Ai GROUP SUBMISSION

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Ai Group Pre 2013-14 Budget Submission to the Victorian Government

AUSTRALIAN INDUSTRY GROUP

Executive summary

The centre of world economic activity is shifting to Asia, and this change brings many significant challenges and opportunities for Victorian businesses. In order for the Victorian economy to prosper in the Asian century and for Victorian businesses to make inroads into Asian markets while overcoming stiff competition from imported substitutes and incumbents in Asian markets, the Victorian economy must become more competitive.

Ai Group urges the Victorian Government to adopt the taxation, funding, education and training and other policy initiatives contained in this submission as they could improve the competitiveness of the Victorian economy and assist current and future Victorian businesses develop and gain market share domestically and internationally.

Ai Group appreciates that the Victorian Government faces challenging fiscal circumstances while having to deliver on these policies and provide essential government services, given the highly uncertain global economic outlook and a softening Australian economy.

In relation to substantial investments in infrastructure, Ai Group supports the involvement of the private sector, including the superannuation industry, in infrastructure development both as a means of financing new projects and in the purchase of existing assets suitable for privatisation. Ai Group also recommends the Victorian Government adopt a greater use of debt financing for spending on infrastructure, as the debt level of the Government remains relatively low.

Ai Group emphasises that the Victorian Government should always remain fiscally responsible even as it relies more on debt financing. However, fiscal prudence should be interpreted strategically so that the longer-term fiscal benefits of measures to boost business competiveness and the capacity of the Victorian economy are fully taken into account.

Business conditions in Victoria are becoming increasingly challenging, and many Victorian businesses are looking to the Victorian Government's firm leadership in guiding and supporting the Victorian economy.

Introduction

The centre of world economic activity is shifting to Asia, and this change brings many significant challenges and opportunities for Victorian businesses. The increasingly well managed and well connected Asian businesses are strong competitors to Victorian businesses. At the same time, the increasingly wealthy Asian middle class and rapid industrialisation in Asian economies present many opportunities for Victoria.

Victoria needs to secure its economic future by increasing its trade links with Asia and investing more in emerging strategic industries in the region, while continuing its economic engagement with the developed economies in the West through trade, finance, tourism and technological transfers.

In order for the Victorian economy to prosper in the Asian century and for Victorian businesses to make inroads into Asian markets while overcoming stiff competition from imported substitutes and incumbents in Asian markets, the Victorian economy must become more competitive.

For some time, Victorian businesses have been weighed by dimmed global economic prospects. This is reflected in the weakness in the Australian Industry Group Australian Performance of Manufacturing and Services Index (PMI® and PSI®, respectively) for Victoria. The index has remained below the neutral 50-point level for the past 18 months, indicating that Victorian manufacturing activity has been contracting throughout this period (Chart 1).

The 2013-14 Victorian Budget is an opportunity for the Victorian Government to improve the competitiveness of the Victorian economy by investing wisely in productivity enhancing initiatives for Victorian businesses as well as to formulate well-targeted policies that will assist businesses seize opportunities globally, especially in Asia.

Ai Group urges the Victorian Government to review its tax system, with the aim of reducing the tax burden of Victorian businesses while maintaining fiscal prudence. In addition, Ai Group recommends that the Victorian Government invest more to lift productivity in the Victorian economy. These measures will help enhance the competitiveness of Victorian businesses in the face of challenging global economic headwinds and an uncertain economic outlook.

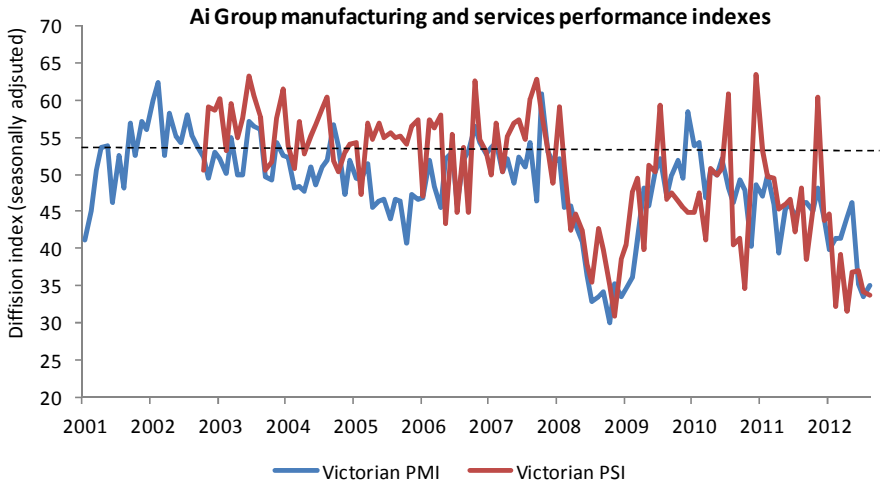
Ai Group urges the Victorian Government to adopt a longer-term approach towards economic development, putting in place taxation, funding, education and training and other policy initiatives that would assist current and future Victorian businesses develop and gain market share domestically and internationally.

Against the backdrop of a slowing Australian economy and highly uncertain global economic outlook, a key challenge for the Victorian Government is to be able to fund these investments amid weaker revenue inflows.

In relation to substantial investments in infrastructure, Ai Group supports the involvement of the private sector, including the superannuation industry, in infrastructure development both as a means of financing new projects and in the purchase of existing assets suitable for privatisation. The latter can be used to reduce debt and to supply capital for new infrastructure development. Ai Group also recommends the Victorian Government adopt a greater use of debt financing for spending on infrastructure, as the debt level of the Government remains relatively low. Ai Group urges the Victorian Government to adopt a long term view in deciding on using debt to finance infrastructure investments in recognition of the fact that when infrastructure investments yield sufficient economic benefits for current and future generations of Victorians, debt financing can make good economic sense. Well-founded and rigorously assessed investments targeted at improving the fundamentals of the Victorian economy will generate economic growth and revenue, which will relive budgetary pressures over time.

Ai Group emphasises that the Victorian Government should always remain fiscally responsible even as it relies more on debt financing. However, fiscal prudence should be interpreted strategically so that the longer-term fiscal benefits of measures to boost business competiveness and the capacity of the Victorian economy are fully taken into account.

Chart 1



Source: Ai Group data

State taxation

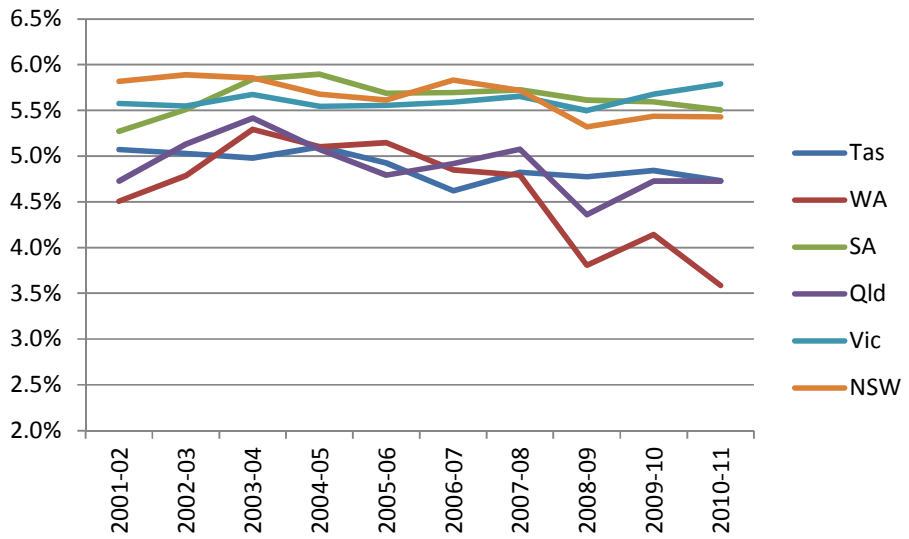
Businesses in Victoria are inhibited by a State tax structure that is inefficient and does not promote international competitiveness. The case for State tax reform is made clearly in Australia's Future Tax System Review ('the Henry Tax Review').

Data from the Australian Bureau of Statistics show that Victoria had the highest tax to gross state product ratio in 2010-11 (Chart 2) and that this ratio has been consistently high over the past decade. In addition, recent research conducted by Pitcher Partners and the Institute of Public Affairs suggest that the Victorian tax system places a significant amount of tax burden on businesses. This causes the Victorian economy to become uncompetitive relative to the other States.

In the following sections, the research of Pitcher Partners and the Institute of Public Affairs are quoted (but not to be regarded as endorsed by Ai Group) to shed light on the tax liability potentially faced by a typical medium-sized Australian business in each of the States.

The State taxes examined include payroll tax, land tax, land transfer duty, insurance duty and motor vehicle duty. Both the analyses reveal the significant tax burden on Victorian businesses.

Chart 2: State and Local Government Taxes
(Share of gross state product, 2001-02 to 2010-11)



Source ABS, 5506.0, Taxation Revenue, Australia, 2010-11 and ABS, 5220.0 Australian National Accounts: State Accounts, November 2012.

Pitcher Partners' analysis[1]

Scenario A:

Business based in a State has an annual payroll of $1,133,103 (including superannuation). It purchases a property for $2,266,000. This property has an unimproved value of $1,155,000. In the first full year, what are the total costs payable in State taxes and charges?

WorkCover premium (based on 2012/13 average premium rates)
Remuneration: $1,133,103

State	NSW	VIC	QLD	SA	WA	TAS	ACT	NT
Premium	$19,036	$14,708	$16,430	$31,160	$19,161	25,835	N/A	N/A
Rank	3	2	2	6	4	5	N/A	N/A

Payroll tax (based on 2012/13 rates and thresholds)
Annual taxable wages: $1,133,103

State	NSW	VIC	QLD	SA	WA	TAS	ACT	NT
Tax	$24,204	$28,572	$1,965	$26,389	$21,071	7,509	$0	$0
Rank	6	8	3	7	5	4	1	1

Land tax (based on rates applicable as at 1 July 2012)
Unimproved value: $1,155,000

State	NSW	VIC	QLD	SA	WA	TAS	ACT	NT
Tax	$12,244	$4,215	$15,135	$14,506	$2,556	$13,913	$17,927	$0
Rank	4	3	7	6	2	5	8	1

Scenario B:

Business based in a State has an annual payroll of $5,665,000 (including superannuation). It purchases a property for $11,330,000. This property has an unimproved value of $5,775,000. In the first full year, what are the total costs payable in State taxes and charges?

WorkCover premium (based on 2012/13 average premium rates)
Remuneration: $5,665,000

State	NSW	VIC	QLD	SA	WA	TAS	ACT	NT
Premium	$95,172	$73,532	$82,143	$155,788	$95,795	$129,162	N/A	N/A
Rank	3	1	2	6	4	5	N/A	N/A

[1] Pitcher Partners (2012), "Pitcher Partners State Tax Review 2012-13".

Payroll tax (based on 2012/2013 rates and thresholds)
Annual taxable wages: $5,665,000

State	NSW	VIC	QLD	SA	WA	TAS	ACT	NT
Tax	$271,192	$250,635	$269,088	$250,718	$270,325	$283,955	$268,178	$229,075
Rank	7	2	5	3	6	8	4	1

Duty on transfer of land (based on rates applicable as at 1 July 2012)
Dutiable value: $11,330,000

State	NSW	VIC	QLD	SA	WA	TAS	ACT	NT
Duty	$733,590	$623,150	$632,000	$616,980	$574,611	$505,035	$796,975	$617,485
Rank	7	5	6	3	2	1	8	4

Land tax (based on rates applicable as at 1 July 2012)
Unimproved value: $5,775,000

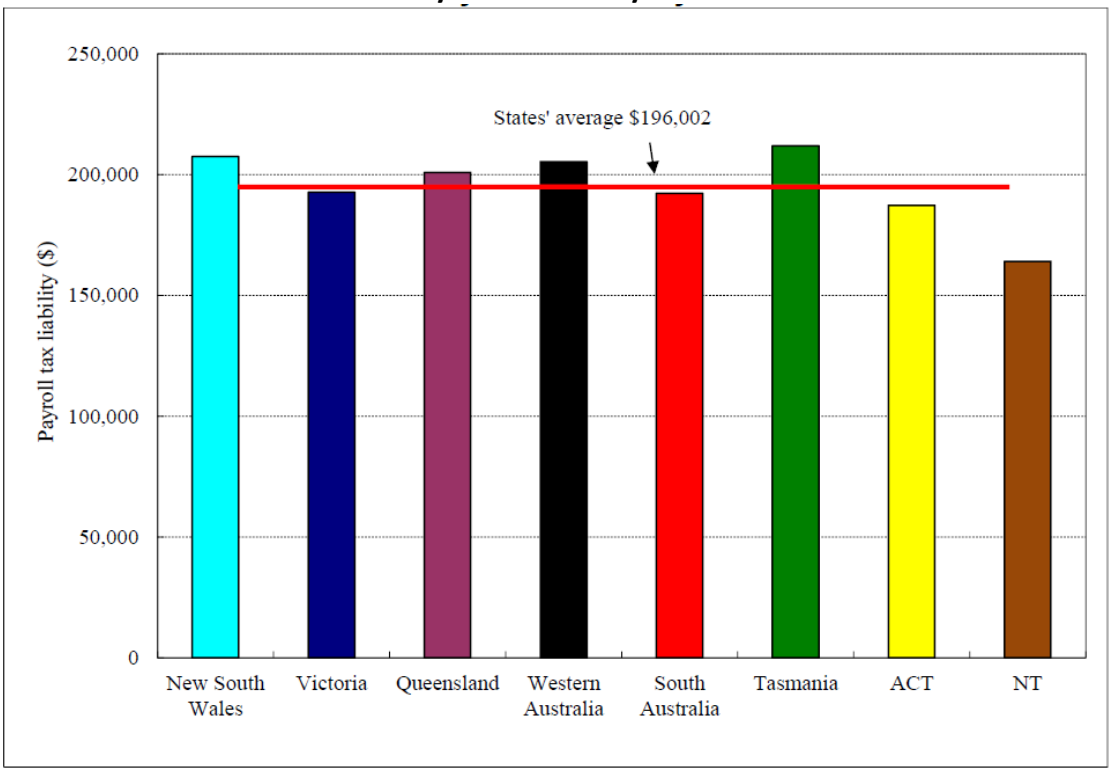
State	NSW	VIC	QLD	SA	WA	TAS	ACT	NT
Tax	$99,580	$87,413	$90,500	$185,446	$58,210	$83,213	$101,088	$0
Rank	6	4	5	8	2	3	7	1

Institute of Public Affairs analysis[2]

The Institute of Public Affairs showed that a medium-sized business in Victoria faces relatively heavy tax liability especially in payroll tax, land transfer duty and stamp duty (Charts 3, 4, 5, and 6).

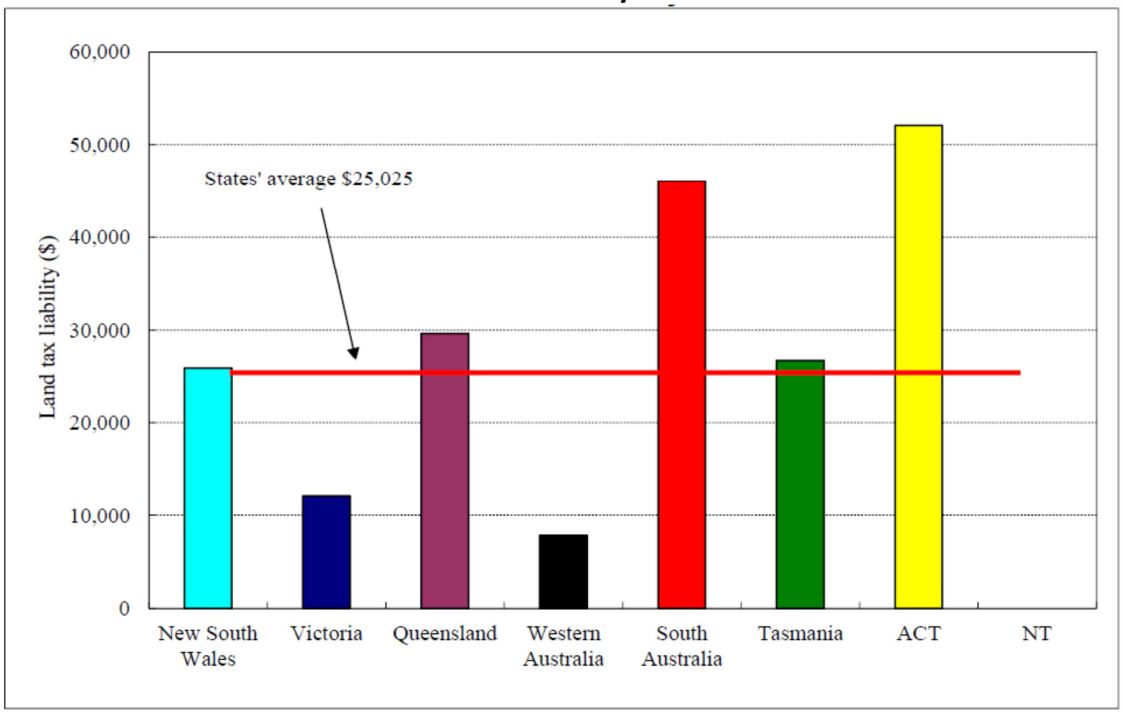
[2] Institute of Public Affairs (2013), "Business Bearing the Burden 2012: The Size and Impact of State and Territory Government Business Taxes: The IPA State Business Tax Calculator".

Chart 3: Payroll tax liability across States



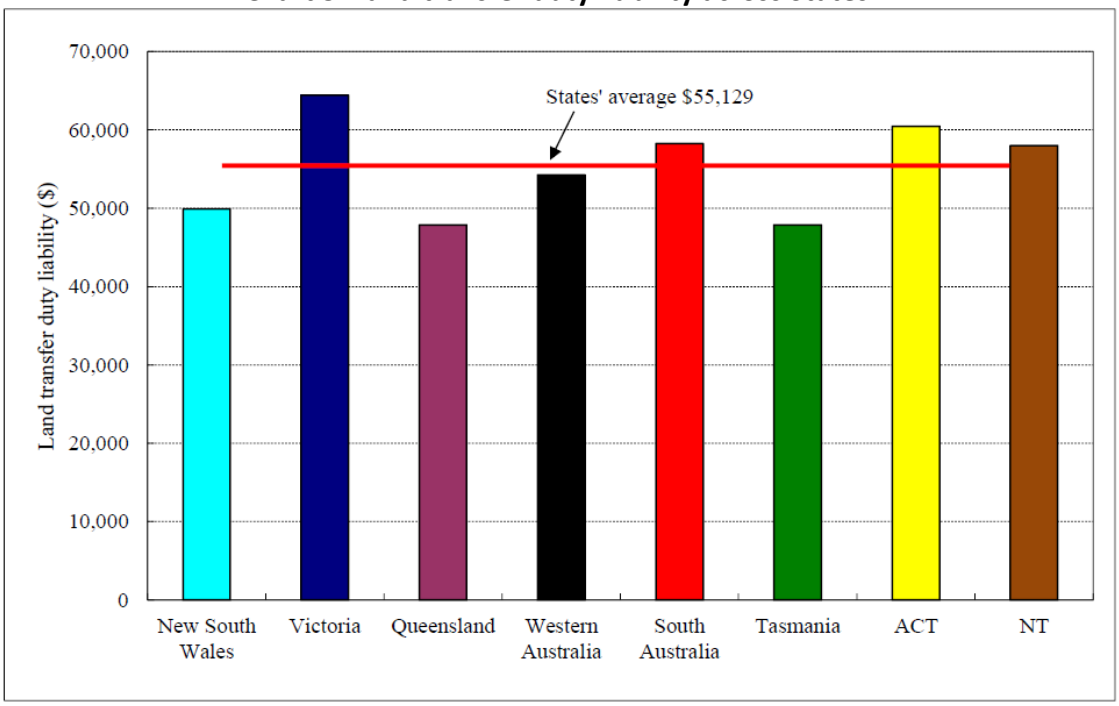
Source: Institute of Public Affairs (2013)

Chart 4: Land tax liability across States



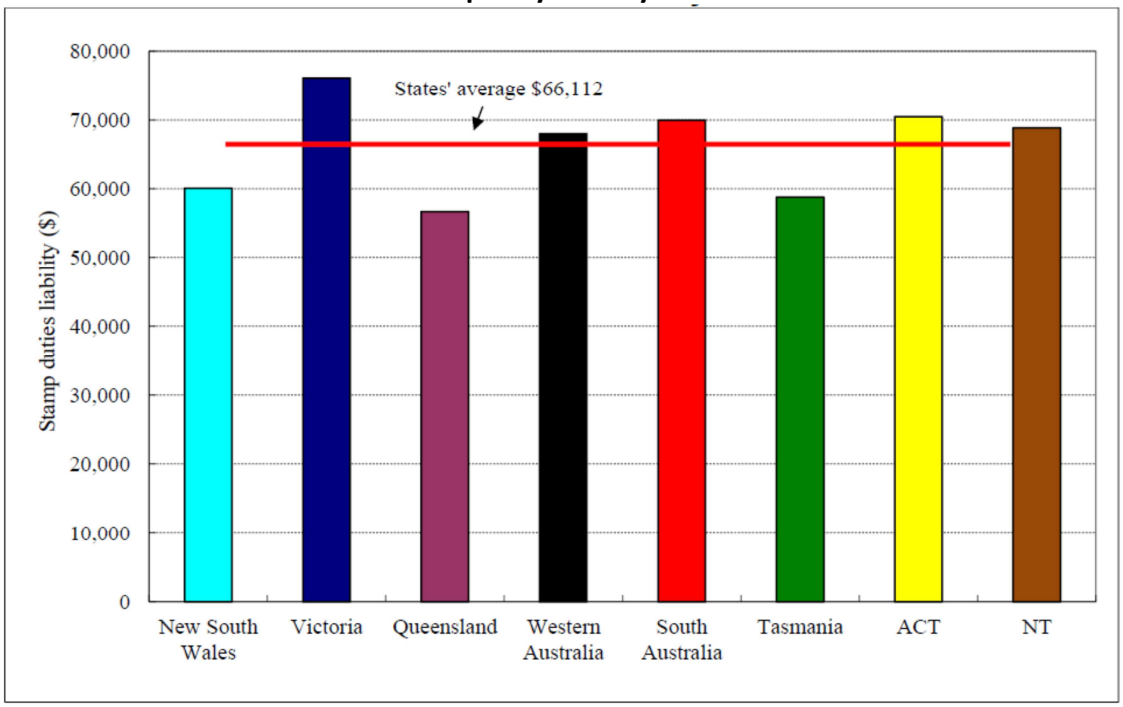
Source: Institute of Public Affairs (2013)

Chart 5: Land transfer duty liability across States



Source: Institute of Public Affairs (2013)

Chart 6: Stamp duty liability across States



Source: Institute of Public Affairs (2013)

For as long as Victoria has significant expenditure responsibilities, it needs to have access to significant and sustainable tax revenue. Although Victoria currently has access to significant State taxes, there are problems with the quality of these taxes or the way they are levied. Furthermore, independent research on the cross-State analyses of tax burdens show that Victoria urgently needs to lower its State taxes to improve its competitiveness position relative to the other States, and retain and attract businesses.

Since the Victorian Government has limited scope to lower or remove existing taxes while ensuring revenue neutrality, the way forward would be for the Victorian Government to reduce taxation and re-prioritise expenditure simultaneously, preferably executed in phases to avoid sudden changes to business and government practices.

Ai Group recommends, as a matter of urgency, that the Victorian Government gives consideration to the State tax reforms outlined in the Henry Tax Review and that it works with the Australian Government to implement the State tax reform recommendations in the Henry Tax Review. This could stimulate economic growth and promote high performing enterprises operating in an internationally competitive Victoria. Victoria's recent lagging productivity performance and longer term challenges associated with ageing of the population mean that the longer Victoria postpones genuine and comprehensive tax reform, the more difficult the task of promoting long-term economic growth across all sectors for the wellbeing of all Victorians.

The State based tax reforms proposed in the Henry Tax Review are not easily implementable in the short-term and are likely to require broader reforms to fiscal federalism and revenue sharing allocations between the States through the Commonwealth Grants Commission. Nonetheless, Ai Group recommends that the Victorian Government continue to play a leadership role in engaging engage the Australian Government and other States to initiate an agreed timetable through the Council of Australian Governments (COAG) to implement the Henry Tax Review recommendations with respect to reform and removal of State based inefficient taxes.

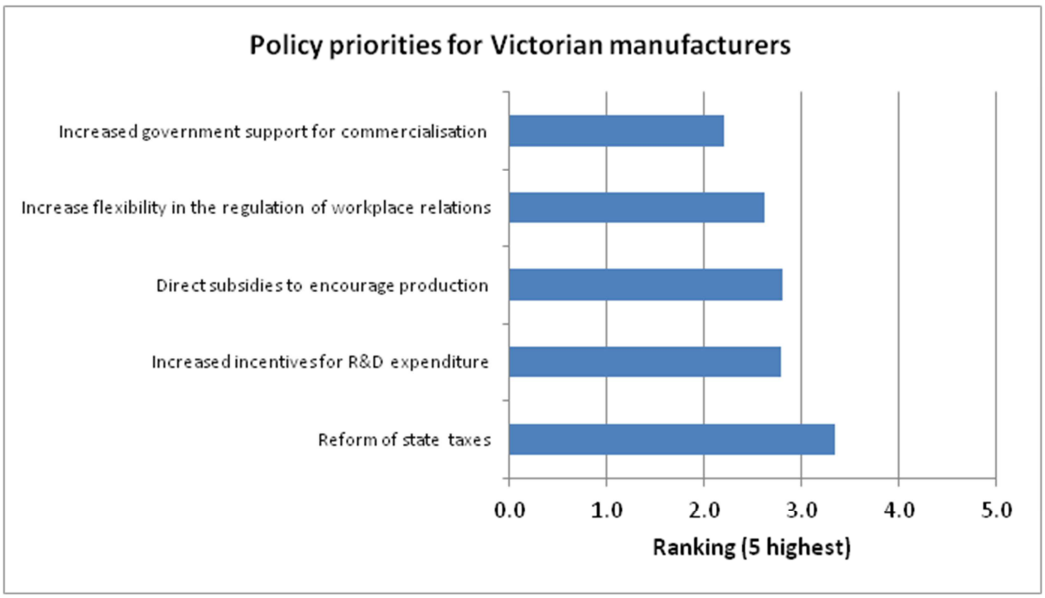
Feedback provided by the members of Ai Group indicates that Victorian manufacturers support State tax reform.

The Ai Group Manufacturing Industry Survey asked respondents to rank the five areas of government policy of most potential benefit to their own manufacturing business.[3] Chart 7 presents the top 5 priorities for Victorian manufacturing businesses in areas

[3] This survey data was collected as part of a comprehensive survey of Australian manufacturing businesses (the "Ai Group Manufacturing Industry Survey). The findings of the survey are based on the responses of CEOs from 419 businesses. The businesses employ around 43,000 full time equivalent staff and turn over a total of $17 billion.

where the State Government has some area of direct influence. The highest ranked priority is State tax reform with a ranking of 3.3 out of a possible maximum of 5.

Chart 7



Source: Ai Group data.

Innovation and R&D expenditure

Innovation is critical for the Victorian economy and its businesses. An important aspect of the innovation process is research and development. Manufacturing businesses value the importance of research and development as part of their business growth strategies to become high performing enterprises that are internationally competitive. For example, according to the Ai Group Manufacturing Industry Survey, the four most important growth strategies for businesses are related to innovation; capital investment; improving business structures and great integration into global markets (Table 1). Each of these strategies will involve some form of research & development, whether in terms of designing new products or revising internal business practices to become more productive.

Table 1: Top manufacturing business growth strategies over the next 3 years

Innovation	Improve efficiency of production processes; introduce new products and services; improve supply chain management; introduction of new technology
Capital investment	Raise spending on skills development; greater (physical) capital investment; greater spend on R&D
Business structure	Outsource production to other domestic businesses; concentrate on fewer products and services; alliances/mergers & acquisitions; vertical integration; establish new distribution channels
Globalisation	Increased sourcing of labour from overseas; outsource production to businesses offshore; develop export markets

Source: Ai Group

Regulatory compliance and costs

Ai Group acknowledges the firm commitment of the Victorian Government to reduce red tape in the public sector, and commends its appointment of John Lloyd as the new Red Tape Commissioner to oversee efforts to reduce red tape in the Victorian Government. This arrangement would hopefully expedite the identification of areas of improvement and provides an important bridge between the business community and government, ensuring that Victorian regulation meets best practice standards.

While the recent moves by the Victorian Government to add impetus to the reduction of red tape in government is encouraging, Ai Group notes that despite all the efforts on regulatory reform by governments in recent years, feedback provided by members of Ai Group indicates that the compliance burden associated with business regulation remains high.

There are a number of actions the Victorian Government can take to address business regulatory compliance costs:

- Reduce the frequency of business regulatory reporting requirements to a minimum and establish reliable electronic and web-based regulatory reporting for businesses.
- Minimise the required number of approvals needed for projects and execute approval processes concurrently.

- Integrate and rationalise approvals for all projects by creating an approvals committee with the authority to issue all relevant approvals. The average Victorian business deals with up to eight regulatory authorities in any given year.
- Work with local government to reduce duplication of regulation across local government boundaries (planning regulations for example) and across State borders (for example the payroll tax harmonisation process through COAG is not yet operational).
- Review the Victorian Government programs related to reducing the regulatory burden, including ensuring methodologies for measuring the impacts of their regulatory reform initiatives are sound and more importantly, measure whether there has been a net decline in the regulatory burden being imposed on businesses, particularly small businesses.
- The Victorian Government also needs to consider how regulatory agencies interact with the business community with respect to regulatory changes and proposals. Consultation is crucial and should continue but governments need to invest in more efficient and less onerous consultation processes which do not impose an additional burden on businesses. Incorporating a 'consultation' regulation impact statement in the regulation making process as well as monitoring and reporting on the quality of consultation are worth considering at all levels of government.
- Victoria could lead the way in having the most efficient and best practice regulatory agencies, in turn reducing the burden on all businesses that interact with these agencies. There is considerable merit in the Australian National Audit Office Better Practice Guide to Administering Regulation being adopted by Victorian regulators at all levels of government and regulatory agencies undergoing regular 'health checks' to ensure these agencies are efficiently implementing regulations and not imposing an additional and unnecessary burden on businesses. This regular review of the regulatory performance of the State's regulatory agencies could be conducted by the Victorian Competition and Efficiency Commission (VCEC).
- Businesses operating in Victoria report energy, emissions and other information under a range of State and Federal programs. Many with operations in multiple States face a number of inconsistent reporting regimes. Victoria should continue to lead efforts to reduce the burden of inconsistent reporting, particularly by advocating for, and facilitating, a single national online reporting portal.

Government purchasing policy

Ai Group acknowledges and commends the Victorian Government for introducing the "Procurement Reform in Victoria" package, which contains a number of proposals to help businesses ensure they can more easily sell to State Government. The new package shows the Government recognises the need to improve its own Department's procurement practices. A number of measures have been considered in the package:

- Greater visibility of forthcoming procurement opportunities will be important and will give businesses an opportunity to plan for tendering;
- Introduction of Chief Procurement Officers within each of the departments is important as this should help ensure the departments have a greater focus on opportunities for local businesses;
- Making decisions based not just on the cheapest price; and
- Debriefing to unsuccessful tenders is a positive development and should enable businesses to be better informed.

Despite these proposed changes being introduced, it is, however, important the Government continues to drive the changes, as otherwise they are unlikely to be properly implemented.

Importantly, Ai Group believes there are a number of areas where other improvements could be made:

- The value-for-money procurement objective is too subjective and uncertain.
    - Government Departments are expected to have considerable flexibility with the Value-for-money Procurement Policy, and this will make it particularly difficult to ascertain a Department's commitment to the new policy. The Victorian Government needs to set clearer guidelines for agencies and departments.
    - The exemption of schools and hospitals from the Value-for-money Procurement Policy may remove up to $6 billion worth of Government procurement.
    - The high level of attention given to small and medium size businesses is not proposed for larger businesses.

In addition to these concerns, Ai Group believes there remains a number of barriers and distortions that frustrate and impede the full and fair participation of Australian suppliers. These barriers include, for example, an undue emphasis on upfront costs

rather than whole of life costs in public sector procurement and an uneven weighting given to conformity with standards.

Ai Group has consistently argued for consideration to be given to the whole of life costs of projects. These costs should include costs incurred by the purchaser from after-sales services, regular maintenance and servicing, parts replacements and any machine down time. In many cases an assessment of these costs will show that for local businesses these costs could be lower than for overseas-based businesses because services could be rendered more quickly and replacement parts delivered more promptly.

Ai Group urges the Victorian Government to collaborate with other States to formulate local procurement policies that could bring mutual benefits to more Australian manufacturers, such as assisting manufacturers broaden its customer base across States.

Ai Group recommends government agencies and major contractors implement an approach that shows a commitment to the following five procurement principles:

- Value for Money: Value for money looks beyond "least cost" and brings cost-benefit approach that considers quality, after sales servicing and maintenance and ongoing supplier relationships.
- 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.
- Full and Fair Access: Procurement processes should ensure local suppliers have full and fair access to supply opportunities under direct government contracts and with prime contractors for major projects. This includes consistency in relation to conformity with Australian standards and no preferential treatment of offshore suppliers.
- Full Opportunities for Local Suppliers: Australian based 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, prime contractors and licence holders should ensure that local suppliers have full and fair access to sub-contracting and supply arrangements.

- 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.

Infrastructure investment

Ai Group believes that the success of the manufacturing industry and the Victorian economy as a whole is dependent on the provision of high-quality infrastructure.

Ai Group recommends that Governments work together to develop a new national infrastructure strategy that: provides a clear strategic framework for planning to meet present needs and support future directions; maintains and reinforces a rational and transparent process to identify the highest-value infrastructure options; directs adequate and appropriate investment towards those options; ensures timely delivery; and ensures efficient use of the resulting assets. This framework should include:

- The Victorian Government could consider setting up an Infrastructure Victoria agency to better coordinate the planning, prioritisation and execution of infrastructure projects throughout the State.

- The Victorian Government should consider establishing and formalising a community and business consultation process, where robust debates on the prioritisation of Victorian infrastructure projects could be conducted.

- Ai Group urges the Victorian Government to regularly update and inform industry about the level of priority attached to major infrastructure projects throughout the State, as this will greatly facilitate the planning processes in businesses and lift productivity throughout the Victorian economy.

- Further development of structured public-private partnership policies that can lower the risks faced by private investors thus attracting more private sector investments while reducing upfront costs to the public.

- Transport infrastructure reform to help address congestion: for example, better provision of real-time information by governments about transport options and network conditions; investment in new and smarter transport infrastructure to keep up with population pressures; and pricing reform to improve utilisation and efficiency in the use of transport infrastructure.

- Institute arrangements to ensure that contractors give full and fair consideration to local businesses when awarding contracts.

Ai Group commends the Victorian Government in having acknowledged that the Victorian economy requires a second port to complement the Port of Melbourne due to increasing strains on its capacity as container traffic volume increases. The development of the second port is critical for the future of the growing freight trade and the viability of the sector well beyond the next decade. This project would enable Melbourne to reap the full advantages of enhanced trade links with the booming Asian economies.

While it is encouraging that the Victorian Government has committed to developing the Port of Hastings as a second container port in Victoria, Ai Group emphasises that the Government needs to conduct the necessary checks and assessments to ascertain that the Port of Hastings is indeed the appropriate location for the second container port for Melbourne. Suggestions should also be considered for alternative port opportunities which may be available to the State, including the use of current infrastructure to defray overall expenses.

The challenge for the Victorian Government is to continue investing significantly in infrastructure while exercising fiscal prudence in funding the investments. This will be especially challenging given the anticipated decline in GST revenue allocated to Victoria by the Commonwealth Government.

Ai Group supports the involvement of the private sector, including the superannuation industry, in infrastructure development both as a means of financing new projects and in the purchase of existing assets suitable for privatisation. The latter can be used to reduce debt and to supply capital for new infrastructure development.

Ai Group also recommends the Victorian Government adopt a greater use of debt financing for spending on infrastructure, as the debt level of the Government remains relatively low. Ai Group urges the Victorian Government to adopt a long term view in deciding on using debt to finance infrastructure investments in recognition of the fact e that when infrastructure investments yield sufficient economic benefits for current and future generations of Victorians, debt financing can make good economic sense. Well-founded and rigorously assessed investments targeted at improving the fundamentals of the Victorian economy will generate economic growth and revenue, which will relieve budgetary pressures over time.

Transport industry policies

Ai Group recommends the Victorian Government increase investments in the rail, tram and bus industries, as part of its overall plans to invest in Victoria's infrastructure. Such investments, which could include purchases of more trams, buses and trains as well as improvements to the tram, train and bus networks, would benefit local manufacturers, improve Victoria's public transportation network, contribute to environmental protection and create more jobs.

Ai Group notes that the Victorian Government has committed to the purchase of 40 new trains for the Victorian train network. The first of seven new Metro trains for Melbourne was delivered to the Victorian government in September 2012, five months ahead of schedule and a positive development for infrastructure development in Victoria. The new six-carriage train, which was put together at manufacturer Alstom's Ballarat factory, an example of how government led infrastructure investments could also help boost local manufacturers.

Ai Group strongly urges the Government to expedite the development and delivery of the remaining newly ordered trains. This is a long term investment in the Victorian economy, and the sooner the purchase is completed the earlier will the positive spillover impacts on local businesses and rail network materialise.

In addition, Ai Group also notes that the local content in these newly order trains is low (below one-third) and could potentially be increased in order to stimulate development of local industries.

It is especially encouraging that the Victorian Government has identified a core set of large-scale, city-shaping projects that will significantly contribute to the national economy. The Victorian Government's major priority infrastructure projects are:

- East West Link
- M80 Upgrade
- Melbourne Metro
- Dandenong Rail Capacity Program
- Port of Hastings
- Western Interstate Freight Terminal

This pipeline of projects will increase the capacity of Melbourne's transport network while reshaping the city by unlocking land use change and urban renewal. Delivering these projects in an integrated and sequential infrastructure program over the next five

to 10 years will enable investment decisions to be made that maximise network benefits, optimise funding availability and integrate infrastructure delivery with urban renewal.

Ai Group strongly urges the Victorian Government to remain firmly committed to these infrastructure projects, as they will help to lift the competitiveness of Victorian businesses and the economy. While a significant amount of money has been allocated for infrastructure spending, it is important that the Victorian Government does indeed spend this money as proposed.

Encourage development of the rail, tram and bus industry supply chain networks

Ai Group strongly suggests that the Victorian Government undertake a firm commitment to upcoming infrastructure investments, even if upfront investments cannot be made due to funding constraints. With no sudden stops-starts and clustering in infrastructure investments, businesses that support the rail, tram and bus industries would find it easier to plan and invest in capital for the future. Such clarity in the Victorian Government's infrastructure investment plans will greatly help businesses plan ahead, and facilitate development of competitive rail, tram and bus industry supply chain networks.

Facilitate demand management

The Victorian Government should leverage its position as the leader in developing the rail, tram and bus industries, and continue to collaborate with other States, particularly in assisting demand management of rolling stock. In order to encourage rolling stock manufacture in Victoria and in other Australian States, all State Governments must be encouraged to have a longer term outlook on the purchase of infrastructure. For example, a decade-long demand cycle would enable companies to confidently invest in capital equipment, knowing that significant purchases will be worthwhile over a longer period. Certainty in the market could create a relatively large manufacturing sector in a number of States.

The Victorian Government's commitment to the rail, tram and bus industries has increased considerably over the past few years and Ai Group believes that should continue. The Victorian Government has and should continue to show leadership in developing these industries. Current efforts revolve around developing and maintaining supply chains and ensuring local companies have the opportunity to be involved with the larger manufacturers. Government and industry should build on the experience

with similar programs in other high-tech manufacturing sectors and develop a new approach to ensure a long-term outlook for the industry.

Encourage consolidation in the rail industry

Ai Group notes that lessons from the car and car parts industry would suggest consideration must be given to smaller businesses that support the rail industry review their long-term future. In the medium-term, this could lead to a consolidation in the industry and put the businesses on a firmer footing to overcome future economic challenges.

Promote collaboration among businesses in defence, rail and vehicle manufacturing industries

Also, Ai Group recommends that the Victorian Government encourage businesses to move between the defence, rail and motor industries, should tough conditions persist in any one industry. This is manageable given the complementarities in the product design of such businesses. The Victorian Government could facilitate the technological transfer across industries by funding appropriate training courses, targeting knowledge and technological transfer.

Help alleviate shortage of skilled labour in industry

Many Victorian businesses cite the shortage of skilled labour as an important inhibitor to their businesses. Ai Group urges the Victorian Government to step up its efforts in the training and retraining of the Victorian workforce to alleviate this problem.

The defence industry sector in Victoria provides critical support to the Australian Defence Force through the provision of new and upgraded equipment, and through-life support. Victorian-based businesses work in all the major sectors of the defence industry, including aerospace, armoured vehicle and ship construction and sustainment. In partnership with the Defence Science and Technology Organisation, many businesses contribute substantial research and development input to high-tech systems and equipment, with a focus on reducing risk associated with complex weapon systems integrations. Many companies are experiencing skills shortages, particularly for systems engineers and highly skilled technicians, including in the aerospace sector. Further government support is required to assist industry to address the current skills challenge.

Assistance to the automobile industry

Ai Group notes the financial support that the Victorian Government has made to the car manufacturing industry. Ai Group regards this as an important investment to encourage the development of manufacturing in Victoria. This investment will enable research and development capacity to remain in Victoria and additional contract work to be undertaken in Victoria for the automobile global supply chain network. The investment will assist Victoria's automotive supply chain manufacturers to expand into global markets and diversify into other major manufacturing sectors.

Education and training reform

The Victorian skills reform model may have become unbalanced and focussed on the individual's demand for training rather than on industry needs, including skills shortages. In essence, the choice of a course by an individual triggered the flow of funding to the registered provider, public or private. All accredited courses were eligible for funding. These changes do little to address future skill development needs, let alone current skill shortages.

This unfettered approached has led to excessive enrolments in some programs without regard to short or medium term employment prospects. Ai Group has been consistent in strongly arguing that there needs to be a balance between the individual demand driven model and the needs of the economy that balances both the private and public good.

In terms of training entitlement the Victorian approach has gone beyond the original intentions of COAG. There has been a 'marketisation' of the notion of entitlement which is open-ended and untargeted. This has the effect of individuals using their entitlement to training in a way that does not provide a career path or direction. This is particularly the case when there has not been proper guidance provided to individuals. This further leads to wasted training opportunities, and results in a poor return on taxpayers' expenditure on training. Entitlement needs to be re-defined and involve individual choice within an industry framework.

The Government is offering low funding for some industry training. 80% of programs have had their subsidy reduced, in many instances to an unsustainable $2 or less per hour. Programs in these categories consumed large tranches of public funds with questionable levels of public good. The proliferation of courses and providers in some of these areas needed to be contained. The low funding can lead to low quality training and consequently damage to the VET system without contributing to an increase in

skills. In addition, some industry programs and areas will miss out on government funded training altogether.

The biggest impact on the Victorian training system however has been the sudden removal of "full service provider" funding from the TAFE institutes, amounting to up $170 million per annum. This funding enables a range of programs and services to be offered; such as, disability programs and support; indigenous liaison; student support; maintenance of equipment, and so forth. Success for many individuals without these services will be severely compromised.

The cuts to TAFE of $300m per annum from this year have caused considerable concern. Industry recognises and values the role the training system plays in developing the broad range of occupationally-linked skills required for meaningful and sustainable employment. Importantly, TAFE and other training providers have also been deeply engaged in the development of language, literacy and numeracy programs for adults. 75% of surveyed employers report that their business is affected by low levels of literacy and numeracy. Development of these skills is of paramount importance; research suggests that lifting the literacy scores of a country by one percent is associated with a 1.5% rise in GDP and 2.5% rise in labour productivity.

A combination of the range of services and programs underpin a successful delivery model. This is critical to the success of a significant number of individuals effectively transitioning to and engaging in employment. TAFE institutes do not just aim at the more lucrative parts of the market but fulfil a much broader training role.

Ai Group proposes that the Victorian Government consider the following:

- The skills reform model be reviewed so that individual demand as expressed through the training market is managed and balanced with the needs of industry and the economy.
- The concept of entitlement be revisited so that individual choice occurs within an industry framework, individual entitlement is not wasted and meets industry employment needs.
- Career guidance needs to be provided on a widespread scale so that training entitlements are based on informed choices.
- Quality measures need to be strengthened so that new entrants to the training market meet stringent requirements and existing providers need more regular audits to ensure quality.

Supporting exporters

Ai Group commends the Victorian Government's efforts in supporting exporters venture into emerging markets, and urges the Government to continue and increase efforts in assisting exporters.

Given the current challenging environment for exporters with the high exchange rate, difficulties in obtaining credit and uncertainty regarding global economic growth, particularly from Europe, the Victorian Government should proactively assist exporters by:

- Continuing to fund more overseas trade missions for businesses, particularly smaller businesses that want to expand into overseas markets, to participate and to facilitate co-funding exporters' businesses trips overseas to establish and/or increase contacts with overseas business partners. Such networks help to increase the chances of smaller Victorian businesses being able to successfully break into new overseas markets.
- Ai Group urges the Victorian Government ensure a continuation of targeted assistance for business participation in trade missions.

- The Victorian food and beverage manufacturing industry includes many smaller and regionally based manufacturers. The industry has performed well in recent times, but they face increasingly challenging business conditions in light of the strong Australian dollar, cheaper import substitutes and slowing domestic demand. This is a promising area for the Victorian manufacturing sector, especially given the high food and safety standards in Victoria and throughout Australia. Victoria has a competitive advantage in this area, and Victorian exports of food and beverage products could be boosted with more assistance from the Victorian Government. Ai Group urges the Victorian Government undertake a comprehensive strategic review of the Victorian food industry to understand the challenges and opportunities faced by the industry, and to inform the formulation of well targeted measures to facilitate the development of the industry.

Online business management

Ai Group believes that utilisation of online web presence for small business coupled with the rollout of national infrastructure including the National Broadband Network (NBN) and fourth-generation wireless services provides a critical platform for business to

harness productivity improvements, and turn new ideas into innovative products and services.

Ai Group proposes the future delivery of a coordinated and consistent business program which is founded on achievement of net benefits to the business community in their efforts to increase their presence via traditional linear website services as well as social networking avenues for business purposes.

Ai Group acknowledges there is a lack of well-integrated and up-to-date information on the potential economic and business benefits of online web presence for business. The broader national and State level productivity agendas have had limited focus on utilisation of either website services or the more complex social networking strategies. Businesses need to be made aware of all the potential benefits that the NBN could bring to their operations.

Victorian businesses require access to a program that provides a substantial opportunity for businesses to gain the advice, expertise and ongoing confidence to invest in new products and services that may be delivered online. The businesses need to receive sufficient training to fully understand and seize the opportunities offered by the NBN.

The potential program should not purely be a macroeconomic examination of businesses having a web site: it should be about finding, describing and seizing opportunities that ubiquitous broadband presents for small business to raise productivity and boost the bottom line.

The key aspects of any business are asset management, operational management, revenue generation and business model innovation. Ai Group envisages that beyond just being online and having a web site, performance measures can be incorporated that benchmark the improvement in key aspects of the business, particularly business model innovation.

With regard to social media, Ai Group has been experiencing a higher demand for training in this area from businesses wishing to build their marketing strategies.

Fire services levy

A new levy on property owners will be imposed through council rates to pay for Victoria's fire fighting services under a tax revamp proposed by the Victorian Government. The new property fee replaces the current levy on insurance premiums,

and will come into effect from next July. The property levy will help pay for the budgets of the Metropolitan Fire Brigade and the Country Fire Authority.

The options which are available to the Government regarding change to the Fire Service Levy leave Ai Group very concerned at the potential implications for business. Government has said this will be a cost neutral change. We trust that cost neutral position also applies to businesses in the State. If significant under-insurance by the general community can be shown, and insurance paid by those who were previously not paying, there should be an acceptance of a new arrangement. Those businesses in fire prone areas, large businesses, small and medium size businesses, farmers etc., should accept liabilities commensurate with the dangers they face. Ai Group is concerned that businesses may be asked to pay an additional levy, despite not being in an area of concern and without getting better protection, should the costs be simply based on assets they own.

As with WorkSafe premiums, business cannot afford to have their levies increased. It should be a repeat of the land tax scenario under the previous government, where businesses with low profits, but high asset prices, faced new imposts.

Any new levy must be reasonable for all the community. The issue will be difficult from a political and economic perspective and may be one the Government needs to give a great deal of thought to, perhaps even waiting until there is an improved economic scenario to implement.

National harmonised OHS legislation

Ai Group and its members – both large and small – remain committed to a nationally harmonised OHS system. Companies working across State boundaries daily see the need for harmonised legislation. Companies working on the Victorian / NSW border have long complained about the inconsistencies and additional costs of doing business. Small businesses have accepted the benefits of having a more efficient arrangement.

The opportunity remains for Victoria to continue to lead OHS reform. We have evaluated the compromises a national system creates and believe – as do many of our members – that the down sides are far outweighed by the positives.

Ai Group encourages the Government to consider the wider and general benefits of national harmonisation for Victorian businesses and for us not to be lead by, what may be a vocal minority.

Victoria needs to re-emerge as the leader in this area.

Container deposit legislation

Container Deposit Legislation (CDL) is currently being considered by the Victorian Government. Ai Group opposes CDL as we believe it to be both unnecessary and would devalue recycling arrangements currently in place in Victoria which have been shown to be working well. In fact, Keep Australia Beautiful's own figures in its KAB National Litter Index, show that litter in Victoria is less of a concern than in South Australia, where CDL has been in place for some time.

The additional costs to industry would be significant without demonstrable improvements in recycling. Again, this is an issue about not imposing further costs on business, especially where the current system has not failed. In fact, Victoria is a leader in Australia on recycling.

Outsourcing government services

Ai Group has for some time suggested to the Victorian Government that it consider outsourcing some administrative functions that are currently undertaken by Government Departments.

In some instances, these projects can be more efficiently run by private groups with less need for bureaucracy but still with a close eye on maintaining governance principles and protecting the Government's interests.

Reduced bureaucracy can improve the facilitation of Government projects and help ensure they are better utilised by industry, while being oversighted by credible organisations. Not surprisingly, Ai Group believes it and other like-minded organisations could serve the Government well in providing this type of assistance. Such organisations usually have a track record with the Government and are well-known to Government bureaucracy, and therefore are well-known for their ongoing Government relationships.

The environment and waste management

The Victorian Government has adopted a number of pragmatic approaches to dealing with important environmental issues which has helped the business community to costs which could potentially have been imposed on it.

Some of these policies maintain election pledges made by the Government while other decisions resulted from a recognition that money had been previously misspent and wasted within the portfolio. Ai Group had supported many of the current Government's pragmatic changes made to improve spending through the portfolio.

As this Government appreciates, additional costs being imposed on businesses in whichever sphere, without improved efficiencies or productivity, simply cause businesses to be less competitive both with other Australian companies and overseas operators. Therefore, any new or additional levies or cost impositions are unwelcome.

Ai Group encourages the Government to consider the most equitable use of Government levies to help ensure businesses can improve their environmental impact, whilst simultaneously improving efficiencies. Those companies which have significant levies imposed on them should be first in line to receive Government funding. Preferably, all levy money should be hypothecated as the stated intent of the levies is to improve environmental performance rather than being a revenue raiser for the Government.

Waste management costs and levies can be quite dissimilar between States and creates anomalous and perverse outcomes. For example, Ai Group is aware that landfill arrangements on each side of the Murray River are quite different, with different cost structures. This encourages businesses to look to the cheapest option rather than recognise the most appropriate option. We encourage the Victorian Government to continue to pursue a consistent environmental regime between States, which may particularly involve, at least initially, Victorian and NSW regulations.

Tender costs of government construction projects

Based on feedback from businesses, Ai Group is aware that the project tender costs of large construction projects are significant and could pose an obstacle to interested Victorian businesses. Ai Group urges the Victorian Government to explore ways to identify and exploit synergies in the tendering process to help lower the costs for prospective businesses.

Manufacturing

Many of the policies sought within this paper, and funding recommended, will assist Victorian manufacturers at a time which is proving particularly difficult. However, we also seek funding which is quite specific to improving the manufacturing environment.

The Victorian Government is the only State to have a Manufacturing Minister which would suggest that the Government is particularly concerned about the manufacturing economy and investment. However, the resource constraints around assisting manufacturing in a general sense remain significant. Given that manufacturing remains a huge part of the Victorian economy – greater than tourism, larger than mining – a significant R&D investor and a large full-time employer, there is a very strong argument for the Government to provide greater resources to the sector.

The Ai Group Performance of Manufacturing Index (refer to Chart 1), shows that manufacturing within the State is performing poorly and, indeed, is performing below the Australian average.

Although manufacturing employment stabilised at around 300,000 to 310,000 from late 2010 to mid-2012, this came after a substantial drop of around 50,000 (14%) between May 2008 and May 2010 (from 340,000 to 290,000). The latest ABS detailed employment data of November 2012 shows a further drop to 284,000 employed in manufacturing in Victoria. This latest decline is consistent with Ai Group's PMI employment sub-index, which continued to indicate contraction throughout 2012.

Businesses have, for some time, been informing Ai Group that they were making or were considering making sizeable redundancies. Or, in other cases, companies were reducing hours of both fulltime employees, and especially contractors, who still remain employed but were under-employed. This was not being recognised in the official employment figures.

Ai Group members have also increased their calls to our organisation in relation to redundancy advice. Calls seeking such advice have increased by almost 200% in some months from 2010 and by around 50% from some months in 2011. More poignantly, and perhaps more worryingly, is that these calls have continued to increase through each month of 2012 and there is no reason to suspect this will not continue in 2013.

The main sectors impacted are metals manufacturing, technology, construction and machinery and equipment.

It is also important to note that Ai Group runs a national call centre receiving calls seeking advice in relation to redundancy. In all but one month in 2013, calls from Victorian companies exceeded those from businesses in other States.

This is a picture which the Victorian Government and Treasury must be cognisant of and which we suggest cannot be ignored. Many of those manufacturing companies making

redundancies are in seriously difficult circumstances and in many cases are in a tailspin which cannot be averted. However, we encourage the Government to recognise that assistance must be provided to other companies which are not terminal and will need assistance, before they too are in difficulty.

Some of the programs currently offered by Government to business can be expanded considerably, primarily by increasing the funding – in many cases competitive funding – being made available.

The Government now has a number of metropolitan business offices within the Department of Business and Innovation which would be well placed to provide guidance to the Government on the type of funding manufacturers require to enable positive returns.

Ai Group would also be willing to provide guidance should the Government decide that investment into the manufacturing industry in general would be beneficial for the economy.

Significantly greater support for manufacturing would be fillip for the local economy and provide confidence to the sector.