

Blueprint Institute

Beyond inertia

Budget Blueprint 2024: Invigorating our future



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About Blueprint Institute

Every great achievement starts with a blueprint.

Blueprint Institute is an independent public policy think tank. The challenges our nation faces go beyond partisan politics. We have a once-in-a-generation opportunity to rethink and recast Australia to be more balanced, prosperous, resilient, and sustainable. We design blueprints for practical action to move Australia in the right direction.

For more information on the institute please visit our website: blueprintinstitute.org.au

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Executive summary

Our 2024–25 Budget Blueprint paper focuses on three areas critical for Australia’s long-term success—system-wide tax reform, picking up the pace and impact of the climate and energy transition, and boosting Australia’s innovation and productivity.

Australia’s economy has been infamously described as one of ‘houses and holes’. Our love affair with property and abundant reserves of coal, iron ore, gas, and other natural reserves have helped us become one of the richest countries in the developed world—flattering the public balance sheets, and fuelling a housing market valued at substantially more than GDP. But our economy faces structural deficiencies and impending challenges to competitively integrate into today’s technology-driven, Asia-dominated global economy. Our long-term economic growth is forecast to slow. Decade after decade of economic, social, and geopolitical stability has shrunk our appetite for substantive change. Our fortunes have bred a complacency that permeates our public policymaking. Ad-hoc, reactive policy responses are the political norm—and inadequate for addressing the challenges ahead.

Disruption abounds across the world, and new economic powers and allegiances are emerging. COVID, the rise of AI and social media, tensions between the US and China, the emerging collaborative force of the anti-Western axis, and ongoing conflicts in Ukraine and Gaza are symbols of a rapidly changing world. Australia’s future prosperity and economic resilience requires us to be adaptive to trade and supply chain disruptions, keep up with our peers, and engage with other nations with geostrategic and diplomatic finesse.

Despite the looming challenges of climate change, an ageing population, mounting public debt, time-limited foreign demand for our key exports as the global economy shifts away from fossil fuels, and a generation becoming more and more indebted—incrementalism prevails as the political status quo. The spectre of election cycles render long-termism unappealing for our politicians. Both major parties have

shied away from brave reforms, leaving those to the crossbench. Inertia reigns supreme in Parliament House. These indicators signal the need to progress beyond the jaded narratives of Australian mercantilism and secure future economic prosperity with meaningful reform. Substantive, ambitious policy reform is overdue.

In a per capita recession with mortgage stress on the rise, the cost of living remains at the forefront of the electorate’s mind. We are just emerging from a sustained period of inflationary pressures, and persistent services inflation suggests that pain may continue.

We rang in the new year with an all-too-familiar song and dance about income tax—where bracket creep has become the most convenient can to kick down the road. Although Labor’s adjustments to the Stage 3 tax cuts are intended to reflect cost-of-living pressures, ambition to advance wholesale tax reform is still found wanting.

That is why comprehensive, wholesale tax reform is first on our Budget agenda. Making improvements to our taxation system’s efficiency, complexity, and equity will be crucial to quell voter dissatisfaction. Fairer taxes will stem the populist urges of the electorate, and will be key to raising enough revenue to fund critical investments into clean energy, education, and innovation. We need to rely less on personal income—and more on consumption, land, resources, and rents.

Whilst unemployment levels have shown remarkable improvement in the early stages of 2024, we are still firmly in a productivity crisis. Reigniting productivity growth, which has been anaemic for decades, is crucial for Australia’s sustainable prosperity, and the lead determinant of wages and living standards. Tax reform is a big part of boosting productivity—but we must also foster our innovation ecosystems adequately to boost private investment into emerging sectors.

Many of the overdue, nation-building investments into clean energy, infrastructure, technology, and education continue to lag behind schedule and blowout in costs. Non-mining business investment has been stagnant for decades. We

still have failed to meaningfully reflect the cost of externalities into our economy. An economy-wide carbon price is a distant hope, and the political unpopularity of resource rent taxes is bipartisan.

Treasurer Chalmers has foreshadowed that this Budget will have a big focus on investment—particularly, *a future made in Australia*. Whilst we welcome the investment ambition, we are sceptical about channelling it toward our sovereign manufacturing capability. We must avoid the perils of old-fashioned protectionism, forever subsidies, and picking losers. We are hoping for careful and sensible economic reforms to federal income, and calculated investment into the sectors critical to our future.

Our final area of focus is the investment that will be required to usher in a new era of productivity, dynamism, and innovation in the Australian economy. This will include expenditure in technology, labour mobility, and initiatives to spur innovation and genuine competition.

The political fault lines in Australia are being rewritten. The 2022 teal wave, the referendum latte line, and the push for further ideological extremes from the left and the right are all pertinent hints of a changing political order. Government disaffection—kindling for populism—steadily encroaches upon metropolitan Australia from outer suburbia. Implementing reforms to reduce inequality and promote equal opportunity will offer a compelling economic appeal to the sensible centre, and help engage those looking for answers in populist rhetoric. Australia has an opportunity in 2025 to demonstrate stability and ambition to lead as a healthy democracy—showing how a fair liberalism can prevail in today’s unforgiving, zero-sum political climate.

The golden era of reform in the 1980s and early 90s sets an enviable precedent for ambitious long-term reform. But a sustainable and prosperous economic future is at stake if we fail to champion a similar sense of aspiration. We can change that—and reorient our national direction toward a prosperous economy and sustainable economic growth for decades to come.

This Blueprint shows how.



Key challenges

- **Cost of living is the key election issue:** this is the make-or-break budget for Labor to test the mood of the nation and respond to cost of living pressures. We need to balance our national ambition with non-inflationary fiscal policy.
- **Intergenerational inequity threatens our social compact:** there is a growing generational bifurcation. We have to do more to support young people.
- **Climate and energy policy has fallen behind:** whilst avoiding reckless fiscal spending, we have to start moving now. The energy transition needs clarity of investment signals and planning. Nature repair is a paramount objective.
- **We are in a productivity crisis:** there is a clear need for Australia to lift productivity and innovation.
- **Economic dynamism and diversification is an existential challenge:** we need sustainable economic growth across diverse industries.

Key recommendations

1. Financing our future: a new, fairer tax bill for Australians

- **Broaden the tax base**
 - Introduce a broad-based annual tax on the unimproved value of land
 - Establish a natural-resource based sovereign wealth fund for renewable energy investments
 - Broaden the base of the GST and raise it to 15%
- **Reduce the complexity of the tax system**
 - Reverse and repeal the new GST distribution regime
 - Abolish state payroll taxes
 - Implement a true indexation of income tax brackets
- **Address intergenerational equity**
 - Index HECS to real wage growth and implement a 3% indexation ceiling
 - Revert to indexation of capital gains
 - Remove negative gearing deductions on investment properties
 - Abolish stamp duty on residential, commercial, and industrial property purchases
- **Boost productivity**
 - Reduce the corporate tax rate to 25%

2. Protecting our future: climate and energy priorities for fiscal expenditure

- **Rethink and implement environmental standards**
 - Fund the development of clear, technology-agnostic biodiversity and environmental standards
- **Aligning understanding and incentives**
 - Reward communities for hosting renewables
 - Fund adult education and tackle mis- and disinformation on climate
- **Fund the transition to net zero and nature positive**
 - Update energy grid system design modelling and approach
 - Accelerate energy efficiency programs
 - Redeploy fossil fuel subsidies
 - Speed up transport decarbonisation
 - Establish a public fund for nature repair

3. Invigorating our future: priorities to boost productivity, drive innovation and improve dynamism

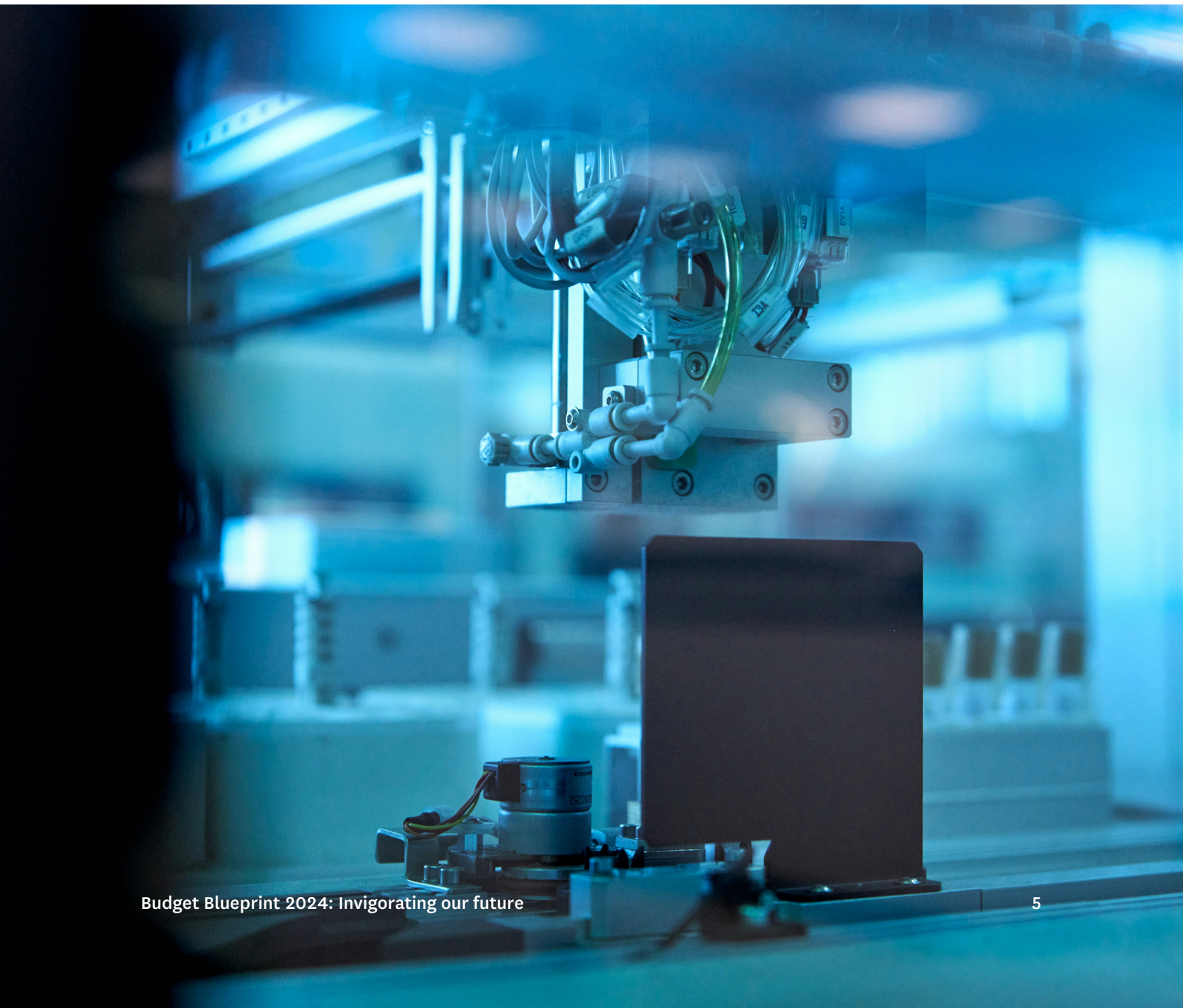
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- **Stimulate investment**
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Beyond inertia: the case for bold reform

This Blueprint outlines the case for ambitious, system-wide reform. Fiscal policy in this economic climate is a balancing act. Paring back spending would be prudent—indeed, running deficits often makes for easier political wins, but is myopic for long-term structural health. The key distinction is that spending today must be in the interests of securing future economic prosperity and wellbeing. The reforms and investments outlined in this Blueprint are critical to the nation’s sustainable long-term growth. Tinkering around the edges instead of enacting bold, wholesale reform will compromise living standards for the next generation, and generations to come.

It is time to progress *beyond inertia*.

This is **part three of our three-part 2024-25 Budget Blueprint series**. This paper outlines reforms to **boost our research capacity and stimulate investment to revitalise Australia’s productivity and competitiveness on the world stage**. Paper one of this series outlines present challenges facing the Australian economy and addresses our need for substantive, wholesale tax reform. Paper two of this series outlines immediate climate and energy priorities for a net zero and nature positive future at both the systemic level and the community level.



Invigorating our future

Priorities to boost productivity, drive innovation, and improve dynamism

Summary of recommendations

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The case for productivity, innovation, and diversification

The story of Australia's innovation and productivity growth makes for [sombre reading](#). Our productivity is in a rut, at its [lowest rate](#) since the 1970s. This stagnation is beyond an economic problem—it's holistic, cultural, and emblematic of the complacency that now permeates our national identity.

Our entrepreneurship skills are weak. We [ranked third last](#) out of 64 countries in the most recent International Institute for Management Development competitiveness yearbook. Moreover, our tax regime is confiscatory on incomes and our economy depends on resource extraction. Calls to [boost innovation](#) as a national priority have enjoyed [bipartisanship](#) across our recent political history.

Despite being on the doorstep of the Asia-Pacific region—the epicentre of economic growth in the 21st century—outside of commodities and

education, we are poorly integrated into Asia's emerging markets. And our archaic tax and transfer system has constrained opportunities for diversification into emerging industries.

Globally, we are accelerating toward a knowledge-driven, digital economy that will depend less on natural endowments and more on intellectual and human capital. An inversion of the Industrial Age is unfolding—the internet-driven service economy and the rise of AI creates new challenges and opportunities. The cultural and economic malleability of the cosmopolitan internet era has dulled patriotic fidelity, and [remote working](#) has become the new normal.

Australia must urgently leverage its envied physical amenities, natural endowments, high living standards, and attractive lifestyle to seek a [larger share of global talent](#). With the right economic incentives and more innovation-friendly regulatory and operating environments, Australia could be the next global epicentre of startup ambition and technological innovation.

Our economy should not be defined by complacency. Now is the time to diversify our economy, broaden our productive capacity and find new engines of sustainable growth.

Boost research capacity

When considering ways to ignite innovation, one must recognise the pivotal role played by our higher education system. Universities drive economic growth and prosperity through the production and transfer of new knowledge and research. Yet, as we continue to navigate unprecedented global challenges, national research and development (R&D) expenditure has declined to a 17-year low of just [1.68% of GDP](#) in FY2022—well below that of our international competitors. Unlike other advanced economies, universities are responsible for the majority of Australia’s research output. Business investment in R&D in Australia is miniscule, accounting for [less than one percent](#) of GDP.

Any discussion of Australian innovation therefore necessitates an evaluation of the university research funding ecosystem, which has become precariously dependent on revenue obtained through international students. Currently, universities are unable to recover the cost of running resource intensive science programs—and subsequently rely on international student fees to [cross-subsidise](#) these programs. International student fees also provide the [bulk of funding](#) for research activities. Having our sovereign research capabilities underpinned by international sources has significant [security implications](#), and is not a sustainable source of dependable revenue.

We see two key target areas for research funding reform: firstly, toward basic, curiosity-driven foundational research to strengthen our sovereign research capacity, and second, toward outcomes-driven translation of applied research.

While we punch well above our weight in terms of the [quality of our research](#), our track record of commercialisation is [weaker](#)—Australia ranks 78th out of 135 countries in a global assessment. Neither universities nor the [private sector](#) are well placed to facilitate research translation. This is in part due to an acute shortage of potential commercial partners, a lack of coordination between industry and academia, and a [university culture](#) that still values the number of publications and citations over other forms of research output. In some contexts, the pursuit of the commercial application or translation of intellectual property (IP) by academic staff appears to [inhibit promotion](#).

Restrictive royalty and IP arrangements enacted at the behest of universities also act to hinder potential investment. Some exceptions have emerged, for example, the Australian National University established a proof of concept fund to allow academics to develop their ideas and facilitate inroads into early-stage capital. They also created [their own venture fund](#) which allows the University to co-invest in projects they are interested in.

One of the major barriers towards achieving higher rates of research translation is the lack of firms in Australia with appropriate developmental capacity. Emergent technologies are typically assessed on a scale from one to nine. A Technical Readiness Level (TRL) of 9 represents the stage where a product or service is commercially available or in use. Universities do not have the internal capabilities to scale a project [beyond a technical readiness level of three](#). Furthermore, there are few firms in Australia that have a significant research budget and even fewer with any sophisticated developmental capacity capable of scaling a product at this level.

If we are to flourish in the knowledge economy and embrace greater economic dynamism, universities need to be given the tools they need to succeed through adequate targeted funding. Our sovereign research capabilities cannot depend on volatile revenue sources. Universities also need to actively foster an entrepreneurial culture by changing their internal incentive structure and relaxing restrictive royalty or IP arrangements which have the potential to deter investors.

Increase government spending in research and development as a percent of GDP on par with the OECD average

The Government should increase spending on R&D to match or exceed the OECD average, securing Australia’s economic future.

Australian Government investment in research and development in 2022 was 0.4% of GDP below the OECD average of 0.8% (see **Figure 13**). More broadly, Australia’s gross expenditure on research and development in 2021–22 as a percentage of GDP was 1.7%, approximately \$17 billion below the OECD average (which is 2.7% of GDP). Both government and business investment in research and development has steadily dwindled over the past 17 years. Chronic underinvestment has weakened our sovereign research capabilities and at times led to the loss of valuable intellectual property to overseas markets.

As business and government investment into research has declined, universities have become an ever more critical part of Australia’s research ecosystem. This differs significantly from the experience of other advanced economies, who

enjoy a greater proportion of private sector research investment. With so much of universities’ discretionary funds dependent on international student fees, Australia’s strategic R&D capacity is susceptible to significant disruption in the event of another COVID-like ‘funding shock’.

As noted in the Universities Accord report, our current approach to R&D spending is neither ‘strategic nor sustainable’. As we enter an era of unprecedented economic, social, environmental, and technical challenges, it is vital that we prioritise the development of our sovereign research capability.

Increase funding to develop Australia’s foundational research capacity

We call on the Government to increase funding for foundational research in Australia. Foundational or basic research is a type of curiosity-driven investigation that aims to expand knowledge and understanding of a particular phenomenon without any predetermined commercial goal in mind. An example includes the study of gravitational waves. This type of research is integral in facilitating innovation and economic growth.

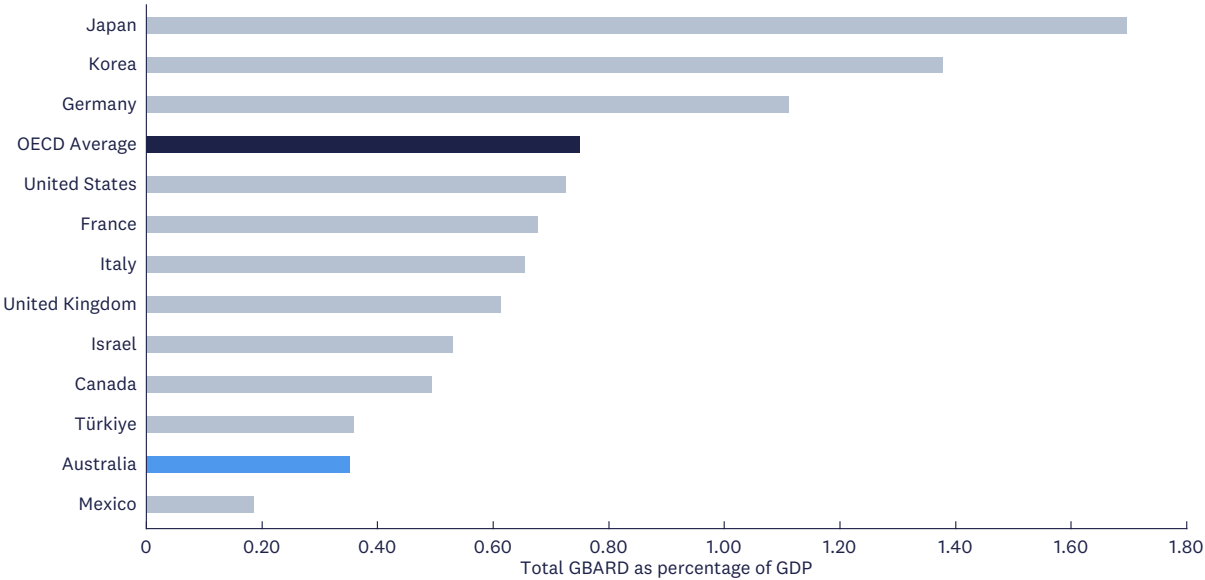


Figure 13 Total government budgetary allocations for R&D (GBARD) as a percentage of GDP (2022)

Source [OECD](#)

Over the last 30 years, the government’s share of investment into basic research has declined by around [14%](#). While applied research in areas of national interest should be an area of strategic focus, it should not come at the expense of [curiosity-driven or basic research](#). This type of research, not tied to specific government priorities, forms the foundation of a healthy research ecosystem. Foundational research is a public good which provides [immense economic value](#). It reflects successful incubation, and sparks breakthrough discoveries across fields, leading to new technologies, industries, and jobs.

As former ANU Vice Chancellor Brian Schmidt [noted](#), research in his field of astro-particle physics was crucial to developing WiFi, GPS, and touch screens for smartphones. These incidental spillover effects are difficult to quantify. Nevertheless, it is imperative to acknowledge the integral role played by foundational basic research in developing new knowledge systems and propelling the innovation that can help us drive economic growth and solve national and global challenges.

There is existing research infrastructure that would benefit greatly from additional funding. Funding to boost Australia’s curiosity-driven foundational research should flow to these bodies to be competitively allocated via grants. The main source of funding for non-STEM related foundational research is the Australian Research Council ([ARC](#))—however, the ARC has not benefited from any significant increase in funding in some time. The government also invests in expenditure via the CSIRO, but the majority of this work is applied.

Bolstering the grants program via larger investment into the ARC would be a vital boost in the capacity of universities to undertake basic research. Other bodies we believe should receive additional investment include the [National Health and Medical Research Council](#) and the [Medical Research Future Fund](#).

Employ an outcomes-driven approach to government applied research investments

We recommend that the Government adopt an outcomes-driven approach to applied research funding, which focuses on achieving specific

policy goals to ensure more effective use of taxpayer dollars.

The Chief Scientist recently released a set of [draft scientific priorities](#) after a lengthy public consultation process. As yet, there is no clear link between these priorities and current expenditure. From the outside in, government funding of applied research can look quite ad-hoc, with [hundreds](#) of different areas being funded at any given time. There is not much public account for the funding.

We recommend aligning funding more closely to outcomes that match agreed public priorities in science and research, supported by better reporting on the impact of this applied research.

Increase PhD stipends and exempt part-time stipends from tax

Central to Australia’s ability to remain competitive in the knowledge economy is our ability to attract and retrain the top quality talent. This necessitates a review of the current financing frameworks for PhD placements.

Current stipends for PhD students as provided through the Research Training Program (RTP) are [low by international standards](#), potentially deterring promising candidates from pursuing research. In 2024, the base rate for a full-time stipend at [\\$32,192](#) is considerably lower than the minimum wage annual after tax salary. We therefore recommend that the minimum stipend awarded to PhD students be increased to at least the minimum wage, accompanied by concurrent increase in the amount of scholarships offered.

Furthermore, full-time PhD students are exempt from paying income tax on their stipend, whereas part-time students are not. This effectively disincentivises those already working in industry to pursue research. Given that it is in the interest of the Government to encourage greater collaboration between universities and industry, this policy is counterintuitive. It also discourages parents from pursuing part-time study—particularly women, who statistically [take on more caregiving responsibilities](#). We thus echo the recommendations of the Universities Accord and recommend that part-time stipends be offered tax free.

Fund mechanisms to retain and effectively engage talented international graduates

We recommend that Temporary Graduate visa holders within the Post Study Work stream be eligible for a two-year extension of their visa if they are employed full time and earning at least \$70,000 a year. The government should also invest in enabling an effective transition into Australian working life for high-potential graduates in target skill areas—such as agtech, cyber security, AI, and the energy transition.

Human capital is essential to remaining competitive in the knowledge economy. The Federal Government has made significant changes to our immigration system as part of the recently released [Migration Strategy](#). The changes also include new visa pathways to fill skill shortages with a commitment to faster processing times for those applying under the Specialist Skills pathway. These are sensible moves, as is the Government's attempt to prevent worker exploitation by offering people on employer-sponsored visas an extra 120 days to find a new sponsor should they cease employment with their current sponsor.

Under current immigration policy, international students are eligible to apply for a Temporary Graduate visa to enable them to stay and work in Australia upon completing their studies. The reforms also include changes to this category of visa holders including increasing the English language requirements and returning the amount of time Temporary Graduate visa holders are permitted to remain in the country to pre-COVID levels. These are a good start, however more needs to be done to encourage the highest quality international graduates to stay and work in Australia.

Evidence indicates that even skilled international graduates may struggle to find employment in their chosen profession—and those who do [earn significantly less](#) than domestic graduates in the same field. Possible [reasons](#) include discrimination, lack of local experience, and a prospective employer's limited understanding of the Temporary Graduate visa and its associated working rights. Employers may also be disinclined to invest time in training a graduate on a

temporary visa, preferring instead those with the security of permanent residency.

We must better support international students in making informed decisions about their future, providing candid advice on their prospects of securing permanent residency and long-term employment in their chosen field.

Given that graduate salary is a reliable indicator of future employability, offering a two year extension for Temporary Graduate visa holders earning at least \$70,000 would also provide reassurance to hiring managers that skilled graduates will remain with them for a sufficient period (thereby justifying any hiring investment). For international graduates, the extension will not only provide valuable work experience, but will also enhance their eligibility towards permanent residency requirements. More broadly, we believe the government should also invest in providing transition support which may take the form of accommodation, language or job-placement support for the highest calibre graduates in relevant fields.

Establish an Australian Institute of Applied Ethics

We echo the calls of the [Ethics Centre](#), [The University of New South Wales](#), and [The University of Sydney](#) for the Federal Government to pledge a one-off grant of [\\$33 million](#) to establish an Australian Institute of Applied Ethics. The Institute would operate similarly to the Productivity Commission, but would be an independent body sitting outside government remit.

The [erosion of trust](#) in our institutions threatens the fabric of Australian democracy. Stronger ethical infrastructure is vital for Australia to confront the distrust epidemic and avoid past [scandals](#) and [crises](#) that have cost the nation dearly. Half of Australia believes that society is [broken](#)—and 67% of Australians believe that a strong leader is needed to wrestle power back from the economic and political elite. Yet, the public also recognises the importance of ethics is at an [all-time high](#). Building back trust in our institutions is crucial to combat the simmering tendencies towards the political extremes and authoritarianism.

Australia is in dire need of an institution to navigate uncertainty and prescient challenges, and shape Australia’s future for the better. Such existential challenges pose profound ethical questions that we have traditionally been ill-equipped in dealing with. Ensuring that decision-making at all public policy levels has the appropriate ethical infrastructure in practice is the first step to mend the growing distrust in our public institutions, our corporations, and leaders.

The economic case for establishing an Australian Institute of Applied Ethics is compelling—a ten percent increase in Australia’s performance in ethics would contribute [\\$45 billion](#) annually for Australia’s GDP, and could contribute up to [6.6%](#) in wage growth. Additionally, businesses could expect a [seven percent](#) increase in return on investment. Investing in ethical infrastructure, rather than regulation, can improve the public good, without creating a [drag on innovation and productivity](#).

The capitalist system grounds its claims to moral legitimacy on both the promotion of liberal values and freedoms and the pursuit of Pareto optimality. But this is dependent on [trust](#)—alongside the aforementioned social consequences, the absence of trust in the capitalist system from its agents will lead to suboptimal economic activity, underinvestment in innovation, and drag on productivity and real income growth.

Ensuring that business acts in accordance with a social or ethical doctrine is the responsibility of government. The Government—and the democratic system that elects it—is the insurance between the eternally divergent interests of businesses and individuals. This outlines the primacy of trust in government to secure not only a healthy democracy and high-functioning government, but a prosperous economy. A mere \$33 million investment to establish a new body of ethical expertise to navigate ethical challenges and build back trust in government is a measure that promises to be as fiscally attractive as it is prudent.



Stimulate investment

Building Australia’s investment capacity, including venture capital (VC), private equity (PE) and angel investment—and by extension the startup and innovation ecosystem it invests in—will support diversification, long-term prosperity and productivity. The investment ecosystem is fundamental to building new markets, jobs, companies, and industries. It is time to address the [commercialisation bottlenecks](#) that exist for our home-grown technologies.

In contrast to the [gold rush](#) that characterised the startup scene until 2022, venture funding hit a [six-year low](#) in the first quarter of 2024. Rising interest rates have [deterred foreign investment](#), leading to a precipitous decline in the number of deals (see **Figure 14**). Last year many

startups endured [headwinds](#), [mass layoffs](#) and saw [valuations plummet](#), with [more collapses forecast](#) in the coming year.

The idiosyncratic dynamics of Australia’s startup ecosystem can also constrain the growth of the market. Many startups could benefit from more support to shift their parochial focus beyond [the domestic market](#). In addition to issues related to distance, as well as a lack of domestic supply chains for numerous products, our [relatively higher](#) corporate tax rates have made Australia a less attractive investment location for Asian and US sources of capital. Like many of Australia’s other comfortable oligopolies, the venture capital landscape suffers a [market concentration problem](#), with suggestions that Australia’s big three funds may be crowding out the emergent funds vital to healthy competition in the market.

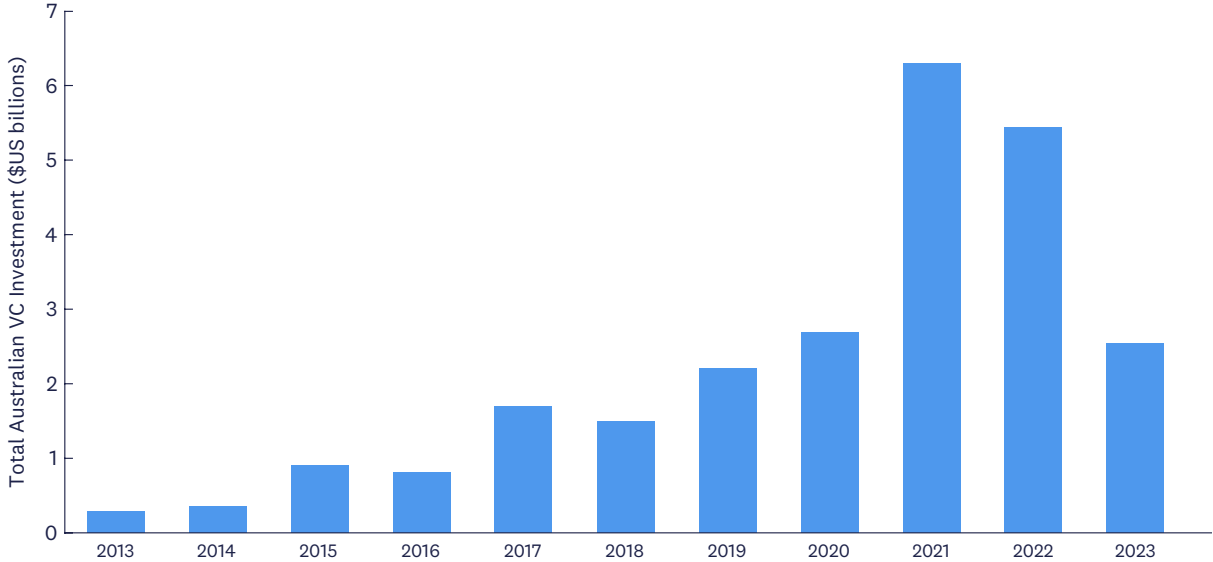


Figure 14 Total cumulative venture deals in Australia (2013–23)

Source [Dealroom](#), [KPMG](#)

Despite these structural issues, Australia has one of the highest success rates for unicorns (startups that exceed a one billion dollar valuation) per venture dollars invested (Figures 15a/15b), despite chronically underinvesting in home-grown startups. There is a huge opportunity if we can strengthen market conditions for venture capital-backed startups.

However, fiscal policy employed to foster the startup ecosystem in Australia has been flawed. Investors and governments often view each other as competitors—when they should be considered teammates. Government activity in the venture space has drawn the ire from VC investors for being too heavy-handed and misunderstanding the way innovation is incubated. We would agree that government-led VC can look like ‘picking winners’ in speculative technology markets and industry policy, resulting in a poor track record and inefficient deployment of capital.

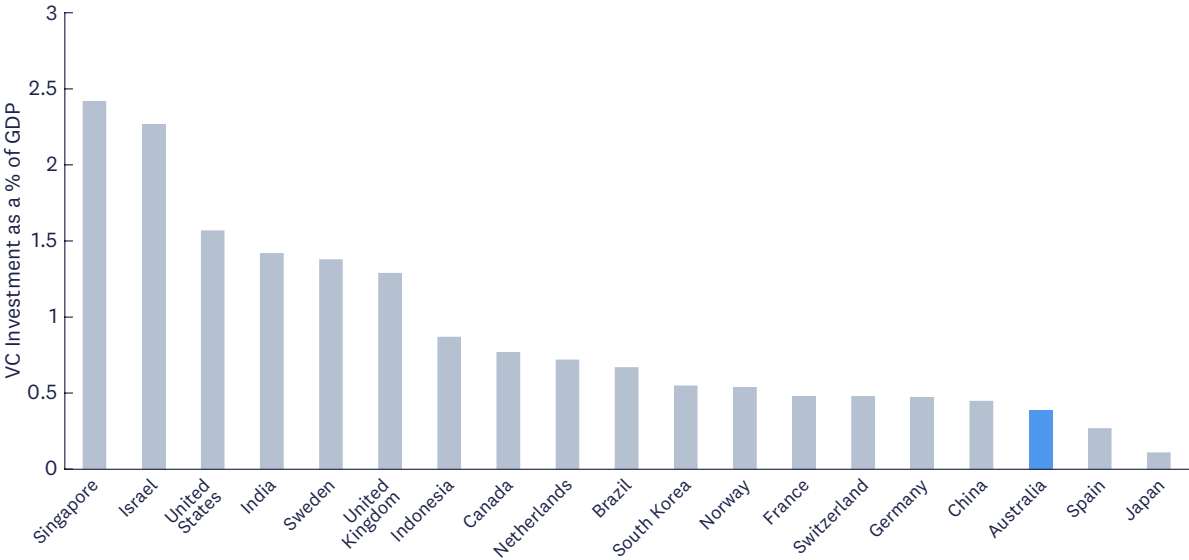


Figure 15a VC investment as a share of GDP (2021)

Source Dealroom

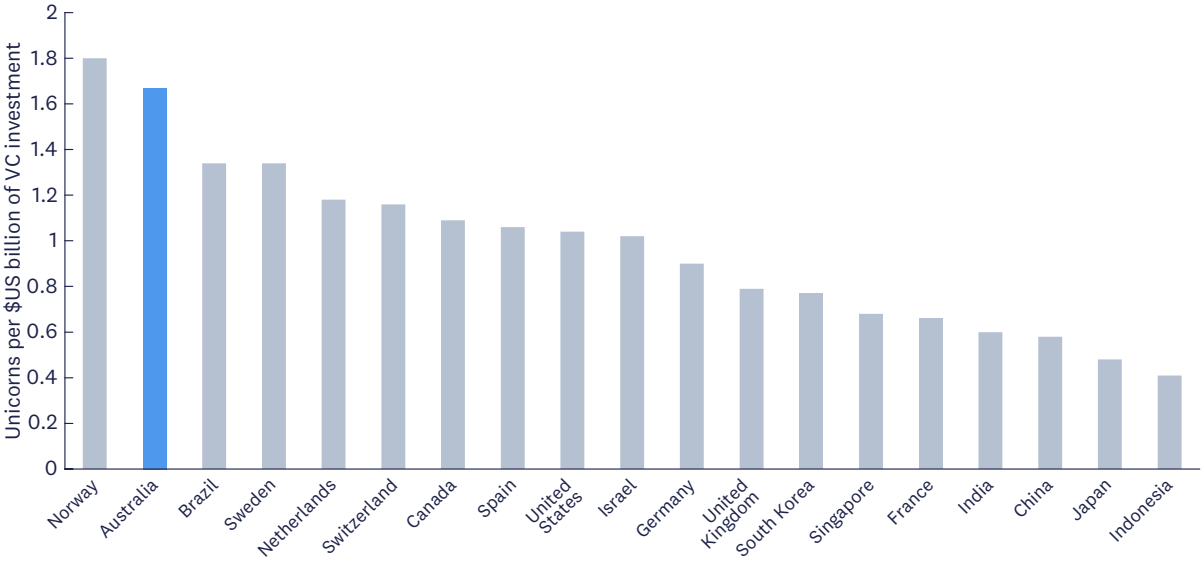


Figure 15b Unicorns per \$US billion of VC investment (2017-21)

Source Dealroom

Government VC funds tend to perform worse than private VC funds. Without the same performance based incentive structures for fund managers, [selection expertise and portfolio management](#) tends to be weaker. Government VCs can [crowd out](#) further private capital if they take a competitive role over a complementary one. [Incentives and mandates may not align](#), as governments may tie their investment to an arbitrary or ambiguous political constraint as opposed to the clearer ‘outlier returns’ incentive for private funds. A Government VC can be operated by employees with zero skin in the game—while private VCs generally require a proportion of personal at-risk capital put up by the investors themselves.

Furthermore, when governments have tried to boost the sector [in the past](#), their investment has failed to assimilate with the existing venture ecosystem. Ironically, the government can often have a [dampening effect](#) on growth by discouraging would-be investors. Venture capital is often described as ‘[patient](#)’—but government appetite for venture investing has also proven to be [temperamental](#) and unfocused. This can

hamstring the development of startups, and distract founders from their goal of scaling a product to more immediate fundraising for survival.

This lends credence as to why the asset class is dominated by venture specific investors. As **Figure 16** shows, venture capital funds make up over half of the total active investors in the venture market.

Instead of stoking a public-private culture war, we recommend a more nuanced and targeted fiscal approach from government—one that outsources investment decision-making to those with a proven track record and that crowds in further private investment. This can be done at a fraction of the cost of setting up state-run competitive VC funds.

We must recognise venture and startup ecosystems as engines of innovation for the Australian economy. The Federal Government must do more to shape the venture market and create the best conditions for Australia’s innovation ecosystem to thrive—acting to complement instead of compete.

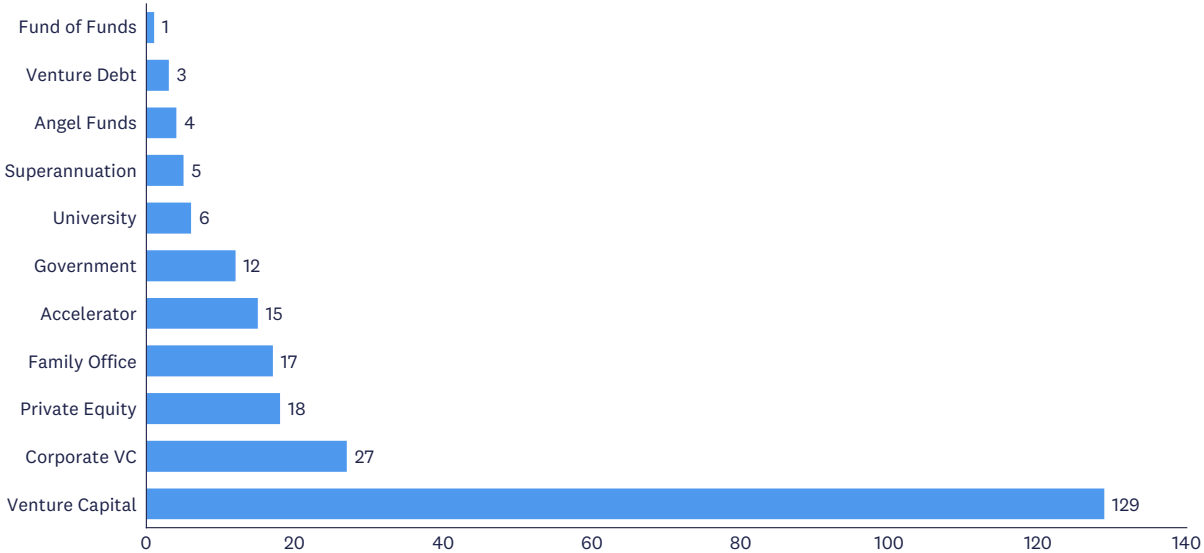


Figure 16 Proportion of active investors in venture market (2021-23)

Source [Monash University](#)

Invest in venture funds rather than startups

If the Government insists on direct investment into venture capital initiatives, we recommend that funding be directed into early-stage investment firms themselves, and that capital allocation is left to the experts. This would be preferable to the status quo of a patchwork of government venture initiatives managed by federal and state officials, and sporadic investments into government-selected startups. There are several ways this can be established at the federal level—such as a matched limited partner funding program, or a capped returns funding model—to support emergent Australian venture capital funds and improve cohesion between state initiatives.

When a government invests in startups directly, there are unintended consequences. The Government appears to be trending down this path—notably with investments into [SunDrive](#) and [PsiQuantum](#). There is no reason to believe that government-operated venture funds are better than industry at [picking winners](#). A recent example is Breakthrough Victoria, a state VC fund which has spent [\\$22 million to invest \\$74 million](#). Many more funds exist at the state level—we found nine with funds under management, with a total value of \$2.6 billion. The patchwork of existing venture initiatives clearly demonstrates the Government’s intention to continue investing in the startup and venture ecosystem.

Venture capital is the riskiest form of early-stage investing, with an [extremely high failure rate](#) and significant investment lead time. If the Government insists on investing in the startup ecosystem, it makes more sense to empower venture capitalists with proven track records. Governments should not lead, but co-invest, in startups. This approach mitigates against [criticism](#) of poor investment decisions and ‘picking losers’ on the taxpayers dime—while sharing realised gains between the public and private sectors. The initiative also preserves the network-driven venture ecosystem rather than building a direct dealflow competitor.

A matched funding program for venture funds would target fiscal support towards a key barrier in the market. Emergent VC firms face a [funding](#)

[chasm](#) when raising their second fund—the key milestone to prove readiness to partner with institutional capital in the future. Many emergent funds in Australia are [currently facing](#) this challenge. For example, if the government wants to invest, they could consider a seed investment of up to two million dollars into a first close fund or a cornerstone investment of up to \$10 million in a second close. The long-term sustainable partner in this asset class is institutional capital—primarily superannuation funds. Super funds generally have evaluation thresholds to partner with emerging funds, such as a minimum funds under management, a five year track record and a certain level of institutional readiness. Helping smaller VC firms unlock institutional private capital is a much more efficient use of public investment than setting up and operating competitor state funds.

Oversight of public investment into venture funds should be managed by a credible board of proven domestic and international venture capitalists, who will assess applicant firms with a rigorous due diligence process on their operations, compliance, and commerciality.

Incentive alignment would be integral to success. The Government, and the administering board, would be entitled to a share of the returns (this could be capped on the upside—the Government would cap their total return, and leave the potential upside to the investors) once the fund realises, meaning federal coffers would see returns based on the performance of the best venture investors. The Government could play a role in more broadly directing investment into areas that venture investors typically avoid, such as where market failures exist.

Redirecting federal venture funding to the investment industry would enhance the ecosystem and mitigate against potential risks. Investing in funds themselves would provide assurance for emergent funds and promote healthier competition and a richer pool of investment theses. This would crowd in much more catalytic capital into many more Australian startups, save the taxpayer a fiscal burden, and maximise public returns, all while boosting Australia’s innovation ecosystem—the key engine for economic diversification and sustainable long-term growth.

Exempt startups from the unrealised gains tax on super balances

In attempting to make superannuation more equitable and sustainable, Labor has proposed an [increase](#) in the tax paid on earnings from 15% to 30% for people with more than three million dollars in their super balance. Notably, this tax increase would apply to unrealised gains. We caution against the complexity and political ramification of this reform—but recommend that if the Government insists, that the proposed tax as it relates to unrealised gains includes an exemption for investments into startups or venture capital firms, to avoid dampening a sector that is a key engine to economic growth and productivity.

Startups require patient capital to succeed, and returns are illiquid. The long-term outlook of superannuation funds make them an ideal source of capital to facilitate growth in Australia's startup ecosystem. Over the past decade self-managed super funds have been a significant [capital partner](#) for Australian venture capital firms. However, the industry has [expressed unease](#) at Labor's proposal and are worried that taxing unrealised gains will disincentive investors given the longer lead times startups require to generate returns.

If these proposed changes are enacted—and investors are required to pay CGT on the increase in market value of an investment that they cannot yet themselves access, it may have a [chilling effect](#) on Australia's growing startup ecosystem.

Introduce an 'educated investor' exemption for the proposed overhauled sophisticated investor test

As originally recommended by ASIC, Labor has hinted at overhauling the sophisticated investor test by increasing the minimum net assets from [\\$2.5 million to \\$4.5 million](#), thereby making it more difficult for retail investors to qualify as 'sophisticated'. We do not support this recalibration—we recommend the threshold be indexed to inflation instead. However, should the government proposal be enacted, we recommend that an 'educated investor' competency test be put in place to enable investors with sufficient

skills and knowledge to access the benefits of being classed as a 'sophisticated investor', even if they do not meet the newer minimum level of assets.

Currently, an investor is considered sophisticated if they have a minimum net asset value of \$2.5 million, or earn \$250,000 in gross income over consecutive years. Sophisticated investors are able to invest in [private equity, private debt, pre-IPO and unlisted investments](#) typically unavailable to retail investors—schemes which are generally complex but lucrative. The sophisticated investor test is designed to improve protections for retail investors from high-risk products. Yet, the asset thresholds have remained unchanged since the introduction of the test in 2001, and the number of sophisticated investors has risen from [1.9% of the Australian population in 2002 to over 16% in 2021](#).

But such a drastic jump in threshold is likely to have adverse effects, particularly in the startup sector. Many eligible angel investors, responsible for seed funding startups at the earliest stage, would no longer qualify as a sophisticated investor—[closing them out of the market](#). VCs have warned that this could be significantly harmful for the sector.

Whether or not an investor has the competency to fully comprehend the risk profile of certain lucrative asset classes should be determined by an examination of their skills, knowledge, and experience instead of their wealth. Successful models of an exam process are already in practice in the [United States, United Kingdom, and Singapore](#). This would ensure that early-stage capital flows from angel investors continue unimpeded, and there is no unnecessary barrier that [impedes](#) the startup sector before the companies are even built.

Exempt startup acquisitions from proposed merger reforms

Should Labor's proposed merger reforms go through, we recommend that they be designed in a way that exempts most startups. Specifically, the notifiable 'merger' threshold should be set so that most startups would be exempt from the new rules, to prevent dampening venture capital flows into startups. Acquisition is an important exit-strategy for many startups—it is essential that this remains an option to support innovation.

Labor's proposed reforms to merger and acquisitions legislation are intended to streamline their processes while continuing to address concerns about [oligopolies](#) and consumer price gouging. Under the [proposed legislation](#), companies above a certain monetary and market share threshold would be required to inform the Australian Competition and Consumer Commission (ACCC) about any intended merger. Mergers would be contingent on ACCC approval, contingent on whether such action would be considered anti-competitive in nature. Although the government has not yet determined the exact parameters of either threshold, we recommend that startup acquisitions be exempted from the new regulations due to their invigorating effect on the Australian economy.

While we laud the ambition to shake up competition policy, it is crucial to acknowledge the potential harm that the merger reforms could have on Australia's startup ecosystem. Mergers and acquisitions have not definitely been shown to be the biggest driver of anti-competitive behaviour in Australia. Years of management consulting advice to large players to maintain 'price discipline'—a euphemism for avoiding competing on price—has arguably had a bigger effect, with positive benefits for shareholders at the expense of consumers.

Startups rely on acquisitions as a key liquidity event to realise returns for investors. If this policy is too heavy-handed, it could have a dampening effect on Australia's innovation ecosystem—scaring away would be investors who are deterred by further red tape for an early-stage company to be acquired and for returns to be realised.

Legislative design should ensure that loopholes are minimised and that the merger reforms can proceed and achieve their intended purpose without having unintended consequences on Australian innovation.

