AI GROUP 2020-21 BUDGET SUBMISSION

The 2020-21 Budget

Executive Summary

The deferred 2020-21 Budget comes at a critical time with the economy certain to have experienced its first recession since the early 1990s and with very high levels of uncertainty hanging over its trajectory over coming months.

For the near-term, measures are clearly required to assist and secure the recovery of activity, investment and employment in the wake of the COVID-19 crisis. This objective needs to be the priority in the 2020-21 Budget.

The Budget also presents an opportunity move forward on measures that will rectify the underlying weaknesses in the economy that were evident prior to the onset of the COVID-19 crisis.

While some of the sluggishness evident prior to February when the COVID pandemic took off were due to drought and bushfires, weak business investment, low growth in wages and business profits outside of the mining sector and poor productivity outcomes over several years, were all signs of these underlying weaknesses.

Our emphasis in this submission is on measures that contribute to both the near-term and longer-term objectives.

As the Treasurer made clear in the Economic and Fiscal Update this July, the budget position has deteriorated sharply as necessary fiscal stimulus measures have lifted government spending and as the slump in activity has undermined revenue collections.

Fortunately, our generally prudent approach to fiscal policy over many years means we are relatively well-equipped not only to manage these increased deficits and the greater levels of debt they imply but also to manage further stimulus in the 2020-21 Budget.

Of course, neither the strong starting point nor the low interest rates on government borrowing are excuses for a relaxation of the rigor with which the spending and taxation measures required to address both the near and longer-term priorities should be assessed. Further, they provide no reason to regard with any less seriousness the interests of future generations in a strong underlying budget position and readily manageable levels of government debt.

Fiscal strength must remain a priority and its restoration will present challenges over coming years, including in relation to the changes that will be required to our pattern of taxation. For the 2020-21 Budget however, it would be premature and detrimental to both the near and longer-term objectives set out above to hold back on well-considered measures that will add to the budget deficit.

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Summary of Recommendations

Measures to Stimulate Demand and the Economy

- Ai Group proposes extending the term of the Coronavirus Supplement and making a further Economic Support Payment along similar lines to the arrangements announced as part of earlier stimulus packages.
- We propose that from 1 January 2021 the $37,000 upper threshold for the 19% tax rate be lifted to $45,000; the rate of tax between $45,000 and $90,000 be reduced from 32.5% to 30%; and the changes to the Low Income Tax Offset (LITO) and the Low and Middle Income Tax Offset (LMITO) currently scheduled to take effect from 2021-22 year also be brought forward to 1 January 2021.
- Ai Group proposes extending to companies with turnover of less than $1 billion the reduction to 25% in the company tax rate that is already scheduled to take effect from 1 July 2021 for businesses with turnover of less than $50 million.
- In relation to stimulus in the form of increased investment in infrastructure and housing, Ai Group's proposes:
    - The federal government work with the states and territories to further accelerate projects already in the pipeline and to add further projects to the pipeline with accelerated approval
    - Assist in addressing any areas of skills shortage by giving priority to skilled migration in key categories where domestic capacity is stretched and sought by the businesses and agencies involved
    - Encouraging the states and territories to take advantage of the expressed willingness of institutional investors to provide long-term patient capital where private ownership of infrastructure and housing assets makes sense.

Measures to Lift Employment, Skills and Employability

Ai Group proposes a suite of measures that can be taken now to assist a more rapid recovery in employment with a particular emphasis on youth unemployment. Many of these measures should be seen as the initial steps in a multi-year transformation of Australia's approach to skills, education and training.

- Broad wage support for commencement of new apprentices and trainees
- Program of new pre-employment initiatives for youth
- Program of skills assessment and adaptive training for displaced workers
- Incentives for companies to invest in training for existing workers
- National program of incentives for cadets in companies
- National program of incentives for interns in companies
- Funded multi-partner industry-training hubs
- Improved funding for vocational education and training

Workplace Relations Measures

- For the period of the JobKeeper Extension, the Government should close the loophole that allows employees to refuse to be nominated or to withdraw their agreement to be nominated as eligible employees.
- Ai Group proposes the Government legislate to ensure that the established meaning of a "casual employee" retain its meaning going forward.

Measures to Build Business Resilience and Innovation

- There is an opportunity to further build on partnerships with industry to develop digital capabilities. Some existing initiatives are working effectively and should continue and be extended where appropriate (examples include Industry Growth Centres, the Innovative Manufacturing and the Entrepreneurs' Programme).

- Other activities that could be further enhanced include raising cyber security awareness, building supply chain resilience and helping businesses (including SMEs) to upgrade their legacy technologies and implementing new technologies – the effectiveness and impact of these can be maximised such as through leveraging industry expertise and trusted advisers (such as industry associations).

- Implementing targeted capability initiatives and accelerating the delivery of government digital services to address this could entail providing targeted training on digital technology use (including cyber awareness) and access to digital technology for different segments of the community, especially for disadvantaged groups.

- Ai Group welcomes the Government's $1.67 billion commitment over ten years to invest in strengthening Australia's security through initiatives designed to improve cyber security. The 2020-21 Budget provides an opportunity to get started on the implementation of these commitments.

- The Government should withdraw the legislative proposal to cut the coverage of the Research & Development Tax Incentive and to remove the spectre of the anomalous application of an intensity-based program.

Measures to Advance Environmental Objectives

- The Australian Government should allocate $500 million over two years for capital grants to rapidly scale up the penetration of existing technologies that are uncommon in the Australian market:
    - Electrification of processes:
        - Heat pumps;
        - Electric induction furnaces; and
    - Energy management systems:
        - Sub metering and data analysis; and
        - Data acquisition system integration;
    - Technology that enables demand response.

- Ai Group supports fresh funding for ARENA in particular of at least $3.3 billion over ten years.

  If ARENA or CEFC are asked to administer or guide further specific recovery investments in the near term, given their relevant expertise, this should involve additional funding.

- Ai Group proposes the Government encourages, funds and coordinates efforts to accelerate adaptation to climate change.

- Waste and circular economy remains an area of critical importance for Australia and government should continue to make funding decisions with this in mind, paying close attention to the outcomes of the current funding initiatives as well as new and emerging opportunities.

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PART 1

The Starting Point

COVID-19

The COVID-19 health crisis is having severe impacts across the globe as infections continue to spread; as countries' health systems struggle to manage new challenges; and as mortality and severe health outcomes continue to rise. The health crisis is impacting severely on the global economy with disruptions to trade; as individuals and governments restrain movement and activities; and as the loss of confidence and incomes flow across national economies.

The deterioration of the economy in 2020

The Australian labour force contracted rapidly in the three months to May falling by 875,000. Official unemployment rose by 227,000. The unemployment rate increased from 5.1 percent to 7.1 percent. The number of people not participating in the workforce lifted sharply by 768,000. In just three months, more than three years' jobs growth was lost with the number of people in employment shrinking to levels last seen in the first half of 2017.

In June and July, the number of employed people rebounded very strongly with a net addition of 343,000 jobs and the number of people not in the labour force retreating by 358,000. The combination of larger numbers looking for work and underlying workforce growth saw the number of people recorded as unemployed rise by 86,000 to 1,009,000 and the unemployment rate climb further to 7.5 per cent.

After the partial rebound over June and July, hours worked were still down 4.7 percent on February levels with broadly similar proportionate falls in hours worked by people in full- and part-time positions. Perhaps unexpectedly, the percentage reduction in hours worked by males over this period was greater than that of females (a 5.0 percent drop in hours worked by males in full-time positions compared with a 4.1 percent fall for females in full-time positions and a 5.5 percent fall in hours worked by males in part-time positions compared with a 4.2 percent fall for females in part-time positions).

In the RBA's May 2020 Statement on Monetary Policy, GDP was expected to contract by 6 percent in the year to the end of June 2020 implying a fall in the June quarter of around 7 percent which well above reduction in hours worked of 8.4 percent in the June quarter (based on the ABS's seasonally adjusted series) and slightly below the Treasury estimate of a 7 percent GDP fall in the quarter.

Undoubtedly the economy would have contracted much more steeply in the absence of monetary stimulus and fiscal measures such as JobKeeper; increases in income support; and business cash flow measures; as well as the range of relief delivered by state and territory governments. Retail sales lifted by 16.9 percent in May which was the month when JobKeeper payments were first made to businesses and lower income employees and by a further 2.7 percent in June. This followed a fall of 17.7 percent in April which more than wound back the leap in retail sales in March as households stockpiled and geared to work from home.

Both the partial rebound of the labour market in June and July and the lift in retail sales in May and June were encouraging signs of an economy ready to embark on a recovery as restrictions were eased. However, the tightening of restrictions on movement and activity and the re-erection of state border barriers associated with the second COVID-19 wave centred in Victoria have severely

impacted approximately 20 percent of the national economy directly and is dampening activity and consumer and business confidence more broadly.

In August, the RBA projected a GDP drop of 6 percent in the year to the end of December 2020, followed by a firm rebound in the first six months of 2021 with year-on-year growth of 4 percent for the year to the end of June 2021 with unemployment stuck at 8.5 percent and reducing gradually from there.

The deterioration of the economy both in Australia and across the world and some of the associated interventions have supressed prices. In the June quarter Australia's Consumer price Index fell 1.9 percent - more than reversing the slight rise of 0.3 percent in the March 2020 quarter. This was the largest quarterly fall in the CPI recorded in an ABS data series that extends back to 1949. The CPI fell 0.3 percent over the twelve months to the end of June 2020 after rising 2.2% over the twelve months to 31 March. Producer prices experienced a comparable fall in the June quarter (although the quarterly data only date from the late 1990s).

The fall in prices, while influenced by one-off factors such as free child care, is of some concern not the least because of its impact on the real value of liabilities and how that might impact on the timing of recovery of consumer and business spending and though that, on broader economic activity.

A further important impact of the COVID-19 crisis is the sharp reduction in net immigration. In recent years net overseas migration has accounted for well over half of Australia's population growth. In 2019 the total population grew by 1.4 percent or by 349,800 people with natural increase of 139,200 and net overseas migration of 210,600 which was slightly below the 10-year average annual level of net overseas migration. In the July Economic and Fiscal Update, the expected rate of population growth was put at 1.2 per cent for 2019-20 and 0.6 percent for 2020-21 with most of the reduction due to the expected drop in net overseas migration. If this expectation is met, total population would grow by just 154,000 in 2020-21.

Fiscal position

With revenues falling sharply and public sector spending rising to ward off a steeper downturn, the budget is anticipated to have worsened by more than $90 billion from the $5 billion surplus predicted in December. The 2020-21 underlying cash deficit was projected to be approximately $190 billion compared with the previous anticipation of a $6 billion surplus. With the extension of JobKeeper, further stimulus measures and the impact of Australia's second COVID-19 wave on revenues, this is very likely to be an underestimate.

The scale of these deficits indicates a fiscal intervention that easily surpasses previous peacetime episodes and they underline the seriousness of the threats to economic activity, employment and taxation revenue imposed by the COVID-19 crisis.

At the time of the July Economic and Fiscal Update, net Commonwealth debt was expected to be $488.2 billion (24.6 per cent of GDP) at 30 June 2020 increasing to $677.1 billion (35.7 per cent of GDP) by 30 June 2021. As noted in the July Economic and Fiscal Update, and reducing the severity of the indebtedness, debt servicing costs are extraordinarily low and expected to remain low for several years.

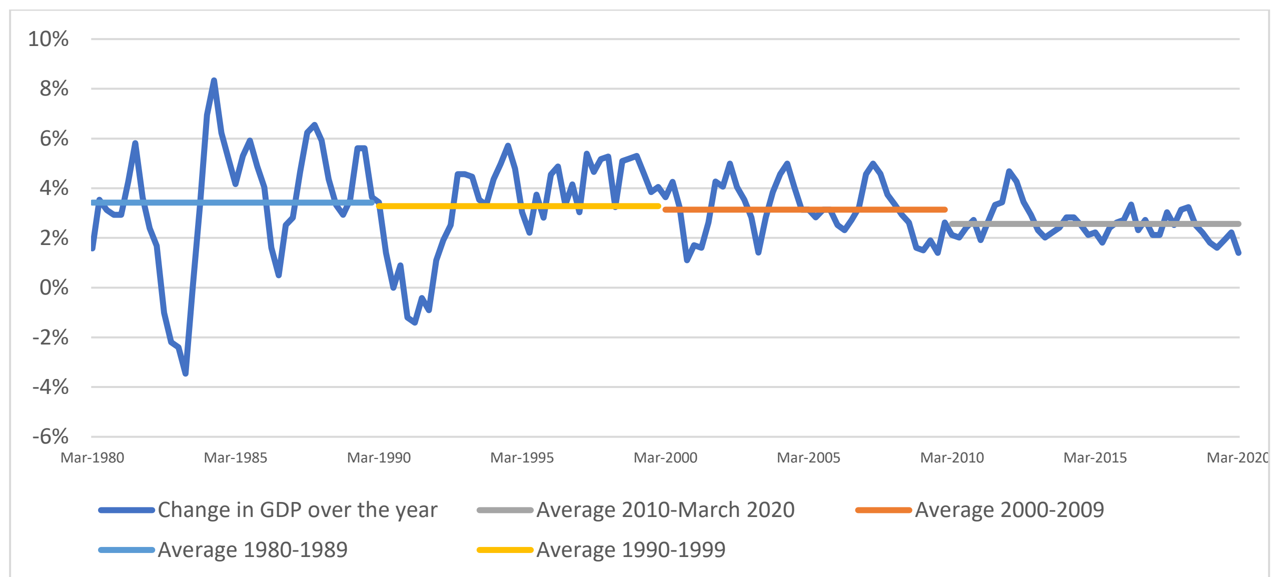
The underlying economy

Even though at the close of 2019, Australia was setting new records for the time since the last recession, the COVID-19 crisis came at a time of underlying weakness in the domestic economy.

Part of the weakness is attributable to widespread drought with the devastating summer bushfires season further detracting from aggregate performance. However, these were far from the full story. Notwithstanding strong employment growth over recent years, incomes growth outside of the financial and mining sectors was tepid; productivity growth had disappointed; residential construction had turned down; and non-mining business investment was weak.

As shown in Chart 1 which looks further back, in the post GFC period GDP growth has been distinctly lower on average than in previous decades notwithstanding the absence, until now, of recession. In contrast to the average annual rate of GDP growth in the 1980s the 1990s, and the opening decade of the current century (averages of 3.4 percent, 3.3 percent and 3.1 percent respectively), the average annual rate of growth between the March quarter of 2010 and the March quarter of 2020 was 2.6 percent.

Chart 1: Annual GDP Growth and Average Annual Growth over each Decade March 1980 - March 2020



Source: ABS

Further, for the entire period since the September quarter of 2018, annual GDP growth has been below the lower average experienced over the period from March 2010 to March 2020. This puts the slowdown over the years prior to the onset of the COVID-19 crisis on a par with the disappointing performance associated with the GFC years.

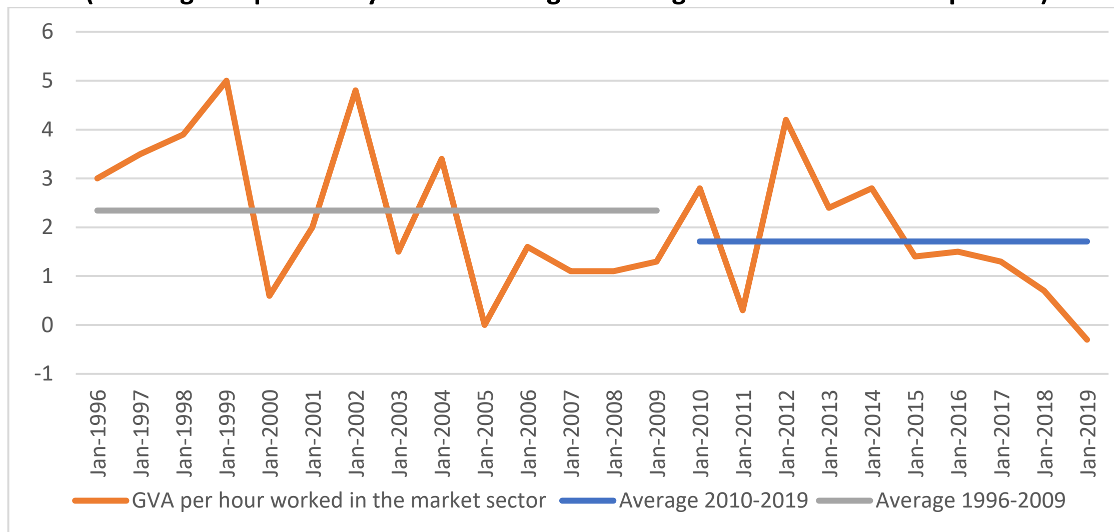
Some of the underperformance is due to the largely uncontrollable forces of population ageing; the disruptions and readjustments associated with the rapid growth in China and other emerging economies; and the extent of technological change – all of which are evident across the developed economies.

That said, Australia's slower growth over the last decade has also occurred while our terms of trade have been very strong and while our exchange rate has remained at relatively competitive levels.

In large part the explanation lies with lower productivity growth. Compared with the average annual growth in labour productivity of 1.6 percent over the three decades from 1980, the average over the

last decade was 1.2 percent for the economy as a whole. During the past five years economy-wide labour productivity growth (GDP per hour worked) has trended lower still. In the market sector labour productivity growth was also lower over the past decade declining from an average of 2.3 percent in the 1980-2009 period to 1.7 percent in the last decade. As shown in Chart 2 it too has trended still lower in the past half-decade.

Chart 2: Productivity: GVA per hours worked in the Market Sector 1996-2020 (% change on previous year and average annual growth over indicated periods)



Source: ABS

On the latest readings the change in labour productivity was at its lowest level in 40 years.

Thus, even as Australia was setting new world records for the longest period of uninterrupted growth and dating from before the traumatic intervention of COVID-19, we were running out of steam and in need of reinvigoration.

PART 2

2020-21 Budget Measures

For the near-term, measures are clearly required to assist and secure the recovery of activity, investment and employment in the wake of the COVID-19 crisis. This objective needs to be the priority in the 2020-21 Budget.

At the same time however, there is a clear need to set our sights on a longer-term agenda centred around lifting productivity.

Our emphasis in this submission is on measures that contribute to both the near-term and longer-term objectives.

Measures to Stimulate Demand and the Economy

Ai Group supports further targeted stimulus to help ameliorate the widespread loss of income, to boost household and business demand and to drive a more rapid recovery of employment and output.

Direct Payments for Low-Income Households and Low- and Middle-Income Households with Children

Ai Group proposes extending the term of the Coronavirus Supplement and making a further Economic Support Payment along similar lines to the arrangements announced as part of earlier stimulus packages.

These measures are targeted to low and middle-income households many of whom do not have enough income tax liabilities to deliver a boost in disposable incomes through the personal income tax system. In determining the amount of payments, careful consideration needs to be given to work incentives noting that the JobKeeper Payment only covers a limited proportion of the total workforce.

JobKeeper Extension

Ai Group supports the extension of JobKeeper and its subsequent broadening in light of the Victorian COVID-19 outbreak and the disruptive impacts on employment and output both in Victoria and in other parts of the country. We also support the proposed dual rate of payment and the reassessment of eligibility for payments for the December 2020 and March 2021 quarters.

Reducing Income Tax to Boost Household Spending

We are currently part-way through a phased reshaping of personal income tax arrangements with further changes due in two more steps: from 1 July 2022 and from 1 July 2024.

To provide an earlier boost to household spending, Ai Group proposes bringing forward to 1 January 2021 some of these changes to rates and thresholds that are currently scheduled. The selected changes seek to deliver proportionally higher benefits to lower to middle-income taxpayers leaving changes to the tax scale at higher income levels for the later years of the phase-in period. The rationale for this is that lower- and middle-income households are more likely to spend a higher proportion of additional disposable income than higher income households.

We propose that from 1 January 2021 the $37,000 upper threshold for the 19% tax rate be lifted to $45,000; the rate of tax between $45,000 and $90,000 be reduced from 32.5% to 30%; and the

changes to the Low Income Tax Offset (LITO) and the Low and Middle Income Tax Offset (LMITO) currently scheduled to take effect from 2021-22 year also be brought forward to 1 January 2021.

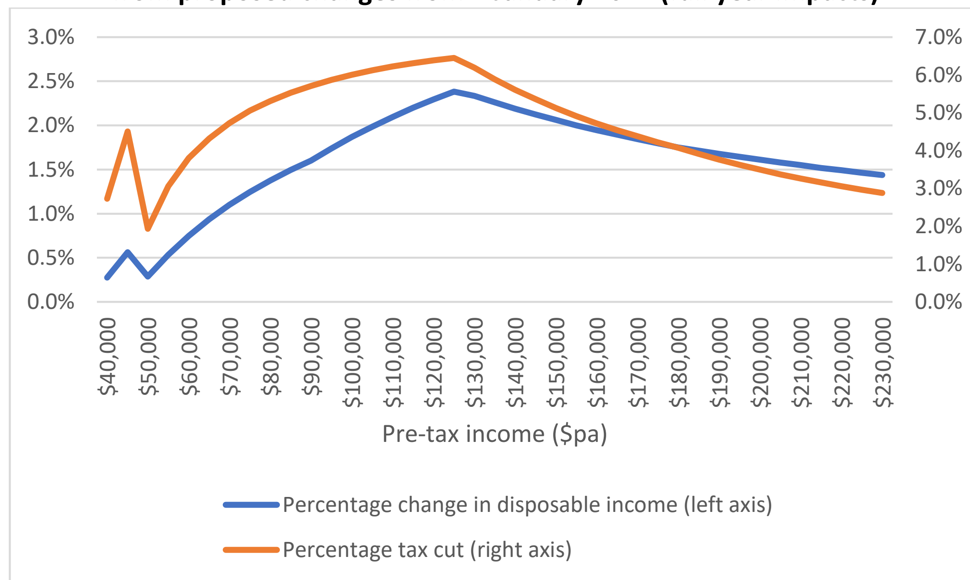
These changes are summarised in Table 1 below.

Table 1: Current and Proposed Personal Income Tax (PIT) Scales

Current PIT Scale			**Proposed PIT Scale (from 1 January 2021)**		
Income		marginal	Income		marginal
from ($)	to ($)	tax rate (%)	from ($)	to ($)	tax rate (%)
0	18,200	0	0	18,200	0
18,201	37,000	19	18,201	**45,000**	19
37,001	90,000	32.5	**45,001**	90,000	**30**
90,001	180,000	37	90,000	180,000	37
over $180,000		45	over $180,000		45
LMITO		$1,080			
LITO		$445	LITO		$700

Higher income earners would still experience a lift in disposable incomes due to lower rates applying to the first $90,000 of income. The proportional impacts on disposable incomes and tax paid are shown in Chart 3.

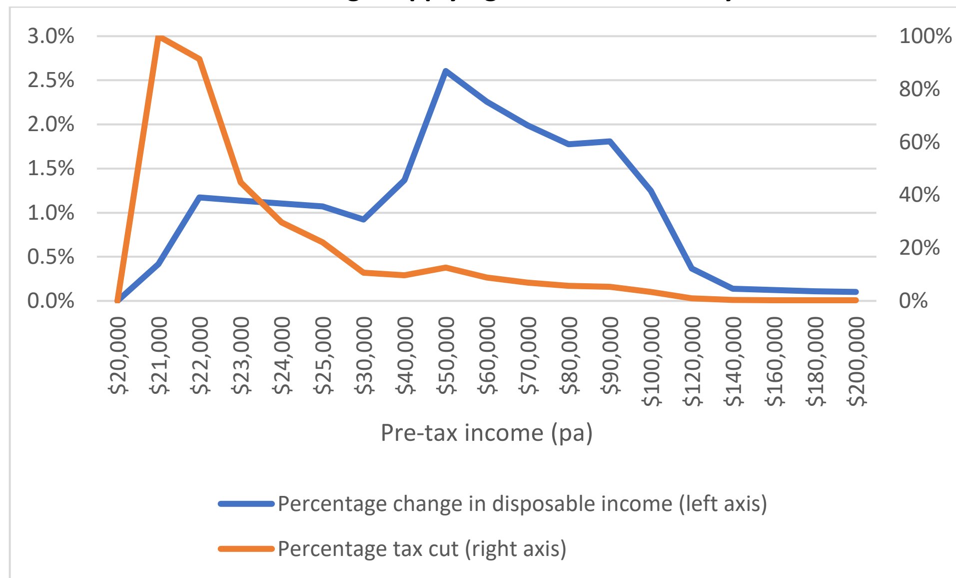
Chart 3: Proportional Changes in Disposable Incomes and Tax Paid from proposed changes from 1 January 2021 (full year impacts)



Note: The Medicare Levy is not included in these calculations.

It should be noted that the proposed scale brings forward elements of the total package of personal income tax changes that began to be phased in from the 2018-19 tax year. The changes already in place prioritised tax relief to low- and middle-income earners and discussion of the impacts on the distribution of gains in disposable income and the extent of the tax cut should include the changes already in place in. Chart 4 maps the changes effective from the 2018-19 year.

Chart 4: Proportional Changes in Disposable Incomes and Tax Paid due to changes applying from the 2018-19 year



Source: 2019-20 Budget Papers, *Lower Taxes*, p.10.

Business Tax Cuts to Lift Business Demand, Investment and Employment

The following points summarise the current and scheduled business tax arrangements:

- A general company tax rate of 30%
- A smaller-business tax rate of 27.5% legislated to go to 25% from July 2021. These rates apply to businesses with annual turnover below $50 million. This was estimated at the time of the 2019-20 budget to cover 970,00 companies employing 5.2 million employees.
- For unincorporated small businesses, a discount on income tax of 13% and set to rise to 16% from July 2021 (up to a maximum of $1,000). This was estimated at the time of the 2019-20 budget to cover 2.4 million businesses employing 1.9 million workers.
- An instant asset write-off arrangement applying to smaller investments (of up to $150,000) extended in May till 31 December 2020. It can be used for multiple investments of this size. It is available to businesses with annual turnover of less than $500 million. In May it was estimated to apply to apply to 3.5 million businesses. By inference about 130,000 businesses had a turnover between $50m and $500m.
- In March 2020 an investment incentive was announced allowing businesses to deduct 50 per cent of the cost of an eligible asset, with existing depreciation rules applying to the balance of the asset's cost. Like the instant asset write off it is available to businesses with aggregated turnover below $500 million. It is available in respect of new assets first used or installed by 30 June 2021.

Even with these measures in place, the July Economic and Fiscal Update projected a fall in business investment in 2020-21 of 12.5% including a fall of 19.5% for non-mining business investment.

Readily implementable business tax measures that could help stimulate activity and employment in the near term are further investment allowances and a cut in the company tax rate.[1]

Investment allowances are only stimulatory to the extent they bring forward planned investment or induce new investment in assets to which the allowance applies. The benefits, while real, relate to the timing of deductions which would be otherwise be made in later years. At current interest rates these timing benefits are limited.

A more stimulatory measure would be to cut the company tax rate. This has two main advantages:

- It is a permanent benefit as opposed to a timing benefit; and
- It leaves more retained earnings in the hands of businesses to invest in whatever they assess as best for their business and not just the assets to which the investment allowance applies. These other areas of spending include employment and workforce training.

Ai Group proposes extending to companies with turnover of less than $1 billion the reduction to 25% in the company tax rate that is already scheduled to take effect from 1 July 2021 for businesses with turnover of less than $50 million.

Under this proposal there is a powerful incentive for businesses with turnover of less than $500 million to take advantage of the investment allowance referred to above. This is because 50% of the cost of eligible investments could be deducted at the present 30% rate (27.5% for businesses with turnover below $50m) whereas the 25% rate proposed to apply from July 2021 would give these businesses less of a deduction in respect of this capital expenditure.

Facilitating Investment in Infrastructure and Housing

A key part of the recovery strategy should be aimed at raising investment and employment in infrastructure and housing.

Increased investment in infrastructure and housing (particularly in lower-cost and community housing to address longstanding shortages) makes a lot of sense with plenty of capacity in many of the relevant segments of the workforce and at a time when debt servicing costs are low and expected to stay low.

While most of the role for government action in these areas is appropriately in the hands of the states and territories, there is clearly a leadership role for the federal government in encouraging and facilitating action in these jurisdictions.

Ai Group's proposes:

- **The federal government work with the states and territories to further accelerate projects already in the pipeline and to add further projects to the pipeline with accelerated approval**
- **Assist in addressing any areas of skills shortage by giving priority to skilled migration in key categories where domestic capacity is stretched and sought by the businesses and agencies involved**

[1] It should be noted that the imputation system dilutes the real benefit of these measures in respect of domestic shareholders because when less tax is paid at the company level there are fewer imputation credits to distribute to shareholders who therefore pay more personal income tax (or superannuation income tax etc.) on distributed profits. This also means that the fiscal cost of the measures is similarly diluted.

- **Encouraging the states and territories to take advantage of the expressed willingness of institutional investors to provide long-term patient capital where private ownership of infrastructure and housing assets makes sense.**

An important initiative in this area is IFM Investors' *Building Australia Model*[2] which offers the advantage of alignment between the capacity of institutional infrastructure investors – in this case superannuation funds - to manage the illiquidity of infrastructure assets with the interests of governments, taxpayers and citizens in sustained multi-decade operational performance.

[2] See https://www.ifminvestors.com/docs/default-source/insights/ifm-investors-insight---building-australian-model.pdf?sfvrsn=a802305_3

Measures to lift Employment, Skills and Employability

Rapid and intense education and training will be a key driver for Australia's economic recovery as we emerge from the prevailing crisis. An open, high quality education system for skills formation is seen as one of the four key pillars for a well-functioning labour market. [3]

The COVID-19 crisis has occurred at a time when Australia was already suffering from a range of skills issues and its education and training system faced challenges in developing the relevant, quality skills in the timeframes required. Highly skilled jobs were increasingly recognised as important to contribute to roles emerging through digital transformation. The crisis has forced many companies to shift further into new technologies. It has highlighted and created urgency around skills broadly and provides impetus to address them. But they must now be accelerated through renewed strategies and funding measures.

Education and training must be related to business growth needs, integrated with industry strategies and include innovative approaches that better anticipate immediate-, short- and medium- term skill priorities for industry sectors. The training then available must be easy to access and relevant for individuals to gain employment in roles that are often different from the past. Strategies must be developed for all workforce age categories and must facilitate the mobility of individuals by providing recognition of achievement.

Our recommendations focus on major labour market programs supported by necessary education and training system reforms.

Broad wage support for commencement of new apprentice and trainee numbers

In May, Ai Group called on the Australian Government to implement universal wage support for apprentices and trainees regardless of the size of the company, the number of employees, age, occupational groupings and geography. Ai Group welcomed the government's Supporting Apprentices and Trainees Wages announcement in July 2020. This announcement was an important step in maintaining current apprentice and trainee numbers, effectively placing a floor in the Australian apprenticeship system, noting that apprentices and trainees had to be in a contract of training effective 1 July 2020.

Further measures will be required to ensure employers are appropriately supported to commence new and additional apprentices and trainees. Timing is critical here. 2020 school leavers will be exiting their schooling facing into the worst labour market in living memory. Well understood university pathways remain intact, however apprentice and trainee options, and work are problematic. Without wage support in various forms, the Mitchell Institute estimates that new apprentices and trainees will decline by 30 per cent within two years. This equates to 130,000 fewer new apprentices and trainees from the start of the pandemic to June 2023.[4] Others suggest that this is an underestimate.

Ai Group encourages the government to extend wage support arrangements to all active and commencing apprentices and trainees in alignment with the recently amended scheme. This needs to be available immediately and capture all apprentices and trainees signed up since 1 July 2020. Furthermore, these arrangements should be extended to December 2021, to ensure that

[3] Shifting the Dial: 5 Year Productivity Review, Productivity Commission, 2017
[4] P. Hurley, Mitchell Institute. May 2020

employers are able to make reasonable commitments to the duration of the apprenticeship experience.

Support for apprenticeship renewal must also utilise Group Training Organisations, which can be multipliers in the recovery. They have wrap-around support mechanisms and experience good completion rates compared with apprentices directly employed by businesses.[5]

Program of new pre-employment initiatives for youth

Young people have been disproportionately impacted by the social, economic and health consequences of the pandemic. Experience from previous economic downturns tells us that it also takes at least twice as long for youth employment levels to recover.

A national program that provides extensive access to new and redesigned pre-employment programs, including pre-apprenticeships, in areas of skill needs must be introduced.

These programs will support young people by widening their entry-level training options. Pre-employment program re-design should consider existing offerings across jurisdictions and be cognisant of different entry level points across different industries. They should build in relevant work placements and specific regional needs.

Post-COVID-19, it is even more important that support programs help young people navigate, prepare and find training and work. Forty-five per cent of young workers work in the three industries (hospitality, retail, and arts and recreation) most exposed to the economic downturn following the closure of many businesses in those sectors.[6] They are at a disadvantage as the economy opens up. Lack of experience and work readiness are commonly cited as barriers to employment for young people and without support and guidance this has the potential to play out again.

Program of skills assessment and adaptive training for displaced workers

A widely promoted, national support program must be established to assess the skills of existing workers that have been displaced during COVID-19 and then train them to transition into roles required by employers.

Assessment must assist them to demonstrate how they can adapt by applying the skills they have developed over time. This assessment and training program could be housed within existing job agencies/training providers, and be an extension to the JobTrainer initiative.

The crisis has seen rapid technology-related impacts in many industries. Workers have had to quickly apply different technology-based skills. However it has only highlighted the changing workplace where new practices are being adopted with increasing regularity.

The acquisition of new skills by older existing and displaced workers, and the refreshing of existing skills, must be met through adaptive training. To set workers up for the future, the education and training programs must incorporate the transferable capabilities of enquiry, agility, adaptability, creativity and problem-solving. The current environment presents an opportunity to utilise the skills of mature aged workers and allow a transition into new roles and industry sectors.

[5] O'Dwyer, L & Korbel, P 2019, Completion rates for group training organisations and direct employers: how do they compare? NCVER, Adelaide.

[6] ANZ Research, Australian Economic Insight, 23 April 2020

Incentives for companies to invest in training for existing workers

As some businesses recover, they will need to build new skills as they re-align their businesses or move into new industry areas. Others will need employees to learn new tasks within roles or undertake completely new roles. This will be particularly acute for SMEs, companies that have accessed JobKeeper and for many regional businesses.

Incentives are needed to support the large investments in training that will need to be made by businesses.

Financial incentives should be available for training to re-skill for COVID-19 changed business models.

While quick learning has necessarily taken place in many businesses during the crisis, these changed practises must be backed up with planned workforce development in order to match skill development in changed directions. Funding to employers could support them to re-develop workforce development plans and contract training providers for training of existing workers.

National program of incentives for cadets in companies

A new national wage support program that enables businesses to employ VET and higher education students as interns and cadets is needed.

Ai Group believes a new national wage subsidies program that assists employers to engage VET and higher education students as interns is urgently needed. The rapidly changing work environments and skill needs thrown up by COVID-19 are best served by learning that is connected to and closely reflects workplace skill needs.

Employment-based learning models are typified by apprenticeships and traineeships, but work based learning includes internships and cadetships, where formal education and training is augmented by application and support on-the-job, over time, from other skilled workers. Apprenticeships and traineeships have generally been delivered at the Certificate III level, but these models should now be designed for more highly skilled occupations to reflect higher workplace skill levels. Higher apprenticeships incorporate this work-based mode. Such models are widely utilised in other high skilled developed economies, ie UK, Germany and Canada.

The proposed national program would require substantial wage subsides in order to incentivise employers to take on interns at scale in the height of exceptionally high youth unemployment and poor labour market prospects. The proposed new program could be developed through Commonwealth/States and Territories partnerships, as well as with Commonwealth Higher Education funding. Existing infrastructure for employer incentives and wage subsidies could be expanded, in particular the Commonwealth funded Australian Apprenticeship Support Network (AASN). Select Group Training Organisations (GTO)s could act as third-part employment platforms that are able to aggregate demand thereby enabling scale at commencement.

Direct subsidies would incentivise employers and training costs could be met by the interns and cadets through FEE-HELP. This recommendation is in concert with a JobLearner initiative designed and proposed by Peter Dawkins (Victoria University) and David Lloyd (University South Australia) and the Mitchell Institute Roundtable attended by Minister Tehan.

Funded multi-partner industry-training hubs

Defence against COVID-19 has led to a number of beneficial partnerships across industry, governments and the community. Moving forward, improvement actions must be underpinned by closer partnerships between industry and all education and training sectors. Rapidly changing work environments and skills are best served by learning that is connected to and closely reflects workplace skill needs.

Funding for a national system of local metropolitan and regional hubs that develop strategies to meet local skill needs will assist large and small companies to create innovative solutions to business problems, assist students and tackle unemployment.

The hubs would develop industry-student-provider engagement models that foster and increase relationships and result in industry-tuned workforce entrants. A range of initiatives already exist in Australia and globally, spanning those organic and local in nature to those that are part of co-ordinated country-wide models. Activities have been initiated by individual companies, industry associations and agencies, levels of government and education and training providers aiming to co-create skills ecosystems. Funding and support that accompanies these initiatives ranges from financial incentives, education vouchers, training grants and scholars and general tax deductions.[7]

In Australia's regions in particular, such partnerships can lead to better alignment between secondary, vocational and higher education and assist teacher and trainer upskilling in vocational and higher skill tech-related areas.

A European example, the Centres of Vocational Excellence initiative, was piloted in 2019.[8] It uses a broadly central framework that encourages operations within a given local context, bringing together centres that share a common interest in specific industry sectors/trades. It also cultivates innovative approaches to tackle social challenges which are now exacerbated through the COVID-19 crisis. Each centre aims to bring together a set of local/regional partners such as VET providers, universities, research institutions, companies, chambers and associations, social partners, national and regional authorities to actively co-create skills ecosystems.

Improved funding for vocational education and training

The Australian Government's commitment and actions to overhaul the VET system must remain ambitious and include additional funding. Current funding arrangements are unacceptably inconsistent and incoherent. Ai Group has been concerned about the long-term decline in funding by all levels of government in vocational education and training. Funding for vocational education and training (VET) is at its lowest level in more than a decade and Australia risks failing to properly provide the high-quality training for the 45 per cent of new jobs needing VET qualifications that will be created in the next five years.

The Australian Investment in Education: Vocational Education and Training report from education policy think tank the Mitchell Institute at Victoria University found that every state and territory government had cut funding to VET over the past decade, with funding falling to 15 per cent below 2006 levels.

[7] For example, High Tech Skills for Europe. *Scaling up best practices and re-focusing funding programmes and incentives*, European Commission, Interim Report, 2018.

[8] Summary of the main features of the initiative on platforms of Centre of Vocational Excellence, European Commission, 2019.

A completely new funding agreement between the Commonwealth and the states and territories must address efficient national pricing, and better coordinate the combination of subsidies, loans and other funding, as well as addressing the decline in overall VET funding.

Current work underway to achieve this end by the National Cabinet and Skills Ministers is welcome and encouraged to continue at pace. The work of the newly established National Skills Commission is vital in informing this process, as well as consideration of the work undertaken by the Productivity Commission.

Workplace Relations Measures

JobKeeper Extension

The Government should also take the opportunity provided by the extension of JobKeeper to address a significant problem encountered by many businesses. Currently employees can exclude themselves from the temporary industrial relations flexibilities if they do not agree to be nominated as eligible employees of a business that is eligible for JobKeeper. This is thwarting the ability of businesses to remain viable in the face of the COVID-19 crisis.

For the period of the JobKeeper Extension, the Government should close the loophole that allows employees to refuse to be nominated or to withdraw their agreement to be nominated as eligible employees.

Casual Employees and General Employment Entitlements & Redundancy Scheme

Ai Group is wary of the implications for the ongoing costs of the Commonwealth in relation to its own casual employees and for liabilities under the General Employment Entitlements & Redundancy Scheme (GEERS) in light of the likelihood of a sharp rise in insolvency in the wake of the COVID-19 crisis.

Like many businesses, the Commonwealth could be faced with a major increase in its own costs relating to its own casual employees.

In addition, the Commonwealth's liabilities of the GEERS is particularly exposed to liabilities related to the leave entitlements of casual employees which, pending currently legal cases, may be extended considerably beyond what was previously considered.

Ai Group proposes the Government legislate to ensure that the established meaning of a "casual employee" retain its meaning going forward.

Measures to Build Business Resilience and Innovation

Developing the capabilities of Australia's businesses and encouraging business innovation are key elements of the medium-to-longer-term agenda to lift productivity and economic performance and to build the resilience of our economy. These themes are covered in greater depth in Ai Group's Post-COVID-19 Policy Papers (particularly the papers on Industry Development, The Defence Industry, the Circular Economy and trade & Migration). The measures below are put forward for consideration in the 2020-21 Budget.

Digital capabilities

The current pandemic has inadvertently accelerated the uptake of digital technology use. However, questions remain as to whether businesses are maximising its use and leveraging it for longer term gains. The following are some measures where Government could help drive digital capabilities.

There is an opportunity to further build on partnerships with industry to develop digital capabilities. Some existing initiatives are working effectively and should continue and be extended where appropriate (examples include Industry Growth Centres, the Innovative Manufacturing and the Entrepreneurs' Programme).

Other activities that could be further enhanced include raising cyber security awareness, building supply chain resilience and helping businesses (including SMEs) to upgrade their legacy technologies and implementing new technologies – the effectiveness and impact of these can be maximised such as through leveraging industry expertise and trusted advisers (such as industry associations).

Many of these areas have been identified in the Industry Advisory Panel's report to the 2020 Cyber Security Strategy.

Greater take up of digital technologies by businesses and other organisations and more far-reaching impacts can be generated by a broader digital inclusion agenda.

Parts of the community require different degrees of assistance around digital inclusion, especially for disadvantaged groups.

Implementing targeted capability initiatives and accelerating the delivery of government digital services to address this could entail providing targeted training on digital technology use (including cyber awareness) and access to digital technology for different segments of the community, especially for disadvantaged groups.

It would be beneficial to connect these ideas with other work in Commonwealth departments and agencies.

Cyber security capabilities

Given the rapidly evolving state of cyber threats and attacks, including the Government's recent announcement about malicious cyber activity against Australian organisations, it is essential that our nation is sufficiently resourced and supported to ensure national security and to protect businesses and the community against global cyber crime and related threats.

Ai Group welcomes the Government's $1.67 billion commitment over ten years to invest in strengthening Australia's security through initiatives designed to improve cyber security. The 2020-21 Budget provides an opportunity to get started on the implementation of these commitments.

Research and Development Tax Incentive

The 2020-21 Budget is an opportunity for the Government to begin to rebuild confidence and stability in the Research and Development Tax Incentive (R&DTI).

The Government should withdraw the legislative proposal to cut the coverage of the program and to remove the spectre of the anomalous application of an intensity-based program.

Measures to Advance Environmental Objectives

Climate and Energy

A successful response to climate change involves doing Australia's part to accelerate global efforts to minimise warming; managing the impacts of the warming we can't avoid; and building a new energy advantage for Australia in a net zero emissions world. The strategic context to these goals and policy reforms towards them are addressed in Ai Group's *Post Pandemic Policy: Climate and Energy*[9] and in a major statement on climate impacts from the Australian Climate Roundtable.[10] These goals should help frame the task of policy development and economic management broadly. They also have great relevance to the pursuit of a faster recovery from the economic impacts of the pandemic. Ai Group would like to highlight the following specific funding measures for consideration in the 2020-21 Budget process.

Energy efficiency

Energy efficiency upgrades should be a high priority across Australia's built environment as they can deliver a triple dividend:

- near-term economic support through an increase in demand for construction, materials, appliances and engineering;
- long-term improvements in the competitiveness of industry and the living cost of households through direct energy savings and lower pressure on wholesale energy prices and network investment needs; and
- faster cheaper emissions reductions, both through avoided energy use and the easier integration of variable generation that an efficient and flexible demand side allows.

Energy efficiency more than pays for itself, but investment faces barriers including widespread caution about capital investment amidst recession; lack of energy management capability; and split incentives. Effectively delivered public support can make a substantial difference.

There are many positive proposals for different parts of the economy; for instance Ai Group would endorse the ACOSS-coordinated public housing upgrade plan[11] and comparable proposals for private housing, commercial building and manufacturing upgrades to be proposed with the Energy Efficiency Council and the Property Council of Australia.[12]

Within this suite of strong opportunities, Ai Group would like to highlight the importance of investment to lift manufacturing energy efficiency. As stated in our forthcoming work with EEC and PCA:

The current crisis means that some manufacturing sites are unusually quiet and able to be upgraded without disrupting other activities. That means there is an immediate and unique opportunity – right now – to support manufacturers to upgrade their energy efficiency and productivity.

[9] See https://www.aigroup.com.au/policy-and-research/policy-papers/climate-energy/.
[10] See https://www.australianclimateroundtable.org.au/.
[11] See https://www.acoss.org.au/wp-content/uploads/2020/06/Economic-Stimulus-Healthy-Affordable-Homes-NLEPP-June-2020-Final-18062020.pdf.
[12] Forthcoming.

Much of the energy consumed by the manufacturing sector is boiler fuel and low temperature process heating (i.e. up to 150 degrees). Ramping up support for manufacturers to transition from gas to electricity – from gas boilers to heat pumps – would both cut costs and allow them to lower emissions with onsite or offsite renewables.

Now is also an excellent time to upgrade energy management systems, as sub-metering and data systems are often rudimentary in small and medium manufacturers. Meters are an 'enabling technology' that gives businesses crucial data so they can more effectively manage their energy use.

Ai Group recommends establishment of a $500m industry energy transformation fund.

The Australian Government should allocate $500 million over two years for capital grants to rapidly scale up the penetration of existing technologies that are uncommon in the Australian market:

- **Electrification of processes :**
  - **Heat pumps;**
  - **Electric induction furnaces; and**
- **Energy management systems:**
  - **Sub metering and data analysis; and**
  - **Data acquisition system integration;**
  - **Technology that enables demand response.**

At a matching rate of 1:1, this would deliver $1 billion of manufacturing investment, equivalent to between 150 and 1,000 electrification projects of the scale costed in the Renewable Energy for Process Heat case studies developed by ARENA and A2EP. That would reduce individual sites' energy bills and emissions by between 5% and 50%. It would be reasonable to target at least 250 projects to deliver an average 10% reduction in energy bills and emissions across the program.

Based on the jobs multiplier for industrial efficiency from the IEA and IMF's 'Sustainable Recovery' report (2020), this program would create over 7,000 job-years of employment.[13]

ARENA

The future of ARENA needs firm backing. Infrastructure, funding and finance for innovative low- zero- and negative-emissions technologies are critical to commercialise options, reduce their costs and ready them for scale. The Australian Renewable Energy Agency (ARENA) and Clean Energy Finance Corporation (CEFC) have been successful institutions in this regard over the past decade and should be continued and expanded to drive broader clean economy progress over the coming decade. It is appropriate to expand their technological and sectoral scope to ensure they can address all relevant tools towards net zero emissions by 2050.

However, the funding and finance at the disposal of ARENA and CEFC will need to expand likewise to meaningfully address a broader remit.

[13] The IEA and IMF's Special Report on Sustainable Recovery states that "it is estimated that industrial energy efficiency measures would create around 10 jobs per million dollars [US] invested" (p82). Based on this multiplier, and adjusted for Australian dollars, this program would create 1,400 FTE job-years of employment.

Ai Group supports fresh funding for ARENA in particular of at least $3.3 billion over ten years.

If ARENA or CEFC are asked to administer or guide further specific recovery investments in the near term, given their relevant expertise, this should involve additional funding.

Some activities, like agricultural innovation, may be far outside the existing expertise base of both organisations; whether these are covered by investing in the institutions' capability or by setting up equivalent institutions, it is critical to address all major economic sectors and sources of emissions. Continuing existing strong governance and maintaining autonomy within a clear overall net-zero mandate are important to ensure funds are allocated sensibly.

Climate adaptation

Climate adaptation needs a substantial investment of attention, coordination effort and funding to lift our national performance. The best possible scenario for global mitigation efforts will still see Australia endure a substantial and costly increase in climate-related impacts and risks. Elements of improvement, as recommended by the Australian Climate Roundtable, include:

- Governance: Coordination of Australia's response to climate change (both mitigation and resilience) should be a standing item for the National Cabinet. Different jurisdictions have different responsibilities and levers to build resilience to the effects of climate change. Coordinated action across these jurisdictions will be needed to ensure the most effective action and efficient allocation of resources.

- Systematic Risk Assessment: Australia has no up to date assessment of the impact of climate change on the country overall, or on people, jobs, specific communities, critical infrastructure and specific economic sectors. We can't plan for what we don't yet understand. Like in other jurisdictions such as the USA and New Zealand, the government should instigate a biannual national climate change vulnerability assessment.

  This assessment should focus on the threat to particular sectors or industries (including the insurance industry and its customers) and examine the synergies between systems. In addition, climate risk assessment should be overlayed with social vulnerability data, to ensure adaptation and resilience plans better address the needs of people and communities more vulnerable to climate change. Without this information, it is difficult to direct efforts to protect our most vulnerable communities and systems from climate change threats.

- Provision of consistent data and information sharing: There is currently a proliferation of data, portals and proprietary tools to assess climate change risk and build resilience. Governments should serve a role in the provision of this core information and provide greater funding to the science that underpins it (such as by refinancing the National Climate Change Adaptation Research Facility). In addition, the Commonwealth should establish a body to coordinate between the Bureau of Meteorology, CSIRO, academia and private, non-government and public sector users for the provision of climate data and authoritative knowledge sharing.

- Build on the work of the Council of Financial Regulators: To ensure macroeconomic and financial stability risks are minimised, climate change must remain a core priority for the Council of Financial Regulators. They should develop rules and guidance for the disclosure of climate-related physical risks to support financial stability and enhance the pricing of physical climate impacts in investment decisions (large and small).

- Support vulnerable communities and the organisations which support them: Based on the national vulnerability assessment, prioritise support and investment for people and communities most vulnerable to the impacts of, and responses to, climate change, and the organisations that support them.
- Ensure policies unlock private sector investment in resilience: Government budgets will be insufficient to build resilience to the impacts of climate change across the economy. Unlocking private sector capital will be crucial. In addition to the above, governments should work with the private sector to facilitate investment in resilience measures through supporting the development of innovative resilience financing options and, where appropriate, the application of national standards to build resilience (e.g. the construction code).
- Integrate building resilience to the impacts of climate change with COVID-19 recovery efforts: Mitigating the risks of climate change and making our economy, labour market, infrastructure, workplaces, supply chains, communities and homes more resilient will require substantial, sustained and astute investment across Australia. Accelerating that investment can also have significant near-term benefits in speeding Australia's economic recovery from the COVID-19 pandemic.

Ai Group proposes the Government encourages, funds and coordinates efforts to accelerate adaptation to climate change.

Circular Economy and Waste

The waste crisis continues to cause concern in Australia and around the world, but if handled properly, better waste management and a shift towards circularity can stimulate the economy while improving environmental outcomes for Australia. Enhancing opportunities in circular economy is extremely important for the nation, given the circular economy has been identified as a major commercial opportunity (worth up to an estimated $4.5trillion worldwide[14]).

At the heart of the challenge is that market prices of new materials, recovered materials and waste disposal are still mismatched with the values governments and individuals say we place on them. Given price challenges and current technologies, recycling and recovery are not currently sufficiently financial to manage as much of the waste stream as we want. Investment is required to unlock the opportunities in this area for Australia.

The Commonwealth has made good progress in funding initiatives to assist with this challenge, most notably the recent commitment of $190 million to a new Recycling Modernisation Fund, the National Product Stewardship Investment Fund and the funding of a Centre of Excellence in product stewardship.

Waste and circular economy remains an area of critical importance for Australia and government should continue to make funding decisions with this in mind, paying close attention to the outcomes of the current funding initiatives as well as new and emerging opportunities.

[14] CSIRO, 'Circular Economy and Waste Management'