitable organisations is inequitable and inconsistent. While some charities including 'Public Benevolent Institutions' attract gift deductibility, others with similar public benefits and charitable purposes do not. For example, charities which advocate policies to government to reduce homelessness do not generally have gift deductibility while those that provide services directly to homeless people do. Both serve an important charitable purpose: the provision of shelter for homeless people.

Recommendation 10: Extend DGR recipient status to a wider range of charities

Extend deductible gift recipient status to those charities whose dominant purpose is altruistic and for the public benefit.

Cost: $700 million ($800 million in 2017-18)

2 Increasing participation and reducing poverty for people of working age

2.1 Working age payments

Expenditure on working age payments comprises around 30% of expenditure on government payments. Reliance on these payments has been declining over the last 20 years. Recent policy changes have increased the barriers to people accessing higher pension payments. As a result of changes to eligibility for the Disability Support Pension (DSP), for example, there has been drop in successful claims from 53% in 2011 to 33% in 2014.[27] This has translated to an overall reduction in the number of people receiving the DSP, both in absolute terms and as a proportion of the working age population. The result is that many people facing significant barriers to work, for example due to disability or caring responsibilities, are now forced to rely on the lower $37 per day Newstart Allowance, most for more than a year.

In addition to the changes to the DSP, there have been numerous policy changes over the last decade which have tightened access to payments or reduced working age payment rates including: moving many single parents from pension to allowance payments, the abolition of the Income Support Bonus, and proposals (so far unlegislated) to introduce waiting periods for young people to access benefits, lift the Newstart access age, freeze allowance free areas and abolish the Pensioner Education Supplement. Further cuts would be economically and socially harmful.

Instead, the 2016-17 Budget should deliver a long-overdue increase to the unemployment payment, which is currently well below the poverty line, and begin a process of structural reform of the payments system for people of working age.

Increase allowance payments rates and improve indexation to alleviate poverty

The real value of the unemployment payment has not increased since 1994 when it was increased by $2.95 or 2%.[28] Today, it provides a single person who is out of work with just $37 per day to meet basic living costs, in addition to any housing assistance. Young people looking for work receive even less: $31 per day. Australia's unemployment payment is the lowest unemployment benefit in the OECD.

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[27] The Auditor-General, *Qualifying for the Disability Support Pension,* Commonwealth of Australia 2016.

[28] *Australia's Future Tax System,* Commonwealth of Australia, page 519.

Far from tiding people over during short periods of unemployment as originally intended, 70% of those relying on unemployment payments must do so for more than a year.[29]

Households relying on the Newstart Allowance are at high risk of poverty (55%).[30] Together with people receiving Parenting Payment and DSP, those receiving the Newstart and Youth Allowance consistently rank highly among people experiencing financial hardship and deprivation.[31] In light of this, there is now broad support for an increase to the payment, including most recently from the coalition of union, business and community groups involved in the National Reform Summit.

People relying on allowance payments have been repeatedly excluded from payment increases (e.g. the $32 per week boost to pensions in 2009) and their payments are indexed at a lower rate than pensions (to the Consumer Price Index (CPI) rather than wages). As a result of these payment anomalies, the gap between pensions and allowances is large and growing: currently $172 for Newstart and $218 for the Youth Allowance.

This is problematic for a number of reasons. The Reference Group on Welfare Reform highlighted the need to address the growing gap between allowances and pensions, noting that 'some people in similar circumstances are receiving significantly different treatment' under the current system.[32] The payment gap also discourages many people on pensions such as the DSP from seeking employment, in case they lose the pension and are transferred to the lower payments. Further, it leads to sudden payment losses for some recipients despite there being no change circumstances. For example, many single parents experience a sharp decline in their income once their youngest child turns 8 years and the parent is transferred to Newstart Allowance, despite the fact that the costs of raising a child increase with age. The gap between pensions and allowance also flows through to supplementary payments, which are lower for those on allowances. For example, pensioners receive the Pension Supplement, which replaced a range of other supplements and is currently $32 a week for single pensioners as well as a $7 per week energy supplement, while single people

[29] Department of Social Services (2015) *Labour Market and Related Payments*, October 2015. Available: https://www.dss.gov.au/labour-market-and-related-payments-monthly-profile-publication/labour-market-and-related-payments-october-2015

[30] ACOSS (2014) *Poverty in Australia* Available: http://acoss.org.au/images/uploads/ACOSS_Poverty_in_Australia_2014.pdf

[31] ACOSS (2012) *Missing out: Material deprivation and income support payments.* Available at: http://www.acoss.org.au/wp-content/uploads/2015/06/Missing_Out_2012_ACOSS.pdf

[32] Reference Group on Welfare Reform (2015): *A New System for Better Employment and Social Outcomes*, Report of the Reference Group on Welfare Reform to the Minister for Social Services, February 2015 at 47.

receiving the Newstart Allowance receive only the energy supplement, paid at a lower rate of $4 per week.

Allowance payments are only indexed to CPI whereas pensions are currently indexed to both consumer price movements and Male Total Average Weekly Earnings. Indexation to both consumer prices and wages is essential to ensure that people who rely on income support do not fall behind the living standards of the rest of the community, as is the experience of people on Newstart and other allowances.

The previous government legislated a small increase in allowance payments in the form of an Income Support Bonus, worth the equivalent of $4 a week. This was the first real increase in these payments for 20 years. The Bonus is now to be phased out at the end of this year (2016), an extraordinary decision we call on the Government to either reverse or redirect the expenditure savings to deliver lasting improvements payment adequacy by indexation allowances to movements in wages as well as the CPI.

The Henry Report on the tax transfer system recommended that the single rate of allowance payments be benchmarked to two-thirds of the partnered rate, as was implemented for single pensioners in 2009. This would currently require a $53 per week rise in the single rate of Newstart Allowance, which should also extend to other allowances such as Austudy and Abstudy payments and the Youth Allowance for those aged over 17 years living away from their parents. Payments for sole parents on Newstart Allowance should also increase accordingly.

As the Henry Report noted, there is room to increase these payments without significantly weakening work incentives. A single adult on Newstart Allowance who obtains a fulltime job at the minimum wage would more than double their disposable income.[33] This payment increase would have a substantial and immediate effect on reducing poverty, including among sole parent families affected by payment cuts in 2013 (which would be fully restored for the poorest of those families by a combination of the Newstart Allowance and FTB increases proposed here).

Begin a process of structural reform of the payments system

A number of reviews of social security payments have been undertaken in recent years, including the Harmer Review of pension payments, a Senate inquiry into the adequacy of allowance payments, the Henry Review of the Tax Transfer system and

[33] Based on a current minimum wage of $656.90 per week. See: https://www.fairwork.gov.au/how-we-will-help/templates-and-guides/fact-sheets/minimum-workplace-entitlements/minimum-wages.

most recently the Welfare Reform Reference Group review led by Mr Patrick McClure. These reviews have built a solid evidence base in favour of structural reform of the system and have highlighted the need to address the payment gap as a priority in the reform process.

We urge the government to take steps to achieve a more streamlined and equitable payments system in which payment rates are determined by reference to living costs, rather than capacity to work.

The present division between working age pensions and allowances should be replaced by a base rate payment that is adequate to meet basic minimum living expenses and supplements to meet additional costs faced by substantial minorities of people on income support, including rent payments, the extra costs faced by people with disability and their carers, the extra costs of raising a child alone, and the costs of any job search and training requirements. The base rate payment would be substantially higher than Newstart Allowance. Activity requirements (where appropriate) would continue to be based on each individual's employment capacity, but maximum payment levels would not.

This reform would reduce the most severe poverty. If carefully crafted it could remove inequities in payment levels without leaving any group worse off financially. Importantly, it would smooth transitions from income support to employment and greatly simplify the system because people would no longer have to move from higher to lower payments as they move closer to paid employment.

The Reference Group on Welfare Reform recommended a new intermediate 'tier' of payments be introduced between allowance and pension levels for groups who are not expected to participate fulltime in the paid workforce such as many people with disabilities. This proposal cuts both ways. It is likely that if it were implemented many people who will receive social security in the future would receive increased payments while many others would receive reduced income support – an unacceptable outcome.

While successive welfare reviews have contributed to our stock of knowledge of the circumstances of people who rely on income support, the options for payment reform and the trade-offs involved, they have all been one-off reviews, and repeated recommendations to improve the adequacy of allowance payments have to date been ignored by governments. To achieve more rigour in the setting of payment levels, an independent commission should be established that reports regularly to the Government and Parliament on the adequacy of all social security payments, appropriate relativities between them, and indexation arrangements. The commission would also consider the impact of its recommendation on employment incentives and budgetary costs. We do not currently propose that the Commission set payment levels but that this remain a decision of Government.

Roll back ineffective income management programs

A concerning aspect of the social security system is the recent implementation of income management, which has operated in Australia since 2007 in a number of different locations and forms. Income management quarantines a proportion of a person's social security income to a special cashless account that offers restricted access, so that funds can only be accessed, for example, via a specific card (e.g., the Basics Card), or on approved items or at specific locations. Its objectives have variously been to reduce expenditure on alcohol and gambling, end welfare dependency, foster individual responsibility, or increase an individual's expenditure on priority needs. Beyond some limited success where people have entered into a scheme voluntarily, there is no evidence of widespread or long term benefit from income management. ACOSS considers that income management is poor policy because it is not well targeted, is not cost effective, and has been found to have detrimental effects – including on mental health, people's sense of dignity and removal of financial management responsibility.

The costs of income management vary between $2,000 and $13,000 per person across the various programs and locations. The 2015-16 budget provided an additional $146 million to continue income management for a further two years to the end of the next financial year (2016-17). ACOSS recommends that funds currently allocated to compulsory income management schemes around the country (including New Income Management in the Northern Territory and the Place Based Trials) could be better spent. We recommend the phasing out of current compulsory schemes over a 12 month period. Where the individuals and communities affected seek to continue some form of income management, they should be replaced by opt-in schemes designed in consultation with the communities, and supported by other necessary interventions and supports, such as drug and alcohol counselling, financial counselling and employment pathway planning.

Recommendation 11: Increase Allowance payments for single people by $53 per week

(1) Allowance payments for single people (other than those on youth and student payments) should be increased by $53 per week and benchmarked to 66.3% of the combined married couple rate of allowances (a higher rate in the case of

sole parents) as is the case for pension payments. This applies to people on Newstart Allowance, Widow Allowance, Sickness Allowance, Special Benefit and Crisis Payment.

(2) Allowance payments for single people on youth and student payments (Austudy Payment, Abstudy Payment and Youth Allowance) who are either over 24 years of age or 18-24 years and living away from the parental home should also be increased by $53 per week and benchmarking of those payments to 66.3% of the married rate should be phased in.

Cost: $1400 million ($1,600 million in 2017-2018)

Recommendation 12: Index Allowance payments annually to movements in earnings

From July 2016, allowance payments for people aged 17 to Age Pension age, and those over pension age not eligible for an Age or Veteran's Pension, should be indexed annually to movements in wages as well as to movements in prices.

Cost: $60 million ($100 million in 2016-17)

Recommendation 13: Establish a social security commission to advise the Government and Parliament on a regular basis on the adequacy of social security payments

A social security commission should be established as a statutory authority to advise the Government and Parliament on a regular basis on the financial needs of people relying on social security payments, appropriate relativities between them, and the budgetary costs and implications for employment incentives of policy options to improve payment adequacy.

Cost: $5 million ($7 million in 2017-18)

2.2 Employment services

At 5.8% in December 2015, the unemployment rate remains high. While the total number of people who are unemployed is low by OECD standards, 70% of people receiving the unemployment payment in Australia are unemployed long term (over 12 months) and many face major barriers to work. Once people are unemployed long term, their future job prospects progressively diminish. As a result, even a temporary weakness in the labour market can have long lasting and harsh economic and social impacts. While the impacts of employment assistance on an individual's job prospects are typically modest, even a ten percentage point improvement over the short to medium term can, if sustained, substantially reduce long term unemployment. This leads to savings in income support, higher tax revenues, and reduced needs for services such as health care as people who would otherwise be excluded from the labour market find employment. Reducing prolonged unemployment is the most important task of our employment services system and should be a core focus of Government investment and policy at this point in our economic recovery.

The Government recently reformed the mainstream employment services system, replacing the previous Job Services Australia with the new Job Active system. Many of the changes introduced are welcome including a greater emphasis on payment for employment outcomes and less administrative burden for providers. The key weakness of the new system is the lack of flexible investment to help people who are experiencing or who are at risk of long term unemployment overcome barriers to employment. Under Job Active, providers receive annual service fees of $510 per annum (or $638 per annum for with regional loading) to assist the most disadvantaged people (those in Stream C) and a one-off up-front 'Employment Fund' credit of $1200 to invest in work experience and training. Unlike the previous system, this fund is not replenished on an annual basis once an individual becomes unemployed long term, except to fund very specific investments such as Work for the Dole and wage subsidies.

In this sense, the greater flexibility of the new system is illusory because flexibility and innovation require investment – and not only in forms of assistance determined in advance by government. While higher outcome payments give providers more scope (and incentive) to invest in people unemployed long term, a typical outcome payment for an individual unemployed for 12 months in Stream 'C' who remains in employment for 6 months is just $5500. If an effective work experience, training or other program improves such an individual's job prospects by 10%, then a provider who invests more an average of $550 in a long term unemployed person would not benefit financially from their investment. The likely outcome of the new model is that people unemployed long term, and those at risk of it, continue to receive employment assistance that is neither specifically tailored to their individual needs nor adequately funded.

This is exacerbated by the requirement that most unemployed people participate in a single program, Work for the Dole, for six months of every year. Participation in work for benefits schemes has little or no impact on people's employment prospects. Data released in June 2014 shows that only 19% of participants in Work for the Dole were employed three months later.[34] An evaluation of the United Kingdom's equivalent of Work for the Dole, Mandatory Work Activity, found that participation in that program had no statistically significant effect on employment.[35] The main drawback of work for benefits schemes is that the work experience participants receive is usually well removed from paid employment opportunities. If it is regular productive employment, then the participants should be paid the legal wage. To invest in this program on a large scale is therefore an inefficient use of public resources. Further, it is not reasonable to require people to undertake a program that will not improve their job prospects, especially where it involves working for less than the minimum wage – as will be the case with the 'fulltime' variant.

From 1 July 2015 Work for the Dole requirements for people (mostly Aboriginal and Torres Strait Islander people) living in remote areas have been expanded, at an additional cost of $95 million over 4 years and with a further $1.5 billion redirected from other purposes. The Community Development Program requires all adults between 18 and 49 who are receiving income support to participate in Work for the Dole 5 days a week for a total of 25 hours. This reduces the flexibility available to job service providers to assist people with other support, including targeted training and work experience linked to real employment outcomes. Funds currently allocated to Work for the Dole in remote communities should be allocated to a flexible and locally driven Aboriginal and Torres Strait Islander community development employment program which accommodates the diverse training and job search needs of individual job seekers and recognises differences between communities.

If the resources devoted to Work for the Dole – including establishment fees ($64,000 one-off payment), service fees ($380,000 per annum); and the placement fees ($220 per placement) paid to Work for the Dole Coordinators, along with the $1000 to $3500 placement fees paid to JobActive providers - were instead made available to providers to invest in substantial help such as work experience and training providers how to best meets the needs of each individual, employment assistance would be more cost effective.

In contrast to Work for the Dole, programs which connect unemployed people with regular jobs are relatively effective. The Wage Connect wage subsidy scheme has achieved promising results, with 47% of the 8084 participants who completed the program's 26 week job placement by May 2013 retaining their positions after the subsidy ended. The scheme, which provides a subsidy roughly equal to Newstart

[34] DEEWR (2014): *Labour market assistance outcomes, June 2014.*
[35] Feargal McGuinness, House of Commons Library (2014): *Work Experience Schemes,* 27 June 2014.

Allowance to employers to offer paid work experience to very long term unemployed people gives people valuable experience in a 'real job' and the employer an opportunity to test their ability on the job. We therefore welcome the Government's amendments to the wage subsidies program in the 2015-16 budget to merge the multiple programs targeting different groups of people into a single program. It is important that rates of access to the program are monitored to ensure that it is offered to all groups who would benefit from it.

To increase the flexibility of employment assistance for people who are disadvantaged in the labour market, restrictions on access to vocational and other training should be removed. If training is restricted to preparation for a specific job, then opportunities for many people whose skills are narrow or out of date to improve their employability would be arbitrarily restricted. Governments have invested for many years in vocational education and training and basic education because these qualifications and skills improve people's career prospects and life chances. People who are unemployed and low-skilled should not be denied these opportunities. Instead, training should be better linked to employment by strengthening the role for employers in the job services system.

A close working relationship between employment services providers, training organisations and employers is essential to improve the employment prospects of people disadvantaged in the labour market. As with the previous Job Services System, Job Active continues to throw up a number of hurdles to such cooperation. These include competition among individual providers (which means that employers are often approached by many different providers when they would prefer to establish a lasting relationship with one), the limited resources available to providers to invest in the work required to establish these relationships in the first place (for which they cannot use Employment Fund credits), and a reward structure that emphasises quick outcomes. In collaboration with the Business Council of Australia and the Australian Council of Trade Unions, ACOSS has identified these barriers to a partnership approach to employment services, and advanced a set of recommendations to address them including: national and regional employment brokers, the establishment of local networks or boards of employers, training and employment service providers, rewards for employment outcomes lasting one year, and allowing providers to use Employment Fund resources to finance the preparatory work required to establish formal partnerships with employers.[36]

[36] ACOSS, Business Council of Australia and Australian Council of Trade Unions, *Partnerships to secure jobs for disadvantaged jobseekers*

Recommendation 14: Strengthen flexible investment for people unemployed long term within the employment services system by redirecting resources to the Employment Fund and easing restrictions on the purposes for which they can be used.

1) Funds earmarked for Work for the Dole in the Job Active System (including for Work for the Dole Coordinators) should be reallocated into the Employment Fund to assist individuals who are unemployed long term with work experience, training and other assistance that improves their job prospects. (Saving =$150 million in 2016-17, $150 million in 2017-18).
2) The Job Commitment Bonus program should be abolished and the savings diverted to the Employment Fund. (Saving = $70 million in 2016-17, $70 million in 2016-17)
3) Credits should be made to the Employment Fund in respect of each jobseeker at the commencement of 12 months of long term unemployment, equivalent to those made at the commencement of the unemployment spell. (Cost: $300 million in 2016-17, $350 million in 2017-18)
4) Employment Fund credits should be available for training whether or not this is linked to a specific job, and for the purpose of establishing 'demand-led' schemes, that is, a formal agreement with an employer to supply them with workers drawn from people who are either unemployed long term or classified within Streams B or C, and to mentor and train those workers for positions with the employer.
5) The Work for the Dole Supplement ($10.40 per week) should be indexed annually to movements in the CPI. Work for the Dole participants should not be required to work for less than an appropriate legal wage beyond the 4 week limit[37] that currently applies to unpaid work experience placements.

Cost: $80 million ($130 million in 2017-18)

[37] See Australian Government, *Guide to Social Security Law,* Version 1.208. Available at: http://guides.dss.gov.au/guide-social-security-law/3/2/9/120/

3 Reducing child poverty: family payments reform

The core purpose of Australia's family payment system is to protect against child poverty, by supplementing the incomes of parents on low or modest incomes. It is intended to cover the extra costs of children (e.g. food, housing, clothing) but not the additional costs of childcare. The current system was established by the Hawke Government and strongly supported throughout the Howard Government era.

The Federal Government proposed changes to the family payment system in the 2014-15 Budget but was unable to secure the passage of legislation through the Parliament. It argued that the changes, which would have reduced payments to many families, were necessary to pay for the additional costs of the proposed new childcare package (see Chapter 6). With support from the Opposition, legislation was passed in on 30 November 2015 to limit FTB Part B to couple families with children under 12 years delivering savings of $525 million over the forward estimates. This will take effect on 1 July 2016. Other aspects of the Government's reform package are still before the Parliament and include:

- Rapidly phasing out end of year FTB Part A and B supplements (currently $726.35 per child for Part A and $354.05 per family for Part B) by reducing them in two steps over two years (between 2016-2018). This would deliver savings of $4 billion over the forward estimates.
- Replacing the current rate of FTB Part B for single parents under 60 years with older children (between 12 and 16 years) with a lower payment (of $1000.10, down from $2737.50 per annum) and increase Part B for families with a youngest child under 1 year by $1000.10 per annum. The combined effect of these changes is a saving of $781 million over the forward estimates. This will leave a gap for children between 16-18 years, previously covered by Part B if at school and not receiving Youth Allowance.
- Increasing FTB Part A by $5 per week for each child up to age 19 years, which would cost an additional $584.2 million over the forward estimates.

The unlegislated changes would deliver savings to Government of $4.26 billion over the forward estimates, and result in severe cuts to payments for low income families.

While we believe the legislated changes to Part B for couples with older children were justified given the purpose of Part B (to support one parent to stay home to care for a child), our support was conditional upon the reinvestment of savings to improve living standards for low income families.

The remaining unlegislated reforms do not have a legitimate policy objective. They will affect those on the lowest incomes the most, including single parent and low income couple households. ACOSS has long advocated for reform of the family payments system but is deeply concerned that the proposed reforms will cause serious financial harm to many low income and vulnerable families, including single parent families who have already experienced a number of cuts to payments in the last decade and are at high risk of poverty.

Analysis of the changes to family payments proposed shows that, when all of the changes have come into effect in 2018:

- A sole parent (under 60) with one child over 13 years will lose roughly $2500 per year and a sole parent with two children will lose roughly $3000 per year ($48 per week and $58 per week respectively);[38]
- A low income, single income couple family with one child over 13 will lose $3500 and with two children will lose $4000 per year ($67 per week and $77 per week respectively);[39]
- Most families with children under 13 will be worse off due to the loss of supplements. The Part A supplement is $730 per year per child and will be partly offset by the Part A increase of $262 per annum (resulting in a loss of $468). The Part B supplement is $354 per family. A dual income family with one primary school aged child will be $468 a week or $9 a week worse off. A single income family with a child under 13 years will be $822 a year worse off, or $16 a week.

It is estimated that 136,000 single parents with older children will be adversely affected by the changes to Part B alone[40], and 76,000 couple families will lose the Part B payment entirely when the changes come into effect, some of who are already on very low incomes.[41] The numbers affected and the extent of the income losses mean that the changes are likely to lead to an increase in child poverty, noting child poverty is already concentrated in single parent families. There are already about 600,000 children living below the poverty line in Australia.

The changes do little to address the major structural flaws in the family payments

[38] See Professor Peter Whiteford, 'Family tax benefit savings trimmed, but families with teenagers hit hardest', *The Conversation,* 22 October 2015 at: https://theconversation.com/family-tax-benefit-savings-trimmed-but-families-with-teenagers-hit-hardest-49496.

[39] Ibid.

[40] Evidence provided by the Department of Social Services to Senate Estimates. Note that the small minority of single parents over 60 will now be exempted from this change. Social Services transcript available at: http://www.aph.gov.au/Parliamentary_Business/Senate_Estimates/clacctte/estimates/sup1516/index.

[41] Ibid.

system. They will mean that assistance will decrease as children get older, despite children becoming more expensive. They will do nothing to arrest the decline in the value of the payments by reference to community living standards, resulting from the decision by the previous Labor Government to reduce indexation to prices only (not wages). The small boost to Part A ($5 a week) will not offset the losses resulting from the withdrawal of the end of year supplements and the cuts to Part B. ACOSS is also concerned that the IT interface between the Department of Social Services and the Australian Tax Office is not yet advanced enough to prevent over and underpayments, which end of year supplements were designed to address. We advocate for a much more gradual withdrawal of the supplements to begin only once the IT system is up to the task and the adequacy of payments levels have been addressed (including to Newstart, upon which the lowest income families rely, and family payments themselves, including improving indexation. See details below).

3.1 A fairer reform agenda

ACOSS supports the need for reform of the family payments system to achieve the following objectives:

1. To reduce child poverty in Australia and ensure all children have an acceptable standard of living;
2. To provide a stable and adequate foundation for the family payment system into the future, by benchmarking payments to the costs of children as they grow older, and indexing them to movements in community living standards not just to consumer prices;
3. To encourage paid workforce participation for those who have capacity to work by removing barriers or disincentives.

While some aspects of the family payments system work well, other parts of the system are poorly designed, especially:

- The steady decline in the value of maximum payments compared with community living standards (and compared with pension rates for adults), since indexation was reduced from linking to wage movements down to CPI in 2009 (Part A and B);
- The lack of a clear rationale for the maximum rates of payment for children of different ages and from different family types (Part A and B);
- Inadequate support for the costs of older teenage children, which are much more expensive (Part A);

- Inadequate support for single parents with the extra costs of raising a child alone (the Part B payment for single parents, which was originally intended to fulfill this purpose, drastically reduces once the youngest child turns 5 despite increasing household costs).

The following set of recommendations is designed to address these problems, reduce child poverty and support increased workforce participation. This package of changes is intended as an alternative to the cuts proposed currently before the Senate. Our support for savings components of the package (the gradual phasing out of supplements and legislated changes to Part B for couples with older children, already passed is contingent on the adoption of the spending measures proposed below, which would improve the adequacy of payments for families on the lowest incomes, including single parent families.

Recommendation 15: Reform family payments to better target assistance and reduce child poverty

The following changes are proposed as a package of reforms.

- **Index family payments to wage movements as well as to CPI:** Restore previous benchmarking of maximum rates of family payments to pension rates, which were based on the age of each child.
- **Introduce a 'middle benchmark' for FTB Part A for children of primary school age and increase rates for older children**[42]: This would increase the FTB Part A rate for families with children over 5 years by $30 per week.
- **Replace FTB Part B for *single parent families* with a Sole Parent Supplement:** The supplement should be set at the level of the current Part B payment for younger child, so that payments to single parent families no longer fall when the youngest child reaches 6 years. This would provide an increase to affected single parent families) of $23 per week.
- **Gradually phase out FTB Part A and B end of year supplements:** Roll supplements into base payment from 1 July 2017 and gradually withdraw.

Cost: $Revenue neutral[43]

[42] Previous benchmarks were 16.6% of the couple pension rate for each child under 13 years and 21.6% for each older child.

[43] This is an estimate only. Detailed modelling is required to assess the budget impact of this proposal.

4 Improving access to affordable housing[44]

High housing costs are the biggest source of financial stress in many households, particularly those on low incomes.

The majority of those in housing stress are in private rental. Nationally, four in five private rental households in the lowest 20% of incomes are in unaffordable housing situations (paying more than 30% of income in rent). Additionally, more than 30% of the second lowest quintile is also experiencing housing stress.[45] Home purchase prices continue to rise nationally. They have been rising faster in our two major cities (Sydney and Melbourne) which, between them, house 40% of the population. Average Australian house prices are approximately 4-5 times the average annual household earnings.[46]

Australia has a shortfall of housing supply, estimated by the most recent reputable assessment as over 500,000 rental dwellings which are both affordable and available to the lowest income households.[47]

One result of these pressures is that many people become, or remain homeless due to a lack of affordable housing. More than 105,000 people were counted as homeless on census night in 2011, an increase from just over 89,000 in 2006.[48] This figure was probably a significant underestimation at the time, and has likely increased since 2011. The Australian Institute of Health and Welfare reported that 255,500 people sought help from specialist homelessness services during 2014-15 with 329 people unable to be assisted each day.[49] Funding to homelessness services is inadequate to meet people's needs.

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[44] This chapter draws on the joint policy paper, *An affordable housing reform agenda: Goals and recommendations for reform*, developed by ACOSS, the Community Housing Federation of Australia (now the Community Housing Industry Association), Homelessness Australia, National Shelter and the National Association of Tenants Organisations published in March 2015, available at: http://www.acoss.org.au/wp-content/uploads/2015/06/Joint_housing_paper_March_2015_final.pdf.

45 Kath Hulse, Margaret Reynolds and Judith Yates (2014): *Changes in the supply of affordable housing in the private rental sector for lower income households, 2006-2011*, AHURI

[46] Ryan Fox and Richard Finlay (2012): *Dwelling prices and household income*, Reserve Bank of Australia Bulletin, December Quarter 2012, available at: http://www.rba.gov.au/publications/bulletin/2012/dec/pdf/bu-1212-2.pdf.

[47] National Housing Supply Council (2013): *State of Supply Report* 2012. The actual figure is 539,000. The figure of 539,000 is arrived at as follows: In 2009-10 there were 857,000 renter households in the bottom 40% of the income distribution, and 1,256,000 dwellings rented at an affordable price for these households. However, 937,000 of these dwellings were rented by households in higher income groups, leaving only 319,000 available for rent by low income households – a shortfall of 539,000.

[48] Australian Bureau of Statistics (2011): *Estimating Homelessness 2011,* p5

[49] Australian Institute of Health and Welfare (2015): *Specialist Homelessness Services 2014-15,* available at: http://www.aihw.gov.au/homelessness/specialist-homelessness-services-2014-15/.

At the time of writing, reviews of federalism and tax reform are underway and an affordable housing working group, involving the Departments of Social Services and Treasury, as well as various state governments has just been announced. It is understood that these processes will inform future Commonwealth-State funding and service delivery arrangements.

ACOSS advocates for the development of a National Affordable Housing Strategy which is underpinned by specific targets. The absence of any national policy about one of the most important issues affecting the community, and the economy is dereliction in political responsibility. The proposed National Strategy should include:

- reform of housing taxation;
- direct investment in the growth of affordable housing stock and incentives for private sector and institutional investment in affordable housing;
- an increase in financial support to low income renters; and
- sustained and adequate support for homelessness services.

The Commonwealth has significant scope to influence the direction of housing reforms through conditions, including through Council of Australian Governments (COAG) negotiations and conditions of national partnership agreements. There is a dire need for a national effort to improve rental standards and tenancy regulation across the country.

4.1 Set affordable housing targets

In order to drive an affordable housing reform agenda, it is recommended that the Federal Government adopt clear targets to increase the supply of affordable housing and reduce homelessness as follows:

- Halve homelessness by 2020 (to 50,000 people experiencing homelessness on any given night and 125,000 persons requiring specialist homelessness services each year);
- Halve the shortfall in housing supply available and affordable to the bottom 40% of household incomes by 2025; and
- Meet the shortfall in housing supply available and affordable to the bottom 40% of household by 2035, thereby ending homelessness caused by lack of housing.

At least 50% of new affordable housing stock should be allocated for those in the bottom 20% of household incomes. Affordable new housing stock should meet accessibility and energy efficiency standards.

4.2 Improve the adequacy of existing housing and homelessness funding agreements

Housing programs are currently funded through the National Affordable Housing Agreement (NAHA) and related Special Purpose and National Partnership payments. The National Special Purpose Payment (SPP) (which delivers funded agreed under the NAHA) is the major funding mechanism for affordable housing programs. The NAHA funding includes funding for homelessness services (estimated at approximately $250 million) with the balance spent on housing. The agreement is ongoing, with $1.3 billion allocated in 2016-17.

The future of the NAHA or replacement national agreement is likely to be determined by the current review of the federation. A future agreement must ensure significantly improved transparency and accountability, with more stringent reporting requirements about outcomes. With the abolition of the COAG Reform Council, there are unresolved questions about how monitoring of the agreement and its outcomes will be conducted. While the development of a future agreement may take some time, steps must be taken in the interim to improve accountability under current funding arrangements.

Funding under the SPP is currently indexed to a growth factor of 1.5% in 2016-17.[50] We recommend that a future agreement ensure a more appropriate basis for indexation, informed by the application of funds under the agreement, by reference to relevant cost drivers (e.g. the building construction index, house price index, wage price index). As an interim measure, and in light of the long term erosion of affordable housing funding, we recommend indexation to CPI or wage price indexation, whichever is higher.

Funding for Aboriginal and Torres Strait Islander housing is currently provided under the National Partnership Agreement for Remote Indigenous Housing, a 10 year agreement due to expire in 2018. The Agreement was designed to reduce overcrowding, increase housing supply, improve the condition of existing housing and improve the management of rental housing. Given the persistent housing affordability and overcrowding challenges experienced by Aboriginal and Torres Strait Islander communities, we urge the Commonwealth, States and the Northern Territory to negotiate adequate and sustainable funding arrangements extending beyond 2018 for Aboriginal and Torres Strait Islander housing. This should extend beyond remote

[50] Commonwealth of Australia (2015): *Budget 2015-16: Budget Paper No. 3* at: http://www.budget.gov.au/2015-16/content/bp3/html/bp3_03_part_2f.htm. The growth factor is the wage cost index 1, comprising a safety net wage adjustment weighted by 75 per cent and the all groups Consumer Price Index weighted by 25 per cent.

communities, recognising the importance of Aboriginal community controlled housing in regional and urbans areas. Governments should provide certainty for affected communities well in advance of the expiry of the current agreement.

4.3 Establish an Affordable Housing Growth Fund

To meet shortfalls identified by the National Housing Supply Council of at least 500,000 properties available and affordable to the bottom 40%[51] will require an investment mix over 20 years of more than $150 billion. Governments cannot be expected to meet that target alone but must develop incentives to attract it from institutional and private sources.

The Government should establish an Affordable Housing Growth Fund to increase the supply of affordable housing through government investment. The fund should be strictly designated for expanding the stock of affordable housing by providing direct capital funding to State and Territory Governments. Program guidelines should enable housing providers to draw on a range of affordable housing programs to deliver maximum affordability and provide mixed tenure developments. Funding in the first year should be delivered through a revived Social Housing Initiative National Partnership Payment to the states and territories for capital funding of social housing stock, until the current federation review and future funding arrangements are determined.

4.4 Create a new affordable rental private investment scheme

The Federal Government has a vital role to play in unlocking private finance in affordable rental housing at scale through the establishment of a national incentive and finance scheme.

With the discontinuation of the National Rental Affordability Scheme in the 2014-15 budget, there is a significant gap in current policy and funding arrangements. State and Territory Governments are unlikely to be able to achieve the scale required without support from the Federal Government. For example, it is reported the WA Government has taken market soundings on the potential for launching a successful housing bond initiative (or similar mechanism) that indicate the need for a

51 National Housing Supply Council, Op.Cit.

national scheme to meet investor requirements for scale, and regularity and diversity of investment opportunities. Schemes should be designed to enable investors to use a combination of different incentives to maximise growth in affordable housing stock.

Housing supply bonds have been successful overseas in financing affordable housing and could play an important role in attracting new forms of private investment at scale in Australia. The model proposed by the Australian Housing and Urban Research Institute would involve a combination of government funding and private bond finance indirectly subsidised through tax incentives and government guarantees.[52] The costs of establishing such a scheme here have been estimated at $25 million in the first year ($145 million over four years), which could raise approximately $2 billion in bonds and generate more than 7200 new dwellings, in addition to the costs of setting up a housing finance intermediary. While making a long term commitment, it may be desirable to stage the development of such a model, with the establishment of the financial intermediary and a modest bond issue, backed by a guarantee, used initially to promote market responses.

The newly established affordable housing working group should engage with experts to develop the financial architecture to attract institutional investment in affordable private rental stock at scale, as part of a broader national affordable housing strategy.

4.5 Reform housing taxation

Tax concessions for housing purposes are, at least in theory, designed to improve housing affordability. In practice they often have the opposite effect, inflating home prices and rents by encouraging over-investment in existing housing stock.

The tax benefits of 'negative gearing' are heavily skewed, providing ten and a half times the benefits to the top 20% of households (around $3,800 a year) than they do to the lowest 20% (around $364 a year).[53] Moreover, over 90% of investment in negatively geared housing stock applies to existing properties, thereby inflating housing costs and fuelling speculative booms in the housing market. This tax concession also skews investment in housing towards individual investors (rather than institutions) and towards investments yielding capital gains (rather than a stable rental income stream).

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[52] AHURI (2014): *How might bond finance expand affordable housing in Australia?*, Issue 173, June 2014.
[53] Yates, J. (2009) *Tax expenditures and housing* AHURI, Melbourne.

Deductions for expenses relating to passive investment in housing, shares, collectables and similar assets purchased after 1 January 2017 should be quarantined to offset income received from those assets, including capital gains realised on their subsequent sale. This is a first step to improving housing market outcomes and reducing the fiscal and social cost of this tax break. The proposed policy change would have a gradual impact on housing investment, as it would not apply to assets purchased before budget night 2016.

As discussed in the tax chapter, part of the revenue savings from this change should be used to introduce a more effective incentive for new investment in dwelling construction for rent. This investment incentive would be paid a lower rate (in proportion to construction costs) for any new construction of a rental dwelling up to a certain cost (to exclude luxury dwellings) and at a higher rate for new 'affordable' rental dwellings, defined as housing where rents are held at least 20% below market values for up to ten years. Both incentives would apply for up to ten years following construction. The lower investment allowance would be paid as an annual tax offset while the higher one could be paid either in that form or as a direct payment to the investor. Unlike 'negative gearing' concessions, these incentives would be available to institutional investors as well as individuals, noting that the form of the incentive would need to be tailored to meet the needs of institutional investors. They would apply regardless of the number of investment dwellings constructed in a given year.

In this way the purpose of rental investment incentives would shift decisively from assisting investors to avoid income tax by speculating in existing real property towards directly encouraging new investment in affordable rental housing.

4.6 Increase financial assistance to low income renters

Commonwealth Rent Assistance (CRA) provides important assistance to low income residents of private housing but has failed to keep pace with steep rental inflation, leaving many struggling to cope with high private rental costs. The Reference Group on Welfare Reform recommended that the levels and indexation of CRA be reviewed to 'ensure it appropriately reflects the costs of rental housing to tenants'. Such a review should be undertaken in 2016 as a matter of high priority. In the meantime, the maximum rate of CRA should be increased by 30% to provide immediate relief to renters on low incomes.

The National Commission of Audit (NCOA) report and the Reference Group on Welfare Reform's final report both flagged potential reform of CRA to extend eligibility to public housing tenants and reform rent setting policies. The NCOA indicated support for the replacement of direct Commonwealth Government investment in housing (including via the NAHA and National Rental Affordability Scheme (NRAS)) with expanded eligibility for CRA. While consideration should be given to reform of CRA it should not be seen as a substitute for Commonwealth investment in the growth of affordable housing stock, but as a complement to supply side investment.

In projecting future expenditure on CRA, the Commonwealth should also take account of the impacts of public housing transfers, with governments having agreed on a target of 35% of social housing to be controlled by community housing providers (CHPs). If this target is met in the next 4 years, it will increase the cost of CRA over the forward estimates by an estimated $500 million.[54] In addition to offering the high quality services for which CHPs are recognised, such transfers will enable them to raise private finance for both modernising retained social housing and, where appropriate, leveraging its land value and redevelopment potential to create additional supply.

4.7 Improve our funding and policy response to homelessness services

Homelessness remains a serious social problem in Australia. Additional investment in homelessness services under the previous Government achieved a reduction in the number of rough sleepers, but with a growth in the number of people living in overcrowded dwellings, overall homelessness figures have remained the same. Further, an increasing number of older people are experiencing homelessness.[55]

Homelessness services in Australia are funded through the NAHA (as noted above, approximately $250 million is allocated to homelessness services) and the National Partnership Agreement on Homelessness (NPAH). The NPAH was extended again in 2015 for a further 2 years to 2017 'while a comprehensive review is undertaken of Commonwealth-State responsibilities'.[56] This was welcome but questions remain about the future adequacy and security of funding. The rollover in 2014 reduced the

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[54] Calculated on the basis of the transfer of a further 80,000 dwellings, using cost estimates in Pawson, H., Milligan, V., Wiesel, I. and Hulse, K. (2013), *Public housing transfers: past, present and prospective,* Final Report no. 215 AHURI Melbourne in Tables 7 and 8.

[55] Council to Homeless Person (2011): *Submission to Inquiry into the opportunities for participation of Victorian seniors.*

[56] The Hon Scott Morrison MP, Media Release – 'Coalition reverses Labor's funding cuts on homelessness with a $230 million commitment prioritizing victims of domestic violence', 23 March 2015. Available: http://www.formerministers.dss.gov.au/15931/coalition-reverses-labors-funding-cuts-on-homelessness-with-230-million-commitment-prioritising-victims-of-domestic-violence/.

quantum of funding by $44 million, by discontinuing funding for capital and research. This reduction was carried over in the last rollover. The reduced amount is not indexed, which means that funding is declining in real terms from year to year.

A future funding agreement should include an emphasis on the prevention of homelessness, including through addressing early life trauma, and adequately fund effective supported housing models and the capital costs of service interventions. Stable, long term funding for research evaluation should also be secured in the negotiation of a future long term agreement to enable the collection of baseline data and ongoing monitoring of impacts. In the interim, the current homelessness agreement should at least be adequately indexed to prevent further erosion of funding.

Recommendation 16: Establish a long term Affordable Housing Growth Fund

An Affordable Housing Growth Fund should be established with a commitment of $750 million in the first year, growing to $10 billion over 10 years.

Cost: $750 million in 2016-17 ($1000 million in 2017-2018)

Recommendation 17: Establish a housing finance intermediary to underpin a future rental investment scheme

The Government should establish the financial architecture to attract institutional investment in affordable private rental stock at scale.

Cost: $20 million ($35 million in 2017-18)

Recommendation 18: Review Commonwealth Rent Assistance and increase the maximum rate of CRA

CRA should be reviewed to ensure that it best meets the needs of people who are on low incomes. As a first step, the maximum rate of CRA should be increased from 1 June 2016 by 30% (approximately $22 per week) for low income households currently receiving the highest rate of CRA.

Cost: $750 million in 2016-17 ($770 million in 2016-17)[57]

Recommendation 19: Index the National Partnership Agreement on Homelessness

That the Commonwealth reinstate capital and research funding under the NPAH and index the Agreement to the CPI or the Wage Price Index, whichever is higher.

Cost: $3 million in 2015-16 ($3 million in 2016-17)[58]

Recommendation 20: Improve the adequacy of NAHA indexation

As an interim measure, until a new national housing agreement is developed, index funding under the National Affordable Housing SPP to a growth factor linked to the CPI, with the relevant proportion which funds staff indexed to wages.

Cost: $13 million 2015-16 ($27 million 2016-17)

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[57] Calculated using Stinmod and indexed to growth in CRA expenditure.
[58] This calculation is based on the funding for 2016-17 indexed to the wage price index at2.75%.

5 Health

The Federal Government, in partnership with states and territories, has a fundamental responsibility to ensure that health services across the continuum are available to the people that need them and that particular at-risk groups in the community are provided with the services they need to live healthy and productive lives. Universal healthcare is the most effective, efficient and equitable way to ensure the delivery of adequate health services to the Australian public.

Health is a driver of expenditure growth for the Commonwealth budget over the next 20 years. Importantly, the projected growth in expenditure in this area is due in part to the costs associated with preventable chronic diseases and population ageing, with consequential increases in health and other services costs (alongside the projected growth in spending on age pensions). This trend is a general one across comparative economies: OECD projections anticipate an increase in average public health and long term care expenditures from 6.2% to at least 8% of GDP from 2010 to 2030.[59]

The other major driver of costs is the Private Health Insurance Rebate (discussed further below).

While public health spending was reduced in many countries after 2009 to consolidate public budgets in the wake of the global financial crisis, it had been rising consistently in proportion to GDP before then and appears to be resuming its upward path in comparative countries.[60] No wealthy OECD country has found the 'magic bullet' to stop the public health share of GDP from rising. Therefore the pressure on the Federal Budget in health should be focused *not* on cutting expenditure, but on a far better distribution of that expenditure, to ensure it achieves value for money in health outcomes and an effective, accessible and affordable health system.

There is no doubt that health care could be provided more cost effectively in Australia. Holding hospitals to account for the costs of procedures would also be likely to reduce the wide disparity in those costs from state to state and from one hospital to the next.[61]

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[59] OECD (2013): 'What Future for Health Spending?', OECD Economics Department Policy Notes, No. 19 June 2013, http://www.oecd.org/economy/health-spending.pdf.

[60] The Economist (2015), 'The pause before fast-forward', Oct 10th, http://www.economist.com/news/finance-and-economics/21672340-new-study-suggests-current-hiatus-spending-will-be-temporary-pause?fsrc=scn/tw/te/pe/ed/thepausebeforefastforward.

[61] Grattan Institute (2014) 'Controlling costly care: a billion-dollar hospital opportunity', http://grattan.edu.au/report/controlling-costly-care-a-billion-dollar-hospital-opportunity/.

But much bigger savings would likely arise from a shift towards greater investment in effective preventive and population health strategies.

5.1 Invest in prevention

Too much of our public health spend is directed towards tertiary or hospital services, with inadequate investment in preventive health initiatives. In essence, we fail to prevent a whole range of conditions, like chronic diseases, that significantly inhibit people's health and wellbeing while also placing an unsustainable burden on our health system. Stronger investment in preventive health care and supporting people to adopt healthier lifestyles would save significant future health care costs.[62] For example, the Victorian Government estimates that savings of over $1 billion a year could be made by better managing chronic illness to avoid hospital visits.

5.2 Redirect existing expenditure including on the Private Health Insurance Rebate towards greater population health outcomes

Current health expenditure should be better directed towards achieving population health outcomes. We propose the redirection of current funding to the Private Health Insurance Rebate and the Extended Medicare Safety Net to public hospitals, community based services and to address existing gaps in the health system.

The Private Health Insurance (PHI) Rebate has failed in its promise to increase private health insurance take-up and take pressure off public hospitals, yet the cost of the rebate is significant within the Federal Budget overall. As the Minister for Health, the Hon. Sussan Ley MP, has acknowledged there is widespread public unhappiness with the value for money people are receiving from their current private health cover.[63] We urge the Government to review the cost of the PHI rebate against the value it achieves both for the Government and for individuals; and to recognise that redistributing the

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[62] For a strong rationale for preventive services, see for example Australian Government (2010) *Taking preventative action: a response to 'Australia: the healthiest country by 2020',* Commonwealth of Australia, Canberra.

[63] Responding to over 40,000 responses to the Government's survey of community attitudes to private health insurance in December, '40,000 Australians have their say on private health', Media Release by the Hon. S. Ley, 5 December 2015, http://www.health.gov.au/internet/ministers/publishing.nsf/Content/health-mediarel-yr2015-ley151205.htm.

expenditure from the PHI rebate could make a significant impact in preventive community based services.

We have similar concerns about the lack of value achieved by the Extended Medicare Safety Net (EMSN). Given the risk of increasing out-of-pocket costs for healthcare consumers, particularly those who are economically disadvantaged, it may seem counter-productive to be arguing to abolish a safety net. However this safety net does not appear to have assisted in reducing out-of-pocket costs for consumers at all, and may in fact have increased the costs of particular medical procedures.[64]

An independent review of the EMSN found it accounted for 3% of total Medicare spending, but that EMSN expenditure was growing at more than twice the rate of total Medicare spending.[65] At the same time, while capping of some items under the EMSN led to a decline in provider fees for some services (such as out of hospital services with fees charged at the median and above), out-of-pocket costs for other services had increased, including services below the median fee (where out-of-pocket expenses increased by at least $100); and some services appeared to have returned to their pre-EMSN levels.[66] Moreover the benefits of EMSN were inequitable: while it did make services more affordable for some (for example people using assisted reproductive technology services and patients with complex conditions such as cancer), it had little impact on affordability of services for those living in more remote or in lower socioeconomic areas.

5.3 Support transparent, accountable universal healthcare

ACOSS continues to argue strongly for universal coverage of essential health services for the whole community; and for measures to improve the accessibility of those services for people and communities that are currently poorly served. As well as being more effective in reducing the health burden of the country, this approach enables the

[64] Introduced by the Australian Government in 2004 to provide financial relief for families and singles who incur high health-related out of pocket (OOP) costs, the EMSN provides benefits in addition to the standard Medicare rebate for Medicare services provided out of hospital to those who qualify. Families and singles qualify for EMSN benefits once they have accumulated a given threshold in OOP costs for out of hospital services during the calendar year. After the threshold is reached, the EMSN pays 80% of all OOP costs for out of hospital Medicare-related services for the remainder of the calendar year (CHERE 2011).

[65] CHERE (2011) *Extended Medicare Safety Net Review of Capping Arrangements*, University of Technology Sydney, http://www.health.gov.au/internet/main/publishing.nsf/Content/2011_Review_Extended_Medicare_Safety_Net/$File/Final%20Report%20-%20Review%20of%20EMSN%20benefit%20capping%20June%202011.pdf.

[66] *Ibid.*

health system to respond to the needs of the community and works to eliminate the current social gradient of health. ACOSS believes that a significant proportion of essential health services should continue to be delivered through Medicare.

Funding arrangements between the states and territories should:

- reflect appropriate indexing;
- be based on evidence and agreement on adequacy of funding; and
- focus on performance and improvement of health outcomes across the community.

Health funding should also support the core principles of transparency and accountability to ensure communities are able to understand and inform the funding and program decisions intended to support them. Government and taxpayer expenditure on health is significant and there needs to be an appropriate level of accountability and transparency within the health system. Healthcare services should be respected as a community asset and vested interests should not be able to access public funds to provide healthcare services without adequate accountability back to Government and community.

5.4 Ensure affordable, timely access to basic oral health

Alongside basic, effective, community based health services, ACOSS has advocated strongly for reform to ensure that low income households have access to affordable dental services. Reforms to improve the national provision of and access to oral health services are particularly urgent at a time when we are seeing high levels of preventable dental decay in children.[67] While we welcomed the reinstatement of the funding from the National Partnership Agreement for adult public dental services in 2015, we are disturbed by the continuing effort to derive (ultimately minimal) savings from a much-needed and poorly funded program. Public dental services are a critical plank in the effort to reduce preventable and persistent health conditions and have a significant impact on people's social and economic wellbeing, as well as their health.

Recommendation 21: Sustain investment in effective preventive health mechanisms.

[67] AIHW (2011) *Dental decay among Australian children,* 3 August http://www.aihw.gov.au/publication-detail/?id=10737419604.

Investment in preventive health programs should be increased through savings derived from ineffective expenditure. Growth should be maintained based on projected growth in population needs and rigorous, population-based evidence about effectiveness in community based services.

Costing: $130 million in 2016-17 ($150 million in 2017-18)

Recommendation 22: Remove the 30% Private Health Insurance Rebate from 1 July 2016.

The rebate has not reduced pressure on public hospitals and should be removed, with approximately half its savings redirected to public hospitals and community based services and to fund preventive and dental health recommendations.

Saving: $3,300 million in 2016-17 (3,400 million in 2017-18)[68]

Recommendation 23: Abolish the Extended Medicare Safety Net

The EMSN should be abolished due to its role in inflating prices, with its savings redirected to public hospitals and community based services.

Saving: $410 million in 2016-17 ($420 million in 2017-18)[69]

Recommendation 24: Increase investment in affordable, accessible dental care for children and adults.

Ensure access to basic, preventive dental care through the public health system for children and adults, funded through the redirection of savings from abolishing the Private Health Insurance Rebate.

Costing: $1,000 million 2016-17 ($1,200 million in 2017-18)

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[68] Commonwealth of Australia (2015) *Budget Paper 1* at 5-23, http://www.budget.gov.au/2015-16/content/bp1/download/Budget_Paper_No_1.pdf.
[69] Estimate based on CHERE 2011, the last published findings from an independent review of EMSN.

6 Education and early childhood services

Evidence shows that a well-educated population is the key to Australia's economic productivity and social wellbeing. Access to high quality early childhood education and care plays a critical role in children's educational outcomes throughout formal schooling, including in areas such as school attendance, completion rates, behavioural outcomes in class and interest and motivation.[70] In addition to providing an important educational foundation for children, access to affordable, flexible care for children strengthens women's workforce participation.

Despite these benefits, significant numbers of children and young people, particularly from low income households and disadvantaged communities, are not currently accessing early childhood education services.

A package of early childhood education and care reforms formed a centrepiece of the 2015-16 budget. The package (as revised in November) will deliver additional investment of $3.2 billion over the forward estimates. It includes the following elements:

- A new streamlined child care subsidy which will replace the Child Care Benefit (CCB), Child Care Rebate (CCR) and JETCCFA from 1 July 2017 which will meet:
    - 85% of the benchmarked costs of care for families under $65,700 per annum;
    - 50% of the benchmarked costs of care for families on incomes of between $170,000 and $250,000 tapering down to 20% of costs for families on more than $340,000 per annum (with a fee cap of $10,000 for those on incomes upwards of $185,000);
- A new requirement that parents participate in at least 4 hours of recognised activity per week to be eligible for more than 12 hours per week of subsidy (down from current eligibility for 24 hours per week without activity requirements). Some exemptions apply (e.g. for grandparent carers);
- The creation of four activity tiers linked to parental activity, with those participating in less than 4 hours per week of approved activity only eligible for subsidised care if deemed to be low income, in which they are eligible for 12 hours of subsidy per week;
- The creation of three programs to provide additional assistance for

[70] Berlinski, S., Galliani, S. and Gertler, P. (2009) 'The effect of pre-primary education on primary school performance'. *Journal of Public Economics*, 93(1-2), 219-234; Queensland Department of Education, Training and Employment (2013) *Evaluation of the Early Years Centre initiative – Summary Report.*

disadvantaged or special needs children, replacing existing programs; and

- The replacement of the current Budget Based Funding program, which provides block funding to Aboriginal children's services (and some other services) with mainstream, user pays models, with limited transitional support for affected services.

ACOSS welcomes increased investment in early childhood education and care, and supports reform to simplify the child care payments system including moving to a single subsidy payment. However, we strongly oppose the linking of child care funding to proposed cuts to family payments. ACOSS recommends that funding for child care investment be secured from general revenue. For ACOSS's alternative proposals for reform of family payments, see Chapter 3.

Revisions to the child care package in November resulted in budget savings of $1.9 billion over the forward estimates compared to the original package. This includes the tightening of income tests, a reduction in the size of the nanny trial and the abolition of the top up assistance for high fee services (together delivering a $400 million saving to Government over the forward estimates), in addition to $500 million saved through a downward revision of program costs[71] and $930.6 million in savings from changes to Family Day Care compliance arrangements. ACOSS believes that these savings should be redirected in the May 2016 Budget to address gaps in the new childcare package as detailed below.

We have been unable to model the budget impacts of the proposed changes outlined below, in part because of the very limited information released by the Government about the distributional impacts of its policy package and the respective costs of various components of the policy. We note that, to date, modelling released by the Government has been limited to cameos only, which have included the interaction with family payment cuts. We urge the Government to release detailed modelling of the distributional impacts of its policy changes, including changes to the activity test and the budget impact of various components of the package.

[71] MYEFO states that this is "largely reflecting a higher than expected proportion of child care fee assistance payments being made in arrears".

6.1 All children should have access to at least 2 days of care per week

Under the current system, families are entitled to a minimum of 24 hours per week of subsidised care and more than 24 hours if they are engaging in at least 15 hours per week of approved activities. Under the proposed new rules, as noted above, families engaging in less than 4 hours of week of approved activity will only eligible for just 12 hours a week of subsidised care, halving their entitlement. This shift to impose more stringent activity requirements is at odds with moves in comparative countries to increase access to free childcare, for all children. For example, the UK Government currently provides access to 2 days free childcare for children aged 3+ years regardless of parental activity, with both major parties pledging to increase access to at least 25 hours per week.

ACOSS recommends that all families should be able to access a minimum of two days of early childhood education and care, regardless of activity level to ensure children in families without paid work have access to sufficient quality care. Longer-term, we recommend that this form one of a number of community service guarantees as part of a broader tax and federation reform agenda, as noted above.

6.2 Beyond a universal base, fee assistance should be effectively targeted

ACOSS broadly supported the Productivity Commission's model for structural reform of the child care system which recommended that families on low incomes receive a higher subsidy (85-90% of benchmarked costs for families under approximately $60,000) with a linear taper down to a universal base subsidy of 20% -30% for higher income families (above $250,000).[72] The Government's revised child care package adopts an 85% subsidy rate or families on less than $65,000 per year, but then adopts a two-step taper: to a 50% subsidy for families on incomes of $170,000-$250,000, then down to 20% for families on more than $340,000 per annum. The Government's package would also increase the fee cap for high income families, from $7500 to $10,000 per annum. The relative generosity at the higher end has increased the overall costs of the package, which the Government is now seeking to pay for through cuts to family payments. It has also made for a more complex system.

[72] The Productivity Commission's Final Report recommended 20% down from 30% in its Draft Report.

ACOSS believes that the level of childcare subsidy should be appropriately targeted to those who struggle with childcare costs, while still providing a universal base payment. We recommend that the maximum subsidy of 85% for families on low and moderate incomes be maintained (under $65,000, as per the Government's proposal) but that the two-step taper be replaced by base rate of 30% for families on $250,000 per annum or above. We also recommend the subsidy cap for higher income families be maintained at its current level ($7500) and indexed[73], rather than increasing it to $10,000 as proposed in the Government's package. Affected families should be able to adjust their subsidy rate to ensure they maintain access to subsidy all year if they are likely to hit the cap.

These changes would ensure that resources are available to address the gaps in the child care system for low income and developmentally vulnerable children.

6.3 Establish an Aboriginal and Torres Strait Islander community based program within the new Child Care Safety Net

The existing Budget Based Funding program is proposed to be abolished under the proposed reforms. The program currently funds 303 services across Australia, most of which are Aboriginal and Torres Strait Islander focused. From 1 July 2017 these services will have to operate on the mainstream, fee-based, Childcare Subsidy. ACOSS is concerned about the viability of this funding model for Aboriginal and Torres Strait Islander services and families. We are also concerned that the reform package fails to deliver investment in the creation of additional Aboriginal and Torres Strait Islander child care services, despite the Productivity Commission report highlighting that an additional 15,000 ECEC places would be needed to close the gap in Aboriginal and Torres Strait Islander children's attendance.[74]

We support the Secretariat of National Aboriginal and Islander Child Care (SNAICC)'s recommendation to establish an Aboriginal and Torres Strait Islander community based program within the new Child Care Safety Net. SNAICC proposes that the program would:

- have an integrated funded formula that provides services with the flexibility to respond to child and family needs where a user pays model is insufficient; and

[73] Indexation of the cap was frozen in 2011 for 3 years. Indexation should be to movements in child care prices.
[74] Productivity Commission, *Childcare and Early Childhood Learning*, Report No. 73, October 2014 at page 525.

- provide top up funding for operational costs to redress services' income gap from the mainstream subsidy and fees based on 3-year applications.

6.4 Ensure that low income families who are not in paid work are, at a minimum, no worse off

Under the proposed new childcare package, additional fee assistance will be available for some parents on income support who are seeking to transition to work through the Additional Child Care Subsidy which will replace the existing JETCCFA program. The impact of this change on very low income families is difficult to determine. We repeat our call for the release of detailed modelling of the distributional impacts of the proposed policy changes and seek assurances from Government that affected low income families will not be worse off as a result of the proposed changes, including single parent families who are beneficiaries of the current scheme.

Recommendation 25: Redirect savings from tightening of income test and caps for higher income households to address improve access for children in low income families

1) Replace the proposed three tiered subsidy with a simpler and more sustainable two tiered model (a linear taper), with a maximum subsidy of 85% for families on less than $65,700 tapering to a base subsidy of 30% for households on more than $250,000 per annum[75].
2) Reduce the subsidy cap for higher income households from $10,000 to $7500 per annum, and resume indexation.
3) Provide a minimum of two full days (20-24 hours) of subsidised early childhood education and care per week for all families, regardless of activity. Activity requirements should apply only to families seeking care for more than two days per week.[76]

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[75] The Productivity Commission estimated the cost of tapering to a base rate of 30% (instead of 20%) at approximately $185 million per annum, compared to its alternative model, but these costs would be offset by the removal of the proposed mid-tier 50% subsidy rate for families on $170,000-$250,000. See Productivity Commission, Childcare an Early Childhood Learning, Inquiry Report Volume 2, No. 73, 2014 at Figure 16.15.
[76] The Productivity Commission estimated the cost of removing the activity test altogether as more than $1 billion per year, while the cost of removing the test for those on Parenting Payment and increasing the minimum weekly entitlement to 20 hours per week was estimated as approximately $250 million per annum. See Productivity Commission, Childcare an Early Childhood Learning, Inquiry Report Volume 2, No. 73, 2014 at Figure 16.15.

4) Establish an Aboriginal and Torres Strait Islander community based program within the new Child Care Safety Net.[77]

Cost: Revenue neutral[78]

[77] Estimated cost of $100 million per annum.

[78] The new system is due to start on 1 July 2017. It is proposed that any additional costs not met by the changes to income tests and subsidy rates would be covered through the redirection of savings committed in MYEFO. Detailed modelling is required to assess the net impact of the changes.

7 Supporting effective and innovative community services

The community services sector plays a vital role in our society and economy, yet has been subjected to savage cuts through the last two Federal Budgets. Community organisations deliver a broad range of services in communities around the country including health and aged care, housing and homelessness, early childhood, disability, legal, financially counselling, alcohol and drug services. These services form the backbone of many communities, and provide essential support to many people who are on low incomes or are otherwise disadvantaged.

7.1 Providing adequate and stable funding streams to support effective services

Like many other social programs and supports, community services have experienced major funding cuts in the last two budgets. The impact of these cuts continues to ricochet across the country almost two years later, with an estimated value of $1.5 billion and rising. Cuts implemented to date or forthcoming include:

- $800 million from Health ('flexible funds' program), affecting community based treatment programs, policy and advocacy capacity (2015 Budget over 4 years).
- $500 million from Aboriginal and Torres Strait Islander programs (Department of Prime Minister and Cabinet, 2014 Budget over 4 years).
- $270 million from Social Services (2014 Budget over 4 years).
- Millions cut across the community legal sector plus a further 30% cut ($12 million) to take effect from 2017.

Key groups experiencing poverty and inequality have been particularly impacted through these funding cuts, including young people, people with disabilities and people experiencing homelessness.

In addition to the devastating impact of the cuts outlined above, the prolonged uncertainty associated with these funding decisions has wrought havoc in critical areas of social infrastructure. Funding cuts were first introduced, then some partially reversed, and still others rolled into new funding allocations and models of delivery. As recently as December 2015 community workers continued to face uncertain employment and job losses as programs ceased and organisations closed. Impacts on people and communities include reduced access to services and increased disadvantage. Particular uncertainty or erosion of capacity in policy advice, representation and advocacy have exacerbated this impact, for example where peak bodies have lost core funding and, in several cases, closed.

Restoration of funds cut in previous budgets would do little at this point for the people who have gone without services in the interim, nor the organisations that have closed and workers that have lost jobs. Moreover, the quantum of past funding has often been arbitrary at best, grossly inadequate at worst. This Federal Budget should make provision for, at a minimum, a restoration of the pre-existing funding levels for community services, commencing from 1 July 2017, in order to fund recommendations arising from a comprehensive mapping of service needs, conducted in open with the community sector and the public.

To inform future funding of community services, the Government should immediately commence work collaboratively with the community to determine together where needs lie and how best to meet them. Following such a mapping process, new investment in the outer years needs to support the full breadth of the community sector's value across service delivery, policy, advocacy and representation by and of people experiencing poverty and inequality. Future service agreements and contracts should include provision for reasonable compensation to providers for the costs imposed by changes in government policy that affect the delivery of the contracted service, for example, changes to eligibility rules, the scope of the service being provided, or reporting requirements, as recommended by the Productivity Commission in its *Report on the contribution of the not-for-profit sector* (rec 8.1).[79] This mapping should incorporate the specific and varied contribution of community service organisations beyond service delivery, including policy advice, representation and advocacy. In addition, we continue to argue for support for institutional capacity for the voices of Aboriginal and Torres Strait Islander communities to be heard in policy processes and national decision-making.

7.2 Ensuring competition policy reform delivers improved service access and quality

[79] Productivity Commission (2010) *Contribution of the not-for-profit sector*, http://www.pc.gov.au/inquiries/completed/not-for-profit.

Decisions about the future of social services funding will take place in the context of a broader discussion about the role of competition and contestability in human services.

In its response to the Competition Policy Review, the Commonwealth included a commitment to establish an Australian Council for Competition Policy; and a proposed reference to the Productivity Commission (PC) to explore how innovative funding and delivery of human services, reduction of waste and high quality service provision can be applied in practice to the human services sector.[80] Efficiency and effectiveness should be key outcomes of human service delivery, but they must be achieved simultaneously. Efficiencies derived from delivering services that are less effective is no efficiency at all. We must learn from the historic failure of markets to improve efficiency without eroding service effectiveness; and the similar failure of markets to meet the various needs of people affected particularly by poverty and inequality.

Effective policy reform will require strong community and community sector involvement, including but not limited to direct representation of non-profit human service and social policy experts on the Australian Council for Competition Policy and as advisors to any PC reference. Undoubtedly the PC has much to contribute in any new reference. However there are a range of outstanding Commission recommendations whose implementation would fill a key evidence gap in the current reform agenda: for example better mechanisms for measuring effectiveness would enable us to measure the extent to which existing efforts to expand competition or contestability in human services have improved outcomes for people and communities (see for example recommendations 5.1 to 5.4 of PC 2010).[81] We continue to call for the collection of reliable data about impacts and effectiveness, and for access to those data by communities and the organisations that support them, to inform effective delivery of services and to better meet the needs of service clients and consumers.

7.3 Social innovation

Further gains can be made in the effectiveness of services by stimulating social innovation in the community sector. Collaboration remains key here, whether it is through support for building the sector's capacity to respond to contemporary challenges; or through place-based approaches that build capacity for diverse responses to the myriad needs and different contexts across the country. At a time

[80] Australian Government (2015) *Government Response to the Competition Policy Review* at pp 34 and 2 respectively. Available: http://treasury.gov.au/harperreview.
[81] Productivity Commission (2010) *Contribution of the not-for-profit sector* Available: http://www.pc.gov.au/inquiries/completed/not-for-profit.

when the Commonwealth government is calling for innovative leaders across the economy, the community sector's social and economic contribution place it at the forefront of the innovation agenda. Again, this is not new terrain for community organisations and we call for the implementation of a further PC recommendation in this respect:

- All programs (of over $10 million) delivering community services through not-for-profit organisations should set aside a small proportion of the program budget to a program-related social innovation fund (the PC endorsed ACOSS' recommendation of 1% of program funding). The fund should support trials of new approaches to service delivery, including evaluation of their cost-effectiveness (rec 9.5).[82]

Importantly, effective innovation requires the integration of emerging practices into core work: it requires resources not just to trial and experiment, but to implement and sustain good practices identified.

7.4 Support for charities to diversify funding

The Government has a stated agenda to promote philanthropy and support organisations to diversity their funding base, yet the inequitable access to DGR for many charities flies in the face of this objective. For example, small organisations who can struggle to access support from philanthropic and other non-government sources are less likely to have DGR status than others in the sector.[83] The current disparate access also constrains innovation, capacity development and the independence that comes from diverse sources of funding. This recommendation has been supported by a range of reviews over time.[84] For more details, see Chapter 1.

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[82] Productivity Commission (2010) Op.Cit.
[83] ACNC (2015) *Australian Charities Report 2014*, Australian Charities and Not-for-profits Commission, http://www.acnc.gov.au/ACNC/Pblctns/Rpts/CharityReport2014/ACNC/Publications/Reports/CharityReport2014.aspx.
[84] For example PC 2010 (Op.Cit); *Charitable Definitions Inquiry* (2001), http://www.treasury.gov.au/ConsultationsandReviews/Reviews/2001/Charities-Definition-Inquiry; and Not-for-profit sector tax concession working group (2013) *Fairer, simpler and more effective tax concessions for the not-for-profit sector,* http://www.treasury.gov.au/~/media/Treasury/Access%20to%20Information/Disclosure%20Log/2014/1447/Downloads/PDF/NFP%20Sector%20WG%20Final%20Report.ashx

Recommendation 26: Index community services funding to wage movements

Ensure funding for the delivery of community services includes adequate price indexation tied to the Wage Price Index.

Costing: $370 million 2016-17 ($373 million 2017-2018)

Recommendation 27: Provision for restored funding levels to pre-Federal Budget 2014 levels, commencing from 1 July 2017

Provision for minimum anticipated funding required to fund community services to adequate levels, arising from comprehensive mapping of service gaps

Costing: $0 million 2016-17 ($1,840 million 2017-2018)

Recommendation 28: Ensure direct representation of non-profit community services in competition reforms

Any Government-established bodies to explore further competition policy reforms should include representation from community based charitable and non-profit services, including but not limited to the proposed Australian Council for Competition Policy.

Costing: revenue neutral

Recommendation 29: Establish an innovation fund for government-funded community services

All programs delivering community services through not-for-profit organisations should set aside 1% of their program budget to a program-related social innovation fund, supporting trials of new approaches to service delivery, including evaluation of their cost-effectiveness.

Costing: $10 million 2016-17 ($15 million 2017-2018)[85]

[85] This costing is indicative only.

Recommendation 30: Provide core funding for the institutional capacity of Aboriginal and Torres Strait Islander representation in policy making and national decision-making.

Costing: $3 million in 2016-2017) ($3.5 million in 2017-18)[86]

[86] This costing reflects the funding submission of the National Congress of Australia's First Peoples.

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