Sustaining growth and competitiveness

Ai Group pre-budget submission to the Victorian Government for 2005/06

Summary

Victoria has now entered its thirteenth year of economic expansion, a record achieved within the context of a strong national economy and Federal and State Government policies supportive of growth. However, Victoria's economy and industry are likely to face significant challenges over 2005/06. Weaker housing activity, easing consumer spending, and intensifying competition in domestic and export markets (in particular from low cost countries such as China) are likely to impact on the State's economic performance over the next year. As noted in *Preparing for Victoria's Future*, population aging presents longer-term challenges for maintaining the State's recent growth track record, necessitating a continued focus on lifting productivity and competitiveness.

While some modest slowing in the Victorian economy is in prospect over the next year, the State's budget position is likely to remain solid largely reflecting strong growth in GST provisions helping to counter weaker property related income. Ai Group believes the 2005/06 Budget represents an opportunity for the Government to implement additional measures to support the economy and industry when growth challenges are building. This will necessitate a lower surplus for 2005/06 than currently forecast ($467 million).

To help sustain growth and competitiveness, Ai Group believes the Victorian Government needs to adopt a strategy targeting initiatives under two complementary streams:

(i) Building Victoria's competitive environment; and
(ii) Advancing the competitiveness of Victoria's industry.

This strategy recognises the importance of a continued focus on improving the competitive environment, and also the importance of industry to the State's economy. Ai Group has proposed a number of initiatives within this framework for consideration in the 2005/06 State Budget (summarised below).

Ai Group also believes the State Government should continue to give priority to capital investment projects for companies that substantially benefit the Victorian economy. More consideration could be given to companies which have already made substantial investments within Victoria, but would benefit from additional Government support to undertake additional capital works.

Ireland for instance, has been a recent stand-out in terms of recent private investment spending supported by a comprehensive industrial development strategy. Along with an aggressive foreign direct investment policy, the Government of Ireland aims to lift local industry development through a range of programs which include grants and direct Government investment certain companies.

Ai Group notes the Bracks Government has implemented an impressive agenda to help position Victoria as a competitive high growth economy, progressively doubling infrastructure spending to over $2 billion annually, investing $900 million in new science, technology and innovation developments, directing $2 billion towards projects in regional

Victoria, and lowering the payroll tax rate to 5.25%, the second lowest (behind only Queensland) in Australia. These outcomes have been delivered alongside strong operating surpluses, prudent net debt levels, and growth in state final demand averaging over 4% per year.

The *Agenda for New Manufacturing* (launched in June 2002) and the economic statement *Victoria: Leading the Way* (released in April 2004) together form a central part of the Bracks Government's blueprint for growth and competitiveness. The recommendations in this submission build on these initiatives.

Overall, these initiatives are consistent with the objective to sustain growth and competitiveness, with potential flow through benefits for employment in the State. As well, programs promoting skills development, employment growth and leadership can deliver economic benefits to those people that may be considered as disadvantaged. This is particularly the case in many regional areas of Victoria where improved participation in the economy can have significant benefits for social mobility and standing.

Summary of recommendations

Building Victoria's competitive environment

Ai Group proposes the Victorian Government:

- Introduce payroll tax offsets for Victorian exporters.
- Ai Group understands that at least $700 million of the 2003/04 profit recorded by the Victorian WorkCover Authority was achieved through improved management, and the savings will be maintained. We believe half of these savings should be returned to employers through a premium reduction, with the remaining half providing the basis for further initiatives to improve workplace safety performance.
- Fund all costs associated with relocating essential infrastructure necessary for dredging around the port area to enable the deepening of shipping channels in Port Phillip Bay.
- Subject to the outcomes of the EES, the Government should fully fund the development of the Nowingi waste containment facility.
- Reduce the rate of land tax applied to properties valued at up to $2.7 million, effective from 1 July 2005.
- Request the Victorian Competition and Efficiency Commission to undertake a comprehensive review of all State Government imposed regulation, and identify and prioritise areas of potential reform.
- Establish a new Regional Best Practice program to facilitate the implementation of best practice operational techniques (building on Innovation Insights Visits and Business Innovation Workshops).
- Implement a new program offering one off grants for initiatives that encourage regional leadership.
- Adopt $2.5 billion as the baseline for future annual investment spending.
- Commit to funding the Growing Victoria infrastructure reserve beyond 2005/06.

Advancing the competitiveness of Victoria's industry

Ai Group proposes the Victorian Government:

- Immediately announce an intention to commit funding under the *Agenda for New*

Manufacturing to 2009/10.

- Lead the regeneration of the *Agenda* through additional funding, and consolidation of programs within three main streams: innovation, skills development and training, and export.
- Implement a new Competitiveness Boost Program to support Victorian companies which have an established track record of international competitiveness to further lift productivity.
- Establish a Partners in Waste program, providing up front funding for projects encouraging partnering in waste materials.
- Establish an Eco-efficiency Investment Fund which would provide funding for companies on a dollar for dollar basis to encourage the acquisition of the latest eco-efficient technologies.
- Introduce an Innovation Accelerator Program for those firms who have had no prior experience in R&D, but are interested in starting an R&D project.
- Allocate recurrent vocational education and training funding to the implementation of the technology cadetship.
- Fine-tune education and training funding and incentives arrangements including establishing an incentive for employers who recognise the early attainment of competency/early sign-off under New Apprenticeships.
- Play a lead role in re-shaping the apprenticeship model to make it more attractive and more relevant to both young people and adult/older workers.
- Engage industry associations in the process of applying for export assistance, and enable them to manage the process for their members.
- Funding under existing export programs be doubled.
- Funding under existing export programs be doubled for companies who are able to demonstrate that a VGBO would be utlised for the purpose of exporting.

Economic conditions and fiscal position

ECONOMIC CONDITIONS

The latest State Accounts published by the Australian Bureau of Statistics show Victorian gross state product rose by 3.7% in 2003/04, marking the twelfth successive year of economic growth (chart 1). Over 2003/04, Victoria's economy was largely driven by strong household consumption (up 4.5%), reflecting employment growth, rising disposable incomes and wealth, and consumer confidence. Net exports continued to act as a drag on growth. While exports were flat over the previous financial year (although some improvement was evident in the first half of 2004), strong domestic demand contributed to a further large rise in imports.

Chart 1

More recent indicators suggest that although underlying conditions remain sound, Victoria's economy faces significant challenges over the coming year. While retail turnover has improved slightly after a mid-year soft-spot, high petrol prices, record levels of household debt and uncertainty over house prices suggest a modest period of growth in consumer spending – certainly below the strong growth levels of 2003. As well, the Housing Industry Association forecasts dwelling starts, a significant driver of growth post-GST implementation, to fall by 11% in 2003/04 and 3% in 2004/05.

On the positive side, business investment intentions remain positive and exports have improved led by dairy products. However, weaker economic data could see investment plans downgraded in coming months, while exports remain challenged by a strong Australian dollar and competition in global markets. Also, the stimulus to the Victorian economy from population growth may also slow over the next year.

Impacted by weaker housing activity and softening consumer spending in particular, the Australian Industry Group – PricewaterhouseCoopers Australian PMI™ shows manufacturing activity contracted (a reading below 50 points) in the period from June to October before expanding modestly in November (chart 2). The factors shaping the outlook for the Victorian economy – more subdued growth in consumer spending, declining housing starts and a challenging export environment – will also shape the growth path for Victorian industry.

While continued solid growth in service sector activity will provide support to the economy, manufacturing conditions are likely to moderate through the course of 2005, with exports unable to take up all the slack from slowing domestic sourced growth.

The Victorian Government forecasts the State economy to grow by 3.25% in 2004/05 (unchanged from the original budget forecast, although down from 3.7% in 2003-04). Forecast growth for 2005-06 has been revised down to 3.25%, from 3.5% previously. While this appears achievable (particularly given state final demand lifted by 0.9% in the September quarter 2004), as noted above there are a number of risks that could drive growth outcomes lower.

Chart 2

FISCAL POSITION

While some modest slowing in the Victorian economy is in prospect, the State's budget position is likely to remain strong reflecting accumulated surpluses and the recent upward revisions to the anticipated 2004/05 budget outcome. This provides a basis for additional fiscal measures to help sustain growth and competitiveness at a time when there are a number of risks confronting Victoria's economy and demographic challenges are building.

The general government sector budget outcome for 2003/04 was a surplus of $990 million, a significant improvement on the previous years result (a $236 million surplus), and higher than previously foreshadowed in the 2004/05 Budget Papers ($432 million). The better than expected outcome largely reflected strong returns on equity investments and lower superannuation costs, while GST-related grants were $192 million higher than originally forecast. Business also contributed strongly to the overall health of Victoria's fiscal position, with payroll tax and land tax revenues combined lifting by almost $188 million over the 2003/04 year.

Overall, total revenue rose by a solid 6.4%, compared to a 3.6% rise in total expenses. Ai Group commends the Victorian Government on containing increases in employee benefits to a relatively modest 4.9%, contributing to the goal of maintaining budget flexibility (Ai Group notes however, that payments for employee benefits were some 8.3% higher in the September quarter 2004 than they were in the corresponding period a year earlier. Containing increases in employee benefits must remain a priority for the Victorian Government).

More recently, the 2004/05 Quarterly Financial Report for September showed strong growth in tax income, with payroll tax revenues 10.6% higher than for the same period in 2003/04, and property taxes 32.1% higher. While property related revenues are likely to ease over the remainder of the financial year, this should be more than offset by growth in GST provisions that are likely to exceed initial estimates (indeed, the Federal Treasurer recently foreshadowed Victoria's GST payments would be $360 million above the minimum guaranteed in the intergovernmental agreement. Ai Group notes however, Victorian Government concerns surrounding Commonwealth distribution of GST revenues and the abolition of payments under competition policy arrangements).

Indeed, in its 2004/05 Budget Update, released in December, the State Government revised the estimated 2004/05 operating surplus up from $545 million to $638 million (chart 3).

Moreover, the budget operating surplus is expected to average a little under $550 million in the ensuing three years to 2007/08, commencing with an estimated surplus of $467 million in 2005/06. While Ai Group supports the Victorian Government's commitment to delivering sustained operating surpluses (with a target of at least $100 million annually), we believe the budgeted outcomes forecast to 2007/08 can be responsibly reduced. The prospect of more challenging economic conditions over the next year, as well as a need to reinvest in the drivers of competitiveness, suggest a 2005/06 surplus in the order of $300 million may be more appropriate.

Chart 3

Priorities for 2005/06 Victorian budget

The Victorian Government through the economic statement *Victoria: Leading the Way* has outlined a comprehensive agenda for improving the State's performance in exports, investment and business competitiveness. Ai Group will support the Victorian Government in the implementation of measures to address the 19 priority actions outlined by the statement, and in the continued implementation of the *Agenda for New Manufacturing*.

Ai Group urges the Victorian Government to quickly progress action to prevent industrial disputes damaging the Victorian economy as outlined in *Victoria: Leading the Way*. This includes the introduction of a new Emergency Powers Act, and seeking from the Commonwealth the power to bring applications to the Industrial Relations Commission to terminate bargaining periods.

As noted above the State's economy and industry sector is likely to face significant challenges over the next year. The 2005/06 State budget presents an opportunity for the Bracks Government to build on its achievements of the past six years and implement additional measures to help sustain Victoria's recent growth and competitiveness track record.

To achieve this, Ai Group believes the Victorian Government needs to adopt a strategy targeting initiatives under two complementary streams:

(i) Building Victoria's competitive environment; and
(ii) Advancing the competitiveness of Victoria's industry.

This strategy recognises the importance of a continued focus on improving the competitive environment, and also the importance of industry to the State's economy. Ai Group has outlined a number of initiatives within this framework for consideration in the framing of the 2005/06 State Budget.

BUILDING VICTORIA'S COMPETITIVE ENVIRONMENT

Providing payroll tax relief for exporters

Ai Group proposes the introduction of payroll tax offsets for Victorian exporters.

Despite some recent improvement Victoria's export position has deteriorated over the past three years. In annual terms, the value of Victoria's merchandise exports has declined from over $23 billion in September 2001 to little more than $18.5 billion in September 2004.

While the appreciation of the Australian dollar over this period has been important (increasing by 45% against the US currency), structural forces are also at work with countries such as China carrying significantly lower production costs than domestic manufacturers.

While Ai Group maintains that the Victorian Government should outline a formal commitment to pursuing the lowest marginal payroll tax rate in Australia, Ai Group believes the urgent need to provide concrete support for exports necessitates a prime focus in the upcoming State Budget.

We propose that effective from 1 July 2005, the Victorian Government implement a program offering payroll tax offsets for exporting companies. As well as providing targeted relief to exporters affected by a strong Australian dollar, this program would be ongoing in order to assist in doubling the number of Victorian companies exporting by 2010 – a target set by the Government.

It is proposed that for every percentage of sales derived from exports, companies be eligible for an equivalent reduction in payroll tax obligations for the following financial year (eg. a company with 5% of sales exported would receive a 5% rebate on payroll tax). Rebates could be capped to a maximum of 30%.

Ai Group has previously estimated that the cost of such an initiative over a 12-month period would be under $60 million. This commitment should be viewed within the context of payroll tax revenues that are expected to rise by more than $400 million over the period from 2003/04 to 2007/08. There are a number of compliance issues that need to be addressed. These include ensuring the calculation of any rebate to companies is simple, and issues surrounding eligibility under the program. In this regard, consideration could be given to:

- Calculating the rebate based on previous years audited sales, so that one calculation is required rather than monthly (also helping to lower any risk of manipulation of sales and export data).
- The rebate may apply to all companies shipping goods out of Victoria. Commercial invoices and a bill of lading would provide evidence that goods for export left from Victoria.

Additional land tax relief

Ai Group recommends the Victorian Government reduce the rate of land tax applied to properties valued at up to $2.7 million, effective from 1 July 2005.

In April 2004 the Victorian Government announced reforms to the land tax system delivering an increase in the tax free threshold (from $150,000 to $175,000), an upward adjustment over two years to the land tax brackets between $675,000 and $1,080,000, and a reduction in the top land tax rate from 5% to 3.5% by 2006/07, further reducing to 3% by 2008/09.

While Ai Group commends the Bracks Government for these reforms, land tax revenues continue to rise strongly and a significant proportion of commercial land owners remain significantly affected. Land tax revenues are forecast to rise by 9% to around $837 million in 2004/05 (after allowing for the $80 million per annum in new land tax on electricity transmission easements).

Like payroll tax, land tax is an impost on the competitiveness of Victorian businesses. Small to medium sized businesses are significantly affected, particularly during periods of significant property price rises. To provide additional relief for business, Ai Group recommends the Victorian Government reduce the rate of land tax applied to properties valued at up to $2.7 million, effective from 1 July 2005.

Reducing WorkCover premiums

> Ai Group understands that at least $700 million of the 2003/04 profit recorded by the Victorian WorkCover Authority was achieved through improved management, and the savings will be maintained. We believe half of these savings should be returned to employers through a premium reduction, with the remaining half providing the basis for further initiatives to improve workplace safety performance.

Ai Group notes the Victorian WorkCover Authority (VWA) achieved a $1.2 billion profit for 2003/04. A $1.2 billion profit is commendable and we congratulate the VWA and the Government on this achievement.

Ai Group remains a strong advocate for a reduction in WorkCover premiums. We understand the VWA to be fully funded with an average premium of 1.68% of salaries. The current average of 1.99% well exceeds the funding necessary to break even.

It is also important to recognise that Queensland has a significantly lower average WorkCover premium. While we accept that the Queensland system is quite different to Victoria, the headline figure is an important part of the attractiveness of the State to business and new investment.

Ai Group understands that at least $700 million of the 2003/04 profit was achieved through improved management and the savings will be maintained. We believe half of these savings should be returned to employers through a premium reduction, with the remaining half providing the basis for further initiatives to improve workplace safety performance.

Tackling business compliance costs

> Ai Group recommends the Victorian Government request the Victorian Competition and Efficiency Commission to undertake a comprehensive review of all State Government imposed regulation, and identify and prioritise areas of potential reform.

The Bracks Government has implemented a range of initiatives aimed at reducing the cost of State Government compliance including the EASY Government initiative, enhancing the ability of businesses to pay taxes on line through the State Revenue Office, and the continuation of industry sector regulation reviews. In *Victoria: Leading the Way*, measures were also announced to improve the efficiency of the State planning system (with an additional $3.1 million allocated over three years to the *Better Decisions Faster* Package), particularly in relation to developments of State and regional significance.

As well, the Victorian Competition and Efficiency Commission (VCEC) was established on 1 July 2004 charged with reviewing regulatory impact statements and advising on the economic impact of significant new legislation, undertaking inquiries referred to it by the Victorian Government, and operating Victoria's Competitive Neutrality Unit.

Businesses continue to highlight compliance as a major concern across a wide range of policy areas including taxes, workplace relations and occupational health and safety. Recent work undertaken by Ai Group (detailed in the report *Compliance Costs Time and Money*) shows that measured in terms of the time cost of staff alone, compliance with all regulation (including administration of State compliance matters) costs the manufacturing industry over $680 million per year (the figure would be significantly higher if other on costs such as professional fees, purchases of equipment and other overheads were included).

We recognise the Governments efforts in this area, and in order to further tackle compliance costs, Ai Group recommends the Victorian Government request the Victorian Competition and Efficiency Commission to undertake a comprehensive review of all State Government imposed regulation, and identify and prioritise areas of potential reform. This may necessitate additional funding in the 2005/06 State Budget.

A new Regional Best Practice program

> Establish a new Regional Best Practice program to facilitate the implementation of best practice operational techniques (building on Innovation Insights Visits and Business Innovation Workshops).

Ai Group strongly supports the Victorian Government's commitment to grow the whole State. The Bracks Government has implemented a range of initiatives, including the Regional Infrastructure Development Fund (which was extended for another five years in the 2003/04 State Budget) and the Small Towns Development Fund (which assists smaller towns in driving new opportunities for economic growth) supportive of regional development.

Ai Group's *Industry in the Regions 2004* shows however, that although the gap is relatively small, metropolitan companies are more competitive than their regional counterparts (based on the Regional Business Competitive Index). While the regions scored better on business leadership, they fell behind on other indicators such as financial strength, and skills and productivity suggesting more could be done to help close the competitiveness gap with benefits flowing through to the entire Victorian economy.

The outcomes of the study indicate that the regional competitiveness may be improved through individual company assistance to facilitate the implementation of best practice operational techniques (including lean manufacturing, Six Sigma etc). Such a program would build on Innovation Insights Visits and Business Innovation Workshops. Funding could be provided to regional companies on a dollar for dollar basis, to hire a facilitator to implement new operational techniques and provide training to staff.

Establishment of a new Regional Leadership program

> Ai Group proposes the Victorian Government implement a program offering one off grants to for initiatives that encourage regional leadership.

Industry leadership makes up a significant element of competitiveness for Australia's regions. Strong and competitive regions need not only the right infrastructure and macroeconomic fundamentals, but also companies whose managing directors are driven by the desire to succeed, grow strongly and remain competitive.

As noted in Ai Group's *Industry in the Regions 2004*, it may well be that in order to remain competitive and dissipate the disadvantages of size and distance from capital cities (and a high dependence on the region itself), regional companies need to exhibit stronger leadership values than their metropolitan counterparts.

Ai Group proposes the Victorian Government implement a program offering one off grants to for initiatives that promote and encourage regional leadership among business leaders. Funding could be provided to individuals to implement a range of initiatives such as local business and networking functions, local company visit programs and attend leadership courses (similar to the completed Rural Leadership and Community Events Program).

Grants would be given to proposals that clearly demonstrate an ability to contribute to positive leadership with the local business community, seek to develop business opportunities within the region, or help overcome some of the disadvantages of regional location. The program would complement the current Community Development Program, but have more of a focus on a specific region. Assistance could be capped at $5,000 per year per individual and be made available to persons at the managing director or equivalent level to enable them to enhance skills and show how that might develop the business community in the region. There should also be a need for other business leaders to support the initiative so there is community benefit.

Maintaining a focus on infrastructure development

> Ai Group urges the Victorian Government to:
>
> - Adopt $2.5 billion as the baseline for future annual investment spending.
> - Commit to funding the Growing Victoria infrastructure reserve beyond 2005/06.
> - Fund all costs associated with relocating essential infrastructure necessary for dredging around the port area to enable the deepening of shipping channels in Port Phillip Bay.

Over the period from 2000/01 to 2003/04, State Government spending on infrastructure rose from around $1 billion annually to over $2.5 billion. Ai Group commends the Victorian Government on this achievement. Recently announced initiatives have included significant investments for modernising existing school and TAFE facilities, upgrading health and community care facilities, improving access to the Port of Melbourne, and redeveloping Victoria's wholesale markets.

As noted in the 2004/05 Budget papers, the Growing Victoria infrastructure reserve, which is expected to have underpinned almost $1.6 billion in accumulated infrastructure investment in the period from 2000/01 to 2005/06, is expected to be extinguished following the next financial year.

Investing in critical infrastructure must remain a key priority if Victoria is to remain competitive. Ai Group views $2.5 billion as the baseline for future annual investment spending, with demands on the State's energy, water, transport and public facilities expected to continue to grow rapidly reflecting demographic changes and economic growth.

In order to maintain a focus on infrastructure investment, Ai Group recommends the Victorian Government commit to funding the Growing Victoria infrastructure reserve beyond 2005/06. As well as ensuring a continued focus on critical infrastructure works covering the whole of Victoria, Ai Group believes the maintenance of this program would deliver an important signal highlighting the Government's ongoing commitment to building a competitive State.

Projects potentially benefiting from the maintenance of the Growing Victoria infrastructure reserve are the proposed Port of Melbourne channel deepening, and the development of the Nowingi waste containment facility (subject to outcomes of environmental assessments).

The Port of Melbourne Corporation has foreshadowed a major initiative in which certain shipping channels in Port Phillip Bay will be deepened to accommodate vessels of 14-metre draught. Ai Group understands the Victorian government and State opposition have given in-principle approval to the Port of Melbourne's proposal, subject to a satisfactory outcome from environmental impact assessment processes and the satisfactory resolution of all technical issues associated with channel deepening.

Ai Group strongly endorses the Port of Melbourne Corporation's proposal, and was the only business association to support the proposal at the recent public hearings for the channel deepening Environmental Effects Statement. This support reflects the Port of Melbourne's immediate and strategic significance to both Victoria and Australia, and anticipated flow on benefits in terms of employment and economic growth.

Ai Group understands the current estimate of the project cost is in the order of $500 million, covering the dredging of material from the bay, maintenance, the relocation of water and telecommunications infrastructure, capital equipment, and other associated works.

At this stage the financing strategy for the project remains uncertain. As Ai Group has previously advocated, there is a strong case for using government debt to fund projects of such significance and public good that can be delivered while maintaining a rigorous and transparent approach to asset management, and control over total public sector debt levels.

Subject to the outcomes of the independent inquiry into the Environmental Effects Statement, Ai Group proposes the Victorian Government fund all costs associated with relocating essential infrastructure necessary for dredging around the port area. Ai Group understands the estimated cost of such works is in the vicinity of $100 million. Such an investment would reaffirm the State Governments commitment to the Port of Melbourne channel deepening, be both fiscally responsible and feasible, help contain usage charges for access to the Port of Melbourne by shipping companies, and enhance Victoria's competitiveness.

A new strategy for waste containment

> Subject to the outcomes of the EES, the Government should fully fund the development of the Nowingi waste containment facility.

Industry continues to make significant ground in adopting environmental practices limiting the extent and hazardous nature of waste. It could be expected that industry will make further advancements in minimising hazardous waste generation, with additional support from the Victorian Government targeted towards research and development into environmentally sustainable processes.

In order to assist in minimising the potential cost implications of waste transport, and subject to the outcomes of the EES process, Ai Group recommends the Victorian Government fully fund the development of the Nowingi waste containment facility. As noted earlier, this may be assisted through reinvesting in the Growing Victoria Infrastructure Reserve.

ADVANCING THE COMPETITIVENESS OF VICTORIA' S INDUSTRY

Renewing the agenda for industry beyond 2005/06

> Ai Group calls on the Bracks Government to:
> - Immediately announce an intention to commit funding under the *Agenda for New Manufacturing* to 2009/10; and
> - Lead the regeneration of the *Agenda* through additional funding, and consolidation of programs within three main streams: innovation, skills development and training, and export.

The *Agenda for New Manufacturing* (with funding currently allocated to 2005/06) represents a shared action plan to develop a world-class industry sector, in recognition of the sectors significance to Victoria's economy. Through representations on the Manufacturing Industry Consultative Council (MICC), Ai Group has been a strong contributor in delivering the *Agenda for New Manufacturing* since its inception in April 2002.

While progress has been made under the *Agenda for New Manufacturing*, the challenge for manufacturers to maintain and grow market share is stronger than ever. The realignment of the Australian dollar to the US currency, the continued emergence of competing economies such as China in elaborate manufactures, and the prospect of a free trade agreement with China are some of the factors pose significant challenges for the long-term competitiveness of Victoria's industry.

Ai Group views the extension of the *Agenda for New Manufacturing* to at least 2009/10 as a critical part of the blueprint for Victoria's future competitiveness, complementing the goals and objectives of *Victoria: Leading the Way.* Ai Group calls on the Bracks Government to announce such an intention as a matter of priority.

Ai Group understands the MICC is currently reviewing the *Agenda.* Ai Group holds a strong view that the program needs regenerating through a significant lift in funding (the original program has been allocated $27 million over four years) and a refocusing of the goals and objectives of the program reflecting intensifying competitive pressures and the significance of the challenge to maintain and grow market share.

Ai Group believes that ultimately, all programs under a revitalised *Agenda* should be directly targeted towards addressing structural issues to lift the competitiveness of our products on world markets, or provide direct support for export or import replacement initiatives. Accordingly, Ai Group recommends current (as well as prospective) programs be reviewed with a view to consolidation, drawing different programs under the *Agenda* within three main streams:

(i) Innovation and process improvement;
(ii) Skills development and training; and/or
(iii) Exports.

Consistent with this, Ai Group has outlined a number of initiatives for consideration in the forthcoming State budget and for consideration in a revitalised *Agenda* for industry beyond 2005/06.

(i) Innovation and process improvement

A new Competitiveness Boost Program

> Ai Group proposes the Victorian Government implement a new Competitiveness Boost Program to support Victorian companies which have an established track record of international competitiveness to further lift productivity.

Ai Group strongly endorses the Victorian Government's *Next Generation Food Strategy*, which delivers initiatives to grow businesses that are competitive, responsive to domestic and international markets and attractive to investment.

As noted above however, there is a strong need for Victoria's industry more broadly to accelerate its pace of productivity improvement and competitiveness. Ai Group proposes the Government implement a new Competitiveness Boost Program. The program would support

Victorian companies which have an established track record of international competitiveness, productivity or creativity, and which are able to provide (in detail) specific proposals to significantly lift productivity in their enterprises in a recordable manner. To be eligible a company would need to have a proven and successful record over the last five years in one or more of the following areas:

a) Export market growth as part of an overall business strategy;
b) Import replacement in a significant market area;
c) Innovation, particularly in new product development; and/or
d) Skills enhancement in their business operations.

While the program would be open to companies across all sectors of the economy, preference will be given to those companies/sectors at the forefront of dealing with the challenges of international competitiveness. Funding would be provided on a matching basis to support specific proposals to significantly enhance business productivity in a demonstrable way in one or more of the following areas:

a) Supply chain improvements – improved transport logistics; cost reductions through better information systems; automated warehousing systems; Kamban systems etc;

b) New technology acquisitions – modification of existing technologies; purchase of new technologies;

c) Skills upgrading – significant new training initiatives to enhance workforce skills and competency; to equip staff with modern tools and technology; job redesign etc;

d) New product development – commercialisation of research; product testing; and

e) Business transformation – major restructure of business operations; consolidation of operations; etc

Applicants would need to demonstrate not only how the grant will lead to significantly higher productivity, but also contribute to further advancing the companies activities in export growth, import replacement, innovation and/or skills enhancements.

Establishment of a Partners in Waste program

> Ai Group proposes the Victorian Government establish a Partners in Waste program, providing up front funding for projects encouraging partnering in waste materials.

Industry recognises that minimising waste, recycling, reducing inefficient energy use, and adopting more environmentally sustainable production techniques is good for Victoria's environment, while also offering opportunities to grow new markets and boost competitiveness.

However, the demands on Victoria's finite energy, land and water resources will continue to grow reflecting a rising population and expanding industry sector. Finding new ways to reduce energy consumption and waste is therefore essential.

Ai Group proposes the Victorian Government establish a Partners in Waste program. Funding would be provided on a dollar for dollar basis for project proposals directed towards partnering in waste materials including effluent discharges and solid materials (recognising that one companies 'waste' eg. water, can be another companies input eg. 'waste' water used to cool machinery). Funding could be used for feasibility studies and capital purchases.

This program would complement proposed initiatives that centre on partnerships between the EPA, water authorities and industry, which are expected to focus on auditing of waste generation processes and assessing the costs and benefits of removing critical pollutants from liquid waste.

A new Eco-efficiency Investment Fund

> Ai Group proposes the Victorian Government establish a Eco-efficiency Investment Fund which would provide funding for companies on a dollar for dollar basis to encourage the acquisition of the latest eco-efficient technologies.

Continued advances in technological innovation are generating significant improvements in eco-efficiency within industry worldwide. While Ai Group believes local development of eco-efficient processes should be encouraged, there would be strong merit in providing direct assistance to companies to assist in purchasing latest technologies that have been proven to deliver eco-efficiency improvements.

An Eco-efficiency Investment Fund would provide funding for companies on a dollar for dollar basis to encourage the acquisition of the latest eco-efficient technologies. With additional support from the Government, companies may be in a better position to speed up adoption of these technologies (that often represent significant investments). Grants would be allocated on a competitive basis.

The positive spin-offs for the Victorian community in terms of reduced waste and improved eco-efficiency would be likely to significantly outweigh the value of initial Government funding under the program.

Implementation of an Innovation Accelerator Program

> Ai Group recommends the Victorian Government introduce an Innovation Accelerator Program for those firms who have had no prior experience in R&D, but are interested in starting an R&D project.

Industry accounts for more than 60% of all expenditure on research and development (R&D) in Victoria. Maintaining sufficient levels of R&D in industry is essential if the sector is to remain at the cutting edge of product development and maintain and lift share in world markets. Moreover, Ai Group's *Industry in the Regions 2004* found that competitive organisations tend to have a strong commitment to product development.

However, Ai Group and Australian Bureau of Statistics research shows that 24 out of every 25 manufacturing companies undertake no research and development (R&D). And while some progress has been made in lifting private R&D activity, business expenditure on R&D in Victoria (as a proportion of sales) remains relatively low in comparison to OECD nations such as the USA, Finland, Germany and Canada. As well, the Government of Israel has for a long period taken an equity position in R&D projects to support private innovation activity.

A significant challenge for local industry is to lift investment in R&D in order to maintain and improve its competitive standing in the global economy. For this to be achieved, a greater R&D effort is required from active firms as well as more firms (a greater spread) undertaking R&D on an ongoing basis.

In order to lift the number of companies involved in R&D and augment existing initiatives, Ai Group recommends the Victorian Government introduce an Innovation Accelerator Program for those firms who have had no prior experience in R&D, but are interested in starting an R&D project. These firms often find it difficult to compete with larger and more experienced firms for government funding which acts as a barrier to involvement.

The program therefore is mainly targeted towards small to medium sized businesses (SME's). As highlighted by the MICC, SME's are often forced to meet the prescriptive demands of larger counterparts to invest in R&D activity and drive down costs. Such a program would help overcome a shortage of capital for investment in R&D by SME's.

Under such a program, grants could be provided to companies (on a competitive basis) on a matching dollar for dollar basis, and be used for a broad range of purposes such as purchasing specialist equipment to undertake proposed R&D, to engage a consultant to assist in R&D activity, to employ a scientist or engineer to undertake R&D, or to engage the expertise of a university, CSIRO or another research centre.

(ii) Skills development and training

Refocusing skills development and training

Ai Group proposes the Victorian Government:

- Allocates recurrent vocational education and training funding to the implementation of the technology cadetship.
- Fine-tunes its education and training funding and incentives arrangements including establishing an incentive for employers who recognise the early attainment of competency/early sign-off under New Apprenticeships.
- Plays a lead role in re-shaping the apprenticeship model to make it more attractive and more relevant to both young people and adult/older workers.

An innovative and internationally competitive industry relies on high skill levels which must be continually upgraded and renewed. As with all Government programs, ongoing monitoring of skills development and training programs is critical to ensure they are appropriately targeted and Ai Group is pleased to be able to assist with that monitoring.

Currently there are around 130,000 apprentices in Australian manufacturing being trained to provide industry with the skills to meet future industry needs. But despite this, a recent Ai Group review of Australian industry estimated that there is potentially between 18,000 and 21,000 positions for skilled tradespersons in manufacturing that currently remain unfilled. The review found 86% of firms regarded skills enhancement as very important/important to their business competitiveness and estimated that 28% of productivity improvement over the next two years is expected to come from skills enhancement. This story is repeated in our other industry sectors.

Ai Group contends that changes to the State education and training funding and incentive arrangements would drive measurable change including the linking of incentive payments to training undertaken in the 'skill rich' industries; allocating recurrent vocational education and training funding to the implementation of the technology cadetship; extending the payment of incentives to cover middle level (technician/para-professional) training to deepen the skills base; and reorienting the funding of training organisations away from rewarding volume to focusing on skill outcomes which are aligned to economic and business forecasts/needs.

Ai Group also believes that having encouraged people into training, it is important to recognise achievement. Currently the apprenticeship system works on a 'time-served' basis where the duration of an apprenticeship is pre-determined and cannot be reduced irrespective of how hard the person works or how quickly they acquire the skills and knowledge in their field. Ai Group supports fully competency-based New Apprenticeships which would allow an apprenticeship to be completed when all of the apprenticeship requirements have been met.

Further, Ai Group proposes the creation of an incentive for employers who recognise the early attainment of competency. The Victorian Government currently offers a completion incentive and this should be extended to include an incentive for *early* completion. This would be a first step in re-shaping the apprenticeship model but which is based on a 19th century model (which has served us well) which is going only part way to meeting 21st century demands.

Ai Group also notes that it is important that we not only focus on areas of critical shortage now, but also have regard for the likely direction of skills needs in the medium to longer term. Consequently, even where student demand for skill training might not be high, it must be facilitated as it is needed by the economy. TAFE colleges must be given the opportunity to recognize these needs and requirements as well as their own business exigences.

(iii) Exports

Improving industry uptake of export assistance

> Ai Group recommends the Victorian Government, through the Department of Industry Innovation and Regional Development, engage industry associations in the process of applying for export assistance, and enable them to manage the process for their members. Funding under current export programs should also be doubled.

As noted earlier, despite some recent improvement Victoria's export position has deteriorated over the past three years. The target to double the number of Victorian firms exporting by 2010 is at serious risk of not being met.

Ai Group recognises that the Victorian Government has demonstrated a strong commitment to improving the State's export performance. More recent initiatives include the $11 million Opening Doors to Export program which re-badged some existing programs, and provided additional support for companies through export advice and provision of resources at Victorian Government Business Offices worldwide.

However, Ai Group understands there is a shortfall in industry take up across a range of export initiatives. Companies have the perception that it is "just one more form to fill out" and are discouraged from investigating the opportunities for support. One remedy could be to engage industry associations in the process and enable them to manage the process for their members. They are in the position to identify suitable candidates and to "de-bureautise" the process.

If Victoria is to achieve the target of doubling the number of exporters by 2010, Ai Group also believes that the current range of support for exports must now be backed by concrete policy action. As well as introducing payroll tax cuts for exporters Ai Group proposes that funding under current export programs be doubled.

Additional incentives for companies using Victorian Government Business Offices

> Ai Group proposes that State Government funding under export programs be doubled for companies who are able to demonstrate that a VGBO would be utlised for the purpose of exporting.

There are currently eight Victorian Government Business Offices (VGBO's) worldwide with offices located in the key target markets of Chicago, Dubai, Frankfurt, Hong Kong, London, Nanjing, San Francisco and Tokyo. In the April 2004 Economic Statement, the Government committed an additional $1 million per year to resource these offices to support Victorian exports. Ai Group strongly supports this initiative and will work with members to help ensure these resources are utilised.

Given the size and growth potential of the markets these offices are located in, Ai Group believes additional incentives for companies to utilise VGBO's for the purpose of exporting to these regions could deliver substantial benefits to the Victorian economy, as well as build on the strategic commitment the Victorian Government has already placed on these eight regions.

Ai Group proposes that State Government funding under existing export programs be doubled for companies who are able to demonstrate that a VGBO would be utlised for the purpose of exporting.