2012-13 PRE-BUDGET STATEMENT TO THE QUEENSLAND GOVERNMENT

SEPTEMBER 2012

AUSTRALIAN INDUSTRY GROUP

FORWARD

The preparation of the first Budget to be delivered by the LNP in Queensland comes at a time when our State faces dual challenges. The first is the important task of fiscal consolidation, given the findings of the Interim Report of the Queensland Government's Commission of Audit, released on 15 June. The second, is to ensure that efforts to fashion our economy into a productive, diverse and resilient growth State are sustained.

This Pre-Budget Statement acknowledges the fiscal reality and makes recommendations to set a path towards a more robust fiscal footing. It does this from the perspective of enhancing our productive capacity, and warns against two significant risks:

- The risk of weakening the drivers of growth through poorly-targeted cuts to productivity-enhancing public spending; and
- The risk of missing opportunities to further strengthen these growth drivers.

Building Productivity

The Australian Industry Group (Ai Group) urges the Queensland Government, in close consultation with industry, to use the 2012-13 Budget to raise the competitiveness of the Queensland economy. This will require the Queensland Government to:

- Undertake tax and regulatory reforms;
- Improve government tender processes;
- Improve the efficacy and efficiency of business capability building programs;
- Invest in the education and training of the Queensland workforce; and,
- Facilitate further investments in infrastructure by considering new and effective ways to fund increased public and private expenditure on infrastructure.

The Government has identified the four 'pillars' (industry sectors) of mining, construction, agriculture and tourism as the future drivers of State economic growth. In addition to these we emphasise that other pillars such as manufacturing and services collectively employ the great majority of Queenslanders. While many businesses in these sectors are struggling under the weight of a strong domestic currency, weak global demand and post-GFC erosion of confidence, they have a critical role to play in ensuring that the State continues to develop as a diverse, competitive, innovative and resilient economy.

Asset Sales

To assist in the fiscal challenge, the Interim Report of the Queensland Government's Commission of Audit, pointed to further asset sales and reductions in public expenditure. These recommendations echoed the point made by the Ai Group in its Pre-Budget Submission in May 2011.

We urge the Queensland Government to commit to a further round of asset sales to get the State's fiscal position into a more sustainable position for the medium term. This will assist the Government to achieve the budgetary flexibility needed to tackle the challenges the state is confronting. Close consideration should be given to selectively privatising some assets including:

- the State-owned electricity transmission and generation companies, Powerlink, CS Energy and Stanwell Corporation; and
- a suite of government-owned real estate assets.

Ai Group has estimated the package of power assets could raise between $9 billion and $12 billion. Power assets in other states have been successfully privatised and it is undoubtedly the sensible path for Queensland to pursue. These types of assets are more efficiently and productively managed by the private sector.

To facilitate these initiatives, Ai Group would like to see a mature and well-informed discussion about the need for further asset sales and proposes the creation of a panel of high-level economic, financial, legal and business advisers to be established to advise the Government on the potential value of State assets, the timing of their presentation to market, and how the funds derived should be used to retire debt and strengthen the state's economy and fiscal position.

Public Sector Reform

Government also needs to curtail expenditure and Ai Group reinforces its calls for a renewed focus within the Queensland Government on public sector renewal, streamlined service delivery, coupled with a focus on achieving increased efficiencies in the operation of government departments. We support a program that targets a reduction in the size of the public sector by 5% over a three-year period.

In executing this, Government however needs to be mindful to retain public sector talent so that robust policy development capability can be maintained within the public service. Queensland needs a modern, flexible, clever and responsive government and the public service needs to be a leader in innovation and best practice. In this regard Government should prioritise restructuring traditional processes, matching technology investments to these changes and managing projects responsibly to ensure an overall return on investment and delivering savings in government running costs.

Opportunities for outsourcing should also be considered – in this regard establishment of an effective industry consultative mechanism for the Queensland business community with an interest in government reform, including investigating and discussing opportunities for outsourcing, is strongly recommended.

Matthew Martyn-Jones
Director (Queensland)

TABLE OF CONTENTS

ATTACHMENT

Budget Priorities for Queensland Industry

1.1 Productivity Enhancement

Maintaining **productivity growth** is a major challenge for Australia both in the short-term and longer-term. After accelerating dramatically during the 1990's, Australia's productivity performance has deteriorated significantly in recent years declining by 1.2 per cent per year since 2003-04. National complacency around this decline has been attributed to the poor performance being masked by high terms of trade created by the Australian resource booms. Australia's economic prospects will deteriorate significantly if the decline in our productivity growth performance is not addressed. As Australia's population ages we will be facing increasingly significant challenges around this - with productivity relied on to do more of the 'heavy lifting'.

Given this environment, it is strongly recommended that the Queensland Government use the 2012-13 Budget to increase funding for targeted programs to enhance productivity. Reversing the decline in our productivity performance will require reductions to the red tape burden on business, improvements to education and training, strong infrastructure investment, a heightened innovation effort including technology "readiness" and entrepreneurship, and flexibility so that businesses can leverage emerging opportunities.

Ai Group commends government on the recent establishment of Infrastructure Queensland (IQ). Business innovation and overall productivity are all boosted by high quality infrastructure – precursors essential to enhanced global competitiveness. Ai Group strongly recommends government utilise the 2012-3 Budget to fund IQ's investigation of structured public-private partnership policies to support delivery of a strategic program of **infrastructure provision** that caters to the State's growing population and emerging climatic patterns.

A number of factors will increase demands on the State's infrastructure networks. These include:

- resources sector expansion;
- a rapidly growing population (over 100,000 new residents annually and a growth rate of 1.8 per cent in 09/10. Despite being Australia's most decentralised state, a relatively larger amount of Queensland's population growth occurs in South East Queensland (SEQ). The estimated resident population of SEQ at April 2011 was 3.18m, projected to rise to between 4.15m and 5.08m (low and high series), by 2031[1];
- a predicted increased frequency of major climatic events.

Since 2007-08, more than $60b has been invested in infrastructure in Queensland[2]. Maintaining this commitment is not only important for maintaining levels of economic

[1] OESR Population & Dwelling Profile - SEQ(April 2012).
[2] QLD Government's 2011 Submission to Infrastructure Australia (November 2011).

activity and employment, but also to build the future capacity of the Queensland economy. In 2009 53.2% of Queensland industry reported significant positive flows from the State's infrastructure program. This is in sharp contrast to much lower figures in other states.[3]

Whilst the last decade has seen significant investment in infrastructure projects that have made serious inroads to the State's previous infrastructure shortfall, the Queensland budget is now in deficit with a return to surplus not expected until 2014-2015. Despite increasing difficulties around infrastructure funding, Government cannot afford to become complacent about the infrastructure required to support future growth. Whilst budgetary constraints will make it extremely challenging for government to maintain capital program delivery at a comparable to recent level using traditional funding models, continued infrastructure provision will be key to future economic growth. Accordingly, it is increasingly critical that **long-term private sector investment in infrastructure** be more urgently investigated.

As Australia struggles to increase productivity, the critical role of infrastructure should not be overlooked. We need to utilise existing infrastructure efficiently and effectively and ensure it is appropriately maintained and fit for purpose. In a 2010 Ai Group survey of industry[4], Queensland was second only to New South Wales in the level of concern in relation to State and National highways and local road infrastructure. In Queensland, industry viewed State and National highways and local road infrastructure as the second and third most significant infrastructure related constraints on growth. Urban congestion is already identified as a major constraint on productivity though there are inconsistent figures around the likely extent of impact. Road congestion in all Australian capital cities was estimated to cost $9.4 billion in productivity in 2005, expected to rise to $20 billion by 2020 if left unchecked.[5] In addition to Ai Group's concerns regarding congestion impacts on productivity, there continues to be an immediate need to commence a project to provide ongoing freight and passenger capacity in the State post-2016, including for the broader productivity benefits major infrastructure projects provide for the economy.

[3] Ai Group, The State of Industry: Report on major issues confronting industry and constraining growth (2010).
[4] Ai Group, The State of Industry: Report on major issues confronting industry and constraining growth (2010).
[5] Department of Infrastructure, Transport, Regional Development and Local Government, The State of Australian Cities 2010 Report (March 2010)

A Robust Infrastructure Framework for Queensland

Ai Group urges government to give consideration to the following:

- Maintain a robust program of integrated infrastructure projects that deliver increased productivity
- Utilise existing infrastructure efficiently including by exploring opportunities to improve productive capacity of current networks
- Ensure existing infrastructure is well maintained and fit for purpose.
- Ensure proposed new projects are based on robust research and sound methodology including having regard for emerging challenges such as population growth and a likely increase in the severity of climatic events.
- Utilise new projects as opportunities to showcase sustainable leading edge technology that showcases Queensland research and manufacturing talent and expertise and promotes and incentivises innovation
- Support participation of local firms in government procurement processes for major projects
- Explore opportunities for better tapping into private sector infrastructure funding
- Ensure infrastructure decisions are based on a coordinated and integrated state-wide planning approach

More specifically there should be a focus on new projects that:

- ease congestion - particularly projects that deliver new capacity in the SEQ rail network
- improve access to international gateways - including delivering increased dedicated freight rail capacity on the network to the Port of Brisbane
- improve infrastructure resilience to natural disasters - with a particular focus on a transport network that maintains connectivity and reduces flood isolation

Nationally concern is increasing regarding **diminishing Australian content in major resource and infrastructure projects** in Australia. In this regard, once in a generation infrastructure and resource projects should be leveraged for the benefit of the broader Queensland economy with Australian businesses having full and fair access to supply the goods and services required. Current barriers and distortions frustrating and impeding the full and fair participation of Australian suppliers include: how costs are determined (upfront or whole of life); uneven weighting of conformity to standards; criteria requiring a record of supply internationally; and preferences given to suppliers from country of company origin. These barriers and distortions are exacerbating the intense competitive pressures currently being experienced by local, trade-exposed industries and particularly the manufacturing sector. Ai Group believes Government should commit to adoption and adherence by government agencies to five purchasing principles that could assist industry to overcome these barriers:

- ***Principle 1: Value for Money***
  Value for money looks beyond "least cost" and brings to bear a broader cost-benefit approach that considers whole-of-life costs, including in relation to maintenance, servicing, quality and ongoing supplier relationships.

- ***Principle 2: Clarity, Transparency and Improvement of Processes***
  Procurement processes should be clear and transparent and be subject to ongoing improvement to reduce costs of tendering and access for domestic suppliers, particularly small and medium-sized enterprises.

- ***Principle 3: Full and Fair Access***
  Procurement processes should ensure local suppliers have full and fair to access to supply opportunities under direct government contracts and with prime contractors and for major projects. This includes consistency in relation to conformity with standards and no preferential treatment of offshore suppliers.

- ***Principle 4: Full Opportunities for Local Suppliers***
  Australian suppliers should have full opportunity to compete for the provision of goods and services under government contracts both directly and indirectly through supply to prime contractors. For major projects, a condition of awarding prime contracts and licences should be that local suppliers will have full and fair access to sub-contracting and supply arrangements.

  Procurement plans should demonstrate how purchasers will facilitate opportunities for participation by local suppliers. Proactive strategies should be adopted to ensure a strengthened Industry Capability Network (ICN) informs local industry of opportunities and links purchasers with local suppliers. Undertakings by purchasers should be monitored over the life of projects and purchasers should publicise the extent of participation by local suppliers.

- ***Principle 5: Supporting Industry through Effective Planning and Communication***
  Large government purchasing activities and major project plans should be developed in a transparent way to ensure local industry is able to invest sufficiently to participate in major tenders. As much as possible, major procurement activities undertaken by Australian governments should be coordinated and staged to allow businesses scope to invest and achieve the economies of scale by aggregating demand across the federation.

Ai Group proposes that all levels of government need to adopt a principled and coordinated approach (as outlined above) to improve access for domestic suppliers to public sector contracts and to the provision of goods and services for major projects undertaken within Australia.

How Queensland can fulfil the projected **demand for skilled workers** into the future will continue to be a critical question for business, the Government and the wider economy. In particular, government must put in place measures to ensure Queensland has the skilled workforce needed to effectively deal with the challenges of our multi-speed economy.

There is a strong ongoing need for high levels of industry input to government around skills, training and education. In particular, anecdotal evidence suggests Queensland industry is increasingly moving away from TAFE QLD towards private training providers due to perceptions around responsiveness, training quality and inflexibility around training delivery.

These matters need to be urgently addressed if TAFE QLD is to retain market share and remain competitive in the Queensland training landscape. Current work underway to reform TAFE QLD is welcomed. Whilst it is critical that the viability of TAFE QLD is retained so that that the State has a solid high performing public provider this should be balanced against the need to achieve system efficiencies – in this regard action should include rationalising the asset footprint, reducing operating overheads to ensure funding is used efficiently, and aggressive reform of the employment conditions of the TAFE workforce. In undertaking this reform the emphasis should be a quantum lift in quality. It is also essential the reforms take place within an industry framework.

Innovation is increasingly recognised as a key source of competitive advantage for small through to large firms, especially in the context of growing competition from globalised markets and low labour cost nations[6]. Accordingly, greater business innovation and productivity is a critical ingredient in supporting long-term economic growth for the state.

[6] *Innovation – New Thinking > New Directions: A Report to the Ai Group by the Innovation Review Steering Committee* (Oct., 2010).

There are concerns that Australian innovation policy is too focused on "research driven" approach to fostering innovation. Ai Group views innovation encompassing a wide range of activities that drive change and add value. Innovation encompasses all work directed at developing new products, new processes and new business models. Wealth is created through changes, either large or small, to goods and services, processes and structures. There is an urgent need to build capacity in Queensland companies to normalize innovation as part of everyday business strategy. A greater focus on a market facing agenda for Australian innovation is urgently required if the core nexus of productivity, competitiveness and economic diversification is to be strengthened.

Several important aspects of current practice in Australian innovation were revealed by a recent Ai Group Innovation Survey, part of *Innovation – New Thinking > New Directions: A Report* to the Ai Group by the Innovation Review Steering Committee, released in October 2010. The report and associated survey found that while businesses mainly innovate by introducing new products/services and improving business processes, adopting new technologies and introducing new skill sets are also significant. The key barriers to innovation were identified as lack of funds, appropriate skills, time and resources. Insufficient tax incentives were also seen as an inhibitor to innovation.

In order to drive much needed enhanced productivity and competitiveness across all sectors government is urged to utilise the 2012-13 Budget to fund development of a multi-sectoral State-wide Innovation Strategy to drive innovation in Queensland. Such a strategy should focus on delivering the business innovation required to drive productivity growth with a component focussing on innovation in government due to the importance of government showing high-level leadership in this space.

Significant research exists demonstrating that **adoption of emerging technologies** also improves productivity and business competitiveness. A 2011 Ai Group survey looking at reasons businesses invest in technology found that that 73.2 per cent seek to increase productivity, whilst 41.1 per cent invested to expand production or as part of the development of new products.[7]

In addition to investing in business innovation capability, government should give consideration to funding support for businesses to leverage emerging technologies, particularly, forthcoming broadband technologies. Such a program would support innovation by assisting the business community to understand and fully utilise emerging technologies to their competitive advantage.

[7] Ai Group Technology Survey (Nov., 2011).

RECOMMENDATIONS:

- **Infrastructure –** Utilise Infrastructure Queensland to prioritise the investigation of new infrastructure funding models to support a proactive and integrated State infrastructure program into the future and prioritise a project to provide ongoing freight and passenger rail capacity in the State post-2016.

- **Local Industry Participation** - Prioritise local industry participation, focusing on development and implementation of appropriate policies to build transparency, fairness and greater opportunity for local business participation in procurement arrangements.

- **Industry Involvement in Skills Programming and Delivery** - Facilitate high levels of industry input to government around skills, training and education programming and delivery.

- **TAFE QLD** - Reform the state's TAFE system to ensure TAFE QLD is a competitive and resilient public provider in a framework where strong pathways exist between secondary school, the TAFE system and onward into tertiary study. Action should include rationalising the asset footprint, reducing operating overheads to ensure funding is used efficiently, and aggressive reform of the employment conditions of the TAFE workforce.

- **State-wide Innovation Strategy** – Prioritise development of a multi-sectoral State-wide Queensland Innovation Strategy to drive innovation in Queensland.

- **Leveraging Emerging Technology** - Establish a program of assistance and support for Queensland businesses in early release broadband areas. The purpose should be to drive capacity building and early adoption to see a fuller utilisation of emerging technologies to their competitive advantage.

1.2 Improved Business Competitiveness

With some Queensland businesses still recovering from events of January 2011, and others facing challenges from a high $AUD, cheap imports, weak domestic demand and growing global economic uncertainty, Government must focus on creating the right environment for driving economic success in the State. This will be achieved in part through reductions to the cost of doing business in Queensland.

In an environment where businesses are struggling, reducing the cost of doing business can be a critical form of relief and a catalyst to reinvigoration. In our 2012 pre-election submission the Ai Group called for a staged program of improvements to the State's tax system to re-build Queensland's competitive position. Ai Group commends the subsequent decision by the new LNP government to increase the tax-free threshold for payroll tax from $1m to $1.6m.

Ai Group also welcomes the Queensland Government's commitment to reducing the **regulatory burden on business** by 20 per cent and broadly supports measures to identify, modify and reduce unnecessarily burdensome or duplicated State and local government regulation outlined in the Queensland Competition Authority's *Measuring and Reducing the Regulatory Burden Issues Paper* (August 2012). Red tape is consistently raised by industry as one of the top issues impacting business. The average Queensland business deals with 9 regulators annually, spending around 6.5% of their total annual expenditure on regulatory compliance. An Ai Group / Deloitte *National CEO Survey: Business Regulation* released in September 2011 found that Queensland businesses face the largest direct compliance costs in Australia, spending on average 17.8 hours per week on compliance activities.

The regulatory environment plays a critical role in business innovation and growth. At a time when Australia's productivity performance is lagging behind major competitors, 57 per cent of the State's businesses report regulation is a barrier to innovation. Whilst business appreciates the need for appropriately targeted well-drafted legislation around critical areas, Queensland must become smarter about how and when regulation is delivered to ensure Queensland businesses are not put at a competitive disadvantage.

Regulatory compliance pressures are all the more acutely felt at a time when many Queensland businesses are not necessarily in the fast lane of the resources boom – and it is times like these when removing red tape can make a difference to business survival. In this regard, Government's proposed exclusive prioritisation of (red tape removal from), "four pillars" sectors (resources, construction, agriculture and tourism) should be extended to include the manufacturing sector.

In addition to identifying burdensome regulation already in place, Government must also focus on improve regulatory processes and working more closely with industry around putting new regulation in place. There is also significant room for improvement around levels of consultation and consultation processes and implementation. In this regard there is a strong desire from industry for:

- appropriate and reasonable consultation with government around new legislation and/or regulatory reform; and
- timing of commencement to minimise industry impacts and support business compliance.

Whilst government plays a legitimate role in putting regulation in place, for example, to protect public safety, to ensure a level playing field between firms, to protect consumer rights, and to protect local amenity and environmental values, the government can do much better in how and what it regulates.

Table 1: Direct costs of business regulation

	New South Wales	Victoria	Queensland	South Australia
	Average number of hours per week			
Time spent by employees	12.4	12.0	17.8	14.6
	Average percentage of total business expenses			
Outsourcing costs	3.3	3.1	3.6	2.7
Government fees and charges	2.5	2.5	2.9	2.7
Total	**5.8**	**5.6**	**6.5**	**5.4**

Source: Ai Group Survey, 2011

Table 2: The 10 most time consuming areas of business regulation (Share of the total number of hours spent per week)

	New South Wales	Victoria	Queensland	South Australia
OH&S and workers compensation	13.1	12.8	15.4	12.9
Other employee-related regulations	10.5	12.1	10.2	12.0
Trading across national borders	12.3	10.8	11.2	8.1
Consumer protection regulation e.g. inspections & labelling	11.3	10.7	10.1	12.1
Health and food safety regulations	10.3	10.0	8.7	5.6
Corporate governance regulation	9.1	8.7	8.9	10.2
Paying taxes	8.7	9.0	9.7	10.6
Trading across state borders	8.3	9.1	9.0	8.0
Other environmental regulations	8.4	8.7	8.2	10.0
Paying fees and charges	8.0	8.2	8.5	10.5
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: Ai Group Survey, 2011

Workers compensation premiums are a further area of concern to industry. Whilst Ai Group welcomes the Government's decision to bring forward the scheduled 2014

review of the Queensland Workers Compensation Scheme, industry does not share the Commission of Audit's view that increased premiums may be an appropriate option for dealing with potential issues around Work Cover Queensland's capital adequacy.

Ai Group strongly supports a fair and sensible workers compensation scheme that provides access to care and support for the seriously injured and speedy and effective recovery and return for all workers who have suffered an illness or injury at work. Most importantly a workers' compensation scheme needs to be efficient, cost effective and fair.

The current scheme has recently lost its historical footing as the cheapest in Australia with a combined premium increase of 26% over the last three years. Whilst the State currently has the second cheapest premiums in the country, premiums in Queensland have been increasing.

The Commission of Audit in their Interim Report released in June 2012 noted that WorkCover Queensland's capital adequacy has been under pressure due to increased claims and a volatile investment performance and suggests that if this position deteriorates further the State may be required to commit additional funding and/or request WorkCover Queensland to increase contribution rates to restore its target level of solvency. Ai Group considers it extremely unfair and counterproductive to lump the burden of any future deficit directly onto employers. Ai Group is confident that by improving the statutory claims management processes and introducing a minimum threshold for common law claims can potentially yield significant savings that may allow premiums to be decreased. Ultimately if QLD is to remain competitive a return to the lowest premiums nationally should be an appropriate target.

In a 2010 survey conducted by Ai Group, **industrial land affordability** was identified by Queensland industry as the most significant infrastructure issue important to business growth in the state, cited by more than one-in-five (21.5%) respondents. This is a more pronounced issue in Queensland than other states. Since this survey, anecdotal evidence suggests industrial land availability continues to be on of the most important issues for industry. This has been emphasised by 2011's natural disasters which affected some of the State's most strategic industrial land. The vulnerability of these areas highlights that ongoing vigilance will be required to ensure adequate levels of suitable, flood free and strategically accessible land are set aside for industry. This will be particularly important into the future due to the potential for increased pressures from urban encroachment driven by residential construction in flood-free locations.

Finally, Ai Group commends government's recent trade mission to China, Japan and the United States. Helping Queensland business identify investment and export opportunities will be key to maintaining the competitiveness of Queensland business, especially where a focus is placed on opportunities in emerging economies.

RECOMMENDATIONS:

- **Reducing the Regulatory Burden** – Continue to work closely with industry to reduce the regulatory burden on Queensland business. This focus should not be restricted to the "four pillars" of resources, construction, tourism, agriculture but also prioritise high employment generating sectors such as manufacturing.

- **Reduce WorkCover Premiums** – Including by improving the statutory claims management processes and introducing a minimum threshold for common law claims to arrest the current trend of increasing premiums.

- **Industrial Land Affordability** - Ensure vigilance in monitoring industrial land availability and affordability in Queensland, with decisive action where necessary to address bottlenecks and overcome shortages.

1.3 Asset Sales

Ai Group continues to strongly support targeted asset sales that deliver increased economic competitiveness and productivity and are calling for a mature and sensible discussion about asset sales in the Queensland community. Despite the significant hysteria and misinformation that went on about the previous asset sales they still yielded a very good return to the State's taxpayers.

QR National listed on the Australian Securities Exchange in November 2010, after the successful completion of the second biggest initial public offering in Australia's history. The sale yielded Queensland a dividend of $4.6 billion, critical to reducing debt, delivering key strategic infrastructure investments and establishing a stronger balance sheet.

The 99 year lease of the Port of Brisbane and Abbot Point Coal Terminal yielded $2.1 billion, in addition to the buyer taking responsibility for future upgrades of sections of the Port of Brisbane Motorway - a total $2.3 billion worth of value to the State whilst also avoiding expected Port infrastructure expansions valued at $1 billion.

In order to ensure a thorough and robust examination of privatisation options, Ai Group urges the Queensland Government to establish a high-level privatisation panel to make recommendations on appropriate asset sales, the timing of their presentation to market and how the funds derived therein should be used to retire debt and strengthen the fiscal position. As a priority this group should be charged with examining selective privatisations including:

- Energy transmission company Powerlink, and the remaining government-owned energy generators. Power assets in other States have been successfully privatised and it is undoubtedly the sensible path for Queensland to pursue.

- Some government-owned real estate assets.

RECOMMENDATIONS:

- **Privatisation Panel** – Establish a high-level privatisation panel to examine and make recommendations on appropriate asset sales. This group should include representatives from the legal, banking, business and industry sectors.

- **Asset Sales** - Undertake a further tranche of asset sales headlined by the energy transmission company Powerlink and the remaining government-owned energy generators.

1.4 Public Sector Reform

Against a backdrop of very significant budgetary constraints, the Queensland Government also needs to curtail expenditure in addition to selling assets. Over 12 months ago Ai Group noted the need for a renewed focus within the Queensland Government on public sector renewal, streamlined service delivery, coupled with a focus on achieving increased efficiencies in the operation of Government departments. One of the recommendations made to the previous Government at this time was to reduce the size of the public sector by 5% over a three-year period.

Given this, industry welcomes the Government reforms currently underway to trim the Queensland Public Service including the overall reduction in the number of public servants, also championed in the recent Interim Report of the Commission of Audit. In executing these reforms Government however needs to be mindful to retain public sector talent so that robust policy development capability can be maintained within the public service. A strong Queensland economy demands **an effective and efficient public service**. Industry interacts with Government in a range of areas, and the standards of service provided by government agencies are important in helping businesses grow and prosper. Government must focus on rebuilding policy development capability within the public service to ensure robust policy development underpins critical decision making in what is a trying period for government, businesses and the economy. Many businesses report concerns in relation to their engagement with government officers and their lack of understanding of the everyday realities facing business.

Similarly, priorities for innovation and productivity need to extend to the public service's own activities and operations. Queensland needs a modern, flexible, clever and responsive government and the public service needs to be a leader in innovation and best practice. In this regard Government should prioritise restructuring traditional processes, matching technology investments to these changes and managing projects responsibly to ensure an overall return on investment and delivering savings in government running costs.

Opportunities for outsourcing should also be considered – in this regard establishment of an effective industry consultative mechanism for the Queensland business community with an interest in government reform, including investigating and discussing opportunities for outsourcing, is strongly recommended.

RECOMMENDATIONS:

- **Efficiency and Savings in Government** – Maintain vigilance around savings in government running costs, including by continuing to pursue appropriate opportunities for "right-sizing" and outsourcing (Ai Group supports a program that targets a reduction in the size of the public sector by 5% over a three-year period).

- **Outsourcing** – Establish an effective industry consultative mechanism for the Queensland business community with an interest in government reform, including to investigate and discuss opportunities for outsourcing.

- **Government Service Delivery** - Continue efforts towards improving Government Service Delivery, particularly in relation to regulatory reform.

1.0 Business Environment

The global economic outlook remains clouded by the ongoing sovereign debt crisis in the Euro zone. Europe's debt problems and recession are weighing on economic growth in other countries and are continuing to reverberate through global financial markets, with direct repercussions for credit, bond and currency pricing in Australia. Meanwhile in the United States, the economic recovery remains tentative. Against this backdrop of weak demand from developed economies, emerging Asian economies are also feeling the pinch, despite their ongoing shift towards domestic demand (i.e. local consumption and investment), rather than exports as the main drivers of growth. China is now in the process of reversing its monetary and fiscal policy settings from a restrictive to an expansionary stance, and may take some time to accelerate back to a higher growth track.

1.1 *National*

The Australian economy continues to perform well at a headline level, with GDP growth of 4.3% p.a. in March 2012 and likely to be well above trend (3%) again in the June quarter. This growth has been supported by mining investment and household consumption (that is, by expenditure) rather than by value-added, income-earning production. Non-rural production continues to track weakly and national investment and construction outside the mining sector are declining. This 'lop-sided' pattern of growth is currently not generating enough new jobs to push unemployment down. Indeed, despite the strong headline GDP growth, national net employment is growing at just 0.6% p.a. (as of July) and the national unemployment rate continues to drift up towards 5 ½%. Labour market participation is falling.

Conditions in Australia's States continue to reflect the multi-speed growth pattern that has been evident for some years. Western Australia continues to outperform all other states on almost every indicator in 2012. This patchwork of growth is a manifestation of deeper structural changes that are occurring in the Australian economy due to the combined simultaneous effects of: the mining investment boom; ongoing recession, rebalancing and risk in the global economy (which is itself a multi-speed story at present); the high level of the Australian dollar over a reasonably long period (largely for global commodity pricing and financial market reasons); the current weak spot in the residential and commercial construction cycles; and significant changes in Australian consumer spending patterns. Whilst the outlook continues to favour Western Australia, Queensland also has a large pipeline of mining investment projects and a relatively strong population growth rate that is supportive of future economic growth. Growth in the other mainland states is generally expected to improve to somewhere close to their average growth rates by 2013-14.

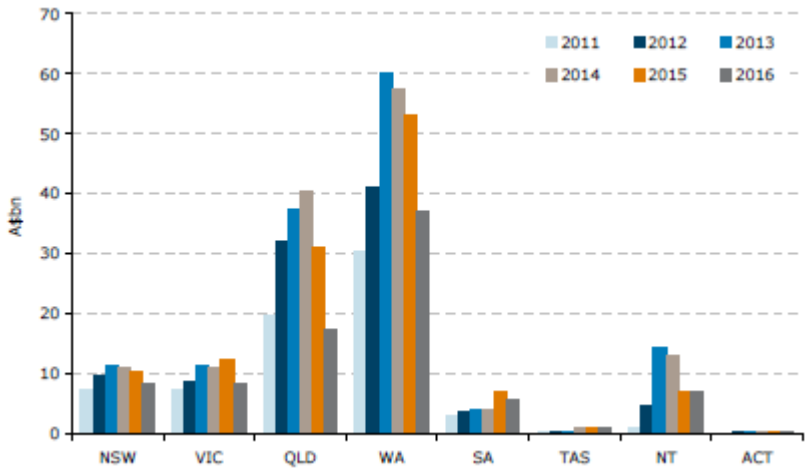
1.2 *Queensland*

Queensland is expanding at a strong pace due to international demand for the State's natural resources. State final demand fell by 0.8% in the March quarter 2012 though remains 7.5% higher over the year driven in large part by private capital expenditure which is 23.2% higher over the year. Queensland is itself exhibiting a strong 'north-south' multi-speed pattern of growth, with rapid activity in the coal and gas regions countering a tourism and residential construction downturn in the south-east corner. The Queensland Treasury expect real gross state product to grow by 5% in 2012-13 and the unemployment rate to fall to 5.25%. This growth is expected to be driven by a strong rise in both iron ore and coal production and exports due to significant expansions to mines and transport infrastructure and the removal of other supply-side disruptions.

Annual growth rates for Queensland are somewhat inflated however, by the 'base effect' of comparing March 2012 to March 2011, which was badly flood affected.

Private investment (capital expenditure) is especially important as a driver of growth at present, with total private investment up 23% higher over the year; housing investment 5.2% higher over the year; and building approvals (which provide an indication of future housing investment activity) close to 5% higher over the year. Much of this investment is related to mining and transport infrastructure which will greatly improve industry capacity in years to come, but which has very long lead times before any return on investment will be visible. ANZ Economics has calculated that the current pipeline of major projects in Queensland will peak in 2014 at around $40bn in new investment, before declining gently in subsequent years (see Figure 1).

Figure 1: Major project investments pipeline by state, 2011-2016



.

Source: ANZ Major Projects Update, August 2012

In addition to the high import intensity of mining investments and the time taken for these investments to translate into increased production capacity, production and export levels in Queensland have also been hampered by adverse weather events and other supply-side disturbances. As noted by the Reserve Bank of Australia in the May 2012 Statement of Monetary Policy: '*Wet weather in New South Wales and Queensland, a shortage of explosives at some coal mines due to the temporary closure of Orica's Ammonia Plant in Newcastle, and industrial action at the BHP Billiton Mitsubishi Alliance mines have all affected coal production to some extent'*.

International exports have been recovering from the recent adverse weather events, growing by 31.1% in the March quarter 2012, following the sharp falls in production levels and shipping rates (especially for coal) seen a year earlier. Production levels have also been affected to some extent by an increase in industrial disputes: The number of days lost per 1000 employees has averaged around 10 days per quarter over the past year, almost double the decade average, with most of these disputes located in or related to Queensland's coal mining sector.

Labour market conditions have been relatively stable over the past few months, with the State unemployment rate remaining at 5.5% in the December 2011 and March 2012 quarters, and the participation rate remaining slightly above 67% (well above the national average). As of July 2012 however, Queensland's labour market had deteriorated along with the other eastern states. Queensland's unemployment rate was 5.6% (above the national rate of 5.2%) and the participation rate was 66.3%, below its average over the past two years. The various job advertisement series (from ANZ, SEEK and DEWR) have all deteriorated further in 2012 in Queensland. This suggests that jobs growth and the unemployment rate will deteriorate further, before beginning to improve from sometime later in 2013.

Other real-time indicators of state economic conditions are also weaking at present. In August the Westpac-Melbourne Institute Index of Consumer Sentiment fell index fell from an already weak 91.7 to 83.0 points (an 8.7 percentage point fall) in Queensland (scores under 100 indicate net pessimism in this survey). This has been attributed to extensive media coverage of likely public sector job losses. Also indicative of very weak confidence levels at present, residential housing construction approvals fell a further 2.4% in July, while total building approvals fell by 19.7%.

1.3 *The Outlook*

The Queensland Treasury expect real gross state product to grow by 5% in 2012-13 and the unemployment rate to fall to 5.25%. This growth is expected to be driven by a strong rise in both iron ore and coal production and exports due to significant expansions to mines and transport infrastructure and the removal of other supply-side disruptions. In line with strong employment and wages growth, consumer price inflation is expected to pick up strongly over the coming year. Looking further ahead, the large LNG investment projects that are currently underway are expected to start contributing to economic growth from 2014-15. Queensland Treasury notes that the three projects currently under construction have the potential to increase export

capacity to over 20 million tonnes of LNG exports per year by the end of the decade. This would result in LNG becoming the State's second largest commodity export behind coal.

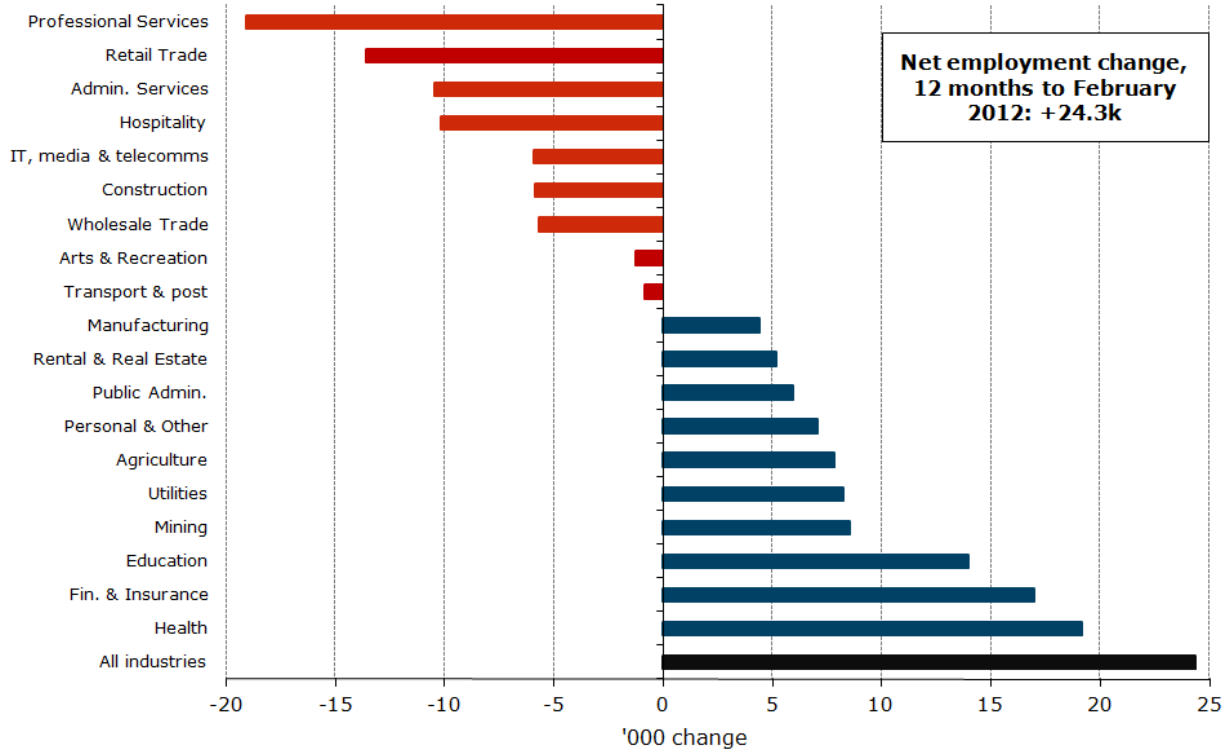
Table 1: State Economic Outlook

Annual % change

	2010-11		2011-12		2012-13	
	QLD	**Aus**	**QLD**	**Aus**	**QLD**	**Aus**
Real gross state product	0.2	2.1	4.25	3.25	5.00	3.25
Employment	2.3	2.2	1.50	1.00	2.25	1.50
Unemployment rate	5.5	4.9	5.50	5.5	5.25	5.50
Headline Inflation	3.3	3.6	2.50	2.25	3.75	3.25
Wage Price Index	3.9	3.8	3.75	3.75	3.75	3.75
Population	1.7	1.4	1.75	1.50	2.00	1.50

Source: Queensland Treasury and Australian Government 2011-12 Mid Year Economic and Fiscal Outlook

Figure 2: Queensland Labour Market



2.0 Business Sectors

2.1 *Manufacturing*

Queensland is home to many modern, value adding forward thinking industries producing high-value, knowledge-intensive goods and services. Nationally manufacturing activity continued to contract in August, albeit at a slower rate than July with the Ai Group PWC Performance of Manufacturing Index (PMI), rising 5.0 points to 45.3. Readings below 50 indicate a contraction in activity with the distance from 50 indicative of the strength of the decrease. Survey respondents remained cautious about the outlook, citing soft demand, the carbon tax, the strong Australian dollar and import competition as inhibitors of activity.

Wages and input costs continued to rise in August, while the decline in selling prices persisted, indicating that manufacturers' profits remain under pressure. The August results represented the sixth consecutive month of contraction for the sector. Australian PMI September 08 – August 2012 is at Figure 2 whilst Figure 3 shows Queensland's performance against the national 2006 – 2012.

Constraints on competitiveness of the sector include a sustained high and volatile Australian dollar, competition from cheap imports, increasing regulatory burden, barriers to participation in the supply chain for major Australian projects, technological change and management capability (many companies are SMEs). An industry perspective on anticipated future constraints is presented in Figure 4.

Figure 3: Australian Performance of Manufacturing Index 2008 – 2012

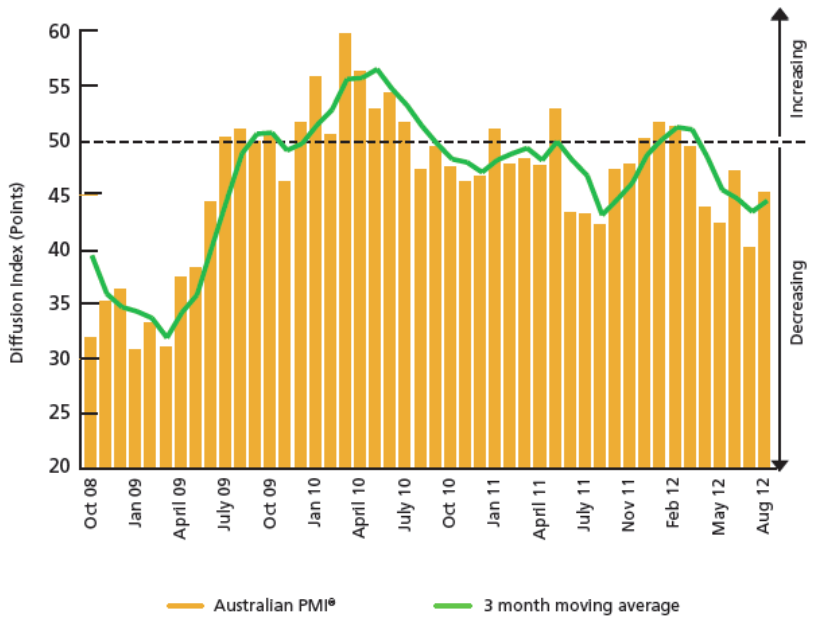


Figure 4: Australian PMI showing QLD Activity Index 2006–2012

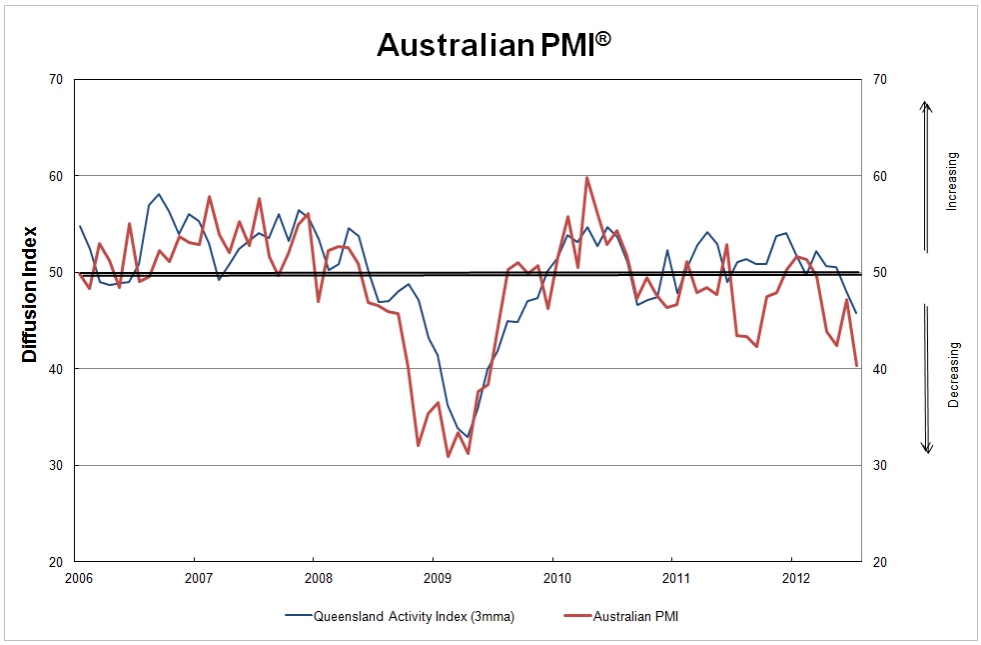
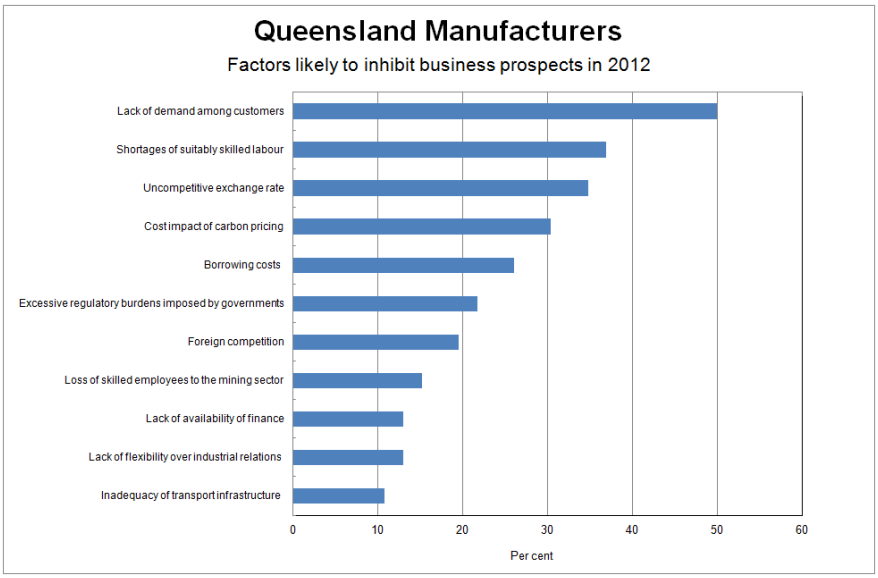


Figure 5: Factors likely to inhibit business prospects in 2012 – QLD Manufacturers



Source: Ai Group internal survey, Dec 2011

2.2 *Construction*

The decline in the national construction industry deepened in July with the Ai Group HIA PCI declined by 2.2 points to 32.6. Continuation of poor demand and subdued workloads led to sharper contractions in both employment and supplier deliveries. The index, which is now at its lowest level since last September, has remained below the critical 50 point level separating expansion from contraction for 26 consecutive months. Activity exhibited particular weakness in commercial and residential construction with both sectors contracting at steeper rates in July. However, apartment construction declined at a notably slower rate than in June, most likely reflecting the recent improving trend in multi-unit approvals. July also saw a decline in engineering construction, although it remained the most resilient of the four broad sectors of the industry.

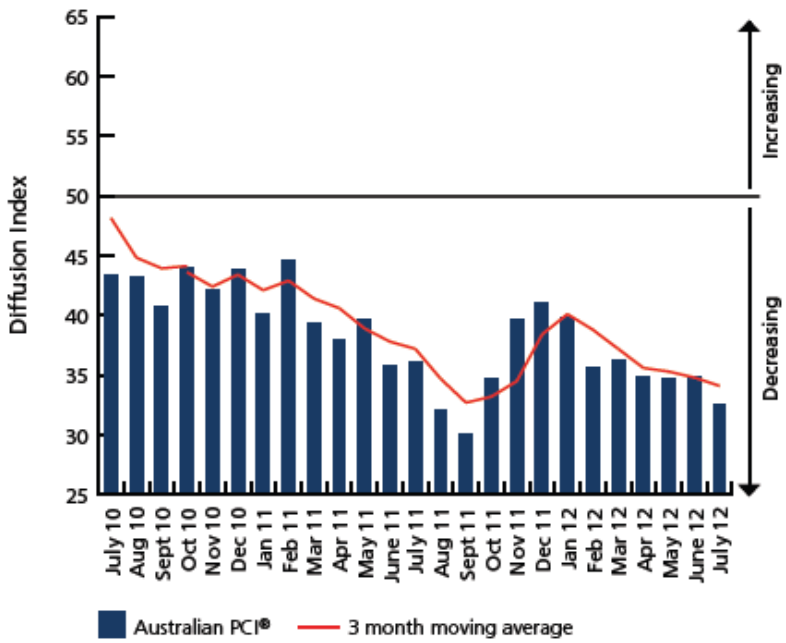
Most businesses linked the ongoing decline in activity to subdued demand conditions, citing low levels of new orders, project delays and weak confidence among consumers and investors. Intense competition to secure existing contracts and difficulties in obtaining credit or other funding for construction work had also contributed to a lack of new business.

ABS data released in late August 2012 showed total construction work in Australia fell 0.2 per cent in Q2 - worse than market expectations. Despite this the value of construction work in QLD has risen for ten quarters (six in WA). Nationally the trend estimate for total construction work done was up 1.7 per cent in Q2, while engineering work increased 3.8 per cent in the same period.

Building approvals also declined nationally in July decreasing by 17.3% to 11,306. This follows a decrease of 1.0% in June. On a state basis, the trend number of dwelling approvals in July increased by 2.9% in Queensland followed by a 2.3% rise in New South Wales. Declines were recorded in South Australia (-1.4%), Victoria (-0.9%) and Western Australia (-0.3%).

Despite the decline in total building approvals, the rise in house approvals is an encouraging sign for the residential building sector. Moreover, in trend terms, which look through the month-to-month volatility, building approvals have now been increasing for six consecutive months. Positive demand influences such as continued population growth, lower borrowing costs, tight rental vacancy rates and the release of new land in several of the major cities are likely to support the housing sector later this year or early in 2013. ABS data also indicates that during Q2 of the State's top ten industries, the highest proportion of unemployed persons was for persons previously employed in the Construction industry group (8.1%).

Figure 6: Australian Performance of Construction Index 2010 - 2012



2.3 *Services*

The latest seasonally adjusted Ai Group/Commonwealth Bank Australian Performance of Services Index (PSI) fell by 4.1 points in August to 42.4.This marks the seventh consecutive month that activity has contracted in the services sector. In August, reports of declining activity levels were common across mainland states and industry sub-sectors. In fact, no services sub-sector reported growth in sales or new orders this month, and only the finance & insurance sub-sector recorded a reading above 50. The reasons businesses identified as contributing to the poor performance included weak consumer demand and the high dollar. Reflecting the low level of local demand and the weak inflation environment, the selling prices sub-index for the services sector fell to its lowest level since the series commenced in 2007. Despite these conditions, the input prices index picked up for a fourth consecutive month and is now above the average level recorded since the start of 2009. A number of businesses reported the carbon tax as a contributor to higher input prices.

Figure 7: Australian Performance of Services Index (PSI) 2009 - 2012

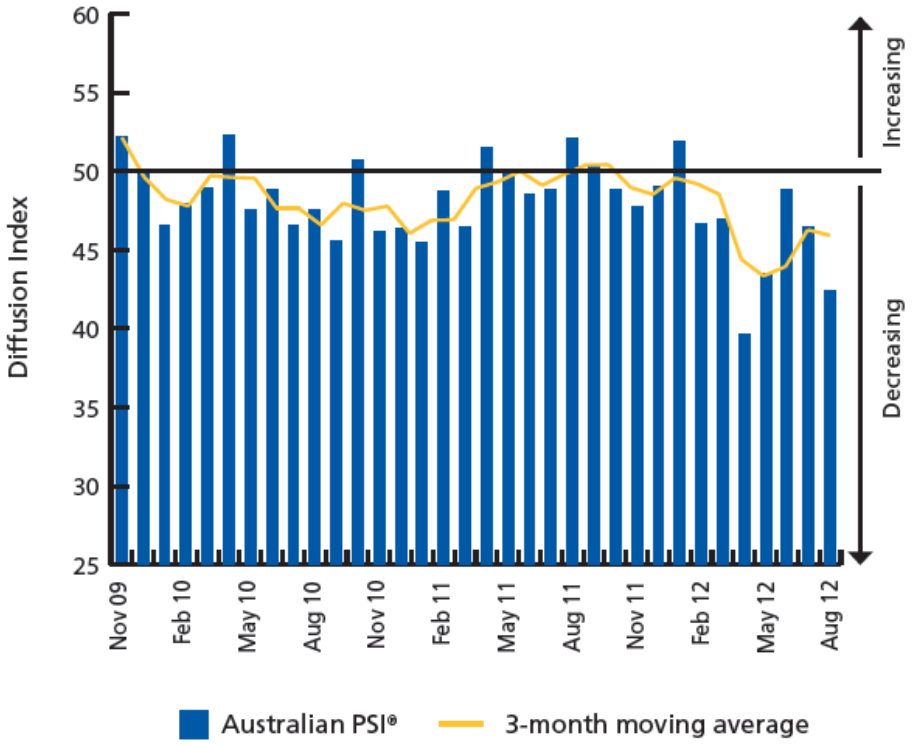
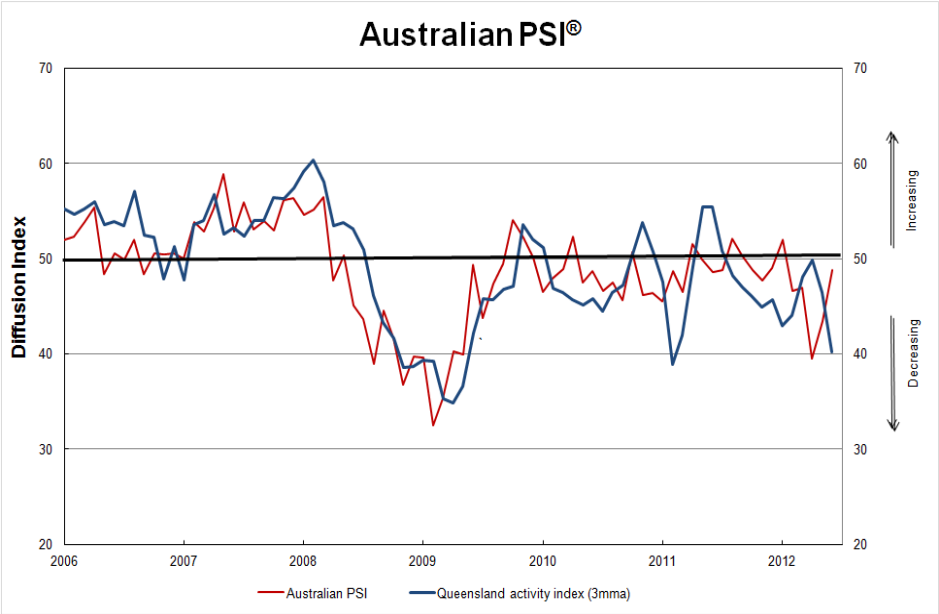


Figure 8: Australian PSI showing QLD Activity Index 2006 - 2012



METROPOLITAN OFFICES

SYDNEY

51 Walker Street
North Sydney
NSW 2060
PO Box 289
North Sydney
NSW 2059

Tel: 02 9466 5566
Fax: 02 9466 5599

MELBOURNE

20 Queens Road
Melbourne VIC 3004
PO Box 7622
Melbourne VIC 8004

Tel: 03 9867 0111
Fax: 03 9867 0199

BRISBANE

202 Boundary Street
Spring Hill QLD 4004
PO Box 128
Spring Hill QLD 4004

Tel: 07 3244 1777
Fax: 07 3244 1799

CANBERRA

L2, 44 Sydney Avenue
Forrest ACT 2603
PO Box 4986
Kingston ACT 2604

Tel: 02 6233 0700
Fax: 02 6233 0799

ADELAIDE

L1, 45 Greenhill Road
Wayville SA 5034

Tel: 08 8394 0000
Fax: 08 8394 0099

REGIONAL OFFICES

ALBURY/WODONGA

560 David Street
Albury NSW 2640
PO Box 1183
Albury NSW 2640

Tel: 02 6021 5722
Fax: 02 6021 5117

BALLARAT

1021 Sturt Street
Ballarat VIC 3350
PO Box 640
Ballarat VIC 3353

Tel: 03 5331 7688
Fax: 03 5332 3858

BENDIGO

87 Wills Street
Bendigo VIC 3550

Tel: 03 5443 4810
Fax: 03 5444 5940

NEWCASTLE

Suite 1, "Nautilos",
265 Wharf Road
Newcastle NSW 2300
PO Box 811
Newcastle NSW 2300

Tel: 02 4925 8300
Fax: 02 4929 3429

WOLLONGONG

L1, 166 Keira Street
Wollongong NSW 2500
PO Box 891
Wollongong East
NSW 2520

Tel: 02 4228 7266
Fax: 02 4228 1898

AFFILIATE

PERTH

Chamber of Commerce & Industry
Western Australia
180 Hay Street
East Perth WA 6004
PO Box 6209
East Perth WA 6892

Tel: 08 9365 7555
Fax: 08 9365 7550

AUSTRALIAN INDUSTRY GROUP **www.aigroup.com.au**

AIG11960